# 2017 Real Estate Outlook survey

**Sustaining momentum – but will it last?**
*A Canadian/US Comparison*

May 2017

kpmg.ca

# Contents

# Macro Canadian trends

## Canadian real estate executives face no shortage of challenges in the year ahead. From tighter markets to game-changing regulations, the way forward will not be without its speed bumps. Yet much like their US colleagues, Canadians are moving forward with measured optimism and a will to grow their businesses, albeit in a cautious manner.

That growth is being influenced by several key trends within the Canadian real estate sector; trends which are also reflected in KPMG's *2017 Real Estate Outlook* survey.

**Flight to quality:** Foreign interest and domestic competition are driving huge demand for high-quality assets within all of Canada's main hubs. This trend is most pronounced in Toronto and Vancouver, where a relatively short supply of office, retail, and residential assets are commanding steeper prices by the day. In response, some are pursuing high-quality assets in some of the country's secondary markets, including Alberta. This reflected in our survey where Ontario, BC, and Alberta were identified as the top three provinces with the largest investment opportunities.

**Increased inbound foreign capital:** Interest from abroad is only making markets more competitive for Canadian real estate players. And while China is often cited the top source of inbound foreign capital, there is also a significant amount of European money being deployed. This is expected to continue throughout 2017 as more institutional product become available.

**Increased high-value sell-offs:** Canada is seeing an increased sell off of large real estate assets from the country's largest pension plans that haven't been put on the market in some time. Vancouver, for example, has been home to multiple, large-scale transactions by pension funds looking to take money off the table.

**Regional disparity:** By and large, Canada is a tale of two cities: Toronto and Vancouver. These hubs represent the bulk of Canada's real estate opportunities. However, there are additional pockets throughout the country that are showing promise for those willing to accept more risk.

Read our report for a closer examination of the perspectives shared by Canadian real estate leaders, the micro and macro factors that are contributing to their outlook, and how their perspectives and plans align with industry stakeholders south of the border. They may have their work cut out for them, but if there's one takeaway from our country-wide research, it's that no one is backing down.

# Introduction

## Continued growth despite uncertainties in 2017

For over 200 years, the average full US real estate cycle has historically run its course, from peak to trough and back again to peak, every 18 years.[1] That is what makes the historically long upturn in real estate that the US is currently experiencing so remarkable. It began with the recovery and stabilization following the housing market collapse in 2007 and has continued for the last decade – when we might expect the industry to plateau or even decline – with few signs of slowing down.

Meanwhile north of the border, Canada's housing bubble has yet to burst, despite predictions of a market collapse over the past few years.

Can the real estate expansion really continue? Industry leaders seem to think so.

For KPMG in Canada's annual Real Estate Outlook Survey, we asked senior Canadian and US commercial real estate executives about their views of the industry and their strategic plans for the next twelve months and the years ahead. Our research captured the feeling of resilience in the market-a notion that despite tighter markets, tougher competition, and game-changing regulations, North American real estate leaders aren't ready to retreat. Instead, Canadian and US executives are facing the years ahead with measured optimism and a will to grow with the industry and their clients. They are predicting promising opportunities ahead; that is, if they can see through the noise in the market and make the necessary strategic choices to seize them.

Nevertheless, the industry is grappling with how to capitalize on a growing domestic economy and strong real estate fundamentals, which also includes growing uncertainty and complexity in the market, from potential tax reform, rising interest rates, and – in the US – the impacts of a Donald Trump presidency.

Our 2017 real estate outlook report explores what micro and macro factors are contributing to this sustained optimism in commercial real estate, including what actions investors, owners, managers, and service providers will be taking in the coming year to get ahead of anticipated challenges, seize near-term opportunities, and "sustain the boom."

**"Most of the signals we are seeing in the market and hearing from our clients indicate that Canada's housing isn't going to experience a dramatic downturn anytime soon. The domestic economy is growing, access to financing and capital is steady, and real estate fundamentals are strong."**

– Lorne Burns, Partner, National Leader Building Construction and Real Estate

[1] *How to Use Real Estate Trends to Predict the Next Housing Bubble, Teo Nicolais (Harvard Extension School, March 11, 2014)*

# Key findings

## It's not over yet

The current real estate upswing cannot last forever and a downturn is inevitable. Still, our research indicates it will likely not occur in the year ahead, as real estate industry leaders are bullish about the market's prospects in 2017.

In Canada, economists are predicting a GDP increase of up to 2% in 2017, creating a sense of optimism amongst the country's real estate sector. 82% of Canadian real estate executives believe the economy will remain the same or better in 2017 compared to 2016, and only 18% believe it will be moderately worse. Additionally, 85% of Canadians predict access to funding will be the same or better in 2017, while 97% believe their access to equity capital will be the same or better.

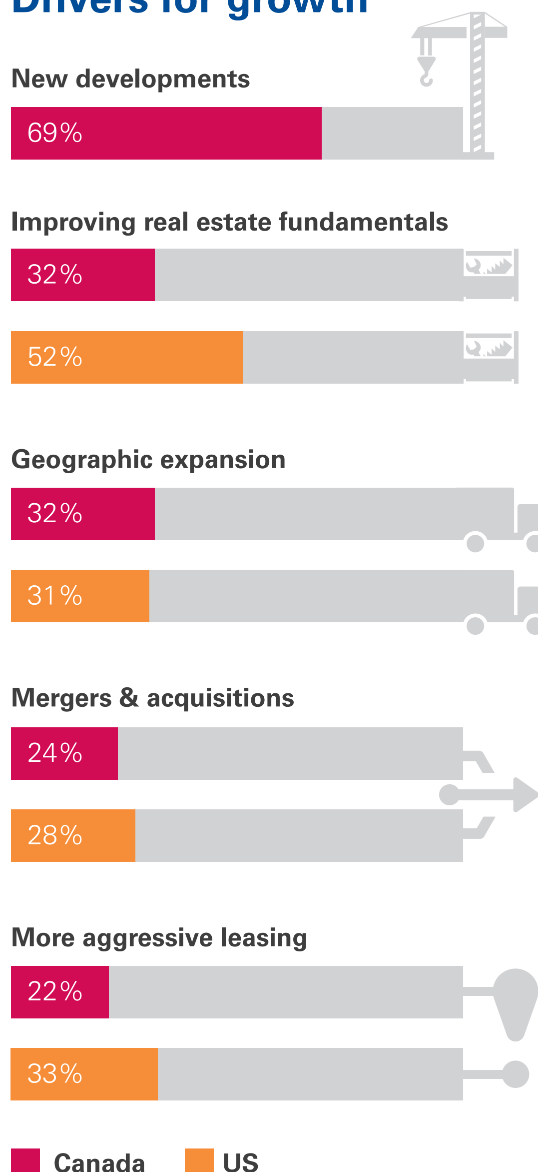
Conditions continue to be favorable in US markets. 77% of US executives say their economy will be the same or better in 2017, and most companies expect to be able to find funding for real estate deals, as debt financing is readily available. According to our survey, 86% of Canadian respondents say their company's access to debt financing will be the same or better in 2017. These forecasts are slightly more reserved than those made by Canadian respondents in last year's report, but reveal a positive outlook nonetheless.

Finally, real estate fundamentals are expected to improve in the coming year. Over three quarters of both US and Canadians executives say real estate fundamentals in their primary markets will be about the same or better in mid-2017. Even more striking is that over half of US respondents (52%) say improving real estate fundamentals will be the biggest driver of their company's revenue growth in the next three years. 32% of Canadians agree improving fundamentals will be a key driver, while 69% believe new developments will be a factor, ranking it the topmost driver in our survey.

## Market noise loud, but not deafening

Behind all of the good news, there are still some uncertainties in the real estate market. And while they don't appear to have dampened real estate leaders' bullishness, they do present some risks that must be understood and managed.

## Drivers for growth



**"Chances are the government will introduce even more changes to tax law, which will almost certainly impact the real estate industry. While clarity on the details is lacking, real estate holders should be examining how those potential changes will affect their business and making their voice heard as these discussions take shape."**

– Lorne Shillinger, Partner, National Tax Leader, Building Construction & Real Estate

For Canadians, some of the biggest uncertainties are coming from new mortgage and foreign investment rules introduced by the Federal government to cool rising markets and better protect home buyers against future market fluctuations (e.g. the "stress test"). New land transfer tax rebates and provincial home buying programs are balancing the scales, however 24% of Canadians executives still believe the impact of new regulations and legislation is a significant threat to their business models – making it their second largest threat behind their perceived ability to find investments delivering sufficient returns (42%).

Furthermore, the top three regulatory changes that have had the most impact to date on Canadian business have been changes to provincial tax laws (52%), changes to Canadian Federal tax laws (31%), and those to the Foreign Investment in Real Property Tax Act (28%). Other impactful changes cited in the survey include the Foreign Account Tax Compliance Act, Adviser Registration, and a variety of provincial/municipal regulations.

Similar concerns are also top of mind in the US, where top concerns also include the ability to find investments delivering sufficient returns (50%) and – albeit to a less degree than Canadians – the impact of new regulations/legislation (13%). One significant question mark for the industry is a new republican administration in the White House. How President Donald Trump's policies – from tax reform to immigration will impact the sector, for good or bad, remains to be seen (see sidebar).And there are other risks and challenges on the horizon.

Moreover, US interest rates are rising. On December 14, 2016, the Federal Reserve raised its key short-term rate to a range of 0.5%–0.75% from 0.25%–0.5% and announced three planned hikes in 2017, a more aggressive approach than expected.[2] Higher rates

[2] *Fed raises interest rates and adds another hike to its 2017 forecast (MarketWatch, Dec. 14, 2016)*

## How will a Trump presidency affect commercial real estate?

President Trump has promised to lower taxes, deregulate businesses, and increase infrastructure expenditures. These policies, designed to create jobs, could cause new households to form, increasing homebuilding and home sales. Young adults may move away from home into multifamily properties. And with more discretionary income, consumers may purchase more household goods and/or travel more.

Trump also campaigned on bringing companies back to America. If these efforts are successful, it could increase demand for office space, manufacturing facilities, data centers, and other property types.

Trump's goal to put the United States interest's first in economic and trade policy could cause some foreign governments to block US investments by their citizens, decreasing overall capital outflows to the US. However, most large foreign investors are unlikely to curb interest in US property assets, as the market offers safety and security, especially relative to other potential locations.

Finally, if Trump's campaign vision for immigration and trade translates into policy, it could also impact demand for real estate in some markets with a high concentration of foreign and immigrant buyers, such as Miami, Florida

So, while "America First" may encourage growth in the US, there is uncertainty on its impact on the rest of the world. For Canada, as the US is its largest trading partner and as the two economies are so closely intertwined, there are divergent thoughts. First, a view that a US centric trade policy could hurt Canadian exporters who sell predominantly to US customers. Second, however, is a contrary view that any increase in US economic activity with drive domestic consumer and business demand and, as a result, Canadian businesses will benefit from the spillover impact.

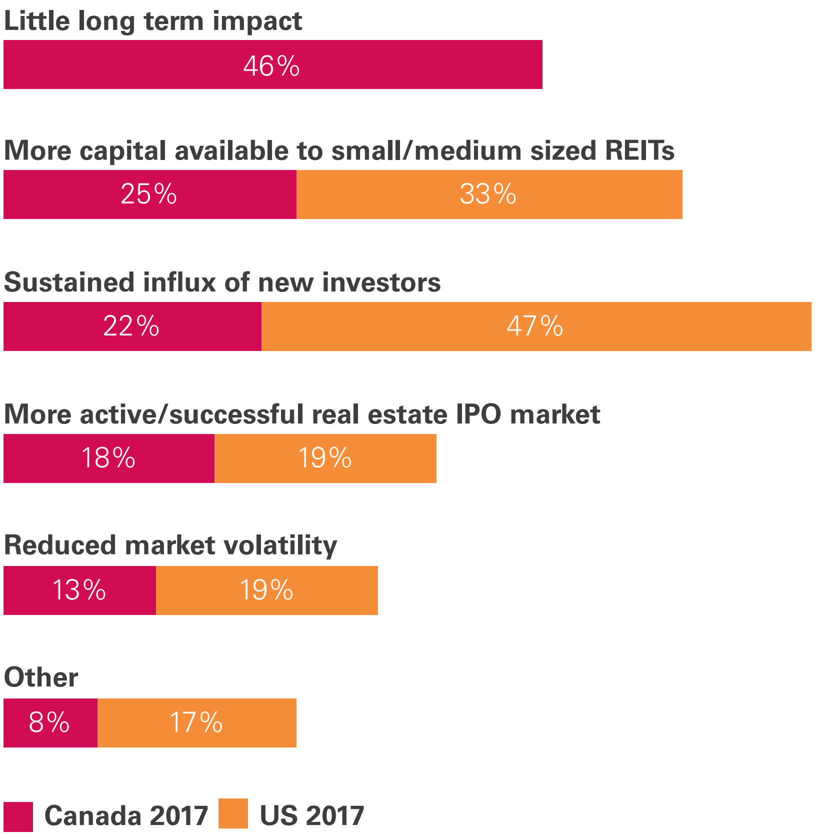
Canada will continue to be a safe haven for real estate investors and businesses wanting to access North American markets.

may impede first-time home buying. However, they reflect a healthy economy and may be a sign of sustained job growth to come, which could lead to more household formation and increased activity in the multifamily, retail, and industrial sectors.

Lastly on the US side, the impact of regulatory change also continues to play out across the sector. Our survey reveals that the Affordable Care Act and changes to federal tax laws have been the most impactful regulatory changes on real estate businesses. Given the fundamentally important nature of these regulations, any changes to them in the future may have a significant impact on US real estate companies' operations and, ultimately, their bottom line.

> **"US tax reform is certainly not guaranteed in 2017, but there is a strong chance it moves forward with the Republican party in control of both the executive and legislative branches."**
> – Russell Crawford, Partner, National Corporate US Tax Leader

## Global industry classification standard taxonomy/leasing standards impact




# Shoring cyber defenses

## Real estate firms can no longer solely focus on the physical threats to their assets or their tenants/occupants. Data breaches are now a clear and present danger, potentially leading to serious financial losses and reputational damage.

Less than half of Canadian real estate executives (44%) and slightly more US executives (50%) feel adequately prepared to prevent or mitigate a cyber-attacks. Despite nearly a third of both saying their firms, or one or more of their properties, have experienced a cybersecurity event in the last two years.

### No room for complacency

How are commercial real estate executives responding to the challenges of today's complex real estate landscape? Not by being complacent. While being cautiously confident in their outlook, there will still likely be substantive activity in the sector in 2017 as executives continue to focus on growth, efficiency, and customer satisfaction. There will be smart buyers and at the same time, there will be smart sellers.

**"Despite heavy competition for the highest-quality properties, new developments and industrial centres are in primary markets remain hot areas of investment. Prices may be higher than expected, and yields lower, but the promise of reliable returns are attractive enough to warrant sustained attention in the industry."**

– Tom Rothfischer, Partner, GTA Leader, Building Construction & Real Estate

## Asset protection in a digital world

All industries, including real estate, are under pressure to step up cybersecurity due to both the business and regulatory risk it presents. Real estate investment advisors are especially in the spotlight, as the US Securities and Exchange Commission (SEC) included investment advisors and companies in its list of 2017 examination priorities.[3]

**What are some of the key cyber threats facing the real estate industry?**

- Residential and office building tenants could be vulnerable to intrusions through connected technologies, such as smart alarms, environmental controls, locks and lights, or even voice-assisted devices.
- Property managers have significant amounts of personally identifiable information (PII) about customers and tenants contained in leases, rental applications, credit reports, etc. This data is valuable to hackers seeking to steal identities or sell data on the black market. Hotels and retailers also have immense exposure to highly targeted consumer data, such as credit card numbers.
- Internal systems could be targeted for their data or even their cash. For example, REITs must protect confidential information on the financing of deals, leasing agreements, and private account information.

*[3] Press Release: SEC Announces 2017 Examination Priorities (US Securities and Exchange Commission, Jan. 12, 2017)*

Driving growth for Canadians is a focus on new developments, which 69% of respondents say will lead their strategies in the years to come, followed by improvements to real estate fundamentals and geographic expansions (32% each). More than half (58%) also say their business model will be somewhat or substantially more different in the next three years, while less (40%) say it will remain unchanged (compared to 49% in 2016).

Organizations are prepared to seek out the best deals in what is becoming a tougher market as far as supply. For Canadians, markets in Ontario (56%), BC (46%), and Alberta (28%) are seen at the most promising markets, while 88% believe multi-family rental units will present more opportunity than in 2016. The surge in online shopping has also driven demand for the industrial centres that are – or will be – developed to support mass distribution and logistics, which is why 57% of Canadians deem industrial to be the second most opportune market segment. Rounding out their perceived opportunities are data centres (52%) hospitality (42%), and single family homes (51%).

Stateside, respondents expect the best opportunities to be concentrated in the hottest locales and property types: the Southeast region of the United States, industrial properties, and niche businesses, such as single-family homes and data centers. In addition, our respondents personally plan to target prime asset classes, with the highest percentage (27%) saying their companies will invest in Class A assets in primary US markets.

## Top 5 significant initiatives

### Significant investment in organic growth


### Significant improvement of operation processes and related technology


### Merger/acquisition


### Entering into new markets


### Staying ahead of (or navigating) significant changes in the regulatory environment


Canada

US

**"Many real estate investors today are seeking lower-risk strategies, with greater levels of portfolio diversification. And we expect to see an influx of new investment in real estate, both from existing investors as well as new entrants."**

– Rogue Hsieh, Partner Tax

When it comes to strategic initiatives, the largest portion of North American companies (45% Canadian / 41% US) plan significant investment in organic growth, including new product development, pricing strategies, and geographic expansion.

## Good deals are hard to find

Our research shows that good deals are hard to find despite today's continued favorable economic conditions. Majority of both Canadian and US executives (91% / 81%) rate the marketplace for investment opportunities as the same or worse than 12 months ago. Additionally, only one-in-five Canadians tell us they are finding high-quality properties that deliver sufficient returns, while the majority (40%) are instead working with high-quality properties but not at prices that can deliver sufficient returns. It's a similar story in the states where 11% of US executives are matching high-quality properties with sufficient returns, and 56% percent of real estate leaders are able to find high-quality properties, but not at the yields they want.

Fewer opportunities coupled with high demand is spurring competition and deal-chasing, thereby driving up prices. But our data doesn't support the notion that investors are necessarily abandoning primary markets in search of better deal economics. Rather, these competitive markets are also driving Canadian Real Estate entities to focus on new developments new and on redevelopment of existing assets.

Expecting pressure on returns, some organizations are starting to consider strategies on the lower end of the risk spectrum and consequently underwriting lower yields. At the same time, though, according to our survey, investment activity is not slowing; in fact, 90% of Canadian companies still plan to invest the same or more real estate investments by their company in 2017, a fraction higher than 89% of US respondents who say the same.

**"As competition intensifies and values increase across Canada's major hubs, traditional domestic owners and investors are eyeing foreign jurisdictions in search of greater returns, with US and Europe remaining their top investment choices."**

– Briain Morris, Partner, Advisory, Building Construction & Real Estate

## Disruption is coming: are you ready?

Only 2% of Canadian executives and 5% of US executives say technology disruptors are the biggest threat to their business. But technological disruption is changing the ways consumers use and interact with all types of commercial real estate, including office space, hospitality, retail, and others, thereby impacting real estate company and investor strategies. Disruptive innovations will also almost certainly affect real estate owners to a significant degree:

- Autonomous vehicles may reduce standard ratios for parking space, allowing developers to use this highly valued space for other purposes.
- Artificial intelligence could replace human jobs, meaning workforces would need less physical property to operate their businesses. This might also impact some rules-based processes, such as investor reporting.
- New models for retail engagement will continue to evolve, leading to customer-centric and channel-agnostic approaches to satisfy consumers' shopping needs.
- Online companies in "the sharing economy," such as Airbnb, Craigslist, and HomeAway, could shift business away from hotels or even apartments.

# Sustaining the boom

All signs point to the Canadian real estate market sustaining its momentum throughout 2017. How can Canadian real estate executives manage economic, political, and business uncertainties to seize the opportunities ahead? KPMG subject matter professionals offer their top tips for capitalizing on strong market conditions in what is shaping up to be a good year.

**1. Leverage technology for competitive advantage.** In every industry, technology is a critical enabler not only of process efficiency, but also of customer satisfaction, sales, and growth – and real estate is no exception. Use cloud, mobile, and social to connect more closely, quickly, and transparently with tenants and buyers and vastly improve leasing and sales activities. Invest in smart buildings and high-tech, nontraditional office environments to capitalize on market trends. Use data analytics to uncover insights about success factors, opportunities, and risks and use those insights to enhance core processes, such as property valuations and assessments and site selection.

**2. Prepare for what comes next.** What will the recent and upcoming interest rate hikes do to real estate investing, long-term fundamentals, and customer use? What are the factors that could impact the overall return of a property or portfolio, and how well are you prepared to exploit those opportunities? What types of resources are you dedicating to your internal R&D efforts to identify worthwhile ideas to pilot? Mining internal data – and going beyond it with data points from nontraditional sources – can help owners, operators, and investors identify trends and patterns in demographic, economic, geographic, and investment signals that impact business decisions. Always think 1, 5, and 10 years ahead so you can act – not react – ahead of change.

**"Alternative lenders offer financing options to offset challenging bank-lending market conditions for US real estate."**

– Salma Salman, Partner, Building Construction & Real Estate

**"Real estate investments and transactions will continue to be closely regulated. Developers, owners, and fund managers should regularly seek new strategies to strengthen in-house compliance and governance programs to manage risk."**

– Chris Huff, Partner, Building Construction & Real Estate

**3. Maintain a robust compliance program.** Long-term predictions on regulation are hard to make. However, the fiduciary and regulatory requirements for securities regulated -registered investment advisers do not appear to be changing anytime soon. It is important to continually review your compliance program to ensure that items such as conflicts of interest, valuation, expense allocation, code of ethics, and the allocation of investment opportunities by and among investment and co-investment vehicles are properly monitored, documented, and addressed.

**4. Be proactive on tax reform.** Comprehensive tax reform in the US is possible in the next few years given Republican control of both Congress and the White House. What the final proposal will look like – or whether Congress enacts a tax bill at all – remains to be seen, but there appears to be general alignment on the House GOP "Blueprint" as a starting point for reforming the tax code. In Canada, after several of modest tax changes, the current government signaling the potential for changes in tax laws as a source of revenue and to redistribute the tax burden to those with more means to pay. Real estate leaders must evaluate how those changes, along with lower tax rates, affect their business model and share their views when appropriate to ensure the industry's needs are well represented.

**5. Ramp up your cybersecurity capabilities.** Data breaches are happening every day across industries, and the consequences can be catastrophic. Are you proactively investing to protect your company? If you do not have a plan to secure your real estate assets, it is time to get one. If you do have a plan, it is time to evaluate it against the ever-changing threat landscape. Don't forget to assess not only your own security vulnerabilities, but those of your partners and vendors. Any business with connection to your operations – whose systems touch yours – could expose you to cyber risk.

**6. Tap into private lenders.** Banks have become increasingly risk-averse to lending for real estate transactions in response to market contraction, global regulatory requirements, and market pressures in the post-financial-crisis era. However, nontraditional, nonbank lenders have largely stepped up in their place to provide financing for global real estate development, construction, and acquisitions. Real estate developers should consider private lenders as a potential source of financing, as they may be more willing to meet capital needs, especially funding for riskier projects and to less established borrowers.

**7. Diversify your talent.** All organizations can benefit from a diversity of experiences, thinking, and perspectives – especially in fast-changing industries like real estate. In fact, research shows hiring, retaining, and promoting talent from underrepresented groups is not only the right thing to do – it is a profitable workforce strategy.[4] Glass ceilings are being shattered across industries, but in Real Estate in particular, there is still much work to be done. In 2017, real estate leaders should consider how to transform company policies to attract and retain more talented women and minorities, mentor and develop them, and promote them into decision-making roles.

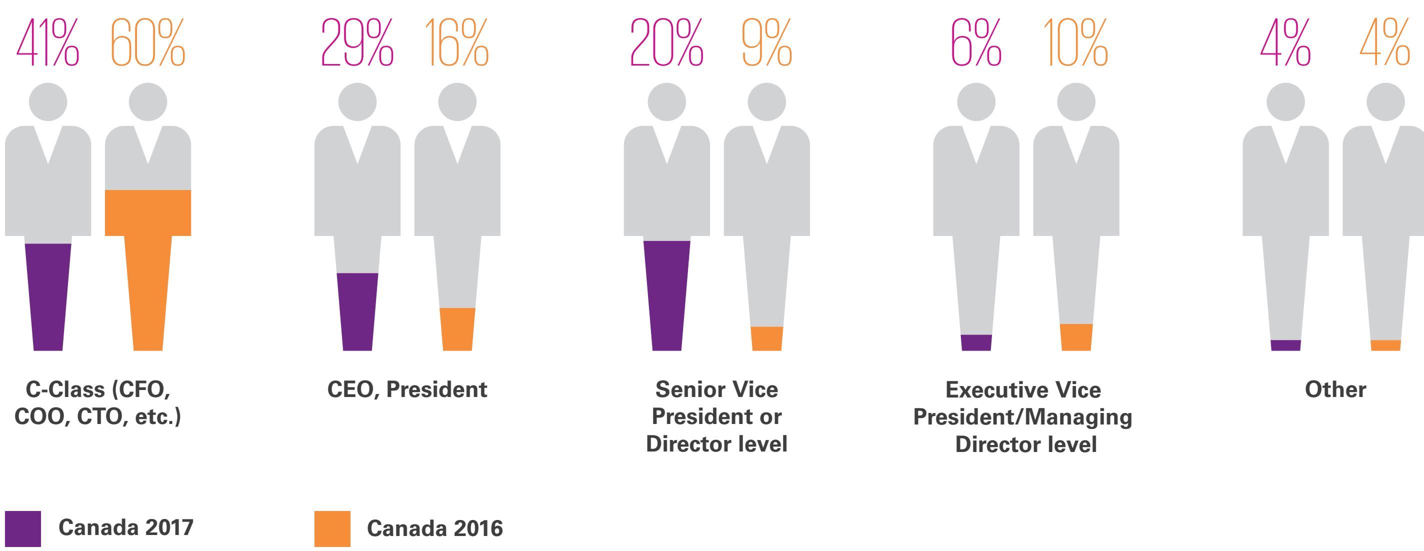
---

[4] *Why It Pays to Invest in Gender Diversity (Morgan Stanley, May 11, 2016)*

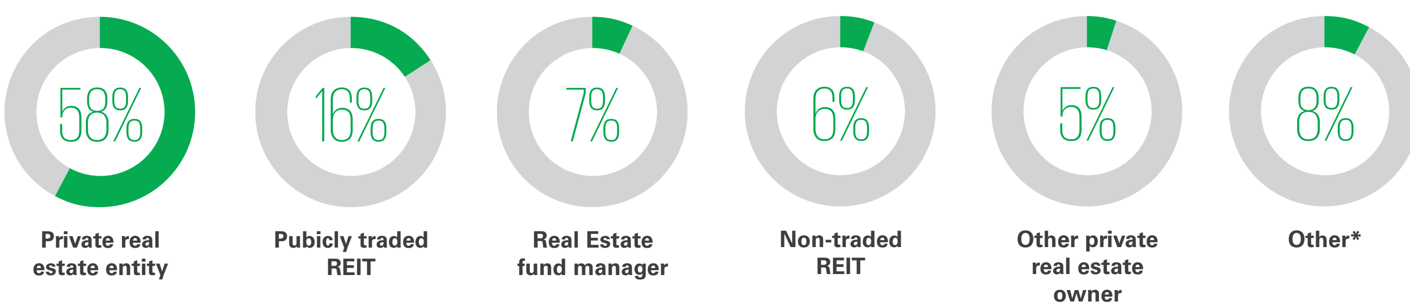
# Methodology

KPMG's 2017 Real Estate Outlook survey – A Canadian/US Comparison reflects upon the viewpoints of senior industry executives in Canada. The web survey was conducted in the fall of 2016.

## Respondent profile




## Type of firm




*Other includes "Asset Management," "Broker," "Real Estate developer," "RE Private Equity," "General Contractor"

# About KPMG's Real Estate practice

KPMG LLP advises owners, managers, developers, lenders, intermediaries, construction and engineering firms, and investors in effectively executing complex transactions ranging from acquisitions and dispositions to securitization of real estate assets for individual properties and portfolios to entity-level mergers and acquisitions. We believe that our experience and knowledge can help you successfully address today's challenges while preparing for tomorrow's opportunities.

KPMG LLP's Building, Construction & Real Estate professionals strive to provide strategic insights and relevant guidance wherever our clients operate. Our member firms provide services on a local and national level – with a network of 1,300+ and 400+ dedicated professionals in the United States and Canada, respectively – and through the global network of KPMG International member firms, comprising more than 9,000 professionals in 110 countries.

# Authors & contributors

**Lorne Burns** is a partner and the National Industry Leader of KPMG's Building, Construction & Real Estate Practice in Canada, specializing in REITs, real estate developers, hotels & hospitality and home builders. During his more than 33 years at KPMG he also served and the Partner-in-charge Audit, GTA and Chief Human Resources Office, Canada. He has worked on Industrial Markets, Biotechnology & Pharmaceuticals, Public Sector, Energy and Publicly Traded Utilities.

**Tom Rothfischer** is an audit partner in KPMG's Toronto office where he provides financial statement audit and advisory services to all sectors of the Real Estate industry. He is currently the leader of KPMG's GTA Real Estate Practice and KPMG's representative on the Real Property Association of Canada Financial Best Practices Committee. Tom has extensive experience addressing the reporting requirements of public market participants, IPO candidates, investment funds, private developers, owners and operators. He has spent three years working for KPMG in Europe and is knowledgeable on how to manage international engagements.

**Briain Morris** is a partner in KPMG's Real Estate Practice and his clients include private equity participants, pension plans, developers, Investment managers, REITs, homebuilders and large family offices. Briain is a finance professional with deep international commercial real estate capital markets, transaction, corporate finance and restructuring experience. Before joining KPMG, Briain worked in Real Estate Private Equity, Investment Banking and for a REIT originating, structuring and executing on large commercial real estate opportunities primarily in Europe and more recently, in North America.

Within KPMG, Briain champions the KPMG Future Leaders in Real Estate event which brings KPMG and Market 'NextGen' participants together to network and gain insight from CEO guest speakers from the industry.

**Lorne Shillinger** is the National Leader for the KPMG in Canada Real Estate Tax Network. He is also the Toronto Tax Practice Leader for Building, Construction & Real Estate. Lorne has been with KPMG for over 30 years. He was admitted to partnership in 1997. His practice is directed to Canadian and International taxation for REITs and public corporations and private entrepreneurial real estate enterprises.

**Greg Williams** is KPMG's national sector leader for Asset Management and is responsible for the strategic direction over the firm's Building, Construction & Real Estate (BC&RE) practice along with its Alternative Investments and Public Investment Management practices. He has more than 29 years of tax experience in the private equity real estate and hospitality industries.

**Phil Marra** is the national Audit leader for KPMG's BC&RE practice, as well as the leader of the firm's US Real Estate Funds practice. With more than 29 years of sector experience. Phil has a wide range of experience in providing audit, accounting, due diligence, and advisory services to real estate, finance, parking, construction, and hospitality clients.

**Roger Power** is the Pacific Northwest leader for KPMG's BC&RE practice with broad experience in the real estate industry. Roger also leads KPMG's Chinese real estate initiative and coleads KPMG's National Hospitality practice.

**G. Chris Turner** is the national Tax leader for KPMG's BC&RE practice with significant experience in real estate funds, real estate investment trusts, developers, and engineering and construction clients. He has more than 31 years of experience in public accounting.

# Contact us

## National Industry Leader


**Lorne Burns**
Partner
Building Construction & Real Estate
**T:** 604-691-3144
**E:** lburns@kpmg.ca


## Regional Leaders


**Toronto**
**Tom Rothfischer**
Partner, Audit
**T:** 416-777-8569
**E:** trothfischer@kpmg.ca

**Ottawa**
**Andrew Watson**
Partner, Audit
**T:** 613-212-3653
**E:** apwatson@kpmg.ca

**Montreal**
**Jason Belanger**
Partner, Audit
**T:** 514-840-2527
**E:** jbelanger@kpmg.ca

**Calgary**
**Randy Kraft**
Partner, Audit
**T:** 403-691-8039
**E:** rkraft@kpmg.ca

**Winnipeg**
**Shawna Lounsbury**
Partner, Audit
**T:** 204-957-2208
**E:** slounsbury@kpmg.ca


**kpmg.ca**