June 2021

Debt market monitor

Can there be too much liquidity?

Liquidity has been described as oxygen for a financial system. Back in the fall of 2019, when the markets went a little fuddled, the Federal Reserve (The Fed) activated a Treasury and mortgage-backed securities (MBS) buying program and handed out repurchase agreements – essentially, they floated the Repurchase Agreement (or "repo") market, providing much-needed liquidity for short-term overnight borrowing purposes. This happened again in March 2020; however, by July 2020, the last repo matured and was unwound, returning the market to approximate normalcy.

Now, thanks to the massive liquidity that the Fed has poured into the system in response to COVID-19 via various quantitative easing (QE) programs, the banking system is very much feeling the strain of the significant amount of reserves amassed. The Fed owns more than US$7 trillion of Treasury securities and MBS. Can there be such a thing as too much liquidity? The Fed has started doing what are being called "reverse repos" which involve the Fed selling Treasury securities to counter parties and taking their cash, thereby draining liquidity from the market – the opposite of QE. In one fell swoop on May 20th, 2020, the Fed sold US$351 billion in Treasury securities through overnight reverse repos to 48 counter parties.

Reverse repos are an indicator that the banking system is struggling to deal with the liquidity that the Fed has been injecting. The result is that there is some clamouring on Wall Street for the Fed to taper its QE purchases as the banking system is now awash in liquidity held as reserves on balance sheets.

With one hand, as part of QE, the Fed is buying US $120 billion a month in Treasury securities and MBS and with the other, it is taking back US $351 billion through reverse repos, undoing nearly three months of QE. Some analysts describe this kind of activity as extreme and believe it has the potential to create some unintended and possibly not-so-nice side effects.

It was Paul Volcker, the retired Chair of the Fed, who once said, "when I hear complaints about less liquidity, remember there is such a thing as too much liquidity."

Fiscal snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending Rate
May 2021	0.50	2.45
April 2021	0.50	2.45
May 2020	0.50	3.95

Government of Canada benchmark bond yields

	5-Year	10-Year	Long
May 2021	0.90	1.49	2.03
April 2021	0.93	1.54	2.08
May 2020	0.39	0.53	1.11

Indicative commercial mortgage spreads* Over Government of Canada bond yields

Conventional	5-Year	10-Year
May 2021	1.45 - 2.00	1.65 - 2.00
May 2020	1.65 - 2.20	1.75 - 2.25

Insured	5-Year	10-Year
May 2021	0.95 - 1.20	0.95 - 1.20
May 2020	0.95 - 1.20	0.95 - 1.20

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

Source(s): Bank of Canada

Debt Capital Markets Services

Highlighted transaction

Asset type	300,000 square foot enclosed shopping mall
Location	Major Canadian city
Facility details	A term facility providing secondary leverage in the amount of $6,000,000, subject to a $30,000,000 senior charge, payable interest only at a competitive rate of interest.

Intelligent debt financing solutions

The Avison Young Debt Capital Markets Group 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.

Our years of combined debt/equity capital markets experience has created meaningful relationships that we can put to work for you.

Avison Young creates real economic, social and environmental value as a global real estate advisor, powered by people. As a private company, our clients collaborate with an empowered partner who is invested in their success. Our integrated talent realizes the full potential of real estate by using global intelligence platforms that provide clients with insights and advantage. Together, we can create healthy, productive workplaces for employees, cities that are centers for prosperity for their citizens, and built spaces and places that create a net benefit to the economy, the environment and the community.

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

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