Canadian Real Estate
Market Update

Q3 2024

FIERA REAL ESTATE

Canadian Economic Summary

Economic Growth Trends[1]

- In the second quarter of 2024, Canada's economy picked up steam, with annualized GDP growth soaring to 2.1%, the fastest pace since early 2023 – this impressive surge exceeded market expectations of 1.6% and showed a solid boost from the previous quarter's revised 1.8%
- The energy behind this growth came from increased government spending and a jump in business investments, particularly in machinery and engineering within the oil and gas sector
- Though household spending slowed and residential construction faced ongoing declines, the overall growth story remains positive, signaling resilience amid headwinds such as weaker exports and a softening housing market
- Despite these challenges, there is still reason for optimism, as wage growth in sectors like healthcare, education, and finance lifted the household savings rate to 7.2%
- While GDP per capita has yet to turn the corner, the momentum building across key industries suggests Canada is on the path to broader, more sustainable growth

Employment Trends[2]

- Canada's labour market defied expectations in September, with the unemployment rate unexpectedly falling to 6.5% (from 6.6%), as job gains of 46,700 beat expectations
- This is the first time the unemployment rate has fallen since January
- The underlying metrics were also strong, with job gains led by full-time positions (112,000), while part-time roles fell by 65,300
- The private sector was also a strong driver, adding 61,200 jobs while the public sector shed 23,600 jobs
- The labour market continues to showcase underlying structural strength recovering from its cyclical weakness during the last couple of years

Inflation Trends[3]

- Canada's annual inflation rate, measured by the consumer price index ("CPI"), continued to slow to 1.6% year-over-year ("Y/Y") in September, down from 2.0% in August – this annualized pace marks the smallest increase since February 2021 and was primarily driven by lower gasoline prices, which dropped by 10.7% compared to 5.1% drop in August
- Despite the slowdown in the inflation rate, price levels remain high, with the CPI higher by 12.7% since September 2021

Monetary Policy Responses[4]

- Overall, September's inflation data signals a gradual return to stability, with the Bank of Canada's ("BOC") recent rate cuts appearing to provide relief to consumers while supporting a controlled economic cool-down
- A CPI reading below 2% has also given the BOC additional cover for its increased pace of rate cutting that occurred on October 23, when the BOC cut 50 basis points ("bps"), instead of 25 bps at the previous three meetings – the policy rate now stands at 3.75%

Real Estate Market Trends

Industrial[5]

- In Q3 2024, Canada's industrial real estate market continued to stabilize, with positive momentum emerging
- The national availability rate edged up 0.3% quarter-over-quarter ("Q/Q") to 4.4%, but still remains below long-term averages
- Net absorption swung positively to 1.9 million square feet ("sf") (+6.6 million sf Q/Q), driven by the delivery of pre-leased new supply, signaling that demand for high-quality industrial space remains robust despite recent market weakness
- The construction pipeline continues to gradually ease, down 8.4% Q/Q to 32.0 million sf, with speculative projects making up 74.3% of space under construction
- Toronto and Vancouver remain the most active markets, reflecting continued confidence in future demand
- The national average asking net rent dipped 3.8% Y/Y to $15.67 per sf, while sale prices marginally declined 2.8% Y/Y

Summary

Despite these moderations, both rents and sale prices remain significantly above pre-pandemic levels, highlighting the sector's long-term strength. Regional markets such as Halifax and London posted notable rental growth, underscoring the continued demand in select areas. Looking ahead, the industrial market remains well-positioned for growth. Strong pre-leasing activity supports Oxford Economics' forecast of 5.9% annualized unlevered total returns from 2024-2026, reinforcing confidence in the sector's future performance.[6]

Multi-Residential[7]

- Heading into 2024, Canada's rental apartment market remained exceptionally tight, with vacancy rates at multi-decade lows and rent growth nearing double digits
- High mortgage rates and a lack of affordable homeownership options continued pushing more Canadians toward renting, particularly in key markets like Vancouver, Toronto, and Calgary
- Population growth, driven by record immigration levels and international students, further amplified rental demand, keeping vacancies low and rents high
- While new purpose-built rental construction has reached multi-decade highs, it has not been enough to meet demand, especially in cities where development costs and rent controls deter large-scale projects

Summary

Despite signs of rental growth cooling slightly due to limited tenant turnover, strong demand persists, with new leases achieving high premiums. Government efforts, such as eliminating GST on new rental builds and an ambitious housing plan, aim to ease the pressure, but supply constraints remain a challenge. As long as homeownership remains unaffordable for many, the rental market will continue to see upward pressure on rents, ensuring strong market fundamentals for investors.

Retail[8]

- The overall market is facing several headwinds as consumers grapple with higher prices, high-interest rates, and elevated debt levels, which have slowed discretionary spending
- However, the robust population growth in key markets, particularly Calgary and Toronto, is supporting leasing demand and rent growth in select areas
- Despite softening consumer sentiment, national retail rents grew by 3.1% Y/Y, largely due to limited new supply and inflationary pressures that buoyed rents, particularly in percentage-based lease structures
- Retail construction activity remains constrained, with only 8.5 million sf under construction nationwide, much of it concentrated in mixed-use developments as landlords seek to integrate retail with residential and office spaces[9]
- Resultingly, national vacancy rates compressed 0.4% to 6.2%, the lowest post-pandemic level

Summary

Notable transactions included the sale of Vaughan Mills for $465 million, underscoring institutional interest in well-performing assets. Investment in retail assets has stabilized despite rising capital costs, with national sales volumes remaining steady at just over $1 billion. Opportunistic redevelopment strategies, particularly in high-density urban areas, are driving investor interest. These trends suggest a continued focus on defensive retail assets while larger, enclosed retail formats like malls and power centres remain under pressure due to shifting consumer habits and weakened demand for discretionary goods.

Office[10]

- In Q3 2024, the Canadian office market continued to struggle with the national vacancy rate creeping up to 18.6% (+0.1% Q/Q)
- Despite this underwhelming performance, 2024 is still on track to post the first positive annual net absorption since 2019, though confidence remains fragile
- While six of the ten major markets recorded positive absorption, led by Toronto with over 650,000 sf absorbed, other key markets like Vancouver, Montreal, and Ottawa fared worse, each reporting over 100,000 sf of negative absorption
- The gap between high-quality trophy assets and Class 'B/C' buildings continues to widen, with vacancy in Class 'A', or trophy assets, hitting its lowest level in nearly four years, while Class 'B/C' properties face rising vacancy and diminishing tenant interest

Summary

Sublease space has declined for the fifth consecutive quarter, but this reduction has done little to boost overall market sentiment. Office space under construction is at a mere 4.2 million sf, its lowest level since 2004, and only 36.7% of this space is pre-leased. For Class 'B/C' landlords, the outlook remains bleak, with further repricing and extensive capital investments likely needed to stay competitive as the flight-to-quality trend shows no signs of abating.

Canadian Economic & Real Estate Outlook

- At the time of writing, the outlook for the Canadian economy remains optimistic, with a 55% probability of a "Soft Landing" scenario over the next 12-18 months, according to Fiera Capital
- In this scenario, central banks globally manage to engineer a soft economic landing, aided by a consistent downtrend in inflation[11]
- This will allow policymakers to shift from a neutral stance to implementing aggressive interest rate cuts as soon as economic weakness appears
- The scenario envisions central banks navigating inflation without triggering a recession or significant job losses – by fine-tuning monetary policy, they aim to sustain an economic environment that is balanced – not overheated nor too cool
- If successful, the economy would avoid a hard landing and will allow the transition into a new cycle of growth
- On the investment activity front, in Q2 2024, Canada's real estate market saw a robust rebound, with volumes surging 67.4% Q/Q to $14.5 billion, marking the strongest quarterly total since Q2 2022[12]
- The quarter recorded 2,662 transactions, a 71.2% increase from Q1 2024 and the highest level in nine quarters
- Private Canadian investors continued to dominate, comprising over 76% of acquisitions
- Industrial assets led the pack with $4.5 billion in transactions, while multi-residential investments hit a nine-quarter high of $3.5 billion
- Major markets like Toronto, Montreal, and Vancouver posted significant gains, with volumes reaching $4.3 billion, $3.5 billion, and $3.0 billion, respectively
- This quarter's performance underscores the resilience and adaptability of the Canadian investment landscape, reflecting renewed confidence as market conditions stabilize and the expected recovery cycle advances[13]

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Endnotes

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13 Michael Le Coche, Quadrant Model - Fiera Real Estate – Q3 2024 – Internal Research

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