



Retail Relies on Solid Fundamentals to Counteract Bankruptcies and Closures

Brick-and-mortar retail continues to be disrupted by technologies that offer convenient online purchasing channels, engaging experiences with consumers, and lightning-fast production time to keep pace with millennial trends. Although this mass adoption of technology affords retailers the opportunity to innovate and create new streams of profit, it has rendered the business models of some less-agile retailers obsolete. The recent wave of firms that have failed to stay afloat amidst this evolution includes The Limited, Payless ShoeSource, hhgregg, Rue21, Gordmans, Gander Mountain, Wet Seal and MC Sports. Big box retailers such as JCPenney, Macy's, Sears and Kmart have continued to close stores in 2017.

The mall subsector has been the segment most impacted by the recent slew of closures, as many malls have struggled over the past few years due to the underperformance of department store anchor tenants. The closures are now leaving many malls and shopping centers with large vacancies that may be difficult to backfill. The repercussions of this turmoil on the CMBS market include a rising delinquency rate for retail loans, as well as elevated loss severity in recent years. To boot, the wall of maturities has placed further pressure on the CMBS sector, especially retail debt.

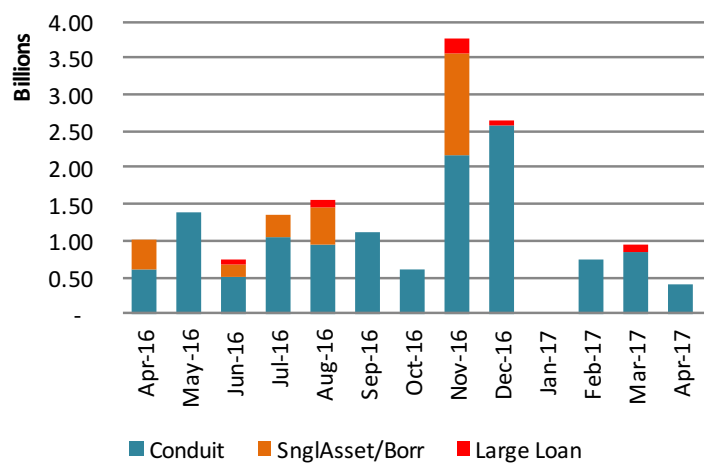
Although a significant amount of real estate is impacted by retail bankruptcies and closures, the sector has robust fundamentals that encourage future sales growth. US consumer confidence and spending is on the rise, and the GDP has increased for eight straight years. Unemployment is also extremely low and remains under 5%. JLL reports that net absorption for US retail space in 2016 was still positive at 105.7 million square

feet, despite the 41.4 million square feet impacted by store closures. This implies that other retailers—such as specialty stores and restaurants—are performing well enough to offset some of the shortfalls from mall turnover.

Retail Issuance Slows, but Conduit Remains King

Trepp data shows that private-label issuance (classified as conduit, single asset/borrower, and large loan deals) for retail CMBS dropped to roughly \$410.6 million in April 2017, compared to March's \$946.1 million. That is the lowest retail issuance volume generated in the last 14 months (excluding January 2017, when no private-label deals closed). Just \$2.1 billion in CMBS has been issued for retail properties thus far in 2017. Conduit loans made up all of last month's retail issuance volume, and 95.4% of the 2017 YTD total.

RETAIL CMBS: ISSUANCE BY DEAL TYPE



Source: Trepp

Retail loans with an interest-only structure made up the majority (81.8%) of April securitizations, a trend that has persisted over the last 12 months. Since April 2016, partial and full interest-only loans have made up over 60% of retail issuance.

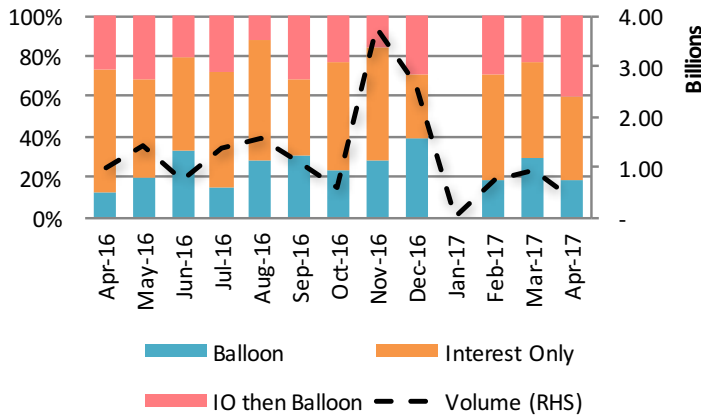
Weighted average LTV has remained steady in 2017 YTD, hovering between 60.4% and 60.7% at securitization. Cap rates for conduit retail loans have compressed

slightly - an indication that retail collateral is being valued higher. The average cap rate for securitized retail loans dipped from 5.84% in March to 5.71% last month.

Losses Subside Despite High Average Severity

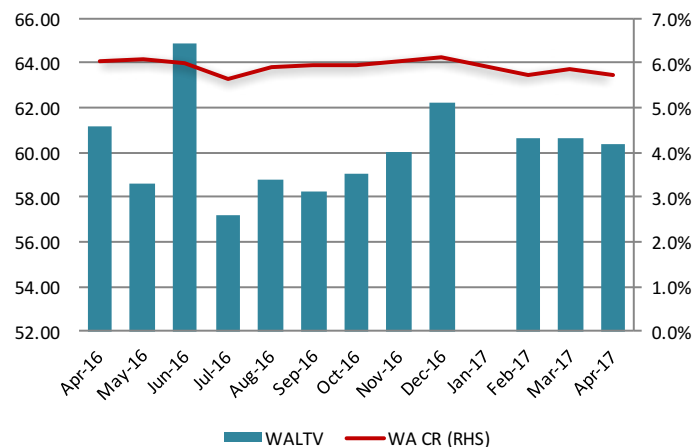
Last month, about \$112.7 million in retail loans paid off with a loss. These loans represented 5.26% of the month's total disposition volume, which is well below the 12-month average of 10.43%. The six-period moving average loss severity remains elevated at 51.5% (compared to 53.7% and 49.1% in the two months prior). However, retail loss severity for April dispositions shrank more than 43 percentage points to 23.97%.

RETAIL CMBS: ISSUANCE BY AMORTIZATION TYPE



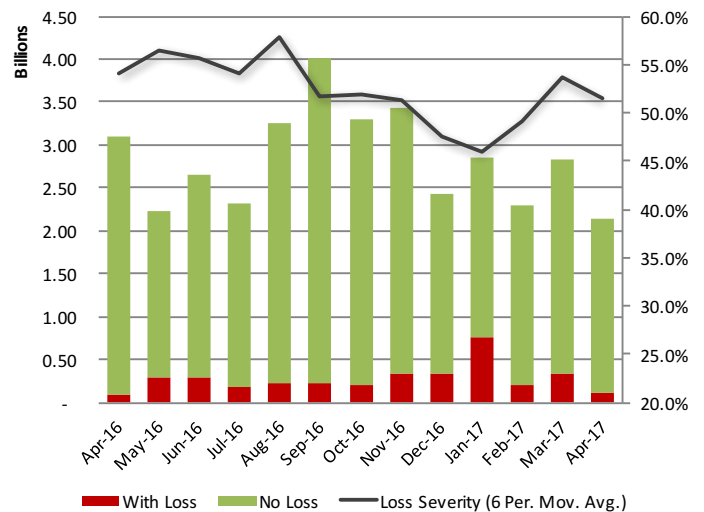
Source: Trepp

RETAIL CMBS: WA LTV AND CAP RATE FOR CONDUIT LOANS



Source: Trepp

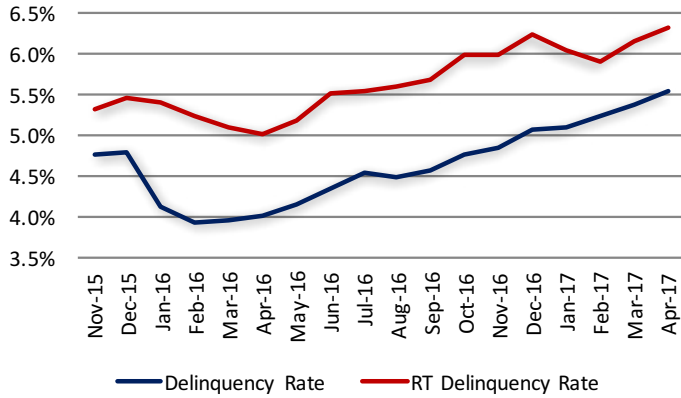
RETAIL CMBS: MONTHLY DISPOSITIONS & LOSSES



Source: Trepp

The delinquency rate for retail CMBS rose to 6.30% in April, while the overall delinquency rate jumped to 5.52%. The CMBS delinquency rate has been on an upward trend over the last 15 months as a large volume of 2006 and 2007 loans continue to mature. Retail loans make up a large portion (35.1%) of all currently delinquent loans, serving as a major catalyst in the delinquency rate's continued climb over the last year.

RETAIL CMBS: DELINQUENCIES



Source: Trepp

FIVE LARGEST NEWLY DELINQUENT RETAIL LOANS IN APRIL (BY BALANCE)					
Deal Name	Property Name	Balance	City	State	Delinquency Status
JPMCC 2007-LD11	Save Mart Portfolio	\$160.0M	Various	CA	Non-Performing Beyond Maturity
BACM 2007-2	Mall of Acadiana	\$124.4M	Lafayette	LA	Non-Performing Beyond Maturity
GSMS 2014-GSFL	Rite Aid Portfolio	\$99.4M	Various	VR	Non-Performing Beyond Maturity
MSC 2007-HQ12	Somerset Crossing	\$25.2M	Gainesville	VA	Foreclosure
JPMCC 2007-CB19	Freehold Mall	\$25.2M	Freehold	NJ	Non-Performing Beyond Maturity

Source: Trepp

A noteworthy retail loan that became newly delinquent in April was the \$124.4 million Mall of Acadiana note, which represents 52.2% of the remaining balance behind BACM 2007-2. The note defaulted at its early-April maturity date, and has been with the appointed special servicer since February. The loan is secured by a portion of the Class B regional mall located in Lafayette, Louisiana, which

is anchored by non-collateral tenants JCPenney, Sears, Macy's, and Dillard's. The special servicer is currently reviewing the borrower's modification proposal.

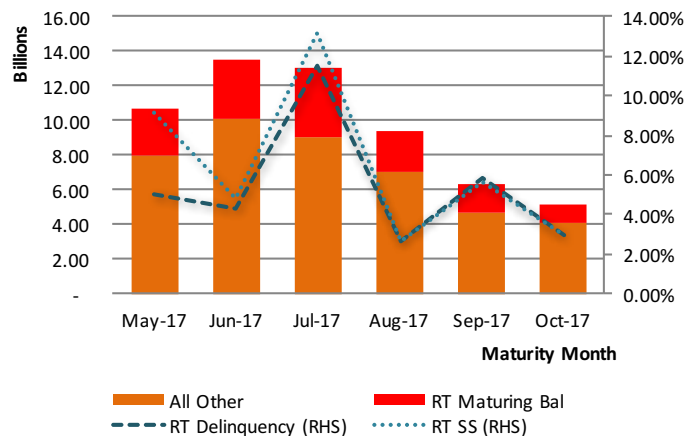
R-N-R: Retail Needs Refinancing

Per Trepp data, \$15.2 billion in retail loans will come due over the next six months, which represents 19.2% of the total balance maturing from between now and October. Of those retail maturities, 6.16% are currently delinquent, and 7.41% are currently in special servicing.

This month, \$2.6 billion in retail debt is maturing, 5.03% of which is delinquent. Next month, \$3.4 billion across 372 retail loans are slated to mature, though only 4.31% of that balance is currently delinquent. Our data indicates that of the \$4.0 billion scheduled to pay off in July, 11.5% of that debt is currently delinquent.

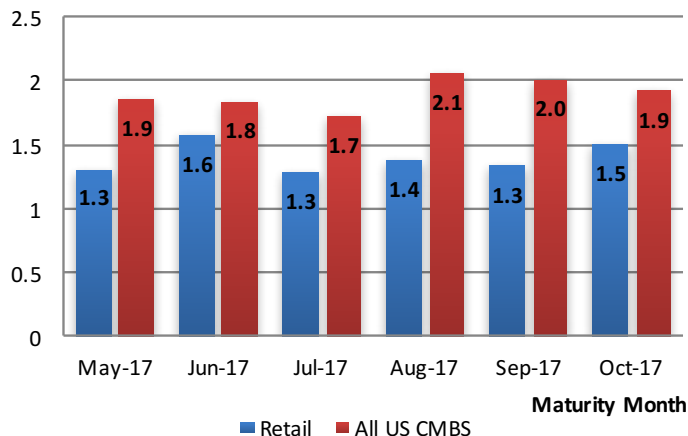
Retail loans coming due within the next six months come with a weighted average DSCR of 1.36x, compared to 1.81x for all US CMBS loans maturing within the same time frame. The loans maturing in May, July, and September boast the lowest DSCRs, as the weighted average level for each of these months is 1.30x.

MATURING RETAIL CMBS - VOLUME AND DISTRESS RATES



Source: Trepp

MATURING RETAIL CMBS - WEIGHTED AVERAGE DSCR



Source: Trepp

Looking Ahead

Most industry players are keeping their eyes peeled on mall loans. As previously mentioned, these loans and underlying properties are the ones most severely impacted by the recent rounds of retail bankruptcies and deserted department stores. According to *The Atlantic*, a fundamental reason for the struggles of big box retail is simply that “America built too many malls” between 1970 and 2015, as the number of malls expanded more than twice as fast as the population during that period. Meanwhile, mall visits have consistently declined every year since 2010.

The rise of social media may actually offer an invaluable window into consumer spending trends. Overall sales for clothing stores have declined in recent years, while traveling and dining out have skyrocketed.

Although many disregard social media content as superficial, *The Atlantic* states a “conventional beach pic[ture] or a well-lit plate of glistening avocado toast” has a much broader implication: that people are interested in spending for photogenic travel destinations, restaurants, and experiences. In this light, traditional malls have lost some appeal. Food, entertainment, and fitness retailers that can adapt and incorporate technological experiences will likely continue to take a growing market share.

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