Altus Group

Q2 2024

Commercial Real Estate Industry Conditions & Sentiment Survey

Canada results and analysis

Introduction

Q2 2024
Commercial Real Estate Industry Conditions & Sentiment Survey

Altus Group is pleased to share the results of our Commercial Real Estate Industry Conditions & Sentiment Survey for Canada with survey participants and partners. This survey was conducted by Altus Group's Research Team in an effort to provide insights into the market sentiment, conditions, metrics, and issues affecting the commercial real estate (CRE) industry.

The survey captures the individual practitioner's perspective, representing various functions and across the capital stack. Participation in the survey is voluntary and responses will remain confidential.

As always, we invite you to share any feedback or questions with your Altus Group contact or reach out to Altus Group's Research Team directly at altusresearch@altusgroup.com.

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CRE Industry Conditions & Sentiment Survey Q2 2024 - Canada

Methodology

Survey size and methodology

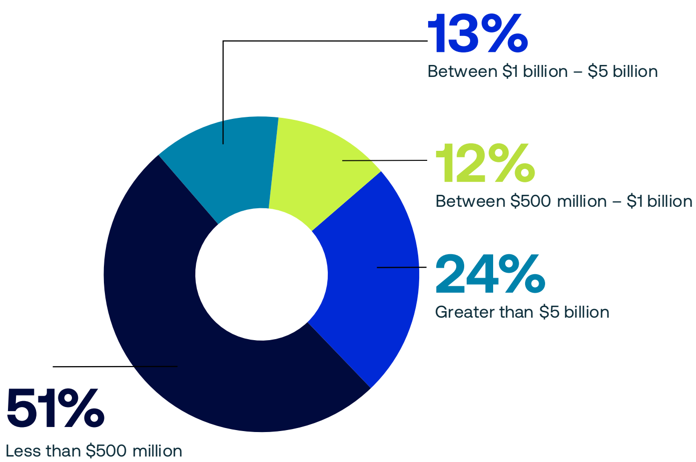
Altus Group's Research Team surveyed industry participants across Canada from March 25 to April 29, 2024. There were 333 respondents, representing at least 48 different firms[1].

Questions in the survey were optional and explored two main topics: current conditions and future expectations. Percentages represent the share of all responses received for each question, excluding "blank" or "not applicable" responses.

333 responses

48 different firms[1]

Firm CRE exposure ($CAD)



[1] Firm count based on participants who chose to identify themselves.

Functional area

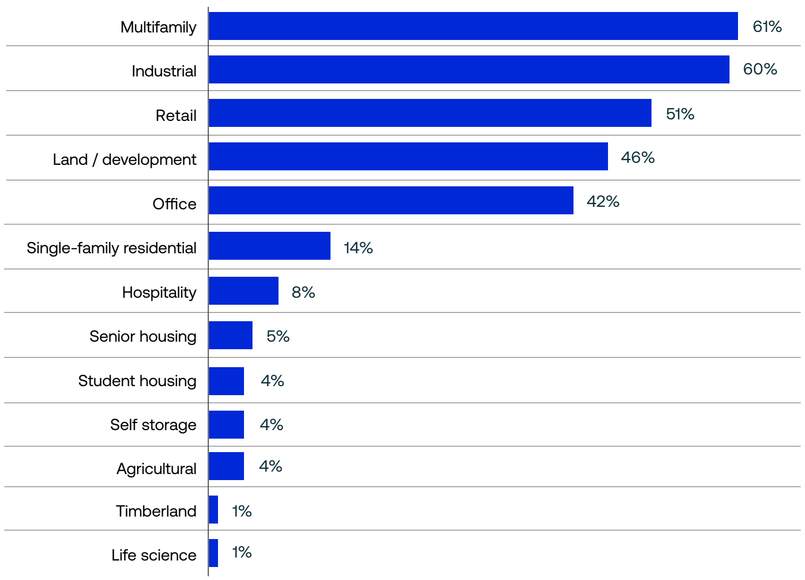
Developer / construction manager	18%
Senior management / executive leadership	18%
Appraiser / valuations	13%
Brokerage (investment sales or leasing)	13%
Property management	6%
Acquisitions / dispositions	6%
Investment strategy / investment research	4%
Asset manager / FP&A	4%
Originations / underwriting	4%
Debt capital markets / mortgage banker	3%
Equity investor	3%
Loan officer / credit risk manager	3%
Corporate (HR, IT, legal, marketing, etc.)	2%
Investor relations / fundraising	1%
Fund or portfolio manager	1%
Other	1%

Organization type

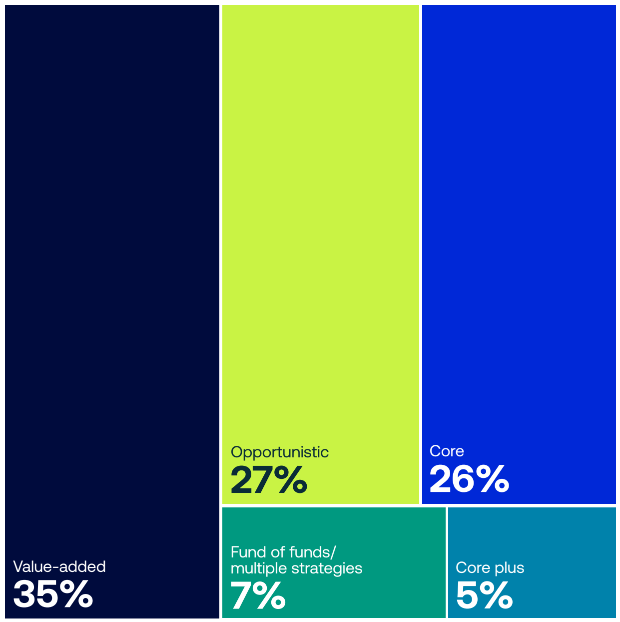
Developer	26%
Brokerage	15%
Advisory	13%
Asset management company	8%
Service provider	7%
Bank	5%
Government or Regulatory	5%
Private equity	5%
Family office or sovereign wealth fund	4%
Investment manager	4%
Non-bank lender	2%
University or academia	2%
Pension fund	1%
Equity REIT	1%
Insurance company	1%

Respondent characteristics

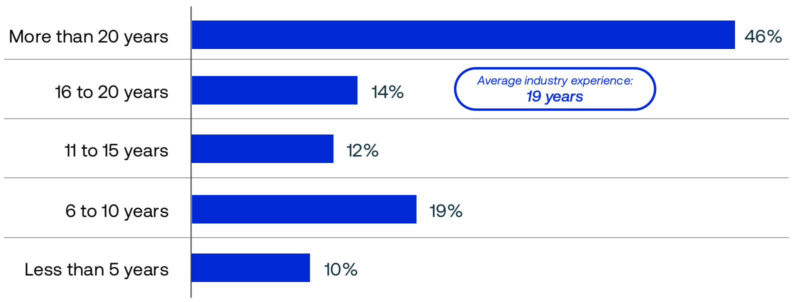
What property types does your firm primarily focus on?



How would you describe your firm's primary investment strategy?



How many years of experience do you have in the industry?



Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses.

CRE Industry Conditions & Sentiment Survey Q2 2024 - Canada

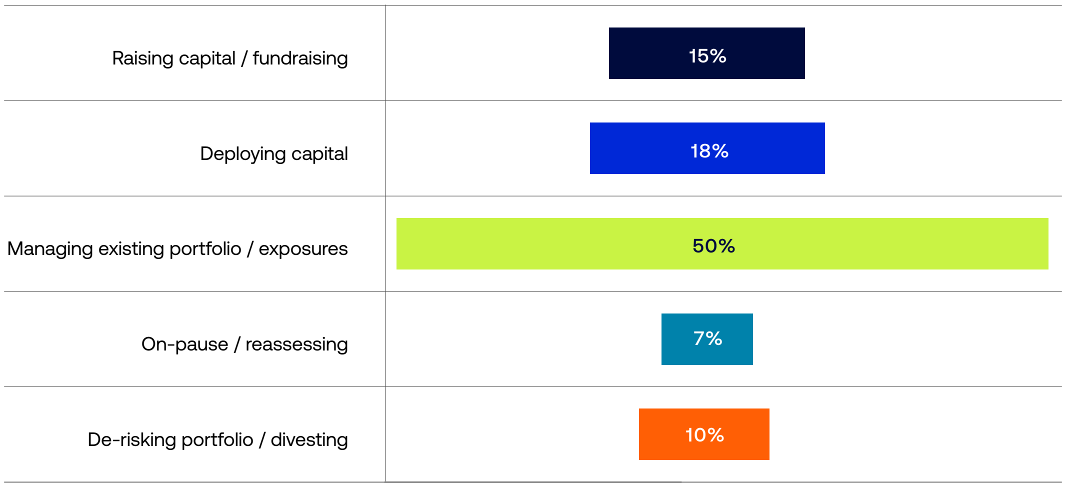
Conditions

Current focus

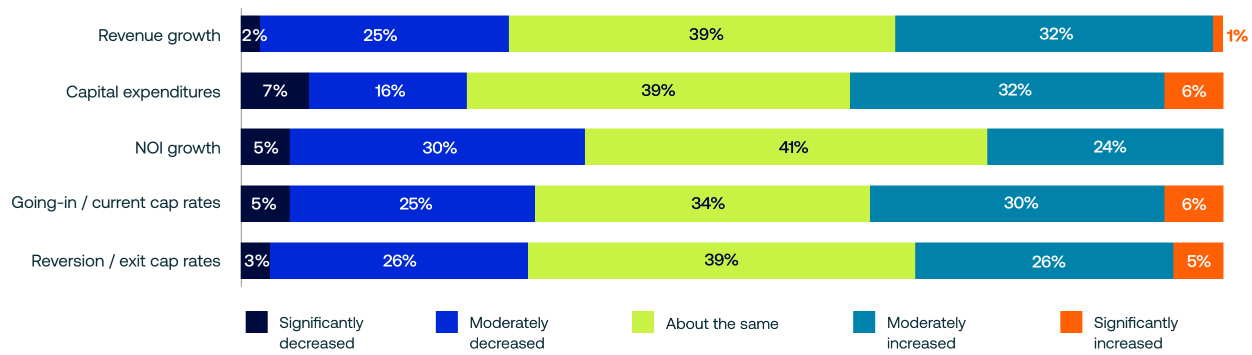
Little change in near-term team priority. Half of the respondents plan to be managing existing portfolios over the next six months, showing virtually no change from Q1 2024. The share of those planning to de-risk their portfolios or actively divest remained stable versus the prior quarter at 10%. However, a slight uptick in the number of respondents looking to deploy capital was seen relative to Q1 2024, up three percentage points to 18%.

Portfolio expectations for key metrics diverging. Responses indicated that participant expectations for key metrics across portfolios have diverged significantly when compared to where expectations were a year ago. 30% of respondents indicated that their expectations for both going-in and reversion cap rates decreased moderately or significantly, while more than 30% say their expectations have moderately or significantly increased. The same divergence is notable for both revenue and NOI growth. Nearly 30% of respondents have decreased expectations for revenue growth while 32% have increased expectations. 35% of participants noted decreased expectations for NOI growth versus 12 months ago, while 24% cited that their expectations have increased. However, around four in ten respondents did note that their expectations for their portfolio were "about the same" versus 12 months ago across all metrics.

What do you think your team's primary focus will be over the next 6 months?



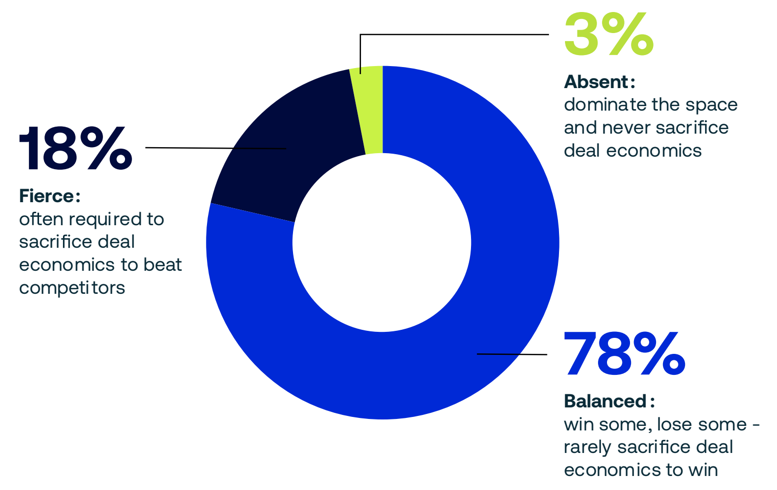
How have your expectations for your portfolio changed compared to 12 months ago?



Competition and pricing

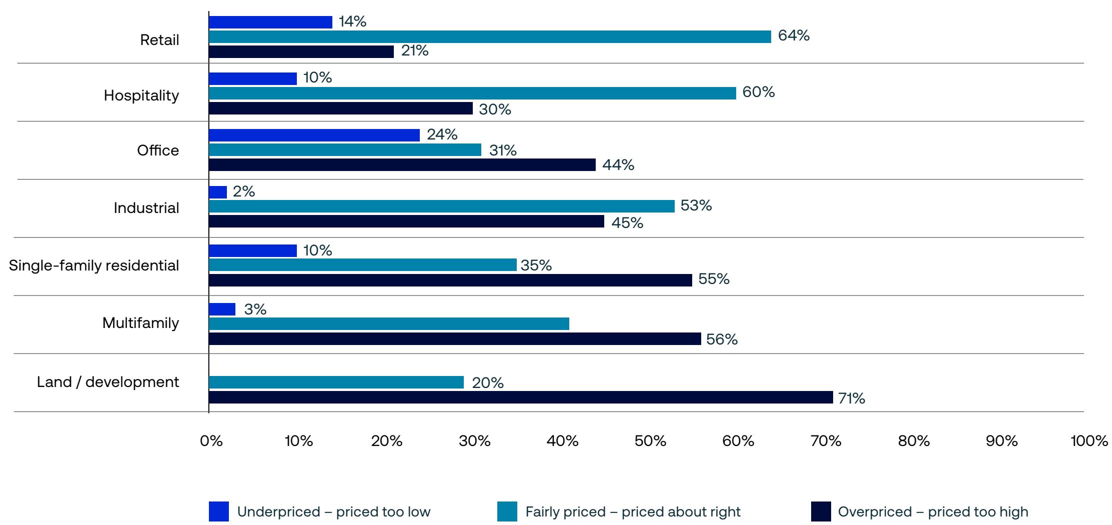
Level of competition remains steady, while perceived "overpricing" increases modestly. In terms of how participants described the level of competition among their peer group, there was no change from the previous two quarters. Half or more respondents characterized the hospitality, retail and industrial properties as "fairly priced", while a majority of respondents characterized land / development, multifamily, and single-family residential as "overpriced". Across the four main property sectors (industrial, multifamily, office, retail), characterization of "overpriced" increased by eight percentage points (pp) compared to Q1 2024 results.

How would you describe the level of competition among your firm's peer group?



Hospitality saw the largest move in characterization towards being more "fairly" and "underpriced" compared to the prior quarter – with the "overpriced" characterization falling by 20 pp compared to the prior quarter – as more respondents reported the sector as being either "fairly" or "underpriced". On the other hand, land / development saw the largest shift to being characterized as "overpriced" – increasing by 19 pp in Q2 2024 versus Q1 2024. And while a much smaller magnitude, 7 pp more respondents characterized office as being "fairly priced" than they did a quarter prior.

How would you characterize current pricing for the following property types?

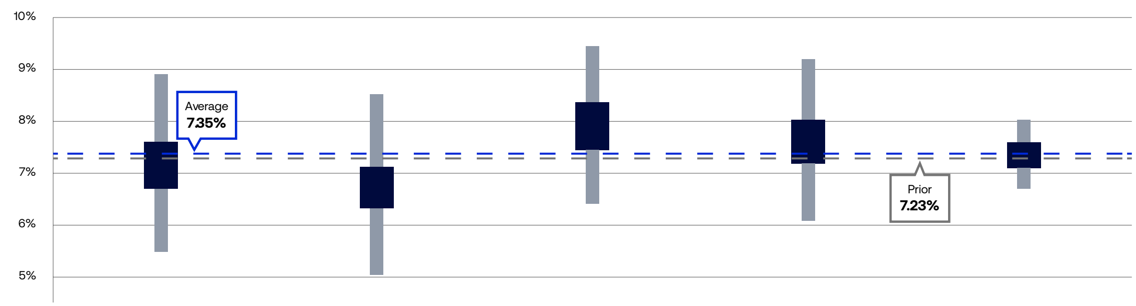


Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses.

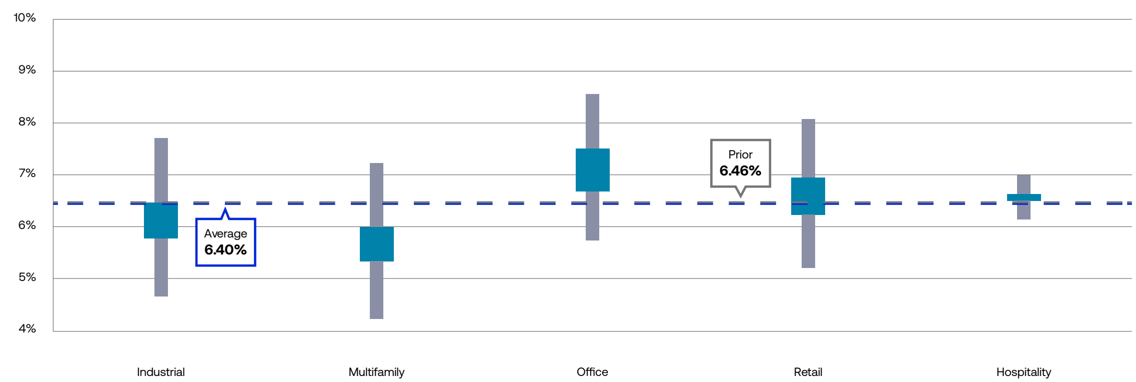
What all-in interest rates are you seeing in the market?

All-in financing costs are up, except for hospitality. On average, reported all-in interest rates across different term structures and property types improved slightly from the prior quarter. However, this quarterly change was driven by hospitality, which saw reported debt costs decline by 86-144 bps over the quarter for both 5-year and 10-year debt. Removing hospitality from the average, the cross-property average increased between 3-45 bps on the quarter with the largest increase in the 5-year floating structure and the smallest increase in the 10-year fixed product.

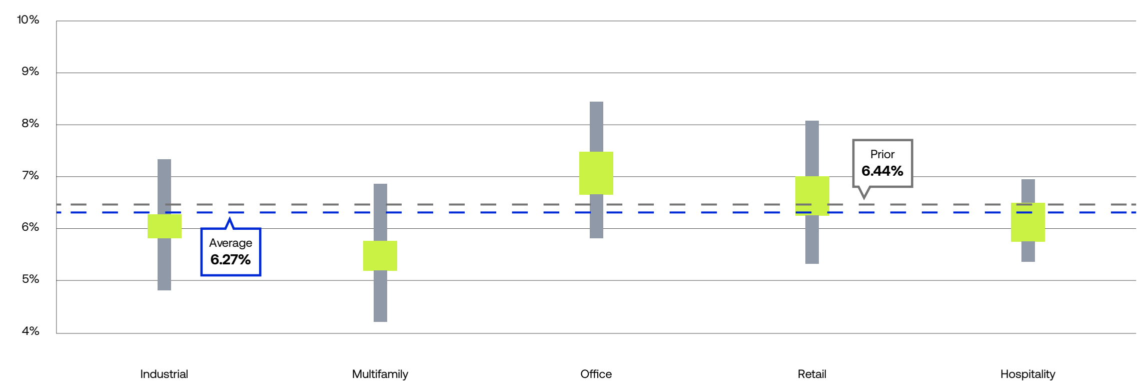
5-Year Floating Rate (%)



5-Year Fixed Rate (%)



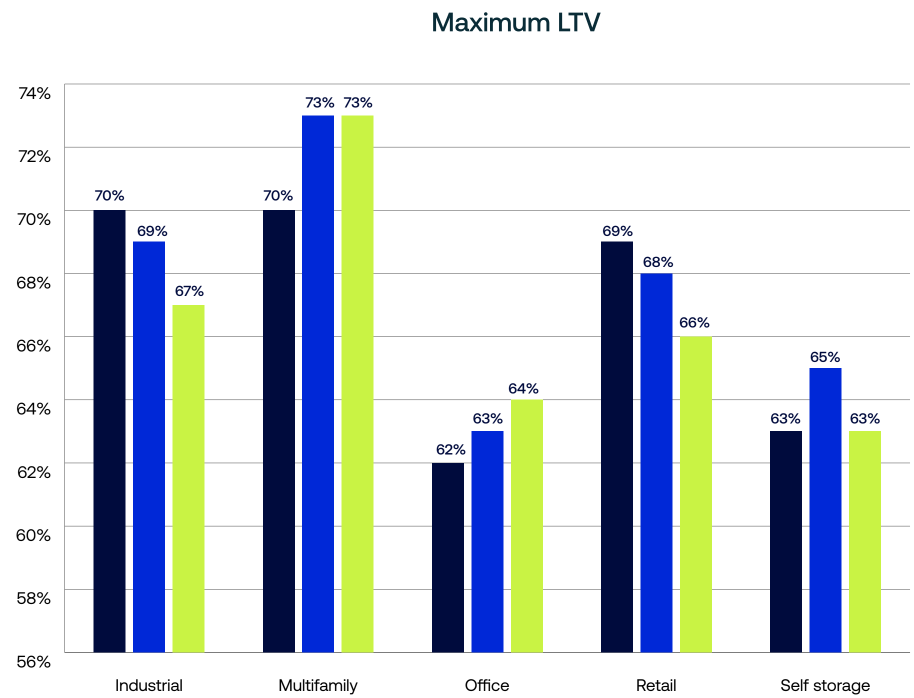
10-Year Fixed Rate (%)

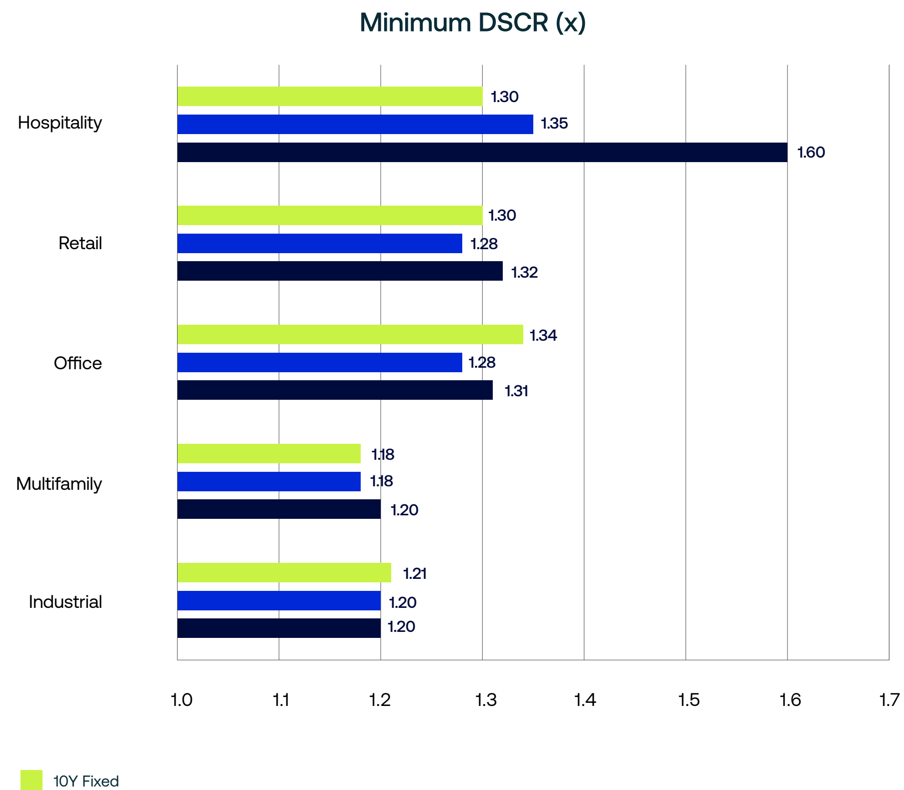


Note: Percentages represent the share of all responses, excluding “blank” or “not applicable” responses.

What senior debt financing terms are you seeing in the market?

Lenders hold underwriting terms steady for most sectors, but loosen slightly for office.
Respondents noted that current maximum loan-to-value (LTV) ratios for debt financing generally remained in line with the prior quarter levels. Office maximum LTVs reported in Q2 2024 were up approximately 5 pp across different financing terms compared to the prior quarter, while those for multifamily were down approximately 2.5 pp across terms. Minimum debt service coverage ratios (DSCR) reported in Q2 2024 saw modest movement compared to the prior quarter, with office DSCRs coming down approximately 10 basis points (bps) and industrial DSCRs down approximately 5 bps across different term financings.



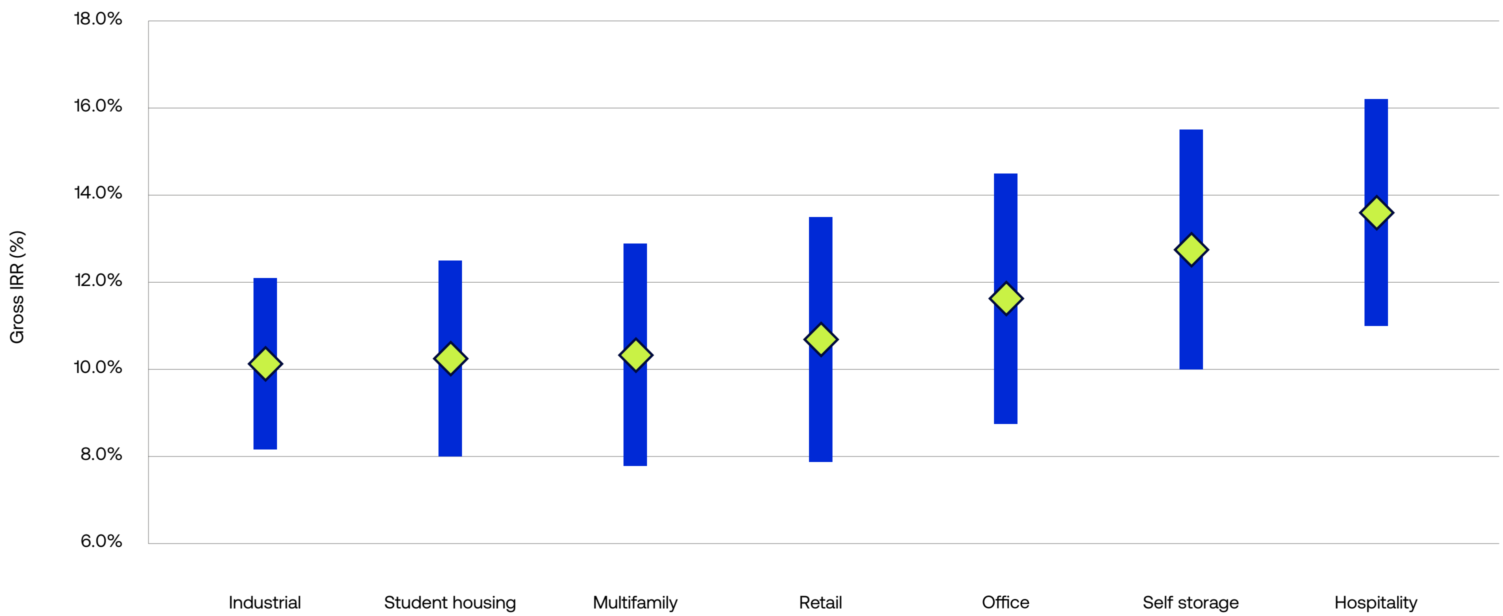


Note: Percentages represent the share of all responses, excluding “blank” or “not applicable” responses.

Reported current market gross IRRs

Target returns for new funds increase slightly over the quarter. Targeted gross IRRs seen marketed for new funds and deals averaged 11.3% across all property types in Q2 2024, up 50 bps from the prior quarter. Across the four main property types (retail, multifamily, office, industrial), the reported average gross IRR was 10.7%, up 30 bps from Q1 2024. However, the biggest quarterly moves in reported midpoint IRRs were seen in self-storage and hospitality, which moved up 200 bps and 148 bps, respectively, to 12.8% and 13.6% in Q2 2024. The largest quarterly decline in midpoint IRRs was reported in multifamily, which saw its reported midpoint IRR drop 82 bps to 10.3%.

What are typical ranges for the returns you are seeing across the current market for new funds?



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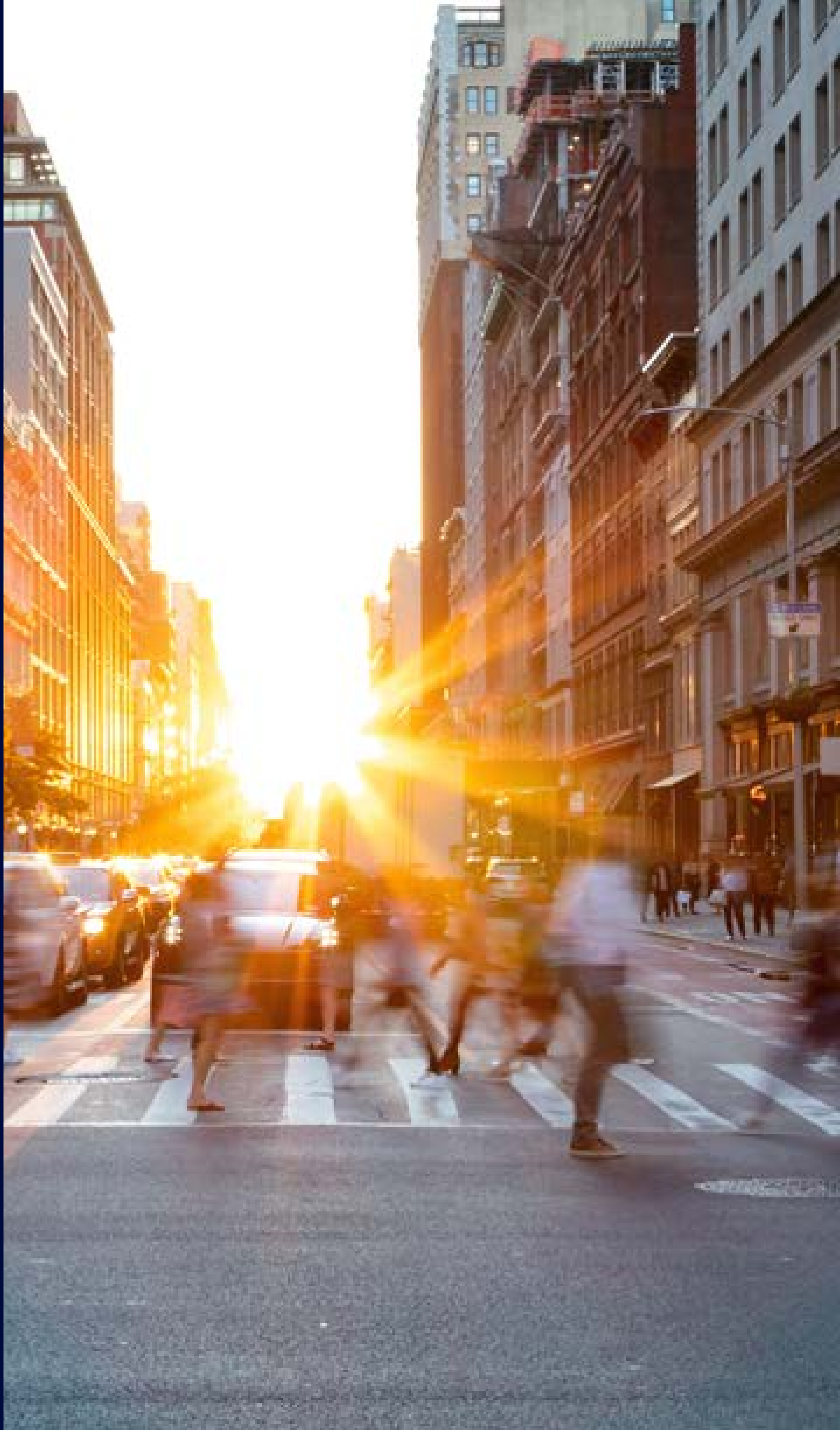
CRE Industry Conditions & Sentiment Survey Q2 2024 - Canada

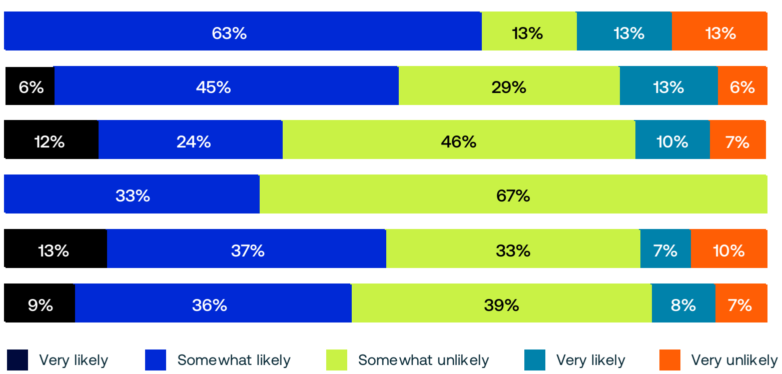
Sentiment & expectations



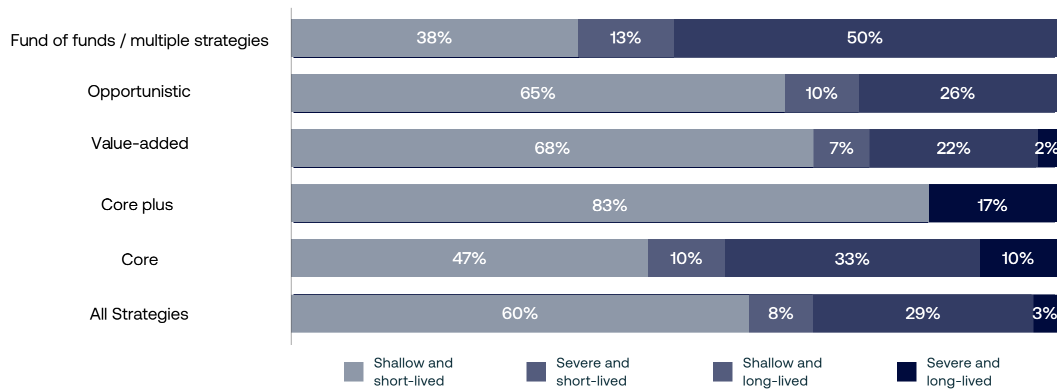
Recession expectations

Near-term recession concerns fade, though uncertainty increases across core and value-added strategies. Across investment strategies, a majority (45%) of respondents expect a recession to be likely (either "very likely" or "somewhat likely") in the next 6 months, however this expectation is down 17 pp from the 63% who stated the same in Q1 2024. While respondents who identified as having either core or value-added strategies for their funds saw similar downward shifts in near-term recession expectations (25 pp and 22 pp, respectively), respondents from these two strategies also saw notable increases in uncertainty ("I don't know") – which measured 10% and 7%, respectively. Most responses also indicated expectations for the next recession to be "shallow", with more than 89% of respondents indicating the next recession to be shallow as opposed to "severe", down slightly from 92% in Q1 2024.

How likely is an economic recession within the next six months?



What will be the depth and length of the next economic recession?



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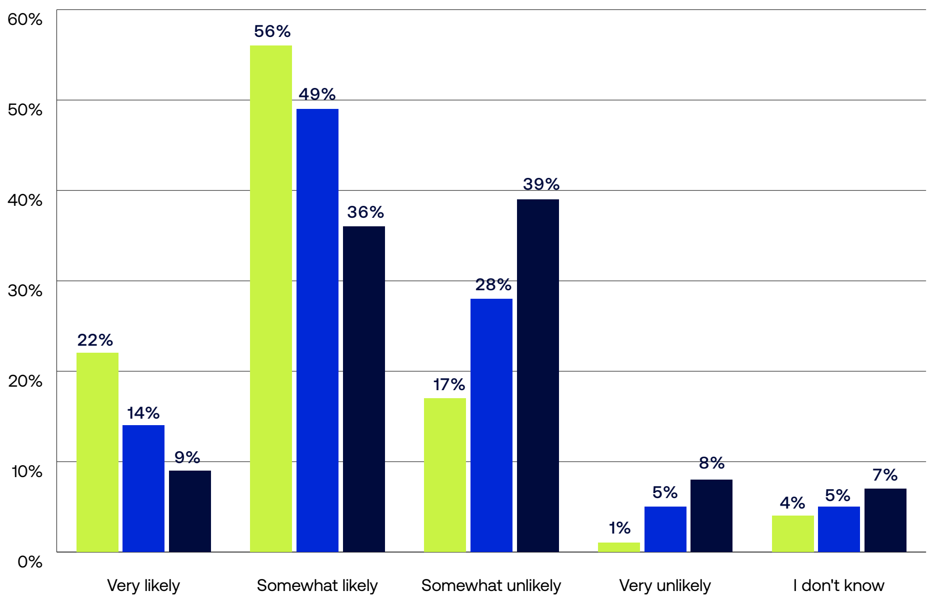

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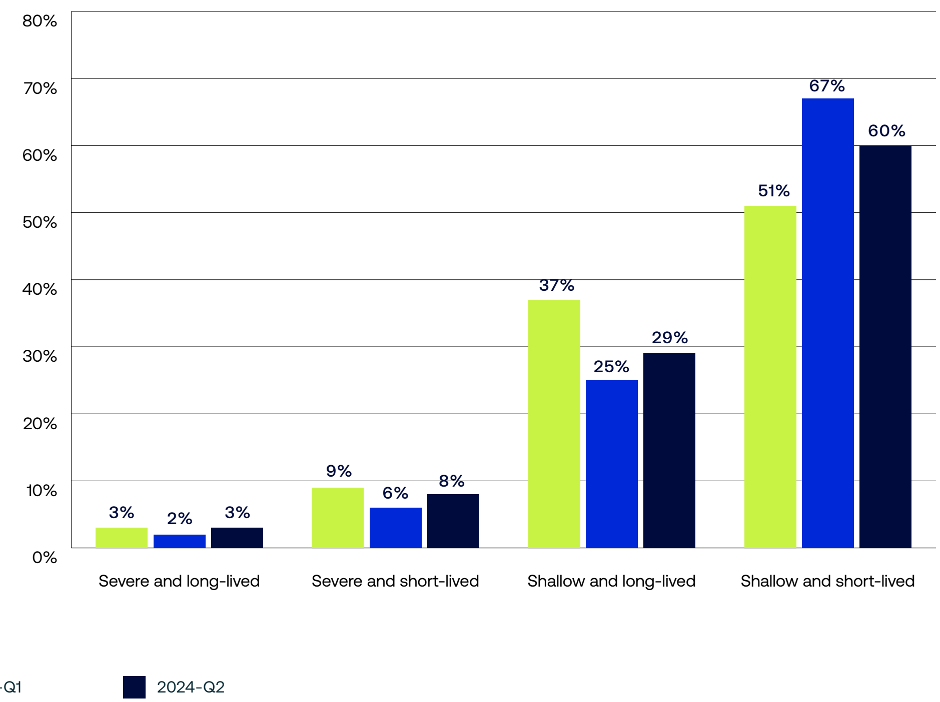
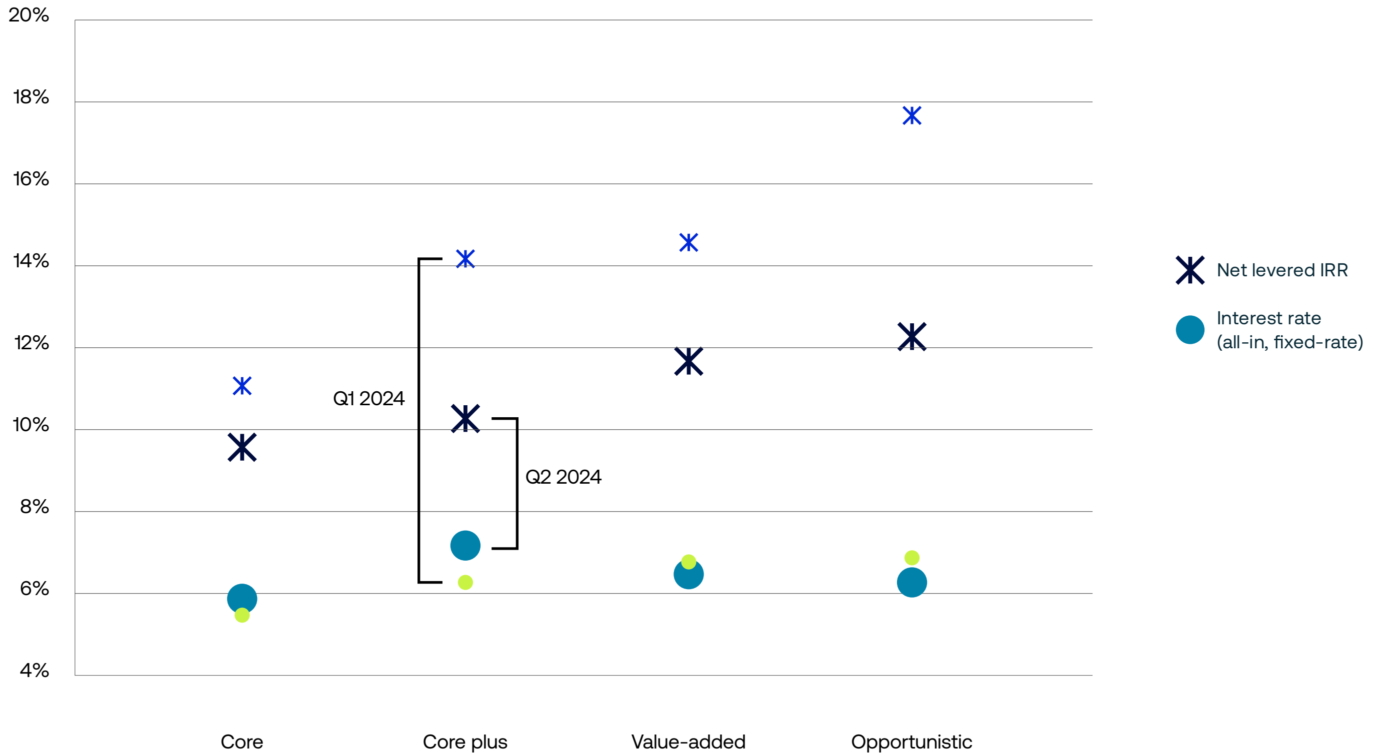


Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses.

Cost of capital expectations

Net levered returns to equity decline and expected cost of debt increases for core and core plus. Respondents' 12-month forward view of all-in, fixed-rate financing increased to 6.0-7.3%, up from 5.6-7.0% in Q1 2024, across the main portfolio strategies. Core and core plus strategies saw expected debt costs increase by 36 bps and 96 bps, respectively, while value-added and opportunistic strategies saw declines of 26 bps and 61 bps, respectively, over the quarter. Expected net returns to equity (net levered IRRs) across all strategies decreased by 343 bps on average; the largest decline was seen in the opportunistic strategy (-548 bps) and the smallest decline was seen in core (-153 bps) compared to the prior quarter.

Where do you anticipate the cost of capital to be over the next 12 months (on annualized basis)?



Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses.

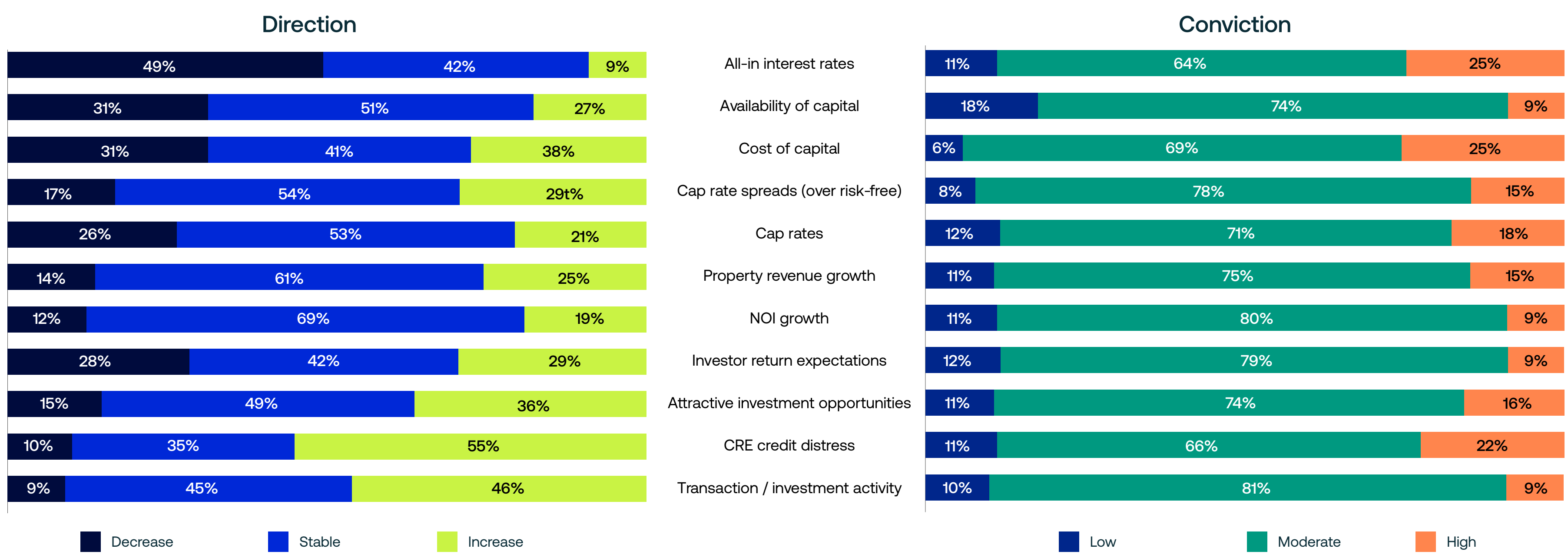
What changes do you anticipate to the following key metrics over the next 12 months?

Capital expectations little changed on the quarter, but conviction with call decreases. Respondents indicated that in aggregate they expect interest rates to remain stable (42%) or decrease (49%), with only 9% anticipating an increase over the next 12 months, little changed from the prior quarter. While 69% of respondents noted that they expect the availability of capital to be either stable or increase over the next 12 months, similar to the 67% who said the same in Q1 2024, there was a notable decline (13 pp) in those reporting "high conviction" for this expectation.

Cap rates are stabilizing. In the last quarter, a third (33%) of respondents expected cap rates to increase over the next 12 months. However, the portion of respondents expecting cap rates to rise over the next year fell to 21% in Q2 2024, while 53% expect cap rates to be stable over the same period.

Cash flow growth expectations and confidence soften. The majority of participants still expect revenue and NOI growth to be stable (61% and 69%, respectively) over the next 12 months, little changed from the prior quarter. However, conviction for these expectations fell by 6 pp and 13 pp over the quarter – currently fewer than 15% and 9% of respondents have "high" conviction in these performance expectations.

Lower investor return expectations anticipated and less distress. More than a quarter (28%) of respondents anticipate investor return expectations will decrease over the next year, a 14 pp increase from Q1 2024. However, this projection is coupled with lower conviction overall ("high" conviction responses fell by 13 pp on quarter). While more than half (55%) of respondents still anticipate CRE credit distress to increase in the next year, this number fell by 6 pp over the quarter.

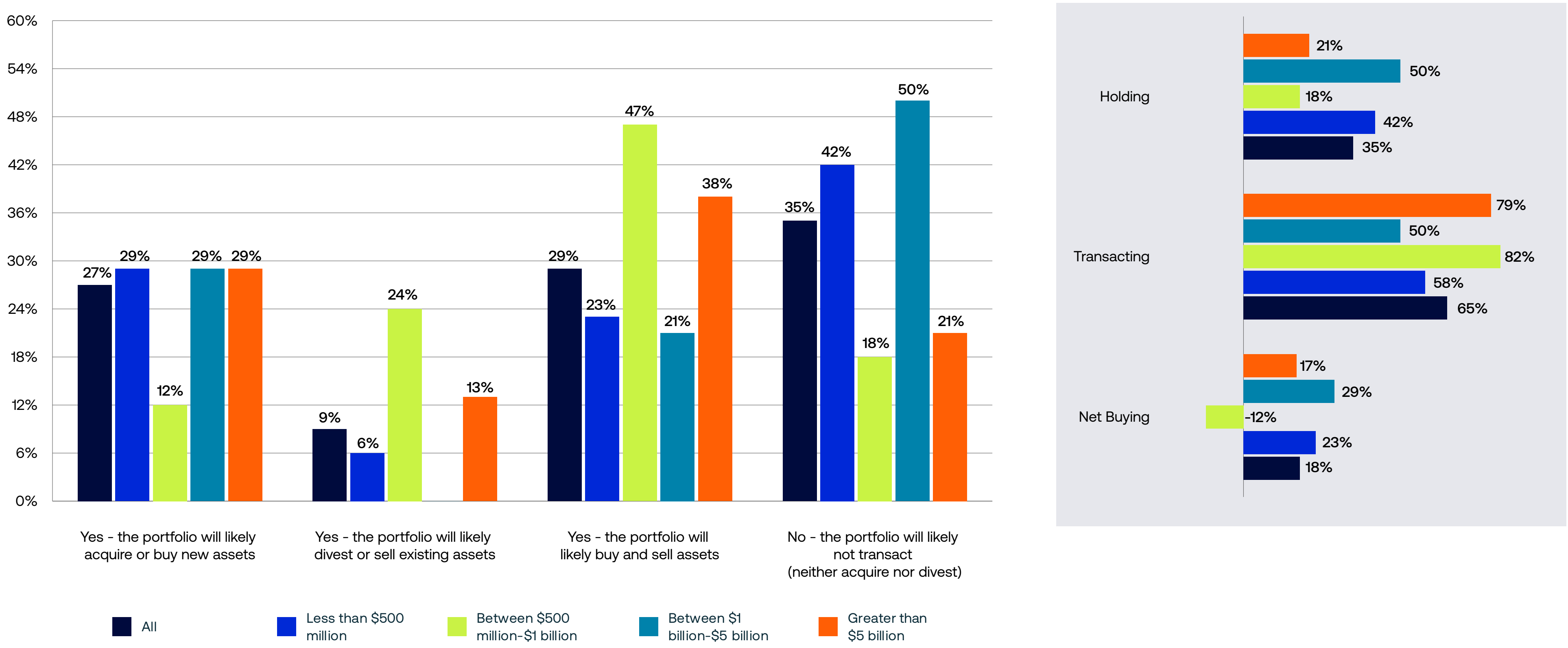


Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses.

Transaction intentions over next 6 months

Intentions to buy in the next 6 months still outweigh intentions to sell, though those intending to hold also increased. Responses indicate that the majority (65%) plan to transact (either buy, sell, or both) over the next 6 months, down from 71% in the prior quarter. Contributing to this shift, the larger mid-sized firms, those with CRE exposure between $1 billion-$5 billion, reported a 28 pp shift away from transacting and towards holding. Meanwhile, the largest firms, those with CRE exposure greater than $5 billion indicated that they plan on buying in the next 6 months; the portion of these firms that said they would be buying increased by 15 pp over the quarter, putting the total that intend to buy in the near term to close to a third.

Over the next 6 months, do you anticipate any transactions in your portfolio?



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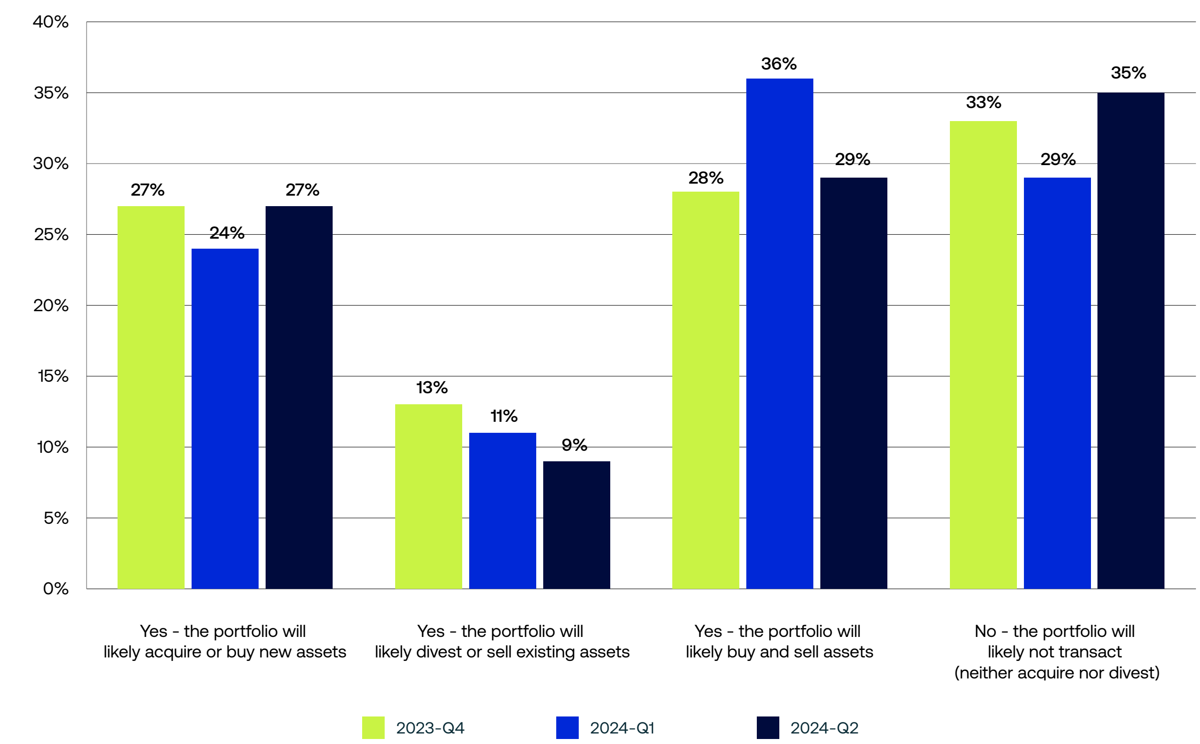
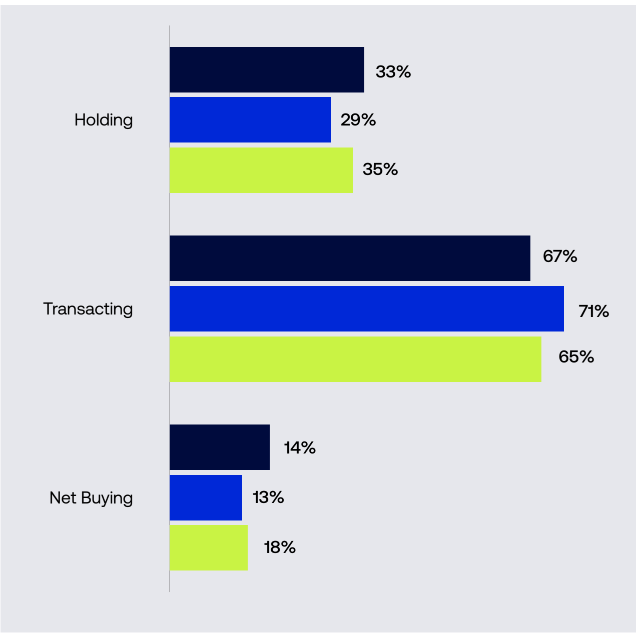
Transaction intentions over next 6 months

Over the next 6 months, do you anticipate any transactions in your portfolio? (Quarter-over-quarter comparison)





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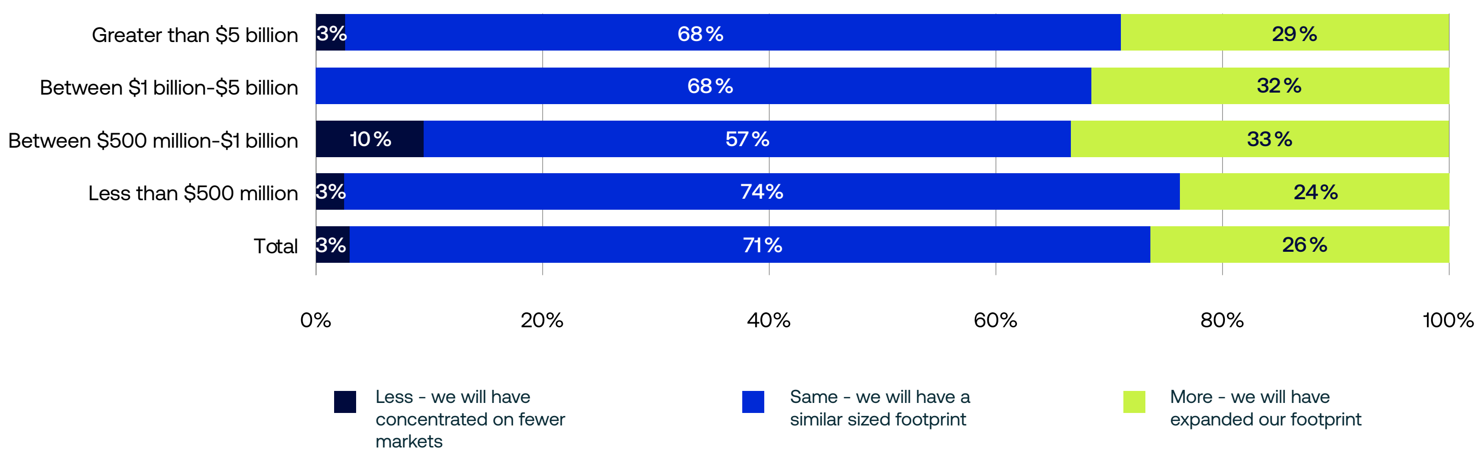
Geographic footprint expectations

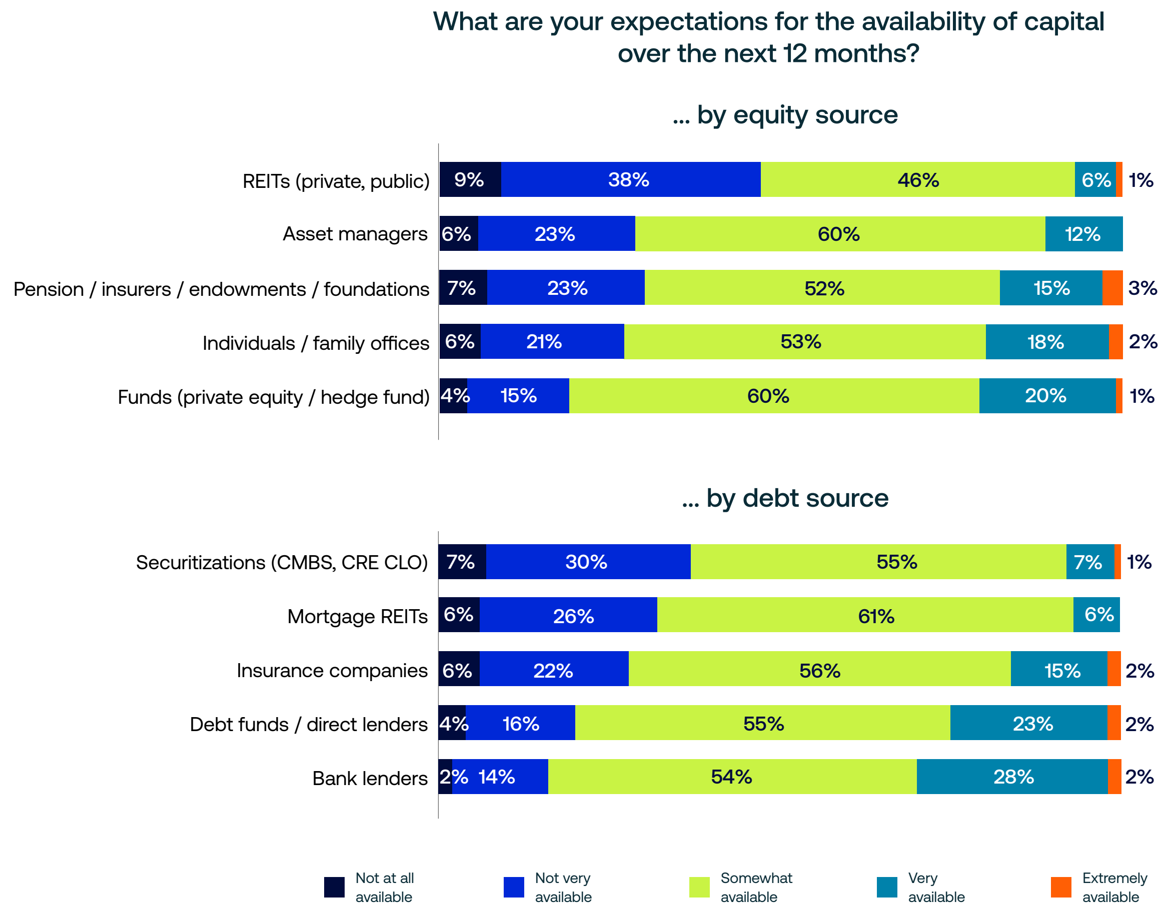
A year from now, how many markets (metros, cities) do you think your firm / fund will be operating in?



Capital availability

Net expectations for capital availability are low and broadly declining. Net expectations (sum of responses for “extremely available” and “very available” less the sum of responses for “not very available” and “not at all available”) for capital availability have broadly declined versus Q1 2024. The overall expectation among respondents is that capital availability will be low over the next 12 months. For sources of equity capital, survey participants indicated that they collectively expect the least amount of availability from REITs, with net expectations of -40%, a notable deterioration from -24% in Q1 2024. Participants expect much less availability of equity capital from individuals / family offices and PE / hedge funds relative to Q1 2024, showing declines in net expectations for capital availability of -21% and -14% respectively. Responses indicated expectations for securitizations and mortgage REITs are still heavily constrained, with net expectations of -29% and -26% respectively.

In stark contrast to responses from the United States, Canadian CRE professionals expect banks to have the greatest amount of debt capital availability over the next year, with 30% of respondents expecting availability to be either “extremely” or “very” available; a net improvement of 14 percentage points from the prior quarter.

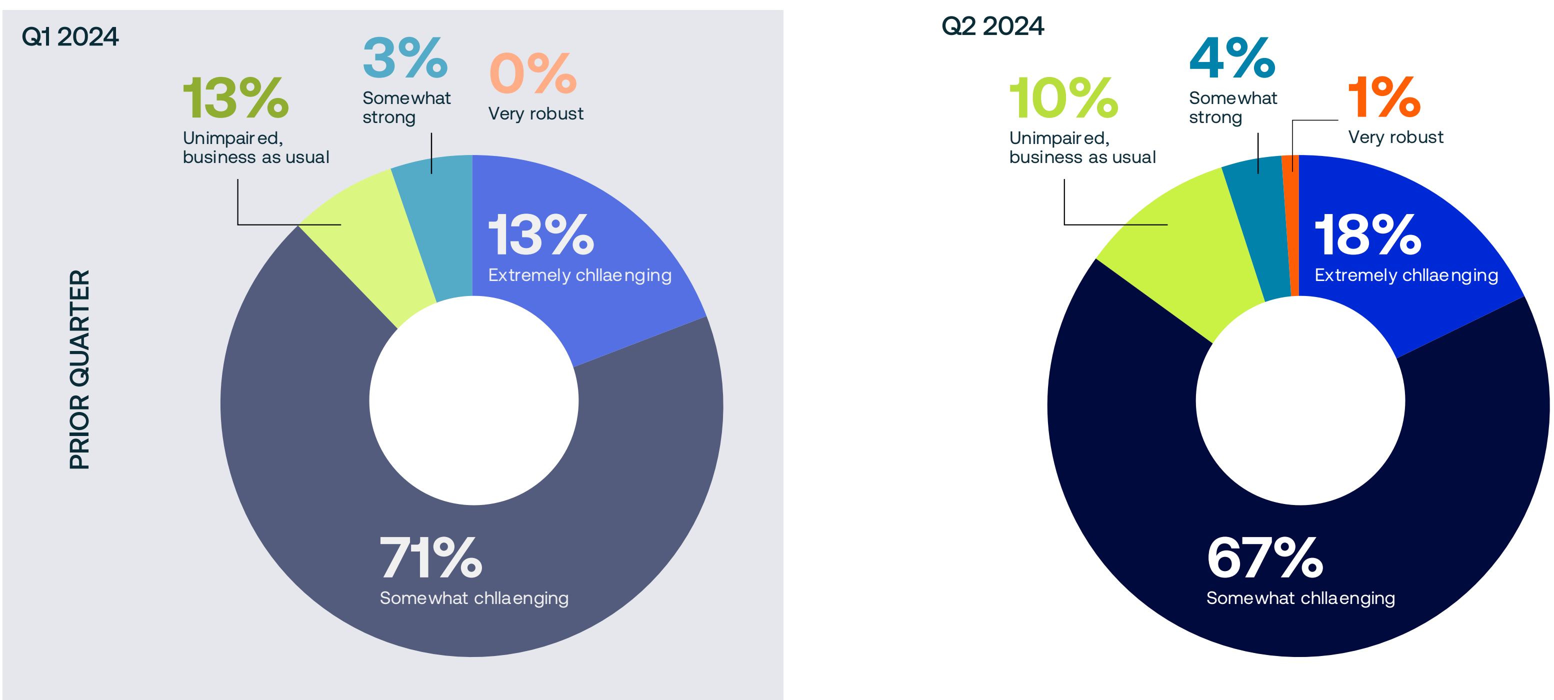


Note: Percentages represent the share of all responses, excluding “blank” or “not applicable” responses. All $ amounts are in Canadian dollars.

Expected operating environment

View of near-term operating environment as "challenging" persists. A total of 85% of respondents anticipate the next 12 months to be difficult (combined "somewhat" and "extremely" challenging responses), nearly identical to the previous quarter. The percentage of respondents who expect the operating environment to be "extremely challenging" increased from 13% to 18% in Q2 2024, nearly matching the 19% figure from Q4 2023. Slightly fewer respondents expect business in the next year to be "unimpaired"; those who described the expected operating environment as "business as usual" accounted for 10% in Q2 2024 vs 13% in Q1 2024. One percent of respondents indicated that they expect the operating environment to be "very robust" over the same period while 4% stated they expected it to be "somewhat strong".

What best describes your expectations for the operating environment over the next 12 months?



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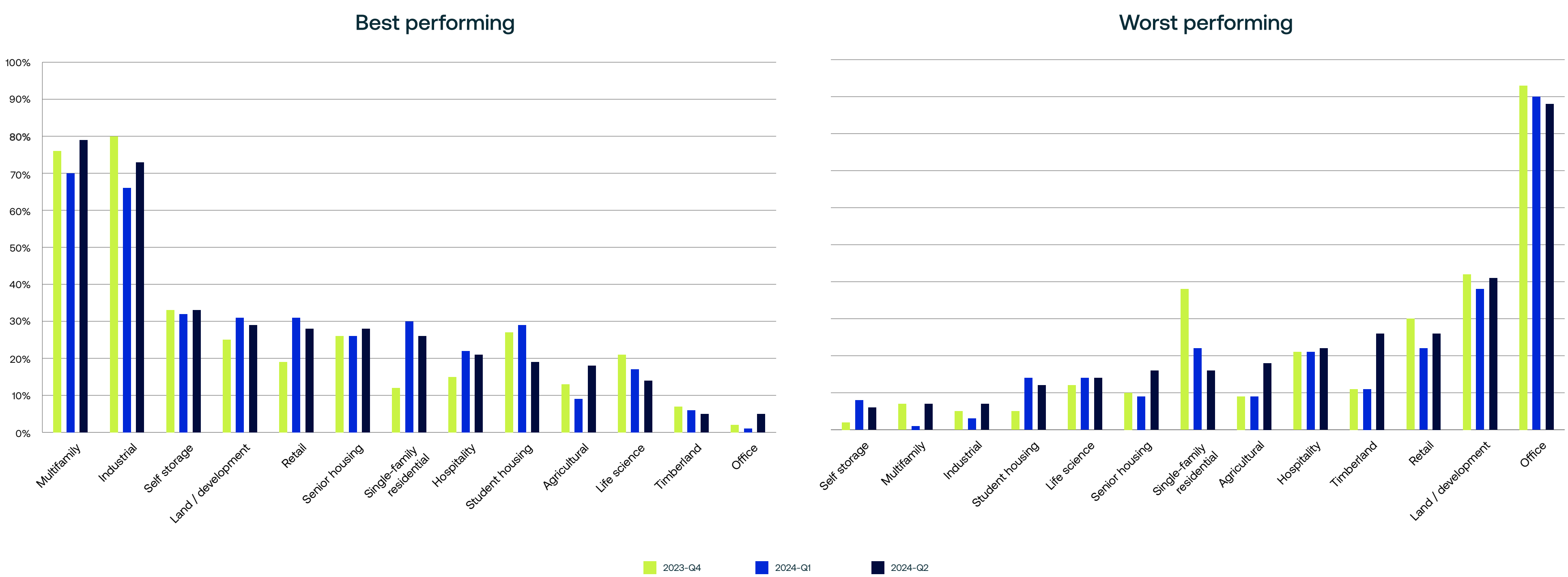
Expectations for property type performance

Little change in the pecking order, with industrial, multifamily still most favoured. For the fourth consecutive quarter, survey responses suggest that participants still maintain the most positive expectations for the industrial and multifamily sectors along with the most negative expectations for office. Net sentiment for any individual sector shifted little from the prior quarter except for timberland, declining in favourability by 16 percentage points to -21% in Q2 2024. Canada's ongoing housing crisis continues to drive a positive outlook for single-family housing, with net sentiment improving slightly from +8% to +10%. The sector garnered net negative sentiment as recently as Q4 2023.

How to read the chart

The survey question asked participants to identify which property types they thought would be either "best" or "worst" performing in the next 12 months. Not all property types needed to be selected and any property type selected could only be identified as either "best" or "worst" performing, so no property could be identified as both "best" and "worst" performing. The percentages shown on the charts represent the share of respondents who included the property type as in either the "best" or "worst" performing categories.

Rank which property types you expect to be the best and worst performing in the next 12 months.



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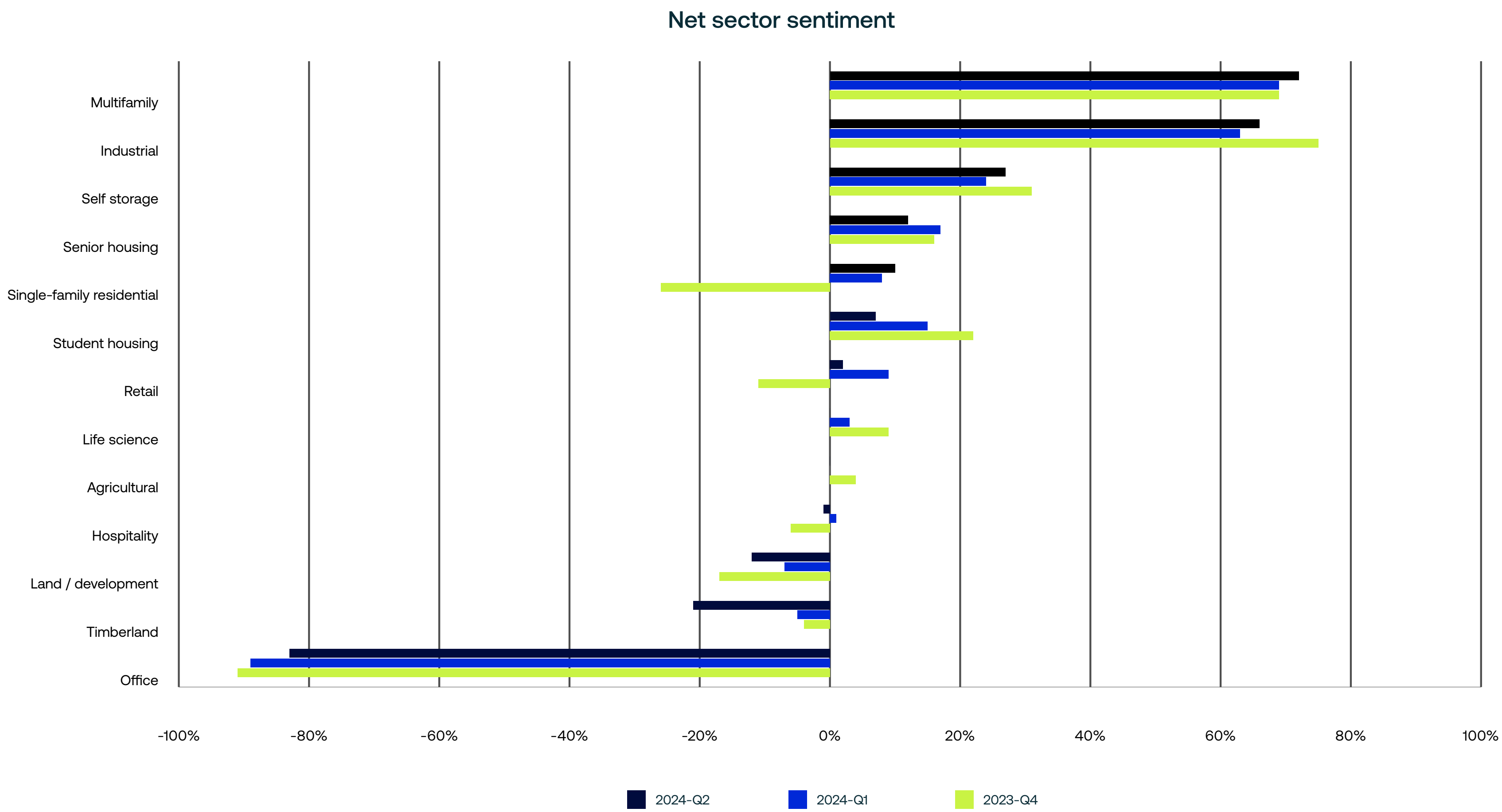
Expectations for property type performance

Rank which property types you expect to be the best and worst performing in the next 12 months.



How to read the chart

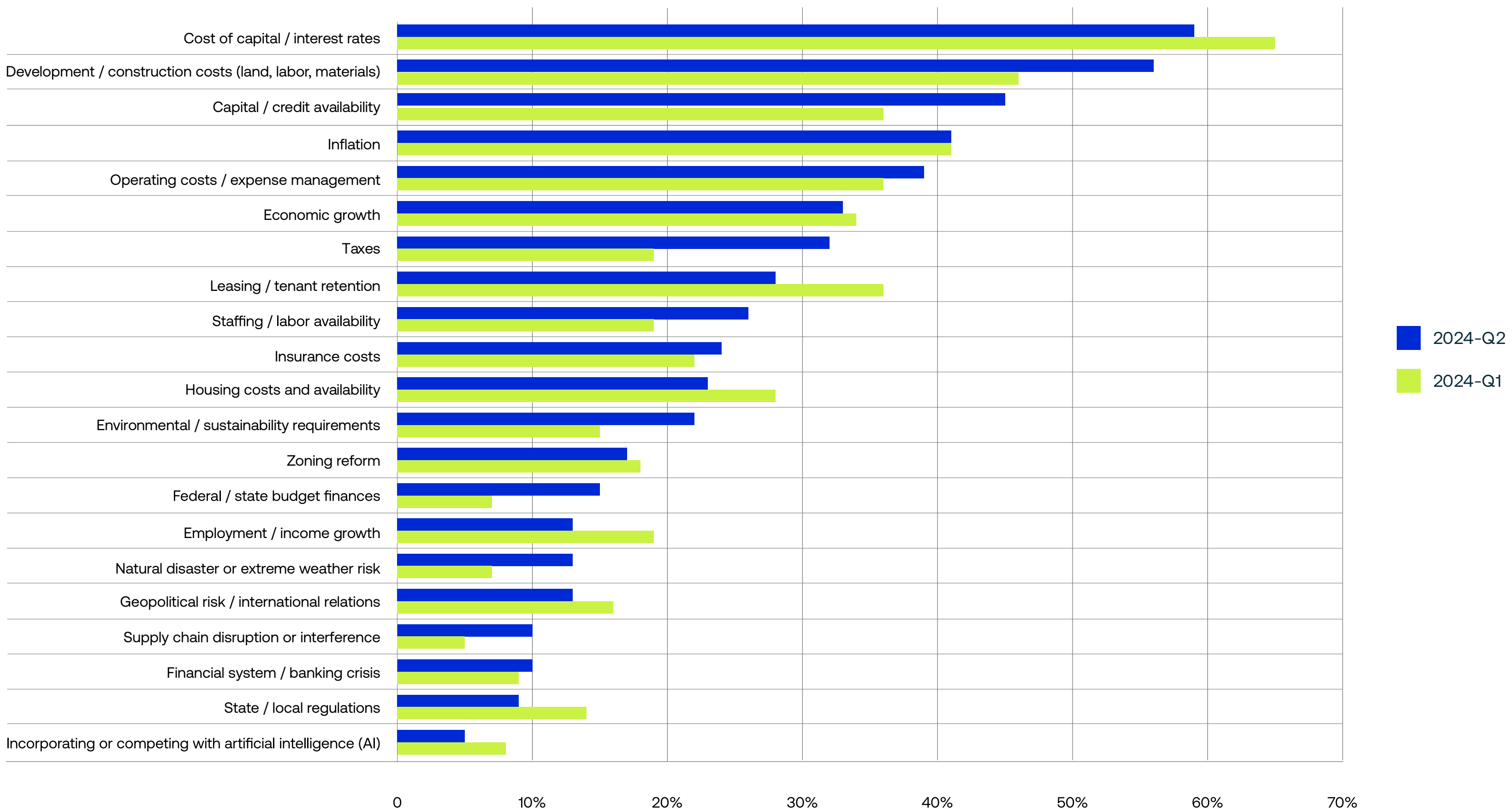
The survey question asked participants to identify which property types they thought would be either "best" or "worst" performing in the next 12 months. Not all property types needed to be selected and any property type selected could only be identified as either "best" or "worst" performing, so no property could be identified as both "best" and "worst" performing. The "net sector sentiment" shown on the chart represents the difference in the percentage of respondents who identified the property type as the "best" less the percentage who identified it as the "worst".

Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses. All $ amounts are in Canadian dollars.

Priority issues over the next 12 months

Capital availability concerns rebound and construction cost concerns spike; property-specific concerns diverge. Cost of capital and development costs topped the list of expected priority issues over the next 12 months for the fourth consecutive quarter. However, the percentage citing cost of capital concerns as a top priority declined six percentage points from Q1 2024 while those citing development costs increased 10 percentage points. Concerns regarding capital / credit availability overtook concerns about inflation with 45% citing the former as a top priority issue in the next 12 months, up nine percentage points to meet its Q4 2023 percentage. The share mentioning inflation remained flat quarter-over-quarter at 41%. Property-specific concerns saw large shifts from the prior quarter. While operating costs / expense management remained a near-term priority of more than one in three respondents, taxes were cited as a concern of 32% of respondents, jumping 13 percentage points from Q1 2024 and 18 percentage points from Q4 2023. Leasing / tenant retention was cited as a top priority of 28% of respondents, down from 36% in Q1 2024 and even below the 30% figure from Q4 2023.

Which of the following do you expect will be high priority issues for you professionally in the next 12 months?

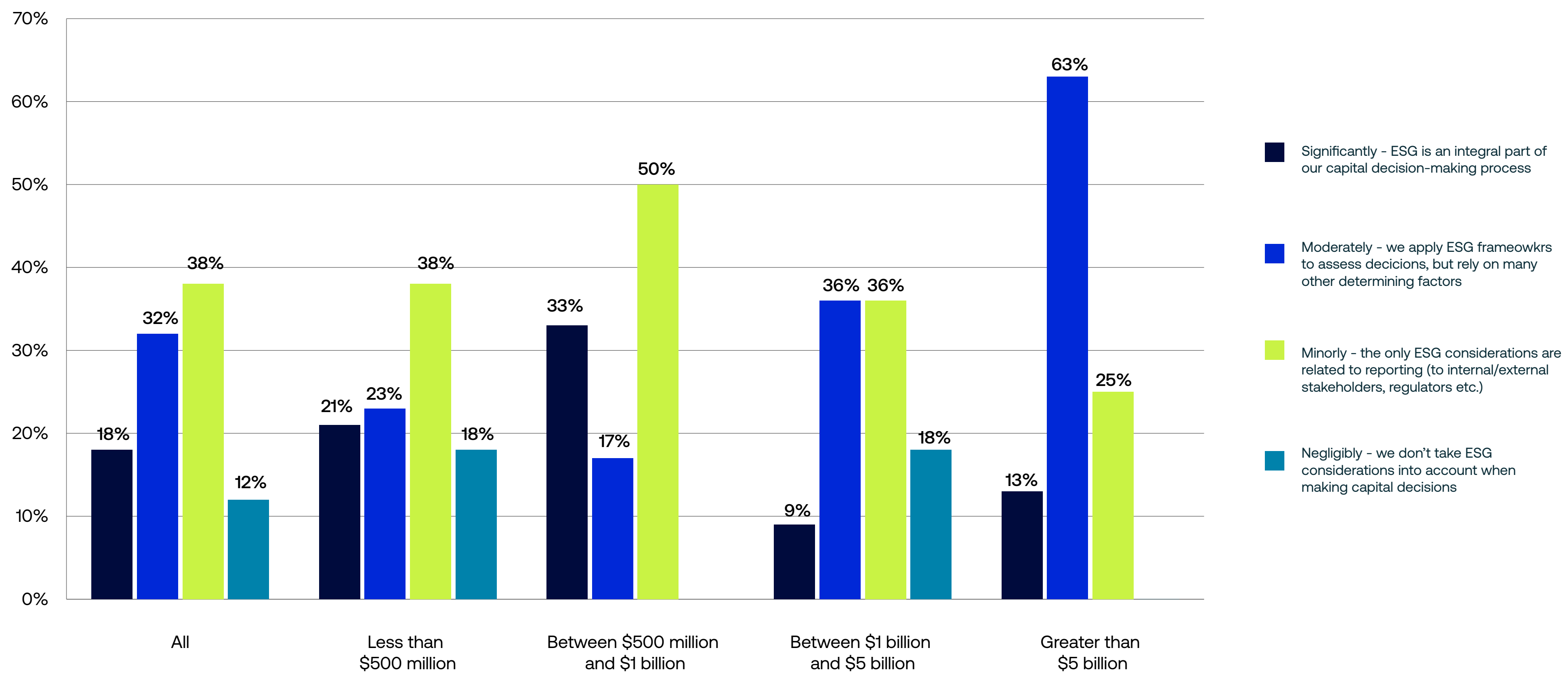


Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses.

ESG considerations in capital decisions

ESG considerations are a greater focus for large firms when making capital decisions. A plurality of Canadian respondents (38%) indicated that they factor ESG considerations into their capital decision-making process “minorly”, while 32% said they did so “moderately”. However, respondents from larger institutions, those with greater than $5 billion (CAD) in CRE under management, showed the most ESG consideration, with three in four (75%) saying that ESG considerations either “moderately” or “significantly” affect their capital decisions. The drop-off is significant by exposure size, with half of respondents from firms with exposure to CRE of between $500 million to $1 billion stating ESG is a minor consideration.

In what way do ESG (environmental, social, governance) considerations affect your investment or credit decisions?



Note: Percentages represent the share of all responses, excluding “blank” or “not applicable” responses.

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Trusted by the largest CRE leaders, our capabilities help commercial real estate investors, developers, proprietors, lenders and advisors manage risk and improve performance throughout the asset and fund lifecycle.

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