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For important information, please see the Important Disclosures beginning on page 57 of this document.
## Figure 1: Canadian real estate comp table

<table>
<thead>
<tr>
<th>REIT/REOC</th>
<th>Ticket</th>
<th>Price 31-Dec-15</th>
<th>Target price</th>
<th>Rating</th>
<th>Price 31-Dec-16</th>
<th>Target price</th>
<th>Rating</th>
<th>Price 31-Dec-17</th>
<th>Target price</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applying Commercial REIT*</td>
<td>CCR.un</td>
<td>$8.84</td>
<td>S</td>
<td>S</td>
<td>S</td>
<td>$207</td>
<td>0.78</td>
<td>8.8%</td>
<td>S</td>
<td>S</td>
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<td>Arko</td>
<td>ALU</td>
<td>$12.80</td>
<td>15.50</td>
<td>B/Y</td>
<td>25.9%</td>
<td>$1,770</td>
<td>11.08</td>
<td>8.4%</td>
<td>7.0%</td>
<td>6.50%</td>
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<td>Brookfield Property Partners (UBS)</td>
<td>BPP</td>
<td>$22.24</td>
<td>28.00</td>
<td>B/Y</td>
<td>25.0%</td>
<td>$10,061</td>
<td>11.06</td>
<td>4.6%</td>
<td>5.9%</td>
<td>5.41%</td>
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<td>S</td>
<td>S</td>
<td>S</td>
<td>$3,064</td>
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<td>S</td>
<td>S</td>
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<tr>
<td>Crown*</td>
<td>CSF</td>
<td>$14.71</td>
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<td>S</td>
<td>S</td>
<td>$2,497</td>
<td>1.47</td>
<td>10.0%</td>
<td>S</td>
<td>S</td>
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<td>Dream Global</td>
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<td>$9.65</td>
<td>11.00</td>
<td>B/Y</td>
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<td>$975</td>
<td>0.80</td>
<td>8.7%</td>
<td>6.6%</td>
<td>6.25%</td>
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<td>HMR*</td>
<td>HMR</td>
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<td>S</td>
<td>S</td>
<td>$5,913</td>
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<td>S</td>
<td>S</td>
<td>$1,380</td>
<td>0.68</td>
<td>15.0%</td>
<td>S</td>
<td>S</td>
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</tbody>
</table>

### Total / Weighted average

- **Equity**
  - **2015E**
    - **Total return**
      - **20.0%**
      - **S$11,317,543**
    - **8.0%**
    - **5.5%**
    - **(18.5%)**
  - **Average**
    - **2.9%**
    - **7.7%**
    - **6.0%**
    - **(19.6%)**
  - **2016E**
    - **21.3%**
    - **S$13,260,963**
    - **7.0%**
    - **8.5%**
    - **(22.4%)**
  - **2017E**
    - **25.6%**
    - **S$17,514,293**
    - **8.0%**
    - **8.9%**
    - **(24.4%)**

### Industrial

- **Pinecone REIT**
  - **Total return**
    - **20.9%**
    - **S$2,466**
  - **Average**
    - **20.9%**
    - **7.7%**
    - **8.3%**
    - **(24.4%)**

### Office

- **Allied Properties**
  - **Total return**
    - **21.2%**
    - **S$3,182,033**
  - **Average**
    - **21.2%**
    - **7.0%**
    - **8.5%**
    - **(22.4%)**

### Residential

- **Bentall**
  - **Total return**
    - **15.3%**
    - **S$3,819,597**
  - **Average**
    - **15.3%**
    - **9.4%**
    - **7.4%**
    - **(15.0%)**

### Retail

- **SmartREIT**
  - **Total return**
    - **15.8%**
    - **S$8,269,828**
  - **Average**
    - **15.8%**
    - **5.0%**
    - **5.3%**
    - **(15.5%)**

### Health Care/Seniors

- **Cherry**
  - **Total return**
    - **17.7%**
    - **S$20,522,513**
  - **Average**
    - **17.7%**
    - **6.5%**
    - **6.1%**
    - **(2.3%)**

### Lodging

- **AHP**
  - **Total return**
    - **20.3%**
    - **S$1,053,550**
  - **Average**
    - **20.3%**
    - **6.0%**
    - **5.9%**
    - **(4.0%)**

*Canaccord research coverage is currently suspended due to analyst maternity leave. Estimates reflect consensus estimates per FactSet.
**Core Canadian averages exclude BAM, BPY, DRM, and TCN, NA. Not applicable: R - Restricted; S - Under coverage suspension due to analyst maternity leave; MR - Mark Rothschild; JM - Jenny Ma
***US$ estimates converted to C$ utilizing an exchange rate of US$1.00=C$1.38
Source: FactSet, REIT/REOC Reports, Canaccord Genuity Estimates
CANADIAN REAL ESTATE OUTLOOK FOR 2016

For Canadian REITs, 2015 was a volatile year that started off strong and turned negative through the spring. While many REITs had positive returns, the overall sector was down 4.6%, and REITs with significant exposure to Alberta posted the lowest returns.

Assuming no material change in long-term interest rates or widening of credit spreads, we expect Canadian REITs to perform well in 2016 and we are forecasting total returns of, on average, 19%. Of concern to us, the Canadian economy could soften further, and, while interest rates would likely remain low, could lead to a widening of credit spreads and lower values for equities.

Overall, there are a number of factors supporting an optimistic outlook for REITs in 2016:

- **The expectation is that long-term interest rates will not rise significantly in Canada.** Economic growth has slowed, inflation is projected to be stable, and we do not expect that the BoC will be in a position to increase short-term interest rates in 2016. Therefore, the 10-year GoC bond yield is not expected to rise significantly in 2016. However, there is a risk that long-term rates rise in Canada along with U.S. rates, in spite of a lack of economic growth in Canada.

- **Based on the current economic and interest rate environment, we believe that cap rates are likely to remain close to current levels.** Investor demand for real estate remained strong through 2015, and we expect this to continue in 2016. Furthermore, the spread between cap rates and the 10-year GoC bond yield remains wide at 448 bps. Therefore, even if there is a modest increase in long-term interest rates, we do not expect cap rates to increase significantly in 2016.

- **The outlook for fundamentals is mixed and should not be a major factor for most REITs.** For the most part, REITs should generate modest internal growth resulting in cash flow per unit growth, while those REITs with significant exposure to Alberta will face pressure on their operating performance. In general, though, we do not believe that fundamentals will be a major factor in how most REIT unit prices perform in 2016. Rather, reflecting attractive valuations, we expect steady fund flows into REITs which should drive unit prices higher.

- **Canadian REITs are trading at sizable discounts to NAV and appear attractively valued relative to private market values and other yield-oriented investments.**
  - **Premiums/discounts to private market values: price to NAV.** Based on our estimates, Canadian REITs/REOCs under coverage are trading at a discount to NAV of 13.6% (simple average), the biggest discount since the financial crisis. Historically, REITs have traded, on average, in line with NAV and at a +2.5% premium to NAV excluding the financial crisis (2008-2009). Should unit prices remain at current levels, we expect to see unit buybacks increase, and potentially a few REIT takeovers.

  We believe that all else being equal, REITs should trade at a slight premium to NAV to account for the diversification, liquidity, and management provided to real estate investors. However, we do recognize that this gap can also narrow through increasing cap rates, and not only through higher unit prices.
**Figure 2: Historical price to NAV for REITs/REOCs under coverage**

*Canaccord research coverage is currently suspended for a number of REITs/REOCs. NAV estimates for those REITs/REOCs used in this figure reflect consensus estimates per FactSet.

Source: FactSet, REIT/REOC Reports, Canaccord Genuity Estimates

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**Cash flow multiples.** Currently, both the commercial and residential REITs/REOCs under coverage are trading slightly lower than their respective historical average forward AFFO multiples (Figure 3). While the fear of widening credit spreads or higher long-term interest rates is likely to remain on the minds of investors, REITs continue to present an attractive option for retail investors for both exposure to commercial real estate as well as current yield.

**Figure 3: Weighted average price to forward AFFO multiple for REITs/REOCs under coverage**

*Canaccord research coverage is currently suspended for a number of REITs/REOCs. AFFO estimates for those REITs/REOCs used in this figure reflect consensus estimates per FactSet.

Source: FactSet, REIT/REOC Reports, Canaccord Genuity Estimates
- **Spreads to long-term bond yields**: REIT AFFO yields and REIT distribution yields vs. the 10-year GoC bond yield. The spreads between the 10-year GoC bond yield and REIT AFFO yields are extremely wide at 584 bps, as depicted below. As well, the spread between the 10-year GoC bond yield and REIT distribution yields have widened to 514 bps.

![Figure 4: Canadian REIT AFFO yields vs. 10-year GoC bond yield](source)

![Figure 5: Canadian REIT distribution yields vs. 10-year GoC bond yield](source)

Having said that, credit spreads widened in 2015, and real estate values appear reasonable when compared to corporate bonds. In fact, if credit spreads were to widen further, there could be some upward pressure on cap rates.

![Figure 6: The spread between cap rates and Canadian BBB bond yields has narrowed](source)

- **Most REITs are well-positioned with healthy balance sheets and reasonable payout ratios.** In general, most Canadian REITs have taken advantage of favourable debt capital market conditions over the past few years to refinance debt at lower rates and reduce payout ratios. On a weighted average basis, REITs/REOCs under coverage are distributing approximately 83% of 2016 AFFO. This is down from 2014 and 2015, when the AFFO payout ratio for REITs/REOCs under coverage was 86%. There are six REITs/REOCs under our coverage with payout ratios below 80%, and all but four REITs/REOCs are below 100%.
Most REIT management teams have placed an increased emphasis on maintaining a strong balance sheet. Currently, 15 of the REITs/REOCs under coverage have leverage under 50%, with leverage ratios ranging from 23% for Granite REIT to 63% for NorthWest Healthcare Properties REIT.

For 2016, we are forecasting a weighted average total return of 19% from our coverage universe. On an individual REIT/REOC basis, we are forecasting total returns ranging from 38% for Dream Unlimited Corp. to 9% for Crombie REIT.

Figure 7: Weighted average AFFO payout ratios for REITs/REOCs under coverage*

*2015-2017 AFFO payout ratio estimates assume current level of distributions
Source: FactSet, REIT/REOC reports, Canaccord Genuity Estimates

Figure 8: 2016 forecast REIT/REOC total returns to one-year target price

*Weighted average excludes BAM, BPY, and DRM
Source: FactSet, REIT/REOC Reports, Canaccord Genuity Estimates
Modest cash flow growth expected in 2016

Aside from REITs with significant exposure to Alberta, fundamentals are for the most part stable and should allow for modest cash flow growth. We expect Canadian REITs/REOCs to post AFFO per unit growth of 3.2% in 2016 and 3.4% in 2017 (weighted average).

- **Expect modest internal growth from most REITs/REOCs.** We expect most REITs to grow same-property NOI through leasing activity and positive rental spreads on expiring leases. However, for REITs/REOCs with significant exposure to Western Canada, fundamentals have softened considerably due to the impact from the drop in oil and commodity prices. We expect internal growth to be muted for these REITs/REOCs due to downward pressure on occupancy and rental rates.

- **Development projects should be accretive.** In the current low cap rate environment, accretive acquisition opportunities are difficult to find. Therefore a number of REITs have become more active in new development to drive FFO growth.

- **Refinancing debt should continue to boost cash flow.** Although much of the interest expense savings from refinancing debt at lower rates has already been achieved, there are still potential savings from refinancing debt at market rates.

Figure 9: Growth in AFFO per unit/share (weighted average for REITs/REOCs under coverage*)

<table>
<thead>
<tr>
<th>Year</th>
<th>AFFO Growth</th>
</tr>
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<tbody>
<tr>
<td>'05</td>
<td>3.2%</td>
</tr>
<tr>
<td>'06</td>
<td>5.6%</td>
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<tr>
<td>'07</td>
<td>8.6%</td>
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<tr>
<td>'08</td>
<td>3.9%</td>
</tr>
<tr>
<td>'09</td>
<td>3.2%</td>
</tr>
<tr>
<td>'10</td>
<td>-2.8%</td>
</tr>
<tr>
<td>'11</td>
<td>7.0%</td>
</tr>
<tr>
<td>'12</td>
<td>8.6%</td>
</tr>
<tr>
<td>'13</td>
<td>3.9%</td>
</tr>
<tr>
<td>'14</td>
<td>3.2%</td>
</tr>
<tr>
<td>'15E</td>
<td>3.2%</td>
</tr>
<tr>
<td>'16E</td>
<td>3.2%</td>
</tr>
<tr>
<td>'17E</td>
<td>3.4%</td>
</tr>
</tbody>
</table>

*Excludes BAM, BPY, DRM, and TCN

**Canaccord research coverage is suspended for a number of REITs/REOCs. AFFO estimates used to calculate the weighted average year-over-year growth rates for these REITs/REOCs reflect consensus estimates per FactSet.**

Source: FactSet, REIT/REOC Reports, Canaccord Genuity Estimates

Risks to our 2016 outlook

In our view, there are a handful of risks which could lead to another year of negative returns from Canadian REITs:

- **We believe that the most significant reason for the weak unit price performance in 2015 was the expectation that long-term interest rates would rise.** Going forward, the outlook for interest rates remains a concern, and could impact REIT unit prices materially. To the extent U.S. economic growth drives the U.S. 10-year bond yield higher, Canadian long-term interest rates could follow, in spite of a lack of growth in Canada. Conversely, if the Canadian economy softens further, credit spreads could widen, and even if interest rates remain low, real estate values would likely decline.
• Less material, but also a factor, fundamentals have softened somewhat and the pace of cash flow growth has declined. We are currently forecasting AFFO per unit growth of 3.2% for 2016, and 3.4% for 2017. This compares with our January 2015 forecast of 5.5% growth in AFFO per unit for 2016.

With significant office development across Canada, it is possible that fundamentals will continue to soften. There is new supply being developed in Calgary, Edmonton, Toronto, and Vancouver, which could lead to increased vacancy. Although less of a concern, there is also a large amount of industrial and rental apartment space under development.

Figure 11: Office vacancy rate forecasts for select Canadian markets

• Consumer debt levels are relatively high and relatedly, the Canadian housing market has been extremely strong for a number of years in both Toronto and
Vancouver. A correction in housing prices, possibly as a result of an increase in the five-year GoC bond yield, could negatively affect the Canadian economy.

- Should the price of oil remain low for an extended period of time, the Canadian economy could suffer. Specifically, those REITs with exposure to Alberta could face additional pressure.

**Changes to target prices**

In conjunction with publishing our 2016 Real Estate Outlook, we are making several changes to our target prices:

- We are lowering our target price slightly for **Dream Global REIT** to C$9.25 (from C$9.50), which equates to a 5% discount to NAV. The new target price, combined with an annualized distribution per unit of $0.80, equates to a forecast total return of 16%. While we expect the fundamental performance of the REIT’s assets to be solid in 2016, we do not believe that the unit price will reach NAV in the near-term.

- We are reducing our target price for **Dream Office REIT** to C$18.50 (from C$20.00), which equates to a 20% discount to NAV. The outlook for the Alberta office market continues to weaken, and it is difficult to see a catalyst in the near term. Additionally, with NOI poised to decline in 2016, and the increase in capex, the likelihood of a distribution cut has increased materially.

- We are lowering our target price for **RioCan REIT** to C$27.00 (from C$28.00), which equates to a 5% premium to NAV. The new target price, combined with an annualized distribution per unit of $1.41, equates to a forecast total return of 20%.

- For **NorthWest Healthcare Properties REIT**, we are raising our target price to C$9.15 (from C$8.75), which is in line with our NAV estimate. The new target price, combined with an annualized distribution per unit of $0.80, equates to a forecast total return of 11%.

- Reflecting the softer housing market in both Saskatchewan and Alberta, we are lowering our target price for **Dream Unlimited Corp.** to C$10.00 (from C$12.00). Though cash flow should rise in 2016 from condo completions in Toronto, investors are likely to remain cautious until there are some signs of improvement in Western Canada housing.

**Upgrading Slate Office REIT to a BUY**

While suburban office fundamentals have softened, **Slate Office REIT** should grow cash flow in 2016 as a result of acquisitions in 2015. In addition, the attractive 10.6% current yield is fully covered by cash flow. The REIT’s units are currently trading at an 18% discount to NAV and only 7.6x our 2016 AFFO estimate, the lowest in our coverage universe. While fundamentals have softened slightly and leverage is relatively high, the REIT’s units provide solid value and we are therefore upgrading our rating for Slate Office REIT from HOLD to BUY.
Figure 12: Changes to target prices and ratings

<table>
<thead>
<tr>
<th>REIT/REOC</th>
<th>Price</th>
<th>Rating</th>
<th>Target Price</th>
<th>Pre-tax NAV per unit/share</th>
<th>Prem (disc) to NAV</th>
<th>Annual dividend/ distribution</th>
<th>Forecast total return</th>
<th>AFFO multiple</th>
<th>Target AFFO multiple</th>
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</thead>
<tbody>
<tr>
<td>DIVERSIFIED COMMERCIAL</td>
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<tr>
<td>ACR.un*</td>
<td>$8.84</td>
<td>Buy</td>
<td>S</td>
<td>$11.69</td>
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<td>0.78</td>
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<td>8.6x</td>
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<td>S</td>
<td>$45.67</td>
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<td>13.3x</td>
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<td>16.5x</td>
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<td>Hold</td>
<td>S</td>
<td>$20.00</td>
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<td>S</td>
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<td>SRU.un*</td>
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*Canaccord research coverage is currently suspended. Estimates reflect consensus estimates per FactSet.
**US$ estimates converted to C$ utilizing an exchange rate of US$1.00=C$1.38
***Forecast total return for D.un assumes a distribution per unit cut to $1.50 (from $2.24)
Source: FactSet, REIT/REOC Reports, Canaccord Genuity Estimates
BEST INVESTMENT IDEAS FOR 2016

For 2016, our best ideas present a mix of value and growth opportunities and cross different asset classes. All of our top picks are currently trading at significant discounts to NAV, which we believe supports unit prices even if internal growth is weaker than expected. For the most part, our top picks own high quality and well-located portfolios and should achieve stronger NOI growth over time. In addition, should the economy soften further, these portfolios should, for the most part, prove more defensive.

**Large caps**
- Brookfield Property Partners L.P.
- First Capital Realty Inc.

**Small-to-mid caps**
- Dream Industrial REIT
- Pure Industrial Real Estate Trust
- Pure Multi-Family REIT LP

Our investment thesis for each of our top picks is provided below

**Large caps**

**Brookfield Property Partners L.P. (BPY : NYSE | US$23.24 | BUY, Target price US$28.00)**

Brookfield Property Partners L.P. (BPY) is a globally diversified company that owns and operates high-quality office and retail assets (mostly through its 34% interest in General Growth Properties (GGP : NYSE | Not Rated)), in addition to industrial and multi-family assets. The portfolio is diversified across the U.S., Canada, Australia, and the United Kingdom. BPY is externally managed by Brookfield Asset Management Inc.

**Potential for significant NAV growth.** We believe that there is potential for significant cash flow and NAV per unit growth as new leases take effect and active development and redevelopment projects are completed. In particular, we expect cash flow to increase in the near term as tenants taking occupancy in Lower Manhattan begin paying rent. Longer term, NAV per unit growth should come from: 1) increasing occupancy; 2) marking expiring leases to market rents; and 3) completion of active development and redevelopment projects.

**Valuation and recommendation.** Our US$28.00 target price is just below our NAV per unit estimate of US$28.81. While we expect NAV to rise dramatically over the coming years, the external management contract, along with BPY’s partnership structure, are liabilities to many investors. BPY’s units currently trade at a 19.3% discount to NAV, and combined with an annualized distribution of US$1.06 per unit, the forecast total return is 25.0%.

**First Capital Realty Inc. (FCR : TSX | C$18.35 | BUY, Target price C$22.00)**

First Capital Realty Inc. (FCR) owns a high-quality portfolio of grocery-anchored shopping centres located in major Canadian markets, with specific exposure to Toronto (36% of fair value), Montreal (15%), Calgary (12%), and Vancouver (12%).

**Expect sector-leading internal growth.** Despite the challenging retail operating environment, we expect FCR’s portfolio to perform well. The company’s portfolio is...
extremely well-located and is expected to maintain occupancy with increasing rental rates.

**Development pipeline should lead to cash flow per share growth.** FCR has several sizable development projects which are scheduled to be completed over the next few years and should boost FFO per share significantly. Additionally, we expect the recent change in management to lead to an increased focus on capital management and FFO per share growth, which should lead to a higher multiple over time.

**Valuation and recommendation.** We utilize a cap rate of 5.50% to value FCR’s portfolio, resulting in a NAV per share estimate of $19.95. Our target price of C$22.00 equates to a 10% premium to our NAV estimate and, combined with an annualized dividend of $0.86 per share (4.7% current yield), equates to a 12-month forecast total return of 24.6%.

**SMALL-TO-MID CAPS**

**Dream Industrial REIT (DIR.UN : TSX | C$7.18 | BUY, Target price C$9.00)**

Dream Industrial REIT owns a portfolio of predominantly small-bay industrial properties totaling 16.9 million sf located in primary and secondary markets across Canada.

**Healthy fundamentals should support modest NOI growth.** Industrial fundamentals remain healthy in most Canadian markets and we expect the REIT to maintain occupancy while achieving modest rental rate increases on renewals, leading to steady internal growth.

**Attractive yield is fully covered by cash flow.** Dream Industrial’s annualized distribution of $0.70 per unit equates to a 9.7% current yield. Considering that the current payout ratio is 84% (based on our 2016 AFFO estimate), we view this yield as extremely attractive, especially when compared to corporate bonds.

**Units are extremely undervalued.** We utilize a 6.85% cap rate to value Dream Industrial’s portfolio, resulting in a NAV per unit estimate of $10.78. The REIT’s units currently trade at a dramatic 33.4% discount to NAV, or an implied cap rate of 8.1%.

In the near term, we expect the unit price to lag as investors are placing a discount on externally managed REITs, and management has yet to take any action to narrow this discount. However, we do not believe that this discount will persist through 2016 without some action taken. Our target price of C$9.00 is based on a ~15% discount to NAV, and combined with the annualized distribution, equates to a 12-month forecast total return of 35.1%.

**Pure Industrial Real Estate Trust (AAR.UN : TSX | C$4.37 | BUY, Target price C$5.25)**

Pure Industrial Real Estate Trust owns a portfolio of industrial properties comprising 17.4 million sf of GLA. The REIT’s properties are predominantly located in major Canadian cities (Calgary, Edmonton, Toronto, and Vancouver) and include a portfolio of FedEx properties in the U.S. (12% of GLA).

**Investment highlights.** With its high-quality portfolio, Pure Industrial is poised to benefit from healthy industrial property fundamentals. Led by a strong and focused management team, we expect steady, albeit modest, internal growth for the next few years, which should lead to multiple expansion. The REIT entered the U.S. in 2014 through the acquisition of a portfolio of properties fully leased to FedEx. We expect the REIT to continue growing in the U.S., although management has indicated that its U.S. exposure should remain below 20%. 

6 January 2016
The REIT’s Vaughan and New Jersey FedEx developments are now substantially complete and should be income-producing in Q2/16, which should provide a boost to cash flow. Further supporting growth, in order to leverage its platform and increase the return on its properties, Pure Industrial has entered into a joint venture with a Canadian institution which will allow it to earn fees on its properties while growing its portfolio.

**Valuation and recommendation.** We utilize a 6.20% cap rate to value Pure Industrial’s portfolio, resulting in a NAV per unit estimate of $5.42. Pure Industrial’s units are currently trading at an implied cap rate of 6.9%, or a 19.3% discount to NAV. We expect management to continue to focus on improving the REIT’s valuation through divesting non-core assets and repurchasing units. We believe that a stronger pace of internal growth will be crucial for the REIT to be awarded a premium valuation. Combined with an annualized distribution of $0.31 per unit (7.1% current yield), our target price implies a 12-month forecast total return of 27.3%.

**Pure Multi-Family REIT LP (RUF. U: TSX-V | US$5.13 | BUY, Target price US$6.50)**

Pure Multi-Family REIT LP owns a portfolio of high quality rental apartment properties located mostly in Dallas-Fort Worth and other large cities in Texas and Arizona.

**Strong fundamentals should drive internal growth.** Fundamentals in the REIT’s core markets are strong and we expect robust same-property NOI growth over the next few years.

**High-grading the portfolio.** The REIT continues to execute on its strategy of growing the portfolio while upgrading the quality of its assets. This is being conducted through disposing older, class B properties in order to partly finance the acquisition of newer, class A properties. While this results in some near-term dilution, higher quality properties should maintain occupancy and produce stronger NOI growth over time.

**Valuation and recommendation.** We utilize a 6.00% cap rate to value Pure Multi-Family’s portfolio, resulting in a NAV per unit of US$6.14. The REIT is currently trading at an implied cap rate of 6.6%, or a 16.5% discount to NAV. On a cash flow multiples basis, the REIT trades in line with Milestone Apartments REIT, although below most of its Canadian peers. We expect the REIT’s relative valuation to improve as investors realize the superior growth profile of Pure Multi-Family’s portfolio.

Combined with an annualized distribution of US$0.38 per unit (7.3% current yield), our target price implies a 12-month forecast total return of 34.0%.
2015 IN REVIEW

Canadian REITs returned -4.6% in 2015
For Canadian REITs, 2015 was a volatile year that started off strong and turned negative through the spring. A weak December capped off an overall poor performance from REITs for the year, and some REITs were down significantly. That said, most of the worst-performing REITs had significant exposure to Alberta, and excluding those REITs, we believe that the total return from the REIT sector was flat to slightly positive.

Notwithstanding the weak performance, demand for direct property remained strong, although fundamentals softened in some markets, Alberta in particular. For 2015, Canadian REITs, as represented by the S&P/TSX Capped REIT Index, returned -4.6%.

Some of the major factors that impacted the sector were:

- Long-term interest rates in Canada declined in 2015, but were volatile for most of the year. The 10-year GoC bond yield declined 43 bps in Q1/15 from 1.79% on December 31, 2014, to 1.36% on March 31, 2015. Since then, the yield was as high as 1.91% in June; however, it declined over the latter half of the year and settled at 1.39% at year-end, down 40 bps from the beginning of the year. This was in contrast to the U.S. 10-year bond yield which was more stable and over the course of 2015 increased 10 bps to 2.27%, as economic growth has picked up in the U.S. Historically, the Canadian and U.S. 10-year bond yields have tracked each other closely; however, the yields have exhibited some divergence over the last few years.

- Credit spreads rose steadily over the second half of 2015, and the spread between Canadian cap rates and BBB corporate yields shrunk as a result. At March 31, 2015, the spread was relatively wide at 280 bps. However, the spread narrowed over the course of 2015 and was 201 bps at December 31, 2015, essentially in line with the 10-year average. We believe that widening credit spreads justify some of the weakness in the REIT market.

- Oil prices continued to decline throughout 2015 and as a result the Canadian economy was negatively impacted. According to the Bank of Canada, business investment in the energy sector declined approximately 40% in 2015 and GDP growth was negative in the first two quarters of 2015. Clearly, the weak performance from Canadian REITs was partially driven by weaker fundamentals.

- Office fundamentals weakened and the national vacancy rate increased from 10.7% at Q4/14 to 11.8% at Q3/15. In Alberta, the softening was most significant. The Calgary office vacancy rate increased from 11.0% at Q4/14 to 15.5% at Q3/15, and in Edmonton from 11.3% at Q4/14 to 12.1% at Q3/15.

- Store closures and the departure of Target drove vacancy higher for some retail REITs and were the key topic of discussion in the retail sector in 2015. Internal growth was negative for some retail REITs and is likely to remain negative in 2016.

- Equity markets in general performed poorly, with the S&P/TSX Composite Index posting a -8.3% return in 2015, below the -4.6% return from Canadian REITs.
Figure 13: The S&P/TSX Capped REIT Index returned -4.6% in 2015

Source: Bloomberg, Canaccord Genuity

Long-term interest rates were volatile in 2015

The 10-year GoC bond yield declined 40 bps over the course of 2015; however, there were some periods of volatility during the year. In Q1/15, long-term interest rates declined and Canadian REITs performed well, returning +8.0% and outperforming the S&P/TSX Composite which returned +2.6%. However, the 10-year GoC bond yield rose 33 bps during Q2/15, and consequently Canadian REITs returned -5.0% during the quarter.

In the latter half of the year, long-term yields fell 42 bps to bottom out at 1.26% in August 2015 before settling at 1.39% at December 31, 2015. Notwithstanding the declining 10-year bond yield, the Canadian REIT index retreated 7.0% in the second half of 2015 as the magnitude of the economic slowdown due to the decline in oil prices became more evident. Additionally, concerns of a rise in long-term interest rates due to the impending rate hike by the U.S. Federal Reserve weighed on the Canadian real estate sector.
During 2015, Canadian REITs lagged other yield-oriented equity investments. The REIT Index’s -4.6% total return underperformed the S&P/TSX Capped Utilities Index (-2.7%), S&P/TSX Capped Financials Index (-3.0%), and S&P/TSX Capped Telecommunications Services Index (+6.0%).

In 2015, Canadian underperformed both U.S. REITS and the Global REIT Index

While the U.S. economy continued to strengthen, concerns of a rise in long-term interest rates weighed on U.S. REITs in 2015. However, the MSCI U.S. REIT Index outperformed Canadian REITs and returned a modest +2.5% for 2015. Meanwhile, the Asian REIT index declined 7.2% whereas the European REIT index increased 4.2%. The Global REIT index posted a total return of -0.4%.
Best and worst performing REITs in 2015

During 2015, the best performing Canadian REIT/REOC in our coverage was Amica Mature Lifestyles Inc., which delivered a total return of +176% as a result of its acquisition by BayBridge Seniors Housing Corp.

In 2015, 18 REITs/REOCs within our coverage universe (of 34) posted positive total returns, with Amica Mature Lifestyles Inc. (+176% total return), SmartREIT (+17%), and Pure Multi-Family REIT LP (+16%) being the top performers.

- The strong performance from Amica Mature Lifestyles Inc. was driven by its acquisition by Baybridge Seniors Housing Corp. at a 113% premium to Amica’s share price.
- Pure Multi-Family REIT LP has posted strong internal growth with same-property NOI increasing 8.5% in the first three quarters of 2015. Fundamentals in the REIT’s core Texas markets remain strong and cash flow growth is expected to continue.
- SmartREIT has posted healthy cash flow growth, partially due to the accretive SmartCentres acquisition in Q2/15 which increased leverage. As well, despite a challenging environment for retail landlords, SmartREIT maintained high occupancy.

The worst performing REIT/REOCs in our coverage were Dream Unlimited Corp. (-25%), Dream Office REIT (-24%), and Mainstreet Equity Corp. (-21%) as all three have significant exposure to Alberta and investors became concerned about the impact of softening fundamentals on cash flow and asset values. In fact, the six worst-performing REITs/REOCs in 2015 all had significant exposure to Alberta or other energy-focused regions such as Saskatchewan and the Territories.
Figure 17: 2015 total returns for REITs/REOCs under coverage*

*Excludes Amica Mature Lifestyle Inc. which returned +176%
**Canaccord research coverage is currently suspended
Source: FactSet, Canaccord Genuity
OUR OUTLOOK FOR 2016

We expect Canadian REITs to perform well in 2016 and we are forecasting total returns of, on average, 19%. That said, we are concerned about widening credit spreads, and recognize that an increase in long-term interest rates would be negative for the sector.

There are a number of factors supporting our optimistic outlook for the REIT sector:

- The expectation is that long-term interest rates will not rise significantly in Canada;
- Based on the current economic and interest-rate environment, we believe that cap rates are likely to remain close to current levels;
- The outlook for fundamentals is mixed and should not be a major factor for most REITs;
- Canadian REITs are trading at sizable discounts to NAV and appear attractively valued relative to private market values and other yield-oriented investments; and,
- Most REITs are well-positioned with healthy balance sheets and reasonable payout ratios.

THE EXPECTATION IS THAT LONG-TERM INTEREST RATES WILL NOT RISE SIGNIFICANTLY IN CANADA

During 2015, long-term bond yields dropped as economic growth slowed in Canada. At year-end, the 10-year GoC bond yield was 1.39%, 40 bps below the 2014 year-end bond yield of 1.79%.

Figure 18: In 2015, the 10-year GoC bond yield declined by 40 bps

In the U.S., both economic output and employment growth have been healthy and the U.S. Federal Reserve raised its key interest rate by 25 bps in December 2015 with further hikes likely in 2016. As the move to raise rates was widely anticipated, long-term bond yields increased modestly in 2015, with the U.S. 10-year bond yield rising 10 bps to 2.27% at the end of the year. According to Bloomberg, economists are predicting that the 10-year bond yield will increase by approximately 60 bps in Canada and 50 bps in the U.S. in 2016, to a median forecast of 2.8% for the U.S. 10-year and 2.0% for the Canada 10-year (Figure 19).
In Canada, however, the economic outlook is more uncertain. Most economic indicators point to long-term interest rates remaining relatively stable:

- The slowdown in the energy sector resulted in GDP contracting modestly in the first two quarters of 2015. Since then, there has been a pickup in economic growth, and the BoC expects 1.1% growth in real GDP for the full-year 2015. For 2016, the BoC expects real GDP growth of +2.0%, below forecast real GDP growth in the U.S. of +2.6% in 2016.

**Figure 20: GDP growth forecasts for Canada and the United States**

- Inflation, as measured by core CPI, has been stable and according to the BoC is expected to remain close to 2.0% for 2016 and 2017 (see Figure 21), which is well within the BoC’s targeted 1-3% range. According to the BoC, a “significant portion” of the measured inflation in 2015 was due to the depreciation of the Canadian dollar which resulted in increased prices for imported goods.
Essentially, economic growth has slowed, inflation is projected to be stable, and we do not expect that the BoC will be in a position to increase short-term interest rates in 2016. Therefore, the 10-year GoC bond yield is not expected to rise significantly in 2016.

That said, U.S. and Canadian long-term bond yields have historically been highly correlated and it is likely that an increase in long-term yields in the U.S. will lead to a corresponding rise in Canadian long-term yields. However, given the significant divergence in the economic outlooks for the two countries, it appears reasonable to expect that long-term interest rates in Canada will remain relatively low.

**BASED ON THE CURRENT ECONOMIC AND INTEREST RATE ENVIRONMENT, WE BELIEVE THAT CAP RATES ARE LIKELY TO REMAIN CLOSE TO CURRENT LEVELS**

Investor demand for real estate remained strong through 2015, and we see this continuing in 2016. Furthermore, the spread between cap rates and the 10-year GoC bond yield is wide. Therefore, even if there is a modest increase in long-term interest rates, we do not expect cap rates to increase significantly in 2016.

While REIT unit prices slumped in 2015 in part due to concerns over rising interest rates, private market demand for real estate was strong. According to CBRE, the national average cap rate in Canada dropped 11 bps in 2015 to 5.88% at Q4/15 as investor appetite for high-quality assets remained strong. A few notable portfolio transactions in 2015 were:

- **Regal Lifestyle Communities Inc.**, a seniors housing operator, was acquired by Health Care REIT, Inc. and Revera Inc. for $764 million at a 6.1% cap rate.

- **CAP REIT** acquired a portfolio of 16 apartment properties located in Montreal for $502 million at a cap rate of 4.5%. The portfolio consisted of 3,661 suites and 194,000 sf of commercial space.

- **Boardwalk REIT** sold its Windsor portfolio to a private REIT for $136 million at a cap rate of 5.4%. The portfolio consisted of high-rise and low-rise apartment complexes and townhouses totaling 1,685 units.
• **Brookfield Canada Office Properties** sold the HSBC building located at 70 York Street in downtown Toronto to Anbang Insurance, a Chinese insurance company, for $110 million at a cap rate of ~4.3%.

Real estate continues to gain popularity among institutional asset managers, which puts downward pressure on cap rates. In our view, this is in part due to the attractive and stable yields generated by real estate in a continued low interest rate environment. Going forward, with long-term interest rates expected to remain low and fundamentals supporting NOI growth for most property types, demand for quality properties should remain strong, and cap rates are unlikely to rise.

**Spread between cap rates and GoC bond yield remains close to all-time high**

Although cap rates have steadily compressed over the last several years, long-term interest rates have dropped at a more rapid pace, which has widened the spread between cap rates and long-term bond yields. Currently, the national average cap rate (excluding hotels) is 5.88% whereas the yield on the 10-year GoC bond is 1.39%, equating to a spread of 448 bps.

**Figure 22: Spread between national average cap rate and long-term bond yield**

However, the spread is somewhat less attractive when considering credit spreads. In fact, credit spreads rose in 2015, and the spread between cap rates and BBB corporate yields narrowed. At March 31, 2015, the spread was relatively wide at 280 bps, suggesting that if long-term interest rates rose modestly, cap rates would have a wide cushion. However, as credit spreads widened through 2015, the spread narrowed, and was 201 bps at December 31, 2015, essentially in line with the 10-year average. Therefore, there could be upward pressure on cap rates if long-term interest rates (or credit spreads) rise significantly.
Healthy demand for quality real estate supports current real estate values

Demand for real estate investment has remained strong and cap rates continue to compress, with the national average cap rate declining 11 bps over the first three quarters of 2015. Assuming no material spike in long-term interest rates or widening of credit spreads, we expect cap rates to hold steady in 2016.

THE OUTLOOK FOR FUNDAMENTALS IS MIXED AND SHOULD NOT BE A MAJOR FACTOR FOR MOST REITS

For the most part, REITs should generate modest internal growth resulting in cash flow per unit growth, while those REITs with significant exposure to Alberta will face pressure on their operating performance. In general though, we do not believe that fundamentals will be a major factor in how most REIT unit prices perform in 2016. Rather, reflecting attractive valuations, we expect steady fund flows into REITs which should drive unit prices higher.

- Office fundamentals have softened with the national vacancy rate expected to increase from 12.3% in 2015E to 13.0% at the end of 2016 according to CBRE.
With more than 17.5 million sf of office space currently under construction (equating to 4% of existing inventory), we expect further pressure on office fundamentals. In Toronto, fundamentals have been mostly stable, with vacancy up 40 bps to 9.9% at Q3/15 from 9.5% at Q4/14. However there is a clear divergence between the downtown market, where demand is strong, and the suburban market where vacancy is now at an 11-year high at 15.1%. For the most part, we are not expecting same-property revenue growth from office portfolios, with Allied Properties REIT’s portfolio being the notable exception. Allied’s 2015 results were negatively impacted by vacancies in its Western Canada portfolio and lower tenant recoveries. However, we believe internal growth should pick up in 2016 as leasing activity in the REIT’s downtown Toronto properties has been healthy.

- **Industrial** fundamentals remained steady in 2015 and are expected to improve in 2016, driven by increasing demand for logistics and distribution space. Although there is currently 23.3 million sf of new space under construction (1.3% of total inventory), we understand that a large portion of this space is pre-leased and as a result should not impact fundamentals. CBRE expects the national average net rental rate to increase 2.2% in 2016 to $6.59 psf, and the availability rate to remain flat at 5.8%.

- **Retail** fundamentals were challenged in 2015 due to elevated vacancy levels. Online sales continue to take market share away from bricks and mortar retailers, and a number of retail store closures in 2015 negatively impacted occupancy rates.

- **Residential** fundamentals were mixed in 2015. According to CMHC, the national vacancy rate increased 50 bps year-over-year to 3.3% in October 2015. However, the increase stemmed mostly from lower net migration to the resource-producing regions whereas residential fundamentals remained strong in British Columbia and Ontario and are improving in Atlantic Canada.

- **Lodging** fundamentals improved in both Canada and the U.S. in 2015, a trend which is expected to continue through 2016. Improved hotel demand, coupled with stable supply, should drive higher revenue per available room (RevPAR) and cash flow growth. Demand has been helped by the weak Canadian dollar, which is resulting in increased travel within and to Canada.

Property market fundamentals by asset class and market are discussed in greater detail in an Appendix on page 49.

**CANADIAN REITS ARE TRADING AT SIZABLE DISCOUNTS TO NAV AND APPEAR ATTRACTIVELY VALUED RELATIVE TO PRIVATE MARKET VALUES AND OTHER YIELD-ORIENTED INVESTMENTS**

In our view, Canadian REITs are attractively valued under most valuation metrics, as detailed below:

- Premiums/discounts to private market values: implied cap rates and price to NAV;
- Cash flow multiples;
- Implied cap rates as compared to long-term bond yields and BBB corporate bond yields; and,
- Canadian REITs continue to offer generous yields compared to other high-yielding equities.

**Net asset value – Canadian REITs/REOCs are trading at a sizable discount**

The demand for real estate investment remains strong and cap rates compressed slightly in 2015. However REIT unit prices have been soft due to concerns of rising interest rates and lower rental income expectations particularly for properties located in Western Canada. Currently, REITs/REOCs under coverage are trading at an implied cap rate of 6.4% on a weighted average basis, unchanged since the end of 2014.
Based on our estimates, Canadian REITs/REOCs under coverage are trading at a discount to NAV of 13.6% (simple average), the biggest discount since the financial crisis. Historically, REITs have traded, on average, in line with NAV and at a +2.5% premium to NAV excluding the financial crisis (2008-2009). We believe that, all else being equal, REITs should trade at a slight premium to NAV to account for the diversification, liquidity, and management provided to real estate investors. However, we do recognize that this gap can also narrow through increasing cap rates, and not only through higher unit prices.

While most REITs are trading well below NAV, the range is wide and a few are actually trading above NAV. The company trading at the biggest discount to NAV is Dream Unlimited Corp. which is heavily exposed to both Saskatchewan and Alberta. Its portfolio is comprised of a number of different assets although its largest investments
consist of land in Regina, Saskatoon, and Calgary. Demand for new housing in these markets has declined considerably, and the near-term outlook is soft.

**Brookfield Asset Management Inc.** is trading at a 2% premium to NAV, the largest in our coverage universe (excluding **CT REIT** for which research coverage is currently suspended). The company is focusing on growing its fee-bearing capital which stood at US$94.7 billion as of September 30, 2015. Moreover, **BAM** is aggressively marketing new funds with the goal of raising a total of US$23 billion in new capital over the next 24 months. As management fees earned on this capital base rise, cash flows and NAV are poised to increase significantly.

**Figure 27: Premium/discount to NAV for REITs/REOCs under coverage**

*Canaccord research currently suspended. NAV estimates reflect consensus estimates per FactSet.

Source: FactSet, REIT/REOC Reports, Canaccord Genuity Estimations

**REITs/REOCs are trading slightly below their historical AFFO multiple**

Currently, both the commercial and residential REITs/REOCs under coverage are trading slightly lower than their respective historical average forward AFFO multiples.

- **Canadian commercial REITs/REOCs** are, on average, trading at 13.5x forward AFFO, below the historical average of 14.2x.

- **Canadian residential REITs/REOCs** are, on average, trading at 15.4x forward AFFO, lower than the historical average of 16.7x.

While the fear of widening credit spreads or higher long-term interest rates is likely to remain on the mind of investors, REITs continue to present an attractive option for retail investors for both exposure to real estate as well as current yield. We note that Canadian REIT portfolios are larger, the management teams are more experienced and in many cases deeper, the portfolios are of a higher quality, and the balance sheets are more conservative than in prior years.
The REITs/REOCs trading at the lowest AFFO multiples are mostly those with exposure to office properties and/or to Alberta. Within our coverage universe, Slate Office REIT, Dream Office REIT, and American Hotel Income Properties REIT LP trade at the lowest 2016 AFFO multiples.

- **Slate Office REIT** trades at 7.6x 2016E AFFO. In our view, the low multiple reflects the recent increase in exposure to the office market and higher leverage.

- **Dream Office REIT** trades at 7.8x 2016E AFFO as the REIT is likely to face declining cash flow due to its significant exposure to the Western Canada office market (40% of NOI).

- **American Hotel Income Properties REIT LP** trades at 8.1x 2016E AFFO. We believe the low multiple is due to the REIT’s relatively small market cap, unique asset class, as well as earnings volatility in 2015. However, as the outlook for hotel fundamentals is healthy, we expect multiple expansion over time.

*Canaccord research coverage is currently suspended for a number of REITs/REOCs. AFFO estimates for those REITs/REOCs used in this figure reflect consensus estimates per FactSet.

Source: FactSet, REIT/REOC Reports, Canaccord Genuity Estimates
Canadian REITs offer generous yields when compared to investment grade bonds

We believe that a more valuable metric is the spread between REIT yields to BBB yields, which takes into account credit spreads. Corporate bond yields increased modestly during 2015 due to widening credit spreads. However, a decline in REIT unit prices pushed REIT yields upwards and caused the spread between REIT yields and Canadian 10-year BBB bond yields to increase 57 bps over the course of 2015 to 267 bps.
Figure 31: Canadian REIT distribution yields versus 10-year BBB corporate yields

The spread between the average Canadian REIT AFFO yield and the 10-year GoC bond yield continued to rise in 2015. The spread is currently 584 bps, which is the highest level in the last five years (Figure 32). Similarly, the spread between the average Canadian REIT distribution yield and long-term bond yields has widened as REIT unit prices declined in 2015. Currently, the spread is 514 bps, a level last observed in mid-2009 (Figure 33).

With the decline in REIT unit prices, distribution yields are at multi-year highs. It appears that investors are either expecting an increase in long-term interest rates or continued softening in fundamentals. From our coverage, almost every REIT is well positioned to maintain distributions through some economic softening. Further, we expect distribution increases from a number of REITs over the next 12 months (more later). Notwithstanding these risks, investors continue to take advantage of the relatively high yields in real estate investments. Fund flows into real estate equities (excluding reinvested distributions) have increased significantly over the first 11 months of 2015 at +$228 million, compared to +$26 million for the full-year 2014 (Figure 34).
Real Estate Investment Trusts
Industry Overview

Figure 34: Fund flows into Canadian real estate equities ($ millions)

Canadian REITs continue to offer higher yields compared to other yield-oriented investments

The S&P/TSX Capped REIT Index is currently yielding 6.5%, a 150 bp premium to the S&P/TSX Capped Utilities Index, which yields 5.0%. On average, the S&P/TSX Capped REIT Index yield is 199 bps higher than the average of the Telecommunication Services, Utilities, and Financials indices, 309 bps higher than the yield provided by the broader market, and 514 bps higher than the 10-year GoC bond (Figure 35).

Figure 35: Current yield on for Canadian sector indices and the 10-year GoC bond

On a weighted average basis, Canadian REITs/REOCs under coverage are currently yielding 6.3%. Canadian REITs/REOCs continue to provide compelling yields, with a third of REITs/REOCs under coverage yielding greater than 8%.
MOST REITS ARE WELL-POSITIONED WITH HEALTHY BALANCE SHEETS AND REASONABLE PAYOUT RATIOS

In general, most Canadian REITs have taken advantage of favourable debt capital market conditions over the past few years to refinance debt at lower rates and reduce payout ratios. On a weighted average basis, REITs/REOCs under coverage are distributing approximately 83% of 2016E AFFO. This is down from 2014 and 2015, when the payout ratio for REITs/REOCs under coverage was 86% of AFFO.

Figure 37: AFFO payout ratios are forecast to decline*
For the REITs/REOCs under coverage, 2016E AFFO payout ratios range from 59% for InterRent REIT to 113% for Dream Global REIT (of note, Mainstreet Equity Corp. does not pay a dividend).

On a weighted average basis, the 2016 AFFO payout ratio is 83%, with six REITs/REOCs below 80%, and all but four REITs/REOCs are below 100%.

**Figure 38: 2016E AFFO payout ratios**

Most REIT management teams have placed an increased emphasis on maintaining a strong balance sheet. Currently, 15 of the REITs under coverage have leverage under 50%, with leverage ratios ranging from 23% for Granite REIT to 63% for NorthWest Healthcare Properties REIT.

**Figure 39: Leverage ratios (including convertible debentures as debt) as at quarter-end Q3/15**

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*Canaccord research currently suspended. AFFO estimates reflect consensus estimates per FactSet.

**Excludes BAM, DRM, and TCN

Source: FactSet, REIT/REOC Reports, Canaccord Genuity Estimates*
Modest cash flow growth expected in 2016

Aside from REITs with significant exposure to Alberta, we believe that fundamentals are for the most part stable and should lead to modest cash flow growth. We expect Canadian REITs/REOCs to post average AFFO per unit growth of 3.2% in 2016 and 3.4% in 2017 (weighted average).

- **Expect modest internal growth from most REITs/REOCs.** We expect most REITs to grow same-property NOI through leasing activity and positive rental spreads on expiring leases. However, for REITs/REOCs with significant exposure to Western Canada, fundamentals have softened considerably due to the impact from the drop in oil and commodity prices. We expect internal growth to be muted for these REITs/REOCs due to downward pressure on occupancy and rental rates.

- **Development projects should be accretive.** In the current low cap rate environment, accretive acquisition opportunities are difficult to find. Therefore a number of REITs have become more active in new development to drive FFO growth.

- **Refinancing debt should continue to boost cash flow.** Although much of the interest expense savings from refinancing debt at lower rates has already been achieved, there are still potential savings from refinancing debt at market rates.

Figure 40: Growth in AFFO per unit/share (weighted average for REITs/REOCs under coverage*)

*Excludes BAM, BPY, DRM, and TCN
**Canaccord research coverage is suspended for a number of REITs/REOCs. AFFO estimates used to calculate the weighted average year-over-year growth rates for those REITs/REOCs reflect consensus estimates per FactSet.
Source: FactSet, REIT/REOC Reports, Canaccord Genuity Estimates

The following table highlights our estimates of FFO and AFFO per diluted unit/share for REITs/REOCs under coverage.
## Figure 41: Forecast FFO per unit/share and AFFO per unit/share growth

<table>
<thead>
<tr>
<th>REIT/REOC</th>
<th>Diluted FFO per unit/share</th>
<th>FFO per unit/sh growth</th>
<th>Diluted AFFO per unit/share</th>
<th>AFFO per unit/sh growth</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DIVERSIFIED COMMERCIAL</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ACR.un*</td>
<td>$1.23</td>
<td>$1.29</td>
<td>$1.36</td>
<td>5.0%</td>
</tr>
<tr>
<td>AX.un</td>
<td>$1.50</td>
<td>$1.49</td>
<td>$1.49</td>
<td>-0.5%</td>
</tr>
<tr>
<td>BPF (US$)</td>
<td>$1.17</td>
<td>$1.36</td>
<td>$1.48</td>
<td>16.6%</td>
</tr>
<tr>
<td>REF.un*</td>
<td>$3.03</td>
<td>$3.09</td>
<td>$3.17</td>
<td>1.8%</td>
</tr>
<tr>
<td>CUF.un*</td>
<td>$1.79</td>
<td>$1.77</td>
<td>$1.80</td>
<td>-1.2%</td>
</tr>
<tr>
<td>DRG.un</td>
<td>$0.77</td>
<td>$0.81</td>
<td>$0.88</td>
<td>5.9%</td>
</tr>
<tr>
<td>HT.un*</td>
<td>$1.91</td>
<td>$1.93</td>
<td>$1.97</td>
<td>1.4%</td>
</tr>
<tr>
<td>MR.un*</td>
<td>$1.00</td>
<td>$1.00</td>
<td>$1.02</td>
<td>0.4%</td>
</tr>
<tr>
<td><strong>INDUSTRIAL</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AAR.un</td>
<td>$0.39</td>
<td>$0.43</td>
<td>$0.44</td>
<td>8.4%</td>
</tr>
<tr>
<td>DIR.un</td>
<td>$0.95</td>
<td>$1.00</td>
<td>$1.02</td>
<td>4.8%</td>
</tr>
<tr>
<td>GRT.un</td>
<td>$3.39</td>
<td>$3.54</td>
<td>$3.67</td>
<td>4.5%</td>
</tr>
<tr>
<td><strong>OFFICE</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AP.un</td>
<td>$2.17</td>
<td>$2.38</td>
<td>$2.55</td>
<td>10.0%</td>
</tr>
<tr>
<td>D.un</td>
<td>$2.81</td>
<td>$2.77</td>
<td>$2.73</td>
<td>-1.6%</td>
</tr>
<tr>
<td>SOT.un</td>
<td>$1.04</td>
<td>$1.12</td>
<td>$1.13</td>
<td>8.0%</td>
</tr>
<tr>
<td><strong>RESIDENTIAL</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>BEI.un</td>
<td>$3.56</td>
<td>$3.51</td>
<td>$3.53</td>
<td>-1.6%</td>
</tr>
<tr>
<td>CAR.un</td>
<td>$1.64</td>
<td>$1.76</td>
<td>$1.81</td>
<td>7.2%</td>
</tr>
<tr>
<td>IIP.un</td>
<td>$0.36</td>
<td>$0.47</td>
<td>$0.54</td>
<td>32.1%</td>
</tr>
<tr>
<td>KMP.un</td>
<td>$0.80</td>
<td>$0.84</td>
<td>$0.88</td>
<td>6.2%</td>
</tr>
<tr>
<td>MEQ*</td>
<td>$2.68</td>
<td>$2.80</td>
<td>$2.91</td>
<td>4.3%</td>
</tr>
<tr>
<td>NVU.un*</td>
<td>$2.42</td>
<td>$2.40</td>
<td>$2.50</td>
<td>-0.9%</td>
</tr>
<tr>
<td>RUF.un (US$)</td>
<td>$0.45</td>
<td>$0.51</td>
<td>$0.53</td>
<td>13.1%</td>
</tr>
<tr>
<td><strong>RETAIL</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SRU.un*</td>
<td>$2.10</td>
<td>$2.20</td>
<td>$2.25</td>
<td>4.5%</td>
</tr>
<tr>
<td>CRR.un</td>
<td>$1.12</td>
<td>$1.11</td>
<td>$1.14</td>
<td>-0.7%</td>
</tr>
<tr>
<td>CRT.un*</td>
<td>$1.04</td>
<td>$1.07</td>
<td>$1.10</td>
<td>3.8%</td>
</tr>
<tr>
<td>FCR</td>
<td>$1.05</td>
<td>$1.11</td>
<td>$1.16</td>
<td>6.0%</td>
</tr>
<tr>
<td>REL.un</td>
<td>$1.75</td>
<td>$1.68</td>
<td>$1.68</td>
<td>-3.9%</td>
</tr>
<tr>
<td><strong>HEALTH CARE/SENIORS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CSH.un*</td>
<td>$0.78</td>
<td>$0.84</td>
<td>$0.88</td>
<td>7.3%</td>
</tr>
<tr>
<td>NWH.un</td>
<td>$0.86</td>
<td>$0.94</td>
<td>$0.98</td>
<td>9.8%</td>
</tr>
<tr>
<td>** Lodging**</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>HOT.un**</td>
<td>$1.27</td>
<td>$1.51</td>
<td>$1.70</td>
<td>19.1%</td>
</tr>
<tr>
<td>INI.un*</td>
<td>$0.61</td>
<td>$0.67</td>
<td>$0.71</td>
<td>9.2%</td>
</tr>
<tr>
<td><strong>SPECIALTY REAL ESTATE</strong></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAM (US$)</td>
<td>$1.47</td>
<td>$1.78</td>
<td>$1.92</td>
<td>21.1%</td>
</tr>
<tr>
<td>DRM (EPS)</td>
<td>$1.50</td>
<td>$1.33</td>
<td>$1.41</td>
<td>-11.8%</td>
</tr>
<tr>
<td>TCN* (EPS)</td>
<td>$0.75</td>
<td>$0.62</td>
<td>$0.73</td>
<td>-17.5%</td>
</tr>
</tbody>
</table>

*Canaccord research is currently suspended. Estimates reflect consensus estimates per FactSet*

**US$ estimates converted to C$ using an exchange rate of US$1.00=C$1.38**

*Source: FactSet, Canaccord Genuity Estimates

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**REITs/REOCs with highest expected cash flow growth in 2016**

From the large cap REITs/REOCs, we expect the strongest 2016 AFFO per unit/share growth from Brookfield Property Partners L.P. (+26%) and Allied Properties REIT (+13%). From the small cap REITs/REOCs, we expect the strongest growth from InterRent REIT (+38%), American Hotel Income Properties REIT LP (+20%), and Pure Multi-Family REIT LP (+15%).
• **Brookfield Property Partners L.P.** has several drivers of cash flow growth for the next few years, in our view. The most significant and immediate driver is rent commencement at its properties in Lower Manhattan as tenants take occupancy. BPY should also benefit from marking leases to market upon expiry and from leveraging its active development/redevelopment pipeline.

• We expect **Allied Properties REIT** to post healthy cash flow growth in the near term as it completes development and redevelopment projects. Demand for space in Allied’s core King West market remains strong and should offset some of the softness in the REIT’s Western Canadian markets.

• **InterRent REIT’s** portfolio is primarily concentrated in Ontario where residential fundamentals are healthy. Going forward, we expect the REIT to achieve strong cash flow per unit growth through raising rental rates, increasing operating efficiencies, and from stabilizing the 442-suite Bell Street redevelopment property.

• Due to healthy hotel fundamentals in the U.S., we expect improvement in **American Hotel Income Properties REIT LP’s** operating metrics, which should lead to growth in same-property NOI and FFO. The REIT can also grow accretively through both acquisitions and property expansions.

• **Pure Multi-Family REIT LP’s** portfolio of high-quality apartment properties is primarily located in large markets in Texas where fundamentals are strong. We expect the REIT to generate robust same-property NOI growth over the next few years, driving cash flows and NAV higher.

2016E AFFO per unit/share growth for the remaining REITs/REOCs under coverage is expected to range from +14% to -8% (Figure 42).

**Figure 42: 2016E AFFO per unit/share growth forecast**

```
<table>
<thead>
<tr>
<th>REIT</th>
<th>2016E AFFO per unit/share growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>BPY</td>
<td>38%</td>
</tr>
<tr>
<td>HOT.un</td>
<td>26%</td>
</tr>
<tr>
<td>RUF.un</td>
<td>15%</td>
</tr>
<tr>
<td>SOT.un</td>
<td>14%</td>
</tr>
<tr>
<td>AP.un</td>
<td>13%</td>
</tr>
<tr>
<td>INN.un*</td>
<td>11%</td>
</tr>
<tr>
<td>KMP.un</td>
<td>10%</td>
</tr>
<tr>
<td>AAR.un</td>
<td>10%</td>
</tr>
<tr>
<td>CSS.un*</td>
<td>9%</td>
</tr>
<tr>
<td>CAR.un</td>
<td>8%</td>
</tr>
<tr>
<td>DRG.un</td>
<td>8%</td>
</tr>
<tr>
<td>FCR</td>
<td>7%</td>
</tr>
<tr>
<td>CRT.un*</td>
<td>6%</td>
</tr>
<tr>
<td>NWH.un</td>
<td>5%</td>
</tr>
<tr>
<td>GRT.un</td>
<td>5%</td>
</tr>
<tr>
<td>DRI.un</td>
<td>4%</td>
</tr>
<tr>
<td>SRL.un*</td>
<td>4%</td>
</tr>
<tr>
<td>ACR.un*</td>
<td>3%</td>
</tr>
<tr>
<td>MEQ*</td>
<td>2%</td>
</tr>
<tr>
<td>REF.un*</td>
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<td>HR.un*</td>
<td>0%</td>
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<tr>
<td>MIR.un*</td>
<td>-1%</td>
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<td>CRR.un*</td>
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<td>AX.un</td>
<td>-2%</td>
</tr>
<tr>
<td>BEL.un</td>
<td>-4%</td>
</tr>
<tr>
<td>REI.un</td>
<td>-8%</td>
</tr>
</tbody>
</table>
```

*Canaccord research coverage is currently suspended. Estimates reflect FactSet consensus estimates. Source: FactSet, Canaccord Genuity Estimates.

**Distribution growth should continue in 2016**

While REIT unit prices have been soft, fundamentals are steady for most REITs. We believe that the expected cash flow per unit growth in 2016 should allow for a number of REITs/REOCs to increase distributions/dividends over the next 12 months.
As detailed in our latest *Quarterly Distributions Monitor* publication, there are six REITs/REOCs that we expect will increase distributions over the next 12 months: Brookfield Asset Management Inc., Brookfield Property Partners L.P., CAP REIT, Granite REIT, InterRent REIT, and Pure Industrial Real Estate Trust.

**Changes to target prices**

In conjunction with publishing our 2016 Real Estate Outlook, we are making several changes to our target prices:

- We are lowering our target price slightly for **Dream Global REIT** to C$9.25 (from C$9.50), which equates to a 5% discount to NAV. The new target price, combined with an annualized distribution per unit of $0.80, equates to a forecast total return of 16%. While we expect the fundamental performance of the REIT’s assets to be solid in 2016, we do not believe that the unit price will reach NAV in the near-term.

- We are reducing our target price for **Dream Office REIT** to C$18.50 (from C$20.00), which equates to a 20% discount to NAV. The outlook for the Alberta office market continues to weaken, and it is difficult to see a catalyst in the near-term. Additionally, with NOI poised to decline in 2016, and the increase in capex, the likelihood of a distribution cut has increased materially.

- We are lowering our target price for **RioCan REIT** to C$27.00 (from C$28.00), which equates to a 5% premium to NAV. The new target price, combined with an annualized distribution per unit of $1.41, equates to a forecast total return of 20%.

- For **NorthWest Healthcare Properties REIT**, we are raising our target price to C$9.15 (from C$8.75), which is in line with our NAV estimate. The new target price, combined with an annualized distribution per unit of $0.80, equates to a forecast total return of 11%.

- Reflecting the softer housing market in both Saskatchewan and Alberta, we are lowering our target price for **Dream Unlimited Corp.** to C$10.00 (from C$12.00). Though cash flow should rise in 2016 from condo completions in Toronto, investors are likely to remain cautious until there are some signs of improvement in Western Canada housing.

**Upgrading Slate Office REIT to a BUY**

While suburban office fundamentals have softened, **Slate Office REIT** should grow cash flow in 2016 as a result of acquisitions in 2015. In addition, the attractive 10.6% current yield is fully covered by cash flow. The REIT’s units are currently trading at an 18% discount to NAV and only 7.6x our 2016 AFFO estimate, the lowest in our coverage universe. While fundamentals have softened slightly, and leverage is relatively high, the REIT’s units provide solid value and we are therefore upgrading our rating for Slate Office REIT from HOLD to BUY.
Figure 43: Changes to target prices and ratings

<table>
<thead>
<tr>
<th>REIT/REOC</th>
<th>Price 31-Dec-15</th>
<th>Rating</th>
<th>Old</th>
<th>Current</th>
<th>Target Price</th>
<th>Pre-tax NAV per unit/share</th>
<th>NAV to NAV</th>
<th>Prem (disc)</th>
<th>Annual dividend/total return</th>
<th>Forecast multiple</th>
<th>AFFO multiple</th>
<th>Target AFFO multiple</th>
</tr>
</thead>
<tbody>
<tr>
<td>DIVERSIFIED COMMERCIAL</td>
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<tr>
<td>ACR.un*</td>
<td>$8.84</td>
<td>S</td>
<td>$11.69</td>
<td>-24%</td>
<td>$0.78</td>
<td>S</td>
<td>8.6x</td>
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<tr>
<td>AX.un</td>
<td>$12.80</td>
<td>BUY</td>
<td>$15.50</td>
<td>$1.08</td>
<td>30%</td>
<td>9.9x</td>
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<tr>
<td>BPY (US$)</td>
<td>$23.24</td>
<td>BUY</td>
<td>$28.00</td>
<td>$1.06</td>
<td>25%</td>
<td>20.7x</td>
<td>24.9x</td>
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<td>REF.un*</td>
<td>$42.06</td>
<td>S</td>
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<td>CG.un*</td>
<td>$14.71</td>
<td>S</td>
<td>$19.19</td>
<td>-23%</td>
<td>$1.47</td>
<td>S</td>
<td>9.4x</td>
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<tr>
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<td>$9.50</td>
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<td>16%</td>
<td>11.2x</td>
<td>11.9x</td>
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<td>HR.un*</td>
<td>$20.05</td>
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<td>$25.46</td>
<td>-21%</td>
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<tr>
<td>MR.un*</td>
<td>$7.21</td>
<td>S</td>
<td>$9.10</td>
<td>-21%</td>
<td>$0.68</td>
<td>S</td>
<td>8.6x</td>
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<td>AAR.un</td>
<td>$4.37</td>
<td>BUY</td>
<td>$5.25</td>
<td>$0.31</td>
<td>27%</td>
<td>11.1x</td>
<td>13.3x</td>
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<tr>
<td>DIR.un</td>
<td>$7.18</td>
<td>BUY</td>
<td>$9.00</td>
<td>$0.70</td>
<td>35%</td>
<td>8.4x</td>
<td>10.5x</td>
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<tr>
<td>GRT.un</td>
<td>$37.96</td>
<td>HOLD</td>
<td>$41.00</td>
<td>$2.30</td>
<td>14%</td>
<td>12.8x</td>
<td>13.8x</td>
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<td>OFFICE</td>
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<tr>
<td>AP.un</td>
<td>$31.57</td>
<td>HOLD</td>
<td>$35.50</td>
<td>$0.31</td>
<td>17%</td>
<td>14.6x</td>
<td>16.5x</td>
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<tr>
<td>D.un***</td>
<td>$17.37</td>
<td>HOLD</td>
<td>$20.00</td>
<td>$2.24</td>
<td>15%</td>
<td>8.0x</td>
<td>8.5x</td>
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<tr>
<td>SOT.un</td>
<td>$7.05</td>
<td>HOLD</td>
<td>$7.50</td>
<td>$0.75</td>
<td>17%</td>
<td>8.6x</td>
<td>8.0x</td>
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<tr>
<td>RESIDENTIAL</td>
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<tr>
<td>BEL.un</td>
<td>$47.45</td>
<td>HOLD</td>
<td>$50.00</td>
<td>$2.04</td>
<td>10%</td>
<td>15.4x</td>
<td>16.2x</td>
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<tr>
<td>CAR.un</td>
<td>$28.64</td>
<td>HOLD</td>
<td>$30.00</td>
<td>$2.27</td>
<td>16%</td>
<td>17.8x</td>
<td>19.9x</td>
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<tr>
<td>IPP.un</td>
<td>$6.56</td>
<td>BUY</td>
<td>$7.50</td>
<td>$0.23</td>
<td>18%</td>
<td>14.3x</td>
<td>16.3x</td>
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<td>KMP.un</td>
<td>$10.51</td>
<td>BUY</td>
<td>$11.50</td>
<td>$0.60</td>
<td>15%</td>
<td>14.0x</td>
<td>15.4x</td>
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<tr>
<td>MEQ*</td>
<td>$30.07</td>
<td>S</td>
<td>$49.87</td>
<td>-40%</td>
<td>$0.00</td>
<td>S</td>
<td>12.4x</td>
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<tr>
<td>NVL.un*</td>
<td>$17.56</td>
<td>S</td>
<td>$23.61</td>
<td>-26%</td>
<td>$1.63</td>
<td>S</td>
<td>8.2x</td>
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<tr>
<td>RUF.(US$)</td>
<td>$5.13</td>
<td>BUY</td>
<td>$6.50</td>
<td>$0.38</td>
<td>34%</td>
<td>11.0x</td>
<td>14.0x</td>
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<td>RETAIL</td>
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<tr>
<td>SRL.un*</td>
<td>$30.19</td>
<td>S</td>
<td>$30.67</td>
<td>-2%</td>
<td>$1.65</td>
<td>S</td>
<td>14.2x</td>
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<tr>
<td>CRR.un</td>
<td>$12.80</td>
<td>HOLD</td>
<td>$13.00</td>
<td>$0.89</td>
<td>9%</td>
<td>13.5x</td>
<td>13.7x</td>
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<td>CRT.un*</td>
<td>$13.00</td>
<td>S</td>
<td>$12.15</td>
<td>7%</td>
<td>$0.68</td>
<td>S</td>
<td>14.6x</td>
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<tr>
<td>FCR</td>
<td>$18.35</td>
<td>BUY</td>
<td>$22.00</td>
<td>$0.86</td>
<td>25%</td>
<td>17.5x</td>
<td>21.0x</td>
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<td>REI.un</td>
<td>$23.69</td>
<td>BUY</td>
<td>$28.00</td>
<td>$1.41</td>
<td>20%</td>
<td>15.7x</td>
<td>17.9x</td>
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<td>HEALTH CARE/SENIORS</td>
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<td>CSH.un*</td>
<td>$12.70</td>
<td>S</td>
<td>$12.88</td>
<td>-1%</td>
<td>$0.55</td>
<td>S</td>
<td>15.6x</td>
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<td>NWI.un</td>
<td>$8.93</td>
<td>HOLD</td>
<td>$8.75</td>
<td>$0.16</td>
<td>1%</td>
<td>11.0x</td>
<td>11.3x</td>
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<tr>
<td>HOT.un**</td>
<td>$10.65</td>
<td>BUY</td>
<td>$12.50</td>
<td>$0.90</td>
<td>26%</td>
<td>7.2x</td>
<td>8.5x</td>
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<tr>
<td>INN.un*</td>
<td>$5.13</td>
<td>S</td>
<td>$5.42</td>
<td>-5%</td>
<td>$0.40</td>
<td>S</td>
<td>9.5x</td>
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<td>SPECIALTY REAL ESTATE</td>
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<tr>
<td>BAM (US$)</td>
<td>$31.53</td>
<td>BUY</td>
<td>$39.00</td>
<td>$0.48</td>
<td>25%</td>
<td>NA</td>
<td>NA</td>
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<tr>
<td>DRK</td>
<td>$7.27</td>
<td>BUY</td>
<td>$12.00</td>
<td>$0.00</td>
<td>38%</td>
<td>NA</td>
<td>NA</td>
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<tr>
<td>TCN*</td>
<td>$9.06</td>
<td>S</td>
<td>$13.23</td>
<td>-32%</td>
<td>$0.24</td>
<td>S</td>
<td>NA</td>
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</table>

*Canaccord research coverage is currently suspended. Estimates reflect FactSet consensus estimates.
**US$ estimates converted to C$ using an exchange rate of US$1.00=C$1.38
***Forecast total return for D.un assumes a distribution cut to $1.50 (from $2.24)
Source: FactSet, REIT/REOC Reports, Canaccord Genuity Estimates

For 2016, we are forecasting a weighted average total return of 19% from our coverage universe. On an individual REIT/REOC basis, we are forecasting total returns ranging from a high of 38% for Dream Unlimited Corp. to 9% for Crombie REIT.
By asset class, we expect the highest returns in 2016 from the specialty real estate REOCs (comprised of BAM and DRM) with a weighted average forecast total return of 26%, followed by diversified commercial at 25% and industrial at 21% (Figure 45).

Figure 45: 2016 forecast REIT/REOC total returns by sector (weighted averages)
KEY CONCERNS FOR 2016

In our view, there are a handful of risks which could lead to a year of negative returns from Canadian REITs:

- We believe that one of the key reasons for the weak performance from REITs in 2015 was the concern that long-term interest rates would rise. Going forward, the outlook for interest rates will remain a key concern, and could impact REIT unit prices materially. To the extent U.S. economic growth drives the U.S. 10-year bond yield higher, Canadian long-term interest rates could follow, in spite of a lack of growth in Canada.

- Less material, but also a factor, fundamentals have softened somewhat and the pace of cash flow growth has declined. We are currently forecasting AFFO per unit growth of 3.2% for 2016, and 3.4% for 2017. This compares with our January 2015 forecast of 5.5% growth in AFFO per unit for 2016.

  With significant office development across Canada, it is possible that fundamentals will continue to soften. There is new supply being developed in Calgary, Edmonton, Toronto, and Vancouver, which could lead to increased vacancy. Although less of a concern, there is a large amount of industrial and rental apartment space under development.

- Consumer debt levels are relatively high and relatedly, the Canadian housing market has been extremely strong for a number of years in both Toronto and Vancouver. A correction in housing prices, possibly as a result of an increase in the five-year bond yield, could negatively affect the Canadian economy.

- Should the price of oil remain low for an extended period of time, the Canadian economy could suffer. Specifically, those REITs with exposure to Alberta could face additional pressure.

**Key concern #1: Long-term interest rates could increase in 2016 in spite of a soft Canadian economy**

In our view, the performance from Canadian REITs was disappointing in 2015 due to concerns of an increase in Canadian long term interest rates. Going forward, there is a possibility that long-term interest rates in Canada could increase in tandem with U.S. interest rates, even if economic growth in Canada is modest. This could lead to an increase in cap rates, and drive real estate values lower as the negative impact of higher cap rates would not be adequately mitigated by growth in rental rates.

**Strong correlation between Canada and U.S. long-term interest rates.** The Canada and U.S. 10-year government bond yields have historically been highly correlated with each other, with a correlation coefficient of 0.98 over the last 30 years (Figure 46).
However, we note that recently there has been some divergence between Canadian and U.S. long-term interest rates. While the average spread between U.S. and Canada 10-year bond yields over the last 30 years has been +50 bps, the current spread is -88 bps. In our view, this is likely because U.S. economic growth has been stronger, whereas the Canadian economy has softened due to the oil price collapse.

Considering the spread between Canadian and U.S. bond yields is already abnormally wide, we believe Canadian long-term interest rates could rise in lockstep with U.S. long-term interest rates, without corresponding economic growth in Canada. **This is a key risk for the Canadian real estate sector.** Alternatively, the divergence between the two bond yields could continue, and Canadian long-term interest rates only rise when the economy returns to healthy GDP growth.

The U.S. Federal Reserve recently increased short-term interest rates, which is likely to drive long-term rates higher as well. The consensus estimate is for a 50 bp increase in the U.S. 10-year bond yield in 2016.
 Rising long-term interest rates could result in upward pressure on cap rates

Cap rates have generally followed the same course as long-term interest rates and have been steadily declining since the early 1990s. However, in the scenario that there is a material spike in interest rates, especially if there is no corresponding economic growth, there would likely be upward pressure on cap rates. The following chart depicts the average impact to our NAV estimates of 25 bp and 50 bp increases to our utilized cap rates, all else equal. A 25 bp increase in cap rates would result in a 7.9% weighted average drop in our NAV estimates for REITs/REOCs under coverage, whereas a 50 bp increase in cap rates would result in a 15.2% drop.
Figure 48: Sensitivity of sector NAV to changes in utilized cap rates

Source: Canaccord Genuity Estimates

In the chart below, we detail the impact of a 50 bp increase in the utilized cap rate on each individual REIT/REOC under coverage. Generally, REITs/REOCs which are more highly levered and which are currently valued at lower cap rates are more sensitive to increases in cap rates. The impact for REITs/REOCs under coverage ranges from a 21% decline in our NAV estimate for Brookfield Property Partners to a 7% decline for Granite REIT.

Figure 49: NAV sensitivity to a 50 bp increase in utilized cap rates

Source: Canaccord Genuity Estimates

Key concern #2: Further softening in real estate fundamentals could put pressure on cash flow growth

Cash flow per unit growth for Canadian REITs has been below expectations in 2015. At the beginning of 2015, we expected weighted average AFFO per unit growth of 5.5% for REITs/REOCs under coverage. However, fundamentals for certain asset classes and geographies have softened, and our current 2015 estimate for average
AFFO per unit/share growth is 3.2% with eight REITs/REOC expected to post negative year-over-year cash flow per unit growth for 2015.

*Canaccord research currently suspended. AFFO estimates reflect consensus estimates per FactSet.
**Excludes BAM, DRM, and TCN
Source: REIT/REOC Reports, Canaccord Genuity

Looking forward to 2016, we expect further softening in fundamentals for some asset classes and geographies. Among real estate asset classes, the office sector remains the most vulnerable as there is an elevated amount of incoming supply. According to CBRE data, there is significant office space construction in Calgary, Edmonton, and Vancouver (Figure 51). As of Q3/15, office space under construction represented 8.8% of existing inventory in Calgary, 8.3% in Edmonton, and 4.8% in Vancouver (4.0% nationally).

In Vancouver, though the proportion of office space inventory under construction is higher than the national average, we do not expect fundamentals to deteriorate significantly as CBRE expects leasing activity to be healthy in 2016 due to strong demand for real estate from the tech and professional services sectors. However, in Calgary and Edmonton, there is an estimated 7.6 million sf in office development that is under construction which is expected to come on line in 2016 and 2017. The incoming supply is likely to have a material impact on vacancy and rental rates over the next few years, especially if oil prices remain depressed and absorption is weak.
Some of the larger properties slated to be completed in the next two years are Brookfield Place in Calgary (1.4 million sf to be completed in 2017) and Bay Adelaide East in Toronto (1.0 million sf to be completed in 2016). Details of downtown office developments currently under construction in Calgary and Toronto are provided in the following table.

- In downtown Calgary, there are five office development projects underway totaling 3.8 million sf. On average, the developments are 67% pre-leased, with completion scheduled for 2016 to 2018.
- In downtown Toronto, there are five office development projects underway totaling 3.6 million sf. On average, the developments are 71% pre-leased, with completion scheduled for 2016 to 2017.

Demand for office space declined in 2015 with negative 1.7 million sf of space absorbed nationally, in the first three quarters of 2015. Although CBRE expects absorption to be positive in 2016, it is expected to total only 2.8 million sf, significantly lower than the 6.8 million sf of new office space expected to come on-line in 2016. As a result, CBRE expects the national vacancy rate to increase from 12.3% in 2015 to 13.0% (Figure 53) in 2016.
Although there is significant industrial space under construction, we believe this is less of a concern since much of the space is built-to-suit. As of September 30, 2015, industrial space under construction in Calgary totaled 3.2% of current inventory (~4.1 million square feet), 3.2% in Vancouver (~5.8 million square feet), and 2.8% in Edmonton (~3.1 million square feet). This compares to the national average of 1.3%.

Rising unemployment due to cutbacks in the energy sector and increasing rental apartment inventory levels are expected to weigh on rental apartment fundamentals in Calgary and Edmonton. CBRE expects the vacancy rate in both of these markets to increase over the next two years and rental rate growth is expected to be much slower than the high growth rates witnessed in recent years.

However, the softness in Alberta should be mostly offset by strength in Ontario and British Columbia, where economic growth is expected to pick up. In our view, the risk of softening rental apartment fundamentals is more apparent for REITs/REOCs with significant exposure to Alberta, Saskatchewan, and other energy-focused regions.
Key concern #3: Consumer debt levels relative to disposable income are at an all-time high

Consumer debt levels have risen steadily over the past 25 years, supported by appreciating asset prices. The current household debt-to-disposable income ratio is a record 167% (according to Statistics Canada). Housing prices in Canada have risen rapidly over the past several years, and a number of brokers and research firms (including CMHC, the IMF, and Royal LePage) have recently warned of overvaluation in the Canadian housing market.

A significant increase in the five-year GoC bond yield and/or a material correction in housing prices could cause widespread deleveraging, which would negatively impact consumer spending and consequently the Canadian economy.

Key concern #4: Persistent low oil prices could continue to adversely impact the Canadian economy, Alberta in particular

The oil price decline has adversely impacted the Canadian economy, particularly in the energy-producing provinces of Alberta and Saskatchewan where there have been
material declines in retail sales and employment levels. One of the hardest-hit real estate markets is the Calgary office market. Per CBRE data in mid-2015, the oil and gas sector accounted for 8.5% of total employment and 75%-85% of downtown office space in Calgary. Not surprisingly, the office vacancy rate has increased 450 bps and rental rates have declined 17.0% in the first three quarters of 2015. Residential real estate fundamentals have also been impacted, with the vacancy rate in Edmonton and Calgary increasing year-over-year by 250 bps and 390 bps respectively, at October 2015 (CMHC data).

A number of REITs/REOCs under our coverage have material exposure to energy markets in Western Canada. We continue to be cautious of these REITs/REOCs. In our view, the REITs with the shortest lease terms and greatest exposure to Alberta are most at risk of being negatively impacted by a weaker Alberta economy as indicated in the following chart (Figure 57).

Figure 57: Exposure to Alberta/Western Canada (percentage of NOI or assets) vs. weighted average lease term to expiry (years) as at Q3/15

- **Boardwalk REIT**'s portfolio of rental apartment properties is materially exposed to Alberta, with 68% of NOI generated from the province. We expect the pace of internal growth to turn negative in 2016 as market rental rates are trending downwards and vacancy is on the rise. However in the near term, the impact on FFO per unit should be partly offset by unit buybacks and interest expense savings from refinancing maturing debt at lower interest rates.

- Approximately 40% of **Dream Office REIT**'s NOI is generated from Western Canada. Elevated vacancy levels and downward pressure on rental rates resulted in same-property NOI growth turning negative in Q3/15. Given the weakening office fundamentals across the country and especially in Calgary, we expect the pressure on internal growth to remain and do not see a catalyst for the units in the near term.

- **Artis REIT** has material exposure to Alberta (35% of Q3/15 NOI). Not surprisingly, internal growth for the Canadian portfolio was -1.6% in Q3/15. However, in our view the REIT is better prepared to handle the current downturn in Alberta as compared to the previous downturn following the financial crisis in 2008/2009,
due to a lower payout ratio, reduced leverage, and fewer lease expiries from the Calgary office market.

Furthermore, strong performance from the U.S. portfolio and the strengthening U.S. dollar have boosted the REIT’s cash flow, more than offsetting the weakness in the Canadian portfolio and the Alberta properties in particular. As fundamentals in its U.S. markets remain strong, we expect continued NOI growth from the REIT’s portfolio.
APPENDIX – PROPERTY FUNDAMENTALS

Office

Canadian office fundamentals weakened in 2015 as growth in supply outpaced demand. For the first three quarters of the year, demand for office space softened and absorption totaled -1.7 million sf, compared to +3.0 million sf for full-year 2014. This, combined with the 4.2 million sf of new space delivered to the Canadian market (as of Q3/15), resulted in a 110 bp increase in the national vacancy rate, from 10.7% at Q4/14 to 11.8% at Q3/15. Over the same period, rental rates have stayed flat according to CBRE, as a 17.0% decline in the average class A net rental rate in Calgary completely offset increases in most other major markets. We believe that net effective rental rates have actually declined as leasing costs have been rising in some markets.

Figure 58: National office market snapshot

Looking ahead to 2016, CBRE expects fundamentals to remain mixed. As of Q3/15, there was 17.5 million sf of office space under construction, which is above the 10-year average of 14.7 million sf. Furthermore, many companies, especially in Alberta, are reducing their office space footprints in an effort to be more efficient, which could result in sustained low absorption and keep downward pressure on occupancy rates. However, there are several bright spots in the Canadian office market. CBRE expects office fundamentals to remain healthy in Vancouver as demand for real estate from the tech and professional sectors should offset weakness in the resource sector. Also, CBRE expects above-average economic growth in Atlantic Canada which should enable office market fundamentals to improve. CBRE’s latest forecast has the national office vacancy rate increasing 70 bps in 2016, from 12.3% at year-end 2015 to 13.0% at year-end 2016 (Figure 59).
On a geographical basis, fundamentals softened in most markets; however, the imbalance between supply and demand has been most prevalent in the Calgary market.

- Fundamentals in **Calgary** have weakened significantly over the past year. Absorption for the first three quarters of 2015 was -2.3 million sf, while a significant 1.7 million sf of new supply was delivered to the market. As a result, vacancy increased 450 bps from 11.0% in Q4/14 to 15.5% in Q3/15.
  
  Furthermore, the overall office class A average net rental rate dropped 17.0% from $28.22 psf in Q4/14 to $23.41 psf in Q3/15. In our view, the net effective rental rate is probably much lower, and in some cases negative, as landlords are forced to offer increased incentives to attract tenants.
  
  According to CBRE, fundamentals will weaken further in the near term as large development projects are completed. As of Q3/15, there was 5.5 million sf of office space under construction (8.8% of existing supply) which is expected to come on-line in 2016-2017. In 2016, CBRE forecasts the Calgary office vacancy rate rising to 18.1%.
  
  - CBRE expects further negative pressure in the downtown office market of Calgary. Vacancy is expected to increase (CBRE data) from 16.3% in 2015 to 18.4% in 2016 as 620,000 sf of new supply is delivered to the market and net absorption is expected to be negative.
  
  - The suburban office market in Calgary is expected to hold up better than the downtown market. According to CBRE, vacancy is expected to increase 20 bps from 17.5% in 2015 to 17.7% in 2016 despite 440,000 sf of new supply entering the market in 2016.

- In **Edmonton**, fundamentals have also softened considerably. Absorption was essentially flat for the first three quarters of 2015 and vacancy increased 80 bps from 11.3% in Q4/14 to 12.1% in Q3/15, as 253,000 sf of new office space was delivered to the market. The development pipeline is quite significant, with 2.0 million sf of office space currently under construction (8.3% of existing supply).
  
  CBRE expects leasing activity to be soft over the next few years as tenants wait for new office space to come on line before making long-term commitments. The Edmonton office vacancy rate is expected to rise dramatically by 400 bps in 2016 to 16.2%.
• In **Toronto**, though absorption was slightly positive over the first three quarters of 2015 at 185,000 sf, it was outpaced by the 1.1 million sf of new supply delivered to the market. As a result, the vacancy rate increased 40 bps to 9.9% at Q3/15 from 9.5% at Q4/14.

For 2016, CBRE expects the vacancy rate to rise to 11.7%.

*Figure 60: Overall office vacancy rate forecasts for select Canadian markets*

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**Industrial**

Industrial fundamentals were strong for the most part in 2015 as demand for logistics and distribution space drove positive leasing activity. Absorption over the first three quarters of 2015 was +8.9 million sf, despite Target’s vacancy from three distribution centres totaling 3.1 million sf. The availability rate increased marginally from 5.4% at Q4/14 to 5.6% at Q3/15, as 12.8 million sf in new completions outweighed the positive absorption. Meanwhile, average net rent increased by a healthy 5.3% from $6.06 psf at Q4/14 to $6.38 psf at Q3/15.
According to CBRE, industrial fundamentals are expected to remain stable in 2016, with the availability rate forecast to be flat and net rental rates forecast to rise 2.2%. Although the improving Canadian manufacturing outlook, weaker Canadian dollar, and strengthening U.S. economy support the industrial sector, we have yet to see a material improvement in fundamentals.

**Retail**

Retail fundamentals were challenged by the departure of Target and store closures of a number of other retailers including Future Shop, Mexx, and Jacob. According to CBRE, only 30-40% of the space vacated by Target was backfilled as at October 2015, which was much lower than CBRE’s initial expectations. We highlight Cominar REIT, H&R REIT, Morguard REIT, and RioCan REIT as REITs that had material exposure to the Target leases.

Additionally, online sales continue to take market share away from bricks and mortar retailers. At mid-year 2015, the retail vacancy rate was 4.0%, up 50 bps from year-end 2014 (CBRE data). Looking ahead, CBRE expects some downward pressure on rental
rates although vacancy should not exceed 5.5%. We believe some retail REITs will struggle to generate internal growth in the near term until the vacancies are re-filled.

**Residential**

According to CMHC’s Fall 2015 Rental Market Report, the national rental apartment vacancy rate rose 50 bps year-over-year to 3.3% at October 2015 from 2.8% at October 2014. Further, rental rate growth slowed to +2.0% year-over-year in October 2015, compared to +3.9% in the year-ago period. While fundamentals have noticeably softened, we note that there is a clear bifurcation geographically. Residential fundamentals in British Columbia and Ontario remain healthy, whereas fundamentals in Alberta and Saskatchewan have deteriorated significantly.

Figure 64: The national rental apartment vacancy rate is trending higher

- In **Vancouver**, demand for rental apartments remained healthy on the back of strong employment and positive net migration to the city. According to CMHC, rental rates grew +4.3% year-over-year in October 2015, higher than the national average growth rate of +2.9%. Also, the vacancy rate continued to decline and was just 0.8% at October 2015, down 20 bps year-over-year.

- In **Toronto**, rental market fundamentals remained stable as an increase in population especially amongst the younger age groups that are more likely to rent, coupled with a decrease in the affordability of house ownership, led to continued demand for rental apartments. This was partly offset by increased supply in rental condominiums. According to CMHC, the vacancy rate remained unchanged at 1.6% and year-over-year rental rate growth was +3.4% in October 2015.

- In **Alberta**, rental demand has been negatively impacted by job losses in the energy industry and lower net migration. As a result, fundamentals have softened considerably and to a much greater extent than was initially forecast by CMHC in its Q4/15 Housing Market Outlook:
  - In **Calgary**, the vacancy rate increased from 1.4% at October 2014 to 5.3% at October 2015. Rental rate growth was essentially flat year-over-year at +0.8% in October 2015, which is a significant departure from the +6.4% year-over-year growth rate observed in October 2014.
  - In **Edmonton**, the rental apartment vacancy rate increased to 4.2% in October 2015 from 1.7% in October 2014. The pace of rental growth slowed considerably with the average rental rate rising +2.2% year-over-year as at
October 2015, compared to the +6.1% year-over-year growth posted in October 2014.

- In Montreal, fundamentals weakened slightly due to lower net migration as well as stiffer competition from rental condominiums. According to CMHC, the vacancy rate increased from 3.4% at October 2014 to 4.0% at October 2015 and rental rates grew +1.8% over the same period. On a same-property basis, however, rental rates remained unchanged year-over-year, suggesting that the rise in overall rental rates was a function of the new supply.

- In Halifax, the rental apartment vacancy rate unexpectedly decreased to 3.4% at October 2015 from 3.8% in the year-ago period. Previously, CMHC had been forecasting a rise in the vacancy rate to 4.1% due to the completion of 1,250 rental apartment units, the second largest annual increase in the past 20 years (according to CMHC). However the market has been boosted by migratory gains as fewer people are moving to Western Canada. Further, the aging population has been fueling demand for rental apartments. Rental rate growth in Halifax was +4.3% year-over-year, although this was mostly due to newly constructed apartment buildings which carry higher rents. On a same-property basis, the growth was a more modest +1.7%.

**Figure 65: Vacancy rate trends in major markets across Canada**

![Vacancy rate trends in major markets across Canada](image)

Source: Canada Mortgage and Housing Corporation, Canaccord Genuity

**Lodging**

Since hotels have substantial operating leverage, in an environment where lodging fundamentals are improving there is an outsized positive impact on net income and cash flows. Currently, the weak Canadian dollar is resulting in higher travel within and to Canada, driving higher demand for accommodation. Moreover, the economic recovery in the U.S. remains very supportive of lodging fundamentals, and key hotel operating metrics such as occupancy, average daily rate (ADR), and revenue per available room (RevPAR) are forecast by PwC and PKF Consulting to improve further.

**Canadian lodging operating metrics forecast to surpass previous highs in 2016**

According to PKF Consulting, fundamentals for the Canadian lodging sector are forecast to improve significantly, as illustrated in Figure 66:

- **Occupancy** is anticipated to increase to 65% in 2016, up 100 bps from 64% in 2015 and up 600 bps from a low of 58% in 2009;
● **ADR** is forecast to increase from $143 in 2015 to $146 in 2016 (4.4% year-over-year increase in 2015 and 2.1% year-over-year increase in 2016); and,

● **RevPAR** is forecast to increase from $91 in 2015 to $96 in 2016 (year-over-year increase of 3.4% in 2015 and 5.5% in 2016), up from the pre-recessionary high of $83 in 2007 and 2008.

*Figure 66: Occupancy, ADR, and RevPAR for the Canadian lodging sector*

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**U.S. lodging metrics to chart new highs**

Lodging fundamentals in the U.S. have improved considerably since 2010, and looking ahead, hotel fundamentals are forecast to maintain the positive trajectory in 2016, according to PwC’s Hospitality Directions U.S. (November 2015), as illustrated in Figure 67:

● **Occupancy** is expected to remain flat at 65.6% in 2016 (up 240 bps from a pre-recession high of 63.2% in 2006), after a 120 bp increase in 2015 to 65.6% from 64.4% in 2014.

● **ADR** is forecast to increase to US$127 in 2016, a 5.8% increase from US$120 in 2015.

● **RevPAR** is forecast to increase to US$83 in 2016, a 5.1% increase from US$79 in 2015.

*Figure 67: Occupancy, ADR, and RevPAR for the U.S. lodging sector (US$)*

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Source: PKF Consulting, Canaccord Genuity

Source: PwC Hospitality Directions U.S., November 2015, Canaccord Genuity
Seniors housing

Long-term fundamentals in the seniors housing sector are trending positively. Demand from the baby boomer generation should increase over the coming years and further drive vacancy lower. Over the last four years, the seniors population in Canada has increased at a CAGR of +4.4% as compared to the overall population growth rate of +1.1%. Reflecting the healthy fundamentals, over the first nine months of 2015 Chartwell Retirement Residences posted a 140 bp year-over-year increase in its weighted average same-property occupancy rate.

Figure 68: Seniors population in Canada is growing

Not surprisingly, there has been increased investment interest in the seniors housing sector with some significant transactions occurring in 2015, including:

- The sale of Regal Lifestyle Communities Inc. to Welltower Inc. and Revera, Inc. for $764 million (6.1% cap rate);
- The sale of Amica Mature Lifestyles Inc. to Baybridge Seniors Housing Inc. for $578 million; and,
- Over $587 million of announced or completed acquisitions of seniors housing assets by Chartwell Retirement Residences since the beginning of Q3/15.

According to CBRE, cap rates for high quality seniors housing assets declined by 75-100 bps in 2015 with average cap rates currently in the sub-7% range.
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