FEBRUARY 2016

Commercial Mortgage Commentary

CANADA'S MORTGAGE COMPANY™

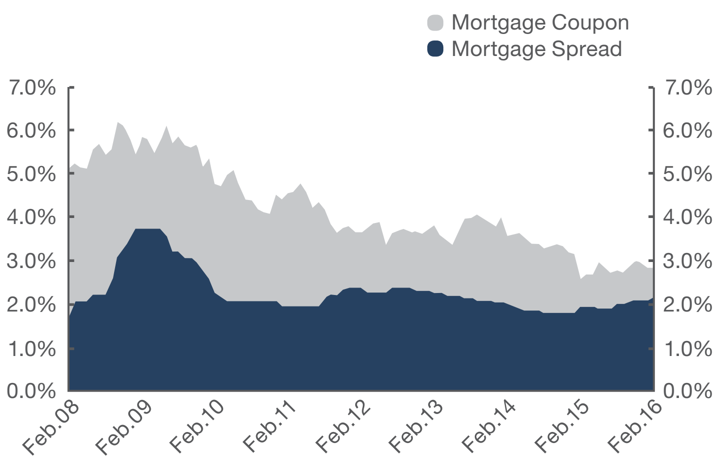
Commercial Spreads

Volatility and risk continue to weigh on investors' minds thus far in 2016. Despite the Fed rate hike in December, 5-year US Treasuries have tightened almost 42 bps to-date, reflecting a renewed flight to quality. The 5-year Canadian government bond tightened to a lesser extent, moving in almost 20 bps over the same period as investors temper expectations for further rate cuts. Swap markets in Canada are now pricing in a 30% chance of a rate cut for the Bank of Canada meeting in March, down meaningfully from a high of 73% on January 15.

As investors seek to improve credit quality and liquidity, corporate credit spreads continue to move wider, with 5-year A-rated credits moving up 22 bps and 5-year BBB-rated credits moving up 32 bps year-to-date in 2016. As a result of the recent poor performance of the equity and corporate credit markets vs. the performance of the commercial mortgage market where spreads tend to be "stickier", we expect the availability of commercial mortgage credit may be more constrained than usual for this time of year, driven in part by the need to rebalance portfolios for certain lenders.

We believe commercial mortgage spreads on high-quality assets are currently being priced in the 190 bps to 205 bps range for 5-year deals and 205 bps to 210 bps for 10-year deals, up approximately 15 bps over Q3/15. This primarily reflects continued spread widening in the credit markets, an increased focus on liquidity given recent market volatility, and slightly lower availability of capital for this time of year.

Commercial Mortgage Spreads



Source: CMHC, CMLS

CMHC

On December 11 the Canada Mortgage and Housing Corporation (CMHC) announced increases to the fees charged to issuers for the timely payment guarantee of interest and principal on market NHA MBS and NHA MBS sold into the CMB. The changes are effective July 1, 2016, and apply to issuers who exceed an annual NHA MBS limit of $7.5 billion (up from $6.0 billion). No changes were made to the NHA MBS guarantee fees below the threshold.

The increase in guarantee fees is targeted at larger issuers (i.e., those issuing above the threshold) and those using the CMB to fund vs. market NHA MBS. Of the total $166 billion of NHA MBS issued in 2015, approximately 25% was sold into the CMB. As we approach the July 1 effective date, we estimate that the increase in funding costs could put upward pressure on CMHC-insured multi-family loans of approximately 0 bps to 5 bps for 5-year loans and approximately 5 bps to 10 bps for 10-year loans.

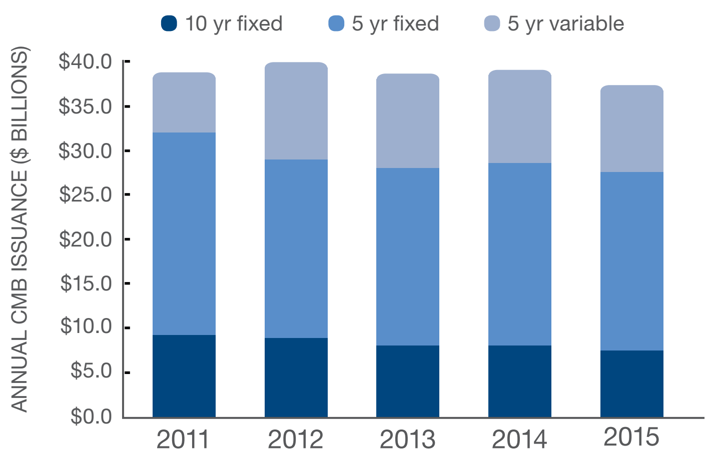
Canada Housing Trust issued $37.25 billion of Canadian Mortgage Bonds for the 2015 calendar year, of which $20.0 billion was 5-year fixed with $7.5 billion being 10-year fixed and $9.75 billion in 5-year floating rate note issuances (FRN). Total issuance in 2015 declined 4.5% year-over-year over 2014, driven largely by a decrease in investor demand for 10-year and FRN issuances.

CMHC Guarantee Fee Increase

Guarantee Fee & NHA MBS Threshold	Prior to July 1, 2016		As of July 1, 2016	
NHA MBS Guarantee Fee Threshold	≤ $6.0 Billion	> 6.0 Billion	≤ $7.5 Billion	> 7.5 Billion
5 Year NHA MBS	30 BPS	60 BPS	30 BPS	80 BPS
10 Year NHA MBS	53 BPS	106 BPS	53 BPS	141 BPS
5 Year CMB	40 BPS		30 BPS + Applicable NHA MBS Fee	
10 Year CMB	80 BPS		60 BPS + Applicable NHA MBS Fee	

Source: CMHC, CMLS Financial

CMB Issuance Down 4.5% Y/Y on Weaker Investor Demand for 10-Year and FRN Product



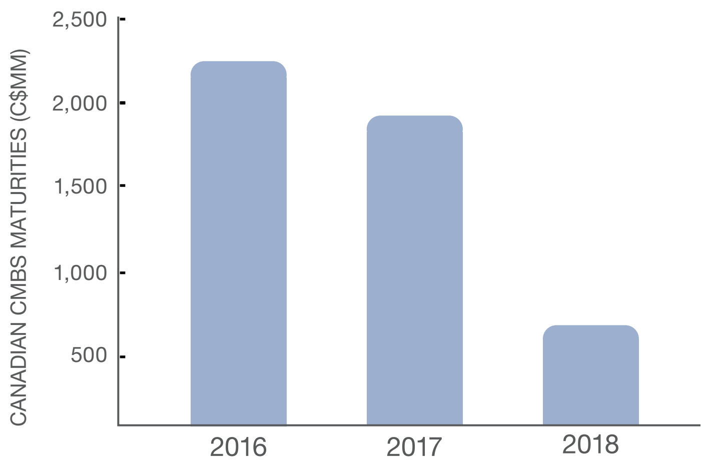
Source: Bloomberg, CMHC, CMLS Financial

CMBS

Issuers continue to find it challenging to price new loans competitively given increased funding costs as a result of higher volatility and risk being priced into the credit markets since Q3/15. Less liquid securities (e.g., CMBS) and riskier assets (e.g., bank NVCC subordinated debt) have been hit the hardest. As a result, we expect conduit pricing to be generally wide of market and availability of funds to continue to be limited.

There is approximately $2.3 billion of CMBS maturities coming due in 2016. With limited availability from conduits, it's likely the majority of CMBS renewals in 2016 will go to balance sheet lenders unless market conditions change in the near-term.

Canadian CMBS Maturities Loom in 2016/2017



Source: DBRS, CMLS Financial

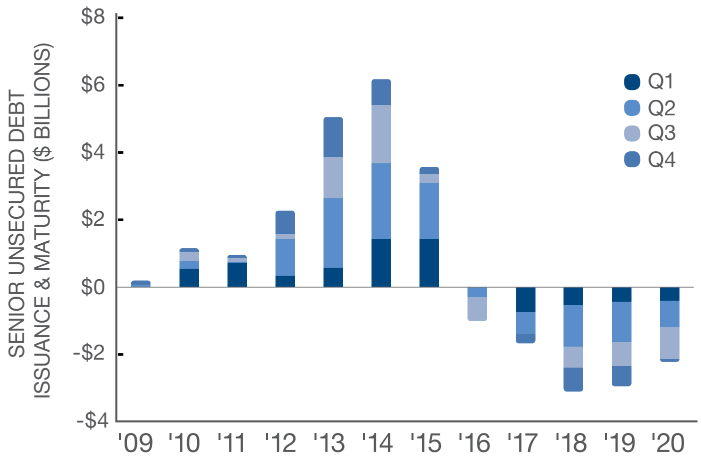
Senior Unsecured Debt

Real estate unsecured financing slowed significantly in Q4/15 with only two new issuances during the quarter. In November, Choice Properties Real Estate Investment Trust issued $200 million of 10-year BBB-rated senior unsecured notes at a spread of 235 bps, and in December HCN Canadian Holdings LP-1 issued $300 million of 5-year BBB-rated senior unsecured notes at a spread of 240 bps. HCN Canadian Holdings LP-1 is a wholly owned subsidiary of Welltower Inc., an American-based real estate investment trust specializing in senior housing.

Total real estate unsecured debt issuance in 2015 was $3.875 billion across 18 deals, down 37% year-over-year from a record high of $6.175 billion across 28 deals in 2014. There was a notable slowdown in issuance in the second half of 2015 with issuance of $775 million across 4 deals vs. $3.1 billion across 14 deals in the first half of 2015, reflecting higher spreads and lower investor demand.

Given the deep discount at which REITs are currently trading to their net asset value (NAV), we may see some REITs look to strategically monetize certain assets given the disconnect between private market commercial real estate valuations and the valuations implied by current share prices. If proceeds are used to buy back shares, we could see a narrowing of the discount to NAV which would bode well for equity investors, but would be seen as a negative for unsecured real estate debt holders. As a result, we expect spreads to generally remain wide, particularly for those REITs trading at a significant discount to NAV, and we anticipate those REITs that are trading wide to prefer secured debt over unsecured debt.

Unsecured Real Estate Debt Issuance/Maturities



Source: DBRS, CMLS Financial

2015 Unsecured Real Estate Debt Issuance

	Issuer Name	Issue Size Millions ($)	Issuance Rating	Term (yrs)	Spread (bps)
Q1	RioCan	300	BBB (high)	9	215
	Crombie	125	BBB (low)	5	220
	Calloway	160	BBB	10	239
	Choice Properties	250	BBB	6	160
	CREIT	100	BBB	5	186
	Ventas	250	BBB+	7	182
	First Capital (re-opening)	90	BBB (high)	11	213
	RioCan (re-opening)	175	BBB	4	150
Q2	Allied Properties	150	BBB (low)	5	270
	Cominar	300	BBB (low)	7	280
	CT	150	BBB (high)	7	155
	bcIMC	500	AA	10	124
	CT	200	BBB (high)	10	187
	bcIMC	350	AA	6	104
Q3	H&R	200	BBB (high)	3.5	CDOR + 143
	Allied Properties REIT (re-opening)	75	BBB (low)	5	295
Q4	Choice Properties	200	BBB	10	235
	HCN Canadian Holdings	300	BBB	5	240
	Total	**$3,875**			

Source: Bloomberg, CMLS Financial

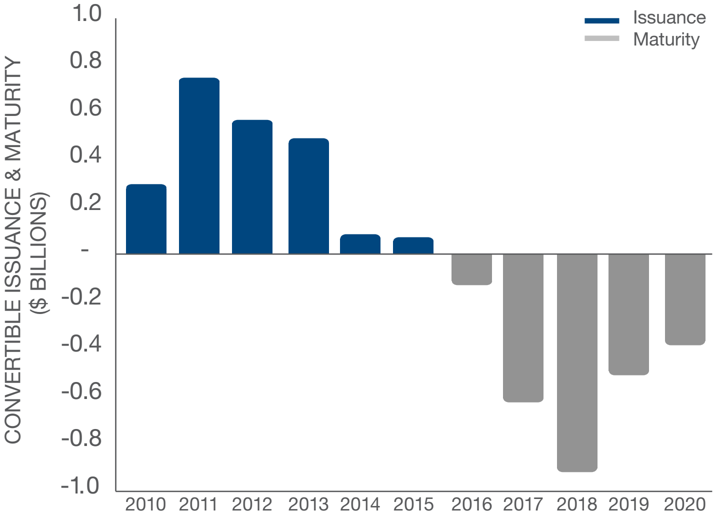
Convertible Debt

2015 has been a slow year for issuance of convertible debentures with only two issuances totalling $75 million, down significantly from its peak in 2011 of $751 million. Convertible debt has fallen out of favour over the last few years as investors seek out competing high yield product.

Northwest Healthcare Properties REIT issued $50 million in October 2015 with a 5.50% coupon at a premium of 29.16%, and in December BTB REIT issued $25 million with a 7.15% coupon at a premium of 21.80%.

Convertible debenture maturities are set to increase steadily over the next 3 years, with $1.55 billion coming due in 2017 and 2018. There is only a minimal amount of convertible debt coming due in 2016.

Convertible Debt Issuance / Maturity



Source: Bloomberg, CMLS

Events Calendar

Date	Event
Commercial Real Estate Industry Events	
Feb. 9	Quebec Apartment Investment Centre (Montreal)
Feb. 23	RealCapital (Toronto)
Mar. 30	Vancouver Real Estate Forum
Apr. 5	Montreal Real Estate Forum
Apr. 27	Quebec City Real Estate Forum
Economic Data Releases	
Feb. 5	January Employment (CAN & US)
Feb. 26	Q4 GDP Second Revision (US)
Mar. 1	December GDP (CAN)
Mar. 4	February Employment (US)
Mar. 9	Bank of Canada Rate Announcement
Mar. 11	February Employment (CAN)
Mar. 16	Federal Open Market Committee Meeting (US)
Mar. 25	Q4 GDP Third Revision (US)
Mar. 31	January 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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