Property Type Snapshot: Retail 2016

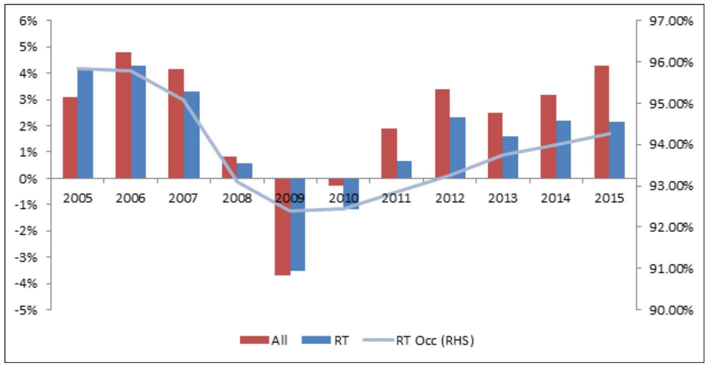
Trends

The retail sector has been the subject of grim headlines since the recession. Lately, Sears, JC Penney, Sports Authority, Macy's, Aeropostale et al. have announced either more store closures or total liquidation. There have been some heavy losses on regional malls in secondary and tertiary markets while Ecommerce has dramatically changed and will continue to shape the industry. The oft-scorned millennial generation spends more on rent and student debt than consumer goods. They also prefer to shop, and do pretty much everything else, on their phones.

Despite negative news, the notion that the end is nigh for brick and mortar retail is overstated. Grocery anchored retail is in high demand, Ecommerce giants are slowly opening physical stores or showrooms, and retail landlords are adapting to fill space left behind by the big box players. Most of the distressed loans have been sold or resolved by special servicers and default rates have hit a post-crisis low. Fundamentally, average occupancy has increased every year since 2009 and NOI growth has been significantly positive since 2011.

Figure 1. Retail Delinquencies

Figure 2. NOI YoY Growth and Average Retail Occupancy

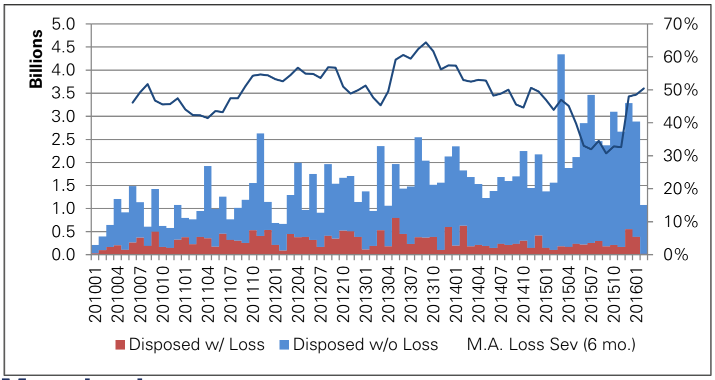


Historical Performance

Since the financial crisis, retail delinquency rates have declined considerably, falling to levels not seen since early 2010. Retail delinquencies dropped to 5.05% in April 2016, down 304 basis points from its peak in March 2012 and 33 basis points from January's rate of 5.38%.

After reaching a peak of 64.34% in September 2013, the six-month moving average loss severity for disposed loans had been trending downward and dropped to the low 30s in the second half of 2015. In late 2015, loss severity displayed a noticeable uptick as the moving average rose over 15 percentage points between November and December to 47.90%. The average continued to climb in the months immediately after, reaching 54.19% in February 2016 mostly due to low volume and a few large hope note losses. With the distressed pipeline down to around 5% of outstanding retail loans, the outlook for losses should be more of the same: low volume and volatile loss severity levels depending on what gets resolved each month.

Figure 3. Retail Monthly Disposition and Loss



Maturing Loans

Retail loans comprise a significant portion of the wave of maturing 10-year loans set to come due over the next two years. With over $200 billion in CMBS loans scheduled to mature by the end of 2017, close to 28% are backed by retail properties. The current status of maturing retail loans can serve as an indicator for potential losses ahead. Out of the retail loans maturing by 2017, 12.92% are delinquent and 10.70% have been assigned appraisal reduction amounts (ARAs). Almost 87% of the these loans are current on payments and have not taken any ARAs, although that may increase as loans on marginally performing properties come up for refinancing.

Removing loans that are already delinquent, the outlook for retail maturities is relatively positive, despite the continued plight of big box retailers. Occupancy remains above 91% for retail properties tied to maturing loans and less than 6% of these properties report an occupancy level below 75%.

Figure 4. Maturing Retail Loans

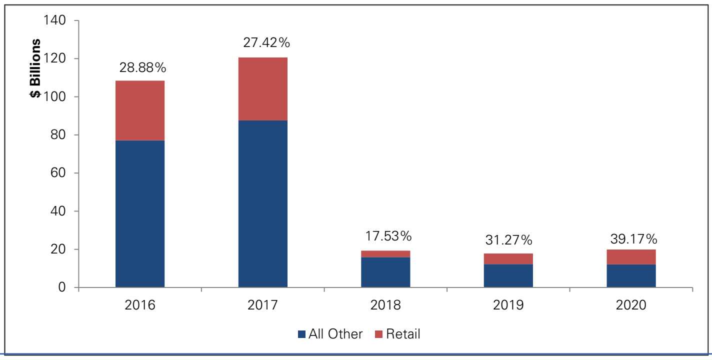


Figure 4.1 Maturing Retail Loans

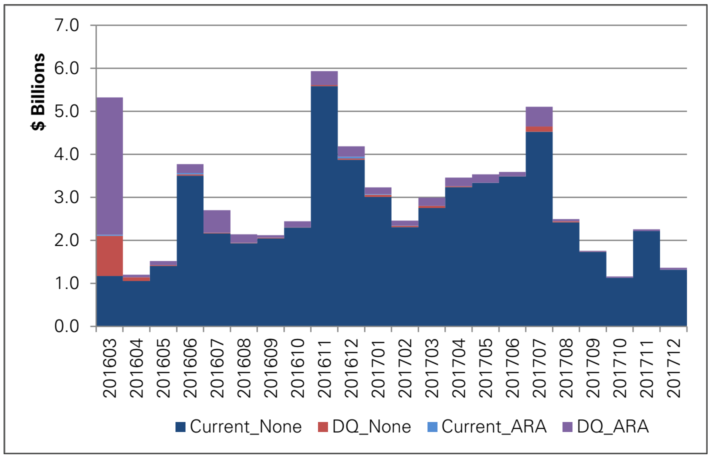
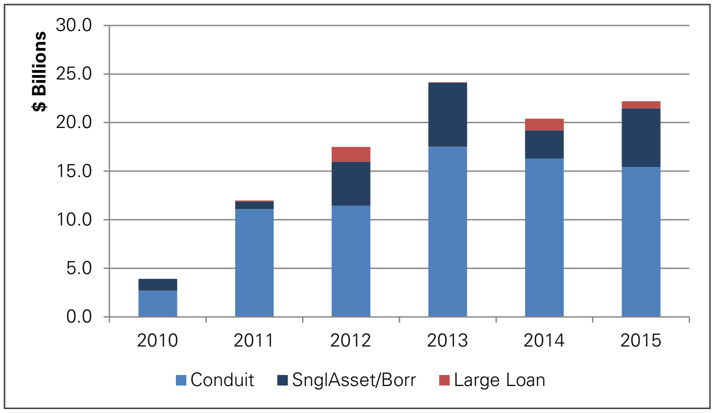


Figure 5. New Issuance



New Issuance

Macro volatility, low oil prices, and the first Fed rate hike caused a freeze in new CMBS issuance in the first quarter. New retail issuance in the first quarter came in at $2.5 billion, down more than 50% from $5.9 billion in Q1 2015. Underwriting quality in retail has remained relatively stable compared to the other major property types. The percentage of partial and full interest only loan structures have increased but average conduit loan LTVs have flattened and dropped over the last four quarters. The effect of Q1 2016 volatility is highlighted in a spike of average retail loan debt yields from the 10-12% range up to above 14%. Total 2016 CMBS issuance was originally projected anywhere from $110 to $150 billion but it now looks like the market will have to stretch to match 2015 levels. Portfolio and non-bank lenders will have to step in to cover the gap between new issuance and maturing loans in need of refinancing. That will go a long way in determining how the wall of maturities will affect the overall CMBS market.

Figure 5.1 New Issuance

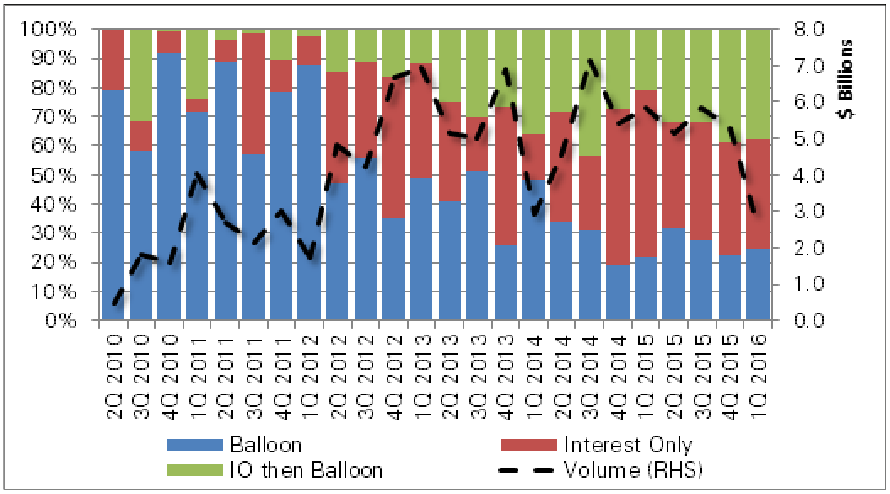
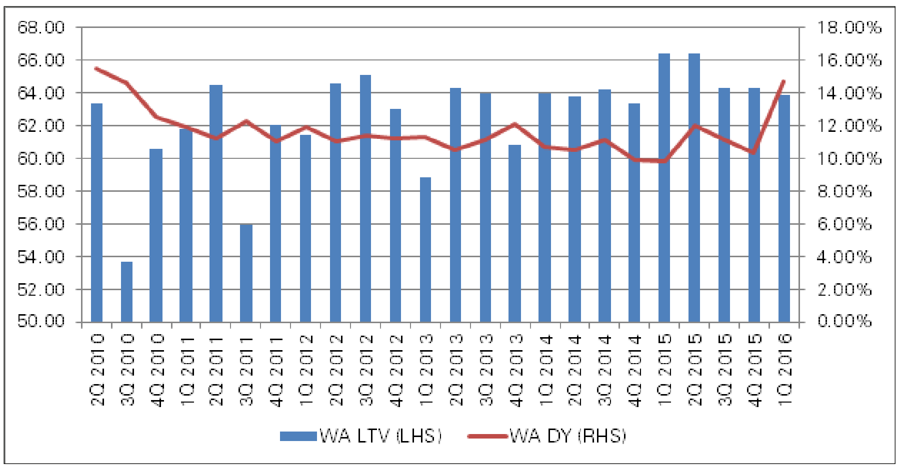


Figure 6. Conduit Retail LTV & Debt Yield



While we don't anticipate Ecommerce to slow its growth or big box retailers to suddenly turn things around, the underlying fundamentals of retail loan in CMBS are resilient. Large retail landlords are renewing their focus on drawing people to their properties and rent growth in well performing properties is strong. The outlook does not forbode an end to physical retail but for a modernized, more experiential, and streamlined brick and mortar world.

For inquiries about the data analysis conducted in this research, contact press@trepp.com or call 212-754-1010.
For more information about Trepp's commercial real estate data, contact info@trepp.com.

About Trepp

Trepp, LLC, founded in 1979, is the leading provider of information, analytics and technology to the CMBS, commercial real estate and banking markets. Trepp provides primary and secondary market participants with the web-based tools and insight they need to increase their operational efficiencies, information transparency and investment performance. From its offices in New York, San Francisco and London, Trepp serves its clients with products and services to support trading, research, risk management, surveillance and portfolio management. Trepp is wholly-owned by dmgi, the information publishing division of the Daily Mail and General Trust (DMGT).