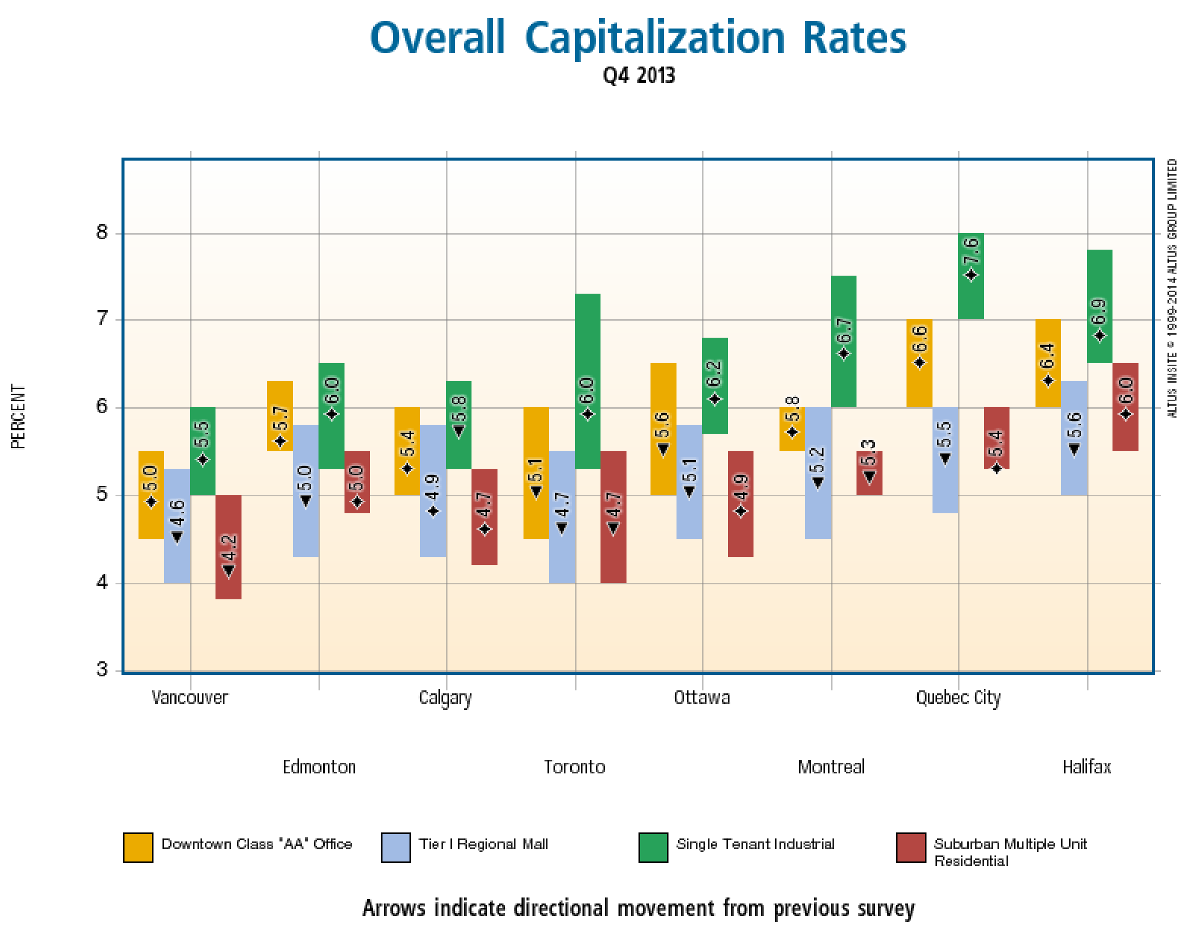
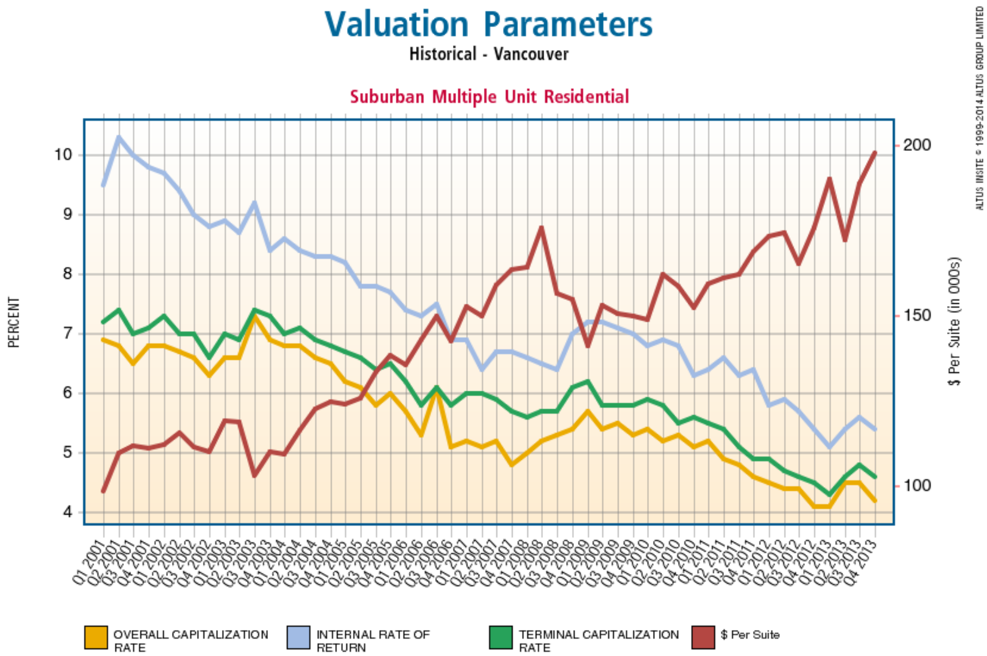
Commercial Real Estate Investors still Bullish amidst Changing Investment Environment

Commercial Real Estate Investors ended 2013 on a bullish note, as indicated by the Q4 Altus InSite Investment Trends Survey results, which reveal cap rate compression for most cities and asset classes over the last quarter. The national 8-city, 4-asset-class average OCR now stands at a record low 5.53%, down from 5.63% in Q3 2013. However the 3rd quarter survey was conducted in late August, after 10-year Government of Canada bond yields had risen by 100 points over the summer, following speculation surrounding potential tapering of Quantitative Easing by the US Central Bank. These new parameters had a clear impact on ITS respondents' expectations for this period, putting an end to 19 consecutive quarters of cap rate compression.

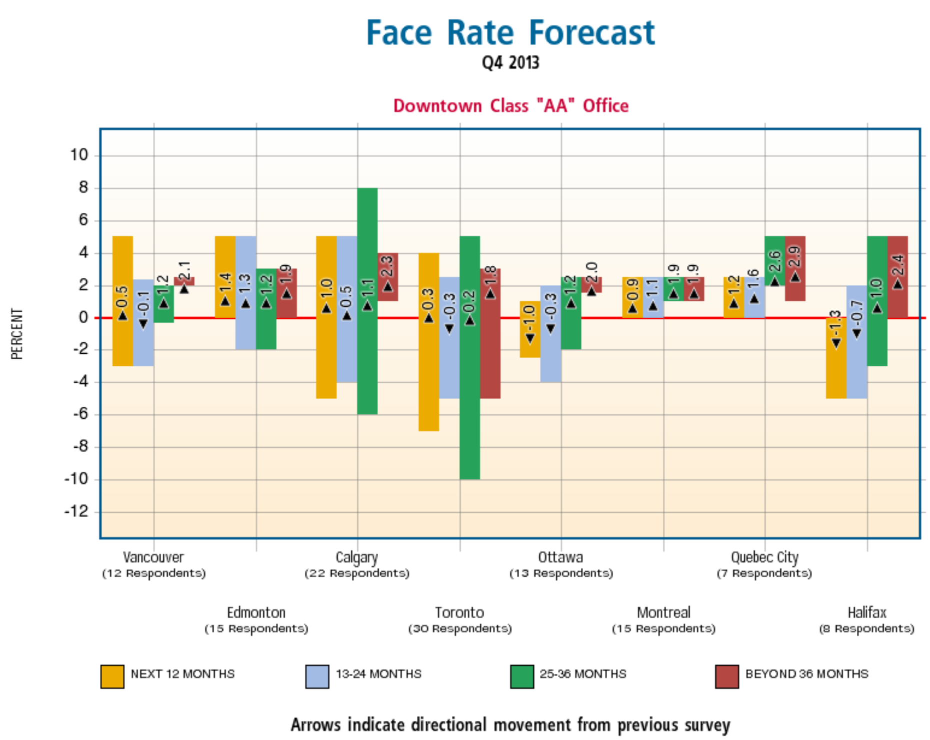
What seemed then like a more definite shift upward in the cycle turned out to be just a dent caused by the anticipation of change. If we overlook the Q3 survey results, OCRs and IRRs for most cities and asset classes in Q4 are back to Q2 2013 levels, despite the fact that GOC 10-year bond yields were 50 points higher during the Q4 survey period than during the Q2 survey period. Investors seem open to reducing the real estate premium to place excess capital. The timing is excellent for institutional and private equity funds, who waited on the sidelines during the REIT acquisition frenzy, to use the accumulated capital to get their hands on prime assets.



Results for Tier 1 Regional Malls this quarter illustrate this. The most preferred asset class on the Altus InSite barometer of investor preference has seen its OCR compressed in all markets between Q3 and Q4, with a national average of 5.08%, the lowest ever recorded. Year over year compressions were significant in the Tier 1 Regional Mall category, which stood at 5.30% in Q1 2013. While Multiple Unit Residential also recorded its lowest 8-city average cap rate in Q4, at 5.03%, there is only a small difference between the Q1 and Q2 2013 results (5.06%). If we look at the 10-year historical trend for Vancouver Suburban Multiple Unit Residential, one of the most aggressively priced asset classes in the country, we can see the market has already bottomed out in terms of OCR and IRR in Q1 2013. Yet at $197,655 per suite, it has reached its highest price ever recorded.



The downtown class AA office market has remained relatively stable. Halifax and Vancouver recorded no movement in the last 3 quarters, holding at 6.4% and 5.0% respectively. After a modest hike in Q3, OCRs for Toronto, Ottawa and Calgary are back to Q2 levels, while Montreal and Quebec City kept the 10-point increase recorded in Q3. The survey also reveals modest Face Rate increases for the downtown Class AA market of most Canadian cities.



Results for Single Tenant Industrial indicate a stable 8-city OCR average hovering between 6.33 and 6.36 over the last five quarters. While each of the markets were stable, the national average conceals wide variances between Western and Eastern Canada. The lowest average price per square foot are found in Quebec City ($80.00) and Montreal ($83.00), while Vancouver ($129.00) and Edmonton ($126.00) command much higher prices.

What to expect from 2014

The survey results clearly show that speculation surrounding interest rates and monetary policies have a direct impact on real estate investor outlook and expectations on values. The survey results in the second half of 2013 reminded us that real estate, while providing a stable and safe investment vehicle, is not immune to financial market upheavals. And yet, amidst changing financial parameters, the market still flows with an abundance of capital looking for limited quality investment opportunities. With REITs consolidating, well-capitalised private and institutional investors now have more room to manoeuvre in the current market conditions and investment activity remains relatively strong in spite of higher GOC bond yields. Looking forward to 2014, we can see the downward trend in rates of return "tapering" off, as will the U.S. Federal Bank's Quantitative Easing Program.

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.