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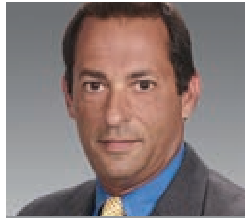
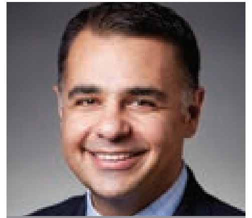


RICK D'EMILIA
BUSINESS DEVELOPMENT OFFICER (ABS/MBS)

PATRICIA SCHULZE
BUSINESS DEVELOPMENT OFFICER (ABS/MBS)



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RICK D'EMILIA
Wilmington Trust, N.A.
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212-941-4414

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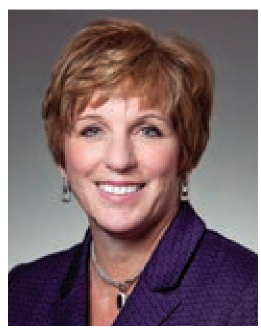
+353 1 792 0711



PATRICIA SCHULZE
Wilmington Trust, N.A.
pschulze@wilmingtontrust.com
302-636-6104

PATRICK TADIE
Wilmington Trust, N.A.
ptadie@wilmingtontrust.com
212-941-4407

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* As of June 30, 2017. Source: M&T Bank
** Asset-Backed Alert, December 31, 2017

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EDITOR'S LETTER

Sweet Spot

Credit has been expanding for the better part of a decade, so it might not seem like the most advantageous time to be putting large amounts of money to work fixing up or repurposing commercial buildings. After all, this kind of investment can take a while to bear fruit. Yet lenders who specialize in transitional commercial mortgage lending have not had it so good since before the financial crisis. In our cover story, one lender says that banks his firm have never done business with are offering to extend lines of credit to warehouse loans for be bundled into collateral for CRE CLOs, and investment bankers are pushing it to do more deals.

What makes CRE CLOs so attractive to investors isn't necessarily what's being financed, however. Rather it's the fact that these loans are relatively short-term, with terms of two to five years, and pay floating rates of interest.

"It's definitely a late-cycle place to play," says Jeffrey Baevsky, a senior managing director at Greystone, which completed its first CRE CLO last year, and is considering doing another one. "You want to be in fixed income instead of equity and hedged with a floater."

This same dynamic is benefiting another corner of the commercial real estate market, large loans that finance a single property or portfolio of properties. Securitization of these loans has outpaced conduit loan securitization so far this year. And a large portion of the single-asset, single borrower deals finance hotels – generally considered a riskier type of commercial property, given the volatility of room rates.

—Allison Bisbey, Editor in Chief

Asset Securitization Report

One State Street Plaza, 27th Floor, New York, NY 10004

Editorial
Editor in Chief: Allison Bisbey
allison.bisbey@sourcemedia.com; 212.803.8271

Senior Editor: Glen Fest
glen.fest@SourceMedia.com; 817.847.8041

Associate Art Director: Neesha Haughton
neesha.haughton@sourcemedia.com; 212.803.8815

Contributors
Brad Finkelstein

Group Editorial Director, Banking & Capital Markets
Richard Melville
richard.melville@sourcemedia.com; 212.803.8679

VP, Content Operations and Creative Services: Paul Vogel
paul.vogel@sourcemedia.com; 212.803.8832

Director of Creative Operations: Michael Chu
michael.chu@sourcemedia.com; 212.803.8313

Director of Content Operations: Theresa Hambel
theresa.hambel@sourcemedia.com; 212-803-8245

Publishing
VP Capital Markets Division: Harry Nikpour
212.803.8638

Vice President of Sales, Banking & Payments: Dennis Strong
212.803.8372

Associate Publisher: Louis Fugazy
212.803.8773

Marketing
Marketing Manager: Leatha Jones
212.803.8374

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Chief Executive Officer: Douglas J. Manoni
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Golden Shares up for Review

Equity stakes with veto power over bankruptcy filings are commonly used as a backup measure for SPVs; but there are several issues to be addressed as case law develops

By Shmuel Vasser

For decades, financial engineers have been searching for a perfect solution to a vexing problem – designing a bulletproof bankruptcy control mechanism.

For example, bankruptcy remote entities, or special-purpose vehicles (SPVs), the legal entities at the heart of securitization structures, serve this purpose as long as the SPV provides sufficient certainty that it would not file for bankruptcy, and, if it did (voluntarily or otherwise) that it would not be substantively consolidated with its parent entity and its affiliates.

The strength of the legal isolation of the SPV from its affiliates is one of the pillars of the rating system, which assigns higher ratings to securities issued by SPVs than the rating that would have been assigned to the securities had they been issued by a non-SPV issuer.

As has been repeatedly noted, however, bankruptcy remote is not bankruptcy- proof, as a small percentage of SPVs have ended up in bankruptcy over the last few decades.

The bankruptcy-proofing of SPVs is a road well traveled. The standard features include: (i) the SPV's organizational document limits the permitted purposes of the SPV to activities related to the transaction, (ii) the SPV's governance requires that major decisions, which include filing for bankruptcy and related actions, be made unanimously, and thus require the consent of an independent member, director or manager, (iii) the independent person owes his or her fiduciary duties to the SPV as a whole, (iv) the SPV must operate in compliance with strict requirements designed to ensure its separateness from its affiliates, and (v) holders of the SPV's securities are subject to a no-petition clause essentially agreeing not to file an involuntary petition against the SPV.

This standard has performed admirably well, as very few SPVs ended up in bankruptcy. For the SPVs that did end up in bankruptcy, some cases were dismissed due to an unauthorized filing (because the filing resolution was not approved by the independent person as required by the organizational documents). In addition, fewer yet were subjected to nonconsensual substantive consolidation. Yet, the standard structure is not bulletproof, so the search for a better one is never-ending. One approach that continues to rear its ugly/golden head is the golden share.

The golden share refers to an organizational structure that requires certain equity holders to consent to a bankruptcy filing and related actions. The shares, rights or other equity instrument held by such holders are

referred to as golden shares.

Many doubt the enforceability of the golden share and, therefore, its utility. To begin with, directors and managers generally owe some form of fiduciary duties to the entity (even in cases of limited liability companies where fiduciary duties are disclaimed) and thus are expected to act for the benefit of the entity. Equity holders, on the other hand, are expected to act in their own self-interest.

Furthermore, without substantial equity investment in exchange for the golden share(s), the mechanism looks and smells like one that hands out a bankruptcy veto power to its holder, which in truth is really a creditor pursuing its own self-interested agenda.

Not surprisingly, courts have often refused to enforce bankruptcy veto

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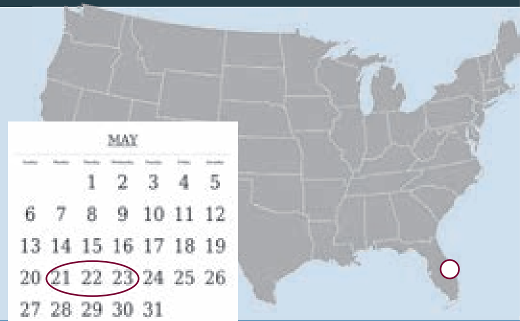

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powers granted to creditors. See, for example, Bay Club Partners-472 LLC, 2014 WL 1796688 (Bankr. D. Or. May 6, 2014) (requiring creditor's approval for a bankruptcy filing);

Lake Michigan Beach Pottawattamie Resort, LLC, 547 B.R. 899 (Bankr. N.D. Ill. 2016) (borrower's operating agreement was amended to add the creditor as a special member whose consent was required for a bankruptcy filing);

Intervention Energy Holdings, LLC, 553 B.R. 258 (Bankr. D. Del. 2016) (creditor received one share and the operating agreement required unanimous members' consent to a bankruptcy filing);

Tara Retail Group, LLC, 2017 WL 1788428 (Bankr. N.D. W. Va. May 4. 2017) (not ruling on the validity of the independent director provision; finding that the independent's lack of action constituted consent to the filing);

Lexington Hospitality Group, LLC, 577 B.R. 676 (Bankr. E.D. Ky. 2017) (creditor was granted equity in an amount that prevented the entity's ability to file without the creditor's consent).

A few cases, however, have respected the golden-share requirement where the veto power was granted to a true equity holder. In Global Ship Systems, LLC, 391 B.R. 193 (Bankr. S.D. Ga. 2007), the court enforced a bankruptcy blocking provision included in the operating agreement where the equity holder was also a creditor.

In Squire Court L.P., 574 B.R. 701 (Bankr. Ed. Ark. 2017), the partnership agreement required consent of all partners to a bankruptcy filing. When the general partner requested the limited partners to consent, they refused. The court dismissed the petition filed by the general partner as being unauthorized under the partnership agreement.

Most recently, in Franchise Servs. of North Am., Inc., Case No. 1702316EE (Bankr. S.D. Miss. Dec. 18, 2017), the court enforced a bankruptcy blocking provision granted to an investor who paid $15 million for a 49.76% of the debtor's Series A preferred stock, becoming its largest shareholder.

The distinction between veto powers given to a creditor vs. an equity holder is unsatisfactory.

The debtor's certificate of incorporation required the consent of the majority of both the series A holders and the common shareholders to a bankruptcy filing. It was undisputed that such consent was not obtained. The bankruptcy court dismissed the case, holding that the provision requiring consent to a bankruptcy filing is valid and enforceable since it required the consent of equity holders, not creditors. As such, the provision did not grant creditors a veto power on the debtor's ability to file for bankruptcy.

Is the golden share truly useful?

The short answer is probably not; at least not yet. First, the distinction between veto powers given to a creditor versus an equity holder is unsatisfactory as it can be easily manipulated by financial engineering. For example, how much equity does a dual hat creditor/shareholder have to hold for the provision to be enforceable?

Second, does the context matter – does it and should it make a difference whether the blocking provision is included in an SPV's organizational document or in the organizational document of a "normal," i.e. non-SPV entity, which was not deliberately structured to be bankruptcy remote? And if it does matter, what is the legal basis for treating these two entities differently?

Finally, the vast majority of entities that file for bankruptcy are insolvent. As a result, equity is not entitled to any distribution until all creditors are paid in full. It would appear, therefore, that enforcing equity's veto power on bankruptcy filing could provide equity with inordinate leverage : It can block a reorganization (including a going-concern sale in bankruptcy), although it is an out-of-the-money constituency. Is that consistent with federal bankruptcy policy?

The Court of Appeals for the Fifth Circuit accepted the bankruptcy court's certification of its decision in Franchise Servs. of North Am for a direct appeal. We hope that as the case law further develops, courts will address these important questions.

Shmuel Vasser is a partner in Dechert's financial restructuring department, resident in the New York office.

Downside to a Hands-Off CFPB

As the agency pulls back its enforcement efforts, it opens the door for state authorities to pursue more cases against financial startups for data collection and privacy practices

By Michael Ross and Emily Bruemmer

The Consumer Financial Protection Bureau has made it increasingly clear that the agency's enforcement unit will be less aggressive going forward.

But that move could actually expose fintechs to more risk, not less.

In February, acting Director Mick Mulvaney told a conference of state attorneys general that the CFPB would no longer be "pushing the envelope" or "look[ing] to create law where there isn't" through enforcement actions. Instead, the acting director said, the CFPB will be "looking to the state regulators and state attorneys general for a lot more leadership when it comes to enforcement." This would amount to a considerable change that comes with its own set of risks for companies that deal with consumers or the public.

For the emerging fintech space, one key area of concern in the pre-Mulvaney regime was the CFPB's enforcement of the Dodd-Frank Act's prohibition on unfair, deceptive, or abusive trade practices. Since many fintech companies rely heavily on the collection and analysis of consumer data — think payment companies and marketplace lenders — those companies' practices and disclosures around protecting that data risked possible CFPB action.

Recall, for example, the CFPB's enforcement action in 2016 against Dwolla for misrepresenting its data security practices. Dwolla had represented to its customers that its data protection practices surpassed the industry standard for protection, and that consumer information was "securely encrypted and stored." In reality, the CFPB charged, Dwolla failed to encrypt sensitive personal information and did not perform adequate data security testing on its services. According to the CFPB, Dwolla's misrepresentations concerning its data security environment amounted to deceptive trade practices, and the company was ordered to pay a penalty and address flaws in its data security scheme.

Under the new regime, it is not yet clear whether the CFPB's overall scaling back of enforcement activity will affect its approach to the data-driven fintech space. But should the CFPB leave these issues to state authorities, fintech companies may, counterintuitively, have more to worry about.

The perception that federal enforcers have left a field open may embolden the agency's state counterparts to step into the fray. It was not that long ago that Eliot Spitzer's aggressive enforcement of New York law led news outlets to dub him the "Sheriff of Wall Street," amid questions about the SEC's scaled-back role in the securities markets. Indeed, state attorneys general have been indicating for months that they intend to step up to fill gaps left by federal authorities.

For state authorities looking for an increased role, fintech companies' protection of consumer information could become an area of focus. All 50 states have statutes prohibiting unfair and deceptive practices. And state attorneys general know how to use their authority to bring enforcement actions for data-privacy-related failures. Acting Director Mulvaney has also indicated that he will generally not interfere with state actions to enforce provisions of Dodd-Frank itself, which the statute authorizes.

In all, with the CFPB encouraging state authorities to step into the fray, the consequence of the CFPB's preference for less enforcement at the federal level may not mean less enforcement activity overall. Instead, it could lead to more inconsistent and unpredictable efforts by state authorities under a disparate set of views of what practices are acceptable.

In the meantime, fintech companies must remain vigilant regarding their privacy practices and disclosures to make sure they are up to snuff in all the jurisdictions in which they operate.

Michael W. Ross is a litigation partner and Emily A. Bruemmer is an associate at Jenner & Block.

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By Allison Bisbey

THERE'S AN ABUNDANCE OF CAPITAL AVAILABLE TO FINANCE LENDING TO fix up or repurpose commercial property, and that has some people wondering how long the party will last.

More and more nonbank lenders are taking advantage of the strong appetite for short-term, floating-rate debt to bundle bridge loans into collateral for vehicles called commercial real estate collateralized loan obligations, or CRE CLOs. This funding is an attractive complement to bank lines of credit because it is matched term. And it is becoming less and less expensive.

"We have banks we've never done business with looking to extend us lines [of credit] in order to warehouse product for a CLO," said Jeffrey Baevsky, a senior managing director in charge of structured finance at Greystone, which completed its first CRE CLO a year ago.

"Underwriters are calling us to push us to do another issuance — they are being pulled by investors to find more product," Baevsky said. "We're trying to take advantage of this situation. We see [the demand], we feel it."

Greystone isn't alone.

This once small corner of the commercial real estate market is growing rapidly. Through February there were four deals totaling $2.3 billion, which was already about 30% of the volume for all of last year, according to Kroll Bond Rating Agency. In a March 6 report, Kroll said it expected to see six additional CRE CLOs announced over the next two months, several of which may be from new issuers.

"This is the most interest I've seen since 2005 or 2006," said Jodi Schwimmer, a partner at the law firm Reed Smith who has represented investment banks, specialty lenders and real estate investors. "Deals are pricing well, and everyone [among issuers] is trying to strike" while they can. "We're advising clients to go to market now."

As issuance picks up, the buyer base for CRE CLOs is expanding, creating a positive feedback loop for issuers as their funding costs continue to fall.

Take Arbor Realty Trust, one of the most regular issuers: The real estate investment trust saw a 63-basis-point decline in funding costs over the course of the three deals it completed in 2017, according to information posted on its website. The weighted average spread on all of the notes issued on the first deal, completed in April, was 199 points over one-month Libor. By comparison, the weighted average spread on the third deal, completed in December, was 136 basis points.

"This may be the most liquid and well-bid part of the" commercial mortgage-backed securities market, Kunal Singh, a managing director and head of U.S. CMBS capital markets at J.P. Morgan, said at the Structured Finance Industry Group's conference in February. J.P. Morgan underwrote nine of the 18 deals issued in 2017, and on average it placed 50-60% of each deal with money managers, 20-25% with banks and 10-15% with credit hedge funds, Singh said at one of the conference panels.

Most issuers of CRE CLOs are real estate investment trusts and other specialty lenders, but the cheaper funding is attracting some new issuers that are not necessarily associated with bridge lending, such as the private-equity and real estate giants Blackstone Group, TPG Capital, Värde Partners and Silverpeak Argentic.

Blackstone's deal, completed in December 2017, raised some eyebrows because all 31 of the loans used as collateral were noncontrolling interests, or "participations," in larger loans that a fund controlled by Blackstone holds on its books. By comparison, most CRE CLOs hold a controlling interest, if not all, of a senior loan on a property.

The $1 billion transaction was also roughly twice the size of most other recent CRE CLOs. Yet it was said to fetch top dollar.

New kids on the block

Cheaper financing has attracted first-time CRE CLO issuers, including lenders not normally associated with transitional loans

- Blackstone Group: $1B
- TPG Capital: $932.3M
- Värde Partners: $348M
- Silverpeak Argentic: $480.3M

Source: Rating agency presale reports

Still a far cry from 'kitchen sink' deals

Inevitably, people are starting to make comparisons to deals minted before the financial crisis, which were called CRE CDOs (for collateralized debt obligations) and were used to finance a much wider range of assets than first-lien commercial mortgages — including mezzanine debt, equity and even undeveloped land — and on much looser terms. These CRE CDOs were sometimes called "kitchen sink" deals, and they ultimately sustained big losses.

Participants say the CRE CLO market is not there, at least not yet.

"Deals [today] are vastly different; frankly they are unrecognizable," Gene Kilgore, executive vice president of structured securitization at Arbor, said at the February conference. Not only is the collateral higher quality, he said, but the capital structure of deals is much simpler. When Arbor returned to the CRE CLO market in 2012, it went out of its way to create a deal that even investors with little experience in the sector could quickly understand — and easily look through to the underlying real estate assets.

Arbor's latest deals are "still fairly simple," Kilgore said, though the sponsor has "added some bells and whistles to protect the investor."

Baevsky also thinks the CRE CLO market bears little resemblance to its former self. "Before the financial crisis, deals, which were then called CDOs, financed office, retail, multifamily, land, hotels — you name the product, you could finance it there," he said. "CDOs had 10-year terms, five years of reinvestment and 94% advance rates. Today's world is completely different."

Greystone is now looking to double origination volume for bridge and mezzanine loans, which was half a billion dollars in 2017, over the next year or two, and to add warehouse lines and possibly doing more CLOs. But Baevsky is not worried about having to compete for loans. Greystone's $9.5 billion in origination in 2017 is still a small share of the total multifamily and health care market, he said. "There's a lot of turf left to capture."

Getting comfortable with more kinds of collateral

There's no doubt that CRE CLO investors are getting comfortable with more kinds of collateral. While many of last year's deals featured heavy exposure to multifamily properties, there has been an increase in the number and kinds of health care properties in deals, including medical treatment facilities (outpatient licensed medical facilities), elder care and assisted living, according to Schwimmer. "There are a lot of baby boomers that need services, and they don't need to go to the hospital to get them," she said. "State-of-the-art medical treatment facilities are available and are doing well."

While this is a far cry from kitchen sink collateral, "we'll get there," Schwimmer said.

"Commercial real estate is doing really well right now ... but you do feel there are clouds moving in," she said. "How long can we go on like this? It [the length of the cycle] is unprecedented."

New construction is also finding its way into CRE CLOs, according to Erin Stafford, a managing director at the rating agency DBRS. "We've seen that when banks can't hold loans after construction, properties will come into CRE CLOs with zero cash flow," Stafford said. "Banks don't want to hold them for the stabilization period. We do see some more loans [in CRE CLOs] that need greater stabilization, typically a brand-new property."

Stafford says that this type of lending is here to stay, because banks cannot, for regulatory and cost-of-capital reasons, originate these loans. "What's interesting to me is that banks are financing the CRE CLO sponsors" via lines of credit, she said. "It's their way of participating in that market without directly lending" to property owners.

At least one bank, The Bancorp in Delaware, is not only continuing to make bridge loans but also tapping the securitization market for funding. In late March it launched a $304 million offering of bonds backed by 30 commercial mortgages on its books. (While neither Moody's Investors Service nor DBRS called the transaction a CRE CLO, Moody's noted that many of the properties operate at below-market occupancy, are under renovation or suffered due to lack of financial strength of previous ownership.)

"There are so many people in the bridge loan business, and a CLO is the perfect funding option."

Room to grow if rating agency coverage expands

As hot as bridge lending is, there could be even more room for it to grow if credit rating agency coverage of CRE CLOs expands. Currently, only one of the "big three," Moody's Investors Service, rates these vehicles. And Moody's has been rating only the senior, or least risky, tranches of notes that are issued by each deal. Many large investors have investment guidelines that restrict them to purchasing securities that are rated by one or more of the big three (which in addition to Moody's are S&P Global Rating and Fitch Ratings). Issuers in other assets classes have found that getting rated by a second of the three boosts investor interest, lowering their funding costs.

"There are so many people in the bridge loan business, and a CLO is the perfect funding option," said Joe Franzetti, senior vice president for capital markets at Berkadia Commercial Mortgage, a brokerage. "The question is, will people stick to their knitting? If they do reasonable bridge loans with first mortgages, we'll be just fine."

Libor May Shrink to Survive

While banks will no longer be compelled by U.K. regulators to submit quotes for the calculation of Libor after 2021, there is nothing preventing them from doing so. The ICE Benchmark Administration, which has been responsible for calculating the index since mid-2013, thinks there is a strong case for keeping it going.

"The vast majority of participants we engage with — banks, borrowers, investors — have encouraged us to find a framework for retaining Libor over the long term," ICE President Timothy Bowler said in a speech at the Structured Finance Industry Group's ABS Vegas conference.

The London interbank offered rate is the average of interest rates estimated by each of 16 panel banks of what it would be charged to borrow from other banks.

Bowler and others at the conference believe that the replacement being promoted by a committee formed by the Federal Reserve may be appropriate for swaps and derivatives contracts. But it is not suitable for many kinds of loans because it is based on financing that is essentially risk free, and so does not reflect banks' funding costs.

And initially, there will only be one index for overnight rates. Longer-term rates are not expected to be available until the end of 2021, well after the 16 panel banks can stop submitting quotes for Libor.

"Financial markets should have a set of reference rates that incorporate bank fund costs and provide a prudent benchmark for setting [interest] rates multiple months in advance," Bowler said.

This would be a much smaller set of benchmarks than the five currencies and seven maturities currently published. Bowler said the ICE is surveying panel banks, other global banks and end users about which currencies and tenors are the most important to them. "The vast majority of activity is concentrated in a few currencies and tenors," he said. "If we can narrow down the universe, more banks might be willing to continue providing quotes. It's far less worrisome for a compliance department to evaluate six numbers, rather than 35."

The ICE is also taking steps to ensure that Libor is robust even if some of the panel banks opt to stop supporting it. The administrator is considering using an expanded universe of unsecured debt transactions in both the primary and secondary markets, and not just interbank lending, to calculate the index.

Bowler stressed that it is ultimately up to the banking industry to decide whether it wants to continue to support Libor on behalf of its clients.

What's Next for MPLs

Last year, marketplace lenders learned that maintaining diverse sources of funding is just as important as managing the credit risk in their loans.

LendingClub, Marlette Funding and others developed their own securitization platforms, rather than relying on whole-loan sales to large investors. They also invited some of these investors to contribute seasoned loans to collateral pools for these in-house deals. Mindful of how much this broadened their investor bases, both lenders are looking at additional changes to both their securitization and whole-loan sale programs.

"The ability to manage credit, manage liquidity risk [for investors] and scale distinguished the winners from the losers" last year, said Sid Jajodia, chief investment officer at LendingClub. He said that bringing securitization of LendingClub loans in-house, as opposed to leaving investors who wanted to resell whole loans to their own devices, was a critical step in attracting a new set of investors to the platform. "A number of investors had been looking at the space, but they needed us to hold risk retention for them to get comfortable," he said.

Jajodia said other new structures

will also drive acceptance by investors, including banks. In December, LendingClub completed its first whole-loan transaction structured as a tradeable, pass-through security, and other marketplace lenders are looking at similar transactions. While some banks invest in marketplace loans, banks also compete with online lenders for borrowers.

At some point, Jajodia said, it might make sense to structure securitizations with revolving periods during which additional collateral can be contributed to the trust. This is a feature common to some other asset classes, notably auto loan ABS.

Marlette is also making changes to its whole-loan program, according to Karan Mehta, the company's head of capital markets. The company has started to aggregate loans and deliver them to these investors periodically, rather than one at a time.

"It takes away a lot of the noise in the form of onesie and twosie loans, which may be canceled, and opens [the product] to investors who may not have the operational capabilities" to take loans one at time, Mehta said.

Another innovation Marlette is contemplating is breaking its whole loans into interest-only strips. "We do hear from investors that uncertainty around prepayment speeds is high on their minds," he said.

FHA Eyeing Further PACE Action

So far, the Federal Housing Administration's opposition to financing energy efficiency retrofits through property assessments has focused on mortgage originators. The agency no longer insures mortgages on homes with existing Property Assessed Clean Energy liens. It has yet to take action when a homeowner with an existing FHA-insured mortgage obtains PACE financing.

Dana Wade, the FHA's acting commissioner and deputy assistant secretary, suggested that this could change. In a Feb. 27 address, Wade said the agency was looking into whether "further action" is needed.

"PACE obligations were effectively given prime status over FHA mortgage insurance, [and] such loans were riskier for both taxpayers and borrowers," Wade said. "There do remain concerns over PACE assessments that are placed on FHA loans after endorsement."

In December, the Department of Housing and Urban Development announced that the FHA would no longer insure mortgages with such priority-lien assessments — a policy reversal engineered by HUD Secretary Ben Carson against an Obama-era policy.

The Dec. 7 change by the FHA only affected new mortgages, but an FHA release stated that Carson and other executives remained "concerned" about PACE liens on outstanding FHA mortgages.

Wade did not outline possible actions the agency might take, but said it will continue to "watch this practice vigilantly to determine whether further action is warranted."

Housing regulators aren't the only detractors. PACE liens are contro-

versial among lenders, who dislike taking a back seat in terms of payment priority. And many real estate agents feel that homes encumbered by PACE liens can take longer to sell. That's because the lien does not "travel" with the homeowner; rather, the buyer inherits it. But some homeowners have been compelled to repay PACE liens in order to sell their property.

The FHA's about-face puts it back in line with Freddie Mac and Fannie Mae, which also refuse to underwrite new mortgages with PACE assessments.

Why Small C-PACE Is Beautiful

Residential PACE securitization is expected to slow this year, but providers of property assessed clean energy financing for commercial properties could pick up some of the slack.

As with mortgages, commercial PACE assessments are much larger than residential assessments, and also require more intensive underwriting, since the sizes and uses of commercial property vary widely. So it's taking commercial PACE providers longer to accumulate collateral for deals.

The first transaction, completed by Greenworks Lending in September, was just $75 million, and the bulk of the notes were sold to a single investor, TIAA Investments. Jessica Bailey, Greenworks' co-founder and CEO, said that despite the deal's small size, "the execution was good enough that it made economic sense."

Attractive funding wasn't the only reason for coming to market sooner rather than later, however. Greenworks was also keen to find out whether rating agencies and re-investors were comfortable with the way that the company is originating and underwriting. "We are putting in place technological improvements ... and we want to be sure we're doing it right, that purchasers of our notes and rating agencies agree with our methods," Bailey said. "When you are operating as a first mover, it's exciting, but it's also a little terrifying," she said.

Other commercial PACE providers may feel similarly. Several speakers said that one or two more securitizations could come to market shortly.

The lumpiness or lack of homogeneity of commercial PACE assessments isn't the only reason it takes time to accumulate collateral for deals. Another issue is the larger number of states that have legislation enabling commercial PACE, as opposed to residential PACE. "We have an opportunity problem," Bailey said. "It can be difficult to decide which states to go into. ... Our company is active in 11 states, and we have a team of 20 people."

To date, Greenworks has primarily provided financing to retrofit older buildings. But in the last six months, it has seen a spike in interest from new development. The company is developing the appropriate underwriting, which Bailey described as "matching construction lending with PACE lending."

More Insurers Plan Risk Transfer

Expect more private mortgage insurers to follow Arch Capital's lead and offload some of their exposure to potential defaults by homeowners to capital markets investors.

Last year, Arch sold $368.1 million of bonds whose performance is linked to that of a pool of mortgages that the company insures. Should losses on the mortgages reach a predetermined level, investors will forfeit some of their principal.

The deal is an alternative form of reinsurance. It was modeled on transactions that Fannie Mae and Freddie Mac have used since 2013 to offload the risk of losses on mortgages that they insure.

Participants at SFIG Vegas said that another private mortgage insurer was marketing a deal, and that several others may follow suit.

"It's an interesting way to think about capital," said Adam Budnick, a managing director at AIG, which invests in credit risk transfer securities issued by both the GSEs and private mortgage insurers.

On the one hand, "you can think of it as shedding risk," Budnick said. But transferring credit risk through the capital markets can also be seen as a way of replacing capital, because the less risk on a company's books, the less capital it needs to set aside. "If the cost is attractive, that can make a lot of sense," he said.

Mary Stone, a managing director at Bank of America Merrill Lynch, says that future deals could be linked to the performance of jumbo loans, and not just conforming loans, as Arch's deal was.

Depending on execution, it may also make sense for banks, as well as mortgage insurers, to do deals transferring the credit risk on nonagency and jumbo conforming loans, Stone said.

CLO Investors' Lament

CLO managers cheered a Feb. 9 decision by the D.C. Circuit Court that they do not need to hold "skin in the game" of their deals. But some investors in collateralized loan obligations see little to celebrate.

"We were sad to see them go," said Kevin Croft, a senior vice president and portfolio manager for the Des Moines-based insurer American Equity and a panelist at SFIG Vegas. "We were very happy to have risk retention in place."

So was William Moretti, a managing director who heads the investment portfolio of MetLife's structured finance group. "In general we favored risk retention as part of more global reform and a healthy securitization market along with transparency and good governance," he said. "It's something that's applied across all structured finance, but it's difficult to have customized solution for each different asset class."

Paul Nikodem, managing director and head of securitized products research for Nomura, noted that retention also brought some new, permanent capital to the market, including $10 billion for investing in risk retention funds. That money appears likely to stay, even if risk retention is ultimately vacated for the asset class. "The question is, where will all that money go?" Nikodem said. "It's not obvious there are any other options. I guess it depends on the docs, but a lot of that money will remain in the sector — new money, new investors."

One investor opposed to risk-retention for CLOs is Matt Natcharian, a managing director and head of CLO investments at Barings, who said that risk retention "was just one piece of understanding the business plan of the managers" and how it fits into an asset management firm's organization. "Is it something important to them, or just something they're trying on the side?"

Solar Panel Tariff Not So Bad

It could have been a lot worse.

The Trump administration's decision to impose a tariff on imported solar panels will have a relatively limited impact on residential installations, industry participants say.

Katya Baron, a managing director at Mosaic, said that solar panels account for just 15% to 20% of the total cost of a residential rooftop installation; much of the rest of the cost is labor and marketing. That means the total price of installation will not rise by the same percentage as the tariff itself. "The overall impact will be fairly muted" on residential demand for solar panels, she said.

David Ridenour, of counsel at DLA Piper, and another panelist, went so far as to call the President's action a "bit of a win" for the U.S. solar industry. He noted that the U.S. International Trade Commission had recommended a 50% tariff.

Instead, the U.S. Trade Representative in January announced a 30% tariff that steps down over four years.

Katrina Niehaus, a managing director at Goldman Sachs, noted that tariff will have a larger impact on utility scale installations, where the cost of panels relative to the cost of installation is higher. But eventually, Chinese solar panel manufacturers are likely to move factories to the U.S. to avoid the tariff. "People are just going to move here," she said.

Eric Neglia, a senior director at


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Kroll Bond Rating Agency, said he's heard that some installers have been stockpiling panels in anticipation of the tariff, and may not have to start importing panels subject to the tariff until the second half of the year.

The fact that solar panel prices have fallen so sharply over the past several years also takes away some of the bite for both residential and utility consumers, Ridenour said.

DeVos Ups Ante with State AGs

The Department of Education secretary says the companies hired by the government to service its own loans should only be subject to federal oversight

By Allison Bisbey

A battle between the U.S. Department of Education and state regulators over student loan servicing is moving into higher gear.

Several states have imposed new regulatory requirements on companies that service loans that the federal government makes through its Direct Loan Program. States have also taken legal action against servicers. Most recently, Massachusetts' attorney general sued the Pennsylvania Higher Education Assistance Agency, which manages over a fourth of the nation's $1.4 trillion in student loan debt, accusing the company of unfair practices.

Department of Education Secretary Betsy DeVos says that the companies hired by the government to service its own loans should only be subject to federal oversight. In January, the department filed a brief in support of PHEAA with the Suffolk County Superior Court. Now the department is taking things a step further.

On March 12 it published a notice in the Federal Register stating its view that state regulation of Direct Loans is preempted by federal law. State regulation of the servicing of Direct Loans "impedes uniquely federal interests," the notice states.

For now, state laws remain in place. But it is possible that the courts will weigh an interpretive notice more heavily than a statement of interest.

How much deference the court will give this kind of notice "is an open question," according to Vaishali Rao, a partner at the law firm Hinshaw & Culbertson and a former litigator in the Consumer Fraud Bureau of the Office of the Illinois Attorney General.

On one hand, "the Department of Education's loans are their own loans; that's a very persuasive point," Rao said. On the other hand, she said, whether particular state law provisions are preempted is a fact-specific question, "so language in each state law is going to have to be looked at individually, and it may not be a clean sweep based on this one notice."

For example, the department made the same arguments regarding preemption in its filing in support of PHEAA's motion to dismiss in the unfair and deceptive trade practice lawsuits brought by the Massachusetts attorney general. And the court denied the motion.

Massachusetts Attorney General Maura Healey is not deterred.

"Secretary DeVos can write as many love letters to the loan servicing industry as she wants, I won't be shutting down my investigations or stand by while these companies rip off students and families," Healey said an emailed statement. "The last thing we need is to give this industry a free pass while a million students a year are defaulting on federal loans."

Bloomberg News

Other state regulators have expressed their opposition. John Ryan, president and CEO of the Conference of State Bank Supervisors, warned DeVos in a March 2 letter that federal preemption "runs counter to the congressionally mandated state-federal balance in financial regulation and exceeds the department's authority."

A CSBS spokeswoman said the group stood by the letter.

While the Department of Education's aim may be to shield servicers from state regulation, Rao thinks that the regulatory skirmishes actually complicate compliance, especially in today's environment where private lending and servicing markets are experiencing significant growth.

New Way to Raise Bank Capital

An Angel Oak affiliate is packaging bank-issued sub debt into collateral for bonds; it recently completed its first securitization and plans to come to market twice a year

By Glen Fest

Angel Oak Capital is joining the ranks of private-equity firms helping regional and community banks tap the securitization market to address their capital needs.

While many banks need to raise capital for regulatory purposes, the market for their debt is limited. The market for bonds backed by the subordinated debt issued by a number of small banks is larger, potentially much larger, and could lower capital costs. These deals limit exposure to any single institution, and are structured so that the senior notes issued are less risky than the underlying debt.

"If you look at how [community] banks capitalize themselves today, they're largely capitalized through equity, far more equity in their capital structure than larger banks," said Navid Abghari, a senior portfolio manager at Angel Oak who leads the effort. "That's not necessarily the most efficient capital structure for them."

In January, an Angel Oak affiliate, Buckhead One Financial Opportunities, privately placed $155.2 million of bonds backed by the subordinated debt of 25 small and midsize banks whose assets range from $200 million to $10 billion. Nomura Securities provided warehouse financing for the collateral and underwrote the transaction, dubbed BFNS 2017-1. The senior notes are rated Aa2 by Moody's Investors Service.

Abghari, who is also Buckhead's chief executive, said the plan is to complete two securitizations a year. If successful, the platform could help more community banks raise capital more cheaply and efficiently, and also create an alternative asset class.

Securitization provided significant capital to community banks in the years leading up to the financial crisis, but those transactions were backed by a debt-equity hybrid called trust-preferred securities. Many trust-preferreds did not perform well during the crisis, and they no longer qualify as regulatory capital.

Buckhead is not the first platform to securitize community bank debt since the financial crisis. At least one other, EJF Capital, has done similar deals, although much of the collateral was trust-preferred securities issued before the financial crisis, rather than newly issued subordinate bonds.

Also contributing to the revival is the fact that much of this debt is now rated. Kroll Bond Rating Agency has issued credit ratings on the subordinated debt of over 110 regional and community banks over the past few years. This gives Buckhead, as well as investors, confidence in the health of these institutions.

Buckhead One will also apply its own internal risk assessment in determining which debt offerings to use as collateral for a securitization. Abghari said the firm's proprietary model measures standard public data on banks, such as leverage and nonperforming asset ratios, to determine credit quality.

Navid Abghari

Sandler O'Neill, one of the primary matchmakers in the community-bank subordinated debt market, helps these institutions raise $3 billion to $4 billion annually from institutional investors, either directly in private placements or through the occasional securitization. Since 2014, when investor appetite for bank debt started to return, the investment bank has placed almost $9 billion in subordinated debt securities, said Jacques de Saint Phalle, a partner at the firm.

Strong Hotel Bookings in CMBS

Demand for hotel rooms is running high, and mortgage bond investors are lining up to finance acquisitions and upgrades of even the largest resorts

By Allison Bisbey

Demand for hotel rooms is running high, and mortgage bond investors are lining up to finance acquisitions and upgrades of even the largest resorts.

At one time, big loans like the $470 million mortgage on the Orlando Hilton, the $189 million mortgage on the Turtle Bay Resort in Oahu or the $189 million mortgage on the Renaissance Aruba Resort & Casino were routinely chopped up into multiple conduit offerings. But it has become increasingly attractive to securitize these mortgages on their own in what are known as single-asset, single-borrower deals.

With terms of three to five years, this kind of financing is shorter term than loans sold to CMBS conduits, and it is floating-rate — a sweet spot in a rising-interest-rate environment.

Joe Franzetti, senior vice president for capital markets at Berkadia Commercial Mortgage, a mortgage brokerage, said that there has been an 80-basis-point reduction in the spreads on the least-risky tranches of notes issued in single-asset, single-borrower deals over the past year or so. "CMBS became a much more attractive rate avenue for borrowers who want to take on floating-rate debt," Franzetti said.

Last year, most loans used in single-asset or single-borrower securitizations refinanced existing debt, but this year, M&A is also a driver, according to Erin Stafford, a managing director at the credit rating agency DBRS. "There are new borrowers that have acquired major portfolios," Stafford said.

For example, in March Citigroup and Goldman Sachs securitized a $405 million first mortgage taken out to help finance the private-equity-led acquisition of the WoodSpring Suites, a low-price, extended-stay hotel chain.

One of the reasons there are so many of these deals to finance hotels is there has been so much growth in the underlying cash flow of trophy properties, the analyst said. "Some of it has to do with a shift in consumer behavior; they are looking more toward experiences as opposed to acquiring goods."

In a lot of portfolios that DBRS rates, "the sponsors [borrowers] have put a lot of capital back into the properties, in the range of $8,000 to $20,000 per key, on a regular basis," she said. It makes a lot of sense to take out floating-rate debt in order to capitalize on potential future growth.

The rush of deals comes despite emerging signs of oversupply in the broader hotel market. In January, Fitch Ratings warned that it has seen an increase in the volume of securitized hotel loans transferring to special servicing in seven of the top U.S. metropolitan markets. Nevertheless, Fitch expects revenue in the broader U.S. hotel market to grow through the end of 2018, albeit slowly.

Adobe Stock

As the WoodSpring Suites deal demonstrates, single-asset, single-borrower financing is not confined to resort hotels. Other recent deals financing the acquisition of portfolios of extended-stay and limited hotels include a $906 million one by the real estate investment trust Colony Northstar.

Franzetti said there are few alternatives to CMBS financing available for these kinds of acquisitions. Insurance companies sometimes co-underwrite "club" loans for large buildings, but it can be hard to get them comfortable with a portfolio of assets, he said.

There have also been several securitizations of large loans backed by multifamily and office properties. In January, JPMorgan Chase securitized $200 million in loans secured by six residential towers in Jersey City, N.J.

Charter Creep Concerns

Freddie Mac and Arch Capital are teaming on a pilot mortgage risk-sharing platform for low-down payment loans, but some are crying foul over the attached insurance feature

By Brad Finkelstein

Freddie Mac and Arch Capital are testing a new form of risk-sharing deal to boost investor appetite for low down payment mortgages. But the pilot is raising concerns about "charter creep" because it dictates private mortgage insurance decisions typically made by lenders.

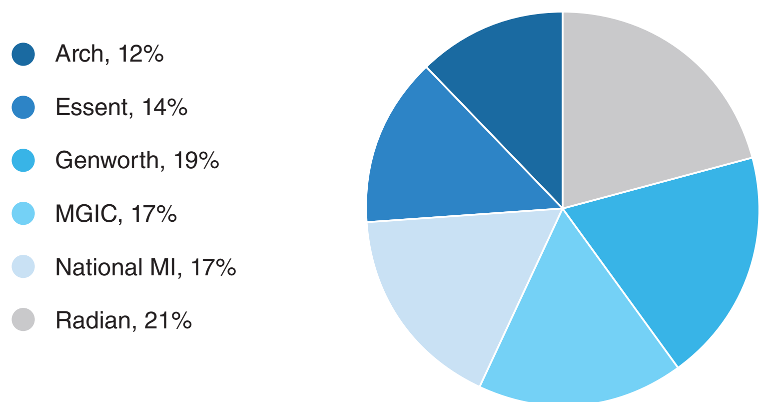
With IMAGIN — short for Integrated Mortgage Insurance — lenders will sell low down payment mortgages to Freddie Mac. At the time the government-sponsored enterprise purchases the loan, private mortgage insurance will be attached using a panel of insurers and reinsurers managed by a newly created subsidiary of Arch Capital, named Arch MRT (for mortgage risk transfer).

"IMAGIN is an alternative structure for lenders to obtain charter-compliant credit enhancement solutions and to bring additional sources of private capital to support low down payment lending," Freddie Mac spokesman Chad Wandler said in an emailed statement.

"This arrangement encourages additional participants and capital to support first-loss exposure in mortgages," Arch Capital said in a March 13 press release. "The high quality panel of (re)insurers will competitively bid, through a transparent process, to provide, over the long term, lower cost mortgage insurance for borrowers."

IMAGIN that

Freddie Mac's Integrated Mortgage Insurance pilot might be a threat to the lender-paid product, which had a 19% share in 2017



Source: Compass Point

The GSE maintains the pilot doesn't exceed the boundaries of its federal charter, and that a "traditional MI structure remains an important tool for Freddie Mac and the industry to provide access to credit for qualified borrowers with low down payments," Wandler said.

But others are not so sure.

IMAGIN "totally violates the spirit of the charter. There is not any public information about what the capital requirements are going to be and what the standards are," Lindsey Johnson, president and executive director of USMI, said in an interview. The trade group represents all of the industry's private mortgage insurers, except Arch.

Those five PMI firms have all seen their stock prices drop by 7% to 14.5% since March 12, when analysts first caught wind of the Freddie pilot.

The USMI members and their shareholders are concerned the pilot gives preferential treatment to reinsurers by not holding them to the same PMI Eligibility Standards that carriers must follow in order to do business with the GSEs.

Part of the concern may be about the lack of available details about the pilot. Freddie and Arch's plans to announce the program may have been preempted by Freedom Mortgage, which was promoting its role as one of the 12 participating lenders in February.

Johnson said the lack of information created uncertainty about IMAGIN's impact. "If this had gone through a public and open process we would know and understand a lot more," she said.

IMAGIN has been compared to lender-paid mortgage insurance, which made up 19% of new insurance written in the industry last year, according to estimates by the research firm Compass Point.

Like LPMI, the PMI premium for IMAGIN loans is rolled into the interest rate. That differs from borrower-paid MI, where the premium is a separate charge paid upfront or as part of the borrower's monthly payments.

One key difference is the length of coverage. LPMI is typically paid in one upfront premium and the policy remains in effect for the life of the loan. With IMAGIN loans, the coverage sunsets after 10 years, a feature similar to the cancellability of borrower-paid mortgage insurance when the loan reaches a 78% loan-to-value ratio.

But any competitive threat to LPMI is mitigated since many lenders already receive discounted rates for those policies. "The prices offered by Freedom might not end up being meaningfully lower than prices being offered by the MIs," Keefe, Bruyette & Woods analyst Bose George said in a March 12 research note.

The actual impact of the program is not expected to be huge; Compass Point puts the volume at around 3% of new insurance written over the next 12 months.

Though Compass Point analyst Isaac Boltansky is not convinced the program crosses the line between primary and secondary markets, he said it comes close.

"While the IMAGIN construct is not a direct foray into the primary mortgage market, it surely blurs the Congressionally-mandated line of demarcation. In this transaction, Freddie Mac selects insurance at the loan level and appears to effectively control both pricing and coverage determinations," Boltansky wrote in a March 13 research note.

"It surely blurs the Congressionally-mandated line of demarcation."

In the short term, IMAGIN is not an immediate threat to PMI carriers, Cowen analyst Jaret Seiberg wrote in a March 12 research note. "Yet it does represent a long-term risk if the savings prove greater than expected or if the enterprises see this as a safer way to obtain congressionally required mortgage insurance on loans with less than 20% borrower equity."

But by market share, Radian does the most LPMI and may be most vulnerable competitively.

With only limited information available about the program, mortgage groups remain cautious. Mortgage Bankers Association President and CEO David Stevens said by email the trade group would study IMAGIN details "closely to better understand how it would work and to ensure it is consistent with the GSE charters and does not cross the bright line that separates the GSEs' secondary market functions from the primary mortgage market."

The lack of public details about IMAGIN was vexing to Community Home Lenders Association Executive Director Scott Olson. While supportive of providing more insurance options for lower down payment loans, "CHLA continues to believe that more transparency about these pilots would be helpful, and more broadly believes that the GSEs should be subject to the Freedom of Information Act," he said in an interview.

Arch Capital was a mortgage reinsurance provider before its acquisition of CMG Mortgage Insurance, now known as Arch Mortgage Insurance, in January 2014. After its acquisition of United Guaranty in late 2016, Arch became the industry's largest PMI carrier. Its size and past experience with reinsurance likely helped it secure the pilot with Freddie. But the GSEs have been known to open up programs to additional participants following a successful test run.

Both Fannie Mae and Freddie Mac have previously done risk-sharing pilots with PMI carriers, and insurers have been advocating for more participation, especially deeper coverage, which is considered 50% of losses, as opposed to the standard 18% to 37%.

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