INVESTMENT REPORT

Canada's commercial real estate investment market has proven resilient over the past decade, and this has also been reflected in the Okanagan investment market, especially since 2012. We are currently seeing a compression of capitalization (cap) rates (see definition below), due in part to the influx of Vancouver investors who are being outbid by Asian investors - the beginning of a domino effect. As an alternative to equities and bonds, the underlying security and lack of relative volatility of prudent real estate investment is gaining popularity with foreign investors.

Foreign investors are willing to accept a lower return through property investment, but taking into consideration the alternatives, real estate is being looked upon more favorably than bond yields and equity markets. The flight of capital emerging from regions of economic or geo-political volatility continues to influence our markets, but has largely been targeted to Toronto and Vancouver. In Toronto, CAP rates have dropped below six per cent, for the first time on record, representing a wider level of investor demand for Canadian assets.

The new property transfer tax came into effect as of August 2, 2016. For foreign nationals who buy real estate in Metro Vancouver, they will pay an additional fifteen (15%) percent, however, this only applies to home purchases, not commercial property. While politically expedient for the BC Liberals, the effect of this property transfer tax on the residential market in the Lower Mainland has not been clearly determined as of this writing. In the Okanagan Valley, however, there is emerging evidence of a 'knock on' effect.

The value of commercial properties is often referred to using a CAP rate. The capitalization rate is the rate of return on a real estate investment property based on the income the property is expected to generate. The lower it goes, the more a property is worth. A five percent cap rate implies a building will pay for itself, based on its income stream, in 20 years.

Closer to home, in the Okanagan, where cap rates were 6.5% to 7% a few years ago, the demand for product has shifted cap rates lower, in some cases to 5% or, in a few rare cases of multi-family transactions, even slightly lower. This of course is dependent on location, quality and vintage of building, income stream, maintenance and taxes, and the strength of the tenants. Bank properties are in fierce demand, as is anything with solid tenants and a sound remaining lease term.

As of today's date, CAP Rates in the Okanagan are falling in the ranges noted below.

MARKET SECTOR	CAP RATE RANGE
Retail	5.0% to 6.50%
Office	5.5% to 7.25%
Industrial	5.5% to 7.0%
Multi Family	5.0% to 6.0%

Evidence of these downward CAP Rates is shown in the table below of properties that have recently sold.

Major Investment Transactions 2015 / 2016 – Okanagan Valley

PROPERTY	SALE PRICE	GLA	TYPE	CAP RATE
Southgate Shopping Centre, Kelowna	$6,300,000	21,237	Retail	5.85%
2903 Pandosy Street, Kelowna	$3,537,500	9,260	Retail	5.10%
437 Glenmore Rd – Glenmore Plaza	$7,380,000	24,502	Ret /Off	5.40%
1850 Spall Road (La-Z-Boy Furniture), Kelowna	$6,925,000	32,500	Retail	Confidential
Anderson Crossing, Vernon	$12,350,000	42,599	Retail	6.50%
TD Canada Trust, Vernon	$2,900,000	4,288	Bank	4.73%
402 Main Street, Penticton (Prospera C.U.)	$1,725,000	4,194	Bank	6.23%
Cherry Lane Shopping Centre, Penticton	$74,800,000	265,000	Shp Ctr	6.25%
3502 Spectrum Avenue, Kelowna	$3,600,000	19,300	Ind	5.92%
1810 Kosmina Road, Vernon	$2,567,000	35,900	Ind	7.00%

Multi family CAP rates have stabilized in the 5.0% to 6.0% range with recent transactions being 165 / 175 / 205 Mills Road, Kelowna; 564 – 576 & 580 Ellis Street, Penticton; 1980 Pandosy Street, Kelowna and 598 Sutherland Avenue, Kelowna, all falling within this range.

ADDRESS	CAP RATE	SALE PRICE	DESCRIPTION
165 / 175 / 205 Mills Road, Kelowna	6.1%	$3,970,000	Located near Hwy 33 / Hwy 97. 2 acres with surplus land. Total of 20 residential rental units and one office space.
564 – 576 & 580 Ellis Street, Penticton	5.87%	$3,112,000	Each 4 unit block contains: 1 - 1 level, 1 bdrm at grade; 1 - 1 level, 2 bdrm at grade; (4) 2 level / 3 bdrm units. Property had tax incentives which were transferred to new owner.
1980 Pandosy Street, Kelowna	5.25%	$5,950,000	Asset sale of 44 unit wood-frame building. Excellent condition with many suite upgrades. Walking distance to DT/Lake/ hospital. 29.6% Expense Ratio.
598 Sutherland Avenue, Kelowna	5.14%	$3,027,000	16 units w/ 18 surface parking stalls. Walking distance to DT/Lake/hospital. Sprinklered. In-suite laundry/heat-pump/ baseboard. 26% Exp. Ratio. Taxes abated in years 2-11 due to city incentive for new build rental.

Development properties and land transactions have also significantly ramped up in the past 18 months. 560 Bernard Avenue, an entire city block with two parking lots on 1.5 acres, is on the market for the first time, while 1915 Enterprise Way, a 1.78 acre parcel at the intersection of Spall Road and Enterprise, was sold in July 2016 with the developer planning a hotel for the site. 1915 Enterprise Way was on the market for over 10 years, but was recently sold by HM Commercial Group.

1187 Sunset Drive (opposite Prospera Place) is under contract, and the purchaser has plans to construct a high rise hotel / residential building. Lucaya, or 1151 Sunset as its been renamed, was purchased three years ago and is back under construction, which is its third attempt at completing the 19 storey tower. SOPA Square's residential component is under construction; Central Green is under construction with their loft style condos; and 10.5 acres sold at 720 Valley Road with plans for multi- family residential and the list goes on.

Another new mixed use development includes The Shore at 3441 to 3471 Lakeshore Road. This project is expected to commence construction in early 2017. Restaurant, retail, office, parking and 91 units of residential rental will make up this high end development.

With the growing influx of foreign national money coming into Canada, along with Vancouverites cashing in on their housing boom, and a substantial amount of investment from Alberta, we expect to see Canadian investors moving their money elsewhere in the country as they continue to be outbid. With our lifestyle, affordability the rapidly growing tech (now employing 7,600 people), wine, medical services and education sectors, Kelowna is a natural place to land.

We forecast that we will likely continue to see a downward effect on CAP rates in the Okanagan and a record pace of continued development in all market sectors as retirees, young professionals and those seeking safe, alternate investments for their capital, continue their migration to Kelowna.

2903 Pandosy Street