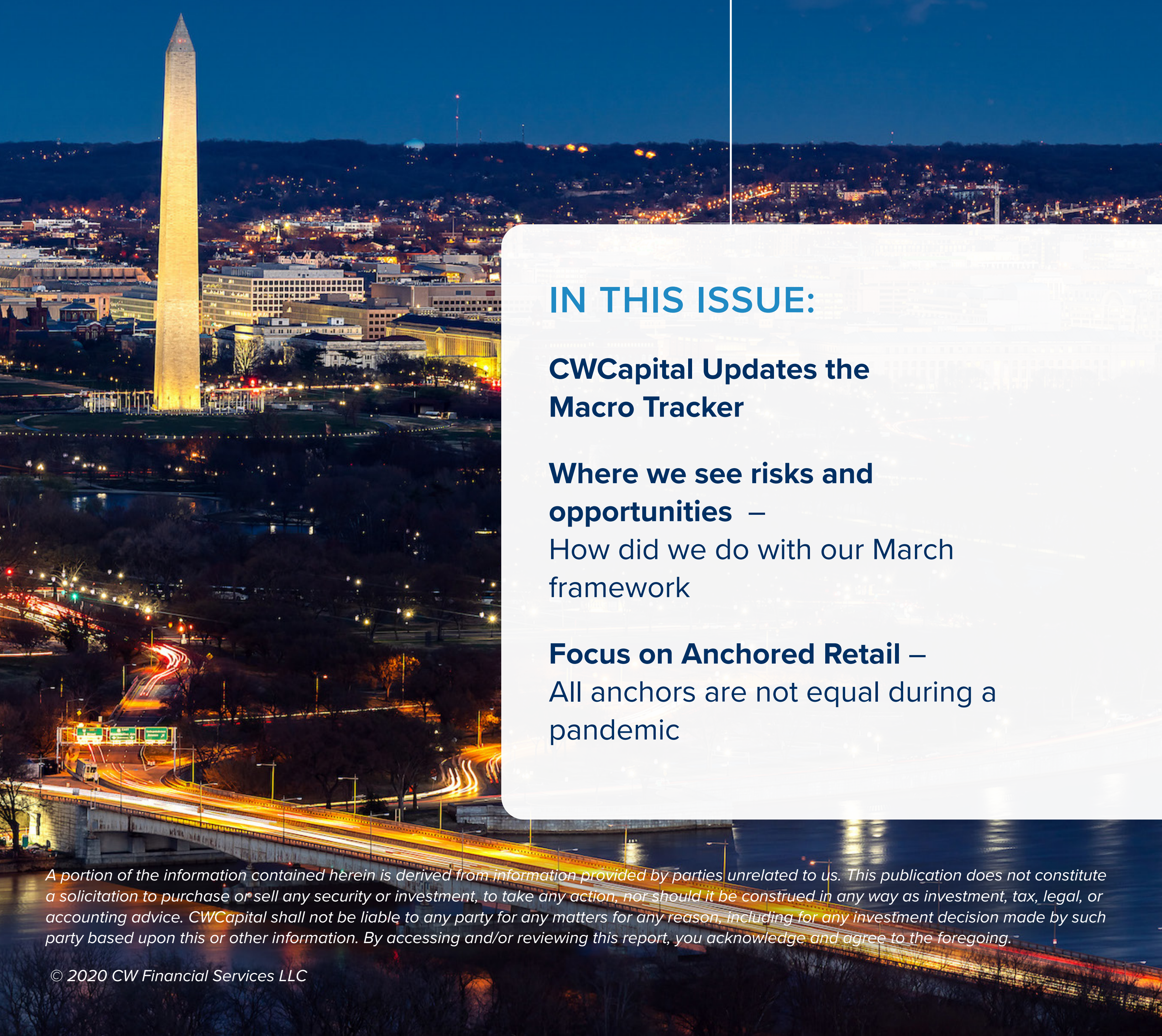
Markets Update

JUNE 2020



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Focus on Anchored Retail – All anchors are not equal during a pandemic

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In this issue of the CWCapital Markets Update, we review current performance, delinquencies, and developments in the marketplace and compare our March framework to how things have played out over the last few months. While the general crisis around the COVID-19 pandemic, oil price and economic collapse, and resultant record unemployment continues to unfold, we can stop for a moment to make some general assessments:

THE GOOD NEWS:

- As of this writing, every state has either re-opened or partially re-opened and many of the previously displaced workers were recalled. Businesses are again in position to generate at least some revenue following the unprecedented shut-down of the global economy.
- The May 2020 jobs report surprised everyone when it reported 2.5 million new jobs. This is tempered somewhat by 1.5 million unemployment claims in June, although the trend is declining.
- WTI oil recovers from $1/bbl in the futures market to $39/bbl. Not a bad recovery.

THE BAD NEWS:

- Overall unemployment remained at 13.3%, higher than at any point during the financial crisis of 2007-2009. Recovery will be slow, with some job losses permanent.
- Surge in new infections in several US states, several of which accelerated re-opening.
- Borrowers initially assuming short-term disruption now face prospects of long-term challenges and business model changes.

CATALYSTS AS WE MOVE FORWARD:
(ASSUMING NO VACCINE OR SIGNIFICANT TREATMENT IN THE NEAR TERM)

- Health implications of wide re-opening. Will we have to live on the plateau?
- Macro shifts in business models - one of our major concerns for the future of commercial real estate.
    - Will CRE continue to be profitable assuming the following business model changes:
        - Hotels – travel reductions, room cleaning, distancing measures
        - Retail – acceleration of e-commerce, and the real need for:
            - Essential goods, non-essential goods
            - Work from home
        - Restaurants – capacity reductions, distancing, cleaning
        - Student Housing – E-Learning, distancing in dorms, cleaning, potential for significant revenue reductions in sports programs and other activities
        - Entertainment – prospects for sporting events, movies, concerts, etc.
- Borrower capitulation – how long before thinly capitalized and other borrowers capitulate and exercise the securitized CRE put option.

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UPDATE – THE CWCAPITAL MACRO TRACKER

We are tracking over 24,000 commercial mortgage loans securitized across some 774 CMBS 2.0/3.0 and SASB transactions. The overall delinquency / Specially Serviced rate increased to 14.68% as of this writing in June 2020. Comparatively, this level exceeds the highest levels (over 9%) during the financial crisis between 2007-2009.

Hotel and Retail properties lead the way in distress with over 35% of all securitized hotels now in that category. Mixed-use properties (retail / office) have also seen a significant spike in distress rates. To date, Multifamily has seen lower levels of distress, however, certain subsectors (Student and Senior Housing) have (and are expected to continue to have) disproportionate levels relative to the category.

Type	Month	Defeased	Current	Late <30	30	60	SS	Total	% Non-SS Delinq	Delinq + SS
$ Balance	Jan-20	20,927.0	473,400.6	4,966.5	112.1	9.4	6,833.3	506,248.8	1.01%	2.35%
	Feb-20	21,503.5	475,176.9	5,021.5	251.3	28.5	6,937.6	508,919.3	1.04%	2.40%
	Mar-20	21,712.8	481,429.2	4,021.4	136.2	3.1	10,286.9	517,589.6	0.80%	2.79%
	Apr-20	21,921.1	452,001.6	27,233.7	584.4	11.8	16,967.1	518,719.7	5.37%	8.64%
	May-20	21,942.0	430,475.6	23,399.5	17,536.6	237.7	26,589.6	520,180.9	7.92%	13.03%
	Jun-20	22,133.3	420,446.5	14,518.2	13,116.9	5,413.6	43,113.2	518,741.7	6.37%	14.68%
% of Total	Jan-20	4.13%	93.51%	0.98%	0.02%	0.00%	1.35%	100.00%	1.01%	2.35%
	Feb-20	4.23%	93.37%	0.99%	0.05%	0.01%	1.36%	100.00%	1.04%	2.40%
	Mar-20	4.19%	93.01%	0.78%	0.03%	0.00%	1.99%	100.00%	0.80%	2.79%
	Apr-20	4.23%	87.14%	5.25%	0.11%	0.00%	3.27%	100.00%	5.37%	8.64%
	May-20	4.22%	82.75%	4.50%	3.37%	0.05%	5.11%	100.00%	7.92%	13.03%
	Jun-20	4.27%	81.05%	2.80%	2.53%	1.04%	8.31%	100.00%	6.37%	14.68%
$ Balance by Prop Type	Hotel	1,505.6	53,977.4	4,757.6	5,217.2	2,837.6	17,923.0	86,218.5	14.86%	35.65%
	Retail	3,496.7	99,326.6	5,494.0	5,602.5	1,535.5	15,243.6	130,699.0	9.66%	21.33%
	Mixed	1,128.2	30,422.9	1,430.1	948.9	589.8	3,984.8	38,504.7	7.71%	18.06%
	Office	5,445.4	137,359.5	1,685.0	535.3	306.8	3,532.9	148,865.0	1.70%	4.07%
	MultiFam	5,432.1	41,366.5	673.5	714.1	90.3	899.9	49,176.4	3.01%	4.84%
	Mfg Hsg	1,300.8	6,482.5	106.8	-	-	52.1	7,942.2	1.34%	2.00%
	Senior	35.2	1,404.4	-	-	-	-	1,439.6	0.00%	0.00%
	Indust	1,529.0	30,277.9	180.7	16.6	29.7	231.8	32,265.6	0.70%	1.42%
	Self Stor	2,027.6	13,194.9	121.9	6.6	-	25.7	15,376.6	0.84%	1.00%
	Special	196.6	4,189.1	19.6	30.1	-	1,157.0	5,592.3	0.89%	21.58%
	Other	36.0	2,444.8	49.1	45.5	24.0	62.5	2,661.8	4.45%	6.80%
		22,133.3	**420,446.5**	**14,518.2**	**13,116.9**	**5,413.6**	**43,113.2**	**518,741.7**	**6.37%**	**14.68%**

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FEATURE – WHERE WE SEE RISKS AND OPPORTUNITIES

HOW DID WE DO WITH OUR MARCH FRAMEWORK:

FIRST WAVE – HOSPITALITY

Leading into the pandemic, we had already noted some weakness in the hotel sector with significant overbuilding and competition in the sector. As in prior financial disruptions, hotels are typically the first commercial property type to be impacted in a crisis. We have seen this dynamic after September 11th, during the financial crisis, and now during the pandemic. Typically, resort and destination hotels, conference and business center hotels, travel hub hotels, and others experience drop offs in demand. During this crisis, we have seen hotel occupancies drop into the single digits, and several closings. One large hotel group CEO noted that things were starting to improve with open hotels seeing occupancies in the mid 20% area, still far from break-even operating levels.

- Delinquent and Specially Serviced Hotels are now over 35% of securitized balance.
- The spike in hotel delinquencies and distress was almost immediate with the onset of the pandemic.

Period	Defeased	Current	Late <30	30	60	SS	Grand Total	Non-SS Delinq	SS + Delinq
Jan-20	1,303.4	85,059.9	807.8	36.1	-	1,004.4	88,211.7	1.0%	2.1%
Feb-20	1,337.6	84,081.4	831.8	106.0	17.4	1,072.6	87,446.8	1.1%	2.3%
Mar-20	1,447.8	83,564.2	766.3	89.5	-	1,291.8	87,159.6	1.0%	2.5%
Apr-20	1,526.6	64,133.9	11,245.7	214.4	8.7	9,506.7	86,635.9	13.2%	24.2%
May-20	1,511.5	54,895.3	7,111.0	8,885.1	117.1	14,024.5	86,544.6	18.6%	34.8%
Jun-20	1,505.6	53,977.4	4,757.6	5,217.2	2,837.6	17,923.0	86,218.5	14.9%	35.6%

SECOND WAVE - RETAIL

With the long-term trends of e-commerce, the decline of shopping malls, and massive overbuilding, retail also had issues coming into the pandemic. Notably, the current crisis seems to have accelerated those trends in a significant way, as opposed to the complete stop experienced by hotels. Although delinquencies are now near all-time levels, retail has experienced a more gradual build toward those levels. Our initial assessment was that Grocery and Pharmacy anchored centers may perform (as essential businesses), while non-essential retail would bear most of the impact from voluntary and mandatory closures.

Period	Defeased	Current	Late <30	30	60	SS	Grand Total	Non-SS Delinq	SS + Delinq
Jan-20	3,839.4	124,180.2	1,565.7	12.4	9.4	3,154.0	132,761.1	1.2%	3.6%
Feb-20	3,964.2	123,809.7	1,298.1	10.0	3.0	3,259.2	132,344.1	1.0%	3.5%
Mar-20	3,773.5	123,041.4	1,175.8	42.8	-	3,571.0	131,604.6	0.9%	3.6%
Apr-20	3,670.0	114,055.1	8,843.2	94.6	-	4,638.3	131,301.2	6.8%	10.3%
May-20	3,670.3	102,218.1	10,414.4	5,509.0	47.0	9,266.1	131,124.8	12.2%	19.2%
Jun-20	3,496.7	99,326.6	5,494.0	5,602.5	1,535.5	15,243.6	130,699.0	9.7%	21.3%

Note the more gradual impact of specially serviced and delinquent loans.

Digging deeper into retail, we analyzed nearly 6,500 loans where we had enough information to match specific properties and tenants. No surprise that Malls lead the SS and Delinquency category, as well as among the highest percentages requesting some type of relief from the lender. Anchored retail, the largest classification of loans, had approximately 19% delinquent and Specially Serviced, with Shadow Anchored and Single Tenant performing somewhat better.

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FEATURE – WHERE WE SEE RISKS AND OPPORTUNITIES

HOW DID WE DO WITH OUR MARCH FRAMEWORK:

SECOND WAVE - RETAIL

Property Subtype	Curr	Late < 30	30	60	SS	Total	Delinq / SS	Covid Reqest	% Covid Req
Mall	25,779.5	1,639.4	2,082.3	315.1	8,141.4	37,957.7	32.08%	9,952.4	26.22%
Factory Outlet	1,006.2	104.1	201.6	-	128.9	1,440.8	30.16%	288.2	20.00%
Power Ctr/Big Box	816.7	161.2	24.6	20.4	53.2	1,076.0	24.10%	327.7	30.46%
Unanchored	5,849.0	402.2	340.0	318.4	450.9	7,360.5	20.54%	1,645.3	22.35%
Anchored	**41,163.2**	**2,669.6**	**2,132.2**	**654.2**	**4,382.9**	**51,002.1**	**19.29%**	**9,871.6**	**19.36%**
Shadow Anchored	4,134.4	180.3	328.0	88.9	143.9	4,875.5	15.20%	1,110.6	22.78%
Single Tenant	10,743.2	269.9	242.4	51.8	1,150.1	12,457.4	13.76%	731.9	5.88%
Lifestyle	1,195.5	-	97.0	51.2	-	1,343.7	11.03%	162.0	12.06%
Specialty	1,031.4	-	-	-	57.4	1,088.7	5.27%	355.4	32.64%
Mixed	2,014.8	-	-	-	-	2,014.8	0.00%	176.8	8.77%
Trade Mart	481.5	-	-	-	-	481.5	0.00%	-	0.00%
Total	**94,215.3**	**5,426.6**	**5,448.0**	**1,500.2**	**14,508.6**	**121,098.7**	**22.20%**	**24,622.0**	**20.33%**

Again, our theory coming into the pandemic was that Grocery and Pharmacy anchored retail would outperform. To test the theory, we analyzed Anchored Retail to determine the type of anchor at each property, and whether that was indicative of performance. Further, we focused on anchors making up at least 35% of the GLA, as these would be most indicative of influence on the center.

Property Subtype	Curr	Late < 30	30	60	SS	Total	Delinq / SS	Covid Reqest	% Covid Req
Prior SS	-	-	-	-	32.9	32.9	100.00%	-	0.00%
Restaurant/Food Svc	27.6	6.1	14.8	-	-	48.6	43.08%	20.9	43.08%
Fitness	781.3	43.5	214.0	60.7	229.3	1,328.8	41.20%	550.0	41.39%
Child Care	16.6	9.7	-	-	-	26.3	36.89%	-	0.00%
Thrift Store	109.3	22.2	12.1	-	-	143.5	23.85%	74.6	52.03%
Anchor < 35% GLA	25,311.6	1,943.3	1,487.8	429.8	3,630.2	32,802.8	22.84%	6,819.6	20.79%
Clearance	97.8	15.0	6.8	-	3.5	123.1	20.51%	24.2	19.63%
Healthcare	57.5	-	-	-	13.4	70.9	18.90%	-	0.00%
Furniture	177.1	34.6	-	-	-	211.7	16.35%	29.4	13.87%
Crafts, Gifts, Cards	208.0	10.3	7.3	9.8	9.1	244.5	14.93%	70.0	28.64%
Home Improvement	841.6	19.8	61.2	-	64.9	987.5	14.77%	129.9	13.15%
Home Goods	221.9	-	37.1	-	-	259.0	14.31%	60.6	23.41%
Hyper / Wholesale	1,255.3	37.9	16.4	15.8	128.0	1,453.3	13.63%	335.9	23.11%
Cinema	558.7	9.1	-	25.4	49.2	642.4	13.02%	238.6	37.14%
Clothing / Dept Store	2,337.7	92.0	117.1	58.9	70.5	2,676.2	12.65%	493.1	18.42%
Dollar Store	79.3	-	-	8.7	-	87.9	9.84%	8.7	9.84%
Electronics / Appl	403.5	22.3	-	12.2	8.5	446.5	9.62%	25.0	5.60%
Sporting Goods	556.4	17.5	12.4	-	23.1	609.4	8.69%	95.3	15.63%
Books / Hobby	454.8	33.6	3.9	-	5.2	497.5	8.57%	107.7	21.65%
Non-Retail	215.9	-	19.0	-	-	234.9	8.08%	33.3	14.16%
Grocery	6,371.5	206.4	122.4	33.0	113.5	6,846.9	6.94%	713.6	10.42%
Pharmacy	622.0	26.3	-	-	1.6	649.9	4.30%	19.5	3.00%
Financial	50.8	-	-	-	-	50.8	0.00%	-	0.00%
Liquor	35.0	-	-	-	-	35.0	0.00%	-	0.00%
Office	58.4	-	-	-	-	58.4	0.00%	-	0.00%
Other	52.2	-	-	-	-	52.2	0.00%	-	0.00%
Pets	81.8	-	-	-	-	81.8	0.00%	22.0	26.84%
Total	**40,983.7**	**2,549.6**	**2,132.2**	**654.2**	**4,382.9**	**50,702.5**	**19.17%**	**9,871.6**	

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FEATURE – WHERE WE SEE RISKS AND OPPORTUNITIES

HOW DID WE DO WITH OUR MARCH FRAMEWORK:

SECOND WAVE - RETAIL

Our findings appear to support our initial theory very well. Non-essential businesses are experiencing the highest default and delinquency rates (25%-45%), while Grocery and Pharmacy anchored centers experience almost the lowest (4%-7%).

Perhaps a few surprises in the list:

- Default and delinquency rates are somewhat lower than the overall average for centers anchored by HyperMarkets / Wholesalers (WalMart, Target, BJ's Wholesale, Costco). We would have expected these centers to perform closer to the grocery / pharmacy centers as many carry essential goods and have remained open.
- Default and delinquency rates are somewhat higher when the "Anchor" is less than 35% of the GLA. Diversity of tenants and smaller exposures may help in the long-term, but without a significant enough space, no specific anchor can support a larger center experiencing closure and business drop off during the pandemic.

THIRD WAVE - MULTIFAMILY

Our initial theory was that multifamily will have a slower progression and impact related to the pandemic than other asset types. As job losses continue to mount, we could see collection issues, declining rents, and added stress on performance. With the exception of certain subsectors (i.e., Student Housing, Senior Housing, and small balance), we still believe this is correct.

We have seen little in the way of delinquency and relief requests in conduit multifamily (3% to 4%). For Agency collateral, experience has been similar with respect to forbearance requests:

Subtype	Balance	Forbearance Request	Pct by Bal
Garden /HighRise	67,841.2	1,654.5	2.4%
Senior	7,953.9	285.5	3.6%
Student	2,965.4	354.8	12.0%
Small Balance	903.9	63.8	7.1%
Other	1,583.64	83.14	5.2%
	81,248.0	**2,441.7**	**3.0%**
		3.0%	

STUDENT HOUSING

Student housing has been on our radar for quite some time. The main reasons have been overbuilding and what may have turned out to be overly optimistic enrollment forecasts by some universities, and their push to build new state of the art housing to meet that. We published a research piece on this topic in the 3rd quarter of 2018 noting the extremely heavy building pipeline (50,000 new beds every year since 2015).

Our main concern is around the economics of online education realized during this crisis, and the cost of education in the US relative to other countries. We may see a re-pricing and student decisions resulting in less wealthy schools losing many of their student body. Third tier schools could also suffer, with their housing along with it.

A mitigant at larger universities could end up being the COVID crisis itself. As universities are required to distance and adopt safety measures in historically crowded and densely populated dorms, capacity will be reduced. That reduction could result in increased demand at nearby privately owned student housing properties.

As the pandemic and resultant unemployment crisis continues to evolve, we expect to write significantly more about the performance of multifamily in future editions of the CWCapital Markets Update.

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SOURCES

The third-party Information set forth herein may be derived from any of the following sources:

- Bloomberg
- CBRE Capital Markets
- Citibank Research
- Commercial Mortgage Alert
- CoStar
- CRE Direct
- FHLMC
- International Council of Shopping Centers
- Intex Solutions
- Morningstar Research
- Moody's / RCA CPPI
- National Real Estate Investor
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