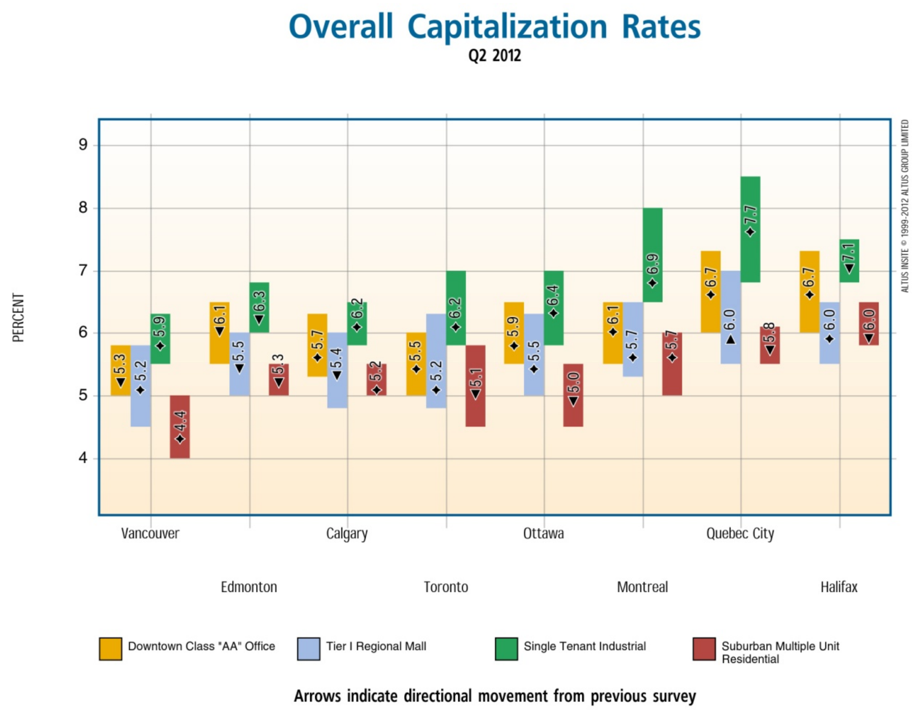
Altus InSite

Q2 2012 Investment Trends Survey Summary Outlook

Steady yet Modest Cap Rate Compression

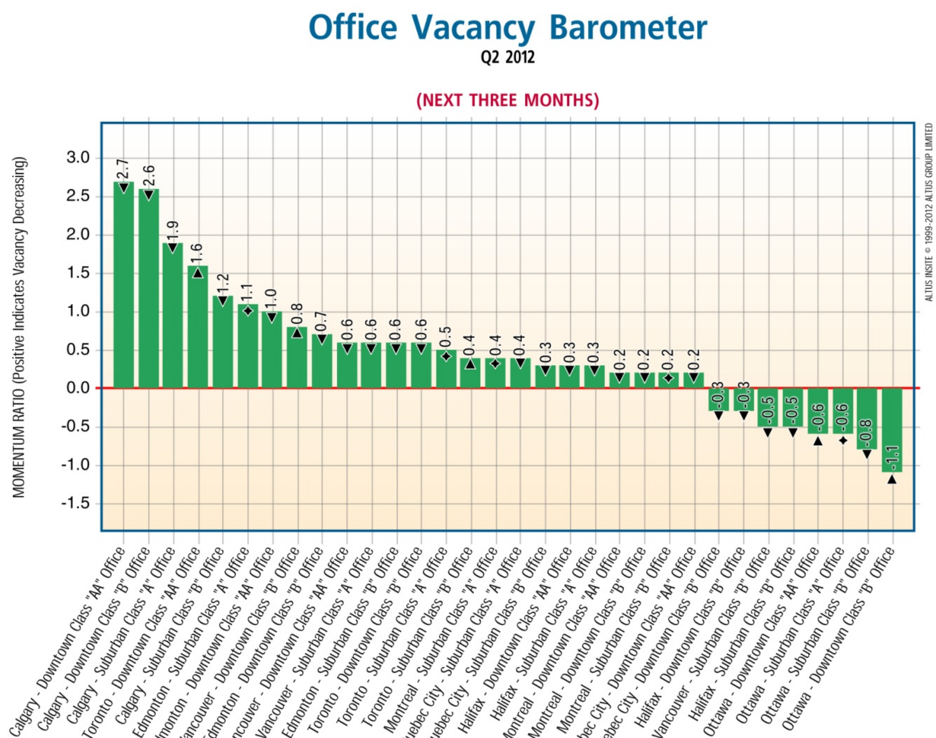
Altus InSite's Q2 2012 Investment Trends Survey results indicate that the recent bull cycle in the Canadian commercial property market has yet to cool off. Yields have not compressed to the point of causing investor discomfort and the market has seen several notable transactions in this quarter. However, projected growth assumptions in terms of rental rates and values seem to have scaled down from those in the previous quarters.



In terms of yield expectations, the graph above clearly demonstrate OCR compressions (▼) for 11 of the 32 benchmark products/locations, while practically all other asset classes show stability (♦) compared to the previous quarter. The greatest compression, quarter over quarter, in the order of 10 to 30 bps was in respect of Class "AA" office and Tier I Regional Mall. More significant is that for a number of products and locations, OCRs are now lower than those reported in the last market peak in Q2 2007. This is a clear signal that the current market cycle has yet to bottom out and that yields continue to compress, primarily due to the historically low interest rate environment.

Declining Office Vacancy

The Office sector has rebounded in popularity during the last 21 months, but the Q2 2012 Office Vacancy Barometer, a forecast of office vacancy trends, indicates some signs of retrenchment. Weaker results are indicated for all locations except for Downtown and Suburban Calgary, which have seen a dramatic drop in vacancy as a result of increased employment activity in the Oil and Gas sector. Most caution is expressed for the office sector in Ottawa, where Downtown and Suburban office vacancy is projected to increase over the next three months. Vacancy is also expected to increase in Suburban Class "B" Office in Vancouver and Halifax. The most significant observation is that for nearly all locations and office classes, the outlook is in a decline of vacancy.



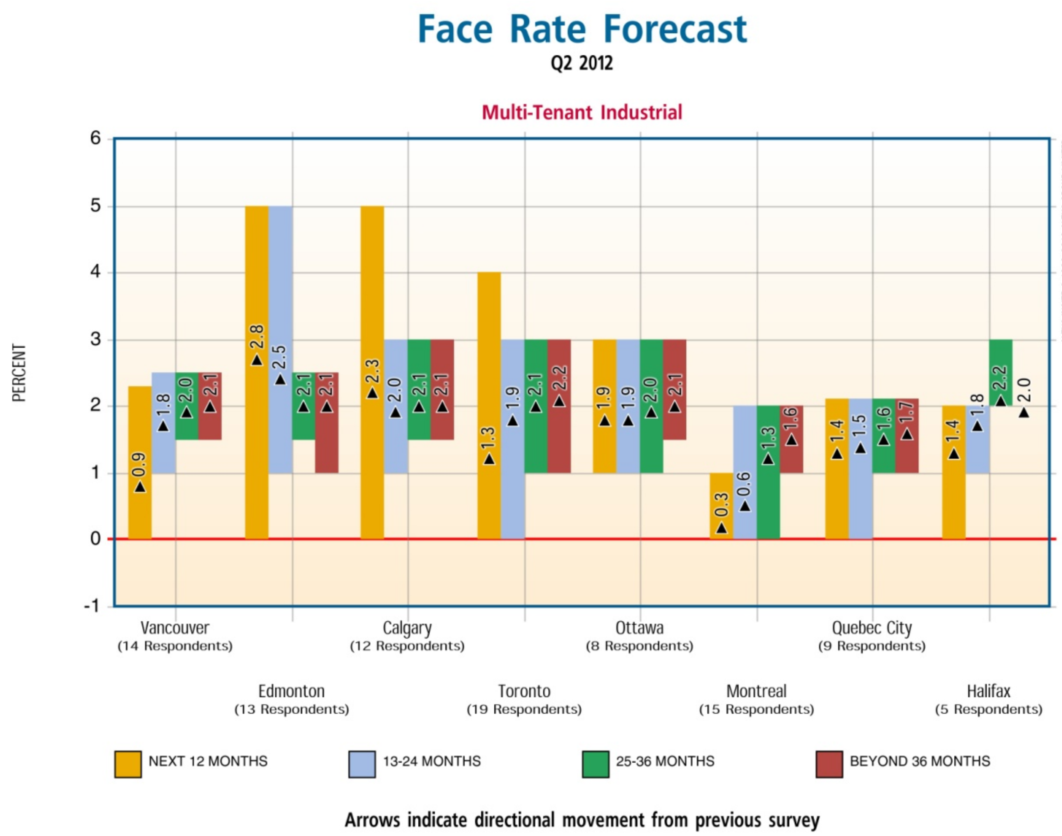
OCRs for Class AA Office now range from 5.3% in Vancouver to 6.7% in Halifax. In all locations, OCRs now equal or surpass those reported at the height of the last cycle in Q2 2007. For example, in Vancouver, the OCR last peaked in Q2 2007 at 5.7% and currently sits at 5.3%, a full 40 bps lower.

Retail more Popular than Industrial, again

The change essentially in this quarter is that investor preference is moving back to retail products as they might be less optimistic about the other alternatives such as Industrial and Office. Tier I Regional Mall and Food Anchored Retail Strip products are in the top two positions in terms of product preference this quarter. These products are considered ‘safer’ assets given the consumer oriented nature of the tenancies that tend to be inelastic to vagrancies of the economy. OCRs range from 5.2% to 6.0% for Tier 1 Regional Mall across the nation with lowest rates indicated in Vancouver, Calgary and Toronto, the three largest markets for this product.

Industrial Investments

Industrial properties continue to remain strong overall, but an obvious change in this quarter survey indicates a declining momentum ratio for the product in most markets, once again confirming the overall sentiment to slow down from earlier frenzy for industrial products. In terms of yield requirements, the OCRs and IRRs for Multi-Tenant Industrial appear to be on a downward shift for the large part across most markets. The spread in the two rates is generally around 100 basis points suggesting moderate growth and stabilization in this product.



In terms of face rate forecasts the accompanying chart indicates a very positive upward trend in rates over the next 12 months and beyond in all markets. Calgary and Edmonton markets expect the largest percentage in growth rate in next 12 months, averaging 2.5% increase, not surprising given the strong positive correlation of this product with the oil sands activity, longer term growth projection are more modest, suggesting similar growth projections for most major markets across the country.

Stable and Predictable Multiple Unit Residential

This asset class remains one of the most stable property investment types and usually produces the lowest yield rates in our survey. The reported yield in terms of OCRs for Suburban Multi Residential ranges from a low of 4.4% in Vancouver to a high of 6.0% in Halifax. This asset class remained a "sought after" group as vacancy has been constantly declining nationwide. This product continues to retain its top ten position on the product preference barometer; although it has receded to the bottom as higher yielding investment products have taken front seat over the past three quarters with gradual economic recovery in the country.

The Canadian market continues to benefit from low interest rates, a shortage of supply in certain sectors and an imposed discipline in the commercial development sector. The Investment Trends Survey reports a continued compression in yields albeit at a more modest pace than in the previous quarter. The risk of increase in interest rates always remains as an overall market threat. Overall the sentiment appears to be cautiously positive.

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.