CMBS MONTHLY

Payden&Rygel Investment Management

September 2022

- September saw continued weakness in CMBS markets with limited new issue and wider secondary spreads. In particular, concerns around prospects for office leasing and valuations increased and focus turned to refinancing difficulties for conduit CMBS office loans with near-term maturities. P&R has limited exposure with office totalling ~20% of CMBS holdings (mostly SASB/CRE CLO).
- Prospects for Q4 issuance are dim. The Fed's aggressive hiking cycle and the broader adjustment in interest rate markets have crimped underlying CRE transaction activity. That, combined with higher capital market risk premia argue for total private label issuance ~20-25% below 2021. While the supply technical looks favorable it is not likely to offset property valuation concerns in a rising rate environment.
- Fundamentals are expected to continue to evolve unevenly. In addition to the aforementioned office concerns, market participants are pricing in valuation declines as a result of higher cap rates across property types. Where appropriate, with spreads in the H200-450 range, we prefer to focus on AAA/AA/A and select BBB bonds in deals backed by property types where rent growth continues to register positive, namely multifamily and industrial.

GENERIC NEW ISSUE CMBS SPREADS & INDEX RETURNS

		Recent			5Y History		
Sector	Class	Last	1y Ago	Chg	Min	Median	Max
Conduit	AAA-LCF	157	69	88	61	90	300
	BBB-	610	385	225	195	345	650
CRE CLO	AAA-A1	240	125	115	75	115	275
	BBB-	580	340	240	205	310	635
SASB	AAA	230	95	135	55	100	397
	BBB-	425	200	225	125	220	600
Single Family Rental	AAA	160	70	90	45	90	300
	BBB-	430	275	155	150	205	775

Sources: Payden & Rygel Structured Products Group, JPMorgan, ICE BofAML

	Total Return*				
CMBS Index	1 Month	3 Month	YTD	2021	2020
AAA	-3.1	-5.0	-10.8	-1.1	7.6
1 to 5	-1.9	-3.1	-6.9	-0.5	5.6
5 to 7	-4.0	-6.5	-13.2	-1.7	8.7
7 to 10	-5.3	-8.5	-17.6	-2.2	10.4
AA	-3.2	-4.6	-11.7	0.5	6.8
A	-3.1	-3.8	-11.6	4.3	2.3
BBB-	-3.1	-3.8	-12.3	6.5	-0.9

*Includes Agency, Conduit, and SASB

inCREdulous … CRE TOPIC(s) OF INTEREST: Retreating Advance Rates

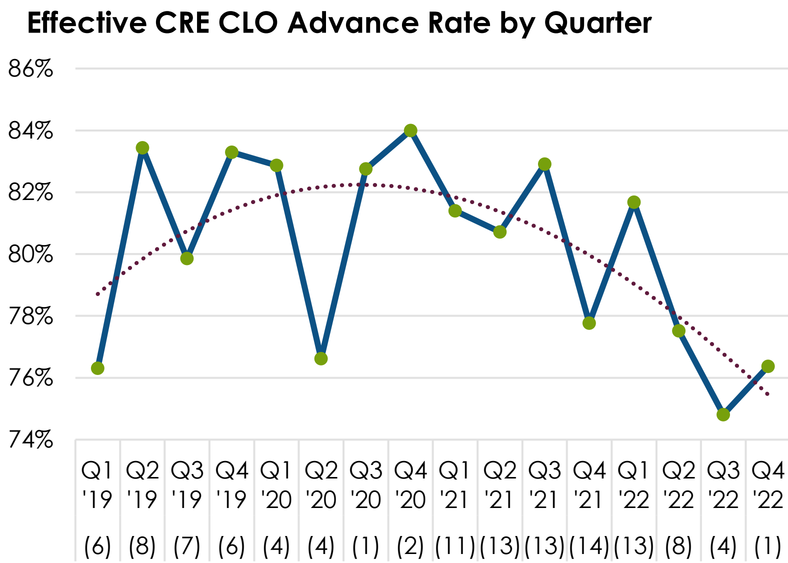
CRE CLO issuers delight in the non-recourse, non-mark-to-market, matched term, matched (floating) rate profile the CRE CLO bond liabilities offer. And who can blame them? Why be subject to the whims of a bank's credit officer on a warehouse line of credit if you needn't be?

This appeal of CRE CLOs remains unchanged in today's market environment. However, in the past, CRE CLOs have also offered very competitive pricing and advance rates compared to the usually better profile offered through bank options. The increased cost of financing loans via CRE CLO has been reported in these pages as spreads widened through 2022. This edition of inCREdulous documents the falling advance rate.

For those unfamiliar with the advance rate concept, a starting point is loan to value (LTV). Unlike an LTV which measures the % of debt relative to the value of a property asset, an advance rate reflects the % of debt a *lender* can use to finance their loans. It matters greatly to lenders because *ceteris paribus* the higher the advance rate the higher the rate of return earned on their equity.

CRE CLOs in '21 offered issuers advance rates of approximately 81%. Said differently, for every $1 of loans made, sponsors needed $0.19 of their own money and borrowed the remaining $0.81 to fund their lending activity.

In recent quarters, these dynamics have changed (see plot right). Effective advance rates are now closer 75% (effective because even though bonds are offered, sponsors have retained classes as the market's collective bid is not economic for the issuer). Some deals have even seen advance rates as low as 61%!



Source: Payden & Rygel Structured Products Group

This seemingly small 6 percentage point change has a large effect on the sponsor's return. Imagine a sponsor with $100 of loans to finance with a 7% coupon and a 5% cost of debt. At the 81% advance rate, the return on equity amounts to 10.5%; at the 75% advance rate, return on equity drops to 8.0%. This toy example ignores the compounding adverse effect of higher cost of debt relative to the asset coupon but serves to show the predicament in which CRE CLO sponsors currently find themselves.

As investors in CRE CLOs, we meet this news with mixed feelings. On the one hand, market discipline wrought by risk-off sentiment is a positive thing—fair pricing of risk relative to other opportunities makes sense. But as CRE market participants we understand the importance of well-functioning financing markets for CRE lenders and borrowers alike. Given current circumstances we don't see this soon reversing but remain hopeful that, over time, the market will rationalize and return to more regular (new issue) life.

NEW ISSUE HIGHLIGHTS

Deal	JPMCC 2022-NXSS	BX 2022-GPA	ILPT 2022-LPF2	BDS 2022-FL12
Type	SASB	SASB	SASB	CRE CLO
Size	$357MM	$1,525MM	$1,100MM	$708MM
Pricing Spreads (AAA/BBB-)	SOFR+230 / SOFR+425	SOFR+225 / SOFR+415	SOFR+230 / SOFR+425	SOFR+225 /
Credit Support (AAA/BBB-)	50.4% / 22.9%	40.8% / 5.0%	50.5% / 17.5%	45.0% / 20.7%
Credit Metrics (LTV/DY/DSCR)	65.8% / 7.2% / 1.24x	47.1% / 8.8% / 1.48x	61% / 7.0% / 1.16x	70.6% / 5.9% / 0.89x
Property Types	Self Storage (100%)	Multifamily (100%)	Industrial (100%)	Multifamily (100%)
Notes	NexPoint Advisors refi of 29 self-storage properties	Financing BX's $12.8B take-private of American Campus Communities	105 property portfolio w/ investment-grade tenant skew	BDS persisted in issuing despite wide spreads as they favor CRE CLO

LOAN FUNDAMENTALS

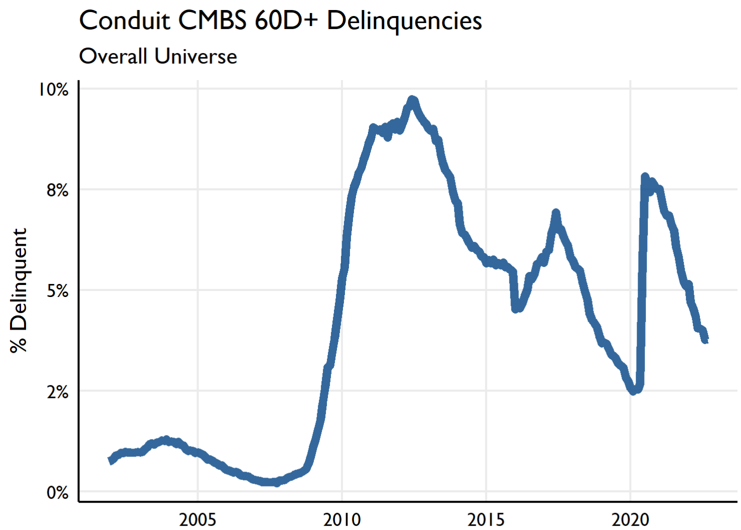
Here we review key developments in the loan assets backing CMBS, as of the most recent monthly remittance reports. Key notes include:

1. Overall, the 60D+ delinquency rate was flat in September at 3.8%, as retail DQs rose 6.8% to 7.1%.
2. By sector, lodging continued to lead improvement with serious DQs dropping from 7.2% to 6.8%.

If you have any questions, please get in touch at structuredproductdata at payden dot com.

Thanks for reading,

Payden CMBS Team



Sources: JP Morgan, Payden & Rygel Structured Products Group

(See following page for disclaimer)