NATIONAL REPORT

CANADA RETAIL

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

2Q/25

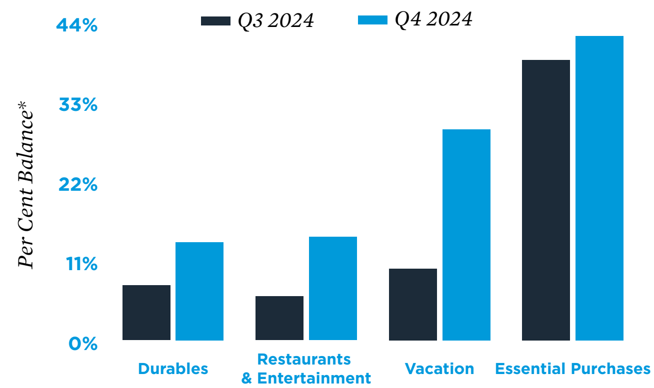
Consumer Resilience, Limited Supply to Curb First Vacancy Rise in Years

Canada's retail sector delivered strong performance last year. In 2024, amid still-elevated population growth, falling interest rates boosted consumer spending, driving net absorption above completions for the fourth consecutive year. As a result, the vacancy rate fell to a record low of 1.5 per cent. Entering 2025, consumers planned to increase both essential and discretionary spending, setting the stage for another year of expansion for retailers. With trade risks rapidly emerging, however, this once seemingly assured recovery now faces renewed doubt. Trade threats may be less severe than initially feared, but lingering uncertainties will weigh on business and consumer confidence. While the previously optimistic retail outlook for 2025 has been dampened, Canada's retail sector is expected to stay resilient. The vacancy rate is projected to stay below 2.0 per cent by year-end.

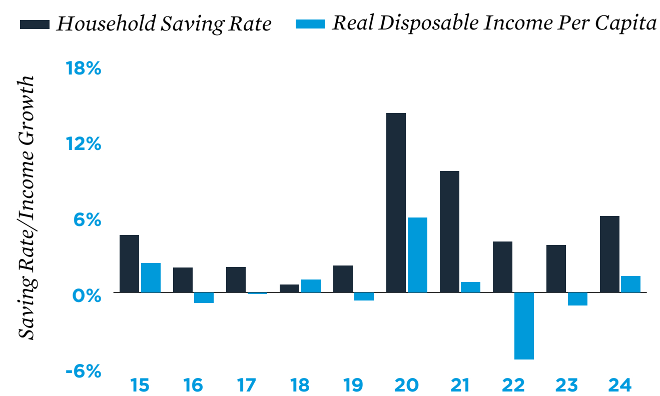
Improved consumer health to support space demand. Trade disruptions could severely impact Canada's economy, but improving consumer health heading into 2025 should help cushion potential headwinds. While cost-of-living pressures eased – driven by falling debt-servicing costs and cooling inflation – disposable income saw its first increase in 2024 after two years of decline, pushing the household saving rate up to 6.1 per cent. Excluding 2020 and 2021, when the global health crisis disrupted economic trends, these indicators suggest the average Canadian consumer has finally regained some strength after nearly a decade of slack. Consumer resilience, combined with expected policy support in the event of escalating trade tensions, will serve as a buffer, preventing space demand from deteriorating under challenging economic conditions.

Limited inventory growth to keep vacancy low. A robust absorption rate has yet to spur new building activity for retail properties, contrasting the demand-driven construction boom for rental apartments and industrial properties. Completions have hit a record low every year since 2018, and 2025 will likely be no exception, given the current under-construction pipeline. Retail projects typically require prime locations, customized designs and extensive amenities. As such, these are not just more costly to build, but also subject to a more onerous approval processes than other property types. Additionally, construction resources in recent years have been directed towards the residential sector to address Canada's housing shortage. As a result, most new retail supply now consists of smaller mixed-use storefronts.

Households Planned to Increase Spending



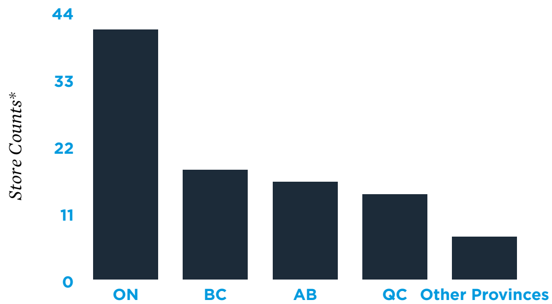
Consumer Health Improved Entering 2025



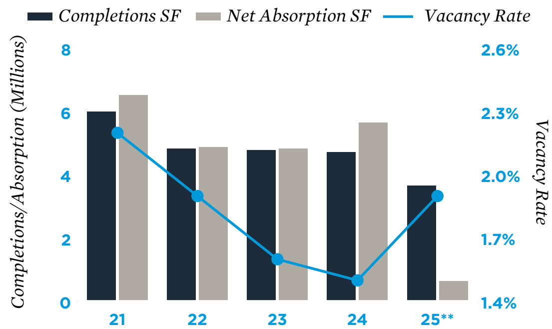
Retail Construction Pipeline Shrinking

** Percentage of respondents expecting their spending to increase minus the percentage expecting their spending to decrease.*
Sources: Bank of Canada; CoStar Group, Inc.; Statistics Canada

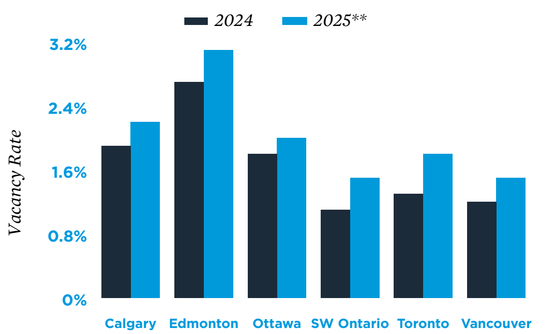
Hudson's Bay Store Distribution in Canada



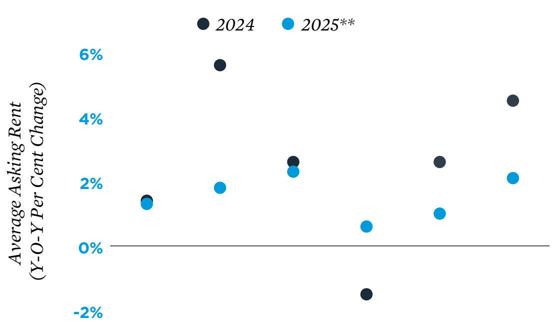
Retail Supply and Demand Trends



Retail Vacancy to Increase in All Metros



Rent Growth to Moderate in 2025



** Includes Hudson's Bay, Saks Fifth Avenue and Saks OFF 5TH stores in Canada;*
*** Forecasts*

Sources: CoStar Group Inc.; Storeys.com

The Bay's Fall and Its Impact

Canada's oldest retailer shuts down stores amid changing retail landscape. The liquidation of Hudson's Bay Company (HBC) marks the latest big-box retailer closure in Canada, following a wave of high-profile exits, including Zellers, Sears and, most recently, Nordstrom. Beyond HBC's own struggles, traditional retailers have faced mounting challenges due to shifting consumption patterns in the post-pandemic era, such as the rise of e-commerce and experiential retail. Retailers have responded by adopting omnichannel strategies, developing interactive and immersive stores, and integrating physical locations with digital experiences. The higher cost of living over the past three years has also fuelled growth in the essential-based retail sector, prompting major grocers to expand into this market segment while consumers are redirecting spending.

HBC's closure unlocks potential for owners and operators. With over five million square feet of retail space expected to be freed up after the closure of all but six HBC stores, vacancy rates may rise in affected areas. Yet because many of these sites are in prime locations, where large, high-quality spaces have become increasingly scarce, they will likely be absorbed in the coming years. Since retailers are unlikely to reuse the vacated floorplans as is under current market conditions, owners may need to redevelop or repurpose these properties for mixed-use. Additionally, many of HBC's long-term leases were signed at below-market rates and have weighed on building performance. The retailer's exit could ultimately boost net operating income for owners once new tenants move in.

Major Market Overviews

Western Canada. In Vancouver, tariff uncertainties and mortgage renewals at higher rates are poised to curb consumer spending, driving an increase in vacancy. Completions will remain limited, though, with the majority of additions consisting of mixed-use projects. This will help maintain a sub-2 per cent vacancy rate in 2025. In Edmonton and Calgary, a lower cost of living and economic diversification have fuelled strong population growth in recent years. Combined with fewer construction restrictions, this growing consumer base has spurred some of the largest retail development pipelines in Canada. As the two metros' population gains are projected to exceed the national average, the retail vacancy rate is set to stay low. That said, the metric may rise slightly due to near-term headwinds amid trade uncertainties.

Eastern Canada. Markets with higher exposure to manufacturing and trade will feel the impact of tariff threats more acutely, including Southwestern Ontario and suburban stretches of the Greater Toronto Area (GTA) such as Oshawa, Brampton and Mississauga. In contrast, space demand may hold up better in Ottawa, where the local economy relies heavily on the public and tech sectors. While vacancy rates are projected to rise across all three metros, limited construction activity will help provide some stabilization. As most of HBC's stores were located in Ontario – primarily in the GTA and Southwestern Ontario – its liquidation will unlock quality retail space. Tenants struggling to expand in prime locations due to space constraints may find opportunities with HBC's closure. Vacancy could rise more notably in affected areas, but absorption over the coming years should lead to stabilization.

2025 Forecast

EMPLOYMENT

1.0% increase Y-O-Y

- Lower interest rates are expected to support job growth in 2025, albeit at a slower pace; however, trade tensions remain a key headwind. Employment could decline if U.S. tariffs push Canada into a recession.

CONSTRUCTION

3.7 million square feet to be completed

- Retail construction is set to reach a new low in 2025. Despite strong demand for space, developers have increasingly prioritized residential projects, incorporating retail primarily as ground-level mixed-use space.

VACANCY

40 basis point increase Y-O-Y

- Vacancy is poised to rise, but hold below 2.0 per cent. Because tariff uncertainties will affect consumer sentiment, putting pressure on spending, retailers are likely to take a more cautious approach.

ASKING RENT

1.4% increase Y-O-Y

- As vacancy stays low, retail rents are expected to continue rising, but the pace of increase will slow due to vacancy rates climbing. The average asking rent is projected to approach $32 per square foot.

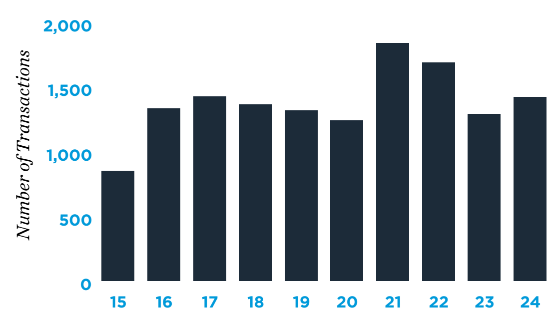
2025 Investment Outlook

- **Eastern Canada and smaller deals characterize sales in 2024.** As financing costs declined last year, investment activity improved, led by a rise in small-sized deals valued under $10 million. Regionally, eastern metros were the main contributors to this sales growth. Montreal led with a 35 per cent increase in the number of transactions, followed by Ottawa and Toronto, where volumes rose by 20 per cent and 10 per cent, respectively. Food-anchored retail strips were the top investment choice in nearly all metros, as essential goods and services drove Canada's retail spending over the past year.

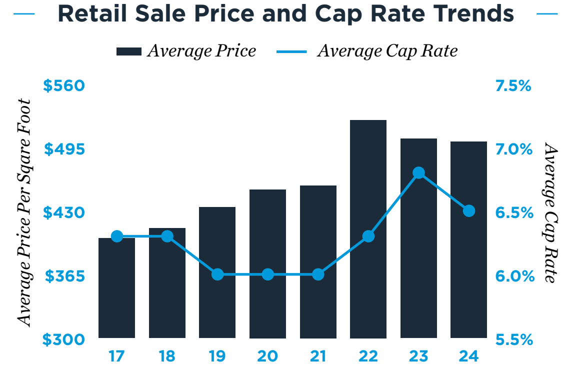
- **Some investors remained cautious**. Despite a sizable increase in the number of sales, dollar volume edged up by just 2.7 per cent, leading to a slight decrease in the average price. Investors eyeing larger properties stayed on the sidelines, likely awaiting further declines in borrowing costs and greater clarity on the sector's outlook. Even so, the average cap rate fell by 30 basis points despite the price drop, suggesting a lower perceived risk for retail investment overall.

- **Uncertainties dim prospects for recovery.** This year's sales outlook will hinge on how uncertainties unfold between tariff threats and policy support. A sustained recovery is possible if trade tensions ease swiftly and investor confidence is restored. As the first quarter closes without a clear resolution in sight, however, buyers are likely to step back, dampening hopes for a broad-based rebound.

Retail Investment Sales Trend



Retail Sale Price and Cap Rate Trends



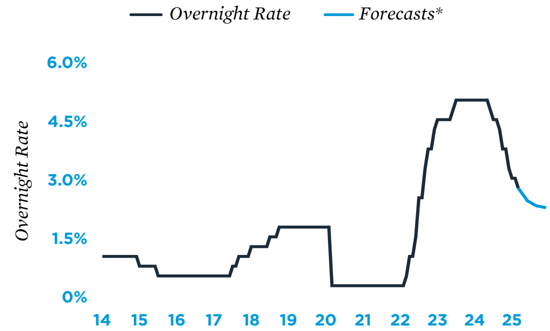
Sources: Altus Data Solutions; CoStar Group, Inc.; Statistics Canada

Falling Interest Rates Present Favourable Entry Points as Trade Tensions Leave Visible Marks

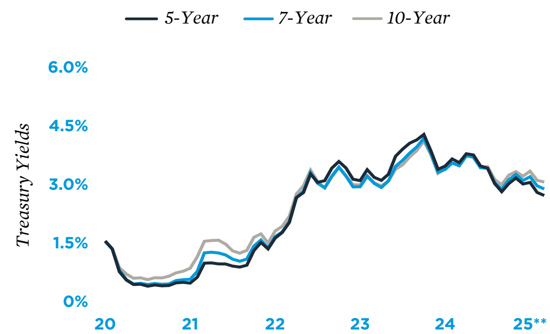
Policymakers watching to see how trade tensions unfold. Since the Bank of Canada's March rate cut, unfavourable economic trends have begun to trickle in. Consumer confidence, as measured by The Conference Board of Canada, fell to a record low in March. Sentiment regarding future job prospects diminished to levels last seen during the Great Financial Crisis. This sharp decline may have been an overreaction, as the pause on U.S. tariffs and a change in Canada's leadership overlapped with the survey period. Even so, concerns over mounting uncertainties were not unwarranted. In the housing market, trade tensions and domestic political uncertainties are placing further pressure on home buyers on top of still-elevated mortgage rates. In February, total home sales in the GTA fell by 27 per cent year over year. Only 400 new homes transacted – a 50 per cent drop from the same month last year. Over the coming months, this sudden shift in confidence will likely be more clear in upcoming hard data releases, such as industrial production, consumer spending and international trade. Governments at all levels are expected to respond with additional support measures to cushion the blow if tariff threats escalate. The Bank of Canada will closely monitor the combined effects of trade disruptions and fiscal support on economic growth and inflation. Maintaining both economic expansion and price stability will remain the central bank's primary goal and its biggest challenge as tariff threats persist.

Lower yields could unlock new opportunities. While trade risks will inevitably weigh on investor confidence, recent interest rate trends signal that favourable entry points may emerge later this year for buyers. Concerns over a slowing economy amid reinflation have recently prompted investors to shift funds from the stock market to the bond market, leading to a decline in bond yields. The 5-year yield, for instance, has dropped by more than 30 basis points since January. Further room for yield drops is likely if the economic outlook deteriorates, fuelling a continued de-risking trend. Because long-term fundamentals in the retail sector are still sound, an improvement in financial conditions will facilitate transactions for larger-sized properties. Assets that can withstand a short-term economic downturn may especially benefit, such as grocery-anchored retail centers offering essential goods and services. The liquidation of HBC will also create opportunities for investors seeking quality spaces in prime locations for long-term gains.

Further Rate Cuts Expected Through 2025



Treasury Yields Trends



** Forecasts are calculated as the average of the latest forecasts from TD, RBC, Scotiabank, CIBC and National Bank; ** Through March*

Sources: Marcus & Millichap Research Services; Altus Data Solutions; Bank of Canada; CIBC; CoStar Group Inc.; National Bank; RBC; Scotiabank; Storeys.com; TD Bank

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