CUSHMAN & WAKEFIELD
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DEBT MARKET TALKING POINTS – 6/21/2022

Economy and Financial Markets

- Market sentiment in Q2 has been decisively risk-off due to a combination of record inflation, a hawkish Fed, rising interest rates, and a volatile stock market. The macroeconomic backdrop has become increasingly complex for investors to navigate—the economic data is mixed, and volatility remains elevated.
- Q1 GDP was revised lower to -1.5% quarter over quarter. Many economists have revised down Q2 GDP estimates as tighter monetary policy and other macro headwinds slow growth. Most of the public and investors now expect the economy to fall into recession before the end of 2024. Consumer and business sentiment indicators have collapsed, but the hard data confirmation of these shifts has not yet materialized.
- The May jobs report showed 390k jobs added, and the unemployment rate held steady at 3.6%. Improving labor supply has helped ease wage pressures. In total, nonfarm employment is down only ~800k from its pre-pandemic level.
- Retail sales fell 0.3% in May from the prior month, the first decline this year, as consumers pulled back spending in the face of record inflation. Consumer spending has been the driving force behind the economic recovery and the decline is a key indicator that the economy is losing momentum.
- The consumer price index hit a new 40-year high, rising 1% in May, increasing 8.6% from a year earlier—a clear sign that inflation pressures aren't slowing, and the Fed must do more.
- At the June FOMC meeting, the Fed hiked rates by 75 bps, the largest move in 28 years, in response to the surprisingly strong May CPI print, bringing the fed funds rate to the 1.50-1.75% range. Markets are pricing fed funds at ~3.60% by year-end and over 4.00% by mid-2023, a significant movement in just the last week.
- The strong CPI print was the catalyst to a surge in treasury yields and increased rate volatility.
  - *Fixed:* The 10Y UST yield is +180 bps this year to 3.30%, and the yield curve is flat. The 10Y yield has room to go higher and likely continues to climb until the combination of rate hikes and quantitative tightening sends the economy into recession and the 10Y yield lower again. The question is not whether this will happen, but how low the Fed will be willing to cut rates during the next recession. The 10Y could have a new floor of 2.50%.
  - *Floating:* The path of SOFR will follow the fed funds rate and futures contracts indicate the market expects 3.50-3.75% by year-end, implying 200 bps more hikes this year.

INDEX SUMMARY				
(Rounded)		Change		
	6/21/2022	1 WK	1 MTH	YTD
SOFR				
30-Day Average	0.85%	5 bps	35 bps	80 bps
1-month Term SOFR	1.50%	15 bps	65 bps	145 bps
Treasury				
5 Year	3.40%	-20 bps	60 bps	215 bps
7 Year	3.40%	-20 bps	60 bps	195 bps
10 Year	3.30%	-20 bps	50 bps	180 bps
SOFR Swap				
5 Year	3.10%	-25 bps	50 bps	200 bps
7 Year	3.05%	-25 bps	45 bps	185 bps
10 Year	3.05%	-20 bps	45 bps	175 bps

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CRE Debt Themes

- The CRE Debt market has regressed further in Q2: lender credit standards are higher, spreads are wider, and liquidity is tighter. Loan volume has slowed as borrowers try to recalibrate expectations for acquisitions and refinancings in a rapidly moving market, but we expect transaction volume to pick-up post-Labor Day when a wave of property sales hit the market.
- Interest rates are up dramatically YTD due to a hawkish Fed, record inflation, and ongoing geopolitical turmoil that has ratcheted up inflation pressures. For most of 2022 both credit spreads and base rates moved wider—which is atypical, they typically have an inverse relationship outside of recessions. The impact of tighter financial conditions and slower economic growth point to continued higher base rates and wider spreads.
- What started as a re-pricing event in Q1 in response to an uncertain macro-outlook has evolved into a liquidity event in Q2 for certain segments of the CRE lending market due to technical factors. There’s still significant debt capital allocated for CRE that needs to deploy, but a dysfunctional securitization market has left bank balance sheets full of loans on repo / warehouse lines that can’t get cleared, causing a liquidity crunch for banks and non-bank lenders alike. The result is a narrower credit box for loans and a spread premium to access it.
- Lenders have reverted to bifurcating the market into the “haves” and “have-nots” by asset class / deal profile / sponsor / market. No asset class is spared from the move in rates, but multifamily and industrial remain the favorites, followed by alternative asset classes (data center, life science, production studio, self-storage) with some additional scrutiny to the sponsor and market fundamentals, ultra-core “A” office, and the hotels and retail centers deemed the “winners” having emerged from COVID unscathed. The rest has become much more challenging and, in some cases, illiquid for debt.
- It’s unclear what normalized interest rates will look like, but we expect spreads to remain biased wider in the medium term due to the macro uncertainty. It will take a meaningful improvement in the macro-outlook starting with the inflation data (i.e., monetary policy is working) before we see spread products tighten. We are tracking corporate bond spreads / yields very closely for signals because core CRE lending tends to fall between the BBB and BB corporate bonds and CRE fixed income products like conduit, SASB, and CLO tend to follow in sympathy with corporates.
- <u>Hot Topics</u>
    - *Sizing constraints:* DSCR is relevant again and higher interest rates are translating to wider debt yields / lower leverage loans based on lender underwritten in-place and stressed take-out analyses
    - *Capital Stack:* Sizing constraints are creating an opportunity for subordinate debt—there’s an abundance of mezzanine and preferred equity capital available that is easier to place than the mortgage
    - *Assumable Debt:* Fixed rate debt placed in 2020 and 2021 is an asset for sellers—prepayment penalties are lower, and buyers can potentially step into more favorable loan terms than today’s market can bear
    - *Rate Caps:* The strike price varies by deal and profile but 2.75-3.75%+ is generally market, and the cost is significant ($100M notional, at 3.00% strike, 2Y term = ~$1.80M or ~180 bps)

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Life Company

- After strong originations in Q1, loan volume has slowed. Most life companies are far from hitting their annual allocation for fixed rate, with a few exceptions that typically run out early in the year.
- CRE spreads moved wider in 2022 in response to IG corporate spreads that are 50-60+ bps wider YTD, in part due to the macro uncertainty but exacerbated by corporate bond outflows due to poor performance.
- Best pricing for low leverage 50-55% LTV is 10Y T+ 150-175 (~4.80-5.05%), but most spreads are 10Y T+ 175-200+ (~5.05-5.30%+).
- Floating rate is available for core low leverage loans SOFR+ 180-205+, 50 bps fee, 3+1+1.

INVESTMENT GRADE CORPORATE SPREADS							
		Change			52 Week		
	6/17/2022	1 WK	1 MTH	YTD	Average	High	Low
IG Corp Cash Bond (UST)	162	8 bps	-8 bps	47 bps	125	170	103
IG Corp 7-10 Year Cash Bond (UST)	169	9 bps	-6 bps	67 bps	116	175	88

Source: J.P. Morgan

CMBS

- CMBS spreads widened this week on the latest rates volatility. 1H 2022 issuance is on track to beat the same period for 2021 but the supply pipeline has slowed dramatically. Right now, there are approximately five conduit and six SASB deals in the works totaling ~$7.7B.
- AAA conduit spreads are P+ 160s-170s, and AAA SASB spreads are 180-200 over for the best deals and mid-200s over for the rest.
- Lenders are quoting 10Y conduit coupons in the high-5's% to 6% (P+ 250-300) and leverage is lower. Floating rate SASB spreads are generally in the 300s depending on asset class and leverage.

CMBS SPREAD SUMMARY							
		Change			52 Week		
	6/17/2022	1 WK	1 MTH	YTD	Average	High	Low
Conduit (bps to SOFR swaps)							
AAA 3 Year	130	15 bps	4 bps	86 bps	60	130	37
AAA 5 Year	155	22 bps	6 bps	81 bps	87	155	62
AAA 30% 10 Year	159	17 bps	-1 bps	67 bps	107	160	88
AAA 20% 10 Year	218	26 bps	1 bps	102 bps	137	218	102
AA-	266	34 bps	9 bps	130 bps	159	266	119
A-	321	36 bps	-1 bps	140 bps	200	322	152
BBB-	599	49 bps	7 bps	213 bps	401	600	290

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 SOFR swaps) - Trailing 90 Days							
6/7/2022	BBCMS 2022-C16	$1,084.7	NA	NA	NA	150	550
6/6/2022	CGCMT 2022-GC48	$633.3	NA	NA	NA	155	560
5/20/2022	BANK 2022-BNK42	$761.1	NA	NA	NA	158	540
5/4/2022	BMARK 2022-B35	$1,121.6	NA	NA	NA	142	590
4/25/2022	BANK 2022-BNK41	$1,170.0	NA	NA	NA	124	485
4/4/2022	WFCM 2022-C62	$531.9	NA	NA	NA	147	575
3/30/2022	BMARK 2022-B34	$914.8	NA	NA	NA	128	460
3/25/2022	MSC 2022-L8	$685.4	NA	NA	NA	135	NAV
3/23/2022	BBCMS 2022-C15	$1,031.3	NA	NA	NA	127	435
SASB Floating (bps to SOFR) - Trailing 90 Days							
5/27/2022	BX 2022-CSMO	$3,025.0	Lodging	2	1,1,1	211	434
5/3/2022	LIFE 2022-BMR2	$2,875.0	Office/Multifamily	2	1,1,1	130	254
5/2/2022	TCO-2022-DPM	$1,000.0	Retail	2	1,1,1	240	500
4/28/2022	JPMCC 2022-NLP	$1,083.0	Industrial/Office	2	1,1,1	150	310
4/28/2022	BOCA 2022-BOCA	$900.0	Lodging	2	1,1,1	177	332
4/8/2022	BX 2022-IND	$1,760.0	Industrial/Office	2	1,1,1	163	298
4/8/2022	NCMS 2022-RRI	$241.3	Lodging	2	1,1,1	189	408
4/7/2022	BPR 2022-OANA	$2,400.0	Retail	2	1,1,1	202	382
4/4/2022	NCMS 2022-JERI	$149.0	Office	2	1,1,1	309	584
SASB Fixed (bps to SOFR swaps) - Trailing 90 Days							
6/8/2022	JPMCC 2022-DATA	$319.1	Data Center	10	NA	191	326

Bank

- After a strong Q1, Banks have reported tighter lending standards due to several factors including limited balance sheet availability, slowing pay-offs, macro uncertainty, and higher cost of capital and return targets.
- The internal cost of funds is higher for many Banks, but pricing is still hard for other lender types to beat if the banks want the deal.
- Floating rate spreads for low leverage stabilized cash flowing deals are in the high-100s to low-200s over SOFR, and swapped interest rates are in the very high 4's% to low 5's%. More transitional profiles and/or very large loans are priced SOFR+ 225-300.

Debt Fund / Mortgage REIT

- Debt Funds have been forced to adjust terms to account for an inefficient market to lever their positions. Pricing has widened and leverage is lower for all deal profiles / asset classes and there is less depth for loans backed by collateral considered to be the "have-nots".
- There is still record amounts of debt capital raised that needs to deploy, but until the CLO market is viable again (AAA bonds are in the SOFR+ mid-200s, +100 bps from Q1), bank balance sheets will remain full, and banks will charge a premium for A-notes and access to repo / warehouse lines via lower advance rates and wider pricing.
- Pricing is heavily dependent on the deal profile, but the best pricing is mostly in the SOFR+ 300's:
    - 60-70% LTC: 300-400 spreads for certain multifamily / industrial / very strong office
    - 65-70% LTC: 400-500+ spreads for other asset classes / heavier lift business plan / riskier profile / weaker markets / small balance loans

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Construction

- Banks and debt funds are actively lending nonrecourse construction for compelling projects. Multifamily and industrial is preferred, but other asset classes including spec office is available for top tier sponsors with projects in high growth markets. Rising interest rates has led to a pullback in quoted leverage based on stressed take-out metrics for DY and DSCR.
- Pricing and terms are heavily dependent on project specifics, including asset class, sponsorship, and loan size. Bank pricing for best-in-class multi and industrial has held-in better than other sectors during the volatility, but debt funds are priced much wider because it's harder for them to efficiently lever themselves.
- Multifamily and spec industrial:
  - Non-recourse 50-60% LTC, in the mid-200s to low-300s over SOFR
  - Mezz / pref available up to 70-80% LTC, 9-12%+
- Office/Life Science:
  - Non-recourse bank 50-55% LTC, SOFR+ 350-400+
  - Debt fund 65%+ LTC, SOFR+ 475-550+
- Investment grade build-to-suit construction from banks is available 55-65% LTC, low-to-mid 200s over SOFR. Debt funds and mezz lenders can provide higher leverage up to 70-75% LTC, translating to a whole loan spread in the high-300s to low-400s over SOFR.

Agency

- Fannie and Freddie are entertaining more aggressive underwriting, sizing, and pricing to be as competitive as possible, especially for mission driven loans with an emphasis on affordability, to pick up the pace of multifamily loan production that so far this year has lagged expectations.
- In addition to lowering quoted spreads multiple times, they are leaning in to underwrite projected lease trade-outs at closing: T-1 or "T-now", and when there is high affordability / strong sponsor / low leverage, selectively sizing to amortizing DSCRs as low as 1.20x or calculating on 35-year amortization instead of 30-year.
- Fixed rate coupons generally range from the high 4's% to lower 5's% and floating rate coupons are in the low 4's% depending on leverage / DSCR, with the tighter end of quoted ranges reserved for mission focused loans.

AGENCY SPREAD SUMMARY

		Change				52 Week	
	6/17/2022	1 WK	1 MTH	YTD	Average	High	Low
Agency CMBS (bps to SOFR swaps)							
10/9.5 DUS TBA	90	-2 bps	5 bps	33 bps	64	92	42
Freddie K0 A1	73	3 bps	-1 bps	30 bps	47	75	30
Freddie K0 A2	81	2 bps	3 bps	28 bps	56	81	39
Freddie K0 B	298	49 bps	36 bps	132 bps	181	298	143
Freddie K0 C	371	59 bps	34 bps	170 bps	219	371	164

Source: J.P. Morgan