LIBOR is something that affects everyone in one way or another. Whether it be 529 planning, buying a new car or having an adjustable-rate mortgage, LIBOR is a prevalent component of financial markets. The London InterBank Offered Rate, or LIBOR, is the average interest rate at which banks can borrow from one another. It is one of the key benchmarks for floating rate loans. U.S. dollar LIBOR is considered the most globally significant reference index, setting the price for $150 to $200 trillion in adjustable-rate mortgages, auto loans, student loans, credit and derivative securities. According to the Intercontinental Exchange (ICE), LIBOR “provides an indication of the average rate at which a LIBOR contributor bank can obtain unsecured funding in the London interbank lending market for a given period, in a given currency. ICE LIBOR rates are the end-product of a calculation based on submissions from LIBOR contributor banks.” However, with LIBOR on the brink of elimination – expectedly by 2021 – it is imperative for investors to be privy to the various benchmarks that will likely replace this very powerful Goliath which plays a part in over $300 trillion in financial instruments.

Daily LIBOR rates are set for periods as short as overnight to as long as 12 months, with levels driven primarily by the federal funds rate set by the Federal Reserve. Typically, when the Fed is tightening, LIBOR will move in lockstep with front-end rates. Since two more rate hikes are expected in 2018, upward pressure on front-end rates and LIBOR should continue as a result. When higher front-end rates are combined with a flattening yield curve (i.e. front-end rates continue to rise while long-term rates fall, or rise less than short-term rates), LIBOR becomes an even more interesting benchmark. In some yield curve flattening scenarios, short-term LIBOR rates may even yield more than a much longer maturity on the yield curve, an atypical scenario. Rising short-term LIBOR rates in a flattening yield curve environment can give rise to attractive investment opportunities.

**Chart 1** shows 1-month, 3-month, 6-month and 12-month LIBOR rates over the last 30 years. While the swings in rates have been drastic, they tend to move together. The most recent rise in rates, while not the most drastic, has been the largest percentage rise.

The most common benchmark is 3-month LIBOR, as seen with many consumer loans as well as floating-rate securities. **Chart 2** begins in January 2008, prior to the financial crisis, and peaks in October 2008 at 4.81%. About a year later, in September 2009, 3-month LIBOR began hovering around 0.30% and stayed there until November 2015. Since then, 3-month LIBOR has been on a steady rise to 2.22% as of this writing. This drastic leap from 0.30% to 2.22%, a 640% increase, has increased the cost of many consumer loans, but has also given a much-needed yield increase to floating-rate investments.
In a perfect world, a benchmark as deeply entwined in the financial markets as LIBOR would have unquestionable validity and transparency. LIBOR underlies trillions of dollars in financial instruments. Unfortunately, there has been much controversy about the possible manipulation of the daily setting of LIBOR. It has even been referred to as “LIE-bor” following a price-fixing scandal among contributor banks and brokers. In addition to the well-documented instances of manipulation, the number of contributor institutions actively quoting the inputs used to formulate daily LIBOR rates has dwindled to a point that it is difficult to achieve a quorum, further undermining the validity of the rate. According to the Financial Conduct Authority, for these reasons and others, LIBOR is expected to be phasing out by the end of 2021.

So if LIBOR is going to become obsolete in a few short years, what will replace it? There are several different possibilities, three of which are outlined below. Starting in the second quarter of 2018, the Federal Reserve Bank of New York will produce three rates: Tri-Party General Collateral Rate (TCGR), Broad General Collateral Rate (BGCR) and Secured Overnight Financing Rate (SOFR). Descriptions of each rate can be found below:

**Tri-Party General Collateral Rate (TGCR)**
The Tri-Party General Collateral Rate is the measure of rates on overnight, tri-party general collateral repo transactions where the counterparties know each other. All terms are negotiated and agreed upon prior to using the service of a tri-party agent to clear and settle trades. This rate would be based primarily on information from BNY Mellon, the bank that clears many of these repo transactions.

**Broad General Collateral Rate (BGCR)**
The Broad General Collateral Rate captures all trades where the specific securities provided as collateral are not specified until all other terms of the trade are agreed upon. BGCR includes all TGCR trades plus general collateral trades.

**Secured Overnight Financing Rate (SOFR)**
The Secured Overnight Financing Rate is the broadest measure of the cost of borrowing in the repo market. It is intended to reflect the general cost of borrowing cash overnight with treasury securities as collateral. SOFR would be the largest volume in the market today because it includes the bilateral repo market.

These proposed rates are all overnight rates, so even if they do become part of the solution for a LIBOR replacement, the challenge of term structure (weekly, monthly, quarterly, etc.) to agree upon remains. What is certainly not “overnight” is the transition process from LIBOR to its appropriate replacement, given LIBOR’s pervasive nature. In order to successfully transition LIBOR to reference rates firmly based on transactions, the process must begin now.

There is no question that a benchmark rate is essential to support the financial markets. It is uncertain at this point the precise future of LIBOR and what will succeed it. However, given the scandals surrounding LIBOR in the past, it is imperative that its replacement should be a benchmark that is grounded in integrity and accuracy, and less susceptible to human manipulation.

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1 Intercontinental Exchange
2 Federal Reserve Bank of New York
Market Snapshot: Middle-Market Mergers & Acquisitions

2017 M&A Recap

- Global M&A deal value and volume in 2017 decreased slightly as uncertainty took a toll on investments.
- 2017 marked the fourth consecutive year in which annual global M&A value broke the $3 trillion level, representing a level that had not previously been reached since 2007.
- Overall, global M&A value decreased 3.5% in 2017 to $3.1 trillion, while volume decreased 0.9% to 18,433 deals.
- Cross-border activity as a share of global M&A stood at 41.9%, representing the second highest level since the financial crisis.

2018 Outlook

- Strong backlogs will drive continued consolidation in the supply chain.
- Cross-border activity will remain strong as dealmakers pursue strategies to spread risk geographically.
- Continued strong performance in the equity markets and a relatively favorable financing environment should drive an active M&A market in 2018.
- Global private equity dry powder hit a record high of $1.7 trillion in December 2017. This flood of available capital will need to be deployed, which should drive significant private equity deal activity in 2018 and beyond.

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Significant Opportunities Exist to Capitalize on the Favorable Financing Environment

- Financial sponsor-driven acquisition multiples reached record highs across the U.S. and Europe averaging 11.6x EBITDA in 2017. Equity contribution for middle-market LBOs averaged approximately 47% in 2017.
- Total leverage in 2017 for middle-market issues with less than $50 million of EBITDA averaged 5.5x, up 0.2x from the 2016 average. Increasing debt capacity and aggressive behavior among leveraged lenders are supporting record valuations being paid by financial sponsors.
The overall fixed income markets have experienced a rising and steepening yield curve over the last month, reflecting market expectations for several Fed tightening moves in 2018, as well as the first signs of inflationary pressure showing up in early 2018 economic statistics. Thus far in 2018, the tax-exempt market has generally outperformed treasuries, largely we believe as a result of positive investor cash flows into munis. These flows are likely the result of retail investors’ response to tax cut changes and investor recognition that munis represent one of a diminished number of tax planning strategies available to retail investors. During the balance of 2018, we will be carefully monitoring the growing strength of the economy, the yield curve’s response to that strength, retail cash flows into tax-exempts and the effect of those cash flows in supporting the current tight credit spreads.
Market Snapshot: Corporate Debt and Infrastructure Finance

Corporate Debt Spreads – Finance Market Summary

- Yields in the corporate debt market across most credit sectors remained steady throughout 2017. 2018 is telling a different story as U.S. treasury rates have risen approximately 50 basis points YTD, a 21% increase. Corporate spreads are remaining steady to narrowing which is mitigating some of the treasury yield increase, but overall we have experienced a significant rate increase and forecasts are calling for this trend to continue.

- Total corporate issuances in 2017 were 4.3% higher than issuances in 2016, closing the sixth consecutive year of growth for the corporate market. Despite this momentum, January issuances in 2018 were down 32.8% compared to January 2017, primarily due to a decrease in investment grade issuances. Nevertheless, we anticipate the appetite for corporate debt to be strong throughout 2018.¹

U.S. Infrastructure Market Starts 2018 on a High Note

- The fourth quarter of 2017 showed an uptick in U.S. infrastructure activity with roughly $22 billion in infrastructure transactions reaching financial close. Brownfield transactions led the way with 26 deals closing with an aggregate value of $9.8 billion. Greenfield activity closely followed, as a few high-profile greenfield public-private partnership projects (P3s) reached financial close. These include I-66 in Virginia, I-70 East in Colorado, Denver Airport Great Hall in Colorado and Wayne State University Student Residential Facilities in Michigan.

- Renewables and power projects made up the majority of infrastructure transactions in 2017 across transaction types, including greenfield, brownfield and refinancing. The highest volume of deals was done in the renewables sector, while power was the largest sector in terms of aggregate transactions size. Transport was the third most active sector in terms of both transaction size and number of deals.

- In February, President Trump released a preliminary infrastructure plan to provide $200 billion in federal funds which could lead to $1.5 trillion of new infrastructure investments. The plan shifts the burden to state and local governments to identify new funding approaches to access the federal funding available and also to attract private investment. While the plan appears to put much of the onus on state and local governments and private investors to finance projects, any additional federal funding is going to help spur much-needed infrastructure projects.

¹ SIFMA.
Featured Mesirow Financial Deals

**Acquisition Financing for Children’s Hospital Regional Outpatient Medical Facility**
Mesirow Financial successfully structured and arranged for a construction and permanent acquisition credit tenant lease (CTL) financing package for a built-to-suit Children’s Hospital regional outpatient medical facility. Upon completion, the property will be three stories totaling approximately 60,000 square feet on a 6.94-acre parcel of land. The property will function primarily as a medical office, ambulatory care outpatient surgery and related ancillary services such as the sale of drugs and other items to the tenant’s patients that are typically offered for sale by a pharmacy. The property is part of the Woodmore Towne Centre, a 245-acre mixed use development comprised of approximately 800,000 square feet of retail, 1,100 residential units, a 120-room select service hotel and additional future office space. The financing structure consisted of two pari passu-rated notes: a single CTL note with a balloon due at maturity (Series A1) and an interest-only note with the principal balance due at maturity (Series A2). The financing represented an approximate 80% loan-to-value on the complete stabilized valuation.

**M&A Sell-side Advisor to Ideal Box Company**
Mesirow Financial acted as the exclusive financial advisor to Ideal Box Company on its sale to Stronghaven, Inc., a wholly owned subsidiary of Hood Container Corporation. Headquartered in Chicago, IL, Ideal Box has provided superior products and services to its customers for over 90 years. With a focus on design and production of enhanced graphic packaging and point of purchase displays, Ideal Box has evolved into a creative and technological leader in the retail merchandising industry. Ideal Box’s state of the art manufacturing capabilities, creative vision and sincere approach to customer relations has earned it the reputation as one of the premier independent corrugated packaging companies in the country. This transaction is yet another example of the strength of Mesirow Financial's relationships with key strategic acquirers in the packaging industry.

**Senior Manager for the City of Chicago**
Mesirow Financial served as senior managing underwriter for the $235,260,000 Second Lien Water Revenue Refunding Bonds, Series 2017-2 on behalf of the City of Chicago (the “City”). The Series 2017-2 Bonds were issued to advance refund $261.33 million of the Second Lien Water Revenue Bonds, Series 2008. The City originally scheduled the advance refunding transaction for the second quarter of 2018, but due to pending tax code changes, accelerated the transaction to a pricing date in mid-December of 2017. Mesirow Financial worked with the City’s staff and advisors to evaluate several structures and call options designed to maximize savings in key years and to provide flexibility in the City's financial planning. In addition, Mesirow Financial assisted the City with an investor roadshow which was viewed by more than 45 institutional investors. Despite 45 transactions in excess of $100 million pricing the same week, Mesirow Financial’s exceptional sales efforts garnered an overwhelming response from the investor community. During final pricing, credit spreads were tightened by an average of 17 basis points from pre-marketing levels. The City realized approximately $46 million in gross savings ($37 million on a present value basis or 14.4% of refunded par). This transaction gave further evidence of Mesirow Financial’s banking and underwriting capabilities in the municipal market.
Capital Markets
Established broker-dealer offering a suite of innovative financial products and services combined with extensive market expertise to serve the unique liquidity needs of your institution.
- Credit Tenant Lease Finance
- Fixed Income Sales and Trading
- Public Finance
- Sale-Leaseback Capital
- Structured Debt Products

Investment Banking
Boutique M&A advisor serving the middle-market and providing customized solutions to meet the unique needs of our clients.

About Mesirow Financial
Mesirow Financial is an independent, employee-owned firm founded in 1937. As specialists in investment, risk management and advisory services, we are committed to helping our institutional, corporate and individual clients achieve their objectives. Our professionals are inspired by an entrepreneurial desire to develop tailored solutions designed to deliver measurable results. To learn more, please visit mesirowfinancial.com.

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