October outlook

Wave of maturities gives clues to future CMBS performance

October was a busy month for European CMBS loan maturities, with 27 loans – totalling €2.71bn by balance – scheduled to repay. Only four repaid in full and on time, creating a number of considerations ahead of the glut of maturities expected next year.

Although by balance only 23% of the loans maturing last month were repaid, defaults were also around 23%. By balance, more than half of the loans scheduled to repay were extended.

"There is still the hesitancy from servicers to enforce and push loans onto special servicing, which is a good thing in a way," says Juan Salinas of Goldstar Research. "We have seen a lot of extensions on loans and the decision of whether or not to extend or to push into special servicing seems to have been purely driven on the strength of the borrower."

Despite the trend towards extensions, not all borrowers were granted them and some loans were forced into special servicing. "In some cases the servicer has just lost faith in the borrower or otherwise the borrower has disconnected," says Salinas.

He continues: "In those cases the loans have had to go into special servicing. We saw that happen with the Stade loan in Titan 2007-CT1, where there just was not a viable business plan."

Nassar Hussain, managing partner at Brookland Partners, notes that differences in jurisdiction also proved to be significant. Only one German loan out of 13 from the jurisdiction repaid in full at or before maturity, while both Dutch loans due to mature were extended.

"In the UK we have a creditor-friendly enforcement regime. Consequently, you are less likely to see an extension versus an enforcement at maturity, unless the borrower is willing to financially support the extension. With some of the stronger assets, we are seeing opportunities to refinance and find solutions," he says.

The insolvency regime in Germany is more favourable to borrowers, which makes enforcement unlikely unless the relationship with the borrower breaks down completely. The overwhelming tendency for German loans to extend last month should cause a re-evaluation in the market.

"In Germany you tend to see more extensions due to the increased costs, lower recoveries and loss of control in going through the insolvency regime. Pending new legislation is likely to improve this position," says Hussain.

He continues: "This enforcement and insolvency risk in these less creditor-friendly jurisdictions was never priced into transactions. This is unlikely to be the case for future transactions."

Another welcome change in the market has been an increased level of information being made available to investors. The destinies of a number of loans were known long before October, largely thanks to increased communication from servicers.

"It marks a real turnaround from two years ago, when the servicers were hesitant to engage with investors and were keeping information to themselves. Investors were then left with a very short time period to gather and utilise the information that was released, so it is really crucial that there has been a good level of communication this time," says Salinas.

He continues: "The level of communication has got a lot better – particularly from the newer servicers – which is fantastic for investors because it gives them more time to be able to absorb the information and come up with some sort of strategy. It is a change for the better and the market desperately needs that level of transparency."

Loan outcomes have historically been mixed among special servicers and that was again the case last month, although the varying servicer performance cannot always be used as an accurate predictor of a loan's fate. "There are some generalisations, but – as with all generalisations – they do not always apply," Hussain explains. "For instance, generally captive servicers are perceived to be more borrower-friendly than the independent servicers. But then you look at the statistics and Morgan Stanley, a captive servicer, actually has one of the highest enforcement rates."

October may give an indication of what future performance will be like for servicers as well as the market at large, however. The increased willingness of servicers to try to avoid special servicing and work with borrowers where possible is very welcome, says Salinas.

He notes: "The hard line they would sometimes take in the past seems to have disappeared, which is a lot healthier and more productive. If a hard line was to be taken across the board, that would be very damaging to the industry."

Salinas adds: "We have a tremendous amount of loans coming up to maturity and one person recently described the CMBS market to me as a NPL market. From what we are seeing, I think that might be a bit harsh; this willingness for a competent borrower, lender and servicer to work together should continue to work through and put together business plans that are executable in the current market."

But some business plans will simply not be executable. A lot of importance is attached to LTVs, with some analysts noting that loans with LTVs under 70% are repaying but loans with LTVs over 70% are not. However, Salinas believes that may be an over-simplification.

He says: "It depends how genuine that 70% is – which varies by loan and also by lender. We have seen a lot of positions reporting a 70% securitised LTV, but when subordinate notes and mezzanine debt are included the actual LTV increases to 90% or more, which is just unworkable for refinancing. In that case, the only option is to go for an orderly sale."

Salinas continues: "If the loan's real LTV is 70% and the loan stands on its own two feet, then refinancing will be viable. If it is a prime asset, then it should refinance and for what are now being called 'secondary assets' there are still people willing to selectively lend – although with higher lending costs."

The uncertainties surrounding the ability of loans to refinance mean the coming months are expected to be a testing time for the market. "Over the past 12 months there has been a trend of improvements in the number of loans defaulting at maturity, although the overall position has not been healthy. However, with the current uncertainty in the banking market, there is definitely potential for the situation to deteriorate again," says Hussain.

He continues: "The recent announcements from Eurohypo and Société Générale, coupled with other banks that have informally stopped lending due to the current uncertainty, [mean that to] refinance real estate debt in the short term is likely to be a difficult process."

Estimates indicate that as many as 60% of maturing European CMBS loans will fail to repay by the end of next year. Barclays Capital CMBS analysts predict as many as 30 maturity defaults in the first two quarters alone, with the majority coming from Germany.

"The situation is going to get worse because you have not had the peak of maturities yet. Also, there were certain loans restructured early on in the cycle that will need to be restructured again over the course of the next 12-24 months," says Hussain.

He continues: "It is going to continue to be a very busy time for servicers and the restructuring market to try and find intermediate solutions, while the banking and capital markets resolve the issues they face."

Salinas agrees that there could be tough times ahead, particularly with so many loans due to mature next year. While some are fearing the worst, he is not yet one of them. He concludes: "A lot of people are preparing for Armageddon, but I am not so sure; it is going to be nasty and it is going to be a hard year, but it is not going to be that bad."

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