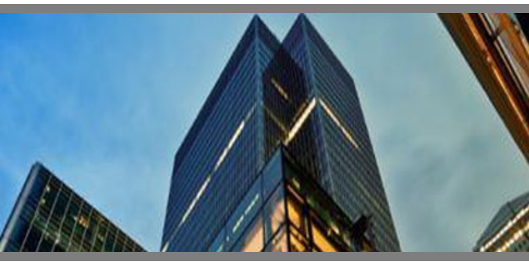
CMBS Credit Focus

Release Prices: Cherry Picking Across Office Portfolios, Sometimes at a Discount



Track Property Releases amid Rising Concern Over Collateral Degradation

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Increasing performance divergence across properties, especially in the office sector, should exacerbate a concern over quality degradation of multi-property portfolio loans following property releases. Borrowers may look to release portfolios' best properties, paving their way to sales or recapitalizations, and leaving CMBS trusts with the poorest performing collateral. For example, portfolio releases could concentrate on strong subtypes such as life science properties in multi-subtype office portfolios such as Core Office Portfolio (CORE 2019-CORE). Or releases could focus on the strongest office markets in multi-region portfolios such as Brookfield Office Portfolio (MSC 2018-BOP), which has exposures to diverse markets including Orlando, FL, and suburban Maryland.

Releasing at a Discount

The just-reported release of an office property in the TOP Portfolio (CSWF 2018-TOP) also spotlights the unusual possibility of the borrower releasing a property for a far smaller amount than the release price set in deal documents. The borrower released the Wells Fargo – Inland Empire property, part of an original 15-property office portfolio, for $33.6 million, ~25% less than the $44.7 million release price that the deal release provisions imply. TOP Portfolio, the only loan in the deal, has seen other property releases over time, reducing the deal's $530 million issuance balance to $51.5 million (Figure 1). Unlike the latest Wells Fargo discounted property release, previous releases, with one exception, had principal paydowns commensurate with or exceeding the contractual release provisions (Figure 2). Discounted prices reduce the release-driven deleveraging benefit for the deal, as the top chart in Figure 2 shows.

Figure 1. TOP Portfolio Loan and Property Parameters

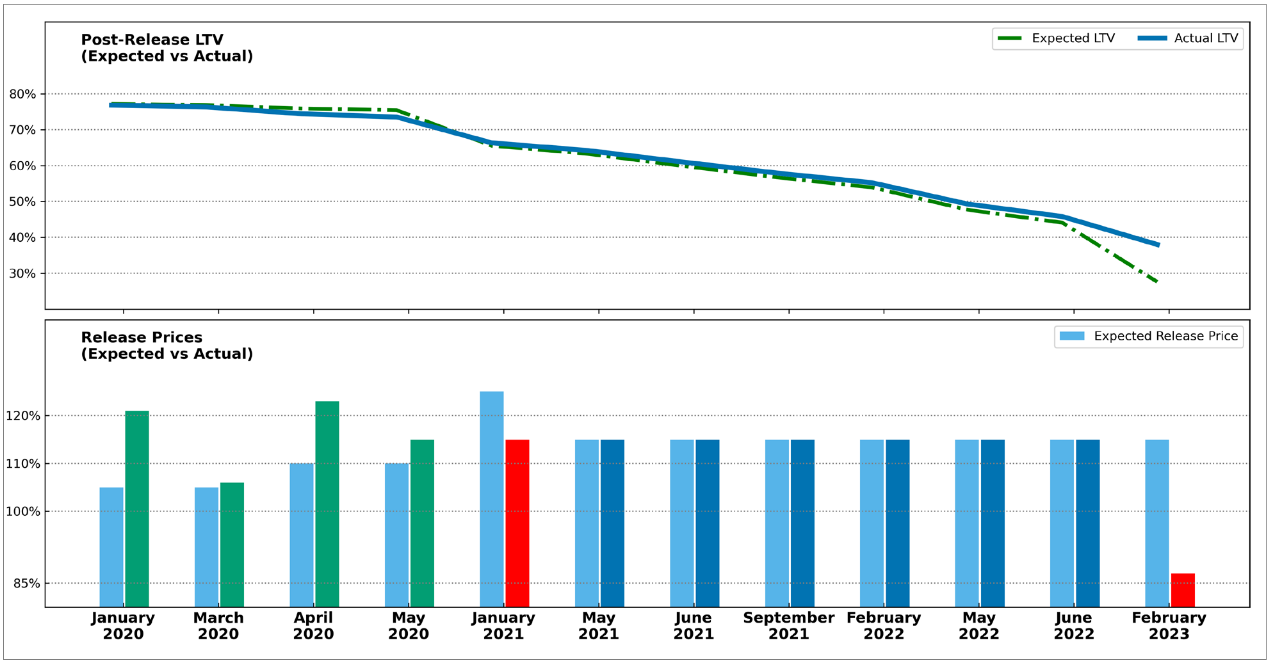
Asset Name	**TOP Portfolio**	
Deal	CSWF 2018-TOP	
Loan Status	Current	
Maturity	August 2023 (August 2024 if extended)	
	At Issuance	Current (March 2023)
Balance ($MM)	$530.0	$51.5
Property Count	15	3
LTV (Appraised Value)	77.3%	38.0%
Debt Yield	9.16%	18.04%

Property Release Terms

Properties may be released with payment of a release amount equal to (i) 105% of the property's allocated loan amount until the mortgage loan balance is reduced to 90% of the original loan amount, (ii) 110% of the property's allocated loan amount until the mortgage loan balance is reduced to 80% of the original loan amount, and (iii) 115% when the balance is reduced to less than 80% of the original loan amount.

Source: MCIA and Academy Securities

Figure 2. TOP Portfolio (CSWF 2018-TOP) Property Releases



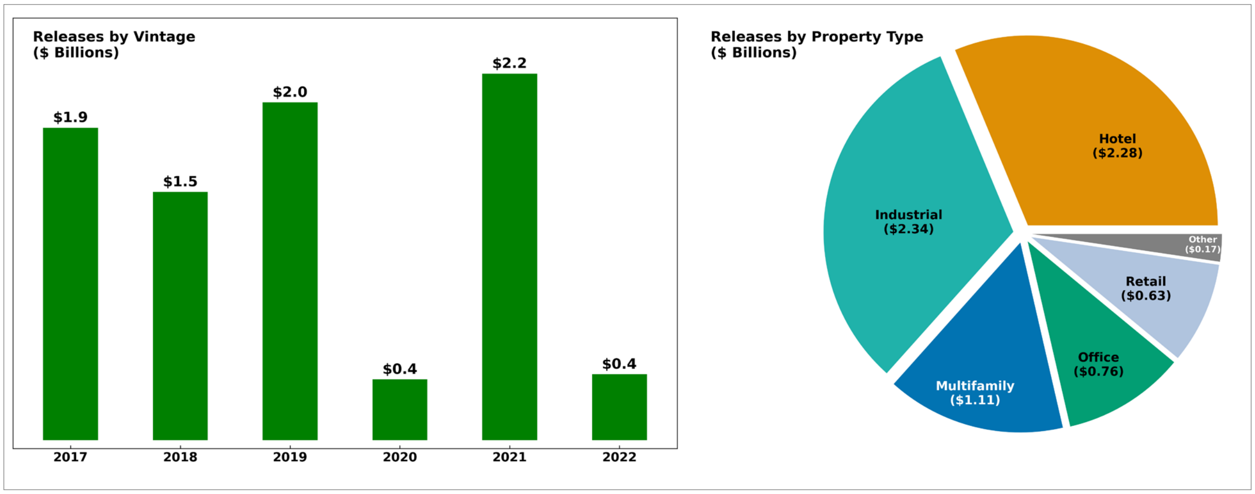
Source: MCIA and Academy Securities

Release Reporting Remains a Challenge

The potential surprise over seeing discounted release prices now joins a lingering challenge in tracking property releases over time. It may not always be clear which precise properties the borrower released once unexpected principal paydowns pop up in remittance reports. Notably, in the TOP deal the trustee had to identify last month the three remaining properties in the portfolio following investor queries (Eisenhower Campus, Bank of America – Charlotte, and Amazon – Phoenix). The Core Office Portfolio also saw investors looking for clarity on which properties were released in the past couple of years. Specifically, deal data shows only two properties of the original seven-property portfolio remaining (One Pierrepont Plaza and Station Square), while apparently stale servicer commentary indicates only three releases. Core's reduced $148.1 million loan balance also appears to incorrectly state the allocated loan amounts of the portfolio's remaining properties.

Investors can track released properties via the IRP's Property Status field (P18). Released properties should have code "4". In addition, the loan's current balances (L6, L7, and L36) and number of properties (L86) fields will reflect post-release levels, though will not identify the exact released properties. The aggregate release activity varies across recent vintages, with 2019- and 2021-vintage deals seeing most releases at $2.0 billion and $2.2 billion, respectively (Figure 3). Interestingly, across property types most of the release activity concentrated in industrial ($2.34 billion) and hotels ($2.28 billion). Office properties have seen relatively limited releases so far. This may change in the coming months.

Figure 3. Property Releases by Vintage and Property Type



Source: MCIA and Academy Securities

Brush Up on Release Provisions

We see the following aspects as relevant for tracking property releases:

- **Dynamic release provisions.** Premium release prices should somewhat reduce borrowers' incentive to release properties and create paydown timing uncertainty. A typical release provision would set release amounts that could range from 105% to 125% of the property's allocated loan amount. Release premiums could be higher if the borrower transfers the released property to an affiliate. The premiums may also change over time as the overall loan balance decreases. For example, in the TOP Portfolio the release amount is 105% until the loan's balance drops to 90% of the original loan amount, and 110% and 115% until the balance decreases to 80% and <80%, respectively. Higher release prices on portfolios that have been whittled down may exacerbate the concern over permissions to release properties at discount prices, of the kind the TOP Portfolio just saw.

- **Property-specific release prices.** Release provisions may set higher release amounts for specific properties in the portfolio. For example, in the Core Office Portfolio the release price for One Pierrepont Plaza is 125%, compared to 110% for other properties. The 746.5 sf office building in Brooklyn, NY, with the largest allocated loan amount in the portfolio, has not been released yet.

- **Subtype release concentration.** The Core Office Portfolio also features multi-subtype office properties, spotlighting the concern over borrowers releasing properties mostly in the strongest office subtypes, as we alluded to above. Among CORE's original seven properties, the Johns Hopkins Life Sciences Property in Baltimore and the UPenn Life Sciences Property in Philadelphia are life science and R&D properties. The borrower released both. To be sure, the borrower also released three other properties in the portfolio, so we cannot necessarily identify subtype-driven release preference. But while office subtypes may have shown more homogenous performance pre-pandemic, current market dynamics clearly favor certain subtypes over others. As such, we will not be surprised to see borrowers increasingly looking to release better performing properties, especially ahead of looming loan maturities.

- **Geographic release concentration.** Divergent performance across office markets could also drive release activity. For example, the Brookfield Office Portfolio loan originally had 12 office properties across four states. The portfolio may draw attention because of its elevated exposure to DC-area office market (nine properties). As the market continues to face challenges on the heels of government employees remote work and a pullback in GSE leasing, leaving the Brookfield portfolio with just the Maryland and Virginia properties could decrease the collateral's quality.[1] The borrower released three properties so far, two in the DC area, and one in Orlando, FL.

1 See "Government Tenants: Short Termination Notices and Specialized Properties," CMBS Credit Focus, Academy Securities, March 28, 2022

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