CMBS Alert

Sears to Close 96 Stores — 15 Locations in CMBS; Six With Elevated Risk

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Morningstar Perspective

Morningstar Credit Ratings, LLC (DBRS Morningstar) expects Sears parent company Transform Holdco LLC's latest round of store closures will modestly affect loans packaged in commercial mortgage-backed securities, with about $256.1 million of loans in eight commercial mortgage-backed securities at elevated risk. In its Nov. 7, 2019, announcement, the retailer said it plans to shutter 45 Kmart and 51 Sears stores by February 2020. Among these 96 stores, we found exposure to the retailer in 19 CMBS loans with a combined balance of $1.02 billion (Table 1).

Table 1 – Sears Closures

Deal ID	Property Name	Location	Allocated Property Balance ($)	Lease Expiration	Maturity Date	Loan Status	Specially Serviced	Elevated Risk
WFCM 2014-LC16, WFRBS 2014-C21	Montgomery Mall	North Wales, PA	100,000,000	10/12/2020(1)	5/1/2024	Current	No	Yes
LBCMT 2007-C3	University Mall	South Burlington, VT	92,000,000	9/30/2048(1)	4/11/2017	REO	Yes	Yes
COMM 2014-CR14, COMM 2014-LC15	McKinley Mall	Buffalo, NY	34,238,544	9/30/2020	7/5/2023	90	Yes	Yes
JPMBB 2013-C14	Country Club Mall	Lavale, MD	22,458,764	10/31/2022	8/1/2023	Current	No	Yes
WFCM 2015-LC22	Bishop Retail	Bishop, CA	4,948,433	9/30/2026	6/6/2025	Current	No	Yes
MSC 2006-HQ10	Fort Roc Portfolio - Kmart Plaza (B)	Ephrata, PA	2,405,525	8/31/2022	9/1/2016	REO	Yes	Yes
JPMBB 2014-C18, JPMBB 2013-C14	Meadows Mall	Las Vegas, NV	137,412,428	Noncollateral	7/1/2023	Current	No	No
MSBAM 2015-C21, WFCM 2015-C27	Westfield Palm Desert Mall	Palm Desert, CA	125,000,000	Noncollateral	3/1/2025	Current	No	No
JPMBB 2014-C24	Mall of Victor Valley	Victorville, CA	115,000,000	10/24/2019	9/1/2024	Current	No	No
JPMCC 2012-C6	Arbor Place Mall	Douglasville, GA	107,058,594	Noncollateral	5/1/2022	Current	No	No
WFRBS 2012-C9	Chesterfield Towne Center	North Chesterfield, VA	98,814,793	4/9/2046(1)	10/1/2022	Current	No	No
CGCMT 2014-GC23	Chula Vista Center	Chula Vista, CA	67,239,936	11/1/2033	7/6/2024	Current	No	No
WFRBS 2012-C10	Animas Valley Mall	Farmington, NM	45,329,046	8/31/2032	11/1/2022	Current	No	No
COMM 2010-C1	Auburn Mall	Auburn, MA	36,323,320	12/31/2022	9/1/2020	Current	No	No
GSMS 2018-SRP5	Plaza West Covina (Starwood Regional Mall Port)	West Covina, NY	30,495,061	Noncollateral	6/9/2021	Current	No	No

In descending balance by risk.
(1) Ground lease
Source: DBRS Morningstar

Notably, Sears will be the second or third anchor closing at the two locations of greatest concern: the McKinley Mall and the Country Club Mall. These properties, where the prospect of finding replacements is constrained by a limited customer base, are feeling the pinch of the loss of multiple tenants.

In total, 117 CMBS loans, backed by 110 properties, with a combined allocated property balance of $5.28 billion have exposure to Sears stores as one of the five-largest collateral tenants.

Loans of Concern

Among properties with a closing location, the largest loan of concern is the $100.0 million loan backed by the Montgomery Mall in North Wales, Pennsylvania, with parri passu pieces in WFCM 2014-LC16 and WFRBS 2014-C21. Sears owns its improvements and leases the ground, so while we do not expect the departure to directly affect the cash flow, the loss of Sears will trigger co-tenancy clauses and make it difficult to retain tenants upon their lease expirations. The 1.1-million-square-foot mall's net cash flow has declined every year since 2016, with a 2018 NCF 31.3% below underwriting, driven largely by declining revenue, and yielding a middling debt yield of 9.7%. Occupancy was 89.0% as of June 2019, down from the 92.0% underwritten occupancy. The mall has added new tenants over the last few years, but at lower rental rates, leading to the decline in NCF. The mall is also anchored by a collateral JCPenney with a lease expiration in March 2022 and a Macy's on a ground lease that expires in 2024. Should both anchor tenants vacate, it's unlikely the NCF will improve, which will make it difficult to find refinance funding prior to the loan's May 2024 maturity. Based on the 2018 NCF, we are valuing the property at $108.2 million, or $98 per square foot, which results in a 92.4% loan-to-value ratio.

The $92.0 million real estate owned University Mall in LBCMT 2007-C3 has ground lease exposure to Sears, and JCPenney is a collateral tenant. Our concluded value suggests a loss of $54.5 million on the South Burlington, Vermont, asset; however, the loss of Sears will lead to a further devaluation.

We believe the closures will worsen the loss severity for the already specially serviced $34.2 million McKinley Mall loan split between COMM 2014-CR14 and COMM 2014-LC15 because the potential for a recovery seems unlikely. The loan is in foreclosure after falling 90 days delinquent because Sears' announcement to close at the Buffalo, New York, regional mall will leave JCPenney as the sole anchor tenant. Elevating the risk, JCPenney has a lease expiring in May 2020, which could leave the mall with four vacant anchor tenants. Based on an April 2019 appraisal, we are forecasting a $20.3 million loss on the asset.

Our view on the Sears store closings is not entirely bearish, as we believe the gradual store closures over the past 10 years have alerted both lenders and borrowers of the potential need to backfill large anchor spaces. That said, 18 of the loans ($981.9 million) affected by the closures are in deals that were securitized before 2016, when the risk of Sears-anchored malls was less well-known. Because of this, the prospect of Sears vacating may not have been anticipated at loan underwriting. While having to move faster than planned because Sears has closed stores at a rapid rate over the past few years, mall owners have had time to address the departure as an opportunity to re-lease the space to higher-paying tenants and revitalize the mall. According to third quarter 2019 results for Seritage Growth Properties, which owns over 250 Sears properties, the company has re-leased Sears and Kmart space at an average of 4.1 times the rent paid by Sears or Kmart. The caveat is that many vacant Sears stores are only partially rented, with nearly 60% of gross leasable area still vacant.

Please see our Morningstar DealView® Credit Risk 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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