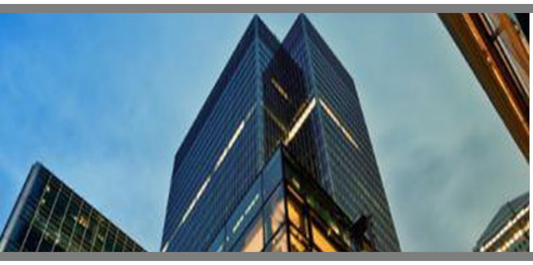
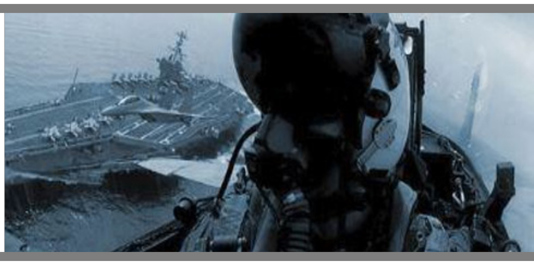
CMBS Credit Focus

Non-Trust Debt: Check the Seniority of Your CMBS Collateral





CXP Office Portfolio Modification Spotlights Senior Non-Trust Exposures

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The recent modification of the $484.7 million CXP Office Portfolio loan (CXP 2022-CXP1) spotlights CMBS workout implications when most of the collateral debt is not securitized, sitting outside the trust. Investors need to consider a whole slew of data, including updated collateral valuations, appraisal reduction amounts (ARAs), and modification terms, in the context of the overall debt stack. If the CMBS underlying notes are also subordinate to non-trust notes, this adds another wrinkle, as is the case in the CXP1 deal.

Notably, the CXP modification dramatically reduced the coupons of the CMBS two underlying notes to a fixed rate of 0.019% (from 4.6% and 5.5% over SOFR), turning the forgone payments into "hope amounts" (Figure 1). In contrast, the $1.07 billion non-trust senior notes continue to receive regular payments. The modification template states that the hope amounts may be paid down following property releases, introducing a potential adverse selection concern.[1] Properties such as 201 California Street and 650 California Street in San Francisco, CA, appear particularly weak compared to other properties in the portfolio, based on reported financials.

Figure 1. CXP Office Portfolio Loan and Property Parameters

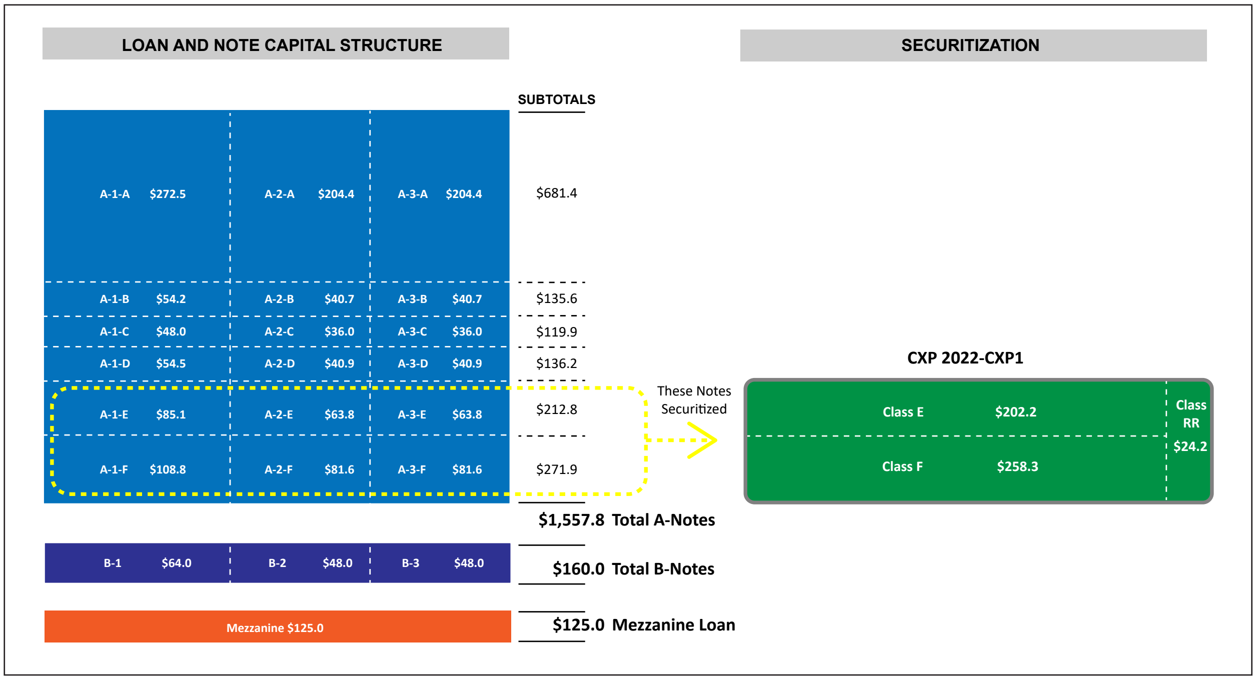
Asset	**CXP Office Portfolio**	
Deal	CXP 2022-CXP1	
Property Type / Size	Office portfolio consisting of 7 buildings, totaling ~2.7 million square feet	
Location (% of sq. ft.)	New York (39.6%), San Francisco (26.5%), Boston (9.9%) and Jersey City, NJ (24.0%)	
	Pre-Modification	**Post-Modification (May 2024)**
Loan Status	Matured	Current (Specially Serviced)
Loan Balance ($psf)	$1,717,842,628 ($622 psf)	$1,717,842,628 ($622 psf)
Coupon / Amortization	SOFR + 270 bps (8.02% rate April 2024) / Interest-only	~4.076% rate May 2024 / Interest-only
Maturity	December 2023	July 2025
Extension Options	Three one-year extension options to December 2026	One extension option to January 2026
Extension Terms	Extension options: (a) No event of default, (b) purchase of new SOFR cap at greater of i) 2.885% and ii) strike rate that would result in 1.05x DSCR, and (c) borrower pays all fees/costs	Extension option: (a) No termination event, (b) minimum 10 business days notice, (c) no event of default, (d) minimum 4.0% debt yield, (e) concurrent extension of mezzanine loan, and (f) payment of out-of-pocket extension costs from the collateral accounts
Other Terms		Current-pay coupon modification and "hope amounts": * Current-pay interest on the junior-most $644 million of the $1.7 billion mortgage loan shall be modified from SOFR + 520.9 bps to a fixed rate of 0.01428% (0.019% on $484.7 million and 0.0% on $160.0 million) * Interest will continue to accrue at SOFR +520.9 bps but will become "Hope Amounts" that shall only be payable to the extent there are adequate proceeds upon the release of any property.

Source: Deal Documents, Morningstar Credit, and Academy Securities

1 "Release Prices: Cherry Picking Across Office Portfolios, Sometimes at a Discount," CMBS Credit Focus, Academy Securities, April 13, 2023

The market may see more situations where the CMBS debt is subordinate to non-trust notes. Originators looking to reduce CRE exposure, especially to riskier parts of the debt stack, could look to securitize subordinate mortgage notes, similar to CXP. This marks a shift from how CMBS investors need to account for non-trust debt, that typically comes in the form of pari-passu mortgage notes, or subordinate B notes and mezzanine debt (which CXP also features, Figure 2).

Figure 2. CXP Office Portfolio Total Debt Stack (Dollar amounts in millions)



Source: Deal Documents and Academy Securities

To be sure, the presence of both pari-passu notes and mezz debt already creates challenges in deal reporting and workout dynamics, as we discussed in previous reports. For example, it may not be clear how servicers allocate cashflows across the securitized and non-securitized components, as the recent $105.1 million holdback release in GSMS 2021-RENT showed (the RENT deal received only ~$40 million of the overall release).[2] In turn, mezz lender actions could impact workout directions, either positively or adversely, depending on the mezz lender's incentives.[3]

Track Total Loan Reports

The prevalence of complex debt stacks that are divided into trust and non-trust notes (or across several trusts, for that matter) puts a focus on the IRP's somewhat obscure Total Loan Report. The report, part of a package of eight so-called supplemental status reports servicers release monthly, shows total debt stacks, including items such as current balances, note rates, and delinquency status. The information in the total loan report is particularly important as

2 "Releasing Holdbacks: RENT is Writing Up Bonds," CMBS Credit Focus, Academy Securities, April 29, 2024
3 "Securitized Mezz: Workout Dynamics in Public Display," CMBS Credit Focus, Academy Securities, July 17, 2023

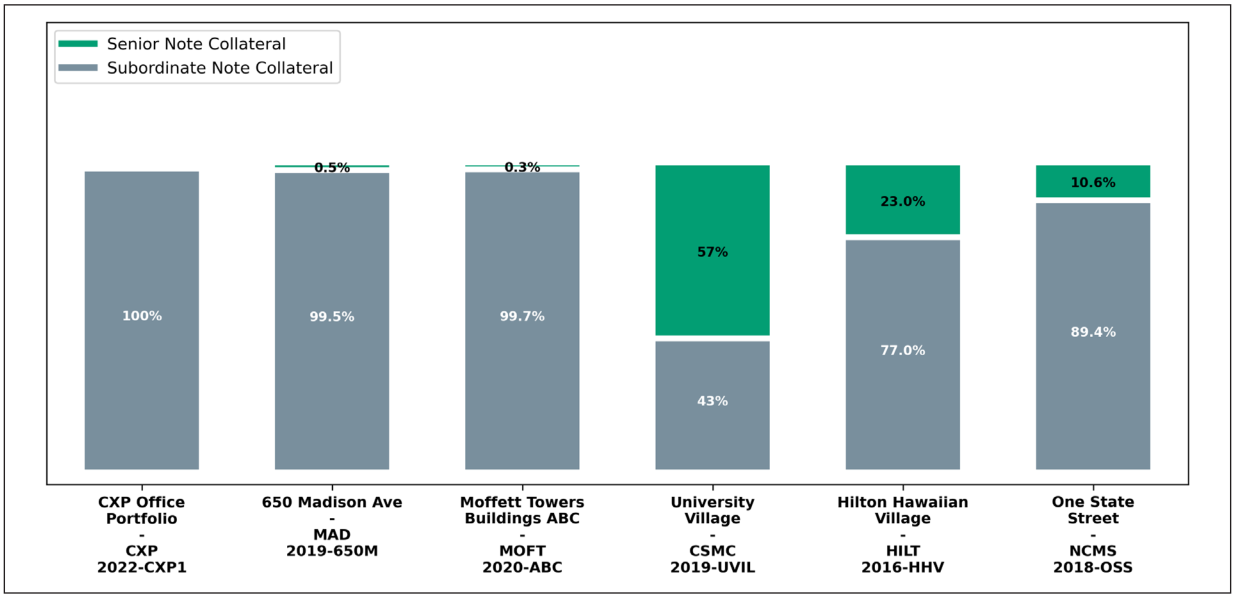
cashflow systems do not readily show non-CMBS components. Investors can typically see on the systems other securitized pari-passu exposures, but not the non-securitized ones. However, we find that populated total loan reports are not always available, even across CMBS deals where the prospectus clearly shows non-securitized notes.

Appraisals and ARAs in the Context of the Total Debt Stack

The situation at CXP illustrates how critical data points such as appraisals and ARAs should be related to the overall debt stack, including non-securitized components. The seven-property office portfolio latest reported valuation is $1.56 billion, significantly higher than the outstanding balance on the CXP1 deal. Of course, the subordination of the trust notes means the trust would stand last in line to see any mortgage payments down the road. In turn, the CXP1 remittance report shows an ARA of $152.1 million on the heels of the recent valuation. This amount seemingly does not tie into the standard ARA formula that subtracts 90% of the appraised value from the sum of the outstanding principal balance, advances, reserves, and several other items. Separate deal reporting shows that the overall ARA was $312.1 million. The ARA amount was first applied to the non-trust B note, appraising it out, and only then reached the CMBS trust.

All told, investors may already be aware of the need to consider related debt components that are not directly backing their CMBS exposures. But varying mortgage seniority levels, and especially the presence of non-trust components, add another layer of complexity. In Figure 3 we show several SASB deals backed by subordinate mortgage positions. Aside from CXP1, there are several office SASB deals that are almost entirely backed by subordinate mortgage notes.

Figure 3. SASB Mortgage Seniority



Source: Deal Documents, Morningstar Credit, and Academy Securities

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Recovering Shortfalls: Credit IO Value in Distressed Office

Releasing Holdbacks: RENT is Writing Up Bonds

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