MAY 2017

Debt Market Monitor

National Debt Capital Markets Services

Retail closures and the effects on lending

More than 3,500 retail stores in the U.S. announced closures in the first four months of 2017. Credit Suisse projects that the total across 2017 may soar above 8,500 rationalizations. Announcements of store closures have included the likes of: Sears, JC Penney, Macy's, Radio Shack, American Eagle, Sports Authority, Payless, Kmart, Abercrombie & Fitch, Guess, The Limited, Family Christan, hhgregg, Bebe, Crocs, Aeropostale, Chico's, The Children's Place, Men's Warehouse/Jos. A. Bank, Walgreens, Wal-Mart, Staples and Rue 21 – and this is a partial list. So what gives? Why now after the economy is reportedly doing not too badly? There are a number of contributing factors, one of which is that the U.S. is simply over-retailed. The country has too many stores. Another impact is online shopping, which has also taken a bite out of retail commerce. For example, take Amazon, which has quintupled its sales over a six-year period to US$80 billion from US$16 billion – an increase of 400%. This rise is known as the Amazon effect. It is estimated by Cowen Research that the mobile commerce share of total digital dollars spent was 20% at the end of the third quarter of 2016. According to the U.S. Labor Department, retailers cut about 30,000 positions in March 2017 alone. This reduction matched the February cut. Together, February and March represented the worst two-month showing since 2009 during the Great Recession. Retail closures, from department store anchors in big city malls to suburban retailers, are happening at a record pace. High-end malls continue to perform well; however, the exodus from brick- and-mortar stores is taking a serious toll on class "C" and "D" shopping centres.

The magnitude of retail contraction has the full attention of lenders and agencies that rate commercial mortgage back securities (CMBS). Lenders are well aware of which retailers occupy the security that is held under a loan and closely track their exposures to any one tenant. This type of monitoring by conventional lenders has resulted in some pushback on leverage amounts and, in some cases, complete refusals to participate in retail-based financings. It is very much a case-by-case, location-by-location analysis. Lenders are still optimistic about lending; however, a much higher degree of caution is governing their actions when proposed deals involve loans secured by retail properties.

In Canada, the story is slightly different. As recently reported by The National Post, per-capita penetration of shopping centres in Canada is 16.5 square feet (sf) per person, as compared to 23 sf in the U.S. The Retail Council of Canada reports that malls are significantly more productive on average than malls in the U.S. with average sales of C$744 per square foot (psf) in Canada versus US$466 psf in the U.S. That is not to say that Canada has not experienced retail closures. Look no further than Target, which recently exited Canada after throwing in the towel. Trepp, a CMBS research and analytics firm, reported that delinquencies related to U.S. retail-secured lending in March 2017 stood at 6.12% as compared to 5.33% a year earlier – an increase of nearly 15% that is projected to rise. By comparison, the total of Canadian CMBS delinquencies was reported by DBRS at 0.94% as of March 2017.

Fiscal Snapshot

Bank of Canada Rate

	BoC Rate	Bank Prime Lending
April 2017	0.75	2.70
One month ago	0.75	2.70
One year ago	0.75	2.70

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
April 2017	1.00	1.54	2.16
One month ago	1.12	1.63	2.31
One year ago	0.87	1.50	2.07

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
April 2017	1.75 - 2.10	1.85 - 2.35
One year ago	1.90 - 2.25	1.95 - 2.45

Insured	5-Year	10-Year
April 2017	0.90 – 1.10	0.90 – 1.10
One year ago	1.00 - 1.25	1.05 - 1.25

*Spreads are indicative of high quality real estate in major Canadian markets.

Highlighted Transaction

Asset Type	Regional Shopping Centre
Location	Secondary Canadian market
Facility Details	$19M senior permanent senior debt facility, amortized over 30 years for a term of 5 years. Leverage was 71% with a provision to draw additional funds upon further lease up of the project.

Intelligent Debt Financing Solutions

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Our years of combined debt/equity capital markets experience has created meaningful relationships that we can put to work for you.

Please contact our National Debt Capital Markets team for more details related to debt financings or real estate transactions.

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