European CRE/CMBS outlook

Cautious optimism

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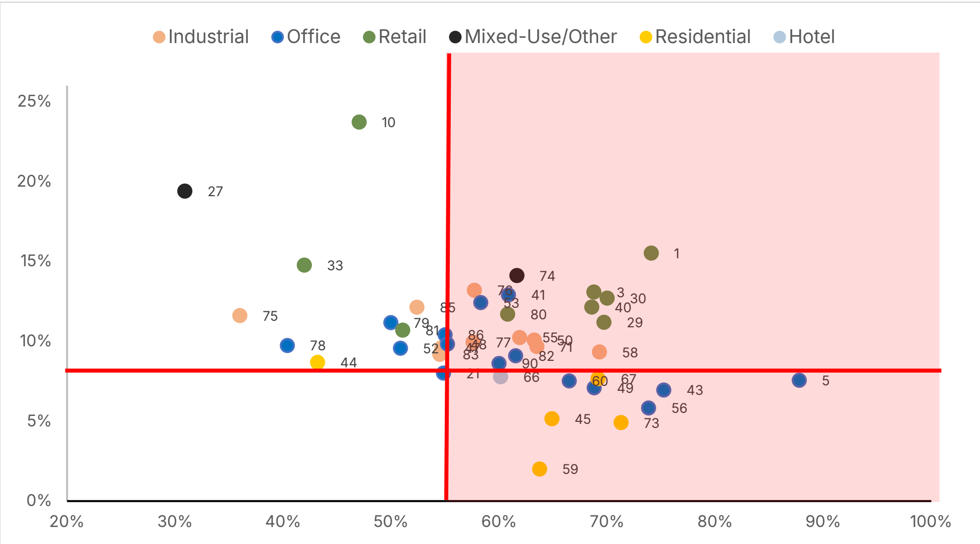
Roughly EUR 2.3bn of European CMBS priced in 2024 across five transactions: three industrial and logistics, one office and one data centre, which together securitised seven loans. That was more than double the EUR 900m of deals that emerged in 2023 across three transactions and loans. The CMBS market is poised for further issuance, given lower rate, the increasing importance of private credit in the commercial real estate sector and improved fundamentals for most asset classes. We expect 5bln of issuance for 2025.

That said, refinancing risk for existing securitised loans will remain elevated in 2025. We expect that 60% of loans by number will face high or very high refinancing risk, with borrowers facing the dual challenges of tougher competition for less and more expensive bank debt as well as lower asset values.

Figure 1: European securitised CRE loans: latest LTV and debt yield ratios



Source: Scope Ratings, Scope CMBS tracker, investor reports

Taking stock of 2024

On the positive side, there were no defaults at maturity and the three defaulted loans of 2024 were either corrected (in the case of the senior loan of River Green Finance 2020 DAC, and the Everest loan of Emerald Italy 2019 SRL) or recovery proceeds are on the verge of being allocated to noteholders (in the case of the Maroon loan of Elizabeth 2018-1), albeit with a loss for all noteholders. Thus the current year is starting with a clean slate.

62% of securitised loans failed to repay or refinance at maturity

On the negative side, the proportion of securitised CRE loans extended or modified at maturity is higher than our January 2024 expectations ("European CRE and CMBS outlook: stormy seas to continue"). We expected eight CRE loans (40%) to face a very high or high risk of refinancing but 13 (62%) did not repay at the expected date. Considering the subsequent repayment of the Palermo loan securitised in Pietra Nera Uno S.R.L. the figure improves to 12 or 57%.

Table 2: Securitised loans: outcomes compared to January 2024 expectations[1]

Refinancing risk	Modified	Extended	Repaid	Corrected	Total	Sub-total %
Very high	5	1	0	0	**6**	29%
High	0	0	2	0	**2**	10%
Medium	1	2	2	0	**5**	24%
Low	2	0	1	0	**3**	14%
Very low	2	0	2	0	**4**	19%
None	0	0	1	0	**1**	5%
Sub-total	**10**	**3**	**8**	**0**	**21**	**100%**
Sub-total %	**48%**	**14%**	**38%**	**0%**	**100%**	
N/A	0	0	2	2	**4**	
Total %	**40%**	**12%**	**40%**	**8%**	**100%**	

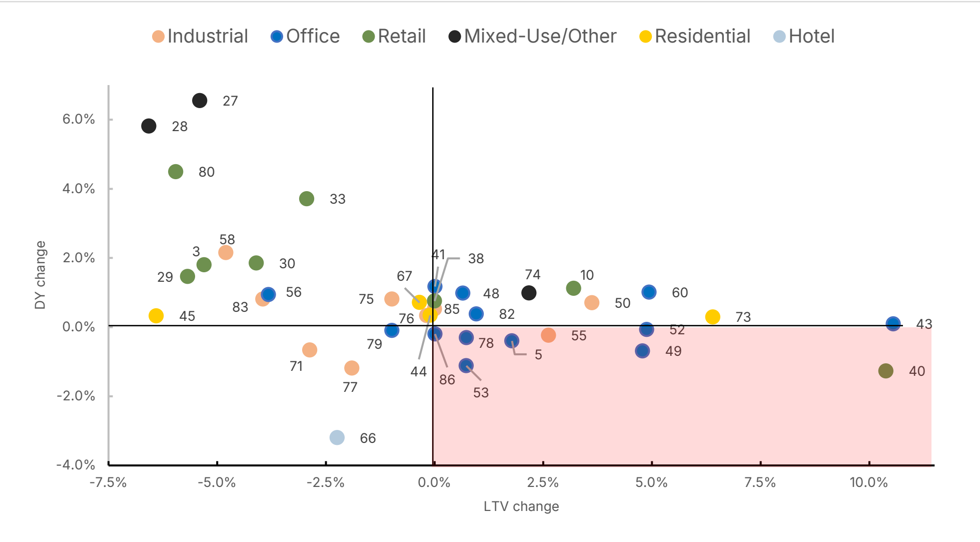
[1]Figures disregard the late repayment of the Palermo loan securitised in Pietra Nera Uno S.R.L.
Source: Scope Ratings, Euronext, investor reports

Metrics improving across all sectors but office

Most loans have shown an improvement in one or both of debt yield or loan-to-value compared to December 2023. A total of 22 loans (47%) have improved on both key metrics and 15 (32%) on at least one. Of the 10 loans (19%) with both metrics deteriorating, six are secured by office properties, three are secured by retail properties and one is secured by industrial properties.

Most loans have shown an improvement in at least one of their key metrics, except office

Figure 3: Year-on-year change in the main loan metrics in percentage points (ppt)



Source: Scope Ratings, Scope CMBS tracker, investor reports

Industrial and logistics steady, office woes and retail renaissance

The industrial and logistics sector continues to ride steady, with nine of the 10 loans exhibiting an improvement in at least one of the two metrics. Noteworthy here is the LTV improvement of -16.4 percentage points (ppt) of the Taurus 2021-1 UK senior loan following a revaluation from GBP 537.2m to GBP 602.2m.

The office sector persists with its woes with just one loan showing improvement on both metrics: Viridis, the senior loan of ELoC No. 38 secured by the Aldgate tower, which benefited not only from the sponsor's last-minute equity injection but also its second largest tenant more than doubling its space and rent. Revaluations continue to take their toll on loan-to-values, however, while debt yields continue to deteriorate due to the double whammy of lower occupancy rates and higher non-recoverable costs in most transactions.

On the LTV front, Salus, the senior loan of ELoC No. 33, is leading the declines. Even though there was no recent revaluation, the sponsor is reported to have put the property up for sale with a GBP 500m price tag, equivalent to a 25% decrease from the March 2023 valuation, resulting in a +18.7ppt LTV change from a year ago.

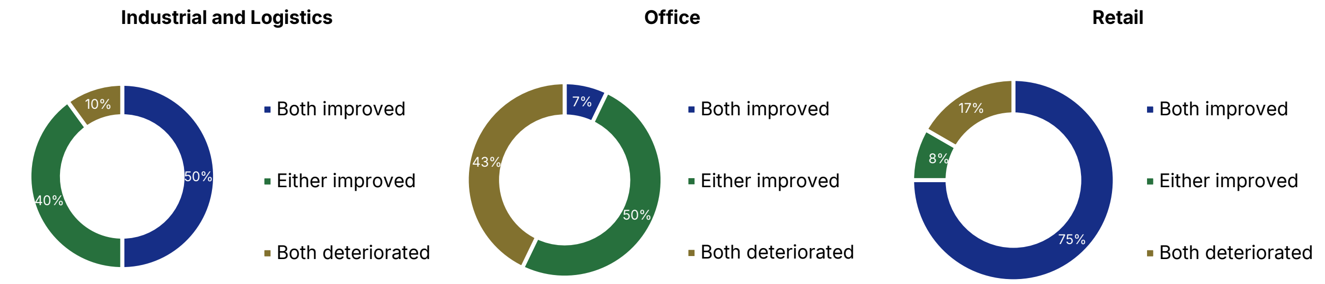
Taurus 2020-1 NL showed a +10.6ppt change, despite a granular portfolio and the disposal of four properties deleveraging the loan by GBP 50m. The transaction is followed by three with changes close to +5pp each: the senior loan of Atom Mortgage Securities (+4.9ppt), the Sirrocco loan of BERG Finance 2021 (+4.9ppt), and The Squaire loan of Taurus 2021-3 DEU (+4.8ppt).

We have not considered the market-value change of the property securing the senior loan of River Green Finance 2020 DAC, which was likely so severe that the special servicer set it aside 'until more clarity on the asset main tenant was available'[1].

On the debt yield front, the decrease is led by the Squaire loan with a 0.7ppt drop. The 3.0ppt change in vacancy and steep rent discount (in excess of 40%) for two tenants that are suffering from severe financial difficulties are the two culprits.

The retail sector is enjoying some sort of renaissance, with 83% of the 12 loans improving from December 2023. This was predominantly driven by the liability management exercises of two Italian retail transactions (Pietra Nera Uno S.R.L. and Deco 2019-Vivaldi S.R.L.), which saw some equity injections to secure the modification of the five loans (four outstanding as of December 2024). Only the-now-defunct Maroon loan of Elizabeth Finance 2018 DAC (which is awaiting final recovery allocation) and the senior loan of Taurus 2019-4 FIN experienced both an increase in their loan-to-value (-100ppt and -10ppt respectively) and a decrease in debt yield (-1.7ppt and -1.3ppt respectively).

Figure 4: Debt yield and LTV year-on-year change by sub-sectors



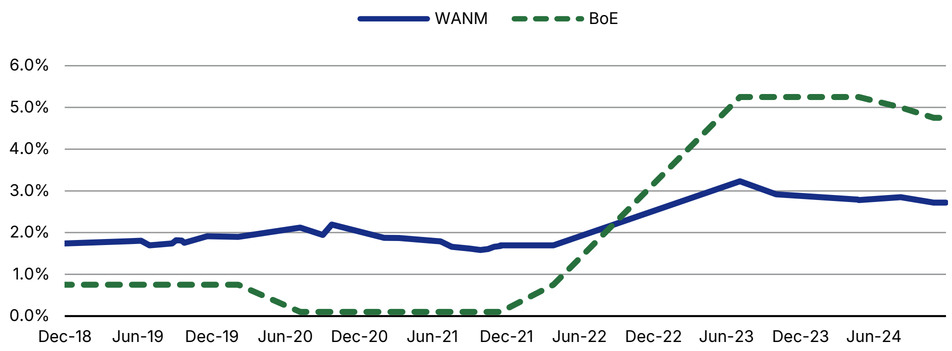
Source: Scope Ratings, Scope CMBS tracker, investor reports, Euronext, Financial Times

CMBS weighted-average note margins tightening

Weighted average note margins (WANM) of CMBS are tightening from their 2023 wides induced by the steep increase in interest rates and commercial real estate concerns at the time. The trailing 12-month WANM peaked at 3.23% and 3.19% in the UK and continental Europe, respectively, in the third quarter of 2023, as the first CMBS were issued more than a year after the previous issues in April 2022. Both are now down 51bp and 82bp to 2.72% and 2.38% for GBP and EUR transactions, respectively, mirroring the decrease in central bank deposit rates.

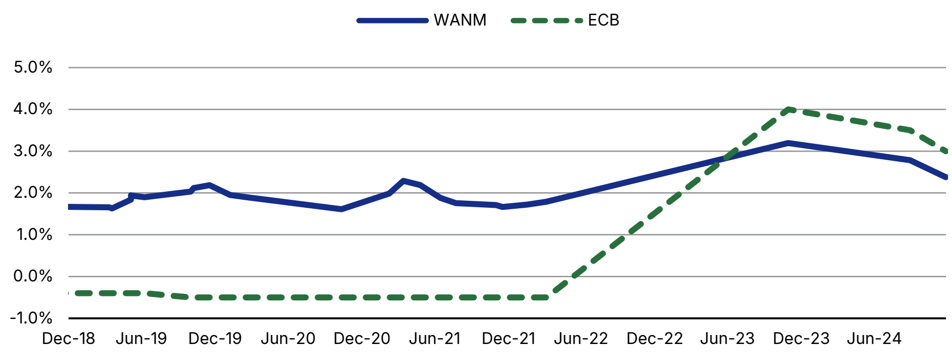
[1] Regulatory information services notification dated 3 April 2024

Figure 5: Trailing 12-month weighted average margin over SONIA vs deposit rate



Source: Scope Ratings, Scope CMBS tracker, transactions' offering circulars, Bank of England ('BoE')

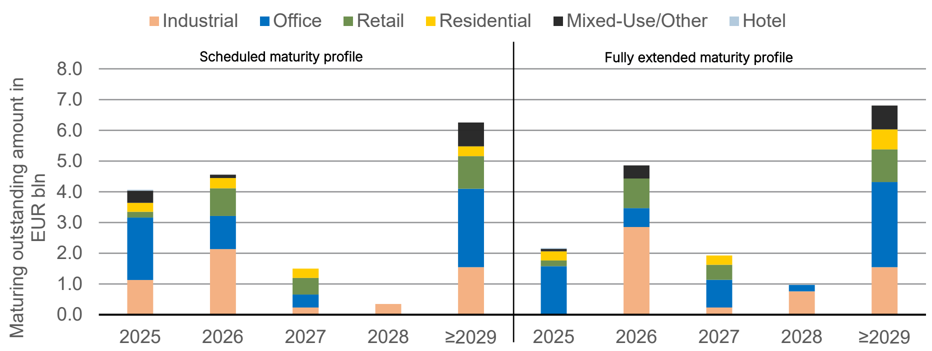
Figure 6: Trailing 12-month weighted average margin over Euribor vs deposit rate



Source: Scope Ratings, Scope CMBS tracker, transactions' offering circulars, European Central Bank ('ECB')

Despite the improvement, we expect borrowers to continue exercising loan-extension options in 2025 to benefit from advantageous locked-in financing conditions especially as the cost of extending interest-rate hedges continues to decrease with lower central bank deposit rates. As a result, the EUR 4.1bn refinancing needs of 2025 are expected to halve to EUR 2.2bln (see Figure 7).

Figure 7: Scheduled vs fully extended maturity profile of the European securitised CRE loans



Source: Scope Ratings, Scope CMBS tracker, investor reports, transaction notices

Refinancing risk: equity injection needed to improve ratios

We expect 60% of securitised loans maturing in 2025 will not be able to refinance without equity injections

However, refinancing will remain challenging for most of the loans reaching their fully-extended maturities: 60% by loan count face high to very high refinancing risks. These loans present LTVs that are considered too high in the current lending environment combined with persistent high structural vacancies and relatively low debt yields (see Table 8). Most have also already benefited from one-year one-off servicer extensions and will need to be modified and require concessions from sponsors such as equity injections in order to extend further.

Table 8: Refinancing risks for securitised loans maturing in 2025

CMBS	Loan	Country	Sector	Vacancy	DY	LTV	Refinancing risk
EloC 33	Salus	UK	Office	11.7%	8.6%	54.9%[1]	Very high
EloC 38	Viridis	UK	Office	9.7%	7.7%	70.0%	Very low
Starz 2021-1	Sellar	UK	Hotel	14.1%	7.7%	60.1%	High
Taurus 2017-1 IT	*Senior*	Italy	Mixed-use	11.9%	2.2%	129.6%	Very high
Taurus 2020-1 NL	Loonie	Netherlands	Office	23.3%	7.2%	74.0%	Very high
Starz 2021-1	Zamek	UK	Residential	2.4%	7.7%	69.2%	Low
DECO 2019-RAM	Derby	UK	Retail	10.4%	29.5%	17.7%	Very low
Taurus 2019-4 FIN	*Senior*	Finland	Retail	12.0%	11.7%	68.6%	Moderate
Sage AR 1	*Senior*	UK	Residential	1.1%	5.2%	64.9%	High
Taurus 2021-3 DEU	The Squaire	Germany	Office	19.0%	7.1%	68.8%	Very high

[1]Taking the reported price tag of the property the LTV jumps to 73.5%
Source: Scope Ratings, Scope CMBS tracker, investor reports, transaction notices

Outlook: cautious optimism

Capitalisation rates to remain stable

Commercial real estate will stabilise in 2025. Refinancing risk will remain elevated for the office sector but improving financing conditions combined with good fundamentals will improve access to capital for the other sectors. We expect capitalisation rates to remain stable as the commercial real estate risk premium is expected to increase while risk-free rates fall to 2.25% by the end of 2025.

Traditional real estate sectors:

Outlook: industrial and logistics (positive), residential (cautiously positive), retail (neutral), office (negative)

Our outlook is positive for industrial and logistics; cautiously positive for multifamily; neutral for retail; and negative for office (see Table 9).

Industrial and logistics will continue to benefit from strong fundamentals, with low vacancy rates and inflation-linked rental income, which have not only alleviated the impact of increased yields on valuations but also secured stable demand for the sector from strong investors.

The multifamily sector continues to benefit from under-supply, exacerbated by low development activity, low regulatory capital requirements, inflation indexation and low vacancy rates. The increase in rates severely impacted the cost of servicing new mortgages while house prices across the EU and UK remained largely unchanged. As such, renting remains the preferred option for most young professionals, helping the multifamily or private-rented sector particularly as few rent controls have been implemented.

The bricks-and-mortar retail sector has proven resilient: decreasing costs and rent increases predominantly driven by strong turnover rents have improved net operating income. However, the phasing out of pandemic-era support combined with the higher interest-rate environment are putting pressure on retailers while existing high-profile bankruptcies in 2024 such as The Body Shop or Homebase continue to negatively impact the sector in addition to the continuous growth in e-commerce.

The office sector faces continuous headwinds in 2025. We expect non-prime offices to suffer from higher vacancy rates than the historically low levels experienced following the global financial crisis as tenants seek prime properties with strong sustainability criteria, flexible office space and generally shorter lease terms while tenant incentives remain high[2]. Obsolescence risk and capex needs are also mounting for old buildings to be able to mitigate environmental and regulatory risks.

Table 9: Outlook for traditional real estate sectors

Sectors		Industrial & Logistics	Retail	Multifamily	Office
Outlook		**Positive**	**Neutral**	**Cautiously positive**	**Negative**
Macro tends	**Positive**	e-commerce, increased onshoring	Stabilising costs	Lack of supply, attractiveness of renting over buying	Strong sustainable credentials attract demand
Macro tends	**Negative**	Bankruptcy rates	Cost-of-living, bankruptcies, e-commerce	Rent control	Work-from-home, recession, environmental regulation.

Alternative real estate sectors:

Outlook: data centres (positive), student housing and hospitality (cautiously positive), life sciences (cautiously negative)

We have a positive outlook for data centres, are cautiously positive for hospitality and student housing, and neutral for life sciences (see Table 10).

Data centres and digital infrastructure transactions benefit from strong fundamentals aided by a lack of supply (both on the property front but also on the power grid), long leases with generally high-quality tenants. Digital transformation combined with AI and increased data protection in the EU mean that the sector is poised for growth in demand.

The hospitality sector has stabilised since the post-pandemic rebound, with occupancy rates still a few percentage points below the peak in 2019 but most transactions reporting net operating income at or above the historical highs thanks to increased revenues and costs under control. Even though inflation is abating, the cost-of-living crisis still very much impacting non-essential spending, but we are cautiously positive on the sector, particularly for well-located properties that benefit from strong foreign tourist demand.

Student housing is showing no sign of weakness, with strong occupancy levels and higher rental income more than offsetting increases in costs and capex.

Life sciences continues to suffer from the current economic environment context of reduced start-ups, investment and growth. The combination of more bankruptcies or occupier concentration via acquisitions in addition to higher property costs is negatively impacting the sector. On the positive side, more public spending such as the UK's 'Life Sci for Growth' package will help the sector fare better than the traditional office sector.

Table 10: Outlook for alternative real estate sectors

Sectors		Data Centres	Student housing	Hospitality	Life sciences
Outlook		**Positive**	**Cautiously positive**	**Cautiously positive**	**Cautiously Negative**
Macro tends	**Positive**	Increasing demand, high-quality tenants, lease length	Supply and demand imbalance, non-cyclical	Post-lockdown leisure splurge;	Highly technical buildings, supply and demand imbalance
Macro tends	**Negative**	Power availability, regulations	Increased costs, capex outlays	Lower business travel activity, increased costs, capex outlays	Weak tenants, higher yields, higher costs

[2] Between 15% to 20% of rent frees for 10-year leases according to British Land's latest quarterly report on the Broadgate Financing PLC transaction.

Appendix I: securitised loans facing high to very high refinancing risks

Salus loan of ELoC No. 33 DAC

This loan is secured against the CityPoint tower in the City of London. At closing, the property was stabilised (3.70% vacancy rate, 61.2% LTV and 8.1% DY). The loan was extended last year to allow for the debt yield to recover thanks to increase occupancy: prospective tenants were on the verge of signing new leases. Since last year, the occupancy indeed increased to 88.3% from 82.4% leading to a stronger debt yield of 8.6% compared to 7.9% last year. The sponsor put the property up for sale at a GBP 500m price tag – a 25% reduction on the latest valuation of GBP 670m and equivalent to a 73.5% LTV. The borrower already negotiated a 3-month extension to April 2025 and the refinancing risk remain very high.

Sellar loan of Starz Mortgage Securities 2021-1 GBP

The Sellar loan is secured against three hotel properties. The borrower was not able to repay at the July 2024 maturity date and the loan was subsequently modified and extended to January 2025 to allow for the sale of the hotels on an individual basis. Since then, the borrower provided a signed term sheet for a full refinancing on the January repayment date. The DY has dropped to 7.7% from 10.9% a year ago while LTV stands at 60.1%. Due to the previous modification of the loan, we consider this loan in the 'high' refinancing risk category.

Senior loan of Taurus 2017-1 IT

The loan's original maturity was August 2022, but it has been modified a few times to extend the final maturity date to 31 January 2025. Three Italian retail properties of the 23 at closing remain. The transaction saw its DY fall to 2.21% in Q2 2024 from 6.88% in December 2023 while the LTV remains above 100% at 129.6% compared to 100.8% two years ago despite a stable performance predominantly of the largest property left, 45° Nord. With the notes' legal final due in August 2029, we expect the special servicer to continue disposing of the remaining properties.

The Loonie loan of Taurus 2020-1 NL

Despite continuous property disposals, the loan metrics are not improving: the LTV is up 10.6ppt to 74.0% and the DY is broadly unchanged at 7.15% (up from 7.06%). It would appear the 'trophy' assets are being sold and occupancy keeps decreasing as properties is sold. Occupancy now stands at 76.7% down from 85.0% a year ago. EUR 17.5m sits in the cash trap accounts and could be used to reduce the debt load but an equity injection from the sponsor will likely be needed for the loan to refinance.

Senior loan of SAGE AR Funding 1

The loan has been performing exceptionally well, with ultra-low vacancies (sub 2.0% since 2022) and continuous gross rents increasing by of more than 10% per annum since 2022 for both social and affordable rent. Nevertheless, the DY remain below 5.5% and the LTV, based on an open-market valuation (MV-ST), is 65%, rising to 80% considering the social housing valuation (EUV-SH). The social aspect of the transaction combined with its strong performance and sponsor does reduce the refinancing risk from very high to high.

Squaire loan of Taurus 2021-3 DEU

The loan secured an 11th-hour extension in exchange for an extension reserve of EUR 14.5m, all the surplus from the hotels' operations to be transferred into the rental income account, and increased reporting obligations in respect of the sponsor's recapitalisation plans, among other items. However, with two of the main five tenants paying around half the rent they paid in December 2023, little traction on the leasing of vacant office space (still down 2.8% from a year ago), the DY continues to deteriorate while the LTV increases. A disposal of the hotels may improve the refinancing prospects.

Appendix II: Outstanding securitised CRE loans

Loan ID	Loan name	Transaction ID	Transaction name	Asset type	Reporting date
66	Sellar	60	Starz Mortgage Securities 2021-1	Hotel	November 2024
76	Jupiter	69	Cassia 2022-1	Industrial	November 2024
77	Thunder II	69	Cassia 2022-1	Industrial	November 2024
71		64	Frost CMBS 2021-1	Industrial	November 2024
83		76	Last Mile Logistics 2023-1 UK	Industrial	November 2024
55		55	Last Mile Logistics Pan Euro Finance	Industrial	November 2024
50		51	Last mile Securities 2021-1X	Industrial	November 2024
75		68	Logicor 2019-1 UK	Industrial	November 2024
85		78	Stark Financing 2023-1	Industrial	November 2024
47		47	Taurus 2021-1 UK	Industrial	November 2024
58	United IV	57	Taurus 2021-4 UK	Industrial	November 2024
87	St Modwen	81	UK Logistics 2024-1	Industrial	November 2024
88	Mileway	81	UK Logistics 2024-1	Industrial	November 2024
92	Indurent	85	UK Logistics 2024-2	Industrial	December 2024
93	Mileway	85	UK Logistics 2024-2	Industrial	December 2024
91		84	Thunder Logistics 2024-1	Industrial	October 2024
25	Aries	26	ERNA S.R.L.	Mixed-Use/Other	October 2024
27	Nucleus	26	ERNA S.R.L.	Mixed-Use/Other	October 2024
28	Raissa	26	ERNA S.R.L.	Mixed-Use/Other	October 2024
74		66	Highways 2021 PLC	Mixed-Use/Other	September 2024
89		82	Vantage DC 2024-1	Data Centre	December 2024
60		59	Atom Mortgage Securities	Office	October 2024
52	Sirrocco	52	BERG Finance 2021	Office	October 2024
78		71	Broadgate Financing	Office	October 2024
53		53	Bruegel 2021	Office	November 2024
79		72	Canary Wharf Finance II	Office	September 2024
21	Salus	23	ELoC No. 33	Office	October 2024
56	Viridis	56	ELoC No. 38	Office	October 2024
5	Polar	13	FROSN 2018-1	Office	November 2024
90	Fora	83	HERA Financing 2024-1	Office	September 2024
86		79	Magritte CMBS	Office	October 2024
41		40	River Green Finance 2020	Office	October 2024
43	Loonie	42	Taurus 2020-1 NL	Office	November 2024
48	Figo	48	Taurus 2021-2 SP	Office	August 2024
49	The Squaire	49	Taurus 2021-3 DEU	Office	September 2024
82		75	Vita Scientia 2022-1	Office	November 2024
59	Haus	58	ELoC No. 39	Residential	October 2024
44	Folio	44	Folio Residential Finance No. 1	Residential	October 2024
73		65	Sage AR Funding 2021	Residential	August 2024
45		45	Sage AR Funding No. 1	Residential	November 2024
67	Zamek	60	Starz Mortgage Securities 2021-1	Residential	November 2024
35	Derby	34	Deco 2019-RAM	Retail	October 2024
29	Franciacorta	28	Deco 2019-Vivaldi	Retail	November 2024
30	Palmanova	28	Deco 2019-Vivaldi	Retail	November 2024
7	Maroon	15	Elizabeth Finance 2018	Retail	July 2024
38	Everest	37	Emerald Italy 2019	Retail	September 2024
80		73	Meadowhall Financing	Retail	October 2024
1	Fashion District	11	Pietra Nera Uno	Retail	November 2024
3	Valdichiana	11	Pietra Nera Uno	Retail	November 2024
84		77	Taurus 2017-1 IT	Retail	August 2024
10	Bel Air	17	Taurus 2018-1 IT	Retail	November 2024
40		39	Taurus 2019-4 FIN	Retail	November 2024
81		74	The Trafford Centre	Retail	October 2024
33		32	Westfield Stratford City No.2	Retail	October 2024

Source: Scope Ratings, Scope CMBS tracker

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