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## Majority of office CMBS loans projected to struggle in refinancing





More than three years after the onset of the Covid-19 pandemic, companies continue to reassess their office space needs.

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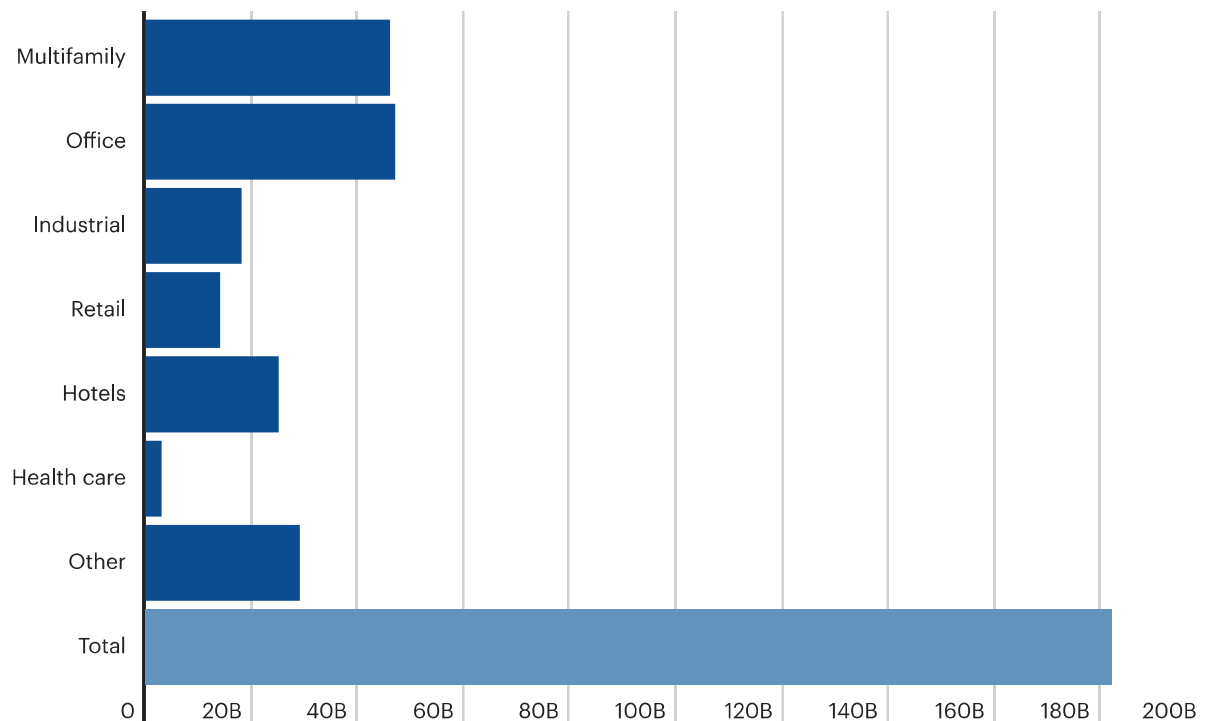
The office market is staring down a tough 2024 as loans backing those properties come due and borrowers face issues at refinancing.

And given higher interest rates and lenders' added scrutiny of all commercial real estate loans, **it's unlikely any real estate sector will be spared** from a more challenging 2024.

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Moody's Analytics Inc. found an estimated \$182 billion is expected to mature among major commercial real estate property types in 2024. Among that, an expected \$47 billion is forecast to mature in the office loan world, according to Moody's, which analyzed data from the Mortgage Bankers Association and the Federal Insurance Deposit Corp., as well as its own data.

## LOANS MATURING IN 2024



Source: Mortgage Bankers Association, Federal Deposit Insurance Corp., Moody's Analytics

Share

Moody's also looked at the share of commercial mortgage-backed securities loans that have been paid off at maturity in 2023 by sector. The majority of office loans were not paid off at maturity, or 68.6% of CMBS loans examined. That share was even higher than malls, a highly bifurcated sector, in which 41% of CMBS loans backing mall properties were not paid off at maturity this year.

Among the six property types examined – office, malls, non-mall retail, hotels, multifamily and industrial – office was the only sector in which the majority of its loans were unable to be paid off at maturity in 2023.

### **Trends impacting the ability to pay off loans**

Kevin Fagan, senior director and head of commercial real estate economic analysis at Moody's Analytics, said during an economic briefing there are a few observable trends among which office loans are likely to be paid off at maturity. For example, there's a correlation between the size of an office loan and ability to pay off the debt, with some 90% of office loans at \$10 million or less successfully paying off at maturity. On the other end, only 26% of loans at \$100 million or higher were paid off.

Loans backing office properties with limited risk of a major tenant leaving – because their lease isn't expiring for some time, or they recently renewed or signed a new deal – also tend to fare better than those facing significant lease rollover. Even more than three years after the onset of the Covid-19 pandemic, many companies are still opting for smaller offices, consolidating their footprint or departing older buildings for the newest, most amenitized properties, increasing the risk that a company – or several – won't renew their leases at renewal.

Based on Moody's calculation of CMBS office loans, an estimated 76% are at a high risk of not being able to be refinanced in 2024. The analysis took into account such factors as lease rollover, whether a loan is already in special servicing and a loan's debt yield to make its estimations.

So far, many lenders have done workouts with borrowers, even on loans facing issues at maturity. It's not uncommon to see extensions on loans or a modification of terms, but as banks and other lenders tighten their standards, and the continuous threat of a recession looms, 2024 may see a higher rate of loan defaults and foreclosures on troubled properties.

"The continued flow of these maturing loans that are running into trouble, particularly on the office side, are basically going to turn into delinquencies, and some will turn into

losses," Fagan said.

Despite the headwinds facing office, many of the losses it's experiencing – as well as other property types – can be attributed to higher capitalization rates. That's eroding returns and values on all commercial real estate properties. Interest-rate hikes are generally correlated with higher cap rates.

"[The] value declines are really driven by market pricing," Fagan said. "It's a weird world right now to understand what's happening with values. One very clear thing that was driving price correction downward was cap rates."