Key trends in Canadian real estate investment

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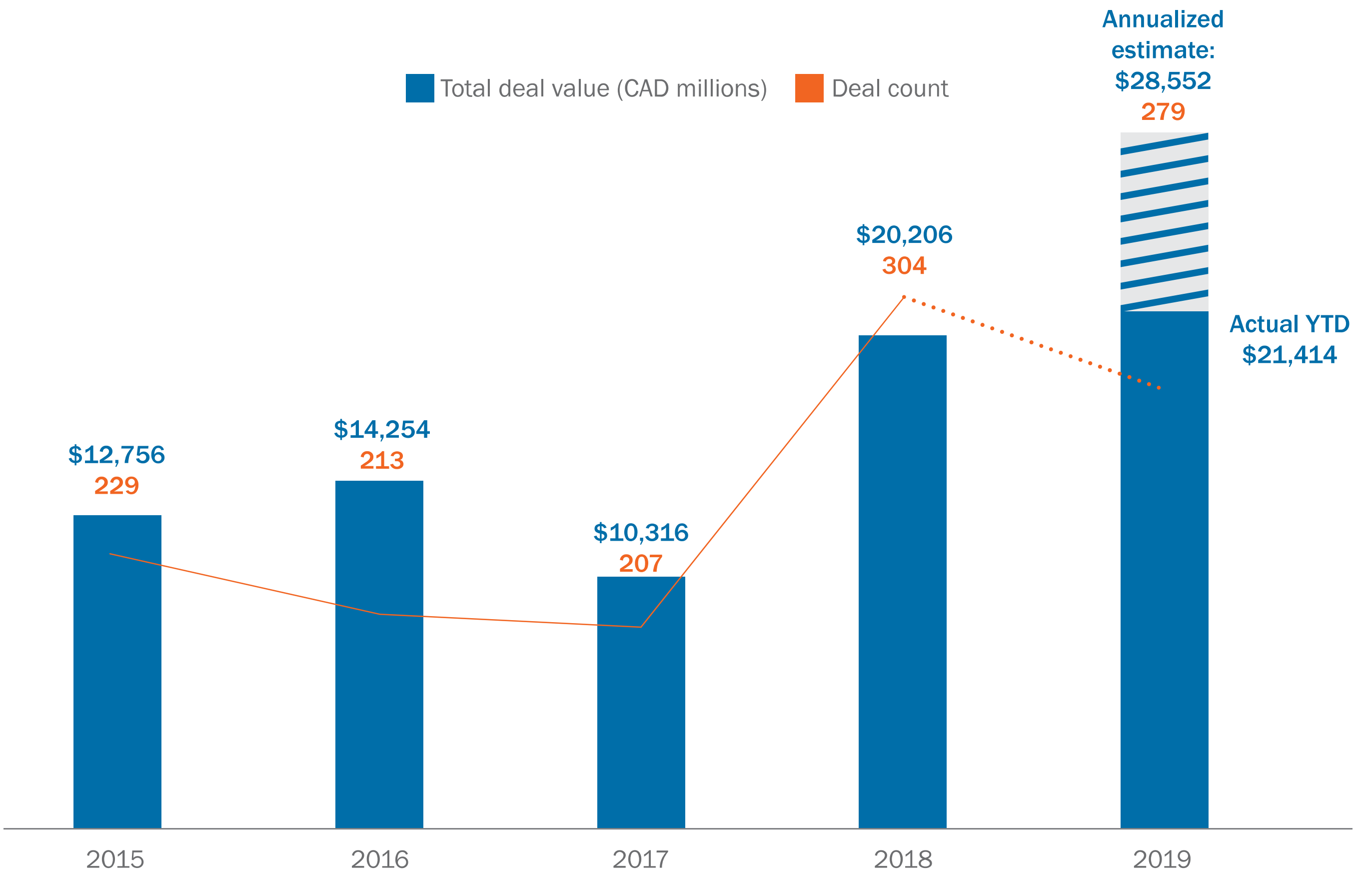
Divestitures of non-core assets, rising institutional investment and multi-use, urban intensification investments are just some of the trends that are shaping Canada's real estate sector. We anticipate that strong investment in the asset class is poised to continue, with investor confidence in a low-interest-rate environment likely to drive robust activity in the sector in the coming months.

Trend 1: Disposals of non-core assets by public companies

Although in the last couple of years we had seen a disconnect between public real estate company stock prices and the net asset values of the underlying public company real estate portfolios, that has largely subsided in 2019 (the S&P/TSX Capped REIT Index is up about 20% year to date). We have, however, seen public companies adjust portfolios by shedding non-core assets, including so as to re-cycle capital into their real estate portfolios, particularly in urban centres. Deal activity in the Canadian real estate market has consequently remained strong, particularly in the Toronto, Vancouver and Montréal markets. Based on current trends and our own discussions with leading players, we expect 2019 to be on par with the four-year high of deal values and trading volumes recorded for 2018 (See Figure 1 and Trend 3, below).

Figure 1: YTD real estate M&A deal value and volume



Source (Figures 1 and 2): S&P Capital IQ. Announced transactions to October 1, 2019 involving a Canadian target in the real estate sector. Cancelled transactions are excluded.

Trend 2: Rise in institutional investment

Canadian real estate assets are more and more being acquired by financial buyers—pension plan, private equity, and other institutional capital funds—who are making up much of the investor pool in Canadian real estate transactions (see Figure 2). As interest rates have remained at historic lows, our financial buyer clients are continuing to seek cash-flow generating hard assets. Many of these funds also have the investment muscle and patience, with longer term investment horizons than typical public company investors, to meet sellers' price expectations.

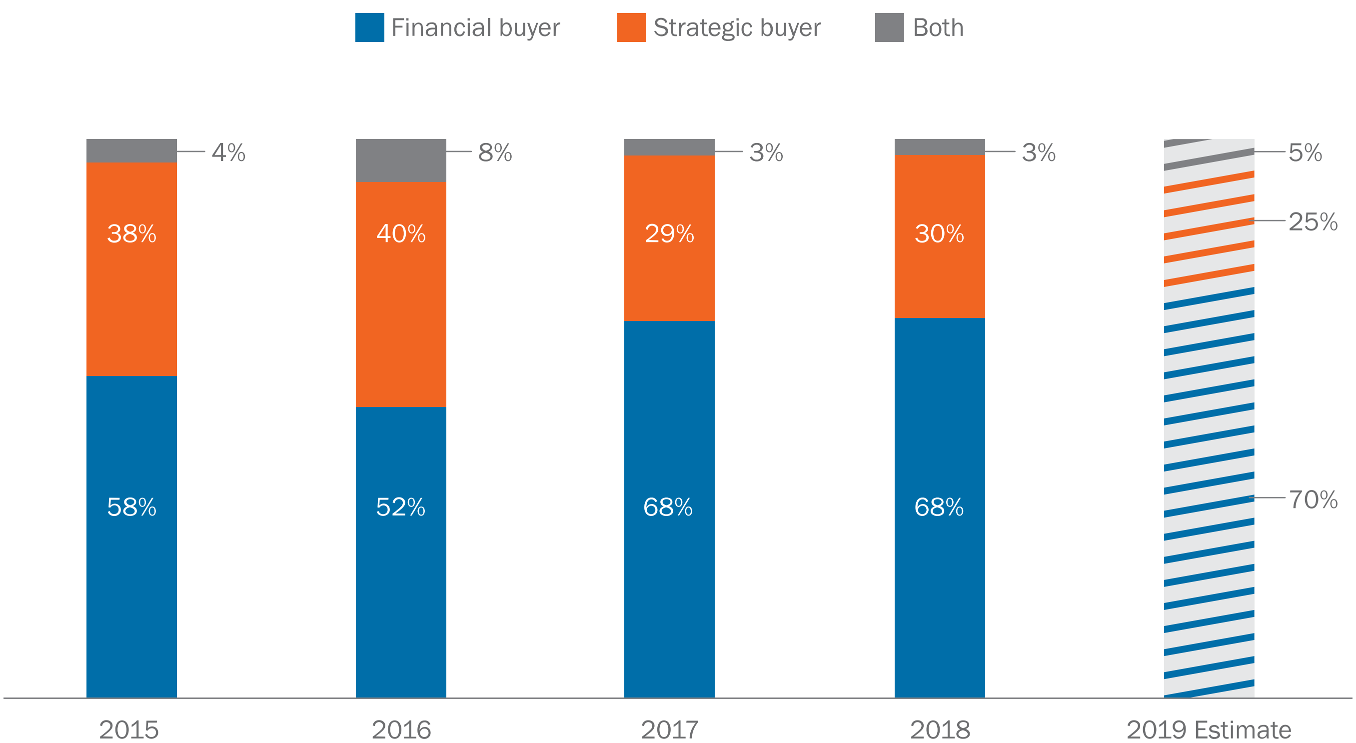
The recently announced acquisition by Blackstone of Dream Global, adding to Blackstone's growing portfolio of logistics assets, is a notable demonstration of this trend, removing another publicly-traded investment option from the Canadian marketplace. Another example is the recent acquisition by Axium Infrastructure of a 75% interest in a portfolio of government-funded long-term care homes in four provinces, in partnership with a private Canadian real estate development and seniors housing operating company. Torys acted for Axium Infrastructure.[1] The rise of institutional investment is being felt across all sector types, including office, retail, multi-family and seniors housing, leading to continued downward pressure on capitalization rates.

Case study: Pension funds are pursuing direct investments

The above trend can be illustrated by two current examples of pension funds making direct investments in Canadian real estate assets. Investment Management Corporation of Ontario (IMCO), as the asset manager for Ontario Pension Board, recently co-invested along with Cadillac Fairview in 160 Front Street in Toronto, Ontario. According to Brian Whibbs, Managing Director of Real Estate, IMCO: "Investing in real estate is an integral part of IMCO's investment strategy because it is well-aligned to Ontario Pension Board's return objectives".[2]

Another example is the partnership investment by OPTrust, along with Great-West Life Real Estate Fund, London Life Real Estate Fund and I.G. Investment Management, Ltd., in a complex of office buildings located at the southeast corner of Yonge and Adelaide in Toronto's financial district. Rob Douglas, Managing Director of Real Estate Investments, OPTrust, noted the importance of finding "income-generating assets that align with OPTrust members' requirements of providing Plan sustainability and security".[3] Torys advised IMCO and OPTrust on each of these transactions.

Figure 2: Investor type



Trend 3: Intensifying existing investments

Increasingly, our Canadian real estate investor clients are intensifying their existing investments by pursuing high-density developments, which continue to be a key driver of both public and private market real estate activity in Canada. We have seen urban intensification outside of the traditional office and multi-family asset classes to now also include seniors housing, as well as transit-oriented development where developers are paying to develop public infrastructure as part of urban intensification.

Case study: New GO station at Woodbine

Earlier this year the Ontario Government announced that it, together with Metrolinx, had partnered with Woodbine Entertainment to build a new GO station at Woodbine, at no cost to taxpayers.[4] Woodbine Entertainment will fund the capital costs of the new build, estimated to be between $75 million and $90 million. Torys is advising Metrolinx.

Especially in the core Canadian urban markets, multi-use, intensification investments are becoming more frequent, as residential and commercial uses share space at high-value locations. These developments are presenting investors with particular challenges, since the skill set required to succeed in mixed-use development is unique, requiring strong project management capabilities to address permitting, planning and capital challenges. Increasing construction costs, including as a result of several large-scale government-backed infrastructure projects and tariffs on building materials, are continuing to put pressure on development budgets.

Conclusion

We anticipate that investors who focus on building out their development capabilities and relationships will remain ahead of the curve in the current dealmaking environment, and vigorous investment in the real estate asset class should continue. Previous concerns about the risks of rising interest rates are also dampening, and the current perception of a low-interest-rate environment should further encourage deal activity in the near term.

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[1] See press release by Axium Infrastructure.

[2] See press release by Cadillac Fairview.

[3] See press release by OPTrust.

[4] See press release by the Government of Ontario.