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Record CRE Loan Defaults Expected This Month

Falling Prices Hindering Already-Difficult Ability To Refinance Loans on Time

An uptick in both the number and average loan size of new defaults resulted in a one-quarter point climb in March CMBS delinquencies to end the month at 1.53%, and there are significant indicators that point to record climb in defaults in April as well, according to Fitch Ratings.

In recent months, Fitch has observed a notable increase in the rollover rate of loans that move from 30-days to 60-days delinquent. As such, the current 30-day delinquency is reliable measure of loans that could go into default.

Of the Fitch-rated loans that were 30 days delinquent in February 2009, approximately 73% remained in default. This compares to a rollover rate of only 21% one year prior.

If the measure continues to function as a reasonable predictor of 60-day defaults, the $1.86 billion of loans 30 days delinquent in March, coupled with additional expected maturity defaults, could produce a record increase to the index this month.

Also worsening the outlook for CMBS defaults are the marked decreases in property values reported for all commercial property types in the first quarter, as noted by CoStar Group.

According to separate analysis by Moody's Investor Services, the significant decrease in commercial real estate prices seen in the last several months has resulted in price depreciation on average for properties backing loans that were originated as far back as 2005. If this trend continues, it would increase the risk that these loans could fail to refinance at maturity.

Although not necessarily representative of the broader commercial real estate loan market, Moody's noted that few CMBS loans maturing in the next two years are from vintages with more than 10% price depreciation. The financial ratings firm expects to see a continued decline in commercial property prices in the coming months as property fundamentals continue to erode and cap rates continue to rise.

Senior real estate executives also said they believe asset values will continue to slide as access to capital remains constricted, according to The Real Estate Roundtable Sentiment Survey for the 2nd quarter 2009.

"If current conditions are allowed to weaken further, the possibility of widespread commercial real estate loan defaults will transform today's threat into an ominous reality," said Jeffrey D. DeBoer Roundtable president and CEO. "It is clear that the nation's frozen credit markets currently do not have the capacity to meet a looming wave of commercial real estate loan maturities."

Newer Loans Make Up Biggest Chunk of Defaults
The 2006 through 2008 CMBS' vintages, which represent 56.6% of the Fitch-rated universe, now account for approximately 53.8% of all delinquencies, according to Fitch Ratings.

The recent vintage defaults are rising at a relatively fast pace compared to averages indicated by historical default curves.

"Continued larger loan defaults within the index are indicative of the moderate to severe macroeconomic stress environment that Fitch now views as applicable to U.S. CMBS performance," said Susan Merrick, Fitch managing director and U.S. CMBS Group head. "Recent vintage transactions, which are typically

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more concentrated by loan balance and have greater exposure to larger loans without stabilized income at issuance, will prove particularly susceptible to future losses attributable to the prolonged macroeconomic downturn."

In March 2009, 202 loans rated by Fitch totaling $1.7 billion became newly delinquent. Excluding small balance and B note loans, the average size of the new defaults was $10.1 million.

Twenty-one loans with a balance exceeding $20 million were added to the index last month, of which 15 were collateralized by retail properties. New defaults included the $86 million Metropolis Shopping Center in Plainfield, IL; the $81 million Southland Mall in Hayward, CA; and the $74 million Deerbrook Mall in Humble, TX.

The average loan balance also continues to rise on a monthly basis. As of March, the average size of traditional CMBS loans within the index stood at $9.2 million, compared to $6.9 million six months prior.

The $225 million Riverton Apartments loan, resolved following repayment of outstanding advances and interest on advances from the reserve accounts and letters of credit, and represents a notable removal from the index.

However, Fitch expects that loans secured by high-profile properties will continue to default. Fitch's delinquency index includes 1,270 delinquent loans totaling $7.4 billion, out of a Fitch rated universe of approximately 44,000 loans totaling $481 billion.

Following a 48% month-over-month increase in total delinquencies, the retail sector has nearly matched multifamily as the leading property type within the index by balance, at $2.5 billion each. When ranked by delinquencies within their individual property types, the multifamily sector continues to lead with a 3.59% rate, followed by retail at 1.79%, lodging at 1.48% and office at 0.65%.

Land Now Accounts for Most CDO Delinquencies
Twenty-one newly delinquent assets also led to an increase in U.S. commercial real estate loan CDO delinquencies to 6.5% for March 2009, up from 5.4% in February 2009, according to Fitch Ratings.

Excluding repurchased assets, nearly all of the new additions consist of matured balloon loans.

"Further maturity defaults are likely as the illiquid credit markets provide limited prospects for the payoff of loans," said Karen Trebach, a Fitch senior director.

Non-cash flowing property types comprise the highest percentage of delinquent commercial real estate CDO assets. Loans backed by interests in land are now the highest percentage of assets (approximately 32%).

Condominium conversions and construction loans comprise an additional 11.1%.

"Under the current credit market conditions, Fitch anticipates increased defaults on land loans as debt service reserves burn off and business plans fail to actualize," Trebach said.

Fitch currently rates 35 commercial real estate CDOs encompassing approximately 1,100 loans and 370 rated securities/assets with a balance of $23.8 billion.

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