CI CANADIAN REIT ETF (TSX:RIT)

Commentary

JUNE 30, 2024

PERFORMANCE SUMMARY

For the quarter ended June 30, 2024, the CI Canadian REIT ETF returned -5.0% net of fees.

SHORT-TERM (AS AT 2024-06-30)

1 Mo %	3 Mo %	6 Mo %	YTD %	1 Y %
0.2	-5.0	-3.5	-3.5	-0.7

LONG-TERM (AS AT 2024-06-30)

2 Y %	3 Y %	5 Y %	10 Y %	15 Y %	20 Y %	S.I. %	Inception date
-0.2	-3.0	1.6	6.5	10.0		8.6	2004-11-15

Contributors to performance: Chartwell Retirement Residences, BSR REIT, and Ventas Inc. were the top individual contributors to fund performance in the quarter.

Detractors from performance: Flagship Communities, Granite REIT, and Interrent REIT were the top individual detractors to fund performance in the quarter.

MARKET SUMMARY AND PORTFOLIO ACTIVITY

The S&P 500 continued its strong performance in the second quarter of 2024 with a return of 4.3%, led once again by Nvidia. The S&P/TSX Composite Index declined by 0.5%. REITs generally underperformed the broader market, and Canadian REITs significantly lagged their U.S. counterparts, with the S&P/TSX Capped REIT Index declining 6.0% while the MSCI US REIT Index was essentially flat. Long bond yields rose slightly, with 10-year Canadian bond yields ending the quarter up 3 bps to 3.50% while U.S. 10-year bond yields climbed 20 bps to 4.40%.

During the quarter, the fund incrementally added to its positions in Crombie, CT REIT, Granite, Sienna, H&R, and Primaris. Also, during the quarter, the fund sold out of its position in Dream Office and trimmed Choice Properties, as well as Dream Industrial. The fund's top ten holdings as of June 30, 2024, included: Chartwell, Dream Industrial, Riocan, Granite, Boardwalk, Killam, CAP REIT, First Capital, Interrent, and Minto. The top ten holdings comprised approximately 51% of the fund.

SUBSECTOR REVIEW

We provide a brief overview of some of the underlying themes for the major Canadian real estate subsectors.

Multifamily

Operating and financial performance from Canadian multifamily portfolios was among the best in the REIT sector in Q1 2024, with occupancy, new lease spreads, and same-property NOI growth averaging 98%, 20%, and 9%, respectively. However, investor sentiment toward the subsector has soured in light of the Federal Government's plans to slow admissions of temporary foreign residents, which have accounted for a large share of Canada's recent population growth. While a slower pace of population growth may slow market rent growth somewhat, the accumulated housing deficit and much higher cost to own versus rent will likely keep vacancy rates low in most markets.

Recent data from Rentals.ca suggests that market rents have plateaued in the least affordable markets (Toronto and Vancouver) but continue to grow in relatively affordable markets with strong population growth (Nova Scotia and Alberta). The investment market remains quiet, with few institutional bids and a gap between buyer and seller pricing expectations. Several multifamily REITs, including CAP REIT, InterRent, and Minto, have sold lower quality assets with greater capex needs and used the proceeds to pay down higher interest rate debt or acquire newer assets. CAP REIT and Boardwalk REIT have both opportunistically acquired new build assets from merchant developers at values below replacement cost. Relative to the benchmark, the fund has a small overweight to multifamily.

Retail

Occupancy rates and blended leasing spreads for Canadian retail REITs averaged 96.8% and 12%, respectively, in Q1 2024, supported by population growth and limited available space. The anticipated failures of Rooms + Spaces and Bad Boy contributed to a dip in occupancy for some REITs during the quarter, although these vacancies are expected to be backfilled before year end at materially higher rents.

High replacement costs make retail development challenging at current market rents, which should continue to limit new supply and support market rent growth. Several Canadian retail REITs are de-levering their balance sheets through dispositions and completing development projects. SmartCentres is targeting $200-400M of dispositions of mostly density-related assets, RioCan expects to generate ~$800M of proceeds from condominium closings over the next two years, and FCR is targeting $1B of dispositions between 2024-2026. The fund has an underweight position in retail relative to the benchmark.

Industrial

New supply deliveries and an increase in space being marketed for sublease have added slack to Canada's industrial real estate market over the past year, with the national availability rate up 210 bps year-over-year to 4.2% as of Q2 2024, according to CBRE. Pricing power has marginally shifted in tenants' favour, with market-wide asking rents down 2.1% year-over-year—the first annual decline in 12 years. Looking forward, 23.5M sf of additional supply is set to be completed in H2 2024, of which only 37% is pre-leased, which could put further downward pressure on market rents in the near term. On a positive note, construction starts have been very limited over the past year, which should provide the market with some breathing room to absorb new supply. A wide gap between in-place and market rent should support strong earnings growth for Canadian industrial REITs over the next few years, even without further market rent growth. The fund is underweight relative to the benchmark.

Office

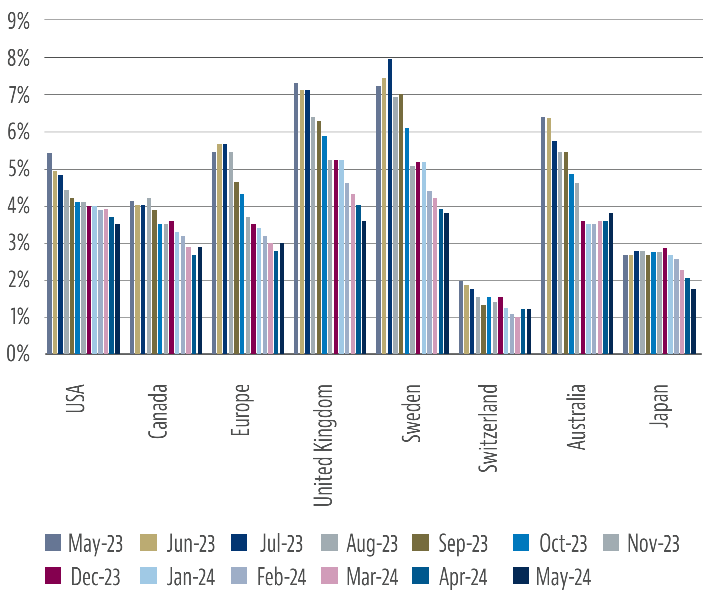
Canadian office market fundamentals appear to be getting "less bad", with the national downtown vacancy rate holding stable sequentially at 19.4%, according to CBRE, although this partly resulted from the completion of pre-leased development projects during the quarter. The gap in vacancy rates between Class A and B/C buildings increased to 850 bps in Q2 2024, according to CBRE, consistent with the trend of higher quality and newer assets outperforming the overall market. Office transaction activity remains muted, although Dream Office REIT is rumored to have reached an agreement to sell its 438 University Ave. property for $102M and Allied Properties has set a target to sell $200M of non-core assets this year. The fund is underweight the office sector.

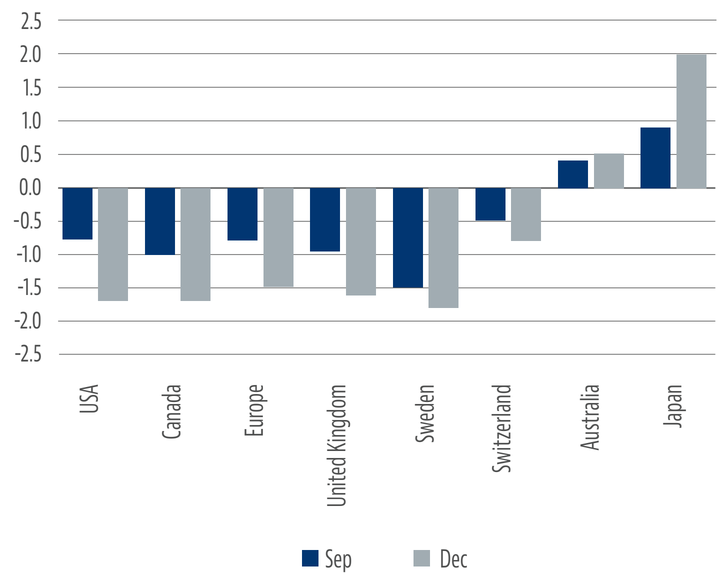
OUTLOOK AND POSITIONING

After being steady at 5% since the July 2023 meeting, the Canadian central bank cut its overnight lending rate by 25 bps in June to 4.75%. Canada joins the European and Swedish central banks with one cut thus far, while the Swiss central bank has cut twice. While the U.S. is yet to cut, Federal Reserve Chair Jerome Powell indicated in early July that the central bank was generally pleased with the resumption of the downward trend in inflation, which, if sustained, could open the door to lower rates, in line with the data-dependent nature of the Fed.

Core CPI measures, as depicted in the exhibit below, have been falling across many markets in the Western Hemisphere. As illustrated in the exhibit below, looking at market expectations based on futures and swap rates, further central bank rate cuts are expected to take place with nearly two cuts priced in for Canada by year end.

CORE CPI Y/Y %   **# RATE CUTS/HIKES PRICED IN BY MARKETS**

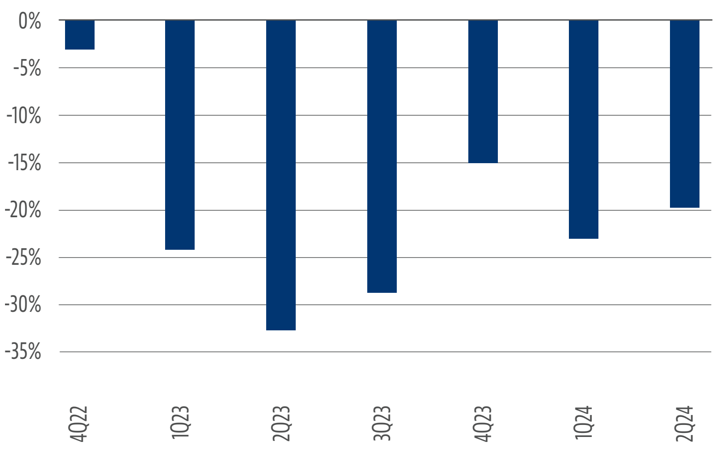




Source: Bloomberg and CI Global Asset Management as of May 31, 2024.

Transaction activity is still subdued; however, the rate of annual declines has moderated. On a trailing 12-month basis, according to CoStar data for the major subsectors, as shown in the exhibit below, transaction volume over the past quarter has declined approximately 19% year-over-year, compared with 33% a year ago. While the absolute level of interest rates caused the initial cost of capital reset and drop off in deal activity, we believe interest rate volatility has been a hindrance to transaction volume more recently. While the absolute level of interest rates is still high compared with a couple years ago, the volatility of changes in the 10-year yield has decreased, as shown below. Should interest rate moves be relatively range-bound, market participants should feel increasingly comfortable with their cost of capital. This should help cause a pick-up in deal activity and pricing discovery. Some signs of optimism in the capital markets are returning, with an uptick in equity deals, including the potential for the IPO of Lineage Logistics, North America's largest cold storage owner and operator, which is reportedly seeking a valuation of US$30 billion or more.

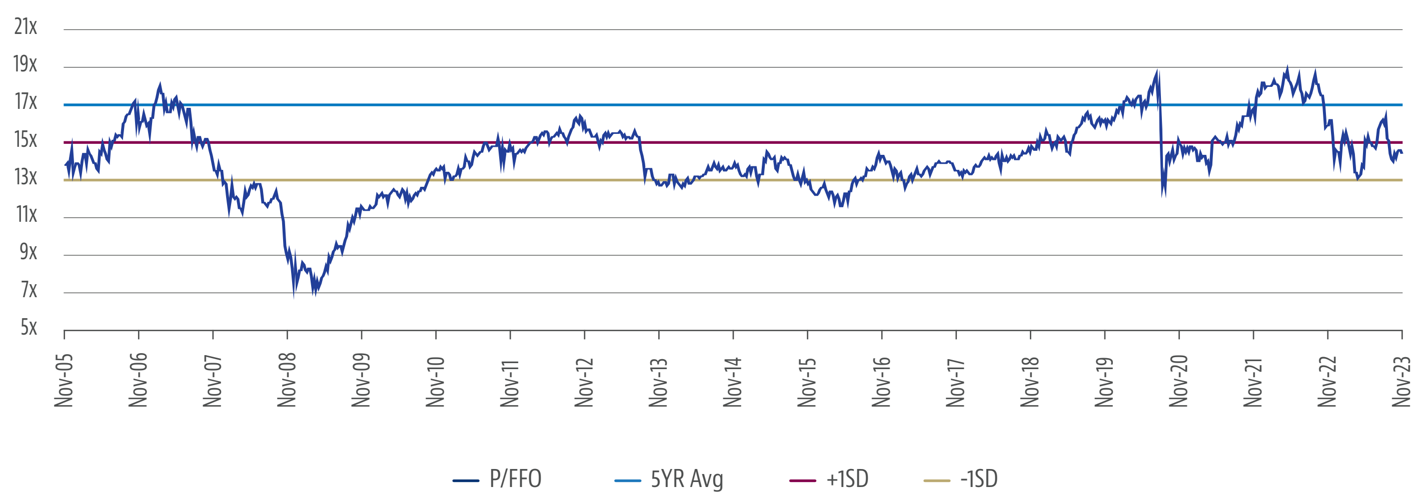
Y/Y CHANGE IN TRANSACTION VOLUME



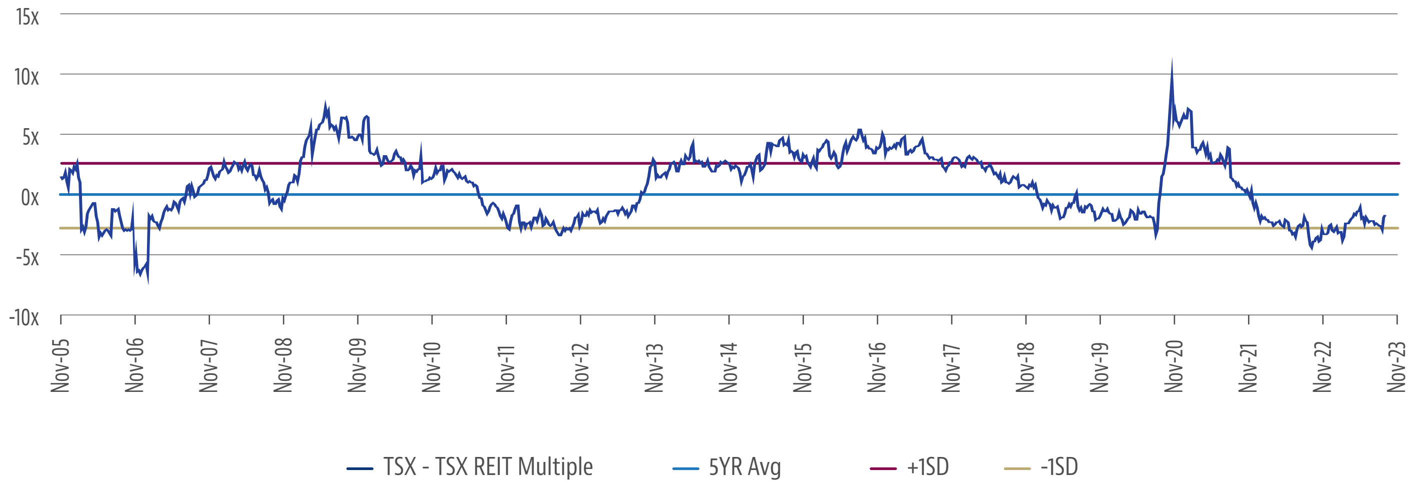
CA 10 YEAR 90 DAY VOLATILITY

Source: Bloomberg and CI Global Asset Management

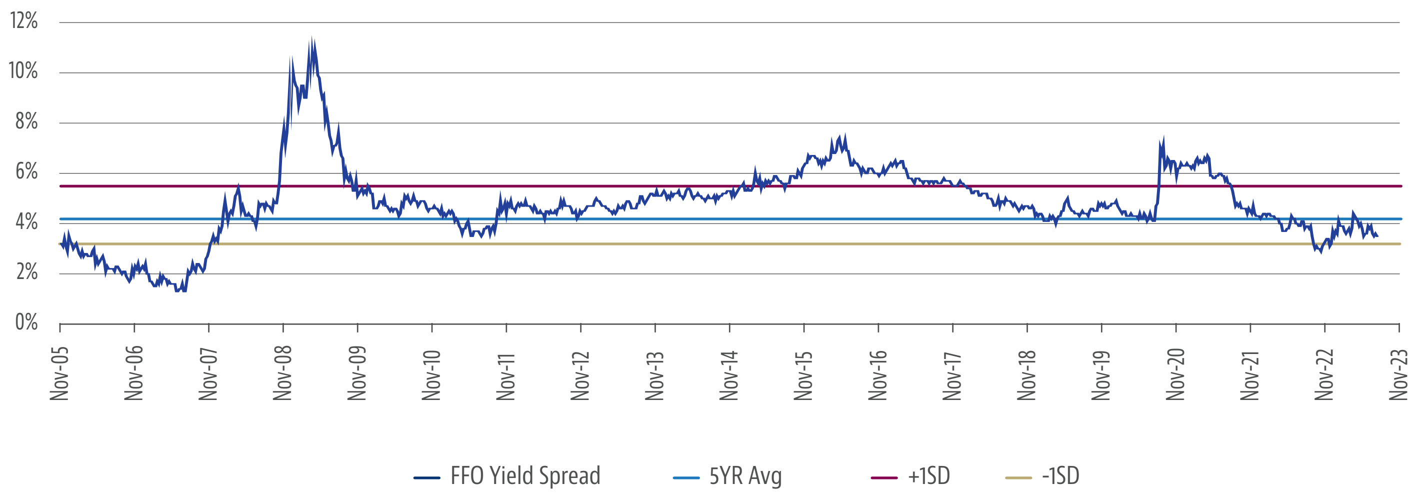
S&P/TSX CAPPED REIT INDEX P/FFO



S&P/TSX P/E SPREAD TO S&P/TSX CAPPED REIT INDEX



S&P/TSX CAPPED REIT FFO YIELD SPREAD TO 10 YEAR



Source: Bloomberg and CI Global Asset Management as of May 31, 2024.

We estimate that the S&P/TSX Capped REIT Index is trading at a 22% discount to NAV, though there is dispersion amongst subsectors. We believe the REITs in the fund are trading at a 24% discount as of the time of writing. Should this NAV gap close, combined with the distribution yield, an attractive total return could be achieved for unitholders. the REIT FFO yield (i.e., the inverse of the P/FFO multiple) and the 10-Year GOC Bond yield has averaged around 4.4%, compared with the recent observation of closer to 5%.

Figures in Canadian dollars unless otherwise stated

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