INSIGHT

VIEWPOINT

American Dream Meadowlands

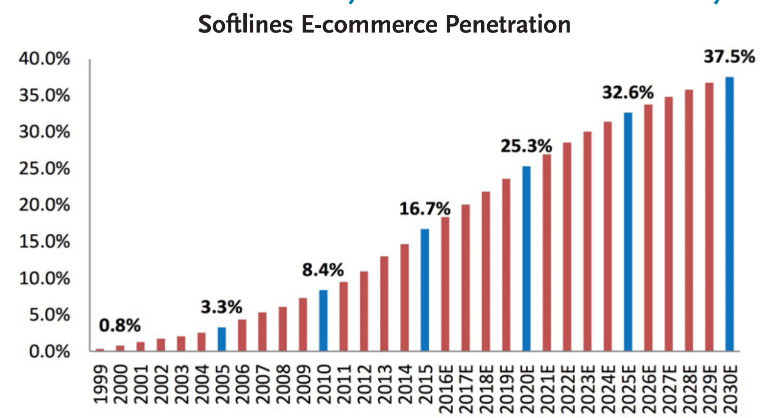
SAGAR PARIKH | OCTOBER 10, 2017

> ***"We're not mall developers. To tell you the honest truth, I loathe malls. I don't like to go to them even when I'm on holiday."***
>
> -- Don Ghermezian, executive of his family's Triple Five Group, sponsor of the biggest mall project in queue.

History of Project:

It was 2004. E-commerce sales were still under 5% of all retail sales. There were dozens of malls being built around the country. A concept was designed in order to create a destination shopping center (at the time, called Xanadu) in the New Jersey Meadowlands. Fast forward 12 years later, e-commerce is over 10% of all retail sales (with expectations from Credit Suisse to nearly double over the next 10 years) and developer Triple Five (the third developer to be involved in the project) decided to stop construction on the site. Despite taking over the project in 2010 and receiving multiple subsidies from the state of New Jersey, Triple Five had refused to put any more of its own money into the development until it could receive additional outside funding.

Estimated Softlines Penetration by 2030 Will Reach 38% of Industry Sales



Softlines: Apparel, Accessories and Footwear
Source: Credit Suisse, U.S. Census Bureau

Earlier this year, Triple Five was able to secure $1.1BN of municipal bond financing and $1.67BN of construction financing after initially failing in the fourth quarter of 2016. The project was expected to be completed back in 2012 when Triple Five took over the project, but the developer was unable to line up additional financing on the project for nearly five years. How Triple Five was able to attain the additional financing is a combination of yield hungry bond investors and the state of New Jersey willing to structure dubious municipal financing in order to avoid a major eyesore on one of the busiest freeways in the country.

Sagar Parikh, CFA
Senior Vice President
Fixed Income

Mr. Parikh is a Trader with the Fixed Income group, specializing in mortgage-backed securities. He joined TCW in 2007 where he previously served as an Analyst that specialized in CLO, RMBS, and CMBS security analysis. Mr. Parikh holds a BA in Business Economics with a minor in Accounting & Political Science from the University of California, Los Angeles. He is a CFA charterholder.

Triple Five initially took on the project in 2010 after the previous developers Mills Group and Colony Capital had taken on too much debt and were unable to see the project through to completion. Triple Five knew it had significant negotiating power with the state of New Jersey when agreeing to take over the site and was able to negotiate PILOT payments (payments in lieu of taxes) and revenue bond financing for its retail development. Tax-free municipal financing is typically allocated for projects with direct public benefits such as schools, roads and bridges. However, the state of New Jersey knew there weren't many developers who had the experience to work on a multi-billion dollar project of this scale and so the state structured the municipal financing to restart the project off the ground.

Historical Timeline

2004	Mills Corp begins development on Xanadu and makes an upfront development lease payment of $160MM to the New Jersey Sports and Exposition Authority
2006	Colony Capital partners with Dune Capital to take the project over from Mills. Together, the three firms will have spent a total of $1.4BN on the project
2010	Colony and Dune Capital succumb to heavy debts and the lenders take over the project. The senior lenders had originally invested $500MM in capital and foreclosed on the property
2010	Triple Five acquires the property from the group of senior lenders on the property
2016	After spending $700MM, Triple Five stops construction until it can raise additional debt
2017	Triple Five secures $2.8BN in additional financing to resume construction on the project

Most Recent Round of Financing:

In order to make the financing attractive to bond holders, the state of New Jersey issued the bonds via the Wisconsin Public Finance Authority. With its low credit rating and concerns over the negative publicity of subsidizing real estate developers, New Jersey knew there would be potential pushback over a municipal financing of this size. However, by issuing the bonds through the Wisconsin Public Finance Authority (which is one of the few states that is able to issue municipal debt outside of its state's borders), New Jersey was able to make sure its taxpayers were not on the hook in case there wasn't enough sales tax revenue to pay the debt service. In the end, Triple Five received $800MM in Redevelopment Area bonds (tax-exempt PILOT payments) and $350MM in Economic Recovery Growth bonds (sales tax grants). Wisconsin's Public Finance Authority has been known to finance projects that other states previously have rejected (e.g. American Dream) and charge higher fees; this municipal financing is the largest since the entity was created back in 2010.

The other portion of financing that Triple Five received was $1.67BN of CRE (commercial real estate) construction debt syndicated by JP Morgan and Goldman Sachs. The financing was bifurcated between a senior and mezzanine portion with the senior financing expected to yield in the high single-digits. The CRE construction debt has a term of four years (recourse to the sponsor) and was contingent on Triple Five also being able to secure additional financing via municipal debt. As CRE lending spreads have continued to compress, the consistent reach for yield enabled Triple Five to secure the financing despite multiple developers having failed on the project.

Breakdown of the 2017 Financing

$300MM	Economic Recovery Growth Bonds (Up of 75% of the project's future sales-tax revenue)
$800MM	Redevelopment Area Bonds (Due in 2049) that will be paid to East Rutherford (Pilot Payments)
$1.2BN	Senior Construction Loan (L+700 Guidance) - No Extension Options
$475MM	Mezzanine Construction Loan (Low Double Digits Yield)
$500MM	Equity from the Mall Operator/Developer Triple Five
$3.275BN	**Total Expected Future Investment**

Debt/Equity Perspective and Evolution of Project:

From the perspective of Triple Five, the financing represents an opportunity for decent upside with mitigated downside. The bondholders, who will need sales tax revenue to meet projections to receive their money back, are taking on the brunt of the risk while Triple Five is expected to only contribute $500MM of equity (less than 16% of the total cost of the project). Due to the delays in financing, Triple Five had time to change its vision of the project from a primarily retail destination (over 80% traditional retail at first design in 2004) to more of an experiential complex. Over 55% of the site is dedicated to dining/ entertainment options and Triple Five is hoping that the new design will make the development a success. Triple Five will benefit from the previous developers having built the majority of the frame for the 45% of the space dedicated to retail and should help the timeline to completion. However, the realities of retail fundamentals are not changing anytime soon and Triple Five will have to figure out a way to differentiate American Dream Meadowlands in a northern New Jersey market that is already over-saturated with brick-and-mortar retail.

Project's Current State

Source: Fred R. Conrad for The New York Times

Rendering of Project at Completion in 2019

The latest renderings from the developer of the American Dream Mall near the MetLife Stadium in New Jersey. Credit American Dream for the New York Times.

The two lead anchor retail tenants, Lord & Taylor and Saks Fifth Avenue, are subsidiaries of Canadian retailer Hudson's Bay, which has recently announced job cuts in addition to declining same-store sales. There are three other large malls in Northern New Jersey within 10 miles of the site and currently only 20% of tourists who visit Manhattan make it to downtown New York City. Far fewer would be expected to endure a 30-minute train ride to New Jersey. Furthermore, the site in Bergen County is subject to blue laws, which prohibit retail sales on Sundays. Triple Five, however, is encouraged by having fully executed leases for 70% of the center and signed LOIs (letters of intent) for an additional 10% of the center. The developers are relying on attractions such as the Nickelodeon Universe Theme Park, Dreamworks Waterpark and Big Snow Indoor Ski Slope to differentiate themselves from their competitive set.

A parallel study for the issues that the American Dream Meadowlands has faced is the proposed American Dream Miami, also being developed by Triple Five. Designed to be the largest mall in the United States, the Miami project has been in planning since 2013, but has changed multiple times as numerous tenants who were expected to be anchors for the retail space have backed away from their commitments. As of September, the project had not received approval and is not expected to open until 2022 at the earliest. Like the American Dream Meadowlands, 55-60% of the Miami mall is expected to focus on entertainment. (Triple Five has also campaigned with the county to create a 'special tax district' for the project, in order to save on property taxes).

The fact that Triple Five has had to change its vision for both developments, multiple times, is indicative of the broader headwinds facing the retail sector. Only three enclosed malls have been built since 2008, and the last, the Mall at University Town Center in Sarasota (FL), has already had multiple tenants leave. To put that into context, between 1956 and 2005, 1,500 malls were built in the U.S. and since 2013, mall visits during the holiday season have dropped by more than 50%. Over 400 of the country's largest 2,000 malls closed between 2008 and 2010 and analysts expect another 25% of malls to close in the U.S. in the next five years. These large, mega-scale projects are developers' only method to attract visitors to their locations, and they are only getting built after numerous subsidies allow the developers to begin construction. Triple Five sat idle on the Meadowlands site for nearly five years and it wasn't until late into the investment cycle (mid 2017) that they could raise over $1BN in unrated muni financing, along with construction financing, on a site that is potentially liable to litigation issues as well as fundamental concerns over the future of brick and mortar retail.

Sources:

http://www.njbiz.com/article/20170828/NJBIZ01/170829854/neither-rain-nor-snow--nor-ecommerce-with-all-pieces-in-place-for-megamall-developer-triple-five-is-ready-to-move-full-steam-ahead-on-american-dream

https://www.nytimes.com/2016/12/13/nyregion/after-many-missed-deadlines-new-jersey-megamall-is-again-taking-shape.html

http://investigations.debtwire.com/public-finance-authority-shakes-up-muni-market-with-help-from-public-good-evolution/

https://www.smithsonianmag.com/arts-culture/death-and-rebirth-american-mall-180953444