

Canadian Real Estate Market Update



Q2 2022

Canadian Economic Overview



Canadian consumers and businesses displayed resilience at the beginning of 2022, as real gross domestic product ("GDP") grew 0.8% in the first quarter of 2022, a third consecutive quarterly increase, mainly on the strength of increased business investment and household consumption

> Growth, however, slowed in the first quarter compared with the previous two quarters due to a drop in international exports volumes¹



Domestic demand accelerated to 4.8% annualized on the back of strong household spending, business investment, and housing²



The latest unemployment rate reading printed 4.9% in June (-0.2% M/M), which is a new record³



Savings rate also rose to 8.1% as compensation gains surged higher at the beginning of the year⁴



Foot traffic at retail stores is now 20% above pre-pandemic levels

> This is having a positive effect on retail sales, which rose 0.9% (M/M) in April and likely a further 1.6% increase into May⁵

Looking ahead, Canadians continue to feel the impact of rising prices as consumer inflation rose 8.1% year-over-year ("Y/Y") in June⁶



> This was the largest yearly increase since January 1983 and up from a 7.7% gain in May
> The acceleration in June was mainly due to higher prices for gasoline, however, price increases remained broad-based with seven of eight major components rising by 3% or more
> On average, prices rose faster than hourly wages, which increased 5.2% in the 12 months to June, based on data from the Labour Force Survey



As a response, the Bank of Canada surprised the market by hiking the overnight rate by 100 basis points to 2.5% in July and reiterated that it has waged war on inflation⁷



With inflationary pressures intensifying and poised to accelerate further in the near-term, the Bank of Canada continues to push forward on its path to neutral, which is putting pressure on risk assets' valuations

1. [Statistics Canada](#) 2. [Statistics Canada](#) 3. [Statistics Canada](#)
4. [Statistics Canada](#) 5. [CoStar](#) 6. [Statistics Canada](#) 7. [Bank of Canada](#)

Canadian Real Estate Outlook

Office⁸

- > Office market conditions are stabilizing as the national vacancy rate ticked up moderately to 16.5% (+0.2% Q/Q)
- > Excluding Toronto and Vancouver, national net absorption would have only been slightly negative at 82,000 square feet
- > However, the recovery continues to be uneven across the country as downtown centres are increasingly underperforming suburban markets
- > Quality bifurcations also exist as the national vacancy rate for downtown Class 'B' office towers sits at 21.0%, compared to downtown Class 'A' office towers at 14.7%
- > Construction levels increased nationally in Q2 2022, with over 15.1 million square feet (3.1% of total inventory) now underway

Industrial⁹

- > The national industrial market availability rate held steady at 1.6%, coupled with a robust 7.2 million square feet of net absorption in Q2 2022
- > All markets aside from Calgary and Edmonton currently have availability rates of 2.0% or lower
- > Among the notable transactions of the last four quarters, the most active industries have been from third-party logistics, retail and wholesale, and e-commerce-related distribution
- > On the valuation front, national average market sale prices have reached an all-time high of approximately \$255 per square foot
- > Of the projects currently under construction, 26.0 million square feet of new supply is expected to be delivered by the end of 2022
- > However, new development's impact to availability rates will likely be marginal given nearly 75% of that space is already pre-leased

8. [CBRE Q2 2022 MarketView](#) 9. [CBRE Q2 2022 MarketView](#)



Summary

Generally, downtown cores have been bolstered by the recent easing of lockdown measures. The tech sector is having an outsized impact in two markets, and in very different ways. Tech users spurred activity in suburban Vancouver, taking down large blocks of space. On the other side of the country, however, Toronto saw a slow down with tenants putting new leasing on hold amidst heightening economic and tech-sector uncertainty. The long-term picture for this asset class continues to reveal itself slowly, but remains unclear given the rolling lockdowns caused by the pandemic that may have changed future business/workplace models indefinitely.



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 43.9 million square feet of total under construction only represents 2.3% of existing inventory – not nearly enough. As Fiera Real Estate (the “Manager”) has consistently been forecasting, continued rental growth remains likely, even on the back of net rental rate growth in Canada that accelerated in Q2 2022 to 24.2% Y/Y from Q1 2022’s record pace of 17.5%.



Retail

- > Aside from the ongoing pandemic, the Canadian bricks and mortar retail sector continues to face challenges¹⁰
- > Global supply chain bottlenecks continue to affect the availability of goods on store shelves
- > Fundamentals suffered modestly in 2021 with national vacancy rates stable at an elevated 6.9%¹¹
- > According to Statistics Canada, the elevated household savings rate has been falling over the last few quarters, but remains elevated at 8.1%, suggesting future spending power to come
- > Retail sales may remain challenged in the short-term as higher inflation and interest rates continue to hit consumer finances
- > A recent study released by CBRE (Global E-Commerce Outlook Update) found that the global bricks and mortar sales were essentially unchanged from 2016-2021 – all the growth came from online sales, which grew at an annualized rate of 19%¹²

Summary

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



Multi-Residential¹³

- > 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 throughout the rest of 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 in 2021¹⁴ 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. A noteworthy risk to this sector is provincial rent controls, which may impede the ability for legacy stock to grow net rents for investors above the rate of inflation.

10. CoStar 11. CBRE Retail Stats 12. Global E-commerce Outlook 2022 Update
13. CMHC 2021 Rental Market Report 14. CIC NEWS

LOOKING AHEAD

- > According to Fiera Capital, the economic outlook has deteriorated given elevated inflation that shows little sign of abating
- > This continues to trigger an overly-aggressive monetary tightening event that sparks a “Deep Recession” economic scenario – forecasted as 50% probability over the next year
- > The depth and duration of the recession hinges on how persistent inflation proves to be, and on how much pain policymakers are willing to inflict on the economy to bring inflation down to levels deemed acceptable
- > In this scenario, central banks look to restore their inflation-control credibility after waiting too long to address mounting price pressures and tighten monetary policy too far, too fast – regardless of the economic fallout
- > As such, policymakers are unlikely to pause the rate hike cycle until they see convincing evidence that inflation is coming down, which ultimately means central banks will be hiking interest rates well into economic weakness, making way for a “Deep Recession”
- > While this outlook bodes unfavourably for both stocks and bonds, the natural evolution for investors seeking stability, higher income, and the potential for capital gains is a pivot towards private markets, which are less susceptible to volatile market swings, act as a hedge against inflation and rising interest rates, and continue to generate stable, healthy returns
- > Direct real estate is time-tested at guarding capital better than traditional investments during volatile economic times

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