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REALPAC

FPL Associates
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REALPAC / FPL Canadian Real Estate Sentiment Survey

Q2
2018

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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 2018 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 came in at 51, down from 55 in Q1. With the exception of Alberta, real estate market conditions remain strong throughout the country and the convergence of real estate and technology has made its way to Canada.
- The demand for real estate is encouraging as office, industrial, and multi-residential rental rates continue to rise, while retail investors are taking a step back to consider implications of current dynamics.
- Overall, asset values are stable, indicating an institutionally sound market and investors agree a correction is needed to increase pricing.
- With a slight reduction, debt capital continues to be readily available and real estate lenders remain active and competitive throughout the country.
- Although availability of equity capital is healthy, investors are starting to experience equity allocations being made outside of Canada.

Data Collection

Data was collected during April 2018. 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

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General Market Conditions

The Q2 index came in at 51, down from 55 in Q1. With the exception of Alberta, real estate market conditions remain strong throughout the country and the convergence of real estate and technology has made its way to Canada.

"General market conditions are positive, very good."

"From a Canadian perspective, things continue to be stable, positive, and tight. There's demand/ activity. The fundamentals are very good. Three years ago, we needed a bit of a correction in the Canadian markets that then allowed for this stability and growth to occur."

"Canada has been the prime beneficiary of the activity in the US, and fundamentals underlying the US economy are very strong; the demand for real estate is at an all-time high. In the US, and potentially in Canada, rising interest rates have an impact on valuations and on velocity in the sense of buying yield spreads. Canada is doing a better job in its major markets than the US; we can absorb it and it will be less dramatic in Canada."

"Market conditions are great. Fundamentals and the demand for real estate are great. We have to look at short-term pricing because underwriting has changed as interest rates have changed."

"From a capital perspective, Vancouver is unique because there's still lots of foreign capital that wants to be in that marketplace. Any noise around residential housing and foreign taxes hasn't really affected the investment market. BC's a frenzied market, specifically Vancouver; every little piece of land is a new development site so it may be a bit of a pyramid game at some point."

"Storm clouds on the horizon… there are a number of things that we have to be cognizant of: obviously government regulations (meaning everything that they are trying to do on the housing side); interest rate policy (we're okay for now but another 25 to 50 basis point increase would prove detrimental; we've weathered this storm but it's a question of how much more can the economy absorb); and then you have NAFTA and other challenges like pipeline issues that impact jobs, growth, and interprovincial relationships."

"This market is obviously driven by capital change churning in the sector as it's done so well. It's an institutionally sound market."

"Keep an eye on interest rates and buyouts as they're starting to move. They've been offset a bit as mortgage companies have lowered their spreads, but they're getting to the point where they can't lower them anymore, so buying yield is just a general macro comment that you have to be watching out for."

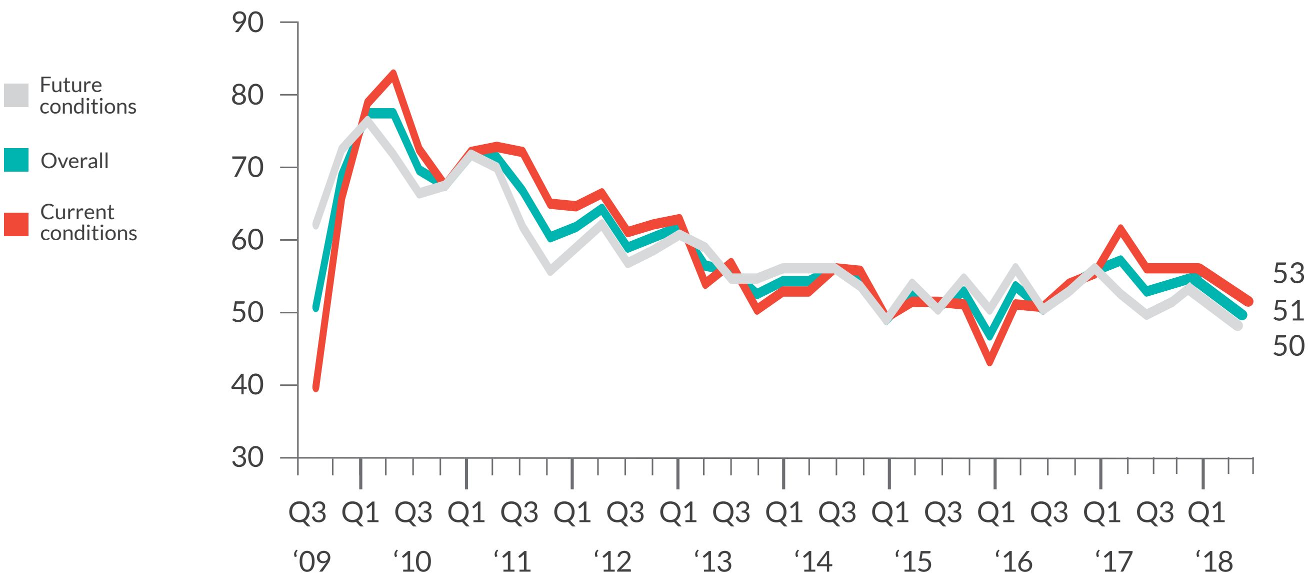
"PropTech is hitting Canada right now."

"My bigger fear is that technology is driving the leasing market. Some of these tech companies (apart from the big five to six) are not that well capitalized. I think that the slowdown in the tech market may be the biggest risk to the real estate market in Canada over the next 12 to 24 months."

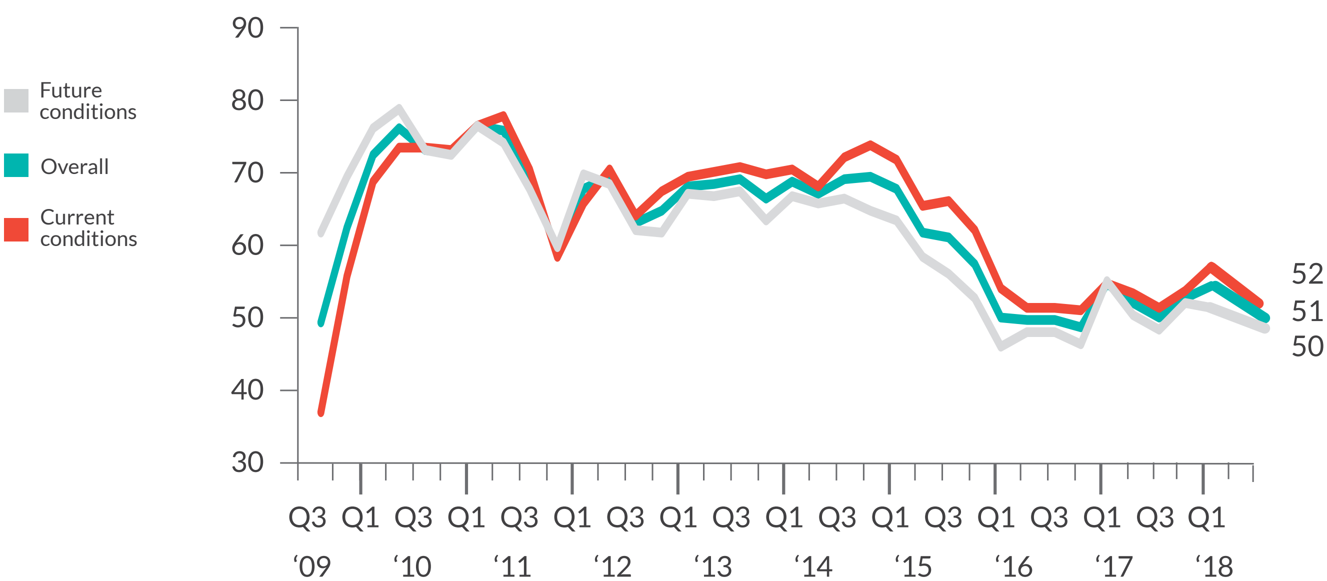
"Vacancies are lower and it's a better market overall; everywhere except Alberta, where vacancies are still very high with no real end in sight there… whether it be three, six, or ten months. In Montreal, there's an expansion in the tech market, so there is more of that going on so that bodes well for the market, especially in industrial."

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

The demand for real estate is encouraging as office, industrial, and multi-residential rental rates continue to rise, while retail investors are taking a step back to consider implications of current dynamics.

"Despite talk of two markets/the housing market softening, people are now prepared to live in a different form of housing at a reduced cost (condos); there's also been a transformation where millennials are prepared to live longer in higher density housing that's closer to work."

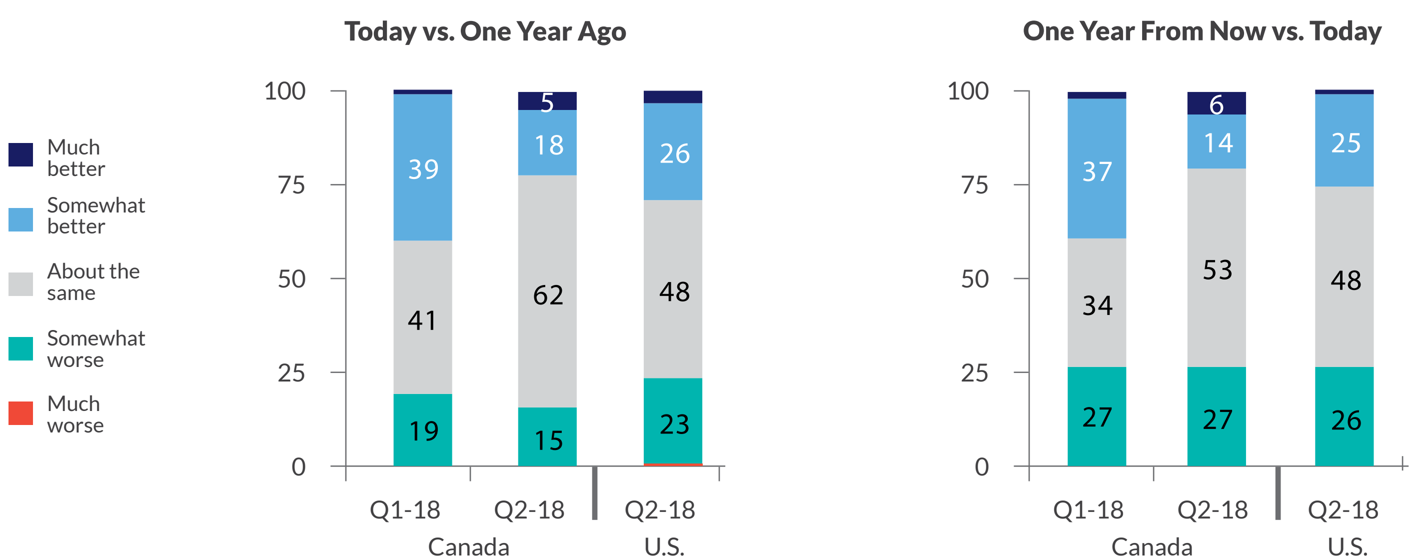
"With the exception of Alberta, which continues to suffer, office is up across the board in the major cities especially Toronto and Vancouver and, to a lesser extent, Montreal and Ottawa (but both are showing some significant signs of growth on the rental side and new development supply). Similarly, in industrial there's more uptick in rents with more demand and development, which should continue in 2018. Retail is a much maligned asset class. People are being very choosy and there's a wider bifurcation between good and bad, with good a very small percentage; there's a widening disparity in terms of pricing. In multi-family residential, everyone's still looking for apartments so it's still in high demand with lots of development in the major markets."

"Vancouver is priced for perfection! It's being priced based on significant rental growth almost universally across all asset classes. There's real rental growth in both office and industrial; from an initial yield capitalization rate perspective, it's the lowest in the country and, in industrial, probably the strongest market in the country, even stronger than Toronto. In office, rental rates are appreciating quicker in downtown Vancouver than they are in Toronto."

"Montreal has probably more momentum today than I've seen in a long time; whether that translates into real rental growth remains to be seen. There's more capital starting to come back into Montreal, but certain buyers just will not go to Montreal."

"I think that everybody's trying to figure out what the evolution of retail will be and what impact it's going to have on various types of retail. Everyone's evaluating their portfolios and trying to determine if they need to reallocate their retail holdings into different types of product. One of the main things that everyone's looking at, particularly in markets like Toronto and Vancouver, and Montreal to an extent, is whether or not these fairly large prime sites that retail assets occupy can be intensified and turned into more of a mixed use community. There's a lot of head scratching and idea generation."

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



Asset Values

Overall, asset values are stable, indicating an institutionally sound market and investors agree a correction is needed to increase pricing.

"By and large, asset values have remained strong. There seems to be a bit of retrenching going on in retail depending on product type. The spread between product types and markets is widening a bit, but certainly the core asset classes that people are concentrating on continue to be very competitive."

"Asset values are pretty much flat from last quarter. Cap rates have not really bounced or changed that much since 2017. There may have been a little tightening, but prices are certainly not going down."

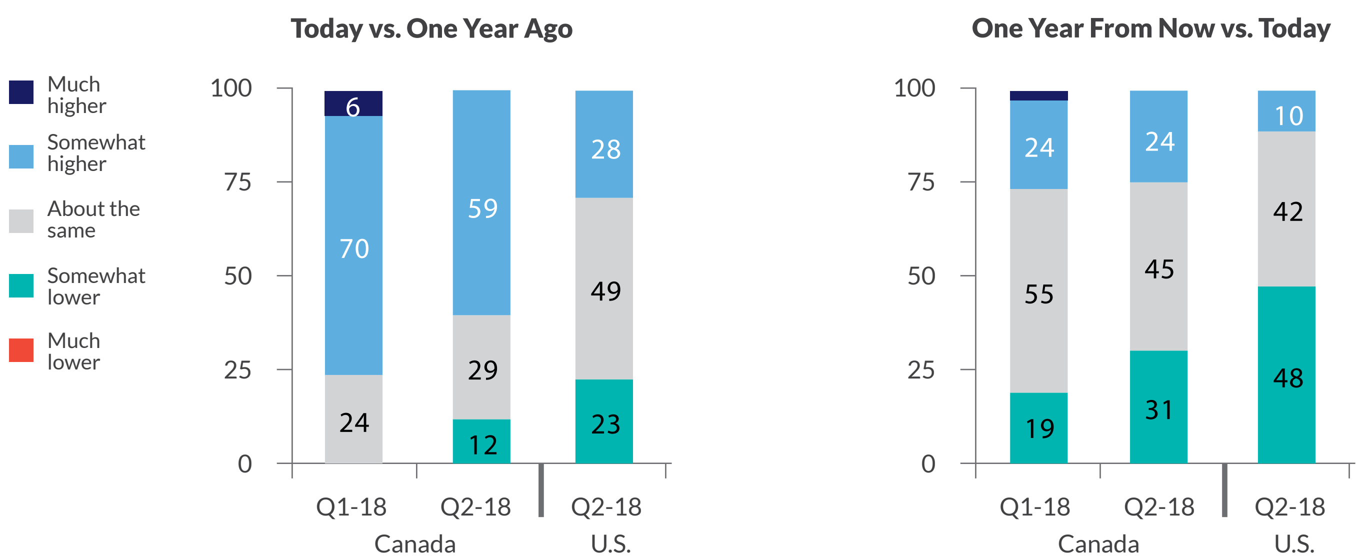
"For a core asset, the 4 cap buyer really doesn't want to buy at a 4 cap anymore; they really want to buy at a 4.75 cap and vendors/sellers loathe selling it at 4.75 because they were the people who bought it at 4, and so there's a bit of a stalemate."

"The value of assets will appropriately go down a bit due to underwriting changes. With that said, if there is inflation, there are replacement costs, rental rates will grow, and there will be a correction. Meaning growth to the upside, which is like letting the air out of the balloon; which is healthy and must happen... the driver at the moment is interest rates."

"Asset values are stable. We're going to see (and it would be healthy) values take a temporary step back due to rising cap rates, interest rates, etc. But we're hitting that part of the cycle where we're starting to normalize pricing a bit and it's being normalized against alternative assets. When government notes and bonds start to increase in their yield, we're really in an alternative class and so we need to keep pace and that will take pricing down. I don't see a crash coming. If everybody can withstand a short-term correction, there is a wall of capital that wants to come in that will ultimately take both fundamentals and pricing back up; but after we take a bit of a pause."

"On the residential front, I see Vancouver slowing a little bit this year; Toronto should still be quite vibrant. In the investor driven market, where foreign and offshore investors are looking for a piece of Canadian rock, they're shifting focus from Vancouver to Toronto on the condo side, and are now looking at Montreal simply because there is less tax and it's more affordable on a price per pound basis."

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



Debt Capital

With a slight reduction, debt capital continues to be readily available and real estate lenders remain active and competitive throughout the country.

"With regards to debt capital, we certainly don't seem to have any challenges getting multiple bids. I don't see the availability of debt capital as being a real issue."

"There's still a bit of skittishness in the market. It's okay, but there seems to be a bit of a tightening as the Bank of Canada came out with revised rates recently."

"Debt capital is accessible but a little tighter."

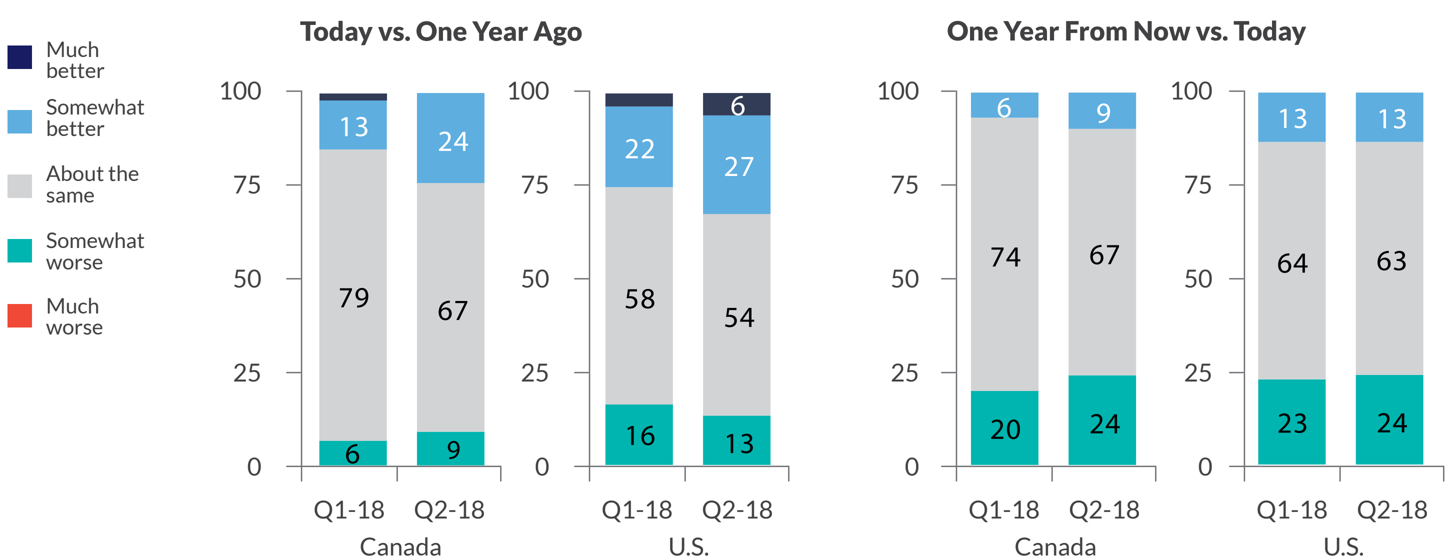
"It seems that, if the site is working, then the banks are happy to accommodate land loans and construction loans."

"Debt availability is as strong as ever! It is still different than it was before the financial crisis, it's still lower."

"Over the past five to six years, there has still been lots of money, spreads have come down, and overall costs have gone up because of buying yields; overall debt capital is as strong as ever."

"I don't see spreads going down anymore, but I also don't see the availability of debt changing unless there is a setback. Obviously Alberta office is a problem to finance but, other than that, I don't see a problem."

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



Equity Capital

Although availability of equity capital is healthy, investors are starting to experience equity allocations being made outside of Canada.

"There's lots of equity capital available. People are just being very selective about where they deploy it. It really depends on the product type and the strategy that you are putting forward. If you have an urban intensification development strategy with holding income, then you have many, many options."

"Equity capital is not an issue. There's quite a bit of money around."

"There is equity capital, but at a price. There's never been this amount of equity capital before that wants to get into real estate. It's a wall of capital. We are at an all-time high in terms of investment dollars that want to come into all the markets, for the right price, of course."

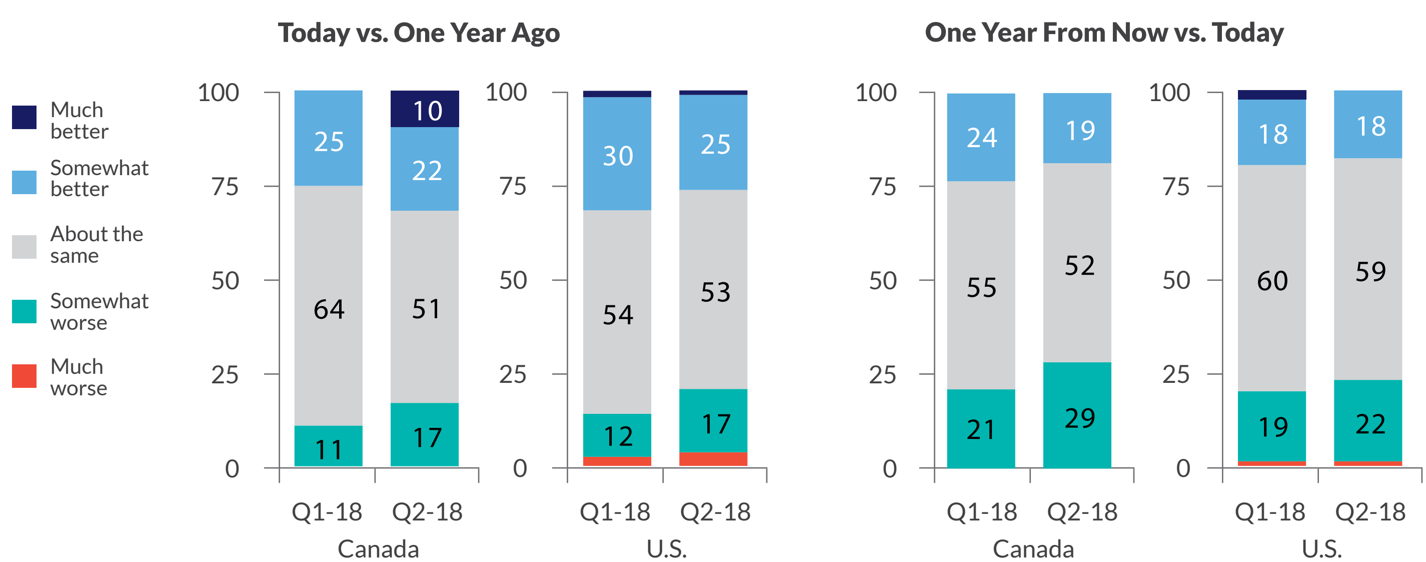
"There's a lot of equity capital available for land development or land acquisition. There's so much equity capital chasing too few deals, which is making the cost of land potentially go to limits beyond what it really should be. In the next four to five years, if they keep the legislation the way it is, the developers who survive will still be doing quite well because there will be a restriction on size, but the number of developers will be fewer."

"There's a little more caution for new players than there was in 2017, or for people increasing their allocations. It's not quite as robust as 2017 but still under-allocated."

"One challenge is that some funds are saying that they would rather go global than focus solely in Canada even though, historically, the returns for global have not been any higher than in Canada; in fact they have been lower."

"Equity capital's still good, but not as good as it has been in other years."

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



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