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CMBS Credit Focus

Non-Recoverable Advances: Unveiling a Rationale for a Key Servicing Decision

Check Milford Plaza Fee as Non-Recoverability Determinations Poised to Rise

Stav Gaon
+1 (646) 768-9173
sgaon@academysecurities.com

Headquarters Address:
Academy Securities, Inc.
622 Third Avenue, 12th Fl
New York, NY 10017

The fresh non-recoverability determination on the $275 million Milford Plaza Fee (MSBAM 2013-C9 and C10) provides investors with a relatively rare opportunity to assess servicer rationale around the sometimes-obscure non-recoverability decisions. The master servicer on Milford noted it will no longer fund any additional P&I advances on the loan. The servicer also promptly recovered $28.0 million of prior advances. This led to large realized losses in the April remit on the J classes of the two exposed deals. In turn, withholding future P&I advances should elevate interest shortfalls across other classes. Shortfalls now reach the originally-rated triple-B-minus classes.

Uncertainty over Milford's resolution timing and lack of cashflow control appear to have been key drivers of the non-recoverability decision. The master servicer noted that the special servicer is not in possession or control of the property or the property cash flow. The servicer mentioned it has limited knowledge of projected capital costs that may be required going forward. The loan has been in special servicing for nearly three years. Interestingly, the servicer also stated it has concerns over the property's projected property taxes, which the servicer will need to continue funding. All told, the servicer concluded that "the amount of the currently outstanding advances is approximately equal to the estimated recoverable value of the asset." We note that total advances stood at $61.4 million, based on the most recent deal records. The property's appraisal was $365 million as of June 2022, up from $324 million the previous year (Figure 1).

Figure 1. Milford Plaza Fee Loan and Property Parameters

Asset Name	**Milford Plaza Fee**			
Deal	MSBAM 2013-C9; MSBAM 2013-C10			
Balance	$275,000,000			
Maturity	April 2023 (ARD)	Other Information		
Coupon	3.48%	Appraisal History		
Loan Status	90+ Days Delinquent	$365.0 MM (Jun-2022)	Total P&I Advanced:	$28.0 MM
Property Type	Leased Fee	$324.0 MM (Jul-2021)	Total Advances:	$31.9 MM
Ground Lessee Improvement	Full Service Hotel	$378.0 MM (Aug-2020)	NRA Amount:	$29.7 MM
Location	New York, NY	$386.0 MM (Jan-2013)	NRA Month:	Apr-2023

Source: Bloomberg and Academy Securities

Non-Recoverability Still Fairly Uncommon, but Perhaps Not for Long

Milford Plaza now tops the list of loans with non-recoverability determination. Other notable loans where the servicers concluded their advances are non-recoverable include Poughkeepsie Galleria ($131.1 million, UBSCM 2012-C1 and UBSC 2011-C1) and Crystal Mall ($81.1 million, UBSBB 2012-C2) (Figure 2). Non-recoverable determinations have been uncommon so far. Such situations account for 6.5% of the overall universe of delinquent or specially serviced loans. But we expect investors to encounter such decisions more frequently in the coming months as uncertainty lingers over loan resolutions, and property valuations deteriorate.

Figure 2. Large Loans with a Non-Recoverability Determination

Loan	Deal(s)	Balance ($MM)	Property Type	Status	P&I Advances ($MM)	Total Advances ($MM)	NRA Repay ($MM)	NRA Repay Period
Milford Plaza Fee	MSBAM 2013-C9; MSBAM 2013-C10	275.0	Leased Fee	90+ DQ	28.0	31.9	29.7	Apr-2023
Poughkeepsie Galleria	UBSC 2011-C1; UBSCM 2012-C1	131.5	Retail	Matured NP	0.0	0.0	5.7	Jan-2022 to Nov-2022
Louis Joliet Mall	UBSBB 2012-C2	85.0	Retail	REO	0.0	0.0	4.0	Jul-2022
Crystal Mall	UBSBB 2012-C2	81.1	Retail	REO	0.0	0.3	4.3	Jul-2022
Hilton Times Square	MSC 2011-C1	75.6	Hotel	REO	0.0	2.1	4.9	Feb-2021
Palmer House Retail Shops	JPMBB 2015-C32	57.7	Mixed Use	90+ DQ	8.2	10.2	0.0	Future Period
West Ridge Mall & Plaza	COMM 2014-CR16	46.0	Retail	REO	0.0	0.0	2.4	Dec-2021
401 South State Street	CGCMT 2016-P4; CD 2016-CD1	42.4	Office	REO	5.3	12.6	0.0	Future Period
Alamance Crossing	COMM 2012-LC4	41.0	Retail	Matured NP	0.0	0.0	3.3	Dec-2022
Lincolnwood Town Center	JPMCC 2014-C20	40.9	Retail	REO	8.4	9.7	0.0	Future Period
Harbourside North	COMM 2013-CR12	35.5	Office	REO	0.0	0.0	2.2	May-2022 to Nov-2022

Source: Bloomberg and Academy Securities

A key implication of non-recoverability determinations is that servicers can immediately withhold trust principal payments to recover prior advances. Absent such determinations, servicers typically recover advances at loan liquidations or in some cases from the trust interest collections, as we recently discussed.[1] Non-recoverability determinations can lead to sudden, potentially large realized losses on exposed bonds. Aside from the fresh Milford-driven principal losses on MSBAM 2013-C9 and C10, other deals that saw such losses include UBSBB 2012-C2 ($13.6 million in July 2022 on loans including Louis Joliet Mall) and WFRBS 2012-C7 ($1.9 million in June 2022).

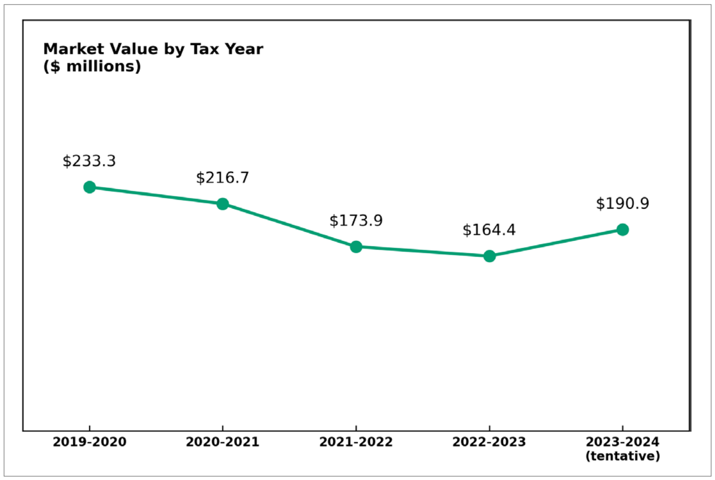
1 "Excess Cash Allocations: Probing Advances on Positive Cashflowing Loans," CMBS Credit Focus, Academy Securities, May 2, 2023

Aspects to Watch on Non-Recoverability Determinations

We see a couple other relevant aspects that Milford highlights on non-recoverability decisions:

- **Non-recoverability can vary across advancing types.** Milford makes it clear that servicers can trigger separate non-recoverability determinations for different types of advances. The Milford servicer noted that it will no longer advance P&I. But it will continue to advance property taxes and other property protection advances ("PPA") type expenses such as legal fees and insurance. In a similar vein, the servicer recovered its prior PPA advances in April, but not prior P&I advances. Although it will continue to advance PPA for now, the servicer also noted that the advancing will be subject to future review and analysis. Interestingly, Milford property taxes are set to increase this year, based on NYC's preliminary tax assessment of the property (Figure 3). The anticipated increase may have also contributed to the servicer P&I non-recoverability decision, as it will need to conserve funds for PPA advancing.

Figure 3. Milford Plaza Market Value by Tax Year



Source: NYC Department of Finance and Academy Securities

- **NRA without ARA.** Servicers can make non-recoverable advance ("NRA") determinations even when the property does not have appraisal reduction amount ("ARA"). This is the case in Milford. NRAs and ARAs are unrelated events. ARAs follow new appraisals (or happen automatically in some cases) and may cause servicers to curtail advances as a function of the appraisal reductions. We discussed in detail some of the mechanics around ARAs and ASERs in a previous report.[2] In contrast, NRAs can happen at any point, get triggered by any set of circumstances, and may lead to partial or full withholding of advances. To be sure, new lower appraisals can be one factor impacting servicers' NRA decisions. But as the servicer's commentary in Milford shows, the property's appraisals played little or no role in the NRA determination.

2 "Triple-A Shortfalls: Destiny Spotlights Delayed ASERs Impact," CMBS Credit Focus, Academy Securities, September 20, 2022

Leased Fee Loan Default

The situation at Milford remains in flux. This is a unique case of a leased fee default, with several moving parts to keep in mind, including the potential friction between the ground owner and leaseholder.[3] The hotel itself, now called the Row NYC, is not part of the collateral. But amid the ground rent default, which led to the CMBS mortgage default, the “see through” analysis typical for leased fee situations is even more critical. Investors may wonder what the prospects are for the ground owner (or the CMBS trust) to seize on the hotel following the failure of the leaseholder to pay ground rent.

The 1,331-room hotel, which was closed during the pandemic, is now serving as a migrant shelter, according to press reports. New York City reportedly signed a $40 million contract back in October 2022 to lease the entire hotel. The lease was slated to run until mid-April. A visit to Milford this week suggested the hotel is still used to house migrants (Figure 4). Large crowds, including many families and kids congregated in front of the hotel. Security guards prevented any unauthorized access to the lobby area. Most of the retail on the hotel’s block on Eight Avenue near Times Square was shut down. Overall it appeared the hotel may face some challenges and likely would need significant investment to regain its positioning as an upscale tourist destination, as many of the hotel’s website photos suggest was the case pre-pandemic.

Figure 4. Milford Plaza / Row NYC, May 2023

Source: Academy Securities

3 “The Road to Conversion: Consider Ground Leases and ARD Loans in Office Analysis,” CMBS Credit Focus, Academy Securities, January 5, 2023

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