SPECIAL REPORT
CANADA FEDERAL ELECTION

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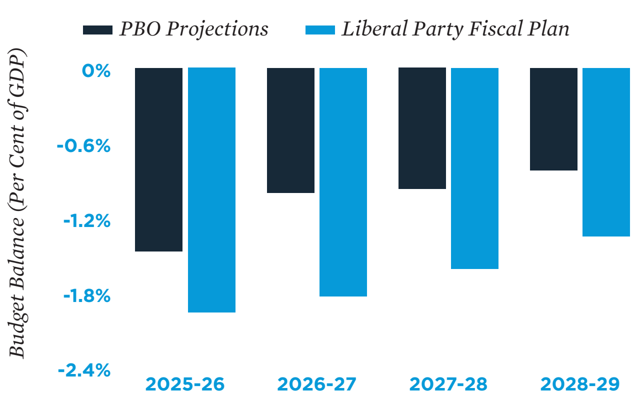
New Fiscal Approach a Tailwind for Commercial Real Estate

Canada's new administration embraces a pro-growth strategy. Although major policies from the new Liberal government are still taking shape, its fiscal and costing plan – released during the campaign – offers some insight into its policy direction. Distinguishing the administration from its predecessor is a stronger emphasis on pro-growth capital expenditure over operating spending. This shift could have important implications for Canada's fiscal balance and long-term economic growth. With a modest fiscal expansion focused on tax relief for consumers and new investments aimed at addressing Canada's persistent productivity challenges, the commercial real estate sector is well positioned to benefit. All major CRE segments are expected to see major gains from this policy tailwind.

Government budget to gravitate towards capital spending. One of the key policy changes under the new Liberal government is a major restructuring of the federal budget framework. For the first time in Canadian fiscal history, a clear separation between operating and capital spending will be introduced. Operating expenditures cover the government's routine costs, such as salaries for federal employees and transfers to individuals. Capital expenditures, on the other hand, involve investments in infrastructure, equipment and new incentives aimed at supporting private-sector capital formation. Prime Minister Mark Carney has pledged to eliminate the operating deficit by the 2028 budget, while allocating more than half of all new spending over the next four years to the capital budget.

The Liberals' Plan for a Larger Fiscal Deficit



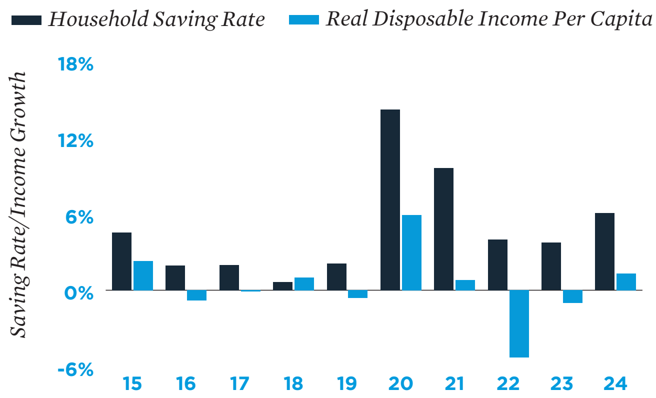
Spending on investment to widen deficit. According to the Liberal Party's fiscal and costing plan, the new government intends to spend $129 billion on new investments over the next four years, including $35 billion in the current fiscal year. Top new spending measures include infrastructure for critical health care, communities and Indigenous groups, as well as the cancellation of the planned increase in the capital gains inclusion rate. Apart from these new investments, the largest single contributor to deficits this year will be a middle-class income tax cut, estimated to cost $4.2 billion. These spending measures are expected to bring the government deficit to just under 2.0 per cent of GDP this fiscal year, with a goal of reducing it to below 1.4 per cent by the 2028-29 budget. Compared with existing projections from the Parliamentary Budget Officer (PBO), the new plan represents a modest fiscal expansion. If the Liberals must cooperate with other parties to pass legislation, fiscal concessions are likely, potentially resulting in a higher deficit than initially planned.

Fiscal expansion could ease the burden on the Bank of Canada. The moderate fiscal stimulus is expected to act as a key counter-cyclical force to help Canada navigate near-term headwinds stemming from higher U.S. tariffs and ongoing trade policy uncertainty. The potential for a higher fiscal deficit also introduces upside risks to the market's expectation of a 2 per cent to 2.25 per cent overnight rate by the end of this year. In the longer term, the investment-driven fiscal plan could help address the weakness in Canada's economy: a lack of productivity growth due, in most part, to subdued investment.

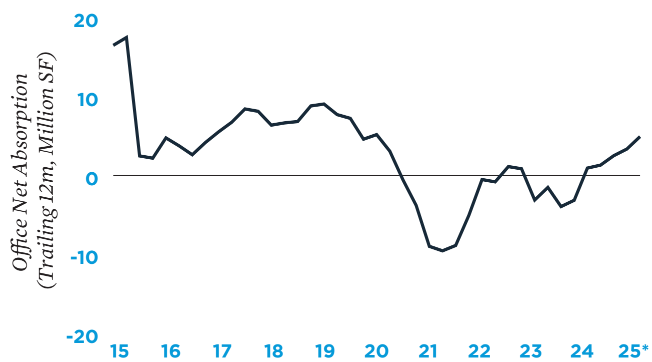
Housing market a key focus. Addressing the ongoing housing shortage – one of Canadians' top public concerns – will be a key priority for the new government. Major policy initiatives aim to boost supply by delivering affordable housing at scale, encouraging development with a 50 per cent reduction in development charges. A suite of tax incentives and financing tools will also be introduced, designed to support and streamline both single-family and multi-unit rental construction. If successfully implemented, these measures could significantly expand housing supply and help address the structural imbalance in Canada's housing market. As a result, the multifamily sector may see a substantial increase in apartment completions going forward. Coupled with easing rental demand due to slower population growth, this supply tailwind may lift the multifamily vacancy rate to a more sustainable level, offering further relief for renters.

Sources: Capital Economics; Liberal Party; Parliamentary Budget Officer

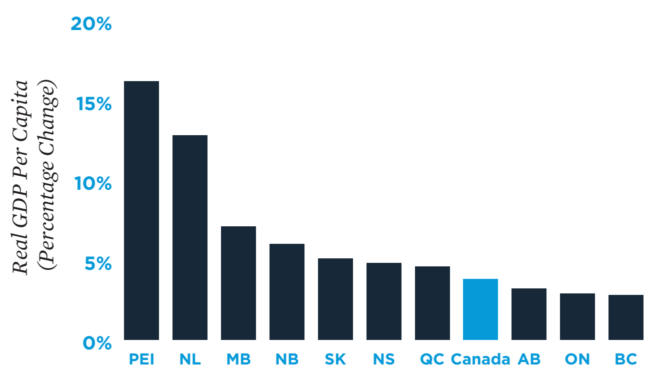
Consumer Health Improved Entering 2025



Office Demand on Recovery Path



Gains From Internal Trade Liberalization



* Through 1Q

Tax cuts to benefit retail sector. The pro-growth fiscal measures with the most immediate and visible impact are the income tax cut and the GST reduction for first-time home buyers. With a one percentage point reduction in the lowest tax bracket, a dual-income family is estimated to save up to $825 per year. The GST cut on homes priced up to $1 million will help first-time buyers save up to $50,000. Following the recent sales tax holiday and the removal of the carbon tax, these measures will continue to support consumption – especially at a time when consumer confidence has been dampened by trade policy uncertainties. Coupled with lower interest rates, improving disposable income and a higher household saving rate heading into 2025, this fiscal tailwind is expected to further benefit the retail sector. It will likely keep net absorption in expansionary territory and help maintain a low vacancy rate this year.

Tech sector to become the next driver for office demand. A focus on artificial intelligence is central to the Liberal government's strategy of building an "economy of the future." The new administration has pledged $446 million to AI investments over the next four years. Additional federal funding, along with private-sector partnerships, is also planned to expand data centre infrastructure. This AI-driven policy is expected to support tech sector employment amid falling interest rates, contributing to growth in office-using jobs and aiding the ongoing recovery in the office sector. Regions with a high concentration of tech employment – such as Ottawa and the Toronto-Waterloo Corridor – are well positioned to benefit from this momentum.

Industrial sector set for long-term growth as trade strengthens. The tariff threat from the U.S. earlier this year posed an existential risk to Canada. As such, the liberalization of internal trade and the diversification of export markets have become priorities for the new government. The Liberals have pledged to reduce internal trade costs by up to 15 per cent by eliminating all federal barriers to interprovincial trade and removing all federal exceptions under the Canadian Free Trade Agreement. The government is also expected to launch a new Trade Diversification Corridor Fund, injecting $5 billion into transportation infrastructure to help expand Canada's trade partnerships. These measures are set to create new opportunities in the manufacturing and transportation sectors. Long-term demand in the industrial market will be supported as Canada becomes more self-sufficient and strengthens trade ties with a broader range of countries.

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