A PORTFOLIO MANAGER'S PERSPECTIVE

Global real estate securities

WEALTH MATTERS

As part of our May 9, 2018 Wealth Matters webcast, we heard from ***Chip McKinley****, Senior Vice-President and* ***Matt Pace****, Senior Vice-President, Director of Client Relationship Management from Cohen & Steers Inc. Their presentation provided an overview of the firm's unique expertise as a global real estate manager. Chip also discussed the team's outlook for the real estate investment landscape and why the current macroeconomic environment is leading to attractive valuations for listed real estate.*

Cohen & Steers

- Cohen & Steers is an asset manager specializing in listed real estate with a focus on liquid real assets and other income solutions
- It is the largest active manager of real estate securities globally and has one of the most tenured teams dedicated to the sector
- Managers concentrate on asset classes that they believe are inherently inefficient. They also believe bottom-up fundamental research applied to a universe of inefficient assets can generate significant alpha over time.

Investment landscape

- The strong global macroeconomic landscape continues to be a positive environment for operating fundamentals for virtually all kinds of commercial real estate
    - We expect the global economy will grow approximately 3.8% in 2018, an acceleration from 3.5% last year
- This strengthening has led to increased inflation, meaning central banks will likely become more aggressive in raising interest rates and withdrawing stimulus, but this is not a significant concern as it is coupled with economic growth
- For the last five years, real estate investment trusts (REITs) have generally underperformed equities despite strong fundamentals
- We now see some attractive valuations and our outlook for listed real estate is very compelling relative to equities and fixed income
- Real estate correlations and volatility are at 20-year lows, meaning the market is distinguishing more and more between "good" and "bad" companies
    - This is happening across every region in which we invest globally, leading to tremendous opportunities for overvalued markets to accelerate into undervalued markets.

Real estate securities outlook

North America

- Demand broadly remains in excess of supply in the U.S. and Canada, but there are supply increases in some markets/sectors
- Retail properties are suffering from e-commerce disruptions and department store obsolescence
    - However, this disruption is supporting properties in the digital ecosystem (i.e. data centres, cell towers, and logistics and warehouse space) through increased tenant demand and cash flow growth
- Mergers and acquisitions, and privatizations are expected to accelerate with companies trading at wide discounts to net asset value
- Many of these trends are happening globally as well.

Asia Pacific

- Tokyo has seen strong expansion with one of the tightest occupancy markets in the world
- Hong Kong retail and office fundamentals are being supported by steady growth in demand from local residents, and mainland consumers and businesses
- Australian retail landlords are preparing for the pending Amazon launch at a time of slowing consumer spending
    - This is something we anticipated in early 2017 and led us to exit all of our retail mall exposure in the country.

Europe

- Steady economic and job growth are driving consumer activity, while business capital expenditure is increasing
- A decelerating U.K. economy and Brexit-induced job dislocation are hurting demand for core retail/office/residential properties
    - However, we do see some positive opportunities, particularly in properties tied to the digital ecosystem.

Equity earnings multiples

- Earnings multiples have expanded tremendously over the last six years, whereas REITs have been very steady cashflow producers, resulting in a wide spread between the two both in the U.S. and globally
- If earnings growth in broad equities weakens, investors could start looking for reasonably priced or underpriced companies that can still generate cashflow.

A WEALTH PLANNING PERSPECTIVE

After the dust settles: Income sprinkling and passive income

WEALTH MATTERS

There has been considerable uncertainty surrounding the tax on split income (TOSI) and passive income rules for private corporations since the federal government announced proposed changes last summer. During the Wealth Matters webcast, Chris Thomson and Melissa Marshall, Regional Vice-Presidents, Wealth Planning at Assante Private Client, a division of CI Private Counsel LP, clarified where these rules stand today, as well as some pitfalls and tax-planning opportunities for Canadian business owners.

TOSI version 3.0

Previous rules on split income allowed business owners to pay dividends to adult shareholders and "reasonable" salaries to lower-taxed family members to share tax burdens. The proposed TOSI rules set out to limit or eliminate this strategy, and as a result, split income is now taxed at the highest marginal tax rate and includes additional forms of income. However, there are some exemptions to the new rules including:

- "Bright line exemptions" or scenarios where the income recipient is: The business owner's spouse and the business owner is over the age of 65; over 17 and made regular and continuous labour contributions in the current year or any of the previous five years; or over 25 and owns 10% or more of the votes and value of the corporation
  - If a "bright line exemption" is not met, can consider if the split income results in a "reasonable return"
- Capital gains that qualify for the lifetime capital gains exemption
- Inherited property where the deceased met any of the exemptions
- Property that is acquired as a result of a marriage breakdown or common-law partnership.

TOSI planning strategies

- If the client is nearing retirement, consider delaying income-sprinkling dividends until after age 65
- Review corporate structures, such as issuing shareholders different class shares or increasing family-member share ownership to 10%
- Document and record family-member involvement in the business as you would other employees… and more!

Passive income

The 2018 federal budget proposed to gradually reduce access to the small business deduction by reducing the $500,000 limit to access the lower tax rate by $5 for every $1 of passive income that a corporation and any of its associated corporations earned in excess of $50,000. The small business limit will be reduced to zero if the corporation and its associated corporations together earn $150,000 or more in passive income. It should be noted these changes do not result in an increase in overall tax, but rather result in the elimination of tax deferral.

The budget also outlined the impact to refunds from a corporation's refundable dividend tax on hand (RDTOH) account. Previously, business owners could defer taxes by obtaining a full refund of their refundable tax using lower-rate eligible dividends. Now, the rules will require two separate RDTOH accounts to track the different types of income and will eliminate the refund when eligible dividends are paid. Business owners will have to choose between paying higher-rate non-eligible dividends or leave the refundable tax from eligible dividends with the government and limit tax-deferral opportunities.

Passive income planning strategies

- Manage investment income on an annual basis
- Trigger gains in years with lower income and avoid triggering gains in years with higher income where possible
- Reduce investment income with life insurance, an Individual Pension Plan or other appropriate expenses.

Your advisor is available to help

If you have questions about how these new rules could impact you and your business, talk to your advisor for assistance.