Top 10 Real INSIGHTS

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1. SIX CONSECUTIVE MONTHS OF GROWTH MEANS ECONOMY IS RUNNING AT 96% OF PRE-PANDEMIC CAPACITY

Second wave and widespread shutdowns indicate that growth will stall in the first part of 2021.

According to the Statistics Canada December report, the Canadian GDP grew by 0.4% in October. This was the sixth consecutive month of growth and it happened at a slightly higher rate than the 0.3% that economists projected.

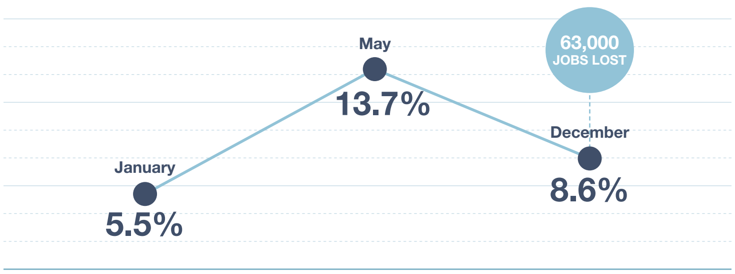
Third-quarter growth recorded 40.5% on an annualized basis. This was largely due to consumer spending which was uncorked when lockdown measures were rolled back between July and September.

When the pandemic dust settles, GDP will have declined by an estimated 5.7% in 2020.

A recent CIBC Capital Markets report stated that businesses and households are sitting on more than $170 B in excess cash, which will eventually help to propel the economy forward in 2021.

Statistics Canada December employment figures record a drop of 63,000 jobs, the first decrease in jobs since April, bringing the unemployment rate up to 8.6%. In May, unemployment in Canada hit its zenith for the year at 13.7%. The country has now regained 80% of the jobs that were lost during the pandemic. The unemployment rate in January 2020 was 5.5%.

2020 Unemployment Rate



These numbers were propped by several government support programs that will likely run their course in 2021.

In addition, the second wave of coronavirus, recording triple the number of new cases on a daily basis than what was seen during the first wave this past spring, is hampering the economic outlook for the near term. As different parts of the country head into lockdown at the end of December, the economy will lose steam as the year winds down and into the first part of 2021.

There will be very little growth in the first quarter of 2021, warns the Bank of Canada Governor Tiff Macklem, and the economy could actually contract in the first quarter. Economists are bracing for another tough few months.

To keep the wheels of the economy turning, the Bank of Canada has committed to keeping the lending rates at 0.25% into 2023 and will continue with its quantitative easing program.

In a November 30th fiscal update, a stimulus plan of $100 B was promised by Finance Minister Chrystia Freeland. The government will not give out any details of the plan until it releases its 2021 budget.

It is widely expected that the incoming Biden administration will help normalize trade relations. Biden is said to be in favour of the United States-Mexico-Canada Agreement (USMCA). He has also pledged to re-enter the Paris Climate Agreement and take a firmer stance on greenhouse gas emissions. This could put the US portion of the Keystone XL pipeline in jeopardy.

Biden's more open stance on immigration could mean competition for Canada. Biden intends to lift the temporary suspension of H-1B visas which have been used by the tech industry to fast-track recruiting efforts.

The effectiveness of the Biden administration, however, will ultimately be affected by the outcome of the January run-off elections in Georgia.

2. LENDERS PROCEED WITH CAUTION

Lending Activity is ramping up in bid to place accrued dry power.

In its 2020 Canadian Real Estate Lenders' Report, CBRE stated that there is always a higher level of risk associated with lending in an economic downturn. The respondents of this year's survey indicated that they will be "taking a more cautious approach into 2021."

These are some key observations from this CBRE's Lender's Report which surveyed 35 companies with over $200 B of loans under management:

Nearly all lenders reported that COVID-19 has impacted their firm's underwriting processes, with the majority putting an increased focus on tenant sponsorship as well as completing detailed due diligence reviews. Also, 40.0% of respondents started to apply stricter net operating income (NOI) thresholds.

Most of the lenders surveyed stated that lending will return to pre-COVID-19 levels in one to two years but in the interim, they will be watching the Canadian unemployment rate, COVID-19 vaccine development and COVID-19 cases as key concerns that will impact their lending decisions. The majority of respondents placed more weight on domestic issues rather than global ones.

Going forward into 2021, capital will remain abundant. Most lenders said that their plan was to maintain their existing real estate lending allocations while 40% said that they were planning to increase their portfolios.

However, lenders will be more targeted in their placement of funds. While 51.4% stated that they will be either 'very actively' or 'actively' bidding on deals over the next six months, 42.9% said that they were 'cautiously bidding'.

"As part of their cautious approach in this economic environment, lenders have altered their real estate strategies with most respondents applying tighter lending discipline as well as improved property type selection in their underwriting. However, an important note is that this pandemic has not forced many lenders to wholly exit secondary markets, refuse new borrowers or outright reduce their real estate lending loan books."

Unsurprisingly, lenders ranked the GTA, Vancouver, Montreal and Ottawa-Gatineau as the top four destinations for their capital. Lenders responded that they would continue to do business in Calgary and Edmonton on a 'Deal-Specific' or 'Relationship-Specific' basis.

Alternative asset classes are garnering more interest among lenders, with student housing and data centres attracting the most attention.

Although every asset class was impacted by the pandemic and the ensuing shift in consumer behaviour, some assets classes have taken a harder hit. The three property types that are the most concerning to lenders are hotels, regional malls in secondary markets and retail, specifically in the entertainment & food services sector.

- Hotels – 77% of lenders expressed concern, up 51.1% from 2019.
- Regional Malls (Secondary Markets) – 74% of lenders expressed concern, up 15.6% from 2019.
- Office (B Class, Core) 64% of lenders expressed concern, up 43.3% from 2019.

Nearly half of lenders are looking to reduce their 2021 lending budgets for retail, 34.3% for office and 28.6% for hotel properties. But even in light of the adversities seen with these property types, a significant number of lenders are still looking to maintain, or even increase, their budgets for these properties.

Most lenders believe that turmoil in the hotel sector is temporary and will bounce back once borders reopen. However, lenders believe that there is a permanent structural shift at play, with 42.9% saying that this will affect the office sector, and 82.9% saying that this will affect retail.

Historically, lenders had very few concerns with the office asset class and were generally favourable to financing office loans. With present-day uncertainties regarding the future of the workplace, lenders have not reached a consensus on whether they believe this is temporary turmoil that will fade or a structural shift.

Despite these uncertainties, 60.0% of lenders are expecting their office lending decisions to be moderately impacted and 25.8% expect a limited impact or none at all.

Lenders believe that loan delinquencies will peak within the next six to 12 months. Only 8.6% said that delinquencies would remain stable.

"2020 has been a highly disruptive year and the real estate lending market was no exception," said Carmin Di Fiore, Executive Vice President of CBRE's Debt and Structured Finance team. "Some property outlooks went unaffected while others are in flux and it may take some time before a new normal is established. However, lenders have belief in the overall prospects for real estate in Canada and remain committed to providing a liquid and sensibly capitalized financing environment going forward."

3. INVESTMENT LEVELS START TO IMPROVE AT THE CLOSE OF 2020

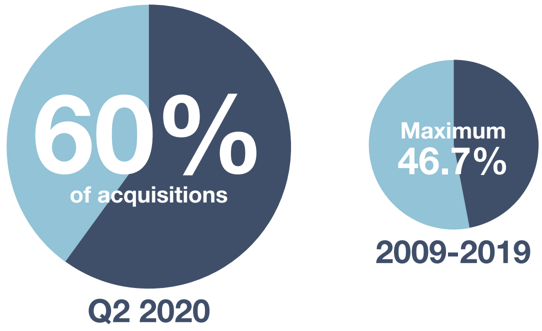
Low cost of capital and pent-up demand will serve to narrow bid-ask spreads.

According to Altus Group, national investment volumes totalled $8.8 M in Q3 2020, with 1,736 transactions recorded. Total national investment volume across the first three quarters of the year dropped 22% compared to the same period in 2019, with 5,106 transactions totalling $22.8 B in volume.

Multi-family investment volumes reached $1.8 B in Q3 2020, Altus Group reports. "The industrial sector has maintained its strong position across major markets throughout the first three quarters, as investors lean into development opportunities to meet rising demand for storage and distribution space amid low availability rates," the company stated.

Nationally, the most active purchasers in Q2 2020 were private Canadian Investors. This group accounted for almost 60% of acquisitions, as stated by CBRE. Over the last decade, participation by this investor group had never exceeded 46.7%, "illustrating how nimble and opportunistic well-funded private investors can be during times of crises," the company observed.

Private Canadian Investors



Of the investment environment, JLL noted, “Buyers and sellers have been far apart on pricing. Most sellers are well-capitalized and unwilling to sell in a downturn or to offer a ‘COVID-19 discount.’ The very logistics of touring assets has been a challenge and contributed to friction in the marketplace. The resulting lack of comparables makes it even more difficult for groups to assess and agree upon value.”

One of the largest office transactions of the year was the acquisition of The Landing in Vancouver, which was acquired by Allied REIT for $225 M. The eight storey Gastown property has 175,470 SF of office space and 27,115 SF of ground floor retail space.

This acquisition came on the heals of Allied REIT’s purchase of the World Trade Centre in Montreal for $276 M which occurred in Q1.

One of the largest sale transactions in Canada to occur during the pandemic this year was BentallGreenOak’s acquisition of 50% interest in Toronto’s Waterfront Innovation Centre from Menkes for $250 M, or $526 PSF. The 475,000 SF office and retail development adjacent to Sugar Beach is currently under construction and is scheduled for occupancy in 2021.

In the third quarter, InterRent REIT acquired five multifamily properties in southwestern Ontario consisting of a total of 723 units for $170.7 M.

In December, a private investor acquired 500 Duplex Avenue, a 330-unit apartment building at Yonge and Eglinton for almost $158 M.

On the first day of Q4, US-based Equinix REIT’s acquisition of Bell Canada’s Brampton Data Centre closed. Located at 30 Bramtree Court and 1895 Williams Parkway, this was one of 13 Bell Data Centres that Equinix bought for a total of $1.0 B.

In the largest multi-residential transaction in Canadian history, Starlight Investments and KingSett Capital acquired Northview REIT for $4.9 B. According to the news release, the transaction included approximately 10,900 multi-residential suites, 1.1 M SF of commercial real estate as well as 340 “execusuites.”

Concord Pacific acquired the St. Paul’s Hospital property located on Burrard Street for $1.0 B. The 6.6-acre site will be redeveloped into a multi-use community. Until the new hospital on Station Street is operational, St. Paul’s will continue to operate on the site for the next few years.

In December, student housing provider Blue Vista LLC of Chicago acquired 50 Gerrard Street, the 12-storey, 188-unit Campus Common residence next to Ryerson. The student housing complex which was built in 2007 was bought for almost $83 M. Blue Vista has plans to revitalize the property. In addition, the company is working on a three-building student residence complex in Kingston that will contain approximately 788 units with about 1,400 beds once complete.

4. NOT ALL ASSET CLASSES ARE WEATHERING THE PANDEMIC TO THE SAME DEGREE

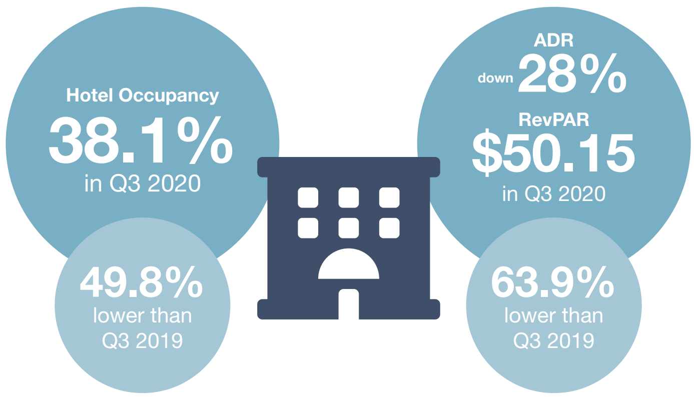
K-shaped recovery predicted for the different commercial property types.

The pandemic has had an imbalanced impact on different asset classes. Industrial and multi-family assets have faired well while other asset classes – hotel, some retail and to a lesser extent, and office products – have struggled.

Restrictions on non-essential travel and warnings to people not to travel outside of their areas has had a distressing impact on the hotel industry that has been hammered by the pandemic.

Hotel occupancy rates declined to as low as 2.5% during the pandemic. While travel picked up a little during the summer months after restrictions lifted, the latest round of shutdowns is having a devastating impact on the already battered industry.

According to hotel data company STR, hotel occupancy in Canada in the third quarter of this year was at 38.1%, down 49.8% from Q3 2019. The average daily rate (ADR) was down 28% and the revenue per available room (RevPAR) was $50.15, down 63.9% from Q3 2019.



The absolute occupancy level was the lowest for any third quarter recorded in STR’s Canada database, but was more than double the level from Q2 2020 (19.4%). The ADR level was the lowest for a Q3 since 2009.

British Columbia fared the best among the provinces, reporting the highest occupancy level (48.3%) in Q3, which was still down 41.5% year over year.

STR estimates that occupancy rates should improve by 60% in 2021 but will still be way off pre-pandemic levels.

According to Statistics Canada, Canadian retail sales were up 6.0% year-over-year over the three months ending October 2020. This was the best result since 2017, but it was not enough to offset the declines that occurred earlier in the year. In 2020, year-to-date retail sales are still down 2.5% compared to the previous year, and numbers are likely to improve only marginally by year end.

While many retailers scrambled to set up digital channels, during the pandemic, many did not invest in sufficient infrastructure to sell at the same levels as their in-store capabilities, Retail-Insider reports.

Dan Kelly, President and CEO of the Canadian Federation of Independent Business, warns that one-third of Ontario businesses will not survive the second lockdown.

Unless there are additional government support programs put into place, Diane Brisebois, President and CEO of the Retail Council of Canada, agrees. She says that the latest lockdown "will be the last nail in the coffin for many small retailers in Ontario."

National retail vacancy rose 100 bps to 4.1%, according to CBRE's mid-year survey of select retail REIT portfolios. This was one of the largest half-yearly increases on record. All retail formats have been impacted, with regional shopping centre vacancy increasing by 190 bps to 7.7%, the company reports.

Between March and the end of September, over 40 brands have announced the intention to shutter some or all their stores in Canada. These announcements amount to more than 1,100 stores that will close in the next year, with many experts speculating that there are more closures to come.

Retail-Insider reports that bankruptcies and store closures are expected to peak in early 2021 after the holiday retail season has ended.

In the third quarter of 2020, Altus Group reported that the national industrial vacancy rate was 4.3%, up only slightly from the 4.2% recorded in the previous quarter. "Although national industrial availability remains relatively stable compared to the previous quarter, growing demand has created a tight industrial market overall. The third quarter saw 29 industrial buildings completed nationally with an availability rate of 17%," stated the company.

Average national rental rates hit $10 PSF – a historic high. Toronto rental rates increased to $10.21 PSF, up a staggering 19.4% year-over-year, according to JLL.

Statistics Canada reports that online shopping by Canadians has doubled during COVID-19 and now constitutes 10% of all shopping by Canadians. In the US, Moody's Analytics estimates that the share of e-commerce spending relative to total retail sales increased from 11.4% at the end of 2019 to a historic 16.4% in March and April alone. This has fuelled an increase in demand for warehouse and distribution space across North America.

"As e-commerce gains traction and an increase in storage and distribution facilities are needed, the industrial asset class is expected to see growth in a tight market, requiring the construction of new facilities," CBRE stated in a recent report.

Supply chain disruptions experienced by some companies during the pandemic have also prompted them to keep more inventory on hand, leading to an increased need for storage space.

Frank Magliocco, PwC Canada Real Estate Leader, states that there is a in increase in 'reshoring' manufacturing facilities to protect supply chains that were made vulnerable during the pandemic.

This will continue to drive the development pipeline and push prices up as industrial land becomes scarce in Canada's major cities.

Overall demand for apartment units has been affected by the pandemic. Border closures have impacted immigration, international students travelling to Canada to study, and has caused former Airbnb units to return to the long term rental stock. Meanwhile the economic slowdown has reduced the number of new household formations, which, according to CMHC is a key driver of rental demand.

Across Canada, rental rates decreased by 9.1% in November year-over-year, as reported by Rentals.ca. Ben Myers of Bullpen Research and Consulting estimates that rental rates will continue to be soft for the first half of 2021, with rents bottoming out in February or March, but anticipates a 3.0% lift by the end of the year.

CHMC projects that 2020 will see 100,000 new apartments completions – both condo and rental – marking a 30-year high, and Meyers does not see development slowing down despite the decrease in rental rates.

Among investors, multi-residential buildings remain in high demand.

PwC and ULI's Emerging Trends in Real Estate 2021 survey showed that 61.4% of respondents favoured buying moderate income apartments.

Despite the current decline in apartment demand, the long-term outlook is positive.

According to Altus Group, the national office availability rate for all classes jumped to 12.6% in Q3 2020, up from 11.6% in the previous quarter, and 11.3% in the same quarter last year.

Office vacancy rates have continued to rise as work from home is projected to last through to 2021. Altus Group also reported that the national vacancy rate increased to 10.1% in Q3 2020, up from 9.6% in the previous quarter and 9.9% in Q3 2019.

Rents, however, ticked slightly higher in the third quarter. According to CBRE, Class A office net rents rose in Toronto to $35.90 PSF, up from $34.77 PSF one year ago, while on a national level, rents are up to $22.25 PSF from $21.93 PSF in the previous quarter.

The Q3 2020 Downtown Vancouver office vacancy rate rose by 130 bps from the previous quarter to 4.6% while Toronto's downtown office vacancy rate rose by 2% to 4.7%, CBRE reported.

According to Ray Wong, Vice President of Data Operations for Altus Group's Data Solutions division, there are discussions between office landlords and tenants about downsizing, renegotiating rents and even increasing space requirements to accommodate physical distancing.

The jury is still out regarding net effect of the pandemic on the office market. However, many major markets in Canada (aside from Alberta's whose office market woes are compounded by the collapse of oil prices) went into the pandemic with very tight office markets and will likely weather demand adjustments fairly well.

5. COVID-19 A TURNING POINT FOR ESG INVESTING

"COVID-19 is accelerating the trend of stakeholder capitalism and challenging shareholder primacy." – JPMorgan.

The 2020 Canadian Responsible Investment Trends Report reveals that responsible investment (RI) continues to grow rapidly in Canada. In the last two years, Responsible Investment assets under management have increased to $3.2 B, representing a growth of 48% within the period. Responsible Investment now represents 61.8% of Canada's investment industry, according to the survey which was conducted by the Responsible Investment Association in conjunction with NEI.

Sustainable investments – those focused on companies with strong ESG principles – outperformed their "conventional counterparts" when the market crashed in Q1 2020, CNBC reported.

Their resilience has a lot to do with the underlying principles of ESG-focused companies. "It's very simple, really – companies truly focused on the well-being of their workers and customers are able to make the right decisions more quickly in a major crisis like this one," John Hale, Morningstar's Director of Sustainability Research told CNBC.

Although sustainable investing has been around for decades, it has become a lot more popular in the last five years, according to Hale. This is the first major market downturn ESG funds have experienced.

One of the key factors of this resilience is that the energy sector is underweighted among ESG investment approaches. This helped mitigate losses associated with the collapse of oil prices and volatility across the energy sector, writes Margaret Childe, Head of ESG Canada for Manulife Investment Management.

While the Environmental component of ESG has been the focal ingredient in the past, the pandemic may shift some of that spotlight to the Social and Governance elements. Investors will scrutinize a company's response to the pandemic and their viability going forward, analysts say.

A survey conducted in 2020 on behalf of BNP Paribas Asset Management revealed that 23% of respondents said that ESG has become 'more of a focus/more important' as a result of the COVID-19 crisis. Although, the importance of all three ESG factors had increased since the beginning of the crisis, and 70% believe that the social element will become "extremely" or "very important" moving forward. The social issues considered important among those surveyed were labour standards (38%), excluding harmful investments (31%), human capital management (23%), gender equality (22%) and community involvement (11%).

A 2020 RBC Global Asset Management Responsible Investment Survey found that investors are looking for more company disclosures around "social" factors such as employee health care.

In fact, 53% of investors are looking for companies to disclose more details about worker safety, employee health benefits, workplace culture and other social factors due to the pandemic.

In November, eight Canadian pension funds representing $1.6 T in assets issued a joint plea for Canadian companies to improve their ESG disclosures. They have also committed to improving their own ESG disclosures.

"How companies identify and address issues such as diversity and inclusion, human capital, and climate change can significantly contribute to value creation or erosion," the joint statement said. "Companies have an obligation to disclose their key business risks and opportunities to financial markets and should provide financially relevant, comparable and decision-useful information."

The CEO of these pension funds cited how the ongoing impact of the coronavirus pandemic has highlighted social inequity, systemic racism, environmental threats and board effectiveness.

Having a good ESG profile is a significant focus for many investors, particularly on the institutional side, since reputational risks and other ESG considerations have a growing impact on property attractiveness and competitiveness, writes PwC in its Emerging Trends report.

6. DEBT FUNDS CONTINUE TO GAIN MARKET SHARE

Debt funds have become an increasingly important source of capital in the CRE lending world.

Debt funds are private pools of non-regulated capital that typically provide borrowers with short-term loans for construction, value-add projects, or other situations that require gap or bridge financing. Debt funds generally offer higher loan-to-value ratios, faster execution and more flexible terms than banks. However, borrowers pay upwards of 250 basis points more for debt fund capital.

In the first half of 2019, debt funds represented a larger share of the commercial mortgage markets than life insurance companies did, according to Real Capital Analytics.

A key contributor to the growth of debt funds is the amount of capital flowing into all commercial real estate over the past years. All types of investors were interested in allocating capital to real estate because of its stability and its growth prospects.

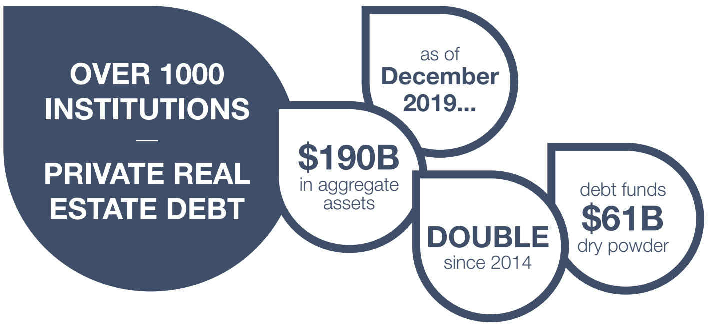
However, the pandemic and the ensuing lockdowns that temporarily sidelined all lenders, had a particular impact on the debt funds that relied on leverage, Joe Gose writes in Commercial Property Executive.

Some of the largest debt funds, including TPG Real Estate Finance Trust, Colony Credit Real Estate and Granite Point Mortgage Trust, had to sell assets to improve their liquidity positions.

"Many leveraged players saw their loans blow up and had to walk away from a lot of equity," said Gary Bechtel, CEO of US debt fund Red Oak Capital Group. "But the funds that didn't use leverage remain in the market and continue to raise and deploy capital."

Although debt funds make up a small percentage of the overall commercial real estate lending market, the space has attracted numerous players over the past few years. According to Bechtel, there was a peak of 360 debt funds in 2019.

Preqin reports that over 1,000 institutions currently allocate to private real estate debt, and as of December 2019, the industry stood at US $190 B in aggregate assets under management – doubling in size since 2014. In addition, debt funds had about US $61 B in dry powder at the end of last year.



At the end of Q3, Blackstone announced the final close of its most recent real estate debt fund, Blackstone Real Estate Debt Strategies IV ("BREDS IV"). BREDS IV has US $8 B of total capital commitments, making it the largest real estate credit fund ever raised.

Going forward, "debt fund managers with demonstrable experience in workouts, restructurings, the enforcement of remedies, and the creation of value will outperform," according to Craig Solomon, CEO of Square Mile Capital.

"The managers with the best infrastructure, a stable balance sheet, and a strong brand reputation are positioned for success to compete for what may be a smaller pool of institutional capital allocating to loan origination strategies, as lending strategy returns are weighed against returns available in distressed equity and other commercial real estate investment strategies," Solomon predicts.

7. LOW INTEREST RATES ARE NOT RESULTING IN INCREASED INVESTMENT IN CRE

Spreads have widened as lenders seek to price in risk.

As a result of COVID-19, the Bank of Canada lowered its key overnight interest rate to 0.25% in Q1 2020. This was a drop from 1.75% in Q4 2019 and is the lowest it has been since the 2009 GFC. The prime rate dropped 150 bps to 2.45%.

The decrease in the overnight and prime rates, and subsequent decrease in the 10-year Government of Canada bond yield, was offset by an increase in commercial mortgage spreads.

"Ten-year commercial mortgage spreads for Class A properties jumped from 170-180 basis points end of 2019 to 250-275 basis points at the end of June 2020, offsetting some of the drop in the GoCs during this period. Conversely, banks pushed the cost of funds higher in Q2 due to fear of liquidity insufficiency but kept spreads stable," JLL reported in their mid year Canadian Investment Outlook.

At the end of 2019, the 10-year Government of Canada bond yield was trading at 1.53%. One year later this same yield was posted at 0.675%.

The increase in commercial mortgage spreads is primarily to account for the elevated risk lenders are taking on during this period and the uncertainty related to future cash flows.

This uncertainty has resulted in reduced Loan-to-value levels and loan sizes.

In a survey of the lending community conducted by EY Canada's Transaction Real Estate professionals at the beginning of Q2 2020, respondents stated that commercial mortgage rate "floors" have been instituted for most five- and 10-year deals for both new and existing borrower clients.

However, EY noted that high-quality assets and well-capitalized institutional and private borrowers with meaningful track records are able to access commercial mortgage rates at similar levels offered pre-COVID-19, while respondents suggested that the increase in commercial mortgage spreads for the next tier of assets and borrowers would more than offset the decrease in base rates. As such, asset and borrower bifurcation has occurred within various Canadian and is likely to become more pronounced over the next 12 months.

This sentiment was echoed by CBRE's Carmen Di Fiore, Executive Vice President, Debt & Structured Finance.

"While credit spreads have come in during the last quarter, the range in cost of debt between best- and worst-in-class has widened materially," Di Fiore said.

Despite all time low lending rates, there has not been an increase in investment activity. In fact, 2020 overall investment levels will be down between 35% to 40%. One of the reasons besides market uncertainty is a gap between ask and bid rates. Purchasers who are looking for deals are finding that would-be sellers are not budging on price.

"In the US, the 10 Year US Treasury has averaged less than 1% every month since March 2020. Commercial mortgage rates have barely budged despite this sustained low level for the interest rate environment. In any normal period, low interest rates would be a positive sign for commercial real estate investment," Real Capital Analytics reports.

The US Capital Trends report, released at the end of Q3 by Real Capital Analytics, shows that these low rates have not inspired new acquisitions, with national sales activity down 68% year-over-year in August and down 36% for the year to date.

While interest rates have fallen, commercial mortgage rates have varied little, averaging 3.8% in the US since March. Potential buyers are scared to step up to higher prices especially with struggling tenants and unclear future income trends.

The spreads between commercial mortgage rates and the ten year US Treasury are not at record high levels seen following the Global Financial Crisis, but they are at the highest levels seen over the last five years, RCA observed.

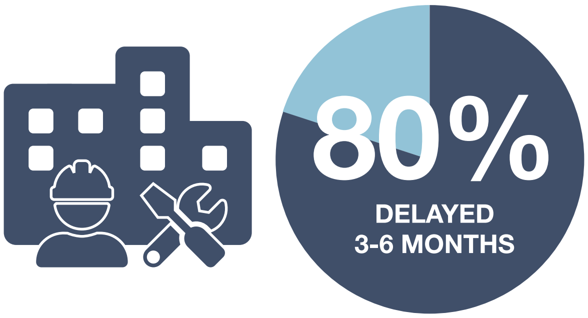
Things are similar in Canada. "Acquisition lending activity has slowed commensurate with a slowdown in overall investment activity. However, this has been offset by an increase in refinancing activity by borrowers looking to take advantage of lower mortgage loan rates," JLL reported in their mid-year Canada Investment Outlook.

8. CONSTRUCTION INDUSTRY CHALLENGED BY COVID-19

Pandemic a catalyst that has led to greater tech adoption within the industry.

In the early days of the COVID-19, many construction sites were shut down. Once they reopened, it was at a reduced capacity to ensure physical distancing could be maintained, delaying projects as a result.

In June, the Building Industry and Land Development Association (BILD) surveyed its members and found that 80% of all projects were delayed between three to six months.



Developers who finance their activities through construction loans, operate on tight schedules that allow them to access money through draws that occur at different milestones in the development process.

When projects stall, loans sometimes turn delinquent. Jim Fraser, Director of Commercial Real Estate Strategy at Built Technologies, which provides lenders with real-time data on their construction portfolios, said that over US $4 B of construction loans that they monitor were in areas across the US where construction was halted in early April.

According to Fraser, aside from subprime mortgages, the largest losses in the banking sector seen during the GFC were construction loans.

During the current crisis, after lending had resumed, institutions became more selective about the projects that they funded. LTV levels declined, as did the size of loans. There has been a reduction in conventional funds availability because of the pandemic, according to Jeremy Wedgbury, Senior Vice President, Commercial Mortgages at First National.

Developers had to look for alternative sources of capital to 'get them over the goal line'.

Delays in construction were compounded by cost increases. "Costs started going up materially about three years ago and inflation was very acute in areas such as window systems and concrete forming. At times, we saw inflation of 20% and even as high as 40%. From what we can see in the market now, and based on information we glean from cost consultants, costs are not rising at this rate, but they also aren't going down," Wedgbury shared at the Canadian Apartment Investment Conference in Q3.

In November, Procore Technologies, Inc., revealed the results of its inaugural "How We Build Now Canada" survey. It showed that despite the challenges created by the pandemic with regard to provincial shut downs and social distancing regulations, productivity on the whole is up. Ten percent reported being much more productive than before the pandemic struck; 17% are edging ahead of pre-pandemic levels, and 44% remain as productive during the pandemic. Still, 26% per cent were less productive than before the pandemic.

Physical distancing requirements has driven many construction contractors to implement technology tools they may have only considered prior to the pandemic.

As the crisis unfolded, the need to utilize cloud-based project management software, for instance became more critical. Many companies adopted this technology more quickly than anticipated in order to maximize safety for personnel and to ensure all stakeholders maintain visibility into project progress without the need to physically visit the site.

More rapid adoption of technology is likely to continue. According to PWC's Emerging Trends in Canadian Real Estate Report, construction tech is predicted to be the most impactful disruptor in 2021.

"Many interviewees believe that modular construction solutions that address labour shortages have reached the point where they make more sense from a cost perspective and are seeing greater adoption as a result," the report says, adding that construction companies are showing heightened interest in "digital twin technologies" that use sensor data to improve design and construction processes.

9. ALTERNATIVE LENDERS FILL THE LENDING GAP LEFT BY BANKS DURING THE PANDEMIC

Hunting for yield, global investors will raise more than US $16.5 B of debt capital in 2020 (PERE).

The rise of alternative lenders followed the GFC. Post-crisis regulations created additional restrictions on traditional lenders that limited the types of loans they could originate. Many private lenders stepped into this gap and began lending to commercial real estate investors and businesses.

Alternative Lending is also referred to as marketplace lending or Peer-2-Peer Lending and takes place through online platforms. These lenders use technology to connect borrowers who may be less served by traditional lending institutions with loan investors looking for yield-generating investments.

Technology has enabled nonbanks and alternative lenders to disrupt the mortgage process, transforming the application process, and digitize and automating both underwriting and closing processes. One of the biggest advantages of these lenders is the speed in which they can deliver funds.

During the pandemic, non-bank lenders across the globe increased activity in real estate markets to finance deals as traditional banks put a pause on their lending due to economic uncertainty, according to JLL.

Alternative lenders accounted for 34% of loan volume in Q3 2020, CBRE reported. These capital sources which did minimal lending in Q2, closed multifamily, retail bridge and construction deals during Q3 in the US.

"We see definite green shoots, and it's really continued since this report was issued," Brian Stoffers, Global President of Debt and Structured Finance for Capital Markets at CBRE told GlobeSt.com. "Now we're more than halfway through the fourth quarter. I think the positive momentum [from Q3] continues."

"Alternative lenders are looking to fill a gap that has widened dramatically during the economic crisis due to banks carefully managing their balance sheets and shifting to lower risk property deals with more certain cash flow profiles," says Matt Duncan, Head of Debt Advisory, JLL Australasia.

"Non-bank lenders are particularly relevant to investors with assets that are considered transitional, such as those with short-term income holes, refurbishment programs, or for developers with large-scale development projects that have few pre-sales," says Duncan. "These investors now have access to a wider variety of alternative and increasingly attractive finance products."

Alternative lender Equitable Group has seen steady loan volumes despite expecting a decrease. The increase was driven by fewer new originations by the big banks, said Darren Lorimer, Senior Vice-President for Commercial Lending.

Last July, alternative lender Cameron Stephens launched a $100 M private placement offering, in response to growing demand for private capital in the commercial mortgage space.

The offering was made available on DealSquare, an online private placement platform for dealers, investment advisors, investors, and capital raisers.

The Cameron Stephens High Yield Mortgage Trust (CSMT) will have a particular focus on the residential land, development, and construction sectors.

Trez Capital has closed the first round of financing on its $100 M fund to invest in debt that has been mispriced by the coronavirus pandemic.

"These are first mortgages, loans that are secure but, because of the current environment, offer higher yields than what we could earn pre-COVID-19," Daniel Marchand, senior vice president at Trez said. "Lenders have pulled back on their borrowing activities and this fund allows our investors to capture the additional spread."

10. LACK OF COMPARABLES A CHALLENGE FOR APPRAISERS

Appraisers need to add context to the numbers to get the full picture.

A stalled market resulted in a lack of investment transactions as well a halt in lending activity that continued through most of Q2 2020.

Despite there being plenty of equity sitting on the sidelines waiting for opportunities, buyers and sellers were far apart in pricing.

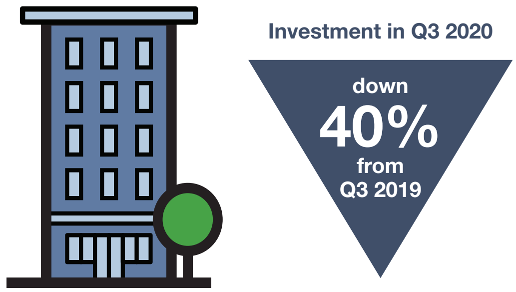
JLL noted, "Buyers and sellers have been far apart on pricing. Most sellers are well-capitalized and unwilling to sell in a downturn or to offer a 'COVID discount.'

In October, Moody's wrote, "we believe that the ongoing uncertainty fuels a bid-ask spread that remains wide." Potential commercial real estate buyers and sellers "have significant differences of opinion on future rents, occupancies, business prospects, and, ultimately, expectations of net cash flow going forward. Owners prefer to value properties on pre-COVID-19 performance with little consideration of current capital market conditions, while opportunistic buyers tend to take the opposite view."

With a lack of comparables, assigning a value to a property has become more challenging and the role of appraisers has become even more important.

Appraisers look for comparable sales to help them determine cap rates, IRRs, dollars per square feet etc. However, investment activity was put on hold for most of Q2 2020 as most sellers would not sell in a depressed market. "Why would you agree as a purchaser to a price when the next week it could be potentially lower," remarked Colin Johnston, President, Research, Valuation & Advisory at Altus Group.

Once market activities resumed, it was at a much slower pace. Investment in Q3 2020 was down about 40% from the same quarter in 2019.



Altus Group consistently reaches out to the industry for information to get updates on a variety of metrics through their "Key Assumptions Surveys," results of which were valuable especially throughout the pandemic. "Reaching out and gauging market sentiment is incredibly important for the appraisal industry, because ultimately when there's not a lot of market activity, market values are a reflection of the prevailing uncertainty and the collective perceptions in the marketplace," Johnston said.

Vacancy allowance, credit loss, downtime, lease-up timelines on vacant space, renewal probabilities and near-term market rental growth are being modelled more conservatively over the next 24 months.

Altus Group reported that some of their appraisal clients moved from quarterly appraisals to monthly appraisals because of the fluidity in the marketplace. "The numbers, particularly for appraisers, are always important, but now more importantly, so it the context behind them," stated Johnston.