June 17, 2016

Talmage professionals attended this week's 2016 Commercial Real Estate Finance Council June Conference in New York which serves as the mid-year CMBS market barometer. The conference was well attended by leading market participants. Overall, the tone was cautious with an emphasis on the impact of macro events such as Brexit, interest rates, the US election, and global growth, all of which could impact the CMBS market despite solid property fundamentals and healthy, though tempered, CMBS issuance. We believe that these macro events, coupled with the "Wall of Maturities" and "Risk Retention" (discussed below), will increase price volatility and create meaningful opportunities in CMBS throughout the year. We favor CMBS as an asset class as it provides current income, capital preservation with upside potential and is senior in all respects to real estate equity.

2016 CREFC Conference – Key Takeaways

- 2016 CMBS issuance is down approximately 50% year-over-year and appears to be reaching a "new normal" issuance level of between \$50-\$70 billion per year as compared to \$100 billion of annual issuance for each of the last two years.
- CMBS AAA spreads remain "range bound" at Swaps + 110 bps to 165 bps. Despite the tightening experienced in the second quarter, spreads have not been able to break through Swaps + 100 bps, a level last seen in June 2015. While spreads have been "range bound," we do expect to see volatility potentially push spreads outside of this range. All in, given a ten-year Treasury yield of 1.6%, CMBS remains a compelling and competitive lending source.
- The "Wall of Maturities" was a focus item at the conference as a total of \$120 billion of 2006 and 2007 vintage loans are maturing through the end of 2017. High quality loans are being funded by insurance companies, regional banks, and non-bank lenders. However, participants were in agreement that more loans are expected to be placed into special servicing as conduit leverage levels are declining and loan proceeds will not be sufficient to refinance these assets.
- "Risk Retention" is weighing on the market as the regulation will force issuers or B-piece buyers to hold a 5% stake in all newly issued CMBS for up to ten years. Market participants are beginning to develop concrete solutions on meeting the requirements as evidenced by Wells Fargo's recent announcement of a "risk retention compliant" CMBS conduit in July.
- Regarding asset quality, retail remains a top asset class concern for investors while hospitality valuations appear to be at peak levels and losses are mounting in specially serviced assets in the more challenging vintages (2006 and 2007). New issue asset quality is good and while property fundamentals are stable, revenue growth is slowing.

The mood of the conference was cautious due to several external (Brexit, liquidity, global growth) and internal (wall of maturities, risk retention) factors that we anticipate will increase CMBS volatility, though we do expect the CMBS market to remain healthy overall. As an active investor and special servicer, we anticipate taking advantage of dislocations and opportunities across the capital structure during this exciting and dynamic period.