Real property. Real leadership.

REALPAC / FPL Canadian Real Estate Sentiment Survey

Q2
2017

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Exhibits

REALPAC (Real Property Association of Canada) and FPL Advisory Group are pleased to announce the results from the second quarter 2017 REALPAC / FPL Canadian Real Estate Sentiment Survey. The survey is the industry's most comprehensive measure of senior executives' confidence in the Canadian commercial real estate industry. This quarter, the survey captured the thoughts of a wide variety of industry leaders, including CEOs, presidents, board members, and other executives from a broad set of industry sectors, including owners & asset managers, financial services providers, and operators & related service providers. The quarterly survey measures executives' current and future outlook on three topics: (1) overall real estate conditions, (2) access to capital markets, and (3) real estate asset pricing. Survey respondents represent the retail, office, industrial, hotel, multi-family, residential, and seniors residential asset classes.

Topline Findings

- The Q2 Index rose one point to 56; investors view Canadian real estate fundamentals in a positive light; Calgary office continues to struggle; government regulation is not seen as a major threat to real estate pricing.
- While the Canadian story is positive, a shortage of available assets and abundance of capital has resulted in questionable deal metrics, more development, and institutional money increasingly flowing to foreign markets.
- Are we at the top? The debate continues as bond yields remain low, assets trade at new highs, and real estate remains a coveted investment strategy. Record industrial trades are the talk of the market.
- Across the board quality borrowers have no issue obtaining secured and unsecured debt financing; construction lending is more challenging to secure; Alberta continues to be a question mark.
- Equity capital continues to be plentiful and available coming from multiple sources, both domestic and foreign, albeit showing signs of slowing from Asian sources. The real challenge is where to place capital.

Data Collection

Data was collected during April 2017. In the pages that follow, survey responses are supplemented by excerpts from interviews conducted with senior executives from Canadian property developers and owners, institutional investors, asset managers, and other organizations.

The most comprehensive measurement of senior executives' confidence in the Canadian commercial real estate industry

Please direct all inquiries regarding this study to:

Mark Ross
Managing Director - Canada

Ferguson Partners Canada
The Exchange Tower
130 King Street West,
Suite 1800
Toronto, ON
M5X 1E3 Canada

t 416.865.3385
e mross@fergusonpartners.com
w fpladvisorygroup.com

Carolyn Lane
VP, Membership,
Marketing & Communications

REALPAC
77 King Street West, TD North Tower
Suite 4030, PO Box 147
Toronto, ON
M5K 1H1 Canada

t 416.642.2700 x223
e clane@realpac.ca
w realpac.ca

General Market Conditions

The Q2 Index rose one point to 56; investors view Canadian real estate fundamentals in a positive light; Calgary office continues to struggle; government regulation is not seen as a major threat to real estate pricing.

"The markets continue to be bullish. New home construction is strong accompanied by significant escalation in pricing. Industrial is very competitive with further compression in cap rates for quality properties. There is significant compression in cap rates for rental apartments with extremely low vacancy. There is aggressive pricing in seniors living communities with a significant decrease in cap rates from 2 years ago. Suburban and core office are really struggling in Calgary, but industrial is holding very well as long as you aren't too exposed to oil and gas exploration."

"Looking back over the past 18-24 months in Canada, we were going through a bit of recovery, not a recession but a slowdown. As we hit 2017, the increase in government regulation has not hurt the market but brought greater discipline. I think you're seeing a very stable to growing set of fundamentals in Canada."

"The real estate fundamentals in Canada have been very good. Toronto and Vancouver have been very stable. Calgary and Edmonton have been difficult, but better than most people think as both markets will have positive absorption this year. Overall, we are positive about the fundamentals in Canada."

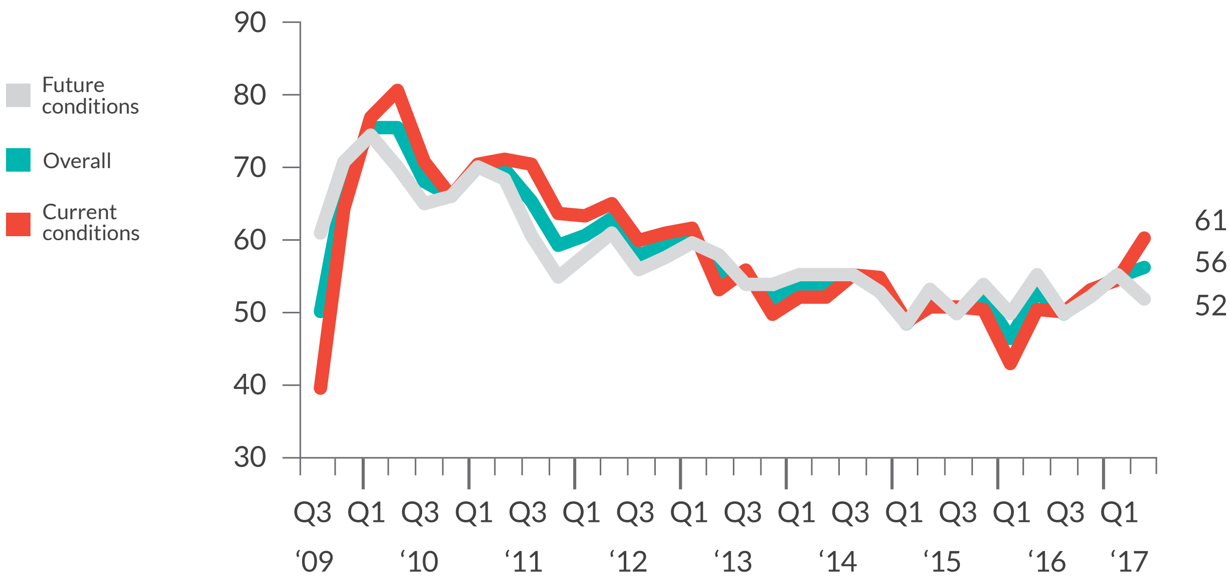
"You are seeing continued demand for Canadian real estate resulting in strong equity markets in the next 12 months."

"Globally speaking, it is difficult to find a good deal. There is a lot of capital chasing few deals. In our core markets we are not buying a lot of core stabilized products. We're active in development. The development cycle still has room to go. The demand is still there. The Canadian real estate market is a microcosm of what we are seeing in other core markets. There is a lot of competition for deal flow."

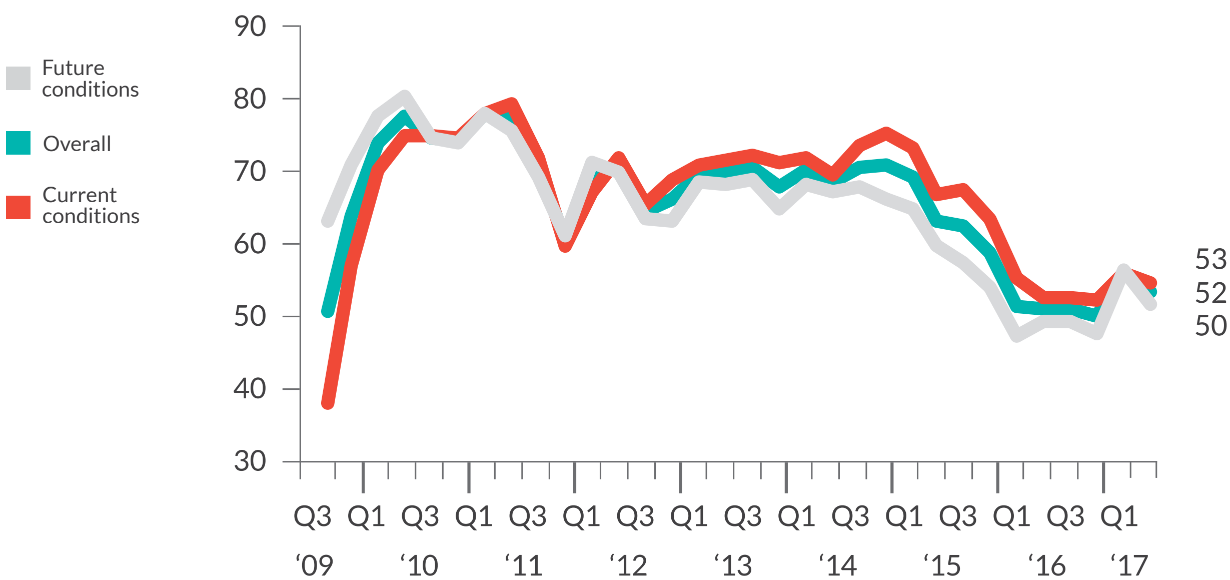
"In the U.S., we're in the 7th or 8th innings of growth. Canada should outperform the U.S. in the next few years. The U.S. Fed fears a slowdown in the next 24 months and needs some breathing room so they are raising rates which could push them into a recession."

Exhibit 1:

REALPAC/FPL Canadian Real Estate Sentiment Index*



Real Estate Roundtable Sentiment Index (U.S.)*



*The REALPAC/FPL Canadian Real Estate Sentiment Index and The Real Estate Roundtable Sentiment Index, organized by FPL Advisory Group, are created using the same survey methodology, questions, and timing.

Key Real Estate Considerations

While the Canadian story is positive, a shortage of available assets and abundance of capital has resulted in questionable deal metrics, more development, and institutional money increasingly flowing to foreign markets.

"The equity markets have been volatile for the past 5 years, I don't expect that trend to change. I don't feel that the recent increase in 10-year bonds should have happened and I feel that Canadian and U.S. treasuries will continue to fall which will alleviate some of the concern regarding rising interest rates in the short-term."

"Acquisition strategies are starting to be driven more by the amount of capital available to real estate managers and owners versus the fundamentals. The need to deploy capital often overrides fundamentals."

"The lack of available assets has really driven development, particularly in cities like Toronto and Vancouver. This is largely driven by the desire to secure high quality assets that aren't available on the income producing sale market so you might as well build your own."

"On the capital markets side, valuations are starting to level off."

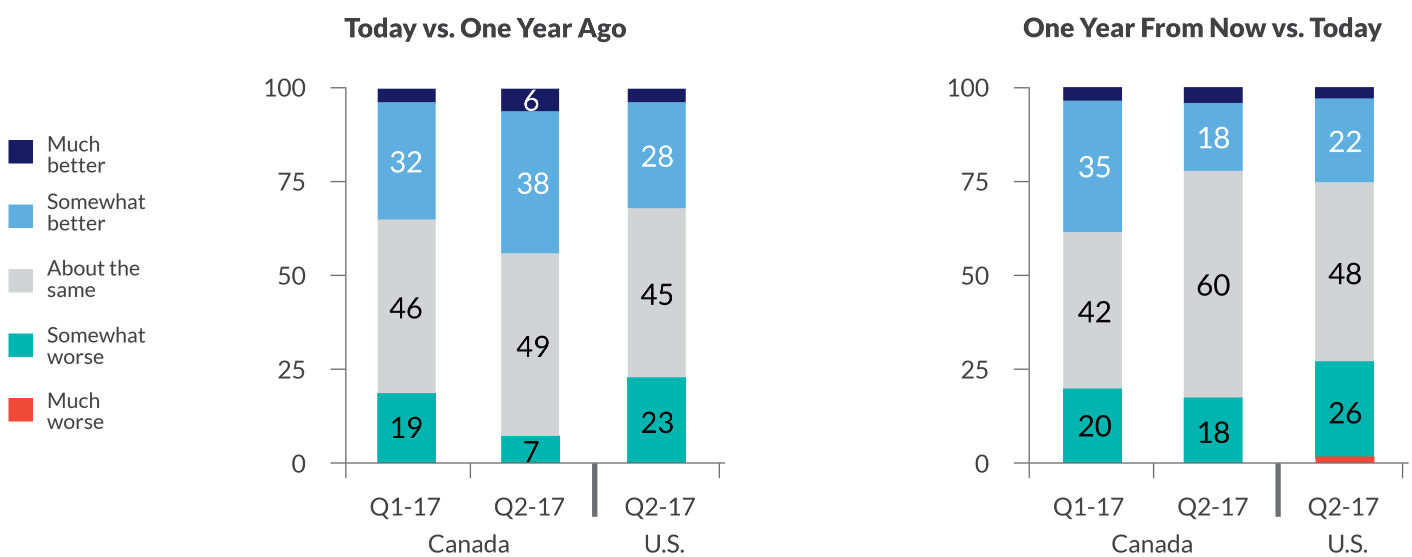
"We're concerned about the general retail environment; notwithstanding that our operating metrics are holding strong."

"Government regulations will have little impact on the Toronto and Vancouver markets."

"I feel that we're in a prolonged 7th inning in Toronto and 8th inning in Vancouver."

"The focus of the big institutions is increasingly concentrating elsewhere. Foreign capital has slowed down partly because of the restrictions in China on outflows and, on a risk adjusted basis, Canada is mispriced relative to the yield that foreign capital can get in other markets."

Exhibit 2: **Perspectives on Real Estate Market Conditions** (% of respondents)



Asset Values

Are we at the top? The debate continues as bond yields remain low, assets trade at new highs, and real estate remains a coveted investment strategy. Record industrial trades are the talk of the market.

"The biggest compression in cap rates was in 2016 and early 2017. It has now leveled out. We recently saw a major industrial trade in Ontario go out at a 4% cap."

"I thought we hit the ceiling two years ago! I never thought I would see sub-4 caps in my lifetime. In Vancouver today, if you sell a well-located commercial property over 3.5%, you got hosed."

"We are at the top. In a zero interest rate environment we have yields that are at historic lows and we're bouncing along the top. As long as interest rates remain low we're stabilized at historic top of market."

"In Vancouver and Toronto, where we're seeing employment and GDP growth, everything is priced to and beyond perfection. Everywhere else there is a pretty big gap. For suburban office, tertiary markets, or mushy middle retail, it's pretty tough to see upside or hold your value."

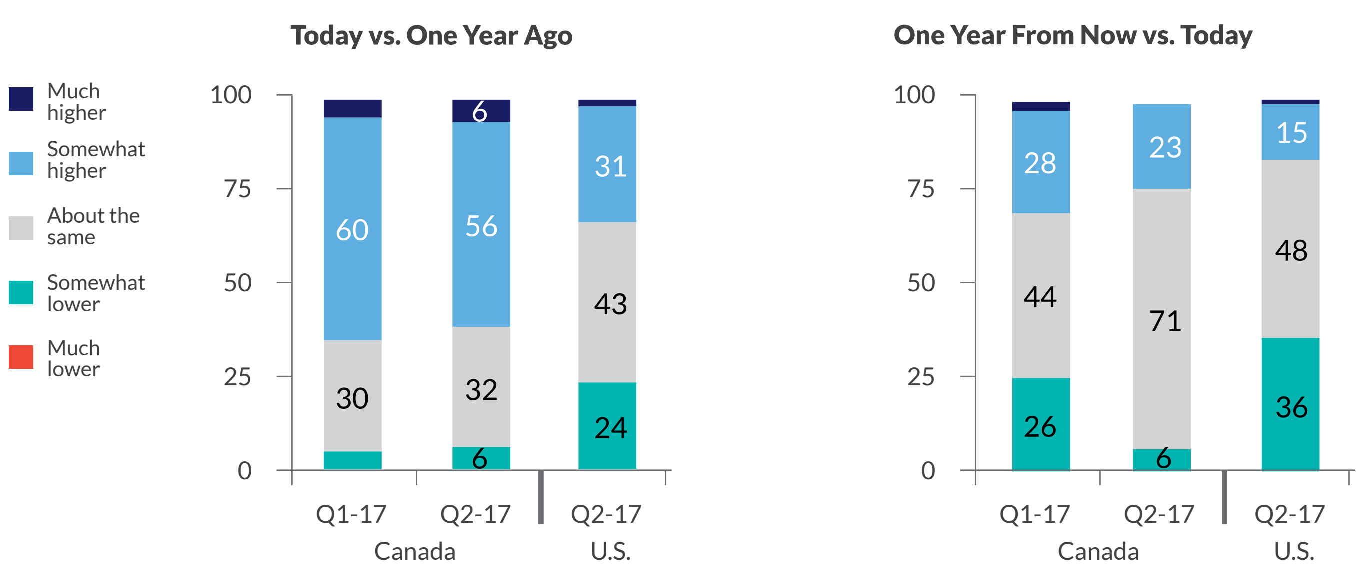
"Industrial right now is trading where multi-family is. I don't think we can get much lower."

"Asset pricing has gotten even more aggressive lately. You have record pricing for industrial in Toronto and you have the same thing happening in office."

"Although everyone expects that interest rates will continue to inch upwards, when you look at the available investment alternatives on a cash return basis, real estate is still pretty attractive."

"We're steady state, there is not that much more cap rate compression that you can squeeze out at this point. I have not seen any evidence of cap rates increasing and there is no tail-off demand in asset pricing. So it is steady but at fairly aggressive prices."

Exhibit 3: **Real Estate Asset Values** *(% of respondents)*



Debt Capital

Across the board quality borrowers have no issue obtaining secured and unsecured debt financing; construction lending is more challenging to secure; Alberta continues to be a question mark.

"We have done extremely well refinancing at lower interest rates. We have had no difficulty at all securing debt and we have secured it very competitively."

"The larger REITs are all issuing unsecured facilities on debentures and that has taken a lot of business out of the banks and life companies on secured lending facilities like mortgages. So those lenders have been very aggressive in trying to retain business. Debt availability is enormous right now for the good companies."

"If you are conservative, and it is a good quality asset, there is no issue at all."

"Calgary really depends on what asset and what the tenancy rate is; who is in your building; what their credit situation is like; and what your term with them is."

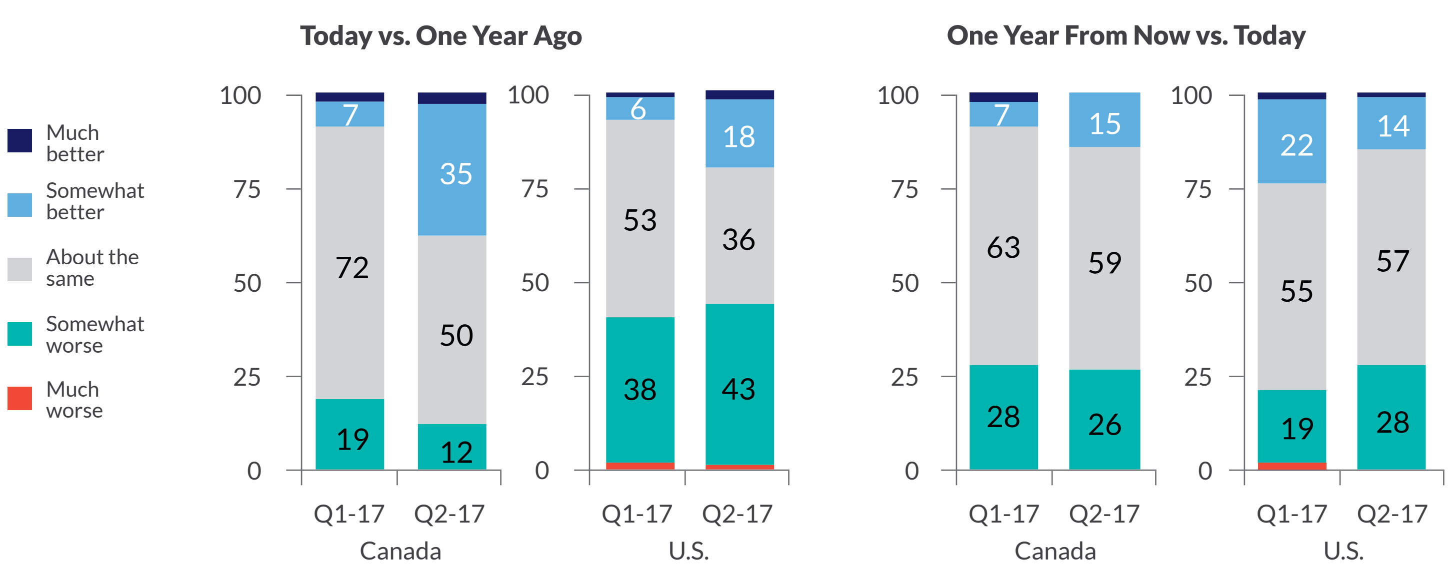
"The secured debt market is wide open; it is very healthy."

"Debt is available on everything except land as lenders are a little bit nervous on land and a little nervous on the condo side depending on the sponsors. In the absence of those two things, it is very abundant."

"The availability of debt is strong with the exception of Alberta, where it is a little weaker. Elsewhere in the country spreads are starting to tighten a bit, loan to values remain consistent, and lenders are at least maintaining or slightly increasing their allocations to real estate."

"There is no problem getting competitive bids from multiple issuers for NHA product."

Exhibit 4: **Availability of Debt Capital** (% of respondents)



Equity Capital

Equity capital continues to be plentiful and available coming from multiple sources, both domestic and foreign, albeit showing signs of slowing from Asian sources. The real challenge is where to place capital.

"The challenge is not raising capital, it is finding product and opportunities in which to place that capital."

"Canada is not a big place; the entire office stock of Canada fits into Manhattan and the surrounding areas; we have a lot of investment money chasing too few assets. Capital is clearly domestic; you are seeing Asian buyers on the west coast; you will continue to see German, Israeli and U.S. funds. Given the state of the Canadian dollar, U.S. buyers should be buying more."

"For institutional quality defensive assets there is no shortage of equity from domestic and global sources of equity. Global capital continues to define the pricing in certain markets like Vancouver and Toronto."

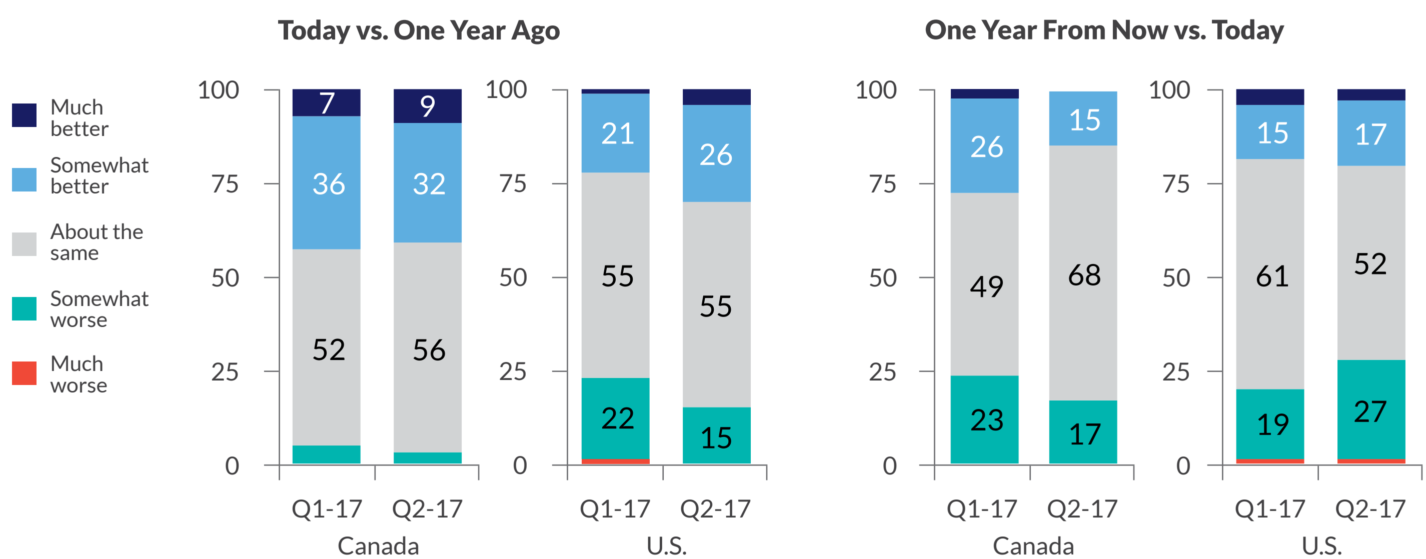
"There is a lot of money chasing the too few good assets in the marketplace."

"There seems to be continuing transformation for pension plans and endowment funds to allocate more capital to real estate which will need to be deployed in the sector."

"There is no shortage of equity; although the equity being dedicated to Canada is becoming a little more challenged."

"There is ample availability of capital. The issue is matching that capital with an appropriate investment strategy or asset. That is challenging because it is difficult to identify new acquisition targets that match your strategy. If you have a ssolid investment thesis there is ample capital to fund that thesis. The challenge is fulfilling that mandate."

Exhibit 5: **Availability of Equity Capital** (% of respondents)



Participants

(Please note that this is only a partial list. Not all survey participants elected to be listed.)

Alberta Investment Management Corporation (AIMCo)
Micheal Dal Bello

Aspen Properties
Scott Hutcheson

Automotive Properties REIT
Milton Lamb

Avison Young
Mark Rose

Bentall Kennedy (Canada) Limited Partnership
Gary Whitelaw

Boardwalk REIT
Roberto Germemia

Canaccord Genuity Corporation
Dan Sheremeto

Canada Pension Plan Investment Board (CPPIB)
Marco Ding

Canadian Mortgage Capital Corporation
Robert Goodall

Canderel
Richard Diamond

CBRE Limited
Peter Senst

Concert Properties Ltd.
David Podmore

Crestpoint Real Estate Investments Ltd.
Kevin Leon

Crown Realty Partners
Les Miller

CT REIT
Ken Silver

Dell Corporation Realty Ltd.
Michael Dell

Dorsay Development Corporation
Geoffrey Grayhurst

Firm Capital Property Trust
Robert McKee

Forgestone Capital Management
Trevor Blakely

Grover, Elliott & Company, Ltd.
Larry Dybvig

Hopewell Residential Management LP
Paul Taylor

Infrastructure Ontario
Toni Rossi

Ivanhoe Cambridge Inc.
Mario D. Morroni

Kircher Research Associates Ltd.
Hermann Kircher

Lincluden Investment Management
Derek Warren

Manitoba Civil Service
Ian Cameron

Margolis Capital Commercial Mortgage
Ron Margolis

Menkes Developments Ltd.
Peter Menkes

Milestone Apartment REIT
Robert Landin

Miya Consulting Inc.
Kevin Miyauchi

Morguard Investments Limited
Gordon Vollmer

Morguard REIT
George Schott

Ontario Pension Board
Brian Whibbs

Otera Capital
Paul Chin

Partners REIT
Jane Domenico

PIRET
Kevan Gorrie

Realstar Group
Wayne Squibb

Realtech Capital Group, Inc.
James McPherson

RioCan REIT
Raghunath (Rags) Davloor

RioCan REIT
Edward Sonshine

Slate Office REIT
Scott Antoniak

SmartREIT
Huw Thomas

Strathallen Capital Corporation
Laetitia Pacaud

The Great-West Life Assurance Company
Ronald Findley

Triovest Realty Advisors
Vince Brown

REALPAC
77 King St West
TD North Tower
Suite 4030 PO Box 147
Toronto, ON
M5K 1H1

t 416.642.2700
tf 1.855.REALPAC (732.5722)
w realpac.ca

Ferguson Partners Canada
The Exchange Tower
130 King Street West
Suite 1800
Toronto, ON
M5X 1E3

t 416.865.3385
w fpladvisorygroup.com