

Which question does this number answer?

Chapter 1 and the conclusion. Before arguing about a number, write down the question it answers. Four seats, four numbers, none of them wrong.

Asset / loan		Analyst	
Deal / fund		Date	

Seat	The question	Our number	Basis (yield, rent, costs, date)	Source
Owner: market value				
Lender: recovery value				
Bondholder: position in the loss queue				
Secondary buyer: equity actually worth today				
Sale-and-leaseback buyer: fair price				
Vacant possession: the floor				

Alder Point, for reference	Number	What it answers
Owner	120,000,000	What would it trade for, properly marketed?
Lender	82,200,000	What would I recover, forced to sell?
Strike	105,109,489	Below what value does the lender lose?
Vacant possession	91,500,000	What is it worth empty?
Fair sale-and-leaseback price (corrected)	114,225,435	What should the 2022 buyer have paid?
Carried, smoothing removed	115,600,000	What is it carried at, once the smoothing is removed?

The gap between the two numbers in dispute, and the ONE line of the bridge it comes from:

Most valuation arguments are two people with defensible numbers answering different questions. The asset manager quoting 120 and the credit officer quoting 82 are one question apart, and the question is compulsion.

The recovery bridge

Chapter 2. Market value to recovery value in three lines, each a separate judgement. Write the list down and the argument moves from the answer to the assumptions.

Asset / loan		Analyst	
Deal / fund		Date	

Step	Input	Running number	Evidence (comparables, quotes, lettings)	Agreed?
Start: NOI at passing rent (rent less irrecoverable costs)				
1. Strip the over-rent: take the LOWER of passing and market rent				
2. Capitalise at the forced-sale yield (market + 100 to 400 bp by quality and liquidity)				
3. Deduct realisation costs (agency, legal, receiver, holding, deferred maintenance)				
Recovery value				
Market value				
Gap, in money and as a share of market value				

Cost of each step, taken alone (Alder Point)	Recovery if skipped	Cost
Over-rent removal	89,600,000	7,395,556
Yield widening, 150 bp	105,691,429	23,486,984
Realisation costs, 4%	85,629,630	3,425,185

Item	Answer	Evidence / note
Before you sign the number		
What proportion of the rent survives a tenant default? (Alder Point: 92 per cent)		
Reversionary asset: no credit for the reversion without a contractual, dated, unconditional reason		
Indexation drift above market counted as over-rent		
Deferred maintenance priced, not ignored: a roof, a plant, certificates		
Loan / recovery value stated beside loan / market value		

Work it backwards: the income below which recovery falls under the loan = loan x forced-sale yield / (1 - costs). Alder Point: 5,062,500, a fall of 12.4 per cent from market-rent income and 19.6 from passing.

The loan as a written put

Chapter 3. The lender receives $\min(\text{loan}, \text{recovery})$. Find the strike, then write the payoff out.

Asset / loan		Analyst	
Deal / fund		Date	

Line	Value	Note
Loan at maturity		
Compound recovery factor (recovery / market value)		
Strike = loan / factor		
Distance from today's market value to the strike		
Headline distance (1 - loan-to-value)		
How much smaller the real distance is		

Market value at maturity	Recovery value	Lender receives	Lender loss	Borrower equity

Item	Answer	Evidence / note
An extension request is a new put: price its conditions		
Paydown, and the new loan-to-value it gives		
Cash sweep: amount a year		
New valuation ordered, by whom		
Margin increase, in basis points		
Strike now relative to the asset, against origination		
Size of the option being written on unchanged terms (see Case 1)		

Alder Point: strike 105,109,489, 12.4 per cent below 120,000,000 - more than two-thirds shorter than the 40 per cent a 60 per cent loan-to-value suggests.

Sizing: which test binds

Chapter 4. Three tests, one constraint. Solve each for the movement that breaks it, then write the one line.

Asset / loan		Analyst	
Deal / fund		Date	

Test	Today	Covenant	Breaches when	Fall required	Rank
Loan-to-value = loan / value					
Debt service cover = NOI / debt service					
Debt yield = NOI / loan					

The line for the credit paper: "Binding test: _____, breaching on a ____ per cent fall. _____ second at ____ per cent. _____ is not a constraint."

Shock	Result	Breach?
Rate +200 bp: cover		
Yield +25 bp: value and loan-to-value		
Income -10 per cent: debt yield and cover		
Loan sized down by: new headroom on the binding test		

Monitoring, set by the binding test	What to watch
Loan-to-value binds	
Debt yield binds	
Cover binds	

Cure	Trigger value	Loan must fall to	Payment
Loan-to-value cure			
Debt yield cure			

Alder Point: loan-to-value binds at 7.7 per cent, debt yield second at 8.6, cover last at 16.3. A 200 bp rise takes cover from 1.43x to 1.08x on an asset whose income has not moved.

The stack and the intercreditor

Chapter 5. Put one bridge underneath every layer, then read the five questions the intercreditor decides.

Asset / loan		Analyst	
Deal / fund		Date	

Layer	Amount	Attaches	Detaches	Recovers at the bridge	Recovers 10% lower
Senior					
Junior / mezzanine / B-note					
Preferred equity					
Sponsor equity					

Item	Answer	Evidence / note
The five questions		
1. Payment blockage: which defaults trigger it (payment, covenant, reporting), and for how long		
2. Standstill: 90, 180 or 270 days, and what the junior may do at the end		
3. Purchase option: price (par plus accrued: what is "accrued"?), when exercisable		
4. Cure rights: how many, how many consecutive, cash or deposit		
5. Release and disposal: order of proceeds, junior consent on price		
The small print		
"Senior debt" definition: hedging, protective advances, default interest (5 to 8 per cent in a two-year workout)		
Junior attachment recomputed on that definition		
Structural subordination: propco creditors, deferred tax, pensions		
Preferred equity: rights in the shareholders' agreement (forced sale, drag, board control)		

Alder Point: senior covered 1.14 times; the junior recovers 85 per cent at 82.2 million and 17 per cent at 74 million. A ten per cent move takes it from bond to equity.

A loan agreement in ninety minutes

Chapter 6. Read these, in this order. They decide what happens on the day the loan stops working.

Asset / loan		Analyst	
Deal / fund		Date	

Clause	What it says	Page / note
1. Cash management		
The four states: free flow, lockbox, cash trap, cash sweep		
Trigger levels against the covenant (a trap far above it costs distributions long before compliance)		
2. Covenant definitions, not levels		
Passing or contracted rent; rent-free periods		
Arrears: included, and for how long		
Debt service: actual, or at the capped rate		
Historic or projected; debt yield: normalised NOI, loan gross or net of blocked cash		
3. Cure rights		
Number in the life; consecutive periods		
Method: prepayment or refundable deposit		
Do cured periods count as defaults?		
4. Events of default		
Non-payment grace (3 to 5 business days)		
Insolvency scope: petition or outcome		
MAC: bargaining chip, not a basis for enforcement		
5. Prepayment		
Lockout		
Step-down penalty		
Yield maintenance, modelled		
Defeasance		
6. Transfer and change of control		
Thresholds		
Consent standard: could a rescue investor get in?		
7. The intercreditor, if any		
Standstill, purchase option, payment blockage		

A lender who grants generous cure rights has sold, cheaply, most of the value of its covenants. A borrower who accepts none has bought a loan that will default on a valuation movement outside its control.

A loan tape in half a day

Chapter 8. The averages describe a pool that does not exist. The tail describes the one you own.

Asset / loan		Analyst	
Deal / fund		Date	

Step	Done	Finding
The method, in order		
Sort by balance; read the top ten rows in full, every column		
Concentration table: cumulative exposure against each tranche's attachment point		
Maturity profile by year: look for a cliff		
Property type against jurisdiction: the largest single cell		
Sort by debt yield, loan-to-value and cover: loans in the weak tail of two or more		
Single-tenant exposures and over-rent: they drive severity, not default		
Only then the weighted averages		

Tranche	Attachment	Loans at total loss to reach it (from the largest)	Top-N share of the pool
A			
B			
C			
D			
E			
F			
G			

Maturing in	Balance	% of pool	Lease left at maturity (weighted)
Year 1			
Year 2			
Year 3			
Year 4			
Year 5+			

RAVEN 2024-1: top five 30.7 per cent, top ten 48.8, 73 per cent maturing in years three and four. The top three alone (20.3 per cent) exceed class D's 20 per cent attachment.

Your tranche: attachment, thickness, control

Chapters 9 to 11. Attachment governs probability, thickness governs severity. Then read who holds control.

Asset / loan		Analyst	
Deal / fund		Date	

Line	Value	Note
Attachment and detachment		
Thickness, and in money		
Largest loan, in points of pool: thicker than your tranche?		
Pool loss = default rate x severity that first touches you		
Pool loss that wipes you out		
Your loss at 1.5x the base case pool loss		

Item	Answer	Evidence / note
Three questions of any rated tranche		
What loss rate does the attachment imply, and is it plausible?		
Thickness against the largest loan		
Which single assumption (forced-sale yield, correlation) closes the gap to attachment?		
Monthly, in sequence		
Servicer report: delinquencies, special servicing transfers, watchlist		
Interest shortfall report: which classes were under-paid, and why		
Appraisal reduction notices: amounts, effect on advancing and control		
Controlling class notice: who holds control this month		
The structure over time		
Sequential or pro-rata principal; the switch triggers		
Available funds cap: do shortfalls accrue?		
Controlling class threshold (typically 25 per cent) and reductions needed to move it		

A single total loss on RAVEN's largest loan wipes class G and takes 19 per cent of class F; class E is untouched. But at 7.74 points against five, once losses reach class E one such loss takes all of it.

Underwriting a pool, and a risk transfer

Chapters 12 to 14. Four questions for any asset-based facility, then the investor's side of a significant risk transfer.

Asset / loan		Analyst	
Deal / fund		Date	

Item	Answer	Evidence / note
1. The receivable		
Obligation, obligor, term, indexation, breaks		
Granular pool or one lease?		
2. The history		
Static pool by vintage: loss curve, vintage drift, recovery timing		
3. Isolation		
True sale opinion		
Commingling period and mitigant		
Set-off		
Back-up servicer, tested		
4. Structure under stress		
Excess spread		
Overcollateralisation		
Reserve funds		
Triggers: what changes behaviour, at what level		
Significant risk transfer, from the protection seller's side		
Reference portfolio, loan by loan (Chapter 8 applies)		
Tranche position and thickness against portfolio expected loss		
Time subordination; call features; excess spread treatment		
Credit event and loss definitions: realised or valuation-based		
Replenishment: eligibility criteria and concentration limits		
Retention: senior tranche and vertical slice kept by the bank		

Where does the money come from, and what has to be true for it to arrive? Alder Point: a refinancing in three years, with three years of lease left on an over-rented single-let building.

Buying a sale and leaseback

Chapters 15 and 16. Seven lines, twenty minutes. Value the over-rent as a finite annuity at a credit rate, never by capitalising it at the property yield.

Asset / loan		Analyst	
Deal / fund		Date	

Line	Value	Note
Market rent, independently evidenced (not the seller's valuer)		
Over-rent in money and per cent (above 15 per cent: a financing)		
Market-rent value, on the SAME basis as the price (net income / yield)		
Over-price = price - market-rent value		
PV of the over-rent: annuity at the credit rate, over the remaining term		
Fair price = market-rent value + that PV; overpayment		
Implied rate on the over-price as a loan to the tenant		
Price / vacant possession value (above 1.5x: the building is incidental)		

Tenant fails in year	Over-rent received	PV at credit rate	Loss on the over-price	Reletting void and cost

Alder Point (corrected)	Value
Market-rent value, net	110,095,238
Over-price	9,904,762
PV of 520,000 for 12 years at 7%	4,130,197
Fair price / overpayment	114,225,435 / 5,774,565
Over-rent that would repay the over-price at 7%	1,247,029 (the lease pays 520,000)

The first edition compared a price on net income with a market-rent value on gross rent and printed an over-price of 7,619,048. On one basis it is the over-rent capitalised: $520,000 / 5.25\% = 9,904,762$.

What the net asset value is made of

Chapter 17. Six components, each with its own reliability, and two things it leaves out. Ask for six items; expect four.

Asset / loan		Analyst	
Deal / fund		Date	

Component	Amount	Basis / convention	Reliability, and the question to ask
1. Property valuations (quarterly? anchored?)			
2. Debt: face or fair value			
3. Cash: free of committed capex?			
4. Accrued items: rent receivable ageing			
5. Deferred tax: provided, at what rate			
6a. Not in it: exit transaction costs (1.5 to 6 per cent)			
6b. Not in it: carried interest provision			
Leverage multiplier = gross / NAV			

Request	Received?	Note
The data room		
Valuation reports themselves, not the summary		
Valuation history by asset, quarterly, three years (for unsmoothing)		
Debt schedule: margin, maturity, covenant, headroom		
Rent roll: passing against market, tenant by tenant		
Tax position on disposal, by jurisdiction		
Carry calculation at the reported NAV		

At 60 per cent leverage a 3 per cent gross error is a 7.5 per cent NAV error. Correcting Alder Point alone to its fair price takes 3.0 per cent off the fund's equity.

Unsmoothing, and the bid

Chapter 18. Two reported values, one coefficient. Present the range, not the point; then add the asset-level correction.

Asset / loan		Analyst	
Deal / fund		Date	

Line	Value
Reported gross, prior (like-for-like)	
Reported gross, current	
Debt	
$V_{\text{true}} = (V_{\text{now}} - a \times V_{\text{prior}}) / (1 - a)$, at $a = 0.60$	
Corrected NAV; stake of it	
Asking price; real discount	
Coefficient at which the discount vanishes	
Asset-level correction (over-rent, identified)	
Fully adjusted NAV; premium or discount	

a	Corrected gross	Corrected NAV	Stake	Real discount

Item	Answer	Evidence / note
Three caveats		
A reliable prior period: no transaction mark, change of valuer or mid-period trade		
Applied in rising markets too, not only when it helps		
Not a substitute for asset-level work: the two corrections are additive		

Pinewood: 486 reported becomes 468 true; the 10 per cent discount is 0.85 per cent and turns into a premium at $a = 0.62$. With Alder Point's over-rent corrected, the buyer pays a 2.5 per cent premium.