CMBX 6 and Beyond: Closing the Book on CMBS's "Big Short" and Searching for the Latest CMBX Short Opportunity

If you participate in or follow finance markets, you are likely asking the same question at the end of each trading day: How did the S&P 500, Dow Jones Industrial Average, and Nasdaq Composite do?

The three aforementioned indices play a crucial role in determining risk appetite, investment trends, and the overall sentiment and trajectory of the US and global economy. They are the most broadly followed indices by investors, and approximately 5,000 other equity market indices exist in the U.S.

Debt market indices on the other hand are much less voluminous, but several exist for asset-backed and mortgage-backed securities. The primary indicator of performance for commercial mortgage-backed securities (CMBS) is the CMBX index.

CMBS accounts for about 10% of the entire U.S. CRE lending market in a given quarter and is stratified rather evenly between the 5 major CRE property types. Thus, CMBX is an important metric not only for CMBS bond traders, but all commercial real estate professionals who would like to get a gauge of commercial real estate market sentiment and confidence.

CMBX Background

CMBX is a set of indexes administered by Markit Partners. There are now 16 separate indexes – the first five were launched prior to the Great Financial Crisis of 2008.

When the markets are functioning, a new series is rolled out every 18 to 24 months by Markit. Each series allows an investor to buy protection ("go short") or sell protection ("go long") on a bucket of 25 separate mortgage pools. An investor can go long or short on AAA, AA, A, BBB- or BB. To buy protection, a buyer pays a fixed premium each month – the premium level is set when the index is launched. If selling protection, the seller is committing to "insuring" the buyer of protection against any bond write-downs.

Origins and Loan Performance of CMBX 6

In Trepp's latest report, we are focusing on one of the most heavily shorted portfolios in CMBX: the CMBX 6 index. CMBX 6 specifically tracks the performance of a basket of commercial mortgage loans that originated between 2011 and 2012, and when the portfolio was released, its loan composition was 34% retail. At origination, the CMBX 6 index had a higher exposure to retail than any of the latter CMBX series. For the full breakdown of CMBX 6 by loan count, securitized balance and percentage by property type, see the table below.

CHART 1: CMBX 6 AT ORIGINATION

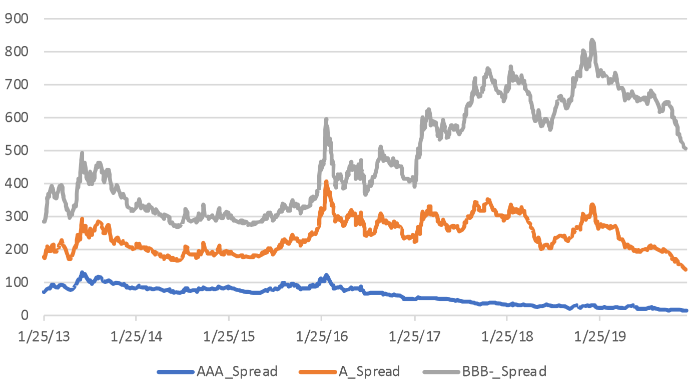
ROW LABELS	# OF LOANS	SECURITIZED BALANCE ($ MILLIONS)	%
CH	1	35.50	0.06%
IN	79	1,457.68	4.86%
LO	241	4,010.75	14.83%
MF	163	2,045.89	10.03%
MH	93	734.36	5.72%
MU	91	2,072.16	5.60%
OF	270	7,824.01	16.62%
OT	11	446.39	0.68%
RT	553	10,473.38	34.03%
SS	123	958.88	7.57%
Grand Total	1625	30,059.00	100.00%

Source: Trepp

At the time CMBX 6 was released, the prospects for US shopping malls weren't nearly as dire as they would become several years later when retailers, small, medium, and large, closed stores in large numbers, filed for bankruptcy, and/or liquidated. In 2012, financing was plentiful and many shopping mall loans made their way into the CMBX 6 index.

However, in 2017, views on the retail sector began to change. Investors circled the BBB- portion of the index as a potential short opportunity, citing the challenges for brick-and-mortar retail as consumers continually gravitated towards online shopping, and chose to bet against the retail-heavy index. By the end of 2017, CMBX 6 spreads widened across tranche levels, and bond prices fell.

CHART 2: CMBX 6 SPREADS – ORIGINATION 2013 - 2019



Source: Trepp

BBB- spreads continued to rise steadily in the months and years after, getting as high as 835 points above the curve in December 2018. Delinquency rates for the retail sector rose in conjunction with spread widening in 2017, but retreated back down to 3.59% in 2019, leading to BBB- spread tightening. It appeared for a moment in time that the retail sector was a resilient property type and able to withstand pressures from e-commerce, but no one could've expected the downturn that was in store in 2020.

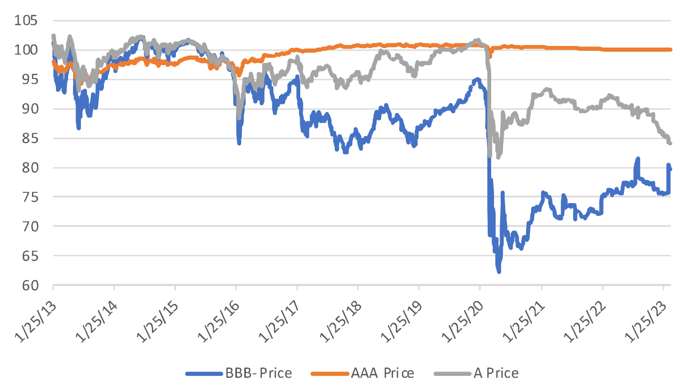
The Pandemic, Loan Defaults & Disposals

The retail segment of CMBX 6 was hit particularly hard by the pandemic, as many retailers were forced to close their doors or scale back their operations in response to lockdown measures. This led to a significant increase in defaults and delinquencies among retail borrowers, which in turn caused the value of CMBX 6 to decline sharply.

The spread on the BBB- tranche of the index widened dramatically when it was clear that we were headed for nationwide lockdowns, rising above 1000 in mid-March 2020 and 2000 a little over a month after. CMBS delinquencies reached their peak in June of 2020, touching a Covid-high of 18.04%.

While the CMBS delinquency rate trickled back down in 2021, spreads, particularly for the BBB- tranche of CMBX 6, continued to widen. The portfolio of CMBX 6 at this point looked drastically different from the property type exposures at origination. By this time, many loans had refinanced while interest rates were low and the old CMBX 6 loans were either prepaid or defeased, and primarily distressed retail loans remained in the portfolio, now accounting for a larger share of the index. The decline in CMBX 6 tranche prices most accurately reflect the value of the index from origination to current day.

CHART 3: CMBX 6 PRICES BY TRANCHE – 2013 TO CURRENT



Source: Trepp

The year is now 2023, and most of the loans within the CMBX 6 portfolio have been disposed of. Given that most of these loans were underwritten on 10 year-terms, the only loans still within the portfolio are those which are still in default or have been extended beyond their underwritten maturity date. The below information represents the 1625 loans in CMBX 6 organized by their disposal type.

- Within CMBX 6, out of the 1,625 loans encompassed in the portfolio, only 65 are still outstanding, and to date, 1,560 have been disposed.
- 45 of these loans have incurred losses, accounting for an aggregate securitized loan balance of $1.21 billion. The amount of losses for the $1.21 billion in loans has been approximately $530.5 million, representing a cumulative loss severity of 30.19%.

CHART 4: CMBX 6 SUMMARY BY DISPOSITION STATUS

Status	# OF LOANS	SECURITIZED BALANCE ($ MILLIONS)	%
Paid at Maturity	415	6,787.79	22.6%
Paid post Maturity	50	1,105.32	3.7%
Prepay with YM	174	2,770.74	9.2%
Prepay with Premium	0	0.00	0.0%
Prepay during Open	843	13,818.34	46.0%
Loss	45	1,213.60	4.0%
Impaired Loan Payoff	7	75.98	0.3%
Unknown	26	680.62	2.3%
Total Diposed Loans	1560	26,452.38	88.0%
Total Outstanding Loans	65	3,606.63	12.0%
Total Securitized Loans	1625	30,.59.00	100.00%

Source: Trepp

10 of the top 11 loan losses within the CMBX 6 portfolio have been attributed to retail anchored properties. In fact 74% of all loan losses within the CMBX 6 portfolio have been to retail-backed loans. These properties struggled heavily during the pandemic, and many of the retail loans were disposed for a loss in the months and years after the onset of covid-19. The delinquency rate for retail has yet to recover to pre-covid levels, and there is still an aura of uncertainty that exists within the sector.

For the 65 loans still outstanding, 49.6% are delinquent and now 67% of all loans in CMBX 6 are retail loans. The office sector accounts for 17.3% of outstanding CMBX 6 loans, while Mixed-Use accounts for 9.2% and Lodging accounts for 5.7%. The current collateral balance totals over $3.1 billion, and regional and superregional malls make up 30 of the 78 properties within the index. In addition to the 49.6% of delinquent loans, an additional 12 are non-current, with one being less than 1 month delinquent and 11 performing beyond maturity. That brings the total of "non-current" loans in CMBX 6 up to 75.6%.

Those who ended up shorting the CMBX 6 index benefited massively from the COVID-19 downturn. In a 2020 New York Times article, Hedge Fund Analyst and shorter of CMBX 6 Catie Mckee noted that the pandemic sped up the rate of demise for CMBX 6 malls by being the final straw for a lot of struggling retailers and mall owners. Prominent investor Carl Icahn made $1.3 billion in total shorting the CMBX 6 index, hedge funds and private equity firms made hundreds of millions of their own implementing the same trade.

CHART 5: 5 LARGEST LOAN LOSSES CMBX 6

DEAL NAME	LOAN NAME	STATE	PROPERTY TYPE	SQUARE FEET	SECURITIZED BALANCE	PREVIOUS BALANCE	LOAN LOSS	LOSS SEVERITY
WFRBS 2012-C7	Town Center at Cobb	GA	RT-Regional Mall	559,940	$130,000,000.00	$108,446,310.00	$63,038,408.00	48.49
WFRBS 2012-C7	Florence Mall	KY	RT-Regional Mall	384,111	$90,000,000.00	$89,404,415.00	$46,958,359.00	52.18
GSMS 2012-GCJ7	Bellis Fair Mall	WA	RT-Regional Mall	538,226	$93,246,596.00	$72,030,193.00	$26,217,344.00	28.12
COMM 2012-CR4	Fashion Outlets of Las Vegas	NV	RT-Outlet	375,722	$73,000,000.00	$62,162,267.00	$62,162,267.00	85.15
COMM 2012-CR3	Emerald Square Mall	MA	RT-Regional Mall	564,501	$74,819,369.00	$61,643,457.00	$47,580,388.00	63.59

Source: Trepp

CHART 6: 5 LARGEST DELINQUENT LOAN EXPOSURES IN CMBX 6 BY CMBS DEAL

DEAL NAME	DELINQUENT BALANCE	% OF DEAL	# OF LOANS	LARGEST DELINQUENT LOAN	LOAN BALANCE
UBSBB 2012-C2	$321,290,756	100	7	Crystal Mall	$81,052,588
WFRBS 2012-C10	$301,051,470	100	6	Republic Plaza	$108,324,439
COMM 2012-CR3	$183,323,266	67.53	3	Solano Mall	$105,000,000
MSBAM 2012-C6	$182,226,014	100	5	1880 Broadway/15 Central Park West Retail	$125,000,000
JPMCC 2012-LC9	$175,958,324	94.71	3	West County Center	$110,260,016

Source: Trepp

CMBX 7, 8, 9, and 12: Betting Against The Office Sector?

In recent months, coverage of the office sector in TreppWire and the Trepp Research & Insights page has been extensive, focusing closely on office vacancies, declines in DSCRs and the looming wall of maturities for office loans in 2023, 2024 and 2025.

The CMBX indices that succeed CMBX 6, CMBX 7-9 are notable for the upcoming maturing loans within each index. CMBX 7 has over $10 billion in loans maturing in 2023, 20% of which are loans to the office sector. CMBX 8 has over $17 billion maturing in 2024, 29% which are backed by office, and CMBX 9 has over $17 billion maturing in 2025, nearly 26% attached to office loans. For all 3 indexes, occupancy has hovered around 80-90% and weighted average DSCR has been just below 2.0.

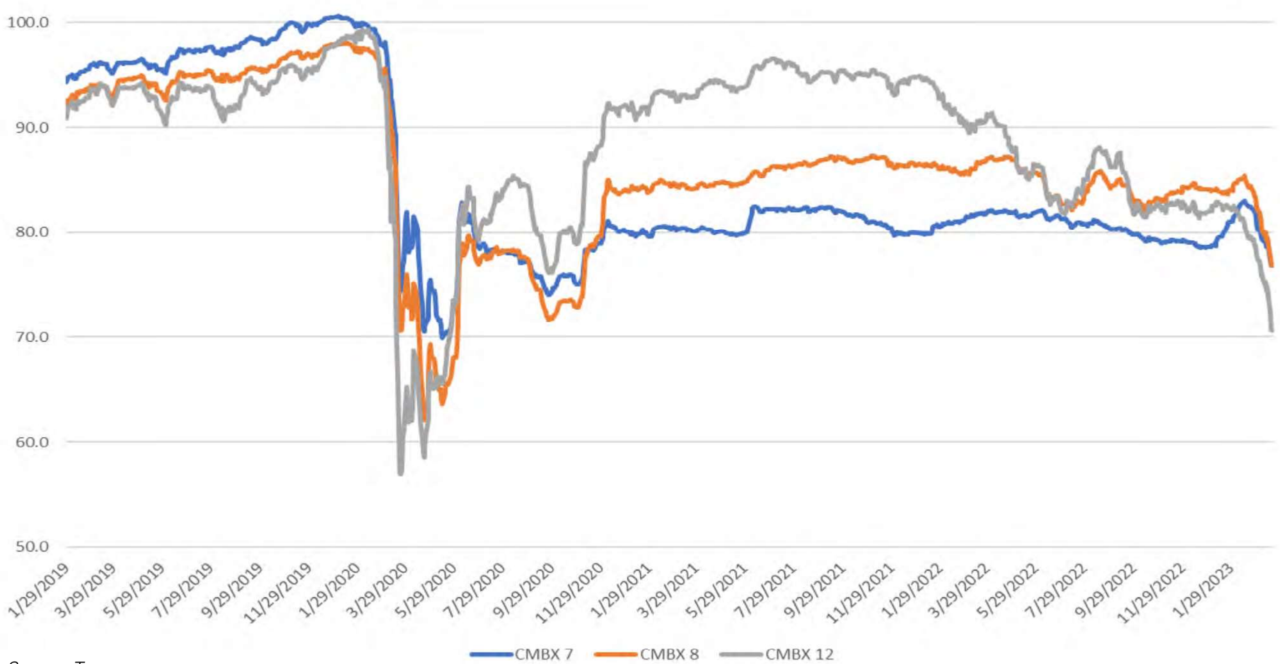
Distress in the office sector has not only caught our attention, but also the attention of institutional investors, many of whom were active participants in the short of the retail heavy CMBX 6. Back in 2020, we noted in a blog that a hedge fund named Land & Buildings Investment Management had placed short positions on several REITs that operate office properties, most notably Vornado and SL Green. We then turned attention to the most office heavy portfolio in CMBX – CMBX 12. CMBX 12 happens to be the index with the heaviest exposure to office collateral. At current day, here is how the current property type stratification is laid out within the index:

CHART 7: CMBX 12 EXPOSURE BY PROPERTY TYPE

CREFC PROPERTY TYPE	PROP COUNT		BALANCE	
	#	%	AMOUNT	%
Office	768	27.8%	6,813,488,126	31.8%
Retail	527	19.4%	5,522,400,078	25.8%
Lodging	377	13.7%	2,889,461,005	13.5%
Multi-Family	236	8.5%	2,002,055,274	9.3%
Industrial	314	11.4%	1,569,849,968	7.3%
Mixed Use	194	7.0%	1,158,114,056	5.4%
Self Storage	225	8.1%	858,367,127	4.0%
Co-op Housing	71	2.6%	264,433,063	1.2%
Mobile Home	37	1.3%	183,464,402	0.9%
Other	11	0.4%	170,311,001	0.8%
Health Care	1	0.0%	3,677,199	0.0%
Warehouse	0	0.0%	0	0.0%
n/a	0	0.0%	0	0.0%
Total	2,761	100.0%	21,435,621,300	100.0%

Source: Trepp

CHART 8: BBB - PRICES FOR CMBX 7, CMBX 8 AND CMBX 12



Source: Trepp

In a Bloomberg article released just a week ago, Daniel McNamara of Polpo Capital Management, a hedge fund manager who made a 119% return shorting debt linked to shopping malls, is betting on fresh pain in the US commercial property market, this time the office sector. The article notes he is wagering against CMBX 12, 13 and 14, all of which have heavy exposure to office loans originated in 2018, 2019 and 2020.

Graph 8 shows just how much the BBB- tranche of the CMBX 12 index has been speculated against in recent days. Starting in Q4 2022, the BBB- is now trading below series 7 and 8 on a dollar price basis.

In February, the office sector sustained the largest month-over-month basis point increase in the delinquency rate since December 2021. Delinquency in the office sector is still quite low, but refinancing risk poses a unique problem in the current interest rate environment, and short sellers will be hoping that a fall in office demand will render big swathes of the office-property market obsolete and loans linked to them at greater risk of delinquency.

The current banking sector turmoil could end up further complicating the refinancing picture for near-term office loan maturities if there's a broader pullback in lending liquidity which appears might be the case given recent spread trends. In the past month, significant price drops have occurred for the BBB- tranches of the CMBX 7, 8, and 12 indexes. Trepp will continue to monitor CMBX price movements in the wake of growing uncertainty in the commercial real estate sector.

For more information about Trepp's commercial real estate data, contact info@trepp.com.
For inquiries about the data analysis conducted in this research, contact press@trepp.com or 212-754-1010.

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