Canada **Capital Markets**

Market Snapshot

Q2 2023

Overview

Investment volume declined 40% year-over-year, as rate hikes have continued to weigh on the market. With the Bank of Canada target rate reaching a 21-year high at 5.0%. Many major banks and data providers (e.g., Oxford Economics, Royal Bank of Canada, and CIBC) have suggested continued rate hikes are possible into Q3 and even Q4. While inflation has declined, continued resilience in the job and housing markets may lead to further tightening, with the attendant impacts on the commercial investment market.

The Q2 volume of $5.4B was down from both Q1 2023 and Q2 last year, but roughly in line with volumes from 2014-2019 period. Larger deals have finally returned to the market with ~$200+ million deals transacting in office, retail and industrial in Q2. Private buyers continue to dominate the market, continuing a years long trend that accelerated during the COVID-19 pandemic. Foreign buyers continue to show interest in Canada, where a combination of favorable demographics and low rents in world context look attractive to major investors. Institutions, historically large players in the Canadian market, are at record-low levels of both buying so far in 2023 H1.

The commercial lending environment has predictably tightened, with lenders eschewing longer-term loans and demanding recourse from new borrowers. Financing office is very challenging, and any loans for speculative development are focused on shorter terms with greater certainty on the leasing side such as industrial.

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Office

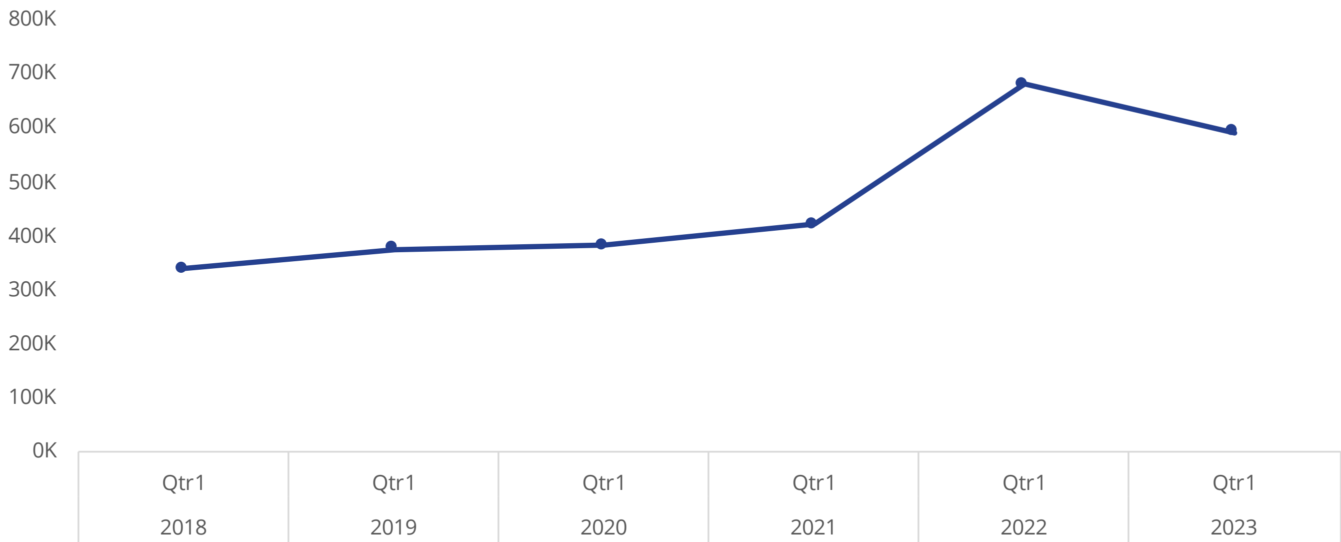
The office investment market declined 56% year-over-year, with volumes roughly in line with Q1. Rate hikes and lender skepticism are making office deals challenging in 2023.

After a quiet period, Q2 saw a larger office transaction, with the sale of Ottawa's third largest office tower to a developer. Private investors seem uniquely willing to take the risk in the office market, or position an asset for redevelopment, conversion, or demolition. Institutional owners remain almost completely unwilling to buy office, as discussed in our previous report. A lack of purchases has created further confusion about yields and pricing remains unclear in many markets due to lack of liquidity.

Vacancy rates rose for most markets, with downtown continuing to see its vacancy increase more rapidly than the suburbs. While downtown office still commands higher rents, suburban office has outperformed for leasing in many different Canadian markets. The concentration of new supply in downtown combined with affordability concerns and rapid population growth has created a challenging situation for downtown commuting and occupancy in many cities.

Year-over-year comparisons will show less dramatic results going forward, as Q2 2022 was the last of the super-charged quarters combining post-lockdown activity with record low rates. We expect Q3 to show a much more moderate yearly decline.

Q1 Full Time Job Vacancies, 2018-2023



Source: Job Vacancy and Wage Survey

$783 Million ↑

Quarterly Volume

$201 ↓

$/SF

What to Watch

Lending Outlook | Suburbs Outperforming Downtown | Lease Rates

Industrial

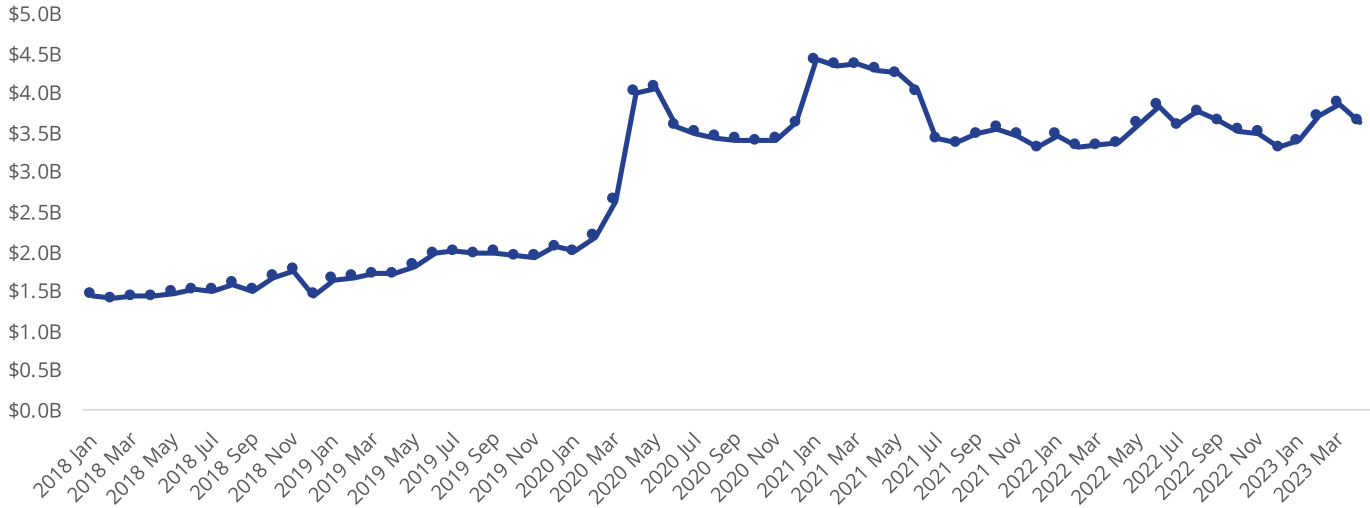
The industrial investment market dropped from Q1, but remains well above pre-pandemic levels, with record high prices.

The industrial sales market declined 37% from Q2 2022 and 64% from a record high Q1 2023, but remains a bright spot in the CRE investment market. Despite obvious pressure from rising rates, industrial leasing volume remains very strong, with a national availability rate hovering near one percent. The combination of record high population growth with land constraints in most major markets continues to mean industrial demand far outstrips supply. Industrial rent growth has partly been driven by a changing ownership profile as well: foreign investors have aggressively raised rents in previously flat markets, Quebec most notably.

To put this in perspective, Colliers internal data shows 28 consecutive quarters of positive industrial absorption in Canada, despite record high levels of construction. Industrial cap rates remain lower than office, though there is pressure in some markets due to construction, labour, land and borrowing costs all rising over the past several years. The short time frame for industrial development continues to attract investors and lenders, especially compared to office.

The question for industrial is the long-term fortune of ecommerce and fulfilment centres; after the tremendous growth during lockdowns, the market for ecommerce has flattened considerably, as consumer spending has shifted from good to services, travel, and entertainment.

Monthly Ecommerce Sales, Seasonally Adjusted



Source: Monthly Retail Trade Survey, Statistics Canada

$2.47 Billion ↓

Quarterly Volume

$299 ↑

$/SF

What to Watch

Rising Availability Rates | Ecommerce Leveling Off

Retail

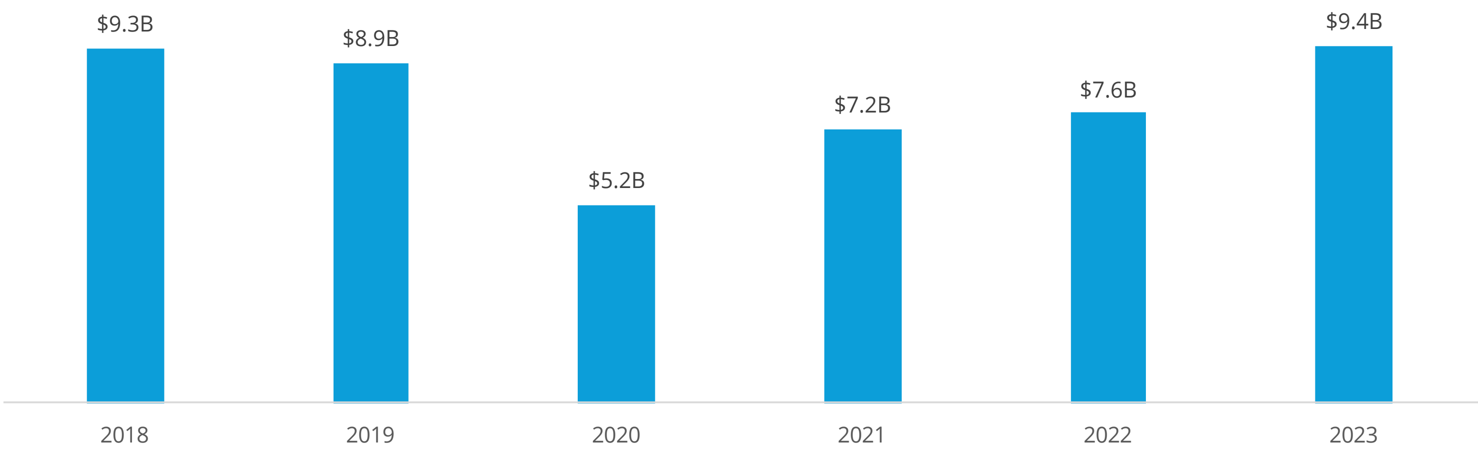
Retail investment sales hit a 10-year low in Q2 (excluding the first quarter of the COVID pandemic), with a lack of large deals depressing the market.

Retail investment volume declined sharply, dropping 74% from Q1 2023 and 53% year-over-year. Rising rates and borrowing costs obviously played a large role, as with every asset class, as the Bank of Canada continued rate hikes after pausing in Q1. Retail spending remains strong, but has rotated away from traditional enclosed mall and big-box staples such as apparel and home furnishings to restaurants, entertainment and travel.

There were many optimistic data points for retail in Q2 2023, including rising retail sales and a tight leasing market. MSCI reports rents at leading malls are at record highs, and inflation has subsided since peaking at over 8% last summer. Basic retail such as grocery, pharmacy, alcohol and variety stores remain strong, continuing their out performance from the pandemic. Demographics remain favorable in Canada, with record high population growth in the past year and a young, educated population. Downtown remains challenging in some markets, as a slow return-to-office weighs on hospitality and urban retail.

Construction of new enclosed malls has been largely absent since the pandemic, and redevelopment pressure on suburban assets continues. The retail inventory may shrink in coming years due to decisions by REITs and investors to redevelop and pursue mixed-use strategies.

May Car Sales, 2018-2023, Canada



Source: Monthly New Motor Vehicle Sales Survey, Statistics Canada

$349 Million ↓

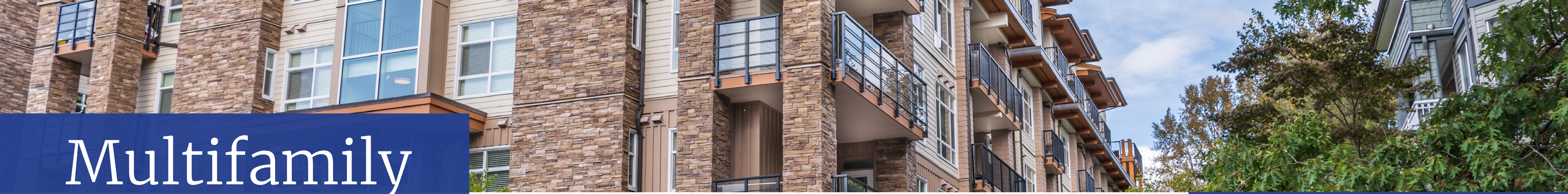
Quarterly Volume

$257 ↓

$/SF

What to Watch

Credit Card Debt | Redevelopment Pressure on Aging Assets



Multifamily

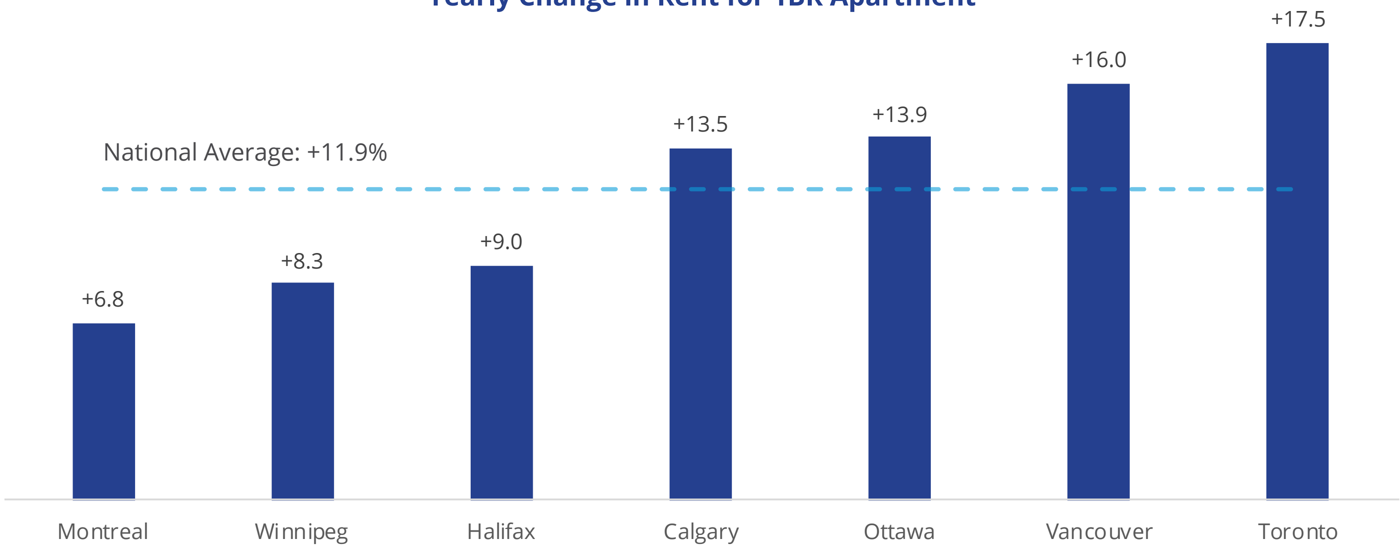
Sales of apartments rebounded in Q2 after a subsided Q1 as multifamily continues to be a safe haven for investors.

Multifamily sales declined 26% year-over-year but increased quarter-over-quarter, as investors continued to seek the rent growth and redevelopment potential of apartments. Montreal, which typically trails Toronto and Vancouver in volume, has led the nation in investment in 2023. Quebec has a more affordable apartment market, with smaller and older stock that attracts private investors.

Apartments continue to command the lowest cap rates in the Canadian market, some even trading below the “risk-free” rate. Unprecedented rent growth has attracted investors, as a population boom in Canada post-pandemic has created extreme pressure on housing availability and affordability. However, this introduces some political risk, as housing affordability has increasingly become a hot topic for municipal and federal politicians. Proposals from rent control to more aggressive development to federal-funded housing have all been seriously discussed in major jurisdictions.

Demographics continue to offer a favorable outlook for apartments, as rising incomes and growing population create upward pressure on rents. Recent research by Great West Life indicated the most common household income category for downtown Vancouver apartment dwellers was $100k and up. As rates have risen sharply and pandemic-fueled housing gains seem to be holding, even higher income households are now in the rental market in many major cities.

Yearly Change in Rent for 1BR Apartment



Source: Rentals.ca

$108.9 Million ↑

Quarterly Volume

$281K ↓

$/Unit

What to Watch

Rising Rents |
Changing Political Environment |
Cap Rates

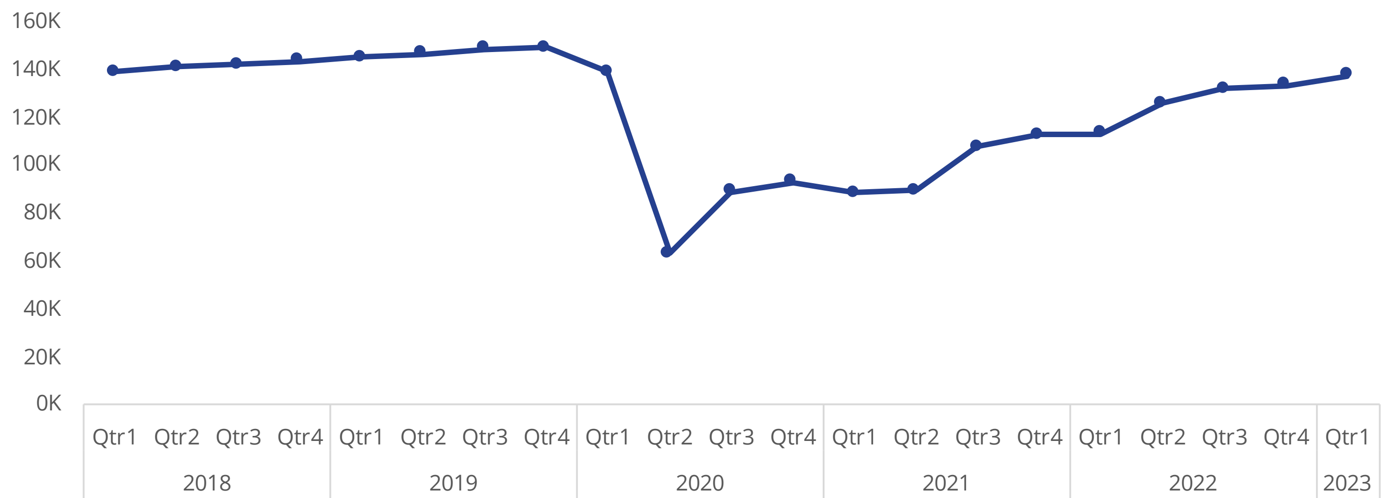
Hotel

A strong pace of activity in the second quarter catapulted first half volume to more than $1 billion with notable urban and resort market sales.

Approximately $1.05 billion of hotels transacted in the first half of the year, nearly double that of comparable investment levels in 2022, with 90% of volume related to acquisitions for ongoing hotel use. Elevated by nine transactions over the $25 million mark, Colliers Hotels recorded some $740 million of sales in the second quarter representing 70% of year-to-date volume with major trades in Toronto, Banff, Kelowna, and the Atlantic coast, among others. Reflecting the influx of high watermark transactions, normalized average price per key metrics paced at $192,100, up more than 30% year-over-year.

Private domestic capital sources continue to drive both buy and sell side activity in the market with moderate participation from institutional capital and public companies. With a sizeable pipeline of hotel offerings recently closed and on the market, we forecast year-end volume will be in the $1.75 to $2 billion range.

Accommodation Employment in Canada, Quarterly



Source: Canada Monthly Civil Aviation Statistics

$740 Million ↑

Quarterly Volume

$192,100K ↑

$/Room

What to Watch

Major Market & Portfolio Investment Activity | Challenged Rate Environment with Relative Debt Market Liquidity | Cautious Optimism for Operating Growth

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