



THE PRIMARY SERVICER (THE POOR RELATION)

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INTRODUCTION

In the CMBS industry at the moment the focus seems to centre on the role of the Special Servicer. These are the people who come in like fire fighters to deal with a problem once it has burst into flames. The poor relation of the industry is the Primary Servicer and yet his role is crucial to the future success of the CMBS market. In fact, if the Primary Servicer is effective he may even be able to prevent the Special Servicer Transfer Event which would activate the Special Servicer's appointment. An ounce of prevention is worth a pound of cure, and for investors it is clearly more prudent to head off a disaster beforehand than to deal with it after it occurs.

While current attention in the CMBS market is predominantly on the Special Servicer, the industry should actually be far more focused on the pure fundamentals of servicing. The Special Servicer is responsible for dealing with a problem or problems, which have occurred due to a Special Servicer Transfer Event. However, there is another party, the Primary Servicer, who can and should be dealing with the day to day duties akin to a "Prudent Lender". It is the sole responsibility of the Primary Servicer to be diligent and proactive to each and every underlying loan. They are effectively living the deals on behalf of their Noteholder and investor audiences. Typical levels of diligence that they should provide and monitor include:

- Covenant compliance checks (ensuring that each reported borrower covenant can be substantiated)
- Property reporting diligence (know what and when to question and in a timely manner)
- Property awareness (knowing the pitfalls and dealing with issues as appropriate)
- Property inspections (having property experts inspect particular assets within a loan or portfolio to assess the risks with the building and or tenants)

- Regular borrower contact (understanding the borrowers objectives, business plans i.e. are they in line with expectations on funding date)
- Tracking and ensuring the timely delivery of borrower Compliance reporting, such as Financials, Annual Budgets / Business Plans and Quarterly Reporting

The challenge for the CMBS industry is that while it may appear that these are fundamental duties and obvious obligations for a Servicer, in what is essentially a volume driven business, inevitably instances occur when some of these simple and obligatory tasks are ignored. When all is well in the underlying market this is not necessarily a significant problem. In today's volatile market, however, this is not the case.

Primary Servicers that are diligent and proactive can without doubt assist in the prevention, although not necessarily the cure, of problematic transactions. Upon evidencing a deterioration in a transaction, which maybe as simple as an Interest Cover Ratio decreasing to within a few points of its cash trap or default levels, a Primary Servicer should be diligently working closely with a borrower to find a solution.

This solution may initially be a temporary one, with a cash deposit or taking additional collateral but nonetheless it is a stop gap to hopefully a longer term solution.

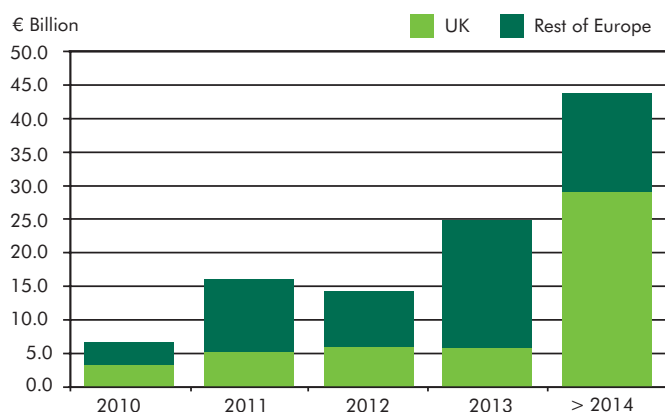
A point made earlier about “understanding the borrowers objectives and business plans”, is paramount for a Primary Servicer. These fundamentals, together with the monitoring, will allow them to assess if the borrower is in fact being a diligent landlord and that the cashflows detailed in the business plan are actually deliverable and achievable. After all it’s not all about rent collection and hence interest payment, it’s more about understanding the realistic net operating income and its effect on the underlying transaction. This can therefore only be done with the knowledge of the underlying markets, sectors and assets as well as having restructuring capabilities.

The Primary Servicer should be capable of developing a robust business plan and working with, and monitoring the borrower to ensure the business plan is implemented. The overall aim is to ensure the value of the cash flow and underlying asset is maximised.

It also may actually be prudent for a Primary Servicer to liaise closely, at this point, with the named Special Servicer on the transaction, who should have the requisite expertise to discuss the possibilities on trying to get the transaction back onto a good footing. This inevitably involves agreement on potential fee sharing.

Primary Servicing is therefore critical to the success of the CMBS industry. Primary Servicers must focus on the up and coming maturities, even those that are 18 to 24 months out from now, especially if you consider the €130bn of outstanding CMBS and circa €80bn of maturities over the next 3 years or so. There may be an opportunity to negotiate extensions for some upside i.e. trapping cash to de-lever loans or put towards portfolio improvements. An extension to the Maturity Date could even attract a partial debt repayment from the equity behind the transaction.

European CMBS Maturity Profile



Source: Standard & Poors

These represent just a few very simplistic proposals that enable the Primary Servicer to show their ability to negotiate and understand the underlying transactions and deliver an improved solution to their audience, the Issuer, Note Trustee and Noteholders.

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