

CMBS Alert

Rising Losses Could Sink Pier 1 and Lift Risk on \$960.5 Million in CMBS

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Morningstar Perspective

Following a series of store closures and a report of lower earnings in September for the second fiscal quarter ended Aug. 31, 2019, Pier 1 Imports, Inc. recently named a bankruptcy veteran to serve as its new chief executive. This may foreshadow a more significant decline in the struggling retailer's bricks-and-mortar presence. Consequently, Morningstar Credit Ratings, LLC (DBRS Morningstar) believes there is elevated risk for the 65 properties backing commercial mortgage-backed securities loans, totaling \$960.5 million in allocated property balance, that have exposure to the home goods retailer.

So far this year, Pier 1 has reportedly closed 70 locations out of the 951 it operates, and a trend we believe could continue. The company's same store sales for the second fiscal quarter of 2020 dropped 12.6% from the same period the year before. Annual net sales, which have fallen every year since 2017, dipped 13.7% from the prior year for fiscal-year 2019, and Pier 1 reported a net loss for fiscal 2019 and the first half of its 2020 fiscal year.

On the retailer's Sept. 25, 2019, second-quarter earnings call, Cheryl Bachelder, Interim Chief Executive Officer, said Pier 1 is prepared to close more than 140 locations if can't negotiate lower rents. While it remains to be seen if the Houston-based retailer can avoid filing for bankruptcy protection—it had about \$295.0 million in outstanding debt against just \$10.0 million in cash and investments and \$328.6 million in inventory as of Aug. 31—we believe the downsizing may pose a risk to stores with upcoming lease expirations. We identified 34 properties in CMBS loans, totaling \$585.0 million in allocated property balance, where Pier 1's lease will expire over the next 36 months, and its departure would likely affect 10 of the properties, totaling \$151.0 million (Table 1).

Table 1 – Potential Closures at Elevated Risk

| Deal ID | Property Name | Location | Allocated Property Balance (\$) | Debt Service Coverage Ratio (x) | % of Gross Leasable Area | Occupancy (%) | Lease Expiration Date | Maturity Date |
|----------------|------------------------------------|-----------------|---------------------------------|---------------------------------|--------------------------|---------------|-----------------------|---------------|
| GSMS 2013-GC12 | Bradley Fair Shopping Center | Wichita, KS | 37,248,440 | 1.66 | 3.3 | 75.0 | 6/30/2020 | 4/6/2023 |
| JPMCC 2016-JP4 | Everett Plaza | Everett, WA | 25,731,250 | 1.10 | 8.1 | 83.0 | 1/31/2021 | 11/6/2026 |
| MSBAM 2013-C7 | Riverside Market | New Orleans | 19,620,768 | 1.57 | 5.9 | 75.0 | 2/29/2020 | 1/1/2023 |
| BMARK 2018-B4 | Kona Coast | Kailua-Kona, HI | 19,050,000 | 1.28 | 14.7 | 90.0 | 6/30/2022 | 6/6/2028 |
| UBSBB 2013-C5 | Chatham Retail | New York City | 18,000,000 | 1.68 | 51.3 | 100.0 | 9/30/2022 | 1/6/2023 |
| MSBAM 2013-C13 | Pacific Town Center | Stockton, CA | 12,449,465 | 1.22 | 7.6 | 63.0 | 8/31/2020 | 11/1/2023 |
| COMM 2014-UBS2 | Turnpike Square | Milford, CT | 9,558,454 | 1.11 | 12.4 | 99.0 | 2/28/2022 | 2/6/2024 |
| COMM 2014-UBS6 | Kerrville Junction Shopping Center | Kerrville, TX | 5,007,063 | 1.58 | 21.3 | 95.0 | 5/31/2021 | 11/1/2024 |
| CSAIL 2015-C1 | Packwood | Visalia, CA | 2,490,526 | 1.60 | 72.5 | 100.0 | 10/31/2019 | 12/6/2024 |
| MSC 2004-T15 | Del Monte Plaza | Reno, NV | 1,663,735 | 1.96 | 28.8 | 95.0 | 8/31/2020 | 3/1/2024 |

Source: DBRS Morningstar

Largest Loans of Concern

The largest loan of concern is the \$37.3 million Bradley Fair Shopping Center loan, 3.9% of GSMS 2013-GC12. Pier 1 accounts for 3.3% of the nearly 280,000-square-foot outdoor lifestyle center in Wichita, Kansas, under a lease that expires in June 2020. Its departure could further strain net cash flow, which is down 9.9% from underwriting because of the closure of Bed Bath & Beyond and Fresh Market, which will continue to pay rent through its June 2022 lease expiration. The loan, which is current, posted a debt service coverage ratio of 1.66x for the first six months of 2019, down from 2.02x at underwriting on 75.0% occupancy. With loan's April 2023 maturity date still more than three years away, the borrower would have time to secure a new tenants. Further, with limited availability of 4.1% thanks to the amount of square footage that delivered after the recession decreasing by more than 70% compared to the last prerecession cycle, we believe the probability of loss is low.

Cash flow may not be able to absorb the potential loss of Pier 1 at Everett Plaza, which secures a \$25.7 million loan in MSBAM 2013-C10 if the tenant departs when its lease expires in just over two years. The 123,913-square-foot property about 30 miles north of Seattle in Everett, Washington, generated a 1.10x DSCR for the first six months of 2019. Pier 1 occupies 8.1% of the space and contributes roughly 11.3% of underwritten base rent. There is also some concern around the two largest tenants, Michael's Stores, Inc. and PetCo, are struggling under increasing competition from mass merchants, online retailers, and warehouse clubs.

Separately, the six-month DSCR for the \$30.1 million Summerhill Square loan in MSBAM 2013-C10 fell to 0.60x from 1.40x at underwriting after the largest tenant, Toys 'R' Us, vacated. Despite the risk of Pier 1, which occupies 6.8% of the space, vacating when its lease expires in February 2022, the borrower has since backfilled the East Burnswick, New Jersey, property with an indoor playground called Rock N Air.

Problems Ahead

News of troubles at Pier 1 comes amid broad and intense competition from discount stores and off price home good retailers, such as TJMax and HomeGoods, mass merchants, and online sites like Wayfair, Amazon, and Etsy, all of which have reshaped the economics behind the home accessories retail category, making a turnaround more challenging.

DealView® clients, 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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