Perspective

MID-YEAR 2017

CANADA

ECONOMY

Encouraging broad-based growth in Canada leaves the oil shock in the rearview mirror

CAPITAL MARKETS

Stable economic, political and property environments attract record capital flows

PROPERTY MARKETS

Healthy fundamentals despite select regional and sector challenges

Bentall Kennedy


PULL

Contents

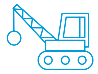
Key

PROPERTY TYPE METRICS

VACANCY / AVAILABILITY

ABSORPTION

NEW SUPPLY



RENT

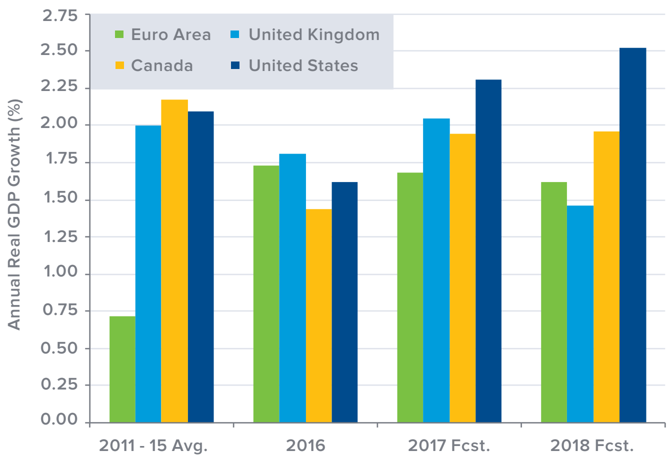
BENTALL KENNEDY RESEARCH SENTIMENT

Positive ⟷ Negative

Global Economy

Growth on more solid footing across regions

A POSITIVE OUTLOOK FOR THE U.S. AND CANADA



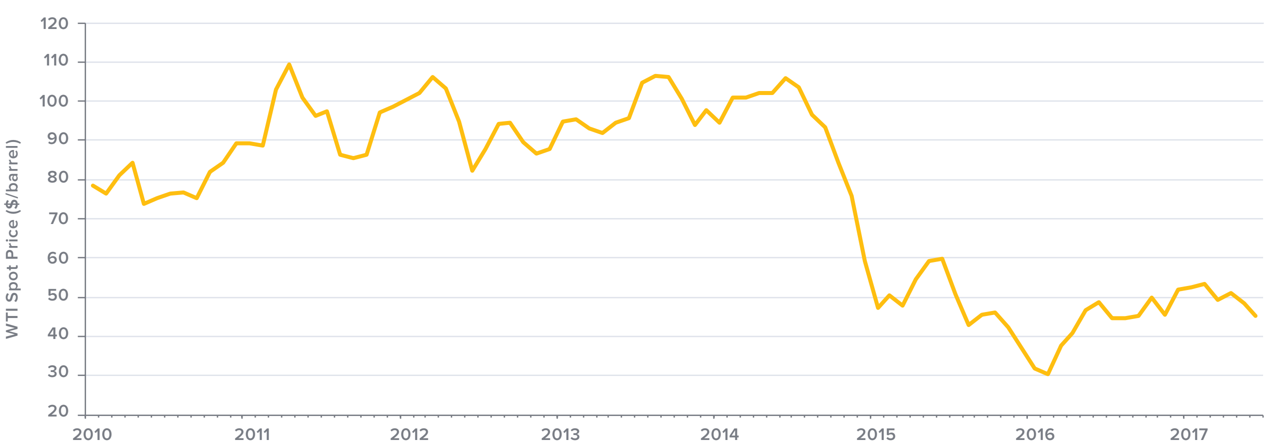
12.7%

DECREASE IN OIL PRICES, FROM **$51.91** TO **$45.30**

Week of 12/16/16 vs 6/16/17

- The U.S. and Canadian economies are poised for improved growth in 2017-18, and will lead many other industrialized nations.
- Europe provides upside as the French and, potentially, German elections favor status quo. "Free money" policies are finally having the desired effect on growth.
- German industrial production is strong and business and consumer confidence in the Euro-Area are near multi-year highs.
- Headwinds persist, however, as geopolitical uncertainty and recent terrorist attacks weigh on growth. Tourism in Europe has ebbed and flowed.
- China posted modestly better than expected GDP growth in 17Q1 of 6.9%, aided by government spending and export growth. Risks remain and Moody's recently downgraded China's credit rating due to rising debt levels.
- Oil prices have trended lower in 2017 as OPEC production cuts have been offset by Non-OPEC production and sluggish global oil consumption.
- Cheap oil remains a headwind for oil exporting countries, but benefits consumer driven economies, namely the U.S.

OIL PRICES FAILING TO SUSTAIN A RECOVERY



Sources: IMF | U.S. Energy Information Administration, Reuters (WTI Spot Price); June 2017 value = week of 6/16

U.S. Economy

Major indicators showing the U.S. expansion has legs

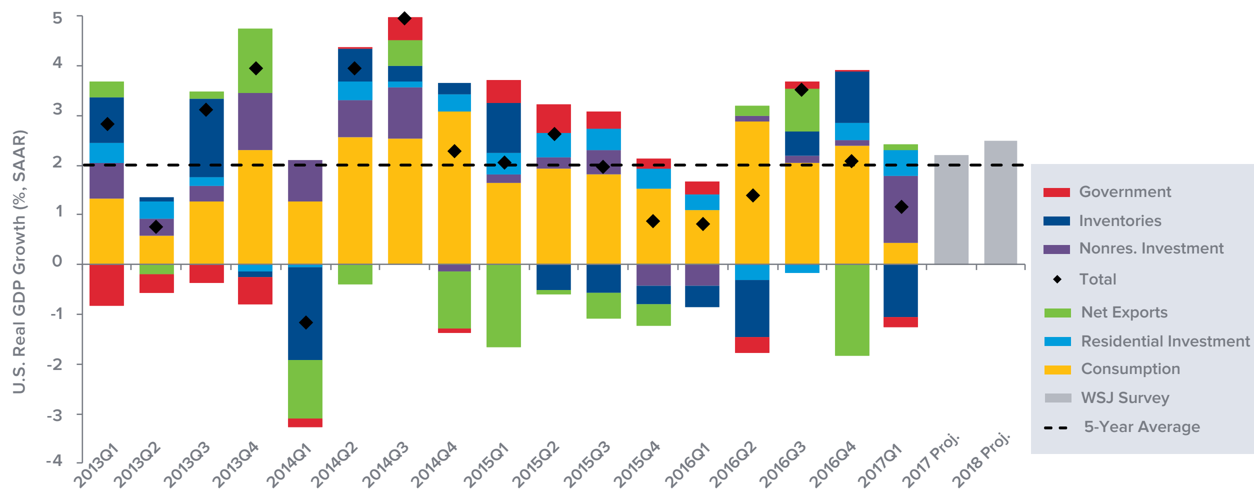
2.2%

PROJECTED 2017 GDP GROWTH

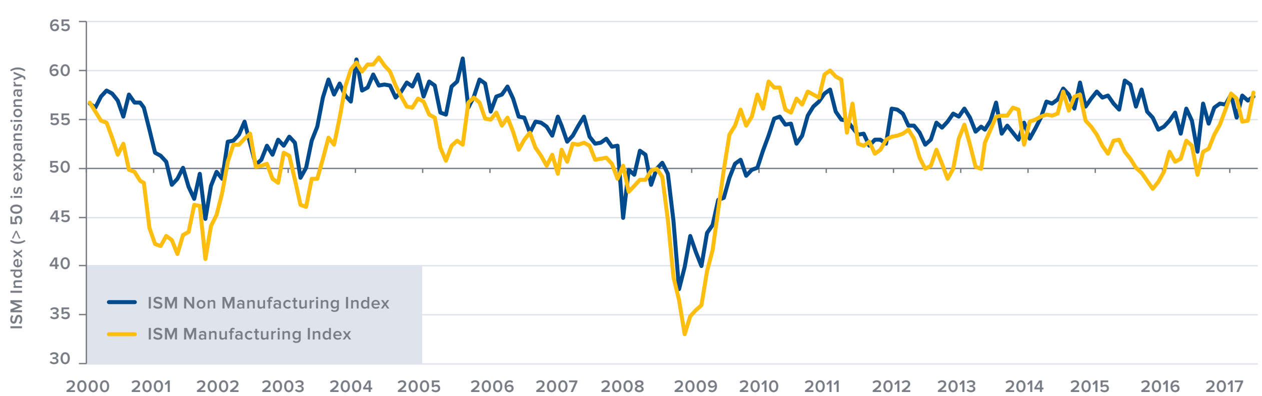
WSJ Economic Survey - May 2017

- U.S. GDP growth was slow out of the gates in 17Q1, but should improve as the year progresses. Still our expectation for upper 2.0%-range growth in 2017 has moderated.
- The post election climate is more unsettled than anticipated. Increased government spending and tax and regulatory reform are likely to take some time. Policy uncertainty will be a persistent drag on growth.
- The U.S. dollar remains strong, but has come down from its post-election bounce. A cheaper dollar may support a resurgence in U.S. exports.
- Corporate earnings and profits are showing signs of strength aided by a healthy domestic consumer and improving conditions in Europe.
- Industrial production is at its highest level in more than two years. Car sales have taken a step back, however, presenting a potential headwind.
- Major indicators such as the ISM indices point to expansionary conditions for both manufacturing and non-manufacturing sectors.
- Job growth is encouraging despite recent moderation due to the maturing business cycle and a labour market that is near full employment.
- Unemployment is now below its pre-recession trough and strengthening wage growth is increasingly evident.

U.S. GROWTH EXPECTED TO IMPROVE SLIGHTLY



ISM INDICES POINT TO CONTINUED ECONOMIC EXPANSION

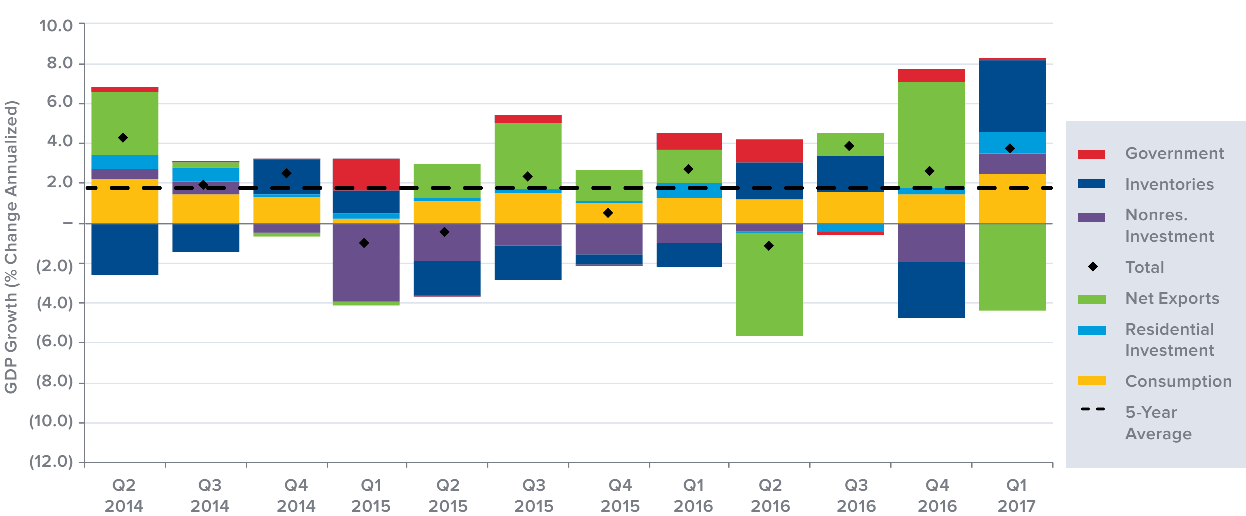


Sources: U.S. Bureau of Economic Analysis, Dow Jones (WSJ Economic Survey, May 2017) | Institute for Supply Management

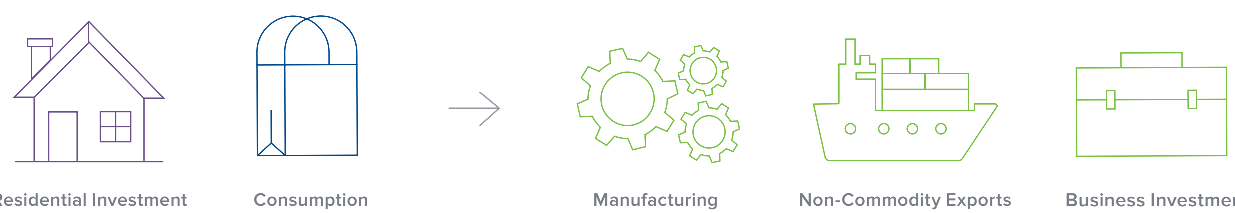
Canadian Economy

Impressive broad-based growth

CANADA REAL GDP GROWTH



EXPANSION OF ECONOMIC DRIVERS



- The Bank of Canada raised its overnight rate by 25bps for the first time in seven years, along with increasing its GDP growth forecast for 2017.
- Trade deficit is expected to narrow as export activity improves. Sustainable growth hinges on continued strength of export oriented sectors.
- Solid output in the manufacturing sector signaling that non-commodity export activity is emerging as another key driver of economic growth.
- Alberta's economy is recovering from the oil-induced recession as conditions in the energy sector have stabilized.
- Prospect of oil prices reaching levels that could encourage new capital investments in Alberta's oil patch is still tentative.
- Toronto housing market is beginning to cool owing in part to the Ontario Fair Housing Plan.
- Solid employment growth reflects improving businesses confidence but wage growth remains subdued.
- Downside risks include: NAFTA renegotiations damaging trade relations; a hard landing in the housing market weighing on domestic demand; and fragility in oil prices.

Source: Statistics Canada, Haver Analytics

Capital Markets

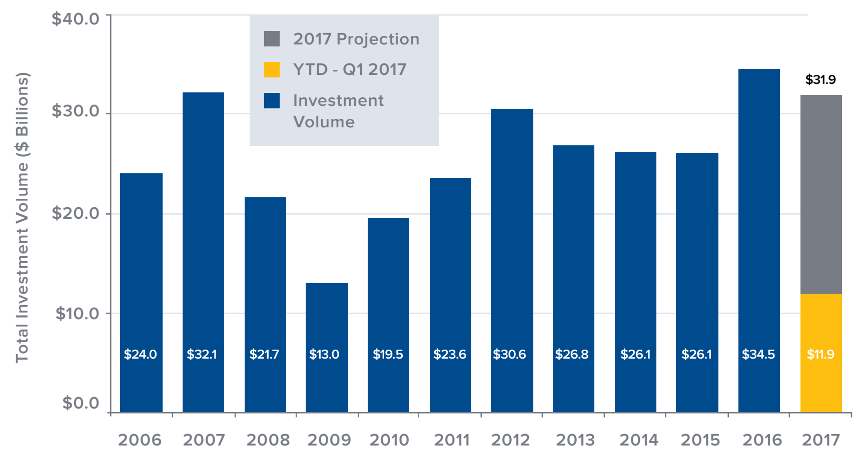
Record transaction volume continues

- Canadian commercial real estate investment activity continues to soar in 17Q1 with the largest quarterly volume on record.
- Gateway markets of Toronto, Vancouver and Montreal continue to attract foreign capital, creating additional pricing pressures.
- Debt capital continues to be plentiful and cheap except for secondary markets and higher risk sub-sectors.
- Cap rates flattening out except for high quality assets in major markets with rent rolls that possess term and credit.
- Expect further isolated yield compression in industrial, multi-residential and office markets that offer more favourable NOI growth prospects.
- Cap rate spreads over risk-free remain above their long-term average, providing some cushion to absorb higher interest rates.
- Strong investor capital flows will be a primary driver to help preserve values.
- With further cap rate compression limited, returns will be largely income oriented with capital appreciation driven by NOI growth.

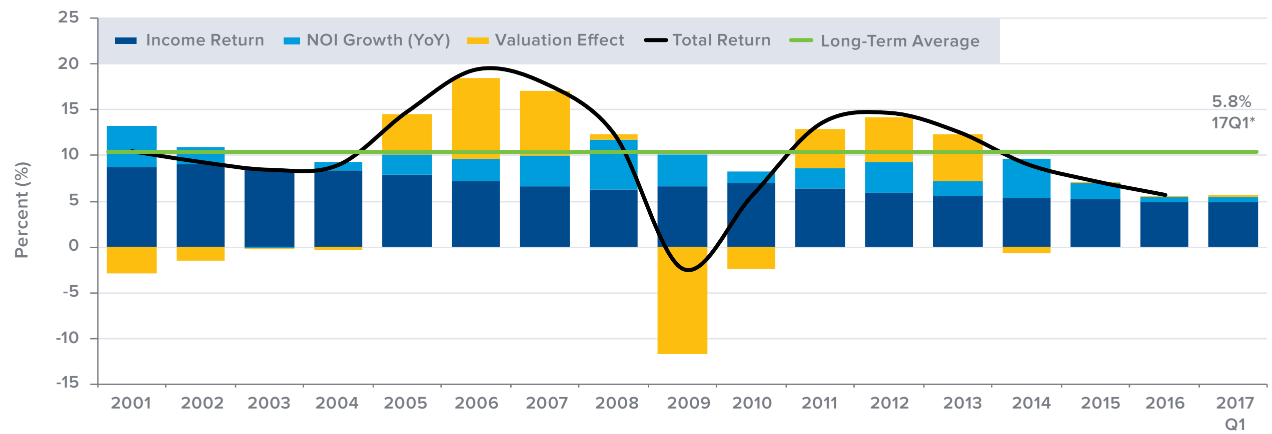
$11.8 Billion

LARGEST TRANSACTION VOLUME FOR A SINGLE QTR IN THE PAST 5 YEARS

CANADIAN INVESTMENT VOLUME



CANADIAN REAL ESTATE TOTAL RETURN DECOMPOSITION



* Q1 2017 represents the 12-month trailling return; decomposition of the valuation effect was not known at the time of print, therefore assumed to be same as 2016

Sources: CBRE | MSCI/IPD Realpac

Office

Office fundamentals improving, underpinned by a strengthening economy and robust job growth

Vacancy

13.1%

Vacancy

as of 17Q2

Quarterly Vacancy Trend

10-YEAR AVERAGE VACANCY **9.6%**

- Office fundamentals are still weak in parts of the country but upward pressure on vacancy has eased in recent quarters.
- Bifurcation remains between Alberta and the rest of Canada as office vacancy rates in Calgary and Edmonton are at or near historical highs.

Source: CBRE

Absorption

6

Million SF

four quarters ending 17Q2

Quarterly Demand Trend

10-YEAR AVERAGE ANNUAL DEMAND GROWTH **3 MSF**

- The technology/creative tenant base has emerged as a key source of demand for office space. This trend should mitigate some downside risk in the traditional office using sectors.
- Absorption has been experiencing positive momentum over the past three quarters, in sync with impressive full-time job growth.

New Supply

10

Million SF

four quarters ending 17Q2

Quarterly Supply Trend

10-YEAR AVERAGE ANNUAL SUPPLY GROWTH **6 MSF**

- An active development cycle delivered a steady flow of new supply over the past few years.
- A new development wave has kicked off in Toronto but new projects are not scheduled to come online until 2020. New projects in Vancouver are likely not far behind.

Rent

-7.4%

YoY Growth

as of 17Q2

Quarterly YoY Rent Trend

10-YEAR AVERAGE ANNUAL RENT GROWTH **1.6%**

- Deteriorating fundamentals in Alberta continue to weigh heavily on national rent levels, outweighing growth in the tighter markets of Toronto and Vancouver.
- Landlords in Alberta are likely to remain focused on occupancy, sacrificing higher rental rates.

Office

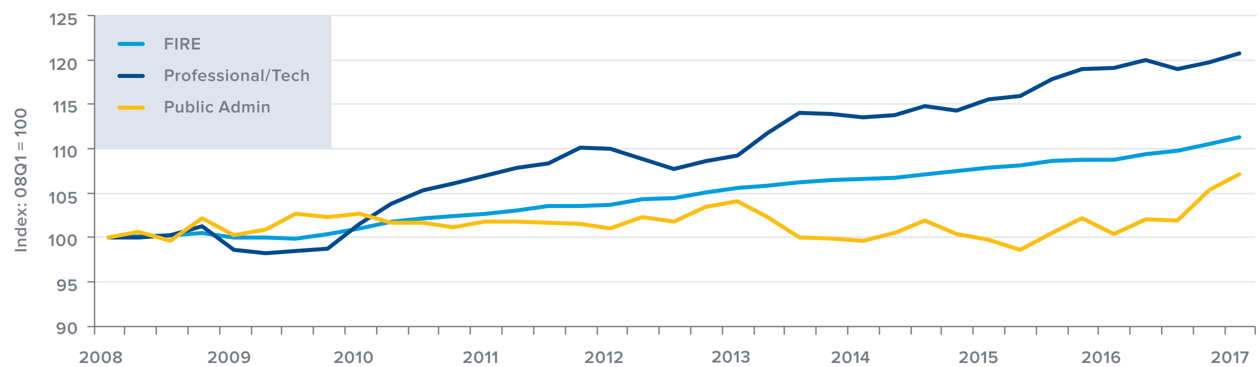
Averages misleading, masking "regional bifurcation"

3.8%

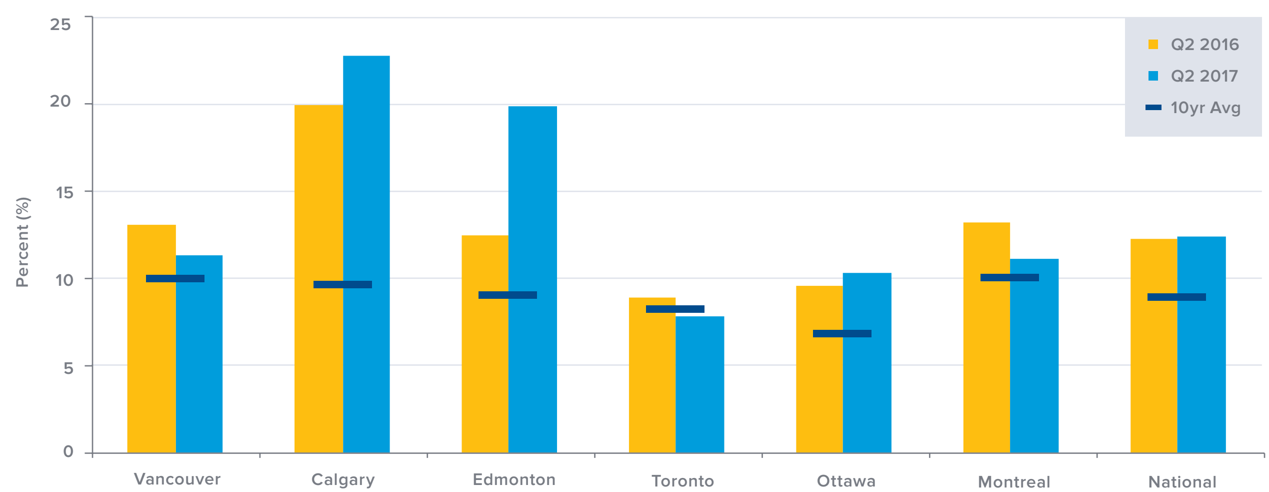
17Q2 VACANCY,
DOWNTOWN TORONTO
Source: CBRE

- Leasing activity has been healthy in both the downtown and suburban markets outside of Alberta, with 70bps and 90bps growth in occupancy YTD, respectively.
- Professional/Tech employment has grown considerably since the recession, hedging softer growth within traditional users.
- Federal government focused on fostering innovation. Tech sectors in Toronto, Vancouver and Montreal poised to experience further growth.
- Shared office space has become another source of demand, with global and niche operators catering to both freelance and enterprise users.
- Downtown Toronto remains one of tightest markets in North America despite a steady flow of new supply. New development cycle kicked off this spring.
- Alberta demand remains tepid with vacancy rates expected to remain elevated at or near historic levels.
- Downside risks include: further office space rationalization and automation of knowledge work resulting in employment dislocation.

OFFICE USING EMPLOYMENT



REGIONAL VACANCY — CLASS A OFFICE (CBD + SUBURBAN)



Souces: Statistics Canada, Haver Analytics | CBRE

Retail

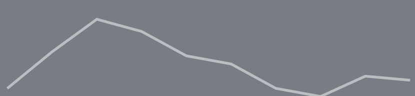
Consumer backdrop supportive of retail spending but secular headwinds are clouding the outlook for retailers

Vacancy

4.6%

Vacancy

as of 16Q4



Annual Vacancy Trend

10-YEAR AVERAGE VACANCY **5.0%**

- Vacancy has been upward trending in recent years due to secular headwinds.
- Super-regional malls, needs-based shopping centres, and urban formats performing well whereas regional malls and community centres remain challenged.

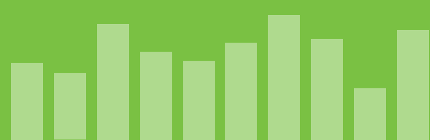
Source: CBRE

Absorption

7

Million SF

four quarters ending 16Q4



Annual Demand Trend

10-YEAR AVERAGE ANNUAL DEMAND GROWTH **6 MSF**

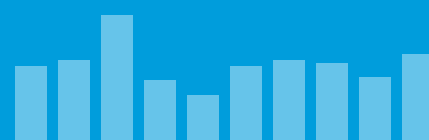
- Retail sales remain healthy however downside risks to consumer spending are increasing with elevated debt levels and the outlook for higher interest rates.
- Too much space, changing consumer preferences and the acceleration of ecommerce will continue to challenge retail demand.

New Supply

7

Million SF

four quarters ending 16Q4



Annual Supply Trend

10-YEAR AVERAGE ANNUAL SUPPLY GROWTH **6 MSF**

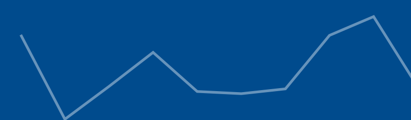
- Majority of the space currently under construction is concentrated in the major urban markets of Toronto, Vancouver and Calgary.
- Capital investment continues to be focussed on urban mixed-use developments.

Rent

1.9%

YoY Growth

as of 16Q4



Annual YoY Rent Trend

10-YEAR AVERAGE ANNUAL RENT GROWTH **3.9%**

- Despite generally healthy fundamentals, expect rent growth to be constrained as consumers and retailers face mounting headwinds.
- With former-Target vacancy still remaining, along with Sears closing stores and dissolution imminent, added market vacancy is likely to exert downward pressure on rents.

Retail

Can retailers keep up with the pace of change to stay relevant?

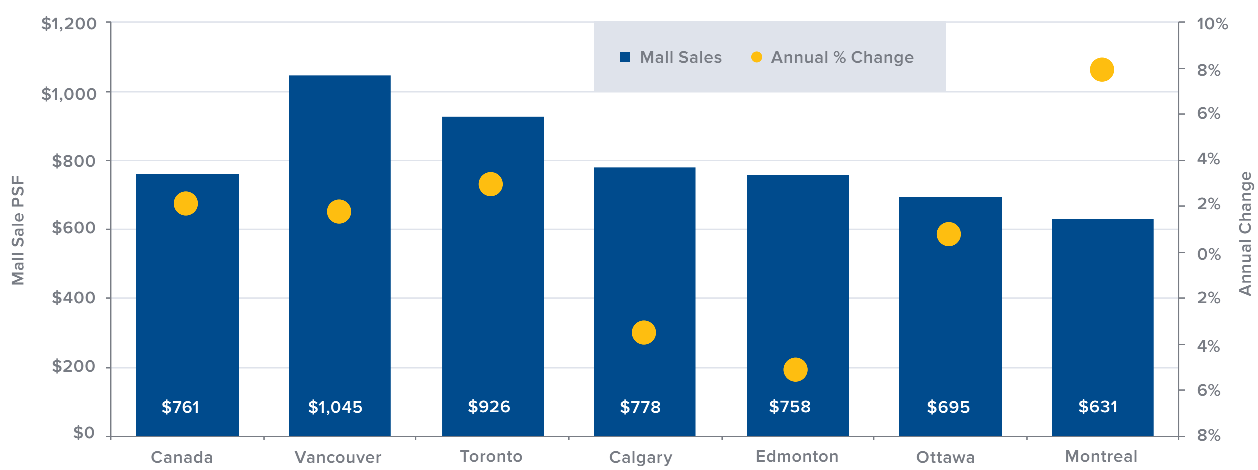
3.9%

ONLINE CORE RETAIL SALES PENETRATION

- Despite the dreary headlines, bricks and mortar retail continues to play a dominant role in the Canadian retail landscape.
- Mall productivity growth healthy in Toronto and Vancouver; Montreal is gaining momentum with improved employment outlook; Alberta malls remains challenged but retail sales showing recent improvement.
- New entrants to the Canadian market are taking a measured approach; meanwhile existing retailers expanding their store counts are concentrated amongst a few players.
- Ecommerce accounts for only 3.9% of all core retail sales but it's growing at an impressive +40% YoY.
- There are few retailers that are "getting digital right"—those that do are attracting a disproportionate share of consumers' wallets.
- Needs-based retail, urban formats and top-tier malls remain the best bets but Amazon's acquisition of Whole Foods signals that it wants to win everywhere, including figuring out experiential retail.

MOST VULNERABLE CATEGORIES

MALL SALES PRODUCTIVITY BY PROVINCE



Source: ICSC Research

Industrial

Low oil prices, a competitive Canadian dollar, stronger growth Stateside, and the rise of ecommerce should continue to fuel robust tenant demand.

Availability

4.7%

Availability

as of 17Q2

Quarterly Availability Trend

10-YEAR AVERAGE AVAILABILITY **6.1%**

- Availability continued to experience downward pressure over the past year and is now at the lowest level since 04Q3.
- Key manufacturing and trade hubs such as Vancouver and Toronto are among the tighest industrial markets in North America

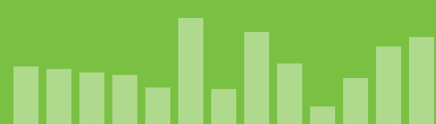
Source: CBRE

Absorption

22

Million SF

four quarters ending 17Q2



Quarterly Demand Trend

10-YEAR AVERAGE ANNUAL DEMAND GROWTH **15 MSF**

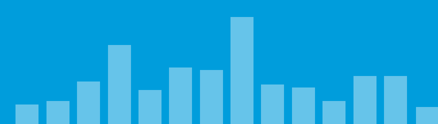
- Macro fundamentals have been supportive of demand. This trend should persist as manufacturing remains strong and export activity picks up.
- Industrial demand should continue to get additional support from the ongoing growth of ecommerce across Canada.

New Supply

12

Million SF

four quarters ending 17Q2



Quarterly Supply Trend

10-YEAR AVERAGE ANNUAL SUPPLY GROWTH **16 MSF**

- Owing to a steady flow of new supply, current volume of space under construction is well below the cycle peak of 23 million sf in 15Q3.
- Construction activity should pick up over the near term as developers look to take advantage of favourable demand conditions.

Rent

4.5%

YoY Growth

as of 17Q2

Quarterly YoY Rent Trend

10-YEAR AVERAGE ANNUAL RENT GROWTH **1.9%**

- Rental growth lost some momentum over the past year mainly due to weak conditions in Alberta.
- Meanwhile the balance of the country continues to experience upward pressure on rents.

Industrial

"Industretail" drives performance

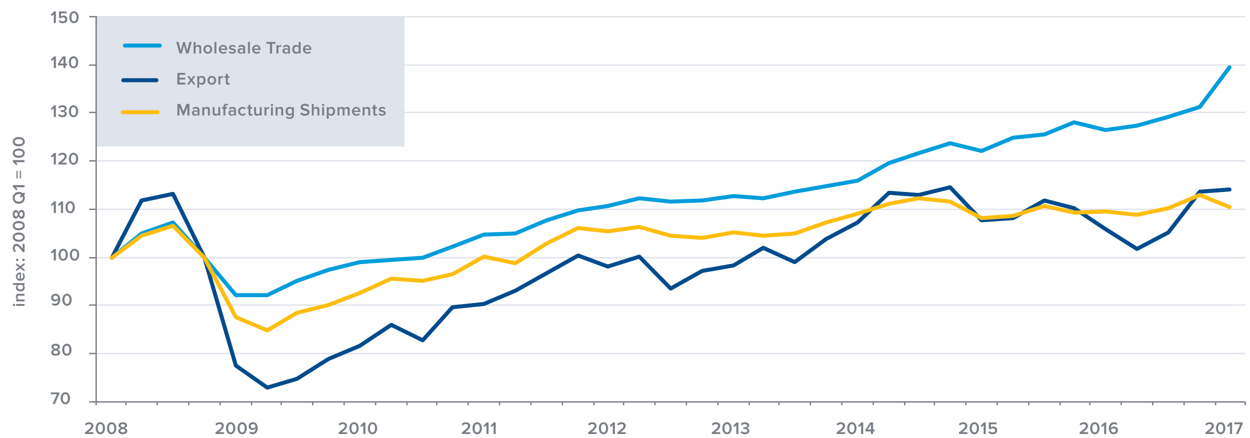
260 bps

INCREASE IN NATIONAL OCCUPANCY YOY

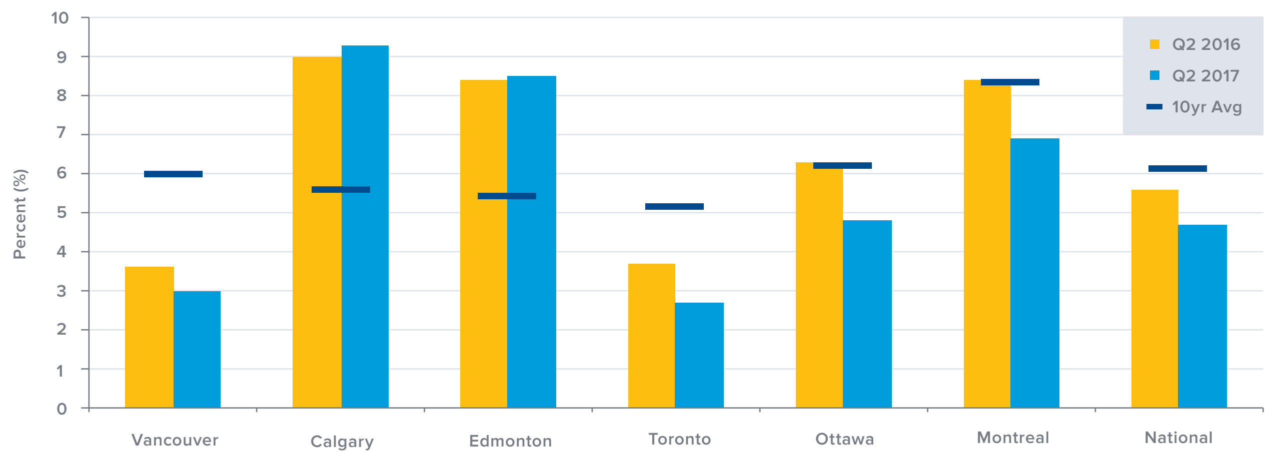
Source: CBRE

- Solid manufacturing production and shipments have been supported by improving U.S. demand and a lower Canadian dollar. Vancouver, Toronto and Montreal should benefit most with strong ties to U.S. trade.
- Conditions in Vancouver remain tight as demand for newer generation distribution space outweighs supply.
- Calgary's role as a key distribution hub for Western Canada continues to support the recovery of its industrial market.
- Given its strong ties to the oil patch, a tentative capex outlook should weigh on Edmonton's industrial market.
- As non-commodity export activity picks up, industrial demand should remain healthy in manufacturing hubs such as Toronto and Montreal.
- Ongoing penetration of ecommerce into traditional retail remains a key demand driver of newer generation space.
- Older generation space should garner increased attention as retailers look to integrate "the last mile" of their distribution networks.

DISTRIBUTION ACTIVITY



REGIONAL AVAILABILITY



Sources: Statistics Canada, Haver Analytics | CBRE

Multi-Residential

Property fundamentals remain healthy and supportive of stable rent growth

Vacancy

3.3%
Vacancy
as of 16Q4

Quarterly Vacancy Trend

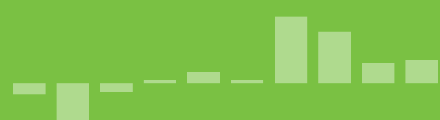
10-YEAR AVERAGE VACANCY **2.6%**

- National vacancy above long-term average is largely a function of elevated rates in Alberta.
- Vacancy remains exceptionally tight in the markets of Toronto and Vancouver as renter formation outpaces new supply.

Source: CBRE, CMHC

Absorption

16k
Units
four quarters ending 16Q4



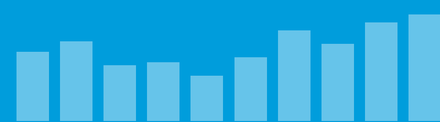
Annual Demand Trend

10-YEAR AVERAGE ANNUAL DEMAND GROWTH **9K UNITS**

- Demand continues to be driven by robust immigration, urbanization and increased renter formation due to deteriorating affordability of home ownership.
- These demand drivers are anticipated to persist, providing a positive outlook for the sector.

New Supply

24k
Units
four quarters ending 16Q4



Annual Supply Trend

10-YEAR AVERAGE ANNUAL SUPPLY GROWTH **16K UNITS**

- New supply continues to be delivered at or near record levels across most major markets.
- 2016 marked a record year for new purpose-built rental completions and another strong year for the secondary rental market (condos).

Rent

2.4%
YoY Growth
as of 16Q4

Annual YoY Rent Trend

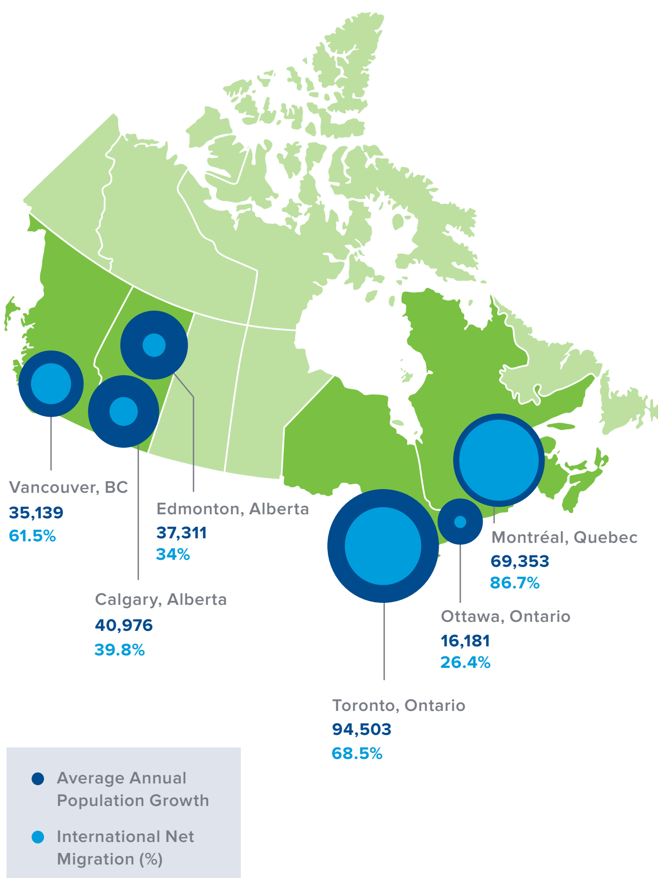
10-YEAR AVERAGE ANNUAL RENT GROWTH **2.8%**

- Rent growth continues to trend well above inflation even within rent controlled provinces.
- Alberta is the only exception where rents continue to fall (albeit at a decelerating pace) and inducements are still required to attract tenants.

Multi-Residential

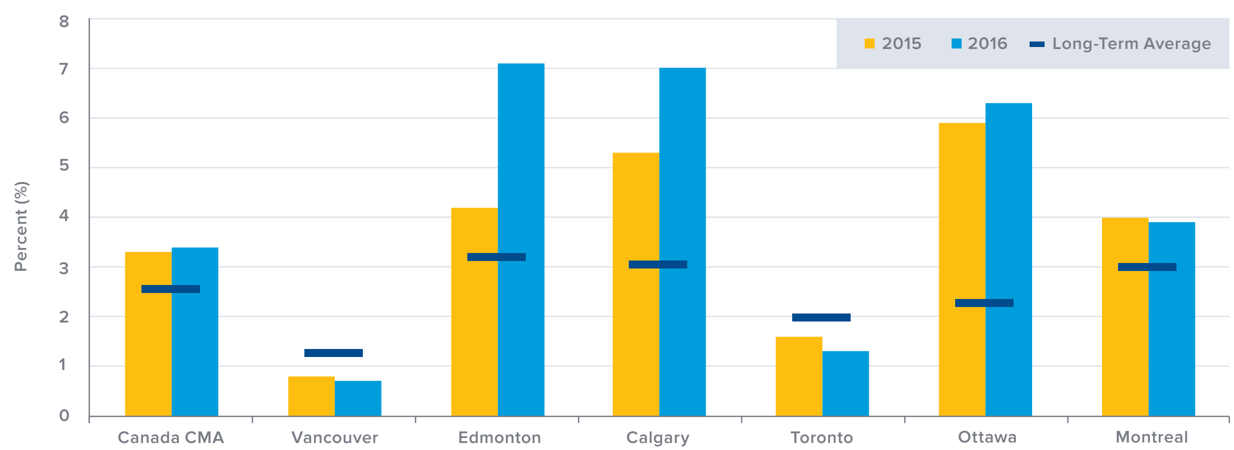
Institutional investors increasingly active in developing purpose-built rental

POPULATION GROWTH
5 YEAR CHANGE

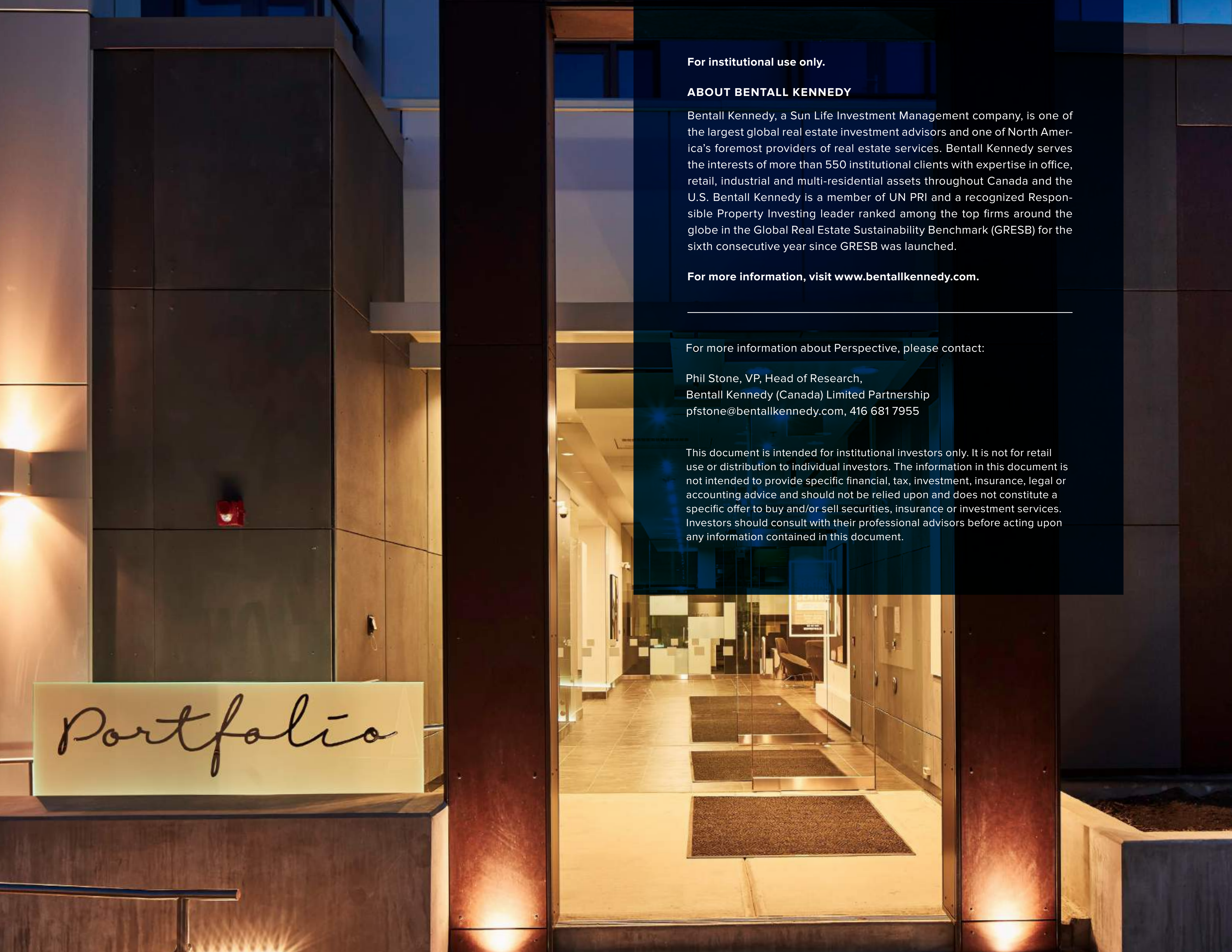


- Population growth fueled by immigration is continuing to drive strong demand, particularly in Toronto, Montreal and Vancouver.
- Tenant demand for new multi-res product is strong across most markets as renters are willing to pay a premium for high quality finishes and life-style amenities.
- Opportunities for purpose-built rental are developing in markets that previously would not have supported the economics to justify new projects.
- The jury is still out on how the newly implemented rent controls in Ontario will impact market fundamentals.
- Developers are building larger suites to attract a more diversified, "want-to-rent" tenant base.
- Although, a push towards smaller units could potentially be a by-product of new rent control policies in Ontario, enabling developers to move rents to market more frequently.

APARTMENT VACANCY RATE



Sources: Statistics Canada I CMHC



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For more information, visit www.bentallkennedy.com.

For more information about Perspective, please contact:

Phil Stone, VP, Head of Research,
Bentall Kennedy (Canada) Limited Partnership
pfstone@bentallkennedy.com, 416 681 7955