January 19, 2017

Last week, our team attended the 2017 Commercial Real Estate Finance Council winter conference in Miami which unofficially launches the CMBS trading year and is attended by 3,000+ leading market participants. Overall, the tone was optimistic but tempered by uncertainty surrounding Risk Retention, rising interest rates, the Trump Effect, liquidity and macro volatility. We feel that these factors, and particularly macro events, coupled with the approximately $185 billion of contractually maturing CMBS over the next two years, will create meaningful event-driven investment opportunities. We favor CMBS as an asset class as it provides current income, capital preservation and upside potential.

2017 CREFC Conference – Talmage Key Takeaways

- **CMBS Issuance.** 2016 issuance was down 32% from 2015 to $68 billion with a sell-side consensus estimate of $70-$75 billion for 2017. Talmage is forecasting lower issuance of between $55-$65 billion. Despite lower CMBS issuance, we expect an increase in floating rate and "Single Asset / Single Borrower" transactions which are our specialty;

- **CMBS Spreads.** AAA spreads are anticipated to "grind tighter" from levels of approximately swaps + 100 basis points at yearend and have already tightened to swaps + 85 basis points, largely as a result of decreased supply. Please note that CMBS AAA spreads ranged from Swaps + 100-171 bps during 2016. We expect this kind of volatility to continue in 2017;

- **Risk Retention.** The new Risk Retention rules were enacted in December 2016 under Dodd-Frank and require that a single investor holds 5% of a CMBS issuance either as a vertical strip or as a horizontal strip for a period of at least five years. We believe that Risk Retention will hinder supply and will favor traditional balance sheet lenders such as banks while eliminating certain historical non-bank CMBS contributors;

- **Wall of Maturities.** Over $185 billion of CMBS contractually matures within the next two years (including $135 billion in 2017) creating dislocation and opportunities. While the maturities are well-known, we believe that the consequences of defaults and unrealized losses are not fully priced into the market;

- **CRE Stability.** Although commercial real estate prices continue to climb, CRE fundamentals are strong and we believe that the asset class will remain stable;

- **"Fed Liftoff."** Market participants are anticipating two or three rate hikes in 2017. We agree and therefore continue to emphasize floating rate investments. Additionally, in 2016, 1-month LIBOR increased 83% to 0.77%. We believe that LIBOR will continue to rise with interest rates and it is worth noting that in 2008 LIBOR was over 4.5% ;

- **Volatility.** Macro events, from political to financial, are expected to be a major factor in 2017. Despite stability for CMBS as an asset class, we expect to see buying opportunities during periods of temporary market dislocation;

- **Trump Effect.** Views were mixed on what the new administration will mean for the CRE industry but it is expected that the administration will ease regulation, which could result in more supply and increased liquidity;

- **Foreign Investment.** The continuance of foreign capital entering the U.S. market in real estate equity and debt will further increase liquidity and demand.

The mood was bullish yet cautious as the CMBS industry works to solve Risk Retention while managing the Wall of Maturities. We expect that spreads will continue to tighten on technical factors and that interest rates will continue to rise. We are well-positioned to take advantage of event-driven opportunities as well as macro volatility to acquire institutional quality "Single Asset Single Borrower" CMBS in primarily floating rate transactions. We expect that opportunities will be plentiful for nimble and well-capitalized investors.