CMBS Credit Focus
Litigation Holdbacks: Long Gone Loans Keep Haunting Trusts

Check Aloft Houston's Post-Liquidation $55 Million Holdbacks

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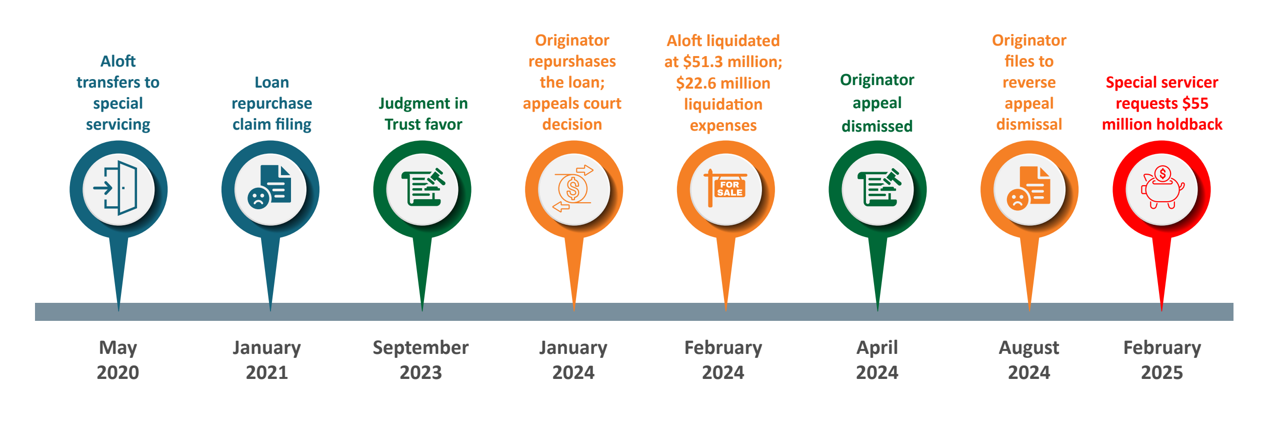
Large, trust-level holdbacks that are popping up across conduit deals show how liquidated loans can keep haunting investors, even years after the loans have left the trust. The special servicer in WFCM 2015-C26 recently directed the trust to hold back $55 million, tied to outstanding litigation on the Aloft Houston by the Galleria loan. The $32.6 million original balance Aloft was liquidated back in February 2024. The requested holdbacks showed up as "other expenses" in the latest deal remits. The expenses triggered realized losses all the way up to class E in C26.

Such unexpected, post-liquidation holdbacks, introduce new cashflow uncertainty. Investors may no longer be surprised when servicers hold back liquidation proceeds, at loan liquidation. The market realized holdbacks can comprise a large chunk of liquidation expenses, after the $164.1 million holdback shock in last year's liquidation of the Veritas Multifamily Portfolio Pool.[1] We also observed some instances of pre-liquidation holdbacks. But the situation in WFCM 2015-C26 shows yet another possibility of holdbacks (Figure 1). Indeed, post-liquidation holdbacks might be harder to project than pre- and at-liquidation holdbacks, because the culprit loans have been long gone.

Figure 1. Aloft Houston by the Galleria (WFCM 2015-C26) Holdbacks



Source: Morningstar Credit and Academy Securities

1 "Holdbacks: RENT in the Limelight, as Other Cases are Brewing," CMBS Credit Focus, Academy Securities, January 25, 2024

Seasoned Deals Especially Prone to Unexpected Holdbacks

Servicers may be particularly inclined to hold back amounts from trust cashflows when the number of outstanding loans dwindles, and many of the remaining loans are in distress. In WFCM 2015-C26, to justify the $55 million holdback, the special servicer explicitly alludes to the "particular characteristics" of the remaining loans in the trust. The deal only has eight loans left. Seven of them matured and are not performing.

The servicer's holdback rationale echoes the approach we believe master servicers now typically adopt in triggering non-recoverability determinations.[2] Beyond evaluating specific loan circumstances, servicers also look at the remaining pool to see if outstanding loans can cover trust expenses. All told, seasoned deals are especially susceptible to both non-recoverability and holdback-driven cashflow disruptions. Deals such as JPMBB 2015-C27 and JPMBB 2013-C15 also saw unexpected holdbacks showing up as other expenses. In turn, servicers are now regularly triggering non-recoverability determinations across multiple older vintage deals.

Sleuthing for Outstanding Litigation on Liquidated Loans

In WFCM 2015-C26, the Aloft loan liquidated last year amid an ongoing legal battle that has been raging for years. The servicer uncovered back in 2020 "defective origination documents". It filed a repurchase claim in the New York Supreme Court against the originator in January 2021. The originator complied with a court order and repurchased the loan in January 2024, which triggered the loan's liquidation to the tune of $51.3 million. The originator appealed the decision around that time. The servicer requested the recent holdbacks to cover the trust's exposure to "unfavorable [court] decision". The Aloft situation, which we pieced together from deal commentary, press reports, and servicer memos, underscores the difficulty in tracking legal proceedings on CMBS loans.

We do not see a way to systematically identify liquidated loans with outstanding litigation. In the absence of a data field marking potential legal exposure of the trust, investors may need to review historical deal commentaries and third-party sources on every liquidated loan. Sometimes it may not even be clear what specific loans triggered sudden holdbacks. In WFCM 2015-C26 the deal reporting clearly ties the trust-level holdbacks to Aloft's repurchase claim litigation. But in JPMBB 2013-C15, for example, the reason for the $19 million holdbacks remains murky.

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

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