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Commercial Mortgage Commentary

CMLS Mortgage Analytics Group

Introduction

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

Making News

Canada Represented in CBRE Tech Talent Report

CBRE's 2019 Scoring Tech Talent report named 4 Canadian cities in its top 50 markets in North America. The list uses 13 metrics to evaluate a city's competitive advantages and attractiveness to both employees and tech talent. Toronto, at third, scored the highest among Canadian cities, with its high concentration of artificial intelligence playing a key role. Vancouver boasted the best year-over-year improvement, climbing 13 spots to number 12. Significantly lower wages and rent were cited as major drivers for Vancouver's position. Montreal, with its fast-growing economy and strength in software development, finished one spot back at 13. With 9.9% of total employment in the tech sector, Ottawa ranked 19th on the CBRE list. Canada's rapidly expanding tech sector has contributed to a falling vacancy rate and is spurring substantial new office construction in its major cities to meet this fast-growing demand.

Riocan Seeks CMHC-Insured Loans

RioCan Real Estate Investment Trust announced in May that it plans to access CMHC-backed funding. The company is hoping to borrow approximately $200M CAD to finance eCentral, a 36-storey downtown Toronto residential rental tower. The financing is subject to CMHC approval. RioCan has indicated it wishes to replace much of its current commercial debt with cheaper CMHC-insured loans.

Economic Environment

Overnight Rate

The Bank of Canada (BOC) held rates steady in July, maintaining its policy interest rate at 1.75%. After its last rate hike of 25 bps in October of 2018, the Bank has not changed its target for six straight rate announcements. Although Canada's economic outlook has improved in recent months, the BOC may feel pressure to follow the U.S. Federal Reserve's dovish tone on rates and adopt an accommodating monetary stance. With the prospect of trade conflicts and geopolitical uncertainty looming, the policymakers may find it difficult to hold off on additional stimulus. Additionally, if the CAD

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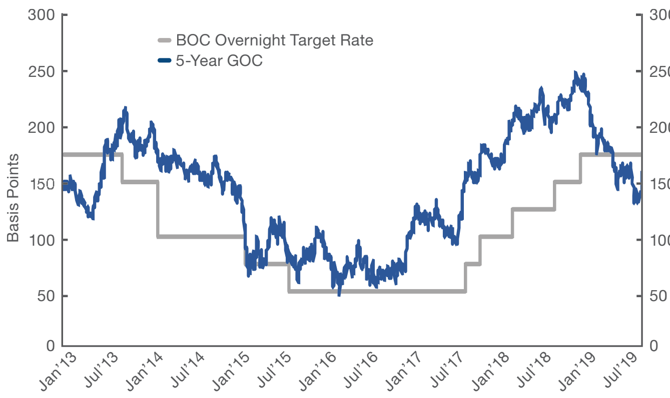
continues its rally against the USD, the corresponding impact on trade will further pressure the BOC to cut rates.

BOC Overnight Target Rate vs 5Y GOC

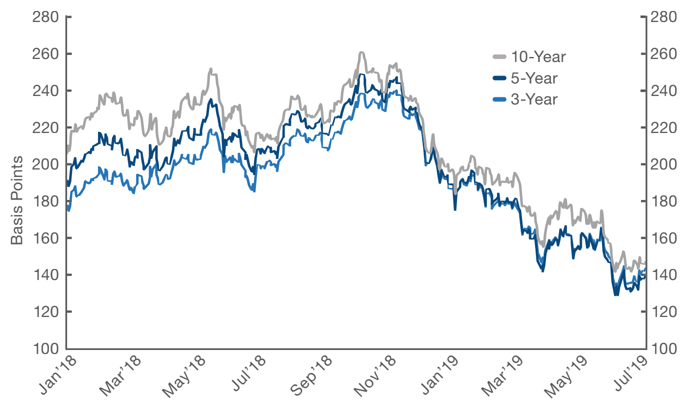


Source: Bloomberg, CMLS

GOC Yields

The 3, 5, and 10-year Government of Canada bonds are trading at their lowest yields since 2017. As of March, the 5-year GOC bond has been trading at a lower yield than that of the 3-year bond. The spread between the 5-year and 10-year issues remains tight, with the 10-year yielding just 8 bps more than the 5-year at the end of Q2. The yield premium of the 10-year over the 3-year finished Q2 at just 4 bps.

Historical GOC Yields



Source: Bloomberg, CMLS

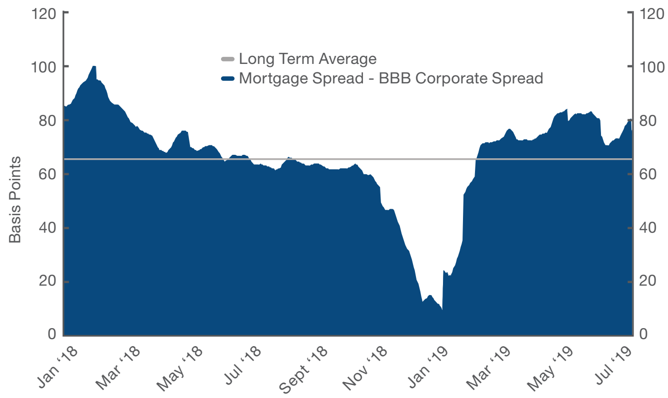
This further flattening of the yield curve during Q2 may be a sign of bearish investor sentiment. Generally, investors demand a higher rate of return for longer term investments to compensate for inflation. A flat yield curve indicates that investors anticipate lower inflation or an economic recession. Indeed, according to our CMLS Q2 2019 Lender Sentiment Survey, of the potential headline choices available, economic recession topped the list as having the highest expected impact over the next quarter, while concerns relating to global events and the economy (e.g., geopolitical tensions, trade wars, etc.) had the biggest increase with participants as compared to last quarter's survey.

Commercial Mortgages

Commercial mortgage spreads have declined gradually after a brief but significant upward shift to start 2019. This compression in spreads may not be a complete surprise to commercial mortgage participants, as the increase in spreads we experienced in early 2019 was perhaps a little overdone. We observed modest decreases of roughly 5 bps for every month of the second quarter. While competition remains strong from the supply side – particularly for higher quality loans – lenders appear to be exhibiting patience and are being selective with their capital deployment. Q2/2019 ended with top quality assets pricing at 150-170 bps over GOC for 5-year deals, and in the 160-180 bps range above GOC for 10-year terms.

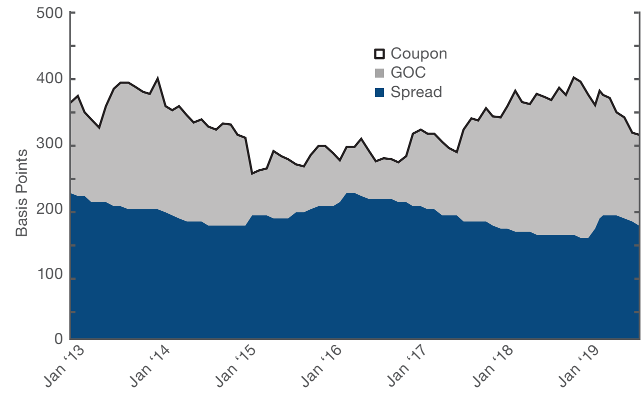
The volatility we saw at the end of 2018 and Q1/2019 in commercial mortgage spreads over BBB-rated corporate spreads stabilized somewhat in Q2. Both commercial mortgage and corporate spreads over GOC moved lower throughout the quarter, with this liquidity premium ending Q2 at 80 bps, about 15 bps higher than its 5-year average.

5-Year Commercial Mortgage Spread Premium Over BBB-Rated Corporate Bonds



Source: Bloomberg, CMLS

5-Year Commercial Mortgage Spreads



Source: Bloomberg, CMLS

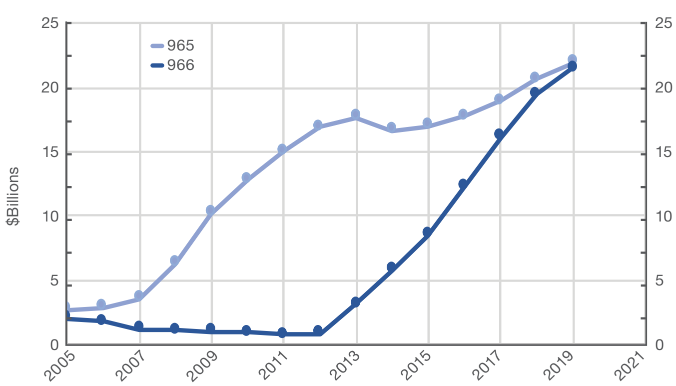
CMHC

For Q2 2019, spreads over GOC on multi-family CMHC-insured loans were mostly unchanged for both 5-year and 10-year terms, with spreads ending the period at around 85 and 100 bps, respectively. As many lenders of CMHC-insured mortgages use Canada Mortgage Bonds ("CMB") to securitize these loans, the CMB yield serves as a more relevant benchmark to this group of lenders. In terms of spread over CMB, 5-year multi-family CMHC-insured loans traded between 50-55 bps throughout Q2 while the 10-year was quoted between 50-60 bps over the same period. A common theme throughout Q2 was the very limited supply of capital for 10-year insured loans.

CMHC-insured multi-family properties can be securitized in either the 965 or 966 NHA MBS pools. The 965 pool includes mortgages that allow prepayment – albeit with a penalty – whereas the 966 pool is closed to prepayment. In the past 7 years, growth in the 966 pool has outpaced that of the 965 pool significantly, with the remaining principal balances of each pool sitting at around $21 billion at the end of Q2/2019.

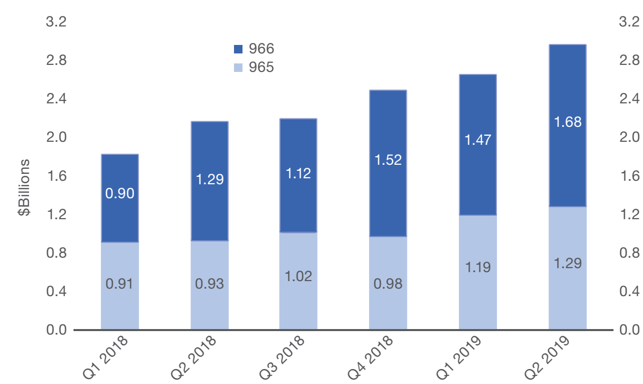
In Q2 2019, the issuances of both the 965 and 966 pools continued to increase, with the combined issuances growing from $2.7 billion in Q1 to $2.97 billion in Q2.

CMHC Remaining Principal Balance



Source: CMHC

CMHC Quarterly Issuances



Source: CMHC

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CMBS

In June 2019, Real Estate Asset Liquidity Trust issued REAL-T 2019-1, the second CMBS issuance in 2019. REAL-T 2019-1 is a $446-million CMBS consisting of 48 loans secured by 77 commercial properties. REAL-T 2019-1 features a 4.4403% weighted average interest rate, an 85-month weighted average term to maturity, and AAA subordination of 13.00% (87% of the pool is rated AAA). According to the DBRS pre-sale report, the property type of the collateral consists of 32.2% anchored retail and 20.1% office. 46.6% of the underlying properties are in Ontario and 21.5% are in Quebec.

Summary of recent CMBS deals

Year	Deal	Original Size ($Millions, CAD)	# of Loans	# of Properties	Weighted Average DBRS Term DSCR
2019	REAL-T 2019-1	$446	48	77	1.39x
	REAL-T 2019-HBC	$250	2	2	1.76x
2018	REAL-T 2018-1	$352	63	72	1.40x
	CCMOT4 2018-4	$550	53	53	1.33x
2017	REAL-T 2017	$407	71	111	1.36x
2016	IMSCI 2016-7	$352	38	60	1.47x
	REAL-T 2016-2	$421	47	72	1.38x
	REAL-T 2016-1	$401	55	91	1.30x
2015	CCMOT 2015-3	$570	42	59	1.41x
	REAL-T 2015-1	$335	46	46	1.50x
	IMSCI 2015-6	$325	47	64	1.44x
2014	MCIC 2014-1	$224	32	32	1.36x
	CMLSI 2014-1	$284	37	37	1.47x
	REAL-T 2014-1	$281	34	46	1.59x
	IMSCI 2014-5	$312	41	55	1.44x

Source: DBRS, RBC

Senior Unsecured Debt

The second quarter of 2019 saw four new issuances of REIT debt. The average term to maturity of the Q2 issuances, at 8.1 years, is more than double that of the REIT debt issued in Q1. Cominar REIT's $200 million issuance, with its non-investment grade BBH rating, offered the widest spread at 290 bps.

Senior Unsecured Debt Issuances

2019	Issuer Name	Issue Size ($Millions)	Issuance Rating	Term (yrs)	Spread (bps)
Q1	SmartCentres REIT	350	BBB	2.25	111.9
	Artis REIT	250	BBBL	2	190
	Brookfield Property Finance ULC	350	BBB	5.05	247.7
	Morguard Corp	225	BBBL	5	280.4
	Total/Average Q1	1175		3.58	
Q2	First Capital Realty Inc.	200	BBB	7.5	191.2
	AIMCo Realty Investors LP	400	AAL	10	125.1
	Choice Properties	750	BBB	10	195
	Cominar REIT	200	BBH	5	290.4
	Total/Average Q2	1550		8.1	
	Total/Average YTD	**2,725**		**5.85**	

Source: Bloomberg, CMLS

ABOUT CMLS MORTGAGE ANALYTICS GROUP

The CMLS Mortgage Analytics Group is a division of CMLS Financial Ltd., and is one of the only independent, dedicated providers of mortgage valuation services and software for the commercial real estate finance industry in Canada. The CMLS Mortgage Analytics Group provides solutions to some of Canada's most prominent financial institutions, investment managers, pension funds and consultants. With investors, regulatory bodies and governing committees requiring increased reporting, independence and third-party advice, the CMLS Mortgage Analytics Group offers a host of risk rating, valuation, and portfolio analysis tools to better manage risk/reward profiles in commercial mortgage portfolios. Clients engage our services to provide independent support for mortgage purchases, fair value accounting, ongoing fund valuation, interest rate appraisals and more.

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