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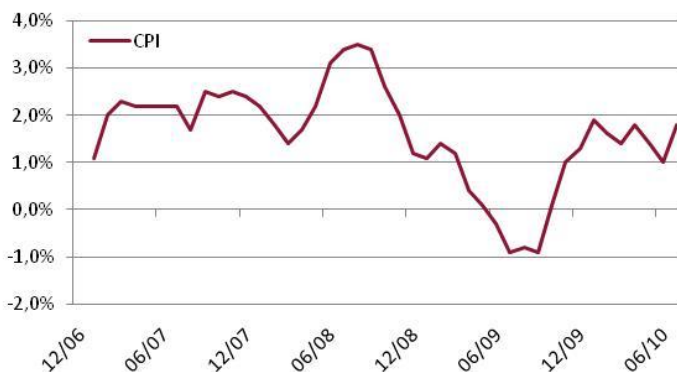
Weekly
review



Financial news

In July, as anticipated, the Consumer Price Index (CPI) rose 0.5%. The increase can essentially be attributed to the introduction of new provincial sales taxes in Ontario, British Columbia and Nova Scotia. On an annualized basis, the inflation rate increased from 1.0% in June to 1.8% in July. Accordingly, inasmuch as industrial capacity utilization rates are approaching their full potential, we can expect the Bank of Canada to continue relaxing its monetary stimulus over the next few months before it actually levels off towards the end of the year. For the time being, the financial markets are not reflecting the opinion of most economists, as trends are indicating that the BoC could soon stop increasing its rates.

Consumer price index
annual % change



Source: Bloomberg, Statistics Canada

According to Statistics Canada figures issued on Tuesday and contrary to the way most economic indicators were pointing, manufacturers' sales grew 0.1% in June, after a 0.5% increase in May. Although relatively weak, manufacturers' volumes, in terms of both sales and inventories, grew 6.5% (in actual terms) in the second quarter, thus making a positive contribution to quarterly economic growth despite the difficult circumstances of the world economy.

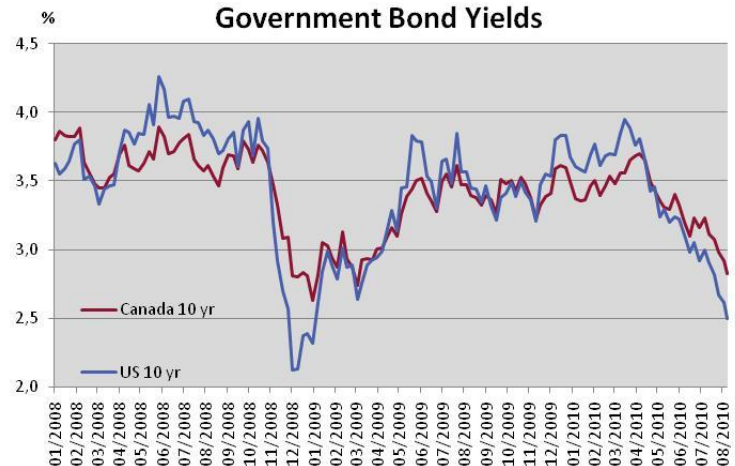
In the U.S., the financial news was good and bad last week. Housing starts dropped 4.2% (month over month) in July, closely followed by building permits, which were down 3.1% over the same period. This news was a not a surprise in itself for economists, given the termination of the federal government's income tax credit program for first-time home buyers. The U.S. Department of Labor logged

500,000 new applications for unemployment insurance in the week ended August 14th, i.e. 2.4% greater than the week before. This third consecutive increase does not augur well for the job market. After a slight, month-long decrease of 0.1%, industrial production rebounded by 1% in July. Also on the plus side, the Composite Leading Indicator was up 0.1% in July, after backsliding 0.3% in June. Despite this bit of good news, however, this indicator's variability seems to imply that the slowdown in the growth of the U.S. economy will continue.

The bond market

These latest rounds of disappointing statistics regarding the U.S. economy and the simultaneous slowdown in worldwide economic recovery have continued pushing investors into hedge securities. These concerns helped maintain the downward trend of long-term bond rates. The Canadian ten-year bond rate posted a drop of 9 b.p. to end the week at 2.89%, while its U.S. counterpart dropped 14 b.p. to 2.56%.

Government Bond Yields



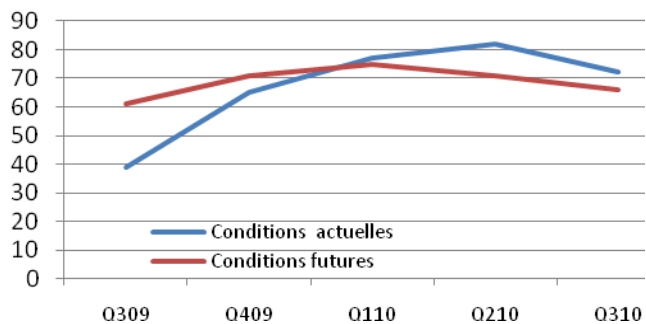
Source: Bloomberg

The debt market

The last survey filed by REALpac (the *Real Property Association of Canada*) reports slightly diminished optimism in comparison to the last two quarters. REALpac queried 47 senior executives working in Canadian real estate and surveyed their opinion on overall real estate conditions, access to capital markets and real estate asset pricing. "While market conditions appear to have stabilised, optimism

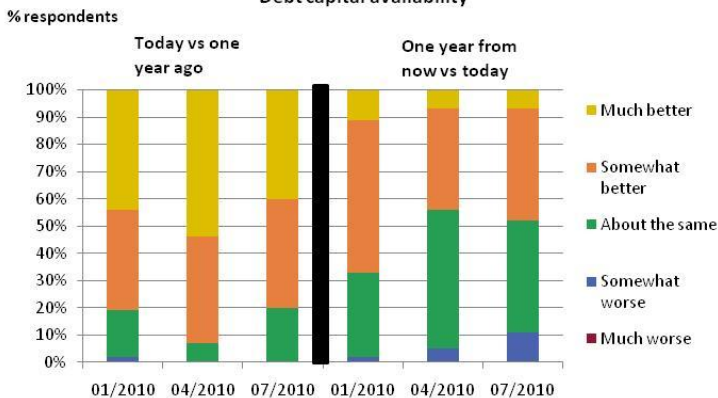
regarding continued improvement has abated” cites the report. Despite the increase in valuations it is felt “values are not supported by fundamentals as much as by capital flow”. The vulnerability of the economic recovery, as exemplified by the problems in Europe and by the unencouraging U.S. economic headlines, remains the primary source of concern.

Indice REALpac/FPL Canadian Real Estate sentiment index

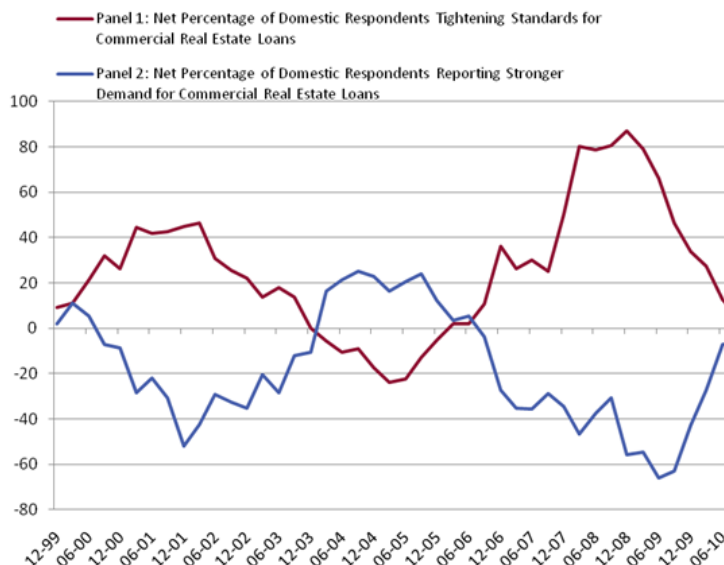


When it comes to credit availability, however, forecasts remain stable—even optimistic. According to one respondent: “Fortunately, our banking system is in far better condition than the U.S. Lenders are back, especially for favoured clients and high quality assets.” Others have acknowledged the availability of capital “There’s tons of capital available for both equity and debt” exclaimed one respondent. By and large, 82% of the survey participants think that the availability of financing in Canada will remain the same or even improve in the coming year.

REALpac/FPL Canadian Real Estate Survey Debt capital availability



In the U.S., on the other hand, the latest Fed survey reports continued tightening of underwriting criteria for commercial real estate loans. The net effect has been observed for 19 quarters, but things are looking up: over the past 7 quarters, the net percentage of respondents tightening standards has been going down. In July, for example, a net percentage of only 5% of participants reported tightening criteria, as opposed to 13% in the April survey and 27% in January. In addition, 7% (net percentage) of banks reported weakened demand for commercial real estate loans, which compares to the previous survey but represents a net improvement over the 27% reported in January.



Research firm Trepp LLC reports that 50% of the CMBS loans maturing in July have been repaid, the highest percentage since December 2008. P, over 70% of loans paid off on time; since then, the figure has averaged 32%! In March 2009, for example, only 15% of maturing paid off. Although the increase in loan payoffs is good news, Trepp senior manager Manus Clancy cautions that “one month does not a trend make”. He would turn optimist only if he saw payoff rates above 50% for several months in a row. The increase can be partly explained by a relaxation of underwriting criteria. According to John B. Levy, borrowers can now obtain financing with LTV ratios approaching the historical average of 75%. Clancy also confirms that he has seen a number of CMBS lenders who were comfortable with LTVs of 70-75%, i.e. somewhat more than the 60% of a year ago. The quality of new loans being underwritten is excellent, on the other hand. Borrowing costs, which dropped in lockstep with government bond rates, are the other factor bringing borrowers some measure of relief. According to Levy, commercial mortgage loans are currently available for only 5.5%, against 7% only a few months ago: “Something that might not have worked at 7%, may work at 5.5%.”

As per a recent Fitch press release, 2,198 fixed-rate CMBS loans will mature in 2011 (issues rated by Fitch). Among these, 18% totalling US\$4.7 B are already in special servicing. According to December 2009 financial statements, loans maturing in 2011 feature a debt service coverage ratio of 1.70 and average LTV of 79%. A significant proportion of loans (35%) belong to the 2001 cohort. Having enjoyed a lengthy amortization period thus far, they should not have too much trouble getting refinanced. In comparison, 34% and 13% of the maturing loans are of 2006 and 2007 vintage respectively, and the LTVs on these more recent loans average 89%, versus only 60% for loans in the 2001 cohort.

In the American secondary CMBS market, spreads continued shrinking last week despite some less-than-encouraging economic news. Analysts attribute this contraction (roughly 15 b.p. for the AAA SS tranches to technical rather than fundamental factors.