ETF CENTRAL

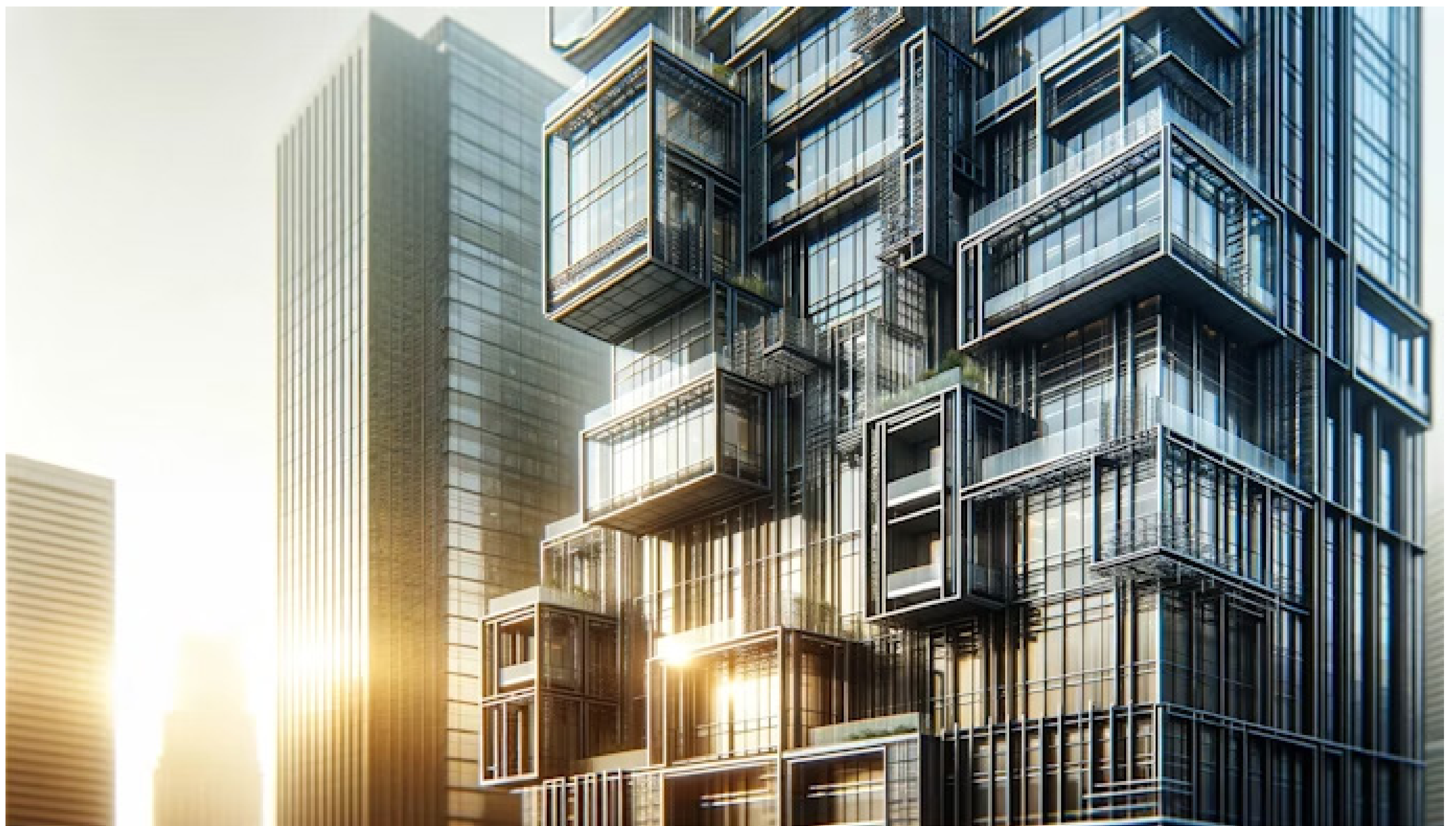
DoubleLine®

# DoubleLine Commercial Real Estate ETF (DCRE) Marks One-Year Anniversary on NYSE ARCA

This highly unique ETF is one of the few out there giving investors exposure to commercial real estate.

By Tony Dong, CETF®, Lead ETF Analyst · April 10, 2024

Reprinted with permission of ETF Central



Despite the vast number of ETFs out there today, some areas, due to their complexity or lack of flashiness, remain niche.

Commercial real estate, especially its fixed income side, is one such area often bypassed for more visible options like office, gaming, residential, and hospitality REITs. When researching this space, I discovered only two notable ETFs.

The first was the iShares CMBS ETF (CMBS -0.14%), a passively managed option with approximately $428 million in AUM and an expense ratio of 0.25%. However, it was the DoubleLine Commercial Real Estate ETF (DCRE) that stood out even more for its active management approach.

Marking its first anniversary on April 1, 2024, DCRE has returned 6.95% in net asset value (NAV) % for the 12 months ending March 31, 2024, outperforming both its benchmark, the Bloomberg US Aggregate 1-3 Year Index which returned 3.56% and the Bloomberg US CMBS Investment Grade Aaa: 1-3.5 Year Index, which returned 5.06% over the same period.

To fully understand DCRE, I spoke with Morris Chen, Head of DoubleLine Capital's Commercial Mortgage-Backed Securities and Commercial Real Estate Debt team and lead portfolio manager of DCRE. Here's the key takeaways from our conversation.

## How DCRE ETF works

DCRE ETF strategically invests in three main types of fixed income securities, all linked to commercial real estate (CRE): Agency and non-Agency Commercial Mortgage-Backed Securities (CMBS) and Commercial Real Estate Collateralized Loan Obligations (CRE CLOs).

Agency CMBS are backed by government agencies and are considered lower risk, while non-Agency CMBS are not government-guaranteed and carry a higher risk and potential return. CRE CLOs are structured finance vehicles and a type of non-Agency CMBS that is comprised of a pool of loans backed by various commercial properties, offering investors diversified exposure to commercial real estate debt, which includes debt backed by apartment, office, retail, hotel and industrial properties.

DCRE aims to achieve two primary objectives: current income and capital preservation. For current income, the ETF boasts a 5.13% 30-day SEC yield. However, a more critical figure for investors to consider is the yield to maturity (YTM) of 6.26%. The YTM is a more comprehensive measure that considers the total returns expected if all of DCRE's holdings are kept until they mature.

For those wary of the bond bear market of 2022, DCRE's portfolio is also designed to mitigate the impact of similar market downturns. With an average duration of just 1.09 years across its 140 holdings, the ETF is positioned to be less sensitive to interest rate changes.

## Why active management?

The standout feature DCRE compared to its counterparts, like CMBS is its active management approach. Unlike a passive strategy that might merely sample an index, DCRE's team actively selects the bonds, allowing them to express nuanced views, such as choosing to avoid certain property types that may be underperforming, like office properties.

Active management in DCRE also allows for a broader investment universe, including Agency and non-Agency CMBS, CRE CLOs, and even floating rate CMBS, which are often excluded by indexes. About one-third of DCRE's portfolio is comprised of these floating-rate securities, expanding the fund's diversification and potential for returns.

The value of active management extends to bottom-up credit analysis of individual issuers. The DoubleLine team delves into the collateral and loan capital structure of each investment, a process that uncovers opportunities missed by a broad index approach.

For example, this detailed examination can include evaluating cash flows from specific loans, such as those secured by hotels, and assessing risks and opportunities on a state-by-state and loan-by-loan basis.

“Our approach isn’t rules-based - every asset and borrower have a story. We rely on our process and our experienced team to navigate these complexities,” Chen added, highlighting DCRE’s ability to adapt to changing market conditions in a way that passive ETFs, bound by index rules, cannot.

**How DCRE manages risk**

With current headlines spotlighting CRE exposure in regional banks and lingering concerns from the 2008 subprime crisis, it’s natural for investors to have some apprehension regarding the types of securities held by DCRE.

Chen emphasized the active monitoring of their holdings as a key strategy to mitigate sector-specific risk.

“One way we mitigate sector-specific risk is by having a process in place to actively monitor our holdings. This ensures that the underlying properties of the bonds are performing as expected. If a property’s performance has declined, presenting a material downside, our processes enable us to be proactive in divesting,” he says.

This flexibility allows DCRE to adjust its investments based on the fundamentals of each property, unlike passive CRE ETFs, which select securities based on the rigid criteria of an index.

Focusing on the portfolio’s structure, Chen pointed out that DCRE leans towards AAA-rated exposures and maintains a very low loan-to-value (LTV) ratio exposure.

“Structurally, it would require a significant downturn for a AAA bond to be impacted, due to its high seniority and priority in the capital structure,” Chen says. “For those concerned about the accuracy of ratings, we suggest looking at the leverage—specifically, the LTV ratio, which stands at anywhere between 30% to 40% on average. This inherently means that the value of the underlying building would need to decline by 60% to 70% before a first dollar impairment occurs at a AAA level,” he says.

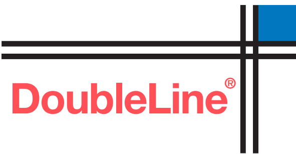
AAA ratings indicate the highest credit quality, implying minimal risk of default. The LTV ratio, which measures the loan amount against the property’s value, offers an insight into the risk level; DCRE’s low LTV exposure suggests substantial safety margins.

Finally, Chen explains that even in light of the 2008 crisis’s rating accuracy issues, DCRE seeks to mitigate risk via diversification and the underwriting of each credit in the portfolio.

“Considering a CMBS with a multi-borrower pool, this would imply that entirety of the pool would need to default and value be impaired by at least 60% to 70%—a scenario that, given the diversification of the underlying pool in terms of property types, geographic locations, and borrowers, has historically not occurred,” Chen says. “We don’t just take the rating at face value; we meticulously analyze the underwriting, capital structure, and subordination levels,” he says.

Overall, DCRE’s approach underscores the value an active management team brings to navigating the complexities of less liquid, more nuanced fixed-income investments.

*Please note this article is for information purposes only and does not in any way constitute investment advice. It is essential that you seek advice from a registered financial professional prior to making any investment decision.*



**Definitions of Terms and Index Description**

**Bloomberg US Aggregate 1-3 Year Index** - This index tracks the one- to three-year component of the Bloomberg US Aggregate Bond Index, which represents securities that are SEC registered, taxable and dollar denominated in the U.S. investment grade, fixed-rate bond market.

**Bloomberg US CMBS Investment Grade Aaa: 1-3.5 Year Index** - This index measures the AAA-rated market of the US Agency and US Non-Agency conduit and fusion CMBS deals with a minimum current deal size of $300, and securities with an average life of 1 to 3.4999 years.

**Bloomberg US CMBS (ERISA Only) Index** – This index measures on a total return basis the performance of investment grade commercial mortgage-backed securities (CMBS).

**Loan-to-Value (LTV) Ratio** - Assessment of lending risk that financial institutions and other lenders examine before approving a mortgage. Typically, loan assessments with high LTV ratios are considered higher-risk loans. Therefore, if the mortgage is approved, the loan has a higher interest rate.

## To download and read the DCRE Statutory Prospectus, please click here.

**Investing involves risk. Principal loss is possible.**

**DCRE Risk Language**

Equities may decline in value due to both real and perceived general market, economic and industry conditions. ETF investments involve additional risks such as the market price trading at a discount to its net asset value, an active secondary trading market may not develop or be maintained, or trading may be halted by the exchange in which they trade, which may impact a fund's ability to sell its shares. Investments in debt securities change in value because of changes in interest rates. The value of an instrument with a longer duration (whether positive or negative) will be more sensitive to changes in interest rates than a similar instrument with a shorter duration. There is the risk that the Fund may be unable to sell a portfolio investment at a desirable time or at the value the Fund has placed on the investment. Illiquidity may be the result of, for example, low trading volume, lack of a market maker, or contractual or legal restrictions that limit or prevent the Fund from selling securities or closing derivative positions. There is risk that borrowers may default on their mortgage obligations or the guarantees underlying the mortgage-backed securities will default or otherwise fail and that, during periods of falling interest rates, mortgage-backed securities will be called or prepaid, which may result in the Fund having to reinvest proceeds in other investments at a lower interest rate. Derivatives involve special risks including correlation, counterparty, liquidity, operational, accounting and tax risks. These risks, in certain cases, may be greater than the risks presented by more traditional investments. The Fund is a "non-diversified" investment company and therefore may invest a greater percentage of its assets in the securities of a single issuer or a limited number of issuers than funds that are "diversified." Accordingly, the Fund is more susceptible to risks associated with a single economic political or regulatory occurrence than a diversified fund might be.

DoubleLine ETFs are distributed by Foreside Fund Services, LLC.
DoubleLine® is a registered trademark of DoubleLine Capital LP.

The iShares Funds are distributed by BlackRock Investments, LLC (together with its affiliates, "BlackRock").

ETF Central is not affiliated with Foreside Fund Services, LLC or Blackrock Investments, LLC (BlackRock). ©2024 DoubleLine Capital LP

**DoubleLine Commercial Real Estate ETF Quarterly Returns (%)**
March 31, 2023 through March 31, 2024

| | 1 Month | 3 Months | 1 Year | Since Inception (3-31-2023) |
|---|---|---|---|---|
| Market Price | 0.71 | 1.59 | 2.91 | 7.09 |
| NAV | 0.60 | 1.60 | 2.69 | 6.95 |
| Bloomberg 1-3 Year US Aggregate Bond Index | 0.41 | 0.45 | 0.37 | 3.55 |
| Bloomberg US CMBS Investment Grade Aaa: 1-3.5 Year Index | 0.60 | 1.12 | 5.06 | 5.04 |

Gross Expense Ratio 0.39%

**The performance quoted represents past performance and does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more than the original cost. Current performance may be lower or higher than the performance quoted. Performance current to the most recent month-end may be obtained by calling (213) 633-8200 or by visiting DoubleLine.com.**

**iShares CMBS ETF**

The iShares CMBS ETF seeks to track the investment results of an index composed of investment grade commercial mortgage-backed securities.

**iShares CMBS ETF Quarterly Returns (%)**
February 14, 2012 through March 31, 2024

| | 1 Year | 3 Year | 5 Year | 10 Year | Since Inception (2-14-2010) |
|---|---|---|---|---|---|
| Market Price | 5.20 | -1.75 | 0.89 | 1.76 | 2.05 |
| NAV | 3.98 | -1.77 | 0.86 | 1.70 | 2.02 |
| Bloomberg US CMBS (ERISA Only) Index | 4.42 | -1.41 | 1.20 | 2.02 | 2.37 |

Management Fee: 0.25%; Expense Ratio: 0.25%

**The performance quoted represents past performance and does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more than the original cost. Current performance may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by visiting www.iShares.com or www.BlackRock.com.**