Top 10 Real

INSIGHTS

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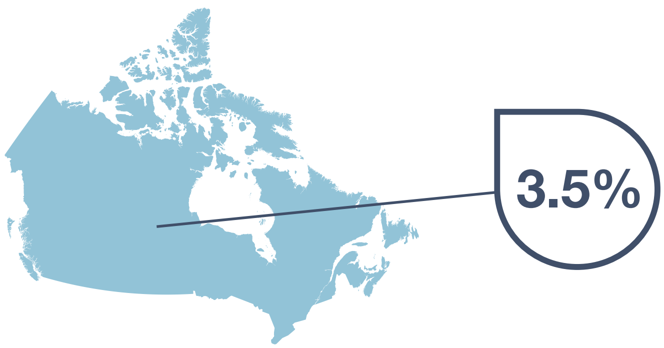
1. WHAT IS THE OUTLOOK FOR CANADA'S ECONOMY?

Despite rising inflation, supply chain issues and government deficits, the outlook for Canada's economy is not so grim.

The full impact of COVID-19 remains to be seen on Canada's economy. Because of high vaccination rates—75 percent of the adult population is completely vaccinated—public health measures are being loosened across the provinces. Despite this favourable position, the pandemic continues to have a negative impact on Canadian economic activity, which will last far into 2022. Cumulative government debt, particularly at the provincial level, is a long-term concern. Statistics Canada records a 21.2 percent increase in accumulated federal debt between September 2021 and October 2021, indicating projected increases with time unless there are drastic changes in the pandemic ridden economy.

Global growth was expected to reach 5.9 percent in 2021, before slowing to 4.9 percent in 2022, according to the IMF. The slowdown of the recovery since the re-openings, as well as the tightening of monetary and fiscal policy support, are the key causes of this deceleration. **Canada's economy is under the international average, projected at 3.5 percent GDP growth for 2022 according to BDC.** Although labour markets have mostly recovered from the pandemic, productivity remains a challenge. The unemployment rate has dropped below 6 percent for the first time since the pandemic, but skill mismatches and labour shortages are limiting potential productivity.

Canada's Projected 2022 GDP Growth



Rising interest rates are also a signal of the growing inflation rates, which remain a concern. Soaring energy prices, recovering demand for freshly reopened services, supply chain issues, container bottlenecks, and labour shortages have all contributed to recent inflation surge. It's critical to distinguish between short-term or transitory inflationary pressures and systemic and structural inflationary pressures. Inflationary pressures are now transitory, but they are weighing more heavily on the outlook and will endure longer than expected. As these increases are phased in over time, loan conditions will remain favourable and affordable in the foreseeable future.

Supply chain concerns and the resultant inflationary pressures are proving to be more persistent than projected, pushing central banks to accelerate their rate rise plans for 2022. Limited supply has slowed the quick recovery in demand for raw materials, intermediate goods, and other logistical services. This has impacted various markets, resulting in significant price rises and late delivery, placing strain on several supply networks. These constraints will continue to cause issues far beyond 2022. Many businesses have delayed or ceased production because they are unable to secure the productive capital and inputs they require. The anticipated hike in interest rates from the Bank of Canada may also put a damper on residential investment – a key consumption driver in the Canadian economy.

The US is one of the few developed countries that have reached pre-pandemic levels in GDP and overall economic state. The same cannot be said for Canada. Commodity price increases, notably oil, helped the Canadian currency in 2021, when it was about US$0.80. Commodity market fluctuations in 2022 are expected to impose some negative pressure, particularly in the second half of the year. Despite the likelihood of a more immediate change of direction from the Federal Reserve, the disparity between US and Canadian interest rates should help maintain the Canadian currency near to US$0.77. This also points towards a deeper look into the Biden administration's effect on Canada.

The dramatic change in US administration from Trump years to the new Biden regime has had significant implications on US-Canada ties. Key issues include the continued border closure restricting fully vaccinated travellers from Canada, climate change initiatives, and perhaps most importantly – a change back to rules-based bilateral trade regime. This will lessen the business uncertainty that Canadian exporters experience, lowering their capital costs and improving the atmosphere for domestic investment. However, actual realities in the United States, such as a relatively high unemployment rate, must temper this hopeful outlook. President Biden has stated that his economic recovery plan will prioritise government purchases from domestic businesses, and this "buy local" emphasis might become a major trade problem in the future. Biden and Trudeau are also on opposing sides of the Keystone XL denial as well as Enbridge's Line 5 oil pipeline, which significantly affects the Canadian economy and may continue to create friction between the two countries.

Not all of it is negative. Trudeau and Biden pledged to construct the required supply chains to make their nations world leaders in all aspects of battery development and manufacturing in their February "roadmap." In the summer of 2021, a bilateral critical minerals working group comprised of US and Canadian federal ministries and agencies was active. Commodity prices soared during the COVID-19 pandemic and are projected to stay high for the rest of 2022, but a decline is beginning due to a slowdown in China's manufacturing. Demand will be further tempered by a shift in spending from commodities to services. Early in 2022, oil prices are projected to stay high. Prices are projected to reduce significantly and revert to levels observed before the epidemic after the northern hemisphere winter is complete, given to the constant but gradual rise in supply by producing countries.

Written by Namista Tabussum

2. WHAT ARE MAJOR LENDERS DOING TO THIS MARKET ENVIRONMENT?

From the top down, two-thirds of lenders plan to grow their real estate loan portfolio proportions in 2022, while the rest plan to maintain their present allocation levels – indicating bullish trends.

Canadian lenders' attitudes regarding real estate have improved significantly since the relative caution of the previous two years. From the top down, two-thirds of lenders plan to grow their real estate loan portfolio proportions in 2022, while the rest plan to maintain their present allocation levels. This reflects a major turnaround in lender mood toward real estate financing, compared to the more cautious approach displayed by lenders during the prior two years. This bullishness among lenders corresponds to 10–20 percent greater net fresh capital available for Canadian real estate in 2022 in absolute dollars. In fact, one out of every two lenders expects to raise their loan books by 20 to 30 percent in the coming year by deploying 20 to 30 percent net new capital. This is also the second year in a row that no lender has said that they want to reduce their lending capital. The real estate sector in Canada continues to be well-served by Canadian lenders. Borrowers should expect even more capital availability for their real estate finance needs in 2022, thanks to lenders' growing trust in the industry.

This year's comeback in commercial real estate investment activity has resulted in new highs in investment volume and heightened competition among lenders. 60 percent of lenders reported a moderate rise in rivalry for real estate projects in the second half of 2021, while another 27 percent anticipated a major increase in competition. This trend is projected to continue into 2022, with Canadian domestic banks, insurance firms, and pension funds expected to be the most active in acquiring transactions in the coming year, according to lenders. Foreign banks and trust businesses are expected to compete at normal levels.

Overall, it was the retail sector that had the most improvement in lender sentiment. Entertainment and food services, CBD regional malls, power centres, and value-add retail were the most improved property categories over the previous year, ranking first, second, fourth, and fifth, respectively. The properties with the greatest momentum ratios in Q1 2022, according to Altus Group, were food anchored retail strips, suburban multiple unit residential, industrial land, single tenant industrial and multi-tenant industrial. 60-70 percent of lenders are unconcerned about these retail models, depending on the type. Land and downtown Class A offices, which rated third and sixth, respectively, saw significant improvements. While lenders' concerns about virtually all property types have decreased, anxiety about regional malls in secondary markets, Class B offices in core cities, and Class B offices in suburban regions has grown. Lender opinion about hotels improved slightly in 2021, but it is still an asset type that two-thirds of lenders are keeping an eye on. Altus Group's data shows that tier II regional malls, suburban class "B" offices, enclosed community malls, downtown class "B" offices and hotels had the lowest momentum ratios of Q1 2022.

Lenders' interest in life science and biotechnology laboratories increased dramatically in 2021, surpassing data centres as the second most popular alternative asset among lenders. Furthermore, across Canada, the Greater Toronto Area, Vancouver, Montreal, and Ottawa continue to garner the most lending interest. These 4 cities had the highest momentum ratios in Q1 2022 of 2.3, 2.1, 1.8 and 1.7 respectively. Even more interesting is the shift in borrower-lender relationships. While in the past lenders gave credence to long term relationships, there is now a shift towards greater focus on the details of the assets and contract specifics. This is especially true for Alberta, where lender sentiments indicate an eagerness to participate in the market, but with a deal specific focus.

The 10-year bond issued by Canada is a significant benchmark for debt financing in the real estate industry. The Bank of Canada has lately begun to accelerate interest rate raise deadlines. As a result, the 10-year bond yield in Canada has risen dramatically toward the end of 2021. Nearly 80 percent of lenders with a perspective on Canada's 10-year bond yield anticipate it to revert to pre-pandemic levels by the end of 2022, with 48 percent expecting rates to stabilise at the 5-year pre-pandemic average of 1.7 percent and 30 percent expecting yields to reach the 10-year average of 1.7 percent. 2.1 percent of the population. Some lenders are predicting that rates will exceed 2.1 percent in 2022, while others believe that the 10-year will settle at 1.5 percent or below. Given lenders' forecasts of a return to the pre-pandemic norm of 1.7 percent inflation, it appears that most lenders do not anticipate the current high levels of inflation to have a major or long-term impact.

The final trend among major lenders is the increased focus on ESG and carbon emissions impact of their financed assets. In all, 172 global financial institutions with a combined asset value of $54.9 trillion have agreed to monitor and publish the greenhouse gas emissions linked with their lending and investment portfolios. The "Big Six" banks of Canada, as well as Desjardins Group, Vancity, and AIMCo, are among these companies. A total of 12 Canadian financial firms have joined on, representing US$5.5 trillion in total assets. Within the next 3–5 years, most Canadian lenders believe that a building's carbon footprint will play a significant role in its ability to acquire a competitive mortgage.

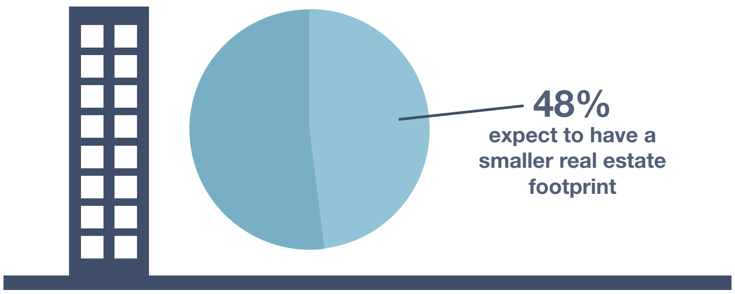
Written by Namista Tabussum

3. THE CFO PERSPECTIVE – WHAT STRATEGIES ARE CHIEF FINANCIAL OFFICERS EXECUTING IN THIS MARKET ENVIRONMENT?

As organisations face the hurdles of returning to office, CFOs must re-evaluate the role of real estate in a post-COVID world.

As organisations face the hurdles of re-entering their offices and other places of business, CFOs have a significant dilemma: re-evaluating the purpose and role of real estate in the post-COVID environment to align with the larger strategy. Many CFOs are already dealing with these problems. Many organisations are carefully re-evaluating their real estate holdings as they prepare to escape from the nothing-is-normal economy and plan to prosper in the new normal. **In fact, 48 percent of 156 respondents in Deloitte's Q2 2020 North American CFO Signals™ poll expect their organisations to have a smaller real estate footprint a year from now.**

Deloitte Q2 2020 CFO Poll



CFOs might expect a section of their personnel to return to the workplace and leave for various reasons when their firms begin to physically reopen. They may demand access to equipment or systems, prefer to engage with colleagues in person, or hold jobs that compel them to leave their homes. Rather of making bold statements (e.g., no one needs to return to work until 2022), CFOs should spend time identifying trends. Some employees, particularly those who may be susceptible to the virus, may believe it is too risky to expose themselves at this time. Others may be unable to return to an onsite schedule due to a shortage of childcare. Some people may have found remote work to be so fruitful that they desire to keep doing it.

The objective should be to integrate the company's real estate demands and costs with its business strategy when it comes to footprint. Remote work, for example, may prove to be an obstacle when organisations try to re-engage clients or attract new business. Face-to-face contacts, as well as the spontaneous cooperation and creativity that might emerge, may not be acceptable alternatives for video-conferencing systems. In fact, running a business from afar may out to be far more realistic than starting one from scratch. Bringing personnel back onsite, on the other hand, may need a financial expenditure. Current workplace rules, for example, will very certainly need to be altered to allow for adequate distance, teamwork, and hygiene practises. It will be necessary to obtain enough personal protection equipment and safety supplies, as well as revisit rules around shared spaces like cafeterias, elevators, stairwells etc.

CFOs should collaborate with their CRE executives to discover the optimal mix of onsite and remote staff, as well as take the required precautions to ensure worker safety. At the same time, they should collaborate to implement temporary cost-cutting measures. They may be able to swap some office space for warehouse space or uncover possibilities to renegotiate lease terms while analysing corporate property expenditures. There may also be chances to make better use of space by adopting workplace technology, a trend that has been spurred by the pandemic. Companies may wish to focus more on digitising property data, investing in analytics to better anticipate demand and manage use, and running scenarios for business continuity planning, for example.

CFOs who make such decisions, on the other hand, should think about how real estate fits into the company's long-term plan. Real estate affects a company's reputation as well as its risks, so it's more than simply a financial consideration. It has also traditionally served as the foundation for job experience, which may be a significant competitive advantage. To better link real estate's function with a company's growth plan, certain issues can be addressed. Firstly, real estate strategies should align with goals of the organization. Since there is a higher probability of employees opting to work from home, it is logical to go for smaller office spaces. However, this should be done with nuance, to leave room for employee development and continued nurturing of organizational culture. Offering flexible work options could also be a great strategy to attract and retain younger talent.

Second, the work culture in these hybrid work conditions will require leaders to revisit what culture means and how employees should continue to be socialized. CFO's and leaders alike need to stitch these fragments into a single culture. This will also include looking for ways to make remote experiences less risky – whether by incorporating satellite offices to reduce employee exposure to outside environments like transit, as well as limiting cybersecurity exposures that are sure to rise due to increased online activity. Finally, CFO's have a unique opportunity to look at real estate as an opportunity for innovative utilization, not just a large peripheral expense. Exploring how spaces can be used can offer great potential for many companies.

Written by Namista Tabussum

4. FINANCING LAND AND CONSTRUCTION REMAINS CHALLENGING

The construction sector is dealing with cost challenges as a result of labour and material shortages.

The increase in land finance deals in 2021 reflects lenders' long-term belief in Canadian real estate. Lenders had the highest demand for land in the previous five years in terms of the proportion of their overall financing budgets devoted to land and new projects, with some statistics indicating as much as 47 percent of total financing budgets dedicated to land and new developments. However, the construction sector is dealing with cost challenges as a result of labour and material shortages. 2021 has brought a much-welcomed rebound, but with new obstacles, after another year marked by construction shutdowns and social distancing laws. Canada, like many other countries, is experiencing a historic construction boom. Low borrowing rates, pent-up savings, the demand for additional space, and the change in spending away from services and toward commodities are all driving this trend. The value of new building permits has soared after a decrease in the early months of the epidemic, hitting a high of over $11 billion in Q2 2021. This was due to the impact of three sectors specifically: Residential, Industrial and Office.

Residential construction is increasing, thanks to cheap mortgage rates and great demand for space, for all forms of housing, from single family houses to high-rise condominiums. To accommodate expanding urban populations, the rental apartment market is experiencing substantial new supply. The total number of house developments in Canada has never been greater. Low vacancy and a high demand for physical items that need to be stored have boosted the industrial sector to a new high of over 41 million square feet of space under development in Canada as of Q1 2022. Toronto, Montreal, Vancouver, and Ottawa had four of the six lowest office market vacancy rates in North America prior to the COVID-19 epidemic with an average total vacant rate of 6.3% in Q4 2019 and 6.0% in Q1 2020. As a result, developers were compelled to produce unprecedented amounts of additional supply. Some of these projects are now finished. Over 2 million square feet of office space was completed across these 4 cities in Q1 2022 alone. Finally, at a time when the future of the workplace has never been more unclear, approximately 16.9 million square feet of office space is still under development throughout Canada. This construction activity has resulted in a surge in demand for building supplies, which is straining global supply systems.

The Delta Variant continues to obstruct suppliers in many circumstances, particularly in nations where immunisation has not yet reached critical mass. Regardless of the pandemic, supply systems are so interconnected throughout the world that interruptions in one location have enormous ramifications in another. Shipping containers, for example, are taking 73 days to cross the Pacific Ocean, compared to 20-30 days pre-pandemic, with much of that time spent waiting in line to dock at the port. The average cost of a 40-ton container from China/East Asia to the west coast of North America has jumped from $4,500 a year ago to over $21,000, according to Freightos.com, a worldwide freight booking platform.

As a result, builders' costs have risen across the board. Overall project costs grew by 8.3 percent for non-residential construction and a startling 20.3 percent for residential construction from Q3 2020 to Q3 2021, according to StatCan's Canadian Construction Cost Index (see Figure 2). Contractors are increasingly juggling many projects and depending on a younger staff. As a result of these expenses being passed on to the end user, they contribute to rental escalation, which is becoming a rising problem for both homes and businesses. According to the 2022 Emerging Trends in Real Estate report by Price Waterhouse Coopers and the Urban Land Institute, real estate executives' top two concerns for the coming year are rising material and labour costs.

The price of construction materials also shows trends in price volatility. The highest volatility sectors are steel, lumber and copper, - all reaching record high prices by as much as 40 percent year over year. Medium volatility sectors include aluminium, gypsum and plastics. All prices are currently affected by supply disruptions across the globe. On the other hand, rise in construction services means an increase in demand for skilled labour. This led to the construction industry moving into recovery well ahead of other sectors. By June 2020, the construction industry had employed 13,000 more people than before the pandemic. Construction employment roared back in 2021 after a third wave stalled projects throughout the winter, culminating at 8 percent of pre-pandemic employment by August.

Despite the increased employment, the industry is experiencing a labour shortage as other industries compete for talent, and COVID assistance programmes make returning to work a less appealing proposition for many individuals. In the third quarter of this year, Statistics Canada recorded a 5.8 percent job vacancy rate in the construction industry. This is one of the highest rates of any sector of the economy, and significantly above the national employment vacancy rate of 4.6 percent. Also, the workforce in this sector has an older demographic, with many deciding to retire early – thus giving rise to skilled labour shortage and a push on wages. Developers now must compete with unions with more clout, as well as offer more lucrative and flexible work options to attract talent.

Written by Namista Tabussum

5. WHAT ARE THE MAJOR DIFFERENCES FROM THE MARKET'S PERSPECTIVE ON OFFICE VS. RETAIL VS. INDUSTRIAL VS MULTI-RESIDENTIAL?

Low loan rates and private investment are still driving the market in Canada, with Industrial and Logistics, Multi-family/BTR and Office gaining investor interest

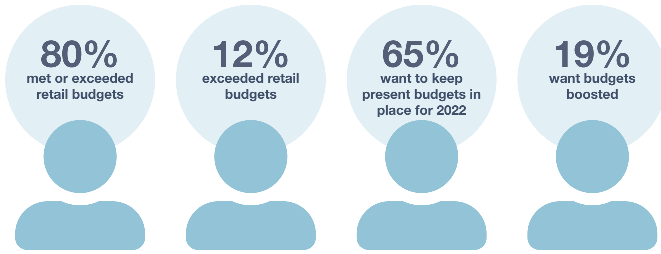
North America's real estate investment prospects appear to be promising. Even without major coastal markets completely rebounding, the United States is anticipated to achieve a record year for volumes in 2021, and 2022 might be even better, according to David Amsterdam, President, U.S. Capital Markets and Northeast Region. Low loan rates and private investment are still driving the market in Canada, with top three sectors predicted to gain investor interest being Industrial and Logistics (67 percent), Multi-family/BTR (53 percent) and Office (45 percent).

Although the office sector has slightly lower expectations than the industrial sector, confidence about office investment is rising, with more firms encouraging their employees to return to physical sites, according to the Colliers Global 2022 Outlook Report. In significant U.S. locations like New York and Boston, offices remain the most sought-after asset type, while Toronto and Vancouver were the most popular in Canada. Despite the uncertainty concerning the future of employment during the pandemic, lenders continued to pursue office acquisitions and provide liquidity in the market in 2021. CBRE stated that three-quarters of lenders were able to fulfil their office budgets, with 17 percent even reporting that they surpassed them. Most lenders currently feel that the office market is during a long-term structural transformation.

In case of the retail sector, although certain areas, such as groceries, are performing well and the rate of store closures is slowing, most investors are still neutral to bearish on retail's capital appreciation potential. Retailers are figuring out what omnichannel means, combining in-store experiences with curbside pick-up and online buying to appeal to customers and capture sales.

According to CBRE in 2021, 80 percent of lenders said they met or exceeded their retail budgets, with 12 percent saying they exceeded them. Lender sentiment has also improved, with intentions at their highest level since 2018. 65 percent of lenders want to keep their present budgets in place for 2022, and 19 percent want to boost them again. Whether it is permanent or temporary, lenders are currently evenly split. The property type that caused the most anxiety among lenders was regional malls in secondary markets, with 93 percent expressing reservations about the asset class. At the same time, lenders are unconcerned about grocery-anchored retail, and all other types of retail properties have seen improvements. Tier I regional malls, tier II regional malls and enclosed community malls made up 11 of the 15 least preferred products in Q1 2022. Meanwhile, food anchored retail strips had the highest momentum ratio of any other property type in Q1 2022 at 9.7 and 5 of the 15 most preferred products in Q1 2022 were food anchored retail strips in Montreal, Vancouver, Toronto, Quebec City and Ottawa.

2021 Lender Survey



Industry leaders expressed a strong interest in the industrial sector with a large majority planning to invest in the area and forecasting significant results in 2022. Capital is flocking to big-box and light industrial/flex properties in key cities across North America. Last year, competition among lenders for the industrial asset class was clearly fierce, and a dearth of agreements appears to have left some lenders hungry. A CBRE study shows that, out of all the property categories, lenders had the greatest problems reaching their industrial budgets, with 34 percent stating that they were under budget for 2021. Lenders clearly believe in industrial assets, with 65 percent expecting market fundamentals to accelerate for another 2 to 3 years and 21 percent expecting it to continue for another 5 years or more. Market circumstances are favourable for continuing growth and demand, with Canada playing catch-up in terms of ecommerce demand, ultra-low levels of availability, and a development pipeline that is essentially spoken for.

Another key development factor is multifamily housing. Rents are rising as a result of a shortage of availability, and investor demand is increasing. "Foundationally, the real driver has been the sustained, low interest rate environment," says Hal Collett, Chief Operating Officer of Colliers Mortgage. "The resiliency of multifamily has been outstanding." Rental growth was recognised as one of the factors expected to boost the industry in 2022. Demographics and growth are driving record volumes, and there is a relatively equal focus on core/core-plus and expansion potential. New York, Toronto, and Montreal have also become attractive alternatives due to declining vacancy rates in core metropolitan areas.

Written by Namista Tabussum

6. ALTERNATIVE LENDERS: THE GROWTH OF NON-BANK COMMERCIAL MORTGAGE LENDERS

Residential mortgages extended by non-banks increased in value in the second quarter.

RBC, TD, Scotiabank, CIBC, BMO, and National Bank are the six main banks that spring to mind when Canadians are looking for a mortgage lender. These six banks accounted for 67 percent of all mortgages in Canada, according to CMHC's 2019 Residential Mortgage Industry Report. These large banks are more recognisable to Canadians in their daily lives, but they are also severe in their lending conditions for a mortgage, such as income, debt levels, and credit score.

Regulation that requires capital allocation based on headline indicators such as leverage, interest cover, and debt yield constraints traditional bank lenders and insurance firms lending from their own balance sheets or funds. Their long-held hegemony in the real estate lending market is being challenged by the increasing availability of alternative capital, which is more flexible in its risk assessment and able to combine traditional metrics with more subjective views on a specific situation to price that risk appropriately.

Hundreds of building and development transactions have been done by several developers, and each one is unique. Because developers are frequently in situations that banks do not always understand or can respond to, they may turn to alternative lenders. Many experienced developers, for example, are headquartered overseas and have no track record in Canada, making it difficult for them to acquire institutional funding for their first Canadian project.

When going the alternative route, there are a few options. There are private mortgages, lent out by private investors rather that a bank or credit union, and not regulated by government policies. Canadalend, Clover Mortgage and Alpine Credits are players in this segment. B-lenders are a step-up from private lenders where they can offer affordable rate, although that comes with stricter requirements because they mainly deal with CMHC insured mortgages. MCAP, First National and Home Trust are well-known in this segment. Equitable and Home Equity Bank provides reverse mortgages, available as steady streams of cash rather than down payments provided to Canadians over 55 years old.

Alternative lenders are occupying a position in the market – providing access to funds for those who may not have good credit scores, debt levels or those with unconventional income. Given the post COVID-19 landscape, it is understandable that such sources of financing would gain traction. However, a report on upcoming trends in non0bank financial institutions by OECD suggests that due to lack of regulatory oversight, such institutions could cause instability in market and finance infrastructure. The 2008 real estate bubble burst is still recent, and with the pandemic as an added layer of uncertainty, policy makers strive to create a space where alternative sources of financing provide the pros and not the cons.

7. ESG AND IMPACT INVESTING IS GROWING IN IMPORTANCE

Buildings account for 39% of worldwide energy-related carbon emissions; ESG can be the missing link between going green and achieving high financial performance.

According to the World Green Building Council, buildings account for 39% of worldwide energy-related carbon emissions, with 28% coming from the energy used to heat, cool, and power them (operational carbon) and the remaining 11% coming from materials and construction (embodied carbon). As the world's building stock grows and embodied carbon—particularly that created before the constructed asset is used (upfront carbon)—becomes a bigger concern, a focus on decreasing and eventually eliminating both forms of carbon is vital.

Pandemic and climate-related disruption, as well as increased consciousness of social unfairness, drove investors to embrace a more thorough approach to sustainability-related risks in 2020, which was a landmark year for Environmental, Social, and Governance (ESG) investing in real estate. According to CBRE's 2021 Global Investor Intentions Survey, 60% of respondents had already used ESG criteria as part of their investment strategy, with the Americas, EMEA, and Asia-Pacific all placing a greater emphasis on ESG problems than prior years. Investors are infusing ESG concerns into every stage of the property lifecycle, from due diligence to acquisitions and leasing to asset management, as ESG plays a far more prominent part in how firms function.

So why should real estate companies focus on impact investing and ESG? Companies that are making progress on environmental, social, and governance (ESG) issues fare better. From 2015 to 2020, the NYU Stern Center for Sustainable Business looked at the link between ESG and financial performance and discovered that performance-based ESG metrics and financial performance had a favourable association. Employees like to work for organisations that have a mission with ESG focus. According to CBRE's Global Live, Work, and Play survey, millennials pay close attention to a company's culture and practises, particularly its environmental credentials, when determining whether to join or stay on as workers. Public vows to achieve zero-carbon goals are becoming more widespread. **More than 30% of Fortune 500 firms claim they have either met or are publicly committed to meeting a climate objective by 2030, up from only 6% in 2016.** With all these global trends, it makes sense for the real estate industry to jump on board.

Climate Objectives

Written by Namista Tabussum

While carbon reduction measures may not always result in improved investment returns, they will play an increasingly important role in asset value preservation as occupiers increasingly avoid properties with poor environmental performance. These assets will be valued more as more occupiers and investors are drawn to homes that are more sustainable. Although property certifications like LEED, BREAM, and NABERS2 will continue to be important indicators of a building's environmental performance, the spotlight is shifting to initiatives like the World Green Building Council's (WGBC) Net Zero Carbon Buildings Commitment, which calls for all buildings to be carbon-neutral by 2050. Other initiatives include the United Nations' Race to Zero campaign, which pushes businesses, cities, regions, and financial and educational institutions to reduce global emissions by half by 2050.

8. INVESTMENT ACTIVITY: INSTITUTIONAL VERSUS FOREIGN SOURCES

In the second quarter, Canada set a new record for commercial real estate investment; foreign investment anticipated to pick up as travel restrictions loosen.

According to Altus Group, Canada exceeded its all-time record for commercial real estate investment in the second quarter of 2021, with volumes exceeding $21.9 billion as a consequence of 2,550 deals, as concluded in CBRE's latest Canada Investment Marketview (excluding merger-and-acquisition-related activity). This is the third-largest investment volume in a single quarter on record. The three cities with the biggest investment activity were the GTA, Vancouver and the GGH, which accounted for $13.4 billion of the $21.9 billion total. The total investment volume was 47% greater in Q2 than in Q1 and 56% more than in the same period last year, when COVID put the global economy on hold. The second quarter statistics also represent the country's fourth consecutive quarter of non-M&A volume increase, indicating growing investor confidence across the board. According to Altus Group's data, total investment activity in Q4 2021 was $24.8 billion. The GTA, Vancouver, the GGH and Montreal accounted for the majority of the investment volume ($22.3 billion). 2021 rounded out with a total of over $80 billion worth of total investment as the result of over 12,000 transactions which was nearly double that of 2020.

In Q2 2021, private Canadian investors were the most active buyers, accounting for 44.6 percent of total investment volume. Other buyer categories, such as REITs and REOCs, accounted for 15.3 percent of investment volumes, Private Equity (15.3 percent), and Pension Fund/Advisor groups, boosted their market share in the quarter (11.8 percent). In Q2 2021, foreign investors expanded their purchasing activities as well, accounting for 7.5 percent of total national volumes. Experts suggest that as travel restrictions loosen, foreign investors should become more active. This adds to confidence that record investment activity will continue, and positive future of Canadian commercial real estate.

This was not the case back in 2020. As the COVID-19 issue evolved, commercial real estate investment volumes faced major challenges across the world in 2020. National investment volumes in Canada totalled $43.7 billion last year, down 24.1 percent from the previous year's totals. While the reduction was significant, Canadian volumes remained rather resilient when compared to their worldwide counterparts. Investment fell 26.3 percent globally and 32.1 percent in the United States year over year. As 2020 continued, so did activity in Canada, which increased month after month after bottoming out in May. By the fourth quarter of 2020, activity had entirely rebounded to pre-COVID levels, and the sum of $13.6 billion in the fourth quarter was the third highest single period of investment activity in Canadian history. In 2022, investment activity is expected to remain at this high level, with totals like those recorded in the three years leading up to the pandemic.

Institutional capital mostly retreated from the investment market after the first wave of COVID cases in March 2020, focusing on internal operational issues and waiting for further clarity on the new picture. Smaller deals using private finance sources dominated investment activity at this time. Deal volume for agreements under $20.0 million remained stable during the summer, decreasing just 23.3 percent from the first to the second quarter. Institutional investments, on the other hand, plummeted by 64.1 percent over the same time. Institutional firms expanded their purchasing activities dramatically as the year continued, and their purchases returned to 100 percent of their Q1 2020 totals in the last quarter of the year. While total acquisitions for this buyer group appeared to have recovered by the end of the year, several groups were remained cautious in their investment selections. Volumes and cap rate reduction will be driven in 2021 by the continuous unfurling of institutional capital and a worldwide stockpile of dry-powder ready for deployment.

As the year continued, asset class preferences increasingly moved due to increased market uncertainty. By the end of the year, buyers had a clear preference for countercyclical asset classes, properties with income growth potential, and industries with fundamentals that were the least vulnerable to the pandemic's effects. During this time, demand for multifamily, industrial, and land assets grew the most, while office, retail, and hotel assets were handled with caution. This followed the same pattern as the previous global recession, which ended in 2009. There is now evidence to suggest that cap rates for these chosen sectors may fall further in 2021, given the backlog of investible capital and the expectation that government bond yields and borrowing rates will continue around record lows for the foreseeable future.

Several benchmark investment sales occurred in the second half of 2020, indicating a return to pre-pandemic levels and the conclusion of the price discovery phase. In 2021, a growing desire for regional and international private capital will help to increase market liquidity and limit cap rate compression across asset classes. Despite a strong listing pipeline through 2021, current investment market circumstances predict that demand for Canadian commercial real estate will outstrip supply in the coming year. Due to limited investment possibilities and a need for income, alternative asset classes such as data centres, life sciences real estate, and cold

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storage facilities might see substantial demand. The acceleration of pre-COVID secular trends has assisted each of these asset classes, and the potential for future income and price increases will make these assets increasingly appealing alternatives for capital allocation in the future.

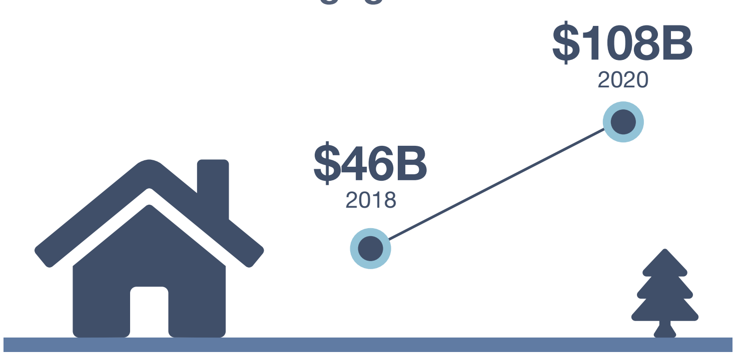
9. THE CONTINUOUS GROWING ROLE OF DEBT AND MORTGAGE FUNDS

Market sentiment hit a tumbling block at the end of 2021, but mortgage liquidity seems to be strong in 2022.

Following the financial crisis of 2008, much emphasis was put on safeguarding global financial market stability and avoiding the sort of reckless lending that may cause a new financial system contagion. Concerns about the strength of Canada's housing market began to develop in late 2015, with suspicions that markets in some Canadian cities were overheating. The Office of the Superintendent of Financial Institutions (OSFI) established various additional regulations in January 2017 to manage these concerns. These included an interest-rate stress test for all mortgages and new restrictions exempting foreign buyers from enjoying tax-free capital gains on residential properties to help prevent property speculation.

As property prices and debt levels rose in many regions of the country, worries about the mortgage market's sensitivity to interest rate risks arose as historically low interest rates and record high loan-to-value ratios exacerbated the problem. In January 2018, OSFI modified its mortgage underwriting criteria (known as the B-20 guidelines) to demand more severe stress tests for all uninsured mortgages, in order to restrict risk in this form of lending. **Mortgage borrowing has been reasonably robust throughout 2020, with families accumulating about $108 billion in debt by November, compared to less than two-thirds of that amount in 2019 and just under $46 billion in 2018.** Note Government-led initiatives such as the Canadian Economic Recovery Benefit, financial institutions' six-month mortgage deferral option, and the Bank of Canada's policy rate being cut to its lowest level since the financial crisis in 2009 have all aided the housing market, while mortgage borrowing has remained resilient.

Mortgage Debt



Market sentiment was strong moving into Q4 2021, until the arrival of Bond markets came to a halt as a result of the Omicron variant. By the conclusion of the year, the newest surge of the illness had prompted new lockdowns in a number of nations around the world. Bond markets signalled a return to increasing rates by the end of 2021, with the Bank of Canada preparing to intervene more forcefully than the Federal Reserve. The emphasis of headlines and conversations throughout the world is no longer on the direction, but on how quickly central banks will raise interest rates. Returning to societal norms, national immunisation rates, established supply chains, and consistent labour availability will all influence central banks' decisions this year. Mortgage liquidity in 2022 appears to be strong, with low spreads, but whether it is a borrower's or lender's market will be determined by asset class.

Mortgage debt increased to levels not seen in a decade in the first half of 2021. The growth of mortgage activity was aided by historically low interest rates and shifting housing requirements. In the first quarter of 2021, Canada's mortgage debt payment burden increased as a percentage of disposable income. The increase was fueled by an increase in planned principal payments. This was partly due to bigger mortgages because of rapidly rising property prices in 2020. Uninsured new mortgage credit increased by 20% in volume, capturing a larger part of the residential mortgage market. The most notable rise was in the number of uninsured mortgages issued for property acquisitions. This more than doubled the amount raised in the first place. The role of debt gives us some insight into the upcoming housing market trends.

The downward trend in fixed mortgage rates, which began early last year, seems to have reached a nadir in the first quarter of 2021. The reason for this was owing to hopes of a stronger economy. In the meanwhile, the Bank of Canada kept the overnight rate at 0.25 percent. More borrowers choose variable-rate mortgages because of the huge discount between fixed and variable rates. Variable rates were used on more than 40% of new mortgage amounts issued in the second quarter of 2021. To take advantage of historically low interest rates, new mortgage holders have continued to choose for longer-term mortgages.

At 78 percent, chartered banks maintained their stronghold on overall mortgage debt. In 2020, they provided a considerable amount of newly generated loans (73%) and in the first quarter of 2021, they provided 75%. In 2020, the Big Six banks offered a bigger percentage of newly extended mortgages (68%) than they did in 2019. (67 percent). Non-bank lenders will give out the remaining 20% of new mortgages in 2020. The lending activity of mortgage investment firms and other forms of mortgage investment organisations was cautious. Their originated mortgages were granted at a slower rate than in 2019, suggesting the pandemic's rising unpredictability. For all types of lenders, mortgage delinquencies of 90 days or more continued to decline. At 0.13 percent, credit unions had the lowest percentage of mortgage arrears. With 0.88 percent, mortgage investment firms continue to have the highest mortgage arrears rates. This was the category in which the arrears rate fell the most.

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10. WHERE ARE INTEREST RATES AND BOND YIELDS EXPECTED TO BE THROUGH 2022?

After the BoC raised interest rates in March, experts make predictions that the rates will see incremental hikes throughout 2022.

On March 2, 2022, the Bank of Canada hiked interest rates to 0.5% after lowering its core lending rate at the start of the pandemic in March 2020, to guarantee that households and companies had access to low-cost credit to keep the economy afloat. However, two years of ultra-low loan rates have been a key contributor to inflation in Canada, which hit over 5% in January 2022, the highest level in more than 30 years.

Many watchers suggested that the delay in changing the interest rate may have costly effects later down the road. By delaying a rate hike, the bank risked inflaming near-term inflation expectations and igniting the housing market's fire. During the pandemic, Canada's housing market was on fire, with low-cost credit acting as rocket fuel on a smouldering tinder of demand, driving up prices. The rate set by the central bank has an influence on the rates that Canadians receive from their banks on items like variable-rate mortgages. While the bank is likely to gradually raise rates, a series of minor increases would add up. A qualified buyer might have received a $400,000 mortgage for 1.35 percent interest, or $1,571 per month while the rate was 0.25%. The quarter-percentage-point increase in the interest rate could raise the monthly payment by $47. However, if the rate rises by a full percentage point, the monthly payment rises to $1,762. Every month, that's a 12% increase in spending. Many believe that the BoC will raise rates again at their meeting in April.

Over the 2021 holidays, a slew of new COVID-19 limitations didn't dampen market expectations that the Bank of Canada would begin hiking interest rates early this year. On the first day of trading in 2022, investors put aside concerns about Omicron to drive Canadian government bond rates higher, reinforcing market forecasts for five rate hikes this year. Many believe that the BoC will raise rates again at their meeting in April. These wagers reflect an understanding that the current conditions of the pandemic will not have a negative impact on the inflation dynamics of a fully healed Canadian economy. Consumer price gains have also been the highest they have ever been in the last three decades.

Bondholders face an unfavourable environment due to ongoing inflation worries and the likelihood of further increasing interest rates. There's been a tug of war between those who believe it's temporary, as the central banks have suggested, and others who believe it's more permanent. Given that both the Bank of Canada and the Federal Reserve placed a large emphasis on reaching full

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employment before rising rates, central banks will raise rates more slowly. Bond investors haven't been sufficiently concerned about inflation to demand a higher, longer-term bond yield to compensate for the risk. Near the end of November, Canada's 10-year yields reached a one-year high of roughly 1.8 percent, but have since dipped below 1.5 percent.

To some extent, one could say that it's a stamp of approval from the bond market, which agrees with the Federal Reserve and the Bank of Canada that inflation will decline next year and approach closer to the 2% objective set by both central banks by late 2022. On the other hand, it might represent fears that central banks would raise interest rates too quickly next year, causing the economy to weaken quicker than expected. To put it another way, monetary policy is being tightened too soon and too hard. Bond yields, or longer-term interest rates, could rise somewhat next year, as GDP and inflation in Canada and the United States stall to about 3%.

In a Nov. 25 interview, Patrick O'Toole, vice-president of global fixed income at CIBC Asset Management, said that investors should look for funds that offer diversification away from traditional Government of Canada bonds and investment-grade corporate bonds, and instead look for high-yield bonds and emerging market bonds, private debt, and "other things to enhance returns." He stated, "We believe some of those options will deliver greater returns than domestic bonds."

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