GLOBAL HEALTH CRISIS

Marcus & Millichap

SPECIAL REPORT CANADA COVID-19 OUTBREAK APRIL 2020

Global Pandemic Weighs on Economy and Commercial Real Estate, Fueling Uncertainty and Reshaping Markets

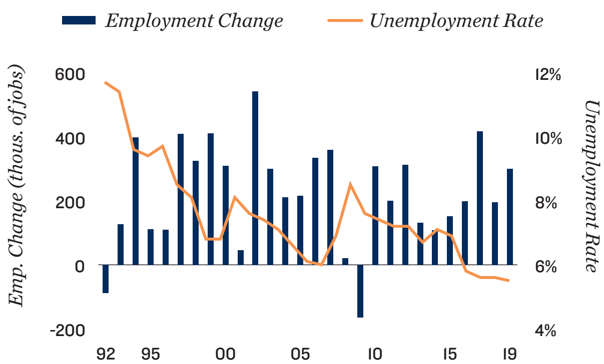
Government works to cushion economy from COVID-19. Canada's decadelong economic expansion was brought to a halt in the first quarter as the global spread of the novel coronavirus shook markets and caused unprecedented financial fallout for investors and businesses. The government has moved quickly to stabilize the economy, outlining new economic measures in response to the millions of workers who have filed unemployment claims and the businesses that have shut down to slow the spread of COVID-19. Emergency legislation has moved through Parliament, delivering $200 billion of stimulus, the largest social aid program ever passed in Canada. One of the primary actions being put into place includes a wage subsidy plan that will cover 75 percent of workers' salaries for all companies that have posted a 15 percent reduction in revenue in March, illustrating the severity of the crisis and the unparalleled steps being taken.

Bank of Canada follows global partners in easing monetary policy. The Bank of Canada escalated efforts in March to shore up the nation's financial system amid the health crisis and a fall in oil prices. The Bank delivered a 50-basis-point rate cut at its March 4 meeting, which was quickly followed by an additional 50-basis-point reduction in an emergency move on March 13. The Bank made a final 50-basis-point cut on March 27, lowering the benchmark overnight interest rate to 0.25 percent, a level not seen since the 2008-09 financial crisis. Additional measures were taken to expand the bank's bond buyback and mortgage fund programs to ensure global market disruption doesn't impact the flow of credit to businesses and households. Coming into the pandemic, the Canada economy was well positioned for the dual threat of the COVID-19 outbreak and sharp drop in oil prices.

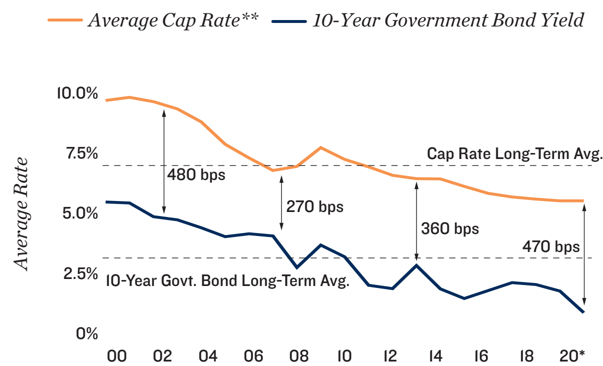
Economic Highlights

- Greater clarity has emerged as global trade conflicts are resolved, including the ratification of the CUSMA. While the trade accord removes uncertainty for much of the manufacturing and agricultural sector, the roughly 80 percent of the economy that is services based remains untouched. The IT services sector has been the leading growth sector in exports, expanding by more than 7 percent on an annual basis as Canada's digital economy takes a more integral role in overall activity.
- The outbreak sparked fear and caused a flight to safety that has driven the 10-year government bond yield to record lows, resting just above 0.8 percent in early April. The steep decline in interest rates widened the yield spread to a new high, opening a window for refinance and acquisition activity, though the availability of capital has tightened. Investors have been able to lock in debt in the 3 percent range, depending on the borrower's credit, asset quality, and location.
- Canada's immigration policies were a major source of growth leading up to the pandemic and once the outbreak is resolved they will likely revive. Strong immigration contributed to the creation of more than 2.5 million jobs over the past decade, bringing the unemployment rate to record lows and supporting greater wage gains. Immigration targets were lifted from 300,000 to 390,000 people, though COVID-19 will likely slow the nation's population boom.

Employment vs. Unemployment

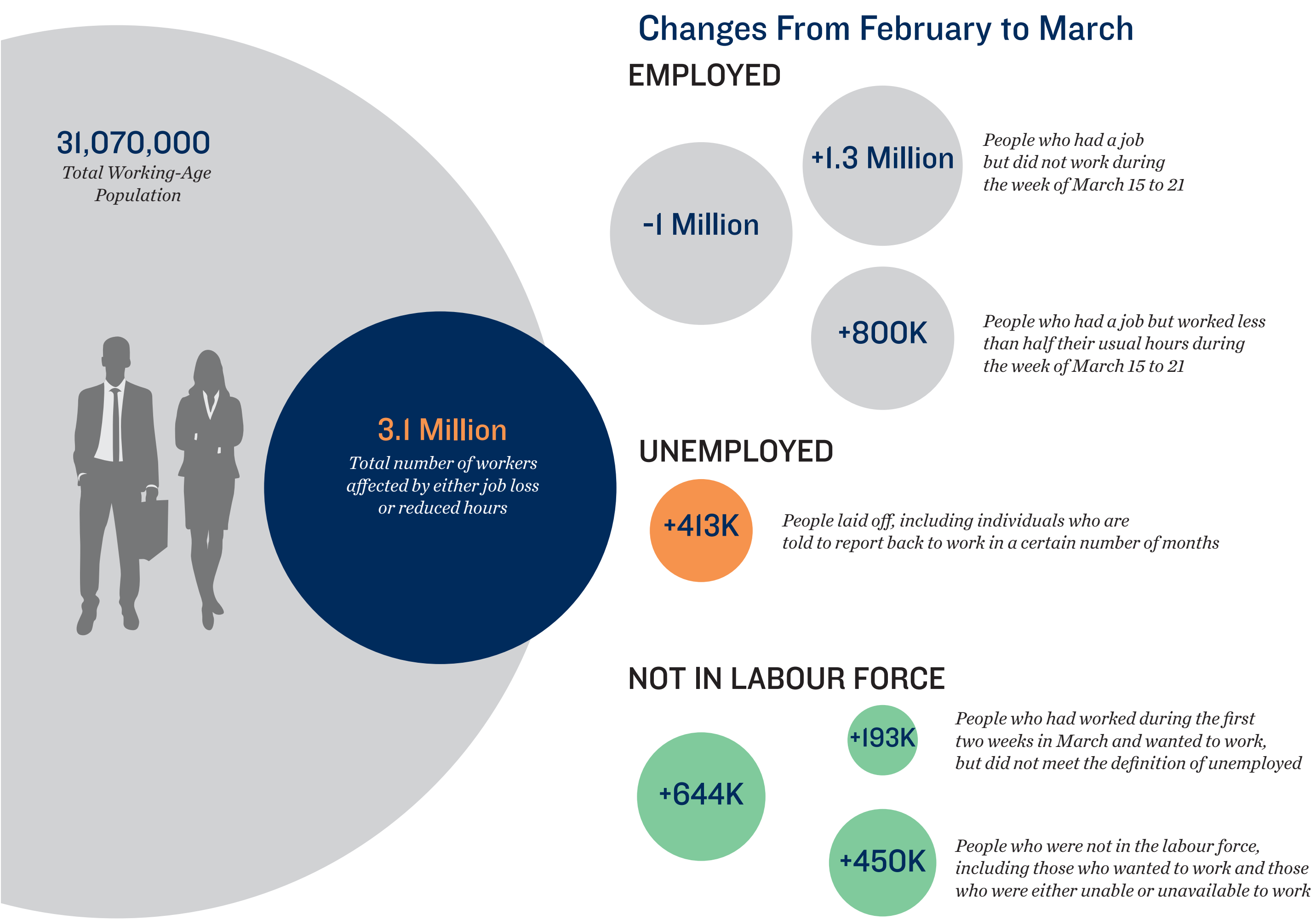


Canadian Cap Rate Trends



* Through April 8; ** Retail, office and industrial

The Impact of COVID-19 on the Canadian Labour Market



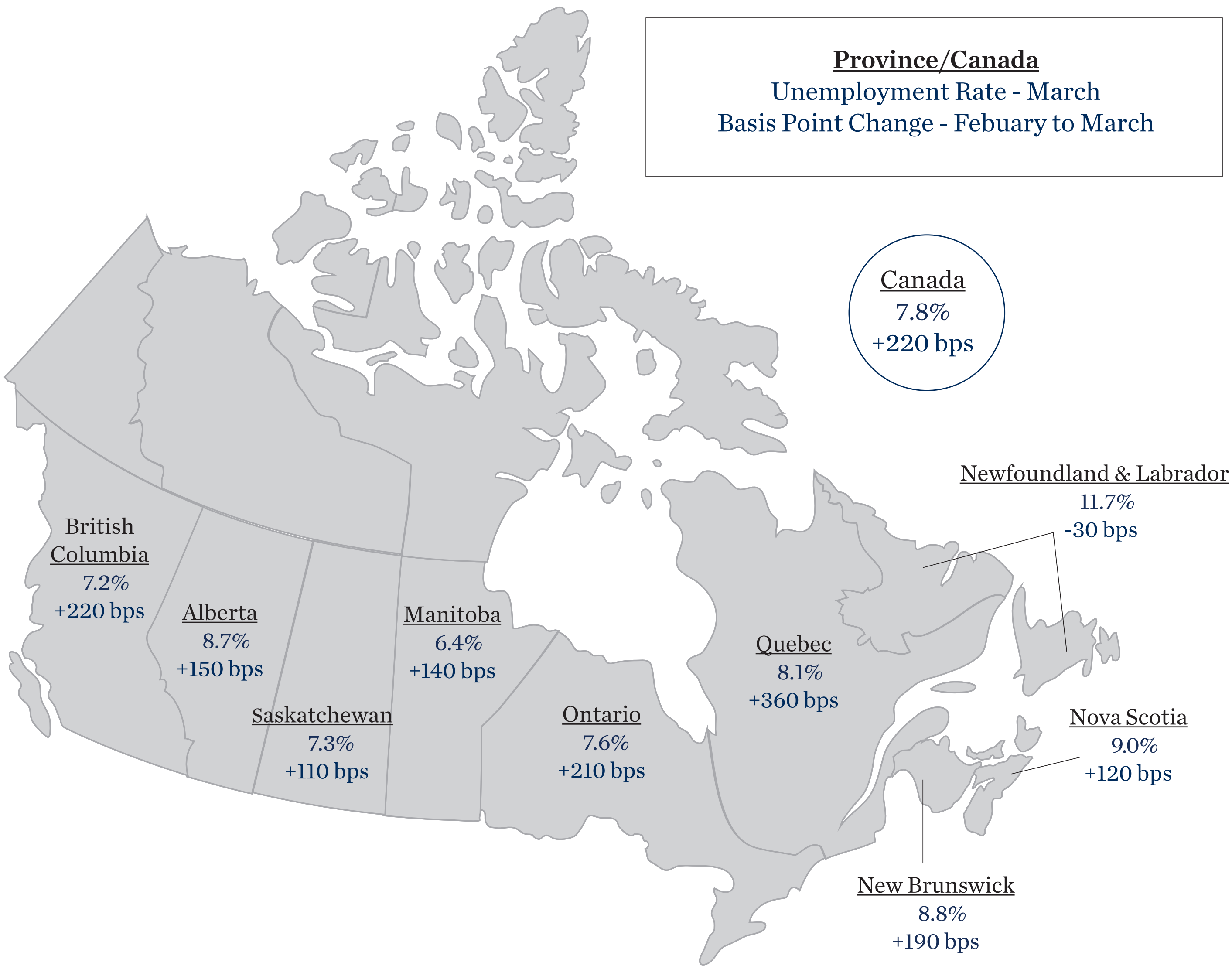
Note: Numbers might not add to totals due to rounding.

In March 2020, measures to contain the COVID-19 outbreak caused sudden interruptions in business operations across Canada. This prevented many Canadians from working as they usually would.

The Labour Force Survey collects information during a single week each month and classifies the Canadian population age 15 and older as either employed, unemployed, or not in the labour force.

Sources: Statistics Canada; Labour Force Survey

Unemployment Rate Change (February to March)



Employment Trends (February to March)

Province	March Labour Force (thousands)	Employment Change	Full-Time Emp. Change	Part-Time Emp. Change
Alberta	2,423	-5.0%	-2.3%	-17.1%
British Columbia	2,593	-5.2%	-2.9%	-13.9%
Manitoba	683	-3.8%	-1.8%	-11.3%
New Brunswick	379	-4.2%	-3.2%	-10.2%
Newfoundland and Labrador	246	-2.6%	0.6%	-18.7%
Nova Scotia	490	-5.3%	-2.0%	-18.9%
Ontario	7,738	-5.3%	-4.0%	-11.3%
Quebec	4,483	-6.0%	-2.6%	-21.3%
Saskatchewan	604	-3.6%	-1.3%	-14.2%
Canada*	**19,726**	**-2.6%**	**-1.8%**	**-8.2%**

** Does not include Prince Edward Island*
Sources: Statistics Canada; Labour Force Survey

COVID-19 to Weigh on Apartment Sector as Economic Shock Rattles the Nation

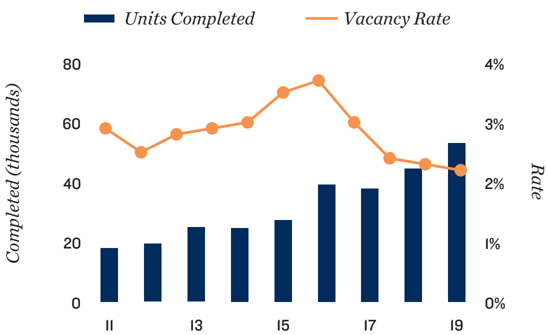
Outbreak to challenge near-term property metrics. As the coronavirus impacts the economy and jobs are lost at a record pace, many tenants will face difficulties in meeting rent obligations over the coming months. Government relief measures could provide stability, though, as some provinces place restrictions on evictions and benefits programs are put in place to aid those impacted by the outbreak. Going into the pandemic, shifting demographics and a challenging single-family housing market channeled more residents to the rental market, compressing vacancy to all-time lows across most metros. While operations are exceedingly tight, property fundamentals will soften over the near term, placing downward pressure on rent growth. With the cost of homeownership still beyond the means of many, and a preference for the renter lifestyle by young professionals, demand for purpose-built rentals will remain intact over the long term, ensuring a steady recovery.

Construction projects hit pause, likely curbing deliveries. During most of the economic expansion, supply growth was unable to keep pace with housing demand, limiting tenants' options and placing upward pressure on the average asking rent. Robust demand-side pressure led developers to respond with more than 70,000 purpose-built rentals under construction at the start of the year, the most on record. Though as COVID-19 shuts down businesses and job sites, many delivery schedules will be slowed, paring back this year's completion total. In 2019, approximately 53,000 apartments were delivered nationally, the strongest supply addition in more than three decades. Last year's rental influx was overshadowed by household expansion, compressing Canada's vacancy rate to 2.3 percent at the end of the year.

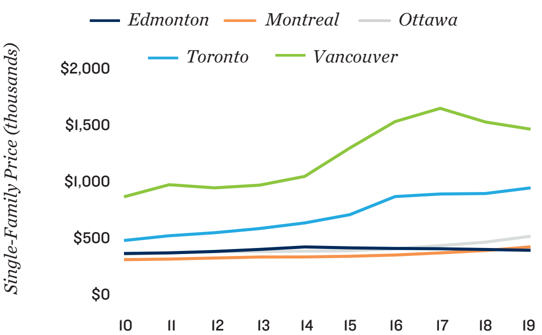
2020 Canadian Housing Outlook

- **Stability of apartments sustains investor sentiment.** As the coronavirus creates uncertainty, purpose-built rentals are emerging as a more durable property type. The lower tenant turnover inherent in rental housing typically makes this asset type less susceptible to economic disruptions, which should sustain acquisition activity this year. Buyers will continue their migration outside of the urban core in search for remaining upside potential, though transaction flow has begun to ebb. With vacancy rates near record lows across many markets, apartments remain a viable long-term opportunity.
- **Housing shortage converges to favour rental market.** Canada's population, largely fueled by liberal immigration policies, increased by nearly 560,000 in 2019. This accounted for the strongest increase since the early '70s at a time when the production of detached single-family homes and rental housing continued to lag behind demand. Last year, just under 53,000 detached single-family homes were completed, marking a nearly 15 percent decline year over year while also placing greater pressure on the apartment market.
- **High cost of homeownership bolsters rental demand.** The single-family home market is beginning to feel the impact of the health crisis as buyers and sellers move to the sidelines. First-time buyers are not likely to see much relief, though, as the cost of homeownership and a shortage of entry-level options continue to create challenges. In March, the single-family benchmark price was more than $1.4 million in Greater Vancouver and was above $950,000 in Greater Toronto. The substantially lower cost of rental housing in these markets maintains demand as new projects are finalized, sustaining investor sentiment.

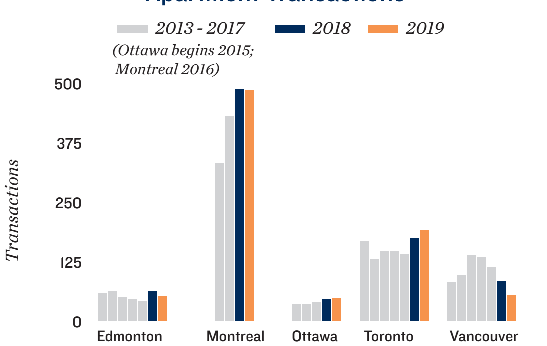
Completions vs. Vacancy



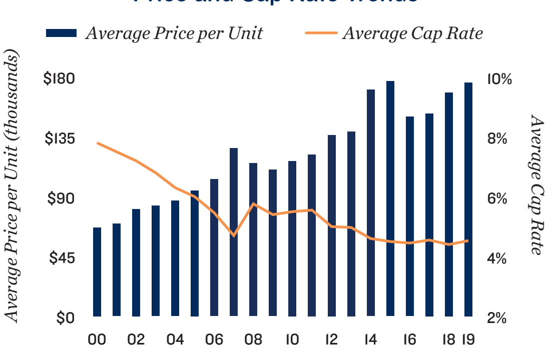
Single-Family Detached Benchmark Price



Apartment Transactions



Price and Cap Rate Trends



Industrial Sector Faces Fewer Risks From COVID-19 Amid Move to Online Shopping

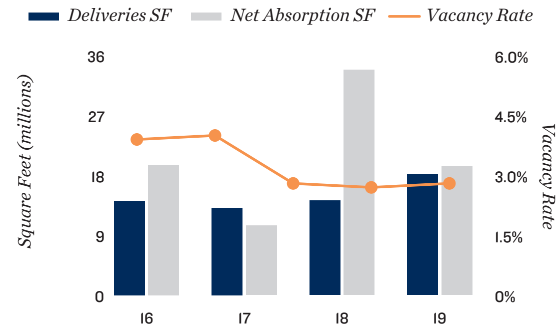
Pandemic drives changes in e-commerce. While consumer confidence and retail sales are shaken by the outbreak, consumers are migrating online rapidly as traditional retailers have been forced to temporarily close. The new environment has accelerated the adoption of grocery and pharmaceutical delivery, which will reshape the sector over the coming years. The crisis is testing supply chains and will drive firms to reexamine their distribution networks to create greater efficiencies. This will maintain demand for modern distribution and fulfillment centres following the crisis, buffering the sector from greater challenges faced by manufacturers. Many plants and factories have had to suspend operations as nonessential business shutdowns are extended, which may weigh on the economic recovery depending on the duration of the closures

Industrial space in short supply across much of Canada. Going into 2020, construction remained elevated with developers underway on more than 23 million square feet as they work to meet space needs. With just over 18.1 million square feet completed in 2019, exceptional tenant demand brought the national vacancy rate down 10 basis points to a tight 2.7 percent, supporting strong rent growth. The average asking rent surged 7.8 percent to $10.72 per square foot at the end of last year. Supply growth was anticipated to accelerate this year, but as construction is disrupted and projects hit pause, some deliveries will be pushed into next year. This will likely ensure another year of tight operations even as COVID-19 creates challenges for supply chains and slows manufacturing. Space users continue to face challenges when sourcing options for expansion, supporting the rapid leasing of modern and upgraded space.

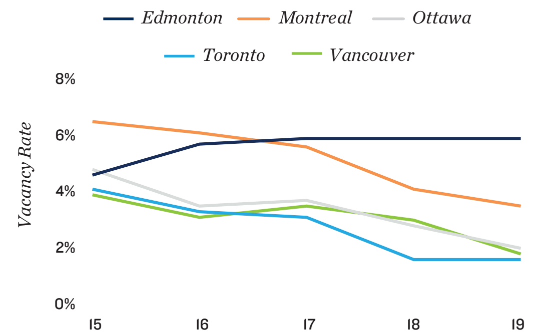
2020 Canadian Industrial Outlook

- **Functioning supply chains key to keep goods flowing.** While economic activity and trade are disrupted over the near term by COVID-19, industrial space demand faces fewer risks. The port markets of Western Canada registered some of the tightest vacancy rates in the nation last year and face minimal threat from new supply, buffering the sector from an economic shock. Distribution hubs including Toronto will post a greater wave of supply, which could soften property metrics, particularly as some firms may postpone expansion plans. An extended runway for logistics space maintains a healthy outlook, though, as retailers have been slow to build out their supply chains until Amazon made greater investments in the nation.
- **Strong underlying demand sustains investor confidence.** The exceptional performance of the industrial sector has captured investors' attention, supporting robust sales activity. Buyers took notice of soaring rents across most markets last year, resulting in deal volume of nearly $8.5 billion. As competition for industrial assets has grown, the average price crested the $200 mark for the first time, reaching $219 per square foot. This resulted in greater cap rate compression, landing in the upper-4 percent territory.
- **Infill fulfillment space a top demand among buyers and tenants.** Investors are placing more focus on infill assets as available land is scarce across the major markets. With e-commerce generating roughly 35 percent of leasing activity, owners are undertaking renovations to add building attributes that attract tenants seeking an ideal last-mile area. The outlook for smaller warehouses located in dense populations is promising, particularly as demand in the cold-storage segment ramps up with more consumers ordering groceries and pharmaceutical products online.

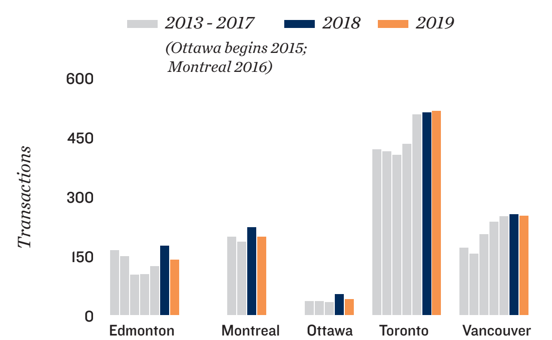
Industrial Supply and Demand



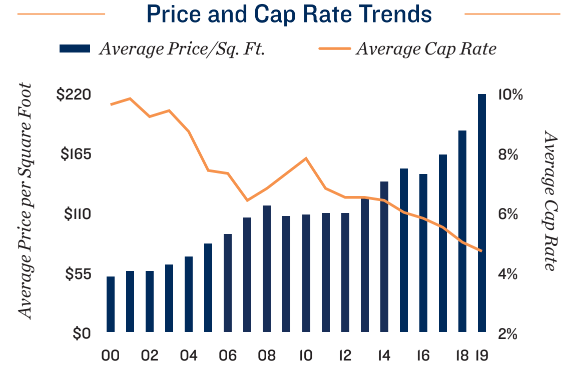
Vacancy by Metro



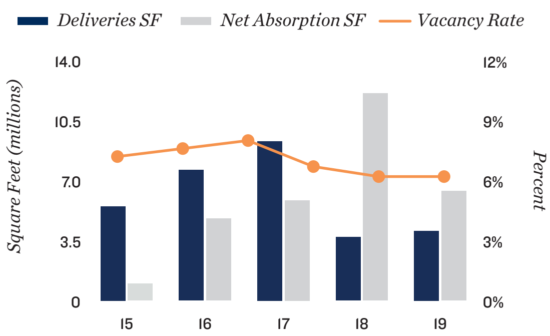
Industrial Transactions



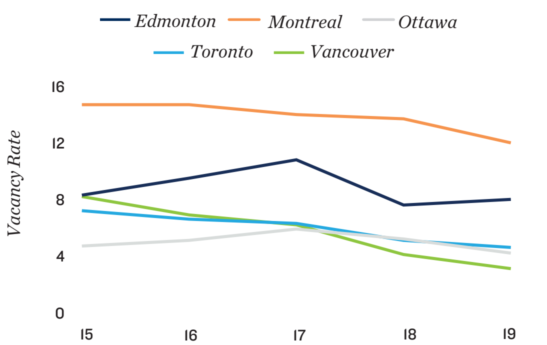
Price and Cap Rate Trends



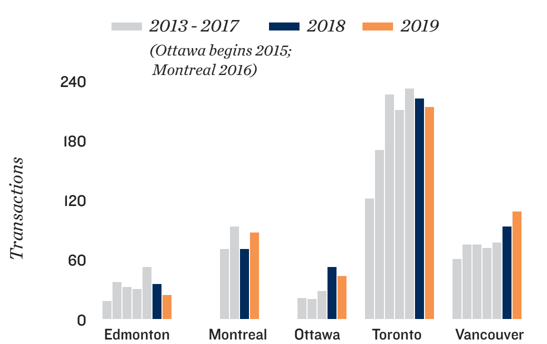
Office Supply and Demand



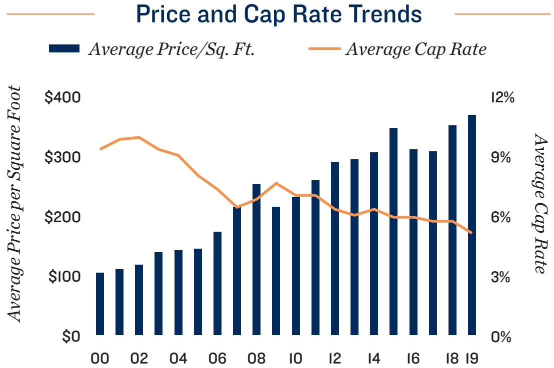
Vacancy by Metro



Canadian Office Transactions



Price and Cap Rate Trends



Duration of Shutdowns Will Weigh on Smaller Firms, Fueling Uncertainty for Office Sector

Tech firms a cushion against coronavirus impact. As the spread of COVID-19 shut down business and took a toll on employment, job losses in the traditionally office-using sectors were minimal in March. Over the coming months, though, smaller firms that are not well capitalized, including startups, could be challenged to maintain operations and meet rent obligations. Stability will come in the form of Canada's digital economy, which has rapidly transformed over the past decade, cementing the nation's status as a global leader in innovation. Major tech titans have been powering leasing momentum, in addition to strong demand from finance and coworking firms in recent years. Vacancy across many markets has compressed to exceptionally low levels as construction has not been able to match absorption, providing a cushion against the impact from the pandemic. The stability of coworking firms will be tested, though, as rising job losses affect workers more likely to lease at shared offices, which will weigh on the sector over the near term.

Wave of supply likely to be put on hold this year. Leading up to the current economic turmoil, the office sector had registered vacancy of 6.2 percent at the end of last year, marking a 50-basis-point reduction to reach the tightest level of the cycle. Tenants have been challenged with finding space that matches their needs, particularly with strong pre-leasing activity and just 4 million square feet completed nationally last year. Supply growth was anticipated to accelerate this year as roughly 20 million square feet works through the pipeline, though many developments will be disrupted by COVID-19, pushing some deliveries into next year.

2020 Canadian Office Outlook

- **Office sector on firm ground.** Office space demand should face fewer risks as traditionally office-using positions are more able to adapt to remote working options, though the duration of lockdowns creates uncertainties. As many office tenants typically sign long-term leases, the sector should be relatively insulated from the economic shock. Western Canada's oil-and-gas industry could be roiled by bankruptcies and layoffs, which may lead to a rise in defaults in Calgary and Edmonton's office market. Operations were already lean in these markets in response to Alberta's 2016 recession, paring back greater downside risks for the sector.
- **Strong pre-leasing activity a boon to operations.** Amazon inked the largest lease in the country last year when it signed for 1.13 million square feet in Vancouver, highlighting the tech industry's progression. Beyond other major leases signed by tech firms, banks and telecommunication companies are driving office demand as well, often choosing to pre-lease at new developments to secure a larger space in a modern building. Strong pre-leasing activity provides a backstop against new supply during the crisis, buoying property metrics.
- **COVID-19 reshapes investment strategy.** Office investors will evaluate their path forward as the economic shock progresses, softening transaction activity over the near term as buyers step up due diligence. Properties with tech tenants will remain targets as the outbreak emphasizes the need for tech in daily life. Going into the crisis, investors exhibited elevated confidence, deploying more than $8.3 billion of capital to compress the average cap rate to the low-5 percent band.

Retail Sector Hit Hard by Health Crisis; Rent Assistance to Shore Up Property Owners

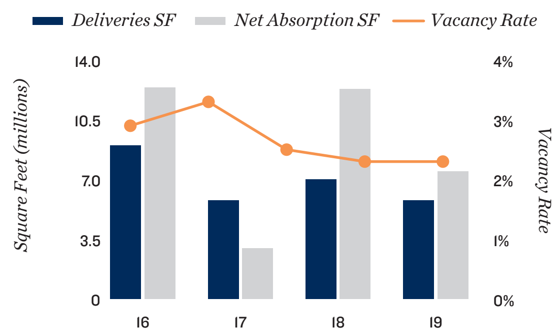
Outbreak to reshape the industry as shutdowns persist. The retail sector faces steep challenges as the pandemic weighs heavily on the performance of small and medium-sized businesses. Cash flow has dried up for many retailers and food and beverage tenants, which may soon lead to a wave of bankruptcies and business shutdowns. Some categories will perform better than others, including supermarket chains and pharmacies, as consumers curb discretionary spending and focus on necessities. Property owners and tenants are working closely to negotiate rent relief, while the federal government is also planning to provide rent assistance for retailers. The Canada Emergency Commercial Rent Assistance program will give loans, some being forgivable, to property owners who allow tenants to forgo or pay reduced rent for April, May and June. For some small businesses, the government packages will not be enough to remain in operation, raising vacancies over a lengthy recovery.

Balanced supply growth favours property owners. Entering the pandemic, retail real estate was in a comparably healthy position following years of realignment with evolving consumer preferences. The national vacancy rate rested at an exceptionally tight 2.3 percent last year, marking a 20-basis-point decline from a year earlier. Tight operations for the sector will be a strong advantage over the coming months, buoying property metrics from the economic fallout. Fundamentals will also be bolstered as construction has seized at many of the nation's projects, pushing some deliveries into next year to buffer the sector from a supply shock. Developers added just over 4.5 million square feet to inventory last year and had nearly 9.5 million more underway prior to the outbreak.

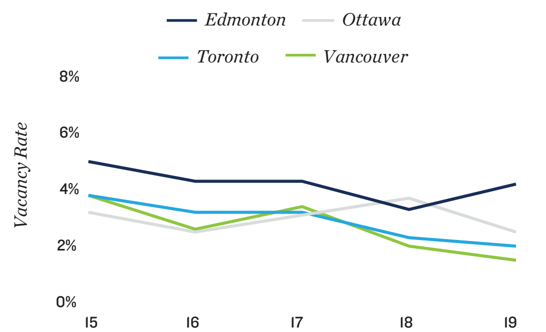
2020 Canadian Retail Outlook

- **Health and wellness sector faces oversaturation risk.** Changing consumer tastes are responsible for the rapid growth of the health and wellness category, driving strong leasing momentum among dental offices, medical clinics and fitness clubs last year. The outlook for the fitness industry has been clouded as quarantine restrictions led many companies to freeze membership payments and they are unable to bring in any revenue currently. Smaller health clubs and boutique fitness studios may be challenged with retaining existing membership as consumers have an abundance of options in the category and are likely to alter spending patterns during the economic recovery.
- **Health crisis accelerates transition to online shopping.** E-commerce and direct-to-consumer shopping have made large strides in recent years, bringing online shopping in Canada to account for 4.7 percent of overall retail sales in December of last year. COVID-19 is driving a faster adoption and will encourage retailers to enhance multichannel experiences to blend digital and physical formats and remain relevant in a competitive marketplace
- **Investors recalibrate strategies.** Amid a rapidly changing landscape and retailers being faced with greater uncertainty from COVID-19, buyers will continue to gravitate to segments that align with consumer trends. Grocery-anchored centres and pharmacies will continue to be sought after for their perceived safety in an online world. Despite challenges faced by less established brands, assets tenanted by restaurants, bars, fitness clubs and medical service providers will remain strong targets.

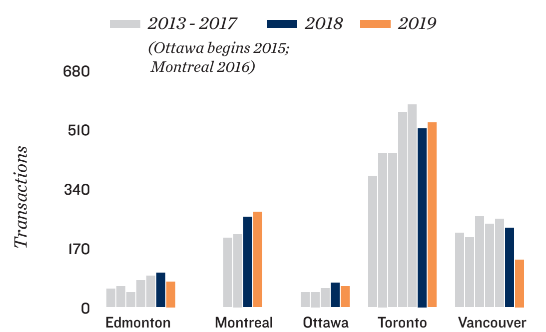
Retail Supply and Demand



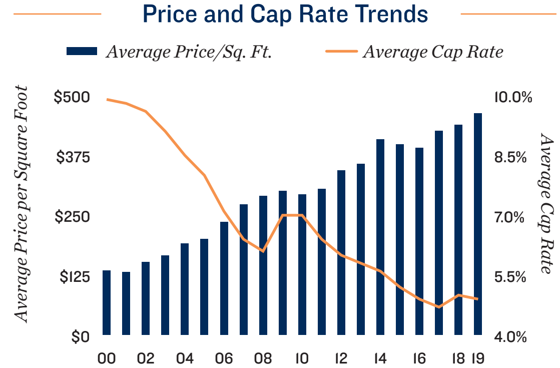
Vacancy by Metro*



Retail Transactions



Price and Cap Rate Trends



Ottawa Takes Unprecedented Steps to Backstop the Economy With $200 Billion Stimulus Package

COVID-19 measures to protect from financial fallout. At the end of March, Canadian officials unveiled the nation's largest ever fiscal package as the government moved swiftly to shore up the economy and stem the spread of the novel coronavirus. Policymakers committed more than $200 billion in new measures to safeguard the economy, including emergency wage subsidies, the expansion of employment insurance benefits, government-backed credit lines and tax deferrals. More programs are in the works, including rent assistance aimed at commercial property owners. Significant support will go toward the nearly 1.2 million small and medium-sized businesses in the country as many have been severely impacted by the outbreak, particularly the services sector. In addition, investors will benefit indirectly from the magnitude of the cash injection that will reach affected workers and businesses. Many of the nation's financial institutions have also been working closely with property owners to extend loan payment deferrals as a greater share of residential and commercial tenants are unable to meet their current obligations.

Programs bring relief to workers and companies. Temporary layoffs have surged, notably in the food and beverage and tourism industries. The Canada Emergency Response Benefit supports those who have lost work from COVID-19, providing $500 a week in employment insurance for up to 16 weeks. For some lower-income households, this will fully replace their wages, allowing them to continue to make rent and mortgage payments. Other sizable packages bringing aid to individuals and businesses are the Canada Emergency Wage Subsidy, covering 75 percent of employees' payrolls, and the Canada Emergency Business Account, providing companies with a $40,000 line of credit.

Groundwork being laid for a quick recovery. The federal government and Bank of Canada have intervened much more quickly to bridge the economy than during the 2008-09 financial crisis to prevent a deep and long-lasting economic downturn. To keep credit markets functioning, the bank introduced new asset purchasing programs to ensure borrowers have access to capital, including the purchase of about $200 billion of government debt. An expansion of the commercial mortgage backed securities program has been established, providing financial institutions with cash to renew mortgages for commercial real estate investors. Additional large-scale programs have been enacted to alleviate the strain on markets and the financial system, setting the groundwork for the economy to recover at a rapid pace once the health crisis is contained.

Marcus & Millichap Canada Offices

Eastern Canada

J.D. Parker *Executive Vice President of Brokerage Operations*
(416) 585-4646 | j.d.parker@marcusmillichap.com

Montreal Office:

John Horowitz *First Vice President | Regional Manager*
1000 de la Gauchetière West Suite 4230
Montreal, Quebec H3B 4W5
(438) 844-6550 | john.horowitz@marcusmillichap.com

Ottawa Office:

Mark A. Paterson *Vice President | Regional Manager*
275 Bank Street, Suite 301
Ottawa, Ontario K2P 2L6
(613) 364-2300 | mark.paterson@marcusmillichap.com

Toronto Office:

Mark A. Paterson *Broker of Record | Vice President/Regional Manager*
200 King Street W., Suite 1210
Toronto, ON M5H 3T4
(416) 585-4646 | mark.paterson@marcusmillichap.com

Western Canada

John Vorsheck *Senior Vice President | Division Manager*
(604) 675-5200 | john.vorsheck@marcusmillichap.com

Edmonton Office:

John Vorsheck *Senior Vice President | Division Manager*
10180 101 Street, Suite 3400
Edmonton, Alberta T5J 3S4
(604) 675-5200 | john.vorsheck@marcusmillichap.com

Vancouver Office:

Michael Heck *Sales Manager*
333 Seymour Street, Suite 1280
Vancouver, British Columbia V6B 5A6
(604) 638-2121 | michael.heck@marcusmillichap.com

For information on Marcus & Millichap Capital Corporation, contact:

Tony Solomon *Senior Vice President, National Director | MMCC*
Tel: +1 (310) 909-5500 | tony.solomon@marcusmillichap.com

Prepared and edited by

Michael Murphy
Research Analyst | Research Services

For information on Canada commercial real estate trends, contact:

Research Services Division

John Chang *Senior Vice President | National Director*
Tel: +1 (602) 707-9700 | john.chang@marcusmillichap.com

Price: $1,500