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DEBT MARKET TALKING POINTS – 11/1/2023

Economy and Financial Markets

- The broader U.S. economy has continued to defy expectations and surprise to the upside despite tighter financial conditions, causing a structural shift in market expectations in recent weeks for sustained higher interest rates. Calls for a soft landing have increased, and the odds of a recession have receded, pushing out consensus timing for a potential downturn another six months or more, to 2H 2024. Heading into year-end, uncertainty remains as investors navigate the risks of geopolitical escalation, potential U.S. government shutdown and long-run fiscal challenges, tighter financial conditions, volatile energy prices, the path of inflation, and Fed monetary policy in response to the complicated macro landscape.
- The advance estimate of Q3 GDP shows the U.S. economy likely grew at an annualized rate of 4.9%, the fastest pace in almost two years, reaffirming the strength of the U.S. economy and its consumers despite tighter monetary policy and price pressures. This after 2.1% annualized growth in Q2, and 2.2% in Q1 (revised).
- The September jobs report blew past expectations as employers added 336,000 jobs (beating estimates of 170,000), and the unemployment rate was unchanged at 3.8%, another example of the U.S. economy's resilience. The October report is expected to show 170,000 jobs added and unemployment rate hold at 3.8%.
- September retail sales grew 0.7% from the prior month (3.8% YoY), more than double economists' expectations of a 0.3% increase and marking the sixth straight month of growth, more evidence that the U.S. consumer is undeterred despite rising delinquency rates on credit card / home / auto payments and declining household savings.
- September inflation data showed prices grew somewhat stronger than expected. Headline CPI rose 0.4% from the prior month (3.7% YoY), and core CPI (ex-food and energy) rose 0.3% (4.1% YoY). Core PCE, the Fed's preferred inflation index, increased 0.3% from the prior month (3.7% YoY). This marks the second consecutive month that core came in below 4%, but still above the Fed's 2% target.
- The Fed held rates at 5.25-5.50% at the November FOMC meeting, for the second consecutive meeting, but kept the door open for more rate hikes if needed. The post-meeting statement and press conference messaged a "hawkish hold", rather than a "pause". What happens next will be determined by economic and financial developments, but for now the Fed seems content to track the "real" Fed funds rate which should become more restrictive in the coming months as inflation slows. As of this writing, the market expects less than a 20% chance of a hike in December.
- Yields have been on a relentless rise in 2H 2023 as traders have increasingly accepted the higher-for-longer outlook, driven by economic data that continues to defy expectations to the upside. So far, rates have not been impacted by the evolving geopolitical situation in the middle east, rather Treasury yields have been more influenced by expectations the Fed will maintain elevated rates and the government will continue to flood the market with bond sales.
  - *Fixed:* The 10Y UST yield is currently around 4.75%, up ±100 bps from mid-year, but down from the recent high of ~5.00%. Treasury yields remain susceptible to volatility induced by macro data and Fed speak.
  - *Floating:* Consensus view right now is that the peak is here or very near, but the notable change in recent weeks is that the market has accepted the higher-for-longer outlook. It's too soon to close the door on rate hikes but, as of this writing, market implied futures expect the peak of 5.45% in Q1 2024 and a slow decline to 4.50% by Q1 2025 and bottoming at 4.10% in Q1 2026.

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INDEX SUMMARY				
(Rounded)		Change		
	11/1/2023	1 WK	1 MTH	YTD
SOFR				
30-Day Average	5.30%	0 bps	0 bps	125 bps
1-month Term SOFR	5.30%	0 bps	0 bps	100 bps
Treasury				
5 Year	4.70%	-20 bps	10 bps	71 bps
7 Year	4.75%	-25 bps	15 bps	79 bps
10 Year	4.75%	-20 bps	20 bps	87 bps
SOFR Swap				
5 Year	4.45%	-20 bps	-5 bps	75 bps
7 Year	4.40%	-20 bps	0 bps	80 bps
10 Year	4.45%	-15 bps	5 bps	95 bps

CRE Debt Themes

- CRE uncertainty is high and sentiment low after the rapid rise in base rates pushed Treasury yields to 5% in October. The market seems to have finally capitulated to accept the Fed's higher-for-longer rates forecast amidst the confusing crosscurrents of a seemingly resilient U.S. economy all as a deep capital markets recession persists in CRE. The CRE debt market remains challenged by tighter liquidity and higher credit standards, but quality loans are still getting placed competitively by today's standards. The outlook for CRE debt in 2024 is similar to 2023, as many of the same themes and challenges will remain.
- CRE fundamentals are softer but it's more so the cost of debt that's limiting transaction volume. Dramatically higher base rates and drifting spreads have pushed best fixed interest rates to 6.50-6.75% and best floating rates 7.25-7.50% which is pressuring cap rates and values, and in some cases causing a bid-ask spread between sellers and buyers trying to avoid negative leverage. The lack of demand for debt has impacted placement volumes significantly below the 2021 and 2022 peaks—the result of fewer trades and no elective refinancings.
- Quoted spreads are wide of normal but have been relatively stable throughout the year compared to the volatile base rates that are close to 5%+, fixed and floating. Where interest rates go from here depends on where the economy goes: a mild to no recession means base rates should stay elevated; a moderate to deep recession means base rates should trend lower somewhat faster (regardless, the outlook for neutral rates remains higher than in recent history). Spreads have room to compress when the macro-outlook stabilizes but remain susceptible to macroeconomic data, monetary policy, and CRE fundamentals.
- Whether to go fixed rate or floating rate depends on the deal profile and investment horizon, but borrower demand for fixed rate has overwhelmingly been for shorter duration with some prepayment flexibility on the back end. Shorter duration 5Y fixed rate loans make sense for borrowers that want out of floating rate loans, but do not want to be locked into higher rates long-term. The rationale being that short term fixed rate debt can carry the property through the next few years of uncertainty while minimizing interest rate risk, eliminating cap costs, and avoiding origination / extension fees. Fixed rate borrowers are also negotiating for more open period, taking advantage of rate buy-downs to improve proceeds, and executing early rate locks, which have saved numerous closings during the recent run-up of Treasury yields.
- Lenders remain selective / disciplined but there is debt capital available for good assets located in growth markets for top tier sponsors. Agency, life company, and debt fund lenders continue to be the most active capital sources targeting quality multifamily and industrial but also proven hotels and retail centers, and alternatives such as data center, select life science and medical office, self-storage, and multifamily subtypes like senior housing, student housing, and SFR/BTR. Lenders are

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leaning-in to compete for the best collateral because there continues to be a limited supply of high-quality loans available. There is a deeper bid for smaller loans rather than larger loans that require syndication, sub-debt is sometimes more readily available than senior loans, and quoted leverage is lower due to higher interest rates. Generally, banks of all sizes are in retreat, dislocated pricing makes CMBS the solution of last resort, and construction loans are getting harder to place. There's a lot of private credit raised waiting for opportunities—but so far it has been expensive and difficult to deploy. Low leverage, low-cost floating rate mortgages are still the key gap in the market left by the banks.

- Distress exists but activity has been muted so far, limited to office assets and situational cap stack distress in other asset classes (like multifamily) driven by higher interest rates. Distress typically lags the market, but time will bring more opportunities as in-the-money rate caps expire, and a wave of 2024-2025 maturities increase the need for rescue capital and spur transactions.

Life Company

- Life companies remain highly selective and have benefitted from the retreat of the banks. Some smaller groups are out of allocation for 2023, while the largest general account and "Alt" insurance lenders have capital available in Q4 but are less motivated to stretch pricing / terms. Short duration capital has become increasingly harder to access, and there is a clear preference from lenders to quote 7-10+ year loans, but borrowers aren't interested in locking in long-term.
- Pricing for low leverage / high DSCR loans is T+ 160s to 180s (~6.40-6.70%), but in practice most loans are low leverage / low DSCR pricing T+ high-100s to low-200s (~6.70-7.00%).
- Floating rate is available for core low leverage loans SOFR+ high 100s to mid-200s, 50 bps fee, 3+1+1.

INVESTMENT GRADE CORPORATE SPREADS							
		Change			52 Week		
	10/27/2023	1 WK	1 MTH	YTD	Average	High	Low
IG Corp (bps to Treasuries)							
Cash Bond	137	-5 bps	5 bps	-13 bps	147	173	129
7-10 Year Cash Bond	159	-6 bps	7 bps	-10 bps	163	193	145

Source: J.P. Morgan

Debt Fund / Mortgage REIT

- Debt funds and other nonbank lenders have been active filling the gap left by banks and other lender types. Best pricing has grinded tighter into the high 200s to lower 300s over SOFR, down from the mid-300s over, for loans backed by preferred collateral in good markets for top tier sponsors.
- Tighter spreads are being driven by improved terms and availability of line leverage / repo, an ability to achieve unlevered target returns with SOFR expected to stay elevated, and a lack of transaction volume that is fueling competition for the best loans. The CLO and A-note syndication markets are still struggling.
- Pricing depends on the deal profile, but the best pricing is mostly in the SOFR+ low 300s:
  - 60-70% LTC: high 200s to mid-300s spreads for preferred asset classes, in the lower half of the range with some in-place cash flow
  - 65-75% LTC: 375-500+ spreads for other asset classes / heavier lift business plan / riskier profile / weaker markets / small balance loans
  - Market SOFR floors are 3.00%

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Bank

- Banks remain in retreat—inactive or quoting uncompetitive, under regulatory pressure to maintain conservative capital ratios (and goalposts moving), focused on capital preservation and deposits. It's difficult to predict which banks will quote on any given deal, but with the right credit / market / sponsor one can expect 0-2 competitive bank quotes. As a result, other lender types continue to take market-share from the banks.
- The banks aren't getting pay-offs fast enough to reduce CRE exposure and meaningfully re-enter the market, and it's difficult to foresee this dynamic changing for the better in 2024.
- Floating rate spreads for low leverage stabilized cash flowing deals are generally in the low to mid-200s over SOFR (with some outliers lower), and swapped interest rates are generally in the mid 6's% to 7%. More transitional profiles and/or large loans could be wider.

CMBS

- CMBS issuance has remained muted, totaling ~$26.5B of conduit and SASB through Q3 2023, a 58% decline YoY ($63.3B YTD Q3 2022), with no relief in sight. Rate volatility combined with higher interest rates has limited transaction volume. Bond spreads have leaked wider but are relatively steady and the relentless rise of base rates has resulted in high interest rates that constrain leverage and generally makes CMBS uncompelling except for those loans of material size or certain property subtypes that have nowhere else to turn.
- CMBS spreads have moved wider over the last couple weeks in sympathy with corporates but look cheap on a relative basis. Higher rated tranches should tighten whenever the market gains confidence that the Fed has reached the end of its hiking cycle, while lower rated tranches are unlikely to improve until bond investors have a better grasp on CRE fundamentals and credit risk.
- AAA conduit spreads are T+ 150s, and AAA SASB spreads for the best profile deals are T+ very high 100s to low 200s fixed and SOFR+ lower 200s floating and range widely by asset class / profile.
- Lenders are quoting conduit coupons in the high 7's% to low 8's% (5Y T+ 300-350 / 10Y T+ 250-325) and leverage is lower due to DSCR constraints. Best fixed rate and floating rate SASB spreads are generally 275-325 over depending on asset class and leverage, however deals perceived to be inferior can be much higher.
- Borrowers can "buy-down" the interest rate to maintain proceeds at a cost of 1% of the loan amount in exchange for 24-27 bps off the 5Y spread (14-15 bps off 10Y).

CMBS SPREAD SUMMARY

		Change			52 Week		
	10/27/2023	1 WK	1 MTH	YTD	Average	High	Low
Conduit (bps to Treasuries)							
AAA 3 Year	137	2 bps	3 bps	19 bps	133	160	102
AAA 5 Year	197	2 bps	13 bps	70 bps	157	197	112
AAA 30% 10 Year	157	2 bps	23 bps	27 bps	146	179	114
AAA 20% 10 Year	235	3 bps	24 bps	30 bps	218	268	165
AA-	279	4 bps	28 bps	14 bps	290	393	212
A-	456	6 bps	35 bps	76 bps	444	578	338
BBB-	981	10 bps	49 bps	261 bps	856	998	650

Source: J.P. Morgan

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CMBS NEW ISSUANCE							
Pricing Date	**Deal Name**	**Size ($MM)**	**Property**	**Term**	**Ext.**	**AAA**	**BBB-**
Conduit (bps to Treasuries) - Trailing 90 Days							
10/20/2023	BMO 2023-5C2*	$777.0	NA	NA	NA	160	NAV
10/19/2023	BBCMS 2023-C22	$693.0	NA	NA	NA	150	NAV
9/19/2023	BANK5 2023-5YR3*	$886.0	NA	NA	NA	153	NAV
9/15/2023	BBCMS 2023-C21	$679.0	NA	NA	NA	137	NAV
8/11/2023	BMO 2023-C6	$604.4	NA	NA	NA	145	NAV
8/3/2023	BANK 2023-BNK46	$720.6	NA	NA	NA	130	NAV
SASB Floating (bps to SOFR) - Trailing 90 Days							
10/16/2023	ORL 2023-GLKS	$750.0	Lodging	2	1,1,1	245	440
8/16/2023	CENT 2023-CITY	$925.0	Retail	2	1,1,1	268	NA
SASB Fixed (bps to Treasuries) - Trailing 90 Days							
10/26/2023	THE 2023-MIC	$235.0	Retail	5	NA	385	NA
10/19/2023	FS 2023-4SZN	$410.0	Lodging	4	NA	212	NA
9/29/2023	BPR 2023-BRK2	$665.0	Retail	5	NA	250	NA
9/20/2023	JPMCC 2023-CCDC	$300.0	Mixed Use	5	NA	328	NA
8/22/2023	DC 2023-DC	$990.0	Data Center	5	NA	190	450
8/4/2023	GSMS 2023-SHIP	$1,035.0	Industrial/Warehouse	3	NA	145	330

**5-Year AAA*

Agency

- Agencies remain focused on mission-driven business but can still be competitive for best-in-class non-mission loans. YTD Fannie and Freddie are on pace to reach $52-55B+ each, far short of FHFA's 2023 multifamily loan purchase caps of $75B each. FHFA's 2024 annual caps for multifamily-loan purchases and latest guidelines for mission-driven goals will be announced in November.
- Hyper focused on sponsorship / relationships and being selective for which deals and markets to lean-in on. Scrutinizing new construction pre-stabilization loans, top line revenue trends, and expense assumptions. Any applications signed in November or later will be pushed to 2024 closings.
- Fixed rate spreads have widened +5-10 bps in recent weeks and generally range from T+ 160-170s for mission and T+ 180-200 for non-mission (mid to high 6's% coupon), depending on sponsorship.
- Borrower demand is for shorter duration 5Y term, and many are taking advantage of the ability to "buy-down" the interest rate to maintain higher proceeds at a cost of up to 2% of the loan amount in exchange for 34 bps off the 5Y spread (25 bps off 10Y). Early rate lock has helped borrowers avoid some of the pain during the recent volatility in Treasury yields.

AGENCY SPREAD SUMMARY							
			Change			**52 Week**	
	10/27/2023	**1 WK**	**1 MTH**	**YTD**	**Average**	**High**	**Low**
Agency CMBS (bps to Treasuries)							
10/9.5 DUS TBA	88	1 bps	10 bps	18 bps	78	104	57
Freddie K A1	80	-1 bps	8 bps	17 bps	68	81	51
Freddie K A2	83	-1 bps	9 bps	18 bps	73	97	54
Freddie K B	303	0 bps	15 bps	-49 bps	316	357	279
Freddie K C	405	1 bps	14 bps	-67 bps	435	500	379

Source: J.P. Morgan

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Construction

- Construction loans are difficult to place, even for quality multifamily and industrial projects. Select banks, life companies, and debt funds are lending nonrecourse construction for compelling projects, but the field of competitive A-note lenders is not deep. Pricing and terms are heavily dependent on project specifics, including asset class, sponsorship, and loan size. Leverage is lower due to higher interest rates and stressed take-out metrics for DY / DSCR.
- Many planned projects have been shelved, but those that still pencil and can get capitalized are moving forward to take advantage of the shrinking supply pipeline and hope to deliver into a market with less competitive product, poised to capture demand.
- Multifamily and spec industrial:
  - Non-recourse 45-55% LTC, in the low to mid-300s over SOFR
  - Mezz / pref available up to 75-80% LTC at 13-15%, but in practice many loans are executing last dollar 65-70% LTC at low teens returns, blending the whole loan spread to SOFR+ high 400s to mid-500s
  - Life companies offering construction-to-perm loans for multifamily and build-to-suit industrial at 55-60% LTC / 1.25x amortizing DSCR priced T+ 250-300 (7.25-7.75%)