CUSHMAN & WAKEFIELD

PERSPECTIVE

QUARTERLY REPORT ON
COMMERCIAL REAL ESTATE CAP RATES
IN MAJOR CANADIAN MARKETS

Q4 2018

Shadows and Light

EXECUTIVE SUMMARY

A continued low interest rate environment could extend this long-run boom cycle through 2019 and possibly 2020

Shadows and Light

A shadow was cast over global economic growth at the close of 2018 due to mounting concerns about the potential for U.S.-led trade wars, a deteriorating euro zone outlook, and turmoil surrounding Brexit. Meanwhile, at home, international oil prices, such as West Texas Intermediate, plunged by more than $25 U.S. a barrel in the fourth quarter, shaking up the fragile recovery underway in Alberta.

The silver lining in this somewhat gloomy picture was the more conservative stance taken by the Federal Reserve and the Bank of Canada to hold back on rate hikes until the conditions that impact tomorrow's market are better understood. While opinions vary, interest rates are unlikely to rise more than 25-basis-points over the next 24 months – and could conceivably be lowered if growth slows further. So, for now, you can count a continued low interest rate environment, which could extend this long-run boom cycle through 2019 and possibly 2020.

The majority of asset classes continued to see strong demand across Canadian markets. One of the hottest sectors, the industrial markets, continued to experience robust demand strength during the latter half of 2018, particularly in Vancouver, Toronto and Montreal, with the momentum shifting towards Montreal. Transformative change, marked by unrelenting demand for warehouse and distribution space to accommodate growing online sales, all but exhausted quality supply and pushed rental rates to record highs in top markets.

In the face of five interest rate bumps since mid-2017, industrial real estate in both Montreal and Calgary saw further cap rate compression in the fourth quarter, underscoring the strength of demand for industrial product in this unprecedented boom cycle.

While softening real GDP growth will moderate demand strength, supply constraints across both office and industrial real estate classes will extend rental rate pressure across gateway CBD office and industrial markets pushing the cycle into overtime. Furthermore, expect interest rate policy restraint to drive continued aggressive pricing even as demand moderates.

CYCLE HEADS DEEPER INTO OVERTIME

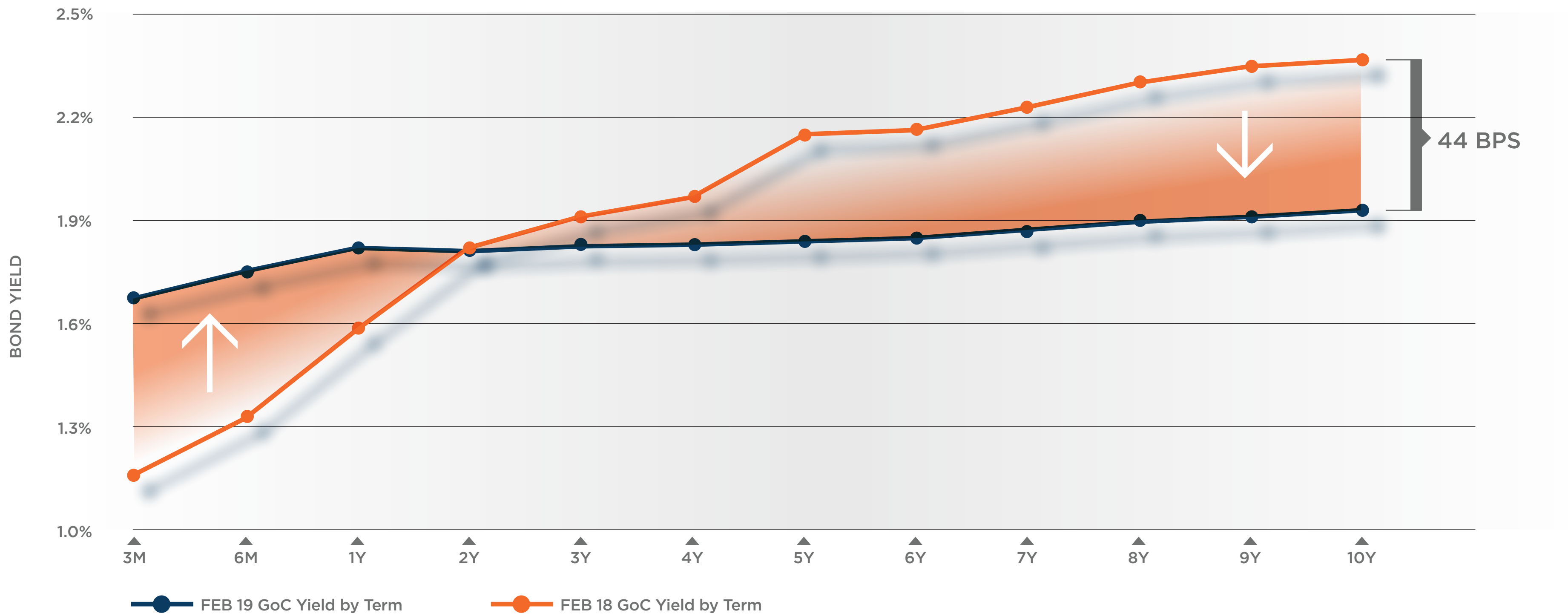
Softer Fundamentals in GTA

Late in 2018, it became apparent that global economic growth was slowing. Volatile financial markets and softer commodity prices were part of that story. Lower oil prices, alongside rising debt service costs, are also putting the brakes on consumption, which is contributing to slower growth in most provinces.

The shifting Government of Canada bond yield curve over the past year (*see chart below*) highlights how these factors have pushed long-term yields downward. As we move through 2019, interest rate stability is now widely expected.

> *"The silver lining of weakening global growth is lower interest rates, which will fuel continued demand for commercial real estate"*

YIELD CURVE



INDICATORS SUGGEST TWO MORE STRONG YEARS

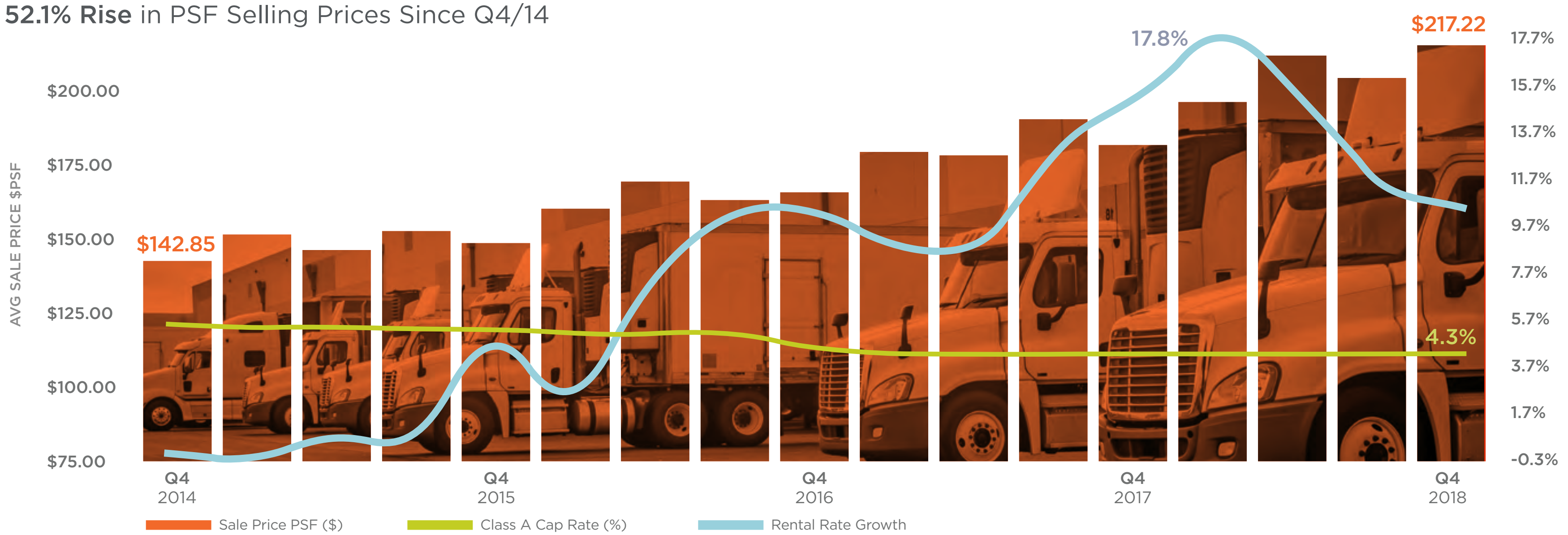
A continued low interest rate environment is music to the ears to owners and developers of commercial real estate. With demand far outstripping supply in major industrial, office and hospitality markets – and with the cost of construction rising – a stable interest rate policy will deliver the boost in confidence needed to extend the development cycle.

Industrial is unquestionably one of the best-performing asset classes. Gateway markets, including Vancouver, Toronto and Montreal, have seen explosive demand for logistics and warehouse space since late 2014. Given supply constraints and the scarcity of available land in these markets, we've seen vacancy hitting record lows and lease rates reaching record highs, with bidding wars erupting in some situations. Since Q4 2014, the average industrial PSF sale price in Vancouver has increased by 52.1%, exceeding $217 PSF. So, within the context of stable cap rates, the upward pressure on both net lease rates and selling values has been unprecedented.

Given the anticipated shift in interest rate policy and the demand momentum across industrial, office, and hospitality asset classes, particularly in key markets, we expect the current cycle to move deeper into overtime, pushing lease rates and selling values to new highs, though at a moderating pace, over the next two years.

VANCOUVER INDUSTRIAL: Sale Prices Head North

52.1% Rise in PSF Selling Prices Since Q4/14



ANTICIPATED IMPACT ON COMMERCIAL REAL ESTATE MARKETS

The downward shift in the long-term portion of the yield curve supports the view that interest rates will likely remain low, which will help to sustain our growth cycle across commercial real estate classes.

Takeaways include:

1. Stable interest rate policy will support the profitability of Canadian-based companies and continued expansionary momentum, though the pace of that growth will moderate
2. The cycle of rising rental rate pressure across hot industrial and CBD office gateway markets will be extended
3. Cap rate stability will likely continue over 2019 and 2020, with further compression possible in secondary markets, in asset classes where greater yield opportunity exists
4. Weakening economic fundamentals will support softening leasing momentum across gateway industrial and CBD office markets
5. Lower interest rates along with weaker oil prices will keep the Canadian dollar competitive driving demand for Canadian goods and services, including real estate

Q4 2018 CAP RATE SURVEY REPORT

Commercial Real Estate Cap Rates Across Canadian Markets

CUSHMAN & WAKEFIELD

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

NEXT »

LEGEND » OUTLOOK: (eye icon) UP: ▲ DOWN: ▼ FLAT: ◀ ▶

Q4 2018 CAP RATE SURVEY REPORT

Commercial Real Estate Cap Rates Across Canadian Markets

CUSHMAN & WAKEFIELD

BACK «

	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%	◄►	4.25%	5.00%	◄►	4.50%	5.50%	◄►	N/A	N/A	N/A
A	5.75%	6.25%	◄►	4.00%	4.75%	◄►	4.75%	5.50%	◄►	5.25%	6.25%	◄►	6.25%	6.75%	◄►
B	6.25%	6.75%	◄►	4.25%	5.00%	◄►	5.25%	6.25%	▼	5.75%	6.75%	◄►	7.00%	7.75%	◄►
SUBURBAN OFFICE															
A	5.75%	6.75%	▼	5.75%	6.25%	▼	5.75%	6.50%	◄►	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%	6.50%	▲	4.25%	5.00%	◄►	4.75%	5.75%	◄►	5.25%	6.25%	◄►	6.25%	7.00%	▼
B	6.50%	7.00%	▲	5.00%	6.00%	◄►	5.75%	6.50%	◄►	6.00%	6.75%	◄►	7.25%	7.75%	▲
APARTMENT															
High Rise	4.50%	5.50%	▼	3.60%	4.00%	◄►	3.75%	4.75%	◄►	4.00%	5.00%	◄►	4.75%	5.25%	◄►
Low Rise	4.50%	5.50%	▼	3.75%	4.50%	▲	4.50%	5.00%	◄►	5.00%	6.00%	◄►	5.50%	6.50%	▲
HOTEL															
Full-Service Downtown	7.50%	9.00%	▼	4.50%	6.00%	▼	7.00%	8.00%	◄►	6.50%	8.00%	▼	7.00%	8.50%	▼
Select Service	7.50%	9.00%	▼	6.00%	7.00%	◄►	7.00%	8.50%	▼	7.00%	8.50%	▼	8.00%	9.50%	▼
Limited-Service Suburban	8.00%	9.50%	▼	6.50%	7.50%	◄►	8.00%	9.50%	▼	8.00%	9.50%	▼	9.00%	10.50%	▼
RETAIL															
Street Front - Top Performer	5.75%	6.75%	▼	4.00%	5.00%	▲	4.50%	5.50%	◄►	4.50%	5.50%	◄►	N/A	N/A	N/A
Regional Mall - Top Performer	5.50%	6.00%	◄►	3.50%	4.50%	◄►	5.00%	5.50%	◄►	4.50%	5.50%	◄►	5.00%	6.00%	◄►
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%	◄►

LEGEND » OUTLOOK: UP: ▲ DOWN: ▼ FLAT: ◄►

Q4 2018 INVESTMENT GLOSSARY

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.

SELECT-SERVICE

A hotel that offers the fundamentals of limited-service properties blended with a selection of features found in full-service properties. Typically, this involves a limited presence of food, beverage and meeting space.

LIMITED-SERVICE

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

RETAIL

STREET FRONT – Top Performer

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

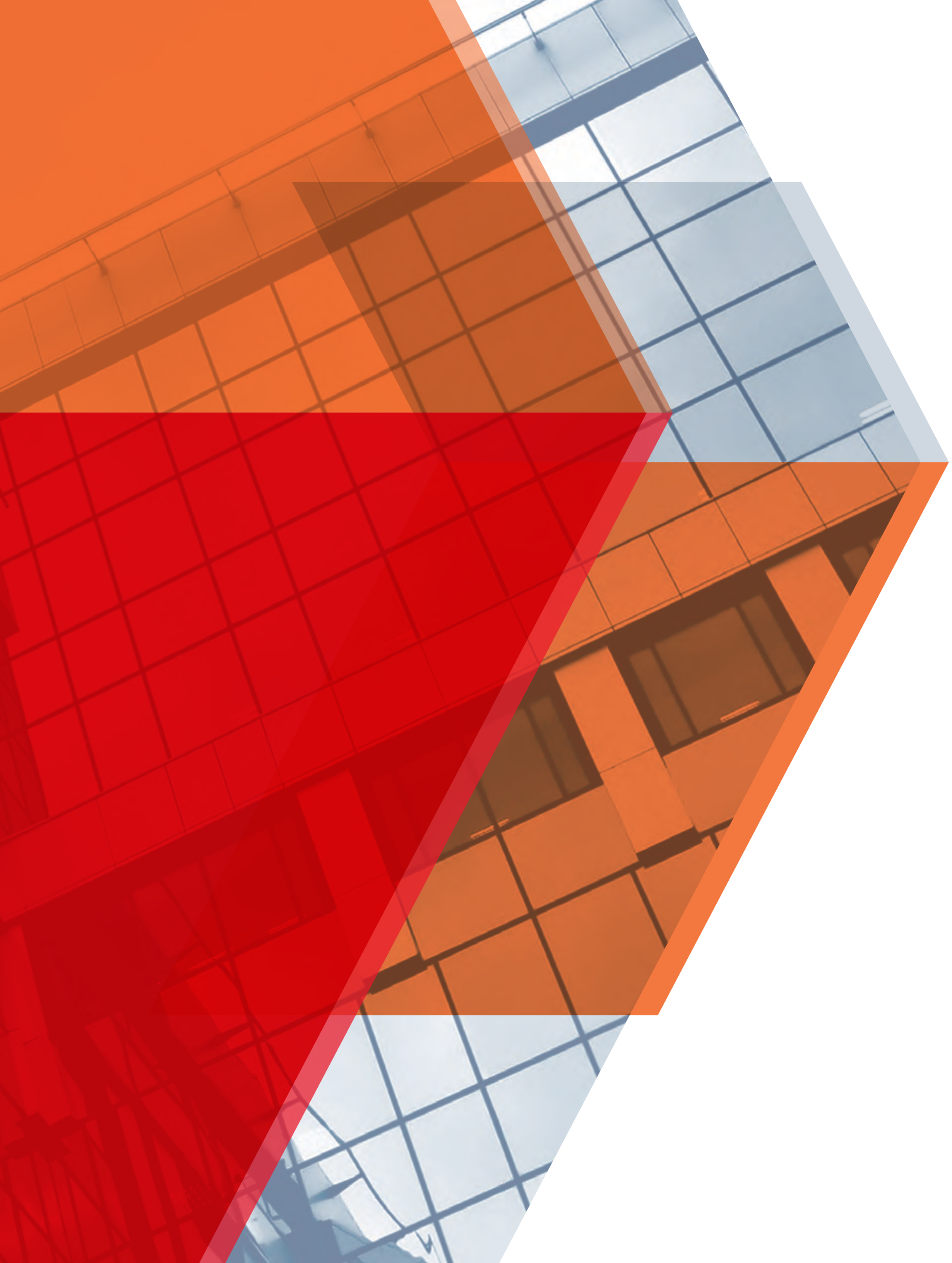
An enclosed centre anchored by a smaller department store, servicing a local community. Tenants may include general merchandise and convenience offerings, including a grocery store. Total GLA is typically between 100,000 and 400,000 SF.

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.



AT THE CENTRE OF
WHAT'S NEXT

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