

Canadian Real Estate Market Update

Q2 2023



Canadian Economic Overview



Canadian economy showed signs of reacceleration with real Gross Domestic Product ("GDP") growth of 0.8% in Q1 2023, a slight improvement from a flat growth in Q4 2022¹



Labour market remained strong with an unemployment rate of 5.4% in June 2023, slightly up from 4.9% in June 2022²



Canada's population surpassed 40 million, underscoring its appeal as an immigration destination



Canada outpaced other G7 countries in economic growth, primarily driven by robust household spending which grew at 5.7% - final domestic demand increased by 2.6%, significantly higher than the trend rate of growth³



The Consumer Price Index ("CPI") rose 2.8% year-over-year ("Y/Y") in June, decelerating from a 3.4% increase in May, with a slowdown led by gasoline prices - Excluding gasoline, headline inflation was 4.0%⁴



Some core components, like grocery prices, remained resilient with a 9.1% Y/Y increase in June



In response to persistent inflation, the Bank of Canada (BOC) continued to raise interest rates and implement its quantitative tightening program, recently raising its policy rate to 5.00%⁵



A consensus is emerging that the BOC is nearing the end of its tightening policy, with expectations of a longer-term rate pause

1. Statistics Canada – <https://www150.statcan.gc.ca/n1/daily-quotidien/230531/dq230531a-eng.htm?HPA=1&indid=3278-1&indgeo=0>

2. Statistics Canada – <https://www150.statcan.gc.ca/n1/daily-quotidien/230707/dq230707a-eng.htm?HPA=1&indid=3587-2&indgeo=0>

3. Fiera Capital Corporation

4. Statistics Canada – <https://www150.statcan.gc.ca/n1/daily-quotidien/230718/dq230718a-eng.htm?HPA=1&indid=3665-1&indgeo=0>

5. Bank of Canada – <https://www.bankofcanada.ca/2023/07/fad-press-release-2023-07-12/>

Canadian Real Estate Outlook

Industrial⁶

- > In Q2 2023, Canada's industrial market rebounded with net leasing activity improving to 3.4 million square feet (sf) from 1.3 million sf in Q1 2023, mainly due to strong tenant demand in Toronto and Edmonton
- > Delivery of new supply led to a minor increase in the national availability rate, which rose to 2.1% (+0.2% Q/Q). Despite the increased supply, the national availability rate remains below the 15-year historical average rate of 4.8%
- > The pace of construction activity has started to moderate, leading to a decrease in the national development pipeline to 44.4 million sf
- > The national average asking rent increased 19.3% Y/Y to \$16.35 per sf, a substantial rise showcasing ongoing demand for industrial spaces
- > The national average asking sale price also marginally increased to nearly \$274 per sf, but this marked the first time in 10 quarters that the Y/Y growth rate has dropped to single digits, signaling a slight cooling in the price growth trend



Summary

As indicated prior, despite the recent softening, the sector remains strong with 6.6 million sf of new industrial construction projects in Q2 2023 and continues to benefit from a structural supply/demand imbalance and offers promising future prospects.

Multi-Residential⁷

- > The average vacancy rate for purpose-built rental apartments across all Canadian centres was 1.9% in October 2022, compressing 1.3% from a year ago, according to the latest CMHC Rental Market Report
- > The rental market saw its strongest growth since 2013, with the completion of 55,000 purpose-built rental apartment units (2.6% of existing inventory)
- > Despite the increased supply, the average national two-bedroom rent rose 5.6% Y/Y to \$1,258 due to growing demand, driven by unaffordable home ownership and record immigration
- > Canada's population grew by 1.1 million to 39.6 million in 2022, 96% of which was due to international immigration⁸ – just recently, Canada vaulted over 40 million people solidifying its reputation as the fastest growing G7 nation



Summary

The Manager expects rental growth will continue throughout 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, despite the potential challenges, the long-term prospects for this property type remain strong as home-ownership affordability continues to pose a problem in the country.

6. CBRE Q2 2023 MarketView – <https://www.cbre-ea.com/data/iprojects>

7. CMHC 2022 Rental Market Report – <https://assets.cmhc-schl.gc.ca/sites/cmhc/professional/housing-markets-data-and-research/Market-reports/rental-market-report/rental-market-report-2022-en.pdf>

8. Statistics Canada – <https://www150.statcan.gc.ca/n1/daily-quotidien/230322/dq230322f-eng.html>

Retail

- > Retail sales in Canada increased by 1.1% in April, or 0.3% when adjusted to volume terms, as reported by Statistics Canada⁹ – average weekly earnings growth was robust at 2.9% Y/Y in April, though it still trails the rate of inflation¹⁰
- > The latest household savings rate of 2.9% is rapidly approaching its pre-pandemic level of 2.1% recorded in 2019, suggesting that Canadian consumers are depleting their savings and may reduce future spending due to higher interest rates and inflation on essentials like food and shelter¹¹
- > The national retail vacancy rate, according to CBRE, has reached 7.1% at the end of 2022, breaking the 5-7% range for the first time since 2017¹²



Summary

Looking ahead, the Manager expects changing consumer behaviors are creating new growth opportunities for low-cost retailers as consumers become more price sensitive. Brands will need to differentiate their products or offer superior service to attract consumers. The retail sector remains stable post-pandemic, with the focus on strategic locations for redevelopment and grocery or drug-anchored centres for future investment.

Office¹³

- > Overall office market conditions remained soft in Q2, with national net absorption at a negative 1.6 million sf and sublet vacancy slightly increasing to 3.4% of inventory
- > A shift in tenant preferences is noted in the Canadian office market with suburban Class 'A' properties experiencing the strongest rental growth of 7.8% since Q1 2020, while downtown Class 'B' properties see declining rates due to increased vacancies
- > Tenant behavior indicates a shift towards higher quality assets
- > Construction activity has been declining steadily since Q2 2022, which, if continued, would significantly reduce the construction pipeline with projected completions in Q3 and Q4
- > The national office vacancy rate has risen to 18.1%, primarily due to increased vacancies in downtown areas, widening the gap between suburban and downtown vacancy rates



Summary

With developers largely placing future projects on hold, the office pipeline could slow to its lowest level in over 20 years if no significant projects commence construction next year. The office market continues to exhibit unfavourable fundamental trends that are not expected to reverse in the near-term. This should translate to a continued downward repricing and limited rental growth prospects over the next several years.

9. Statistics Canada – <https://www150.statcan.gc.ca/n1/daily-quotidien/230621/dq230621a-eng.html>

10. Statistics Canada – <https://www150.statcan.gc.ca/n1/daily-quotidien/230629/dq230629a-eng.htm?lnk=dai-quo&indid=3555-1&indgeo=0>

11. Statistics Canada – <https://www150.statcan.gc.ca/n1/daily-quotidien/230531/dq230531a-eng.htm?lnk=dai-quo&indid=3278-2&indgeo=0>

12. CBRE Q2 2023 MarketView – <https://www.cbre-ea.com/data/iprojects>

13. CBRE Q2 2023 MarketView – <https://www.cbre-ea.com/data/iprojects>



LOOKING AHEAD¹⁴

- > Fiera Capital predicts a 50% probability of a deep recession if inflation remains elevated and central banks continue monetary tightening
- > The severity and duration of the recession would depend on inflation persistence and the policymakers' actions to address it
- > If a recession and financial market weakness become too severe, inflation momentum could decrease, leading to a more accommodative monetary policy and setting the stage for the next economic growth phase
- > Despite these challenges, the fundamental strength of real estate, especially in the industrial and multi-residential sectors, remains strong owing to limited land supply and Canada's fast population growth rate among G7 countries
- > In an environment of structurally higher inflation, real estate is likely to outperform traditional assets such as equities and fixed-income investments in the long term - the trend of higher inflation is expected to drive more inclusion of *real assets* in pension plan portfolios as alternative investment options
- > The allocation of capital to real assets is crucial in the current economic climate, emphasizing the need for an experienced manager who can deliver superior performance in fund allocations and make research-based, data-driven decisions specific to different real estate sectors
- > The Manager's expertise in asset management, coupled with the use of its proprietary Target Markets Model, allows it to effectively guide the allocation of capital, align investments with long-term objectives and safeguard capital value in changing market conditions - consistently maintaining high occupancy rates is vital for delivering value in real estate
- > When the economic cycle shifts towards recovery, real estate is well-positioned to capture macro-tailwinds and provide superior performance

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