Takeaways from CREFC Miami

Why U.S. CMBS Isn’t Traveling Very Well

Jan. 17, 2019

Morningstar Perspective

While the CREFC Miami conference mainly focused on U.S.-based commercial real estate finance, the topic of foreign investment was also on people’s minds. It came up twice in different panels on Tuesday, and a Wednesday panel was dedicated to the global perspective. Representatives from Hong Kong, Japan, the United Kingdom, Germany, and Canada gathered on the last day of the conference to discuss what’s going on in their worlds. According to the panelists, the various regions—Asia, Europe, and Canada—have differing relationships with the United States’ commercial mortgage-backed securities market.

In Asia, investment in U.S. CMBS has dried up considerably. In a Tuesday panel, Nilesh Patel said that his company, Prima Capital Partners, saw a “tremendous appetite” from several Asian investors in mezzanine loans 18 months ago. When active, Chinese investors were mostly involved with hotels and condominiums, with some office space. “They have completely pulled back, and not surprisingly, we’ve seen those sectors soften a bit,” said Greta Guggenheim, CEO of TPG RE Finance Trust, at that same panel. On Wednesday’s global panel, Yung Vu, who works for Natixis in Hong Kong, provided some answers. He explained that the Chinese government didn’t like “seeing this kind of investment” and dissuaded companies from investing overseas, noting that it wasn’t “furthering the economic development” of the country. In fact, Vu added that the government has an expansionary initiative for its domestic investments, specifically in multifamily development and ownership. He cited the trade war as another reason for “Chinese investors looking more around the region.” Despite continued demand from China for U.S. CMBS, it isn’t as robust as it once was. And the same goes for demand from Japan. Junya Kato, a partner at KPMG, described Japanese activity in U.S. CMBS as “almost dormant” because of the low interest-rate environment. “The Japanese government still has some trauma around the CMBS crisis,” he said. The country’s regulators prefer simpler cash flow. If there is any demand, it’s because the securities fall within a specific set of parameters. In another Tuesday panel, Freddie Mac’s Robert Koontz said Asian demand depends on spread, interest rate risk, and the exchange rate.

European regulations are the biggest hurdle to the region's investment in the U.S. On the global panel, U.K.-based HSBC director Matt Kimberley said that if a European company wants to invest in a U.S. financial instrument, then the financing must comply with European regulations, especially those concerning risk retention. Generally, the U.S. requirements are not as stringent as the European ones. However, Fannie Mae's Dan Dresser did say that the U.S. government-sponsored entity has added some language to address European risk-retention rules. J.P. Morgan's Gareth Davies, who moderated the global panel, brought up commercial real estate collateralized loan obligations as an opportunity because 85% of them last year complied with the European risk-retention rules. Kimberley said, "It's a market we continue to look at," even before the last crisis. But he wonders "if the risk return premium is really there." Within Europe itself, Andreas Wuermeling from pbb Deutsche Pfandbriefbank, noted that "securitization as a percentage of new lending is a relatively minor share." Also, there is fragmentation among the different countries despite being governed by European law.

Norm Camiré, managing director and head of CMBS for the Royal Bank of Canada, had a different outlook on his country's relationship with its southern neighbor. At the global panel, he said that Canada is trying to attract U.S. investors into the Canadian CMBS market. Since Canada re-entered the CMBS market in 2014, all new deals are what he calls "144A compliant" and follow the U.S. risk-retention requirements as well. The currency exchange is the biggest issue, with the Canadian dollar being weaker than the U.S. dollar. However, Camiré said, "Current Canadian CMBS, I think, is a significant improvement creditwise over the U.S. CMBS market." He explained that even during the credit crisis, the delinquency rate for Canadian CMBS was between 30 basis points and 40 basis points, significantly lower than that 1,200 basis points to 1,400 basis points in the U.S. during that time. Write-offs amounted to less than 10 basis points of the Canadian CMBS universe. Camiré credited this to "the consistency of the Canadian lending market." No matter if a borrower went to a credit union, bank, life insurance company, or an alternative lender, the credit metrics are similar. "That is just a function of the Canadian mentality," he said. Patel hinted at this on Tuesday, when he described Canadian investors as "very even-keeled." Camiré also thinks that the recourse nature of the loans has to do with their performance.

As the global discussion ended and the panelists went back to their home countries, the conference attendants were left with something to think about. How can we make the CMBS market more attractive to investors across regions?

Morningstar Credit Ratings, LLC

Caitlin Veno

Writer

+1 215 442-6545

DISCLAIMER

The content and analysis contained herein are solely statements of opinion and not statements of fact, legal advice or recommendations to purchase, hold, or sell any securities or make any other investment decisions. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MORNINGSTAR IN ANY FORM OR MANNER WHATSOEVER.

To reprint, translate, or use the data or information other than as provided herein, contact Vanessa Sussman (+1 646 560-4541) or by email to: vanessa.sussman@morningstar.com.