

CMBS lose their sheen owing to falling interest rates

Commercial mortgage-backed securities carry fixed rates and bullet payments

Raghavendra Kamath | Mumbai November 24, 2015 Last Updated at 18:04 IST



Commercial mortgage-backed securities (CMBS), once a hit with top developers such as DLF and Rahejas, are losing their sheen. The reason being falling rates. Since interest rates are fixed in CMBS, developers are not favouring it as interest rates in the country are falling and they do not want to lock themselves with fixed rates.

Although the Reserve Bank of India has cut rates by 125 basis points in the past year, banks have reduced rates by 60-65 basis points, which have brought down the cost of borrowing for developers.

In CMBS, unlike normal loans, the principal payment is to be made at the end of the tenure of the loan and they carry lower interest rates.

"We have done the first round of CMBS in 2014. We are currently getting very competitive rates from banks and will re-examine CMBS issuance once rates stabilise," said Ashok Tyagi, chief financial officer, DLF, the country's largest property developer.

According to sources, DLF borrows funds from banks at 10.25 per cent to 10.50 per cent.

DLF had completed the country's first CMBS issue in the last quarter of 2013-14, raising Rs 900 crore through the issuance on DLF Emporio and DLF Promenade, two of its malls in Delhi. The Emporio CMBS carried an interest rate of 10.9 per cent.

DLF planned to raise Rs 3,500 crore through CMBS in one of the large special economic zones (SEZs) and to issue CMBS in a few other projects of smaller size, but now it seems to have kept them on hold, sources said.

A senior executive of K Raheja Corp, which raised funds through CMBS last year, said: "Interest rates are going down and bank loans are getting cheaper; hence, we have kept it on hold. Besides, there are some costs attached to CMBS. If we get reduction in costs, we will do it," said the executive.

Intime Properties, part of the K Raheja Corp group, raised Rs 340 crore through the issue of non-convertible debentures with a fixed rate of 9.95 per cent. Intime owns and operates three commercial office buildings in Mindspace IT Park, Hyderabad, with a total leasable area of 1.71 million square feet.

The group was also planning to raise more funds through CMBS for its Hyderabad properties.

"We raised funds through CMBS at 9.95 per cent last July. Today, we are raising funds at around 10 per cent from banks. So there is not much difference between bank funds and CMBS," he said.

Although there was a buzz that Bengaluru-based Embassy group, which has a joint venture with Blackstone for commercial properties, is looking at CMBS, its chairman and managing director Jitu Virwani said they are not looking at it.

"We are waiting for the Reit (real estate investment trust) laws to kick in. We would pay the EMI (equated monthly instalment) rather than paying interest only (as in case of CMBS)," he said.

Chintan Patel, partner, deal advisory at KPMG, believes since rates are going down, developers get cheaper rates in lease rent discounting (LRD) than CMBS. "In CMBS, developers need to give yields, which are around 10 per cent and adhere to lock in, they are preferring LRD to CMBS," he said.

"Given the current scenario, rates are going to go down," he said.

However, Ruchir Sinha, co-head, private equity and mergers and acquisitions at Nishith Desai Associates, believes instruments such as CMBS will pick up.

"Currently, the challenge is lack of faith in the Indian cap rate compression story and currency even though the yield remain inherently high; however, once the commercial assets monetisation starts, with interest rates coming down and availability of cheaper foreign capital, interest in CMBS will pick up." said Sinha.