The CMBX Trade Against Retail: Has it Paid Off?

Since early this year, a number of opportunistic investors have sought to profit from the expected demise of the physical retail sector. In what was dubbed the next "Big Short" by some, investors bought credit-default swaps against subordinate bonds in certain CMBX derivative indices that are tied to CMBS deals with healthy concentrations of loans against shopping malls and retail centers.

CMBX-plain It to Me

The trade gained notoriety last February, when spreads for the BBB- and BB rated components of the indices went through a massive widening. They continued to widen at a somewhat steady clip until only recently. That alone indicates the trade, particularly if executed early, has paid off nicely.

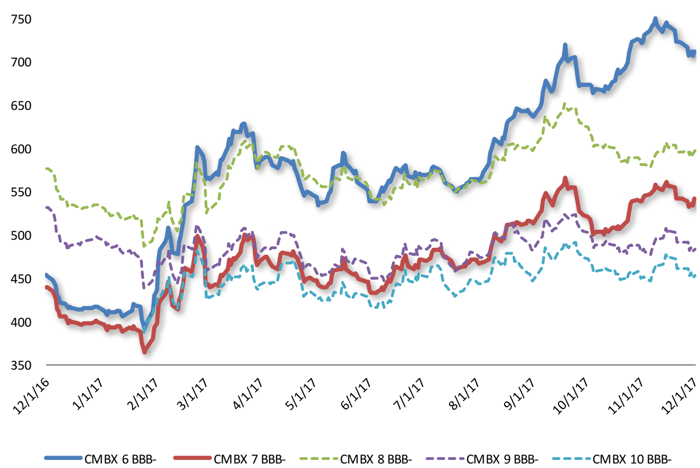
CMBX consists of a group of indices that are each linked to a group of 25 CMBS conduit deals issued during a particular year. The indices are used as an indicator of the overall performance of the CRE market and enables investors to make bets on corresponding long and short positions.

Investors who expect deals in a specific index to incur losses can buy protection. That is, they would pay a fixed-rate premium to a seller of protection who would bet against losses. If losses occur, the seller of protection would cover them. So, a short trade becomes most profitable when deals in an index suffer actual losses. It also becomes profitable in the event spreads widen, as they have.

Spreads Move Wider and Wider

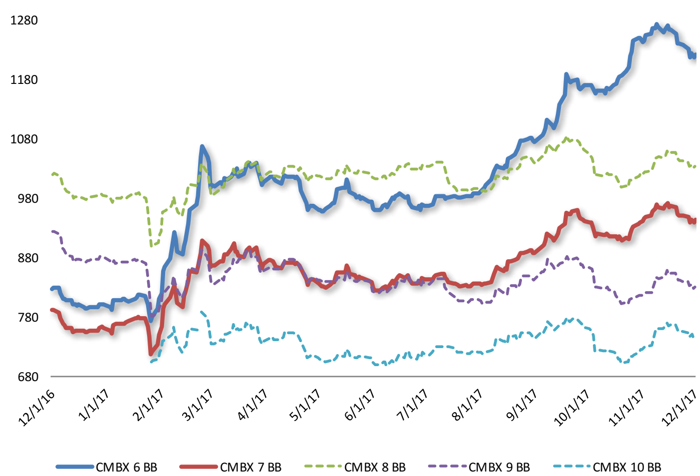
The spread blowout in CMBX has been especially pronounced for the 6 and 7 series, which are tied to CMBS deals issued in 2012 and 2013. Those spreads have widened largely due to the perceived greater exposure

GRAPH 1: CMBX 6/7/8/9/10 BBB- SPREADS



Source: Trepp

GRAPH 2: CMBX 6/7/8/9/10 BB SPREADS



Source: Trepp

to struggling mall properties and retail bankruptcies. The focus of the trade has been placed on junior bonds in the lower credit stack because the notes are typically the first to incur losses when distressed loans are liquidated or written off.

Compared to their tightest levels in late January, BBB- and BB spreads for the two segments initially widened between 130 and 295 basis points, respectively, in just two months as word about the trade emerged. While the sell-off paused momentarily in April, spreads for the BBB- tranches of CMBX 6 and 7 resumed their climb by August. The spreads then peaked at year-to-date highs in early November that were 358 and 202 basis points wider, respectively, than their lows in January.

By the same token, spreads for the lower credit BB bonds in those same indices reached highs that were a staggering 499 and 254 basis points wider than their narrowest points roughly 10 months ago. During this devaluation period, the traded price pegged to the BBB- and BB portions of CMBX 6 and 7 series were reduced by 10 to 17% as investors rushed to crowd the trade. Prices and spreads for the derivative positions have since recouped some of their losses as the market has begun to catch on that the underlying bonds are being priced below their actual worth.

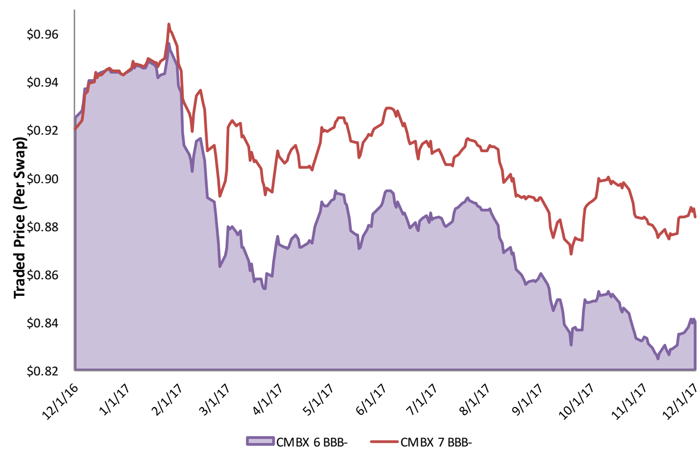
Broader Retail Worries Weigh on CMBX

It's no secret that the retail landscape is in the midst of an unprecedented revolution. The cause of the blowout in CMBX spreads centers on the idea that the weak performance of certain retailers, particularly JCPenney, Sears, and Macy's, would impact the properties they occupy. The three department store chains often anchor class-B and -C malls and have been shuttering stores by the dozens.

Such closures often trigger co-tenancy clauses for other in-line mall tenants, prompting them to downsize or vacate altogether. The thinking has been that properties, particularly those in secondary or tertiary markets, exposed to the three firms are at greater risk of default and losses. As such, those holding short positions in certain CMBX indices would receive a payout.

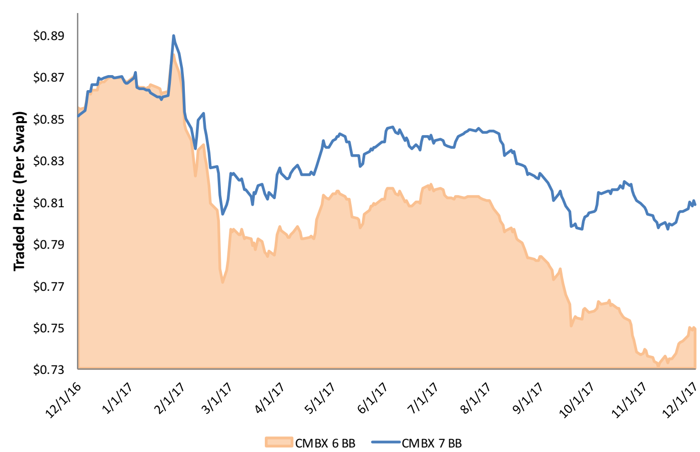
But has the bet paid off? Not quite. Retail loans are the most exposed property type for both the CMBX 6 and CMBX 7 indices with a 38.24% and 32.4% concentration, respectively. But only 1% of the remaining balance of retail assets has been marked as delinquent.

GRAPH 3: TRADED PRICE ON CMBX 6-7 BBB- BONDS



Source: Trepp

GRAPH 4: TRADED PRICE ON CMBX 6-7 BB BONDS



Source: Trepp

So far, only 40 retail loans in deals tied to the CMBX 6 and 7 series have paid off, and four incurred losses totaling $4.3 million. Each of those notes disposed was in a 6 series deal. No losses have been attributed to deals tied to CMBX 7. But the number of distressed retail mortgages will likely increase as they inch closer to their scheduled maturity dates and collateral performance continues to deteriorate.

CHART 1: CMBX 6 OVERVIEW

PROPERTY TYPE	% IN SERIES 6	WA LTV	WA DSCR	WA DEBT YIELD	AVG OCCUPANCY
Industrial	4.17%	64.31%	1.76	16.33%	95.14%
Lodging	10.65%	61.49%	1.96	17.45%	74.70%
Multifamily	5.42%	68.41%	1.67	12.75%	92.94%
Office	26.87%	66.35%	1.74	13.56%	90.23%
Other	14.64%	61.61%	1.99	14.10%	90.54%
Retail	38.24%	64.17%	1.89	15.16%	94.37%

**Based on a December 2017 snapshot*

Source: Trepp

CHART 2: CMBX 7 OVERVIEW

PROPERTY TYPE	% IN CMBX 7	WA LTV	WA DSCR	WA DEBT YIELD	AVG OCCUPANCY
Industrial	3.90%	65.18%	1.72	14.59%	94.20%
Lodging	13.48%	62.66%	2.14	17.71%	74.04%
Multifamily	12.61%	72.95%	1.64	11.65%	92.89%
Office	18.32%	62.92%	1.92	15.40%	90.40%
Other	19.28%	62.28%	1.83	14.44%	90.45%
Retail	32.40%	62.54%	2.07	19.64%	95.78%

**Based on a December 2017 snapshot*

Source: Trepp

CHART 3: 10 LARGEST MALL LOANS IN CMBX 6 AND 7

DEAL NAME	LOAN NAME	LOAN BALANCE ($)	CITY, STATE	DSCR (NCF)	OCCUPANCY (%)	CAP RATE (%)	% SF EXPIRING WITHIN 4+ YEARS	TOP 3 TENANTS
WFRBS 2013-C18	Garden State Plaza	150,000,000	Paramus, NJ	4.79	97	4.84	73	Macy's, Nordstrom, JCPenney
COMM 2013-CR11	Miracle Mile Shops	145,000,000	Las Vegas, NV	1.48	97	5.03	44	V Theater, Saxe Theater, Victoria's Secret
COMM 2013-CR12	Miracle Mile Shops	145,000,000	Las Vegas, NV	1.48	97	5.03	47	V Theater, Saxe Theater, Victoria's Secret
WFRBS 2012-C7	Northridge Fashion Center	142,982,079	Northridge, CA	1.59	89	7.31	48	Pacific Theatres, Ross Dress for Less, Forever 21
GSMS 2013-GC13	Mall St. Matthews	142,079,959	Louisville, KY	2.11	97	7.20	72	JCPenney, Forever 21, Cinemark Theater
WFCM 2012-LC5	Westside Pavilion	141,274,500	Los Angeles, CA	1.28	89	4.71	47	Nordstrom, Macy's, Landmark Theater
WFRBS 2013-C18	The Outlet Collection | Jersey Gardens	140,000,000	Elizabeth, NJ	3.66	97	7.27	31	AMC Theatres, Burlington, Forever 21
WFRBS 2013-UBS1	The Outlet Collection | Jersey Gardens	130,000,000	Elizabeth, NJ	3.66	97	7.27	31	AMC Theatres, Burlington, Forever 21
MSBAM 2013-C13	Stonestown Galleria	130,000,000	San Francisco, CA	2.86	98	5.53	80	Nordstrom, City Sports, Target
JPMCC 2012-LC9	West County Center	124,974,419	Des Peres, MO	2.01	99	6.33	78	Macy's, JCPenney, Nordstrom

**Based on servicer data reported for the 2016 fiscal year*

Source: Trepp

For inquiries about the data analysis conducted in this research, contact info@trepp.com or call 212-754-1010. For press inquiries, contact press@trepp.com.

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