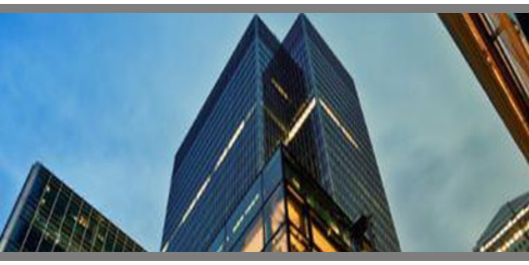
CMBS Credit Focus

Mall Foreclosures: What to Track as Servicers May Shift Away from Modifications



Mall Foreclosures Could Become Less Amicable

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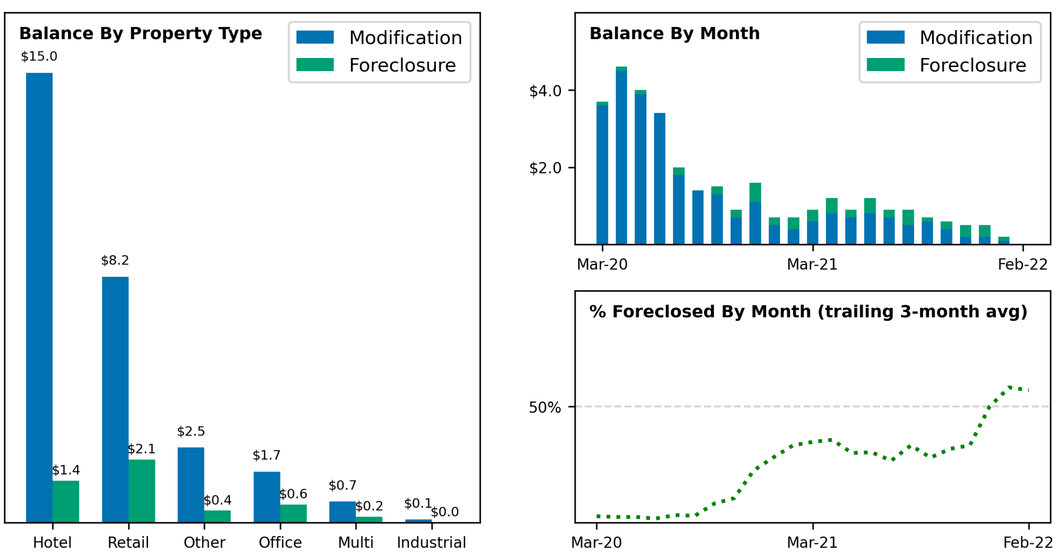
We expect to see a growing number of non-amicable mall foreclosures in the coming months. Servicers could be less inclined to approve deep modifications, even when borrowers profess commitment to their property. The potential foreclosure of the $135.9 million Poughkeepsie Galleria (UBSCM 2012-C1 and UBSC 2011-C1) is a case in point. The servicer is now recommending a foreclosure of the 1.2 million sf (691K sf collateral) regional mall in Poughkeepsie, NY, according to recent servicer commentary. This recommendation follows the rejection of a borrower-submitted mod proposal. The Poughkeepsie loan matured in November 2021.

It is not unusual for servicers to dual-track on defaulted loans. The Poughkeepsie servicer may be using the threat of foreclosure as a negotiation tactic. But if the market sees more contested foreclosures and the threat to foreclose becomes credible even on struggling malls, this could change loan resolution dynamics. Servicers clearly preferred to work with borrowers experiencing trouble during the pandemic (Figure 1). The market saw quite a few mall modifications with deep concessions, such as Las Catalinas Mall ($128.8 million, JPMBB 2014-C22 and C23) and Jefferson Mall ($58.2 million, JPMCC 2012-CBX). In mod substantiation commentary, servicers stressed the importance of having a committed borrower in place.

Figure 1 Modifications and Foreclosures Since March 2020 (Dollars in Billions)



Note: % Foreclosed represents the foreclosed loan balance out of the total foreclosed and modified balance.
Source: Bloomberg, MCIA, and Academy Securities

Recent mall foreclosures were mostly related to borrowers walking away. Examples include the $74.2 million Park Plaza (WFRBS 2011-C3) and the $66.4 million Brunswick Square (WFRBS 2014-C20 and C19)(Figure 2). Deed-in-lieu ("DIL") or friendly foreclosures feature several advantages to the trust. Notably, a DIL can streamline the path to taking title. In contrast, servicers usually mention the length of foreclosure proceedings as a reason to opt for modifications. But with courts opening back up, the retail environment brightening, and mall conversions potentially offering liquidation upside, servicers may increasingly look at foreclosures as a viable alternative to mods.

Figure 2 Recent Mall Foreclosures Were Amicable

Loan	Deal	Balance ($MM)	Location	# of Mos REO	Total Adv. & ASER ($MM)	Total Exposure ($MM)	Maturity Date	Most Recent Appraisal ($MM)	At Issuance Appraisal ($MM)	Most Recent Appraisal Date
Louis Joliet Mall	UBSBB 2012-C2	85.0	Joliet, IL	3	4.6	89.6	Jul 2022	65.2	131.8	Jun 2021
Park Plaza	WFRBS 2011-C3	74.2	Little Rock, AR	4	2.0	76.1	Apr 2021	32.5	142.0	May 2021
Kitsap Mall	WFRBS 2013-C15	74.0	Silverdale, WA	2	2.6	76.6	Jul 2023	32.0	111.0	Oct 2021
Rimrock Mall	WFCM 2013-LC12	72.3	Billings, MT	3	7.9	80.2	Jul 2023	50.0	112.0	Sep 2021
Lincolnwood Town Center	JPMCC 2014-C20	44.1	Lincolnwood, IL	6	7.4	51.4	Apr 2021	15.2	89.1	May 2021
Fashion Square	WFRBS 2012-C7	31.5	Saginaw Twshp, MI	4	1.9	33.3	Jun 2022	7.3	67.5	Dec 2021
Charlottesville Fashion Square	JPMBB 2014-C21	25.8	Charlottesville, VA	2	3.3	29.1	Apr 2024	7.5	83.9	Aug 2020
Albany Mall	DBUBS 2011-LC3A	24.1	Albany, GA	4	0.3	24.5	Jul 2021	13.0	40.0	Aug 2021
Coleman Marketplace	BANC 2017-CRE2	17.4	Danville, VA	2	2.4	19.8	Mar 2020	15.9	22.1	Jun 2021
Charlottesville Fashion Square	JPMBB 2014-C22	17.2	Charlottesville, VA	2	2.0	19.2	Apr 2024	7.5	83.9	Aug 2020
Pavilions at Hartman Heritage	BANC 2017-CRE2	16.3	Independence, MO	2	1.7	18.0	Aug 2020	13.3	23.9	Nov 2020

Source: Bloomberg, MCIA, and Academy Securities

Limits on Redeveloping REO Properties

A foreclosure could allow a servicer to work through issues hobbling a property, thereby improving the liquidation value. For example, in Charlottesville Fashion Square ($42.9 million, JPMBB 2014-C21 and C22), the servicer noted several buyer prospects surfaced during the foreclosure sale, especially after the servicer cured a defaulted ground lease.

On the other hand, the servicer could lose some flexibility when dealing with a foreclosed property. Deal documents usually restrict construction work on REO properties, other than repair, maintenance, or certain types of tenant build-outs. Servicer commentary on foreclosed malls suggests servicers are undertaking limited actions. For example, in Kitsap Mall ($74.0 million, WFRBS 2013-C15), which saw a foreclosure sale in December 2021, the servicer plans to stabilize the 533K sf regional mall in Silverdale, WA, by improving in-line occupancy, renewing existing tenants, and improving collections. Such limited actions may not be enough to salvage many struggling malls needing more aggressive re-positioning efforts.

Foreclosures Could Crystallize Loss Timing

Servicers' choice to pursue foreclosures rather than modifications on troubled malls could impact loan resolution timing, bond cash flows, among other aspects. We suggest investors track aspects such as:

- **Foreclosures could accelerate losses.** Deal documents require servicers to liquidate REO loans before the end of the third calendar year following foreclosure. In contrast, loan extensions theoretically can stretch for many years. A typical limitation on how long a servicer can extend a specially serviced loan is no longer than five years before the deal's legal final maturity. Deal documents usually set legal final maturities decades into the future. To be sure, the foreclosure process itself can take a while, especially when contested and taking place in a judicial foreclosure state.
- **Non-recoverability determinations**. A shift to foreclosure and the potential distressed liquidation that follows may incentivize servicers to make non-recoverability determinations. The servicer could start recovering outstanding advances from the trust's monthly principal payments in such a case. Non-recoverability determinations have been pretty rare, even during the pandemic. Interestingly, in Poughkeepsie Galleria, the servicer has made a non-recoverability determination.

We show some salient differences between foreclosure and modification resolutions in Figure 3.

Figure 3 Foreclosures vs. Modifications Comparison

	Foreclosure	Modification
Timing	Servicers need to liquidate an REO property before the end of the third calendar year following the foreclosure	Extensions could significantly delay resolution timing. Deal documents usually allow extensions to stretch for years
Interest Shortfalls	Advancing, ASERs, and other shortfall drivers continue to increase the loan's total exposure and impact the eventual liquidation proceeds available to bondholders	Coupon reduction could drive shortfalls
Advancing and Non-recoverability	Servicers may be more inclined to determine non-recoverability as a foreclosure could foreshadow a distressed valuation	Mods could potentially reduce ASERs or advancing, thereby limiting the growth of the loan's total exposure
Property Redevelopment	Limits on REO properties constructions; some exceptions allowed	Some mods require dark anchor space redevelopment; limits on "material changes" of the property

Source: Deal Documents and Academy Securities

Pyramid Exemplifies Committed Borrowers

The potential foreclosure of Poughkeepsie Galleria is also notable given the identity of the mall owner. Pyramid has been very proactive in negotiating modifications on its CMBS malls, repeatedly stressing its commitment to the properties (Figure 4).

Figure 4 Pyramid Mall Loans Have Seen Several Modifications

Loan Name	Deal Name	Balance ($MM)	Location	DQ Status	Maturity Date	Most Recent Appraisal ($MM)	At Issuance Appraisal ($MM)	Modified (Y/N)	Mod Date
Palisades Center Mall	PCT 2016-PLSD	388.5	West Nyack, NY	Perform(w)	Oct 2022	425.0	881.0	Y	May 2020
	JPMDB 2016-C2	30.0			Oct 2022			Y	May 2020
Destiny USA Phase I	JPMCC 2014-DSTY	300.0	Syracuse, NY	Perform(w)	Jun 2022	118.0	490.0	Y	Jun 2019
Destiny USA Phase II	JPMCC 2014-DSTY	130.0	Syracuse, NY	Perform(w)	Jun 2022	85.0	220.0	Y	Jun 2019
Crossgates Mall	COMM 2012-CR1	100.6	Albany, NY	Perform(w)	May 2023	281.0	470.0	Y	Jul 2020
	COMM 2012-CR2	60.4			May 2023			Y	Jul 2020
	COMM 2012-CR3	90.5			May 2023			Y	Jul 2020
Crossgates Commons	BANK 2017-BNK5	18.4	Albany, NY	Perform(w)	May 2022	55.8	55.8	N	-
	CGCMT 2017-B1	11.5			May 2022			N	-
Walden Galleria	JPMCC 2012-WLDN	237.7	Cheektowaga, NY	Perform	May 2022	216.0	600.0	Y	May 2020
Holyoke Mall	JPMCC 2011-C3	175.9	Holyoke, MA	Perform(w)	Feb 2024	200.0	400.0	Y	Jun 2020
Poughkeepsie Galleria	UBSCM 2012-C1	74.8	Poughkeepsie, NY	Matured Non-Perf	Nov 2021	69.2	237.0	N	-
	UBSC 2011-C1	61.2			Nov 2021			N	-
Poughkeepsie Galleria II	WFRBS 2011-C5	6.9	Poughkeepsie, NY	Matured Non-Perf	Jul 2021	16.5	15.5	N	-
Sangertown Square	JPMCC 2011-C3	52.7	New Hartford, NY	Perform(w)	Jan 2024	19.1	107.0	Y	Jun 2020
Champlain Centre	GSMS 2011-GC5	28.7	Plattsburgh, NY	Matured Non-Perf	May 2021	21.0	61.0	Y	Jun 2020
Hampshire Mall	WFRBS 2011-C3	19.3	Hadley, MA	Matured Non-Perf	Apr 2021	14.0	39.0	N	-
Aviation Mall	WFRBS 2011-C2	19.2	Queensbury, NY	Matured Non-Perf	Nov 2020	10.2	45.0	Y	Jan 2022

Source: Bloomberg, MCIA, and Academy Securities

The recent valuations of Poughkeepsie do not bode well for the borrower's motivation to remain committed to the property. Poughkeepsie saw an updated appraisal of $68.5 million in November 2020, well below the loan's $135.9 million outstanding debt. At securitization, Poughkeepsie appraised at $237 million. The November 2020 appraisal may reflect a distressed valuation, an approach prevalent early in the pandemic. Interestingly, a fresh valuation from December 2021 pegs Poughkeepsie's value at $69.2 million. Still, it appears the sponsor has not been re-investing capital or re-positioning the mall in a meaningful way prior to the loan's maturity, according to Morningstar. Anecdotally, the former JC Penney space in Poughkeepsie is now serving as a Covid-19 vaccination site. Vaccination rates have reached a new low last week, according to press reports.

The ongoing performance deterioration at Poughkeepsie and the apparent lack of recent developments to suggest the mall is turning a corner likely factored into the servicer decision making. Servicers may have been more receptive to deep mods earlier in the pandemic, even on poor-performing shuttered properties. Now servicers may be looking for more tangible improvements before approving lender concessions.

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