Commercial Mortgage Delinquencies Near Record Levels

Delinquency rates across commercial mortgage-backed securities (CMBS) have tripled in three months, edging close to their previous 2012 peaks.

CMBS: a basket of loans backed by a pool of commercial mortgages

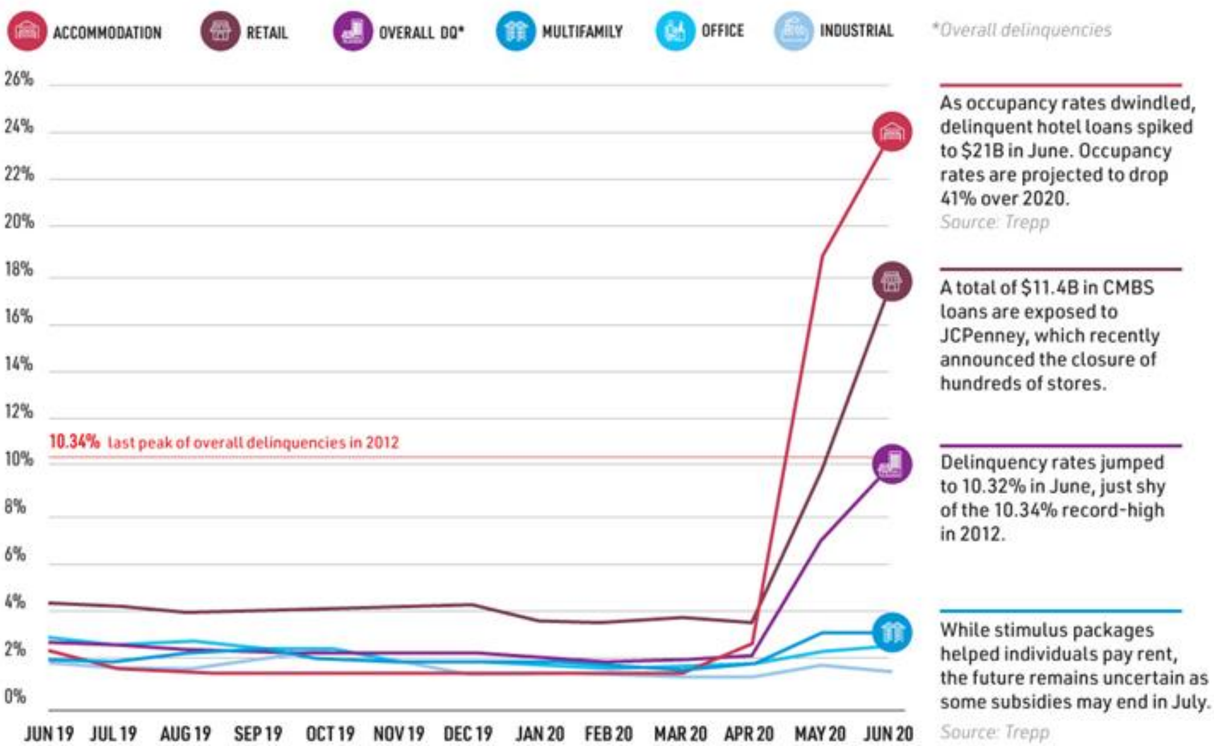
However, vulnerabilities vary widely by property type. While accommodation has seen high delinquencies, industrials and multifamily properties have proven resilient.

Below, we chart the change in CMBS delinquency rates in the U.S. during the COVID-19 pandemic.

Source: Trepp

DELINQUENCY RATES BY PROPERTY TYPE

Month-over-month delinquency rates by major property type



Source: Trepp

Commercial Mortgage Delinquencies Near Record Levels

Delinquency rates across commercial properties have shot up faster than at any other time.

As thousands of restaurants, hotels, and local businesses in the U.S. struggle to stay open, delinquency rates across commercial mortgage-backed securities (CMBS)—fixed income investments backed by a pool of commercial mortgages— have tripled in three months to 10.32%.

In just a few months, delinquency rates have already effectively reached their 2012 peaks. To put this in perspective, consider that it took well over two years for mortgage delinquency rates to reach the same historic levels in the aftermath of the housing crisis of 2009.

The above chart draws data from Trepp and illustrates the recent shocks to the CMBS market, broken down by property type.

Storm Rumblings

While there is optimism in some areas of the market, accommodation mortgages have witnessed delinquency rates soar over 24%.

Amid strict containment efforts in April, average revenues per room plummeted all the way to $16 per night—an 84% drop.

Property Type	January 2020	June 2020
Accommodation	1.5%	24.3%
Retail	3.8%	18.1%
Multifamily	2.0%	3.3%
Office	1.9%	2.7%
Industrial	1.6%	1.6%
Overall	2.1%	10.3%

Similarly, retail properties have been rattled. Almost one-fifth are in delinquencies. From January-June 2020, at least 15 major retailers have filed for bankruptcy and over $20 billion in CMBS loans have exposure to flailing chains such as JCPenney, Neiman Marcus, and Macy's.

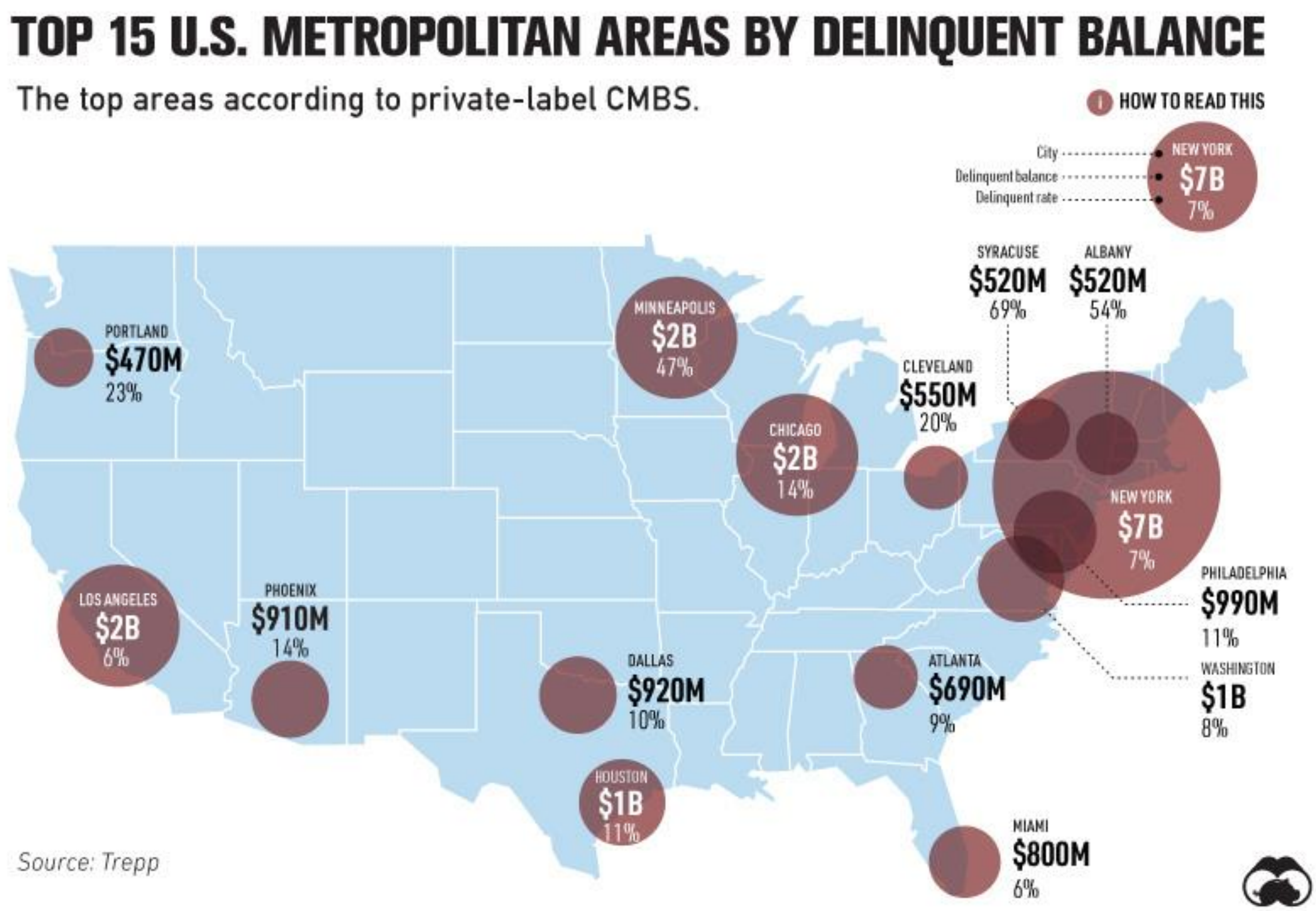
On the other hand, industrial property types have remained stable, hovering close to their January levels. This is likely attributable in part to the fact that the rise in e-commerce sales have helped support warehouse operations.

For multifamily and office buildings, Washington's stimulus packages have helped renters to continue making payments thus far. Still, as the government considers ending stimulus packages in the near future, a lack of relief funding could spell trouble.

Weighing the Impact on U.S. Cities

How do delinquency rates vary across the top metropolitan areas in America?

Below, we can see that the delinquent balance and delinquency rates vary widely by city. Note that this data is for private-labeled CMBS, which are issued by investment banks and private entities rather than government agencies.



Despite the New York city metropolitan area having a delinquent balance of $7 billion, its delinquency rates fall on the lower end of the spectrum, at 7%. New York alone accounts for 18% of the total balance of private-label CMBS.

By comparison, the Syracuse metropolitan area has an eye-opening delinquency rate of 69%. Syracuse is home to the shopping complex, Destiny USA, which is facing tenant uncertainties due to COVID-19. The six-story mall attracts 26 million visitors annually.

Like the overall market, delinquencies are being driven by accommodation and retail properties across many of these U.S. metropolitan areas.

What Comes Next?

What happens when delinquency rates get too high?

Often, when borrowers do not make payment after a reasonable amount of time, they enter into default. While time ranges can vary, defaults typically take place after at least 60 days of nonpayment. Between May and June, defaults in the CMBS market surged 792% to $5.5 billion.

As effects reverberate, properties could eventually fall into foreclosure. At the same time, institutional investors who own these types of securities, which include pensions, could begin seeing steep losses.

That said, the Federal Reserve has set up mechanisms to purchase CMBS loans with the highest credit quality. This is designed to inject liquidity into the mortgage market, while also financing small and mid-sized properties that house small businesses. In turn, this can enable the employment of millions of Americans.

Of course, it remains to be seen whether the mortgage market will face a sustained downturn akin to the financial crisis, or if the temporary decline will soon subside.