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Distressed Real Estate Symposium

CRE Workouts, Still the Same

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1. First Loss Position



First Loss Position

- In most debt stacks where there are two or more tranches of debt and one tranche is senior to the other, when a default occurs, the senior is paid in full before any payments are made to the holder of the junior tranche.
- We therefore refer to the junior tranche as the “first loss” position because, in a downside scenario, that is the position that will experience a loss before the more senior tranches.
- The senior position, in contrast, is protected by payment priority (among other things) so should be less interested in the outcome of the workout (i.e. it is likely to be paid irrespective of the form of the workout).



2. Basic Structures

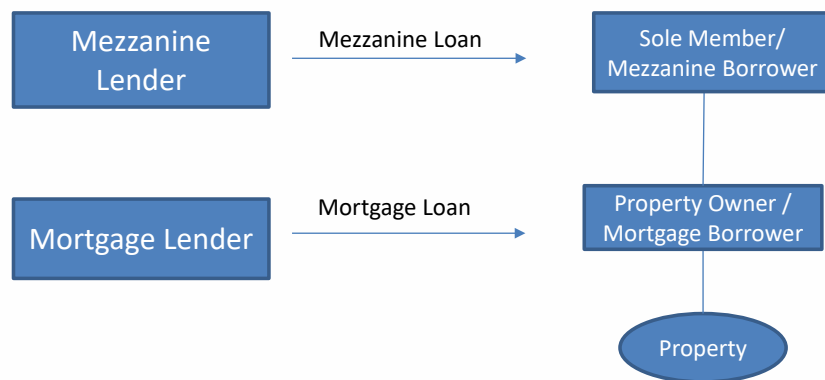


Basic Structures: Mortgage/Mezz

- Intercreditor: Two separate loans:
 - The mortgage lender, which is the lender to the property owner, is the senior lender.
 - The mezzanine lender, which is the lender to the sole member / parent of the property owner, is the junior lender.



Basic Structures: Mortgage/Mezz



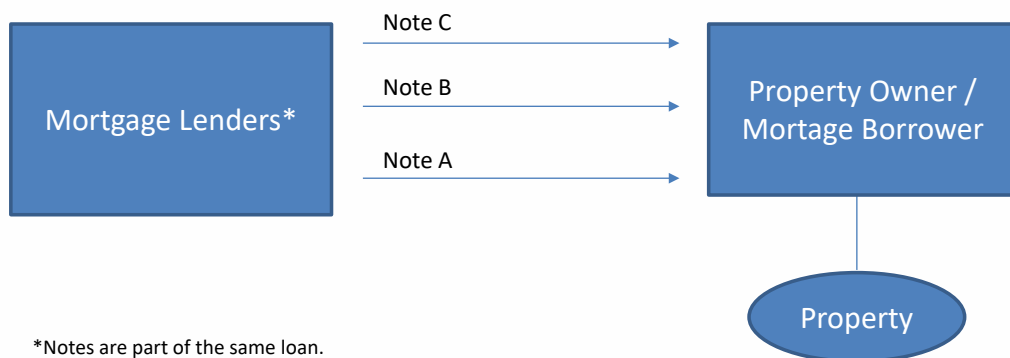


Basic Structures: Co-Lender

- Co-Lender: One loan that has been split into multiple notes or “tranches.”
 - There is only one borrower (the property owner), who has borrowed from multiple lenders
 - Borrower may or may not be aware of split / who is controlling, particularly if loan is agented.



Basic Structures: Co-Lender





Advantages/Disadvantages of Structures

- Intercreditor Advantages
 - Each lender has its own loan, so no need to agree with other debt holders on what to do (sort of – see below).
 - Junior lender can foreclose and keep senior lender in place (i.e. assume the senior loan).
 - Not subject to being “appraised out” (see below).



Advantages/Disadvantages of Structures

- Intercreditor Disadvantages
 - Junior loan is structurally subordinate.
 - Sits behind all trade & other creditors of property owner.
 - Will be equity in the event of a bankruptcy of property owner.



Advantages/Disadvantages of Structures

- Co-Lender Advantages
 - Reverse of the above.
 - Can foreclose out trade creditors.
 - If there is a recovery in value, are next in line to be paid after senior tranche.
- Co-Lender Disadvantages
 - You do not control your own destiny. In a quasi-joint venture arrangement with other lenders (both senior and junior, if any).



3. Control In Co-Lender Structure



Control in Co-Lender Structure

- First loss position controls
 - Who is first loss?
 - When / how determined?
- Who is first loss?
 - Most junior tranche with at least 25% of its value still in the money.
 - Typically calculated based on discounted (90%) value of the property, i.e., an assumed fire-sale price.
 - Right to regain control by posting "Threshold Event Collateral."



Control in Co-Lender Structure

- When determined?
 - "Control Appraisal Event"
 - Typically an Event of Default (but can have other triggers as well).
- Control not absolute because shared loan (i.e. will be subject to set of decisions that will require consent of more senior positions).
- In CMBS structures, only certain tranches of bonds are eligible to take control. If the most senior of these tranches is appraised out, then a control party for hire (Operating Advisor) takes control.



4. Control In Mortgage/Mezz Structure



Control in Mortgage/Mezz Structure

- Not control in the same sense as other structures because there are separate loans, so each lender can make its own decision with respect to its own loan.
 - Exception: there are a set of modifications that each lender is not permitted to make to its loan without the other lender's consent.
 - Most (but not all) of these restrictions fall away after an uncured Event of Default.
 - Lists should be different (senior can do more harm to mezz than vice versa).



Control in Mortgage/Mezz Structure

- So if no appraisal text / loss of control, how to deal with valuation issue?
 - Intercreditor places pressure on mezz lender to act.
- Most restrictions on senior lender amending its loan fall away if mezz lender does not cure senior event of default.
- Number of cures limited → mezz lender then required to initiate foreclosure.
- Purchase option also time limited (either outright or via price).
- At some point, if the mezz lender does not see recovery value in its position, it will not spend money to exercise its cure remedies or foreclose, in which case senior lender will no longer be required to standstill (i.e. control de facto shifts to senior). Fact specific inquiry, including regarding costs of mezz foreclosure, including transfer tax.



5. What If You Can't Agree?



What If You Can't Agree?

- Purchase option
 - Exists in all structures
 - Price
 - Timing
 - Different structure in REMIC → right to buy whole loan out of trust



What If You Can't Agree?

- Foreclosure
 - Mezzanine Loan
 - Mezz foreclosure results in mezz lender becoming (owning) the property owner/mortgage borrower
 - Requirements under the Intercreditor Agreement
 - Replacement guaranties
 - Replacement developer / property manager



What If You Can't Agree?

- Foreclosure
 - Co-Lender
 - Co-lender likely to have "auto-foreclosure" regime if lenders can't agree
 - Lenders bid independently
 - Junior lender must cash bid through senior tranche (while senior is credit bidding)
 - If bids do not clear senior tranche, junior lender is eliminated
 - Senior/sub co-lender should not have LLC paragraph seen in pari co-lenders, which contemplate lenders taking the property in a JV



Appendix A: Warehouse Lending Overview

Warehouse Lending Overview

CRE Mortgage Origination

MARCH 2025



Unless otherwise noted, information as of March 2025
Confidential and Proprietary - Not for distribution, in whole or in part, without the express written consent of ATLAS SP. It should not be assumed that investments made in the future will be profitable or will equal the performance of the investments shown in this document.

Warehouse Lending Overview

Definitions and capital stack

What is warehouse lending?

- Buyer closes an uncommitted debt facility which can purchase commercial real estate mortgage loans at an advance percentage to the underlying loan UPB.
- Warehouse lending provides liquidity and leverage to the originator or owner of commercial real estate mortgage loans.
- Commercial mortgage loans can be seasoned until retired at maturity or be pooled and contributed to a CRE CLO securitization.

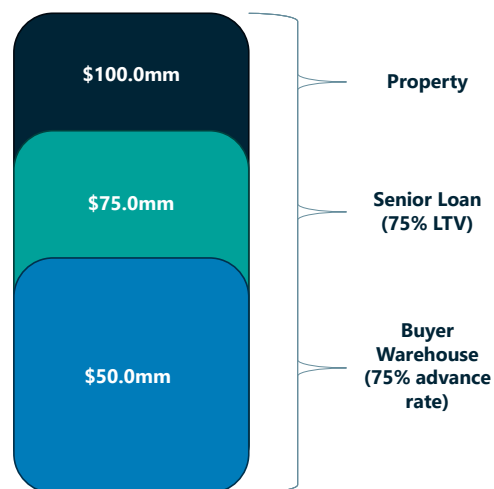
What is a repurchase agreement?

- Repo refers to the commitment the Seller makes to repurchase assets if requested by the Buyer (i.e. ATLAS SP).
- Collateral (mortgage loans) is pledged to a bankruptcy-remote SPV in exchange for financing.
- The Seller's Guarantor provides a guaranty ranging from full recourse to non-recourse, subject to bad-boy carveouts.
- The Seller is otherwise free to repurchase assets at any time subject to applicable exit fees, regardless of the term on the facility.
- Additionally, if collateral is no longer eligible, Buyer will request Seller to repurchase the asset.

Waterfall

- All loan cash flow (P&I) is remitted by servicer to a cash management account at a mutually agreed institution. Seller then manages the waterfall which can be processed monthly or intra-period:
 1. Servicer and cash management account bank net their fees from any remitted cash.
 2. Seller is paid interest, pro-rata principal if paydowns or payoffs have occurred, and any applicable fees agreed upon.
 3. Seller receives all excess cash.

Warehouse lending capital stack



Private and Confidential 2

Warehouse Lending Overview

Offerings across the credit spectrum

Example Facility Terms			
Term	364-day	2-3 year	3+ year / matched term
Recourse	Full recourse	25% recourse	Non-recourse
Facility Spread to 1M SOFR	200bps	250bps	350bps
Credit / Mark	Daily mark-to-market	Credit marks / partial	Triggers / non-mark-to-market
Max Advance Rate	80%	75%	60% - 65%



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Appendix B: Commercial Real Estate's Debt Maturity Wall Is Unprecedented. Is It Disastrous?

Commercial Real Estate's Debt Maturity Wall Is Unprecedented. Is It Disastrous?

By William Russo, Andrew Manley, Ian Mackie

Between now and 2028, the commercial real estate (CRE) sector will see more than [\\$2.8 trillion in debt](#) come due as mortgage loans and extensions made prior to and during the COVID pandemic run their course. This is on top of the \$541 billion in debt that matured last year—the [highest amount](#) ever in a single year.

The vast scale of that debt, current state of real estate capital markets, and certain asset-specific idiosyncrasies are prompting speculation around whether parts of the industry are headed for a disaster. The situation echoes the 2008 financial crisis—the last time a CRE debt maturity wall loomed—further stoking fears about how (or whether) borrowers will be able to refinance and potential downstream economic effects.

To understand the seriousness of the current debt wall, it's important to reflect on how the situation took shape and differs from what came before. Several key factors—including interest rates, collateral availability, and consumer behaviors—will play a consequential role in shaping what comes next.

Most important, borrowers (and their lenders) facing this challenging refinancing environment are not without options. Here's what they should know.

Why This Debt Maturity Wall Is Different

This is not the first debt maturity wall or wide-reaching challenge the industry has faced. Prominent examples include the 2008 financial crisis and the savings and loan crisis of the early 1990s, which was caused by the [outsized leveraging](#) of the 1980s commercial construction boom. However, this moment does have some important differences.

The trend in capital costs and availability is different.

Capital costs generally compressed starting in the early to mid-1990s. While the approach to resolving nonperforming loans differed during the previous two crises, falling interest rates and steady value recovery enhanced the functioning of real estate capital markets and enabled borrowers and lenders to transact. Because capital costs compressed and asset values recovered, borrowers were more capable of servicing and ultimately refinancing debt. As a result, loan extensions led to positive outcomes, which created a tailwind effect for transactions.

The rapid run-up of interest rates since 2022 has created the opposite situation. Although the Federal Reserve is expected to relax rates in 2024 or 2025, over the past two years the industry has faced the fastest and most substantial interest rate hikes since the 1980s. Even with rate relaxation, the prevailing rate environment likely will remain elevated—in many cases by a factor of more than two.

All things being equal, the obvious effects of this situation will be two-fold: It will diminish borrowers' ability to meet debt-service requirements (i.e., coverage) *and* will apply downward pressure on available loan proceeds. This will likely be intensified by valuation pressures, which will impact different asset classes in different ways.

Real estate capital markets are not functioning efficiently.

A dearth of CRE sales since the COVID pandemic has rendered price discovery difficult. As borrowers and lenders struggle to find valuation data points, we can expect a more intensive focus on existing or in-place cash flow in the underwriting of real estate loans and valuation of assets. Additionally, this focus will likely contribute to reduced loan proceeds as lenders' appetites for underwriting prospective cash flows will probably remain muted until market clarity improves.

History suggests that price discovery will again become possible as transaction volume normalizes. However, fundamental shifts in the functionality and usage of certain asset classes likely will have a more enduring impact. This is especially true of the hardest-hit asset types, like retail and office, where tenant demand has become extremely difficult to underwrite.

The CRE sector is grappling with post-pandemic cultural shifts.

This occurs namely in declining demand for office space and shifting retail formats. Technology is the clear catalyst behind these trends, as remote work and online shopping have become commonplace. Unfortunately, solutions are not nearly as obvious; this has intensified questions about the reliability of cash flows.

COVID did not *cause* these changes. Rather, COVID *accelerated* existing trends as the sudden closure of offices pushed companies to widely use technology tools to maintain productivity. The average office space per employee had been [shrinking for years](#), well before 2020, suggesting that a full return to occupancy may be unlikely even as the pandemic recedes in the rear-view mirror.

It's worth noting, however, that asset classes within CRE are not all facing the same circumstances. Some have benefitted from the same technological changes that have negatively impacted office and retail sectors. In particular, industrial warehouse and distribution space saw advantages from online retailing and the resulting need for efficient distribution networks to promote rapid delivery of goods.

Geography and age also play a part. Older buildings can face greater valuation pressure as tenants migrate or "trade up" to superior-quality assets. The same can be said for geographic markets; superior and more desirable locations will benefit from tenant migration to quality, while less desirable locations will continue to diminish.

In addition, in the UK and EU, borrowers with older buildings may face even more valuation issues than those with newer CRE assets thanks to [stronger environmental, social, and governance \(ESG\) building regulations](#), particularly around [energy efficiency](#). These requirements—typically involving [expensive refurbishments](#) to older properties—are coming into effect as many borrowers are exploring refinancing options, heightening their risk profile and raising refinancing costs on top of these other challenges.

What This Could Mean for CRE

Do these unique circumstances spell disaster for CRE, borrowers, lenders, and the broader economy? Short answer: probably not on a universal basis, but that doesn't mean there won't be challenges ahead.

The past six months have offered some startling examples of value deterioration in office space assets. They include a Washington, DC, office that sold for [less than one-third](#) of its loan value, as well as the tallest office building in Fort Worth, whose lender bought it back at a foreclosure auction for [under 10 percent](#) of its earlier sale price. Similar examples are likely to follow as borrowers and lenders are unable to "amend and extend" loans any further.

Yet a flood of distressed asset sales has not happened. This suggests that for the few borrowers that default, many more successfully negotiate with lenders behind the scenes. If this persists over the next few years, as the post-pandemic readjustment and financial recovery stabilize, then the debt maturity wall may prove to be more of a rolling hill.

Of course, it's too early to definitively say how the CRE debt situation will evolve. The magnitude and direction of interest rates rising or falling will have a significant impact on capital costs, available loan proceeds, and financing transactions in general. Changing habits of consumers, employers, and employees may have a more enduring effect.

Options When Facing CRE Debt Maturity

Borrowers and lenders facing maturing CRE loans typically have three options available:

1. **Refinance or Extension:** Refinancing is by far the preferred option for both borrowers and lenders. Extension is a viable strategy if value and/or market recovery will permit a future repayment. Yet refinancing or extending at a higher interest rate can prove challenging, especially if it results in reduced proceeds.

Lenders may demand a “cash-in re-fi” where the borrower must inject additional capital to balance valuation shortfalls to refinance or extend a loan. This may be a difficult ask for borrowers who are pessimistic about the future value of their asset and fear wasting further capital—or for those who don't have the money. Negotiating is also more difficult when multiple lenders are involved.

2. **Sell the Asset:** Though a less-common option to date, this may be the most attractive choice for borrowers either unable or unwilling to front additional capital to refinance a loan. It may mean that the borrower will make nothing—or possibly lose capital. In severe cases, the lender may suffer a principal loss. In the absence of more viable alternatives, however, this may be the best option for both borrower and lender.

Buyers with capital to spend, however, could snap up deals. In fact, opportunistic funds in search of distressed debt or assets are becoming increasingly prevalent.

3. **Foreclosure:** This tends to be the option of last resort. Lenders have learned that taking ownership of and managing collateral is too much of a burden and requires expertise that does not typically exist in-house. This is particularly true for small and regional banks. Still, foreclosures may result if borrowers and lenders are too far apart on better options.

Whether it proves to be a wall or a speed bump, CRE's maturing debt situation differs meaningfully from what has come before, with expanding capital costs, inefficient capital markets, and profound cultural change creating a unique moment for the sector. The challenges may be significant, but current signs are not pointing toward disaster—and borrowers have tools at their disposal to weather what comes next.

2025 DISTRESSED REAL ESTATE SYMPOSIUM



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