CMS TacOpps I - Trends & Opportunities in CRE Debt

CMS TacOpps I Opportunity Catalysts

Regulatory and capital constraints have limited the availability of CRE credit, despite strong borrower demand and stable CRE fundamentals. CMS believes the best opportunities can be found in middle market CRE lending

CMS Opportunity Summary

- Real estate fundamentals have rebounded post-crisis, new supply and vacancies have stabilized leading to higher rents
- As a result, CRE prices have rebounded sharply. Given the later stage in the CRE cycle, CMS believes CRE credit is attractive
- Borrower demand for credit also remains strong, driven by new construction, CRE transaction activity, private equity real estate capital formation and new Opportunity Zone investment tax incentives
- However, traditional lenders remain constrained by post-crisis regulations that limit lending and increase the cost of capital
- CMS believes this creates attractive opportunities for non-bank lenders who can provide flexible capital
  - Flexibility to structure loans that comply with restrictions at partner banks
  - Flexibility to structure loans uniquely tailored to the sponsor and project
- Primary focus on directly originated middle market loans for projects in gateway markets
  - Less competitive and has attracted less interest from institutional investors
  - Ability to directly negotiate key terms and capture illiquidity premium

Key Catalysts for Middle Market CRE Credit

Strong real estate fundamentals and late stage of the cycle favor CRE credit

Middle market is highly fragmented, historically less competitive and may offer better risk-adjusted returns

Regulatory and capital constraints create opportunities for non-traditional lenders

Direct origination may provide yield premia, while bespoke negotiated terms help mitigate risk

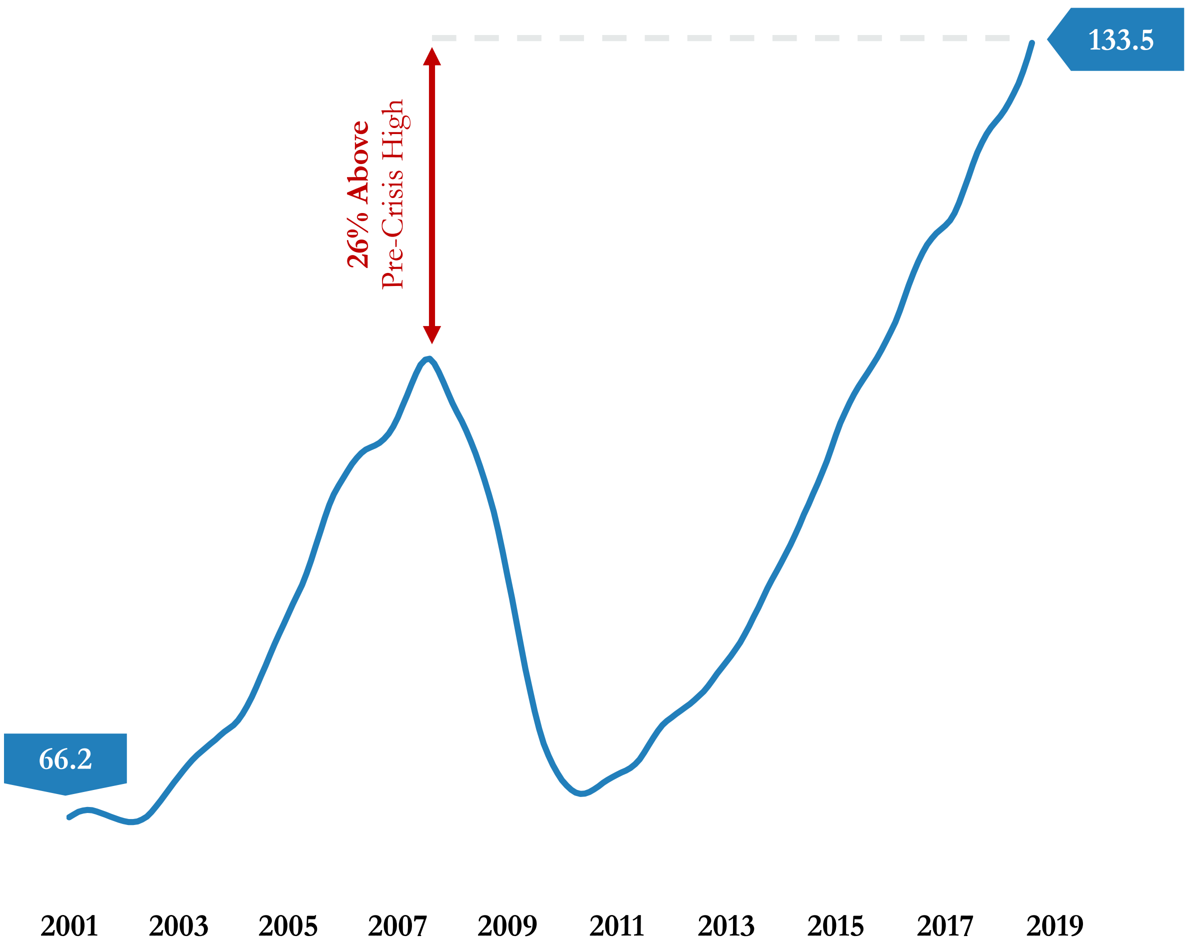
Strong borrower demand for capital, despite credit tightening from traditional lenders

Proximity of investors to investments provides transparency, reduces adverse selection and helps align interests

Commercial Real Estate Sector has Rebounded Post-Crisis

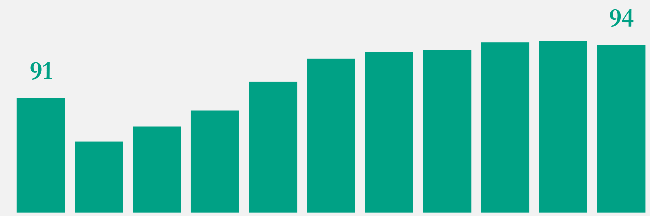
CRE values have rebounded post-crisis, driven by strong fundamentals and demand for real assets. Prices, net operating income ("NOI") and vacancies have all improved, while new supply and demand has stabilized

Property Prices have Rebounded Sharply
RCA Commercial Property Price Index (Index Level)



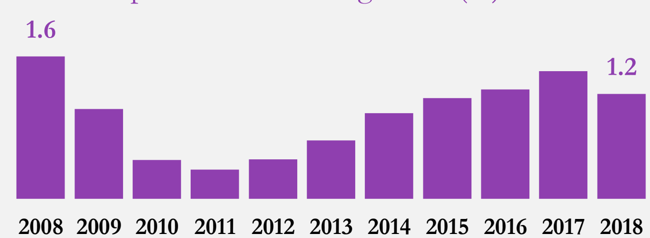
CRE Property-Level Performance is Strong

Occupancy Rate has Rebounded and Stabilized
Equity REIT Occupancy Rate (%)



Same-Property NOI has Grown Consistently
Equity REIT NOI Y/Y Growth (%)

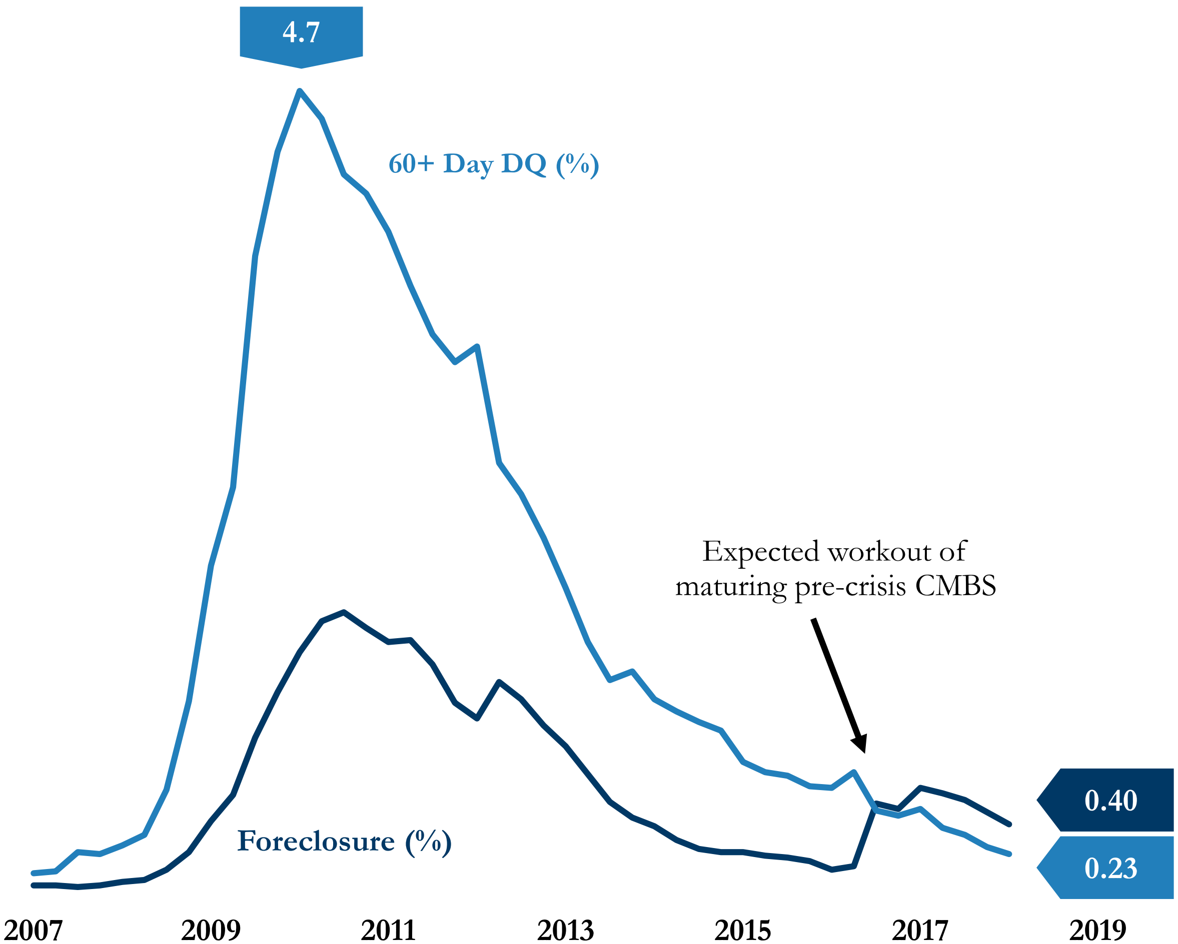
Supply and Demand Remain in Balance
New Completions to Existing Stock (%)



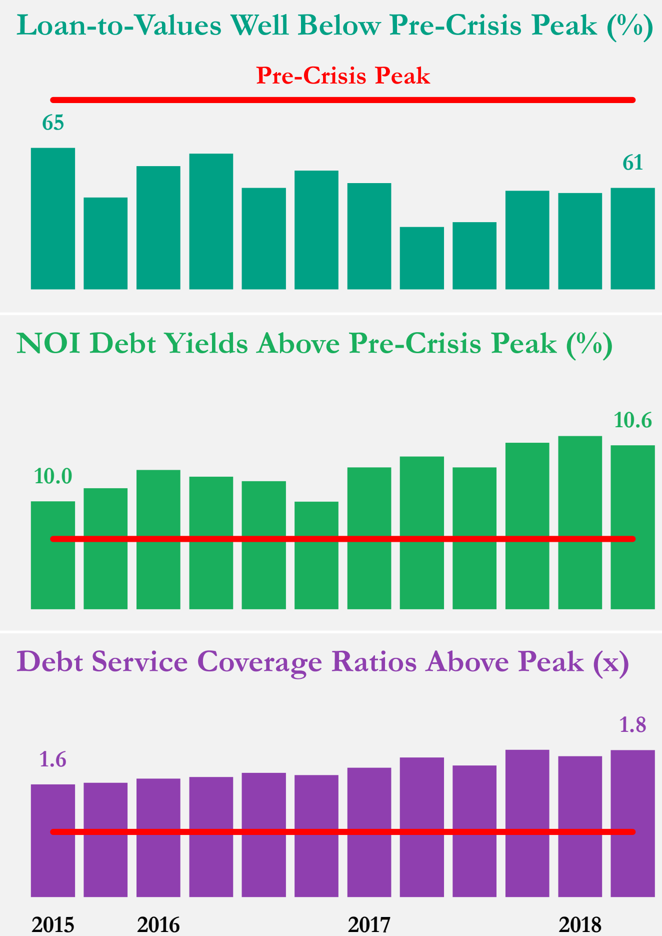
As of 12.31.18. Source: CoStar, HFF, NAREIT, RCA.

Improving Loan Performance and Tighter Credit Standards

CRE Loan Delinquencies and Foreclosures have Returned to Pre-Crisis Levels



CRE Credit Demand Signals are Strong



A strong rebound in commercial real estate property-level fundamental performance, combined with rational and stable post-crisis lending standards, creates an attractive environment for CRE credit investors

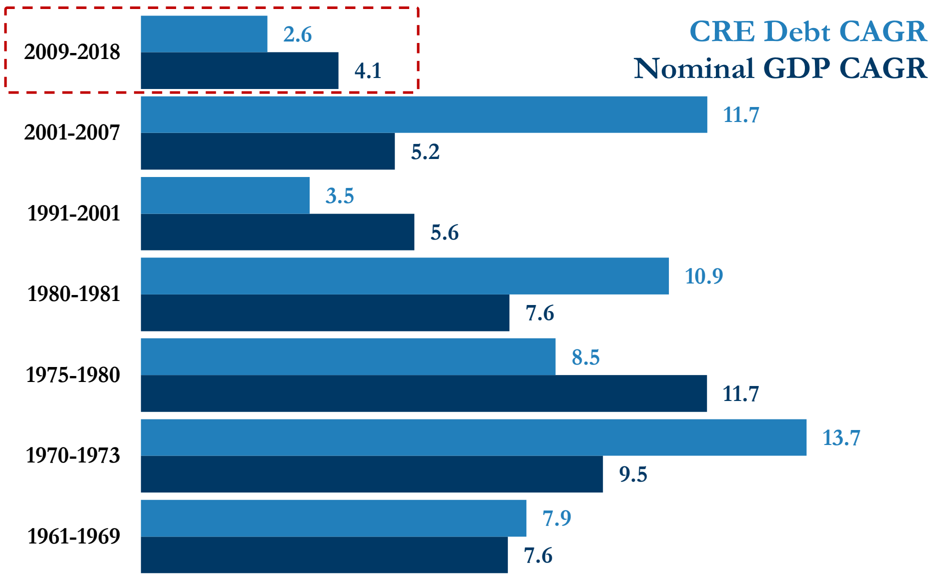
As of 12.31.18. Source: Morgan Stanley, RCA, Reis.

Strict Lending and New Constraints have Limited CRE Credit

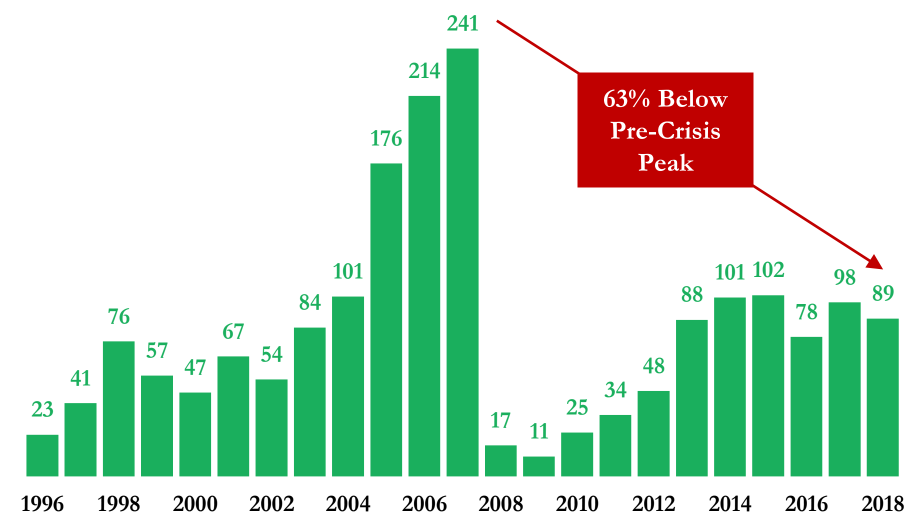
CRE debt growth has been slow post-crisis, resulting in unmet borrower demand. Banks and other traditional CRE debt lenders have been constrained by new financial regulations, higher risk capital requirements and greater risk aversion

- CRE mortgage debt outstanding has seen a relatively low 26% cumulative increase post-crisis. The multifamily sector has driven much of the growth due to a shift away from single family residences. Mortgage debt outstanding for other CRE sectors increased by only 12% cumulatively
- For comparison, borrowings of non-financial corporations (debt securities and loans) in the U.S. have increased over 48% during the past 10 years
- Banks have historically been the primary source of commercial debt capital and hold almost 50% of outstanding commercial and multifamily mortgages. New opportunities for alternative lenders, like CMS, have emerged as banks have pulled back

Annual Growth Rates during NBER Economic Expansions (%)



Annual CMBS Issuance has Stagnated Post-Crisis ($B)



CRE debt outstanding has increased at a significantly slower pace during the current expansion

As of 12.31.18. Source: Federal Reserve, NBER, SIFMA. Corporate debt securities and loans excludes mortgage debt. Commercial mortgage debt includes multifamily and nonfarm, nonresidential.

Traditional CRE Lenders are Caught in a Web of Regulation

Banks, other financial institutions and CMBS securitization have been significantly limited by post-crisis regulation. New capital charges, increased oversight and risk retention have curtailed their ability to lend, creating opportunities for CMS

Too Big to Fail

- Requires incremental capital and liquidity at bank and financial firms deemed as globally systemically important banks ("G-SIBs") by Financial Stability Oversight Council ("FSOC")
- Attractive lending activities have become uncompetitive under the regulations due to capital requirements

Volcker Rule

- Bank sponsored trading of mortgage loans and securities through funded subsidiaries is restricted under Volcker Rule
- Regulation has forced many banks to spin-out internal private funds and proprietary trading desks

Increased Liability

- Traveling representations and warranties ("reps and warranties") on new loan originations
- Banks originating CRE loans required to maintain reps and warranties on loans regardless of sale to third-party

Basel III

- Large global banks now require substantially more capital against structured credit and high volatility CRE ("HVCRE")
- HVCRE includes some development lending and is now hit with 150% risk-weighted capital charges
- Onshore capital "ring fencing" required for foreign banks

Risk Retention

- CMBS originator or control investor must hold 5% of the capital structure for a minimum of 5 years
- Can be structured as a vertical or horizontal (first loss) slice
- Pre-crisis, these positions could be traded by qualified institutions

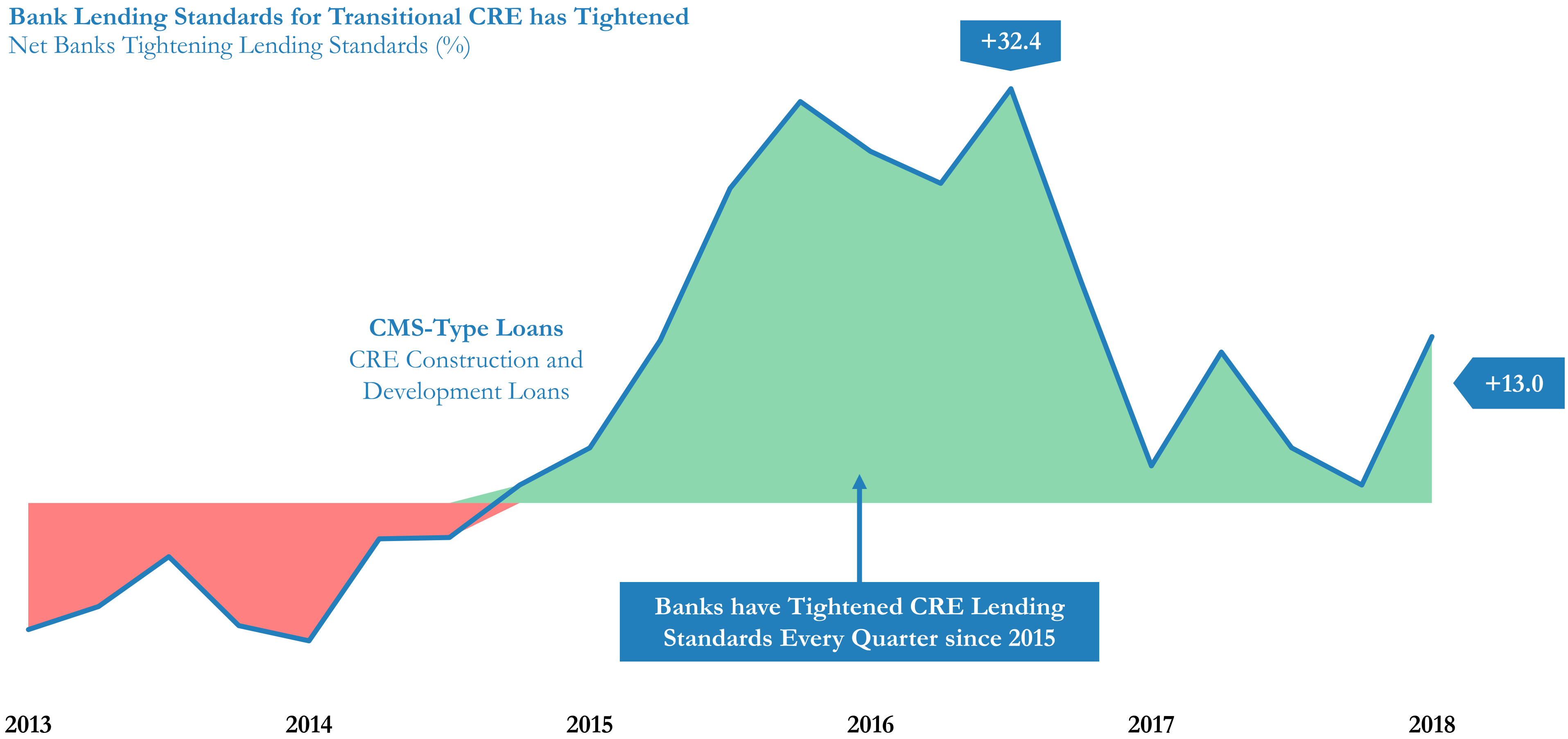
Future Funding Costs

- Banks originating loans with future funding will be required to fund the commitment in cash
- Key consideration for construction loans, which may be structured with future borrower draws as project milestones are achieved

As of 1.1.19. Source: Government Accountability Office, FDIC, Federal Reserve.

New Regulation has led Banks to Tighten Lending Standards

New bank capital requirements specifically target the acquisition, development & construction loan products that CMS seeks to originate. As a result of these regulations, banks have consistently tightened lending standards despite strong demand



Regulatory changes have created a persistent headwind for banks, fundamentally altering the commercial real estate lending landscape and creating opportunities for CMS TacOpps I to fulfill unmet borrower capital needs

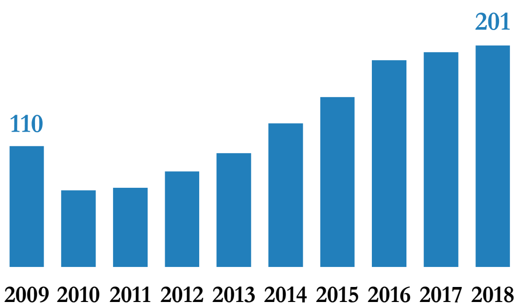
As of 12.31.18. Source: Federal Reserve, FDIC, Preqin, RCA.

Demand for Credit is Strong, despite Tighter Bank Lending

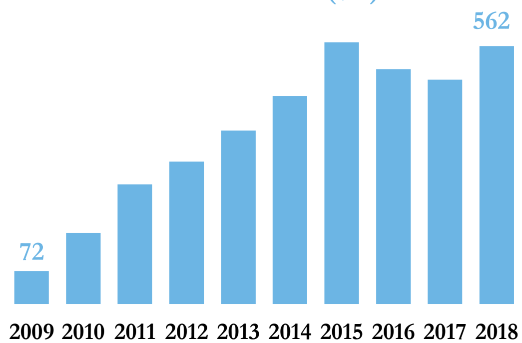
Demand for CRE credit has proven resilient, driven by increasing construction spending and CRE transaction volumes. Strong CRE equity capital formation should drive future CRE credit demand as institutions increasingly allocate to real estate

Construction and Transaction Activity are Supportive of CRE Credit demand

CRE Construction Spending ($B)

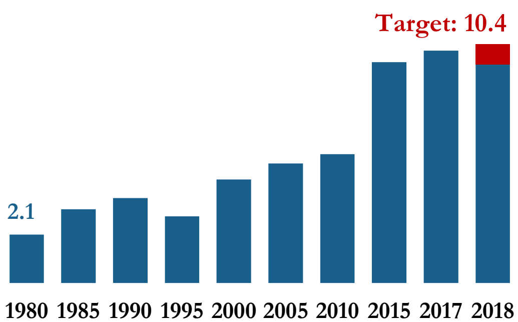


CRE Transaction Volume ($B)

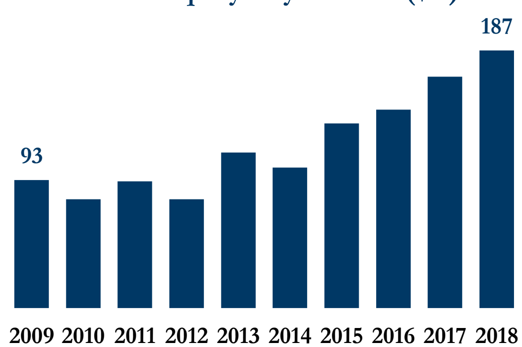


CRE Equity Capital Formation Expected to Drive CRE Loan Demand Going Forward

Institutional Investor CRE Allocations (%)



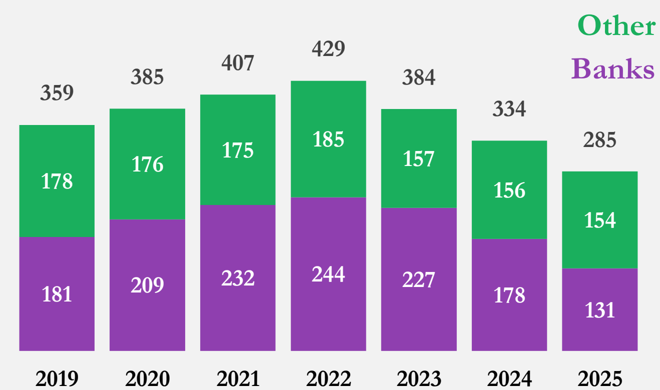
CRE Private Equity Dry Powder ($B)



Loan Maturities also Supportive of Demand

- CMBS maturities peaked in 2017, but a large volume of loans originated by banks, insurance companies and other lenders are still outstanding
- Over $2.5T of loans are scheduled to mature over the next 7 years, including $1.4T from banks
- Some of these maturing loans may struggle to refinance, given regulatory changes and stricter lending standards limiting traditional lenders
- Borrowers may need to seek out alternative sources of capital, which CMS seeks to provide

Expected CRE Loan Maturities ($B)



CRE private equity dry powder is at a all-time high and over 60% is focused on opportunistic or value-add strategies. These funds will need to deploy equity capital before their investment periods end, driving demand for CRE credit

As of 3.22.19. Source: Preqin, RCA, U.S. Census.

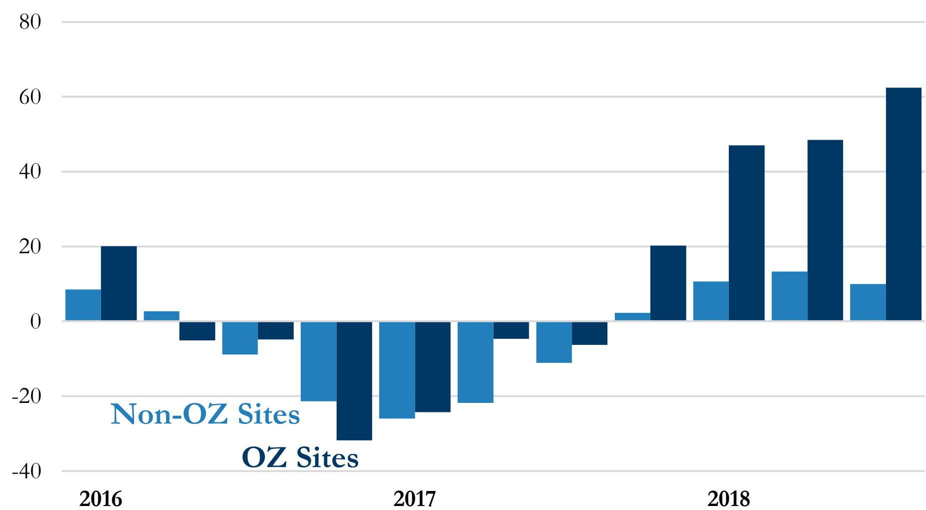
Opportunity Zones Expected to Further Boost Credit Demand

New Opportunity Zone ("OZ") legislation provides significant tax incentives for investors in CRE projects with a development or redevelopment component. These projects will likely require significant debt capital, increasing demand for CMS-type loans

- OZs allow investors to reduce or eliminate capital gains for investments in over 8,700 economically challenged communities across the U.S.
- The U.S. Treasury and IRS recently provided updated guidance in October 2018, creating a rush to raise and deploy capital. Funds need to be dedicated OZ vehicles and capital must be invested before the end of 2019 to realized the full tax benefits
- Expected to drive new CRE development and value-add activity. Investors need to double the property basis within 30 months of acquisition. A recent Preqin survey of institutional investors found 51% were considering making OZ investments in the next 12 months

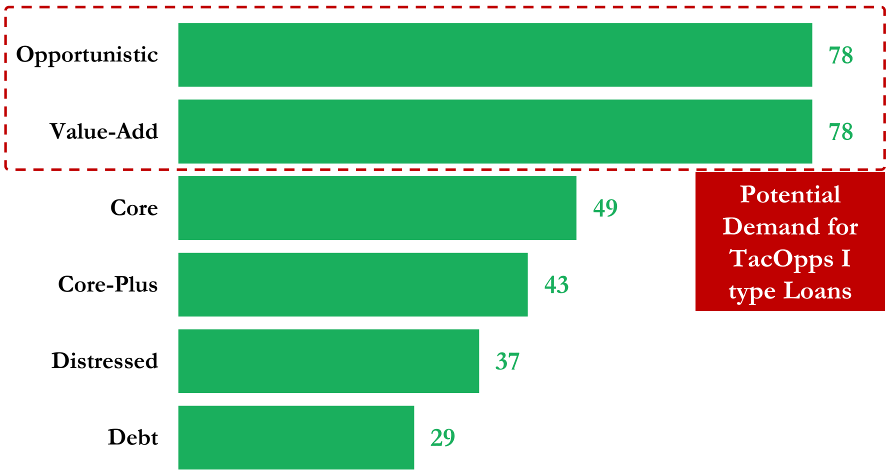
Demand for CRE Development Sites has Already Begun to Surge

Development Site Acquisitions (Y/Y %)
Sites located in OZ areas vs. non-OZ areas



Preqin Investor Survey shows Strong Demand for OZ Projects

OZ Investor Real Estate Strategy Survey (%)
Investors may be considering multiple strategies



New credit demand from OZ projects comes on top of already strong demand due to favorable CRE fundamentals. Banks remain the largest lenders for OZ development projects, creating opportunities for non-bank lenders

As of 12.31.18. Source: Preqin, RCA, U.S. Census.

Demand Exceeds Supply for CRE Development Credit

Recent surveys have shown strong demand for CRE construction credit, with approximately 50% of participants believing that debt capital for development & redevelopment are undersupplied. Surveys also show limited concern about excesses

Survey of CRE Market Participants		Shortage	Balanced	Surplus
Debt Capital for Acquisitions	2018	17%	59%	23%
	2017	22%	58%	21%
Debt Capital for Refinancing	2018	12%	68%	21%
	2017	19%	62%	18%
Debt Capital for Development	2018	47%	42%	10%
	2017	48%	42%	12%

Potential Demand for CMS TacOpps I type Loans

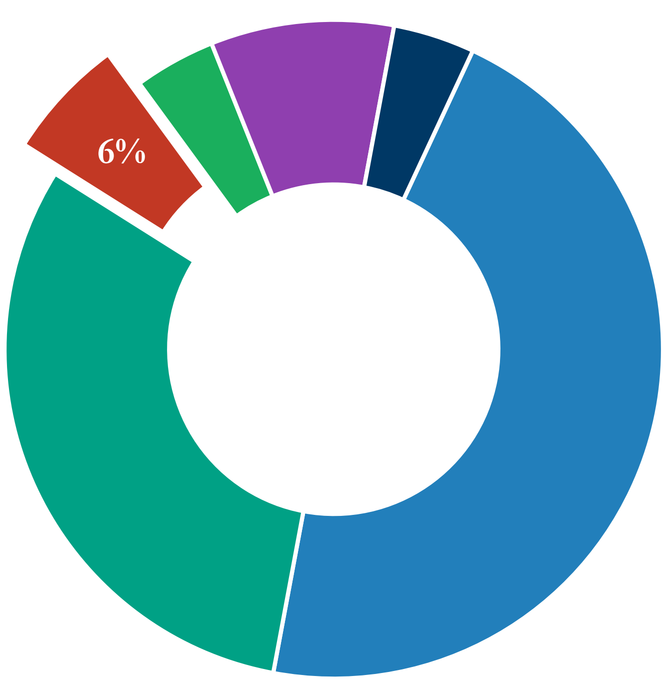
As of 1.1.19. Source: Emerging Trends in Real Estate surveys. U.S. respondents only.

New Lenders have Emerged, but Mostly for Large Loans

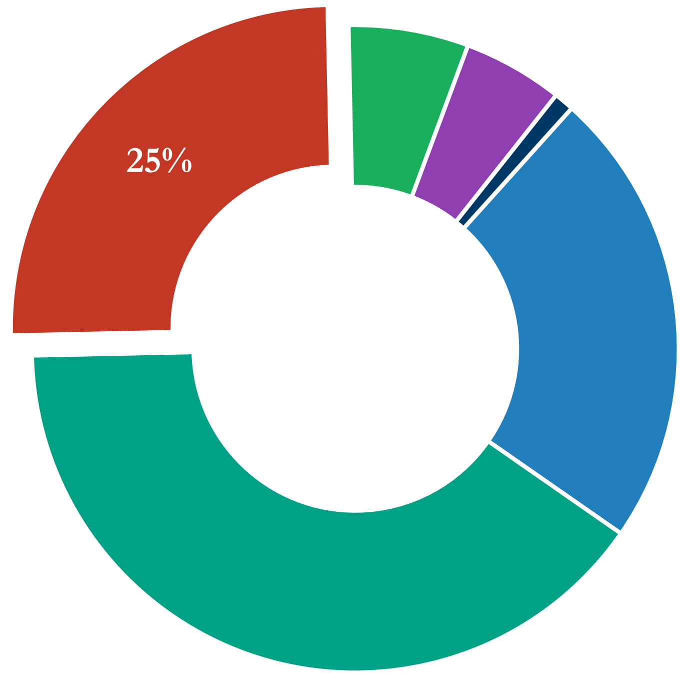
Debt funds and REITs have emerged as alternative capital sources, but these lenders tend to focus on large loans where significant capital can be deployed quickly. Middle market CRE continues to rely on banks, which face regulatory headwinds

CMS TacOpps I Opportunity Set

2017 Lender Market Share for Middle Market Loans: $10-50M



2017 Lender Market Share for Large Loans: $50M+



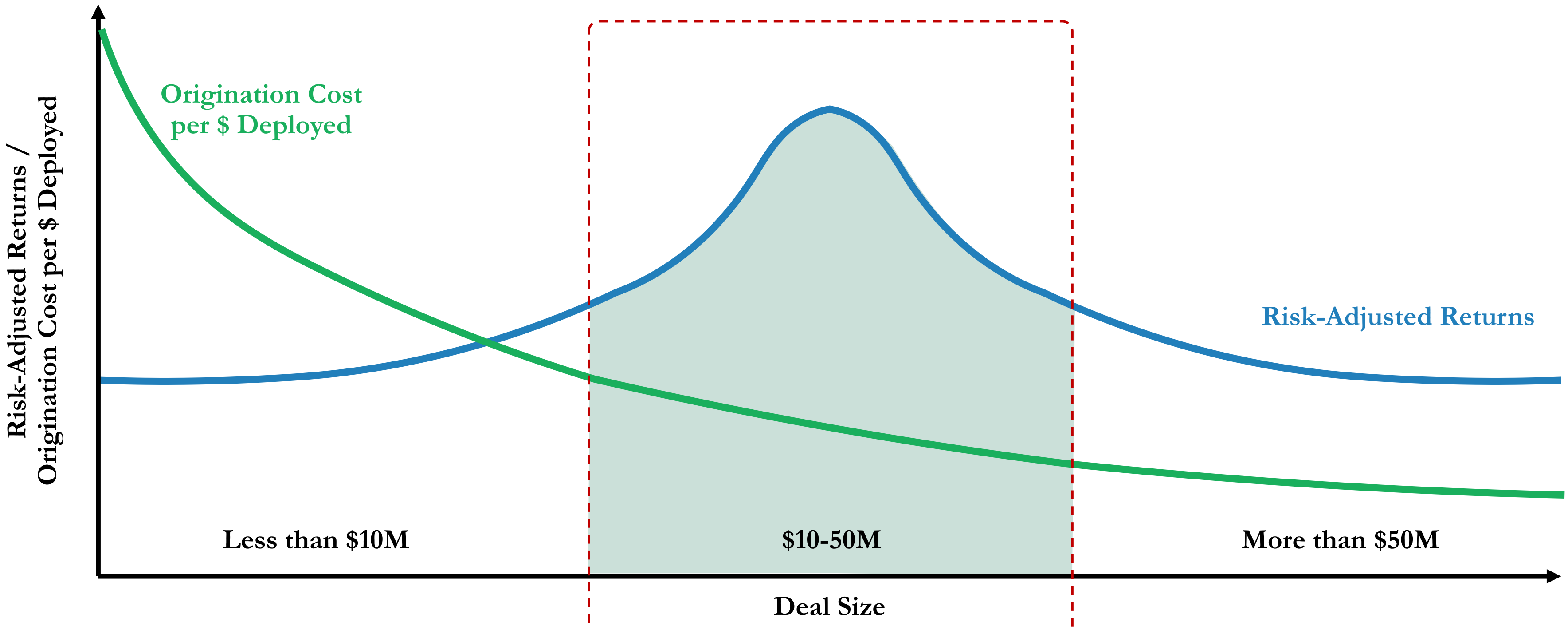
■ Regional Bank ■ Major Bank ■ Debt Fund / REIT ■ Insurance ■ Government Agency ■ Other

Alternative lenders have emerged, but they have primarily focused on large loans. Middle market CRE continues to rely on banks, creating opportunities for CMS to partner with banks in order to meet strong demand for credit

As of 10.1.18. Source: Morgan Stanley, RCA.

The Middle Market Sweet-Spot

Larger investors often avoid the middle market due to fixed per-deal costs and lack of local market knowledge. A nimble structure and key partnership with a tech-enabled servicer allows CMS to efficiently originate in the CRE middle market



Key Notes	• No historical data/track record • No infrastructure/poor servicing • No capital markets access	• Limited competition • Tech-enabled servicer allows for efficient lending and monitoring	• Significant capital formation • Highly competitive markets • Transparent pricing

"A $10M deal takes just as much time and work as a $100M deal." – every fund manager ever…

Source: CMS. **Example for illustrative purposes only.**

Direct Origination Model may Offer Significant Benefits

CMS TacOpps I focuses on directly originating Fund investments. CMS believes this provides a number of economic and non-economic benefits, including greater control over the diligence process, capital structure, loan covenants and transaction pricing

- **Economic Terms:** Direct origination economics may be more attractive vs. strategies that rely on intermediaries. The CMS team has direct control over the loan price and may retain origination or other fees typically paid to the arranger.
- Directly originated loans also tend to offer higher spreads than broadly syndicated loans due to less competition and as compensation for illiquidity and complexity

- **Non-Economic Terms:** Greater control over diligence and structuring. The CMS team will have direct access to the sponsor, will have a say in the borrower's capital structure and will lead the negotiation of key loan covenants and intercreditor terms
- Maintaining control also helps ensure CMS can protect the Fund's interests during amendments or workout scenarios and can limit adverse selection issues
- **Relationships:** CMS seeks to serve as a "one stop" shop. This flexibility allows CMS to structure loans that fulfil sponsor needs and align with the Fund's objectives
- CMS believes this provides a strong value-add proposition to borrowers seeking financing solutions that cannot typically be provided by traditional lenders. Further, it facilitates a direct relationship with the borrower and helps maintain a robust pipeline
- Direct origination allows the Fund to drive premium pricing on a risk-adjusted basis. CMS believes this flexible approach allows the Fund to source attractive investment opportunities throughout cycles and across a borrower's capital structure

Direct Origination Highlights

Potential for Higher Risk-Adjusted Returns

- Highly fragmented and less competitive
- Control over pricing
- Capture origination and other fees
- Illiquidity premium

Ability to Dictate Terms and Greater Control

- Negotiate loan terms and covenants
- Influence borrower capital structure
- Lead intercreditor term discussions
- Control for amendments and workouts

Ownership of Key Relationships

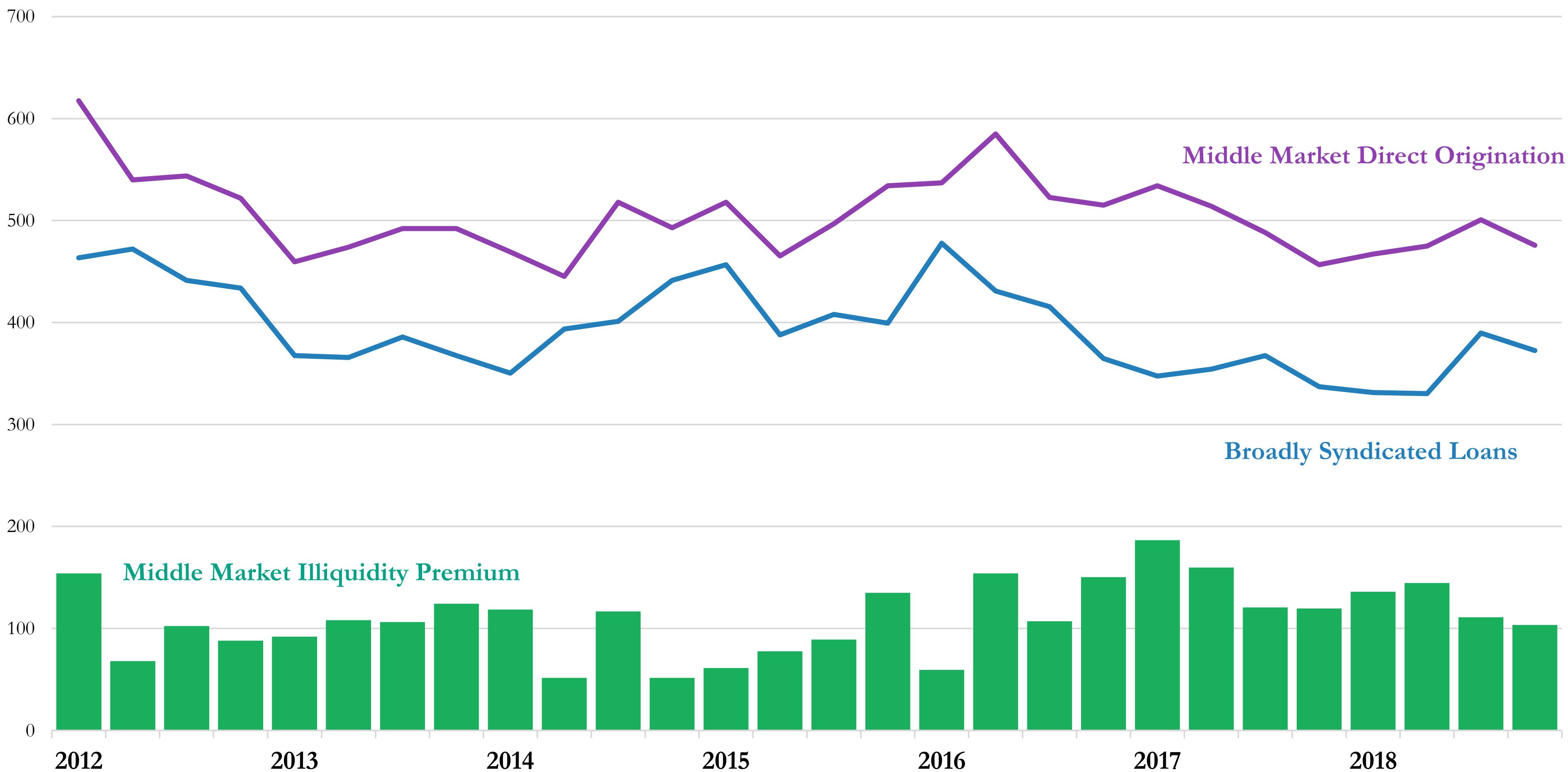
- Direct contact with sponsor
- "One stop" shop value proposition
- Build pipeline via repeat business
- Ability to source across cycles

CMS seeks to leverage the experience and network of its IC members while pursuing a direct origination strategy. Direct origination may provide higher risk-adjusted returns and greater control of the investment process

Middle Market Lending has Historically Offered a Premium

Middle market CRE loans may offer an illiquidity premium. Corporate loans provide a good proxy, where broadly syndicated loans arranged by investment banks trade tighter vs. directly originated middle market loans despite lower leverage levels

Corporate Loan Primary Market Spreads (bps): Broadly Syndicated Loans vs. Middle Market Directly Originated Loans



Example for illustrative purposes. CMS TacOpps I investments may differ. Past performance not indicative of future results.
As of 1.1.19. Source: Refinitiv. Middle market deal size <=$100 million.

Proximity of Investors to Investments may Mitigate Risk

Abuses in credit markets historically occur when the end investor and original borrower become excessively intermediated. CMS directly connects investors to the investment. Transaction parties retain significant risk and have "skin in the game"

Highly Intermediated Investment Process

Investment Bank → RMBS
CDO Manager → CDO

Potential for adverse selection and misaligned incentives

→ RMBS → CDO → Fund → Client

Subprime mortgages are packed into RMBS

RMBS repackaged into ABS CDOs or CDO-squared

CDO sold to investment manager

Investment manager manages on behalf of client

CMS Direct Investment Process

Partner Bank → CMS TacOpps I

Senior lender with significant skin in the game

→ CMS TacOpps I → Client

CMS works directly with borrower and partners to structure the investment

CMS invests on behalf of the client

CMS TacOpps I Structural Benefits

- Pre-crisis, financial engineering allowed consumer credit to be repackaged and distributed around the world. End investors had a limited understanding of the risks
- Each step in the intermediation process reduces transparency and creates misaligned incentives
- CMS seeks to disintermediate the CRE credit investment process by providing direct access and transparency
- CMS believes this closer proximity to the underlying investment provides a number of potential benefits:
  - Greater transparency and better understanding of the key risks
  - Directly negotiate key terms to address specific risks

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