CMLS Financial®
CELEBRATING | 40 Years

COMMERCIAL MORTGAGE COMMENTARY

CANADA'S MORTGAGE COMPANY.™

NOVEMBER 2014

Q3 2014 was an active quarter in the real estate finance world. We witnessed changes to the Canadian lending landscape with transactions including two large mortgage portfolios. In August, Alberta Investment Management Corporation (AIMCO) announced the acquisition of a $520 million mortgage portfolio from Ontario Municipal Employees Retirement System (OMERS); with this sale, OMERS is exiting the commercial mortgage business. In September, it was announced that Manulife would acquire Standard Life's Canadian operation, including a mortgage portfolio of over $4 billion.

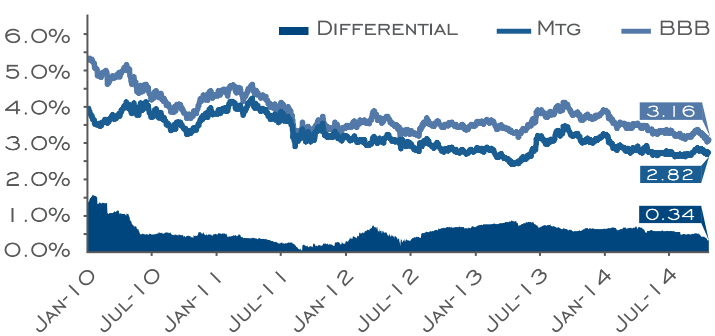
This quarter also witnessed two large real estate transactions. In August, Cominar REIT announced the acquisition of a portfolio of shopping centres and office buildings from Ivanhoe Cambridge valued at approximately $1.63 billion. The transaction was financed using $500 million of equity, $250 million of mortgage debt from Otera, and a $950 million syndicated bridge loan facility from National Bank and Bank of Montreal. In September, Ventas Canada Finance (a subsidiary of Ventas Inc listed on NYSE) refinanced its 29-property independent living portfolio, purchased in August, with two tranches of senior unsecured debt totalling $650 million.

COMMERCIAL SPREADS

The portfolio transactions for both debt and equity speaks to the continued investor demand for real estate based asset classes. On the debt side, investing in commercial mortgages has increased in popularity largely because of the yield pickup over other fixed income products, including corporate bonds. Most Canadian real estate lenders have had to work hard to find product to meet increasing investor demand and internal allocation targets.

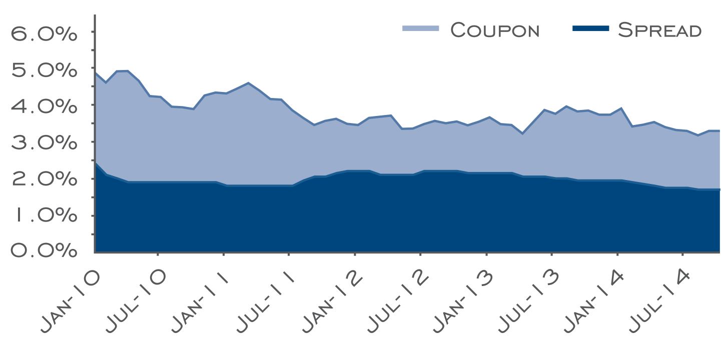
We have seen spreads decline throughout the first half of the year, but they appear to have bottomed out as they remained relatively flat for both 5 and 10 year mortgages throughout Q3. It is yet to be seen if this is a true bottom or a temporary pause before further declines. Currently, mortgages on high quality assets with conservative underwriting metrics are pricing at spreads of 155 – 165 bps for 5 year terms and 165 – 175bps for 10 year terms.

5 YEAR COMMERCIAL MORTGAGE VS BBB CORPORATES YIELD



Source: CMLS Financial, Bloomberg

COMMERCIAL MORTGAGE LOAN COUPONS AND 5 YEAR SPREADS



Source: CMLS Financial, Bloomberg

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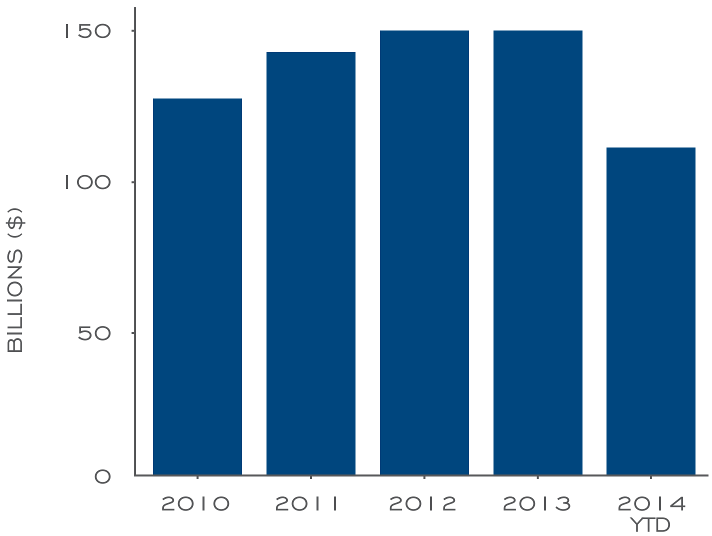
CMHC

CMHC insured mortgages offer an attractive option to investors who are looking to pick up spread over Government of Canada bonds, while retaining a government guarantee and recourse to high quality assets. Spreads on multi-family CMHC insured mortgages have remained largely unchanged, compressing early in the quarter and remaining flat since.

NHA MBS ISSUANCE



Source: CMHC

A large portion of CMHC insured mortgages are funded through CMHC's NHA MBS and CMB securitization programs. Year-to-date NHA MBS issuance has totalled roughly $108 billion, reflecting a material decrease of $12 billion (10%) from the same time last year. The falling issuance has not been the result of diminishing market appetite, but due to annual allotment limits. In an effort to manage sustainable housing market growth and curb government exposure to real estate, the Minister of Finance has limited CMHC to providing $80 billion in new guarantees for NHA MBS, and $40 billion in new guarantees for CMB. Given the more restrictive limitations on NHA MBS, lenders may need to turn to alternative sources of funding in the future.

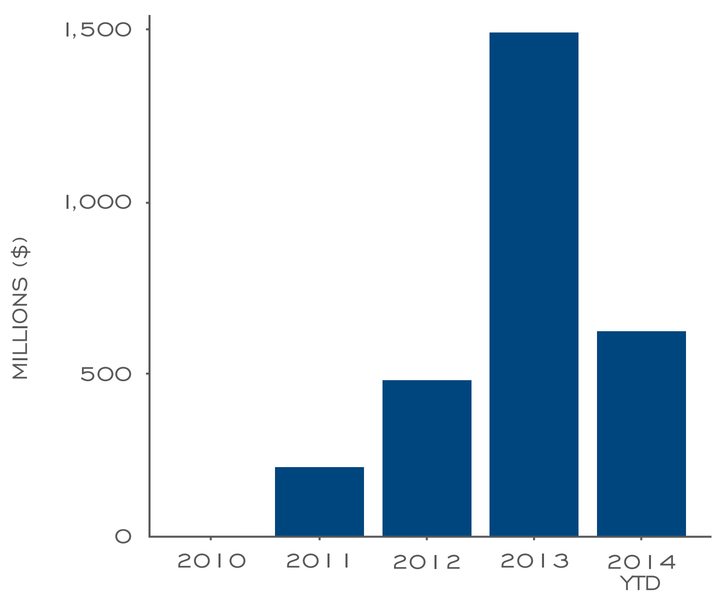
One alternative source of funding for residential mortgages available to certain registered schedule A banks is covered bonds. Covered bonds are debt instruments issued by financial institutions that are backed by residential mortgage pools. In Q3, TD Bank, Royal Bank of Canada and Bank of Nova Scotia made a total of seven covered bond issuances in GBP, USD, AUD and EUR denominations. CMHC also announced that Canadian covered bonds will soon qualify as liquid assets in the European Union. The Basel Committee on Banking Supervision has set rules for banks to retain a certain amount of liquid assets, should it be necessary to sell them easily in a crisis. The ability for EU-banks to use covered bonds as liquidity buffers may increase the demand for these securities.

CMBS

In Q3, Royal Bank of Canada (RBC) returned to the Canadian CMBS market with the launch of Real Estate Asset Liquidity Trust (REAL-T), 2014-1. The transaction marked RBC's first CMBS issuance since the credit crisis and included loan contributions from RBC, Institutional Mortgage Capital and Trez Commercial Mortgage LP. The $281 million pool consists of 34 fixed-rate loans secured by 46 properties and provides a weighted average underwritten debt service coverage of 1.59X. The transaction is slightly smaller than the year's previous transaction, Institutional Mortgage Capital's $312 million CMBS (IMSCI 2014-5) in Q2 2014.

We expect CMBS issuance for 2014 to exceed $1 billion but fall short of the $1.4 billion mark reached last year. The competitive lending environment has led to slower than expected origination and limited the number of CMBS transactions this year.

CANADIAN CMBS ISSUANCE



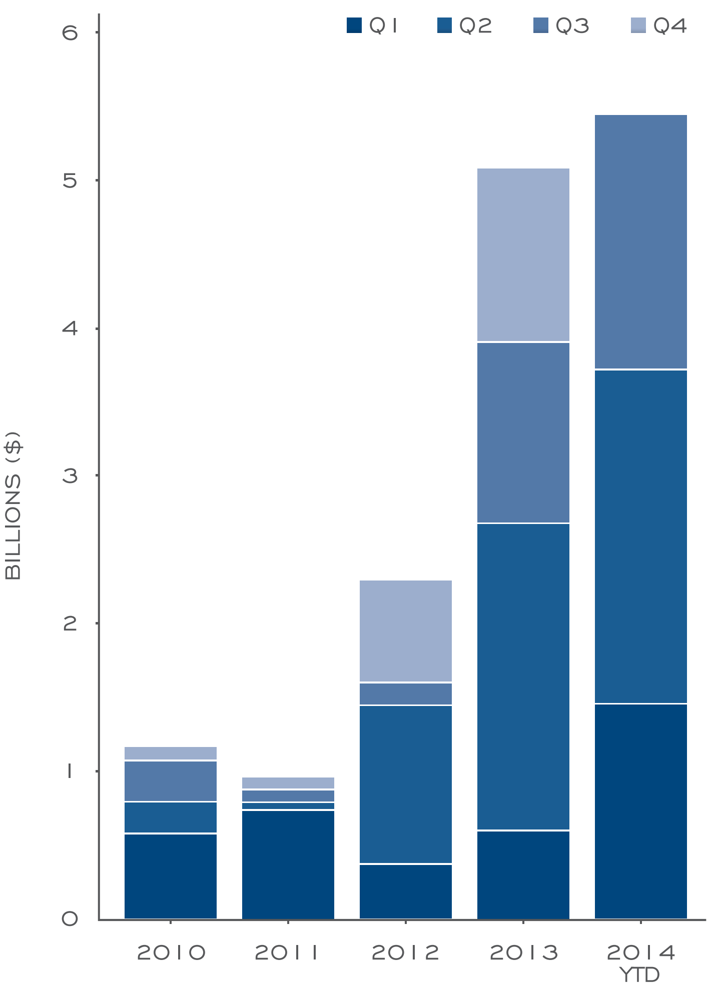
Source: Bloomberg

SENIOR UNSECURED DEBT

Q3 2014 was another busy quarter for the senior unsecured market with $1.7 billion of new issuances by REITs and REOCs. Year-to-date we have already surpassed the record level achieved in 2013.

Highlighted earlier, Ventas Canada Finance entered the Canadian senior unsecured market, issuing $650 million in a two tranche offering; a $400 million 5-year tranche originated at a 138 bps spread and a $250 million 10-year tranche originated at a 194 bps spread. These issues were rated BBB+ by S&P and Fitch. Ventas Canada Finance is a wholly-owned subsidiary of Ventas Inc, a US REIT comprising more than 1,500 seniors housing and healthcare properties in the US, Canada and the United Kingdom. Ventas established its presence in Canada when it acquired 29 independent living seniors housing communities from Holiday Retirement for $980M (3,354 units spread across 7 provinces) in August, 2014.

SENIOR UNSECURED DEBT ISSUANCE



Source: Bloomberg

This quarter also saw the return of floating rate issuances with Cominar REIT issuing a $250M, 2 year debenture at the 3-month CDOR plus 108 bps. In comparison, Cominar's 2013 floating rate debenture issued at 3-month CDOR plus 205 bps. Cominar also issued a 5 year, $300 million fixed-rate offering at 202 bps over GOCs. Artis REIT, a new entrant to the senior unsecured market in Q1, issued their second offering in August. The 5 year $75 million debenture had a spread of 198 bps which is inline with the 195 bps spread on their $125 million 5 year issuance in Q1.

	Issuer Name	Issue Size Millions ($)	Issuance Rating	Term (yrs)	Spread (bps)
Q1	First Capital	300	BBB (high)	11	184
	Dream Office	150	BBB (low)	6	221
	RioCan	150	BBB (high)	6	160
	Choice Properties	200	BBB	10	198
	Choice Properties	250	BBB	7	171
	Calloway	150	BBB	7	187
	Crombie	100	BBB (low)	7	195
	Artis	125	BBB (low)	5	200
Q2	OMERS	300	AA (low)	7	95
	Choice Properties	200	BBB	3	100
	Choice Properties	300	BBB	2	94
	Choice Properties	200	BBB	7	155
	Choice Properties	200	BBB	5	128
	Choice Properties	300	BBB	6	140
	Choice Properties	300	BBB	8	167
	RioCan	250	BBB (high)	8	167
	First Capital	210	BBB (high)	11	197
Q3	Granite	250	BBB	7	187
	Calloway	50	BBB	9	185
	Calloway	150	BBB	8	172
	Cominar*	250	BBB (low)	2	108
	Cominar	300	BBB (low)	5	202
	Artis	75	BBB (low)	5	198
	Ventas	250	BBB+	10	194
	Ventas	400	BBB+	5	138
	2014 YTD Issuance	$5,410			

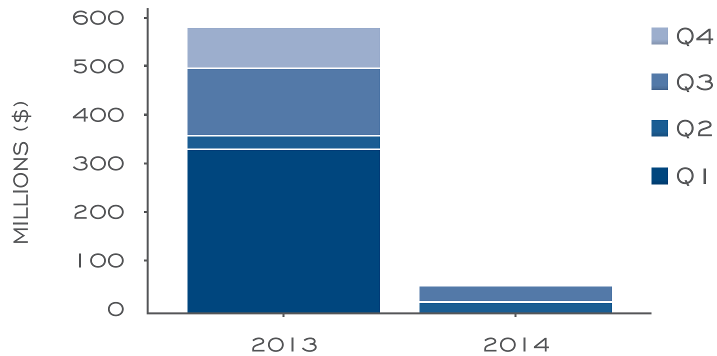
*floating rate issues based on 90 day CDOR

Source: Bloomberg, DBRS, RBC

CONVERTIBLE BONDS

NorthWest International Healthcare Properties REIT was the lone issuer, with one convertible debenture in Q3. The $35 million 5 year issuance has a 7.25% coupon and converts to 384.6154 shares representing a conversion price of $2.60 per share. The ending Q3 share price was $2.19 per share. The $58 million of convertible debenture issuance year-to-date is well short of the $586 million issued in 2013.

CONVERTIBLE DEBENTURE ISSUANCE



Source: Bloomberg

ABOUT THE MORTGAGE VALUATION GROUP

The Mortgage Valuation Group is Canada's leading provider of independent mortgage risk rating and mortgage pricing services, currently valuing in excess of $12 billion of commercial mortgages per annum. Our clients include some of Canada's most prominent investment managers, public pension funds and financial institutions.

In addition to valuation and market research, the Mortgage Valuation Group provides in-depth portfolio analytics and reports through its proprietary "Target Asset Management" software. Target Asset Management offers lenders better insight into their mortgage portfolios, from portfolio and fund level metrics to specific mortgage loan details. Target Asset Management consolidates loan and asset level information, allowing lenders to:

- monitor portfolio exposures to borrowers, tenants, regions, and industry groups
- perform 'what if' scenarios to assess the impact of new loans and portfolio rebalancing
- stress multiple variables (interest rates, rents, cap rates, etc.) to analyze the impact on portfolio and loan level metrics

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.

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