APRIL 2022

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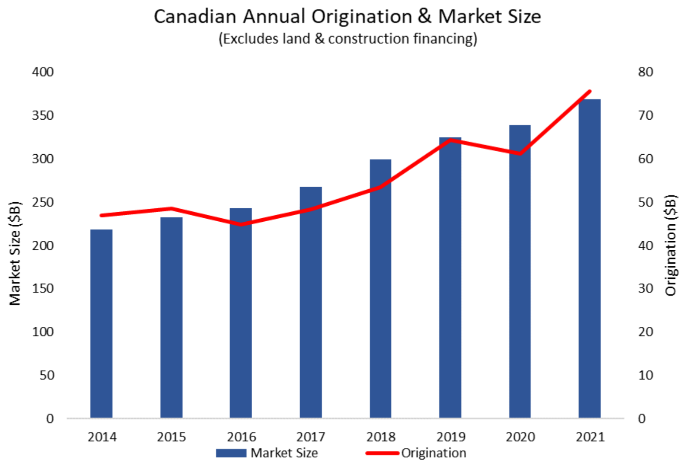
Commercial Mortgage Commentary

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, Construction Financing, First Mortgage Bonds and Senior Unsecured debt for REITs and REOCs.

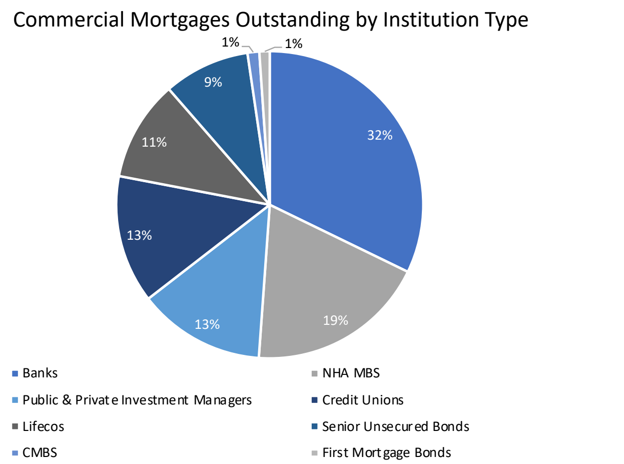
Making News

Commercial Mortgage Market Approaches $370B

Results from Intellifi's 12th Annual Commercial Mortgage Survey point to a robust lending environment in 2021, lifting outstanding commercial mortgage debt in Canada 9% year-over-year to $368.7 billion. Following a slight decline in 2020, origination rose to a record $75.6 billion in 2021, up 24% year-over-year. The results confirm lenders' strong preference for multi-family product since the onset of the pandemic, which accounts for 54% of total origination. Prior to 2020, multi-family consistently accounted for 40-45% of origination volume. Banks continue to own the largest share of the outstanding market at about a third, while market share of insured mortgages securitized through the NHA MBS program has nearly doubled since 2015 to 19%. Regionally, Ontario remains the largest share of the market at 40% and BC is second at 20%. Looking at property types, office and retail make up roughly 38% of the market, down 5 percentage points from pre-pandemic levels. In contrast, strong demand for industrial product has lifted market share by 3 percentage points to around 12%.



Source: Intellifi



Source: Intellifi

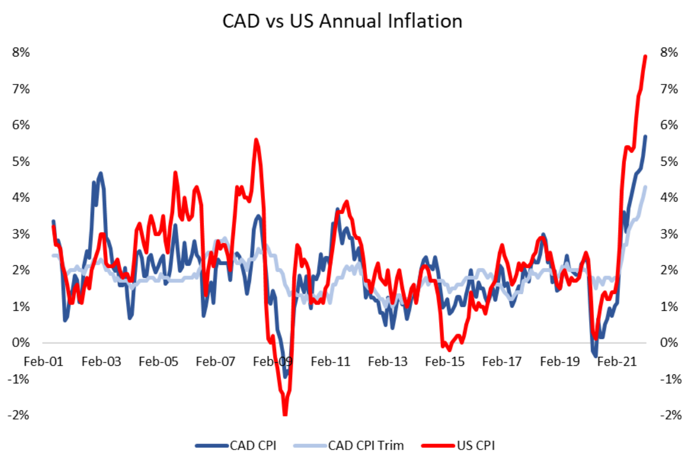
If you are a commercial mortgage lender and are interested in obtaining a copy of the survey, contact mortgageanalytics@intellifi.ca for more info.

CMLS Financial®

Economic Environment

Ukraine War Poses Further Challenges for Economy

As the humanitarian crisis caused by Russia's invasion of Ukraine continues to unfold, reverberations are being felt the world over via rising commodity prices, trade disruptions and greater market volatility – all factors that are expected to weigh on global growth. Canada's limited trade exposure with Russia and large oil and gas industry will offset some of the negative economic impacts, but consumers are expected to face further headwinds. Higher commodity prices and further supply chain disruptions will likely accelerate already elevated inflation. Headline inflation hit a 3-decade high of 5.7% in February (prior to the invasion), the 11th consecutive month it has surpassed the Bank of Canada's (BoC) mandated target range of 1-3%. Furthermore, CPI Trim, a measure of inflation that excludes 40% of the most extreme price variations, hit 4.3% in February. The indicator surpassed 3% in July 2021 for the first time in available data back to 1995 and points to more widespread upward price pressure. The BoC took its first step to tamp inflation with a 25bps rate hike in early March and followed that with an oversized hike of 50bps in April. The last time the Bank hiked rates by 50bps at a single meeting was May 2000. Economists from Canada's major banks all see the overnight lending rate climbing to between 2-3% by year end from 1% currently, which insinuates several more hikes by the BoC through 2022.

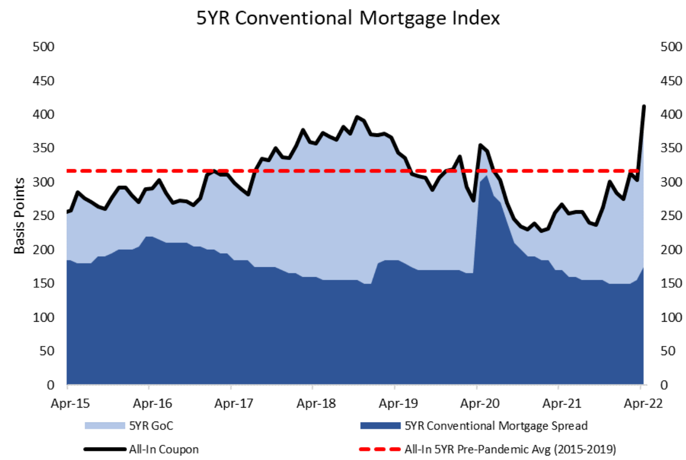


Source: Statistics Canada, Bank of Canada, U.S. Bureau of Labor Statistics

Conventional

Mortgage Rates Surpass Pre-Pandemic Levels

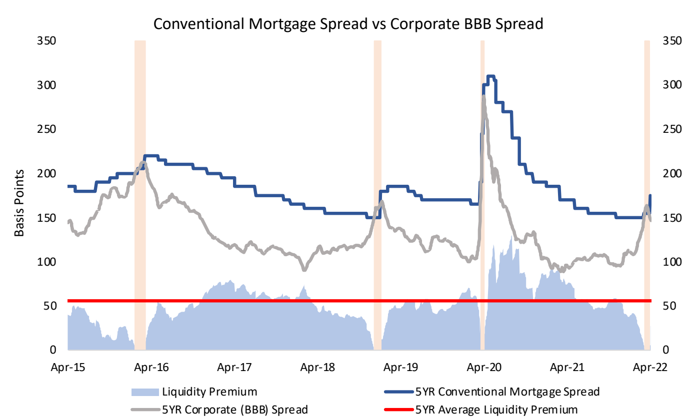
Government of Canada (GoC) bond yields continued to surge in Q1, with the 5-year up 112bps to close the quarter at 2.37%. Seventy-nine percent (89bps) of that rise occurred in March alone and follows a 43bps rise in Q4 2021. As per Intellifi's conventional mortgage index, the sharp increase in yields has pushed the all-in 5-year conventional mortgage rate to 4.12%, officially eclipsing its 5-year pre-pandemic average of 3.16%. Government bond yields cratered at the onset of the pandemic as investors fled to safe assets and central banks slashed interest rates, ushering in some of the lowest borrowing costs in a generation by mid-2020. All-in coupons based on Intellifi's conventional mortgage index began 2021 at 2.27% and averaged 2.60% through the whole of last year. Thus far, the rise in mortgage rates has primarily been a function of rising GoC yields, which have climbed in response to inflation concerns and tightening monetary policy, among other things.



Source: Intellifi, Bloomberg

Key Indicators Point to Rising Mortgage Spreads

Investment grade corporate bond yields rose sharply in Q1 in conjunction with the wider bond market. The spread between 5-year BBB-rated corporate bond yields and GoC bond yields – generally a leading indicator for the direction of commercial mortgage spreads – was up 32bps in the quarter to close at 143bps. Over the past 5 years, conventional mortgage spreads have on average maintained a 56bps liquidity premium to their corporate counterparts. That premium was quickly erased in early March, marking just the fourth such instance in data going back to 2009. The 3 previous occasions all coincided with a sharp rise in conventional mortgage spreads. Direct market intel suggests that mortgage lenders have indeed shifted their pricing guidance higher, although it remains to be seen where exactly spreads will settle. In the conventional space, adjustments have ranged anywhere from a 20-50bps increase.



Source: Intellifi, Bloomberg

CMHC

CMHC Rolls Out New MLI Select Program

CMHC launched its new MLI Select insurance product for multi-residential mortgages on March 7th. The program is available for newly constructed and existing properties and offers more favourable financing terms for borrowers who commit to affordable, accessible and sustainable rental housing. Properties are allocated points based on the percentage of units offered at below-market rents, GHG reduction targets and the degree by which physical barriers are removed to make the property more accessible. Depending on the property's score, borrowers can access various levels of reduced insurance premiums, higher leverage and longer amortization periods. The highest ranked properties are eligible for insurance premiums as low as 1% of mortgage proceeds, LTC/LTV ratios up to 95% and amortization periods up to 50 years. Uptake thus far has been largely positive with borrowers appreciative of the added benefits and flexibility compared to CMHC's previous MLI Flex Program. If you are interested in learning more about this program, reach out to your CMLS contact.

Insured Spreads Stable as Rising Bond Yields Push Up Coupons

In stride with the conventional space, Intellifi's insured mortgage index climbed significantly in Q1. The 5-year all-in rate closed the quarter at 3.17%, well above its 5-year pre-pandemic average of 2.22%. Surging Canada Mortgage Bond (CMB) yields, the preferred base rate for insured financing, were the primary driver with the 5-year yield up 118bps in Q1 to 2.74%. Contrary to the conventional space, however, spreads for higher quality insured deals remain relatively flat in the range of 45-50bps over CMB. There continue to be instances of deals pricing sharper, although these appear to largely be one-offs and not reflective of current market conditions overall. Reports indicate that some banks, who often benefit from a lower cost of funds relative to other lenders, have been seen pricing as low as 35bps over CMB to win the highest quality deals. Contact CMLS to discuss term and spread options for your project.

Construction

Developers Shift Focus to Condos as Rates Rise

Some developers are reassessing their product preferences as rising interest rates and construction costs challenge the economics of new rental housing. Market intel suggests that developers are increasingly turning to condo development to lock in cashflows in the wake of escalating condo prices across Canada. As per the MLS Home Price Index, national benchmark condo prices reached $597,500 in February, up $129,200 (28%) since January 2021. In larger urban markets like Toronto and Vancouver, benchmark condo prices reached $769,600 and $807,900 in February, up 33% and 19% respectively since January 2021. Although the rising interest rate environment is pushing up borrowing costs on floating rate construction loans, pricing continues to be competitive, especially in the CMHC insured space. Lender intel suggests that pricing remains around prime (2.70% as of Q1) for insured floating deals, with some lenders dipping as low as prime minus 50bps (2.20% as of Q1) for high quality developers.

High Yield

Activity Climbs for Office and Retail

The rising interest rate environment has led to an increasing preference by high yield lenders to issue floating rate debt. Fixed rate terms appear to still be widely available, albeit at a notable premium to their floating rate counterparts. With market liquidity still elevated, competition for new deals remains strong. Banks have been reported to still have market-leading pricing in many instances thanks to a relatively cheaper cost of funds.

Continuous inflows of capital into the high yield lending space have led to a broadening of risk appetite from some lenders. This is best epitomized by the growing number of subordinate loans on office and retail assets that have been observed as of late – something that was wholly avoided by many lenders a year ago. Direct market intel suggests this may be due in part to differences in underwriting and comfortability around assuming the collateral in a worst-case scenario. Lenders with access to, and close ties with, an in-house equity team may be more willing to extend extra leverage given a higher degree of confidence in the valuation and outlook of specific properties. This may be a result of the often more robust analysis on a region and property that is conducted when looking to purchase said property. The in-house equity experience may also provide an extra level of comfort for the lender around assuming the collateral should the borrower default.

CMBS

RBC and BMO Reignite the CMBS Market

The final quarter of 2021 saw the Real Estate Asset Liquidity Trust (REAL-T) re-open the Canadian CMBS market with the first transaction since Q1 2020. REAL-T 2021-1 consists of 79 loans secured by 150 commercial properties for an aggregate principal balance of $543.7 million. RBC contributed approximately 83% of the mortgages to the pool and BMO contributed the remainder. The CMBS was issued with a 3.87% weighted average interest rate and an 85-month weighted average term to maturity. Multi-family and industrial properties make up the greatest proportion of the mortgage pool at 30% and 18%, while Ontario and Alberta had the largest regional contributions at 43% and 18%, respectively. The Class A tranche was rated AAA by DBRS and carried a 13% subordination level (87% of the bonds were rated AAA). As per Intellifi's 2021 Annual Commercial Mortgage Survey, CMBS issuances last year were down 80% relative to 2015 when they reached $2.7 billion and accounted for 6% of total mortgage origination. Market share of CMBS has declined in recent years to just over 1% of outstanding commercial mortgage debt versus 3% in 2015.

Deals	Issue Size Millions ($)	# of Loans	Wtd. Avg. Interest Rate	Wtd. Avg. LTV at Issuance	Wtd. Avg. DSC at Issuance
REAL-T 2021-1	544	79	3.868%	65.3%	1.49x

Source: DBRS Morningstar November 2021 Rating Report

Senior Unsecured Debt

Issuances Sag to Kick Off 2022

After an active final quarter to close 2021, issuances of senior unsecured bonds were down 56% quarter-over-quarter to start the year, totaling $1.3 billion across 5 transactions. Primaris REIT, the enclosed mall portfolio that was spun off by H&R REIT in the fall of 2021, held an inaugural bond offering of $350 million at the end of March. Green bond issuances accounted for just over 50% of the total, down relative to previous quarters.

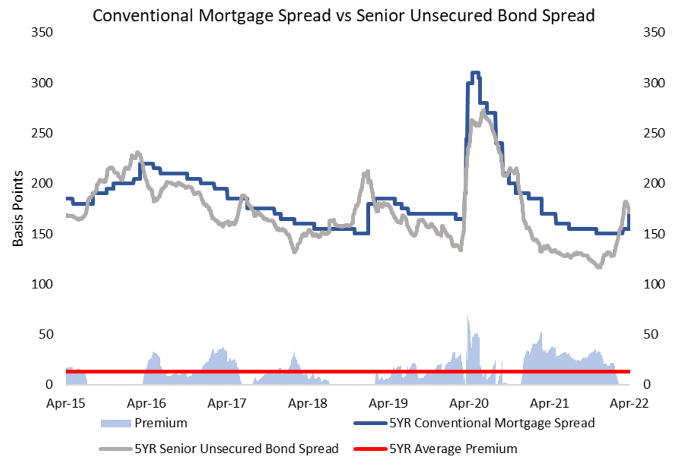
Of note this quarter, proceeds from the $250 million issuance by Canadian Core Real Estate LP (CCRE) will be used toward the acquisition of two top tier office properties – the 810,000 sf Jamieson Place in downtown Calgary and the 430,000 sf 745 Thurlow in downtown Vancouver. Both offices have received LEED Gold certification and are thus deemed eligible green projects under CCRE's green bond framework. The transactions are part of a wider partnership between QuadReal, the real estate division of British Columbia Investment Management Corporation (BCI), and RBC Global Asset Management that was announced in 2019. At the time, QuadReal agreed to sell a 50% interest in 40 high-quality Canadian commercial properties over several years for the development of RBC GAM's new $7 billion Canadian Core Real Estate Fund. QuadReal will maintain its role as property manager across the portfolio on behalf of BCI and the fund.

2022	Issuer Name	Issue Size Millions ($)	Issuance Rating	Term (Yrs)	Coupon	Spread (bps)
Q1	CT REIT	250	BBB	7.0	3.03%	145.1
	BCI QuadReal Realty	400	AA-	4.4	2.55%	91.3
	Canadian Core Real Estate LP	250	A-	5.0	3.30%	150.4
	Primaris REIT	150	BBB	5.0	4.73%	222.1
	Primaris REIT	200	BBB	3.0	4.27%	185.1
	Q1 Averages	250		4.9	3.33%	144.6
	Q1 Total Issue Size	1,250				

Source: Bloomberg

Senior Unsecured Spreads Rise Sharply in Q1

Similar to corporate bond spreads, the spread over GoC on 5-year senior unsecured bonds for Canadian REITs closed the quarter at 171bps, up 41bps from the beginning of the year. That sharp rise quickly erased the premium on conventional mortgage spreads, which has averaged approximately 15bps over the past 5 years. The jump provides further indication as to the likely upward direction of mortgage spreads in the weeks ahead as lenders reassess their pricing expectations in a more volatile and uncertain economic environment.



Source: Intellifi, Bloomberg

ABOUT CMLS FINANCIAL

CMLS Financial is one of Canada's largest independently owned mortgage services companies. Founded in 1974, we are proud to be Canada's Mortgage Company™ for over 40 years. With offices across the country, we provide a wide range of commercial lending services, residential real estate mortgages and institutional services.

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