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What Can We Learn From High-Yield Debt Study?

Are high-yield commercial mortgages priced in a manner commensurate with the risk to investors?

The question has long been a puzzle, largely due to the paucity of data. Originators and holders of subordinated debt tend to be private operators that keep a tight lid on information for fear of giving away trade secrets.

Now, however, a new study of high-yield loan performance has an answer. The paper by Michael Giliberto, a co-founder of the Giliberto-Levy mortgage indexes, found that high-yield debt originated between 2010 and 2020 produced returns in line with its position in the commercial real estate capital stack.

The Giliberto study, first published in the October issue of the *Journal of Portfolio Management*, reported that high-yield debt produced a return of 8.5% during the 2010s decade, more than senior instruments such as senior fixed-rate debt (5.5%) and CMBS (5.9%) and less than equity indexes produced by the National Council of Real Estate Fiduciaries: the ODCE fund index (10.5%) and NCREIF Property Index (9.4%).

Since mezzanine mortgage debt falls between equity and senior debt in the capital stack, those results make intuitive sense and indicate that the industry is pricing risk efficiently. However, the study won't be the last word on the topic. For one thing, the study was based on a relatively small sample, $20.9 billion of loans in the Giliberto-Levy 2 index, which is the first index to track the performance of high-yield debt.

A much bigger caveat is that there was no property market downturn during the time period in which the study took place. That means the study doesn't cover the impact on mezzanine debt during down markets—such as the early 1990s or 1998, or after the global financial crisis of 2008-10—when high-yield loans experienced a wave of defaults.

G-L index co-founder John Levy said there was no attempt to avoid downturns. The study was made possible by the formation of the G-L 2 high-yield debt index in 2017, which helped the firm to obtain data on loans dated back to 2010. Whatever its limitations, the study provides valuable information on the high-yield commercial mortgage market.