

*Ontario Land Economists*

*Commercial Property  
Markets*

*September 19, 2002*

# W5

- ◆ Who are the buyers?
- ◆ What are they buying?
- ◆ Where are buyers buying?
- ◆ Why are buyers buying?
- ◆ When will buying slow down?

# Who are the buyers?

- ◆ Private
- ◆ Corps/REITs
- ◆ Pension Funds
- ◆ Offshore

# Private

- ◆ Strong competition has emerged from REITs and offshore buyers
- ◆ Debt availability and cost are critical - significant liquidity and variety of options
- ◆ CMBS maturity has increased choice - more lenders greater competition (floating rate)
- ◆ Private/Institutional partnerships maturing

# Corps/REITs

- ◆ Stock market performance has provided significantly more capital
- ◆ At current interest rates “bulk up” strategy is very appealing
- ◆ Active debt players - new and restructuring
- ◆ Their time is “now”

# Pension Funds

- ◆ Supply of quality assets has diminished
- ◆ Declining stock markets have distorted ratios, inhibited buying
- ◆ Selective pruning but no rush to reduce ratios
- ◆ Excellent performance as a sector
- ◆ Dormant funds coming to life

# Offshore

- ◆ Israel empty of real estate executives - condos are often the point of entry
- ◆ German investors have returned
- ◆ US investors remain arbitrage players and are a declining sector of the market
- ◆ No significant Asian influence

# CMBS Landscape

- ◆ More players are entering the market
- ◆ Existing
- ◆ Merrill Lynch - Term
- ◆ Caisse De Depot - Term
- ◆ Manulife - Term
- ◆ CIBC - Term and Floating
- ◆ CMO - Term
- ◆ GMAC - Term and Floating
- ◆ Column Financial - Term
- ◆ GE - Term

# What are they buying?

## Product Preferences

### *Top 5*

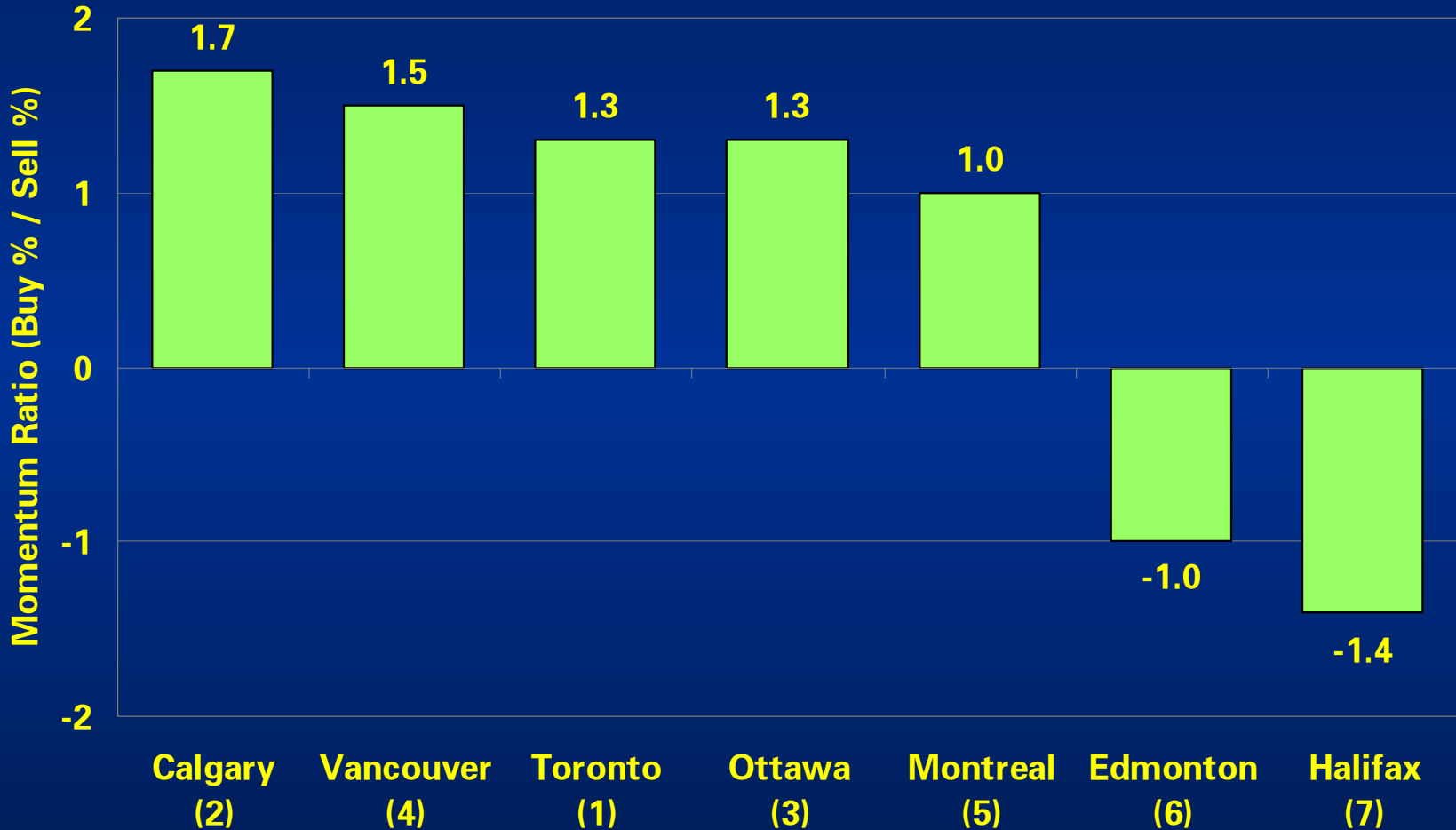
1. Multi tenant industrial
2. Retail food anchored strip
3. Single tenant industrial
4. Multi unit residential
5. Industrial Land

## *Bottom 5*

1. Suburban office land
2. Community mall
3. Office suburban “B”
4. Hotel
5. Downtown office land

# Where Are the Buyers Buying?

## Location Barometer Q2 - 2002



# Product/Market Barometer

## Top 10

1. Vancouver Multi Residential
2. Calgary Suburban “A” Office
3. Vancouver Multi Tenant Industrial
4. Vancouver Regional Mall
5. Vancouver Industrial Land
6. Calgary Multi Tenant Industrial
7. Ottawa Multi Tenant Industrial
8. Calgary Regional Mall
9. Vancouver Retail Strip
10. Halifax Multi Tenant Industrial

# Product/Market Barometer

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# Product/Market Barometer

## Bottom 10

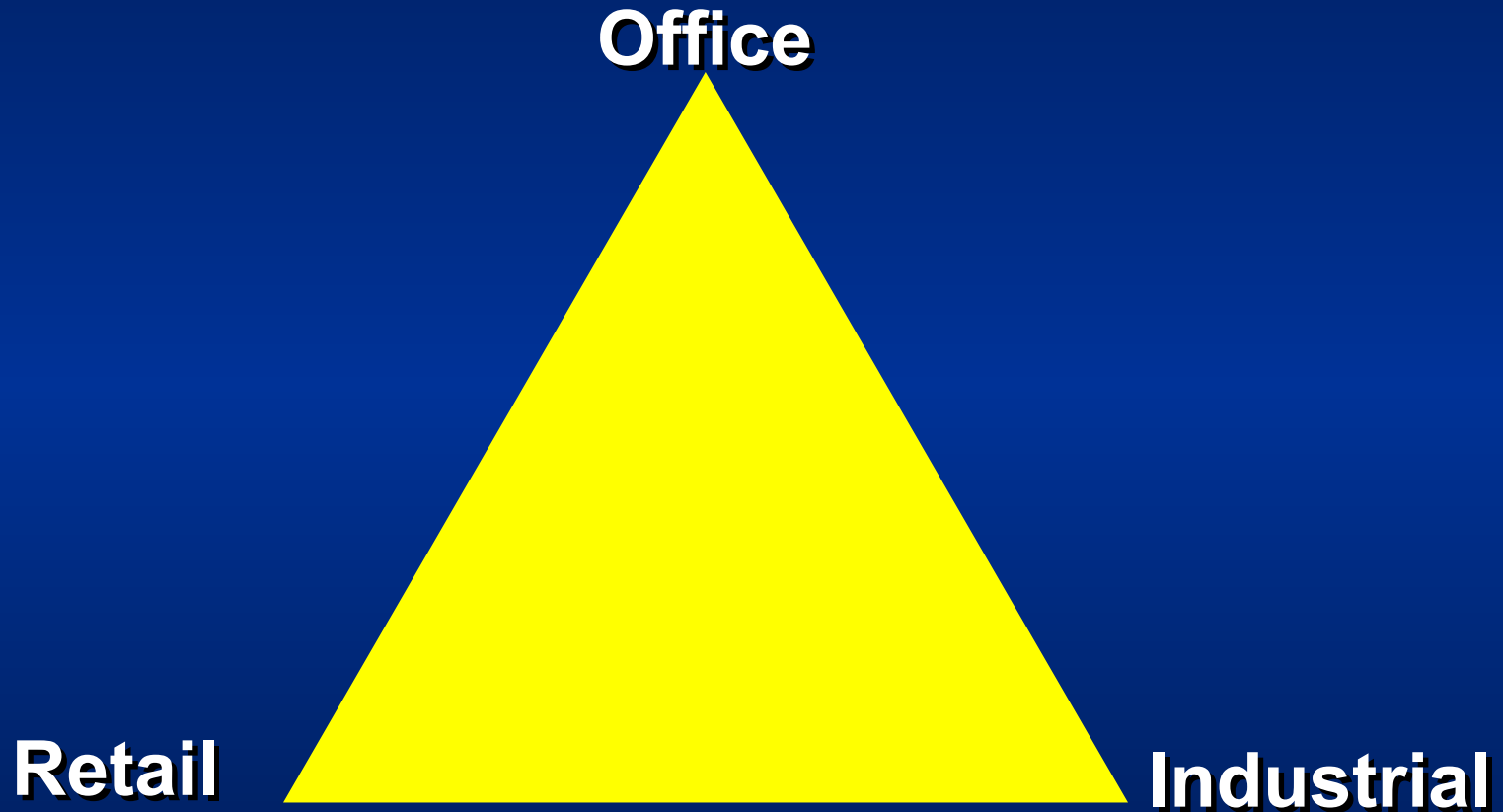
1. Halifax CBD “B” Office
2. Halifax Community Mall
3. Halifax Suburban Office Land
4. Edmonton Community Mall
5. Montreal Community Mall
6. Ottawa Suburban “B” Office
7. Ottawa Suburban Office Land
8. Montreal Suburban “B” Office
9. Toronto Suburban Office Land
10. Calgary Hotel

# Product/Market Barometer

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9. Toronto Suburban Office Land
10. Calgary Hotel

# Why Are Buyers Buying?



# Industrial Market

- ◆ Strong industry fundamentals
- ◆ Supply tap was controlled amidst softening economic indicators
- ◆ Lowest vacancy rates ever in most markets, however an increasing trend for availability rates
- ◆ Rental rates have softened / leveled off in many sub markets
- ◆ Very recent increased demand
- ◆ High demand for investment product

# Industrial Vacancy Rates

	<b>1990</b>	<b>1995</b>	<b>2000</b>	<b>2001</b>
Halifax	13.2%	17.5%	7.1%	5.4%
Montreal	9.0%	9.8%	4.3%	4.3%
Ottawa	11.0%	8.5%	3.4%	3.6%
Toronto	10.1%	7.3%	4.0%	4.3%
Edmonton	5.3%	8.2%	3.9%	3.7%
Calgary	4.0%	3.8%	2.5%	3.1%
Vancouver	4.9%	3.9%	1.9%	3.4%

# Retail Market

## Fashion

- ◆ US retailers buying (e.g. Children's Place)
- ◆ Expansion of some cut back (e.g. Old Navy)

## Cinemas

- ◆ Cineplex nearly complete
- ◆ Closing or renegotiating old format locations
- ◆ \$30 to \$40 per square foot to rehab
- ◆ AMC big winner

# Retail Market

## Chapters/Indigo

- ◆ Closing a number of locations (5 to 7 stores)

## Hardware Box Stores

- ◆ Home Depot dominates the market
- ◆ Rona / Revy consolidation and sales
- ◆ Reno Depot / Building Box scaling back

## Zellers / The Bay

- ◆ Continued rumours of American players (ie. Target)

# Retail Market - Trading Activity

## Four Classes of Retail

- ◆ Food anchored strip centres
- ◆ Community shopping centres
- ◆ Power centres
- ◆ Regional malls

# Retail Market

## Food Anchored Strips

- ◆ Services local community
- ◆ Generally performing well, sustainable income
- ◆ Location and age critical
- ◆ More common for food stores to own pad (shadow anchor)
- ◆ Strong retail buying demand private and institutional (REIT)

# Retail Market

## Community Centres

- ◆ Enclosed centres, usually with junior department store anchor and/or food
- ◆ Undersized anchors
- ◆ High CAM and tax
- ◆ Higher yield - decent interest - trading (10.5-12.5% cap)

# Retail Market

## Power Centres / New Format Retail

- ◆ Generally doing well
- ◆ Often anchored by:
  - Wal-Mart
  - Loblaws
  - Home Improvement Warehouse
- ◆ Cheaper and larger alternative to community centres
- ◆ Shift of CRU tenancies to power centres e.g. Danier, Roots and Chapters
- ◆ Yields in the 9.0-10.0% range

# Retail Market

## Regional Malls

- ◆ Exclusive ownership by major pension funds
- ◆ Performing well
- ◆ Adding new concepts
- ◆ Absorbed Eatons demise
- ◆ Limited trading

# Retail Market

## Retail Supply

- ◆ Retail only asset class with major additions - equivalent of two regional malls per year
- ◆ Wal-Mart continues expansion/relocation
- ◆ Consumer spending is bolstered by low interest rates
- ◆ So is the competition from retailers/formats

# Retail Market

## Key to Retail - Franchise Value

- ◆ Leverage with tenants is key to success
- ◆ Examples are:
  - Cadillac (Teachers)
  - Ivanhoe/Cambridge (Caisse)
  - Riocan
  - First Pro
- ◆ Niche players:
  - First Capital
  - Penreal Funds
  - Centrecorp / Sterling

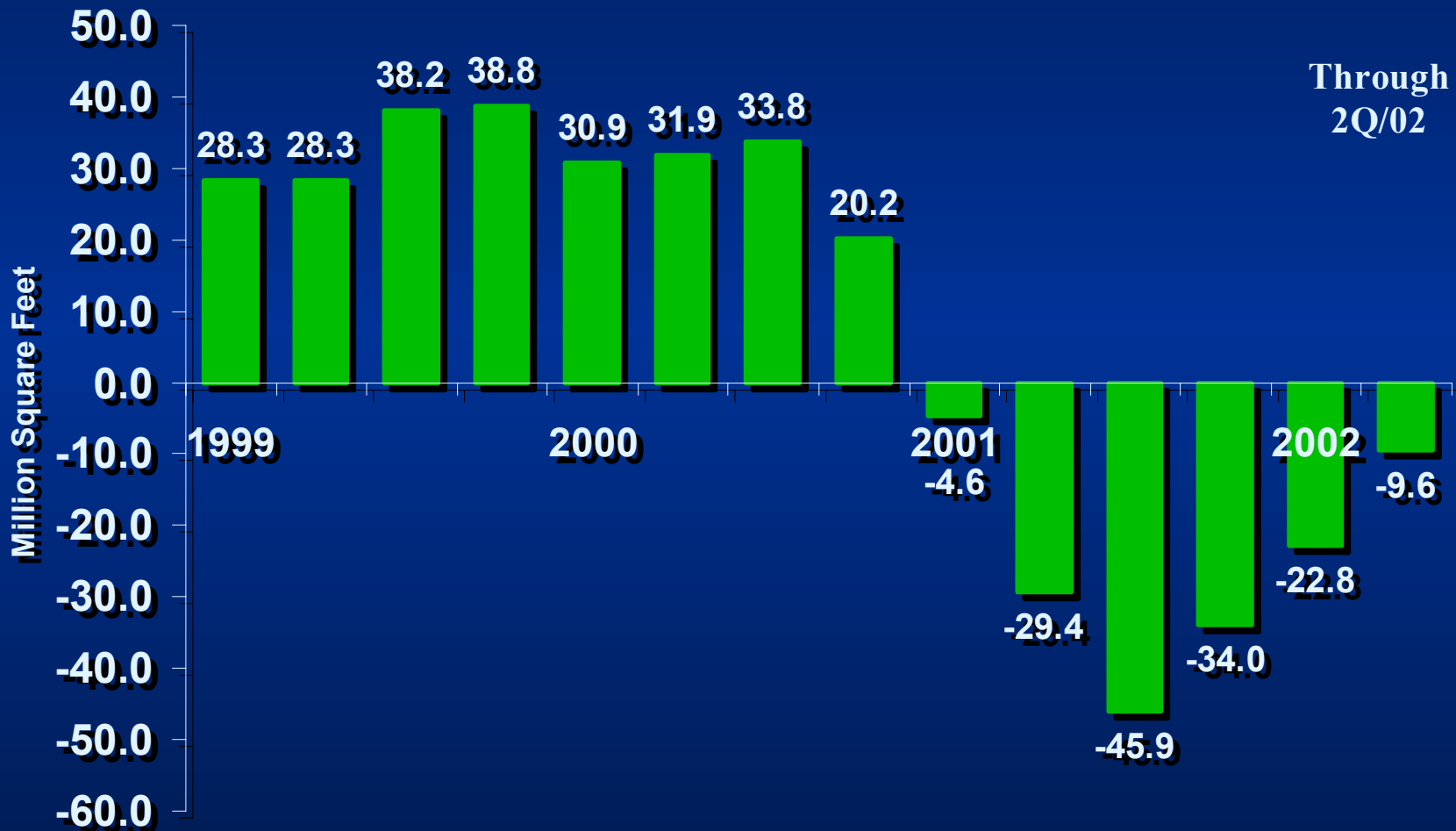
# Office Market

**(US VS CANADA)**

# US Office Vacancy Rates



# US Office Absorption Still Negative, But Looks to Be Bottoming Out



# US Office Vacancy Rates, 2Q02

## Highest Vacancy Rates

Dallas	24.0%
Austin	22.6%
San Jose	21.6%
San Francisco	20.6%
Columbus	19.9%
Phoenix	19.0%
Raleigh-Durham	19.0%

## Lowest Vacancy Rates

District of Columbia	6.0%
New York	9.5%
Suburban Maryland	10.4%
San Bernardino	11.4%
Baltimore	11.5%
Philadelphia	11.8%
San Diego	11.8%

US =15.3%

# US Office Rents Have Declined Back to 1999 Levels



Through  
2Q/02

# Comparison of Canadian Vacancy Rates

Ottawa	7.5%
Calgary	10.5%
Montreal	10.7%
Toronto	11.7%
Edmonton	11.7%
Vancouver	12.1%

# Demand Trends - Rolling 4Qs

National Vacancy	↑	33%
National Sublets	↑	57%
Toronto Vacancy	↑	43%
Toronto Sublets	↑	67%

# Demand Statistics Q2 2002

National Vacancy	8.5%	(8.2%)
National Sublets	2.2%	(2.2%)
Q2 National Absorption		(220,122 sf)
Toronto Vacancy	9.0%	(8.8%)
Toronto Sublets	2.6%	(2.5%)
Q2 Toronto Absorption		65,194 sf

# Supply Trends - Rolling 4Qs

National supply as % inventory ↓ 11%

National space under construction ↓ 15%

Toronto supply as % inventory ↓ 40%

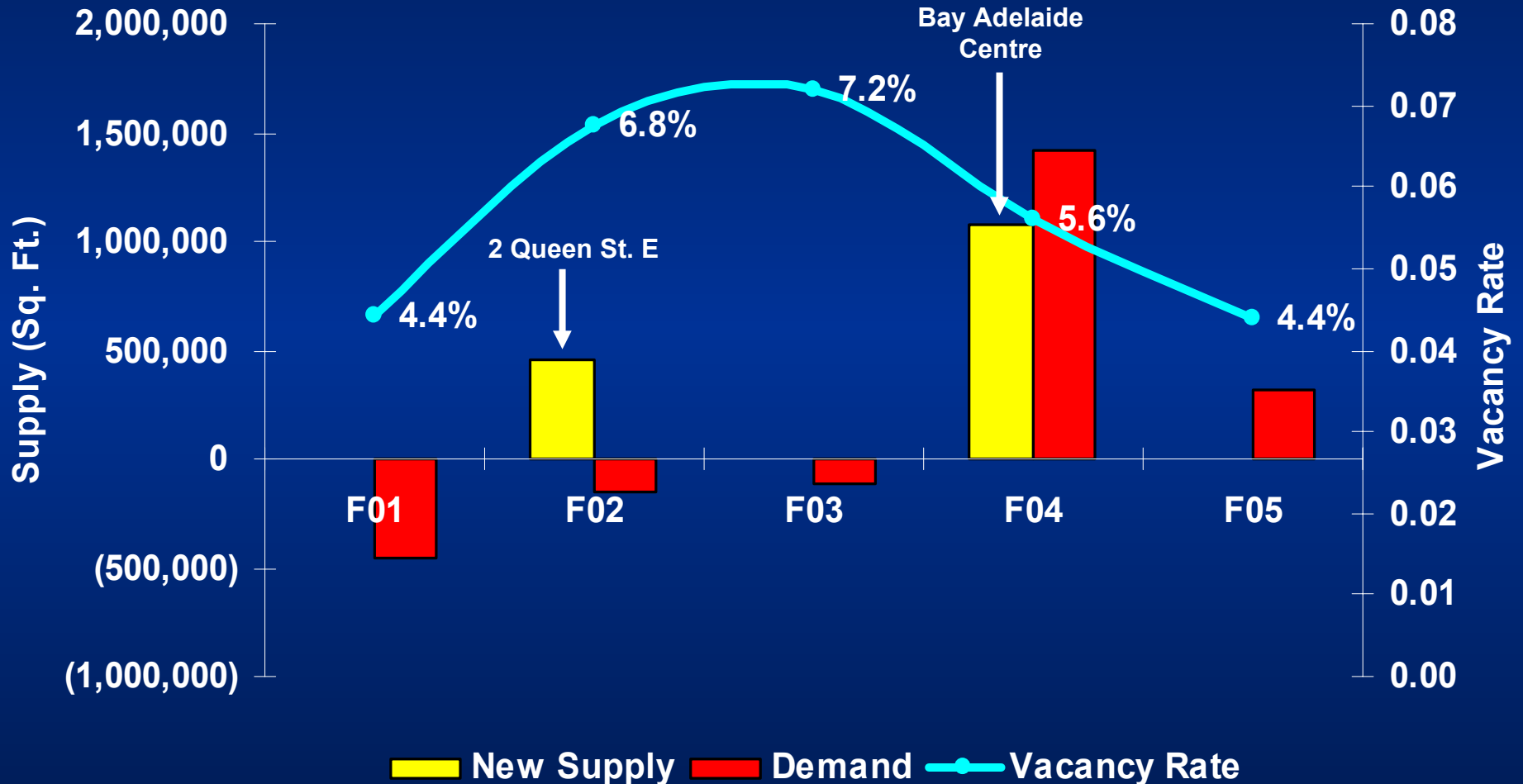
Toronto space under construction ↓ 40%

# Supply Statistics Q2 2002

National supply as % inventory	2.7%
National pre-leasing	68%
National supply downtown	33%
Toronto supply as % inventory	1.7%
Toronto pre-leasing	71%
Toronto supply downtown	27%

# This Feels Like the Early 90s

## Financial Core - Class "A" Forecast



# Vacancy Rate Comparison

## Dec 2000 - Dec 2001 - Downtown

	2000	2001	% CHANGE
<b>Boston</b>	1.5%	9.8%	(553%)
<b>Atlanta</b>	7.3%	13.6%	(86%)
<b>Philadelphia</b>	5.8%	12.5%	(115%)
<b>Montreal</b>	9.15%	10.39%	(14%)
<b>Toronto</b>	6.1%	8.27%	(36%)
<b>Ottawa</b>	4.6%	3.79%	17%

# Vacancy Rate Comparison

## Dec 2000 - Dec 2001 - Suburbs

	2000	2001	% CHANGE
<b>Boston</b>	3.4%	20.1%	(491%)
<b>Atlanta</b>	10.6%	16.0%	(51%)
<b>Philadelphia</b>	9.4%	13.8%	(47%)
<b>Montreal</b>	9.0%	7.0%	14%
<b>Toronto</b>	8.6%	11.3%	(31%)
<b>Ottawa</b>	2.2%	13.4%	(509%)

# Space Under Construction as % of Inventory Dec 2001

Boston	5.10%	Montreal	4.00%
Atlanta	3.80%	Toronto	2.65%
Philadelphia	<u>4.70%</u>	Ottawa	<u>1.20%</u>
Average	4.53%		2.62%

**73% difference!**

# Net Additions to Space 1999 & 2000 as % of Inventory

Boston	10.5%	Montreal	1.7%
Atlanta	10.0%	Toronto	3.5%
Philadelphia	<u>2.2%</u>	Ottawa	<u>3.8%</u>
Average	7.6%		3.0%

**153% difference!**

# Ownership Improves Stability

## Big 5 Office Building Owners

Caisse / SITQ

OMERS / Oxford

OTPPB / Cadillac Fairview

BCIM / GWL

Brookfield / Gentra

# Highlights of Ownership

28% of all office space

45% of all Class A office space

64% of all Class A downtown office space

## **Larger Cities - Downtown Class A**

Vancouver 65%

Calgary 72%

Toronto 71%

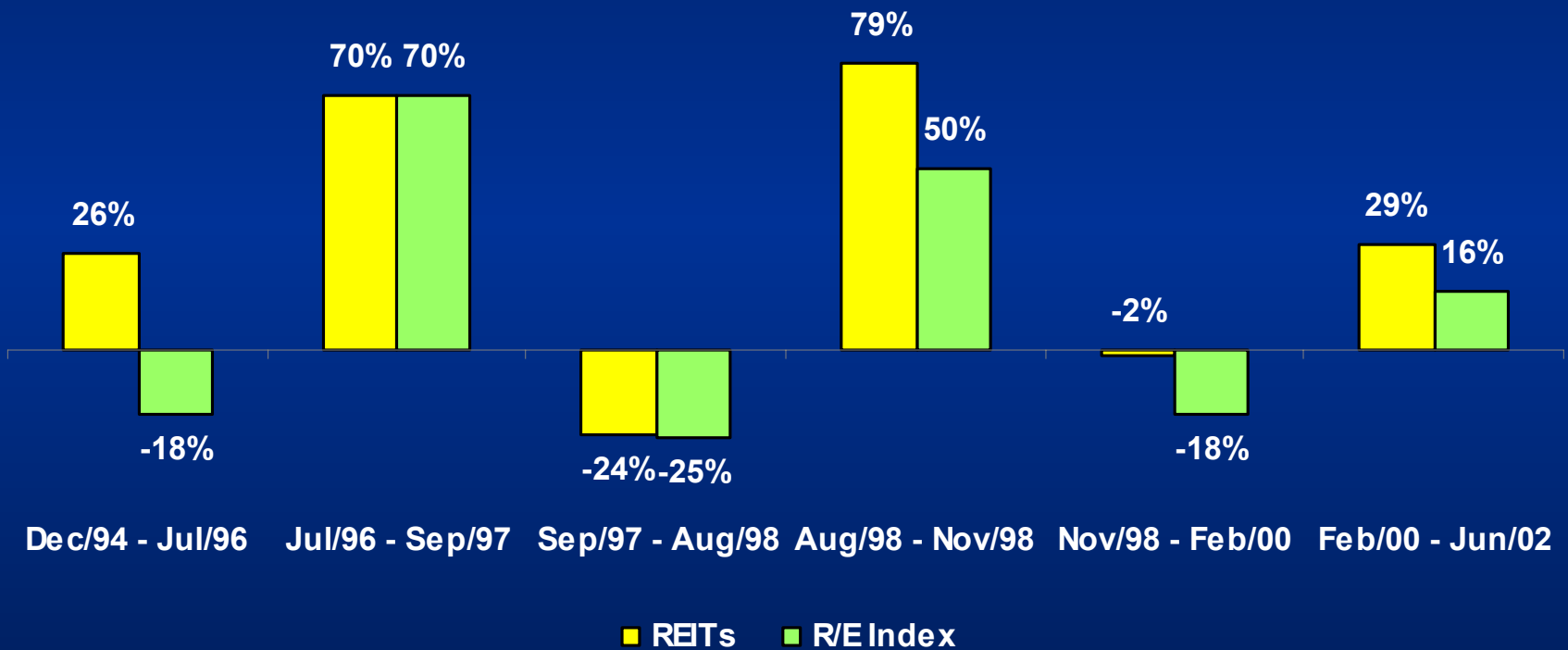
Montreal 77%

## Example - Toronto Suburbs (West and East) 1990-1992 vs 1998-2001

	<b>1990-1992</b>	<b>1998-2001</b>
New Supply	9,332 M sf	7,957 M sf
Absorption	4,547 M sf	6,216 M sf
Surplus/Short Fall	4,785 M sf	1,741 M sf
% of Total Inventory	20.0%	13.3%

# When Will Investors Slow Down?

# Buy/Sell Signals



## Buy Signals

- ◆ Interest rates have peaked/about to decline
- ◆ Any short-term (<3 months) sector correction of 10% or more
- ◆ Peak in investor demand for momentum/growth stocks

## **Sell Signals**

- ◆ Interest rates have bottomed/about to rise (to what extent?)
- ◆ Sector bull run lasting more than 12 to 18 months

*Risk is when a consistent BOC/Fed-tightening trend occurs*

## 2-year Corr. Coeff.



# Conclusions

- ◆ Canada better positioned than US
- ◆ Supply side discipline continues
- ◆ Office employment lagging
- ◆ Stock markets are severe drag on confidence
- ◆ Retail investment interest renaissance
- ◆ REITs more resilient than history might suggest
- ◆ Real estate reclaimed former prominence