

# Global CMBS Newsletter

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## RETAILER BANKRUPTCIES: A CLOSER LOOK AT THE EXPOSURE OF DBRS-RATED CMBS TO STEVE & BARRY'S

It's not news that consumer spending is down and, as a result, retailers have a heightened sense of urgency to make tough business decisions to survive in this market. Many retailers, including the retail darling Starbucks, have announced plans to reduce the number of stores and scale back on expansion plans. On one hand, there are the financially solvent ones who can take appropriate measures to survive in a declining economy; on the other hand, there are the ones who are forced to seek bankruptcy protection as a means of trying to recapitalize and reorganize their companies or are forced to liquidate. It is our belief that more retailers will be forced to choose the bankruptcy route and many will liquidate, leaving behind big holes in our regional malls, lifestyle centers, power centers and strip centers. As evidence, retail delinquencies in CMBS have begun to rise as a result of lost tenants and reduced revenue. Trepp currently reports retail delinquencies at 0.35%, showing an uptick in new delinquencies, with 29% being loans that have recently gone 30 days delinquent. The hidden danger associated with store closures and retailer bankruptcy liquidations is the co-tenancy clause that may be embedded in leases, giving other ailing retailers the option to reduce their rents or break their leases and vacate dying centers.

Recently Steve & Barry's (S&B) filed for Chapter 11 bankruptcy protection and many reported that the exposure to S&B within CMBS was small, based on the number of loans and number of CMBS deals affected. Over the past ten years, S&B positioned itself as a viable anchor in many regional malls. Oftentimes, S&B was able to take space that may have been sitting on the market for quite some time, having been left vacant by another defunct or consolidated retailer. Landlords were happy to fill the void, even if it meant cutting a deal on rent and tenant improvement allowances. Therefore, it is good news for most of the loans in DBRS-rated CMBS pools secured by malls with exposure to S&B that the rent is low and the bottom-line contribution from S&B is minimal in most cases. If S&B finds itself in a liquidation scenario, the likelihood of it alone translating into substantially more delinquencies is low. However, it could amplify, depending on the exposure to other contracting or liquidating tenants: CompUSA, Bombay Company, The Sharper Image, Charming Shoppes, Starbucks, Demo Clothing (PacSun), Talbots, Ethan Allen and Movie Gallery. The same holds true as rumors of a potential Mervyns bankruptcy emerge.

The following five loans, each in a different CMBS transaction rated by DBRS, have exposure to S&B stores. The effects of a complete liquidation would be different on each of the loans and we explore each loan's sensitivity to S&B. In bankruptcy court, the retailer has the ability to accept or reject certain leases based on performance. Because we do not have updated sales figures for the spaces that S&B occupies, it remains a coin toss when predicting which leases would be kept or rejected in the event the retailer successfully reorganizes. S&B often leased large blocks of undesirable space; therefore, even with their low contractual rent payments, there may not be a lot of value in accepting leases with in the hopes of being able to assign them to new tenants.

### Exposure from Largest Impact to Smallest Impact

Loan	Deal	OPB (\$)	% of Pool	S&B SF	% of Total Owned NRA	% of Total Rent
Colonial Mall at Glynn Place	<a href="#">MLCFC 2006-1</a>	21,813,572	1.04%	86,579	30.6%	16.8%
Ashtabula Mall	<a href="#">MSC 2007-IQ16</a>	40,300,000	1.55%	76,889	10.2%	5.8%
Silver City Galleria	<a href="#">JPMCC 2005-LDP4</a>	131,420,605	5.13%	73,641	10.3%	6.2%
Charleston Town Center	<a href="#">BSCMS 2007-TOP28</a>	100,000,000	5.69%	31,687	9.0%	4.4%
Lakeside Mall	<a href="#">GECMC 2005-C1</a>	91,521,141	5.68%	13,641	2.1%	1.3%

OPB = outstanding principal balance. SF = square feet. NRA = net rentable area.

### **Colonial Mall at Glynn Place**

S&B is the largest owned tenant at this location, comprising 30.6% (86,579 sf) of the total net rentable area (NRA). The annual rent that S&B pays is 16.8% of the total rent for the center. Originally, the loan was underwritten at a 1.29x DSCR and the direct impact of removing the S&B space would bring the issuance DSCR down to 1.19x. However, based on the YE2007 servicer operating statement analysis report (OSAR), without rent from S&B, the net cash flow (NCF) DSCR would decrease to 0.93x. This loan is subject to a cash flow sweep if one of its anchors files for bankruptcy protection; at issuance, S&B was considered an anchor in the underwriting and term sheet. DBRS has asked the servicer whether or not the cash flow sweep has been implemented. The cash flow sweep is only expected to build if S&B is in place paying rent; without S&B's rent, there will be a debt service shortfall. The loan amortizes on a 25-year schedule, which should help to de-lever the loan (currently \$77 per square foot) as long as it remains current; however, should S&B vacate, finding a replacement tenant and sufficiently increasing cash flow over the remaining 29-month term could prove difficult, increasing the refinance risk of this asset. DBRS has added the loan to its HotList and will continue to monitor the loan while the tenant is in bankruptcy. The mall is owned by a joint venture of three entities: Babcock & Brown, General Property Trust and Colonial Properties Trust (currently the mall manager).

### **Ashtabula Mall**

S&B is currently one of four major draws at the mall. As was known and addressed at issuance, Dillard's vacated in December 2007. In addition, there is a vacant 90,000 square foot (sf) pad site, formerly occupied by Do-It-Yourself Home Store. Based on DBRS's original issuance debt service coverage ratio (DSCR) of 1.23 times (x) (assumes a principal and interest payment), which did not include any rental income or recoveries from Dillard's, losing S&B would bring the term DSCR down to 1.13x and substantially compromise the refinance profile of the asset if new tenants were not found during the term of the loan. DBRS is not aware of any co-tenancy clauses associated with S&B at this mall. While we have not added this loan to the Hotlist because term coverage should remain above 1.0x and rollover is minimal until 2012, DBRS will continue to watch this asset for further deterioration given its tertiary location and loan structure. The mall is owned by a tenants in common (TIC) structure, which diminishes the ability of the sponsor to put additional funds into the mall; however, there is a reserve in place for leasing and the sponsor has hired a reputable manager (Jones Lang LaSalle) to manage and lease the property.

### **Silver City Galleria**

S&B is the fourth largest tenant and an anchor at the mall. It comprises 73,641 sf and 6.2% of the total rent, with a lease expiring in 2012. The loan was structured with a springing reserve if the DSCR falls and remains below 1.25x. Without S&B, the projected cash flow from the YE2007 OSAR would decline from a DSCR of 1.42x to 1.36x and likely not hit the DSCR reserve trigger. The mall is owned and managed by GGP.

### **Charleston Town Center**

S&B is the fourth anchor, with 31,687 sf, and is part of the mall collateral. The other three anchors own their stores. S&B contributes 4.4% of the base rent; therefore, performance is not likely to decline substantially without S&B rental revenue. At issuance, DBRS noted that S&B had experienced declining sales and therefore marked its rent down accordingly to a 10% occupancy cost rather than a 16% occupancy cost. Losing S&B would bring the YE2007 DSCR down from a reported 1.77x to 1.69x. The loan sponsors, Forest City and The Cararfo Company, are experienced mall and retail center owners, operators and developers.

### **Lakeside Mall**

S&B is the third largest in-line tenant in this mall, with 13,641 sf. S&B's rent comprises only 1.73% of the total rent. Even though it is the third largest in-line tenant, if the store were to close, the impact on the bottom-line DSCR would be minimal. The mall is owned and managed by General Growth Properties, Inc. (GGP).

Our concerns with S&B probably end with Colonial Mall at Glynn Place and Ashtabula Mall; however, we do find that it will be essential for retail owners and managers to closely monitor declining sales volumes, consolidations, lease expiries and tenant bankruptcies. The well-capitalized operator with national management should be in a better position to weather the storm. Properties with remote or challenged locations will have a difficult time attracting new tenants, especially in a market where retailers are contracting. As a result, DBRS expects in the near term that retail delinquencies will continue to rise.

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