

THE WALL STREET JOURNAL.

Lenders Tighten The Spigots on Mall Landlords

With foot traffic on the wane, retail property owners face more financing hurdles

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April 11, 2017 5:30 a.m. ET



The retail malaise hasn't stopped shopping-center landlords from getting loans—it's just getting harder.

With an oversupply of malls, changing consumer habits and increasing competition from e-commerce, property owners frequently have to spruce up their assets to make them trendier and draw more foot traffic.

But the process of getting the financing for this reinvestment has

gotten more complicated, said analysts, lenders and landlords. Lenders now grill landlords repeatedly about tenants' creditworthiness and exposure to competition from neighboring developments and e-commerce. On top of that, borrowers may have to pay higher interest rates than they are used to, as the perception of risk increases and the Federal Reserve boosts short-term interest rates.

"There is a sea change in attitudes over the last eight months," said Joseph Miller, co-founder of Runyon Group, a real-estate company with offices in Los Angeles and New York. "Everyone is more cautious."

A broad swath of banks, private-equity funds and insurance companies "have a risk-off approach and are more selective," he said.

Loan terms have become more conservative. The average size of a retail real-estate loan was \$8.3 million in 2016, down from \$12.2 million in 2015, according to data from Real Capital Analytics. The average loan-to-value ratio fell to 66% in 2016 from 70% in 2015, while the average occupancy rate of the underlying properties rose to 98% in 2016 from 92% in 2015.

A steady drumbeat of store closures is escalating concerns about the [fate of retail shopping centers](#), especially lower-tier malls and strip centers. Major retailers such as [Macy's Inc.](#), Sears Holdings and [JC Penney Co.](#) have said in recent months they plan to close as many as 290 stores, while Payless ShoeSource Inc. last week [filed for chapter 11 bankruptcy protection](#) and said it would close 400 stores.

Real-estate executives and financiers said it is more difficult these days to value shopping centers amid the shift in shopping habits.

“Lenders are more forward-looking this time, and question what the property is going to look like five years from now,” said Eric Wolf, managing director at Katz Properties LLC, a property investment, development and management firm. “There is more face time with lenders, and you go over things, and go over again,” said Mr. Wolf, whose firm owns 27 shopping centers in the U.S.

Mall values can drop more sharply than residential and office properties if anchor tenants close and [surrounding tenants then peter out](#). JC Penney and Macy’s closed stores at Hudson Valley Mall in Kingston, N.Y., in 2015 and 2016, respectively, and the value of the mall plummeted 90%. The mall was valued at \$87 million in 2010. Last December, Kroll Bond Rating Agency said it was worth \$8.1 million.

Not all malls are struggling. Some better-quality properties in affluent coastal cities with a steady stream of tourists continue to boost rents. Larger mall operators still make hefty investments in their best properties to keep them competitive.

“The stronger centers are getting stronger and the weaker centers are getting weaker,” said Bill O’Connor, chief executive of O’Connor Capital Partners, a real-estate investment and development firm. “All this is happening faster than the previous cycles. It’s a game of musical chairs—when the music stops, you’ll find out who has a seat.”

But capital for retail real estate isn’t drying up. In addition to banks, insurance companies also are extending loans to real estate owners, and private equity and hedge funds are on the lookout for deals for their debt funds.

Mr. Miller’s Runyon Group recently secured a \$47 million, 10-year securitized loan from [Wells Fargo & Co.](#) to refinance a mixed-use, open-air retail and office property in Los Angeles. It started negotiations in October, and over the next two months the 10-year Treasury rate jumped to 2.5% from 1.6%.

“Generally in two to three years, interest rates will be higher,” said Mr. Miller. “We’re stress-testing our business plans to be successful in an environment like that.”

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