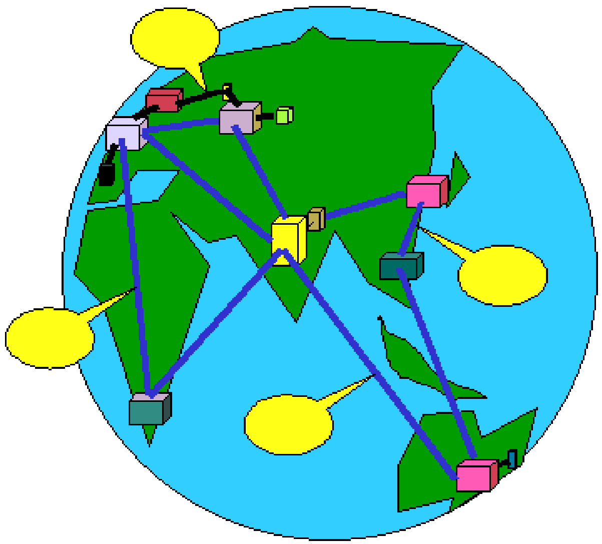
Real Estate Investing in an Interconnected World



Source: Google images

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Please see important disclosures in appendix.

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Real estate investing alliances – historical background

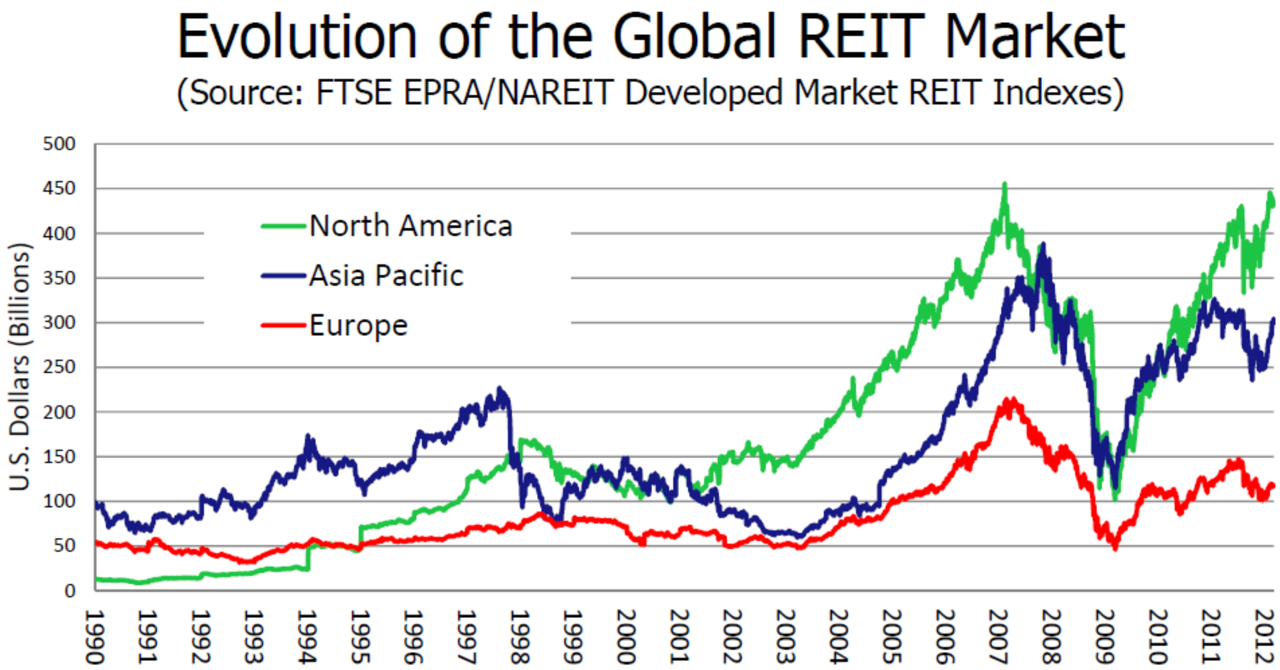
1970s-1980s: Typically real estate investing alliances were formed as private syndications through limited partnership structures. It was an early form of "democratization" in real estate investing, as this was an asset class which, for the most part, was previously reserved for the wealthiest investors. Combined with the allure of certain tax benefits, LPs became a very popular investment vehicle.

Early 1990s: The real estate boom in the 1980s led to significant overbuilding across many asset classes, and consequently resulted in the real estate bust in the late 1980s and early 1990s.

Many private syndications did not fare well through the downturn, and led to a substantial number of LP investors losing their entire capital investment. Syndication of real estate became a "dirty word" in the 1990s, and this form of investing has only survived in very limited forms to this day.

With the benefit of hindsight, we believe the lack of liquidity and transparency were key shortfalls of these types of real estate alliances

An industry reshaped by change…proliferation of listed REITs

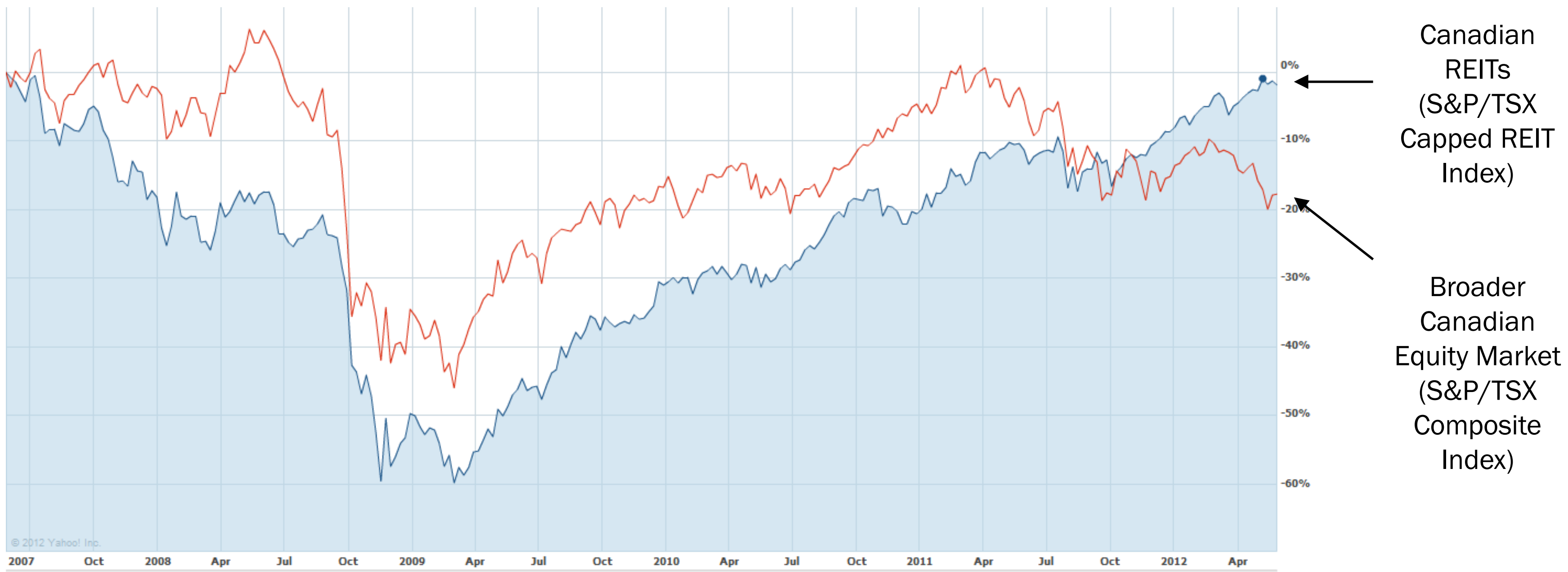


Mid to late 1990s: The publicly listed REIT (real estate model) began to gain popularity around the world as a liquid, transparent and accountable form of real estate investment

2012: Today the equity market capitalization of listed Real Estate Investment Trusts (REITs) in the US is ~$500 billion, ~$50 billion in Canada, and ~$1 trillion globally across all major property subsectors.

Source: EPRA, FTSE World Investment Forum 2012

An industry reshaped by change…



The game has changed: Due to the significant amount of dollars invested globally in REITs, they have become a proxy for direct real estate investment (and may even act as a leading indicator of changes in underlying real estate values).

The global financial crisis helped to educate the investing world that all asset classes have become highly interconnected. Real estate was clearly no exception as evidenced by the volatility depicted in the chart above.

Source: EPRA, FTSE World Investment Forum 2012

An industry reshaped by change…building a new roadmap

We need to develop a roadmap in order to understand how the real estate industry is being reshaped by considering the confluence of

- Securitization of real estate through the REIT model
- global integration of capital markets through technological innovation
- and information symmetry enabled by the internet and social media

To be sure, "location, location, location" will always remain the three most important drivers of underlying real estate value in the **long-term.**

However, we are living in a highly volatile world, and it is impractical to assume location alone will be the key to successful real estate investing.

Change is occurring rapidly, and the above noted factors need to be well understood to have the **staying power** in order to ride out volatile conditions.

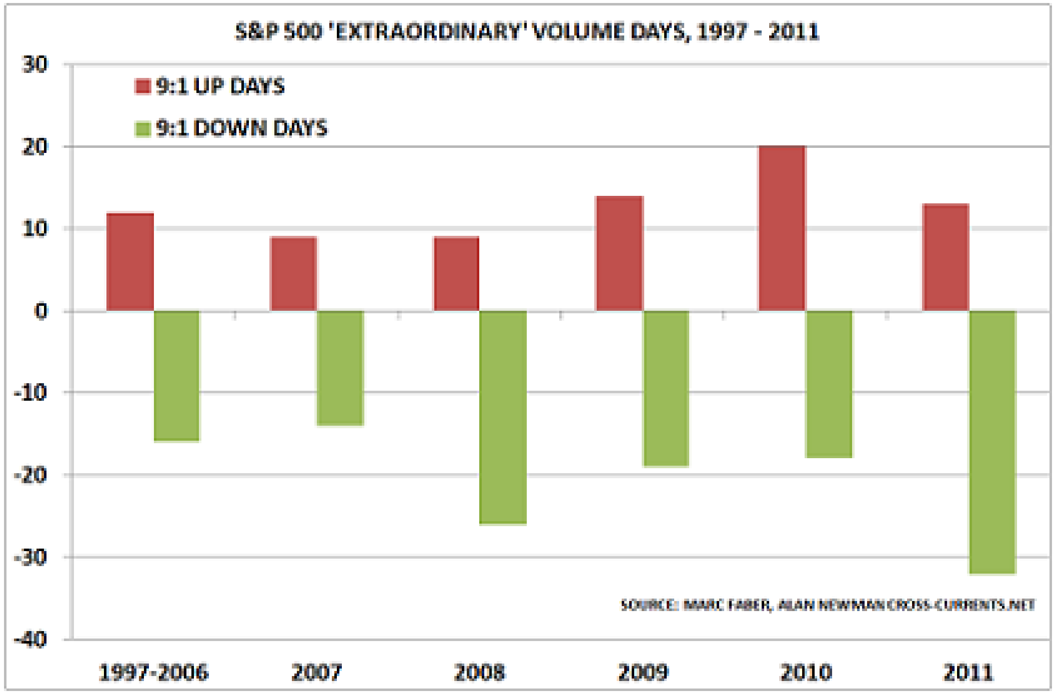
The investing game has evolved. Volatility is the new normal

As central banks around the world continue to maintain highly accommodative monetary policies (ie. emergency level interest rates), this has done little to contain market volatility.

What will happen if/when fiscal austerity measures are fully implemented in the developed world? Conversely how long can governments continue to avoid austerity and kick the can further down the road?

Source: Yahoo! Finance

Consider the impact High Frequency Trading (HFT) brings to market volatility – this is a trend which is not going to disappear anytime soon



- 2009, 2010 and 2011 have each seen more high volume Up and Down days than in the whole of the 10 years between 1997-2006
- 1997-2006 saw only 12 Up days of 9:1 volume, and 16 Down days
- 2011 has seen 13 Up and 32 Down (annualised through November)

"It is truly frightening to consider we have already surpassed the previous record of 26 huge downside daily swings in 2008, when the financial system nearly collapsed... never before have we seen a methodology overwhelm the US stock market as HFT has done".

Dr Marc Faber, author of The Gloom, Doom and Boom Report

Source: www.icis.com

If volatility isn't going away, then we must understand the big picture to know which waves to ride (and those to avoid)

- How many of you are watching the events unfolding in Europe, and their impact on global financial markets?
- Consider where and how you receive information - websites, email alerts, blogs, CNBC, Bloomberg, BNN – on your desktop/laptop or mobile device, or both?
- Why should we care about the timing and magnitude of a US housing market recovery or whether there is a macro-economic slowdown in China? What does this mean for Canadian interest rates, export activity, employment conditions?

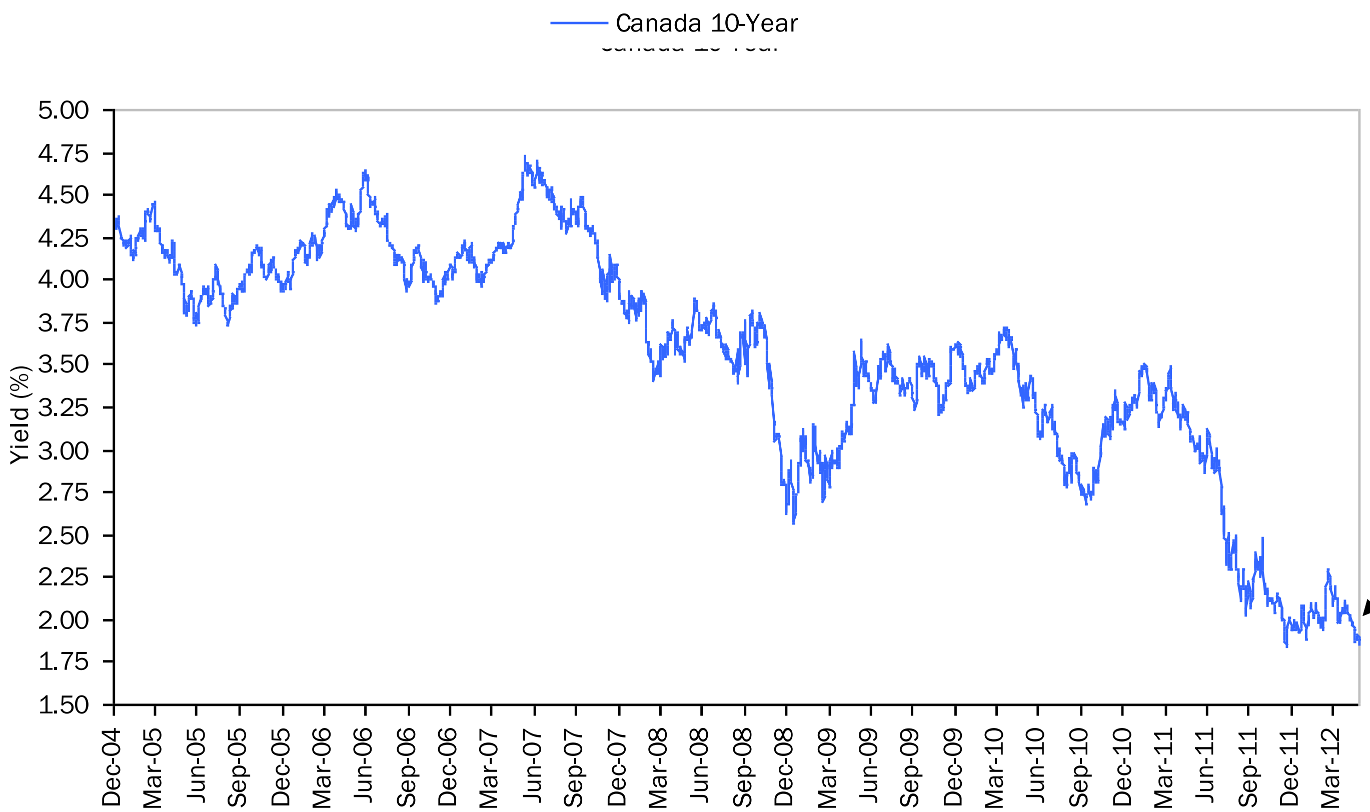
Global information flow is now practically instantaneous and impacts pricing across all asset types and markets

It's unlikely that the morning newspaper is your key source anymore, or that "Wall Street/Bay Street" professionals have any information edge anymore

All of this feeds into the outlook for interest rates, domestic macro-economic conditions, and ultimately for underlying property fundamentals

Source: Bloomberg

The good news: In a volatile world, the “flight to safety” in gov’t bonds a boon for stable income yielding investments

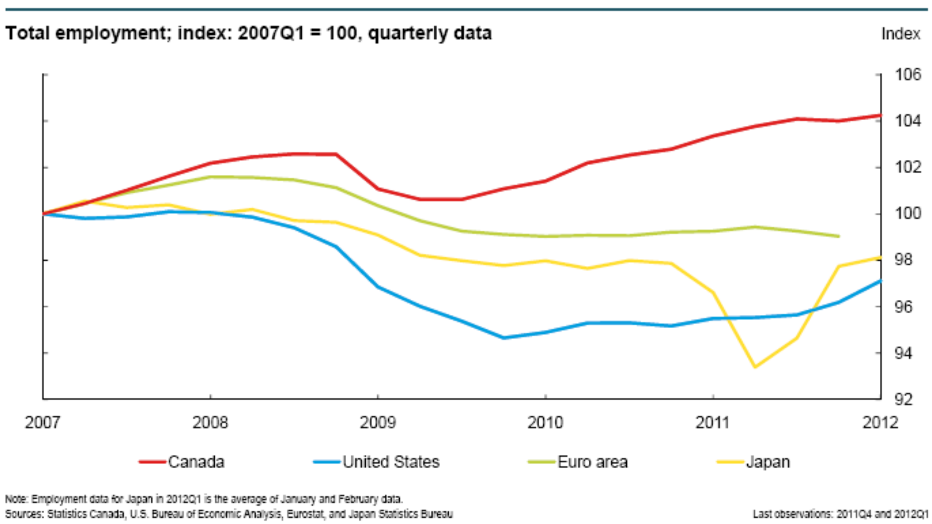


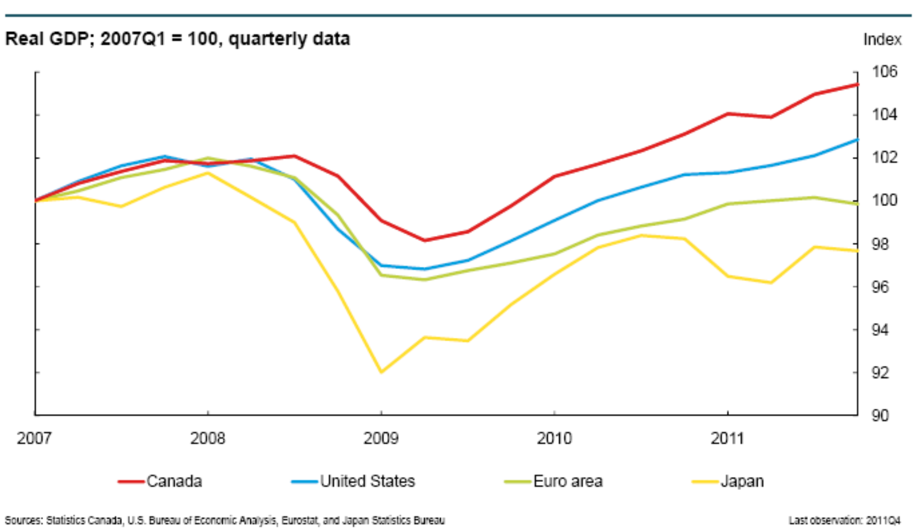
Is now the right time to boost leverage?

With 10-year government of Canada bond yields hovering at 1.8%, it is relatively easy to secure attractive fixed rate long-term commercial real estate mortgage financing well below 4.00%. Combined with stable macro-economic and employment conditions, Canadian commercial real estate is currently being valued like a “safe haven” asset class

Source: Bloomberg

The good news: Solid domestic macro economic fundamentals underpin Canadian real estate markets





Canada "paid its dues" in the 1990s by raising taxes and aggressively reducing government debt.

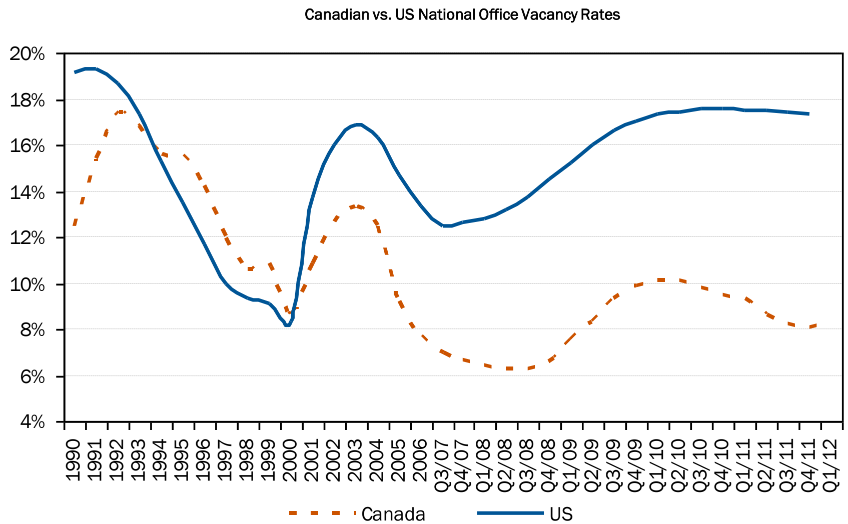
In addition, strong financial services regulation limited the fallout from the global credit crisis, which materially aided in Canada's ability to rebound from the 2008/2009 downturn.

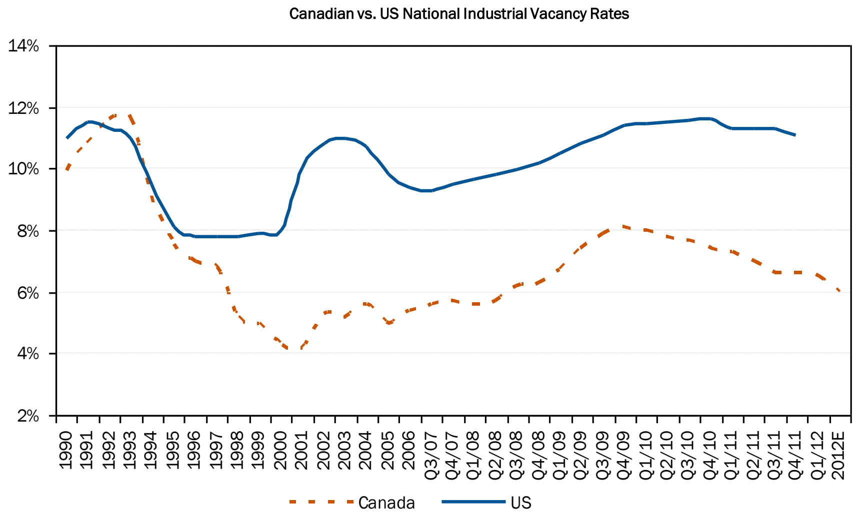
Today, there is little concern about Canada's sovereign credit, or ability to return to budget surpluses within the next five to ten years.

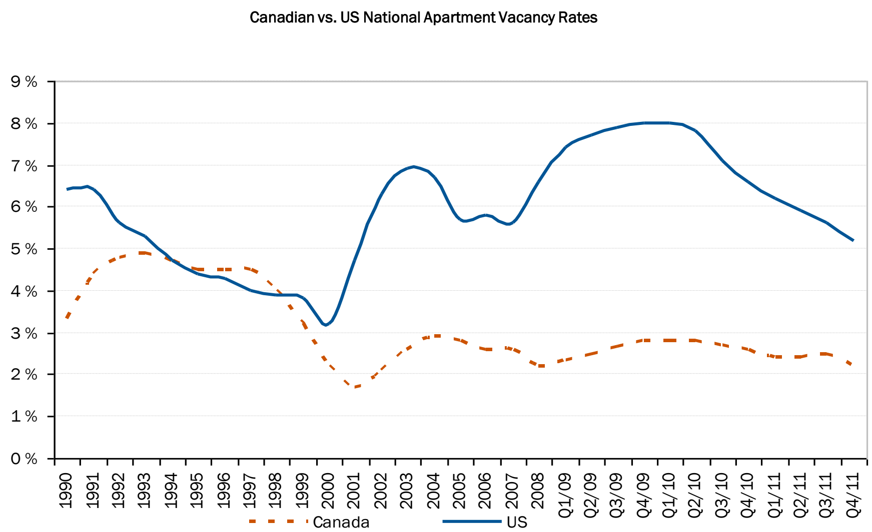
Canada's healthy banking system, constructive immigration policies, and its resource-rich economic-base should continue to support G-7 leading economic performance

Source: Bank of Canada

The good news: Canadian property fundamentals are in their best shape at this point when compared to prior cycles





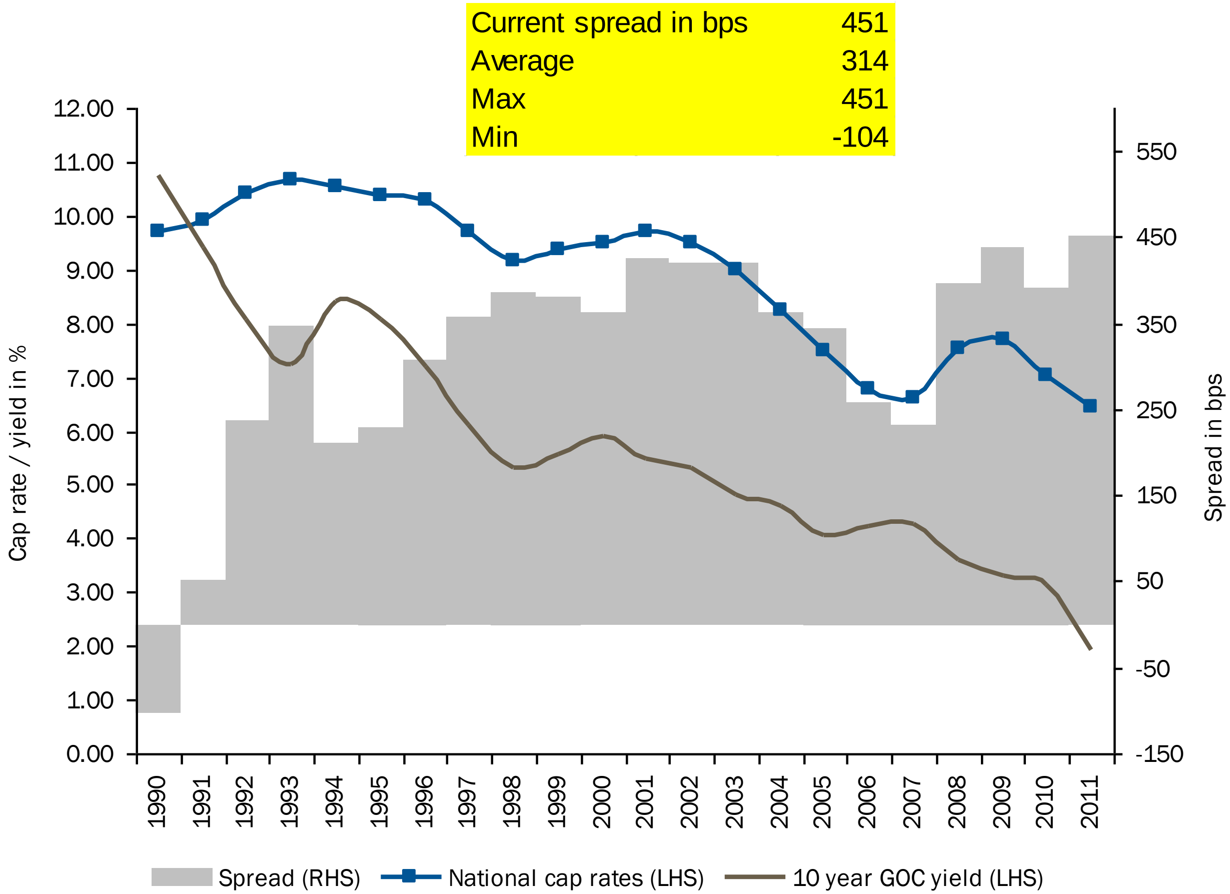


1. Canadian vacancy levels are at ½ of US levels

2. We have never experienced Canadian real estate coming out of a recession with such low vacancies

Source: CB Richard Ellis, CMHC, REIS Inc., Canaccord Genuity

The good news: Goldilocks scenario still playing out in Canadian commercial real estate



Canadian commercial real estate cap rates are now back to their pre-credit crisis levels (i.e asset values at peak levels).

This is <u>NOT</u> because of strong growth prospects, but because borrowing costs have fallen dramatically.

We are now at the widest positive investing spreads (cap rates – long GOC bond yield) in the past two decades

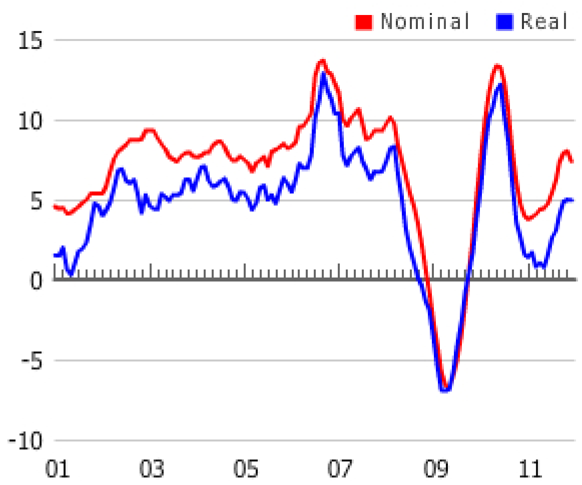
Source: CBRE Richard Ellis, Bloomberg, CMLS.ca, Canaccord Genuity

The good news: Goldilocks scenario still playing out in Canadian residential real estate

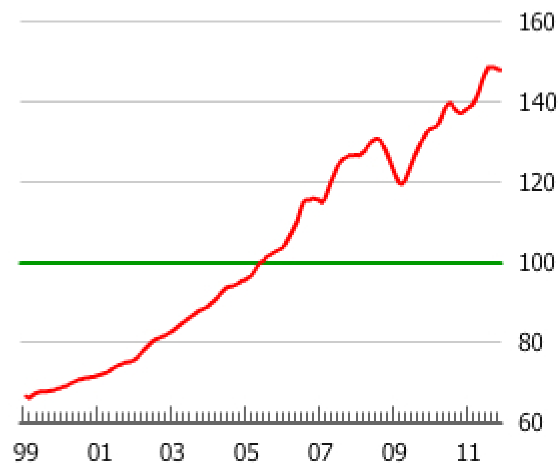
Canada

House Price Change (Composite 6 Cities)

% change over a year earlier



Teranet- National Bank House Price Index, Composite 6 cities (June 2005=100)



Aside from a temporary correction in late 2008/early 2009, Canadian residential real estate has experienced boom conditions for the past decade.

Canadian lenders aggressively competing for market share has more than offset tightened CMHC rules. Limited new supply and low borrowing costs continue to fuel seller market conditions across most of Canada.

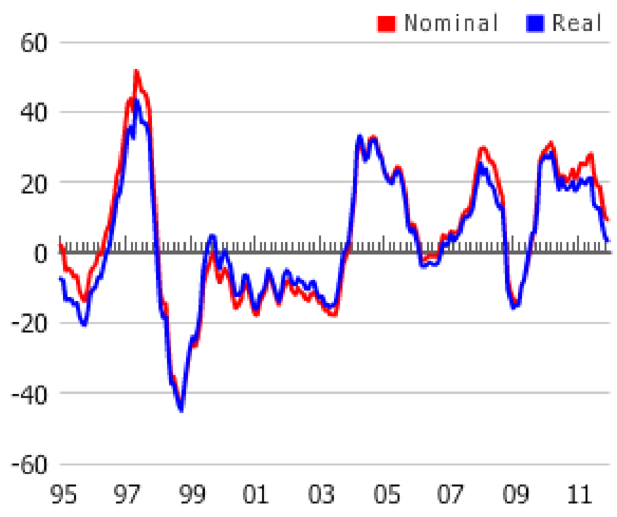
Source: www.globalpropertyguide.com

The bad news: What precludes Canada's major housing markets experiencing more volatility?

Hong Kong

House price change

% change over a year earlier



Private Domestic Price Index, All Classes

(1999=100)

The recent softness in Vancouver's housing market (Canada's most expensive) could be an early sign of volatility similar to that experienced in Hong Kong

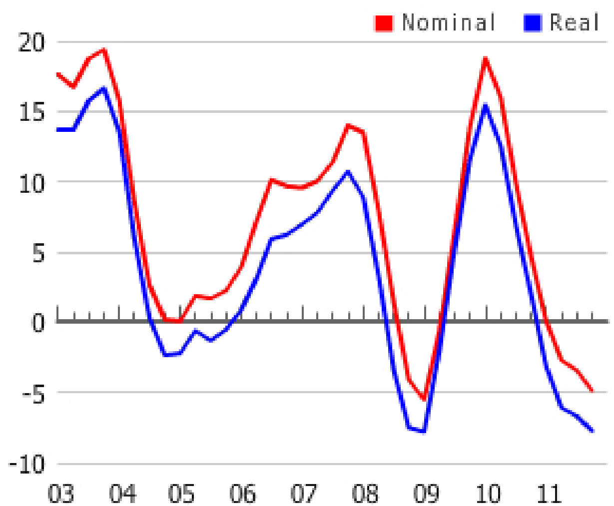
Source: www.globalpropertyguide.com

The bad news: What precludes Canada's major housing markets experiencing more volatility?

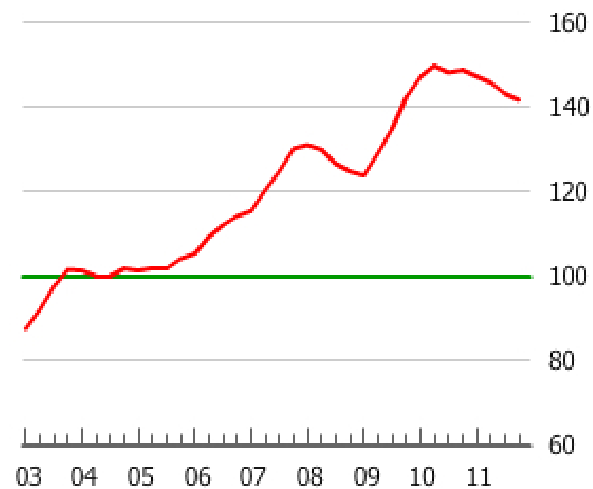
Australia

House price change (8 capital cities)

% change over a year earlier



Price Index of Established Houses, Weighted Average of 8 Capital Cities (2003-2004=100)

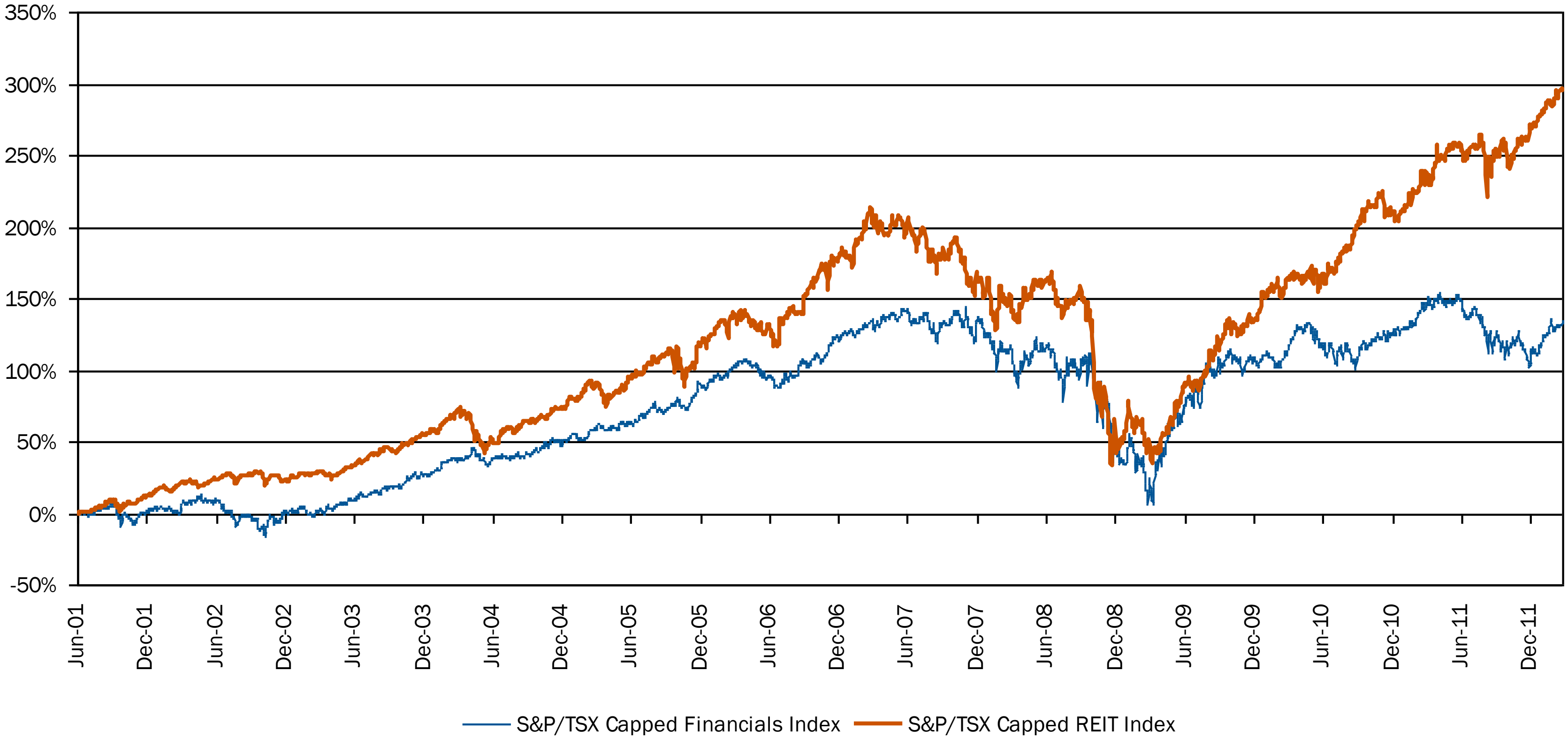


Australia's resource-based economy is similar to Canada, although its largest trading partner is China, not the US.

In order to keep inflation in check, Australia has kept interest rates much higher than Canada, and this is now starting to negatively impact the housing market.

Source: www.globalpropertyguide.com

The bad news: Borrowers unlikely to win in the long-term while Lenders continue to suffer



How can this wide performance gap be sustained if interest rates jump or credit becomes more difficult to obtain?

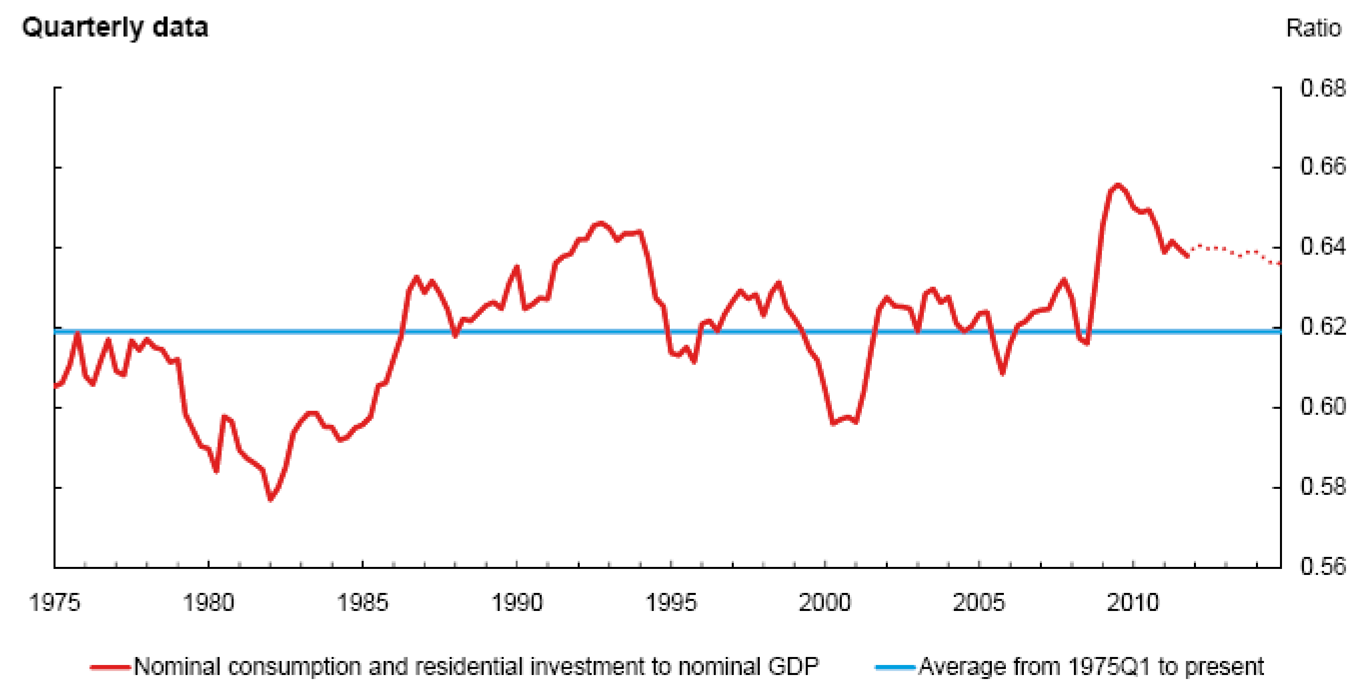
Source: Bloomberg

The bad news: Borrowers unlikely to win in the long-term while Lenders continue to suffer

Source: Bloomberg

The bad news: What happens when the Canadian consumer runs out of steam?

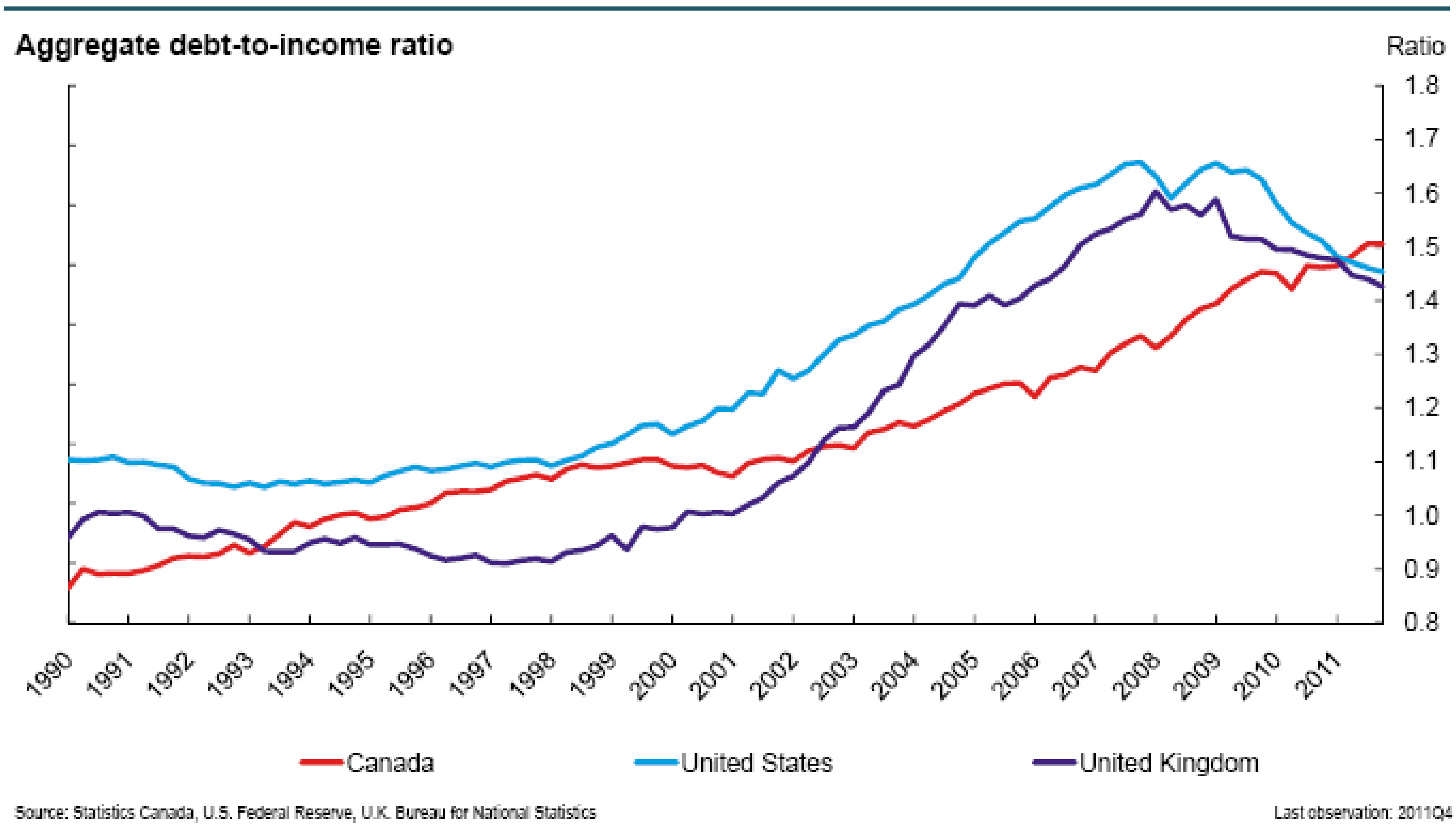
Share of household expenditures in GDP now high



Note: Dotted line indicates a projection.
Sources: Statistics Canada and Bank of Canada calculations

Source: Bank of Canada

The bad news: Canadians have taken on a lot of debt, and are now more indebted than US and UK counterparts



Source: Bank of Canada

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Key takeaways

- There is a wealth of public information on the real estate industry through the proliferation of REITs around the world to help you formulate "the big picture"
- Volatility is here to stay due to technological innovation and the speed with which information now flows on a global basis.
- We are living in an interconnected world (which we learned during the fall of Bear Stearns and Lehman Bros in 2008), and this has a major impact on asset pricing.
- Debt and equity markets are no longer considered separate and distinct – be mindful of the interplay between them (rising/falling credit spreads directly impact equity valuations)
- Low interest rates are largely driven by major problems in markets outside Canada While the risk of materially higher interest rates in Canada do not appear to be a cause for concern in 2012 (and possibly 2013), the outlook can quickly change by key events in Europe, the US, or China.
- Canada's status as a safe haven only exists on a relative basis to nations which are currently much weaker. However, if Canada experiences a major housing downturn, this could substantially derail domestic consumer spending and simultaneously hurt the banking system (and potentially the gov't guaranteed CMHC insurance program)

Protect your downside risk by building adequate liquidity and a capital cushion in the event of a major unforeseen negative shock as these appear to be occurring more frequently due to the aforementioned reasons

Thank you for your time!

Q&A

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