

## Commercial Mortgage Spread Commentary – 1st Quarter 2010

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### *Spread Compression Accelerates*

This quarter the trends established in the middle of 2009 continued and in fact accelerated. Generally speaking there is strong to very strong interest and plenty of lending capital in many sectors. Demand is very high for both insured- and conventional multifamily and all three of the main income producing categories of retail, industrial and commercial/office. We are also seeing renewed interest in some of the secondary markets and in “B” or “C” quality properties.

We believe that lenders are no longer simply competing on price. We have begun to see underwriting standards start to relax somewhat, in particular, loan to value ratio. Time will tell if we get back to the heady times of the spring of 2007.

### Current Market Spreads

**By the end of March, borrowers were able to attract quotes for good quality commercial mortgages in the range of 190 to 220 basis points over Government of Canada bonds, some 60 bps inside December levels. A nice multifamily loan was attracting quotes in the 170 to 200 bps range, down by approximately 45 bps.**

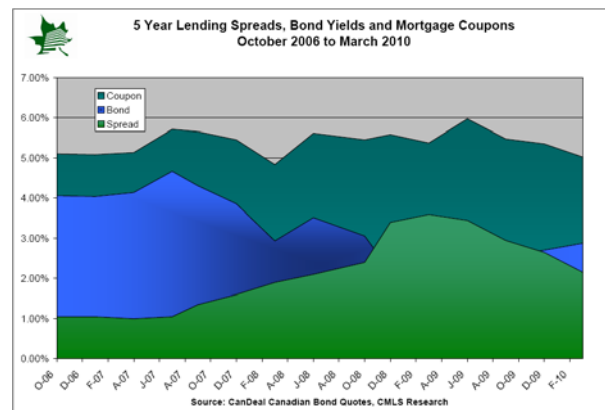
**CMHC insured lending spreads for multifamily loans have come in to 75 to 115 basis points over GoCs, with the highly sought after five year loan attracting quotes even lower. This is about 40 bps tighter than the end of last quarter.**

### Conventional Mortgages

Mortgage coupons are currently hovering around the 5% level for high quality five year commercial mortgages. Mortgages which were rate locked in February and early March would have seen coupons as low as 4.5%. A recent expansion in the five year GoC yield has pushed rates to the 5% level. Mortgage coupons at the 4.5% level represent the lowest rates we have seen in over five years.

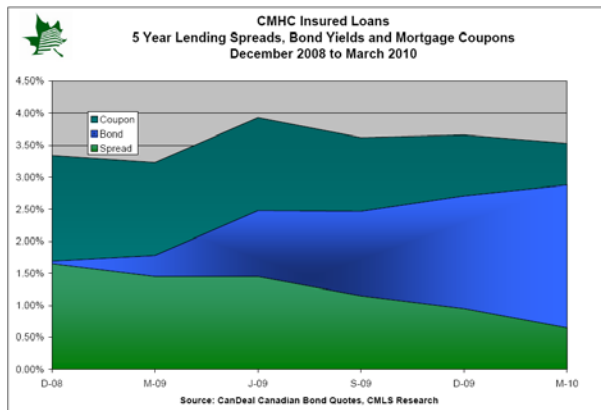
It has been very difficult for some lenders to justify lending at these historically low coupons. The ability of participants to compete at these levels is being largely driven by the investment objectives of their program. Lenders that can't provide the lowest pricing must be creative to find attractive yield opportunities in this environment. We are thus finding renewed interest in secondary markets, or in financing properties that need modest renovation or leasing. This is all driven by a need to win business while achieving yield targets.

Lenders who had the foresight to be aggressive and deploy capital at high spreads over recent months are being rewarded due to the drastic compression in spreads. We foresee spreads continuing to compress. Life insurance companies, banks, credit unions and some pension funds have substantial



allocations they are looking to deploy. Competition is exacerbated by limited commercial real estate sales activity. Participants must also consider that the commercial mortgage universe is also smaller due to tighter underwriting standards and lower property values. Although one development of interest in the first quarter of 2010 was the willingness for some lenders to move back to the 70% loan to value level.

*“One development of interest... ..the willingness for some lenders to move back to the 70% loan to value level.”*

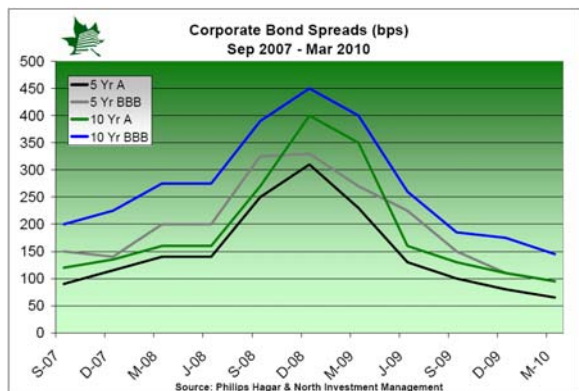
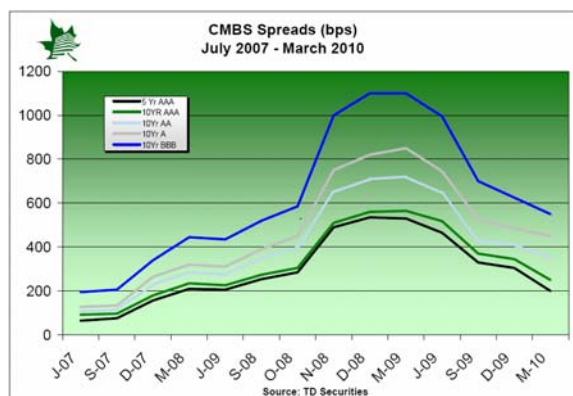


### CMHC Insured Mortgages

National Housing Act Mortgage Backed Securities and Canada Mortgage Bonds continue to remain a sought after investment product. The spread premium between GoCs and CMHC insured loans has continued to fall. We are now seeing CMHC insured loan being priced as low as 65 basis points over GoCs. This still provides an attractive premium given the Government guarantee of these loans.

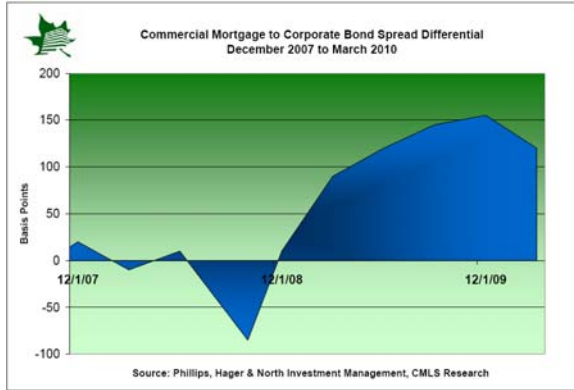
### CMBS Spreads

The year over year change in the secondary CMBS market has been dramatic. Spreads have decreased from 300 to 550 basis points depending on the term and class of the transaction. Five year triple A CMBS spreads are now at the 200 basis point level. Volume has picked up substantially in the first quarter of 2010. Spreads compressed on average approximately 75 basis points across the curve. TD Securities reports that buyers are paying much closer attention to the transaction specifics – particularly credit enhancement in each pool.



### Corporate Bond Spreads

The first quarter of 2010 proved to be relatively quiet when compared to the volatility in 2009. Corporate bond spreads have decreased modestly in the first quarter of 2010. The pace of compression has slowed dramatically which was to be expected given corporate spread premiums are approaching their historical averages.



The premium between commercial mortgage spreads and triple B rated corporate bonds has tightened to approximately 120 bps. The spread premium between these asset classes remains at a historically high level. Until this premium diminishes, commercial mortgages will continue to offer an attractive yield relative to alternative investment classes especially considering their strong track record. If you believe in trend analysis, one look at the steepness of the chart at left would indicate that this gap will continue to narrow.

#### About Canadian Mortgage Loan Services Limited

Canadian Mortgage Loan Services and its affiliate Penmor Mortgage Capital Corporation have been originating and servicing commercial mortgages for over thirty five years. CMLS services a portfolio exceeding \$3 billion. Penmor originates approximately \$1 billion in commercial mortgages annually.

In addition, CMLS is a leading CMHC insured mortgage lender, active across Canada specializing in term mortgages secured by multifamily properties. Loan amounts available range from \$1 million to \$100 million and larger.

CMLS also provides mortgage valuation services to institutional mortgage investors, currently valuing in excess of \$5 billion of mortgages per annum. Such services involve a review of each mortgage at origination and then on a periodic basis resulting in a recommendation of the appropriate spread to apply for the purposes of valuation. Introducing objective, third party valuation to a commercial mortgage portfolio enhances governance by increasing transparency and aids in the objective assessment of fund and fund manager performance.

For more information about commercial mortgage spreads, mortgage valuation services, mortgage servicing or any other related matter please do not hesitate to contact us.

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