

## Economic volatility impacts loan spreads



We are a month into 2019 and volatility shows no signs of slowing. How will the equity markets and economic instability affect loan spreads? Typically, loan spreads widen in times of economic distress and narrow while the economy is improving.

The first major increase in loan spreads since the global financial crisis of 2008 came during the recession of 2009 as capital flowed rapidly away from commercial real estate to safer assets, leaving some lenders unable or unwilling even to quote spreads as they were widening so quickly that capital providers could not keep pace. The next significant increase in spreads was in 2011 when Standard & Poor's downgraded the United States' credit rating. In 2016, when oil prices fell materially, high-yield bonds issued by energy companies cratered, pulling most fixed-income yields higher in sympathy.

The spread increase in 2009 had a bigger impact than the widening that took place in 2011 or 2016 because the base U.S. treasury rate was much higher. An increase in spread of 150 to 200 basis points is substantial; however, when the 10-year treasury yield is offering less than 2% and the growing spread results in loan rates increasing from 3.5% to 5%, the effect is not as shocking as when the 10-year treasury yield was closer to 5% itself.

What do rising interest rates mean for loan rates? Simply that loan rates will increase, as will debt-service burdens. The more complex answer is that loan spreads widen out further – approximately 65% higher, on average – when the 10-year U.S. treasury yield is above 4%. That is to say that higher interest rates have dictated higher spreads in the past. Once the line of an acceptable debt-service coverage is crossed, the amount of equity required to restore the necessary cash-flow cushion beyond that needed just to service the debt will increase. As spreads widen, we are starting to see some situations where debt-service coverage issues create constraints on the amount of leverage that can be obtained.

## Fiscal Snapshot

### Bank of Canada

	Bank Rate	Bank Prime Lending Rate
January 2019	2.00	3.95
December 2018	2.00	3.95
January 2018	1.50	3.45

### Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
January 2019	1.78	1.88	2.14
December 2018	2.20	2.27	2.39
January 2018	1.86	2.04	2.26

### Indicative Commercial Mortgage Spreads\* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
January 2019	1.65 - 2.00	1.70 - 2.00
January 2018	1.50 - 2.00	1.65 - 2.00
Insured	5-Year	10-Year
January 2019	0.80 - 1.10	0.80 - 1.10
January 2018	0.85 - 1.10	0.85 - 1.10

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

# Highlighted Transaction

Asset Type	Single tenanted industrial property
Location	Major Canadian city
Facility Details	A senior charge in the amount of \$19.5M for a 5 year term, amortized over 25 years at a competitive rate of interest.

## Intelligent Debt Financing Solutions

The Avison Young Debt Capital Markets 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 - CMHC and Fannie Mae / Freddie Mac.

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.



**Norm Arychuk**, Mortgage Broker\*  
416.673.4006  
norman.arychuk@avisonyoung.com

**Michael Ho**, Mortgage Broker\*\*  
416.673.4012  
michael.ho@avisonyoung.com

\*Licence #: M09002260  
Brokerage Licence #10637

\*\*Licence: # M15000834  
Brokerage Licence #10637

Avison Young is the world's fastest-growing commercial real estate services firm. Headquartered in Toronto, Canada, Avison Young is a collaborative, global firm owned and operated by its principals. Founded in 1978, the company comprises 2,700 real estate professionals in 87 offices, providing value added, client-centric investment sales, leasing, advisory, management, financing and mortgage placement services to owners and occupiers of office, retail, industrial, multi-family and hospitality properties.

### AVISON YOUNG GLOBAL CAPITAL MARKETS OFFICES

Calgary | Edmonton | Mississauga | Montreal | Toronto | Vancouver | Boston | New York | Washington DC | Chicago | Denver | Raleigh-Durham | Memphis | Nashville | Atlanta | South Florida | Houston | Phoenix | San Francisco | Los Angeles | Orange County | Mexico City | Coventry | London | Hamburg | Frankfurt | Munich | Dusseldorf | Seoul



avisonyoung.ca

Avison Young Commercial Real Estate (Ontario) Inc., Brokerage  
18 York Street, Suite 400  
Mailbox # 4  
Toronto, Ontario, Canada M5J 2T8  
416.955.0000