CMBS Research

Morningstar Monthly Highlights

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Morningstar Credit Ratings

July 2019 Remittance

Contents

Executive Summary

- July's 3-basis-point drop in the delinquency rate to 1.48% set another postcrisis low and reflects a 1.7% decline in the balance of delinquent loans and a slight uptick in the balance of the CMBS universe.
- The delinquency rate fell in 15 of the past 19 months and is down 57 basis points from a year ago. With steady new issuance volume pushing the outstanding balance of commercial mortgage-backed securities loans higher and special servicers actively resolving or liquidating assets, Morningstar Credit Ratings, LLC believes the delinquency rate will hold below 2.0% well into 2020.
- The Morningstar Watchlist hit a 28-month high of $26.83 billion, up from $26.08 billion in June as a number of high-balance office loans reported lease rollover issues and declining net cash flow.
- The special-servicing unpaid principal balance, or UPB, and special servicing rate fell to postcrisis lows of $15.57 billion and 1.80%, respectively, as precrisis loan liquidations continue at a swift clip and the volume of newly transferred loans remained low.
- Our projected losses on specially serviced loans have improved over the past 12 months, falling $1. 71 billion, or 13.8%, since July 2018.
- The payoff rate of maturing loans in CMBS surged to 92.9% from 66.0% in June, 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 (%)
CD 2017-CD3, CD 2017-CD4, CGCMT 2017-P7	111 Livingston Street	120,000,000	(105,253,125)	1,188,400	41.6	105.5
DBUBS 2011-LC2A	Barneys Chicago	70,798,460	(68,034,000)	107,615	51.2	100.6
JPMBB 2015-C27	The Branson at Fifth	73,000,000	(56,580,000)	2,649,099	61.4	116.9
CGCMT 2015-GC29	Parkchester Commercial	62,307,246	(34,818,168)	-	63.1	97.5
DBUBS 2011-LC1A	Westgate I Corporate Center	38,093,110	(33,021,000)	3,778	53.7	100.5
FREMF 2017-KF27	The Domain At Oxford	39,375,000	(28,000,000)	5,790,000	74.4	158.1
WFCM 2015-NXS3	Northline Commons	65,000,000	(25,500,000)	-	66.2	89.4
JPMCC 2017-FL11	Park Hyatt Beaver Creek	67,500,000	(25,500,000)	-	68.1	91.7
WBCMT 2007-C31	Toll Brothers Corporate Headquarters	34,709,184	(12,060,000)	28,283,522	182.3	453.7
GCCFC 2006-GG7	Portals I	155,000,000	29,529,000	40,283,584	163.2	110.8

Source: Morningstar Credit Ratings, LLC

Significant Value Changes Among Watchlist and Specially Serviced Loans

In July, we raised our value on properties securing 33 loans with a combined balance of $560.6 million, while we lowered our values on properties securing 49 loans with a combined balance of $1.58 billion. Of these, 25 loans showed value declines that resulted in increased loss forecasts.

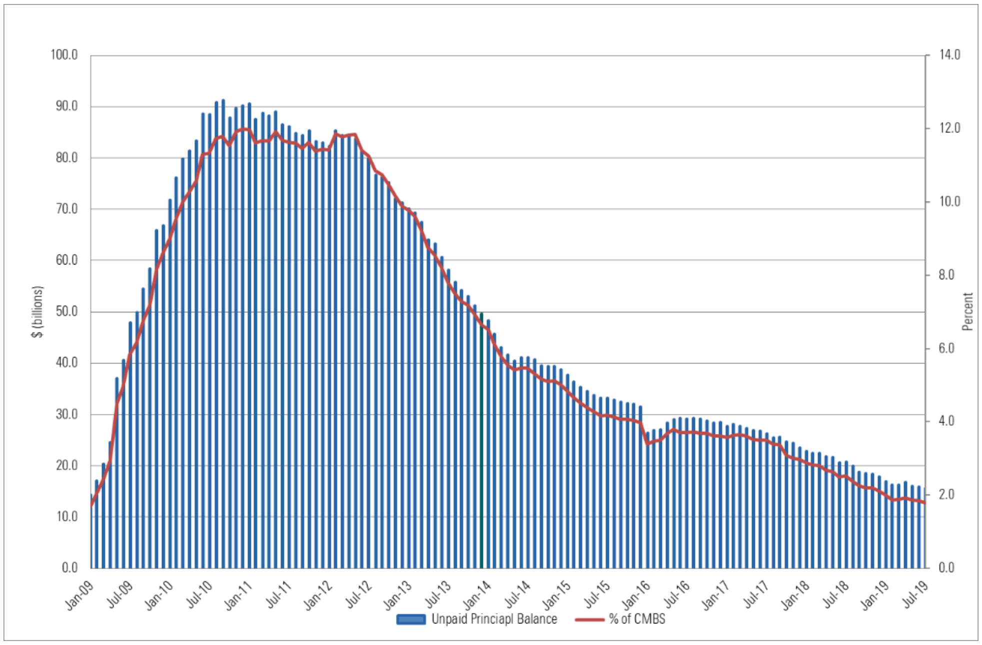
The largest value decline was on the $120.0 million Livingston Street loan split among CD 2017-CD3, CD2017-CD4, and CGCMT 2017-P7. We placed the loan on the Morningstar Watchlist and lowered our estimate of value to $113.7 million from $219.0 million because the largest tenant, New York State Office of Temporary and Disability Assistance with a lease expiration in 2020, did not renew its lease before the specified trigger date, according to servicer commentary. With the tenant's departure, we expect occupancy at the 22-story, Class A office building in Brooklyn, New York, to drop to 72.0% from 100.0% at year-end 2018. Our 10-year discounted cash flow analysis assumes the space is re-leased within two years. One positive factor is that the property's downtown Brooklyn submarket is an attractive alternative to the more expensive Manhattan submarket.

Special-Servicing Exposure

The special-servicing UPB fell for the third consecutive month, hitting a postcrisis low of $15.57 billion in July, down $356.6 million from June, as the volume of new transfers remained below $400 million for the third straight month and is below the 12-month moving average of $484.8 million. The special-servicing rate also hit a postcrisis low of 1.80%, down 4 basis points from June. While legacy CMBS now accounts for 2.2% 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 moved down to $10.70 billion from $11.21 billion in June, a decrease of $511.5 million, and has improved over the past 12 months, down $1.71 billion since July 2018.

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



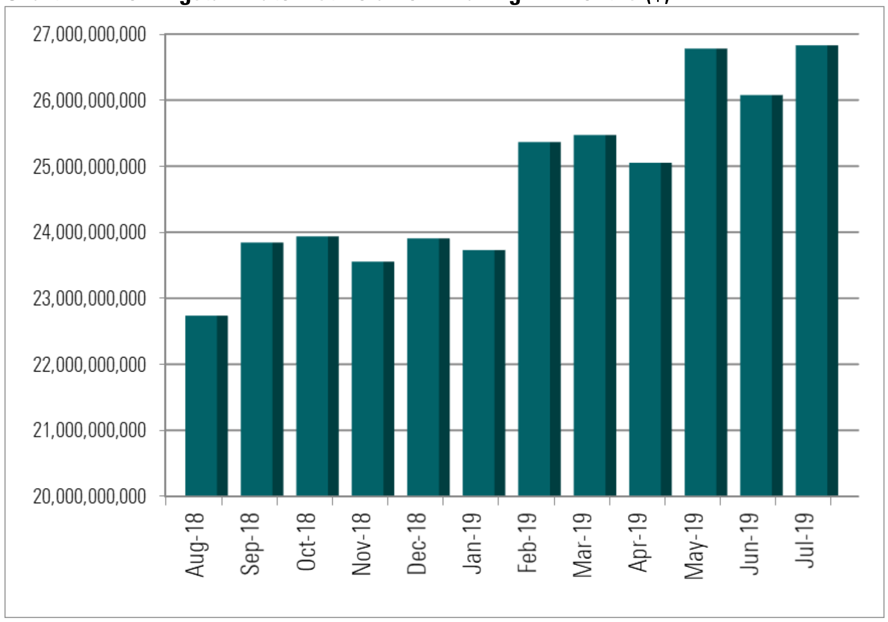
Source: Morningstar Credit Ratings, LLC

After falling to a 12-month low last month, the volume of special-servicing transfers ticked up to $367.2 million in July from $232.1 in June. The $79.6 million Park Plaza loan in WFRBS 2011-C3, was the largest loan transferred to special servicing in July. Sales have been stagnant at the Little Rock, Arkansas, regional mall, and we project that net cash flow, which was 25.0% below underwritten, will remain low through the loan's maturity date in 2021. Although occupancy has improved to the mid-90% range in March from a low of about 81% in 2017, the borrower attracted new tenants with below market rents. Because of this, the 2018 debt service coverage ratio tumbled to 1.03x from 1.44x at underwriting. Our $67.4 million value estimate suggests a $12.2 million loss.

Watchlist Exposure

The Morningstar Watchlist rose to a 28-month high of $26.83 billion, up from $26.08 billion in June. The Watchlist increased significantly since reaching a postcrisis low of $17.34 billion in November 2017. This progression is not a surprise to us, given the increase in conduit origination (the outstanding balance is up over 15% in the past four years) as well as the seasoning effect. We expect the Watchlist percentage to rise, over time, as deals season.

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



Source: Morningstar Credit Ratings, LLC

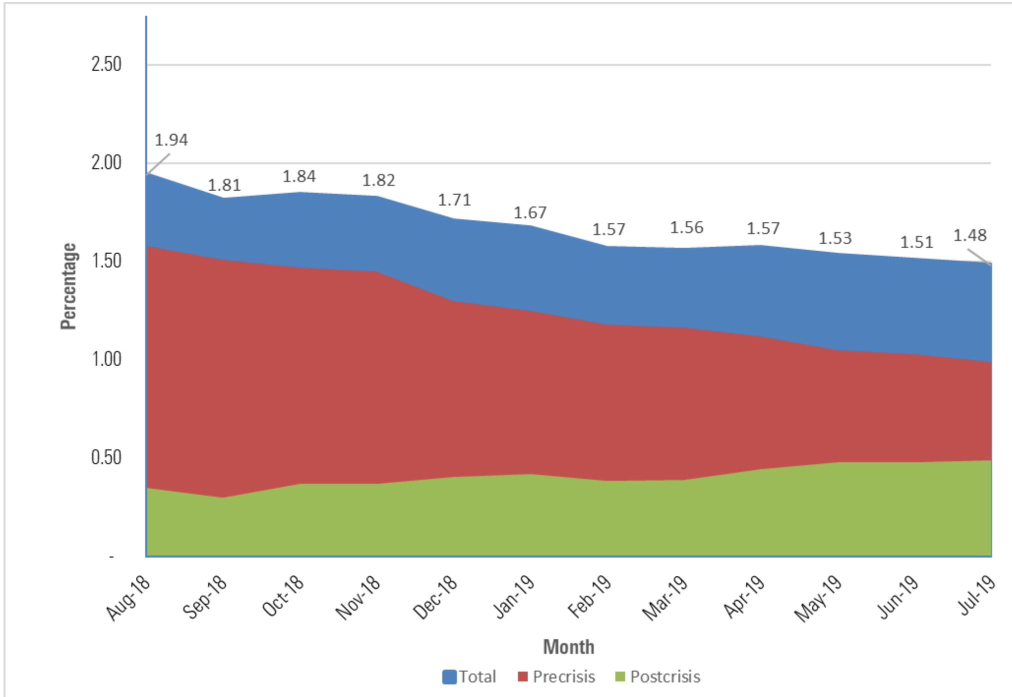
The largest loan we added this month was the $240.0 million 1500 Market Street loan, the sole asset backing the CGCMT 2017-1500 deal. The borrower failed to extend or pay off the loan by its initial July 2019 maturity date. Because of this, the loan, which has three extension options, was subsequently transferred to the special servicer. The collateral, three adjoining office buildings with a combined 1.8 million square feet in downtown Philadelphia, failed to meet the debt yield hurdle required to exercise the first extension option. The property did not meet that threshold partly because the second-largest tenant, Willis Towers Watson, indicated it will vacate the collateral when its lease expires in 2020. Our $299.1 million value estimate suggests an 80.2% LTV.

Delinquency

The CMBS delinquency rate fell to another postcrisis low in July, inching down to 1.48 from 1.51% in June, because the balance of delinquent loans declined 1.7% while the size of CMBS universe ticked up modestly. The balance of delinquent loans fell to $12.85 billion from $13.07 in June, and it's down $4.03 billion, or 23.9%, from the year-earlier period. Delinquencies from deals issued from 2010 through 2019 remain a small portion of the total, representing just 0.49% of the CMBS universe, while delinquent precrisis loans account for 0.99%, suggesting that continued loan workouts and resolutions of precrisis loans continue to keep a lid on 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 July 2019, the rate had risen to 0.49%. 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

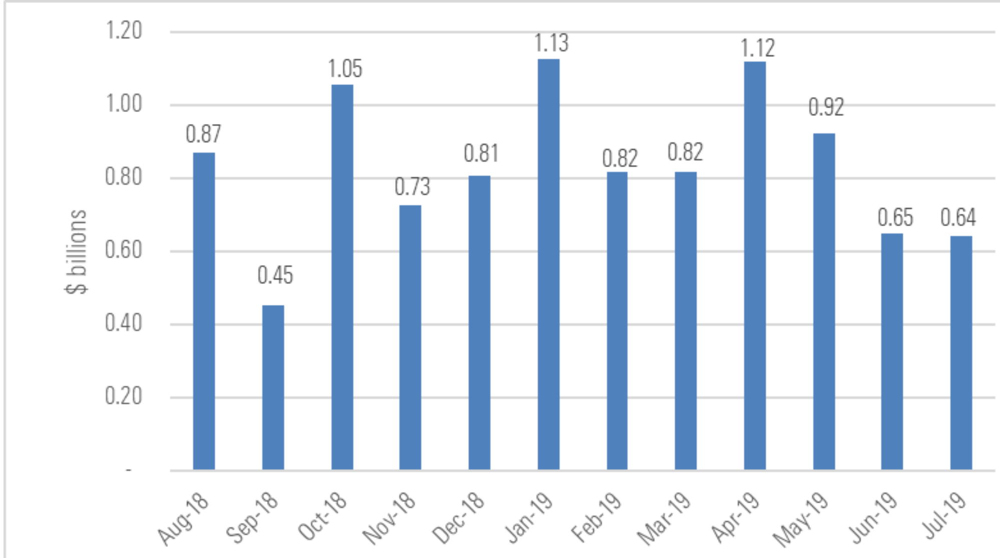
Table 2 – Trailing 12-Month Delinquency ($ UPB in billions)

Category	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19
30-Day	1.10	0.54	0.60	0.72	0.94	1.25	0.90	0.94	1.30	1.21	1.00	0.73
60-Day	0.37	0.23	0.31	0.26	0.39	0.38	0.42	0.51	0.30	0.53	0.60	0.64
90-Day	1.79	1.8	1.7	1.7	1.47	1.72	1.65	1.55	1.88	1.77	2.03	2.2
Foreclosure	3.67	3.43	3.15	2.86	2.62	2.42	1.93	1.87	1.81	1.72	1.49	1.43
Real Estate Owned	9.25	9.07	9.79	9.75	9.07	8.59	8.78	8.64	8.44	7.99	7.95	7.85
Total CMBS Del.	16.19	15.08	15.55	15.29	14.49	14.36	13.68	13.51	13.73	13.22	13.07	12.85
Current	818.93	818.27	828.40	825.05	834.09	836.63	855.53	854.09	860.62	849.85	850.93	852.49
Total CMBS	835.12	833.35	843.95	840.35	848.58	850.99	869.22	867.60	874.35	863.07	864.00	865.34
Delinquency %	1.94	1.81	1.84	1.82	1.71	1.69	1.57	1.56	1.57	1.53	1.51	1.48

Source: Morningstar Credit Ratings, LLC

After dipping below $700 million for the first time in seven months in June, the volume of newly delinquent loans ticked down to a 10-month low of $641.0 million, down $7.9 million from June, and registered below the 12-month moving average of $833.3 million. The $142.3 million Triangle Town Center loan with pieces in LBUBS 2006-C1 and LBUBS 2006-C7, was the largest newly delinquent loan. The collateral, 475,000 square feet of inline space at a 1.4-million-square-foot regional mall in Raleigh, North Carolina, was taken back by the trust after falling 30 days delinquent in July because of impending maturity default. The loan, which had an initial maturity date in 2015, was previously modified and extended to September 2019 because of declining net cash flow, which, for year-end 2018 was 43.2% lower underwriting. Our analysis suggests a $39.0 million loss.

Chart 4 – Newly Delinquent Loans



Source: Morningstar Credit Ratings, LLC

Compared with year-ago levels, the industrial sector, which represents just 2.5% of total delinquent loans, saw the largest percentage decline in delinquent balance, tumbling 57.1%, or $432.3 million, to $324.7 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 34.0% to $3.46 billion from $5.25 billion one year ago, as liquidations far outpaced newly delinquent loans.
- Hotel loan delinquency fell 28.1% to $1.10 billion from $1.52 billion one year ago.
- Retail loan delinquency dropped 17.6% to $5.43 billion from $6.58 billion one year ago.
- Multifamily loan delinquency, which represents 13.8% of all delinquencies, rose by 24.7% to $1.77 billion from $1.42 billion one year ago because of a rise in delinquent small-balance agency loans.

Table 3 – July Delinquency by Property Type

Property Type	$ Current Balance	# of Loans	% of CMBS Universe	% of CMBS Delinq.	% of Property Type
Retail	5,425,048,163	369	0.63	42.22	4.37
Office	3,464,789,885	154	0.40	26.96	2.71
Multifamily	1,771,922,431	422	0.20	13.79	0.40
Hotel	1,095,954,180	79	0.13	8.53	1.38
Other	688,945,334	37	0.08	5.36	0.97
Industrial	324,670,720	24	0.04	2.53	1.36
Healthcare	78,338,317	5	0.01	0.61	3.68
Total	12,849,669,030	1,090	1.48	100.00	-

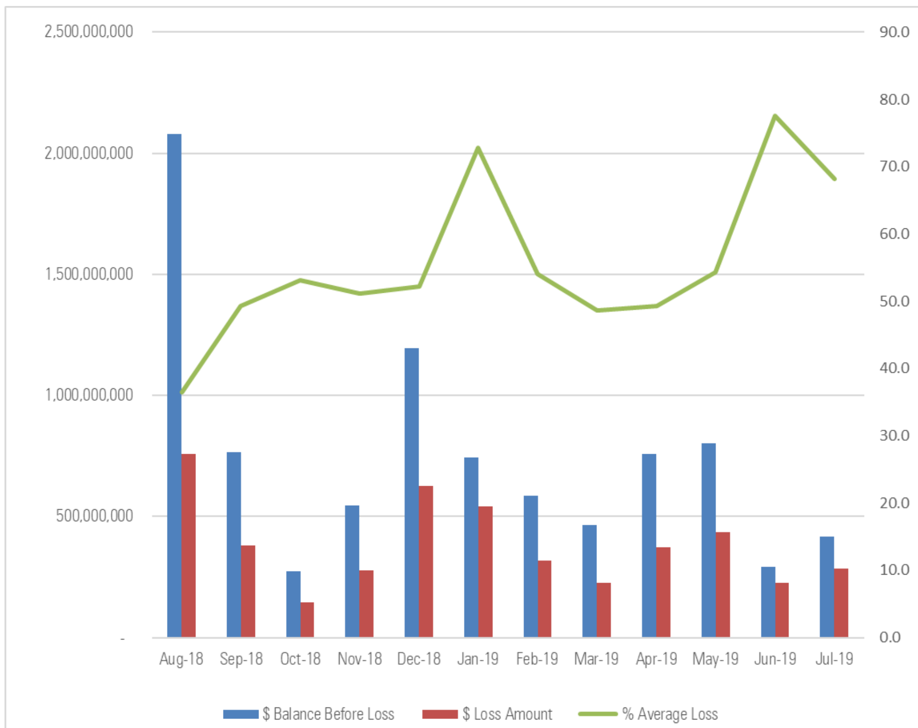
Note: Figures may not sum to totals because they are rounded.
Source: Morningstar Credit Ratings, LLC

CMBS Liquidations

After rising last month to the highest level since we began tracking this data in 2005, July's weighted average loss severity remained elevated because of legacy mall and office liquidations. Twenty-five loans with a combined balance of $417.8 million were disposed with a weighted-average loss severity of 68.2%, down from $292.4 million disposed at a 77.6% severity in June. The largest write-off came from the $89.4 million Boulevard Mall loan in GCCFC 2007-GG9. Performance began spiraling down beginning in 2017 after the suburban Buffalo mall lost Macy's and Sears. The liquidation resulted in a $65.4 million loss for a 73.1% loss severity.

Losses continue to run ahead of last year. Through the first seven months of 2019, approximately $4.07 billion across 216 CMBS loans were disposed with a cumulative loss of $2.41 billion, generating a weighted-average loss severity of 59.2%. This is up from an average loss reading of 43.7% for the first seven months of 2018.

Chart 5 – Trailing 12-Month CMBS Liquidations and Losses

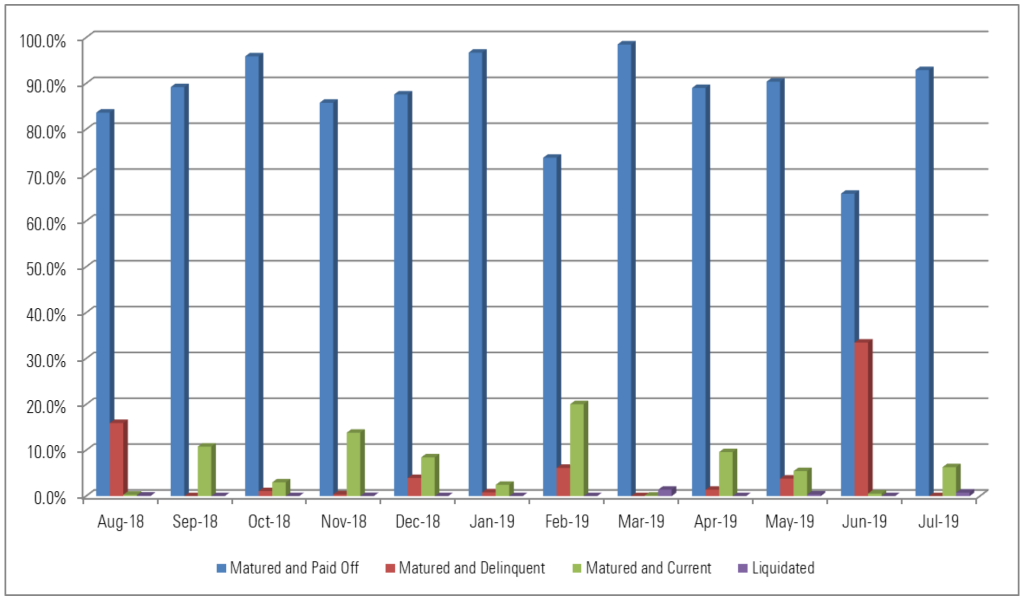


Source: Morningstar Credit Ratings, LLC

Monthly Maturity

After sinking to the lowest level over the past 16 months in June, the July payoff rate surged to 92.9% from 66.0% in June. The payoff rate would have been even higher if not for delays surrounding the $18.4 million SRC Multifamily Pool 1 and the $11.0 million Viceroy Palm Springs loans, both of which paid off before publication of this report.

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

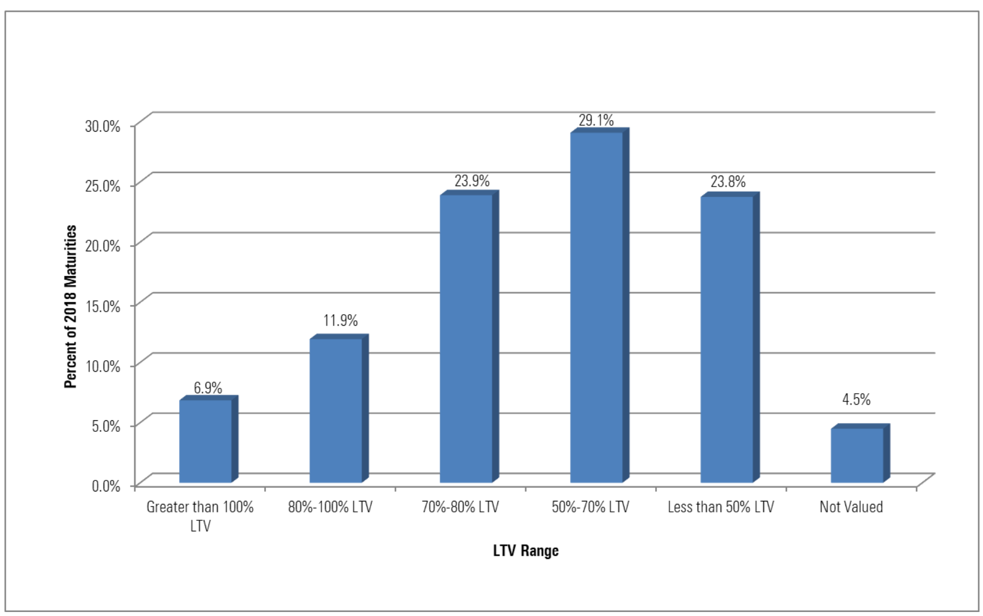


Source: Morningstar Credit Ratings, LLC

Maturity Outlook for 2019

Some $3.96 billion of CMBS loans will mature through December. We have valued approximately 95.5% of them, and 18.8% have LTVs greater than 80%. Consequently, we expect the maturity payoff rate for 2019 will come in at about 80% to 85%, little changed from 82.3% through the first seven months of the year. 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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