CMBS Research

Mall Monitor – What's in Store for 2012 Mall Loans?

April 2018

Authors:

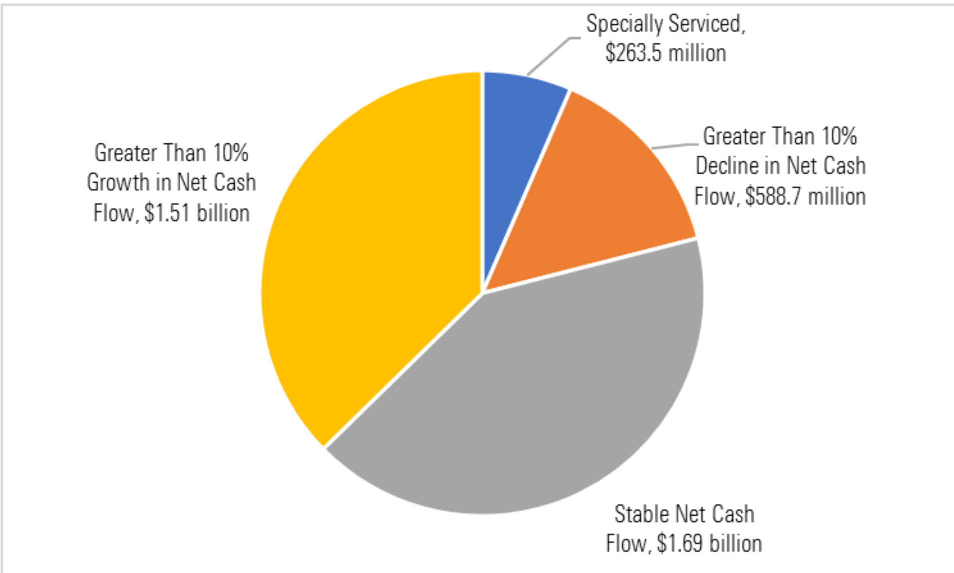
Steve Jellinek | Vice President – CMBS Research | steve.jellinek@morningstar.com | +1 267 960-6009
Edward Dittmer, CFA | Senior Vice President – CMBS Credit Risk Services | edward.dittmer@morningstar.com | +1 267 960-6043
Lea Overby | Managing Director – Head of CMBS Research and Analytics | lea.overby@morningstar.com | +1 646 560-4583

Morningstar Perspective

Amid concerns over store closures, changing consumer habits, and stiff competition from online retailers, all eyes are on the $4.05 billion of 2012 vintage mall-backed commercial mortgage-backed securities, which were underwritten before mall defaults began mounting in 2013. At first glance, they are a risky bunch, with higher leverage than their 2013 and 2014 counterparts, including a weighted-average loan-to-value ratio of 61.7% and debt yield of 10.6%. In addition, Morningstar Credit Ratings, LLC is concerned that some of these loans may face headwinds as they approach maturity as a result of changes in lender and investor appetites for the property type. However, most mall-backed securitized commercial mortgages issued in 2012 have performed well, with more than 75% posting stable or improving cash flow since underwriting, and, thanks in part to low interest rates, healthy debt service coverage ratios, and a robust economy, Morningstar's near-term view is that most of these loans will remain stable with a low level of term default risk.

Malls can benefit from a prime location, even in smaller markets. And, over the longer term, loans that amortize over their terms have a higher likelihood of paying off at maturity, as do those backed by malls that are dominant in their market and those that enjoy stable occupancy. We have observed, however, that capitalization rates for some properties have increased significantly over the past five years. While appraisers often valued Class B malls in secondary and tertiary markets with a small premium over their primary market counterparts, there is evidence that investors have taken a dimmer view of the properties. As a result, though operations may be stable, values for some of the properties may have dropped. Also, lenders may be assigning higher debt yield requirements on these properties when borrowers are refinancing the loans. What used to warrant a 9% to 11% going-in debt yield now requires a 12% to 13% range for lenders to consider even relatively stable malls. Both factors may result in additional maturity defaults in 2021 and 2022.

Chart 1 – 2012 Mall-Backed Loan Performance



Source: Morningstar Credit Ratings, LLC

State of the Mall

The changes in the regional mall landscape may produce a bifurcation into the haves and have-nots. Although market observers increasingly consider malls an outdated concept, some malls are not only surviving but thriving. Even as major retailers such as Sears, Macy's, and JCPenney have announced hundreds of store closures over the past couple of years, stronger malls are adapting to changes in demographics and shopping habits by changing their mix of retailers, offering additional amenities, focusing on dining and experiential offerings, and aggressively retenanting vacated spaces. Meanwhile, second-tier properties not only have difficulty filling empty spaces, but often vacancies can trigger a domino effect with other anchor and in-line tenants vacating, pushing the properties' performance lower. Consequently, owners may see little value in investing additional cash into these lower-quality assets.

Since 2016, 25 mall-backed loans have transferred to the special servicer, 17 of which were from precrisis deals. High leverage as a result of lax underwriting standards of the 2006 and 2007 vintages left many malls that were otherwise performing well in the hands of CMBS trusts. As the maturity wave culminated in 2017, the decline of CMBS issuance from 2008 through 2010 likely means that we will see a smaller number of defaults in the near term, as our research has shown that mall loans tend to default more at maturity than during the loan term, because of a lack of attractive refinance options.

Despite the U.S. mall vacancy rate increasing to 8.4% in the first quarter of 2018, up from 8.3% in the fourth quarter of 2017 and the highest since the fourth quarter of 2012, according to Reis, Inc., many of the 1,120 regional and super-regional malls in the United States, including those in smaller markets, continue to perform well. In its fourth-quarter earnings calls, GGP, Inc. reported that same-store net operating income increased 1.6% for 2017, while Simon Property Group, Inc. reported retail sales per square foot at its malls and premium outlet centers were $628 in 2017, compared with $614 the prior year, an increase of 2.3%.

As we discuss in the following sections, a mall's success depends on a myriad of factors including its location, competitors, and underwriting. First, we look at distressed mall-backed loans that are specially serviced and how their chances of being worked out depend on location and borrower investment. Second, we analyze the prospects for several loans that have experienced a material net cash flow decline of more than 10% since underwriting. We then highlight several loans that have stable metrics, but whose high initial leverage may limit their chances of paying off. Lastly, we examine several loans that continue to perform well, posting improving net cash flow that will boost the value of the property and enable them to pay off.

Specially Serviced Loans

While the wave of mall defaults from 2017 is not likely to be repeated in 2018 (with 2017's wave being fueled by maturing loans that were originated at the height of the precrisis market), several 2012 mall loans have transferred to the special servicer since the latter half of 2017. In total, four loans with a combined balance of $263.5 million, accounting for only 6.5% of the 2012 vintage's exposure to malls, are in special servicing. While these transfers are instances in which the collateral properties have struggled to retain tenants, the largest is likely to be resolved without a loss.

Table 1 – Specially Serviced Loans

Deal ID	Property Name	City and State	Loan Balance ($)	Projected Loss ($)	NCF Change From U/W (%)
WFCM 2012-LC5	Westside Pavilion	Los Angeles, CA	140,502,855	-	-8.6
COMM 2012-CR4	Fashion Outlets LV	Las Vegas, NV	66,374,697	12,881,811	-24.7
JPMCC 2012-LC9	Salem Center	Salem, OR	30,938,954	4,877,948	-23.6
COMM 2012-LC4	Susquehanna Valley Mall	Selinsgrove, PA	25,702,242	12,750,638	-39.4

Source: Morningstar Credit Ratings, LLC

Westside Pavilion

The collateral for the $140.5 million Westside Pavilion loan, 13.6% of WFCM 2012-LC5, includes 535,448 square feet of a 755,448-square-foot three-story, super-regional mall in Los Angeles. The loan, which saw 2016 net cash flow decline 8.6% from issuance, is locked out from prepayment, but it can defease. According to the *Los Angeles Times*, anchor tenants Macy's and Nordstrom relocated to the nearby Westfield Century City after that property completed a $1 billion renovation. Rather than fight the uphill battle of retenanting a significant amount of space, the property's owner opted to enter into a joint venture with Hudson Pacific and Macerich that will convert 80% of the property to office space, which is more in demand in the property's submarket.

The borrower expects the reconfiguration to be completed by mid-2021. The Westside Pavilion is set to have 500,000 square feet of offices and 100,000 square feet of retail space. The project's cost is estimated to reach upwards of $475 million, including the estimated value of the mall. The plan does not include the Macy's building, which the retailer sold to GPI Companies for $50.0 million, and the tenant shuttered its location in March 2018.

We view the reconfiguration as a positive credit event that will likely increase the value of a retail property with declining cash flow. However, it would be unusual for the servicer to allow the transformation to occur under the current CMBS structure. It's more likely that the loan will be modified and either defeased or paid down with a penalty. The servicer has given no indication of the borrower's plans. We do not forecast a loss based on our $161.9 million value, which is based on a discounted cash flow analysis assuming a three-year lease-up period, a 6.5% capitalization rate, and a 9.5% discount rate.

Fashion Outlets of Las Vegas

Fashion Outlets of Las Vegas is a 375,722-square-foot outlet center in Primm, Nevada, that backs a $66.4 million loan in COMM 2012-CR4. While Primm is part of the Las Vegas metropolitan statistical area, the property has the disadvantage of being in a tertiary submarket about 40 miles south of Las Vegas. The mall had difficulty obtaining financing because of operational challenges and a sharp value decline, and the owner likely found that using internal cash to pay off the loan was a poor use of resources. The Fashion Outlets of Las Vegas, which saw occupancy tumble to 69.0% in March 2017 from 95.0% at year-end 2014, experienced a substantial drop in revenue. From 2014 through 2016, revenue weakened 23.1%. We value the property at $55.6 million, or $148 per square foot, using a discounted cash flow analysis. We believe it's unlikely the property will recover to historical occupancy levels, so we assumed the space would lease-up to 80.0% occupancy over the next four years at an in-place rent of $25 per square foot. We adjusted the market capitalization rate of 7.0% to 10.0% to account for the lack of investor appetite in tertiary malls.

Consequently, we forecast a loss of about $12.9 million after liquidation expenses. Our downside scenario value is $41.6 million, which assumes reduced rent and a higher capitalization rate.

Salem Center

The Salem Center loan, backed by 212,007 square feet of a 649,624-square-foot regional mall in downtown Salem, Oregon, failed to pay off on its November 2017 maturity. The $30.9 million loan in JPMCC 2012-LC9 had a 9.2% debt yield based on 2017 net cash flow, which was down 23.6% from underwriting on 79.0% occupancy, down from 83.0% over the same period. The sponsor is an affiliate of Och-Ziff Capital Management, which is one of the largest institutional alternative asset managers in the world.

Noncollateral tenant Nordstrom announced that it will close its anchor at this location, which is also making it difficult to refinance the loan. The closure could affect foot traffic within the mall's two buildings, which are connected by a set of sky bridges to nearby noncollateral anchors JCPenney and Macy's, as well as two parking garages. As the workout process has only recently begun, it is difficult to project a resolution. A modification that would leave the borrower in place could be the most desirable solution for investors. A reduction in the property's cost basis could encourage the company to invest additional cash for improvements, while a takeover by the trust with a receiver acting as property manager may be unlikely to generate additional cash flow. Using a 10.6% capitalization rate, we value the collateral at $27.0 million and estimate an LTV of 114.4%.

Susquehanna Valley Mall

A conversion plan like the one noted above for the Westside Pavilion is only possible in cases where market demands and investment from the borrower are adequate to execute the strategy. Conversely, the Susquehanna Valley Mall in Selinsgrove, Pennsylvania, will likely face significantly higher hurdles in surviving. The mall, which we highlighted in a May 2017 CMBS Alert, backs a $25.7 million loan that transferred to special servicing in March after a third anchor tenant announced plans to close. The loan, 3.4% of COMM 2012-LC4, which had been on the Morningstar Watchlist since 2015, saw 2016 net cash flow tumble 31.1% below underwriting after the loss of JCPenney prompted several tenants to close their in-line stores. As is common for shopping mall lease structures, in-line tenants frequently negotiate co-tenancy clauses into their leases, allowing them to either reduce rent or terminate their lease upon the departure of a major anchor.

Gap, Deb Shops, RadioShack, and Limitless Mobile exercised such co-tenancy clauses and vacated the mall following JCPenney's 2015 closure. Those vacancies limited the property manager's ability to attract new, desirable tenants, and the mall's appeal significantly declined. Sears was the second anchor to close at Susquehanna Valley in March 2017, and Bon-Ton's recent announcement to close darkens the cloud over the property and leaves the door open for additional in-line store closures. We assumed the Bon-Ton space would remain vacant under our 10-year discounted cash flow analysis that applied a capitalization rate of 12.0% and a 15.0% discount rate. Our value under this approach is $13.0 million, which suggests a $12.8 million loss. For our bearish scenario value of the property, we identified eight sales of distressed regional malls in the Mid-Atlantic region from Virginia to upstate New York. The properties include several CMBS liquidations such as Newburgh Mall and Hudson Valley Mall. The average value was $10.26 per square foot, which would suggest a $6.4 million value for the Susquehanna Valley Mall. The sponsor is Susquehanna Valley Mall, L.P., which was controlled at issuance by Alma Cohen, Edwin Lakin, the late Albert Boscov, and Mid-Island Properties. Lakin and Boscov were senior managers of the Boscov's department-store chain.

Declining Net Cash Flow, Low Debt Yields, and High LTVs

Six loans with a combined $588.7 million balance have seen their most recent full-year net cash flow decline more than 10% since underwriting. None of the loans have a value deficiency in our view because of low leverage at issuance and other mitigating factors. We highlight four loans, two with the lowest debt yields, which, combined with their drop in net cash flow, may elevate maturity risk, and two loans that, despite their stable cash flow, have seen capitalization rates and the recent sale of the collateral property push the value lower.

Table 2 – Select Loans With a Significant Decline in Net Cash Flow, Low Debt Yields, or High LTVs

Deal ID	Property Name	City and State	Loan Status	Loan Balance ($)	Debt Yield (%)	NCF Change From U/W (%)	Loan-to-Value (%)
COMM 2012-CR4, COMM 2012-CR5	Eastview Mall and Commons	Victor, NY	Current	210,000,000	8.4	-17.6	94.7
WFRBS 2012-C10	Dayton Mall	Dayton, OH	Current	81,364,893	11.3	-2.7	88.4
WFRBS 2012-C10	Rogue Valley Mall	Medford, OR	Current	52,871,923	9.6	-1.5	88.1
UBSBB 2012-C2	Pierre Bossier Mall	Bossier City, LA	Current	43,954,351	8.4	-27.4	82.5

Source: Morningstar Credit Ratings, LLC

Eastview Mall and Commons

The collateral for the Eastview Mall and Commons loan, a $210.0 million loan composed of two pari passu notes in COMM 2012-CR4 and COMM 2012-CR5, totals 811,671 square feet and includes an 725,303-square-foot, one-story, super-regional mall and an 86,368-square-foot power center about 15 miles southeast of Rochester, New York. The collateral does not include 918,182 square feet leased to seven noncollateral anchor tenants: Macy's, JCPenney, Von Maur, Sears, Lord & Taylor, Target, and Home Depot.

Based on 2017 figures, net cash flow has declined 17.6% from underwriting and the debt yield is 8.4%, down from 10.2% over the same period, primarily because of increased property taxes.

Nevertheless, the loan is a low term default risk largely thanks to the low leverage at issuance. Although the loan structure included a full interest-only term, the 2.17x debt service coverage ratio and 57.1% LTV at issuance allow for some cushion should cash flow decrease further. We did not adjust the 7.5% market capitalization rate to arrive at our $234.7 million value because we view the property as a high-quality destination mall rather than a Class B regional mall. However, with an 89.5% LTV, the loan may have trouble refinancing without an increase in value. Wilmorite, a commercial real estate development and management company, is the loan sponsor.

Dayton Mall

A portion of Dayton Mall, 778,487 square feet of the total 1.4 million square feet, in Dayton, Ohio, secures an $81.4 million loan in WFRBS 2012-C10 that matures in 2022. The property, which was built in 1970 and includes collateral anchor JCPenney and shadow anchors Macy's, Elder-Beerman, and Sears, added an 85,000-square-foot lifestyle component in 2006 and a Dick's Sporting Goods in November 2012. Despite the capital improvements, cash flow declined 2.7% in 2016, and another 11.5% to $8.4 million for the 12 months ended September 2017 from $9.5 million in 2012. Based on the 2016 net cash flow and a 10% capitalization rate, the loan has an LTV of 88.4%. While the loan's metrics at issuance were favorable, with an 11.5% debt yield and a 62.1% LTV, declining cash flow (despite stable occupancy that's never slipped below 92.0%), could render the loan a refinance risk.

There is a mitigating factor, however. Plans for a mixed-use area around the mall show the potential removal of the Seritage-owned Sears anchor in favor of a 'main street' corridor with a walkable, community-based layout, according to a June 2017 article by Bizjournals.com. While Sears has not indicated it will close this location, we believe the plan illustrates the community's commitment to the mall and the potential for performance upside should the surrounding area be redeveloped. The sponsor is Washington Prime Group.

Rogue Valley Mall

The collateral for the Rogue Valley Mall loan, a $52.9 million loan in WFRBS 2012-C10, includes 453,935 square feet of a 640,294-square-foot two-story regional mall in Medford, Oregon. Based on its 2016 net cash flow, which is down only 1.5% from underwriting, the loan has an 11.0% debt yield. The mall's value took a hit in 2016 when Brixton Capital, a private real estate investment firm, acquired the property from GGP for $60.0 million. This represents a 25.0% drop from the at-issuance appraised value of $80.0 million and implies a 9.5% capitalization rate based on the 2015 net cash flow, which was the most recent at the time, compared with the underwritten capitalization rate of 7.4%. The resulting LTV is 88.3%.

Performance through September slid with annualized net cash flow tumbling 22.2% from underwriting. The property's declining cash flow may be due in part to the loss of Sports Authority, which closed in 2016. Although Macy's subleased the space, the sporting goods retailer's departure may have led to a reduction in foot traffic at the mall. Further, nearby competition may be taking a toll on the mall in terms of both reduced traffic and downward pressure on rents. Northgate Marketplace, less than one mile from Rogue Valley Mall, opened a second phase in 2016, including a Dick's Sporting Goods, Field & Stream, and Marshall's. In addition, the 420,000-square-foot Village at Medford Center, a lifestyle center less than two miles away, still has an enclosed portion, and a recent redevelopment added more dining.

Despite increasing competition and declining fundamentals, there are some mitigating factors. First, the mall occupies a dominant position in the market and has the advantage of being the only enclosed regional mall in Southwest Oregon. Another consideration is that in 2016 JCPenney renewed for five years to October 2021, and Macy's Home Store renewed to 2022 from its previous 2018 lease expiration. Although occupancy has ticked up to 93.0% as recently as September from a low of 87.0% at year-end 2015, increasing competition may make it difficult for Rogue Valley to attract new tenants, which may hinder the loan's refinancing prospects.

Pierre Bossier Mall

A portion of Pierre Bossier Mall, 265,347 square feet of the total 612,239 million square feet, in Bossier City, Louisiana, secures a $44.0 million loan in UBSBB 2012-C2 that matures in 2022. The loan's metrics at issuance were favorable, with a 10.5% debt yield and a 69.7% LTV, but have deteriorated over time. Cash flow decreased to $4.0 million in 2016 from $5.1 million in 2012, and the DSCR was 1.11x for the first nine months of 2017, down from 1.64x at underwriting.

These weakened metrics suggest the loan may not pay off, but there is not a lot of competition for the mall, with only one other regional mall within a 10-mile radius. With no new retail centers under construction in the mall's trade area, occupancy and rental rates should remain stable. On another positive note, future economic forecasts for 2018-20 are projecting job growth for the Shreveport–Bossier City area, according to the Economics & Policy Research Group at Louisiana State University. In spite of these encouraging signs, shoppers are increasingly turning to neighborhood centers, as Pierre Bossier Mall saw its occupancy drop to 84.0% in September from 92.4% at issuance, while occupancy at community shopping centers remained above 92% for the 12-

month period ended June 2017. Given the declining income at the property, we used the income approach to determine our value. Morningstar applied a capitalization rate of 10.0% to the year-end 2016 net cash flow. Our resulting value under this approach is $40.0 million, which suggests a 110.0% LTV. The loan is sponsored by Brookfield Properties via its acquisition of Rouse Properties in 2016.

Stable Performance but Elevated Maturity Risk

Even with stable cash flow that's within 10% of underwriting, loans with elevated underwritten LTVs may preclude full-takeout financing as lenders pull back on proceeds for B quality properties in smaller markets, and borrowers are unwilling or unable to pay the shortfall. We highlight three loans that fall in this category.

Table 3 – Select Loans With Stable Performance but Elevated Maturity Risk

Deal ID	Property Name	City and State	Loan Status	Loan Balance ($)	Debt Yield (%)	NCF Change From U/W (%)	Loan-to-Value (%)
WFRBS 2012-C7, C8	Town Center at Cobb	Kennesaw, GA	Current	187,915,735	9.9	-3.2	90.5
UBSCM 2012-C1, UBSC 2011-C1	Poughkeepsie Galleria	Poughkeepsie, NY	Current	144,434,802	9.7	-7.7	85.7
UBSBB 2012-C4	Newgate Mall	Ogden, UT	Current	58,000,000	10.8	-4.9	83.5

Source: Morningstar Credit Ratings, LLC

Town Center at Cobb

Despite stable cash flow that's down only 3.2% from underwriting, we consider Town Center at Cobb a potential maturity risk. The $187.9 million loan, with two pari passu notes in WFRBS 2012-C7 and WFRBS 2012-C8, was underwritten with a 9.7% debt yield, which we consider low, and is still below 10% because of stagnant cash flow. Applying a 9.0% capitalization rate to the 2017 net cash flow of $18.7 million, down from $19.3 million at underwriting, suggests an LTV of 90.5%.

The collateral comprises 559,940 square feet of a 1.3-million-square-foot regional mall in Kennesaw, Georgia, roughly 20 miles northwest of Atlanta. The property is anchored by Macy's, Macy's Furniture, Sears, JCPenney, and Belk. Belk and a portion of the JCPenney space (29,703 square feet) are part of the collateral for the loan, while the remaining anchors own their own stores and are not part of the collateral. The mall may be feeling competitive pressure from Cumberland Mall, which is in a denser submarket 13 miles southeast and adjacent to the Atlanta Braves new baseball stadium, SunTrust Park. In addition, Cumberland Mall is closer to Atlanta and has a stronger tenant roster, including Costco, Apple, and Cheesecake Factory. Credit positives include stable occupancy history and strong ownership and management in Simon Property Group. In fact, we believe strongly that term default risk is low, and, if cash flow stays constant, the loan's debt yield will be reasonable at 10.9% by maturity.

Poughkeepsie Galleria

The collateral for the Poughkeepsie Galleria loan, with $144.4 million in pari passu debt spread between UBSCM 2012-C1 and UBSC 2011-C1, includes 691,325 square feet of a 1.2-million-square-foot, two-level, enclosed regional mall in Poughkeepsie, New York, roughly 70 miles north of New York City. JCPenney, Dick's Sporting Goods, Regal Galleria 16, DSW Shoe Warehouse, Finish Line, and Forever 21 represent anchor and large in-line tenants that are included as part of the collateral. Sears, Macy's, Target, Best Buy, Old Navy, and a portion of H&M (11,000 square feet) are not part of the collateral.

The loan, which matures in November 2021, continues to operate normally but was overleveraged at issuance, and with a 7.7% decrease in net cash flow since underwriting, we believe that the borrower may not be able to obtain full takeout proceeds. Net cash flow decreased to $14.0 million at year-end 2017 from $15.1 million at issuance, while the DSCR was 1.19x for 2017, down from 1.29x at issuance, and the 2017 debt yield slipped to 9.7%. The loan was underwritten with a 9.8% debt yield and an LTV of 65.1%, which we consider high leverage for a Class B mall in a tertiary market today.

Capping the most recent net cash flow with an 8.5% capitalization rate, which we adjusted upwards from 7.5% to account for weak demand for older enclosed mall assets, results in a total value of $164.5 million and suggests an 87.8% LTV, which is above our 80.0% maturity risk threshold. Further, our downside scenario value is $139.8 million, which assumes reduced rent and a higher capitalization rate. The borrower is affiliated with Pyramid Companies, a privately held shopping mall developer and manager in the Northeast.

Newgate Mall

Investors are increasingly wary of second-tier malls, which has led to a widening of capitalization rates and declining prices when these properties are sold. A case in point is the Newgate Mall, which backs a $58.0 million loan in UBSBB 2012-C4. GGP sold the Ogden, Utah, mall in 2016 for $69.5 million to Time Equities Inc., a New York City-based commercial and residential investment company. Based on 2015 net cash flow, the 9.6% capitalization rate implied by the sale is nearly 200 basis points, or 2.0%, higher than the one implied by the issuance appraisal. Although the full-term interest-only loan had high leverage at nearly 70% based on the issuance appraisal of $83 million, the underwritten debt yield was conservative at 11.4%, and occupancy and cash flow have held firm since issuance. However, the 2016 sale price implies an LTV of 83.4%, which is a concern for refinancing but does not necessarily represent a term default risk. Time Equities Inc., a private real estate investment firm, is the sponsor.

Stable or Improving Cash Flow

Most mall loans issued in 2012 continue to perform well, registering stable or improving cash flow. Other positive factors that minimize risk and will enable them to pay off include being the dominant mall in their trade area, even in secondary or tertiary markets, borrower investment, and amortization. We highlight three large loans that have exhibited positive metrics that will enable them to pay off.

Table 4 – Select Loans With Stable or Improving Cash Flow

Deal ID	Property Name	City and State	Loan Status	Loan Balance ($)	Debt Yield (%)	NCF Change From U/W (%)	Loan-to-Value (%)
COMM 2012-CR1, CR2, CR3	Crossgates Mall	Albany, NY	Current	274,071,478	10.5	5.9	76.1
WFRBS 2012-C10, WFRBS 2013-C11	Concord Mills	Concord, NC	Current	235,000,000	14.0	14.7	60.9
COMM 2012-CR1, CFCRE 2011-C2	RiverTown Crossings Mall	Grandville, MI	Current	140,156,749	15.4	26.6	51.7

Source: Morningstar Credit Ratings, LLC

Crossgates Mall

The collateral for the Crossgates Mall loan, with $274.1 million in total debt spread among three pari passu notes in COMM 2012-CR1, COMM 2012-CR2, and COMM 2012-CR3, includes 1.3 million square feet of a 1.7-million-square-foot three-story, enclosed super-regional mall in Albany, New York. The loan is a likely payoff candidate largely thanks to the low leverage at issuance and the steady performance of the collateral. In addition, thanks to amortization, the loan's balance decreased from $300.0 million at issuance. The property's cash flow increased over the past few years with the net cash flow in 2017 nearly $1.6 million above underwriting, resulting in a strong debt yield of 10.5% and, using an 8.0% capitalization rate, an LTV of 76.1%.

We classify Crossgates Mall as Class B, given its sales per square foot of $400, according to issuance documents, and the middle-tier nature of its six anchors. In addition, after losing clothing retailers The Limited, J Crew, and Ann Taylor, ownership attracted new tenants, with Lucky Strike opening in late 2016 and Zara, which opened a two-level store in late 2017. The mall also boasts the only Apple store in the area, whose sales per square foot are higher than the national average, according to issuance documents. While the mall's Macy's and JCPenney stores have been spared from the retailers' closing lists so far, exposure to the struggling companies remains a longer-term risk. The other anchors include Regal Cinemas, Dick's Sporting Goods, and Best Buy. The sponsor is Pyramid Crossgates Co., a New York general partnership owned roughly 66% by Robert J. Congel and Madeira Associates, and 34% owned by other individuals and trusts.

Concord Mills

Concord Mills is a 1.3-million-square-foot regional mall in Concord, North Carolina, that backs a $235.0 million loan divided into two pari passu notes in WFRBS 2012-C10 and WFRBS 2013-C11. Concord is about 15 miles northeast of Charlotte, and the property has the advantage of being the only outlet center on the northeastern side of Charlotte. Long associated with the Charlotte Motor Speedway, Concord became one of the fastest-growing areas in North Carolina as the Charlotte area expanded. We believe that the tenant roster, which includes Bass Pro Shops, Burlington Coat Factory, and Dave & Busters, is a strength as many traditional retailers, particularly department stores, are experiencing declining sales. In addition, the borrower, Simon Property Group, continues to invest capital in the property. Several renovations have taken place since issuance, including the addition of a Sea Life Aquarium in 2014.

The loan is a likely payoff candidate largely thanks to the low leverage at issuance and net cash flow that has grown 14.7% since underwriting. Based on 2016 financials, the loan had a strong debt yield of 14.0%. Although the loan structure includes a full interest-only term, the property's cash flow increased over the past few years with the net cash flow in 2016 more than $4.1 million above issuance, which should cushion the lack of amortization. The loan sponsor is a joint venture of Simon Property Group and Kan Am Group, a private real estate investment firm in Germany.

RiverTown Crossings Mall

A portion of RiverTown Crossings Mall, 635,769 square feet of the total 1.3 million square feet, in Grandville, Michigan, secures $140.2 million in debt spread between two pari passu loans in COMM 2012-CR1 and CFCRE 2011-C2, which mature in June 2021. The loan's metrics at issuance were favorable, with an 11.1% debt yield and a 60.9% LTV, and have improved over time. Cash flow increased to $21.2 million in 2016 from $17.1 million in 2012. With these improved statistics, we view this loan as a low risk. The mall had the highest in-line sales among its competition at $441 per square foot in 2011, the latest available, according to issuance documents. It also benefits from Grand Rapids' healthy economy, which posted 2.5% job growth in 2017 among major metros and a national best of 4.4% in 2016, according to the U.S. Bureau of Labor Statistics.

RiverTown Crossings' improved cash flow may have come at the expense of Woodland Mall, 11 miles east, which is undergoing a redevelopment. That property, which opened 31 years before RiverTown Crossings, lost its Sears and Limited stores in 2017 but plans to add a Von Maur store, additional in-line shops, and 30,000 square feet of dining. PREIT purchased the property, which doesn't back a securitized loan, in 2006 for $177.4 million. GGP is the loan sponsor.

Looking Ahead

While a shifting economy, changing trends in shopping, and the rise of online retailing present challenges for malls, most mall loans issued in 2012 are posting improving cash flow and should continue to perform well based on low LTVs and strong location. Amortization also is a factor. Loans that amortize over their terms have a higher likelihood of paying off at maturity, as do those backed by malls that are dominant in their market and those that enjoy stable occupancy. However, even where properties are stable, the lack of financing for second-tier properties may affect the borrowers' ability to refinance. If loan proceeds fall short of the loan balance, borrowers face a decision to invest additional capital to pay off a loan, pursue a modification, or hand the property back to the trust. While exposure to struggling anchor tenants increases long-term risk, losing an anchor tenant may present an opportunity to increase revenue at most properties with strong demographics.

Appendix 1 – 2012 Mall Loans

Deal ID	Property Name	City and State	Loan Status	Loan Balance ($)	Projected Loss ($)	NCF Change From U/W (%)
WFCM 2012-LC5	Westside Pavilion	Los Angeles, CA	Specially Serviced	140,502,855	-	-8.6
COMM 2012-CR4	Fashion Outlets LV	Las Vegas, NV	Specially Serviced	66,374,697	12,881,811	-24.7
JPMCC 2012-LC9	Salem Center	Salem, OR	Specially Serviced	30,938,954	4,877,948	-23.6
COMM 2012-LC4	Susquehanna Valley Mall	Selinsgrove, PA	Specially Serviced	25,702,242	12,750,638	-39.4
UBSBB 2012-C2	Pierre Bossier Mall	Bossier City, LA	Current	43,954,351	-	-27.4
WFRBS 2012-C7	Fashion Square	Saginaw Township, MI	Current	36,341,620	-	-20.3
COMM 2012-CR4, CR5	Eastview Mall and Commons	Victor, NY	Current	210,000,000	-	-17.6
UBSBB 2012-C2	Crystal Mall	Waterford, CT	Current	89,078,125	-	-17.0
COMM 2012-CR3	Solano Mall	Fairfield, CA	Current	105,000,000	-	-12.4
COMM 2012-CR3, CR4	Emerald Square Mall	North Attleboro, MA	Current	104,318,719	-	-11.0
UBSCM 2012-C1, UBSC 2011-C1	Poughkeepsie Galleria	Poughkeepsie, NY	Current	144,434,802	-	-7.7
WFRBS 2012-C7	Florence Mall	Florence, KY	Current	90,000,000	-	-6.0
JPMCC 2012-LC9, JPMCC 2013-C10	West County Center	Des Peres, MO	Current	181,677,113	-	-5.8
UBSBB 2012-C4	Newgate Mall	Ogden, UT	Current	58,000,000	-	-4.9
WFRBS 2012-C7, C8	Town Center at Cobb	Kennesaw, GA	Current	187,915,735	-	-3.2
WFRBS 2012-C10	Dayton Mall	Dayton, OH	Current	81,364,893	-	-2.7
WFRBS 2012-C10	Rogue Valley Mall	Medford, OR	Current	52,871,923	-	-1.5
UBSBB 2012-C2	Westgate Mall	Spartanburg, SC	Current	34,725,982	-	-1.1
MSC 2012-C4	Shoppes at Buckland Hills	Manchester, CT	Current	117,954,056	-	0.9
WFRBS 2012-C10	Animas Valley Mall	Farmington, NM	Current	46,985,525	-	2.0
WFRBS 2012-C9	Chesterfield Towne Center	North Chesterfield, VA	Current	102,194,915	-	3.8
JPMCC 2012-CBX	Southpark Mall	Colonial Heights, VA	Current	60,714,009	-	5.2
COMM 2012-CR1, CR2, CR3	Crossgates Mall	Albany, NY	Current	274,071,478	-	5.9
MSBAM 2012-C5	Hamilton Town Center	Noblesville, IN	Current	80,257,529	-	6.7
UBSBB 2012-C2	Louis Joliet Mall	Joliet, IL	Current	85,000,000	-	8.9
COMM 2012-LC4	Square One Mall	Saugus, MA	Current	90,882,499	-	10.0
JPMCC 2012-C6	Arbor Place Mall	Douglasville, GA	Current	110,879,370	-	12.1
WFRBS 2012-C7, C8	Northridge Fashion Center	Northridge, CA	Current	223,069,635	-	13.5
MSBAM 2012-C6	Cumberland Mall	Vineland, NJ	Current	44,958,063	-	13.9
WFRBS 2012-C10, WFRBS 2013-C11	Concord Mills	Concord, NC	Current	235,000,000	-	14.7
MSC 2012-C4	Capital City Mall	Camp Hill, PA	Current	59,770,842	-	20.5
JPMCC 2012-CBX	Jefferson Mall	Loisville, KY	Current	64,400,735	-	20.8
JPMCC 2012-C8	Battlefield Mall	Springfield, MO	Current	119,450,736	-	20.8
COMM 2012-CR2	Chicago Ridge Mall	Chicago Ridge, IL	Current	80,000,000	-	22.3
MSBAM 2012-C6	Greenwood Mall	Bowling Green, KY	Current	62,312,352	-	23.6
COMM 2012-CR1, CFCRE 2011-C2	RiverTown Crossings Mall	Grandville, MI	Current	140,156,749	-	26.6
UBSBB 2012-C2	Southland Center Mall	Taylor, MI	Current	71,795,109	-	27.3
JPMCC 2012-C6	Northwoods Mall	North Charleston, SC	Current	66,200,983	-	28.5
UBSBB 2012-C4	Visalia Mall	Visalia, CA	Current	74,000,000	-	30.1
GSMS 2012-GCJ7	Bellis Fair Mall	Bellingham, WA	Current	84,513,140	-	32.8
COMM 2012-CR3	Midland Park Mall	Midland, TX	Current	76,740,914	-	44.5

Source: Morningstar Credit Ratings, LLC

DISCLAIMER

The content and analysis contained herein are solely statements of opinion and not statements of fact, legal advice or recommendations to purchase, hold, or sell any securities or make any other investment decisions. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MORNINGSTAR IN ANY FORM OR MANNER WHATSOEVER.

To reprint, translate, or use the data or information other than as provided herein, contact Vanessa Sussman (+1 646 560-4541) or by email to: vanessa.sussman@morningstar.com.