Commercial Mortgage Commentary

Retail: Back from the Dead or Back from Vacation?

Retail in Canada has changed a lot over the last several years. Even prior to the pandemic, there was already a heightened sense of concern as e-commerce continued to grab market share from brick-and-mortar.

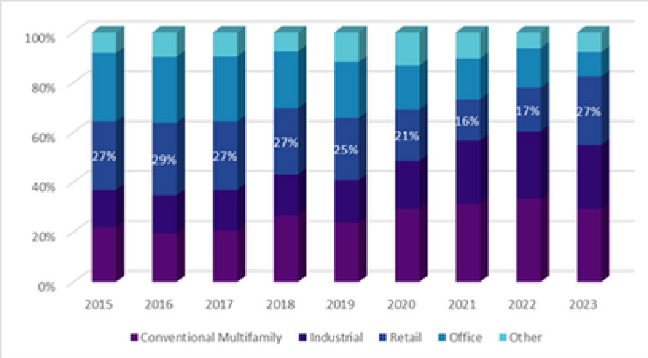
Despite those concerns, and in opposition to the e-commerce trend, retail has regained its footing. While there have been ongoing economic challenges, particularly higher interest rates and inflation, the retail sector shows signs of new life and an optimistic outlook from lenders.

The current resilience is driven by strong demand for necessity-based retail spaces such as grocery and discount retailers. In addition to growing demand, nobody seems to be building new malls or shopping-centers in the current environment which is making the existing spaces more competitive. RioCan REIT, for instance, has reported increased profits due to sustained demand and a lack of new supply in the market, which has kept the existing inventory in high demand (RenX).

While the Bank of Canada's rate hikes have somewhat depressed the commercial market overall, the retail sector has maintained some strength. In 2023, the volume of retail sale transactions in Canada totaled $2 billion (CBRE) confirming that deals are still getting done despite a tough environment.

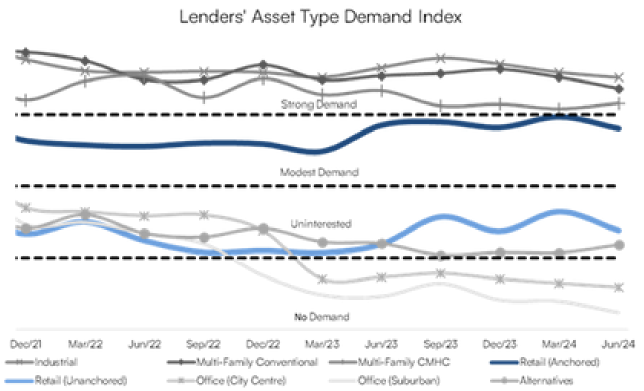
Can I Get Competitive Financing for My Retail Property in the Current Environment?

The short answer is yes! Lender demand for well-positioned retail assets is certainly on the way up. Compared to 2022, new retail loan originations grew by 36% to approximately $12B in 2023, putting demand back in line with pre-COVID figures as shown below. There are obvious signs that retail is becoming more competitive among lenders as well, with pricing for these loans coming down for the best-in-class assets.



Source: Intellifi, 2024

Notably, most of the demand is centered in grocery-anchored and other top-tier retail but demand on the unanchored side is showing signs of picking up as well. Over the last four quarters, there has been an upward trend in lender demand for these assets that will likely create an opportunity for borrowers to get more competitive pricing than they have seen since before the pandemic. Below the dark blue line represents anchored retail, light blue is unanchored.



Source: Intellifi, 2024

Trends in Retail

In today's market, retail assets are excelling by being either cool and unique or essential and reliable, meeting the diverse needs of consumers.

On one hand, innovative, and appealing locations like The Well in Toronto are drawing significant shopper interest by offering trendy retailers, restaurants, and experiences. Similarly, the development of Oakridge Park shopping mall in Vancouver is expected to be completed within the next 12 months and is already over 90% leased, highlighting the rising demand for these spaces among both investors and customers.

On the other hand, essential retailers such as Walmart, and Loblaws continue to be vital for everyday needs. This trend is underscored by the rapid growth seen in discount retailers like Walmart, which experienced a 15% increase in foot traffic YoY. Moreover, smaller suburban shopping centers are benefiting from population growth and a strong job market, with neighborhood shopping centers (primarily enclosed) seeing a 12.4% increase in traffic and outlet malls experiencing a 10.5% increase (Colliers, Foot Traffic Report). We anticipate that unenclosed malls, or open-air shopping centers, have been the main beneficiaries of this recent uptick in foot traffic. This preference for open-air environments aligns with the live-work-play factor that has become increasingly popular over the past few years.

Check-in with a CMLS Advisor

Strong demand for necessity-based retail and limited new supply has maintained the sector's robustness. While economic uncertainties and demographic shifts present hurdles, the overall sentiment remains cautiously optimistic.

For borrowers, connecting with a trusted advisor like CMLS, with flexible capital solutions and knowledge of the current market dynamics, is crucial for making informed financing decisions. Reach out to one of our advisors today for the most up-to-date capital solutions!

What's Going on with Rates?

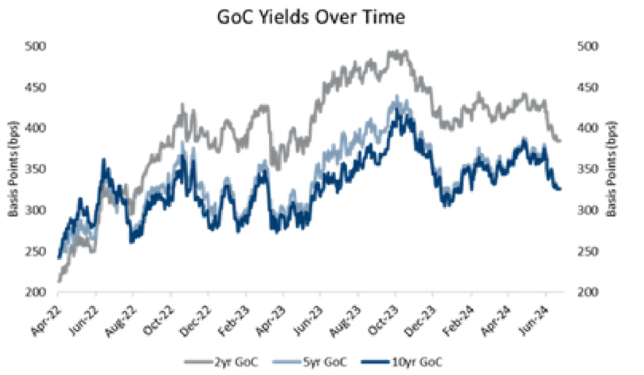
BoC Rate Decisions and Economic Indicators

On July 24, 2024, the Bank of Canada (BoC) decided to cut its key policy rate to 4.50%, marking the second reduction since 2022. The decision comes amidst a mix of economic signals. Notably, the Consumer Price Index (CPI) went down to 2.7% in June 2024, as expected. Inflation had been above estimates in May 2024 at 2.9%. The hope is that the inflation will continue to drop closer to the Bank of Canada's target inflation of 2% in the coming months to allow for further rate cuts later in the year. Employment numbers show moderate growth, with 27,000 new jobs added in April, though the unemployment rate nudged up slightly to 6.2%. These mixed signals indicate that while the economy shows signs of stability, the BoC's rate cut aims to boost economic growth and make borrowing cheaper.

Government Bond Yields and Implications for Borrowers

Government bond yields have slightly decreased in response to the BoC's July rate cut. The 5-year Government of Canada (GoC) bond yield is now at 3.20%, down 125 bps from its 52-week high of 4.45% in late 2023. For commercial mortgage borrowers, this drop in bond yields means lower fixed mortgage rates, creating a more favorable borrowing environment. Additional rate cuts could create opportunities for borrowers to lock in at lower rates.

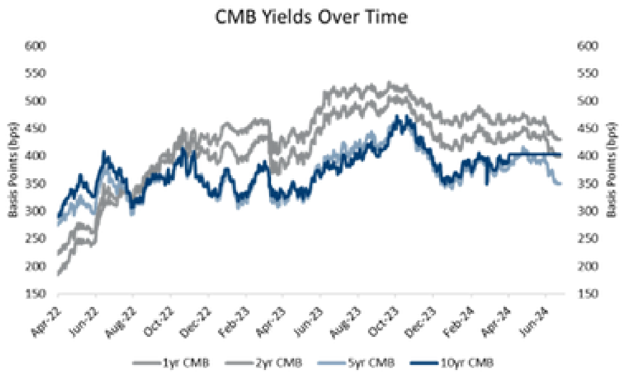
Currently, commercial spreads continue to compress for the most favored asset classes, while those higher up the risk curve remain unchanged. Best- in- class commercial assets are being pushed into 150-160 bps while the standard commercial pricing remains in the 200-230 bps range.



Source: Bloomberg, 2024

In the second quarter of 2024, Canada Mortgage Bond (CMB) rates trended downward. The 5-year CMB rate started the second quarter at 3.90% and dropped consistently throughout, settling at 3.37% as of July 29, 2024. Over the past three months, the 5-year rate saw a cumulative decrease of 40 bps, 15bps over the past month. The 10-year CMB rate had mixed performance, adjusting to new economic data and expectations around the Bank of Canada's interest rate decisions.

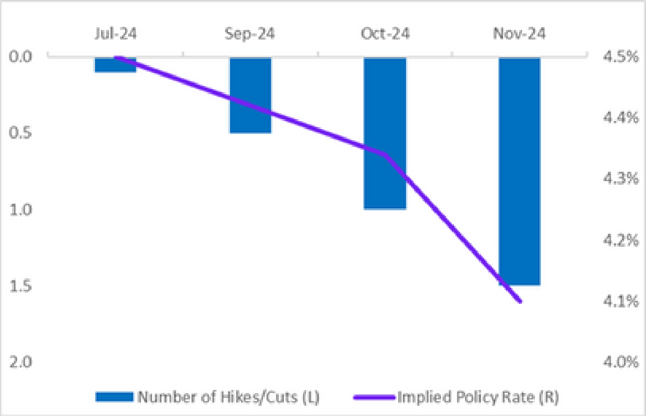
Insured spreads continue to be in the mid-to-high 40 bps over CMB with premiums for loan amounts below $10M and assets outside of core markets.



Source: Bloomberg, 2024

More Rate Cuts on the Way?

Financial markets have anticipated and priced in 1 to 2 more interest rate cuts by the Bank of Canada by the end of 2024. If these expectations hold true, the implied federal funds rate would drop from its current level of 4.5% to 4.1%, a 40-basis point reduction. This shift reflects investor sentiment and economic forecasts, suggesting a more accommodating monetary policy in response to potential economic slowdowns or lower inflation pressures.



Source: Bloomberg, 2024

Government Policies Impacting CMHC Commercial Mortgages

On June 4th, 2024, CMHC announced major revisions to its lending programs, impacting energy efficiency scoring, refinancing criteria, and amortization periods. The MLI Select Program now features reduced points from energy efficiency that may result in less flexible lending metrics for some projects. At the same time, refinancing restrictions have been lifted, offering more flexibility to borrowers.

For borrowers, the elimination of refinancing restrictions allows for greater flexibility. These adjustments collectively support broader economic and social goals, reinforcing CMHC's commitment to balancing immediate market needs with long-term sustainability.
CMHC has also announced that, effective September 3rd, lender correspondents will no longer be permitted to submit multi-unit insurance applications directly to CMHC. The full market impact of these changes on all industry participants will be seen in the coming months.

For more details, visit the CMLS CMHC Lending Program Update or contact your CMLS Advisor.

About CMLS Financial

CMLS Financial is one of Canada's largest independently owned mortgage services companies. Founded in 1974, we are proud to be Canada's Mortgage Company for 50 years. With offices across the country, we provide a wide range of commercial lending services, residential real estate mortgages and institutional services.

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