



British Columbia Real Estate Investment Review

First Half 2006

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Real Estate Solutions

First Half 2006

Total Value (Sales > \$5 Million): \$765,100,000

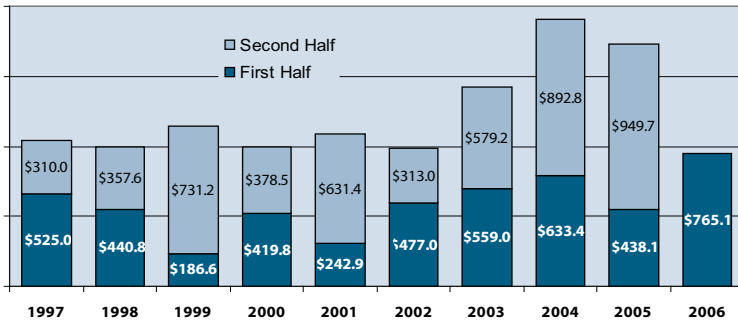
Total Transactions: 42

Most active sellers: Private Investors

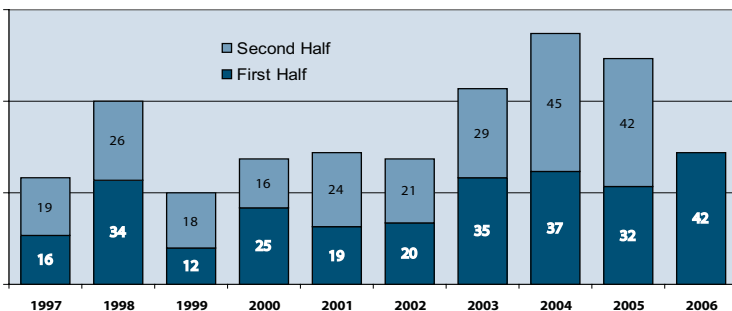
Most active buyers: Private Investors

Most active asset class: Office Buildings

BC Investment Sales Value (properties >\$5 Million)



BC Investment Sales Transactions



In this issue:

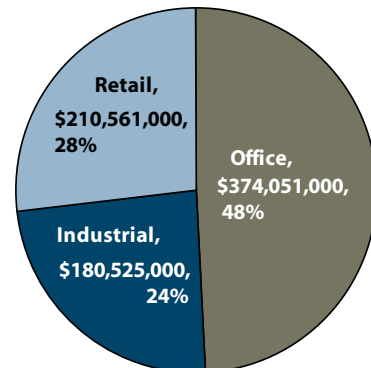
Guest column by J. Liam Murray of Altus Heylar:
10 Impacts of Higher Construction Costs

Market Summary

The first six months of 2006 generated record value and volume of transactions for the first half of a calendar year. 42 assets traded for a combined value of \$765.1 Million.

Over the past six months lending rates and bond yields have risen while capitalization rates continue to decline (see back page). Theory, and evidence from past market cycles, would suggest that this should diminish buyer interest. Nevertheless, demand remains robust: unsolicited offers are driving a large portion of transaction activity while multiple bids chase properties formally listed. The imbalance between demand and supply continues to push prices skyward and cap rates downward.

Investment Sales by Asset Type
First Half 2006



Vendor and Purchaser Trends

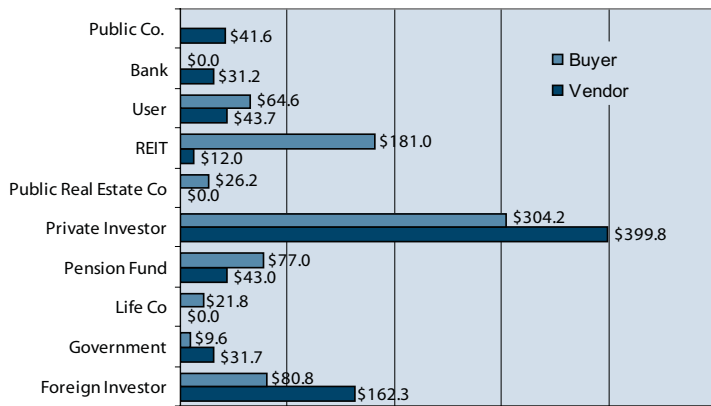
Buyer Profile

Private investors were the dominant buyers, although all investor types purchased properties. In the highest value transaction, a REIT acquired the \$151 Million TELUS Headquarters building at 3777 Kingsway from a foreign entity.

Despite high prices and low cap rates some investors appear to see British Columbia real estate as a solid long term investment and are not overly-concerned about whether we could be nearing the top of this market cycle as many are looking one or more cycles into the future.

Pension funds continue to pursue investment opportunities. They prioritize placing funds in long term investments with stable cash flows. If property values themselves fluctuate downward in the short term this may be less of a concern than it would be for other investors.

Buyers and Sellers (by value)

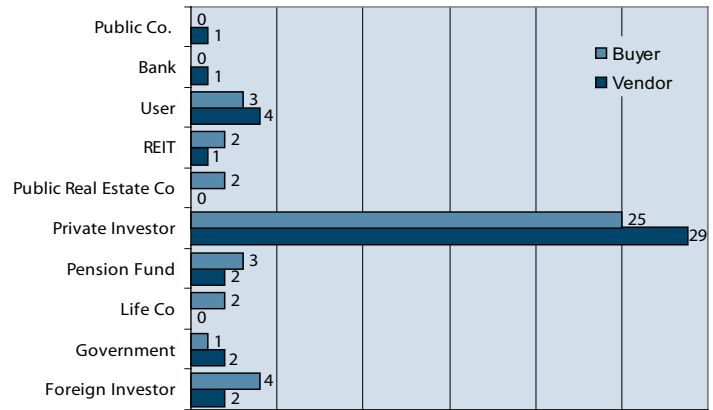


Seller Profile

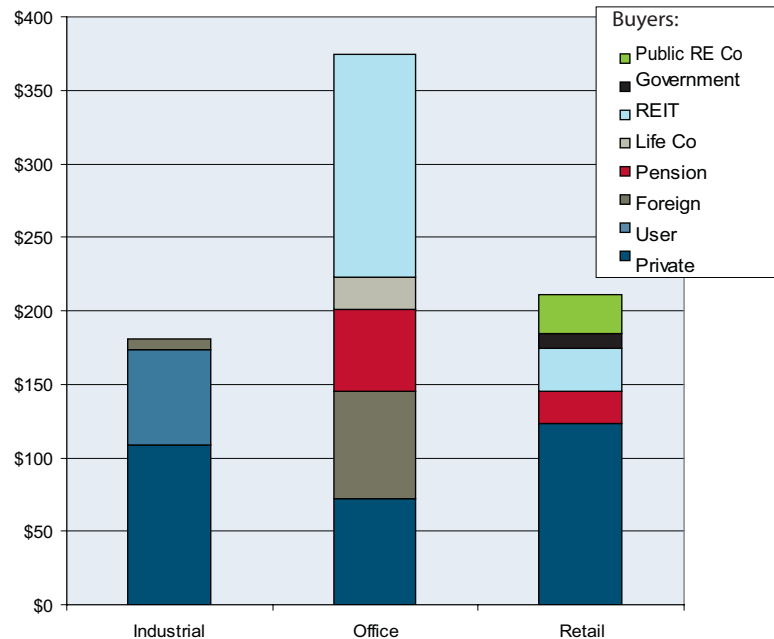
Private investors were the dominant vendors during the first six months of 2006, selling 30 of the 42 properties traded.

As a group, sellers had different reasons for property disposition. To some, market conditions are ripe for unloading marginal properties or assets with challenges. For others, rapid price increases have allowed them to realize returns on investments several years earlier than anticipated. Some investors believe the market is nearing its peak for this cycle and they want to profit before it is too late. And in many of these cases, continued generous unsolicited offers pushed owners to sell.

Buyers and Sellers (by number of transactions)



Buyer profile by asset type



Buyers and Re-Development:

Many buyers -- particularly private investors -- are purchasing income-producing assets with a view toward redevelopment sometime in the future. Most older industrial assets that traded will likely be developed shortly, whether by the new owner-user or a private investor. At least two office buildings that sold will likely see redevelopment activity within the next 5 years. In addition, the purchase of 1285 West Pender Street provided its new owner with 177,000 square feet of transferable heritage density that they are expected to use toward the development of a new office tower. In another example, the new owner of Lions Gate Film Studios sees the asset as having a good income stream today, with the potential for re-development should the BC film industry decline to the point where the studio facility is no longer profitable.



AltusHelyar

10 Impacts of Higher Construction Costs

Guest Feature by J. Liam Murray
Altus Helyar



The cost of constructing any given building has increased from between 60% to 100% over the past four years. The newspapers highlight daily the latest project to overrun its budget. The pressure is especially hard on projects where revenues are fixed, or where profit is not a consideration (e.g. 2010 Olympic Construction).

This article does not address why this has happened (supply and demand, really), nor how to control it (see our website - thealtusgroup.com). Instead we focus on what impact it is having on the investment industry.

Impact #1: The cost of development is high. This creates pressure on potential yields or profit for the developer. More significantly, it is creating uncertainty on the attainability of yields (given the pace at which costs are escalating). A pension fund developing a site may find that escalating construction costs reduce profitability.

Impact #2: Investors get "less" for their money. This is best illustrated in the July 4th Vancouver Sun's article "Vancouver condos get even smaller"! The article is 100% correct. Whether the buyer is a homeowner to be or an investor, the fact is \$300,000 (or \$300-million) buys a lot less today than it did four years ago.

Impact #3: Pre-sales are a good investment for buyers, less so for developers. In this scenario, the developer ties down his costs (as best as possible), then prices his products at today's rate. When complete (in say two years time), the "cost push" inflation will mean a higher value which in turn means a paper profit for the buyer on closing. On a number of recent condominium developments the individual unit buyers make a better percentage return than the developers themselves.

Impact #4: Real estate portfolios are "worth more". To replace a building in any portfolio today would cost significantly more to replace than four years ago.

Impact #5: Insurance bills are bigger. Sometimes way bigger. The most significant synergy attained to date with the Altus merger has been our ability to provide better, more accurate insurance appraisals for portfolios of real estate.

Impact #6: Tenants know construction costs are higher. They want a better T.I. deal. \$20 per sq.ft. does not stretch as far as it use to do.

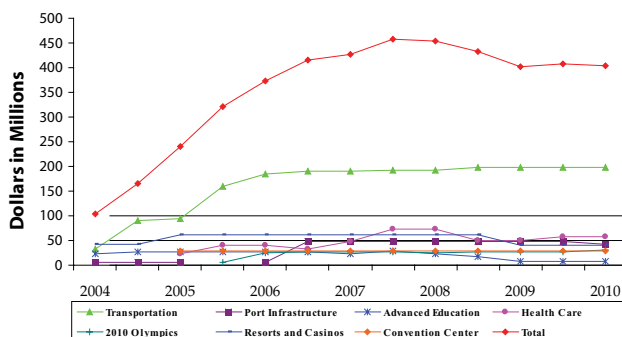
Impact #7: The project will take longer owing to a lack of available labour. Completion dates are overshooting by 10% to 20%. So if you are waiting for occupancy, or for delivery, or perhaps for a return on your mezzanine financing; wait some more.

Impact #8: Bankers are nervous. The risks of development have never been higher, and investment risk is just one step behind. In our role of monitoring evolving construction costs for lenders, we are dealing daily with increased risks on the cost side, but are aware of the close relationships with risks on the "return side" - for the banker, the investor, the purchaser, and the tenant.

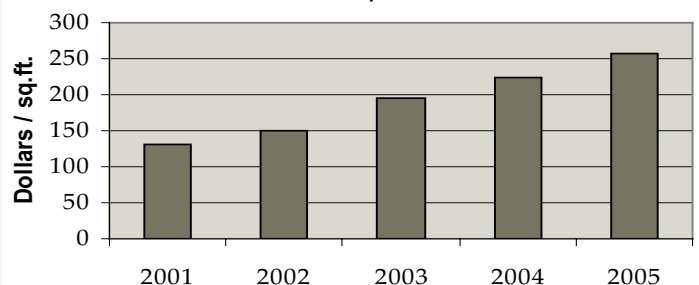
Impact #9: Developers are nervous. Why wouldn't they be? It used to be easier; more predictable. A fixed price contract previously meant a fixed price. Not anymore. Today a "guaranteed maximum price" simply guarantees you the lowest price they will pay. A number of larger contractors refuse to fix their prices today, and if they must, the developer will pay hefty for the privilege.

Impact #10: Investor uncertainty. Investors are what? Happy? Sad? Concerned? Better off? Worse off? Left town? The answer of course depends on where they are in the deal. But with record low Cap rates and 20% escalation in costs many investors are staying on the sidelines for now.

Major BC Capital Projects 2004 - 2010



Concrete Condominium Construction Costs Vancouver, BC - 2001 to 2005



Office

Property	Price	Vendor Type	Buyer Type	Date
3777 Kingsway Burnaby	\$151,000,000	Foreign	REIT	May 2006
221 West Esplanade North Vancouver	\$38,250,000	Gov't	Foreign	March 2006
1285 West Pender Street Vancouver	\$33,000,000*	Private Investor	Pension Fund	May 2006
777 West Broadway Vancouver	\$22,750,000	Pension Fund	Pension Fund	March 2006
856-858 Homer Street Vancouver	\$22,000,000	Private Investor	Private Investor	March 2006
220 Cambie Street Vancouver	\$20,200,000	Pension Fund	Foreign Investor	June 2006
8100 Granville Street Richmond	\$19,050,000	Gov't	Private Investor	January 2006
570 Dunsmuir Street Vancouver	\$15,000,000	Private Investor	Foreign	April 2006
1038 Hamilton Street Vancouver	\$13,050,000	Private Investor	Private Investor	May 2006
3480 Gilmore Way Burnaby	\$11,800,000	Private Investor	Life Co.	April 2006
3605 Gilmore Way Burnaby	\$10,000,000	Private Investor	Life Co.	April 2006
1060 West Broadway Vancouver	\$6,100,000	Private Investor	Private Investor	June 2006
McLaren Centre Burnaby	\$6,050,000	Private Investor	Private Investor	January 2006
625 5th Avenue New Westminster	\$5,801,000	Private Investor	Private Investor	May 2006
TOTAL:	\$374,051,000			

*includes 177,000 s.f. of transferable density

Capitalization rates for office product declined further over the past six months. With vacancy rates now approaching historic lows in most Greater Vancouver leasing districts, rental rates are increasing. Investors appear confident that they can raise yields as leases expire and are renegotiated.

Market conditions now favour landlords, as demand for office space greatly exceeds supply. The downtown vacancy rate dropped to 4.0% (from 6.2%) over the past six months while vacant space in the entire Greater Vancouver area declined to 5.8% (from 7.9%). In six months to June 30, 2006 the market absorbed 960,000 square feet of office space across Greater Vancouver. Meanwhile only 1.1 Million square feet of new office space is scheduled for construction and delivery through 2009. Vacancy rates are therefore expected to reach record low levels by year end 2006 and continue declining over the next 18-24 months unless the economy begins to falter. This should push rental rates higher and allow office owners to increase operating income over the next few years.



The Leckie Building at 220 Cambie Street. Sold by Avison Young for \$20.2 Million.



Avison Young sold 3777 Kingsway, Burnaby for \$151 Million.

Retail

Property	Price	Vendor Type	Buyer Type	Date
Rutherford Mall Nanaimo	\$31,150,000	Financial Institution	Private Investor	January 2006
Lougheed Power Centre Penticton	\$30,000,000	Private Investor	REIT	April 2006
London Village Coquitlam	\$21,900,000	Private Investor	Private Investor	May 2006
255-260 West Esplanade North Vancouver	\$21,400,000	Private Investor	Private Investor	May 2006
Delta Shoppers Mall Delta	\$21,250,000	Private Investor	Pension Fund	January 2006
Chahko Mika Mall Nelson	\$15,000,000	Private Investor	Private Investor	January 2006
Woodgrove Crossing Nanaimo	\$14,150,000	Private Investor	Public Real Estate Co.	April 2006
1085 Woolridge Street Coquitlam	\$12,000,000	REIT	Public Real Estate Co.	June 2006
15177 Thrift Avenue White Rock	\$11,275,000	Foreign Investor	Private Investor	April 2006
4020 No. 3 Road Richmond	\$9,630,000	Private Investor	Government	April 2006
Austin Avenue Mall Coquitlam	\$6,550,000	Private Investor	Private Investor	January 2006
The Gap, Government St. Victoria	\$5,554,000	Private Investor	Private Investor	February 2006
Long Lake Plaza Nanaimo	\$5,200,000	Private Investor	Private Investor	January 2006
6250 Lougheed Hwy Burnaby	\$5,102,000	Private Investor	Private Investor	May 2006
TOTAL:	\$210,561,000			



Woodgrove Crossing Shopping Centre
Nanaimo.
Sold by Avison Young for \$14,150,000.

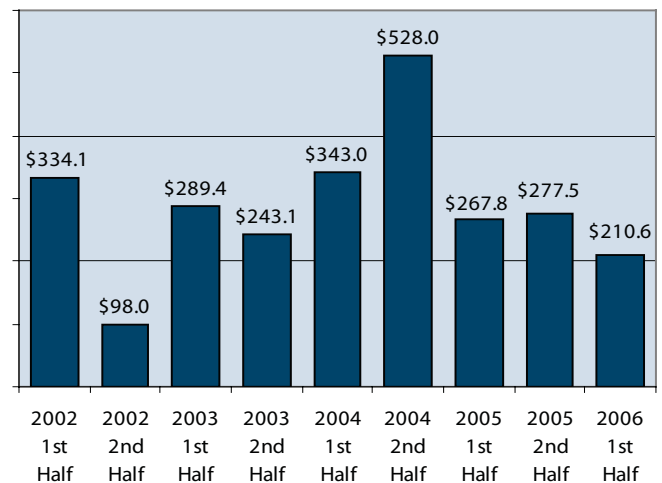


Rutherford Mall, Nanaimo.
Sold for \$31,150,000.

Capitalization rates for retail product declined over the past six months, even for marginal properties. Yields of 6% - 6.5% are becoming typical. Unlike for office assets where rental rates are increasing, retail owners cannot expect the same rental income growth in many cases.

Despite low returns, high prices being paid for existing product may be justifiable given the cost of new construction. Escalating land, materials and labour costs make developing new retail product challenging. Many tenants cannot afford to pay the rents developers or owners of new shopping centres must charge to justify the project. As a result, many developers need to appeal to national and global high end tenants or combine residential into the project in order to produce a profit.

Retail sales value trends



Industrial

Property	Price	Vendor Type	Buyer Type	Date
Safeway Distribution Ctr Burnaby	\$42,400,000	Private Investor	User	February 2006
Lions Gate Film Studios North Vancouver	\$41,600,000	Public Co.	Private Investor	March 2006
13340 - 76th Avenue Surrey	\$15,500,000	User	User	April 2006
Taiga Portfolio (BC Component)	\$13,100,000	User	Private Investor	February 2006
1150 Station Street Vancouver	\$12,625,000	Gov't	Private Investor	April 2006
27452 - 52nd Avenue Langley	\$8,300,000	User	Private Investor	June 2006
7400 River Road Richmond	\$8,000,000	Private Investor	Private Investor	March 2006
13120-76th Avenue Surrey	\$7,350,000	Private Investor	Private Investor	February 2006
26712 Gloucester Way Langley	\$7,325,000	Private Investor	Foreign Investor	April 2006
6940 - 14th Avenue Burnaby	\$6,800,000	User	Private Investor	January 2006
456 Humber Place Delta	\$6,700,000	Private Investor	User	February 2006
11660 Mitchell Road Richmond	\$5,825,000	Private Investor	Private Investor	January 2006
2320 & 2340 Rogers Ave Coquitlam	\$5,000,000	Private Investor	Private Investor	April 2006
TOTAL:	\$180,525,000			



Lions Gate Film Studios sold for \$41.6 Million in a deal brokered by Avison Young.



Taiga Building Products Portfolio of 17 buildings across Canada was sold by Avison Young for \$52 Million. BC portion valued at \$13.1 Million.

Private buyers and owner-users purchased all industrial properties valued at over \$5 Million. The largest deal involved Safeway buying the portion of their distribution complex that they had leased since the 1950s. (Safeway already owned the remainder of the site.)

The other large deals involved a variety of disposition or acquisition reasons. Lions Gate Films sold their production studios, which had become non-core assets in their business focus on film distribution. Mountain Equipment Co-op purchased 13340 - 76th Avenue as it matched a precise list of criteria for their new warehouse. And Taiga Building Products decided to divest themselves of real estate ownership in a nation-wide sale-leaseback portfolio sale.

Capitalization rates for industrial assets have begun to level off, however they remain lower than those of office and retail product. One possible reason for the slowing of cap rate declines may be continued low industrial lease rates. With tenant demand significantly exceeding the supply of industrial space, lease rates should logically be rising quickly, but this is not happening in existing product. Lease rates have risen for new, build-to-suit facilities -- out of necessity to reflect escalating land and construction costs. In existing inventory, many landlords are regularly renewing tenants at rates lower than they might achieve in this market.

An Industrial Land Reserve?

Over the past six months politicians, planners and industrial users have begun to discuss the concept of an Industrial Land Reserve (ILR). Similar to the Agricultural Land Reserve, a government body would designate certain areas for industrial development only, thereby stopping the gradual but steady conversion of industrial land to other uses. If such a plan goes ahead, it may have some impact on investment property values. In situations where an investor purchased a property with a long term hope of residential or retail redevelopment, such an eventuality may be quashed which could reduce a property's value. In other situations, an ILR will likely have a minimal impact on values. It will ensure a larger supply of industrial land than might otherwise transpire, which could have a slight negative impact on value, but likely only theoretically. Geographic constraints will prevent there ever being an over-supply of industrial land in Greater Vancouver.

Other Investment Real Estate Trends and Transactions

Multi-residential trends

The multi-residential sector has seen the largest decline in capitalization rates over the past few years. Several properties sold in 2006 for yields in the 3.75% range -- below lending rates and bond rates. While the buyers likely have plans to improve the yields by raising rental rates, such capitalization rates remain noteworthy.

Low apartment cap rates provide evidence that investors place a higher premium on owning residential property versus commercial and industrial assets in Vancouver. The strong condominium market is another such indicator.

If the "invisible hands" of the market are to be believed, they may be telling us that Vancouver has more value as a place to live than a place to work or conduct business -- a resort city rather than a financial centre. To combat this trend, city land use policies, zoning and incentives to construct commercial buildings may be necessary. To assist developers of office or retail buildings, increasingly the city of Vancouver may need to consider promoting mixed-use projects with a more valuable residential component.



1945 Barclay Street sold at a 3.7% cap rate.

Bay Parkade Sale

TA Properties -- owners of 1111 West Georgia Street -- recently purchased The Bay Parkade Building for \$50 Million, a 3.5% cap rate on existing income. This is the most promising site for new office construction in Downtown Vancouver, particularly if the owner-developer can assemble some smaller neighbouring properties and can successfully petition the City of Vancouver to increase the allowable density from the current 5.0 FSR. Although any development is several years away, this is a site to watch.



Bay Parkade - Potential office development site sold for \$50 Million.

TGS REIT Purchase

Red Mile Acquisitions, a subsidiary of Great West Life Realty Advisors (GWLRA) purchased the TGS REIT in June. According to our sources, the gross value of the real estate portfolio is \$326.2 Million US or approximately \$370 Million Canadian. The estimated cap rate on the Portfolio is 7.1%. The REIT comprised properties in Greater Vancouver, Calgary and Edmonton as well as two office assets in Houston Texas. The Greater Vancouver properties involved were:

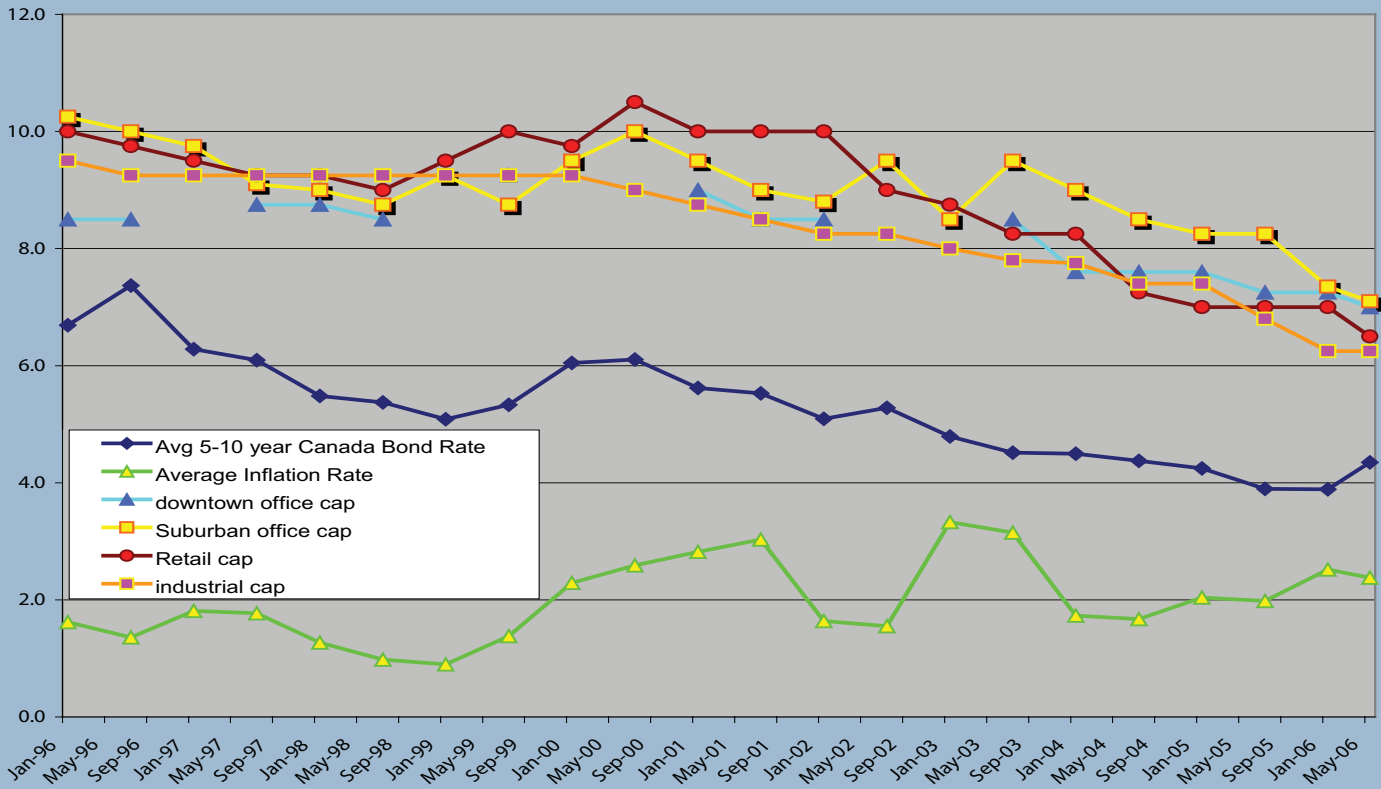
- » Country Club Centre (retail) - 75% share.
- » Poco Place (retail / office)
- » Commerce Court International Phases III and IV (office)
- » Riverside Heights (retail)
- » Valley Centre (retail)

Because we were unable to obtain assigned values for the individual buildings, they were not included in our statistics for mid year 2006.



Commerce Court International Phase III.
Was part of the TGS REIT Portfolio purchased by a subsidiary of Great West Life Realty Advisors.

Predictions Observations



For this issue we at Avison Young have decided not to make predictions. Instead, we present the facts above and a few observations below. We invite readers to decide for themselves what will happen in the real estate investment market over the next 6 to 12 months.

As the above graph shows, the spread between capitalization rates and the long-term bond rate has narrowed. Industrial real estate in Greater Vancouver offers less than a 200 basis points advantage over bonds. Well located and leased properties can sell at even lower spreads.

Historically, most investors have insisted on a spread between yields and the long term bond rate of approximately 300 to 400 basis points.

Yields are now below these long standing comfort levels. This could indicate that the end of the current real estate cycle is approaching -- or not.

Other factors may be influencing investor decisions. The local national and global economies contain uncertainties and investors may still see BC real estate as a secure holding. Or investors may be anticipating long term income growth potential in their recent purchases.

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