



**SummerStreetAdvisors**

A Wave of Loan Maturities  
&  
PJ Finance Case Study

April 26, 2013

# AGENDA

- Summer Street Advisors
- Wave of Loan Maturities?
- Case Study: PJ Finance – CMBS Loan Restructuring

# Summer Street Advisors

Commercial  
Real Estate  
Solutions

Experience in all major CRE asset classes:

- Office
- Retail
- Industrial
- Multi-family
- Condominium
- Hospitality
- Golf Courses
- Self Storage
- RV Resorts
- Vacation Ownership
- Manufactured Housing
- Healthcare

Senior Level  
Expertise

Experience in all aspects of risk management, due diligence and underwriting:

- First Mortgage Debt
- Securitized Debt
- Leases
- Subordinated/Mezzanine Debt
- Preferred Equity
- Leveraged Equity

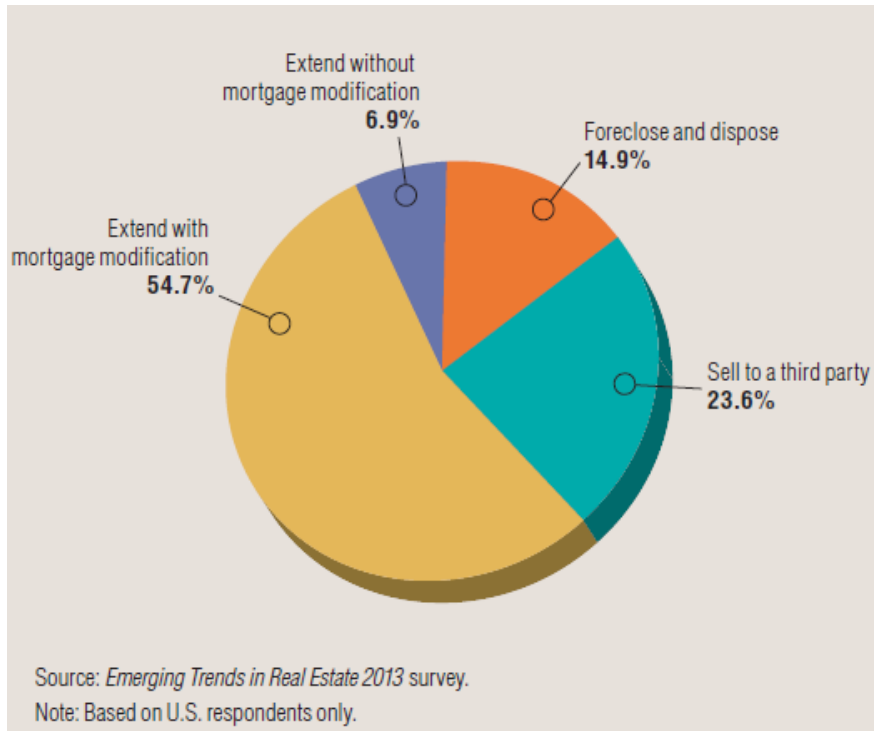
Results  
Driven

Deep industry knowledge and experience with data-driven analyses:

- Due Diligence – desktop (time-sensitive), full document review (Six Sigma/LEAN-derived disciplines)
- Underwriting & Valuation – assess asset quality (risk/market); portfolios, individual loans
- Loan & Loan Process – risk rating/reserve analysis; default/loss assessment; stress testing; best practices
- Transaction Management – efficiency to closing process
- Loan Workout/Asset Management – recommend actions; execute strategy

# A Wave of Loan Maturities – What will be the Resolution?

# Matured Loans – Preferred Strategy



- “Extend and pretend” remains to be the preferred strategy (61.6%).
- Banks need to “clear the decks” before they can lend on a meaningful basis.

# A Wall of Maturities



Source: Trepp LLC, August 2012

# Resolution Strategies

- Restructure/Modify & Rescue Capital
  - Evaluation of status - current losses
  - Ability to reset value
  - Market viability
  - Human capital resource availability
- Foreclosure/Deed-in-Lieu
  - Judicial v. non-judicial (\$\$\$\$ & Time)
  - Court systems (Judge) vs. default/sale
- Loan Sale
  - Small Loan in a large portfolio v large loan (in proportion to portfolio)
  - Universe of prospective buyers
- Refinance

# Refinanceable?

- 60% of 2006 & 2007 vintage CMBS 5-year loans which have matured in the last 2 years have not been able to refinance

	Average First Lien Debt Yield	Bottom Decile Average First Lien Debt Yield
CMBS 2010 - Present	11.60%	8.70%
% of 2006 & 2007 CMBS Average first Lien Debt Yield Less than Corresponding 2010 Debt Yield	85%	55%

- Assuming similar yield distribution of CMBS and non-CMBS loans, then somewhere between \$495 billion (at 8.7%) and \$765 billion (at 11.6%) will need some sort of alternate structure in order to refinance

Source: TCW Group – Fixed Income Commentary: January 7, 2013

# What has to Happen?

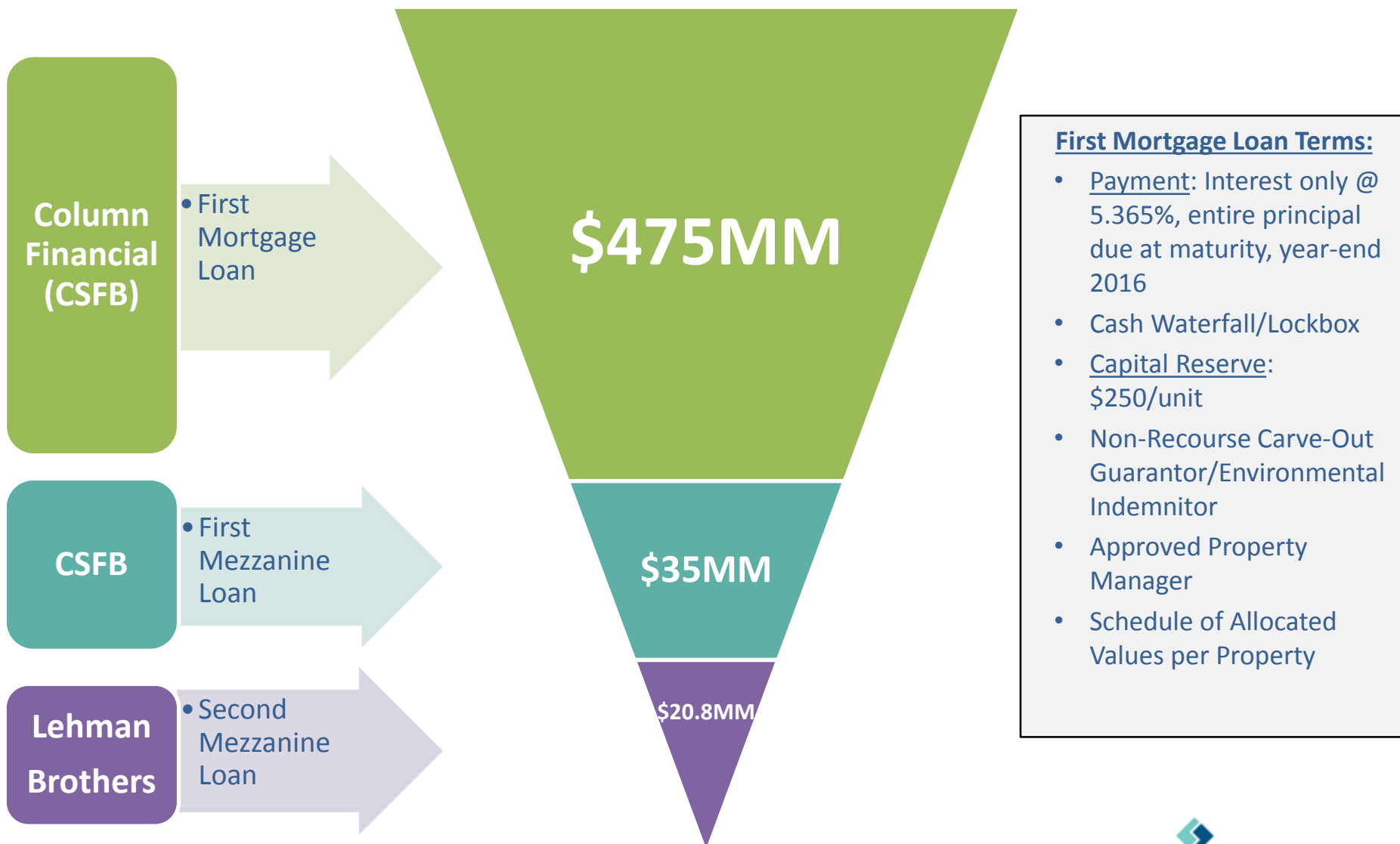
- Market continues to relax its underwriting standards
- Net Operating Income of CRE improves
- Current loan-to-value ratios need to be reduced through write-downs from modifications or equity infusion

# CMBS Restructuring Case Study

## PJ Finance

# Loan Origination Debt Structure - March, 2007

## \$530.8 Million



# The Collateral

32 Class “B” and “C” multi-family properties  
+/- 9,500 units

**Dallas, TX (45%); Houston, TX (8%); Corpus Christi, TX (6%); Phoenix, AZ (19%); Atlanta, GA (8%); Ft. Lauderdale, FL (7%); Orlando, FL 3%; and Nashville, TN (5%)**



# The Collateral



# The Players

## At Loan Origination

- **Lenders:**
  - Credit Suisse/First Boston (“CSFB”) (1<sup>st</sup> Mortgagee – subsequently securitized)
  - Credit Suisse/First Boston (1<sup>st</sup> Mezzanine Lender)
  - Lehman Brothers (2<sup>nd</sup> Mezzanine Lender)
- **Borrower:** Affiliates of Alliance PJ Holdings
- **Guarantors:** “Shell” entity affiliates of the Borrower (for non-recourse carve-outs and environmental obligations)
- **Property Manager:** Affiliate of the Borrower

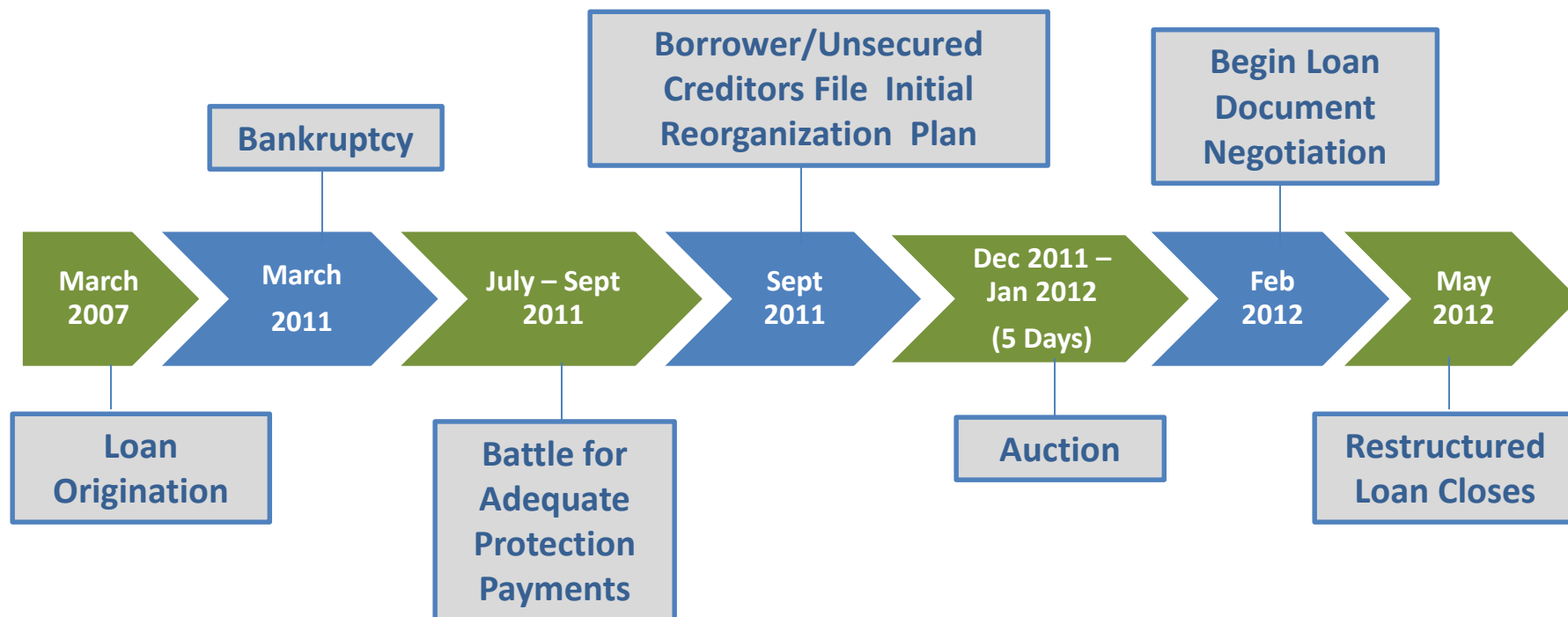
## During Bankruptcy

- **Lender:** Special Servicer for CMBS Trust
- **Borrower:** Equibase Capital Affiliate
  - Purchased 1<sup>st</sup> Mezzanine position from CSFB post-closing
  - Foreclosed out Lehman Brothers (2<sup>nd</sup> Mezzanine Lender)
- **Guarantors:** “Shell” entity affiliates of the Borrower (for non-recourse carve-outs and environmental obligations) – interests transferred but still a “Shell”
- **Property Manager:** West Corp., an affiliate of the New Borrower
- **Unpaid Vendors/Contractors:** Later became the unsecured creditors
- **Financial Advisors:** Ernst & Young (accountants for the debtor/borrower); CBRE Capital Advisors (retained to raise equity for a restructured borrower)

# The Issues

- Borrower filed for bankruptcy
- Guarantor a “shell” entity with no assets
- Deteriorating properties (need for capital, decreasing tenant quality, poor management, many adversarial parties)
- Borrower inexperienced in operating real estate (affiliate of mezzanine lender which foreclosed and stepped into ownership position)
- Lockbox “broken” in bankruptcy and borrower using cash to sustain (not improve property) and pay its professionals
- Borrower attempts to force lender to accept its own equity and restructured debt proposal

# How the Timeline Played Out



# The Bankruptcy

## Borrower's Initial Filing

- **Value of Collateral:** Asserts \$200 million of value evaporated
- **New Capital Partner:** Borrower attempts to put a new capital partner in place to dictate terms of new financing
- **Auction:** Borrower to initiate and control auction process for new capital
- **Allocation of First Mortgagee Debt:**
  - \$275 Million Secured 1st Mortgage
  - \$200 Million Unsecured Note (deficiency claim)

## During Bankruptcy

- **Lockbox/Cash Management Agreement:** Broken – several months of no payments to Lender
- **Properties:**
  - **Occupancy:** Pre-bankruptcy had decreased to approximately 77% due to off-line units (markets typically 90-95%) – borrower begins to re-tenant but with poor quality
  - **Physical Status:** Monies being used to bring units on-line and not for capital expenditures
- **Initial Plan Filed By “New” Borrower and Unsecured Creditors:**
  - **Auction for New Sponsorship:** To be run by “New” Borrower’s own financial advisor
  - **New Equity Investment:** \$10 million
  - **Secured Claim for the Trust (1<sup>st</sup> Mortgage):** Ranging from \$305-\$375 million -- remaining portion to be unsecured or an immediate loss -- attempt to “cramdown”
- **Borrower Estimate of Trust Recovery:** \$260 - \$300 Million

# Lender's Response & the Failed Mediation

- Never received any acceptable proposals for committed new equity or restructured debt
- Objection to initial plan of reorganization
- In face of largest creditor contesting plan, judge orders mediation
- Mediation fails
- Endorse appointment of independent “CRO” to oversee reorganization plan process – maximize recovery to all
- Insist and negotiate for more transparent auction process

# The Auction

- Auction procedures negotiated by all parties and court issues order
- CBRE and CRO to manage auction
- 5 bidders (including borrower) submitted qualified bid packages
- Auction timeline: Over approximately 5 days in Chicago and New York in December, 2011 and January, 2012 (in excess of 60 hours of open bidding)
- Winning Bidder: GAIA Investments and Starwood Capital
  - Substantial increase in net present value recovery to the trust over the borrower's initial plan of reorganization (approved plan of reorganization estimated mid-90% recovery to trust)
  - Substantial enhanced protections added to modified loan documents

# The Auction Bid Structure

Principal Balance
A Note
B Note
C Note
Interest Rate
A Note
B Note
C Note

Maturity Date
New Equity Amount
New <i>Equity</i> Sponsorship
Non-Recourse Carve-Out/ Environmental Guarantor
Property Manager
Property Replacement Reserves

Cash Flow Waterfall Priority (after Property Operating Expenses)
Property Reserves
Interest
Preferred Return
Principal Amortization
New Equity Investment
Amortization
Any Waterfall Shortfalls
Unsecured Creditors

Capital Event Priority
A Note
B Note
C Note
New Equity Investment
Other Property Sale/Refinance
Fees, Expenses of Trust

Equity Investment
Initial Minimum for Property
Third Party Professionals
Trust Expenses
BK Administrative Costs
Unsecured Creditors

# The Winning Bid/Restructuring the Debt

Principal Balance	\$503,000,000 Fully Secured by First Mortgage
A Note	\$423,000,000
B Note	\$52,000,000
C Note	\$28,000,000
Interest Rate	
A Note	3% in Yr. 1, escalating to 5.365% in Yrs. 6-8
B Note	Non-interest bearing
C Note	Non-interest bearing

Maturity Date	January 11, 2020
New Equity Amount	\$22,500,000 + \$5,000,000 supplement
New Equity Sponsorship	GAIA Real Estate Starwood Capital
Non-Recourse Carve-Out/ Environmental Guarantor	Kenneth Woolley with Starwood Affiliate Backstop
Property Manager	Pinnacle Property Management
Property Replacement Reserves	\$625/Unit in Yr. 1 \$650/Unit in Yr. 2 Decreasing to \$475-\$575 in Yrs. 3-8

# The Winning Bid/Restructuring the Debt (cont'd)

Cash Flow Waterfall (after Property Operating Expenses)	
Category	Priority
Property Reserves Interest Preferred Return Principal Amortization New Equity Investment Amortization Any Waterfall Shortfalls Unsecured Creditors	<ol style="list-style-type: none"> <li>1. Property Reserves</li> <li>2. A-Note Interest</li> <li>3. Preferred Return on Outstanding Equity Investment</li> <li>4. General Unsecured Creditors (capped annually and amount owed)</li> <li>5. New Equity Investment Amortization (\$0 in Yr. 1 and at varying caps in subsequent years)</li> <li>6. 90% to A-Note Principal Amortization; 10% New Equity Investment Amortization</li> </ol> <p><i>Potential Shortfalls in Items 3, 4 and 5 were also accounted for under catch-up provisions</i></p>

Capital Event Waterfall	
Category	Priority
A Note B Note C Note New equity Investment Other Property Sale/Refinance Fees, Expenses of Trust	<ol style="list-style-type: none"> <li>1. A Note Principal + Trust Disposition Fee (fee not paid if a refinancing)</li> <li>2. Outstanding Supplemental Equity</li> <li>3. B-Note Principal</li> <li>4. C-Note Principal</li> <li>5. Fee to the Trust</li> <li>6. New Equity Investment</li> </ol>

# The Winning Bid/Restructuring the Debt (cont'd)

Total Equity Investment: \$22,500,000 (combined with unutilized property cash) + \$5,000,000 working capital supplement	
Category	Allocation
Initial Minimum for Property	1. \$6,000,000
Third Party Professionals	2. Paid in Full
Trust Expenses	3. Substantially Paid
BK Administrative Costs	4. Paid in Full
Unsecured Creditors	5. Contributed to create fund which will be combined with cash from waterfall

## Contact Information



**SummerStreetAdvisors**

**Jack Mullen**

**Founder & Managing Director**

**(203) 293-4844**

**[jack.mullen@summerstreetre.com](mailto:jack.mullen@summerstreetre.com)**

**Steven Jason**

**Managing Director**

**(203) 293-4844**

**[steven.jason@summerstreetre.com](mailto:steven.jason@summerstreetre.com)**

**15 Ketchum Street, 2<sup>nd</sup> Floor, Westport, CT 06880**