COMMERCIAL MORTGAGE COMMENTARY

CANADA'S MORTGAGE COMPANY.™

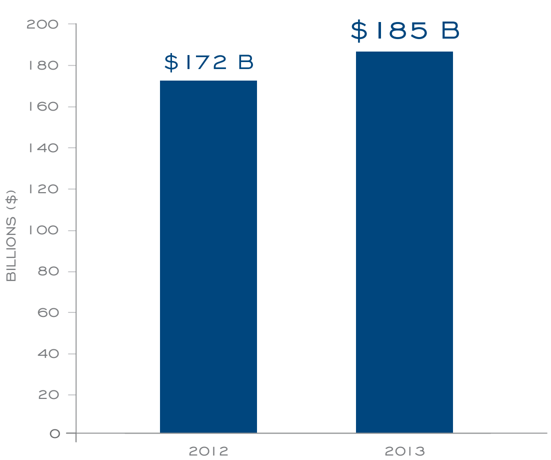
MAY 2014

SURVEY

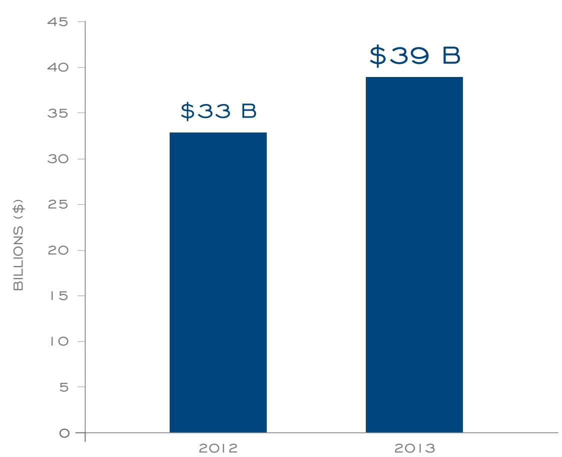
For the past 4 years, CMLS has conducted an annual Commercial Mortgage Market survey to help accumulate information on the size and composition of the Canadian commercial mortgage market, quantify annual originations, and gauge industry sentiments heading into the new year. With the participation of 26 lending institutions and publicly available data on CMBS and NHA MBS issuance, the survey has direct coverage of more than 80% of the commercial mortgage market.

CMLS estimates the size of the Canadian mortgage market at approximately $185 billion and total commercial mortgage origination at $39 billion for 2013. This represents an increase of 8% in total outstanding balance and an 18% increase in production compared to the previous year. By comparison and according to the Mortgage Bankers Association of America, outstanding balances grew 5% and origination increased 15% in the United States in 2013. The increase in our survey results is reflective of both growing origination volume, as well as an increase in the quality of data gathered.

OUTSTANDING BALANCE



ORIGINATION



WHAT ELSE DID WE LEARN?

- Increased availability of capital is the key risk for lenders heading into 2014. This prevailing theme of *too much capital* in the market proved to be a valid concern in 2013, helping credit spreads narrow by 20-35 bps year over year.
- Lenders identified senior unsecured and CMBS as being the primary threats to their origination volumes. Both senior unsecured and CMBS recorded 5-year highs in issuance for 2013, and they are expected to increase in volume again this year.
- An increasingly competitive landscape saw renewal rates fall in 2013, with pricing identified as the key but not only reason for lost deals.

If you have any suggestions, questions or thoughts, or would like to participate in 2015, please do not hesitate to contact Mark Achtemichuk directly at 604-687-0874 or mark.achtemichuk@cmls.ca.

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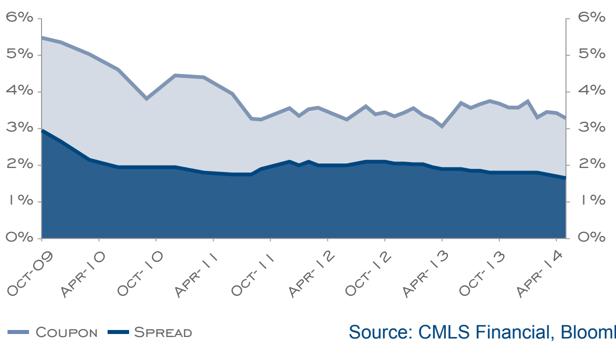
COMMERCIAL SPREADS

Spreads in the commercial mortgage sector continued their downward trend in the first quarter of 2014; spreads on high quality assets range from 165 – 180 bps for 5 year terms and 180 – 195 bps for 10 year terms.

COMMERCIAL MORTGAGE LOANS
COUPONS AND 5 YEAR SPREADS



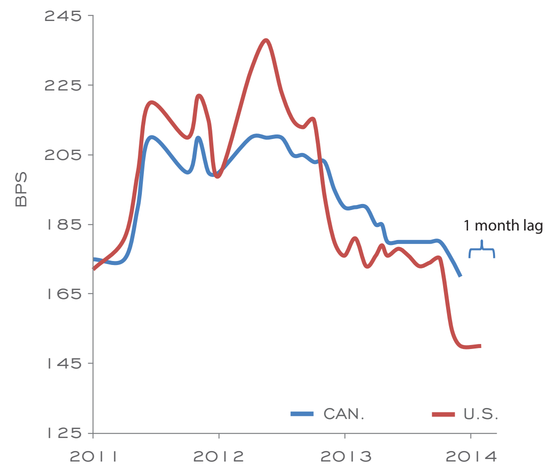
Source: CMLS Financial, Bloomberg

The abundance of capital continues to be the driving force behind spread compression. Below are some of the key sources:

1. **Increased allocation targets:** The yield premium on real estate debt continues to attract excess investment flows.
2. **Increased supply of senior unsecured debt:** The increased investor demand for senior unsecured debt issued by REITs and REOCs has led to record issuance over the past 12 months.
3. **New entrants:** We understand two new institutions are originating mortgages for CMBS programs in 2014. Sun Life Investment Management seeded a $200 million commercial mortgage fund in February 2014, and other institutions are expected to launch new funds in the near future.
4. **Transferring of capital from construction to term mortgages:** The slowing construction market in parts of the country has resulted in real estate capital moving from construction to term loans.

To shed light on where rates may go in the future, we look to the US market as more data is available. Historically speaking, Canadian and American markets have shown a strong tendency to move together, with the two countries' BBB corporate and mortgage spreads showing strong correlations over time. The mortgage spread movement in the US acts as a leading indicator of what may transpire in Canada.

US AND CANADIAN (1-M LAG) COMMERCIAL
MORTGAGE SPREADS



Source: Trepp, CMLS Financial

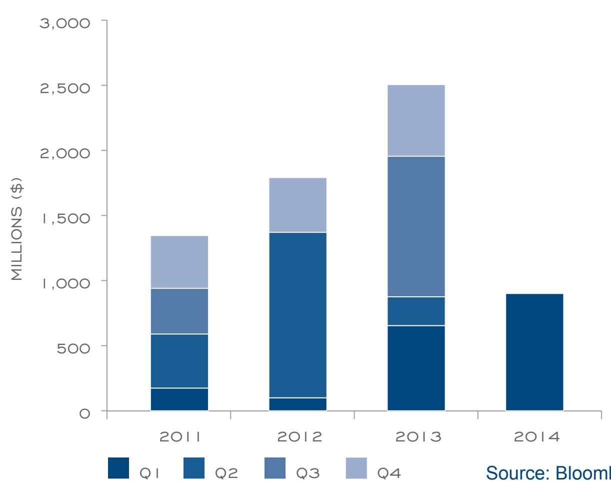
As noted above, US spreads have dropped a significant 25 bps in the past few months; a drop which may foreshadow further downward pressure on Canadian spreads from their current level.

FIRST MORTGAGE BONDS

In Q1 2014 there was one first mortgage bond issued by West Edmonton Mall (WEM). The financing contained two series of bonds totalling $900 million. The B1 series is a $350 million interest-only 10 year bond bearing an interest rate of 4.309%. The B2 series is a $550 million 10 year term and 22.3 year amortizing bond bearing an interest rate of 4.056%. Both series were rated A by DBRS. The proceeds from these current financings will be used to defease the issuer's previous first mortgage bonds, where the amount owing will be invested in AAA-rated government bonds. The previous bond was $600 million bearing an interest rate of 5.66%, and matures in September 2016.

WEM is among the largest shopping complexes in North America, with a total gross building area of approximately 4.2 million square feet. It consists of approximately 2.5 million square feet of retail space, a 355-room luxury hotel and 557,000 sq.ft. of entertainment facilities.

FIRST MORTGAGE BOND ISSUANCE



Source: Bloomberg

SENIOR UNSECURED

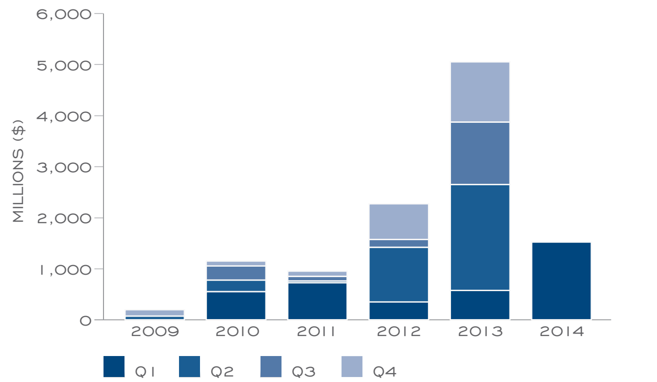
Q1 2014 saw Canadian listed-real estate companies issue 9 senior unsecured debentures totalling $1.5 billion, the most active first quarter to date. Artis REIT (TSX: AX.UN) was a new entrant to the senior unsecured market, issuing a $125 million offering with a 3.753% coupon and a five year term.

We note that new issuances are attracting lower spreads compared with similar issuances last year. Choice Properties REIT's 10 year $200 million BBB rated debentures in Q3 2013 commanded a spread of 238 bps, while a similar issuance this quarter attracted a spread of 198 bps.

	Issuer Name	Issue Size Millions ($)	Issuance Rating	Term (yrs)	Spread (bps)
	First Capital Realty	300	BBB (high)	10	184
	Dundee REIT	150	BBB (low)	6	221
	RioCan REIT	150	BBB (high)	6	160
	Choice Properties REIT	200	BBB	10	198
Q1	Choice Properties REIT	250	BBB	7	171
	Calloway REIT	150	BBB	7	186.5
	Crombie REIT	100	BBB (low)	7	195
	Cominar REIT	100	BBB (low)	6	260
	Artis	125	BBB (low)	5	200
	Total	$1,525			

Source: Bloomberg, RBC

SENIOR UNSECURED DEBT ISSUANCE



Source: Bloomberg

CMHC

2013 marked an active year for CMHC, both in issuance and in legislative/policy changes. This passing quarter saw continued pace on both fronts.

Effective May 1, 2014, mortgage loan insurance premiums for new single-family dwellings and 1-4 unit rental properties are set to increase by 10 to 45 bps. Mortgage loan premiums, which now range 0.60% - 3.35% of the loan amount are usually amortized over the life of the loan. This quarter also saw the Office of the Superintendent of Financial Institutions ("OSFI") release their draft B-21 guidelines for mortgage insurance providers, calling for insurers to end cash-back down payments, put heightened focus on lenders and underwriting, and increase public disclosures. Mortgage insurers have until May 23 to respond with their comments. While these issues impact residential insurance, they highlight CMHC's efforts to pursue measures to reduce and offset taxpayer exposure to the real estate market.

NHA MBS and CMB activity has largely been on pace to meet the allotted $120 billion limit imposed by CMHC, booking $40 billion or 33% of their limit in the first four months of the year. The covered bonds registry has showed signs of life as well, with Desjardins and BMO signing up for the program in the past few months.

On the commercial side, we noticed a slight dip in both 5 and 10 year CMHC spreads in the first quarter of 2014. The decline might be a result of borrowers using conventional financing as an alternative. Conventional loans allow for higher loan-to-value ratios and more flexible terms. The spreads over GOCs for quality multi-family assets are ~80bps for 5 year terms and ~90bps for 10 year terms.

CMBS

CMBS lending in Canada is off to a slow start in 2014, suggesting it may be a challenge to achieve the previously forecast issuance volume of $2 billion by year end. Multiple factors including decreased acquisition and refinance activity, the availability of unsecured debt for strong institutional borrowers and an increased supply of mortgage capital for all borrowers has resulted in spread compression across the risk spectrum. As a result, CMBS lenders are finding creative ways to compete while maintaining credit standards and continuing to meet minimum profitability thresholds. Despite the slow start, several issuers – some new to Canadian CMBS – are expected to market deals by year end. Issuers will be hoping for tighter bond pricing to facilitate a decrease in minimum spread requirements which will enable them to remain competitive with traditional lenders.

HIGH YIELD

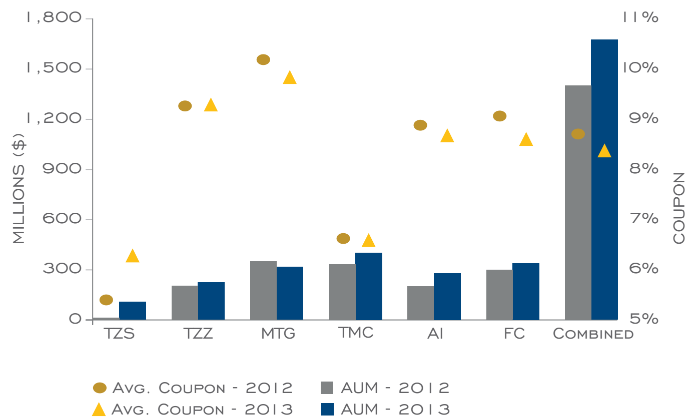
In Q1 2014, Atrium and Timbercreek (TMC) each issued $30 million 5 year convertible unsecured subordinated debentures at 6.25% and 6.35%, respectively. The debentures have an option to convert into common shares at a conversion price of $13.30 and $11.25, respectively. Atrium's new debentures are pari-passu to existing 5.25% convertible unsecured debentures due June 30, 2020. Timbercreek also raised $35 million of equity by selling 3,737,500 common shares at a price of $9.35 per share.

ROI Advisors ("ROI") agreed to sell the management rights of four funds (three public and one private) to DREAM Unlimited ("DREAM"). DREAM has formed an open-ended investment fund called "DREAM Alternative Fund" which will house the $700 million of assets upon completion of the transaction. The three public ROI investment funds were all non-redeemable and would have been impacted by proposed regulations requiring non-redeemable investment funds containing mortgages without government insurance to convert to a public company reporting regime.

As spreads on traditional mortgages compress, investors hungry for yield appear to be moving money to higher yielding funds.

The capital available in the high yield space has led to increased competition for riskier loans. We highlight a decrease in the weighted average coupon and an increase in fund size for the existing six public MICs.

PUBLIC MIC YEAR-OVER-YEAR CHANGES



ABOUT CMLS FINANCIAL LTD.

CMLS Financial is a diversified provider of lending products and services to the commercial real estate and real estate finance industry.

CMLS has been providing mortgage valuation services to Canada's leading institutional mortgage investors and borrowers for over 10 years.

NEED MORE SPECIFIC INFORMATION?

For additional detail on our spread ranges or any other matter with respect to commercial mortgage valuation in Canada, please do not hesitate to contact our team.

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