CMLS Financial®

COMMERCIAL MORTGAGE COMMENTARY

CANADA'S MORTGAGE COMPANY.™

MAY 2015

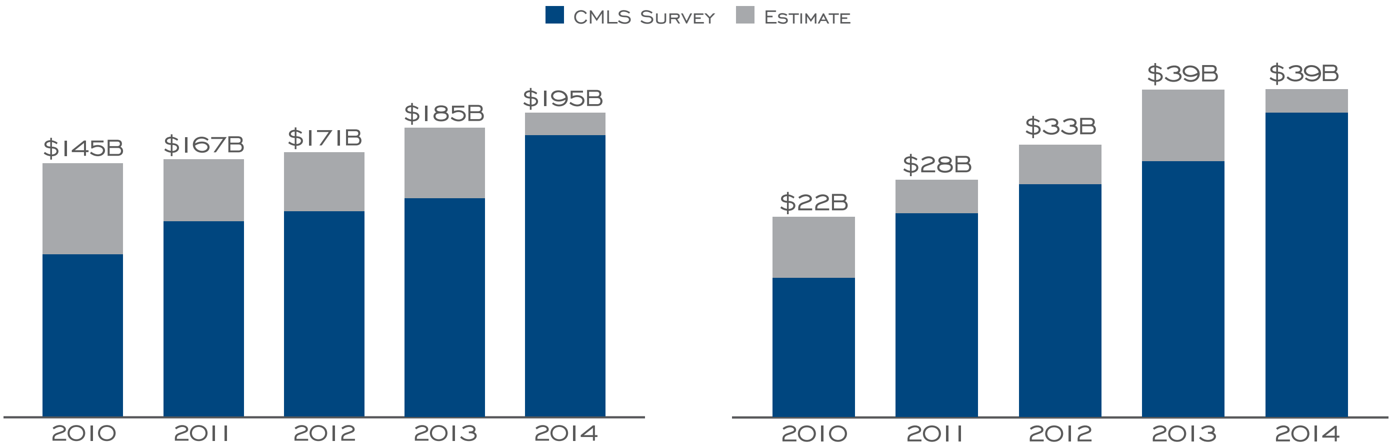
CMLS is proud to present the results from its 5th annual Canadian Commercial Mortgage Market survey. With participation by 27 of Canada's top lending institutions and publicly sourced data, the survey has direct access to over 90% of the Canadian commercial mortgage market. The goal of the survey is to:

- Determine the size and composition of the commercial mortgage market
- Quantify annual production
- Compile sentiments by industry experts

For 2014, CMLS estimates the size of the commercial mortgage market at $195 billion, up 5.4% from $185 billion last year, while commercial mortgage origination remained unchanged at $39 billion (both figures exclude construction lending).

OUTSTANDING BALANCE*

ORIGINATION*



*Excludes construction lending

WHAT ELSE DID WE LEARN?

• Last year's survey identified increasing availability of capital as a primary concern for lenders in the year ahead. This proved to be a valid concern given the influx of new lenders and the growing popularity of competing forms of financing available to borrowers. Senior unsecured notes, which in particular were identified as being a key cause for concern, had a record issuance of over $6 billion in 2014. For the upcoming year, most lenders expect their own volumes to remain level but available capital in the market to grow in size.

• Participants correctly anticipated the bottoming out of spreads in the previous survey as commercial mortgage spreads remained flat for the remainder of 2014. Going forward, participants expect spread movements to be minimal in the absence of exogenous market shocks. The resistance to further downward pressure comes despite the expected increased competition within the market.

The commercial mortgage industry continues to suffer from limited market information. CMLS is committed to continuing this annual survey and providing relevant data to market participants. Full survey results, including composition by lender type, renewal figures, construction loans and further information are only made available to participating organizations. If you have any suggestions, questions, thoughts, or would like to participate in 2015, please do not hesitate to contact Eric Clark directly at 604.488.3897 or Eric.Clark@cmls.ca.

COMMERCIAL SPREADS

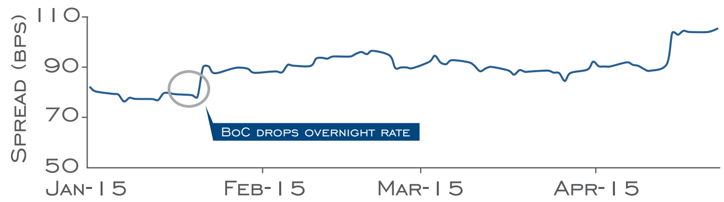
A surprise cut in the overnight rate by the Bank of Canada and weaker-than-expected oil prices sent bond yields sharply down to start the new year. Yields on 5 and 10 year Government of Canada (GoC) bonds fell by almost 60 bps to reach new lows of 0.62% and 1.2% respectively, causing many to rethink the oft-used adage "rates can't get any lower". Commercial mortgage lenders, faced with a sub 2.5% coupon market, generally responded early in the quarter by either:

1) Increasing spreads to protect yield
2) Implementing floors
3) Remaining on the sidelines

This translated into an increase of 20 to 30 bps in commercial mortgage spreads; however, the widening was short lived as the need to put out money and climbing bond rates caused lenders to bid spreads back down again. Consequently, a divergence in 5 and 10 year spreads has formed as lenders seem to have less availability for long-term money. This widening between 5 and 10 year spreads is consistent with the Canadian corporate bond market.

STEEPENING OF THE CREDIT CURVE

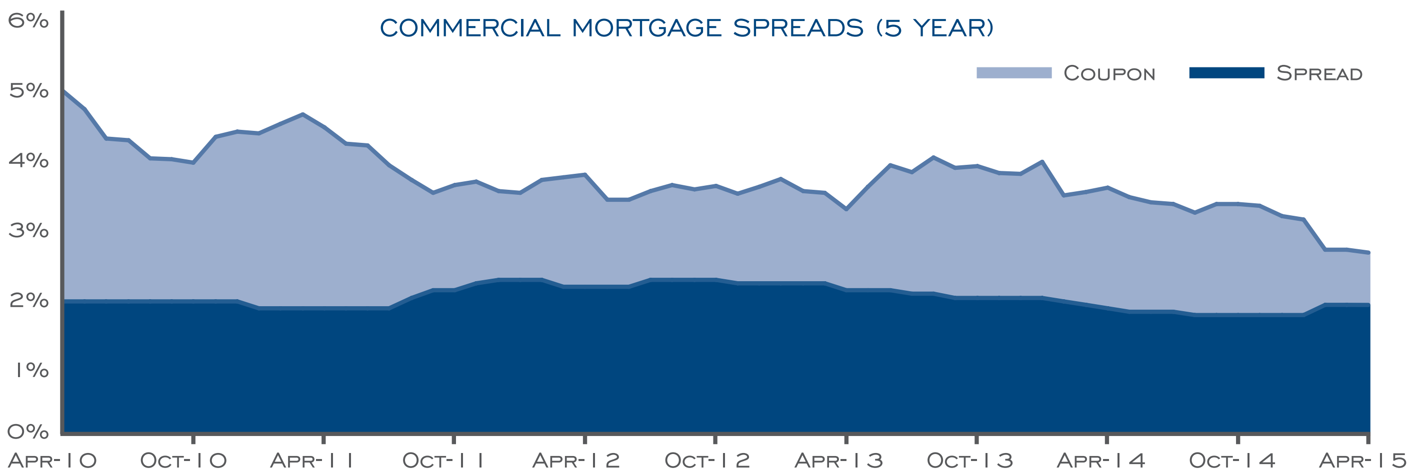
5YR VS 10YR BBB CORPORATES



Source: Bloomberg

In general, commercial mortgages on good quality assets priced at spreads of 170–180 bps for 5 year terms and 185–195 bps for 10 year terms by the end of Q1/15. We have also noticed a regional spread premium of 10–25 bps in Alberta due to concerns in the Alberta economy.

COMMERCIAL MORTGAGE SPREADS (5 YEAR)



Source: CMLS Financial, Bloomberg

CMHC

Spreads on multi-family CMHC-insured loans increased 5 bps over the past quarter, with 5 and 10 year spreads now in the range of 80–90 bps over GoCs. This is partially attributed to the new 3 bps timely payment guarantee, which came into effect March 1, 2015.

Insured mortgages securitized via NHA MBS or Canada Mortgage Bonds ("CMB") represented 16% ($6 billion) of 2014 total commercial mortgage volume. Despite its material size in the commercial market, insured multi-family mortgages represent a sliver of the overall insured market dominated by single-family residential. For 2014, CMHC insured $118 billion of new mortgages, slightly below the $120 billion annual limit imposed by the Minister of Finance.

IN THE NEWS

• CMHC, Genworth and Canada Guaranty have increased premiums for buyers who put a down payment of less than 10%. The increase comes as a response to OSFI's suggestion to raise minimum capital test ("MCT") up from 200% to 220%. All insurers currently report MCT above 220%.

• CMHC reports 2014 year end Insurance-in-Force of $543 billion, a decline of $14 billion from 2013.

• Issuers are now able to construct NHA MBS pools using loans from multiple insurers, a move expected to make it easier for smaller players to participate.

CMBS

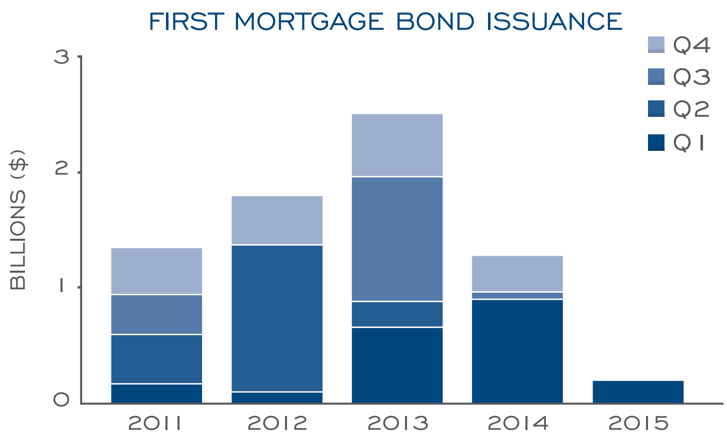
Institutional Mortgage Capital successfully launched and marketed their sixth post-crisis CMBS issuance, IMSCI 2015-6. The $325 million transaction consisted of 47 loans secured by 64 properties across Canada. The pool was well-diversified with representation by nine different property types and no loan balance greater than 8% of the total pool.

Market volatility and a general increase in commercial mortgage spreads have allowed CMBS shops greater success in their origination efforts; this should contribute towards a strong 2015 and post-recession record deal volumes. There are likely to be five or six transactions this year between the issuers shown in the table below, assisted by smaller contributions from additional CMBS lenders in the market. This could translate into annual volume above $2 billion, the first time since 2007.

Issuer Shelf	First Post-Recession Issuance	Sponsor
Institutional Mortgage Securities Corp	2011	Institutional Mortgage Capital
Canadian Commercial Mortgage Origination Trust	2012	CMLS Financial
Real Estate Asset Liquidity Trust	2014	Royal Bank of Canada
CMLS Issuer Corp	2014	CMLS Financial
MCAP CMBS Issuer Corp	2014	MCAP Financial Corporation

FIRST MORTGAGE BONDS

Q1/15 saw the issuance of a 10 year $200 million Series A first mortgage bond on Place de Ville ("PDV") I & II located in the central business district of Ottawa. The collateral, PDV I & II, comprises 3 office buildings, including Ottawa's tallest tower, spanning 1.1 million square feet of office space. The properties further benefit from a linked underground retail concourse, 4-storey podium and a 5-level underground parking garage.

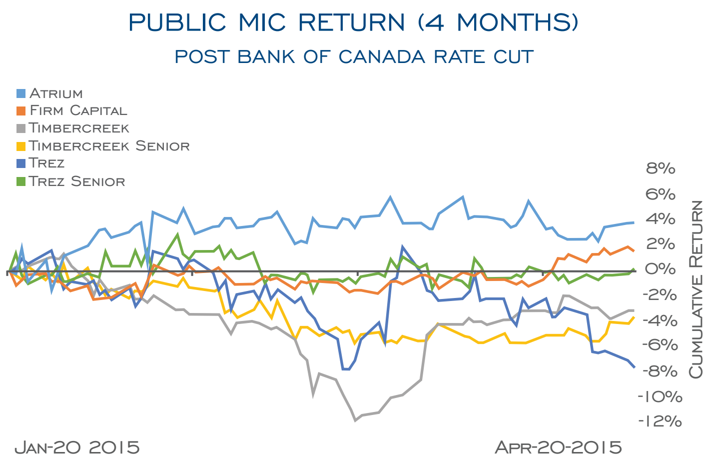


Source: Bloomberg

HIGH YIELD

In the continued low interest rate environment, investors searching for yield in real-estate backed securities may look at investing in public/private High Yield Funds ("HY") or Mortgage Investment Corporations ("MIC").

HY/MIC funds earn a greater overall coupon when compared to traditional lenders by dealing in riskier or non-conventional real estate backed mortgages. Given the higher risk profile, the funds are mostly composed of short-term/floating "credit story" loans resulting in little to no correlation with bond markets. This can be evidenced by MICs muted reaction to the ~60 bps drop in GoC bonds when compared to conventional mortgage funds which, due to their bond-like investment nature, saw a large impact to fund valuation.



Source: Bloomberg

SENIOR UNSECURED DEBT ON REITs, REOCs AND PENSION FUNDS

Q1 2015 had $1.5 billion of senior unsecured issuance, nearly identical to Q1 2014. Despite the fast pace, annual issuance for the year is likely to fall short of the record-setting $6 billion in volume seen last year given:

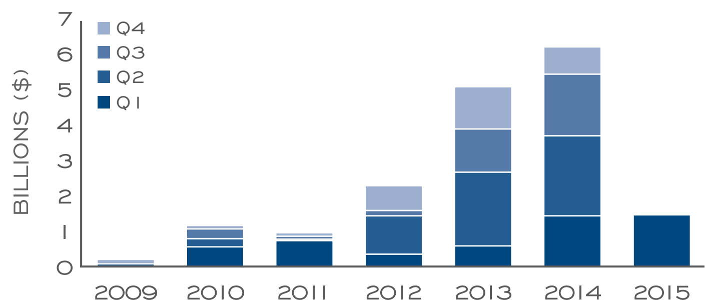
1) Choice Properties, which had $2 billion or one-third of 2014 issuance, is not expected to be as active
2) Only $500 million of unsecured notes roll in 2015

Senior unsecured financing has gained in popularity amongst credit-rated borrowers and institutional investors, with the former appreciating the flexibility in terms and the latter appreciating the yield pickup and liquidity. Pricing on unsecured notes relies heavily on issuer rating and leverage; however, we observe a noticeable uptick in spreads this quarter, likely in response to the same macroeconomic pressures which have lifted commercial mortgage spreads. This quarter's 11 year note issued by First Capital Realty priced 16bps higher than their similar term note issued in Q2 2014, while Choice Properties' 6 year note priced 23bps higher than their previous 6 year issuance in Q2 2014.

	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
	Total	$1,450			

Source: Bloomberg, DBRS, RBC

SENIOR UNSECURED DEBT ISSUANCE



Source: Bloomberg

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.

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.

Eric Clark, CFA
Associate Director, Mortgage Valuations
604.488.3897
eric.clark@cmls.ca

Sukhman Grewal
Business Analyst
604.637.0166
sukhman.grewal@cmls.ca

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