A Closer Look at the First CMBS Deal Compliant with Risk Retention Rules

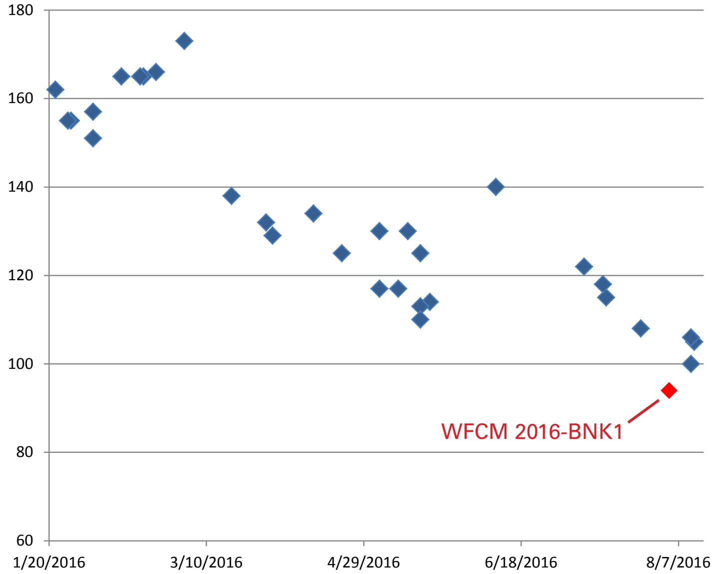
Earlier this month, the CMBS market welcomed its first conduit offering with a risk retention structure formulated to comply with Dodd-Frank regulations. Sponsored jointly by Wells Fargo, Bank of America, and Morgan Stanley, the $870.6 million WFCM 2016-BNK1 is the first to feature a vertical interest strip, becoming the industry's preliminary example of a potential deal structure that can be adopted to meet regulatory standards. Other structural strategies that are risk retention compliant would include a "first loss" horizontal option and an "L-shaped" arrangement, which is a combination of the vertical and horizontal structures. The BNK1 deal has been designed to satisfy both US and European credit risk retention requirements in an effort to attract a larger pool of investors. After the rules go in effect in December 2016, such deals will become the structural norm for CMBS securitizations.

According to the deal's prospectus documentation, the issuing parties determined that none of the loans fall under "qualifying CRE loans." These are loans backed by qualifying assets that meet certain underwriting standards that are, therefore, granted full or partial exemption from the requirements. As such, the $43.5 million vertical interest strip was calculated from the entire pool balance. The three bank issuers retained 5% of the fair value of each tranche in proportion to the bank's relative contribution to the collateral portfolio. Wells Fargo (39.40%) and Bank of America (35.5%) collectively retained close to 75% of the risk retention interest while Morgan Stanley (25.20%) held the remaining quarter. If the banks decide to follow all the provisions of the vertical risk retention option, they would be required to retain their slice for a set number of years without hedging or transferring the credit risk.

Due to heavy investor interest, "all-bank" collateral backing, and sponsor "skin in the game," the pricing of the WFCM deal blew past the previous lows recorded for issuance spreads in 2016. The AAA LCF priced at 94 basis points over swaps while BBB- spreads at the bottom of the investment grade stack came in at 425 basis points over swaps, tighter than initial talks. The 94 basis point swap for the benchmark class ranks as the tightest conduit pricing of the AAA since June of 2015. Thanks to the recent CMBS rally, the three subsequent conduits that priced after BNK1 also showcased some of the tightest spreads of the year but with a slightly higher risk premium, falling within the 100 to 106 basis point-range for the super senior.

Backed by 46 properties, WFCM 2016-BNK1 includes 40 loans with a WALTV of 55.6%, a WADY of 15.04%, and a WADSCR of 2.35x. Roughly 66% of the loans have a partial or full term interest only structure while nearly 70% were originated to refinance existing debt.

Figure 1. New Issue AAA LCF Spreads of 2016 Conduits



Office loans make up the largest share of the deal's overall balance at 31.6%, followed by retail (26.2%), lodging (15.2%), and industrial (11.2%). In terms of geographical composition, 70% of the loans are secured by properties ranked in the top 25 MSAs. Most of the exposure is concentrated in California at 18.2%. Massachusetts (11.4%), Texas (10.7%), Nevada (9.9%), and New York (8.7%) round off the top five states with the most collateral representation in the deal based on loan balance.

Figure 2. Deal Summary*

Class	Balance ($)	Coupon (%)	Credit Enhancement (%)	Fitch Rating	Pricing (%)	Pricing Swap
A1	36,136,000	1.321	30	AAA	100.000	S + 36
A2	230,000,000	2.399	30	AAA	102.997	S + 92
A3	267,018,000	2.652	30	AAA	102.997	S + 94
ASB	45,766,000	2.514	30	AAA	100.998	S + 84
AS	67,197,000	2.814	21.875	AAA	102.995	S + 110
B	44,452,000	2.967	16.5	AA-	102.996	S + 125
C	39,284,000	3.071	11.75	A-	99.996	S + 170
D	39,284,000	3.000	7	BBB-		
E	18,608,000	2.585	4.75	BB-		
F	8,271,000	2.585	3.75	B-		
G	31,013,795	2.585	0	NR		
RRI	43,527,883					
Total	870,557,678					

*As of Pricing

The top three largest loans in WFCM 2016-BNK1 are the $80 million The Shops at Crystals, the $80 million Vertex Pharmaceauticals HQ note, and the $71.4 million One Stamford Forum. Slated to mature in July 2026, the three loans constitute over 25% of the deal.

An $80 million piece in the deal is part of a $550 million loan behind The Shops at Crystals mall situated on the Las Vegas Strip in Nevada. The 262,327 square foot high-end shopping center is part of a hotel, retail, and casino complex known as CityCenter that opened in 2009. The Shops at Crystals currently serves as the flagship location of luxury brands such as Louis Vuitton, Prada, Gucci, Tiffany & Co., and Ermenegildo Zegna. The loan was underwritten with a DSCR of 3.41x at 92% occupancy. Earlier this year, the mall was acquired by Simon Property Group and Invesco Real Estate for $1.13 billion.

The $80 million Vertex Phamaceuticals HQ note comes from a $425 million loan backed by a 1.1 million square foot urban office complex in the Central Business District of Boston, Massachusetts. Built in 2013, the property is 95.47% occupied by Vertex Pharmaceuticals, a Boston-based biotech company focused on research and treatments for serious and life-threatening conditions. Vertex's lease runs through December 2028 which is over 2 years after the loan matures. At securitization, the property was appraised for $1.2 billion while DSCR and occupancy clocked in at 6.31x and 98%.

The third largest note in BNK1 is a $71.4 million loan that comprises the A-1 portion of two pari-passu notes totaling $110 million. Built in 1973 and renovated in 2000, the underlying collateral is the One Stamford Forum building in downtown Stamford, Connecticut. The 504,471 square foot office property is fully leased to UBS Group AG and Purdue Pharma through December 2020. Although UBS does not physically occupy any of its space as the largest tenant (66.89%), the firm has subleased 98% of its footprint to three smaller tenants. Purdue Pharma currently occupies 33.11% but is contracted to take over the entire building

Figure 3. Top Five Loan Details

Property Name	The Shops at Crystals	Vertex Pharmaceuticals HQ	One Stamford Forum	Renaissance Dallas	Pinnacle II
Securitized Balance	$80,000,000	$80,000,000	$71,387,964	$60,000,000	$40,000,000
Underwriter	Wells Fargo/BoA	Morgan Stanley	BoA	Wells Fargo/BoA	Wells Fargo
City/State	Las Vegas, NV	Boston, MA	Stamford, CT	Dallas, TX	Burbank, CA
Property Type	Retail	Office	Office	Hospitality	Office
Appraised Value	$1,100,000,000	$1,198,000,000	$227,000,000	$118,800,000	$142,000,000
DSCR	3.14	6.31	1.73	2.64	2.11
Notes	The $80 million portion of a $550 million mortgage, comprised of 11 A notes, 11 B notes, and 9 subordinate notes	The $80 million A-1 portion of 10 pari passu notes totaling $425 million.	The A-1 portion of 2 pari passu notes with a cut-off balance of $109.8 million.	A $60 million loan on the full-service Renaissance hotel.	A $40 million piece of 3 pari passu notes totaling $87 million loan on a class A office building which is fully occupied by Warner Brothers Entertainment

between 2021 and 2031. DSCR at securitization was reported at 1.73x while the property received an appraisal of $227 million.

In order to monitor the deal's collateral performance more carefully, a risk retention consultation party (RRCP) appointed by the majority holder(s) of the RRI interest has non-binding consultation rights in certain matters pertaining to specially serviced loans. However, this right can be terminated and is subject to certain loan exclusions. Expected to be the primary choice for the initial RRCP, Wells Fargo will represent the interests of the risk retention holders and may consult with the servicer to provide recommendations for further action. The servicer will not be obliged to carry out these recommendations, especially if they conflict with certificate holder interest or goes against servicing policy and standards.

For inquiries about the data analysis conducted in this research, contact press@trepp.com or call 212-754-1010. For more information on Trepp's CMBS products, contact info@trepp.com.

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