

Canadian Real Estate Market Update

Q3 2021



Canadian Economic Overview



The Bank of Canada signaled on October 27 that it could hike interest rates as soon as April 2022 and said inflation would stay above target through much of next year, due to higher energy prices and supply bottlenecks⁴. Stronger and more persistent inflationary pressures drove this hawkish policy adjustment. The central bank did hold the key overnight interest rate at 0.25%, as expected, and said it was ending quantitative easing (QE) and moving into the reinvestment phase, during which it will purchase Government of Canada bonds solely to replace maturing bonds. The hawkish-leaning response comes even amidst a less rosy outlook for the Canadian economy, which makes it difficult to reconcile these aggressive rate expectations with downward adjustments to the Bank of Canada's GDP forecasts through 2023. Indeed, the Bank of Canada acknowledged that considerable uncertainty in its forecasts exist. 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 settle into reopening
- Canada, has been recently showing some weakness as its Q2 2021 real GDP growth figure was -0.3%¹ (or -1.2% annualized)
- According to Statistics Canada, substantial declines in home resale activities and exports were major contributors to the weakness
- Shortages of microchips and other inputs curtailed trade in motor vehicles and domestic consumption
- After returning to its pre-pandemic level in September, employment held steady (+31,000; +0.2%) in October. The unemployment rate fell by 0.2 percentage points to 6.7%.²
- Canada's latest headline inflation rate for September 2021, as measured by the consumer price index ("CPI"), reached its highest reading since February 2003, increasing 4.4% from a year ago³
- Base effects in categories such as energy were largely responsible for the price growth
- The current inflation metric is elevated and looks to persist for some time due to central bank balance sheet expansion as a response to the pandemic
- According to Fiera Capital's base case economic scenario (Reflationary Recovery – 50% probability), the global economic recovery continues to extend at an above-trend pace over the next 12 to 18 months, without the fear of a premature monetary policy tightening event
- The successful rollout of several safe and effective vaccines and/or treatments ultimately accelerates the return to economic normality
- However, given the elevated levels of inflation present and the remote potential of further lockdowns in Canada's colder months, a "stagflation" economic scenario now has a 40% probability of unfolding

1. [Statistics Canada](#)

2. [Statistics Canada](#)

3. [Statistics Canada](#)

4. [Bank of Canada](#)

Canadian Real Estate Outlook

Office⁵

- > Canada's national office market saw an increase in its vacancy rate to 15.7% (+0.4% Q/Q) – its highest point since 1994, exceeding the vacancy levels of the tech bubble and global financial crisis, according to CBRE
- > Leasing activity is showing signs of growing, especially by tech occupiers, and four out of the 10 Canadian markets recorded positive net absorption this quarter
- > Demand for built-out space, which has been high demand in the gateway markets of Toronto and Vancouver since this summer, is now seeing sublet space decline nationally
- > Only representing 20.5% of vacant space, many of the remaining quality sublets are under offer
- > New builds are also seeing elevated interest as the flight-to-quality trend continues



Summary

This tepid improvement in sublet space has now persisted for a few quarters, making the case for a near-term office market recovery. However, the fundamentals of this property type will continue to face challenges as companies adapt to more hybrid solutions and national under construction figures of 17.3 million square feet (representing 3.6% of existing national inventory) are worked through the market.

Industrial⁶

- > Canada's national industrial market continues to approach record space shortage conditions
- > Although Q3 2021 national net absorption was 9.3 million square feet (-41.8% Q/Q), the national availability rate compressed to a mere 2.0% (-0.3% Q/Q)
- > Resultingly, national net rents broke the double-digit marker for the first time to \$10.03 per square foot (+2.1% Q/Q)
- > Vancouver, London, Waterloo Region, and Toronto each have availability rates of 0.9% or less, leaving occupiers with no practical present-day options
- > Montreal is not far behind with an availability rate of just 1.2%. Calgary was also a surprising mover, with its availability rate compressing 1.0% in a single quarter to 5.6%



Summary

Development remains the only long-term solution; however, supply-chain disruptions, swelling construction timelines, and a lack of developable land mean that solutions will be a challenge. The current 34.1 million square feet of development pipeline will only increase existing inventory by 1.8% and projects slated for delivery through to year-end 2022 are already 63.4% pre-leased. As consistently reiterated, the Manager expects robust rental growth to continue in this sector in order to resolve the space shortage.



Retail

- > The Canadian bricks and mortar retail sector continues to adapt and cope with the ongoing effects of the pandemic⁷
- > Ongoing capacity restraints for service-oriented retailers such as restaurants, together with reduced foot traffic for various indoor malls and main street retailers, continues to result in both store closure announcements and bankruptcies
- > According to a recent JLL Retail Outlook, Canadian households managed to save about \$180 billion in 2020, or roughly \$5,800 per Canadian adult⁸
- > Likely as a result of these savings, Canadian retail sales increased 5.3% Y/Y in July 2021, a positive indication⁹
- > According to CBRE, the national under construction total decreased slightly from year-end, now 9.6 million square feet, with few projects kicking off during this time of uncertainty¹⁰
- > Mixed-use projects account for 74.8% of under construction nationally, with some markets like Toronto having nearly their entire active pipeline comprised of projects of this nature¹¹

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.



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 but, representing only 0.6% of total expected rent, highlighting that lower paid workers were most impacted¹²
- > 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
- > 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 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 apartments¹³

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 vs. 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

7. [CoStar – Retail Report](#)
8. [JLL Retail Outlook](#)
9. [Koyfin](#)
10. [CBRE Q3 2021 MarketView](#)
11. [CBRE Q3 2021 MarketView](#)
12. [CMHC 2020 Rental Market Report](#)
13. [CMHC 2020 Rental Market Report](#)
14. [RBC Economics](#)

LOOKING AHEAD

- > Rising vaccination rates 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's a light at the end of the tunnel and that the worst may finally be behind us
- > 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
- > Future real estate supply also remains relatively disciplined against past cycles; therefore, should be likely exceeded by demand
- > Consistent with FRE'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; however, rising inflation is becoming a larger risk than initially thought, potentially leading to a more stagflationary environment
- > 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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