Commercial RealEstate Direct

THE YEAR-END

2015

BASEL III

LACK OF LIQUIDITY

RISK RETENTION

CAPITAL REQUIREMENTS

HVCRE

STRESS TESTING

REGULATORY UPHEAVAL

INDUSTRY FACES PRESSURE FROM RULES, REGULATIONS

CMBS FACES HEADWINDS

MARKET TURNS UGLY, IMPACTING 2015 ISSUANCE

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LETTER FROM THE EDITOR

Orest Mandzy
Managing Editor

Last year was somewhat of a disappointment for the CMBS sector, thanks to choppy market conditions. With spreads ballooning during the second half, domestic, private-label issuance fell roughly 15 percent shy of the $110 billion that many had expected early in the year.

This year, the expectation is for issuance to total between $100 billion and $125 billion—a rather big range, thanks to the uncertainty surrounding market conditions and the impact of a barrage of rules and regulations that will change the way CMBS lenders and issuers historically have done business. So, this year promises to be interesting, to say the least.

Some $87.1 billion of conduit loans come due in 2016 and will need to be refinanced, and investors are expected to remain voracious buyers of commercial properties. Last year, investment-sales activity increased by 18 percent from the previous year. Under normal circumstances, that demand for financing would result in a bonanza of issuance for the CMBS market. But, if the past six months are any indication, market conditions could remain anything but normal.

In this issue of the *Year-End*, we explore the most significant rules facing CMBS players, their status and potential repercussions. We also look at how increases in interest rates would specifically impact the ability of certain CMBS loans to get refinanced and how rates might affect investment-sales activity. The short answer is—not by much.

This issue also includes the latest version of our annual *Commercial Real Estate Derby*, a cheat-sheet that's a reader favorite for gauging how likely it is that some of the largest maturing CMBS loans get refinanced.

Finally, we present our *Year-End* CMBS Awards—our league tables—in which we rank bookrunners, loan contributors, servicers and B-piece buyers. Tops in the bookrunner race is Deutsche Bank again. It's the fourth straight year in which the bank has led that ranking. However, it didn't top the list of loan contributors last year. That distinction went to JPMorgan Chase Bank.

I hope you enjoy this edition of the *Year-End* and find the information we've compiled useful. As always, we look forward to your feedback. Have a happy and prosperous New Year.

Best Regards,

Orest Mandzy

Despite Some Bright Spots, 2015 Was Disappointing for CMBS

By Manus Clancy

Last year was tough on CMBS players. Spreads blew out during the second half of the year, causing issuance volume to fall short of expectations.

Each year, we publish the market review, The Good, The Bad and The Ugly. If CMBS investors, issuers and traders were to create their own review, they might just call it The Ugly.

There were some positive events last year, including the $5.3 billion sale of Manhattan's Stuyvesant Town & Peter Cooper Village apartment property, which will redeem a $3 billion CMBS loan at par that previously was expected to suffer losses in the hundreds of millions of dollars. However, most trending stories during the year had a negative slant. Consider:

- Spreads blew out over the second half of the year, as volatility increased and issuers found it hard to book profits.
- Late in the year, issuers pushed off new deals until 2016 due to market volatility.
- Total 2015 volume, up slightly from the year before, was below consensus industry expectations.
- Increased capital charges led to banks looking to shed inventory, leading to reduced liquidity and choppier execution.
- Regulation AB II became a reality.
- Risk-retention rules for CMBS are now one year closer to implementation.

Spreads were remarkably stable through the first half of last year, even rallying in the first few months. Some of the year's first deals saw benchmark, 10-year AAA classes clear in the swaps plus 95 basis points range and the BBB- classes price in the neighborhood of 360 to 385 bps more than swaps. By late winter/early spring, new issue spreads for those classes had declined to 85 bps and 310-335 bps, respectively, and remained in those ranges through May.

In June, however, new-issue spreads began to move consistently wider. They ended the year with benchmark bonds in the swaps plus 136-140 bps area and BBB- bonds in the range of 525-615 bps more than swaps. The persistent spread widening from June to December led some issuers to take their ball and go home late in the year, pushing some deals that had been scheduled to come to market in 2015 into early 2016, when those issuers hope the market will be more favorable. The results were a reversal from 2014, especially for the BBB- part of the market. That segment performed extremely well in 2014 only to give back those gains, and then some, last year.

For reference, the yield on the 10-year Treasury was 2.12 percent on Jan. 2 and fell to its lowest closing yield of 1.68 percent later that month. By June 30, the yield was 2.35 percent and on Dec. 10th it was 2.24 percent. The yield peaked at 2.5 percent in early June.

We tip our hat to Donald Sheets, who presented at the Commercial Real Estate Finance Council's conference last June as part of the High Yield and Distressed Realty Asset (HYDRA) forum. His thesis was that the oil market had the potential to turn the fixed income markets upside down. Falling energy prices would lead to defaults among borrowers in the high-yield market, which would lead to significant spread widening in that part of the fixed-income market. That widening then would drag other markets down. While that was not the only reason for the widening in CMBS, it certainly was part of the equation. Sheets also made prescient calls on Brazil and Petrobras.

New issuance disappointed for the second straight year. In each case, prognosticators had extremely high hopes for CMBS issuance. After tremendous issuance in the second half of 2014, a 2 percent yield on the 10-year Treasury bond and the belief that borrowers would be racing to refinance ahead of a rate hike, industry experts expected an increase of 20 to 30 percent over 2014's volume. In the end, the 2015 new issuance increase was less than 10 percent. (Count us among the disappointed and overly enthusiastic. We were at the top of the bullish list with expectations of $130 billion of volume.) Regardless of where investors put their chips at the beginning of last year, they likely were disappointed.

Spread widening was prevalent across the credit stack and spanned both the new issue and legacy markets. Continuing to impact the legacy CMBS market was growing prepayment risk. That was particularly true of the 2006 and 2007 vintages, which either began to burn off quickly or were approaching the period where they would start burning off. All of this helped push spreads on legacy super-senior bonds sharply wider.

A good example of such widening was the A4 class from GS Mortgage Securities Corp. II, 2007-GG10. Its spread was 87 bps more than swaps at the end of 2014, but ballooned to more than 200 bps a year later.

But the news wasn't all bad:

- Last January, Congress extended the government's terrorism insurance backstop program.
- The Belnord and StuyTown loans, both of which were expected to see huge losses at one time, were resolved—or got closer to being resolved—with little or no loss.
- The Trepp CMBS delinquency rate continued to decline, dropping 67 bps during the year through November. The rate, at 5.17 percent as of the end of December, should drop to well below 5 percent once the StuyTown loan is formally resolved. It's now 58 bps lower than at the end of 2014.
- CMBS issuance was up for the sixth straight year.
- Commercial real estate prices continued to increase in nearly all sectors, despite increased economic and geopolitical volatility. ■

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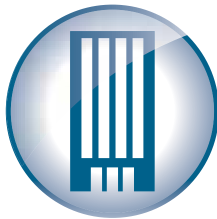

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CRE Lending Sector Faces Unprecedented Regulatory Pressure

Rules, rules and more rules face the commercial real estate lending sector this year.

By Orest Mandzy

The commercial real estate sector will face unprecedented regulatory pressure this year, from risk-retention rules that could fundamentally change the way the CMBS market long has operated, to new capital rules that could stifle real estate lending by banks. Meanwhile, there's a risk that Congress, in its quest for more tax revenue, could try to do away with tax-deferred property exchanges—a possible game-changer for the industry and economy as a whole.

The rules, both existing and upcoming, are already having a profound impact on the lending sector and will continue to do so.

In the CMBS market, for instance, issuers of recent deals were loath to include loan contributions from small players out of discomfort from certifying the veracity of information provided. That certification was mandated by Regulation AB II, a revision of the SEC's disclosure rules that went into effect late last year.

The rule requires that, among other things, senior executives from the issuing entity certify collateral information in deal prospectuses. It originally was to be more strict and required that executives warrant the information, but in the end was watered down so those certifying deal information are only verifying that they're comfortable with the information's accuracy.

Nonetheless, issuers clearly are not comfortable vouching for information that other lenders might provide. The result might be that the number of contributors to CMBS deals begins to shrink. When an industry faces fewer competitors, costs typically increase.

Regulation AB II is just one of roughly a half dozen new rules or revisions to current rules that have gone or are going into effect that could result in commercial real estate loans becoming more expensive for borrowers. If that's the case, prices for properties very well could decline.

The biggest issue facing securitized lenders is the risk-retention rule that goes into effect Dec. 24. The rule will require that B-piece buyers, or pairs of investors, purchase at least a 5 percent risk piece, based on market value, of a CMBS deal and retain that investment for at least five years. Historically, B-piece investors bought roughly 5 percent of a deal's face value and often traded out of the most senior chunks, effectively leveraging their investments. That won't be allowed starting late this year.

A number of existing players have been gearing up for the new rules by raising funds designed to invest in B-pieces. Because they'll soon have mandated hold periods and will have to buy more bonds than they've been accustomed to, they'll likely demand greater discounts on the prices they pay for bonds in order to eclipse their yield hurdles. That would translate to a greater cost of funds for securitized lenders, resulting in greater loan coupons to borrowers.

As currently written, the rules also would impact single-asset CMBS deals. Industry groups have joined forces to seek modifications that would relax the rules when it comes to such deals, whose collateral typically would qualify as low-risk loans. Since large loans that typically are securitized on a stand-alone basis are backed by substantial amounts of equity,

Continued on next page

Tax-Deferred Exchanges Come Under Congressional Scrutiny

Tax-deferred exchanges, which have been part of the federal tax code since 1921 and have been a substantial driver of commercial property transactions, have become a target of Congress as it gears up to rewrite the country's tax laws.

The transactions, facilitated by section 1031 of the Internal Revenue Code, are often referred to as 1031 exchanges. They allow investors to defer paying taxes on gains from the sale of property as long as proceeds are plowed into a similar, or "like-kind," property, whose value is at least as much as the property that's sold. Taxes on gains are ultimately paid when the replacement property is sold.

The exchanges have come under scrutiny by Congress in its quest to increase tax revenue. Two potential legislative attempts to modify the rule died on the vine. And for the past two years, President Obama has included scaling back tax-deferred exchanges in his budget proposals. Those efforts never gained traction.

The concern now is that the modification of 1031 exchanges could be part of comprehensive tax-reform efforts orchestrated by Congress this year or next.

"We have a big bulls-eye on our back," explained Margo McDonnell, president of the trade group Federation of Exchange Accommodators and 1031 Corp., a Collegeville, Pa., intermediary. Congress eyes exchanges as a quick way of generating increased revenue. However, the downside is substantial.

It's tough to quantify exactly how many completed real estate transactions were subject to the benefits of section 1031. But an academic study commissioned by the Real Estate Roundtable found that between 1999 and 2005, roughly one-third of all apartment property transactions involved a tax-deferred exchange, as did 20 percent of all office deals.

Ernst & Young, in another study that looked at the potential effects of a repeal of section 1031, noted that Gross Domestic Product would decline by $8.1 billion annually as a result.

It would stand to reason that if section 1031 is repealed, transaction volume would decline and property values would drop.

Instead of selling an asset to invest in another with a greater value, investors might simply hold on to their initial investments. Fewer transactions would result in a decline in demand for the services of property brokers, mortgage originators, appraisers and a host of others. In addition, it would result in a drop in revenue for municipalities, which typically generate mortgage-recording taxes as well as transfer taxes.

Meanwhile, the Roundtable estimated that prices for properties in areas with moderate taxation levels would drop by 8 percent to 12 percent. In areas with high tax rates, price declines would be more pronounced. ■

Continued from previous page

they ought to be considered low-risk loans and exempt from the risk-retention rules, explained George Green, associate vice president of commercial/multifamily at the Mortgage Bankers Association.

Nonetheless, "It seems to be a challenging environment for CMBS lenders at the moment, with the bumpy market, a tougher regulatory landscape, and greater competition from life companies, banks and non-banks and everything in between," explained Mark Edelstein, chair of real estate finance and distressed real estate practices at law firm Morrison Foerster.

Meanwhile, additional Basel III rules impacting how banks determine how much capital to set aside for their fixed-income trading operations could be implemented by 2019. Certain scenarios envision the amount of capital set aside for CMBS trading would jump by at least 82 percent, which, according to analysis by JPMorgan Securities, would make it impossible for firms that currently make markets in CMBS to continue to do so.

Separately, early last year rules governing high volatility commercial real estate loans (HVCRE) went into effect, which essentially increase by 50 percent the risk weighting of certain acquisition, development and construction loans banks might write. So far there's been no consensus among banks when it comes to classifying loans that would fall in the HVCRE bucket.

Green noted that the MBA, which has been leading industry efforts seeking regulatory clarity on the rule, has quantified, through the use of bank call-report data, how inconsistently banks are interpreting the rule. The upshot could be that banks, which hold nearly one-third of the country's universe of commercial real estate loans, will reduce their lending activity.

"This will certainly require that banks have to hold back more capital," said Dennis Russo, chairman of the real estate group at law firm Baker Hostetler. "Spreads will have to widen," he added, but noted that overall lending also is subject to market conditions. They might dictate that banks simply absorb the added costs of needing to increase their capital set-asides for certain loans. If that happens, banks might sit on the sidelines.

"This is good for the shadow-banking market," countered Brian Good, founder and president of Eagle Group Finance, a Los Angeles provider of short-term bridge loans. He said that many banks are only providing financing against projects backed by their best customers, and that's creating a void that lenders like his are trying to fill. "The demand is tremendous."

However, evidence of that hasn't surfaced yet. Banks and thrifts, long the biggest holders of commercial real estate loans, actually increased their market share during the third quarter, to 37.5 percent from 36.9 percent in the second quarter, according to the MBA. Non-bank lenders—life-insurance companies, REITs, finance companies, pension funds—saw their collective share of the universe increase in the third quarter to 18.3 percent from 18.2 percent.

Perhaps the biggest threat to the real estate industry reared its head in late 2014, when a budget bill initially included language that would have ended the tax treatment of like-kind property exchanges. But that bill died when Congress recessed at the end of that year. President Obama's 2016 budget proposal includes language that would have modified such exchanges, capping the amount of capital-gain deferrals at $1 million annually.

In addition, Sen. Bernie Sanders (I-Vt.) introduced legislation last summer that would have paid for shortfalls at the Pension Benefit Guaranty Corp. with tax proceeds generated by limiting the amount of tax deferral permitted under property exchanges.

So far, however, none of those legislative efforts have gained traction. But just about every industry group is cautious that Congress, in its never-ending quest for additional tax revenue, might target the exchanges, eying them as a potential cash cow.

"When they're looking to close such a big deficit, everything's on the table," explained Margo McDonnell, president of both the Federation of Exchange Accommodators and 1031 Corp., a Collegeville, Pa., intermediary for tax-deferred exchanges.

Like-kind exchanges, facilitated by Section 1031 of the Internal Revenue Code, have been part of the country's economic fabric since 1921. A study by Ernst & Young forecasts an annual drop in Gross Domestic Product, investment activity and labor income if the tax advantages of exchanges were repealed. ■

HVCRE Rules Remain Confusing for Banks

Rules governing high-volatility commercial real estate loans, or HVCRE, have been in place for a year, and there's still little agreement among banks on exactly what loans should be classified as such.

The rules govern acquisition, development and construction loans against commercial real estate. The HVCRE classification was introduced by the Basel III regulatory framework and is designed to ensure that banks have adequate capital set aside for their risky loans—an honorable goal that some say could have disastrous consequences.

The issue is that there's been very little agreement on how to interpret the rule. That's even after bank regulators—FDIC, Comptroller of the Currency and Federal Reserve Board—issued a frequently asked questions, or FAQ, list last June.

"It's never a good thing when three lenders have three interpretations" of the same rule, noted Mark Edelstein, chair of the real estate finance and distressed real estate practices of law firm Morrison Foerster. "A lack of clarity is never a good thing."

Lenders could simply pull back on providing ADC loans if there's a risk the loan would be classified as HVCRE, which would require that the lending institution increase the amount of capital against the loan by 50 percent.

A loan would be tagged an HVCRE if it has a loan-to-value ratio of more than 80 percent and if its sponsor, or borrower, has put up less than 15 percent of the collateral's equity. It also gets the classification if the sponsor is able to recover any excess cash flow from the collateral, typically a construction project, during the loan's life. The confusion arises over, among other things, what could be considered equity.

Banks, for obvious reasons, would prefer not classifying any of their loans as HVCRE. But if they have to, they'll naturally increase the prices they charge, risking becoming noncompetitive against non-bank lenders. ■

EB-5 Program Extended Through September

By Josh Mrozinski

Federal lawmakers have extended the EB-5 regional center program through this September.

The EB-5 program, which was created by The Immigration Act of 1990, lapsed last Sept. 30 and already had been extended twice. The latest extension was included in the omnibus spending bill that Congress approved and President Obama signed on Dec. 18.

The program allows foreigners to earn visas by investing $1 million, or $500,000 in so-called targeted employment areas, in projects that create at least 10 permanent jobs. It relies on regional centers to raise capital and to vet investment opportunities, so the program that facilitates those centers is instrumental in keeping the EB-5 program alive.

Legislation introduced by Sen. Patrick Leahy (D-Vt.) in June would have extended the program for five years. That bill, the American Job Creation and Investment Promotion Reform Act, died in the Senate. Congressional leaders, however, opted to support a temporary extension.

"Nobody wants this program to go away," explained Rick Spees, chairman of Akerman LLP's government affairs and public policy practice.

Targeted employment areas, or TEAs, became a sticking point during Congressional negotiations. At issue is how TEAs are defined, which often allows developers of projects in densely populated areas, like midtown Manhattan, to qualify for low-cost funding through the program. TEAs are defined by individual states, but generally are determined by an area's population and take into account its unemployment rate.

Some legislators are proposing that the areas be more narrowly redefined so a developer building a project in a densely populated and affluent area couldn't qualify for the program.

While current legislation is being extended without any changes, a number of modifications to the existing program could ultimately be enacted.

For instance, the minimum required investment in TEAs is likely to be increased to $800,000 from $500,000. In addition, family members likely will be exempted from the program's 10,000 visa annual cap, which would free up visas for other investors. Currently, every member of an investor's family would count against the cap. Legislators also have considered setting aside 4,000 visas for investors earmarking capital for projects in rural or impoverished areas and requiring that at least 10 percent of the jobs created be directly tied to that project.

The extension of the program without any changes eliminates uncertainty over its fate for now.

"I think you will see a healthy increase of activity, with a crunch taking place as we get close to the sunset date of Sept. 30, unless there is a clear extension," said Steve Polivy, chairman of the economic development and incentives practice of Akerman. ■

T-Minus 11 Months Until Risk-Retention Rules Kick In

The risk-retention rules that dictate how much of a given structured transaction is retained and for how long go into effect on Dec. 24.

The rules, part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, were finalized late last year by the FDIC, SEC, Federal Housing Finance Agency, Treasury Department, Federal Reserve and Department of Housing and Urban Development. They would require that at least 5 percent of the market value of any securitization be retained for at least five years. In CMBS, B-piece buyers traditionally have purchased the riskiest bonds of transactions. But those bonds typically have amounted to roughly 5 percent of a deal's par, or face value.

The requirement that 5 percent of a deal's market value be retained simply means B-piece buyers will have to buy more bonds than they've been accustomed to.

While the pending rules will allow two investors to retain the risk pieces, they could do so only on a pari-passu, or equal basis. That, too, is counter to current practices.

B-piece buyers often sell off bonds rated BB and keep the remaining bonds, down to the unrated class. That practice allows the investors to leverage their investment capital, as well as goose the effective yields they get from their bond purchases.

But that practice won't be allowed starting in December, which is expected to result in B-piece buyers and their investor partners paying less for the bonds they buy. That, in turn, would result in higher prices for borrowers, which could have an impact on property values.

The rules also apply to single-asset, single-borrower transactions, whose collateral is typically underwritten to very conservative levels. Industry groups are trying to get the risk-retention requirement waived for such transactions, arguing that the conservative nature of their collateral warrants a waiver.

In addition, those groups, which include the Commercial Real Estate Finance Council and Mortgage Bankers Association, are making efforts for a legislative fix to address the pari-passu investment requirement. They'd prefer if investors could share B-pieces on a senior/subordinate basis, as it's done now.

Most traditional B-piece buyers have been gearing up for the rules. Each has raised investment vehicles that would provide them with the long-term capital needed to invest in transactions. But other investors that previously had moved into the sector opportunistically likely won't be able to do so after December. That likely will stifle demand. ■

Basel III Proposal on Trading Book Capital Could Devastate CMBS

By Orest Mandzy

Basel III, the regulatory framework designed to address certain banking risks, includes a set of rules designed to revise capital requirements for banks' trading books that could have a debilitating impact on the CMBS and other securitization markets.

The rules, spelled out in the "Fundamental Review of the Trading Book," are designed to streamline previous capital rules and capture all risks in a firm's trading book. In effect, the Basel Committee on Banking Supervision, which is behind the Basel III framework, aims to reform the way risk is mitigated across assets, effectively overhauling the capital treatment of banks' trading activities. But as currently envisioned, the rules could make it unfeasible for any bank to trade in securitized bonds.

Analysis by JPMorgan Securities, which evaluated the proposed rules' impact on residential mortgage-backed securities, CMBS, asset-backed securities and collateralized loan obligations, determined that dealers would need to hold capital far in excess of the market value of the bonds they were trading.

In a letter to the Bank of International Settlements' trading book group, which is charged with developing the Trading Book rules, three trade groups—the International Swaps and Derivatives Association (ISDA), the Global Financial Markets Association (GFMA) and the Institute of International Finance (IIF)—said the rules, as currently envisioned, "may lead to unjustifiably high capital charges that overestimate empirical losses."

In a separate briefing to its members, the ISDA noted that the capital rules, while not yet finalized, could "lead to punitive capital increases in certain business lines, and will potentially cause some key markets, such as securitization, to become uneconomic."

Indeed, JPMorgan, in its analysis, determined that the amount of capital needed to be held against a super-senior CMBS bond would increase by 82 percent, for a junior-AAA bond by 191 percent and by 416 percent for below investment-grade bonds. The increase is driven by a "credit spread shock multiplier," which would increase based on the credit quality of the bond in question. The investment bank's CMBS research team also noted that using indexes as hedges would be ineffective in terms of capital relief. It added that other methods of offsetting capital requirements also would be unworkable, "providing no way for broker/dealers to effectively make markets in CMBS."

If it becomes unprofitable to trade existing bonds, the issuance of new bonds would wither away. That could lead to a drop in overall lending, given that CMBS accounts for close to 20 percent of all commercial real estate lending activity.

But the exact impact won't be known until the Basel committee conducts an impact study of its proposed rules. Those rules are still years from being implemented and likely will change by then. The current timeline has them being put into effect in 2019.

Trade groups with a commercial real estate focus, led by the Commercial Real Estate Finance Council and the Real Estate Roundtable, are starting the process of educating their members on the proposed rules, as well as legislators on the possible repercussions of the rules. ■

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Property Sales Volume Climbs 18 Percent in 2015; Pace of Increase Slowing

By Josh Mrozinski

The volume of commercial real estate sales topped $511 billion in 2015, according to Real Capital Analytics. That was an 18 percent increase from the $432.6 billion of deals that were done a year earlier, marking the sixth straight year of double-digit growth in sales volume since the 2009 trough, when only $69 billion of properties changed hands.

Last year's volume compares with the $574.9 billion of sales volume that took place in 2007, when 60 percent of deals involved portfolios. Nearly 70 percent of the volume in 2015 was comprised of single-asset deals—a record.

Transaction volume continued to be driven by low interest rates, an abundance of capital seeking yield and improving property fundamentals—factors that have been in play since the market started recovering in 2010.

In addition, foreign investors have become more substantial buyers than in the past. For the first time, they were responsible for more investment volume than REITs and other public companies, which became sellers as a result of strong investor interest and healthy pricing. Their share of the acquisition market declined to 13 percent from 16 percent in 2014.

Private domestic buyers continued to be the most active players, with a roughly 42 percent share of the market. That was down slightly from the 44 percent share they held in 2014.

Foreign investors saw their share of the acquisition market increase the most. According to Real Capital Analytics, foreigners accounted for about 17 percent of the total volume in 2015, up from roughly 11 percent a year earlier.

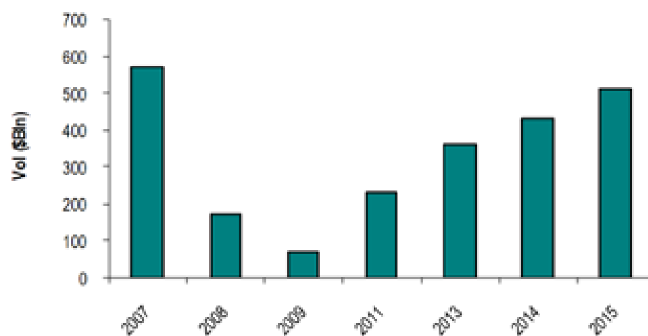
Canadian investors dominated, accounting for 28 percent of all foreign investment activity. Singapore investors were well behind, with 17 percent of the total. Other foreign investors with substantial activity last year were from Norway, with 10 percent, and China, with 8 percent.

Foreign investors are drawn to commercial property in the United States because of the relatively healthy risk-adjusted returns it can provide, which often represent a healthy premium over comparable investments in their own countries.

Among the most active Canadian investors were the Canada Pension Plan Investment Board (CPPIB), which administers the country's national retirement system, and Caisse de depot et placement du Quebec, which manages a number of Canadian pension funds and has $175 billion of assets under management.

CPPIB has some $200 billion of assets under management and invests globally, with roughly $75 billion in the U.S. A total of 11.5 percent of its assets are invested in real estate. It is funded with contributions from its 18 million beneficiaries and is expected to grow in size to $220 billion by 2020 and nearly $370 billion by 2030. As a result, "Canadians will continue to be huge investors in the U.S.," explained Amy Erixon, principal and managing director of Avison Young.

Investment Sales Volume



Source: Real Capital Analytics

Chinese investment activity, which doubled last year from 2014, was driven in part by a relaxation of rules that allowed insurance companies to invest in completed properties outside of China. They also were allowed to increase their allocation to real estate to 30 percent of total assets from 20 percent.

Foreign demand for U.S. commercial real estate is expected to remain healthy in 2016.

Meanwhile, domestic institutional investors have plenty of built-in demand for the asset class. Real estate investment managers have $251 billion of equity commitments, or dry powder, available for investment. That's up 22 percent from the $206 billion they had available in 2014, according to Preqin, a London research firm.

"There is still a tremendous amount of capital lined up trying to find safe-harbor assets, and real estate fits that bill," explained Jim Costello, senior vice president and head of research for Real Capital, a New York research firm.

While sales volumes continue to climb, the rate of increase has slowed in recent months. Third-quarter volume, for instance, was up only 7.5 percent from a year earlier. As a result, overall volumes could climb slightly, or actually decline.

"I think we're in a fully priced market," explained Brian Ward, president of capital markets and investment services, Americas, for Colliers International. That could impact demand and likely will result in a slowdown in price escalation.

Prices were up by 0.4 percent in October, according to the Moody's/RCA Commercial Property Price Indices. They're now 16.1 percent greater than they were before the market's collapse in 2008.

So while real estate as an asset class still remains in favor, it won't be a cake-walk for investors.

"Finding good deals where yield and risk match is getting more difficult," said Jeanette Rice, CBRE's head of investment research for the Americas.

That's driving some to pursue investments in secondary markets, which haven't seen the escalation in pricing that primary markets have. Indeed, transaction activity in secondary markets last year through October was up 34 percent from a year earlier. In primary markets, activity was up 20 percent.

The thinking is that secondary markets, particularly the strongest, most diverse markets, will continue to benefit from that investor migration. ■

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Wall of CMBS Loan Maturities Shrinks, Remains Daunting

By Susan Persin

A total of $205.2 billion of conduit loans will come due by 2018. Increases in interest rates will naturally put some loans at risk.

The volume of CMBS conduit loans that were scheduled to mature last year totaled $54.5 billion, excluding those that previously had been defeased. That volume will increase further during the next two years, with the overwhelming majority comprised of loans originated in 2006 and 2007.

Between now and 2018, $205.2 billion of conduit loans come due, with $87.1 billion maturing this year and $105.8 billion in 2017. Maturities scheduled for 2018 drop off to $12.8 billion.

Strong underlying market conditions mean that fewer loans have problems. Trepp's U.S. CMBS delinquency rate fell to 5.13 percent in November from 5.8 percent a year earlier. The "seriously delinquent" rate, which tracks loans that are more than 60-days late, was 5.02 percent in November.

Healthy real estate market fundamentals have enabled many owners to increase rents and income, which has contributed to an increase in property values and made refinancing easier than it otherwise would be. Borrowers have taken advantage of the strong market fundamentals, the availability of debt capital and relatively low interest rates to defease CMBS loans and refinance properties before their underlying loans mature.

More than 1,300 loans totaling nearly $20 billion were defeased, or replaced by government securities, last year through November. That's up from the full-year activity in 2014 and well above the $11.8 billion in 2013.

Maturing Loan Balance

Source: Trepp LLC

As a result of early refinancings and defeasance activity, the volume of maturities slated for 2016 and 2017 is down 17 percent from the $232 billion that last year would have been due during those years. A snapshot of Trepp data from late 2015, compared to year-ago levels, shows that outstanding maturing loan balances for 2016 and 2017 have declined for every property type.

Nonetheless, the volume of loans coming due in the next two years remains daunting. Consider that new CMBS issuance in 2015 totaled only $95.6 billion, less than what had been expected.

Meeting DSCR Requirements

Effect of Rate Changes on Loan DSCR

Maturing CMBS Loans			Proportion of Loans with DSCR <1.2 for Each Interest Rate Shift						
	Balance $bln	Coupon %	0	+ 25 BPS	+ 50 BPS	+ 75 BPS	+ 100 BPS	+ 150 BPS	+200 BPS
Office	$64.6	4.48	7.8%	9.1%	10.2%	11.3%	12.5%	15.8%	20.7%
Retail	$63.2	4.47	3.6%	4.2%	4.8%	5.7%	6.9%	9.9%	14.7%
Multifamily	$24.8	4.51	2.9%	3.4%	3.9%	4.6%	5.7%	8.2%	12.1%
Lodging	$20.0	4.64	4.3%	4.5%	5.2%	5.7%	6.5%	7.5%	9.4%
Industrial	$11.9	4.45	4.8%	4.9%	5.5%	6.3%	6.8%	8.8%	11.1%
Total	$205.2	4.49	3.5%	4.1%	4.6%	5.2%	6.0%	7.9%	10.9%

Source: Trepp LLC

Interest rates would have to rise substantially for debt service coverage levels to become a refinancing issue during the next two years. Interest rates remain below where most loans were originated in 2006 and 2007.

The average coupon for CMBS loans that were originated last year through mid-November was about 4.5 percent. At that coupon, net operating income easily covers debt service for most loans and property types. However, last month, the Fed began to increase its benchmark interest rate that had stayed near zero since 2008. Movement by the Fed sets the tone for other interest rates and could portend an increase on the long end of the yield curve.

We've reviewed how higher rates would affect borrowers' ability to meet a 1.2x debt-service coverage ratio, a level that is generally considered to be the minimum required by lenders. It indicates that a property would generate 20 percent more in cash flow than that needed to fully service its loan. The data show that 96.5 percent of loans slated to mature through 2018 would meet that level at current rates. That's up from 93.9 percent a year ago.

But as interest rates increase, meeting the DSCR requirement becomes more difficult. With a 100 basis point increase in interest rates, the proportion of loans meeting the DSCR hurdle falls to 94 percent. That compares with 88.9 percent a year ago. And if rates climb by 200 bps, 10.9 percent of loans could face difficulty refinancing, down from 19.8 percent in late 2014.

Office and retail, the two property types with the largest representation in the CMBS universe, face the greatest refinancing risk. About $65 billion of office loans are set to

Continued on next page

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mature through 2018. A total of 7.8 percent of those loans already are at risk of not meeting the DSCR hurdle. That proportion climbs to 20.7 percent with a 200 bps increase in rates. Similarly, $63 billion of retail loans come due through 2018. A comparable increase in rates would make it challenging for nearly 15 percent of those loans to refinance.

Hotel properties would have the easiest time meeting the DSCR requirements despite their higher initial coupon rate. More than 90 percent of hotel loans facing maturity would meet the hurdle, even after a 200 bps increase in rates. But hotel cash flows are far more fickle than those of office and retail properties because of the properties' reliance on transient leases.

Loan-to-Value Requirements

The picture's not so rosy when loan-to-value ratios are used as the refinancing benchmark. Last year, the average underwritten LTV ratio for CMBS loan originations was 63 percent and ranged between 62 percent and 70 percent, depending on property type. The consensus has been that underwriting standards have softened, so stressed LTV levels are likely greater.

The amount that borrowers can refinance based on current collateral appraised values in some cases falls below the amount owed against the loan in need of refinancing. However, because lenders generally have been willing to provide more loan proceeds against apartment properties, which results in greater LTV ratios (leverage levels have been just shy of 70 percent), few such loans would have difficulty refinancing.

Loan-to-Value Ratio - 2015

	2015 LTV %	Total Appr Value ($bln)	Amt. Could Refi ($bln)	Outstanding Loan Bal ($bln)	Difference ($bln)
Industrial	65.50	19.00	12.41	11.90	0.53
Lodging	62.46	32.70	20.41	20.00	0.45
Multifamily	69.91	37.70	26.39	24.80	1.63
Office	63.89	103.60	66.21	64.60	1.61
Retail	66.43	94.40	62.73	63.20	-0.43

Source: Trepp LLC

Meeting current LTVs is a more significant issue for retail properties, where the amount that could be financed, based on leverage levels lenders are providing, would fall below the balance that needs to be refinanced. That could create opportunities for providers of mezzanine financing or preferred equity, or other capital that could be used to fill the gap needed to meet current LTV requirements.

So the wall of CMBS loan maturities has shrunk, but remains significant. Widening bond spreads have translated to higher costs for borrowers in last year's second half and could remain an issue this year. Borrowers will need to consider the impact of higher interest rates and lower LTV requirements on their ability to refinance. ■

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Federal Legislation, Regulations to Accelerate Changes to Commercial Real Estate Sector

By Martin Schuh and Christina Zausner

As 2016 opens, the commercial real estate sector faces many public policy changes in addition to rising interest rates, peaking refinance needs and geopolitical challenges. The following represent some of the weightier legislative and regulatory agenda items anticipated in 2016 and beyond.

Legislative Issues for 2016

All year we've heard rumors of bipartisan negotiations on regulatory relief for financial services firms, but to date have seen scant evidence. The year-end appropriations scramble thus far has yielded very little after Senate Banking Committee Chairman Richard Shelby (R-Ala.) and fellow moderate Democrats failed to agree on a framework. As we go to press in mid-December, the annual appropriations bill still has not taken shape and there is little indication that banking provisions will be among the year-end compromises that accompany the massive funding bill.

There are yet more rumors of "grand bargains" on a host of tax and spending provisions. We remain skeptical as long as the parties maintain their current stances of outright demagoguery or pledged-to-defend-at-all-costs the signature issues of the president.

Early in his tenure, House Speaker Paul Ryan (R-Wis.) laid out plans to pursue a sweeping overhaul of the tax code—one of his goals for years, including from his time as chairman of the tax-writing Ways and Means Committee. He also said that he would lead Republican efforts to develop trade agreements to benefit American manufacturers and to strengthen the military.

This year we will be looking at another aggressive agenda from the relevant banking committees. We expect a strong focus on housing in 2016 from the House Financial Services Committee. While broader reform of the government-sponsored enterprises, or GSEs, remains a very low probability, we think there will be a series of hearings and possibly legislation considered and passed.

Also of interest to the CRE sector is whether the EB-5 program will be rolled over. The visa-for-investment program was renewed temporarily (see story on page 8.)

The Senate Banking Committee likely will focus on Federal Reserve oversight and monetary policy in the wake of any interest-rate increase. Also demanding committee attention are a host of nominations that will need to be approved. Those nominations are to the Federal Reserve Board, Securities and Exchange Commission, Department of Treasury and Department of Housing and Urban Development. We expect further oversight hearings on the Financial Stability Oversight Council and the Consumer Federal Protection Bureau, given the banking committee chairman's history with both.

Back in the House, Financial Services Committee Chairman Jeb Hensarling (R-Texas) has said the committee will begin work on legislation aimed at choking off funding for terrorist organizations, given the recent attacks. Hensarling's committee will be busy as well with unfinished business from this session, having failed to complete many bi-partisan bills. We expect subcommittee action on corporate governance, proxy issues and international insurance issues.

Regulatory Issues for 2016

This year, regulators will near the end of their proposals for banks and will put relatively more emphasis on non-bank policies. For banks, the focus will be on implementation of existing pieces of regulation and on revisions to risk-based capital rules. For non-banks, the scope of the regulatory goals and the supervisory perimeter—which regulatory agencies oversee what entities—itself is still evolving.

One of the big questions is whether the Financial Stability Oversight Council will designate additional non-banks as systemically important financial institutions (SIFIs) or be satisfied with an "activities" approach that addresses weaknesses on market- and transaction-level bases without applying banking requirements to non-banking entities.

The points below represent only a fraction of the new requirements expected to flow through the rulemaking pipeline or to be applied in 2016. However, they are likely to be some of the more important changes to be made in the near future, representing deep and permanent structural shifts, and in some cases, making certain businesses uneconomic.

- **Larger banks** will face greater capital charges through the Total Loss Absorbency Capital (TLAC)[1] and changes to risk-based capital rules[2]. At the same time, they are likely going to be asked to absorb additional liquidity charges in the form of the Net Stable Funding Ratio (NSFR)[3].
- **Medium and smaller banks** will be absorbing a host of shifts, including implementation of stress testing requirements, High Volatility Commercial Real Estate (HVCRE)[4] reporting and new protocols for booking loss reserves.
- **Asset managers of varying types** are being considered for activity- and entity-level regulations that seem to be aimed largely at deleveraging short-term funding strategies and tightening up liquidity management.
- **Insurers** have been considered for holding company-level capital assessments.
- **Private-label commercial mortgage backed securities** will be subject to Risk Retention and Regulation AB II, as

Continued on next page

1. TLAC applies to global systemically important banks as one measure intended to ensure an end to too-big-to-fail by requiring higher capital and some component of convertible debt.
2. The Basel Committee on Banking Supervision in early 2016 is expected to finalize several work streams that will apply to CRE portfolio loans and CMBS. It then will require U.S. rulemaking.
3. The NSFR, which has yet to be proposed in the U.S., will require banks to hold a certain amount of stable debt and deposits depending on the perceived riskiness of the assets generated by the business line.
4. HVCRE applies to acquisition, development and construction lending and requires that all banks hold 1.5 times as much capital as in the past against such loans.

Continued from previous page

well as new capital requirements for bank-related trading desks and possibly real-time trade reporting dissemination.

• The SEC and the Financial Industry Regulatory Authority may finalize a set of margin rules that would apply to **GSE multifamily deals** that would require broker-dealers to collect initial and ongoing margin against advance-purchase arrangements.

In sum, the whole-loan and CMBS markets will feel the greater weight of regulation starting this year, with full implementation late in the decade or early next with some, but not substantial, legislative fixes. While an EB-5 renewal will assist in maintaining valuations, it will not, in and of itself, counteract the market changing forces of new regulation. ■

Martin Schuh is vice president, legislative and regulatory policy, and Christina Zausner is vice president, industry and policy analysis, of the Commercial Real Estate Finance Council, which is based in Washington, D.C.

Optimizing Data Quality for Regulatory Compliance

By Kenneth Segal and Ozgur Kan

In 2015, data quality remained a major stumbling block that many banks faced when generating their regulatory reporting packages. Banks are generating more and more data, both in response to regulators' requirements and for financial modeling purposes.

This massive data accumulation has required banks to maintain centralized repositories that capture data from a myriad of internal systems and other repositories. Invariably, as data is captured and aggregated, inconsistencies and inaccuracies arise that can materially impact the integrity of macro reporting provided to bank stakeholders and regulators.

An effective data management exercise should start with a gap analysis that identifies the data that needs to be either collected or validated. It is important to note that the granularity of data depends on business lines, underlying collateral, associated risks and reporting requirements.

The next step would be to ensure accuracy and completeness of the data as it is being populated and validated. In our experience, the gap in historical data is often the biggest issue that banks face. With a large-scale collection of data, the solution is often akin to "data dumpster diving," that is, manually digging through loan files, inputting data and ensuring accuracy. Validation and reconciliation of data is critically important. While the goal is to automate the process eventually, the starting point often is manual, requiring a large-scale effort on the part of the bank.

Lastly, after the data is harvested, the bank needs to embark on a system-wide integration of data, combining its technical and informational infrastructure into its risk and finance functions. The goal is to integrate regulatory reporting into the overall risk management and capital planning processes.

A good data management program should encompass:

• Thorough review of data requirements.

• Generating data files and integrated platform by consolidating data from various sources.

• Ensuring accuracy of data through multiple edit checks, while eliminating duplication.

• Fixing errors and omissions, often at a granular level, by reviewing historical and physical files.

• Enabling the institution to gain greater insight into risk data defects and key compliance indicators, as well as to achieve greater transparency in data across business lines.

Beyond cleaning up data, banks should also have effective model risk-management practices in place, consistent with existing supervisory guidance (for instance, FRB SR11-7/OCC 2011-12.) The growing use of quantitative models in supervision increases concerns over model risk, which, while impossible to eliminate, must be managed.

The effective management of such risk should incorporate:

• Implementation of robust processes around model development.

• A sound model governance structure.

• An independent model validation program.

Banks today realize that data quality, data aggregation and data validation are not ad-hoc exercises that are done only for the benefit of regulators. There are wide-ranging implications on collateral management, planning, and ultimately, assessing the risk tied to systemically important institutions.

Despite the realization, the challenges in achieving this ideal are obvious: there are operational challenges, data/IT challenges and challenges in governance—all of which impede the process. It remains the common belief that regulatory requirements are not expected to soften in the foreseeable future. Firms should be aware of the near- and long-term implications of the increased requirements and expectations on the part of regulators, and accordingly, make improvements in their process management, data management and systems infrastructure.

While the degree of improvements needed would depend on the diversity of a bank's product base and its organizational complexities, addressing the issues early empowers a bank to achieve a more sustainable framework that is conducive to regulatory expectations and internal requirements. ■

Kenneth Segal and Ozgur Kan are managing directors of Berkeley Research Group, a leading global strategic advisory and expert consulting firm.

The views and opinions expressed in this article are those of the authors and do not necessarily reflect the opinions, position or policy of Berkeley Research Group LLC or its other employees and affiliates.

The Good, The Bad and The Ugly of 2015

By Joe McBride

Going into 2015, investors were prognosticating what the effects of a Federal Reserve rate hike would be and CMBS pros were saddling up for the first year of the wall of maturities. Just when we thought we might be copying and pasting 2014's introduction to the annual "Good, Bad and Ugly" compilation, the Fed finally pulled the trigger on a 25-basis-point increase in the target Federal Funds rate. Almost immediately, some were asking whether the hike came too soon, but most were happy just to get it done and move on with their lives.

Bad and Ugly Headlines from 2015

- **January**: JPMCC 2007-LD11 sees 10 loans liquidated with a total loss of $177.9 million.
- **February**: Frederick's of Hollywood announces it will be closing one-third of its stores.
- **April**: $50.1 million loan backed by the Hudson Valley Mall sent to special servicing; largest CMBS 2.0 loan to go to special so far.
- **June**: Samson Resources looks to restructure—tenant in big 2014 loan.
- **August**: $410 million One & Two Prudential Plaza loan paid off—loss to hope note leaves investors bitter.
- **October**: $127.44 million Two North LaSalle loan heads to special servicing after borrower submits hardship letter.
- **December**: Loan that started CMBS panic in 2008 resolved seven years later; Bush Terminal saga ends with nearly 100 percent loss to B-note.

As far as commercial real estate goes, the hike is not expected to affect values or performance significantly. Property capitalization rates generally move in relation to the 10-year Treasury bond, which shouldn't move drastically due to the hike, at least not in the near term.

Meanwhile, volatility in fixed-income markets has taken its toll on CMBS bond prices. However, that has more to do with the energy industry and regulatory constraints on market liquidity than with the rate hike's timing.

So far, the market has handled the 2015 wave of mortgage maturities much better than it handled the swell of maturing five-year loans in 2012. Back then, the delinquency rate hit its highest level ever, largely because many of those five-year loans didn't pay off at their maturity.

This year, thanks to continued low rates and three more years of healthy commercial real estate value growth, the 2015 maturities proved to be no problem for the market to digest and refinance. High defeasance volume this year showed that it was still worthwhile for borrowers to lock in low-coupon loans today, despite the costs of defeasance, rather than risk a drop in values or uptick in interest rates a year or two from now.

In the spirit of consistency, let's begin with last year's lowlights—the bad and the ugly—with the caveat that even ugly stories often have silver linings. Take the $170 million loan against the Parkoff Portfolio in MSC 2007-HQ12, for example. It had defaulted, but ultimately paid off at par.

Another ugly corner of the CMBS market in 2015 was the Connecticut office market. As big banks announced office consolidations, property values were slashed.

Meanwhile, the normally staid grocery portion of retail caused some concern, as A&P and Haggen declared bankruptcy and Fresh & Easy announced plans to liquidate and shut down operations.

Although persistently low oil prices haven't affected the commercial real estate sector in a significant way yet, we would be remiss to leave it out. Oil is now less than $40 a barrel and down nearly 50 percent for the year. Exposure to new construction in the fracking regions of the country, as well as large energy company footprints in office buildings are of concern going forward.

Things also got ugly in the primary CMBS market as spreads blew out late in the summer and into the end of the year, with the final deals having their benchmark AAA bonds price at spreads in the neighborhood of 140 basis points more than swaps, nearly double the levels seen earlier in the year.

New issue volume reached $95.1 billion last year, excluding collateralized debt obligations and agency transactions.

Good Headlines from 2015

- **January**: Overheard at 2015 Miami Conference: "The swag bag has gotten so much better than last year, it must be telling us we've reached a new bubble."
- **March**: NYC's Belnord apartments sold for $575 million; the loan, written on a pro forma basis, pays off at nearly par, after once having an appraisal reduction of $134 million against it.
- **May**: 100 Wall St. sells for $275 million—a record $528/sf for lower Manhattan office.
- **July**: Previously modified Renaissance Mayflower Hotel loan gets refinanced.
- **December**: Blackstone Group-led venture buys StuyTown/Peter Cooper Village for $5.3 billion.

Although the initial upper range of expectations was about $130 billion, the volume still sets a post-recession high and investors are cautiously optimistic going into 2016.

Probably the biggest good news story of the year was the $5.3 billion sale of Manhattan's Stuyvesant Town and Peter Cooper Village apartment complex, which resulted in the resolution of the largest loan in CMBS conduit history. All else being equal, the resolution should bring the CMBS delinquency rate below 5 percent.

The loans against One & Two Prudential Plaza, the Schron Industrial Portfolio, the Belnord apartment property and Bush Terminal are some other notables that rolled off the troubled loan lists last year. Delinquency rates moved slightly downward during the year. ■

CMBS Conduit Spreads Take Beating During 2H

Prices for newly issued CMBS conduits, which were relatively stable during the first half of the year, started a steady decline in July.

Bond prices are reflected by spreads, or the premiums over risk-free yields that investors require. For benchmark bonds—those with 30 percent subordination, the highest ratings and 10-year average lives—spreads during the first half of the year remained in a relatively tight band, generally between 80 and 92 basis points more than swaps, with a couple of exceptions. Then, they started their march wider, peaking at 140 bps near the end of the year.

Spreads for BBB- bonds saw a more dramatic movement. During the first half, they ranged from a low of 305 bps to 360 bps, again with a couple of exceptions. But they ended the year at 615 bps and even hit 620 bps. ■

CMBS Conduit Spreads (bps vs. swaps)

Source: Trepp LLC

2H 2015 Conduit Issuance

Px Date	Trepp Abbr	Amt $mln	Top 10%	AAAJrLvl	BBB-Lvl	UW DSCR	IO%	Part IO%	PX10yr AAA	PXJR AAA	PXBBB-
1-Jul	COMM 2015-PC1	1,462.94	38.70	24.75	7.42	1.70	21.40	52.40	107	145	440
16-Jul	GSMS 2015-GC32	1,003.12	51.60	23.00	7.50	1.75	9.00	40.50	100	125	375
17-Jul	JPMBB 2015-C30	1,331.46	44.20	22.75	7.50	1.82	19.60	52.90	105	145	400
24-Jul	MSBAM 2015-C24	935.42	49.50	24.13	8.38	1.51	28.00	43.60	105	135	400
24-Jul	COMM 2015-CR24	1,388.16	50.80	23.88	7.38	1.74	21.30	40.50	102	135	385
27-Jul	WFCM 2015-C30	740.31	45.70	23.00	7.50	2.10	11.10	46.30	102	142	385
6-Aug	CGCMT 2015-P1	1,095.78	60.50	23.50	8.25	1.90	19.60	47.40	106	137	390
6-Aug	CSAIL 2015-C3	1,419.79	46.30	23.88	8.13	1.89	25.10	42.30	107	140	390
13-Aug	COMM 2015-CR25	1,127.41	40.30	24.00	8.25	1.68	12.40	53.30	116	150	440
13-Aug	JPMBB 2015-C31	1,027.32	51.30	24.75	7.75	1.50	3.70	38.40	120	150	475
18-Aug	WFCM 2015-SG1	716.33	40.40	24.25	8.00	1.66	11.90	42.50	120	145	440
14-Sep	BACM 2015-UBS7	757.28	64.80	23.38	7.13	1.85	32.10	28.30	117	145	440
14-Sep	CGCMT 2015-C33	958.49	54.60	25.00	8.25	1.66	13.40	58.20	124	157	460
15-Sep	WFCM 2015-LC22	963.70	45.10	22.75	7.88	2.07	12.00	50.50	122	158	460
25-Sep	WFCM 2015-NXS3	814.50	41.20	23.13	7.50	2.13	26.90	46.10	115	150	460
28-Sep	COMM 2015-CR26	1,090.90	51.20	25.63	7.00	1.69	15.80	53.20	125	171	525
7-Oct	MSBAM 2015-C25	1,179.42	63.10	26.13	8.38	1.52	22.10	54.90	125	168	520
14-Oct	GSMS 2015-GC34	848.38	55.30	25.25	8.38	1.52	8.50	62.50	125	165	510
19-Oct	JPMBB 2015-C32	1,148.16	44.00	25.50	7.50	1.52	0.30	43.50	127	165	565
20-Oct	COMM 2015-CR27	931.62	47.70	24.25	8.25	1.77	20.60	45.50	125	162	525
28-Oct	MSBAM 2015-C26	1,048.17	51.50	22.63	8.00	1.79	32.10	39.40	120	155	500
29-Oct	WFCM 2015-C31	988.48	37.40	25.00	8.38	1.66	20.50	45.50	127	162	540
6-Nov	COMM 2015-LC23	960.91	51.20	23.63	8.25	1.82	38.70	21.80	122	160	575
16-Nov	GSMS 2015-GS1	820.60	65.5	23.75	7.63	1.99	38.40	33.10	125	155	485
17-Nov	JPMBB 2015-C33	761.78	48.80	24.63	8.75	1.74	41.70	18.10	130	155	525
18-Nov	CSAIL 2015-C4	939.64	38.00	24.00	8.00	1.71	16.20	51.40	134	170	620
19-Nov	MSBAM 2015-C27	822.29	55.50	23.00	8.13	1.60	25.30	47.90	134	165	560
19-Nov	WFCM 2015-NXS4	774.47	49.30	24.75	8.38	1.77	31.50	37.50	130	155	600
24-Nov	CGCMT 2015-GC35	1,105.17	63	24.13	8.13	1.95	37.50	32..09	138	163	525
2-Dec	MSCI 2015-UBS8	805.00	51	24.00	7.38	1.83	29.30	37.60	140	170	600
8-Dec	WFCM 2015-P2	1,002.20	50.4	25.25	8.50	1.64	26.90	49.50	136	156	525
15-Dec	JPMCC 2015-JP1	799.22	55.8	26.13	9.00	1.63	30.90	37.30	140	160	615

Source: Trepp LLC

The 2nd Commercial Real Estate Derby

Refinancing Odds for 2016

Purse: $12 Billion
Post Time: January 1, 2016
Track Condition: Extremely Fast
Distance: 1 3⁄16 miles

Analysis by MANUS CLANCY

Program number represents poll position.

Despite disparaging remarks made about the Class of 2006, many of the largest loans slated to mature over the next 12 months look likely to refinance.

Disclaimer: Odds are purely fictional and do no represent true odds of each loan paying off.

PETER COOPER & STUYTOWN — 1-10

1

Loan Balance: $3,000,000,000

Maturing Date: Dec. 2016

Sires: CWCI 2007-C2, MLCFC 2007-5, MLCFC 2007-6, WBCMT 2007-C30, WBCMT 2007-C31

The Skinny: The only thing that can keep this horse of a loan from paying off is the legal jockeying of its owners. Had trouble staying healthy between '09 and '13, but it seems rev'd to put up impressive numbers. Sometimes referred to as the "Big Horse That Could." Actor Paul Reiser once lived here.

SCRATCHED

131 SOUTH DEARBORN — 20-1

2

Loan Balance: $472,000,000

Maturing Date: Dec. 2016

Sires: JPMCC 2006-LDP9, JPMCC 2007-CB18

The Skinny: Owners are already signaling that the horse is not 100% healthy. The loan is with the special servicer and early 2017 occupancy at the Chicago property is projected to be only 55%. Special servicer comments indicate refinancing risk over vacancies. Modification possible. 2014 value is below the current note value.

GAS COMPANY TOWER — 2-1

3

Loan Balance: $458,000,000

Maturing Date: Aug. 2016

Sires: JPMCC 2006-LDP8, WBCMT 2006-C28

The Skinny: Recent results look weak, with 2014 DSCR under 1.0x, but sometimes numbers can be deceiving. New leases and extensions at the Los Angeles property should provide "gas." Look for improved results in 2016 and a high likelihood of a payoff. Ready to go the distance.

280 PARK AVENUE — 6-1

4

Loan Balance: $429,860,933

Maturing Date: June 2016

Sires: CSMC 2006-C4, CSMC 2006-C5

The Skinny: Low leverage (35% LTV) to CMBS debt makes this seem like a no-brainer, but the property carries tons of mezz debt. DSCR has been weak, but new Franklin Templeton lease should push number closer to 1.0x. Horse lives in a pricey Manhattan "neigh"-borhood, which should help cause. Supports NYC Mayor DeBlasio's plan to ban carriage horses.

770 BROADWAY — 1-5

5

Loan Balance: $353,000,000

Maturing Date: March 2016

Sires: CSMC 2006-C3

The Skinny: After StuyTown, this is closest to a sure thing in the race. Outstanding numbers (1.87x DSCR in 2014) in a hot market. If this NYC property can't refinance, plan to stock up on freeze-dried food and survival gear.

MERCHANDISE MART — 1-5

6

Loan Balance: $350,000,000

Maturing Date: Dec. 2016

Sires: GCCFC 2007-GG9, JPMCC 2006-LDP9

The Skinny: Another no-brainer. Latest DSCR was over 3.0x (2.73x for 2014). The Chicago property was built in 1930 during the Great Depression, but only a Greater Depression will keep this thoroughbred from crossing the finish line.

ONE NEW YORK PLAZA — 1-3

7

Loan Balance: $342,449,128

Maturing Date: Dec. 2016

Sires: GCCFC 2007-GG9, JPMCC 2006-LDP9

The Skinny: Third NYC property in the derby (a Brookfield entry). Another trophy property in a strong market. Office suffered Hurricane Sandy damage in 2012, but rebounded. Low leverage loan (50% LTV) with 100% occupancy and growing DSCR should get this property across the finish line.

Loan number 1, New York City's Peter Cooper Village & Stuyvesant Town, is set to resolve as a result of the property's $3.3 billion sale.

125 HIGH STREET 1-1

8

Loan Balance: $340,000,000

Maturing Date: Aug. 2016

Sires: LBUBS 2006-C6

The Skinny: One of two Boston entries. Cause for concern when top tenant PwC (26% of GLA) announced it was leaving, but two major leases for over 300,000 sf were signed, putting the property back on firm footing. Securitization LTV was 45%, but the horse is carrying extra $189 million in mezz debt. Should refinance even if Tom Brady is writing the terms.

WARNER BUILDING 3-1

9

Loan Balance: $292,700,000

Maturing Date: Aug. 2016

Sires: JPMCC 2006-CB15

The Skinny: Only Washington, D.C., entrant looks cuspy. Low occupancy (70s %) and DSCR well below 1.0x since 2012 make this horse "interesting." Unlike other low DSCR entries, this came to market in 2006 with a relatively high LTV of 75%. Lease extension with GE would help, but this horse could use a shot of Lasix and a few sugar cubes.

CHERRY CREEK SHOPPING CNTR 1-1

10

Loan Balance: $280,000,000

Maturing Date: June 2016

Sires: MSC 2006-HQ9, MSC 2006-HQ10

The Skinny: A rare traditional retail property in the field, this horse sports blistering DSCR and occupancy levels. Should finish without breaking a sweat. Benefits from training in Denver's high altitude. First time wearing blinders.

EZ STORAGE PORTFOLIO 1-4

11

Loan Balance: $300,000,000

Maturing Date: Dec. 2016

Sires: COMM 2006-C8, BACM 2006-6

The Skinny: Not the most glamorous name on the field, the EZ Storage Portfolio should refi with EaZe. Loan is backed by 48 self-storage facilities totaling 3.7 million sf. 2014 financials saw DSCR blow past the 3.0x level. As Kramer would say, its "mudder was a mudder."

53 STATE STREET 5-1

12

Loan Balance: $280,000,000

Maturing Date: Aug. 2016

Sires: JPMCC 2006-LDP8

The Skinny: Second Boston entrant is a tough read. Top tenant Goodwin Proctor, in 37% of the space, will vacate in April. Latest occupancy is 88%, but that could drop sharply, as could the 1.65x DSCR. Include in exotics, but don't overpay.

PRIME OUTLETS POOL II 1-5

13

Loan Balance: $266,921,215

Maturing Date: March 2016

Sires: WBCMT 2006-C26, WBCMT 2006-C27

The Skinny: Don't be fooled by the fact that this is a three-legged retail portfolio. DSCR has been strong and growing. Loan should leap, not limp, over the finish line.

NEWPORT BLUFFS 1-2

14

Loan Balance: $264,000,000

Maturing Date: Oct. 2016

Sires: WBCMT 2006-C28, WBCMT 2006-C29

The Skinny: Only apartment entry in the field, the 1,052-unit California property sports a DSCR of 1.29x, which has been growing in recent years. Spent formative years in great weather. Can it handle the rain and mud?

2015 CMBS Award Winners

Deutsche Again Tops CMBS Bookrunners

By Orest Mandzy

For the fourth straight year, Deutsche Bank was the most active bookrunner of domestic, private-label CMBS, handling nearly one out of every five deals that priced last year.

The investment bank received credit for handling the books of deals totaling $17.2 billion for an 18.25 percent share of the market. It participated in 22 of the year's 121 deals, but got credit for 18.2 deals because of the way *Commercial Real Estate Direct* divvies up credit for the ranking.

Its share of the market dropped from 26.25 percent in 2014 largely because of its smaller role in the large-loan business. Whereas it contributed $6 billion of loans to single-borrower deals in 2014, typically taking sole bookrunner duties, last year it only contributed $3.3 billion to such deals.

Because of that, the total volume of loans it contributed to CMBS deals in 2015 was down by 37 percent to $8.9 billion, putting it well behind JPMorgan Chase Bank, which led all loan contributors to the market, with $10.9 billion.

Wells Fargo Securities, meanwhile, was the second most-active CMBS bookrunner, with a 15.6 percent share of the

Continued on next page

Top Bookrunners Domestic, Private-Label CMBS

	2015			2014		
Investment Bank	**#Deals**	**Vol $mln**	**Mkt-Shr%**	**#Deals**	**Vol $mln**	**Mkt-Shr%**
Deutsche Bank	18.23	17,210.79	18.25	27.14	23,479.37	26.25
Wells Fargo Securities	17.77	14,715.47	15.61	16.85	12,256.48	13.70
JPMorgan Securities	15.07	12,105.67	12.73	18.62	13,752.01	15.38
Morgan Stanley	14.47	9,715.97	10.30	7.13	6,035.68	6.75
Credit Suisse	10.75	8,593.95	9.11	4.78	2,359.77	2.64
Goldman Sachs	10.17	8,463.19	8.98	8.96	7,896.25	8.83
Citigroup	10.79	7,608.49	8.07	9.09	7,526.97	8.42
BofA Merrill Lynch	9.70	6,966.40	7.39	8.71	6,140.38	6.87
Barclays Capital	10.18	6,719.75	7.07	4.18	4,004.22	4.48
UBS	2.35	2,141.92	2.27	4.70	3,440.07	3.85
Jefferies	0.32	462.29	0.49	0.00	0.00	0.00
Cantor Fitzgerald	1.00	140.00	0.15	0.50	256.00	0.29
Societe Generale	0.13	127.28	0.13	0.00	0.00	0.00
Scotia Capital	0.10	125.00	0.13	0.00	0.00	0.00
RBS				1.76	2,066.77	0.29
Ladder Capital				0.50	225.00	0.25
TOTAL	**120.00**	**94,296.94**		**114.00**	**89,865.50**	

Moody's Rates Every Conduit of Year; Tops Ratings Ranking

Moody's Investors Service rated every single conduit and 20 percent of the single-borrower deals issued last year, giving it a market share of just more than 73 percent—tops in the CMBS ratings business.

But in most cases, issuers paid only for its ratings on the most senior bonds of conduit deals, including their A-S, or junior-AAA classes. They paid for its ratings on lower rated bonds for only 16 of the 59 conduit deals. That's due to the rating agency's strict views on collateral quality. It often has said that it would give lower grades to bond classes than would its competitors.

Nonetheless, issuers continue to hire Moody's because many investors still require bonds to be rated by at least one of the three major raters before they're able to buy them. And with S&P still out of the picture—it was given a one-year suspension from the conduit business last year by the SEC—issuers are relying heavily on the remaining two legacy agencies. And as a risk-avoidance maneuver, they've routinely used three, and sometimes four agencies, benefiting the relative newcomers.

Fitch Ratings and Kroll Bond Rating Agency were in a virtual tie in the *Commercial Real Estate Direct* rating agency ranking, each with a roughly 56 percent share of the year's issuance.

Morningstar Credit Ratings, meanwhile, saw a 35 percent increase in its market share, tops among all rating agencies. It rated nearly 45 percent of the year's deals, up from 33 percent in 2014. ■

Domestic Private-Label CMBS Rankings - Rating Agencies

	Conduits			Single-Borrower			Total - 2015			Total - 2014		
	#Deals	**Vol $mln**	**Mkt Shr%**	**#Deals**	**Vol $mln**	**Mkt Shr%**	**#Deals**	**Vol $mln**	**Mkt Shr%**	**#Deals**	**Vol $mln**	**Mkt Shr%**
Moody's	59	61,882.40	100.00	8	6,186.33	20.03	67	68,068.73	73.38	62	60,783.00	68.13
Kroll	42	42,123.03	68.07	14	9,898.20	32.05	56	52,021.23	56.08	61	52,394.21	58.73
Fitch	38	38,817.02	62.73	17	13,472.00	43.63	55	52,289.02	56.37	42	42,916.15	48.1
Morningstar	27	26,797.63	43.30	25	14,455.96	46.81	52	41,253.59	44.47	42	29,414.10	32.97
DBRS	23	23,734.36	38.35	7	3,177.93	10.29	30	26,912.29	29.01	41	36,823.23	41.27
S&P	0	0.00	0.00	37	22,364.33	72.42	37	22,364.33	24.11	44	27,383.62	30.69

2015 CMBS Award Winners

Continued from previous page

market. It contributed to 19 of the year's deals, so its loans were securitized every 20 days. It securitized a total of 369 loans—by far the most of any CMBS lender—totaling $6.1 billion.

Domestic private-label issuance totaled $95.1 billion last year. Even if you add the $4 billion of collateralized loan obligations, issuance still fell far below the $110 billion that was anticipated early in the year. That was largely due to the choppiness that hit the market starting in July. Spreads to that point were in a range between 82 and 92 basis points more than swaps. They then started their march wider, causing a sharp slowdown in issuance.

Indeed, $52 billion of CMBS was issued during the first half and $43.3 billion in the second half, when spreads jumped to levels not seen in two years. When that happened, it got tougher to profitably lend, which caused lenders to slowdown. Only 31 lenders contributed to the CMBS market during the second half, while 35 contributed during the first six months of the year.

Market professionals expect anywhere from $100 billion to $125 billion of CMBS to be issued in 2016. That's driven largely by the $87.1 billion of conduit loans that come due next year. ■

Top Managers of Domestic, Private-Label CMBS - 2015

Investment Bank	#Deals	Bal$mln	MktShr%
DrexelHamilton	46	41,446.67	43.58
Deutsche Bank	35	33,646.87	35.38
Morgan Stanley	31	25,470.73	26.78
Citigroup	34	24,503.06	25.77
Goldman Sachs	21	20,612.26	21.68
Wells Fargo Securities	24	19,723.84	20.74
JPMorgan Securities	23	18,655.51	19.62
BofA Merrill Lynch	22	17,881.42	18.80
Cantor Fitzgerald	17	16,923.07	17.80
Barclays Capital	14	12,437.20	13.08
Credit Suisse	16	12,389.06	13.03
UBS	9	8,577.84	9.02
Natixis	8	8,337.01	8.77
CIBC World Markets	9	8,214.46	8.64
Jefferies	7	8,056.36	8.47
CastleOak	7	7,592.79	7.98
Academy Securities	3	1,991.00	2.09
RBC	1	281.50	0.30

Top Loan Contributors

	2015			2014	
Lender	#Loans	Vol $mln	Mkt Shr%	Vol $mln	Mkt Shr%
JPMorgan Chase Bank	161.60	10,858.98	11.55	11,440.63	13.03
Deutsche Bank	218.00	8,867.97	9.43	14,005.13	15.95
Morgan Stanley	241.50	8,264.67	8.79	5,339.71	6.08
Bank of America	242.80	6,533.69	6.95	5,565.68	6.34
Citigroup	217.40	6,274.94	6.67	5,604.13	6.38
Goldman Sachs	156.40	6,258.96	6.66	5,098.86	5.81
Wells Fargo Bank	369.00	6,117.35	6.51	5,849.16	6.66
Credit Suisse	151.60	5,982.51	6.36	2,141.28	2.44
Barclays Bank	183.10	5,178.16	5.51	3,111.20	3.54
Cantor Commercial Real	277.80	4,325.86	4.60	5,750.69	6.55
UBS Real Estate Securities	166.30	2,699.80	2.87	2,959.06	3.37
Ladder Capital Finance	209.60	2,584.94	2.75	3,493.47	3.98
Natixis	167.00	2,548.32	2.71	1,371.94	1.56
Rialto Mortgage Finance	221.00	2,412.71	2.57	1,490.24	1.70
Starwood Mortgage Capital	204.00	2,067.73	2.20	1,618.57	1.84
MC-Five Mile	95.00	1,484.06	1.58	1,174.28	1.34
CIBC World Markets	104.00	1,237.01	1.32	1,240.71	1.41
Jefferies LoanCore	68.00	1,215.69	1.29	828.90	0.09
Silverpeak Real Estate	79.00	980.30	1.04	282.55	0.32
KeyBank	95.00	855.62	0.91	864.37	0.98
Principal Commercial	37.00	819.12	0.87	0.00	0.00
Redwood Commercial	59.00	740.49	0.79	845.24	0.96
BNY Mellon	42.00	658.98	0.70	0.00	0.00
Benefit Street Partners	62.00	637.28	0.68	0.00	0.00
C-III Commercial Mortgage	139.00	629.35	0.67	508.90	0.58
Liberty Island Group	46.00	562.83	0.60	846.39	0.96
Societe Generale	46.00	534.19	0.57	0.00	0.00
Bancorp Bank	78.00	524.21	0.56	362.98	0.41
Basis Real Estate Capital	48.00	397.10	0.42	415.90	0.47
RAIT Financial Trust	37.00	367.12	0.39	606.45	0.69
Walker & Dunlop	18.00	279.24	0.30	117.57	0.13
NCB FSB	92.00	274.47	0.29	314.81	0.36
Scotia Capital	0.10	125.00	0.13	0.00	0.00
KGS-Alpha Real Estate	22.00	102.30	0.11	0.00	0.00
Freedom Commercial Real	24.00	93.52	0.10	0.00	0.00
GE Capital Corp.	12.00	92.43	0.10	584.17	0.67
Ares Commercial	0.00	0.00	0.00	378.80	0.43
Bank of China	0.00	0.00	0.00	450.33	0.51
RBS	00	0.00	0.00	2,234.86	2.54
Total	**36**	**93,586.89**	**100.00**	**87,828.13**	**100.00**

2015 CMBS Award Winners

Special Servicer Ranking - 2015

	Total			Conduit			Single-borrower			Other Deals		
Servicer	#Deals	Vol $mln	Mkt Shr%	#Deals	Vol $mln	Mkt Shr%	#Deals	Vol $mln	Mkt Shr%	#Deals	Vol $mln	Mkt Shr%
Midland Loan Services	26	21,055.00	50.76	17	18,187.87	29.39	7	2,562.13	8.30	2	305.00	13.07
Rialto Capital Advisors	15	14,672.62	30.09	14	14,517.82	23.46			0.00	1	154.80	6.63
Wells Fargo Bank	21	14,610.55	44.19	2	1,927.92	3.12	19	12,682.63	41.07			0.00
LNR Partners	13	12,278.43	19.84	13	12,278.43	19.84			0.00			0.00
CWCapital Asset Management	8	7,690.12	12.43	8	7,690.12	12.43			0.00			0.00
KeyBank	12	6,974.13	22.58			0.00	12	6,974.13	22.58			0.00
Aegon	6	3,968.35	12.85			0.00	6	3,968.35	12.85			0.00
Torchlight Loan Services	4	3,959.35	6.40	4	3,959.35	6.40			0.00			0.00
Strategic Asset Services	6	3,617.33	53.35			0.00	4	2,566.23	8.31	2	1,051.10	45.04
C-III Asset Management	3	3,320.89	5.37	3	3,320.89	5.37			0.00			0.00
Pacific Life	1	1,050.00	3.40			0.00	1	1,050.00	3.40			0.00
Trimont Real Estate	1	796.59	2.58			0.00	1	796.59	2.58			0.00
Hudson Advisors	1	281.50	12.06			0.00			0.00	1	281.50	12.06
Berkadia Commercial	1	280.00	0.91			0.00	1	280.00	0.91			0.00
Orix	1	218.80	9.38			0.00			0.00	1	218.80	9.38
FirstCity Financial	1	112.70	4.83			0.00			0.00	1	112.70	4.83
A10	1	209.80	8.99							1	209.80	8.99
Total	**121**	**95,096.16**		**61**	**61,882.40**		**51**	**30,880.06**		**9**	**2,333.70**	

Master Servicer Ranking

	2015									2014		
	TOTAL			Conduits			Single-Borrower			TOTAL		
	#Deals	Vol$mln	MktShr%	#Deals	Vol$mln	MktShr%	#Deals	Vol$mln	MktShr%	#Deals	Vol$mln	MktShr%
Wells Fargo Bank	68	58,639.53	61.66	40	40,764.73	65.88	27	17,593.30	56.97	67	58,216.54	64.78
Midland Loan Services	25	20,177.33	21.22	16	17,600.20	28.44	6	2,272.13	7.36	16	14,581.94	16.23
KeyBank	21	13,836.90	14.55	3	3,517.47	5.68	15	9,594.63	31.07	22	14,538.27	16.18
Berkadia Commercial Mortgage	4	1,965.10	2.07				3	1,420.00	4.60	3	1,254.57	1.40
FirstCity Financial	1	112.70	0.12							1	289.76	0.32
Rialto Mortgage Finance	1	154.80	0.16							1	94.70	0.11
A10 Mortgage	1	209.80	0.22							1	132.40	0.15
Total	**121**	**95,096.16**		**59**	**61,882.40**		**51**	**30,880.06**		**111**	**89,108.18**	

2015 CMBS Award Winners

Rialto Once Again Tops B-Piece Buyers

By Orest Mandzy

Rialto Capital Management remained the top dog in the CMBS B-piece market last year, investing in 14 conduit transactions with a total balance of $14.5 billion, or nearly a quarter of the year's conduit issuance.

The Miami investment manager, a unit of Lennar Corp., was one of 11 investors to buy B-pieces during the year. That was an increase from nine that participated in the market in 2014. Its closest rival, Eightfold Real Estate Capital, also of Miami, invested in eight deals totaling $8.6 billion, or 13.8 percent of the year's conduit issuance.

Seer Capital, a relative newcomer that started investing in the sector only in 2014, got credit for buying into 9.3 deals totaling $8.1 billion. It actually invested in 11 deals, but had teamed up with LNR Partners and Ellington Management on three and got proportional credit for those.

The list of the year's B-piece buyers likely will remain unchanged next year. Risk-retention rules go into effect late this year, requiring investors to retain 5 percent of every deal's market value for at least five years. Each of last year's participants has raised long-term capital, typically through investment funds, that would be ideally suited to meeting those rules.

Top Buyers of CMBS Conduit B-Pieces

	2015			2014		
Investor	#Deals	Vol $mln	Mkt Shr%	#Deals	Bal $mln	Mkt Shr%
Rialto	14.00	14,517.82	23.46	13.00	15,416.14	27.16
Eightfold Real Estate	8.00	8,559.23	13.83	4.00	4,103.69	7.23
Seer Capital	9.30	8,088.57	13.07	8.75	10,602.32	18.67
LNR Property Corp.	7.21	7,607.21	12.29	6.31	6,858.28	12.08
Doubleline Capital	5.00	5,343.95	8.64	3.00	3,973.44	7.00
KKR Real Estate	4.00	4,362.28	7.05	0.00	0.00	0.00
Torchlight	4.00	3,959.35	6.40	2.00	2,060.60	3.63
Raith/AllianceBernstein	3.00	3,311.50	5.35	4.00	4,551.55	8.02
Ellington Management	3.50	3,243.61	5.24	5.94	6,500.91	11.45
BlackRock Realty	2.00	1,783.71	2.88	2.00	2,714.34	4.78
C-III Capital Partners	1.00	1,105.17	1.79	0.00	0.00	0.00
Total	**61**	**61,882.40**		**49**	**56,781.27**	

Absent from the market last year, and possibly in the future, are the fast-money investors that pursued B-pieces opportunistically in prior years. But new on the list was C-III Capital Partners, which bought its first B-piece in more than seven years. It funded its investment through C-III High Yield Real Estate Debt Fund IV, which is raising $115 million of equity commitments.

Also new last year was KKR Real Estate Finance Holdings, which bought into four deals totaling $4.4 billion. The unit of KKR & Co., got into the business in late 2014 by hiring a team of professionals led by Matt Salem from Rialto. It too has raised long-term capital through a fund and is said to be gearing up a second vehicle.

B-piece investors typically get to pick the special servicers for the deals in which they invest. Four investors — Rialto, LNR, Torchlight Investors and C-III—each operate businesses to which they award special servicing rights. LNR bought into nine deals, including four in which it teamed with other investors. ■

Trustees Ranking - 2015

	Total			Conduit			Single-Borrower			Other		
Trustee	#Deals	Bal $mln	Mkt Shr%	#Deals	Bal $mln	Mkt Shr%	#Deals	Bal $mln	Mkt Shr%	#Deals	Bal $mln	Mkt Shr%
Wilmington Trust	58	51,898.93	54.58	38	38,666.01	62.48	19	12,951.42	41.94	1	281.50	12.06
Wells Fargo Bank	34	24,453.81	25.71	13	12,997.25	21.00	16	10,280.96	33.29	5	1,175.60	50.37
Deutsche Bank	12	10,184.31	10.71	6	6,195.31	10.01	6	3,989.00	12.92			
USBank	16	8,164.11	8.59	4	4,023.83	6.50	9	3,263.68	10.57	3	876.60	37.56
Citibank	1	395.00	0.42				1	395.00	1.28			
TOTAL	**121**	**95,096.16**		**61**	**61,882.40**		**51**	**30,880.06**		**9**	**2,333.70**	

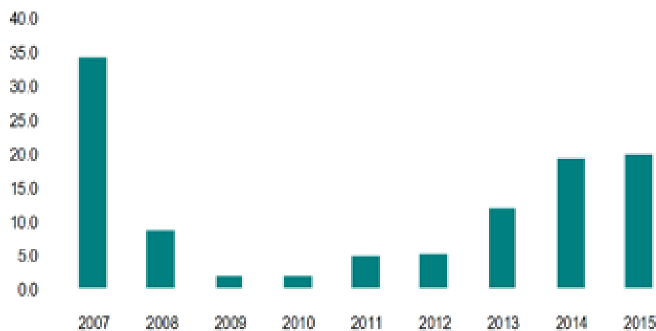
Defeasance Activity Reaches New Post-Recession High

By Orest Mandzy

Defeasance activity continued to blossom last year, as conditions remained favorable—property values continued to increase, interest rates remained at historically low levels and lenders generally were generous with loan proceeds.

A total of 1,332 loans with a balance of $19.8 billion were defeased, or replaced by government securities, through November. That sum will increase as remittance data for December is tallied. The balance through November compares with $19 billion for all of 2014 and is a clear indication that borrowers made efforts to lock in new mortgages with relatively low coupons well ahead of the maturity of their existing loans.

Defeasance Volume



Source: Trepp LLC

Borrowers who want to pay off a mortgage before it's due would face what could be onerous costs in the form of yield-maintenance or prepayment penalties, or they can replace its collateral with government securities that generate the same income stream as the loan. To be sure, the latter option—defeasance—comes with its own set of headaches and costs.

In fact, Boston Properties Inc. incurred $23.5 million of costs when it defeased a $640.5 million CMBS loan late last year that had another 10 months before it became open to prepayment. The REIT had to buy $667.4 million of government securities in order to mimic the cash flow generated by the loan it wanted to retire. That loan, backed by 100 and 200 Clarendon St. in Boston, had a coupon of 5.599 percent and required only interest payments.

In a defeasance transaction, a borrower has to identify and buy the appropriate securities and negotiate with a number of third parties, from the loan's servicer to the rating agencies. As a result, a number of advisory firms have become active in the sector, which include AST Defeasance of Los Angeles; Chatham Financial of Kennett Square, Pa.; Commercial Defeasance and Waterstone Capital Advisors, both of Charlotte, N.C.; Trimont Real Estate Advisors of Atlanta; Bank of America and Wells Fargo Bank.

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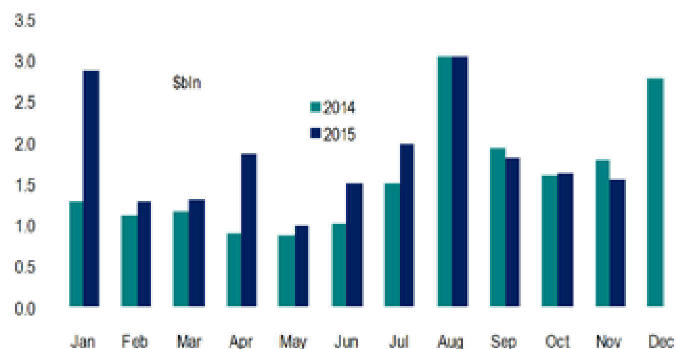
Borrowers typically factor in the amount that would be saved, as well as additional equity that could be taken out of a property, and compare that to the costs of defeasance in determining whether to proceed with such a transaction. While Boston Properties, in the earlier example, executed its transaction as a de-leveraging move, other property owners might turn to defeasance in order to access what could be viewed as trapped equity. That is, the equity hidden in a property because its value has increased.

For instance, JEMB Realty Corp. defeased the $60 million CMBS loan against 150 Broadway, a 266,427-square-foot office building in lower Manhattan with proceeds of a $110 million mortgage provided by AIG Investments. That decision allowed it to access the equity that was created because the collateral building's value had skyrocketed since the CMBS loan was written, to nearly $200 million from $103.3 million.

The largest loan to get defeased last year was the $806 million mortgage, securitized through Credit Suisse Commercial Mortgage Trust, 2006-C4, against 11 Madison Ave. in Manhattan's Flatiron district that SL Green Realty Corp. had acquired for $2.29 billion. The New York REIT defeased that loan, which doesn't come due until next September, with proceeds of a $1.4 billion financing package that was provided by Deutsche Bank, Morgan Stanley and Wells Fargo Bank.

The 2.3 million-sf office property was valued at $1.1 billion in 2006. It most recently was appraised at a value of $2.35 billion. The defeasance transaction allowed SL Green to bring the property's leverage level up to roughly 60 percent of current value. ■

CMBS Defeasance Volume



Source: Trepp LLC

Top Defeased Loans - 2015

Mo. of Defeasance	BloombergName	Vintage	Property Name	City	ST	Property Type	Bal $mln	DSCR	NOI $mln	Maturity
September	CSFB 2006-C4	2006	11 Madison Avenue	New York	NY	OF	806.00	0.93	43.62	Sept. 11, 2016
August	LBUBS 2006-C6	2006	1211 Avenue of the Americas	New York	NY	OF	400.00	1.76	77.28	Sept. 11, 2016
November	GCCFC 2007-GG9	2007	590 Madison Avenue	New York	NY	OF	350.00	3.30	63.79	June 2, 2017
January	JPMCC 2005-LDP5	2005	Brookdale Office Portfolio	Various	VR	OF	313.44	1.45	30.95	Sept. 11, 2015
August	LBUBS 2006-C7	2006	1211 Avenue of the Americas	New York	NY	OF	275.00	1.76	77.28	Sept. 11, 2015
April	JPMCC 2005-LDP5	2005	Selig Office Portfolio	Seattle	WA	OF	242.00	2.00	28.34	Jan. 1, 2016
October	JPMCC 2006-LDP9	2006	Galleria Towers	Dallas	TX	OF	232.00	1.22	16.54	Dec. 1, 2016
January	DBUBS 2011-C1	2011	353 North Clark Street	Chicago	IL	OF	213.93	1.82	26.06	Jan. 6, 2016
January	GSMS 2006-GG8	2006	222 South Riverside Plaza	Chicago	IL	OF	193.46	1.26	18.75	Jun. 6, 2016
March	CSFB 2006-C3	2006	535 and 545 Fifth Avenue	New York	NY	OF	177.00	1.09	11.32	May 11, 2016
November	MSC 2007-HQ11	2007	525 Seventh Avenue	New York	NY	OF	172.00	1.35	12.95	Feb. 8, 2017
January	MSC 2011-C1	2011	Michigan Plaza	Chicago	IL	OF	170.29	2.01	22.35	Nov. 5, 2015
October	MLCFC 2007-5	2007	Tower 45	New York	NY	OF	170.00	1.17	12.33	Feb. 8, 2017
May	GSMS 2007-GG10	2007	Harbor Point Apartments	Boston	MA	MF	156.64	1.51	17.13	July 6, 2017
August	CD 2007-CD4	2007	Bank of America Plaza	Charlotte	NC	OF	150.00	1.55	12.82	Nov. 6, 2016
August	CWCI 2007-C3	2007	Charles River Plaza North (1)	Boston	MA	OF	145.00	1.32	21.81	July 6, 2017
February	MLMT 2005-CKI1	2005	Ashford Hotel Portfolio	Various	VR	LO	144.97	2.00	23.10	July 1, 2015
Septemer	WBCMT 2006-C27	2006	One Illinois Center	Chicago	IL	OF	141.20	0.50	5.51	July 11, 2016
April	GSMS 2007-GG10	2007	9200 Sunset Boulevard	Los Angeles	CA	OF	135.00	1.87	14.85	July 6, 2017
July	LBUBS 2006-C6	2006	The Terrace Office Complex	Austin	TX	OF	124.74	0.99	9.55	July 11, 2016
March	DBUBS 2011-C1	2011	300 South Riverside Plaza	Chicago	IL	OF	112.95	1.89	15.36	Jan. 6, 2016
January	MSC 2006-HQ8	2006	COPT Office Portfolio - Roll-up	various	MD	OF	108.54	1.57	9.60	Jan. 1, 2016
July	CGCMT 2006-C5	2006	Tower 67	New York	NY	MF	100.00	2.25	13.24	July 11, 2016
August	BSCMS 2007-PW15	2007	1325 G Street	Washington	DC	OF	100.00	0.76	4.25	Nov. 1, 2016

Source: Trepp LLC

Will the Music Stop?

By Jim Costello

Commercial real estate prices are at record levels in high-profile markets and property subtypes. This pricing is set against a backdrop of anticipated rate increases on the long end of the yield curve. The combination of these situations has raised concerns that the music will stop, with price declines in the year ahead.

Commercial real estate prices are at record levels throughout the country. Interest-rate hikes are on the way, leaving many to worry that a drop in sales pricing is not that far behind.

But price declines are not a foregone conclusion. Think about it this way, sometimes at a party, the music does not stop, but the DJ changes the tune. The view by many is that the market has been dancing to a frenetic high-energy beat punctuated by double-digit growth in sale prices and investment volume. The anticipated increases in interest rates need not end the party, but it might change the tune to a slower dance.

Managing the expectations of buyers and sellers in a transaction can be a complicated endeavor. Among other factors, sellers will look at an asset with a set of pricing expectations tied to recent prices achieved by comparable or peer assets. Buyers, on the other hand, will be setting pricing expectations based more on current interest rates, their ability to finance a transaction and the type of returns they will need. Brokerage professionals are tasked with bringing these expectations together. Sometimes that job is more complicated.

When interest rates are falling and capital pressures are pushing up prices at a double-digit pace, aligning the interests of buyers and sellers does not need as much help. Sellers can more easily achieve pricing at or above that of peer assets as buyers incorporate the near-term growth in pricing into their expectations for the future. Like hormone-fueled students at a college party, buyers and sellers can be easy to bring together, though here too sometimes with disastrous consequences.

A rising rate environment instills doubt and caution on the part of buyers. Not that they will forgo investments, but with uncertainty around financing costs as deals are underway, buyers will be less likely to stretch on pricing and meet seller expectations. Just as getting a group of middle-aged people off their seats and onto the dance floor is a tough job for a DJ with the wrong music, brokerage professionals trying to bring buyers and sellers together have their work cut out for them in such an environment as they work to curtail doubt on both sides of a transaction.

In the context of the current market, there is reason to believe that even with expectations for steady increases in

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the long-end of the yield curve, commercial property capitalization rates need not adjust much in the near term. It is surprising to many to hear the truth of this, but buyers have actually been cautious during the current market expansion.

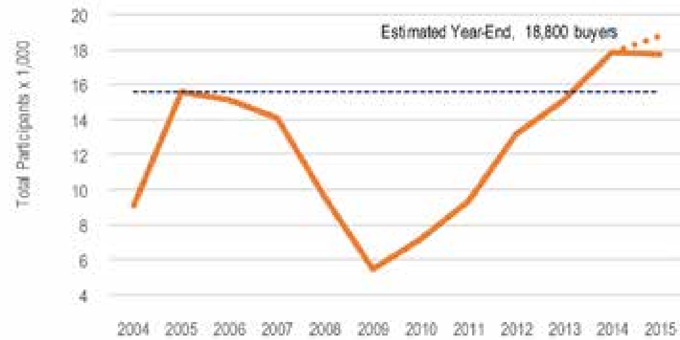
Yes, cap rates have been falling to record low levels—lower than those in 2007 in some cases—but with the overall low interest rate environment, these deals have more cushion in them than deals during the previous cycle. The spread between interest rates and cap rates for commercial properties overall is still roughly 60 basis points greater than the average over time as of November 2015.

Fundamentally, increases in interest rates both on the short and long ends of the yield curve are positive signs. Interest rates at record low levels for a nine-year period were indicative of an unhealthy economy. Some increases on the long end of the curve will only come about with growth in the economy, and investors competing a bit more for investment capital, thus bidding up its price. With those signs of health, investors should be willing to step up their risk exposure, and accept tighter spreads between cap rates and interest rates when making property purchases.

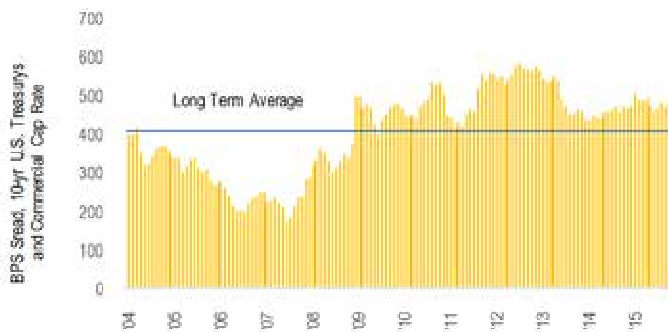
The implication here is that rather than driving a cap-rate increase, if interest rates expand along with risk tolerance, the spread can compress and potentially drive cap rates further down. It is less likely at this point that cap rates would fall further, but at a minimum, cap rate compression will come to an end. Still, it may take a while before such changes would impact property market pricing.

There are a lot of people still on the dance floor. Real Capital Analytics tracks not just property sales but all of the participants involved in transactions. Last year saw record numbers of unique purchasers of commercial property in the United States. Through November, we recorded 17,800 buyers and, given activity underway, we anticipate 18,800 unique purchasers will be active for the full year. If this figure holds, it would suggest that the buyer pool is now 21 percent deeper than it was in 2005.

Number of Unique Buyers by Year



Source: Real Capital Analytics



Source: Real Capital Analytics

Deeper Pool of Buyers for U.S. CRE Assets in 2015

A deeper pool of buyers will help support property market pricing, even as interest rate pressures weigh on cap rates and cap rate spreads. If the belle of the ball loses one potential suitor when dozens are calling, it will be of little consequence for any final transaction.

In truth, the music has not been quite as intense as that which was played in 2007. Buyers are not coming in with the same abandon as in the previous boom and even with cap rates at record low levels, these participants are acting with more caution. Even with expected interest rate increases, it may take a while for the dance floor to clear, given the crush of investors looking for yield in commercial property.

The backdrop of double-digit growth in prices and sales volume will likely change as interest rates increase. Cap rates may well flatten at something like their current level. Without the boost of cap-rate compression, the tune of the market will be more suited for a slow dance. In such a case, the music will not stop and prices will not decline, rather prices will only begin to grow at single digit rates to reflect growth in property income. ■

Jim Costello, CRE, is senior vice president of Real Capital Analytics, a New York data and analytics company.

Regulatory Compliance: Big Issue for Real Estate Owners

By Seth Dotterer

There may be no other industry in which regulatory compliance is such a sophisticated endeavor than real estate. When we look at the numbers, it doesn't seem like we're quite keeping up. Yet, it has never been more critical for property owners, investors and managers to be in tune with the regulatory requirements of operating their buildings.

While we see this across the United States, it's most pervasive in our backyard of New York City. The Environmental Control Board is a division of the Office of Administrative Trials and Hearings in the city that adjudicates hearings for about a dozen city agencies. Over the past year, it has issued more than 583,000 notices of violations, and imposed almost a quarter of a billion dollars in fines as a result of the violations. And it's not slowing down.

The Regulatory Environment is Ever-Changing—and Consequences Steep

Local compliance laws also have become more complicated. An example is in the Fire Department of New York Permitting. There are 950 different types of equipment, systems and prevention measures that are monitored by the FDNY, and we've found that more than 50 percent of New York City properties currently hold expired permits. Those violations automatically incur a fine, which doubles after one year, regardless of whether the property owner is aware of them. FDNY violations are serious, often impacting life safety at a building, and in some cases, can result in a criminal summons for the building operator.

Beyond permits, compliance continues to affect transactions. Every month, more than a thousand liens are issued against properties in New York City. SiteCompli research shows that 72 percent of buildings with more than 10,000 square feet each have liens on record. Those directly affect valuation and refinancing, and can delay or impair building and construction projects.

One recent example illustrates the importance of diligence. A property that was sold had incurred violations in its elevator inspections. While they technically had a year to be corrected, the violations didn't come up during disclosure. The building was sold during the period of correction. Nothing was mentioned on the title report indicating an issue. Unfortunately, the new owner also purchased a substantial (more than $50,000) civil penalty along with the building.

Minimizing compliance expenses doesn't mean just knowing what's on the books, but keeping abreast of new challenges. We saw this in New York City, when cooling towers were tied to Legionnaires' disease, requiring inspections and remediation at buildings across the city. The resulting rush left owners scrambling to make sure their cooling towers were up to code.

Managing Compliance Across Multiple Buildings Adds Complexity

If keeping track of the multiple agencies that hand out violations and fines for compliance issues wasn't a large

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enough challenge, most regulatory bodies don't make it easy for owners of multiple properties. The building, lot and tax identification information that the city uses to direct violations has little relationship to owner, manager, vendor and tenant relationships, leaving owners to play traffic cop to the incoming, and follow up from, compliance work.

For owners and managers of residential properties, compliance becomes even more complex, and requires a more proactive approach. We've seen property owners achieve significant savings and avoid headaches by intercepting complaints that likely would result in fines and routing those alerts to management for remediation, before an inspector arrives. Those taking this proactive approach have avoided costly repeat violations, and profit by making sure that the inevitable little things that come up don't turn into costly fines and delays. Being able to compare performance data by manager, staff or vendor gives these multi-location owners and managers the ability to optimize performance and minimize risk.

The Solution: Don't Delay or Defer

Ultimately, it's unlikely that we'll see a reduction of regulations and requirements under which our investments are governed. But it is clear that the most profitable approach is to be armed with the right information and to take a proactive approach. ■

Seth Dotterer is a vice president at SiteCompli, a New York-based real estate compliance monitoring technology company.

Recovery, Optimism, Caution: A Look at Risk Management in 2016

By Dianne Crocker

The environmental site-assessment market continues on its path to recovery, along with the broader commercial real estate market. The good news is that based on EDR Insight's internal research and its broad-based Commercial Property Due Diligence Fall Benchmark Survey (November 2015), the forecast for 2016 is positive, but with some notable changes emerging.

The commercial real estate market has benefited from a robust pace of deal making over the past several years. One of the most promising recent trends is the growing universe of investors and lenders. The number of active buyers in commercial real estate has increased three-fold since 2009, new non-traditional lending sources are entering the market and foreign investment is at an all-time high. Financial institutions, particularly regional banks, are finally playing offense again. However, heightened interest in the United States commercial real estate market is not without its challenges. Well-capitalized players are crowding the field, and investment managers are feeling pressure to put capital to work in a highly competitive marketplace.

Top-10 High-Growth Metros for Property Due Diligence 3Q 2015

Metro	Growth
Las Vegas	27%
Baltimore	24%
Honolulu	22%
Portland, Ore.	19%
Sacramento, Calif.	15%
Philadelphia	15%
Salt Lake City	15%
Long Island, N.Y.	12%
Hartford, Conn.	11%
Charlotte, N.C.	11%

Source: EDR Insight

Secondary Metros Are Hip

One trend that is expected to define 2016 points to a strategy of essentially making the pie bigger by looking at smaller metropolitan areas for opportunities. EDR Insight's ScoreKeeper model tracks environmental due diligence activity (measured in terms of the volume of Phase I environmental site assessments) for the U.S. market, regions, states and metros. Since due diligence is performed prior to a property transaction, Phase I ESA hot spots are a leading indicator of growing commercial real estate investment markets—much like the Architectural Billings Index is an indicator of future commercial real estate construction.

Smaller secondary markets with strong growth profiles are seeing investor interest. The table to the left shows the 10 metros with the highest growth in 2015 environmental due diligence activity. Worth noting is that this table looked quite different several years ago, when the highest growth occurred in the big gateway markets. Now, smaller metros like Las Vegas, Baltimore and Portland, Ore., are attracting attention from investors and lenders as they crawl out of the recession. Capital is moving into secondary cities in ways that these areas have not seen since before the downturn. It moves activity beyond San Francisco, New York, Houston, Seattle and several other markets that were the strongest over the past few years. Among the hot spots being forecast for 2016 are Charlotte, N.C.; Dallas; Austin, Texas; Seattle and Atlanta. Common denominators among these are low costs of living, perceived "hip" cultures, strong transportation systems and growing millennial populations.

Risk Aversion Still High

Risk management this year will be different than in prior years. The market is hyperactive and awash with capital, so finding good deals requires more prudent due diligence. Regulatory pressure to manage all types of risk, including environmental, has had an impact in terms of more institutions having formal policies and ensuring that they are being adhered to and documented consistently.

As the era of record-low interest rates ends, buyers can no longer assume the market will go their way, so there will be a need to build in the downside of a deal. Higher interest rates have the potential to take value away very quickly. In contrast to a decade ago, when speculators would borrow the full cost of a property in the hope that the rising market would outpace costs, buyers are now more conservative. At this late stage in the real estate cycle, investors are even more selective because they can no longer assume that the market will be

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in their favor when they are ready to sell their property down the road. There's also much more transparency than there was prior to the downturn, so that's going to hold investors and lenders accountable in a way they haven't been before.

EDR Insight's Fall 2015 Benchmark Survey of Commercial Property Due Diligence revealed the latest trends on this front, including:

- 53 percent of environmental consultants say their lender clients tightened environmental due diligence and are more demanding in terms of having thorough property investigations conducted.
- Only 12 percent reported a loosening of underwriting standards.

Need for Speed

The pressure to place capital in commercial real estate is driving up demand on providers, including environmental consultants, to complete due diligence in record time. In the past, it was not uncommon for an investor to have as long as four weeks to complete their due diligence. Today, the average time for a Phase I ESA is 14 business days, but 40 percent of environmental consultants are "often" or "frequently" getting requests for an even speedier turnaround. Speed comes at a cost—68 percent charge investors and lenders a premium for faster delivery.

Forecast

Although the pace of growth is moderating from the early days of the recovery, market indicators point to continued increases in transactions. Other trends to look for over the near term include:

- Increasing popularity of smaller metros.
- Modest increases in originations and refinance activity.
- More due diligence activity at class-B properties, with the potential for environmental and structural issues.

The moderate-growth forecast correlates very well with what survey respondents expect to see, based on our fall survey results. The bulls win over the bears. The majority of environmental consultants are expecting flat to moderate growth in due diligence activity next year (92 percent) and only a small percentage of the market (8 percent) is expecting a decline.

In terms of risk management, investors are being even more selective because they can no longer assume that the market will be in their favor when they are ultimately ready to sell their property. Likewise, banks are also behaving and managing risk in a more careful way than they did during the last cycle. Efficiency is paramount. Advances in mobile, online and cloud technology are rapidly accelerating the deal-making process, cutting paperwork and increasing transparency. The dealmakers and service providers who can be agile and responsive to the market's need for speed will be the winners in 2016 and beyond. ■

Dianne Crocker is principal analyst of EDR Insight, the analytical research arm of EDR, a national provider of data, risk management and technology tools and insight for property due diligence and compliance.

The Risk in Model Validation

By Chris Albela and Snehal Kanakia

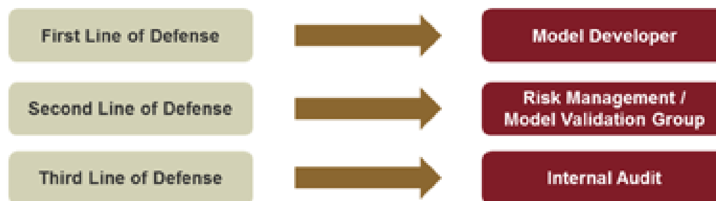
Of all the review and challenge activities that take place, model validation is one that has been frequently emphasized by regulators in guidance, with the expectation that it be independent, competent, and influential in order to adequately assess forecast/model methodology, assumptions and management overlays.

Model validation reports also should conform to regulatory guidance on testing, with the frequency of validation influenced by the risk and complexity of the model. The results of the validation, as well as remediation tracking, also must be adequately communicated to stakeholders.

Independence/Incentives

All three lines of defense are active participants in the model risk function. However, the independence of the second and third lines is essential to foster strong challenges to the model.

In the first line of defense, developers work closely with the line of business to identify and understand risk drivers/factors that should be incorporated in the development process. Those risk factors should be linked to the risk inventory/risk process.



Source: Protiviti

In the second line of defense, model validation provides an independent perspective on the soundness of the (internal or third party) model and its assumptions, and results with a clear and structured way to communicate questions, challenges and recommendations back to the developers. Management and the model developers should document the review and discussion of the validation report findings. The challenge processes here should be appropriately supported with well-designed compensation practices to influence behaviors and performance goals.

In the third line of defense, an internal audit independently evaluates the design and effectiveness of controls, documentation and compliance with regulatory expectations.

Competence

Individuals in the model validation function require technical expertise to effectively validate model assumptions, limitations,

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usage and outcomes. Given the increased implementation of quantitative models and processes at financial institutions—within capital management, as well as in other areas, such as bank secrecy act/anti-money laundering, credit risk and operational risk—the demand for qualified technical personnel is high. However, having a technical person is only part of the recipe needed for quality model validation.

An understanding of business processes, bank products and services, as well as financial knowledge, all contribute to the challenge function's value in risk management. Finding model validation personnel with that ideal mix of quantitative backgrounds who also demonstrate familiarity with bank products has proven to be challenging for both small and large financial institutions.

As regulators continue to emphasize forecasting segmentation and enhanced modeling approaches, the pressure to find competent and available personnel could increase. This market stress for human capital could be further compounded by new financial institutions (as asset thresholds are crossed) entering into stress testing.

Influence

Model validation has explicit authority and responsibilities supported by policies and procedures, as well as senior management commitment. The challenge function has stature and visibility within the organization and is a respected partner to the business. The validation function works within an environment in which management can communicate findings and provide feedback that the first line of defense is held accountable to.

Shared Responsibilities

A healthy model validation function supports overall internal routines and controls for capital adequacy planning. In order to provide a foundation for success, roles, responsibilities, communication and deliverables should be adequately socialized and documented. As the table (*top right*) shows, model developers, independent validators and internal audits have specific roles to play in all stages of the modeling process.

Activity Players	Development	Implementation	Production	Reporting	Validation
Model Developers	• Code • Document assumptions, theory, and testing	• Conduct user acceptance tests (UAT)	• Monitor performance	• Support user interpretation of model results	• Provide code and documentation
Independent Validators	• None (maintain independence)	• Review implementation	• Periodic reviews	• Ensure model reports are used appropriately	• Evaluate • conceptual soundness, outcomes analysis, • ongoing monitoring
Internal Audit	• Evaluate adequacy of development guidelines • Test completeness of development documentation	• Test systems development life cycle (SDLC)	• Evaluate model risk monitoring controls	• Evaluate completeness of reports	• Evaluate design adequacy of validation guidelines • Test effectiveness of validations

Source: Protiviti

Common Model Validation Findings

Financial institutions, large and small, have many common challenges with their implementation and/or execution of model development. Those include:

1. Development challenges

A. Data constraints to proper testing and analysis
B. Lack of alternative model analysis
C. Too many performance testing exceptions.
D. Inadequate understanding of modeling software functionalities.
E. Limited staffing resources creating concentrations in personnel, i.e. few resources responsible for the majority or all of the model development.
F. Difficulty in selecting the appropriate level of conservatism.

2. Documentation challenges

A. The lack of explanation on assumptions and overlays.
B. Inadequate or missing model validations performed on third-party models.
C. Development documentation that is not clear or does not crisply explain the model, model functionality methodology and limitations.

Model validation is high on regulators' lists of priorities and will remain so for the foreseeable future. Financial services firms therefore cannot afford to be negligent in ensuring they have a credible validation program in place, which is independent and competent, but that also can be used to assess forecast methodology, assumptions and management overlays.

A quality model validation program with a strong governance, comprehensive model coverage and clearly communicated findings should only make stress testing results more meaningful and capital planning better informed. ■

It was authored by Chris Albela, Director, and Snehal Kanakia, Senior Manager.

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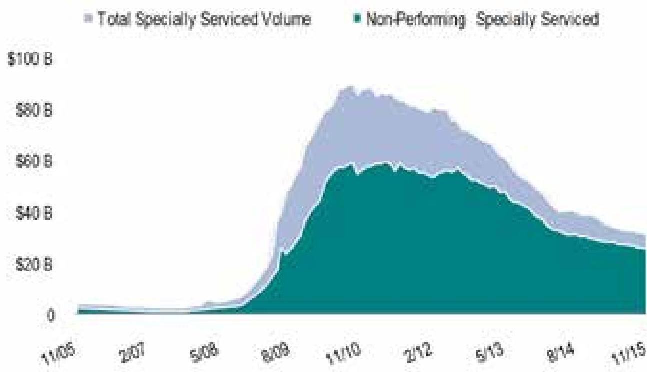
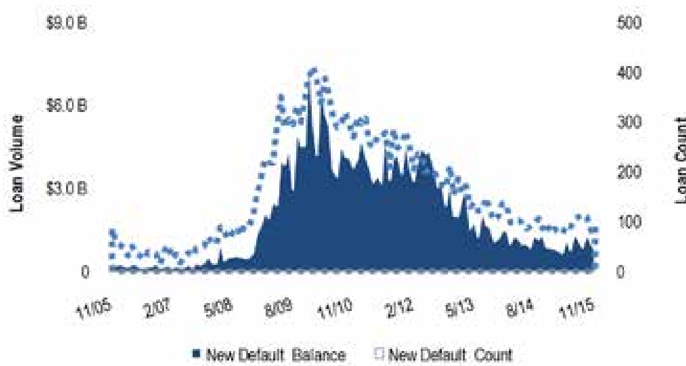


Source: Trepp LLC

A total of $31.86 billion of CMBS loans were in the hands of special servicers as of November. That's down from $39.23 billion a year earlier.

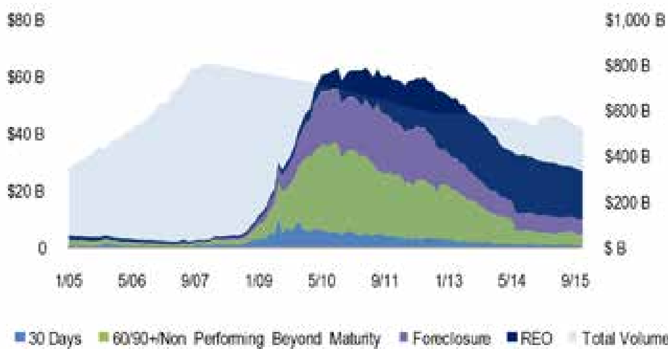
Monthly New Defaults



Source: Trepp LLC

Last year, an average of $956.4 million of loans defaulted every month. That was down from the $1.1 billion monthly average for 2014. Last March saw only 75 loans with a balance of $652.5 million default, while June saw 104 loans with a balance of $1.4 billion default.

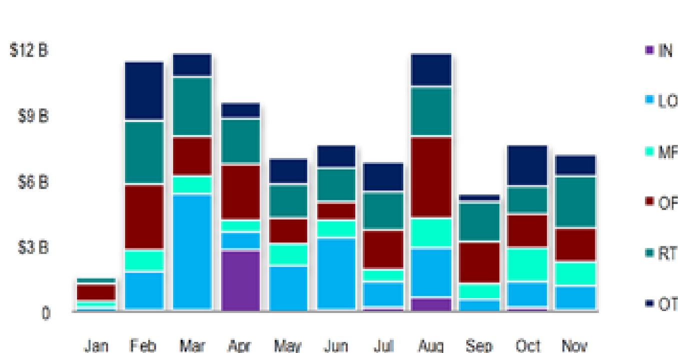
Delinquency Breakdown



Source: Trepp LLC

A total of $26.4 billion of CMBS loans were delinquent as of the end of November, down from $30.2 billion a year earlier. Every delinquency category, except for matured nonperforming, has improved, with the volume of loans classified as more than 60-days but less than 90-days late dropping by 45 percent to $1.4 billion.

2015 CMBS Activity



Source: Trepp LLC

An average of $8.1 billion of CMBS was issued every month last year through November. A total of $20.9 billion of office loans and $20.5 billion of retail loans were securitized during the year, followed by $19.6 billion of hotel loans, $9.4 billion of multifamily loans and $5.2 billion of industrial loans.

Delinquencies by State

Mountain
7.33%

Northwest
Central
4.76%

Northeast
Central
6.50%

New England
4.04%

Mid-Atlantic
5.82%

Southeast
Central
6.72%

Pacific
3.41%

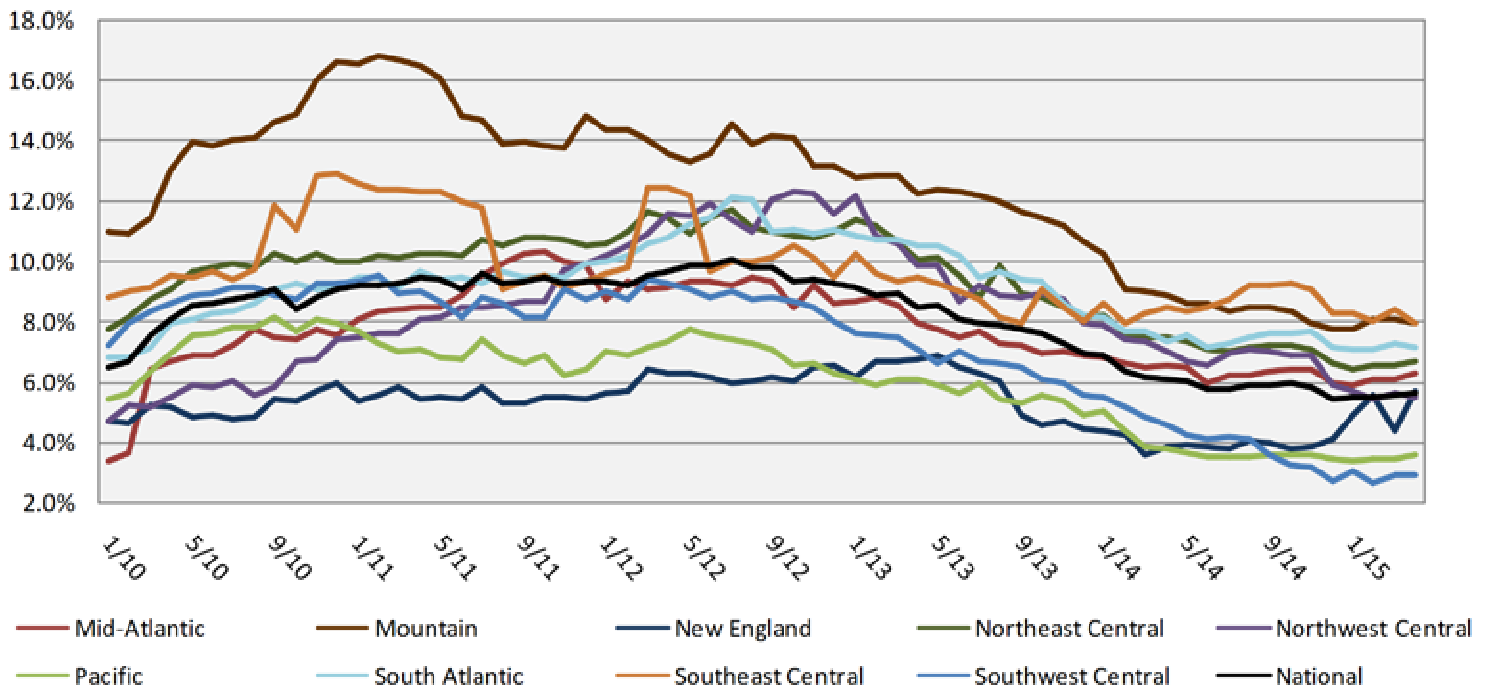
South-
Atlantic
6.67%

Southwest
Central
2.54%

Legend
0.00%
1.00%
2.00%
3.00%
4.00%
5.00%
6.00%
7.00%
8.00%
9.00%
10.00%
≥ 11.00%

Source: Trepp LLC

Delinquencies by Region



Source: Trepp LLC

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