JULY 2018

Debt Market Monitor

Debt Capital Markets Services

What makes up bond yields?

Looking back over the history of U.S. bond yields, it becomes evident that there are several trends. From 1902 to 1920, yields rose to 5.67% from 2.82%, with most of the increases occurring during the last four years of that period due to risks of war and inflation. The 1921 to 1945 period experienced a decline in yields to 1.55% from 5.67%, resulting from deflation, depression and the manipulation of bond yields during World War II. Between 1945 to 1981, yields rose dramatically from 1.55% to 15.84% – the highest level for government bond yields in almost 500 years – as inflation was out of control. Between 1981 and 2011, yields fell just as dramatically, plummeting to 1.46% from 15.85%. The trend over the past seven centuries has been for bond yields to decline. Since the mid-1600s, the average yield on government bonds has been around 4%.

Bond yields are determined by a number of factors, including growth in real GDP, the inflation rate, supply and demand, and risk. Over the past seven centuries, the trend has been for bond yields to decline – not due to lower growth or inflation but, rather, lower risk of default.

The country at the centre of economic power can issue more bonds at a lower cost because of the lower risk to the world's economic centre. Over time, power tends to slip away from that country, and investors begin to place their money in the new world economic power's bonds. Over the past eight centuries, the crown of economic power had progressively shifted from Italy to Spain to the Netherlands to Great Britain and the current kingpin, the United States.

With U.S. debt mushrooming and foreigners reducing their holdings in that country, some people are starting to wonder whether the U.S. will be able to maintain its position as the world's central economic power. In 2008, foreigners owned 57% of outstanding treasury debt. In 2017, that number shrank to 45%, and it is now down to 43%, according to the U.S. Treasury Department. Perception of safety and actual safety are the focus of investors who do not want to take on risk – not only risk of repayment failure but risk of high and unpredictable volatility. Generally, a U.S. government debt increase, necessitating a higher issuance of bonds, translates into higher interest rates designed to attract buyers. It is a balancing task to employ higher bond rates to attract those buyers are those who have less belief in other economic centres and have resorted to fleeing to the safety of more stable bond markets – such as the U.S. currently.

Fiscal Snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending
June 2018	1.50	3.45
One month ago	1.50	3.45
One year ago	0.75	2.70

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
June 2018	2.06	2.17	2.20
One month ago	2.11	2.30	2.40
One year ago	0.94	1.41	2.05

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
June 2018	1.50 - 2.00	1.65 - 2.00
One year ago	1.70 - 2.10	1.85 - 2.35
Insured	**5-Year**	**10-Year**
June 2018	0.80 - 1.10	0.80 - 1.10
One year ago	0.90 - 1.10	0.90 - 1.20

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

Highlighted Transaction

Asset Type	Office Park
Location	Secondary Canadian city
Facility Details	A $60,000,000 senior facility was secured at a floating rate of interest to allow for lease up and ultimate sale of the project.

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.

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