VIEWPOINT

FOUR QUADRANTS

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Public Debt

Debt markets reacted to unfolding events as excitedly as their equity market counterparts in March. Whereas on the equity side we saw tumbling prices in one quadrant (public equities) and market closure in another (private funds gating), in public debt we have seen both these phenomena. in the one quadrant; March 2020 saw strongly increasing prices rapidly expanding spreads for corporate debt backed by real estate companies on the one hand, and the effective closure of the CMBS and syndication markets on the other.

Compared with a month ago, investment grade real estate corporate bonds have seen yield to maturity increase by over 100bps, with a steady increase in spreads across different maturities and therefore not just in short dated bonds. Increases have been even sharper in companies and markets perceived to be exposed more to the threats associated with Covid-19, including retail but also healthcare.

Away from REITs, we have seen a near halting of the CMBS and syndication markets, which can effectively be considered closed for new issuance. This has a significant impact in itself to participants in this market, but also affects things further up the pipeline as lenders reliant on this exit route may not start to begin originating again until they are confident that it will open back up. Where spreads are quoted, there has been considerable movement over the course of the month. BofA Global Research cite UK and European AA CMBS spreads as having risen to 400bps at the end of March, from 140bps and 150bps respectively at the end of February. Despite such movement, it feels unlikely that the levels and / or extent of losses seen in CMBS 1.0 will be repeated. Generally speaking CMBS 2.0 has seen better structuring, more sensible leverage and a smaller pool of loans, while there appear to be fewer “exposed” deals in the short term, however, time will need to tell if this assumption is correct.

As the Global Financial Crisis abated, it was arguably the public debt markets where investors first saw value, and where performance was subsequently first to pick up as capital returned to the quadrant. While it will likely take time for new CMBS and syndication deals to come to the market, it may well be that pricing stability and recovery in new and existing REIT debt and existing packaged loan structures will again give investors the first signs of an upturn in fortunes in the wider real estate market.

Figure 1. UK and European CMBS spreads

Source: BofA Global Research.

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