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Commercial Mortgage Commentary

CMLS Mortgage Analytics Group

The Commercial Mortgage Commentary aims to inform the market on 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

Amazon's Downtown Vancouver operation to occupy entire Canada Post building

While Amazon's occupation of the former Canada Post building known as "The Post" was finalized in April 2018, it has been reported that Amazon will now take over the lease of the entire building upon expected completion in 2023. Amazon will occupy all of the 1.13 million square feet of office space provided by the redevelopment. In the constrained office space environment of Vancouver, one estimate indicates that this decision will result in a decrease of forecasted office vacancy rates by 2%.

Canada Life closes deal on 1.1 million sq. ft. industrial facility in GTA

In December, GWL Realty Advisors, on behalf of Canada Life, completed a $180 million transaction securing a mixed industrial and office warehousing facility in Milton, Ontario. Consisting largely of industrial warehousing space, the development also includes office space totalling 3% of the entire available commercial square footage on the property. The property will serve as the Canadian headquarters for DSV, a global transport and logistics company. This deal highlights the current strong demand for industrial spaces in Canada, especially in Ontario.

Economic Environment

Overnight Rates/BOC Movements

Despite prevailing economic sentiment, as well as pressures from international counterparts in the fourth quarter of 2019, the Bank of Canada elected to maintain its overnight rate at 175 basis points in its December meeting, marking an entire year where the Bank did not change rates. As one of the first inflation targeting regimes, the Bank's rate decision indicated an expected robust and healthy level of core inflation. Outside of any unexpected shocks to the macroeconomy, the central bank expects core inflation to continue near the targeted 2% rate over the next year. If more negative data persists, such as the soft Q4 GDP and jobs numbers, the BOC may revise its monetary stance.

The Bank held rates steady again in late January, reiterating its near-term inflation outlook of roughly 2%. Supported by increased stability in the global economy and positive trade agreements, the Bank projects global growth of over 3% in the coming months. While the Canadian economy remains robust, economic data does indicate weaker job growth and retail consumer activity.

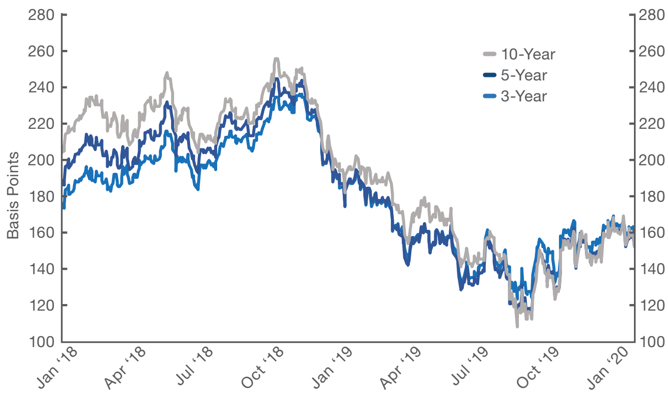
Economic Events

The US-China Trade War was a significant topic of discussion throughout 2019. In December, US and Chinese delegates announced a Phase One deal, where the United States agreed to halt new tariffs and China agreed to purchase billions in agricultural products, amongst other trade goods. This event should have positive ripple effects on the Canadian economy in services and manufacturing.

GOC Yields

Recent movements in the bond markets, sovereign and otherwise, have eased the bullish sentiment in bonds. Across term lengths, Government of Canada bond yields have climbed from a low of 120-130 basis points in the third quarter to the 160-170 basis point range. The yield curve, however, remains largely flat. In recent weeks, the spreads between 1-year, 5-year, and 10-year GOC bond yields have largely diminished and are slightly inverted. Bond yields continue to be lower than they were in 2018.

Historical GOC Yields



Source: Bloomberg, CMLS

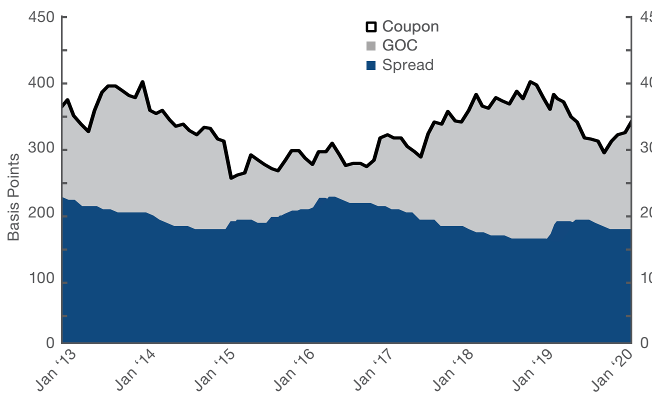
Commercial Mortgages

Just as they did in Q3, commercial mortgage spreads over GOC remained flat throughout Q4. While they exhibited some short-term swings throughout the year, GOC yields hit their 2019 highs in the early months, bottomed out at the beginning of September, and then proceeded to trade back up to close out the year. Commercial mortgage coupons mirrored this pattern, climbing over the final three months of 2019 to finish the year at levels close to where they started. The typical 5-year conventional commercial mortgage coupon ended 2019 at around 3.40%.

The competitive lending environment we saw in Q3 remained throughout Q4 as abundant capital supply persisted. While spreads were tight and high-quality assets continued to attract strong interest, borrower demand to lock in rates in this low rate environment offset that ample supply, resulting in stable commercial spreads throughout H2 2019. For the last half of 2019, mortgages on top-quality assets were originated at spreads of 150-160 bps.

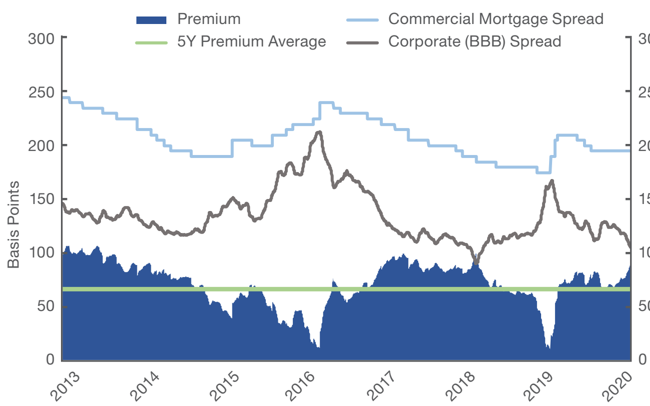
As a fixed income asset, commercial mortgages tend to draw comparisons to BBB-rated corporate bonds. Although they are somewhat similar in risk, commercial mortgage investments earn a premium over their corporate debt counterparts due, in large part, to their relatively lower liquidity. This spread premium for commercial mortgages over BBB-rated corporate bonds does fluctuate over time and may indicate potential shifts in capital

5-Year Commercial Mortgage Spreads



Source: Bloomberg, CMLS

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



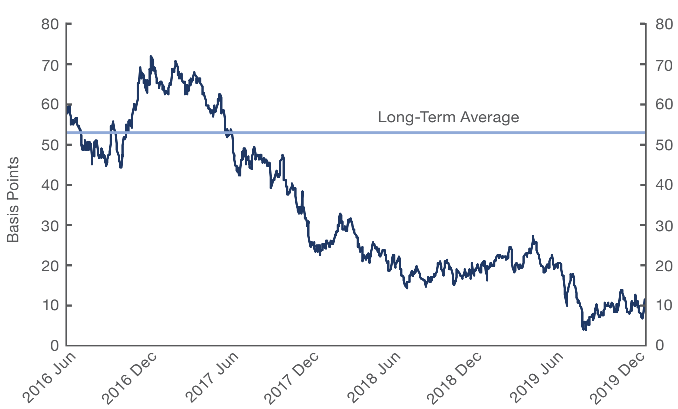
Source: Bloomberg, CMLS

supply. At the beginning of 2019, the premium was down to 10 bps, matching a low not seen since early 2016, as bond spreads hit an interim peak. Corporate debt spreads reversed direction and trended downward throughout the calendar year, closing out 2019 at their lowest levels of the year. Meanwhile, commercial mortgage spreads remained flat for the last half of the year, resulting in the commercial mortgage premium over BBB-rated corporate bonds hitting its highest level since early 2018. The premium ended Q4 at 90 bps, around 20 bps above the 5-year moving average.

CMHC

Strong demand by borrowers for 10-year loans continued to be the story for CMHC-insured mortgages in Q4. With the spread between 10 and 5-year Canada Mortgage Bond rates still hovering around 10 bps, there are no signs of demand for 10-year money abating. The 10-year minus 5-year CMB spread has declined significantly since 2017, well below its long-term average of 53 bps. We expect 10-year mortgages to continue to be in high demand until this term spread widens back out.

10Y-5Y Canada Mortgage Bond Spread

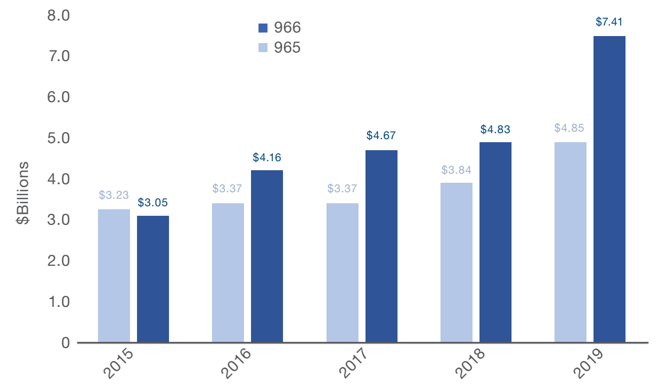


Source: CMHC

For 2020, new NHA MBS guarantees, authorized by the Minister of Finance, are increasing from $140 billion in 2019 to $145 billion. The MOF also authorized CMHC to provide up to $40 billion in new guarantees for CMB.

2019 saw significant increases in the CMHC-insured multi-family 965 and 966 pools. Combined, the two multi-family pools totaled $13.26 billion for the year. It is likely these two pools will continue to increase to meet CMHC's drive for housing market affordability.

965 vs. 966 Issuances

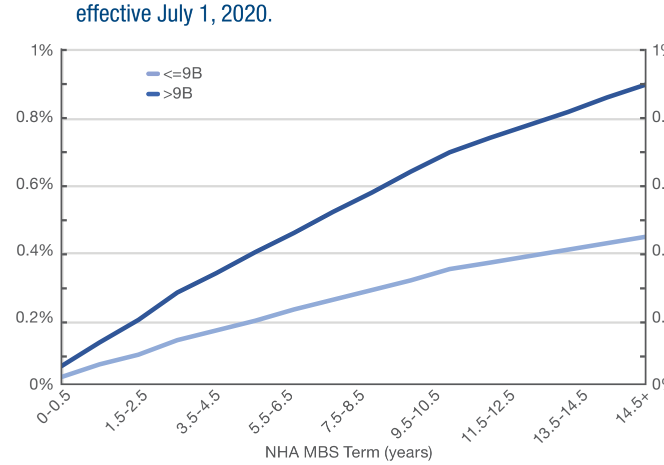


Source: CMHC

CMHC Guarantee Fee Changes

In exchange for CMHC's guarantee of payment of interest and principal for NHA MBS, issuers are charged a fee. The fee rate payable by an issuer (in bps) increases with the term of the specific MBS. In addition, an issuer is subject to a higher term fee structure once total guarantees exceed $9 billion. In December, CMHC announced changes to the fee schedule for these guarantees, effective July 1, 2020. Fee rates will be going up for each term tier. Also, under the new fee structure, standard NHA MBS pools receive different treatment from Affordability-linked pools, which include social housing pools and certain multi-family pools in which a minimum percentage of loans are eligible to be insured by CMHC Affordability Mortgage Loan Insurance. Fees on Affordability-linked pools will not be subject to the increase in guarantee rates. Furthermore, Affordability-linked pools will not count against an issuer's $9 billion guarantee pricing threshold. This new fee structure is aimed at incentivizing lending towards affordable housing.

Increase in Guarantee Fee Structure for NHA MBS, effective July 1, 2020.



Source: CMHC

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CMBS

We saw little Commercial Mortgage-Backed Securities (CMBS) issuance in 2019, with no executed deals in Q3 or Q4. Total CMBS issuance for the year was $696.4 million, compared to the $908.1 million we saw the prior year.

Senior Unsecured Debt

The final quarter of 2019 was a busy period in terms of REIT debt issuance. BTB REIT came to market with a $24 million convertible bond issuance. Ventas Canada raised $900 million in total debt, including a $300 million floating rate bond issuance. REIT debt financing reached $2.649 billion in Q4, more than doubling the amount raised in Q3. Overall, 2019 REIT debt issuance was $6.8 billion, exceeding the $6 billion raised in 2018.

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	600	BBB	5.05	222
	Morguard Corp	225	BBBL	5	280.4
	Total Issue Size/Average Term Q1	1,425		3.58	
Q2	AIMCo Realty Investors LP	600	AAL	10	125.1
	Choice Properties	750	BBB	10	195
	Cominar REIT	200	BBH	5	290.4
	Total Issue Size/Average Term Q2	1,550		8.3	
Q3	First Capital Realty Inc	200	BBB	7.5	191.2
	RioCan REIT	500	BBBH	5.5	143
	Allied Properties REIT	300	BBBL	10	215.7
	Crombie REIT	200	BBBL	7	246.9
	Total Issue Size/Average Term Q3	1,200		7.5	
Q4	BTB REIT	24	N/A	5	N/A
	Allied Properties REIT	300	BBBL	7.5	179.9
	Ventas Canada Finance Ltd	300	N/A	2	N/A
	Ventas Canada Finance Ltd	600	N/A	4.4	118.4
	Morguard Corp	225	BBBL	5.0	269.8
	Ivanhoe Cambridge II Inc	300	AAL	5.0	67.9
	HCN Canadian Holdings - 1 LP	300	N/A	7.0	135
	Crombie REIT	150	BBBL	7.5	225
	SmartCentres REIT	450	BBBH	10.0	180.8
	Total Issue Size/Average Term Q4	2,649		5.93	
	Total Issue Size/Average Term 2019	**6,824**		**6.14**	

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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