RESEARCH BRIEF
CANADA RETAIL SALES

INSTITUTIONAL PROPERTY ADVISORS
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CRE Remains Well-Positioned, Despite Elevated Borrowing Costs Impacting Broader Economy

Momentum fades, given economic backdrop. Canada's retail sales contracted 0.2 per cent monthly in February, which, after accounting for inflation, translated into a 0.7 per cent decline in total volume. With the Bank of Canada holding its overnight rate at 4.5 per cent, the cumulative interest rate hikes of 425 basis points over the trailing 12 months are beginning to be absorbed by the broader economy. Households are tightening budgets as real disposable income erodes and debt servicing payments rise. However, despite ongoing headwinds, February retail sales beat the general consensus, and inflation-adjusted sales were up 1.4 per cent annually. While retail sales, and thus overall economic growth, may continue to trend down over the coming months, commercial real estate remains well positioned to weather short-term hurdles as robust fundamentals and sustained demand persists across the property spectrum.

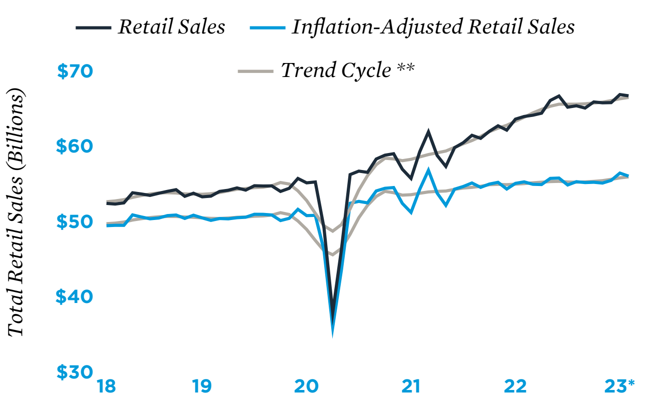
Softening sales may benefit CRE investment. With retail sales and overall economic growth showing signs of easing, it is becoming more likely that inflation will approach the target range of 1 to 3 per cent by the latter half of this year. As a result, the Bank of Canada should gain additional confidence in its conditional interest rate pause, making further rate hikes unlikely. Consequently, transaction activity could see an uptick over the coming months as market participants absorb this new, higher-cost investment environment. With increasing levels of certainty returning to the market, price expectation gaps should mitigate, and many buyers with large volumes of deployable capital will likely emerge from the sidelines to capitalize on robust fundamentals for almost all property types.

Commercial Real Estate Outlook

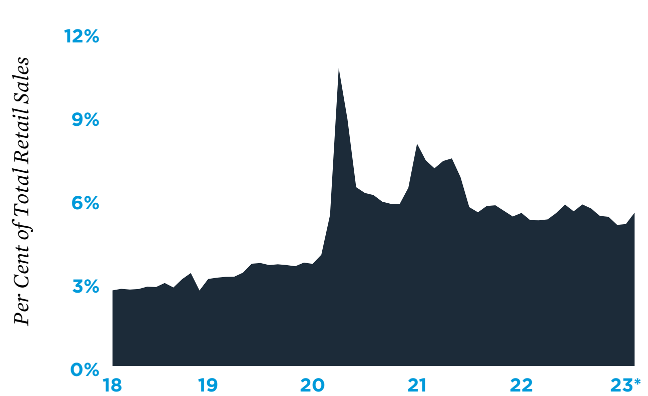
E-commerce sees boost. After nearly half a year of decline, seasonally-adjusted online sales jumped 10 per cent annually in February. While e-commerce as a percentage of total sales has eased from the pandemic highs, it remains nearly 200 basis points above the 2019 level, despite in-person shopping regaining momentum. Looking forward, with many retailers adapting to changing consumer behaviour, online activity should stay elevated compared to its long-term average. As a result, e-commerce-related demand, although softening, coupled with emerging forces stemming from the uptick in nearshoring, should aid long-term performance. With an influx of new supply coming to market, however, vacancy is expected to rise slightly in the short-term. Nonetheless, with the under construction pipeline only accounting for 2 per cent of existing inventory, and with nearly 40 per cent of this space already pre-leased, upward pressure on vacancy is limited and should remain sub-2 per cent.

Grocery-anchored retail continues to attract investor attention. Sales velocity of retail properties have fared better during the recent market disruption, due to high yields and sound fundamentals. Grocery-anchored strip centres are attracting the most investor enthusiasm due to the stability of the asset, as well as the essential nature of the products offered. Additionally, this property type typically attracts a well-diversified tenant mix that tends to hold strong covenants. With ongoing economic uncertainty, investors will look for stable assets in order to generate return, while mitigating risk. Grocery-anchored retail, as a result, should remain an attractive investment option, given its stable and diversified nature.

Upward Trend Shows Signs of Easing



E-Commerce Reverting to Long-Term Trend



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** Through February; ** Smoothed version of a seasonally-adjusted time series*
Sources: IPA Research Services; Altus Data Solutions; Bank of Canada; Canada Mortgage and Housing Corporation; Capital Economics; CoStar Group, Inc.; Statistics Canada