NATIONAL REPORT
RETAIL

IPA INSTITUTIONAL PROPERTY ADVISORS

3Q/22

Strong Consumer Base Serves as a Backbone; Macro Conditions Overshadow Near-Term Outlook

Robust recovery led by healthy retail demand. Solid employment growth, excess household savings, the removal of pandemic-related restrictions, an uptick in immigration and a further improvement in tourism have worked in tandem this year to aid a consumer-led recovery in the retail market. This has propelled leasing activity to remain elevated after a strong rebound last year. The vacancy rate declined steadily to 2.0 per cent as a result, which is 10 basis points below the 2019 level. Out of the six major metros, Vancouver remained the tightest market with its ultra-low vacancy rate of 1.2 per cent, which was partly driven by the return of tourism. Edmonton saw the largest yearly drop in availability of 150 basis points, with local net absorption far outpacing completions. Across all major markets, tenant demand for space improved at a solid pace in the suburban areas while remaining relatively subdued in the downtown core, mainly due to continued delays in a broad-based return-to-office movement.

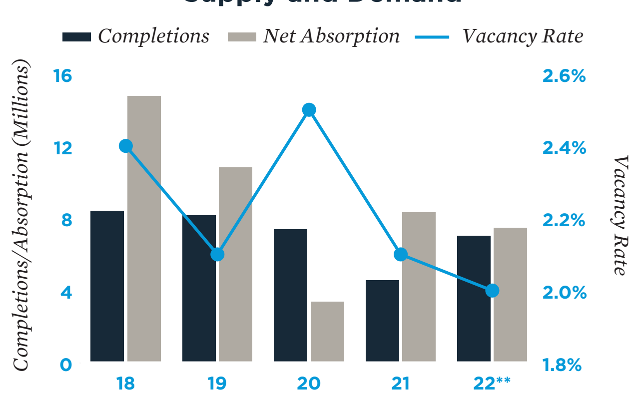
Strong labour market paves the way for steady consumer spending. With 221,000 jobs being added to the economy in the first half of the year, the unemployment rate declined to 4.9 per cent in June, solidifying a robust consumer base for retail demand. An increase in spending activity was reflected in Canada's household savings rate dropping from 27.2 per cent at the height of the pandemic to 6.2 per cent in June 2022. As a result, inflation-adjusted retail sales rose 9.0 per cent above its pre-pandemic level, helping net absorption reach 4.1 million square feet nationwide.

Immigration and tourism strengthen consumer base. As border restrictions were eased, Canada resumed welcoming new residents from overseas in early 2022, after a two-year pause during the global health crisis. As immigration accounts for 75 per cent of Canada's population expansion, it has helped national growth recover. This has bolstered the consumer base and the foot traffic that comes with it, especially in the suburban areas where newcomers tend to reside upon arrival. Furthermore, the Canadian Tourism Activity Tracker shows that domestic tourism has almost returned to pre-pandemic levels, with inbound activity from international visitors rapidly recovering as well. This has resulted in tourism-related real spending rising 71 per cent year-over-year, reaching nearly 80 per cent of the pre-COVID-19 level. This return of tourism was felt across most regions, especially in places like Granville Island in Vancouver and Old Montreal.

Economic headwinds to soften spending in final months of 2022. With pent-up consumer demand playing out in the summer, elevated inflation and rising interest rates have since started eating into household budgets, leading to consumers readjusting their spending habits. July's retail sales recorded the first month-over-month decline in 2022, and leading indicators on credit card spending also point to a further softening in retail demand this fall, especially in experiential and non-essential categories, which outgrew the essential segment earlier this year. This cooling consumer demand will translate into softer net absorption of 3.4 million square feet in the second half of 2022.

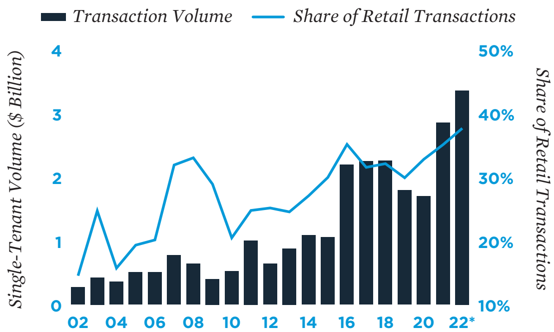
Inflation-Adjusted Retail Sales

Supply and Demand

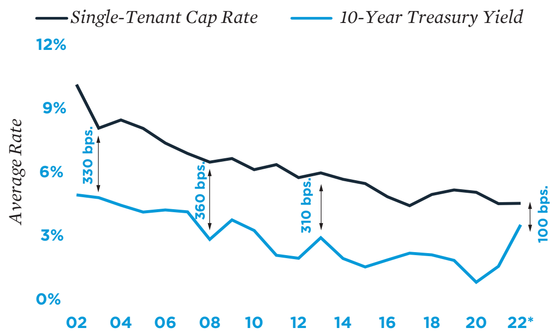


* Through July, 2012 prices ** Forecast
Sources: IPA Research Services; CoStar Group, Inc.; Immigration, Refugees and Citizenship Canada; Statistics Canada

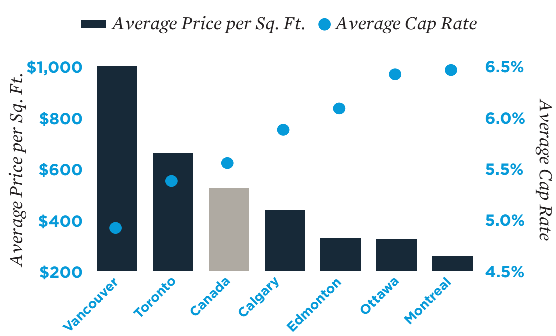
Single-Tenant Transactions on the Rise



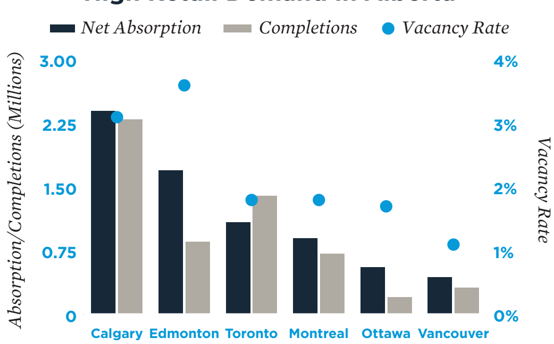
Single-Tenant Cap Rate Trends



Vancouver Remains Most Expensive Market✢



High Retail Demand in Alberta**



** Trailing 12 months for transaction volume, 10-year treasury yield as of October 7, 2022.*
✢ As of 2Q
*** 2022 Forecast*
Sources: IPA Research Services; Bank of Canada; CoStar Group, Inc.

Single-Tenant Properties Fared Better During Pandemic; Suburban Essential Retail in a More Robust Position

Single-tenant properties favoured during the health crisis. Over the years, investors have become increasingly bullish on single-tenant retail properties, and this trend only accelerated during the health crisis. Single-tenant properties often attract nationally-known tenants with long-term triple-net leases, which can be perceived as lower risk during times of economic uncertainty. Trailing 12-month single-tenant deal flow through the second quarter of 2022 increased by almost 90 per cent relative to the 2019 level, and made up nearly 40 per cent of total retail deals. The average sale price, as a result, rose by over 30 per cent on a year-over-year basis, far outpacing the growth rate for multi-tenant properties. The gap between the multi- and single-tenant cap rates has also widened, now standing at 100 basis points compared to 30 basis points in pre-pandemic times.

Suburban essential retail positioned to weather near-term uncertainty. As higher borrowing costs and elevated inflation erode consumers' purchasing power, discretionary retail businesses will likely face headwinds in the final months of this year and into 2023. Downtown retailers, who have yet to enjoy a full recovery, will likely continue to see their businesses affected by subdued foot traffic, due to the broad resistance of a return to office. A slowing economy in the near term, which could lead to some employment losses, will likely further complicate this process. As households continue to work and shop locally outside city centres, suburban essential retail businesses will likely stand out as the most robust property type moving forward, as consumers pull back on non-essential spending.

Fundamentals in Western Canada Remain Healthier

Affluent consumers and the return of tourism bode well for Vancouver. With the wealthiest populace among major metros, the retail segment in Vancouver will likely weather near-term economic uncertainty better than the eastern markets. Often the entry point for international retailers aiming for further expansion to other parts of Canada, Vancouver's retail market has long been known for its tight availability, with most new supply being pre-leased prior to delivery. The strong rebound in tourism has played an important part in driving the retail sector recovery this year, and the recent removal of all pandemic-related border and quarantine requirements should aid foot traffic and spending, likely resulting in a continued improvement in leasing activity for the remainder of 2022.

Alberta's oil industry shields consumers from elevated energy costs. While soaring energy prices have had a nationwide impact, consumers in Calgary and Edmonton working in the oil sector were better protected with ancillary income from higher oil prices and increased oil production. This has provided extra support for the local retail sector recovery, and will continue to underpin consumer demand. Net absorption in Calgary and Edmonton, as a result, is projected to comprise over 50 per cent of the national level this year. However, the comparatively ample supply in Alberta could offer potential risks to underlying fundamentals if the economy faces a slowdown.

Sales Volume Boomed; Infrastructure Opens Door to Future Opportunities

2022 Forecast

CANADA EMPLOYMENT

1.2% increase Y-O-Y

- Employment has exceeded the pre-pandemic level and will record another year of growth. However, the labour market will likely face headwinds in the final months of 2022 as rising interest rates slow hiring activity.

CANADA CONSTRUCTION

7 million square feet to be completed

- Last year's uncertainty, labour shortages and supply chain constraints caused development timelines to be pushed to this year, leading to 2.5 million more square feet to be delivered in 2022.

CANADA VACANCY

10 basis point decrease Y-O-Y

- As strong net absorption outpaces completions, the vacancy rate will continue on its downward trajectory and reach 2.0 per cent by year-end, 10 basis points below the pre-pandemic level.

CANADA ASKING RENT

4.6% increase Y-O-Y

- Strong retail demand will push the average asking rent to $25.17 per square foot by year-end. Rents quickly rebounded after a brief contraction in early 2021, and will rise 8.5 per cent above the 2019 level.

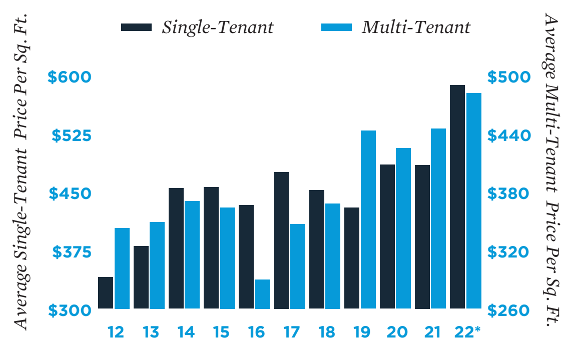
2022 INVESTMENT OUTLOOK

- **Sales activity at record high, boosted by single-tenant transactions.** The trailing 12-month total dollar volume transacted reached a record high in the second quarter, advancing 42 per cent year-over-year. The most notable growth was seen in the $20 million or greater single-tenant segment, topping a fivefold increase, likely due to a flight-to-quality during the pandemic.

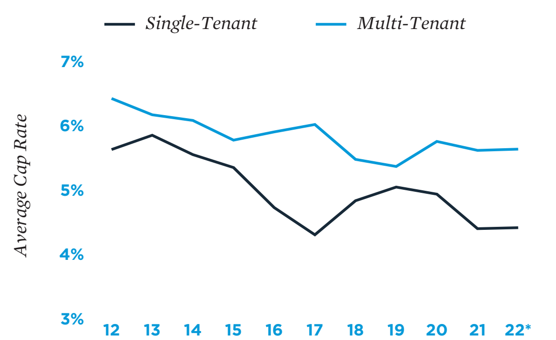
- **Price growth seen across the board**. The second quarter ended with a 12-month average sale price that broke the $500 per square foot mark for the first time, marking the highest year-over-year increase since 2001. Despite this price growth, the average cap rate increased by 10 basis points to 5.6 per cent. This was likely caused by higher net operating income, due to strong rent growth and investments with higher yields being favoured in the rising interest rate environment.

- **Investors eye infrastructure plans for future retail possibilities.** Major metros in Canada are expecting various infrastructure projects to be completed in the coming years. Public transit constructions are underway in Toronto, Vancouver, Montreal and Edmonton to accommodate population growth and the need for more cost-effective transportation options. Ottawa and Calgary are responding to changing demographics by optimizing the suburban areas and transforming underutilized office properties to residential space. These developments will likely contribute to increased foot traffic in select areas, stimulating retail demand and opening up investment opportunities.

Canada Retail Sale Price Trends



Canada Retail Cap Rate Trends



* Through 2Q

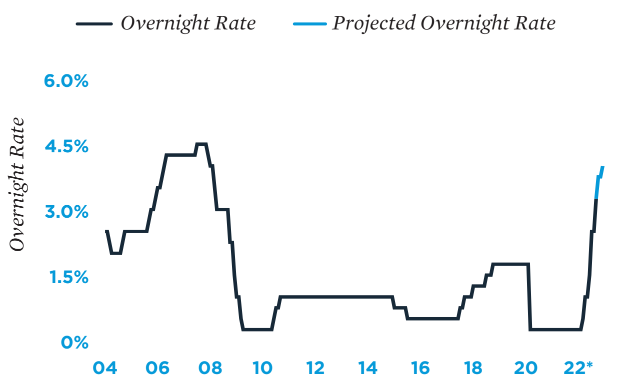
Sources: IPA Research Services; CoStar Group, Inc.

Lenders and Borrowers Adjust Positions amid Monetary Tightening

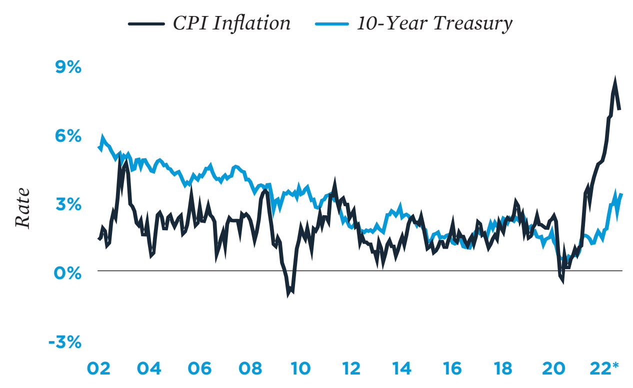
The Bank of Canada on a tightening cycle to tame persistent inflation. Strong pent-up consumer demand, global supply chain bottlenecks and a sharp rise in commodity prices that seems to have culminated earlier this year have pushed inflation to a multi-decade high, far above the Bank of Canada's 2 per cent target. This prompted the BoC to decisively start its quantitative tightening program and interest rate hikes. The BoC had unloaded $71 billion from its balance sheet by the end of September, representing a 14 per cent reduction from the peak level seen in January 2022. The bank has also raised its overnight rate five times, totaling 300 basis points since March, and more rate hikes are likely to happen in the final months of 2022 amid still-elevated inflation. Soaring borrowing costs, as a result, are subsequently quelling overall demand in the economy, especially in Canada's residential real estate market, and will likely translate to lower demand-driven inflationary pressure moving forward. However, the contractionary monetary policy could potentially cause a decline in overall economic activity and induce a near-term recession.

More restrictive financial conditions impact credit market and investment activity. As the BoC aggressively reduces liquidity from the financial market and raises borrowing costs for businesses and households, lenders are adjusting quoted rates to reflect widening spreads. Both balance sheet lenders and CMBS issuers are tightening underwriting criteria, with intensified focus on borrowers' balance sheet resilience to higher debt-servicing liabilities. Lending activity was front-loaded this year before interest rates began to increase, and as further interest rate hikes are expected, commercial mortgage rates will likely stay on an upward trajectory for the foreseeable future. This will likely cause the full year's activity to retreat from last year's high, with reduced balance sheet lending and CMBS issuances. In response to the higher interest rate environment and potentially slower economic growth in the near term, borrowers are also increasingly active in re-evaluating their CRE strategies by prioritizing assets perceived as lower risk over upside opportunities. The heightened scrutiny on lending may moderate transaction volume in the final months of 2022, which could soften price growth and put upward pressure on cap rates as the price expectation gap between buyers and sellers slowly begins to narrow.

Overnight Rate to Rise Further



Inflation and Interest Rate Trends



** Forecast — assumes a 50 bps rate hike in October and a 25 bps rate hike in December 2022; ** CPI through August; 10-Year Treasury through October 7*
Sources: IPA Research Services; Bank of Canada, Capital Economics; Statistics Canada

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Sources: IPA Research Services; Bank of Canada; Capital Economics; CoStar Group, Inc.; Immigration, Refugees and Citizenship Canada, Statistics Canada.