CANADIAN ECONOMIC OUTLOOK & MARKET FUNDAMENTALS

THIRD QUARTER UPDATE 2018

20TH ANNUAL EDITION

Morguard

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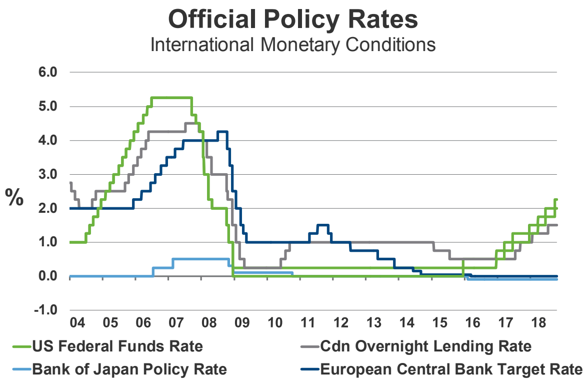
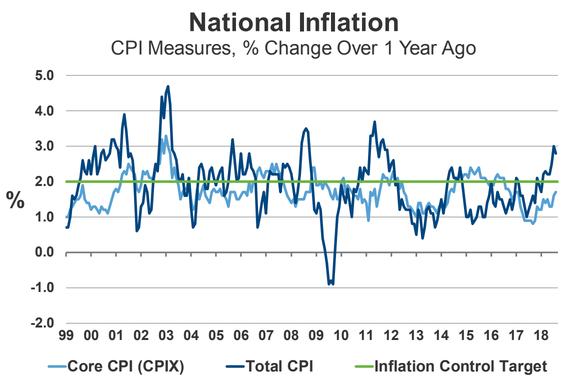
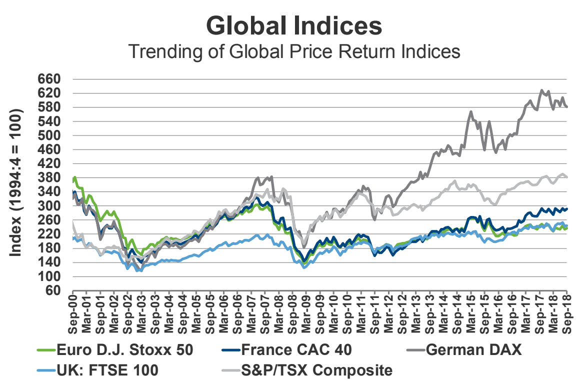


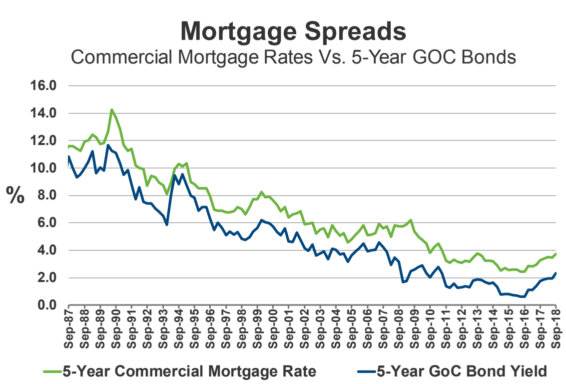
Source: Bank Of Canada, Federal Reserve Board, European Central Bank, Bank of Japan



Source: Bank Of Canada, Statistics Canada



Source: RBC Capital Markets



Source: RBC Capital Markets, Bank of Canada

BANK OF CANADA MAINTAINED TARGET RATE

The Bank of Canada (BofC) maintained the overnight rate at 1.5% on September 5th, despite a “steady stream of better-than-expected” economic indicators. There was some speculation that the BofC would raise its target rate, given an expectation that inflation might reach the 3.0% mark. The bank indicated its three measures of “core” inflation ranged nearer to the 2.0% mark, which was within an acceptable range of between 1.0% and 3.0%. The BofC cited a number of other factors that played into their decision to maintain the target rate in September. The upward pressure on inflation levels, for example, was rooted in rising gasoline prices, a trend that was expected to ease in early 2019. Elevated trade risks and the resulting downward pressure on commodity prices was a factor in its decision to hold off on a rate increase. Ongoing NAFTA negotiations and other trade discussions and their impact on inflation was another area of concern for the bank. Finally, the bank’s need for more evidence related to how consumers were dealing with rising interest rates was another factor in the September rate decision. While the bank chose not to raise the overnight rate on September 5th, there was plenty of speculation that it might happen in October.

INFLATION EDGED DOWN FROM 11-YEAR HIGH

Canada’s inflation rate edged down slightly in August of 2018, on the heels of an 11-year high reading a month earlier. The Consumer Price Index (CPI) rose to 2.8% year-over-year in August, down 20 bps from the previous period. Prices increased in eight major components out of 12 over the month, according to the latest Statistics Canada release. Transportation cost increases were the most acute during the same two-month period, at 8.1% and 7.2% in July and August, respectively. The rising cost of air travel was the key driver of this trend. The price of gasoline has increased substantially of late, rising 19.9%, year-over-year as of August. From a regional standpoint, the inflation rate was lower in eight provinces, year-over-year. Increases of 2.7% and 3.1% for Nova Scotia and Ontario, respectively, matched those reported in July. Prices in Saskatchewan rose at a slower rate, when compared to the other provinces, at 2.2%. The lower rate of inflation posted during the third quarter was one of several factors that prompted the BofC to hold off on raising its target overnight rate in September.

TRADE WAR THREAT ERODED EQUITY MARKET PERFORMANCE

The ongoing threat of a U.S.-driven global trade war has negatively impacted third quarter and year-to-date equity market performance. The S&P/TSX Index has returned a meagre 0.3% year-to-date, as of the end of the third quarter. If the outperformance of the cannabis sector were set aside, the return would have been negative. Ongoing uncertainty surrounding NAFTA negotiations continued to have a negative impact on business confidence during the third quarter. A resolution was eagerly anticipated by Canada’s export-dependent business sectors in particular, after which earnings were expected to strengthen. Beyond Canadian borders, trade-dependent emerging economies had seen earnings revisions turn negative for the first time since 2016. Conversely, the S&P 500 reached a new high during the third quarter, a performance that was driven by a stronger-than-expected economic performance and boost in corporate profits during the previous quarter. After-tax profits surged 16.0% during the second quarter, which represented the strongest increase in more than five years, according to the National Bank of Canada. Looking ahead to the final few months of 2018, Canadian equity market performance was expected to improve in light of the recent U.S.-Mexico-Canada Agreement (USMCA). This would signal an end to the Canadian equity market sluggishness reported in 2018 year-to-date.

INVESTMENT MARKET FIRED ON ALL CYLINDERS

Canadian commercial property investment market activity surged during the second and third quarters, after a slightly slower pace reported for the first few months of 2018. Sales activity remained brisk during the third quarter, on the heels of a record-high $16.5 billion in sales recorded in the second-quarter. To a large extent, the spike in overall investment during the first half of 2018 was rooted in the industrial sector. Industrial property sales totaled $6.1 billion during the second quarter of 2018 alone, a pace that carried over into the third quarter. Transaction volume has increased markedly in all asset classes year-to-date. The surge in activity levels was, to some extent, a reflection of the ongoing strength of the market's demand cycle. Investor confidence levels remained stable and healthy in the third quarter, with a range of private and institutional groups actively pursuing properties across the country. As was the case over the past several years, the country's major markets were the most popular. Many groups looked further afield to smaller markets with strong economic and population characteristics, given intense competition for prime properties. The strength of the market's demand cycle was also a factor in driving property values moderately higher. This was to some degree evidenced in recent investment performance patterns. Capital growth was reported for all major assets classes on average, for the 12-month period ending June 30, 2018. The residential and industrial sector posted the strongest capital growth trend during this period, over the period, as investment sales trended significantly higher.

INDUSTRIAL SECTOR WAS "RED HOT"

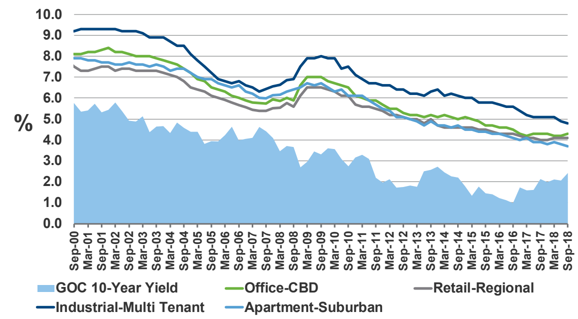
Canada's industrial sector was the most actively traded asset class in the first half of 2018, a trend that carried through to the end of the third quarter. Transaction activity remained brisk during the third stanza, with a number of larger assets trading hands. Eight properties were sold with a sale price in excess of $20.0 million in the Greater Toronto Area alone during the third quarter. This activity came on the heels of record-high quarterly industrial asset sales of $6.1 billion for the country's major markets combined. Sales volume for the first half of 2018 already presented the third highest annual total dating back to 2001, with half of a year still to go. Several factors were instrumental in supporting the record pace of industrial property sales year-to-date as of the end of the third quarter. A healthy economic and business outlook, strong leasing fundamentals including rent growth and a modest development cycle were three of the main factors cited by investors. In addition to helping drive driving sales to a record level, the rationale for investing in this sector was also bolstered by a largely positive near-term outlook. The industrial sector was expected to continue to produce positive results for investors, against a backdrop of a healthy fundamental outlook. Therefore, a brisk sales environment was expected to persist over the near term.

SECTOR RISKS WERE LARGELY UNCHANGED

There were few changes in the Canadian investment property risk profile anticipated for the near term as the third quarter came to a close. The national economy was projected to expand by roughly 2.0% annually over the next few years. This assumed no material changes in the global economy or financial markets. Concerns related to high levels of Canadian household debt and an ongoing slowdown in the national housing market were not only related, but also top of mind for policy-makers. Transformative change in the retail sector remains a concern placing the relevance of some shopping centres and retail brands in question. The wary continue to monitor the impact of online shopping. Finally, the potential for a global trade war also merits attention, although the settlement of the Canada US Mexico trade agreement may alleviate some concerns. In short, investment property sector risk was relatively stable during the third quarter.

Yield Spreads

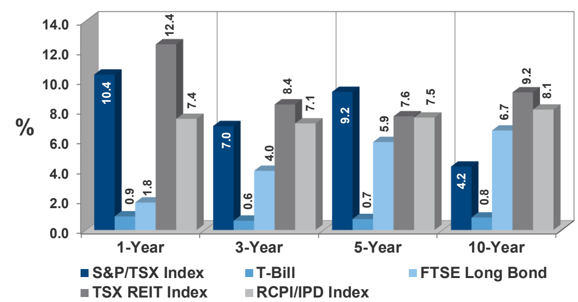
Cap Rates vs. 10-Year GOC Bonds



Source: AltusInSite, Bank of Canada

Relative Performance

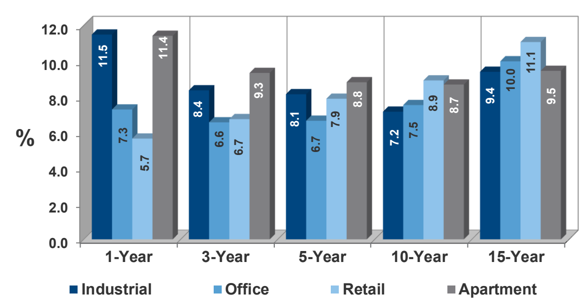
Comparing Annualized Returns To June 2018



Source: © MSCI Real Estate; RBC CM; TSX Datalinx; SCM; PC Bond Analytics

RCPI/IPD Returns

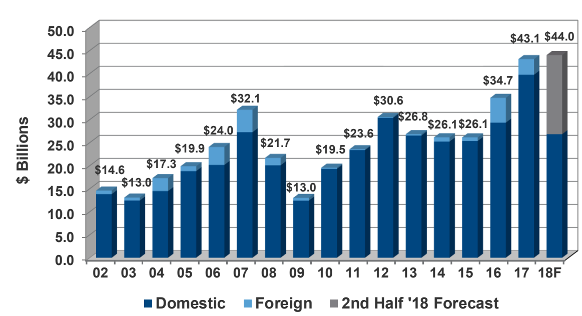
Annualized Returns By Property Type To June 2018



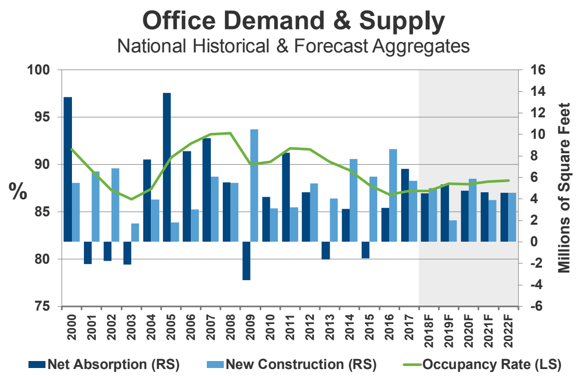
Source: RCPI; © MSCI Real Estate

Investment Activity

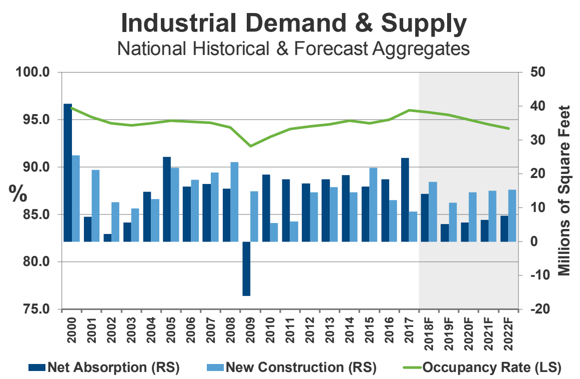
Total Investment Volume



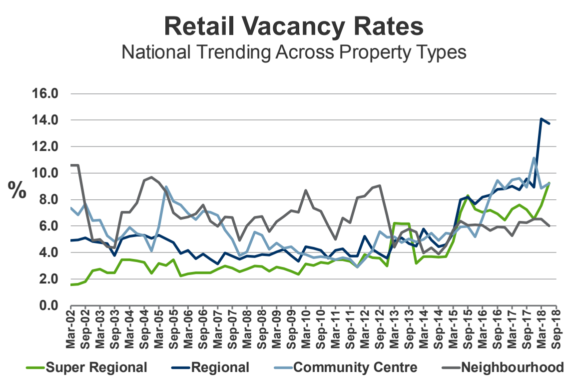
Source: CBRE Limited; Morguard



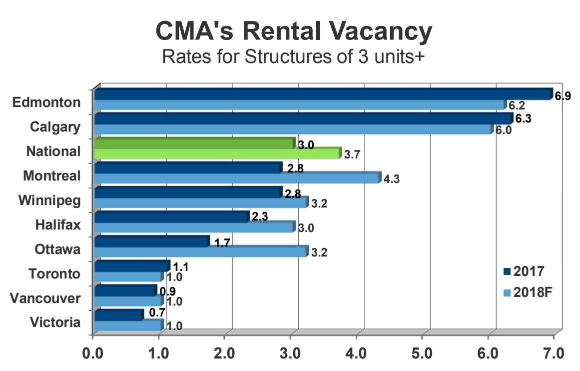
Source: CBRE Limited; CBRE Econometric Advisors



Source: CBRE Limited; CBRE Econometric Advisors



Source: © MSCI Real Estate



Source: CMHC, Housing Market Outlook Report

VARIATION IN DOWNTOWN SUPPLY FUNDAMENTALS REPORTED

There was variation in downtown office supply fundamentals reported across the country in the third quarter. Downtown vacancy levels in some markets was so low that tenants found it difficult to source alternatives in which to expand and/or relocate. This was the case in Vancouver and Toronto, where downtown vacancy stood at 4.4% and 3.1% at the end of the third quarter for all classes of space, respectively. Tenants looking for Class A space also found acquiring space difficult, with vacancy rates of 4.8% and 2.2% reported, respectively. In a number other cities, downtown space was also in relatively short supply, though not to the same extent as Vancouver and Toronto. These included Montreal, Ottawa and Winnipeg, where downtown vacancy stood at 9.5%%, 7.5%%, and 10.8% at the end of the third quarter for all space classes, respectively. Once again, conditions were also tight in the downtown Class A inventory of buildings in the downtowns of these same three cities. Conversely, some cities boasted a relatively healthy supply of vacant space for tenant expansions and relocations. The most prominent of these were Edmonton and Calgary, which continued to suffer through the after effects of the most recent oil sector downturn. Additionally, a number of smaller cities also posted vacancy rates well into the double-digits, including London and Waterloo, as of the end of the third quarter. Looking ahead, the variation in downtown supply fundamentals across Canada's office market was expected to continue for at least the next 12 to 18 months.

RETAIL VACANCY STABILIZED

Retail sector vacancy levels looked to have stabilized as the third quarter began, with rates generally holding at the cycle-high. National vacancy rested at 6.8% as of the end of the first half of 2018, up a modest 40 bps from the end of 2017. Previously, retail vacancy had risen more sharply. The national vacancy rate increased 240 bps, year-over-year, as of the end of the first half of 2018. Moreover, the national vacancy rate had increased 150 bps during 2017 alone. The increase in national vacancy over the recent past was focused in the regional centre market segment. Specifically, the closure of Sears stores across the country drove vacancy to a 20-year high by the end of 2017. The impact of these closures has varied. On the one hand, some retailers have gained access to prime space that might otherwise have been unavailable. On the other hand, some owners have been forced to incur the added expense of reconfiguring the space to lease it out or re-purpose it altogether. In the coming months, at least some of this space will be re-leased or re-purposed. Therefore, retail sector vacancy was expected to continue to stabilize during the last few months of this year and into 2019.

CONTINUED INDUSTRIAL LEASING MARKET STRENGTH FORECAST

The strength observed in Canada's industrial leasing market of the past few years was expected to persist for at least the near term. A solid economic outlook was expected to support demand for warehouse and distribution space during the balance of this year and into 2019. For the most part, demand was expected to outstrip vacant supply in most jurisdictions, especially Toronto and Vancouver. Persistent shortages of functional space were also anticipated in a number of other cities. The supply of newly built, state-of-the-art space was also expected to fall short of demand by a significant margin. The broad based demand supply imbalance anticipated for the next 12 to 18 months will push rents higher in most regions of the country. The strongest upward pressure on rents was forecast for newly built, state-of-the-art premises. More modest pressure was projected for older and often less functional space. In Calgary and Edmonton, leasing conditions were expected to slowly improve, but remain comparatively weak. In summary, the near-term outlook for the Canadian industrial sector was broadly positive as the third quarter came to a close.

SOLID ECONOMIC START TO SECOND-HALF OF YEAR POSTED

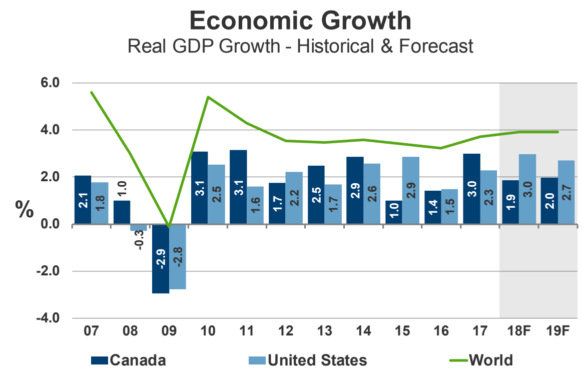
The Canadian economy registered a solid start to the second half of 2018, with a positive performance in the month of July. Canada's economy grew 0.2% month-over-month, with the nation's manufacturing sector leading the way. Previously, there was essentially no change in Gross Domestic Product reported for June. Both the goods-producing and services-producing sectors of the economy registered increased output during the month of July, at 0.3% and 0.2%, respectively. Ouput increased in 12 of the 20 major business sectors month-over-month. The manufacturing sector posted its strongest monthly performance dating back to November of 2017, with a 1.2% rise. Durable and non-durable manufacturing output rose, with increases of 2.4% and 0.3% recorded, respectively. The Wholesale Trade sector bounced back in July, with expansion of 1.4%, following a contraction of 1.2% in June. The warehousing sector posted a moderate increase in sector output of 0.9%. Weakness was reported in the mining, quarrying and oil and gas sector of the economy, with output falling 0.3%. The drop was the result of a dip in oil and gas extraction activity, largely due to a shutdown at Syncrude Canada's oil sands mine and upgrader complex. The increase in economic output reported for July lacked breadth. However, the resumption of activity in the oil and gas sector was viewed positively, given its potential to support above-average economic performance over the balance of 2018.

EMPLOYMENT GROWTH TREND SOFTENED

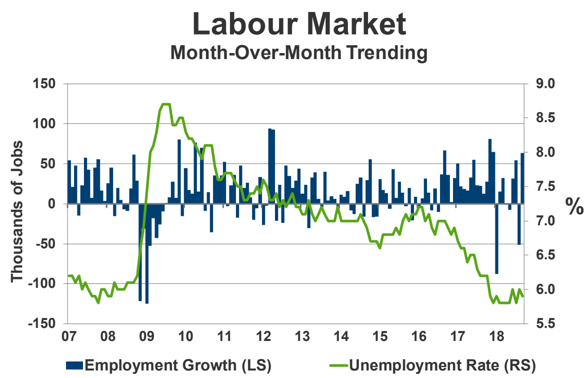
The Canadian employment growth trend stalled during much of the third quarter, in part due to an economy that had effectively reached 'full employment'. In August, Canadian employment fell by roughly 52,000 positions. This performance pushed the national unemployment rate 200 bps higher to 6.0%. Part-time employment dropped sharply, with 92,000 positions lost. The plunge reversed the gains recorded in July and more than offset the 40,400 full-time jobs created during August. The biggest losses were in the professional services, whole and retail trade, and construction sectors. Ontario accounted for much of the job losses of the recent past, which totaled over 80,000. Alberta added 16,200 positions during the month and attracted a similar number of people back into the labour force. The employment market news was not all bad in August however, as aggregate hours worked edged 0.2% higher, month-on-month.

US-MEXICO-CANADA AGREEMENT REDUCED UNCERTAINTY

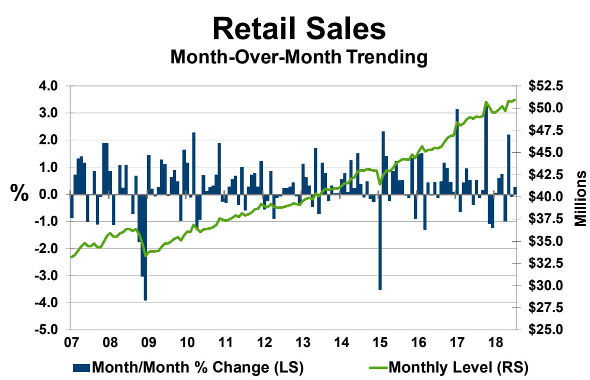
Economic risk related to the potential outcome of ongoing NAFTA negotiations between the U.S. and Canada was reduced as the third quarter of 2018 came to a close. An agreement in principle for the new U.S.-Mexico-Canada Agreement (USMCA) was established on the final day of September. The agreement effectively removed the potential economic fallout of steep tariffs imposed on Canadian automotive exports. Moreover, the agreement solidified Canada's relationship with its largest trading partner. The agreement also indicated a willingness on the part of the U.S. to negotiate a trade deal. Therefore, the hope was that agreements might also be reached with other countries that trade with the U.S., thereby reducing the potential for a global trade war. While the USMCA contained a number of positives for Canada, there were concessions made. For one, the U.S. dairy industry attained greater access to Canadian markets. In addition, the duty limit for goods brought into Canada from the U.S. was raised to $150.0 from $20.0, much to the chagrin of the Canadian retailer sector. The agreement also appeared to have added a layer of complexity to the already burdensome regulatory requirements for the trade of goods and services between the U.S. and Canada. Despite these negatives however, the USMCA reduced at least some of the uncertainty related to Canada's economic outlook.



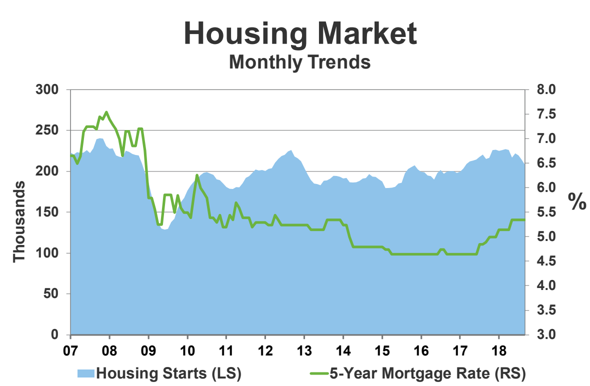
Source: Conference Board Of Canada (June 2018); International Monetary Fund (Jan 2018)



Source: Statistics Canada



Source: Statistics Canada



Source: Statistics Canada, CMHC

OFFICE

Property	Date	Price	SF	PSF	Purchaser	City
Containers Phase II	Sep-18	$92.0 M	138,343	$665	Concert Properties	Vancouver
1243 Islington Ave	Sep-18	$40.4 M	111,370	$363	Montez Corporation	Toronto
125 Commerce Valley Dr W	Aug-18	$57.6 M	189,210	$304	Industrial Alliance	Toronto
Government House*	Aug-18	$227.0 M	222,032	$1,022	Crestpoint	Vancouver
41 Victoria St	Aug-18	$58.8 M	134,369	$438	Morguard	Gatineau
Edmonton Tower	Jul-18	$400.0 M	631,027	$634	AIMCo	Edmonton
Pearson Corporate Ctr	Jul-18	$63.5 M	305,446	$208	Crown Realty	Toronto
Lansing Square	Jul-18	$162.3 M	439,612	$369	Elad Canada	Toronto

INDUSTRIAL

Property	Date	Price	SF	PSF	Purchaser	City
350 Parkhurst Square	Sep-18	$27.6 M	173,446	$159	Pure Ind. REIT	Toronto
8080 36th St SE	Aug-18	$37.9 M	403,232	$94	Nicola Crosby	Vancouver
1001 Thornton Rd S	Aug-18	$36.6 M	369,500	$99	Summit Ind. REIT	Toronto
161 West Mall, 400 Norris Glen	Aug-18	$34.3 M	204,914	$167	Dream Ind. REIT	Toronto
Manulife GTA Porfolio	Aug-18	$69.0 M	450,596	$153	Berkshire Axis	Toronto
1555 Wentworth St	Jul-18	$30.6 M	380,845	$80	Fiera Properties	Toronto
6625 Tomken Rd	Jul-18	$45.1 M	339,502	$133	Pure Ind. REIT	Toronto
3455 Argentia Rd	Jul-18	$41.6 M	285,350	$146	OPTrust	Toronto

RETAIL

Property	Date	Price	SF	PSF	Purchaser	City
Century City	Sep-18	$41.8 M	86,848	$482	Supreme Capital	Edmonton
Megacentre Rive-Sud	Aug-18	$42.6 M	207,201	$206	BTB REIT	Quebec
Market at Quarry Park	Aug-18	$52.7 M	90,407	$582	LaSalle Canada	Calgary
9025, 9055, 9145 Airport (50%)	Jul-18	$22.5 M	161,300	$279	Fieldgate Properties	Toronto
751-775 King St W	Jul-18	$22.8 M	18,026	$1,262	First Capital Realty	Toronto
Sumas Mountain Village	Jul-18	$65.8 M	93,583	$703	GWL Realty Advisors	Vancouver

MULTI-SUITE RESIDENTIAL

Property	Date	Price	# Units	/Unit	Purchaser	City
151 Greenbank Rd	Sep-18	$20.7 M	60	$345,000	Killam REIT	Ottawa
Wynn Group Portfolio	Sep-18	$402.1 M	1,527	$263,351	Starlight Investments	Toronto
50 Burnhill Rd	Aug-18	$32.6 M	163	$200,000	Starlight Investments	Toronto
763 Woodbine/Gerrard St E	Aug-18	$32.4 M	64	$506,250	Realstar Group	Toronto
1465 Lawrence Ave W	Jul-18	$33.9 M	153	$221,569	Starlight Investments	Toronto
151 St. George St	Jul-18	$17.5 M	48	$364,583	Hollyburn Properties	Toronto

* share sale

ACKNOWLEDGEMENTS & CITED RESEARCH RESOURCES

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