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The success of Patron Capital and TPG in taking over Uni-Invest following Europe's first CMBS to default upon legal maturity could be a blueprint for the future. PERE Magazine, May 2012 issue

Robin Marriott

To be honest, there are times when a slightly jaded reporter could be excused for not giving credit to anyone for anything. However, a situation arrived in Europe last month where there is clearly something to be said about its innovation.

In a hugely publicised deal, Patron Capital and TPG Capital have gained ownership of Uni-Invest and its €634 million office portfolio after acquiring a loan in a soured securitised debt vehicle known as Opera Finance (Uni-vest). In doing so, they have succeeded in the first known credit bid involving a commercial mortgage-backed securities (CMBS) deal.

In case you missed it (and if you did, you can find reams of articles about it online), Uni-Invest was taken private for €884 million in 2002 by a consortium involving Lehman Brothers, but the Dutch company got into trouble over €750 million of securitised debt arranged in 2005. This February, that debt became the first CMBS to default upon legal maturity.

Patron and TPG essentially may have bought debt and enforced it, but this is an operational play at its heart, whereby the two firms are putting in some €160 million to €180 million of equity to recapitalise the company. The game plan is to improve asset management of the roughly 200 office properties in the portfolio. Around two-thirds of the assets can be improved, while the other third could be sold earlier because they are hopeless assets or perhaps good assets that cannot be improved much further.

Normally, a transaction such as we have witnessed in Opera Finance (Uni-vest) would not succeed because Patron and TPG's solution involved wiping out junior bondholders while immediately paying back some 40 percent of the outstanding principal to Class A noteholders. Under normal circumstances, junior noteholders will always block a credit bid because they have hard rights. However, in this case, they couldn't do that because atypically there was a 'note of event default', which occurs on a default of the notes upon maturity, insolvency of the issuer or non-payment on the most senior class of notes.

So far, we haven't seen any note maturity defaults in Europe. The way things work is that a loan matures, it defaults and the rating agencies require parties to build in time to work out the loan. Only upon bond maturity does control pass to Class A bondholders, which happened in February in the case of Uni-Invest.

Eurohypo, the German bank and special servicer in this case, ran a dual process to resolve the issue involving two competing proposals. There was the credit bid by Patron and TPG and the more consensual proposal by Valad Europe, whereby it would extend the bonds, manage the properties and seek to get repayment of some of the outstanding loan over time through property sales. The problem with the Valad bid was that Class A noteholders preferred a big payment on a portion of the principal upfront, rather than taking their chances with Valad's longer-term asset management plan.

If one puts sympathy for the junior bondholders to the side and looks at it from the viewpoint of Patron and TPG, what we have here is a ground-breaking deal that took months of hard work (nearly two years for Patron and one year for TPG). That is not to mention money spent in terms of due diligence.

Furthermore, the deal proves that there are ways to get things done in complex situations. In this case, the senior bondholders get money back, banks have been de-levered and tenants will feel they have a more stable landlord with money behind it to improve upon its real estate holdings. Experts say the structure is good for the market and admire how the two firms managed to create vendor financing in the structure by offering existing Class A bondholders an exchange for new re-priced bonds.

To make their money, Patron and TPG are not relying on any improvement in the market, just real estate skills in terms of change of use or improving what is there. In addition, the two firms apparently will not be pocketing the full profits either, as there are allocated loan amounts for each property. If the pair sells a property above the allocated amount of the debt attached to it, they can keep the surplus.

Though observers say the pair got control at a good value, Patron and TPG will have to work hard over a short period of time to make a profit. The Dutch real estate market is an absolute mess, and the Uni-Invest portfolio is comprised of secondary and even tertiary assets.

Apart from how successful this deal ultimately will be for Patron and TPG, the wider question is how relevant is the deal to the European market? The answer in the short term is not very much, but in the longer term potentially 'very'.

This was a highly unusual case that worked because of a note event of default. However, because most note maturities don't occur for another two to four years, it is going to be of less relevance in the short term. Once that period arrives, though, we will know if Patron and TPG's Opera Finance (Uni-vest) deal is the exception or the blueprint.

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