

Accrued Interest

CMLS mortgage fund

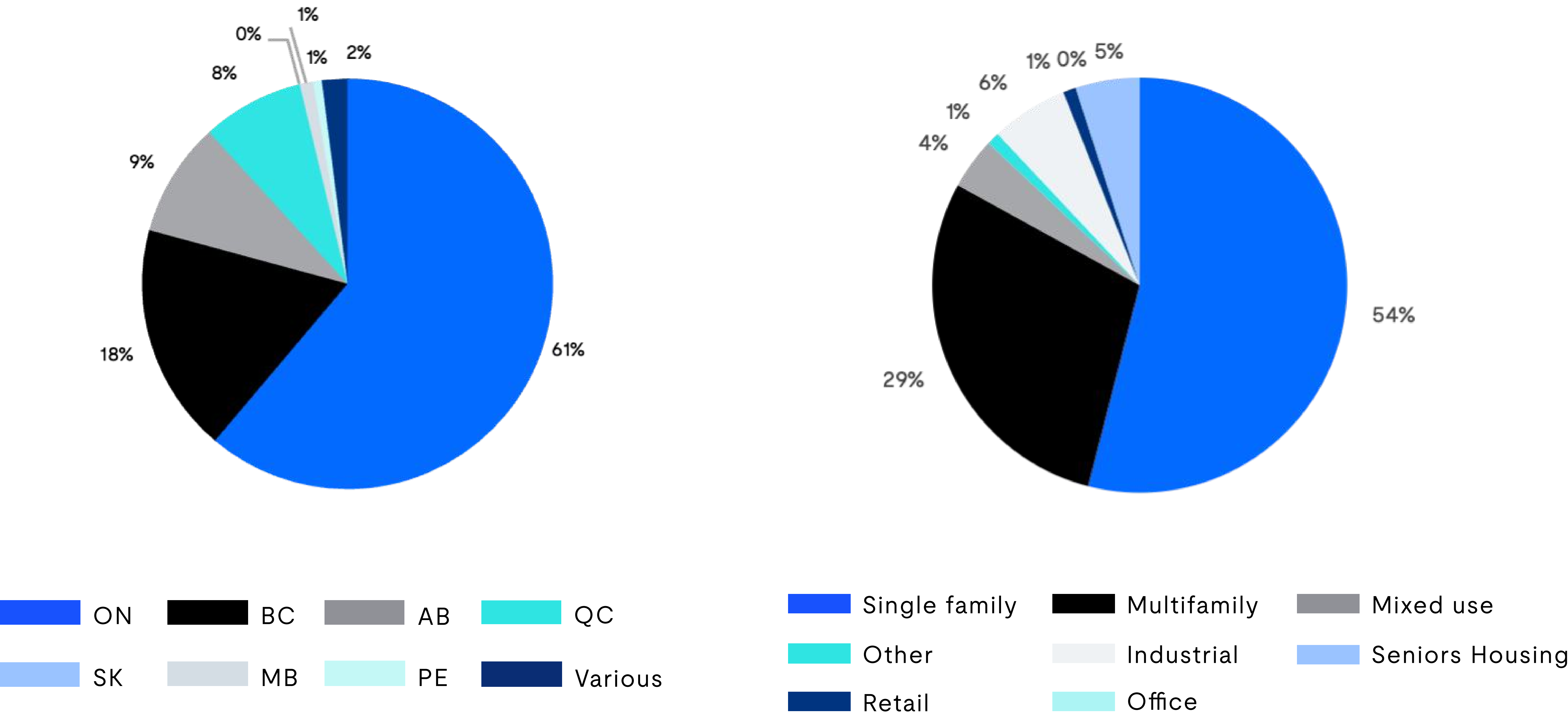


September 2025

cmls asset
management

Thank you for reading the September edition of [Accrued Interest](#). In August, the CMLS Mortgage Fund delivered a monthly return of 0.57%, or 6.92% annualized. Our weighted average coupon has remained relatively flat, going from 7.96% in July to 7.91% at the end of August. Capital deployment was slower in August, resulting in a small cash position of 4% at the end of the month.

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](#).

Why invest in real estate debt?

Investors are blessed with choice among countless potential investments, new launches and new product inventions seemingly every day. When we think of our clients, we consider why they would allocate a portion of their portfolio to real estate debt. Once you zoom into real estate as a category, how does this compare with real estate equity investments? And how does an investment in real estate debt impact the whole portfolio?

Real estate debt and equity are exposed to the same underlying collateral risk, but they behave very differently as investments. For one, real estate equity allows investors to capitalize on growth in property values and net operating income (NOI), while returns on real estate debt are limited to contractual yields on the loans in the portfolio. Conversely, real estate equity is exposed to the first dollar of loss if property values decline, whereas real estate debt generally has a buffer for property values to decline before being exposed to any losses.

The value, or price, of a cash-flowing real estate asset is derived by discounting the property's NOI by the market's required return on that asset, also known as a capitalization rate. Recognizing that NOI will not stay the same forever, particularly given real estate's broad acceptance as an attractive hedge against inflation, an implied growth rate should be embedded into the capitalization rate. The Gordon Growth Model outlined below gives insight into the relationship between a property's capitalization rate and the implied growth rate of NOI. We can observe that the cap rate (the denominator) decreases as the NOI growth rate increases, and vice versa. Now, why should someone care about this relationship when deciding between real estate equity and real estate debt?

Gordon Growth Model

$$P = \frac{D_1}{(r - g)}$$

D_1 = Expected Dividend Per Share Next Year

r = Required Rate of Return (Cost of Equity)

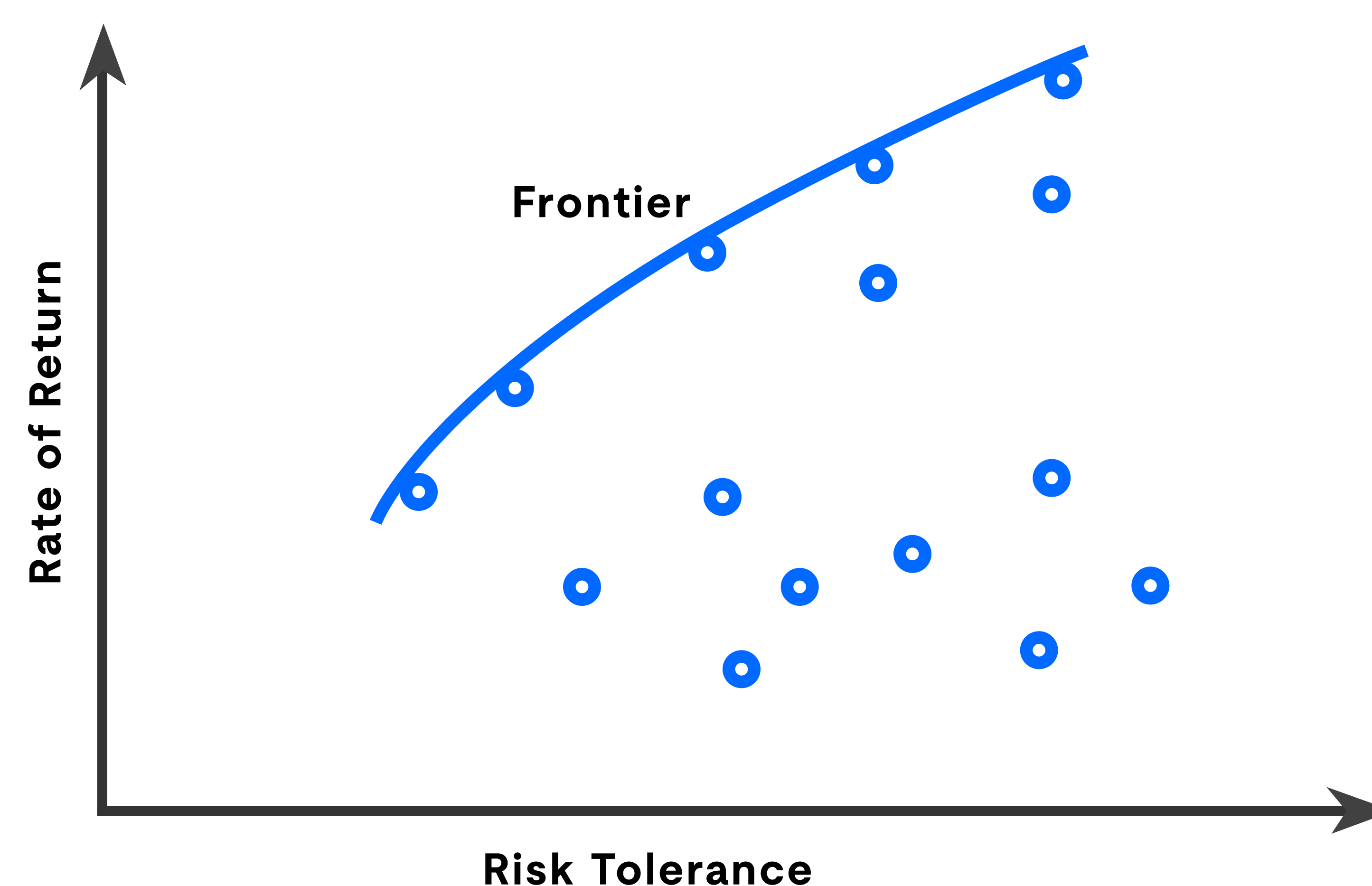
g = Dividend Growth Rate (constant)

The primary reason, in our view, is that it represents a market based measure of expected unlevered asset class returns which can be compared with more easily observable debt yields across your investment options. To illustrate, national capitalization rates on multi-family residential properties in Canada range from 4.44% – 4.86%^[1]. Despite slowing in 2025, we continue to experience growth of average rents due to the significant positive differential between rents on new leases and in place leases^[2]. If we use the midpoint of the capitalization rate range above of 4.65% and assume that NOI grows continuously at the 15-year average annual rental growth rate (3.99%)^[3], the implied required multi-family residential property return per the Gordon Growth Model is 8.64%.

As readers will know, we invest in debt secured by multi-family residential properties. The required return above compares to the weighted average coupon of 7.31% on all 1st ranking multi-family residential loans in our portfolio (note that we've excluded 2nd ranking mortgages which present characteristics of a levered investment and therefore offer an unfair comparison to unlevered equity returns). Once you consider lender fee participation (a feature missing in real estate equity investments), the gap between unlevered debt and equity returns shrinks to approximately 75-100 bps.

We touched briefly on the different risk characteristics between real estate equity and debt. Real estate equity is exposed to the first dollar of loss if property values decline whereas real estate debt has a buffer for values to decline before losses occur. To put this in our fund's context, the average loan-to-value ratio for 1st ranking multi-family residential loans is 50%, meaning that prices can decrease by 50% on average before being at risk of loss. In addition to this, all multi-family residential loans in the fund have recourse to an individual or entity that has additional resources outside of our security (the weighted average equity position of the guarantors on 1st ranking multi-family residential loans in the fund is \$78 million). To reframe, even if values decrease by enough to wipe out the equity in the asset, another layer of defense is activated by way of claim against the guarantor. So, while the yields are similar between equity and debt, common underlying risks are significantly mitigated with the latter. The question becomes whether 75-100 bps is appropriate compensation for the added risk of the former.

A common use of debt in a portfolio is to reduce volatility of returns through limited correlation with public markets. Modern Portfolio Theory is based on the concept that investment portfolios are optimized by maximizing the expected return for specific level of risk, or by minimizing risk for a specific level of return. This is achieved by combining investments whose returns have low or negative correlation into a portfolio, or in other words, diversification. The below graph shows the optimized portfolio allocations which lie along the efficient frontier.



Real estate debt serves this function in multiple ways: 1) real estate values and income don't move directly in line with stocks, 2) debt yields are driven by interest rates instead of earnings, and 3) real estate debt has a value buffer built in before a loss is incurred. Since inception, our fund has had a low correlation of monthly returns to the S&P 500 of 0.19 and has had a low standard deviation of monthly returns of 0.13%. Our fund is revalued monthly, so these numbers show the true performance of the loans in the fund, but due to our low duration the NAV has historically been steady.

Through the addition of real estate debt, investors can obtain strong returns with added layers of defence, and reduce the volatility of their portfolios.

[1] CBRE – Canadian Cap Rates & Investment Insights Q2 2025
 [2] Rentals (National Rent Report)
 [3] CMHC (Rental Market Survey)