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22ND ANNUAL EDITION

# 2020 CANADIAN ECONOMIC OUTLOOK AND MARKET FUNDAMENTALS

## SECOND QUARTER UPDATE

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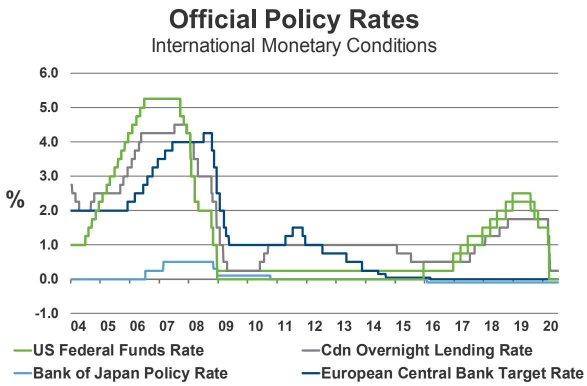
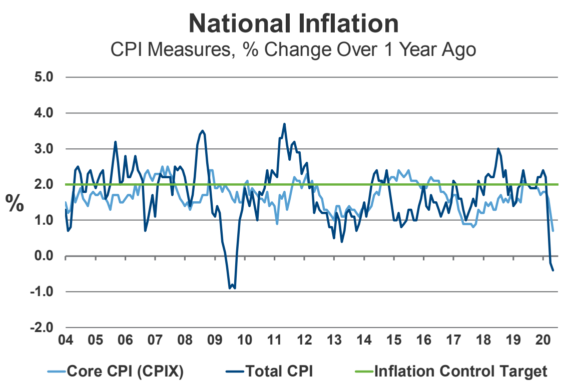
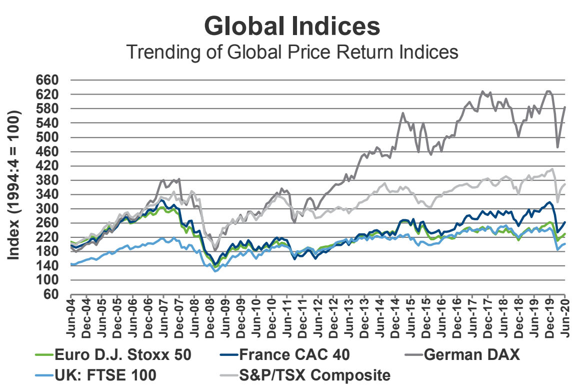


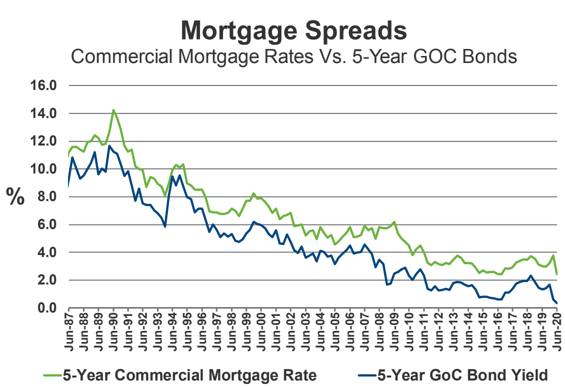
Source: Bank Of Canada, Federal Reserve Board, European Central Bank, Bank of Japan



Source: Bank Of Canada, Statistics Canada



Source: RBC Capital Markets



Source: RBC Capital Markets, Bank of Canada

## CENTRAL BANK MEASURES HELPED STEM THE TIDE AND LAY RECOVERY FOUNDATION

Measures implemented by the Bank of Canada (BofC) appeared to have stemmed the tide of the negative impacts of the COVID-19 pandemic during the second quarter. The banks maintenance of its policy interest rate at 0.25% looked to have supported consumers and businesses in meeting their more immediate debt obligations. Additionally, the bank took steps to minimize the risk of a liquidity crisis and ensure access to short-term cash. At the same time, measures were implemented to keep credit flowing and avoid a full-blown financial crisis. After the initial set of measures were implemented the bank began to lay the foundation for recovery. The bank communicated its intention to hold the policy rate lower for longer to help hold long-term government yields low. In addition, the bank looked to drive down credit risk spreads for both consumers and businesses. This entailed the purchase of a range of financial assets, including provincial and corporate bonds. In short, steps taken by the BofC to combat the negative impacts of the COVID-19 crisis appeared to have had the desired effect as the second quarter came to an end.

## INFLATION PRESSURE REMAINED LOW

Inflation pressure remained low during the second quarter, as a result of the combined effects of significant economic and labour market slack and low commodity prices. For a second consecutive month, inflation pressure was negative in May. The main cause of the negative pressure was gas prices, which were well below those of a year ago despite a 17.0% rise in May. To some extent, downward pressure on prices in several other consumer categories offset upward pressure on gasoline. Excluding gas and food, prices were down 1.2% on a three-month annualized basis, as of the end of May. Previously, the April Statistics Canada headline inflation rate had fallen 0.2%, with a subsequent 0.4% back step reported for May. During the second quarter, the risk of disinflation was prominent, rather than outright price deflation. Consumer prices were expected to begin to rise as the economy reopened after the first COVID-19 virus wave. However, the inflation rate was forecast to remain below the pre-virus level over the near term.

## EQUITY MARKET BOUNCED BACK

Global equity markets continued to recover from the COVID-19 driven lows posted in late March. As early as May, the MSCI ACWI (formerly Morgan Stanley Capital International All Country World Index) was up 20.0% from the first quarter low of March 23. The index dropped 32.0% from the most recent peak. Gains were posted in most of the world's major equity markets, with the anticipated reopening of several major economies. Canada's S&P/TSX registered healthy advancement during the second quarter, despite the combined negative impacts of a global recession and a price war between the world's top oil producers. The index was up almost 12.0% from the beginning of the quarter to the end of the first week of May. The IT and Materials sectors both posted gains in excess of 40.0% during the second quarter. In June, global equity markets continued to improve. The MSCI ACWI racked up a 15.7% advance quarter-to-date as of June 12, with Latin America at 19.9% and the U.S. at 18.5%. The second-quarter global equity market bounce back was a byproduct of the implementation of a range of government programs to combat the negative impact of the COVID-19 crisis. Measures included direct financial support for consumers and businesses. Loan guarantees were also provided to ensure banks continued to lend. Central banks also acted quickly by purchasing financial assets and willingly expanding their balance sheets. The unprecedented steps taken by the world's governments and central banks supported the global equity market bounce back of the second quarter.

## COMMERCIAL PROPERTY INVESTMENT ACTIVITY STALLED

Canadian commercial property sector investment activity stalled in the second quarter, as investors retreated to the sidelines in response to the COVID-19 crisis induced uncertainty. Transaction volume plunged 44.2% in the nation's largest market, the Greater Toronto Area (GTA), year-over-year for April and May combined. By asset class, office was down 80.5%, retail 59.4%, and multi-suite residential 58.3% while industrial was the only asset class to see sales volume rise by 25.1%, according to Altus Group figures. Many of the transactions completed during the second quarter were negotiated either in late 2019 or prior to the COVID-19 crisis in early 2020. Previously, investment activity had peaked with record high sales recorded for the 2019 calendar year. The retail sector was the only asset class to experience a significant slowdown in transaction closing activity prior to the pandemic due to concerns over changes in consumer behaviour, competition from online shopping, and demographic trends that have impacted sector performance and sales activity over the past few years. Increased sector risk eroded investment demand while office, industrial, and multi-suite residential properties were very much in demand prior to the pandemic. As the second quarter came to an end, investors remained on the sidelines awaiting some degree of certainty surrounding COVID-19 and the broader economic outlook.

## INDUSTRIAL SECTOR BUCKED THE TREND

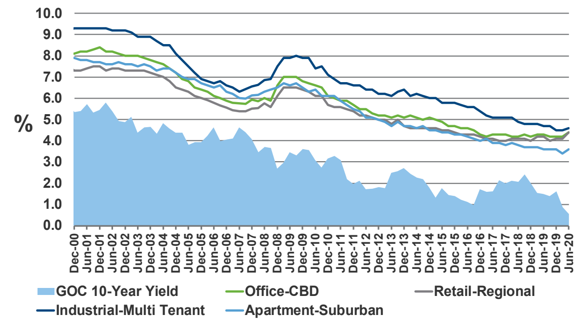
Canada's industrial property sector bucked the national trend during the second quarter, in posting an increase in investment sales activity. In the GTA, for example, $958.6 million in property sales was recorded for April and May of this year combined. The total was up 25.1% year-over-year. Over the same time period, all other asset class totals, except for hotels, were down sharply according to Altus Group data. Investment sales volume was down 44.2% for all asset classes combined. The COVID-19 pandemic was the main cause of the overall plunge in activity. Investors were of the belief that the industrial leasing market would outperform over the near term, given a substantial increase in online shopping as a result of the pandemic. Moreover, the popularity of online shopping was expected to persist for at least the foreseeable future. As a result, the industrial leasing outlook was relatively healthy, which will continue to drive above-average industrial property sector investment activity levels over the near term.

## INVESTORS WILL BE SELECTIVE OVER THE NEAR TERM

Investors will continue to be selective when acquiring Canadian commercial investment properties over the near term. Premium pricing will be reserved for low risk properties with stable long-term tenant rosters in established nodes. The industrial and multi-suite residential rental asset classes will be the most highly sought-after. Both asset classes performed relatively well during the early days of the pandemic and were expected to continue to do so over the near term. The outlook for retail and office is less certain, with investors exercising higher levels of caution when assessing opportunities. Generally, investors will closely scrutinize all opportunities, particularly those with a riskier profile. The desire of investors to reduce portfolio risk will likely continue to dampen sales volume totals. At the same time, vendors will be somewhat more reluctant to place properties on the market for sale during a period when values are trending lower. In the coming months, strategic acquisitions will continue, albeit at a reduced pace. A degree of pricing uncertainty will also hamper sales activity over the near term. By 2021, the anticipation of a COVID-19 vaccine and a modest global economic recovery will increase investor confidence levels. In the meantime, commercial property sector investors will be selective when looking at potential acquisitions.

**Yield Spreads**

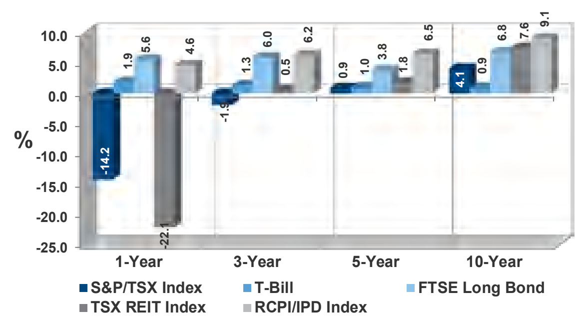
Cap Rates vs. 10-Year GOC Bonds




Source: AltusInSite, Bank of Canada

**Relative Performance**

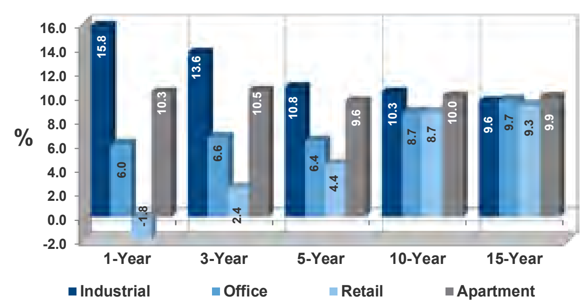
Comparing Annualized Returns To March 2020




Source: © MSCI Real Estate; RBC CM; TSX Datalinx; SCM; PC Bond Analytics

**RCPI/IPD Returns**

Annualized Returns By Property Type To March 2020



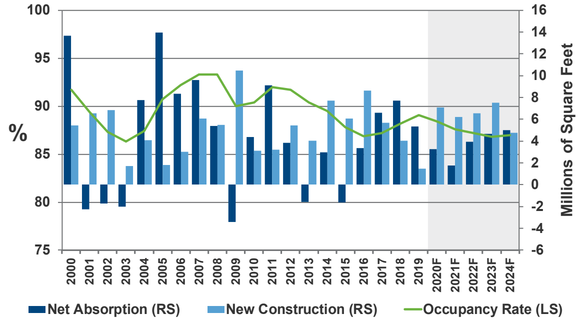

Source: RCPI; © MSCI Real Estate

**Investment Activity**

Total Investment Volume

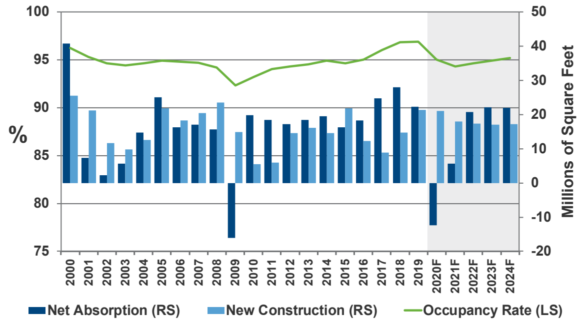

Source: CBRE Limited; Morguard

**Office Demand & Supply**
National Historical & Forecast Aggregates



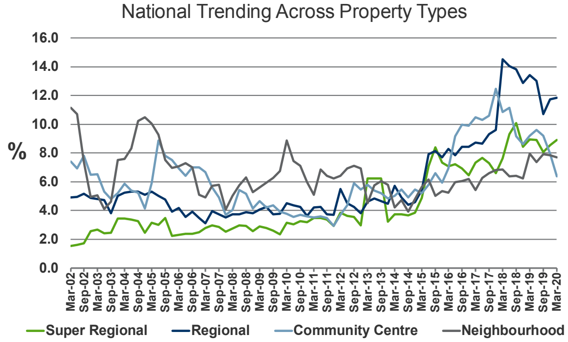

Source: CBRE Limited; CBRE Econometric Advisors

**Industrial Demand & Supply**
National Historical & Forecast Aggregates



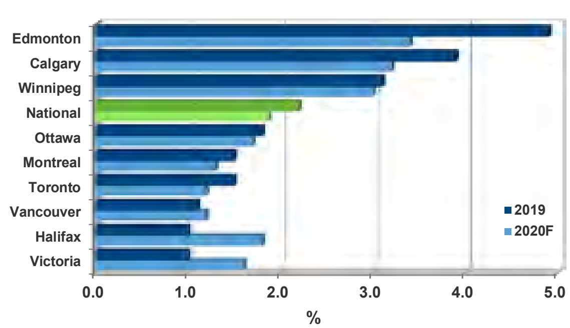

Source: CBRE Limited; CBRE Econometric Advisors

**Retail Vacancy Rates**
National Trending Across Property Types




Source: © MSCI Real Estate

**CMA's Rental Vacancy**
Rates for Structures of 3 units+




Source: CMHC, Housing Market Outlook Report (Jan 2020 release)

## OFFICE LEASING SUPPLY FUNDAMENTALS SOFTENED

Office leasing supply fundamentals softened during the second quarter, driven in part by restrictions implemented as a result of the COVID-19 crisis. The national average vacancy rate rose 50 bps between the beginning of April and the end of June. A rate of 10.8% was reported for the country's major urban centres at the end of June up from 10.3% three months earlier. The rate was down 40 bps year-over-year, however, reflecting the market's pre-pandemic strength. The office leasing market softening was also evidenced in a significant increase in sublease availability during the second quarter. The increase in sublease availability was concentrated largely in the Vancouver and Toronto downtown submarkets. In Vancouver, downtown vacancy rose 110 bps to 3.3% during the second quarter, driven largely by a sharp rise in sublease availability. A similar vacancy pattern was recorded in Toronto's downtown submarket during the second quarter. An increase of 86.0%, or roughly 650,000 square feet, of sublease space was recorded during the three-month period, driving vacancy up to the 2.7% mark. Over the near term, businesses were expected to continue to reduce premises costs by shedding excess space, resulting in the continued softening of office leasing fundamentals over the near term.

## INDUSTRIAL LEASING MARKET HEALTH WAS SUSTAINED

The health of Canada's industrial leasing market was sustained during the second quarter. Leasing demand has been relatively healthy and stable during the second quarter, despite the negative impact of the COVID-19 crisis on several sectors of the broader economy. E-commerce and related logistics companies continued to drive demand, with the increased volume of online shopping and distribution of both essential and non-essential consumer goods. Curbside pick-up programs also supported demand for industrial space across the country. Largely positive demand characteristics ensured supply conditions remained tight in most regions. The national availability rate rose to 2.9% as of the end of June, up 80 bps quarter-over-quarter. For the most part, leasing demand has kept pace with the delivery of a significant volume of new supply over the recent past. During the second quarter alone, 6.9 million square feet of new supply was added to Canada's industrial building inventory, bringing the year-to-date total to 9.5 million square feet. Even with the rise in availability, conditions remained tight and rents held near the cycle peak. The market's demand supply dynamic of the second quarter provided further evidence of the market's sustained health.

## RETAIL SECTOR WOES CONTINUED

The struggles of Canada's retail sector continued during the second quarter. Restrictions imposed as a result of the COVID-19 crisis reduced retailer revenues sharply and in many cases to zero. As a result, many tenants were unable to meet their rent obligations, thereby reducing revenues for many landlords. Some stores were forced to close, in some cases permanently. Restaurants and clothing stores were hardest hit. In some cases, retailers were able to generate modest revenues with e-commerce platforms. Food outlets were able to supplement their revenues to some extent with take-out and delivery orders. In general, retail landlords were faced with substantial declines in rental income with the closure of non-essential stores. A few fared relatively well, particularly those with essential retail tenants including grocery and drug stores. However, landlords incurred additional costs of signage and other safety measures in order to ensure the safety of employees, shoppers and store staff upon reopening. The industry's struggles began to negatively impact leasing fundamentals. As the second quarter came to an end, many stores and malls were operating at less than full capacity. Therefore, the struggles of the retail sector were expected to continue for some time.

### RECOVERY WILL BE UNEVEN

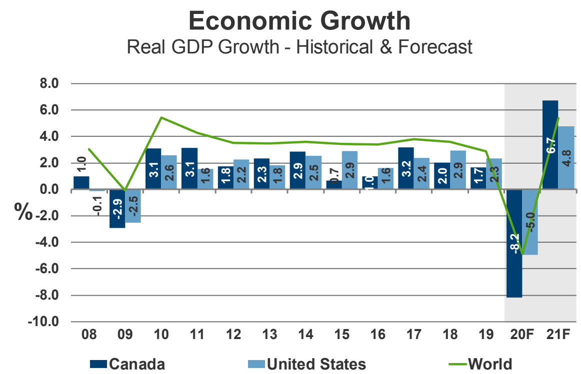
Canada's economic recovery from the COVID-19 driven downturn will include a significant level of unevenness. Recovery was expected to unfold in the second half of 2020 and continue over the medium term. National GDP was projected to contract between 4.0% and 6.0% on an annualized basis in 2020. Subsequently, output was predicted to advance by between 4.0% and 5.0% in 2021, before settling into a moderate annualized growth pattern over the medium term. Initially, economic output was expected to have dipped by between 30.0% and 35.0% in the second quarter of 2020 alone, on an annualized basis. This followed an 8.0% decline during the first three months of the year. The characteristically uneven nature of the recovery was also applicable from a geographic standpoint. British Columbia, Manitoba, and New Brunswick, for example, were expected to recover more quickly given lower levels of COVID-19 exposure and earlier economic re-openings. Conversely, lower oil prices and global demand were expected to hamper progress in Alberta, Saskatchewan and Newfoundland and Labrador. Slower recoveries were forecast for regions more dependent on tourism. In short, an uneven economy was expected to unfold over the next few years from the COVID-19 crisis.

### JOB MARKET CAME BACK TO LIFE

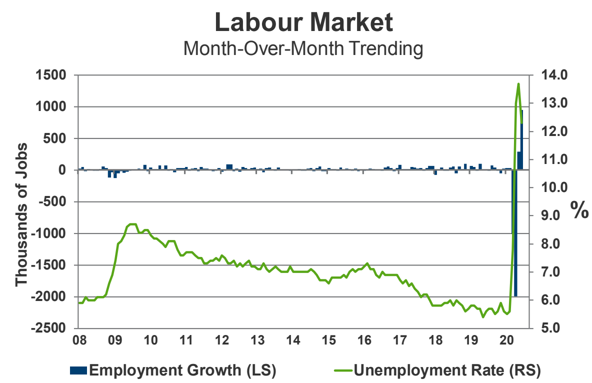
Canada's job market came back to life in the latter half of the second quarter, following an unprecedented decline as a result of the COVID-19 crisis. A reported 953,000 spike in employment was reported for June, building on a modest 290,000 gain in May. The combined May and June advances represented 40.0% of the March and April freefall. However, total employment rested 1.8 million below the February level, as of the end of June. Despite the shortfall, the June employment spike was stronger than expected. Canadian labour market participation also looked to have improved since the March/ April plunge. Roughly 580,000 more people were permanently laid off and not looking for work than a year earlier, as of the end of June. The total represented a significant improvement over the 1.4 million reported at the end of April, despite remaining well above the averages of the past few years. The national unemployment rate also trended in the right direction during the second quarter. The rate was yanked down to 12.3% at the end of June, from 13.7% a month earlier but remained high when compared with recent history. As the second quarter came to an end, Canada's labour market was weak by any historical comparison. However, as the quarter progressed the market exhibited signs of life that indicated the COVID-19 driven correction was more moderate than first thought.

### SPENDING PATTERNS STRENGTHENED AFTER MONUMENTAL DROP

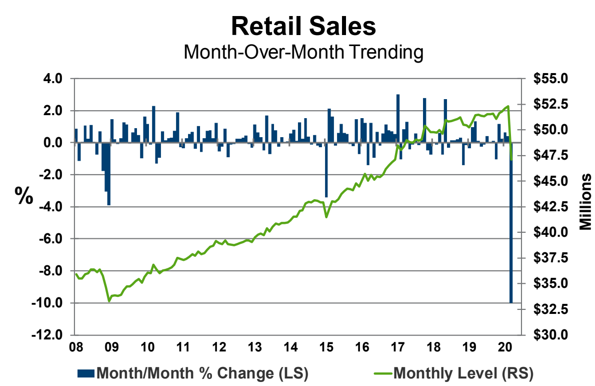
Canadian spending patterns looked to have improved as the second quarter came to an end, due partially to the reopening of non-essential stores in several regions. A recent RBC brief indicated consumer spending had increased by roughly 4.0% year-over-year as of the end of the first quarter, through an examination of its cardholder data. Additionally, small business spending had steadily increased during the month of June. The sharpest increases were recorded in the health and wellness, jewelry and giftware spending categories. Moderate increases in Canadian spending were also reported for June in a recent TD Economics report. Most spending categories advanced, except for high-touch categories like professional services and clothing. Prior to the recent uptick, retail spending had plummeted by 33.6% cumulatively between the unfolding of the COVID-19 crisis in March and the end of April. Since then, Canadian spending patterns have steadily improved through to the end of the second quarter. Looking ahead, Canada's retail sales growth pattern was expected to gradually improve, after a sharp decline as a result of the COVID-19 shutdown.



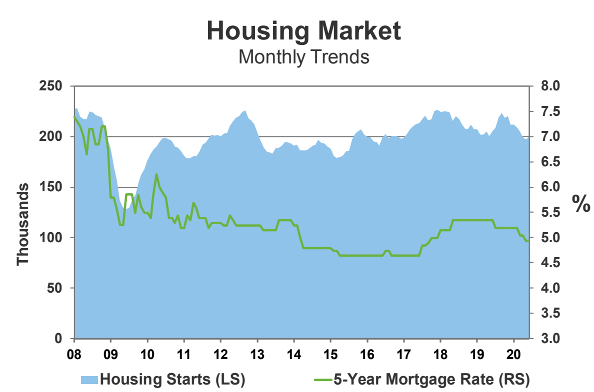

Source: Conference Board Of Canada (June 2020); International Monetary Fund (June 2020)




Source: Statistics Canada




Source: Statistics Canada




Source: Statistics Canada, CMHC

## OFFICE

| Property | Date | Price | SF | PSF | Purchaser | City |
|---|---|---|---|---|---|---|
| 400 Sainte-Croix Ave | Jun-20 | $33.7 M | 282,644 | $119 | Groupe Mach | Montreal |
| 126 York St | Jun-20 | $33.0 M | 41,000 | $805 | Canvar Group | Ottawa |
| 5040-5060 Spectrum Way | Jun-20 | $33.8 M | 114,505 | $295 | Private | Toronto |
| 230-240 Richmond St W (50%) | May-20 | $39.4 M | 119,442 | $659 | SunLife/Bentall | Toronto |
| District Beaumont | Apr-20 | $18.2 M | 93,456 | $195 | Mondev | Montreal |
| CanFirst Flex Portfolio | Apr-20 | $56.4 M | 415,561 | $136 | Crown Realty | Ottawa |
| 395 Terminal Ave | Apr-20 | $97.5 M | 240,000 | $406 | BentallGreenOak | Ottawa |
| The Landing* | Apr-20 | $225.0 M | 175,470 | $1,282 | Allied Properties REIT | Vancouver |

## INDUSTRIAL

| Property | Date | Price | SF | PSF | Purchaser | City |
|---|---|---|---|---|---|---|
| Steelcom Business Ctr | Jun-20 | $32.0 M | 231,405 | $138 | Takol | Toronto |
| 240 Edward St | Jun-20 | $12.8 M | 104,150 | $123 | Effort Trust | Toronto |
| 37 Bethridge Rd | May-20 | $19.1 M | 128,256 | $149 | Adelaide Development | Toronto |
| 9393 Metropolitain Blvd E | May-20 | $10.8 M | 81,500 | $132 | Pure Ind. REIT | Montreal |
| 3399 Francis-Hughes Ave | May-20 | $18.0 M | 119,808 | $150 | Broccolini | Montreal |
| Kesmat/Mirlaw Portfolio | Apr-20 | $43.0 M | 284,909 | $151 | Pure Ind. REIT | Montreal |
| 85-89 Freeport Way NE | Apr-20 | $23.9 M | 207,993 | $115 | Skyline Comm. REIT | Calgary |
| 7007 54th St SE | Apr-20 | $28.4 M | 177,747 | $160 | Skyline Comm. REIT | Calgary |
| 5618 76 Ave, 3921 81 Ave | Apr-20 | $11.0 M | 90,348 | $122 | Firm Capital | Edmonton |

## RETAIL

| Property | Date | Price | SF | PSF | Purchaser | City |
|---|---|---|---|---|---|---|
| 365 Queen St W | Jun-20 | $25.0 M | 14,900 | $1,678 | Ergo Properties | Toronto |
| 9651 Yonge St | Apr-20 | $23.8 M | 31,858 | $746 | Private | Toronto |
| 315-319 Valmont St | Apr-20 | $13.8 M | 43,304 | $319 | Private | Montreal |
| 1472-1478 Ste Catherine St W | Apr-20 | $17.5 M | 17,660 | $991 | Uno Investments | Montreal |

## MULTI-SUITE RESIDENTIAL

| Property | Date | Price | # Units | /Unit | Purchaser | City |
|---|---|---|---|---|---|---|
| Sea Place Apartments | Jun-20 | $16.4 M | 35 | $469,714 | Starlight Investments | Vancouver |
| Belanger St, 20th Ave | May-20 | $12.9 M | 142 | $90,845 | Lazar Equities | Montreal |
| Westview Apartments | May-20 | $12.0 M | 78 | $153,846 | Gemstone | Ottawa |
| 600 Eglinton Ave W | Apr-20 | $17.8 M | 60 | $296,667 | SpiceCart | Toronto |
| 25 Villa Rd, 90, 92 James St | Apr-20 | $26.5 M | 102 | $259,804 | Starlight Investments | Toronto |
| Le Courant III | Apr-20 | $29.8 M | 102 | $291,667 | Cons Properties 12 | Montreal |
| 2313 Islington Ave | Apr-20 | $22.4 M | 80 | $280,000 | Golden Equity | Toronto |

* share sale

# ACKNOWLEDGEMENTS & CITED RESEARCH RESOURCES

In the course of compiling the statistical information and commenting on real estate markets, national, regionally and across Canadian metropolitan areas, we acknowledge the assistance and feedback from the following parties in completing this report:

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