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Debt collectors bulk up to deal with US property loan defaults

Rise in distressed commercial mortgages puts special servicers in demand

Joe Rennison in London YESTERDAY

Debt collectors for US property loans have been on a hiring spree to deal with a deluge of defaults and prepare for lenders to assume control of shops and hotels — an alarming omen for owners of billions of dollars worth of commercial mortgage-backed securities.

When property loans that have been bundled into these bonds come under severe stress they are passed to so-called special servicers, which work with borrowers to either find a way to keep them paying their mortgage, or to eventually foreclose on the property and recoup cash for bondholders.

The onset of coronavirus and worldwide lockdowns have plunged a vast number of commercial properties into jeopardy, putting these companies in demand.

“It’s a naturally countercyclical business,” said Alex Killick, head of special servicing at CW Capital, who joined from JPMorgan Chase at the start of 2008.

CW Capital, responsible for just under $34bn of commercial mortgages according to data from Wells Fargo, says it has boosted the number of staff working on distressed loans by almost 30 per cent, taking the total workforce across the business to more than 100 people. Almost $4bn of loans have been transferred to its hands since the pandemic hit.

Midland Loan Services — part of the financial services group PNC and one of the country’s largest special servicers, named on almost $100bn worth of CMBS deals — has increased its staff by double-digits. The value of loans on its books has leapt from $1.4bn in February to almost $9bn this month.

The dramatic rise in unpaid mortgages has already led to $54bn of loans transferring to special servicers in recent months — more than 10 per cent of the CMBS market tracked by the data company Trepp.

LNR Partners, the special servicing arm of Starwood Property Trust — which invests in some of the riskiest slices of CMBS deals — has reallocated staff from investing in new deals to managing deals in distress.

“We have dramatically increased the resources available to special servicing,” said Adam Behlman, president and chief investment officer of the real estate investing and servicing division of Starwood Property Trust. “We have moved a lot of people into the loan asset management area and hired externally.”

Each of the special servicers said foreclosure on the properties they are responsible for was a last resort. But the longer mortgages remained unpaid, the more this will come into focus. Trepp estimates 12 per cent of all CMBS loans will be foreclosed on as a result of the coronavirus crisis. Bondholders are braced for losses: in August, the asset manager Pimco warned of “significant pain” to come for the sector.

The Hilton-run Palmer House in Chicago, America's oldest continuously running hotel, is the sole loan backing a 2018 CMBS deal. The hotel was reappraised at $305.5m last month, down from $560m and less than the $330m mortgage on the property. Foreclosure proceedings have begun.

Sometimes proceedings are started early because of the length of time it can take to complete, with different rules governing each US state and some areas imposing foreclosure moratoriums.

A group of 48 hotel properties across 21 states that secure one $780m mortgage for Tom Barrack's Colony Capital are moving to foreclosure after an agreement on a loan modification could not be reached, according to filings.

Starting foreclosure proceedings is sometimes considered to be a tactic to pressure borrowers into resuming mortgage payments for fear of losing the property altogether.

"We are faced with a choice, do you drag this out through the crisis and see where we end up, which is not a good outcome for bondholders?" Mr Killick said.

"On the other hand, rushing into foreclosure can put the lender in the position of having to fund expenses on the property. There is not a rush to foreclose but we also don't want to create a huge pile of zombie loans that as we move into next year still won't have paid."