December 7, 2021

Why real estate investors can no longer overlook Canada

We believe for institutional investors with growing allocations to real estate, Canada's growth prospects and disciplined investment markets may provide an opportunity for diversification and consistent, stable returns.

The Canadian real estate market: diversification for a volatile world

In the search for yield and stability in today's uncertain environment, Canada, the world's 7th largest commercial real estate market, may offer underappreciated opportunities for investors. Driven by a unique set of characteristics, Canadian private real estate has a history of offering steady income and attractive risk-adjusted returns while complementing property portfolios with exposure to U.S., Asia, Europe, and other markets.

Why invest in Canada?

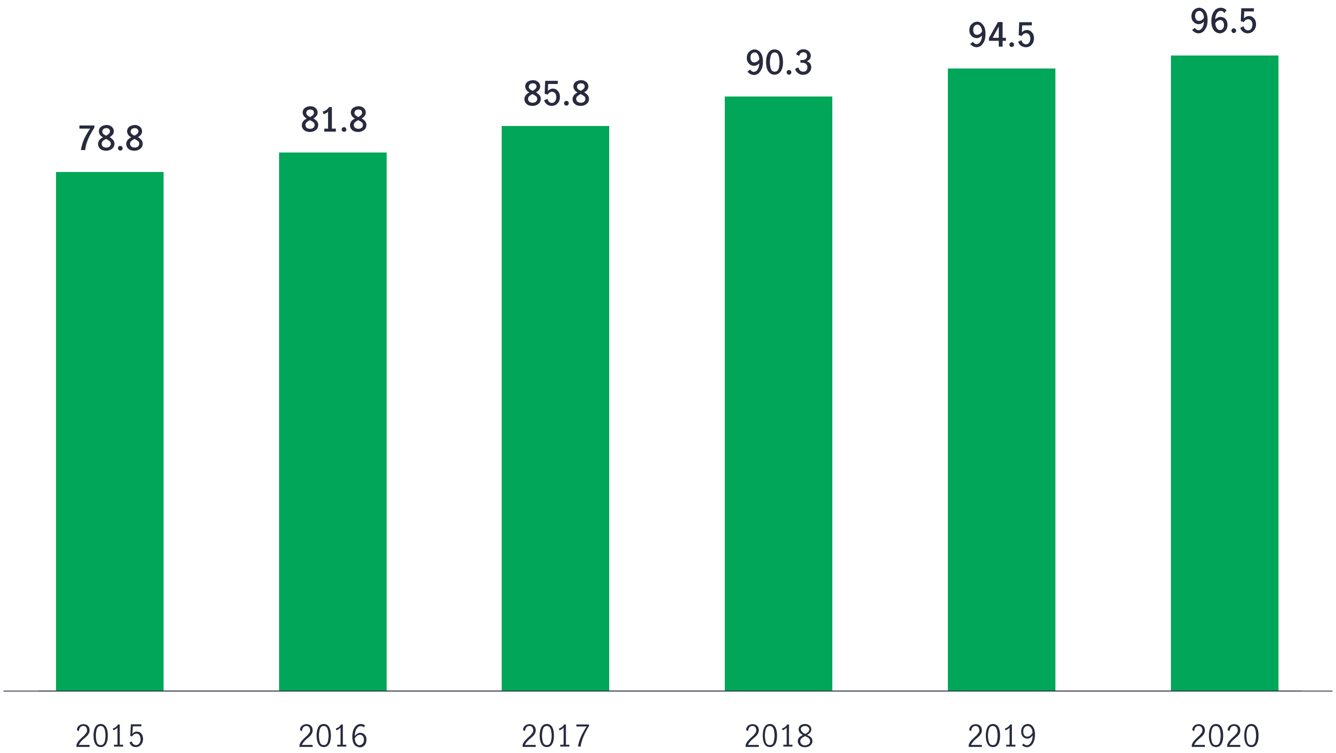
Before diving into Canada's real estate market, it's important to understand the evolving characteristics of the country itself.

A growing reputation as a global leader in technology

While Canada is blessed with vast natural resources, persistently low commodity prices over the last decade have highlighted the country's need for a strong knowledge economy. To that end, Canada's government has focused on implementing policies and actions to enable the free flow of knowledge, support investment in information and communications technology (ICT), and encourage entrepreneurship. As a result, since 2015, the ICT sector has seen a compound annual growth rate of 4.2%, compared with 0.7% for the overall Canadian economy.

Information and technology sector GDP

(2012 constant dollars, billions)



Source: "Gross domestic product at basic prices, by industry, annual average," Statistics Canada, November 25, 2021.

Today, the ICT sector is a driving force of economic growth, job creation, and innovation. Start-ups and tech companies looking to expand their operations are drawn to Canada for its:

- **Rich talent pool—**Canada offers a deeply skilled pool of tech talent across the country. Among the top tech markets in North America, five Canadian cities made the top 50 list: Toronto (3rd), Montreal (10th), Ottawa (21st), Calgary (31st), and Edmonton (39th).
- **Steady pool of local graduates—**Canada is home to many world-leading universities. Between 2015 and 2019, Toronto (#1), Montreal (#3), and Vancouver (#4) were the top growing markets in North America for producing tech graduates.
- **Ability to bring in skilled workers from around the world—**With its friendly immigration and foreign worker policies, Canada continuously attracts some of the best workers from around the globe. Over the next three years, the government of Canada has committed to welcoming 1.2 million immigrants.

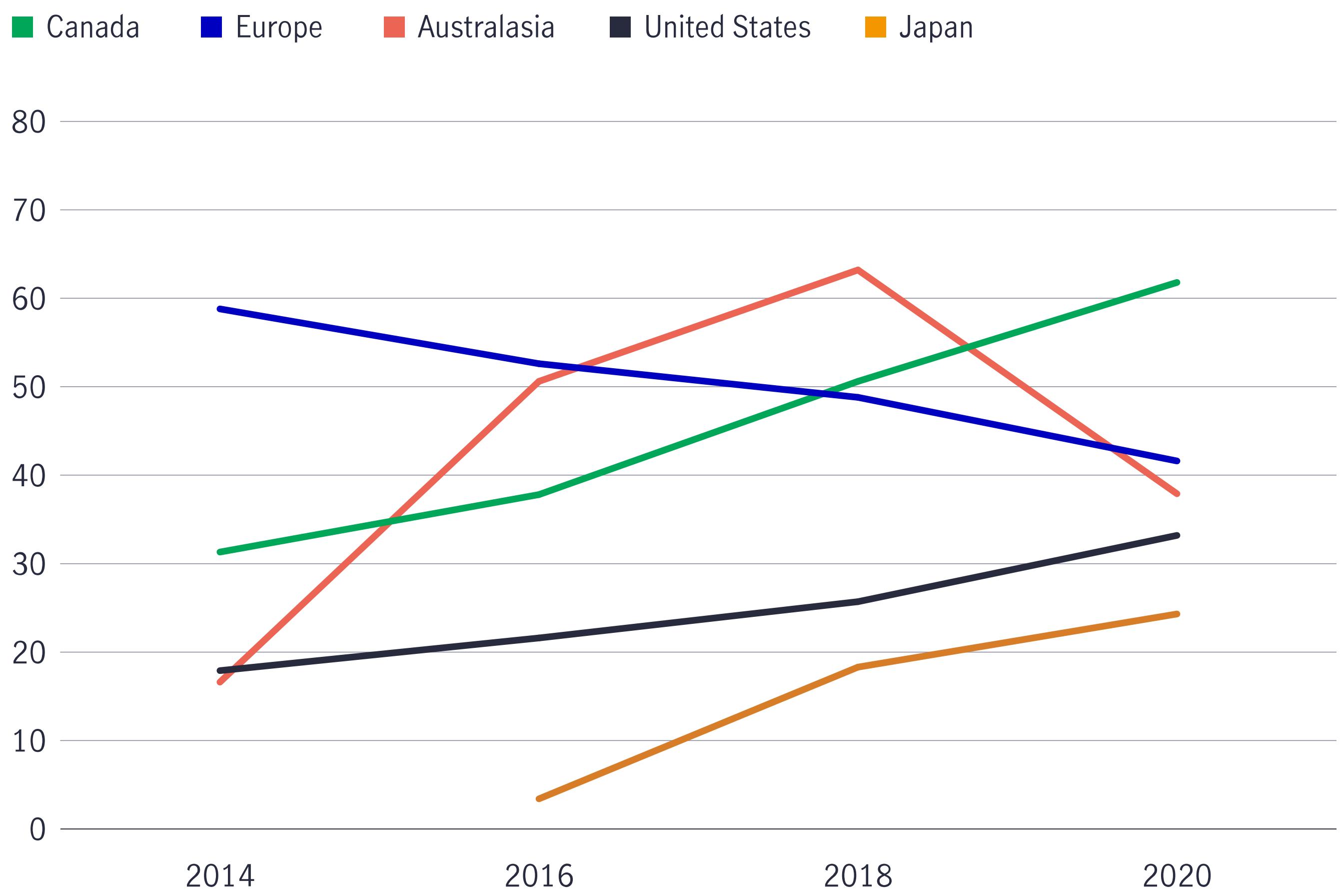
- **Low cost of operation—**As of the end of 2020, Canada's six major markets of Montreal, Vancouver, Toronto, Edmonton, Ottawa, and Calgary were among the lowest-cost tech markets in North America to operate in based on office rent and employee wages.
- **High quality of life—**Canada was ranked #1 in the 2021 U.S. News Best Countries report based on 10 attributes: adventure, agility, cultural influence, entrepreneurship, heritage, movers, open for business, power, social purpose, and quality of life—factors that attract highly skilled immigrants and business investments.

As a result of the pandemic, we anticipate accelerated adoption of technology solutions and increased investments in digital infrastructure around the globe. Given the attractive host of qualities the country offers, we think Canada is well positioned to become a world leader in the technology industry.

A global leader in ESG integration

Canada is also quickly becoming a global leader in environmental, social, and governance (ESG) investing. Over the past two years, Canada has seen a 48% growth in sustainable investing assets—the largest increase for any region in the world; in fact, Canada now has the highest proportion of sustainable investment assets relative to Europe, Australasia, the United States, and Japan. The drivers of growth behind Canada's sustainable and responsible investing market include consumer and investor demand, regulatory and policy developments, and environmental and social legislation.

Proportion of sustainable investing assets relative to total managed assets 2014–2020



Source: "Global sustainable investment review 2020," Global Sustainable Investment Alliance, 2021.

What potential benefits can Canadian real estate offer?

With economic growth underpinning demand for real estate, it's important to understand the evolving drivers of the Canadian landscape. Now let's dive into what makes the Canadian commercial private real estate sector unique.

A history of stable income generation and capital appreciation

At a time when stable risk-adjusted return opportunities are growing increasingly challenging to find, Canadian private real estate has a history of offering an attractive combination of income generation and capital appreciation. In fact, over the last 10 years, Canadian real estate has offered investors an annual return of 8.3%, with income accounting for more than 50% of total return.[1]

Canada	1 year	3 years	5 years	10 years
Income return	3.52%	3.75%	3.96%	4.39%
Capital return	7.52%	3.08%	3.56%	3.76%
Total return	**11.26%**	**6.93%**	**7.63%**	**8.29%**

Source: MSCI/REALPAC Canada Quarterly Property Index (unfrozen), gross of fees, as of Q3 2021. It is not possible to invest directly in an index. Past performance does not guarantee future results.

A history of portfolio diversification benefits

Additionally, Canada's correlations with other G7 countries range from –0.3 (Germany) to 0.8 (France),[2] which suggests that an allocation to Canadian real estate may reduce the overall volatility of a portfolio invested in other global property markets.

Total return correlation matrix

	Canada	France	Germany	Italy	Japan	United States	United Kingdom	Global
20-year return	**9.0%**	**8.2%**	**5.1%**	**5.5%**	**5.0%**	**7.5%**	**6.9%**	**7.0%**
Canada	1.00							
France	0.80	1.00						
Germany	-0.33	-0.13	1.00					
Italy	0.54	0.75	-0.25	1.00				
Japan	0.56	0.79	0.21	0.49	1.00			
United States	0.78	0.77	-0.01	0.48	0.76	1.00		
United Kingdom	0.49	0.50	-0.28	0.28	0.42	0.64	1.00	
Global	0.77	0.84	0.02	0.54	0.85	0.97	0.72	1.00

Source: MSCI Annual Property Index (unfrozen), as of Q4 2020. MSCI/REALPAC Canada Annual Property Index (unfrozen) is the source for Canada. MSCI France Annual Property Index (unfrozen) is the source for France. MSCI Germany Annual Property Index (unfrozen) is the source for Germany. MSCI Japan Annual Property Index (unfrozen) is the source for Japan. MSCI U.S. Annual Property Index (unfrozen) is the source for the United States. MSCI UK Annual Property Index (unfrozen) is the source for the United Kingdom. MSCI Global Annual Property Index (unfrozen) is the source for global. Italy is based on an 18-year history. Correlations are based on local currency returns and therefore represent currency hedged returns.

A disciplined investment environment

The Canadian private real estate market is dominated by large, highly respected institutional players such as well-capitalized pension funds, life insurance companies, public corporations, and investment trusts that operate in a disciplined manner and have a long-term investment horizon. The presence of these institutional investors has historically acted as a stabilizing force during periods of market uncertainty due to their ability to better withstand market downturns, maintain positions throughout market cycles, and tendency to avoid speculative plays. In fact, since 2001, the return volatility of Canadian private real estate has been relatively muted at 5.6% annually.[3]

Total return, annual, 16 years (Q3 2001–Q3 2021)	**Average**	**Volatility**	**Lowest**	**Highest**
Direct real estate	9.0%	5.6%	-3.7%	18.3%
Corporate bond	5.7%	3.9%	-1.1%	15.3%
Public real estate	13.9%	19.4%	-38.3%	55.3%
Public equity	8.5%	16.5%	-33.0%	35.1%

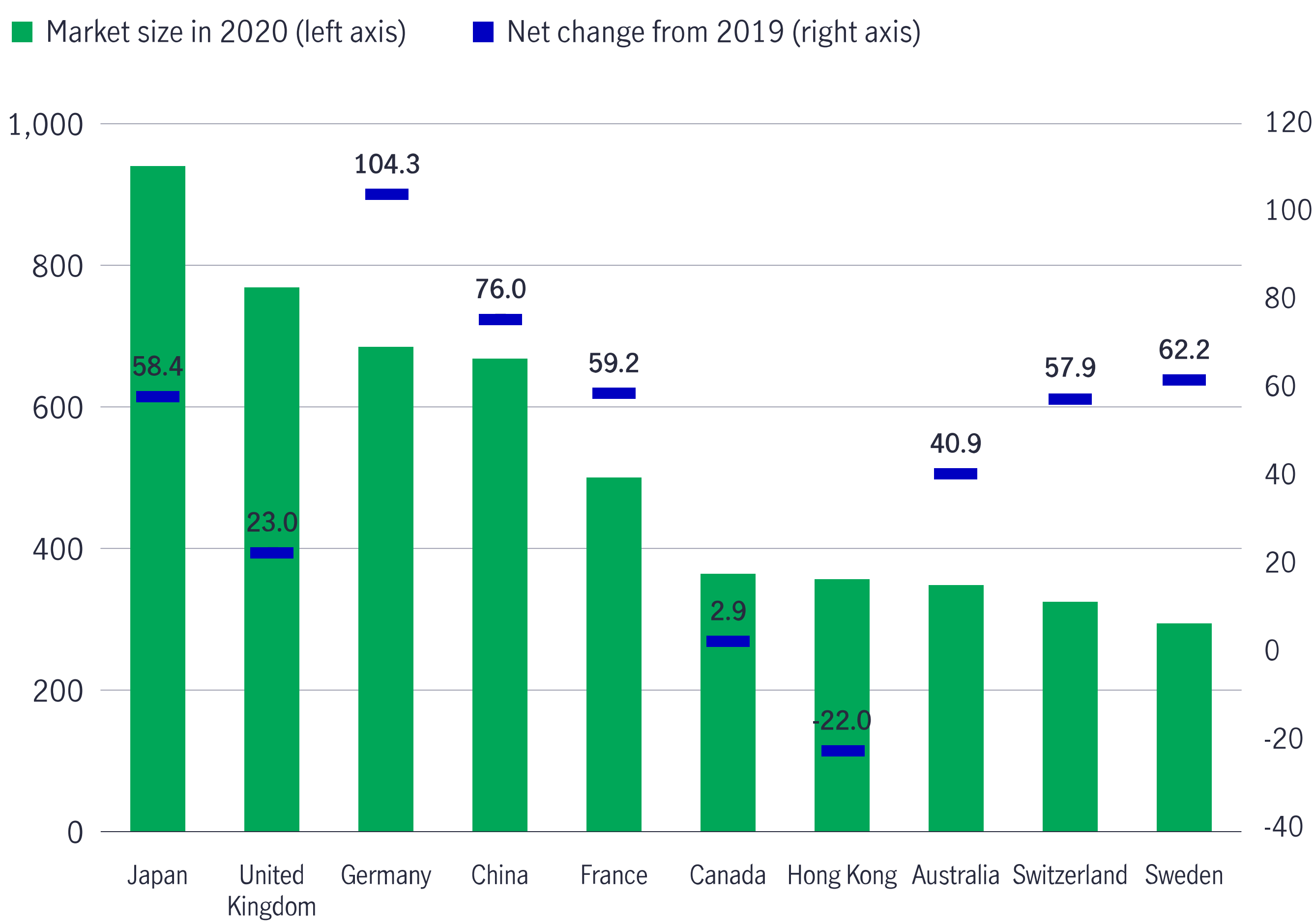
Source: MSCI/IPD, Bloomberg, Manulife Investment Management, as of Q3 2021. Direct real estate is represented by the MSCI/REALPAC Canada Annual Property Index (unfrozen), corporate bond is represented by the ICE BofA Canada Corporate Index, public real estate is represented by the S&P/TSX Capped REIT Total Return Index, and public equity is represented by S&P/TSX Composite Total Return Index. These statistics are calculated using historical returns and assume returns follow a normal distribution. All statistics are calculated using 12-month ending third-quarter gross total return series, calculated from quarterly gross (excluding management fee) total return series. It is not possible to invest directly in an index. Past performance does not guarantee future results.

A market with size and liquidity

Last, the professionally managed Canadian real estate market is valued at ~$364 billion. With annual transaction volume between $35 and $50 billion, over the last three years,[4] the market offers size and liquidity, enabling investors to transact with price efficiency and low friction.

Canada's keeping pace with world's biggest real estate markets

Exluding the United States, USD billions

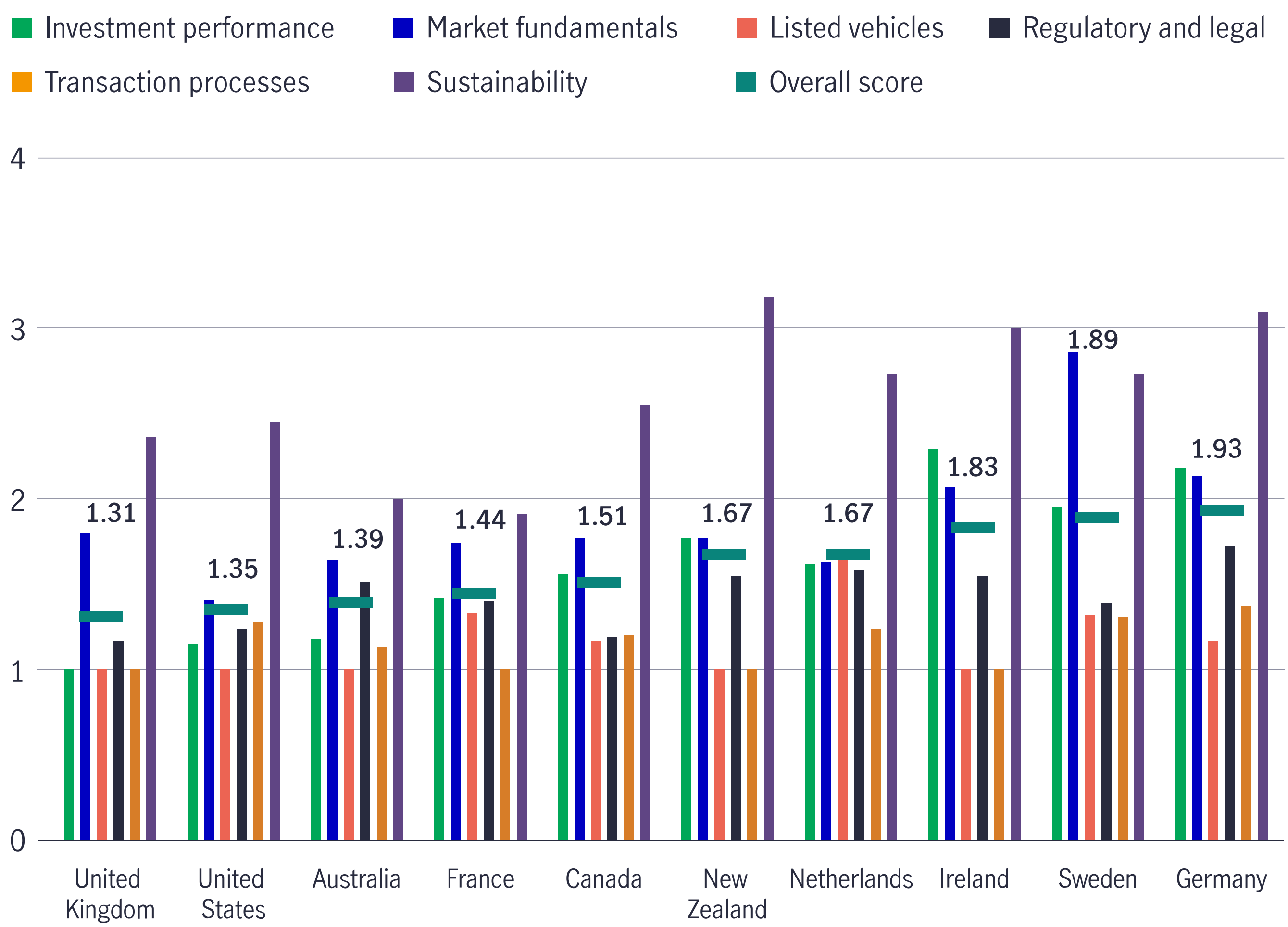


Source: "Real Estate Market Size Report 20/21," MSCI, 2021.

Furthermore, elevating the attractiveness of the market is Canada's high transparency ranking, sitting proudly at 5th on a global scale. Transparency is critical to the operation of efficient markets and is instrumental in boosting investment and business activity.

Global Real Estate Transparency Index 2020 rankings

The index score markets on a scale of 1.00–5.00 (with 1.00 being the highest possible score)



Source: JLL Research, 2020. This index is based on quantitative market data and survey results across 99 countries and territories. The 210 individual measures are divided into 14 topic areas and further grouped and weighed in the six subindexes above. The index scores markets on a scale of 1.00 to 5.00. Depending on the overall ranking, markets are assigned one of the following transparency tiers: highly transparent, transparent, semitransparent, low transparency, opaque.

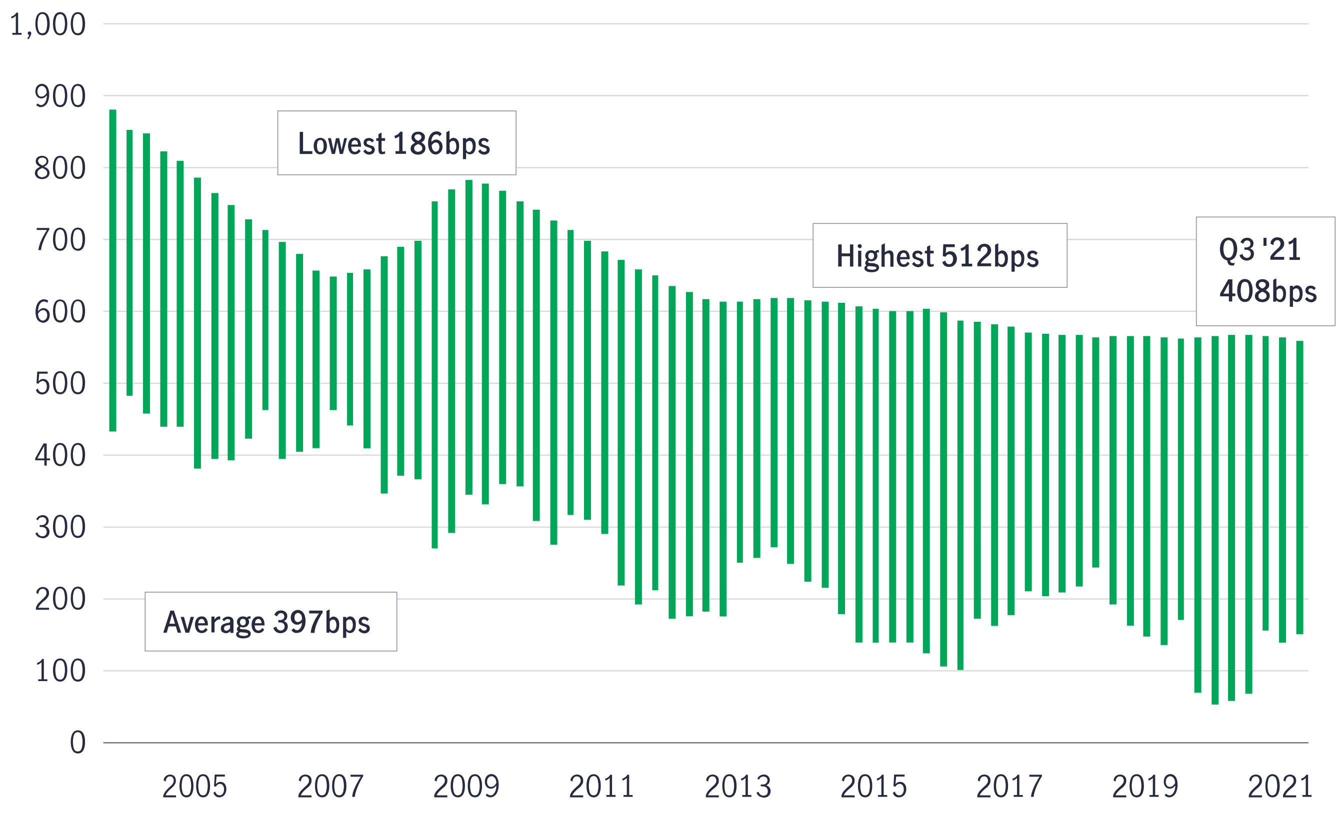
Why invest in Canadian real estate now?

Current cap rate spread points to a favourable entry point

The Canadian commercial real estate cap rate spread is currently elevated relative to history—a potentially favourable opportunity for those searching for yield in a muted fixed-income environment. As of the end of Q3 2021, the spread was 408 basis point (bps), above the long-term average spread of 397bps (high spreads generally indicate there's room for spread compression and, by extension, for real estate values to appreciate).[5]

Average national cap rate spread

Canadian commercial real estate, all properties average national cap rate over the Canadian 10-year government of Canada bond yield



Source: CBRE EA, Manulife Investment Management, as of Q3 2021.

Given the long-term prospects of the economy combined with favourable market characteristics, the Canadian commercial private real estate market may offer investors an attractive combination of growth, stability, portfolio diversification, and income.

1 MSCI/REALPAC Canada Quarterly Property Index (unfrozen), gross of fees, as of Q3 2021. **2** MSCI Annual Property Index (unfrozen), as of Q4, 2020. **3** MSCI/IPD, Bloomberg, Manulife Investment Management, as of Q3 2021. **4** "National Real Estate Investment Summary," CBRE, Q2 2021. **5** CBRE EA, Manulife Investment Management, as of Q3 2021.

Important disclosures

A widespread health crisis such as a global pandemic could cause substantial market volatility, exchange-trading suspensions and closures, and affect portfolio performance. For example, the novel coronavirus disease (COVID-19) has resulted in significant disruptions to global business activity. The impact of a health crisis and other epidemics and pandemics that may arise in the future could affect the global economy in ways that cannot necessarily be foreseen at the present time. A health crisis may exacerbate other preexisting political, social, and economic risks. Any such impact could adversely affect the portfolio's performance, resulting in losses to your investment.

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