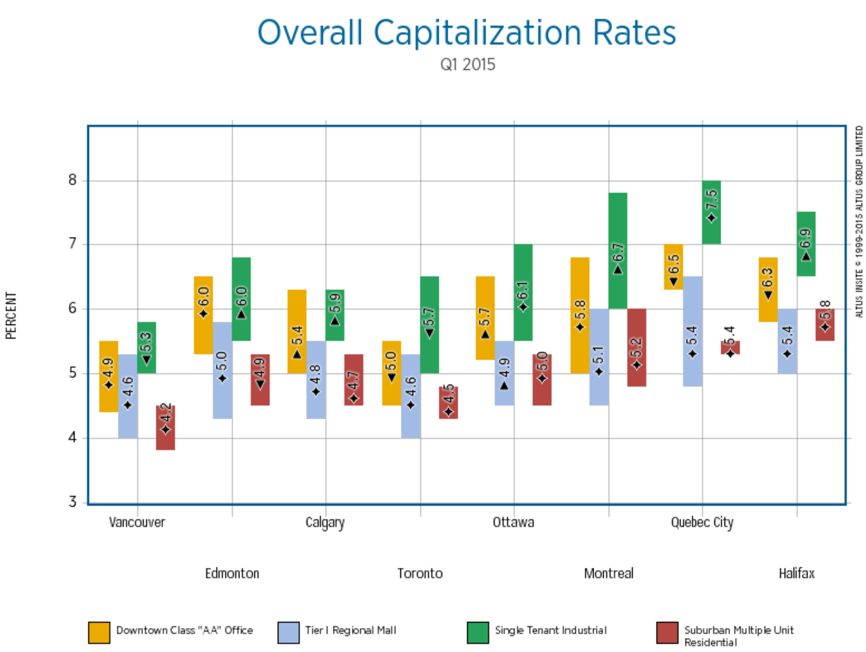
Commercial Real Estate Investors' Expectations Remain Stable – Oil's Softness Offset by Surprise Bank of Canada Rate Cut

Investors' expectations for cap rates in Q1 2015 are basically the same as they were exactly one year ago, as reported in the most recent Altus InSite Investment Trends Survey results. The survey was conducted in February, after the Bank of Canada's January rate cut and yet, the survey results do not reveal a change in investors' expectations in spite of the changing economic situation. While the national average per-asset-class remained stable, some regional disparities are beginning to emerge.

The sudden drop in oil prices and the resulting softness of the Canadian economy contributed to the unexpected decision by the Governor of the Bank of Canada to cut interest rates in January. While the consequences of declining oil prices are still difficult to fully assess, the confidence of business, consumers and governments have shifted and all have become more cautious. Many economists expect the Bank of Canada's Governor, Stephen Poloz, to cut rates by another 25 basis points this year. For real estate investment, that means the long-expected increase in interest rates most economists had forecasted for mid-2015 is delayed, once more.

Real estate typically thrives on low borrowing costs. Investor appetite remains strong, given the superior returns real estate has been providing when compared to other investment alternatives. Government of Canada 10-year bond yields hovered around 1.5% in Q1 2015, while the Capped REIT Index provided an overall return above 10% and the Investment Property Databank (IPD) Index closed the year with an average overall return of 7.3%.



Arrows indicate directional movement from previous survey

The Altus InSite Investment Trends Survey 8-city, 4-benchmark-asset-class average OCRs remained essentially unchanged between Q4 2014 and Q1 2015. Average OCRs compressed by only 7 basis points in the last year, and another 7 basis points between Q1 2013 and Q1 2014. The results by asset class show less than 5 basis points variation between Q4 2014 and Q1 2015 for all 4 benchmark asset classes. The 8-City average OCR for Suburban Multiple Unit Residential dropped by 4 points in the last quarter, bringing it to a record low 4.96%. The Tier 1 Regional Mall average remains low, at 4.98%, up from 4.95% last quarter. Downtown Class AA

Office remained basically unchanged, from 5.73% in Q4 to 5.70% this quarter. The most affordable asset class, Single Tenant Industrial, increased by 5 basis points in one quarter, and now stands at 6.26%

Regional variances, while modest, are good indicators of investors' confidence. Not surprisingly, Calgary saw its average OCR climb by 10 basis points since last quarter, while the two most high-priced markets, Vancouver and Toronto, registered further compression, albeit small. The Ottawa Market also showed a modest increase in OCRs, while other markets remained unchanged.

	Average OCR 4 Benchmark Asset Classes	Q4 2014/Q1 2015 Variance
Vancouver	4.75	-0.05
Toronto	4.95	-0.05
Calgary	5.20	0.10
Ottawa	5.43	0.05
Edmonton	5.48	0.00
Montreal	5.70	0.00
Halifax	6.10	-0.02
Quebec City	6.20	0.00

On average, values of most asset classes have been stable for almost two years and cap-rate-driven changes to values are unlikely unless expectations for interest rates and bond rates shift in the medium term. On the other hand, quality commercial real estate assets have become fully valued and further upside will most often be a result of repositioning, redevelopment, leasing and or other risk reduction and asset improvement initiatives. More modest cap rate compressions are possible, as additional interest rate cuts could encourage investors to bid more aggressively for the limited number of top quality assets. Lenders are competing fiercely to finance both existing and new projects at extremely competitive rates. Capital is abundant and affordable for borrowers with relationships and track records. The 50% decline in oil prices and the Bank of Canada's cut in interest rates caught many by surprise. It is impossible to know what the next surprise will be, when it will occur and if it will be paired with another partially or fully offsetting event. It seems unlikely that the rest of 2015 and 2016 will be boring.

Every quarter, senior Altus Group professionals reach out to over 300 investors, managers, owners, lenders, analysts and other market stakeholders to survey their opinion on value trends and perspectives. Conducted with the same benchmark properties for over 10 years, the survey provides valuable insights on valuation parameters for 32 asset classes in Canada's 8 largest markets. For more detailed survey results, please contact support@altusinsite.com.