Capital Debt Markets Update

Spring 2021

GOC 5-Year Bond

0.99

▲ 0.59

01/01/2021 – 01/04/2021

GOC 10-Year Bond

1.522

▲ 0.85

01/01/2021 – 01/04/2021

TSX

18,730

▲ 1,162

01/01/2021 – 01/04/2021

Prime Rate

2.45%

No Change

Certain Uncertainty

Advising during a generational changing event is obviously more challenging than during normal periods where trends evolve more slowly. The dramatic movement in the GOC which began in March of 2021 caught most financing professionals and borrowers off balance. We had commented in our Winter 2021 Newsletter that the Bank of Canada had begun a policy of quantitative easing in an attempt to keep interest rates low. While this may have had the desired effect on prime rates, that certainly did not occur with GOC bonds.

Through the later part of 2020 and into the first couple of months of 2021, the Canadian Government was purchasing in the order of $5B in bonds per week. Through this same time period and into early February 2021, the 5 year Bond was trading closely around the 40bps level. The impact of quantitative easing then began to be reflected by upward pressure on bond rates. By the end of February and into the first couple of weeks of March, the 5 year moved up into the 100bps range and has retained that level through to the end of the month. Current policy which would come into effect in April 2021 would see purchases falling to $4B per week and a possible further reduction in Fall 2021 to $3B per week.

Can the reduced tapering purchase of GOC allow for some downward pressure in bond rates? How does the specter of increased inflation as the economy comes out of this pandemic later in 2021 and into 2022 impact the potential for increased borrowing costs? As the TSX begins to flirt with levels close to 20,000, will investment in real estate look to be a safer harbor? Are current GOC prices reflective of what is required to purchase a financial instrument in uncertain economic times?

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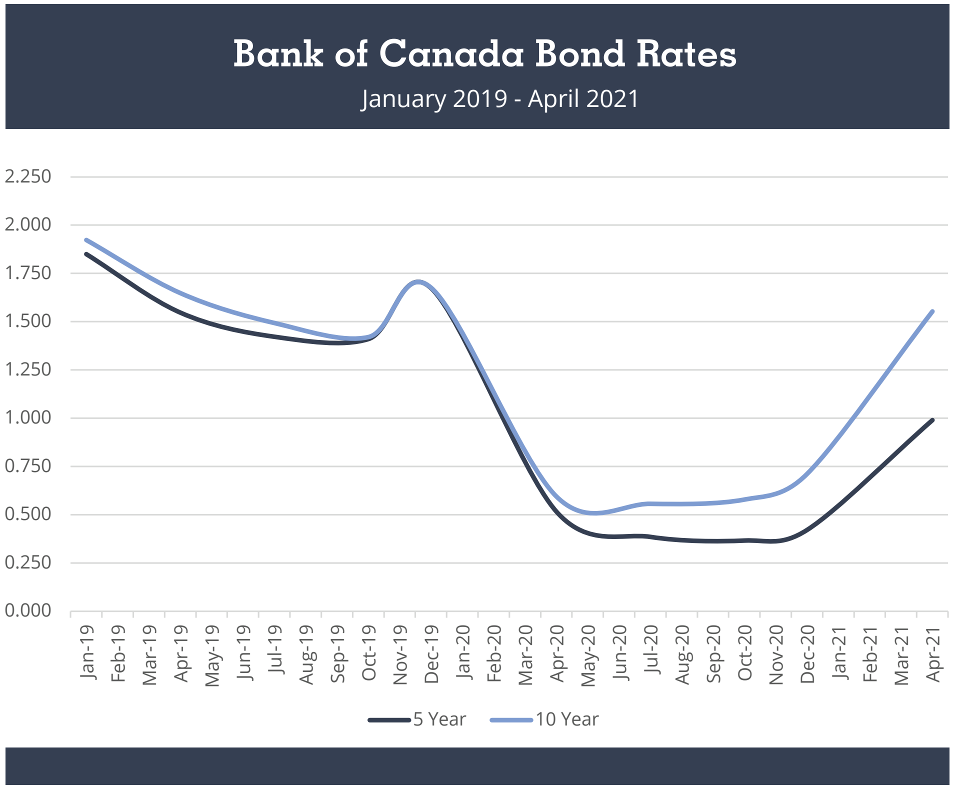
Looking back at the beginning of 2020 the 5 year GOC was trading at approximately 157bps and the 10 year GOC was close to the same level. As the impact of the pandemic took hold the 5 year dropped to 50bps by March 2020, with the gap for 10 years being about 9bps. This variance increased through the Spring to 18bps in April, 22bps in June, 30bps by December with the current status being close to a 60bps differential.

The takeaway is that currently the GOC is still trading far below the start of 2020. The spike in bond rates occurred through March 2021 with the end of the month showing a settling in around the mid 90bps to 100bps range. The gap for the 10 year GOC remains at a premium of between 55 and 60 bps. Given the questions being posed regarding the economy coming out of Covid, this remains a strong period to secure low interest debt.



Lender Update

As we have now entered the 3rd lockdown, there is a caution being evidenced with the underwriting process. Lease expiries and sensitivity to the lease rates in place have begun to impact the level of debt that lenders are comfortable with. Interest rates are being "stressed out" in the calculations for Debt Coverage Ratios as there really is no consensus as to what the economy will look like given the continuing impact of the pandemic. While an initial quarantine period could be considered a factor that can be overcome, falling back into additional periods of lockdown has created concern as to the continued volatility of certain sectors of the economy. Spreads have remained consistent with the ranges noted in our Winter 2020 report. Good quality assets can expect spreads in the 170bps to 200bps range. Trophy assets can command spreads towards the 150bps and lower. While there is not a large supply of 10 year money, spreads can be found between 200bps and 250bps. For investment properties with lease up or re-positioning requirements spreads can move into the high 200's to low 300's. CMHC financing remains a positive opportunity even in this uncertain environment. Although the CMB has closely tracked the increases in the GOC over the past month, spreads have recently compressed, and Lenders are aggressively bidding for CMHC business. Multi-family proved to be a relative safe haven through Covid and is still considered to be a very low risk lending opportunity. There is ample liquidity and appetite in the CMHC market.

The application process to obtain insurance remains somewhat lengthy but there are cost effective strategies we can utilize to bridge that timeline.

In the first quarter of 2021 there have been substantial trades of both owner user and investment properties. This has begun to reflect some upward pressure on capitalization rates, though the magnitude is specific to the asset type. Lenders are showing a tendency to look more closely at the price per square foot of the asset as a support to the underwriting value rather than purely based on financial indicators. Lease terms and short term renewals are creating this situation.

The supply of money for mortgages remains high, related somewhat to the selective underwriting process impacting the desire to conclude a debt transaction.

Case Study

Case Study 1

The AY team has concluded the bridge acquisition financing for an apartment in central Vancouver. This was a structured debt facility that provided funds for the purchase as well as capital to undertake renovations, inclusive of an interest reserve. The term was 2 years and the rate was in the mid-5% range.

Case Study 2

We were engaged by a client to provide consulting services to conclude whether the offers provided by his typical debt sources maximized the available capital stack for the acquisition. This was an 81,000 SF retail centre in B.C. with strong tenancies and a solid Borrower. The results were required in a very short timeline.

The debt was for $29,000,000. Upon producing alternate options the client was able to reduce the interest rate by approximately 50bps thereby saving substantial costs over the term of the mortgage.

"On every assignment, we strive to find the most competitive financing option available in the market that matches the requirement of the Borrower"

- Get in touch with our team

Get more market information

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