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Office loan delinquencies come off lag; increase more than 20% in September

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Story

Office loan delinquencies rose 53bps to 2.8% in September from 2.27% in August - a significant spike for the year, according to data provided by Trepp LLC and speakers on a Barclay's CMBS conference call Tuesday.

Although many office loans have been at high risk since unemployment spiked, office loan delinquencies have remained relatively flat this year compared to other commercial real estate types, Glenn Boyd, head of CMBS research at Barclays, said on the call.

Since December 2008, office delinquencies have risen a total of 220bps, while retail, apartment and hotel sectors grew 560bps, 440bps, and 500bps, respectively, since December 2008, according to the Barclays presentation. As of 31 August, there were USD 4.3bn of retail loans delinquent, USD 3.9bn of multifamily/apartment loans delinquent and only USD 2.5bn office loans delinquent, according to Fitch, although office properties constitute the largest share of outstanding commercial real estate, with roughly 90bn outstanding in Fitch's universe of CRE. Office loans comprise about USD 203bn, or 27%, of the entire CMBS universe, according to Trepp.

Fixed rents that were collected years ago and long-term leases have helped keep office delinquencies low even with rising unemployment, according to several CRE experts. The length of leases for office properties are typically three to five years, while hotels are by the night, and retail and apartment leases are six to 12 months, making other types much more reactive to market conditions than office properties, said Susan Persin, partner at Foresight Analytics, a commercial real estate research firm in Oakland, California.

Office sector performance is set to weaken, however. Net operating income, which incorporates forecasted rent, is expected to drop 11% to 17% over the next five years, suggesting USD 17bn to USD 25bn of 2005 and later vintage office loans are currently at high risk of default, according to Barclays. A loan is considered "high risk" if its most recent debt service coverage ratio is less than 1.1x.

CRE delinquencies remain high, liquidations and foreclosures still low

In terms of total CMBS delinquencies, a little over 5%, or roughly USD 35bn, of the USD 700bn universe, are 30 days or more past due, Aaron Bryson, CMBS analyst at Barclays said during the call. "We still think collateral performance in CMBS is set to weaken and the pace of [delinquencies] is set to accelerate," he said. Excluding the GGP loans, delinquencies have increased by roughly 30 to 35 basis points per month, which is equivalent to USD 2bn. Delinquencies will reach within 8% to 10% by early next year, Bryson predicts.

Meanwhile, special servicers remain reluctant to liquidate loans. "The actual foreclosures and liquidations remain extremely low in CMBS," Bryson said, "There's really nothing being liquidated right now." Comparing December to September levels, he noted that delinquent loans are up USD

17bn while foreclosures are up by only USD 7bn. "At the current pace, it would take over 10 years for all these delinquent loans to work through the pipeline. So, at some point, these special servicers will need to start liquidating properties," he said.

On top of the delinquencies, Bryson noted that roughly 2.5% of CMBS loans are current but held in special servicing. The borrowers are often looking for relief or some sort of modification on the loans, he said. "These loans tend to be a pretty good leading indicator of future delinquencies," Bryson said, noting that their rate of transfer into special servicing has recently picked up.

Special servicers are going to reach their maximum capacities in time, said Mark McClure, EVP of Texas markets for A10 Capital, a commercial real estate lending, advisory and management group headquartered in Boise, Idaho. It is only a matter of time before assets falling out of CMBS are eventually liquidated, he said. Loan extensions will be offered for one to two years at the most, but that will not solve the problem, he added. Barclays phrased the idea as "pretend and extend," in Tuesday's call.
By Diana Aqra and Sarika Gangar

Source Debtwire