



REALpac/FPL Perspectives on 2010

Featuring the 1st Quarter 2010
REALpac/FPL Canadian Real Estate Sentiment Index

Released Wednesday, February 3, 2010

REALpac/FPL Perspectives on 2010

“The Canadian market is breathing a sigh of relief.”

While many things can be said about the year to come, perhaps the best is that it's neither 2008 nor 2009. Both were extremely challenging years, though 2009 saw some positive surprises. Most notable is the fact that the downturn in Canada ended up being milder than expected and far milder than the one experienced in the United States. Final numbers are not yet in; however, it appears that the Canadian economy resumed growing in the second half of 2009, albeit at a relatively slow rate.

Though Canada is clearly beginning 2010 below recent economic activity highs, a number of statistics point to the potential for a positive trajectory in the coming year:

- Retail sales were up between 1.5% and 2.0% for the 2009 holiday season¹.
- GDP growth is expected to be 2.9% for 2010², a significant improvement from an estimated 2.5% decline for 2009³.
- Household net worth continues to increase; it was up 2.3% in the third quarter of 2009⁴.
- Unemployment appears stable, recorded at 8.5% in December 2009⁵.

Predicting the future is a near impossible task, but each quarter we ask the leaders of the Canadian real estate industry to do just that as we conduct the REALpac/FPL Canadian Real Estate Sentiment Survey. Our goal is to measure the pulse of the Canadian commercial real estate industry over time, and this quarter's data could hardly be more consistent with the information provided above.

Topline Findings

- The Q1 2010 edition of the REALpac/FPL Canadian Real Estate Sentiment Index came in at 76 on an overall basis, up from 68 last quarter,
- Overall, expectations for the coming year are modest, but up. Respondents are “cautiously optimistic,” with 87% of respondents are now expecting conditions to improve in the next year, compared to 63% in last quarter's survey.
- Trading volume and pricing are expected to solidify. While trading was thin in the past quarter, many of those we spoke with have expectations for increased volume and pricing stability in the coming year.
- Capital appears to be widely available. An overwhelming majority (81% and 90%, respectively) see debt and equity as more available than it was a year ago.

Data Collection

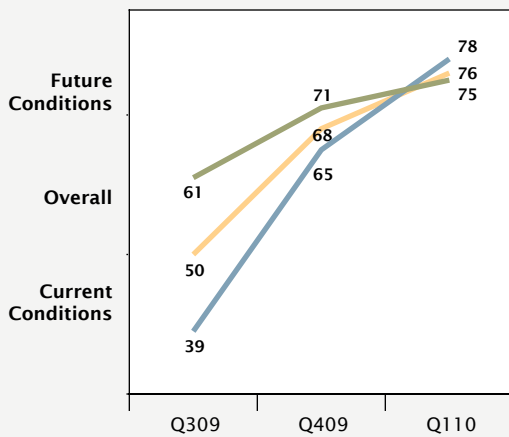
The REALpac/FPL Canadian Real Estate Sentiment Survey is the industry's most comprehensive measure of senior executives' confidence in the Canadian commercial real estate industry. This quarter, the survey captured the thoughts of 62 senior real estate executives, including CEOs, presidents, board members, and other executives from a broad set of industry sectors including owners & asset managers, financial services providers, and operators & related service providers. The quarterly survey measures executives' current and future outlook on three topics including (1) overall real estate conditions, (2) access to capital markets, and (3) real estate asset pricing. Survey respondents represent the retail, office, industrial, hotel, multi-family, residential, and seniors residential asset classes.

REALpac/FPL Canadian Real Estate Sentiment Index

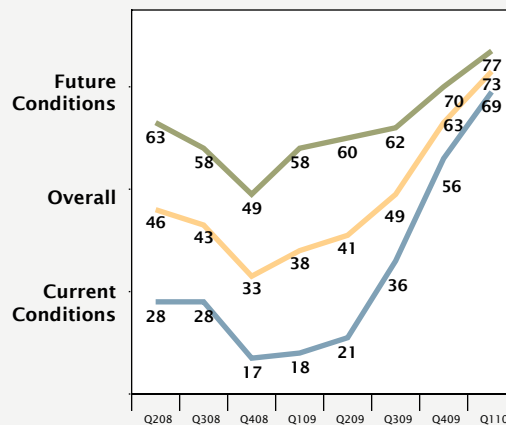
The Q1 2010 edition of the REALpac/FPL Canadian Real Estate Sentiment Index came in at 76 on an overall basis, up from 68 last quarter, which in turn marked a significant improvement from the 50 we saw in the third quarter of 2009. Also, for the first time, we're seeing respondents feel better about where the industry is today compared to where the industry will be in 12 months, though by a very slim margin (78 and 75, respectively). As in the past, this data is consistent with the trajectory of The Real Estate Roundtable Sentiment Index in the U.S. (also conducted by FPL Associates, using an identical methodology), though the Canadian results continue to reflect somewhat more optimism, particularly in perspectives on current conditions.

Exhibit 1

REALpac/FPL Canadian Real Estate Sentiment Index



Real Estate Roundtable Sentiment Index (U.S.)



¹ The Indices are measured on a scale of 1–100. To register an Index of 100, all respondents would have to answer that conditions are “much better” today than one year ago and will be “much better” one year from now.

Market Conditions

Overall, expectations for the coming year are modest, but up.

If we were to summarize overall expectations for the coming year, we would probably say respondents are “cautiously optimistic.”

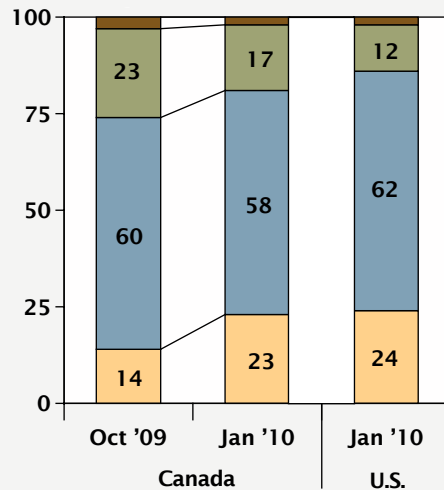
Similar to last quarter, a majority of respondents (58%) told us that they expected the coming year to be “somewhat better,” but now a further 23% are expecting the next year to be “much better,” up from 14% last quarter.

Most we spoke with shared thoughts that reflected modest, but positive, expectations. As one respondent told us, he is “hoping for a slight improvement across all asset classes.” Another said, “2010 won’t see a return to normalcy, but it will be moving in that direction.” A third said, “I don’t think things will go crazy, but we’re hoping for some improvement. Retailers were much stronger than expected in the fourth quarter, so that has made us more optimistic.”

Exhibit 2
**Perspective on Real Estate Market Conditions:
One Year From Now vs. Today**

% of respondents

- Much worse
- Somewhat worse
- About the same
- Somewhat better
- Much better



Market Conditions

(continued)

We also spoke to some who reflected a higher degree of optimism. According to one respondent, "In general, we're on the bullish side of the equation. We have good information about debt, values are relatively less volatile, and there's been little new product coming into the market in the last 18 months. We're expecting to see healthy demand and rebounding real estate values in the coming year." Another saw moves in the equity markets as a strong sign of optimism: "I think the best sign is that we're pitching IPOs again. Because of their unique pricing nature, this really speaks to the optimism of both companies and investors." A third saw the core drivers of the sector as being quite strong: "I'm very optimistic on 2010/11/12. Lenders were conservative, we haven't overbuilt, and our financial system is stable. Armageddon is behind us."

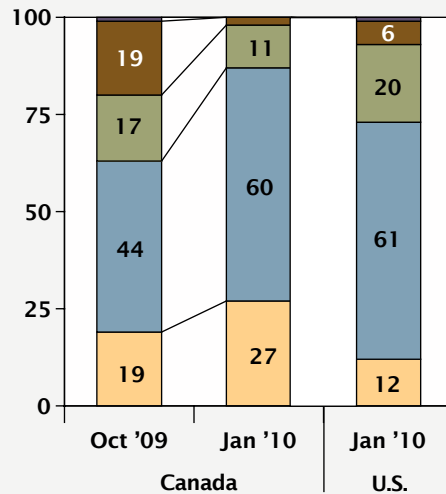
One of the primary sources for improved expectations seems to be the change from last year. As one respondent put it, "The Canadian market is breathing a sigh of relief. 2009 wasn't nearly as bad as it could have been. We saw some rent declines, but in the back half of the year, tenant interest was up." According to another, "A year ago, nothing was happening. Nothing. Everything was frozen. The banks weren't even enforcing, that's how shut down things were. Everything is very different today."

Our survey clearly reflects this thinking, with a notable increase in positive sentiment from last quarter to this quarter. As shown in Exhibit 3, 87% of respondents are now expecting conditions to improve in the next year, compared to 63% in last quarter's survey.

Exhibit 3
**Perspective on Real Estate Market Conditions:
Today vs. One Year Ago**

% of respondents

- Much worse
- Somewhat worse
- About the same
- Somewhat better
- Much better



Asset Values

Trading volume, pricing expected to solidify.

While trading was thin in the past quarter, many of those we spoke with have expectations for increased volume and pricing stability in the coming year. In our survey, respondents were roughly split between expecting no change and modest increases in pricing (see Exhibit 4).

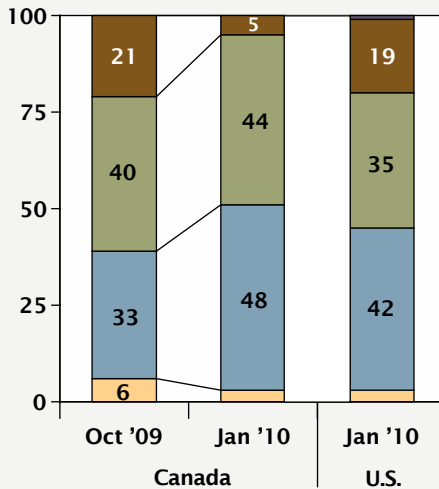
There is a sense that much of this pricing stability is driven by an imbalance between buyers and sellers in the market, much of which has been caused by relatively easy access to capital (more on this in the next section). As one respondent told us, “There are far more buyers than sellers in the market today. Buyers, REITs in particular, have a lot of capital, but there’s not much product available.”

There’s also a sense that the bid-ask spread is closing, though it is still a challenge in some situations. According to one respondent, “We saw some good assets trade in the fourth quarter, and the bid-ask spread was narrowing.” According to another, “I see a wide spread between the bid and ask at the beginning of every deal, but they’re getting to the finish line. That wasn’t the case a few months ago.”

Exhibit 4
**Real Estate Asset Values:
One Year From Now vs. Today**

% of respondents

- Much worse
- Somewhat worse
- About the same
- Somewhat better
- Much better



Asset Values

(continued)

According to some, the U.S. is expected to provide an outlet for capital flows. “We haven’t seen sellers capitulate in Canada yet, so all the capital is still looking for a place to go. Many firms are looking south, to the U.S., for opportunities,” said one respondent. Another explained the situation by looking to a fundamental shift in the types of companies operating in the Canadian real estate business: “Twenty years ago, it was all small players; now it’s an institutional business. As a result, there’s little distress in Canadian markets today. These companies are solid.”

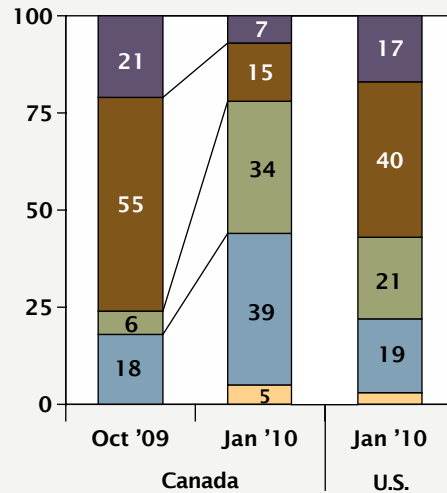
Perhaps the most notable change reflected in our entire survey is the change from last quarter to this quarter in sentiment about year-on-year pricing change. When asked where they think pricing is today vs. one year ago, 78% of respondents said that prices were about the same or higher now. This stands in stark contrast to the prior quarter, in which almost the same percentage (76%) felt that prices were either somewhat lower or much lower.

Our interviews suggest there is a clear sense that pricing has come down materially, but is largely stabilized. As one respondent told us, “There’s no product to buy right now—no great deals on offer. Good assets (in industrial) are selling at a 7½ cap, up from a six cap—not that dramatic, if you think about what could have been.” According to another: “Pricing will be stable this year. I don’t expect a lot of ups and downs.”

Exhibit 5
**Real Estate Asset Values:
Today vs. One Year Ago**

% of respondents

- Much worse
- Somewhat worse
- About the same
- Somewhat better
- Much better



Capital Availability

Capital appears to be widely available, particularly equity.

Our survey and interviews reflect the sentiment that capital, particularly equity capital, is no longer a barrier to doing business in Canadian commercial real estate. Whether looking at today versus one year ago or looking out at the year to come, respondents are quite optimistic. An overwhelming majority (81% and 90%, respectively) see debt and equity as more available than it was a year ago. Looking forward, the message is similar, in that most expect debt and equity capital availability continue to improve (67% and 62%, respectively).

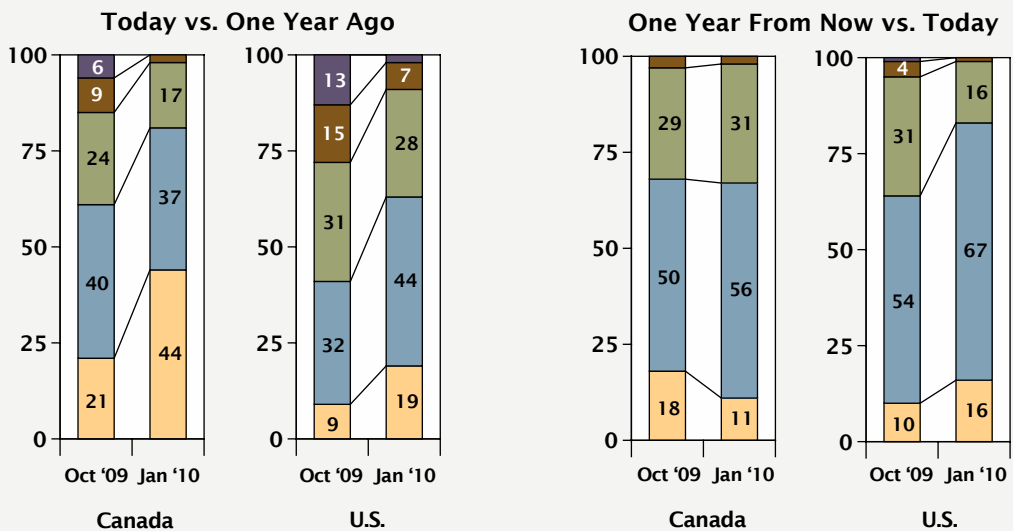
It is, however, interesting to note that the figures for equity capital availability going forward have started to tick down, with an increasing (though small) share of respondents expecting equity availability to be worse or about the same, compared to the prior quarter. Perhaps this reflects sentiment heard in our interviews, where a range of respondents were clear that equity is currently widely available, particularly to REITs. As one respondent told us, "In March [2009], access to capital in Canada was restored, and now we're seeing an enormous amount of flow into yield product. REIT structures are very attractive right now." According to another, "On the equity side, we're seeing capital flood the market, but there's no product available...there's nothing of any quality being traded in Canada."

Exhibit 6

Availability of Debt Capital

% of respondents

■ Much worse
 ■ Somewhat worse
 ■ About the same
 ■ Somewhat better
 ■ Much better



Capital Availability

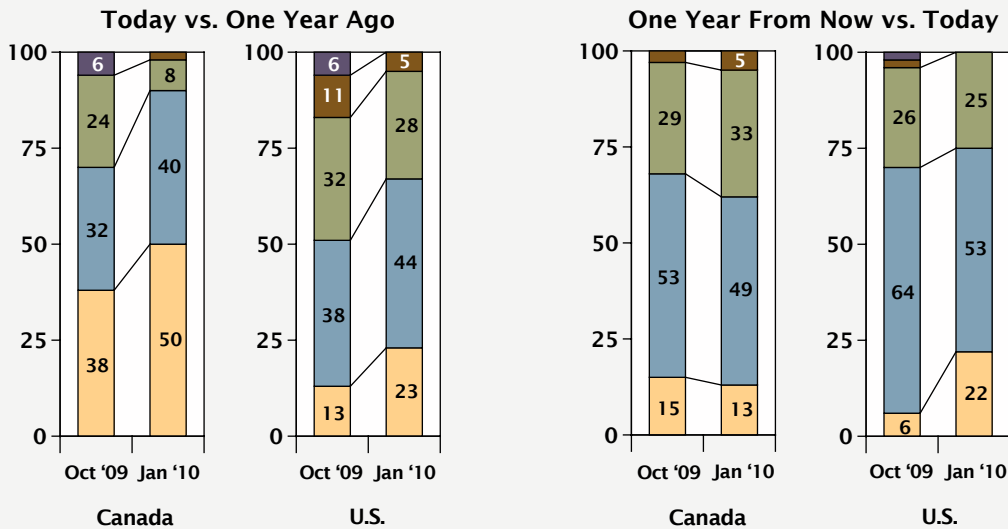
(continued)

Exhibit 7

Availability of Equity Capital

% of respondents

■ Much worse
 ■ Somewhat worse
 ■ About the same
 ■ Somewhat better
 ■ Much better



Our interviewees were also clear that they felt they had the access to the capital they need, particularly those organizations of size. One interviewee was very clear on this matter: “We just completed a huge financing, so we’re feeling pretty good about debt availability.” According to another, “If you’re not too aggressive, you can pretty much get the debt you need.” A third told us, “Equity is not a factor in deals right now. Everyone seems to be able to get what they want on that front.”

There were some questions about how that capital will be put to work, as suggested in the previous section. There’s an increasing sense that there is little product available in Canada: “Little of size has traded. We need to see some \$80-\$100M assets trade to see that people can really get deals done.” There is also a question as to whether that capital will end up leaving the country in search of deals. According to one respondent: “There’s been a fair bit of equity capital entering. How much of that is interested in Canada is a different question. We’re looking at other markets.”



Conclusion

Will 2010 deliver on its promise?

Throughout interviews, survey responses, and other discussions with Canadian real estate leaders, it seems clear that there is some hope for 2010. Most seem to expect a mild recovery that will pick up steam going into 2011 and 2012. Respondents are already noting debt and equity capital becoming more readily available and pricing stabilizing, both of which bode well for the coming year. Metrics around economic fundamentals, while still relatively weak, are showing the right trajectories. Additionally, our respondents seem to expect improvement, both in their businesses and in the real estate market more broadly.

Unfortunately, weaknesses in key areas counter these reasons for optimism. Large transactions haven't resumed, and overall transaction volume is still light. The kind of "great deals" on properties that can motivate more aggressive entry into the space don't seem to be appearing. The CMBS market is still largely frozen. Additionally, the U.S. is still reeling from its downturn, and the market there is well behind the Canadian one, potentially weakening Canadian economic fundamentals, lengthening the time to recovery, and siphoning off capital that could be deployed domestically.

Taken together, this picture offers reasonable grounds for optimism, though of the milder sort. Let's hope that the coming year delivers on its promise and that all of us experience a more profitable and rewarding one than in the recent past.

Participants

(Please note that this is only a partial list. Not all survey participants elected to be listed.)

Agellan Capital Partners Inc.
Damien Moore

Alberta Investment Management Corporation (AIMCO)
Micheal Dal Bello

Alliance Rockliffe Limited
Collin Craig

bcIMC (British Columbia Investment Management Corporation)
Chuck Swanson

Bennett Jones LLP
Jane Helmstadter

Bentall LP
Gary Whitelaw

Brookfield Properties
Thomas F. Farley

Building Industry & Land Development Association
Stephen E. Dupuis

Calloway REIT
Simon Nyilassy

Canaccord Adams
Shant Poladian

Canderel
Richard Diamond

CanFirst Capital Management
Paul Braun

Coldwell Banker Commercial Integrity Real Estate
Michael L. Schuler

CSCA Ryerson
Tony Hernandez

Cushman & Wakefield Ltd.
Pierre Bergevin

Fengate Capital Management Ltd.
Lou Serafini Jr.

First National LP
Moray Tawse

Global Dimension Capital, Inc
Neil J. Labatte

Great Gulf Group of Companies
Dino DiVito

Great-West Life
Ronald L. Findley

Grosvenor Americas Limited
Andrew J. Bibby

GWL Realty Advisors Inc.
Paul Finkbeiner

Homestead Land Holdings Limited
Francine A. Moore

IGRI Inc.
Amy P. Erixon

Ivanhoe Cambridge
Kim McInnes

Jones Lang LaSalle Real Estate Services
Ian V. Boake

Killam Properties Inc.
Philip D. Fraser

KingSett Capital
Jon Love

M3 Capital Partners LLC
George W. Ahl

Menkes Developments Ltd.
Peter Menkes

MIYA Consulting Inc.
D. Kevin Miyauchi

Moody's Investors Service
Merrie S. Frankel

Morguard Investments Limited
Stephen Taylor

O.R.E. Development Corporation
Mike Hanna

Osmington Inc.
George Schott

Public Storage Canadian Properties
Troy McLellan

RBC Capital Markets
Neil Downey

Retrocom Mid-Market REIT
David Fiume

RioCan REIT
Rags Davloor

Scotiabank
Andrew B. Lennox

Standard Life Investments
Peter Cuthbert

Stonehenge Partners Inc.
Richard Dansereau

Sun Life
Philip C. Gillin

The Minto Group
Roger Greenberg

Timbercreek Asset Management
Ugo Bizzarri
Blair Tamblyn

University of Toronto – Rotman School of Management
William Strange

Urban Development Institute
Michael Mooney

Waterfront Toronto
John Campbell

Westcorp Inc.
Phil Milroy

York University – Schulich School of Business
Andre Kuzmicki
James McKellar



Sources

- ¹ Reuters. "Canadian holiday retail sales seen up modestly." Anderson, Scott. January 4, 2010.
- ² Bank of Canada. Press release. January 19, 2010.
- ³ Global Forecast Update. Scotia Economics Group, Scotiabank. January 8, 2010.
- ⁴ The Globe and Mail: Report on Business. "We're Richer, But Deeper in Debt." Grant, Tavia. December 14, 2009.
- ⁵ Statistics Canada. www.statscan.gc.ca. Accessed January 8, 2010.



Contact

Please direct all inquiries regarding this study to:

Jonas D. Bordo

Senior Director
FPL Associates L.P.
191 North Wacker Drive
Suite 2850
Chicago, Illinois 60606 USA
Phone: (312) 368-5088
Fax: (312) 368-0359
E-mail: jbordo@fplassociates.com

Carolyn Lane

Vice President, Research & Communications
Real Property Association of Canada
One University Avenue
Suite 1410
Toronto, Ontario M5J 2P1 Canada
Phone: (416) 642-2700
Fax: (416) 642-2727
E-mail: clane@realpac.ca

© 2010, FPL Advisory Group LLC. All rights reserved. No business or professional relationship is created in connection with any provision of the content of this document (the "Content"). The Content is provided exclusively with the understanding that FPL Advisory Group LLC is not engaged in rendering professional advice or services to you including, without limitation, tax, accounting, or legal advice. Nothing in the Content should be used in or construed as an offer to sell or solicitation of an offer to buy securities or other financial instruments or any advice or recommendation with respect to any securities or financial instruments. Any alteration, modification, reproduction, redistribution, retransmission, redisplay or other use of any portion of the Content constitutes an infringement of our intellectual property and other proprietary rights. However, permission is hereby granted to forward the Content in its entirety to a third party as long as full attribution is given to FPL Advisory Group LLC.

The views and opinions expressed by each participant are such individual's own views and are not necessarily the views of FPL Advisory Group LLC or such participant's employer.