MBA COMMERCIAL REAL ESTATE FINANCE

Role of CMBS in the Financing Of Commercial and Multifamily Real Estate in America

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About MBA

The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. MBA represents all segments of the real estate finance industry, uniting the interests of diverse stakeholders, from Main Street to Wall Street, spanning all aspects of real estate finance, including commercial, multifamily, and residential. Our membership of 2,300 companies includes all elements of real estate finance: mortgage banking companies, insurance companies, commercial banks, thrifts, REITs, securitization conduits, and others in the mortgage lending field. As the leading advocate for real estate finance, MBA represents and serves our members through advocacy, networking opportunities, news, data and leadership. For additional information, visit MBA’s website: mba.org/cref or contact us at cref1@mba.org.
# Table of Contents

**Executive Summary** ................................................................................................................................. 4

**Introduction** ............................................................................................................................................... 6

**The Key Role of Commercial Mortgage-Backed Securities in Commercial Real Estate Finance** ................................................................. 7

**Overview of CMBS** .................................................................................................................................... 9

  - Types of Transactions .......................................................................................................................... 9
  - Structural Features .......................................................................................................................... 9
  - Size of the Asset Class and Trends ................................................................................................ 10
  - Transaction Participants in CMBS .................................................................................................. 11

**History of CMBS Lending in CRE Debt** .................................................................................................. 13

  - 1980s and 1990s: RTC Trusts Vehicles then CMBS ..................................................................... 13
  - Early 2000s: The Size of the Market Share Rises ......................................................................... 14
  - 2008 and The Great Recession ......................................................................................................... 14
  - Post-2010 Legacy Workouts and CMBS 2.0 ............................................................................... 15

**CMBS Regulatory Regime** ...................................................................................................................... 17

  - Risk Retention .................................................................................................................................. 17
  - Regulation AB ...................................................................................................................................... 17
  - Operating Advisor .............................................................................................................................. 18
  - Volcker Rule ....................................................................................................................................... 18
  - Regulation 17-g5 ................................................................................................................................. 18

**Why CMBS is Important to the Lending Market** ................................................................................... 19

**Conclusion** ............................................................................................................................................... 20
Executive Summary

• CMBS plays a significant role in the commercial and multifamily lending market as a provider of fixed-rate and floating-rate mortgage loans for a wide variety of properties in primary, secondary and tertiary markets across the country.

• The role of CMBS includes providing access to non-recourse capital for a broad range of borrowers and property types.

• The CMBS product allows access to commercial real estate debt investment opportunities for different types of investors with the benefit of a credit rating, providing enhanced liquidity for the instrument. The liquidity of CMBS bonds for investors can be a clear benefit as compared to the liquidity profile of whole loan alternatives. For investors seeking exposure to commercial real estate, CMBS provides borrower, geographic and collateral diversity in addition to exposure to different levels of risk and yield for the range of related risk-adjusted returns.

• Through decades of experience including several market cycles, CMBS structures, underwriting and reporting have evolved and contributed to increased standardization and transparency both within CMBS and across the wider CRE finance ecosystem. The transparency created by CMBS has been one of the factors that attracted more institutional investors to commercial real estate generally.
• Often, CMBS loans are originated with the assistance of mortgage bankers, mortgage brokers, loan correspondents or other intermediaries who play integral roles in the origination process. Given the complexities involved in CMBS transactions, originators and intermediaries provide vital education and counsel to borrowers regarding the process and substance of the life of the CMBS loan.

• While challenges remain for private label CMBS, these financing vehicles and the securitization technology they employ remain important components of a healthy commercial real estate finance marketplace.
Introduction

MBA’s membership consists of the broad range of capital sources, intermediaries, servicers and other parties involved in the finance of real estate. MBA represents its broad membership before policymakers, delivers industry information and research, provides education and training programs, and convenes market participants at industry conferences and meetings.

These activities help its members, including CMBS market participants, expand their businesses, strengthen company performance and manage operational risk. MBA and its members have successfully worked together for many years to shape the CRE finance industry. Virtually all the various parties that are involved in CMBS lending are members of the MBA.

This paper is a high-level summary of private-label CMBS, its history and the vital role it plays as a capital source for the financing of commercial real estate. While the GSEs, Fannie Mae and Freddie Mac leverage securitization and each have large bond product offerings, this paper will focus specifically on conventional private-label CMBS. The value of the securitization technology that underpins private label CMBS and various other CRE finance executions is tremendous in that it connects investors to tailored risk/return profiles that would not otherwise be available.
The Key Role of Commercial Mortgage-Backed Securities in Commercial Real Estate Finance

Relative to many of the other capital sources in commercial real estate, CMBS lending is a relatively new way to source capital for commercial real estate debt. CMBS lenders emerged as a viable business in the commercial and multifamily financing market in the 1990s. CMBS lenders are conduits that connect commercial real estate borrowers to bond market investors with various risk tolerances.

CMBS, like other financing sources, involves details and nuances that could fill volumes. This paper, however, provides an overview that should be informative to those interested in commercial real estate and those who are interested in how this capital source developed and why CMBS will continue to be important to the CRE finance marketplace.

**FIGURE 1: CMBS STRUCTURE WITH FEATURES AND PARTIES**

Conduit Loan is another name for a CMBS loan. This refers to a loan that will be pooled together with many other loans into a conduit transaction. While all conduit loans are associated with CMBS, there are also CMBS loans that would not be referred to as a conduit loan, i.e. — loans that are securitized in a CRE CLO transaction for instance.
The CMBS lending industry has a wide variety of investor participants, with various investment needs and different business approaches to filling those needs. A network of companies formed around CMBS during the 1990s and beyond to meet these diverse needs. These include originators, servicers, rating agencies, data providers, accountants and law firms. CMBS lenders make a wide variety of loans by size, geography, market type, etc. Loan sizes start around $1 million and can exceed $100 million. CMBS lending provides capital across various property types to borrowers in primary markets; however, they also provide financing alternatives to those borrowers in secondary and tertiary markets where capital may not have been as plentiful at certain points in time.
Overview of CMBS

TYPES OF TRANSACTIONS
What is generally called CMBS is really a series of related transaction types which all share the common technology of pooling mortgage loans to unaffiliated borrowers and selling securities backed by the cash flow of those loans. The three principal types of transactions are detailed below.

The Conduit
The securitization of relatively large numbers of typically fixed rate, long term, mortgage loans, generally 5–10 years. These transactions are typically known as conduit transactions. The revenue of this business model comes from spread income during an accumulation period, banking fees and gain on sale of the securities.

The Commercial Real Estate Collateralized Loan Obligation (CRE CLO)
CRE CLO transactions typically have a smaller number of floating rate short term loans with properties that are transitional in nature with a business plan to stabilize property operations. These loans are pooled in non-registered and non-REMIC securitizations in which the transaction sponsor typically owns a relatively thick slice of the most junior securities in the transaction.

The Single Asset Single Borrower (SASB)
In these transactions, a single loan, which may be secured by a single asset or a portfolio of assets owned by a single borrower, is securitized. Typically, a securitized lender will make the mortgage loan with the intention to securitize. Investors who appreciate the information density of a single asset transaction and do not mind the lack of diversity as compared to conduit and CRE CLOs are the ideal investors for these transactions.

STRUCTURAL FEATURES
Once the originated loans are pooled together and the bonds are issued, the cash flow from these commercial mortgages is split into different classes of bonds which provide investors with various risk/reward opportunities via different pricing and payment priority for each class. The senior investors, in line to be paid interest and principal first, take less risk than the most junior investors who are in line to be paid principal and interest last, and the price paid for bonds generally reflects these dynamics.

The result of this sequential payment of interest and principal is that any losses on the loans backing the CMBS security are allocated first to the most junior classes first. This creates a cushion for senior bondholders referred to as credit enhancement or credit support, a key factor in credit ratings for CMBS. Other key factors that play a role in analyzing the risk inherent in CMBS transactions for rating agencies (nationally recognized statistical rating organizations or “NRSROs”) and/or investors include typical commercial real estate finance calculations such as loan to value ratios, debt service coverage ratios and debt yields, as well as the pool characteristics such as market, property type and borrower concentration and risk mitigants built into both the loans and the specific CMBS transaction.

Many conduit transactions are governed by a pooling and servicing agreement (PSA) which adds an additional layer of controlling documentation above and beyond the borrower’s mortgage loan documents. The PSA details rights, responsibilities and various requirements for transaction parties included in a securitization and is distinct from but subject to the loan documents. One key structural feature which places certain requirements and constraints on many conduit CMBS loans is the tax structure.

CRE CLO is a securitization vehicle backed by a pool of mortgages on transitional properties. The properties have loans that are commonly referred to as bridge loans, meaning that the properties are underperforming and the borrower intends to complete a business plan that will ultimately stabilize property performance. These bridge loans generally have a floating interest rate and a pool that serves as collateral for CRE CLOs is generally much smaller in terms of number of loans than a conduit transaction.
needed to comply with Real Estate Investment Mortgage Conduit (REMIC) under the Internal Revenue Code. This structure came into place in 1986 and enables securitization to function as a business model. The REMIC is a pass through entity for tax purposes; however, certain requirements must be met to ensure this status is maintained. For example, REMIC requirements dictate that a loan deposited into a REMIC conduit may not be significantly modified and also what can or cannot be done to resolve defaulted mortgage loans. The pool also must generally be “static,” meaning no additional loans can be added to, or loans modified in, the pool after issuance. Most CRE CLOs and SASB transactions are not structured through REMICs.

Because CMBS bond investors are not generally involved in the origination of the loans supporting the CMBS securities, the loans and the CMBS securities are described along with their risk characteristics in a prospectus supplement document which details various transaction features, loan/property details and the different classes of investment certificates offered (or tranches). An example of a pool feature that could be described is prepayment risk and mitigants. CMBS loans, as commercial loans, generally have some type of prepayment protection, which often takes the form of a yield maintenance or a defeasance feature. These features essentially balance borrower and investor interests, by creating a method that allows the borrower to prepay the loan (essentially substitute the collateral with cash or cash equivalent) prior to the scheduled maturity. Doing so provides bondholders with predictable cash flows and duration which they can model with certain default assumptions.

A primary benefit of securitization for investors is the ability to invest in a diverse set of cash flows across different markets, property types, and sponsors; however, because the pool of mortgages is split into different classes of bonds, different investors in a given transaction can at times, have competing interests creating a structural tension. This tension can be compounded by the structural feature which allows the purchaser of the most junior bonds to determine the party that serves as special servicer. The special servicer makes recommendations and executes on strategy for resolving defaulted mortgage loans. Accordingly, PSAs generally provide a the “Servicing Standard” requiring, in part, that the Servicer represent all of bond investors in the pool “as a single whole” as they discharge their duties, thereby not putting the interests of any one investor group above another’s.

This potential set of issues makes transparency of information and communication a key structural component of CMBS paramount for all parties involved in a CMBS transaction.

**SIZE OF THE ASSET CLASS AND TRENDS**

At its peak in 2007, the mortgage debt outstanding for the CMBS market was $800 billion while its size was $480 billion by August 2018. Aside from shrinking for a few years with significantly lower annual issuance than the extremely high bar set in 2005–2007, the clear trends since 2010 include increased lending and issuance of single asset and single borrower transactions ("SASB"), agency mortgage-backed securities and CRE CLOs.
The size of the CMBS asset class matters not only for CRE finance market share and the participants trying to compete in it, but also for institutional bond investors. Because of the large size of the bond market, investors have many options to consider. Thus, having sufficient scale to attract investor demand is a key element for the long term viability of CMBS.

**TRANSACTION PARTICIPANTS IN CMBS**

**Originator**
The mortgage loan originator sources, screens and underwrites mortgage loans and ultimately lends money to commercial real estate borrowers, with the goal of selling the loans (as a whole loan seller) to depositor under a mortgage loan purchase agreement making certain representations and warranties, while noting certain possible exceptions.

**Loan Seller/Depositor**
Each CMBS transaction has one of more loan sellers that sell the loans to the trust. Each loan seller will sign a mortgage loan purchase agreement (“MLPA”), pursuant to which the loan seller will make representations and warranties with respect to the loans. This party may also be the loan originator. The depositor aggregates mortgages and transfers these mortgages to the Trust via the issuance of securities. The depositor may also be a loan seller.

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**Defeasance** is a process by which a borrower may prepay their mortgage loan before maturity. The borrower must purchase U.S. Treasury Bonds or some other cash equivalent to replace the interest income that the lender would have received if the loan was not prepaid.

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**Market Size and Market Share**

The overall U.S. commercial and multifamily debt market outstanding is over $3.46 trillion in size. Private-label CMBS is a significant player in this market.

Statistics from the MBA Quarterly Data Book — Q1 2019:

- Total commercial and multifamily debt outstanding $3.46 trillion
- Private-label CMBS hold 13.5% of all commercial multifamily debt equaling $466 billion

**FIGURE 2: COMMERCIAL MULTIFAMILY MORTGAGE DEBT OUTSTANDING, Q1 2019**

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks &amp; Thrifts</td>
<td>39%</td>
</tr>
<tr>
<td>Agency and GSE portfolios and MBS</td>
<td>19.9%</td>
</tr>
<tr>
<td>Life insurance companies</td>
<td>15.4%</td>
</tr>
<tr>
<td>CMBS, CDO &amp; other ABS issues</td>
<td>13.5%</td>
</tr>
<tr>
<td>Others</td>
<td>12.3%</td>
</tr>
</tbody>
</table>

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Issuer
The issuer sells the bonds that are supported by cash flow from a pool of loans. It is also obligated to report on and take responsibility for certain regulatory matters.

Trustee
The trustee, usually a commercial bank, is an independent third party that administers the trust for the benefit of investors as detailed in the PSA.

Servicers
There are three types of servicers involved in CMBS transactions — master, primary and special servicers. Their various roles are defined in the PSA and supporting documents and involve actions from the tracking, receipt and remittance of loan payments to asset management, critical reporting, underwriting changes to the loan, property or borrower, default management and workout, investor relations, overall monitoring of borrower and property performance and compliance, and [managing] the competing interests of the parties. The master servicer focuses on day to day loan administration, reporting and advancing. The primary servicer handles various specific performing loan tasks which include maintaining relationship with the borrower. Finally, the special servicer is responsible for giving certain consents and approvals and making recommendations in the instance(s) when a mortgage loan defaults. All three servicers are subject to the Servicing Standard.

Rating Agencies
The rating agency role of providing ratings on a CMBS pool’s bonds is critical. Many investors require minimum rating from one or more rating agencies to meet their investment criteria.

Some investors require specific NRSROs to rate their investments to comply with their enabling legislation or organizational documents. These agencies analyze the credit of CMBS loans and transactions and issue ratings in addition to reviewing servicer operations. Ratings are assigned when bonds are issued and additionally maintained and monitored during the life of CMBS transactions. Credit ratings criteria are instrumental in determining the make-up of securitization pools since the investment grade rating is so important to many investors as well as to the issuers. The agencies rely on transaction information provided by servicers to conduct surveillance of their existing ratings and loan performance.

Investors
Investors in CMBS bonds may purchase bonds up and down the capital stack that carry different risk — investment grade to below investment grade (or unrated) bonds. To simplify, they can be thought of in three categories although an investor might purchase bonds in more than one category. Investment grade investors acquire bonds that are the most senior in the capital stack and the most likely to be repaid given their place in line, first to be repaid. The senior bonds also pay the least amount of interest compared to more junior bonds given their lower default profile. Mezzanine purchasers purchase bonds that are neither the most senior nor the most junior in a CMBS transaction.

The purchaser of the most subordinate bonds is referred to as B-Piece Buyer and is granted certain contractual rights as the holder of the first loss position in addition to a higher yield given the risk profile.
History of CMBS
Lending in CRE Debt

1980s AND 1990s: RTC TRUSTS VEHICLES THEN CMBS
The 1980s was a period of a few episodic bespoke deals. The market began to grow in earnest with the passing of the 1986 tax law, which among other changes, created the REMIC structure that remains central to most CMBS issuances to this day.

Following a 1990–91 recession and accompanying distressed mortgage market, the Resolution Trust Corporation (RTC) was created to facilitate the resolution of, among other things, distressed commercial real estate debt held by failed the savings and loan institutions. The RTC built on prior, simpler models of securitization and invented (for all intents and purposes) the securitization structure that is in place today, including pooling of loans under the REMIC structure and, at the time, significant amounts of governmental support to facilitate sales of the resulting securities. This government initiative effectively incubated CMBS and by the mid-1990s, the securitization business was well established. By the mid-1990s, CMBS had shifted from a tool for managing distressed debt to an alternate source of capital for commercial real estate.

The CMBS industry required large amounts of data to operate and satisfy investor and rating agency demands. The various types of information include loan payment information (receipts, remittances, advances, expenses, etc.); performance information (delinquency, watch lists, property financials); and compliance data (triggers and liquidity tests, guarantors, audits). Data standards were created and new providers of data emerged to meet these needs. The transparency that was created by this public commercial mortgage market impacted all participants in the market and has been one of the factors that has attracted more institutional investors to commercial real estate. There was also a belief that periods of illiquidity, like the one experienced in the early 1990s, will be reduced or mitigated by the flow of public capital into the real estate market.

In August 1998, the CMBS market experienced its first hiccup. In a series of events beginning with Thailand's currency dropping precipitously in 1997 after which other Asian currencies followed suit and ultimately Russia defaulting on its sovereign debt, the spreads that investors were willing to accept (a proxy for their risk tolerance) increased significantly. This series of events and a variety of other factors led to a “risk-off” capital markets environment, worsening economic performance and lower CMBS issuance. The required mark to market and margin calls from mortgage warehouse and repo lines as the values of mortgages declined caused significant losses for both originators and investors and the failure of several industry participants.
EARLY 2000s: THE SIZE OF THE MARKET SHARE RISES

While the CMBS market recovered by December 1998 and a healthy pace of issuance resumed soon after the events surrounding Russia’s default and the market’s reaction, September 11th brought another slowdown for lending driven in part by the cost and availability of terrorism insurance. Congress removed some of this uncertainty in 2002 by providing an insurance backstop, the Terrorism Risk Insurance Act (TRIA), and by 2003, a growing pace of CMBS issuance resumed.

Before the events of 9/11, economic fundamentals had been weakening. In response to these economic conditions, the target federal funds rate was substantially lowered from 2000 to 2003. This created a backdrop of rising commercial real estate prices, leading to increased sales and refinance transactions, which would continue for a number of years during which time the CMBS market share of commercial real estate finance grew exponentially. CMBS loans, unlike many other commercial real estate loans, were non-recourse — meaning a borrower or its sponsor would generally not be liable for more than the equity investment included in their loan transaction on the condition that they did not commit any fraudulent acts.

By the mid-2000s, CMBS originations reached approximately 50% of CRE finance origination market share. The mood, given the growth and positive performance, was captured pre-crisis by industry participant Joseph Forte (now a partner at Sullivan and Worcester) who wrote:

“The effects of the development of a CMBS market on the primary mortgage market will be considerable. The benefits should include increased liquidity; avoidance of cyclical credit crunches; increased geographic, borrower, and collateral diversification; evolving market standardization of underwriting; servicing and documentation; and the resulting stabilization of commercial property values. The disadvantages could include the risk that lenders may leave the real estate finance market or consolidate, the risk of poor underwriting and servicing, the loss of portfolio lender discipline, the loss of the personal lender/borrower relationship, the unresponsiveness of investors, and the risk of governmental intervention in the market.”

Some of Forte’s observations would prove accurate and these risks would be particularly problematic for CMBS lenders, investors and commercial real estate borrowers during the financial crisis and the period that followed.

2008 AND THE GREAT RECESSION

Commercial real estate, like so many other asset classes suffered during this time period due to lower economic growth as well as significant job losses. Many of the aggressive projections that had been made when underwriting loans before the recession did not materialize. The impact on commercial real estate performance and CMBS loan performance was significant. The broad potential economic impacts of the Great Recession led to the US government’s decision to inject large amounts of capital into the banking system, and the legislative and regulatory landscape shifted considerably across financial sectors including, but not limited to, CMBS after these events occurred.

The difficulty of maintaining functioning credit markets across various asset classes during 2008 and 2009 inevitably impacted commercial property finance, loan performance,
property values and CMBS bond values, along with the broader economy. The financial crisis and various watershed events leading up to a U.S. recession in 2008 have been described through many outlets since that time.

CRE finance (with the exception of multifamily finance which was largely supported by increased demand for rental housing) and CMBS issuance slowed to a trickle in 2008 and 2009 as demand dried up quickly and investment sales transaction activity stalled as well. The context for this was a struggling economy, where job losses and business slowdowns, impacted the property performance. Of note, the size of CMBS asset class went from approximately $800 billion in mortgage debt outstanding at year-end 2007 to closer to $400 billion at year-end 2017, given CMBS pool run-off numbers and decreased CMBS originations and overall issuance.

Figure 3 shows average reported losses across CMBS transactions by vintage pre-crisis as well as the average credit enhancement levels for post-crisis senior investment-grade bond classes (AAA, junior AAA and A). Credit enhancement levels represent the amount of losses than may be incurred in a CMBS transaction before a given class of bonds will incur a loss of principal. While the chart references average post-crisis credit enhancement levels which increased after the most recent US recession, even at the peak of the most aggressive underwriting in CMBS before 2008, the most senior investment grade CMBS bonds pre-crisis have not incurred any principal losses.

**FIGURE 3: CMBS LOSS SEVERITIES AND CREDIT ENHANCEMENT LEVELS**

![CMBS Loss Severities and Credit Enhancement Levels](image-url)

Source: Trepp, CMBS.com.
POST-2010 LEGACY WORKOUTS AND CMBS 2.0

The 2010 era started with a large number of defaults occurring as the stalled credit markets in the previous years had impacted both the availability of financing, commercial real estate property performance and values.

The largest three special servicers were acquired by private equity firms whose varied business models included traditional special servicing workout fees, in addition to other ancillary business opportunities such as property brokerage, acquisition, property management among other lines of business. Some of these types of opportunities available in legacy CMBS transactions would be removed from transaction structures in CMBS issued after 2008 and third party special servicers rather than B-piece buyers with a subsidiary as named special servicer would become a larger part of the CMBS market.

When new CMBS issuance began to recover in 2011, the market and structures had changed significantly. Some of the key shifts were smaller conduit pools by dollar volume and loan count than before 2008 which creates a larger potential concentration risk for certain investors across pools. Prior to the recession, as large loans were originated on trophy properties, the loan notes were split and included in multiple securitizations. Post-recession, certain investors have been more focused on avoiding too large an exposure to one sponsor, asset and submarket. An additional shift was an increase in compliance costs as various regulations promulgated by since the financial crisis.

Additionally, there are now more single asset and single borrower transactions (SASB) than before the crisis as well which began occurring around 2010 time frame and this trend has only strengthened. Lastly, the amount of agency MBS from both Fannie Mae and Freddie Mac is actually comparable to private label non-agency MBS issuance. This and other factors have changed the property type composition of CMBS pools.

FIGURE 4: CMBS DELINQUENCY RATES
CMBS Regulatory Regime

The CMBS regulatory regime expanded substantially after the Great Recession and the congressional passage of Dodd-Frank Act in July 2010. The legislation focused on securitization in particular with overarching goals of aligning investor and issuer interests and even more transparency.

The various agencies which have some level of oversight for various activities and participants involved in CMBS are the Board of Governors for Federal Reserve System, Department of Housing and Urban Development, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission. These six entities, for instance, jointly issued the risk retention rule. Given the role of securities in CMBS securitization, the Securities and Exchange Commission is a key stakeholder when it comes to the CMBS regulatory regime.

What follows is a brief discussion of the most important regulatory changes since the Great Recession that impact securitization.

RISK RETENTION

October 21, 2014, five federal banking and housing agencies and the Securities and Exchange Commission adopted a rule implementing credit risk retention for asset-backed securities. The rule requires sponsors of CMBS securities to retain at least 5% of the credit risk for a transaction’s collateral. Alternatively, an investor in the “B-piece,” the tranche with the highest risk profile — must. This skin in the game incentive is meant to align the interests of the sponsor with those of the investor, by requiring the sponsor to retain an economic interest in the performance of the loans supporting the CMBS securities (making the sponsor more likely to monitor and control loan quality). The risk retention rules are probably one of the most impactful changes made to the CMBS industry resulting from the Dodd-Frank law and its progeny. It has resulted in an entire new market in investing in risk retention securities and SASB as well as created a host of regulatory complexities that market participants must navigate.

REGULATION AB

Regulation AB, a rule promulgated by the SEC, governs the securitization of asset-backed securities sold to investors. Changes to Regulation AB which came into effect November 2015 and made significant changes to disclosure and structure of CMBS transactions. First, and most notable, the rule required each issuer to designate a senior officer to certify the veracity of the information provided about a transaction. The rule affected the timing of the distribution of offering materials, attempted to depress the importance of bond ratings provided by NRSROs, made other material changes in the offering process and enhanced the process to police the accuracy of loan level representations and warranties.

OPERATING ADVISOR

As part of the risk retention rule, operating advisors are required to play an oversight role in CMBS transactions. Starting in 2010-issued CMBS transactions and all those since with a B-piece buyer and special servicer playing roles in the transaction, the operating advisor is responsible for overseeing work of the special servicer on behalf of the trust and potentially recommending replacement of the special servicer if warranted. This transaction party did not exist in legacy CMBS issued before 2010.
VOLCKER RULE

Named after former Federal Reserve Chair Paul Volcker and enacted as part of the Dodd-Frank Act, the Volcker rule prohibits banking entities from engaging in proprietary trading and from owning or controlling hedge funds or private equity funds. The Mortgage Bankers Association previously stated that the rule in its current form “has hindered both market making functions necessary to ensure a healthy level of market liquidity and hedging necessary to mitigate risk.” The regulatory agencies announced changes in October 2019 that will go into effect in January 2020 with the expressed goal of reducing banks’ compliance costs while maintaining the rule’s effectiveness and consistency.

REGULATION 17G-5

In 2009, in an effort to increase transparency and mitigate conflicts of interest created by hired NRSROs, the SEC amended Rule 17g-5 under the Securities Exchange Act of 1934. The amended rule imposed additional disclosure and conflict of interest requirements on NRSROs and, by extension, additional disclosure requirements on issuers, sponsors, and underwriters of CMBS as well as other structured finance products. An issuer now must set up a web site that offers “free and unlimited” access to other non-hired NRSROs. This website is used for communication in credit rating process between the issuer and hired NRSROs. While this rule was intended to create additional transparency with the thought being to provide more openness with the capability for unsolicited ratings (non-paid) creating better information parity, one unintended consequence is challenges for market participants to get information post-issuance which creates less transparency in the secondary market.
Why CMBS is Important to the Lending Market

There are a number of factors to consider as to why private label CMBS is important to the commercial real estate finance landscape. First, the securitization technology developed by CMBS provides a variety of benefits to the broader market portfolio lenders as well. Investor benefits include diversification with exposure to varied sponsors, collateral in different markets, and differing property types that often perform differently. Further, investors can purchase different securities with different risk profiles depending on their appetite for such, investment objectives as well as yield requirements.

CMBS Lenders:

- Are natural providers of long term fixed-rate and in some cases, floating rate capital to secondary and tertiary markets where capital was not as plentiful prior to the development of CMBS
- Diversify risk in the system by distributing investments with risk/return characteristics that are catered to investor needs
- Can play a critical role when other capital sources become constrained due to economic or regulatory issues as occurred in the 1990s or due to concentrations (i.e. banks can only have so much exposure to one borrower or market, etc.)
- Are consistently in the market for loan opportunities albeit with the volatility of the capital markets being a feature of the product
- Are providers of a wide variety of non-recourse, assumable loans of various sizes, characteristics which are attractive to sponsors
- Will lend on a wide range of property types, borrowers and geographic locations
- Have provided standardization of underwriting, reporting and documentation that has benefited both CMBS borrowers and investors as well as the broader commercial real estate finance industry through increased transparency

While other sources of funding available for commercial real estate can each provide for many of these characteristics, CMBS has a unique combination that makes it a unique capital source. The innovations in CMBS have also been adopted by other capital sources resulting in improvements and standardization that benefits the commercial real estate finance market as a whole. CMBS is important for the commercial real estate industry and the communities the industry serves across the United States. Since the downturn structural enhancements have been made while the regulatory reforms made in the last few years and the industry self-regulation have provided improved rules for the road helping to ensure CMBS is here to stay. Further, the commercial real estate finance ecosystem and the borrowers, investors and communities it serves are better for having CMBS as an additional source of liquidity.
Conclusion

CMBS has and continues to play an important role in the commercial real estate finance industry. It has materially increased the range of finance products available to users of capital. It has brought a much wider and robust fixed income marketplace to commercial real estate. It has broadly transformed all commercial real estate lending transactions along with the introduction of its new technology, its transparency, and standardization.

In some cases, it has provided mortgage products to users of capital that might not have otherwise have had the ability to access these products and generally has buoyed the commercial real estate market, its growth and vibrancy. CMBS is and remains an execution characterized by innovation and will continue to embrace new products and services, fulfilling an important role in the commercial real estate finance ecosystem.