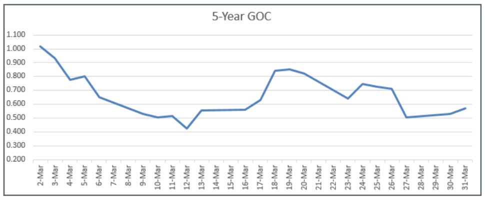
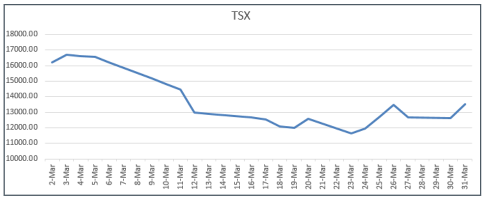
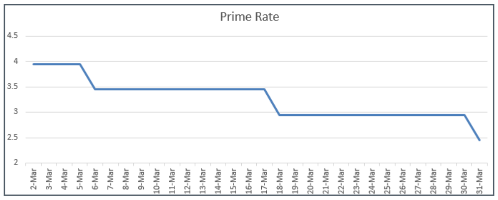
Capital Debt Markets Update

SPRING 2020

5 - Year GOC		TSX		Prime Rate	
1.020 - 0.572	**0.45** 03/01/2020 - 03/31-2020	16220.18 - 13,524.90	**2,695.28** 03/01/2020 - 03/31-2020	3.95% - 2.45%	**1.50%** 03/01/2020 - 03/31-2020







Through a Glass, Darkly

The usual format for our newsletters provides background on the historic direction of interest rates based on movement in key indicators, allowing us to provide some insight on what we see as evolving trends over the short to medium term. Suffice it to say events through March have made such an attempt to be quite futile. Previous economic downturns in the real estate business, will have no comparison to what is ahead of us. The headline to this newsletter says a lot, as darkly is defined as "to have an obscure or imperfect vision of reality".

It is critical to remember that after each recessionary occurrence, the real estate markets have established new benchmarks and valuation metrics based on market conditions at that time. Real estate is typified by creativity and the ability to execute, key attributes in the new environment we will be in. What will become clear is that we will need to rethink the basic underwriting guidelines for the short term at least. Unlike the impact arising from the 1980's Canadian government energy policy, lenders have learned that taking back real estate assets and then attempting to complete dispositions did not result in any beneficial gain. As long as the Borrower covenant remains acceptable and a plan is in place to deal with potential tenant/revenue issues, time should be available to better understand the strategies which can be implemented. It may be that we will not be entering a "Credit" problem, rather it will be one of "Liquidity".

Dealing with the deferral of mortgage payments on behalf of clients is reflecting how fractured the approach truly is. Some Lenders have opted for interest only payments, some for a total "holiday" of payments, while other's wanting to obtain financial statements on tenants asking for relief. Generally, the period being offered is between 3 to 6 months. Some tenants have the misconception that somehow lenders are not asking for interest payments where the truth is that any interest not paid is being accrued to a later date.

The First Quarter of 2020

As 2019 closed out the GOC bond yields reflected a small spike from the range of 140bps – 150 bps for a 5 year, to in the range of 160bps to 170bps. The variance between 5- and 10-year bond yields was minimal. By mid-January 2020 the downward trend began with the month closing out in the 130bps to 140bps. A short-term inversion of the yield occurred whereby the 10-year bond yield was marginally lower than the 5. Through February the GOC was yielding between 120bps down to 60bps. As April has unfolded the general pricing range has been in the 50bps to 65bps.

One of the key takeaways is that the market has become so volatile that where we would see variance of 20bps to 30bps over a week or a month, this can occur in a 24-hour period. Over the past week the pricing on the 5 year GOC is trading in a more compressed range, but the expectation is that we will continue to see extraordinary movement in response to the unique situation we all find ourselves in.

The cost of 10-year money is also showing signs of becoming more expensive and limited. While we did discuss the short period when an inversion occurred between 5- and 10-year GOC's, the typical variance through the later part of 2019 was in the order of 7bps to 11bps. Where the opportunity is available, secure a longer term for your debt before the framework changes.

Though some Lenders have initiated a halt on taking in new applications this is not across the board. That segment that was more heavily weighted into construction and bridging facilities will be more impacted over the short term. Until there is potential for redemptions of capital arising from securing long term debt or sellout of a project, these types of transactions will require more effort and proponent support that would have been the case at the beginning of the year.

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Looking Forward

- The preference in new loans will be pushed more towards the Borrower covenant than over the past number of years. With the uncertainty regarding whether tenants can pay rent, how will deferrals impact the needs of utility companies and tax regimes as well as operating income assets with reduced staffing and higher tenant needs, the ability to maintain contractual obligations through the Balance Sheet or alternate assets will be key to approval.

- What is the Capitalization Rate? Lower interest rates do not imply that capitalization rates will decline. Rather it is the risk of the revenue stream base on tenant profile and variances in regional economic wellbeing that will determine how the property is being valued.

- Expect that the stressing out of interest rate and amortization periods will be a component of the underwriting process. Short term this may result in loans amounts reducing in relation to value to embed the "risk" adjustment that renewals may not occur, new tenants being in the market and lease rates are adjusted short term in response to business activity.

- Lenders need to secure interest payments to make their business models work. The same volatility that impacted the GOC market will also be evident in the debt sector. While transaction volumes decrease through 2020, there should be ample opportunity to secure acceptable debt with a detailed presentation that can be given a through exposure to the market.

Case Study

We funded two deals in the middle of March that are excellent examples of our team's ability to execute. The first was an $8,000,000 refinance for a ~150,000 sf industrial property in the Greater Edmonton Area. The property was 100% leased to 2 national tenants and is owned by a strong private Borrower. The 5-year term is fixed at 3.30% and amortized over 15 years to accelerate the principal pay down.

The second property is a motel located in Grande Prairie, AB for $1,800,000. The asset had undergone numerous renovations and has since stabilized which allowed us to secure a 5-year mortgage amortized over 15 years at 4.32%.

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