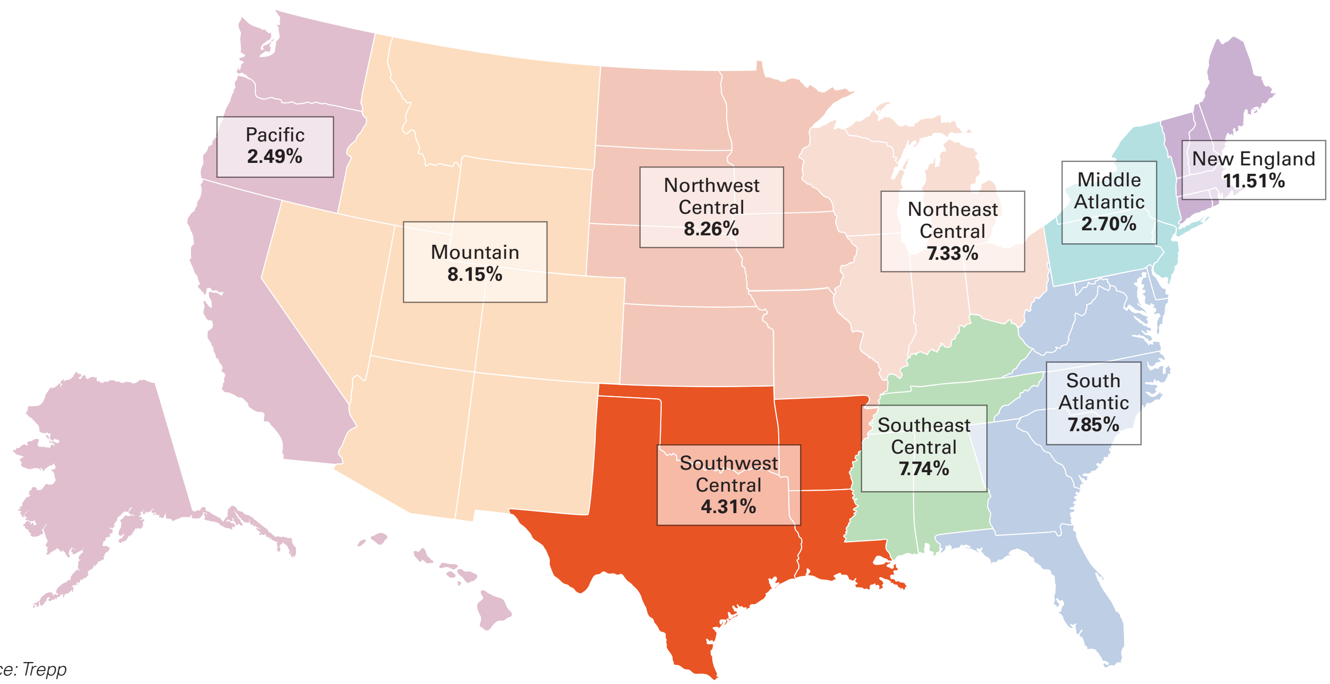
Texas Boosts Southwest CMBS Performance, but is High Retail Concentration Concerning?

Barbecue, Mardi Gras, and cattle ranges might be some of the images that come to mind when one thinks of the Southwest Central region of the US, which is made up of Texas, Louisiana, Arkansas, and Oklahoma. However, the region also represents a significant portion of the CMBS market. More than $40.4 billion in outstanding CMBS features a Southwest Central property as collateral, which makes up about 10% of the total private-label CMBS balance in the US. The region has a relatively low delinquency rate of 4.31% overall, compared to the 5.21% delinquency rate for all US CMBS loans measured in October. Louisiana loans are underperforming the set, while Texas loans are outperforming with the highest DSCRs and below-average delinquency. Loans backed by Texas properties represent more than 80% of the region's CMBS balance, with approximately $33.3 billion of outstanding debt.

The largest MSAs by CMBS balance within these states are Houston, Dallas-Fort Worth, Austin-Round Rock, New Orleans, San Antonio, and Oklahoma City. The Houston metro area has a high concentration of retail and multifamily loans, and the local economy is largely driven by both traditional and renewable forms of energy technology. Office loans make up a sizeable portion of the Dallas-Fort Worth market, as its key industries include information technology and data, financial services, life sciences, telecommunications, and defense. The Austin-Round Rock area — which features nearly $3 billion of outstanding CMBS debt — is a hub for creative & digital media technology, clean energy, and manufacturing. The New Orleans MSA secures the next-highest balance, the majority of which is lodging debt, as the area is driven by tourism. Five of the ten largest MSAs in the region are located in Texas.

MAP: US CMBS DELINQUENCY RATES BY REGION



Source: Trepp

In late August, the Houston area was hit hard by Hurricane Harvey, the most powerful Category 4 storm to make landfall on the United States in more than a decade. Although Harvey dumped approximately 19 trillion gallons of water onto Southeast Texas in a span of four days, JLL research reports that the majority of the Houston CRE market was relatively unharmed and is in the process of repair. The firm reports that the industrial and retail sectors were largely unaffected by the storm, while about 16 million square feet of office inventory was damaged. The damaged office space in Houston comprises about 10% of Class A and B offices that is tracked by JLL. As of October, the majority of this damaged space is already operational. About 10,600 multifamily units were damaged by storm waters and flooding, which only represents 1.7% of Houston's multifamily market.

CHART 1: TOP SOUTHWEST CENTRAL MSAs BY CMBS BALANCE

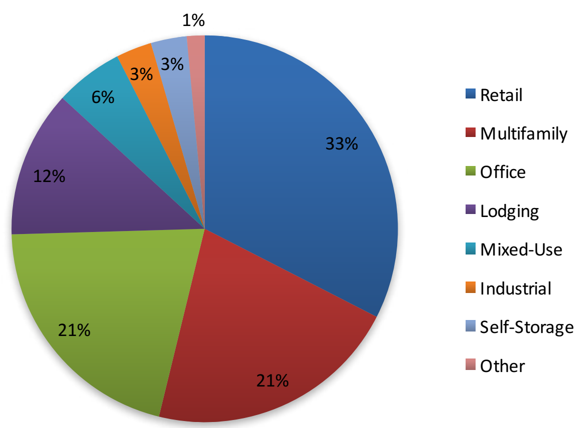
MSA	CURRENT BALANCE ($ MILLIONS)	LOAN COUNT
Houston-The Woodlands - Sugar Land, TX	$12,131	814
Dallas-Fort Worth-Arlington, TX	$10,448	724
Austin-Round Rock, TX	$2,907	179
New Orleans-Metairie, LA	$2,387	108
San Antonio-New Braunfels, TX	$1,795	146
Oklahoma City, OK	$995.4	59
Baton Rouge, LA	$570.3	53
Lubbock, TX	$469.2	26
Tulsa, OK	$416.0	37
Lafayette, LA	$376.5	20

Source: Trepp

Malls and Shopping Centers Abound in Southwest Central

Retail loans comprise 33% of the total Southwest Central region loan balance. Texas-backed loans make up the majority of the retail volume with about $10.1 billion of outstanding debt. Multifamily loans make up the next-highest percentage of the region's total CMBS balance with 21.3%, followed by the office sector with 20.7%. Dallas and Austin offices make up the majority of the region's CMBS office debt, while Houston properties secure the majority of the retail and multifamily segments.

GRAPH 1: SOUTHWEST CENTRAL CMBS BY PROPERTY TYPE



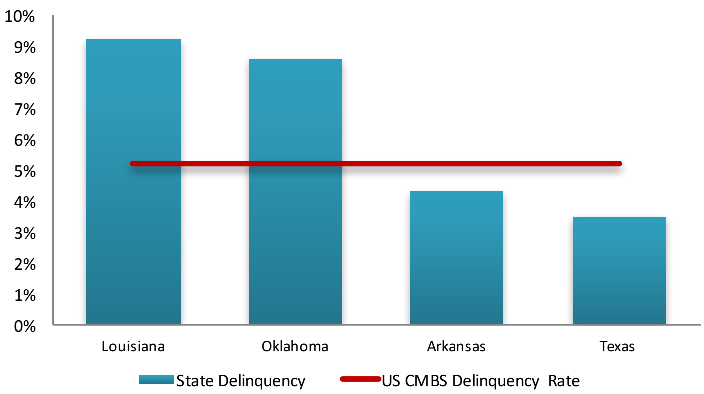
Source: Trepp

Everything's Bigger in Texas, Except the Delinquency Rate

On a state-by-state basis, Louisiana and Oklahoma posted the highest respective delinquency rates of 9.2% and 8.6% in October. While these numbers are higher than the US CMBS delinquency rate of 5.21%, loans secured by Louisiana and Oklahoma properties combine for just 15% of the Southwest Central region's outstanding balance. Arkansas properties back the smallest amount of CMBS debt ($1.0 billion for 2.5% of the region's total), although the state boasts a low 4.28% delinquency rate. Texas loans have an even more impressive 3.5% delinquency rate across its $33.3 billion in outstanding debt.

The delinquency rates for Louisiana and Oklahoma loans began to notably trend upwards in the second quarter of 2017. Louisiana loans carry the highest delinquency rate in the region, which rounded to a multi-year high of

GRAPH 2: SOUTHWEST CENTRAL CMBS DELINQUENCY RATES BY STATE



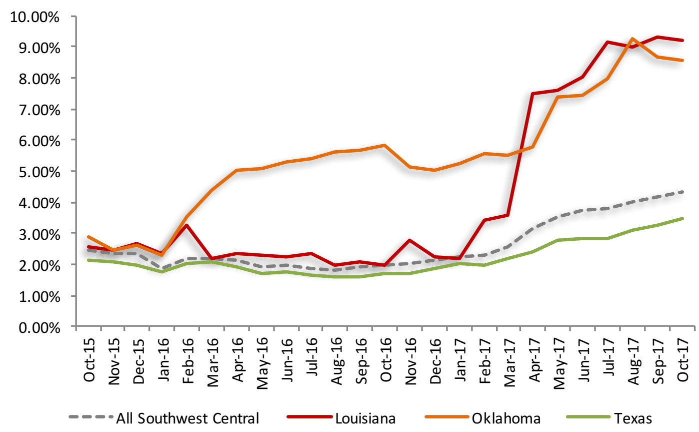
Source: Trepp

9.2% last month. The state's delinquency reading shot up nearly four percentage points in April. The increase was driven by the maturity default of two relatively large 2007 loans at their April balloon dates: the $123 million Mall of Acadiana loan (which represents 62.8% of BACM 2007-2), and the $36.1 million Bon Carre note (16.5% of MLCFC 2007-9).

Oklahoma-backed delinquencies have been on an upward climb since the start of 2017, and drove the state's delinquency rate to 8.6% in October. Both Oklahoma and Louisiana are retail-heavy states, and retail loans comprise around 60% of each of their delinquent CMBS balances.

The largest Southwest Central loan to become newly delinquent in October was the $45.1 million Sterling & Milagro Apartments loan. The loan is split between a $28.8 million A-note that makes up 2.13% of CSAIL 2015-C2, and a $16.3 million piece within CSAIL 2015-C3. The underlying collateral is a 1,179-unit garden apartment complex in Houston that was built in 1978 and renovated in 2014. The loan became 30 days delinquent last month, and was transferred to special servicing after suffering major damage from Hurricane Harvey.

GRAPH 3: SOUTHWEST CENTRAL CMBS DELINQUENCY RATES



Source: Trepp

Another loan to default in October was the $19 million Arlington Center loan, which is non-performing past its maturity date. The asset is a 171,540 square-foot office building located in the Dallas metro area. The office was built in 2000 and is fully leased to JPMorgan Chase. The note makes up 8.6% of the remaining balance behind CD 2007-CD5.

CHART 2: SOUTHWEST CENTRAL CMBS – FIVE LARGEST NEWLY DELINQUENT LOANS

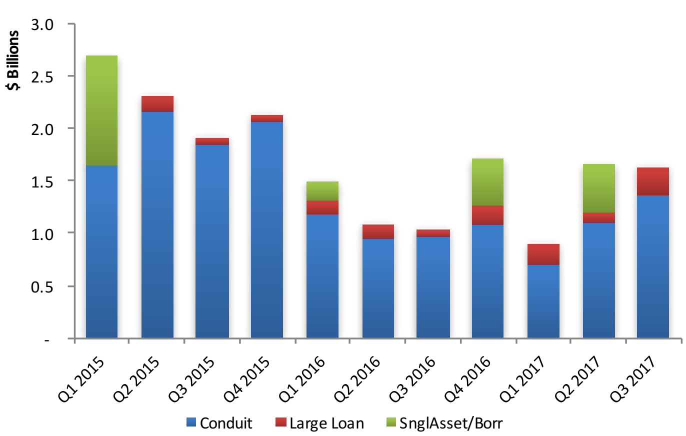
BLOOMBERG NAME	PROPERTY NAME	BALANCE	CITY	STATE	DELINQUENCY STATUS
CSAIL 2015-C2	Sterling & Milagro Apartments	$45.1 MM	Houston	TX	30 Days
CD 2007-CD5	Arlington Center	$19.0 MM	Arlington	TX	Non-Performing Beyond Maturity
BSCMS 2007-PW16	Kingwood Office	$14.8 MM	Kingwood	TX	Foreclosure
JPMCC 2016-JP4	Timbergrove Heights	$10.2 MM	Houston	TX	30 Days
GSMS 2013-GC13	Tree Tops at Post Oak	$8.0 MM	Houston	TX	30 Days

Issuance for 2017 Racing to Top 2016 Level

Private-label CMBS issuance for the Southwest Central region totaled $656 million last month, bringing the region's year-to-date 2017 total to $4.9 billion. New securitizations reached $1.6 billion in both the second and third quarters. Issuance was able to surpass the $1.5-billion mark in Q2 2017 thanks to the $465 million Greenway Plaza loan securitization. The single-asset/single-borrower loan represents GSMS 2017-GPTX in full, and is backed by a 16-property mixed-use complex in Houston. The plaza consists of ten office buildings, four retail properties, and two parking facilities. The $100 million Riata Corporate Park large loan securitization helped boost the total issuance volume for the third quarter. The collateral is a 689,069 square-foot, Class-A office campus located in Northwest Austin, Texas.

Looking at yearly totals, Southwest Central issuance levels have declined over the past few years. The yearly issuance volume dropped from $9.0 billion in 2015 to $5.3 billion in 2016. Issuance for 2017 may catch up to the 2016 volume by the end of the year if issuance keeps pace with the 2017 monthly average of $490 million through December.

GRAPH 4: SOUTHWEST CENTRAL CMBS ISSUANCE BY DEAL TYPE

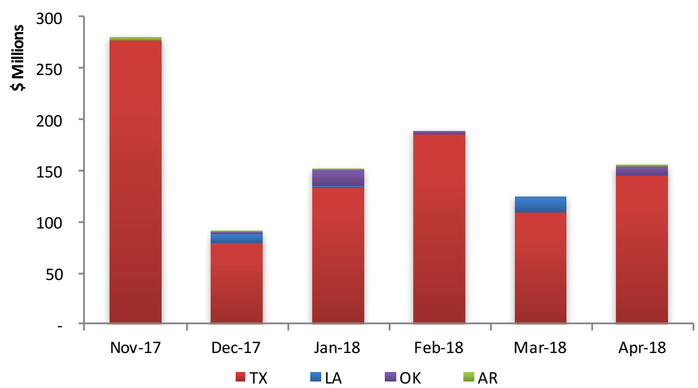


Source: Trepp

What's Due in the Next Six Months

A combined $374 million in Southwest Central debt is coming due in the last two months of 2017, which marks the end of the wall of maturities. Nearly 94% of the regional balance maturing over the next six months is backed by properties in Texas. The total volume of Southwest Central loans maturing within that time frame is about $990 million.

GRAPH 5: SOUTHWEST CENTRAL CMBS MATURITIES

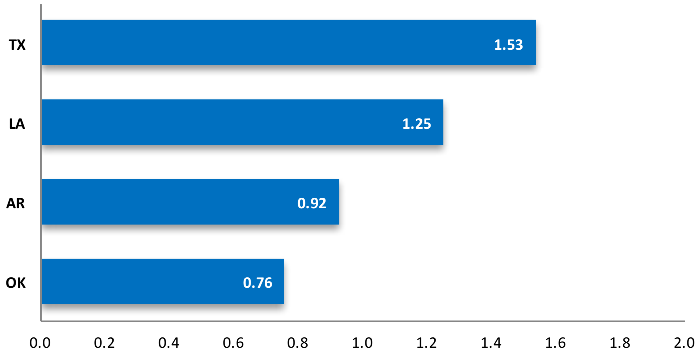


Source: Trepp

Of all Southwest Central loans coming due in the next six months, loans collateralized by Texas properties are outperforming with a weighted-average DSCR (NCF) of 1.53x. Although these loans are the strongest in the region, their average DSCR still trails the overall US CMBS average of 1.63x for loans maturing in this time frame. Louisiana-backed loans coming due in that period carry a WADSCR of 1.25x, while Oklahoma loans are lagging significantly with a rate of 0.76x. Maturing Arkansas loans are also averaging a DSCR below the 1.0x threshold, but those loans make up less than 1% of the set.

Looking ahead, maturing loans with collateral in Texas are among the top performing in the Southwest Central region, and make up the majority of the balance by a wide margin. The Houston CRE market fared better than expected in regards to the

GRAPH 6: WEIGHTED AVERAGE DSCR OF SOUTHWEST CENTRAL CMBS MATURING IN NEXT SIX MONTHS



Source: Trepp

recent tropical storm, but recent statistics may not yet reflect difficulties from property damage caused by Hurricane Harvey. More loans like the Sterling & Milagro Apartments note may report distress in the coming months, due to damage and repair costs. Even so, Texas loans have a very low delinquency rate, and the thriving office, retail, and multifamily markets in Dallas, Houston, and Austin will likely keep loan performance up and delinquency down.

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