CMLS Financial®

COMMERCIAL MORTGAGE COMMENTARY

CANADA'S MORTGAGE COMPANY.™

AUGUST 2015

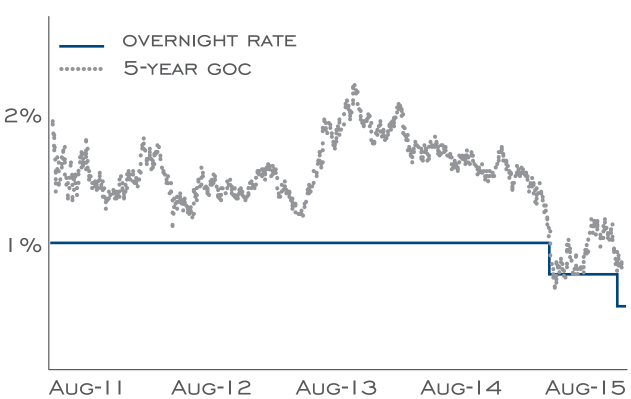
The Bank of Canada ("BoC") dropped the overnight lending rate from 0.75% to 0.50% in Q2 2015, sending the overnight rate back to Q3 2010 levels. This marks the second consecutive quarter the BoC cut the overnight rate after holding rates steady for almost 5 years. Major financial institutions responded by lowering their prime rate by 15 basis points ("bps") to 2.70%.

The drop in the overnight rate comes on the heels of weakness in both domestic and global markets. The Canadian economy contracted by an estimated 0.5% in Q2 2015. Having already posted a contraction in the previous quarter, Canada has technically entered into a recession with two consecutive quarters of negative GDP growth. Although growth is expected to revert to positive levels in the second half of the year, market participants have lowered their GDP forecasts.

Global markets also weighed heavily on investors' minds: Greece remains on life support, the Shanghai Stock Exchange Composite Index (SSE) fell 32% in the span of one month, and commodity prices tumbled 28% as Chinese demand for raw materials declined.

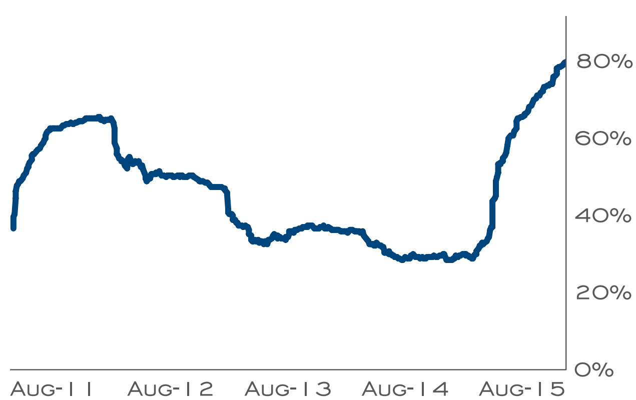
In light of these domestic and global events, volatility in Government of Canada ("GoC") bond yields has increased since the start of 2015. This is made evident with the 5-year GoC increasing by 35 bps in the first half of Q2 2015 and falling by an equal amount in the second half.

OVERNIGHT RATE VS 5-YR GOVERNMENT OF CANADA



Source: Bloomberg

180-DAY IMPLIED YIELD VOLATILITY
GOVERNMENT OF CANADA (5-YR)



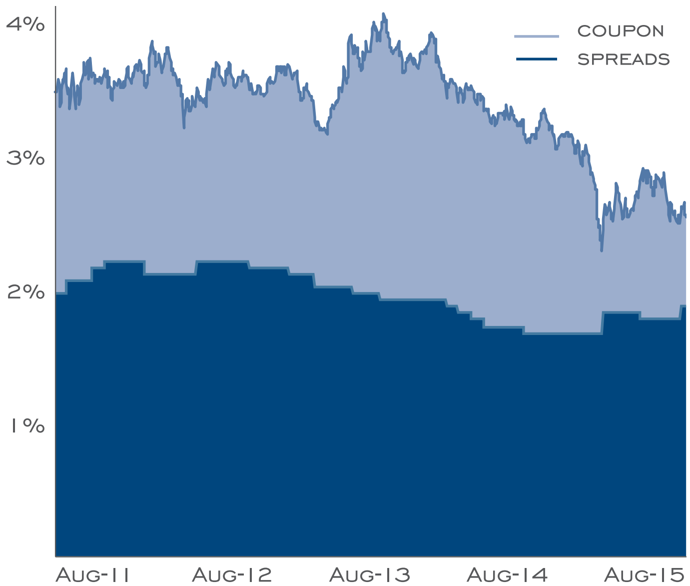
Source: Bloomberg

COMMERCIAL SPREADS

Commercial spreads have widened by 10 bps since our previous commentary, with spreads on high-quality assets priced at 175 – 185 bps for 5-year terms and 190 – 200 bps for 10-year terms. Spreads on BBB corporate bonds have increased by 25 bps throughout the quarter as well, now priced at 145 – 155 bps for 5-year terms and 190 – 200 bps for 10-year terms.

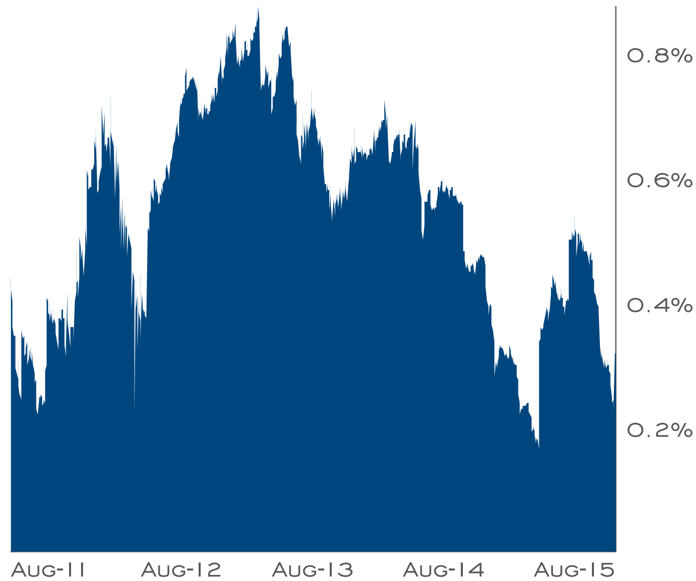
The increase does not come as a surprise, as mortgage spreads tend to rise when GoC bond volatility and corporate spreads increase. Corporate bonds and commercial mortgages are often considered substitutes for one another from a risk perspective. Commercial mortgages, the less liquid of the two securities, generally enjoy a "liquidity premium" to corporate bonds. This premium has been decreasing over the past quarter, contributing to the upward pressure in commercial mortgages.

COMMERCIAL MORTGAGE SPREADS (5-YR)



Source: Bloomberg, CMLS

5-YR MORTGAGE PREMIUM OVER BBB CORPORATE BONDS



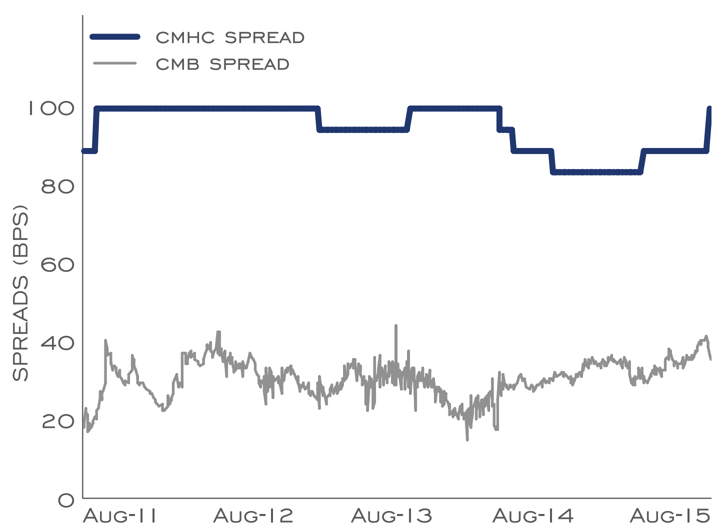
Source: Bloomberg, CMLS

CMHC

Spreads on multi-family CMHC insured loans increased 10 bps since our previous commentary, with 5-year and 10-year spreads now in the range of 90 to 100 bps. The increase in spreads is partly attributed to increasing spreads on CMHC-backed Canada Mortgage Bonds ("CMB"). 5-year CMB spreads increased from 35 bps to 44 bps between March and July, but have since come back to 37 bps.

Canada Housing Trust brought two new CMB deals to market in Q2 2015. The first issuance was a floating-rate $8 billion 5.5-year CMB bearing a coupon of quarterly Canadian Dollar Offered Rate ("CDOR") minus 3.5 bps in April 2015. The second issuance was a 5-year $5 billion CMB bearing a coupon of 1.45% in June 2015. Year to date issuance for Canada Mortgage Bonds ("CMBs") is $13 billion, just $7 billion shy of the annual limit set by the Minister of Finance.

CMHC-INSURED VS
CANADA MORTGAGE BOND SPREADS (5-YR)



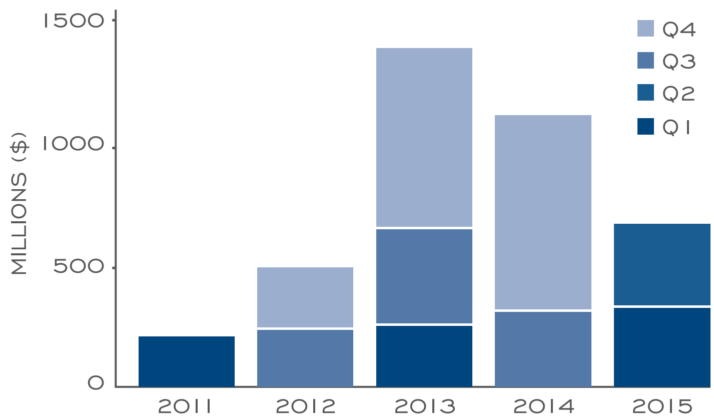
Source: Bloomberg, CMLS

CMBS

Following IMC's $325 million CMBS issuance in February, RBC brought the second CMBS transaction of 2015 to market through its REAL-T platform. The $335 million REAL-T 2015-1 transaction is backed by 46 loans, each secured by a single property. The portfolio had a weighted average term of 9.4 years and weighted average amortization of 25.5 years at the time of issuance. The Class A bonds were rated AAA by DBRS and Fitch, and carried a 13.5% subordination level (86.5% of the pool is rated AAA).

The average pool size for Canadian CMBS in 2014 was $275 million, while 2015 to date stands at $330 million and is expected to grow larger as additional conduit deals hit the market through the second half of 2015. Canadian CMBS volume is still likely to near $2 billion this year across 6 to 7 deals.

CMBS ISSUANCE



Source: Bloomberg

DEAL SUMMARY: 2014 – 2015 (YTD)

	Cut-Off Date	Deal	Size (M)	# of Loans	Cut-Off Date LTV	NCF DSCR	AAA Subordination	AAA Spread ~ 5 Years	Weighted Average Life A1	A2
2014	Jul-14	IMSCI 2014-5	$312	41	60.2%	1.44x	13.0%	95	2.85	5.81
	Oct-14	REAL-T 2014-1	$281	34	64.6%	1.59x	13.9%	n/a	5.49	n/a
	Dec-14	MCIC 2014-1	$224	32	64.2%	1.36x	15.5%	n/a	3.76	n/a
	Dec-14	CMLSI 2014-1	$284	37	54.8%	1.47x	13.4%	115	5.50	9.78
2015	Feb-15	IMSCI 2015-6	$325	47	61.0%	1.49x	13.1%	115	5.50	9.87
	May-15	REAL-T 2015-1	$335	46	60.9%	1.54x	13.5%	112	5.80	9.84
			$1,761						Source: Bloomberg, National Bank	

FIRST MORTGAGE BONDS

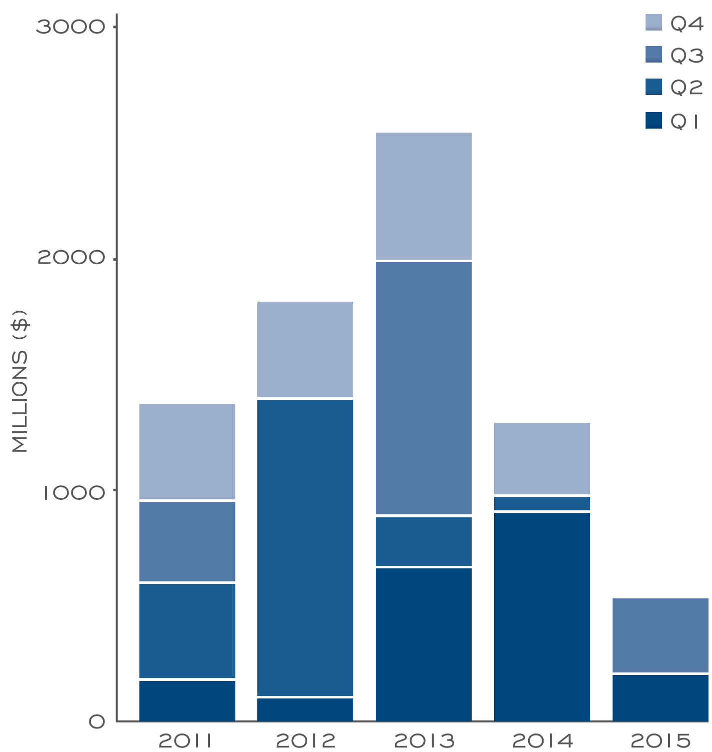
We did not see any new first mortgage bond issuance in Q2 2015, but market pace has picked up with some early Q3 issuance and deals in the pipeline.

A 10-year $225 million first mortgage bond closed in July 2015 on TELUS Garden located in Downtown Vancouver. Coined as one of the most technologically innovative and environmentally friendly sites in North America, TELUS Garden will be one of the first in the country built to Canada's LEED Platinum standard. The multi-tenant 496,000 square foot Class AAA office tower is in the final stages of completion. Based on the use of proceeds from the offering and the expected LEED Platinum certification of the property, the bonds are designated as "Green Bonds".

There are two further deals in the pipeline expected to close in Q3. The first is a 15-year $71 million bond on a property located in Ottawa head-leased to a local educational institution, and the second is a 7-year $35 million bond on an office property in Ottawa. Both deals are priced aggressively at 150 to 160 bps.

Year to date issuance, including the early Q3 activity and pipeline, is $530 million for the first mortgage bond market.

FIRST MORTGAGE BOND ISSUANCE



Source: Bloomberg

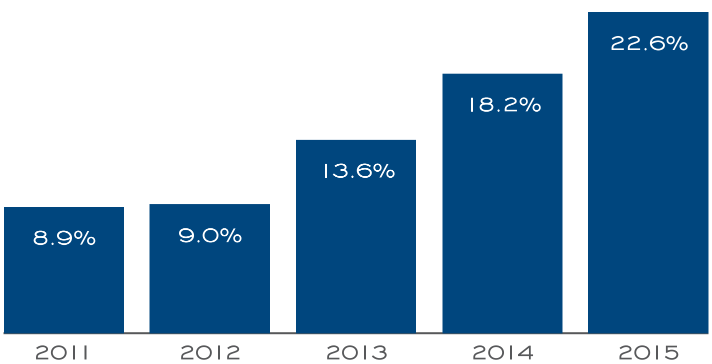
SENIOR UNSECURED DEBT

Q2 2015 showed continued momentum in the senior unsecured market, with $1.7 billion in new issuances by REITs, REOCs and pension funds. This quarter's largest issuer, bcIMC Realty Corp, had 2 issuances totaling $850 million: a 10-year $500 million offering with a 124 bps spread and a 6-year $350 million offering with a 104 bps spread. Both issues were rated AA by DBRS.

The uptick in spreads we noted in our previous commentary has continued into the summer months. This quarter, Cominar's 7-year offering had a spread of 280 bps, which is 17 bps higher than a similar offering by Cominar in Q3 2014. This increase is consistent with the general trend of increasing spreads on corporate bonds.

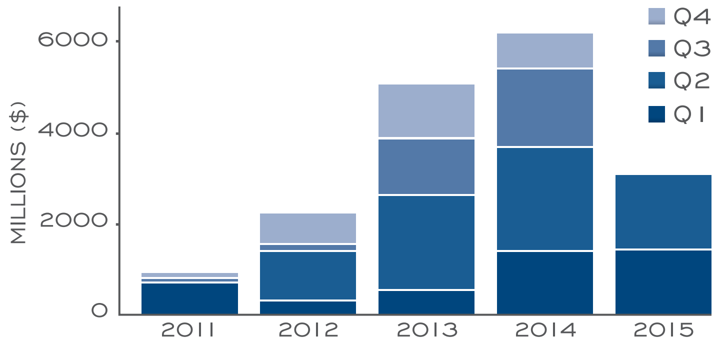
The rise of senior unsecured debt issuance amongst REIT/REOCs comes at the expense of traditional mortgage financing. Senior unsecured debt made up 8.9% of the total debt stack amongst REIT/REOCs in 2011, and has since ballooned to 22.6% as of 2015.

SENIOR UNSECURED SHARE OF TOTAL DEBT (REIT/REOCS)



Source: DBRS

SENIOR UNSECURED DEBT ISSUANCE



Source: Bloomberg

	Issuer Name	Issue Size Millions ($)	Issuance Rating	Term (yrs)	Spread (bps)
Q1	RioCan	300	BBB (high)	9	222
	Crombie	125	BBB (low)	5	220
	Calloway	160	BBB	10	238
	Choice Properties	250	BBB	6	163
	CREIT	100	BBB	5	186
	Ventas	250	BBB+	7	182
	First Capital	90	BBB (high)	11	213
	RioCan	175	BBB	4	151
Q2	Allied Properties	150	BBB (low)	5	273
	Cominar	300	BBB (low)	7	280
	CT REIT	150	BBB (high)	7	155
	bcIMC	500	AA	10	124
	CT REIT	200	BBB (high)	10	187
	bcIMC	350	AA	6	104
	Total	$3,100	Source: Bloomberg, DBRS, RBC		

ABOUT CMLS FINANCIAL LTD.

CMLS Financial Ltd. ("CMLS") is a diversified provider of lending products and services to the commercial and residential real estate finance industry. We take great pride in continuing our over forty year tradition of exceptional service to borrowers, lenders, mortgage bankers and brokers. CMLS is one of the only independent, dedicated providers of mortgage services for the commercial real estate finance industry in Canada.

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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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