

Emerging Trends in Canada

“In Canada, real estate behaves as advertised, producing steady cash flow-oriented returns without much volatility, but an **ownership hold mentality** frustrates investors looking for opportunities to buy.”

Canada barely experienced recession and jolted into a V-shaped recovery. Now, 2011 promises slowing, steady growth and decent prospects for real estate investors as long as the U.S. economy does not drag them down. “Relieved” Canadian property owners and financial institutions cannot help contrasting their reasonably healthy condition with parlous U.S. markets. Fundamentals trend near equilibrium, “employment bounces back,” and banks boast sound balance sheets. Most industries experience growth, including finance and energy, which helps support the service sector. “The domestic consumer has been pushing the economy, and jobs levels bounced back to prerecession levels. It’s been phenomenal compared to the U.S.”

Investment Prospects

U.S. Connection. Recent experience puts “Canada in a better place” and boosts confidence “that we can escape U.S. problems.” Always linked to its more populous southern neighbor, the nation “tries to diversify” beyond a dependence on U.S. exports, extending trading relationships to Europe and Asia, particularly China. Still, a weak U.S. greenback and sputtering U.S. economy dampen cross-border commerce, hurting especially Ontario industrial markets, which serve Midwest manufacturing centers.

No Distress. The big difference for Canada has been the sound condition of its banks—“you can get a loan for anything”—since lenders maintained relatively strict underwriting standards and never were sucked into the CMBS maelstrom.

“We have no distress—no distressed banks, no distressed owners, no distressed sales.” Now, rising interest rates coupled with tight bank requirements tamp down a recent home-buying spurt, particularly in Ontario and British Columbia, where purchasers stepped up activity before a new sales tax went into effect.

EXHIBIT 5-1
Firm Profitability Forecast

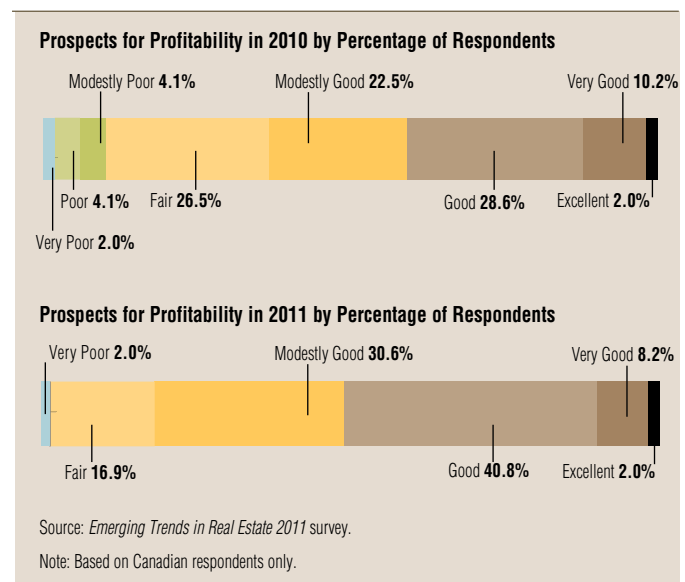
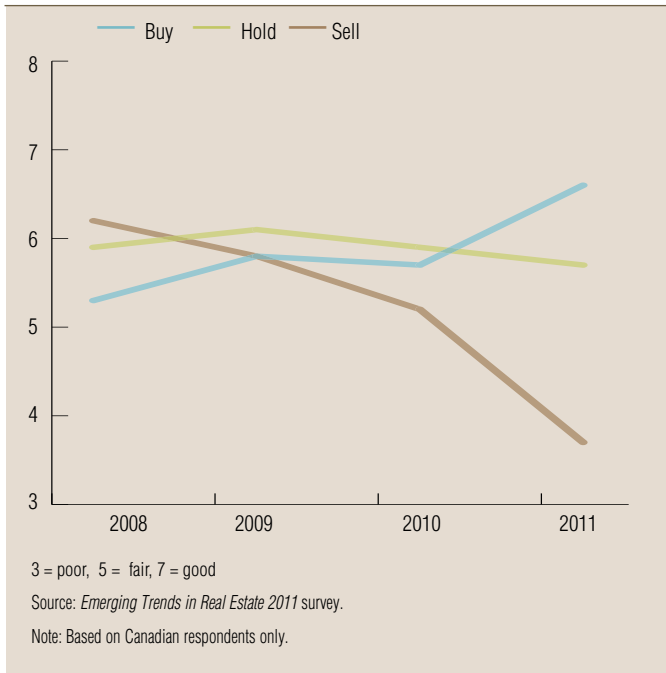


EXHIBIT 5-2

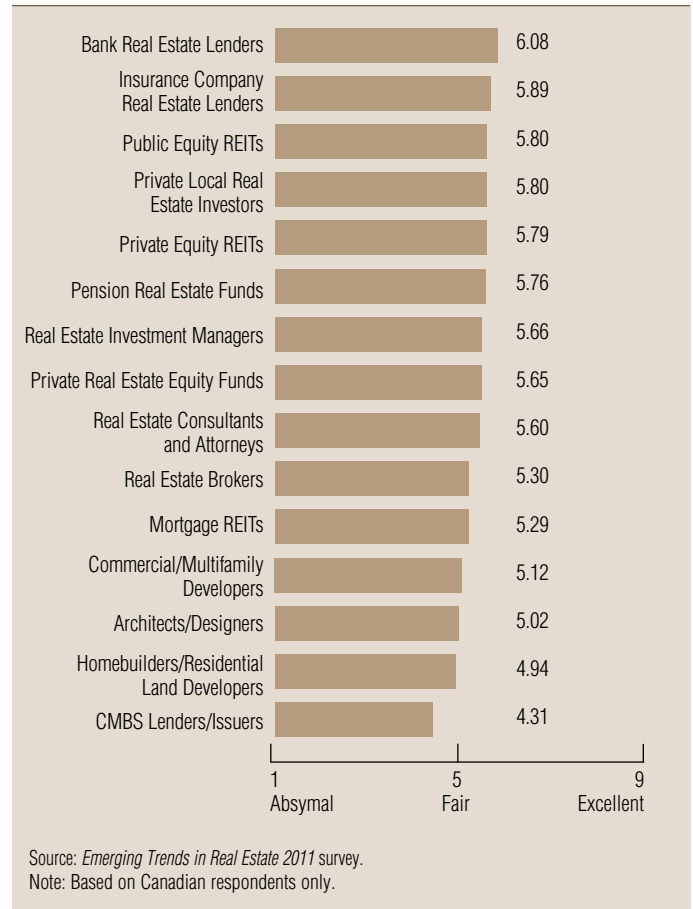
Emerging Trends Barometer 2011



Investment Malaise. For 2011, “fundamentals should be okay, not great.” Capital is back—“all the savvy players have dry powder”—and (as usual) investment opportunities will be limited; institutions dominate the major central city markets, holding on to assets for steady income instead of trading. *Emerging Trends* respondents exemplify the hold-on mentality: they think it is a good time to buy, but do not want to sell (see exhibit 5-2). “Bids are strong,” says a broker, “but nothing’s for sale.” Investors “go crazy because there isn’t anything to buy,” and try to show discipline by walking away rather than overpaying for what is available. They have only slim chances to land discounted bargains—maybe off market in a fringe suburban district or a hotel where the owner has cash-flow problems. In this “compressing cap rate” environment, many deal-starved Canadians will be active in the United States, where they should have greater opportunity to spend their bankrolls and find higher yields.

EXHIBIT 5-3

Real Estate Business Prospects for 2011



Restrained Development. Except in Calgary, Canada’s version of Wild West hot growth, builders have not overstepped. Imagine: “no large developers have gone bankrupt” in the country. North America’s largest condominium market, Toronto keeps erecting high rises, but a greenbelt boundary to encourage denser neighborhoods helps support urban residential development. Toronto probably needs to take a breather in new office construction: four major new buildings come on stream. And the country does not need much additional retail space. Ontario typically provides good industrial development opportunities, but until the U.S. economy strengthens, sluggish demand does not support much new building. Pushed by municipal policies and code changes, Canadian developers increasingly buy into green building trends: “Anyone who doesn’t embrace it will be economically imperiled.”

EXHIBIT 5-4

Prospects for Capitalization Rates

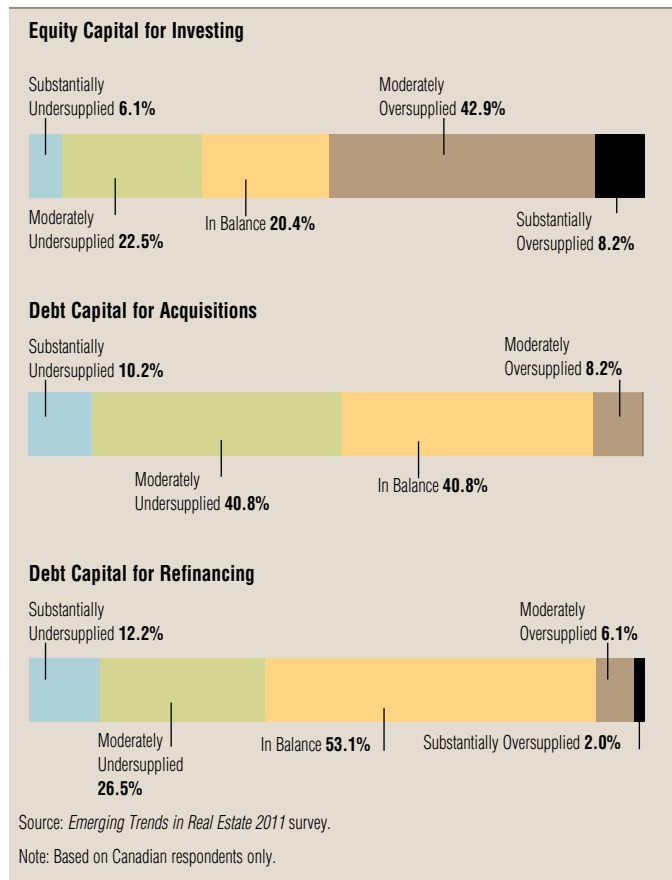
Property Type	Cap Rate August 2010 (Percent)	Expected Cap Rate December 2011 (Percent)	Expected Cap Rate Shift (Basis Points)
Apartment Rental: High Income	5.92	5.74	-19
Apartment Rental: Moderate Income	6.24	6.06	-18
Central City Office	6.46	6.35	-10
Power Centers	7.01	6.66	-35
Neigh./Community Shopping Ctrs.	7.28	6.87	-41
Regional Malls	6.77	6.89	+13
Suburban Office	7.41	7.34	-7
Warehouse Industrial	7.58	7.56	-2
R&D Industrial	7.76	7.77	+1
Full-Service Hotels	8.67	8.68	+1
Limited-Service Hotels	9.15	8.98	-16

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

Capital in Balance

Canadians admirably restrain any national gloating, but they can lay claim to having one of the world's healthiest capital markets. "Liquidity is back; no one's hard pressed." Except for some hotel owners, few borrowers confront refinancing issues. "In Canada, the real estate industry didn't get over-levered," and the markets never suffered any interruption of credit availability. Canadian banks benefit from a combination of institutional risk aversion and relatively stringent government regulation. Bankers prefer to credit their own discipline rather than regulator oversight: "We have fear of losing money." For whatever reasons, the system works, and the country and its consumers have "no credit hole to dig out of." During the past several years, "very cheap debt" propelled housing prices, but recent government interest rate hikes discourage further bubble formation, and lenders never sold exotic mortgage structures. Overall in 2011, *Emerging Trends* respondents expect a reasonable balance in debt market capital availability and an oversupply of equity capital, the result of nonsatiated buyers (see exhibit 5-5).

EXHIBIT 5-5

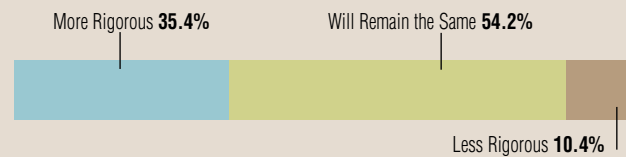
Real Estate Capital Market Balance Forecast for 2011

Insurers and Pension Funds. A dominant handful of large insurance companies and public pension funds, which link liabilities to steady property cash flows, will continue to command ownership of the country's trophy commercial assets—downtown office space and regional malls. This story does not change.

REITs. Prices leveled off after strong run-ups in 2009. For 2011, analysts do not see "much room for big gains," and these stocks should stick close to valuations. Managements "can't significantly improve cash flow generation," but returns should be solid.

EXHIBIT 5-6

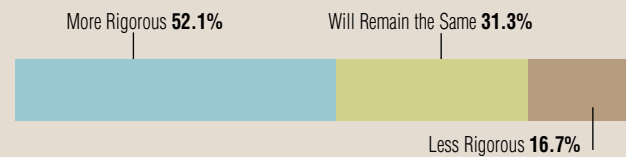
Equity Underwriting Standards Forecast for Canada



Source: *Emerging Trends in Real Estate 2011* survey.
 Note: Based on Canadian respondents only.

EXHIBIT 5-7

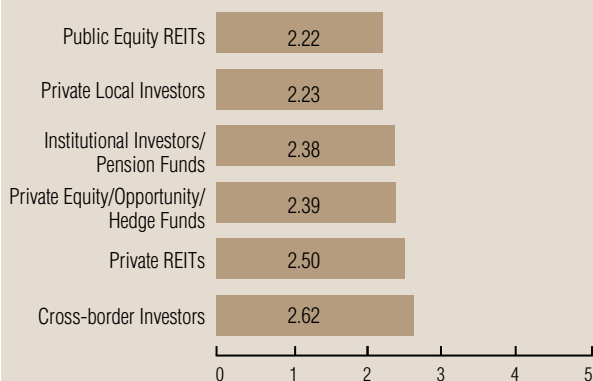
Debt Underwriting Standards Forecast for Canada



Source: *Emerging Trends in Real Estate 2011* survey.
 Note: Based on Canadian respondents only.

EXHIBIT 5-8

Active Buyers/Acquirers of Real Estate in 2011

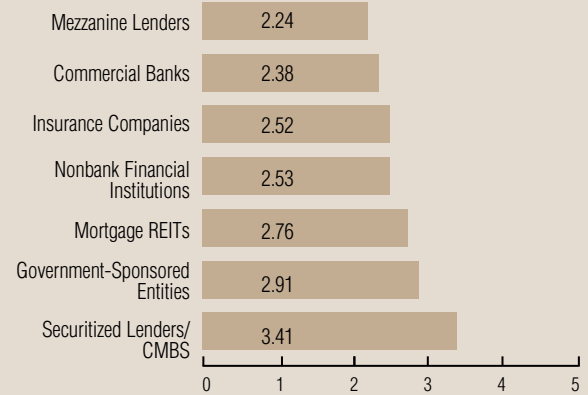


1 = strongly agree, 2 = agree, 3 = undecided, 4 = disagree, 5 = strongly disagree

Source: *Emerging Trends in Real Estate 2011* survey.
 Note: Based on Canadian respondents only.

EXHIBIT 5-9

Active Providers of Debt Capital in 2011

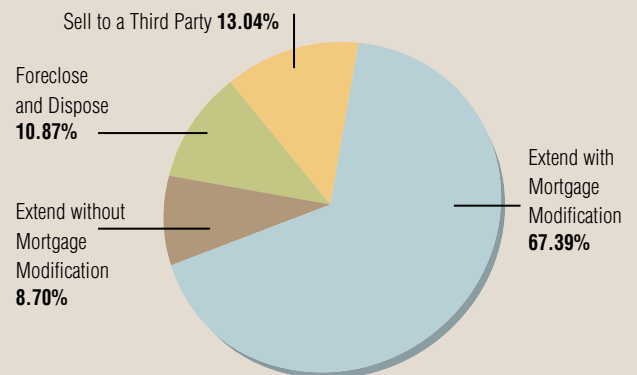


1 = strongly agree, 2 = agree, 3 = undecided, 4 = disagree, 5 = strongly disagree

Source: *Emerging Trends in Real Estate 2011* survey.
 Note: Based on Canadian respondents only.

EXHIBIT 5-10

Preferred Strategy for Lenders



Source: *Emerging Trends in Real Estate 2011* survey.
 Note: Based on Canadian respondents only.

Foreign Investors. If it is not hard enough for domestic investors to find good acquisition opportunities, foreign players struggle even more to break in. "It's just hard to buy in Canada with markets dominated by a few players, so offshore investors can't build portfolios easily."

EXHIBIT 5-11

Canadian Markets to Watch

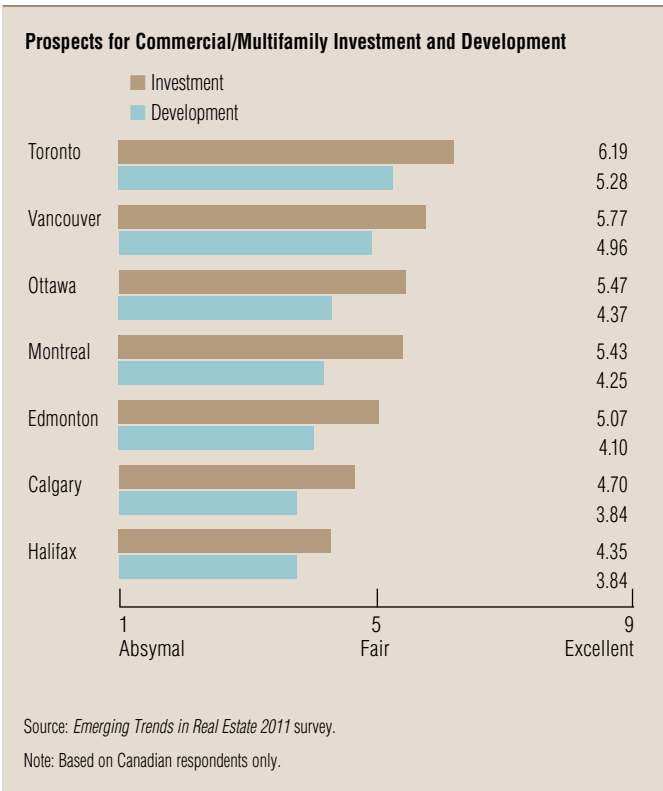
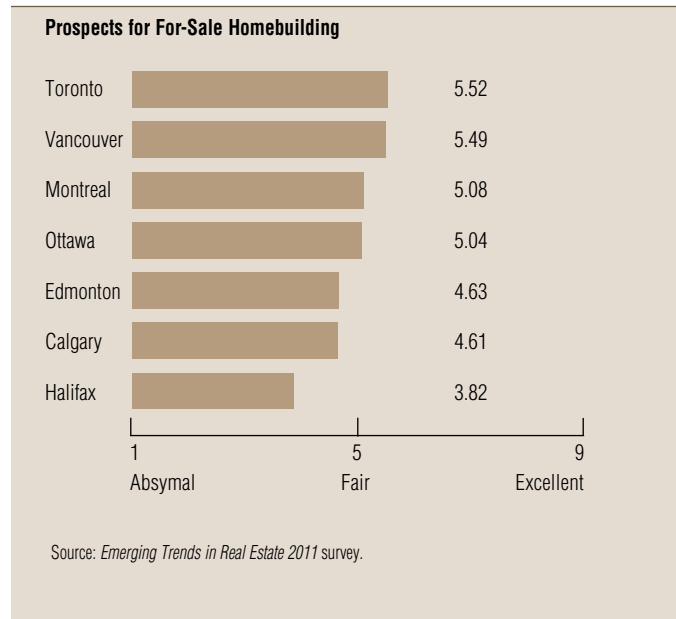


EXHIBIT 5-12

Canadian Markets to Watch Prospects for For-Sale Homebuilding



Markets to Watch

For 2011, major Canadian real estate markets settle in a fair to good investment range, with only modest investment prospects and constrained development potential. Toronto bumps Vancouver from the top ranking in the *Emerging Trends* survey, while Calgary must hope to recuperate from cooled demand and a touch of development binging. Population continues to concentrate in and around a handful of major 24-hour cores scattered from coast to coast, leaving extremely limited investment opportunities in small cities and rural areas in between. Shut out of primary cores, some investors scrounge for product in select secondary and sub-urban markets.

Toronto. Canada’s “where-to-be market,” Toronto stands out as a primary North American gateway and the country’s most important economic engine. This vibrant metropolitan area radiates “lots of positives”—the rock-solid Bay Street financial sector and diverse manufacturing industries and service

businesses, as well as immigration flows to support growth. “We’re hard to slow down.” Some softness creeps into the office market as major tenants “play musical chairs” and move into new Class AAA development projects. No one gets too worried about vacated buildings because institutional owners will spend the necessary money to upgrade, reposition, and release space into future demand. Market vacancy will not increase materially above the current mid-single digits, and any near-term additional office development will be “small and niche.” Observers wonder how the condo market just keeps expanding: new apartment projects pop up in all directions, fashioning one of the world’s most expansive vertical skylines. Provincial policies encourage density in high-rise development south of a legislated greenbelt, which pressures demand. “We need approximately 40,000 new housing units to keep pace with population growth, but new projects provide less than 20,000.” Smart money figured out “you can make a ton on infill land parcels,” and anything near transit stations looks like gold. However, opportunities are few: “If you’re already in the game and own, you can make a lot of money; if you’re not, it may be impossible to get in.” Some interviewees worry about flattening apartment rents as a surfeit of condo investors lease out units. High housing prices and immigration flows help make apartments a good bet. Investors retain interest in

EXHIBIT 5-13

Canadian Apartment Buy/Hold/Sell Recommendations by Metropolitan Area

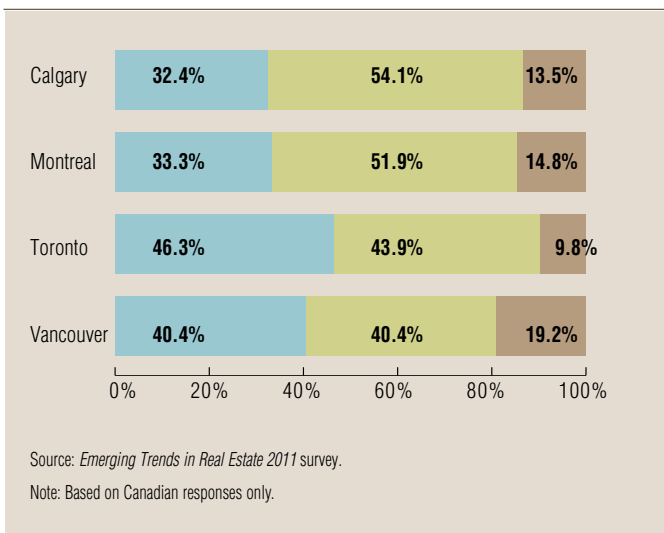


EXHIBIT 5-15

Canadian Retail Property Buy/Hold/Sell Recommendations by Metropolitan Area

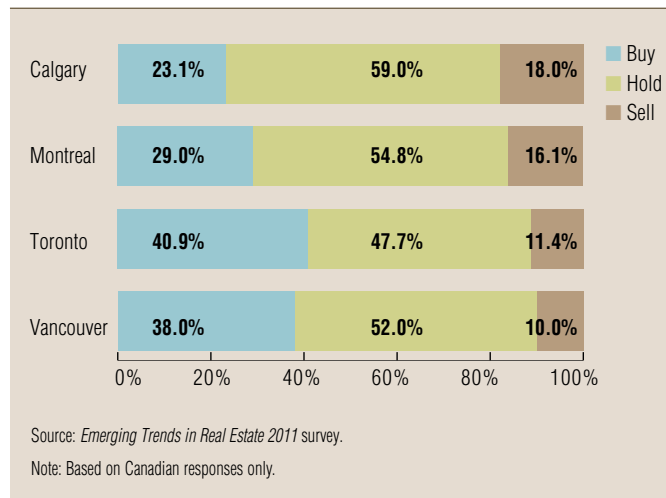
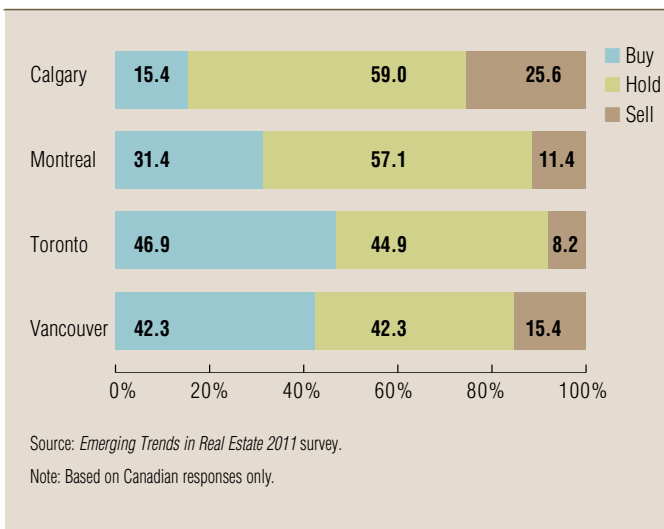


EXHIBIT 5-14

Canadian Office Property Buy/Hold/Sell Recommendations by Metropolitan Area



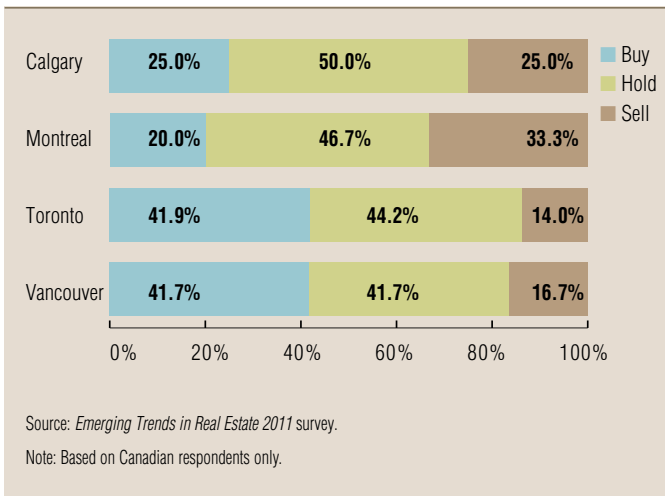
buying and holding industrial properties, which should recover from higher-than-average vacancies and rent declines once the United States gets untracked.

Vancouver. “Office and condo markets almost defy logic”; they stay “red hot.” Instead of experiencing a post-Olympics dip, the city caught the attention of well-heeled international visitors, who stuck around and bought apartments after the games. “Everybody wants a view and waterfront location, but not everybody can afford it.” Many wealthy Asians park money and look for a path to eventual citizenship. Institutional investors control the relatively small office market, which enjoys minuscule vacancies. Surrounded by water and mountain vistas, Vancouver’s natural barriers control development and attract investors—a powerful combination. But some interviewees grow uneasy: “The market is artificially inflated; it’s been too hot for too long.” A new provincial sales tax raises costs and temporarily cools demand for midtier housing in some areas outside the core.

Ottawa. Canada’s federal center offers low risk and little upside. “Nothing much changes.” The government does not downsize, but the Canadian capital will never attract the same lobbying intensity or contractor-related business drawn to Washington, D.C.’s much more vast bureaucracy and

EXHIBIT 5-16

Canadian Industrial/Distribution Property Buy/Hold/Sell Recommendations by Metropolitan Area



military/life sciences–related enterprises. A new convention center opens next year and could provide a potential market lift, especially for hotels and retail.

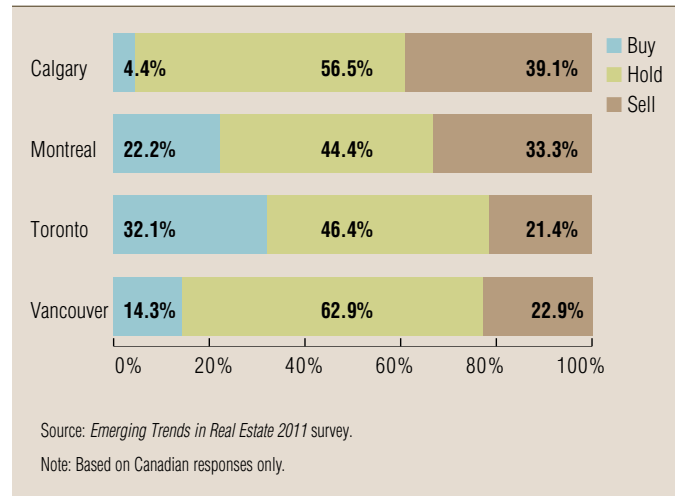
Montreal. Investors tend to short-shrift “slow and steady” Montreal in comparison with Toronto and Vancouver, but the market holds its own. “It’s a good value” with “better yields.” Besides mainstay Quebec provincial government offices, the city features a fairly diversified economy, including aerospace and financial services.

Edmonton. Edmonton “comes off a boil,” avoiding the level of oversupply that deflates Calgary. Oil services businesses thrive because Canada strengthens its position as a leading supplier of oil and gas to U.S. markets. Locals expect positive impacts to filter through the economy, including employment growth.

Calgary. This market behaves more like a U.S. Sunbelt metro area than the typical Canadian 24-hour city. Sprawl and overbuilding “temporarily” subdue outlooks, but “absorption will come.” Developers retreat in the face of high vacancies and show no appetite for new office projects. Locals put faith in robust commodities markets and U.S. consumption of oil from tar sands. “We may have a dirty process, but not comparable

EXHIBIT 5-17

Canadian Hotel Property Buy/Hold/Sell Recommendations by Metropolitan Area



to what happened with BP in the gulf.” Expect spreading hot growth to resume in coming years; voters rejected a high-density-development greenbelt modeled after the one in Toronto.

Halifax. Off the radar screens of the big institutions, Halifax muddles along in slow growth mode. The Maritime Provinces fail to draw much new population and industry.

Property Types in Perspective

Reflecting modest expectations, property sector ratings improve over last year’s tepid forecasts, especially for apartments and offices. Retail and industrial hold up, but hotels suffer from reduced U.S. tourist travel. Commercial markets promise to deliver cash flow but not much appreciation, while housing prices could ebb after an unsustainable surge. Most investors take heart in consistent metrics from markets, which linger in reasonable equilibrium; it beats writedowns, defaults, and foreclosures.

Apartments. Owners do not sell, and buyers bid up any multi-residence deal that comes to market—even older product. “You can’t wrestle anything away from all the mom-and-pop landlords.” Immigration fuels “high” tenant demand, while operators “fatten bottom lines” with cost controls, and overbuilding is a nonissue. Buying REIT stocks may be the

best way to get a piece of this action. Some investors grow concerned about deferred maintenance on aging stock: “You need to factor capex into pricing.”

Office. Occupancies trend well over 90 percent in all major markets except Calgary, where vacancies settle in the relatively manageable low teens. Even the best U.S. markets cannot come close to approaching these healthy supply/demand fundamentals. Rents generally stay in a narrow range without significant growth drivers. Pension fund owners “don’t like vacancies,” so they willingly make allowances in lease deals. In Canada, office investments behave the way core real estate is advertised, delivering reliable, income-oriented returns.

Retail. Shopping centers lease to capacity: “At 2 to 3 percent vacancies, they’re essentially full.” Low interest rates encouraged higher-than-normal levels of consumer debt, but most Canadians never caught credit fever and avoid going into hock. After only a mild recession, “we have decent consumer confidence and people feel good.” Several U.S. department stores consider expanding across the border—“reinforcing already-strong demand for space”—but find few pad options at potential mall sites. Development activity focuses on small projects in infill areas; urban retail is under-supplied with stores, but land is difficult to find.

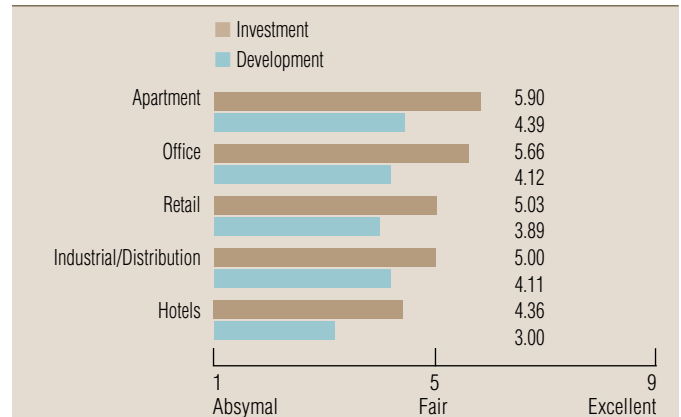
Industrial. Until U.S. exports increase, expect only “marginal improvement” in warehouse rents and occupancies, which begin to stabilize after a slump. “Owners work hard to fill empty space,” but most are not overleveraged and can persevere through the turbulence. Seemingly insatiable investor demand appears unaffected by market softness. If owners get in trouble, they have ready exits. In Ontario, some warehouse markets outside of Greater Toronto face greater challenges, particularly Windsor.

Hotels. Lodging-sector fundamentals show signs of life, but need a bigger lift from American visitors, who stay closer to home. Some borrowers cry uncle and bail, giving cash investors a rare opportunity for bottom feeding.

Housing. Interviewees expect house prices to level off and soften, possibly slipping 5 to 10 percent, after a solid run. Rising interest rates and higher sales taxes in Ontario and British Columbia douse buyer fervor. The market had taken advantage of “free money”; now it’s time to back off. Overseas purchasers buoy Toronto and Vancouver condo markets.

EXHIBIT 5-18

Prospects for Major Commercial/Multifamily

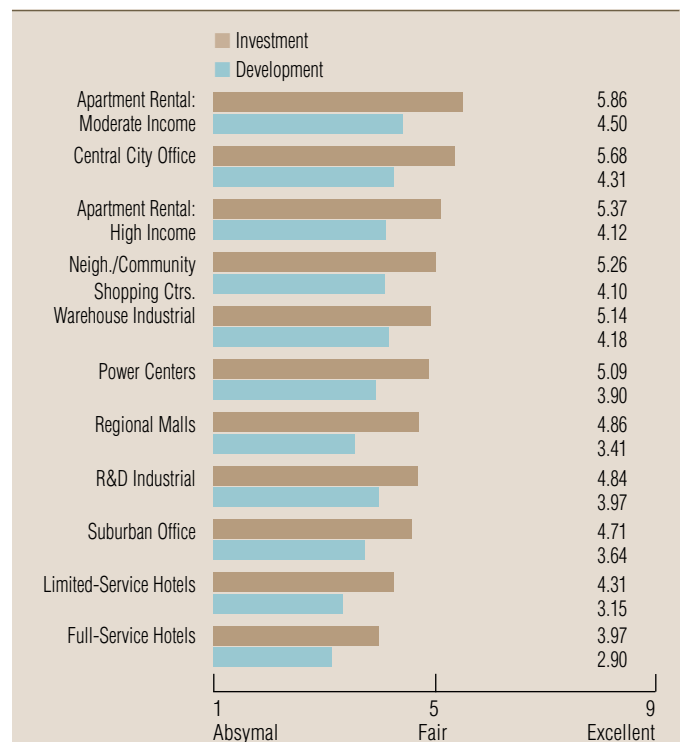


Source: *Emerging Trends in Real Estate 2011* survey.

Note: Based on Canadian respondents only.

EXHIBIT 5-19

Prospects for Commercial/Multifamily Subsectors in 2011



Source: *Emerging Trends in Real Estate 2011* survey.

Note: Based on Canadian respondents only.

EXHIBIT 5-20

Prospects for Residential Property Types in 2011

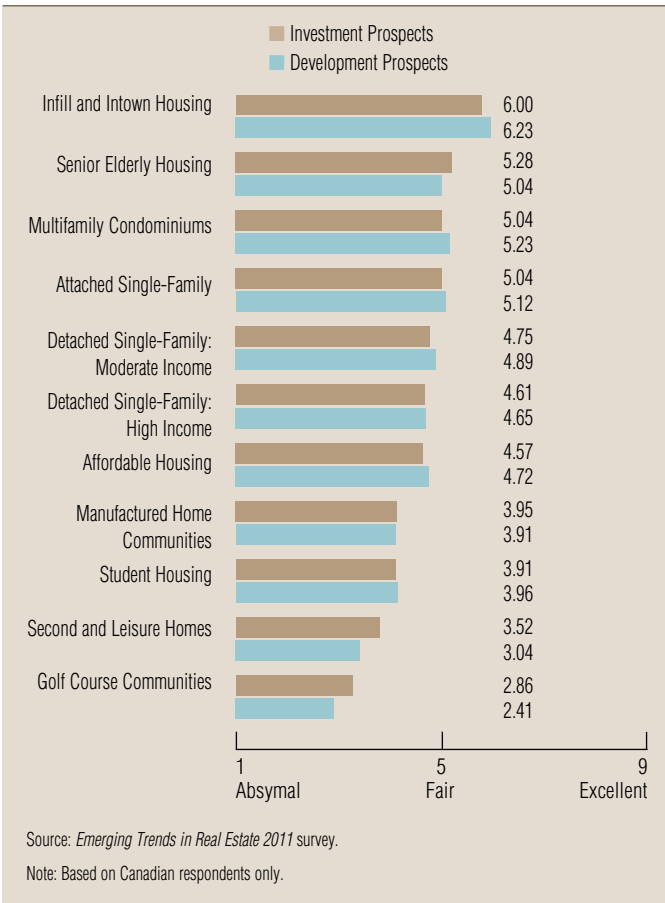
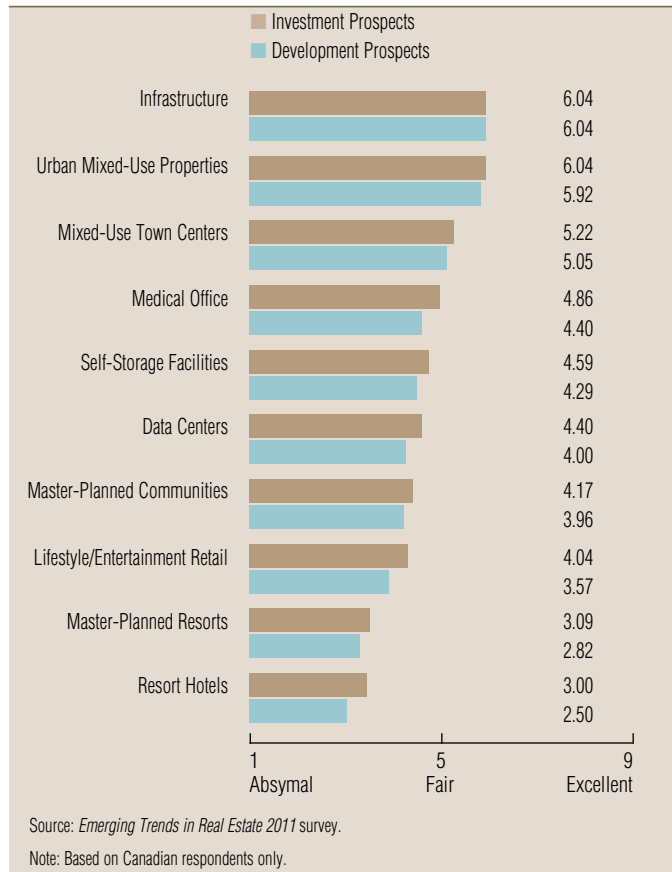


EXHIBIT 5-21

Prospects for Niche and Multiuse Property Types in 2011



Best Bets

- Winnow portfolios of select low-yielding assets and reinvest opportunistically in a U.S. market recovery.
- Time investments to the market and buy down-but-not-out center city hotels.
- Ditto on struggling industrial properties in the Greater Toronto area.
- Buy apartments if you can find anything available. "They offer the best security."
- Look for underperforming infill retail or commercial space, and position for redevelopment as condos. Canadian cities will continue to grow vertically as planners seek to encourage 24-hour environments.
- Husband land sites inside the Toronto greenbelt for future residential development; demand and pricing should continue to increase.

EXHIBIT 5-22

Canada: Downtown Office Vacancy—Class A Space

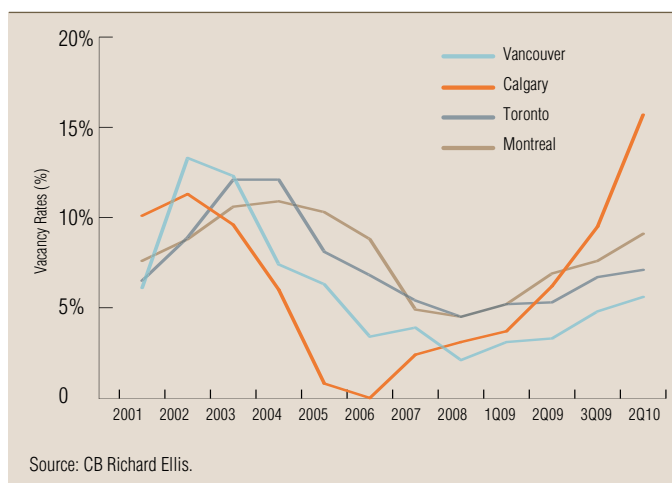


EXHIBIT 5-23

Canadian Central City Office

2011	Prospects	Rating	Ranking
Investment Prospects	Good	7.26	1st
Development Prospects	Modestly Poor	4.31	2nd
Expected Capitalization Rate, December 2011		6.4%	
Buy	Hold	Sell	
41.9%	46.5%	11.6%	

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-26

Canadian Neighborhood/Community Centers

2011	Prospects	Rating	Ranking
Investment Prospects	Fair	5.26	4th
Development Prospects	Modestly Poor	4.10	5th
Expected Capitalization Rate, December 2011		6.9%	
Buy	Hold	Sell	
34.2%	47.4%	18.4%	

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-24

Canadian Apartments—Moderate Income

2011	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.86	2nd
Development Prospects	Fair	4.50	1st
Expected Capitalization Rate, December 2011		6.1%	
Buy	Hold	Sell	
59.0%	35.9%	5.1%	

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-27

Canadian Warehouse Industrial

2011	Prospects	Rating	Ranking
Investment Prospects	Fair	5.14	5th
Development Prospects	Modestly Poor	4.18	3rd
Expected Capitalization Rate, December 2011		7.6%	
Buy	Hold	Sell	
31.7%	53.7%	14.6%	

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-25

Canadian Apartments—High Income

2011	Prospects	Rating	Ranking
Investment Prospects	Fair	5.37	3rd
Development Prospects	Modestly Poor	4.12	4th
Expected Capitalization Rate, December 2011		5.7%	
Buy	Hold	Sell	
38.5%	48.7%	12.8%	

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-28

Canadian Power Centers

2011	Prospects	Rating	Ranking
Investment Prospects	Fair	5.09	6th
Development Prospects	Modestly Poor	3.90	7th
Expected Capitalization Rate, December 2011		6.7%	
Buy	Hold	Sell	
23.7%	63.2%	13.2%	

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-29

Canadian Regional Malls

2011	Prospects	Rating	Ranking
Investment Prospects	Fair	4.86	7th
Development Prospects	Poor	3.41	9th
Expected Capitalization Rate, December 2011		6.9%	
Buy 23.7%	Hold 73.7%	Sell 2.6%	

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canada respondents only.

EXHIBIT 5-32

Canadian Hotels—Limited Service

2011	Prospects	Rating	Ranking
Investment Prospects	Modestly Poor	4.31	10th
Development Prospects	Poor	3.15	10th
Expected Capitalization Rate, December 2011		9.0%	
Buy 12.1%	Hold 63.6%	Sell 24.2%	

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-30

Canadian R&D Industrial

2011	Prospects	Rating	Ranking
Investment Prospects	Fair	4.84	8th
Development Prospects	Modestly Poor	3.97	6th
Expected Capitalization Rate, December 2011		7.8%	
Buy 21.1%	Hold 60.5%	Sell 18.4%	

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-33

Canadian Hotels—Full Service

2011	Prospects	Rating	Ranking
Investment Prospects	Modestly Poor	3.97	11th
Development Prospects	Poor	2.90	11th
Expected Capitalization Rate, December 2011		8.7%	
Buy 8.8%	Hold 64.7%	Sell 26.5%	

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-31

Canadian Suburban Office

2011	Prospects	Rating	Ranking
Investment Prospects	Fair	4.71	9th
Development Prospects	Modestly Poor	3.64	8th
Expected Capitalization Rate, December 2011		7.3%	
Buy 18.4%	Hold 65.8%	Sell 15.8%	

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.