CMBS Research

Morningstar Monthly Highlights

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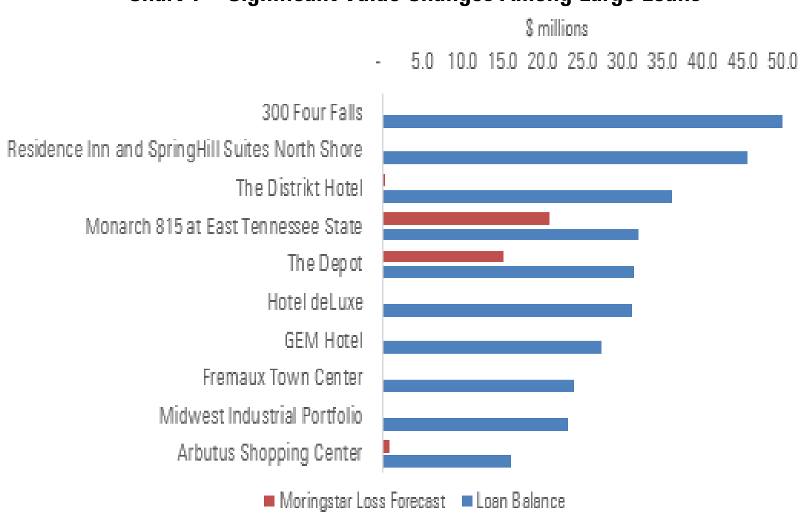
Morningstar Credit Ratings
May 2018 Remittance

Contents

Executive Summary

- The delinquency rate hit a postcrisis low of 2.15% in May, down 9 basis points from April and 94 basis points from a year ago.
- Morningstar Credit Ratings, LLC believes the delinquency rate will hold below 2.5% for the rest of the year as steady new issuance volume will continue to push the outstanding balance of commercial mortgage-backed securities loans higher and special servicers actively resolve or liquidate assets.
- Delinquencies from deals issued from 2010 through 2018 remain a small portion of the total, representing just 0.3% of the CMBS universe, while delinquent precrisis loans account for 1.9%.
- The payoff rate of maturing loans in CMBS surged above 90% for the month after holding below 80% for the previous two months, improving to 94.5 from 79.2% in April. We anticipate that the maturity payoff rate will finish the year between 80% and 85% because most of the remaining maturing loans have strong metrics.
- The balance of loans on the Morningstar Watchlist declined for the first time in four months, improving to $24.21 billion, down $602.2 million from April as the number of bankruptcies and store closures affecting CMBS have tapered off.
- The special-servicing unpaid principal balance, or UPB, fell for the eighth-consecutive month to $21.70 billion, ticking down $165.1 million from April, and the percentage of loans in special servicing fell to a postcrisis low of 2.64%.
- Our projected losses on specially serviced loans improved to $12.58 billion, down $46.1 million from April but up $154.6 million from January.

Chart 1 – Significant Value Changes Among Large Loans



Deal ID	Previous MORN LTV (%)	Current MORN LTV (%)	Value Change ($)	Loss Forecast ($)
MSBAM 2016-C29	50.8	99.7	(28,193,000)	-
GSMS 2016-GS2, GSMS 2016-GS3	25.3	99.2	(28,524,333)	-
MSBAM 2012-C5	68.7	104.9	(18,164,529)	424,700
COMM 2015-CR25	71.7	312.7	(34,300,000)	20,785,959
CSAIL 2015-C2	125.4	191.9	(8,680,198)	15,062,113
COMM 2015-CR27	65.9	90.9	(13,000,000)	-
COMM 2014-LC15	70.0	101.3	(12,108,520)	50,451
WFCM 2016-C37	119.7	95.8	(42,400,000)	-
WFCM 2016-C37	42.8	100.0	(15,490,000)	-
GSMS 2014-GC24	71.5	129.4	(10,040,000)	888,811

Source: Morningstar Credit Ratings, LLC

Significant Value Changes Among Watchlist and Specially Serviced Loans

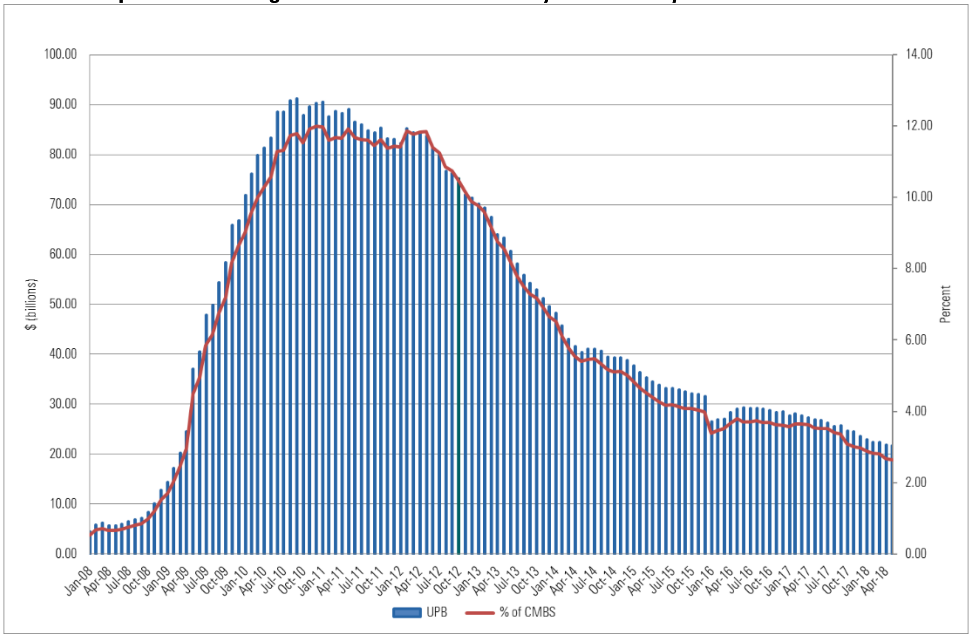
In May, we raised our value on properties securing 57 loans with a combined balance of $1.25 billion, while we lowered our values on properties securing 90 loans with a combined balance of $3.67 billion. Of these, 49 loans showed value declines that resulted in increased loss forecasts. For example, the value of the Monarch 815 at East Tennessee State, which backs a $31.9 million 60-day delinquent loan in COMM 2015-CR25, was reduced to $10.2 million from $44.5 million. Occupancy at the student-housing property that serves East Tennessee State University in Johnson City, Tennessee, dropped to 65.0% at year-end 2017 from 96.4% at issuance, pushing the debt service coverage ratio, or DSCR, below break-even as net cash flow tumbled 72.8% from underwritten. While the property is one of the newest in its submarket, East Tennessee State has seen its enrollment drop since 2014, which has reduced demand for the property. Our $10.2 million value is based on a 7.0% capitalization rate and 2017 net cash flow of $718,000, which suggests the potential for a $20.8 million loss.

Separately, The Depot, another student housing property, which backs a $31.4 million loan in CSAIL 2015-C2 and serves the University of Akron in Ohio, saw 2017 net cash flow plummet 67.2%. The market is struggling because of oversupply. The University of Akron has seen a spike in supply since 2014 with more than 2,500 units having entered the submarket, according to CoStar, Inc. We valued the property using a discounted cash flow assuming a market vacancy of 5.0% and in place rents of $900 per unit. We used a terminal cap rate of 7.90% with a discount rate of 10.90%. Our concluded value of $16.3 million is a 64.6% reduction from the $46.0 million underwritten appraised value.

Special-Servicing Exposure

The special-servicing unpaid principal balance fell for the eighth-consecutive month, ticking down by $165.1 million to $21.70 billion as liquidations continue to outweigh recent transfers. Special-servicing exposure fell to a postcrisis low of 2.64%, a level not seen since March 2009, when it registered 2.40%.

Chart 2 – Special-Servicing Balance and Rate January 2008 – May 2018



Source: Morningstar Credit Ratings, LLC

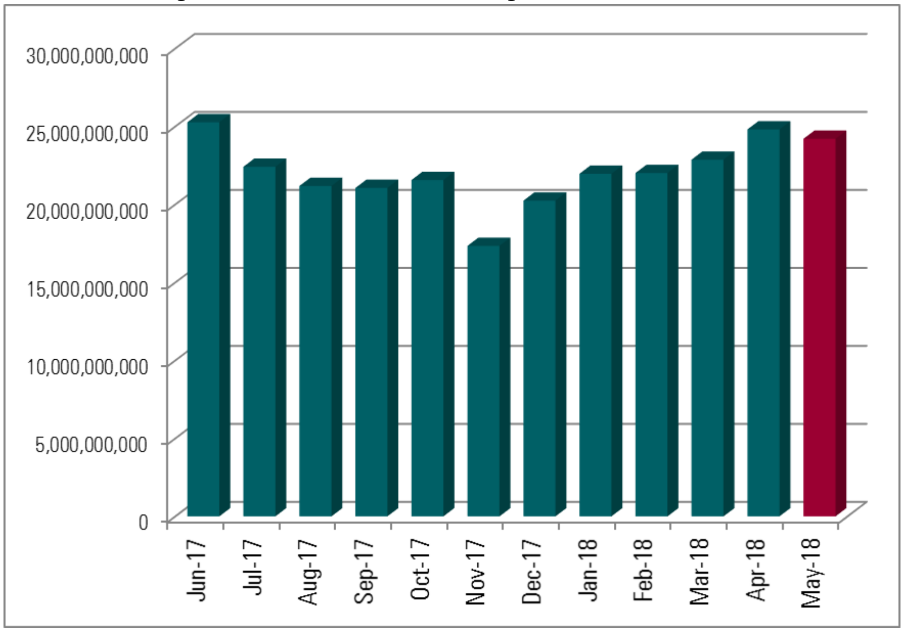
While special-servicing transfers, which rose by $243.4 million from April to $513.1 million, include 11 postcrisis loans totaling $160.1 million, we don't project a loss on any of these loans. Our largest projected loss is on the precrisis $94.0 million Rushmore Mall loan in BACM 2006-3. The loan transferred to the special servicer after the news that the property's anchor tenants, Sears and Herberger's, will be vacating the Rapid City, South Dakota property. We anticipate the effect to be minimal in the short term because those tenants were paying a low combined 12% of the base rent and the DSCR should remain above breakeven. However, long-term risk centers on reduced foot traffic and tenants exercising cotenancy clauses, especially those tenants closest to the anchor space. The previously modified loan includes a $36.0 million B note, that we believe will be a total loss based on our $25.7 million value, which is based on a discounted cash flow assuming in-place revenue of $10 per square foot, stabilized occupancy of 60%, and a reversion capitalization rate of 12%. Our $60.7 million projected loss suggests the $58.0 million A note could incur a $32.3 million loss.

Watchlist Exposure

As shown in Chart 3, after rising to a 10-month high in April, Watchlist volume dipped in May. In total, 903 loans with a UPB registering $24.21 billion were on our Watchlist, down $602.2 million from $24.81 billion in May. In May, we added 69 loans with a total UPB of $1.91 billion to the Morningstar Watchlist, up from $2.43 billion added in April. Morningstar also removed 38 loans from the Watchlist, five of which were transferred to special servicing.

We expect the volume of transfers to moderate in the coming months, as the number of retail bankruptcies and store closings that began in 2017 has tapered off. However, we are most cautious on the office sector given a combination of the late stage corporate credit cycle, less demand as companies become more efficient, and potential disruption from technology, reducing space requirements. Further, new construction in the office market may weigh on occupancy in the coming year. Separately, signs of overbuilding could lead to declining multifamily and hotel occupancy rates in gateway markets as demand slows.

Chart 3 – Morningstar Watchlist Volume – Trailing 12 Months ($)



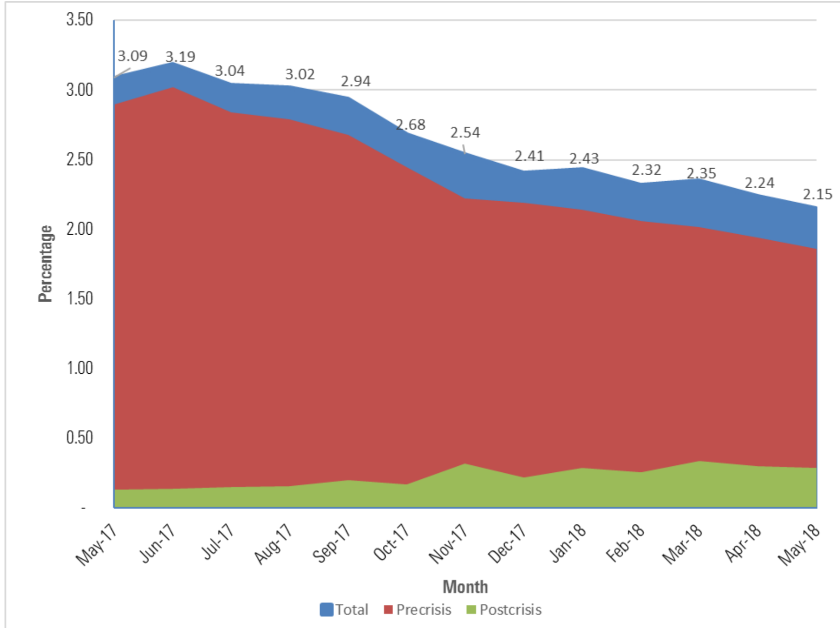
Source: Morningstar Credit Ratings, LLC

The $401.9 million Lone Star Portfolio Trust, the sole loan in LSPT 2015-LSP, was the largest added to our Watchlist. The collateral for the loan, 49 office and three industrial properties, down from 103 at underwriting, with a combined 7.2 million square feet, generated $40.9 million in net cash flow during 2017, which is 25.6% below the underwritten amount of $55.0 million due to a decline in occupancy. Six properties, four of which are in New Jersey, operated in the red. The at-issuance weighted average occupancy for the 60 properties was 75.0%, and as of December 2017, the latest month for which data is available, it dropped to 68.9%. We consider term risk low and balloon risk high because the total debt loan-to-value (inclusive of the $97.6 million mezzanine loan) is 103% based on our likely valuation. The initial maturity date is in September 2018, and the borrower has two successive one-year extension terms. To qualify for the first extension, the total debt yield must be a minimum of 10.4% based on net operating income for the 12 months preceding the extension date. The debt yield, based off the reported 2017 NOI, is 9.7%. The borrower will most likely have to prepay the loan in an amount that would be sufficient to satisfy the debt yield hurdle.

Delinquency

The CMBS delinquent UPB declined modestly to $17.69 billion, down $670 million from $18.36 billion in April, while the delinquency improved 9 basis points to 2.15% from 2.24% from the prior month. The balance of delinquent loans is down $1.63 billion from January, and down $6.15 billion, or 25.8%, from the year-earlier period. While legacy CMBS now accounts for less than 4% of the CMBS universe, delinquencies from deals issued before 2010 represent 86.4% of all delinquencies by balance. Comparatively, delinquencies from deals issued from 2010 through 2018 contribute 13.6% of all delinquencies and represent 0.3% of the CMBS universe.

Chart 4 – Monthly CMBS Delinquency by Percentage



Source: Morningstar Credit Ratings, LLC

Table 1 – Trailing 12 Months Delinquency ($ UPB in billions)

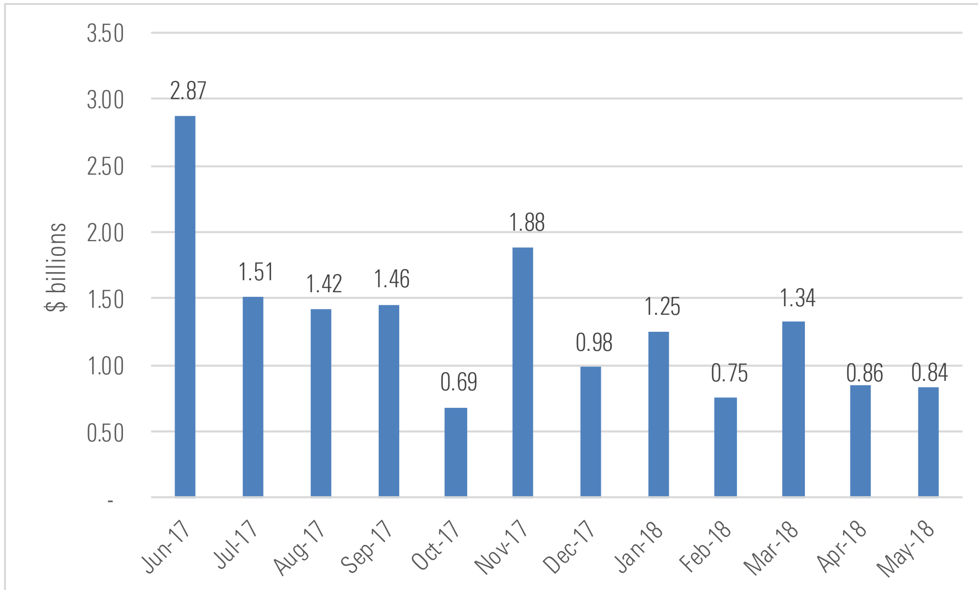
Category	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18
30-Day	3.07	3.22	2.24	2.72	2.50	1.66	2.02	0.95	1.03	0.86	1.27	1.08	0.79
60-Day	1.68	1.16	1.37	1.08	0.98	0.76	0.63	0.40	0.68	0.27	0.34	0.62	0.24
90-Day	3.52	4.22	3.95	3.6	3.26	3.19	2.95	2.99	2.92	2.57	2.52	2.26	2.25
Foreclosure	6.09	6.28	6.3	5.91	6.02	5.78	5.16	5.33	5.3	5.03	4.85	4.55	4.21
Real Estate Owned	9.49	9.69	9.05	9.55	9.89	10.26	10.15	9.49	9.39	9.65	9.86	9.86	10.2
Total CMBS Del.	23.84	24.57	22.89	22.86	22.65	21.64	20.90	19.16	19.32	18.38	18.85	18.36	17.69
Current	746.37	744.77	730.10	735.30	747.75	787.06	801.98	774.77	775.01	774.84	781.77	800.45	804.38
Total CMBS	770.20	769.34	753.00	758.16	770.40	808.71	822.88	793.93	794.33	793.22	800.62	818.82	822.07
Delinquency %	3.09	3.19	3.04	3.02	2.94	2.68	2.54	2.41	2.43	2.32	2.35	2.24	2.15

Source: Morningstar Credit Ratings, LLC

The volume of newly delinquent loans remained below $900 million for the second consecutive month, registering $840.4 million, down $16.4 million from the prior month. After the previously mentioned $94.0 Rushmore Mall loan, the $81.2 million Regions Harbert Plaza loan in LBUBS 2008-C1 is the largest. The 613,764-square-foot office building in Birmingham, Alabama, that backs the loan is just 63.7% occupied according to CoStar because the largest tenant moved out in December, leaving the borrower unable to pay the loan off by its March 2018 maturity. A June 2017 appraisal valued the collateral at $61.0 million, which suggests a potential loss of $30.0 million after servicer fees.

Separately, the $57.2 million Eagle Ridge Village loan in GSMS 2013-GC12 is the largest newly delinquent postcrisis loan. A sharp drop in cash flow at the 648-unit Evans Mills, New York, apartment property and the dependence on one major demand generator could still leave the property exposed to losses over the long term. The property is about nine miles west of Fort Drum, a U.S. Army Base and is the closest new off-base multifamily housing complex to the front gates of Fort Drum. Net cash flow tumbled 44.7% from issuance as cutbacks of over 2,000 personnel at Fort Drum and the high inventory in the market pushed both occupancy and rental rates lower. While revenue has recovered over the past year, the lack of growth in demand could make further improvement in cash flow unlikely. Our most recent valuation of $44.5 million, based on a 7.4% cap rate and 2017 net cash flow of $3.3 million, results in a value deficiency of approximately $13.5 million.

Chart 5 – Newly Delinquent Loans



Source: Morningstar Credit Ratings, LLC

Compared with year-ago levels, the office sector saw the largest decline in delinquent balance, tumbling $2.24 billion, or 28.0%, as liquidations have far outpaced newly delinquent loans. By dollar amount, the other four major property types exhibited the following activity year over year:

- Retail loan delinquency dropped by $1.66 billion, or 19.2%, to $6.97 billion from $8.63 billion one year ago, because more loans were either liquidated or resolved than were replaced with newly delinquent loans.
- Industrial loan delinquency fell by $432.3 million, or 34.9%, to $807.2 million from $1.24 billion one year ago.
- Multifamily loan delinquency eased by $311.9 million, or 19.0%, to $1.33 billion from $1.64 billion one year ago.
- Hotel delinquency slid by $750.6 million, or 32.0%, to $1.60 billion from $2.35 billion one year ago.

Table 2 – May Delinquency by Property Type

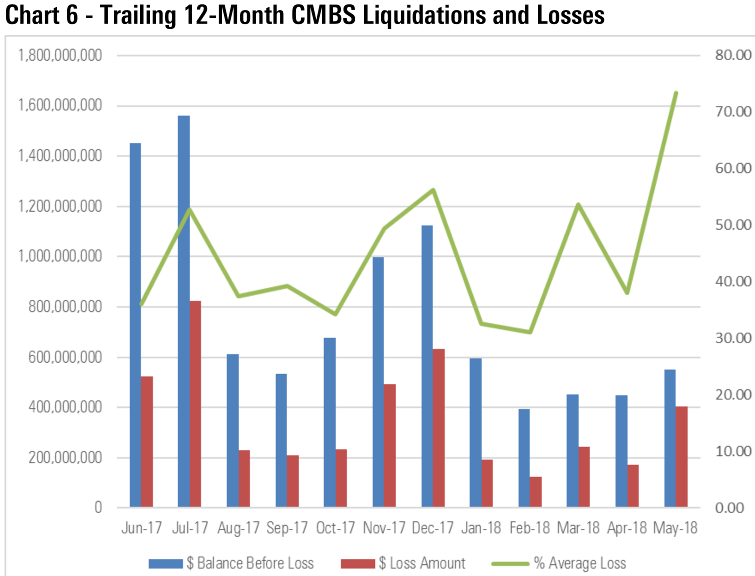
Property Type	$ Current Balance	# Loans	% of CMBS Universe	% of CMBS Delinq.	% of Property Type
Healthcare	71,272,211	5	0.01	0.40	1.80
Hotel	1,598,671,452	96	0.19	9.04	2.13
Industrial	807,230,952	44	0.10	4.56	3.64
Multifamily	1,328,247,165	275	0.16	7.51	0.32
Office	5,776,762,077	274	0.70	32.65	4.59
Other	1,138,783,637	63	0.14	6.44	1.85
Retail	6,969,364,869	500	0.85	39.40	5.47
Total	17,690,332,364	1,257	2.15	100.00	

Figures may not sum to totals because they are rounded.
Source: Morningstar Credit Ratings, LLC

CMBS Liquidations

After touching a nine-month low in February, the largest retail write-off in eight years drove the weighted average loss severity to an all-time high (since we began tracking the statistic in 2005) of 73.4%, up 35.4 percentage points from April's tally. The $133 million Galleria at Pittsburgh Mills note alone comprised roughly 35% of total losses reported for the month. Built in 2005, the underlying asset is a 1.07 million-square-foot super-regional mall in the Pittsburgh suburb of Tarentum, Pennsylvania. The mall was occupied by Sears, Macy's, JCPenney, and Dick's Sporting Goods at securitization. The REO asset ultimately incurred a 112.1% loss severity based on a write-down of $149.1 million. That disposal currently ranks as the highest realized loss recorded on any retail loan since 2010. An article from the *Pittsburgh Post-Gazette* indicated that the property was sold to Mason Asset Management for $11.35 million. This price tag was considerably greater than its February 2018 appraisal of $6.48 million. The loan represented 85% of MSC 2007-HQ11 at disposition. The subsequent loss wiped out the remaining balances of classes D through H in full, as well as 37% of class C.

Chart 6 - Trailing 12-Month CMBS Liquidations and Losses

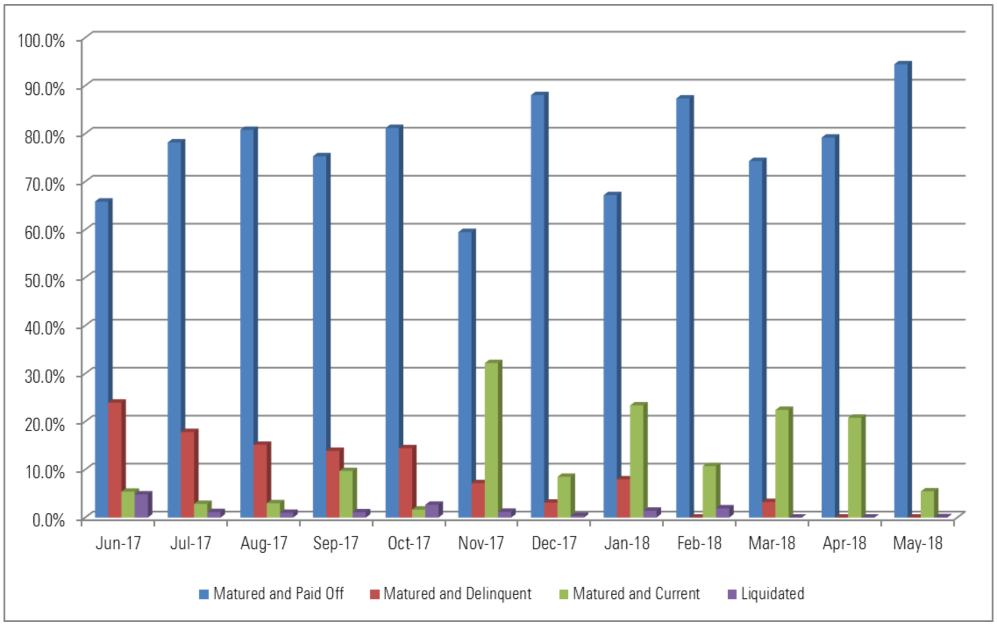


Source: Morningstar Credit Ratings, LLC

Monthly Maturity

With the 2015-2017 maturity wave behind us, the maturity payoff rate jumped above 90% for the first time in nearly three years as precrisis loans represented just 12% of May's maturing loan balance. The $25.8 million Lakeview Commerce Center in BACM 2007-4 was the largest loan that failed to pay off, but we believe risk is low because the sole tenant's lease runs until 2030 and the borrower requested a 30-day extension, according to servicer commentary.

Chart 7 – 12-Month Performance Trend by Loan Status at Maturity



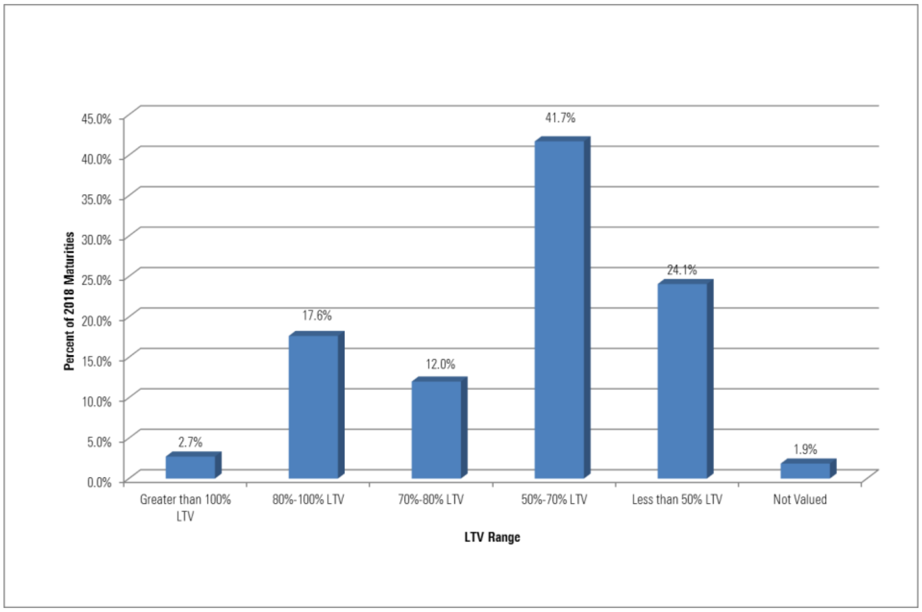
Source: Morningstar Credit Ratings, LLC

Maturity Outlook for 2018

Some $5.39 billion of CMBS loans will mature through the remainder of 2018. We have valued 98.1% and project that the payoff rate will come in at roughly 80% because 82.4% of the loans have LTVs below 80% or are defeased.

The largest loan of concern is the $59.4 million Matrix Corporate Center, 8.2% of MSBAM 2013-C11. We forecast a loss of about $9.5 million on the loan, which matures in August 2018, as December 2017 occupancy plummeted to 16.0% from 72.3% at underwriting after the two largest tenants vacated the one-million-square-foot Danbury, Connecticut, office building. Losing both tenants has severely diminished cash flow and will hamper the borrower's efforts to refinance as maturity approaches. Our loss forecast, which includes fees and expenses, is based on a $60.8 million July 2017 appraisal.

Chart 8 - 2018 Maturing Loans – Morningstar LTVs



Source: Morningstar Credit Ratings, LLC

Although LTV is a reasonable barometer in Morningstar's maturity analysis, a loan's refinancing ability is also subject to its DSCR, debt yield, amortization, and lease expiration risk. Beyond an individual property's performance, factors such as capitalization rates and specific real estate market trends also will influence a loan's refinance prospects.

Once logged into Morningstar's CMBS Credit Risk Monitoring and Analytics, clients have access to loan-level details for all maturing loans in Microsoft Excel format by clicking the download icon at the top of Page 1.

Detailed Morningstar analyses and value estimates for all delinquent, matured-delinquent, and matured-current loans as well as loans on the Morningstar Watchlist can be found in the respective Morningstar DealView CMBS Monitoring Analyses or Watchlists.

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