AVISON YOUNG

Debt Market Monitor

National Debt Capital Markets Services

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Kicking the Kool-Aid Habit

The general consensus is that the Federal Reserve will soon reduce the dose of medicine it has been dispensing to nurse the economy back to health, emanating from a perception that the economy is getting back on its feet and in a position to look towards going it alone, i.e., allowing market forces to dictate risk reward formulas.

In the past, increases in bond/treasury yields have resulted in credit spread contractions. One thing is certain; we are clearly in unfamiliar territory when it comes to trying to predict the economic future by trying to interpret historical economic events. The sheer volume of economic stimulus poured into recovering markets is simply unprecedented; therefore, the reaction to removal of this stimulus will also be unprecedented and as such, highly unpredictable. Using debt to cure a debt crisis is a double-down scenario; hence, the volatility we are experiencing, not only in fixed income markets but in equity markets as well. Many pundits believe that there is no alternative to a painful economic reset. Market sentiment and forces are a powerful influence.

There is potential for the Fed to be incapable of controlling the free market when it comes to interest rates. The fact is, even the three largest central banks in the world don't seem to have the ability to lead markets away from the current shift, regardless of their repeated attempts to guide the outcome.

What does this mean for commercial real estate borrowers?

It is apparent that we will continue to see higher bond and treasury yields. Even if history repeats itself and spreads are compressed, the end result will be higher borrowing rates. In a market that is reacting highly negatively, it could mean a real crimp on longer-term debt of 10 years and greater. There could be reluctance by lenders and investors to take positions, knowing that the environment is one of cycling-up interest rates. Spreads typically start to widen at this time of year, largely due to approaching fiscal period ends and further compounded by some larger lenders having exhausted their mortgage investment allocations.

It may be safe to say that we will not see the return of the lowest 10-year GOC/UST yields seen in mid-2012. There is only one place to go from a ZIRP.

Fiscal Snapshot

Bank of Canada Rate

August 2013	1.25
One month ago	1.25
One year ago	1.25

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5 Year	10 Year
August 2013	1.70-2.25	1.80-2.60
One Year Ago	1.70-2.25	1.80-2.50

Insured	5 Year	10 Year
August 2013	0.70-1.10	0.80-1.20
One Year Ago	0.90-1.25	1.00-1.40

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

Bank Prime Lending Rate

August 2013	3.00
One month ago	3.00
One year ago	3.00

Government of Canada Benchmark Bond Yields

	5 Year	10 Year	Long
August 2013	1.88	2.60	3.06
One month ago	1.74	2.45	2.97
One year ago	1.36	1.77	2.34

CANADA'S BEST MANAGED COMPANIES

Highlighted Transaction

Asset Type	Business Campus Portfolio
Location	Major Canadian city
Financing Details	A 5-year term facility in the amount of $17.7M, amortized over 25 years at a competitive interest rate.

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We Originate Financing

We originate fixed and floating rate mortgages for all types of property owners, for all types of properties including term, construction, bridge, interim, mezzanine, construction and CMHC insured financings.

Please feel free to contact our National Debt Capital Markets team for more details related to debt financings or real estate transactions.

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