

Accrued Interest

CMLS mortgage fund

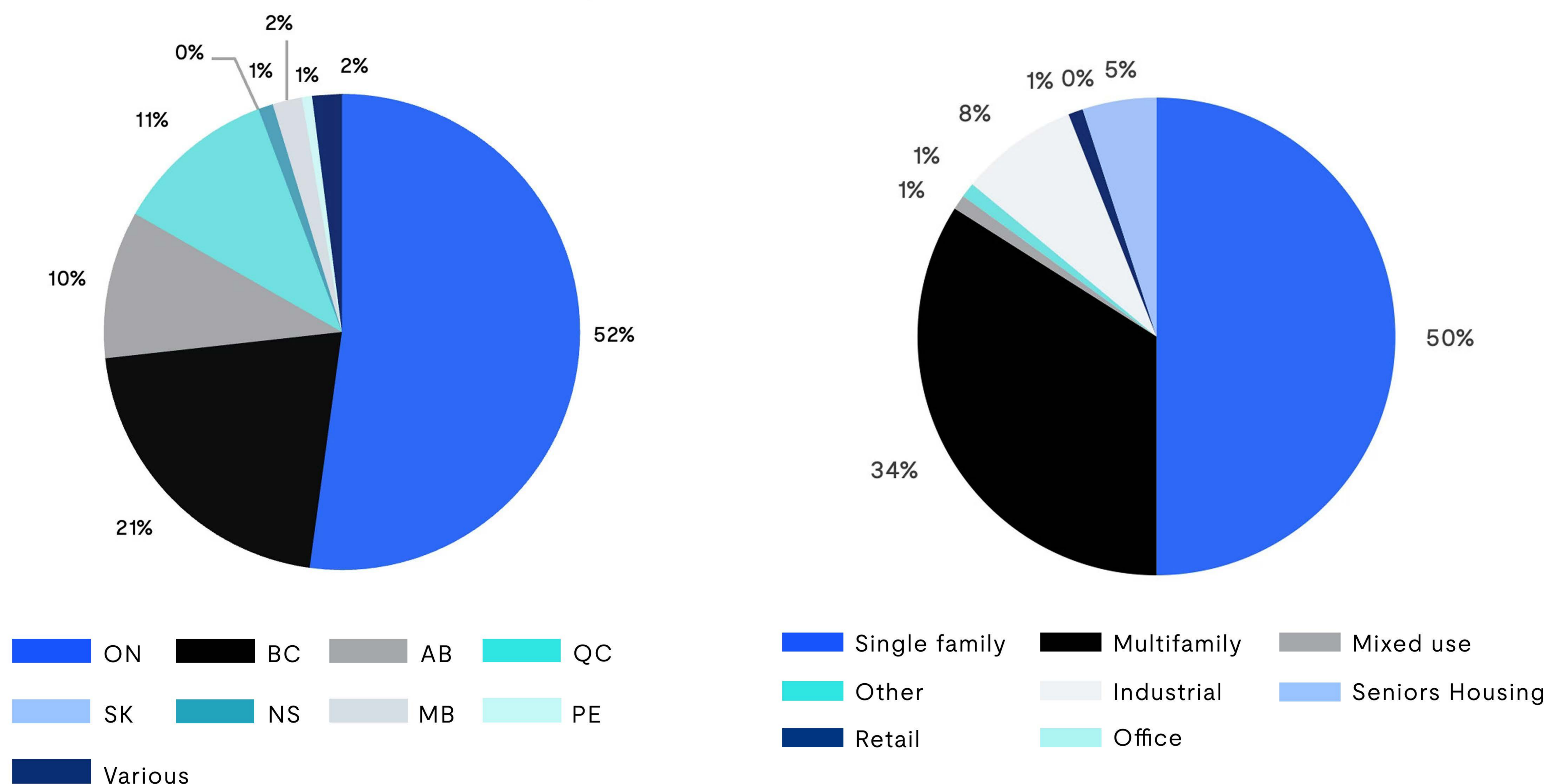


March 2026

cmls asset
management

Thank you for reading the March edition of [Accrued Interest](#). In February, the CMLS Mortgage Fund delivered a monthly return of 0.53%, or 7.13% annualized. Our weighted average coupon is 7.81% and our weighted average loan-to-value ratio is 62%.

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](#).

A Brief Analysis of Market Inefficiencies in Commercial Real Estate and Real Estate Debt

Utopia – an imagined place or state in which everything is perfect. In the past we have expressed our belief that the market is, for the most part, efficient. That it is less alpha and more the results of structural (e.g. leverage) and risk considerations that lead to different performance among managers in a particular asset class. That last component, *in a particular asset class*, is important. If we narrow the scope enough and the players are restricted to a certain market sandbox, it is more likely that no one will have an advantage.

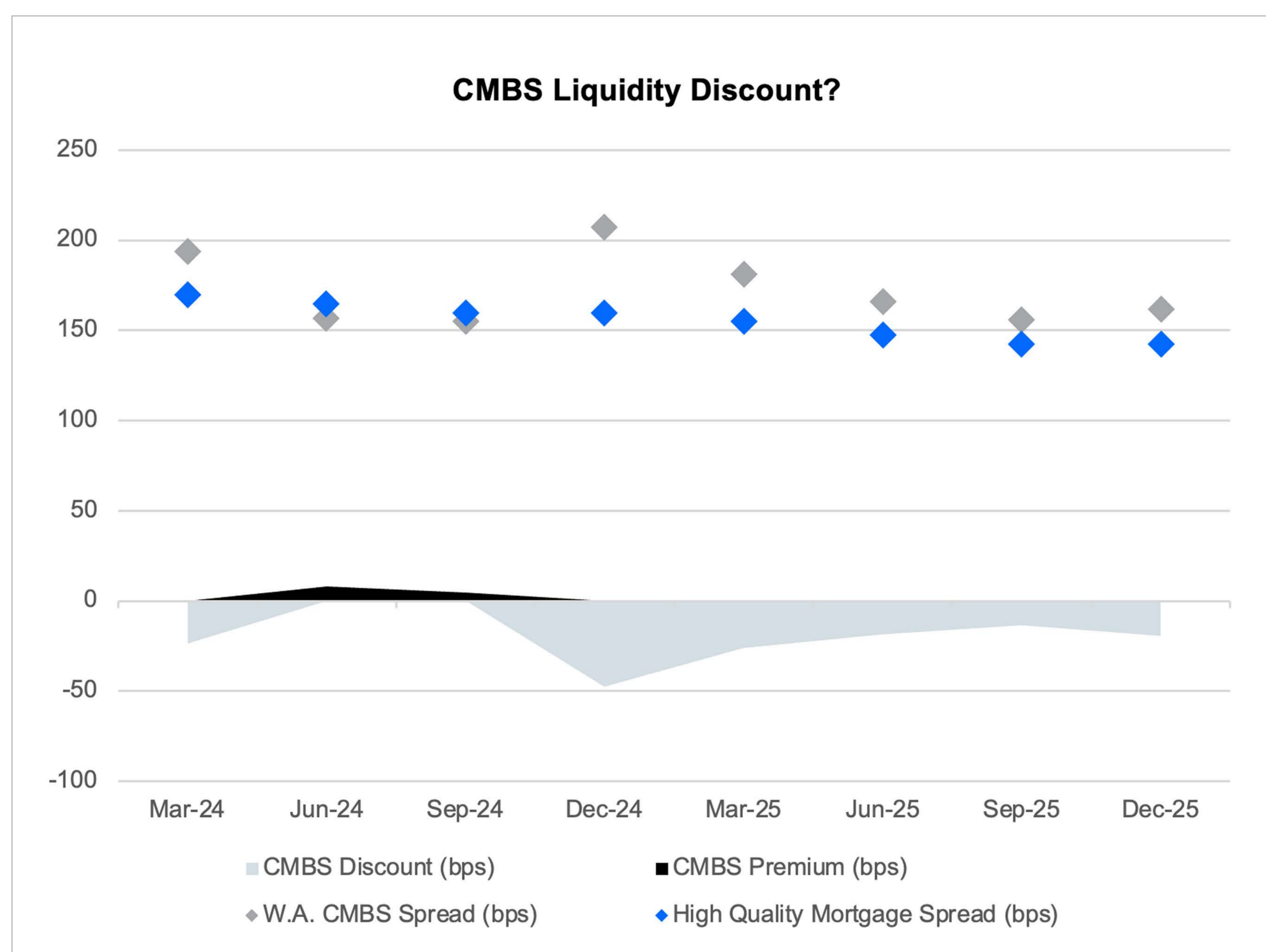
But real estate and real estate debt exhibit anomalies worth highlighting and attempting to explain. These primarily relate to how investors access the asset class – for example, public versus private investments and direct investments versus securitized vehicles. The simplest explanation and expected relationship rely on the value ascribed to liquidity: when something is more easily bought and sold, its value should increase. However, there are multiple instances in which the theoretical effect of increased liquidity is challenged in reality. We cover these below.

Counterintuitive relationship between raw commercial mortgage spreads and commercial mortgage-backed securities (CMBS) spreads

The process of securitization is designed to create liquidity. By taking an asset or a pool of assets which is generally illiquid – meaning infrequently traded between buyers and sellers and therefore difficult to determine a market price – and (1) creating several individual securities, (2) in many cases creating classes of different payment priority and risk profile, and (3) obtaining standardized credit ratings on these securities, theoretically vastly increases the potential buyer pool.

When issuers and bankers collaborate to create commercial mortgage-backed securities, they bring in multiple third parties to achieve the three outcomes above. Legal counsel assists in creating documents governing the securities, accountants audit underlying documents and sign off that those documents accurately represent the underlying assets, and servicers, custodians and reporting agents commit to administer the transaction until the mortgage or mortgage pool is paid off.

The securitization then becomes a source of funding for the issuer. They expect that buyers will pay more for the incremental liquidity created and that this will cover the costs of the third parties noted above, plus a profit for their troubles. Unfortunately for issuers in Canada, the expected premium for liquidity does not materialize. In fact, raw mortgages are clearly and counterintuitively more expensive than CMBS. Below we chart mortgage spreads over the previous two-year period alongside estimates of CMBS pricing at each year end. Perhaps it's the fact that only ~\$2.5B in CMBS was issued through that period, versus greater than \$200B in term commercial mortgages. For liquidity to truly be realized a deep market is required.



Notes:

- **W.A. CMBS Spread** reflects the weighted average spread applied to the various rated and unrated classes of representative CMBS transactions CCMOT 2022-5 for spreads in 2024 and CCMOT 2024-6 in 2025, applying consistent rating levels reflective of a high quality CMBS transaction (e.g. the AAA component represents 86% of the overall capital stack); spread estimates provided by Casgrain & Company.
- **High Quality Mortgage Spread** reflects the midpoint of the two highest rated classifications in Nesto Cloud's monthly spread matrix as of each quarter end.
- **CMBS Discount** and **CMBS Premium** reflect the representative High Quality Mortgage Spread less the W.A. CMBS Spread. A higher CMBS spread corresponds to a discount relative to mortgage spreads (i.e. lower resulting price).

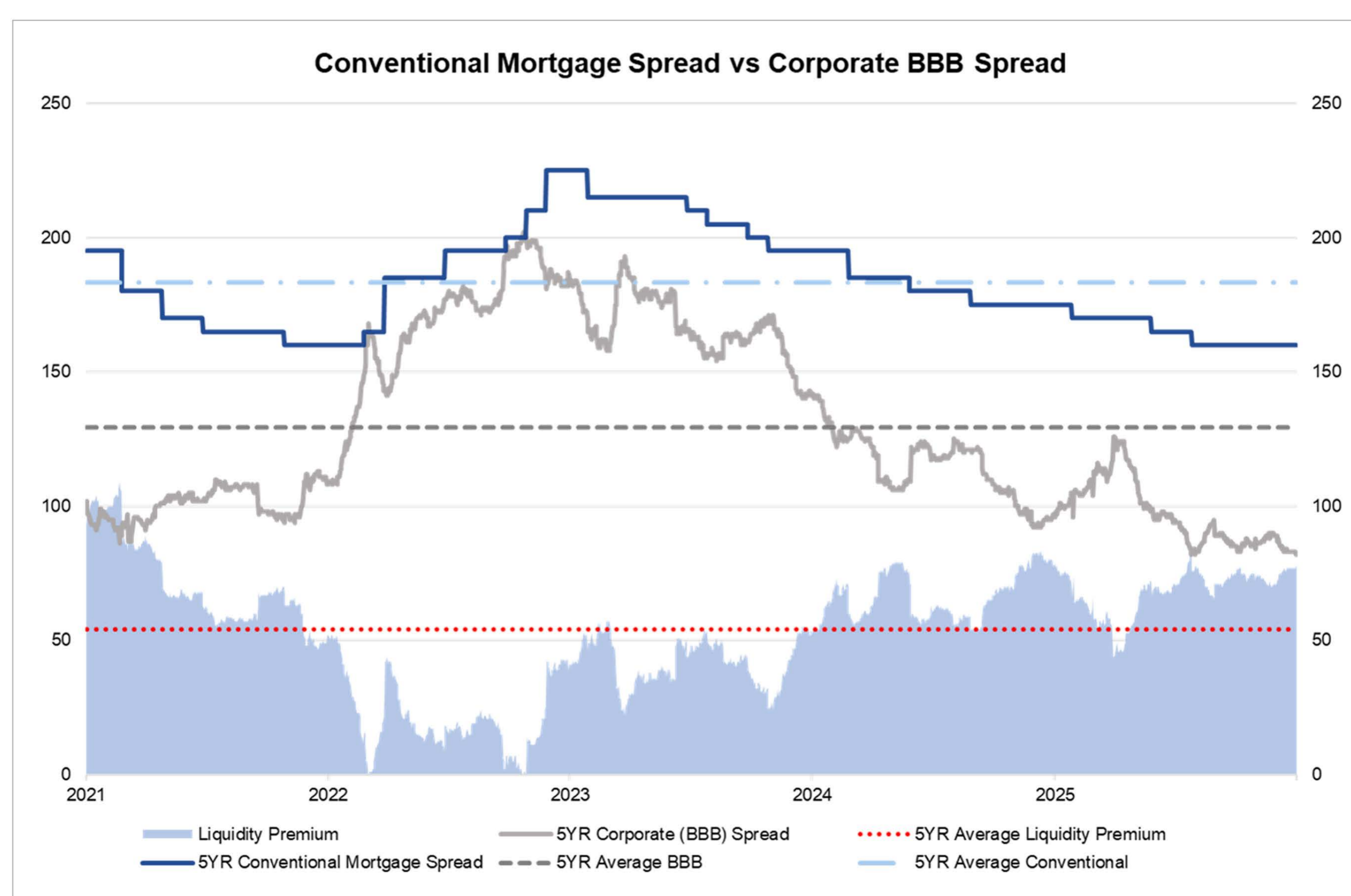
We are taught in business school that this would represent an arbitrage opportunity. Could we raise a pool of capital to buy up all CMBS in Canada, collapse the securitization structures, and sell the mortgage loans for a profit? Just the same as CMBS issuers capturing the arbitrage in the other direction in normal functioning markets (e.g. US)? The problem with illiquidity and, for lack of a better word, “clunky” markets is that transaction friction could wipe out those profits in short order. But it would be interesting to see someone try.

Drivers of illiquidity which, paradoxically, can temporarily *reduce* the illiquidity premium carried by commercial mortgages over corporate debt of equivalent or similar credit quality

The commercial mortgage investment process is measured in weeks, sometimes months. It is not as simple as searching Bloomberg for the most attractive corporate bond and calling the trading desk at your preferred investment bank. What starts with a high level review and issuance of indicative financing terms is followed with a detailed underwriting, the issuance of a commitment, engagement of legal counsel to paper the transaction and, finally, closing the investment. The detailed underwriting and legal review is, in part, a response to asymmetric information in a private market environment, and contributes to the illiquidity of commercial mortgages as an investment.

Borrowers of commercial mortgage loans value service levels and certainty of execution, so lenders are hesitant to stray from indicative terms provided early on in the process. While many lenders are benchmarked against observable and/or public credit spreads, which fluctuate frequently, absent a significant capital markets disruption lenders will typically stand behind the spread, or interest rate, provided in their original quote. The result is that movements in funded commercial mortgage spreads historically tend to lag corporate credit spreads. In prolonged periods of rising corporate spreads the illiquidity premium afforded commercial mortgages can be compressed to unattractive levels, or even reversed. Conversely, when corporate spreads are falling the premium expands.

Shown below is the differential between mortgage spreads and corporate credit carrying a BBB credit rating – a conservative proxy for the credit risk in a pool of conventional term mortgages. You will see that although mortgage spreads respond slower to market disruption and improvement, over the long run a significant illiquidity premium is observed. Of note, Nesto Cloud recently completed a ratings mapping exercise and found the observed default characteristics of high quality conventional commercial mortgages to be most comparable to AA and A corporate credit ratings, suggesting an even greater illiquidity premium is captured.



Source: Nesto Cloud

Long-run, resilient public market REIT discounts

This is a more accessible metric given the publicly traded nature of many real estate investment trusts. RBC Capital Markets Real Estate Group estimates that as of March 9, 2026 the Canadian public REIT universe traded at an average discount to net asset value of 17%, ranging from office-focused REITs at a 30% discount through to seniors housing and healthcare focused REITs at a 6% premium. Interestingly, residential focused REITs were second from the bottom carrying a 23% discount.

It is important to scrutinize estimates of net asset value and whether it truly reflects underlying property value. Advocates of public REIT investment would likely contend that we should defer to the public price as the most informed and accurate. A counter-argument would be take-private transactions that support the higher net asset value. Some examples in recent years are set out below:

- Dream-GIC privatization of Summit REIT – announced in November 2023 at a **31% premium** to the November 4, 2023 closing price of the REIT.
- CLV Group/GIC privatization of InterRent REIT – announced in March 2025 at a **35% premium** to the March 7, 2025 closing price of the REIT.
- Crestpoint privatization of Minto REIT – announced in January 2026 at a **32% premium** to the January 2, 2026 closing price of the REIT.

In each case, the reference point for the premium reflects the trading day preceding the day of the announcement. These examples lend support to underlying net asset values at a premium to public share prices, but are less directly informative as to why. Some reasons could include a control premium, where a single buyer of the assets of a REIT has more influence than a buyer of shares who is reliant on, and at the behest of, the REIT's management team, and a scale premium, where large buyers with deep pockets are putting significant dollars to work in one transaction and immediately gaining a dominant position in the market. It would follow that these premiums dwarf any liquidity premium created by trading in a public vehicle.

As an aside, we find Avenue Living's recent announcement in March 2026 of their intentions to take the Avenue Living Core Trust and Mini Mall Storage Properties Trust public interesting in this context. We will be watching closely as to how public/private pricing dynamics play out in any resulting public offering.

Takeaways

For us, this was a fun illustrative analysis of market inefficiencies and the differences that investment structure and the resulting pool of buyers can have on an asset's valuation characteristics. But a few takeaways:

- It is clear that massive amounts of capital would be needed to actively pursue related arbitrage opportunities – e.g. purchasing the entire capital stack of an existing CMBS pool or building a controlling position in a public REIT to then seek privatization.
- As an investor, it is important to scrutinize the valuation policies of private investment vehicles against comparables both public and private if available.
- Particularly in conventional mortgages, the long-run illiquidity premium exists and is readily observable in using these investments as a partial replacement for similar credit corporate fixed income. This lends support to the benefit of private asset vehicles as a segment of your portfolio with a longer investment horizon.