Canadian Real Estate
Market Update

FIERA REAL ESTATE

Q1 2022

Canadian Economic Overview

- With the end of the COVID-19 pandemic seemingly in sight, due to the benign Omicron variant becoming wide-spread/endemic, the global economy was thrown another curveball in the first quarter, as Russia invaded Ukraine on February 24, 2022
- The economic implications so far have been sharp energy price spikes (WTI Crude Oil reached as high as $130 USD per barrel)[1] and further disruptions in funding markets as the western world aggressively added financial sanctions to Russia – creating an exasperation of inflationary pressures and tightening of financial conditions
- This is an unfavourable development as the world was desperately trying to repair its supply chains in the aftermath of COVID-19 and will now have to suffer another set-back
- Lagging economic data is showing a solid recovery – in the latest reported quarter (Q4 2021), Canadian real gross domestic product ("GDP") rose 1.6%[2]
- The unemployment rate was 5.3% in March 2022, which is now the lowest rate on record since comparable data became available in 1976[3]
- Canada's economy and labour market have adapted and evolved in response to several challenges, including the gradual easing of public health measures, record-high job vacancies, and supply chain disruptions
- A tight job market, elevated household savings rate (6.4% in Q4 2021)[4], supply-chain disruptions, and geopolitical risk to energy prices continue to underpin a higher rate of inflation relative to what was experienced in the 2010s
- Evidence of this is Canada's latest headline inflation rate for March 2022, as measured by the consumer price index ("CPI"), reaching its highest reading since January 1991 and increasing 6.7% from a year ago[5]
- Price increases were broad-based in March 2022 pinching the pocketbooks of Canadians
- Consumers paid higher prices for gasoline and groceries compared with the same month a year earlier
- Shelter costs continued to trend higher, rising at the fastest year-over-year pace since August 1983
- Resultingly, the Bank of Canada has responded with two separate rate hikes – the first at 0.25% and the second at 0.50%[6] to counter the inflationary pressure

1. Koyfin, 2. Statistics Canada, 3. Statistics Canada,
4. Statistics Canada, 5. Statistics Canada, 6. Bank of Canada

Canadian Real Estate Outlook

Office[7]

- Canada's national office market experienced a further rise in its vacancy rate to 16.3% in Q1 2022 (+0.5% Q/Q)
- Interestingly, western markets led the country with positive absorption figures, particularly in Calgary and Edmonton – this may be an early sign of a long-awaited improvement in these markets, likely driven by inflating global energy prices
- Despite a quarter of vacancy increases, office market conditions remain balanced in the downtown centres of Vancouver, Ottawa, and Toronto
- Tech tenant demand has largely continued, and direct vacancy remains in the single digits
- On a national basis, construction levels remained largely stable, decreasing slightly to 14.7 million square feet, as nearly 686,000 square feet of space was delivered in the first quarter that was 71.2% pre-leased

Summary

Overall, market activity was robust over the quarter as sentiment remains positive. Downtown cores have been bolstered by the recent easing of lockdown measures and the outlook is optimistic with many businesses set to more formally return to in-person work soon. The long-term picture for this asset class continues to reveal itself slowly, but remains murky given the rolling lockdowns caused by the pandemic.

Industrial[8]

- The national industrial market continues to set new availability rate records as the metric continued its downward trend to 1.6% in Q1 2022
- Edmonton and Calgary saw the largest quarterly decreases in availability rates, falling 1.1% and 0.8%, respectively
- Solid decreases were also recorded in Winnipeg and Halifax, with 0.4% and 0.3% decreases, respectively
- Canada recorded its strongest quarter of net rental rate growth on record, rising 17.4% Y/Y to $11.20 per square foot
- Valuations are also rising at their fastest pace on record as evidenced by a 39.8% Y/Y increase in sales price in Q1 2022
- Construction activity is responding, albeit slowly, rising 17.9% in the first quarter and representing 6.3 million square feet of new projects

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 41.7 million square feet of total under construction only represents 2.2% of existing inventory – not nearly enough. Fiera Real Estate ("FRE" or the "Manager") continues to favour the fundamentals of this sector and holds an overweight position across its mandates.

7. CBRE Q1 2022 MarketView, 8. CBRE Q1 2022 MarketView

Retail

- Aside from the ongoing pandemic, the Canadian bricks and mortar retail sector is also facing a few other emerging challenges
- Global supply chain bottlenecks may be affecting the availability of goods on store shelves
- Fundamentals suffered modestly in 2021 with national vacancy rates stable at an elevated 6.9%[9]
- On the positive side, Canadian retail sales increased 12.0% Y/Y in January 2022[10]
- It's also expected that as the global economies continue to open that more spending will be shifted towards the services sectors, rather than durable goods
- The elevated household savings rate has been falling over the last few quarters, but remains elevated at 6.4% in the fourth quarter of 2021, suggesting future spending power to come
- The national under construction was 10.9 million square feet as at H2 2021 – mixed-use projects account for the majority of this figure[11]

Summary

In the 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[12]

- According to CMHC's latest Rental Market Report, the average vacancy rate for purpose-built rental apartments across all Canadian centres was 3.1% in October 2021, stable from its 3.2% in 2020
- The vacancy rate remains above the low levels of 2018 and 2019, but in line with its longer-run average
- The rental market universe grew by 40,000 purpose-built rental apartment units or 1.9% of existing inventory
- Across all surveyed centres, growth in the average rent for two-bedroom apartments ($1,167 per month) slowed for a second consecutive year to 3% from 3.5%

Summary

The Manager expects rental growth will begin to accelerate heading into 2022 and beyond because, as consistently reiterated, the long-term prospects for this property type remain strong as home-ownership affordability continues to pose a problem in the country, particularly for lower-income households. This dynamic should further support rental demand. Furthermore, Canada welcomed 405,000 new immigrants[13] in 2021 and it is likely to welcome more than this over the next few years. Net international migration is a large contributor to rental demand since most newcomers to Canada tend to rent when they arrive.

9. CBRE Q1 2022 MarketView, 10. Statistics Canada , 11. CBRE Q1 2022 MarketView, 12. CMHC 2021 Rental Market Report, 13. CIC NEWS

LOOKING AHEAD

- According to Fiera Capital, the outlook has deteriorated given the prospect of slowing growth and persistently elevated inflation, while heightened geopolitical turmoil stemming from the war in Ukraine has exacerbated the already-vulnerable macroeconomic landscape
- These factors, as highlighted throughout, creates an increased probability for a ***"Stagflation" economic scenario*** – forecasted as 55% probability over the next year
- This base case economic scenario is characterized by a toxic combination of slowing global growth and accelerating prices
- This scenario assumes that inflationary pressures prove much stickier than previously assumed and last long enough to become embedded in inflation expectations, with global economic prospects subsiding amid the fallout
- 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
- Canadian real estate is likely to continue attracting foreign investor dollars and increasing its allocation in domestic pension plans , which will bode well for values

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