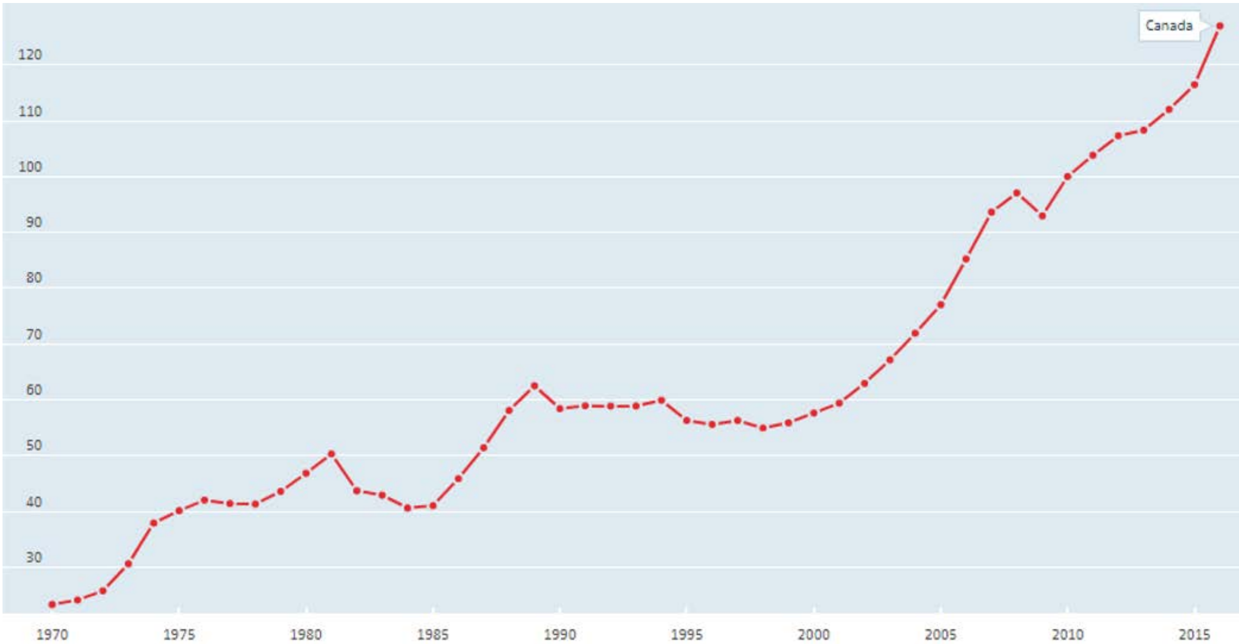
CENTURION ASSET MANAGEMENT INC

Centurion Update

Moves by the Province of Ontario to cool the real estate market, and further tightening of macroprudential policies to restrict the market seem to be having some effect. Price growth has abated and the frenzied market activity slowed. This is a good thing. It is still early to say how this will play out but with no major increases in rates expected, I anticipate the market to just cool down and settle for an extended period. Some downside on houses and condos is likely, which is a good thing as well. We are seeing though, that rental demand has exploded higher as our call centre books north of 120 appointments per day for apartment viewings of which there are only a few available units for rent. Market vacancy rates have collapsed in many Ontario markets as it seems tenants are either choosing to stay as renters or have no other choice but to do so. Resident turnover rates, which, historically, have been in the 25-35% range for the industry, have declined substantially as residents are now "locked in" to their units as there are few apartments to rent so they cannot move. Residents who may have been looking to buy cannot afford to do so and rents on turnover are increasing rapidly meaning if they do choose to move, they would likely be paying much higher rents. Due to this rapid build up of rental demand, market rental rates in Ontario have increased materially.

If we look at home prices versus the cost of renting, we see that home prices relative to rents have trended higher for nearly 37 years (i.e., home prices have risen faster than rents). Much of these gains have occurred since about the year 2000, with home prices rising at double the rate that rents have (see Figure A below). We believe that due to the current elevated levels of house prices and increasing macroprudential controls recently put in place, in addition to those likely coming, we will see this ratio turn the corner and rents will rise significantly relative to home prices over the next few years (i.e., this ratio will decline). This is what happened in the US after the global financial crisis. Homeowners lost their homes, fewer could qualify to buy homes, and a generation became scarred by fear of real estate losses. The desire to own declined. Rental demand went up substantially and rents followed. We are confident that we are at a major inflection point, and that rental demand and rents are set to surge and that this ratio will decline into a more "normal" range in the years to come.

Figure A: Canadian Price to Rent Ratio (Source: OECD)



The strong demand for rental apartment investments meant that we have had a difficult time finding attractive acquisitions that meet our yield requirements. Market activity is very strong, and we are seeing a lot of deal flow but very little that we will buy at the prices being asked. As with the past year or so, debt investment opportunities seem to be much more attractive on a total return as well as risk adjusted basis than buying apartments right now. That is where much of our attention lies.

Loan demand has been robust and we have seen a number of very attractive opportunities. With all the noise about the real estate market, a number of lenders have pulled back from funding commitments which has given us some high quality lending opportunities. A squeeze higher in interest rates in the type of loans that we do seems to be in progress. We are using this opportunity to move down the risk curve, to pick up deals that we would not have won previously due to our pricing model. We anticipate robust portfolio growth through the rest of the year. The portfolio continues to perform with no expected losses.

In our corporate debt business in the Centurion Financial Trust (CFiT), we are also seeing excellent deal flow. We have a few transactions which we are close on that we hope to fund in the next few months and believe that this portfolio will grow significantly.

Of our three funds, the Centurion Apartment REIT, Centurion Real Estate Opportunities Trust, and CFiT, only CFiT remains open to investment and it seems that for the foreseeable future, our debt investments are what will be growing and where we will be able to accept funds from investors.

Greg Romundt