Markets

A $1.5 Trillion Wall of Debt is Looming for US Commercial Properties

- Morgan Stanley sees refinancing risks front and center
- Office, retail property valuations could fall as much as 40%

The view from Park Avenue in New York. *Photographer: Jeenah Moon/Bloomberg*

By Neil Callanan
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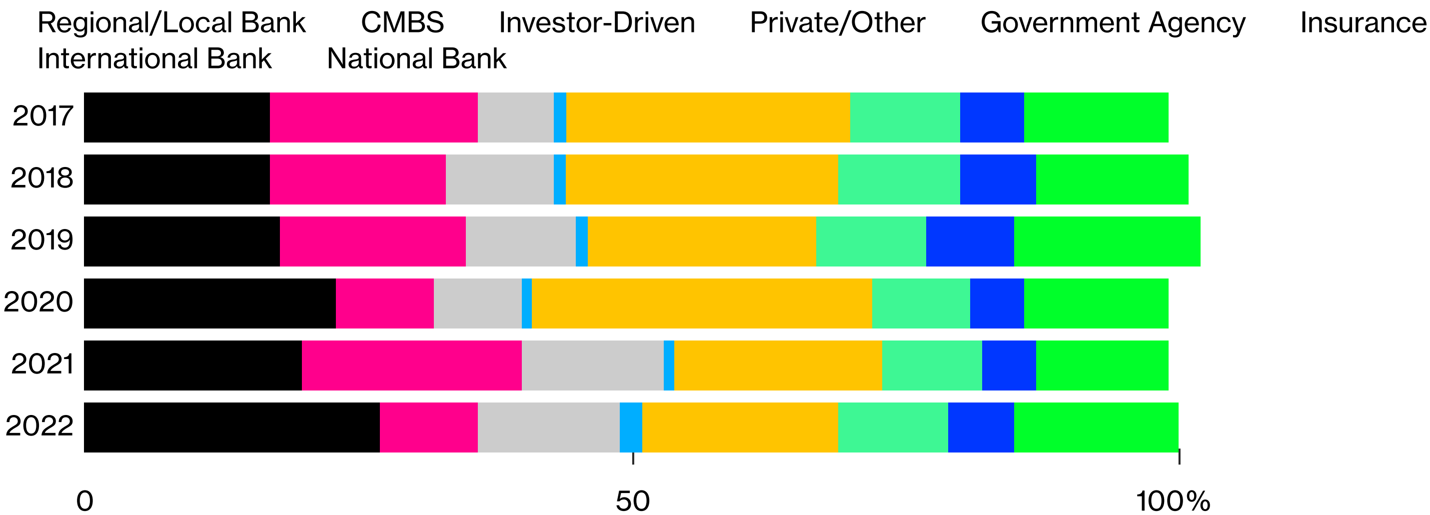
Almost $1.5 trillion of US commercial real estate debt comes due for repayment before the end of 2025. The big question facing those borrowers is who's going to lend to them?

"Refinancing risks are front and center" for owners of properties from office buildings to stores and warehouses, Morgan Stanley analysts including James Egan wrote in a note this past week. "The maturity wall here is front-loaded. So are the associated risks."

The investment bank estimates office and retail property valuations could fall as much as 40% from peak to trough, increasing the risk of defaults.

Adding to the headache, small and regional banks – the biggest source of credit to the industry last year – have been rocked by deposit outflows following the demise of Silicon Valley Bank, raising concerns that will crimp their ability to provide finance to borrowers.

Smaller Banks Pushed Into Commercial Real Estate Lending



Source:MSCI
Percentages are rounded

The wall of debt is set to get worse before it gets better. Maturities climb for the coming four years, peaking at $550 billion in 2027, according to the MS note. Banks also own more than half of the agency commercial mortgage-backed securities – bonds supported by property loans and issued by US government-sponsored entities such as Fannie Mae – increasing their exposure to the sector.

"The role that banks have played in this ecosystem, not only as lenders but also as buyers," will compound the wave of refinancing coming due, the analysts wrote.

Rising interest rates and worries about defaults have already hurt CMBS deals. Sales of the securities without government backing fell about 80% in the first quarter from a year earlier, according to data compiled by Bloomberg News.

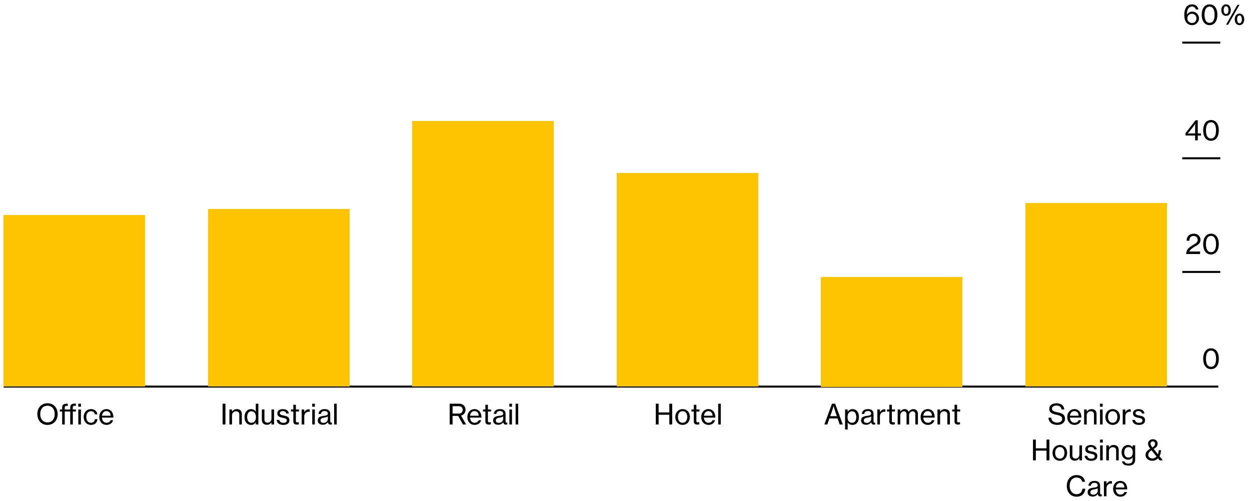
Amid the gloom, there are some slivers of good news. Conservative lending standards in the wake of the financial crisis provide borrowers, and in turn their lenders, with some degree of protection from falling values, the analysts wrote.

Sentiment toward multifamily housing also remains much more positive as rents continue to rise, one reason why Blackstone Real Estate Income Trust had a positive return in February even as rising numbers of investors lodge withdrawal requests. The availability of agency-backed loans will help owners of those properties when they need to refinance.

Regional and Local Banks Are Big Lenders to Retail and Offices

The lenders are the biggest credit provider in each real estate category

Market share of lending in 2022



Source: MSCI

Still, when apartment blocks are excluded, the scale of the problems facing banks becomes even starker. As much as 70% of the other commercial real estate loans that mature over the next five years are held by banks, according to the report.

“Commercial real estate needs to re-price and alternative ways to refinance the debt are needed,” the analysts said.

European real estate issuers, meanwhile, have the equivalent of more than €24 billion due for repayment over the remainder of the year, Bloomberg Intelligence analyst Tolu Alamutu wrote in a note.

“We are definitely seeing real estate companies do all they can to delever - scaling back investment programs, more joint ventures, bond buybacks and where possible, dividend cuts,” she said in an email. “Disposals are a key focus too. Some recent comments from real estate issuers suggest it’s still not easy to sell large portfolios.”

WHAT TO WATCH IN THE DAYS AHEAD:

Debt syndicate desks are expecting $10 billion to $15 billion of US investment-grade corporate bond issuance after about $9 billion this past week. In Europe, a majority of those surveyed expect at least €15 billion of sales.

The coming week will offer updates on inflation around the world, with US consumer-price index data on Wednesday, followed by Germany CPI on Thursday and figures for France and Spain on Friday.

A ruling on the restructuring plan of troubled German real estate firm Adler Group SA, via a scheme of arrangement, is due on Wednesday.

For an in-depth look at the data and events around the world that could impact market sentiment this week, see this on the Bloomberg terminal and choose a region.

Elsewhere:

Investors snapped up Europe's first subordinated bond sale in almost a month after the market for such debt was effectively shut by Swiss regulators' decision to wipe out $17 billion of Credit Suisse AG's junior notes. Meanwhile, a global index linked to so-called contingent convertible bank bonds rebounded, reaching levels seen before the Credit Suisse bond writedown.

A 954 billion yuan ($139 billion) corner of China's credit market has been showing that smaller banks aren't without some challenges of their own. Capital bond issuance by city and rural commercial banks during the first three months of 2023 plunged 70% from a year earlier, data compiled by Bloomberg show.

A group of Canadian Pacific Railway Co. creditors are trying to have $2.4 billion of bonds repaid early – and at a premium – after they say the company missed a deadline tied to its acquisition of Kansas City Southern, Bloomberg News reported Thursday. The efforts are being contested by the company, which says its requirements have been satisfied.

Sound Point Capital Management is buying Assured Guaranty's collateralized loan obligation platform, forming a $47 billion credit investment firm that will be the fifth-largest CLO manager globally.

China Evergrande Group, the developer at the heart of the nation's property crisis, said it signed restructuring support agreements with some dollar bondholders backing its proposed debt restructuring. Meanwhile, another Chinese builder, Shimao Group Holdings Ltd., is circulating draft restructuring offers to advisers of an ad-hoc bondholder group.

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– With assistance by Bruce Douglas, Kevin Kingsbury and James Crombie