CMLS Financial®

Over 40 Years, 10,000 customers and
10 billion in assets under administration.
A dedication to Customer Forward.

NOVEMBER 2017

Commercial Mortgage Commentary

CANADA'S MORTGAGE COMPANY™

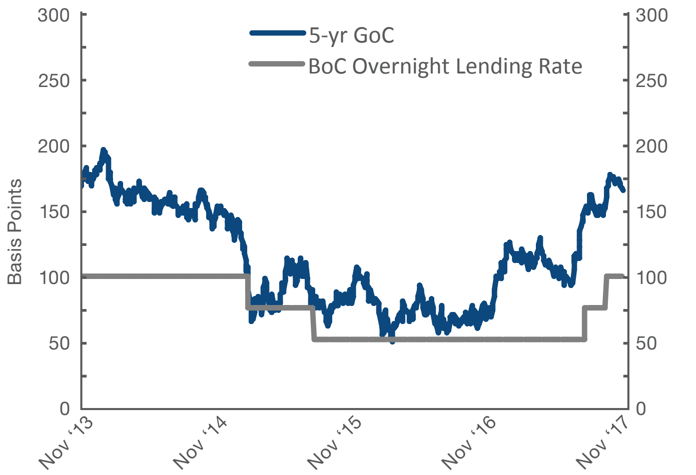
In the News

OSFI: The Office of the Superintendent of Financial Institutions ("OSFI") published its final version of the updated B-20 mortgage guidelines which will take effect on January 1st 2018. The updated guidelines, which apply to all OSFI-regulated residential mortgage lenders (i.e, banks, insurance companies, trusts), introduced a stress test on low ratio mortgages (less than 80% LTV) among other changes. Borrowers looking to refinance or switch lenders will now have to qualify for their loan amount at the higher of contract plus 2% or the Bank of Canada ("BoC") posted mortgage rate which is currently 4.99%. These changes are expected to make it more difficult for borrowers to re-finance or switch lenders.

Retail: Sears Canada received approval from the Ontario Supreme Court to liquidate all inventory and proceed with closure of its 131 remaining Canadian stores, having failed to secure a buyer to operate the company as a going concern. The iconic retailor filed for bankruptcy protection earlier in June 2017 to give itself time to restructure and emerge financially viable, having burned through 30% of cash reserves and maxing out existing credit lines in recent quarters. Toys "R" Us also joined the growing list of retailors facing financial hardship in recent times. The company filed for Chapter 11 bankruptcy protection in September 2017, but will continue to operate its 82 Canadian stores while it restructures and establishes a long-term growth strategy. Commercial mortgage lenders sentiment reflects the recent headwinds faced by traditional bricks-and-mortar retailors, with over 50% of lenders adopting a bearish outlook for the asset class (source: CMLS Q3 2017 Lenders Sentiment Survey).

Bank of Canada: After two consecutive rate hikes, the BoC elected to hold the overnight rate steady at 1.00% in the October 2017 meeting. Swap markets are pricing in a 33% probability for another rate hike before the new year which would bring the overnight rate to 1.25%. Yields on the risk free GoC bond have risen by almost 100 basis points ("bps") over the past year, partly in response to the 50bps increase in the BoC overnight rate during the same time frame.

Yields on the 5-yr GoC increase by 100 basis points over the past year



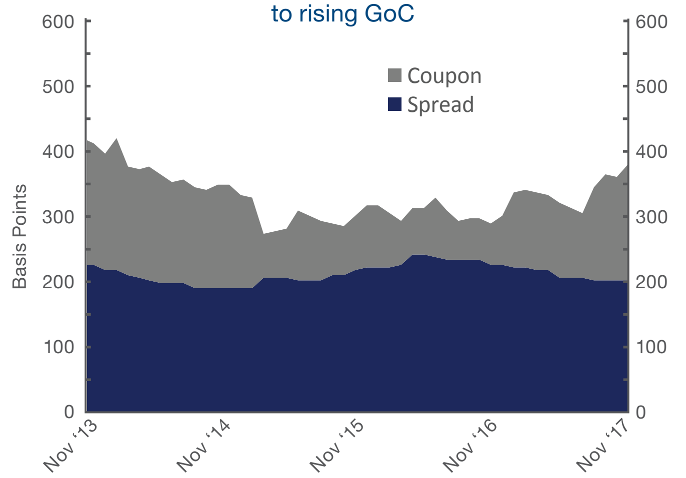
Source: Bloomberg, CMLS

FSCO LICENSE NO. 11749

Commercial Mortgages

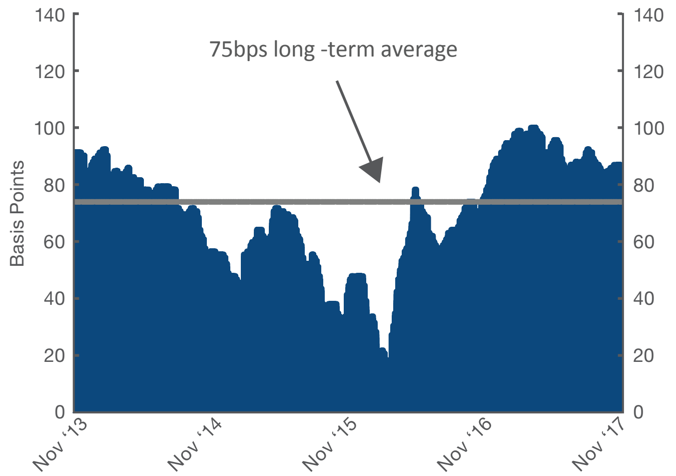
The commercial mortgage market remains competitive and well-capitalized as we near the end of 2017, with lenders reporting strong appetite for deals across the risk spectrum. Spreads over GoC bonds remain near five year lows, with high quality assets pricing in the 160 to 180 bps range for 5-yr terms and 170 to 195 bps for 10-yr terms. Similar to previous quarters, lenders struggled to get enough "top-tier" mortgages (best-in-class asset with strong loan fundamentals). Conventional commercial mortgages remain an attractive investment from a fixed income lender perspective, earning an additional 85 bps over BBB-rated unsecured corporate bonds.

Mortgage spreads tightened 20-30 bps year to date, but all-in coupon continues to climb due to rising GoC



Source: Bloomberg, CMLS

Commercial mortgages earn an additional 85 bps over 5-yr BBB rated corporates

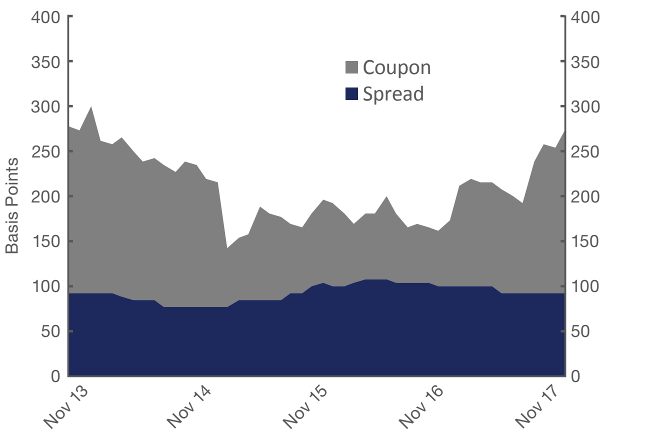


Source: Bloomberg, CMLS

CMHC

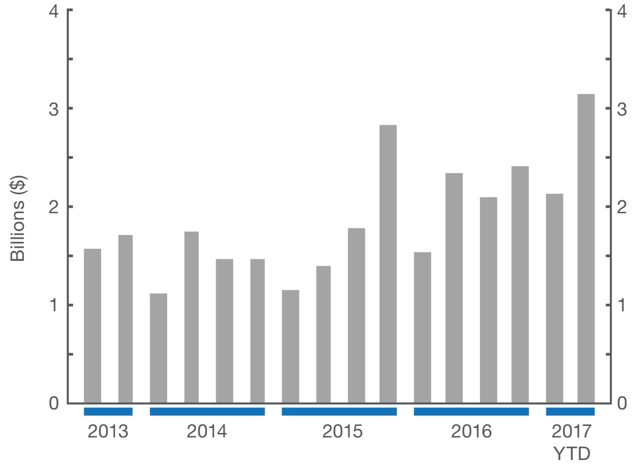
Spreads on CMHC-insured product tightened by 5 basis points since the previous quarter, with best pricing on 5-yr terms in the range of 85 to 90 bps and 10-yr terms in the range of 90 to 95 bps over GoC. Atlernatively, participants quoting directly over the Canada Mortgage Bond are seeing spreads in the range of 40 to 50 bps on best quality deals. The market size for insured multi-family product continues to grow with CMHC's latest quarterly report indicating $65.0 billion in outstanding insured commercial mortgages, up from $62 billion one year ago.

CMHC insured spreads remain flat over the past year quarter



Source: CMHC, CMLS

Quarterly multi-unit residential volumes on the rise



Source: CMHC Quarterly Financial Report

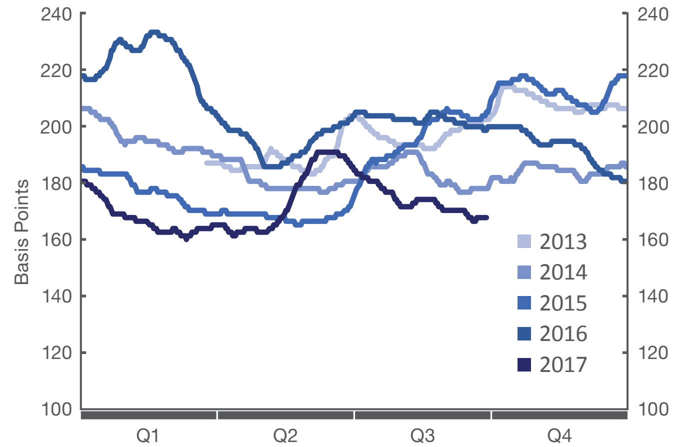
Senior Unsecured Debt

Year-to-date senior unsecured debt issuance surpassed the total annual issuance in the previous 2 years with $4.7 billion issued as of November 2017. The most recent issue by OMERS Realty Corp, a $700 million 10-yr note (AAL), priced at a spread of 113 bps. Spread over GoC bonds for unsecured BBB-rated issues currently range 160 to 170 bps, unchanged from the previous quarter and near 5-year lows.

While unsecured debt is often preferred for its ability to accommodate large financing needs at flexible terms, it is primarily only available to rated REITs, REOCs and pension funds. Cominar REIT recently had its rating downgraded by DBRS from investment grade BBB (low) to speculative BB (high), limiting its ability to tap into the unsecured market.

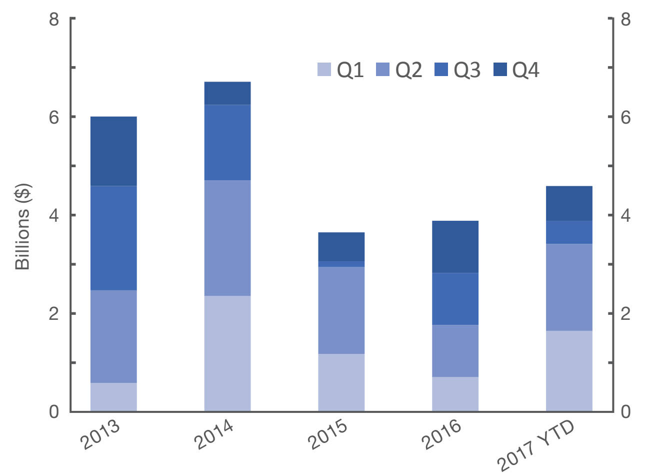
In response to the downgrade, Cominar announced that it intends to sell all non-core assets valued at $1.2 billion and use the majority of proceeds to reduce its overall remaining debt of $1.7 billion. Cominar, which has not had an unsecured issue come to market since late 2016, also advised shareholders that it intends to refinance any remaining unsecured debentures through secured debt in the form of mortgages.

Mortgage spreads tightened 20-30 bps year-to-date, but all-in coupon continues to climb due to rising GoC



Source: Bloomberg, CMLS

YTD issuance has surpassed previous two years annual total insurance



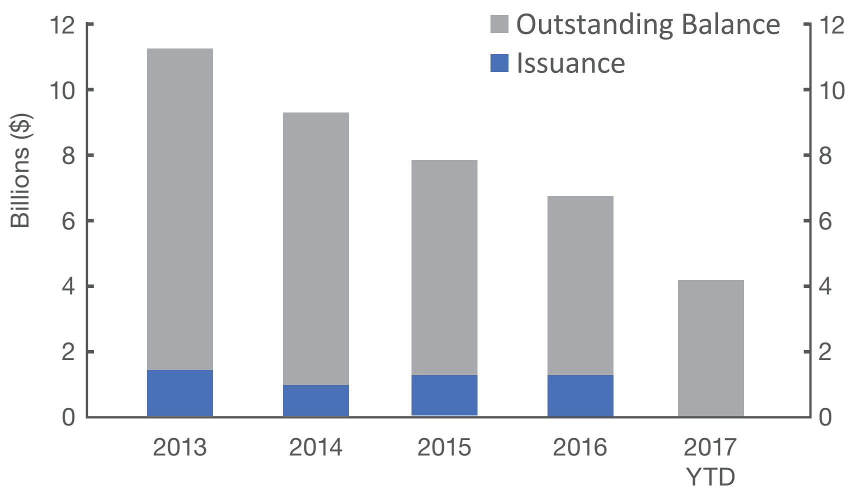
Source: Bloomberg, CMLS

CMBS

There has not been much noise in the CMBS space since RBC pulled their $360 million REAL-T 2017-1 last quarter. Pricing remains the primary obstacle to an active and profitable CMBS market in Canada. In the absence of new issuance, CMBS continues to shrink as a percentage of the overall market. At approximately $4 billion of outstanding balance, the market represents less than 2% of the overall commercial mortgage market.

A report by DBRS indicates the delinquency rate for Canadian CMBS market increased from 0.65% to 1.24% between July 2017 and August 2017. "Legacy" CMBS issues (those issued prior to 2008) had delinquency rate jump from 4.85% to 18.26%. While a drastic increase in percentage terms, the increase from a dollar perspective is less than $7 million on $120 million remaining balance. In contrast, the delinquency rate for CMBS 2.0 issues (issued post 2008 credit crisis) is much lower at 0.29% on remaining balance of approximately $4.0 billion, reflective of the more conservative underwriting.

CMBS maturities outstrip new issuance thus far in 2017



Source: Bloomberg

About CMLS Financial Ltd.

CMLS Financial is one of Canada's largest independently owned mortgage services companies. Founded in 1974, we provide lending solutions to real estate owners, developers and related real estate services for some of Canada's most prominent financial institutions, insurance companies, investment managers and others. We originate over $3 billion of annual loan funding and currently manage a mortgage portfolio of more than $11 billion.

CMLS Financial Ltd. 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 Financial is one of the only independent, dedicated providers of mortgage services for the commercial real estate finance industry in Canada.

We are proud to be Canada's Mortgage Company. Our business is mortgages and our goal is satisfying you. Building on our solid foundation of financial strength and industry experience, we deliver unparalleled solutions for all our customers with competitive rates, flexible financing and innovative solutions to meet your commercial financing needs.

Eric Clark, CFA
Director, Mortgage Analytics Group
604.488.3897
eric.clark@cmls.ca

Sukhman Grewal, CFA
Manager, Mortgage Analytics Group
604.235.5110
sukhman.grewal@cmls.ca

Colin Fernandes
Credit Analyst
colin.fernandes@cmls.ca

Tri Nguyen
Credit Analyst
tri.nguyen@cmls.ca

Vinotha Sanmugam
Credit Analyst
vinotha.sanmugam@cmls.ca

Tyler Jones
Junior Credit Analyst
tyler.jones@cmls.ca

Cevina Ghuman
Junior Credit Analyst
cevina.ghuman@cmls.ca

Christy Hua
Junior Credit Analyst
christy.hua@cmls.ca

FSCO LICENSE NO. 11749