Canadian Real Estate
Market Update

Q4 2022

Canadian Economic Overview

- Real Gross Domestic Product ("GDP") expanded 0.1% in October 2022, putting it on track to expand at an annualized rate of 1.2% in Q4 2022[1]

- Inflation data showing firm underlying price pressures may lead to further interest rate hikes by the Bank of Canada ("BOC") in early 2023

- The labour market showed signs of resilience, with employment growing for a fourth straight month in December and the unemployment rate falling to near a record low of 5.0%
  - Average hourly wages up 5.1% from a year earlier, resulting in retail sales increasing 1.4% to $62.0 billion in October[2]

- Consumer Price Index ("CPI") rose by 6.3% Y/Y in December, following a 6.8% increase in November[3]

- BOC is likely to continue raising rates to push forward on its path to neutral, putting further pressure on risk assets' valuations

- Persistent inflation that remains elevated could trigger the continuation of aggressive monetary tightening measures by central banks, leading to a potential economic recession

1. Statistics Canada 2. Statistics Canada 3. Statistics Canada

Canadian Real Estate Outlook

Office[4]

- National office market had a weak quarter in Q4 2022, with negative net absorption of 2.1 million square feet and an overall national office vacancy rate increase from 16.4% to 17.1%
- Sublet listings are on the rise, representing 18.1% of vacant space nationally, with a clear distinction between the downtown and suburban markets
- National office development pipeline has continued to decrease, now standing at 11.0 million square feet, its lowest level since Q3 2017

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.

Industrial[5]

- Canadian industrial market experienced positive net absorption of 10.4 million square feet in Q4 2022, bringing the annual total to 35.8 million square feet
- Toronto had the most activity with 4.7 million square feet of positive net absorption, followed by Edmonton and Calgary
- All markets in Canada except for the Waterloo Region recorded positive net absorption
- Market conditions across Canada remain exceptionally tight, with a national availability rate of 1.6% in Q4 2022
- Six out of ten Canadian markets have availability rates of 1.2% or lower, with the Waterloo Region being the tightest
- The industrial development pipeline in Canada has reached a new high of 44.6 million square feet of projects under construction
- In Q4 2022, 13 million square feet of new projects began construction, primarily in Toronto, Calgary, and Montreal

Summary

As indicated last quarter, even as construction projects ramp up, pre-leasing activity remains strong with almost 57% of the 20.3 million square feet of space expected to be delivered in H1 2023. This offers minimal immediate relief for tenants looking for new space, keeping it as a landlord's market. Resultingly, developers continue to show confidence in the sector with speculative construction driving industrial development, accounting for 78% of the total pipeline.

4. CBRE Q4 2022 MarketView 5. CBRE Q4 2022 MarketView

Retail

- According to Google mobility statistics, retail and recreation traffic is up 5.4% and grocery traffic is up 1.4% from the same time last year[6]
- Posting its second increase in five months, core retail sales rose 0.9% in October, led by higher sales at food and beverage stores (+2.2%)[7]
- Household savings rate is falling but remains slightly elevated at 5.7% in Q3 2022, indicating potential for future spending[8]
- Study by CBRE highlights that while e-commerce sales have grown at an annualized rate of 19% between 2016 and 2021, bricks and mortar sales have remained unchanged[9]

Summary

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-Residential[10]

- According to the latest Rental Market Report by CMHC, the average vacancy rate for purpose-built rental apartments across all Canadian centres was 3.1% in October 2021, remaining stable from its 3.2% in October 2020
- The vacancy rate is higher than the low levels of 2018 and 2019, but in line with its longer-term 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 3.0% from 3.5%

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, which 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 welcomed a record number of over 431,000 new permanent residents in 2022[11]. Net international migration is a large contributor to rental demand since most newcomers to Canada tend to rent when they arrive.

6. Google Mobility Trends 7. Statistics Canada 8. Statistics Canada
9. Global E-commerce Outlook 2022 Update 10. CMHC 2021 Rental Market Report
11. Canada Immigration News

LOOKING AHEAD

- According to Fiera Capital, the economic outlook that is the most probable continues to be characterized by an overly-aggressive monetary tightening event that sparks a "Deep Recession" – forecasted as 55% 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
- This should put pressure on risk asset valuations
- Long-term, however, real estate is likely to outperform other traditional assets, such as equities and especially fixed-income investments
- The Manager's primary objective is to ensure that the funds' income returns remain at a stable level and maintained as high as possible – occupancy is paramount to ensuring robust income returns are delivered
- The Manager's proprietary Target Markets Model continues to objectively guide the funds' allocation decisions with predictive analytics by helping them select markets and property types within opportune times in their growth cycles relative to their market prices

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