CANADA'S MORTGAGE COMPANY™

NOVEMBER 2016

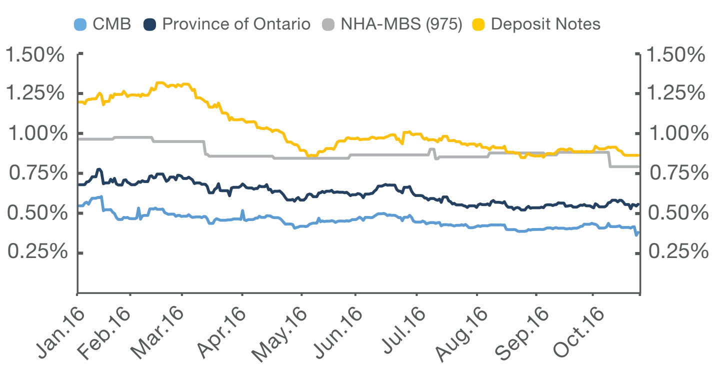
Commercial Mortgage Commentary

Introduction

Credit spreads on high quality fixed income and real estate related securities continued to inch tighter since Q1/16, with CMBs trading at year-to-date lows around 36 bps back of government of Canada bonds, 25 bps lower than a wide of 61 bps back in Q1/16. Similarly, syndicated new issuance of NHA-MBS (975 pools) are currently pricing around 80bps, approximately 20 bps lower than Q1/16 highs of 100 bps.

As of the date of writing, Government of Canada base rates, on the other hand, are currently trading in-line with the start of the year. Given the declining trend in credit spreads highlighted above and a flat trend in base rates year-to-date, credit risk spread now makes up less as a percentage of the total investment return than it did at the beginning of the year. Said differently, investors are generally now accepting less compensation per unit of risk than they were back in Q1/16.

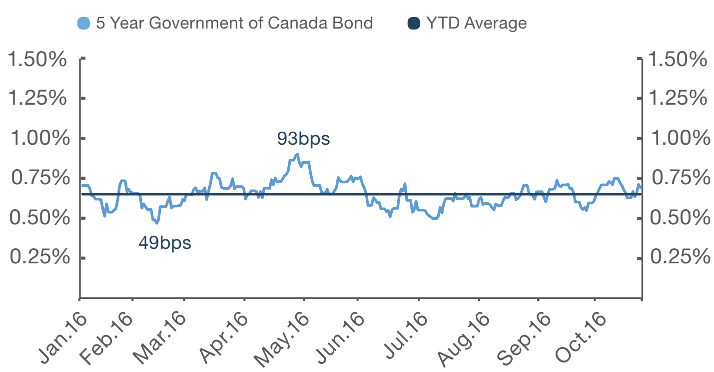
5-year credit spreads move tighter year-to-date



Source: Bloomberg, Casgrain, CMLS Mortgage Analytics

Notes: NHA-MBS (975) pools typically have a 4-year weighted average life

5-year Government of Canada bond yield flat year-to-date



Source: Bloomberg, CMLS Mortgage Analytics

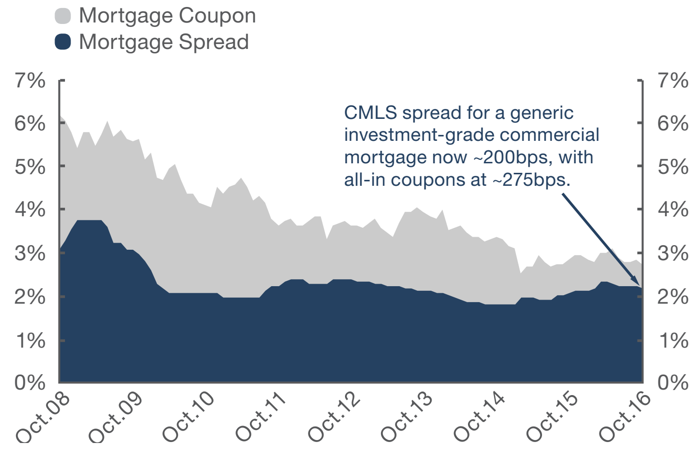
Commercial Spreads

Indicative commercial mortgage spreads on high-quality assets are currently being priced in the 185 to 210 bps range for 5-year deals and 200 to 225 bps for 10-year deals. This represents a decrease of 5 bps over Q2/16, driven largely by a renewed increase in capital chasing deals after the summer doldrums. We anticipate those lenders that had a slow start to the year may be looking to fill their remaining allocation in Q4, adding increased competition which tends to drive spreads lower, all else equal.

The tightening bias has also been reflected in the capital markets with senior unsecured REIT debt tightening approximately 15 bps since the end of Q3/16. There also appeared to be better tone in the real estate structured finance market as well, with strong investor demand for REAL-T's second offering of 2016 in mid-September. However, some of the momentum in the structured finance market retraced in late October with the pricing of IMSC 2016-7 coming in wide of the REAL-T issue.

From a quality perspective, although lenders' bias remains to more liquid and less volatile markets/asset classes (e.g. Toronto multifamily vs. Calgary office...etc.), we are hearing that some lenders are warming back up to the Alberta market selectively as the price of oil has rebounded from its lows in Q1/16.

Commercial mortgage spreads tighten slightly over Q2/16



Source: CMLS Mortgage Analytics

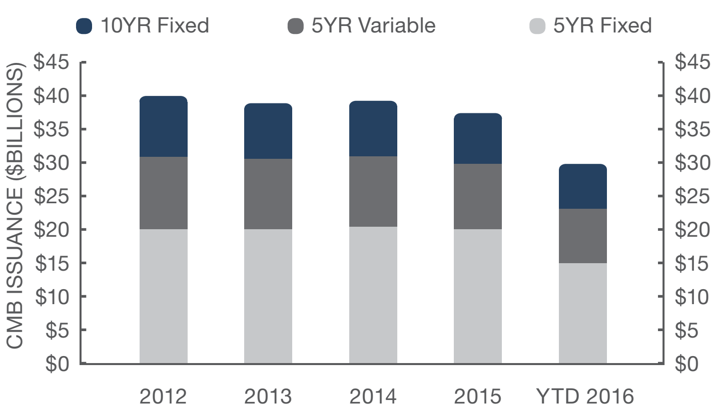
CMHC

Canada Housing Trust issued $10.25 billion of Canada Mortgage Bonds in Q3/16, bringing the year-to-date total to $30.25 billion, up 7.1% from $28.25 billion over the first three quarters of 2015. Current quarter issuance included a $2.75 billion, 5-year floating rate note, a $2.5 billion 10-year fixed rate note, and a $5.0 billion, 5-year fixed-rate note.

We anticipate another +/- $9.75 billion of CMB issuance in Q4/16 spread across three issues: a re-opening of the 10-year fixed 9/15/2026 maturity pool and an initial opening of the 5-year variable-rate 3/15/2022 maturity pool, both likely to be issued at the end of November; and a re-opening of the 5-year fixed 12/15/2021 maturity pool mid-December.

From a pricing perspective, we are currently seeing spreads on new multi-family CMHC insured mortgages of 90-100 bps for 5-year terms and 95-105 bps for 10-year terms. This is down approximately 5 bps Q/Q over Q2/16.

2016 year-to-date CMB issuance up 7.1% over 2015



Source: CMHC, CMLS Mortgage Analytics

Senior Unsecured Debt

Senior unsecured REIT debt issuance of $750 million remained reasonably strong Q/Q, down only slightly from $875 million in Q2/16, but up considerably Y/Y from $275 million in Q3/15 (Q3/15 was a period when spreads widened significantly).

The pace of REIT debt issuance tends to be lumpy as maturities come due and REITs weigh the benefits (e.g. increased asset flexibility, large loan size, semi-annual interest-only payments… etc.) vs. the costs (e.g. spread relative to secured debt, capital diversification/capital market liquidity). There is approximately $1.25 billion of REIT debt maturing in 2017, of which $550 million will mature in Q1/17.

Indicative secondary trading spreads on 5-year senior unsecured REIT debt ended the quarter at 199 bps, 2 bps tighter Q/Q from 201 bps in Q2/16. Since the end of Q3/16, 5-year senior unsecured REIT debt spreads have inched in a further 15 bps, and are currently sitting in the 185 bps range, only 5 bps wider than where we see current spreads on conventional mortgages secured by best-in-class assets with an investment-grade covenant.

Indicative 5-year senior unsecured REIT secondary trading spreads trending lower

Source: Bloomberg, CMLS Mortgage Analytics

Notes: Average spread represents closest 5-year maturity for the following REITs: Choice Properties – Feb 21s, First Capital – Jan 22s, SmartREIT – July 22s, Allied – Nov 22s, Crombie – June 21s, CREIT – Jan 21s, CT REIT – Jun 22s, Cominar – Dec 21s, RioCan – Dec 21s, H&R REIT – Mar 20s.

Senior unsecured REIT issuance remained strong in Q3/16

2016	Issuer Name	Issue Size Millions ($)	Issuance Rating	Term (yrs)	Spread (bps)
Q1	OMERS Realty Corp	375	AA (low)	8	186
	Choice Properties REIT	100	BBB	30	325
	Choice Properties REIT	250	BBB	7	217
Q1/16	**Total/Average**	**725**		**15**	**243**
Q2	First Capital Realty	150	BBB (high)	10	205
	Allied Properties	150	BBB (low)	6	306
	Cominar	225	BBB (low)	7	325
	CT REIT	200	BBB (high)	10	198
	CT REIT	150	BBB (high)	5	143
Q2/16	**Total/Average**	**875**		**8**	**235**
Q3	Riocan	250	BBB	4	160
	Smart REIT	250	BBB	10	244
	Smart REIT	100	BBB	8	217
	First Capital Realty (re-opening)	150	BBB (high)	10	217
Q3/16	**Total/Average**	**750**		**8**	**209**

Source: Bloomberg, CMLS Mortgage Analytics

CMBS

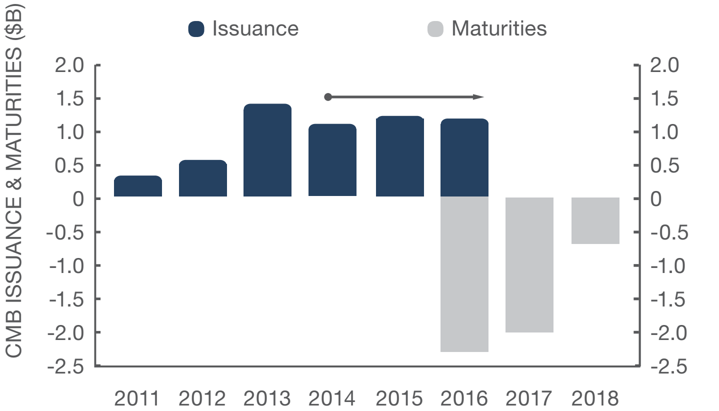
CMBS issuers were back in the market with two new issues this fall, bringing year-to-date issuance just shy of $1.2 billion over 3 deals. Not surprisingly, none of the CMBS deals issued in 2016 thus far have had any exposure to Alberta, or the prairie regions more generally.

On September 16, REAL-T 2016-2 priced a $401 million deal at +125 bps over the Government of Canada curve (3.5-year WAL A1 tranche) and +165 bps over the curve (7.0-year WAL A2 tranche) with strong investor demand. 4 loan sellers contributed collateral to the deal: RBC, MCAP, Trez and MacQuarie.

The momentum was short lived, however, as IMSC priced a $352 million deal at less favourable pricing on October 25, with the A1 tranche selling at 163 bps OTC (5.5-year WAL) and the A2 tranche selling at 200 bps over the curve (8.9-year WAL). Loan sellers in this deal were IMC, RBC and Trez.

CMBS maturities are likely to outstrip new issuance in 2016 and 2017 due primarily to ongoing CMBS funding spread volatility in the capital markets.

CMBS maturities likely to outstrip issuance in 2016 and 2017



Source: DBRS, CMLS Mortgage Analytics

Events Calendar

Date	Event
Commercial Real Estate Industry Events	
Nov 29	Global Property Market (Toronto)
Nov 29	Apartment Construction Development Workshop (Toronto)
Nov 30	Toronto Real Estate Forum
Economic Data Releases	
Nov 23	Federal Open Market Committee Meeting (US)
Nov 30	Q3 GDP (CAN)
Dec 2	Employment (CAN & US)
Dec 7	Bank of Canada Rate Announcement
Dec 14	FOMC Rate Decision (US)

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 Financial 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.

Eric Clark, CFA
Director, Mortgage Analytics
604.488.3897
eric.clark@cmls.ca

Sean Adamick, CPA, CA
Associate Director, Mortgage Analytics
604.637.1660
sean.adamick@cmls.ca

CMLS.CA

FSCO LICENSE NO. 11749