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CMBS Make a Comeback in Europe

By ALESSIA PIROLO – Tuesday, November 25, 2014 14:44 ET

Recovery in U.S. Market Is Spreading Across the Pond

Since the financial crisis, bankers have been waiting for the recovery in the U.S. commercial mortgage-backed securities market to make its way to Europe.

Now, some of the biggest CMBS originators in the U.S., including Deutsche Bank AG , Bank of America Merrill Lynch and Goldman Sachs Group Inc., are ramping up in Europe and say deal activity is increasing. Others are getting ready to follow.

"We fully intend to be an active lender in the European CMBS market," said Wesley Barnes, head of real-estate finance for Europe at Citigroup Inc., which rebuilt its lending operation in Europe in 2012 but hasn't yet started to originate CMBS, a lending tool that involves packaging real-estate debt into securities that are than sold in the public market.

Ever since the downturn the market has sputtered as Europe has struggled with anemic growth, prompting the European Central Bank to continue making asset purchases to spur activity. Deal volume level is still a trickle compared with the precrash years. There have been seven new CMBS issues in Europe this year worth €2.57 billion ($3.2 billion), according to data firm Trepp LLC, compared with €47.3 billion in the peak year of 2006.

Still, analysts are encouraged that the market's volume is growing, as is investors' willingness to buy CMBS backed by a wider variety of property types. The number of new issues in Europe this year is expected to exceed the 10 deals in 2013. There have been seven so far, and analysts estimate that up to 12 additional deals are in the pipeline and are expected to come to market by the first quarter of 2015.

Just as significant, property investors this year greatly increased their use of CMBS for financing new acquisitions. In 2013, they mainly used CMBS for refinancings.

Furthermore, this year, for the first time since the crash, CMBS deals in Europe have involved debt backed by multiple loans and multiple borrowers of real estate rather than single properties. “This is the first time since the crisis that we are seeing a significant pipeline in the market,” said Conor Downey, a London-based partner at law firm Paul Hastings LLP.

The trend bodes well for Europe’s commercial real-estate industry. While many of the continent’s countries are seeing values rise, the strength of the rebound has been limited partly by the limited supply of debt financing.

In 2014 and 2015, the gap between the refinancing needs of European commercial property owners and available debt is expected to be €124 billion, according to a report earlier this year from property-services firm DTZ. Borrowers and investors are hoping the shortfall will be partly filled by CMBS.

The European CMBS market has always been smaller than its counterpart in the U.S., partly because it is more challenging to create pools of securities out of mortgages from different countries, with different regulations and lending practices.

The CMBS markets in the U.S. and Europe both crashed in 2008. But the U.S. market recovered much more quickly, partly because its economy and real-estate markets did. Banks have sold more than $74 billion in new issues in the U.S. so far in 2014, according to Trepp LLC.

In Europe, after a limited number of deals in 2012, the CMBS market slowly restarted in 2013, but was dominated by refinancing of multifamily portfolios. Last year, about €7.2 billion of CMBS was issued, but almost all of that was from the refinancing of three large German residential portfolios, according to Trepp.

“The predominance of German multifamily in new securitization at the beginning of 2013 was significant,” said Patrizia Pirinoli, CMBS analyst at Goldstar Research Ltd. Most issues, she added “stemmed also from previous securitizations.”

The recovery of Europe’s CMBS market is partly due to work by a trade organization, the Commercial Real Estate Finance Council, which issued new guidelines for the securities in Europe, so-called CMBS 2.0. The guidelines are meant to guarantee to investors “more transparency, more access to the underlying documents,” said Charles Roberts, a partner at Paul Hastings.

Many of the deals this year have been more complex than simple refinancing. Some have provided debt to borrowers to finance new acquisitions and others involved multiple loans. For example, Goldman Sachs completed two CMBS originations backed by loans on Italian portfolios owned respectively by Blackstone Group LLP and Morgan Stanley .

Deutsche Bank has been a leading player in Europe this year. For example, in October, together with Crédit Agricole CIB, it sold a £750 million ($1.18 billion) CMBS issue to refinance the Westfield Stratford City shopping center in London. This year, Deutsche Bank also underwrote the first postcrisis multiborrower CMBS in Europe backed by two loans on retail and office buildings across the Netherlands.

Markus Kreuter, director for CRE origination at Deutsche Bank, confirmed that Deutsche Bank expects more deals and added France, Benelux and Spain among the markets that might see more CMBS activity next year. Italy is another market where, in the lights of Italian banks' negative results to the European Central Bank's stress tests, CMBS "is a product that can bring liquidity," said Mr. Kreuter.

Prelios Credit Servicing recently teamed up with U.S. asset manager Fortress Investment Group LLC in bids for Italian nonperforming loans.

"CMBS are a key tool for the real estate investment market in Italy which with the tightening of lending [from banks] has experienced a dramatic lack of funding," said Riccardo Serrini, chief executive of Prelios Credit Servicing, part of Italian asset management Prelios SpA which manages assets worth some €5.6 billion. "[In Italy] we haven't seen yet CMBS financing the acquisition of NPL portfolios but I hope and think that this tool will help some of the forthcoming large acquisitions."

Other investment banks also are increasing their pipeline and contemplating new structures. "We are considering single-borrower, pan-European transactions, as well as multi-borrower deals," said David Lehman, head of real-estate finance at Goldman. "We expect to see them in 2015."