Capital Debt Markets Update

WINTER 2020

5 - Year GOC		TSX		Prime Rate	
1.37%	▼ 0.17% 10/11/2019 - 1/28/2020	17,496.33	▲ 1,105.33 10/11/2019 - 1/28/2020	3.95%	— 10/11/2019 - 1/28/2020

The Fourth Quarter of 2019

The Avison Young Western Canada Debt Capital Group services Edmonton, Calgary and Vancouver. This creates a unique perspective on how real estate assets are being analyzed and financed. We mentioned last quarter that Vancouver's market was beginning to show minor stress as some investors looked to place capital into Alberta seeking higher yields, and this continues to hold true. The final quarter of 2019 closed out the year of political uncertainty with the federal election in October. The results of the election proved somewhat troublesome for Western Canada, and Alberta especially.

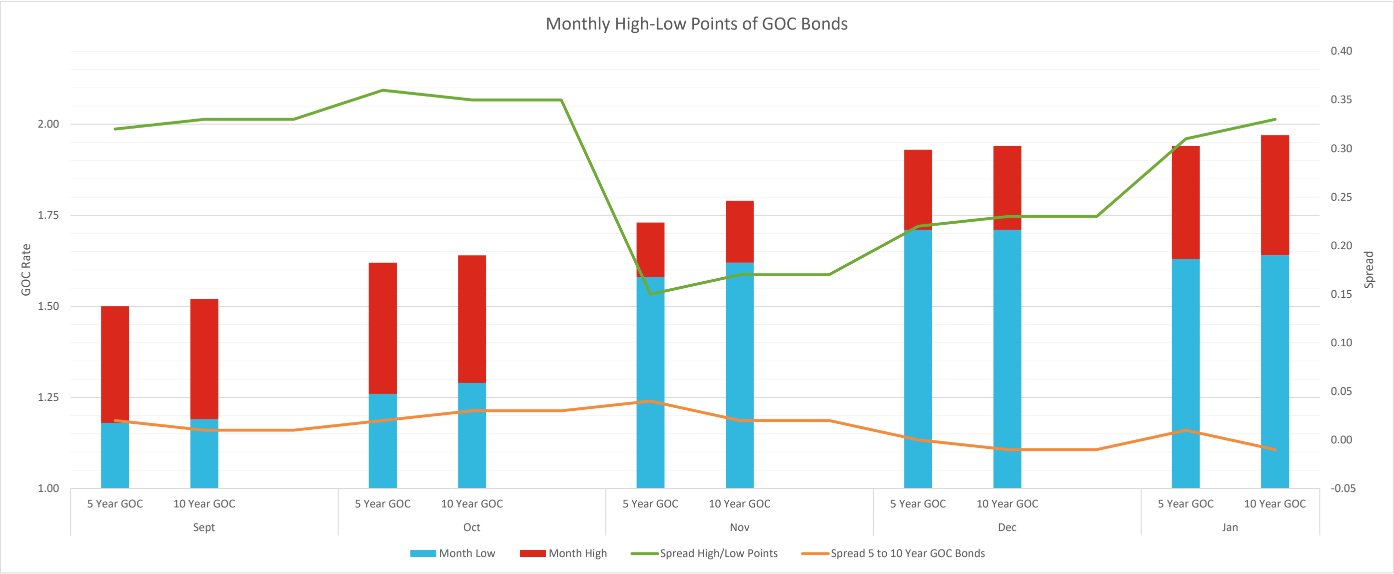
The availability of debt is still strong for Alberta, but we have seen the further tightening of how risk is factored into the debt underwriting. This is exacerbated by the receivership of a major Alberta player, Strategic Group. With excess of $650M of debt facilities being registered on titles, the exposure of lenders, whether direct or indirect, may cause some lessening of the desire to lend in Alberta for specific groups.

The Bank of Canada held its key interest rate target steady on January 22, marking the tenth straight Prime Rate hold at 3.95% (the last change was a 0.25% increase in October 2018), but forecasted a slower than expected start for the Canadian economy in 2020. This increases speculation that there will be a rate cut in the upcoming months, which would be the first Prime Rate decrease since 2015. Immediately after the announcement of a rate hold, the GOC took a dramatic downward turn.

The trend of inverted bond yields continued throughout the fourth quarter, with the 10-year GOC consistently being 1 – 2 bps below the 5-year GOC in November and December. The volatility of GOC bond rates also sustained as the variance between the high and low points in December reached 23 bps, with a monthly high for the 5-year GOC of 1.71 and monthly low of 1.48. The 5-year GOC saw a decrease of 20 bp from 1.53 on January 21 to 1.33 on January 27. Our advice to clients regarding this volatility is to always be ready to set rate in advance of funding, as the premium for setting rate early may be beneficial over the term of the loan. This is also true for an upcoming refinance, as the earlier you are prepared to set a rate, the better the chance to take advantage of a trough in the GOC rate. While the GOC Bond and Deposit Rates are the baseline components of the offered mortgage rates, one should be concerned about the spreads being offered moving upward if there is a perceived risk baked into the quote.

We have seen numerous opportunities for investors looking for short-term bridge loans to reposition and stabilize assets. Vendors that have mismanaged properties are looking for an exit with a purchaser willing to take on perceived risk for an excellent price. Our team has been successful in finding institutions willing to lend on bridge loans in Western Canada, although that list of lenders has been tightening in the last 6 months.

Bond Rate Variance



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Market Update

- The 5-year GOC saw an upward trend from September to December. The quoted rates around 1.15 at the beginning of September saw a jump to 1.60 at the end of October, then another peak to a 9-month high of 1.71 in December.
- The variance between the 5-year and 10-year GOC has also been volatile, as it ranged from 4 to 5 bps in September and October, and then inverted to range from 2 to -2 bps in November and December.
- Spreads over the GOC and Deposit Rates (or cost of funds) have been holding steady over the past 6 months. In some cases, Lenders have continued to implement floor rates or minimum loan amounts.
- The start of 2020 will be an interesting time to monitor rates, as the next Bank of Canada target rate announcement is March 4, 2020.

Looking Ahead

- The supply of debt capital remains strong but will be centered on the security of the borrower and ability to maintain servicing debt, outside that specific to the asset. It should be noted that we are still at a low point of the GOC trading range not seen since 2016.
- Bridge loan opportunities for investors should continue in 2020, with the availability of lenders willing to competitively price short-term loans beginning to tighten.
- Global economic conditions continue to decelerate amid trade war disputes as well as the trend towards some dismantling of the global economic structure. The US began to lower their Prime Rate in September and again in October, and though we have not followed this lead over the recent past, the future may reflect a much different landscape. Real estate markets are quite fragmented when one considers the developments and transactions occurring in Alberta during what has been a lengthy re-adjustment.

Case Study

We had an exciting story of a deal close in December, that saw our client take advantage of a trough in the GOC bond cycle. The loan amount was $5,900,000 on a $7,850,000 purchase of a commercial investment condo, with a lease term of over 6 years remaining to a strong international tenant. We took on the assignment after convincing the Borrower we were looking out for their best interests (to save them money) and that we would do a broad search of the market for debt capital. There were some difficulties in the lending market as the condominium corporation ownership was less than 50%, but we were able to emphasize the strength of the Borrower and the well-performing asset to a Canadian Bank willing to lend at a compelling rate. Being able to set the rate at the most beneficial time resulted in an interest rate of approximately 3.40%, which was 35 bps lower than the rate quoted by our client's long-time lender (and 0.55% lower than Prime Rate).

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