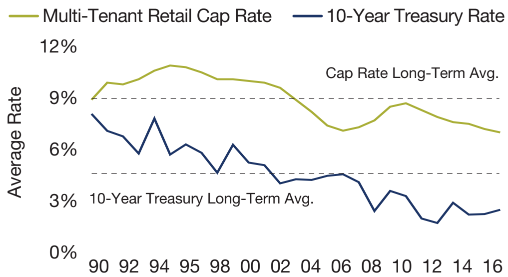
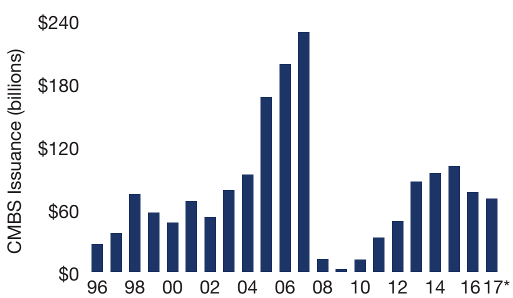
Multi-Tenant Retail Cap Rate Trends

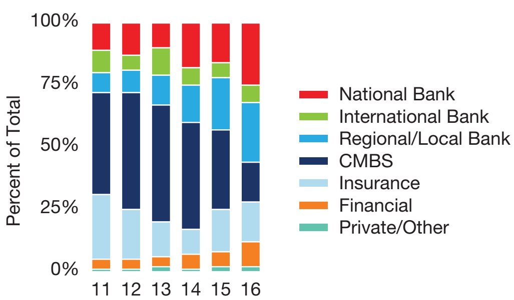


Note: Sales $1M and above

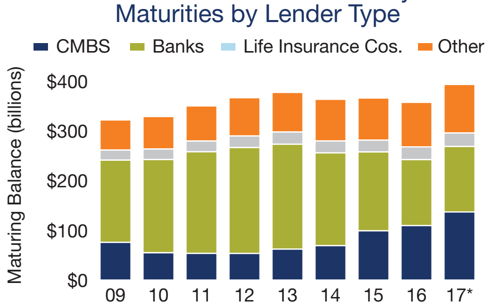
U.S. CMBS Issuance



Retail Mortgage Originations by Lender



Estimated Commercial/Multifamily Debt Maturities by Lender Type



* Forecast`

Lenders Following Disciplined Approach While Borrowers Account for Higher Costs

Rising lending costs cause investors to recalibrate. Following years of particularly low borrowing rates, the sharp postelection increase in the 10-year U.S. Treasury sparked a re-evaluation of pricing and asset yields. Although broad-based economic and retail-property-sector momentum remains intact, higher lending costs could force a repricing of specific assets. Investors have already begun to adapt their underwriting models to a rising interest rate environment, and debt market liquidity remains elevated, offering investors access to a wide range of capital. Despite lender competition, debt sources have maintained disciplined underwriting, reducing market risk and diminishing the prospect of a liquidity-induced bubble. Debt sources also remain cognizant of changes underway in the retail market. Specifically, lenders will closely monitor properties' exposure to underperforming chains and vulnerability to e-commerce. However, retail properties that have improved performance by adding services and high-credit restaurants to tenant lineups will be viewed favorably by lenders.

CMBS lenders look for reboot in 2017. Portfolio lenders, including national and regional banks, stepped in last year as CMBS lending eased amid heightened risk aversion in early 2016 that stymied bond trading and the securitization of loan pools. Dodd-Frank risk-retention rules officially took effect in December and the first CMBS offerings issued under the new guidelines went to market a few months earlier. The securitizations were well received by the bond market and offer a potential framework for additional deals in 2017. The prospects of major changes to the Dodd-Frank Act could materially change CMBS standards this year, but revisions will likely emerge slowly. In this environment, banks are expected to pose competition for CMBS lenders, offering a range of maturities for relatively low-leverage loans. Banks are also a common source of construction lending, but higher borrowing costs may pose challenges for funding new projects.

2017 Capital Markets Outlook

- **Monetary policy in transition.** The yield on the 10-year U.S. Treasury bond jumped following the election but has remained in the low- to mid-2 percent range throughout the first quarter of 2017. The moderate pace of economic expansion has allowed the Fed to delay raising its short-term benchmark rate, but the increase in December underscores a positive outlook for the economy. The central bank will likely be more assertive in its rate hikes in 2017.
- **Sound economy potentially sowing seeds for inflation.** Inflationary pressures are beginning to mount for the first time during the current economic cycle. Long-awaited wage increases and the stabilization of oil prices are pushing up prices, but both factors are also positive forces for overall economic growth. Further wage gains and rising consumer confidence in 2017 could stimulate consumption and drive more traffic to retail properties.
- **Lenders exercise disciplined underwriting.** Retail properties remain a popular down-leg in 1031 exchanges and investors will continue to find liquid debt markets in 2017. Overall, leverage on acquisition loans continues to reflect disciplined underwriting, with LTVs typically ranging from 55 percent to 65 percent for most retail properties. The combination of higher rates and conservative lender underwriting encouraged some investor caution that slowed deal flow in late 2016, a trend that will likely extend into 2017. A potential easing of regulations on financial institutions, though, could liberate additional lending capacity and higher interest rates may also encourage additional lenders to participate.