

25. September 2022

The Canadian real estate market in times of Covid-19, the Russian war of aggression, rising interest rates and inflation

"There's something to be said for real estate investing in Canada!"

Thomas Gütle is the founder and managing partner of the consulting firm Primera Advisors and provides comprehensive support to RECan Global GmbH in its sales activities.

Mr. Gütle, it feels like we are sliding from one crisis to the next. First Covid-19, then the Russian war in Ukraine. Now, in Germany, there is the energy crisis, interest rate hikes and inflation. What does that mean for investors?

Bayern LB's chief economist recently spoke of the beginning of a new era - namely a "VUCA world". VUCA stands for volatility, uncertainty, complexity and ambiguity. At the moment, everything is connected. We have war, interest rate hikes, uncertainties in the market. That is the environment in which an investor is currently operating - in other words, a very, very difficult environment to assess. You can't just put it into a model and see what the outcome will be. Many developments are new, where there are no empirical data with which to build a model.



How are investors reacting to this, especially those in Germany?

We see that, at the moment, a whole series of investors are no longer making new investments. There appears to be a reluctance to invest, at least until the end of the year. In addition, some investors have a problem with their real estate allocation. With other asset classes losing value, this creates an over-allocation to real estate. It's a wait and see for repricing against the backdrop of interest rate developments.

In summary, there has been minimal investment activity recently, which will certainly continue at least until the end of the year.

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You just mentioned the interest rate development. Here, it seems to us, North America is once again one step ahead. What does that mean?

If you look at the global figures for transaction volumes for the first half of the year, i.e. the comparison of the first half of 2022 with the first half of 2021, we see an increase of 19 percent. The momentum that you see here comes particularly from the American market, the U.S. market. However, given recent interest rate developments, we do not expect this trend to continue in the second half of the year. In North America, interest rates have risen sharply. Interestingly,

in Canada the key interest rate is currently at 3.25%, and in the U.S. we are now also above 3%. The Euro Zone is at 1.25%. You can see quite clearly: North American is once again, as it often does, the ones who are leading the way, who have taken the strongest action against these inflationary developments. That will continue to evolve and repricing has already started. For example, in the U.S. we have seen purchase price declines of 10% to 20% recently in the resilient Multi-family sector. It's interesting to note that Canada is leading the interest rate ranking in this context.

Why Canada, actually?

I mentioned that we live in this VUCA world. That's why criteria such as legal certainty, the rule of law, and political and financial stability have become much more important for investors - a "flight to quality" is taking place here. If I may take a brief look at Asia, the investors I speak to there tell me across the board that we will only invest in a fund that does not invest in China or Hong Kong. These considerations have not been present to this extent before. From experience, I can say that this sentiment will only increase.

What does this mean for investors who are considering investing in Canada?

Canada fulfills exactly the criteria I mentioned - on the one hand, real estate market strength, and on the other, political, financial and legal stability. It is no coincidence that Canada is considered a "safe harbor" and regularly ranks second or third in the global FDI Confidence Index. This advantageous situation, which we see very clearly in Canada, is not often found in other countries.

This speaks in favor of Canada, especially in the current times, but also in the long term. But there are even more points that an investor should look at that are attractive in Canada. In real estate, two criteria are extremely important: population growth and job growth. And that is exactly what we find in Canada due to its well thought out immigration policy, which is well supported by the Canadian population.

Does the climate change factor also play a role?

Sure. This is a fact that we can no longer explain away. It looks like Canada could be a beneficiary of climate change. There are regions there that are thawing due to climate change, where it will be possible to live for the foreseeable future and where raw materials will also be released. In addition, Canada is undergoing a transformation process toward a diversified economy - in other words, away from a dependence on commodities.

Of course, immigration policy is also contributing to this, as Canada is actively bringing in people in large numbers to help diversify this economy even more, because they are experts in other sectors.

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RECan is a new manager with a highly experienced team in the market that has exclusively Canadian real estate in their portfolio. They are acting in an advisory capacity for the company. In this respect, we assume that there is a corresponding conviction behind this. A conviction that says: "This thing works!"

Yes, of course. At this point, I would like to mention five points that definitively speak for the manager and the product. One is the real estate market in Canada, which has both "safe harbor" security, and huge development potential - i.e. population growth, intelligent immigration policy. This increases the demand in the real estate market in various sectors. The second point is the "boots on the ground", as RECan in Canada has a very experienced team that has been working exclusively in Canada for 30 years. The same is true for the team in Germany and Luxembourg. This is a combination that is of course very unique and beneficial to investors.

The third point?

Thirdly, all parties involved have an entrepreneurial component. This means that you only profit if you are successful - and are therefore in the same boat as the investor even if there are negative developments. I see this as a very important motivation for everyone involved. The investor, point four, can basically put together his own portfolio of multi-family and commercial properties according to his needs. Last but not least, we are dealing with a real estate criteria-matching and ESG Article 8 compliant product with German reporting, which is very easy for German investors to invest in. In addition, if someone invests in the U.S., then Canada can indeed be a hedge, should Trump (or even another populist) perhaps come to power again soon. That would be, let me put it this way, indeed an employment program for Canada. But that's just in passing.

If you talk about strengths, you should also talk about weaknesses to be fair.

The critical point is certainly that potential investors are dealing with a new manager. Moreover, it is a first-time fund.

But?

The people who are active here in Canada, in Germany and in Luxembourg all have the necessary and, above all, very good expertise in the respective areas. I myself have brought a whole series of new products and new managers to the market over the past 20 years. The most important thing is that investors are satisfied, and that has basically always been the case. In this respect, I think that I can judge this situation on the basis of my experience. In my estimation, the team will do a great job and is already doing so today.

Finally, your advice to potential investors.

My advice in the short-term is to keep your "powder dry" so that when opportunities arise in the coming year, you can quickly take advantage of the opportunity, because the North American markets react much faster. In short, things can get interesting again very quickly. And then, as an investor, you have to be able to react very quickly. Investors there don't wait as long as they do in Europe, for example, where people tend to be rather hesitant. The decisive factor for such investments is to have a manager at your side who has many years of expertise in the market and ideally has a DNA in the region. Good research is also likely to be important in such a market situation.

That means finalizing everything administratively this year, and preparing everything for next year, and then firing at the right moment.

Right!

Thank you very much for the interview!