Council Unveils Best Practices Proposal for CMBS Sector

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Commercial Real Estate Direct Staff Report

The Commercial Real Estate Finance Council has released a draft document outlining a series of what it terms best practices that should be followed in order to jump start the CMBS industry.

The document was distributed to attendees of the Council's annual convention at the Waldorf Astoria in Manhattan earlier this week by one of the trade group's forums. The forum is comprised of holders of investment-grade CMBS and providers of services to them and is designed to address issues that affect them.

The eight-page draft document is divided into two broad components: alignment of interests and transparency, with the former focused on the retention of risk by issuers of future transactions. The document is by no means set in stone. Instead, it was designed to spur talks among investors, issuers and other parties in the hopes of finalizing practices that would help prod new CMBS issuance.

The objective, said one panelist at the Council's convention, is to prompt "originators to write loans they like, not because they can sell them."

It is not without controversy.

While investors would prefer that issuers keep a 5 percent "vertical" strip of every new deal, on top of any B-piece that is sold, issuers are generally opposed to the rigid nature of the proposal.

For starters, the structure of CMBS would dictate that the bulk of the vertical strips they'd retain would be comprised of AAA securities, which by nature do not represent risk. And secondly, issuers might run into capacity concerns.

In addition, issuers would be restricted from hedging their risk positions for the life of the transaction or selling their risk pieces.

Forcing an issuer to keep 5 percent of every deal it sells would be analogous to forcing General Motors or any other car company to keep 5 percent of all the cars they build, said Jonathan Strain, managing director of JPMorgan Chase. Keeping the cars on the lot wouldn't make them better, he noted and suggested that better lender standards and representations and warranties would. He also said the retention requirement, as proposed, would penalize smaller issuers and favor larger issuers, who generally have greater balance-sheet capacity.

In terms of reps and warranties, the forum said it would recommend that the Council put together a task force to endorse a minimum set of representations.

Meanwhile, a proposal calling for every CMBS transaction to include an operating adviser, to be paid for by the trust and whose role would be to serve as a sort of ombudsman between investors and a deal's servicers, raised hackles. Some panelists questioned the wisdom of adding costs to transactions for a service that should already be provided by existing parties.

The draft document also calls for the public dissemination of a greater volume of collateral-level information on assets in any CMBS transaction. That would include financial reports for collateral properties and complete rent rolls. The latter would blend in with a proposal by Mortgage Industry Standards and Maintenance Organization, or Mismo, for a new technology standard for the mortgage industry. The standard would require that mortgage servicers include information on every lease in every property securing a CMBS transaction and would standardize the way property operating statement information is provided.

Currently, the investor reporting package, or IRP, that lays out what mortgage-level information must be made available to CMBS investors requires that rent information be made available only for the three largest tenants of any given property that backs a securitized mortgage. The mandated information includes tenant name, amount of space leased and lease expiration.

The proposal by the forum would broaden that information to include every lease for every property in every deal.

Servicers and property owners have long opposed such a mandate because of the costs involved in implementing the standard, and fear that the information could jeopardize the financial performance of a given property. If, for instance, a property owner knows the expiration date and rents of every lease in a neighboring property, he can siphon off tenants.

But proponents of greater transparency argue that the lease information is already available through third-party data providers, such as CoStar.

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