AUGUST 2019

# Debt Market Monitor

Debt Capital Markets Services

## Collateralized Loan Obligations 2019 vs. Collateralized Debt Obligations 2008

The U.S. collateralized loan obligation (CLO) market has now grown to more than US$600 billion. It is the first time this asset class has reached this peak level. A CLO is a single security backed by a pool of debt – primarily company loans instead of the mortgages, bonds and loans that constituted the collateralized debt market which was identified as a contributor to the 2008 credit crisis. Some of the corporate loans that are included in CLOs have low credit ratings and are subject to substantial market volatility.

Japan-based Norinchukin Bank is the single largest owner at more than US$68 million, according to Forbes. U.S.-held exposure to CLOs has more than doubled in the past nine years to about US$46 billion. The outstanding CLO market is the largest segment in the $1.2-trillion U.S. leveraged loan market, which has been growing steadily since the credit crisis. Buyers seeking higher returns have flocked to this asset class, ballooning the outstanding position of CLOs with their materially increased demand.

CLOs contain repackage loans that were generated, in many cases, from non-cash-flow-generating activities such as leveraged buyouts and dividend payments. Many of these loans are low-credit leveraged finance loans given to companies that already have substantial leverage on their balance sheet. Some fund managers have referred to the CLO market as a potential time bomb.

Much of the growth of the CLO market has been attributed to high demand from Japanese investors hunting yield. A recent change by Japanese regulators will now have impact on the largest buyers of CLOs. Since March 2019, U.S. sellers of CLOs to Japanese buyers must retain at least 5% of the issue. This is similar to a change that was brought to the commercial mortgage-backed securities world in order to improve the underlying quality of the assets and issuer underwriting by enforcing a "skin in the game" policy. This move by Japanese regulators has caused a slowdown in the market, which could impact overall liquidity and, in turn, may lead CLO spreads to widen and/or to more defaults. The result could be a domino effect. Most owners of CLOs are required to mark to market valuation changes, thus incurring losses as defaults or imminent defaults occur.

CLOs are a market segment that should be watched closely. The sheer size of the CLO market means that, should it shudder, the results would be felt in nearly all lending for all asset classes. The reach for yield comes with greater risk-taking – especially in today's low-interest-rate environment.

## Fiscal Snapshot

### Bank of Canada

| | Bank Rate | Bank Prime Lending Rate |
|---|---|---|
| July 2019 | 2.00 | 3.95 |
| June 2019 | 2.00 | 3.95 |
| July 2018 | 1.75 | 3.70 |

### Government of Canada Benchmark Bond Yields

| | 5-Year | 10-Year | Long |
|---|---|---|---|
| July 2019 | 1.20 | 1.22 | 1.47 |
| June 2019 | 1.39 | 1.46 | 1.68 |
| July 2018 | 2.22 | 2.31 | 2.33 |

### Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

| Conventional | 5-Year | 10-Year |
|---|---|---|
| July 2019 | 1.50 - 2.00 | 1.60 - 2.10 |
| July 2018 | 1.75 - 2.10 | 1.85 - 2.35 |
| **Insured** | **5-Year** | **10-Year** |
| July 2019 | 0.90 - 1.10 | 0.85 - 1.10 |
| July 2018 | 0.90 - 1.10 | 0.90 - 1.10 |

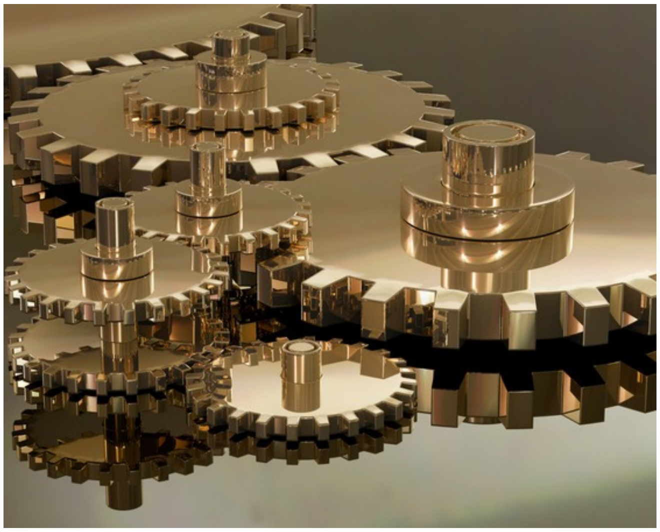
*Spreads are indicative of high quality real estate in major Canadian markets.

Source(s): Bank of Canada

# Highlighted Transaction

| | |
|---|---|
| Asset Type | A single tenanted office building |
| Location | Major Canadian city |
| Facility Details | 70% leverage or $13,265,000 was secured for acquisition purposes for a term of 7 years, which included 3 years of interest only payments at the term commencement, amortized over 25 years at a competitive rate of interest. The mortgage was structured with limited recourse to the borrower. |

## 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.

**Norm Arychuk,** Mortgage Broker*
416.673.4006
norman.arychuk@avisonyoung.com

*Licence #: M09002260
Brokerage Licence #10637

**Michael Ho,** Mortgage Broker**
416.673.4012
michael.ho@avisonyoung.com

**Licence: # M15000834
Brokerage Licence #10637

Avison Young is the world's fastest-growing commercial real estate services firm. Headquartered in Toronto, Canada, Avison Young is a collaborative, global firm owned and operated by its Principals. Founded in 1978, with legacies dating back more than 200 years, the company comprises approximately 5,000 real estate professionals in 124 offices in 20 countries. The firm's experts provide value-added, client-centric investment sales, leasing, advisory, management and financing services to clients across the office, retail, industrial, multi-family and hospitality sectors.

AVISON YOUNG CANADA CAPITAL MARKETS OFFICES

Calgary | Edmonton | Mississauga | Montreal | Toronto | Vancouver

avisonyoung.ca

Avison Young Commercial Real Estate (Ontario) Inc., Brokerage
18 York Street, Suite 400
Mailbox # 4
Toronto, Ontario, Canada M5J 2T8
416.955.0000

AVISON YOUNG



CANADA BEST MANAGED COMPANIES Platinum member