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Media Release

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Investors continue to diversify portfolios, pursue prime assets in key markets

Avison Young releases its Fall 2017 North America and Europe Commercial Real Estate Investment Review

Toronto, ON — Vendors of commercial real estate assets continue to attract a diverse group of eager buyers deploying an abundant supply of capital across asset classes and geographical boundaries. In some markets, scarcity of product has resulted in peak pricing, leading some investors to look further afield in a world of shrinking returns – and to take on more risk.

These are some of the key trends noted in **Avison Young's** ***Fall 2017 North America and Europe Commercial Real Estate Investment Review***, released today.

The report covers commercial real estate investment conditions in 54 markets in five countries on two continents: **Calgary**, **Edmonton**, **Montreal**, **Ottawa**, **Toronto**, **Vancouver**, **Atlanta**, **Austin**, **Boston**, **Charlotte**, **Chicago**, **Cleveland**, **Columbus, OH**; **Dallas**, **Denver**, **Detroit**, **Fairfield County**, **Fort Lauderdale**, **Hartford, Houston**, **Jacksonville, Las Vegas**, **Long Island**, **Los Angeles**, **Miami**, **Minneapolis**, **Nashville, New Jersey**, **New York**, **Oakland**, **Orange County**, **Orlando**, **Philadelphia**, **Phoenix**, **Pittsburgh**, **Raleigh-Durham**, **Sacramento**, **San Antonio**, **San Diego County**, **San Francisco**, **San Mateo**, **St. Louis, Tampa**, **Washington, DC**; **West Palm Beach**, **Westchester County**, **Coventry**, **London, U.K.**; **Berlin**, **Duesseldorf**, **Frankfurt**, **Hamburg**, **Munich** and **Bucharest**.

"The commercial real estate sector remains awash in capital; and despite varying global economic, political and property market conditions, including the ongoing interest-rate scenario, there is no better place to put your money than in hard assets," comments **Mark E. Rose**, Chair and CEO of Avison Young. "In short, real estate has established itself as a real alternative asset class to stocks and bonds."

He continues: "Our review of commercial real estate investment activity across diverse markets, countries and continents revealed a continued pursuit of prime assets in gateway markets.

However, as scarcity of product and fierce competition are resulting in peak pricing in some of these markets, investors are continuously looking to diversify across product types and geographies, which means climbing up the risk ladder."

The report, which covers commercial real estate investment activity in the first half of 2017, shows that, on a year-over-year basis, Canada recorded an increase in investment sales with higher dollar volumes in five of the six markets surveyed. The majority of the capital went towards the office sector, while the retail sector registered the greatest increase. In contrast, the U.S. market lagged slightly behind the mid-year 2016 tally with 21 of 40 markets reporting reduced investment activity. Investors coveted U.S. office and multi-family product, while more capital flowed into the industrial sector compared with the same period one year earlier.

Office also reigned in the five German markets with the industrial sector increasing its share of investment year-over-year. Following the Brexit shock in 2016 and a snap national election in June 2017, the U.K. investment market remains robust, while in Bucharest, Romania – the newest Avison Young market – deals comprised both single-asset and portfolio sales with the office sector once again producing the majority of investment dollar volume in the first half of 2017.

Rose adds: "As we go through 2017 and into 2018, the commercial real estate investment market will continue to be characterized by motivated buyers and sellers operating in relatively stable property markets and in a largely still-favourable debt environment. Despite elevated valuations, in the longer term, interest rates will rise and asset pricing will normalize."

CANADA

Investment in the Canadian commercial real estate sector is buoyed by a relatively healthy economy that is the envy of the G7 countries and a commercial property market that continues to see varying, but largely healthy, fundamentals across the country's regions and asset classes.

"With record amounts of capital still seeking a home, investors continue to find ways to buy into Canada's finite investable commercial real estate sector," notes **Bill Argeropoulos**, Principal and Practice Leader, Research (Canada) for Avison Young. "Capital from domestic and foreign investors continues to be largely directed towards Vancouver and Toronto, while the other major markets are also seeing their share of activity."

"On the vendor side, capital recycling continues in order to reduce debt, upgrade asset quality and diversify investments geographically. Surplus capital that can't be placed domestically often finds its way south of the border, as Canada has retaken its place as the primary source of foreign investment in U.S. commercial real estate. Canadian institutional buyers, such as Ivanhoé Cambridge, Oxford Properties and the Canada Pension Plan Investment Board – on their own or in joint-ventures – were active during the first half of 2017 across major U.S. markets, including Chicago, Los Angeles, New York, San Francisco and Washington, DC, with office properties being the most notable assets purchased."

Argeropoulos continues: "Domestically, among the top-ranked transactions by dollar volume in Canada's six major markets, office assets were the most numerous, followed by retail and multi-family. Office transactions ranked among the top five in all markets except Edmonton, comprising a combination of partial-interest, single-asset and portfolio sales."

Notable First-Half 2017 Canadian Investment Market Highlights:

- Following a record $28.4 billion in commercial real estate investment sales in 2016, Canada's six major markets had first-half 2017 sales of almost $19 billion – up $4.3 billion, or 29%, compared with the first half of 2016. Investors coveted office and retail assets, which combined for more than $10 billion in trades, or 55% of the first-half investment tally.

- Vancouver ($7.8 billion/41% share) outpaced Toronto ($6.5 billion/34% share) with investment proceeds surging 75% year-over-year as vendors sought to capitalize on strong demand and peak pricing. With the exception of Ottawa (which saw investment activity plunge 57%), the remaining markets – Calgary, Edmonton and Montreal – all recorded increases year-over-year, and each exceeded the $1-billion mark.

- Supported by notable $200-million-plus transactions, office was once again the top investment sector with $5.3 billion in sales – an increase of 16% year-over-year – and captured 28% of total dollar volume. Toronto and Vancouver made up almost three-quarters of the national office total as investors poured nearly $2 billion into each market, mirroring the results registered one year earlier.

- Disrupted by e-commerce, the retail sector was a close second with $5.1 billion in transactions (27% share) as first-half investment more than doubled year-over-year. This result was bolstered by tremendous interest in Vancouver, which saw its country-leading retail investment total nearly quadruple year-over-year to $3.1 billion. Toronto was a distant second, with $1.3 billion in volume.

- First-half investment in industrial product came in at $3.3 billion (17% share) nationwide – up 35% year-over-year. All markets recorded growth in transaction volume with the greatest sales total in Toronto ($1.7 billion/53% of the national total). Accelerating industrial market drivers continue to be tenants' demands for modern, high-ceiling logistics and fulfilment centres, and for facilities close to major urban centres for last-mile delivery service.

- The multi-family sector was not far behind with $3.2 billion in first-half transactions (17% share). Perhaps the most restrained markets by scarcity of available product, Ottawa and Toronto registered declines compared with first-half 2016; meanwhile, sales in Vancouver increased 146% to more than $1.5 billion, leading the country.

- Finally, the least-traded asset class was ICI Land as $2.1 billion worth of properties changed hands during the first half of 2017. Year-over-year, this was the only sector to record a decline in sales (-11%) as dollar volume decreased in all markets with the exception of Montreal.

- Average capitalization (cap) rates were marginally lower across all markets and all five asset types (with the exception of suburban class A office, which was flat) compared with one year earlier. Multi-family assets commanded the lowest yields – closely followed by retail – while overall rates showed the greatest compression year-over-year in Vancouver and Toronto.

Argeropoulos goes on to say: “Almost three months into the second half of the year, we have already seen more than $3.5 billion change hands in Canada, including the likes of the 1.1-million-square-foot (msf) Constitution Square office complex in Ottawa for $480 million and Dream Office REIT’s estimated $1.4-billion office portfolio sale in Toronto, as well as a half-interest in Scotia Plaza.”

Robin White, Avison Young Principal and Chair of the firm’s capital markets group, adds: “The remainder of the year and start of 2018 hold the promise of several more large-asset sales, such as 1000 Rue de la Gauchetière, a 917,000-square-foot (sf) office tower in Montreal; and the 2.2-msf Bay-Adelaide Centre office complex in Toronto. In addition, Cominar REIT intends to sell its non-core assets outside of Quebec and Ottawa comprising 6.2 msf. Taking current market trends and forthcoming deals into account, the overall 2017 investment total could match or exceed the record level registered in 2016.”

U.S.

In Avison Young’s U.S. markets, deal flow remained robust in the first half of 2017, and although total investment volume lagged slightly (by 12%) compared with the same period one year earlier, foreign investors continued to pursue U.S. assets aggressively. Canadian investors have retaken the lead, displacing China as the largest source of cross-border investment. Despite this overall pullback by Chinese investors, investment from other Asian countries, including Japan, Singapore and Hong Kong, increased.

“A 12% year-over-year reduction in transaction volumes is significant, and it illustrates the disconnect between seller expectations and buyer underwriting occurring in many markets across the U.S.,” notes **Earl Webb**, Avison Young’s President, U.S. Operations. “This disconnect is somewhat in conflict with the broad improvement in market fundamentals that the U.S. continues to register.”

Webb adds: “Nevertheless, the competition for institutional-quality assets continues to push values higher, and 16 of the 40 Avison Young U.S. markets registered sales volume in excess of $3 billion. Not surprisingly, Los Angeles and New York topped the list.”

John Kevill, Avison Young Principal and Managing Director, U.S. Capital Markets, notes: "Valuations have remained high across asset classes, and deals that do execute reflect strong pricing, leading owners looking to balance portfolios to bring deals to market. Generally however, uncertainty in financial markets, macro-economic conditions and increasing geopolitical risk have investors largely satisfied with their real estate portfolios, and those who don't need to transact are increasingly taking a wait-and-see approach."

He adds: "The first six months of the year have highlighted a widening gap between seller expectations and buyer underwriting in properties where there is near-term asset-level risk. In many instances, a view that we are late in the cycle is limiting buyers' ability to underwrite

steady growth, thus negatively impacting price. As a result, many deals are not getting done, contributing to the decrease in sales volume."

Notable First-Half 2017 U.S. Investment Market Highlights:

- Total U.S. real estate investment volume dropped by 12% compared with the same period in 2016, with industrial being the only sector to increase volume in the first half of 2017.

- While cap rates for office, industrial and multi-family properties dipped slightly across the U.S., the overall average cap rate across all markets and property types remained unchanged from June 30, 2016 (6.5%) due to a rise in retail cap rates.

- Large markets, such as New York, San Francisco and Los Angeles, continue to record cap-rate compression. Other attractive metro markets, such as Washington, DC, San Diego, Denver and Miami, registered an uptick in cap rates generated by a limited supply of trophy CBD assets, which have historically exhibited the lowest cap rates.

- Los Angeles led the way in total investment sales dollar volume at $11.5 billion as of the end of the second quarter of 2017, albeit $2.7 billion less than the same period in 2016. Office, retail and multi-family sales dollar volumes were all below their mid-year 2016 levels. Only industrial sales volume picked up, by 17%, from the same time in 2016.

- New York lost its title as the top U.S. investment sales centre after a dramatic drop of more than 50% in total dollar volume in the first half of 2017. This decline was due largely to a relatively low supply of properties for sale. Manhattan continues to see interest from foreign buyers, who are attracted to the robust health of the office market.

- Washington, DC remained a stable market overall with investors, and especially foreign investors, continuing to show interest in the office market. A 29% drop in multi-family sales volume was due to a relative lack of supply.

- The most significant increase in U.S. investment sales volume occurred in San Francisco, which registered a 73% hike compared with the same time in 2016. Of the largest real estate markets, Orlando, Boston and Houston also posted impressive growth rates of 61%, 52% and 40%, respectively.

Kevill goes on to say: “Investors will continue to place a premium on transit-served locations where a live-work-play environment exists or can be developed. These locations tend to attract demand generators in the form of key office tenants and superior amenities, which lead to rental-growth premiums and strong asset performance."

Webb concludes: “Despite the somewhat murky national economy, the U.S. continues to be viewed as a safe place for global investors due to the nation’s stable real estate market and yields. And although it registered lower sales volume overall year-over-year at mid-year, the U.S. remains a seller’s market with available capital chasing core, core-plus and opportunistic deals in preferred locations, and that trend will bolster investment sales well into 2018.”

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Please turn to the following pages of the report for fall 2017 market highlights of the local investment markets. For further info/comment, please contact the Avison Young Principals/Managing Directors listed below. Thank you.

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