AST DEFEASANCE RATE MARKET UPDATE

Good Morning! Please see below for the RCA | AST Defeasance *Rate Market Update* for November 14, 2023. Please let us know if you would like additional market color or have any questions. We are also always happy to provide indications for your defeasance needs, or for interest rate caps, floors, swaps, swaptions or other derivative hedging products. *Please feel free to reach out to us anytime!*

RATE MARKET UPDATE 11/14/2023:

- **Headline and Core CPI print lower than anticipated**
- **US Treasury and SOFR swap yields drop materially on the weaker inflation data**
- **This morning's CPI data likely keeps the FOMC on the sidelines in December**
- **Next up: PPI and Retail Sales data released tomorrow at 8:30 a.m.**

Treasury yields and SOFR swap rates tumbled after lower than expected CPI data reinforced the market view that interest rates have peaked and the FOMC may have room to ease policy next year. Market pricing now virtually rules out a rate hike in December – market participants now see a 99% chance that the FOMC holds rates steady at the December 13th meeting. US inflation broadly slowed in October, an encouraging sign of progress for the Federal Reserve in the long path to taming inflation. Core CPI, which excludes more volatile food and energy costs, increased 0.2% from September (vs. +0.3% expected) and Headline CPI was flat at 0.0% (vs. +0.1% expected). Economists favor the core gauge as a better indicator of underlying inflation than the overall CPI. The lower than expected core CPI was restrained by a drop in gasoline prices.

CHARTS 1 & 1A: CPI Results & Market Reaction

The below Bloomberg table below details this morning's CPI results compared to market expectations. The table illustrates that inflation showed decreases *across the board*. This was definitely a positive sign that the FOMC is winning the fight against inflation. We will see if tomorrow's PPI inflation data supports today's CPI inflation reading. If it does, the combination of lower CPI and PPI will likely rule out a rate hike in December and potentially signal the end of the current rate-hiking cycle.

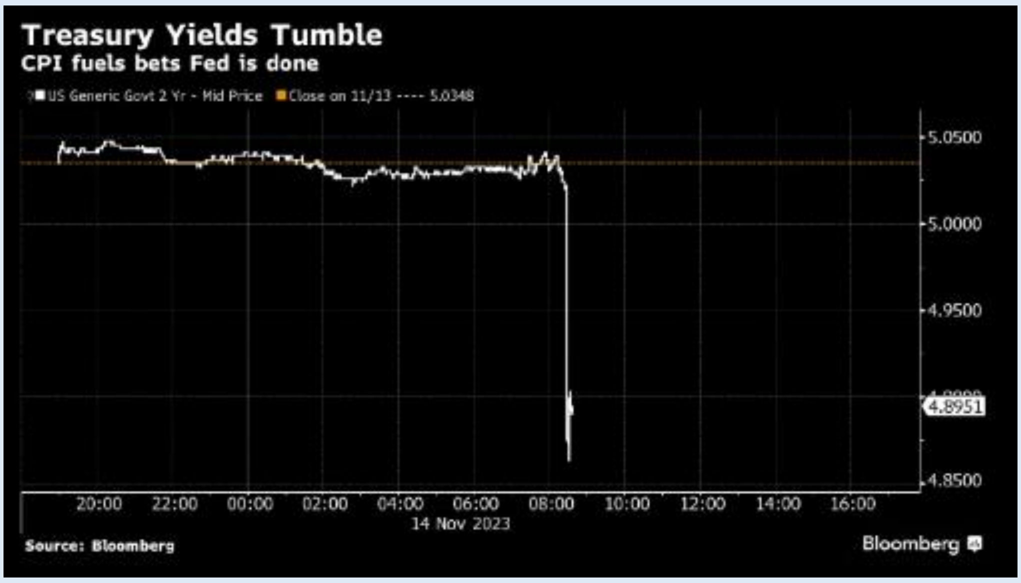
October CPI Results

Metric	Actual	Estimate
CPI MoM	+0.0%	+0.1%
Core CPI MoM	+0.2%	+0.3%
CPI YoY	+3.2%	+3.3%
Core CPI YoY	+4.0%	+4.1%

Source: Bloomberg, LLP

The Bloomberg graph below shows the 2Y T-note reaction immediately after the CPI data printed. You can clearly see that traders were hoping for a weaker than expected inflation number – they got it and immediately pushed rates lower. Rates had spiked on Chairman Powell's hawkish speech last week, but it now looks like the market may have overreacted to his testimony. Powell said that the FOMC would remain vigilant and not hesitate to raise rates again should inflation levels warrant. However, he was *very* clear that might not be necessary and that the Fed was pleased with the inflation progress to date and the sustained disinflation trend. He emphasized the Fed would be data-driven and make near-term monetary policy decisions on a "meeting-by-meeting" basis. If that is indeed the case, based on today's CPI data, the FOMC will hold rates steady at the December meeting. Beyond that, they will need a compelling, inflation-based reason to raise rates again. However, they will also need a compelling reason to *cut* rates. Yes, the economy is showing small cracks of weakness and some inconsistent data recently, but overall there is still strong optimism the Fed can engineer a soft-landing.

2Y Treasury Note Reaction To CPI Data

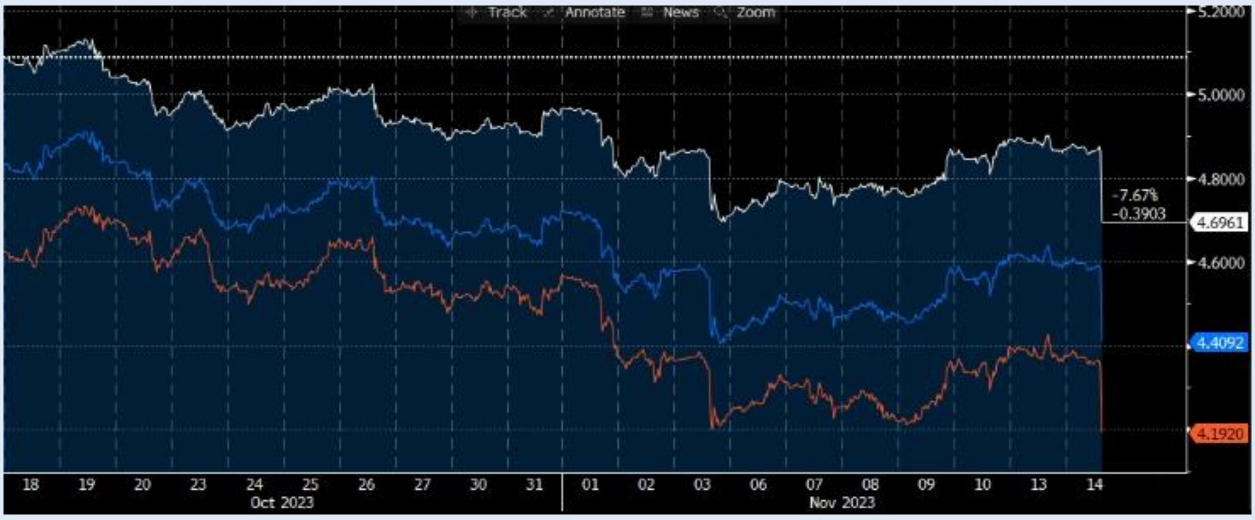


Source: Bloomberg, LLP

CHART 2: 2Y, 3Y & 5Y SOFR Swap Rates - Prior 30 Days

The Bloomberg chart below shows the rate movement over the prior 30 days for 2Y (white), 3Y (blue) and 5Y (orange) SOFR swaps. Despite tremendous rate volatility since the Nov 1ST FOMC meeting, SOFR swap rates are currently right on top of the 11/3 market levels. Rates dropped after the FOMC "hold" and dovish Fed-speak and continued to drop after a weaker than expected Employment report on 11/3. Rates popped back up after Powell's speech last week was viewed as more Hawkish than his post meeting comments – our view was that he basically said the same thing on both occasions. The Fed is on record as being "data-dependent", so the weaker than forecast CPI pushed rates immediately lower. As we have discussed, the retreat in rates this morning signals the market expects the FOMC to hold the benchmark rate steady at the Dec 13TH meeting. The market does not expect Retail Sales and PPI to deviate from expectations, so the market is hoping tomorrow's numbers provide further evidence that rates have peaked and the Fed is done raising rates.

2Y, 3Y & 5Y SOFR Swap Rates, Prior 30 Days: – Volatility Rules!

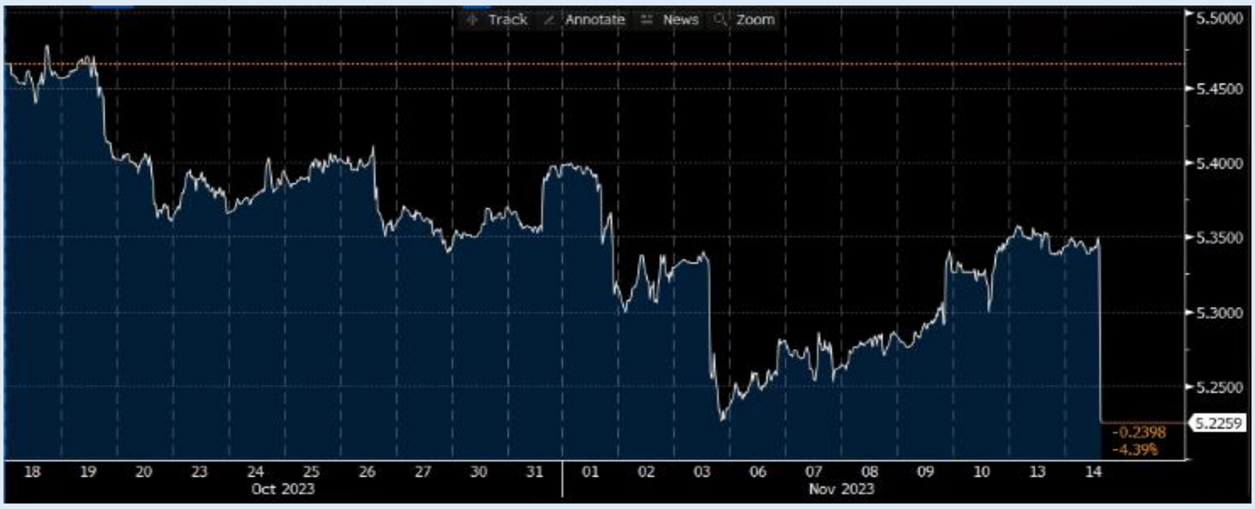


Source: Bloomberg, LLP

CHART 2A: 1Y SOFR Swap Rates, Prior 30 Days

1-year SOFR swap rates, like their longer term brethren, are also basically unchanged since 11/3. The 1Y SOFR swap is most impacted by FOMC rate decisions. You can see from the graph that the current 1Y swap rate (5.22%) is right on top of the Fed Funds rate. That typically portends that the market expects short-term rates to be close to unchanged for the next year. That could change if expectations for rate cuts increase. It is too early to make a call on rate *cuts* next year, but the market definitely expects a rate cut or two next year. At the moment market pricing has moved up the first potential rate cut from June 2024 to March 2024. That timetable still seems optimistic to me, but there are some growing signs the economy may slow down enough next year to merit a rate cut earlier than later. The FOMC will not cut rates if they are still worried about inflation and the economy is still relatively strong. The lower than expected CPI number definitely helps the case for rate cuts. The FOMC will be more inclined to cut rates if the US economy begins to materially slow down *and* inflation remains contained. For now, that seems to be the way the situation is unfolding in the market.

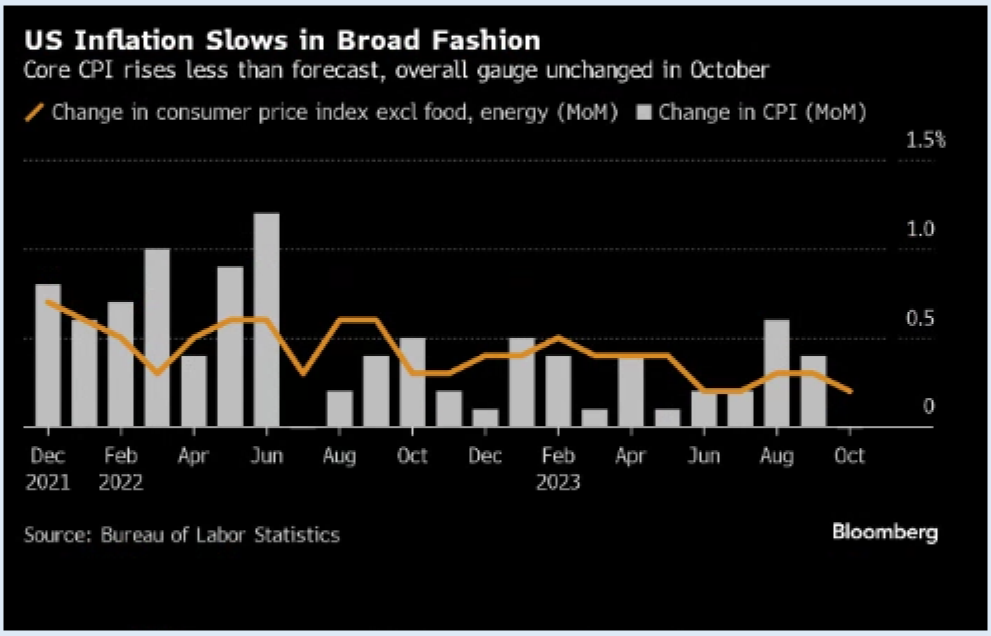
1Y SOFR Swap Rate, Prior 30 Days



Source: Bloomberg, LLP

CHART 3: Disinflation Trend Continues

The Bloomberg graph below details US CPI since 2021. You can clearly see that the disinflation trend is intact. Inflation has come down dramatically since the FOMC began their tightening campaign and the October CPI number showed they are getting the job done. Most encouraging was the fact that inflation slowed down across the board. Core CPI was helped by lower gasoline prices and a slight down-tick in food prices. Today's CPI figures make the prospect of a soft landing ever more likely, with the Fed inching closer to its 2% inflation target. The reduction in inflation suggests that recent monetary policy has been successful and reinforces the likelihood that central bankers will hold off from further rate hikes. Said another way, if the Fed is nearing the end of their tightening campaign, it reduces the possibility that they will do further damage to the economy by raising rates further. Thus far, despite some weaker than expected economic data recently, the US economy remains relatively strong. That means the FOMC may have engineered a soft-landing while crushing high inflation – precisely what they set out to do when they began raising rates.



Source: Bloomberg, LLP

Product Update:

Week of 11/13/23 - What We Are Seeing In The Market…

New cap volume increased recently and we continue to see our clients looking at cap extensions. Given the uncertainty that still remains about forward rates, many clients are grappling with when or if to extend. This is a difficult question – our advice has been to monitor the market closely and be on-boarded and ready to trade, should the market move in your favor. We also advise borrowers to check the market pricing for extensions, similar to how you purchased the original cap. Market pricing discovery is a key component to any cap transaction – new caps, extensions or terminations.

We also encourage our clients to speak to their lenders. In some cases recently we have seen lenders approve shorter term extensions (i.e. 3 months) – some borrowers may need to extend, but not for the *full* year. Other borrowers are simply looking to dynamically manage hedging rate risk by entering shorter term caps and hoping cap premium costs will drop ahead of the next cap purchase. This is not without risk, but could be a viable strategy if you believe rate are going down next year.

On another front, borrowers who have "floors" embedded in their loan have been considering purchasing a separate, stand-alone interest rate floor to *offset* the loan floor. Borrowers with a loan floor will *not* be able to benefit from floating rates that drop below the loan floor rate. They will miss out on the benefit of lower floating rates, which depending on the rate environment can be significant. To offset the loan floor, borrowers can purchase an interest rate floor which will payout should floating rates drop below the floor's strike rate. Details vary depending on the individual situation – some borrowers prefer to choose a strike on the floor that matches the floor rate on the loan, whereas others look to use a strike rate below the loan floor. (For example: Your loan floor is 3.50% - the floor you purchase can be priced at the loan floor of 3.50%, or you could look at a strike of 3.00%). The lower the floor strike, the cheaper the premium cost of the floor. Pricing ultimately depends on the individual situation and objective.

We also continue to see clients grappling with ways to manage burdensome replacement cap escrow costs. In certain cases there *may* be a way to restructure the existing cap to extract value which can offset escrow created cash-flow pressure. Short of biting the bullet and purchasing the replacement cap and ceasing escrow deposits, restructuring the cap can add risk. Many of the solutions are designed to alleviate short term cash flow pressure but as mentioned, often create additional rate risk.

Please contact us if you would like to discuss an upcoming rate cap extension, explore ways to reduce or eliminate escrow deposits for replacement caps or learn more about interest rate Floor pricing.

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AST Defeasance Consultants, one of the nation's leading commercial real estate consulting firms, was founded in 2007. We have extensive experience in commercial real estate defeasance, hedging, derivatives, and financial instruments. More than $50 billion worth of transactions have been executed by the AST team. Only AST can combine innovation, expertise, and exceptional customer service.

Rate Cap Advisors was established in 2015 that focus on providing commercial real estate interest rate cap solutions. Our innovation and desire to explore new possibilities that benefit our clients have allowed us to save our clients millions of dollars. No matter the service or product, we take great pride in our pursuit of perfection with a unparalleled closing track record.

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