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# COMMERCIAL MORTGAGE UPDATE



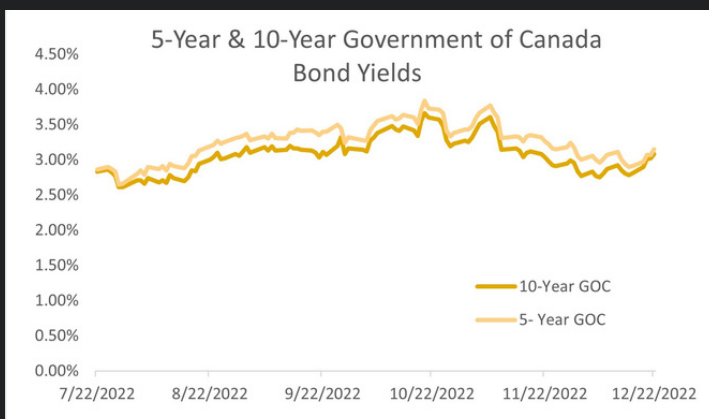
Global economic instability as a result of Covid, a war in eastern Europe, inflation and other factors, have collectively set the stage for a potential recession in the near future. Although the impact of a recession is uncertain, commercial real estate lenders are taking into account current market conditions by being more selective with financing.

In 2022, the Bank of Canada rapidly increased its policy rates from 0.25% in January to 4.25% in December, pushing prime rates and mortgage rates along with it to levels we have not seen in a long time. Comparing the 10-year Government of Canada Bond (GoC) yield and the overnight rate, there is a 140 Bps difference - this presents a drastic yield curve inversion which suggests a coming recession.

Based on TD's most recent economic data, housing starts in Canada continue to trend at healthy levels roughly 30% above their pre-pandemic run-rate, however, it is only a matter of time before weaker demand conditions that have persisted since early 2022 begin to materially impact homebuilding. December's CPI report showed that Canadian inflation is starting to decrease - sitting at 6.4% as opposed to November's reading of 6.7% Inflation remains well above the Bank of Canada's 1-3% target.

As for unemployment levels, the economy gained 381 thousand jobs, while the unemployment rate has remained right around the historical low of 4.9%. However, Bank of Canada needs to see a weakening of the labour market as evidence of a reduction in the demand for goods.

In these times where inflation and interest rates are high, real estate developers and investors should take be cautious and take appropriate measures as the sentiment heading into 2023 is unknown.



## COMMERCIAL MORTGAGE RATES

The Canadian Mortgage Bond (CMB) yields peaked in October around 4.00%. In the final months of the year, CMB yield declined - this provided some relief to borrowers working with insured multi-family loans. As for the Bank of Canada Policy Rate, it is unlikely to soften throughout 2023. There is an expectation of another 0.25% hike in Q1 of 2023.

Based on discussions with top lenders, conventional construction and bridge pricing will be at or above 8% (Prime + 150bps) similar to high yield financing over the last 5 years. Land financing in 2022 has been the least desirable to lenders. The asset had a range of Prime plus 175 to 425 bps and is expected to remain at the same level in the short term.

## COMMERCIAL LENDING OUTLOOK

- Lender spreads are widening due to volatility in underlying bond market yields and increased borrower risk in current economic conditions
- One of the headwinds affecting pricing for both land and construction financing is the implementation of Basel III regulations scheduled to come into place on March 1, 2023. OSFI will regulate lenders to risk weight at 150%, which will inevitably raise interest rates in lockstep with the increased cost of capital.
- Land financing has become more difficult. Conventional lenders had fully deployed their 2022 land allocation and were only servicing existing borrowers. Spreads for land continued to widen. Developers are looking to utilize the CMHC MLI Select and RCFI programs by considering rentals in order to achieve targeted returns.
- To help with top borrowers with refinancing, some major lenders are being creative with deal structures and involving interest rate swaps, increased amortization (i.e., > 30 years), or interest only loans.
- In the last two quarters of 2022, construction underwriting has tightened considerably, with most institutional lenders requiring higher contingencies (75-10% of cost to complete) and interest rate for their interest reserves. Many existing construction projects are facing cost overruns due to the rapid increase of the overnight rate.
- Multifamily rental and industrial are currently the most sought after asset classes. Lenders are more willing to lend in this capital space.

# COMMERCIAL REAL ESTATE LENDING SPREADS AND BENCHMARK YIELDS

Q4 2022

## COMMERCIAL REAL ESTATE LENDING SPREADS

Financing Type	Benchmark	Lender Spread		Indicative Rate		Max LTV/LTC
<b>Term Financing</b>						
5-Yr Conventional	5-Year GOC	2.20%	3.50%	5.32%	6.62%	75.00%
10-Yr Conventional	10-Year GOC	2.00%	3.30%	5.23%	6.53%	75.00%
5-Yr CMHC Select	5-Year CMB	0.38%	0.65%	4.04%	4.31%	95.00%
10-Yr CMHC Select	10-Year CMB	0.38%	0.65%	4.09%	4.36%	95.00%
<b>Floating Rate Financing</b>						
Conventional Construction	Prime	1.00%	2.50%	7.45%	8.95%	80.00%
High Yield Construction	Prime	3.00%	6.50%	9.45%	12.95%	85.00%
CMHC Select Construction	Prime	-0.50%	0.75%	5.95%	7.20%	95.00%
Land Financing	Prime	1.00%	6.00%	7.45%	12.45%	60.00%
Bridge Financing	Prime	1.25%	3.50%	7.70%	9.95%	75.00%

## BENCHMARK YIELDS

	Dec. 30, 2022	Dec. 1, 2022	1-Mth Change	Sept. 29, 2022	3-Mth Change	Jul. 4, 2022	6-Mth Change
5-Year GOC	3.40%	3.07%	0.33%	3.33%	0.08%	3.05%	0.35%
10-Year GOC	3.29%	2.83%	0.46%	3.17%	0.12%	3.18%	0.12%
5-Year CMB	3.74%	3.44%	0.30%	3.60%	0.14%	3.48%	0.26%
10-Year CMB	3.81%	3.42%	0.39%	3.56%	0.25%	3.71%	0.10%
Prime	6.45%	5.95%	0.50%	5.45%	1.00%	3.70%	2.75%



## FUNDED DEAL SUMMARY

Designer Capital worked with our clients to secure Construction Financing for a 29-unit multi-family development in Sooke, BC, consisting of 17 residential townhomes and 12 residential apartments. Our clients are successful developers with excellent track records and many income generating assets in their real estate portfolio.

The subject property was purchased in January 2021 as a future development site and went through rezoning which completed in Q4 of 2022. With now a higher appraised market value, it was the right timing to commence the construction project.

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: \$8,400,000
- 70% Loan-To-Value based on Completed Value
- 75 % Loan-To-Cost
- Construction Loan: Priced at Prime + 1.50% during construction
- Competitive mortgage rates to be offered upon completion
- The construction draw mortgage will be termed into a CMHC-insured mortgage upon completion of the project

Designer Capital's *Unbiased Advice* secured our clients *Construction Financing* at a *high Loan-To-Value* 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 acquisition, 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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