# CMBS Research

## Morningstar Monthly Highlights

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**Morningstar Credit Ratings**

September 2018 Remittance

**Contents**



### Executive Summary

- The delinquency rate continued its descent, hitting another postcrisis low of 1.81% in September, down 13 basis points from August.
- The delinquency rate is down 113 basis points from a year ago, and, 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% for the rest of the year.
- Delinquencies from deals issued from 2010 through 2018 remain a small portion of the total, representing just 0.3% of the CMBS universe, while delinquent precrisis loans account for 1.5%.
- The payoff rate of maturing loans in CMBS held above 80% for the fifth-consecutive month, rising to 89.2% from 83.6% in August. With the year-to-date rate maturity payoff rate at 81.8%, we anticipate that the rate will finish the year between 80% and 85% because most of the remaining maturing loans have strong metrics.
- After falling for only the second time in the previous nine months in August, the Morningstar Watchlist unpaid principal balance rose $1.11 billion to $23.84 billion.
- The special-servicing UPB improved to a postcrisis low of $18.78 billion, down $1.17 billion from August and the percentage of loans in special servicing sunk 14 basis points to 2.29%.
- Our projected losses on specially serviced loans ticked up to $12.04 billion, an increase of $236.7 million from August, and down $391.2 million from January.

**Chart 1 – Significant Value Changes Among Large Loans**

| Deal ID | Asset Name | Loan Balance ($) | Value Change ($) | Loss Forecast ($) | Previous MORN LTV (%) | Current MORN LTV (%) |
|---|---|---|---|---|---|---|
| TRU 2016-TOYS | Toys 'R Us - Call Protected | 408,763,340 | (116,900,000)* | 75,569,422 | 90.8 | 122.7 |
| WBCMT 2007-C33 | Independence Mall | 200,000,000 | (41,923,000) | 115,058,502 | 147.1 | 212.6 |
| WFRBS 2014-C24 | Two Westlake Park | 91,000,000 | (34,076,905) | 43,437,796 | 111.0 | 190.0 |
| CSFB 2005-C2 | 390 Park Avenue | 83,635,069 | (48,800,000) | 66,164,452 | 122.1 | 424.5 |
| COMM 2015-CR24 | Palazzo Verdi | 73,500,000 | (23,382,000) | 7,541,000 | 89.9 | 125.8 |
| MSC 2016-BNK2, BACM 2017-BNK3, WFCM 2016-C37 | Fremaux Town Center | 68,923,236 | (42,400,000) | - | 24.6 | 94.9 |
| JPMCC 2007-CB18 | The Plaza at PPL Center | 65,018,681 | (8,640,000) | 56,457,943 | 322.5 | 564.4 |
| JPMCC 2006-CB16 | REPM Portfolio | 55,441,830 | (8,910,000) | 44,656,596 | 278.4 | 503.7 |
| BACM 2007-5 | 4000 Wisconsin Avenue | 53,000,000 | (53,000,000) | 53,205,564 | 100.0 | - |
| MSBAM 2016-C31 | Vintage Park | 84,000,000 | (46,900,000) | 1,420,000 | 70.2 | 115.4 |

*Reflects principal paydown

Source: Morningstar Credit Ratings, LLC

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

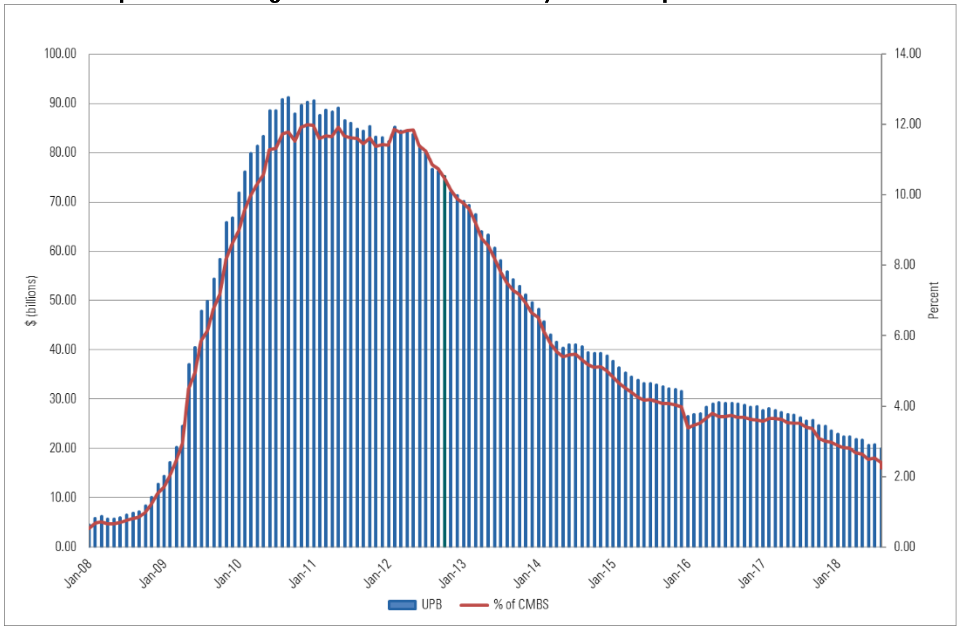
In September, we raised our value on properties securing 24 loans with a combined balance of $701.3 million, while we lowered our values on properties securing 54 loans with a combined balance of $3.06 billion. Of these, 29 loans showed value declines that resulted in increased loss forecasts. For example, we reduced our value of the Two Westlake Park loan to $47.9 million from $82.0 million. The $91.0 million loan in WFRBS 2014-C24, which we first alerted readers to in our August 2017 Alert, Running on Fumes–Swell in Vacancy Threatens $91.0 Million Houston Office Loan, was transferred to special servicing in July for imminent monetary default. According to CoStar Group, Inc., occupancy at the 450,154-square-foot building in Houston's Energy Corridor dropped to 70.0% in October, and the 2017 year-end cash flow was nearly 33% below underwritten levels. Furthermore, CoStar lists that approximately 90% of the net rentable area is available either directly or for sublease. The largest tenant, ConocoPhillips Co., has vacated almost half its space and listed all but 66,000 square feet for sublease, leading us to believe the company will vacate the remainder of its space when its lease expires in November 2019. Our discounted cash flow analysis assumes that ConocoPhillips and BP Corporation North America Inc., the two largest tenants, will vacate upon their lease expirations in 2019. We re-leased the property up to a stabilized rate of 75.0% over three years at the in-place rent, inflated 3.0% per year.

Separately, the collateral backing the $73.5 million Palazzo Verdi loan, a 15-story Class A office building in Greenwood Village, Colorado, will lose its largest tenant, Newmont Mining Corp., which represents 64.0% of the underwritten base rent. Further, in November 2017, Envision Healthcare Corp., the second-largest tenant, cut earnings projections and is considering "strategic alternatives," according to *The Wall Street Journal.* Our discounted cash flow analysis assumed re-leasing Newmont Mining and Envision space over three years to 88.0% occupancy at in-place rents. Our reversion cap rate is 7.1% and our discount rate is 10.1%. The resulting value is $58.4 million, which suggests a 125.9% loan-to-value ratio.

**Special-Servicing Exposure**

The special-servicing unpaid principal balance continued its descent, hitting another postcrisis low of $18.78 billion, tumbling $1.17 billion. The special-servicing rate also hit a postcrisis low of 2.25%, down 14 basis points from August. While legacy CMBS now accounts for 3.5% of the CMBS universe, specially serviced loans from deals issued before 2010 represent 74.5% of all specially serviced loans by balance. Retail and office assets continue to represent the bulk of specially serviced loans, with more than 70% of the exposure combined.

**Chart 2 – Special-Servicing Balance and Rate January 2008 – September 2018**




Source: Morningstar Credit Ratings, LLC

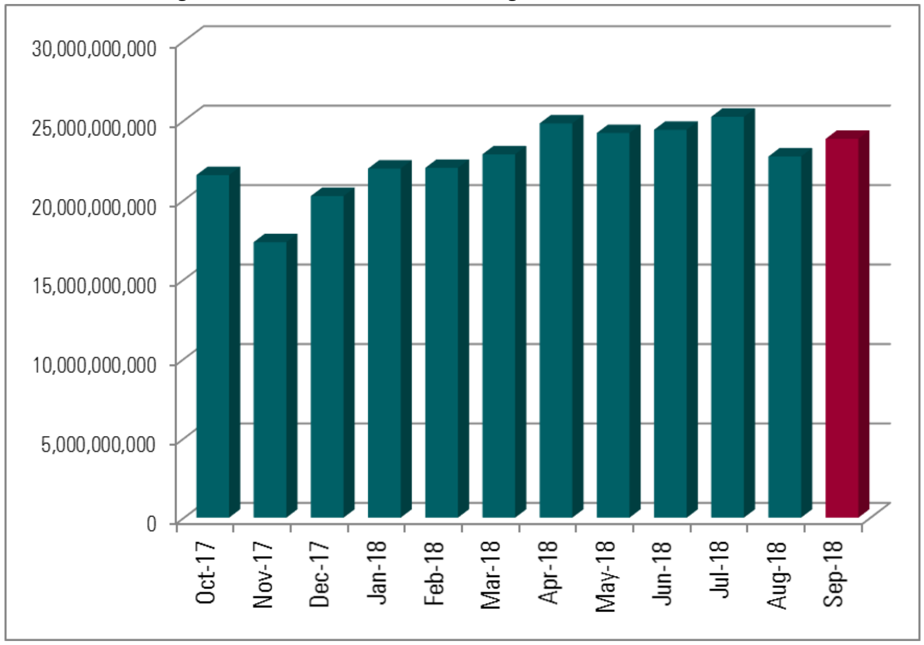
Special-servicing transfers declined by $71.6 million from August to $260.8 million. Nearly three fourths of the transfer volume was backed by precrisis loans, including $142.5 million Triangle Town Center loan in LBUBS 2006-C1 and LBUBS 2006-C7. The loan's second trip to the special servicer, following its 2015 stint during which the maturity date was extended, could lead to a total loss of $56.6 million. Year-end 2017 net cash flow at the collateral, 625,509 square feet and the ground leases to 12,007 square feet of out-parcels at a 1.4-million-square-foot regional mall in Raleigh, North Carolina, was 42.9% lower than underwritten and 26.6% lower than 2016. Despite a healthy debt yield of 11.5%, we believe the loan is a high risk given its low quality, prior refinance difficulties, poor NCF performance, and lack of institutional investor demand for regional malls. Our $86.2 million value is based on applying a 10.0% cap rate, adjusted up from base market of 7.7% to account for waning regional mall demand, to the most recent full year NCF.

### Watchlist Exposure

After falling for only the second time last month in the previous nine months, the Morningstar Watchlist volume rose $1.11 billion to $23.84 billion. In September, we added 37 loans with a total UPB of $1.31 billion to the Watchlist, up from $1.10 billion added in August. Morningstar also removed 31 loans from the Watchlist, six of which were transferred to special servicing.

Driven in part by continuing retail weakness, especially in shopping centers with exposure to troubled tenants, the volume of Watchlist loans should continue its gradual upswing. We are also cautious on the office sector given a combination of the late-stage corporate credit cycle, less demand as companies become more efficient, and potential disruption from technology, reducing space requirements. Further, new construction in the office market may weigh on occupancy in the coming year. Separately, signs of overbuilding could lead to declining multifamily and hotel occupancy rates in gateway markets as demand slows.

**Chart 3 – Morningstar Watchlist Volume – Trailing 12 Months ($)**



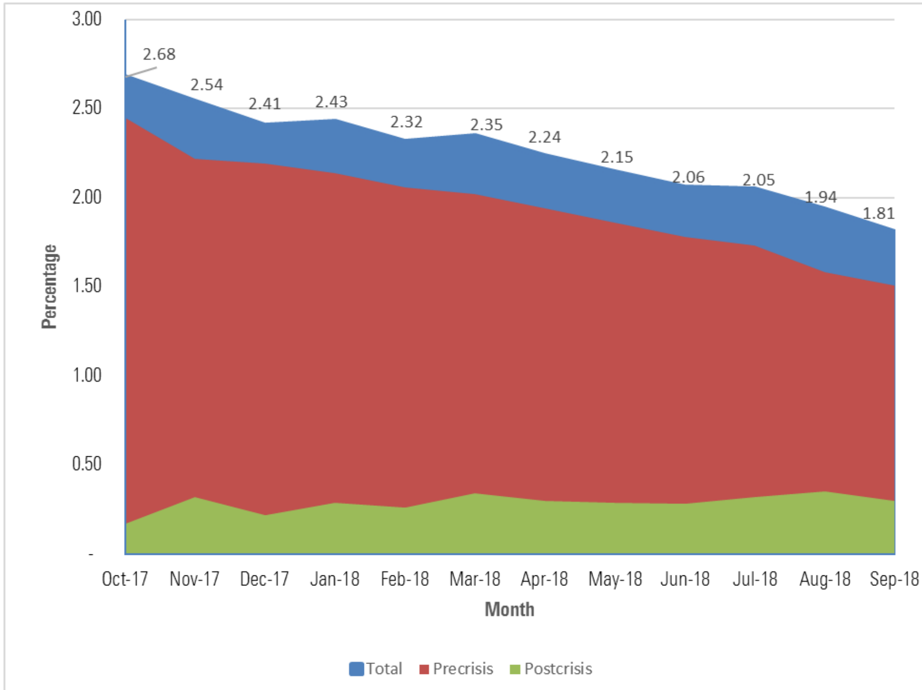

Source: Morningstar Credit Ratings, LLC

The $191.0 million Holyoke Mall loan in JPMCC 2011-C3 was the largest added to our Watchlist. The mall's net cash flow has dropped each year since 2014 and is down 16.4% since underwriting. Although all the anchors remain open according to the mall's website, Sears announced in August 2018 that it will be closing at the south-central Massachusetts regional mall in the coming months. Furthering the risk, two additional anchor tenants, JCPenney and Macy's (noncollateral), have both reduced their brick-and-mortar footprints in recent years and JCPenney's lease expires around the loan's maturity in early 2021. If the mall is unable to redevelop Sears' space, we believe refinancing the loan will be difficult. Based on our discounted cash flow analysis, we value the collateral at $190.7 million. We assumed that Sears and JCPenney both vacate and that filling the space would take two years. We used an in-place occupancy of 85.0% and in-place rents of $19.00 per square foot. We also used a stressed cap rate of 9.3% (adjusted upward from 7.8% given the property type and location) and a 12.3% discount rate. Our concluded value suggests a 100.2% LTV.

### Delinquency

The CMBS delinquent UPB declined for the sixth-consecutive month to $15.08 billion, down $1.11 billion from $16.19 billion in August, while the delinquency rate improved 13 basis points to 1.81% from 1.94% from the prior month. The balance of delinquent loans is down $4.08 billion from January, and down $7.57 billion, or 33.3%, from the year-earlier period. Delinquencies from deals issued before 2010 represent 83.6% of all delinquencies by balance.

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




Source: Morningstar Credit Ratings, LLC

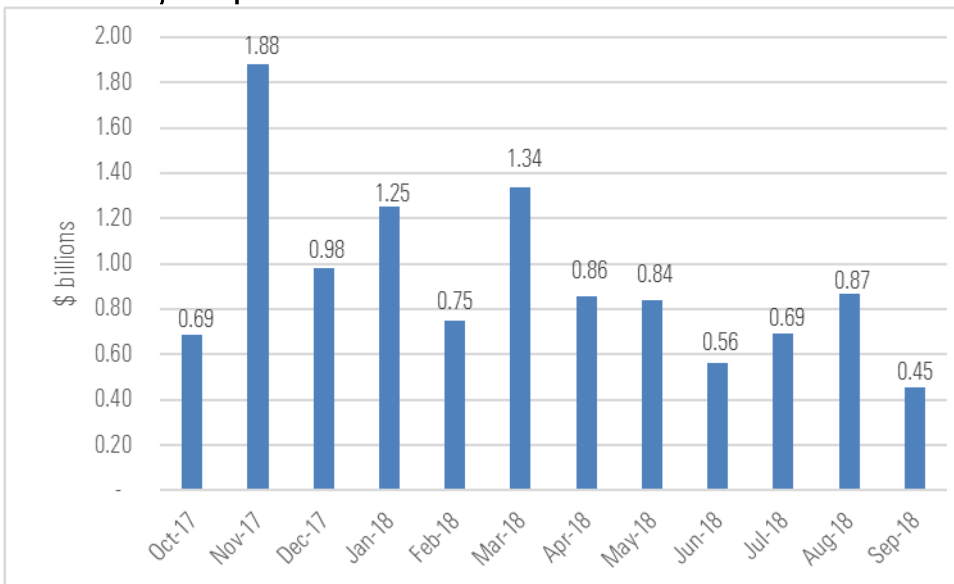
**Table 1 – Trailing 12 Months Delinquency ($ UPB in billions)**

| Category | Oct-17 | Nov-17 | Dec-17 | Jan-18 | Feb-18 | Mar-18 | Apr-18 | May-18 | Jun-18 | Jul-18 | Aug-18 | Sep-18 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 30-Day | 1.66 | 2.02 | 0.95 | 1.03 | 0.86 | 1.27 | 1.08 | 0.79 | 0.67 | 1.00 | 1.10 | 0.54 |
| 60-Day | 0.76 | 0.63 | 0.4 | 0.68 | 0.27 | 0.34 | 0.62 | 0.24 | 0.26 | 0.30 | 0.37 | 0.23 |
| 90-Day | 3.19 | 2.95 | 2.99 | 2.92 | 2.57 | 2.52 | 2.26 | 2.25 | 2.05 | 1.65 | 1.79 | 1.8 |
| Foreclosure | 5.78 | 5.16 | 5.33 | 5.3 | 5.03 | 4.85 | 4.55 | 4.21 | 4.24 | 3.89 | 3.67 | 3.43 |
| Real Estate Owned | 10.26 | 10.15 | 9.49 | 9.39 | 9.65 | 9.86 | 9.86 | 10.2 | 9.83 | 10.05 | 9.25 | 9.07 |
| Total CMBS Del. | 21.64 | 20.90 | 19.16 | 19.32 | 18.38 | 18.85 | 18.36 | 17.69 | 17.05 | 16.88 | 16.19 | 15.08 |
| Current | 787.06 | 801.98 | 774.77 | 775.01 | 774.84 | 781.77 | 800.45 | 804.38 | 809.30 | 807.17 | 818.93 | 818.27 |
| Total CMBS | 808.71 | 822.88 | 793.93 | 794.33 | 793.22 | 800.62 | 818.82 | 822.07 | 826.35 | 824.05 | 835.12 | 833.35 |
| Delinquency % | 2.68 | 2.54 | 2.41 | 2.43 | 2.32 | 2.35 | 2.24 | 2.15 | 2.06 | 2.05 | 1.94 | 1.81 |

Source: Morningstar Credit Ratings, LLC

The volume of newly delinquent loans improved for the first time since June, declining by $415.8 million from $869.0 million in August.

**Chart 5 – Newly Delinquent Loans**




Source: Morningstar Credit Ratings, LLC

Compared with year-ago levels, the office sector saw the largest decline in delinquent balance, tumbling $2.95 billion, or 38.7%, as liquidations have far outpaced newly delinquent loans. By dollar amount, the other four major property types exhibited the following activity year over year:

- Retail loan delinquency dropped by $2.34 billion, or 28.2%, to $5.95 billion from $8.29 billion one year ago, because more loans were either liquidated or resolved than were replaced with newly delinquent loans.
- Industrial loan delinquency fell by $547.5 million, or 49.9%, to $548.8 million from $1.10 billion one year ago.
- Multifamily loan delinquency eased by $430.1 million, or 25.5%, to $1.26 billion from $1.69 billion one year ago.
- Hotel delinquency declied by $872.2 million, or 37.1%, to $1.48 billion from $2.35 billion one year ago.

**Table 2 – September Delinquency by Property Type**

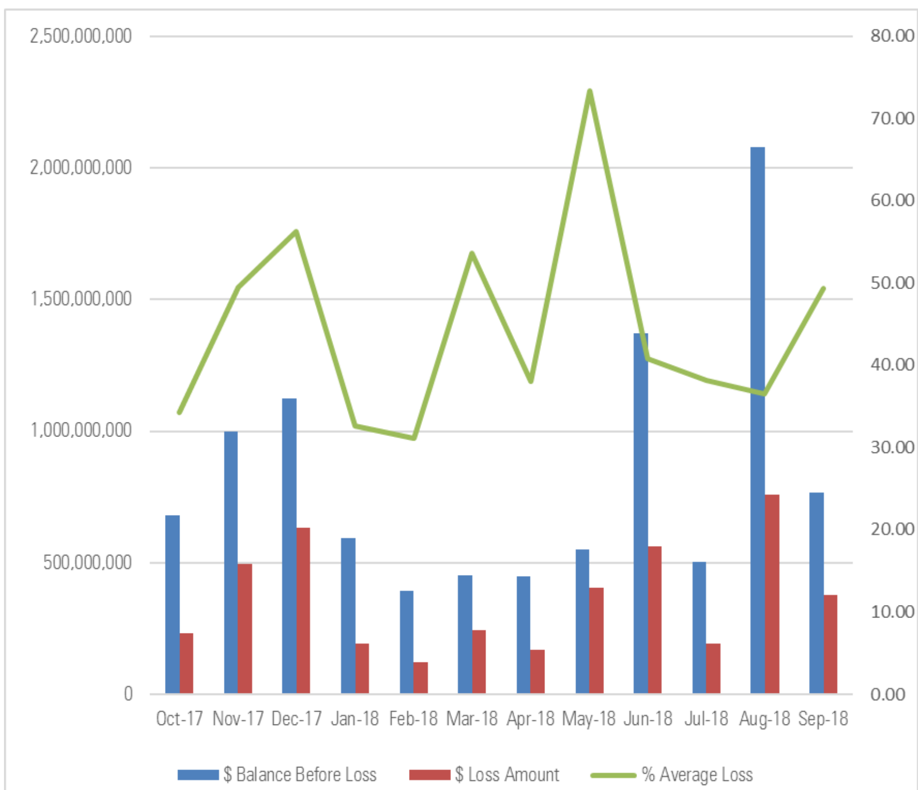
| Property Type | Current Balance (%) | # Loans | % of CMBS Universe | % of CMBS Delinq. | % of Property Type |
|---|---|---|---|---|---|
| Healthcare | 59,630,000 | 3 | 0.01 | 0.40 | 1.94 |
| Hotel | 1,477,197,714 | 85 | 0.18 | 9.80 | 1.91 |
| Industrial | 548,830,287 | 38 | 0.07 | 3.64 | 2.51 |
| Multifamily | 1,258,383,659 | 307 | 0.15 | 8.35 | 0.30 |
| Office | 4,677,743,838 | 220 | 0.56 | 31.03 | 3.74 |
| Other | 1,103,420,582 | 55 | 0.13 | 7.32 | 1.71 |
| Retail | 5,952,078,827 | 430 | 0.71 | 39.48 | 4.74 |
| Total | 15,077,284,908 | 1,138 | 1.81 | 100.00 | |

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

## CMBS Liquidations

After shooting up to $2.08 billion in August, the volume of liquidated loans tumbled to $767.1 million in September. The weighted-average loss severity registered 49.3%, up from 36.5% in August, primarily because of the write-off of the $133.9 million Schron Industrial Portfolio loan, which took an 89.8% loss and comprised nearly one third of September's total realized losses. A diversified pool of 36 real-estate-owned industrial properties across 14 states backed the loan. The loan, which backed 76.0% of GCCFC 2005-GG5 at disposition, had been in special servicing since 2010.

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

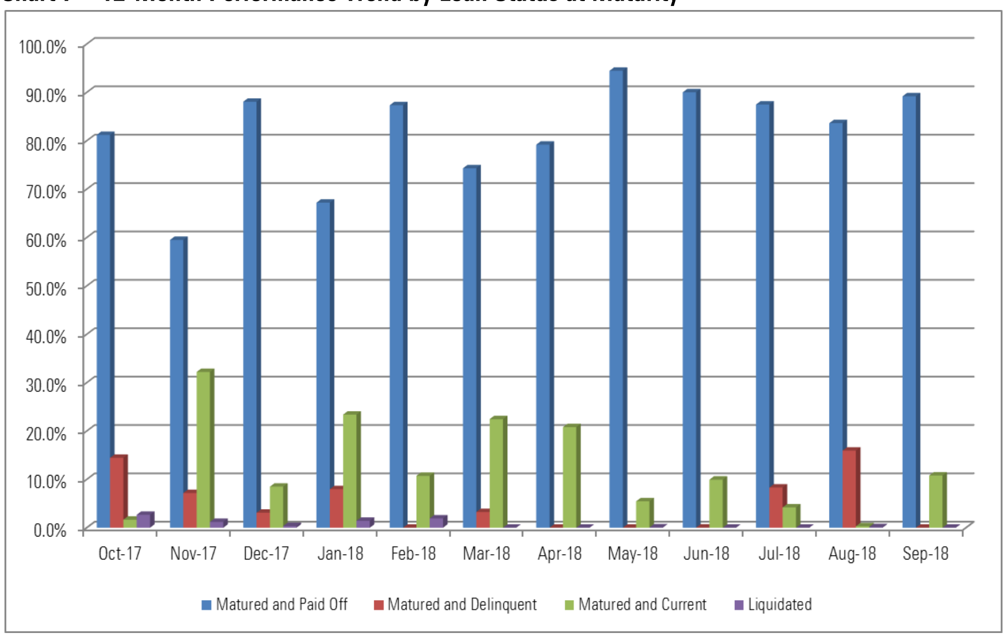



Source: Morningstar Credit Ratings, LLC

**Monthly Maturity**

With the 2015-17 maturity wave behind us, the maturity payoff rate remained above 80% for the fifth straight month as precrisis loans represented just 8.9% of September's maturing loan balance. The $43.5 million Point at Las Colinas loan, 4.3% of MSBAM 2013-C12, is the largest loan that failed to pay off that remains outstanding as of the date of this report. According to the servicer, the borrower has signed a term sheet for refinancing and has requested a 60-day forbearance to accommodate the closing. We initially placed the loan on our Watchlist in March 2017 because of maturity risk. The 398,771-square-foot office building in Irving, Texas, saw 2017 net cash flow fall 18.9% since issuance. The declining cash flow has implications for refinancing as the debt yield is low at 7.4%. If the refinance falls through, we project a value deficiency of $7.9 million based on a discounted cash flow analysis that assumes the borrower leases the property to a stabilized occupancy of 85.0% based on CoStar market forecasts, a 7.3% capitalization rate, and a discount rate of 10.3%.

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



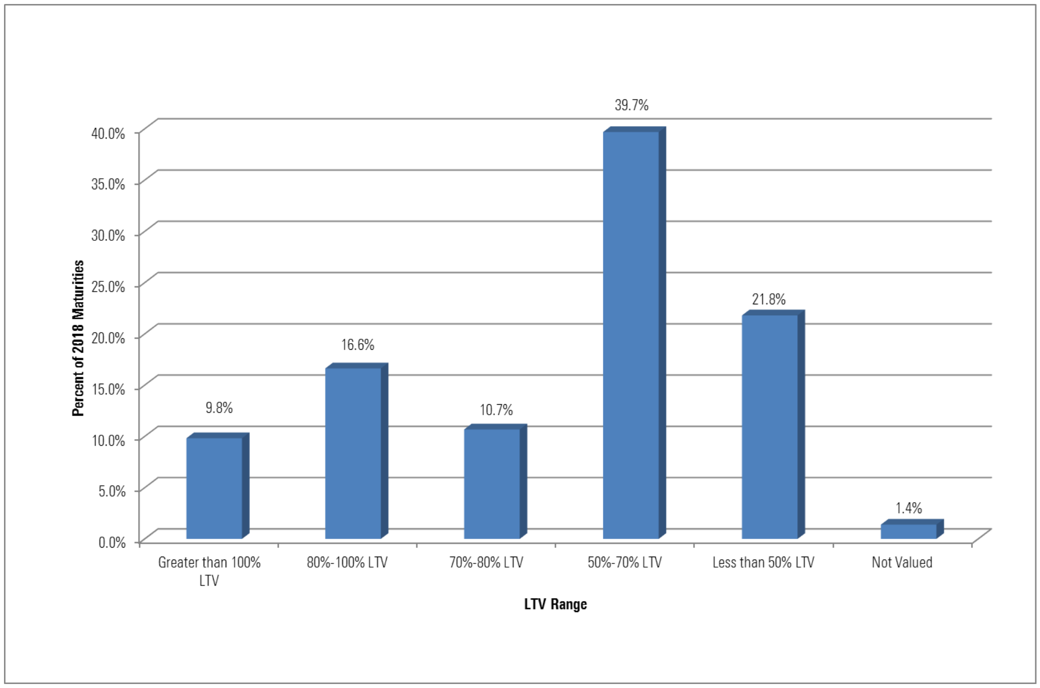

Source: Morningstar Credit Ratings, LLC

**Maturity Outlook for 2018**

The year-to-date payoff rate stands at 81.8%, and, with some $1.74 billion of CMBS loans that will mature through the remainder of 2018, most with LTVs above 80%, we project that the payoff rate will remain between 80% and 85% for the year.

The largest master-serviced loan of concern is the $18.6 million Quito Village Center, 1.6% of COMM 2014-LC17. Our analysis suggests a 115.5% LTV on the loan, which matures in December. Anchor tenant Gene's Fine Foods, occupying 42.0% of the GLA, vacated the Saratoga, California, shopping center, dropping occupancy to 49.0% as of June 2018.

**Chart 8 - 2018 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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