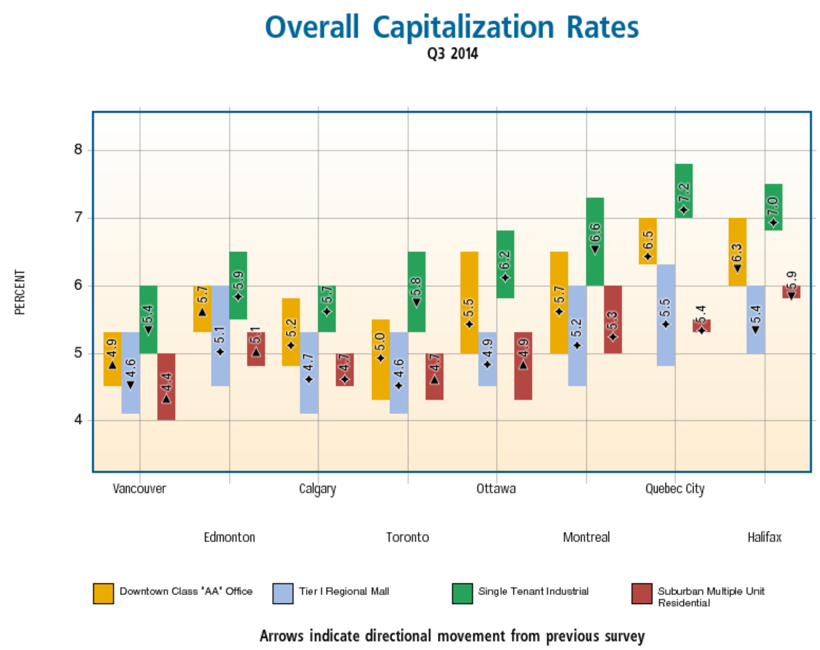
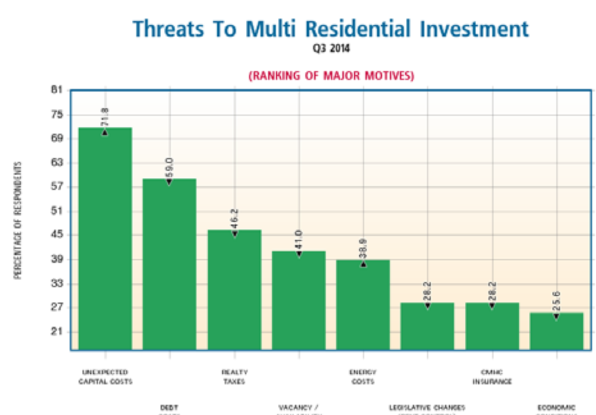
Latest Altus InSite ITS Results Support View that Cap Rates have Plateaued

Altus InSite Investment Trends Survey national Cap Rate (OCR) average has reached an all-time record low of 5.47% for Q3 2014, a small three-basis-point compression from the 5.50% average reported in the previous quarter. Over the last year, the eight-city, four-property-type OCR average has compressed by a mere six basis points, from 5.52% in Q4 2013 to 5.55% in Q1 2014 and from 5.50% in Q2 2014 to 5.47% in Q3 2014. These results signal that the long-running trend of declining OCRs and IRRs has perhaps run its course.

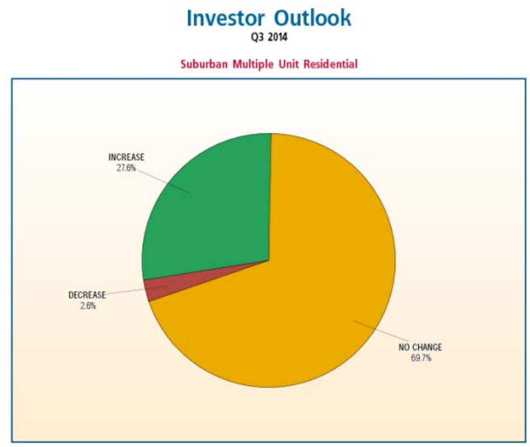
While it is too early to predict an increase in expected returns, some assets and markets have registered small upward movement, others continue to slide by single-digit basis points. After increasing by six basis points between Q1 and Q2 2014, Tier 1 Regional's eight-city OCR average compressed by six basis points this quarter. Single Tenant Industrial benchmark properties registered the largest compression in the cap rate, from 6.34% last quarter to 6.23% this quarter, dropping below 6.30% for the first time since the survey began in 2000. Downtown Class AA office markets showed mixed results with three markets, Vancouver, Quebec City and Ottawa, showing no change since last quarter, four markets registering modest OCR compressions and one market (Edmonton) moving up.



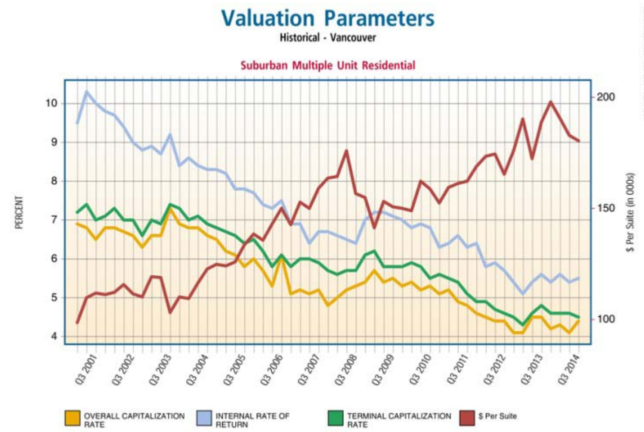
The most noticeable change can be seen in the results for the Suburban Multiple Unit Residential Market, which has seen its national average OCR increase by nine points since last quarter. All cities are moving upward except for Quebec City (down 10 points), Halifax and Calgary (no change). Montreal, Toronto and Ottawa all registered a 10-point increase, while Edmonton and Vancouver saw their average increase by 20 points and 30 points respectively.



Several factors can explain this modest increase in cap rates on the Multi Residential Market. According to the survey, respondents ranked Unexpected Capital Costs and Debt Costs as threats to Multi Residential Investments as the two largest threats to investment. Realty Taxes, Vacancy/Availability and rising Energy Costs were also cited as a threat by approximately 40% of respondents. However, the OCR increases noted this quarter for Suburban Multiple Unit Residential are recent and it is too early to predict a trend. It is worth noting that only 3% of respondents expect that values for this asset class will decrease over the next 12 months while almost 70% of investors surveyed expect stability and 27.6% expect further value increases.

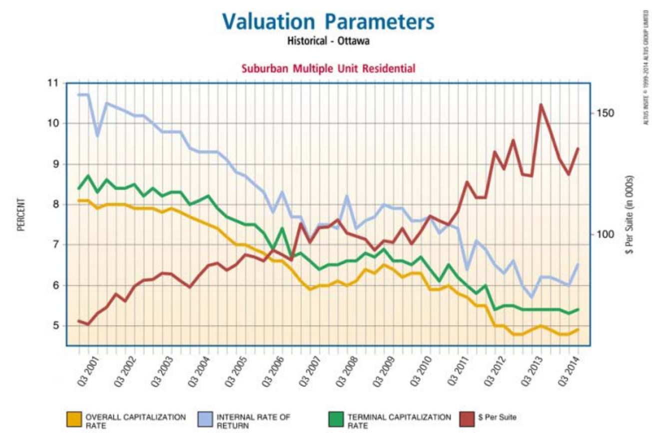


Patterns are also quite different when comparing different cities. In the charts below, while the three fully priced markets: Vancouver, Toronto and Ottawa, all showed signs of stability, the minor fluctuations were different in each market. All results show that the rise of bond yields in August 2013, when the Q3 2013 survey was conducted, did have a small yet noticeable impact on real estate investor outlook and expectations. Vancouver was the first market to start stabilizing with record-low OCRs and IRRs in Q1 2013, more than 18 months ago.

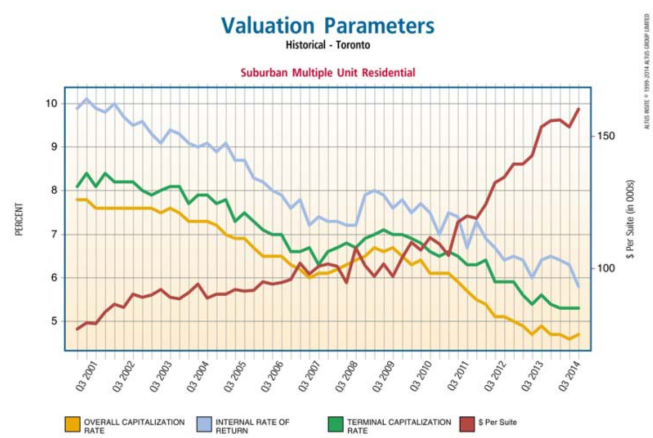


A Shift from Cap Rate Compression to Operational Excellence

For more than a decade declining capitalization rates have enhanced values and returns for virtually all commercial real estate investors. The opportunity to continue to ride the wave appears highly unlikely as cap rates in most markets and for most asset classes plateau.



The survey results still consistently show minor reductions in rate of return for most asset classes but the compression trend seems to have run its course. While higher interest rates, when and if they start to increase, foretell of a minor and gradual upward trend in OCRs and IRRs, possibly beginning in June 2015. Even in the event of increasing cap rates, capital remains plentiful and investors will still be looking for safe, high-return alternatives such as commercial real estate. Value creation in this space can no longer depend on easy capital gains and will require increasing income properties' net operating income. With the era of riding the wave of cap rate compression drawing to a close, future returns and the ability to out-perform the market will require operational excellence.



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.