NATIONAL REPORT

CANADA RETAIL

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

3Q/25

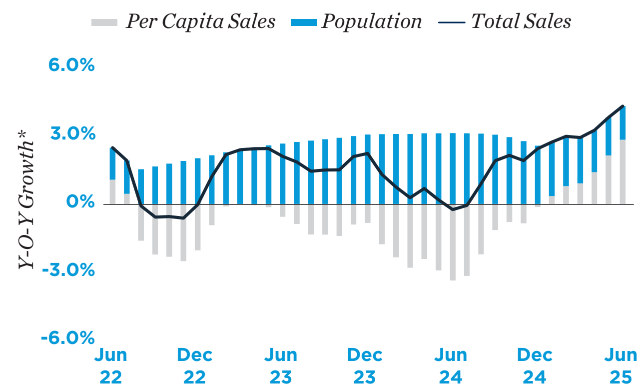
Resilient Spending and Limited Supply Drive Retail Sector Strength

Sector fundamentals hold up despite headwinds. With the release of second quarter data, the impact of trade policy uncertainties and higher tariffs over the first half of the year has become more apparent. A mild decline in space demand reflects softening leasing activity, leading to higher vacancy rates as net absorption lagged completions. Absorption remained firmly in positive territory, however, beating initial fears of a recession-driven wave of store closures. While trade negotiations appear to be progressing more slowly than expected, Canada's recent removal of retaliatory tariffs on USMCA-compliant U.S. imports offers some hope for easing tensions that could bolster confidence for both retailers and consumers. Faster retail sales growth may strengthen space demand in the second half of the year, ending 2025 with robust sector fundamentals.

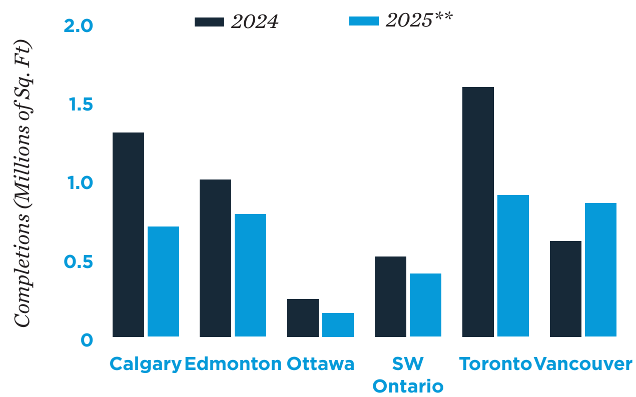
Per-capita spending driving larger receipts at retailers. Although the latest consumer sentiment survey points to reduced spending intentions, retail sales have shown no signs of slowing so far this year. On a three-month average basis, year-over-year real retail sales growth accelerated to 4.3 per cent in June – the fastest pace since August 2021. Given the sharp slowdown in population growth, this resilience is particularly notable. Resident gains now account for only about 34 per cent of total real sales growth, compared with mid-2024 when total sales gains were driven entirely by population increases. Instead, per-capita spending has taken the lead, supported by lower borrowing costs. With the Bank of Canada expected to maintain a dovish stance through the rest of 2025, retail spending is likely to sustain this momentum, providing a solid foundation for space demand.

Limited supply growth persists. In 2025, retail construction activity is projected to slow to its lowest pace since 2016. With fewer new openings in Toronto, Calgary and Edmonton, total completions are expected to fall to 3.8 million square feet. The slowdown is a result of elevated financing and construction costs, as well as lingering uncertainty around trade policies, which are limiting project feasibility. Additionally, the post-pandemic shift towards e-commerce and the diversion of resources towards housing construction are tempering the supply of new large-format retail space. Even with demand moderating in the first half of the year, limited supply is expected to keep the vacancy rate below 2.0 per cent through year-end.

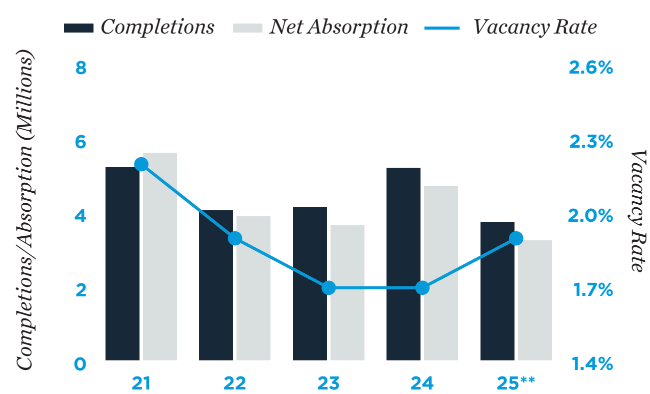
Real Retail Sales Fueled by Per Capita Gains



Completions to Decline in Most Metros



Retail Supply and Demand Trends



** 3-month moving average ** Forecast*
Sources: Bank of Canada; CoStar Group, Inc.; Statistics Canada

2025 Rent and Vacancy Forecasts

Sources: CoStar Group Inc.; Statistics Canada

WESTERN CANADA

- **Calgary, Alberta:** Calgary's retail market shows a clear divide: rapid suburban growth is fuelling demand for grocery-anchored and mixed-use shopping centres, while downtown continues to lag amid limited population gains and office sector headwinds. Still, city-led initiatives, including office conversions and post-secondary relocations, are poised to boost foot traffic and support a gradual downtown retail recovery.

- **Edmonton, Alberta:** Edmonton's retail sector shows strength in suburban areas, where affordability and population growth are driving demand and keeping vacancy below 3.0 per cent. Yet downtown continues to struggle with rates above 10 per cent due to weak office-driven foot traffic. Even so, strong consumer fundamentals – high disposable incomes, energy and tech sector jobs, and rising retail spending – support a positive outlook.

- **Vancouver, British Columbia:** The metro's retail sector remains one of Canada's strongest, supported by a resilient economic base that is less exposed to U.S. tariffs and bolstered by robust employment growth. Retail sales are outpacing the national average, while tourism continues to provide an additional lift. Together, these factors position the retail sector for sustained outperformance in 2025.

EASTERN CANADA

- **Ottawa, Ontario:** Downtown Ottawa is showing signs of recovery, as return-to-office trends and the city's Downtown Ottawa Action Agenda are supporting leasing demand. Suburban vacancies, however, have edged higher amid slowing population growth. With no major projects in the pipeline, limited new supply, alongside improving core activity, is expected to help fundamentals, positioning downtown vacancy to gradually move back towards pre-pandemic levels.

- **Southwestern Ontario:** Strong population-driven demand that once tightened Southwestern Ontario's retail market is now easing as immigration slows and trade frictions weigh on leasing activity. Yet despite these near-term headwinds, limited new development and a relatively thin under-construction pipeline are expected to keep vacancy rates low, maintaining stable fundamentals.

- **Toronto, Ontario:** Resilient suburban demand and limited new supply kept retail vacancy near record lows in mid-2025, even as downtown conditions softened. With construction activity focused on mixed-use projects, retail inventory growth will remain restrained, supporting existing operators. These dynamics, along with shifting consumer preferences towards local goods, are expected to uphold healthy fundamentals despite trade-related uncertainty.

2025 Forecast

EMPLOYMENT

0.7% increase Y-O-Y

- Although trade tensions are slowing employment growth this year, lower interest rates are likely to provide some relief. Additionally, lower population growth could help cap the rise in the jobless rate.

CONSTRUCTION

3.8 million square feet to be completed

- Retail construction is expected to hit a record low. Even amid resilient demand, developers are increasingly focusing on residential projects, with retail largely limited to ground-floor mixed-use components.

VACANCY

20 basis point increase Y-O-Y

- Stronger-than-expected consumer spending will help leasing activity, keeping the vacancy increase modest. The national average rate is projected to remain below 2.0 per cent, still signalling tight market conditions.

ASKING RENT

1.9% increase Y-O-Y

- Retail rents are expected to continue rising as vacancy remains low, though the pace of growth will slow as uncertainty lingers. The average asking rent is projected to approach $32 per square foot by year-end.

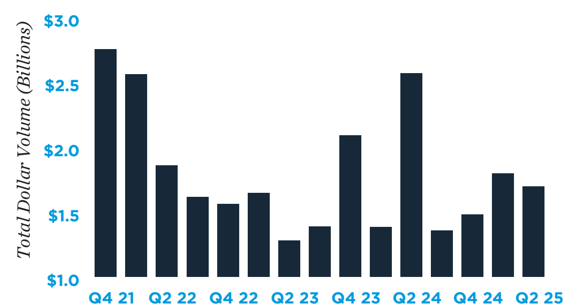
2025 Investment Outlook

- **Investment activity held up in the first half.** While both total dollar volume and deal count were lower year over year, transaction momentum stayed solid in the first half of 2025. Part of this was likely due to a change in capital gain tax policy last year. Compared with the second half of 2024, the total number of transactions edged down, yet overall dollar volume rose by 23 per cent, reflecting a shift towards larger, high-profile acquisitions. This trend suggests that investors are increasingly targeting prime retail assets, even as overall market sentiment was hit by trade policy uncertainties earlier this year.

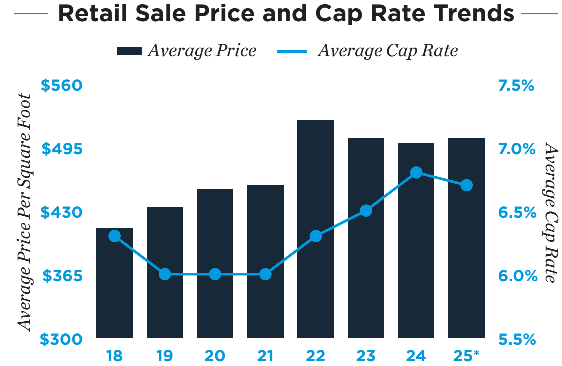
- **Prices rose, putting downwards pressure on cap rates.** The steady deal flow has helped sustain the average sale price, which climbed back above $500 per square foot in the second quarter. Gains in key markets including Calgary, Montreal, Ottawa and Vancouver more than offset declines seen in other metros, indicating strong investor demand for high-quality assets. As a result, the average cap rate edged down by 10 basis points, underscoring pricing pressures and the relative scarcity of prime retail properties.

- **Trade uncertainty has failed to shake investors.** Retail investors have largely viewed trade policy uncertainties as a short-term headwind, leaving long-term investment plans intact. This perspective has supported robust investment activity in 2025 — a trend likely to be further reinforced by resilient consumer spending underpinning demand for retail space.

Retail Investment Sales Trend



Retail Sale Price and Cap Rate Trends



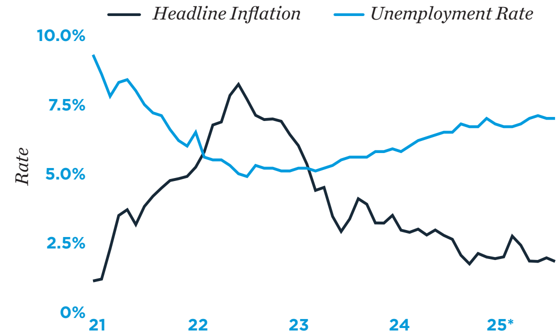
** Trailing 12-month through 2Q*
Sources: Altus Data Solutions; CoStar Group, Inc.; Statistics Canada

Domestic and Global Factors Supporting Lower Borrowing Costs

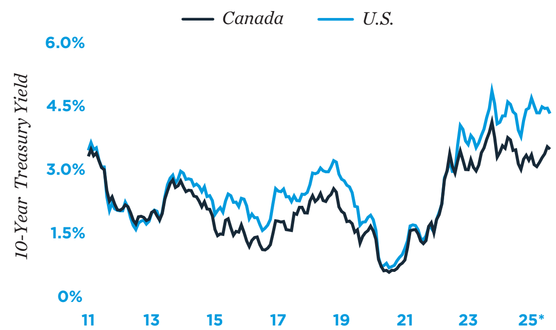
Trade developments strengthen case for rate cuts. Economic data from the first half of 2025 indicates a modest rise in core inflation alongside a slowdown in economic activity, driven primarily by weaker exports and reduced investment. This mild stagflationary environment, stemming from supply-side pressures, has prompted the Bank of Canada to adopt a cautious, wait-and-see approach after its precautionary rate cut in March. Recent developments, however, suggest that conditions may be shifting in the near term, which could allow the BoC to recalibrate its policy stance. The removal of import duties from Sept. 1 on all USMCA-compliant U.S. goods is expected to ease cost pressures for both businesses and consumers. At the same time, the U.S. has raised tariffs to 35 per cent on non-USMCA-compliant Canadian imports, which alters the inflation outlook by making the slowdown in economic growth a stronger downwards force on prices. Taken together, these factors may clear the way for the BoC to consider further interest rate cuts, as downside risks to economic growth take center stage.

U.S. policy development may improve Canada's financial conditions. Since the Bank of Canada began cutting interest rates in June 2024, long-term rates have remained stubbornly high. While the overnight rate has been lowered by 225 basis points, the 10-year government bond yield has barely budged. This persistence reflects a combination of factors, including Canada's growth outlook, fiscal policy, long-term inflation expectations and elevated U.S. long-term rates. Recent U.S. developments, however, suggest long-term yields may start to ease. The July U.S. nonfarm payroll report revised June and May employment down by a combined 258,000 jobs, signalling a notably weaker labour market than initially estimated. Following this, at the Jackson Hole economic summit, Fed Chair Powell indicated the potential need to adjust U.S. monetary policy. Market participants now see a September rate cut as highly likely, with consensus pointing to almost a 100 per cent probability. Should a cut materialize, it would mark the resumption of the Fed's easing cycle, which could help lower long-term rates in both the U.S. and Canada. Lower borrowing costs, particularly for financing tied to long-term rates, may subsequently provide a meaningful boost to investment activity in Canada's commercial real estate sector.

Inflation and Unemployment Rate Trends



Canada and U.S. 10Y Yield Trends



* Through August

Sources: IPA Research Services; Bank of Canada; Federal Reserve; Statistics Canada

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