Commercial Mortgage-Backed Securities

Increasing Supply in 2021

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Property performance remains under pressure, but senior CMBS have fully recovered from the COVID selloff.

CMBS spreads have tightened significantly since the COVID-19 selloff in March 2020 (see chart, top right), and demand for CMBS remains high. Several factors have led to high demand and tighter spreads, including reduced volumes of new issuance, lower concentrations of retail and hospitality loans within pools, improving macroeconomic conditions, and rollout of the vaccine.

In 2020, new issuance within CMBS fell by 45 percent—conduit down 37 percent, single asset/single borrower (SASB) down 48 percent, and CRE-CLO down 56 percent—due to lower loan volumes from issuers as pandemic uncertainty persisted (see chart, bottom right). Furthermore, investor demand for lower concentrations of retail and hospitality loans within securitizations constrained issuers even further as risks associated with those property types remain elevated.

We expect increased issuance in 2021 as optimism from issuers and investors grows due to stable market conditions, the rollout of COVID-19 vaccines, and a settled election offering clarity around policy related to commercial real estate. As we evaluate opportunities in both primary and secondary markets, we remain cautious and selective regarding which deals to pursue for two reasons. First, some pools will likely have incrementally higher concentrations of retail and hospitality loans. Even with the rollout of vaccines and positive economic trends, we believe these property types will experience some interruptions in cash flows through the next few years. Second, relief for borrowers through temporary loan covenant forgiveness and debt service forbearance is partially responsible for sustaining performance in the near term. Once these measures run out, the status of some loans marked as current could shift to delinquent.

One of the areas we are targeting in secondary markets is subordinate CRE-CLO bonds. CRE-CLO transactions, collateralized by short-term, floating rate, transitional commercial real estate loans, feature low loan-to-value ratios and remain money good in our stress analysis. These securities offer compelling carry, but because current prices are also at discounts to par, there is additional upside potential in the event of early loan payoffs and spread tightening.

CMBS Spreads Are Likely to Continue to Tighten in the First Quarter

Source: Guggenheim Investments. Data as of 1.15.2021.

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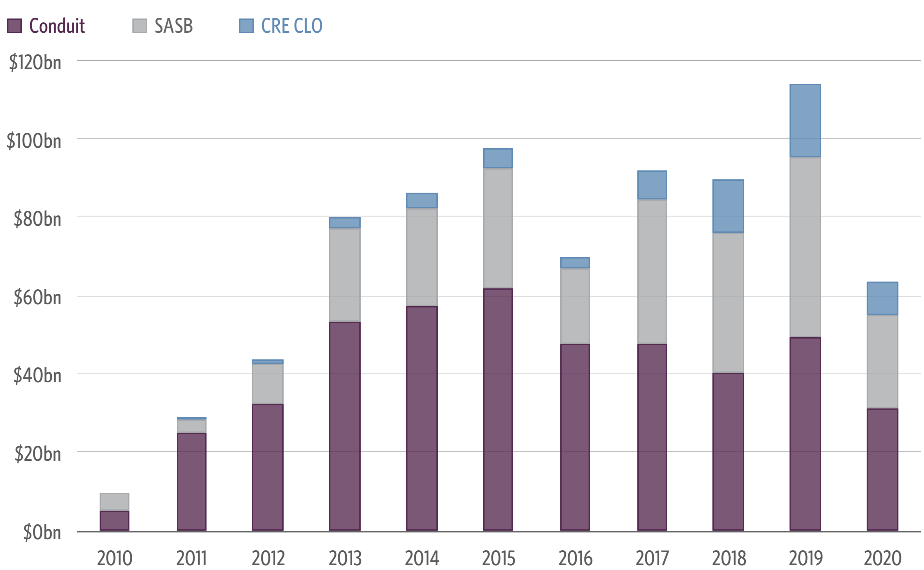
Issuance Should Bounce Back in 2021 as Investor Confidence Recovers



Source: Guggenheim Investments, J.P. Morgan. Data as of 12.31.2020

In 2020, new issuance within CMBS fell by 45 percent—conduit down 37 percent, SASB down 48 percent, and CRE-CLO down 56 percent—due to lower loan volumes from issuers as pandemic uncertainty persisted. However, we expect higher issuance in 2021 over 2020 as optimism from issuers and investors grows.