THE OUTLOOK
CANADA

IPA INSTITUTIONAL PROPERTY ADVISORS

MIDYEAR 2021

Economic Indicators Divergent After Third Wave of Lockdowns; Property Owners Optimistic for a Strong Second Half

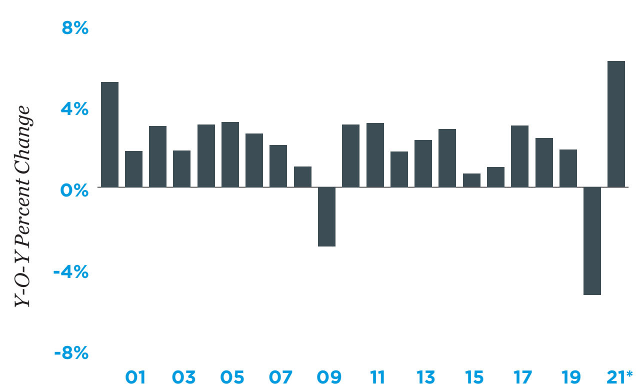
Additional outbreak stunted jobs recovery. A third wave of the virus in the spring induced greater restrictions in some provinces. This temporarily weighed on the country's recovery in the first half. Canada shed roughly 275,000 jobs across the months of April and May, many of which were part-time roles in the service industries. The depletion of part-time staff is usually not career-altering, and thus has less of a negative economic ripple effect as these positions can be recovered quickly. This was the case as provinces reopened in early summer, leading to the addition of 230,700 roles in June, approximately 84 percent of what was lost in the previous two months. Minimizing the health threat is also permitting more firms to bring employees into the office, aiding the sectors' recovery. Nevertheless, in the first two weeks of July, Google mobility data revealed that daily commutes to workplaces were still more than 30 percent below the pre-pandemic level on average.

Savings hint at forthcoming retail surge. The consumption of goods and services was impeded by the additional virus outbreak and related restrictions. Retail sales dropped 5.7 percent in April, the largest monthly reduction since the onset of the pandemic. The moderation was driven by weaker demand for nonessential goods like clothing and accessories, with many confined to their residences. A return to workplaces and public spaces should generate demand for these types of products and underpin a broader retail recovery. Property owners in most provinces will benefit from an uptick in domestic foot traffic, and eventually tourist spending. In early July, the Bloomberg Nanos Canadian Consumer Confidence Index was at the highest value since polling began in 2008. Sentiment is buoyed by ongoing vaccination efforts as well as healthy household financials. The household savings rate was at 13.1 percent in the first quarter, up from 2.3 percent two years earlier, spearheading expectations for pent-up consumption playing out in 2021.

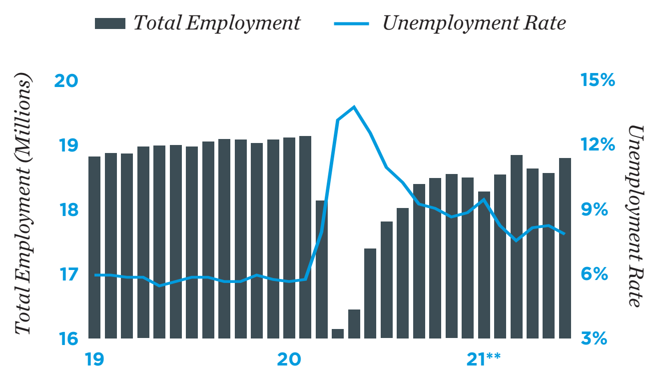
Exporter confidence soars as GDP makes headway. The economy grew by 5.6 percent annualized in the first quarter, though likely lost some momentum in April and May as COVID-19 lockdowns subdued several sectors. Exports and imports have been in flux, with Canada posting a trade surplus in April followed by a deficit in May. Activity has been constrained by internal and external forces as closed borders and a global chip shortage have disturbed the production and logistics of key commodities like motor vehicles. Many anticipate a stronger second half, however, and demand for industrial properties will elevate as trade volumes advance. Orders from the U.S., the nation's biggest trade partner, are ramping up as pent-up demand there drives spending. Meanwhile partnerships with new countries, particularly in Southeast Asia, are being formed as the nation attempts to lessen its reliance on China. From the end of 2020 to June of this year the EDC Trade Confidence Index, which surveys Canadian exporters, jumped 19 percent and notched a two-decade-plus high.

Reviving immigration is key. In the first quarter the population expanded by 82,000 residents, the biggest quarterly gain since before the pandemic. Momentum will build once the U.S. border fully reopens. Current plans are to permit vaccinated Americans to enter Canada starting in August. Prime Minister Trudeau wants to expedite immigration through student visas, intending to add 400,000 permanent residents in 2021. New citizens and students underpin multifamily demand, especially as rising home prices and tighter lending have made homeownership unattainable for many. Borrowers must now prove they can afford loans at the current rate plus 200 basis points, or 5.25 percent. Prior to this stress test enacted in June, it was estimated that one-fourth of new mortgages had loan-to-income ratios above 450 percent. These rules should bolster apartment demand and protect from the fallout of high household debt.

GDP Growth Trends



Employment Trends



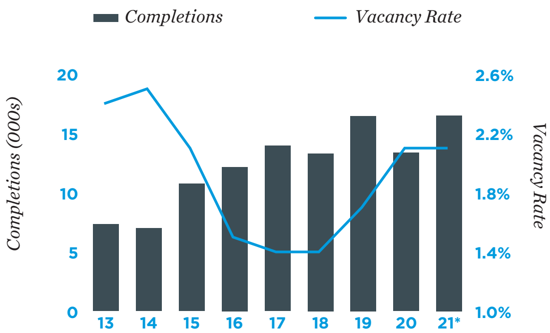
* Forecast
** Through June
Sources: Capital Economics; StatCan

APARTMENT

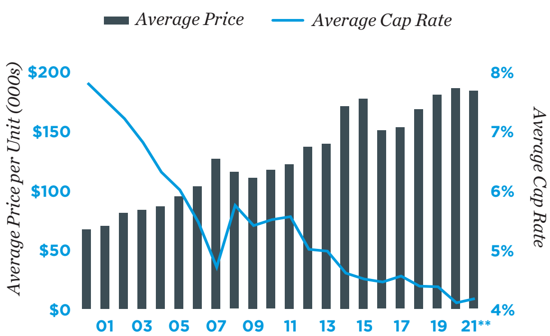
Rent Growth and Pandemic Resilience Support Buyer Appetite With Vacancy Set to Hold Firm

- Completions totaled 12,090 units over the past year ended in the first quarter, expanding stock by 1.1 percent. The pace of arrivals is expected to accelerate in 2021, with deliveries exceeding 16,000 units for the second time in the past three years.
- Canada's vacant stock elevated by one-third, or 5,720 units, during the past 12 months. The most difficult stretch has seemingly passed, however, as vacant stock shrunk in the first quarter of 2021 following three consecutive quarterly increases.
- The vacancy rate was 2.1 percent in March, up 50 basis points from the recording one year prior. Lower joblessness will translate to higher demand, aligning with the uptick in completions and keeping the vacancy rate steady through year end.
- Over the past 12 months ended in the first quarter, the average effective rent grew by 1.2 percent to $1,574 per month in March. Newly built high-quality units entering lease-up will underscore a 2.4 percent annual rise to $1,610 per month in 2021.
- Apartment buildings changed hands with an average sale price that was 1 percent higher than the previous yearlong period ended in March at $183,000 per unit. Montreal led all major markets with a 12 percent annual jump. The average cap rate in Canada was 4.2 percent, 10 basis points below last year's reading.

Apartment Supply and Demand



Apartment Sales Trends



* Forecast

** Through 1Q

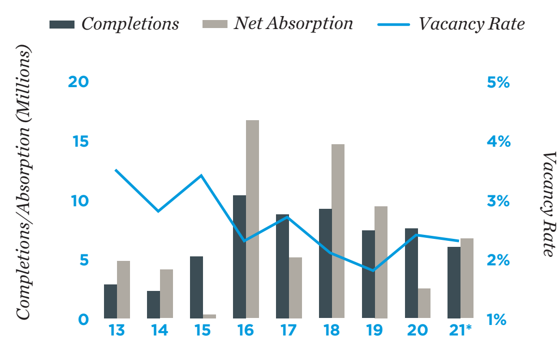
Sources: CoStar Group, Inc., RealNet

RETAIL

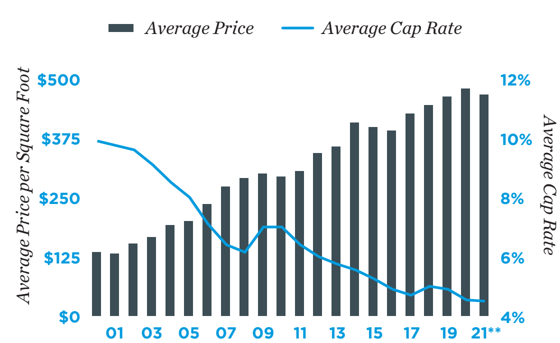
Reduced Construction to Aid Occupancy; Second-Half Spending Will Boost Sector

- Deliveries totaled 6.7 million square feet over the past year ended in the first quarter, falling below the previous period's influx. Construction will remain in check through year end, with 2021 completions anticipated to be the smallest in six years.
- In the past four quarters, vacant stock in Canada grew by 3.5 million square feet as net absorption decreased by nearly 60 percent annually. Leasing activity should accelerate in the second half of 2021, however, as COVID-19 restrictions are lifted.
- Canada's vacancy rate moved up 40 basis points year over year to 2.4 percent in March after staying flat in the previous four-quarter stretch. Fewer deliveries in 2021 will allow absorption to surpass arrivals and lower the rate to 2.3 percent.
- The average asking rent fell 0.5 percent in the past year to $23.71 per square foot in the first quarter. Rent growth is expected to resume in 2021 as headwinds retreat when a return to in-store shopping fuels greater tenant demand for space.
- Multi-tenant assets traded for an average of $459 per square foot during the past four quarters ended in March with an average cap rate of 4.5 percent. Single-tenant properties changed hands for a mean of $486 per square foot with an average initial yield of 4.3 percent. Cap rates dipped 40 basis points annually in each segment.

Retail Supply and Demand



Retail Sales Trends

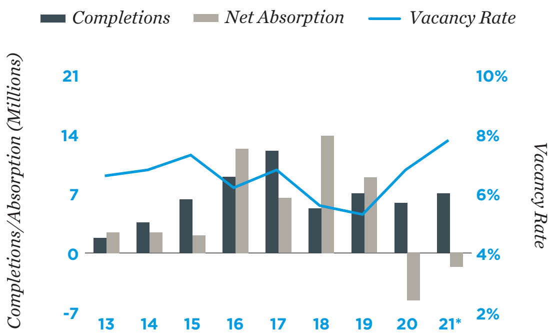


* Forecast

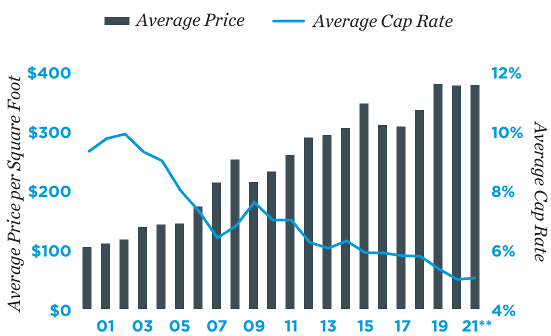
** Through 1Q

Sources: CoStar Group, Inc.; RealNet

Office Supply and Demand



Office Sales Trends



** Forecast*

*** Through 1Q*

Sources: CoStar Group, Inc.; RealNet

OFFICE

Vacant Stock Expanding as Demand Recalibrates; Risk-Tolerant Buyers Could Seize Opportunity

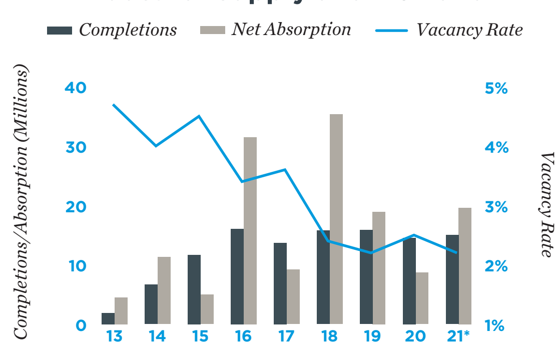
- Developers finalized 5 million square feet in the past 12 months ended in March, a 40 percent contraction from the previous year. Annual completions in 2021 are expected to total 7 million square feet, growing national inventory by 0.9 percent.
- Vacant stock expanded by 15 million square feet during the past year with net absorption totaling negative 10 million square feet. As some firms reconsider their space needs in the post-pandemic environment, absorption will remain subdued.
- Over the past four quarters, the national vacancy rate soared 180 basis points to 7.1 percent in March. The sizable influx in new space expected this year, paired with sluggish demand, will further lift the vacancy rate to 7.8 percent at year end.
- Lower occupancy applied pressure as the average asking rent fell 0.1 percent annually to $33.20 per square foot in the first quarter. New Class A builds in pricier markets will contribute to a 0.7 percent asking rent hike in 2021 to $33.45 per square foot.
- The average sale price moved up 3 percent from the previous yearlong period to $377 per square foot in March, buoyed by a double-digit jump in Toronto. Nationally, the average cap rate fell 40 basis points to 5.0 percent. These trends may be linked to buyers' shifting tolerances as they focus primarily on quality assets amid headwinds.

INDUSTRIAL

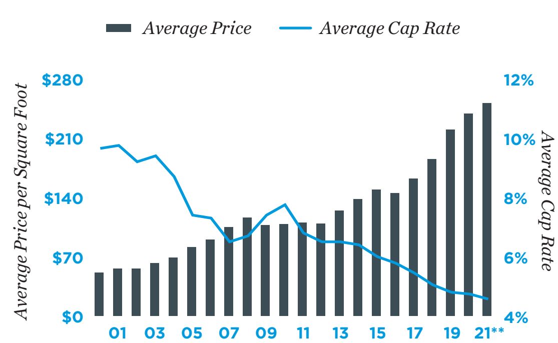
Steady Flow of Deliveries Offset Demand Momentum; Strong Outlook Luring Buyers, Fueling Higher Prices

- Canada's industrial inventory expanded by 0.9 percent during the past year ended in the first quarter as 14.3 million square feet finalized. Construction activity will remain elevated, with 15 million square feet expected in 2021.
- Annual absorption fell 3.5 million square feet shy of the previous year's 14.1 million-square-foot total as national vacant stock lifted by 11 percent. In 2021, absorption should return closer to the trailing-five-year average of 21 million square feet.
- The decline in absorption paired with consistently high deliveries pushed the vacancy rate up 20 basis points year over year to 2.3 percent in March. By the end of this year the vacancy rate will contract to 2.2 percent.
- Rent growth was less stellar than the 12.1 percent advance noted in the prior period yet remained on an upward trajectory. Robust demand in 2021 will underpin a 7.9 percent jump, reaching a national average asking rent of $10.20 per square foot.
- Facilities traded with an average sale price of $251 per square foot during the past four quarters, up 14 percent annually. Toronto, Vancouver and Montreal each had gains larger than 10 percent. The acceleration of e-commerce during the pandemic garnered the attention of more investors, intensifying the bidding environment.

Industrial Supply and Demand



Industrial Sales Trends



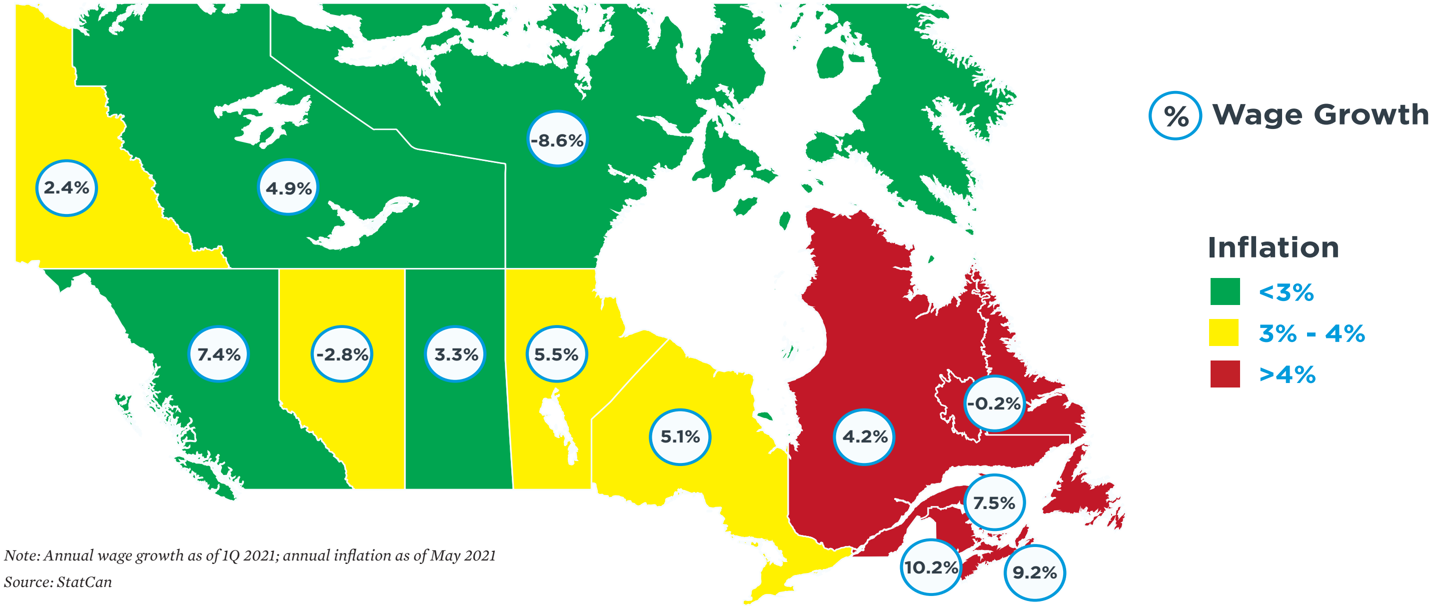
** Forecast*

*** Through 1Q*

Sources: CoStar Group, Inc.; RealNet

Inflationary Concerns More Pronounced in Eastern Provinces

Wages vs. Inflation



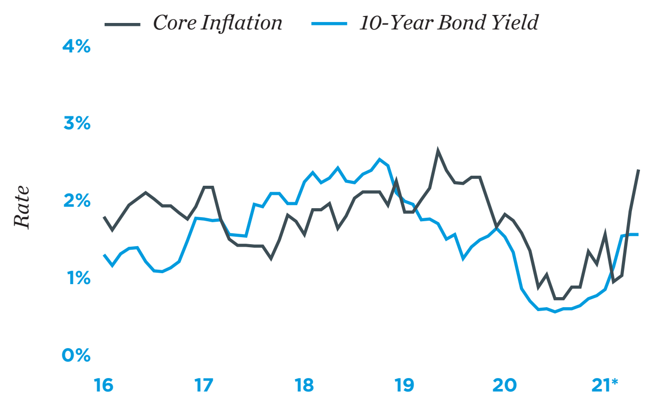
Note: Annual wage growth as of 1Q 2021; annual inflation as of May 2021

Source: StatCan

Key Policy Rate Expected to Remain Unchanged; Inflation Becoming a More Distinct Issue

Central bank to moderate quantitative easing. Core inflation reached 2.8 percent in May, while the economy hit recovery roadblocks amid a surge in COVID-19 cases. Rising prices and stalled labor market momentum in the second quarter could force the hand of the Central Bank of Canada, but as of now it considers inflation transitory and plans to keep the key policy rate at 0.25 percent. Though, it has moved up the timeline for raising the rate, setting its sights on the second half of 2022 to increase it by 25 basis points. Additionally, in the third quarter of this year the Central Bank will begin reducing weekly asset purchases from $3 billion to $2 billion, with an expectation that the economic rebound is poised to accelerate. The recent hurdles were largely due to the health threat and a higher rate of vaccinations should mitigate that front, allowing the recovery to pick up steam.

Inflation and Interest Rate Trends



** Through May*
Sources: Bank of Canada; StatCan

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Sources: IPA Research Services; Bank of Canada; Bloomberg; Capital Economics; CoStar Group, Inc.; Google COVID-19 Community Mobility Report; Export Development Canada; RealNet; StatCan