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## Morningstar Projects 66.5 Percent Pay-Off Rate for 2016 CMBS Maturities

The \$174.3 billion of CMBS loans maturing this year and next could face greater challenges than previously projected, according to analysis by Morningstar Credit Ratings.

The Horsham, Pa., rating agency estimates that the pay-off rate for the \$71 billion of non-defeased loans coming due this year would be 66.5 percent, while that for the \$103.3 billion of loans maturing next year could be less than 60 percent. Those estimates are based on the assumption that a loan with a leverage level, or loan-to-value ratio, of more than 80 percent would not be able to get refinanced without some sort of gap equity investment.

In order to determine just how much debt a collateral property would be able to support when it came time to get refinanced, Morningstar placed a value on the properties securing \$69.8 billion, or 98.3 percent of the loans coming due this year, and \$85.8 billion, or 83 percent of the loans that are maturing next year.

If lenders would be willing to write loans of up to 85 percent of a property's value, the pay-off rate for this year's maturities increases to 75 percent.

The picture remains gloomy if a loan's likelihood of getting refinanced is best determined by the amount of net operating income its collateral generates. Lenders look

at a property's NOI to determine its debt yield. The greater the debt yield, which is NOI divided by loan amount, the lower the probability that the loan would default.

Morningstar assumed lenders would be willing to write loans with debt yields of at least 9 percent. Based on that, it determined that the pay-off rate for this year's maturities would be 63.9 percent and that for 2017 would be 52.9 percent.

Previous analyses of pay-off rates have typically relied on existing cash-flow data reported by CMBS deal trustees. Those have predicted pay-off rates of well more than 90 percent if loan coupons remained below 5 percent and lenders were willing to write loans with debt-service coverage ratios of 1.2x. As coupons increase, or required DSCRs increase, pay-off rates naturally would decline.

Morningstar takes that analysis a step further by determining individual property values, a key factor for lenders in determining just how much financing they'll provide.

While overall property prices have increased to 17.3 percent more than their pre-recession levels, according to the Moody's/RCA Commercial Property Price Indices, that's generally been skewed by the big run-ups in the value of multifamily and central business district offices. Values for suburban office proper-

ties, for instance, are still 8.2 percent lower than they were during the previous market peak. And retail property values remain 2.2 percent below their peaks.

Morningstar warned that 45 percent of the retail loans that mature this year have LTV ratios of more than 80 percent, based on its valuations, putting those loans at risk of not being able to easily get refinanced.

Its conclusions are relatively dire, yet they don't take into account the potential illiquidity that could envelope the market. The volatility impacting the CMBS market, much of it driven by pending risk-retention rules, has made it extremely difficult for securitized lenders to price their loans. As a result, they're becoming ever-more judicious on what properties they'll lend against.

So what happens when loans don't get paid off when they mature? They transfer to special servicing. The end result often involves the recapitalization of the collateral property with an injection of additional equity, often by a third party that takes an ownership position.

Special servicers have seen a sharp decline in their workload over the past five years and now handle \$26.4 billion of mortgages. That's down from \$91.2 billion during the market's trough in 2010.