NORTH COVE ADVISORS

Nov 30, 2018

will have five musicians performing with him, including Larnell Lewis

Traditional Mas ... in Trinidad. Marcano

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THE CARIBBEAN CAMERA | Thursday, October 25, 2018 17

File under "seems legit". From a small Toronto paper:
"The builder will hold your first or second mortgages"
"…will give you a mortgage if you are a student, seasonal worker from outside of Canada, an upcoming Hip Hop, R&B or Reggae artist or unable to prove your income but you pay rent or live with your mother…"

Interesting data points, anecdotes, and articles from the past week or so:

1) **More signs of tapped out consumers in Q3 GDP print**
2) **Domestic mortgage growth hits new 30-yr lows in October**
3) **Timbercreek Financial and the Northumberland Mall**

1) More signs of tapped out consumers in Q3 GDP print

Q3 GDP was in line with expectations this morning, but the internals were quite weak.

With business fixed investment falling 7.1% annualized and with imports tumbling 7.8%, this print really calls into question the BoC's assumption that business investment will pick up much of the slack from weaker housing and consumption going forward.

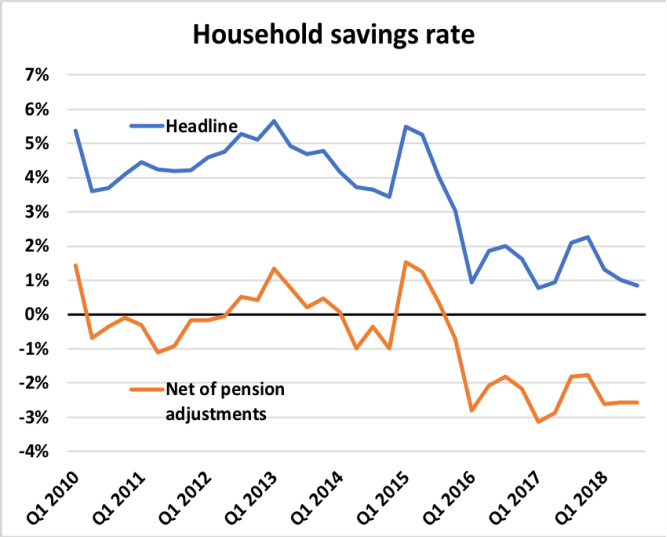
Perhaps the most interesting data that hasn't gotten enough coverage is the massive downward revision in the historical series on personal savings rates due to slower income growth than previously assumed. Headline savings rate was revised down to an average of 1.5% in 2017 (from closer to 4% previously!) and now sits at a scant 0.8% in Q3…one of the lowest prints on record.

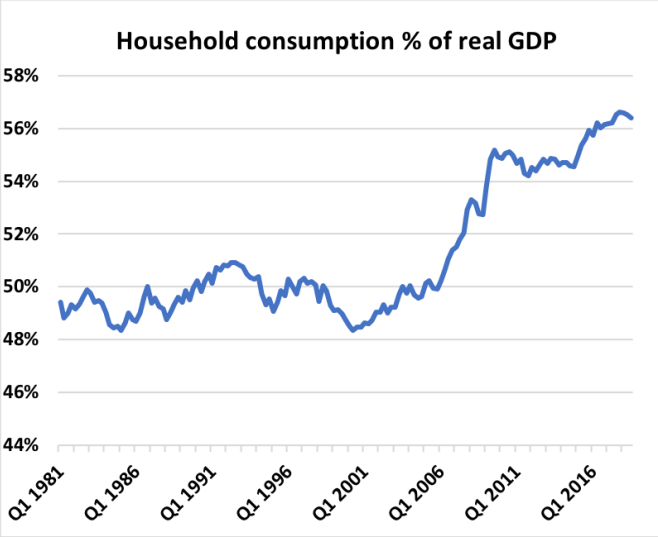
Moreover, the "active" savings rate (i.e. savings net of pension entitlement adjustments) is now sharply negative at -2.6%.

Two important points on this:

- This revised data strengthens our view that households have virtually NO capacity to divert savings to maintain consumption as interest costs outstrip disposable income growth.
    - If weak business investment becomes a trend, this could be problematic. Household consumption has accounted for 80% of real GDP growth since Q1 2015.

- Households have less by way of liquid savings than generally perceived. All of the apparent "savings" since 2016 have accrued in illiquid pensions that cannot be easily accessed. Households are stretched thin and have little cushion to absorb an unexpected expense or job loss…a very different setup from the last true credit cycle in the early 90s where consumers ran high single digit net savings rates through the late 80s.

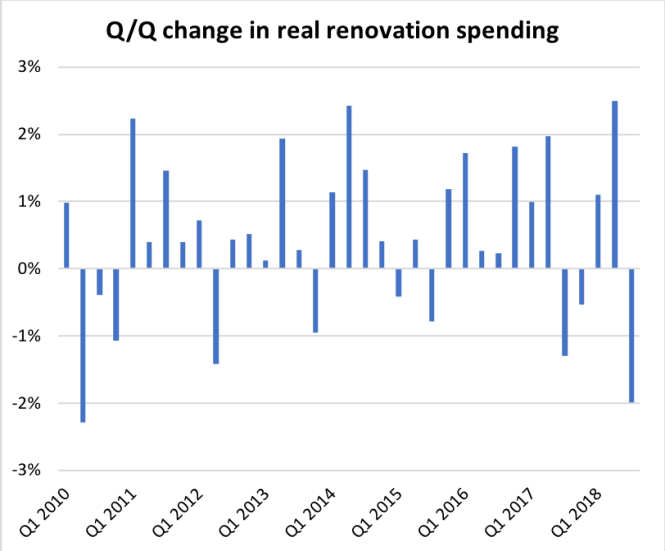


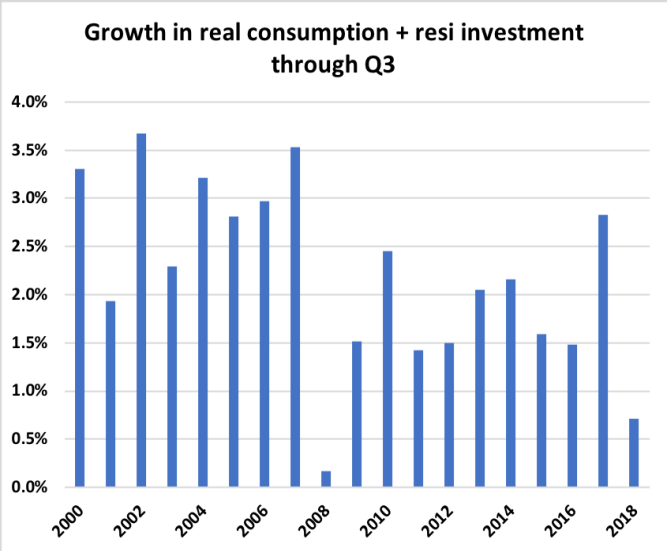


Data flow this week also hinted at a softening labor market. From the September payrolls:

- Average work week plunged from 30.3 hours to 29.9, the first sub-30 print since April 2017
- Wage growth decelerated sharply to 1.8% y/y from 2.9% previously.
- Overall job growth was solid at +21.6k m/m, but expect a nasty surprise in the official October data. ADP, which uses a similar methodology to Stats Canada's payroll survey, has already reported a 22k drop in employment last month…the largest drop since Feb 2016.

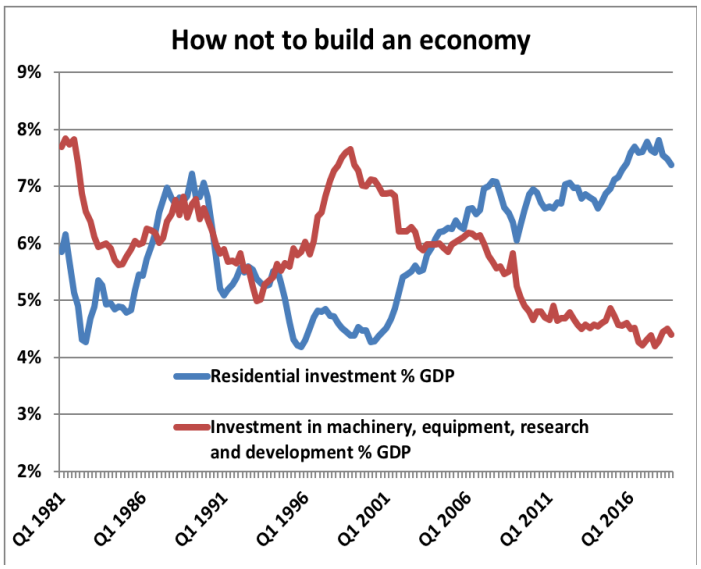
Residential investment fell an unexpectedly large 5.9% annualized in Q3, in part due to the largest quarterly decline in real renovation spending since 2010. And with household consumption scratching out a mere 1.2% gain, we find that YTD growth in these two important components is sitting at the lowest since 2008:



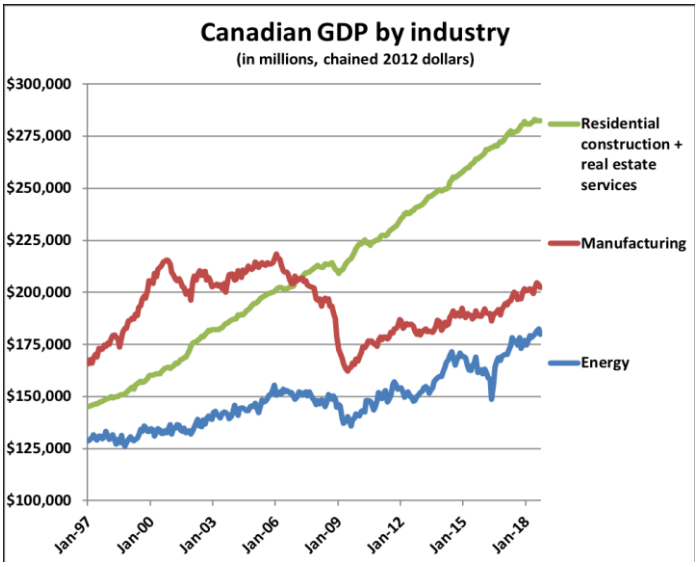


But even with the recent declines, residential investment as a share of GDP is still running well above previous cyclical peaks and is dwarfing business investment in machinery, equipment, research and development.

In fact, Canada spent more on realtor commissions in Q3 than we did on industrial machinery and equipment. So much for that rotation!



The monthly GDP print for September came in a tad light, down 0.1% with broad declines across all goods-producing sectors. The powerhouse residential construction and real estate services sectors are finally hitting stall speed, effectively flatlining since May:

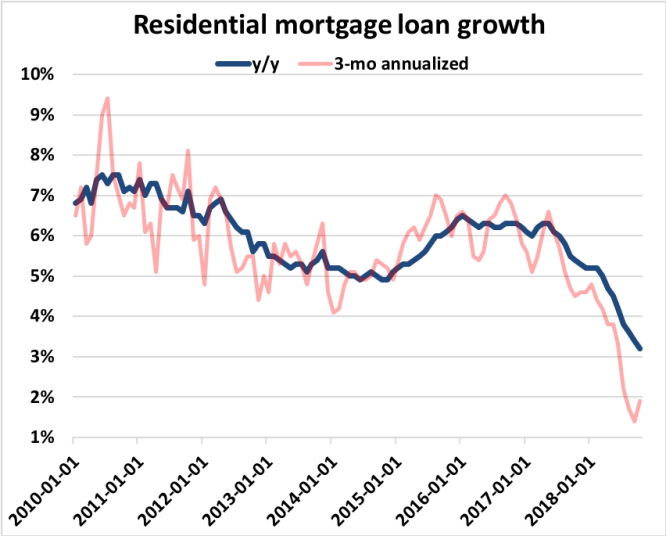


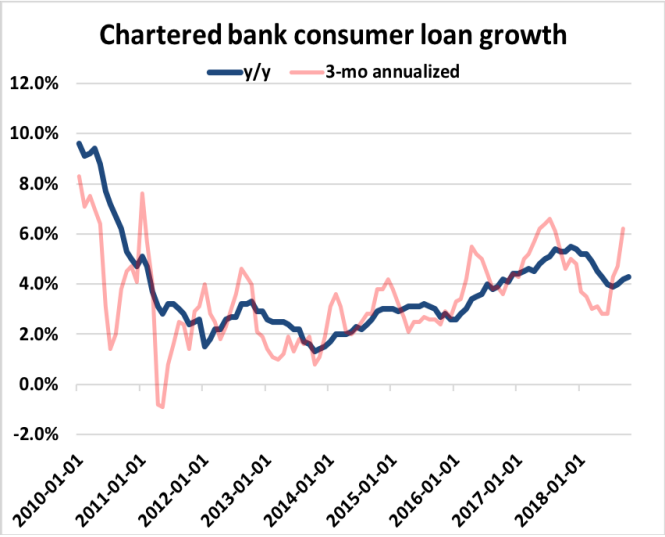
2) Domestic mortgage credit growth hits new 30-yr lows in October

The BoC released October household and business credit data this morning. The data reveals a continuation of familiar trends:

- Domestic residential mortgage credit growth slowed to fresh 30-yr lows at 3.2% y/y overall and just 2.9% y/y for the chartered banks (+3.2% prev).

- Conversely, non-mortgage consumer credit is accelerating, now up 4.3% y/y (+4.2% prev). This is likely a "last hurrah". As we've written previously, OSFI has HELOC growth in the cross hairs, and they will achieve their desired outcome.





For those who may have missed it, the BoC quietly announced an expansion in the assets it will acquire for balance sheet purposes. Key paragraph below:

https://www.bankofcanada.ca/2018/11/expansion-assets-bank-canada-will-acquire-balance-sheet/

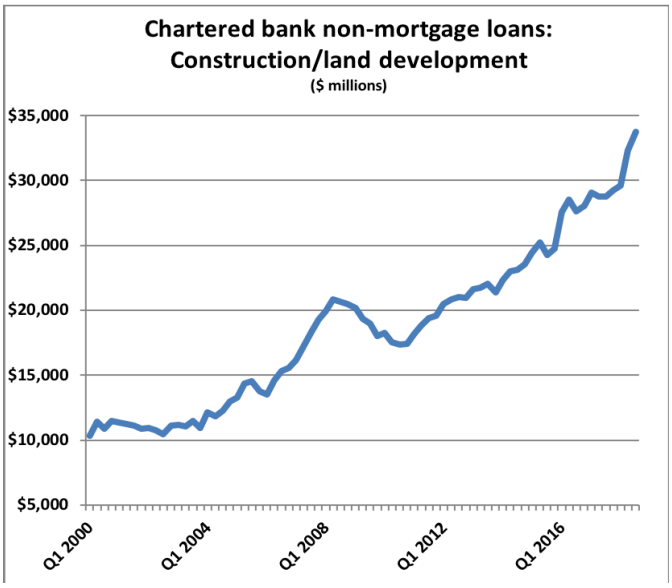
As part of these changes the Bank plans to allocate a small portion of its balance sheet for acquiring federal government guaranteed securities by purchasing Canada Mortgage Bonds. These purchases will be conducted in the primary market, on a non-competitive basis, and are expected to commence in the latter part of 2018 or in the first half of 2019.

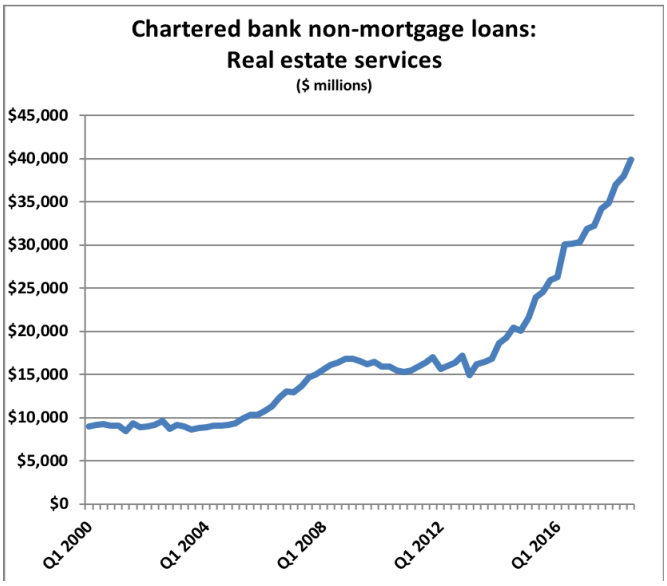
Likely nothing, but one couldn't be faulted for wondering if this isn't perhaps a pre-emptively move to address future liquidity or (ill-placed) credit concerns.

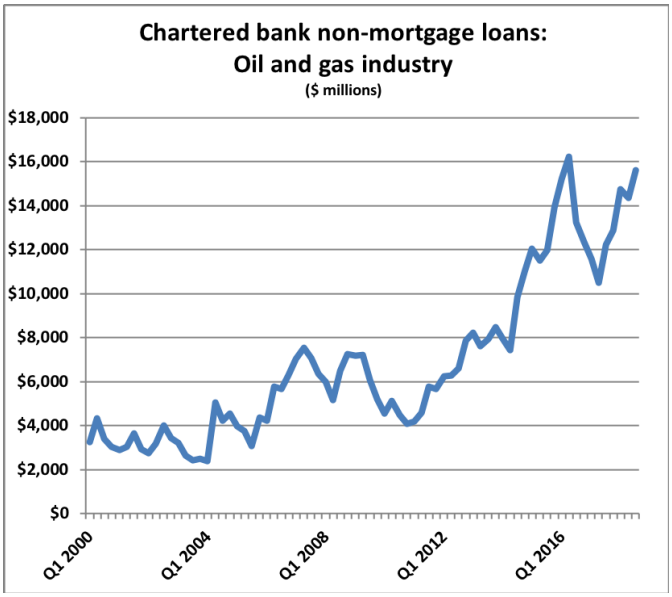
Meanwhile, bank business loan growth came in at 14.4% y/y in October (+12.2% prev).

Stats Canada data this week showed bank business loans up 13.6% y/y in Q3. <u>But the industry breakdown was quite telling:</u>

- **+16.4% y/y to real estate services**
- **+22.7% y/y to builders and developers**
- **+27.8% y/y to oil and gas**







But who really knows how accurate those construction figures really are when, "*we all define construction a bit differently*"? From CIBC's conference call this week:

Mario Mendonca, Analyst

And could you speak to how large construction is in that 16 billion.

Jon Hountalas, Senior Executive Vice President and Group Head of Commercial Banking & Wealth Management-Canada

As so -- I don't break it down. I don't think about it as construction, specifically, there's operating lines in there, so I don't have a construction number and we all define construction a bit differently. So I can't really quote number.

Analysts are probably wise to press management on construction exposure. New home sales in Toronto were down 40% y/y in October and -52% YTD, according to data released this week. And things are not better in Calgary or Vancouver either based on conversations with local realtors and developers.

As for oil exposure, we thought this Twitter thread from an Alberta-based insolvency lawyer was quite excellent:

https://twitter.com/doug_schweitzer/status/1068334873767665666?s=21

Summary: "This is worse than 08-09 and 14-15"

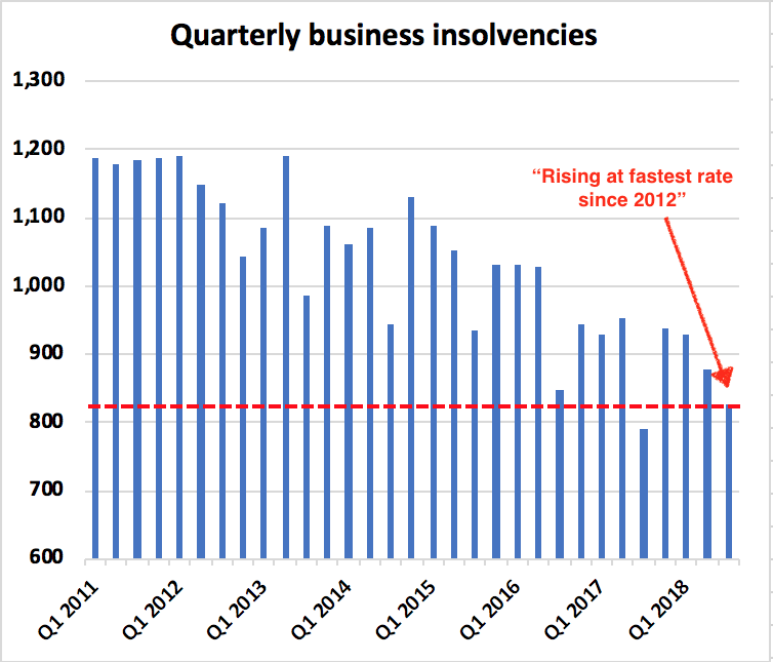
But it's only starting to trickle into the official data. Q3 business insolvencies jumped 47% y/y in Calgary and were up 8.3% y/y across Alberta.

The national picture isn't so bad….at least not yet. While we do love a good bearish headline, the one below from Bloomberg is uncharacteristically click-baity:

Business insolvencies in Canada rise at fastest rate since 2012

https://www.bloomberg.com/news/articles/2018-11-23/business-insolvencies-in-canada-rise-at-fastest-pace-since-2012

Sure, insolvencies were up 5% y/y, but some perspective is needed here. This is all base effect off an absurdly low print in Q3 2017. If/when they start to move in earnest, we'll be sure to pound the table.



We also received some questions about this Globe and Mail article:

Canadian banks battle for deposits adds to funding cost pressures

https://www.theglobeandmail.com/business/economy/article-canadian-banks-battle-for-deposits-adds-to-funding-cost-pressures/

We do track GIC rates across select lenders. Shown below is the change in 1 and 2-yr GIC rates by lenders since mid-October. Note that bigger banks have seen costs rise a touch more than the smaller players. The narrowing spread between lenders is something we discussed this in the last Credit Trends Monitor:

	1-yr (bps)	2-yr (bps)
RY	+35	+40
BNS	+35	+40
BMO	+36	+36
NA	+30	+30
LB	+40	+35
CWB	+26	+17
EQB	+26	+14
HCG	+23	+15

3) Timbercreek Financial and the Northumberland Mall

In their Q3 results, Timbercreek Financial (TF CN) reported ~$37.3MM in stage-3 impaired loans in their "other mortgage investments" category, against which they held a $463k allowance for losses:

Provision for credit losses :

Multi-residential	Stage 1	Stage 2	Stage 3	Total
Gross mortgage investments, including interest receivable	863,094	—	2,752	865,846
Mortgage syndication liabilities, including interest receivable	384,600	—	—	384,600
Net	478,494	—	2,752	481,246
Allowance for loan losses	566	—	3	569
Mortgage investments, net of allowance and mortgage syndications	477,928	—	2,749	480,677

Other Mortgage Investments	Stage 1	Stage 2	Stage 3	Total
Gross mortgage investments, including interest receivable	801,702	—	37,256	838,958
Mortgage syndication liabilities, including interest receivable	225,339	—	—	225,339
Net	576,363	—	37,256	613,619
Allowance for loan losses	276	—	463	739
Mortgage investments, net of allowance and mortgage syndications	576,087	—	36,793	612,880

Other loan Investments	Stage 1	Stage 2	Stage 3	Total
Gross loan investments, including interest receivable	69,949	—	—	69,949
Other loan syndication liabilities, including interest receivable	—	—	—	—
Net	69,949	—	—	69,949
Allowance for loan losses	197	—	—	197
Other loan Investments, net of allowance and mortgage syndications	69,752	—	—	69,752

We understand that TF management has indicated to analysts that this loan is on a grocery anchored retail commercial property in Ontario near the Greater Toronto Area (GTA).

A quick Google search for "Timbercreek mall Ontario" brings up this article (emphasis ours):

> https://www.cobourgblog.com/news-2018/major-upgrades-planned-for-mall/
>
> **Major Upgrades Planned for Mall**
>
> On July 1, 2018, Timbercreek Assets Management took over ownership of Northumberland Mall – they then appointed Sandalwood to take over management.
>
> […] Timbercreek is "well financed" and they want to put a significant investment into the mall. They are looking at all options which range from (as a minimum) a facelift with many overdue repairs being done, to possibly a complete revamp.
>
> […] The new owner is *Timbercreek* which is a Canadian asset management company specializing in Real Estate both through financing and active ownership. They own or invest in properties globally – see link below. They had been financing the mall but it had a negative cash flow so ended up taking ownership. They are based in Toronto but have offices worldwide.

Note that the article is not technically correct. We reached out to Timbercreek Asset Management who clarified that they do not technically "own" the mall, but they are the lender in possession. More on that in a moment.

A land registry search on the address (1111 Elgin St, Cobourg) shows a $33.5MM mortgage registered against the property in 2012.

ND74981	2012/04/26	CHARGE	$33,500,000	NORTHUMBERLAND SHOPPING CENTRE INC.	COMPUTERSHARE TRUST COMPANY OF CANADA	C
ND74982	2012/04/26	NO ASSGN RENT GEN		NORTHUMBERLAND SHOPPING CENTRE INC.	COMPUTERSHARE TRUST COMPANY OF CANADA	C
	REMARKS: ND74981.					
ND76343	2012/05/29	NOTICE		THE CORPORATION OF THE TOWN OF COBOURG LAKEFRONT UTILITY SERVICES INC.		C
39R12893	2013/07/30	PLAN REFERENCE				C

$33.5MM charge in 2012

NOTE: ADJOINING PROPERTIES SHOULD BE INVESTIGATED TO ASCERTAIN DESCRIPTIVE INCONSISTENCIES, IF ANY, WITH DESCRIPTION REPRESENTED FOR THIS PROPERTY.
NOTE: ENSURE THAT YOUR PRINTOUT STATES THE TOTAL NUMBER OF PAGES AND THAT YOU HAVE PICKED THEM ALL UP.

Ontario ServiceOntario

LAND REGISTRY OFFICE #39

PARCEL REGISTER (ABBREVIATED) FOR PROPERTY IDENTIFIER

51089-0001 (LT)

Transferred to numbered company in May, 2018

PAGE 4 OF 4
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ON

teranet eXpress

* CERTIFIED IN ACCORDANCE WITH THE LAND TITLES ACT * SUBJECT TO RESERVATIONS IN CROWN GRANT *

REG. NUM.	DATE	INSTRUMENT TYPE	AMOUNT	PARTIES FROM	PARTIES TO	CERT/ CHKD
ND166154	2018/05/08	TRANSFER OF CHARGE		COMPUTERSHARE TRUST COMPANY OF CANADA	2292912 ONTARIO INC.	C
	REMARKS: ND74981.					

Land registry lists the chargee as *Computershare Trust Company*, but in opening the mortgage instrument we see that Computershare held it on behalf of Timbercreek Senior Mortgage (one of the entities that merged into Timbercreek Financial):

Chargee(s)	*Capacity*	*Share*
Name	COMPUTERSHARE TRUST COMPANY OF CANADA	
Address for Service	c/o Timbercreek Senior Mortgage Investment Corporation 1000 Yonge Street, Suite 500 Toronto, ON M4W 2K2 Loan No. 12−28	

According to the land registry document above, the loan was transferred in May 2018 to a numbered company (2292912 Ontario Inc) which is an indirectly wholly-owned subsidiary of TF, per their Annual Information Form:

http://timbercreek-mic.s3.amazonaws.com/docs/default-source/regulatory-filings/2017---annual-information-form.pdf?sfvrsn=cfc5398c_4

Subsidiaries

The Company currently has one wholly-owned subsidiary, TMIF, which is a trust governed by the laws of the Province of Ontario, and one indirectly wholly-owned subsidiary, 2292912 Ontario Inc., a corporation incorporated under the *Business Corporations Act* (Ontario). Timbercreek Senior Mortgage Trust, a trust governed by the laws of the Province of Ontario and a wholly-owned subsidiary of the Company, was dissolved effective February 8, 2018.

It's unclear why the charge was transferred to the numbered company, but three months after the transfer, the borrower (Northumberland Shopping Centre Inc) declared bankruptcy, listing $34.2MM in liabilities and $33MM in assets:

BIA Estate Number I Numéro du dossier en vertu de la LFI :	31-2424617
BIA Estate Name I Nom du dossier en vertu de la LFI :	NORTHUMBERLAND SHOPPING CENTRE INC.
Birth Date I Date de naissance :	
Province :	Ontario I Ontario
Address I Adresse :	2300 Yonge Street, Suite 904, Toronto, Ontario, M4P1E4
Estate Type I Type de dossier :	BANKRUPTCY I FAILLITE
Date of Proceeding I Date de la procédure :	2018-09-26
Total Liabilities* I Total du passif* :	$34,165,071
Total Assets* I Total de l'actif* :	$33,000,000
First Meeting of Creditors I Première assemblée des créanciers :	2018-10-11 11:00:00
Discharge Status I Statut de la libération :	
Effective Date I Date d'entrée en vigueur :	
Court Number I Numéro de cour :	31-2424617

* As declared by debtor I Tel que déclaré par le débiteur

Appointed Licensed Insolvency Trustee or Administrator I Syndic autorisé en insolvabilité ou administrateur nommé :	SCHWARTZ LEVITSKY FELDMAN INC.
Responsible Person I Personne responsable :	GRAHAM, JAMES KENNETH
Address I Adresse :	2300 Yonge St, Suite 1500, TORONTO, Ontario, Canada, M4P1E4
Telephone I Téléphone :	416-785-5353
Fax I Télécopieur :	416-784-3025
Licensed Insolvency Trustee or Administrator's Discharge Date I Date de la libération du syndic autorisé en insolvabilité ou de l'administrateur :	

The town of Cobourg (population of 19,400) is located just east of the GTA. Northumblerland Mall's largest current tenant is a Metro grocery store, according to the website of the mall manager.

We're not certain that this is the property/loan in question, but it sure seem to fit the bill. The $33.5MM charge listed on land registry doesn't align perfectly with the stage-3 impaired loan, but it's not hard to get to the $37.2MM reported by TF if we assume some accrued interest and legal fees.

We're going to run on the assumption that this is the stage-3 loan disclosed by TF. If we're wrong, it probably raises even more questions. But for now, TF investors may want to grapple with the following.

1) What is the mall worth, and is a $463k provision adequate?

Given the size of the loan relative to the ~$13.7MM net income reported by TF last quarter, the adequacy of the provisioning here is an important consideration. The bankrupt borrower lists assets of $33MM but we wonder if that accurately reflects fair market value. Even assuming it does, the $463k provision is not going to cover the losses, particularly once legals and transaction expenses are factored in.

On the Q2 conference call, management was asked about this stage-3 impairment. They indicated that, "we are fully covered, and we expect them to be dealt with by the end of the year."

Graham Ryding, Analyst

Okay. And just my last question, just the color around stage three impairments. So, there was 2.7 million that's senior multi sort of bucket and then there was 40 million in your other mortgage investments. Can you just sort of break out what those actual loans are, maybe some color?

Cam Goodnough, Chief Executive Officer

Well, perhaps I'll start and then if I miss anything, I'll ask Gigi to highlight them. These stage three assets were in stage two prior quarter, so these are assets that -- I don't want to say graduated, whatever the inverse of graduated from stage two to stage three is. Two out of the three and the preponderance of the assets relate to income producing assets. We're in rolling up our sleeves as an active investor in dealing with them. We are fully covered, and we expect them to be dealt with by the end of the year.

This was reiterated in Q3, after the borrower declared bankruptcy and Timbercreek became "lender in possession":

Dylan Steuart, Analyst

Okay, perfect. And just one more if I can, just on the Stage 3 assets, doesn't look like much change from last quarter, but just wondering if sort of the sizable ones on track for a resolution by year-end, I think, was sort of the goal last quarter anyway?

Gigi Wong, Chief Financial Officer

Yes, we are on track.

Dylan Steuart, Analyst

So, everything is on track, that pretty much same, view as you had last quarter?

Gigi Wong, Chief Financial Officer

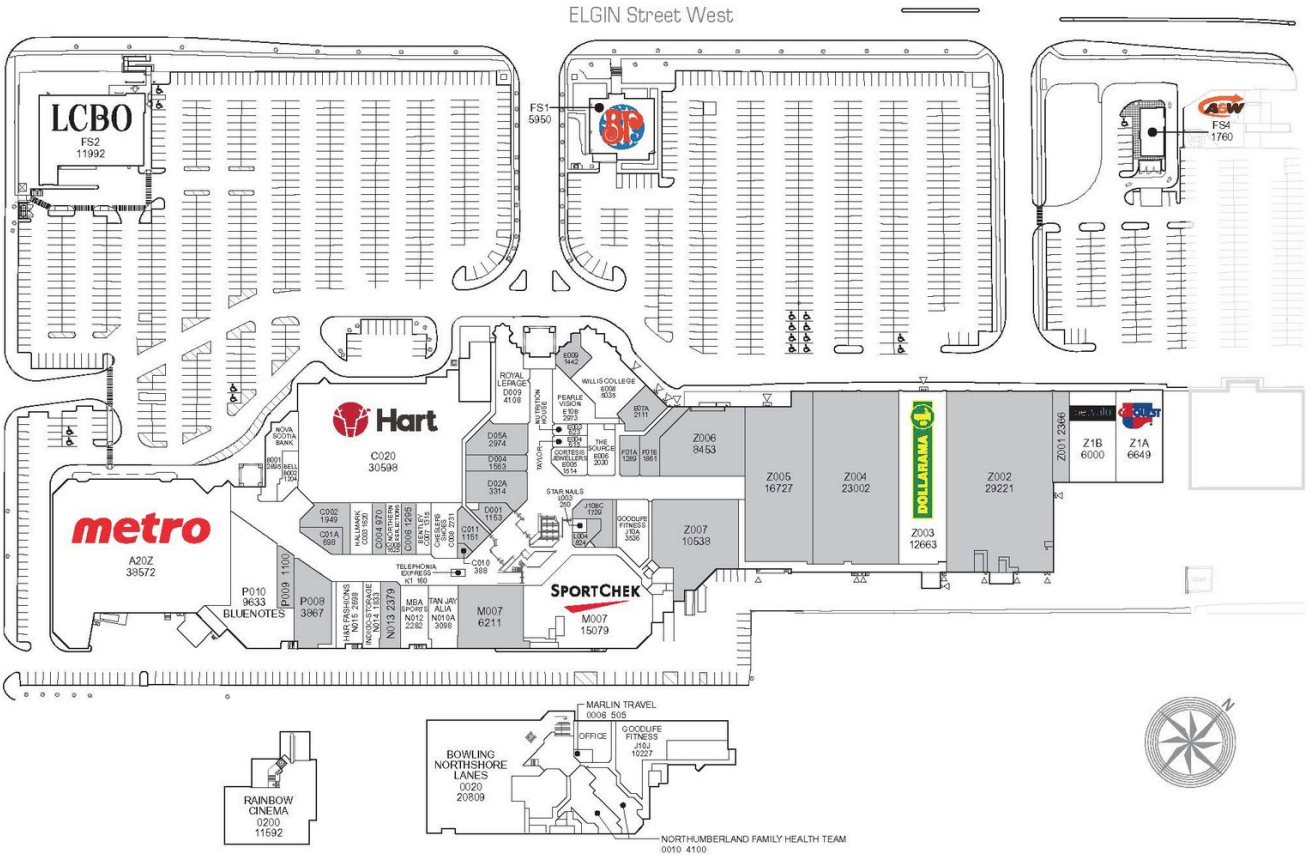
Yes.

With regards to this being dealt with "by the end of the year", our research (which includes speaking with several commercial realtors in the Cobourg area) indicates that the mall is not currently listed for sale. To the extent that "resolution" means having this asset sold, this would be a monumental achievement to pull off in 4 weeks.

As to the value of the mall, the link below from the property management company indicates gross leasable space of 370,769 sq ft for the entire mall, of which a combined 130,973 sq ft are currently available for lease! That's a whopping 35.3% vacancy rate!!!

http://www.sandalwoodmgt.com/CA/en/CM/PropPage.aspx?BLDGID=650

The shaded areas below are vacant stores:



Further, reviews on Google and TripAdvisor seem to suggest that the mall is in need of serious upgrades. Average rating is 2/5 on TripAdvisor and 3/5 on Google, so clearly not everyone is disappointed. But among some of the recent reviews…

A Green
2 reviews

★☆☆☆☆ 3 months ago

The mall has cracked and broken tiles on the floor throughout the building, and peeling/hanging paint from the ceiling due to water damage (outside former HR Fashion Plus & Fido). Unplugged camera wires hang down from a security camera in front of Cortesis. The front entrance is dirty. Approximately 9 empty store fronts. Outdated music, if the music is playing, some days it's off. Unfortunately there is no food court.

Like

Laura Bojarzin
Local Guide · 17 reviews · 34 photos

★☆☆☆☆ 3 weeks ago

One of the worst malls I've ever been to. What could be a mall for all the surrounding towns, villages, and townships has turned into an empty wasteland where staff seem completely untrained and uninterested in their work. Mall security is basically non-existent as they are constantly chatting with each other, with friends, or on their phones.
This mall is in incredible disrepair, it feels dirty and empty, half the stores are literally empty.

Like

Alexandra Foley-Eby
Local Guide · 24 reviews
★★★☆☆ 2 weeks ago
Nostalgia is what gives this place three stars, because, let's face it, the building is falling apart a little bit, the major anchor stores are gone, and you'd have a hard time spending more than 2 hours here shopping. Someone needs to really rescue this place.

Like

And one from 2017:

AnneB11
Cobourg, Canada
47 31

Reviewed July 11, 2017 via mobile

Sorry excuse for a mall

No flagship store left. More empty stores than occupied. Floor tiles broken, ceiling tiles water stained and run down. Some serious effort needs to be put in to attract new stores and clean it up. Can't even buy a coffee unless you go to the grocery store

Show less

The land registry documents suggest that the mall last sold in 2006 for $38.15MM, but our research shows that the mall had major anchor tenants and flagship stores at that time, notably Sears and Zellers. Both of those stores are now gone. Two questions on this point:

i) What is an aging mall in a second-tier market evidently in need of some significant upgrades and currently sitting less than 65% occupied actually worth?

ii) If there's sufficient collateral coverage on this loan, why hasn't the mall been sold already, particularly since the loan may have been in default as far back as 2015? More on that below.

2) When was the loan actually in default and why wasn't it sold previously?

The ~$37MM loan first showed up as a stage-3 impaired loan in Q2 2018. Prior to that, it showed up in stage 2 in the previous quarter (see below). From TF's Q1 report, stage 2 impairments are "performing financial assets" that have experienced an increase in credit risk. Emphasis ours.

> Under the IFRS 9 expected credit loss ECL methodology, an allowance is recorded for expected credit losses on financial assets regardless of whether there has been an actual loss event. We recognize a loss allowance at an amount equal to 12 month expected credit losses, if the credit risk at the reporting date has not increased significantly since initial recognition (Stage 1). We will record expected credit losses over the remaining life of performing financial assets which are considered to have experienced a significant increase in credit risk (Stage 2).

TIMBERCREEK FINANCIAL

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(In thousands of Canadian dollars)

Provision for credit losses :

Multi-residential	Stage 1	Stage 2	Stage 3	Total
Gross mortgage investments, including interest receivable	864,080	20,329	—	884,409
Mortgage syndication liabilities, including interest receivable	319,023	—	—	319,023
Net	545,057	20,329	—	565,386
Allowance for loan losses	603	26	—	629
Mortgage investments, net of allowance and mortgage syndications	544,454	20,303	—	564,757

Other Mortgage Investments	Stage 1	Stage 2	Stage 3	Total
Gross mortgage investments, including interest receivable	755,230	52,962	—	808,192
Mortgage syndication liabilities, including interest receivable	240,696	—	—	240,696
Net	514,534	52,962	—	567,496
Allowance for loan losses	15	209	—	224
Mortgage investments, net of allowance and mortgage syndications	514,519	52,753	—	567,272

Other loan Investments	Stage 1	Stage 2	Stage 3	Total
Gross loan investments, including interest receivable	45,441	—	—	45,441
Other loan syndication liabilities, including interest receivable	—	—	—	—
Net	45,441	—	—	45,441
Allowance for loan losses	228	—	—	228
Other loan Investments, net of allowance and mortgage syndications	45,213	—	—	45,213

The original loan from 2012 matured in May 2015 at which point, per the mortgage instrument, it would be deemed in default if not repaid in full:

Chargor(s)

The chargor(s) hereby charges the land to the chargee(s). The chargor(s) acknowledges the receipt of the charge and the standard charge terms, if any.

Name	NORTHUMBERLAND SHOPPING CENTRE INC.
Address for Service	2300 Yonge Street Suite 904 Toronto, ON M4P 1E4

I, Harold Spring, President and Darren Latoski, Vice President, have the authority to bind the corporation.

This document is not authorized under Power of Attorney by this party.

Chargee(s)		*Capacity*	*Share*
Name	COMPUTERSHARE TRUST COMPANY OF CANADA		
Address for Service	c/o Timbercreek Senior Mortgage Investment Corporation 1000 Yonge Street, Suite 500 Toronto, ON M4W 2K2 Loan No. 12-28		

Statements

Schedule: See Schedules

Provisions

Principal	$33,500,000.00	*Currency*	CDN
Calculation Period	monthly		
Balance Due Date	2015/05/01		
Interest Rate	See Schedule		
Payments			
Interest Adjustment Date	2012 05 01		
Payment Date	1st day of each month		
First Payment Date	2012 06 01		
Last Payment Date	2015 05 01		

From the schedule:

ARTICLE 6 - EVENTS OF DEFAULT

Section 6.1

In this Charge, "Event of Default" means, without limitation, each and every one of the following events.

(a) the Chargor fails to pay the then-outstanding Principal Sum and any other amounts secured by this Charge and the Additional Security on and as of the Maturity Date;

(b) the Chargor defaults in payment of the regular monthly payment of Interest payable hereunder;

(c) the Chargor defaults in payment of any other amount payable hereunder or any portion thereof, when the same becomes due under the provisions hereof;

We're not real estate lawyers or appraisers, so please discount our views here accordingly. But given that the loan was not removed from title and does not appear to have been refinanced, it would seem to our untrained eyes that this loan may have been technically in default since 2015. This doesn't mean the asset wasn't "performing" per se, but it does raise questions as to why it wasn't refinanced with another lender if collateral coverage was there, or why it wasn't sold previously by the owner or foreclosed and sold by TF.

Bottom line: Northumberland appears to be a highly distressed asset. We have serious concerns regarding the adequacy of the provisioning on this loan.

Regards,

Ben Rabidoux
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519-477-5211