CUSHMAN & WAKEFIELD

Rob Rubano - Vice Chairman | +1 310 595 2225 | rob.rubano@cushwake.com
Brian Share - Executive Managing Director | +1 310 595 2231 | brian.share@cushwake.com

DEBT MARKET TALKING POINTS – 2/28/2023

Economy and Financial Markets

- Markets are reassessing the timing and odds of recession and are increasingly optimistic that a soft-landing scenario is plausible based on surprisingly strong domestic data, China re-opening, and Euro-zone resilience. Soft-landing, hard-landing, or no-landing—remains to be seen, but the latest wave of domestic data suggests the Fed has more work to do to tame inflation and the lagged effect of monetary policy means economic pain is more likely postponed, rather than avoided. The ongoing risk of geopolitical escalation adds uncertainty to the outlook. For the time being, good news economic data is still bad news for interest rates and a risk-on outlook.
- GDP grew at a better-than-expected annualized rate of 2.7% in Q4, down from 3.2% in Q3. However, the underlying data looks weaker than the headline, and showed that the economy lost momentum as the final quarter of 2022 progressed. Though moderating overall, the economy has proven resilient.
- The U.S. economy added a massive 517,000 jobs in January, a shocking result more than double the top-end forecast. The blockbuster jobs report came after several consecutive months of slower hiring and pushed the unemployment rate down to a 50-year low of 3.4%. The incredibly strong labor market suggests that a potential recession is likely delayed and adds uncertainty around Fed monetary policy and upward pressure on rates.
- January retail sales jumped 3.0% from the prior month, the largest monthly gain in almost two years, as consumers continued to spend despite rising inflation pressures. This was a surprise rebound following the spending declines registered in November (-1.1% MoM) and December (-1.1% MoM).
- January inflation data accelerated more than expected to start the new year, adding pressure on the Fed to do more. Headline CPI rose by 0.5% from the prior month (6.4% YoY), representing the biggest increase since October, and core CPI (ex-food and energy) rose 0.4% (5.6% YoY). Core PCE, the Fed's preferred inflation index, increased 0.6% (4.7% YoY).
- As expected, the Fed hiked rates 25 bps to 4.50-4.75% at the February FOMC meeting. Markets interpreted Powell's press conference as dovish and rallied, but the surprise jobs headline, retail sales data, and inflation data caused a swift retracement and upward shift in Fed futures expectations. Post-meeting Fed-speak has since been more hawkish. Another 25 bp hike was always anticipated in March, but now also May and June—the outcome remains data dependent.
- Stronger than expected domestic data caused yields to rebound as investors repositioned bets for a higher terminal Fed funds.
  - *Fixed:* The 10Y UST yield is 3.95%, up 55 bps in February. Treasury yields remain susceptible to volatility influenced by macro data and Fed speak. Yields can go higher in the near-term but should come down later this year as monetary policy slows economic growth, investors seek safety in government bonds, and anticipated rate cuts start to get priced in on a forward-looking basis.
  - *Floating:* The market has become increasingly realistic and repriced a higher and later Fed funds peak at 5.25-5.50% in summer 2023. Because the pace of tightening has been faster than past cycles and the lagged effect of monetary policy has not been realized, once the hikes stop, the cuts could come faster than prior cycles.

Rob Rubano - Vice Chairman | +1 310 595 2225 | rob.rubano@cushwake.com
Brian Share - Executive Managing Director | +1 310 595 2231 | brian.share@cushwake.com

INDEX SUMMARY				
(Rounded)		Change		
	2/28/2023	1 WK	1 MTH	YTD
SOFR				
30-Day Average	4.55%	5 bps	25 bps	50 bps
1-month Term SOFR	4.65%	10 bps	10 bps	35 bps
Treasury				
5 Year	4.20%	5 bps	60 bps	21 bps
7 Year	4.10%	0 bps	50 bps	14 bps
10 Year	3.95%	0 bps	45 bps	7 bps
SOFR Swap				
5 Year	4.00%	5 bps	55 bps	30 bps
7 Year	3.80%	0 bps	50 bps	20 bps
10 Year	3.65%	0 bps	40 bps	15 bps

CRE Debt Themes

- Debt market conditions are still far from normal. The year kicked-off with a sense of optimism that the worst was behind us until a wave of domestic economic data scrambled the outlook and triggered renewed interest rate volatility. There is pent-up debt capital to deploy, and lenders / investors seem eager to get back to doing deals but new uncertainty around the path of rates has slowed momentum.
- Lenders are targeting a narrow segment of the market: best-in-class multifamily and industrial located in growth markets for top-tier sponsors—but also proven hotels and retail centers, self-storage, select life science, medical office, data center, and select production studio. Transaction volume is low compared to past years and so far, there is not enough deal flow for lenders to get their fair share—the result is a bidding frenzy for loans backed by the best collateral. Other general liquidity themes: smaller loans are more liquid than large loans, sub-debt is sometimes more available than senior mortgages, and quoted leverage is lower on account of higher rates.
- Quoted spreads are generally 15-25 bps tighter YTD for all lender types. However, interest rate volatility is back after a period of relative stability and a multi-month rally in fixed income spreads. Stronger than expected economic data has triggered a repricing of Fed tightening expectations and paused the risk-on trade. Fixed income spreads, a leading indicator for broader CRE debt, have backed up recently in response.
- Borrowing costs for fixed rate versus floating rate diverged in the 2H 2022 and continue today. Today's best fixed rate quote could be 100+ bps less coupon than a floating rate quote on the same asset and avoid a costly interest rate cap that can be another 50-150+ bps upfront. Shorter duration five-year fixed rate loans make sense for borrowers that want out of floating rate loans, but do not want to be locked in long-term. However, the SOFR forward curve projects an average of 3.85% over the next five years, and typically has overshot the actual path. Additionally, cap costs tend to fall substantially once the Fed stops hiking. Whether to fix or float depends on the deal profile and hold period, but historically the best time to lock rate is right before the Fed starts hiking, and the worst time to lock is right before the Fed starts cutting.
- Debt has become a popular investment theme for equity capital coming down the capital stack targeting mezzanine or preferred equity as a strategy to deploy capital at today's high interest rates to achieve attractive risk adjusted returns at a safer basis. We welcome the additional liquidity, but it remains to be seen if this will be a viable strategy for new entrants—gap capital is needed in a low leverage environment, but sub-debt is expensive and does not always pencil for borrowers; additionally, full-time debt platforms are often more competitive than newcomers pivoting to debt.

Rob Rubano - Vice Chairman | +1 310 595 2225 | rob.rubano@cushwake.com
Brian Share - Executive Managing Director | +1 310 595 2231 | brian.share@cushwake.com

CMBS

- CMBS spreads have benefitted from a multi-month rally, pent up investor demand, and a lack of supply of bonds resulting in tranche spreads from AAA to BBB- that are roughly 10 to 40 bps tighter YTD. However, renewed volatility has stalled the rally and spreads have backed up in sympathy with corporates. Issuance is slow and will be choppy until interest rate volatility stabilizes.
- AAA conduit spreads are P+ 150s, and AAA SASB spreads for the best profile deals are P+ 160s fixed and SOFR+ 170-180s floating and range widely for other profiles.
- Lenders are quoting conduit coupons in the very high 5's% to mid 6's% (P+ 225-275) and leverage is lower on account of DSCR constraints. Best fixed rate and floating rate SASB spreads can be in the 200s to 300s depending on asset class and leverage.

CMBS SPREAD SUMMARY

		Change			52 Week		
	2/24/2023	1 WK	1 MTH	YTD	Average	High	Low
Conduit (bps to SOFR swaps)							
AAA 3 Year	113	5 bps	-7 bps	-20 bps	120	157	72
AAA 5 Year	136	3 bps	-3 bps	-17 bps	141	174	97
AAA 30% 10 Year	153	8 bps	2 bps	-9 bps	154	196	117
AAA 20% 10 Year	207	14 bps	-15 bps	-30 bps	213	265	160
AA-	259	19 bps	-23 bps	-38 bps	254	305	179
A-	387	21 bps	-8 bps	-25 bps	334	423	222
BBB-	707	24 bps	-13 bps	-45 bps	620	755	443

Source: J.P. Morgan

CMBS NEW ISSUANCE

Pricing Date	Deal Name	Size ($MM)	Property	Term	Ext.	AAA	BBB-
Conduit (bps to SOFR swaps) - Trailing 90 Days							
2/10/2023	FIVE 2023-V1	$765.5	NA	NA	NA	130*	740
2/9/2023	BANK 2023-BNK45	$705.2	NA	NA	NA	145	770
1/20/2023	BMO 2023-C4	$785.1	NA	NA	NA	158	NAV
SASB Floating (bps to SOFR) - Trailing 90 Days							
2/17/2023	BLP 2023-IND	$550.0	Ind/Office	2	1,1,1	175	425
SASB Fixed (bps to SOFR swaps) - Trailing 90 Days							
2/24/2023	SCOTT 2023-SFS	$500.0	Retail	5	NA	190	NA
2/15/2023	OAKST 2023-NLP	$275.0	Office/Retail/Ind	5	NA	210	NA
1/31/2023	BX 2023-LIFE	$380.0	Life Science	5	NA	165	NA

**5-Year*

Rob Rubano - Vice Chairman | +1 310 595 2225 | rob.rubano@cushwake.com
Brian Share - Executive Managing Director | +1 310 595 2231 | brian.share@cushwake.com

Life Company

- Life companies have fresh allocations that are generally flat to slightly down from the prior year. Appetite is strong for multifamily, industrial, and strong grocery anchored retail and spreads are generally 15-25 bps tighter supported by a multi-month corporate bond rally.
- Best pricing for low leverage 50-55% LTV is T+ 140s to 160s (~5.35-5.65%), but some lenders are still quoting T+ 170s to 200 (~5.65-5.95%) for full leverage.
- Floating rate is available for core low leverage loans SOFR+ 170s to mid-200s, 50 bps fee, 3+1+1.

INVESTMENT GRADE CORPORATE SPREADS							
		Change			52 Week		
	2/24/2023	1 WK	1 MTH	YTD	Average	High	Low
IG Corp Cash Bond (UST)	146	2 bps	8 bps	-5 bps	158	186	134
IG Corp 7-10 Year Cash Bond (UST)	159	3 bps	8 bps	-9 bps	168	204	131

Source: J.P. Morgan

Bank

- Banks are still the weakest segment of the debt capital markets, preserving capital for top tier relationships and sometimes requiring principal recourse and/or deposits to make loans to new borrowers. Banks are showing up on bid sheets, but it is difficult to predict which banks will quote competitively on any given deal and other lender types have been more aggressive.
- For a healthy functioning debt market, we need the large money center banks to come back more meaningfully—there are signs of improvement, but slow payoffs and regulatory pressure still weigh on them.
- Floating rate spreads for low leverage stabilized cash flowing deals are generally in the high 100s to mid-200s over SOFR (although we have seen quotes as low as the mid-100s), and swapped interest rates are generally in the high 5's% to mid 6's%. More transitional profiles and/or large loans are priced wider.

Debt Fund / Mortgage REIT

- No material change: debt funds have adjusted terms to account for an inefficient market to lever their positions. Spreads are stable and slightly tighter for the best multifamily and industrial.
- CLO pricing rallied tighter in Q1, tracking the improvement seen in CMBS and broader fixed income, but is still too wide for a normal functioning market.
- Pricing depends on the deal profile, but the best pricing is mostly in the SOFR+ lower 300s:
  - 60-70% LTC: 300-400 spreads for preferred asset classes, in the lower half of the range with some in-place cash flow
  - 60-75% LTC: 375-500+ spreads for other asset classes / heavier lift business plan / riskier profile / weaker markets / small balance loans

Rob Rubano - Vice Chairman | +1 310 595 2225 | rob.rubano@cushwake.com
Brian Share - Executive Managing Director | +1 310 595 2231 | brian.share@cushwake.com

Agency

- Agencies are behind pace and motivated to win mission focused loans but are quoting competitively for non-mission loans as well. The 2023 multifamily purchase caps are $75B each (slightly down from $78B in the prior year), and 50% must be mission-driven affordable housing.
- Coverage has constrained leverage, but both Fannie and Freddie are granting 35-year amortization for mission driven loans <65% LTV. They are also leaning in to capture borrower demand for shorter duration with pricing reductions, spread adders for open prepay in last two years, and full interest only at 1.30x DSCR. In the higher interest rate environment, agencies are allowing borrowers to buy down the rate 2-3 points upfront to maintain coverage and proceeds.
- Fixed rate spreads are in 15-25 bps YTD and generally range from T+ 140-160s for mission and T+ 160s-180s for non-mission (mid to high 5's% coupon), with the tighter end of quoted ranges reserved for mission focused loans. Floating rate spreads are low to mid 200s.

AGENCY SPREAD SUMMARY

		Change			52 Week		
	2/24/2023	**1 WK**	**1 MTH**	**YTD**	**Average**	**High**	**Low**
Agency CMBS (bps to SOFR swaps)							
10/9.5 DUS TBA	57	-4 bps	-8 bps	-13 bps	74	111	57
Freddie K A1	51	-3 bps	-4 bps	-12 bps	55	78	36
Freddie K A2	54	-2 bps	-4 bps	-11 bps	65	100	50
Freddie K B	288	8 bps	-38 bps	-64 bps	286	358	185
Freddie K C	398	8 bps	-38 bps	-74 bps	376	476	225

Source: J.P. Morgan

Construction

- Banks and debt funds are still 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.
- A number of planned projects have been shelved, but those that still pencil typically have a low land basis negotiated pre-2022 or the land price was re-cut more recently with a willing seller, and in some cases strong rent growth combined with some hard cost savings have helped maintain returns.
- 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, but in practice most loans are executing last dollar 65-70% LTC at low teens returns, blending the whole loan spread to SOFR+ mid 400s to mid-500s