Trepp®
CMBS Research
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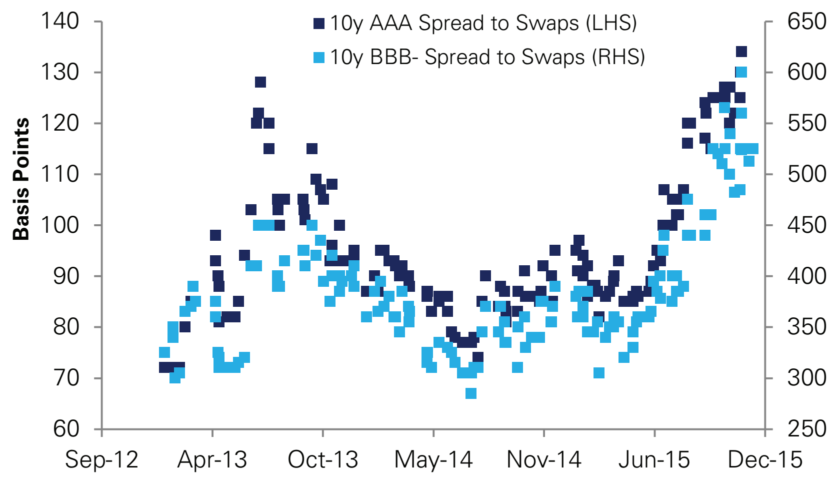
CMBS New Deal Spreads Highest Since the Taper Tantrum of 2013

After almost two years of consistent spread tightening and relative calm in new issue pricing, new issue CMBS spreads began widening in June of 2015. Now, 10-year AAA and BBB- tranches are pricing 40 and 200 basis points wider, respectively, than at the beginning of the year. New issue spreads have not been this wide since the 'taper tantrum' in the summer of 2013 when the Federal Reserve began winding down its quantitative easing of bond purchases.

Figure 1. New Issue Conduit CMBS



Fundamental Factors

CMBS bond prices are a function of fundamentals (duration, credit enhancement, coupon, collateral quality, etc.) and macro factors (liquidity, credit spreads, treasury rates, swap rates, etc). Loosening underwriting standards play to the fundamental factors, as evidenced by increased weighted average LTVs, more interest only loans in the pool, reduced debt yields, and lending outside of primary and secondary markets.

While the credit quality of new deals looks relatively similar to a year ago on the surface, ratings agencies, B-piece buyers, and investment grade investors are scrutinizing collateral more than ever. Those investor groups are pushing issuers to reward them with higher yields, especially at the bottom of the investment grade stack.

Figure 2. New Issue Conduit Yields

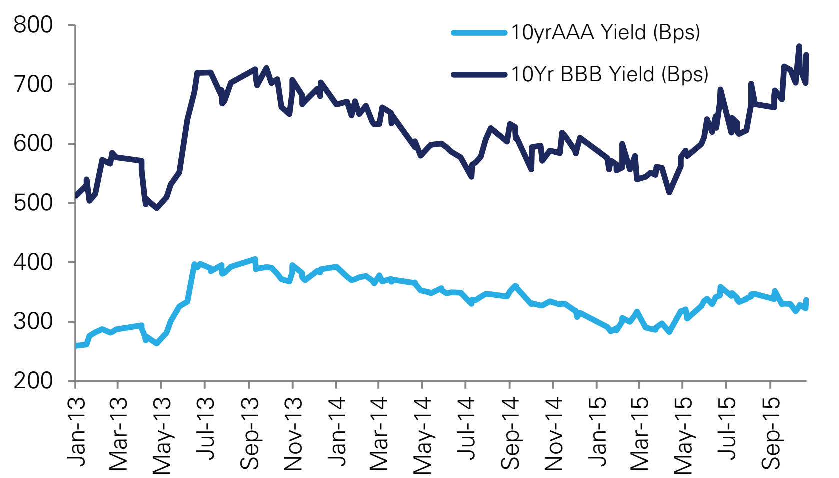


Figure 3. 10-Year Swap Spread to Treasury

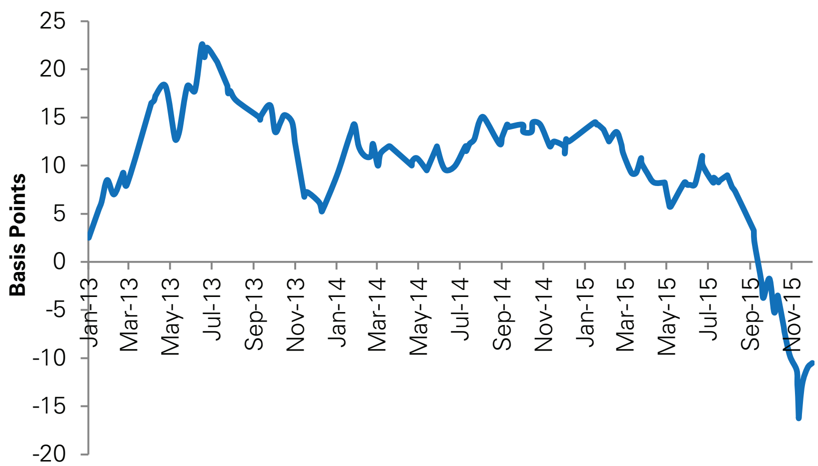


Figure 4. New Issue Conduit BBB-

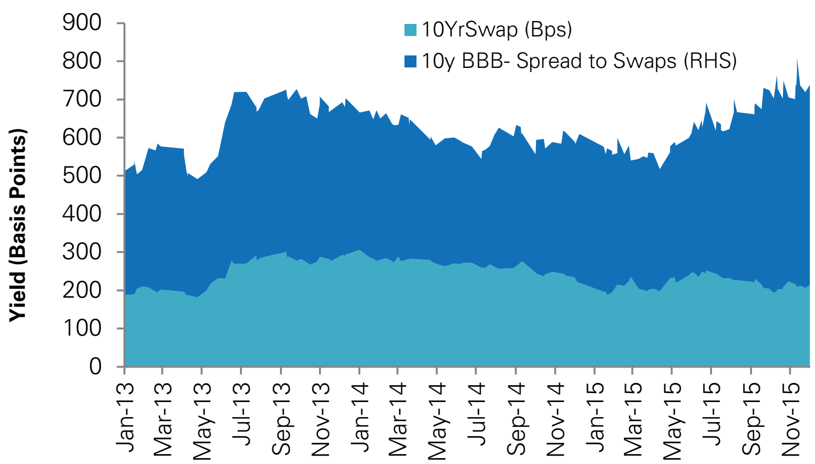
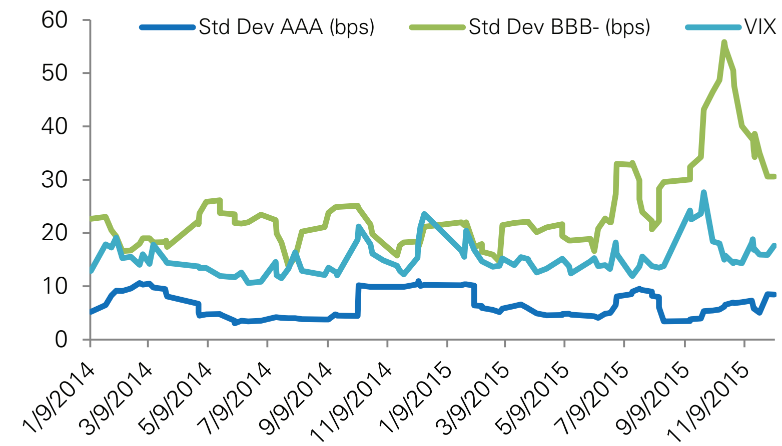


Figure 5. New Issue Swap Spread Dispersion



All in yields on new issue 10-year last cash flow bonds are now about 50 basis points lower than in 2013, but BBB- all in yields have eclipsed 2013 levels. New issue AAA tranches are yielding around 30 basis points more than corresponding bonds that came to market in late 2014 and earlier in 2015.

Macro Factors

The recent blow out in new issue CMBS spreads is a result of Fed rate hike expectations, international economic uncertainty, impending regulation, and a growing lack of primary market liquidity. Swap rates have turned negative over the last few weeks, putting even more upward pressure on CMBS spreads to maintain absolute yield levels.

Another external factor pulling risk spreads wider is the recent sell off in high yield fixed income, which has been caused in most part by sustained low energy and commodity prices. This seems to be playing out more so in the riskier part of the CMBS stack.

The lowest investment grade tranches in new deals have widened significantly over the past three months. A few recent deals have split the BBB- tranche into two bonds, a BBB+ and BBB-, which has brought the weighted average spread down slightly. Still, the absolute yields on the BBB- tranches are up as much as 250 basis points since earlier in the year.

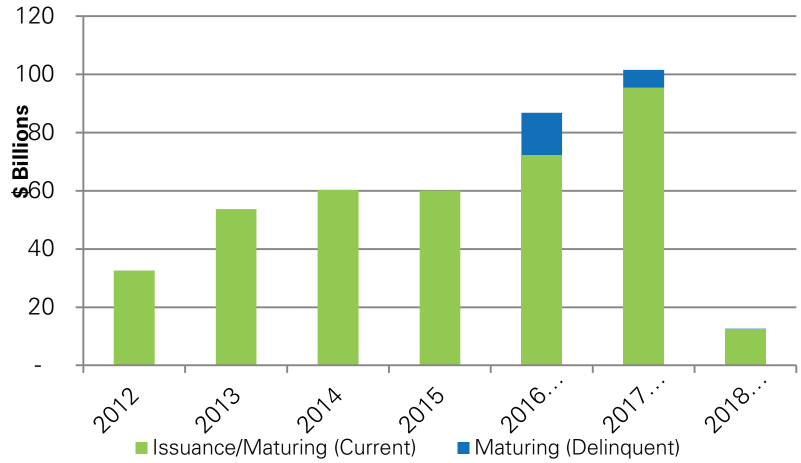
Most conduit deals coming to market a year ago were pricing in a tight range, one after another. Over the past three months, deals have shown wider spread dispersion based on deal fundamentals as well as their timing in terms of broader market volatility. Standard deviation of new deal spreads to swaps on a trailing 15 deal basis has remained within a 10-basis-point range for LCF tranches, but has swung to a 40 to 60 basis point window over the past month for the BBB- classes.

Looking Forward

Moving into 2016, commercial real estate fundamentals should maintain their growth, even with slowly rising interest rates. The brunt of the wall of maturities will provide plenty of fuel for new originations. However, the follow-on effect of sustained low oil prices is worrisome on the commercial real estate front in those areas highly exposed to energy, and on the CMBS front if high yield energy bonds drag all risk assets wider.

Risk retention, Reg AB 2, and risk based capital requirements are all a concern for CMBS spreads and their ultimate effect on borrowing costs. The structure of issuing entities and B-piece buyers a year from now could look very different, and depending on how the adoption of those rules is handled, spreads could widen further. Then again, everything could be different once the interest rate hike is in effect. ■

Figure 6. Conduit Issuance vs Upcoming Non-Defeased Maturing Vol.



For inquiries about the data analysis conducted in this research, contact press@trepp.com or call 212-754-1010.
For more information about Trepp's commercial real estate data, contact info@trepp.com.

About Trepp

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