# CMBS Research

## Morningstar Monthly Highlights

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**Morningstar Credit Ratings**

August 2019 Remittance

**Contents**



### Executive Summary

- August's 8-basis-point drop in the delinquency rate to 1.40% set another postcrisis low thanks to the rising volume of outstanding loans in the CMBS universe and the dwindling volume of troubled precrisis loans.
- The delinquency rate fell in 16 of the past 20 months and is down 54 basis points from a year ago. Morningstar Credit Ratings, LLC believes the delinquency rate will hold below 2.0% well into 2020. Longer-term, we expect a gradual increase as postcrisis deals season.
- The Morningstar Watchlist hit a 29-month high of $27.14 billion, up from $26.83 billion in July as a number of Freddie Mac multifamily loans reported occupancy issues and declining net cash flow.
- The special-servicing unpaid principal balance and special-servicing rate fell to postcrisis lows of $15.55 billion and 1.74%, respectively, thanks in large part to the continued resolution of legacy loans.
- Our projected losses on specially serviced loans have improved over the past 12 months, falling $1.00 billion, or 8.5%, since August 2018.
- The payoff rate of maturing loans in CMBS pulled back to 83.8% in August from 92.9% in July, 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 (%) |
|---|---|---|---|---|---|---|
| BSCMS 2007-PW16 | Shops at Northern Boulevard | 31,132,454 | (35,600,000) | 9,068,278 | 56.2 | 124.5 |
| UBSBB 2013-C5 | Harborplace | 66,216,492 | (27,100,000) | 22,320,565 | 93.2 | 143.3 |
| BSCMS 2006-PW11 | Hickory Point Mall | 27,446,366 | (18,200,000) | 13,659,983 | 85.8 | 198.9 |
| COMM 2012-LC4 | Susquehanna Valley Mall | 25,056,107 | (17,610,000) | 20,168,735 | 111.2 | 477.3 |
| GSMS 2014-GC18 | Wyoming Valley Mall | 72,903,357 | (14,600,000) | 42,060,044 | 160.2 | 235.2 |
| MSC 2016-UB11 | Nameoki Commons | 15,494,845 | (9,919,904) | 8,825,246 | 93.5 | 223.6 |
| WFCM 2015-C26 | 44 Plaza | 26,430,000 | (7,300,000) | 579,908 | 90.8 | 121.2 |
| COMM 2013-CR12 | Exchange Center | 16,163,376 | (6,161,485) | - | 67.8 | 91.5 |
| JPMBB 2015-C29 | Aspen Heights - Texas A&M University Corpus Christi | 26,000,000 | (5,854,147) | 4,199,067 | 121.9 | 168.0 |
| WBCMT 2007-C30 | Silver Oak - Medical Office Building | 15,061,994 | (5,275,044) | 9,662,535 | 141.1 | 278.9 |

Source: Morningstar Credit Ratings, LLC

**Significant Value Changes Among Watchlist and Specially Serviced Loans**

In August, we raised our value on properties securing 28 loans with a combined balance of $499.5 million, while we lowered our values on properties securing 37 loans with a combined balance of $1.44 billion. Of these, 18 loans showed value declines that resulted in increased loss forecasts.

The largest value decline was on the $31.1 million Shops at Northern Boulevard loan in BSCMS 2007-PW16. The collateral, the leasehold interest in a 218,059-square-foot grocery-anchored retail property in Long Island City, New York, became real estate owned in June. The borrower was unable to refinance the loan ahead of its 2017 maturity because of a ground rent reset in 2022. Net cash flow also took a hit because of escalating real estate taxes. The property was reappraised for $27.8 million in August 2018, down from $53.4 million at underwriting. We project a loss of roughly $9.2 million.

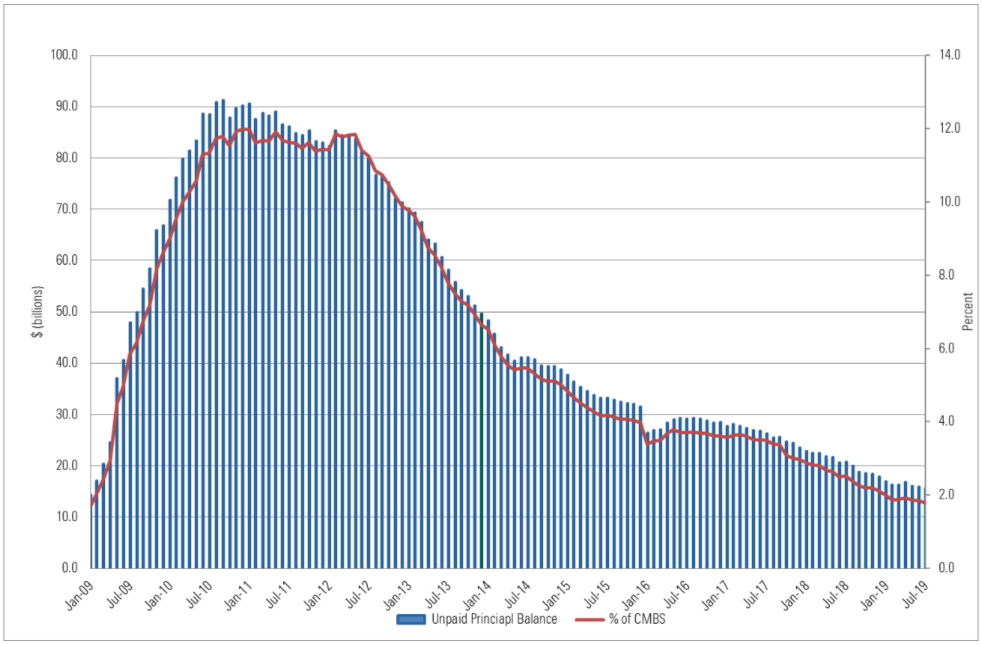
Separately, the $66.2 million Harborplace loan in UBSBB 2013-C5 had the largest value decline among postcrisis loans. According to CoStar Group, Inc. roughly half of the space at the pair of two-story retail pavilions in the Inner Harbor section of Baltimore is available for lease. The loan was transferred to the special servicer in February 2019 because of low occupancy and net cash flow. The 2018 net cash flow was about 65% below underwriting, pushing the debt service coverage ratio below break-even. Our $46.3 million value suggests a loss of $22.3 million.

**Special-Servicing Exposure**

The special-servicing UPB edged lower for the fourth-consecutive month, hitting a postcrisis low of $15.55 billion in August, down $17.7 million from July. The improvement was largely attributed to distressed legacy loans getting resolved. Because the overall CMBS universe grew, the special-servicing rate also hit a postcrisis low of 1.74%, down 6 basis points from July. While legacy CMBS now accounts for 2.3% of the CMBS universe, specially serviced loans from deals issued before 2010 represent more than 55% 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.

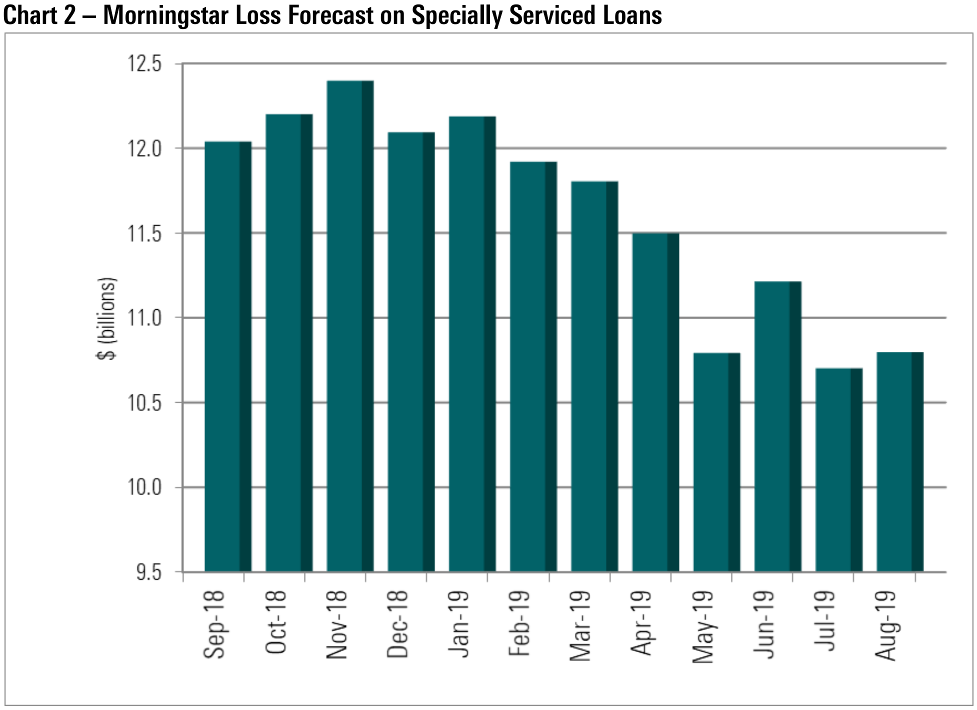
Our projected losses on specially serviced loans ticked up to $10.80 billion from $10.70 billion in July, an increase of $95.0 million, but has improved over the past 12 months, down $1.00 billion since August 2018.

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




Source: Morningstar Credit Ratings, LLC

**Chart 2 – Morningstar Loss Forecast on Specially Serviced Loans**



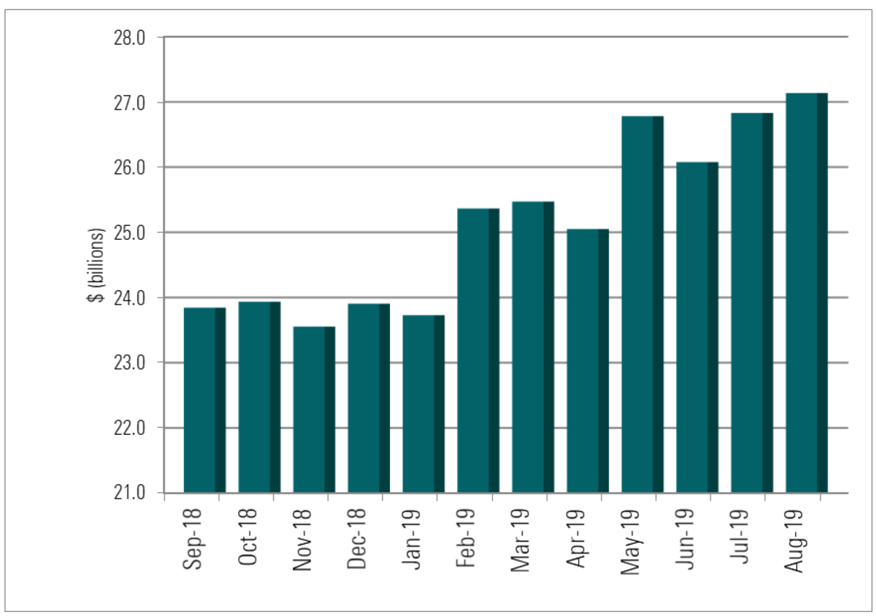

Source: Morningstar Credit Ratings, LLC

After falling to a 12-month low in June, the volume of special-servicing transfers rose for the second consecutive month, growing to $797.9 in August from $367.2 million in July. The $240.0 million 1500 Market Street loan, the sole asset backing the CGCMT 2017-1500 deal, was the largest loan transferred to special servicing in August. 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 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.

**Watchlist Exposure**

The Morningstar Watchlist rose to a 29-month high of $27.14 billion, up from $26.83 billion in July. 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 3 – Morningstar Watchlist Volume – Trailing 12 Months ($)**




Source: Morningstar Credit Ratings, LLC

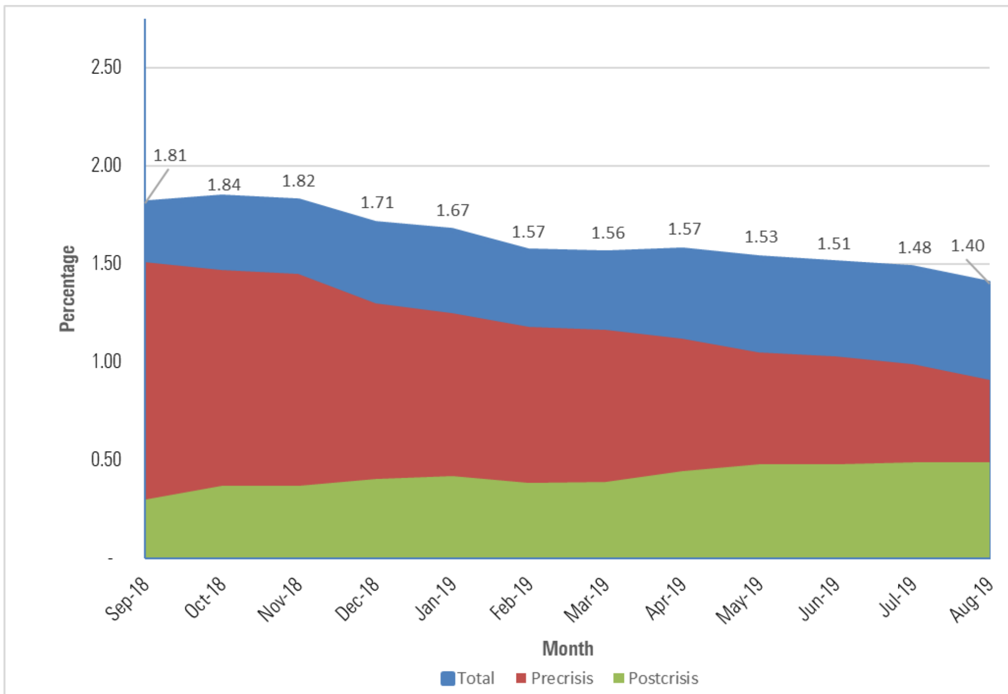
The largest loan we added this month was the $268.7 million 20 Exchange Place loan in FREMF 2017-KL1E. Net cash flow in 2018 at the 767-unit multifamily high-rise building with 87,707 square feet of commercial space in the Financial District of Manhattan declined 15.9% below underwriting because of a spike in real estate taxes and operating expenses. Although the property is well located, one block from Wall Street, we forecast a value deficiency of around $1.3 million based on our $267.4 million value.

### Delinquency

The CMBS delinquency rate posted another postcrisis low in August, falling to 1.40% from 1.48% in July, because the balance of delinquent loans declined 2.6% while the size of CMBS universe rose 3.1%. The balance of delinquent loans fell to $12.52 billion from $12.85 billion in July, and it's down $3.67 billion, or 22.7%, 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.

Since peaking at 8.5% in May 2012, the delinquency rate has steadily declined; however, we believe the rate will reach an inflection point in 2020. The burning off of legacy loans has been a significant factor in the steady decline in recent years. However, its impact will eventually wane, with the legacy balance representing less than 3% of the universe today and declining rapidly.

**Chart 4 – Monthly CMBS Delinquency by Percentage**




Source: Morningstar Credit Ratings, LLC

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

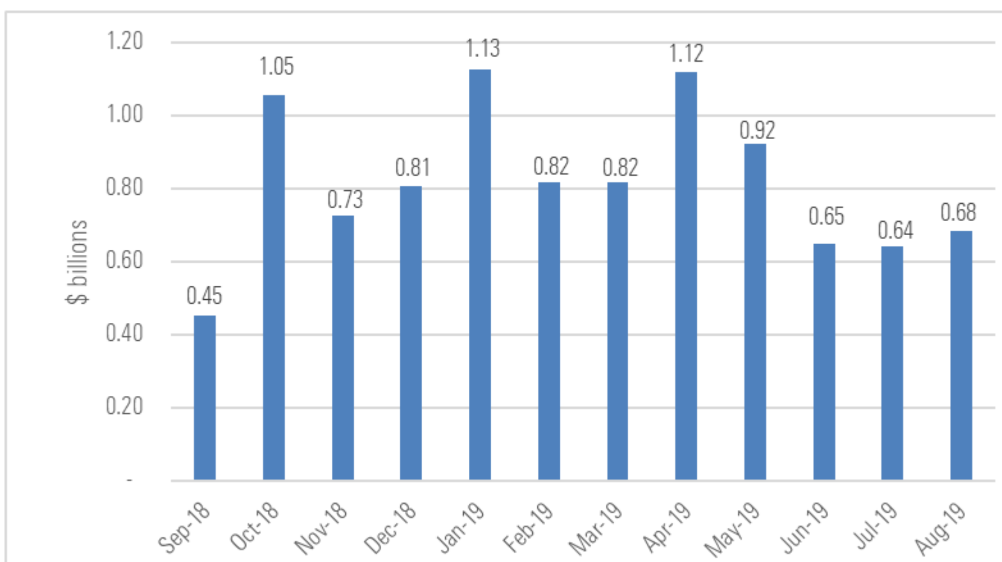
| Category | Sep-18 | Oct-18 | Nov-18 | Dec-18 | Jan-19 | Feb-19 | Mar-19 | Apr-19 | May-19 | Jun-19 | Jul-19 | Aug-19 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 30-Day | 0.54 | 0.60 | 0.72 | 0.94 | 1.25 | 0.90 | 0.94 | 1.30 | 1.21 | 1.00 | 0.73 | 0.90 |
| 60-Day | 0.23 | 0.31 | 0.26 | 0.39 | 0.38 | 0.42 | 0.51 | 0.30 | 0.53 | 0.60 | 0.64 | 0.52 |
| 90-Day | 1.8 | 1.7 | 1.7 | 1.47 | 1.72 | 1.65 | 1.55 | 1.88 | 1.77 | 2.03 | 2.2 | 2.08 |
| Foreclosure | 3.43 | 3.15 | 2.86 | 2.62 | 2.42 | 1.93 | 1.87 | 1.81 | 1.72 | 1.49 | 1.43 | 1.55 |
| Real Estate Owned | 9.07 | 9.79 | 9.75 | 9.07 | 8.59 | 8.78 | 8.64 | 8.44 | 7.99 | 7.95 | 7.85 | 7.47 |
| Total CMBS Del. | 15.08 | 15.55 | 15.29 | 14.49 | 14.36 | 13.68 | 13.51 | 13.73 | 13.22 | 13.07 | 12.85 | 12.52 |
| Current | 818.27 | 828.40 | 825.05 | 834.09 | 836.63 | 855.53 | 854.09 | 860.62 | 849.85 | 850.93 | 852.49 | 879.77 |
| Total CMBS | 833.35 | 843.95 | 840.35 | 848.58 | 850.99 | 869.22 | 867.60 | 874.35 | 863.07 | 864.00 | 865.34 | 892.29 |
| Delinquency % | 1.81 | 1.84 | 1.82 | 1.71 | 1.69 | 1.57 | 1.56 | 1.57 | 1.53 | 1.51 | 1.48 | 1.40 |

Source: Morningstar Credit Ratings, LLC

The volume of newly delinquent loans remained below $700 million for the third straight month, inching up to $682.9 million, an increase of $41.9 million from July, registered below the 12-month moving average of $817.8 million.

The $28.9 million specially serviced Countrywood Crossing loan in COMM 2013-LC13 was the largest newly delinquent loan that remains delinquent as of the date of this report. The collateral, a 233,981-square-foot community center outside of Memphis, Tennessee, lost its largest tenant, Gordmans, in 2017, reducing occupancy to 68.0% from 94.0% at underwriting. Both Dick's Sporting Goods and Ross Dress for Less (representing about 35% of the leasable space combined) extended their leases to 2023. Although we believe it will take time to back-fill the space, we don't forecast a loss. However, the loan could struggle to refinance in 2023 if the space is not back-filled.

**Chart 5 – 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 56.2%, or $402.6 million, to $314.2 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 28.3% to $3.50 billion from $4.88 billion one year ago, as liquidations far outpaced newly delinquent loans.
- Hotel loan delinquency fell 28.9% to $1.08 billion from $1.51 billion one year ago.
- Retail loan delinquency dropped 22.9% to $5.11 billion from $6.64 billion one year ago.
- Multifamily loan delinquency, which represents 14.0% of all delinquencies, rose by 38.9% to $1.75 billion from $1.26 billion one year ago because of a rise in delinquent small-balance agency loans.

**Table 3 – August Delinquency by Property Type**

| Property Type | $ Current Balance | # of Loans | % of CMBS Universe | % of CMBS Delinq. | % of Property Type |
|---|---|---|---|---|---|
| Retail | 5,113,002,069 | 358 | 0.57 | 40.84 | 4.08 |
| Office | 3,497,556,702 | 152 | 0.39 | 27.94 | 2.66 |
| Multifamily | 1,753,203,556 | 372 | 0.20 | 14.00 | 0.38 |
| Hotel | 1,075,038,646 | 77 | 0.12 | 8.59 | 1.33 |
| Other | 687,185,821 | 37 | 0.08 | 5.49 | 0.92 |
| Industrial | 314,156,636 | 23 | 0.04 | 2.51 | 1.29 |
| Healthcare | 78,301,452 | 5 | 0.01 | 0.63 | 3.39 |
| Total | 12,518,444,882 | 1,024 | 1.40 | 100.00 | - |

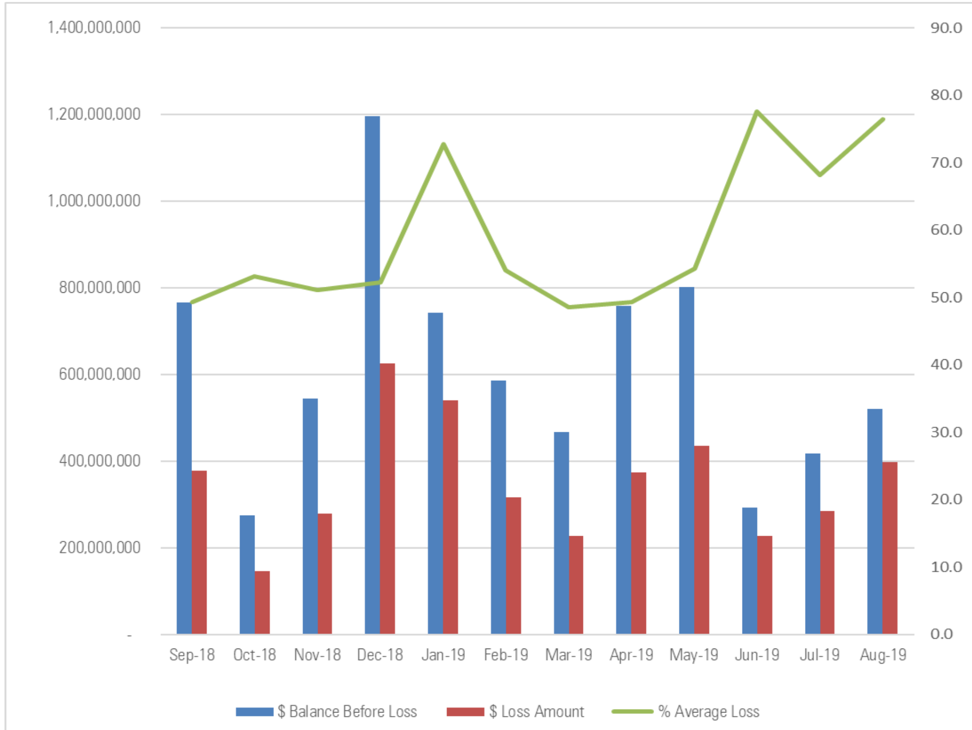
Note: Figures may not sum to totals because they are rounded.
Source: Morningstar Credit Ratings, LLC

**CMBS Liquidations**

After the weighted-average loss severity hit its highest level in June since we began tracking it, August's severity climbed into second place, skewed by the TRU 2016-TOYS resolution. Twenty-seven loans with a combined balance of $520.3 million were disposed with a weighted-average loss severity of 76.5%, up from $417.8 million disposed at a 68.2% severity in July. The largest write-off came from the liquidation of the $116.9 million Toys R Us - Call Protected loan in TRU 2016-TOYS. The liquidation of the $116.9 million loan, which had been paid down from the initial $512.0 million because of property sales, resulted in a $104.9 million loss for an 89.7% loss severity. Based on the original balance, the loss severity was a more modest 20.5%.

Losses continue to run ahead of last year. Through the first eight months of 2019, approximately $4.59 billion across 243 CMBS loans were disposed with a cumulative loss of $2.80 billion, generating a weighted-average loss severity of 61.1%. This is up from an average loss reading of 41.4% on $6.39 billion through August 2018.

**Chart 6 – Trailing 12-Month CMBS Liquidations and Losses**

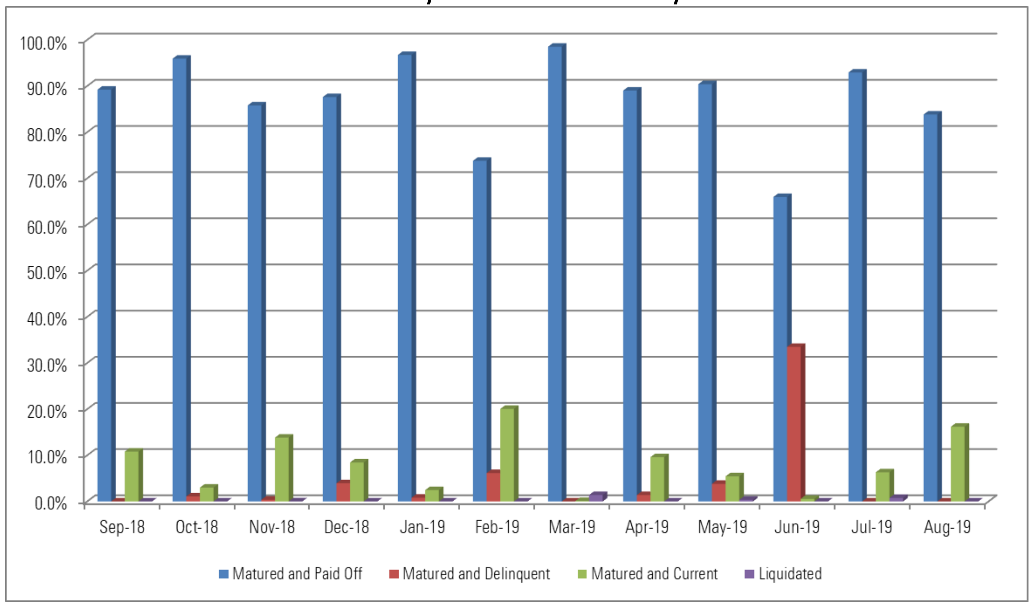



Source: Morningstar Credit Ratings, LLC

## Monthly Maturity

The payoff rate continued its roller coaster ride, dropping to 83.8% in August from 92.9% in July. This comes after sinking to the lowest level over the previous 16 months in June. All of August maturities were current in their monthly payments, which leads us to believe that most were subject to delays in the refinancing process and will pay off within a few months. The $57.0 million Residence Inn Midtown East loan in JPMBB 2014-C23 was the largest to miss its scheduled payoff. The 211-room extended-stay hotel on 48th Street between Lexington and Third Avenues in Manhattan has a relatively expensive ground rent, although it doesn't reset until 2036. Our $69.1 million value suggests an 82.5% loan-to-value ratio.

**Chart 7 – 12-Month Performance Trend by Loan Status at Maturity**

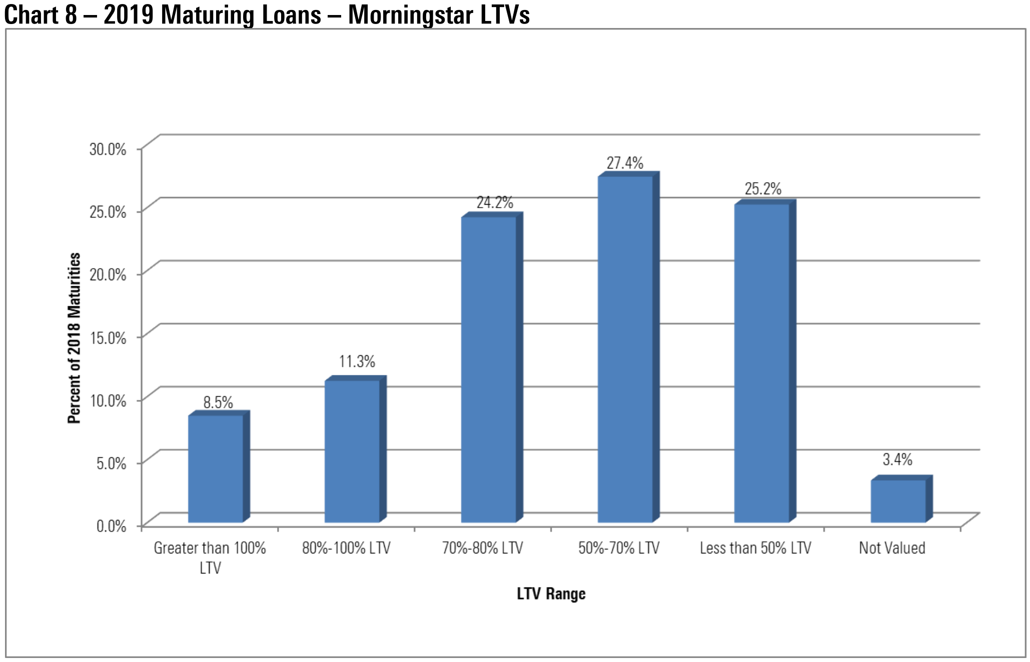



Source: Morningstar Credit Ratings, LLC

### Maturity Outlook for 2019

Some $2.84 billion of CMBS loans will mature through December. We have valued approximately 96.6% of them, and 19.7% 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 82.6% through the first eight months of the year. This information is displayed in Chart 7.

**Chart 8 – 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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