

Structured Finance > Mortgage Credit



CMBS: Extension Protected Duper Tranches

Updated: Oct 26, 2015

Trade Idea:

- ▶ Purchase extension protected senior bonds from recently issued CMBS transactions, priced at ~2 bps inside of the last cash flow senior tranche but offering significant structural benefits

Investment Rationale:

- ▶ **Credit enhancement:** These classes are the “duper” tranche of CMBS deals, offering 30% credit support and significant protection above and beyond expected pool losses.
- ▶ **Structural attributes:** Recently issued CMBS transactions have low coupon rates on the underlying loans, which typically mature in 10 years, and relatively low cap rates supporting current CRE valuations. There is a concern that as rates move higher, refinancing becomes more difficult due to increasing debt service requirements and/or lower valuations due to higher cap rates, which would result in extension of cash flows due to modifications and/or workouts once loans reach maturity. As a result, structures have evolved to include a tranche that has a similar average life as the last cash flow bond but gets priority on repayment of principal due to maturity and/or liquidations, offering a much more stable cash flow profile.
- ▶ **Relative value:** These tranches typically price 2 bps inside of the last cash flow senior tranche, which we believe is a very cheap pay-up for the structural benefit. We believe that as rates rise, the market will begin to recognize the benefit of this structure and the differential between this class and the last cash flow senior tranche will widen materially.

Recommendation(s):

View	Trade Horizon	Deal & Tranche Info	Ratings	Cusip	Average Life / Duration	Tranche Par	Spread to Swaps	\$ Price	Current Yield*	Ability to Source Similar
Buy	12+ Months	JPMBB 2015-C32	Aaa/AAA/AAA/AAA (Moody's / Fitch DBRS / Kroll)	46590JAV9	9.70 / 8.16	\$100mm	125	101	3.26%	large pipeline

* As of 10/26/15