Distressed Debt Deep Dive

Market Overview

Webster Hughes, PhD

Managing Director, Thirty Capital

Spring 2024

Introduction

As of the end of 2023, commercial-property distress, encompassing financially-troubled assets and those taken over by lenders, amounted to a staggering $85.8 billion, underscoring the urgent need for a deep understanding of distressed debt in today's market. In the first article of our series about distressed debt, we provide a comprehensive exploration about distressed debt, drawing insights from loan and property data extracted from agency and non-agency CMBS and CRE-CLO investor reporting. Focusing our lens on loans secured by precisely one property and properties encumbered by exactly one loan, we begin by offering a high-level decomposition of distress across this rich dataset.

As we progress, anticipate granular deep dives into individual consolidated metropolitan survey areas (CMSAs), property types, and correlations with property, loan, and demographic characteristics. However, it's essential to note that our analysis primarily pertains to permanent loans secured by stabilized income-producing properties. Keep in mind that results may significantly vary for other segments of the commercial real estate (CRE) market, such as bank loans on transitional properties, or when using alternative distress definitions.

Moreover, our methodology calculates aggregated distress percentages by loan and property count, offering insights into the likelihood of distress rather than the percentage of loan balance affected. Armed with data-driven insights and a commitment to unraveling this critical aspect of the market, let’s learn more about distressed debt.

Distress Categories

As of February month-end reporting dates, we analyzed a research dataset comprised of 21,291 loans secured by exactly one property and properties encumbered by exactly one loan. Using this dataset, we define the following four distress categories:

- Loans reported as being in workout
- Loans reported as having servicer advances of principal and interest
- Loans reported as delinquent or matured with an outstanding balance
- Loans with upcoming maturities in the next year which require a capital investment of at least 25% of existing loan balance to refinance.

For the latter refinancing calculation, we assume DSCR<1.0 on the existing loan balance using the most recent NCF and a 7% loan payment rate. Results will vary for other definitions.

Using these categorizations, we identify 1,385 of the 21,291 loans in our dataset as distressed. This equates to an overall distress percentage equal to 6.51%. Figure 1 below shows percentages for the four distress categories.

Figure 1: Distress Categories

NUMBER OF LOANS	NUMBER OF DISTRESSED	% DISTRESSED - TOTAL	% WORKOUT	% SERVICER ADVANCES	% DELINQUENT	% UPCOMING MATURITY
21,291	1,291	6.06%	2.15%	2.95%	3.22%	2.80%

When reviewing this categorization, keep in mind that these distressed categories will often overlap (i.e., a distressed loan may be in more than one distress category). For this reason, the sum of percentages across the four distress categories will always exceed the aggregated distress percentage for the full dataset.

Property Types

Each property in our dataset includes a property type pulled from the CMBS investor reporting files: Office, Mixed Use, Hotel, Healthcare, Multifamily, Retail, Industrial, Manufacturing, and Self-Storage. In Figure 2 below, we show the wide variation in distressed percentages across these property types.

Figure 2: Distressed Loans by Property Type

PROPERTY TYPE	NUMBER OF LOANS	NUMBER OF DISTRESSED	% DISTRESSED
Office	1,698	193	11.37%
Mixed Use	636	50	7.86%
Warehouse	64	5	7.81%
Hotel	1,288	100	7.76%
Healthcare	248	17	6.85%
Multifamily	12,237	761	6.22%
Retail	3,310	133	4.02%
Industrial	485	14	2.89%
Manufacturing	503	10	1.99%
Self Storage	747	5	0.67%

It should not be surprising to anyone reading the news that the Office property type has the highest percentage of distressed loans. Also, note that Multifamily is far-and-away the most populated property type. This is due in large part to the dominant role of Agency Multifamily lending programs in the securitized loan market. In subsequent articles we will examine the characteristics of each property type segment, but in this first article we focus on the broader averages.

CMSAs (Consolidated Metropolitan Survey Area)

Each property in our dataset is geo-mapped to a CMSA, latitude, longitude, and a unique census tract (used for demographics). Figure 3 below shows wide variation in distressed percentages across the largest CMSAs:

Figure 3: Distressed Loans by CMSA

CMSA	ACTIVE LOANS	NUMBER OF DISTRESSED	% DISTRESSED
(NY, NJ, PA) New York, Northern New Jersey, Long Island	1,607	248	15.43%
(MD) Baltimore, Towson	207	21	10.14%
(CA) San Francisco, Oakland, Fremont	365	37	10.14%
(TX) Dallas, Fort Worth, Arlington	884	81	9.16%
(AZ) Phoenix, Mesa, Scottsdale	498	44	8.84%
(TX) Houston, Sugar Land, Baytown	775	64	8.26%
(IL, IN, WI) Chicago, Naperville, Joliet	598	46	7.69%
(MN, WI) Minneapolis, St. Paul, Bloomington	196	14	7.14%
(TX) Austin, Round Rock	229	16	6.99%
(NC, SC) Charlotte, Gastonia, Concord	196	13	6.63%
(PA) Pittsburgh	167	11	6.59%
(TX) San Antonio	207	13	6.28%
(CO) Denver, Aurora	354	22	6.21%
(WA) Seattle, Tacoma, Bellevue	399	24	6.02%
(IN) Indianapolis, Carmel	184	11	5.98%
(PA,NJ, DE, MD) Philadelphia, Camden, Wilmington	465	27	5.81%
(GA) Atlanta, Sandy Springs, Marietta	631	35	5.55%

Figure 3: Distressed Loans by CMSA cont'd.,

CMSA	ACTIVE LOANS	NUMBER OF DISTRESSED	% DISTRESSED
(DC, VA, MD, WV) Washington, Arlington, Alexandria	461	25	5.42%
(MO, KS) Kansas City	196	10	5.10%
(NV) Las Vegas, Paradise	354	17	4.80%
(OR, WA) Portland, Vancouver, Beaverton	251	12	4.78%
(FL) Miami, Fort Lauderdale, Pompano Beach	486	21	4.32%
(CA) Los Angeles, Long Beach, Santa Ana	1,150	46	4.00%
(FL) Orlando, Kissimmee	208	8	3.85%
(MA, NH) Boston, Cambridge, Quincy	172	6	3.49%
(MI) Detroit, Warren, Livonia	438	13	2.97%
(FL) Tampa, St. Petersburg, Clearwater	258	7	2.71%
(CA) San Diego, Carlsbad, San Marcos	301	11	3.65%
(CA) Riverside, San Bernardino, Ontario	313	8	2.56%
(OH) Columbus	184	4	2.17%
(VA, NC) Virginia Beach, Norfolk, Newport News	164	3	1.83%
(CA) Sacramento, Arden, Arcade, Roseville	192	2	1.04%

It is not surprising that the NYC CMSA (NY-NJ-New York-Northern New Jersey-Long Island) has a sizable percentage of distressed properties. For example, we hear daily news regarding commercial real estate loan distress at NY Community Bank, as well as notable defaults by large players in the NYC market.

Figure 4 below provides a breakdown of NYC CMSA distressed loans by property type.

Figure 4: Distressed NYC CMSA Loans by Property Type

CMSA	PROPERTY TYPE	NUMBER OF LOANS	NUMBER OF DISTRESSED	% DISTRESSED
(NY, NJ, PA) New York, Northern New Jersey, Long Island	Hotel	45	11	24.44%
(NY, NJ, PA) New York, Northern New Jersey, Long Island	Multifamily	970	175	18.04%
(NY, NJ, PA) New York, Northern New Jersey, Long Island	Office	161	22	13.66%
(NY, NJ, PA) New York, Northern New Jersey, Long Island	Retail	178	18	10.11%
(NY, NJ, PA) New York, Northern New Jersey, Long Island	Mixed Use	150	15	10.00%
(NY, NJ, PA) New York, Northern New Jersey, Long Island	Self Storage	20	2	10.00%
(NY, NJ, PA) New York, Northern New Jersey, Long Island	Industrial	40	3	7.50%

In contrast to the broader averages shown in Figure 2 above, we see that the Hotel segment has the highest distress percentage in the NYC CMSA and that Multifamily tops Office and Mixed Use. A plausible reason for a high distress percentage in the NYC CMSA Hotel sector is that properties are still recovering from the COVID disaster. Regarding Multifamily, that sector continues to face headwinds from negative net migration, broader geographic resident alternatives due to remote working, and rent-control constraints. Also, NYC Multifamily includes a significant concentration of smaller loans to small-time operators with less access to capital and often underwritten with less-stringent loan requirements.

On a more granular level, what categories of distress are most prevalent across the NYC CMSA and across the property types within the CMSA? And how does distress correlate to loan and property attributes and demographic characteristics?

Conclusion

As we conclude our examination of distressed debt, we've uncovered crucial insights. However, this is just the tip of the iceberg. Our findings illustrate the nature of distressed loans, bearing implications for investors, lenders, and property owners alike. Look out for the next articles in our series about distressed debt in the commercial real estate market. We will review other CMSAs with similar breakdowns, as well drill down to individual loans and properties within the various CMSA/Type buckets.

Next Steps

At Thirty Capital, we're your partner across the asset and investment lifecycle, including distressed debt. With our expertise and industry knowledge, we can provide valuable guidance and tailored solutions to navigate debt distress.

Reach out to us today by visiting ThirtyCapital.com.