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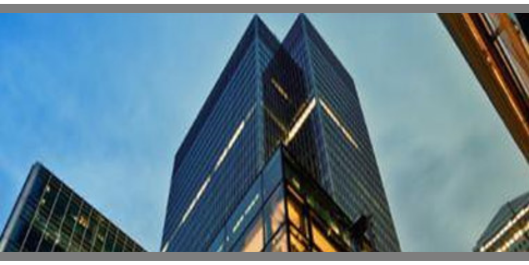
CMBS Credit Focus

Equity Pledges: Hotel Bossert Spotlights Dual Collateralized Loans



Servicers May Secure Unique Investor Protection Tool in Loan Modifications

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Recent developments on the $112 million Hotel Bossert (CF 2019-BOSS) spotlight equity pledges as unique aspect investors should track on upcoming loan modifications. The servicer of the troubled boutique hotel in Brooklyn, NY, noted it is postponing a scheduled UCC foreclosure to continue negotiating with the borrower. At first blush, the reference to such type of foreclosure appears quite confusing. CMBS investors typically see UCC foreclosures in connection with mezzanine loans that sit outside the trusts. Mezz lenders have security interest in the real estate's owner entity as their collateral, enforceable via UCC foreclosure. In contrast, CMBS trusts have a security interest on the property itself, and special servicers can pursue mortgage foreclosures upon default.

Bossert does not have mezzanine debt, according to deal documents. But digging deeper into the situation reveals that as part of a June 2021 modification of the CMBS loan, the servicer was able to secure equity pledges on the borrower's interest in the hotel. Provision 7 of the Bossert loan modification agreement, publicly available as an exhibit in a court docket, grants the BOSS trust membership interest pledge in the borrower. As such, the loan became dual collateralized (aka accommodation pledge). With such dual security, the servicer could choose either UCC or mortgage foreclosure as the Hotel Bossert borrower defaulted at loan maturity (Figure 1).

Figure 1. Hotel Bossert Loan and Property Parameters

Asset Name	**Hotel Bossert**			
Deal	CF 2019-BOSS			
Balance	$112,000,000			
Maturity	December 2021	Other Information		
Coupon	1ML + 5.05%	Appraisal History		
Loan Status	Matured, Non-Performing	$129.3 MM (Apr-2022)	Total P&I Advanced:	$11.1 MM
Property Type / Size	Full-Service Hotel / 280 Rooms	$117.0 MM (Nov-2020)	ASER:	$93.3 K
Year Built / Renovated	1909 / 2022	$178.0 MM (Mar-2020)	ARA:	$1.7 MM
Location	Brooklyn, NY	$143.0 MM (Nov-2019)		

Source: MCIA and Academy Securities

Speedier UCC Foreclosures

Securing equity pledges as servicers negotiate loan modifications may prove to be a powerful investor protection tool. Investors may see pledge provisions becoming more prevalent as modification activity picks up.[1] Equity pledges and potential UCC foreclosures may be especially pertinent in situations of "strategic" defaults, or when borrowers remain committed to their properties, as appears to be the case in the just-reported delinquency of the $484.7 million GSMS_22-CXP Portfolio. Initiating UCC foreclosures instead of mortgage ones can streamline recovery timelines, avoid potential costly transfer taxes, and incentivize borrowers to remain cooperative when they can. Notably, UCC foreclosures can take as little as 30 days to complete, according to legal memoranda. In contrast, mortgage foreclosures may drag on for months or even years. A few other aspects further underscore the benefits of UCC foreclosures:

- **Foreclosure timelines can vary by state.** Investors may find UCC foreclosure especially beneficial in states where judicial mortgage foreclosure can take very long. New York is one example. Mortgage foreclosure can take two years or longer in the Empire State. In turn, some states facilitate particularly speedy UCC foreclosures. For example, in Texas such foreclosure can take only 21 days, according to market participants.

- **Mortgage foreclosure moratoriums.** Court decisions exempted UCC foreclosures from executive orders imposing mortgage moratoriums during the pandemic. While such moratoriums have now expired, the decisions highlighted that the courts see UCC foreclosures as distinct from mortgage foreclosures. The decisions imply UCC foreclosures are not considered judicial processes, and should face fewer legal or regulatory obstacles compared to mortgage foreclosures, according to legal briefs.

Expect Some Sleuthing in Tracking Equity Pledges

Tracking new equity pledges on CMBS loans should prove very tricky. We do not see an IRP field that could directly identify such pledges. This may not be surprising. Obtaining equity pledges, either at loan origination or as part of modifications, has been uncommon. Borrowers are reluctant to give lenders such pledges in addition to the mortgage, according to market participants. With no specific equity pledge IRP code, investors may look at modification templates to see if the servicer obtained such pledge from the borrower. Servicer commentary or court documents may be other sources to identify new pledges, as was the case in Hotel Bossert.

It is not clear if the threat of UCC foreclosure was the key driver in maintaining Hotel Bossert borrower commitment to the property. But it appears likely that the special servicer move to foreclosure, and the imminent threat of quickly losing the ownership stake in the property, put additional pressure on the borrower. The UCC foreclosure, scheduled for November 2022, was just postponed because the borrower presented a new re-positioning business plan, and brought in additional business partners, according to press reports. The special servicer is now reportedly negotiating an additional two-year extension on the CMBS loan.

1 "Office Modifications: 285 Madison Could Offer a Blueprint for More to Come," CMBS Credit Focus, Academy Securities, October 27, 2022

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