

CMBS Surveillance Commentary:

Pall Mall: Regional Malls in Washington, D.C. Are Smoking

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Morningstar Perspective

The Washington, D.C. area, epicenter of the U.S. government and the home of several prestigious universities, also boasts some of the nation's most successful shopping malls. With a myriad of shopping options within 25 miles of the nation's capital, one mall stands out – Tysons Corner Center, which has transformed the area near McLean, Virginia, into a diverse, regional center since the mall opened nearly five decades ago. Morningstar Credit Ratings, LLC considers four malls to be dominant, based on tenants, location and sales, as well as their ability to drive growth and development in the surrounding area. Another three are stable, well-performing core malls, while three are considered opportunistic, or possessing the potential for improvement, and three we consider transitional properties. Morningstar's analysis considered key performance barometers, including sales per square foot, anchor stores and other tenants, improvements and renovations, proximity to mass transit, and market drivers in the surrounding area. As noted below, commercial mortgage-backed securities transactions rated by Morningstar have exposure to five of the properties – Tysons Galleria, Westfield Montgomery, Potomac Mills, the Mall at Prince Georges, and Lakeforest Mall. Of these five, Tysons Galleria and Westfield Montgomery are in CMBS transactions for which Morningstar was paid by the issuer to provide initial ratings.

Introduction

Regional malls in the Washington, D.C. area include some of the nation's most successful retail properties, thanks to a diverse economy beginning with the hub of the federal government, as well as stable industries, including defense, education, high technology and health care, making the area among the most affluent in the country. Perhaps more so in Washington than in other parts of the country, the New Urbanist movement has taken retail development in new directions, away from the monolithic shopping center and towards mixed-use properties with offices, apartments, shops and community space, all within walking distance of public transit hubs.

In 1968, Tysons Corner Center became one of the first enclosed regional malls in the area, followed shortly thereafter by Montgomery Mall, now known as Westfield Montgomery. Both properties benefited from the growth in the suburbs. As the areas around those properties developed, mall developers in the 1980s pushed further from the center, where abundant land and lower costs allowed the construction of even larger malls. By the 1990s, developers built Potomac Mills, Fair Oaks Mall and Lakeforest Mall, all more than 20 miles from Washington, and surrounded them with homes and offices.

Although retail developments pushed further into Loudoun County and Prince William County in Virginia and other outlying regions, some developers recognized the potential of areas closer to the nation's capital, as residents of Washington, D.C., Arlington, Virginia, and Bethesda, Maryland, some of the wealthiest neighborhoods in the country, sought out more upscale shopping. Residents also had become accustomed to using the Washington Metro, which opened in 1976 and expanded into the suburbs throughout the 1980s. With land becoming more expensive, newer entrants had to make better use of the available land and, influenced by emerging urbanist philosophies, included office and residential components as part of new retail developments. Rather than interior-facing properties that passersby must enter in order to experience, newer properties are likely to have exterior-facing shops and courtyards. Reston Town Center in Reston, Virginia; Fairfax Square in Fairfax, Virginia; Pentagon Row in Arlington; the Shops at Wisconsin Place in Chevy Chase, Maryland; and Gallery Place near Chinatown in the District, are among these entrants that are making use of their smaller footprints.

Morningstar expects the mixed-use trend to continue. Even where sizable parcels of land are available, developers see the opportunity to unlock more value by adding new uses and, just as importantly, density, to their projects. The dominant centers, most of which have office and residential development around them, will continue to act as economic engines, generating jobs and development in the communities around them and continuing to attract consumer spending. But other properties, as their customers and the markets around them evolve, may need to make changes, from making better use of street-level frontage to redevelopment, which may include demolition of existing structures.

Morningstar took a detailed look at malls in the Washington, D.C. area and classified them in four categories: dominant, core, opportunistic and transitional. We considered qualitative factors in our categorizations, because in a market as large and complex as Washington, D.C., some properties may not neatly fit in one category or may straddle more than one category. We endeavored to explain these classifications more fully in the individual property summaries.

Dominant malls are the market leaders in terms of sales, occupancy and traffic. These malls attract the most desirable tenants and, in some cases, may have the only location for particular chains in that market. As a result, their trade areas can extend more than 25 miles. More than any other factor, these market leaders often are the catalyst to further growth of their surrounding areas and remain

economic engines in their own right. When allocating funds for capital expenditures, owners of dominant malls will look to expand or renovate these assets before lesser quality malls in their portfolios. Under dominant malls, we include three of the largest properties in the area: Westfield Montgomery, Fair Oaks Mall and Fashion Centre at Pentagon City. Although Pentagon City is smaller than the others, its proximity to the District and access to the Metro have helped it generate sales of more than \$1,000 per square foot. Because it meets our criteria of strong sales, occupancy and tenants, we include Tysons Galleria in this category, although this high-end niche player, built as a companion to Tysons Corner Center but now with separate ownership, could be less successful without the nearby presence of Tysons Corner Center, in our opinion.

Core malls are strong performers and may share some characteristics with their dominant counterparts. The rent rolls of these properties include familiar anchor and inline tenants but often will lack the upscale flair of dominant properties. Core properties generate sales that are consistent with or higher than national and regional averages and are part of their local economic fabric. Mall owners will invest capital to maintain and preserve these assets, but may not consider major renovations to have a similar return on cost as their dominant counterparts. This category includes Potomac Mills, Shops at Wisconsin Place and Westfield Wheaton.

Opportunistic malls are characterized as properties that have strong locations but underperform for a variety of reasons. The properties may have less favorable demographics than core properties or may have uninviting structures that would require more capital than their owners are willing to invest. We include Mazza Gallerie and Chevy Chase Pavilion in Friendship Heights, a neighborhood straddling the District and southern Montgomery County, Maryland, and the Mall at Prince Georges in Hyattsville, Maryland, in this category.

Rather than distressed, we elected to discuss Springfield Mall, Lakeforest Mall and White Flint Mall as **Transitional Assets**. Despite negative news surrounding these assets, including a loss to a loan in a commercial mortgage-backed security backed by Springfield Mall and the vacancy of White Flint Mall, the malls are being redeveloped and, ultimately, could become dominant or core properties.

We excluded Tysons Corner Center from these categories and present the property on its own, for reasons that we discuss below.

Tysons Corner Center



With just under 2 million square feet, Tysons Corner in McLean is one of the ten largest regional malls in the United States by rentable area. The mall, owned by the Macerich Company, enjoys popularity with both locals and tourists, hosting more than 20 million visitors a year. In 2013, the latest year figures were available, Morningstar reported that Tysons Corner had sales per square foot, a key measure of performance, of \$835, placing it third in the Washington area behind Tysons Galleria and Fashion Centre at Pentagon City.

More than size and sales, the growth of Tysons Corner from a retail crossroads into a major employment center in northern Virginia helps it stand alone among its peers. Since the mall opened, the Tysons Corner area has grown into a major regional center with over 26 million square feet of office space, 6 million square feet of retail space and 14 hotels with more than 3,900 rooms. In 2014, the Washington Metrorail opened a station on its new Silver Line near the property, offering car-free access to thousands more residents and visitors of the region.

Tysons Corner stands to be the centerpiece of a thriving new urban area. With the opening of the Metro station, Fairfax County published a comprehensive plan to create a pedestrian-friendly urban center that will also be desirable for residents. Santa Monica, California-based Macerich teamed with the Alaska Permanent Fund to add new nonretail uses around the mall. The joint venture is building a 22-story office tower that will be the new U.S. headquarters of communications satellite company Intelsat S.A., a 430-unit residential tower and a 300-room Hyatt Regency hotel adjacent to the mall.

There are five anchors at the property: Macy's, Lord & Taylor, Nordstrom, Bloomingdale's and L.L. Bean. The tenant list includes standard mall tenants, many of whom operate flagship stores at the location, to more upscale tenants such as A/X Armani Exchange and Louis Vuitton. Apple opened the first of its highly successful retail stores at Tysons Corner Center in 2001, and a 16-screen movie theater was added in 2005.

Having highlighted the uniqueness of Tysons Corner, the largest mall in our survey, we now discuss malls we consider dominant players in Washington and its suburbs.

Dominant Malls

Fashion Centre at Pentagon City

With unparalleled access to a wider trade area than many of its competitors, the Fashion Centre at Pentagon City, which, as the name

implies, is a stone's throw from the Pentagon, is an example of a dominant mall. In terms of floor space, the mall, which is owned by Simon Property Group, is modest in size, with just over 800,000 square feet of retail space and a small office component. However, the Arlington property is one of the better performers in the area in terms of its sales productivity. The property, just four Metro stops from downtown Washington, D.C., has only two anchors, Nordstrom and Macy's, with an attached Ritz Carlton Hotel. The interior consists of three main retail levels plus a food court and Forever 21 store on the Metro-access level. The core is open with stores circling a large atrium. Its rent roll includes common mall tenants combined with upscale retailers and local service providers such as shoe-repair outlets. Apple maintains a store at this location as well.

The area is dominated by the mall's namesake, the Pentagon, which employs approximately 23,000 people, according to the Defense Department website. Nearby, in Pentagon City, there are over 12,000 employees with the Transportation Security Agency and Drug Enforcement Agency working in 2.4 million square feet of office space. Crystal City and Rosslyn, two stations away on the Metro, have more than 60,000 people working in nearly 20 million square feet of office space. This is in addition to the hundreds of thousands of people who live and work in Washington D.C., many of whom utilize the Metro.

The mall's direct competition includes properties in the District and nearby areas along Metro lines. We consider the Friendship Heights area, which hosts shopping centers including the Shops at Georgetown Park, Chevy Chase Pavilion and the Mazza Gallerie, to be competitive. With its status as a retail destination, Tysons Corner Center is also a comparable asset.

Westfield Montgomery Mall



Westfield Montgomery, part of the Westfield Corp. portfolio, is in a crowded retail landscape in upscale Bethesda but remains a highly successful property with stable occupancy and sales of over \$600 per square foot. The property's strength is derived from the demographics of its neighborhood, which has a population of more than 286,000 residents and an average household income of \$176,700, more than twice the national average. A \$350 million mortgage on the property was securitized in the WFLD 2014-MONT transaction.

This mall, a 1.3 million-square-foot property 12 miles northwest of Washington, D.C., opened in 1968, just after Tysons Corner Center, and grew from three anchors and 58 shops to over 200 shops today. There are now four anchors: Macy's, Macy's Home, Sears and JCPenney. Westfield has undertaken a renovation and expansion of the property that will ultimately cost about \$90 million and increase the space by up to 300,000 square feet.

The property's rent roll includes a standard roster of regional mall tenants with a slightly upscale contingent including Lush Cosmetics, footwear and handbag maker Stuart Weitzman and Apple. Apple's store is highly successful with sales of over \$10,000 per square foot, according to data provided to Morningstar. Excluding the sales from Apple, the property generates inline sales of more than \$530 per square foot.

Retail competitors include Westfield Wheaton, Lakeforest Mall and three smaller shopping centers in Friendship Heights. One of the closest malls, White Flint Mall, is largely vacant as its owners prepare for a redevelopment.

Fair Oaks Mall



Fair Oaks Mall, which Taubman Centers completed in 1980, ranks third in size in the Washington area behind Tysons Corner Center and Westfield Wheaton. We consider the property, which consists of 1.6 million square feet of retail space outside Fairfax, a dominant asset given the property's size as well as its ability to generate reported 2013 sales of \$615 per square foot, including Apple, more than Westfield Montgomery. The property occupies a strong location along Lee Highway, or Route 50, where it crosses Interstate 66. The mall draws its customers from western Fairfax and eastern Loudoun County, but does cede its preeminence to powerhouse mall Tysons Corner Center 10 miles east.

The property has five anchors including two Macy's stores, JCPenney, Sears and Lord & Taylor. The rent roll consists of familiar mall tenants plus an Apple retail store. The property does not report individual sales for this Apple location.

In an effort to maintain the property's competitiveness, Taubman began a multimillion dollar renovation that was completed in late 2014. Among the upgrades, Taubman replaced the existing mall entrances with a larger and more contemporary design. The company also installed free Wi-Fi and charging stations to meet the needs of a more mobile and tech-dependent shopper.

The mall enjoys strong demographics, boasting a population of nearly 1.3 million residents and a median household income of \$141,000 within its trade area. Increased development to cities further north could pose a serious threat to the mall's dominant status. By 2018, the Washington Metro will open the second phase of the Silver Line to Dulles International Airport and Ashburn, Virginia. The new line will have a station at Reston Town Center, seven miles north, and could attract businesses and residents to areas along the new rail line and away from the mall.

Tysons Galleria



Chicago-based General Growth Properties Inc. owns Tysons Galleria, built in 1988 as an upscale companion to Tysons Corner Center. At 800,000 square feet, the property is one of the smaller regional malls in the Washington area, but also one of the most productive. With anchors including Neiman Marcus and Saks Fifth Avenue, and inline tenants including Burberry, Cartier, Chanel and Yves St. Laurent, the property in 2013 had sales per square foot of \$968, which is not inflated by the presence of an Apple store.

Although the inline sales of nearly \$1,000 per square foot place the mall among the dominant centers, we believe that it would be difficult for the property, 15 miles from the District, to stand on its own as a niche regional mall without the presence of Tysons Corner Center, and this sort of dependence typically is not characteristic of a dominant center. Affluent visitors to Washington, D.C. might have less interest in visiting the property, especially given the upscale options available in the District, were it not for the presence of Tysons Corner. In addition, the property can have volatile sales as a result of its high-end customer base. For example, in 2009, the mall's inline sales decreased to less than \$700 per square foot. In times of economic distress, the real or perceived loss of wealth may cause even affluent consumers to retrench. The retailers at this mall have less ability to offer discounts to win back consumers for fear of diluting their respective brand images.

A \$325 million mortgage on the property was securitized in BBCMS Trust 2013-TYSN. The 2013 operations were consistent with the underwritten levels, with \$25.9 million in net cash flow compared to \$26.1 million at issuance. This was 15.9% better than the 2012 net cash flow of \$22.4 million.

As the Tysons Corner area expands, we expect this property to continue in its role as a complementary asset to the retail landscape. The addition of Metrorail access may help increase its appeal to affluent foreign tourists that would normally shop in Washington.

Core Malls

Potomac Mills



Potomac Mills, now an asset of Simon Property Group, is the furthest from Washington D.C., 25 miles south in Woodbridge, Virginia. Even so, the 1.6 million-square-foot mall, which was Mills Corp.'s first shopping mall when it was built in 1985, has been a stable and successful property. From 2007 to 2013, the property steadily improved its revenue to \$49.7 million from \$41.6 million with cash flow increasing to \$35.2 million from \$27.9 million. Occupancy has ranged from the mid- to high-90 percent range.

The diverse tenant list includes traditional anchors like JCPenney, outlet stores such as Off Fifth and Nordstrom Rack, and big-box retailers like Costco. The value-oriented concept has worked well for Simon Properties since its acquisition of the Mills Corp. Simon also has succeeded in attracting traditional mall tenants like XXI and H&M to the mall.

Although Potomac Mills has been a solid performer, we consider the property a core asset because of the location and the tenant mix. Prince William County, less affluent than Bethesda and Washington, remains more open for developers given the relative availability and cost of land. The property's access to mass transit is poor with the Metro's terminus several miles north and a Virginia Railway Express station several miles from the property.

Competition could increase in the coming years. Stonebridge at Potomac Town Center, a new mixed-use center that is across Interstate 95, opened its first phase in 2010 and a second phase in 2012. The master plan includes nearly 500,000 square feet of retail space, 308 apartments and 345,000 square feet of commercial space, and the property could emerge as a strong competitor. The property features a 138,000-square-foot Wegmans grocery store, a 42,000-square-foot health club, as well as outdoor-gear retailer REI, Apple, DSW Shoes and Jos. A Bank.

With Springfield Mall closed for redevelopment, Potomac Mills is the only regional mall within Prince William County. Later this year the renamed Springfield Town Center will open, and Potomac Mills could be the first to feel the competitive effect of the redeveloped property. A \$410 million mortgage on Potomac Mills was securitized in LU-UBS Commercial Mortgage Trust 2007-C6 and Wachovia Bank Commercial Mortgage Trust 2007-C33.

Shops at Wisconsin Place



Shops at Wisconsin Place, a mixed-use center that opened in 2007, is the newest entry in the Friendship Heights landscape. The property was developed over a former Woodward & Lothrop, and later Hecht's, department store. Although not a regional mall, this property includes 305,000 square feet of street-facing retail space that combines more traditional mall tenants such as Bloomingdale's, Sephora, and White House/Black Market, with Whole Foods and the Capital Grille. The entire development consists of 1.1 million square feet,

including 432 apartments, 295,000 square feet of office space and a 20,500-square-foot community center. Most of the office space is leased to Microsoft Corp. on a long-term lease.

The trade area, which straddles the border of Washington, D.C. and Montgomery County, Maryland, includes some of the most affluent areas in the country with median home values of over \$900,000 on both sides of the border. The Friendship Heights Metro station is directly beneath the property, making it accessible to residents outside of the primary trade area.

In 2012, TIAA-CREF acquired the retail portion of the property, excluding Bloomingdale's, for \$113.25 million, or \$957 per square foot. TIAA-CREF is also the owner of the nearby Mazza Gallerie, discussed later in this report.

Westfield Wheaton



When Ted Lerner and Isadore Gudelsky completed the 1.1-million-square-foot, open-air mall, known as Wheaton Plaza in 1960, they established the first regional mall in the Washington, D.C. area. Although the mall's size ranks it fourth among all area malls, Morningstar views its tenant mix to be increasingly more consistent with a power center than a regional mall. On one hand, while we believe that property owners must make the necessary adjustments to meet the needs of their customers, this mall, rather than setting

the retail trend in its area, is following the trend.

Although the developers had planned to enclose the property in 1974, they did not complete the process until 1981. The mall's anchors include Target, JCPenney, Macy's, Costco and Dick's Sporting Goods. Target took over the space of the defunct chain Montgomery Ward, and Costco and Dick's occupy new space that replaced a former Hecht's department store. Both Target and Costco have entrances to the mall, which can be important in preserving foot traffic to these sections. The mall integrated Costco particularly well, with the retailer's food stand operating outside the store and readily accessible to mall shoppers.

Westfield Wheaton, with nearby Westfield Montgomery and the shopping centers of Friendship Heights, make up a crowded retail landscape in Montgomery County, Maryland. The property is only seven miles east of Westfield Montgomery and four miles from the White Flint Mall. The planned redevelopment of White Flint could ultimately pose a threat to this property.

The property benefits from strong demographics, which are similar to those of Westfield Montgomery, as well as a stop on the Washington Metro across the street. In time, the Metro station could act as a catalyst for growth at the property.

Opportunistic Malls

Mall at Prince Georges



Despite performance that could be described as stable, but mediocre, the Mall at Prince Georges has one enviable characteristic -- direct access to a Metro station. Therefore, we consider the property to fall into the category of opportunistic malls. There is no question that the surrounding demographics are less affluent than in Tysons Corner and Bethesda. The median household income for the area is half of that for the Washington, D.C. metropolitan statistical area. However, in other areas, developers seeking to be near

coveted transit stations have transformed neighborhoods with new retail, residential and office developments. Columbia Heights, once a low-income neighborhood scarred by race riots, changed for the better after the opening of the Columbia Heights Metro station in 1999. By 2008, the influx of residents attracted the attention of developers, who constructed DC USA, an 890,000-square-foot retail center anchored by Target, Bed Bath & Beyond, Best Buy and Staples over the station.

When Morningstar visited, we found the Mall at Prince Georges in average condition with a dated look and feel. Inside, the mall appeared to have a higher concentration of local tenants rather than national retail players.

The mall, which is owned by Pennsylvania Real Estate Investment Trust, more commonly known in the industry as PREIT, is a 900,000-square-foot, single-story enclosed mall in Hyattsville, less than two miles from the main campus of the University of Maryland. The mall is anchored by Macy's, JCPenney and Target, with Old Navy, T.J. Maxx, Marshalls and Ross Dress for Less as junior anchors.

The Mall at Prince Georges has had relatively stable occupancy but also experienced a dip in performance during the recession. Although cash flow increased to over \$11 million in 2006, decreasing revenue pushed the cash flow to \$9.3 million by 2009. Since then, the property's performance has improved to near-issuance levels. But there is concern that the low debt yield of 7.5% may not support a full refinancing of the asset at maturity in June 2017. A \$150 million mortgage on the property was securitized in Bear Stearns 2007-PWR16. The loan has never defaulted; however, Morningstar monitored this loan on its Watchlist in 2010 and 2011 when the property's cash flow was \$9.7 million during the recession. Since then, the net cash flow improved to \$11.3 million in 2013, and Morningstar no longer considers the loan to be an immediate default risk.

Across the street, adjacent to the Metro station, retail venues include Giant Foods and Home Depot. There is also a mixed-use development called the Metropolitan Shops that includes 251 residential units, 300,000 square feet of office space, and 160,000 square feet of retail, with Bob's Discount Furniture, Staples and LA Fitness as major tenants.

Adjacent to the mall is University Town Center, an office development that is leased to several federal agencies including the Treasury Department, Federal Emergency Management Agency and the National Center for Health Statistics. The property's website suggests that University Town Center has about 2,500 employees. The surrounding area is largely residential.

Chevy Chase Pavilion

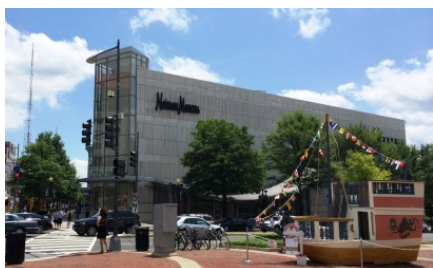


Chevy Chase Pavilion, another mixed-use property with direct access to Friendship Heights Station, includes 140,000 square feet of retail space, a 198-room Embassy Suites hotel and 200,000 square feet of office space. The interior has three levels of retail space and hosts tenants like H&M, J. Crew, CVS, Cheesecake Factory and World Market. There is also a Washington Sports Club location and Range, a restaurant founded by celebrity chef Bryan Voltaggio. In addition to their mall entrances, J. Crew, CVS and Cheesecake Factory have street-level access.

From broker listings and our on-site observation, the mall appeared to have low levels of activity. A listing from the leasing broker suggests that 35% of the property is available for lease. This is in stark contrast to shopping areas along Wisconsin Avenue which seem to be well leased with strong traffic.

Although Clarion Partners, which bought the property in 2005 and made \$32 million in renovations in 2012, has made efforts to increase the property's appeal, the answer may lie in adding more street-facing retail. Surrounding centers, including the aforementioned Wisconsin Place, Collection at Chevy Chase and Friendship Center, benefit from their visibility and street access, while Chevy Chase Pavilion may have difficulty in persuading customers to enter the mall itself. We would not characterize the mall as "dead" or even "dying," but at this point, it is not performing up to its potential.

Mazza Gallerie



In 1978, Western Development Corp. and Neiman Marcus partnered to develop Mazza Gallerie as an upscale center in northwest Washington D.C. Although the property currently is 95% leased, it has had struggles in the past. Neiman Marcus was an initial tenant at the 289,000-square-foot mall and was later joined by Saks Fifth Avenue, which opened a Men's Store location in 2000. In 2013, T.J. Maxx opened in the 40,000-square-foot Filene's Basement space that had been vacant for nearly two years.

Similar to Chevy Chase Pavilion across the street, the mall ultimately may benefit from creating more street-facing retail space. This may prove to be more difficult given the large Neiman Marcus store on the corner; however, prior owners have made efforts to make the mall more inviting for pedestrians. The initial vision of adding residential units to the property, rejected in the 1970s, may also be a way of unlocking value in this excellent retail corridor.

Transitional Malls

Lakeforest Mall



Lakeforest Mall, a 1.1 million-square-foot mall, opened in 1978 in the suburb of Gaithersburg, Maryland, 25 miles north of Washington, D.C. From 1970 to 1989, Gaithersburg became a popular destination for families seeking to escape the higher cost of living in Bethesda and Washington, and the population of the city increased from 8,344 to 39,542 residents with surrounding cities experiencing similar rates of growth. The mall benefited from this influx of residents and had relatively stable performance through 2004 when the Mills Corp. acquired the property for \$271.1 million, or \$253 per square foot, as part of a portfolio of nine malls. A \$121.1 million loan that was securitized in Bear Stearns Commercial Mortgage Securities Trust 2005-TOP20 financed the acquisition.

While Mills originally intended to invest \$200 million to \$300 million into the malls after the acquisitions, by 2006, the company soon found itself mired in problems that included corporate accounting irregularities, in addition to losses related to its ill-fated development in New Jersey, Meadowlands Xanadu. Tenant losses began to mount as the economy slowed and, without significant investment in the aging mall, management was unable to restore the lost revenue.

The loan defaulted on its maturity date in 2010 and was worked out twice by the special servicer. The second workout in 2012 allowed Simon Property and Farallon Capital, which had acquired Mills, to sell the property to Five Mile Capital for \$102.5 million, down nearly 62% from its original acquisition price. The servicer agreed to an assumption of the loan by Five Mile, extended the maturity date to September 2015 and wrote down the loan balance to \$82 million, resulting in a loss to the CMBS trust of over \$30 million. Five Mile announced in 2013 that it planned to partner with Hines, one of the largest developers in the United States, on a redevelopment of the mall. The mall is less accessible to the Metro, with the Shady Grove Station about four miles south, but has a Maryland Area Rail Commuter, or MARC, station one mile south in central Gaithersburg. The mall's location near the historic center of Gaithersburg may allow the developers to create a walkable, urbanist mixed-use center 25 miles north of the District.

Springfield Town Center

Vornado Realty Trust acquired the former Springfield Mall in 2005 and assumed a \$181.2 million CMBS loan that was an asset of Nomura Asset Securities Corp., 1998-D6, and Commercial Mortgage Asset Trust, 1999-C1. The mall had already shown signs of weakness, and Vornado saw value in its Springfield, Virginia, location, one-quarter mile from Franconia Station on the Metro, but not the interior spaces. Its plan was to redevelop the center into a contemporary, pedestrian-friendly, mixed-use center. By 2009, with the economy floundering and construction lenders unable to provide funds, Vornado sought a loan modification from the servicer. In 2011, Vornado received approval for a discounted payoff that resulted in a loss of more than \$50 million for the two CMBS trusts. As the economy recovered, Vornado restarted construction on the project. The anchor tenants, Macy's, JCPenney and Target, remained open during construction. The initial \$225 million phase will develop 450,000 square feet of inline space, including Dick's Sporting Goods, H&M, Maggiano's Little Italy, LA Fitness and a Regal Cinema. The surrounding phases could include up to 2,000 residential units and 500,000 square feet of office space.

Vornado announced last year it planned to sell the property to PREIT for \$465 million. The transaction is expected to be completed in March. Vornado will continue to work on development of the nonretail space.

White Flint Mall

White Flint Mall, between Westfield Montgomery and Westfield Wheaton on Rockville Pike in North Bethesda over the White Flint Metro station, could be considered a "Dead Mall by Design." Montgomery County planners sought to increase the density around the White Flint Station and bolster residential units over time. As a result, the property's owner, a partnership between Lerner Enterprises and the Tower Companies, has refused to extend tenant leases and evicted others to make the space ready for demolition. The challenge to moving forward has been lawsuits from tenants. Dave & Busters filed several lawsuits to delay its eviction before closing its doors in August 2014. Lord & Taylor, which has a lease through 2055, also sued to stop the development. While the ownership has prevailed in court against both parties, the legal wrangling could continue through the appeals process.

The mall's owners proposed a redevelopment of the site that the Montgomery County Planning Board approved in 2012. The plan calls for a total of 5.2 million square feet with 1 million square feet of retail, 1 million square feet of office space, 2,500 housing units and a 300-key hotel. The proposed change was part of a sector plan for the White Flint area that the board adopted in 2010 to help create a new urban center with 16 acres of open space, some of which would be open to the public.

Conclusion

Regional malls, a product of and a catalyst for suburban sprawl, have transitioned to become centers of urbanization in the Washington area. Although some property owners found success by building far from the District, others are now seeing the value of a mixed approach that combines access to transit, pedestrian-friendly spaces and additional density. With the high cost of both housing and office space, developers have found that adding these uses to properties helped produce higher marginal income than what may be the diminishing returns from additional retail space. Even at the dominant centers, we are seeing increasing development of additional uses. Still, we do not expect owners of core assets that elect to stay exclusively in the retail space to experience a decline in sales or performance. Those properties likely will continue to generate stable, reliable sales. We believe, however, that as owners debate their use of capital expenditure funds, more of those funds could go to build uses that complement existing retail spaces rather than add to it.

Washington, D.C. has advantages over other urban areas because of the stability of its economy, strong demographics and its extensive mass-transit system. Owners of regional malls in other regions may find similar redevelopment strategies infeasible given their market characteristics.

Exhibit 1 – Property Summary

Tysons Corner Center	Macerich	McLean, VA	Macy's Lord & Taylor Nordstrom Bloomingdale's	L.L. Bean Apple Armani Exchange American Girl	Pottery Barn The Limited Foot Locker	American Girl Bistro California Pizza Kitchen Season's 52 BRIO Tuscan Grille
Dominant Malls	Management	City, State	Anchors	Inline Tenants		Restaurants
Westfield Montgomery	Westfield America	Bethesda, MD	Sears Macy's Nordstrom	Apple J.Crew Old Navy	Victoria's Secret Limited Forever 21	The Cheesecake Factory Bobby's Burger Palace California Pizza Kitchen
Fair Oaks Mall	Taubman Centers	Fairfax, VA	Sears Lord & Taylor Macy's JCPenney	Apple J.Crew Michael Kors	Sephora Bath and Body Works	The Cheesecake Factory Texas de Brazil Churrascaria
Fashion Centre at Pentagon City	Simon Property Group	Arlington, VA	Nordstrom Macy's	Apple Coach Cole Haan	Kate Spade Hugo Boss J.Crew	FYVE Restaurant Lounge Harry's Smokehouse Burgers & BBQ
Tysons Galleria	General Growth Properties	McLean, VA	Macy's Neiman Marcus Saks Fifth Avenue	Hugo Boss Coach Gucci Louis Vuitton	Ralph Lauren Tommy Bahama Versace	The Cheesecake Factory Legal Sea Foods Maggiano's Little Italy P.F. Chang's
Core Malls	Management	City, State	Anchors	Inline Tenants		Restaurants
Potomac Mills	Simon Property Group	Woodbridge, VA	Nordstrom Rack Costco Marshalls Bloomingdale's Outlet	Ann Taylor Banana Republic Brooks Brothers	Coach Gap Finish Line	The Cheesecake Factory Bahama Breeze Bobby's Burger Palace
Shops at Wisconsin Place	TIAA-CREF	Chevy Chase, MD	Bloomingdale's Whole Foods	Cole Haan Sephora Talbots	Anthropologie Eileen Fisher	Le Pain Quotidien P.F. Chang's The Capital Grill
Westfield Wheaton	Westfield America	Silver Spring, MD	Macy's JCPenney Target Costco Dick's Sporting Goods	Jo-Ann Fabrics Finish Line Hollister Co.	Express DSW	Ruby Tuesday
Opportunistic Malls	Management	City, State	Anchors	Inline Tenants		Restaurants
Chevy Chase Pavilion	Clarion Partners	Washington, D.C.	Embassy Suites Offices	J.Crew H&M CVS	Civil Cigar Lounge World Market	Lunch Box Range The Cheesecake Factory
Mazza Gallerie	TIAA-CREF	Washington, D.C.	Neiman Marcus Saks Fifth Avenue	Ann Taylor Pottery Barn Williams-Sonoma	Foot Locker T.J. Maxx	
Mall at Prince Georges	PREIT	Hyattsville, MD	JCPenney Macy's Target Old Navy Marshalls	Victoria's Secret Champs Payless ShoeSource	Men's Wearhouse Radio Shack	Outback Steakhouse Olive Garden
Transitional Malls	Management	City, State	Anchors	Inline Tenants		Restaurants
Lakeforest Mall	Five Mile Capital	Gaithersburg, MD	Macy's JCPenney Lord & Taylor Sears	American Eagle H&M Payless ShoeSource	Hollister Finish Line	Red Robin Ruby Tuesday Silver Diner
Springfield Town Center	Vornado / PREIT	Springfield, VA	Macy's JCPenney Target Dick's Sporting Goods	Express Foot Locker Gymboree J.Crew, Loft	Nordstrom Rack Sephora Victoria's Secret	Maggiano's Little Italy
White Flint Mall	Lerner Enterprises / Tower Companies	Bethesda, MD	Lord & Taylor			

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