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CMBS Alert

Not Getting Any Younger: Potential Closures Put $513.7 Million in Forever 21 CMBS Loans at Risk

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Morningstar Perspective

Following Forever 21's identification of 178 stores that it may close as part of its bankruptcy filing, Morningstar Credit Ratings, LLC (DBRS Morningstar) sees elevated risk in six loans backed by five properties in commercial mortgage-backed securities where the retailer rejecting its lease may cause a significant drop in net cash flow. Of the six loans, two have value deficiencies: $70.1 million Brunswick Square and the $49.3 million Oakdale Mall. These loans were among those we highlighted in our Oct. 1 Alert, Overly Ambitious: Forever 21's Bankruptcy Filing Could Affect $1.26 Billion in CMBS.

Following its Sept. 29 bankruptcy filing, the retailer on Oct. 1 issued a list of 178 U.S. stores for possible closure in its filings with the bankruptcy court. Forever 21 also issued a statement that not all the U.S. stores listed will necessarily close because the company is renegotiating leases with mall owners and other property owners in hopes of obtaining more favorable terms.

Table 1 – Forever 21 Potential Closures at Elevated Risk

Deal ID	Property Name	Location	Allocated Property Balance ($)	Debt Service Coverage Ratio (x)	% of Gross Leasable Area	Occupancy (%)	Maturity Date	Value Deficiency ($)
BBCMS 2015-VFM	Vintage Faire Mall	Modesto, CA	254,936,496	1.76	22.3	99.1	3/6/2026	-
CGCC 2014-FL1	Yorktown Center	Lombard, IL	121,317,603	1.98	4.2	77.0	3/9/2020	-
WFRBS 2014-C20, WFRBS 2014-C19	Brunswick Square	East Brunswick, NJ	70,100,346	1.21	4.3	90.0	3/1/2024	4,700,000
WFRBS 2011-C3	Oakdale Mall	Johnson City, NY	49,329,310	0.62	1.6	51.0	2/1/2021	38,055,387
GSMS 2011-GC3	701 Lincoln Road	Miami, FL	18,021,811	2.13	92.7	100.0	1/6/2021	-

Source: DBRS Morningstar

In total, 86 CMBS loans, backed by 55 properties, with a combined allocated property balance of $9.56 billion have exposure to Forever 21 stores that the company is reviewing for potential closure, but DBRS Morningstar believes that the remaining 80 loans won’t see a significant decline in net cash flow because Forever 21 doesn’t represent a large portion of the net rentable area.

Loans of Concern

We have a $4.7 million value deficiency on Brunswick Square, as sales have continued to decline since issuance. In-line sales at the East Brunswick, New Jersey, regional mall as of August 2018 (the most recent reported) were $246 per square foot, compared with $253 per square foot in December 2016 and $263 per square foot in December 2015, respectively. In-line sales were as high as $332 per square foot in 2013. Additionally, Macy's (noncollaeral) sales have declined 42.3% since 2013. The loss of Forever 21, representing 6.2% of the underwritten base rent, would drag the debt service coverage ratio, which stood at 1.21x for the first six months of 2019, closer to break-even. Further, the property is less competitive than the nearby Menlo Park Mall (CGCMT 2014-GC19) and Woodbridge Center (secured in this deal), both of which have more entertainment components. According to servicer commentary, rental rates have dropped and expenses are increasing, suggesting some weakness in demand. The collateral, 292,685 square feet of the 760,311-square-foot mall, backs $70.1 million in debt split between WFRBS 2014-C20 and WFRBS 2014-C19.

The potential loss of Forever 21 would be another blow for the already struggling Oakdale Mall, which secures a $49.3 million specially serviced loan in WFRBS 2011-C3. The property, an 851,498-square-foot enclosed regional mall near Binghamton, New York, of which 708,695 square feet is collateral, is down three anchors after losing Sears and Macy’s in 2017, followed by Bon-Ton in 2018. Declining occupancy and loss of revenue from co-tenancy agreements pushed 2018 net cash flow down more than 60% from underwriting as the debt service coverage ratio fell to 0.75x from 1.94x at underwriting. Based on our discounted cash flow valuation, we forecast a $38.1 million loss.

Separately, we do not forecast a value deficiency on the Vintage Faire Mall, the largest loan in the group with a balance of $254.9 million. We believe that strong in-line sales at the Modesto, California, regional mall and limited competition for the surrounding customer base will serve it well in back-filling the space, should Forever 21 close. Further, the Sears space, which fell vacant in early 2018, was quickly back-filled with attractive additions to the mall, supporting this opinion. The high sales for the Sears box and the strong in-line sales are likely contributors to the speed with which Macerich and Seritage were able to secure replacement tenants Dave & Buster’s and Dick’s Sporting Goods, both of which have been expanding store footprints over the past few years, with many former Sears locations targeted by both companies. Forever 21 is a noncollateral tenant in an unusually large space with a 154,518-square-foot box that formerly housed a department store anchor. About two thirds of the retailer's space is used for storage and a regional hub for merchandise clearance, according to the deal's offering circular. The loan, which is current, reported a year-end 2018 DSCR of 1.78x on 99.4% occupancy and net cash flow has grown 9.7% since underwriting.

We do not forecast a loss on the $121.7 million specially serviced Yorktown Center loan based on a February 2019 appraisal. But we believe that the value could likely sink to about $84.7 million based on a discounted cash flow analysis that accounts for the closure of Forever 21, which occupies 4.2% of the gross leasable area. We also increased the market capitalization rate of 8.0% by 200 basis points to account for the lack of investor appetite in retail, resulting in a capitalization rate of 10.0% and a discount rate of 13.0%. Given that 2018 financials do not appear to take into account the prior year's asset sales, we used 2017 year-end financials and discounted the 142,210 square feet that were released that year. The loan, which is backed by a 645,179-square-foot retail complex in Lombard, Illinois, was modified with a new maturity date of March 2020 after failing to pay off on its fully extended March 2019 maturity.

Forever 21's potential departure from 701 Lincoln Road, which backs an $18.0 million loan in GSMS 2011-GC3, would push the DSCR well below break-even and raise default risk. However, despite occupancy potentially dropping to less than 10% if Forever 21 were to reject its lease, we do not forecast a value deficiency because of the collateral's prime location in Miami Beach's Lincoln Road retail corridor. We value the 40,847-square-foot retail property at $24.9 million based on a discounted cash flow analysis assuming it take three years to back-fill the space.

Loan-level details for all CMBS loans with Forever 21 as one of the tenants can be found in Excel format by clicking the download icon at the top of page one.

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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