LENDERS' REPORT

A review of 2015 and a look at 2016 Canadian commercial real estate lending trends

Canadian Capital Markets
Debt & Structured Finance

CBRE

Introduction

On behalf of the CBRE Debt and Structured Finance group, I hope readers will appreciate the perspectives and analysis shared via our 2015 Canadian Lender Survey. The objective of the survey was to establish factors, trends and themes in the Canadian commercial real debt market in 2015 with a forward look at the 2016 debt market.

In undertaking the survey, CBRE requested participation from all the financial institutions operating in Canada under the Bank Act and those unregulated sources known to the industry who have financed Canadian-based commercial real estate transactions. Participation and results were provided on an anonymous basis. Other than the ability to tabulate the responses from each lender category, the survey was established in a manner that does not disclose proprietary strategies, pricing and risk management practices.

Based on the number of respondents from across the industry and strong representation from those deemed to be ‘market makers’ in their respective categories, the results are considered to have significant merit. We hope that the survey results will provide the industry with a unique perspective, while setting expectations and allowing for better business planning in 2016.

We thank all those that invested the time in the 2015 survey and look forward to your continued support in 2016.

Sincerely,

Carmin Di Fiore
Executive Vice President,
CBRE Limited

Executive Summary

In 2015, key pillars of the Canadian economy faced significant challenges, which put Canadian lenders in uncharted territory. Energy and commodities were repriced, which along with the failure of a major American retailer, resulted in increased scrutiny of the domestic economy. The Bank of Canada endeavoured to keep the Canadian economy growing while other countries showed signs of stagnating growth. Two cuts to the key overnight interest rate sent Government of Canada bond yields to historic lows and provided commercial real estate lenders with the challenge of trying to earn acceptable lending returns.

Economic volatility is juxtaposed against an unprecedented demand for yield. The shift in the lending environment can be summarized by the performance of Commercial Mortgage Backed Security (CMBS) issuances. Investors began demanding higher premiums for tranched interests after mid-year, and then new issuances were set aside due to the locations of the assets involved and their return prospects.

To get a better grasp of the outlook for the Canadian debt market in 2016, CBRE surveyed debt industry leaders to determine what factors shaped their decisions in 2015 and how they will approach lending for commercial property purchases in the coming year.

While macroeconomic issues, including China's economic slowdown and European debt issues dominate headlines, 77% of Canadian lenders looked past these macro factors. Lenders are making a concerted effort to focus on microeconomic variables including commercial real estate fundamentals. 55% of respondents reported these key factors as strong determinants for loan approvals next year:

- the quality of the asset
- the spread that could be earned on the loan
- the amount of existing leverage the borrower was carrying

This approach is reinforced by the fact that many lenders reported a lack of concern surrounding transformations in the retail market, as 87% of the lenders look to either increase or maintain their exposure to the asset class in the coming year. The Canadian failure of Target and pressure on midmarket retailers will have limited impact given the strong financial base of the controlling landlords, such as the REITs and Pension Funds.

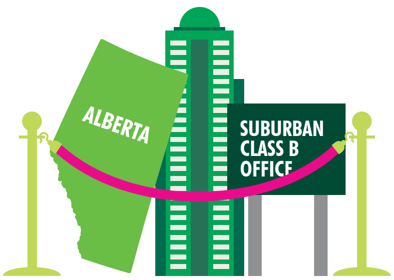
In terms of other specific asset classes, lenders are looking favourably upon industrial properties given the expectations for increased export activity as a result of a weak Canadian dollar and the improving U.S. economy. The issue for lenders keen on securing industrial deals is that demand is outstripping supply, which will leave some investors empty handed. Suburban Class B office properties drew the greatest concern from lenders. This was attributed to a belief that there is a waning tenant interest for this type of product, especially among millennial employees.

Lenders look to secure industrial deals due to solid fundamentals

One global event that will impact lending patterns in 2016 is the dramatic decline in oil prices. Lenders will be looking to revise their pricing, terms and conditions in oil rich areas such as Alberta. As it

Executive Summary *(continued)*

currently stands, lenders expect the downturn in the province to be an extended event; however, lenders see growing opportunities in other parts of the country that are not reliant on the energy sector as its main source of revenue.



The traditional leading markets like the Greater Toronto Area (GTA) and Greater Vancouver Area (GVA) will be the primary beneficiaries of Alberta's challenges. The influence of foreign capital on the GVA commercial real estate market will continue to be transformational as asset valuations continue to head northward and capitalization rates experience further compression. In 2016, the competitive environment will not deter 80% of lenders that have signalled a strong appetite for lending in Canada's hottest market. When looking at budget allocations for 2016, a strong majority of lenders stated a desire to increase lending as it pertains to multifamily properties in the GTA and GVA, where densification continues and a growing population is increasingly priced out of homeownership. Interestingly, lenders also indicated growing interest in the Ottawa-Gatineau region. This likely stems from infrastructure investment in the city and the assumption that the Liberal's stance on expansive government will spur demand for space.

The majority of lenders expect spreads to widen 10-20 bps on average.

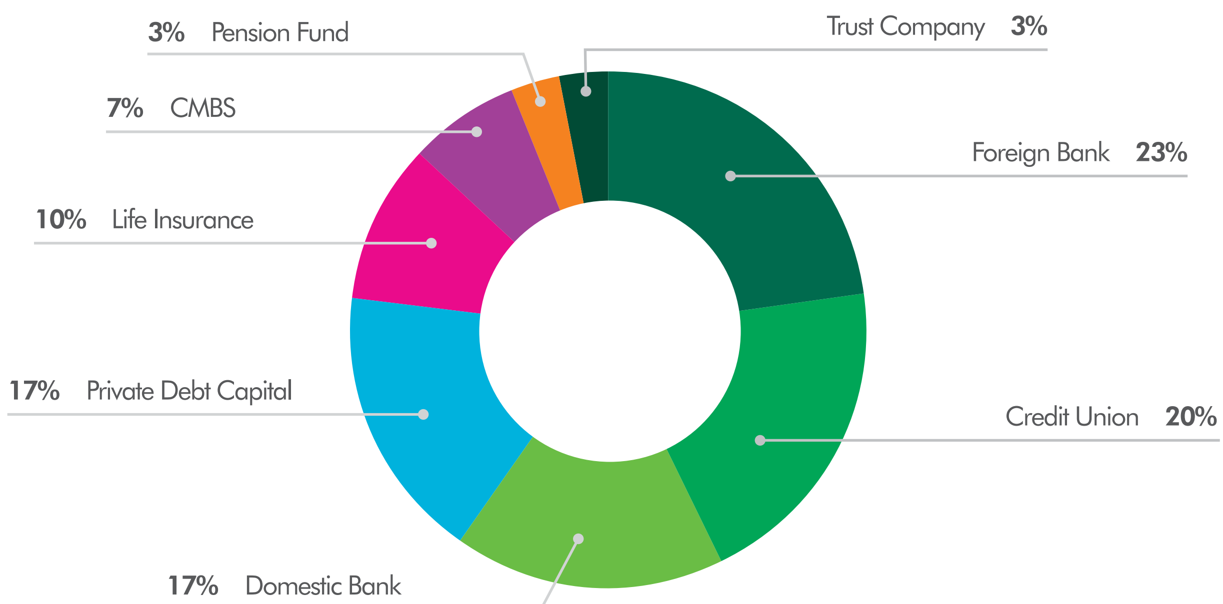
In 2016, 57% of the lenders expect spreads to widen by 10-20 basis points on traditional lending terms. A deflationary environment and accommodative policies from the Bank of Canada are likely to keep bond yields subdued and possibly trending downwards incrementally. An increased reliance on debt should see a growth in leverage by Canadian private investors who are already utilizing debt capital to a larger degree than at any time in recent memory.

As a result of increased demand for debt financing for commercial real estate deals, lenders expect increased competition from foreign banks. Those banks will be drawn to the controlled development pipeline and relative stability of Canadian commercial real estate fundamentals.

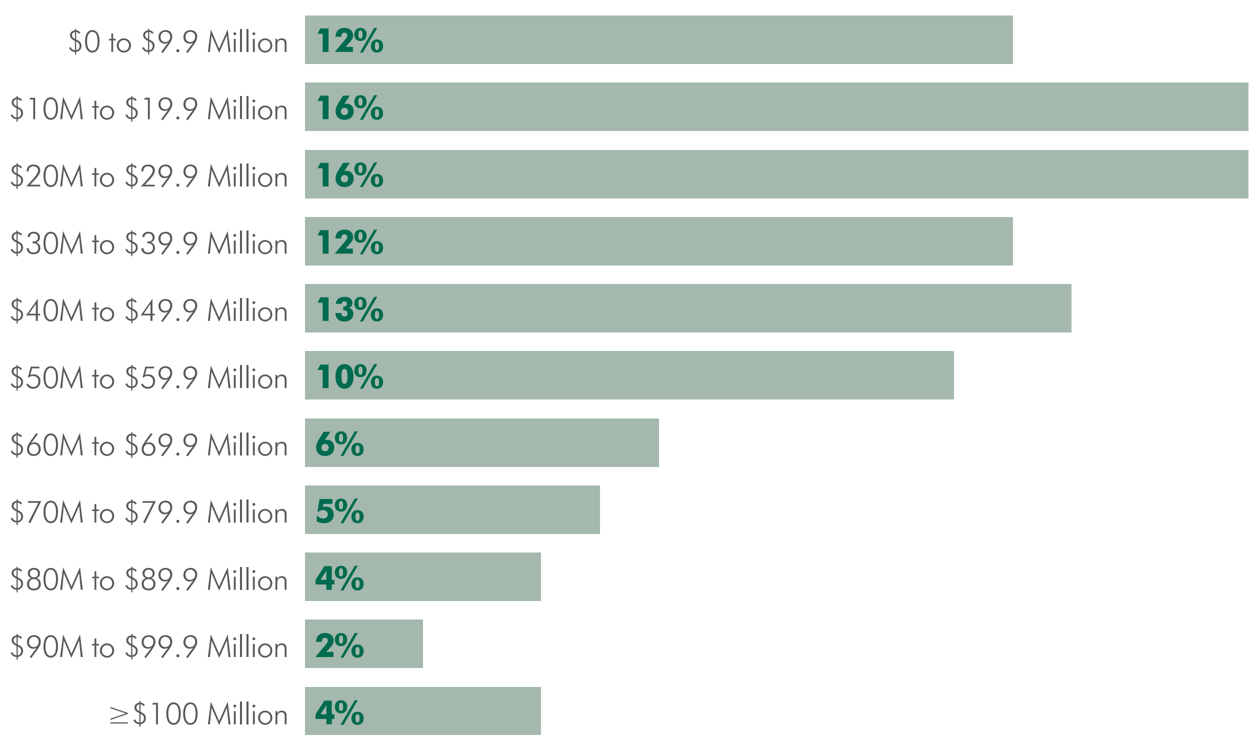
Lenders were able to navigate through the past turbulent year by relying on an established methodology and focusing on commercial real estate fundamentals. In 2016, Canadian lenders will continue to position themselves according to asset type, pricing, and geographic considerations that assure a stable path. These criteria will keep borrowers in much of the Canadian commercial real estate market within reach of a vital source of financing.

Participant Profile

1. How would you classify yourself as a lender?



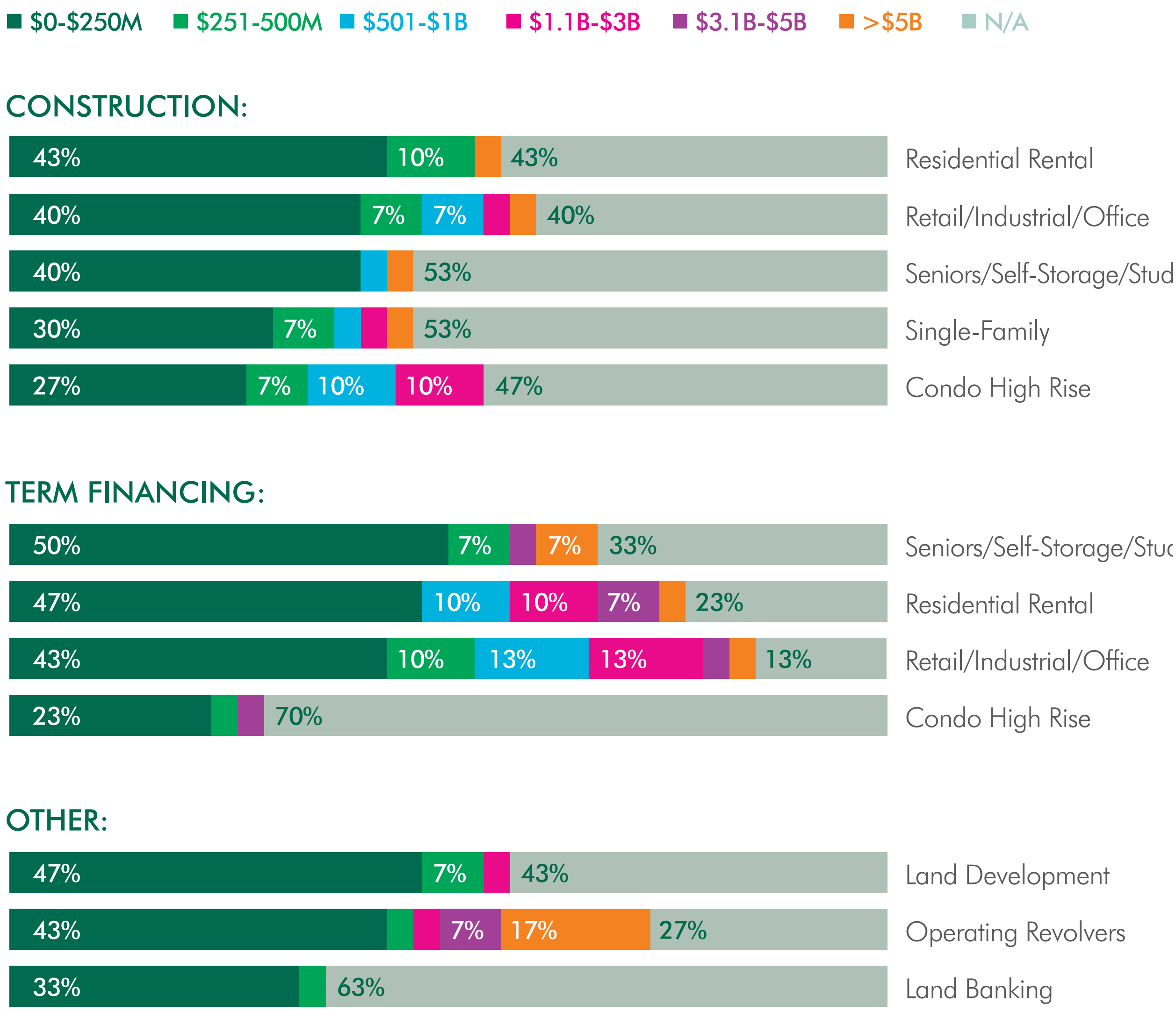
2. What segment of the market do you predominantly service (single loan size amount)?*



**Respondants could select multiple responses*

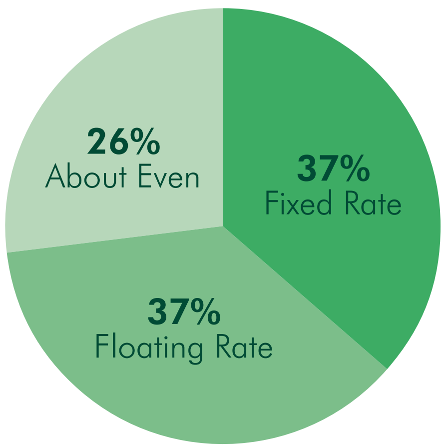
Participant Profile *(continued)*

3. What was the make-up of your commercial real estate loan book for 2015?

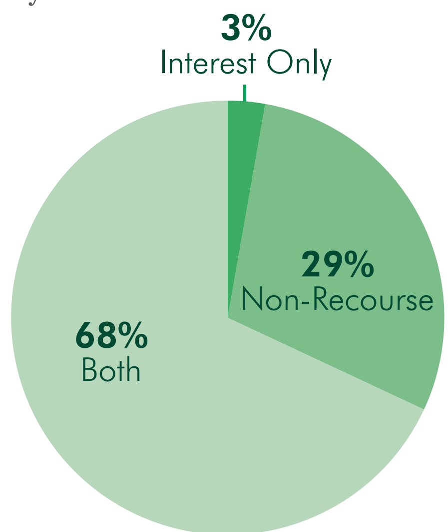


Offering

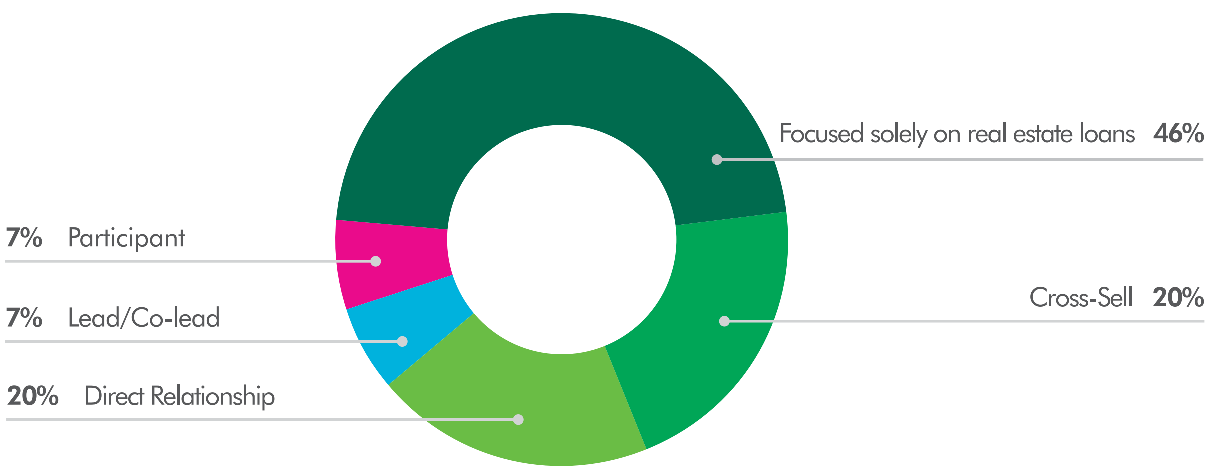
4. Do you predominantly lend on a fixed or floating basis?



5. Do you offer non-recourse and/or interest only loans?

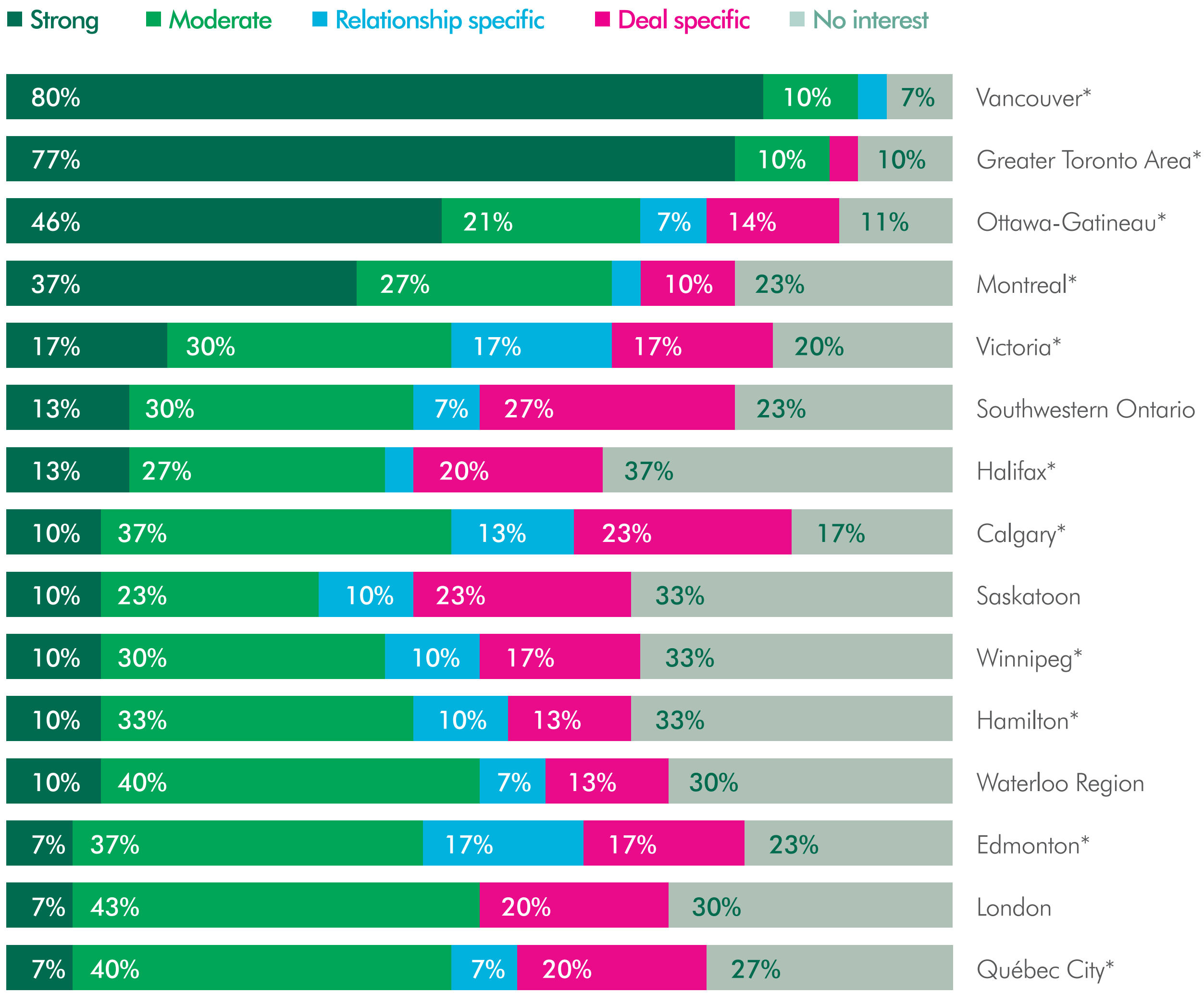


6. What are your primary motivations as a lender?



Offering

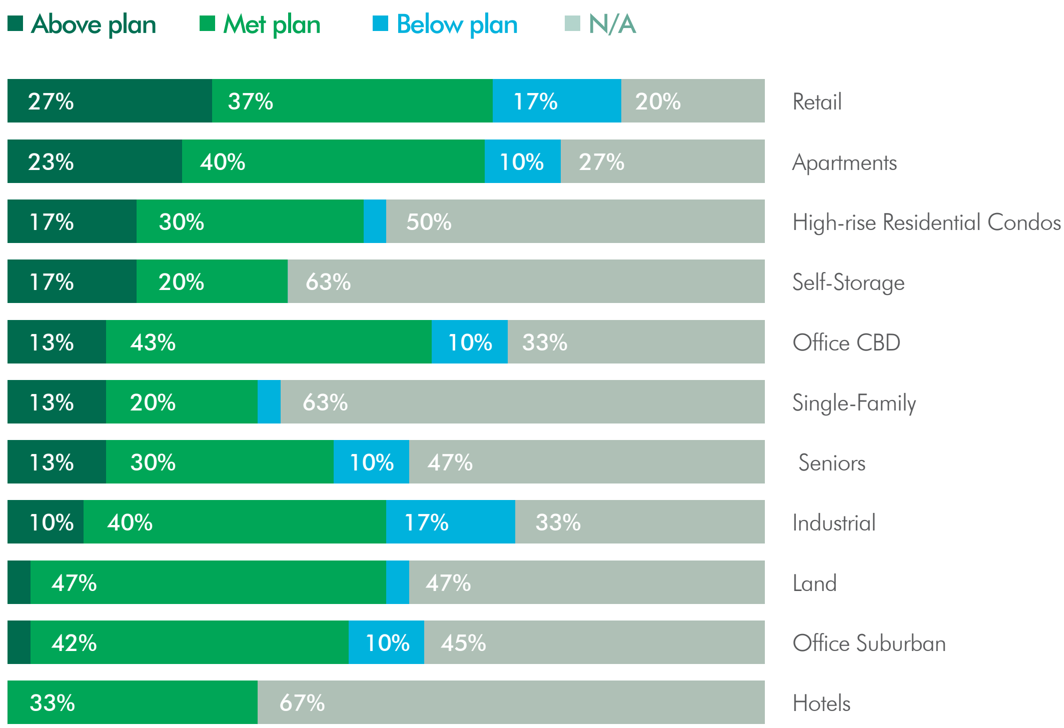
7. Rate your appetite to lend in the following markets:



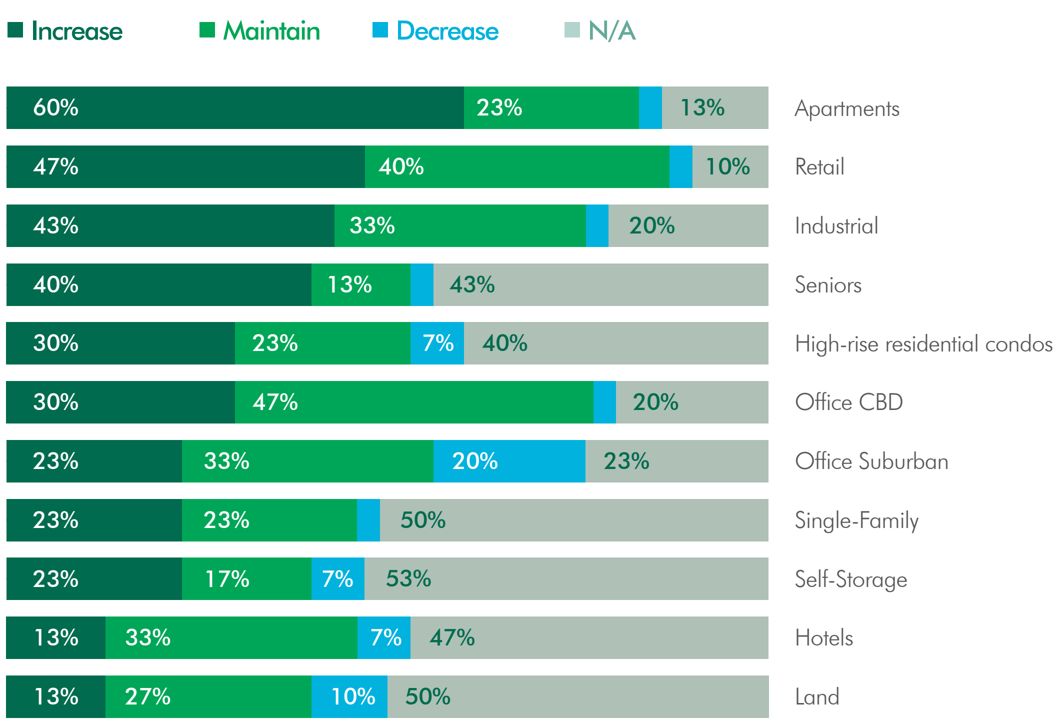
Teranet - National Bank National Composite House Price Index™

Demand

8. In 2015, did you exceed your budget in the following categories?

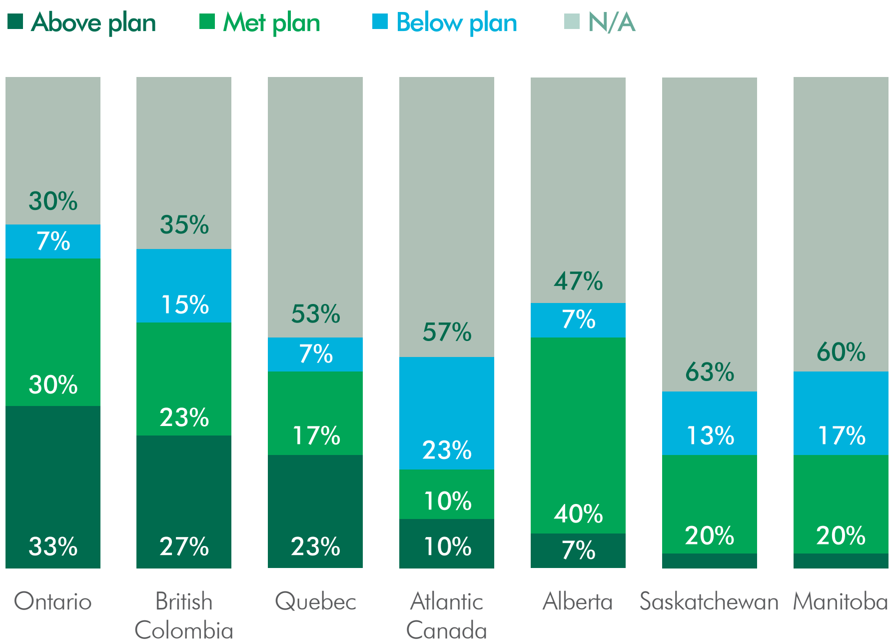


9. For 2016, what are your budget intentions for the following stated asset classes?

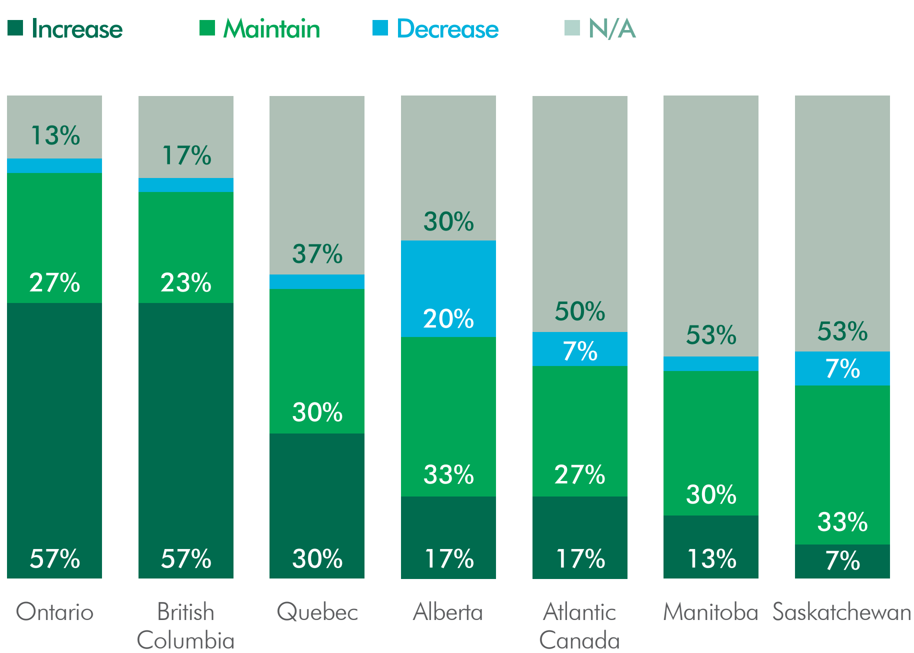


Geography

10. In 2015, did you exceed your budget in the following provinces?

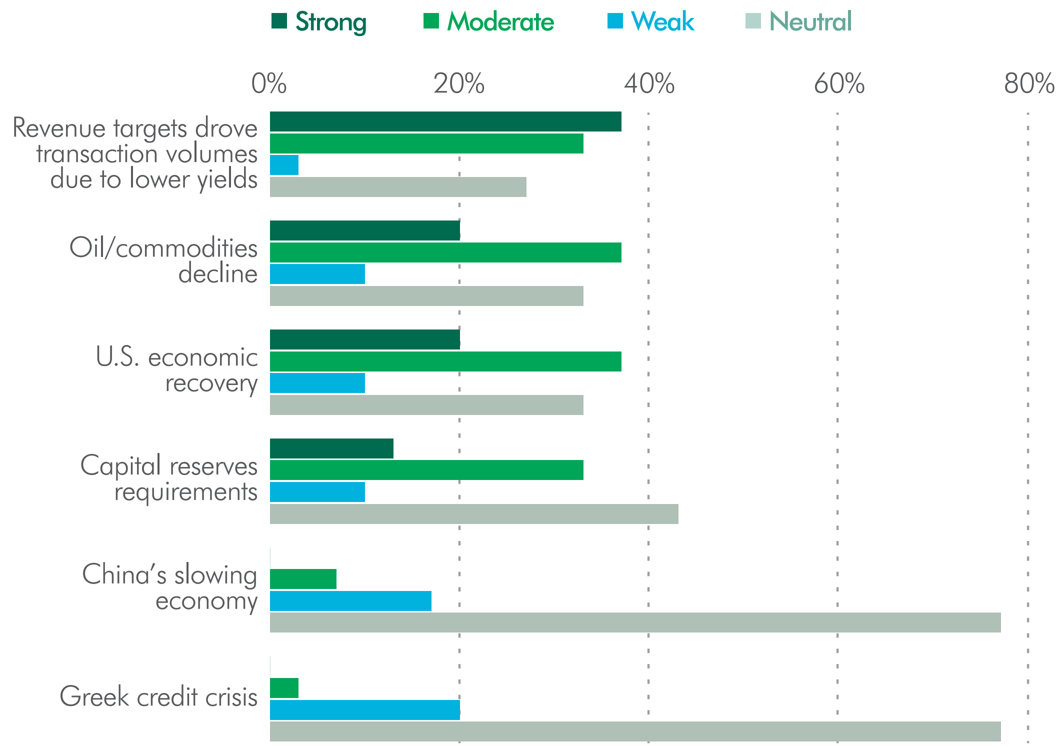


11. For 2016, do you plan to increase your budget for the stated provinces?

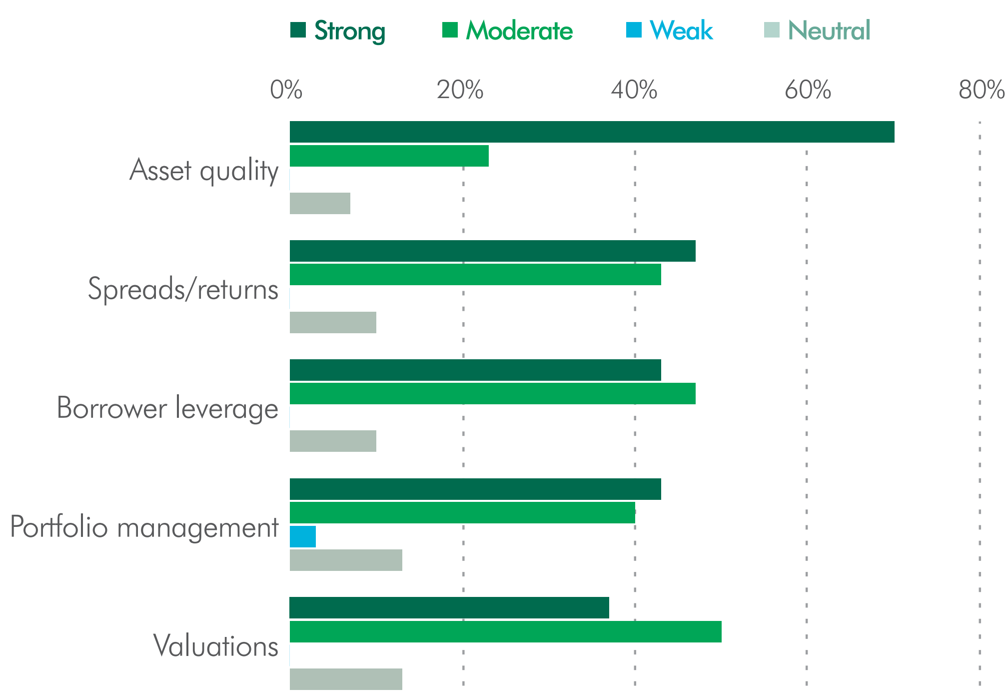


Lending Considerations

12. What primary macro factors shaped your organization's real estate lending decisions in 2015?

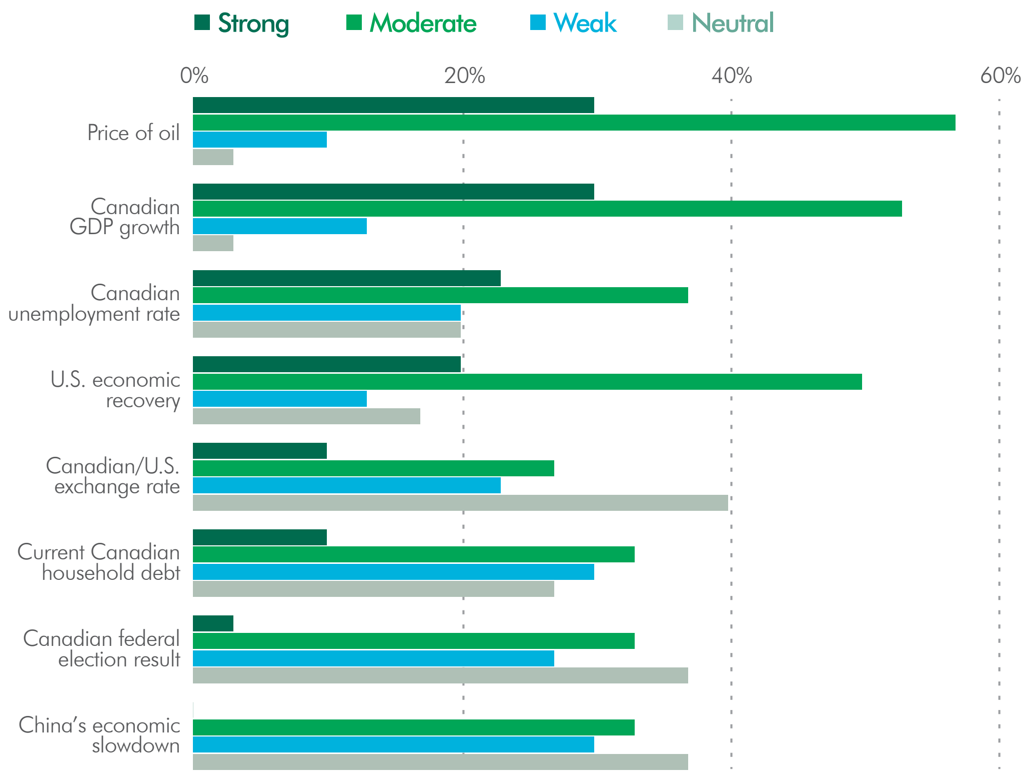


13. What primary micro factors shaped your lending decisions in 2015?

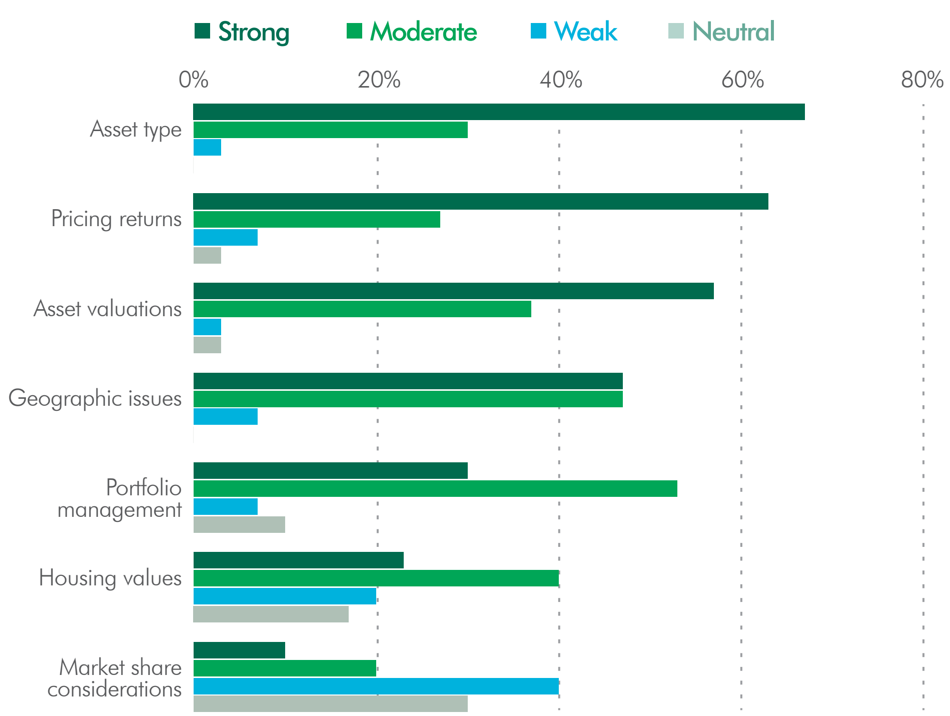


Lending Considerations *(continued)*

14. Which macro factors have the largest potential to shape your lending decisions in 2016?

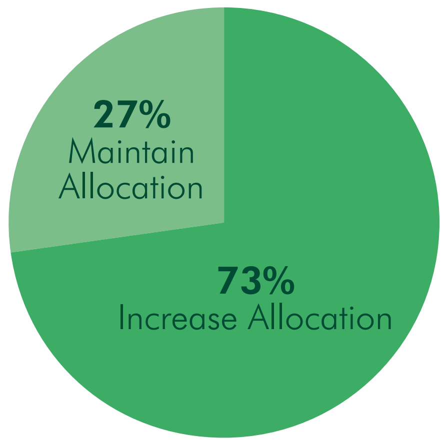


15. Which microeconomic factors have the largest potential to shape your lending decisions in 2016?



Supply

16. From an asset allocation perspective, which of the following best describes your organization's appetite towards real estate lending in the future?

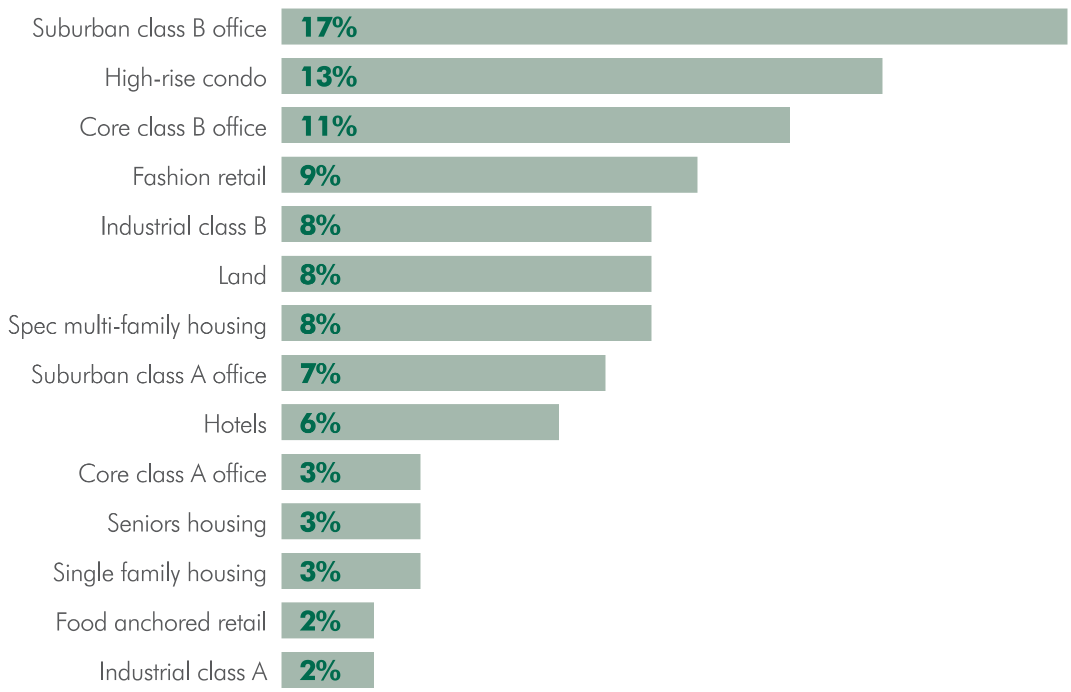


17. Assuming no repayments of your existing outstanding book, how much net new capital are you planning on lending in real estate in 2016?*

*Respondants could select multiple responses

Supply *(continued)*

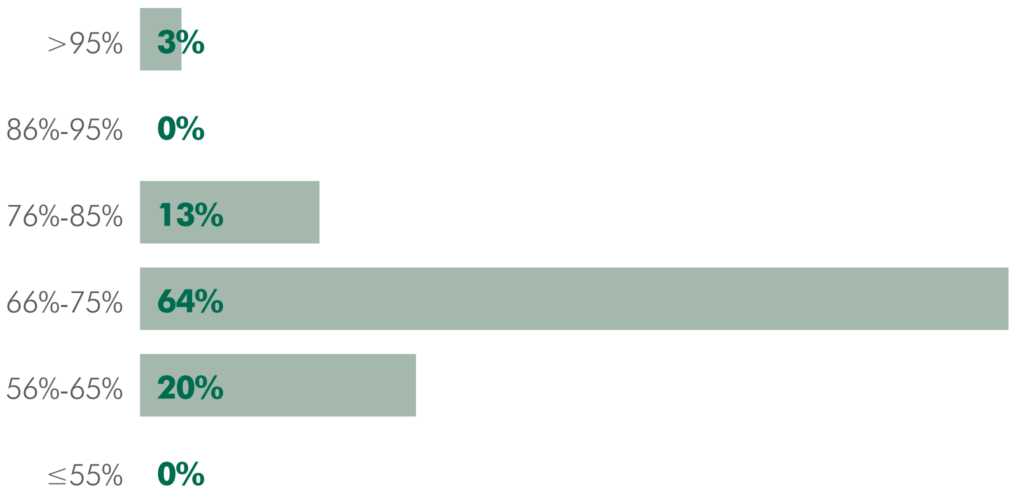
18. Which of the following asset classes cause you concern?*



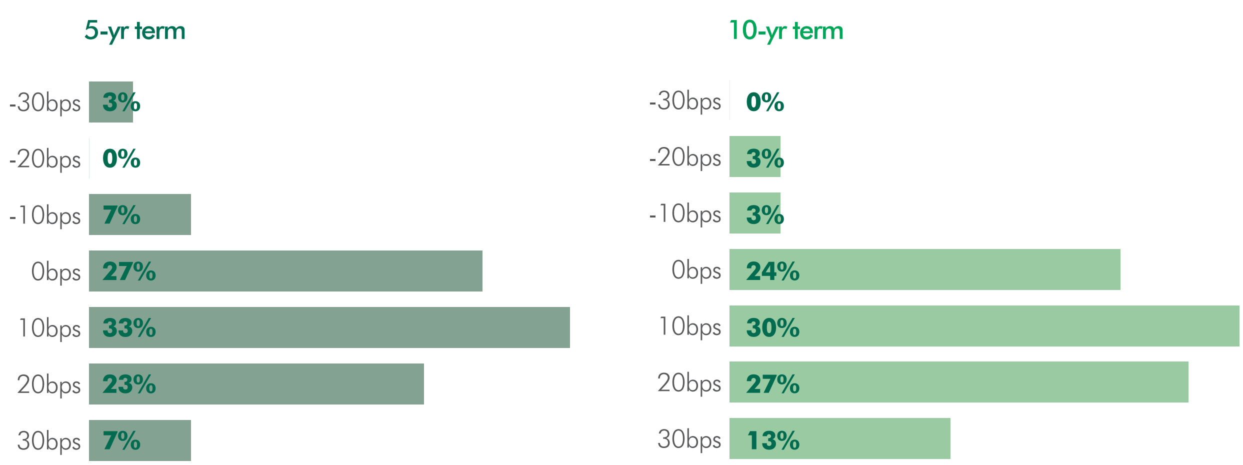
**Respondants could select multiple responses*

Underwriting

19. What is the maximum loan-to-value (LTV) you would consider (for stabilized, well-performing asset in Tier-1 market with strong sponsor)?

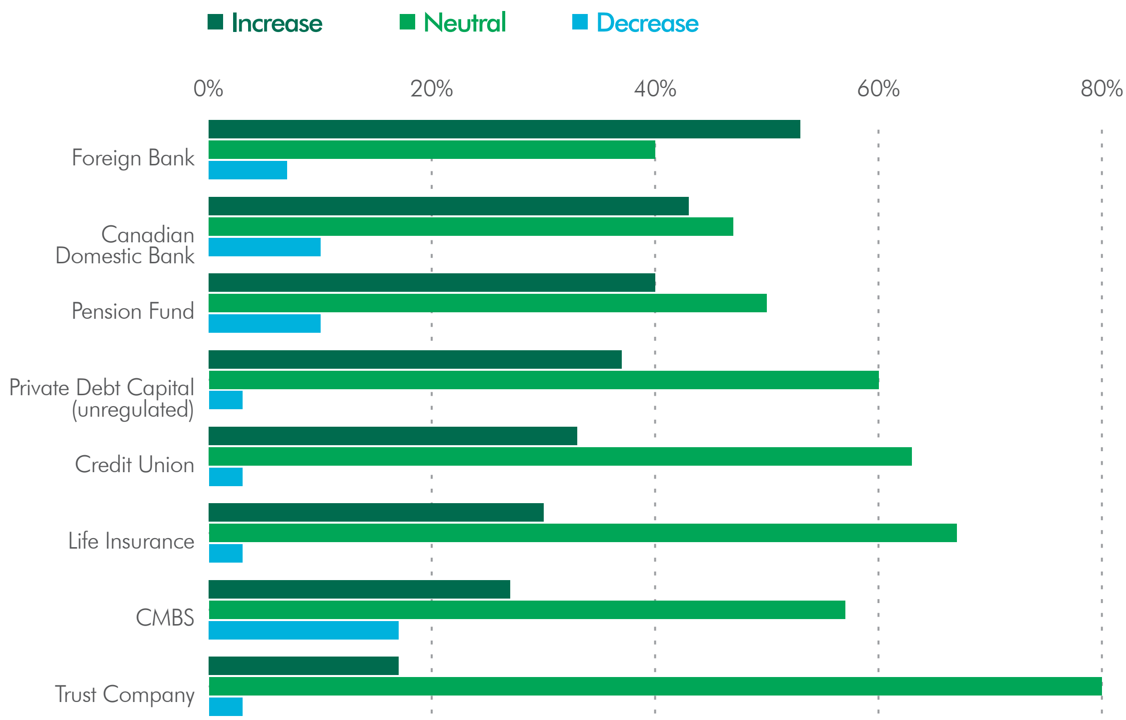


20. Where do you anticipate spreads going in fiscal year 2016?

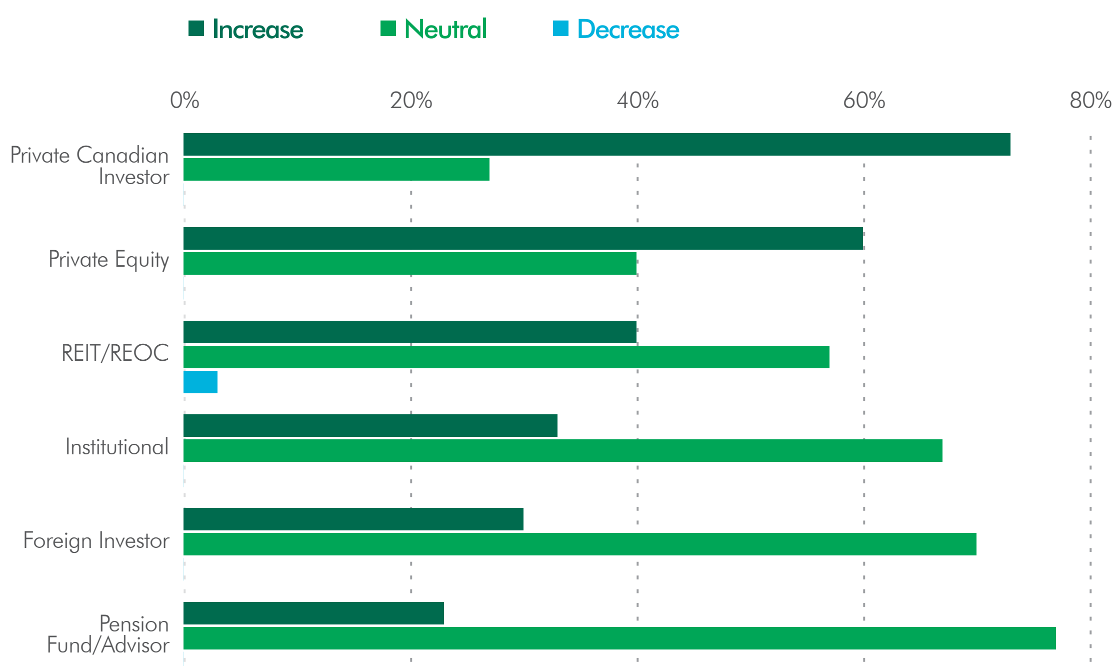


Underwriting *(continued)*

21. In 2016, do you expect greater competition for real estate loans to change from the following industry players?

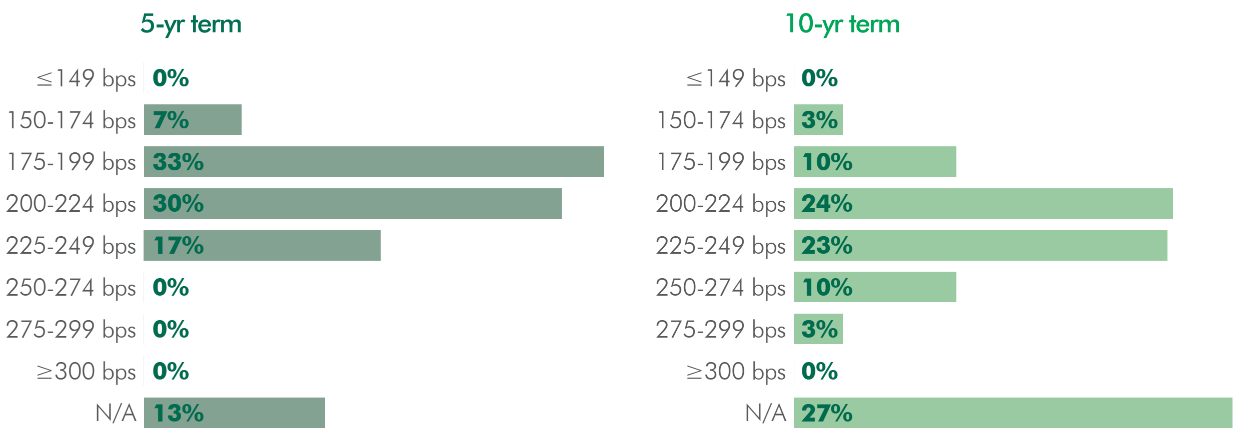


22. Has the low all-in borrowing rate caused borrowers to alter their use of leverage to finance real estate acquisitions (excluding the issuance of debt)?

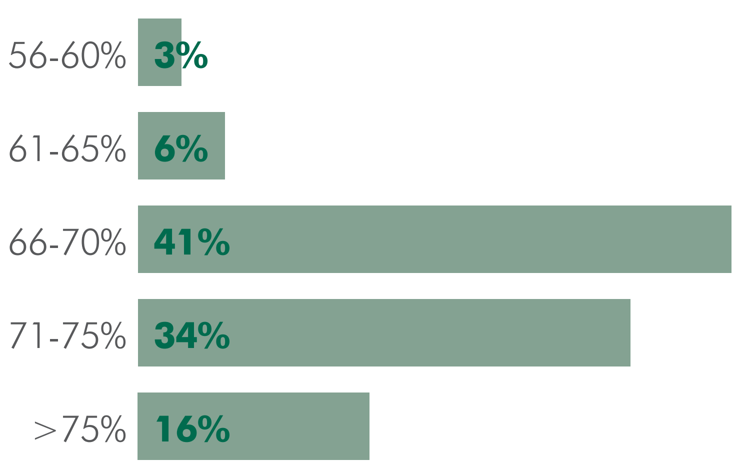


Pricing

23. Based on your organization's cost of capital, where would you typically price a deal for a well- performing Class A commercial real estate asset in a stable Tier 1 market with strong sponsorship and recourse?



24. What would be the maximum allowable LTV for a well- performing Class A commercial real estate asset in a stable Tier 1 market with strong sponsorship and recourse?*



**Respondants could select multiple responses*

Pricing *(continued)*

25. Would you assign a premium for a Class B commercial real estate asset in the same market?

26. Would you assign a premium for real estate in a secondary market?*

**Respondants could select multiple responses*

About

CBRE

CBRE Group, Inc. (NYSE:CBG), a Fortune 500 and S&P 500 company headquartered in Los Angeles, is the world's largest commercial real estate services and investment firm (in terms of 2014 revenue). The Company has approximately 52,000 employees (excluding affiliates), and serves real estate owners, investors and occupiers through approximately 370 offices (excluding affiliates) worldwide. CBRE offers strategic advice and execution for property sales and leasing; corporate services; property, facilities and project management; mortgage banking; appraisal and valuation; development services; investment management; and research and consulting. Please visit our website at www.cbre.com.

In Canada, CBRE Limited employs approximately 2,079 people in 22 locations from coast to coast. Please visit our website at www.cbre.ca.

CBRE CAPITAL MARKETS

CBRE Capital Markets comprises two seamlessly integrated, complementary services: the disposition and acquisition of institutional and investment properties for owners and investors, and the placement of Debt & Structured Finance. Capital Markets can respond to the full spectrum of real estate investment requirements by offering services designed specifically to meet the client's expectation and needs. Our teams were created to service each client in every sector across all markets.

DEBT & STRUCTURED FINANCE

With $33.8 billion of closed loan originations in 2014 worldwide, our team of skilled professionals is uniquely positioned to provide financing solutions by leveraging their invaluable collective experience and relationships with key institutional and private capital sources.

The Canadian Debt & Structured Finance operation is an integral part of our extensive Global platform. In addition to working seamlessly with the Capital Markets professionals, Debt & Structured Finance acts as a trusted advisor providing innovative financing solutions to real estate investors.

LENDERS' REPORT

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