CBRE

CANADIAN HOTELS

2019 OUTLOOK

CBRE

COMMERCIAL REAL ESTATE INVESTMENT

Canadian Commercial Real Estate Overview

Canadian commercial real estate has been a direct beneficiary of Canada's economic momentum, enjoying an influx of global capital, record construction activity, rising home prices and technological advancements. Record-setting trends across most asset classes and markets demonstrate the exceptional strength of the sector and its growing prominence on the global stage.

66% **Hotel occupancy reached 66.0% nationally in 2018, setting a new Canadian record.**

2.7% **Downtown Toronto's office vacancy rate has been the lowest in North America since Q2 2016 and currently sits at 2.7%. Vancouver and Ottawa were also strong performers with 3.8% and 7.4% downtown office vacancy as of Q4 2018, respectively.**

>$1 M **The average price for a single acre of low-density land in the Greater Toronto Area, used for single-family and semi-detached homes, surpassed $1.0 million for the first time, up from $382,000 ten years ago.**

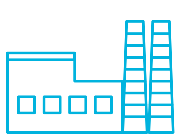
#1 **CBRE's prime industrial rent study found that Vancouver's hub is leading the world in rental rate growth. The overall industrial availability rate fell to 2.3% in 2018, fueled by strong demand for warehouse and distribution space.**

<2% **Five of Canada's ten largest cities (Vancouver, Toronto, Ottawa, Montreal and Halifax) have overall apartment vacancy rates below 2.0%.**

$49.3 B **Commercial real estate investment reached a third consecutive annual record in 2018 at $49.3 billion, 68.3% above the 10-year average.**

> **"For Canadian Commercial Real Estate, 2019 will present a 'Once-in-a-Generation' moment. Amid record-low vacancy and availability, property owners across all sectors will have unprecedented control of their portfolios."**

Paul Morassutti,
Vice Chairman, CBRE Limited



Industrial activity was up a staggering 71.8% in 2018 significantly over 2017, reaching $12.7 billion. Office transaction volume set a record of $10.8 billion in 2018 surpassing 2017 levels Record low vacancy rates for both industrial and office space were reported in major cities across Canada.

Capital flows continue to be driven by blockbuster deals including Bay-Adelaide Centre (office) in Toronto ($850 million), Downsview Airport (development) in Toronto ($825 million) and Telus Garden (mixed-use) in Vancouver ($600 million). The country has seen an increase in international firms expanding their operations over recent quarters. While entrants have come from a variety of sectors, the majority have been tech firms, thanks in part to the deep pool of talent that exists across the country.

Most real estate sectors reported solid operating performance last year and a robust level of demand for all types of assets, from housing to hotels. The demand has spurred new supply across the country with exciting developments such as the River Landing mixed-use urban project in Saskatoon, Winnipeg's Sports, Hospitality, and Entertainment District (the SHED) and the Cogswell District, a new mixed-use development and transit hub in Halifax.

HOTEL INVESTMENT

Canadian Hotel Investment Overview

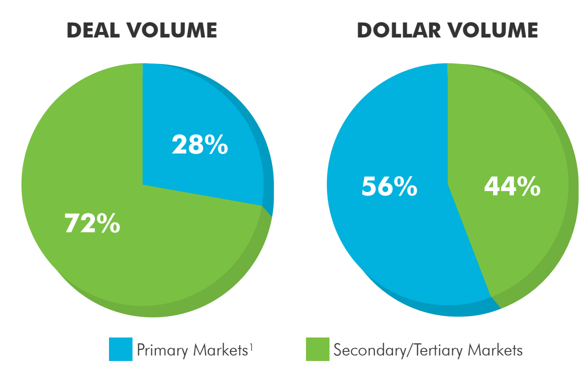
Canadian hotel investment activity declined noticeably in 2018 in sharp contrast to overall commercial real estate trends and in the face of strengthening hotel operating fundamentals. Hotel transaction volume in 2018 fell by 55% year-over-year to $1.5 billion and was 16% lower than the ten-year average of $1.8 billion. As we dissected the headline figures, some noteworthy trends emerged:

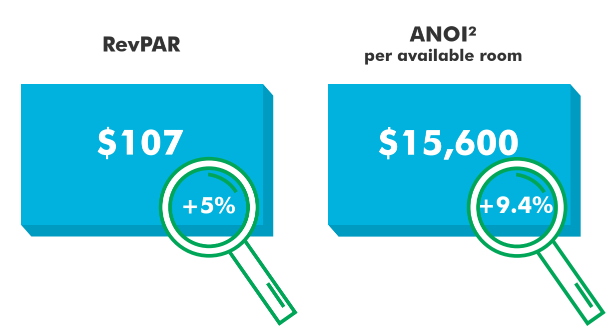
- **The Investment Conundrum**
  With hotels in most major markets reporting at or near peak occupancy and rising ADR and profit levels, many owners are taking a wait and see approach to asset disposition reducing the availability of product on the market. Yet they have capital to deploy and are actively looking for opportunities. The combination of limited availability of product for sale and significant capital to deploy is having upward pressure on prices. Even if you could find product, why buy old when you can buy new, especially as hotel pricing is nearing replacement cost in many markets?

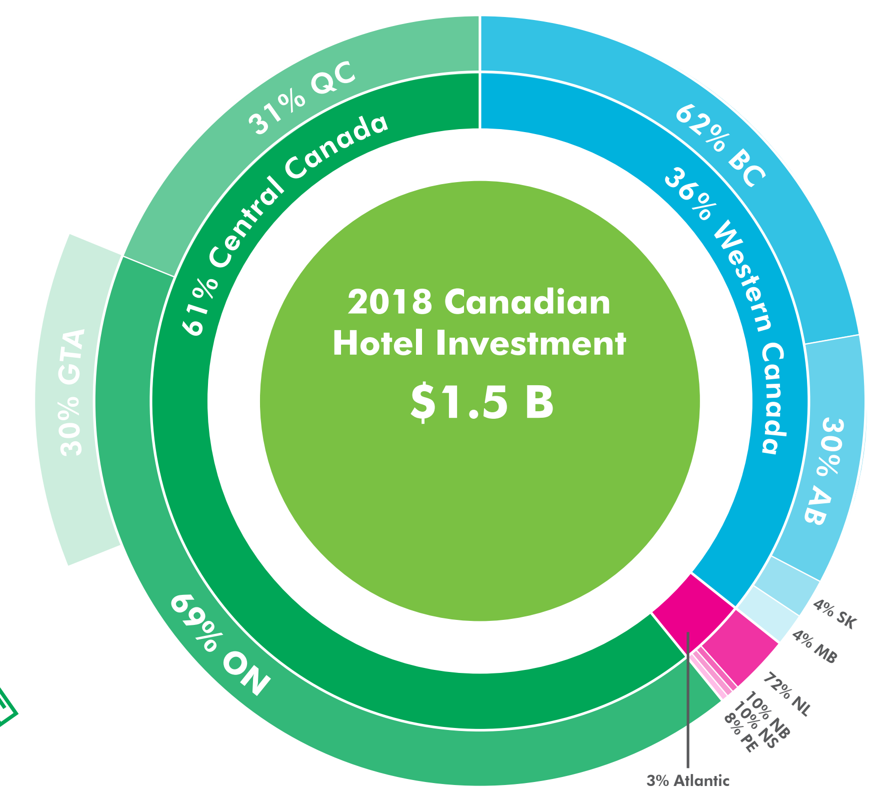
- **Absent M&A and Entity Level Deals**
  Missing from 2018 were the entity level deals that bolstered volume levels to $4.1 billion in 2016 and $3.4 billion in 2017. However, even when M&A and portfolio sales are excluded, 2018 volume fell short of 2017 levels by 34% or nearly $800 million.

- **Focus Shifts to Secondary and Tertiary Markets**
  The number of trades in secondary and tertiary markets increased significantly in 2018, accounting for 72% of trades occuring outside primary markets. This substantially differs from 2017 when these trades comprised 59%. With fewer opportunities coming to market in the country's major markets, transaction volume in smaller markets rose to nearly 44% of total volume in 2018 compared to 21% in 2017 (excludes Leadon Investments' acquisition of the SilverBirch Hotels & Resorts portfolio as individual pricing was confidential). Increased interest has also led to a rise in per room pricing in secondary/tertiary markets, from $81,200 in 2017 to $86,000 in 2018.

- **Off-Shore Interest Remains Strong**
  Domestic and foreign investors alike continue to show strong interest in acquiring hotels in Canada's global gateway cities. While recent regulations may slow and to some extent limit foreign capital to entering Canada, interest remains particularly as Canada is a considered a safe haven for investment.



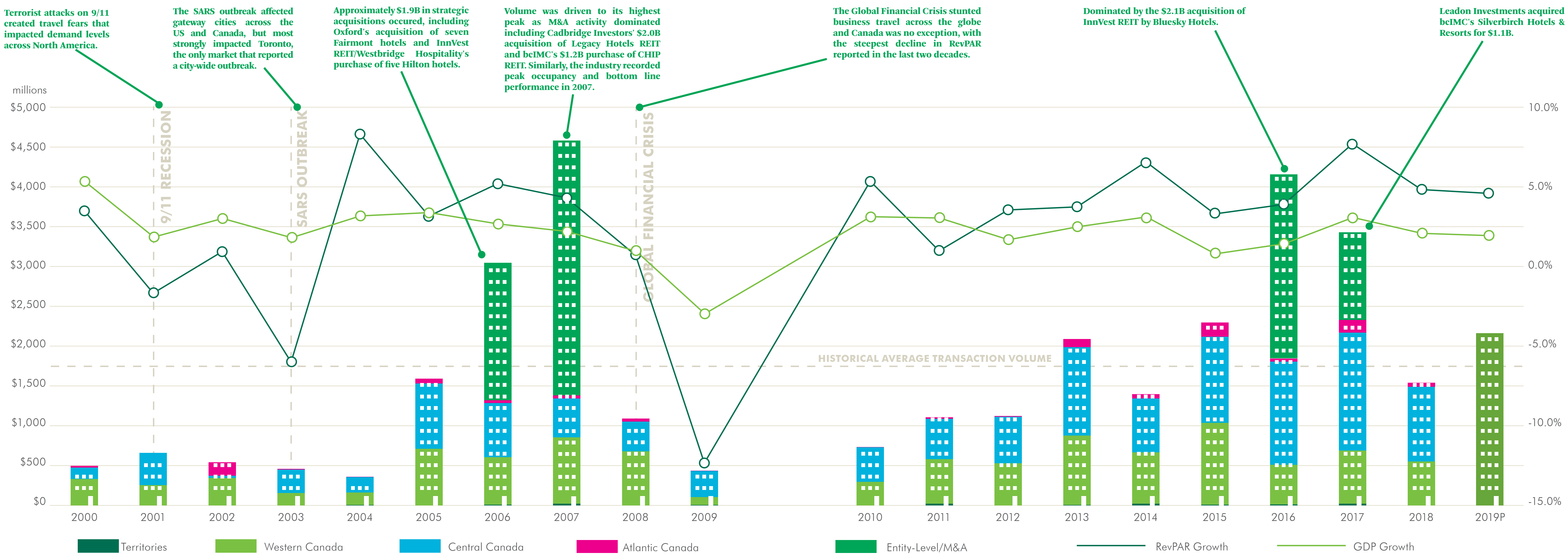




Source: CBRE Hotels

[1]Defined as the major metropolitan areas in each province/territory
[2] ANOI = Adjusted Net Operating Income

2018 IN REVIEW
HOTEL INVESTMENT



Source: CBRE Hotels, The Conference Board of Canada

Financing

CBRE's Canadian Real Estate Lenders Survey for year-end 2018 indicated Canadian debt capital is anticipating current economic conditions to extend deep into the cycle with lenders being proactive and adjusting accordingly. Overall, lender's will continue to provide sufficient liquidity for market purposes albeit at slightly reduced levels from the prior year. Typical with late cycle adjustments, the significance of sponsorship grows the longer we extend into the cycle.

Central Canada Activity Dominates

Central Canada accounted for a little over 60% of total transaction volume in 2018 with Ontario representing 69% of the deals in the region ($641 million) and Quebec following at 31% ($293 million). Western Canada reported $554 million in transaction volume representing about 36% of national deal volume. Almost two thirds of this activity, or 62%, was within British Columbia. Despite the challenged economic environment in Alberta and Saskatchewan, transaction volume was minimal with lenders continuing to be patient with owners experiencing operational pressures.

Notable Sales

The largest multi-hotel trade was InnVest Hotels' portfolio sale of 12 hotels across five provinces which was acquired by a domestic group of buyers (pricing confidential). Subsequently, several of these hotels were sold individually, both to first-time hotel buyers eager to enter the sector and seasoned hotel owners focused on expanding their portfolios.

The two largest single asset transactions (by volume) were both located in Montreal and included the 825-room Le Centre Sheraton Montreal and the 611-room Montreal Marriott Chateau Champlain.

Also significant was the sale of 60% interest of the 77-room Hazelton Hotel in Toronto to First Capital Realty. When deal metrics are considered on a 100% interest basis, this reflects record setting per room pricing of $961,000.

Further Cap Rate Compression

As the sector continued to perform at record income levels, coupled with a slowdown in transaction activity, there was further cap rate compression. Of the ten major markets that form CBRE's quarterly cap rate survey, seven reported reduced cap rates on a year-over-year comparison. While other sectors are anticipating further compression such as industrial, multi-family high rise and suburban office, hotel cap rates are forecast to remain at 2018 levels.

CBRE CAP RATE SURVEY - DOWNTOWN FULL-SERVICE HOTELS

CAP RATES (%)[1]	2017	2018	2019F	YoY
Vancouver	4.50-6.00	4.50-6.00	4.50-6.00	◄►
Calgary	7.00-8.75	6.75-8.50	6.75-8.50	◄►
Edmonton	7.25-8.75	7.00-8.50	7.00-8.50	◄►
Winnipeg	7.25-9.00	7.00-8.50	7.00-8.50	◄►
London-Windsor	7.75-9.00	7.50-8.75	7.50-8.75	◄►
Kitchener-Waterloo	8.00-9.00	7.50-8.50	7.50-8.50	◄►
Toronto	5.00-6.00	4.50-6.00	4.50-6.00	◄►
Ottawa	7.00-8.00	7.00-8.00	7.00-8.00	◄►
Montreal	7.00-8.00	6.50-7.50	6.50-7.50	◄►
Halifax	7.50-9.00	7.25-8.75	7.25-8.75	◄►

Source: CBRE Hotels
[1]Cap rates are averages based on normalized operations.

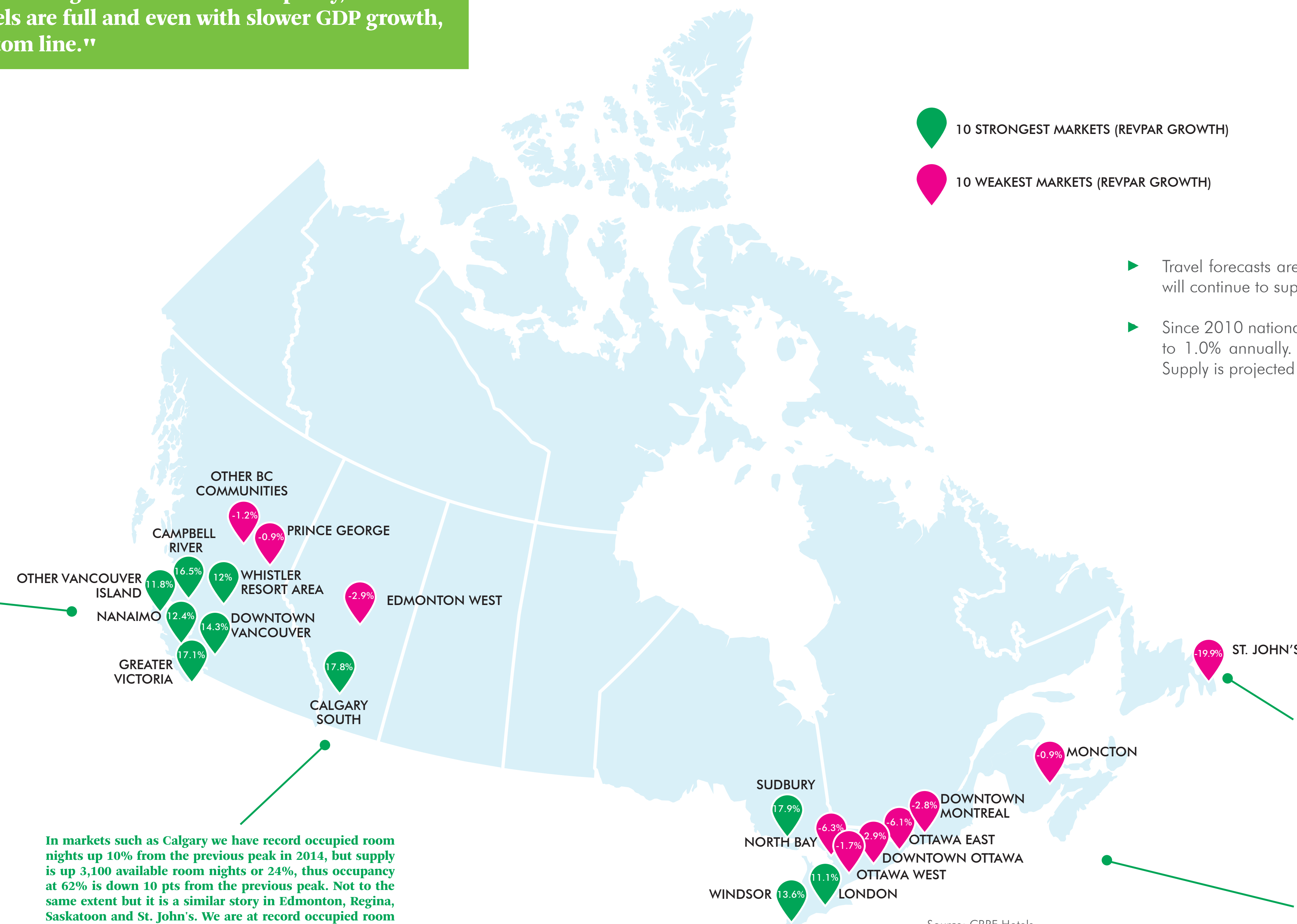
2018 IN REVIEW
HOTEL OPERATIONS

"The hotel industry in Canada is performing at all time highs with record occupancy, ADR and RevPAR, as well as bottom-line performance. Our hotels are full and even with slower GDP growth, we are in good shape to continue to grow top and bottom line."

David Larone
Senior Managing Director, CBRE Hotels

- Over the last eight years RevPAR has grown at a compound annual growth rate of 4.0% as the industry recovered post the Global Financial Crisis.
- There is still considerable pricing power in the hands of operators in many markets across the country to drive RevPAR growth.
- In 2018 ANOI climbed 9.4% to $15,600 per available room, nationally.

- Travel forecasts are positive in all regions of the country and this will continue to support growing revenues.
- Since 2010 national supply growth has been in the range of 0.5% to 1.0% annually. In 2018, supply growth edged up to 1.3%. Supply is projected to grow by 2.0% in 2019.



Source: CBRE Hotels

The strongest ADR growth nationally was recorded in the Vancouver Airport (Richmond) market at 12.2%.

In markets such as Calgary we have record occupied room nights up 10% from the previous peak in 2014, but supply is up 3,100 available room nights or 24%, thus occupancy at 62% is down 10 pts from the previous peak. Not to the same extent but it is a similar story in Edmonton, Regina, Saskatoon and St. John's. We are at record occupied room nights in all those markets but well off peak occupancy. Supply is the story.

St. John's recorded the largest amount of new supply in 2018, seeing 434 rooms enter the market and supply growth by 18%.

Atlantic Canada led the country in supply growth in 2018 recording an increase of almost 3%.

TOP 10 SUPPLY MARKETS (2019)	YoY
Ottawa West/Airport	12.9%
Calgary Downtown	10.2%
Calgary Airport	8.9%
Halifax	7.9%
St. John's	7.8%
GTA West	5.9%
Downtown Edmonton	5.7%
Other Montreal	4.9%
Calgary South	4.6%
Saskatoon	4.2%

Source: CBRE Hotels

The outlook for 2019 remains bullish for commercial property, with early indicators suggesting the market has the potential to defy traditional cycles and achieve record investment volume for a remarkable fourth consecutive year.

For the first quarter of 2019 reported hotel transaction volume is tracking 54% below the same period last year. However, there are several hotels and portfolios for sale in the market at varying stages of the sales process. Accordingly, we expect trade volume to well-exceed last year's total and surpass the ten-year average of approximately $1.8 billion. Other trends to watch for in 2019:

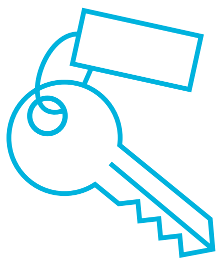
- Despite a slowdown in GDP and ADR growth rates, economic and operating fundamentals in Canada continue to show strength and look to be holding steady for the coming year. As we've seen in the past with catastrophic events such as 9/11 or the Global Financial Crisis, unless there is a black swan event, hotel fundamentals are anticipated to reach levels similar or better than the past five years.
- Mixed-use commercial projects with a hotel component will continue to draw attention from a variety of investors beyond traditional hotel owners and developers. Notable projects announced or recently completed including the Four Seasons Hotel Montreal (opening Q2 2019) and Riu Plaza Hotel Toronto (opening 2021).

According to the International Monetary Fund, global economy is expected to grow 3.3%, the slowest expansion since 2016.

- There is significant volatility fueled by a slowing global economy, international trade tensions, political distractions in Canada and the United States. The resulting overall uncertainty and questions surrounding market liquidity will be offset by the significant amount of investment capital available in the market. With these headwinds at play, asset values may be at all time highs, or at a minimum growth will slow in major urban markets.
- As operating fundamentals improved over the last several years and acquisitions became more competitive, owners flush with capital began pursuing new build development opportunities. CBRE Hotels projects new supply will increase by 2.0% in 2019 - the highest single of year supply growth since 2008.
- The majority of new supply is being built in suburban areas of major markets across the country where land acquisition and development costs remain reasonable.
- Investors have shifted their investment parameters to a longer-term focus, including extended holding periods and more conservative returns. This aligns with a process of looking for quality in the assets that one purchases. The buy low, fix up and flip strategy that has worked so well for many years has been challenged recently.
- The increase in hotel supply is still relatively constrained in major markets, due to both availability and affordability in the major urban core, development costs rising faster than RevPAR growth in many markets and further widening of spreads in the debt markets.
- We are seeing Alberta as the tale of three markets. The Alberta Mountain Resorts continue at a sprinter's pace, Edmonton and Calgary are beginning to develop green shoots, while some smaller, oil and gas towns are still struggling.

> **"9th inning...says who? Canadian hotel operating performance and investment metrics have never been stronger, and all indications point to hotel investment volume exceeding historical averages in 2019. Disrupters could be an unforeseen global event and new hotel supply, but with base industry fundamentals holding strong and readiness to react, our sector is well-prepared to address any challenge that may come."**

Bill Stone
Executive Vice President, CBRE Hotels



All-in development costs range from about $150,000 for economy hotels to well-in excess of $1M for luxury assets.

- As the operating performance of the sector has strengthened, there has been a notable increase in the willingness to provide financing to a wider pool of buyers and from a variety of lenders such as locally-focused credit unions, Schedule A banks and international lending institutions. The number of lenders who have re-entered the market, combined with improved hotel operating results and favourable interest rates are factoring into funding decisions, and for experienced, well-capitalized owners favourable financing terms are available.
- Tariffs, if prolonged, will have an impact in markets such as southwestern Ontario, eastern Quebec and parts of Alberta, where steel and aluminum form an integral part of the local economy.

NATIONAL

NATIONAL & REGIONAL OUTLOOK	2017	2018	2019P	YoY
NATIONAL				
Supply Growth	0.9%	1.3%	2.0%	▲
Demand Growth	3.9%	2.6%	2.2%	▼
RevPAR	$102	$107	$112	▲
ANOI per Available Room	$14,200	$15,700	$16,800	▲
Transaction Volume[1]	$3.4B	$1.5B	+2.0B	▲
WESTERN CANADA				
Supply Growth	1.5%	1.0%	1.9%	▲
Demand Growth	4.4%	3.2%	2.0%	▼
RevPAR	$96	$103	$107	▲
ANOI per Available Room	$14,800	$16,900	$18,100	▲
Transaction Volume[2]	$670.5M	$554.4M		▲
CENTRAL CANADA				
Supply Growth	0.5%	1.3%	1.9%	▲
Demand Growth	3.0%	1.9%	2.3%	▲
RevPAR	$110	$115	$120	▲
ANOI per Available Room	$14,600	$15,900	$16,800	▲
Transaction Volume[2]	$1479.8M	$934.2M		▲
ATLANTIC CANADA				
Supply Growth	-0.1%	2.8%	2.9%	▲
Demand Growth	3.5%	1.0%	2.7%	▲
RevPAR	$86	$86	$88	▲
ANOI per Available Room	$10,300	$9,900	$10,200	▲
Transaction Volume[2]	$160.3M	$47.9M		▲

[1] National volume includes entity-level/M&A transactions
[2] Entity-level/M&A transactions excluded from regional analysis
Source: CBRE Hotels

National

- Hotel markets across the country finished the year with strong RevPAR growth, driven by significant gains in ADR. Most provinces realized positive RevPAR improvements in 2018, although there were a few soft spots such as Manitoba and Quebec, which had weaker demand growth, and Newfoundland, which experienced a substantial drop in occupancy in the face of a slowing economy.
- Looking forward, national RevPAR is expected to continue growing in 2019 at 4.0%.

Western Canada

- RevPAR finished strong in 2018, led by British Columbia, which posted a 10% RevPAR increase year over year. Much of the province's RevPAR gains came from strong ADR growth. In addition, Alberta and Saskatchewan reported strong occupancy increases. Manitoba saw modest growth in both occupancy and ADR.
- Looking forward, RevPAR is expected to grow in all western provinces led mainly by ADR. Occupancy in 2019 will be slowed by additional supply entering many western markets. Supply and demand growth in 2019 are projected at 0.7% and 1.0%, respectively.

Central Canada

- Occupancy in Quebec and Ontario remained relatively stable in 2018 compared to last year, however ADR in both provinces grew by 4.7% and 3.0%, respectively.
- Thanks to strong ADR growth in the region, RevPAR for Central Canada improved by 4.7%.
- With solid operating fundamentals forecast for 2019, it is no surprise further supply growth is projected for 2019, along with an increase in demand of 2.3%.

Atlantic Canada

- Occupancy fell by 2 percentage points in 2018 over the prior year period. The decline was largely impacted by significant new supply outpacing demand growth in Newfoundland. This caused occupancy to fall from 63.0% in 2017 to 53.2% in 2018 in St. John's.
- Despite ADR growth of 3.1%, RevPAR was flat in 2018 over 2017 and is projected to grow by 2.0% in 2019 for the region.
- Supply is projected to climb 2.9% in 2019 with demand forecast to grow 2.7%.

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