USAA Real Estate Company

WHAT HAPPENED TO CMBS ISSUANCE IN 2016?

RESEARCH ARTICLE

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The final tally is in, and U.S. CMBS issuance fell by nearly 25.0% last year to $76 billion. This marked the first annual decline in issuance since 2009. A number of factors influenced CMBS issuance declines, such as a volatility of bond spreads in the first quarter, implementation of new regulation, and investors requiring greater compensation for perceived increased market risks. After six consecutive years of growth, many market participants are wondering if last year's performance was an anomaly or if it represents a secular shift in CMBS expectations.

Market participants expected another year of growth for CMBS. Early projections called for the market to reach between $100 billion and $125 billion in 2016. Market participants had reason to be optimistic given the more than $87.1 billion of CMBS loans that were scheduled to mature during the year (according to Trepp), interest rates were expected to remain historically low, and property sales activity appeared likely to remain robust. Normally, these would be solid predictors of increased issuance. Commercial mortgage originations from securitized lenders, however, slowed early in the year as it became challenging to profitably price loans amid rising market volatility.

What caused the uncertainty? Investors became increasingly concerned about a global economic slowdown in early 2016, as U.S. GDP slumped to its slowest first half of the year since 2011. As a result, bond spreads widened as investors demanded more compensation for perceived risk. Contemporaneously, new risk- retention rules were set to take hold in December 2016, requiring issuers to retain at least 5.0% of each transaction. Investors and lenders struggled to price loans appropriately given the strict regulatory environment and the broader market uncertainty, which ultimately resulted in a deterioration in annual CMBS issuance.

Looking ahead into 2017, CBMS volume will likely remain flat (at roughly $70 billion), or decline slightly. Lenders are still grappling with risk-retention rules and while U.S. economic conditions appear to be on solid footing, the unknowns associated with the Trump administration adds another layer of complexity to the market. While it is too soon to determine the long-term viability of the CMBS segment, the sector faces significant headwinds and will likely have a diminished role within the credit markets in near term, especially compared to its peak transaction volume of $230 billion in 2007.

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