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NEWS & ANALYSIS

Waterfall Asset Management takes contrarian tack with CMBS, whole loan acquisitions

The manager is seeing opportunity at a time when most lenders and investors are staying on the sidelines.

New York-based manager Waterfall Asset Management is seeing pockets of opportunity emerge in the US commercial real estate debt market – specifically in public commercial real estate securities and loan acquisitions – at a time when many lenders and investors remain on the sidelines.

The firm's activity this year includes the acquisition of public securities across CMBS, CRE CLOs and REIT corporate with a market value of about $2 billion and more than $500 million of CRE whole loans. These acquisitions were made across its commingled asset-backed credit vehicles as well as its single-investor funds, said Keerthi Raghavan, portfolio manager and head of asset-backed credit.

Waterfall sees a clear opportunity set for the firm to move forward – and to educate its investors about investing in a difficult market.

"[The weakness in the sector] is led by offices where occupancy, rents and valuations are falling. It is now spreading into other sectors," Raghavan told PERE Credit. "It is important to educate our investors about opportunities [that arise] because the fundamental risk is real."

The firm, which can invest throughout the capital stack, is seeing the impact of a heavy slate of near-term maturities on bank and insurance company balance sheets. The underlying properties often have weak fundamentals, Raghavan added.

"There is a lot of sensitivity to CRE exposure," said Raghavan. "But the opportunity is there for someone who knows real estate to come in and produce positive returns going forward."

Raghavan is also looking ahead to the impact of a heavy pipeline of near-term maturities. There are more than $600 billion of loans slated to mature this year, according to New York-based data provider MSCI. With extensions of loans from 2023 moving into this year, that number is close to $920 billion.

"Put all these factors together and commercial real estate looks very distressed," noted Raghavan.

He continued: "With half a trillion of debt coming due every year for the next three or four years, the question is, when will we see repricing. The debt markets are such that they are not going to wait until the debt comes due to reprice, they will reprice today."

Investor education

Alongside raising capital for its funds, another focus for the manager is to educate its investors.

"We are actively trying to raise money and educate investors about how this is a really interesting opportunity to buy really safe real estate assets on the debt with positive returns," said Raghavan. "This is a huge market, there's plenty of room for our investors who are opportunistic, and looking to deploy assets."

Education involves keeping investors informed on the state of the market; the nuances of location; building quality and tenancy; and how Waterfall can take advantage of risk being mispriced across these dimensions.

"Pricing across the CRE markets is somewhat indiscriminate, even for high quality assets located in prime areas with significant equity support," said Raghavan. "It is important for investors to understand how deep, boots-on-the ground underwriting of every individual asset can help identify higher quality investment opportunities at attractive yield levels.

"Equity indices are at all-time highs, corporate high yield spreads are at all-time lows, so it doesn't appear to be a tremendous amount of opportunities out there. But this is the one market where there is, [especially] when it is dislocated and if you can be comfortable [with that]."

In addition to its focus on education, Waterfall offers refinancing solutions for maturity CRE loans in senior or mezzanine format with tighter covenants, triggers and lower LTVs.

"The debt market really is the driver of distress in this market. And that's why the debt market has repriced meaningfully. Across the board, every debt position has been repriced," said Raghavan, adding that opportunities are a function of where the distress is sector-wise, and in which part of the capital structure it is, too.