

## **Egan-Jones' Approach to Rating Collateralized Mortgage-Backed Securities (a non-NRSRO rating)**

**Commercial Mortgage-Backed Securities (CMBS)** – a storm is hitting many segments of this market as a result of COVID19 (with reduced travel and in-store purchases), over-building and decreased demand in the retail sector, and the potential massive shifts in commercial space usage stemming from the work-from-home trend. Retail bankruptcies appear to be running neck-to-neck with energy-related bankruptcies, with the upshot being that many malls are simply losers with lenders concluding that under no circumstances can projects work. Regarding commercial offices, while the pain has been deferred because of longer-term leases with corporate clients, the mantra that central-located urban office space is bullet-proof from a credit perspective is being questioned. The underlying question is whether central workplaces are still needed or whether work-from home supplemented by periodic in person meetings is more optimal. The consequence of the COVID19 crisis is that workers and managers are rapidly concluding work-from-home is a viable option for many and that the needed commercial space footprint is significantly lower than it was just a short while ago. Lastly, until travel returns, the hospitality industry will remain stressed. If the airlines are an indication, the problems are likely to continue for the next several quarters. Our approach in evaluating CMBS is to stress the net cash flow.

For CMBS ratings EJR has re-underwritten the assets of CMBS and have found that in many cases, the new analysis does not support publicly available credit assessments. The current industry 'sleight of hand' is to restructure a CMBS loan by cutting interest rates and making it interest only, thereby popping the debt service coverage metric. While this technique buys time, it does not solve the fundamental issue with performance and value associated with a troubled property and ultimately the issue will be manifested.

Please see Egan-Jones' "Methodology for Rating Commercial Mortgage-Backed Securities (CMBS)(Non-NRSRO)".

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