MORNINGSTAR

CMBS Alert

Sears to Close 103 Stores—14 Locations in CMBS, Six With Elevated Risk

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Morningstar Perspective

About $302.5 million of loans in eight commercial mortgage-backed securities could be adversely affected by Sears Holdings Corp.'s latest round of store closures. In its Jan. 4, 2018, announcement, the retailer said it plans to shutter 64 Kmart and 39 Sears stores this spring. Among these 103 stores, Morningstar Credit Ratings, LLC found a total of 16 CMBS loans with a balance of $671.1 million. Notably, Sears will be the second anchor closing at two locations, the Bangor Mall, which is already specially serviced, and the Hanford Mall. With the loss of multiple anchors, we are concerned that these properties could begin to lose in-line tenants if the anchor boxes are not backfilled.

Table 1 – CMBS Exposure to Sears Closings

Deal ID	Property Name	City	State	Allocated Property Balance ($)	Tenant	Lease Expiration	Occupancy (%)	DSCR (x)	Maturity Date	Loan Status	Specially Serviced	At Risk
BACM 2006-3	Rushmore Mall - A note	Rapid City	SD	58,000,000	Sears	9/30/2019	93.0	2.16	2/1/2019	Current	No	Yes
BACM 2006-3	Rushmore Mall - B note	Rapid City	SD	36,000,000	Sears	9/30/2019	93.0	2.12	2/1/2019	Current	No	Yes
JPMBB 2014-C21	Westminster Mall	Westminster	CA	51,776,723	Sears	Non-collateral	88.0	1.31	4/1/2024	Current	No	Yes
JPMCC 2014-C20	Westminster Mall	Westminster	CA	28,241,849	Sears	Non-collateral	88.0	1.31	4/1/2024	Current	No	Yes
MSC 2007-IQ16	Bangor Mall	Bangor	ME	80,000,000	Sears	10/31/2018	86.1	1.65	10/1/2017	Foreclosure	Yes	Yes
CFCRE 2011-C2	Hanford Mall	Hanford	CA	23,650,865	Sears	7/31/2019	96.0	1.18	12/11/2021	Current	No	Yes
JPMCC 2006-CB14	Green Bay Plaza	Green Bay	WI	16,203,764	Sears	Non-collateral	77.9	0.67	12/1/2015	REO	Yes	Yes
WFRBS 2011-C3	Belleview Regional Shopping Center	Belleview	FL	8,630,278	Kmart	10/31/2020	77.0	1.49	5/1/2021	Current	No	Yes
UBSBB 2013-C5	Valencia Town Center	Valencia	CA	195,000,000	Sears	3/31/18 Ground Lease	93.0	2.96	1/1/2023	Current	No	No
COMM 2012-CR3	Midland Park Mall	Midland	TX	77,172,494	Sears	Non-collateral	95.0	2.52	9/6/2022	Current	No	No
UBSBB 2012-C4	Newgate Mall	Ogden	UT	58,000,000	Sears	10/31/2026	86.0	2.88	5/1/2020	Current	No	No
GSMS 2014-GC20	Hermitage Towne Plaza	Hermitage	PA	14,542,240	Kmart	11/30/2020	98.0	2.05	3/6/2024	Current	No	No
CGCMT 2014-GC25	Gateway Fashion Center	Bismarck	ND	9,998,234	Sears	10/31/2019	85.0	3.44	10/6/2024	Current	No	No
CSAIL 2015-C2	Sugarcreek Towne Centre	Sugarcreek Township	PA	6,429,465	Sears	12/31/2020	100.0	4.81	4/6/2025	Current	No	No
GSMS 2011-GC3	Piney Green Shopping Center	Midway Park	NC	4,123,670	Kmart	11/30/2019	100.0	1.57	3/6/2021	Current	No	No
MSC 2007-IQ16	Taft Kmart (Kmart Portfolio)	Taft	CA	3,332,796	Kmart	5/31/2024	100.0	1.08	1/12/2018	Current	No	No

Source: Morningstar Credit Ratings, LLC

At-Risk Loans

Morningstar identified six properties with heightened risk related to the latest Sears store closings.

We see a high level of risk with the Bangor Mall, a 534,919-square-foot regional mall in Bangor, Maine, where Sears will be the second anchor to close, following Macy's in early 2017. Sears' departure could accelerate the mall's decline and could lead us to raise our $51.1 million loss projection on the $80.0 million loan. The property's value is already down 77.4% from $128.0 million at underwriting. The loan in MSC 2007-IQ16 matured in October 2017 and the servicer reports that the loan is in foreclosure, which may indicate that the borrower, Simon Property Group, Inc., is no longer engaged in discussions to modify the loan. Likewise, Sears is the second anchor closing at the Hanford Mall in California, which backs a $23.7 million loan that makes up 6.2% of CFCRE 2011-C2, where noncollateral anchor tenant Forever 21 closed in 2016. With the loss of multiple anchors at these two regional malls, we are concerned that they could begin to lose in-line tenants if the anchor boxes are not backfilled. We also consider the Hanford Mall loan a long-term maturity risk, especially with the loss of two anchors making it unlikely that a lender will take a chance on a take-out loan.

The $94.0 million Rushmore Mall loan, the largest of the two remaining in legacy transaction BACM 2006-3, was modified in 2014 with an A/B note structure and its maturity was extended to February 2019 from June 2016. The departure of Sears from this mall raises the risk of losses eating into the $58.0 million A note; we already project that the $36.0 million B note will suffer a total loss. Sears occupies 16.8% of the 737,725 square feet that serve as collateral of the more than 830,000-square-foot South Dakota mall. Lease rollover is limited in the near term; however, rollover could be an issue closer to maturity when roughly 30% of the property's net rentable area is scheduled to expire, including Sears in September 2019.

Another property in a postcrisis deal has seen net cash flow decline and could be a longer-term concern. The $80.0 million Westminster Mall loan, with two pari passu loans in JPMBB 2014-C21 and JPMCC 2014-C20, faces a moderate level of risk as NCF is down more than 28% since issuance despite improving occupancy. Nevertheless, the owner, Washington Prime Group, classified the property as a Tier 1 asset as of the end of 2016. The mall, in Orange County, California, has four anchors including noncollateral Sears and JCPenney, and Target and Macy's, which are on ground leases. While the property continues to generate positive cash flow and support a debt service coverage ratio comfortably above 1.0x for the 12 months ended September 2017, declining cash flow and the loss of an anchor may raise long-term maturity risk. What's more, as cash flow declines, the borrower may be reluctant to invest resources to broaden the mall's appeal.

The loss of the noncollateral Sears at Green Bay Plaza, which is real estate owned and makes up 35.6% of JPMCC 2006-CB14, will likely accelerate the property's decline, and the only Kmart of concern is at Belleview Regional Shopping Center, 0.88% of WFRBS 2011-C3, which Morningstar believes could default at its May 2021 maturity as a result of the store closure.

Time Is Running Out

Sears has spent years trying to modernize while failing to keep pace with the evolving marketplace. And, while the Hoffman Estates, Illinois-based company has managed to stay afloat by selling and spinning off its real estate assets to generate cash, including the 2015 spin-off of Seritage Growth Properties, the chance of a turnaround seems bleak. Sears may be running out of big cash-raising opportunities, as it included many of its higher-quality properties in the Seritage deal.

Unrelenting same-store sales declines underpin Sears' problems. Same-store sales have dropped in each of the past 13 years, and through the first three quarters of fiscal 2017, domestic comparable-store sales plummeted 12.8% year-over-year. The changing retail landscape is constraining department store growth. "Pricing power is limited," said Morningstar, Inc. equity analyst Bridget Weishaar in a January report on Macy's, "given that consumers are less brand sensitive in apparel purchases than in the past and will compare the price of a shirt with what they can get from other brands at other stores." She went on to say that those outside the department store sector are also a threat. "Consumers now seem willing to pay more for healthier food and better or new technologies and appear to be prepared to sacrifice their apparel budget to do so. Department stores have been losing market share, falling to 3.2% from 5% of total retail sales since 2010. This implies that department store sales have fallen at a 3% compound annual rate over the past five years, versus general retail sales that grew at a 3% compound annual rate over the same period."

Morningstar will provide further alerts on Sears, which has 305 locations backing 195 CMBS loans with an aggregate allocated principal balance of $12.68 billion, as additional information becomes available.

Please see our DealView® CMBS Monitoring Analyses in the coming months in which property-level analysis, performance, and value analysis will be available at the loan and deal level.

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