



The Dividing Line Between Modification Agreements and PSA/TSAs

Split A/B modifications spotlight the interplay between loan modification agreements and deal documents, especially pooling and servicing or trust and servicing agreements (PSA/TSA). Split A/B mods typically include complex cashflow allocation priorities and liquidation waterfalls. The mod waterfalls sometimes may appear to contradict (or overly complicate) the trust waterfalls and allocation priorities. The \$725 million HILT 2016-SFP is a case in point.

The mod template of the distressed Hilton San Francisco Hotel Portfolio loan lays out a “liquidation waterfall” that appears to prioritize all deferred senior interest payments over principal, and even over special servicer fees and related expenses (Figure 1). The mod priorities are not fully consistent with the standard trust liquidation waterfall. Still, the mod also requires reimbursing servicer advances at liquidation as top priority, which is aligned with typical liquidation priorities. All told, reviewing the Hilton San Francisco mod template, it is not entirely unreasonable to believe the mod introduces a new liquidation waterfall, overriding the HILT 2016-SFP trust waterfall.

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Figure 1. Hilton San Francisco Hotel Portfolio Loan and Property Parameters

	Hilton San Francisco Hotel Portfolio	Modification Terms
Deal	HILT 2016-SFP	Borrower commits to injecting \$230 MM fresh equity. Maturity date extended to Nov-2028 with original loan bifurcated into \$407.9 MM A-Note and \$317.1 MM B-Note. Interest rate reduced to 2.95% on A-Note and 0% on B-Note. Interest due first two years is based on available cash, with any shortfalls accruing. Hard interest payments required starting in year three. <u>LIQUIDATION WATERFALL</u> <ul style="list-style-type: none"> • Servicer advances and interest • A-Note deferred interest • A-Note principal • Liquidation fee to Lender • Special servicing fees and any other Lender fees • New Borrower equity plus 16% return thereon • 75/25 split to Borrower/Lender until Lender repaid all accrued interest and principal on the B-Note • 100% to Borrower
Loan Balance (\$ per unit)	\$725,000,000 (\$246k per room)	
Original Maturity	November 2023	
Original Coupon	4.11% fixed	
Amortization	Interest-only	
Loan Status	90+ Days Delinquent	
Property Size / Occupancy	2,943 rooms / 41% occupancy (Dec 2024)	
Property Type / Location	Hotel / San Francisco	
Appraisal History	\$1,561.0 MM (Aug 2016); \$489 MM (Nov 2024)	
Total Advancing & Interest	\$103.4MM (Apr 2026)	

Source: Morningstar Credit and Academy Securities

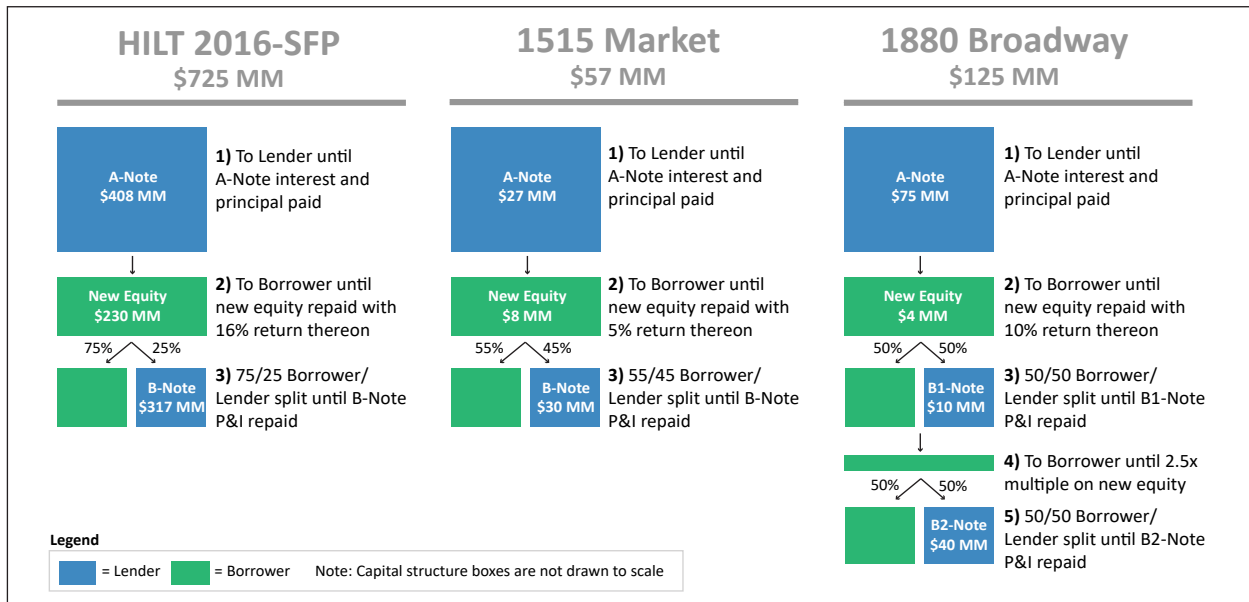
We view mod waterfalls and trust waterfalls as two separate things. Conceptually, loan modification agreements determine what cashflows the trust receives from a modified loan. The trust PSA/TSA and other contractual provisions continue to govern how those received cashflows are allocated across servicers, trust expenses, and the outstanding deal classes. Loan mods should not override the waterfalls and priorities of the trust.

Mod Waterfalls: Split A/Bs Should Not Override Deal Allocation Priorities

Loan Modification Agreements Govern the Property/Loan Cashflow Allocations

Split A/B waterfalls determine how property cashflows and any sale/refinance proceeds are allocated across the A and B notes of the modified loan, and the borrower. The common simplified priorities of property sale or loan refi (so-called “capital event”) would be: (1) interest and principal to the A note; (2) payment of borrower equity and a defined rate or return; (3) 50/50 split (or another percentage split) on the B note and the borrower. We see such waterfalls described in several split A/B mods executed in recent months, including 1515 Market (\$57.2 million, JPMBB 2014-C26) and 1880 Broadway/15 Central Park West Retail (\$125 million, MSBAM 2012-C6). In 1515 Market, the B note/borrower split is 45%/55%. In 1880 Broadway/15 Central Park West Retail, the modified loan structure includes two B note tranches below the A note (Figure 2).

Figure 2. Select Split A/B Modification Allocations



Source: Deal documents and Academy Securities

Mods typically include borrower equity contributions towards reimbursement of servicer advances or trust expense, as well as replenishment or establishment of reserve accounts. For example, in HILT 2016-SFP the borrower is providing an initial \$25 million equity contribution to pay down outstanding advances and closing costs. The borrower also committed to reimburse additional \$30 million advances in later years. In turn, in 10333 Richmond (\$34.7 million, JPMBB 2014-C22), \$2.5 million of the overall \$6.4 million borrower new equity is funding an “all purpose” reserve account. All of these reimbursements and expense recoveries should not create tension with the PSA or TSA.

The mod provisions also should not impact servicer decisions around non-recoverable advances (NRA) – either the NRA recovery timing, or the NRA determination itself.¹ Indeed, in 1880 Broadway/15 Central Park West Retail deal commentary noted that the master servicer is maintaining the loan’s non-recoverable status following the modification. As such, the master is not advancing any mod-driven shortfall, and may use loan payments to recover expenses.

¹ “Non-Recoverable Advances: Unveiling a Rationale for a Key Servicing Decision,” CMBS Credit Focus, Academy Securities, May 18, 2023

Amendment of TSA/PSA Requires Bondholder Approval, Unlike Loan Mod

Servicer commentary and PSA/TSA provisions support the view that deal’s waterfalls and priorities prevail even in split A/B situations.² Servicers and trustees repeatedly note in deal disclosures that loan payments will be allocated “according to the payment priority in the PSA.” We see such commentary on deals with split A/B mods such as HILT 2016-SFP and MSBAM 2012-C6, among other situations. Separately, significant amendments of a PSA or a TSA typically require the consent of 51% of any class that will be “affected” by the change. Such voting/consent mechanism appears to create clear distinction between a loan modification agreement, which a special servicer can unilaterally approve (subject to the servicing standard), and PSA/TSA amendments.

Mod templates may not fully reflect the underlying loan modification agreements. Interestingly, HILT 2016-SFP disclosed the other week the “amended and restated” loan agreement of the Hilton San Francisco loan, a few months after the disclosure of the loan’s mod template. The full agreement suggests that the “liquidation waterfall” that the mod template laid out, appears in somewhat different context in the full agreement, and may not necessarily reflect priority directions. In the full agreement, the waterfall is a list of items that maturity payoff should include to be considered a “full” loan payoff. There might be simple explanation or reconciliation to the apparent liquidation waterfall mischaracterization in the mod template. But the inconsistency suggests investors should always look to consult the full mod agreements, rather than just mod templates.

² To be clear, we are offering observational views, rather than legal analysis of deal and loan agreements. Despite having legal background, the authors are not dispensing legal advice.

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