CMBS still waiting for post-crisis revival

Loan maturities in European CMBS deals will come thicker and faster than ever in 2013, but an acute refinancing need alone will not necessarily be enough to force a return of CMBS dealflow. Joe McDevitt reports.

THE COMMERCIAL real estate refinancing mountain looms larger than ever, at €40bn over the next three years. But CMBS has shown only fleeting signs of life. The last 12 months have, however, offered a much clearer picture of the type of CMBS deals that at least stand a chance of successful execution.

Deutsche Bank in September completed its long-awaited Florentia CMBS, backed by German multi-family assets managed by Vitus. The weighted average spread of the five tranches, rated from triple-A down to triple-B minus, was a hefty 300bp over three month Euribor.

But at €754m, the securitisation provided a much larger chunk of refinancing than borrowers could expect to obtain through German bank loans, bankers said at the time.

More importantly, the deal was a successful execution of an agency-style CMBS, whereby Vitus sold notes directly to investors, rather than Deutsche having to originate and retain bonds on its balance sheet. This removes the need for the bank to take on principal risk and assign capital to holding that risk — one of the big stumbling blocks to reviving the European market.

The crucial hurdle that Florentia cleared was on the eligibility of a non-bank being allowed to fulfil the 122a retention requirements in the European Commission's Capital Requirements Directive IV. The regulation demands that the "originator, sponsor or original lender" retain 5% of the bonds. The German regulator agreed that Vitus fell under CRD IV's definition of an eligible entity.

This opens up the possibility of more deals following this agency model, says Conor Downey, partner at Paul Hastings, a law firm. "CRD IV is a directive, so it's drafted in very general terms," he says. "So once a solution is found, that solution can be applied to other transactions."

Nassar Hussain, founder of Brookland Partners, a real estate advisory firm, says: "Initial deals are likely to be mainly single-borrower agency-style transactions with a focus on homogenous asset classes or trophy buildings, which are easier to analyse and either very granular or high quality."

Citi analysts said in November that the hypothetical weighted average cost of issuing a CMBS was, for the first time since the crisis, lower than lending margins for UK office properties.

Gagfah, another German residential property company, has already confirmed it is thinking about bringing a €625m CMBS, also backed by German multi-family units as part of its roughly €2bn of refinancing needs.

But the majority of attendees at the Commercial Real Estate Finance Council's conference in the autumn of 2012 expected less than €5bn of issuance in 2013. This is partly because there is a lack of lending appetite for non-prime commercial real estate, not just among banks looking to deleverage but also among potential CMBS bondholders. Whatever demand there is to refinance does not extend to non-prime assets.

One deal in the second half of 2012 bucked this trend, though. RBS securitised the financing it provided to Blackstone to purchase a portfolio of its non-performing loans in a deal called Project Isobel.

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The portfolio included mezzanine loans and loans on non-prime operating assets to numerous borrowers, some of whom were not named at all in the offering circular.

Despite this, RBS said it managed to place all of the £230m of 'A' notes and £60m of 'B' notes with investors, at 255bp and 425bp over, respectively. Market participants reckon Isobel, if the notes were indeed fully sold, will prove to be a rare exception.

Some managers (particularly those with access to higher yielding underlying assets) are looking at the high yield bond market for refinancing, instead of securitisation. A deal for Center Parcs in 2011 used a combination of high yield and securitisation. Terra Firma's Four Seasons nursing homes business has also used the high yield bond market to refinance.

Christian Aufsatz, CMBS analyst at Barclays, agrees with the conference delegates' conservative issuance projections for 2013. "I expect more of the same as last year," he says. "Loans will not repay in time and servicers will get more forceful."

"Two years ago there were a lot of outright extensions by two or three years that only postponed the issues. Last year the trend was for servicers, especially for large loans, to give one year extensions with the option to extend by another year on a rolling basis, based on the deal reaching certain milestones. Last year most of those loans did not meet their milestones and servicers could have extended again, but instead they put them into special servicing."

The market expects this servicing trend to continue in 2013. Aufsatz estimates that 155 loans with a securitised balance of €20.9bn will mature this year. ∎