CMBS LOAN MATURITIES AND POTENTIAL DEFAULTS – A TSUNAMI OR A RIPPLE?

July 6, 2016

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For the last few years, financial analysts have been warning of the wave of CMBS loan maturities in 2016 and 2017 and the resulting "parade of horribles". Morningstar Credit Ratings estimates that between now and 2018, $205.2 billion in conduit loans will mature, with $87.1 billion maturing in 2016, $105.8 billion in 2017, and $12.8 billion in 2018. See here. But are the problems expected to be caused by the predicted wave of CMBS loan maturities really more like a ripple than a tsunami?

Morningstar reports that due to refinancing and defeasance activity, the volume of maturities scheduled for 2016 and 2017 is down 17% from the $232 billion projected last year. Trepp, the industry's largest commercially available database of securitized mortgages data, also positively reflects a decrease in outstanding loan balances for 2016 and 2017 in every property type. Despite the looming maturities, according to Trepp data, CMBS delinquency rates have fallen consistently from 2010 through 2015. The default rate is expected to increase slightly in 2016; however, strong market conditions in 2016 will mean that fewer loans than previously expected to will have problems. But that said, the amount in maturing loans over the next few years - over $200 billion - seems huge.

For borrowers facing a maturity date, timing is key. Interest rates are favorable, remaining below the levels being paid by the borrowers of most of the CMBS loans that are maturing during 2016 and 2017. With current rates, net operating income can cover debt service for most loans and property types. But, as noted in Morningstar's recent report, the U.S. government's recent increase of its benchmark interest rate may set the stage for additional rate hikes. Rising rates may sabotage a borrower's ability to meet its debt service coverage ratio requirements. Morningstar predicts that with a rate hike of 100 basis points, the proportion of loans meeting the debt service coverage ratio hurdle falls to 94%, compared to 88.9% in 2015; and if rates increase by 200 basis points, 10.9% of loans could face difficulty refinancing, compared to 19.8% in late 2014.

Higher loan-to-value requirements will also have a negative impact on refinancing. In May 2016, Moody's/RCA Commercial Property Price Indices (CPPI) report noted property price growth decelerating. See here. "The CPPI is now is now roughly at the level it achieved in December 2015," says Moody's Director of Commercial Real Estate Research, Tad Philipp. "Since then, prices have effectively moved sideways." "Property price growth has decelerated on an annual basis", Philipp says in Moody's/RCA CPPI – "prices have leveled off since late 2015." Lowering property values will have a negative impact on refinancing. Morningstar predicts certain property assets such as retail, where leverage levels lenders are providing may fall below the balance that needs to be refinanced, will face a greater refinancing risk.

Still, the "maturity wave" coming between now and 2018, although decreased due to favorable market conditions in recent years, is looming. With a potential increase in interest rates, and lender's requiring lower loan to value requirements, refinancing may not be a slam dunk, despite the favorable market conditions we have enjoyed during the last several years. Borrowers facing the sword of a maturity date will heavily rely on timing and perhaps short term lending solutions to make it through. Both lenders and borrowers should act proactively. Lenders can provide advance notice to those borrowers who they are either unwilling or unable to

continue banking with, reminding the borrower of their upcoming maturity date and forewarning that no modification to the upcoming maturity situation will be made. Borrowers should plan in advance for a payoff by considering their lending options, ensuring their organizational and financial documents are in order, and proactively seeking to improve or restructure their balance sheets. For a borrower, figuring out the timing of maturity and the receptivity of the market will be key.

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