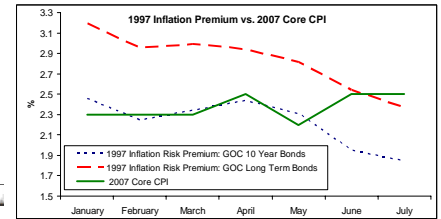




#### INDUSTRY COMMENTARY – Long Term Interest Rates and Cap Rates

Although the cost of debt is increasing in the short term, cap rates should remain constant across all asset classes in the GTA during the current financial market liquidity crunch and should resume their compressing trend as the crisis runs its course.

1. Inflation is above Bank of Canada target but in control.
2. Economic growth will remain strong through 2007 - 2008.
3. Increasing mortgage spreads during the financial crisis.
4. Continued demand for real estate as an asset class.



[Click here to read more about Interest Rates and Cap Rates](#)

Commentary by: *Chad Gemmell, Sales Representative*  
P.G. Gagné Commercial Real Estate Corp. 416-955-1681

#### RECENT SALES: BENCHMARK CAP RATES

Source: Marshnet.com

##### RENTAL APARTMENT (4.8% - 5.7%)

- **5.70% Cap Rate - 530 Scarlett Rd.** - 106 suites located north of Eglinton Ave. East overlooking the Humber River. Closed on May 10, 2007 at \$10,100,000 or \$95,283 per suite.
- **4.80% Cap Rate - 64 St. Clair Ave. West** - 97 suites located west of Yonge Street. Closed on January 31, 2007 at \$12,125,000 or \$125,000 per suite.

##### OFFICE (6.25% - 6.50%)

- **6.25% Cap Rate - 1 City Centre Plaza in Mississauga** - 287,684 SF of office space located beside Square One Shopping Centre. Closed July 2007 at \$80,000,000 or \$275 PSF. (Sale \$90m less \$10m for land component.)
- **6.50% Cap Rate - 50 Bay St.** - 170,000 SF office space located just south of Front Street Building is attached to the Air Canada Centre. Closed on March 29, 2007 at \$43,600,000 or \$256 PSF.

##### RETAIL MALL (6.0% - 7.03%)

- **6.0% Cap Rate - Hopedale Mall - 1515 Rebecca St.** - Located in Oakville south of the QEW. 300,000 SF of recently renovated & expanded mall space. Closed on March 30, 2007 at \$59,225,000 or \$197 PSF.
- **7.03% Cap Rate - 1000 Islands Mall - 2399 Parkdale Ave. West** - Located in Brockville just north of Highway 401. 275,477 SF of recently renovated and expanded mall space. Closed on June 26, 2007 at \$50,250,000 or \$182 PSF.

##### INDUSTRIAL (6.3% - 7.0%)

- **7.00% Cap Rate - 275 Steelwell Rd.** - Single tenant 82,235 SF building located near Pearson International Airport off Steeles Ave. West at the Hwy 410/407 junction. Closed on January 18, 2007 at \$6,800,000 or \$83 PSF.
- **6.30% Cap Rate - 225 Rexdale Blvd.** - 303,724 SF of warehouse space with minimal office space located east of the Woodbine Racetrack. Closed on January 16, 2007 at \$32,000,000 or \$105 PSF.

#### WE'RE GROWING!



P.G. Gagné Commercial Real Estate Corp. is proud to welcome **Chad Gemmell** to the team as a RECO licensed sales representative. Chad comes to P.G. Gagné with several years of professional work experience focused on risk management and project management roles in finance and construction. He holds an honours degree specializing in finance from Lakehead University. His experience and education are the foundation to an understanding of real estate transactions from an integrated perspective including valuation, construction process, risk management and due diligence.

"My immediate goals are to establish a business relationship with my peers in the industry, start my CCIM education requirements, and of course close my first deal." Chad can be reached at 416-955-1681 or chad@gagnerealestate.ca



#### Life Lessons at P.G. GAGNÉ COMMERCIAL REAL ESTATE CORP., Brokerage – Lesson # 24

We are experiencing a period of significant change in the financial markets, the world, and for some us ourselves. Change is a process, not a discrete event, but we live in a discrete world that wants to manage and micro manage the events that happen. We want prescriptions, details, and specific best practices. We are uncomfortable with the fact that so much is left to the unknown process of change. Yet change is the evidence of growth and with growth we gain wisdom and knowledge and life without knowledge is not much a life. Let us therefore accept change, be it perceived as good or bad, expected or not, as there is knowledge in every experience. Eight lessons of change: 1. You can mandate what matters. 2. Neither centralism nor decentralism works. 3. Problems are our friends. 4. Connect with the environment. 5. Change is a journey not a blueprint. 6. Everyone needs to be one's own change agent. 7. Individualism and collectivism must have equal power. 8. Vision and strategic planning come later in the process, not at the beginning.



#### INDUSTRY COMMENTARY – Long Term Interest Rates & Cap Rates

*Although the cost of debt is increasing in the short term, cap rates should remain constant across all asset classes in the GTA during the current financial market liquidity crunch and should resume their compressing trend as the crisis runs its course.*

1. Inflation is above Bank of Canada target but in control.
2. Economic growth will remain strong through 2007 - 2008.
3. Increasing mortgage spreads during the financial crisis.
4. Continued demand for real estate as an asset class.

The Bank of Canada's overnight target rate is generally expected to remain unchanged on September 5<sup>th</sup> and October 16<sup>th</sup>, the next two scheduled key policy rate announcement dates. There is too much volatility in the financial markets for the Bank to make any strong moves. The next Monetary Policy Report Update from the Bank in October will send clearer signals of a possible rate change on December 4<sup>th</sup>, the final announcement date for 2007. The impact of current market volatility in the U.S. economy will have to be assessed at this time. Will a U.S. slowdown occur and spill over to Canada? How will the CAN-US exchange rate react to U.S. monetary policy changes? The Bank may only raise rates on December 4<sup>th</sup> if the Canadian economy continues its strong forward momentum through the end of 2007 and appears to continue in 2008. Such increase, if any, would provide the monetary leadership in controlling inflation.

#### Background: Recent Monetary Policy Moves

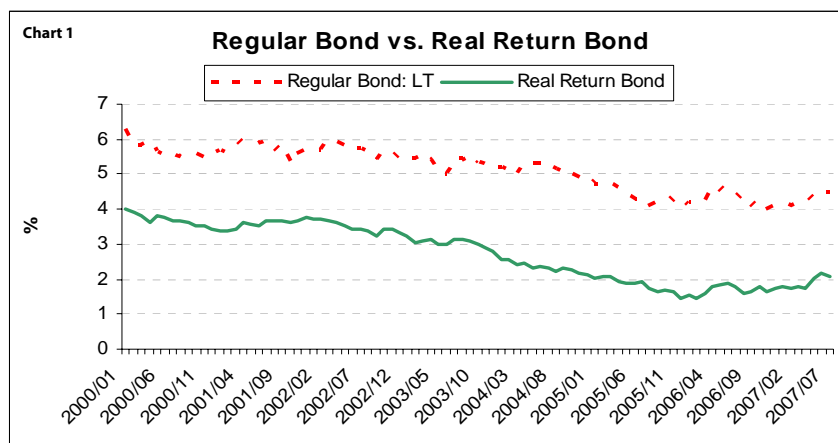
On July 10, 2007 the Bank raised its target for the overnight rate from 4.25% to 4.50%, the first such move by the Bank in over a year. This is the longest period of inactivity by the Bank in over 10 years. The bank was responding to three factors it believed would allow inflation to slow on its own but never materialized: 1) an 85-cent Canadian dollar 2) a U.S. slowdown, and 3) a retreat in energy prices. One month ago, before these three factors reversed against common expectations, the consensus was the Bank would raise rates; however the consensus now is the Bank will hold rates on September 5<sup>th</sup>.

1. Inflation is above Bank of Canada target but in control

Implied inflation over the next 10 – 30 years is expected to be less than 2.5% as evidence by the inflation risk premium. The inflation risk premium is calculated as the spread between regular bonds and real return bonds. (see Chart 1).

Generally, bond investors have been accurate forecasting future inflation. The inflation premium on 10 year bonds in 1997 was accurate to within 2 basis points of actual inflation for the first 5 months of 2007 (see Chart 2).

Yields began to drop August 2<sup>nd</sup> in Canada and the US as investors turned to government bonds for safety. This renewed interest in long term treasuries and T-bills has reduced yields from their highs in mid June as seen in Chart 3.

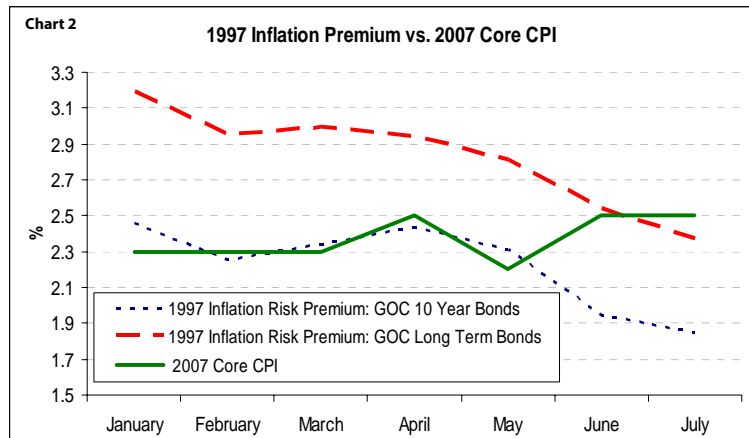


Source: Bank of Canada

2. Economic growth will remain strong through 2007-2008.

If inflation is not to blame for higher yields, perhaps bullish expectations of economic growth over the next several years and hence demand for longer-term credit may be driving the yield increases. The expectations of a strong economy are mirrored by the Bank. In its most recent Monetary Policy Report Update the Bank raised its projection of GDP growth for the remainder of 2007 and slightly lowered GDP for 2008 and 2009. With that, the Bank expects core inflation to remain above 2% for the remainder of 2007 but retreating to the 2% target by early 2009.

Nonetheless, TD Economics predicts, with a 2% inflation target, short-term yields will be in the range of 3.4% to 3.9% and long-term yields will be in the 3.3% to 5.6% range over the next decade with bias towards the lower range. That said, we should expect a positive but relatively flat yield curve and interest rates to drop in the coming years and remain stable aside from regular cyclicity.



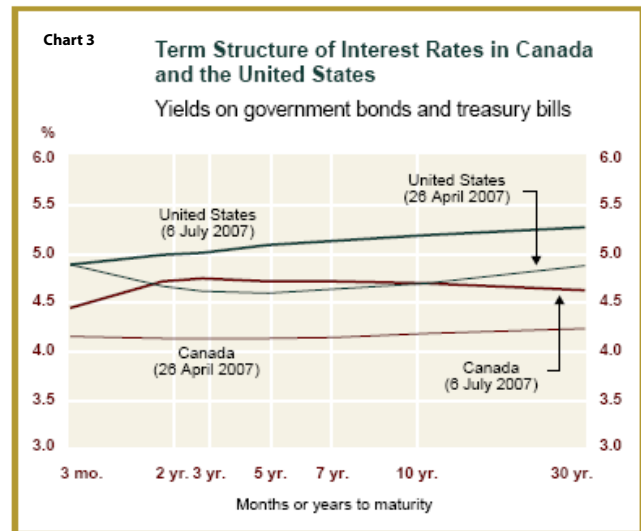
Source: Bank of Canada

3. Increasing mortgage spreads during the financial crisis

Demand has shifted from CMBS financing to conventional financing methods during the last three to four week financial crisis. As a result, CMBS lenders are having difficulty selling the securities to investors and have to offer better yields. The result is mortgage spreads have increased by 50-70 basis points and new CMBS issues have been forced to raise their spreads to 80-180 basis points.

4. Continued demand for real estate as an asset class.

The increased cost of borrowing will certainly not reduce demand for real estate in the GTA. Domestic and foreign investors continue to acquire property as quickly as it becomes available for purchase. Sales volume for the first six months of 2007 totalled \$3.75 billion in the GTA vs. \$3.2 billion for the same period in 2006. There is too much demand-momentum for real estate and leasing fundamentals are still very favourable in most asset classes. Institutional investors continue to see real estate as a viable option in their investment portfolios.



Source: Bank of Canada

Effect on Cap Rates

Cap rates should remain stable during the current liquidity crunch because many assets are purchased with a high equity component and leasing fundamentals are strong across most asset classes. In addition, cap rates will likely resume their compressing trend after the current financial market crisis runs its course. The rise in short-term interest rates is the result of operational monetary policy designed to smooth economic cyclicity. Cap rates will fall in line with long-term bond rates. There are no systemic problems in our economy and general expectations are favourable which suggests long term interest rates will remain in the 4% – 5% range after the financial crisis is over regardless of current short term increases in the cost of debt as caused by increasing spreads.