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Debt Market Monitor

Debt Capital Markets Services

Rising interest rates: Good or bad?

If you are a saver, higher interest rates translate into higher returns. Of course, if you are a borrower, a higher interest rate means that it will cost you more to service the debt due to increased borrowing costs. Your reaction to an increase may depend on which side of the saver/borrower table you sit. Changes in interest rates can have both positive and negative effects on markets. When the Federal Reserve Board (the Fed) changes the rate at which banks borrow money, the adjustment has a ripple effect across the entire economy.

When interest rates are rising or falling, you commonly hear about the Fed moving the federal funds rate – the rate that banks use to lend each other money. It can change daily, and because this rate's movement affects all other loan rates, it is used as an indicator to show whether rates are rising or falling. The Fed manages the movement of the federal funds rate by keeping a close eye on many statistical indicators, two important ones of which are the consumer price index and the produce price index. When these indicators show increases in the 2% to 3% range, the Fed will start to raise interest rates to control rising prices. Since higher interest rates mean higher borrowing costs, people will eventually start spending less. In turn, the demand for goods and services will decrease, causing inflation to relax.

This process of interest-rate manipulation was employed in 1981 and 1982 when inflation was 14% and the Fed raised rates to 20%. A recession was the result; however, spiraling inflation was put to an end. Conversely, in 2001 and 2002, the Fed reduced the federal funds rate to 1.25% thus fueling an economic recovery. By raising and lowering the federal funds rate, the Fed can prevent runaway inflation and lessen the severity of recessions.

In theory, raising interest rates to prevent inflation is a straight-forward and simple principle. The problem is that an interest-rate increase is not experienced in isolation. Other areas of the economy are impacted eventually – with many of the effects camouflaged by economic growth in the meantime. Usually, it takes about a year for the effects of any change in interest rates to have meaningful influence. In some ways, the adjustment is like turning a large ship. You can start to chart a new course; however, it will take some time to get the vessel on track – because the change does not produce an immediate reaction.

Fiscal Snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending Rate
October 2018	2.00	3.70
One month ago	1.75	3.70
One year ago	1.25	3.20

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
October 2018	2.42	2.49	2.52
One month ago	2.33	2.42	2.41
One year ago	1.62	1.95	2.30

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
October 2018	1.40 - 1.90	1.60 - 2.20
One year ago	1.50 - 2.00	1.65 - 2.25

Insured	5-Year	10-Year
October 2018	0.80 - 1.10	0.80 - 1.10
One year ago	0.95 - 1.15	0.95 - 1.25

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

DEBT CAPITAL MARKETS SERVICES

Highlighted Transaction

Asset Type	Office/warehouse portfolio
Location	Major Canadian cities
Facility Details	A $50M senior debt facility was arranged to assist with acquisition of the portfolio. The structure of the debt included a 10-year term, 25 year amortization, limited recourse and 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.

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