# CMBS Research
## Morningstar Monthly Highlights

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**Morningstar Credit Ratings**
June 2019 Remittance

**Contents**


### Executive Summary

- June's 2-basis-point drop in the delinquency rate to 1.51% set another postcrisis low and reflects a 1.1% decline in the balance of delinquent loans and a slight uptick in the balance of the CMBS universe.
- The delinquency rate fell in 14 of the past 18 months and is down 55 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.
- After rising to a 24-month high in May, the Morningstar Watchlist dipped to $26.08 billion, down $703.8 million from May. Still, it remains about 50% higher than its November 2017 postcrisis low, which suggests that forward-looking risk is increasing as postcrisis deals become more exposed to credit events.
- The special-servicing unpaid principal balance, or UPB, and special servicing rate fell to postcrisis lows of $15.92 billion and 1.84%, respectively, as the volume of newly transferred loans fell to a 12-month low.
- Our projected losses on specially serviced loans have improved over the past 12 months, falling $1.17 billion, or 9.4%, since June 2018.
- The payoff rate of maturing loans in CMBS tumbled to 66.0% from 90.4% in May, and we expect it to finish the year at roughly 80% 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 2016-CD2, CD 2017-CD3, WFCM 2016-LC25, CGCMT 2016-C3 | Marriott Hilton Head Resort & Spa | 92,309,822 | (65,676,500) | - | 56.5 | 94.7 |
| FREMF 2016-K723 | Alexander at the Perimeter | 54,500,000 | (33,171,680) | 1,210,752 | 68.5 | 117.4 |
| WFRBS 2011-C3 | Oakdale Mall | 50,934,567 | (23,800,000) | 32,034,567 | 119.3 | 262.5 |
| JPMBB 2015-C32 | The Outlet Shoppes at Gettysburg | 37,454,704 | (22,600,000) | - | 57.8 | 88.8 |
| MLCFC 2007-9 | Bon Carre | 35,100,454 | (21,690,000) | 25,290,454 | 111.4 | 353.9 |
| COMM 2014-UBS5 | The Campus at Greenhill | 24,208,527 | (18,600,000) | 7,108,527 | 67.8 | 138.9 |
| COMM 2015-CR27 | Midwest Shopping Center Portfolio | 35,744,113 | (17,300,000) | - | 65.5 | 95.8 |
| CSAIL 2017-C8 | Northridge Plaza | 32,463,817 | (14,332,475) | - | 64.8 | 90.8 |
| FREMF 2013-K24 | Dutch Village | 30,510,485 | (12,611,787) | - | 69.5 | 97.5 |
| MSBAM 2012-C5 | The Distrikt Hotel | 35,382,522 | 12,199,986 | - | 102.6 | 75.8 |

Source: Morningstar Credit Ratings, LLC

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

In June, we raised our value on properties securing 43 loans with a combined balance of $680.4 million, while we lowered our values on properties securing 42 loans with a combined balance of $802.1 million. Of these, 22 loans showed value declines that resulted in increased loss forecasts.

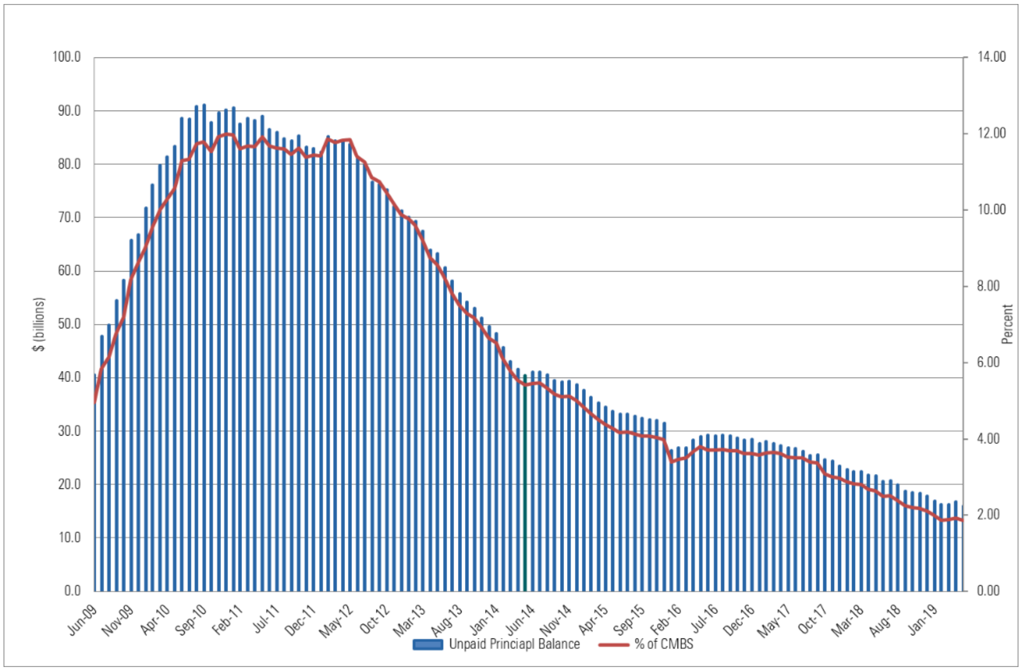
The largest value decline was on the $92.3 million Marriott Hilton Head Resort & Spa loan split among CD 2016-CD2, CD 2017-CD3, WFCM 2016-LC25, and CGCMT 2016-C3. We lowered our value to $97.8 million after applying a more market-based capitalization rate of 7.0%, down 100 basis points from the regional capitalization rate to account for the property's resort location, to 2018's net cash flow. This compares with the underwritten appraised value of $163.5 million, which implies an aggressive 6.1% capitalization rate on 2016's net cash flow. Performance at the asset--a 513-room, full service beachfront hotel on Hilton Head Island, South Carolina--continues to remain weak. Longer term, we believe the small size and seasonality of Hilton Head's lodging market serve as the largest risk, as new supply would substantially weaken the subject's competitive position. In addition, the hotel depends heavily on the health of Hilton Head Island's tourism industry, much of which is derived from the area's renowned golf courses. As such, we believe there are limited demand drivers. Further, occupancy and average daily rate were underwritten higher than any of the prior three years of operation, while the hotel has never achieved underwritten net cash flow. For the most recent 12-month period, the debt service coverage ratio, or DSCR, registered 1.00x as of year-end 2018, down from 1.23x in 2017.

**Special-Servicing Exposure**

The special-servicing UPB fell for the second consecutive month, hitting a postcrisis low of $15.92 billion in June, down $164.1 million from May, as the volume of new transfers remained below $300 million for the second straight month and is roughly half the 12-month moving average. The special-servicing rate also hit a postcrisis low of 1.84%, down 2 basis points from May. While legacy CMBS now accounts for 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 moved up to $11.21 billion from $10.79 billion in May, an increase of $421.3 million, but has improved over the past 12 months, down $1.17 billion since June 2018.

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




Source: Morningstar Credit Ratings, LLC

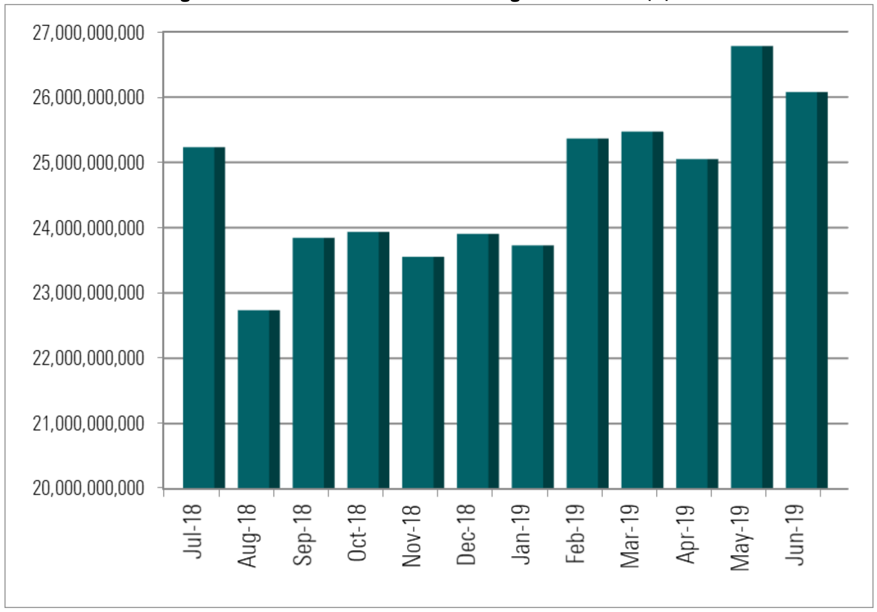
The volume of special-servicing transfers fell to a 12-month low of $232.1 million, down from $276.1 million in May. The $80.2 million Regent Portfolio loan, with pari passu notes in SGCMS 2016-C5 and WFCM 2016-C34, was the largest loan transferred to special servicing in June. Late payments have been common for the note, with remittance data reflecting the borrower's first late payment back in December 2017 and with past delinquencies satisfied prior to the loan running 60 days late. However, late charges continue to accrue. The collateral, 12 medical office buildings and one warehouse spread among New Jersey, New York, and Florida, is performing well with a 1.68x debt service coverage ratio on 80.0% occupancy as of September 2018. Accordingly, we do not project a loss.

**Watchlist Exposure**

After hitting a 24-month high last month, the Morningstar Watchlist eased to $26.08 billion, down $703.8 billion from May. We added 76 loans with a total UPB of $1.41 billion to the Watchlist, down from $2.82 billion added in May. Morningstar also removed 37 loans from the Watchlist, nine of which were transferred to special servicing, while three loans paid off.

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

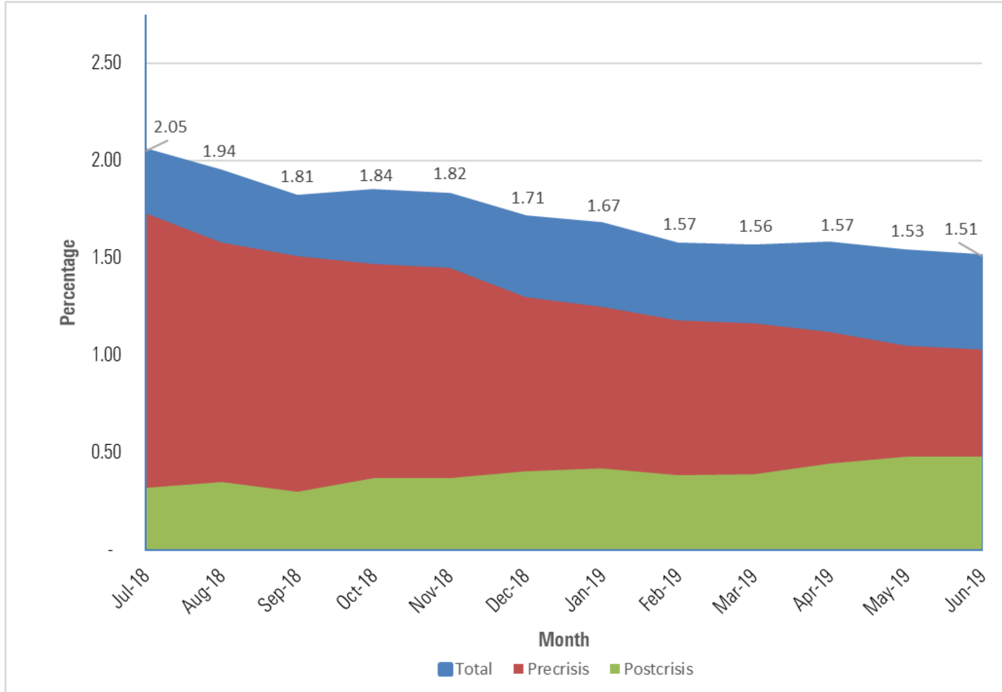
The largest loan we added this month was the $165.0 million Decoration & Design Building loan in CGCMT 2015-GC33 and CGCMT 2015-P1, where our primary concern is the ground lease, which has a fixed rental payment until the reset date in January 2024, at which time the ground rent will likely increase to $13.8 million from $3.8 million. The collateral is the leasehold interest in an 18-story, 588,152-square-foot design/showroom building with 21,350 square feet of ground-floor retail space in the Midtown submarket of Manhattan. While we believe the property's strong net cash flow can more than cover a $10 million increase in the ground rent, our discounted cash flow analysis, which incorporates the bump in the ground lease payment, suggests a loan-to-value of 101.6%. Further, the loan, which matures about two years after the ground lease resets, will begin amortizing in 2021, which will further crimp net cash flow.

**Delinquency**

The CMBS delinquency rate fell to another postcrisis low in June, ticking down to 1.51% from 1.53% in May, because the balance of delinquent loans declined more than 1% while the size of CMBS universe ticked up modestly. The balance of delinquent loans fell to $13.07 billion from $13.22 billion in May, and it's down $3.98 billion, or 23.4%, 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 1.03%, 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 June 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

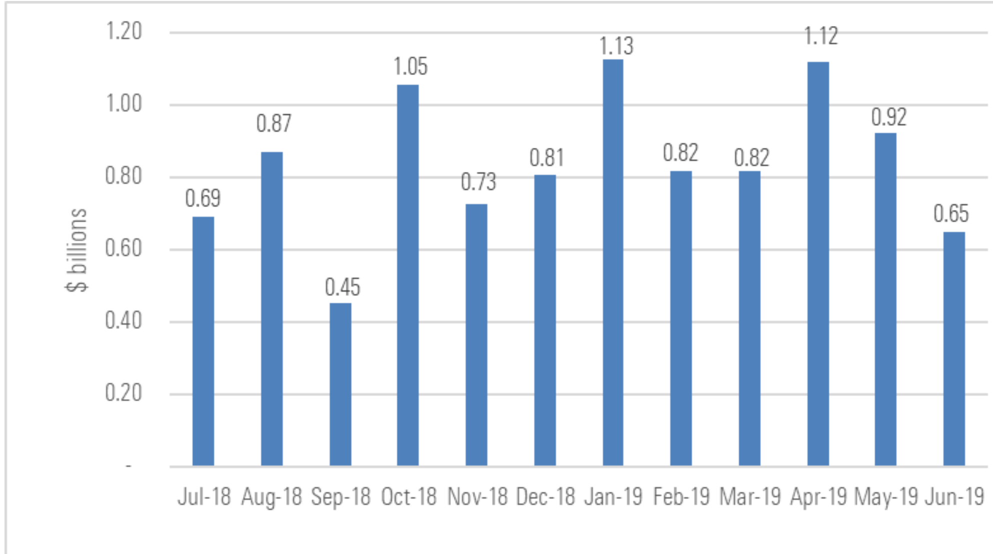
**Table 2 – Trailing 12-Month Delinquency ($ UPB in billions)**

| Category | Jul-18 | Aug-18 | Sep-18 | Oct-18 | Nov-18 | Dec-18 | Jan-19 | Feb-19 | Mar-19 | Apr-19 | May-19 | Jun-19 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 30-Day | 1.00 | 1.10 | 0.54 | 0.60 | 0.72 | 0.94 | 1.25 | 0.90 | 0.94 | 1.30 | 1.21 | 1.00 |
| 60-Day | 0.30 | 0.37 | 0.23 | 0.31 | 0.26 | 0.39 | 0.38 | 0.42 | 0.51 | 0.30 | 0.53 | 0.60 |
| 90-Day | 1.65 | 1.79 | 1.8 | 1.7 | 1.7 | 1.47 | 1.72 | 1.65 | 1.55 | 1.88 | 1.77 | 2.03 |
| Foreclosure | 3.89 | 3.67 | 3.43 | 3.15 | 2.86 | 2.62 | 2.42 | 1.93 | 1.87 | 1.81 | 1.72 | 1.49 |
| Real Estate Owned | 10.05 | 9.25 | 9.07 | 9.79 | 9.75 | 9.07 | 8.59 | 8.78 | 8.64 | 8.44 | 7.99 | 7.95 |
| Total CMBS Del. | 16.88 | 16.19 | 15.08 | 15.55 | 15.29 | 14.49 | 14.36 | 13.68 | 13.51 | 13.73 | 13.22 | 13.07 |
| Current | 807.17 | 818.93 | 818.27 | 828.40 | 825.05 | 834.09 | 836.63 | 855.53 | 854.09 | 860.62 | 849.85 | 850.93 |
| Total CMBS | 824.05 | 835.12 | 833.35 | 843.95 | 840.35 | 848.58 | 850.99 | 869.22 | 867.60 | 874.35 | 863.07 | 864.00 |
| Delinquency % | 2.05 | 1.94 | 1.81 | 1.84 | 1.82 | 1.71 | 1.69 | 1.57 | 1.56 | 1.57 | 1.53 | 1.51 |

Source: Morningstar Credit Ratings, LLC

The volume of newly delinquent loans fell below $700 million for the first time in seven months in June, sinking to $648.9 million, down $273.0 million from May, and registered below the 12-month moving average of $837.4 million. The $66.5 million Harborplace loan in UBSBB 2013-C5, was the largest newly delinquent loan. Occupancy at the collateral, two two-story retail pavilions in heart of Baltimore's Inner Harbor, has never recovered since falling to the low 70% range in 2016. The loan, which was transferred to special servicing in February 2019, saw 2018 net cash flow tumble 65.5% below underwriting, pushing the DSCR below breakeven. We value the collateral at $73.4 million based on a discounted cash flow analysis, which suggests the loan is leveraged at 90.6%.

**Chart 4 – Newly Delinquent Loans**




Source: Morningstar Credit Ratings, LLC

Compared with year-ago levels, the industrial sector, which represents just 2.8% of total delinquent loans, saw the largest percentage decline in delinquent balance, tumbling 55.1%, or $445.6 million, to $363.1 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 31.9% to $3.66 billion from $5.38 billion one year ago, as liquidations far outpaced newly delinquent loans.
- Hotel loan delinquency fell 28.2% to $1.10 billion from $1.53 billion one year ago.
- Retail loan delinquency dropped 19.4% to $5.51 billion from $6.84 billion one year ago.
- Multifamily loan delinquency, which represents 12.9% of all delinquencies, rose by 35.2% to $1.69 billion from $1.25 billion one year ago because of a rise in small-balance agency loans.

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

| Property Type | $ Current Balance | # of Loans | % of CMBS Universe | % of CMBS Delinq. | % of Property Type |
|---|---|---|---|---|---|
| Retail | 5,513,361,321 | 372 | 0.64 | 42.20 | 4.43 |
| Office | 3,658,767,887 | 160 | 0.42 | 28.00 | 2.88 |
| Multifamily | 1,685,720,348 | 311 | 0.20 | 12.90 | 0.38 |
| Hotel | 1,097,591,683 | 79 | 0.13 | 8.40 | 1.38 |
| Other | 668,943,969 | 36 | 0.08 | 5.12 | 0.94 |
| Industrial | 363,102,042 | 26 | 0.04 | 2.78 | 1.53 |
| Healthcare | 78,377,316 | 5 | 0.01 | 0.60 | 3.72 |
| Total | 13,065,864,566 | 989 | 1.51 | 100.00 | - |

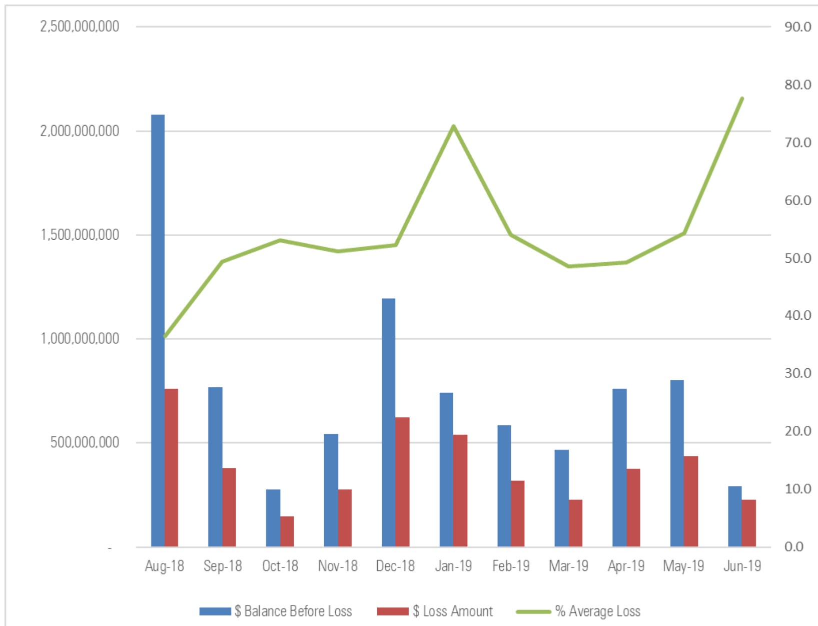
Note: Figures may not sum to totals because they are rounded.
Source: Morningstar Credit Ratings, LLC

**CMBS Liquidations**

Despite disposition volume that that sank to an eight-month low, the weighted average loss severity rose to its highest level since we began tracking this data in 2005. Twenty-six loans with a combined balance of $292.4 million were liquidated with a weighted-average loss severity of 77.6% with the largest write-off coming from the $59.2 million 777 Scudders Mill – Unit 1 loan. The property is part of a three-building suburban office complex in Plainsboro, New Jersey, that once served as the regional campus for sole tenant Bristol-Myers Squibb. The pharmaceutical company relocated in 2015 leaving all three properties vacant. The liquidation resulted in $47.7 million in losses for an 80.6% loss severity.

During the first half of 2019, approximately $3.65 billion across 191 CMBS loans were disposed with a cumulative loss of $2.12 billion, generating a weighted-average loss severity of 58.1%. This is up from an average loss reading of 44.4% for the first six months of 2018.

**Chart 5 – Trailing 12-Month CMBS Liquidations and Losses**

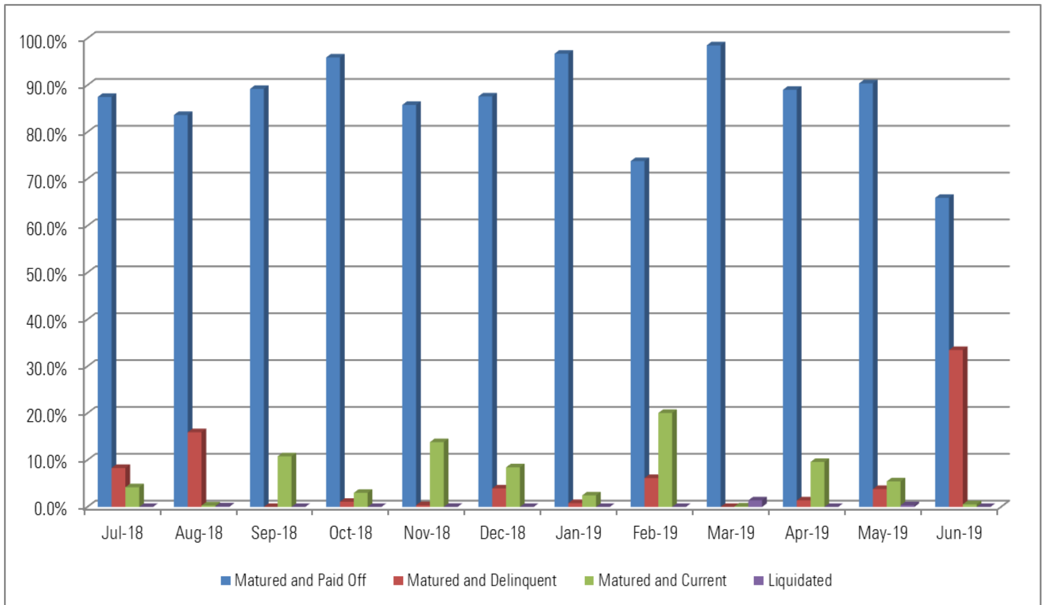



Source: Morningstar Credit Ratings, LLC

## Monthly Maturity

The June payoff rate plunged to 66.0% from 90.4% in May as three loans with balances of more than $100 million did not pay off on time. Among the largest loans to not pay off on time in June were the $300.0 million Destiny USA Phase I and $130.0 million Destiny USA Phase II loans. The loans, which are the sole loans backing the JPMCC 2014-DSTY deal, were transferred to special servicing in June and are backed by separate portions of a 2.4-million-square-foot mall in Syracuse, New York. Phase I represents 1.2 million square feet, and Phase II is 874,200 square feet. Revenue for Phase I in 2018 was down 14.0% from underwriting while net cash flow tumbled 29.2%. With the loss of key tenants such as Sports Authority, the Limited, Bon-Ton, Uno Chicago Grill, and Ruby Tuesday, Phase I occupancy has fallen since issuance and was 84.0% as of December 2018 compared with 90.2% at issuance. The DSCR for 2018 registered 1.73x. For the Phase II loan, 2018 revenue declined 8.4% from underwriting while net cash flow fell 15.3% over the same period. Year-end 2018 occupancy was 70.0%, down from 78.2% at underwriting. The year-end 2018 DSCR was 2.03x. We forecast a loss of about $35.4 million on Phase I and no loss on Phase II.

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

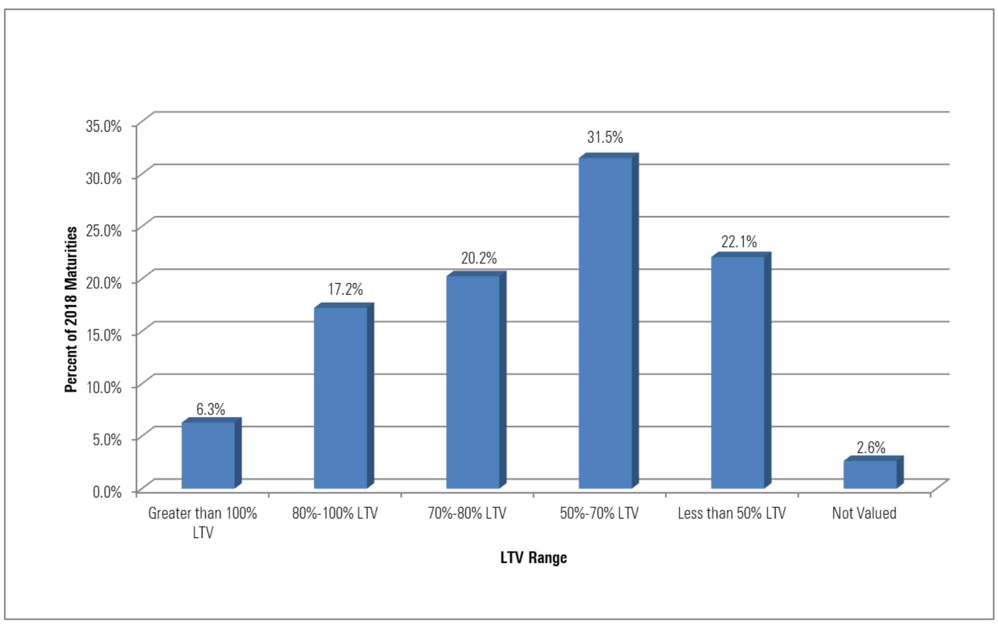



Source: Morningstar Credit Ratings, LLC

### Maturity Outlook for 2019

Some $6.52 billion of CMBS loans will mature through December. We have valued approximately 97.4% of them, and 23.5% have LTVs greater than 80%. Consequently, we expect the maturity payoff rate for 2019 will come in at about 80%, little changed from 80.7% through the first six 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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