JULY 2019

# Debt Market Monitor

Debt Capital Markets Services

## Italy's debt and the Eurozone challenges


Across the Eurozone, a number of countries have experienced material declines in long-term bond yields (i.e. price rallies), at a time when minimal inflation and slow economic growth are the norm. The one country to buck the trend has been Italy – which faces a separate set of internally driven challenges related to its sovereign debt and budget deficit. As if it is not enough to struggle with these issues internally, the European Union (EU) is also putting pressure on Italy to manage its debt downward by invoking EU austerity rules which would limit government spending.

Some analysts say that Italy has entered a permanent recession with no way out, which could lead to a Eurozone crisis of significant magnitude. Although Greece experienced similar debt circumstances a few years ago, the fear is that because Italy is so much bigger– and one of the big three economies underpinning the Eurozone – the scale of such a crisis would make it more difficult to contain. If a default event were to happen, the effect would be felt well beyond the Eurozone, sending shockwaves through the world's financial markets.

Not surprisingly, the cost of insuring against an Italian default – using credit default swaps (CDS) – is relatively high. The older CDS does not insure against a change in the currency denomination of the debt. The newer contracts do provide the currency insurance. The cost gap between the two vintages of CDS has been growing meaningfully – which speaks to investors' expectations that Italy will exit the Eurozone and return to the lira.

It is odd that Italy believes it can pay its creditors with IOUs rather than hard currency; however, this is on the table. Italy has government arrears of €53 billion – the highest of any country in Europe – and carries the fourth-highest debt load anywhere behind the U.S., Japan and China, according to a Capital Economics report. All of this results in the high yield required by investors to hold their bonds.

## Fiscal Snapshot

### Bank of Canada

| | Bank Rate | Bank Prime Lending Rate |
|---|---|---|
| June 2019 | 2.00 | 3.95 |
| May 2019 | 2.00 | 3.95 |
| June 2018 | 1.50 | 3.45 |

### Government of Canada Benchmark Bond Yields

| | 5-Year | 10-Year | Long |
|---|---|---|---|
| June 2019 | 1.36 | 1.46 | 1.68 |
| May 2019 | 1.36 | 1.49 | 1.77 |
| June 2018 | 1.39 | 2.17 | 2.20 |

### Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

| Conventional | 5-Year | 10-Year |
|---|---|---|
| June 2019 | 1.50 - 2.00 | 1.60 - 2.10 |
| June 2018 | 1.75 - 2.10 | 1.85 - 2.35 |
| **Insured** | **5-Year** | **10-Year** |
| June 2019 | 0.90 - 1.10 | 0.85 - 1.10 |
| June 2018 | 0.90 - 1.10 | 0.90 - 1.10 |

*Spreads are indicative of high quality real estate in major Canadian markets.

Source(s): Bank of Canada

# Highlighted Transaction

| | |
|---|---|
| Asset Type | Retirement Residence |
| Location | Major Canadian city |
| Facility Details | A hybrid structure of fixed rate, amortizing debt and a revolver, both on a committed term basis of 5 years at competitive interest rates and on a non-recourse structure, in the aggregate amount of $15,000,000. |

## Intelligent Debt Financing Solutions

The Avison Young Debt Capital Markets dedicated team is focused on providing innovative North American-wide debt and equity solutions to accomplish goals. We originate debt and equity for all types of real estate and all types of clients. Debt origination includes fixed and floating rate structures, permanent and construction financing, structured finance, bridge and mezzanine debt and insured agency financing - CMHC and Fannie Mae / Freddie Mac.

Our years of combined debt/equity capital markets experience has created meaningful relationships that we can put to work for you.

Please contact our Debt Capital Markets team for more details related to debt financings or real estate transactions.

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