VIEWPOINT

FOUR QUADRANTS

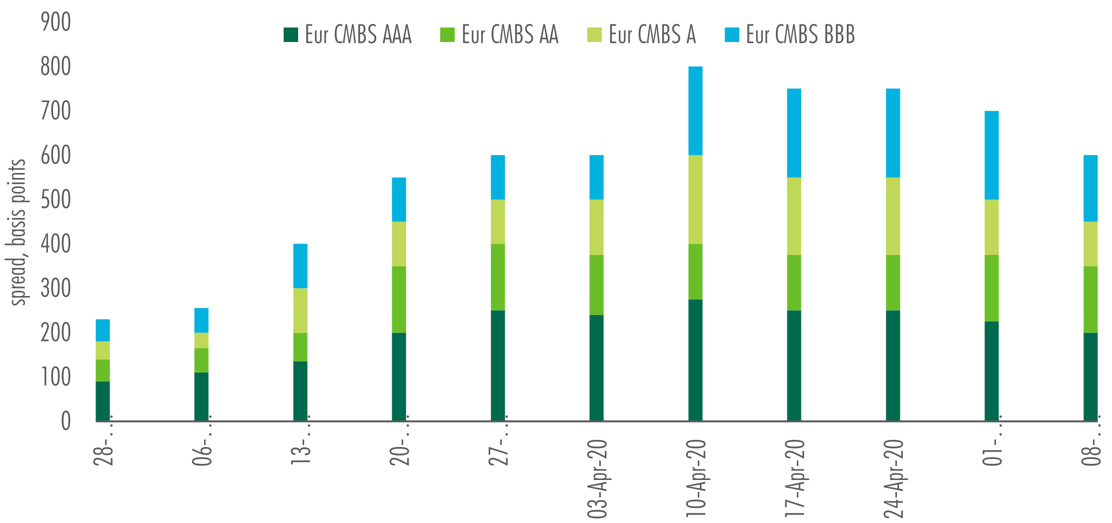
EMEA CAPITAL ADVISORS

Public Debt

After four weeks of near continuous tightening in pricing, it looks like the trough in CMBS pricing can be called for now as having occurred at the beginning of April. Since then, spreads on AAA have declined from 275bps to 200bps, still some way above their recent peak at end February of 90bps. The improvement in A and BBB pricing has been greater in nominal terms – 150bps and 200bs respectively – but pricing at the higher risk end of the capital stack is nonetheless furthest from its pre-crisis norm; A and BBB spreads are 270bps and 370bps respectively above end February levels.

While spreads are once again tightening, the market remains some way from seeing new issuance. Indeed, investor focus tends towards evaluating the varying prospects and strategies for default of existing structures. Distress is not expected to be widespread, and even within the most affected sectors – such as retail and hotels – it is likely to be specific to deals where underlying operators or owners are particularly constrained operationally or from a capital perspective. In the hotel sector there is a strong likelihood that servicers will look through covenant breaches where assets have been forced to close, taking the view that those operators remain best placed to manage assets on re-opening. In retail, there may be instances of activist intervention in some cases, particularly by junior lenders in instances where borrowers are poorly capitalised , potentially resulting in a change in the balance of control of underlying assets.

Figure 1 European CMBS pricing



Source: Bank of America Global Research.

On the corporate bond side, we have seen the markets open for a number of REITs who have found it possible to issue debt, albeit that these are often the better capitalised players operating at lower LTVs, and even in these cases debt has been more expensive than would have been the case pre-crisis. That said, of the €4.1bn of debt EPRA estimate has been issued in 2020 year to date, €3.1bn completed in April. Unibail-Rodamco-Westfield issued €600m of five year and €800m of ten year debt at coupons of 2.125% and 2.625% respectively, while Vonovia issued €500m of both four and ten year debt, at slightly lower coupons of 1.625% and 2.225% respectively. Since then, more deals have come through including Klepierre issuing €600m of nine year debt at a coupon of 2%. Liquidity is likely to remain focussed in this area of the market (rather than CMBS) for the remainder of the year, and those utilising it should benefit from debt that, while more expensive than at the start of the year, is certainly comfortably below prevailing property yields.

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Contacts

For more information, please contact our Capital Advisors team:

Richard Dakin
Global Head
Capital Advisors
t: +44 (0)20 7182 2030
e: richard.dakin@cbre.com

Mark Evans
Executive Director
EMEA Equity Placement
t: +44 20 7182 2964
e: mark.evans@cbre.com

Paul Coates
Executive Director
Debt and Structured Finance
t: +44 20 7182 8050
e: paul.coates@cbre.com

Clarence Dixon
Executive Director
Loan Services
t: +44 20 7182 2917
e: clarence.dixon@cbre.com

Paul Robinson
Executive Director
Alternative Investment
t: +44 20 7182 2740
e: paul.robinson@cbre.com

Anthony Martin
Executive Director
Investment Advisory
t: +44 20 7182 2466
e: anthony.martin@cbre.com

Tim Ryan
Executive Director
Real Estate Investment Banking
t: +44 20 7182 2775
e: timothy.ryan@cbre.com

Dominic Smith
Senior Director
Research
t: +44 20 7182 2369
e: dominic.smith@cbre.com

Graham Barnes
Executive Director
Corporate Finance
t: +44 20 7182 2516
e: graham.barnes@cbre.com