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CMBS Problems Slow - More Leave Special Servicing

Delinquencies Decline, Investor Interest Rises, Risk Appetite Grows

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As CMBS delinquencies decline and more assets leave special servicing, investor interest in CMBS bonds has grown. Investors are once again taking on more risk in search of yield.

Delinquencies are still high by historic standards but improvement is evident. The 60 day-plus delinquency rate declined overall to 9.38% in October, the most recent month available. That is down from 9.57% a month earlier and was the third monthly decline. Delinquency rates decreased for all major property types except multifamily rental apartments. At the same time, total delinquencies fell $600 million to $51.5 billion. Approximately $2.1 billion in loans were newly delinquent while $2.7 billion were resolved during the month, clearly a move in the right direction. Total CMBS loans outstanding also declined in October to $544.5 billion. That is down from $548.7 billion a month earlier. Outstanding balances have steadily declined in both the CMBS sector and in bank portfolios as few new loans are being made, resolutions are increasing and most new commercial construction today is still not justified by continuing weak demand nor is new development economically feasible; two conditions that are inseparable.

Over the last year, shrinking outstanding balances have been largely the result of pay downs outpacing new originations. We expect that trend to continue at least into 2013. The majority of loans backed by five year leases begun in 2007 have seen leases renegotiated at lower rates thus removing what could have been a huge downside risk, Outstanding balances have declined for 52 of the last 57 months after peaking at $793.5 billion in December 2007. That month was also the peak value month for commercial real estate; the starting point from which the sector lost 50% of its value. Outstanding CMBS balances are down over 31% since that time.

The large decline in CMBS delinquencies was driven primarily by a large increase in the value of loans leaving special servicing. The value of those loans far exceeded the value of incoming loan delinquencies. The remaining inventory of problem CMBS loans is more troublesome and most are not good liquidation candidates at the moment. While that has caused the volume to decline, the length of time loans remain in special servicing has increased. According to Fitch Ratings, the average time in special servicing rose to 18.6 months in June 2012. The duration was 14.8 months a year earlier and 10.8 months, two years earlier in June 2010. Again, the movement is in the right direction.

Investor risk appetite has been growing as investors quickly snap up new offerings; even those that include mortgages secured by assets with significant vacant space and underwriting based on projections. This type of underwriting was responsible in large part for many problems still being worked out today.

Here is a look at CMBS delinquencies in October 2012 by property type:

Property Type	Delinquency October 2012	Delinquency September 2012	Delinquency March 2012
Industrial	10.39%	11.62%	12.18%
Office	10.15%	10.25%	9.21%
Retail	7.46	7.81%	7.73%
Multifamily	13.15%	12.82%	14.56%
Hotel	10.78%	11.21%	11.17%

SOURCE: Moody's Investors Service

The author is Senior Director, Economic and Consulting Services at Focus Valuation Advisors in Orlando, Florida. Contact Mr. Pittenger at Bill.pittenger@focusvaluation.net

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