Canadian Real Estate
Market Update

Q3 2022

FIERA REAL ESTATE

Canadian Economic Overview

Real gross domestic product ("GDP") rose 0.8% in the second quarter, driven by increased business investment in inventories, non-residential structures, machinery and equipment, and household spending on services and semi-durable goods[1]

Canadian economy, however, lost momentum throughout the summer

> While the goods sector (mining, oil and gas, and agriculture) held fairly firm, the services industry has cooled, with pullbacks in retail trade, accommodation/food services, and real estate activity underscoring that the environment of high inflation and rising interest rates is beginning to take its toll

> Third quarter GDP is tracking well below the Bank of Canada's ("BOC") 2% forecast[2]

On the contrast, the Canadian labour market broke its three-month losing streak and added 21,000 positions in September 2022, with full-time employment up by 5,700 and part-time employment rising 15,400

> Unemployment rate fell to 5.2% (from 5.4% in August 2022) as the labour market shrank, but remains up 0.3% from the previous quarter's figure of 4.9% (June 2022); wages were up 5.2% Y/Y[3]

September Consumer Price Index ("CPI") rose 6.9% year over year ("Y/Y"), down from a 7.0% increase in August 2022 and its recent peak of 8.1% in June 2022[4]

> It is encouraging to see this figure begin to decelerate, but it remains elevated and energy prices are threatening an upward climb again

BOC surprised the market by hiking the overnight rate by 100 basis points in July, 75 basis points in September and another 50 basis points in October 2022[5] to 3.75%, reiterating that waging war on inflation is its top priority

With the economy continuing to grow above trend and inflation still elevated, the BOC is likely to continue raising rates to push forward on its path to neutral, putting further pressure on risk assets' valuations

1. Statistics Canada 2. Bank of Canada 3. Statistics Canada
4. Statistics Canada 5. Bank of Canada

Canadian Real Estate Outlook

Office[6]

- Office market conditions are stabilizing as there was 2.1 million square feet of positive absorption in the quarter
- This resulted in a minor compression of national vacancy to 16.4% (-0.1% quarter over quarter ("Q/Q")), although this figure remains well above its historical average
- Most markets were relatively stable with a few exceptions; on the positive side, Calgary and Waterloo Region experienced a pick-up in activity primarily from engineering, financial services, and creative industry firms
- Vancouver and Ottawa, meanwhile, saw some softening with tenants no longer requiring the full utilization of their spaces after settling on new workplace strategies; in both cases, this resulted in an uptick to sublease offerings

Summary

As downtown tenants prioritize quality over cost, the national vacancy rate of Downtown Class 'B' office towers is nearly 50% higher than that of their Downtown Class 'A' peers. The long-term picture for this asset class continues to reveal itself slowly and may have changed future business/workplace models indefinitely.

Industrial[7]

- National net absorption rose to 9.6 million square feet in Q3 2022, supported in large part by the 4.0 million square feet delivery of three fully pre-leased design build facilities in Calgary
- Continued tight market conditions remain across the country as the national availability rate is only 1.5% (-0.1% Q/Q)
- Industrial projects currently under construction declined slightly to 42.8 million square feet (only 2.2% of current inventory) in Q3 2022
- However, the current pace of development remains well above last year's pipeline quarterly average of 30.0 million square feet

Summary

As indicated last quarter, even as construction projects ramp up, pre-leasing is accounting for 71.4% of the space expected to be delivered in Q4 2022. This offers minimal immediate relief for tenants looking for new space, keeping it as a landlord's market. Resultingly, strong growth in the immediate future is still likely with net rental rates reaching a new national average record high of $12.89 per square foot, for a 29.4% Y/Y increase, representing an acceleration from the prior quarter's 24.2% Y/Y increase.

6. CBRE Q3 2022 MarketView 7. CBRE Q3 2022 MarketView

Retail[8]

- With the economy opening and foot traffic returning, core retail sales (which excludes spending on autos and gas) has also continued to bounce back, up 8.6% from year ago levels in June 2021
- Looking under the hood by store type, activity remained steady at non-discretionary categories such as food and beverages
- Activity also remained strong in some housing-related categories, just as it has done so throughout the pandemic
- According to Statistics Canada, the household savings rate has been falling over the last few quarters, but remains elevated at 6.2% in the second quarter, suggesting future spending power to come, although households continue to feel the effects of inflation and higher interest rates
- A recent study was released by CBRE (Global E-Commerce Outlook Update)[9], which found that that 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%

Summary

In the long-term, Fiera Real Estate (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-Residential[10]

- 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 October 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 continue heading into 2023, but may begin to slow its pace as the economic picture softens. A noteworthy risk to this sector is provincial rent controls, that may impede the ability for legacy stock to grow net rents for investors above the rate of inflation. 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 has already welcomed about 300,000 new permanent residents in 2022, putting it on pace for a record 431,000 for the year.[11] Net international migration is a large contributor to rental demand since most newcomers to Canada tend to rent when they arrive.

8. CoStar 9. Global E-commerce Outlook 2022 Update
10. CMHC 2021 Rental Market Report 11. CIC NEWS

LOOKING AHEAD

- According to Fiera Capital, the economic outlook remains fraught with risk and the most probable scenario continues to be characterized by an overly-aggressive monetary tightening event that sparks a "Deep Recession" – forecasted as 50% probability over the next year
- 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 tightening 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"
- In addition to being experienced real estate professionals with a strong asset management focus, the Manager's proprietary Target Markets Model continues to objectively guide the Fund's allocation decisions with predictive analytics by helping it select markets and property types within opportune times in their growth cycles relative to their market prices
- Capital allocations to "real assets" with an experienced manager matters more now than ever

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