Green Street

Commercial Mortgage REITs

Spread-ing Our Bets: Commercial mREITs 101



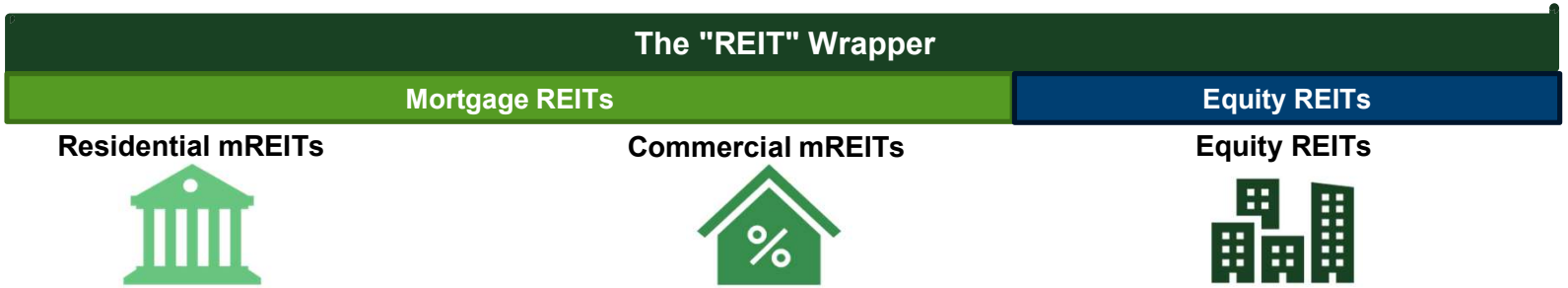
Author:

Harsh Hemnani, CFA
Analyst

October 10, 2024

Mortgage REITs: Overview

Unpacking the REIT Wrapper: The REIT structure was established in 1960 as a tax efficient way for investors to access a diversified portfolio of real estate debt and equity. Continental Mortgage Investors, a commercial mortgage REIT, IPO'd in 1965 as the first publicly traded REIT. Since then, the REIT industry has matured, experienced various rule changes, and split into two categories: equity REITs – that own properties, and mortgage REITs ("mREITs") – that own loans and securities backed by property. Green Street has covered equity REITs for over three decades. This report is a primer on their lending counterparts – mREITs. Broadly, mREITs are split into two categories separating those that own mortgages backed by residential vs. commercial properties.



	Residential mREITs	Commercial mREITs	Equity REITs
Assets Owned:	Agency Mortgage Backed Securities (MBS) and their derivatives	Loans and securities backed by commercial property	Equity in commercial real estate
Sensitivity to Changes in CRE Values	Low	Moderate	High
Liquidity of Underlying Assets	High	Moderate to low	Low
Key Source of Financing	General collateral repo (short term, collateralized borrowing)	Bank warehouse facilities (a.k.a loan-on-loan financing)	Public unsecured notes and secured mortgages
Leverage	Extremely High	Very High	Reasonable

Source: Green Street

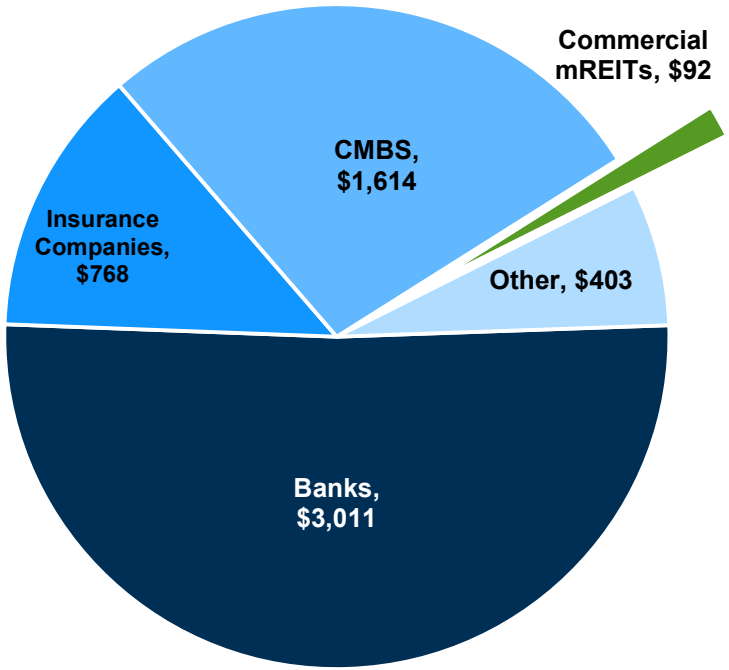
 © 2024, Green Street.
Use of this report is subject to the Terms of Use listed at the end of the report.

This Green Street sample report may not be copied or disseminated to others without written permission.

Commercial mREITs in Context

Playing in Expert Mode: mREITs have found a niche in the CRE debt pie that gives them a competitive advantage in a small, but growing slice of the market. These REITs are operated by established CRE owners that use their expertise to underwrite loans on transitional assets. Additionally, their institutional relationships give them access to large borrowers and the ability to drive repeat business. Lastly, mREITs have embraced institutional deals with larger check sizes that typically draw fewer lenders to the bidding tent.

Slicing the CRE Debt Pie*
(in $ billions, as of 2Q24)



mREITs Underwrite Loans Where They Have Competitive Advantages:

Transitional Assets: Typically higher risk loans, as lenders underwrite either construction, lease-up, or business plan risk in addition to risks on typical stabilized assets. mREITs are generally managed by established CRE operators, making them uniquely positioned to underwrite such risks.

Short Term, Floating Rate Loans: Reduces interest rate risk for lenders, and allows borrowers the flexibility to refinance into long-term fixed rate financing upon project stabilization.

Large Checks: Lender bidding tents are smaller at larger check sizes. mREITs will typically underwrite loans >$50 million, appealing to institutional sponsors. For context, the largest CRE loans on bank balance sheets are ~$130 million, with larger loans underwritten by syndicates or destined for securitization.

*Total CRE debt Includes mortgages backed by construction projects (~$550B) and owner-occupied properties (~$650B). CMBS includes agency (~$1T) and non-agency CMBS (~$0.6T). mREITs holdings are adjusted to exclude consolidated CMBS securities as a result of variable interest entity (VIE) treatment.

Source: Federal Reserve, Green Street

 © 2024, Green Street.
Use of this report is subject to the Terms of Use listed at the end of the report.

This Green Street sample report may not be copied or disseminated to others without written permission.

Transitional CRE Assets

Shades of Transition: "Transitional" is a general term used for pre-stabilized real estate assets. The cash flows generated from these assets do not fully reflect their potential economic value, making long-term fixed rate debt a sub-optimal financing option. There are several shades of transitional assets, ranging from temporary cash flow disruption due to a lease turnover that may not require much capital infusion to redevelopment projects.

Light Transitional (lower risk, lower spreads)	**Value-Add Projects** (moderate risk and spread)	**Heavy Transitional** (high risk, high spread)
Requires minimal property level changes: The property is typically cash-flowing, but not to its full capacity. **Examples:** • Upcoming lease turnover that leaves current cash flow below stabilized levels • Minor renovations on new assets acquired (e.g., refreshing the lobby in a hotel) **Cash Flow Increase:** Involves some cash flow upside **Time to Stabilization:** 1-2 years	Requires some property level changes: Property is not cash-flowing or well below potential. **Examples:** • A newly completed construction project that needs to be leased up • Significant unit-level renovations in a multifamily building **Cash Flow Increase:** Large increases in property NOI after sponsor's capital investment **Time to Stabilization:** 2-3 years	Redevelopment/ Repositioning / Construction: Property is not cash-flowing. **Examples:** • Lending against a construction project • Repositioning an office building to mixed-use **Cash Flow Increase:** Significant cash flow upside (from "zero to one") **Time to Stabilization:** 3-5 years

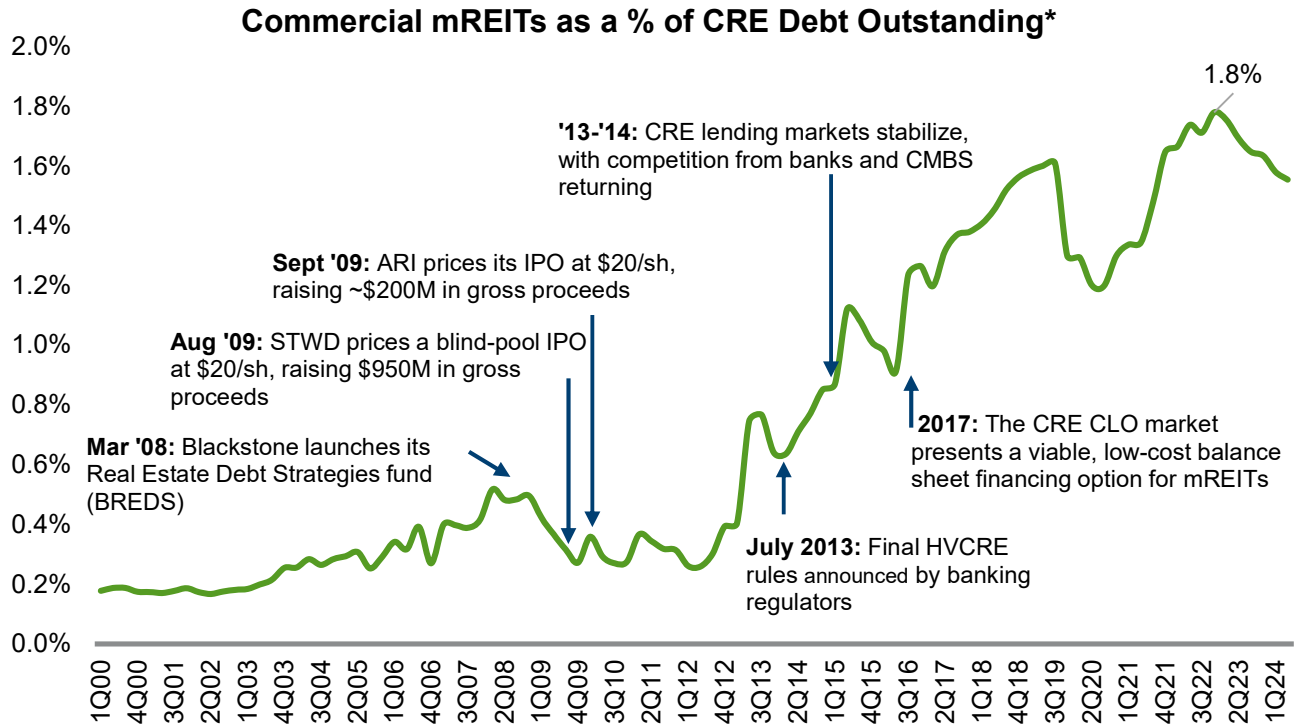
Source: Green Street

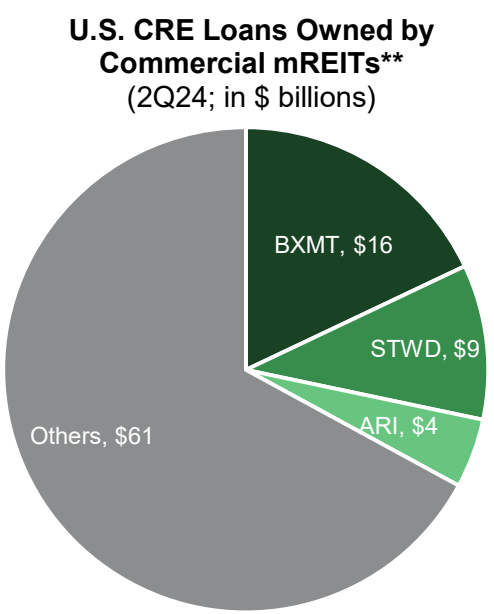
 © 2024, Green Street.
Use of this report is subject to the Terms of Use listed at the end of the report.

This Green Street sample report may not be copied or disseminated to others without written permission.

Modern Era

Rise from Ashes: The commercial mortgage REIT industry found its footing against this backdrop, embracing short-term, floating-rate loans on transitional CRE assets that banks and CMBS markets pulled away from. Over the last 15 years, commercial mREITs have grown from ~0.3% to ~1.6% of all CRE loans outstanding. As of 2Q24, the U.S. CRE loan books of Blackstone Mortgage Trust ("BXMT"), Starwood Property Trust ("STWD"), and Apollo Commercial Real Estate Finance ("ARI") make up roughly one-third of all US mREIT loans outstanding. Green Street will be initiating coverage on these three mREITs in an upcoming report.





*mREITs holdings are adjusted to exclude consolidated CMBS securities as a result of VIE treatment. ** Includes the mREITs' U.S. CRE loans books only (i.e., excludes foreign loans, infrastructure loans and securities)

Source: Federal Reserve, Green Street

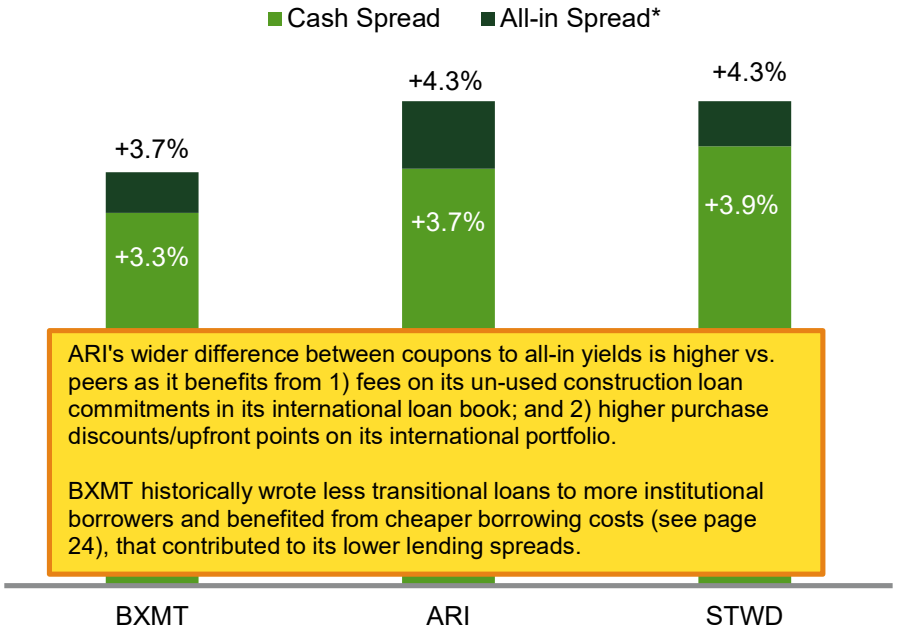
 © 2024, Green Street.
Use of this report is subject to the Terms of Use listed at the end of the report.

This Green Street sample report may not be copied or disseminated to others without written permission.

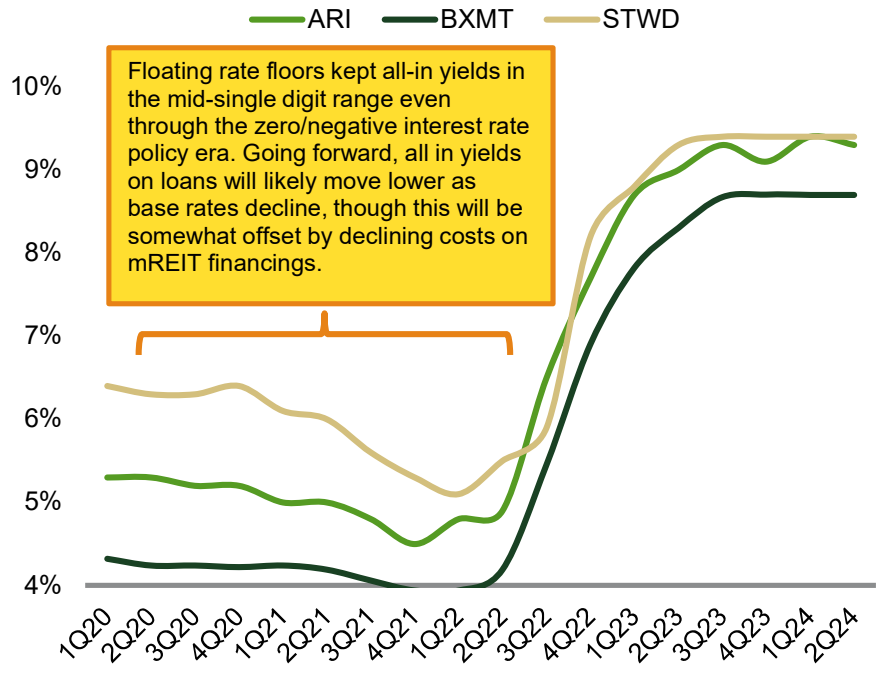
Loan Spreads

Healthy: Commercial mREIT in-place loan books are largely comprised of loans originated over '21 and '22 (~65% on average, see page 17). These loans were originated at cash spreads of ~325-400 bps, and at all-in spreads (including origination fees, discounts etc.) of ~375-425 bps. Conversations with mREITs and other market participants suggest that new transitional loan spreads are pricing in the ~325-450 bps over SOFR range depending on the level of transition and property type. Apartments and industrial are favored sectors with the most competitive pricing, while office and lodging price on the wider end of the range.

Spreads on In-place CRE Senior Loan Portfolios by REIT*



All-in Yields on Senior CRE Loan Portfolios by REIT



Source: Company disclosure, Green Street * Senior loans only, excludes subordinated and mezzanine loans all-in spread includes: 1) pick-up from fees and origination discounts; 2) negative impact of loan origination costs over the life of the loan.

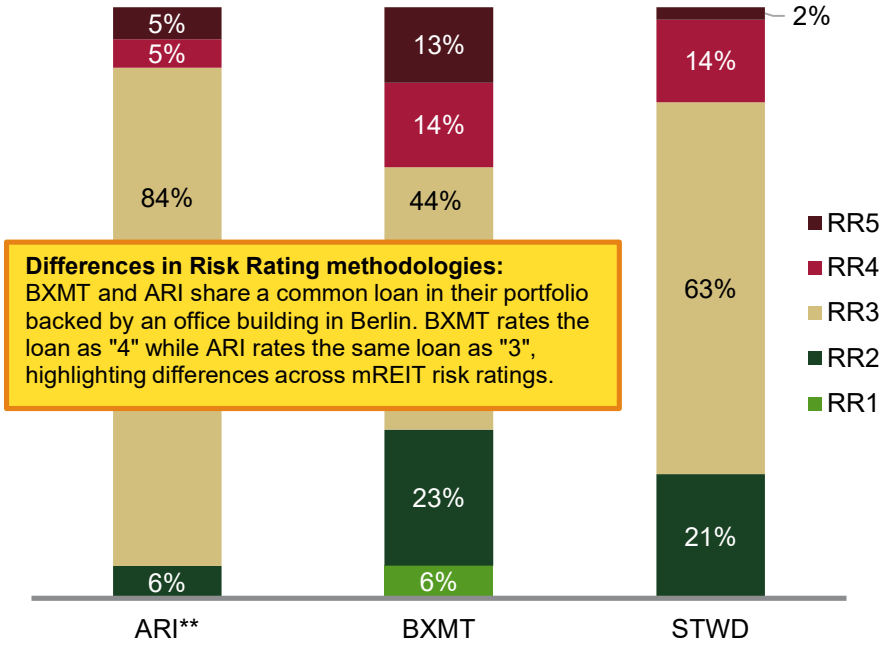
my.greenstreet.com © 2024, Green Street.
Use of this report is subject to the Terms of Use listed at the end of the report.

This Green Street sample report may not be copied or disseminated to others without written permission.

Portfolio Credit Metrics

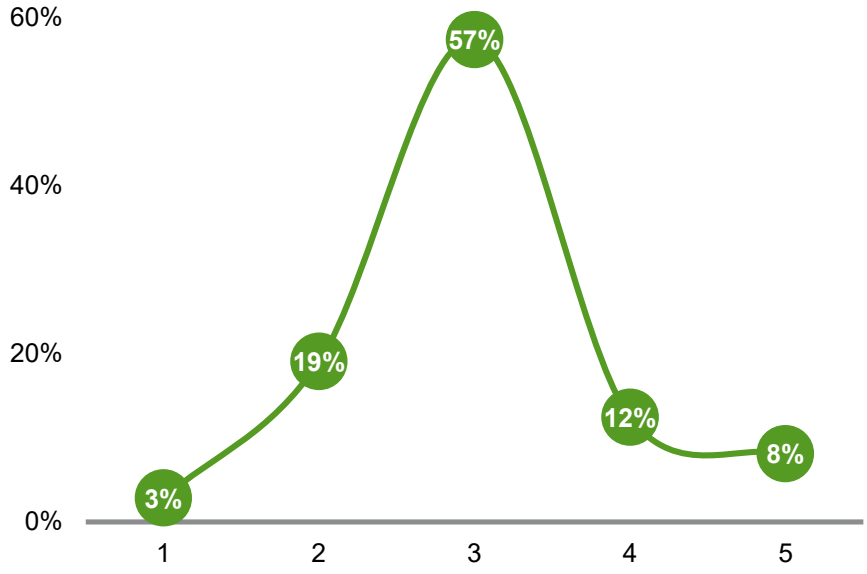
Internal Credit Metrics: Commercial mREITs bucket their loans into five risk ratings. Very low- and low-risk loans are rated 1 and 2, respectively. Loans that perform in-line with the business plan underwritten at the time of origination are assigned a risk rating of "3" or medium risk. Higher risk loans with potential losses are rated "4", while impaired loans with losses imminent/likely are rated "5". As of 2Q24, ~20% of mREIT loans were rated 4 or 5 vs. a historical average of <10%. These ratings are defined by each REIT and therefore are not fully comparable across companies.

Risk Ratings Distribution by mREIT*



Differences in Risk Rating methodologies:
BXMT and ARI share a common loan in their portfolio backed by an office building in Berlin. BXMT rates the loan as "4" while ARI rates the same loan as "3", highlighting differences across mREIT risk ratings.

mREIT Risk Rating Distribution



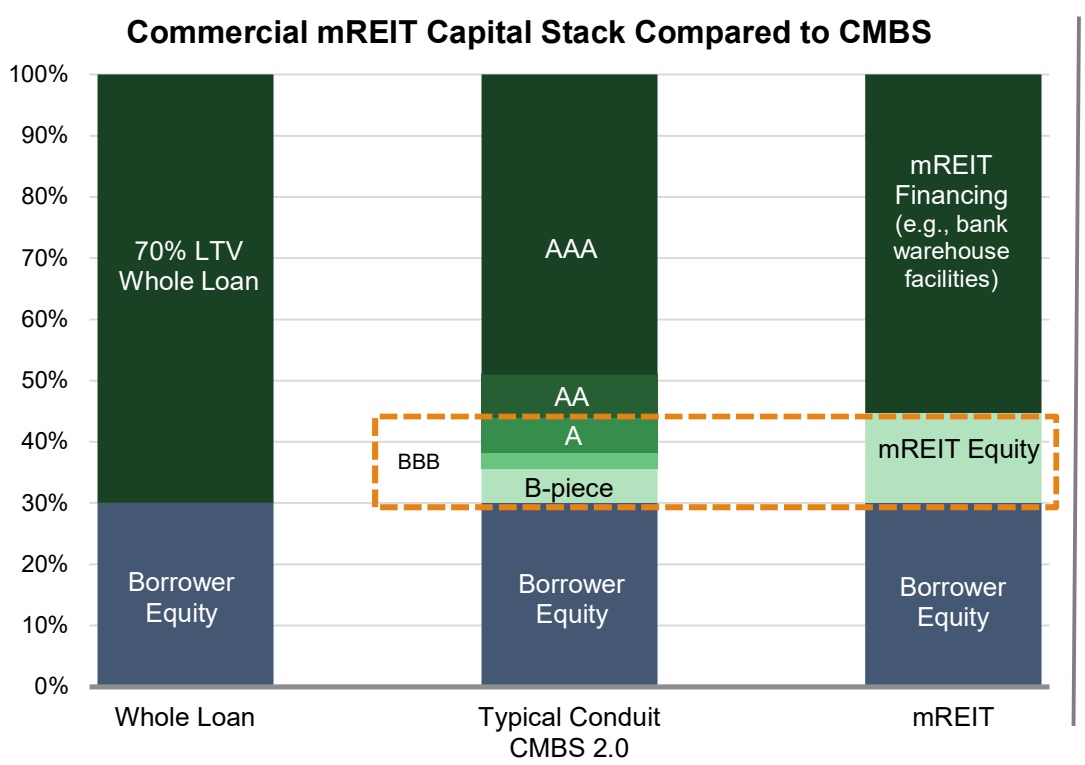
Source: Company disclosure, Green Street * RR = Risk Rating. **ARI's specific CECL reserves are added to the risk rated 5 bucket.

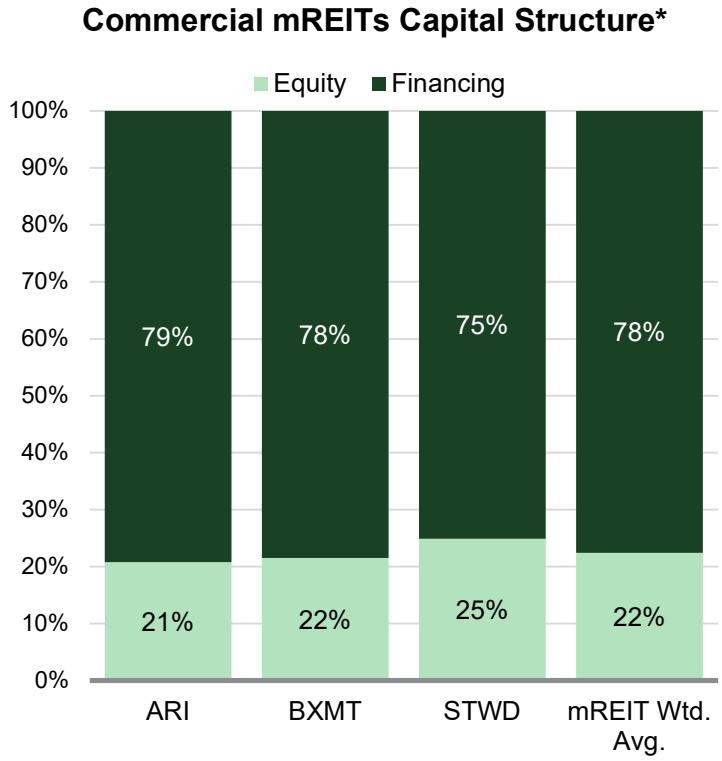
 © 2024, Green Street.
Use of this report is subject to the Terms of Use listed at the end of the report.

This Green Street sample report may not be copied or disseminated to others without written permission.

Financing Strategy

First Loss Piece: Investing in the equity of an mREIT can be viewed as buying subordinate tranches of floating rate CMBS. Commercial mREITs make whole loans, and then effectively sell the most senior portions of the loans to banks (i.e., finance them with secured bank facilities). mREIT equity is subordinate to this financing, and acts as the first loss piece when loans default. Current leverage metrics imply ~20% subordination to mREIT financing, which is on par with subordination on "AA" rated CMBS tranches. Therefore, the mREIT equity has a risk profile similar to tranches rated single-A and below.

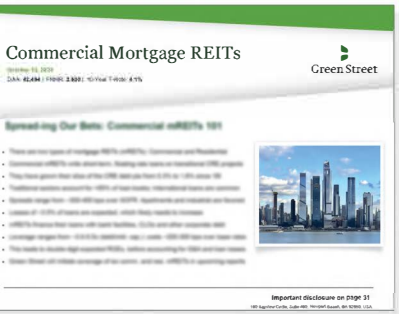




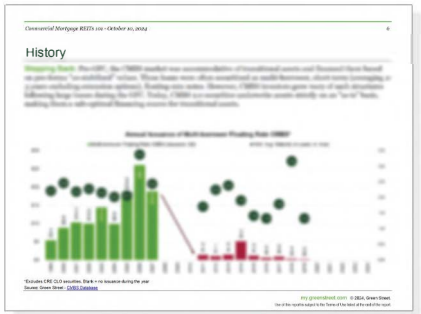
Source: Company disclosure, Green Street; * Assets = principal balance of CRE loan portfolios only; financing at face/par value plus preferred securities less cash; equity implied by assets and financing. Both assets and financing are on mREIT CRE loan books only, i.e., exclude securities held and real estate owned assets and their associated financing.

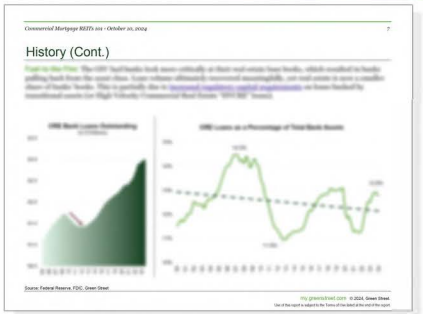
my.greenstreet.com © 2024, Green Street.
Use of this report is subject to the Terms of Use listed at the end of the report.

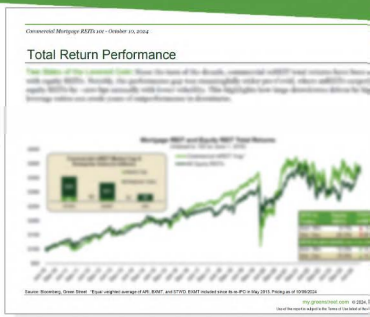
This Green Street sample report may not be copied or disseminated to others without written permission.

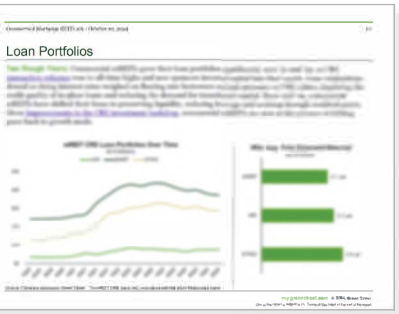


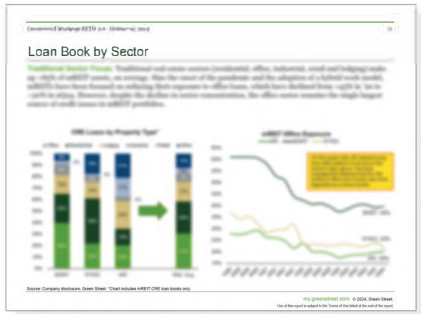


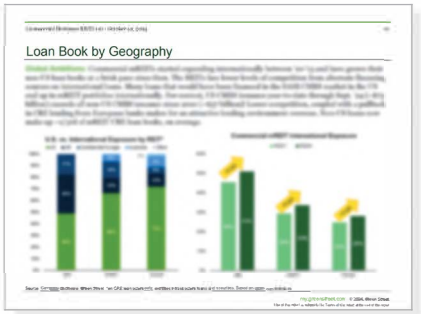


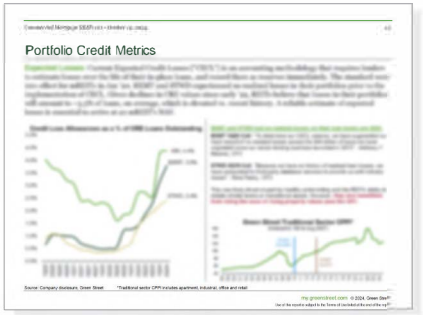


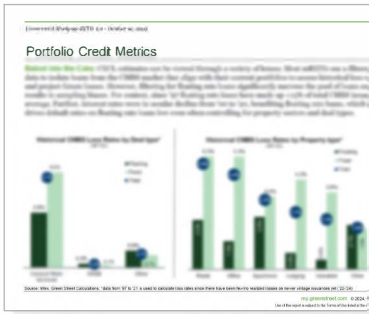


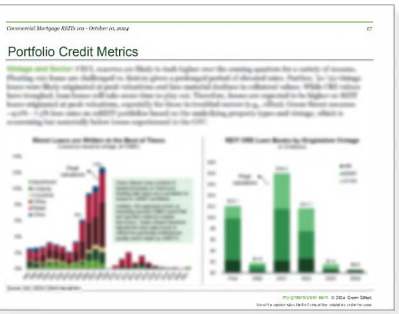


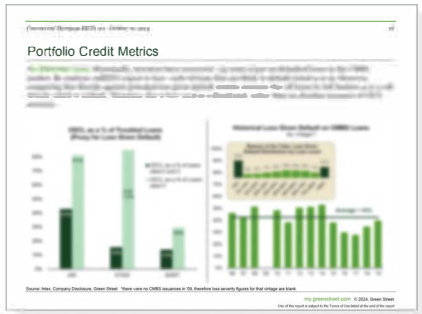




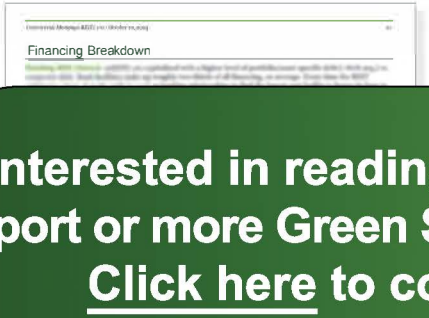


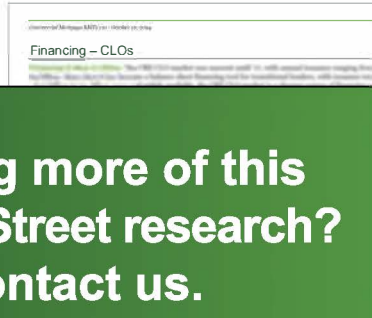




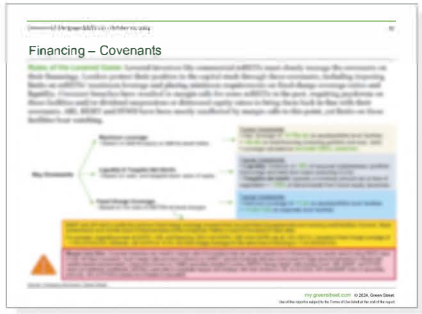


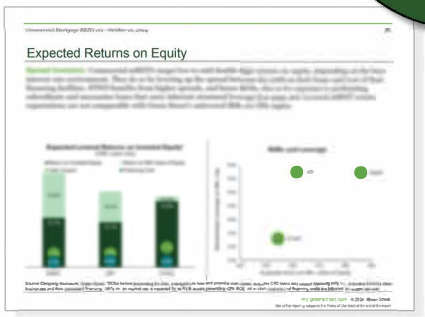


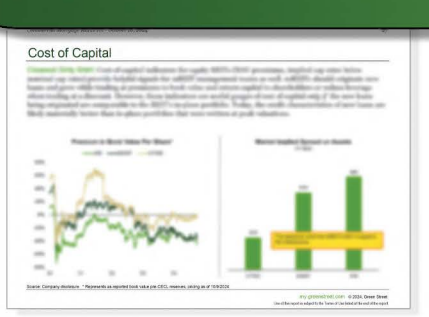


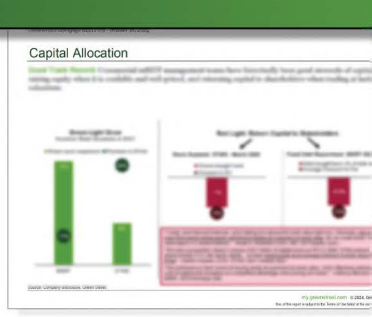












Interested in reading more of this report or more Green Street research? Click here to contact us.

Green Street's Disclosure Statement

This report does NOT constitute investment advice nor is it provided in the capacity of a fiduciary.

The information contained in this report is based on data obtained from sources we deem to be reliable; it is not guaranteed as to accuracy and does not purport to be complete. This report is produced solely for informational purposes and is not intended to be used as the primary basis of investment decisions. Because of individual client requirements, it is not, and it should not be construed as, advice designed to meet the particular investment needs of any investor. This report is not an offer or the solicitation of an offer to sell or buy any security.

Issuers of this Report US and EEA: *This report has been prepared by analysts working for Green Street (Green Street US) and/or Green Street (U.K.) Limited (Green Street UK). Green Street US is the parent company of Green Street UK.*

This report is issued in the European Economic Area (EEA) by Green Street UK. Green Street US accepts no responsibility for this report to the extent that it is read by persons based in the EEA. Green Street Advisors (UK) Ltd is registered in England, (Company number. 6471304), and its registered office is 3rd and 4th Floors, 25 Maddox Street, London W1S 2QN. Green Street Advisors (UK) Ltd is authorized and regulated by the Financial Conduct Authority in the United Kingdom (FRN 482269).

Green Street US relies on the Limited Connection Relief for services provided to our clients located in Australia.

Green Street UK is exempt from the requirement to hold an Australian financial services license under the Act in respect of the financial services; and is regulated by the FCA under UK laws, which differ from Australian laws.

Green Street, along with its research professionals, are not registered as an advisor or dealer in any category with a securities regulator in Canada and any advice provided is not a solicitation to offer or sell or trade in specific securities or to provide tailored advice to any person in Canada.

Swiss recipients: the funds, the REITs, the investment companies and any collective investment schemes referred to in these reports may not have been registered with the Swiss Financial Market Supervisory Authority (FINMA) and no Swiss representative or paying agent has been appointed. This report is provided in Switzerland for the use of the addressees only and may not be distributed, copied, reproduced, or passed on to any third parties.

Green Street reserves the right to update the disclosures and policies set out in this document at any time.

Other Important Information

Automated Valuation Model: The valuation estimates do not constitute an appraisal of the properties or portfolios and should not be relied upon in lieu of an appraisal or underwriting process. The estimated values are based upon data collected from public record sources, client inputs, and Green Street proprietary metrics and models. The accuracy of the methodology used to develop the valuation estimates are based on available data and are not guaranteed or warranted. The condition of the properties and current market conditions can affect the validity of the valuation estimates and custom reports generated. Any valuation estimate and custom report generated does not include a physical inspection of the properties or a visual inspection or analysis of current market conditions by a licensed or certified appraiser, which is typically included in an appraisal.

Management of Conflicts of Interest: Conflicts of interest can seriously impinge the ability of Green Street employees to do their job. In that spirit, Green Street adheres to the following policies across its organization regarding conflicts of interest:

- Green Street employees are prohibited from actively trading the shares of any company in our coverage universe.
- Green Street employees do not serve as officers or directors of any of our subject companies.
- Neither Green Street nor its employees/analysts receive any compensation from subject companies for inclusion in our research.
- On occasion, Green Street analysts may be contacted by companies within the firm's coverage universe regarding potential employment opportunities. Additional disclosure will be made when appropriate.
- Green Street's Advisory business services investors seeking to acquire interests in publicly traded companies. Green Street may provide valuation services to prospective acquirers of companies which are the subject(s) of Green Street's research reports.

Green Street publishes research reports covering issuers that may offer and sell securities in an initial or secondary offering.

Green Street US generally prohibits research analysts from sending draft research reports to subject companies. However, it should be presumed that the analyst(s) who authored this report has(/have) had discussions with the subject company to ensure factual accuracy prior to publication and has(/have) had assistance from the company in conducting due diligence, including visits to company sites and meetings with company management and other representatives.

Terms of Use

Protection of Proprietary Rights: To the extent that this report is issued by Green Street US, this material is the proprietary and confidential information of Green Street and is protected by copyright. To the extent that this report is issued by Green Street UK, this material is the proprietary and confidential information of Green Street (U.K.) Limited and is protected by copyright.

This report may be used solely for reference for internal business purposes. This report may not be reproduced, re-distributed, sold, lent, licensed or otherwise transferred without the prior consent of Green Street. All other rights with respect to this report are reserved by Green Street.

EEA and UK Recipients: For use only by Professional Clients and Eligible Counterparties: Green Street Advisors (UK) Ltd is authorized by the Financial Conduct Authority to issue this report to "Professional Clients" and "Eligible Counterparties" only . This report is not for the use of "Retail Clients". This report is provided in the United Kingdom for the use of the addressees any other person who receives this report should not act on the contents of this report.

https://my.greenstreet.com/disclosure/ResearchDisclosure

This Green Street sample report may not be copied or disseminated to others without written permission.

Green Street United States Team

Research

Leadership
Cedrik Lachance, Director of Research — clachance@greenstreet.com

Strategic Research
Peter Rothemund, CFA, Co-Head of Strategic Research — prothemund@greenstreet.com
Daniel Ismail, CFA, Co-Head of Strategic Research — dismail@greenstreet.com
Evan Lustick, Associate — elustick@greenstreet.com
Duane Green, CFA, Associate — dgreen@greenstreet.com

Debt Research/Ground Lease
Harsh Hemnani, CFA, Analyst — hhemnani@greenstreet.com

Company and Sector Research
Michael Knott, CFA, Managing Director, Head of U.S. REIT Research — mknott@greenstreet.com

Data Centers and Towers
David Guarino, Senior Analyst — dguarino@greenstreet.com
Elina Samandyk, Senior Associate — esamandyk@greenstreet.com

Industrial and Malls
Vince Tibone, CFA, Managing Director — vtibone@greenstreet.com
Jessica Zheng, CFA, CPA, Analyst — jzheng@greenstreet.com
Naishal Shah, Senior Associate — nshah@greenstreet.com

Lodging and Gaming
Chris Darling, CFA, Senior Analyst — cdarling@greenstreet.com
Michael Herring, Senior Associate — mherring@greenstreet.com

Net Lease and Self-Storage
Spenser Allaway, Senior Analyst — sallaway@greenstreet.com
Ryan Caviola, Associate — rcaviola@greenstreet.com
Salil Mehta, Associate — smehta@greenstreet.com

Office
Dylan Burzinski, Analyst — dburzinski@greenstreet.com
Natacha Jouonang, Associate — njouonang@greenstreet.com
Reny Pire, Associate — rpire@greenstreet.com

Residential and Health Care
John Pawlowski, CFA, Managing Director — jpawlowski@greenstreet.com
David Segall, Senior Analyst — dsegall@greenstreet.com
Michael Stroyeck, CFA, Analyst — mstroyeck@greenstreet.com
Ann Chan, Senior Associate — achan@greenstreet.com
Emily Meckler, Senior Associate — emeckler@greenstreet.com

Strip Centers
Paulina Rojas-Schmidt, Senior Analyst — projasschmidt@greenstreet.com
Daniel Purpura, Senior Associate — dpurpura@greenstreet.com

CRE Analytics
Andrew McCulloch, CFA, Chief Analytics Officer — amcculloch@greenstreet.com

Forecasting & Data Science
Daniel Wijaya, Co-Head of Forecasting & Data Science — dwijaya@greenstreet.com
Dmitry Nikalaichyk, Co-Head of Forecasting & Data Science — dnikalaichyk@greenstreet.com
Otto Aletter, Senior Analyst — oaletter@greenstreet.com
Wilkie Ma, Senior Quant Analyst — wma@greenstreet.com
Sumit Beniwal, Quant Analyst — sbeniwal@greenstreet.com
Jung Suh, Quant Analyst — jsuh@greenstreet.com
Aaron Mueller, Quant Analyst — amueller@greenstreet.com

Research & Development
Weston Mui, CFA, Senior Analyst — wmui@greenstreet.com
Alexandra Boyle, Analyst — aboyle@greenstreet.com
Max Motlagh, Associate — mmotlagh@greenstreet.com
Aleksey Smityukh, Associate — asmithyukh@greenstreet.com

Market Analytics
Seth Laughlin, Head of U.S. Market Analytics — slaughlin@greenstreet.com
Rob Filley, CFA, Senior Analyst — rfilley@greenstreet.com
Ryan Miller, CFA, Senior Analyst — rmiller@greenstreet.com
Emily Arft, Analyst — earft@greenstreet.com
Colette Cote, Senior Associate — ccote@greenstreet.com
Isabella Ierulli, Senior Associate — iierulli@greenstreet.com
Ryan McDowell, SeniorAssociate — rmcdowell@greenstreet.com
Katharina Shultz, Senior Associate — kshultz@greenstreet.com
Kelsey Burns, Associate — kburns@greenstreet.com
Roberto De La Herran, Associate — rdelaherran@greenstreet.com
Lauren Guistolise, Associate — lguistolise@greenstreet.com
Kelly Jensen, Associate — kjensen@greenstreet.com
Brian Lymberopoulos, Associate — blymberopoulos@greenstreet.com
Nick Webster, Associate — nwebster@greenstreet.com

Executive
Jeff Stuek, Chief Executive Officer — jstuek@greenstreet.com
Walter X. Palhetas, Chief Growth Officer — wpalhetas@greenstreet.com

Sales
Michael Richardson, Chief Sales Officer — mrichardson@greenstreet.com

Advisory
Dirk Aulabaugh, EVP, Global Head of Advisory Services — daulabaugh@greenstreet.com

Marketing
Kinsey Kappeler, Marketing Manager — kkappeler@greenstreet.com

Green Street
100 Bayview Circle, Suite 400
Newport Beach, CA 92660
T 949.640.8780

Green Street (UK) Limited
3rd and 4th Floors, 25 Maddox Street
London W1S 2QN
T +44 (0)20.3793.7000

While Green Street offers some regulated investment advisory services through its U.S. and U.K. companies, the U.S. and Canadian Research, Data, and Analytics, the U.K. Data products, and Green Street global News products are not provided in the capacity of an investment advisor or a fiduciary.

my.greenstreet.com © 2024, Green Street
Use of this report is subject to the Terms of Use listed at the end of the report