CMBS Alert

Federal Reserve Cashes Out of Washington, D.C., Office; Elevates Risk on $450 Million Loan

December 3, 2019

Morningstar Perspective

Morningstar Credit Ratings, LLC (DBRS Morningstar), lowered its valuation for the International Square–a 1.2 million-square-foot office building in Washington, D.C.,--to $459.1 million, down 9.7% from its previous estimate of collateral value because the Board of Governors of the Federal Reserve System will not renew when its leases expire. The Federal Reserve will instead consolidate its existing offices and relocate to a government-owned property, according to the *Washington Business Journal*. The $450.0 million total debt is split into four pari passu notes: a $370.0 million note in BAMLL 2016-ISQ, a $20.0 million note in MSBAM 2016-C30, and two $30.0 million notes in MSBAM 2016-C31 and MSC 2016-BNK2.

The Federal Reserve occupies 33.7% of the 1.2 million-square-foot office building in the golden triangle section of Washington, D.C., under four leases, with the largest, accounting for 22.1% of the gross leasable area, expiring in March 2022. The rest of its leases expire between 2026 and 2028. With the Federal Reserve continuing to pay its lease through the first expiration date in 2022, the risk over the near term is minimal.

Strong Submarket

If the borrower is unable to back-fill the former Federal Reserve Board space that expires in 2022, occupancy at the property could drop to about 66%; however, that is unlikely, as the property is in the most prestigious section of Washington, D.C., and four blocks from the White House. Further, according to the *Washington Business Journal* article, it is anticipated that the consolidation project will take three years to complete. We feel that is ample time to market the available space; the property has a history of attracting quality tenants and maintaining strong occupancy.

Further, the Golden Triangle submarket is outperfoming the Washington, D.C., market. Its 9.8% vacancy rate, compared with 14.1% for the overall market, should bouy the borrower's efforts in back-filling the space.

Nearly 10% Value Decline

We used a discounted cash flow model and estimated the present value of this property to be $459.1 million (98.0% loan-to-value ratio) based on a 10-year holding period. Our valuation assumes that submarket occupancy will ramp up to 89.0% over two years after the Federal Reserve's 2022 departure. Our capitalization rate was placed at 6.0% with a 9.0% discount rate.

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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