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# British Columbia Real Estate Investment Review

Second Half 2007

**AVISON  
YOUNG** Intelligent  
Real Estate Solutions

Metric	Second Half 2007	Full Year 2007
Total value (sales > \$5 million)	\$650.6	\$966.8
Total number of transactions	23	47
Most active buyers	Pension Funds	Private Investors
Most active sellers	Government	Private Investors
Most active asset class:	Mixed Use	Retail

## MARKET SUMMARY

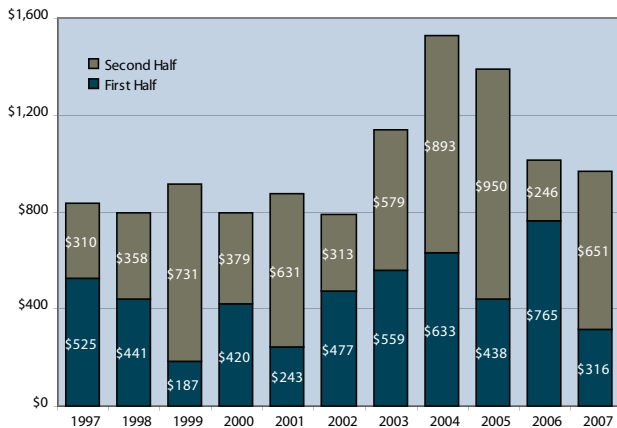
Avison Young tracks investment sales in British Columbia greater than \$5 million. The value of all sales during 2007 was \$967 million, only slightly down from the \$1.0 billion recorded in 2006. Fifty-four transactions were recorded in 2006 for an average transaction value of \$18.7 million. During 2007, the comparative figures were forty-seven sales and an average sale price of \$20.6 million. The average transaction size over the last decade was \$20.9 million.

The market for investment sales during 2007 may be characterized as unexciting but reasonably rational. There has not been the momentum in this market that was in evidence in earlier periods. In our view, seller expectations exceeded, by a wide margin, what many buyers found acceptable. From mid-year onwards, the market was not helped by disturbing economic and financial news emanating from the United States.

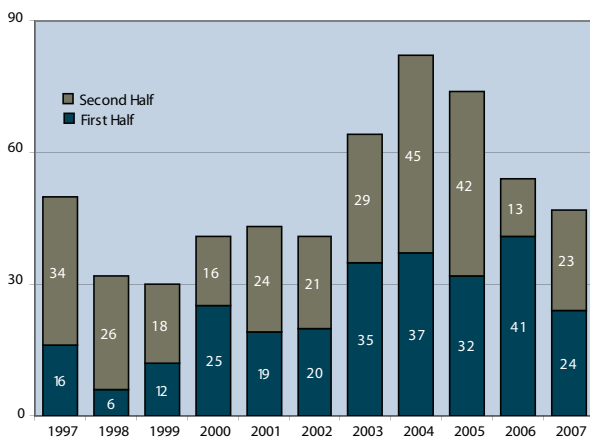
Going forward the turmoil in capital and credit markets will make debt financing scarcer and more expensive for some leveraged buyers. However, for most well financed real estate borrowers, buying at sustainable prices, or rolling-over debt at fair valuations, there should not be a problem providing borrowers are able to meet more stringent lender underwriting criteria. The wheels of commerce are unlikely to fall-off totally notwithstanding the excesses of some members of the investment banking fraternity.

We believe the market is in the process of a correction and we predict that yields will soften as we go into 2008 by 25 to 75 basis points across all asset classes. Real estate risk will be priced at more rational levels.

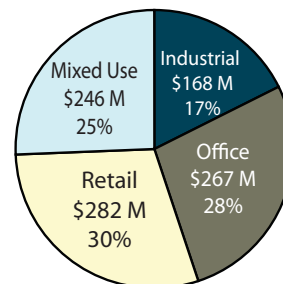
BC Investment Sales by Dollar Volume (\$'000)  
(Properties >\$5 Million)



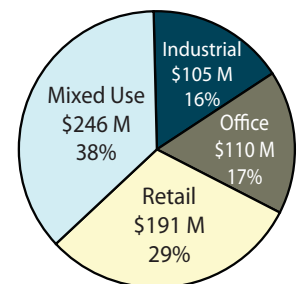
BC Investment Sales by No. of Transactions  
(Properties >\$5 Million)



2007 - Total Sales > \$5 Million by Dollar Volume



Second Half 2007 - Total Sales > \$5 Million by Dollar Volume

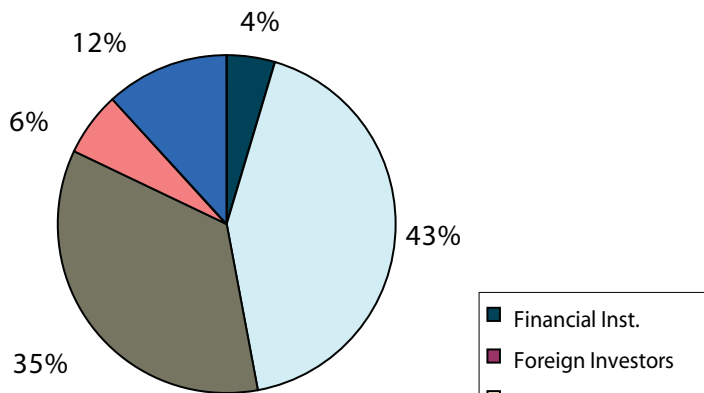


# Buyer and Seller Profiles

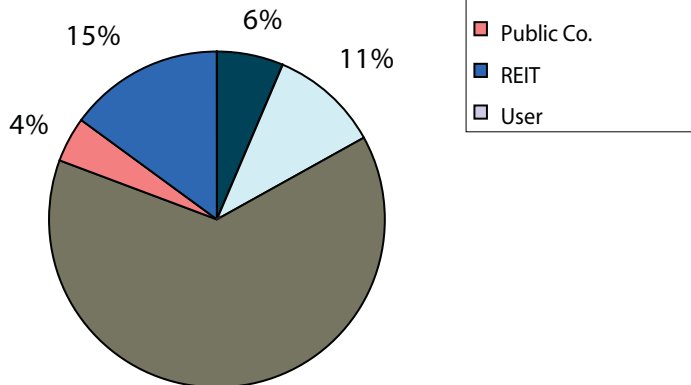
## Buyer Profile

During the first half of 2007, the dominant buyers were private investors, which bought investment properties worth \$199 million. In the second half, pension funds were the principal investors investing \$394 million. The year ended with pension funds having bought properties worth \$410 million, out-spending private investors at \$340 million. Private investors and pension funds accounted for 78% of all investment sales of greater than \$5 million during 2007.

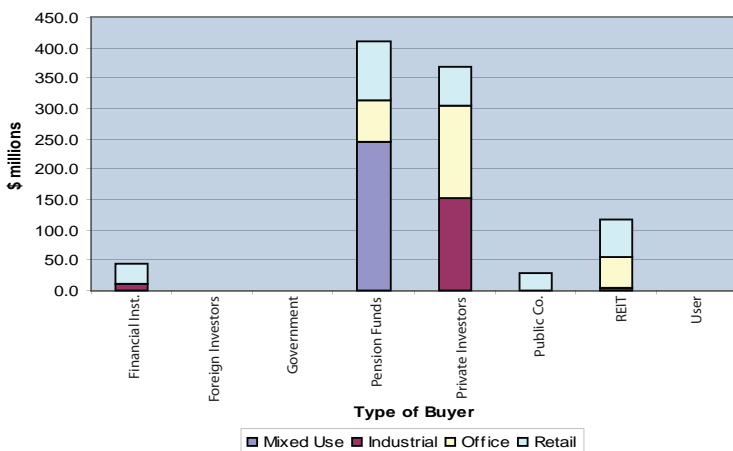
2007: Value of Purchases by Buyer Profile



2007: No. Transactions by Buyer Profile



2007: Buyer Purchases by Asset Type



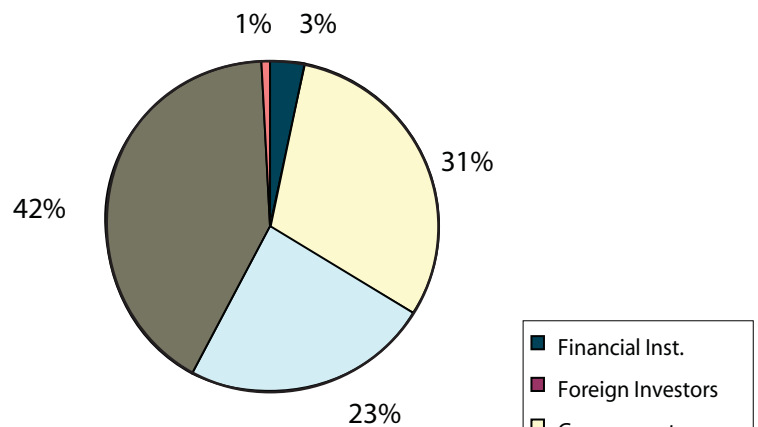
## Seller Profile

Sellers of investment properties during the first half were dominated by private investors who sold \$204 million of investment grade real estate. This was 65% of all sales in the first half of the year. During the second half of the year, government agencies topped the activity chart, largely on account of the ICBC sale of Central City, Surrey for \$246 million. The next most active group were private investors at \$201 million.

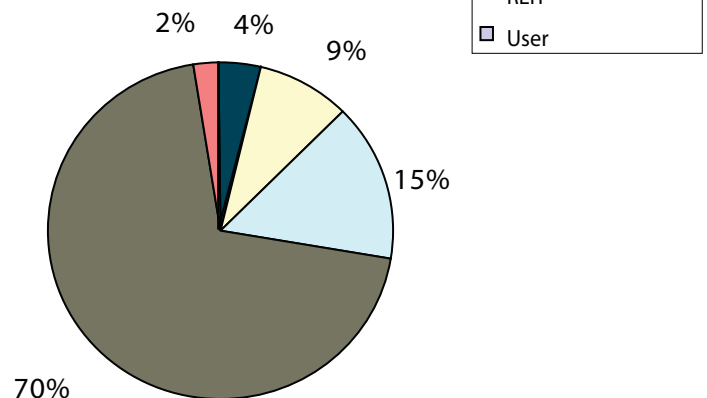
By year-end private investors led all sellers with the sale of properties worth \$405 million spread over 33 transactions. They were followed by government sellers at \$296 million in four trades and pension funds executing sales for \$243 million in eight sales.

Overall, government was a net seller of assets during 2007, with a net reduction in assets of \$296 million. Private investors sold more than they bought by \$65 million.

2007: Value of Sales by Seller Profile



2007: No. Transactions by Seller Profile



## MARKET ISSUES AND CONCERNS

Investors have much to think about given the current state of global economies and financial markets in particular.

Will the U.S. economy sink into a severe recession? Consumer demand in the U.S., including the demand for Canadian goods and services is declining. This will have an effect on the demand for space in all asset classes as



Canadian businesses respond to the situation in the U.S. by cutting back on production and the office space supporting those production processes.

In which direction are interest rates headed? With oil recently peaking at around U.S. \$100 a barrel, what will be the effect on inflation and, by extension, interest rates? With a possible recession, coupled to rising inflation, will the economy "stagnate"? In other words will we enter a period of rising prices when the economy and jobs are in decline?

Will buyers have a difficult time raising debt capital? Credit and capital markets have been in a state of disarray as lenders assess the effects of the irresponsible mortgage lending practices in the United States and the securitization opportunities, which followed.

Where is the value of the Canadian dollar headed? What continuing effect will there be on Canada's balance of trade? How dramatic will be the effect on the British Columbia export sector, the forest products industry in particular?

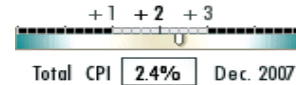
Questions concerning the general economy, interest and exchange levels are always at the forefront of the real estate investor's mind. However these risk factors have attracted considerable attention recently, because of volatility engendered by the sub-prime housing debacle in the U.S.

On the more positive side of things the fundamentals of demand and supply in the British Columbia real estate investment markets are strong. There is increasing population, increasing disposable income and declining unemployment rates. Demand for offices, warehouse, factories and shops remains strong. There isn't an over-supply of buildings in any of the primary asset classes.

## A COMMENTARY

### Inflation

During 2007 inflation, as measured by the Bank of Canada's core inflation index, moved from 2.0% to 2.4%.



SOURCE: BANK OF CANADA

There is a concern, not wholly unjustified, concerning the price of oil, which has an uncanny way of affecting the cost of almost everything that is consumed.

Against the concern for inflation are the effects of the slowdown in the U.S. economy, and by extension the Canadian economy. The Bank of Canada recently lowered its growth forecast for 2008, lowering the rate of growth in GDP to 1.8%. At the same time the Bank lowered its overnight lending rate by 25 basis points to 4%. This is 50 basis points less than a year ago.

### Currency Exchange Rate

A major concern for exporters in Western Canada is the high value of the Canadian dollar. The consequence of the Loonie trading at current levels, coupled with a disastrous housing market in the U.S. is a contraction in the output of the forest products industry followed by job lay-offs, not only in out-lying communities but also in the metropolitan areas. Commercial real estate investors need to be aware of the effect on leasing and investment markets.



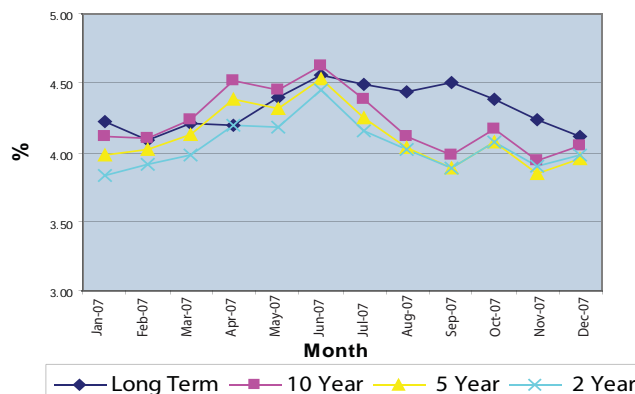
USD-CAD Noon Rate  
25/01/08: 0.9956  
(1 CAD = 0.9956 USD)

SOURCE: BANK OF CANADA

### Bond Yields

With turmoil in global financial markets over the last six months, we would have expected a movement in bond yields. From the Chart below, it can be seen that bond yields have declined since mid-year as investors appear to have flown to safety. While yields have declined, spreads for real estate borrowers have increased with the net effect that borrowing costs have not come down and have likely increased as risk is more rationally priced as a consequence of more rigorous underwriting.

Selected Government of Canada Benchmark Bond Yields





The new Shangri-La hotel, currently under construction illustrates the need to increase density in the Downtown core. How long can it be before strictly commercial office buildings are built to more than the current maximum 9 FSR?

## COMMENTARY

The British Columbia investment office market is weighted heavily towards Metro Vancouver. It is a market which has shown exceptional strength from an investor's point of view with strong capital appreciation and solid income returns. However, during 2007 capitalization rates bottomed out between 6.0 – 6.5 %.

The Metro Vancouver office market is a tale of two markets; Downtown coupled with Yaletown and Broadway and the suburban markets stretching eastwards to Surrey.

Within the central urban markets there is an imbalance between demand and supply. The average vacancy rate is 3.0% across the three sub-markets. There is an identified and pending supply of 734,000 s.f. over the next three years. Absorption during 2007 was 575,000 s.f. The situation in the Downtown market is particularly critical. Rents for Downtown AAA space have pushed through the \$50 / s.f. net threshold. How much upside is left for investors is a matter of some conjecture.

Property	Price	Vendor Type	Buyer Type	Date
4259-4299 Canada Way I & II Burnaby	\$26,800,000	Financial Institution	Pension Fund	June-07
Pacific Business Centre Richmond	\$24,500,000	Pension Fund	Pension Fund	Aug-07
First Capital Place New Westminster	\$16,600,000	Private	REIT	Nov-07
4200 North Fraser Way Burnaby	\$12,000,000	Government	Private	Sept-07
1907 W. 4th Ave Vancouver	\$10,500,000	Private	Private	May-07
233 W. 1st Ave North Vancouver	\$10,400,000	Private	Private	July-07
1750 W. 10th Ave Vancouver	\$8,900,000	Private	Private	Oct-07
<b>TOTAL</b>	<b>\$109,700,000</b>			

In the suburban markets, the balance between demand and supply is less favourable to investors. The average vacancy rate across the suburban markets is 7.7%. There was 360,000 s.f. of space absorbed last year. There is 390,000 s.f. of new space entering the market during 2008.

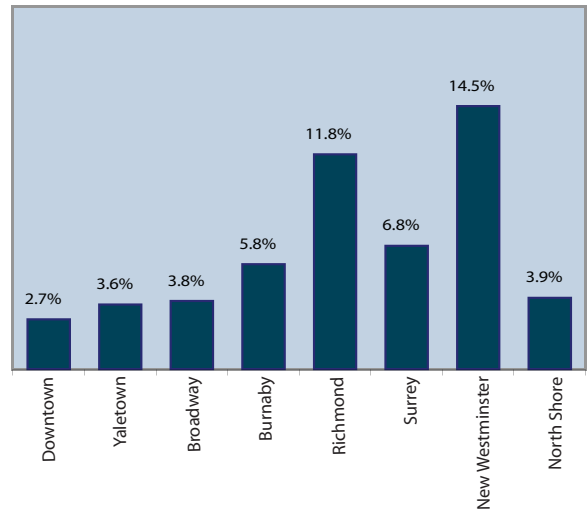
There has not been significant extraordinary upward pressure on suburban rents. Land is readily available for development and the relatively smaller buildings constructed in the suburbs may be brought on stream quickly to meet evolving demand for space.

A concern for investors in the Metro Vancouver market, as in other metropolitan markets will be the state of the U.S. economy and the relatively high value of the Canadian dollar as these two factors play out in the Canadian market place.

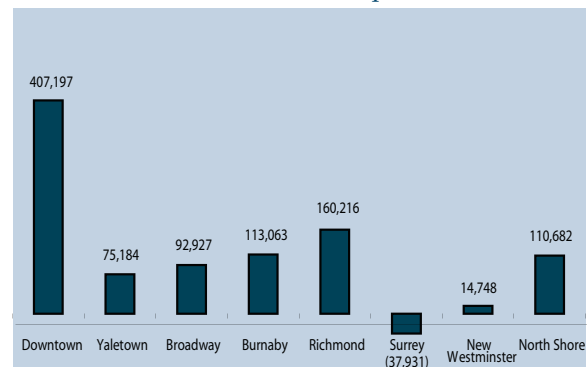
The U.S. economy, showing weakness as a result of a collapse in the U.S. housing market, will almost certainly have a negative effect on economic growth in this country. Similarly, the relatively high value of the dollar is wreaking havoc on the forest products and tourism industries in British Columbia. Off-setting the negative, to a large degree, is the economic activity being generated regionally by both the public and private sectors in an extensive program of capital works.

During 2008, we expect yields to increase by 25 to 75 basis points and we expect to see a widening of the differential between Downtown and suburban yields as risk is more rationally priced.

Metro Vancouver Vacancy: Year End 2007



Metro Vancouver Absorption: 2007





## COMMENTARY

The November seasonally adjusted figures for Canadian retail trade show B.C. sales increased 8.7% over twelve months. This compares to Canada at 6.1%, Alberta at 7.6% and Ontario at 4.7%. BC accounted for approximately 13.7% of all Canadian retail sales during November. The Metro Vancouver region accounts for 50% of all provincial sales, followed by Greater Victoria, Kelowna and Kamloops.

Growth in retail sales is a result of increasing population and increasing disposable income.

B.C. is growing its population at 1.5% annually, on a base of approximately 4.4 million, 13.3% of the Canadian population. Canada is growing at two-thirds of the B.C. rate. Per capita disposable income for British Columbians during 2006 was \$25,194, of which almost 50% was spent on retail sales.

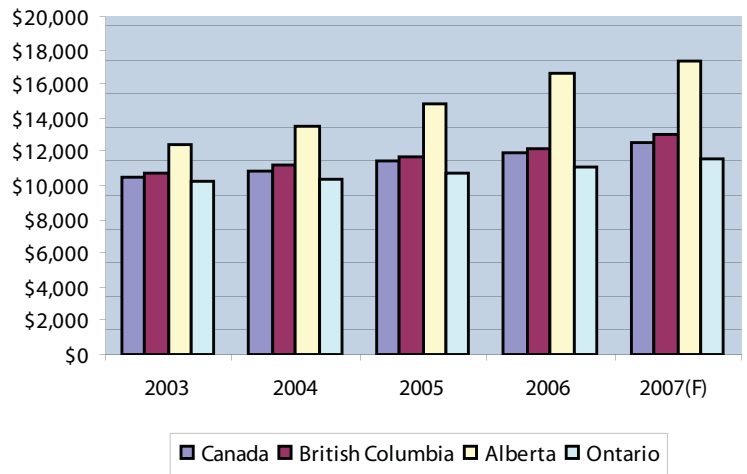
Property	Price	Vendor Type	Buyer Type	Date
Millstream Village Victoria	\$97,000,000	Pension Fund	Pension Fund	July-07
Longwood Station Nanaimo	\$29,000,000	Private	Public	Nov-07
Delta Shoppers Mall Delta	\$24,000,000	Pension Fund	REIT	Sept-07
Westbank Shopping Centre Westbank	\$19,000,000	Pension Fund	REIT	June-07
34530 McConnell Abbotsford	\$16,250,000	Private	Financial Institution	Sept-07
Steveston Marine Vancouver	\$5,422,000	Private	Private	Sept-07
<b>TOTAL:</b>	<b>\$190,672,000</b>			

The retail sector is an attractive area for investors not only because of the potential for growth in an expanding economy but also they provide an instant hedge against inflation through percentage rent.

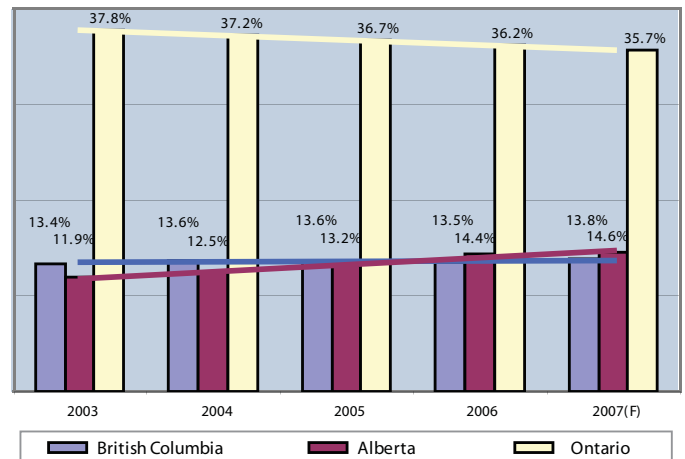
As noted elsewhere in this report, B.C. is susceptible, like all of Canada, to an economic slowdown as the U.S. economy heads to recession in response to the housing market situation in that country. In addition to an economic slowdown, the relatively high value of the Canadian dollar continues to take its toll on retailers susceptible to cross-border shopping.

We are of the view that investors, while optimistic about the B.C. economy, are also cautious and will consider B.C. retail investments with circumspection. We expect yields to fall-off in concert with yields for all competing investments.

Per Capita Retail Sales by Selected Provinces  
2003 - 2007 (Forecast)



Percentage Share of Canadian Retail Sales  
2003 - 2007 (Forecast)





The newly merged Vancouver Fraser Port Authority's Centerm Container Terminal in Downtown Vancouver is a critical piece of economic infra-structure in the industrial supply chain.

## COMMENTARY

The British Columbia industrial investment market is almost exclusively centred on Metro Vancouver, the hub of the Province's industrial activity. Metro Vancouver, through its sophisticated port system, is both an entrepôt for goods entering the region for distribution throughout North America and a port for the export of Western Canada's significant export trade, particularly bulk commodities.

The export market for commodities of all types has been booming for the last several years. More importantly for industrial investors, the region has experienced strong growth in container traffic as trade between North America and Asia has expanded. This has led to a demand for efficient distribution facilities. In addition, domestic demand for industrial facilities has also been growing in response to an increasing regional population and a burgeoning regional economy.

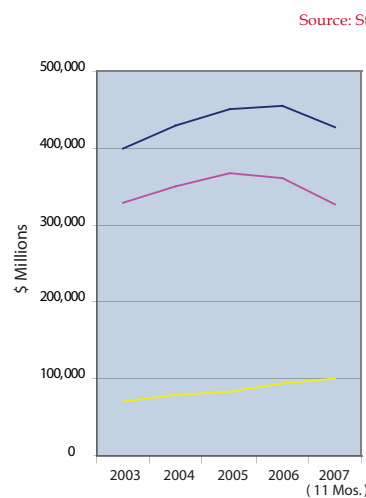
The strong fundamentals in the economy are manifested in low vacancy rates and increasing net rental rates and escalating land values. The average industrial vacancy across Metro Vancouver is 1.5% with typical suburban warehouse rates pushing through \$8.50 per s.f. Serviced and zoned industrial land is scarce. It is not unusual to see industrially zoned land trading in excess of \$1 million an acre.

Demand for industrial product is almost insatiable in Metro Vancouver. However, there is concern with macro economic factors, in particular the slide in the British Columbia forest products sector. Exports of forest products were down 15.9% from a year ago.

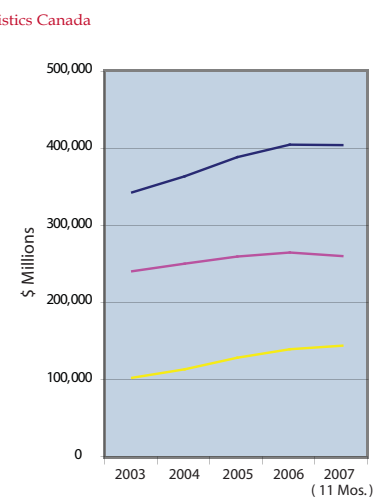
We expect to see continuing interest in this asset class in 2008. As with all asset classes, however, we expect yields to soften.

Property	Price	Vendor Type	Buyer Type	Date
1337 Townline Road Abbotsford	\$45,000,000	Private	Private	Aug-07
8264 - 8268 Ontario Vancouver	\$12,888,888	Private	Private	Jul-07
2390 - 2440 Canoe Avenue Coquitlam	\$10,600,000	Private	Financial Institution	Jul-07
4460 Jacombs Road Richmond	\$7,750,000	Private	Private	Aug-07
50 Fell Avenue North Vancouver	\$30,400,000	Private	Private	Sept-07
9430 198th Street Langley	\$6,300,000	Private	Private	Oct-07
1603 & 1625 West 3rd Avenue Vancouver	\$5,405,000	Private	Private	Sept-07
13720 Mayfield Place & 13330 Maycrest Way Richmond	\$5,176,000	Private	Private	July-07
7500 Alderbridge Way Richmond	\$5,000,000	Private	Private	Sept-07
<b>TOTAL:</b>	<b>104,469,888</b>			

Canadian Exports:  
2003 - 2007



Canadian Imports:  
2003 - 2007



## UNDERSTANDING RISK

Risk is a concept that is critical to all investing and real estate is no exception.

The shambolic situation with the sub-prime debacle in the U.S. and its knock-on effect throughout international financial markets should serve as a very good illustration of the importance of understanding risk.

In exchange for high yielding securities, investors took on risks that they either ignored or which were glossed over by the rating agencies that endorsed a bill of goods. Snake oil salesmen could not have done a better job of marketing something that wasn't i.e. high yielding, high grade investment assets.



In the real estate world, yield is a composite of current or contractual returns and speculative or expected future reversionary returns. Over the last several years, this simple concept has been overlaid with something colloquially re-

ferred to as a 'weight of capital'. In lay terms, there has been a glut of capital looking for a home to earn a return to equity. The capital has often been cheap and easy debt capital. Investors have been able to borrow at rates that were less than investments would yield, with the gain juicing the returns to equity.

Not all investors are undisciplined and many will appreciate the risk of reverse leverage and only borrow to prudent levels. Regrettably, high ratio financing is seductive to many less wise and inexperienced real estate investors.

In the more rational markets, a relatively low yielding asset suggested reversionary gains. A relatively high yielding asset indicated that the investor placed greater importance on current returns and discounted future capital appreciation.

For example, apartments in Vancouver's West End have traded at the low end of the risk spectrum whilst motels have traded at the other end with the relevant yields reflecting the perceived relative risk of each investment class.

In more recent times, investors often seem incapable or unwilling to differentiate the degree of risk both between asset classes and within asset classes. Suburban office buildings, for example, recently traded at yields that were more directly applicable to better located, better tenanted and better constructed properties. In the rush to unburden themselves of a weight of capital, many investors threw rigour, in the form of underwriting standards, out the window. They assumed that there was no risk that they couldn't

manage with the judicious application of their often new found expertise and wisdom.

Well in the words of that old sage Bob Dylan, "The times they are a changin' ". If there is one thing that a tight credit environment will do it is to force real estate investors to identify, assess and price risk rationally.

In real estate markets, cheap and readily abundant money is no longer the norm. Banks are facing a re-alignment of their balance sheets and in the process will be required to curtail their lending practices. Credit is not only more expensive but also unavailable to many. Debt investors are being marginalized and the weight of capital is easing.

The importance of sound underwriting of risk is returning to its rightful place and investors will be considerably more discerning where they place funds and what they expect in return. Central to the process are the key elements of identifying, evaluating, mitigating and pricing risk.

We live in interesting times. Real estate investors, perhaps confused with what is happening, will do well to take professional advice on risk management before acquiring or disposing of real estate assets. Those that have a true picture of market, operational and financial risk will be successful. Those that don't could probably do as well in Las Vegas.

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## RAPID TRANSIT AND REAL ESTATE INVESTMENT

The Provincial government recently announced plans for a \$14 billion investment programme for public transit improvements in Metro Vancouver, Victoria and Kelowna between now and 2020.

Apart from the politics associated with an announcement of this kind, there are significant ramifications to the way Metro Vancouver, in particular, is likely to develop over the next two decades. The new transportation infra-structure will radically change the region including where people live, work and play.

The proposals should also change the way the region is administered.

Real estate investors considering Metro Vancouver should be aware of the changes that are likely to occur over the next twelve years as a result of the proposed transportation improvements.

Improvements to the regional transportation system will have very significant ramifications on land use, particularly the rate and direction of growth and the form of development.

In the short term, we should expect extensive speculation as bets are placed around key intersections along the new and extended routes. As station plans are firmed-up, there will be a move by local authorities to re-zone land around designated intersections at which stations are intended.

## Commentary (cont.)

### Proposed Public Transit Plan: 2008 – 2020

\$ Billion	Projects	Description	Completion	Notes
2.0	Canada Line	YVR / Richmond	2009	19 km
1.4	Evergreen Line	Coquitlam TC / Lougheed TC	2014	11 km
2.8	UBC Line	Broadway / UBC	2020	12 km
3.1	Expo Line	Extension to Surrey	2020	6 km
1.0	West Coast Express	Railcars	-	-
1.2	Rapid Bus BC Lines	Kelowna / Victoria / Metro Vancouver	-	-
1.6	1,500 Buses	BC	-	-
<b>\$13.2 Billion</b>				

Source: BC Ministry of Transportation – January 14th, 2008

Land use planning and transportation policies are set by several intersecting jurisdictions. Metro Vancouver, through Translink, is responsible for regional transportation and the many municipalities forming Metro Vancouver are responsible for land use within their boundaries. That must change if the region is to work effectively not only as a sustainable region in terms of the social and environmental conditions but equally, if not more importantly, in terms of economic efficiency.

With certainty of location assured, the speculators will exit the picture, no doubt at significant profit for those that bet correctly, and developers will move in to physically re-develop properties to a higher and better use. This will result in significant density increases around stations as Metro Vancouver pursues its Liveable Region Strategy of reducing dependency on the automobile and provide residents with an affordable and efficient means of reducing travel time to work.

As the regional population increases and those populations are dispersed along the new transportation routes, there will be demand not only for apartments and other dense forms of housing, but also retail, service retail and office uses. We would not be surprised to see major food stores, banks, health clinics and others scouting locations at this early stage to secure a position at the more obvious locations.

In summary, investors looking at Metro Vancouver will do well to consult their professional real estate advisors to discuss transportation and land use changes contemplated for the Metro Vancouver region. Opportunities exist for those with the foresight to exploit change at an early stage.

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