



News

'Innovative' Velvet loan restructuring proposed

The proposed restructuring of the Velvet loan, securitised in the Titan Europe 2006-2 CMBS, includes the deferral of interest - believed to be the first time this has featured in the European market. The restructuring, which also involves extending the loan maturity and investing in the underlying properties, is ultimately expected to increase the loan's recovery value.

"We believe that, given the limited flexibility to fund the necessary capital expenditure for underperforming properties, the interest deferral is a reasonable course of action in the event the borrower and/or sponsor lacks the financial means and when investment into the properties is highly likely to increase the recovery value," note CMBS analysts at Barclays Capital.

They add: "Notwithstanding further yield widening for German multifamily properties, investment in the Velvet loan property portfolio with the aim of reducing the maintenance backlog is likely to increase its value. In addition, we agree that the investments increase the chance of reducing the vacancy rate, which would be further value enhancing."

According to the special servicer on the transaction (Hatfield Philips), the multifamily properties securing the Velvet loan suffered from a substantial maintenance backlog. This affected the property value, which has declined by 51% since November 2005.

Over 2H10 the vacancy rate stabilised at a high level, which - in the opinion of the special servicer - can be attributed to the change of the asset manager. The new asset manager prepared a business plan indicating that, with proficient asset management, a value increase is possible over the years to come.

Based on a restructuring opinion, Hatfield Philips examined three work-out scenarios: an immediate sale of the properties; invest and hold until 2016; and invest and sell before 2012. Based on a NPV analysis, it chose the third option, which features a loan extension until December 2012 and a deferral of loan interest until then. The interest not paid will instead be invested in capital expenditure and property maintenance, which is expected to result in a lower vacancy rate over time and consequently a higher property value.

The restructuring plan foresees the disposals of some properties in Dueren, Herne and Gelsenkirchen in 2Q11 - generating proceeds of approximately €28m - and a sale of the remaining properties in 4Q12 for an estimated €125m. Not discounted and disregarding deferred interest, these anticipated sale proceeds would be sufficient to repay the current principal balance of the securitised loan.

On what basis interest will defer under the restructuring remains unclear, however. The loan is floating rate and the borrower level swap matured in January 2011. Consequently, the BarCap analysts assume that the basis for deferral will be the floating rate interest agreed on in the loan agreement - with or without default interest.

Nonetheless, they note that the Velvet restructuring is an "innovative and appropriate" way to work out the loan. "The fact that deferred interest on the loan is not due subordinates junior note interest to senior note principal recovery, which is in the spirit of securitisation, in our view. Other outstanding loans might be in a similar situation as the Velvet loan, so we can imagine that the Velvet loan restructuring will serve as a template for future workouts."

The analysts add that the special servicer's explanation of the rationale behind the restructuring and its analysis is very helpful, with the same openness in similar cases to be welcomed in the future.

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