Real property. Real leadership.

REALPAC / FPL Canadian Real Estate Sentiment Survey

Q3
2018

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REALPAC (Real Property Association of Canada) and FPL Advisory Group are pleased to announce the results from the third 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 Q3 2018 index came in at 48, down from 51 in Q2. Canadian capital continues to flow internationally; the domestic market remains stable with a focus on investments within city centres across office and multi-family asset classes.
- Real estate conditions remain about the same as in 2017. Office, multi-family, and condo assets continue to perform well in urban centres while investors are looking to diversify into industrial.
- While market perception is one of confidence; year over year, the reality is that asset values are lower than in 2017. Industrial and office prices are on the rise, while retail values appear to be flat.
- Similar to Q2, availability of debt in Q3 2018 remains strong and real estate lenders continue to be active, making for a competitive and healthy market.
- Institutional capital is strong and allocations to real estate continue to grow with an increasing interest in development; privately raised equity continues to remain strong and available.

Data Collection

Data was collected during July 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 Q3 2018 index came in at 48, down from 51 in Q2. Canadian capital continues to flow internationally; the domestic market remains stable with a focus on investments within city centres across office and multi-family asset classes.

"In terms of Canada focused market conditions, it is a bit segregated so it depends on the asset class. Cap rates for core assets continue to compress to all-time lows. Most investors are looking for opportunities to diversify outside of the core because, frankly, that market and the number of buyers for core real estate assets just continues to increase. And by core, I mean Toronto and Vancouver (office, industrial, urban retail, and development land), and maybe Montreal. In other markets, there seems to be less liquidity. The topics that keep coming up are that there continues to be interest in land intensification, and land pricing continues to increase exponentially. Pension funds are looking at the US more now as they are running out of product to acquire in Canada. All the REITs, particularly the retail REITs, are recycling assets and getting out of secondary markets as they are being punished by the public market. There are a lot more joint venture partnerships that are happening to access product."

"The market in Canada is very robust in the centres, so it is becoming even more 'big city' centralized than I have ever seen it before; but writ large, we are very busy; our backlogs are at record levels and our biggest problem is manpower shortages top to bottom. So we are as busy as we have ever been."

"In terms of overall activity level - outside of retail - it has been quite quiet in terms of availability of product (apartment and industrial). On the retail side, we are seeing a little more availability, but on the industrial and multi-family side, it has been extremely tight."

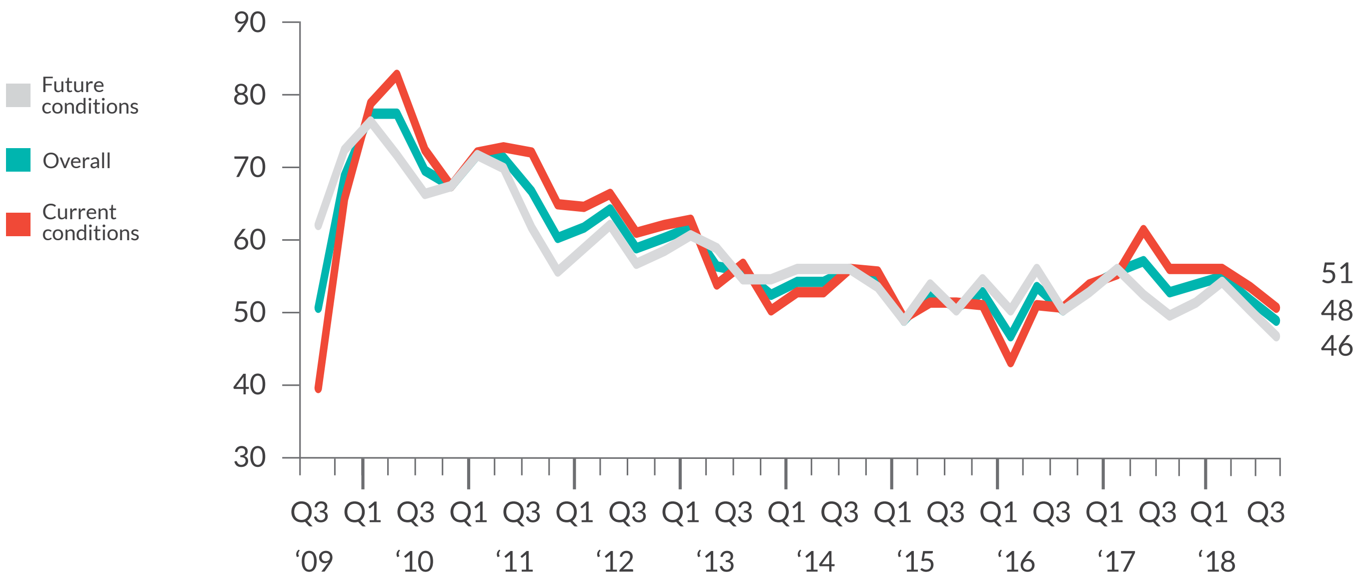
"In terms of market conditions, geopolitical, NAFTA, and tariffs present their challenges, but have not affected the market yet."

"With regards to market conditions specifically in the core industrial sector, valuations have been affected by rental rate decreases. Ontario, Atlantic Canada, Quebec, and British Columbia are all performing well and are on an upward swing. Alberta is starting to see some stability in industrial, Edmonton in particular. Numbers are starting to reset in Alberta."

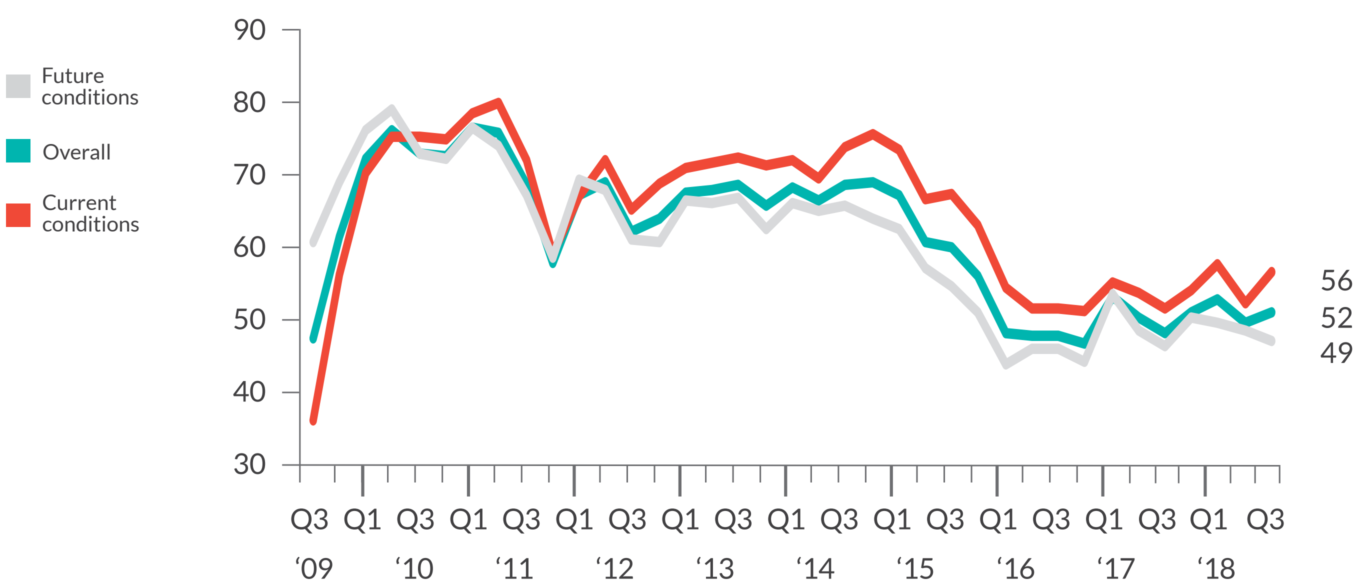
"If it is downtown core office (Toronto and Vancouver), you are looking at cap rates in the 3s, which is effectively an all-time low. If you are in industrial, you are looking at cap rates that will break a 4, which are also at historic lows. But some assets are still shattering records with the rationale to create critical mass of industrial with rents to go up as you are not going to get value appreciation from cap rates, it has to be through increasing rents. With retail in secondary markets, the buyer profile has changed. It used to be a lot of institutions, and now it is less institutions and more opportunistic funds and private, which typically pay higher cap rates. So we are seeing valuations for non-core retail go up and that is also a function of sector specific issues, primary being that there is a lot of retail bankruptcy and disruption. Regional malls have actually had their highest vacancy rate ever at 14% so that is driving a lot of buyers out of that sector and into other asset classes. Multi-family is performing just fine. It is still shattering cap rate records as well, simply because it has got the lowest volatility, it has historically performed really well. What we are seeing is the sector becoming more institutionalized as it is another way to access more capital and institutionalize that asset class. There has been a lot of development of multi-family. We are seeing renewed focus on multi-purpose rental in addition to condos. The market was stagnant for 20 years and now, all of a sudden, we are seeing a resurgence in building multi-purpose rental properties so that is translating into higher and higher prices per billable square foot. Toronto land prices for residential are in the $250+ per square foot range."

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

Real estate conditions remain about the same as in 2017. Office, multi-family, and condo assets continue to perform well in urban centres while investors are looking to diversify into industrial.

"Overall, the Greater Toronto Area market is spotty. There are definitely companies that are being careful as they do not know what the future is going to be in terms of the growth of our economy. That said, we are still seeing good activity in the industrial and office sectors. Residential is way off in the condo and single family homes."

"What we are seeing is what the papers are saying… continued strength in the condo sector in Toronto and elsewhere. You are seeing very weak velocity and absorption on the single family and townhouse sales side, and that is (a) just a function of affordability, and (b) we are continuing to see migration back to the City of Toronto. But even suburban Toronto is being driven more by affordability than just a move into the city. Sales out west and particularly in the Calgary area showed a little bit of strength last year, but this year, it is down the toilet. On the rental side, out west though (probably because of the stress tests on the mortgages; a lot of those people may be driven to rent that may have previously been buyers), we are seeing some strength, particularly in Edmonton on the rental side and the multifamily side. In St. John's, we have had some leasing strengths recently in retail. In Halifax, we are seeing a little uptick recently in the condo market… it has been ticking along."

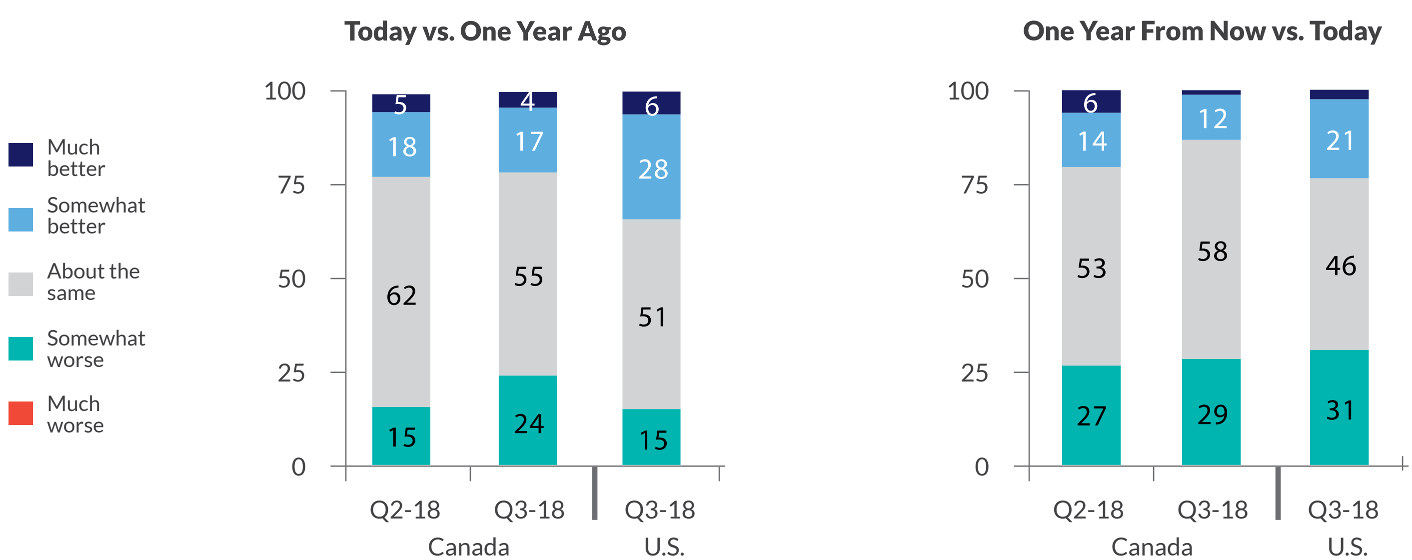
"With regards to key real estate considerations, Greater Toronto Area urban office is going up while suburban office is staying the same. Trophy top retail is going up while secondary retail is doing down. In secondary market retail, there is an absence of bidders and prices are soft. Multi-family is going up; rents seem to be going higher, even in suburban markets, where there is employment and population growth."

"Avoid secondary market retail."

"Industrial and self-storage seem to be the flavour of the month with institutional capital. It seems like a lot of people are underweighted and want more industrial, but it needs to be developed."

"The Greater Toronto Area suburban office market has definitely slowed down and the downtown market remains pretty strong. Urban retail with suburban shopping centres has remained unchanged. Industrial is very hot right now."

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



Asset Values

While market perception is one of confidence; year over year, the reality is asset values are lower than in 2017. Industrial and office prices are on the rise, while retail values appear to be flat.

"Industrial asset values are up and that is really driven from so much demand and a real lack of decent product. Apartment values are probably flat to maybe up a little bit. There are some select markets in the Greater Toronto Area and Greater Montreal Area, where values are maybe slightly up from where they were a quarter or two ago. But outside of those major nodes, it is probably more flat. On the retail side, a lot of it is really driven off of the increased amount of product availability and the overall market sentiment; and people trying to get their heads around a lot of the press and discussions around online shopping and how it is going to impact people; and that uncertainty has put some people on hold a bit, trying to figure out what they want to do."

"Asset values are still in check/have not moved; notwithstanding the confidence out there. There is a lot of capital looking for a home. Good assets are still at very healthy levels."

"Retail seems pretty neutral to me. Office and industrial seem quite strong."

"What you are seeing, with interest rates coming up, is less of a propensity for people to pay subfloor caps for street front property. You do have some institutions buying that as a new asset class, but it is still not in the institutional wheelhouse. It is showing a bit of an uptick and I think it is based purely on interest rates. But you have not seen the same fervor around those offerings with private that you maybe have had in the past."

"Everything is as expensive as we have ever seen it by any metric. Real estate developers/big pension funds are having to pay more than they have ever paid before, and that inflation is extending right throughout the supply chain. The inflation over the last six months, in the construction and development industry, whether that is for a piece of steel, a person, or a service, has been significant and so everything is expensive... and we do not foresee a break in the immediate future. I expect that, when the break comes, it will be sudden and it will be spurred on by some event. But right now everyone is still investing."

"The Toronto office market is the tightest office market in North America right now; there is a natural demand absorption of space; it is very strong. Montreal has never looked better in the last 30 to 40 years, with office in particular very strong. It is weak across retail, which is no surprise,

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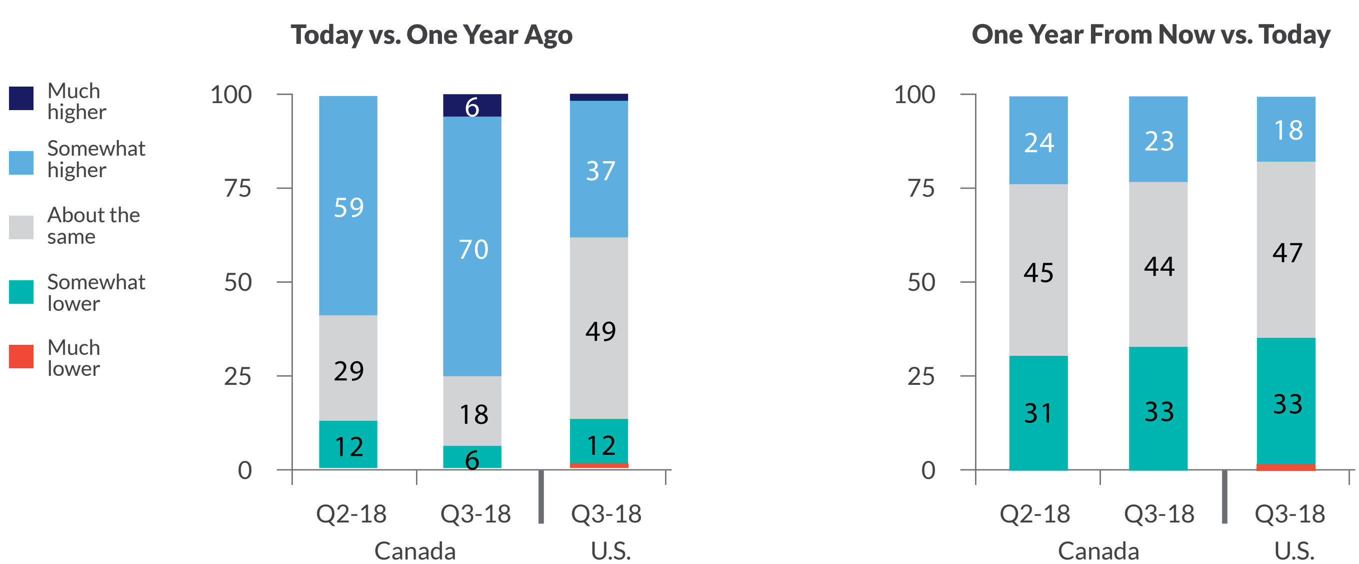
Exhibit 3: **Real Estate Asset Values** *(% of respondents)*



especially in secondary retail markets. Exceptions are RioCan, Oxford, and Cadillac. Well located retail is doing well - even out west in Calgary; and in Vancouver, the income has not fallen very much. The condo market is very strong within the Greater Toronto Area, and the single-family housing market in the 905 area has come to a bit of a halt, probably due to the mortgage rules. The condo market in Vancouver is very strong while in Calgary it is weak. Things are generally good in the various markets. The west is good. "

Debt Capital

Similar to Q2, availability of debt in Q3 2018 remains strong and real estate lenders continue to be active, making for a competitive and healthy market.

"For debt capital, availability is still quite strong, which is driven by people's nervousness about placement of equity, and there are still a lot of funds out there looking for a home to make a return. So people move to something a little more conservative, a little more secure; and move to the debt markets. Combine that with overall lower transaction levels, more lenders are competing for less mortgages to be placed."

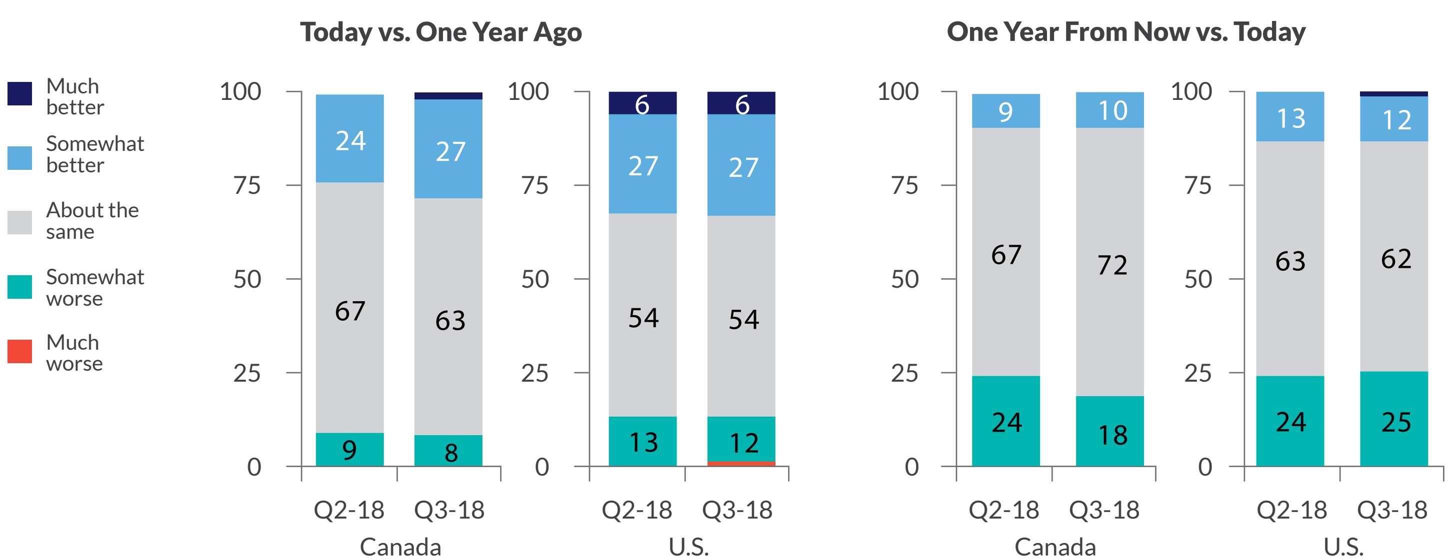
"Debt capital is very available — multiple term sheets per asset. There continues to be a bit of a no fly zone on Calgary office specifically (whether debt or equity), and that is just a function of the market being stuck in the mud; they are still doing negative Net Effective Rent (NER) deals; the vacancy rate is still around 30%. Historically assets would trade between $400 to $500 per square foot; today it is probably $100 to $120 per square foot."

"Both corporate debt products and real estate debt products are available and popular, which is a reflection of where we are in the Canadian real estate cycle."

"Land debt, for the right sponsor, still seems to be readily available. Construction debt - once you have sales - is not an issue. For what you could get construction debt for two years ago, you are getting it for today. The pre-sale test might be harder but it is still pretty readily available."

"There is an abundance of debt, and no issues in the mortgage or banking markets. Some of these condo projects are getting so large (for example, $500 to $600 million of interim construction credit), so you need all the banks to show up for that."

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



Equity Capital

Institutional capital is strong and allocations to real estate continue to grow with an increasing interest in development; privately raised equity continues to remain strong and available.

"Writ large, if you just take the availability to equity and debt, there is lots of it out there for proven concepts. As soon as you get off the beaten path a little bit, or ask people to do something a little bit new, red flags go up."

"Despite fierce competition for equity, institutional capital does not want to look at alternative asset classes."

"Availability of equity is reasonably good for all products. Not many people are pulling back. You have more institutions and high net worth backed equity capital that have sprouted up recently. I still think it is pretty good."

"In terms of availability of equity on an institutional basis, there is a very large abundance in the domestic market. There is an abundance of institutional capital chasing deals. On the public side, it is pretty decent with good access and a resurgence in real estate equities, with retail not that popular. The quality of the institutional names is very strong."

"Nobody is decreasing their allocations to real estate, and some institutions are looking to diversify to markets outside of Canada."

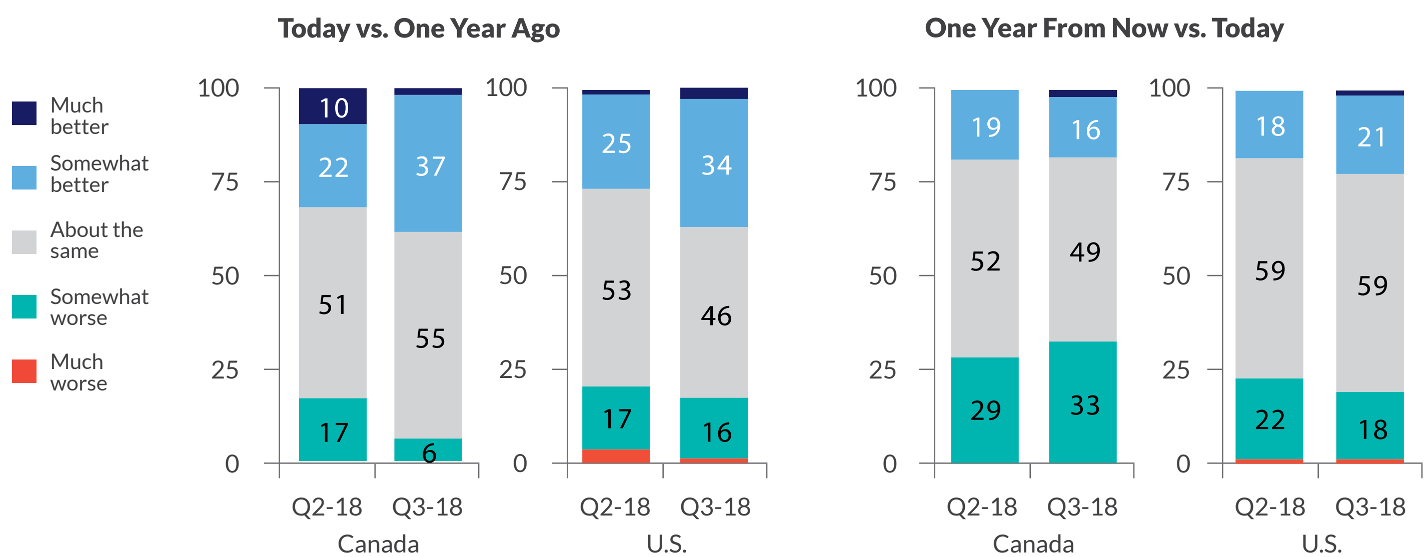
"With regards to availability of equity, it has been very good, with a lot of interest in the development side."

"There is a lot of equity and debt out there, and it is all flagged to quality. There is good availability of capital out there and, if you are a certain tier, now is a good time to be a borrower."

"It is flush with capital. The pension funds are continuously increasing their weighting towards real estate. Like risk adverse companies, they continuously seek new acquisitions. We are not seeing a lot of foreign entrants so there is not a lot of foreign money simply because the cap rates are too low and they can find better opportunities elsewhere. We are also seeing less activity among public REITs as a lot of REITs are trading below Net Asset Value (NAV) so it is a tougher market to raise capital in. But that is being offset by a lot of the institutional capital out there."

"Even for privately raised capital, availability is still exceptionally strong."

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



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