Capital Debt Markets Update

Winter 2021

GOC 5-Year Bond

0.386

▲ 0.046

07/09/2020 – 01/04/2021

TSX

17,542.61

▲ 2,091.95

07/09/2020 – 01/04/2021

Prime Rate

2.45%

No Change

End of the Infamous 2020, But Not the End of the Famously Low Interest Rates

We didn't publish a newsletter in the fall, in order to accurately review the lending environment after the inevitable "second wave" of COVID-19 in Canada. In the last newsletter in Summer 2020, we stated the capital markets were beginning to loosen up, and that inquiries for debt had began to increase. This statement holds true at the start of 2021, with many lenders back open for business, and a large portion of them looking to increase their loan book and real estate portfolio allocations this year. The strongest real estate classes remain to be industrial and multi-family, while there is still a strong demand for service-based retail properties.

In Western Canada, almost all lenders remain active in Alberta, however most remain cautious and deal- or borrower-dependent. Vancouver and Victoria remain strong on the list for appetite while Winnipeg has more of a moderate appetite from lenders.

Many Canadian economists continue to caution that a slight tightening could occur in early 2021 as a second wave of cases stalls economic momentum, and at the same time, the Bank of Canada remains committed to keeping interest rates near zero until 2023 and recently expanded quantitative easing to keep rates low across the yield curve. The desire is that even as the economy is expected to ramp up again in 2021, the Canada 5- and 10-year bond yields will remain low. Real estate debt in Canada has never been cheaper for borrowers thanks to this current low bond yield environment. Lending spreads surged during the early days of the pandemic but have since tightened significantly, though still remain elevated relative to early 2020 and late 2019. Today, lending spreads over the GOC bonds are moderately wider with lenders typically pricing loans approximately 25 bps higher than the pre-pandemic environment at 170–200 bps for 5-year terms and 200–250 bps for 10-year terms.

CMHC insured financing rates for multi-family rental buildings have remained flat in the last 2 quarters of 2020, and due to the lower Canadian Mortgage Bond (CMB) yields interest rates are extremely attractive starting at 1.20% for 5-years and 1.50% for 10-years.

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Lender Underwriting Update

With the uncertainty still in the market lenders are continuing to be cautious with underwriting. The major effects in today's lending environment are lower loan to value ratios along with the need for more security. Although loan to value ratios achievable may be more conservative in general today the fact remains that a AAA quality asset with a strong proponent can yield extremely aggressive rates and push the loan to value to 75%.

Since the beginning of COVID, lenders became more flexible on underwriting mortgages on commercial real estate in the final quarter of 2020. Throughout the year we have seen many lender's re-entering the mortgage market as the economic impacts of COVID became clearer. However, applications for mortgages today require a much more stringent level of due diligence in terms of COVID impact to the borrower, the tenant profiles, and the likelihood of tenants remaining in business. These items are mostly impacting the retail and office sectors due to the direct impact this pandemic has had on the tenants' ability to pay rent and requirement for space. Lenders look for "COVID-proof" business models throughout the tenancy base. The shift to work from home that many are speaking to in the office sector is something lenders will consider, but is not the sole reason for a deal to be passed on.

Case Study

In November 2020 the Avison Young Debt Capital Markets & Advisory Western Canada team successfully arranged a $10,140,000 non-recourse first mortgage, at 65% LTV, 2.45% interest rate for a 5-year term. The property was a retail shopping centre in the interior of BC where the majority of the tenants were not affected by COVID. Avison Young was able to identity the best-suited lender for the opportunity that was looking to deploy debt capital in the market and was offering a "rate sale" for strong retail properties in Western Canada, as well as negotiate a rate lock 40 days prior to funding to secure the best rate possible for our client.

This deal confirms that extremely low interest rates are still available for high-quality, well-located properties with strong tenant bases.

Get more market information

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