THE ANALYST

MARYLAND CAPITAL MARKET OVERVIEW

Q3 2018

INTEREST RATE FEARS

We are currently trying to decide what to do with an office asset we own. We have a loan due in about 3 years – should we refinance now despite the defeasance costs or wait until the loan is due to pay it off without defeasance. Conventional wisdom right now is that interest rates are rising but how much will they have to rise over the next three years to make paying defeasance a smart financial decision?

First thing to do would be looking at trends in the 10 Year Treasury.

Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018
2.45%	2.35%	2.35%	2.34%	2.46%	2.73%	2.87%	3.09%

10 Year Treasuries were very stable from Q1 2017 to Q1 2018 but then they began to increase. Further data shows that the 10 Year Treasury ended at 3.15 on 10/12. What is causing this recent rise in the 10 Year Treasury?

Current Economic Expansion – When an economy is growing as it currently is with low unemployment the Federal Reserve increases rates to stem potential inflation.

Trillion Dollar Budget Deficits – In order to fund budget deficits, the Federal Reserve will have to issue more debt.

Stock Market Uneasiness – The extended economic expansion must end at some point and many investors will begin pivoting to bonds if the stock market's future is not as bright.

Will rates continue to rise? I believe they will continue to slowly rise. Not at the same rate that they have over the past year but more closely to what the rate has been over the past two years – 30 to 40 basis points per year. The Federal Reserve will likely increase rates, investors will take a more cautious approach with the stock market and the market will continue to adapt to the new high deficit environment.

Back to our office property and our decision whether or not to refinance now. Assuming we are going to refinance $40 Million dollars, a 110 basis point increase in the 10 Year Treasury would result in $440,000 more in interest payments per year. Since we are comparing 10 year loans, this would result in savings of $4.4 Million dollars over the life of the new loan. The 10 Year Treasury would have to increase by more than 75 basis points for us to recoup our $3-million defeasance payment. I think that is a safe bet to make.

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