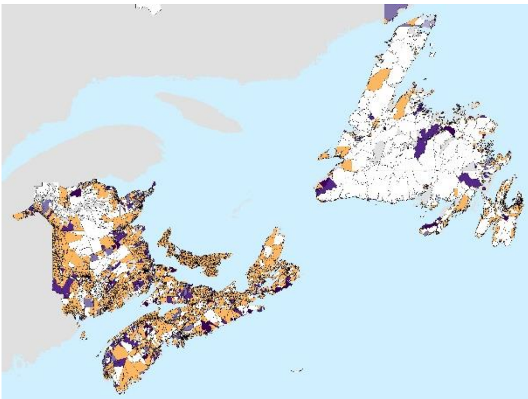
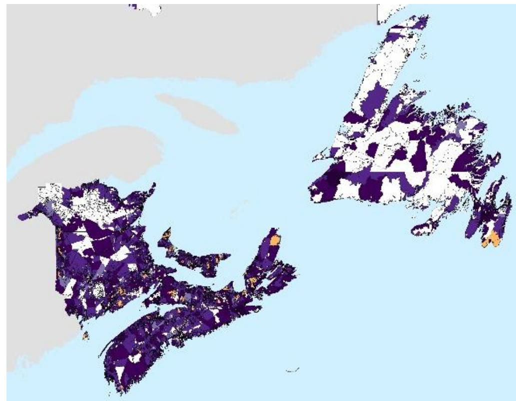
THE LAND THAT WOULD BE GREECE

2001 Demographic Map



Source: Statistics Canada 2001 Census

2011 Demographic Map



Source: Statistics Canada 2011 Census

Three years ago Facebook paid $1 billion for Instagram, an internet photo sharing site with 13 employees and no revenue. Last year they purchased WhatsApp, an instant messaging site with just $10 million in sales, for $22 billion. Airbnb a seven year old app that transforms homes into hotels is valued at $26 billion: Uber, age six, works the same magic with private cars and taxis and is worth $51 billion. (All figures are quoted in USD). Sometimes it is difficult to keep a grasp on reality … or even to determine what is reality. A single app is worth more than the real estate of any province in Atlantic Canada. Yet when its price collapses, as it surely will when it is eclipsed by an upstart competitor, the world will barely note its passing. Not so unfortunately with real estate: when markets tremble the impact echoes throughout the economy. Almost all real estate is leveraged, subject to a mortgage or line of credit, so a slide in property values quickly triggers a rout. This is what happened in 1990, an experience seared in the souls of those of us who experienced it. The problem then was exacerbated by the actions of the mortgage companies, particularly the banks, as they withdrew credit and compounded the problem by flooding the market with foreclosed properties at knock down prices. In business centres such as Halifax, landlords panicked and reduced office rents in a "rush to the bottom" as they attempted to snare the few tenants available in a recessionary market, glutted by overbuilding during the previous decade. Institutional investors meanwhile exited real estate markets with the same foresight they exhibited when entering them a few years earlier. The markets were flooded with commercial property for which there was no demand and prices collapsed … many industrial properties outside the major centres had a negative value. Businesses that relied on their real estate to finance operations faced the future with the same confidence as the priest who discovers there is no God. For many, the 1990's were a lost decade. Prices slowly started to recover in 1995 led by hotels/motels, apartments (1997), industrials (1997/1998), offices (1998) and retail (1999) but property values did not reach their pre-recession 1989 (current dollar) levels for another 10 to 15 years. Most of that recovery in value resulted from the fall in interest, and hence capitalisation rates, rather than an increase in net operating income. Ironically their saviour, the fall in interest rates, resulted from an effort to rescue the world from yet another financial crisis in 2007-2008, itself caused by the massive flood of money into real estate (a "Niagara of Capital") which started in 1997.

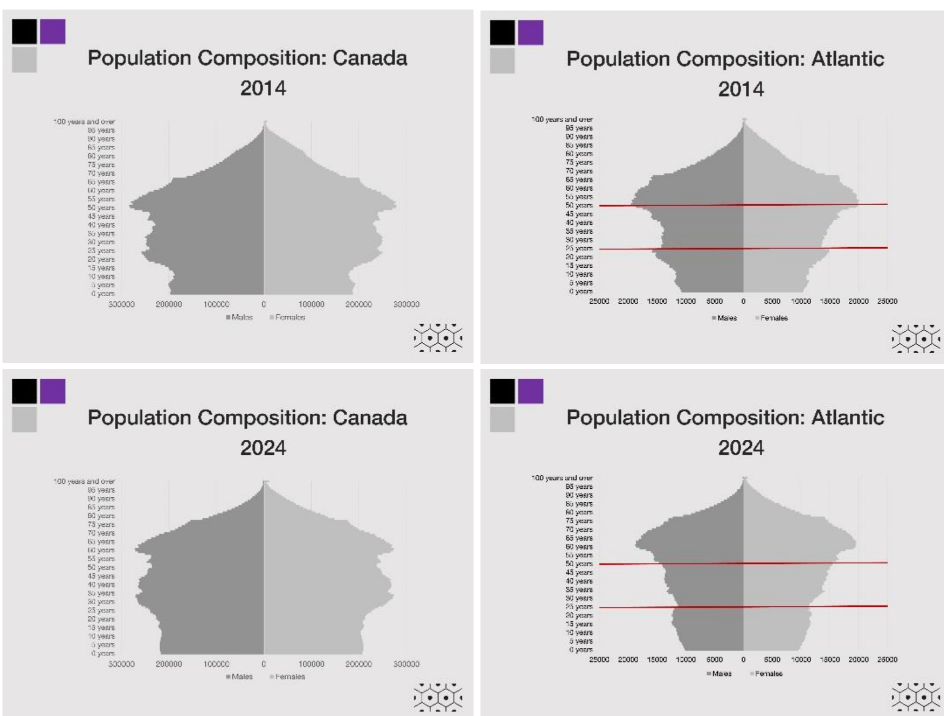
Money continues to pour into real estate in Atlantic Canada primarily from Real Estate Investment Trusts (REITS) but also from pension funds, public and private companies. Canada did not suffer the "Great Recession" which decimated many real estate markets in the United States during the period December 2007 to June 2009. However cheap financing has encouraged development and some markets are overbuilt. Eventually interest rates will rise and/or we will suffer a recession. In either case property values will fall and in the normal course of events, could be expected to fully recover again in time. However there are now two new kids on the block, technology and demographics, and this time history may **not** repeat itself.

Two Thirds of Everything

We first produced the Demographic Maps (see above) for a couple of seminars staged for the Federal Government in 2012. We published them in our 2013 Spring/Summer issue of Newsletter (Vol. 2 No. 96). They show the population distribution by dominant age group on a census tract basis, and dramatically illustrate the transformation of the Atlantic Region from a youthful (gold) to elderly (purple) populace. Whilst they certainly elicited concern from our civil service audiences they failed to set the world on fire.

The impact of our aging population found public voice in the government initiated “Report of the Nova Scotia Commission on Building our New Economy” (the “Ivany Report”), released in February 2014 to much initial public angst in that province … and apathy elsewhere despite the fact that the impact is region wide. It was probably optimistic to expect people to storm the barricades but the general lack of concern is astonishing. (When the T. Eaton Company closed their Moncton, NB catalogue warehouse in the 1970's and Canadian National’s locomotive repair shop closed in the 1980's, it galvanised that community in an effort that was truly impressive: a “can do” attitude that united the public and private sectors and produced the “Moncton miracle”). The Ivany Report called for bold action to unfetter the private sector by *“openly addressing attitudinal barriers to business development and entrepreneurship”* and lamented the reliance on government spending since *“it had failed in the past and was in any event no longer affordable”* … a tactful rebuke to politicians and civil servants for squandering hundreds of millions of our tax dollars on lunatic projects of self-aggrandisement. So far the Nova Scotia government’s timid attempts at change have engendered fierce opposition from public service unions grimly determined to appropriate the lifeboats for their members as the ship goes down … women and children be damned! Given the Report’s warning that Nova Scotia (and by extension the Atlantic Region) *“is today in the early stages of what may be a prolonged period of accelerating population loss and economic decline”* the unions’ attitude is as productive as re-arranging the deck chairs on the Titanic, albeit much more dangerous. The Report offers the hope that *“these negative prospects are not however, inevitable or irreversible”*. So what are the facts? What is the quantum of the challenge facing this Region and what will be the impact on real estate if we fail to meet it? As Dr. David Foot observed in his seminal book “Boom Bust & Echo”, published in 1996, demographics explain two thirds of everything. So that is where we start.

Atlantic Canada: It’s Different Here.



The baby boomer generation, almost one third of Canada’s population, is a disruptive force particularly in real estate. A direct result of the second world war, it is unique to Canada, the United States, Australia and New Zealand. Fuelled by economies that had “benefitted” from the war, and plenty of food, their populations expanded rapidly. As the boys returned home, family formation exploded in Canada resulting in a 10 million strong baby cohort born between 1947 and 1966 (the “Baby Boomers”). Part of the impetus came from increased family size: at the peak of the boom in 1959 the Canadian Fertility Rate had risen to 3.9, up from 2.6 during the intermediate pre-war years. (Fertility rate is the average number of children a woman aged 15 to 48 will have in her lifetime). The war however had provided women the opportunity to enter the workforce and with it relative financial and personal freedom. The two decades immediately after the war again tied them to the kitchen sink (metaphorically speaking) with an average of four children to raise. They were determined that their brief taste of freedom should benefit their daughters. Education, birth control and technology (washing machines, dryers, microwaves, etc.) were the keys necessary to unlock that opportunity. During the 1960's expanded educational opportunities for young women (regrettably sometimes resisted in areas such as engineering by men) presented the chance for a career outside the home, provided family formation was deferred until later in life. By happy coincidence the invention of the birth control pill (by a man) and its commercial introduction in Canada during the early 1960's gave women control over the timing and size of their families. By the end of the 1960's, their fertility rate had plunged to 2.0; below the 2.1 level required to sustain the population (in 2011, Stats Canada reported the following fertility rates: Canada 1.61, Newfoundland 1.45, Prince Edward Island 1.62, Nova Scotia 1.47, New Brunswick 1.54). However because of immigration, Canada's birth rate continued to increase. Immigrants tend to be in their 20s and 30s, family formation years, and have larger families. Canada's population had an annual growth rate of 2.7% in the 1950, 1.8% in the 1960's … post 2010 it is expected to average 0.9%.

The leading edge of the Baby Boomers reached age 65 in 2012: the trailing edge will reach retirement age in 2035. They comprise just under one third of the country's current population and are heavily invested in real estate rather than assets that stimulate the economy. Real estate accounted for 45% of Canada's total wealth in 2012, up from 32% in 1999, accordingly to Stephen Poloz, Governor of the Bank of Canada in a March 2014 address to the Halifax Chamber of Commerce. As the baby boomers transition from first time home owners (early to mid '30s) to upgraded/larger dwellings and/or country retreat owners (mid '40s), investors in other types of real estate directly or through investment vehicles such as REITs and pension plans (mid 30s through to late 50s), to sellers (≥ 60s), the supply and demand for real estate will fluctuate accordingly. Outside Atlantic Canada there is a broad base of purchasers supporting the Baby Boom cohort partly because the fertility rate is about 8% higher but largely because immigration has increased the birth rate (see graphs previous page). The impact of the Baby Boomers will thus be muted. This is **not** the case in Atlantic Canada … the Baby Boom cohort is supported by an ever dwindling base (see graphs previous page). As demand for the various types of real state first expands and stimulates supply, then contracts as the Baby Boom cohort proceeds through the next stage of their life cycle, there will be no cohort following them to fill the demand gap. The pattern will be echoed by the working age population … first creating demand for and supply of office, industrial, retail and institutional space … then contracting demand as they retire. However the supply of real estate generated by the Baby Boom demand will remain … unwashed and unloved, unless immigration replaces the contraction in demand.

Immigration

Discussing demographics in any of the major metropolitan areas in Atlantic Canada is rather like breaking wind at a party; unacceptable behaviour in polite company. Many metropolitan real estate markets are currently booming, fuelled by rural to urban migration. The Atlantic Region trails the country, only 55% of its population is urbanised compared to the national rate of 81%. However the dominant preference of aging Baby Boomers and coming of age Millennials - easy access to services, amenities, jobs, social life, healthcare - are exerting their influence. Urban migration, especially to major centres, has been picking up steam. Unless they are within commuting distance of the major urban centres, small towns, villages and rural communities face stagnation or decline. There is a rush to amalgamate, the better to stave off bankruptcy or meet increasingly stringent Federal standards for water supply and sewage disposal. This growing divide has fostered complacency in the major urban areas as they denude the countryside of its population to feed their prosperity. This is very apparent from the following table which documents the percentage of population growth due to interprovincial migration during the last 10 years:

CMA	% of Growth
St. John's	63%
Moncton	52%
+Fredericton	46%
*Charlottetown	41%
Halifax	32%
Saint John	19%

+York County (2001 - 2011).
*Queens County (2001 - 2011).

Almost two thirds of St. John's population growth over the past 10 years, and a third of Halifax's, is due to pilfering souls from elsewhere in the province. However, by its nature, rural to urban migration is a temporary phenomenon in provinces with declining populations. Eventually the rural areas will run out of people or the urban areas will meet the 80% threshold common to the remainder of Canada and the industrialised world.

The Ivany Report placed great emphasis on meeting population shortfalls by promoting immigration from outside the country, instancing Prince Edward Island's success as evidence that such was possible. *The Atlantic Region's working age population peaked in 2011. Stats Canada's Medium Growth Scenario predicts that it will lose 20% of its workforce during the period 2011 to 2036. Immigration to the Region would have to quadruple its 2001-2014 rate to combat that shortfall. This appears unlikely.*

Love Lasts Forever: Life is Less Permanent

	2001	2006	2011	2016	2021	2026	2031	2036
Newfoundland								
TOTAL POPULATION	522,046	510,584	525,037	521,500	511,500	499,200	483,200	464,000
WORKING AGE (20-64)	329,426	328,984	335,245	318,800	294,800	270,500	248,000	229,200
AGE 65 AND OVER	63,619	69,461	82,304	101,800	121,000	138,300	151,500	157,000
Prince Edward Island								
TOTAL POPULATION	136,665	137,865	144,038	149,400	156,700	163,800	170,500	176,100
WORKING AGE (20-64)	81,137	83,974	88,151	89,100	90,100	90,200	90,400	91,800
AGE 65 AND OVER	18,583	20,117	22,909	28,200	33,500	39,300	45,100	48,600
Nova Scotia								
TOTAL POPULATION	932,491	937,869	944,469	945,700	951,200	953,000	949,200	939,600
WORKING AGE (20-64)	576,249	588,856	594,552	577,700	556,300	525,500	498,400	483,400
AGE 65 AND OVER	126,579	137,138	153,871	184,300	215,300	248,400	275,600	286,500
New Brunswick								
TOTAL POPULATION	749,819	745,609	755,530	760,200	765,400	767,200	764,800	756,800
WORKING AGE (20-64)	466,817	470,243	474,298	461,600	443,000	419,400	398,600	385,600
AGE 65 AND OVER	100,105	107,656	122,294	147,900	174,900	201,700	224,200	233,500
Atlantic Canada								
TOTAL POPULATION	2,341,021	2,331,927	2,369,074	2,376,800	2,384,800	2,383,200	2,367,700	2,336,500
WORKING AGE (20-64)	1,453,629	1,472,057	1,492,246	1,447,200	1,384,200	1,305,600	1,235,400	1,190,000
AGE 65 AND OVER	308,886	334,372	381,378	462,200	544,700	627,700	696,400	725,600

Sources: Stats Canada: CARSEM Tables and Population Projections Medium Growth Scenario.

The table shows the actual Total, Working Age, and Retired, population for the census years 2001, 2006, 2011 together with Stats Canada's projections from 2016 to 2036 under their Medium Growth Scenario. The peak populations are shown in red. A more nuanced analysis by age group is required to measure the impact on each sub-market. Consideration of the impact of technology, for example in reducing the office space per worker, would also be required as would the impact of rural to urban migration, to translate the population trends into space demand. The age of the buildings in each sector and their ability to compete for a shrinking pool of occupiers is also a factor. It is therefore not possible to draw the direct conclusion that the anticipated 20% reduction in the workforce will translate into a similar loss in demand for office space: the impact will be greater. However actual vacancy will be mitigated since buildings will be taken out of service before the end of their physical life and renovation of existing stock will not occur. Investors will demand a higher return and values will decrease relative to similar investment opportunities elsewhere in the country: the yield gap will widen.

The biggest concern is the realisation, and ability of governments to adjust their budgets as their tax base shrinks. Their salary and pension commitments already exceed those of the private sector on a per capita employee basis … and the latter's capability and willingness to pay for them. For the major municipalities these are the good times, the honeymoon before harsh reality strikes. Yet as our Market Surveys show (see Killing The Goose That Laid The Golden Egg) municipalities relentlessly continue to increase property taxes, effectively confiscating an increasing share of the Gross Rent and forcing the Net Absolute Rent per square foot downwards. Since Market Value is a function of Net Operating Income (Net Absolute Rent minus Vacancy) divided by the Overall Capitalisation Rate, the municipalities are reducing Market Value and appropriating a portion of the property owner's equity to fund their operations.

Summary

Real estate markets in Atlantic Canada face unique challenges which are not as yet recognised by investors or the municipalities.