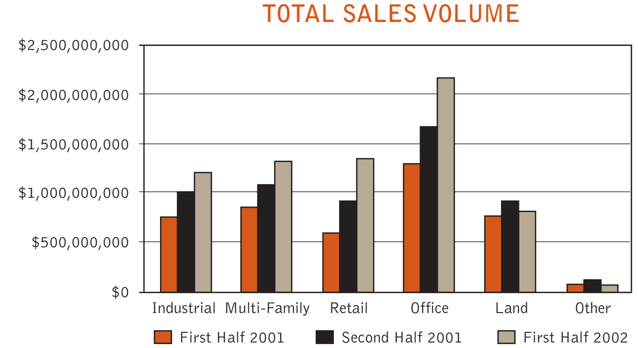
Commercial Real Estate Boom

More investors turning to asset class to enhance returns

The sales volume of Canadian commercial real estate peaked in the first half of 2002, according to a report issued recently by Colliers International, a real estate services firm. The total dollar volume of major Canadian commercial real estate sales for the first six months of 2002 increased by 21 per cent over the last six months of 2001 and 62 per cent over the same six-month period in 2001.

During the first half of 2002, dollar volume increases were seen in most commercial real estate markets in Canada. The biggest gain was in Moncton, which experienced an increase of 134 per cent. Other increases reported were 38 per cent in Halifax, 14 per cent in Montreal, 25 per cent in Toronto, 46 per cent in Edmonton, 28 per cent in Calgary, 29 per cent in Vancouver, and 78 per cent in Victoria. Only two cities in Canada saw a decrease in volume and both are in Ontario—the dollar volume of commercial real estate fell by 4 per cent in Kitchener and 27 per cent in Ottawa.

As investors look for stable sources of investment returns, multiple bids for prime assets have become common across the country, especially when it comes to office buildings. Colliers points out that higher-profile buyers and those who attach few conditions to their bids tend to be the most successful.



Asset Mix and Fund Performance

This table is a measure of the equal weighted average asset mix for pension funds in the Russell/Mellon Canadian Trust Universe (RMCTU) as of June 30th, 2002.

In the quartile ending on that date, funds greater than $1 billion in the RMCTU saw an average median return of –4.22 per cent, with a maximum return of –2.43 per cent and a minimum of –7.13 per cent. Overall, the median one-year return for the same funds was just 0.34 per cent.

EQUAL WEIGHTED AVERAGE ASSET MIX OF BALANCED ACCOUNTS UNIVERSE
(as of June 30, 2002)

Asset Class	Equal Weighted Avg. Asset Mix (%)
Canadian Stocks	35.6
U.S. Stocks	9.9
Non-North American Stocks	11.4
Real Estate	0.4
Total Equity	57.3
Fixed Income	38.3
Mortgages	0.2
Cash & Equivalents	3.9
Total Debt	42.4
Other Investments	0.3
Total Portfolio	100.0

Source: Russell/Mellon Analytical Services

Canadian Corporate Credit Quality Tumbles in 2nd Quarter of 2002

Contrary to the trend in other advanced economies, corporate credit quality in Canada deteriorated in the second quarter of 2002. According to a report issued by Standard & Poor's, the credit ratio (the ratio of downgrades per upgrade) fell to 4.0 from 2.0 in the first quarter. The second quarter also saw an increase in the number of rating downgrades, with the telecom sector taking the biggest hit. Altogether, there were 16 downgrades in this sector and only one upgrade. The overall number of telecom downgrade actions was boosted by companies that experienced multiple downgrades in the same quarter; for example, Teleglobe Inc.

While the report says that credit quality is likely to stabilize in the coming months, it does warn that any additional fallout from U.S. accounting woes could create a domino effect in Canada. Robert Palombi, fixed income analyst with Standard & Poor's, notes that the resulting volatility has led to fragile consumer and business confidence. Says Palombi, "If financial markets don't settle down and we don't see a rebound in the economy, then the rating environment could remain problematic." Moreover, Palombi points to the fact that a full 20 per cent of the Canadian companies rated had a negative outlook as of July 9, 2002—and there's a risk there could be more downgrades.

But Palombi also says we may be over the worst of the credit cycle and things seem to be stabilizing. "We've had two quarters of profits growth for companies," he says. "That's helping to improve corporate balance sheets and, over time, that should be reflected in the stabilization of credit quality among Canadian companies." This could mean good news for institutional investors, Palombi points out. "The wide bond spreads that we're seeing in the bond market will narrow—and that's where institutional investors will benefit."