DESIGNER
CAPITAL

Q3 2023

COMMERCIAL MORTGAGE UPDATE

Q3 was another volatile quarter as the lending environment changed drastically due to continued high rates and frequent government policy changes. With a 25 bps increase in July, the policy rate is currently sitting at 5.00% - the highest level since 2001. Since March 2022, the policy rate has risen 475 bps over 10 interest rate decisions, which is the fastest than any of the previous 6 tightening cycles going back to 1997.

The Canadian economy has slowed down considerably as consumption has been subdued, with softer demand for housing, durable goods and many services. The Bank downgraded its growth forecast to 1.2% this year (from 1.8% in July). This indicates that the slowing economic momentum is enough for the Bank to hold the policy rate at 5%.

The Consumer Price Index (CPI) cooled to 3.8% year-over-year in September, down from 4.0% in August. After easing to 2.8% in June, the annual inflation rate climbed over the summer, largely because of rising energy prices. Despite the recent months, the Bank of Canada still sees inflation returning to target at 2% in 2025.

In September, the federal government announced that it will introduce an enhanced 100% Goods and Services Tax (GST) Rental Rebate on new rental construction projects. This will be available to new projects beginning Sept 14, 2023 to Dec 31, 2030, and completed before Dec 31, 2035. This enhanced GST rental rebate only applies to the 5% federal GST. This effectively removes the requirement for GST self-assessment which was a significant cost to many developers.

Another positive decision was announced in September. The government of Canada will be expanding the Canada Mortgage Bond (CMB) program by increasing the annual cap from $40B to $60B. Prior to this announcement, securitized lenders had begun increasing their spreads and/or reserving their allocations against that $40B cap towards their existing clients. Some lenders were running out of 10-year term money recently. As the majority of CMHC-insured loans are securitized via the CMB program, this additional $20B will help alleviate supply concerns and should serve to reduce insured loan spreads in the coming months as the allocation is made available.

In summary, inflation is heading in the right direction which suggests that the effect of the interest rate hikes is finally working. However, a recent Royal LePage survey stated that 3.4 million Canadians will renew their mortgage by 2025. If rates do not decrease, many Canadians might not be able to support higher mortgage payments which could result in many foreclosures. We will also see many apartment owners forced to liquidate their rental assets as net operating incomes can no longer service these high rates. We advise Canadians to immediately reach out to their financial advisors and plan cautiously for their future.

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

- Land Financing:

Land financing remains challenging in Q3 as lenders continue to be conservative. Conventional lenders generally present loan-to-values of 50% or lower, whereas some private lenders may go higher.

- Construction Financing:

Construction loans for either rentals or condos have been difficult to finance due to the rate environment. Lenders have been underwriting construction files at stress rates up to 200 basis points over, reducing the Loan-to-Cost ratios on many projects, and thus requiring developers to inject substantially higher equity. Many projects are currently put on hold as there is an expectation that rates will possibly decrease in 2024.

We are seeing many developers requesting for high densities and applying for development permit variances to redesign unit mixes in hopes of making projects financially feasible.

- CMHC Financing:

On the CMHC side, a few changes were implemented in September. Once a file has been submitted to CMHC and prior to the commencement of the affordability period, updates to the designated affordable units in rent rolls will not be accepted for the purpose of (i) accounting for any annual rent increases (e.g.: consumer price index) and (ii) designating alternate units as affordable. Also, for purchases and refinances, CMHC will not allow the lowest rental units to be non-affordable units (to limit the rental upside to CPI).

Effective immediately, CMHC is no longer refinancing existing properties with mortgage debt in place of less than 24 months at the time of application. In addition, all debt must be from an approved CMHC Lender and cannot have been used to perform capital expenditures within the 24-month period. This was implemented to prevent renovictions, however, it will create other problems for apartment owners.

CMHC wait times have improved. For newly submitted applications, document reviews will be completed within 48 hours of submission date. However, it may still take several months for an underwriter to be assigned.

- Term Financing:

With interest rates sitting slightly above 7% on this type of product, many income producing properties are experiencing much lower debt serviceability.

- Owner-Occupied Financing:

Many owner-occupied businesses have mortgages that are coming up for renewal. These business owners may have to liquidate their commercial properties as their businesses can no longer service higher mortgage rates. We advise owners to reach out as there are favorable terms and interest rates for owner-occupied financing compared to financing for investment properties.

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%	2.75%	6.24%	6.99%	75.00%
10-Yr Conventional	10-Year GOC	2.00%	2.75%	6.00%	6.75%	75.00%
5-Yr CMHC MLI Select	5-Year CMB	0.50%	0.70%	5.02%	5.22%	95.00%
10-Yr CMHC MLI Select	10-Year CMB	0.50%	0.70%	5.02%	5.22%	95.00%
Floating Rate Financing						
Conventional Construction	Prime	1.50%	2.00%	8.70%	9.20%	75.00%
High Yield Construction	Prime	3.00%	6.50%	10.20%	13.70%	85.00%
Land Financing	Prime	2.00%	4.00%	9.20%	11.20%	50.00%
Bridge Financing	Prime	1.50%	3.00%	8.70%	10.20%	75.00%

BENCHMARK YIELDS

	Sep 29, 2023	Sep 1, 2023	1-Mth Change	Jun 30, 2023	3-Mth Change	Apr 3, 2023	6-Mth Change
5-Year GOC	4.24%	3.91%	0.33%	3.76%	0.48%	3.30%	0.94%
10-Year GOC	4.00%	3.59%	0.41%	3.33%	0.67%	2.89%	1.11%
5-Year CMB	4.52%	4.11%	0.41%	4.01%	0.51%	3.34%	1.18%
10-Year CMB	4.52%	4.03%	0.49%	3.80%	0.72%	3.37%	1.15%
Prime	7.20%	7.20%	0.00%	6.95%	0.25%	6.70%	0.50%

FUNDED DEAL SUMMARY

Designer Capital facilitated Construction Financing for a 16-Unit Townhouse Development in Victoria, BC. Our clients are experienced home builders and developers of purpose-built rentals. They have successfully rezoned and have begun construction on the project.

Working with one of the local credit unions, Designer Capital was able to achieve the following Novel Financing Solution:

NOVEL FINANCING SOLUTION

- Mortgage: $6,500,000
- 75% Loan-To-Cost
- 65% Loan-To-Value
- Construction Loan: Priced at Prime + 2.00%
- 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).

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