Accrued Interest

CMLS mortgage fund

May 2025

cmls asset management

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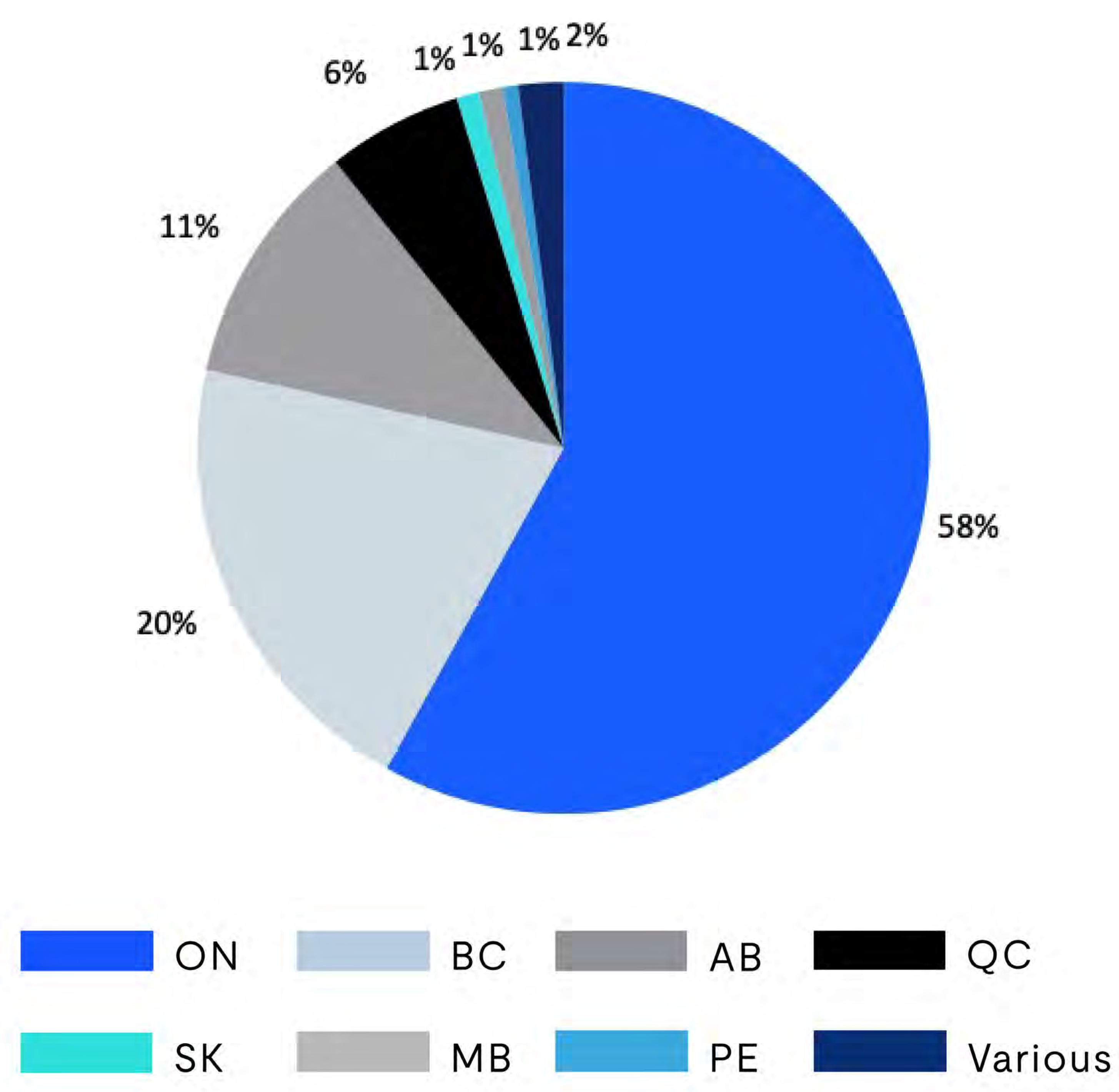
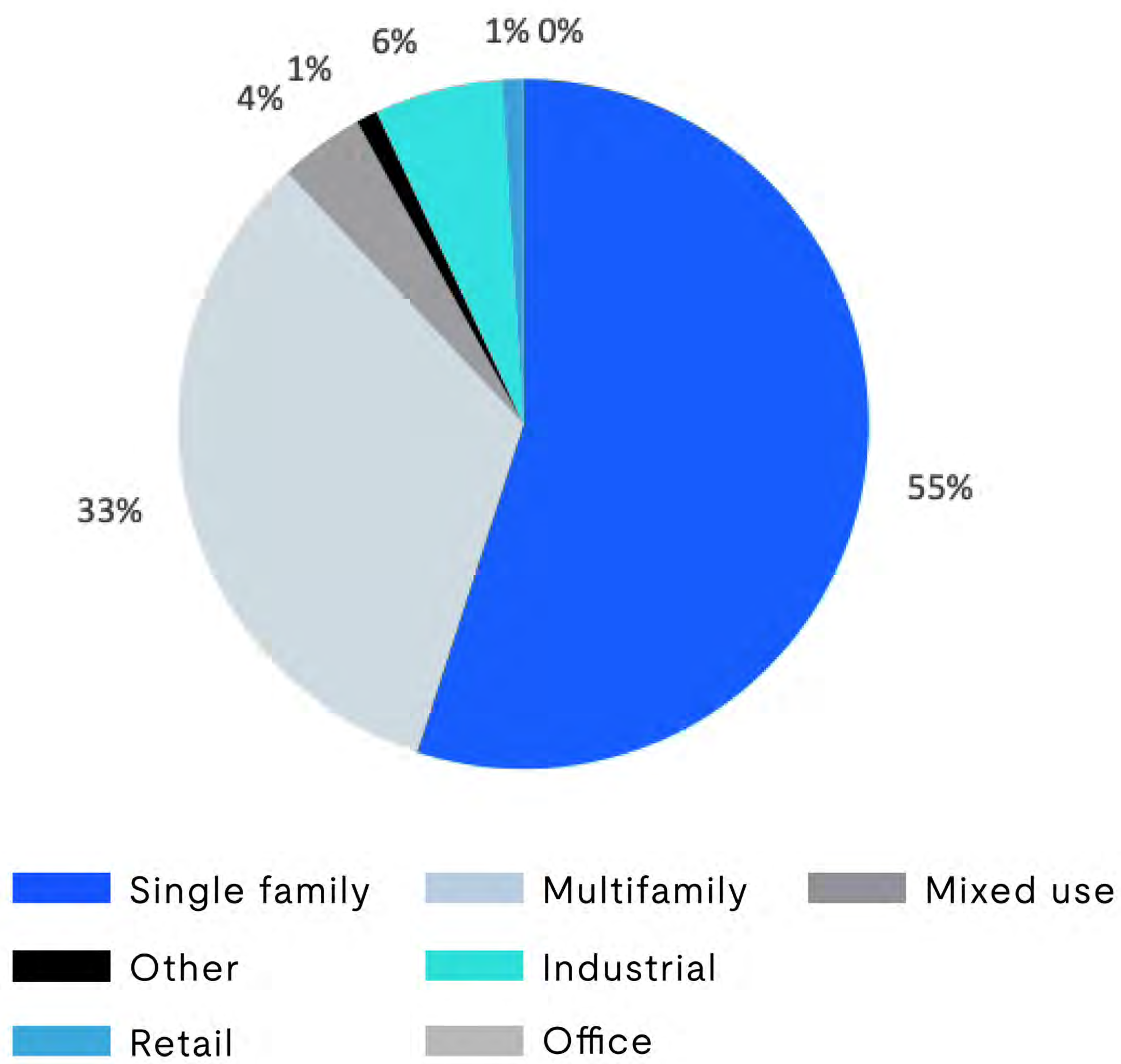
Thank you for reading the May edition of **Accrued Interest**. In April the CMLS Mortgage Fund delivered a monthly return of 0.65%, or 8.17% annualized. Our weighted average coupon now sits at 8.08%, accepting a slight reprieve from downward rate pressure in new lending opportunities but still facing much lower coupons than in 2024. With that in mind, as we've noted several times prior, our ability to maintain returns in a downward rate environment is greatly improved by remaining fully invested. Cash now sits at less than 2% of AUM with a healthy pipeline of near-term investments.

Our portfolio is composed as follows:





More detailed and up-to-date portfolio information can be found in our monthly Fund Facts, available on our website here.

Making Sense of the Condo Market

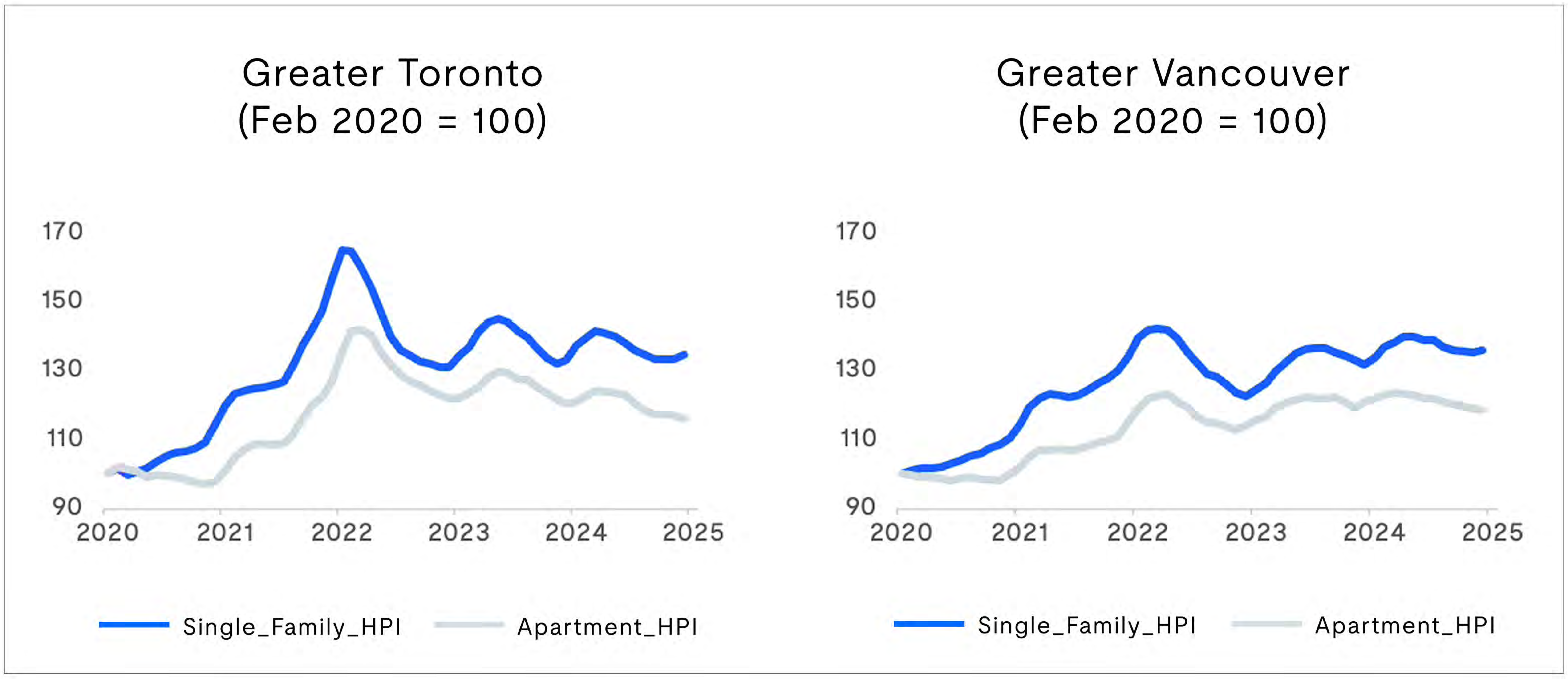
Before we get into the details, it is important to note up front that despite what we cover below, there is an affordability problem in Canada. In recent years, historic population increases, limitations on available land, and high municipal taxes and bureaucracy meant that delivery of new affordable units for median income households was far from optimal. Broad public pronouncements in the industry suggest it is up to governments to reduce the red tape and eliminate the cash grabs to make these projects feasible once again. It is also important to note up front that this is a valid argument.

One recurring theme across the push for affordability is the need for density. With land constraints plaguing the core urban markets of Greater Toronto and Greater Vancouver, the only viable way to boost supply in the face of increasing demand was to increase density on existing available land. Although bureaucracy (noted above) affected speed of delivery, both public and private sector forces acknowledged this need and henceforth created the conditions for a condo boom, in two of the most livable cities in North America.

This was not without friction, as developer budgets were burdened by more than just municipal taxes. Add a tight labour market, higher materials costs by way of supply chain disruptions through the COVID-19 pandemic, and suddenly Prime rate expansion by nearly 3x as we lost control of inflation in 2022. None left room for error in a developer's pro forma, and the result, unsurprisingly, was a focus on building the most profitable structures. What that meant was a tendency toward larger towers and smaller units, a shrewd avoidance of diminishing revenue economies re: unit size and capture of diminishing cost economies re: building size.

Using January to March as an example, the start of each year between 2021 and 2025 in each of Vancouver and Toronto brought with it nearly 5x the number of the condo starts than detached or semi-detached single family homes – and this excludes rentals[1].

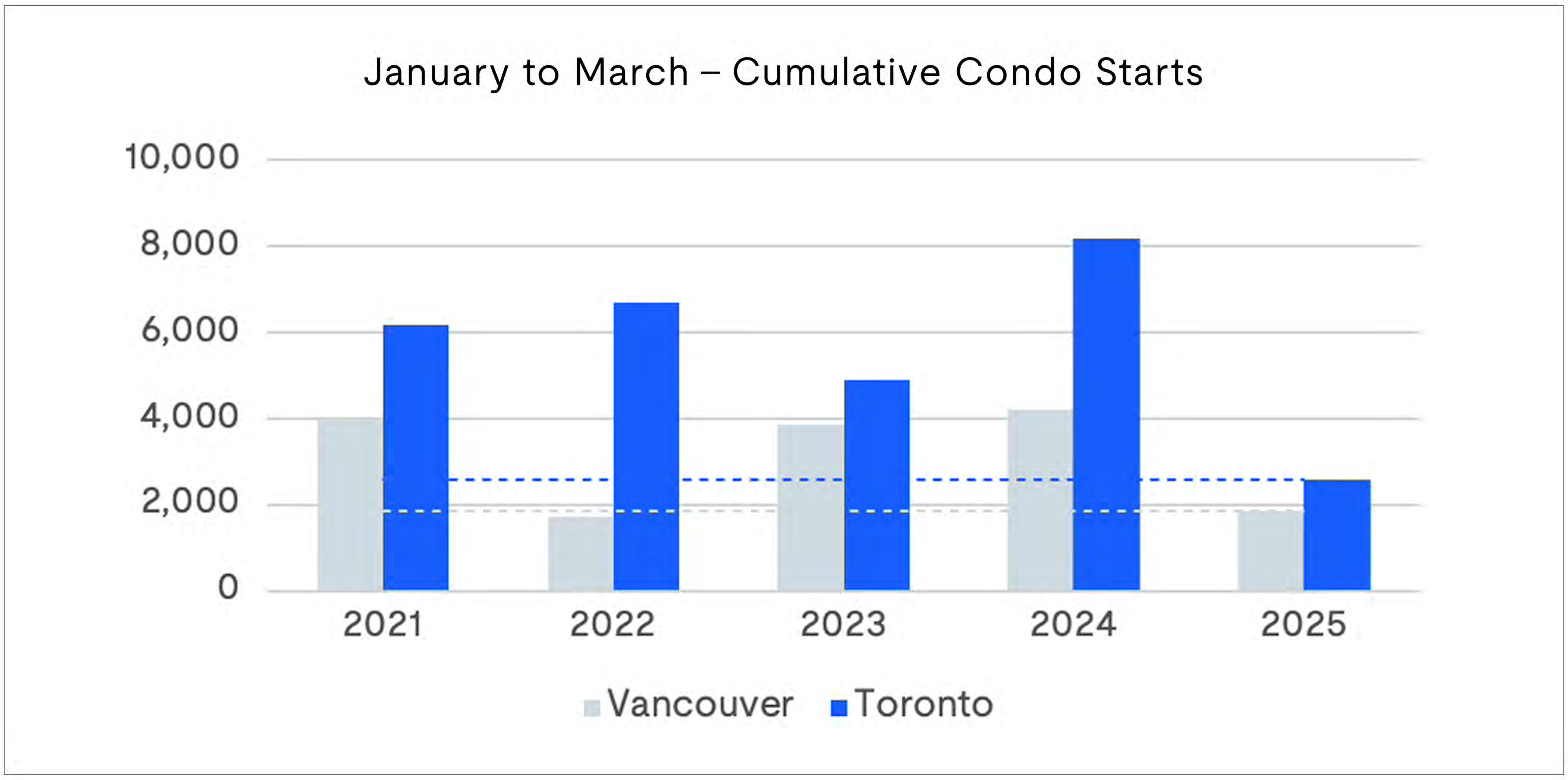
Through roughly the same period we've seen a growing gap between prices of detached homes and condominiums[2]. Growing listings-to-sales ratios evidence softness in condominiums with the level of active listings pushing past historical norms with significant YoY increases.



The question we are debating is whether further downside risk to condominium values exists. Have we reached the point where the inability to assign presales at a profit, a lack of expected future price appreciation and softness in rents has effectively removed the investor-buyer group for bachelor and one bedroom units? Perhaps we have just accepted we will not be London or New York and Canadian families value space and backyards over urban core living, further reducing the buyer pool for small downtown units. Optimistically, we could suggest that what young families love about downtown-adjacent neighbourhoods are not the modest backyards but the shared amenities – the parks, the trendy coffee shops and restaurants, and the daycares – and just the right amount of distance from the core in a post-COVID, return-to-work environment. This could mean lower-case "d" densification, or the missing middle we hear about, really is a workable solution.

[1] CMHC (Starts and Completions Survey)
[2] The Canadian Real Estate Association

We have always been careful with larger loan amounts on single family residential properties. Housing is typically financed with debt, and so financing homes which are accessible by a larger portion of the population suggests greater liquidity – particularly a greater demand pool for the collateral property. This dynamic has made lending on condominiums attractive, as they carry a lower price point. But demand is only a useful statistic in relative form. Softness in the market suggests we've reached a level of supply such that this more accessible part of the market has become even more accessible. This is a good outcome for affordability overall, irrelevant for backyard barbecues, and a negative outcome for pre-sale condo lenders with exposure to peak prices. It also may spell opportunity as new condo starts, which have steeply descended year over year, could forewarn of supply shortages once again just two or three years in the future[3].



What does this mean for our portfolio? To start, we primarily provide mortgages on houses (detached/semi-detached/townhomes), with 70% of our single family residential allocation secured by houses. This leaves 30% of our single family residential allocation (15% of AUM) allocated to condominiums. Despite the headwinds facing this segment of the market (see charts above), we remain open to mortgages secured by condominiums.

You might ask why. The stress on the system is evident. Developer defaults and pricing challenges now frequently populate the headlines. But when we look at the key metrics of our portfolio, particularly our wtd. avg. loan per square foot of $528, and wtd. avg. borrower credit score of 743, we are in a position of strength. Much of the stress lies in overheated pre-sale pricing well into 4-digits per square foot, comfortably distant from our typical exposure leaving room for continued downward price pressure. We avoid a portion of this risk by re-valuing properties at the time of funding (using third party appraisals) instead of relying on stale values from the time of the pre-sale. We also only lend on properties after they have been completed, which removes the risk of a developer running into issues during construction.

Our response to current conditions is to proceed with caution. Return, like demand, is a useful statistic only in relative form, and returns have been attractive. In fact, both credit performance and yield available in this segment have remained strong, with no discernable pattern of elevated delinquency relative to detached homes in the portfolio. We will be hesitant to significantly increase our condominium exposure in the current market environment, but are comfortable with where we stand today.

[3] CMHC (Starts and Completions Survey)