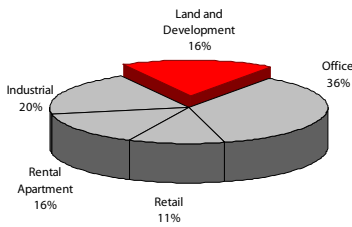




### Pierre Gagné's Historic Scope of Business



The corporate branding exercise we recently completed has revealed that different clients have a different understanding of the scope of business covered by our firm. In all cases, we are clearly identified as GTA experts advising and assisting in the sale of mid-market assets. However, many of our clients associate our preferred asset class along the lines of their own scope of business. In fact, P.G. Gagné Commercial Real Estate Corp. covers all major asset classes: office, retail, industrial, residential and land..

[www.gagnerealestate.ca](http://www.gagnerealestate.ca)

### NEW LISTING -34 Southport Street, Toronto



The Property comprises approximately 3.0 acres with frontage of 348.50 feet on the west side of Southport Street in the Swansea District of Toronto. The site is improved with a 43,156 square foot shopping centre and is site plan approved for redevelopment into 323 residential condominium units plus a maximum of 50,730 square feet of commercial space. **Offers are due on Thurs. Sept. 15<sup>th</sup>, 2005 at 12:00 noon.**

Find out more by visiting [www.gagnerealestate.ca/southport.php](http://www.gagnerealestate.ca/southport.php)



### PIERRE'S RECENT SALES – The Mary Ellen Baker Lands, Vaughan

We have closed the sale of a 65.199 acre site with 2,219 foot frontage on the south side of Rutherford Road and 1,302 foot depth on the east side of Dufferin Street located within Block 10 of the City of Vaughan. The site was un-zoned but planning study indicates potential for single family dwelling housing. Closed August 16 2005.



### OTHER RECENT RESIDENTIAL LAND SALES

**10400 Bathurst Street** – a 77.24 acre site approved for 256 lots located on the west side of Bathurst Street south of Teston Road in Vaughan. Closed January 12, 2005 at \$33,200,000 or \$129,688 per lot.

**Dufferin St. north of Rutherford Rd** – a 52.93 acre site with 306 proposed lots located west of Dufferin Street north of Rutherford Road in Vaughan. Closed January 21, 2005 at \$28,543,860 or \$93,281 per lot.

### OTHER RECENT APARTMENT SITE SALES

**96 St. Patrick Street** – a 0.512 acre apartment site approved for 199 suites and a GFA of 191,400 square feet located on the west side of St. Patrick Street north of Queen Street West. Closed March 10, 2005 at \$4,700,000 or \$23,618 per suite or \$25 per square foot.

**133 Wynford Drive** – a 3.729 acre apartment site with 349 proposed suites and a GFA of 405,700 square feet located on the southwest corner of Wynford Drive and Concorde Place. Closed March 30, 2005 at \$7,810,000 or \$22,378 per suite or \$19.25 per square foot.

**234 Adelaide Street East** – a 1.863 acre apartment site with 520 proposed suites and a GFA of 610,550 square feet bounded by the north side of Adelaide Street East, Jarvis Street and George Street. Closed April 1, 2005 at \$14,000,000 or \$26,923 per suite or \$23 per square foot.

**311 Adelaide Street East** – a 0.310 acre apartment site with 158 proposed suites and a GFA of 144,800 square feet located at the southeast corner of Adelaide Street East and Frederick Street. Closed March 16, 2005 at \$4,085,000 or \$158 per suite or \$28 per square foot.



### FORUM - Your Feedback and Comments on "What is a Cap Rate After All?"

#### Volume #11.05 - Asset Focus: Office



"Further to your discussion of cap rates, I have to agree with you that interest rates help to shape cap rates, however I think it is important to point out the real determining factor is the real interest rate and not just the nominal interest rate. While a full analysis of cap rates could fill an entire textbook the general rule is that cap rates should move in the same proportion and in the same direction as real interest rates and cap rates should not change due to a change in expected inflation because the higher interest costs are largely offset by the higher expected capital appreciation and higher future rent levels." – Patrick laboni

Patrick laboni is the President of Berkeley Development and a real estate lecturer at the Schulich Business School.

For Patrick's full commentary [click here...](#)



## FORUM – Your Feedback and Comments on Volume #11.05 – Asset Focus: Office Commentary – “What is a Cap Rate After All?”

Further to your discussion of cap rates, I have to agree with you that interest rates help to shape cap rates, however I think it is important to point out the real determining factor is the real interest rate and not just the nominal interest rate. While a full analysis of cap rates could fill an entire textbook, a summarized version of this idea is as follows:

As we all recall from Economics 101, interest rates are made up of two main components: the real cost of money, plus a premium to compensate for expected inflation. When real interest rates (the nominal interest rate minus the expected inflation rate) decrease, the industry as a whole is saying that the cost of money has decreased. Therefore, it is fair to expect a lower return on your invested capital and expect cap rates to decrease (in a general sense the expected return on real estate). This is a result of the market finding an equilibrium whereby if non-real estate investments are earning lower returns than real estate, it is only natural for capital to flow from non-real estate sectors into real estate until the expected returns are equalized (on a risk adjusted basis).

If on the other hand, interest rates change as a result of changes to the expected inflation rate, a theoretical analysis suggests that cap rates should be largely unaffected. If expected inflation causes long term interest rates to increase, society is expecting general price levels to increase. This would naturally mean increasing rent levels and real estate prices. Therefore, higher interest rates (due to higher expected inflation levels) will lead to greater nominal returns from real estate. Therefore cap rates do not need to go up to compensate for higher interest rates. Effectively, the higher capital appreciation and rent growth offset the higher interest costs. Similarly, if interest rates decrease (as a result of lower expected inflation) cap rates should not decrease.

To fully understand why this is the case, one has to realize that a cap rate is simply the denominator in a constant growth perpetuity calculation where 1st year NOI is the numerator. We all understand that the cap rate, even with no leverage, does not represent the expected total yield from a property over the holding period. Given that most of us expect some level of growth in NOI,

Value = NOI / Cap rate If Y = the expected yield and g = the expected constant growth rate in NOI then the formula above can be re-written as follows:

$$\text{Value} = \text{NOI} / (y - g)$$

Y can be further broken down as R representing the risk free rate of return and P, the risk premium associated with the investment. Therefore,

$$\text{Cap rate} = (R + P) - g$$

Given that R and G are both influenced in large part by the inflation rate, they are for the most part cancelled out (since g is subtracted from R). Therefore, inflation should have only a minimal impact on cap rates. A numerical example can help to illustrate this concept:

	No Inflation	10% Inflation
Cap Rate	10%	10%
Purchase Price	\$ (100.00)	\$ (100.00)
NOI		
y1	10.00	10.00
y2	10.00	11.00
y3	10.00	12.10
y4	10.00	13.31
y5	10.00	14.64
y6	10.00	16.11
y7	10.00	17.72
y8	10.00	19.49
y9	10.00	21.44
y10	\$ 110.00	\$ 282.95
IRR	10%	20%
Real IRR	10%	10%

From this example we see that the investor in the inflationary environment realizes the same real return as the investor in an environment with no inflation when they purchase with the same cap rate.

While this is a simplified example, the real world carries many more variables to consider including “perception”, leverage, and cash flow. To fully analyze these influences would truly require the full text book.

*Patrick Iaboni, President, Berkeley Developments*