SPECIAL REPORT
CANADA CONSTRUCTION OUTLOOK

IPA INSTITUTIONAL PROPERTY ADVISORS
A DIVISION OF MARCUS & MILLICHAP, BROKERAGE

FEBRUARY 2025

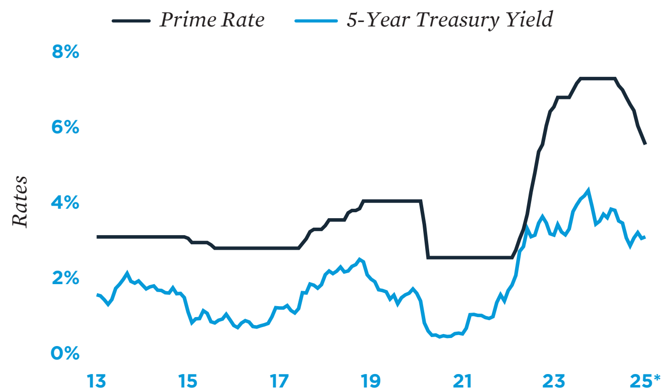
Construction Sector Under Strain As Downside Risks Impact Developer Sentiment

Development activity to face growing pressures in 2025. Entering the new year, construction costs continue to rise at a fast pace despite falling interest rates and improving labour availability. As the elevated cost structure necessitates a compelling return on investment, builders increasingly require robust and sustained space demand to justify new construction projects. A recovery in space demand across all commercial real estate sectors is set to take shape – driven by the Bank of Canada's efforts to boost economic activity – but mounting uncertainties surrounding trade policies and demographic challenges could derail this outlook. These downside risks have likely eroded developer confidence, possibly leading to a slowdown in construction activity throughout 2025.

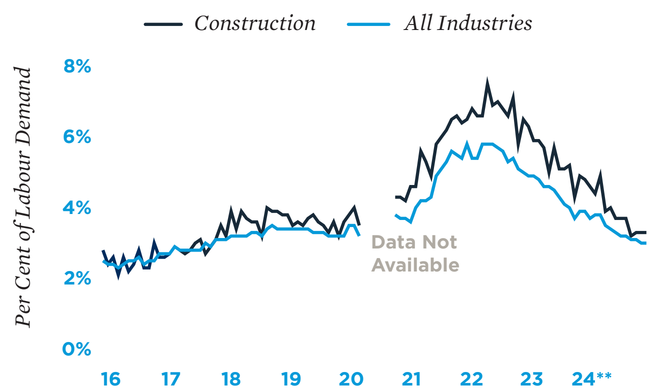
Certain cost pressures have partially eased. As a key driver of development activity, financing costs have declined over the past nine months while the Bank of Canada began lowering interest rates. The drop in short-term rates has been the primary factor behind this improvement in credit conditions. With the central bank expected to maintain a dovish stance throughout 2025, borrowing costs will likely keep falling, supporting construction activity. Additionally, labour shortages have eased alongside a softening job market. The job vacancy rate in the construction sector has not only become better aligned with the overall vacancy rate, but has also dropped to pre-pandemic levels. While a structural skilled labour shortage persists as a result of Canada's aging population, this improvement in labour availability helps alleviate some near-term cost pressures for developers.

Overall construction expenses to remain elevated. Despite falling interest rates and a less constrained labour market, the construction sector continues to grapple with cost increases that outpace common inflation metrics. Rising land prices, changes in building codes and elevated raw material costs are still key challenges for builders. These pressures drove a 4.4 per cent jump in residential construction costs and a 4.3 per cent rise in non-residential development costs last year. Such increases significantly outpaced a 2.4 per cent climb in the consumer price index and a 0.9 per cent uptick in the industrial production price index over the same period. Looking ahead, building expenses are expected to remain high, with cost growth potentially accelerating if trade tensions between Canada and the U.S. escalate, pushing up import prices for raw materials like steel and aluminum.

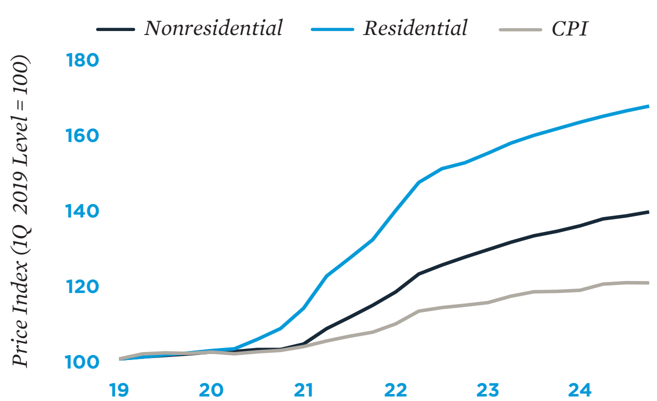
Long-Term and Short-Term Rate Trends



Labour Shortages Are Easing

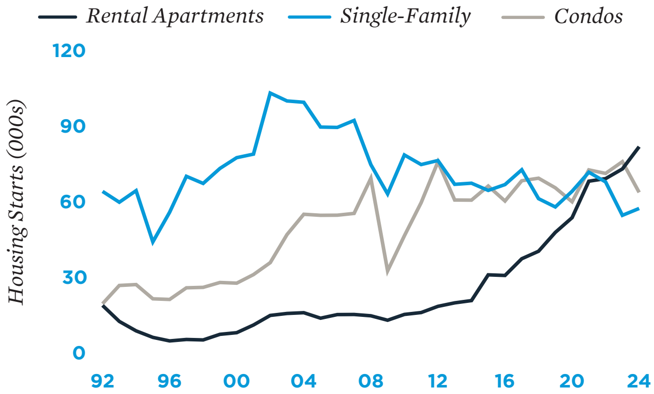


Construction Price Index Outpacing Inflation

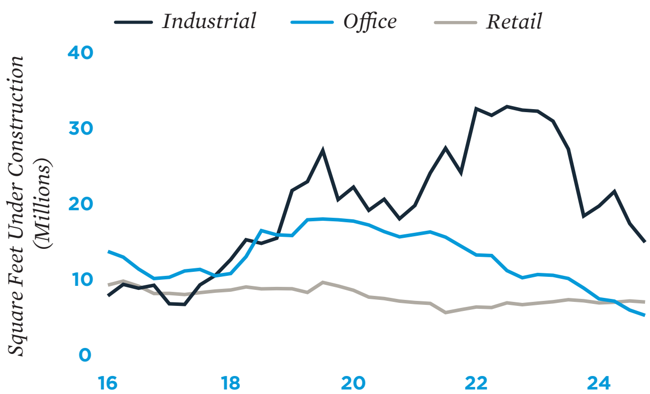


** Through January; ** Through November;*
Sources: Bank of Canada; Statistics Canada

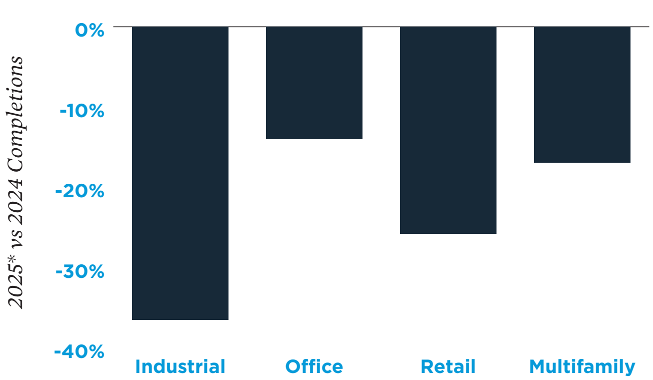
Apartment Rentals a Preferred Build Type



Nonresidential Construction Pipeline Shrinking



Completions Projected to Decline in 2025



Demand dynamics a key factor for developer sentiment. With construction costs elevated, the strength of demand has become increasingly crucial for builders in assessing the feasibility of development projects. In the multifamily sector, recent surging population and barriers to homeownership have fuelled strong interest in rentals. Alongside government support aimed at increasing supply, this momentum has led to a boom in purpose-built rental development. From 2020 to 2024, apartment rental construction starts grew at an average annual rate of 11 per cent, making it the most active dwelling type in terms of new starts last year. In contrast, elevated interest rates over the past two years have slowed consumer spending and business investment, leading to weaker demand in the industrial and office sectors. This has weighed on developer confidence, resulting in the total under-construction pipeline falling to a seven-year low by the end of 2024.

Builders to maintain a risk-off stance in 2025. Looking ahead, the anticipated demand recovery in 2025 is likely to be clouded by uncertainties, which will weigh on construction activity. A dovish Bank of Canada should keep cutting interest rates to stimulate investment and consumption, driving demand growth across all commercial real estate sectors. Lingering tariff threats and a projected slowdown in population growth, however, pose considerable headwinds to this outlook. Shifts in economic policies following this year's federal election will also further stoke uncertainty. As a result, developers will likely adopt a more cautious approach this year, awaiting greater clarity on economic and political conditions before initiating new projects.

Limited supply growth helps to stabilize CRE fundamentals. Amid growing uncertainties, the anticipated supply constraint will help mitigate the impact of a potential demand downturn. In the industrial sector, escalations of trade tensions could delay projects currently under construction and lead to the cancellation of planned developments, resulting in lower-than-expected completions in 2025 and beyond. This will help keep a lid on the rise in the vacancy rate while demand and supply adjust to a new equilibrium. In the multifamily sector, although development activity has been on a recent rise, decelerating population growth expected in the future and other cost pressures have now started to weigh on construction. This has lead to a modest slowdown in starts entering 2025, especially in Canada's more expensive markets like Toronto. Coupled with Canada's persistent housing shortage, this pullback in new supply will provide further runway for rent growth over the long term.

Prepared and edited by
Frank Zhao
Research Analyst,
Canada | Research Services

Luke Simurda
Director of Research,
Canada | Research Services

For information on national commercial real estate trends, contact:
John Chang
Senior Vice President, Director
Research & Advisory Services
Tel: (602) 707-9700
jchang@ipammi.ca

** Forecasts assume no implementation of U.S. tariffs*

Sources: Marcus & Millichap Research Services; Altus Data Solutions; CMHC; CoStar Group, Inc.; Bank of Canada, Statistics Canada

Price: $1,500