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RISING CMBS DELINQUENCY: THE IMPACT IS VINTAGE DEPENDENT

Delinquencies in the U.S. fixed-rate conduit commercial mortgage-backed securities (CMBS) market crossed the 1% mark at the beginning of 2009. Delinquencies within this subset of fixed-rate conduit products are greater than $7.5 billion, representing more than 800 loans, and are expected to continue to rise throughout 2009 as the property markets deteriorate in response to a contracting economy. The delinquency figures are led by multi-family loans (43% of the delinquencies), retail (28%) and office (13%). The states with the largest balances of delinquent loans are Texas (15%), Florida (13%), multi-state portfolios (12%), New York (7%) and Michigan (5%). By loan count, Texas (128), Florida (102), Michigan (67), Georgia (57) and Ohio (47) make up the top five.

The U.S. Fixed Rate Conduit Market (1998–2008), As of January 2008 Remittance Data

Vintage	Number of Loans	Number of Transactions	Outstanding Balance (USD)	Total Delinquency*	Number of Delinquent Loans	Number of Transactions with No Delinquencies	Non-Performing Matured
1998	1,529	33	7,144,353,434	6.45%	72	7	1.69%
1999	2,869	36	13,734,610,523	2.08%	65	12	1.15%
2000	3,748	31	19,881,634,239	1.69%	59	4	0.27%
2001	4,125	35	26,482,679,978	1.76%	68	5	0.01%
2002	3,806	35	27,919,826,009	0.96%	46	11	0.01%
2003	5,124	47	42,193,962,497	0.73%	39	25	0.09%
2004	6,348	59	65,419,649,994	0.74%	59	25	0.11%
2005	10,363	64	131,233,915,069	0.69%	96	18	0.08%
2006	11,936	65	160,477,206,149	1.04%	171	13	0.00%
2007	12,778	65	197,887,284,941	1.07%	155	18	0.00%
2008	819	8	10,686,727,535	2.40%	7	3	0.00%
Total	**62,626**	**470**	**692,375,122,833**	**1.05%**	**837**	**138**	**0.08%**

* Includes 60-day, 90+, foreclosure and REO.
Source: Trepp, LLC.

The vintages that appear to be outliers are on each end of the historical data outlined above. The higher delinquency rate of the 1998 vintage is likely due to the lower denominator of the equation. This vintage has had ample time to season and only has 14.6% of its original collateral balance outstanding; in fact, 83.5% of the collateral has been repaid through loans refinancing at maturity, amortization or liquidation recoveries and only 2% of the original balance to date has resulted in a realized loss. The ten-year loans that could refinance paid out of the pool at their maturity dates, leaving the transactions with those loans whose maturities are longer than ten years and those needing more time or extensions (only 1.69% of the vintage is categorized as non-performing matured loans). The delinquencies, as a percentage of origination balance, are actually in line with that of the 2001 and 2004 vintages.

The 2008 total delinquency percentage is high, particularly given the limited seasoning of its vintage. As implied by the chart above, one would expect delinquencies to increase as the vintages season because delinquencies can take up to three years to cure. These delinquencies are driven, predominately, by two large properties in one transaction: the $125 million Promenade Shops and the $100 million Westin Portfolio in the JPM 2008-C2 transaction. Together, the loans comprise 88% of the 2008 delinquencies.

It is not surprising, given the volume of loans (in number and balance) originated in the 2006 and 2007 vintages, that those two vintages lead in terms of balance and number of delinquent loans, with 171 and 155, respectively. For these vintages in particular, rising delinquencies will have a greater negative impact on ratings higher up the capital stack than the same level of delinquencies in older vintages. This will occur for a number of reasons,

(1) Severe Global Downturn Affecting All Property Types
We are in the midst of a severe global downturn. Real estate is cyclical, but in previous cycles (e.g., the dot-com downturn), not all property types in all markets were affected. In this current downturn, it is hard to imagine that any property type in any market will not have some downward pressure on rental rates and increased vacancy as a result of the higher national unemployment and the ripple effect it has on consumers' ability to pay rent, their retail spending habits, office usage, hotel bookings and overall production and warehousing of goods. The impact will be higher on the vintages at each end of the spectrum, for very different reasons. In the older vintages, it will affect the maturing loans because capital is constrained and stabilized performance may be difficult to measure, which is seen in the higher percentage of non-performing matured loans; however, in most instances, there is sufficient equity to support a maturity extension. In the more recent vintages of 2006 to 2008, it is the higher leverage loans that will cause increased delinquencies. Borrowers will not continue to feed an asset stressed from the downward pressures of the cycle when what little equity they had in the property is likely gone.

(2) Lower Credit Support Levels within These Vintages.
The average credit enhancement of a 2004 transaction compared with a 2007 transaction is 8% to 10% higher on the AJ or comparable AAA class of the 2004 vintage. The increased credit enhancement helps to absorb losses on defaulted loans, keeping the impact on higher-rated classes to a minimum, whereas the same loss experienced in a 2007 vintage would directly affect more classes.

(3) Lack of Seasoning Allowing for Counter-Balancing Positive Trends
In the past years, as delinquencies rose within transactions, there have been some simultaneous positive credit events occurring in the transactions, including cash flow growth and defeasance. Many loans of more recent vintage transactions were originated assuming future cash flow growth would occur. That potential cash flow growth is uncertain and will not occur in a lot of properties. In fact, borrowers within all property sectors, especially retail and office, will continue to face increased vacancy and downward pressure on rental rates as leases roll.

On a positive note, there are many transactions that have no delinquencies. Of the 470 transactions in the sample, 138 have no 60-day or greater delinquencies. It will be interesting to study the credit dynamics of these transactions if they continue to ward off delinquencies.

In the most recent Monthly CMBS Surveillance Report, DBRS included delinquency tracking by vintage for fixed-rate CMBS product for both the Canadian and U.S. markets.

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