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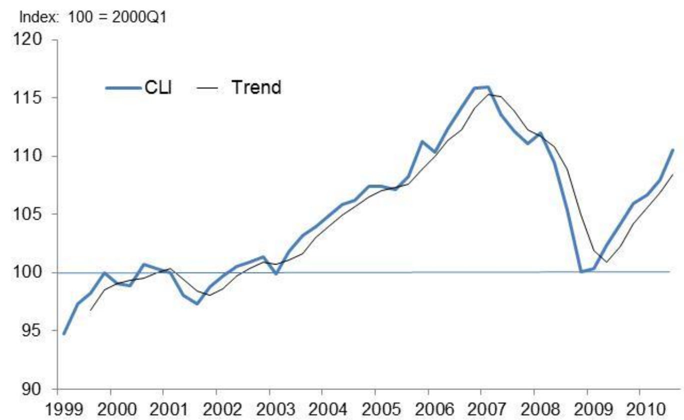
BC Commercial Real Estate Market to Strengthen

Vancouver, BC – February 28, 2011. The BC commercial real estate market should continue to strengthen through 2011, according to the new first quarter *Commercial Leading Indicator* (CLI) index developed by the British Columbia Real Estate Association (BCREA). The BCREA CLI rose 2.3 per cent in the fourth quarter of 2010 to an index level of 110.5, marking seven straight quarters of improvement.



The CLI peaked at a level of 115.9 in the second quarter of 2007 before the onset of the financial crisis pushed it to a low of 100.1 in the first half of 2009. In 2010, the index posted a more material recovery, albeit from a relatively weak level, and is still 5.3 per cent below its peak.

"Economic indicators that tend to lead activity in the commercial real estate market have posted strong growth over several consecutive quarters," said Brendon Ogmundson, BCREA Economist. "Based on these macro-level indicators, we would anticipate 2011 to be a strong year for the commercial sector."

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The full BCREA *Commercial Leading Indicator* index is available at: www.bcrea.bc.ca/economics/2011-02CLI.pdf.

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About BCREA

BCREA represents 11 member real estate boards and their approximately 18,000 REALTORS® on all provincial issues, providing an extensive communications network, standard forms, economic research and analysis, government relations, applied practice courses and continuing professional education (**cpe**).

To demonstrate the profession's commitment to improving Quality of Life in BC communities, BCREA supports policies that encourage economic vitality, provide housing opportunities, respect the environment and build communities with good schools and safe neighbourhoods.

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BC Commercial Real Estate Market to Strengthen

The BCREA Commercial Leading Indicator (CLI) rose 2.3 per cent in the fourth quarter of 2010 to an index level of 110.5, marking seven straight quarters of improvement. The CLI peaked at a level of 115.9 in the second quarter of 2007 before the onset of the financial crisis pushed it to a low of 100.1 in the first half of 2009, where it languished for much of the year. In 2010, the index posted a more material recovery, albeit from a relatively weak level, and is still 5.3 per cent below its peak.

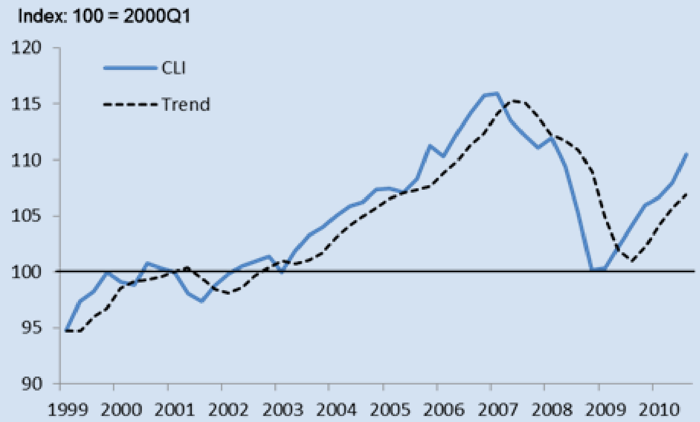
Much of the recent rebound in the CLI is a result of dramatically improved financial conditions, which helps explain the impressive surge in commercial real estate investment into BC last year. Other indicators such as office employment and retail sales have also climbed out of the depressed levels during the recession. However, the rebound in these indicators may reflect more of a normalization than a signal of robust future commercial activity. Overall, we view the recent positive trend in the CLI as a sign that the BC commercial real estate market is set to strengthen in 2011.

Economic Environment

The BC economy surged out of the 2009 recession, propelled by stimulus from the 2010 Winter Olympics along with a rebounding housing sector and restored consumer confidence. We estimate that the BC economy grew at a rate of 3.5 per cent in 2010, the strongest provincial GDP growth in two years.

Economic growth will likely slow over the next year as interest rates begin rising from historical lows, debt-burdened consumers rein in spending and the government begins to firm up its budget position. We therefore expect real GDP growth in BC to register 2.9 per cent in 2011 and 3.1 per cent in 2012.

Commercial Leading Indicator



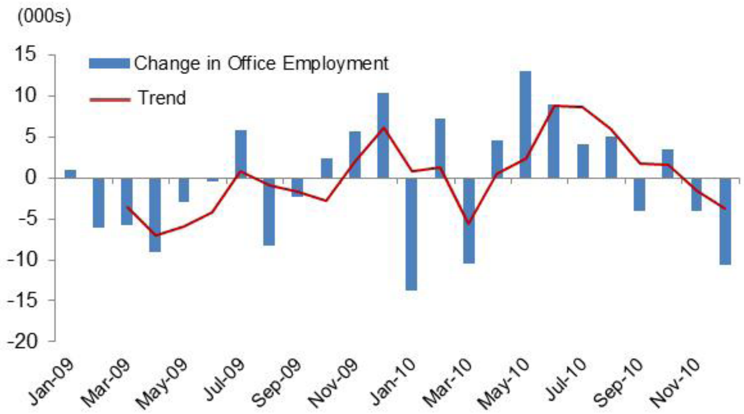
Employment

Renewed economic vitality in 2010 meant that employment growth in BC was relatively strong throughout the year with the labour market recovering nearly all of the jobs lost during the recession.

While job growth has been encouraging, it has unfortunately been tilted towards part-time employment rather than the full-time jobs that are more conducive to sustainable growth in disposable income.

Moreover, employment in key sectors of the economy supportive of commercial real estate activity, particularly the office market, has shown recent signs of weakness. Activity in the office market tends to track employment in office-using sectors of the economy such as finance and professional services which, after posting encouraging gains in the first three quarters of 2010, began shedding jobs towards the end of the year.

Photo by: Thom Quine



Source: Statistics Canada

Although we anticipate economic growth to slow modestly in 2011, the BC economic recovery is on solid footing and it is unusual to be losing jobs at this point in the business cycle. Therefore, as the recovery becomes further entrenched in 2011 and business confidence rises, we expect renewed strength in office-using employment. This job growth should, in turn, support increased office leasing activity and help to put downward pressure on vacancy rates.

In contrast to the office-using sectors of the economy, employment in manufacturing, transportation and warehousing has showed signs of momentum heading into 2011. Those sectors added over 30,000 jobs in the second half of 2010 and, if sustained, this employment growth could herald a pick-up in industrial real estate activity in the coming year.

Consumer Spending and Retail

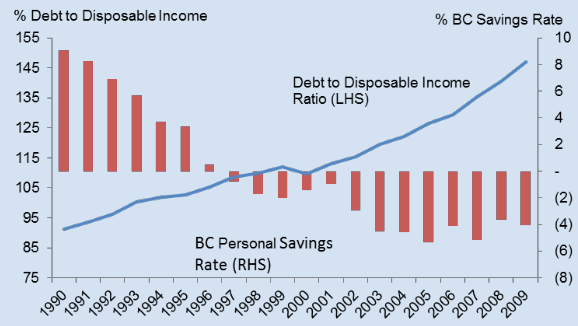
As is the typical pattern in economic recoveries, it was residential investment and consumer spending that led the BC economy out of the 2009 recession. Retail sales began increasing near the end of 2009 as consumer expectations brightened and confidence returned.

Buoyed by a brighter outlook and the 2010 Olympic Games, retail sales grew at an impressive 7.7 per cent annual rate in the first six months of 2010. Investors were even more enthusiastic about retail than consumers in the first half of 2010, investing over $700 million in retail assets in just the first six months of the year.

Consumer Deleveraging?

The debt-loads of Canadian households has reached over 140 per cent of disposable income while savings has dipped below zero.

A reversal of current debt levels would mean a tighter grip on wallets and purse-strings in 2011 which could translate to thinner crowds at malls and a dip in retail sales.



Source: Statistics Canada

However, the toll the recession took on already highly-indebted BC households, along with somewhat weak full-time employment growth, may have tempered enthusiasm in the second half of the year. Growth in retail sales began fading in the latter half of 2010, leading many analysts to speculate over the potential for so-called household "deleveraging." That is, the eschewing of consumption in favour of saving and paying down debt.

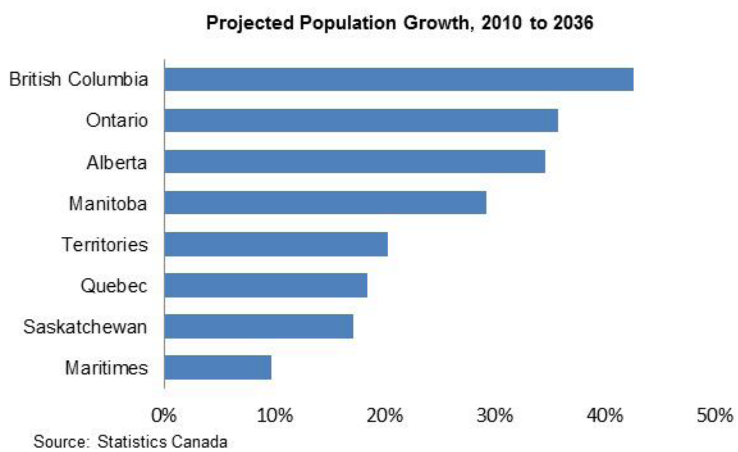
Such deleveraging, in our view, represents a key risk to the retail sector in 2011. We are forecasting a slight dip in retail sales growth in 2011, from 4.8 per cent in 2010 to around 4 per cent in 2011.

Construction Investment

Residential investment rebounded vigorously last year with total housing starts increasing 65 per cent. Because household growth in BC tends to concentrate in high-density areas of the lower mainland, there is an established trend of strong multi-family construction in BC and this trend continued in 2010 with multi-family units again outpacing single family starts, increasing 84 per cent over last year.

An increased supply of rental units, including private investor-owned apartments, met with steady demand to keep province-wide vacancy rates roughly unchanged in 2010. Given somewhat balanced conditions in the rental market and subdued inflation, average rents rose by a modest 2.3 per cent in 2010.

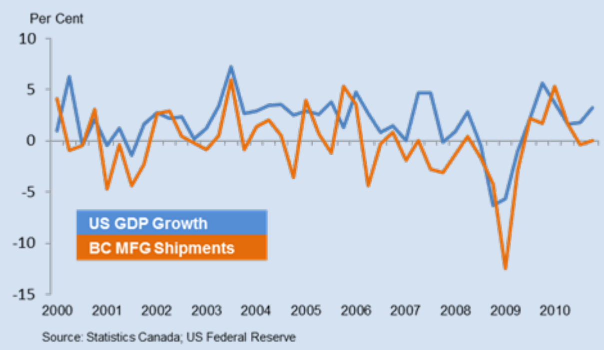
However, there were some signs of softness in the residential market as building permits declined sharply towards the end of the year. This decline in permits may signal slower building activity in early 2011. However, because BC boasts such strong long-run demographic fundamentals, any slowdown is likely to be only temporary in nature.



Renewed growth in the US economy, which purchases over half of BC's exports, is vital to a recovery in BC's manufacturing and transportation sectors, and by relation, to the industrial real estate market.

US Growth Drives BC Manufacturing Sector

A turnaround in the US economy is vital to the local industrial market because so much of BC's industrial sector relies on the manufacture, stor-age and transportation of BC goods bound for the US. The uncertainty that currently exists in the US economy has been a significant restraint on investment and other commercial activity in BC's industrial sector. Sustained, higher growth in the US economy is a potential boon to the BC industrial market in 2011.



While multi-family residential construction enjoyed a relatively strong year, commercial and industrial construction continued to lag the rest of the economy for much of 2010, with the value of non-residential construction put-in-place falling 12 per cent (in inflation adjusted terms). Moreover, permit data for the end of 2010 is signalling that softness in non-residential construction may persist into 2011.

Trade and Manufacturing

On the trade front, international export growth in BC was particularly strong through the end of 2010 and there are encouraging signs that this growth could continue in 2011. The US economy, boosted by a second round of quantitative easing by the Federal Reserve and additional tax cuts passed at the end of 2010, seems poised for a return to meaningful growth in 2011.

While the US is still the main driver of BC's exports, there are encouraging signs that the province is diversifying its export sales in the direction of faster growing emerging markets. Exports to China increased 59 per cent year-over-year and the emerging markets of the Pacific Rim (excluding Japan) accounted for almost a quarter of BC exports through November 2010.

Even though BC export growth has been solid, much of this growth is a result of high commodity prices for raw material exports, particularly coal, copper, and pulp. On the other hand, exports of manufactured goods have been held back by weakness in durable goods exports. Much of this weakness is due to the prolonged struggles in the US housing market and associated impact on BC wood products.

Although exports of BC wood products increased 25 per cent in 2010, shipments are still well below their pre-recession level. However, higher softwood lumber prices as well as a stable, if not expanding, US construction market are positives signs for 2011.

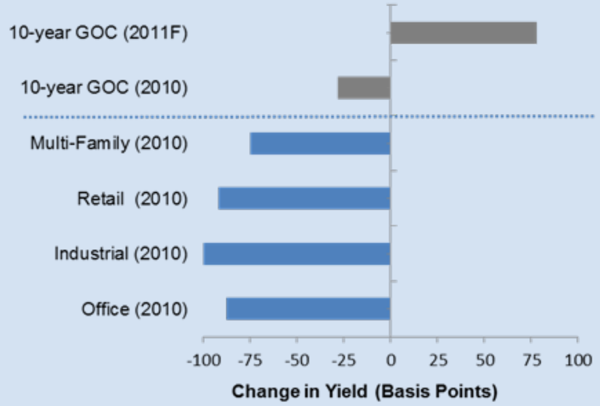
Interest Rates and Investment

Exceptionally low interest rates and British Columbia's reputation as a safe harbour for investment combined to attract a record amount of investment into BC's commercial real estate sector in the first half of 2010.

The total volume of commercial investment in BC surpassed the $1 billion mark by the halfway point of 2010 as investor appetite was impeded only by a limited supply of available product.

Interest Rates Set to Normalize, but What About Cap Rates?

Investors were undeterred by BC's falling cap rates over the past two years. However, if yields for competing asset classes increase, valuations may come down from their current elevation and cap rates may start correcting higher near the end of the year.



Source: Colliers; Bank of Canada.
Note: Cap rates are Q2/10 over Q2/09 change

The very low-interest rate environment of the past two years has certainly played a role in fuelling demand for BC commercial properties as well as in driving up valuations. Cap rates across all asset classes have been further compressed from levels that were already the lowest in Canada. In spite of this, investors have not been deterred and continue to pursue Vancouver's somewhat limited opportunities, helping to sustain high prices.

We anticipate that the second half of 2011 will see interest rate normalization begin in earnest but that key benchmark bond rates, though higher, will still be at relatively low levels for most of 2011. Therefore, although investment may slow from its current pace, investors are likely to continue to view the BC commercial sector as an attractive climate for investment in 2011.

Note: The BCREA *Commercial Leading Indicator* was designed to forecast changes in broad commercial real estate activity. Our research shows that the variables that compose the CLI reliably forecast BC commercial real estate activity at a lag of two to four quarters.

Send questions and comments about *Commercial Leading Indicator* to:

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