North America Capital Markets | Q2 2021

North America Market Snapshot
Overview

The North American investment sales market is powering back to normal, a positive sign after a year of uncertainty. Multifamily and industrial remain the top investment choices by volume. In Q2, USD $136.7 billion was traded in the U.S., a 186% increase from 2020 levels and ahead of the pre-pandemic, 2016–2019 quarterly average. Canadian volume increased 84% over year-ago figures, with CAD$8.3 billion traded. Office hovers below long-term investment share trends, indicating the market still has room to grow. Cap rates continue to compress across asset classes, and pricing has increased across the board.

Macroeconomic factors are driving capital to commercial real estate. Inflation picked up in Q2 and real estate, historically an inflation hedge, picked up speed. Job growth accelerated. Millions of workers returned to offices across North America with millions more expected to follow after the summer, and U.S. interest rates began to fall. All of these combine to set the stage for future real estate investment.

Multifamily remained the most sought-after North American asset class in Q2. With nearly 40% of all volume in the U.S. and nearly one-third in Canada, it drove the strongest price gains of all asset types over the past year in the U.S. and the second strongest in Canada. Industrial came in second in the U.S., and first in Canada, benefitting from improved fundamentals and a pivot of capital. Office and retail posted price gains as well in the U.S., though to a lesser extent.

Capital sources allocated billions of dollars to single-family rental housing in the U.S., a fast-growing market segment that’s worth keeping an eye on. Investors are finding numerous ways to capitalize on its early growth across the capital stack, with investors in Canada beginning to pay attention to this asset type as well. Sunbelt metros in the Southeast and Southwest U.S. are the focus of developers today.

Fundraising continues at a strong pace with investors focused on core investments and strategies further out along the risk spectrum. There is record capital ready and waiting on the sidelines, per Preqin data. This bodes well for overall investment volumes, as value-add deals, particularly within office and retail, have been limited in recent quarters. Adding these deals back to the market will drive volumes higher as the year progresses.
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Multifamily

Multifamily is the most liquid asset type in the U.S. Investors are driving pricing to record highs in many markets. Secondary and tertiary markets are now hotly contested. Rent growth has also soared, further supporting top pricing in this product type.

Multifamily has posted the strongest year-over-year volume increases of the major property types. Volumes are up 238% and account for 38% of all sales activity. Markets in the Southeast and Southwest continue to lead the country in sales volume, adding up to 60% of the national total, with solid demographics, affordability, and job growth. Dallas, Atlanta, and Phoenix are the top three markets through mid-year.

Employees’ return to cities should prompt additional sales activity, especially in urban centers along the East Coast; two of the largest deals in Q2 took place in New York City and Cambridge, MA. Expect occupancies to receive an additional boost once students return to class this fall.

Single-family rentals are gaining traction due to product demand and changing trends including the desire for more living space. This segment remains a relatively small share of the investable universe but is growing rapidly. Investments in the billions from prominent capital sources further support the “institutionalization” of this asset class.

Record First Half Volume In Numerous Markets

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$52.7 Billion ↑
Quarterly Volume

12% ↑
Year-over-year Price Change

Starwood Capital Portfolio Acquisition
$1.2 Billion | 16 Properties | 5,300 Units

Top Markets
Dallas, Texas | Atlanta, Georgia | Phoenix, Arizona

What to Watch
Single-family Rental | New Construction Pricing | Urban Migration

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Office

Office investors continue to seek safety in term and credit. Life science is an ever-growing investment focus, and office fundamentals appear to be through the worst of the pandemic slowdown. A post-Labor Day return for many companies bodes well for future investment activity.

Signs of recovery are emerging in the office market. Workers are returning to the office, with many employers expecting their teams back post-Labor Day. Negative absorption in Q2 was not as severe as in Q1, and one-third of markets posted positive absorption. Growth markets such as Charlotte, NC, Nashville, TN, and Austin, TX, led the charge. Tech companies have taken on additional space, and tenant activity has increased across the country. Meanwhile, asking rents have by and large held firm.

Of the major asset types, office is rebounding at the slowest pace. Investors are still favoring long-term leased and credit assets. Recent top deals include assets occupied by Amazon, Fannie Mae, and NetApp. Life science also remains popular, with Alexandria selling a stake in a Merck leased asset in South San Francisco and BioMed acquiring an under-construction office asset in Boston with plans to convert it to lab space. LinkedIn acquired its headquarters in Sunnyvale, CA, signifying its need for physical space. Deals like these have propped up valuations, preventing aggregate pricing from falling despite the softened fundamentals.

Manhattan, the nation’s largest office market, is waking back up. June volume roughly doubled its annual volume through May. This is important, as Manhattan is considered an indicator of national investor sentiment. Expect sales in this key NYC market, along with value-add deals, to boost activity in the second half of the year.

Historical Average
Volume Share 2014-2019

Volume Share Q2 2021

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Historical Average
Volume Share 2014-2019

Volume Share Q2 2021
Investors remain ravenous for industrial product. Cap rates are still compressing, and portfolio allocations – as well as a slew of new investors – continue to shift focus to the asset class from other property sectors. Fundamentals support continued expansion with high levels of pre-leasing, rising rents, and robust investment.

After record-breaking absorption figures in Q1, the market set another high in Q2. Newly delivered product is filling quickly as e-commerce, 3PLs, and manufacturers look to gobble up space. As a result, pricing has never been higher. Steadily rising rents and a lack of available product support further increases.

Key distribution networks like Atlanta, Chicago, Dallas, and Los Angeles/Inland Empire lead the charge. Expect them to remain top investment markets through 2021, thanks to sound intermodal connectivity, access to vast populations, and a large consumer base.

Portfolio sales activity was the main driver of volume in Q2, but the deal sizes were relatively small compared to historical averages. There were no billion-dollar-plus transactions to anchor the quarter. Despite this, volume increased by 139% over 2020 Q2 figures.

Amazon deals continue to trade with regularity, setting pricing records across numerous markets. Fundamental shifts in the way U.S. consumers shop have industrial set for an extended run. As a result, volume should increase throughout the remainder of the year.

**Portfolios Driving A Lower Volume Share**

Source: Real Capital Analytics, Colliers
Retail investment is picking back up. Portfolio activity is scarce, and many investors are seeking safety. Grocery-anchored shopping centers remain a popular choice along with drug stores. In Q2, shopping center activity began to show signs of life, a promising indicator of future volume.

Retail has proven resilient. Fundamentals are improving, with 19 million square feet of retail space absorbed in Q2. New store openings are outpacing store closures, and retail rent collections are nearly back to 2019 levels, especially with national chains.

While retail sales activity is improving, it currently accounts for just 10% of aggregate sales volume, well below its 16% average from 2014-2019. The largest single-asset retail sale since the pandemic closed in Q2—a $218.6 million joint venture of Big V Properties, Kimco, and Equity Street Capital for the 1.1-million-square-foot The Rim in San Antonio, TX. It traded for $204 per square foot at a quoted 7.3% cap rate. Other shopping centers have begun trading, suggesting the market is thawing.

The distress that seemed likely at the outset of the pandemic has not come to pass. CMBS delinquencies are improving. While they’re still above those of other asset types, they’re falling. Retailers are adapting to the “new normal” by adopting omnichannel services, opening new formats, and automating tasks. These changes should make retailers more profitable and entice additional investment activity.
Multifamily

Many investors point to the mantra “beds, sheds, and redevs” as their outlook on where to place capital, with multifamily a clear front-runner. Cap rates are down, but exceptionally low finance rates mean that leveraged investors can still drive pricing.

Rent growth and investor interest in multifamily assets remain strong, despite rent freezes and rising vacancy rates during the pandemic. These assets are attractive to investors thanks to the stable income they offer, and the positive outlook as immigrants, students, and young professionals return to the rental pool. Furthermore, with the country’s runaway housing affordability issues, many Canadians will likely remain in the rental market for years to come.

Many institutional investors are looking at assets that require significant capital expenditures, which offer an opportunity for increasing rents due to renovations or redevelopment. The national average multifamily cap rate, has decreased from 4.41% in 2019 to 4.30% in Q2 2021, however, expect much lower cap rates in markets like Vancouver, at 3.25%, and the Greater Toronto Area (GTA), at 3.31%.

**Multifamily Demand & Immigration**

2020 immigration was curtailed by the pandemic. Pandemic will likely delay 2021 target.

Office

A successful vaccine rollout and an increase in employees returning to the office post-Labour Day are reducing uncertainty surrounding this asset class. A reduction in sublet space and increased tenant touring activity bodes well for future demand.

Canada only recently eased lockdown measures in late Q2 2021, yet many employers are touting a hybrid strategy for their return to the office, with some expecting to kick off after Labour Day. As such, a growing number of sublet offerings are being removed from the market as tenants anticipate needing the space. Despite rising vacancy during the pandemic, mainly attributed to downtown sublet space, landlords have held relatively firm on rents, preferring to negotiate on a net effective basis instead.

Many investors remain on the sidelines when it comes to office, with some looking for nonexistent COVID discounts. The year-over-year decrease in the average price per square foot is partially due to the generally smaller assets trading, with quarterly volume down 55.6% year-over-year and 84.3% compared to Q2 2019. National average office cap rates are up 13 bps year-over-year to 6.34%.

Working From Home (WFH)

One million Canadians returned to the office within 6 months of the start of the pandemic! 400,000 have returned since the end of the third wave!

![Graph showing millions of Canadians working from home from 2020-01 to 2021-06]


What to Watch

The Delta Variant and the Return to Office After Labour Day | New Supply and the Backfill Situation | The Sublet Market
Industrial

Industrial assets are popular with many institutional investors, and the allure has only increased during the pandemic. Exceptionally low industrial vacancy rates across the country, combined with continued strong demand, should result in strong investment performance.

Industrial assets and land are in high demand from both tenants and investors, with Canada’s national industrial vacancy rate at 1.7% in Q2 2021. Net absorption remained strong, with developers kicking into overdrive to meet demand from E-commerce, manufacturing and film production tenants, as well as a shift in supply chain management from just-in-time to just-in-case. As such, national rents are up significantly year-over-year, with Vancouver rents up 13.2%, the Greater Toronto Area up 15.6%, and Montreal up 18.2%.

Demand from tenants and investors is expected to remain strong over the coming years, and developers will likely be unable to keep up. As a result, vacancy will remain depressed, placing upward pressure on rents, building prices, and land prices. The national average industrial cap rate is up 36 bps year-over-year to 5.38%, with some prime assets trading below 3%.

National Industrial Outlook
Developers will be unable to meet demand, driving vacancy down and rents up!

Source: Colliers, Q2 2021.
Retail

Retail investment activity is picking up, mainly from those looking for assets ripe for intensification or redevelopment. Grocery and essential retail-anchored assets remain a popular choice for investors, while tenants actively look for open-air access.

Canadian retail has some bright spots, despite being one of the hardest-hit sectors throughout the pandemic and a dramatic uptick in e-commerce adoption. As public health measures relax, indoor malls and restaurants are reopening, and commuters are beginning to return to normal travel patterns, and retailers, retail landlords/investors, and consumers are feeling optimistic. However, hurdles remain, including capacity limits, the threat of COVID variants, and mounting consumer debt, which will be compounded by the expectation that the Bank of Canada will begin increasing its Overnight Lending Rate in late 2022.

Aside from investors looking for COVID deals, many remain interested in retail assets that lend themselves to intensification or redevelopment plays. As a result, national average retail cap rates have only moved up by 11 bps year-over-year to 5.90%.

National Retail Outlook

Retail Vacancy by Asset Type

Source: Colliers, Q2 2021.
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The world of Colliers

- **Annualized Revenue**: $3.3B (US$)
- **Established in**: 67 Countries
- **Managing**: 2B (square feet)
- **Lease/sale transactions**: 54,000
- **Assets under management**: $40B
- **Comprised of**: 18,000+ (professionals)

All stats are for 2020, are in U.S. dollars and include affiliates

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