Wall of CMBS Loan Maturities Shrinks, Remains Daunting

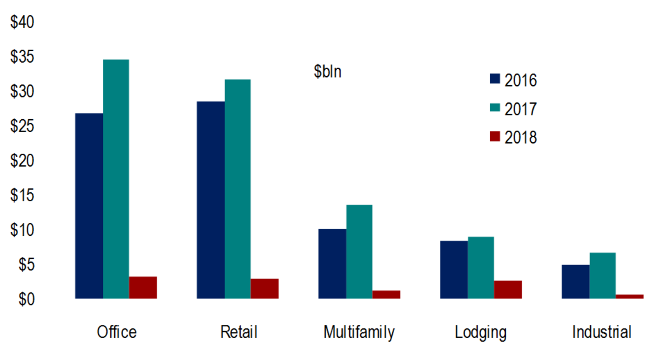
by Susan Persin

The volume of CMBS conduit loans that were scheduled to mature last year totaled $54.5 billion, excluding those that previously had been defeased. That volume will increase further during the next two years, with the overwhelming majority comprised of loans originated in 2006 and 2007.

Between now and 2018, $205.2 billion of conduit loans come due, with $87.1 billion maturing this year and $105.8 billion in 2017. Maturities scheduled for 2018 drop off to $12.8 billion.

> A total of $205.2 billion of conduit loans will come due by 2018. Increases in interest rates will naturally put some loans at risk.

Maturing Loan Balance



Source: Trepp LLC

Strong underlying market conditions mean that fewer loans have problems. Trepp's U.S. CMBS delinquency rate fell to 5.13 percent in November from 5.8 percent a year earlier. The "seriously delinquent" rate, which tracks loans that are more than 60-days late, was 5.02 percent in November.

Healthy real estate market fundamentals have enabled many owners to increase rents and income, which has contributed to an increase in property values and made refinancing easier than it otherwise would be. Borrowers have taken advantage of the strong market fundamentals, the availability of debt capital and relatively low interest rates to defease CMBS loans and refinance properties before their underlying loans mature.

More than 1,300 loans totaling nearly $20 billion were defeased, or replaced by government securities, last year through November. That's up from the full-year activity in 2014 and well above the $11.8 billion in 2013.

As a result of early refinancings and defeasance activity, the volume of maturities slated for 2016 and 2017 is down 17 percent from the $232 billion that last year would have been due during those years. A snapshot of Trepp data from late 2015, compared to year-ago levels, shows that outstanding maturing loan balances for 2016 and 2017 have declined for every property type.

Nonetheless, the volume of loans coming due in the next two years remains daunting. Consider that new CMBS issuance in 2015 totaled only $95.6 billion, less than what had been expected.

Meeting DSCR Requirements

Interest rates would have to rise substantially for debt service coverage levels to become a refinancing issue during the next two years. Interest rates remain below where most loans were originated in 2006 and 2007.

The average coupon for CMBS loans that were originated last year through mid-November was about 4.5 percent. At that coupon, net operating income easily covers debt service for most loans and property types. However, last month, the Fed began to increase its benchmark interest rate that had stayed near zero since 2008. Movement by the Fed sets the tone for other interest rates and could portend an increase on the long end of the yield curve.

We've reviewed how higher rates would affect borrowers' ability to meet a 1.2x debt-service coverage ratio, a level that is generally considered to be the minimum required by lenders. It indicates that a property would generate 20 percent more in cash flow than that needed to fully service its loan. The data show that 96.5 percent of loans slated to mature through 2018 would meet that level at current rates. That's up from 93.9 percent a year ago.

But as interest rates increase, meeting the DSCR requirement becomes more difficult. With a 100 basis point increase in interest rates, the proportion of loans meeting the DSCR hurdle falls to 94 percent. That compares with 88.9 percent a year ago. And if rates climb by 200 bps, 10.9 percent of loans could face difficulty refinancing, down from 19.8 percent in late 2014.

Effect of Rate Changes on Loan DSCR

	MATURING CMBS LOANS		PROPORTION OF LOANS WITH DSCR <1.2 FOR EACH INTEREST RATE SHIFT						
	BALANCE $BLN	COUPON %	0	+25 BPS	+50 BPS	+75 BPS	+100 BPS	+150 BPS	+200 BPS
Office	$64.6	4.48	7.8%	9.1%	10.2%	11.3%	12.5%	15.8%	20.7%
Retail	$63.2	4.47	3.6%	4.2%	4.8%	5.7%	6.9%	9.9%	14.7%
Multifamily	$24.8	4.51	2.9%	3.4%	3.9%	4.6%	5.7%	8.2%	12.1%
Lodging	$20.0	4.64	4.3%	4.5%	5.2%	5.7%	6.5%	7.5%	9.4%
Industrial	$11.9	4.45	4.8%	4.9%	5.5%	6.3%	6.8%	8.8%	11.1%
Total	$205.2	4.49	3.5%	4.1%	4.6%	5.2%	6.0%	7.9%	10.9%

Source: Trepp LLC

Loan-to-Value Ratio—2015

	2015 LTV %	TOTAL APPR VALUE ($BLN)	AMT. COULD REFI ($BLN)	OUTSTANDING LOAN BAL ($BLN)	DIFFERENCE ($BLN)
Industrial	65.50	19.00	12.41	11.90	0.53
Lodging	62.46	32.70	20.41	20.00	0.45
Multifamily	69.91	37.70	26.39	24.80	1.63
Office	63.89	103.60	66.21	64.60	1.61
Retail	66.43	94.40	62.73	63.20	-0.43
Total	**62.92**	**323.40**	**203.45**	**205.20**	**-1.76**

Source: Trepp LLC

Office and retail, the two property types with the largest representation in the CMBS universe, face the greatest refinancing risk. About $65 billion of office loans are set to mature through 2018. A total of 7.8 percent of those loans already are at risk of not meeting the DSCR hurdle. That proportion climbs to 20.7 percent with a 200 bps increase in rates. Similarly, $63 billion of retail loans come due through 2018. A comparable increase in rates would make it challenging for nearly 15 percent of those loans to refinance.

Hotel properties would have the easiest time meeting the DSCR requirements despite their higher initial coupon rate. More than 90 percent of hotel loans facing maturity would meet the hurdle, even after a 200 bps increase in rates. But hotel cash flows are far more fickle than those of office and retail properties because of the properties' reliance on transient leases.

Loan-to-Value Requirements

The picture's not so rosy when loan-to-value ratios are used as the refinancing benchmark. Last year, the average underwritten LTV ratio for CMBS loan originations was 63 percent and ranged between 62 percent and 70 percent, depending on property type. The consensus has been that underwriting standards have softened, so stressed LTV levels are likely greater.

The amount that borrowers can refinance based on current collateral appraised values in some cases falls below the amount owed against the loan in need of refinancing. However, because lenders generally have been willing to provide more loan proceeds against apartment properties, which results in greater LTV ratios (leverage levels have been just shy of 70 percent), few such loans would have difficulty refinancing.

Meeting current LTVs is a more significant issue for retail properties, where the amount that could be financed, based on leverage levels lenders are providing, would fall below the balance that needs to be refinanced. That could create opportunities for providers of mezzanine financing or preferred equity, or other capital that could be used to fill the gap needed to meet current LTV requirements.

So the wall of CMBS loan maturities has shrunk, but remains significant. Widening bond spreads have translated to higher costs for borrowers in last year's second half and could remain an issue this year. Borrowers will need to consider the impact of higher interest rates and lower LTV requirements on their ability to refinance. ■