Real property. Real leadership.

REALPAC / FPL Canadian Real Estate Sentiment Survey

Q3
2017

Table of Contents

Exhibits

REALPAC (Real Property Association of Canada) and FPL Advisory Group are pleased to announce the results from the third 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 Q3 Index fell 4 points as Canadian interest rates are on the rise and bifurcation continues to be the major theme across markets, asset classes, and regions; investor skepticism could also be on the rise.
- Record pricing, illiquidity, rising rates, skittish capital markets and the e-commerce affect could lead investors abroad or to other asset classes.
- Rising interest rates will not stop cap rates from hitting new lows in most core markets but will likely impact negatively on secondary and tertiary market trades and pricing.
- Debt is readily available from traditional sources and a growing number of new debt platforms in Canada and around the globe as lenders compete aggressively for business.
- There continues to be an abundance of equity available for attractive Canadian real estate assets but the capital markets have not been as friendly to the REITs in the less attractive sectors and markets.

Data Collection

Data was collected during July 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 Q3 Index fell 4 points as Canadian interest rates are on the rise and bifurcation continues to be the major theme across markets, asset classes, and regions; investor skepticism could also be on the rise.

"The theme is bifurcation between core and non-core real estate. Rewind a couple of years ago when all the public companies were actively buying suburban office and Alberta. That demand has gone away. What is really hot is downtown Toronto and Vancouver office. Fashion orientated retail in secondary markets is pretty much dead."

"Canada continues to be a bifurcated market. Calgary is still in a hole as we are looking at zero net effective rents for office. Toronto, Vancouver and even the Montreal market continue to be stable and see cap rate compression. Multifamily might have peaked about a year ago as we are not seeing a further compression in cap rates this year versus last year. Toronto industrial continues to be very hot."

"The underlying message is that assets in the right locations, particularly those that lend themselves to the right uses, will still be priced at a premium price but assets in more secondary and tertiary markets, particularly in certain industries like retail, are going to be more and more challenged."

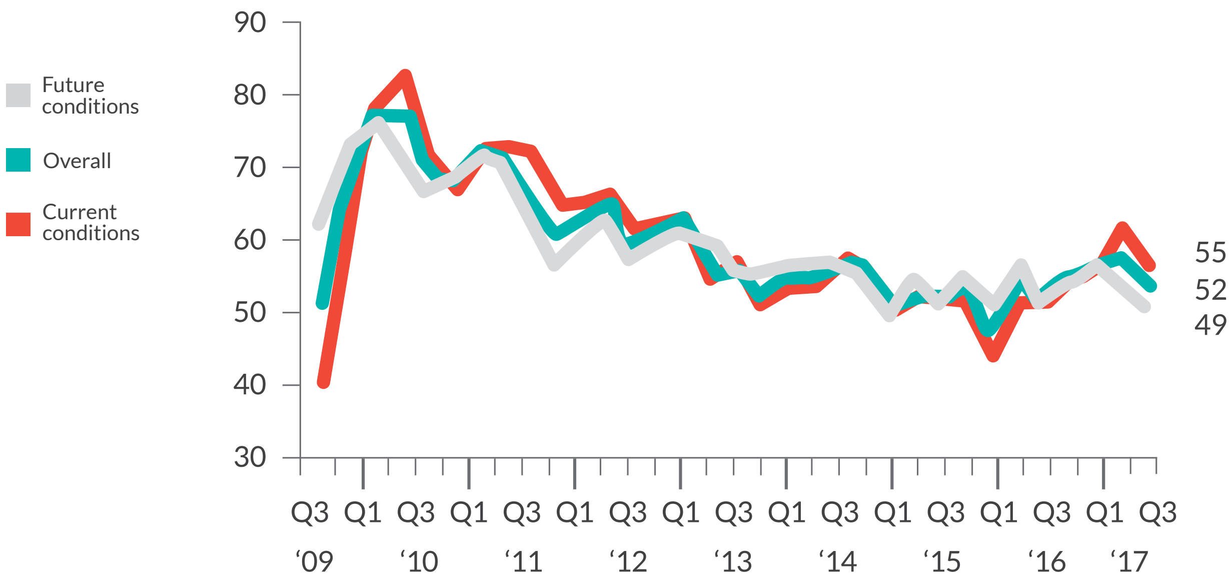
"There is a bump in interest rates in Canada and no one knows what is going on in the U.S., there is as much uncertainty as there was previously and people are not making decisions. When he first got elected there was a big thrust but it has tailed off. U.S. demand hasn't backed off but it is not all that strong."

"We have seen a slowdown in investor appetite. I don't see it as a "drop off the cliff" slowdown. I feel that we may be returning to 2014 levels as we are seeing a little bit less activity in the capital markets. Investors in Canada are having trouble finding product that makes economic sense."

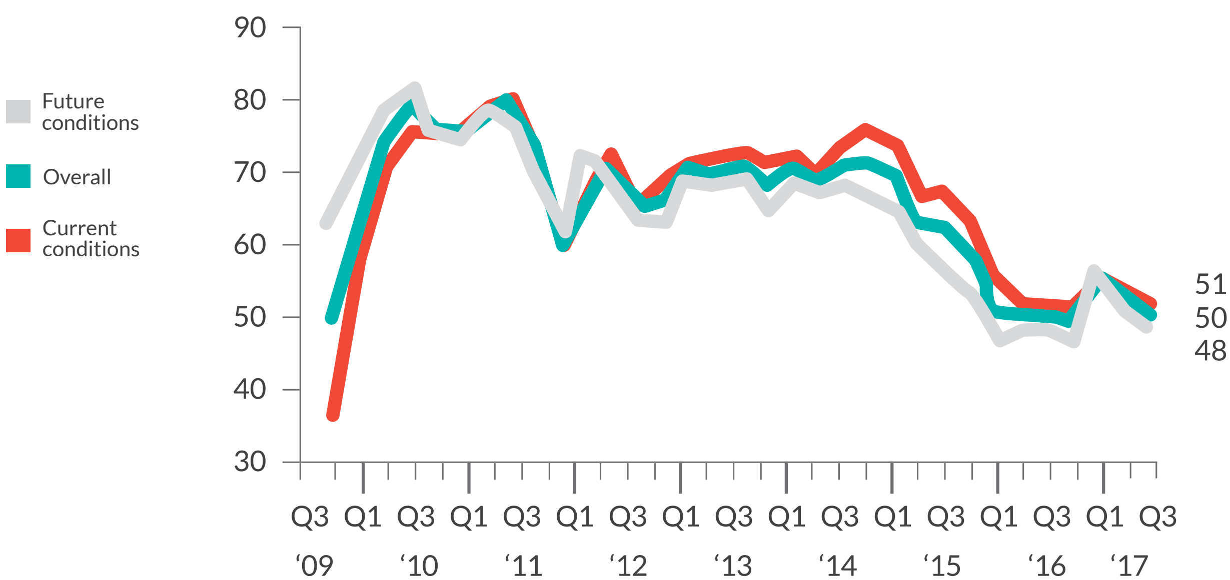
"Many have turned to development as the development yield spread has narrowed."

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

Record pricing, illiquidity, rising rates, skittish capital markets and the ecommerce affect could lead investors abroad or to other asset classes.

"25 basis points at a time is not changing REIT operating business metrics as everything is locked in and it is a small raise, but it is changing the mindset of investors."

"Secondary and tertiary retail mall formats are really going to struggle."

"Canadian institutional investors have looked abroad because when you look at markets of similar size and liquidity in places like Europe, across assets with similar risk styles, there is a discount to pricing in Canada."

"A lot of institutional investors have been priced out of Canada and forced into international markets."

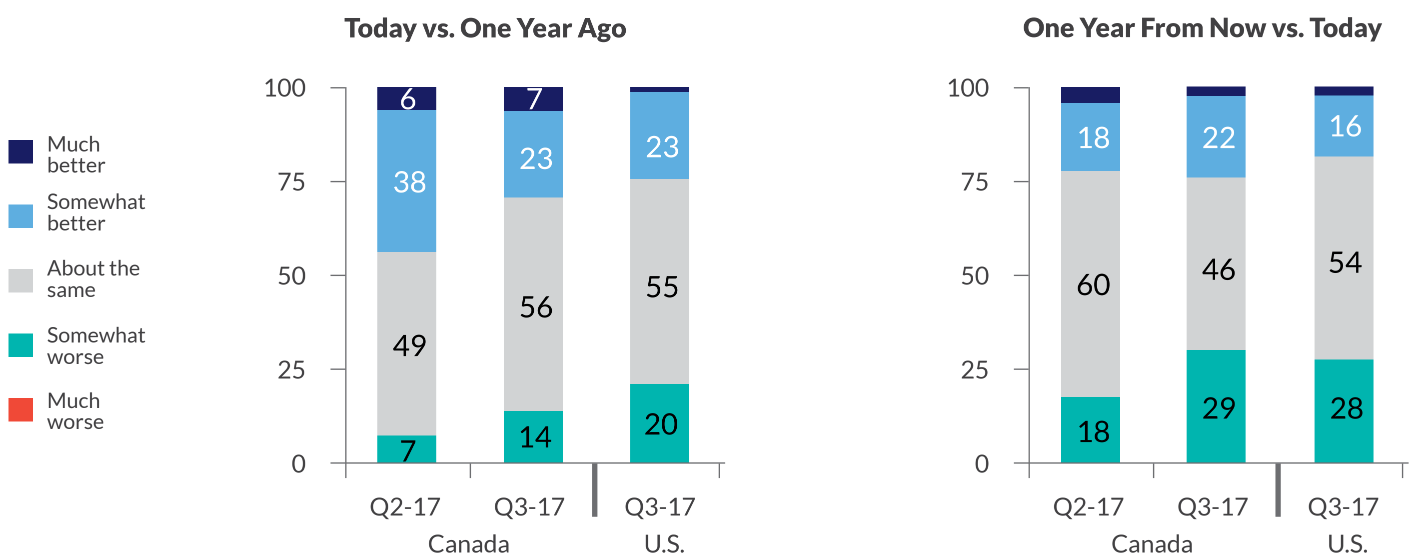
"Cap rates are breaking records in downtown Toronto and Vancouver but if you go to the suburbs you don't have a lot of liquidity as the traditional participants in those markets were public REITs and those REITs are stuck in the mud as they can't raise equity at accretive rates and the institutions aren't buying in those markets."

"Pension funds have a 'no fly zone' over Alberta."

"We don't have enough real estate private equity firms in Canada. In the U.S., you have TPG, LoneStar, Blackstone, and a ton of other private equity firms that are looking for opportunistic plays. We don't have enough of those groups in Canada. Instead, we have pension funds that don't make decisions that are controversial and buying in Alberta right now is controversial."

"I have seen major change on the residential side where people's definition of core market is expanding. The definition of the GTA is now including Oshawa, Burlington and Hamilton."

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



Asset Values

Rising interest rates will not stop cap rates from hitting new lows in most core markets but will likely impact negatively on secondary and tertiary market trades and pricing.

"It is easy to say that we are at a peak in terms of where cap rates are and interest rate forecasting but I feel that this will lead to more bifurcation in the market in that core cap rates for quality assets are going to remain under huge pressure and won't be impacted by rising rates."

"In Canada, multi-family has peaked in most markets. In Alberta, specifically Calgary office, we have found a bottom in terms of valuations based on the rental curve. Appraisers have been writing down assets based on the declining rental curve, but I think it has found its bottom; however, if interest rates start to edge up, then we can see further downturn on those valuations in terms of cap rates backing up."

"Toronto and Vancouver have had continuous cap rate compression for the broader asset classes."

"Values are a function of the asset. If its core assets, you are seeing pricing breaking records again."

"You throw math out the window when you talk about cap rates in the 3s."

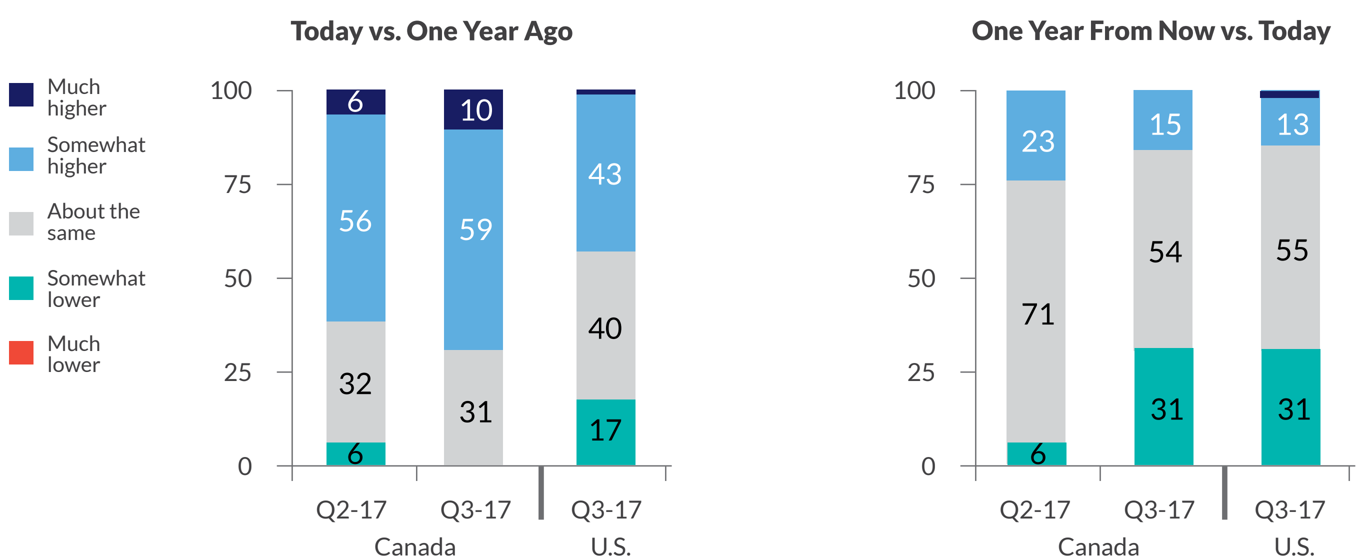
"Stagnant; they haven't moved in either Canada or the U.S. in the last quarter."

"I have been doing this for 30 years and have never seen these levels before."

"It will be interesting to see over the next 6 months how rate increases impact and put pressure on cap rates. From a shortage of quality assets standpoint, you will have to see a 50-75 bps hike before people begin to push back."

"I see cap rates coming off in the secondary and tertiary markets as a lot of that investing was driven by the ability to finance and I think people are going to get more nervous financing in those markets, so costs will go up."

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



Debt Capital

Debt is readily available from traditional sources and a growing number of new debt platforms in Canada and around the globe as lenders compete aggressively for business.

"We are just going to market now to raise construction financing for a major project and there is no shortage of suitors and it is very competitive in terms of rates."

"The insurance companies and pension funds are being very aggressive in terms of their willingness to pre-lock on rates up to 3 months ahead."

"On the bank side, there is no shortage of capital. There is an abundance of debt capital."

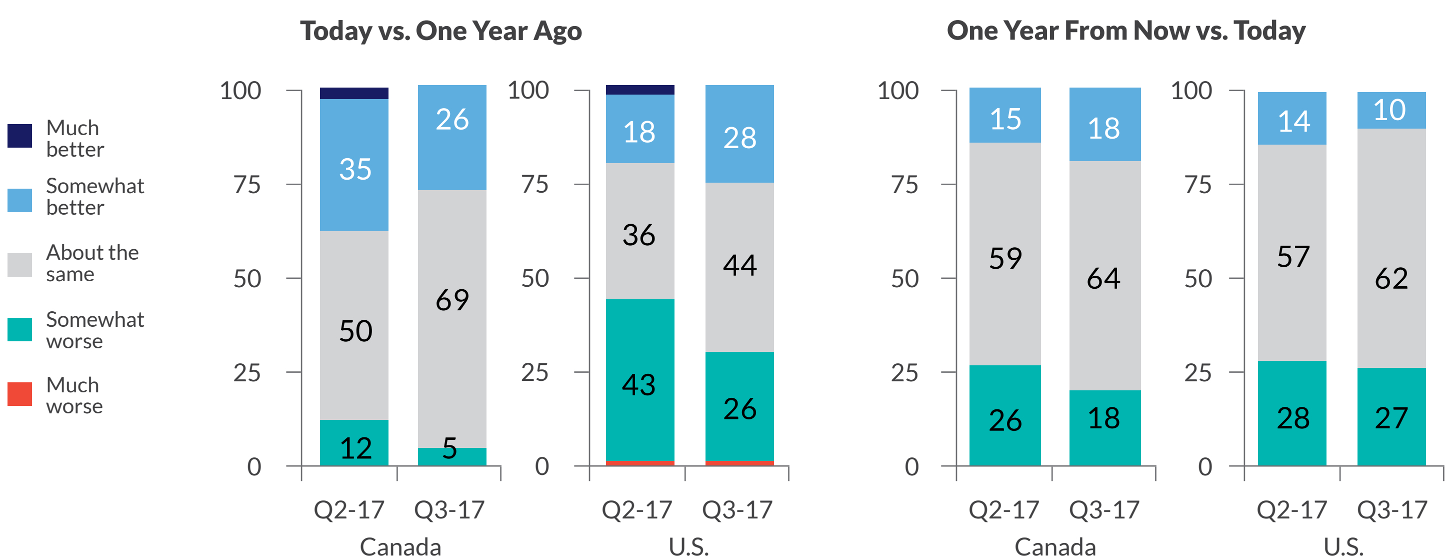
"For institutional investors there still continues to be liquid debt markets in Canada."

"There has been an uptick in the number of debt funds out there, globally and in Canada. So clearly many have seen an opportunity to invest from the lending side in first lien and mezzanine debt for the increased activities in the development markets."

"There is a lot of capital on the debt side. You can easily raise 5-10 year money. Spreads keep coming down. Lenders are being very aggressive particularly at the end of the year. They have to fill their books and they haven't filled their books yet. Lenders have not been active enough in the first half and there haven't been enough trades in the first half."

"The access for us is still there as it is for most people. The demand from lending institutions to put out debt for real estate is still there."

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



Equity Capital

There continues to be an abundance of equity available for attractive Canadian real estate assets but the capital markets have not been as friendly to the REITs in the less attractive sectors and markets.

"The market in our sector is still very nervous about the e-commerce effect and it has had an overhang on our units; everyone in the retail space has an overhang, but all of us arguably are moving towards mixed use, however, we are not at that inflection point yet where the unit prices reflect the value created. I do not think that any of us is in a market where we feel that we want to raise equity."

"There is equity available but we may be going back into a more picky environment. There is still capital out there for the right deals and use of proceeds but I sense that there is more pickiness as people are unsure what the next 12-24 months look like."

"There are still funds out there raising capital and they are well capitalized; I don't get calls for co-investment capital."

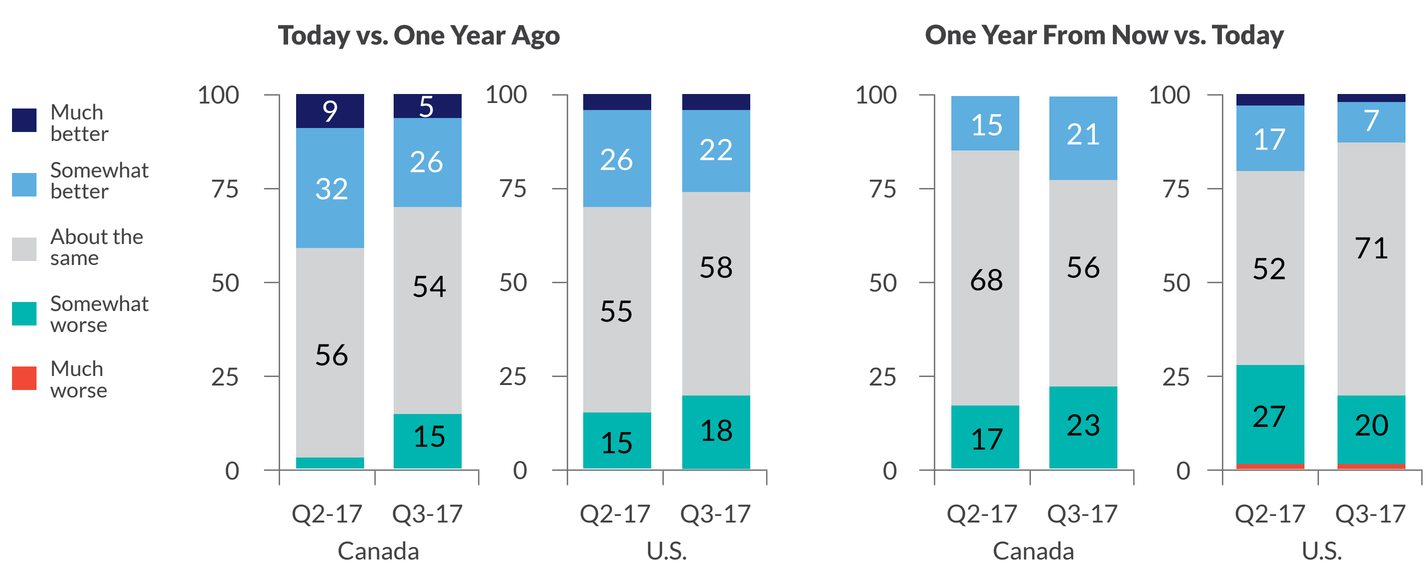
"The markets are clearly open for the right names. There are certain darling REITs that can raise money at will and are trading at an all-time high. You will see them continuing to hit the market this year. Other REITs have lost their shine and cannot raise equity."

"It is name dependent and some REITs can raise money at will while others have lost the confidence of the investment community and are trading well below their previous levels. As they can't make accretive acquisitions there is nothing to raise money for."

"There is no shortage of equity anywhere."

"The capital markets have slowed down and I am not sure if this is structural or summer related. We were very busy Q1 and Q2 but slower since. Recently a couple of deals have not sold well. We are seeing rising interest rates and a Canadian economy that is exhibiting buoyancy, so investors are looking for better returns and growth elsewhere."

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.)

Adgar Investments & Development Inc.
Chris Tambakis

Agellan Capital Partners Inc.
Frank Camenzuli

Alberta Investment Management Corporation (AIMCo)
Micheal Dal Bello

Aspen Properties
Scott Hutcheson

Avison Young
Mark Rose & Amy Erixon

Bell Real Estate Services
Robert Struthers

BMO Capital Markets Real Estate Inc.
Walid Cheaib

Canada Post Pension Plan
Tom McCulloch

Canadian Mortgage Capital Corporation
Robert Goodall

Canderel
Richard Diamond

CREIT (Canadian REIT)
Stephen Johnson

Crombie RIET
Donald Clow

Dell Corporation Realty Ltd.
Michael Dell

Dorsay Development Corporation
Geoffrey Grayhurst

EllisDon Corporation
Geoff Smith

Fengate Capital Management Ltd.
John Bartkiw

Firm Capital American Realty Partners Corp.
Kursat Kacira

First Gulf Corporation
David Gerofsky

Grover, Elliott & Company, Ltd.
Larry Dybvig

Hopewell Residential Management LP
Paul Taylor

Investment Management Corporation of Ontario
Brian Whibbs

Ivanhoe Cambridge Inc.
Mario D. Morroni

Kircher Research Associates Ltd.
Hermann Kircher

Margolis Capital Commercial Mortgage
Ron Margolis

Miya Consulting Inc.
Kevin Miyauchi

Montrose Mortgage Corporation Ltd.
Richard Brownscombe

Morguard REIT
George Schott

National Bank Financial
Andrew Wallace

Northam Realty Advisors Limited
Patrick Handreke

Nova Scotia Pension Services Corporation
Chris Taylor

ONE Properties
Darren Durstling

Paradigm Quest Inc.
Kathy Gregory

Partners REIT
Jane Domenico

PIRET
Kevan Gorrie

QuadReal Property Group
Steve Barnett & Remco Daal

Realstar Group
Wayne Squibb

Realtech Capital Group, Inc.
James McPherson

Revera Inc.
Gilbert Schiller

Skyline Group of Companies
Mike Bonneveld & Jason Castellan

Strathallen Capital Corporation
Laetitia Pacaud

TD Securities Inc.
Andrew Phillips

The Great-West Life Assurance Company
Jim Anderson

Vista Hospitality Group
Amin Visram

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