Lenders Dial Back on Grocery-Anchored Property Investments

The U.S. retail sector finds itself headed toward another tailspin early this year as commercial mortgage-backed securities investors (CMBS) pull back from the industry as grocer transformation is underway and store closures are impending.

Among the impacted are the traditional grocery stores, meaning those that specialize in groceries, meats and produce. Nontraditional grocers, such as Walmart, Costco and Sam's Club, often have a mix of groceries and additional goods, and sometimes, services.

According to Morningstar's latest CMBS research for January 2018, lenders and investors are "shying away" from grocery-anchored shopping centers, with the expectation that large format stores are becoming bigger and small format stores are narrowing their focus. Inmar Willard Bishop Analytics expects traditional store count to drop by nearly 25% by 2021, with a 3.5% decline in dollar share of sales.

Meanwhile, nontraditional grocery outlets are leading the charge in share of sales, going up 40% in 2016—up 38% from share of sales three decades ago.

"Lenders appear to be more selective and less tolerant of risk in grocery-anchored properties, as they shift to lower-leveraged, lower-balance loans," the Morningside report stated. "The percentage of grocery-anchored loans with balances below $20 million grew by 16% over 2015 levels, while the volume of loans above $50 million shrunk by 34.8%."

In 2014, the average loan-to-value ratio was 69.2%, falling 6.8% by the third quarter of 2017.

Year-over-year acquisition of retail properties also declined by just over 32% in the third quarter of 2017, Morningstar said, while the Mortgage Bankers Association's retail lending index moved 16% for the first six months of last year.

Retail Remains Risky for Creditors

Despite recognition as the past decade's best holiday shopping season for retailers in 2017, this January proves no different as the peak month for retail bankruptcy filings, according to Bloomberg Markets. Early estimates indicate repeated hits to retailers, such as Macy's Inc., which Bloomberg reported will close 11 stores early this year.

Credit Suisse Group AG strategists Roger Lehman and Benjamin Rozyn suggest that parts of the CMBX 6 and CMBX 7 commercial mortgage bond indexes could continue declining in 2018, noting that the CMBX 6 had fallen 12% in 2017. Less commercial mortgages are including financial security, the analysts stated, tightening financing options for mall and store owners.

“That’s a risk to CMBS investors because servicers will have to figure out what to do with assets that have ‘little to no comparable valuations,’” the analysts said in the Bloomberg report.

Last month, based on data from Trepp, Commercial Observer wrote that approximately $29.3 billion in securitized mortgages that were backed by retail properties between November 2016 and October 2017 were paid off or liquidated. Trepp and Morningstar Credit Ratings data also concluded that the 244 retail loans in 2017 were resolved with losses at about $1.8 billion. The 244 retail loans totaled $3.4 billion.

“If I had to guess, [retail loss severities] are in excess of 50%,” CWCapital Asset Management Managing Director Andrew Hundertmark said in last month’s Commercial Observer. “ … There were assumptions made to rent growth and tenant strength that didn’t turn out to be true, and 10 years ago [when] these loans were made, no one saw Macy’s as a troubled retailer.”

Hundertmark continued by saying that this way of thinking led people to underwrite loans.

Although loans outside the traditional mall stores are usually smaller, Lehman and Rozyn stated that investors should remain wary as retailers flock elsewhere to stay afloat.