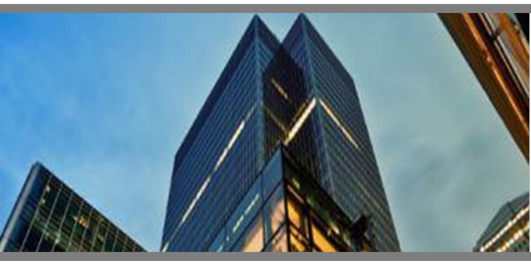
CMBS Credit Focus

Holdbacks: RENT in the Limelight, as Other Cases are Brewing



Massive Holdbacks Throw Subordinate Bond Valuation into Disarray

The just-reported liquidation of the $451.1 million Veritas Multifamily Portfolio Pool CMBS loan dramatically refocused the market's attention on elevated liquidation expenses, and the role holdbacks play in driving up realized losses. The San Francisco multifamily portfolio backed two CMBS deals, GSMS 2021-RENT and RNT2, a few pari-passu non-securitized notes, and $80 million mezzanine loan position (Figure 2 lays out the full Veritas' capital structure).

Quite a few market participants, including us, scratched their heads this week amid the $199.3 million liquidation expenses on a reported $351.2 million gross sales proceeds in the GSMS 2021-RENT deal. This left $148.9 million of net proceeds distributable to the bonds, leading to a realized loss of ~57% on the pre-liquidation balance (Figure 1).

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Deal reporting suggests that the servicer held back $164.1 million of RENT's liquidation proceeds. This is the second prominent case that unexpected, hard-to-project held back amounts create significant losses to the capital stack. The holdbacks in RENT directly drove full writedowns on classes D through G, and a partial writedown on class C. The liquidation of Crossgates Mall (COMM 2012-CR1, CR2, and CR3) back in July 2023 was the first time a large holdback amount stood out.[1] Within Crossgates' liquidation expenses, $14.5 million, or 49% of the overall expenses, was chalked up to amounts held back for future payment. In RENT, the magnitude of the holdbacks is clearly at a new level.

Figure 1. Veritas Multifamily Portfolio Pool Liquidation ($ millions)

	GSMS 2021-RENT	GSMS 2021-RNT2	Non-Securitized	TOTAL LOAN
Original Note Balance	$347.2	$105.0	$222.6	$674.8
Note Balance at Liquidation	**$343.6**	**$103.9**	**$220.3**	**$667.8**
Gross Sale Proceeds	$351.2	$54.0	$114.5	$513.7
Expenses	$35.2	$1.2	$2.2	$7.4
Holdbacks	$164.1	$0.0	$0.0	$164.1
Total Expenses/Holdbacks	**$199.3**	**$1.2**	**$2.2**	**$202.7**
Net Liquidation Proceeds	$148.9	$52.8	$112.3	$314.0
Realized Loss to Trust	**$194.7**	**$51.1**	**$108.0**	**$353.8**
Loss Severity	56.7%	49.2%	49.0%	53.0%

Source: Deal Documents and Academy Securities

1 "Crossgates Liquidation: Holdbacks Complicate Severity Projections," CMBS Credit Focus, Academy Securities, September 11, 2023

Ultimate Losses Can Sharply Swing

Deal documents suggest servicers have broad discretion on determining the scope and timing of holdbacks. Reviewing a sample of PSAs, we do not see explicit provisions that limit holdbacks. Servicer commentary may allude to the rationale for holding back amounts. For example, in Crossgates, the servicer noted that funds have been held back for “contingencies related to the resolution/liquidation of recently resolved and remaining assets, including trailing expenses and litigation risk.” We have not yet seen commentary on the rationale for the holdbacks in RENT. However, deal notices do suggest potential litigation risk on the heels of a dispute between certain investors in the deal and the special servicer.

Releasing holdbacks to the bondholders also appears to be upon the servicer’s discretion. There is no formal mechanism that dictates timing or milestones for holdback release (other than the general “servicing standard”). As such, the prospects for more situations such as Veritas and Crossgates obviously introduces significant uncertainty over loss projections. The loss on the RENT deal can theoretically sharply dial down to only $30.7 million from the current $194.8 million if all holdbacks are released.

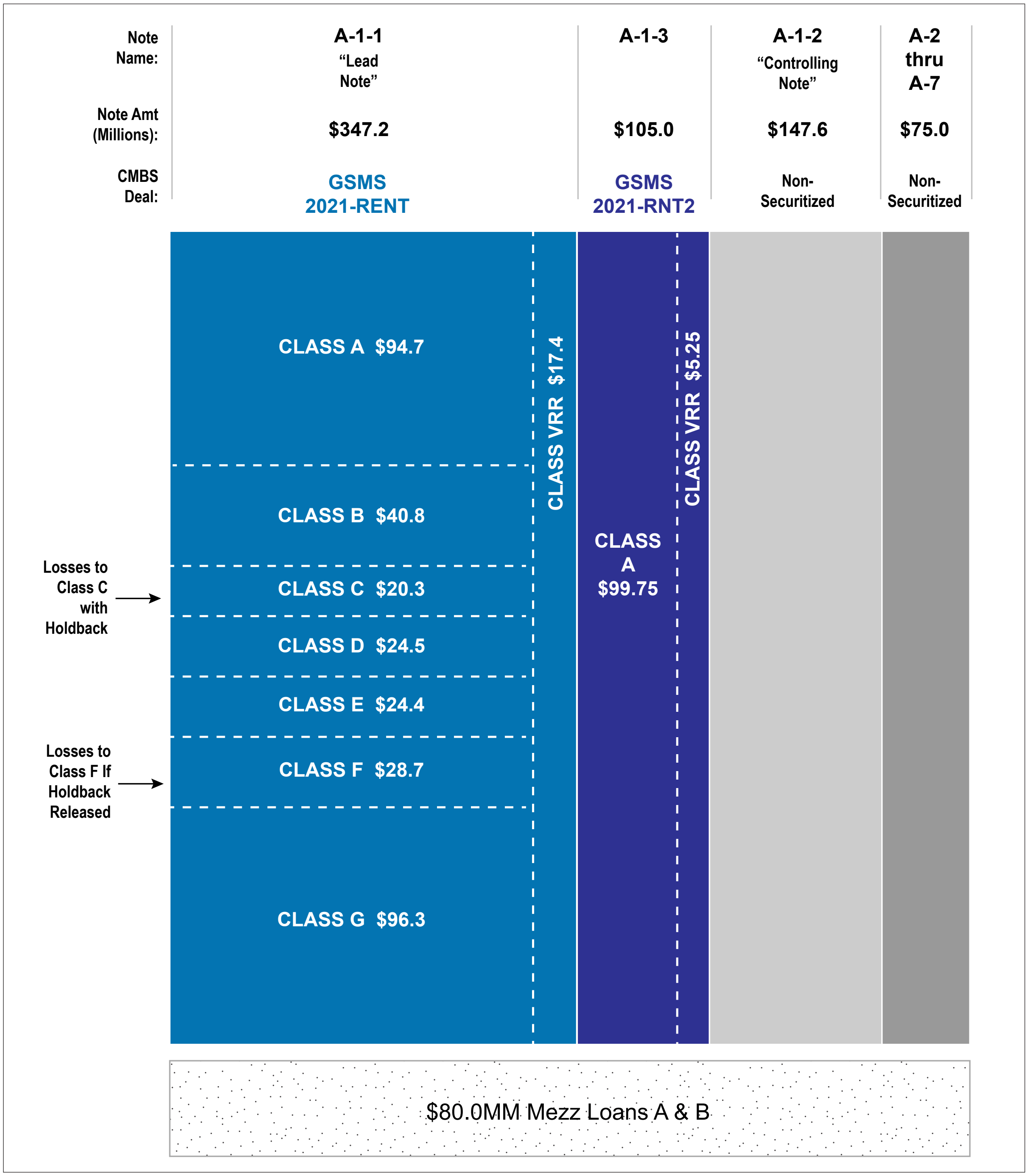
Tracking holdback releases further confounds the situation. Although writing up CMBS classes is not unprecedented, it is not clear how investors will see holdback releases, which might stretch over a long period of time. Still, the Crossgates deals are seeing such releases, shortly after the loan’s liquidation. The servicer released $3.0 million holdbacks in November 2023, based on deal reporting. Another $2.5 million was released this month. Shedding some light on the rationale behind the releases, the Crossgates servicer noted they are considering the servicing standard, remaining pool assets, and maintenance of appropriate levels of reserves for potential liabilities when determining timing and amounts of releases.

Pre-Liquidation Holdbacks Also Pop Up

Amid the heightened focus on holdbacks at loan liquidations such as Veritas and Crossgates, we also suggest investors gear up for pre-liquidation holdbacks. We identified at least one case where the special servicer instructed the master servicer to hold back a significant amount on a conduit deal. In JPMBB 2013-C15, the servicer held back $19.0 million in the October 2023 distribution. The holdback did not appear to be associated with any particular loan. Deal commentary suggests that the holdbacks are because “the pool [is] winding down to four loans remaining.” The holdback showed up as “Other Expenses” in the bond/collateral cash flows reconciliation, and triggered a commensurate realized loss on C15’s first-loss class. All told, seeing such unexpected holdbacks clearly adds yet another wrinkle to cashflow scenarios on seasoned deals, echoing the current market concern over non-recoverability decisions.[2]

2 “Blanket NRAs: Shutting Down Advances Upends Credit IO Trades,” CMBS Credit Focus, Academy Securities, January 3, 2024

Figure 2. Veritas Multifamily Pool Capital Structure



Source: Deal Documents, Ratings Agencies, and Academy Securities

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