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CMBS Research

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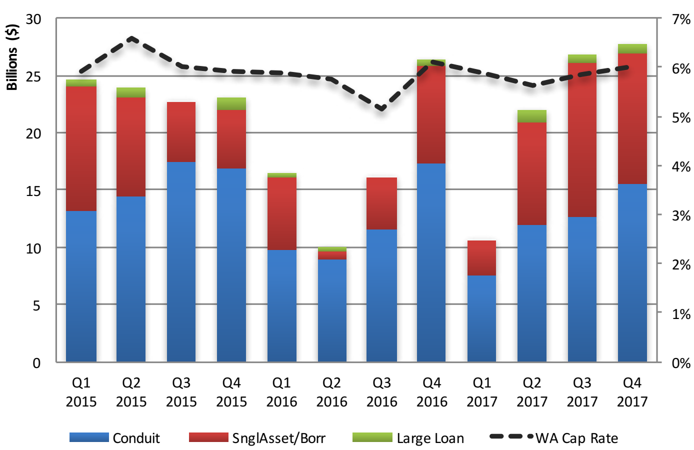
Q4 CMBS Issuance Recap: 2017 Finishes on Strong Note

While many in CMBS approached 2017 with uneasiness and precaution due to new regulatory mandates, the CMBS market found its footing with risk retention as the year progressed. As the securitization industry refinanced the tail-end of the Wall of Maturities, 41 private-label deals totaling $27.7 billion were issued between October and December, up slightly from the $26.8 billion tally that closed during the third quarter. The Q4 issuance total was the highest quarterly volume recorded in 2017. On top of the $32.48 billion in CMBS loans that cleared the domestic pipeline during the first half of 2017, full-year issuance ultimately reached $87.06 billion across 124 deals. This marks a surprising 26.4% rise in volume compared to 2016, thanks to greater macroeconomic stability and reduced market volatility.

GRAPH 1: QUARTERLY CMBS ISSUANCE BY DEAL TYPE



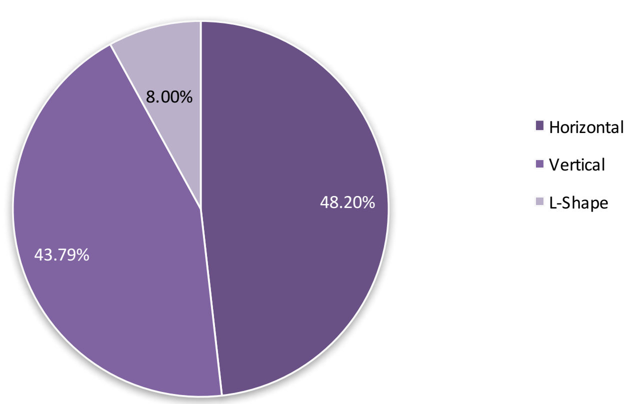
Source: Trepp

Issuers Looked to the Horizon for Risk-Retained Holdings in Q4

Under Dodd-Frank risk retention provisions implemented in December 2016, sponsors and third-party investors of an asset-backed securitization (ABS) are required to retain a 5% interest in the transaction. This can be done through a vertical (5% of each class), horizontal (5% of the lowest bonds in the deal waterfall), or hybrid/l-shaped structural holding (combination of the vertical and horizontal structures equal to 5%). By balance, the horizontal risk retention structure represented the largest portion of fourth quarter issuance. A total of 19 CMBS deals with a combined balance of $13.36 billion were issued with the horizontal holding, which amounted to 48.20% of the overall Q4 volume. The vertical structural option once again ranked first in our issuance tally by deal count with 20 transactions totaling $12.14 billion closed during this period. Issuance of deals which employed the hybrid strategy continued to dwindle, as just $2.22 billion (or roughly 8.00% of the aggregate balance) was securitized with this structure. Underwriting credit metrics appear to be conservative with weighted-average DSCR topping 2.50x and weighted-average LTV remaining below 59%. In the fourth quarter, horizontal deals stood out in particular with a considerably higher weighted average cap rate of 7.06%, a figure that was pushed up by high income-generating properties like Caesars Palace Las Vegas.

Based on a full-year overview, horizontal and vertical new issues amounted to a combined $74.18 billion or 85.20% of total issuance, with each structural type making up about half of this total. L-shaped deals took up the remaining 14.80% with $12.88 billion in new issues.

GRAPH 2: Q4 2017 CMBS ISSUANCE – RISK RETENTION STRUCTURE



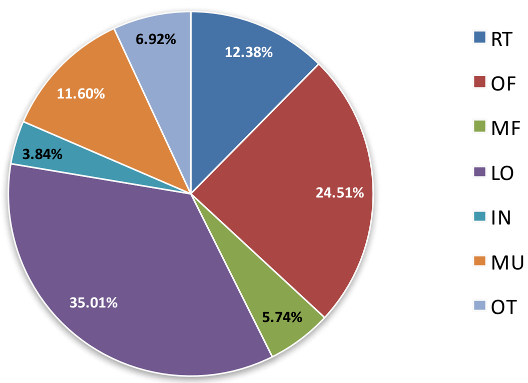
Source: Trepp

CHART 1: Q4 2017 CMBS ISSUANCE - RISK RETENTION STRUCTURE

	HORIZONTAL	VERTICAL	L-SHAPED
Balance ($B)	$13.36	$12.14	$2.22
% of Q4 Issuance	48.20%	43.79%	8.00%
# of Deals	19	20	2
WA LTV	58.84%	56.62%	49.99%
WA Cap Rate	7.06%	6.89%	5.76%
WA DSCR	2.57	2.98	2.69

New Hotel Deals Keep Coming

GRAPH 3: Q4 2017 CMBS ISSUANCE – PROPERTY TYPE



**A sizable portion of loans categorized as mixed-use include collateral consisting both office and retail space*

Source: Trepp

Buoyed by the inclusion of large pari passu notes amid heavy deal flow in that sector, new hotel issues from Q4 2017 totaled $9.71 billion, the most of any property type. Much of the securitization activity was driven by the refinancing and recapitalization of Las Vegas hotels and portfolio assets operating under the Hyatt, Marriott, Hilton, or Starwood flagship brands. While lodging debt only makes up about 16.1% of the total CMBS universe, the sector has the highest volume of loans that are due to mature in the next three years. Office transactions comprised another 25% of the Q4 issuance pipeline with the New York City, Los Angeles, San Jose, and Phoenix metropolitan areas among the top contributors of collateral. With the retail landscape adapting to ongoing sector-wide changes, the share of retail issuance fell to 12.57% of the Q4 total. The mixed-use and multifamily sectors rounded out the top five property categories, as they added another $3.22 billion (11.60%) and $1.59 billion (5.74%), respectively.

From an annual perspective, the total issuance contribution by major property types is as follows: office ($26.12 billion; 30.01% of the total), lodging ($24.67 billion; 28.34%), retail ($11.83 billion; 13.59%), mixed-use ($11.28 billion; 12.96%), multifamily ($4.61 billion; 5.29%), and industrial ($2.66 billion; 3.05%).

The Gap Between SASB and Conduit Volume Narrows

Roughly 56%, or $15.5 billion, of Q4 CMBS issuance came from 17 conduit deals. Single-asset/single-borrower (SASB) transactions made up 41.2% of last quarter's total as 22 deals totaling $11.4 billion were issued. Approximately two large loan deals totaling $778.9 million were securitized in Q4. Though conduits were still the most popular deal type for 2017 transactions, the single-asset space continues to fetch a larger chunk of issuance year by year. This increase in SASB volume has helped keep a lid on leverage ratios and average transaction sizes. Single-asset

CHART 2: FIVE LARGEST CMBS LOANS ISSUED IN Q4 2017

DEAL NAME	PROPERTY NAME	DEAL TYPE	PROP TYPE	CITY, STATE	SECURITIZED BALANCE	LTV	DSCR
CZR 2017-VICI	Caesars Palace Las Vegas	Single-Asset	LO	Las Vegas, NV	$1,550,000,000	49.05%	4.42
CHT 2017-CSMO	The Cosmopolitan of Las Vegas	Single-Asset	LO	Las Vegas, NV	$1,380,000,000	47.30%	5.01
BX 2017-IMC	IMC Portfolio	Single-Asset	OT	Various	$955,000,000	65.10%	2.76
GSMS 2017-SLP, GSMS 2017-GS8	Starwood Lodging Hotel Portfolio	Single-Asset/ Conduit	LO	Various	$775,000,000	65.65%	2.34
WPT 2017-WWP, GSMS 2017-GS8	Worldwide Plaza	Single-Asset/ Conduit	OF	New York, NY	$805,000,000	54.02%	2.47

**Based only on deals that closed in Q4 (For large pari-passu notes securitized across several quarters, only the loan balance securitized in the fourth quarter was included in our analysis)*
**LTV and DSCR are based on values reported for the largest loan piece*

loans accounted for 42.15% of total issuance in 2017, up from 29.17% in 2016 and 31.66% in 2015. Many in the market foresee single-borrower deals taking a bigger piece of the issuance pie again in 2018.

Viva Las Vegas! Pair of Silver City Hotels Top New Issue List

While a number of famed luxury hotels on the Las Vegas Strip have undergone large-scale renovations in recent years, the $1.55 billion securitized note behind the Caesars Palace Las Vegas hotel and casino and the $1.38 billion refinancing on The Cosmopolitan of Las Vegas were the two largest issues of Q4.

Built in 1966, the 3,974-unit, 401,867 square-foot Caesars Palace secures a five-year, $2.2 billion fixed-rate mortgage that includes a $1.55 billion securitized portion (which fully comprises CZR 2017-VICI) and a $650 million piece of mezzanine debt. The loan was sponsored by REIT spinoff VICI Properties, which was formed to facilitate Caesars Entertainment Corporation's exit out of bankruptcy in August 2017. Under the firm's plan to reduce its debt load by $9 billion, Caesars Entertainment will sell and then subsequently leaseback the flagship Caesars Palace and several of its gaming and golf course operations to VICI Properties. The leasehold interest, trademark license, and intellectual property behind the iconic Caesars Palace Las Vegas hotel was valued at $3.16 billion in September 2017, making it the highest appraised lodging collateral in CMBS.

Another noteworthy new issue is the $1.2 billion recapitalization of the Midtown Manhattan skyscraper at 825 Eight Avenue. Constructed in 1987, the 82-unit, 2.05 million-square-foot office building known as Worldwide Plaza backs a $940 million securitized loan package and $260 million in mezzanine notes. The financing was used in a joint venture between RXR Realty and SL Green Realty Corp. to purchase a 48.7% stake in the subject property from New York REIT Inc. Five single-asset and conduit loan pieces totaling $805 million of the whole loan were securitized in the previous quarter through the conduit GSMS 2017-

CHART 3: Q4 CONDUIT CMBS ISSUANCE - PRICING

CLOSING DATE	CMBS DEAL	AAA SPREAD	BBB- SPREAD	RISK RETENTION TYPE
10/18/17	UBSCM 2017-C4	93	460	Vertical
10/17/17	WFCM 2017-C40	93	450	Vertical
10/19/17	MSBAM 2017-C34	88	415	Vertical
10/31/17	JPMDB 2017-C7	83	370	L-shape
10/31/17	CGCMT 2017-C4	83	Not Disclosed	Horizontal
11/15/17	BANK 2017-BNK8	76	340	Vertical
11/16/17	UBSCM 2017-C5	78	Not Disclosed	Horizontal
11/30/17	CD 2017-CD6	75	Not Disclosed	Horizontal
11/30/17	GSMS 2017-GS8	77	Not Disclosed	Horizontal
11/30/17	WFCM 2017-C41	79	Not Disclosed	Horizontal
11/30/17	CSAIL 2017-CX10	77	375	L-Shape
11/30/17	CCUBS 2017-C1	84	Not Disclosed	Horizontal
12/13/17	UBSCM 2017-C6	83	425	Vertical
12/20/17	BANK 2017-BNK9	81	350	Vertical
12/21/17	WFCM 2017-C42	84	410	Vertical
12/22/17	MSC 2017-HR2	83	Not Disclosed	Horizontal
12/27/17	UBSCM 2017-C7	87	Not Disclosed	Horizontal

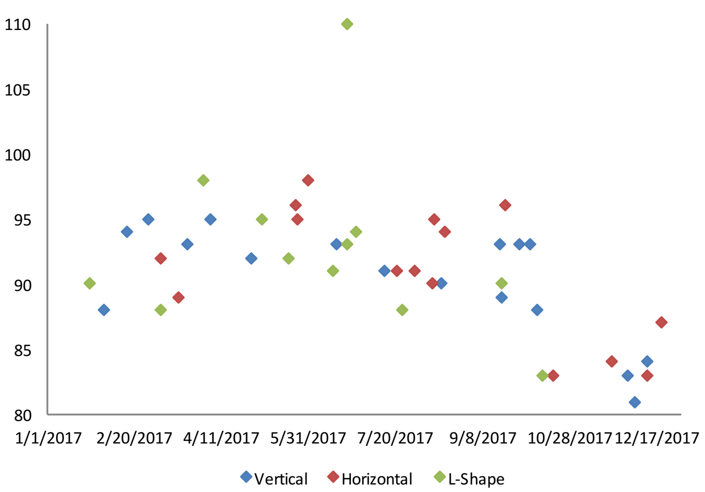
Source: Trepp

GS8 deal and single-asset WPT 2017-WWP transaction. Remaining loan pieces are expected to appear in future CMBS transactions which are currently in the 2018 pipeline. The top anchor tenants at the property include financial services company Nomura Holdings and law firm Cravath, Swaine & Moore.

Benchmark Spreads on New Issue Conduits Keep Tightening

Through the last quarter of 2017, spreads tied to all

GRAPH 4: Q4 2017 CMBS ISSUANCE – AAA SPREADS ON NEW CONDUIT ISSUES



Source: Trepp

segments of CMBS continued to tighten considerably, including those in CMBX and newly issued deals. LCF AAA spreads for deals that closed from October to December clocked in between 75 to 93 basis points over swaps, compared to a range of S+88 to S+96 on deals issued in Q3. BBB- spreads were more varied and ultimately settled between 340 and 460 basis points over swaps for Q4. The spread rally was largely attributed to the strength of the broader equity market, aided by greater investor optimism in the US economy and a strong holiday retail season.

The general consensus seems to be that CMBS spreads will remain at tight levels, with market conditions favorable for further contraction into the first half of 2018. Results from a semi-annual survey conducted by *Commercial Mortgage Alert* indicated that CMBS traders generally anticipate spreads to tighten by six basis points for super senior AAA paper, while spreads at the lower end of the credit spectrum – mainly BBB- bonds – are expected to widen by up to nine basis points. With interest rates on the rise amid the backdrop of other Fed-implemented tightening policies, sector volatility could increase in the coming months.

Market Trends

- Price-tiering and differentiation by risk retention structure, collateral quality, and issuer reputation among securitized products is a prevailing trend of the primary and secondary markets. Credit barbelling in new deals has become more prevalent with heightened pari passu exposure.

- CRE trade groups have been pushing for less stringent regulatory provisions under Dodd-Frank, especially those which govern propriety trading (Volcker Rule) and risk retention (i.e. qualifying CRE loans that can be exempted from risk retention requirements). In their view, many of these regulatory restrictions are deemed as overly complex and vague, have hindered bank trading activity, and have reduced liquidity in the market. Reform efforts such as the Financial CHOICE Act and others spearheaded by the House Financial Services Committee may gain more traction with additional bipartisan support.

- Some industry players expect 2018 to be a notable turning point for the CMBS industry due to the significant drop-off in the volume of loans that will be up for refinancing. Projections for private-label issuance in 2018 range from $60-75 billion to more bullish predictions of $90 billion.

- Passage of the GOP Tax Cut and Jobs Act is perceived to be a net positive for the industry since the bill incentivizes greater investment and development activity for CRE assets, though there are concerns about overbuilding risk.

Outlook

Under present market conditions, CMBS continues to distinguish itself as an increasingly attractive capital source compared to other securitized lending products. Despite the significant wind-down in the volume of maturing debt this year amid other regulatory headwinds, the outlook for the sector is positive given its strong demand fundamentals and competitive pricing. With year one of risk retention complete, benchmark spreads on new issues are expected to remain relatively steady into 2018, which will draw interest from middle-market entrants that have traditionally been active outside the CMBS space. The newly-passed GOP tax legislation will provide additional stimulus for CRE financing and expansion activity, giving the sector room for further growth.

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