



PERSPECTIVE

▲
COMMERCIAL REAL ESTATE
CAP RATES ACROSS
CANADIAN MARKETS
▼

Q4
2017

SHIFTING DYNAMICS
IN A MATURING CYCLE

EXECUTIVE SUMMARY

 *Expect a narrowing cap rate spread between suburban and downtown premium office properties.* 

With the Bank of Canada bumping its lending rate for the third time in January, we are clearly in the midst of a rising interest rate environment, but that doesn't mean rates will rise as quickly as they once fell. Economic headwinds like the new stress-test rules for homebuyers and rising mortgage rates are putting added pressure on debt-ridden Canadians. This, along with the looming NAFTA renegotiation threat, suggests the central bank will move cautiously.

While traditional office-using sectors are expected to experience slower growth as we approach 2019, the tech sector will remain a demand leader in markets where technology has a sizable presence. Continued growth will support strong investment fundamentals, particularly where technology is a key driver.

Industrial markets are poised to reap another year of strong sales activity driven by the ongoing evolution of the retail sector and a low interest rate environment.

Demand for smaller multi-residential properties in some markets has begun to cool as prospective buyers weigh expected returns against higher mortgage rates and rising long run bond rates. Ontario has seen some softening, supported in part by the added burden of rent controls introduced in 2017.


As ten-year Government of Canada bond yields rise, investors are likely to seek out stronger returns by focusing on asset classes and secondary markets where above-average returns can be achieved.

A key sector to watch? We see fundamentals strengthening across suburban premium-class office product and a narrowing of the cap rate spread between suburban and downtown premium office properties.

For a closer look at the shifting dynamics of suburban markets, [click here](#).

Our Forecast -

Watch for Spreads to Narrow as Suburban Markets Recover



We believe that the stage is set for well-located, amenity-rich, suburban office assets to experience a significant turnaround in demand, positively impacting both occupancy and rental rates. Further, in a rising interest rate environment, prospective investors will be looking for potential upside from acquisitions that provide greater yield and the story improves when there is an expectation of stronger fundamentals. Suburban office assets fit the bill.

We are forecasting a convergence between suburban and downtown premium class cap rates between late 2018 and 2020. This convergence will be observable within markets that led cap rate compression downward over recent years, Vancouver and Toronto. We expect cap rate spreads between downtown and suburban assets to narrow by between 15 and 25 basis points as we move towards 2020.



► If we look at Canadian office market trends, there is an obvious correlation between significant shifts in expansionary momentum and underlying cap rate movement.

Focusing on suburban versus downtown premium-quality office assets, the financial crisis marked a historic turning point. In the wake of the downturn, a new operating paradigm emerged that saw companies around the world embrace new densified workplace concepts and urban

locations as a means to attract and retain a tech-savvy generation of talent. As demand and development transformed downtown markets, growth in suburban markets slowed dramatically. For a closer look at the shifting dynamics of suburban markets, [click here](#).

Cap Rates* Tell the Tale

Consistent with these shifting trends, spreads between downtown and suburban Class A assets had narrowed significantly before the

financial crisis, from 93 basis points in 2004 to 66 basis points in late 2008. Shockingly, after 2008, suburban office markets saw all-classes absorption tank to about one-fifth of pre-financial crisis levels and demand for premium quality space fell to about one-third of historic norms (2009 to 2017). Over this same period the spread between suburban and downtown premium-quality cap rates widened from 66 basis points in late 2008 to 88 basis points by the latter half of 2017.

*Cushman & Wakefield ULC & Altus InSite Investment Trends Survey

	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	4.75%	5.25%	◀▶	3.75%	4.50%	◀▶	5.00%	5.75%	◀▶	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%	◀▶	5.75%	6.50%	◀▶	6.75%	7.50%	▲	5.50%	6.25%	◀▶	6.50%	8.25%	◀▶
B	5.25%	5.75%	◀▶	4.25%	4.75%	◀▶	6.75%	7.75%	◀▶	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%	▲	6.25%	6.75%	◀▶	6.00%	8.00%	◀▶
B	5.50%	6.00%	◀▶	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%	◀▶	7.50%	8.75%	▼
APARTMENT																		
High Rise	3.25%	3.75%	◀▶	2.50%	3.00%	◀▶	5.00%	5.50%	◀▶	4.50%	5.00%	◀▶	4.75%	5.75%	◀▶	4.50%	5.75%	◀▶
Low Rise	3.50%	4.00%	◀▶	2.75%	3.50%	◀▶	5.00%	5.50%	◀▶	5.75%	6.25%	◀▶	5.00%	5.75%	◀▶	5.50%	6.50%	▼
HOTEL																		
Full-Service Downtown	6.00%	7.00%	◀▶	5.00%	6.25%	◀▶	7.00%	8.00%	◀▶	8.00%	9.00%	◀▶	8.00%	9.00%	▼	8.00%	8.50%	◀▶
Select-Service Suburban	7.00%	8.00%	◀▶	6.00%	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%	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%	◀▶

	KITCHENER/ WATERLOO			TORONTO			OTTAWA			MONTREAL			HALIFAX		
	RANGE			RANGE			RANGE			RANGE			RANGE		
	LOW	HIGH		LOW	HIGH		LOW	HIGH		LOW	HIGH		LOW	HIGH	
DOWNTOWN OFFICE															
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%	◀▶	3.875%	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%	▼	5.50%	6.50%	▼	6.00%	6.75%	▼	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%	◀▶	5.00%	6.00%	▼	5.75%	6.75%	◀▶	6.25%	7.00%	▼
B	6.75%	7.25%	◀▶	5.50%	6.25%	◀▶	6.00%	6.75%	▼	6.50%	7.50%	◀▶	7.25%	7.75%	▲
APARTMENT															
High Rise	4.75%	5.50%	▼	3.60%	4.00%	◀▶	4.00%	4.75%	▼	4.25%	5.25%	◀▶	4.75%	5.25%	◀▶
Low Rise	5.00%	5.50%	◀▶	3.50%	4.50%	◀▶	4.50%	5.00%	◀▶	5.00%	6.00%	◀▶	5.50%	6.50%	▲
HOTEL															
Full-Service Downtown	8.00%	9.00%	◀▶	5.00%	6.50%	▼	7.00%	8.00%	◀▶	7.00%	8.00%	◀▶	7.50%	8.50%	◀▶
Select-Service Suburban	8.50%	9.50%	◀▶	6.50%	7.50%	▼	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%	▼	3.75%	4.75%	▲	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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