AVISON YOUNG

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Debt Market Monitor

Debt Capital Markets Services

Negative-yielding bonds demonstrate investors' willingness to pay above par

Prior to the recent bounce back of bond yields, there was much discussion about the possibility of negative yields for U.S. Treasuries. Markets are hyper-reactive to news, and it is quite probable that if bad economic news were to appear to rattle the markets, bond prices would once again increase significantly. Bonds provide the basis for pricing in virtually every asset class; hence, the scrutiny occurs.

The recent bond rally was a typical case of investors fleeing risky assets to safe ones, notwithstanding the inherent small returns. The British 10-year bond was yielding its lowest level recently, only returning 0.5%. The German 30-year bond went negative. The Swiss 30-year yield has been negative since mid-2016 and recently yielded -0.322%. Switzerland led the negativity recently with its 10-year yield at -0.92%. Even Austria's 100-year bond has seen its yield fall below 1% recently. All told, with the spike in bond prices, there is approximately $17 trillion of global debt trading with negative yields.

Negative yields have been confined to places outside the U.S., though some Federal Reserve officials have hypothesized on tinkering. Former Federal Reserve Chairman Alan Greenspan recently said that there is nothing in the way of negative U.S. rates. Negative-yield bonds are symbolic of how much above par investors are willing to pay.

There has been plenty of fuel to stoke bond rallies. Slowing global economic growth due to the U.S.-China trade dispute is resulting in many central banks easing their monetary policies. An array of geopolitical risks generated by Brexit uncertainty, Italian political and financial instability, U.S. sanctions on Iran and violent protests in Hong Kong is driving investors into the safe haven of U.S. debt – to such an extent that bond markets are oversold and yields have fallen to extreme lows.

Why would anyone buy a negative-yielding bond? Well, if you are a pension fund or an insurance company or a bank, you have to fulfill regulations that require you to hold a certain percentage of your assets in your country's government bonds, no matter what the yield or impact. Maybe you believe that you will be able to sell the bonds at a profit when yields drop even lower. Negative-yielding bonds are used in highly complex, risky investments in which high leverage is utilized.

When bond markets rally significantly and then there is a correction like the one that we have seen recently, the term used by bond traders is snapback. Snapbacks in bond yields can be traced historically – and they do not disappear overnight. Past snapback patterns have been averaging five to six months before cooling.

Fiscal Snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending Rate
September 2019	2.00	3.95
August 2019	2.00	3.95
September 2018	1.75	3.70

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
September 2019	1.40	1.37	1.53
August 2019	1.18	1.16	1.42
September 2018	2.33	2.42	2.41

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
September 2019	1.55 - 2.00	1.65 - 2.10
September 2018	1.75 - 2.10	1.85 - 2.35
Insured	**5-Year**	**10-Year**
September 2019	0.90 - 1.10	0.85 - 1.10
September 2018	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	Flex Office Portfolio
Location	Major Canadian city
Facility Details	$45M term facility was arranged to repatriate capital for a 5 year term, 25 year amortization, structured on a non-recourse basis.

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

*Licence #: M09002260
Brokerage Licence #10637

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

**Licence: # M15000834
Brokerage Licence #10637

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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

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