CMLS Institutional Services®

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Commercial Mortgage Commentary

CMLS Mortgage Analytics Group

The Commercial Mortgage Commentary aims to inform the market about commercial real estate finance news. We focus on the following capital sources for commercial real estate: Conventional Mortgages, CMHC-Insured Mortgages, Commercial Mortgage Backed Securities (CMBS), High Yield Mortgages, First Mortgage Bonds and Senior Unsecured debt for REITs and REOCs.

Making News

City of Burnaby Looking to Create New City Centre

Burnaby City Council is working on a long-term plan to dramatically revamp Metropolis at Metrotown from its longstanding traditional mall structure to a walkable, more integrated city centre. The plan involves converting the 18-hectare site into a vibrant downtown core with more of a neighbourhood feel for the Vancouver suburb. The transformation will eventually see B.C.'s largest mall replaced with an array of new high-rises, public gardens and plazas, and interior streets. As part of the process, the City of Burnaby will be demanding more amenities from developers, such as providing a minimum number of rental units, meeting sustainability requirements, and providing other street level benefits. The mall site is currently owned by Ivanhoe Cambridge. The redevelopment project for the pedestrian-oriented downtown core will take place over multiple phases spanning 70+ years.

True North Acquisitions

True North Commercial REIT acquired two office properties: the ATB Westwinds office campus in Calgary and an award-winning office complex in Markham. The three-storey Calgary property has about 209,400 square feet of rentable space. True North's purchase in the GTA is a LEED Gold certified complex with approximately 315,400 rentable square feet. It won the 2019 TOBY Award for The Outstanding Building of the Year in the Renovated Building category. Both acquisitions are Class "A" office properties with a combined cost to True North of about $190.5 million.

Economic Environment

Overnight Rate

Unlike many of its central bank counterparts who have been cutting rates - most notably the Federal Reserve - the BOC elected to maintain its overnight rate at 1.75% at its recent rate announcement in late October. Even with the expected negative impact of trade wars on exports and overall business investment, current domestic economic data does not justify easing in the eyes of the Governing Council of the BOC. This decision to hold rates steady comes less than two months after the Bank's last policy meeting, where it also opted against dropping rates. The September decision to hold rates steady was not a complete surprise, as it followed a solid second quarter performance by the Canadian economy.

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Overnight Rate (Continued)

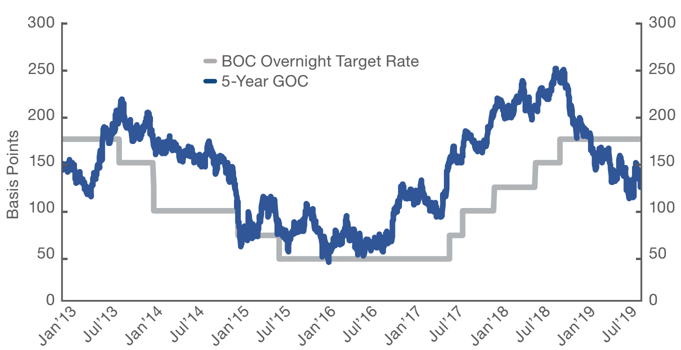
Still, for many it remains a matter of "when" and not "if" the BOC will follow suit with the U.S., Europe, and most other central banks and start easing. Declining domestic demand, slowing global growth, and the worsening of U.S. – China trade relations continue to be concerns for Canada's central bank as it weighs its next policy moves.

The Bank of Canada's autumn Business Outlook Survey supported its decision not to cut rates. Although there were stark regional differences, with particularly negative sentiment in the Prairies largely due to continued weakness in energy, Canadian businesses overall reported improved business sentiment. Expectations are for moderate sales growth, increased investment, and diminishing credit concerns. While the BOC still needs to be wary of threats to growth, this outlook report allowed it to continue its policy position of holding rates steady.

GOC Yields

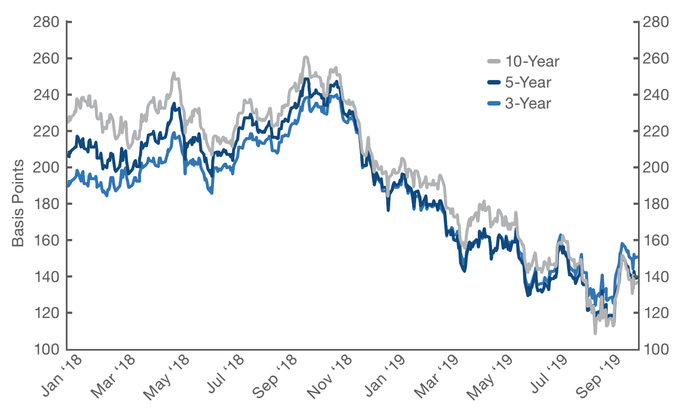
Bearish sentiment, as evidenced by a flat or inverted yield curve, appears to have grown stronger in Q3. As of the end of the third quarter, the negative slope produced by the 3 and 5-year Government of Canada yields steepened relative to where it was at the end of Q2, and the 10-year bond traded to a negative spread versus the 5-year bond. Overall, the GOC yields are still trading at low levels, but have bounced off their recent lows seen in mid-August and early September.

BOC Overnight Target Rate vs 5Y GOC



Source: Bloomberg, CMLS

Historical GOC Yields



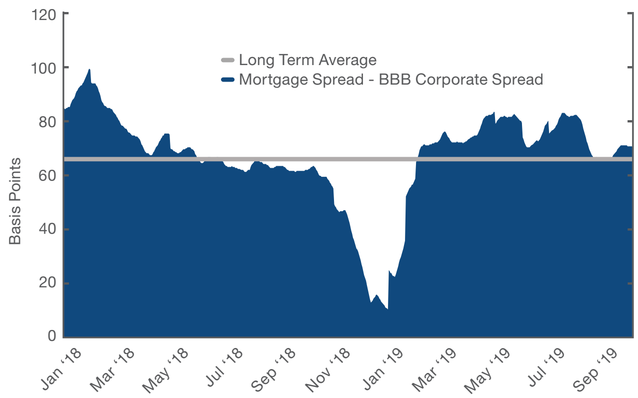
Source: Bloomberg, CMLS

Commercial Mortgages

No change seemed to be the recurring theme throughout the third quarter of 2019. As the season transitioned from summer to fall, the days got shorter and the temperatures dropped, but commercial mortgage spreads held steady relative to GOC yields. Competition for high quality assets from the capital supply side remained strong, with the usual rumblings of the occasional deal being won with an aggressive quote at a below-market spread, but overall, the market appeared to stabilize with spreads settling in at a constant range for Q3. Commercial mortgages secured by top tier properties were priced at 150-170 bps over GOC for 5-year deals, while mortgages for comparable high-quality assets were priced in the 160-180 bps range for 10-year terms.

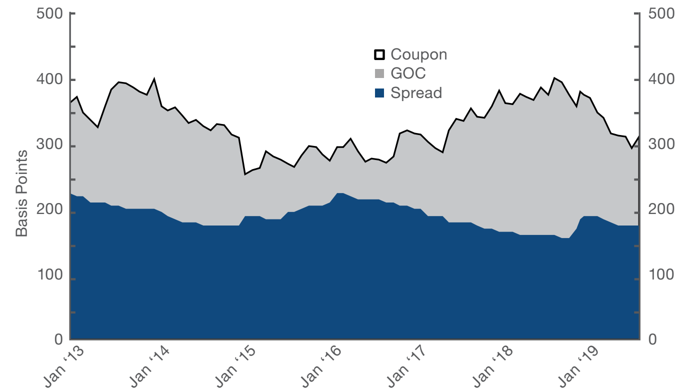
Commercial mortgages are currently earning about 70 bps over their corporate bond counterparts. This liquidity premium has come in about 10 bps compared to the end of Q2 and is now only 5 bps above its 5-year average of approximately 65 bps. In terms of volatility, much like it behaved during the previous quarter, the premium stayed within a very tight range throughout Q3.

5-Year Commercial Mortgage Premium Over BBB-Rated Corporate Bonds



Source: Bloomberg, CMLS

5-Year Commercial Mortgage Spreads

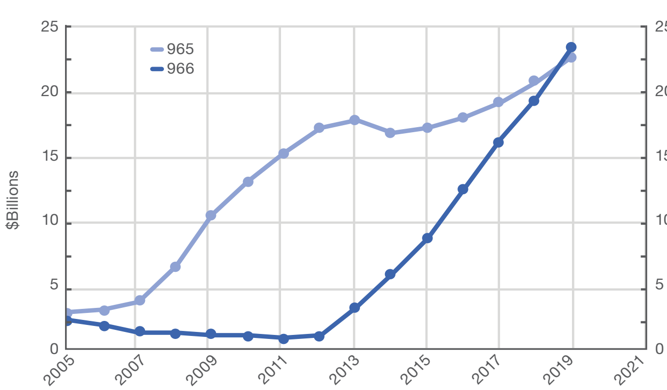


Source: Bloomberg, CMLS

CMHC

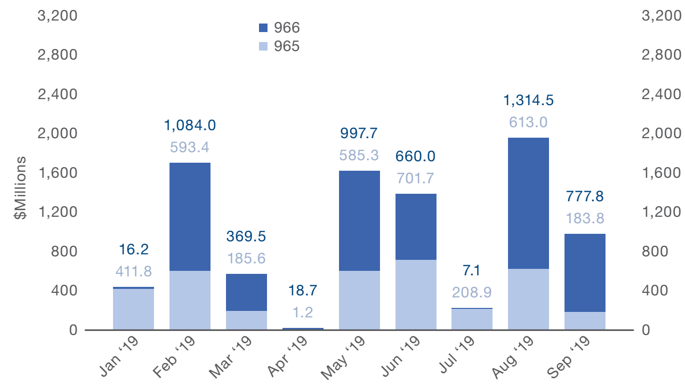
For Q3 2019, the spread over GOC for 5-year multi-family CMHC-insured loans remained unchanged at around 85 bps. The spread over GOC for 10-year insured loans decreased from 100 bps to 95 bps. The decrease of the 10-year spread is likely due to an increase in liquidity of 10-year funds made available through the latest Canada Mortgage Bond issuance by Canada Housing Trust (CHT). The proceeds from this bond issuance are used to purchase NHA MBS securitized by commercial lenders, thus increasing the funding available for 10-year CMHC-insured mortgages. In terms of spreads over CMB, 5-year multi-family CMHC-insured loans were trading between 50-55 bps throughout Q3, and 10-year insured loans were quoted around mid-55 bps.

CMHC Remaining Principal Balance



Source: CMHC

CMHC Monthly Issuances



Source: CMHC

Q3 2019 saw some significant occurrences in the NHA MBS multi-family space. CMHC-insured multi-family properties can be securitized in either the 965 or 966 NHA MBS pools. Loans securitized in the 966 pool are more attractive to investors as they do not give borrowers the same prepayment flexibility offered by loans within the 965 pool. In Q3, we saw total issuances for YTD 2019 of the two pools reach $8.73 billion, exceeding the issuance of all of 2018 of $8.67 billion. Also of note, in the month of August, 966 issuance more than doubled 965 issuance. In the same month, the remaining principal balance of the 966 surpassed that of the 965 pool. In September, the remaining principal balances of the 965 and 966 pools accounted for 4.6% and 4.8%, respectively, of the total outstanding NHA MBS balance of $491.3 billion. These figures represented an uptick from June, when the 965 and 966 pools were 4.5% and 4.4 %, respectively, of the negligibly higher $491.43 billion outstanding balance.

CMBS

Commercial Mortgage-Backed Securities (CMBS) are bonds secured by uninsured mortgages on commercial properties, which lack a government guarantee. There has been no executed CMBS issuance in Q3, 2019. The total YTD 2019 CMBS issuance is $696.40 million. The YTD 2019 issuance consists of 59% anchored retail and 13% office. The locations of the loans are 54% in Ontario and 25% in Quebec.

At the current cost of funds for conduit CMBS issuers (i.e. the spread required by purchasers of CMBS bonds), underlying mortgages would need to be priced at spreads approximately 70 to 80 bps higher than those of current conventional mortgages to ensure a profitable securitization. Issuance volumes will likely continue to be muted and driven by other regulatory factors.

Senior Unsecured Debt

The third quarter of 2019 saw four new issuances of REIT debt. The average term to maturity of the Q3 issuances was 7.5 years. In Q3, Brookfield Property Finance ULC increased the issue size of its Q1 issuance from the initial $350 million to $600 million. The spread for the additional debt issuance decreased to 222 bps, compared to the 247.7 bps indicated at the time of the first issuance. AIMCo Realty Investors LP also increased the size of its Q2 issuance from $400 million to the current $600 million in Q3, with the spread unchanged.

Senior Unsecured Debt Issuances

2019	Issuer Name	Issue Size ($Millions)	Issuance Rating	Term (yrs)	Spread (bps)
Q1	SmartCentres REIT	350	BBB	2.25	111.9
	Artis REIT	250	BBBL	2	190
	Brookfield Property Finance ULC	600	BBB	5.05	222
	Morguard Corp	225	BBBL	5	280.4
	Total/Average Q1	1425		3.58	
Q2	AIMCo Realty Investors LP	600	AAL	10	125.1
	Choice Properties	750	BBB	10	195
	Cominar REIT	200	BBH	5	290.4
	Total/Average Q2	1550		8.1	
Q3	First Capital Realty Inc	200	BBB	7.5	191.2
	RioCan REIT	500	BBBH	5.5	143
	Allied Properties REIT	300	BBBL	10	215.7
	Crombie REIT	200	BBBL	7	246.9
	Total/Average Term Q3	1200		7.5	
	Total/Average YTD	**2,975**		**5.61**	

Source: Bloomberg, CMLS

ABOUT CMLS MORTGAGE ANALYTICS GROUP

The CMLS Mortgage Analytics Group is a division of CMLS Financial Ltd., and is one of the only independent, dedicated providers of mortgage valuation services and software for the commercial real estate finance industry in Canada. The CMLS Mortgage Analytics Group provides solutions to some of Canada's most prominent financial institutions, investment managers, pension funds and consultants. With investors, regulatory bodies and governing committees requiring increased reporting, independence and third-party advice, the CMLS Mortgage Analytics Group offers a host of risk rating, valuation, and portfolio analysis tools to better manage risk/reward profiles in commercial mortgage portfolios. Clients engage our services to provide independent support for mortgage purchases, fair value accounting, ongoing fund valuation, interest rate appraisals and more.

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