Altus Group

Q4 2023

Commercial Real Estate Industry Conditions & Sentiment Survey

Canada survey results

Introduction

Altus Group is pleased to share the results of our Commercial Real Estate Industry Conditions & Sentiment Survey with survey participants and partners. This survey was conducted by Altus Group's Research Team across Canada 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 the Altus Research Team directly at altusresearch@altusgroup.com.

Survey size & methodology

Altus Group's Research Team surveyed industry participants across Canada from October 13 to November 1st. There were 294 respondents, representing at least 54 different firms[1].

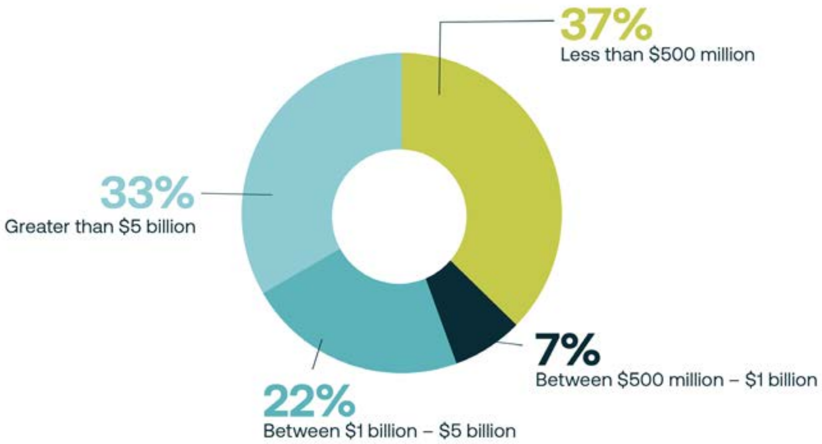
Questions in the survey were optional and explored two main topics: current conditions and future expectations. Percentages represent the share of all responses received for each question, excluding “blank” or “not applicable” responses.

294 responses

from more than

54 different firms

Firm CRE exposure



Notes: 1) Firm count based on participants who chose to identify themselves.

Percentages are rounded, so they may not sum up to 100%.

Organization type

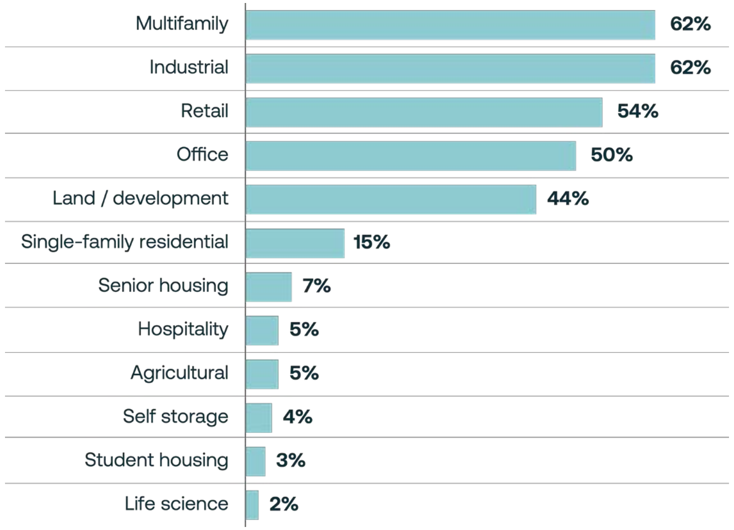
Service provider	33%
Developer	16%
Asset management company	10%
Bank	9%
Investment manager	7%
Private equity or REIT	6%
Insurance company	5%
Pension fund	5%
Non-bank lender	4%
Family office or sovereign wealth fund	2%
Other	5%

Functional area

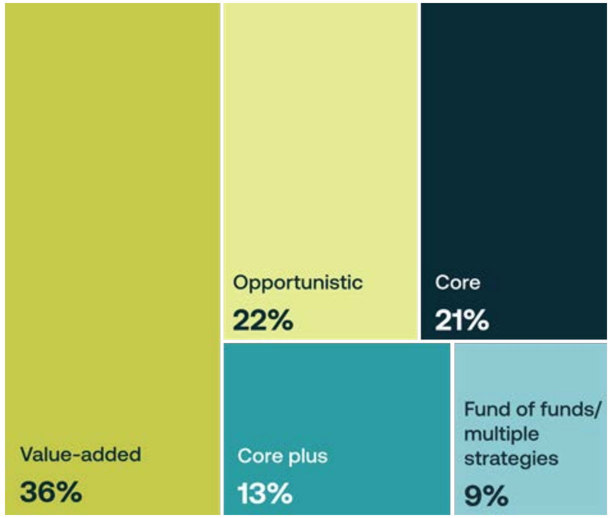
Investments / fund / portfolio management	23%
Appraisals / valuation	18%
Capital markets / financing / lending	17%
Brokerage (investment sales or leasing)	14%
Architectural, construction, development, or engineering	11%
Asset or property management	10%
Other	8%

Respondent characteristics

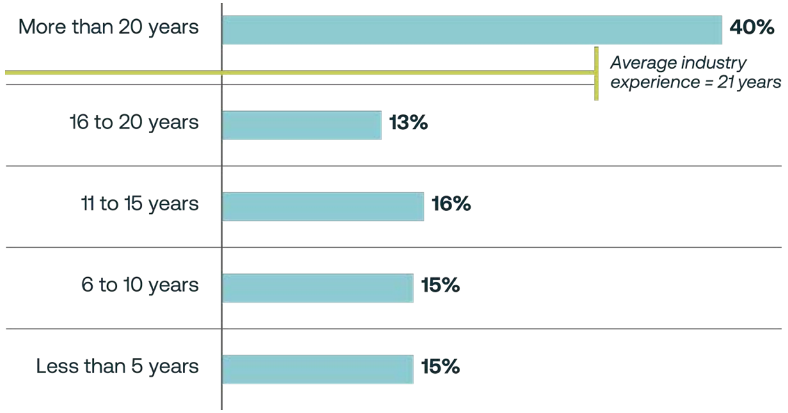
What property types does your firm primarily focus on?



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



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



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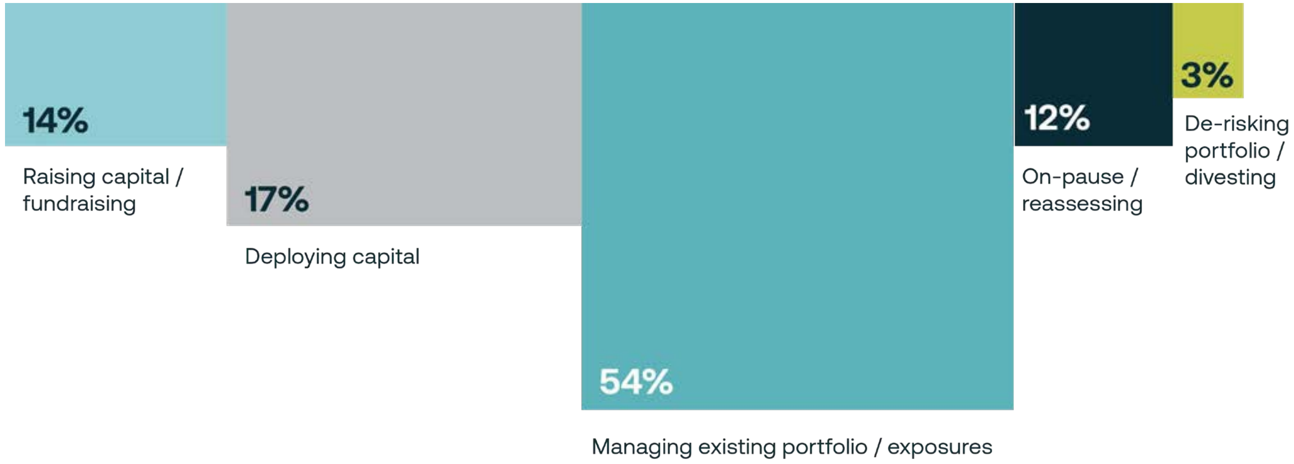
Current focus

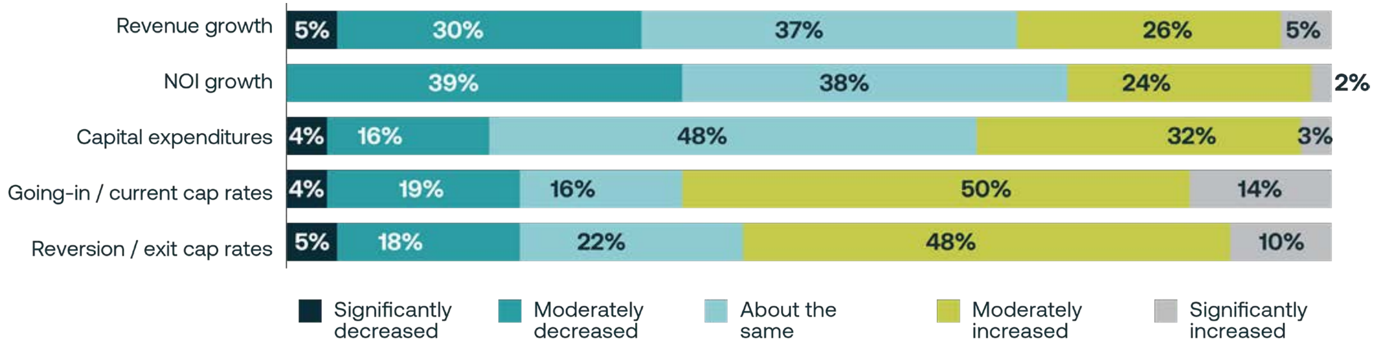
What do you think your team's primary focus will be over the next 6 months?

Focus shifts to deploying and managing. One in six (17%) respondents noted that their primary focus over the next 6 months will be on deploying capital, up from 8% in the prior quarter. The share of respondents focused on managing existing portfolios grew from 42% in Q3 2023 to 54% in Q4 2023.



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

Expectations continue to deteriorate. Respondents' expectations soured over the year, but are little changed from last quarter. More than a third of respondents noted that their expectations for revenue and NOI growth have deteriorated in the last 12 months, in line with the responses from Q3 2023. Responses also indicated that expectations for cap rates (going-in and exit) are increasing. Expectations for capital expenditures were the most stable, with the majority of respondents noting "about the same".



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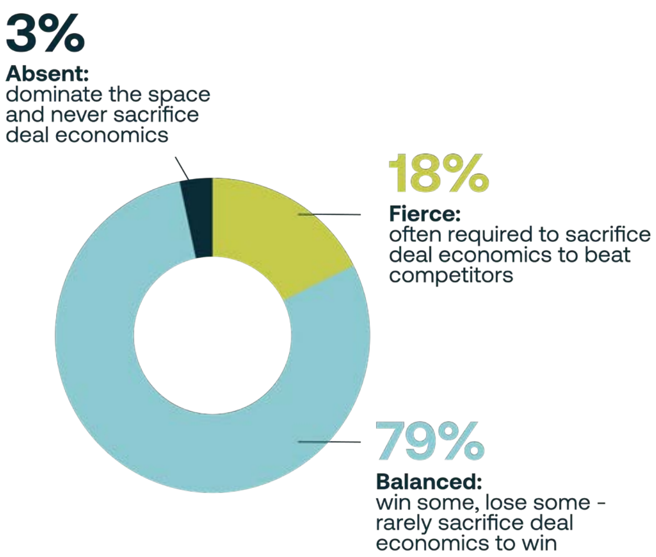
Competition and pricing

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

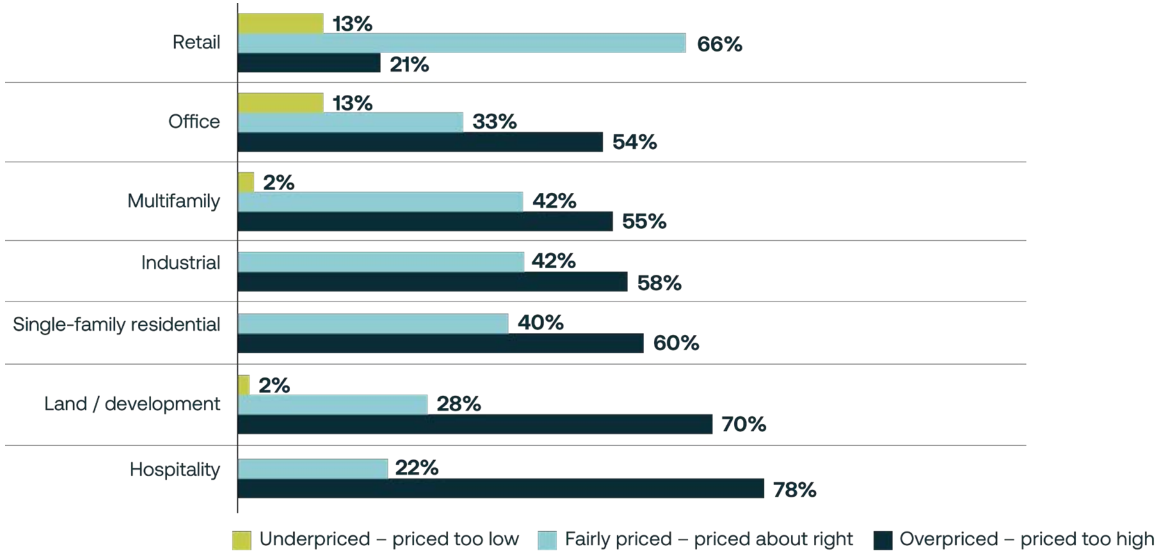
Competition turns "fierce" in a generally "overpriced" marketplace. More than one in six respondents (18%) described the current market competition as "fierce: often required to sacrifice deal economics to beat competitors", up from 15% in the prior quarter. Nearly four in five (79%) described it as "balanced: win some, lose some – rarely sacrifice deal economics to win". Overall, the responses suggest that competition is alive and well, despite the reduced transaction volume.



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

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

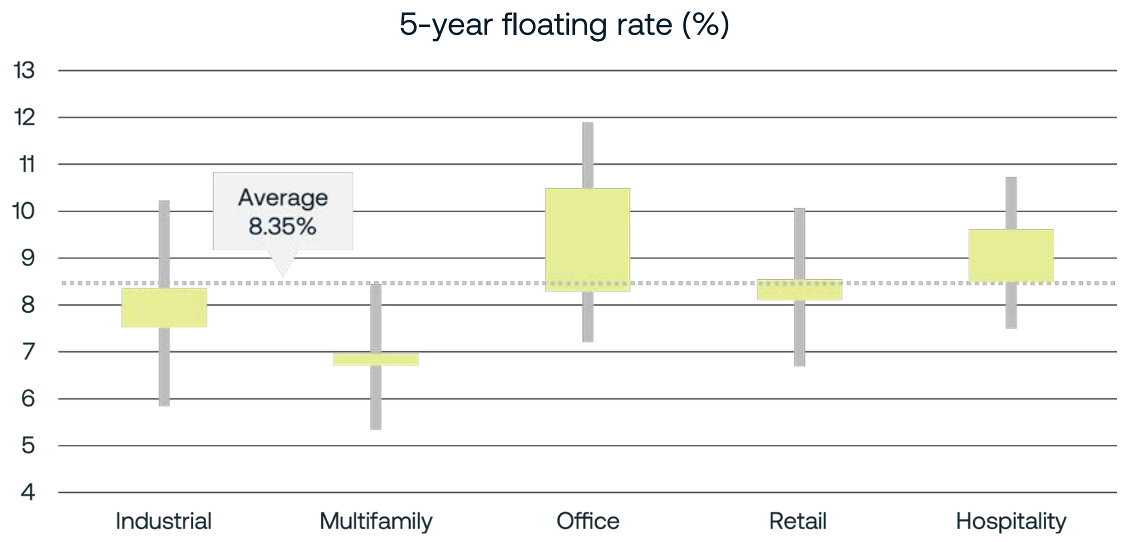
More than half of respondents characterized the markets for key property types to be "overpriced". While four property types (retail, office, multi-family, land) were characterized as being "underpriced" by some respondents, these views were in the clear minority. Retail was a notable standout property type, as the majority of respondents characterized this property type as being "fairly priced".

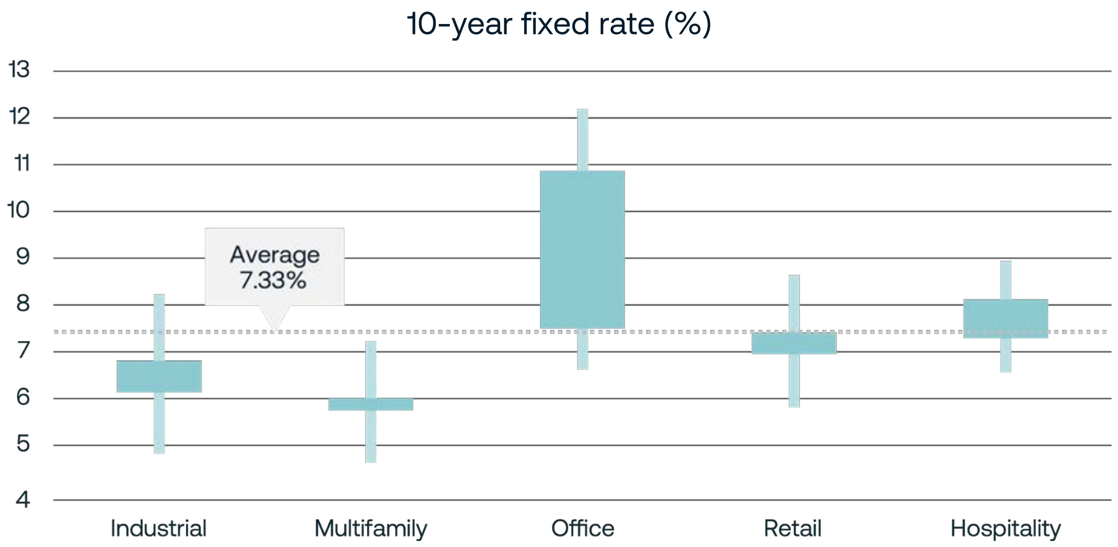


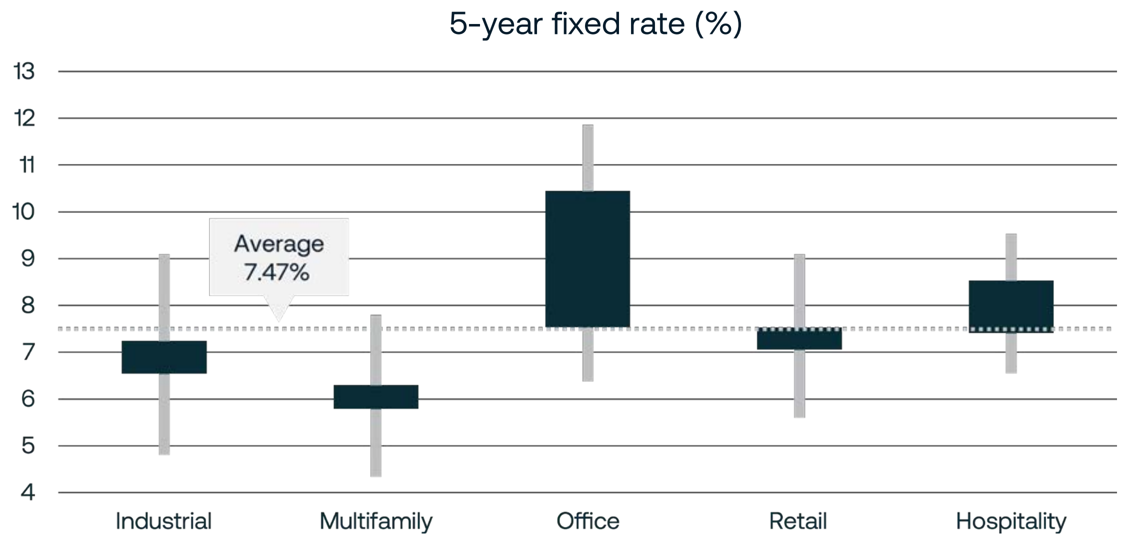
Percentages are rounded, so they may not sum up to 100%.

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

All-in financing costs reflect market, and sector conditions. Responses reflected the elevated capital costs across property types. The overall average 10-year fixed-rate financing across the main property sectors was 7.33%. There was a notable difference in the overall averages between fixed vs. floating, and 5- vs. 10-year options – with the fixed-rate and longer-dated financing options being the most attractive. Responses varied widely across many property types but multi-family, industrial, and retail financing costs being the lowest. All-in interest rates for office varied the most, perhaps reflecting the complex outlook for the property sector. This was a new question to the survey, so comparisons to the prior quarter were not possible.

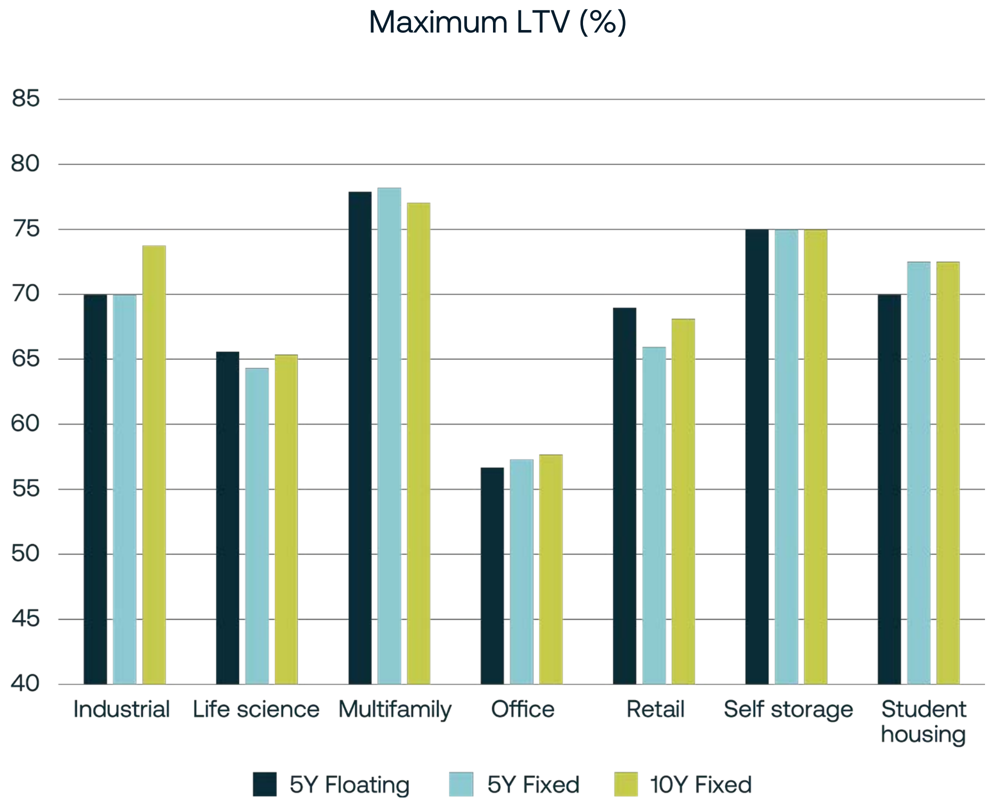


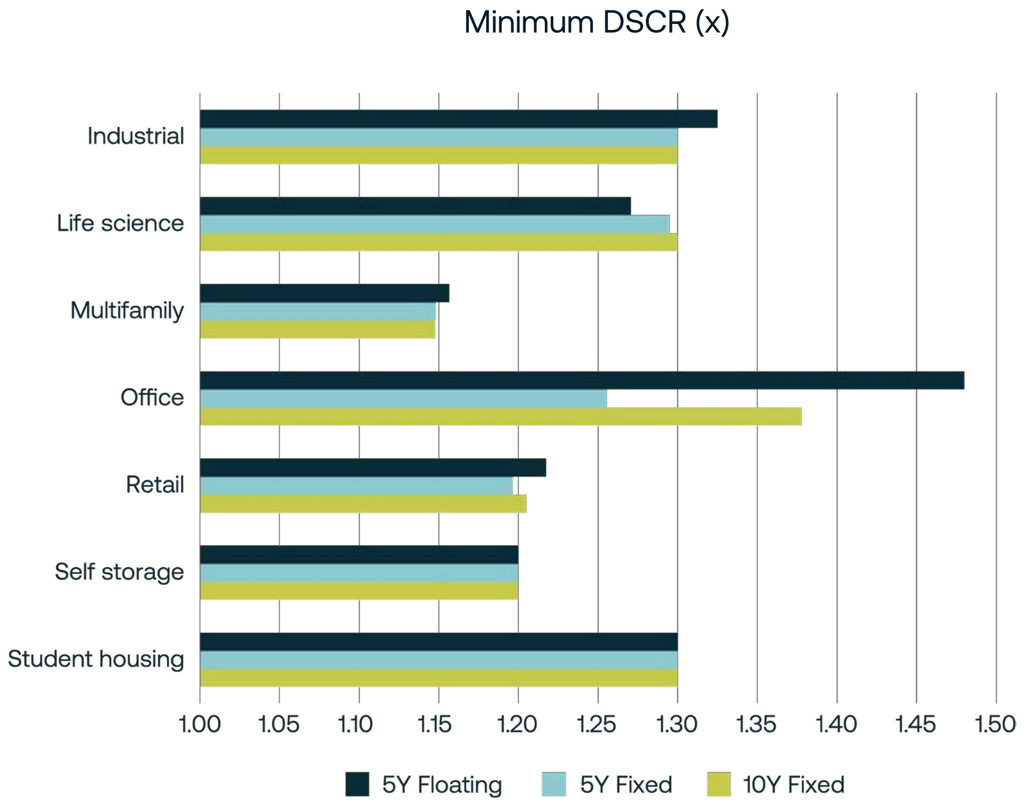




What senior debt financing terms are you seeing in the market?

Underwritten terms remain conservative – except for multi-family. Current underwritten debt terms show a degree of conservatism across most property types, with a few exceptions. Loan-to-value (LTV) ratios remain below 70% for all property types except multifamily, self-storage and student housing. Debt service coverage ratios (DSCR) are at or above 1.2x for all property types except multi-family.



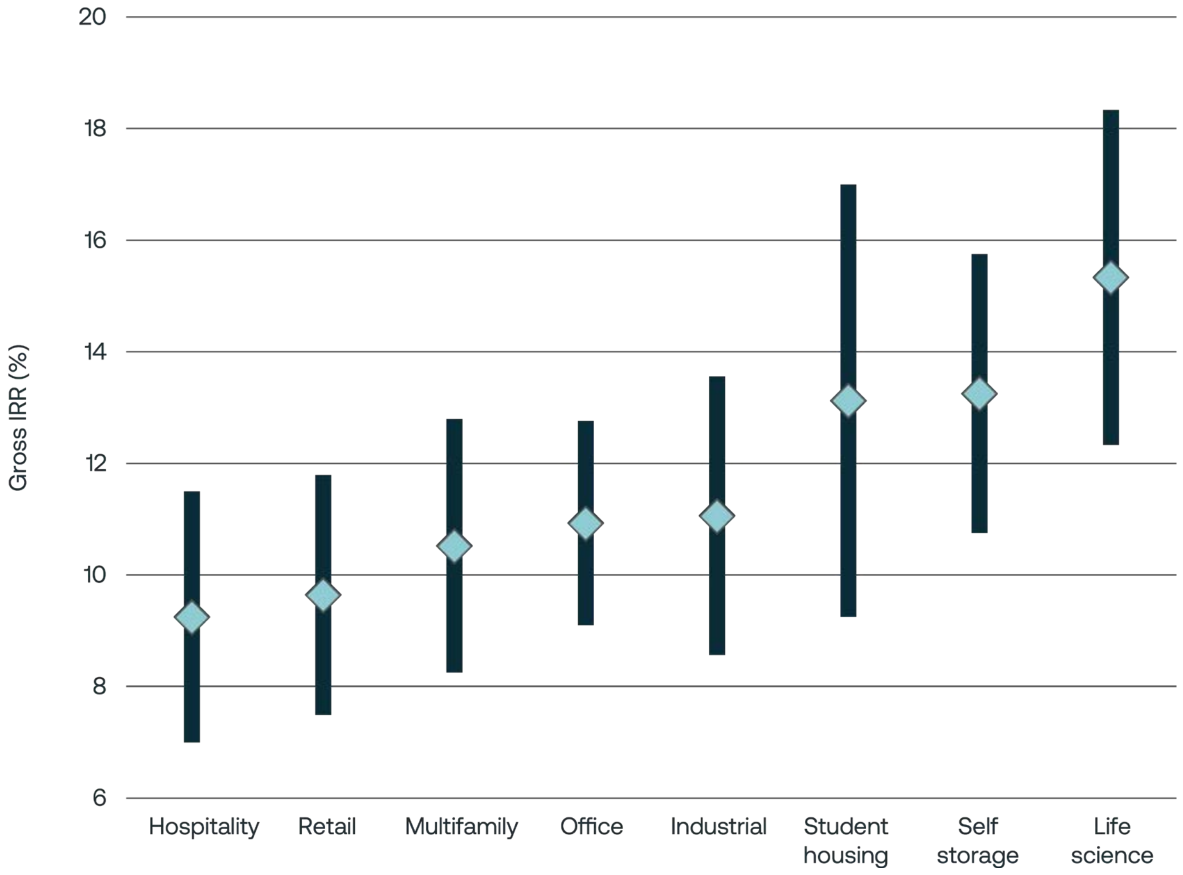


Reported current market gross IRRs

Target returns for new funds show attractiveness of “alternatives”.

Targeted gross IRRs seen marketed for new funds and deals averaged 11.6% across all property types and 10.5% across the four main property types (retail, multi-family, office, industrial). Many of the smaller “alternative” property types, including student housing, self-storage, and life sciences showed notably higher gross IRR midpoints (13.1%, 13.3%, 15.3%, respectively), reflecting the attractive returns investors expect to find in these niche sectors. Responses varied most for student housing, with a low of 9.3% and a high of 17.0%. Also of note are the lower reported gross IRRs for the consumer-driven hospitality and retail property types, the first and second lowest, respectively.

What are typical ranges for the gross IRRs seen across the current market for new funds?



Recession expectations

Expectations align on a shallow recession within the next 6 months. Across investment strategies, a consensus emerges on near-term recession. A significant majority (78%) of respondents expect a recession to be likely (either "very likely" or "somewhat likely") in the next 6 months. While there was variance of responses across different investment strategies, those in the "likely" camp remained the majority. Most responses also indicated that expectations for the next recession to be "shallow" – with more than 88% of respondents indicating the next recession to be shallow as opposed to "severe".

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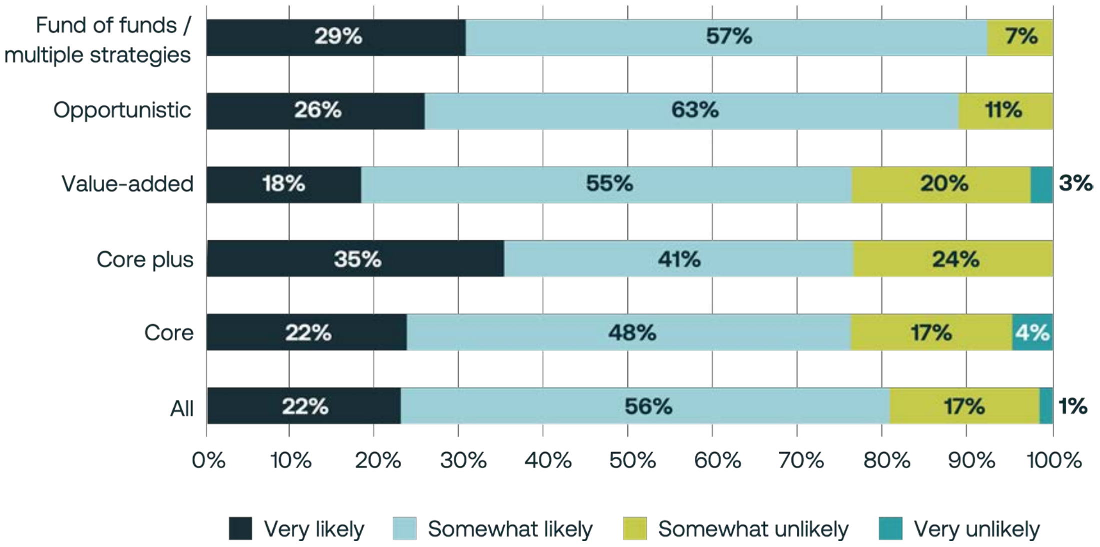
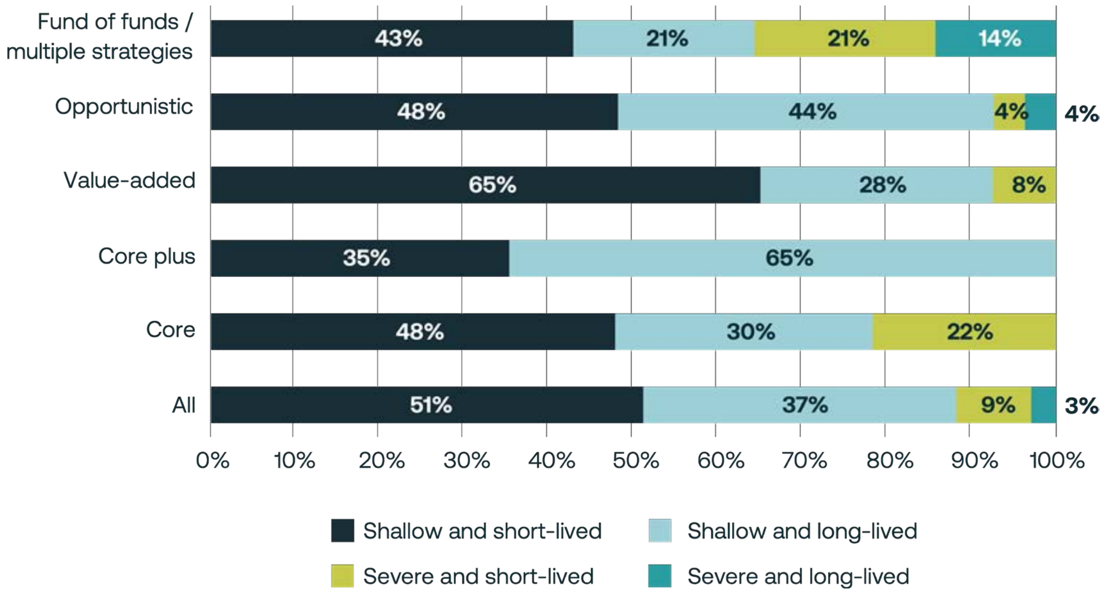
How likely is an economic recession within the next six months?



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

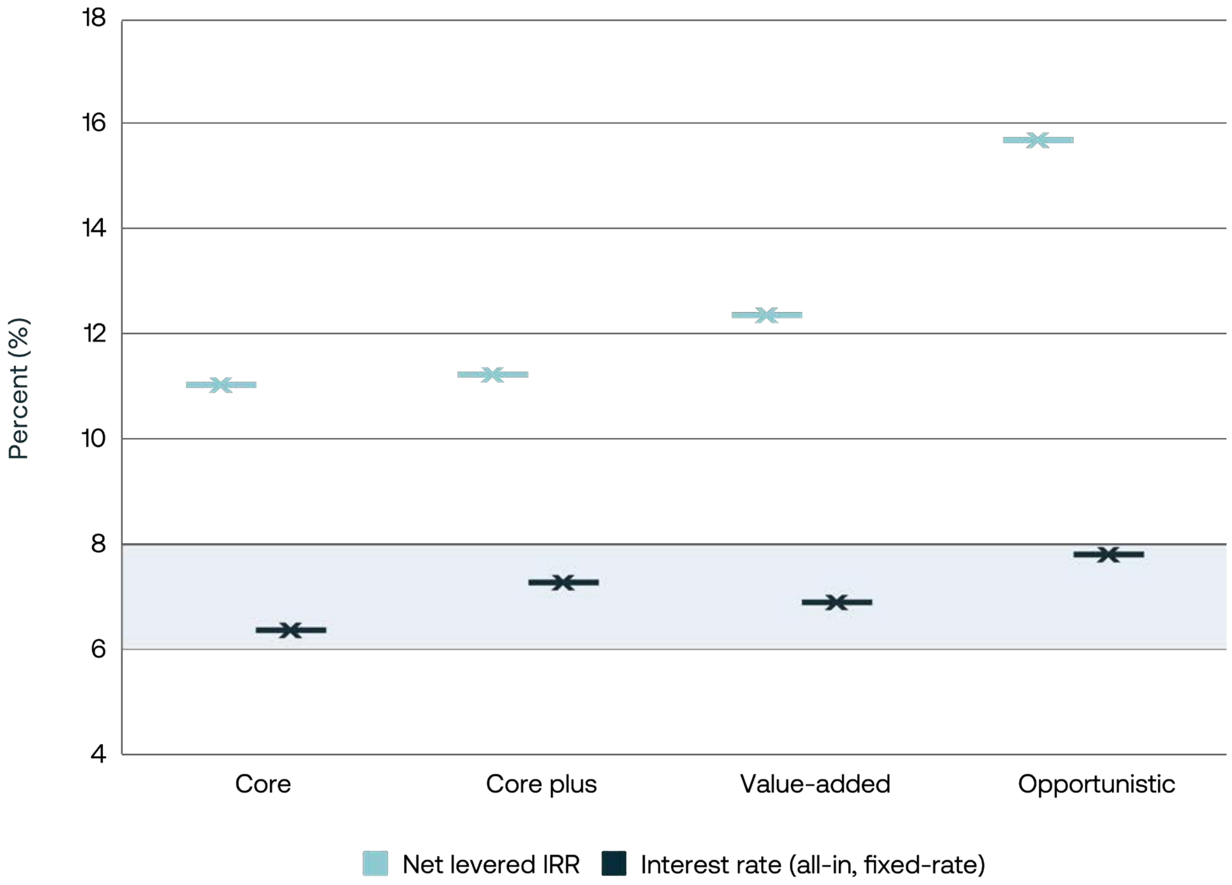


Percentages are rounded, so they may not sum up to 100%.

Cost of capital expectations

Interest rate expectations stabilize, and investor-level returns by strategy emerge. Respondents' 12-month forward view of all-in, fixed-rate financing was range-bound between 6.3-7.8%, across the main portfolio strategies. This tighter range of interest rate expectations across the strategies aligns with the shift to the "pause-or-cut" phase of monetary policy pursued by the Bank of Canada. Expectations for net levered IRRs (the returns an investor would expect) reported across the strategies differed, but reflected the different risk profiles targeted by the different strategies. Net levered IRRs ranged from 11% for core strategies to 15.7% for opportunistic strategies.

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



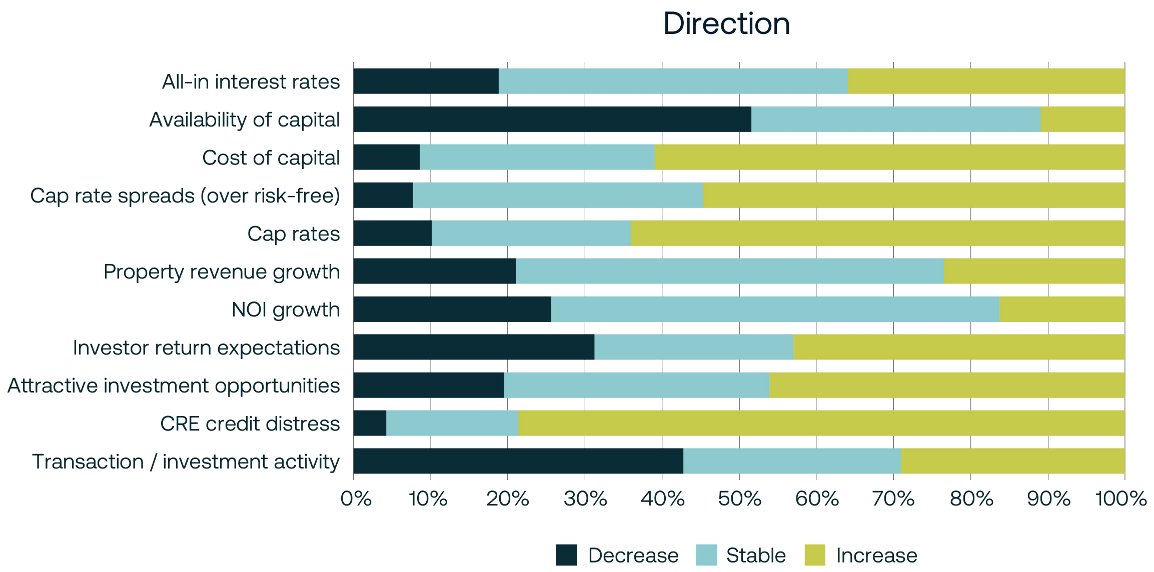
What changes do you anticipate to the following key metrics over the next 12 months?

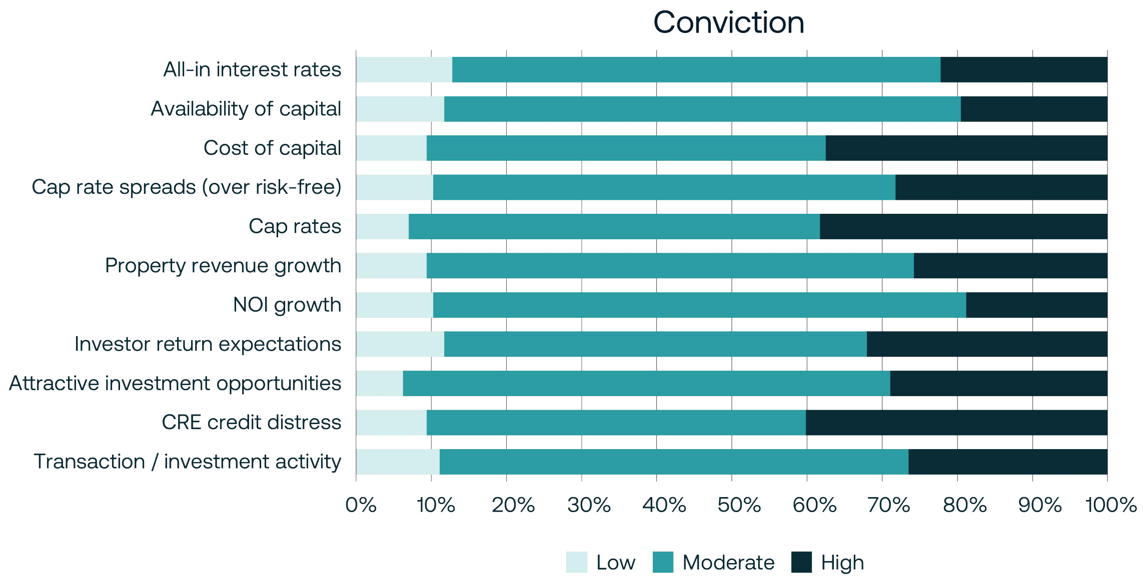
Capital complications: availability down, cost up. The majority of respondents indicated that over the next year they expect the capital availability to decrease and the cost of capital to increase. While the collective conviction of these directional shifts remains mostly moderate, 38% of respondents noted high conviction regarding their call on the cost of capital. The results in the current survey were little changed from the Q3 2023 survey results.

Cap rates, and CRE credit distress are expected to rise. Nearly two-thirds (64%) of respondents expect cap rates to increase over the next 12 months, with 38% of respondents noting high conviction. Nearly 80% of respondents expect CRE credit distress to increase, with the highest "high" conviction rate (40%).

Stable cash flow growth but rising investor return expectations. Participants generally expect stable revenue growth (55%) and NOI growth (58%) over the next 12 months, with slightly higher net conviction on revenue growth than NOI growth. In isolation, these are positive expectations, but taken with collective expectations for higher cap rates, it is unclear if these stable growth expectations will be sufficient to offset the cap rate impact and meet increasing investor return expectations (43%).

Fewer, more attractive investment opportunities. Only 20% expect a decrease in attractive investment opportunities over the next year – collectively, the least "low" conviction call (6%). Yet, 43% of those surveyed believe that transaction activity will decline, suggesting that competition for these opportunities may be even more "fierce".





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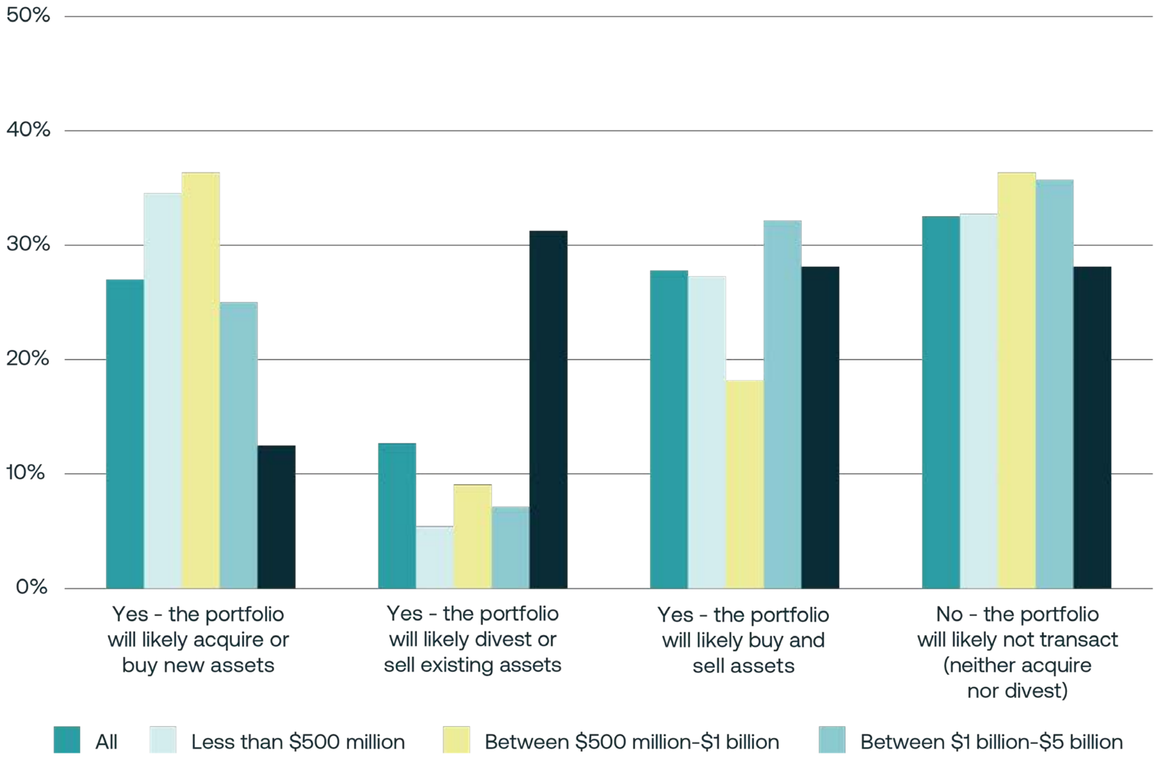
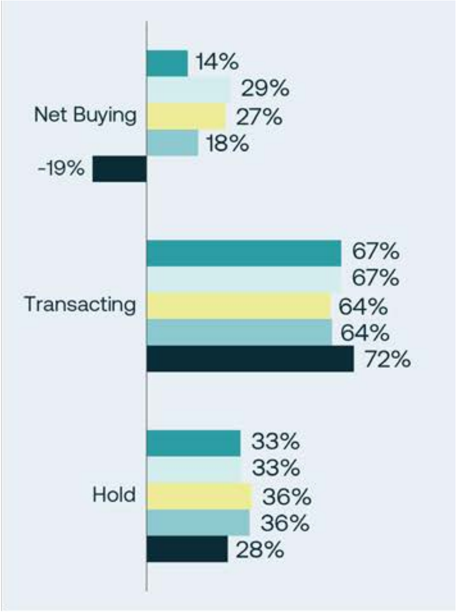
Transaction intentions over next 6 months

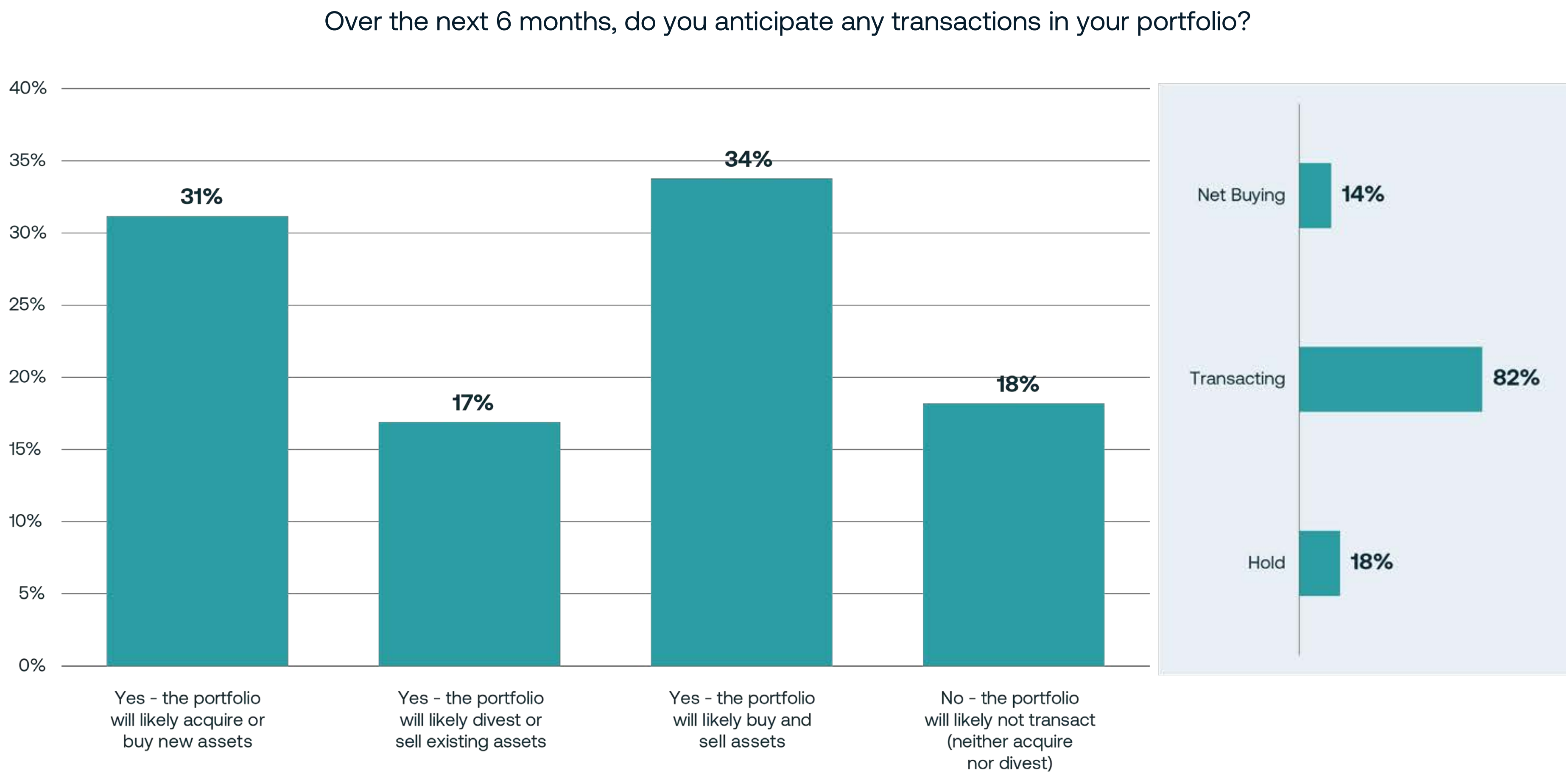
Majority planning to transact; larger firms to be net-sellers. Responses indicate that the majority (67%) plan to transact (either buy, sell, or both) over the next 6 months. Though these intentions vary significantly by firm size. Larger institutions (>$5 billion) plan to be net sellers (net 19%), while smaller firms (<$5 billion) plan to be net buyers, with the smallest (<$500 million) to be the most active buyers (net 29%).

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





Transaction intentions for owners[1]



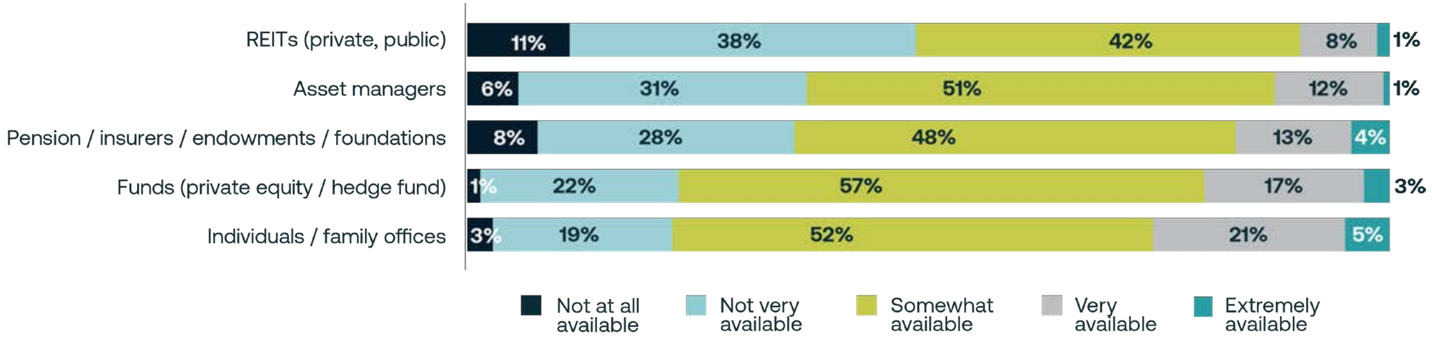
Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses. All $ amounts are in Canadian dollars.
1) All respondents, excluding those who identified as lenders ("Banks", "Non-bank lenders"), "Service Providers", and "Other"

Capital availability

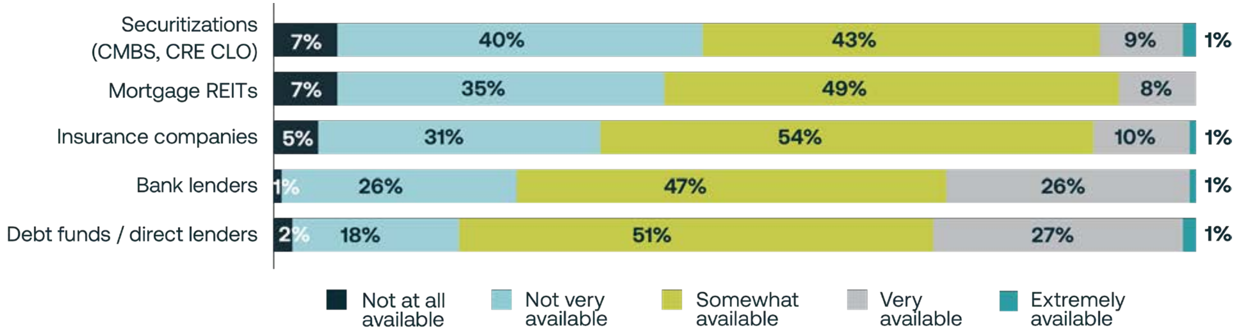
CRE professionals expect greater capital availability from sources less exposed to capital markets. While the overall expectation is that capital availability will decrease over the coming year, responses suggest that capital partners are open for business, though much less so from sources with greater public market execution exposure. For sources of equity capital, survey participants indicated that they collectively expect the least amount of capital availability from REITs and asset managers – with responses of “not at all available” or “not very available” summing to 48% and 37%, respectively. Meanwhile, participants expect greater availability of equity capital from individuals / family offices and PE / hedge funds – with 26% and 20%, respectively, expecting these sources of equity to be either “extremely” or “very” available. The degree of capital market execution or exposure also seemed to be reflected on the debt side of the capital stack. Aggregate responses indicated expectations for securitizations and mortgage REITs to be the most constrained, with a 47% and 42% of responses, respectively, expecting these to be either “not at all available” or “not very available” over the next year. Canadian CRE professionals expect debt funds and banks to have the greatest amount of capital availability over the next year, with 29% and 27% of responses expecting availability to be either “extremely” or “very” available. It is worth noting that the expectations for Canadian bank capital availability are in stark contrast to those of the US (see the US results for more detail).

What are your expectations for the availability of capital over the next 12 months?

By equity source



By debt source



Percentages are rounded, so they may not sum up to 100%.

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

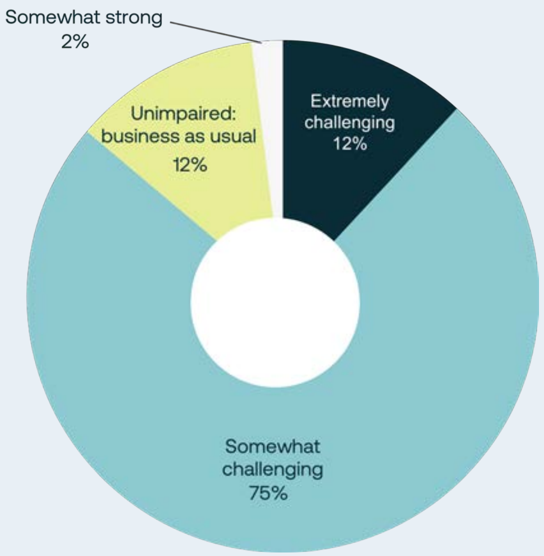
Expected operating environment

Increasingly challenging environment anticipated; though outlooks diverge on operating environment ahead. A total of 87% of respondents anticipate the coming months to be more difficult and pose some degree of challenge over the next 12 months (combined “somewhat” and “extremely” challenging responses). While the Q4 2023 responses indicated the same percentage of responses expecting challenges as in the prior quarter, the percentage of respondents who expect the operating environment to be “extremely challenging” jumped to 19% up from 12% in the prior quarter. Those who expect the next year to be less than challenging also saw a shift over the prior quarter – as those who expect a “somewhat strong” operating environment accounted for 5% in Q4 vs. 2% in Q3 2023.

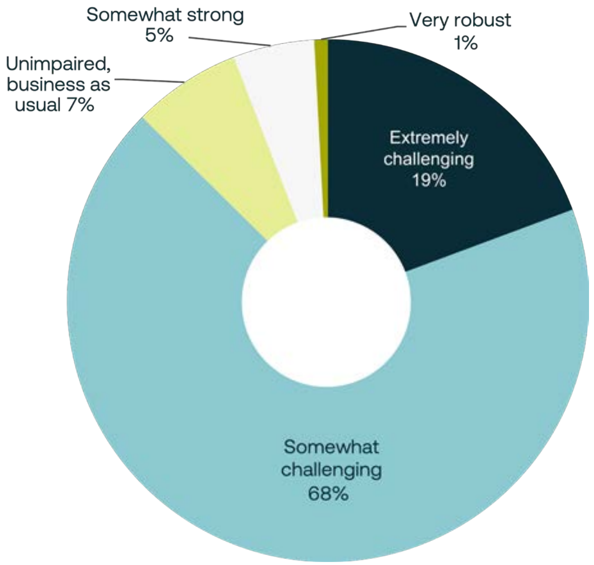
What best describes your expectations for the operating environment over the next 12 months?

PRIOR QUARTER

Q3 2023



Q4 2023



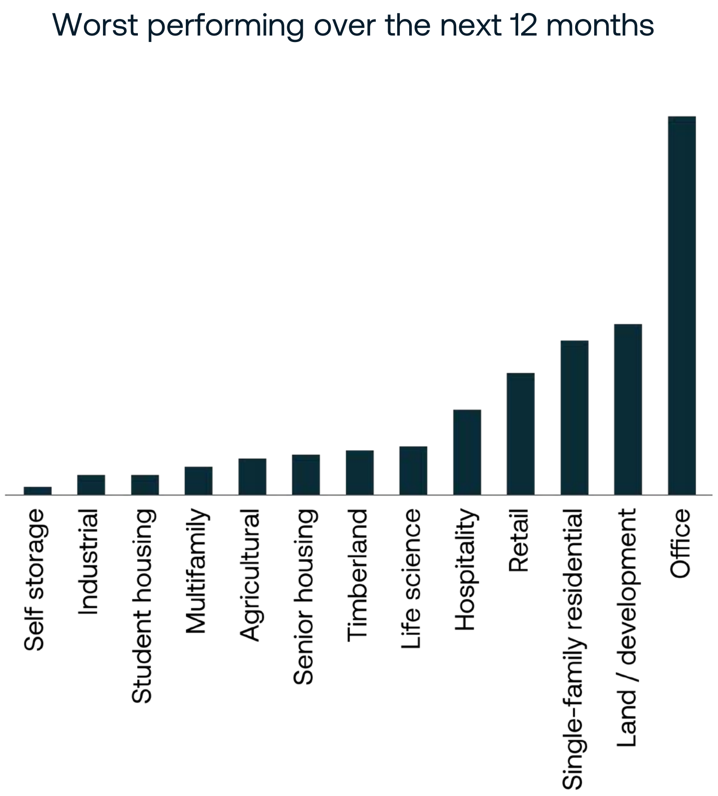
Percentages are rounded, so they may not sum up to 100%.

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

Expectations for property type performance

Supply-demand balances leave industrial, multifamily as most favored; office remains the leading laggard. Survey responses suggest that participants still expect industrial and multifamily to be the best-performing property types and office to be the worst over the next 12 months – with no changes in the top five ranking compared to Q3 2023 results. The ranking of the "worst performing" property types changed slightly compared to the prior quarter's survey results; office remained the leader of the laggards, while land / development and single-family residential displaced retail becoming second and third worst, respectively, and pushing retail to the fourth-ranked worst-performer.

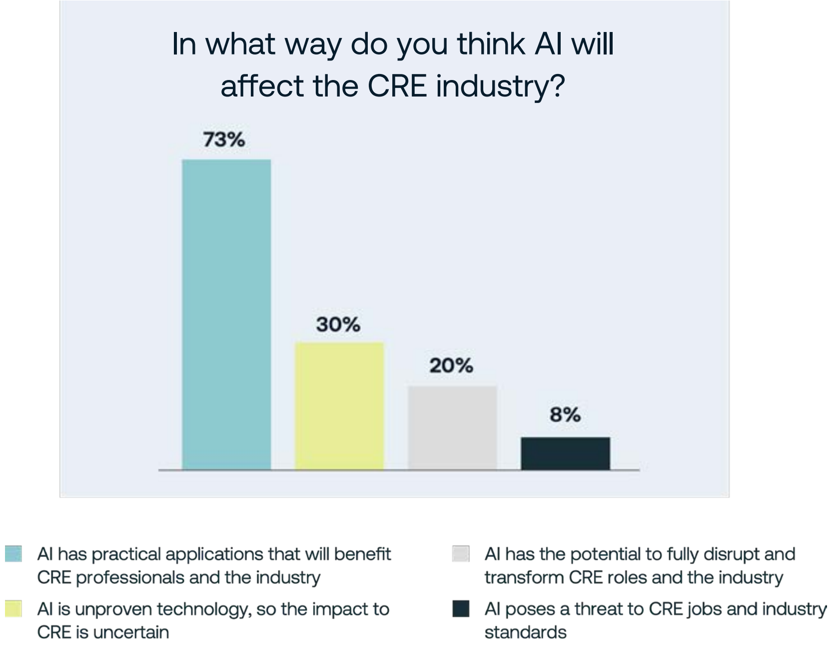
<u>How to read the charts:</u> The survey question asked participants to identify which property types they thought would be either "best" or "worst" performing in the next 12 months. Not all property types needed to be selected and any property type selected could only be identified as either "best"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



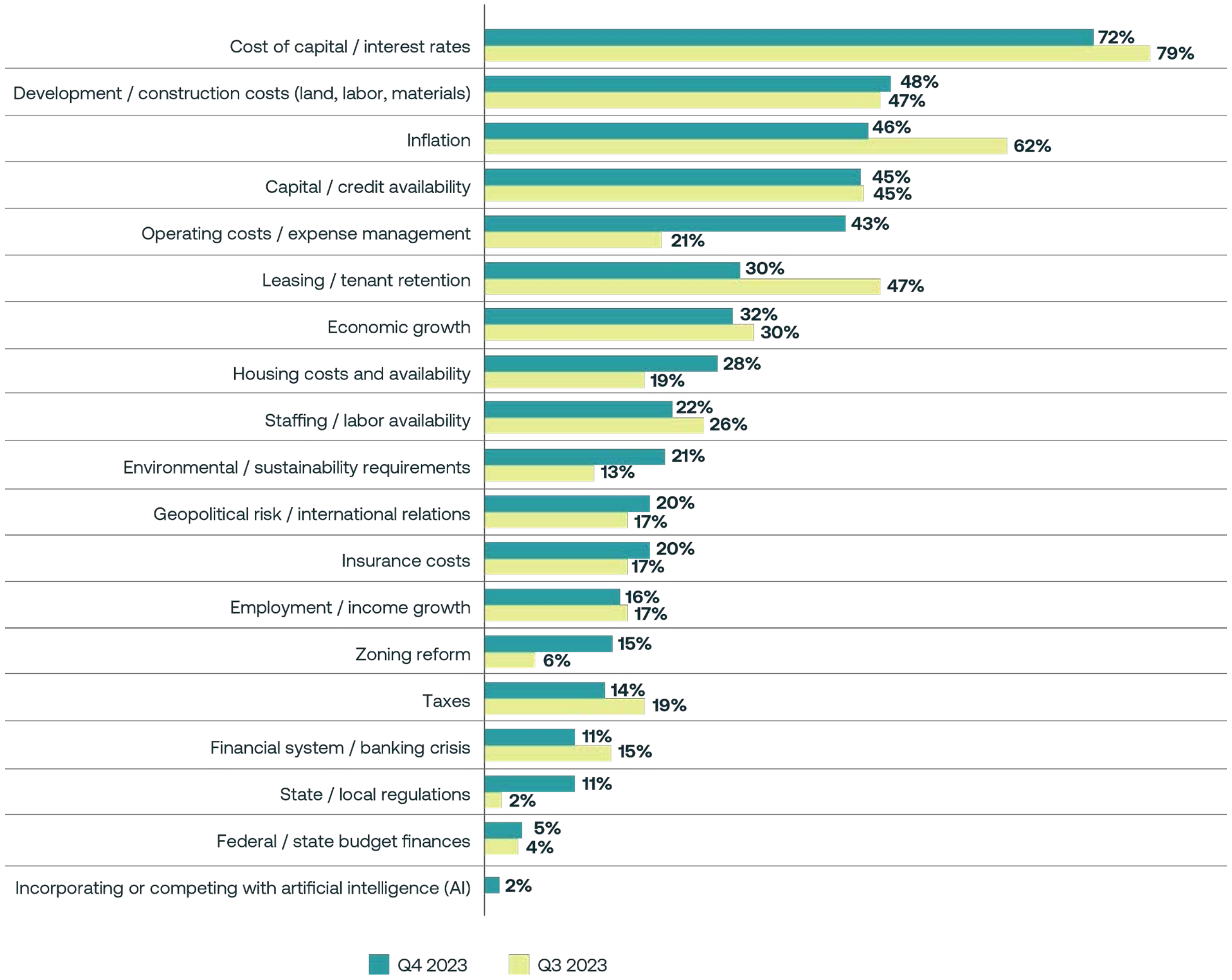
Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses. Respondents could choose more than one property type to be either "best" or "worst" performing, so bars do not sum to 100%.

Priority issues over the next 12 months

Cost concerns weigh heavy on minds, top the list of priorities. Cost of capital, development costs, and inflation topped the list of expected priorities over the next 12 months for the second consecutive quarter. While both cost of capital and inflation saw notable declines in respondents' flagging as top-priority issues over the prior quarter, the results suggest that much uncertainty and focus on these issues remains. Further down the ranked list of issues, operating costs / expense management was identified as a priority issue for 42% of respondents in Q4 2023, doubling from 21% in the prior quarter. While very few respondents are prioritizing artificial intelligence (AI), nearly three-fourths (73%) see beneficial, practical applications of the technology, and only a minority (8%) of respondents viewed it as a potential threat to CRE jobs and industry standards.



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. All $ amounts are in Canadian dollars. "Incorporating or competing with artificial intelligence (AI)" was added to the 4Q 2023 survey, so cross-quarter comparisons were not possible. The question "In what way do you think AI will affect the CRE industry?" allowed participants to choose more than one answer so percentages do not sum to 100%.

Altus Group (TSX: AIF) is a leading provider of asset and fund intelligence for commercial real estate. We deliver our intelligence as a service to our global client base through a connected platform of industry-leading technology, advanced analytics and advisory services.

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.

Altus Group is a global company headquartered in Toronto with approximately 3,000 employees across North America, EMEA and Asia Pacific.

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