Altus Group

Q1 2024

Commercial Real Estate Industry Conditions & Sentiment Survey

Canada results and analysis

Introduction

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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Survey size & methodology

Altus Group's Research Team surveyed industry participants across Canada from January 23 to February 9, 2024. There were 214 respondents, representing at least 55 different firms[1].

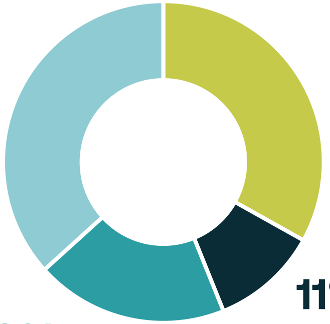
Questions in the survey were optional and explored two main topics: current conditions and future expectations. Percentages represent the share of all responses received for each question, excluding "blank" or "not applicable" responses.

214 responses

FROM MORE THAN

55 different firms

Firm CRE exposure ($ CAD)



Organization type

Service provider	28%
Developer	19%
Asset management company	10%
Investment manager	9%
Lenders (Bank or Non-bank)	9%
Private equity or REIT	8%
Insurance company	7%
Family office or sovereign wealth fund	5%
Other	5%

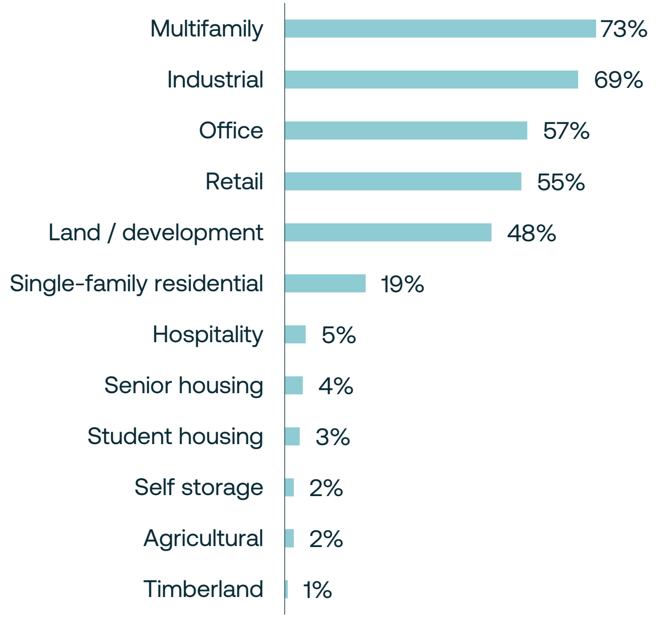
Functional area

Brokerage (investment sales or leasing)	22%
Senior management	19%
Appraisals / valuation	18%
Developer / construction manager	11%
Investments / fund / portfolio management	8%
Capital markets / financing / lending	8%
Other	8%
Asset or property management	7%

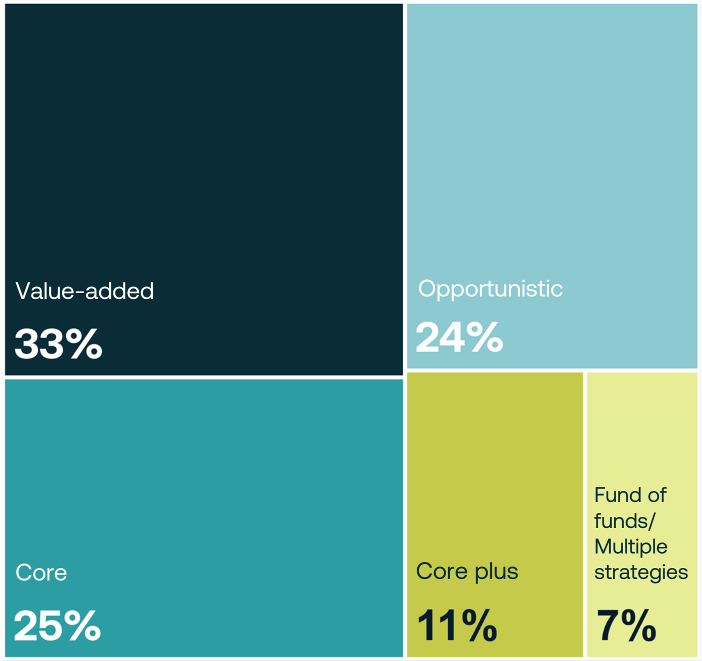
Notes: 1) Firm count based on participants who chose to identify themselves.

Respondent characteristics

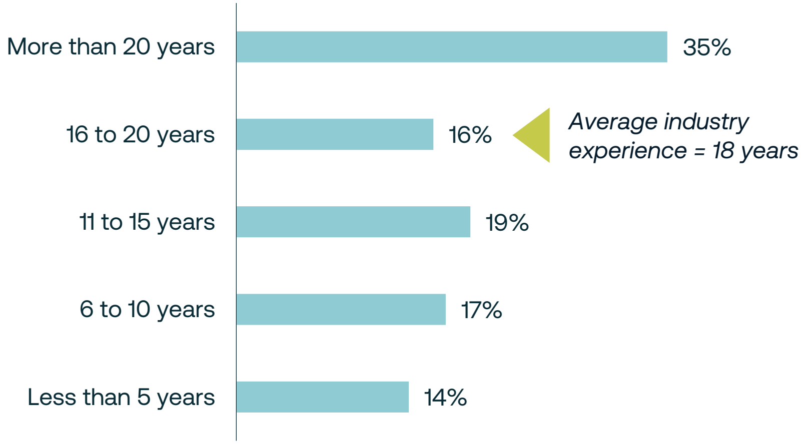
What property types does your firm primarily focus on?



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.

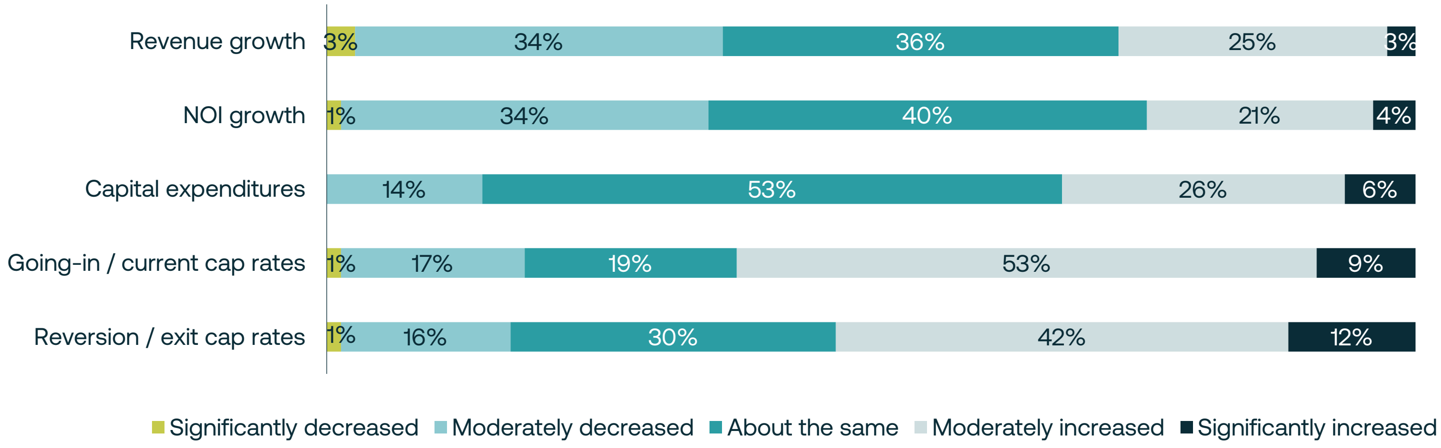
Current focus

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

Fewer managing exposure or re-assessing; de-risking picks up. Nearly half of respondents plan to be managing existing portfolios over the next six months, though the share declined from 54% in Q4 2023 to 49% in Q1 2024. The share of those planning to de-risk their portfolios or actively divest increased from 3% to 10%.

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

Shifting portfolio expectations slow, moderate. Respondents indicated that their expectations for key metrics across their portfolio have moderated or remain about the same compared to where their expectations were a year ago. Across the five key metrics surveyed, the respondents indicated a notable 23% shift to "about the same" from the prior quarter. For example, 30% of participants noted that their expectations for reversion / exit cap rates remained "about the same" compared to 12 months ago, a 9 percentage point (pp) increase from the 21% which answered the same in Q4 2023. The second largest percentage point increase for "about the same" response for the quarter was seen for capital expenditures expectations, which increased to 53% of responses, up 7pp from prior quarter. While higher exit cap rates and higher capital expenditures are not to be cheered, the moderating pace of changes to expectations is a silver lining.

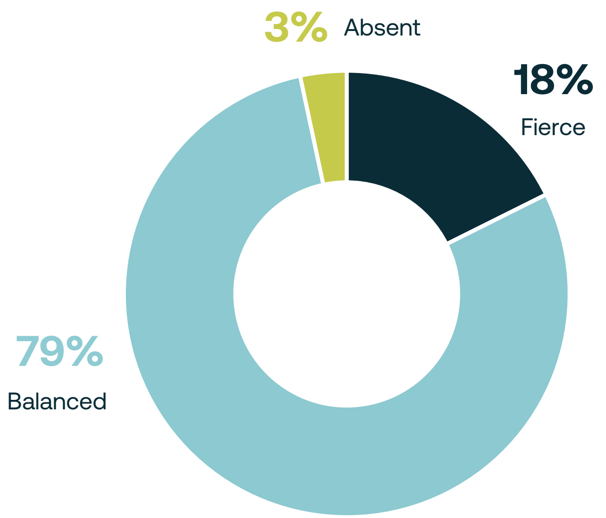


Note: Percentages represent the share of all responses, excluding “blank” or “not applicable” responses.

Competition and pricing

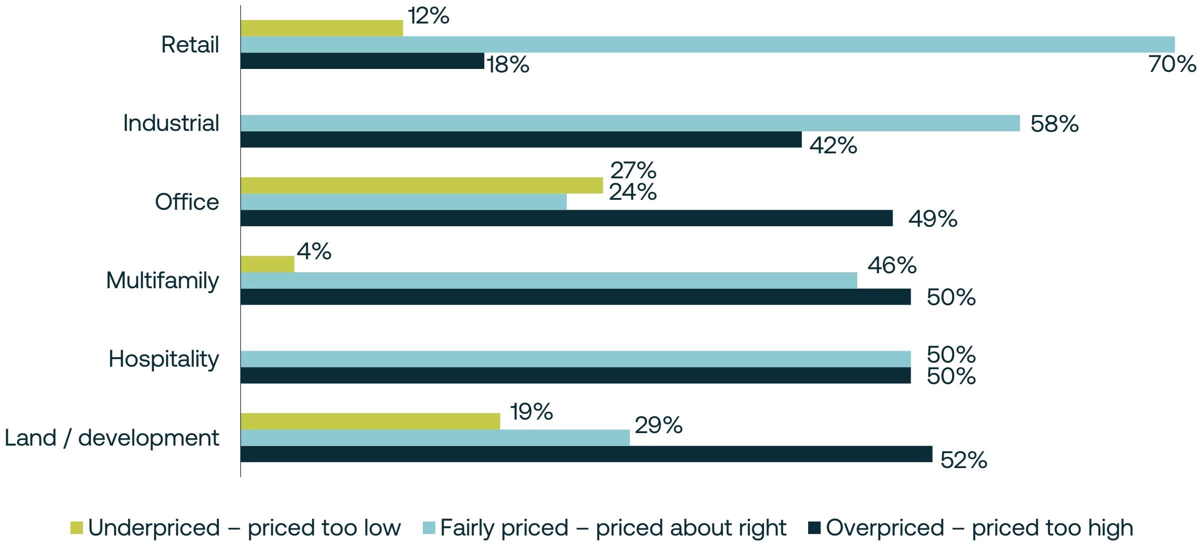
How would you describe the level of competition among your firm's peer group?

Level of competition remains in more "fairly" priced marketplace. In terms of how participants described the level of competition among their peer group, there was no change from the previous quarter, with nearly half finding the property type "overpriced" and 27% characterizing it as "underpriced". Half or more respondents characterized the land/ development, hospitality, and multifamily properties as "overpriced" while some viewed four property types (retail, office, multifamily, land) to be "underpriced". Retail and industrial are notable with most respondents having characterized the sectors as being "fairly priced".



At a high-level, how would you characterize current pricing for the following property types?

While the "overpriced" was the most common descriptor for all but two property types, there was a significant shift away from this characterization from the prior quarter. Hospitality, land / development, and industrial saw the biggest changes, each with double-digit percentage shifts away from "overpriced" to either "fairly" or "underpriced". Together, these shifts may suggest that the bid-ask spread that contributed to frozen transaction activity in 2023 may be compressing.



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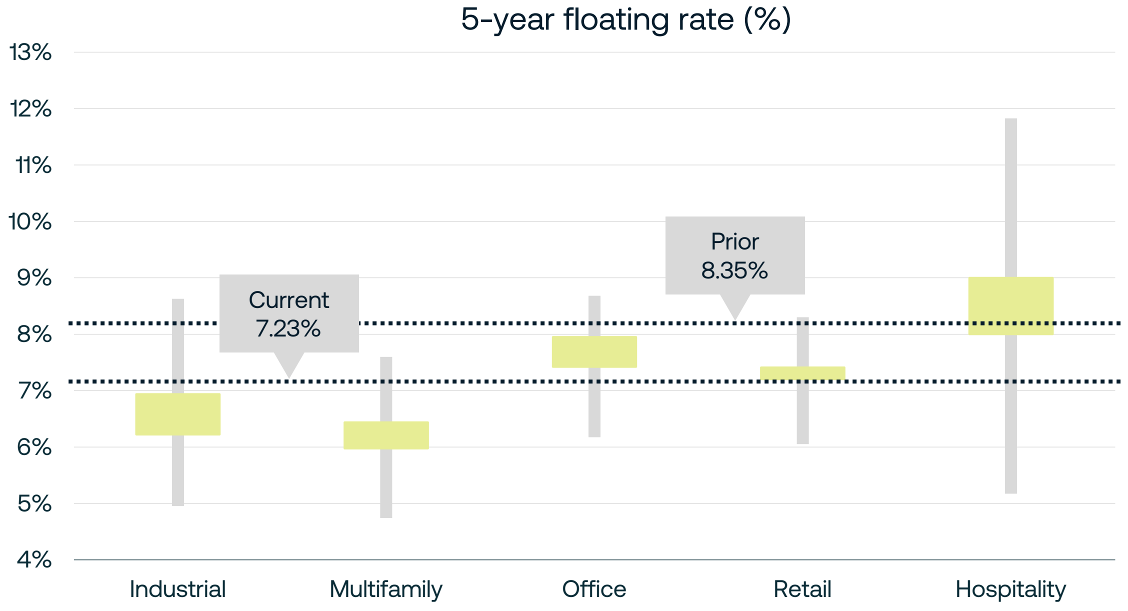
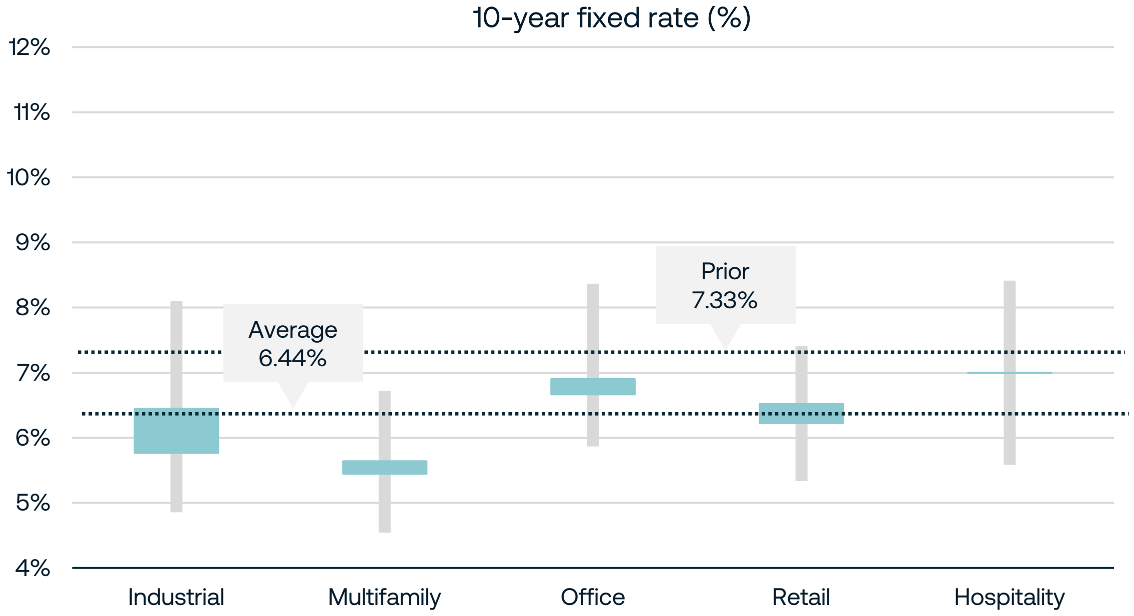
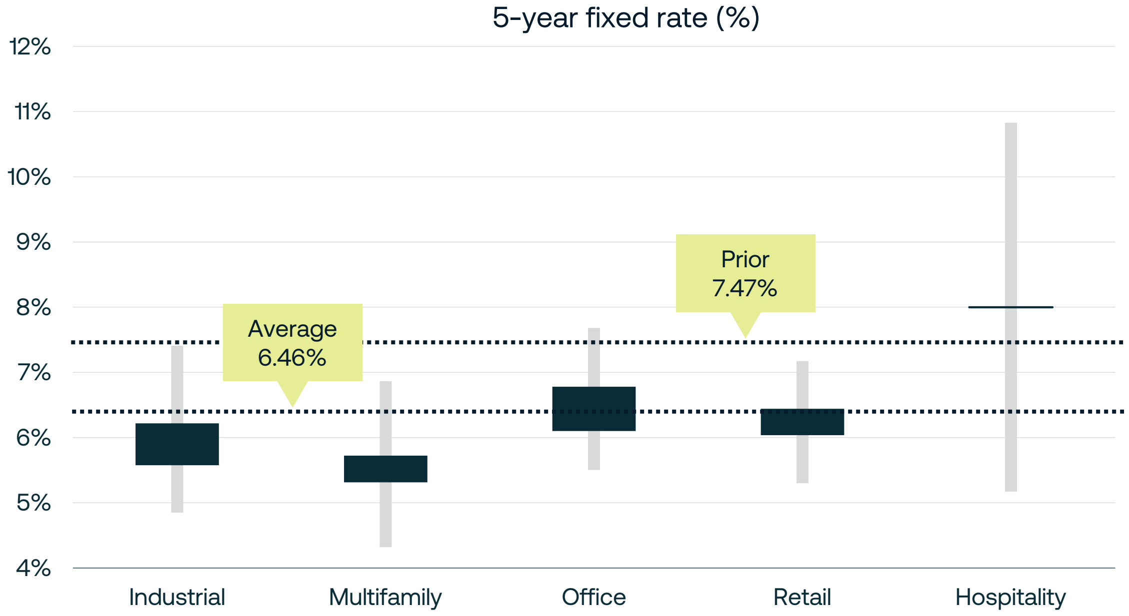
What all-in interest rates are you seeing in the market?

All-in financing costs edge down on steadying outlooks. The reported cost of capital seen across different term financings and property types improved from the prior quarter. Whether attributable to improved market outlooks or steadying expectations for collateral performance, the average all-in financing costs reported by survey respondents dropped by nearly 100 bps across both 5-year and 10-year debt products, with the largest decline seen for 5-year floating rate structures (7.23% vs 8.35% in Q4 2023) and the smallest decline seen for 10-year fixed rate (6.44% vs 7.33% in Q4 2023). Multifamily and industrial continue to have the overall lowest rates, followed by retail, then office and hospitality. Overall ranges for interest costs compressed compared to the prior quarter, compressing the most for office and widening for hospitality.

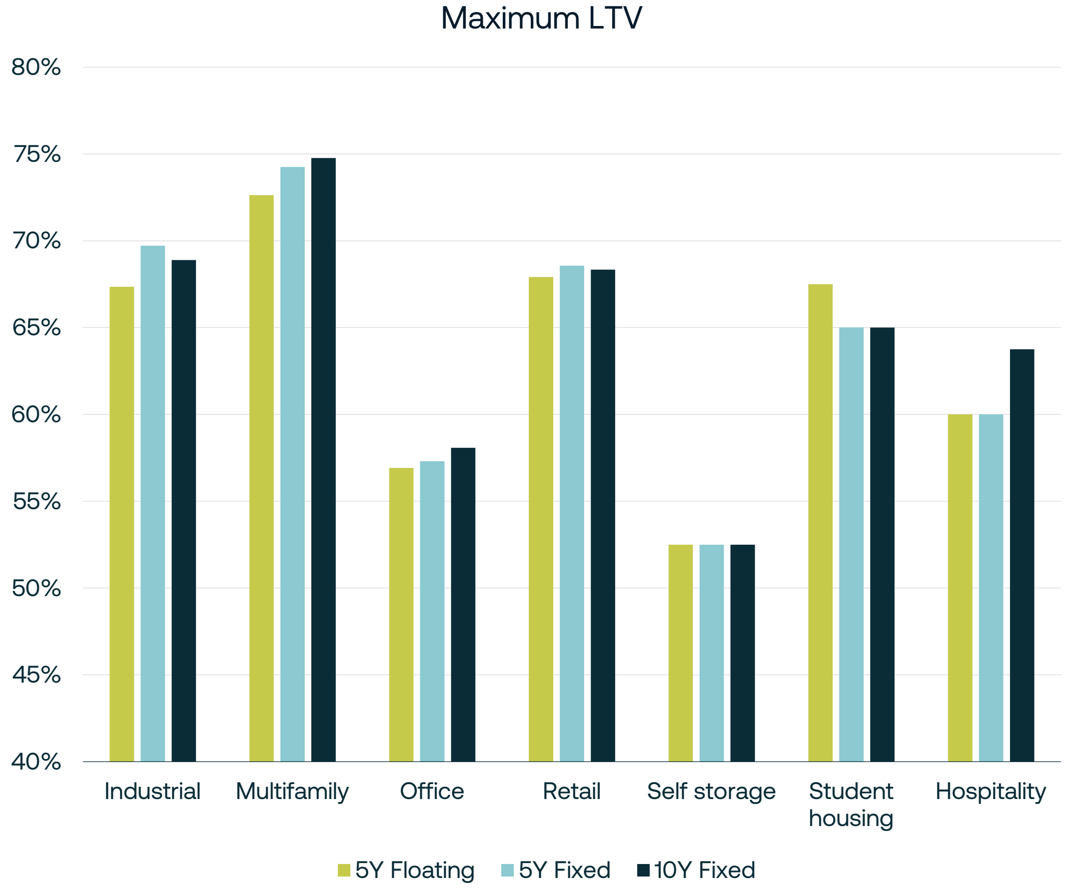


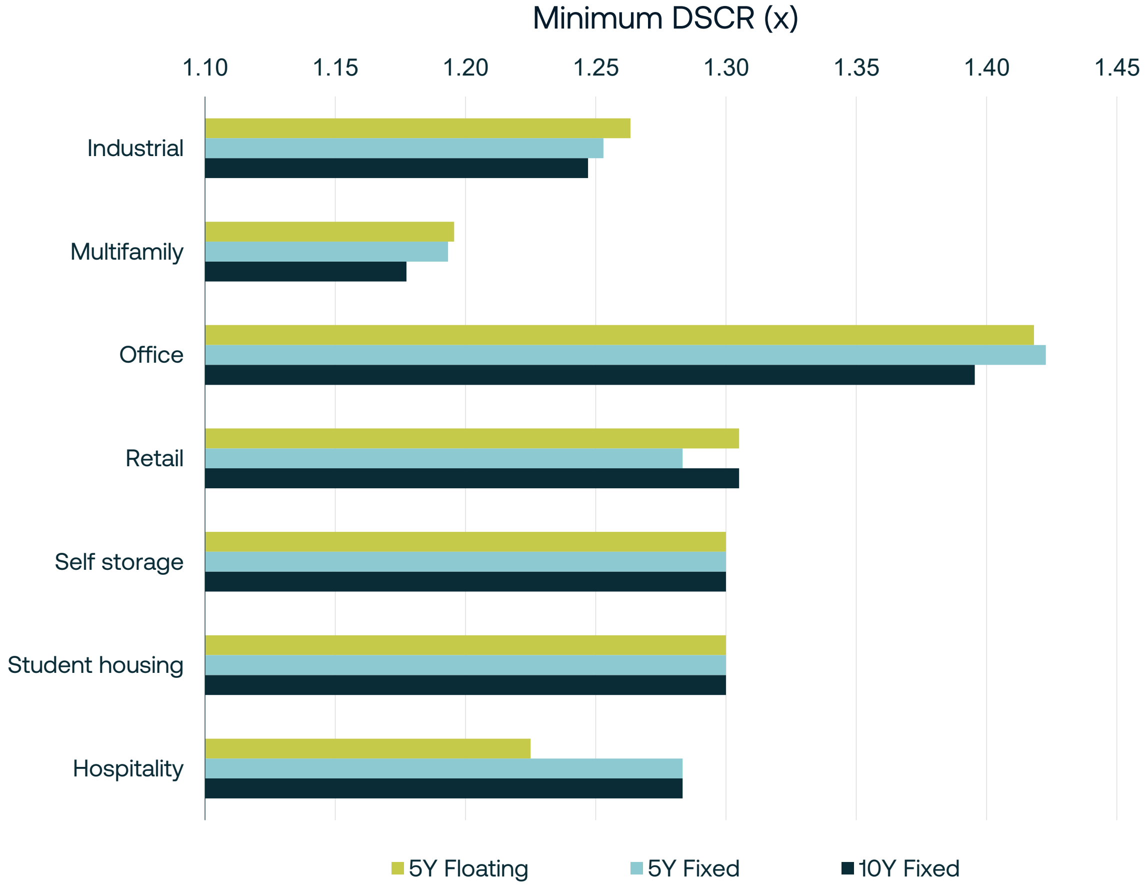




What senior debt financing terms are you seeing in the market?

Lenders tighten loan criteria slightly on the quarter. Respondents noted that current debt maximum loan-to-value (LTV) ratios seen in the market generally remain below 70%, with the exception of multifamily. Reported max LTVs for Q1 2024 were up low-single-digit percentage points for retail, down near 10 percentage points for student housing and hospitality, and little changed for the rest – compared to Q4 2023. Observed minimum debt service coverage ratios (DSCR) were also slightly more conservative in Q1 2024 vs Q4 2023, including being up +0.03 to +0.06x for multifamily and industrial – two of lenders' more favored property types.

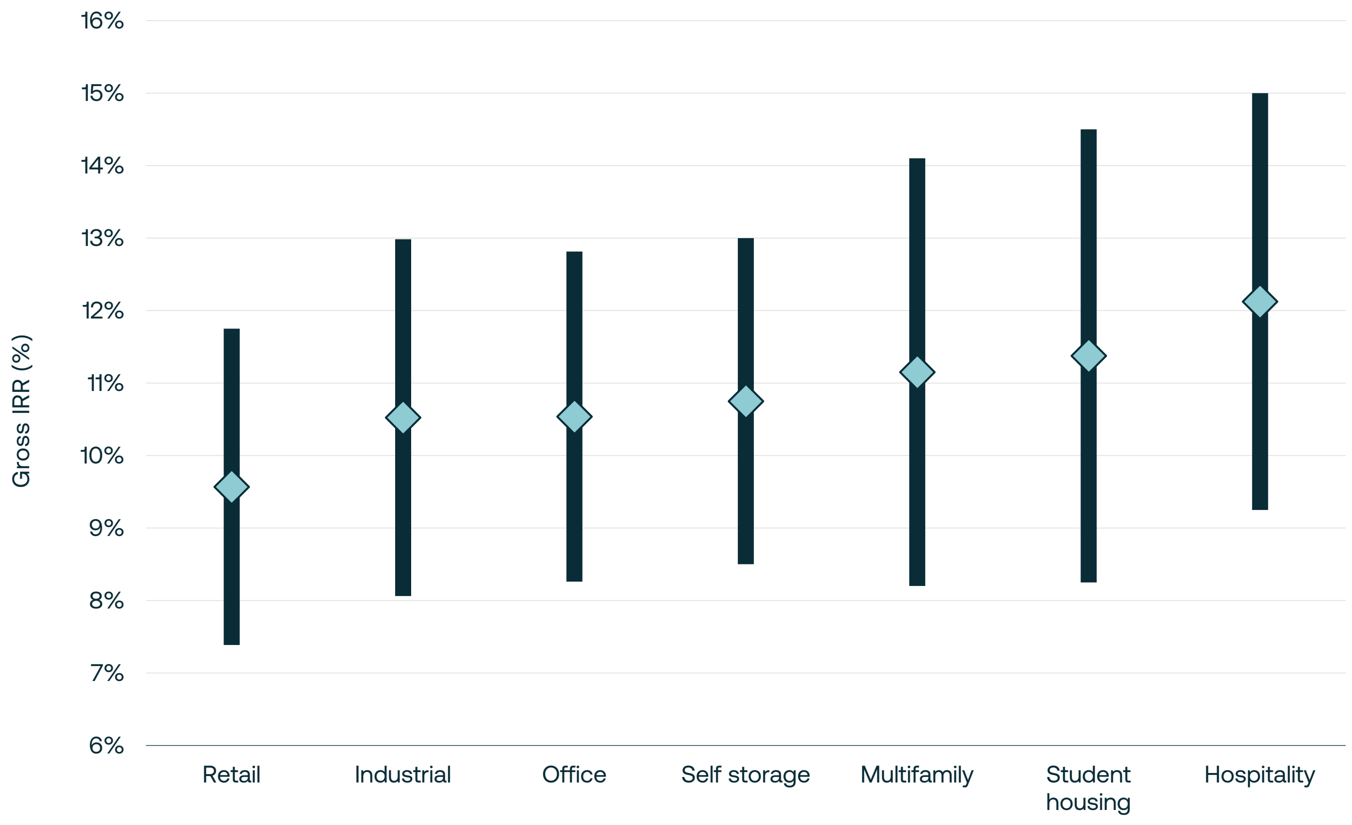




Reported current market gross IRRs

Target returns for new funds come down modestly. Targeted gross IRRs seen marketed for new funds and deals averaged 10.8% across all property types in Q1 2024, down 78 bps from the prior quarter. Across the four main property types (retail, multifamily, office, industrial), the reported average gross IRR was 10.4%, down 9 bps from Q4 2023. However, the biggest quarterly moves in reported midpoint IRRs were seen in hospitality, which moved up 288 bps to 12.1% in Q1 2024, and the largest quarterly decline in midpoint IRRs was in self storage, which saw its reported midpoint IRR drop 250 bps to 10.7%.

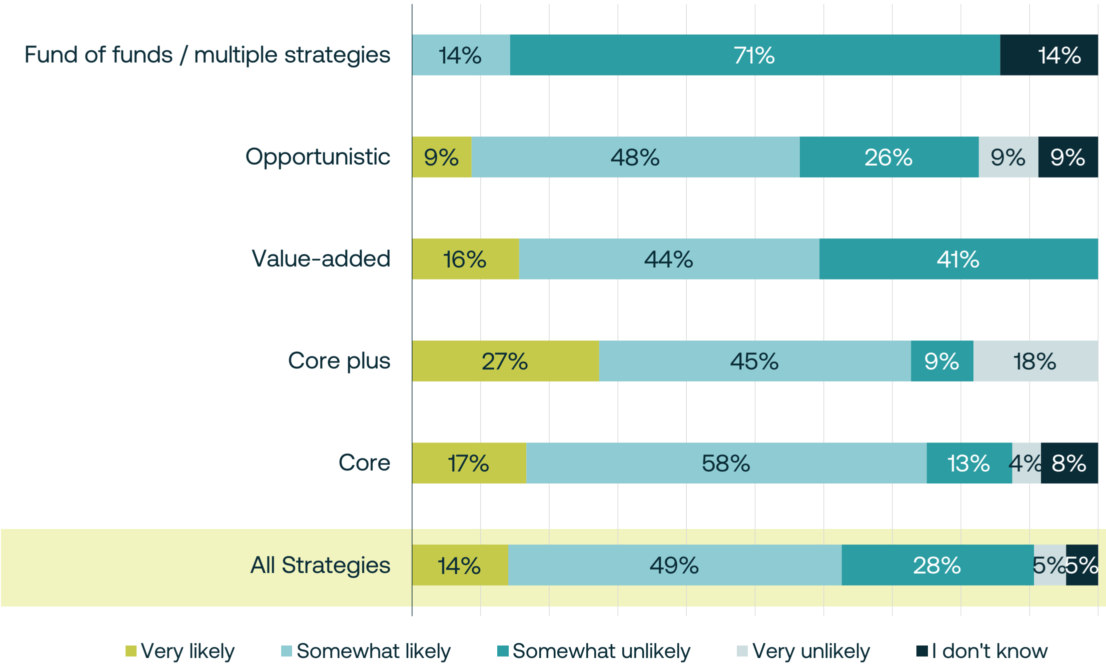
What are typical ranges for the returns you are seeing across the current market for new funds?



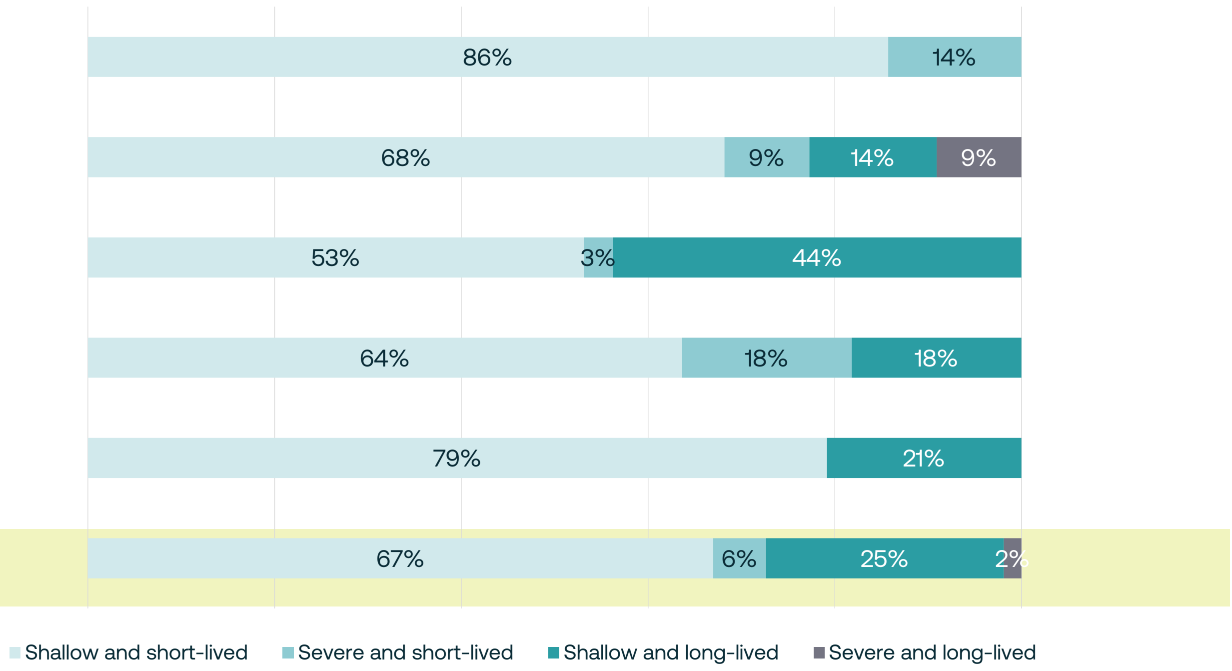
Recession expectations

Majorities less confident a recession coming within the next 6 months. Across investment strategies, a consensus regarding a near-term recession persists, but fewer are certain about it's likelihood. A majority (63%) of respondents expect a recession to be likely (either "very likely" or "somewhat likely") in the next 6 months, down 15 percentage points from the 78% who stated the same in 4Q 2023. While there was a variance in responses across different investment strategies, those in the "likely" camp remained the majority for all but funds or firms with multiple strategies, which are confident a recession is "somewhat unlikely" within the next six months. Most responses also indicated expectations for the next recession to be "shallow", with more than 92% of respondents indicating the next recession to be shallow as opposed to "severe", up slightly from 88% in 4Q 2023.

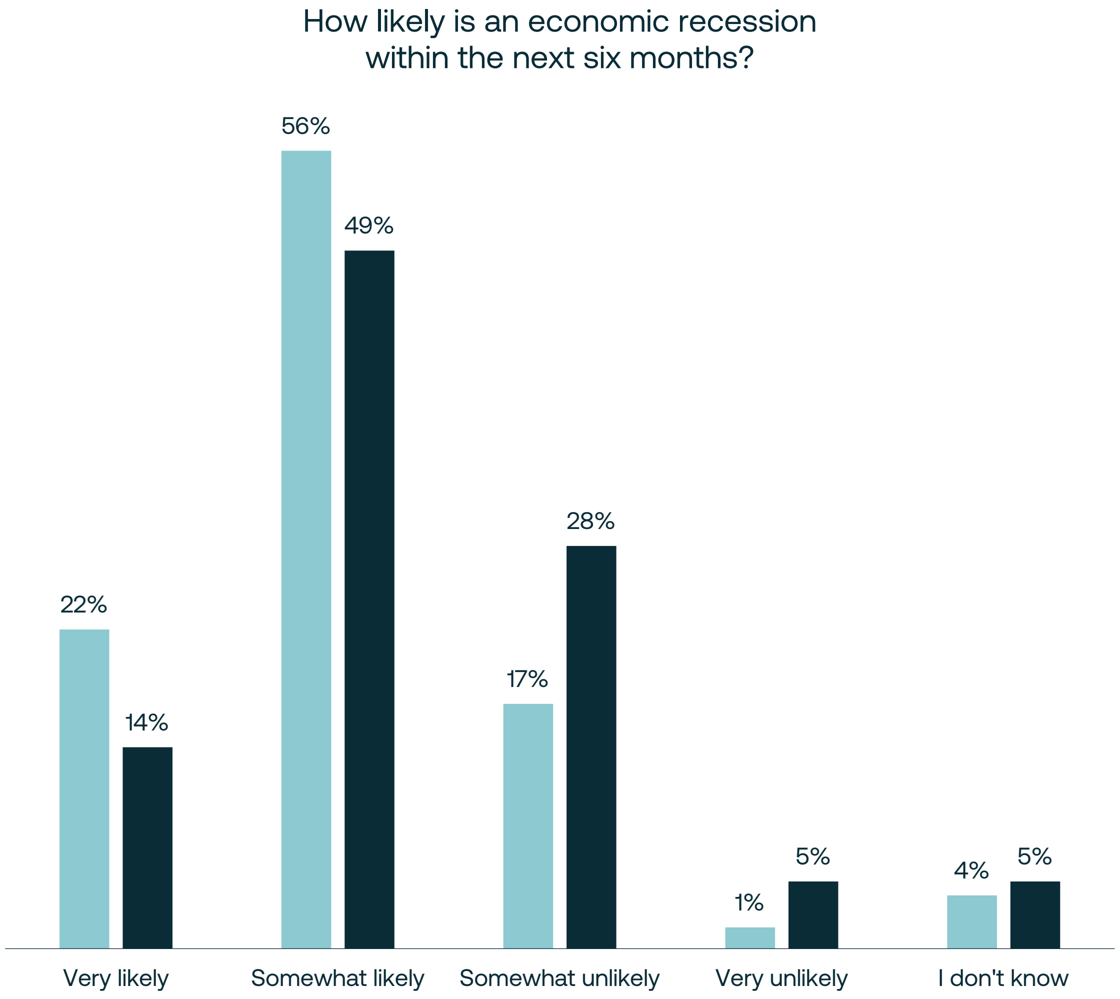
How likely is an economic recession within the next six months?

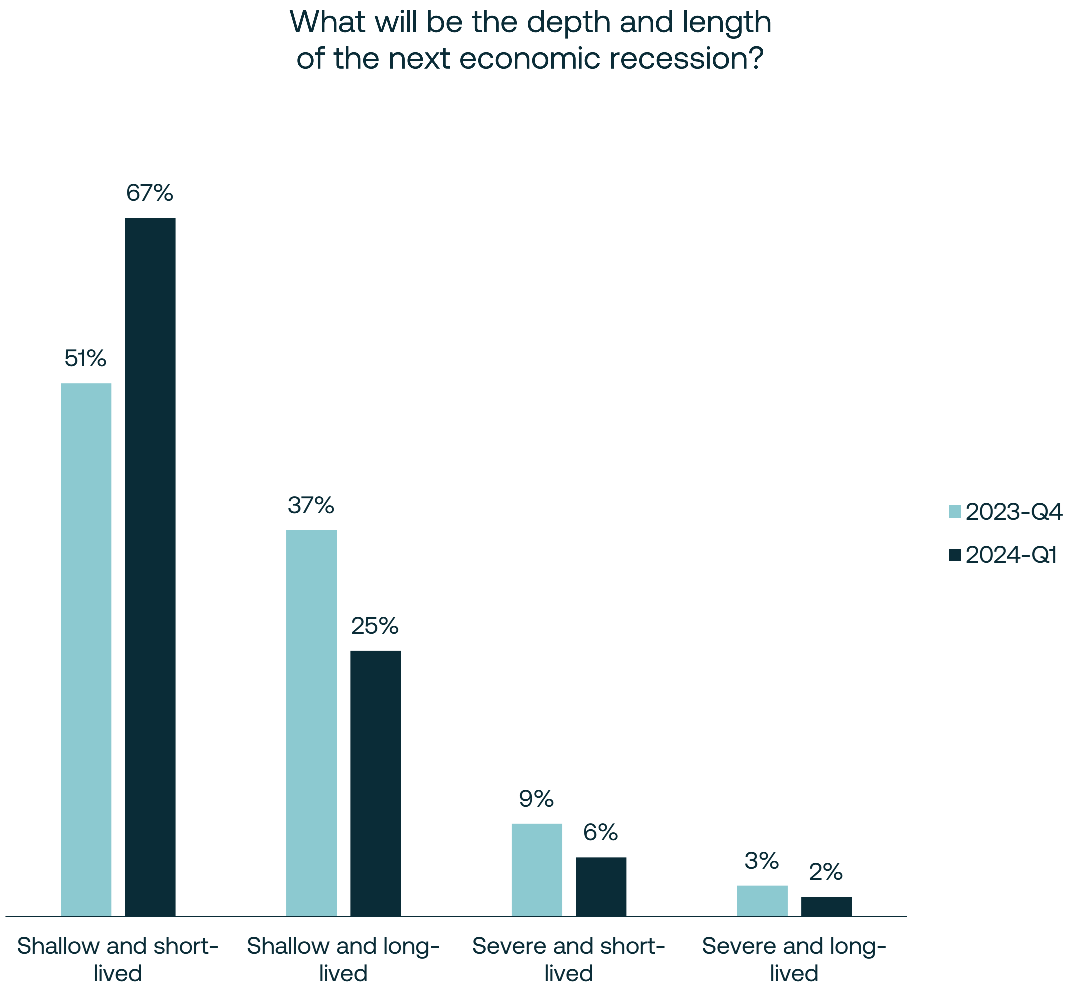


What will be the depth and length of the next economic recession?



Recession expectations

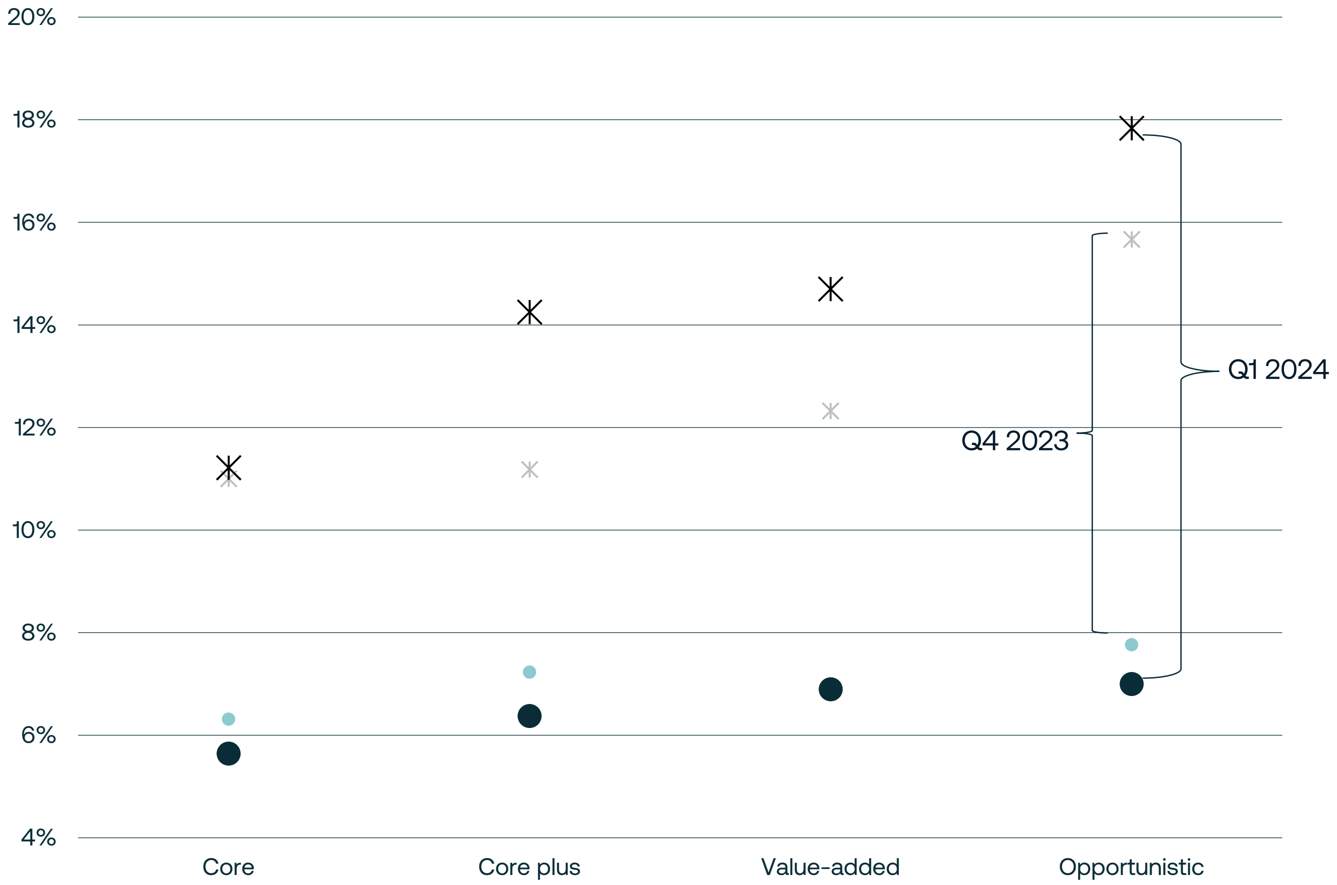




Cost of capital expectations

Expectations for lower cost of capital lifts equity return profile across strategies. Respondents' 12-month forward view of all-in, fixed-rate financing remained range bound between 5.6-7.0%, across the main portfolio strategies, shifted down by 60 bps on average across all strategies from the prior quarter. Expectations of lower debt financing costs over the next year was accompanied by an increase in net returns to equity (net levered IRRs), which across all strategies increased by 200 bps on average compared to the prior quarter. The biggest shifts were seen in the Core-Plus and Opportunistic strategies, where all-in, fixed rate interest costs fell 90 bps and 80 bps, respectively, compared to the prior quarter. Anticipated net IRRs for Core-Plus and Opportunistic strategies increased by 310 bps and 220 bps, respectively, compared to the prior quarter.

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



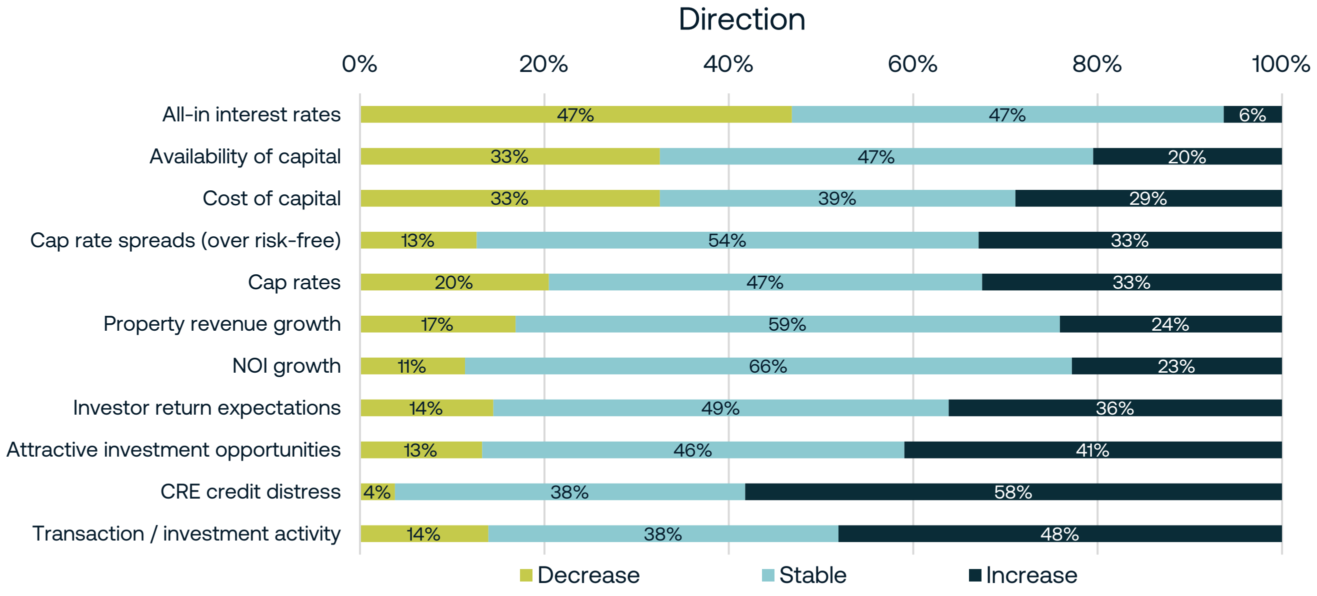
What changes do you anticipate to the following key metrics over the next 12 months?

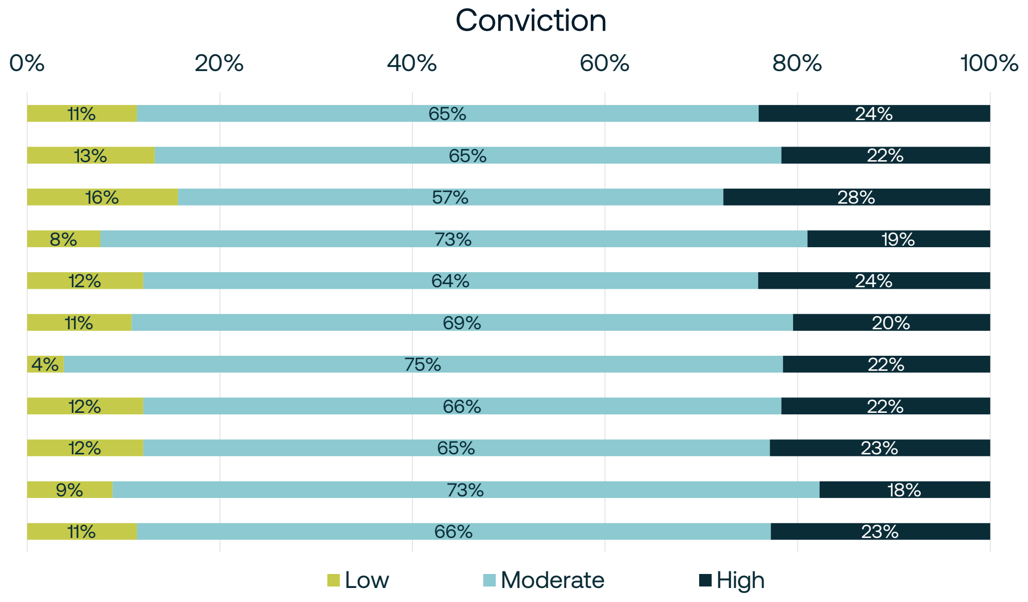
Major expectation shift to stable or decreasing interest rate environment. Respondents indicated that in aggregate they expect interest rates to remain stable (47%) or decrease (47%), with only 6% anticipating an increase over the next 12 months. Compared to the prior quarter, those expecting a decrease in interest rates over the next 12 months jumped by 28 percentage points in the current quarter. Expectations for the availability of capital also improved, with those reporting "decrease" falling by 19 percentage points in the prior quarter to 33%. While the directional change for cost of capital over the next year is split across increase (29%), decrease (33%), and stable (39%) – the metric received the highest conviction (28%) of all questions.

The outlook for cap rates also improved, stabilizing from prior quarter. A third (33%) of respondents expect cap rates and cap rate spreads to increase over the next 12 months, perhaps not a positive outlook, but compared to the prior quarter, the percentage of respondents anticipating increases fell by 32 and 22 percentage points, respectively.

Canadian CRE cash flows expected to moderate. The majority of participants still expect revenue and NOI growth to be stable (59% and 66%, respectively) over the next 12 months. Compared to the prior quarter, this was a modest improvement, as the percentage of respondents anticipating revenue and NOI growth to "decrease" fell by 4 and 14 percentage points, respectively.

Distress still anticipated, though investor expectations steady. 58% of respondents expect CRE distress to increase over the next 12 months, down 20 percentage points from the prior quarter, with only 18% of participants noting high conviction in their directional call – a 22 percentage point drop from Q4 2023. Despite expected increase in distress, 48% of participants expect investment transaction activity to pick up in the coming year, up 19 percentage points from the prior quarter.





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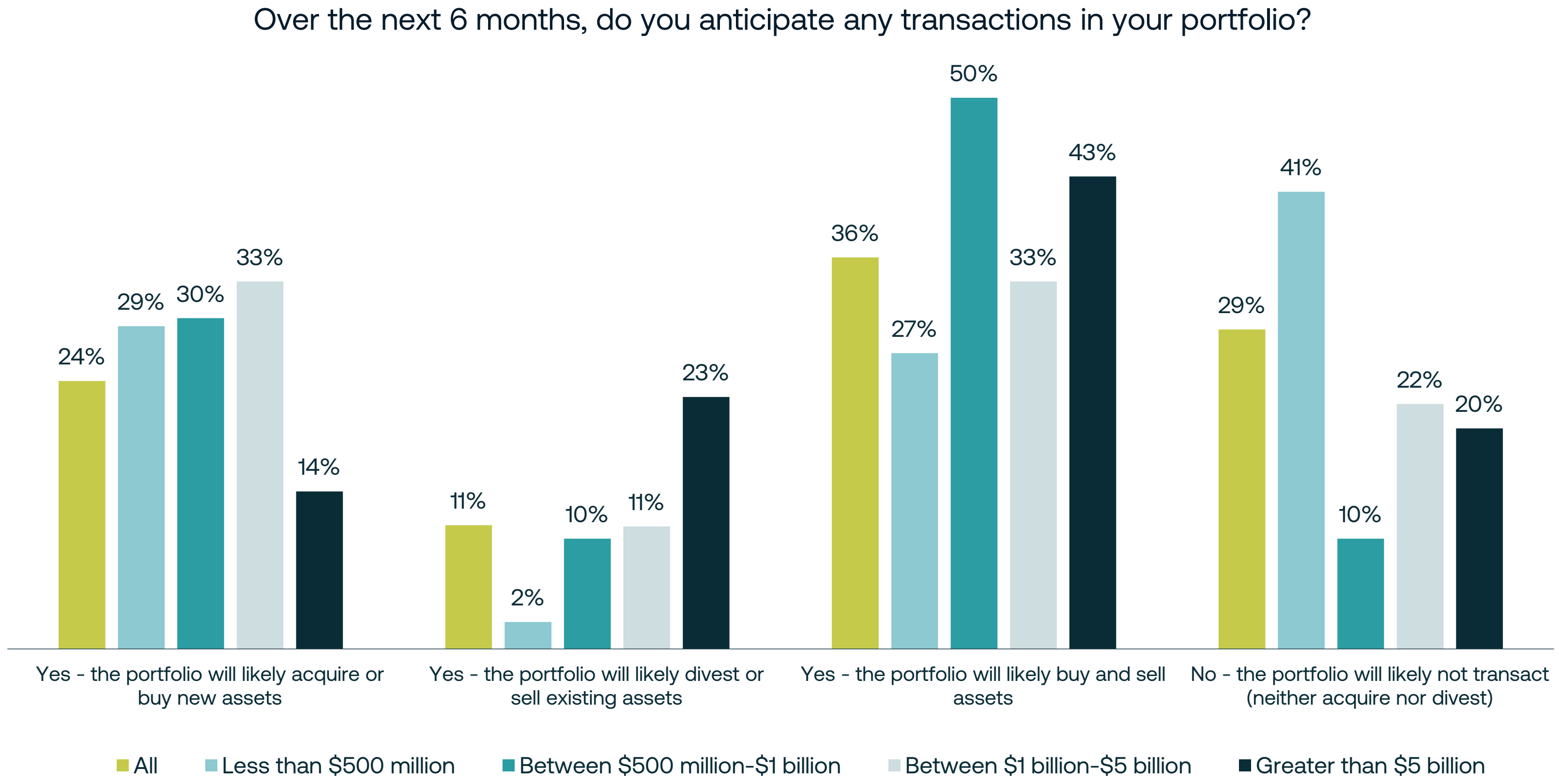
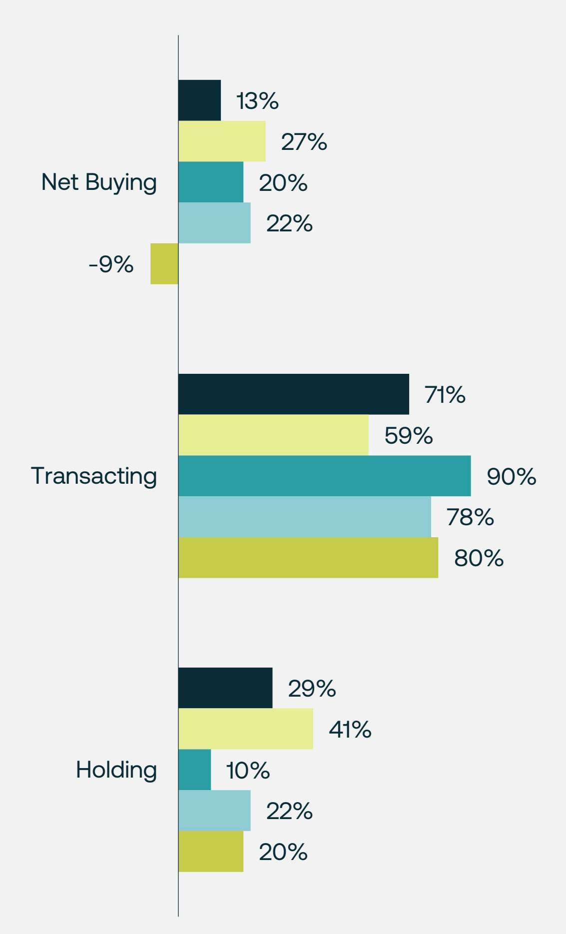
Transactions intentions over next 6 months

Mid-sized firms drive anticipated transaction activity up over prior quarter. Responses indicate that the majority (71%) plan to transact (either buy, sell, or both) over then next 6 months, up from 67% in the prior quarter. Mid-sized, those with CRE exposure between $500 million-$1 billion and those with between $1 billion-$5 billion, drove the quarter on quarter increase in anticipated transactions – each of these firm sizes increasing their transaction intentions by 26 and 13 percentage points, respectively. While nearly a third (29%) of the respondents indicated no intentions to transact in the near-term ("holding"), this percentage dropped 3 percentage points from the prior quarter.





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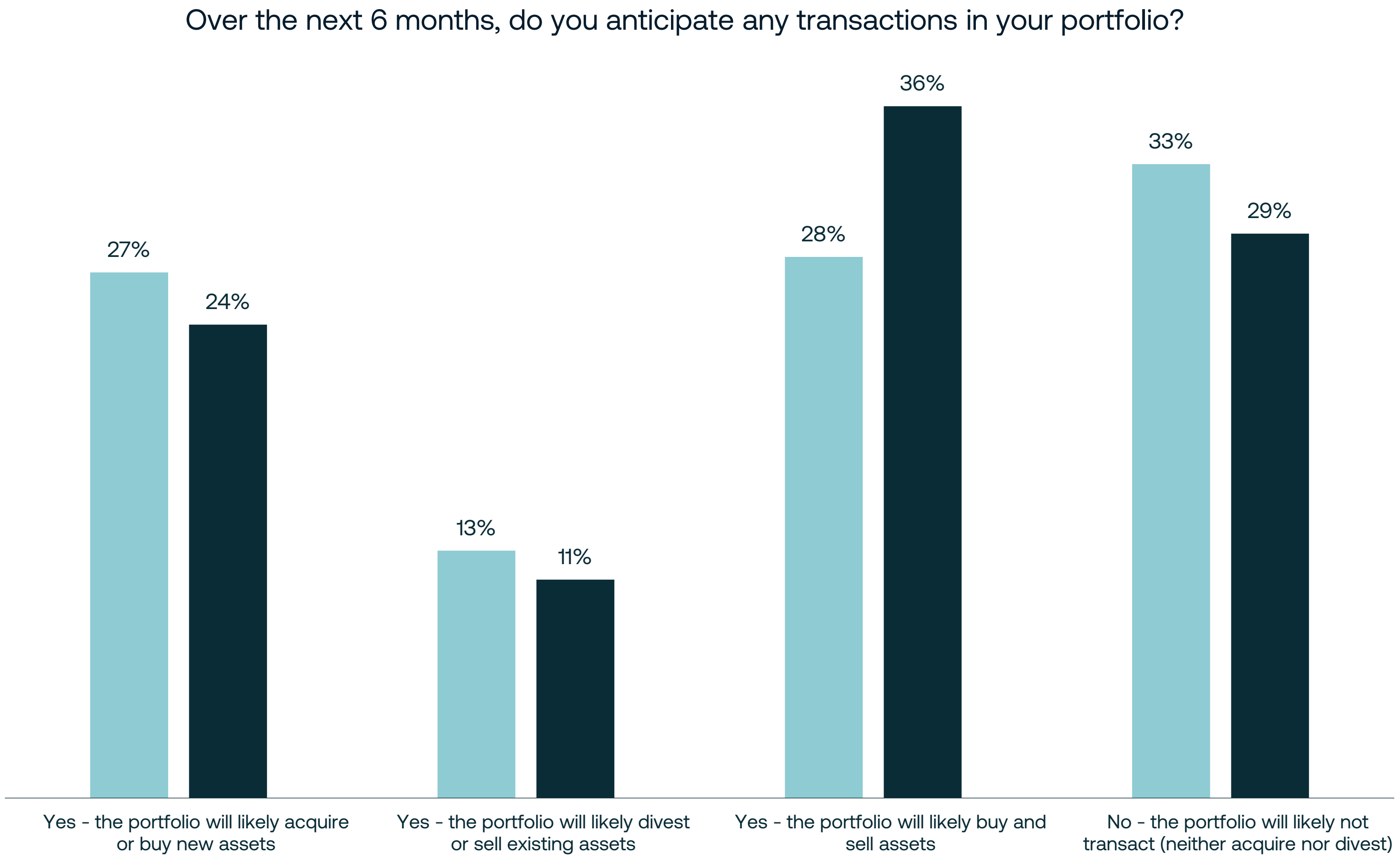
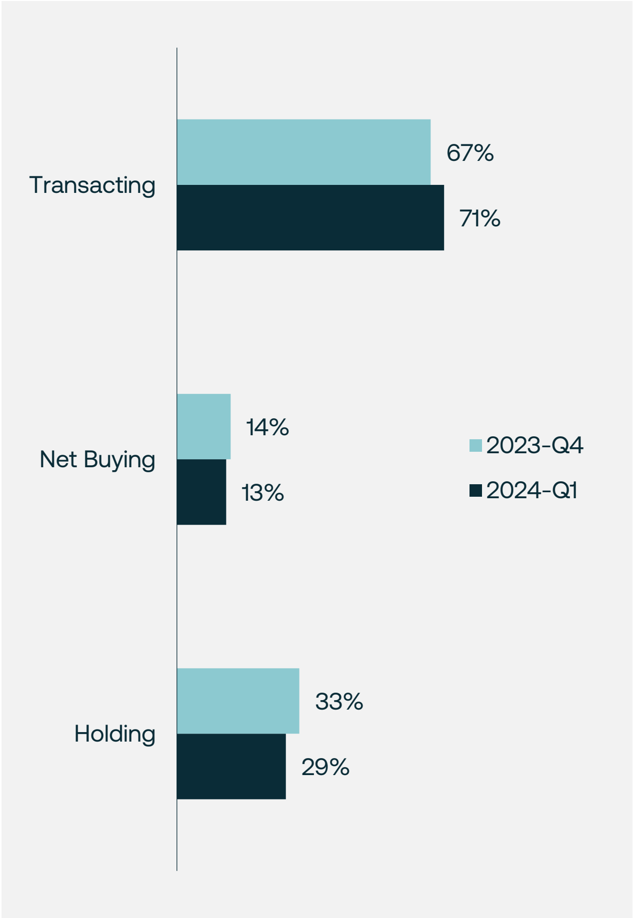
Transaction intentions over next 6 months





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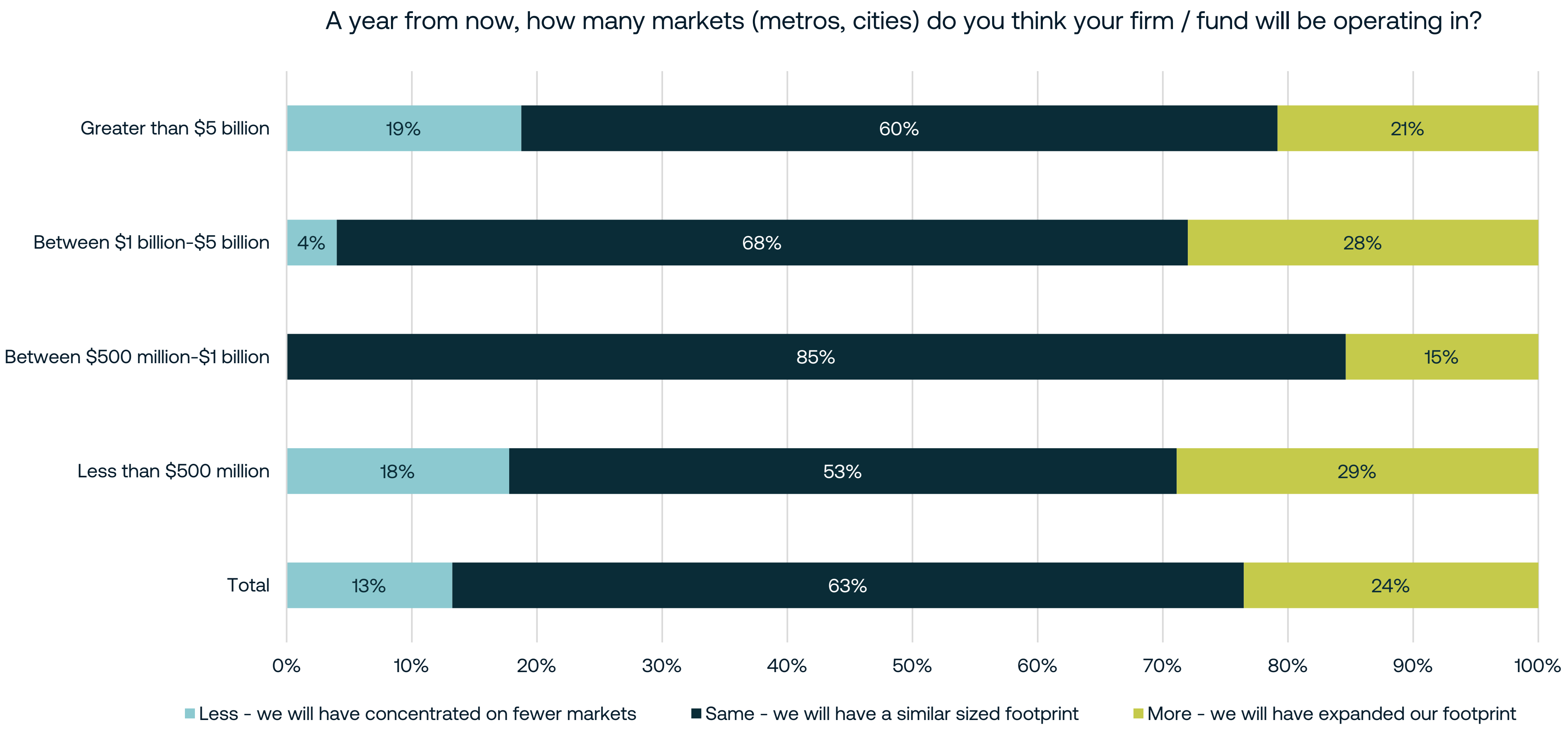
Geographic footprint expectations



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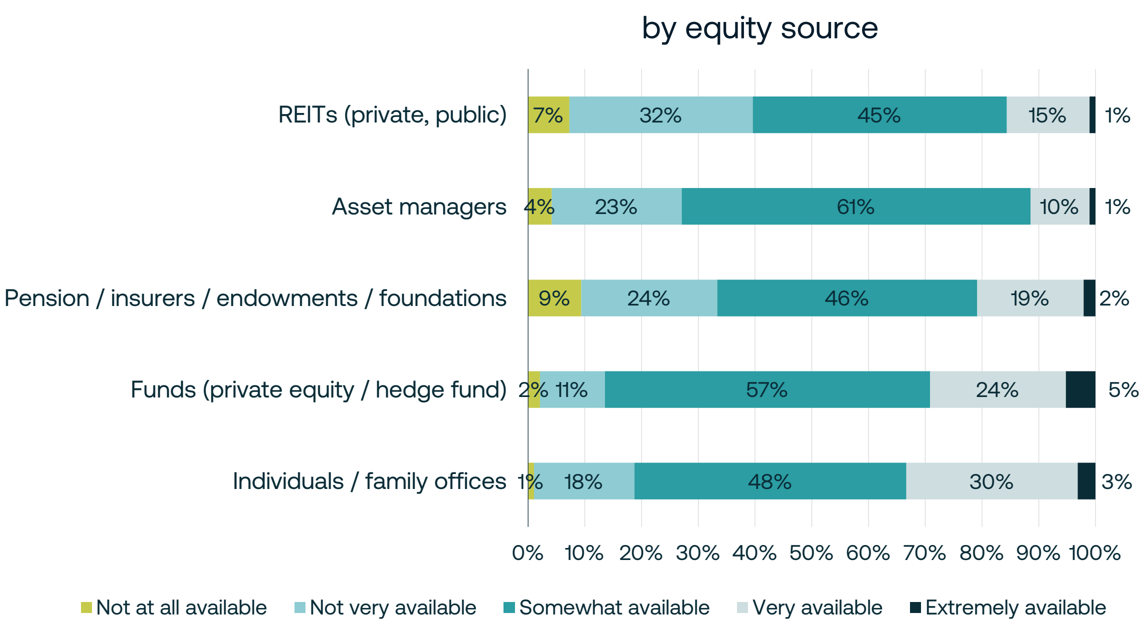
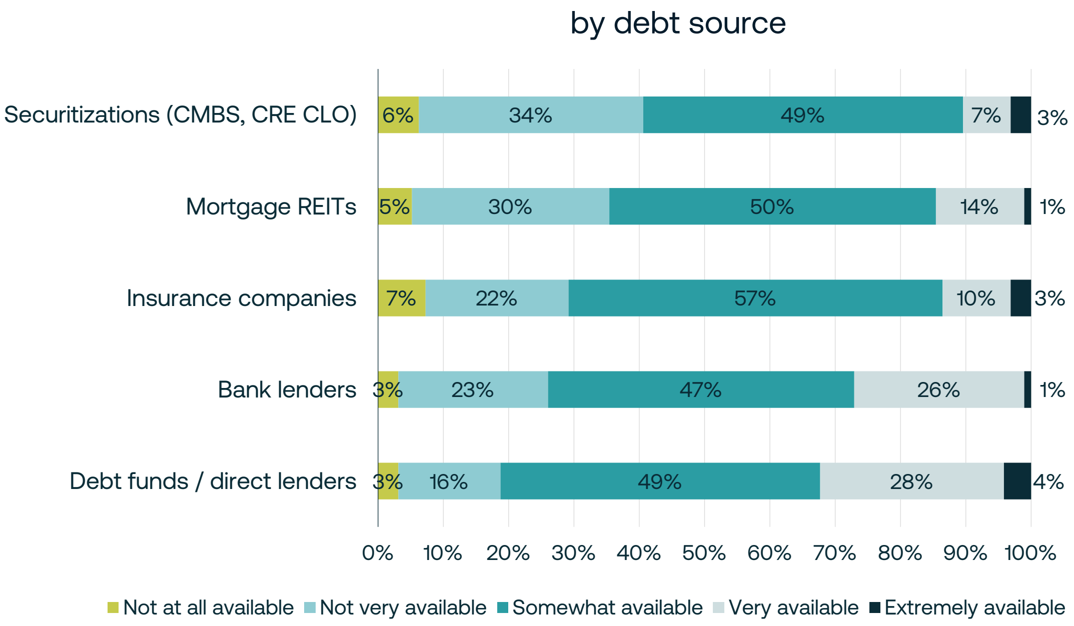
Capital availability

Net expectations for capital availability up for all sources except banks. While the overall expectation is that capital availability will be low over the next 12 months, responses suggest that 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”) have broadly improved since 4Q 2023. For sources of equity capital, survey participants indicated that they collectively expect the least amount of capital availability from REITs and asset managers – with net expectations of -24% and -16% respectively, a notable improvement from -39% and -24% in 4Q 2023. Meanwhile participants expect greater availability of equity capital from individuals / family offices and PE / hedge funds. Responses indicated expectations for securitizations, mortgage REITs, and insurers are heavily constrained, with net expectations of -30%, -21%, and -16% respectively. Canadian CRE professionals expect debt funds and banks to have the greatest amount of capital availability over the next year, with 32% and 27% of responses expecting availability to be either “extremely” or “very” available – little change from the prior quarter. Expectations for Canadian bank capital availability is still 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?





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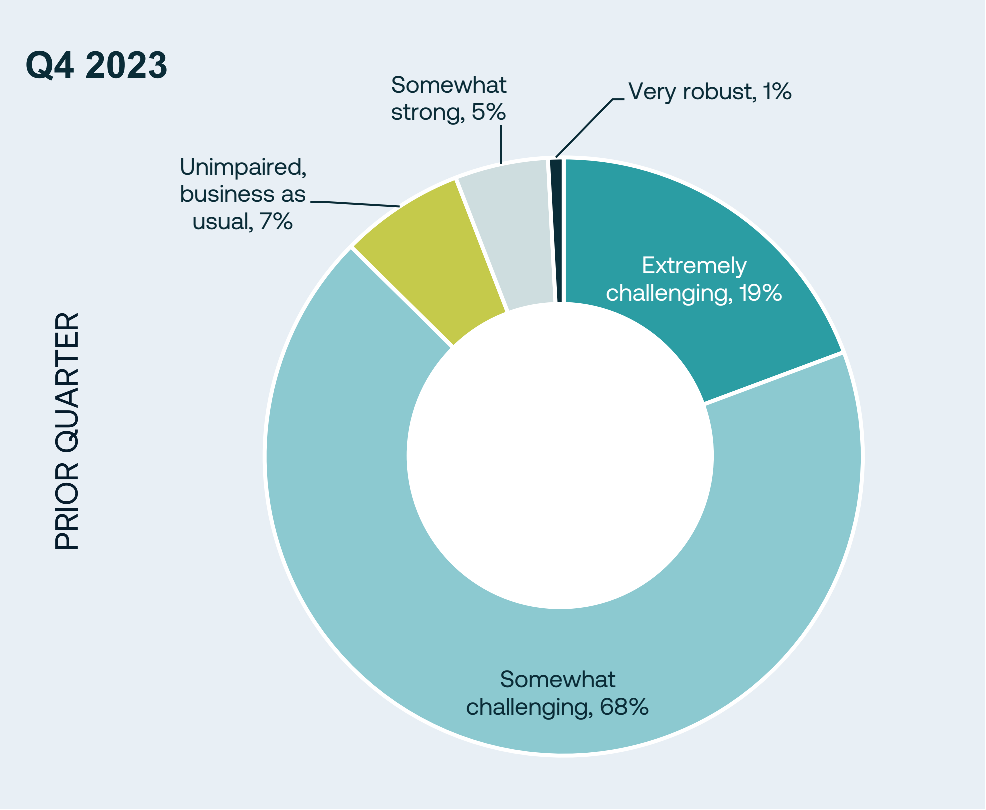
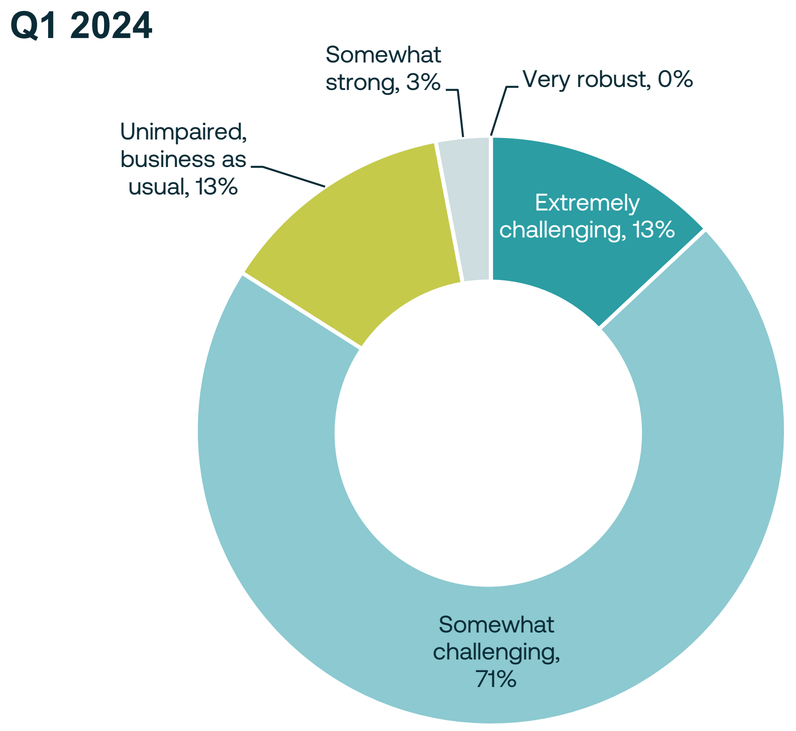
Expected operating environment

Challenging environment anticipated, though outlooks still divergent. A total of 84% of respondents anticipate the next 12 months to be difficult (combined "somewhat" and "extremely" challenging responses), slightly down from 87% in the prior quarter. However, the percentage of respondents who expect the operating environment to be "extremely challenging" ticked down to 13% from 19% in the prior quarter. More respondents expect business in the next year to be "unimpaired" – as those who described the expected operating environment as "business as usual" accounted for 13% in 1Q 2024 vs 7% in 4Q 2023. No respondents indicated that they expect the operating environment to be "very robust" over the same period, though 3% stated they expected it to be "somewhat strong", down from 5% in Q4 2023.

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





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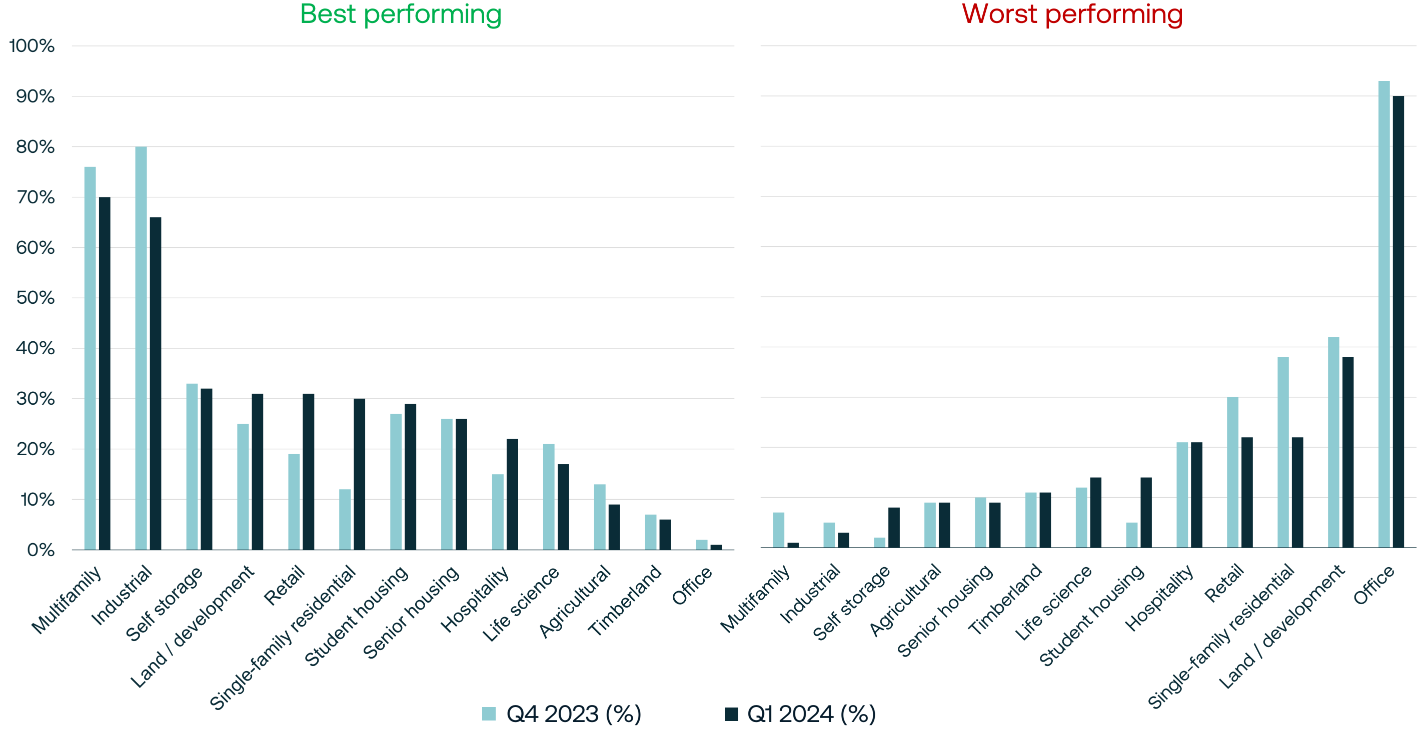
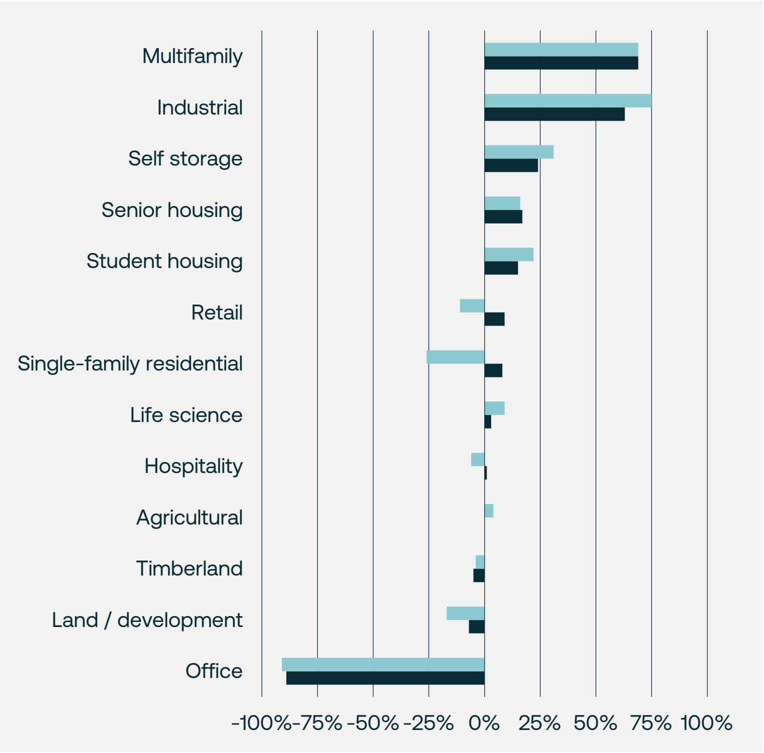
Expectations for property type performance

Industrial, multifamily still most favored; single-family residential and retail surge. 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 toward either office and multifamily changed little change from the prior quarter, though net positive sentiment toward the industrial sector declined from +75% in 4Q 2023 to +63% in 1Q 2024. Net expectations for single-family housing surged 34 percentage points, from -26% to +8%, as the housing crisis continues to grip Canada. Retail similarly jumped, with net sentiment rising 20 percentage points from -11% to +9%.

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





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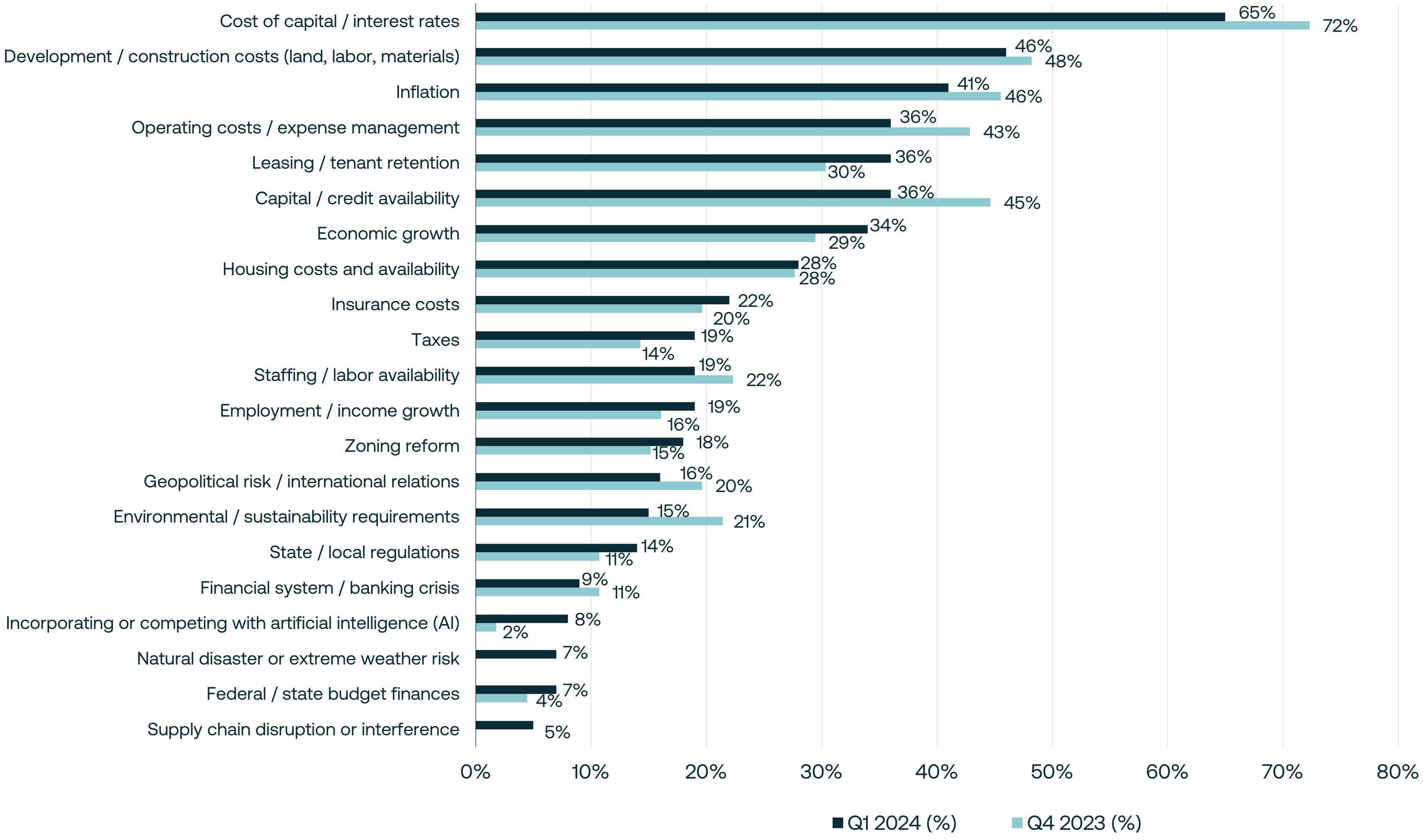
Priority issues over the next 12 months

Capital concerns ease, cost concerns still top of mind. Cost of capital, development costs, and inflation topped the list of expected priorities over the next 12 months for the third consecutive quarter. Still, the percentage of respondents citing each declined slightly from the prior quarter. Property-specific concerns such as operating costs/ expense management and tenant retention rounded out the top five near-term priorities as a result of capital availability concerns experiencing a notable drop in 1Q 2024 – from 45% to 36%. Leasing/ tenant retention was the only concern among the top five that increased between 4Q 2023 and 1Q 2024, with the percentage of respondents citing this concern jumping from 30% to 36%. (Note: “Supply chain disruption or interference” and “Natural disaster or extreme weather risk” were added to the 1Q 2024 survey, so a comparison to the prior quarter’s results was not possible.)

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



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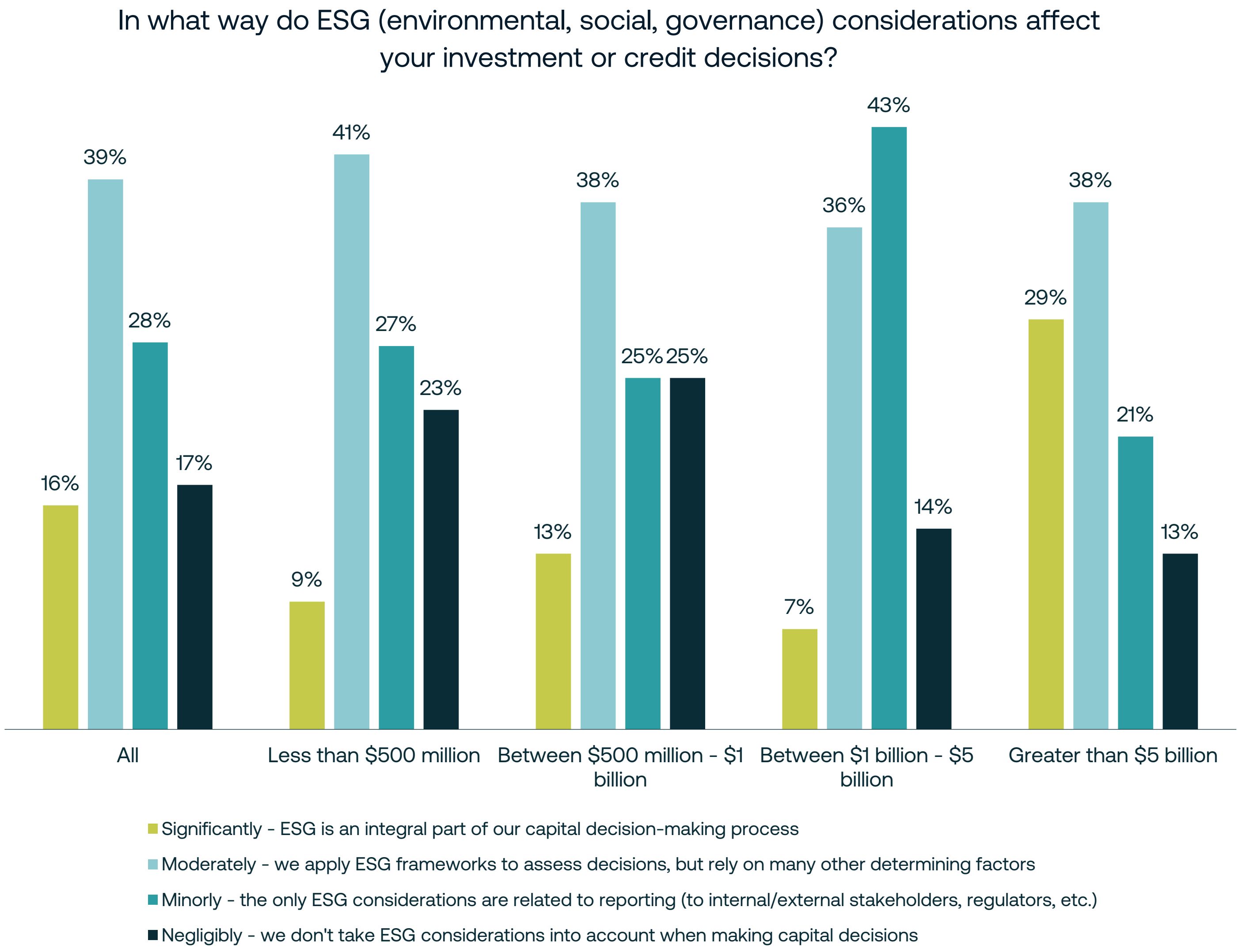
ESG considerations in capital decisions

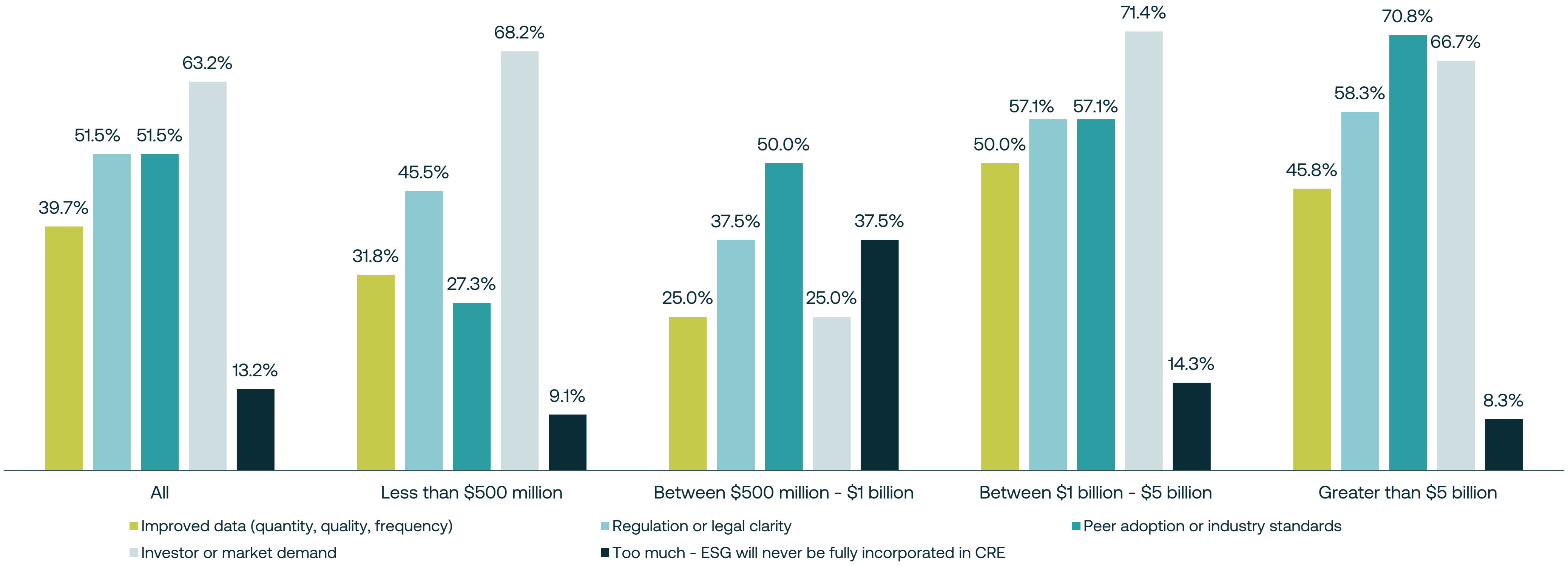
Moderate consideration given to ESG when making capital decisions. A new question to the survey in Q1 2024, nearly two-fifths (39%) of respondents noted that they factor ESG considerations into their capital decision-making process "moderately", applying ESG frameworks. Respondents from larger institutions, those with greater than $5 billion (CAD) in CRE under management, showed the most ESG consideration, with more than two-thirds (67%) saying that ESG considerations either "significantly" or "moderately" affect their capital decisions.



Drivers of ESG adoption

ESG in need of investor or market demand. Nearly two in three Canadian respondents (63.2%) believe ESG needs “investor or market demand” for it to be more widely considered and incorporated by the CRE industry. More than half of the respondents noted “peer adoption or industry standards” and “regulation or legal clarity” as the next top responses, both with 51.5% of responses. Overall, the Canadian respondents seem to have higher confidence in ESG being adopted into the CRE industry than their US counterparts – as Canadian responses were higher across all options, with the exception of “too much – ESG will never be fully incorporated into CRE” (Canada 13.2% vs US 21.8%).

What do you think it would take for "ESG" to be more widely considered and incorporated by the CRE industry?



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