CMBS Research

Morningstar Monthly Highlights

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Morningstar Credit Ratings

May 2019 Remittance

Contents

Executive Summary

- May's 4-basis-point drop in the delinquency rate to 1.53% set another postcrisis low and reflects a 3.7% decline in the balance of delinquent loans.
- The delinquency rate fell in 13 of the past 17 months and is down 62 basis points from a year ago. Given the ongoing liquidations of legacy loans and steady new origination volume, Morningstar Credit Ratings, LLC believes the delinquency rate will hold below 2.0% well into this year. Longer-term, we expect a gradual increase as postcrisis deals season.
- The Morningstar Watchlist rose to a 24-month high of $26.78 billion, up $1.73 billion from April, as a number of high-balance agency multifamily loans reported weak operating metrics.
- The special-servicing unpaid principal balance and special servicing rate fell to postcrisis lows of $16.09 billion and 1.86%, respectively, as precrisis loan liquidations continue at a swift clip and the volume of newly transferred loans fell to a three-month low.
- Our projected losses on specially serviced loans have improved over the past 12 months, falling $1.79 billion, or 14.2%, since May 2018.
- The payoff rate of maturing loans in CMBS ticked up to 90.4% from 89.0% in April, and we expect it to finish the year at roughly 80% to 85% based on our maturity analysis.

Table 1 – Significant Value Changes Among Large Loans

Deal ID	Asset Name	Loan Balance ($)	Value Change ($)	Loss Forecast ($)	Previous MORN LTV (%)	Current MORN LTV (%)
COMM 2015-LC21	155 Mercer Street	41,000,000	(48,400,000)	-	44.1	91.9
DBUBS 2011-LC2A	Malibu Colony Plaza	42,928,776	(27,054,000)	-	69.8	124.5
COMM 2015-LC21	University Fountains at Lubbock	27,400,000	(22,900,000)	7,030,397	75.1	201.5
COMM 2014-LC17	50 Crosby Drive	32,500,000	(22,680,000)	240,559	74.4	154.8
JPMBB 2015-C32	Gateway Business Park	52,836,391	(20,400,000)	-	70.4	96.6
JPMCC 2010-C2	The Shops at Sunset Place	63,509,652	(17,972,859)	2,164,338	89.9	120.5
DBJPM 2016-C1	Sheraton North Houston	38,809,800	(15,866,012)	11,101,781	105.8	186.6
COMM 2014-LC17	SRC Multifamily Portfolio 2	28,373,893	(7,929,000)	6,961,384	101.6	141.9
COMM 2015-LC21	Santa Monica Clock Tower	26,700,000	29,800,000	-	94.7	46.0
DBJPM 2016-C1, Unsecuritized	SLS South Beach	68,800,000	68,073,932	-	150.8	75.3

Source: Morningstar Credit Ratings, LLC

Significant Value Changes Among Watchlist and Specially Serviced Loans

In May, we raised our value on properties securing 47 loans with a combined balance of $924.5 million, while we lowered our values on properties securing 90 loans with a combined balance of $3.02 billion. Of these, 51 loans showed value declines that resulted in increased loss forecasts.

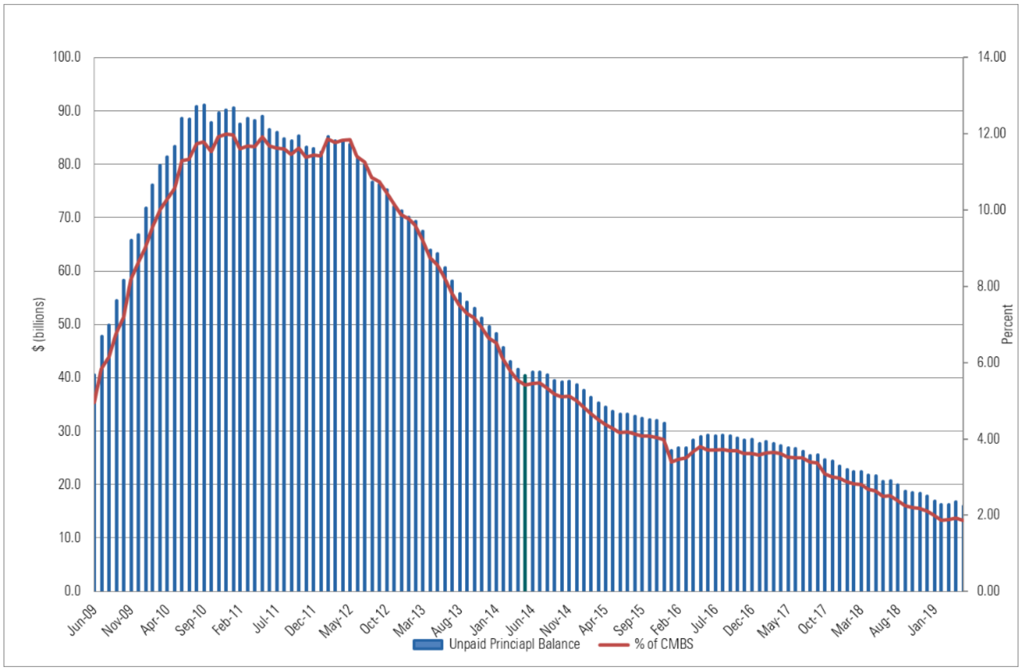
The largest value decline was on the $41.0 million 155 Mercer Street loan in COMM 2015-LC21. We lowered our value to $44.6 million after applying a more market-based capitalization rate of 6.7%, down 25 basis points to account for the property's SoHo location, to 2018's net cash flow. This compares with a 2016 sale of the property for $93.0 million, which implies a very aggressive 3.1% capitalization rate on 2016's net cash flow and is more than a 40% premium on the original appraised value of $65.0 million. The asset--a single-tenant, three-story, 14,589-square-foot Class A retail store in Manhattan's SoHo neighborhood--is stable, posting 2018 net cash flow that's in line with the year prior and with issuance. However, based on its 2018 net cash flow, the loan has a 7.0% debt yield and a loan-to-value ratio above 90%, which may hinder refinancing in 2025. Several other factors suggest the loan has elevated maturity risk. It is increasingly difficult to command the astronomical asking rents for ground-floor retail space in SoHo, and we have seen several tenants renegotiate their leases. Dolce & Gabbana's lease expires in 2022; the property owner's successful renewal of the sole tenant will determine the loan's fate. Further, we found that loans that don't amortize over their loan terms have a marked disadvantage over their interest-only counterparts because the lower debt yields hamper the borrowers' ability to overcome financing challenges. Nevertheless, with a 1.54x debt service coverage ratio and stable occupancy as of year-end 2018, a term default is unlikely.

Special-Servicing Exposure

After rising modestly for two consecutive months, the special-servicing UPB resumed its decline, hitting a postcrisis low of $16.09 billion in May, down $725.5 million from April, as troubled legacy loan liquidations continue apace. The special-servicing rate also hit a postcrisis low of 1.86%, down 6 basis points from April. While legacy CMBS now accounts for less than 2.5% of the CMBS universe, specially serviced loans from deals issued before 2010 represent more than 60% of all specially serviced loans by balance. Retail and office assets continue to represent the bulk of specially serviced loans, with a combined exposure of nearly 75% by balance.

Our projected losses on specially serviced loans fell to $10.79 billion from $11.50 billion in April, a decrease of $705.3 million, and has improved over the past 12 months, down $1.79 billion since May 2018.

Chart 1 – Special-Servicing Balance and Rate January 2008 – May 2019



Source: Morningstar Credit Ratings, LLC

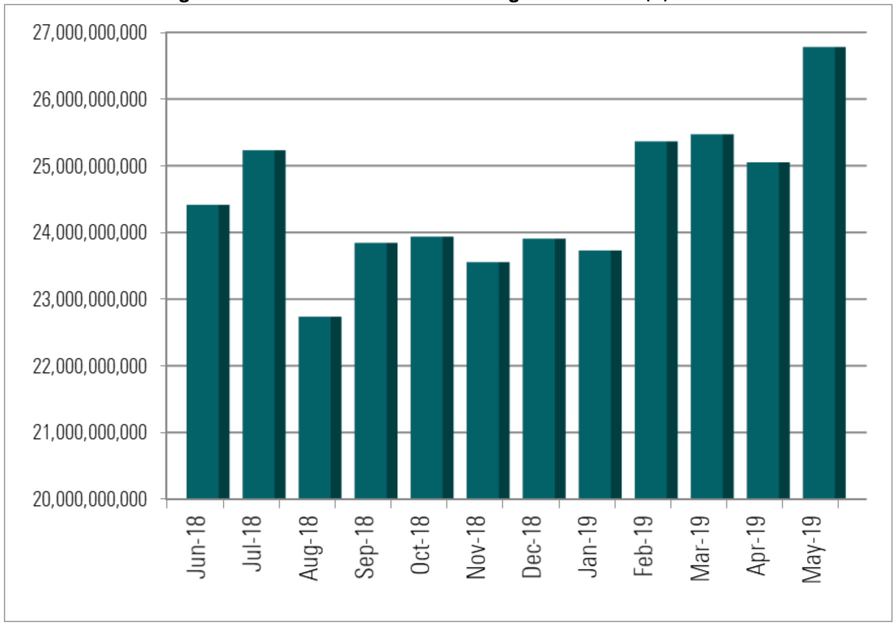
After rising for two straight months, the volume of special-servicing transfers tumbled to $276.1 million, down from $1.30 billion in April. The largest loan transferred this month was the $66.6 million Greenbrier Mall loan in LBUBS 2006-C6, ahead of its December 2019 maturity. The loan, which was modified in 2016, had its maturity date extended three years. In August 2018, Sears, which was not part of the collateral, closed. Further, the Chesapeake, Virginia, regional mall has exposure to both Macy's and JCPenney, which have both reduced their footprints in recent years. Mitigating the risk, the first floor of Macy's was converted into Macy's Backstage, which opened in August 2018, showing the tenant's commitment to the property. Although occupancy is strong at 97.0% at year-end 2018, we believe refinancing the asset has been difficult because of the lack of lender interest in traditional regional malls. Based on our income approach using a stressed 10.0% capitalization rate, we believe a $7.2 million loss is possible. According to *Commercial Real Estate Direct*, the sponsor values the property at $56.3 million, which implies an even greater loss. Based on the article, we believe the sponsor would be willing to hand over the keys if it’s unable to negotiate a workout.

Watchlist Exposure

The Morningstar Watchlist hit a 24-month high, rising to $26.78 billion from $25.05 billion in April. We added 141 loans with a total UPB of $2.84 billion to the Watchlist, up from $1.07 billion added in April. Morningstar also removed 58 loans from the Watchlist, seven which were transferred to special servicing, while four loans paid off.

The Watchlist increased significantly since reaching a postcrisis low of $17.34 billion in November 2017. The rise suggests that forward-looking risk is increasing, possibly signaling an inflection point for the delinquency rate. We believe that postcrisis deals will become more exposed to credit events, such as competition from new construction, vacating tenants, and general changes in market demand, as they season.

Chart 2 – Morningstar Watchlist Volume – Trailing 12 Months ($)



Source: Morningstar Credit Ratings, LLC

The largest loan we added this month was the $72.1 million Lofts at NoHo Commons loan, which may have trouble paying off before its maturity. The loan, which is 19.7% of FREMF 2018-KI02, is scheduled to pay off in December 2019. The 2018 net cash flow fell 6.6% from underwriting primarily because expenses shot up 31.9%. The property is buoyed by strong occupancy of 91.0% as of March and the submarket fundamentals are strong. Based on our $66.2 million value, we project a value deficiency of $5.9 million.

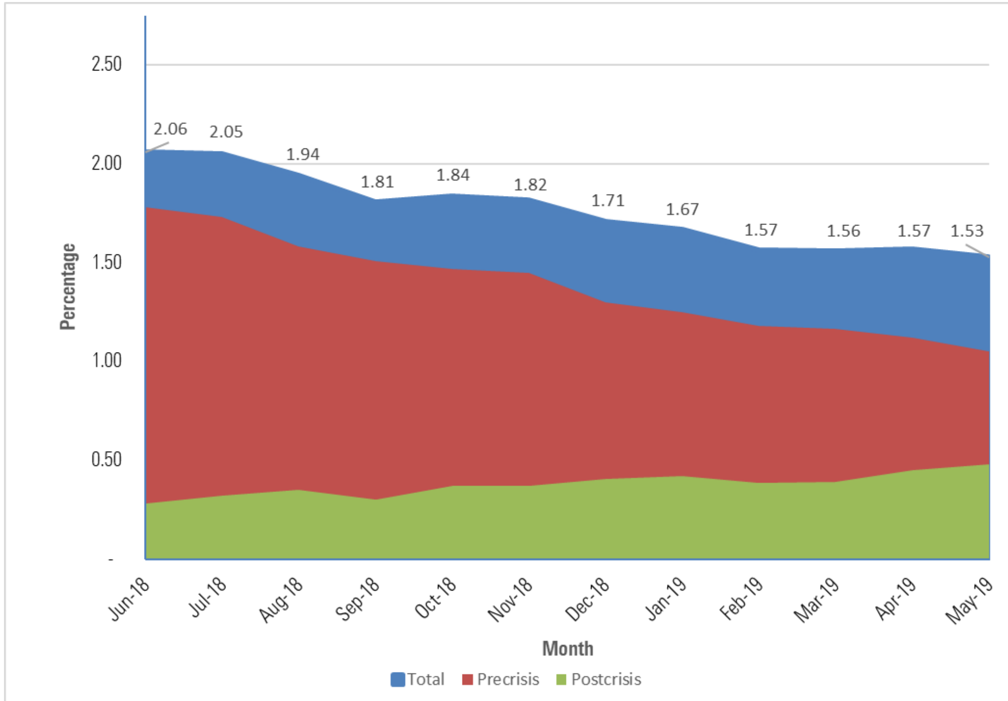
Separately, the $55.9 million Dulles View loan in JPMCC 2013-LC11 was the largest conduit loan we added to the Watchlist. Despite some recent lease signings, occupancy of the more than 350,000-square-foot Herndon, Virginia, office property stands about 71%, according to CoStar Group, Inc. The submarket's high vacancy rate of about 18% could force the borrower to lower asking rents to attract additional tenants. Our $70.0 million value suggests a 79.9% LTV.

Delinquency

After rising a modest 1 basis point in April, the CMBS delinquency rate resumed its descent, falling to another postcrisis low of 1.53% in May, down from 1.57% in April, because the decline in the balance of delinquent loans outpaced a modest drop in the size of CMBS universe. The balance of delinquent loans fell to $13.22 billion, which is down $4.47 billion, or 25.3%, from the year-earlier period. Delinquencies from deals issued from 2010 through 2019 remain a small portion of the total, representing just 0.48% of the CMBS universe, while delinquent precrisis loans account for 1.05%, suggesting that continued loan workouts and resolutions of precrisis loans will lower the overall delinquency rate.

However, the delinquency rate of postcrisis, or CMBS 2.0, loans has started to climb. In May 2018, only 0.29% of postcrisis loans were delinquent; by May 2019, the rate had risen to 0.48%. As legacy loans dwindle, their effect on falling delinquency rates will lessen, and postcrisis problem loans will take center stage. While we believe the rate could still fall as the remaining legacy loans are liquidated, we anticipate an inflection point will come in 2020, as a slowing economy and changing consumer trends could cause certain loans to falter.

Chart 3 – Monthly CMBS Delinquency by Percentage



Source: Morningstar Credit Ratings, LLC

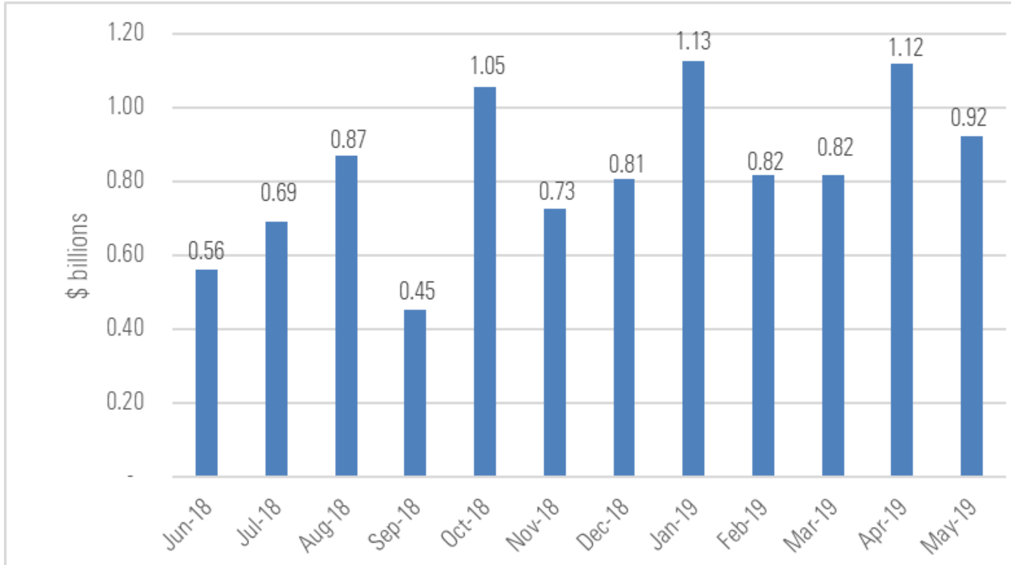
Table 2 – Trailing 12-Month Delinquency ($ UPB in billions)

Category	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19
30-Day	0.67	1.00	1.10	0.54	0.60	0.72	0.94	1.25	0.90	0.94	1.30	1.21
60-Day	0.26	0.30	0.37	0.23	0.31	0.26	0.39	0.38	0.42	0.51	0.30	0.53
90-Day	2.05	1.65	1.79	1.8	1.7	1.7	1.47	1.72	1.65	1.55	1.88	1.77
Foreclosure	4.24	3.89	3.67	3.43	3.15	2.86	2.62	2.42	1.93	1.87	1.81	1.72
Real Estate Owned	9.83	10.05	9.25	9.07	9.79	9.75	9.07	8.59	8.78	8.64	8.44	7.99
Total CMBS Del.	17.05	16.88	16.19	15.08	15.55	15.29	14.49	14.36	13.68	13.51	13.73	13.22
Current	809.30	807.17	818.93	818.27	828.40	825.05	834.09	836.63	855.53	854.09	860.62	849.85
Total CMBS	826.35	824.05	835.12	833.35	843.95	840.35	848.58	850.99	869.22	867.60	874.35	863.07
Delinquency %	2.06	2.05	1.94	1.81	1.84	1.82	1.71	1.69	1.57	1.56	1.57	1.53

Source: Morningstar Credit Ratings, LLC

After rising to more than $1 billion in April, the volume of newly delinquent loans eased in May, falling to $921.9 million, down $195.7 million from April, but remains above the 12-month moving average of $830.1 million. The $103.1 million Aegon Center loan in GCCFC 2004-GG1, was the largest newly delinquent loan. Occupancy at the collateral, a 35-story, multitenant, Class A, office tower comprising 633,650 square feet, plus a 504-space attached parking garage in the heart of the central business district of Louisville, Kentucky, has never recovered since falling to the low 70% range more than five years ago. The loan, which was transferred to special servicing for the second time in March 2019, was previously split into an $82.0 million A note and a $21.0 million B note. For the second modification, the maturity was extended to April 2019 and the payments were converted to interest-only. We project a loss of $21.1 million based on the B note.

Chart 4 – Newly Delinquent Loans



Source: Morningstar Credit Ratings, LLC

Compared with year-ago levels, the industrial sector, which represents just 2.6% of total delinquent loans, saw the largest percentage decline in delinquent balance, tumbling 57.2%, or $461.6 million, to $345.7 million because of several large loans that were liquidated or paid off. By percentage, the other four major property types exhibited the following activity year over year:

- Office delinquency declined by 35.6% to $3.72 billion from $5.78 billion one year ago, as liquidations far outpaced newly delinquent loans.
- Hotel loan delinquency fell 31.7% to $1.09 billion from $1.60 billion one year ago.
- Retail loan delinquency dropped 22.5% to $5.40 billion from $7.00 billion one year ago.
- Multifamily loan delinquency, which represents 13.8% of all delinquencies, rose by 37.1% to $1.82 billion from $1.33 billion one year ago because of a rise in small-balance agency loans.

Table 3 – May Delinquency by Property Type

Property Type	$ Current Balance	# of Loans	% of CMBS Universe	% of CMBS Delinq.	% of Property Type
Retail	5,398,730,373	371	0.63	40.85	4.30
Office	3,720,354,307	163	0.43	28.15	2.93
Multifamily	1,821,512,905	391	0.21	13.78	0.41
Hotel	1,092,045,015	77	0.13	8.26	1.39
Other	779,051,198	44	0.09	5.89	1.11
Industrial	345,654,104	25	0.04	2.62	1.62
Healthcare	59,630,000	3	0.01	0.45	2.82
Total	13,216,977,902	1,074	1.53	100.00	-

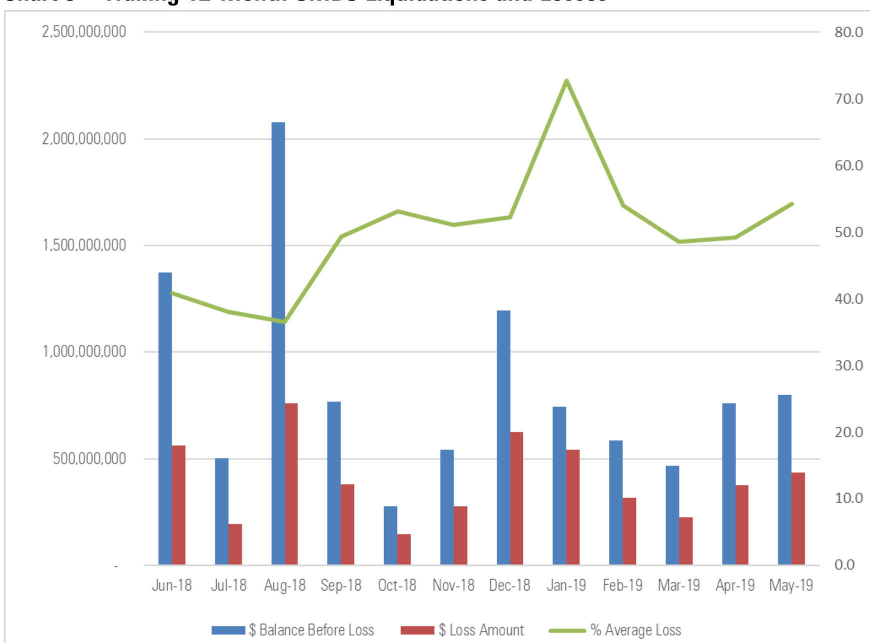
Note: Figures may not sum to totals because they are rounded.
Source: Morningstar Credit Ratings, LLC

CMBS Liquidations

The weighted average loss severity registered above 50% for the first time in three months, rising to 54.3% from 49.3% in April, and is above the 50.0% 12-month moving average. Liquidation volume also rose, hitting a five-month high. About $801.2 million in debt was written off, up from $759.3 million in April, as several precrisis office portfolios and mall loans were liquidated with substantial losses. The $127.5 million COPT Office Portfolio incurred the largest loss at $112.7 million. The more than 1 million square feet of office properties that backed the loan became real estate owned in 2013, as occupancy issues plagued the portfolio and the properties, primarily in Colorado and Maryland, were sold off.

The $80.0 million Bangor Mall REO asset incurred the second-largest loss at $71.5 million, posting a severity of 89.4%. Loan performance declined significantly after Macy's and Sears, which occupied 40% of the collateral's square footage combined, both departed, triggering cotenancy clauses of in-line tenants. Final liquidation proceeds came in at $12.4 million, considerably below the original appraised value of $128.0 million in 2007.

Chart 5 – Trailing 12-Month CMBS Liquidations and Losses

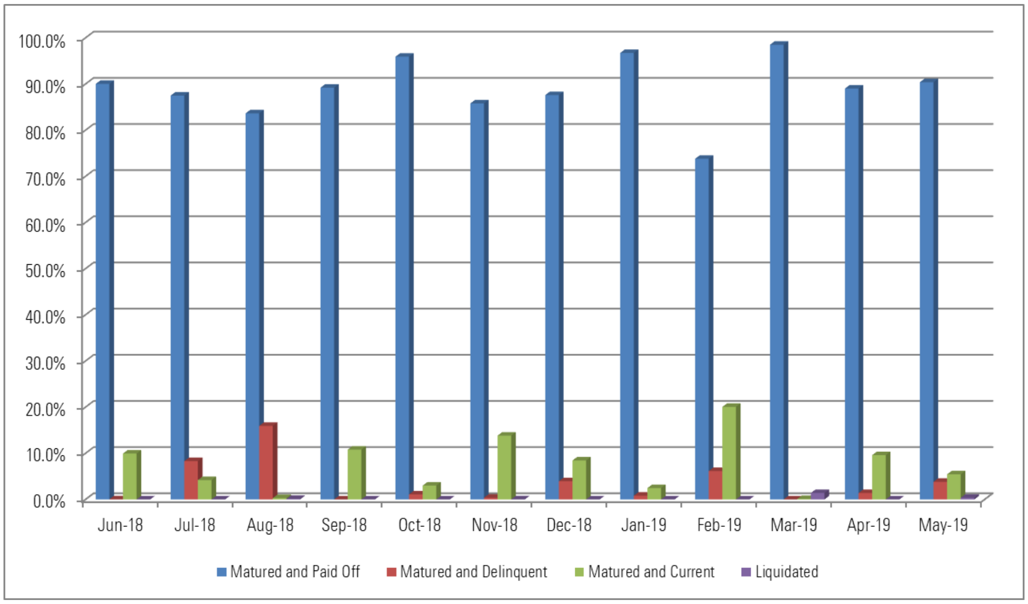


Source: Morningstar Credit Ratings, LLC

Monthly Maturity

The May payoff rate remained strong, rising to 90.4%, up modestly from 89.0% in April. The largest loan to miss its maturity payoff was the $31.7 million Employers Reinsurance Corp I loan in JPMCC 2004-PNC1. The loan was not able to pay off at maturity because the sole tenant vacated the Overland Park, Kansas, office property at its December 2018 lease expiration.

Chart 6 – 12-Month Performance Trend by Loan Status at Maturity

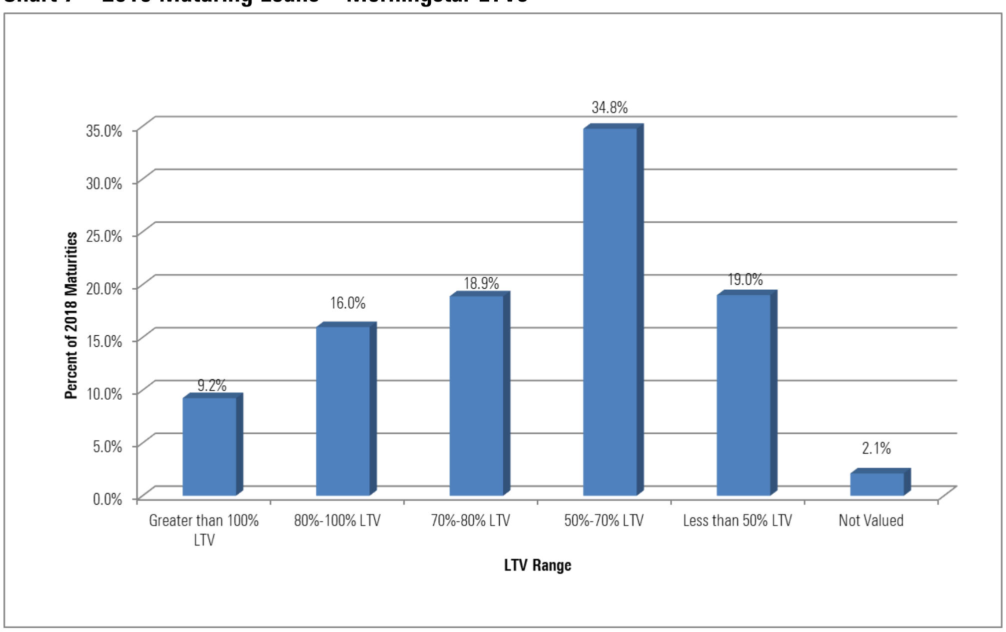


Source: Morningstar Credit Ratings, LLC

Maturity Outlook for 2019

We expect the maturity payoff rate to fall to about 80% to 85% for the year from 88.3% through the first five months of 2019 because a significant volume of loans maturing through year-end are overleveraged. Some $6.52 billion of CMBS loans will mature through December. We have valued approximately 97.9% of them, and 25.2% have LTVs greater than 80%. This information is displayed in Chart 7.

Chart 7 – 2019 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 debt service coverage ratio, 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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