Canadian Real Estate
Market Update

Q2 2021

FIERA REAL ESTATE

Canadian Economic Overview

The Bank of Canada is maintaining its extraordinary forward guidance on the path for the overnight rate. According to the Bank of Canada's April 2021 projection, the expected timeline for a policy interest rate hike off the effective lower bound is expected sometime in the second half of 2022.[6] The Manager will continue to monitor inflation metrics that can have major positive implications for future real estate rents and values.

- The global economic outlook continues to normalize and improve as more economies begin reopening
- Although behind on its reopening relative to other major economies such as the US, China and the Eurozone, Canada produced a strong Q1 2021 GDP growth of 1.4% (or 5.6% annualized)[1]
- The growth was largely fueled by higher prices of exported products, favourable mortgage rates, continued government transfers to households and businesses, and an improved labour market ultimately boosting consumer spending[2]
- These factors also boosted the demand for housing investment, while rising input costs heightened construction costs
- The national unemployment rate now stands at 8.2% in May 2021 after peaking last May at 13.7%
- Canadian retail sales recovered 56.7% year over year ("Y/Y") in April 2021, after dropping to -31.0% Y/Y in April 2020 and industrial production showed a 1.8% Y/Y reading in March 2021 – the first positive monthly sign since the pandemic began[3]
- Canada's headline inflation rate in May 2021, as measured by the consumer price index ("CPI"), reached its highest reading in a decade, increasing 3.6% from a year ago[4]
- Base effects in categories such as energy were largely responsible for the price growth. Even still, factoring those out, the core CPI rate was 2.8% Y/Y – its highest level since March 2003[5]
- The current metric is elevated and looks to persist for some time due to central bank balance sheet expansion as response to the pandemic

Canadian Real Estate Outlook

Office[7]

> Canada's national office market saw an increase in its vacancy rate to 15.3% (+0.7% quarter over quarter ("Q/Q")) – broken down further into downtown at 14.9% (+0.5% Q/Q) and suburban at 15.7% (+0.8% Q/Q)

> Reduction in sublease space and a meaningful pick-up in touring activity are key themes highlighted last quarter, which are persisting and making the case for an office market improvement

Summary

Continued structural changes to office space requirements resulting from the COVID-19 pandemic remain; 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; however, national under construction figures are currently 18.1 million square feet (representing 3.8% of existing national inventory), which may remain a challenge for the market to digest in the near-term.

1. Statistics Canada
2. Statistics Canada
3. Koyfin
4. Statistics Canada
5. Statistics Canada
6. Bank of Canada
7. CBRE Q2 2021 MarketView

Industrial[8]

- Canada's national industrial market is approaching a dangerous shortage of space for tenants
- If 10.4 million square feet was a head turner for Q1 2021, according to CBRE, Q2 2021 national net absorption was 16.0 million square feet (+54% Q/Q)
- High demand levels, contracting availability rates and rising rents are present in every Canadian industrial market
- Every single Canadian market saw availability rate contractions this quarter and all markets outside of the Prairies have availability rates of 3.0% or less, including the three largest markets: Toronto (1.2%), Vancouver (1.1%), and Montreal (1.4%)

Summary

With national rents at $9.82 per square foot and only 27.2 million square feet under construction (representing only 1.4% of existing national inventory), it appears that this situation will likely be resolved with much higher rents. Accordingly, the Manager expects robust growth to continue in this sector.

Retail

- The Canadian bricks and mortar retail sector continues to adapt and cope with the ongoing effects of the pandemic
- Landlords of enclosed centers are shifting to percentage rent deals with shorter terms
- Total Canadian retail sales are now about 8.5% above pre-pandemic levels, which is obviously a good news story[9]
- Canadian households managed to save about $180 billion in 2020, or roughly $5,800 per Canadian adult
- Another key story to mention regarding recent trends is that monthly retail e-commerce sales fell by 5.7% in February 2021[10]
- This reflects the fact that more bricks and mortar stores were allowed to open their doors to in-person shopping during the month
- This by no means suggests that e-commerce market share will reverse course as online shopping remains up at a striking 92% Y/Y in February 2021[11]

Summary

Long-term, the Manager expects that e-commerce sales growth will continue to outpace bricks and mortar sales and will be very selective by considering only grocery or drug-anchored centres in strategic locations primed for re-development.

Picture: Maestria - Montreal - FRE Opportunity Fund II - Multi-Residential

8. CBRE Q2 2021 MarketView
9. CoStar – Retail Report
10. JLL Retail Outlook
11. CoStar – Retail Report

Multi-Residential

- Of 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 – represented approximately $150 million in total rent in arrears or 0.6% of total expected rent[12]
- Interestingly, Toronto CMA recorded the highest share of rent arrears in Canada. It also recorded about 11.0% of all units reporting arrears in rent payments
- The pandemic disproportionately affected lower paid workers in the hospitality and service industries
- Rental market demand would have been weaker if not for the unprecedented levels of government financial support such as the Canada Emergency Response Benefit, Canada Recovery Benefit, and Employment Insurance benefits
- These programs allowed households whose incomes were adversely impacted by the pandemic to pay their rent and remain in their units
- The overall CMAs vacancy rate rose to 3.2% end of year 2020 (+1.2% Y/Y), but rental rates grew 3.6% Y/Y to an average of $1,165 for 2-bedroom apartments[13]

Summary

The long-term prospects for this property type appear to be strong as lower interest rates for longer continue to fuel higher Canadian home prices leading to a large cost of ownership versus rental gap. According to RBC Economics, recognizing that it needed to get immigration back on track, Canada was one of the few developed countries to increase immigration targets at the height of the pandemic. The new targets (400,000-plus newcomers in each of the next three years) would make up for 2020's shortfall.[14]

Picture: Maestria - Montreal
- FRE Opportunity Fund II - Multi-Residential

12. CMHC 2020 Rental Market Report
13. CMHC 2020 Rental Market Report
14. RBC Economics

LOOKING AHEAD

- Rising vaccination rates and receding caseloads have spurred many provincial governments to release reopening plans and a roadmap for how and when restrictions may be scaled back, which suggests that there is a light at the end of the tunnel and that the worst may finally be behind us
- Consistent with Fiera Real Estate's view, this has set the stage for the Canadian economy to play catch-up on the growth front in the second half of 2021
- Future real estate supply also remains relatively disciplined against past cycles; therefore, should likely exceeded by demand
- 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
- Given elevated global debt levels, interest rates are likely to remain relatively lower for longer despite rising inflation
- Canadian real estate likely to continue attracting foreign investor dollars and an increasing percentage of domestic pension plan allocations, which will bode well for values

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