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Media Release

For Immediate Release (11 pages)
Wednesday, October 3, 2018

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Investors seek opportunities to deploy capital outside their traditional parameters

Avison Young releases its Fall 2018 North America and Europe Commercial Real Estate Investment Review

Toronto, ON — Capital continues to flow into global commercial real estate markets, inhibited only by the scarcity of available product for sale. Yields on commercial real estate are still attractive when compared with alternative investments; however, limited supply and cap-rate compression are leading some investors to seek opportunities outside their traditional parameters.

These are some of the key trends noted in **Avison Young's** ***Fall 2018 North America and Europe Commercial Real Estate Investment Review***, released today.

The report covers commercial real estate investment conditions in 59 markets in six 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**, **Indianapolis, Jacksonville, Las Vegas**, **Long Island**, **Los Angeles**, **Memphis**, **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 Jose/Silicon Valley, San Mateo**, **St. Louis, Tampa**, **Washington, DC**; **West Palm Beach**, **Westchester County**, **Mexico City, Coventry**, **London, U.K.; Manchester**, **Berlin**, **Duesseldorf**, **Frankfurt**, **Hamburg**, **Munich** and **Bucharest**.

"Public and private capital continue to target commercial real estate assets around the globe, pushing asset values higher and making it more difficult for investors to find rewarding opportunities – leading to more joint-venture, value-add and redevelopment opportunities," comments **Mark E. Rose**, Chair and CEO of Avison Young. "Investment capital flowing into the sector is buoyed by sound property leasing fundamentals with good demand; and with some exceptions, supply is still relatively constrained."

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He continues: “With prime assets delivering slim returns, there’s a real quest for consistent growth across countries and asset types. All of these dynamics are occurring against a backdrop of ongoing geopolitical concerns, including the negotiations leading up to the new trade agreement between the U.S., Mexico and Canada, trade-war tensions in Asia-Pacific and Brexit in the U.K., not to mention the prospect of higher long-term interest rates and the impact on asset pricing – all of which continue to weigh on the minds of investors.”

According to the report, even while the U.S. was in the process of negotiating a new trade agreement with Mexico and Canada, cross-border investment into the commercial real estate sector continued to flow, especially from Canada to the U.S. Mexico’s stable and healthy macroeconomic fundamentals have made the country a well-regarded destination for global investment capital and one of the most open economies for international trade and investment.

Across the Atlantic, London’s commercial real estate market has continued to show remarkable resilience in the face of stiff headwinds – enduring significant political and economic uncertainty caused by the EU referendum result, the shock result of the snap U.K. election and growing tensions between the U.S. and China, which have raised fears of a trade war that could have global economic impacts.

Across Germany’s five major markets, office assets once again attracted the most capital as already tight capitalization (cap) rates continued to compress. Frankfurt posted the country’s largest single transaction of the first half, while in Berlin, alternative asset types gained popularity with investors. In Romania, the capital city of Bucharest remains in top position with positive fundamentals and improving liquidity, and still offers favourable returns compared with other countries in the region.

Rose adds: “While concerns over rising interest rates and their impact on values remain, we don’t expect to see a material decline in investor appetite during the second half of 2018."

CANADA

Investors remain enthusiastic about Canada’s commercial property market, despite uncertainty surrounding rising interest rates, the lateness of the investment cycle and – in particular – scarcity of available product to meet insatiable demand. Against a backdrop of geopolitical tensions and financial volatility, Canada is still viewed globally as a safe haven, given the country’s stable economic and political climate and sound property market fundamentals.

“Canadian and international investors continue to view the country in a favourable light,” notes **Bill Argeropoulos**, Principal and Practice Leader, Research (Canada) for Avison Young. “Toronto and Vancouver remain the primary destinations for investor capital, but investment was relatively evenly distributed among the asset classes nationwide in first-half 2018. In fact, Toronto is in good company among North America’s major markets – the only Canadian market to crack the top 10.”

The report goes on to say that office product is attracting its share of capital as the influx of technology and co-working firms adds to demand from traditional sectors. Ongoing urban intensification is not only impacting the office sector, but rising population density and the strong links between the industrial and retail sectors – resulting from the growth of e-commerce and last-mile logistics – mean that both asset types are garnering investors’ attention. Meanwhile, tight housing supply is driving multi-family investment, yielding the lowest cap rates. With development robust in all sectors, the scarcity of developable land has put land sales on pace for a record year.

"Among the top five transactions by dollar volume in each of the six major Canadian markets, office building sales outnumbered all other asset types as investors paid top dollar for these prized properties, including a 50% interest in Toronto's Bay Adelaide Centre, which was sold to a foreign investor for $850 million," says Argeropoulos. "Other noteworthy transactions included Bombardier's sale of its Downsview Airport site in Toronto for $825 million – the largest ICI land sale on record in Canada, while the Gateway Casinos portfolio in Greater Vancouver was Western Canada's largest deal at $501 million."

Argeropoulos adds: "The first half of 2018 was notable not only for direct investment in commercial real estate assets, but also multi-billion-dollar M&A activity in the industry, with headline transactions including Choice Properties REIT's purchase of CREIT and Blackstone's acquisition of PIRET. At the same time, Canadian capital continued to flow into the U.S. as trade-agreement negotiations and political uncertainty did not dampen investors' interest in assets south of the border."

Notable First-Half 2018 Canadian Investment Market Highlights:

- After pouring a record $36.2 billion into commercial real estate assets (office, industrial, retail, multi-family and ICI land worth $1 million or more) across Canada's six major markets (Vancouver, Calgary, Edmonton, Toronto, Ottawa and Montreal) in 2017, investors placed another $17.7 billion in first-half 2018 – down a modest $1.3 billion, or 7%, from the first half of 2017. Though office was the most sought-after asset type among investors, retail, ICI land and industrial were not far behind.

- Toronto, the top investment location, ($8.2 billion/46% share) outstripped Vancouver ($5.1 billion/29% share) from one year earlier as the two markets combined for three-quarters of total first-half 2018 dollar volume. Toronto attracted the most capital in four of the five sectors, placing second to Vancouver only in retail asset sales. Apart from in Toronto and Ottawa, property sales in all markets declined by varying degrees year-over-year.

- Office was the most desired asset class, securing one quarter, or $4.5 billion, of investor capital, but sales declined 16% year-over-year. Toronto was the only market to register year-over-year sales growth (+35%) as it garnered $2.7 billion (60% of first-half 2018 office dollar volume) in sales – more than the other five markets combined, and almost triple Vancouver's $1.1-billion performance.

- Coming off a record $9-billion performance in 2017, retail posted $3.9 billion (22% share) in first-half 2018 sales – a decrease of 25% year-over-year. As in first-half 2017, investors favoured retail properties mostly in Vancouver ($1.7 billion) and Toronto ($1.3 billion) as these two markets combined for 78% of total retail investment in the first half of 2018.

- Given robust construction activity across the country, ICI land was in high demand. In all, $3.8 billion worth of land parcels changed hands in the first half of the year – the only sector to post notable year-over-year growth in sales (+82%). The land sector was exceptionally hot in Toronto and Vancouver as annual sales in each market nearly doubled to $1.8 billion and $1 billion, respectively.

- The value of industrial acquisitions inched up 1% year-over-year to $3.3 billion at the midway point of 2018, while cap rates compressed in nearly every market. Buyers continued to seek product in one of North America's biggest and tightest industrial markets, Toronto – accounting for almost half of overall investment in the sector. Meanwhile, more capital flowed into Ottawa, Montreal and Edmonton compared with one year earlier.

- Accounting for only 13% of the total first-half 2018 investment tally, multi-family property sales dropped 28% to $2.3 billion from $3.2 billion one year earlier. Blackstone's foray into the Canadian multi-family sector (a joint-venture with Starlight Investments) propelled Toronto ($848 million/+46%) ahead of Vancouver ($698 million/-55%) from one year earlier.

- Multi-family assets commanded the lowest cap rates – closely followed by retail. On a market-by-market basis, overall average rates showed the greatest compression year-over-year in Montreal and Ottawa, while the lowest yields were found in Vancouver and Toronto. The overall average cap rate across the six markets and five asset types was 5.2% at mid-year 2018, down 10 bps year-over-year.

Argeropoulos concludes: "In a world of moderating returns, investors are looking to capitalize on landlord-favouring markets and sectors offering significant rental growth – pushing beyond pure-play acquisitions to redevelopment and upgrade opportunities – while debt reduction and geographic diversification continue. For the near term, asset values will remain elevated and cap rates low."

Robin White, Avison Young Principal and Chair of the firm's capital markets group, adds: "Despite the challenges being faced in many parts of the world, Canada's economy has maintained its resilience with low unemployment and moderate growth. This situation has translated into continuing demand for real estate as an asset class from domestic and international investors, both private and institutional. They have been attracted to the strong fundamentals of the asset class, and there is no sign of this interest dissipating in the near term."

U.S.

Despite investor concerns over interest-rate hikes, the economy and the country's political landscape heading into 2018, overall U.S. investment sales volume in the first half of the year increased 4% year-over-year to approximately $137 billion in markets in which Avison Young has an office. Industrial, retail and multi-family investment sales volume increases contributed to this growth, while office investment decreased slightly. Multi-family investment sales volume represented the largest portion of overall investment sales volume at $48 billion and was followed closely by office investment sales at $46 billion.

Earl Webb, Avison Young's President, U.S. Operations, notes: "Again in 2018, there is an abundance of capital chasing a scarcity of quality assets, and when quality inventory is available, pricing is being upheld. Not surprisingly, sales volume for multi-family assets overtook office sales in the first half of this year, a trend we expect to continue."

John Kevill, Avison Young Principal and Managing Director, U.S. Capital Markets, states: "This year, we are seeing the composition of buyers vary according to each deal's asset class, size and

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location. There have been no appreciable price changes as a result of recent interest-rate increases, showing us that although pricing can be affected by interest rates, they are not directly correlated."

Foreign investors continued to demonstrate interest in the U.S. in first-half 2018, even in the face of rising U.S. protectionism and global trade uncertainty.

Webb continues: "Foreign capital flow focused on high-profile and high-priced assets and was concentrated in the New York, Los Angeles and Washington, DC metro markets. Notably, foreign capital has shown a rising interest in construction investments although investors still prefer to buy existing assets for their portfolios when available."

The report goes on to say that Canada led foreign investment in the U.S. once again although the composition of cross-border investors changed significantly. Investment from Chinese investors, who had been particularly active in the U.S. in 2015 ($16 billion) and 2016 ($17 billion), fell off. In comparison, Chinese investment in U.S. assets had reached approximately $4.9 billion by mid-year 2018.

Private investors, REITs and institutional investors were all active in first-half 2018, fueled by the availability of debt and commercial-loan increases. Private and institutional investors have persistently been more active than foreign investors and REITs in recent years. The abundance of accessible debt has created a competitive lending market, specifically for higher-quality assets.

The U.S. economy posted an unemployment rate of 4% and GDP growth of 4.2% in June 2018, and these figures support the continued bullish outlook of many investors.

Kevill concludes: "Looking ahead to the rest of 2018, investment will likely be on par with the $300 billion of overall investment achieved in 2017."

Notable First-Half 2018 U.S. Investment Market Highlights:

- Multi-family investment sales volume in the U.S. accounted for a whopping 35% of total investment volume and totaled $48 billion – a 12% increase compared with the same period in 2017. This prominent increase was supported by an abundance of recent development across the U.S.

- U.S. office investment in the first half of 2018 demonstrated a slight decline compared with the same period in 2017, falling 9% to $45.6 billion. The decline in individual asset values year-over-year likely accounts for this decrease. Additionally, investors in the office market have displayed a preference toward newer and higher quality office buildings. These trends in the office market are expected to continue through the rest of 2018.

- U.S. industrial investment volume increased by 19% year-over-year to $23.6 billion in the first half of 2018. The majority of this performance increase was due to megadeals, largely because of high demand for industrial assets in light of the growth in online retail and need for distribution centers. Industrial investors have displayed a tendency to focus on smaller markets where they predict greater yields.

- Cap rates have remained stable year-over-year even as interest rates have risen. The average cap rate across all sectors dipped slightly to 6.4% at mid-year 2018 from 6.5% at mid-year 2017. The most compressed cap rates in the U.S. were recorded in the multi-family markets of Manhattan and San Mateo, both at 3.6%. Overall, the U.S. office market had the highest cap rate at 7% and the multi-family sector had the lowest at 5.6%.

- Los Angeles was the top market performer overall for the second year in a row with total investment ($11.2 billion) constituting 8% of all U.S. investment sales. Although office and industrial volume in the first six months of 2018 lagged what was achieved in first-half 2017 due to limited inventory and a decrease in Chinese investment, the retail and multi-family sectors increased by 200 and 460 bps, respectively.

- Washington, DC continued to be a favored investment target as its volume increased 22% to $9.8 billion year-over-year. Although office sales decreased slightly, significant growth in the multi-family and industrial sectors drove the overall volume higher.

- Manhattan also remained one of the top performers, achieving $8.7 billion in investment volume in the first half of 2018 and a 5% increase in investment volume year-over-year partly due to increases in cross-border investment. The retail and multi-family sectors exhibited increases in sales volume – 50% and 19%, respectively, while Manhattan's office sales market remains the strongest in the U.S. at $6.7 billion.

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