Commercial Mortgage-Backed Securities

Healthy Volumes Overshadow Credit Fundamentals

Maintaining caution and discipline in a technical rally.

Powered by healthy annuity and fixed-income fund flows, demand for credit-enhanced structured products such as CMBS continues to increase. While CMBS new issuance has recovered from the trough of 2023, investor demand has recovered even more strongly. As fundamental challenges persist across commercial real estate (CRE) sectors, we remain cautious in CMBS as we see limited opportunities to secure attractive risk-adjusted returns amid this technical rally.

Sector Commentary

- Year-to-date CMBS issuance of $83 billion exceeds the $32 billion issued in 2023 over the same period but lags the $92–$105 billion totals seen in 2022 and 2021.
- Over $50 billion of 2024 issuance has been via single asset/single borrower (SASB) transactions financing specific, high quality properties or portfolios, with a heavy concentration to industrial, multifamily, and lodging property types.
- Just 64 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 workout. Less than 40 percent of CMBS office loans have been repaid on time.
- Performance issues, including weak demand for office space, will continue to weigh on CRE performance and could expose CMBS to heightened risk, especially if macroeconomic conditions worsen. The 60-plus day delinquency rate currently stands at 5.9 percent.

Investment Themes

- 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

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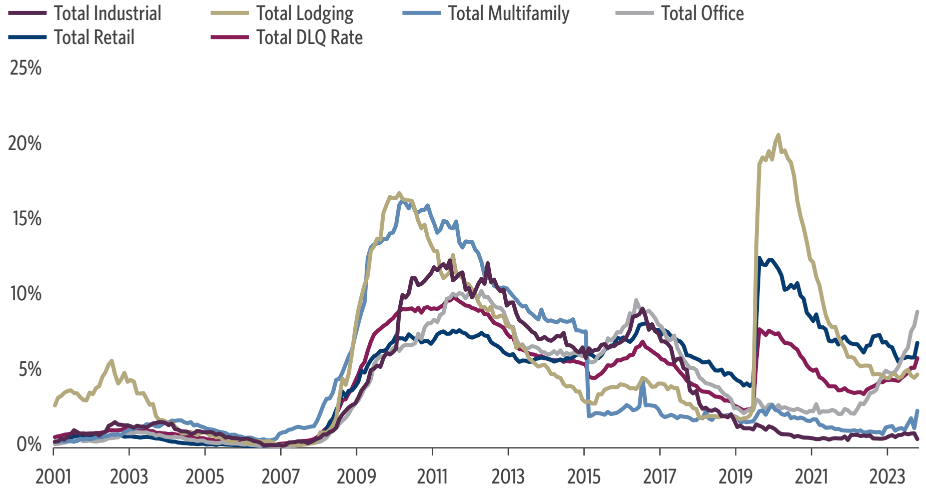
Office and Retail Sectors Lead CMBS Delinquencies

Delinquency Rate by Property Type (%)



Source: Guggenheim Investments, JP Morgan, Trepp. Data as of 9.30.2024.