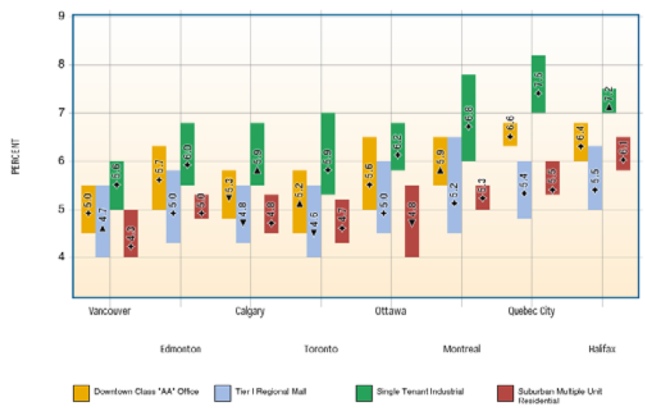
After a Decade of Compression, Cap Rates were Stable Last Year with No Big Changes Anticipated for Next Year

Investors' expectations for Cap Rates in Q1 2014 are the same as they were exactly one year ago, as reported by most recent Altus InSite Investment Trends Survey results. With the exception of the Q3 2013 survey, which was conducted in mid-August in the midst of market speculation based on sudden BOC increase in yields, average OCRs have remained flat over the last year.

Demand for real estate remains strong and the pressure to place capital continues to attract investors to the safe and stable Canadian market. Financing is still relatively cheap and plentiful. But these favorable conditions are no longer enough to push prices up. Generally speaking, the market has reached a plateau and creating value is now more a question of improving NOI and asset performance than about opportunities created by a mix of financial market conditions. Cap rate compression over the last year was too small to make a big difference: according to the Investment Trends Survey results, the average 8-city, 4-benchmark-asset-class OCR compressed by only 7 points between Q1 2013 and Q1 2014. This was significantly less than the 35 points of compression between Q1 2012 and Q1 2013.

Overall Capitalization Rates
Q1 2014



Arrows indicate directional movement from previous survey

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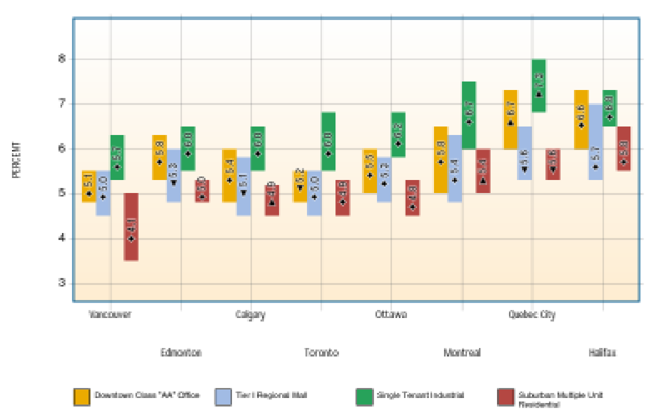

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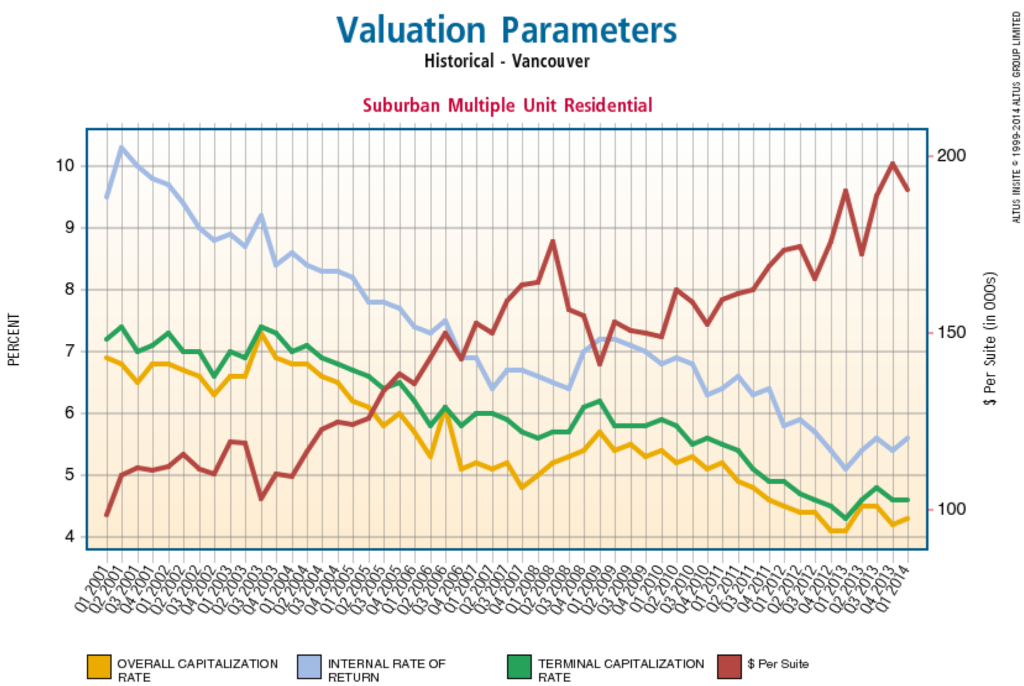
As always, the averages are dangerous. Results vary from one asset class to another. Tier 1 Regional Malls average OCR compressed by almost 30 points in the last year, and another 30 points the previous year. Downtown Class AA Office cap rates compressed by only 5 points since Q1 2013, compared to 30 points of compression the year before. Depending on the city, the average OCR for Single Tenant Industrial has either compressed by 10 points or increased by 10 points since Q1 2013, for a country-wide average increase of 5 points (compared to 38 points of compression during 2012). The national average for the Suburban Multiple Unit Residential market recorded no change between Q1 2013 and Q1 2014. Not a single point…

It is still too early to predict that values in general will decrease. Comparing Q1 2014 national results with Q1 2013 results indicates not only a trend in stabilising cap rates but also less market consensus, illustrated by the differences in the height of bars on the two graphs, which represent the range between the minimum and maximum survey responses. The Q1 2014 ITS Survey Results reflect recent transactions analysed by the Altus Group, which point to stable values and cap rates, although deals now seem to take longer to close.

Values of most asset classes have now been stable for many quarters and some have even started to climb slowly. As shown in the graph below, Suburban Multiple Unit Residential in Vancouver, one of the most, if not the most, expensive asset classes in the country has seen its average OCR reach a bottom at 4.1% in Q1 2013 and has been trending upward since.



The Canadian real estate outlook for the next 12 months now calls for stability in values, as compared to a more positive outlook a year ago. Canadian investors, when questioned for the Q1 2014 Altus InSite Investment Trends Survey (ITS) on eight property types, expressed the following expectations: value increases, 17% vs. 29% one year ago; stable market, 68% vs. 65% one year ago; and value decreases, 15% vs. 6% one year ago.

We view the Q4 2013 and Q1 2014 results as an indication that the decade long pattern of declining cap rates has halted.

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.