CMLS
Canadian Mortgage Loan Services Limited

Commercial Mortgage Spread Commentary

Commercial Mortgage Survey Highlights

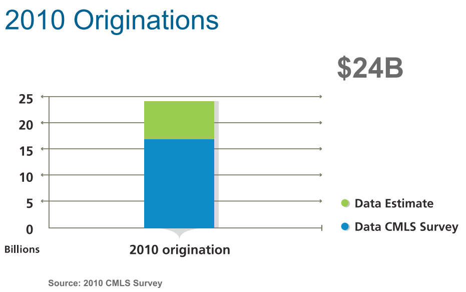
May 2011

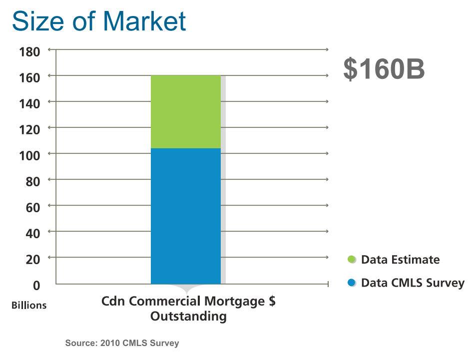
CMLS presented the highlights from our inaugural Canadian commercial mortgage market survey at RealCapital 2011 in Toronto. CMLS undertook this survey because we feel that there is a critical lack of financial information on the commercial mortgage market in Canada. The objective was to accumulate information on the size and makeup of the Canadian commercial mortgage market, quantify originations in 2010 and previous years, and identify the relative importance of key underwriting standards across the industry.

CMLS estimates the size of the Canadian mortgage market at approximately $160 billion. 2010 survey participants reported balances in excess of $103 billion. CMLS estimates 2010 originations at approximately $24 billion. 2010 survey participants reported originations in excess of $16.6 billion.

Survey participants included twenty-three lenders, twenty-one of whom held in excess of $750 million of commercial mortgages. We also included data from the NHA MBS program and the current outstanding balance of CMBS. In order to provide a view on the entire Canadian market, we identified key lenders who had not participated and made assumptions of their current outstanding balances and 2010 originations based upon direct discussions with these lenders, corporate filings, or other publically available information. Full survey results were only made available to participating organizations. Exposure during RealCapital led to commitments to participate in 2011 from a few of the large lenders who did not do so in 2010. This can only improve the survey for 2011.

CMLS is committed to continuing this annual survey and providing relevant data to market participants and we will be looking for your participation again towards the end of the year. We have also received some good feedback on the structure and makeup of the survey. If you have any suggestions, questions or thoughts, please do not hesitate to contact Mark Achtemichuk directly at 604.687.0874 or mark.achtemichuk@cmls.ca.

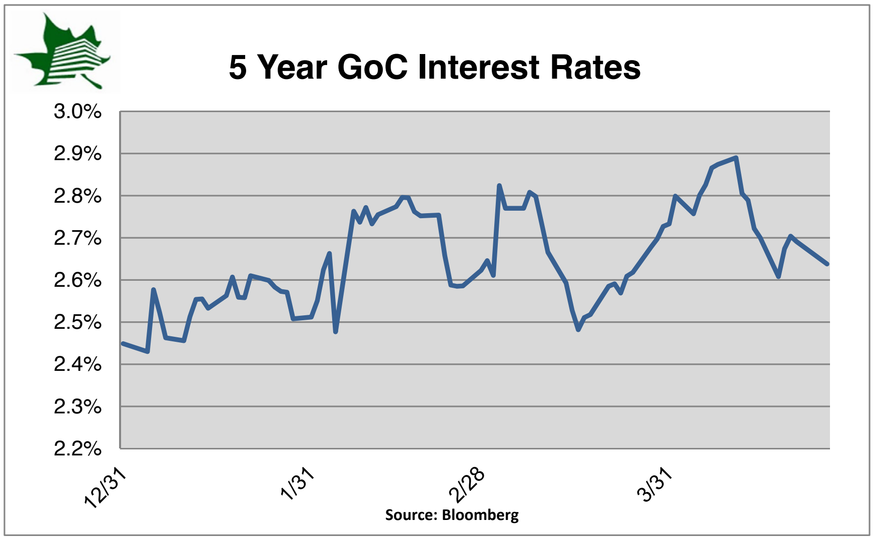


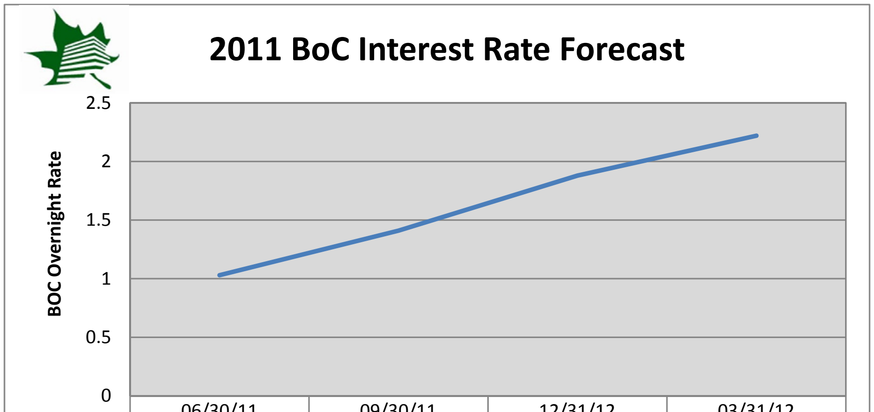


Commercial Mortgage Market

The first quarter of 2011 has proved to be a turbulent time for bond markets which have been affected by numerous global events. Uncertain economic effects of Japan's earthquake, unrest in the Middle East, and continuing European sovereign debt concerns have all contributed to an uncertain global economic landscape. These events, combined with an ever changing Canadian economic outlook have created a volatile market where Government of Canada Bond yields have experienced sharp movements throughout the past two months. The five year GoC interest rate graph illustrates multiple 30 to 40 basis point swings in a very tight period. This has created difficulty for borrowers wishing to rate lock at the most opportune time.

On April 12th the Bank of Canada ("BoC") elected to leave the overnight interest rate unchanged at 1.0%. The BoC stated that "persistent strength in the Canadian dollar could create even greater headwinds for the Canadian economy, putting downward pressure on inflation through weaker-than-expected net exports and larger declines in import prices". However, Canada's inflation rate soared in March beyond all economists' forecasts which puts additional upward pressure on interest rates. BoC estimates that core inflation will remain below 2.0 percent until mid-2012 as the economy continues to operate below full capacity. The BoC estimates that excess slack in the economy will be removed by mid-2012. This latest statement is six months earlier than previously estimated and appears to be leading the way for the BoC to begin removing stimulus and trending to a more neutral monetary policy stance.





	06/30/11	09/30/11	12/31/12	03/31/12
Forecast	1.03	1.41	1.88	2.22

Conventional Mortgage Spreads

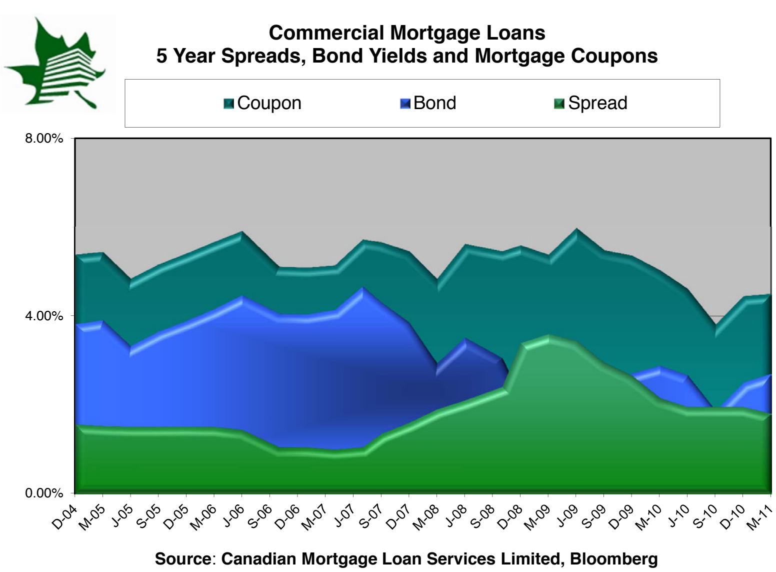
Commercial mortgage spreads have remained steady since February 2011. Based upon CMLS' risk rating model, conventional multi-family and commercial mortgages ranging from very good to fair quality would have attracted spreads between 150 and 240 basis points over GOC Bonds.

Many mortgage lenders were fearful leading into 2011 that a high supply of mortgage capital would lead to an ultra-competitive landscape where underwriting standards would be relaxed and spreads would be cut to win business. Fortunately, a high supply of mortgage capital has been met with an equally high demand from borrowers. Many lenders report seeing a very substantial volume of mortgage investment opportunities and are satisfied with the level of business that has been completed year to date. Some lenders have already initiated the transition from an active lending program to a more selective program as allocations and targets are close to being achieved. We have noticed a trend of ten year funds becoming rarer as some lenders with an active supply of five and ten year mortgage capital report seeing less competition in the longer term universe.

The market continues to price risk rationally with top level pricing being reserved only for institutional quality borrowers with AAA assets and reasonable loan parameters. Loans with any second tier characteristics are quickly being priced at a level that is materially higher. Underwriting standards being applied are also consistent with the quality of the overall mortgage investment. AAA assets with attractive fundamentals will qualify for leverage and coverage levels that are not available to lower quality assets. Non-traditional asset classes and unique loan characteristics continue to represent appropriate risk adjusted yield opportunities for lenders willing to work through the complexities. Attractive opportunities also exist for loans with characteristics that do not fit within the traditional underwriting "box" of some institutions.

The conventional multifamily mortgage market continues to be a very thin market at best. Borrowers have a significant advantage to opt for CMHC insured funds which can offer a 70-80 basis point advantage relative to non-insured funds. Borrowers who elect to go with traditional funds are typically motivated by a strategy or circumstance that does not work with CMHC underwriting criteria. These unique circumstances might even limit the universe of conventional lenders who are able to deal with these issues, such as higher leverage amounts or restructuring opportunities.

A noteworthy transaction recently completed was a $300 Million first mortgage bond secured by the new RBC Centre located at 155 Wellington Street West in Toronto. The bond was issued by Ontrea Inc. which is a wholly owned subsidiary of the Ontario Teachers' Pension Plan Board. The building was completed in 2009 and is one of a few office towers in the downtown core that has achieved a LEED Gold designation. The asset is currently 95% leased with RBC and RBC Dexia being lead tenants accounting for 72% of the net rentable area. The coupon on this seven year term, 30 year amortization bond is 4.619% which equated to a spread of approximately 150 basis points at issuance.



Source: Canadian Mortgage Loan Services Limited, Bloomberg

CMHC Insured Mortgage Spreads

The National Housing Act Mortgage Backed Security ("NHA-MBS") program continues to provide a very efficient source of funding for CMHC insured mortgages. Competition continues to be high from CMHC Approved Lenders and a few traditional lenders who can justify the tight spreads driven by the NHA-MBS program. Based upon CMLS' risk rating model, CMHC insured mortgages would have attracted a spread between 80 and 130 basis points over GoC bonds. Top tier assets could achieve a discount from this range.

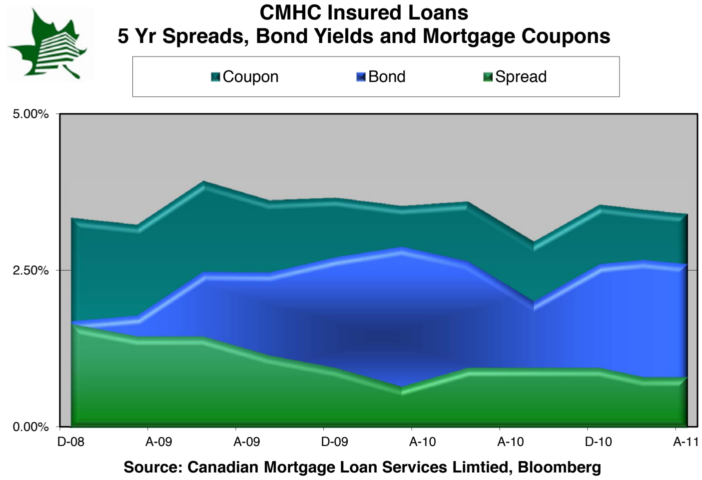
Canada Housing Trust has issued two Canada Mortgage Bonds ("CMB's") in 2011. Series 41 is a 2.75% five year bond with a $6.25 Billion principal amount and Series 40 is a 3.80% ten year bond with a $2.5 Billion principal amount. Through the sale of CMB's, CMHC continues to play a key role in providing a cost effective funding source to the real estate market in Canada. The CMB market has been underwritten and structured in a conservative manner which has prevented it from being tarnished with the same image as other international securitized products. Continued demand for CMB's by international and domestic investors verifies the quality of this product.

CMBS Market

The CMBS market continues to perform extraordinarily well in Canada. The delinquency rate for the Canadian CMBS universe continues to remain low at only 0.43% (source: DBRS). The secondary market has also seen spreads contracting and volatility diminishing. Investors have realized that Canadian CMBS offers a fundamentally different investment opportunity when compared to its U.S. counterpart. Improving secondary market characteristics are beginning to attract more traditional institutional quality investors. Opportunistic high-yield buyers are exiting the market as opportunities are becoming limited. The lack of new issuance is creating demand for well-seasoned pools as more investors are looking to maintain or even increase exposure to this asset class.

High Yield Market

The high yield market continues to see further compression in yields as lenders face stiff competition attempting to deploy capital. Income producing assets remain the most sought after investment in the high yield universe. Conservative, income producing second mortgages can attract lenders willing to originate at a sub 7% level. Attractive opportunities exist for Lenders that have an appetite for large second mortgage loans. Sophisticated lenders can also be rewarded for taking the time to work through complex issues associated with unique loans requests.



About Canadian Mortgage Loan Services Limited

Canadian Mortgage Loan Services has been servicing commercial mortgages for over thirty five years and currently services a portfolio exceeding $4.2 billion. CMLS has also been providing mortgage valuation services to Canada's leading institutional mortgage investors and borrowers for over 10 years. The Valuation division currently values in excess of $7 billion of mortgages per annum. Such services involve an annual review of each mortgage to determine the overall risk profile which drives a mark to market spread which is updated on a monthly basis. CMLS can price mortgages as frequently as required by your financial statement, performance measurement, or portfolio valuation needs, from daily to annually. Introducing objective, independent, third party mortgage valuation enhances governance by increasing transparency and aids in the objective assessment of fund and fund manager performance.

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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