MAY 2016

Commercial Mortgage Commentary

CANADA'S MORTGAGE COMPANY™

Introduction

The CMLS Mortgage Analytics Group presents the results of its 6th annual Canadian commercial mortgage 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 was to:

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

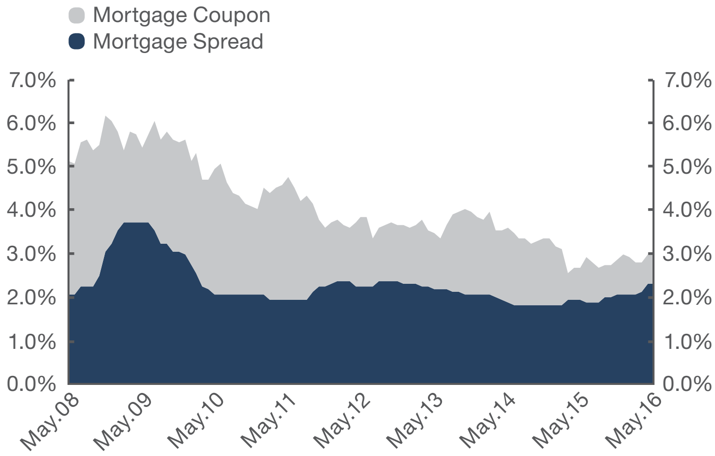
At the end of 2015, we estimate the size of the secured mortgage lending market (excluding construction lending) to be $205 billion, up 4.1% year-over-year from $197 billion in 2014. Total origination for 2015 was approximately $42 billion. Not surprisingly, financial institutions (e.g. banks and credit unions) remain the single biggest lender category at a little over 50% of the market.

Notwithstanding a generally optimistic group of participants, over 20% of respondents believe the amount of capital available to the market will decrease year-over-year in 2016. This represents the largest downside bias since we started tracking sentiments in 2012. Similarly, from a cost of debt perspective, a strong majority of lenders believe spreads will increase through 2016, representing the largest year-over-year upward bias in spread expectations we have seen since we started tracking sentiments.

Commercial Spreads

Commercial spreads on high-quality assets are currently being priced in the 195 to 220 bps range for 5-year deals and 210 to 235 bps for 10-year deals. This represents an increase of approximately 15 bps YTD in 2016, but 5 bps tighter than the intra-quarter peak reached in Q1/16. We are currently seeing more lenders return to the market and as a result we anticipate spreads will move directionally lower.

5-year commercial mortgage spreads up approximately 15 bps over Q4/15

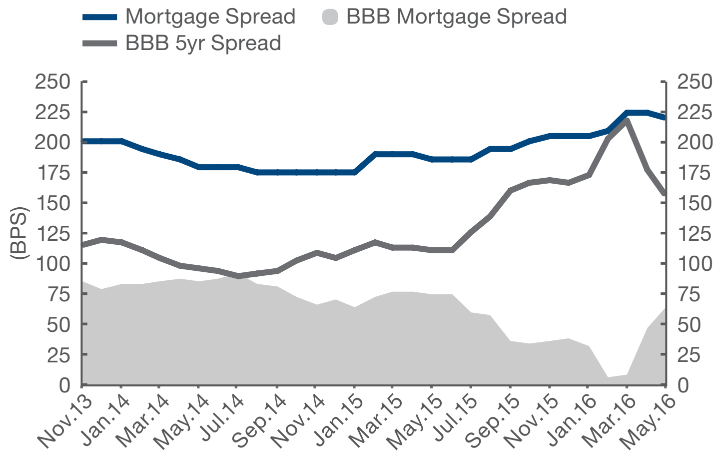


Source: Bloomberg, CMLS Financial

For those lenders that evaluate commercial mortgage credit from a relative value perspective, the roller coaster ride in corporate credits through Q1/16 forced certain lenders to rebalance portfolios away from commercial credit during the first half of the quarter, redirecting cash to attractively valued corporates. However, we are beginning to see an improvement in the availability of secured mortgage credit as corporates have rallied.

Given the "stickier" nature of commercial mortgage credit vs. corporate credits, the basis between commercial mortgage spreads and generic BBB corporate credits reached new lows not seen in the last 5 years in the first half of Q1/16. The commercial mortgage spread over equivalent-term BBB generic corporate bonds is now approximately 64 bps, below the 5-year average of 82 bps, but beginning to mean-revert primarily driven by the recent rally in generic BBB corporate bonds.

5-year commercial mortgage vs. 5-year corporate bond spread returning to more normal levels



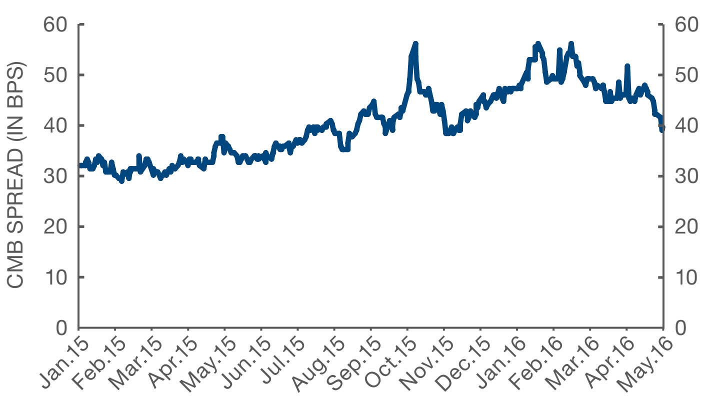
Source: Bloomberg, CMLS Financial

CMHC

Canada Housing Trust issued $9.25 billion of Canada Mortgage Bonds in Q1/16, up 3.0% year-over-year over Q1/15. Current quarter issuance included $5.0 billion of 5-year fixed, $2.0 billion of 10-year fixed and $2.25 billion in 5-year floating rate note issuances. There will be two new openings for the CMB in May – a 10-year fixed pool maturing September 2026 and a 5-year variable pool maturing September 2021.

Spreads for CMHC-insured product have increased year-to-date albeit to a lesser extent than conventional commercial mortgages. Current spreads on new 5-year multi-family CMHC insured mortgages are approximately 100 bps to 110 bps, up approximately 5 bps from the end of Q4/15. We may see spreads on multi-family CMHC insured mortgages begin to tick up for loans funding after the July 1 effective date for the increase to the timely payment guarantee on NHA-MBS.

CMB funding costs ended the quarter 3 bps lower year-to-date after peaking mid-February



Source: Bloomberg, CMLS Financial

CMBS

After two consecutive quarters with no new CMBS issuance, Royal Bank was back in the market in May with a $401 million CMBS pool deal (REAL-T 2016-1). The pool metrics are strong with 55 loans secured by 91 properties, 93.3% of the collateral is in historically stable asset classes (multifamily, office, retail, industrial) and none of the collateral is located in Alberta.

REAL-T 2016-1 priced at a spread of 150 bps and 195 bps over the curve for the 5.8 year WAL A1 and 9.4 year WAL A2 bonds, respectively. This translates to a premium of approximately 50 bps wide of indicative new issue AA-rated senior unsecured bank deposit notes, well above the average of 25 bps for a CMBS 2.0 deal. Despite the better tone in the credit markets of late, it's clear that investors continue to require larger liquidity premiums for CMBS bonds relative to other spread product.

In other CMBS news, DBRS placed fifteen classes of CMBS Certificates across five Canadian deals under review with negative implications as a result of seven non-performing loans secured by six properties. The majority of the collateral in the impacted pools is comprised of multi-family buildings located in Fort McMurray, Alberta. Notwithstanding the current wildfire situation, the average vacancy for the five multifamily properties located in Fort McMurray was 52% at the end of 2015 vs. 17% at the end of 2014 and 7% as underwritten.

Summary of recent CMBS deals

	Cut-off Date	Deal	Size (M)	# of Loans	# of Properties	Cut-off Date (LTV)	NCF DSCR	AAA Subordination	Weighted Average A1	Weighted Average A2
2014	July 2014	IMSCI 2014-5	$312	41	55	60.2%	1.44x	13.0%	2.85	5.81
	October 2014	REAL-T 2014-1	$281	34	46	64.6%	1.59x	13.88%	5.49	n/a
	December 2014	CMLSI 2014-1	$284	37	41	57.8%	1.47x	13.38%	5.50	9.78
	December 2014	MCIC 2014-1	$224	32	40	64.2%	1.36x	15.50%	3.77	n/a
2015	February 2015	IMSCI 2015-6	$312	47	64	61.0%	1.49x	13.10%	5.50	9.87
	May 2015	REAL-T 2015-1	$335	46	46	60.9%	1.54x	13.50%	5.80	9.84
	September 2015	CCMOT 2015-3	$570	42	59	59.1%	1.49x	20.00%	3.85	4.74
2016	May 2016	REAL-T 2016-1	$401	55	91	62.0%	1.46x	13.50%	5.80	9.40

Notes: CCMOT 2015-3 AAA subordination represents the A-senior subordination.

Source: Wells Fargo, Bloomberg, CMLS

First Mortgage Bonds

The first mortgage bond market has remained stagnant for a second consecutive quarter, with no new issuance since Q3/15. Although lumpy in nature, this marks the longest period of inactivity since 2011 but given the tone in the credit markets since Q3/15, this is hardly surprising.

Credit metrics and ratings have remained stable through 2015 on first mortgage bonds secured by properties in Alberta despite the worsening economic conditions, with vacancy up only slightly year-over-year on these class A office assets in downtown Calgary. However, The Bow Tower is one to watch given its significant exposure to Encana.

First mortgage bonds with Alberta exposure

Property	City	Asset Type	Credit Rating	Vacancy 2015	Vacancy 2014	Change in Vacancy (BPS)
Bankers Hall	Calgary	Office	A (low)	5.10%	0.00%	510
The Bow Tower	Calgary	Office	A	0.00%	0.00%	-
Suncor Energy Tower	Calgary	Office	A	0.00%	0.00%	-
Centennial Place	Calgary	Office	AA (low)	0.70%	0.00%	70
West Edmonton Mall Property	Edmonton	Retail	A	4.90%	4.80%	10

Source: DBRS

Senior Unsecured Debt

Real estate senior unsecured debt continues to be slow with only three new issues totaling $725 million in Q1/16, down 50% year-over-year from $1.45 billion issued in Q1/15. In February, OMERS Realty Corp issued $375 million of 8-year AA (low) rated unsecured notes at a spread of 185bps and in March, Choice Properties Real Estate Investment Trust issued two BBB rated unsecured notes - a $250M 7-year note at a spread of 217 bps and a $100M 30-year note at a spread of 325 bps. The 30-year bond issued by Choice was the longest unsecured bond ever issued by a REIT.

In part as a result of the volatility in the credit markets seen in Q1/16, two issuers (Allied Properties REIT and H&R REIT) structured unsecured floating-rate credit lines with a Canadian bank that were later swapped to fixed-rate loans, effectively simulating an unsecured issuance in the capital markets. The cost of financing for these borrowers ended up being significantly less than indicative new issues at the time.

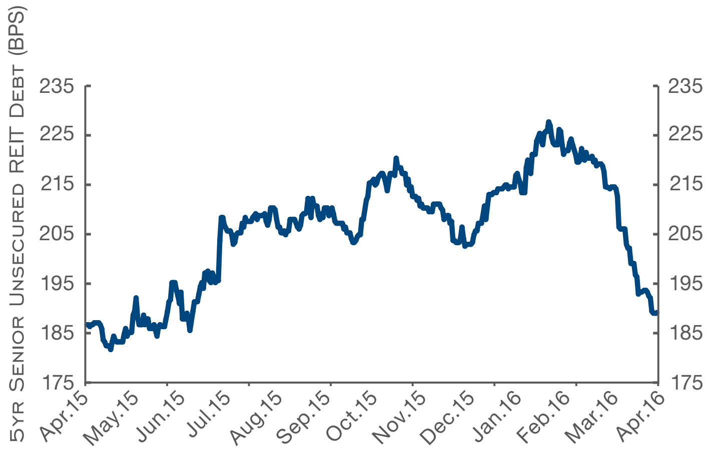
Senior unsecured REIT debt issuance in Q1/16

2016	Issuer Name	Issue Size Millions ($)	Issuance Rating	Term (yrs)	Spread (bps)
	OMERS Realty Corp.	375	AA (low)	8	185
Q1	Choice Properties REIT	100	BBB	30	325
	Choice Properties REIT	250	BBB	7	217
AVG				**15**	**242**

Source: Bloomberg, CMLS Financial

5-year spreads on senior unsecured real estate debt peaked in February 2016, before coming back down to end the quarter approximately 13 bps tighter than Q4/15. Unsecured REIT debt has outperformed BBB generic corporate bonds YTD, tightening approximately 10 bps more than generic BBB corporates. With several REITs turning to the banks for unsecured lines of credit as oppose to issuing in the capital markets, the outperformance could in part be to a dearth of new issuance relative to generic BBB corporate bonds.

5-yr senior unsecured REIT debt rallied through Q1/16



Notes: First Capital Realty, H&R REIT, RioCan REIT, Smart REIT 5-yr constant maturity spreads

Source: Bloomberg

Economic Calendar

Date	Event
Commercial Real Estate Industry Events	
May 17	Winnipeg Real Estate Forum
Economic Data Releases	
May 25	Bank of Canada Rate Announcement
May 31	Q1 GDP (CAN)
June 3	May Employment (US)
June 10	May Employment (CAN)
June 15	Federal Open Market Committee Meeting (US)
June 30	April GDP (Can)

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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