Commercial Mortgage-Backed Securities

Not a Lot of Bright Spots

Avoiding office properties and staying senior in structure.

AAA-rated conduit Commercial Mortgage-Backed Securities (CMBS) bond prices decreased by 0.5–2.0 percent quarter over quarter while BBB-rated conduit CMBS prices increased by 2 percent or more. We attribute this credit curve flattening dynamic to technical factors rather than credit fundamentals. CMBS supply continues to underwhelm investor demand given strong annuity and fund flows, causing investors to pay up to source bonds, especially higher-yielding bonds. We remain selective in CMBS as markets offer limited return for elevated risk in many cases.

Sector Commentary

- Approximately $50 billion in CMBS was issued in the first half, compared to $20 billion for the same period in 2023, powered by higher investor demand for yield products, especially credit-enhanced structured products.
- Over $30 billion of CMBS issuance has been in single asset/single borrower (SASB) transactions financing specific, well-performing properties, especially industrial, lodging, and multifamily properties.
- Legacy CMBS loans backed by over levered or underperforming properties—especially offices—struggle to refinance. Just 63 percent of conduit CMBS loans were refinanced on time, meaning over one-third of loans scheduled to repay this year are in some state of extension, modification, or other workout.
- Performance issues, including continued deterioration in demand for office space, will continue to weigh on Commercial Real Estate performance in coming months and expose CMBS to heightened risk.

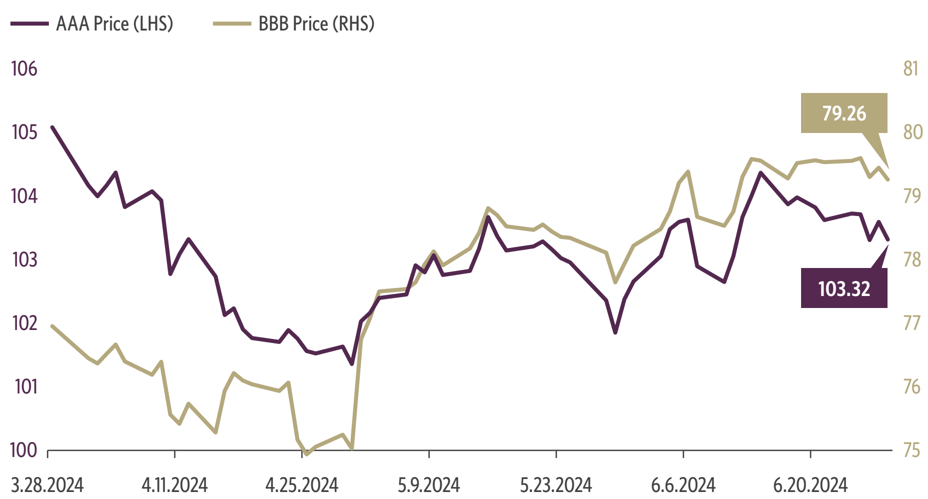
Investment Themes

- Broadly, we maintain a relatively low exposure to the sector.
- In CMBS, we maintain a preference for senior securities with higher credit enhancement, capable sponsorship, and limited office exposure.
- Select SASB transactions and CRE CLOs continue to offer the potential for attractive risk-adjusted returns.
- 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

AAA-rated conduit CMBS bond prices decreased by 0.5–2.0 percent quarter over quarter while BBB-rated conduit CMBS prices increased by 2 percent or more. We attribute this credit curve flattening dynamic to technical factors rather than credit fundamentals.

BBB Conduit CMBS Prices Rose While AAA Conduit CMBS Fell



Source: Guggenheim Investments, JP Morgan. Data as of 6.30.2024.