Accrued Interest

CMLS mortgage fund

November 2025

cmls asset management

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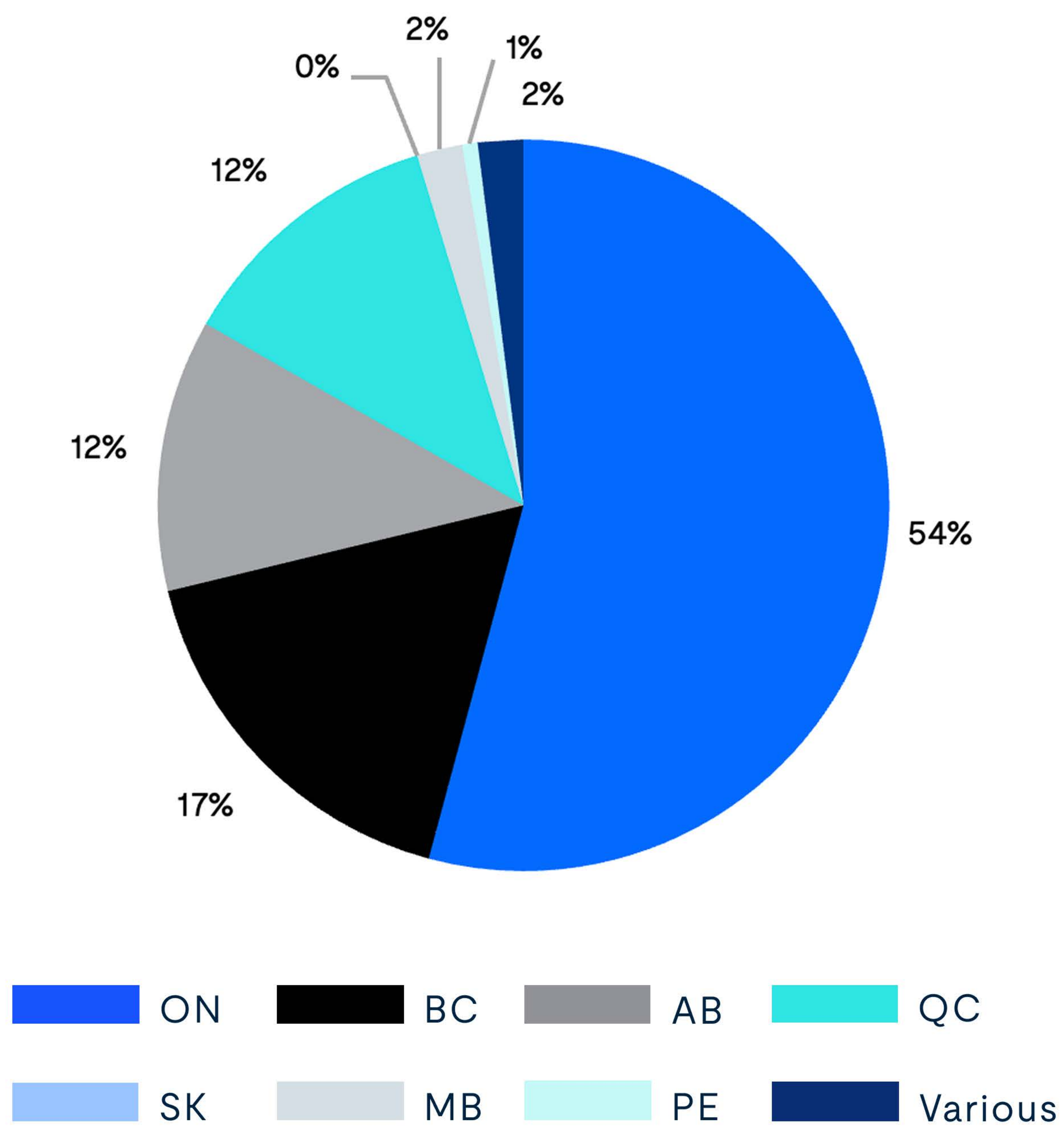
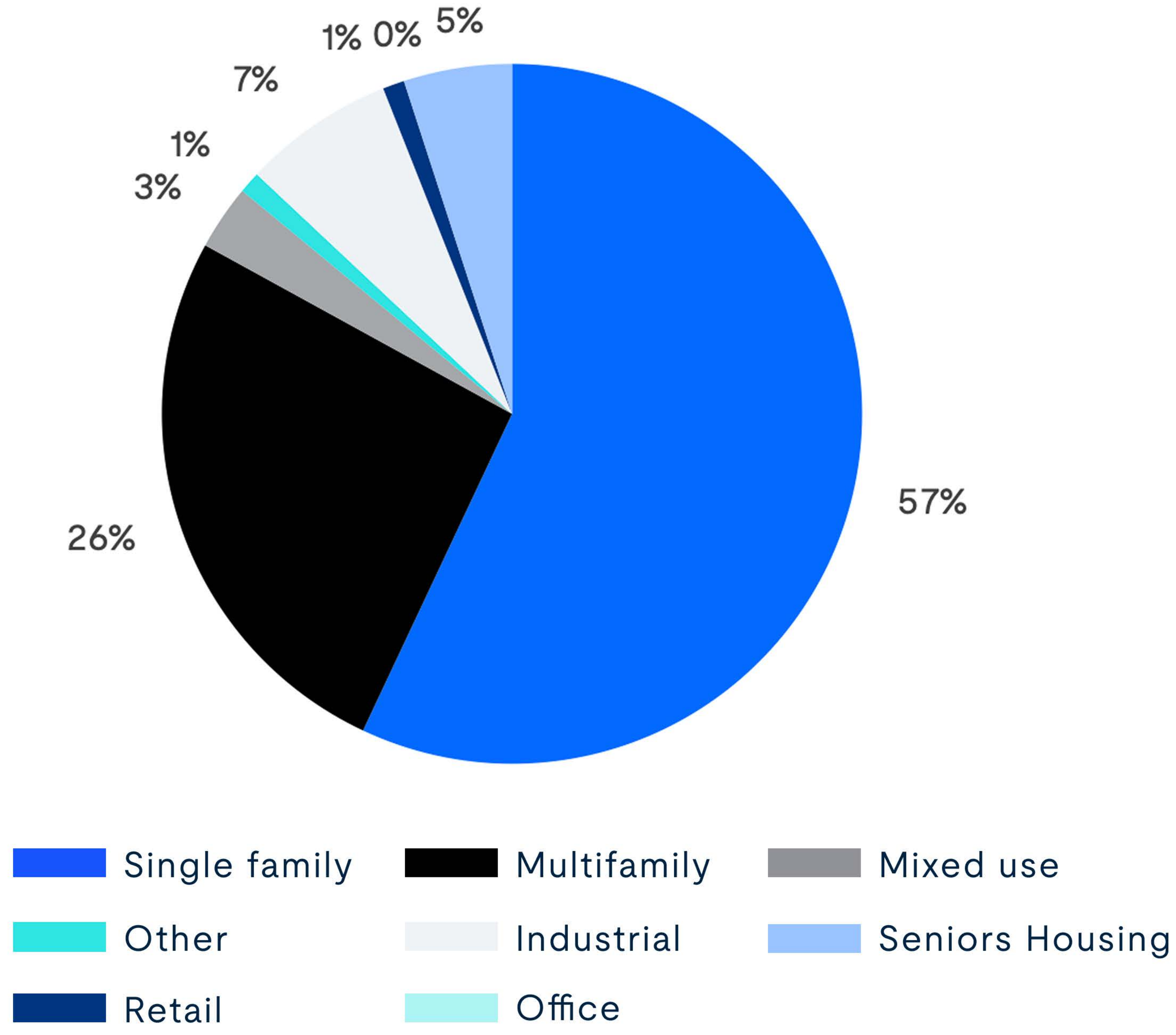
Thank you for reading the November edition of **Accrued Interest**. In October, the CMLS Mortgage Fund delivered a monthly return of 0.59%, or 7.17% annualized, marking the third consecutive month of increasing returns. Our weighted average coupon is 7.69% and our weighted average loan-to-value ratio is 62%.

Our portfolio is composed as follows:





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

Anatomy of a Real Estate Debt Transaction:

“Health” is a word that appears often. Perhaps it is just an obsession with our mortality that requires us to frequently address its mitigation and project it upon inorganic observations. We would wager with a healthy dose of confidence that you crossed upon a headline, somewhere today, espousing the latest wellness trend. Look back into our quarterly reports and we would expect that we have highlighted a “healthy” distribution yield at least once in our history. The conceptual theme of health is covered more in the Google Books library than each of science, the economy, and media (according to Gemini).

The state of human health is complex and dependent upon factors and characteristics not always observable. Financial products have been developed, via health insurance, that attempt to price the risk of downside scenarios appearing in the form of declining human health. Using an extreme level of diversification, the inputs into those modeled scenarios can be kept quite generalized, and the result is that you can provide health insurance to many different people on similar terms. Property insurance is no different in that it protects the buyer against unforeseen issues at a commercial or residential property, and the related costs.

Lending requires a similar review of downside scenarios as insurance. The main difference is that a lender is actively financing a portion of the subject's value. In simple terms: lending is money out, and if there is a loss, less money back to the lender, whereas insurance is a commitment under which a loss, or claim, means money is permanently out for the insurer. The "cost of capital" is therefore different in that the lender is providing a much larger capital outlay up front and must be compensated accordingly. This is why the interest rate on a real estate loan is greater than the premium for property insurance.

The lender also, facing capital constraints, is most likely less diversified. This restricts a prudent lender from simply relying on long term distributed probabilities of certain downside scenarios, and requires them to more closely analyze individual contributors to the health of the subject property and sponsor. Below is intended to be a comprehensive review of those contributors, although certainly not exhaustive. You may note that many are closely related to the "five C's" of credit, but we've purposefully avoided categorizing in that manner. The idea is to give you a more "on-the-ground" perspective of how decisions are made during underwriting and importantly, how they need to be made in the context of other factors.

Loan Metrics: Debt service coverage ratio and loan to value ratio are the two most important. The former ties to the probability that a loan will default. The greater the income sources (property level, for commercial, and borrower level, for single family residential), the less likely it is that the borrower will miss a payment. The latter is associated with the loss incurred under a default scenario, or "loss given default". The closer the debt is to the value of the underlying collateral, the higher probability the lender fails to secure repayment when enforcing their rights in default and selling the asset.

In context: loan metrics carry the most influence on the yield required for a transaction, as they are typically the starting point for whether or not a certain type of lender will look at a deal. Conventional commercial term transactions (think GOC + 150-200 bps) require debt service coverage over 1.25x and loan to value ratios less than 75%, whereas transitional mortgages (think 7-9%) will go down to 1.0x and up to 80%, respectively.

Income quality: Two transactions with the same debt service ratios can represent very different risks. It's important the lender considers how much due diligence is completed to verify the income presented, and how resilient that income stream is. Between commercial, multifamily residential and single family residential, considerations can range from tenant quality, length of lease terms, termination rights, and concentration/diversification of income streams, to borrower tenure at their current employer and whether official tax documentation is used to confirm underwritten income.

In context: For non-bank single family residential lenders, government regulation related to this particular factor presents an opportunity for outsized returns. Regulated lenders provide low cost, and in many cases insured, financing to borrowers who can provide a specific set of income documents to their lender. Lenders who can find other ways to substantiate borrower income and/or become comfortable with the borrower's capacity to repay, can often do so with a significant premium in interest rate. As an investor, the important thing is to find mortgage funds who are prudent and creative in doing so, rather than ignoring income altogether and focusing solely on loan to value ratio.

Location: This should be observed on both a macro and micro level. Is the property in a regional market with significant demand for real estate and a wide range of potential buyers for similar real estate? Within that market, is the property in a neighbourhood or core urban area with demand drivers for its target tenant base? How does this contrast with the supply of similar properties in the area?

In context: This should start as a binary, deterministic factor as a lender focuses on areas with minimum population metrics or a defined list of acceptable lending areas (and may rate those lending areas in a structured manner). Within those requirements, the lender can then tailor aspects of the deal to a broader set of underwriting factors. For example, the lender may accept weaker location characteristics if offset by elevated borrower strength, or a leasing profile of investment grade tenants on long lease terms.

Borrower/Sponsor Net Worth: secured lending allows the lender two primary sources of repayment, sales proceeds and any rental income from the collateral security. The additional resources of the borrower or sponsor can further support the loan when the collateral provides insufficient value and net income.

In context: Higher sponsor strength may allow you to be more flexible in other areas, like loan to value ratio, debt service coverage or loan priority. In owner-occupied single family lending, this is typically your first line of defense to avoid default, given the collateral itself is not producing any income.

Borrower/Sponsor Reputation: Leveraging the lender's history working with an individual or company, obtaining references from trusted sources and a simple Google search can go a long way in separating out bad actors from good. This will help them understand how the borrower will act under stress and whether they can rely on borrower integrity when fielding responses to your underwriting or post-funding questions.

In context: This is an underrated and undervalued consideration, mostly because it is incredibly hard to value. It's best to view this as a binary factor and trust your gut. We have been in this business a long time, and have experienced firsthand how a stressful situation can turn a well-meaning borrower into a cynic to preserve their financial status. Working with individuals and groups of demonstrated integrity can avoid, or at least reduce, these outcomes.

Property Condition: A lender wants to be confident that their collateral will maintain its value and, where applicable, income producing capability. Here we loop back to the insurance discussed earlier, which is often required to cover for unforeseen events or breakdowns at the property. As you can imagine, this does not cover everything, so lenders will go further in requiring the appraiser to comment on property condition and review inspection reports if applicable. Commercial and multi-residential transactions are secured by structures larger and more complicated than single family homes. In most cases, commercial lenders will require a building condition assessment from a qualified engineer. Think of this as investigating for "pre-existing conditions" that insurance won't cover.

In context: Uncovering issues with property condition is not on its own a reason to pass on a potential transaction. In commercial and multifamily residential lending, a lender may respond by requiring that funds are held back in a reserve, controlled by the lender, to be drawn upon to mitigate the issue. For example, a building condition assessment may state that the roof needs repair imminently and it will cost $200,000. The lender can place those funds in the reserve, obtain a contractual commitment from the borrower to replace the roof within 6 months of funding, and only release those funds upon proof of completion. If the borrower defaults, the money is there for the lender to arrange the replacement themselves, preserving the value of the property (or, alternatively, use the reserve to pay down the loan recognizing that a buyer will discount the sale price for immediate required repairs).

Again, this is not exhaustive, but illustrates the need to interpret many related and in some cases conflicting aspects of a potential transaction. A strong lending platform includes multiple decision points in the deal cycle – an initial review, agency provided to those conducting due diligence, a credit or investment committee and well-defined decision making authorities and processes prior to commitment. Bringing in multiple experienced perspectives as opposed to a single decision maker helps eliminate bias and can build a portfolio primed for performance in up and down cycles.