



CELEBRATING  
**100**  
YEARS

# PERSPECTIVE



▲  
COMMERCIAL REAL ESTATE  
CAP RATES ACROSS  
CANADIAN MARKETS  
▼

Q2  
2017

**CONTINUED INVESTMENT STRENGTH  
IN A RISING INTEREST RATE  
ENVIRONMENT**

## EXECUTIVE SUMMARY

## Canada: Further cap rate compression as interest rates begin to rise

 *Strengthening fundamentals in key CBD Class A office markets support continued cap rate compression, as interest rates begin to rise* 

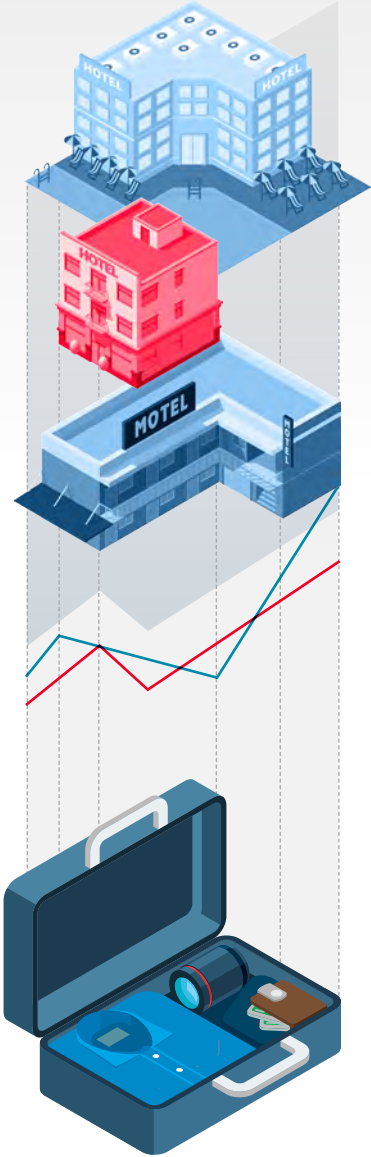
The desire to own trophy office assets, fueled by strengthening fundamentals in growth markets, continued to nudge CBD office cap rates downwards in Toronto, Ottawa and the Waterloo region during the second quarter of 2017.

Modest cap rate compression in downtown Toronto was driven in part by upward pressure on Class A rental rates within a very tight CBD market and expectations of more of the same. Tenants will see little relief until 81 Bay Street and 16 York Street open for business in late 2020.

Until 2017, rising rental rates have been kept at bay by the expectation of a healthy amount of new supply arriving at market. However, strong demand has absorbed the lion's share of this space in downtown Toronto, including the space displaced by tenants moving into the new towers. Consequently, availability is expected to remain near record lows until 2020. Upward rate pressure on Class A space should lead to higher IRR's which supports the notion of further cap rate compression.

We don't often see top-tier office product trade in downtown Ottawa. A 50% interest in Minto Place sold during the quarter, offering shared ownership of a three-building complex in the financial core. In addition, the pending sale of Constitution Square, a top-tier, three-building complex also located in downtown Ottawa, is anticipated to provide further evidence of cap rate compression for core investment assets. With the federal government starting to expand again after years of austerity, fundamentals are strengthening in the Ottawa market.

Canadian interest rates began creeping up in July 2017, though the 25-basis point increase has had little effect on investor interest. Continued rate increases would ultimately dampen the red-hot demand by owner/users and investors for lower-priced commercial real estate. For now, this segment continues to sell near or at record prices.



## Hotel Investments-Timing is Key

When it comes to investing in Canadian real estate, finding a hotel portfolio for sale is a rarity. Still, for investors that seize opportunities, the payoff when the tourism industry kicks into high gear can be very attractive. As wise investors know, when the going is good and demand high, the hotel sector becomes the envy of other asset classes.

Remarkably, two of the most notable portfolio transactions in recent years seemed timed perfectly to coincide with a boom in tourism growth in Canada. Bluesky Hotels and Resorts Inc. purchased InnVest Real Estate Investment Trust in mid-2016, with 109 hotel properties, including a stake in Toronto's Fairmont Royal York Hotel, for \$2.1 billion. Hong Kong-based Leadon Investment Inc. acquired a portfolio of 26 hotels and resorts owned by a BC pension fund for a price tag of more than \$1 billion in early 2017.

The advantage of timing can heavily impact returns. Buying a portfolio with the knowledge that not all assets will be a strategic fit is a given. However, if the inevitable culling of properties takes place during a rapid acceleration in market fundamentals, then the superior price achieved on the sale of individual or clusters of hotels is an added bonus.

Right now across much of Canada, tourism growth is on a tear: room rates are rising rapidly and gross revenues are heading towards record levels, particularly in key destination markets such as Vancouver, Montreal, and Toronto.

Room revenues in these three cities over the first half of 2017 rose by a very notable 7.2%, 11.4% and 11.8% respectively when compared to the first half of 2016. Across Canada, almost all markets showed gains in either or both of room demand and

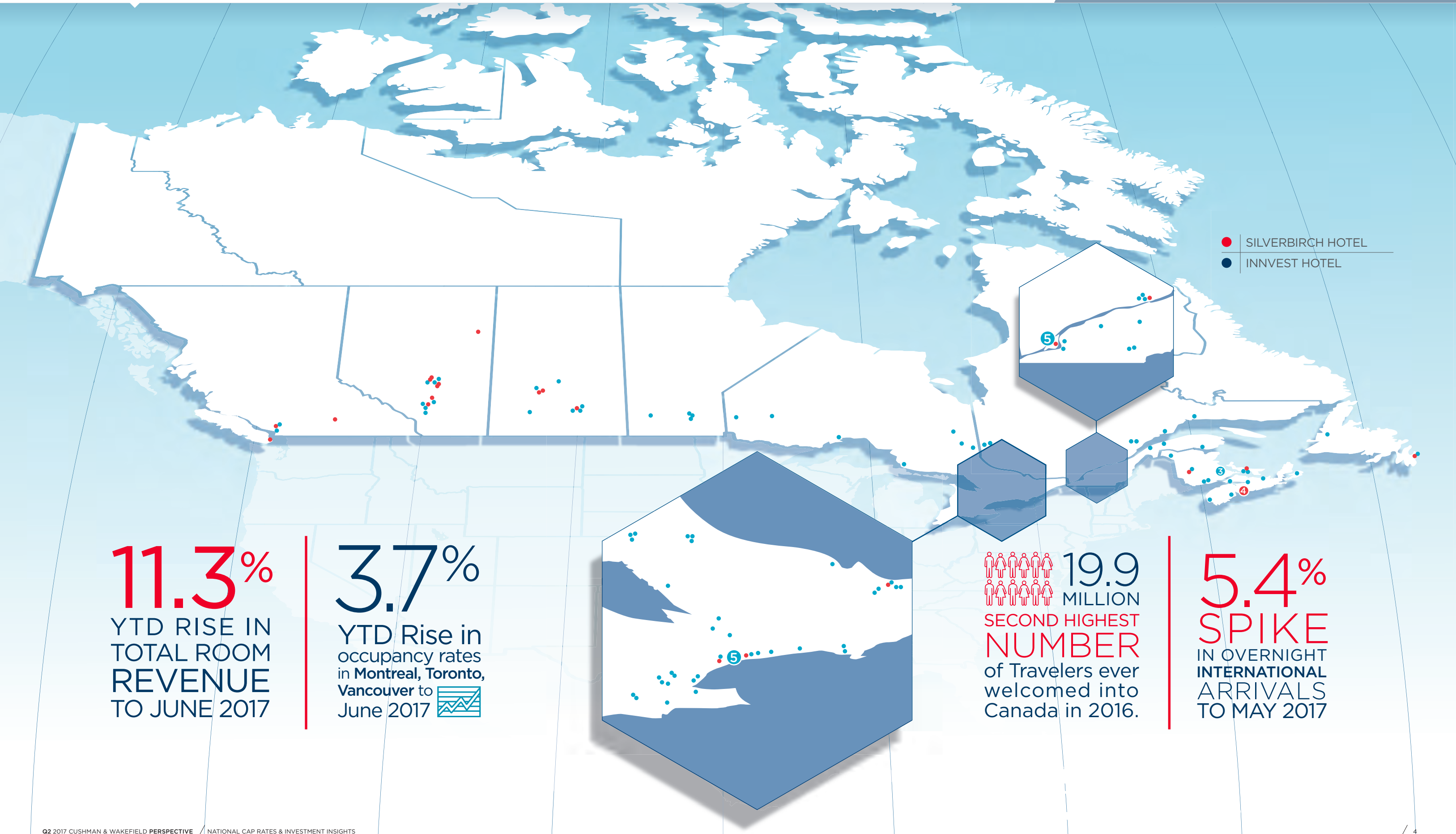
room rates, resulting in what is shaping up to be a year where hotel performance has exceeded expectations. On a national scale, year-to-date June results show demand has grown by 2.9% in 2017, while the average room rate has climbed 4.7% - with much of the strong summer season's results still to be recorded (P3, Note 1).

The perception of Canada as an outstanding and safe tourist destination is clearly a drawing card within an ever-more complicated global market. Low energy costs have kept flight costs contained and a competitive Canadian dollar, along-side celebrations of Canada's 150th birthday and Montreal's 375th birthday, are all contributing factors to an exceptional 2017.

Strong tourism activity creates an opportunity to add value through accretive investment in core assets and to dispose of properties not seen as a strategic fit. The upside for a company like Leadon is that assets targeted for disposition will generate impressive sale values driven by strong fundamentals through 2017 and into 2018.






Even in Alberta, where the decline in oil and gas prices has had a devastating impact on the downtown Calgary office market, occupancy within the Calgary hotel sector has seen modest gains. This bodes well for an eventual recovery, and the upside on such properties could provide opportunities to hold, or sell, depending on an investor's strategy.

Note 1 (STR June Monthly Hotel Review - includes Montreal, Vancouver, Toronto,





	VICTORIA			VANCOUVER			CALGARY			EDMONTON			WINNIPEG			LONDON		
	RANGE			RANGE			RANGE			RANGE			RANGE			RANGE		
DOWNTOWN OFFICE	LOW	HIGH		LOW	HIGH		LOW	HIGH		LOW	HIGH		LOW	HIGH		LOW	HIGH	
AA	5.00%	5.50%	▼	3.75%	4.50%	◀▶	5.00%	5.75%	◀▶	5.50%	6.50%	▲	N/A	N/A	N/A	N/A	N/A	N/A
A	5.25%	5.75%	▼	4.00%	4.75%	◀▶	5.75%	6.50%	▲	6.50%	7.25%	▲	5.50%	6.25%	◀▶	6.50%	8.25%	◀▶
B	5.75%	6.25%	▼	4.25%	4.75%	◀▶	6.75%	7.75%	▲	7.75%	8.75%	▲	6.25%	6.75%	◀▶	8.00%	9.00%	◀▶
SUBURBAN OFFICE																		
A	5.50%	6.00%	▼	4.50%	5.25%	◀▶	5.75%	6.25%	◀▶	6.25%	6.75%	▲	6.25%	6.75%	◀▶	6.00%	8.00%	◀▶
B	5.75%	6.25%	▼	5.25%	5.75%	◀▶	6.75%	7.75%	▲	7.00%	7.75%	▲	6.75%	7.50%	◀▶	8.00%	8.75%	▼
INDUSTRIAL																		
A	5.25%	6.00%	◀▶	4.00%	4.50%	▼	5.25%	5.75%	◀▶	5.75%	6.50%	◀▶	6.50%	7.00%	◀▶	6.75%	8.00%	◀▶
B	5.75%	6.25%	◀▶	4.50%	5.00%	◀▶	5.75%	6.25%	◀▶	6.50%	7.50%	◀▶	7.00%	7.75%	◀▶	7.75%	9.50%	▼
APARTMENT																		
High Rise	3.50%	4.25%	▼	2.50%	3.00%	◀▶	5.00%	5.50%	◀▶	4.50%	5.00%	◀▶	4.75%	5.75%	◀▶	4.50%	5.75%	◀▶
Low Rise	3.50%	4.25%	▼	2.75%	3.50%	◀▶	5.00%	5.50%	◀▶	5.75%	6.25%	◀▶	5.00%	5.75%	◀▶	5.75%	6.50%	◀▶
HOTEL																		
Full-Service Downtown	6.00%	7.00%	▼	5.00%	6.25%	◀▶	7.00%	8.00%	◀▶	8.00%	9.00%	▼	8.25%	9.25%	◀▶	8.00%	8.50%	◀▶
Full-Service Suburban	7.00%	8.00%	◀▶	6.50%	7.50%	◀▶	8.25%	9.25%	◀▶	8.50%	9.50%	▼	9.00%	10.00%	◀▶	8.50%	9.50%	▲
Limited-Service Suburban	7.50%	8.50%	◀▶	7.00%	8.00%	◀▶	9.00%	10.00%	◀▶	9.00%	10.00%	▼	9.50%	10.50%	◀▶	9.00%	10.00%	▲
RETAIL																		
High Street	4.75%	5.25%	◀▶	3.25%	4.00%	◀▶	N/A	N/A	N/A	6.00%	6.50%	◀▶	N/A	N/A	N/A	6.00%	7.00%	◀▶
Regional Mall - Top Performer	5.00%	5.50%	◀▶	4.25%	4.75%	◀▶	5.00%	5.50%	◀▶	5.00%	5.75%	◀▶	5.50%	6.00%	◀▶	5.75%	6.00%	◀▶
Power Centre	5.00%	5.50%	◀▶	4.75%	5.25%	◀▶	5.50%	6.00%	◀▶	5.25%	6.00%	◀▶	5.75%	6.25%	◀▶	6.00%	6.50%	◀▶
Community Commercial Centre	5.25%	6.00%	◀▶	4.50%	5.25%	◀▶	5.00%	5.50%	◀▶	6.50%	7.25%	▲	5.75%	6.25%	◀▶	6.50%	8.00%	◀▶
Strip Plaza Anchored	5.00%	5.50%	◀▶	4.25%	4.75%	◀▶	5.25%	5.75%	◀▶	5.50%	6.25%	◀▶	5.75%	6.50%	◀▶	5.75%	6.50%	◀▶
Strip Plaza Non-Anchored	5.25%	6.00%	◀▶	4.50%	5.00%	◀▶	5.75%	6.25%	◀▶	6.50%	7.25%	▲	6.50%	7.00%	◀▶	5.75%	7.00%	▼

	KITCHENER/ WATERLOO			TORONTO			OTTAWA			MONTREAL			HALIFAX		
	RANGE			RANGE			RANGE			RANGE			RANGE		
DOWNTOWN OFFICE	LOW	HIGH		LOW	HIGH		LOW	HIGH		LOW	HIGH		LOW	HIGH	
AA	N/A	N/A	N/A	4.00%	4.50%	▼	4.50%	5.25%	▼	4.50%	5.50%	◀▶	N/A	N/A	N/A
A	5.75%	6.25%	◀▶	3.88%	4.75%	▼	4.75%	5.50%	▼	5.25%	6.25%	◀▶	6.25%	6.75%	◀▶
B	6.25%	6.75%	◀▶	4.50%	5.25%	▼	6.00%	7.00%	◀▶	5.75%	6.75%	◀▶	7.00%	7.75%	▲
SUBURBAN OFFICE															
A	6.00%	6.75%	▼	5.75%	6.75%	◀▶	6.50%	7.00%	▼	6.00%	7.00%	◀▶	6.50%	7.50%	◀▶
B	6.75%	7.50%	▼	6.50%	7.50%	◀▶	7.00%	7.75%	▼	6.50%	7.50%	▲	7.50%	8.50%	▲
INDUSTRIAL															
A	6.00%	6.75%	◀▶	4.50%	5.00%	▼	5.75%	6.25%	◀▶	5.75%	6.75%	◀▶	6.25%	7.00%	▼
B	6.75%	7.25%	◀▶	5.50%	6.25%	▼	6.25%	7.25%	◀▶	6.50%	7.50%	◀▶	7.25%	7.75%	▼
APARTMENT															
High Rise	4.75%	5.50%	▼	3.50%	3.75%	◀▶	4.25%	4.75%	◀▶	4.25%	5.25%	◀▶	4.75%	5.25%	◀▶
Low Rise	5.00%	5.50%	◀▶	3.50%	4.25%	▲	4.50%	5.00%	◀▶	5.00%	6.00%	◀▶	5.50%	6.50%	▲
HOTEL															
Full-Service Downtown	8.00%	9.00%	◀▶	5.75%	7.00%	▼	7.00%	8.00%	◀▶	7.00%	8.00%	◀▶	7.50%	8.50%	◀▶
Full-Service Suburban	8.50%	9.50%	◀▶	7.00%	8.00%	◀▶	8.00%	9.00%	◀▶	8.00%	9.00%	◀▶	8.50%	9.50%	◀▶
Limited-Service Suburban	9.00%	10.00%	◀▶	7.25%	8.25%	◀▶	9.00%	10.00%	◀▶	9.00%	10.00%	◀▶	9.50%	10.50%	◀▶
RETAIL															
High Street	5.75%	6.75%	▼	3.50%	4.50%	◀▶	5.00%	6.00%	◀▶	4.50%	5.50%	◀▶	N/A	N/A	N/A
Regional Mall - Top Performer	6.00%	6.75%	◀▶	3.50%	4.50%	◀▶	5.00%	5.50%	◀▶	4.50%	5.50%	◀▶	5.25%	6.25%	◀▶
Power Centre	5.75%	6.50%	▼	5.00%	6.00%	◀▶	5.25%	5.75%	▼	5.00%	6.00%	◀▶	5.75%	6.75%	◀▶
Community Commercial Centre	6.00%	6.50%	◀▶	5.00%	6.00%	◀▶	5.75%	6.75%	◀▶	6.00%	7.00%	◀▶	6.75%	7.75%	◀▶
Strip Plaza Anchored	5.00%	6.00%	◀▶	4.75%	5.25%	◀▶	6.00%	6.50%	◀▶	5.50%	6.50%	▲	6.50%	7.50%	◀▶
Strip Plaza Non-Anchored	5.00%	6.25%	◀▶	4.75%	7.00%	◀▶	6.75%	7.75%	◀▶	6.50%	7.50%	◀▶	7.50%	8.50%	◀▶

## CAPITALIZATION RATE

Cushman & Wakefield's Investor Council provides quarterly estimates of capitalization rates for the asset classes contained in this report based on our market expertise. The cap rate ranges are based on transaction data as well as demand and supply dynamics in the region. These estimates are meant to encompass the majority of assets within each class and may not represent outlier transactions or deals relating to assets with specific attributes that would significantly differentiate them.

## DOWNTOWN OFFICE

### CLASS AA

A best-in-class office product, with more elaborate common areas, modern construction and building efficiencies, that commands the highest rents and tends to attract stronger covenant tenants, such as banks, government, insurance companies, etc. These buildings tend to be situated close to the core within their respective markets and have excellent access to major public transit hubs. Buildings are typically larger than 750,000 SF, with 5 to 10-year tenancies and some 15-year leases for inbound tenants. Occupancy levels assumed to stabilize at close to 95% of comparable market net rates.

### CLASS A

A strong-performing asset, typically between 400,000 and 700,000 SF, which is well located, and may have smaller floor plate sizes, solid amenities and less elaborate common areas. The majority of the tenants have 5 to 10-year lease commitments. Occupancy levels assumed to stabilize at close to 95% of comparable market net rates.

### CLASS B

Older office product, typically in the range of 100,000 to 250,000 SF. Buildings tend to be occupied with a diversified tenant mix but lack a large anchor tenant. Shorter lease commitments occur in this asset class with the average term ranging between 5 and 10 years. Average floor plate size can be significantly smaller. Generally not connected to the subway.

## SUBURBAN OFFICE / INDUSTRIAL

### CLASS A

Newer high-quality suburban product, typically between 100,000 and 300,000 SF. Attracts good covenant tenants for 5 to 10-year lease terms.

### CLASS B

Older suburban product that attracts a wider range of tenants and covenants for lease terms ranging between 3 and 10 years.

## APARTMENT

### HIGH RISE

An apartment building greater than 4 storeys in height or having more than 80 units.

### LOW RISE

Any apartment complex having fewer than 80 units.

## HOTEL

### FULL-SERVICE

A hotel with extensive dining and meeting facilities. Quality ranges from upscale to luxury. Examples include Hilton, Westin, Hyatt, etc.

### LIMITED-SERVICE

A room-focused hotel with minimal facilities. Quality ranges from economy to mid-scale. Examples include Comfort Inn and Super 8.

## RETAIL

### HIGH STREET

Typically considered the street or section thereof where the greatest dollar value psf is generated from streetfront retail stores within each market.

### REGIONAL MALL - Top Performer

Top-performing fully enclosed mall. These buildings tend to be greater than 800,000 SF and have a wide product offering, featuring destination retailers and 2 to 3 anchor tenants. Often located near large transit hubs and serve a trade area between 10 and 30 kilometres.

### POWER CENTRE

Large format, category dominant retailers in an open-air configuration that may include "club" or discount department stores. Total GLA is typically between 100,000 and 1,000,000 SF.

### COMMUNITY COMMERCIAL CENTRE

An enclosed centre anchored by a smaller department store, servicing a local community. Tenants may include general merchandise and convenience offerings, including a grocery store. Total GLA is typically between 100,000 and 400,000 SF.

### STRIP PLAZA - Anchored

An open-air configuration of attached retail stores that may include retail PAD sites. They are often anchored by a food or drug store tenant. Tenants are generally servicing residents in the neighbourhood. These would include dry cleaners, take-out food stores, convenience stores, etc.

### STRIP PLAZA - Non-Anchored

An open-air configuration of attached retail stores, not anchored by a grocer or drug store, that may include retail PAD sites. Tenants are generally servicing local neighbourhood residents.

# IDEAS INTO ACTION



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