CMBS Credit Focus

Loan Assumptions: Watch Waterfalls as New Borrowers Redevelop

Mall Loan Assumptions Set a Blueprint for Distressed Office

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We expect to see a growing number of loan assumptions in distressed situations, especially as new sponsors take over with the goal of executing capital-intensive property redevelopments. Such loan assumptions typically coincide with loan modifications. The new borrower will look to negotiate a favorable position for its fresh capital in a revamped capital structure, or waterfall mechanisms to recoup development costs.

Executed mod/assumptions around mall redevelopments could provide a blueprint for what CMBS investors should expect in such situations. Notable examples include the recent assumption on the $125 million Westfield Palm Desert loan (MSBAM 2015-C21 and WFCM 2015-C27), and before that on the $300 million Bridgewater Commons loan (GSMS 2012-BWTR). Interestingly, in Westfield Palm Desert the assumption provisions set up a mechanism for the new borrower to recover capital expenses as it looks to redevelop portions of the 977K sf regional mall in Palm Desert, CA, with housing, entertainment, and other mixed-use components.

Taking a cue from the mall loan precedents, distressed assumptions are especially pertinent for struggling CMBS office buildings. Servicers may look to incentivize new borrowers to pursue the capital expenditures or redevelopment projects such properties need. Examples of office buildings that servicers are currently marketing for sale, and could see mod/assumption as one eventual outcome, include the $309.8 million River North Point (GSMS 2018-RIVR) and the widely-watched $308 million 1740 Broadway (BWAY 2015-1740).[1]

Figure 1. River North Point Loan and Property Parameters

Asset	**River North Point**			
Deal	GSMS 2018-RIVR			
Loan Balance ($psf)	$309,799,056 ($238 psf)			
Maturity	July 2023			
Coupon / Amortization	TSFR1M + 1.54% floating / Interest-only	Appraisal History	Total Advancing (as of 2/2024)	
Loan Status	Matured Non-Perf & Specially Serviced	$489.0 MM (May-2018)	Principal & Interest:	$0.0 MM
Property Type	Mixed Use (Office & Hotel)		Taxes & Insurance:	$7.7 MM
Property Size / Occupancy	1,298,176 sq. ft. / 72% occ. (Aug 2023)		Unpaid Advance Interest:	$0.0 MM
Location	Chicago, IL		Total Advances & Interest:	$7.7 MM

Source: Morningstar Credit and Academy Securities

1 "Special Servicer Replacements: 1740 Broadway Crystalizes Implications," CMBS Credit Focus, Academy Securities, October 16, 2023

Office Properties on Sale Could See New CMBS Borrowers

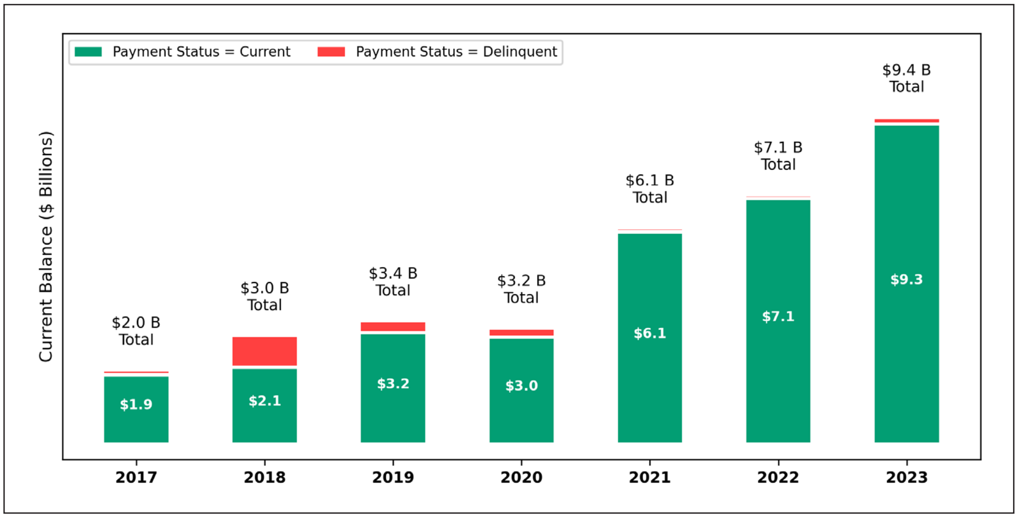
In River North Point and 1740 Broadway, as well as in similar situations, servicers may debate between a highly distressed liquidation that terminates the outstanding CMBS debt, and a complex mod/assumption that introduces a new borrower to the capital structure. The latter can come in the form of a split A/B modification, that market participants expect to become prevalent again. Split A/B cutoff points have been a contentious aspect in the past, and should continue attracting attention as we discussed in a previous report.[2] But some challenges that we see in tracking loan assumptions, or assumptions that are not tied to split A/B mods, add another layer of complexity.

Deals report loan assumptions via a dedicated Investor Reporting Package (IRP) field "Date of Assumption" (L91/D32). The field will show the date a new borrower executed the most recent assumption. L91/D32 will be empty if the original borrower is still in place. The reporting package also includes an assumption posting template, that generically shows many reporting items, including funds attributable to the old borrowers and those that the new borrower is responsible for. However, we observed that the assumption IRP fields are not readily available on a few cashflow systems investors use. We also could not track down populated assumption templates, even on loans we clearly identified as assumed.

Most Assumptions to Date Have Been on Performing Loans

Assumption surveillance may not attract much attention when new borrowers take over performing loans that face no credit issues. To be sure, investors do care about the identity of the borrower. As such, standard assumption provisions in PSAs are aimed at allowing only so-called qualified borrowers to assume loans. Most of the loan assumptions we see in recent years have been on performing loans (Figure 2).

Figure 2. CMBS Loan Assumptions, 2017-2023



Source: Morningstar Credit and Academy Securities

2 "Credit 2023: Advancing and Workout Approaches to Play a Central Role," CMBS Credit Focus, Academy Securities, December 22, 2022

In distressed situations the timing and mechanics of loan assumptions, and the identity of the new borrower that is looking to redevelop a struggling property becomes much more critical. This underscores the relevance of the assumption reporting fields. The fields can also inform about situations where modification templates do not explicitly allude to loan assumptions. One example is the $169.1 million 625 Madison Avenue (COMM 2014-CR14 and CR15).[3] A recently released modification template on the leased fee CMBS loan notes the "borrower" will pay down $25 million of the outstanding balance, terminate the ground lease, and demolish the existing building. The L91 field on the loan suggests that the loan was assumed in December 2023, coinciding with the modification. The apparent mod/assumption on 625 Madison blurs a bit the future path of the loan, which some rating agencies and other market participants expected to pay off following SL Green's property sale announcement in December 2023.

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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