Commercial Mortgage Backed Securitization (CMBS) Market in Singapore

Securitizing non-recourse commercial mortgages is a process commonly known as commercial mortgage backed securitization (CMBS), in which tradable securities are created for investors to diversify their portfolio into commercial mortgages. These commercial mortgages are secured by commercial real estate like office buildings, shopping malls, multi-family apartments, hotels, warehouses and factories, or mix developments with hybrid property use types. In the US, the CMBS market has developed rapidly and dollar volume of commercial mortgages securitized increased more than five times from US$4.9billion in 1989 to US$27.2 billion in 1996.

In the US, a typical CMBS process starts with a secondary mortgage institution purchasing commercial mortgages from banks and putting them into a mortgage pool. When the pool reaches an adequate size, the institution would securitize it with the assistance of an arranger, usually an investment bank. The securities are divided into different classes, or tranches. They are rated by a credit-rating agency and then sold to investors in the capital market. The investors will receive regular coupon payments with different priority according to the subordination structure of the CMBS bonds. Through the CMBS process, banks can raise new capital directly from the market and use it to originate more loans.

In Singapore, the pooling of commercial mortgages for securitization is a relatively new innovation and is yet to be adopted by local banks. The healthy liquidity position, the low default risks of the commercial mortgages and the reluctance of banks to sever the good relationships with their corporate mortgagors are the obstacles that impede banks to securitize their valuable commercial mortgages. Owners of commercial properties, however, have taken the lead in tapping into capital markets for new source of funding. In the late 1980s and early 1990s, bonds backed by mortgages on single commercial building, such as Hong Leong building, have been arranged by banks. In the 1999, securitization of commercial properties took a different form, which involves off-balance-sheet transfers of the equity interest in the properties to a special purpose vehicle (SPV). Investors were then invited to purchase bonds backed by cash flows generated from the properties. Commercial properties securitized under this structure include NOL building, Robinson Point, 268 Orchard Road, 6 Battery Road and Raffles City Complex. In 2002, the first CMBS backed by mortgages collateralized with three retail malls in the portfolio of CapitaMall Trust (CMT) was launched via the Silver Maple Investment Corporation Limited, the mortgagee of the malls. Four CMBS issues have come into the market since then.

The tranching structure of CMBS is dissimilar to that in the US. The process of creating CMBS in Singapore was, however, initiated by owners of the properties (Figure 1). The intermediary role of the lending institutions in this case has been taken over by the SPV, which takes the advantage of the secondary market issuance of CMBS to convert the existing floating-rate mortgage loans from typical banks to fixed-rate bond obligations over a medium term of 4 to 5 years. Banks, on the other hands, can reduce their exposure to credit risks by holding on to the senior CMBS tranche. At the same time, they can also earn fee-based income through underwriting the CMBS issues and servicing the mortgages. CMBS opens up new opportunity for institutional investors to diversify their portfolio into
commercial real estate market. In the CMBS issued by CapitaRetail Singapore, a private retail fund set up by CapitaLand Limited to hold a portfolio of three retail malls (Rivervale Mall, Lot One Shoppers Mall and Bukit Panjang Plaza), 30% junior E-class bonds were subscribed by CMT to provide yield accretion without having to stretch the gearing limit.

In a mailed questionnaire conducted between end December 2003 and February 2004, 80 out of the 500 firms surveyed responded. Among these respondents, 15 were banks involved in the supply side activities such as origination, underwriting and servicing of commercial mortgages. The remaining respondents are interested in participating in the demand side of the CMBS activities. The questionnaires were mostly answered by people in top management positions with more than 10-year experience in the financial sectors. Of the responding banks, 60% would consider selling their commercial mortgages as a way of injecting new capital. On the demand side, 86% of the responding firms felt positive about the potential of creating an active CMBS market in Singapore. In addition to an attractive yield spread, factors that are deemed important to improve the appeal of CMBS instruments include credit rating and market liquidity (ease of selling in the market) (Figure 2). The respondents also felt strongly of the need to have a government sponsored secondary mortgage institution (SMI), such as the like of Hong Kong Mortgage Corporation (HKMC), Korean Mortgage Corporation (KoMoCo) and National Mortgage Corporation of Malaysia (CAGAMAS) to facilitate the development of CMBS in Singapore.

In summary, there is tremendous potential for the creation of a CMBS market in Singapore. At least from the demand side, investors are receptive to include CMBS as an investment asset in their portfolio. The initial steps taken by the CMT in utilizing the CMBS to secure medium to long-term fixed-rate loans has opened up ample opportunity for real estate developers to tap onto international money market for funding. The support from government through setting up a SMI to facilitate issuance of CMBS and to provide credit enhancements will be a strong push for more CMBS activities in Singapore. The success in CMBS issuance and distribution would provide necessary depth and breadth to the local capital markets to position Singapore as a regional financial hub.

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Figure 1: A typical CMBS Process in Singapore

- Suppliers of Funds
  - Commercial Building 1
  - Commercial Building 2
  - Commercial Building 3

- Sponsoring Issuer / Developer
- Investment Banks
- Rating Agency

- Obtain capital directly from capital market through sale of CMBS
- a) Creating loan pool
- b) Credit enhancement
- c) Currency / Interest rate swaps
- d) Credit Rating

- Tranching of securities
  - Class A Security
  - Class B Security
  - Class C Security
  - Class Z Security
  - Residual Tranche

- Issuer/ Underwriter
- Sale of CMBS

Figure 2: Important Factors for CMBS Investors

- Correlations with other assets: 34
- Issuing agents & underwriting banks: 12
- Denomination of tranche: 13
- Information efficiency: 33
- Market liquidity: 62
- Rating of issues: 60
- Credit enhancement/guarantee: 44
- Term to maturity: 39

Frequency (No of Response)