AVISON YOUNG

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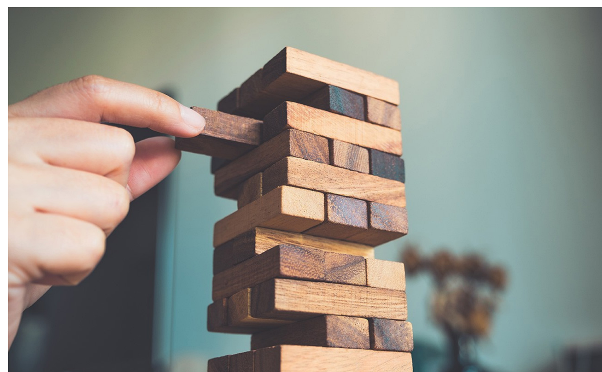
Debt Market Monitor

Debt Capital Markets Services

Corporate debt – out of sight, out of mind



The leveraged loan market amounts to approximately $3 trillion (all figures U.S.). Leveraged loans are a broad category with a higher default risk than other debt and are more aptly referred to as "junk bonds" as they are speculative and non-investment grade. Much of this debt has been taken on subsequent to the 2008 global financial crisis (GFC), doubling in quantum since that time. U.S. and European regulators have been vocal about the risks associated with this type of debt and the potential impact a significant default would have.

Banks are the biggest direct holders of leveraged loans, according to the U.S. Financial Stability Board (FSB), which does its best to track who holds these loans and what the market's vulnerabilities may be.

About 25% of leveraged loans are held by engineered collateralized loan obligations (CLO). These are similar to the vehicles that held subprime mortgages prior to the GFC, except they hold corporate debt rather than home mortgages. Unlike the direct leveraged loan market, there is a significant portion of the CLO market held by unknown investors – which is problematic as the potential impact on these investors of a major default is unknown. Banks' exposure to leveraged loans and CLOs, although sizable, is not seen as a risk as the banks' risk-management procedures and capitalization have improved substantially since the GFC. The bigger concern, as stated by the FSB, relates to other non-bank financial intermediaries who are unknown – are they hedge funds, sovereign wealth funds, pension accounts or private investors?

The catalyst for the current scenario has been low yields. Ten-year treasury bonds are yielding very close to 1% and equivalent German yields are negative. Globally, about $15 trillion worth of bonds have negative yields. More and more investors have resorted to reaching for higher yield despite the accompanying risk. Investors are getting weaker loan covenants while taking on the higher risk – which goes against the typical logic of risk/reward lending.

There does not have to be a major event to disrupt the leveraged loan market. The International Monetary Fund estimates that an economic slowdown half as severe as the GFC would risk some $19 trillion of debt – about 40% of the world's corporate debt in major economies – meaning companies' earnings are not sufficient to provide debt service coverage.

The potential for a worldwide economic slowdown due to COVID-19 virus concerns may magnify the corporate debt issue. For example, The Monetary Authority of Singapore adopted measures in late February to help corporations facing short-term cash flow constraints while adhering to prudent risk assessments. No doubt other countries will follow; however, there comes a time when the load becomes too heavy to carry and defaults will have to be realized.

Fiscal Snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending Rate
February 2020	2.00	3.95
January 2020	2.00	3.95
February 2019	2.00	3.95

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
February 2020	1.07	1.12	1.30
January 2020	1.29	1.27	1.42
February 2019	1.82	1.94	2.19

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
February 2020	1.55 - 2.00	1.65 - 2.10
February 2019	1.70 - 2.10	1.80 - 2.35

Insured	5-Year	10-Year
February 2020	0.90 - 1.10	0.85 - 1.10
February 2019	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	Suburban office complex
Location	Major Canadian city
Facility Details	A $49.4M senior loan was arranged for refinancing purposes. The structure included a term of 5 years, amortized for 25 years at a competitive rate of interest.

Intelligent Debt Financing Solutions

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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.

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