Capital Debt Markets Update

Summer 2021

Quick Stats

GOC 5-Year Bond

0.776

▼ 0.18

1/3/2021 – 30/7/2021

GOC 10-Year Bond

1.18

▼ 0.33

1/3/2021 – 30/7/2021

TSX

20,153

▲ 1518

1/3/2021 – 30/7/2021

Prime Rate

2.45%

No Change

Resetting

After living in an unprecedented period where the economy was in disarray, people had to adapt to not only one but a series of lockdowns, uncertainty regarding health and wellness coupled with the impact arsing from government financial support, acceptance and resolve as to what the future holds for the commercial real estate market seems to present some degree of certainty. Transactions are occurring in all sectors and the availability of debt remains strong.

The housing market in Alberta reached levels of activity not seen for decades. Anticipated inflationary pressures may be a driver behind purchase decisions in both the commercial and residential markets. This has clearly been evident in the commodity markets as the impact of Covid shutdowns in manufacturing caused run ups in pricing and shortages of products. Oil prices have been rising however that is more a supply chain reaction.

Inflation rates posted for April at 3.4% and May at 3.6% are the highest seen since May of 2011. Projections are that averaged inflation rates through 2021 should be at 3.0% and down to 2.4% average for 2022. The Bank of Canada's current position is to hold off on any movement in Prime until such time that the inflation rate can be sustained at the 2.0% level. The expectation is that this should be achieved in the second half of 2022, which may result in a possible hike towards the latter part of that year and into 2023.

The substantial increase in GOC Bond rates which began in the Spring of 2021 coincided with the quantitative easing strategy by the Bank of Canada. In the fall of 2020 up to $6 billion of bonds were being purchased each week. In our Spring report we made mention that by April of 2021 this was to be reduced to $4 billion and anticipated to fall to $3 billion by the fall. The July 14th interest rate announcement has reduced purchases to $2 billion per week, well ahead of that suggested timeline.

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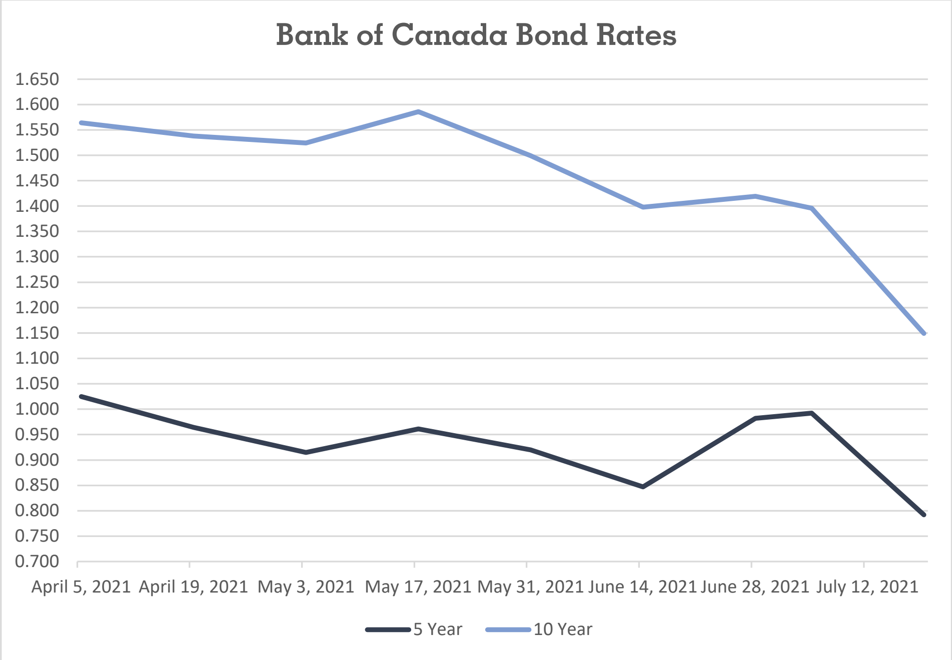
Interestingly the GOC bond rates have shown an approximate decrease of 20% since that statement. While Bond Rates were generally in the range of 95bps to100bps through April until the beginning of June, where sub-90bps rates were noted. The July Bank of Canada announcement resulted in the 5 Year rate dropping below 80bps. It will be of interest to see if the reduced purchasing strategy will place further downward pressures on bond rates.

Through the early part of 2021 the variance between 5 Year and 10 Year bonds was maintained at approximately 60bps. At the date of this report the variance has reduced to between 35bps to 40bps. The supply of 10 year debt is limited but can be obtained for better quality assets.



Lender Update

Spreads have remained consistent with the ranges noted in our Spring 2021 report. Good quality assets can expect spreads in the 170bps to 200bps range. Trophy assets can command spreads towards 150bps and lower. While there is not a large supply of 10 year money, spreads can be found between 200bps and 250bps. For investment properties with lease up or re-positioning requirements, spreads can move into the high 200s to low 300s.

As we move into the resetting phase of the economy and money markets, a window is available to obtain debt at unprecedented terms. As discussed in the Case Studies below, the impact on cash flow and yield can be realized immediately on renewals, as well as having a competitive environment for the placement process.

CMHC financing remains a positive opportunity even in this uncertain environment. Although the CMB has closely tracked the increases in the GOC over the past month, spreads have recently compressed, and Lenders are aggressively bidding for CMHC business. Multi-family remains a safe haven and is still considered to be a very low risk lending opportunity. There is ample liquidity and appetite for both Conventional and CMHC lending opportunities.

The application process to obtain a Certificate of Insurance remains somewhat lengthy but there are cost effective strategies we can utilize to bridge that timeline. Recently CMHC amended the required time to correct any submission errors or deficiencies from 10 days to 5 days. Having an experienced broker compiling and submitting applications has therefore become even more important.

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Market Considerations

In the first half of 2021 there have been substantial trades of both owner user and investment properties. While in the beginning of the year there was some evidence of marginal increases in capitalization rates, the cautious certainty and continued low cost debt have taken much of that impact away. Lenders continue to look more closely at the price per square foot of the asset as a support to the underwriting value rather than purely based on financial indicators.

The supply of money for mortgages remains high, related somewhat to the selective underwriting process impacting lenders desire to conclude a debt transaction. The Post-Pandemic trends impacting underwriting value and debt are slowly starting to be reflected in market and should stay relatively static towards the fall. The next announcement by the Bank of Canada on September 8th may provide some insight to future trends.

Case Study

Case Study 1

We recently completed a re-finance of a mixed-use retail/industrial property for a client. As the outstanding loan compared to the estimated value was very low, we looked to repatriating some equity to provide capital for investing in other real estate assets. Even though the existing Lender was willing to allow for this, the need for new third party reports provided the base to solicit the broader market to ensure the best available terms.

The net result was that we were able to increase the loan amount by $1,000,000, reduce the interest rate from 4.40% to 2.75% (5 Year term) and move the amortization period back to 25 years. This reduced the debt service from approximately $25,000 per month to $17,979.

We would be more than happy to review any situation without any upfront cost where there are renewals coming up in the coming year.

Case Study 2

As the CMHC approval process has continued to lengthen, we have solved this issue with cost effective bridge financing to allow the acquisition of multifamily properties and the subsequent refinance with CMHC insurance. On a recent transactions, we have placed 12 month interim loan facilities at 75% of purchase price to facilitate the closing of the acquisition within standard 60/30 day timelines. The interim facility was priced at prime + 0.50% (2.95% all in) with a reasonable Lender fee, interest only payments, and fully open to prepayment at any time with no fee or penalty. While arranging the interim loan facility we also submitted the CMHC application to provide the fastest turnaround time possible for our Client. In addition to being the lowest cost of capital and allowing a smooth process for the purchase, the interest only payments actually allow for additional revenue while waiting for the CMHC approval to more than offset the costs of the financings.

Get more market information

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