AVISON YOUNG

Capital Debt Markets Update

Fall 2021

Quick Stats

GOC 5-Year Bond

1.448

▲ 0.672

30/7/2021 – 29/10/2021

GOC 10-Year Bond

1.660

▲ 0.480

30/7/2021 – 29/10/2021

TSX

21,111

▲ 958

30/7/2021 – 29/10/2021

Prime Rate

2.45%

No Change

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You ain't seen nothing yet

It has been a strange end to the 3rd quarter of 2021. Supply chain issues are not yet resolved entirely, the potential bankruptcy of property companies in China coupled with an energy crisis both there and in the UK as fall sets in will have impact on our North American markets. The anticipation of the announcement by the Bank of Canada to halt the quantitative easing strategy, played major havoc with GOC Bond rates resulting in the cost of investment capital to rise by over 50bps. The election of the Liberals in the fall amid a "green policy" that is grounded in anything other than strengthening the Canadian economy will definitely impact the Western Provinces, though the movement of population to what is perceived to be a less costly place to live with adequate opportunities for employment, should benefit Alberta.

One of the key considerations for investors and Avison Young's Debt Capital and Advisory team is to find that sweet spot during the volatility of Bond Rate swings, where we can realize the best interest rates possible. While we have moved dramatically from the low point in late 2020 to early 2021 when the 5 Year GOC traded below 40bps, looking back over the last 5 years some interesting trends can be analyzed and provides some direction given current circumstances.

- In 2016 the year started with the 5 year at a range between 70 bps to 50 bps. Towards the end of the year the 5 year was trading above 100 bps and peaked at 120 bps. There was a premium for 10 year bonds, moving between 6 bps to 60 bps.
- By 2017 the 5 year moved up to 150 bps by July and peaked at 180 bps by the fall and winter. The premium for 10 year bonds was 3bps to 10 bps.
- 2018 began a period where 5 year bonds traded above 200 bps, with the range to mid-year being 190 bps to 220 bps. By the end of that year the 5 year had increased to 250 bps. 10 year bonds were being price at a differential of 5 bps to 20 bps, though there were points where the difference was negligible.

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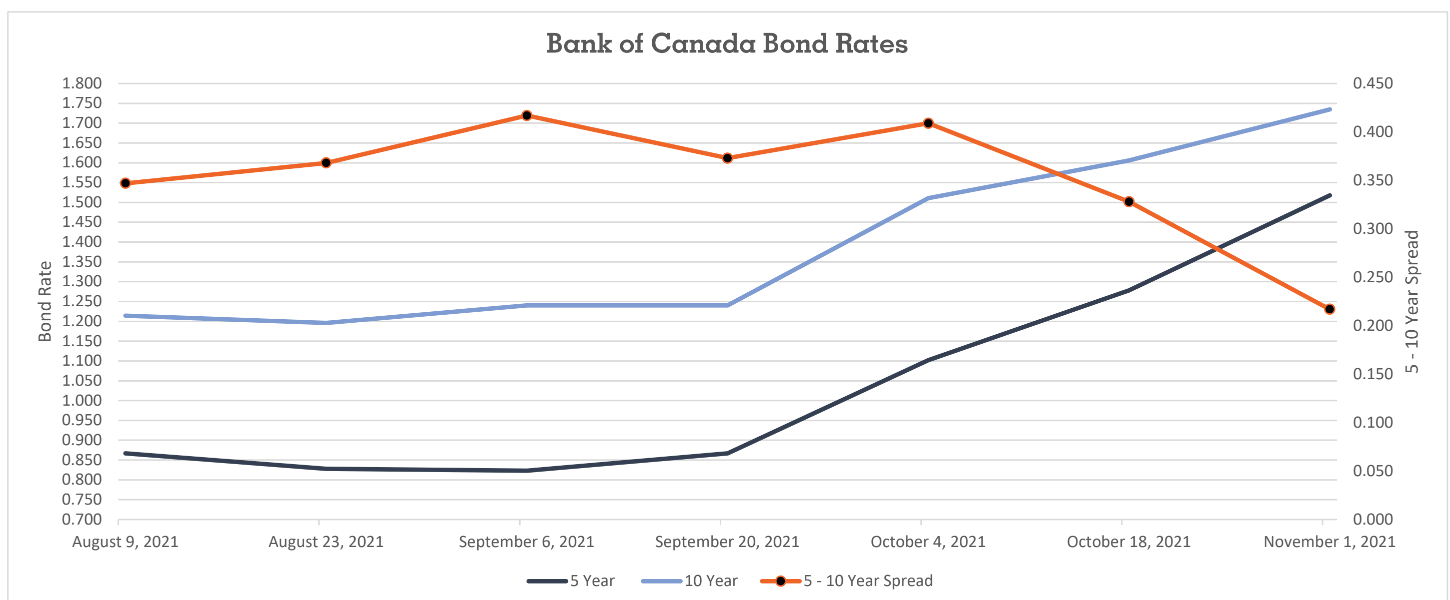
- Being the last year where the impacts of Covid were not at play, 2019 saw the 5 year bond decline below 200 bps at the start, dropping to 140 bps by mid-year, rebounding to 170 bps by years end. The variance between 5 and 10 year bonds ranged between 5 bps to 10 bps, though as in 2018 there were short periods where the variance was again negligible.
- 2020 started off with the 5 year declining to 160 bps and by mid-March had been within the 50 bps to 75 bps range. The variance in 5 and 10 year bonds started to expand to 15 bps mid-year, increasing above 20 bps and maxing out at 30 bps by years end.

2021 began the year with an unprecedented pricing model for 5 and 10 year GOC's in the 40 bps to 60 bps range with the premium for 10 year bonds being between 40 bps to 60 bps. A spike occurred in the Spring which increased the 5 year to an excess of 100 bps with the premium for longer bonds trending downward. As we entered the fall the 5 year moved into a trading range of 120 bps to 150 bps. At the same time the variance reduced to 20 bps.

The impact of the alteration in BOC bond purchasing strategy was anticipated prior to the October Rate Announcement placing upward pressure on yields. Once the direction and commentary became public knowledge, downward trends became evident. Saying that, the volatility evidenced over the past 6 months will continue into 2022. The next Rate Announcement is scheduled for December 8th.

There may be greater likelihood of rate increases in the 1st Quarter of 2022, as the impact of inflation remains a concern. Our developer clients are seeing continued price increases across most material suppliers, limited availability of product and labour shortages are creating lengthier development time frames and difficulty in maintaining budgets. Canada's inflation numbers attained a high of 4.4% in September which was the highest figure since 2003. Through the remaining part of the year the figure should settle around 4.75%.

As mentioned, the gap between short and longer term bonds are shortening. Where available, the ability to lock into current rates still presents an advantage when contrasted to the last 5 years. Generally, investors will require a higher yield the longer the maturity period. As we see the spread compressing, consensus could be that interest rates could be anticipated to fall again as economies begin to stabilize and seek a path out of the past 2 years. The existing curve, which had been baking in upward pressure on interest rates, is flattening quicker than normal ahead of an actual rate hike.



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Case Study

Case Study 1

The team recently funded a first mortgage financing of a portfolio consisting of two industrial investment properties totaling 48,231 sf on 7.35 acres located in Saskatoon, SK and Aldersyde, AB for a Calgary-based client. The buildings are 100% leased to a mix of national, regional and local tenants with varying lease terms remaining. The mortgage terms secured included a fixed interest rate of 3.29% for a 5-year term and 25-year amortization. The loan amounts were approximately $5,460,000 (73% loan to appraised values), and the team was able to solicit limited guarantees required by the client. The Saskatoon property was on a land lease at the Airport, which the team advised the client to extend in order to secure a 25-year amortization and maximize cash flow. We were also able to fund using the lowest cost of funds over a 2-week period, in order to lock the best interest rate possible as bonds/cost of funds rose almost 70 bps from the signing of the Commitment letter to funding.

Case Study 2

We recently funded the refinance of a 104 key hotel located in interior British Columbia. The uncertainty Schedule 1 lenders experienced throughout changing COVID restrictions presented a challenge throughout the process. As some lenders begin to open their capital to hospitality lending and believed in the Borrowers ability to manage the changing landscape, we were able to secure a 57% LTV first mortgage amortized over 20 years at 4.80%. The term loan allowed the Borrower the payout high interest private financing, begin amortizing the debt and complete improvements to the asset.

Strategic Considerations

With the recent surge in bond rates due to the current inflationary period we are navigating, borrowers might want to look for a rate lock option as their new life preserver. In the last month alone we saw rates increase 50 bps from the beginning of September to mid-October. The deals that we were able to secure a rate lock helped save the borrower an additional 20-30 bps during that time frame. This is where having a lender who has the ability to rate lock will become more important moving forward; especially if we see another surge in bond prices prior to the December announcement. This is where having a broker who can secure a rate lock option can help save the borrower substantial costs if interest rates begin another upwards run.

CMHC insured loans remain the lowest cost option for Multi Family investors, however the time it takes to get an approval from the corporation continues to be a challenge. The system is backlogged and the current time frame for an approval sits at approximately 16 to 20 weeks. If you are acquiring a property, the vendor is unlikely to give you that much time to remove your financing condition, so the alternative is a short term bridge loan to fill the gap. Bridge loans terms and rates vary though we are seeing increased activity in this sector, as new lenders enter this market. Current interest rates for CMHC insured loans range from 2.08% to 2.18% for a 5 year term and 2.45% to 2.55% for 10 year terms.

Interest rates for conventional loans range from 3.00% to 3.50% for 5 years and 3.10% to 3.50% for 10 years. The lower mainland of BC seems to be able to command the lowest spreads and lenders are going to are going to have to reduce their conventional rate spreads by at least 20 basis points to win the business.

The supply of debt remains high as many institutions were somewhat sluggish towards the final quarter of their fiscal year ends, generally October 31st. With new targets being set and a pool of capital needing to be placed, a competitive environment is in play for at least the coming 6 months. We have also seen increased activity in the Conduit market with terms and security being very fluid.

Overall, there has not been any major pressure on spreads within property segments since the last Newsletter. Those assets that are considered institutional quality can still obtain debt in mid-150 bps over the GOC. A general range for 5 year debt is in the 185 bps to 225 bps. This would relate to whole rates in the 3.25% to 3.75% for good quality assets. As well, lenders that had been difficult to deal with in regard to the Alberta economy are starting to alter the view of the risk associated with lending in Alberta.

As stated in the previous Newsletter, expiry of existing debt facilities provides an excellent opportunity to free equity at low interest rates and relieve the investor of any capital gains. In 2022 there will be purchasing opportunities which can be taken advantage of if one has the ready capital to execute the acquisition. Comment had also been made in the summer that the available interest rates were at unprecedented levels. We are still at rates that are below those reflected over the past 10 years.

Get more market information

Ron Dezman, AACI
Broker, Senior Vice President
+1 780 408 6771
ron.dezman@avisonyoung.com

Myles Strilchuk
Principal
+1 780 702 0699
myles.strilchuk@avisonyoung.com

Don Taylor
Senior Vice President
+1 604 647 1333
don.taylor@avisonyoung.com

Jordan Dezman
Senior Associate
+1 780 408 6773
jordan.dezman@avisonyoung.com

Sam Dezman
Associate
+1 780 408 6770
sam.dezman@avisonyoung.com

Brennan Yadlowski
Associate
+1 403 232 4301
brennan.yadlowski@avisonyoung.com

Tristan Starzynski
Analyst
+1 780 910 7894
tristan.starzynski@avisonyoung.com

Contact one of our local offices

Edmonton
Suite 2100, 10111 - 104 Avenue
Edmonton, AB T5J 0J4
+1 780 428 7850

Calgary
Eight Avenue Place, West Tower
Suite 1200, 585 - 8 Avenue
Calgary, AB T2P 1G1
+1 403 262 3082

Vancouver
#2900 - 1055 West Georgia Street
Box 11109, Royal Centre
Vancouver, BC V6E 3P3
+1 604 687 0031

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avisonyoung.com

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