AST DEFEASANCE RATE MARKET UPDATE

Good Morning! Please see below for the RCA | AST Defeasance *Rate Market Update* for November 28, 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 11/28/2023:

- **SOFR swaps trade in a broad range as market awaits key economic data later this week**
- **FOMC expected to hold rates steady at the December meeting**
- **GDP released 11/29 at 8:30 am, PCE inflation data released 11/30 at 8:30 am**
- **There are also a host of other economic numbers set for release this week, including Personal Income and Personal Spending (11/30)**
- **Next FOMC Meeting: December 13, 2023 at 2:00 pm**

Treasury yields and SOFR swap rates continue to trade in a broad range, as market participants ponder what is next for the Fed. Market pricing still shows a virtually unanimous (96.6%) consensus that the FOMC will again hold rates steady at the December meeting. SOFR swap rates have been trading sideways since the CPI and Retail Sales data were released mid-November. As you can see in the graph below, the market reaction to that data series was lower swap rates – traders basically removed the possibility of any further rate hikes. 2Y SOFR swap rates have bounced around in a 20 bp range over the prior two weeks as the market awaits key economic data released later this week and tracks Fed-speak for any clues to forward monetary policy. At the moment, it feels like the market believes the Fed is done raising rates. However, there is an underlying and lingering feeling the FOMC may still have one more 25 bp rate hike to go. Inflation, despite tremendous progress, remains stubborn. Make no mistake, sustainably lowering inflation to 2.00% is still the Fed's primary mandate. There still seems to be a disconnect between the market and the FOMC. Market participants are still forecasting rate cuts as early as 2Q 2024, whereas the Fed has stated they do not think economic conditions support rate cuts. We will see if the data released this week brings the market and the Fed any closer in terms of the possibility of rate cuts in 2024 and more importantly, the timing of those cuts.

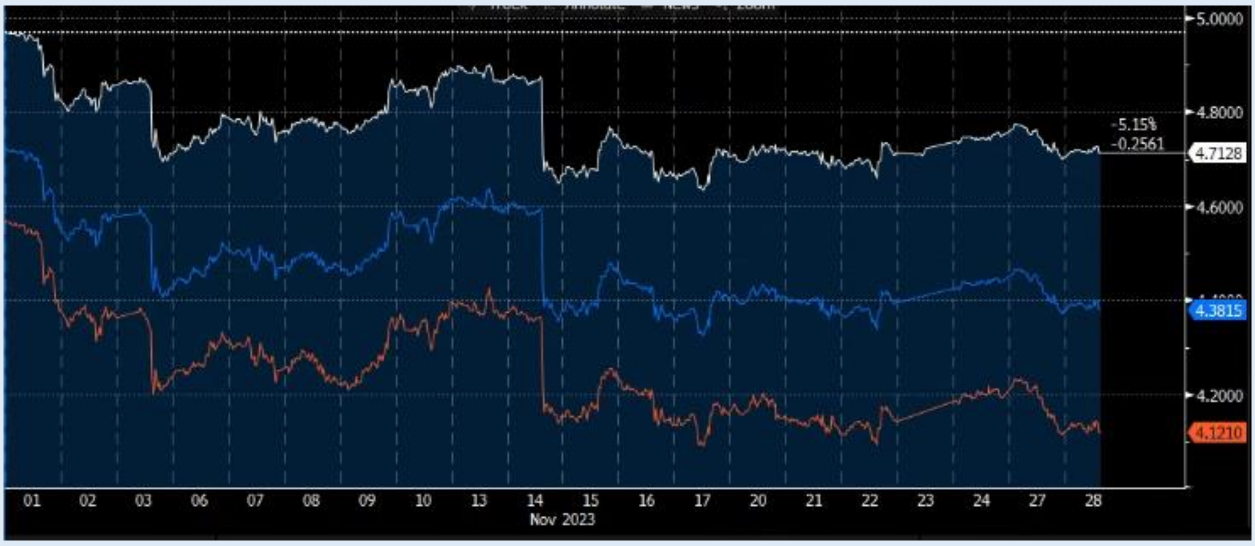
As mentioned, we see a host of economic data released this week. The highlights are: 3Q GDP released on 11/29, PCE inflation data, Personal Income and Personal spending released on 11/30. All releases are at 8:30 am. The FOMC is closely tracking GDP and as we know, Core PCE is the Fed's preferred inflation gauge, so these are important numbers. That said, "as expected" results will not likely change anything fundamentally for the Fed, in terms of the December meeting. The Fed is looking for consistency and sustainability when it comes to inflation – they will be looking to see if the disinflation trend for PCE remains intact. If it does, it would likely give the FOMC confidence that holding rates higher for longer remains the best path forward for monetary policy. They will be encouraged that the rate hikes done to date are having the desired lagging effect on reducing inflation. Should the numbers diverge dramatically from expectations, we could see some rate volatility as traders adjust forward rate expectations.

CHART 1: SOFR Swap Rates Trade In A Broad Range

The Bloomberg graph shown below details 2Y (white), 3Y (blue) and 5Y (orange) SOFR swap rates for the prior 30 days. Rates have remained range bound since mid-month as traders await the next round of economic data. We are also approaching the final FOMC meeting of the year and "year-end" for many organizations, so we could see increased rate volatility in December as traders and institutions digest the Fed meeting, shore-up positions and prepare year-end balance sheets. At the moment, consensus is that the Fed holds rates steady at the December meeting. However, Powell's post-meeting press conference will be highly anticipated – as we discussed there is currently a dichotomy between the FOMC and the market concerning the possibility, timing and magnitude of rate cuts next year. The market will be eager to hear Powell's insight on this topic. Unless the upcoming GDP, PCE or

Jobs report data wildly diverge from forecasts, we expect swap rates to remain range-bound ahead of the Fed meeting on 12/13.

2Y, 3Y & 5Y SOFR SWAP RATES: PRIOR 30 DAYS



Source: Bloomberg, LLP

CHART 2: FOMC Projections For 2024

The Bloomberg table below shows economists' projected 2024 Fed Funds levels, by FOMC meeting. Recent Fed-speak has reinforced two-things: that the FOMC remains convinced that rates need to stay higher for longer in order to lower inflation and that they are not *currently* planning any rate cuts. The Fed's Mester recently said that "monetary policy is in a good place" and that the FOMC is currently assessing "if rates need to go higher" and "how long to remain restrictive". That does not sound like a Fed that is preparing to cut rates imminently. In addition, economic growth is solid, inflation continues to drop and the employment market is cooling off. These are all things the FOMC wants to see and so far, seems to portend a soft-landing scenario for the economy. The FOMC is not likely to deviate from the current restrictive monetary policy without good reason. Of course, economic conditions could change dramatically next year, prompting the Fed to accelerate their rate cut timetable. The data this week and next week (Employment Report released on 12/8) is highly anticipated by the market and will set the stage for the 12/13 Fed meeting.

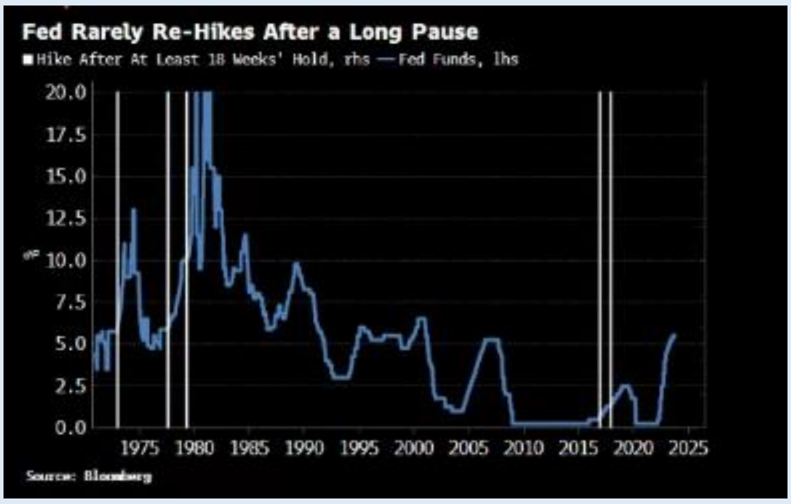
FOMC Projections For 2024

	Dec. 13 2023	Jan. 31 2024	Mar. 20 2024	May 1 2024	Jun. 12 2024	Jul. 31 2024	Sep. 18 2024	Nov. 7 2024	Dec. 18 2024	Jan. 29 2025
Fed funds, lower bound	5.25%	5.25%	5.25%	5.25%	5.25%	5.00%	4.75%	4.75%	4.50%	4.25%
Previous survey	5.25%	5.25%	5.25%	5.25%	5.25%	5.00%	4.75%	4.50%	4.25%	n/a
Fed funds, higher bound	5.50%	5.50%	5.50%	5.50%	5.50%	5.25%	5.00%	5.00%	4.75%	4.50%
Previous survey	5.50%	5.50%	5.50%	5.50%	5.50%	5.25%	5.00%	4.75%	4.50%	n/a

Source: Bloomberg, LLP

CHART 3: Fed Rarely Hikes After Long Periods "On Hold"'

I found the below Bloomberg chart interesting – it shows that the FOMC has rarely resumed rate hikes after a prolonged pause (at least 18 weeks). The historical data therefore supports the current market view that the Fed is done raising rates. Since 1971, the Fed has only resumed rate hikes after a prolonged pause 5 times. The FOMC does not want to cause a recession. As we know, they are trying to engineer a lower-inflation, soft-landing scenario. So far, so good. However, they are now at a crossroads, where tightening too far could tip the economy into recession, but stopping too soon (or cutting rates too soon) could reignite inflation. Even though, based on historical perspective, it seems unlikely the Fed would hike again, that does not mean it will not happen. Stickier-than-expected inflation may yet require tighter policy. With that in mind, current swap yields look on the low side and they could be pulled higher by an increase in short-term rates and stubbornly high nominal GDP. Looking ahead to the first quarter of 2024, the FOMC is likely to remain data driven and to proceed cautiously with any changes to monetary policy.



Source: Bloomberg, LLP

Product Update:

Week of 11/27/23 - 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. *Volatility has softened somewhat during the past two weeks, providing some premium relief for cap purchasers, especially for strikes at or out-of-the-money.*

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.

Disclaimer: *The information provided in this communication is intended for discussion purposes only. Nothing presented in this communication should be taken as a recommendation. All market data shown is indicative only and subject to change depending on current market conditions.*