CANADA

Perspective

2019

Global economic expansion continues, but risks are growing

Space markets are resilient and rents are rising

Investors showing a bias to quality as the cycle matures

Bentall Kennedy

We would like to acknowledge the assistance we received from the following parties in completing this report:

Altus Group, Archival Economic Data St. Louis Fed (ALFRED), Avison Young, BMO Capital Markets, Bank of Canada, Bloomberg, BuildForce Canada, CB Insights, CBRE, CBRE Econometric Advisors, Calgary Economic Development, Canada Mortgage and Housing Corporation (CMHC), Canadian Real Estate Association (CREA), Canada Visa, CMLS Financial, Colliers International, Conference Board of Canada, CoStar, Cushman & Wakefield, eMarketer, Emergent Research, Environics Analytics, Global Coworking Unconference Conference (GCUC), Globe & Mail, Haver Analytics, Gluskin Sheff, Hofstra University, International Council of Shopping Centres (ICSC), International Monetary Fund (IMF), J.C. Williams Group, Jones Lang La Salle, KPMG, MSCI REALPAC Canada, Macrobond, Montreal Institute for Learning Algorithm (MILA), L2 Inc., National Autonomous Vehicle Technology and Innovator Directory, National Association of Real Estate Investment Trusts (NAREIT), National Council of Real Estate Investment Fiduciaries (NCREIF), National Post, Prequin, Organisation for Economic Co-operation and Development (OECD), RBC Capital Markets, RBC Economics Research, RBC Financial Group, RealNet Canada, REALPAC, Recode, Residential Construction Council of Ontario, Ryerson Centre for the Study of Commercial Activity (CSCA), Statista, Statistics Canada, Scotiabank Economics, SunTrust Robinson Humphrey, TD Economics, US Department of Transportation, Urbanation, WeWork.

We would also like to thank the many individuals who are employed by these parties as well as the real estate owners and managers who helped us with insights and guidance along the way.

Bentall 5, Vancouver, BC

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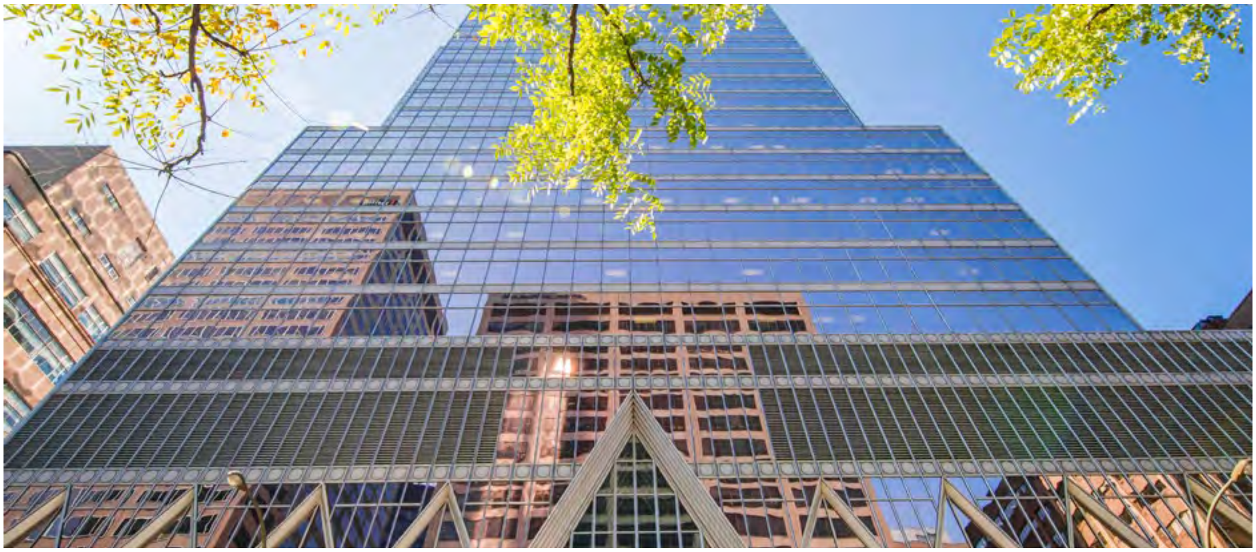
Up-in-quality as cycle matures



Tour KPMG, Montreal, QC

Investor sentiment remains strong supported by solid real estate fundamentals and healthy job growth, but downside economic risks are building.

As we look ahead to 2019, the outlook for global economic growth remains solid. But there are increasing signs that growth is slowing and is more fragile as trade tensions linger between the U.S. and China. Financial markets are more volatile as they grapple with some major global central banks steadily tightening monetary policy. Barring an unforeseen financial shock, mid-2019 will mark the longest U.S. economic expansion in history. And, although real estate fundamentals in Canada are solid, there are many pressing questions for investors. How much further can this economic expansion run? Have real estate values peaked or is there a new pricing paradigm for institutional quality real estate? How to invest prudently at this stage of the cycle?

What do we see in the year ahead? Here are the key takeaways from this year's Canada Perspective.

Global growth has peaked but remains solid
Despite increased headwinds and emerging signs of slower economic activity, mid-3.0% global GDP growth is anticipated for 2019.

U.S. growth resilient
Strong stateside demand combined with the expected approval of the United States-Mexico-Canada Agreement (USMCA) will support slower but steady Canadian growth.

"Help wanted"
Record low unemployment and a mismatch of skills will become the biggest challenge for Canadian businesses.

Immigration is a boon for growth
Canadian cities are capitalizing on the opportunity to attract economic migrants. Signs of a growing populist wave threaten this key labour source.

Real estate fundamentals as strong as ever
Business optimism and consumer confidence remain high, near historic levels, which bode well for real estate demand. Developers remain disciplined.

Technology's impact on knowledge work accelerates
Not only is tech affecting the demand for space, but it's changing the future of work, office space design and building operations.

Cyclical headwinds add to negative sentiment in retail
Borrowers are adjusting well to higher interest rates but at the expense of consumer spending. Grocers are ramping up digital offerings.

Not enough industrial real estate
Supply constraints and steady logistics demand will continue to exert upward pressure on rents, especially for urban infill locations. Institutional investors are clamouring for increased exposure to the sector.

301 College Street, Toronto, ON

Not enough purpose-built rental apartments
A myriad of tailwinds for demand have accelerated rent growth. Supply is up, but rising land and construction costs and an inefficient approval process make new construction very challenging.

Investors exhibiting an "up-in-quality" bias
But that hasn't slowed the pace of investment activity, which is expected to reach a new all-time high in 2018. Strong momentum should continue into 2019.

Ample availability of low-cost debt
Favourable lending conditions should continue to provide liquidity.

Industrial and multi-residential outperform
These sectors should continue to generate the highest returns across property types as they offer the greatest prospects for rent growth and remain under-allocated in many portfolios.

Operational excellence will be paramount to performance
Healthy operating fundamentals and strong investor demand for real estate should help support valuations in the face of higher interest rates. Future returns will become harder to come by as valuations have inched higher. But supply-side constraints and steady tenant demand will limit the downside risk of space market dislocation. Investors will need to exercise patience and prudence when navigating this maturing cycle.

KEY TAKEAWAYS: THE YEAR AHEAD

1. Global growth steady but more fragile
2. U.S. growth remains solid
3. Record low unemployment
4. Immigration positive for growth
5. Property fundamentals as strong as ever
6. Technology impacts knowledge work
7. Slowing consumption a headwind for retail
8. Short supply of industrial real estate
9. Short supply of purpose-built rental apartments
10. Investor sentiment remains strong
11. Ample availability of low-cost debt
12. Best opportunities are in industrial and multi-residential
13. Operational excellence is critical

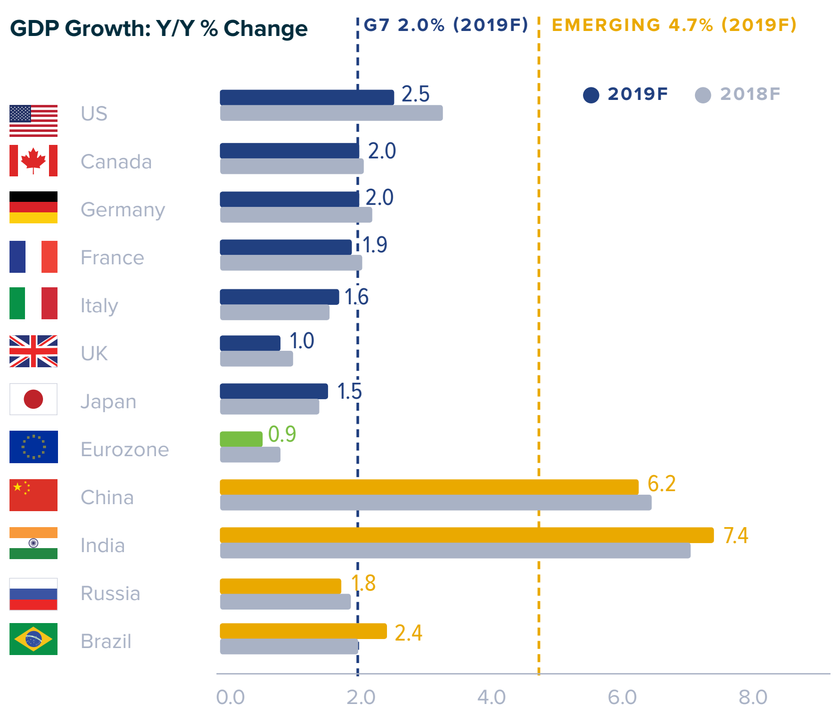
Global economy

Expansion continues, but growth has peaked

There are undoubtedly signs of decelerating growth in the global economy. Faltering leading indicators from the Organization for Economic Co-operation and Development (OECD) and modest downward revisions to global growth projections for 2018–19 by the International Monetary Fund (IMF) both signal a more challenging economic environment ahead.

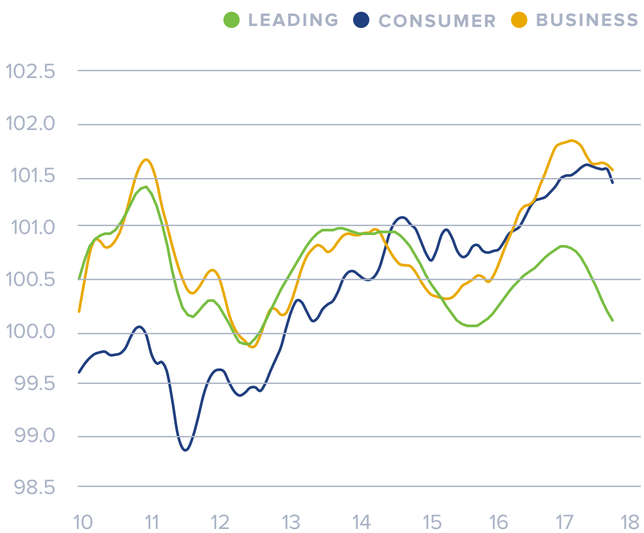
Projected global GDP growth

3.7% 2019F



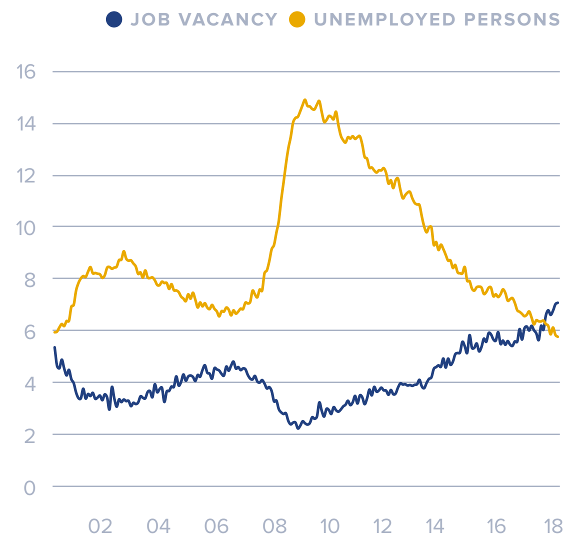
Source: IMF, Deutsche Bank Research

Leading indicators signal softening outlook
OECD Confidence Indices



Source: OECD

U.S. labour shortage accelerating
Persons (Millions)



Source: St. Louis Federal Reserve

Trade tension between U.S. and China could dampen growth

The outlook for global growth is far from dour. In its October, 2018, forecast, the IMF projected average annual global GDP growth to run near 3.7% through 2020. Growth over the preceding five years was 3.5%. In China, economic reports are mixed, but growth is projected to hold above 6.0% annually. Meanwhile, in North America, leading indicators of near-term growth are solid in both Canada and the U.S.

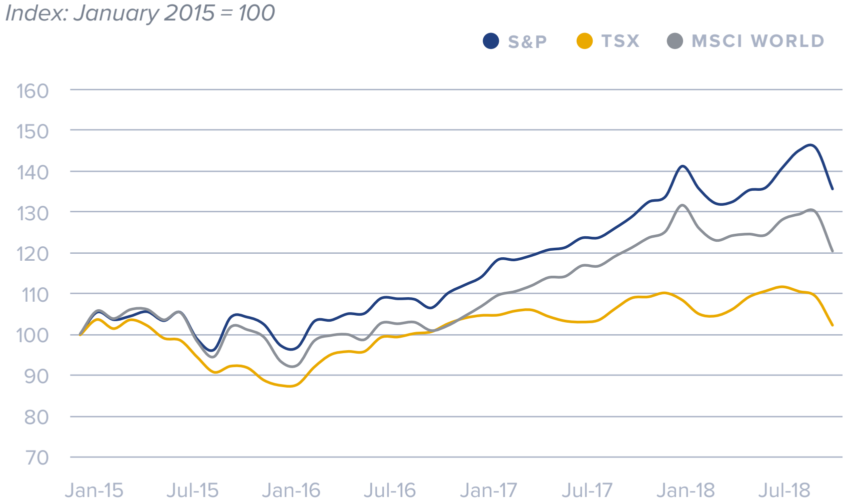
There are lingering headwinds and risks that could lead global growth lower in 2019 and beyond. China's focus on deleveraging financial risks and managing other economic, political, and environmental reforms could result in missteps that undermine growth. Further escalation in the trade war between the U.S. and China would undoubtedly have spillover effects on the global economy. But at the time of this writing, the two sides agreed to a temporary and partial truce in hopes that a long-term deal can be reached.

In the U.S., household wealth has been bolstered by the home price and stock market gains of the past several years. Tight labour market conditions are supporting wage growth well above the pace of inflation. These conditions are encouraging consumption. More recently, rising interest rates, volatility and losses in the stock market, rising government deficits, and a cooling housing market are generating some concerns about growth.

At its December, 2018 meeting, the Federal Reserve saw fit to move ahead with the year's fourth rate hike as expected. The central bank notes that underlying economic fundamentals are strong in the U.S. even if there are signs of softer growth compared to earlier in 2018. Comments from Federal Reserve Chairman Jerome Powell indicated a slightly more dovish stance on rate hikes in 2019.

Synchronized retreat in global equity markets

Index: January 2015 = 100



Source: Bloomberg

Monetary policies diverge

Risks in Europe have accelerated. Trade protectionism, weaker global demand for European exports and looming uncertainty around Brexit have translated into slower-than-anticipated growth this year. The outlook for 2019 is even more muted.

Monetary policy is diverging as the Fed and Bank of Canada are raising interest rates. Meanwhile, the European Central Bank is looking out to the latter half of 2019 to move and the Bank of England is currently on pause until Brexit is resolved. The net result is a rising dollar and increased borrowing costs, which are causing stress on emerging markets, making it harder to repay dollar-denominated debt.

Despite numerous headwinds and risks, underlying fundamentals point to further expansion in the global economy. Financial conditions are still broadly accommodative. The recent plunge in world oil prices is negative for oil-exporting countries but will have a stimulative effect on the global economy as consumers have more money to spend. Consumer spending in the U.S. may continue to rise, despite some more negative factors.

The path of global growth will be largely predicated on the trajectory of the U.S. economy where conditions are far better than recent stock market losses would suggest. All told, the global economy is on solid footing. Downside risks have increased for 2019 and beyond but, barring any unforeseen shock, the current expansion is expected to continue.

Canadian economy

Backdrop remains supportive for real estate demand

Bentall 5, Vancouver, BC

Despite real GDP growth easing to a more sustainable pace, economic fundamentals in Canada remain buoyant. Growth is expected to be broadly based across the country. Barring any unanticipated shocks, the net impact from the current upside and downside risks should remain positive for the Canadian economy as we head into 2019.

Projected Canadian GDP growth

2.0% 2019F

Source: IMF Forecast

UPSIDE RISKS

Strong U.S. economy
Stateside demand continues to drive goods-producing sectors

North American trade
USMCA removes uncertainty on trade — further boosting confidence

Business investment
Business confidence and capacity constraints spur investment

Tech sector
Canadian value-play gains further momentum

DOWNSIDE RISKS

Rising interest rates
Consumer spending grinds to a halt as high debt levels weigh on borrowers

Trade wars
U.S.-China-led global trade war accelerates

Housing market
Vancouver market continues to slide and/or Toronto recovery fades

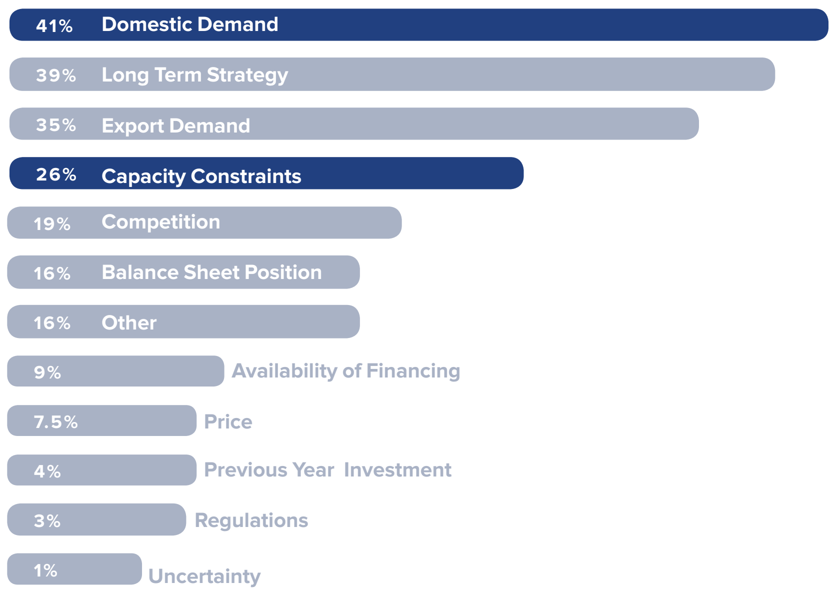
Oil price
Prices remain low, Canadian oil spread exacerbated by pipeline capacity issues

Onus on capital investment as the economy nears full capacity

Inflation has risen to 2.4% as of October, 2018, up significantly from 1.4% a year earlier. Core inflation is nearing the Bank of Canada's policy target range of 2% to 3%. This implies that the Canadian economy is at or near its output potential. Above-average economic growth going forward will be largely dependent on the propensity to raise output capacity through capital investment. Fortunately, Canadian fixed capital investment is poised to gain further momentum, pending congressional approval of the USMCA. In the October Bank of Canada Business Outlook Survey, the expectation of stronger domestic demand, along with reaching the limits of existing capacity, are cited as two of the main drivers of capital investment.

Domestic demand and capacity constraints key drivers of investment

% Firms Citing Drivers of Future Investment



Source: Bank of Canada Business Outlook Survey, October 2018

10 Dundas East, Toronto, ON

Signs of a labour shortage prevalent

While the rate of job creation has slowed compared with the impressive levels observed a year ago, the labour market is still churning out jobs at a healthy pace — in line with historical averages. Over the 12-month period ending November, 2018, the Canadian economy added 219,000 jobs, dropping the unemployment rate to a 44-year low of 5.6%. Even more encouraging, 227,000 full-time jobs were created mostly in the private sectors (8,000 part-time lost). This generally signals a positive business outlook because it suggests employers are more willing to commit to longer-term, higher-paying full-time positions.

Signs of full employment are prevalent as labour shortages are intensifying. The latest Bank of Canada Business Outlook Survey indicated that 50% of firms can't find enough qualified applicants for all open jobs. This shortfall appears to be getting worse as evidenced by how the labour shortage intensity level is seeing considerable upward pressure. Job vacancies are on the rise, suggesting tighter labour conditions and possibly indicating that, even if labour is available, the candidate skill set for the job is inadequate.

While this has yet to result in material wage growth, scarcity in qualified labour along with an economy poised to surpass its potential production means employers are likely to respond with higher wages in 2019. Higher earnings should ease the trend of softening consumer spending and help mitigate the risks stemming from elevated household debt.

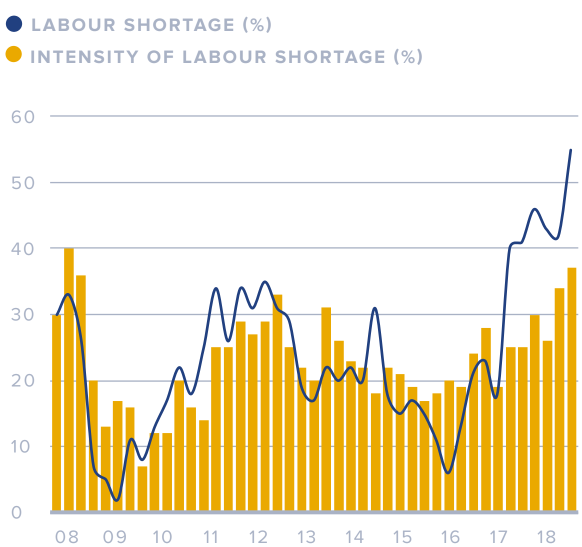
The Canadian unemployment rate is at a

44 YEAR LOW

5.6%

Source: Statistics Canada

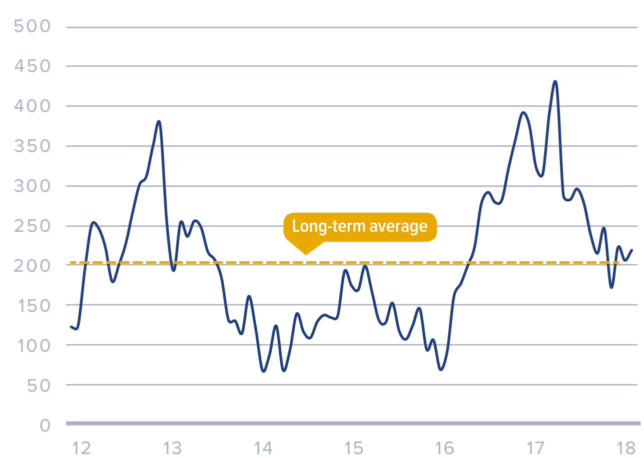
Businesses citing labour shortage



Source: Bank of Canada Business Outlook Survey
**Labour Shortage: % of Firms Experiencing Labour Shortage*
***Intensity: % Firms Facing Labour Shortage Today Minus Relative To 12 Months Ago*

Job growth slowing to long-term average

Rolling 12-Month Employment Change (Thousands)



Source: Statistics Canada, Haver Analytics

National housing market stabilizing, but Vancouver's slide continues

Stricter mortgage qualifications rules and higher interest rates led to a softening in the national housing market in 2018. As Toronto stabilizes, so does the national market with the Canadian Real Estate Association (CREA) reporting in October, 2018 that its national Housing Price Composite Index rose by 2.5% year-to-date. This is far removed from the double-digit gains registered prior to mid-2017, but these more balanced conditions suggest more sustainable growth in home prices is on the horizon.

Resale activity in Vancouver has cooled considerably and inventories of unsold new housing units are building. From a home ownership cost-to-income standpoint, Vancouver remains the most unaffordable housing market in the country. Rising interest rates will continue to challenge homeownership there. The Toronto housing market is also grappling with affordability issues, despite the recent downturn. Signs are emerging that suggest the Toronto market may be stabilizing.

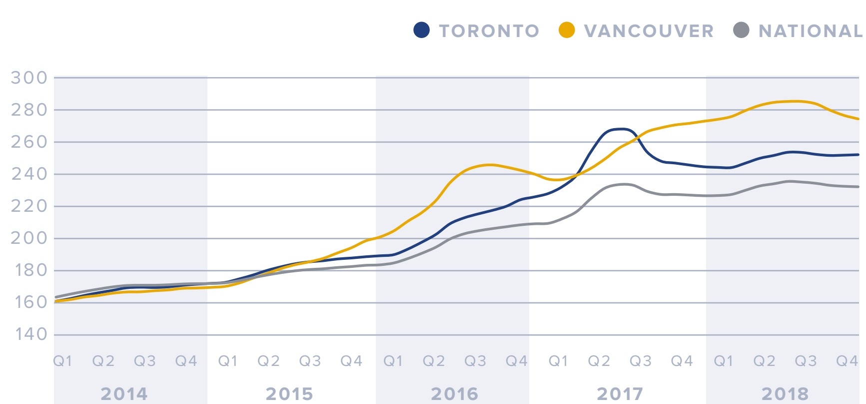
NATIONAL MLS HOME PRICE COMPOSITE INDEX ROSE BY

2.5% year-to-date

Source: CREA, October, 2018

Housing market stabilizes outside of Vancouver

MLS Home Price Index



Source: CREA

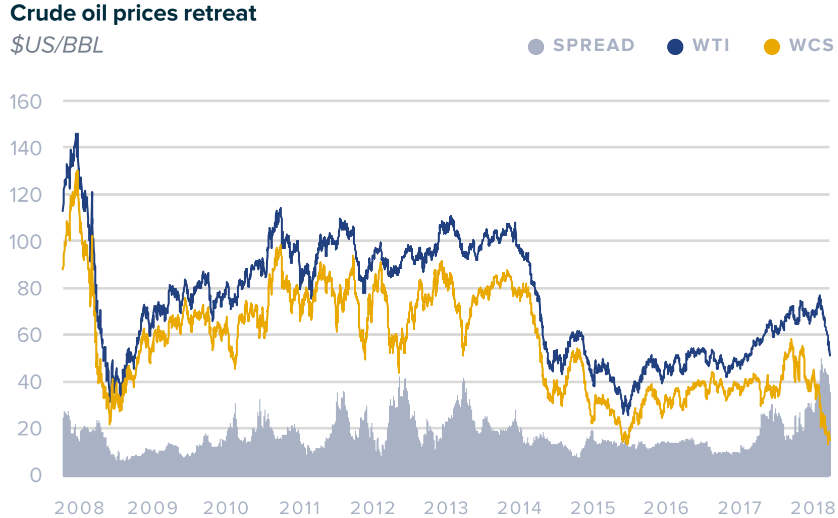
Trade landscape improves but uncertainty remains

Canada's trade balance registered a surplus in August for the first time since December, 2016. Energy and non-energy exports were significantly up on a year-to-year basis. Barring a dismissal from legislators, the newly signed USMCA should positively benefit exports and investment. Tariffs remain in place for aluminum and steel, and this uncertainty remains a risk for non-energy exports. The important energy sector got a boost from the $40-billion liquefied natural gas project (LNG Canada), a network of pipelines aimed at transporting liquefied natural gas from British Columbia to China and Japan. However, the longer-term outlook for the energy sector remains tepid as pipeline constraints continue to impact the competitiveness of crude oil originating from Western Canada.

Global crude prices have plummeted over recent months after showing signs of life earlier in the year. But even if oil prices rebound, Canadian crude prices are trading at a significant discount compared with the West Texas Intermediate (WTI) benchmark. This will continue to be a downside risk to the Canadian economy heading into 2019.

Crude oil prices retreat

$US/BBL



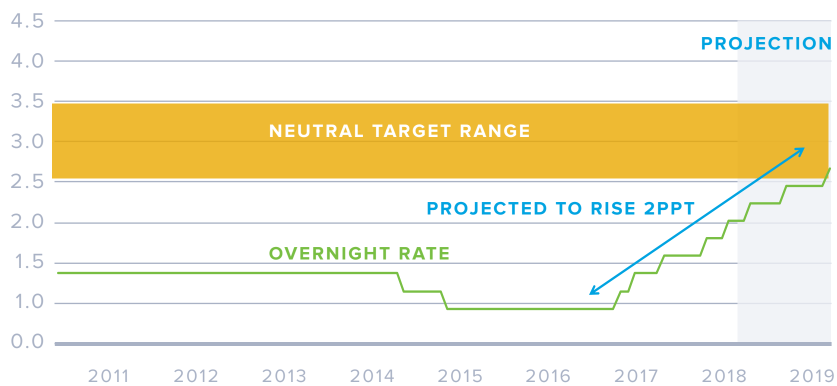
Source: Bloomberg

Bank of Canada more cautious in 2019

The Bank of Canada has been more aggressive in tightening monetary policy over the past two years. However, the Bank of Canada left the overnight rate unchanged at 1.75% in December, signaling that its commitment towards a neutral policy rate of 2.5% to 3.5% could be on hold. Three more rate hikes resulting in an overnight rate of 2.5% by the end of 2019 would mean that the policy rate increased by 2.0% in a span of 2.5 years (mid-2017 to 2019). This would represent one of the most aggressive interest-rate hike cycles on record, which could be debilitating for interest rate-sensitive parts of the economy. Given that private debt levels remain elevated, any sharp rise in interest rates could weigh on consumer spending and create further dislocation in the housing market. The recent plunge in oil prices is also a significant downside risk for inflation. Bank of Canada Governor Poloz will be keeping a close eye on the Fed, which has become more dovish recently as trade tensions with China remain unresolved. For these reasons, it's likely that the Bank of Canada will take a more cautious approach in 2019.

Bank of Canada signals a neutral rate policy stance

Overnight Rate (%)

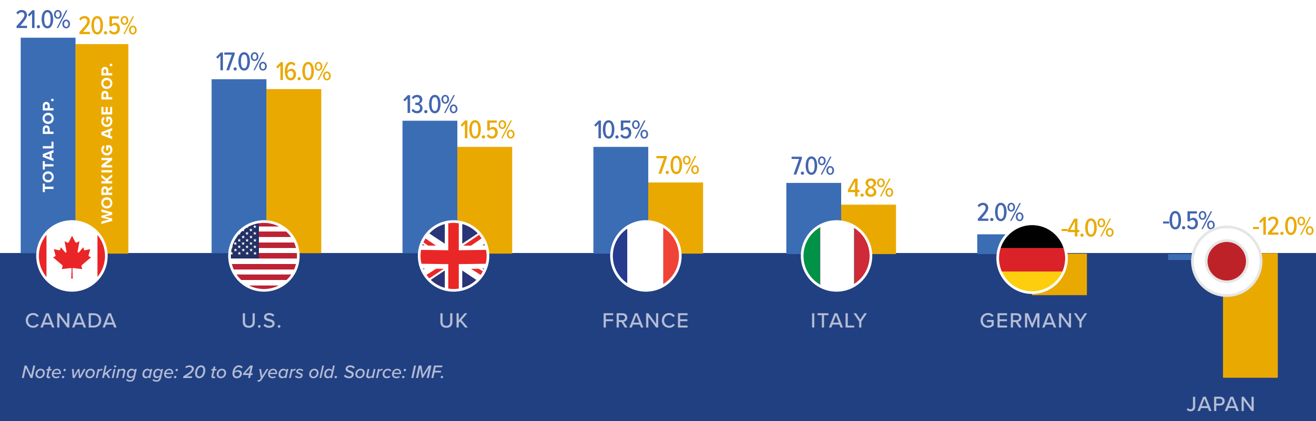


Source: Bank of Canada, Bentall Kennedy

Surging population growth fuelled by immigration

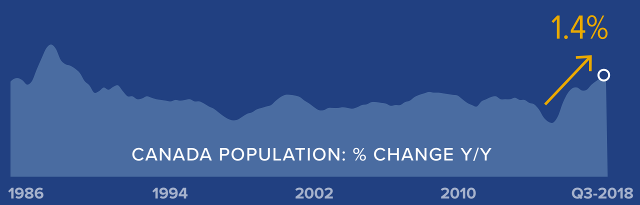
1 Canada leads all G7 nations in population growth

POPULATION GROWTH: 2000-2018 % CHANGE

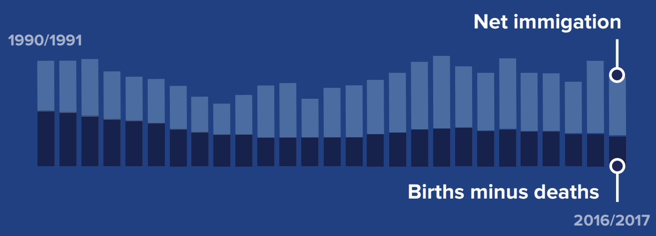


Note: working age: 20 to 64 years old. Source: IMF.

2 Canadian population growth surges to the fastest pace in nearly three decades



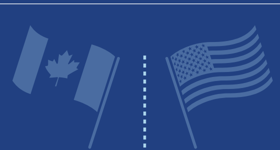
3 Immigration is key to Canada's population growth



4 Canada's key immigration drivers

Canada has a long history of immigration innovation

Over the past 50 years, Canada has been a world leader on immigration policy. It was the first country—and is still one of only a handful of countries—to implement a points-criteria system. This merit-based system helps ensure that immigrants have the best chance at finding gainful employment to integrate more quickly and more fully.



Canadian programs and strategies

Global Skills Strategy
Enhanced in 2017, this program expedites the work-permit process to two weeks for "low-risk, high-skilled" foreign workers.

Express Entry
Launched in 2015, this electronic system helps to expedite the permanent residency approvals process to as little as 6 months from what had been up to 10 years.

Closing doors in the U.S

Immigration uncertainty
Since the 2016 U.S. presidential election, there has been speculation about the future of U.S. work visa programs, including the H1B visa, upon which many tech companies rely on to recruit talent from abroad.

International students
Enrolment in Canadian universities is up 40% over the past two years. Enrolment in American institutions fell 6.6% in 2017-18 and by 3.3% the previous year.

5 Immigration is critical to lifting Canada's potential economic growth

Declining natural increase

By 2023, natural increase (Canadian births minus deaths) will contribute to a declining annual population growth.

1.6 Ranked 181st globally

Canadian fertility rate (number of births per woman)

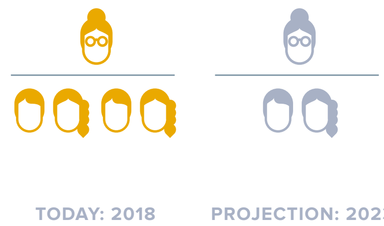
An aging population

Will lower revenues and drive up costs for federal and provincial governments (health care and Old Age Security costs).

25%

of the population will be older than 65 by 2035

Ratio of retirees to workers



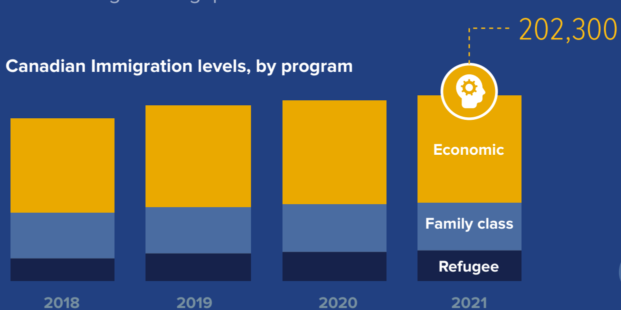
Source: Conference Board of Canada

6 Population growth concentrated in urban centres, especially in the GTA

Canada extends immigration targets 350,000 annually by 2021

The vast majority of these newcomers are coming under economic programs designed to address skills shortages and gaps in the labour market

Canadian Immigration levels, by program



Source: Canada Visa

Share of Ontario population growth
Thousand persons, Y/Y population change as of July 2018

Source: Statistics Canada, Haver Analytics

Key election issue in 2019

Immigration is poised to become a key federal election issue in 2019 because it is the most vulnerable to populist attack. Conservatives have already started to test populist rhetoric on such issues as immigration and trade. Almost 35,000 people have entered Canada from the U.S. to claim asylum since January, 2017. There are undoubtedly issues to be addressed that are more acute to refugee claimants, such as how to successfully integrate them into the community.

Source: Conference Board of Canada

But the reality is, immigrants:

- Boost trade ties between Canada and the world
- Add diverse and skilled labour to the workforce
- Strengthen culture and diversity
- May boost productivity of domestic workers
- Are motivated, innovative and entrepreneurial
- Boost demand for goods and services
- Do not significantly affect the wages of existing workers
- Can result in higher business investment

Office

Broad-based strength across non-energy-dependent markets

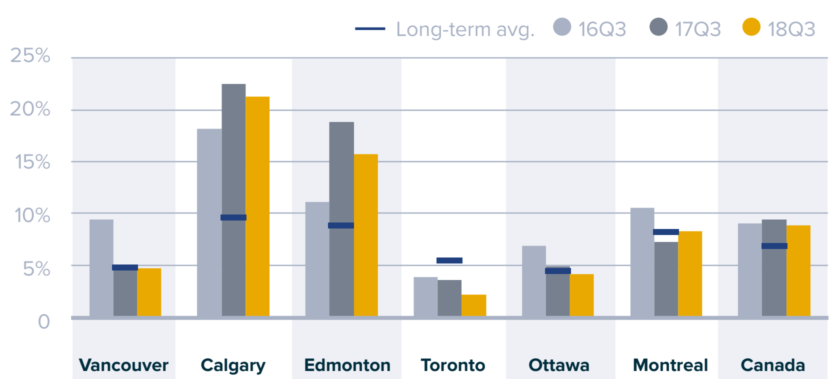
150 King Street West, Toronto, ON

The Canadian office market is making positive strides but national numbers overlook regional dynamics. Outside of Alberta, conditions are generally healthy with some metro sub-markets performing at record vacancy levels.

A thriving tech sector and the rise in co-working have been drivers of demand for office space, especially in Vancouver, Toronto, Ottawa and Montreal. This is most evident in downtown markets where securing large blocks of quality space is a challenge for prospective tenants. As such, downtown Class A vacancy rates are seeing considerable downward pressure. As tight conditions persist within the cores, suburban and midtown sub-markets are poised to see spillover demand. This trend is most evident in Vancouver where the suburban Class A vacancy rate fell by 5.6% year-over-year as of 2018 Q3. Looking ahead, suburban nodes such as the GTA West and Montreal's Midtown might garner more attention going forward.

Under these favourable conditions, development activity is picking up. As expected, the majority of this activity is taking place in Vancouver, Toronto and Montreal. Given very strong demand in these markets, new supply, along with any backfill space, should be absorbed with relative ease. As such, prospects of strong rental rate growth remain rather bullish in these markets as we head into 2019. While conditions are not as robust in Calgary and Edmonton, upward pressure on vacancy rates has subsided, signalling a bottoming phase.

Downtown Class A office vacancy improves



Source: CBRE Econometric Advisors

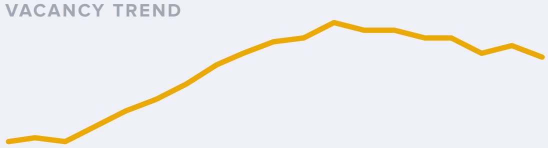
Vacancy

Upward pressure on vacancy rate subsides

12.4% Vacancy As of 18Q3

10-Year Avg. Vacancy **10.4%**

QUARTERLY VACANCY TREND



- Downtown class A office space outperforms with Toronto and Vancouver at or near record low vacancy.
- Downtown Class A conditions in Ottawa and Montreal tightening.

Rent

Alberta weighing down an otherwise positive rent outlook

-4.2% Y/Y Growth As of 18Q3

10-Year Avg. Ann. Rent Growth **-0.1%**

QUARTERLY Y/Y RENT TREND

- Market rent growth remains elusive in Calgary and Edmonton as these markets work through a long bottoming phase.
- Downtown Class A rent growth in Vancouver and Toronto accelerated to 13.5% and 10.3%, respectively year-over-year.

Absorption

9 consecutive quarters of positive absorption

4.6M Square feet Four quarters ending 18Q3

10-Year Avg. Ann. Demand Growth **3 Million SF**

QUARTERLY DEMAND TREND

- Demand underpinned by strong job creation, especially within the tech sector.
- Co-working space operators are an accelerator of demand.

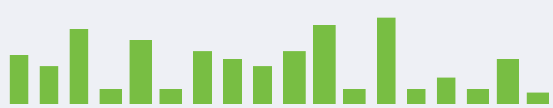
New supply

Supply easing as the market awaits the next wave of development

4.3M Square feet Four quarters ending 18Q3

10-Year Avg. Ann. Supply Growth **6 Million SF**

QUARTERLY SUPPLY TREND



- Current development cycle has 14 million sf under construction.
- 54% (7.6 million sf) of this new supply is poised to enter the market in 2019 and 2020.

Source: CBRE Econometric Advisors

Canadian tech sector continues to thrive

Healthy economic fundamentals, political stability and an open immigration policy have been the driving forces behind the tech sector in Canada. This fertile environment for innovation is encouraging many tech companies, both home-grown and foreign, to set up shop in the major corporate hubs across the country.

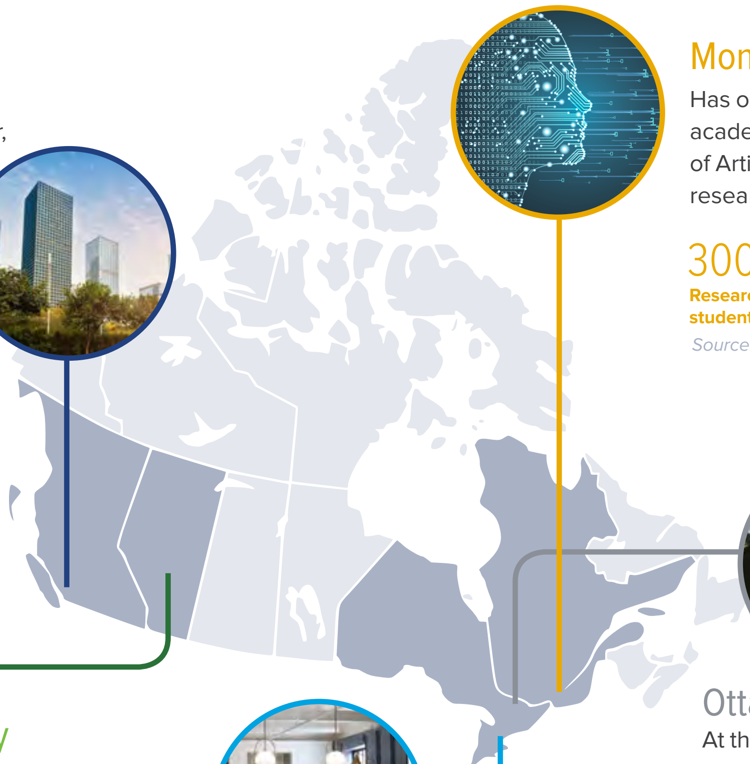
Vancouver

As a key hub within the Cascadia Innovation Corridor, large tech enterprises are expanding their footprint in Vancouver.

802,000SF*

Amazon's footprint* of DT office market ~ 2.9% by 2023

Source: CBRE
** sf including leased and pre-leased*
**projection includes future inventory*



Montreal

Has one of the highest academic concentrations of Artificial Intelligence researchers in the world.

300+

Researchers and doctoral students in the AI field

Source: MILA

Calgary

Local economy continues to diversify by bolstering its clean energy sector.

$600M

Direct contribution to local GDP

Source: Calgary Economic Development

Toronto

Considered as one of the world's largest innovation and startup hubs.

Home to

4,000

active startups

Source: KPMG

Ottawa

At the forefront of autonomous vehicle research, especially for software support and hardware design.

Home to approximately

93%

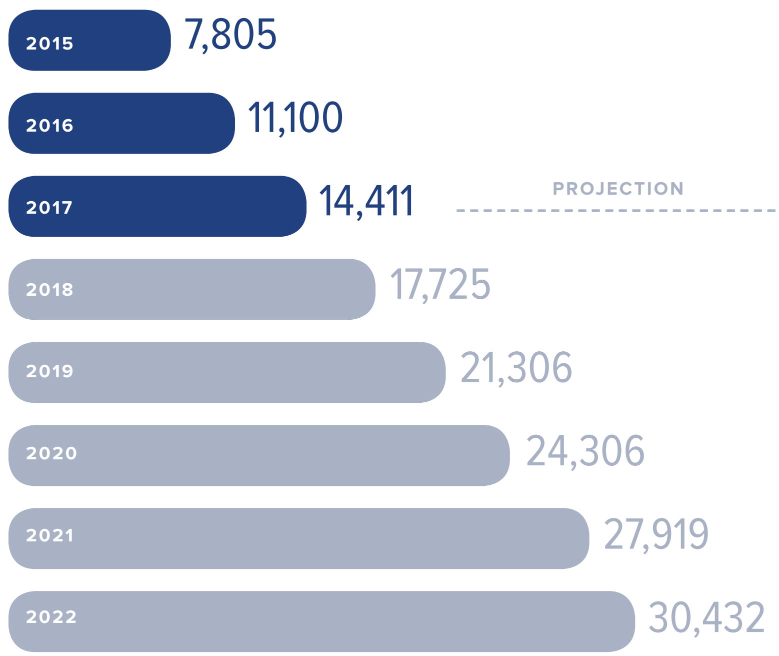
of firms that service the AV industry in Canada

Source: National Autonomous Vehicle Technology and Innovator Directory

Co-working providing agility

Co-working has grown exponentially in recent years and has become an accelerator for office absorption. As of 2017, there are approximately 14,000 co-working office spaces globally and that figure is projected to double by 2022. The impetus for this success has been a structural shift within the labour market, particularly the growing reliance on flexible or contingent labour. This coincides with the rise of the "gig economy," where highly skilled labour is increasingly being provided in the form of freelancing. Tech-savvy millennials are most active in this new marketplace. Given its size, this generation is projected to account for 75% of the global labour force by 2025, a trend that should continue to shift labour market dynamics further toward "on-demand" arrangements.

Global number of co-working spaces expected to double by 2022

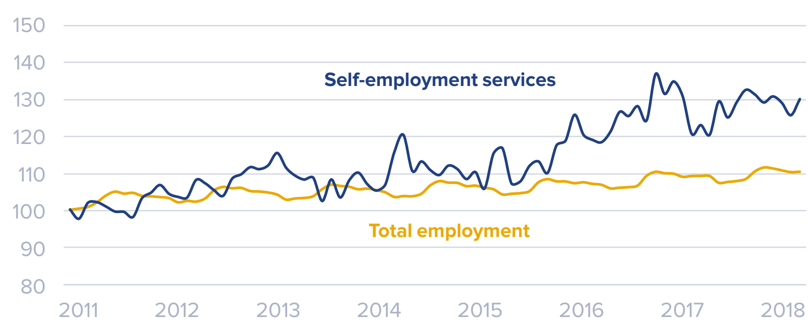


Source: Emergent Research, GCUC, December 2017

Millennials are also active entrepreneurs starting small businesses whereby low overhead costs and maintaining flexibility is crucial. A closer look into employment data by class of workers (self-employed vs. employee) reflects a rise in entrepreneurship across Canada. In particular, self-employment within the services sector (a proxy for entrepreneurs) has grown at a pace that is much quicker than the overall labour market.

Robust gains in self-employment growth

Index (January 2012 = 100)

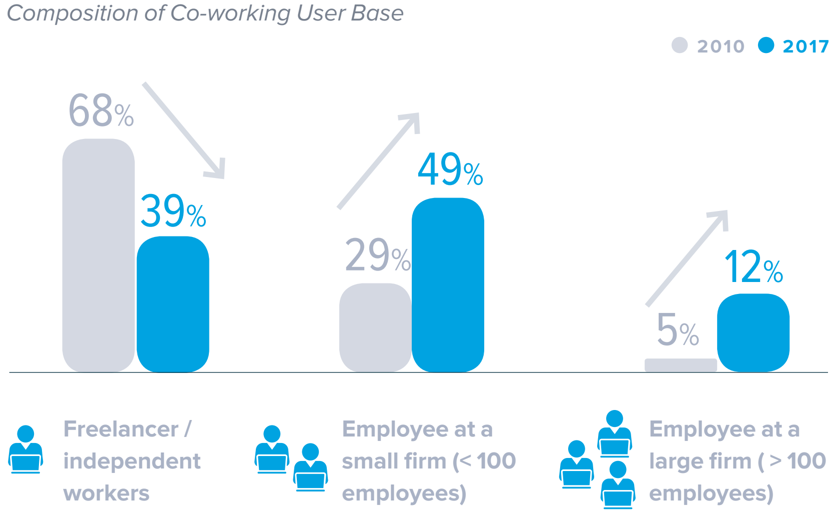


Note: self-employment = incorporated with no paid help *Source: Statistics Canada*

While individual entrepreneurs should continue to play a key role, the co-working industry's next phase of growth is likely to focus more on larger enterprises to diversify its revenue. According to findings from Emergent Research, there has been a shift in the composition of the co-working user base. Enterprise users are occupying more flexible space relative to the traditional freelance source of demand. Increasingly, enterprise users are experimenting with "agile workforce" environments to a) improve employee productivity; b) gain efficiency in space utilization; and c) maintain flexibility.

Enterprise co-working use on the rise

Composition of Co-working User Base

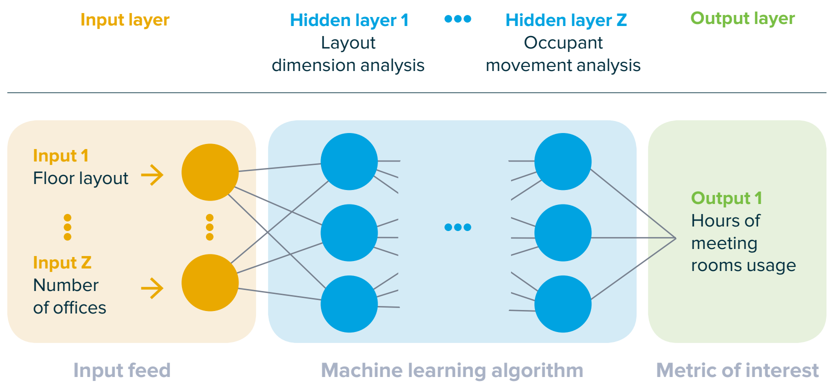


Source: CB Insights, Emergent Research, Recode

Making better decisions using innovative technology

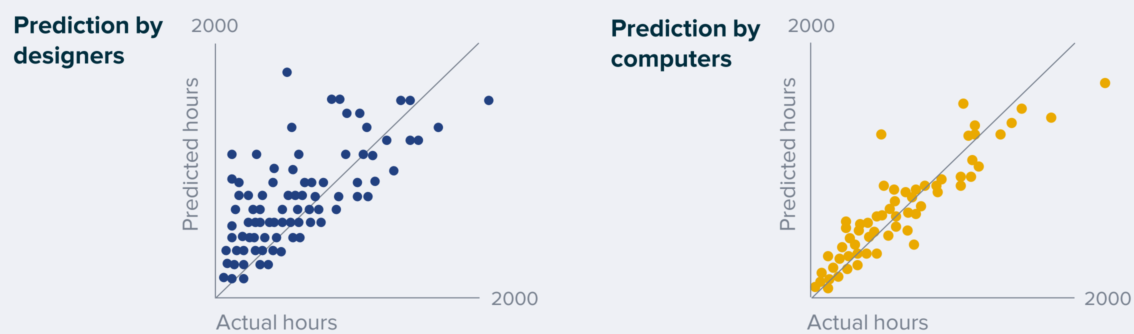
Data-driven decision making in real estate management is becoming easier due to advancements in sensory hardware and other measurement tools. For example, it has made it feasible to apply machine learning for guidance in space utilization decisions. One such application is Artificial Neural Networks (ANN), a process that, among other things, recognizes patterns within vast amounts of data that otherwise might be too complex to detect.

Artificial neural network example



Source: WeWork, Bentall Kennedy

Prediction of conference room usage



Source: WeWork

Data for the entire building, ranging from floor layouts to occupier movements to temperature, feed into an ANN. In theory, any metric of interest for an asset could be projected using this process. For example, by using its ANN, WeWork was able to predict the usage of meeting rooms for a new location with far greater accuracy than their designers. This ultimately resulted in a more optimal allocation of collaborative spaces within their floor layouts.

The use of artificial intelligence can extend beyond architectural decisions. It can also be used to determine what attributes are significant in causing variations in asset performance (occupancy, rental growth, etc). This can potentially provide an additional layer of empirical data for investment management decisions.

Distributed ledger technology (blockchain), albeit still in its infancy and far removed from mass adoption, could improve the efficiency of some industry practices. The potential of blockchain technology stems from its decentralized nature. With data maintained through a distributed ledger, it eliminates a central point of failure that typically has been vulnerable to tampering. In a world where transaction history, land registry, leasing information and building servicing reports are managed through a private or public blockchain, the need for resources to assess counterparty risk and due diligence would greatly diminish. This removes friction, ultimately resulting in greater efficiency in investment decision-making and transacting.

Retail

Consumer spending slows sharply

Cyclical headwinds for the retail sectors are mounting heading into 2019. Much of the consumer spending during this expansion has been fuelled by debt derived from home equity, as real estate values have increased while wages have only recently gained momentum. However, household credit growth has slowed to anemic levels, which resulted in a sharp slowdown in consumer spending in the third quarter.

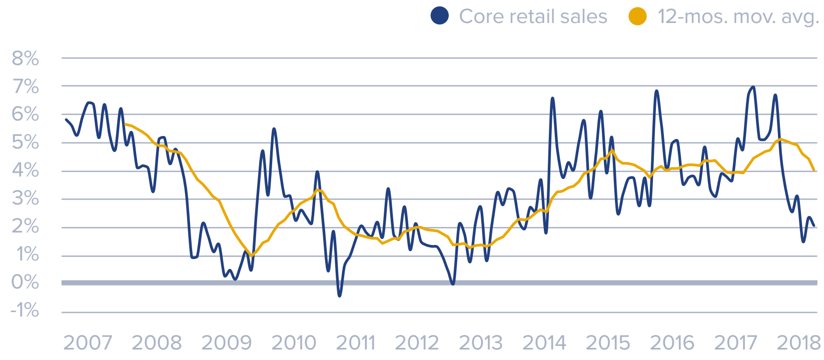
Following that trend, core retail sales growth retreated to 2.6% year-to-date as of August — down from 5.0% in the same period in 2017.

Canadian retailers are breathing a sigh of relief as the new USMCA trade agreement limited the increase on the de minimis threshold on purchases from the U.S. to $150 (previously $20). This amount is far from the opening negotiating position of the U.S. administration, which was $800. Nonetheless, it adds another headwind as it gives U.S. retailers a leg up. These headwinds add to an otherwise challenging brick-and-mortar retail environment.

The divide between the winners and losers in retail is becoming more pronounced. Investors will need to be more active than ever and ensure that operators are creative and can maintain flexibility in this increasingly dynamic environment.

Core retail sales moderating

Y/Y % Change



Source: Statistics Canada

Vacancy

Vacancy trends higher post Sears closure

6.8% Vacancy As of 18Q2

10-Year Avg. Vacancy **5.1%**

ANNUAL VACANCY TREND

- ~15 million square feet left by Sears will take longer to re-lease than Target and challenge the creativity of landlords.
- Regional malls and power centres registered the largest increases in vacancy, while other retail formats remain relatively stable.

Rent

Rent growth restrained in challenging retail environment

1.3% Y/Y Growth As of 18Q2

10-Year Avg. Ann. Rent Growth **2.1%**

ANNUAL Y/Y RENT TREND

- Moderating retail sales will constrain the ability to charge higher rents.
- Knowing your customer (shoppers) and working with retailers to improve convenience and experience is the only way to drive rents.

Absorption

Absorption to remain soft for the foreseeable future

-4.0M Square feet Four Quarters Ending 18Q2

10-Year Avg. Ann. Demand Growth **5 Million SF**

ANNUAL DEMAND TREND

- Pace of negative absorption decelerated in H1 2018 (-200K SF) relative to the -3.8 MSF in H2 2017.
- Right-sizing of physical store networks and footprints continues, limiting absorption.

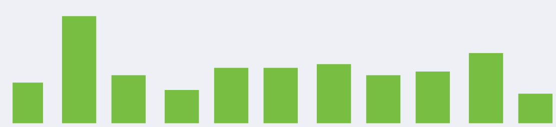
New supply

New supply focused on major urban metros

3.2M Square feet Four Quarters Ending 18Q2

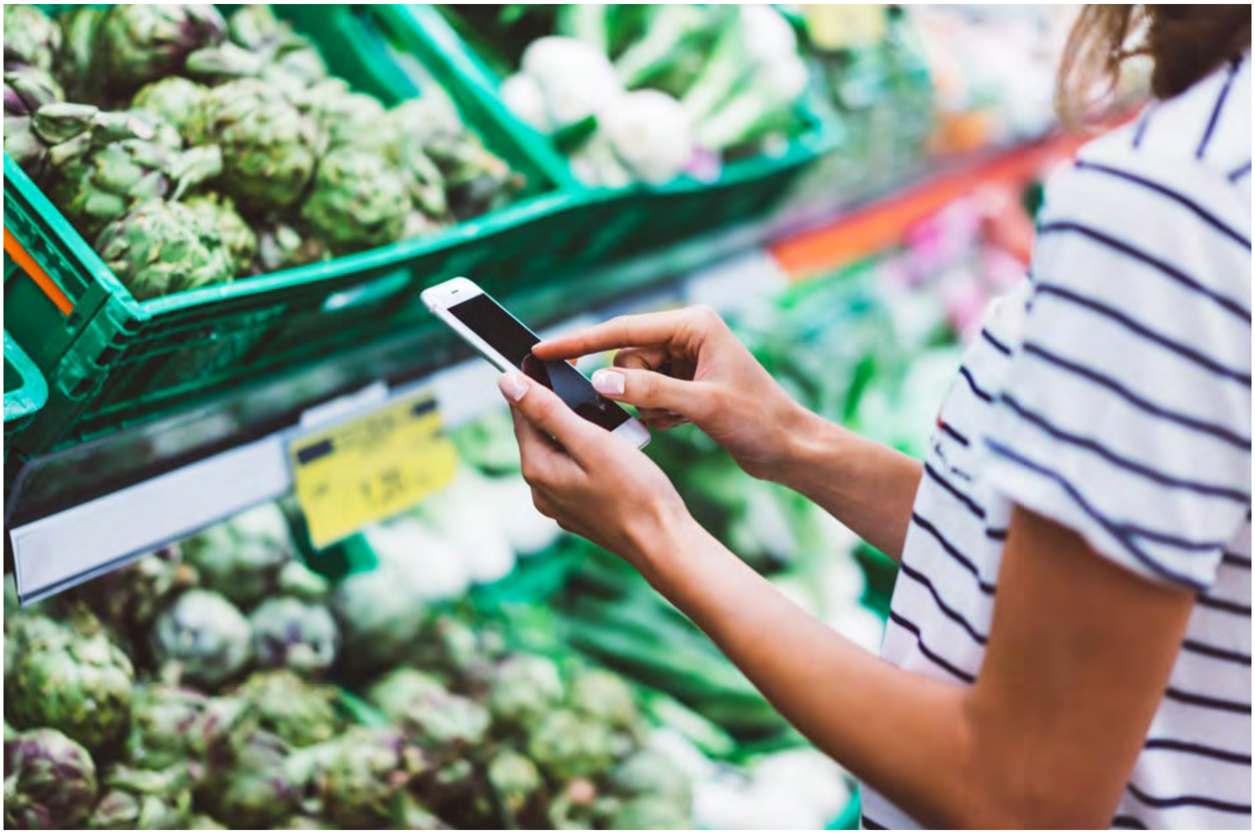
10-Year Avg. Ann. Supply Growth **6 Million SF**

ANNUAL SUPPLY TREND



- Deliveries running well below historical average as development opportunities are generally limited to urban mixed-use.
- 11.9 MSF of retail under construction but highly concentrated (77%) in Toronto (4.6 MSF), Montreal (2.5 MSF) and Vancouver (2.1 MSF).

Source: CBRE Econometric Advisors, MSCI REALPAC Canada Property Index



Grocery wars escalate

Canadian grocers are also dealing with their share of headwinds. A low Canadian dollar is increasing their cost of goods sold at the same time as higher minimum wages are increasing labour costs. Meanwhile, a fierce battle for market share is limiting many grocers' ability to pass on these higher input costs to the consumer. Grocery store operators are battling among themselves, as well as with larger wholesale and discount merchants such as Costco and Walmart (now the largest grocer in the U.S.). Market share is being lost to convenience and specialty food stores that are catering to the unique tastes and preferences of consumers. And now Amazon has become a force, with an estimated 35% of Canadians having Prime subscriptions. Consumers have become more price-conscious and mobile apps are making it easier to find the best deals, increasing competition among grocers.

These factors are putting a strain on profit margins. In addition, the macro backdrop is becoming less favourable as household credit growth dipped to its lowest level in any non-recessionary environment. This decline, along with higher interest rates, will act to slow consumer spending, dampening the outlook for grocery sales in 2019.

KEY FACTORS

INCREASING COST OF GOODS

- Low Canadian dollar
- Higher minimum wages

COMPETITION

- Competition among wholesale and discount merchants
- Mobile apps enable price comparison

MACRO ECONOMIC

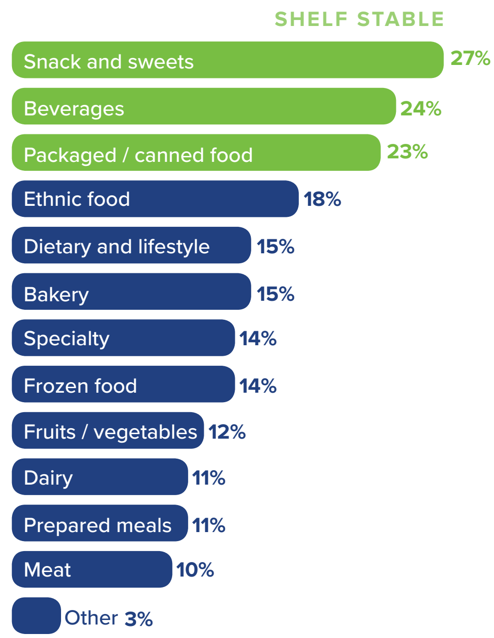
- Household credit and higher interest rates slow consumer spending

Online grocery still in its infancy

Ecommerce could ultimately have the most transformative impact on the grocery industry and the real estate that it occupies. Current estimates are that ecommerce grocery penetration is around 1% to 2% in Canada, when measured by the total dollars spent online relative to total grocery sales. Other developed economies are at varying stages of adoption with penetration rates as low as 0.5% in Italy and as high as 20% in South Korea, which has the world's fastest average internet connection speed. A recent study by BMO Capital Markets suggests that the number of Canadians who have purchased groceries online recently is around 30%. These shoppers are typically buying only occasionally and are spending approximately $50 per transaction. Amazon was overwhelmingly the ecommerce website of choice and saw twice as many shoppers as Loblaw.ca, the second-ranked destination for online grocery. It also concluded that current usage of grocery ecommerce appears to be primarily for pantry-restock, and that consumers appear to prefer home delivery as opposed to click-and-collect. Another study by the J.C. Williams Group supports the findings that when it comes to categories, shelf-stable items such as snacks and sweets, beverages, and packaged or canned foods are the most-often purchased.

Amazon's foray into the space with the acquisition of Whole Foods in late 2017 may be looked back upon as the tipping point for the industry. It appeared to galvanize Canadian grocers' digital strategies as they realized they were behind in delivering what today's digitally savvy consumers want.

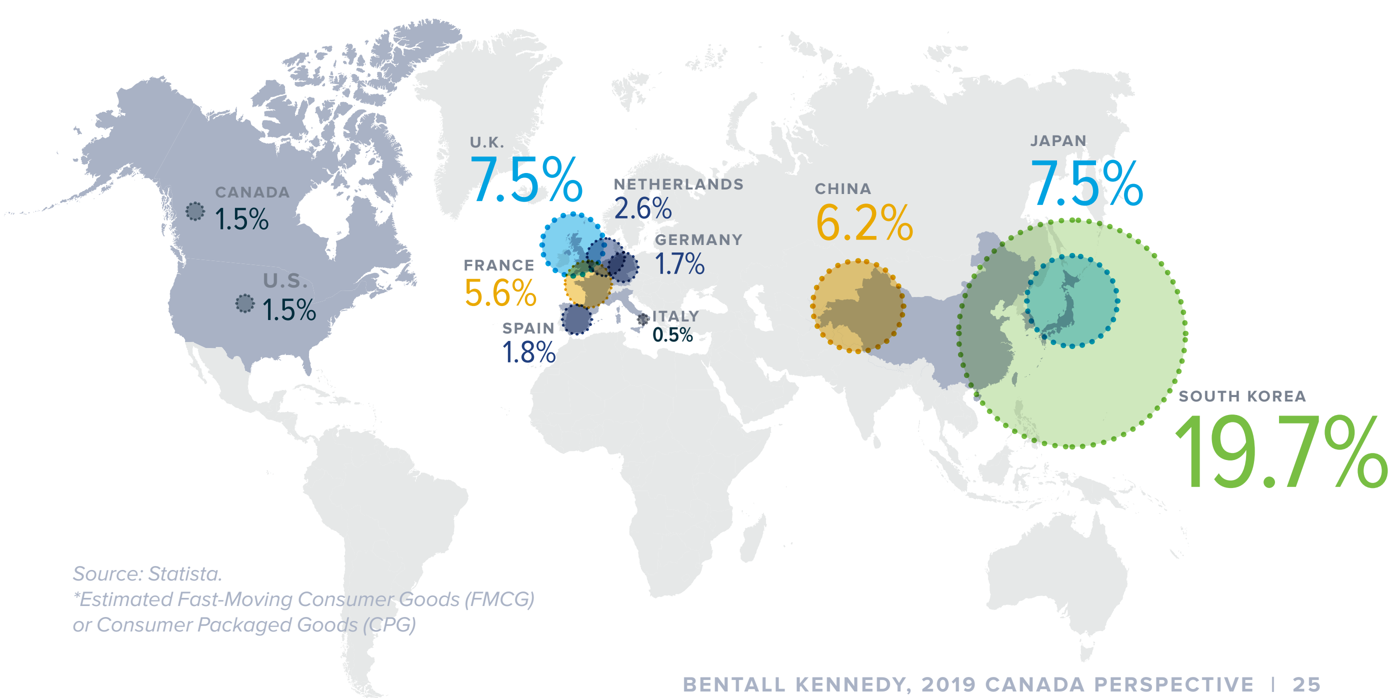
Percentage of budget spent online by product category



Source: J.C. Williams Group - Canadian E-tail Report Summer 2018

Ecommerce revenue as a share of total FMCG revenue in selected countries

Y/E March 2017



Source: Statista.
**Estimated Fast-Moving Consumer Goods (FMCG) or Consumer Packaged Goods (CPG)*

Multimodal distribution is key

Consumers want convenience, great prices and experience. And convenience means options for different modes of distribution. Grocers need to be able to deliver to home, to provide buy-online and pick-up-in-store options (click-and-collect) as well as create great in-store experiences that focus on convenience. Bricks-and-mortar grocery stores are traditionally designed to maximize dwell time, not reduce it. The produce is front and centre upon entering the store but the milk is in the far back corner. Adapting to these preferences will require a paradigm shift in the model for grocers.

Being multimodal is as much about customer acquisition as it is about brand loyalty and retention. Walmart U.S. has indicated that 30% of its online grocery shoppers are new to Walmart. And while online penetration rates are low (for now), small percentage point shifts have huge dollar implications as grocery sales make up almost one-third of core retail sales in Canada. Given much lower margins in grocery, losing 5% of your customers to a competitor's online offering makes a big difference in both your bottom line and that of your competitor's. Moreover, online grocery sales typically attract the most-profitable customers: dual-income households that prioritize convenience over price or promotions — and they typically have big basket sizes.

	IN-STORE PICK-UP		HOME DELIVERY	
Grocer / strategy emphasis	Availability	Cost	Availability	Cost
Weston Group → click and collect *Delivery partner: Instacart*	✓ 500 stores nationally, expanding to 700 (end of 2018)	$3-6/order + free promos	✓ Select locations nationally	Instacart pricing: $3.99 and up + service fee of 7.5% of order
Empire → home delivery *Delivery partner: The Ocado Group*	✓ Quebec only	$4/order	✓ Quebec, Toronto and Ottawa; GTA warehouse in 2 yrs	$9.50/order Quebec; $15/order Ottawa, Toronto (min order $50)
Metro Inc. → hybrid *Delivery partner: owns trucks, uses 3rd-party operator*	✓ Quebec only, plans for Ontario in 2019	$4/order	✓ Same-day in Quebec, plans for Ontario in 2019	Varies
Walmart → click and collect *Delivery partner: Instacart, Food-X Urban Delivery Inc. in Vancouver*	✓ Select location nationally	Free (min $50 order)	✓ 1-hr in GTA and Winnipeg	$9.97 (min $50 order)
Costco → home delivery *Delivery partner: Instacart*	✗ Not available	—	✓ Southern Ontario	Free (min order $75) within 2 days, non-perishable only

Source: Bentall Kennedy, Company websites and reports
Notes: Digital strategy typically in reference to its prominent banner

Which digital offering will win out?

Each of the Canadian grocers has taken a slightly different approach to their digital offerings. Walmart and Loblaw are placing more emphasis on click-and-collect. Joining Amazon, Empire has moved predominantly in the direction of home delivery. That said, Amazon's acquisition of Whole Foods is an acknowledgement that a network of physical stores is a valuable brand tool in addition to a means to distribute from closer proximity to customers. Metro and Costco are taking a more cautious approach, waiting for this nascent trend to play out further before committing to significant investments. What's clear is that all grocers are looking across all three channels to some degree to deliver convenience to their customers. They realize that transforming their business to have a greater digital presence is critical to their bottom line.

Online grocery will become pervasive across generations

Online grocery is most appealing to households with children who (also) lead busy lives. They also consume the largest grocery basket. The back end of the millennial generation is largely comfortable with mobile technology and is beginning to form households, earn higher incomes and move into their higher consumption years. Younger and digitally native generations are very comfortable online. What does that mean for penetration rates once they become decision-makers? And as the population ages, technology is enabling many older Canadians to maintain their independence and remain in their own homes. Click-and-collect and home delivery are two solutions that will help them do that.

> Click-and-collect is growing among digital native generations and older Canadians

What does it mean for grocery real estate?

The outlook for the physical grocery store is evolving. It's likely that the trend toward smaller stores carrying less inventory will continue. Existing store footprints are likely to be reconfigured to facilitate multimodal distribution, meaning an increase in "back-room" inventory space, as well as more floor space designated for prepared foods and experiential shopping. Current levels of online delivery are relatively "capital-light" but reconfiguration of stores and expansion of logistics networks could prove to be capital-intensive depending on the growth online. These reasons, along with current macro headwinds, could limit the upside on rents as grocers grapple with tighter profit margins. Larger chains have the deep pockets to compete but smaller operators without a unique product offering will be challenged to deliver on all levels that customers desire. The best locations will be fine, but investors need to be mindful of how well grocers are adapting to the changing needs of their customers.

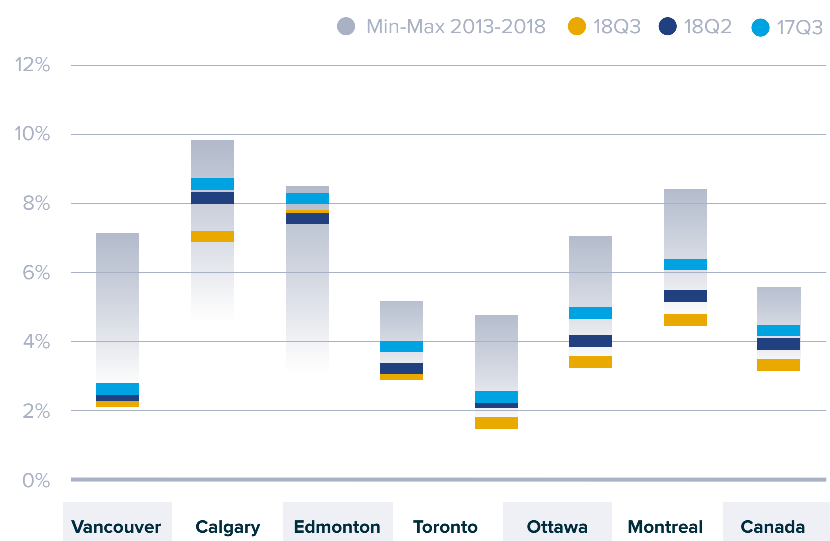
Industrial

Firing on all cylinders

10 Ronrose Drive, Concord, ON

Ecommerce-driven logistics and strong macro fundamentals are driving industrial demand. Without much new supply delivered to the market, robust absorption has lowered availability to record levels. There is some relief in sight as the volume of space under construction has risen to 19.5 million square feet with approximately 11 million more scheduled to become available in 2019. Nonetheless, persistent demand for new-generation space should easily absorb this influx. Under these landlord-favourable conditions, industrial rents should continue to register robust gains, generating attractive net operating income (NOI) growth for investors.

Industrial availability tightening across markets



Source: CBRE Econometric Advisors

Availability

Availability rate reaching the lowest level on record

3.1% Availability As of 18Q3

10-Year Avg. Vacancy **5.9%**

QUARTERLY AVAILABILITY TREND

- Availability rates tightening across the six major markets in Canada.
- Historically tight conditions in Toronto (1.6%) and Vancouver (2.3%).

Rent

Rent growth continues to accelerate

7.9% Y/Y Growth As of 18Q3

10-Year Avg. Ann. Rent Growth **2.2%**

QUARTERLY Y/Y RENT TREND

- Robust growth pushing average market rents to $7.50 psf, the highest level on record.
- Vancouver remains the priciest market as net rent increased by 16% year-over-year to $11.75 psf.

Absorption

2018 on pace to set an annual record for net absorption

30.1M Square feet Four quarters ending 18Q3

10-Year Avg. Ann. Demand Growth **15 Million SF**

QUARTERLY DEMAND TREND

- Absorption levels outstripping new supply by almost 3-to-1.
- Warehousing, distribution and logistics remain key drivers for industrial demand.

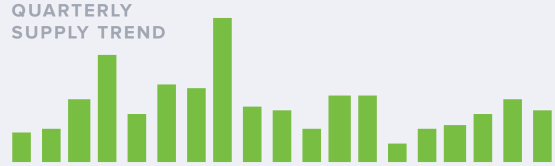
New supply

Supply relief ahead in 2019

12.4M Square feet Four quarters ending 18Q3

10-Year Avg. Ann. Supply Growth **14 Million SF**

QUARTERLY SUPPLY TREND



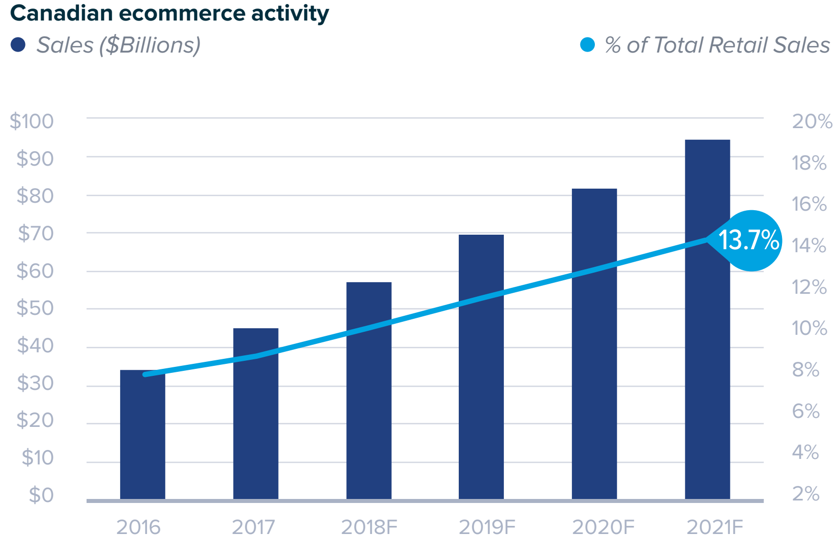
- 19.5 million sf is under construction — highest volume since 2015 Q3.
- 73% of construction volume taking place in Toronto, Vancouver and Calgary.

Source: CBRE Econometric Advisors

Logistics activity a key driver of industrial demand

Due to the rapid rise of ecommerce, logistics activity has been a catalyst for industrial demand. Ecommerce sales continue to grow at double-digit rates in Canada, significantly outpacing core retail sales growth. According to Prologis, ecommerce fulfillment requires approximately three times the logistics space compared with traditional bricks-and-mortar retail, due to: 1) shipping parcels vs. pallets; 2) high inventory turnover levels; 3) broader product variety; and 4) reverse logistics (product returns). For these reasons, even as retail sales moderate, demand for logistics space should remain healthy.

Canadian ecommerce activity



Source: eMarketer

Urban infill space garnering more attention

Users of logistics space are now focused on the end-to-end total network costs rather than individual procurement operations for transportation, real estate and labour — something that the major retailers have been doing for years. Optimizing a supply chain often means securing infill logistics real estate for better service and access to the urban consumer base. Estimates are that real estate costs are merely ~4% of the end-to-end costs, with transportation costs accounting for the lion's share (~50%). As such, proximity to inbound suppliers and outbound customers is paramount in reducing overall costs. This suggests that industrial rents have room to grow as logistics users are increasingly willing to pay more for location, specifically for industrial space that reduces distance to end consumers.

Identifying who the end consumers are and where they reside is crucial. From this standpoint, demographics play a key role in dictating ecommerce logistics and industrial demand. These ideal locations tend to be in close proximity to: a) dense populations; b) households with high disposable income; c) millennials; and d) households with young children.

Real estate only a fraction of supply-chain costs

Source: Colliers, Hofstra University

Infill vs. peripheral industrial dynamics in the Greater Toronto Area

Online shopping is likely to be most prevalent in large metropolitan areas such as the GTA. Aggregating the demographic variables above into an "econsumer index score" and then mapping it across space, sheds more light on infill and peripheral industrial dynamics.

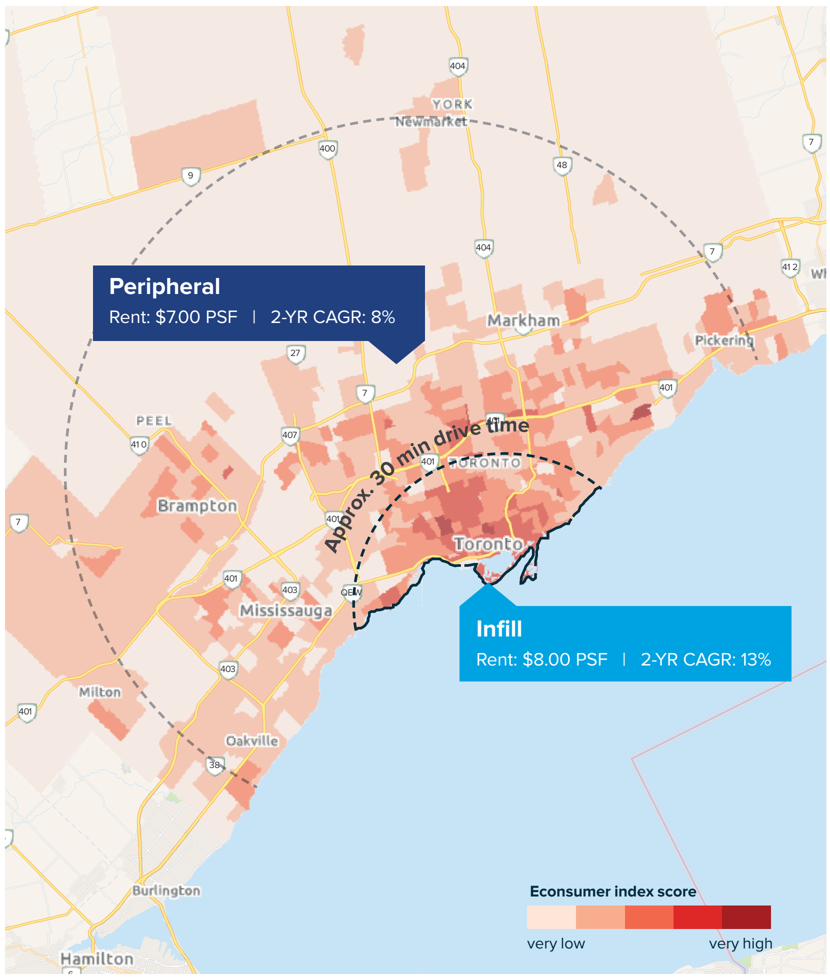
The results show there is an overwhelmingly greater concentration of nodes having a higher score closer to urban centres. This ultimately serves as a pull factor for demand, particularly for older industrial space located around the edge of the urban core. There are pockets in suburban areas in the west, north and east ends that fit this demographic profile as well, albeit to a lesser extent. However, these markets are typically served by larger fulfillment centres that tend to be located near major highway infrastructure outside the City of Toronto.

Comparing the performance between infill and outer sub-markets using a 30-minute drive time boundary lends support to the growing demand of urban infill assets. This is reflected in rental rate trends, which show that infill industrial space has outperformed its counterpart over recent years. The average net rental rate for infill industrial space is $8.00 per square foot, reflecting a 14% premium relative to peripheral assets. This premium has emerged in as few as two years. Previous to that, there was very little discernible difference in rents.

Highest propensity to shop online

Econsumer index score

Population density + Millennials (20-34) + Families with young children + High-income household >100K



Note: Each variable within its dissemination area is indexed relative to the GTA. An equally weighted "econsumer index score" is calculated thereafter.

Source: Environics

Rent premium for highway access in the GTA

Accessibility to arterial highway networks is another factor that logistics users consider when choosing a location. Our analysis of assets located along major highway corridors within the six major markets shows that only Toronto and Montreal exhibit a material rent growth premium in recent years compared to their overall benchmarks.

The premium in the GTA is most pronounced, where a sprawling population base and traffic congestion encourages tenants to favour locations that improve mobility, thereby reducing transportation costs. According to Colliers research, the GTA is among one of the most under-served metro areas when it comes to highway access per capita. As such, its industrial market is concentrated along arterial highway corridors. Approximately 67% of industrial assets in the GTA are within 1 kilometre of its major highways. This subset of assets with superior access is seeing rents at over a 6.5% premium compared to the broader GTA market.

North American highway density

Area	Highway density*
Dallas-Fort-Worth-Arlington	157
Houston	144
Atlanta	136
Boston	104
Calgary	94
Montreal	91
Washington DC	87
Detroit	83
Philadelphia	81
San Francisco - Oakland	80
Miami	77
Los Angeles - Long Beach -Santa Ana	72
New York - Newark	68
Chicago	59
Toronto	**59**
Vancouver	34

**Highway KM Per 100K People*
Source: Colliers, Statistics Canada, US Department of Transportation

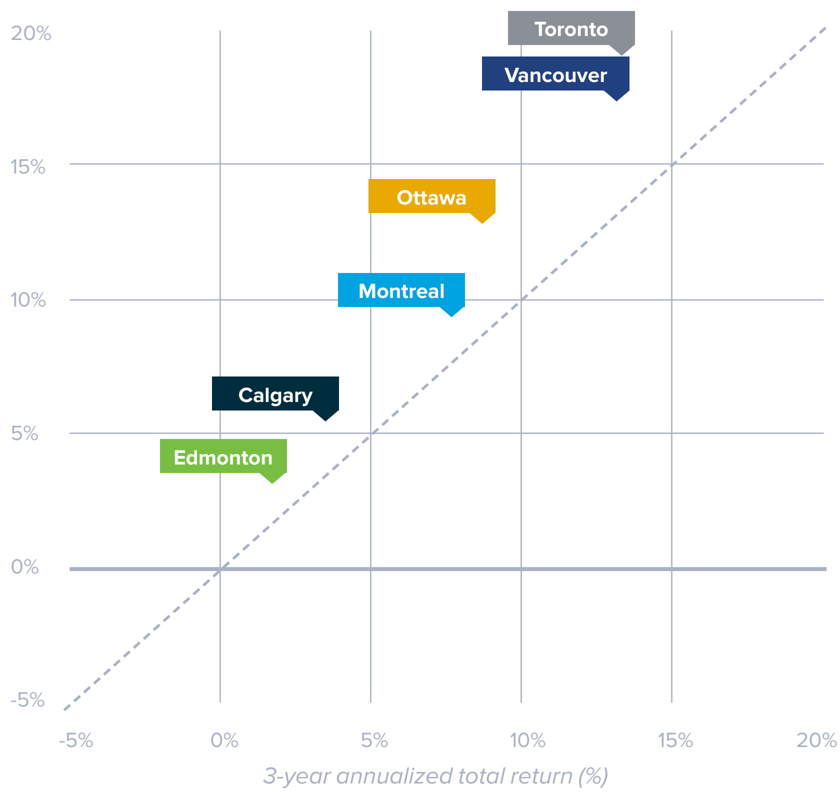
Industrial generates robust returns

For the four-quarter period ending 2018 Q3, industrial total returns registered an impressive 12.1%. Capital appreciation has been driven by both cap rate compression and NOI growth. Institutional capital continues to flow into this asset class as investors look to capitalize on the current bullish environment. As pricing adjusts upwards, investors are looking to NOI growth to drive returns going forward. Fortunately, rental rate growth is strengthening leading to four-quarter trailing NOI growth of 2.3%, the highest in more than a decade.

Toronto and Vancouver continue to outperform, but near 20% returns are likely unsustainable. Montreal and Ottawa are gaining considerable interest from investors as relative yields have become more favourable in comparison with pricing in Vancouver and Toronto. Meanwhile, conditions in Calgary and Edmonton are clearly improving. Perhaps what is more reflective of the strength of Canada's industrial market is how broad-based performance improvements have been across the six major markets.

Increasing momentum across all major markets

2018 Total Return



Source: MSCI/REALPAC Canadian Quarterly Property Index
Note: Period ending Q3 of every year

10 Driver Road, Brampton, ON

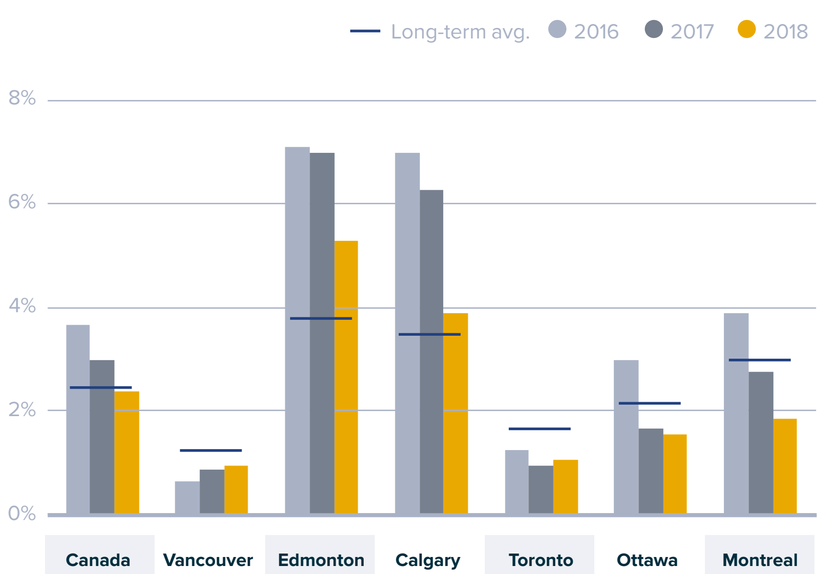
Multi-residential

Vacancy continues to fall

Two St. Thomas, Toronto, ON

Vacancy in purpose-built rental continues to fall as a myriad of strong demand drivers outpaced constrained supply. The national vacancy rate fell to 2.4% from 3.0% a year ago (as of October, 2018) — the lowest level since 2008. Robust population growth fuelled by immigration and a strong labour market underpinned solid demand. Stricter mortgage stress test rules and higher interest rates have also made it harder for first-time home buyers to enter the market, meaning there are fewer leaving the rental market and more opting to rent as they form households. These demand factors are more acute in the highly desirable urban areas of Toronto, Vancouver and Montreal where the vast majority of job creation has occurred in recent years.

Vacancy declines in most markets



Source: CMHC, As of October of every year

Vacancy

Vacancy tightens below historical average

2.5% Vacancy As of 18Q3

10-Year Avg. Vacancy **2.6%**

QUARTERLY VACANCY TREND

- 4 of 6 major markets experienced reduced vacancy.
- Vacancy rates near record lows in Montreal and Ottawa.

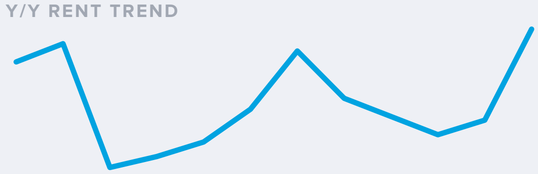
Rent

Further rent growth in the cards for the year ahead

4.4% Y/Y Growth As of 18Q3

10-Year Avg. Ann. Rent Growth **3.1%**

ANNUAL Y/Y RENT TREND



- Landlord-favourable markets outside of Alberta will enable landlords to drive rents.
- Rent levels in some markets may be reaching levels that may not support further growth without a corresponding rise in wages.

Absorption

Renter formation continues to outstrip new supply

28K Units Four Quarters Ending 18Q3

10-Year Avg. Ann. Demand Growth **14K units**

ANNUAL DEMAND TREND

- Deliveries remain well-above long-run trend but not enough to satiate robust demand.
- Demand for professionally managed apartments is increasing in secondary markets where home ownership is challenged.

New supply

Lack of new supply is the prominent driver of eroding rent affordability

26K Units Four Quarters Ending 18Q3

10-Year Avg. Ann. Supply Growth **13K units**

ANNUAL SUPPLY TREND

- Rising development costs are increasingly challenging the financial feasibility of projects.
- Elimination of rent control on new developments in Ontario could shift investment capital east from Vancouver.

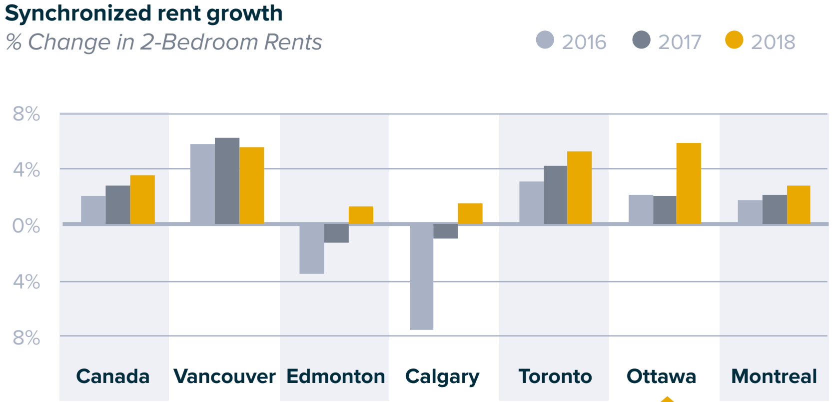
Source: CMHC, As of October of every year

Rents grow at fastest pace since 2007

On the supply side, despite a record number of purpose-built rentals being delivered to market in 2018, it was not enough to satiate demand. Tighter market conditions resulted in an increase in rent growth across major Canadian cites. While evidence of higher rents is no surprise in Toronto and Vancouver, the pace of rent growth in Ottawa stood out. Two-bedroom market rents in Ottawa grew at the fastest pace since 2001 at 5.8% year-over-year — well above the Ontario rent guideline increase of 1.8% for 2018. This strength can be largely attributed to growth in population driven by non-permanent residents, of which many are international students. Zeroing in on newer purpose-built rentals completed after 2005, highlights the strength of the Toronto market. According to Urbanization's 18Q3 Purpose-Built Rental Apartment Survey, average index rents in the GTA, increased a staggering 17% year-over-year.

Synchronized rent growth

% Change in 2-Bedroom Rents



Rents grew at the fastest pace since 2001 at 5.8% year-over-year — well above the Ontario rent guideline increase of 1.8% for 2018.

Source: CMHC

Diverging rent control policies in Ontario and B.C.

There are diverging trends on rent control in Ontario compared with B.C., which could have the effect of shifting investment capital eastward. In September, the B.C. government introduced a 2.5% cap on rent increases (previously set at inflation + 2.0%). Meanwhile in Ontario, the newly elected Progressive Conservatives removed rent control on new developments effective November 15, 2018. This was somewhat of a reversal of the prior government's policy change, as part of its Ontario Fair Housing Plan in April, 2017, which blanketed rent controls across all rental units. Previous to that, rent control had only been applicable to units constructed prior to 1991. Rent control remains in place in Ontario for any unit built prior to November 15, 2018. As many empirical studies have shown, rent controls reduce the new supply of purpose-built rentals.

Vancouver implications

The removal of rent control for new construction in Ontario is a step in the right direction, which will help the economics of development. Meanwhile, vacancy control is currently being considered by a government rental task force in British Columbia. This would mean that landlords could not raise the rent to market rates when a unit becomes available. It would result in reduced incentive for landlords to invest in their assets without the ability to recover those costs through higher rents over time. It is shifting development toward for-sale condominiums as developers would be adverse to being exposed to the rising costs of operating a building.

The bottom line is that rent control and vacancy control will only exacerbate the housing crisis in Vancouver.

Cost pressures add to challenge of development

A recent study by Altus Group that looked at current global trends in development indicated the biggest challenges facing developers over the next five years are project cost escalations, labour/trade shortages, and slow approval processes. Development cost inputs such as labour, materials, government charges and land prices are all facing upward cost pressure making it challenging to make development projects economically feasible.

3 BIGGEST CHALLENGES FACING DEVELOPERS OVER THE NEXT 5 YEARS

Labour/trades shortage

Escalating project costs

Slow approval processes

Source: Altus Group

Portfolio, Calgary, AB

Labour challenges

Labour costs are rising due to a shortage of skilled workers and an unemployment rate that now sits at a 44-year low. Adding to the cyclical challenges are the structural headwinds of an aging workforce in the skilled trades. Replenishing a retiring workforce is one of the construction industry's most significant challenges. BuildForce Canada estimates that 255,000 skilled construction workers, or 21% of the current workforce, will need to be replaced over the next 10 years.

PERCENTAGE OF CONSTRUCTION WORKERS RETIRING IN THE NEXT 10 YEARS

21%

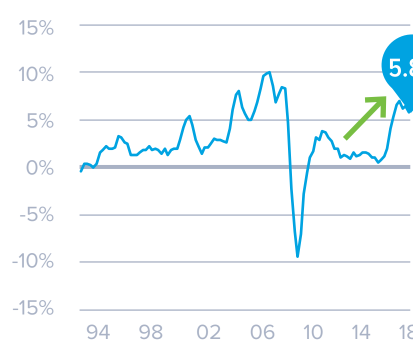
Source: BuildForce Canada

"Tariffy-ing" materials cost escalation

Construction material costs have increased substantially in the past 18 months, especially for concrete, windows and doors, electrical and mechanical, elevators, and finished carpentry. Steel and aluminum tariffs are exacerbating price increases. In an effort to protect Canadian steel makers from the effects of the Trump administration's 25% tariffs on imported steel, the Canadian government introduced a surtax on select steel products to prevent international steel producers from dumping products in Canada that are no longer destined for the U.S. Projects in B.C. rely heavily on imported steel because of the challenges and costs of bringing steel across the country from Ontario producers. The Residential Construction Council of Ontario suggests the increased cost of re-bar alone could increase the price of a new Vancouver condo unit by $10,000. Fortunately for developers, there is evidence that cost pressures are easing, in part due to fewer new housing starts anticipated over the next five years. Rent increases have also worked to help preserve development yields, although they are narrowing as land costs continue to rise.

Canada Top 11 CMAs: highrise apartment building construction price index

% Change Y/Y; 2017=100



Source: Statistics Canada

Portfolio, Calgary, AB

Capital markets

Real estate investor sentiment strong but cautious

150 King Street West, Toronto, ON

Real estate continues to benefit from increasing institutional portfolio allocations to the asset class because of the stable income it delivers. But investors are increasingly mindful of rising interest rates, escalating trade tensions, a maturing business cycle and what it means for their portfolios. These crosscurrents combined with recent volatility in the equity markets are creating a sense of unease among investors. It remains to be seen whether recent equity market volatility is a healthy correction or if it signals the beginning of the end of the longest bull market in history.

There is also growing concern that an unfavourable credit market is emerging as corporate debt levels are elevated and the quality of investment grade credit is the weakest it has ever been (as measured by the number of investment grade credits that are BBB-rated). While corporate credit spreads remain at historically tight levels, they have widened this year and widening typically precedes the turning of a credit cycle. The downside could be more severe, given weaker credit quality, which could have a negative ripple effect through financial markets.

$39B

investment volume on pace to surpass 2017's record of $43B

Source: CBRE, 18Q3 YTD

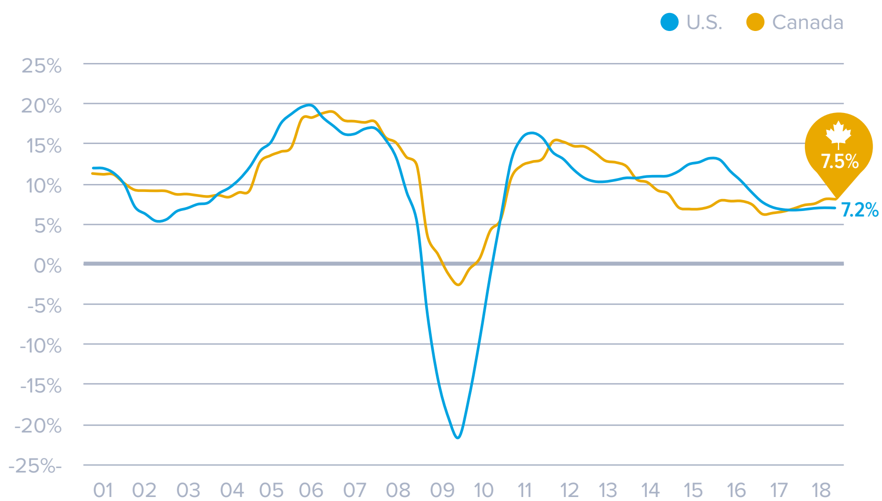
Interest rates move higher

Monetary policies are tightening as the Bank of Canada and the Fed judiciously raise interest rates. How quickly and how high will interest rates ultimately go? And what is the impact on asset prices?

In the current environment, real estate cap rate decompression is becoming evident across select sectors in the U.S. such as infill apartment and non-transit-oriented suburban office markets, and is more widespread across much of the retail sector, as well as smaller secondary/tertiary locations. While there is a sense that asset values have peaked (with perhaps the exception of the industrial sector), there has not been evidence of widespread cap rate decompression in the U.S. Canadian cap rates across most markets have generally flattened with the exception of core properties offering credit and term. Industrial and multi-residential sectors continue to experience downward pressure due to favourable net operating income prospects and strong investor demand. Assets with vacancy, near-term rollover risk, functional obsolescence and/or inferior locations will be the most negatively impacted by rising interest rates.

Canadian returns now outperforming the U.S.

Four-Quarter Trailing Total Returns, 2018 Q3



Source: NCREIF Property Index, MSCI/REALPAC Canada Quarterly Property Index

150 King Street West, Toronto, ON

150 King Street West, Toronto, ON

Canadian property returns gain momentum

The MSCI/REALPAC Canada Property Index posted a 7.5% total return for the four-quarter period ending Q3 2018. This performance marks a significant 120-basis-point increase from the prior four-quarter period. Improved performance was driven in large part by strength in the multi-residential and industrial sectors, particularly in Toronto and Vancouver, where rent growth was strongest. These are now bearing fruit as assets are being delivered at values well in excess of development costs. Development is becoming a key driver of benchmark performance although newer projects are now forecasting lower development yield spreads as a result of rising construction costs. Income yields remain attractive relative to other investment alternatives but their spread over risk-free rates has narrowed below historic averages, reaffirming fulsome pricing.

MSCI/REALPAC Canada Property Index

TOTAL RETURN

7.5% Four quarters ending 18Q3

Basis-Point Increase: 120

From the prior 4-quarter period

U.S. property returns moderate

For the past two quarters, Canadian property returns have been slightly outpacing those in the U.S. This is a reversal from the stronger U.S. returns going back to the third quarter of 2013. The National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index returned 7.2% over the past four quarters, which was 30 bps higher than the same period a year prior. Similar to Canada, technological changes in supply chain logistics have been driving industrial returns while challenges in retail have detracted from performance with negative capital appreciation. Geographically, the innovation economies in the Pacific and Mountain regions continue to outperform.

NCREIF Property Index

TOTAL RETURN

7.2% Four quarters ending 18Q3

Basis-Point Increase: 30

From the prior 4-quarter period

Toronto industrial just had its best 4-quarter performance ever

Canada, All Asset Total Returns: Q3 2018, 4-Quarter Trailing, %

- 8% -6% -4% -2% 0% 2% 4% 6% 8% 10% 12% 14% 16% 18% 20%

	SEP-18	JUN-18	MAR-18	DEC-18	SEP-17	JUN-17	MAR-17	DEC-16	SEP-16	JUN-16	MAR-16	DEC-15	SEP-15
Toronto - Industrial	18.9	18.2	17.1	16.3	12.7	10.9	9.7	8.7	8.2	8.4	8.0	8.9	7.3
Toronto - Residential	18.8	17.9	15.6	15.9	11.6	12.3	12.1	11.3	11.4	10.6	11.0	10.6	9.8
Vancouver - Industrial	17.3	15.3	13.5	14.2	11.3	10.6	10.8	10.8	10.7	10.2	10.0	9.4	9.2
Ottawa / Hull - Industrial	12.6	11.5	12.4	9.9	7.5	7.0	6.7	7.0	5.8	6.2	5.6	6.1	6.1
Toronto - Office	11.3	12.1	11.2	10.7	10.4	9.7	9.0	9.3	11.5	14.9	14.5	15.3	11.9
Vancouver - Retail	10.2	10.4	10.4	9.2	13.6	13.0	12.5	12.7	13.4	13.5	12.8	12.9	11.5
Vancouver - Office	10.0	10.6	10.7	10.0	12.8	12.9	14.8	14.8	17.2	16.3	13.7	14.0	8.6
Vancouver - Residential	9.8	10.5	8.8	9.9	12.4	15.2	17.0	14.7	13.9	11.7	10.1	11.1	7.3
Toronto - Retail	9.4	9.2	8.3	8.4	8.7	8.5	8.6	8.2	11.5	11.5	11.8	11.7	7.2
Montreal - Industrial	9.2	8.6	7.2	6.8	5.5	5.3	6.2	6.7	8.7	8.6	8.5	7.7	6.6
Ottawa / Hull - Residential	9.1	8.8	9.3	8.8	6.3	6.2	5.0	5.0	5.3	5.5	6.4	6.5	5.1
Ottawa / Hull - Office	8.9	9.2	9.5	8.9	7.2	5.7	5.4	5.3	6.7	6.4	6.1	6.4	4.5
Montreal - Residential	7.4	5.6	5.5	5.6	6.1	6.8	7.2	7.3	7.3	7.0	7.6	7.7	4.6
Montreal - Retail	6.7	6.8	6.0	6.1	2.3	2.4	2.7	2.6	5.1	5.0	5.1	5.2	4.6
Montreal - Office	6.2	6.4	7.5	7.9	2.2	2.3	2.6	2.8	6.7	6.6	6.3	6.2	2.7
Calgary - Industrial	5.3	4.9	4.4	4.3	2.3	2.2	2.1	1.4	2.9	2.3	2.4	2.7	7.5
Edmonton - Residential	3.6	3.5	3.0	2.9	(1.7)	(2.6)	(2.8)	(3.3)	2.7	4.4	5.5	6.2	6.3
Ottawa / Hull - Retail	3.5	3.1	3.4	3.9	2.7	2.7	2.4	2.3	7.7	8.0	7.3	7.3	4.1
Calgary - Residential	3.4	3.6	2.4	0.9	(4.5)	(4.6)	(3.7)	(2.6)	2.8	3.1	2.9	3.9	7.4
Edmonton - Industrial	3.1	3.7	3.4	3.4	0.5	(0.4)	(0.9)	(0.8)	1.7	1.5	2.1	2.6	7.8
Edmonton - Retail	2.7	2.3	2.5	3.4	4.4	4.6	4.5	3.4	5.5	5.7	5.9	6.3	7.6
Edmonton - Office	2.3	2.1	0.4	(1.0)	(4.8)	(3.9)	(2.9)	(2.2)	(0.4)	(0.3)	(0.7)	(0.6)	(1.8)
Calgary - Retail	1.8	2.0	0.7	0.7	1.6	1.6	2.2	2.1	7.2	7.1	7.2	7.3	9.4
Calgary - Office	(2.1)	(2.3)	(1.8)	(2.0)	(1.6)	(2.9)	(5.5)	(6.1)	(7.0)	(6.7)	(4.1)	(3.1)	4.2

Source: MSCI/REALPAC Canada Quarterly Property Index, Q3 2018, 4-Quarter Trailing

Investment volume at record pace

CHALLENGE IN CANADA:

Lack of supply

of institutional quality real estate to satiate demand

Strong demand for real estate from both domestic and foreign capital sources continue to drive record levels of investment volume. One challenge in Canada to achieving higher volumes is the shortfall in available institutional quality real estate to satiate demand. There are emerging signs that buyer pools are thinning in terms of both breadth and depth on certain offerings. These occurrences are likely a result of an "up-in-quality" bias in the maturing cycle rather than an outright decision to sit on the sidelines waiting for a correction. This phenomenon is most acute in the retail sector where negative sentiment is reducing liquidity. Although retail transaction volume is in line with historic trends, it doesn't reflect the absent bids for select retail assets that were softly marketed this year. Regardless, investment volume should remain buoyant in 2019, supported by healthy fundamentals and strong investor demand.

Debt markets remain favourable for borrowers

The availability of debt remains exceptionally strong and real estate lenders continue to be active, making for a competitive market. As pricing for assets has increased to record levels, mature cycle de-risking by equity investors has resulted in a greater number of investment dollars shifting up the capital stack to more conservative, secure debt positions. As a result, there is ample capital and liquidity, which has compressed lending spreads throughout the year, especially for high-quality assets. However, there are signs that spreads have hit a resistance level forcing lenders to compete on deal structure such as loan-to-value (LTV), amortization and recourse. The effect for borrowers is that even though interest rates have been inching higher, the all-in borrowing costs have not increased significantly throughout the year.

Canadian conventional mortgage spreads over risk-free rates:

5-YEAR TERM

145-160 bps

Compared with 150-180 bps a year ago

10-YEAR TERM

155-170 bps

Compared with 170-200 bps a year ago

Source: CMLS, CBRE, Bentall Kennedy

Investment outlook

Solid operating fundamentals, strong investor appetite and ample low-cost debt all suggest a strong outlook for real estate performance in 2019. Although economic growth is slowing, it remains supportive for real estate demand, which will continue to support property fundamentals and drive NOI growth. Investors and capital sources remain disciplined in transaction underwriting and, importantly, prudent in evaluating development projects. There are very few signs of over-building and thus no imminent threat of supply-induced dislocation. The year 2019 will be characterized by an “up-in-quality” bias as the business cycle matures. Prudent deployment of capital will increase “flight to quality”. The result is that transaction volume is likely to pull back from the record highs we’ve witnessed over the past two years but remain elevated.

In this environment of renewed volatility, real asset returns including commercial property look especially attractive on a relative basis. But at this juncture, investors would be wise to maintain an up-in quality bias, look to markets and sectors that are rich in knowledge-based capital, and focus on operational excellence to boost NOI growth to drive performance.

About the Bentall Kennedy Group

Bentall Kennedy, a Sun Life Investment Management company, is a leading global real estate investment advisor and one of North America's foremost providers of real estate services. Bentall Kennedy serves the interests of more than 545 institutional clients with expertise in office, retail, industrial and multi-residential assets throughout Canada and the U.S. Bentall Kennedy's Investment Management group has approximately $48 billion (CAD)/$36 billion (USD) of assets under management (as of September 30, 2018). Bentall Kennedy is one of the largest real estate services providers in Canada, managing more than 60 million square feet on behalf of third-party and investment management clients (as of September 30, 2018). Bentall Kennedy is a member of UN PRI and a recognized Responsible Property Investing leader ranked among the top firms around the globe in the Global Real Estate Sustainability Benchmark (GRESB) for the eighth consecutive year since GRESB was launched.

Bentall Kennedy includes Bentall Kennedy (Canada) Limited Partnership, Bentall Kennedy (U.S.) Limited Partnership and the real estate and commercial mortgage investment groups of certain of their affiliates, all of which comprise a team of real estate professionals spanning multiple legal entities. The assets under management shown above include real estate equity and mortgage investments of the companies within Bentall Kennedy. For more information, visit www.bentallkennedy.com.

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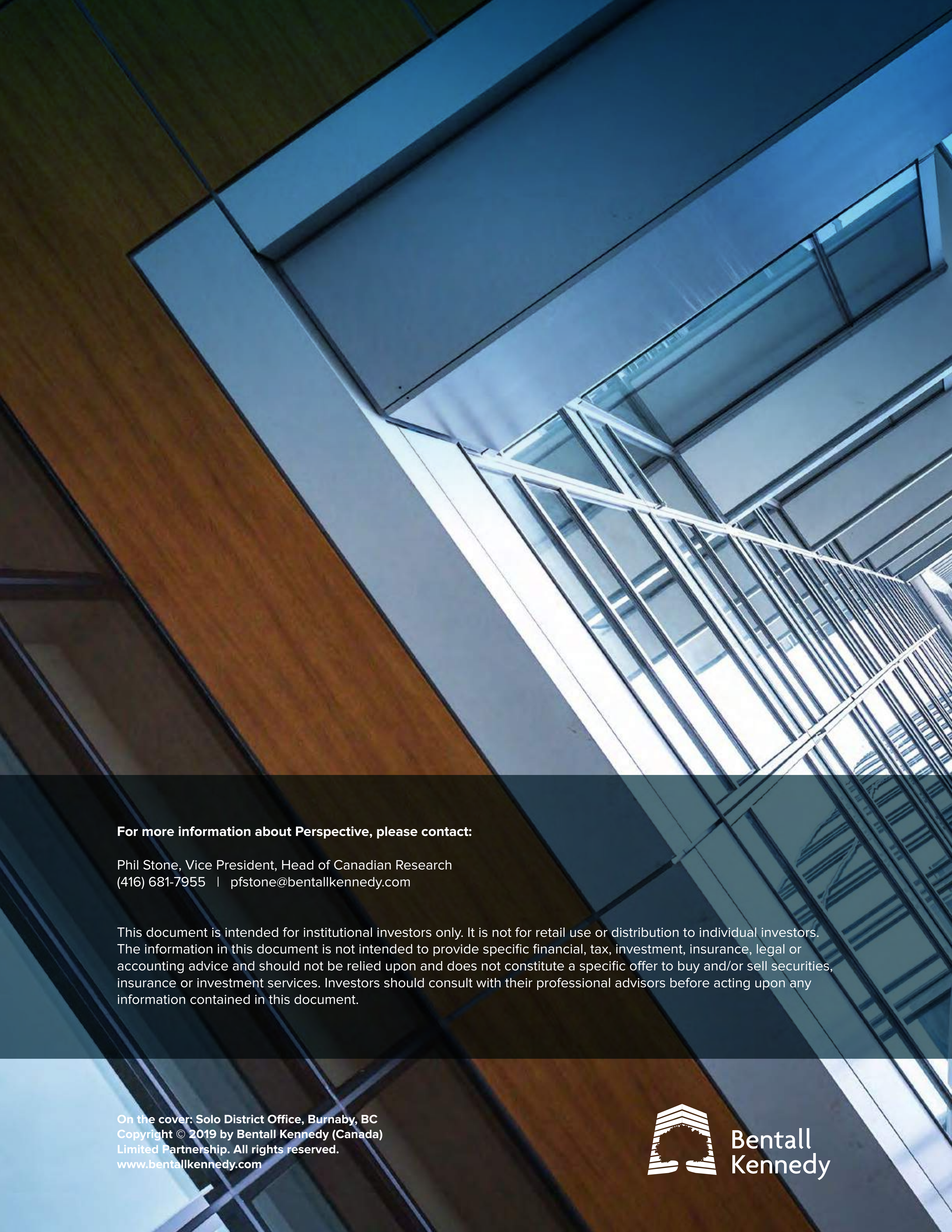

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