Home About Contact Advertise RESOURCE GUIDE

⇒ SELECT A PUBLICATION

CANADIAN PROPERTY | PART OF THE REMI NETWORK
E-News Sign Up | E-News Archives

Canadian Property Management
property management news
Toronto, ON
February 9, 2016

Properties Management Operations Building Systems Development Sustainability
Regulations Videos

REMI Network › Canadian Property Management

Market divergence in 2015 investment returns

Notable weak spots, but Canada-wide real estate outperforms equities and bonds

Tuesday, February 9, 2016

By Barbara Carss

Tweet Share 2 Email Article Print Article 12

Comments 0

Related Items

Articles

Intensification impacts on millennial consumers

CPPIB asset allocation scorned and defended

Videos

Debt and equity market outlook

The state of Canadian real estate

Supposition about 2016 figured prominently in an analysis of 2015 investment returns when real estate professionals gathered in Toronto last week for the release of annual results from the *REALpac/IPD Canada Quarterly Property Index*. While still digesting the news of an improvement over 2014 — for a total return of 8 per cent on the 42 index participants' directly held standing assets — industry insiders participating in an associated panel discussion reiterated that many others are watching Canada's low dollar and resource-related vulnerabilities with growing interest.

"Rumours are accelerating that foreign money is going to come in and swoop up one of our top REITs," reported Derek Warren, assistant vice president with Lincluden Investment Management.

"Calgary is the place where people are starting to hover for the opportunities," added Mark Rose, chairman and CEO of Avison Young.

"We're seeing a lot of U.S. investors coming here looking. I think we're going to start seeing a lot of trades," concurred Ted Willcocks, global head of asset management, real estate, with Manulife Financial.

Still respectable performance as Canada moves along the down slope of its real estate cycle could also factor into the allure, reinforcing an international reputation as a politically stable environment with growing urban centres and presumed inevitable resource booms to offset the occasional bust.

"It's probably safe to say these numbers will surprise on the upside," said Simon Fairchild, executive director with the index producer, MSCI Inc., as he unveiled the 2015 results at the event sponsored by the Real Property Association of Canada (REALpac). "So far, at least, it seems like the market has avoided sharp corrections we've seen in the 1990s and following the financial crisis in 2008."

Calgary slides, Toronto surges

Nevertheless, last year's seeming stable performance across the total index of 2,440 properties valued at nearly $136 billion nationwide hides fairly dramatic divergence among the 11 surveyed markets. Perhaps most notably, returns in Calgary plunged to 0.9 per cent as the fallout from sustained low oil and gas prices walloped the Alberta economy. In contrast, properties in Toronto, Vancouver, Regina, Victoria, Ottawa/Gatineau and Montreal delivered improved returns, with Toronto posting a chart-topping total return of 12.8 per cent.

"We are seeing a pulling apart of the market," Fairchild reflected. "Looking at individual portfolios, some will outperform and some will underperform based on location."

The gradient among property types is not so steep, but there has also been a reordering of status. Industrial was the top performing sector of 2014 with a total return of 8.7 per cent, but that dropped to 6 per cent in 2015 to trail retail, residential and office. Meanwhile, retail's leading 8.8 per cent performance, which might seem counterintuitive in a year of chain closures and surging e-commerce competition, is attributed to the weighting of super-regional malls in the index.

"You have to think about the quality of the assets that are showing that return," observed Sharm Powell, a director with the Canada Pension Plan Investment Board (CPPIB) and one of the four panellists sharing their on-the-spot reaction to the 2015 index results.

Others suggested that's something of a defining trend for the year. "Anything that was deemed 'quality' or 'core' did actually have pretty good returns," Warren said. "But there is still such a spread between Cs and As."

Capital growth and income yields

Index-wide capital growth at 2.8 per cent was stronger than 1.9 per cent recorded in the previous year, while capital growth for retail properties measured what Fairchild typified as a "robust" 4 per cent. Regionally, Toronto and Vancouver saw capital growth of 7.4 per cent, while Halifax, Calgary, Edmonton and the eponymous Rest of Canada representing an amalgam of secondary markets all tumbled into negatives.

In drawing out the five key messages from the 2015 results, Fairchild acknowledged that he had simply copied one from last year's presentation: "income yields continue to fall into historically low territory, although premium over government bonds remains."

This is expressed in a fractional overall slippage in income return from 5.2 per cent in 2014 to 5.1 per cent in 2015. Across the entire index, office properties held steady with an income return of 5.6 per cent, while retail, residential and industrial experienced a slight decline. Victoria, Ottawa/Gatineau and Edmonton were the only markets to see gains, with Edmonton emerging with the highest income return of 5.9 per cent. Vancouver bottomed out the list at 4.8 per cent.

Index participants' 2015 investment returns on directly held real estate outshone 9 per cent losses on equities, 0.5 per cent losses on REITs and a 3.1 per cent return on bonds — a pattern of performance against bonds and equities that largely holds ups for the long term with 10-year returns of 10.3 per cent versus 10-year returns of 5.8 per cent on bonds and 4 per cent on equities. Although Fairchild sees something of a new order in the drop of income return from 8 per cent in 2005 — "It just shows very clearly we're in a different world than 10 years ago," he said — the property yield to bond yield spread remains consistently favourable to the index.

In contrast, listed real estate has been much more volatile with a three-year return of 17.4 per cent to put against last year's dip, smoothing out to a 10-year return of 8.3 per cent. "REIT investors are real estate investors on Ritalin," Warren quipped, while maintaining this illustrates the advantages of institutional investors' disciplined, long-term approach.

Portfolio additions

Plotting Canada among global markets, its performance fell to the middle of the pack in 2015, well behind Ireland, the United Kingdom and the United States, while outperforming 12 European Union nations, China, Taiwan and Hong Kong.

"So, a below par year. It's underperforming maybe globally, but certainly outperforming other asset classes," Fairchild mused. "This is still an asset class that institutional investors want to be in and want to add to their portfolios."

The U.K. and U.S. ascendance is also good news for Canadians in general since Powell noted the largest portion of CPPIB's $40-billion real estate holdings is in those countries. Within Canada's borders, though, the fund remains open to arising opportunities.

"We like retail. We like office in the major markets. We like Toronto. We like Vancouver," she affirmed.

Similarly, Willcocks reports Manulife is surveying the domestic field, while also actively pursuing acquisitions in the U.S. "We want to see what Q1 looks like in '16," he said.

For his part, Rose speculated "2016 could very well look exactly like this. With zero to negative interest rates and the greatest flow of capital in the history of the world, this could continue. The question to ask is: do you have your plan for when something is going to change?"

While 2011's 21.6 per cent total return may now just be nostalgia in Calgary, he maintains today's scenario is also quite different from the collapse in the 1980s.

"We're smarter, we're better capitalized and people are holding on longer," Rose said. "Strong hands in Calgary are going to be fine. Weak hands are going to drop out."

Barbara Carss is editor-in-chief of Canadian Property Management.

Photo courtesy of REALpac.

Tags: Asset Management, Barbara Carss, Investment, Real Estate

---

Leave a Reply

Your email address will not be published. Required fields are marked *

*

*

Post Comment