aegon asset management

Commentary
March 2025

US Commercial Mortgage Loans

This year's MBA CREF conference was characterized by optimism tempered by realism. The optimism is generated from the fact that seemingly every lender at the conference has capital to deploy in 2025 with larger mandates than at any time over the past three years. Additional positivity results from the continued compression in CML spreads driven by compression in the corporate bond market. We believe the relative value of CMLs remains compelling.

The realism stems from stymied transaction volume expectations driven by the level of US Treasury yields as of this writing, the still-sluggish but strengthening acquisition market, apprehensions over supply/demand fundamentals that could make some properties in certain submarkets not finance-able, and wider geopolitical concerns surrounding the new administration. The overwhelming majority of conversations at the conference focused on shorter-term loans (under five years) and flexibility features on loan structures, whether it be prepayment mechanisms, open par prepayment periods, rate reset options, or rate buydowns.

According to the Mortgage Bankers Association, 20% ($957 billion) of $4.8 trillion of outstanding commercial mortgages will mature in 2025, a 3% increase over the projected level from 2024. Among life insurance company CML managers, it is estimated that $64 billion of that cohort's outstanding mortgage balances (9% of total) will mature in 2025.[1]

A subset of loans that were set to mature in 2024 were extended into 2025, similar to what had happened in 2022 and 2023. Based on projections that rates should remain close to current levels and diminished willingness on the part of lenders to continue to provide short-term "band-aid" extensions, the path forward for these mortgages that were extended will provide challenges and opportunities for lenders in 2025.

Key Takeaways

- Lenders have plenty of capital to deploy in 2025.
- Shorter-term loans are most desired.
- Many lenders are willing to lend on a full-term interest-only basis.
- Life companies have generated significant investable cash as the industry has shifted the product mix and sales focus into annuities.
- Core life company spreads are projected at 140-175 basis points (bps), with certain lenders dipping a little lower to approximately 120 bps for the highest-quality deals.

- Given elevated rates and tighter debt service coverage ratios, we believe CMBS will be very active in response to proceeds' needs.
    - CMBS issuance growth is projected to be 25-30%.
- Agencies are expected to be very competitive again to start the year, however the process has grown more cumbersome, making acquisition loans difficult to pursue with Fannie or Freddie and turning off some borrowers.
- Indications are that banks, including money center banks, want to put more money out.
    - The willingness of banks to "kick the can" on existing problematic loans has diminished.
- The bridge lending space has seen many new entrants, with spread compression from the mid-300s down to low 200s. This is driven in part by banks providing aggressive warehouse lines of credit (i.e., "back leverage") to lenders.

Conclusion

Overall, the lending market in 2025 is expected to be highly competitive, with lenders having ample capital to deploy. The overwhelming preference for shorter-term loans and an increased emphasis on interest-only structures will place an increased emphasis on lenders to underwrite refinance risk. The playing field will include traditional sources such as life companies, agencies, and banks along with a wide group of bridge lenders (which will take advantage of a deep warehouse lending market driven by the money center banks). The competition should create spread compression, although CMLs are expected to retain a compelling relative value spread advantage over corporate bonds. The acquisition market should continue its slow climb out of the 2023-era trough despite sellers and buyers navigating an environment of altered return expectations based on Treasury yields, at the time of this writing. Investors should remain adaptable and strategic in their approach to capitalize on opportunities in the evolving real assets landscape.

[1]Mortgage Bankers Association, February 21, 2025.

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