Commercial Mortgage-Backed Securities

Demand Exceeds Supply in CMBS

Fundamental challenges remain, requiring careful security selection.

Demand for CMBS from yield-focused buyers remains elevated, while supply is struggling to keep up as secular changes—especially in the office sector—and still-elevated interest rate volatility complicate underwriting. These technical forces are tightening spreads across the sector, which should encourage more issuance of real estate debt in CMBS format, including from data center owners amidst the AI boom. Active management and security selection will remain paramount as fundamental challenges persist.

Sector Commentary

- 2024 CMBS issuance of $112 billion more than doubled the $46 billion printed in 2023.
- Given challenges in the office sector and other subsectors, such as lower-tier regional malls, CMBS investors are increasingly reluctant to extend credit on diversified pools.
- Instead, they are more inclined to "credit pick" bonds backed by single assets or portfolios collateralized by in-favor property types, including lodging, multifamily, industrials, and even data centers.
- Over $70 billion of 2024 issuance came from single asset/single borrower (SASB) transactions, a trend we believe will continue given the bifurcation across real estate fundamentals.

Investment Themes

- We prefer senior securities with higher credit enhancement, capable sponsorship, and limited exposure to legacy real estate problems, especially in the office sector.
- Select SASB and CRE CLO transactions offer potentially attractive risk-adjusted returns, with spreads still wide relative to more liquid corporates.
- Conversely, we continue to find that most mezzanine and junior bonds across CMBS subsectors fail to appropriately compensate investors at current levels.

By Tom Nash and Hongli Yang

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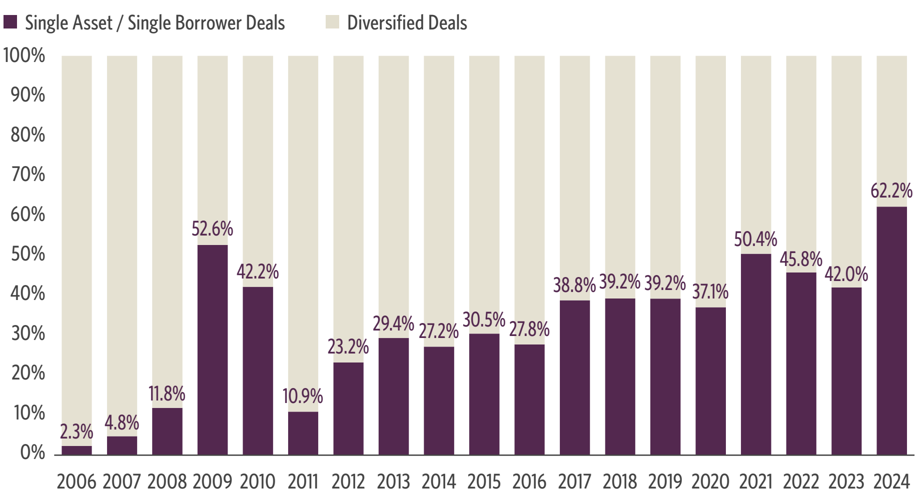
We Expect SASB Deals to Continue to Dominate Over Diversified Deals in 2025



Source: Guggenheim Investments, JP Morgan. Data as of 12.31.2024.