REALPAC / Ferguson Partners Canadian Real Estate Sentiment Survey

Q2
2022

Table of Contents

Exhibits

REALPAC (Real Property Association of Canada) and Ferguson Partners (FP) are pleased to announce the results from the second quarter 2022 REALPAC/Ferguson Partners Canadian Real Estate Sentiment Survey. The survey is the industry's most comprehensive measure of senior executives' confidence in the Canadian commercial real estate industry. This quarter, the survey captured the thoughts of a wide variety of industry leaders, including CEOs, presidents, board members, and other executives from a broad set of industry sectors, including owners and asset managers, financial services providers, and operators and related service providers. The quarterly survey measures executives' current and future outlook on three topics: (1) overall real estate conditions, (2) access to capital markets, and (3) real estate asset pricing. Survey respondents represent the retail, office, industrial, hotel, multi-family, residential, and senior residential asset classes.

Topline Findings

- We are in a transitioning environment. Most of us are trying to figure out what the world looks like post pandemic.
- Geopolitically, we are in a changed world. Governments are removing the stimulus they have been pumping into the economy since 2010. All of this will lead to higher inflation, higher interest rates and lower growth as compared to the prior decade.
- With rising interest rates, inflation growth, price shocks, COVID-19 lingering and a war in Europe, Canada continues to be a very stable and desirable place to allocate capital. We have a very good story evidenced by the talent inflow to our country. Canada is a highly sophisticated, well-capitalized and institutionalized market.
- The overall situation is optimistic, not as optimistic as it was five months ago, but still optimistic. There is still capital waiting to be deployed in real estate and the reopening of society is helping the office and retail sectors. However, investors are more tempered, because of rising interest rates and inflation, which are impacting development pro formas and the economy overall.
- Income properties continue to be very strong. Both institutional and private investors like the certainty of bricks and mortar.
- Both debt and equity capital will continue to be available for the best borrowers and solid performers. There continues to be a flight to quality on best in-class real estate, managers and partners with strong track records.

Data Collection

Data was collected during April of 2022. In the pages that follow, survey responses are supplemented by excerpts from interviews conducted with senior executives from Canadian property developers and owners, institutional investors, asset managers, and other organizations.

Please direct all inquiries regarding this study to:

Veronica Pastor
Managing Director, Executive Search

Ferguson Partners Canada
TD Bank Tower
66 Wellington Street West,
Suite 4020
Toronto, Ontario M5K 1E7
Canada

t 647.417.3152
e vpastor@fergusonpartners.com
w fergusonpartners.com

Jeff Hauswirth
Chairman

Ferguson Partners Canada
TD Bank Tower
66 Wellington Street West,
Suite 4020
Toronto, Ontario M5K 1E7
Canada

t 647.417.3155
e jhauswirth@fergusonpartners.com
w fergusonpartners.com

Celeste Wright
Manager, Industry Research

REALPAC
77 King Street West
TD North Tower
Suite 4030, PO Box 147
Toronto, Ontario M5K 1H1
Canada

t 416.779.5884
e cwright@realpac.ca
w realpac.ca

General Market Conditions

As uncertainty increases, there is still demand for "beds and sheds" and life sciences, while demand for office and retail is more muted.

"We continue to stay bullish on multi-residential in major markets in Canada. There is a concern that rising interest rates will take a bit out of forward-looking returns as residential is typically more highly leveraged."

"We have not yet seen a slowdown on the condo side but believe one is coming with rising interest rates. Conversely, the prognosis is for current low immigration levels to increase above pre-Covid levels. Increased immigration will drive demand for residential."

"We like the fundamentals of industrial, but pricing is overly aggressive in Canada, so investing in industrial more globally is our strategy."

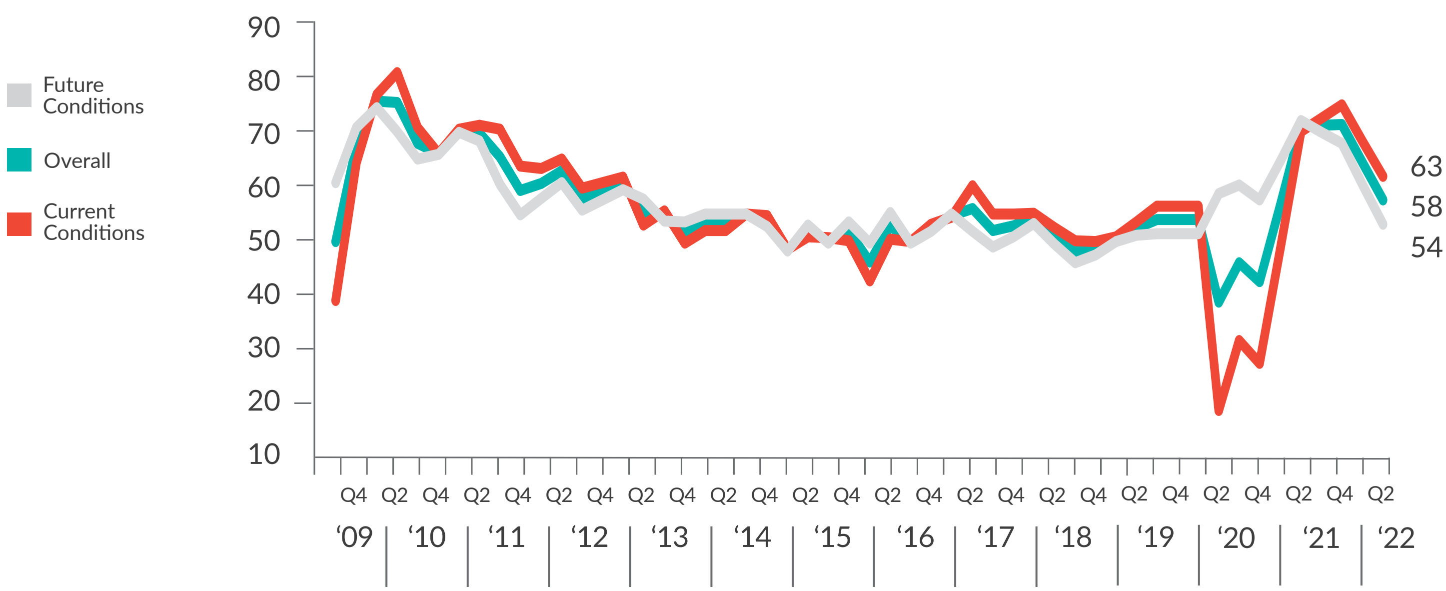
"After a period of very strong growth, people are starting to question how long is this e-com Bull run going to last? With Covid, the stars were aligned for e-commerce. Now we are hearing the likes of Amazon talking about a slowdown post-Covid. How sustainable is a market where you are seeing a 30% increase in pricing year over year? There is a feeling that people are taking their foot off the gas—it feels a little toppy. On the other hand, there is virtually no subleasing of space going on despite the talk of slowdowns."

"With supply chain disruption and gas prices increasing, the cost of distribution will go up. Labour and transportation costs are under pressure. What impact will that have on the covenants of those businesses? Then there is "China Plus One": people are looking to secure an extra source of supply. There is a move from Just in Time (JIT) to Just in Case (JIC) which will keep demand high for logistics. Industrial landlords are favoring shorter term leases, so they don't get caught in a rent inflation environment."

"Retail operating performance (except for large regional enclosed malls) has been relatively strong through Covid and post-Covid, however, there is a lack of visibility on rental growth (if any) and while the odd food-anchored, well-located retail asset has achieved decent

Exhibit 1A:

REALPAC/FP Canadian Real Estate Sentiment Index*



*The REALPAC/FP Canadian Real Estate Sentiment Index and the Real Estate Roundtable Sentiment Index are measured on a scale of 1–100. Each are the average of a Future Index and a Current Index. To register an Index of 100, all respondents would have to answer that they believe conditions are "much better" today than one year ago and will be "much better" one year from now. The REALPAC/FP Canadian Real Estate Sentiment Index and the Real Estate Roundtable Sentiment Index, organized by Ferguson Partners, are created using the same survey methodology, questions, and timing.

demand, the demand for retail is muted. The pathways need to be rethought. 25% of clients are back to the office – the pathway retail is not sustainable. Most large retail institutional holders (specifically pension funds) are looking to divest retail assets."

"We are seeing retail back to 2014 levels. We are doing more percentage rent deals, sharing participation on the upside with our tenants."

"Office occupancy remains relatively good as most large corporations seem loathe to shed space until they work out their respective return-to-office strategies and see where demand lies. While there have been episodic large trades, the bid for office assets generally remains muted and the visibility of forward rental growth is elusive."

"In terms of office, we are seeing the fundamentals improving in terms of rental tone in Toronto, Vancouver and even Calgary as companies return to work and are continuing to hire more people. We are not seeing the massive downsizing of office space the pundits predicted because of "work from home" initiatives which is positive."

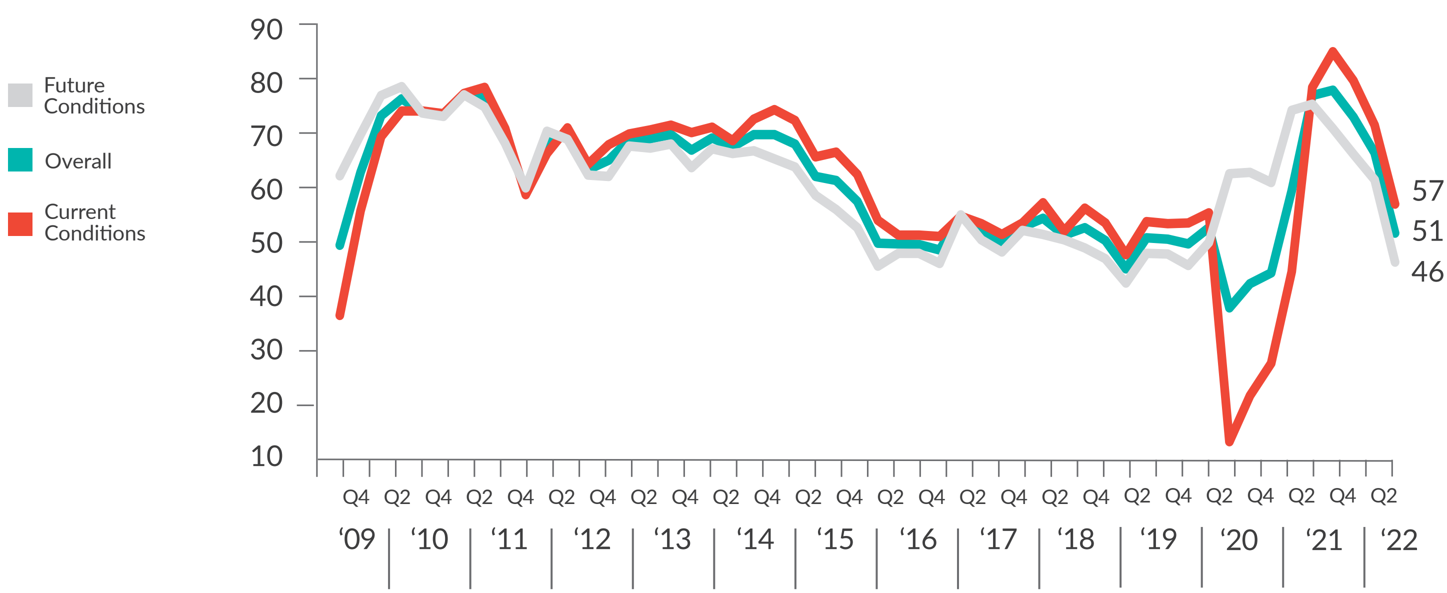
"We are seeing some weakening performance in the office sector. The world is sorting through what "work from home" means, yet we are continuing to add supply while people are working differently. This bifurcation will have a net-net effect on office supply and demand."

"Work from home and flexible working arrangements are having a negative effect on downtown retail and while any large-scale shedding of office space is currently muted, at the margin, the demand for office space, in general, seems to be down. Having said that, the demand for the high quality and well-located space seems to be holding in."

"The office business is becoming a hospitality business. There is a focus on tenant experience and technology to address the needs of hybrid work arrangements. Landlords are trying to get very creative to monetize their buildings."

Exhibit 1B:

Real Estate Roundtable Sentiment Index (U.S.)*



*The REALPAC/FP Canadian Real Estate Sentiment Index and The Real Estate Roundtable Sentiment Index, organized by Ferguson Partners, are created using the same survey methodology, questions, and timing.

Key Real Estate Considerations

Markets are moving at lightning speeds and investors are reacting quickly. Companies need to stay nimble to withstand the shock.

Speed of Change

"We are experiencing solid conditions with higher-than-average risk levels. With unprecedented volatility in capital and debt markets, high interest rates and inflation, a heightened regulatory environment, the war on talent, uncertainty about the future of e-commerce, move to work-from-home, climate change, nuclear and pandemic threats, everything is moving and changing so rapidly. External factors are having a severe impact quickly. Markets are moving at lightning speed and money is moving with them, creating shocks in the system. Companies need to be ready with strong balance sheets and liquidity to respond nimbly and withstand the shakeup."

"Interest rates have risen quickly and the speed at which the market has reacted has mimicked that rise. US Capital markets are very efficient and fast widening spreads indicate that people are extremely nervous."

"We need to beat cap rate increases through pricing and growth if we are to protect value. Velocity has become a key part of our strategy. With things changing so quickly we need to be nimbler in the way we approach development. We are looking for predictivity and stability through a higher volume of smaller projects."

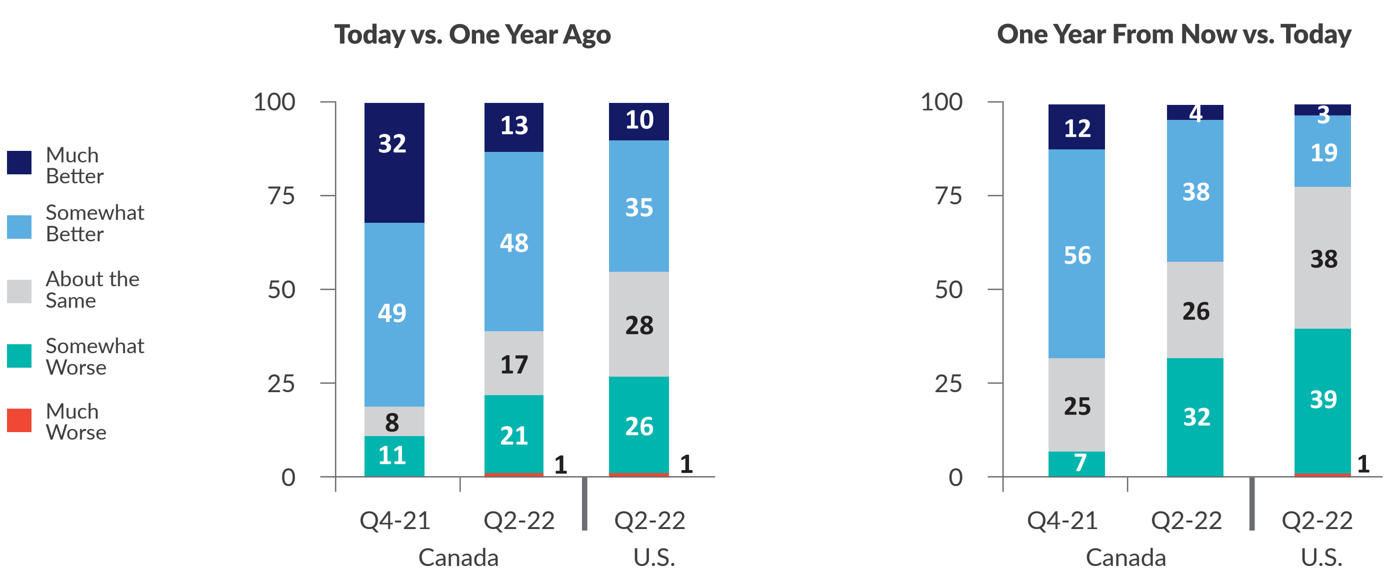
Regulatory Headwinds

"In Canada, specifically Ontario, we have a supply problem with housing—there is not enough supply, but government officials are not seeing rental development as a solution. We are constantly being challenged with increasing development charges, talks about rent control, zoning restrictions, and entitlement processes are taking much longer than they need to. It is not constructive to address the housing shortages we have, and Ontario is making the development of multipurpose built rental really challenging. As a result, we are putting our dollars into markets that create investor-friendly climates."

"The Liberal government's 'threatened' special taxation of large owners of multi-res is causing concern among large landlords."

"The speculation in Ontario that changes will be made to rent control (primarily a possible

Exhibit 2: **Perspectives on Real Estate Market Conditions** (% of respondents)



prohibition on rolling rents to market on a turn) that would adversely affect values should have dissipated given the recent Conservative majority in Ontario, multi-res stocks did not receive a bounce however, this could potentially be attributed to the general malaise in the stock market.

Municipalities around the world are having a challenge. Jurisdictions that are partnering with private capital can address these complexities most effectively."

"From a development perspective, especially in multi-family, we need to make things more developer-friendly to address supply shortages and affordability challenges. Increased development charges and length of time to entitlements are making it very challenging for developers to provide any product."

"Current and additional potential regulatory headwinds around development charges, length of time to entitlement, rent controls and evolving taxation for real estate are becoming increasingly concerning. Real estate developers continue to be depicted as "villains" when they could be a major contributor to solving our housing crisis."

"We are working with various levels of government on a single affordable housing project but there is a disconnect between them. Their programs and processes are not aligned, and it is very difficult to advance these projects. If governments align their requirements for affordable housing, there could be a huge opportunity."

"We are constrained in supply which impacts affordability. Canada is becoming a more challenging market to invest in with increased risks and regulatory uncertainty. We could be deploying much more capital into this country if it wasn't for these challenges. The government is talking about limiting "interest deductibility" for RE companies; companies that use higher leverage could be affected."

ESG

"Increasing requirements around ESG are becoming more and more stringent with respect to carbon pricing and municipal by-laws on emissions. ESG is quickly becoming a requirement for all asset classes, especially impacting office and retail currently."

"There is a lack of newer generation real estate product available. Those buildings that are located near transportation hubs and meet ESG requirements will command the highest values and attract the best financing arrangements."

"Net Zero development is around the corner. We are lagging in Canada building "net zero ready" facilities. The high energy and tax costs, along with the implementation around standards for green financing are making the advancement to net zero development more financially feasible."

Rising Costs of Labour and Materials

"Rising construction costs, labour strikes and inflation in construction input costs (material and labour) are making new development challenging, particularly in new build multi-residential to the point where, in certain situations the land input cost needs to be zero to make a new development economic."

War on Talent

"We have never seen such demand for talent, so ferocious, so acute as now—businesses need to have great spaces to attract employees. In New York, corporate tenants are renewing their leases, still signing the same terms, NERs are stable even though people are still not coming back to the office."

Asset Values

The direction of value, generally, seems flat to down.

"At this point, we are not seeing any trades (because there haven't been many) that would point to a change in valuation. However, we are seeing certain parties stand back from processes and the bid seems to be thinning out. The market is turning over time. There is an orderly and healthy repricing of risk, taking place across the sector."

"Interest rates are having a negative impact on valuations and financing rates have exceeded recent historical cap rates in some industrial and multi-residential assets and markets. Our investor clients don't want to buy at the top of the market. In the US, we are hearing of prices going down in a second round which we haven't seen for some time."

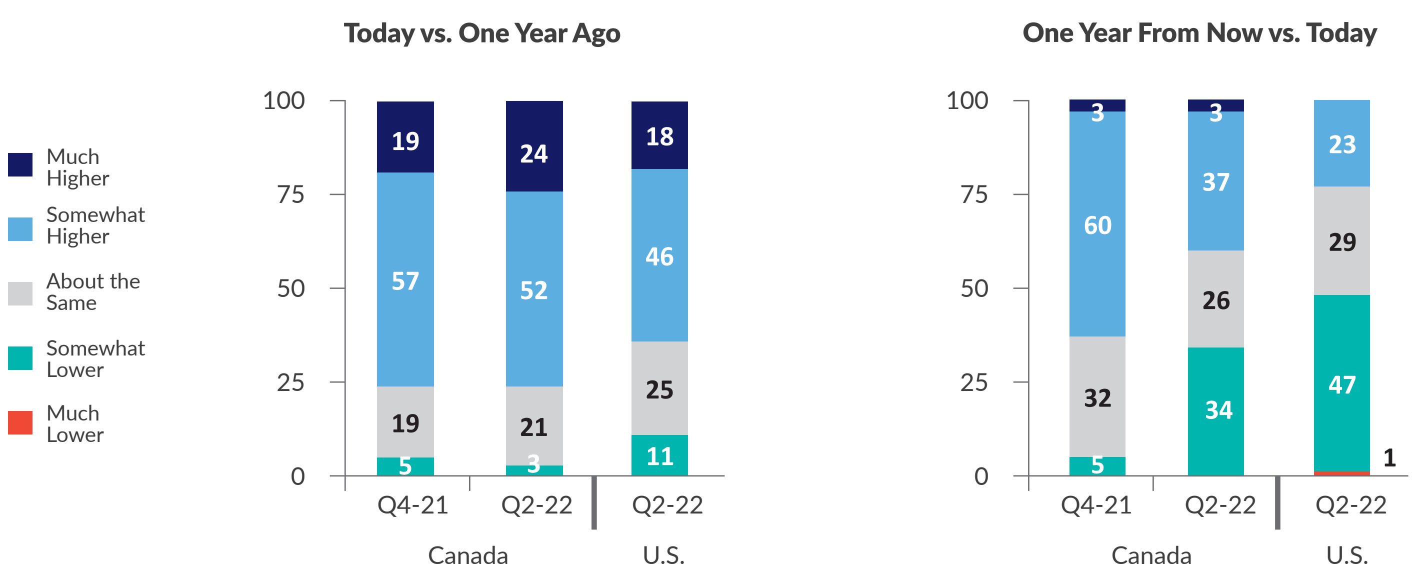
"There is a huge discovery going on when it comes to value; most are taking a pause, but no one is changing their allocation. People are sitting on the sidelines waiting for the central banks to respond."

"Investors, asset managers and developers need to sift through the short-term turbulence and differentiate between the immediate and long-term shifts in the market. When it comes to the latter, we need to get ahead of it, measure and quantify risk and make the appropriate changes where necessary. We need to adjust our proformas for long-term vs. short term."

"Real estate pricing overall is too high, apart from retail, which is being priced more fairly. We will see the needle start moving downwards in one to two quarters. In more liquid markets, we are already seeing those price adjustments taking place."

"There is a definite expectation that we will start to see cap rates moving up soon. Those who are highly leveraged may get burned. In private markets, cap rates have not risen yet. We will need to be in a position where our cash flow growth exceeds the pace of cap rate growth."

Exhibit 3: **Real Estate Asset Values** (% of respondents)



"We have been net sellers in Canada because we have been able to get better risk adjusted returns globally. Office pricing came down somewhat consistently across the board but is remains overpriced. Unless it is well connected to transit or highways or has had significant cap ex invested to make it ESG compliant, it is overvalued. Office is squeezed between cap rate increases and the inability to grow rental rates currently which is creating stress on its valuations."

"On the capital markets side, there is a lot of uncertainty as to where values are going with these rising interest rates. This is creating much anxiety in the market."

"Price corrections will largely depend on the growth prospects of the asset class. For industrial and multi-family, there may not be a massive adjustment to pricing, but office is still soft and enclosed retail malls are challenged so we will likely see some price adjustments there."

"We are seeing a 5-10% adjustment to deals that were in the hopper and are now in due diligence period. Costs have risen more than they have budgeted for in their projections, so we are seeing some price adjustments to get deals across the finish line."

"Real estate investments need to be approached more thoughtfully. We are seeing many more institutions become net sellers as pricing has become 'whacky'."

"We have still not seen investors' return expectations move. With financing costs going up, general real estate return expectations should also increase as people view real estate as a spread on fixed income. We have not seen this yet but is it going to happen?"

"It is difficult to value office right now. There is lots of uncertainty in the office market from a leasing perspective as well as from an investment sales perspective."

"Industrial product continues to be extremely expensive in Canada and the US. As a result, we are focusing on development over purchasing existing income producing assets as it is more accretive to do so. On the capital markets side, there is a lot of uncertainty as to where values are going with these rising interest rates. This is creating much anxiety in the market."

"Things are working themselves out economically and prudent investors will be conservative, and stress test their pro formas when underwriting so that they will be comfortable when it comes to financing or refinancing."

Debt Capital

Debt continues to be available, but it is no longer as abundant as it once was. There is less of it flowing and it is more expensive.

"Lenders will ask for more equity from the projects and more recourse when it comes to guarantors and covenants."

"Lenders are very prudent and not willing to lend on big projects right now. Some large tier one lenders are completely out of the market right now, putting a pause on activity in office and retail for sure, some for all RE across the board."

"Bankers are supporting only their best customers. The average loan to value ratio is decreasing."

"Debt is available but it's costly and moving up quickly. We are seeing a return to mortgages and unsecured debt (LOCs) as a less expensive alternative to bonds."

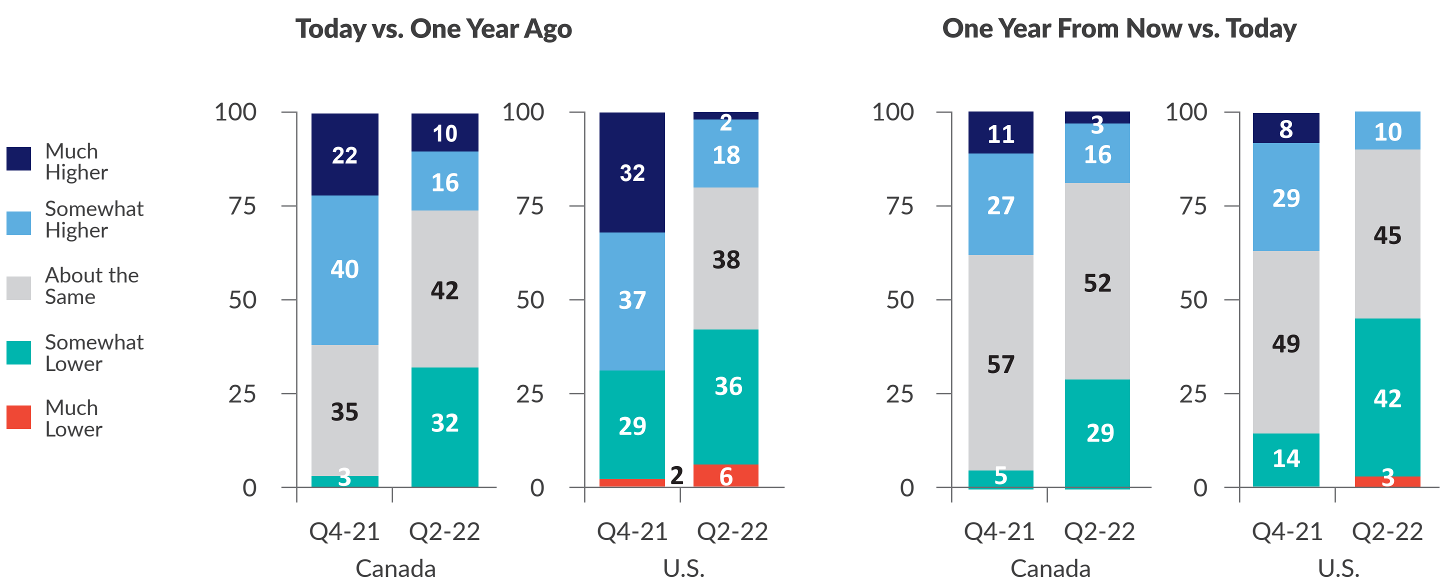
"Companies are raising multiple sources of capital to maintain their access to capital and contain the cost. They are looking for creative solutions to debt, particularly when it comes to short term debt structures."

"In terms of debt capital, there is lots of it available: bank capital very liquid, mortgage capital available for investment grade issuers, alternative and private credit."

"ESG is playing into financing in a serious way – it will not be available for assets which are not compliant."

"Our network of banks is not what is used to be. They have become very strict because capital markets have taken a dive and REITs have been crushed. From a financing perspective, logistics and apartments are still in play with some tightening underway, there is a move towards life sciences, financing for office is dependent on the right WALT and tenant mix, and it is still very tough to get decent LTV ratios on enclosed malls."

Exhibit 4: **Availability of Debt Capital** (% of respondents)



Equity Capital

While there is still access to private equity, investor decisions are elongated and have become more discerning.

"There is still equity capital available, but its availability has peaked. There is more consolidation in the industry with fewer and better firms and managers, making things less competitive."

"We have the capital available to deploy at the right opportunities with the right pricing and returns. There continues to be equity available for the right manager."

"Public equity – the new issuer market for real estate (and other corporates) is very thin with very low volumes. There has been only one IPO on the TSX so far this year, which happened to be a real estate name, but with real estate stocks trading, for the most part, well below published NAVs, the appetite to issue equity is muted."

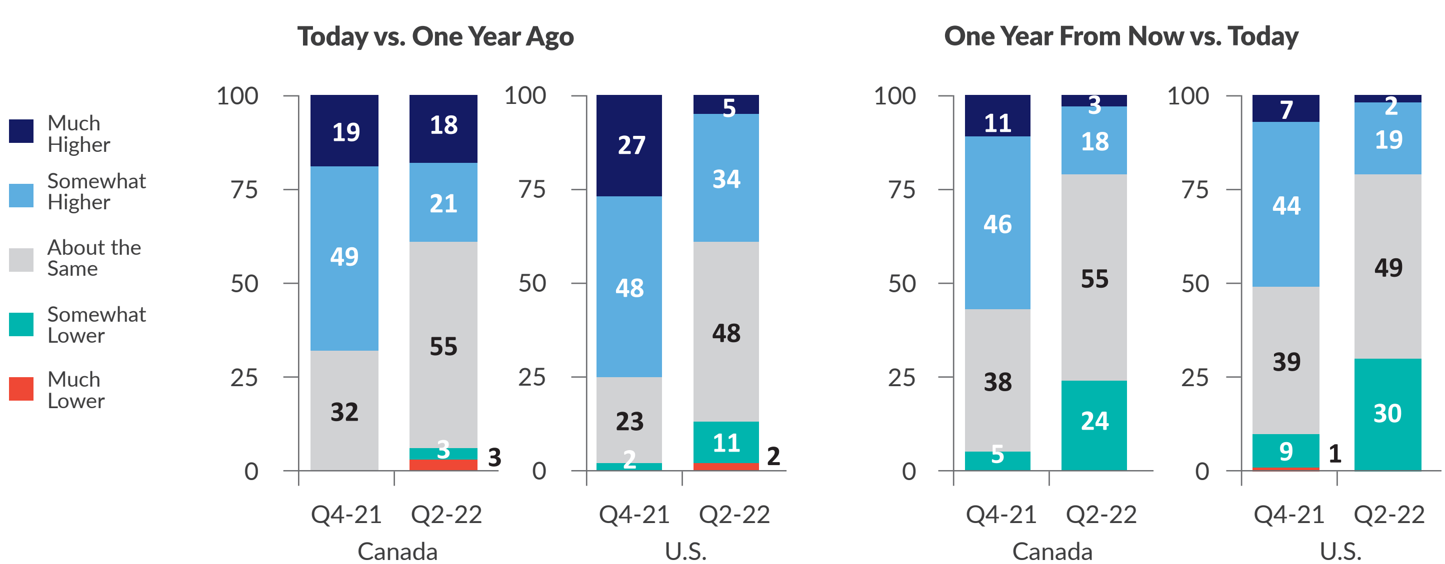
"The availability of public equity is zero. Investors are sitting on cash; trading volumes are way down. There is lots of deleveraging going on and investors are sitting on the sidelines. Access to equity that makes any sense is very limited. There is a strong rotation from growth to value."

"Private equity – there continues to be substantial equity on the private side for real estate assets, however, this is focused towards industrial (assets and land), multi-residential and life sciences. There is a limited bid for office and retail."

"With the repricing in the market, all pension plans have seen a drop in their overall value, rendering their reallocation higher as a percentage of total value. If you are close to your allocation, maybe you are not a buyer anymore."

"Private Equity firms are deploying ample amounts of capital through non-traded "B" REITs backed by retail dollars. As a pension fund, it is becoming very difficult to compete with these groups."

Exhibit 5: **Availability of Equity Capital** (% of respondents)



Participants

(Please note that this is only a partial list. Not all survey participants elected to be listed.)

ACM Advisors Ltd.
Chad Mallow

Avison Young (Canada) Inc.
Mark Rose

Boardwalk Real Estate Investment Trust
Sam Kolias

Canada Life
Jim Anderson

Canada Post Pension Plan
Marie-Josée Turmel

Canadian Net Real Estate Investment Trust
Kevin Henley

Canderel
Richard Diamond

CanFirst Capital Management
Paul Braun
Allan Perez

CBRE
Werner Dietl

Concert Properties Ltd.
Andrew Tong

CPPIB
Marco Ding

CREIT (Canadian REIT)
Kevin Henley

Crombie REIT
Donald Clow

DekaBank Deutsche Girozentrale
Timo Drexler

Dorsay Development Corporation
Geoffrey Grayhurst

Epic Investment Services
Craig Coleman

Equitable Bank
Kasey Chauhan

Fengate Real Asset Investments
John Bartkiw
Jaime Mckenna

First Capital REIT
Adam Paul

Granite REIT
Kevan Gorrie
Teresa Neto

Grosvenor Americas Limited
Graham Drexel

Homestead Land Holdings Limited
Francine Moore

IMCO-Investment Management Corporation of Ontario
Brian Whibbs

Ivanhoe Cambridge
Simon Lauzier

Laurentian Bank of Canada
Tony Migliara

Manulife Investment Management
Scott Gordon

Meridian Credit Union
Jay-Ann Gilfoy
Kevin Van Kampen

Oxford Properties Group
Michael Turner

Pure Industrial
Charlie Deeks

Realstar Group
Greg Speirs
Wayne Squibb

Strathallen Capital Corp.
Cathal O'Connor

TAS Impact
Richard Crofts
Mazyar Mortzavi

TD Asset Management
Colin Lynch
Matt Sych

TD Investment Banking
Andrew Philips

Vancity Credit Union
Bill Sherritt

REALPAC
77 King St West
TD North Tower
Suite 4030 PO Box 147
Toronto, ON
M5K 1H1

t 416.642.2700
tf 1.855.732.5722
w realpac.ca

Ferguson Partners Canada
TD Bank Tower
66 Wellington Street West,
Suite 4020
Toronto, ON
M5K 1E7

t 647.417.3150
w fergusonpartners.com