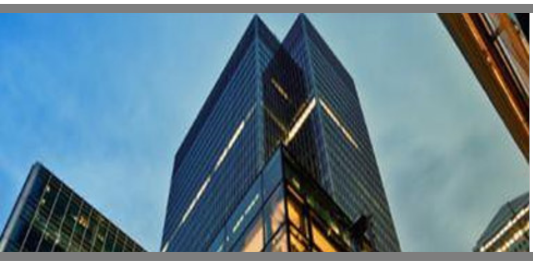
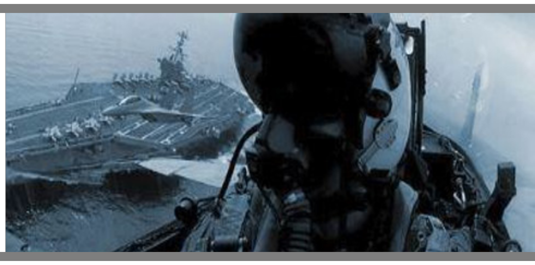
CMBS Credit Focus

Recovering the Non-Recoverable: Liquidation Waterfall Nuance Bolsters Bond Paydowns





A Curious Recovery in Mall at Tuttle Crossing Distressed Liquidation

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The fresh liquidation of the $125 million The Mall at Tuttle Crossing (MSBAM 2013-C10 and C11) spotlights the rare case of recovery of non-recoverable advances (NRA), which increases principal paydowns. To be clear, in such a case the trust recovers at liquidation funds that the servicer previously determined as NRA and used trust collections for pre-liquidation reimbursement. In Tuttle Crossing, which liquidated via discounted payoff at reported $10.6 million net proceeds on the C11 deal (74.0% loss severity on original balance), $6.3 million of the liquidation expenses apparently allocated to NRA recovery (Figure 1). Such recovery was distributed to the bondholders, based on deal documents. This made the Tuttle Crossing liquidation-driven principal paydowns higher than what the reported loss severity implied.

Figure 1. The Mall at Tuttle Crossing Loan & Liquidation Parameters

Loan Parameters	
Asset	The Mall at Tuttle Crossing
Deal	MSBAM 2013-C10; MSBAM 2013-C11
Orig Loan Balance ($psf)	$125,000,000 ($325 psf)
At-Liquidation Balance ($psf)	$105,982,757 ($275 psf)
Maturity	May 2023
Coupon / Amortization	3.564% fixed / 36 mos IO then 30yr amortization
Loan Status	90+ Days Delinquent & In Foreclosure
Property Type	Regional Mall
Property Size / Occupancy	385,057 sq. ft. / 72% occupied (Jun-2023)
Location	Dublin, OH
Previous NRA Amount	$6.3MM
NRA Determination Date	August 2023

Net Liquidation Proceeds Waterfall	
Original Note Balance	$125.0
Note Balance At Liquidation	**$106.0**
Gross Sales Proceeds	**$25.1**
less: Advances (Incl Interest)	-$2.4
less: NRA Recovery	-$6.4
less: Scheduled Interest	-$0.8
less: Other Fees & Expenses	-$6.3
Net Liquidation Proceeds	$13.6
Realized Loss	**$92.7**
Loss Severity (on original balance)	74%

Source: MCIA and Academy Securities

We expect investors will see more cases of NRA recoveries in the coming months, as the number of non-recoverability determinations rises. Servicers currently are likely more inclined to trigger NRAs as uncertainty lingers over loan resolutions, and property valuations deteriorate. This will be a shift from the experience in recent years that saw very few NRA situations, as we discussed in a previous report.[1] A key implication of non-recoverability determinations is that servicers can

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

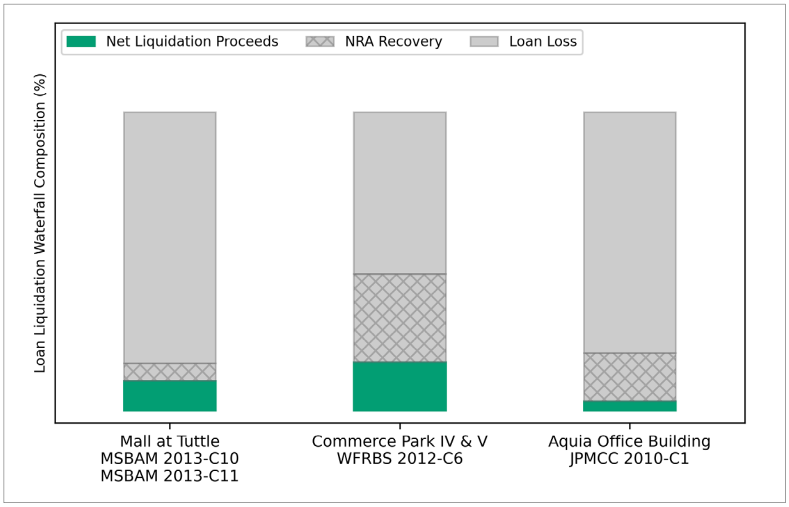
immediately withhold trust principal payments to recover prior advances. But the resolution uncertainty that accompanies non-recoverability determinations also means that trusts may end up with liquidation proceeds that can support NRA recoveries.

NRA Recoveries are Part of the Liquidation Proceeds Waterfall

Allocation to NRA recoveries is senior to the distribution of liquidation proceeds to bondholders. NRA recoveries join many other expense items in the liquidation proceeds waterfall that precede principal paydowns. Most of these liquidation expenses are various servicer and trustee fees, or servicer reimbursement of advances. Some of the more unusual expense items could be so-called "holdback" amounts, which can unexpectedly jack up the overall liquidation expenses, as we recently saw in the Crossgates Mall liquidation.[2] The accumulation of all the liquidation expenses can significantly reduce the net liquidation proceeds, elevating loss severities. However, NRA recoveries is one of the expense items that can actually reduce such severities.

Tuttle Crossing and a handful of other earlier cases of NRA recoveries we identified illustrate how this nuance might play out. After loan liquidation, remittance reports show negative NRA amounts, reducing the trust's cumulative NRA levels, and effectively increasing principal distributions to bondholders. Aside from Tuttle, we spotted such recoveries following the liquidations of Commerce Park IV & V (WFRBS 2012-C6, $3.8 million recovery) and Aquia Office Building (JPMCC 2010-C1, $1.9 million recovery) (Figure 2).

Figure 2. Loans with Recovery of Non-Recoverable Advances



Source: MCIA and Academy Securities

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

Generic realized loss templates show four expense items related to non-recoverable advances. Two items deal with accrued interest, which funnel into the total accrued interest expenses (IRP fields L117, D76). The other two items relate to non-recoverable principal and servicing advances, and funnel into the "additional trust fund" expense category (IRP fields L118, D77). For example, in the recent liquidation of Coleman Marketplace (BANC 2017-CRE2) the realized loss template shows $2.2 million allocation to non-recoverable servicing advances (line item "g" in L118). The deal's subsequent remittance reported NRA recovery amount in that range (albeit oddly a bit higher).

Still, virtually all the other NRA recovery situations we found apparently lack full reporting of the liquidation expense breakdowns. This makes it hard to directly tie such recoveries to specific liquidation expense items. It leaves investors potentially doing some guesswork as NRA recoveries pop up in remittance reports.

Even if Recovered, NRAs Impact Principal Paydown Timing

NRA determinations and any subsequent recoveries impact principal paydown timing. Interestingly, we find wide variation in the time periods between determinations and recoveries across the handful of such situations. For example, in Tuttle Crossing, the NRA trigger and servicer reimbursement happened only two months prior to the NRA recovery. The August 2023 remittance report of the C11 deal shows trust expense of $6.3 million because of "non-recoverable advances", the exact amount that the trust apparently recovered last month. WFRBS 2012-C6 also had only a two-month gap between the NRA reimbursement and its later recovery. In contrast, in JPMCC 2010-C1 we see a much longer time period between the buildup of NRA expenses, in November 2021, and its recovery in August 2022. All told, as servicers potentially move up NRA determinations, and liquidations drag on, the impact on paydown timing would be more pronounced. Figure 3 shows some of the large loans that currently carry non-recoverability determinations.

Figure 3. 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 Reimbursement Period
Milford Plaza Fee	MSBAM 2013-C9; C10	275.0	Leased Fee	90+ DQ	28.0	37.2	29.7	Apr-2023
Poughkeepsie Galleria	UBSC 2011-C1; UBSCM 2012-C1	135.9	Retail	Matured NP	0.0	0.0	5.7	Jan-2022 to Nov-2022
Hilton Times Square	MSC 2011-C1	75.6	Hotel	REO	0.0	2.8	4.9	Feb-2021
Palmer House Retail Shops	JPMBB 2015-C32	57.7	Mixed Use	90+ DQ	5.5	9.3	0.0	Future Period
West Ridge Mall & Plaza	COMM 2014-CR16	45.8	Retail	REO	0.0	0.0	2.4	Dec-2021
401 South State Street	CGCMT 2016-P4; CD 2016-CD1	42.4	Office	REO	7.8	18.4	0.0	Future Period

Source: Bloomberg and Academy Securities

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