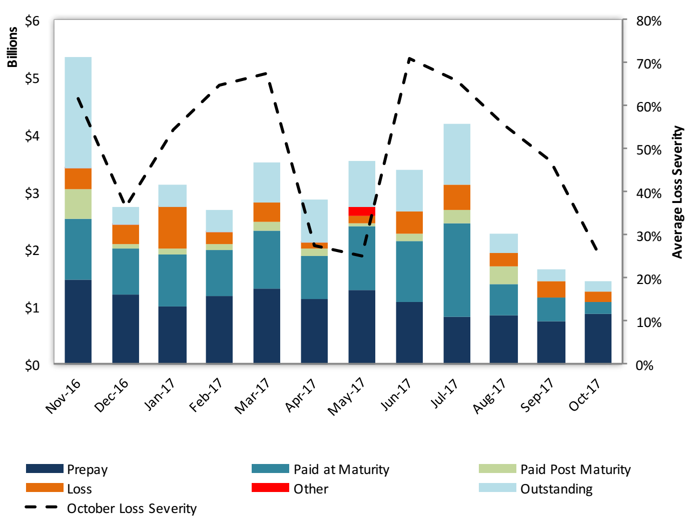
Retail Round-Up: Fewer Loans in Default; Big-Box Gets Tech-Savvy

In light of the large wave of bankruptcies and store closures that have hit the retail sector since 2016, Trepp will publish a retail recap every month to keep readers up-to-date on the sector.

As the retail landscape continues to change, a rising number of big-box department stores and grocery retailers have ramped up their partnership and investment initiatives with ecommerce, tech, and delivery businesses to broaden their consumer base and brand identity. Amidst mounting pressure from online competitors, chains like Walmart and Target have been fighting back against Amazon's continued foray into various product categories and brick-and-mortar retail through new agreements and acquisitions aimed at strengthening their digital presence and delivery reach. To further engage their customers in innovative ways, many of these retailers are introducing revamped loyalty reward programs, price-matching policies, mobile shopping alternatives, and the launch of their own private-label offerings. In the securitized lending realm, changes in the way retail space is being modeled and utilized have spurred new investment into the sector and enabled many operators to thrive despite widespread concerns over the performance of the physical retail environment.

GRAPH 1: RETAIL CMBS – PAYOFFS FROM LAST 12 MONTHS



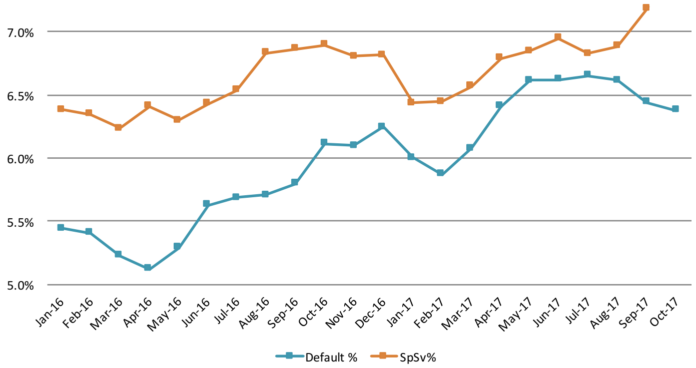
Source: Trepp

In the 12-month period between November 2016 and October 2017, roughly $29.3 billion in securitized mortgages backed by retail properties were paid off or liquidated. About 11.76% of that debt was disposed with losses at resolution. The disposed loans were written off at an average loss severity of 54.87%, resulting in a 6.89% loss on the total balance of all retail loans that paid off. In comparison, the overall CMBS loss severity for loans disposed within that time frame was just 42.78%. Based on underwritten maturity dates for loans that were scheduled to pay off during this time frame, 470 retail loans totaling $7.8 billion are still outstanding. The total volume of retail loans liquidated during the month of October reached $1.51 billion, while average loss severity for loans disposed reached a low of 25.77%.

Secured by a 439,273 square-foot, regional power center situated in a suburb of Denver, Colorado, the $50.9 million Marketplace at Northglenn note incurred the heaviest loss among all October retail disposals. Multiple tenants shuttered their locations at the REO collateral property over the years, which triggered co-tenancy clauses and drove rent rates lower. At the same time, overall sales performance in the broader Denver metropolitan area had been sluggish. The regional mall was later was purchased by Hutensky Capital Partners for a price tag of $48 million in late September, resulting in a loss of more than $18.8 million on the note.

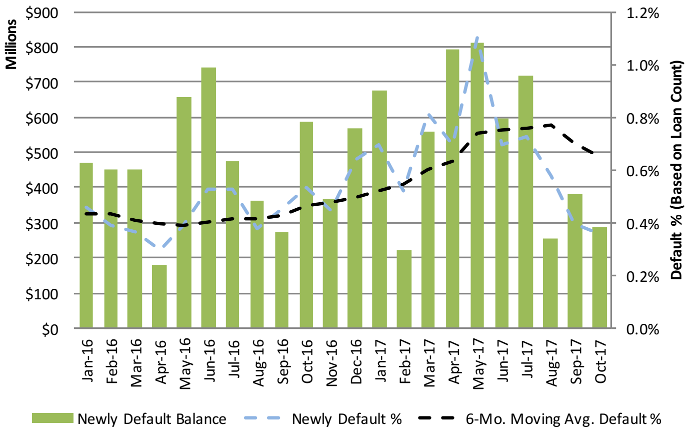
In Trepp's analysis, default rates were calculated by taking the total number of retail loans that have entered default every month and dividing that by the total number of loans that were not categorized as being in default in the previous month. To us, default is defined as loans that are 60+ days delinquent, in foreclosure, REO, or non-performing balloons. Similarly, the percentage of loans

GRAPH 2: RETAIL CMBS – SPECIAL SERVICING TRANSFER AND DEFAULT RATES



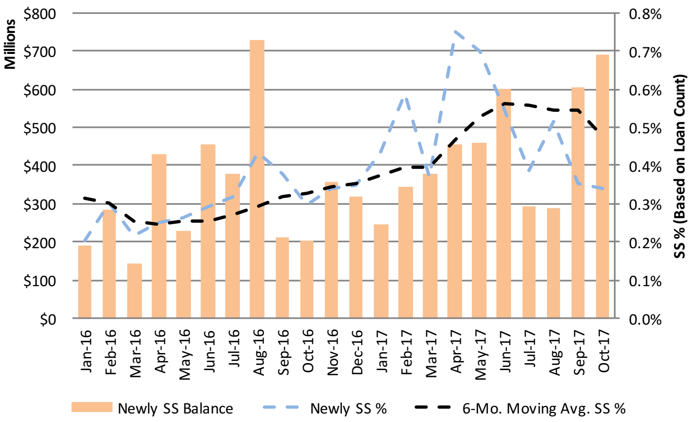
Source: Trepp

GRAPH 3: RETAIL CMBS – NEWLY DEFAULTED RATES



Source: Trepp

GRAPH 4: RETAIL CMBS – SPECIAL SERVICING TRANSFER RATES



Source: Trepp

that are newly transferred to special servicing is calculated by taking the total count of loans that were transferred to special servicing in the present month as a numerator, and using the total number of loans that were not in special servicing in the month prior as a denominator. Total loan count was used in this study rather than outstanding loan balance to give equal weight to each retail transaction, regardless of asset size.

Newly Defaulted Retail Loans

In the month of October, 23 loans with a combined outstanding balance of $286.5 million were newly categorized as in default last month at a rate of 0.36%. This is roughly four basis points lower than September's rate of 0.40%. The six-month moving average default rate, which can be used as an indicator of prevailing trends, fell five basis points from 0.70% in September 2017 to 0.65% in October.

The largest loan to default in October was the $80 million Bangor Mall note which represents 22.04% of the remaining balance behind MSC 2007-IQ16. Constructed in 1979, the subject collateral is a regional mall in Bangor, Maine containing 658,827 square feet of retail space. Recent servicer commentary indicated that the loan was sent to special servicing in late August for imminent maturity default after the borrower expressed difficulty in securing refinancing despite actively reaching out to potential lenders. To make matters worse, lead tenant Macy's (which occupied 22.16% of the net rentable area) flagged the Bangor Mall location as one of the stores it was closing this past spring. The loan matured last month and is currently marked as a non-performing matured balloon.

The percentage of all retail loans in default dipped to 6.38% in October, down from a reading of 6.44% in September and 6.62% in August. The national CMBS default rate for all property types, which has been trending downwards in the past two months, came in at 5.28% and 5.19% for September and October, respectively. This compares to a rate of 5.43% for the month of August.

Newly Transferred to Special Servicing

In October, 22 loans with a combined balance of $691.6 million were sent to special servicing, generating a special servicing transfer rate of 0.34%. This is down from a transfer rate of 0.51% and 0.35% for the months of August and September, respectively. The six-month moving average transfer rate was pegged at 0.48% for October, which is down seven basis points from the rate recorded in September.

The largest loan that was sent to special servicing in October was the $506.6 million Toys R Us single-borrower transaction that makes up 100% of TRU 2016-TOYS. Anchored by a portfolio of 123 retail properties tied to Toys "R" Us and Babies "R"Us stores, the loan was sent to special servicing shortly after the retailer filed for bankruptcy protection in mid-September. Toys "R"Us representatives have noted that the vast majority of its physical stores remain profitable and that the bankruptcy is not expected to impact its current nationwide operations.

In the past two months, the retail special servicing rate has jumped considerably due to a drop in outstanding retail CMBS coupled with a rise in the balance of retail loans currently in special servicing. Consequently, the special servicing rate climbed to 7.60% in October from a figure of 7.18% in September and 6.88% in August.

Recent Retail Headlines:

- **Amazon/Kohl's:** Amazon and Kohl's have entered a new partnership. In a bid to increase in-store sales traffic, select Kohl's stores will accept Amazon customer returns, and will carry a number of Amazon products from its "smart home" line.

- **BJ's Wholesale Club:** Due to the weak performance of retail in the public markets, private equity owners CVC Capital Partners and Leonard Green & Partners are reportedly exploring a potential sale of BJ's Wholesale Club Inc. instead of taking the company public via IPO. The two firms are hoping to attract a purchase offer ranging between $4 billion to $4.5 billion, with KKR named as one of its potential buyers.

- **Gymboree:** The children's clothing retailer recently closed up its four-month bankruptcy protection stint that involved eliminating more than $900 million in debt from its balance sheet and closing 330 physical stores. Bain Capital now shares ownership of Gymboree with its existing lenders Searchlight and Apollo Global Management, among others. As a result of the exit restructuring, Gymboree also obtained an $85 million loan, in addition to access to a $200 million revolving credit facility.

- **Mattress Firm:** According to a document from the Office of the Harris County District Clerk, the nation's largest specialty bedding retailer submitted a lawsuit in late October against two of its former in-house executives, a series of developers, and its nationwide broker, Colliers International. The lawsuit alleges that the aforementioned parties colluded in a multi-year scheme involving bribery, fraud, and kickbacks. Mattress Firm, which currently operates about 3,400 stores in the US, claims that Colliers accepted gifts from brokers and was responsible for steering the company to locations with inflated rates. The suit indicates that the parties involved were responsible for the opening of roughly 1,500 stores since 2009, 800 of which may have been affected by the alleged scheme.

  Mattress Firm is listed as one of the five largest tenants at 168 CMBS properties backing 124 securitized deals which amount to rougly $1.12 billion. Out of this total, 117 locations back single-property loans, while another 51 stores serve as collateral for multi-property retail portfolios.

- **Perfumania:** On October 11, the nation's largest discount retailer and distributor of fragrances officially emerged out of chapter 11 bankruptcy following a two-month recapitalization effort that involved closing underperforming stores and transforming to a privately held entity. During the bankruptcy process, Perfumania Holdings downsized its physical footprint by 65 stores, slashed roughly 195 employee jobs, received an equity infusion to fund ongoing operations, and offered stockholders the option to collect $2 per share in exchange for a shareholder release agreement. Going forward, Perfumania hopes to place a greater emphasis on growing its ecommerce business.

- **RadioShack:** RadioShack received court approval for a reorganizational plan in late October that would bring the firm out of bankruptcy for the second time since 2015. After shuttering all but 28 locations from its 1,500-store footprint this year, the electronics retailer plans to shift away from brick-and-mortar retail and will primarily operate through web-based platforms, as well as its dealer network connections. Radioshack will also assume a $23 million second-lien mortgage and pursue a litigation case against former co-branding sponsor Sprint while its debtors attain full ownership of the company.

- **Sears:** After a failed attempt to find a solution that would enable the retailer to continue running its operations, the Ontario Superior Court allowed Sears Canada to commence liquidation sales on its remaining 130 stores throughout the country after 65 years in business. The liquidation process that began on October 19th will affect around 12,000 employees and follows the first round of Sears Canada closures from June that impacted roughly 2,900 workers and 59 stores. Sears Canada is a major tenant for two CMBS loans with a combined balance of $32.1 million. The loans are backed, respectively, by a 224,836 square-foot community shopping center in Stratford, Ontario, and a 358,410 square-foot regional mall in Sorel-Tracy, Quebec.

  Regarding its US operations, Sears Holdings Corp. announced on November 2nd that the retailer will close another 18 Sears stores and 45 Kmart locations nationwide by January 2018. The latest batch of US closures poses exposure to seven CMBS loans totaling $132.0 million. The largest loans to watch are the $61.2 million Southpark Mall note (which comprises 6.58% of JPMCC 2012-CBX), the $26.1 million Sunset Mall loan (19.97% of CD 2007-CD4), and the $15.2 million University Mall loan (100% of WBCMT 2004-C11). Sears currently serves as the top anchor tenant in all three of the properties behind these loans. Two of the loans from our exposure list are securitized in deals linked to CMBX 6 and CMBX 7.

- **Target/Google:** Target recently joined the list of retailers such as Walmart and Home Depot that have partnered with Google in an attempt to remain competitive against the growing dominance of Amazon. In addition to offering a voice-activated shopping service via Google Assistant, Target will also

CHART 1: MSAs WITH THE LARGEST EXPOSURE OF RETAIL CMBS IN DEFAULT

MSA	RETAIL DEFAULT BALANCE	TOTAL RETAIL EXPOSURE	WALTV*	WADSCR*	AVG. OCCUPANCY*
Las Vegas-Henderson-Paradise, NV	$319,267,614	$4,677,977,680	58.94%	2.12	93.79%
Chicago-Naperville-Elgin, IL-IN-WI	$310,168,764	$2,786,201,857	66.38%	1.75	96.20%
New York-Newark-Jersey City, NY-NJ-PA	$306,410,713	$12,375,913,269	59.65%	2.09	97.33%
Phoenix-Mesa-Scottsdale, AZ	$253,172,025	$2,276,376,732	62.57%	1.86	93.16%
Detroit-Warren-Dearborn, MI	$224,620,565	$1,636,328,713	76.19%	1.80	94.34%
Riverside-San Bernardino-Ontario, CA	$220,513,530	$2,018,192,225	63.59%	1.97	93.93%
St. Louis, MO-IL	$215,627,653	$977,524,420	56.13%	2.79	95.94%
Dallas-Fort Worth-Arlington, TX	$191,004,892	$2,564,082,020	65.42%	1.89	93.25%
Virginia Beach-Norfolk-Newport News, VA-NC	$171,068,058	$1,158,738,371	68.02%	2.03	96.06%
Pittsburgh, PA	$155,735,728	$581,782,207	68.96%	1.90	96.78%

**WALTV, WADSCR, and average occupancy columns are based on most recently reported values for all current, fixed-rate securitized retail loans* undergo a nationwide expansion of its Google Express program to facilitate faster home delivery. The retailer will also debut its loyalty card as a payment option starting next year.

- **Walgreens/Rite Aid:** Walgreens, which gained formal regulatory approval to purchase a share of Rite Aid's store portfolio back in September, announced plans to shutter roughly 600 locations next year during a recent Q3 earnings call. Over the past two years, Walgreens has faced intense criticism surrounding its attempts to finalize a Rite Aid merger due to antitrust concerns claiming the acquisition could drive up drug prices. Under the newly approved agreement, Walgreens will be taking over 1,932 Rite Aid locations in a cash deal worth $4.38 billion. The closures are expected to commence in early 2018 and should take place over the course of 18 months. Those stores on the chopping block are mostly Rite Aid locations that are in close proximity to other Walgreens stores.

- **Walmart:** Walmart's Jet.com is debuting a new private-label brand coined Uniquely J, aimed at providing household items for the value-conscious millennial demographic. The department retailer is featuring a new higher-end product line of daily essentials and grocery products to cater to its younger group of consumers.

For more information about Trepp's commercial real estate data, contact info@trepp.com

For inquiries about the data analysis conducted in this research, contact press@trepp.com or 212-754-1010.