Capital Debt Markets Update

FALL 2019

AVISON YOUNG

5 - Year GOC		TSX		Prime Rate	
1.54%	▲ 0.22% 06/20/2019-10/11/2019	16391.00	▼ 192.67 06/20/2019-10/11/2019	3.95%	— 06/20/2019-10/11/2019

The Third Quarter

The Avison Young Western Canada Debt Capital Group services Edmonton, Calgary and Vancouver. This creates a unique perspective on how real estate assets are being analyzed and financed. Vancouver's market while still being active in most sectors, has begun to show some minor stress leading investors to look to Alberta. The lower cost base and rationalization of real estate fundamentals over the past 5 years offers some upside in the Alberta marketplace. In terms of loan underwriting and the availability of funds, Western Canada is not suffering from any lack of desire to lend. Private lenders continue to expand their portfolios in Western Canada. There may be some positive influence towards the end of the year as certain Lenders finalize structural changes to their business about how underwriting of loan requests will be handled, which may extend the approval process.

The political landscape has influenced real estate markets throughout the year. The results of the Alberta election are beginning to initiate some positive influence in real estate activity, albeit modest in nature. When coupled with economic predictions and actual results, it is very difficult to gauge how the results of the Federal election in October may influence the availability of debt and how risk may be factored into debt underwriting.

Relative to Prime Rate influence on commercial real estate conventional loans, we undertook a review of how the 5 Year GOC Bonds reacted the week before and the week after the setting of the Prime Rate from July 2007 to October 2018. Through that timeframe, the rate was set 6 times in 2008, 3 in 2009, 3 in 2010, 2 in 2015,2 in 2017 and 3 times in 2018; Oct 2018 being the last time the Prime Rate moved. In 2015, the decline in the Prime Rate did result in the GOC reflecting a decline. There are two rate sets remaining for 2019 being October 30th and December 4th. As with most predictions one has a 50% chance of being right and the likelihood of movement is more certain in 2020.

So, what does this have to do with commercial realty debt? There does not seem to be any discernable relationship between Prime Rate and the movement of the GOC that can be relied upon. While indications might be that interest rates will decline, often this thought is directed to Prime Rate movement. While the GOC Bond and Deposit Rates are the baseline components of the offered mortgage rates, one should be concerned about the spreads being offered moving upward if there is a perceived risk baked into the quote.

Movement in the stock market can be the litmus test for commercial mortgage rate movement. Since our mid-year newsletter, the TSX held solid in the 16,500 range. Dips occurred through July and early August to the 16,000 range and moved up continually to early September topping out at 16,900 in mid-September. Though not consistent, downward movement in the TSX is starting to reflect a similar movement in the GOC.

Market Update

- The 5 year GOC continued the downward trend from June 2019 to today. The quoted rates in the 1.45bps to 1.50bps range in March 2019 were the lowest point since mid-2017. July showed some minor upward movement, though by August the 5 year GOC was trading between 1.15bps to 1.30bps. September reflected a range that at the high point, was in the 1.45bps to 1.50bps range again. October is continuing the volatile trend. Being prepared to execute on debt through the balance of the year will provide benefits to investors yield requirements. October has shown a dramatic increase as at the 15th to 1.51bps for the 5 year from 1.37bps on October 10th.
- The variance between the 5 year and the 10 year GOC has ranged between 5bps to 10bps through July. Through September the variance was nil at times and as much as 7bps for others. Presently the variance is moving upward, and October will be an interesting month to monitor.
- Spreads have been holding steady through the past 3 months. In some cases, Lenders have had to hold off on accepting applications early in the summer as loans that were anticipated to be paid out required extensions. This situation was rectified by September where we have been able to obtain offers from those same Lenders. The situation is very lender specific.
- The volatility in bond rates has again resulted in the setting of floor rates for many loan offers. While the Cost of Funds is a benchmark for many Lenders, the spike in GOC during the mid-part of October has also resulted in these rates being adjusted upwards. Overall the need to conduct a thorough debt search can produce time sensitive benefits.

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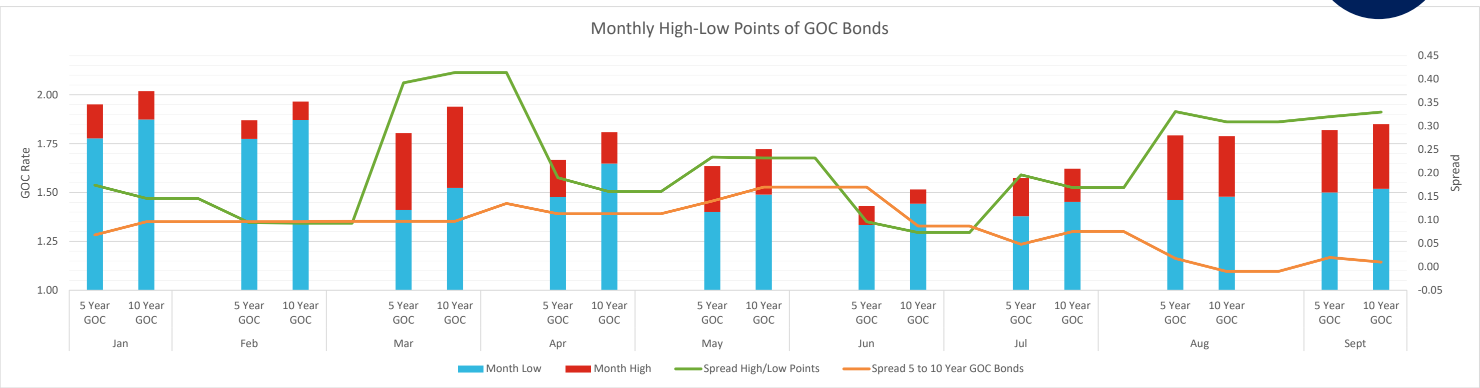
Bond Rate Variance



Looking Ahead

- The supply of debt capital remains strong. Throughout 2018 the 5 year GOC traded in the 200bps to 230bps range. It was not until the beginning of 2019 that the 5 year GOC began to fall below the 200bps level and continued to drop through the year. As we finish 2019 it should be recognized that we are again at a low point of the trading range not seen since the 2016-17 period.
- Global economic conditions continue to decelerate amid trade war disputes. There seems a consensus that the US will begin to lower their Prime Rate, and though we have not followed this lead over the recent past, the future may reflect a much different landscape. Real estate markets are quite fragmented when one considers the realty developments and transactions occurring in Alberta during what has been a lengthy re-adjustment.
- Even after the conclusion of our Federal election later this month, there will be a lag period before one can begin to rationalize how policy will impact investment risk in the Western Canadian real estate market.

Case Study

We have two interesting assignments that have been completed recently. The first was a $12,000,000 CMHC insured loan on a concrete Hi-Rise located outside of a major Canadian city. Several of the units were furnished to accommodate specific long term tenancies we were able to work with CMHC as an approved correspondent to ensure that any adjustments to the underwriting did not negatively impact the clients lending needs. Being able to set the rate at the most beneficial time resulted in an interest rate at approximately 2%.

The second dealt with securing debt on two retail centres, one located in a major city in Alberta and one in a secondary oil based community. The overall debt was allocated between the assets to allow for flexibility in case a sale of either asset became a consideration. The loan amount was for $6,000,000.

Contact Information

Ron Dezman, AACI
Senior Vice President
780.408.6771
ron.dezman@avisonyoung.com

Don Taylor
Senior Vice President
604.607.1333
don.taylor@avisonyoung.com

Jordan Dezman
Associate
780.408.6773
jordan.dezman@avisonyoung.com

Sam Dezman
Associate
780.408.6770
sam.dezman@avisonyoung.com

Garrett Plester
Associate
403.232.4301
garrett.plester@avisonyoung.com

Brennan Yadlowski
Associate
587.882.9753
brennan.yadlowski@avisonyoung.com