AUGUST 2017

Commercial Mortgage Commentary

CANADA'S MORTGAGE COMPANY™

In the News

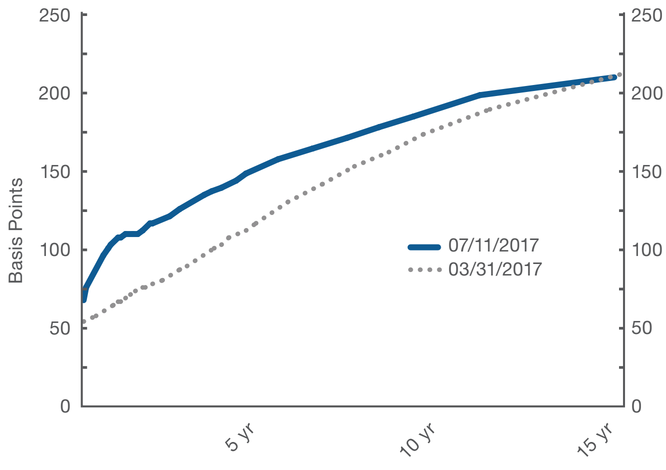
Bank of Canada: The Bank of Canada ("BoC") raised its target overnight interest rate from 0.50% to 0.75% on July 12th, marking the first rate hike in almost 7 years. The increase was anticipated by the market, as evidenced by the rapid rise in Government of Canada ("GoC") yields in the weeks preceding the announcement. From early May to end of July, 5-yr GoCs increased by approximately 70 basis points ("bps").

Home Capital Group: Home Capital Group ("HCG") closed a $150 million equity investment and a $2 billion line of credit with Berkshire Hathaway Inc ("BHI") in late June. The equity investment represents a 20% stake in HCG. BHI has agreed to a further $250 million equity investment (raising their stake to 38.4%) subject to HCG shareholder approval later in September. HCG has also entered into multiple mortgage sale agreements, including a $1.2 billion commercial mortgage asset sale to Kingsett Capital for 97% of the outstanding principal. The proceeds of mortgage sales were used to repay credit facilities in full (including the BHI facility), and since June 1, HCG has improved their aggregate liquidity and credit capacity from $1.1 billion to $3.6 billion.

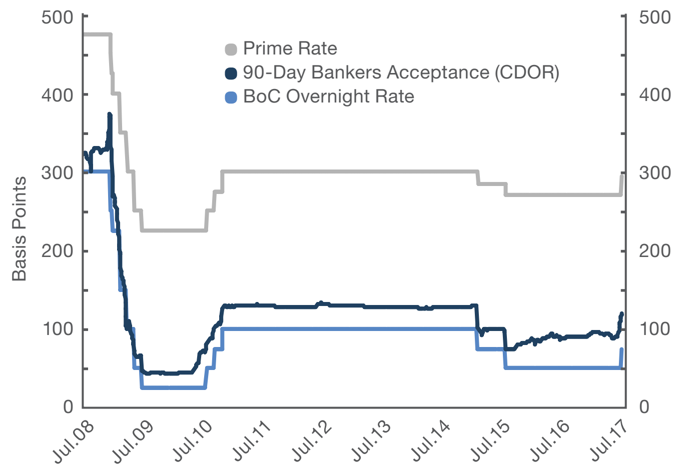
Canada's Big Six: In May 2017, Moody's Investors Service downgraded the credit ratings of Canada's big six banks one notch, citing increased vulnerability from rising consumer debt and housing prices. The downgrade placed upwards pressure on bank borrowing through deposit note spreads.

Floating Rate Indexes: Floating rate indexes have demonstrated a history of moving almost lock-step with the overnight interest rate, and as such, movements have favoured borrowers over the past 7 years. Yields on 90-day Bankers Acceptance increased by 30 bps in anticipation of the BoC rate hike, and following the official announcement, all major financial institutions increased prime rate by 25 bps to 2.95%. Floating rate loans make a sizeable portion of commercial mortgage financing and are often utilized for construction and high-yield loans.

Rise and flattening of the GoC yield curve in anticipation of a rate hike



Floating rate benchmarks on the rise with latest BoC announcement



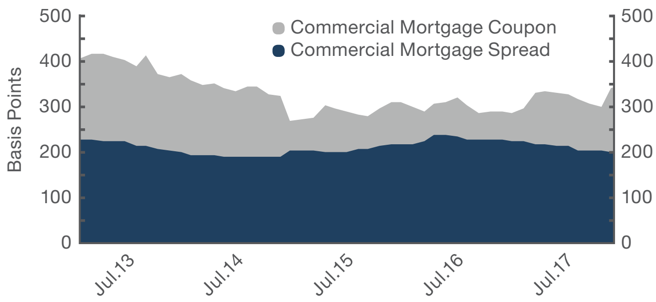
Source: Bloomberg, CMLS

Commercial Spreads

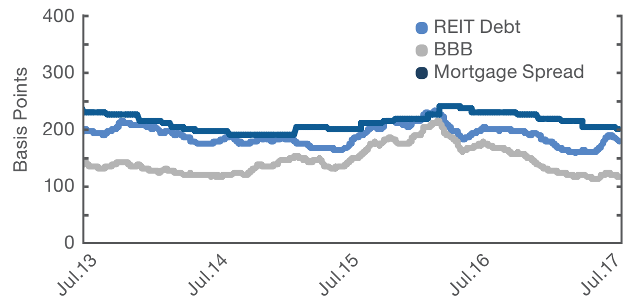
Since May 2017, spreads on high quality commercial mortgages tightened by 10 to 15 bps and currently range 160 to 180 bps on 5-yr and 170 to 195 bps on 10-yr deals. In addition to a general decrease in spreads, a flattening in the credit curve was observed as spreads on longer duration commercial mortgages fell by more than their shorter duration counterparts.

From a lender standpoint, the liquidity premium of commercial mortgages over corporates continues to shrink. As of July, commercial mortgages earned a 70 bps premium over BBB-corporate bonds, slightly below the 5-yr average premium of 75 bps. Spreads on REIT-backed debt rose modestly by 5 to 10 bps since May 2017, and price at spreads close to 170 bps for 5-yr BBB rated REIT issuers.

Spreads continue their descent while GoC yields climb



Commercial spreads inch towards Corporates



Source: Bloomberg, CMLS

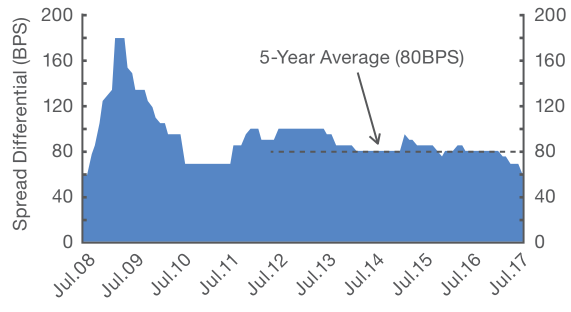
CMHC

CMHC-insured mortgages offer an attractive risk and reward for lenders looking to earn additional yield while maintaining an indirect guarantee from the Government of Canada. Spreads on CMHC-insured products currently range between 90 to 95 bps over GoC on 5-yr terms, and between 95 to 100 bps over GoC on 10-yr terms. Since the start of 2017, spreads on insured mortgages have remained stable in comparison to spreads on uninsured mortgages which have come in by almost 25 bps. As of July, uninsured mortgages earned an additional 60 bps of yield over insured mortgages, marking the narrowest differential between the two securities in almost a decade and well below the 5 year average of 80 bps.

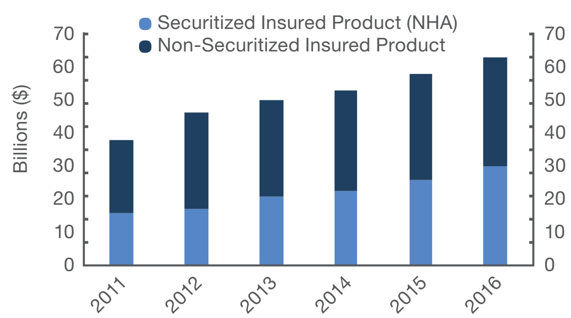
The size of the CMHC-insured multi-unit residential market has increased significantly in recent years. CMHC's Q1/17 Financial Report indicated approximately $63 billion in multi-unit residential insurance-in-force ("IIF") – almost twice the IIF in 2010. As a percentage of the overall commercial mortgage market, insured multi-family mortgages represented 30% of market outstanding balance at the end of 2016, a significant increase from 20% in 2010.

Whereas the vast majority of uninsured mortgages are originated and held until maturity, approximately 50% to 60% of insured mortgages are originated for the purpose of securitization into the National Housing Act Mortgage Back Security ("NHA") program run by CMHC. As such, a significant portion of lenders quote directly off the Canada Mortgage Bond ("CMB"), which rose by a similar amount to GoCs.

The spread differential between uninsured and insured mortgages nears a 10 year low



Total insurance-in-force ("IIF") doubled for multi-unit residential properties over the past 7 years



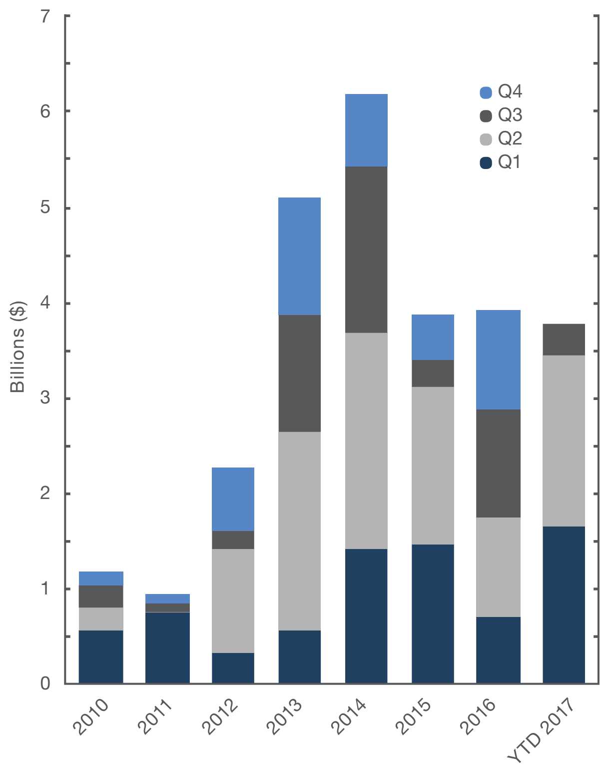
Source: CMHC, CMLS

Senior Unsecured Debt

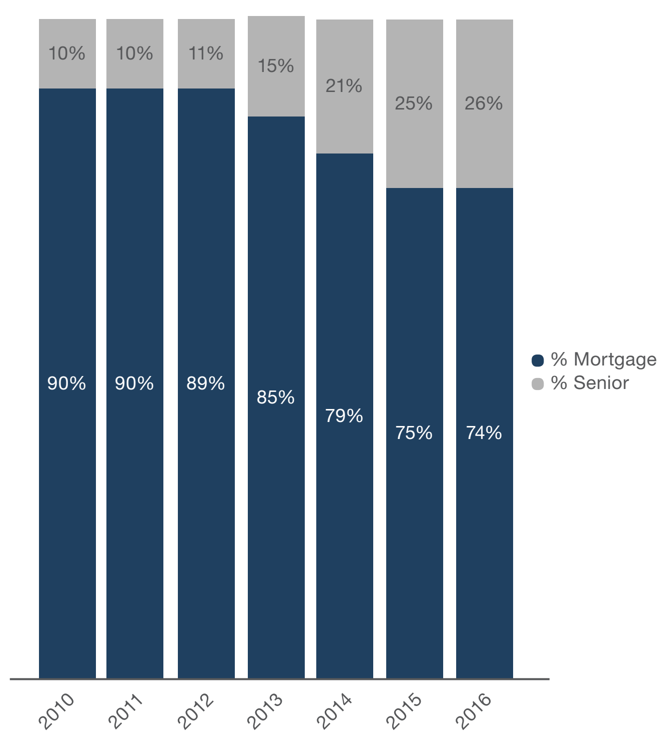
Year-to-date issuance for senior unsecured debt issued by REITs/REOCs reached $3.8 billion, nearly surpassing total 2016 issuance and keeping on pace with the record issuance year of 2014. AimCo's $400 million 7-yr note (AAL), priced at a spread of 97 bps, was the largest issuance in Q2/17. First Capital Realty is the lone senior unsecured issuer so far in Q3/17, coming to market with a $300 million 10-yr note (BBBH), priced at a spread of 195.7 bps.

Unsecured debt continues to gain momentum amongst credit-rated REITs/REOCs as a flexible financing option with comparable spreads to conventional mortgages. Investors are equally drawn towards the security, benefiting with a higher yield pickup relative to other corporates alongside the security of a real estate backed asset. Investors have shown strong appetite for the security recently, which historically has earned a yield premium over the general BBB-corporate index.

Issuance in the first half of 2017 nearly surpasses total annual issuance in 2016, and is on pace with 2014



Preference for debt amongst credit-rated REITs/REOCs gradually shifting towards senior unsecureds



Source: Bloomberg, DBRS

High Yield

There were two debt offerings by Mortgage Investment Corporations ("MIC") in Q2/17. The first offering was completed by Atrium MIC. Due June 30, 2024, the offering of convertible unsecured subordinated debt carries an aggregate principal of $22 million, an interest rate of 5.30% and a conversion price of $14.94 per share.

The second offering was completed by Firm Capital MIC. Firm Capital issued convertible unsubordinated debt of $26.5 million at a rate of 5.30%. The debentures are set to mature on August 31, 2024 with a conversion price of $15.25 per share.

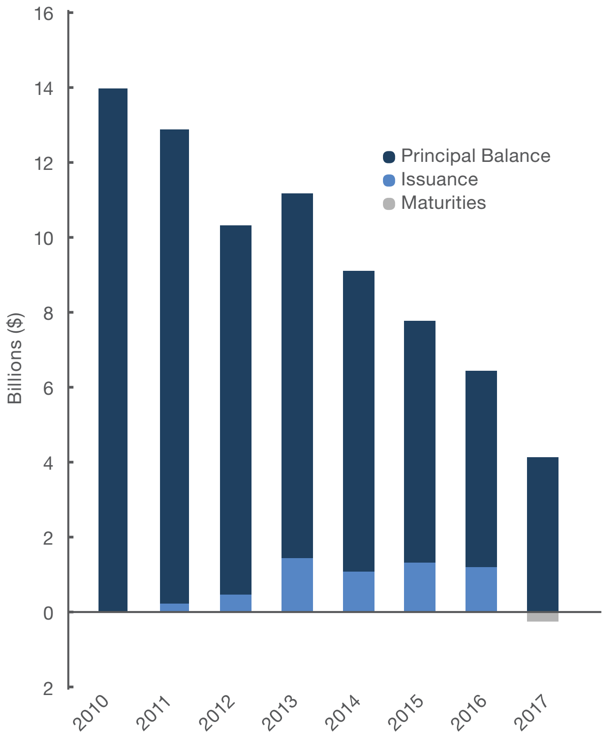
In May 2017, Trez Capital MIC ("TZZ") received approval from the Toronto Stock Exchange for the renewal of its normal course issuer bid that will allow it to repurchase up to 10% of its public float. The share repurchase is instrumental in TZZ's intention for an orderly wind-up of the MIC.

CMBS

There have been no executed CMBS issues thus far in 2017 as pricing continues to be the hurdle in the inactive Canadian CMBS market. RBC's 2017-1 series was expected to market this spring; however, the transaction was not closed successfully and DBRS withdrew its provisional rating. According to the 2017-1 Presale Report by DBRS, the issue was planned to be $360 million and contained 60 loans backed by 73 properties. The portfolio had a weighted average term of 7 years and DSCR of 1.38x at the time of the original rating.

Approximately $4 billion in outstanding balance remains in the CMBS market, representing less than 2% of the overall commercial mortgage market (down considerably from the 10% market share in 2010). $315 million in CMBS loans are scheduled to mature for the remainder of 2017.

CMBS balance and market share decreases year after year



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.

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