DESIGNER CAPITAL

Q1 2023

COMMERCIAL MORTGAGE UPDATE

Uncertainty remains the theme of Q1. From our vantage point, we are seeing strict lender underwriting policy with limited expectations being granted. Without a broad-based consensus amongst this uncertainty, optimistic caution is what prevails. We will start off by discussing the biggest market mover of Q1.

SVB utilized their cash deposits from VCs and increased its holdings of long-term securities in 2021. The market value of these bonds decreased significantly throughout 2022 and 2023 as the Federal Reserve raised interest rates to curb inflation. As borrowing costs increased, SVB clients started withdrawing money to meet their liquidity needs. To raise cash to pay withdrawals by its depositors, SVB had to liquidate their assets and borrow money. This announcement resulted in a bank run as customers panicked and withdrew funds.

While this has created a ripple effect in the world economy, an event as such is unlikely to occur in Canada as its banking system is widely recognized for its prudent lending and risk management practices.

Since January 25, 2023, the Bank of Canada has held its target for the overnight rate at 4.50%. It will continue its policy of quantitative tightening to relieve price pressures. They are prepared to raise the policy rate if needed to return inflation to the 2% target. The next scheduled date for announcing the overnight rate target is June 7, 2023. CPI inflation eased to 5.2% in February and dropped to 4.3% in March, with the Bank expecting it to fall quickly to around 3% in the middle of 2023 and then decline more gradually to the 2% target by the end of 2024.

Based on TD's most recent economic data, housing starts continued to cool with the quarter down 14% compared to Q4 of 2022. The lack of supply, coupled with an expected continued decline in housing starts, will push prices higher going forward. Many reports have suggested that Canada's housing market is reaching the cyclical bottom. However, economists believe the recovery phase will begin later in 2023 or early 2024 once inflation returns to target and interest rates cuts take place.

Under the Immigration Levels Plan 2023-2025, Canada is expecting to welcome over 460,000 new immigrants each year. The Canadian employment market shows no sign of slowing. 35,000 positions were added in March, with full-time employment up 18.8k and part-time employment up 15.9k. The unemployment rate held steady at 5.0%. Continued labour market strength may maintain aggregate consumption and make it challenging for the Bank of Canada to achieve the 2% CPI target.

In summary, even though there has been improvement in the economy over the last few months, sentiment has not recovered. Consumers and businesses are still cautious given the high interest rate environment. Quantitative tightening will continue as the Bank of Canada remains resolute in its commitment to restoring price stability for Canadians.

Over the last quarter, we have identified the following trends in the lending sector for commercial real estate:

- Land Financing:

Landscape is similar to Q4 in 2022 where lending spreads for land remain wide. Lenders have become conservative when it comes to financing land, with many only willing to consider these deals if the land has already been rezoned with its development permit almost or already approved.

In the first half of 2022, lenders were comfortable with financing land up to 75%. Based on recent conversation with lenders, the majority of them have reduced their loan-to-value ratios to 50-55%.

- Construction Financing:

Lenders are scrutinizing deals more closely and demanding projects to be monitored by quantity surveyors in order to produce accurate budget reports and avoid cost overruns.

Interest reserves are typical and frequently built into financing, and in some cases, lenders are asking for capital reserves (P+I payments) on top. Spreads are generally between Prime + 50-200bps with Prime at 6.70% as of this report.

- CMHC Financing:

This product remains to be a hot commodity, as lenders are willing to lend on these deals since they are insured. Due to high demand for CMHC financing, many lenders are increasing their deal size minimums making it difficult for small deals to acquire financing for.

There is currently a wide lender spread with $3M+ deals being priced at 70-80bps over and $10M+ deals being priced at 30-40bps over.

- Term Financing:

Lenders continue to have an appetite for industrial or multi-family properties that are not financed through the CMHC MLI Select Program. Lending values continue to be around 75% LTV. The interest rates are sitting slightly above 6% on this type of product.

- Other Insights:

➞Difficult for small developers to get into the market unless they are co-developing as lenders want to see strong track records and financial capability.

➞Future risks include government intervention and increased costs which are not absorbed by developers but are ultimately passed onto consumers.

➞National Bank of Canada and CMLS Financial have stated that approximately 9/10 deals that they have being working on are going through CMHC as opposed to conventional in the multi-family space.

Overall, the commercial and construction markets have gained some steam heading into the last bit of Q1. We expect Q2 and Q3 to be busier. We are optimistic that this is a positive trend and that the market will continue to show signs of growth.

COMMERCIAL REAL ESTATE LENDING DEBT TERMS

Financing Type	Benchmark	Lender Spread		Indicative Rate		Max LTV/LTC
Term Financing						
5-Yr Conventional	5-Year GOC	2.00%	2.50%	5.08%	5.58%	75.00%
10-Yr Conventional	10-Year GOC	2.00%	2.65%	4.94%	5.59%	75.00%
5-Yr CMHC MLI Select	5-Year CMB	0.35%	0.55%	3.75%	3.93%	95.00%
10-Yr CMHC MLI Select	10-Year CMB	0.35%	0.55%	3.78%	3.90%	95.00%
Floating Rate Financing						
Conventional Construction	Prime	0.50%	2.25%	7.20%	8.95%	80.00%
High Yield Construction	Prime	3.00%	6.50%	9.70%	13.20%	85.00%
Land Financing	Prime	1.25%	3.25%	7.95%	9.95%	55.00%
Bridge Financing	Prime	1.50%	3.00%	8.20%	9.70%	75.00%

BENCHMARK YIELDS

	Mar 31, 2023	Mar 1, 2023	1-Mth Change	Dec 30, 2022	3-Mth Change	Sep 29, 2022	6-Mth Change
5-Year GOC	3.08%	3.57%	-0.49%	3.07%	0.01%	3.33%	-0.25%
10-Year GOC	2.94%	3.37%	-0.43%	2.83%	0.11%	3.17%	-0.23%
5-Year CMB	3.35%	3.79%	-0.44%	3.44%	-0.09%	3.60%	-0.25%
10-Year CMB	3.38%	3.83%	-0.45%	3.42%	-0.04%	3.56%	-0.18%
Prime	6.70%	6.70%	0.00%	6.45%	0.25%	5.45%	1.25%

FUNDED DEAL SUMMARY

Designer Capital facilitated Construction Financing for an 89-unit condominium project in Esquimalt, BC, consisting of 5 standalone townhomes, 78-bedroom units, and 6 penthouse units across two buildings. Our clients are both established owners / operators and developers of purpose-built rental properties, spec build residential homes, and condo projects. They purchased the subject properties over the last several years, building them up as a land assembly with the intention to develop the property.

Working with one of Canada's major financial institutions, Designer Capital was able to leverage their strong liquid asset position (cash and investments in corporations) to achieve the following Novel Financing Solution:

NOVEL FINANCING SOLUTION

- Mortgage: $48,400,000
- 80% Loan-To-Cost
- Construction Loan: Priced at Prime + 1.50%
- Built-In Interest Reserve

Designer Capital's *Unbiased Advice* helped secure our clients *Construction Financing* at a *high Loan-To-Cost* to allow for the *minimum amount of capital injection* from the clients to complete the construction of their development.

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ABOUT DESIGNER CAPITAL

Based in Victoria, Designer Capital is a real estate capital advisory firm that provides novel and unbiased solutions for residential and commercial financing.

We support developers and real estate investors in optimizing returns by structuring debt financing in the form of land acquistion, construction, mezzanine, bridge, and term loans.

From multi-tenant investment properties, new construction and development to owner-occupied space, we have facilitated successful funding across all major asset classes.

Designer Capital is licensed and regulated as a Mortgage Broker by the BC Financial Services Authority (BCFSA).