QUESTION & ANSWER

Investors **Real Property Fund**

Investors Real Property Fund is unique among Canadian mutual funds due to its direct ownership of commercial real estate.

For a perspective on the Fund's performance and outlook, we spoke with **Graham Zakaluk**, Vice President and Portfolio Manager of the Fund.

Q | Could you explain what goes into valuing commercial real estate?

A | Investors Real Property Fund buys commercial real estate for investment purposes, the total return on which comes from both rental income and changes in market value. Property values are determined by an independent appraiser at least annually, and depend upon general economic conditions, local real estate markets, the financial strength and stability of tenants' businesses, the supply and demand of leased premises, competition from other available premises, and interest rates. Rental income yield is valued similar to income from other securities. Like a bond's yield, it is lower the higher the price paid for the property. High quality real estate commands a high price and so tends to have a lower income yield.

Q | Why has the performance of the Fund been trending lower the last few years?

A | Many parts of the country are seeing commercial property values hit by declining rental income as the economy continues to struggle. Also high quality property, especially in Toronto and Vancouver, is in high demand and short supply. As the Fund improves the quality of the buildings it owns we are forced to pay higher prices which results in a lower yield. Furthermore, the low interest rate environment is challenging as about 30% of the assets are usually invested in short term debt.

Last year the Fund's return was virtually flat. The most significant challenges related to certain properties in Alberta, where 30% of the Fund's real estate is located. About 10% of our assets are invested in office buildings in Calgary, where market values have been declining due to depressed rental rates resulting from the struggles in the oil industry. Our retail and industrial properties in Alberta, including all our holdings in Edmonton, seem better insulated from what is affecting the office buildings.

Q | Does the Fund have exposure to areas where commercial real estate is doing well?

A | The Fund invests in all major Canadian cities. But outside of Vancouver and the Greater Toronto Area (GTA), commercial real estate is not performing as well, a reflection of slower growth in the Canadian economy. The Fund's properties in BC continue to see strong appreciation along with stable occupancy and income. In the GTA the Fund owns mainly suburban properties which have not performed as well as those located in or close to downtown Toronto.

We continue to look for opportunities to increase the overall quality of the Fund's real estate in all markets, but the challenge in Toronto and Vancouver is that properties do not become available very often and when they do, they attract high bids which drives down yields. Bidding wars can move prices to levels where properties may no longer be in the best interests of our unit holders.

Q | Is it fair to compare the Fund's performance to the strength of residential real estate?

A | The location of properties is important for both, but that is where the similarities typically end. Commercial real estate is business-focused: leased by businesses and used to achieve specific business objectives. Its return is comprised of rental income and changes in market value.

Residential property on the other hand addresses wants and needs of homeowners and is used primarily for family dwellings. Valuing residential real estate is not as cut-and-dried as there are often emotional elements driving prices.

Q | The Fund's cash position has been quite high in the past. Are there plans to reduce it?

A | The Fund manages its short-term investments in order to provide sufficient liquidity to unit holders, fund property acquisitions, and engage in development opportunities. A high level of liquidity is necessary due to the illiquid nature of real estate. We need to look no further than 2008 when property values became quite stressed, yet at no time was it necessary to close the Fund for redemptions. Recently we have put a large amount of cash to work and the Fund's allocation to real-estate is the highest it's been in some time, almost 78%.

Q | **What should we expect from this fund moving forward?**

A | We continue our efforts to improve the Fund's overall quality of holdings. Also, the Fund's rental income is expected to remain stable next year as we finalize the purchase of several new properties. Contributing to this stability is the Fund's 94% occupancy rate, which, while already high, we'd like to see higher. To this end we have targeted action plans to retain current tenants, attract new ones, and attain increasing rental rates.

To address the limited number of high quality properties for sale, a few years ago we began building our own. This involves buying land in prime locations and hiring developers to build the structures. Currently 2.6% of the Fund's assets are allocated to property development.

The value of commercial real estate is dependent on many uncertain factors. But we know that if a property's occupancy level, tenant rental rates, and local economic conditions remain the same or improve, then the property's market value will remain the same or increase. Our portfolio is well diversified across geographies and property types which helps insulate it against changes to any specific business, industry, or region. With a long term view, investors in this Fund will capture the benefits of directly investing in real estate from both an asset allocation and risk/return perspective.

Q | **What are the key benefits of investing in this Fund?**

A | Firstly, it gives investors a unique opportunity to invest in office buildings, shopping centers and industrial properties through a mutual fund structure. The Fund also adds stability to a portfolio. Investors often compare the Fund to exchange-traded Real Estate Income Trusts (REITs), which may offer the chance of higher returns but come with higher volatility. So this Fund is ideal for investors looking for high levels of capital stability and a consistent level of income.

A **final word**

With real estate, it's common for lulls in performance like this to occur. Given the economic challenges in parts of the country, there remains the possibility that rental rates and values of some properties may be further affected. In times like these, it's important for investors to remain patient as the cycle can change at any time.

Because of the uncertainties associated with commercial real estate, it is recommended that clients not invest more than 10% of their assets in the Fund.