Canadian Real Estate
Market Update

Q1 2021

Canadian Economic Overview

As populations get inoculated and larger parts of the economy reopen, the powerful revitalization in confidence should unleash massive amounts of pent-up demand, particularly as savings remain extraordinarily elevated around the world. While the factory sector has demonstrated a growing resilience during the pandemic, the resumption in services sector activity should make way for more broad economic gains, emboldening the call for a rapid recovery in 2021.

- The global economic outlook has brightened considerably given the emergence of several viable vaccines to repress the pandemic, which should create the needed conditions for a return to normalcy in 2021
- Canadian economy has already recovered a substantial portion of lost real GDP as it rebounded 8.9% and 2.3% in Q3 and Q4 2020,[1] respectively
- As vaccinations slowly but surely ramp-up, restrictions are eased, and the reopening progresses, economic activity should pick-up markedly
- Persistent strength in the commodity markets should also add to Canada's recovery narrative in the coming year
- There are expectations that Canada's Consumer Price Index ("CPI") could reach a recent high due to base effects from the depressed reading this time last year
- Higher inflation may also be sustained, something that Tiff Macklem, Governor of the Bank of Canada has indicated
- The bond market appears to be expecting much higher growth and inflation, discounted through the relentless march of long-term Government of Canada ("GOC") bond yields, which have increased over 100 basis points ("bps") since August 2020 when the 10-Year GOC yielded just 0.50%[2]
- Although the bond market is discounting higher future growth and inflation, there are questions if a highly indebted global economy can support higher interest rates

Canadian Real Estate Outlook

Industrial[3]

> Canada's industrial market looks to be continuing its record run into 2021, with strong leasing that has led to a further compression of the national availability rate to 2.9% (-0.4% Q/Q)

> National net absorption totaled 10.4 million square feet, which ranks as one of the largest quarterly figures in Canadian history

> If sustained, this level of absorption would see several Canadian cities runout of logistics space before year's end

> Development has ramped up to 26.2 million square feet under construction; however, this only represents a mere 1.4% of national inventory, according to CBRE

Summary

With many institutional investors experiencing pent-up capital deployment, it is likely that the industrial sector, which no doubt has the strongest national fundamentals, will receive the dominant share of investment volumes. The Manager's Target Markets Model ("TMM") forecasts continued robust growth ahead for this sector. Resultingly, capital flows will likely continue to push valuations higher for warehouse and distribution centres suited for last mile uses, as well as industrial land for future development.

1. Statscan
2. Bank of Canada
3. CBRE Q1 2021 MarketView

Office[4]

- Canada's national office market saw an increase in its vacancy rate to 13.2% (+1.2% Q/Q) – broken down further into downtown class 'A' at 11.9% (+1.2% Q/Q) and suburban at 15.0% (+1.1% Q/Q)
- Sublease additions in Q1 2021 totaled 1.8 million square feet, down 43.8% from the 3.3 million added in Q4 2020 – a remarkable improvement
- Of the 30 largest downtown markets in the US and Canada, four of the five tightest are Canadian: Vancouver (6.2%), Toronto (9.1%), Montreal (10.6%), and Ottawa (10.7%)

Summary

Continued structural changes to office space requirements resulting from the COVID-19 pandemic remains; however, it is now more likely that employers will adapt more flexible work from home ("WFH") options for employees. Future demand is anticipated to improve as, according to Oxford Economics, Canada's employment growth over 2021-25 will lead the G7, doubling its average.[5] The short-term office picture may remain challenged, but the longer-term outlook appears to be improving with leasing interest moving in the right direction.

Retail

- Given the modest pace of demand, retail vacancies continue to rise, although not as sharply as south of the border
- Enclosed retail such as malls and power centres are seeing the most difficulty given closure notices and tenant failures, while essential-based retail including grocery-anchored stores are performing better
- As restaurants across Canada closed their doors in the wake of the pandemic, new delivery-only endeavors also gained market share while ghost kitchens expanded to meet a growing demand for food delivery[6]

Summary

According to Statista, e-commerce sales in Canada are expected to grow 6.4% annualized from December 2020 to December 2024,[7] more than twice that of total retail sales, which should continue to cannibalize the bricks and mortar segment. The fundamentals of the discretionary retail sector remain challenged in the short-term, but future repurposing for multi-residential densification or last-mile fulfillment centres is a trend to watch. In the intermediate-term, grocery-anchored defensive retail should continue to outperform.

Multi-Residential[8]

- According to CMHC's 2020 Rental Market Report, among Canada's census metropolitan areas ("CMAs"), 6.1% or 116,929 apartment units were in arrears out of a total universe of 1,912,290 units
- This represented approximately $150 million in total rent in arrears or 0.59% of total expected rent
- The survey suggests arrears were primarily apartment units with lower rents
- National vacancy rate rose to 3.8% end of year 2020 (+1.5% Y/Y)

Summary

With a marked improvement of Canada's national unemployment rate to 7.5% from the May 2020 peak of 13.7%,[9] as well as the Federal Government's commitment to provide monetary aid, this segment is likely to remain defensive in the short-term. However, the long-term prospects for this property type appear to be strong as lower interest rates for longer may continue to fuel higher Canadian home prices, leaving some with no choice but to rent, especially for newcomers. Canada is still expecting to welcome over 400,000 immigrants this year, according to its 2021-2023 Immigration Levels Plan.[10]

Maestria Rooftop

4. CBRE Q1 2021 MarketView
5. Oxford Economics
6. CoStar – Retail Report
7. Statista
8. CMHC
9. Statscan
10. Government of Canada

LOOKING AHEAD

- Despite all the changes arising in the commercial real estate market today due to the pandemic uncertainty, the broad fundamentals underpinning the asset class remain unchanged – the land that is capable of housing the economy is finite and increasingly scarce relative to intangible currency and financial assets, which can be created at will
- This dynamic is likely to accelerate the trend toward more alternatives, particularly "real assets" in pension plan portfolios
- Future supply also remains relatively disciplined against past cycles; therefore, should be met or exceeded by demand
- Once travel restrictions are lifted and immigration resumes, Canada is likely to continue to attract more immigrants per year in the next decade than it has in the 2010s
- In a world where growth will be difficult to come by due to aging demographics, Canada has an immigration tailwind that should help grow its population faster than other nations, leading to increased demand for Canadian real estate
- Canadian real estate likely to continue attracting foreign investor dollars and increasing percentage of pension plan allocations, which will bode well for values

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