CMBS Lenders and Deeds in Lieu of Foreclosure – Current Challenges and Considerations

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For borrowers in today's commercial real estate market, resolving a distressed loan through a deed in lieu of foreclosure can seem like a clean alternative to foreclosure. But when the loan is a CMBS (commercial mortgage-backed securities) loan, servicers are often unwilling—or unable—to agree. This insight explores why CMBS lenders resist deeds in lieu, what alternatives exist, and how borrowers can prepare for negotiations.

Why CMBS Deed in Lieu of Foreclosure Negotiations Are Difficult

Multiple Stakeholders

In a CMBS loan, the lender is a securitization trust, and decisions are made by a special servicer on behalf of the bondholders. The servicer must comply with the Pooling and Servicing Agreement (PSA), which often limits flexibility in **workouts and restructurings**.

Tax & REMIC Restrictions

REMIC (Real Estate Mortgage Investment Conduit) tax rules can restrict a trust's ability to take title to a property directly, especially before certain default triggers are met. Violating these rules can jeopardize the tax status of the entire securitization. *(See* ***IRS Publication 938*** *for details.)*

Liability & Environmental Risk

Taking title can expose the trust to environmental liability, operating expenses, and management obligations—risks servicers prefer to avoid unless foreclosure is complete. Borrowers may need to provide recent environmental reports to reduce this barrier.

Loss Recovery Considerations

A deed in lieu can limit the ability to pursue carve-out guarantors or other recovery sources. Servicers may choose foreclosure to preserve all claims and remedies.

Valuation and Investor Approval

Before accepting a deed in lieu, a servicer may need updated appraisals and sometimes Controlling

Class certificate holder consent, adding cost and delay.

Common Related Issues

Timing & Delay

Even when a deed in lieu is theoretically possible, decision-making in CMBS structures is slow, prolonging uncertainty.

Nonrecourse Loan Carve-Outs

Foreclosure may trigger recourse liability for “waste,” “misapplication of rents,” or “bankruptcy” carve-outs. Servicers may leverage these in negotiations.

Receiver Appointments

Instead of accepting title, servicers often prefer having a receiver appointed to operate the property during foreclosure.

Deficiency Claims

Foreclosure preserves potential deficiency judgments, which a deed in lieu typically waives.

Borrowers engaged in **commercial lending and leveraged finance** should evaluate how these provisions impact long-term resolution strategies.

Practical Steps for Borrowers

Understand the Servicer’s Constraints

Recognize that the special servicer’s flexibility is limited by the PSA, REMIC rules, and investor expectations.

Provide a Strong Business Case

Show why a CMBS deed in lieu of foreclosure could benefit the trust: lower loss severity, faster resolution, reduced legal costs, and minimized environmental risk.

Address Environmental Concerns

Provide Phase I or Phase II reports to mitigate one of the major barriers. See **EPA All Appropriate Inquiries (AAI)** and the **Assessing Brownfield Sites fact sheet** for guidance on environmental due diligence.

Be Ready with Alternatives

Consider pre-negotiated foreclosure consent, receiver transition, note sale, or discounted payoff. Families exploring these may also benefit from advice on **real estate acquisitions and sales** strategies post-resolution.

Mind Guaranty Exposure

Review loan documents carefully to identify carve-out triggers and potential personal liability. Partnering with counsel experienced in **joint ventures and structured investments** can help evaluate risks if multiple investors are involved.

Practical Takeaways

- Refusals are common in CMBS loans due to tax, legal, and structural restrictions—not necessarily servicer unwillingness.
- Preparation is essential: support your proposal with documentation, valuations, and a business case.
- Explore alternatives early: foreclosure consent, receivership, or discounted payoff may be more realistic paths.
- Legal guidance helps borrowers protect guarantors, structure fallback strategies, and evaluate potential **real estate development** opportunities after resolution.

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