AVISON YOUNG

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Debt Market Monitor

Debt Capital Markets Services

Distressed debt funds stoke up

The wall of money sitting on the sidelines has been keeping a patient eye on the secured real estate lending market. There is a sense of a sizable opportunity that last appeared during the Global Financial Crisis (GFC) in 2008 and 2009. The GFC was a financial shock, while the current pandemic environment is related to a contraction in the real economy. One significant difference between the two situations relates to the availability of debt. During the GFC, new debt was nearly impossible to price and obtain. In today's pandemic environment, new loans for good-quality real estate remain available – albeit with greater scrutiny and generally lower leverage amounts, and with pricing remaining ultra-competitive.

Distressed debt funds are popping up everywhere around the world. PIMCO's distressed asset fund – which is targeting US$3 billion – is likely to be the largest of many funds looking for yield in a dislocated atmosphere. The current conditions are not reflective of a fully distressed market, which is largely due to government support funds and the actions of financial regulators. The latter have provided breathing room to lenders to relieve the pressure caused by under- and non-performing assets through a relaxation of capital reserve requirements. This easing of the necessity for capital to be allocated to these defaulted assets allows for business to carry on as usual – for now. The worry for financial institutions (and the opportunity for the distressed debt funds) is that the regulators will, at some point, determine that these institutions will have to resort to the regulations that have been established for financial safety. Re-imposing strict capital regulations, even if gradually implemented, would cause the dislocation between values determined by buyers and sellers to face a sharp adjustment as distressed sales start to occur. Financial institutions would be somewhat incented to clean up their lending portfolios by realizing on defaulted assets. This is where the distressed debt funds come in. As with many items, buying "in bulk" gets you a discount – and these funds can act swiftly as they are not subject to the same financial regulations that the institutions are.

Although the distressed debt during the GFC and the pandemic evolved from different factors, the end game could be much more similar.

Fiscal Snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending Rate
September 2020	0.50	2.45
August 2020	0.50	2.45
September 2019	2.00	3.95

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
September 2020	0.36	0.57	1.11
August 2020	0.40	0.63	1.17
September 2019	1.40	1.37	1.53

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
September 2020	1.70 - 2.25	1.80 - 2.35
September 2019	1.85 - 2.25	1.95 - 2.45

Insured	5-Year	10-Year
September 2020	0.90 - 1.25	1.05 - 1.35
September 2019	0.95 - 1.20	0.95 - 1.20

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

Source(s): Bank of Canada

Highlighted Transaction

Asset Type	Industrial Portfolio
Location	Major Canadian city
Facility Details	$22M arranged for a 5 year term, 25 year amortization to repatriate equity

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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