Colliers

Accelerating success.

Colliers Canada

Mid-Year 2021
Canada Retail Update

Contents

Introduction

Mid-Year 2021 Canada Retail Update

Despite being one of the hardest hit commercial real estate sectors throughout the pandemic, the Canadian retail sector has some bright spots. As public health measures are relaxed, indoor malls and restaurants have reopened, commuters have begun to return to normal patterns, and optimism is starting to return among consumers, retailers, and retail landlords/investors. Also on the positive side, many households are sitting on record savings accumulated over the last 16 months, and many consumers are just itching to partake in retail therapy.

There remain hurdles to the retail recovery though, including limited capacity for retailers, worrying COVID-19 variants, such as the delta variant, and mounting consumer debt levels. Although debt levels have been a concern since at least 2017, when the Bank of Canada started increasing their Overnight Lending Rate, there is cause for more concern now as many Canadians have stretched to buy homes throughout the pandemic, driving up both home values and mortgage principles. Adding to the concerns about debt servicing are the many surveys indicating that Canadians are looking to leave jobs instead of going back to the office, potentially resulting in more single income families, and that this is all coming at a time when the Bank of Canada is expected to begin increasing its Overnight Lending Rate in 2022, from the current 0.25% to 1.00% by mid-2023.

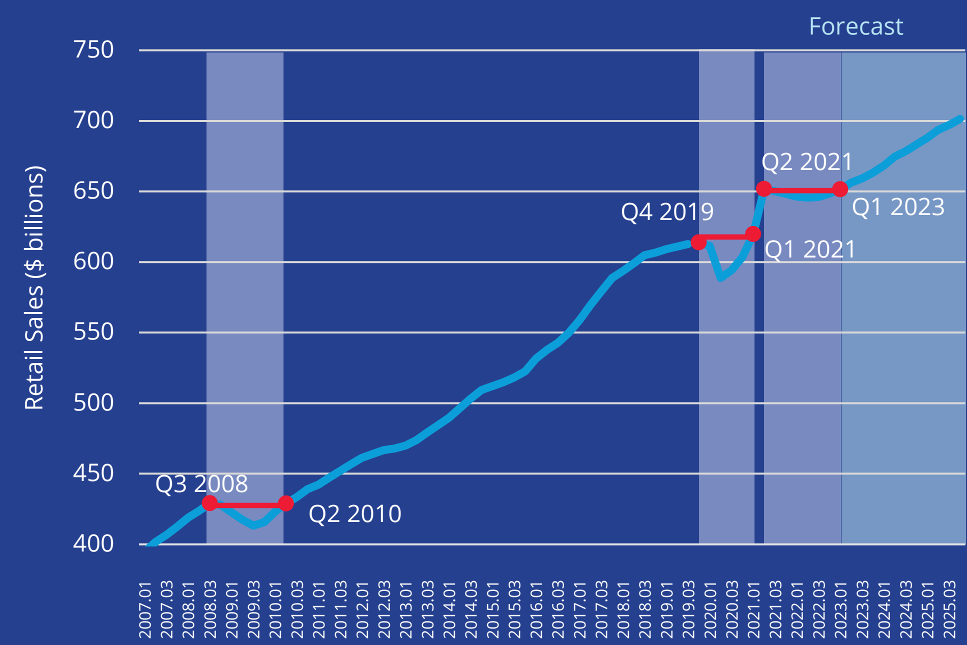
Retail Sales Outlook

Even in-light of these concerns, and despite the numerous lockdowns, total retail sales have already rebounded to above pre-pandemic levels. However, the rebound has been very unequal, with e-commerce taking a larger proportion of these gains. Furthermore, the gains were not spread evenly among the retail sectors.

Along with this, the expected slowdown in retail sales in Q3 2021 is concerning, and although this dip will not be nearly as deep as the one that occurred during the pandemic, it will last longer and retail sales will not fully rebound until Q1 2023.

Retail Sales Outlook

Retail sales will not fully rebound until Q1 2023



Source: Statistics Canada, July 23, 2021, and Conference Board of Canada, July 13, 2021

Retail Sales Outlook (cont'd)

On a provincial basis, the relatively more open jurisdictions seem to have fared better. All provinces reported higher retail sales in May of 2021 when compared to May of 2020, which was only the second month of the pandemic.

This dynamic illustrates how consumer confidence was much higher this spring due to the vaccine rollout, despite many provinces still being in some form of lockdown, and how both consumer buying habits and retailer strategy pivoted towards the continuity of retail activity throughout the pandemic regardless of the difficulties presented by the public health measures; granted a greater proportion of this activity was occurring through e-commerce and "essential" big box retailers with open air access and curbside pickup.

"Retailers are adapting quickly to the preferences of customers and we are seeing in our enclosed malls that "Inside Out" is being a future requirement that Anchor Tenants are looking for. Stores want to have an exterior entrance to serve customers directly, not just one entrance from the interior of the mall.

The traditional 2-anchor dumbbell model is changing, and Rio Can is on the leading edge or redesigning to suit retailers and customers' needs. One of the most important Principles that RioCan believes in is to listen to our Customers otherwise known as our Tenants."

Jeff Ross
Senior Vice President, Leasing and Tenant Construction
Riocan

Retail Sales Rebound and Return to the Office

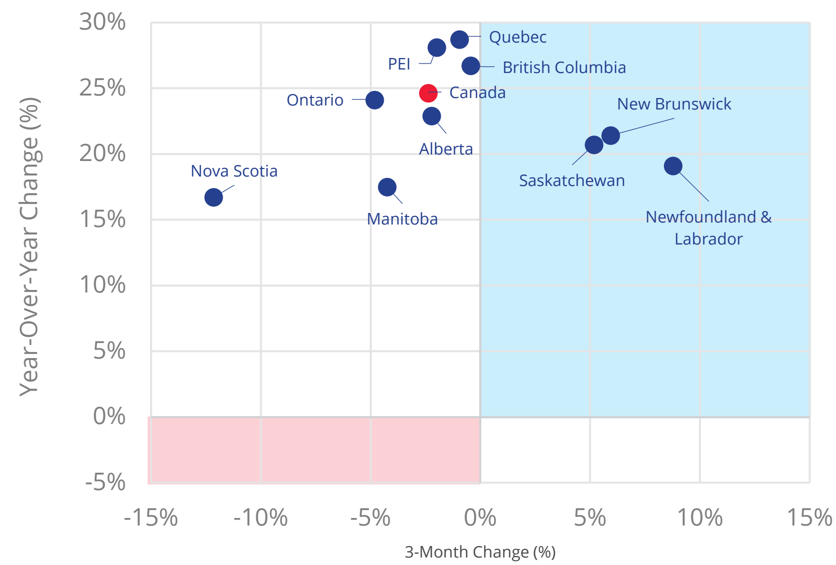
Retail Sales Rebound

Employment: The Job Story Shows the Rebound in Retail and Entertainment

On the employment front, the recovery highlights the so called 'K' shaped recovery experienced throughout the pandemic, with lower skilled employees suffering in 2020 while higher skilled employees continued to thrive. The Finance, Insurance, and Real Estate (FIRE) and the Professional, Scientific and Technical Services (PSTS) sectors have performed quite well despite the COVID-19 lockdowns, as most companies in these sectors were able to transition to a work from home strategy. However, because most of these thriving employees have not longer been travelling to and from work, or until recently have been unable to eat out, their spending has dropped dramatically. This was apparent in the job losses in 2020 for the Retail Trade; Information, Culture and Recreation; as well as Accommodation and Food Services sectors. However, through the first half of 2021, Retail Trade has shown slight positive job growth, with stronger growth more recently in the Information, Culture and Recreation as well as the Accommodation and Food Services sectors. As more retailers, malls and entertainment venues reopen across the country, it is expected that positive job growth will continue for these sectors, however, it will take some time to fully recover all of the lost jobs in these sectors.

Retail Sales Rebound by Province

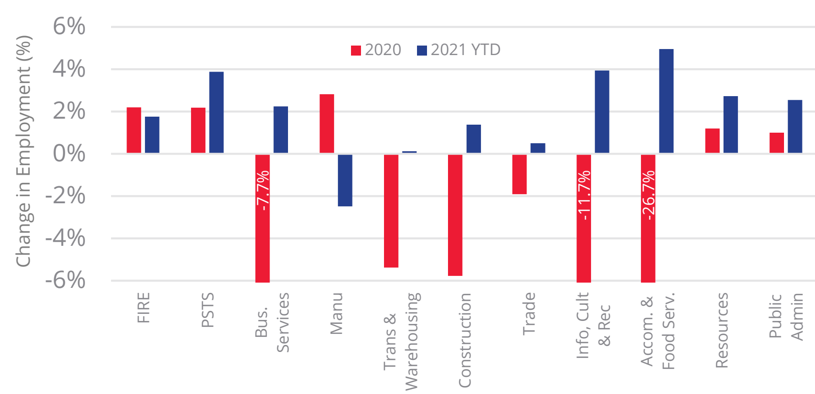
May 2021 Retail Sales up year-over-year across the country, compared to May 2020



Source: Statistics Canada, Retail Trade – May 2021, released July 23, 2021.

Canadian Employment

By commercial real estate use

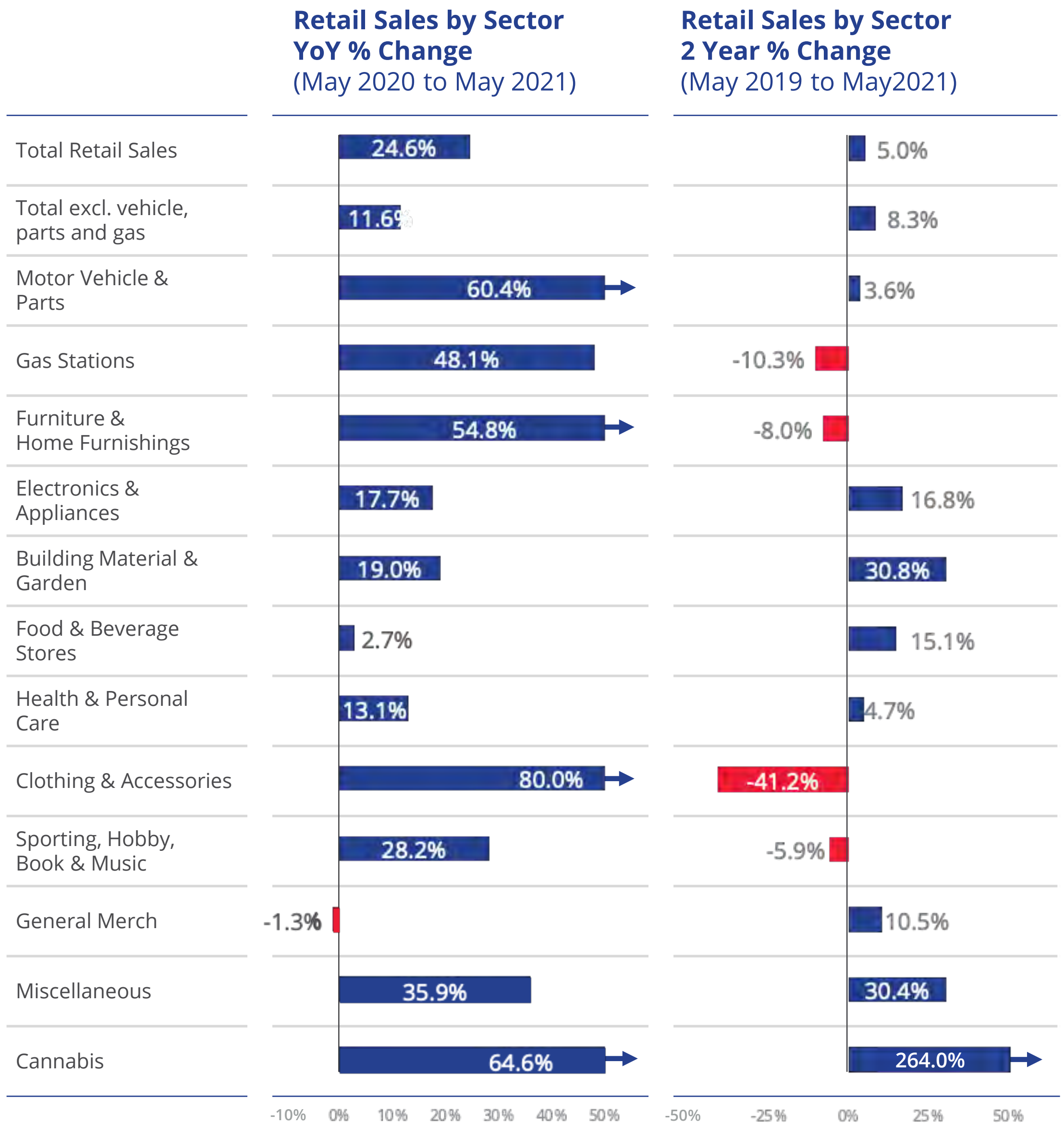


Source: Conference Board of Canada, Statistics Canada, June 2021

Retail Sales Rebound (cont'd)

Retail Sales by Industry

The rebound in retail sales has truly been unequal, by retail property, retailer type, and retail sector. Throughout the pandemic, as more people stayed at home, it was not surprising that spending was strongest among industries related to home outfitting and recreation. As the pandemic drew on, supply chains were impacted, which put a damper on sales for sporting, recreation and hobby equipment among other sectors. Furthermore, as people went into the office less compared to pre-pandemic levels, and travelled less in general throughout the lockdowns, gasoline sales as well as clothing and accessory sales slowed dramatically.



Source: Statistics Canada, Retail Trade – May 2021, released July 23, 2021.

Return to the Office

The Return To The Office and Changing Commuter Patterns

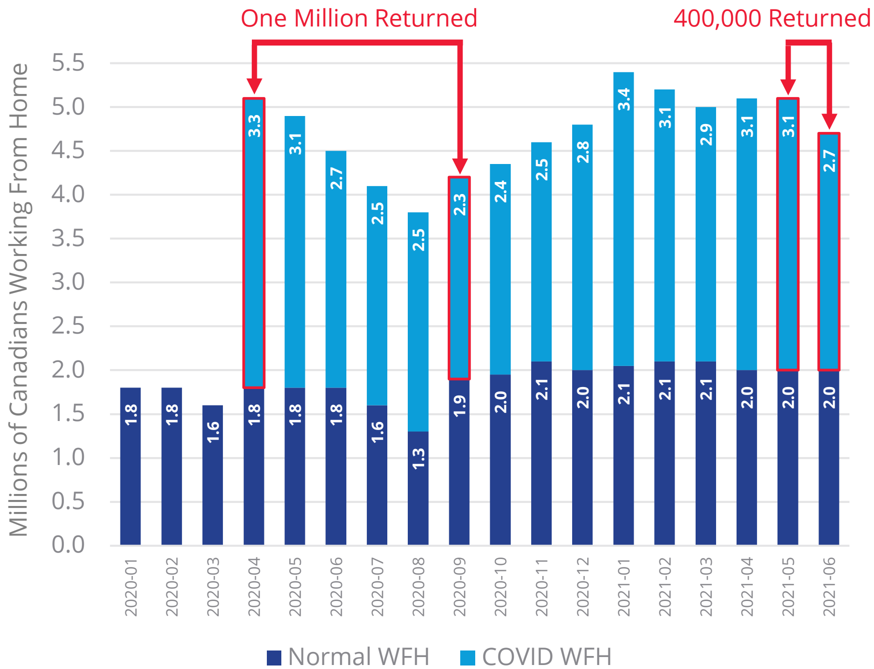
As many Canadians are now starting to return to the office, or at least beginning to contemplate the return, there will likely be a boom in clothing and accessory sales as people look to update their wardrobe with new styles and sizes. Furthermore, because children tend to grow, and many did not attend school in person last year, we expect a strong back to school shopping season this year. Furthermore, the return to office and school will change commuter patterns once again.

The sudden increase in Canadians working from home in mid-March 2020 essentially cut off the foot traffic and lifeblood for many downtown and commuter centric retailers, which resulted in a boom for more automobile focused and suburban properties.

These commuter patterns are beginning to change again, and with these changes so will the fortunes of retail properties. Similar to what was experienced in 2020, we expect at least one million Canadians to return to the office at least 3+ days a week by September of 2021, however, unlike last year, the vaccine rollout should allow these folks and more to return permanently, even if just 3 days per week on a hybrid schedule.

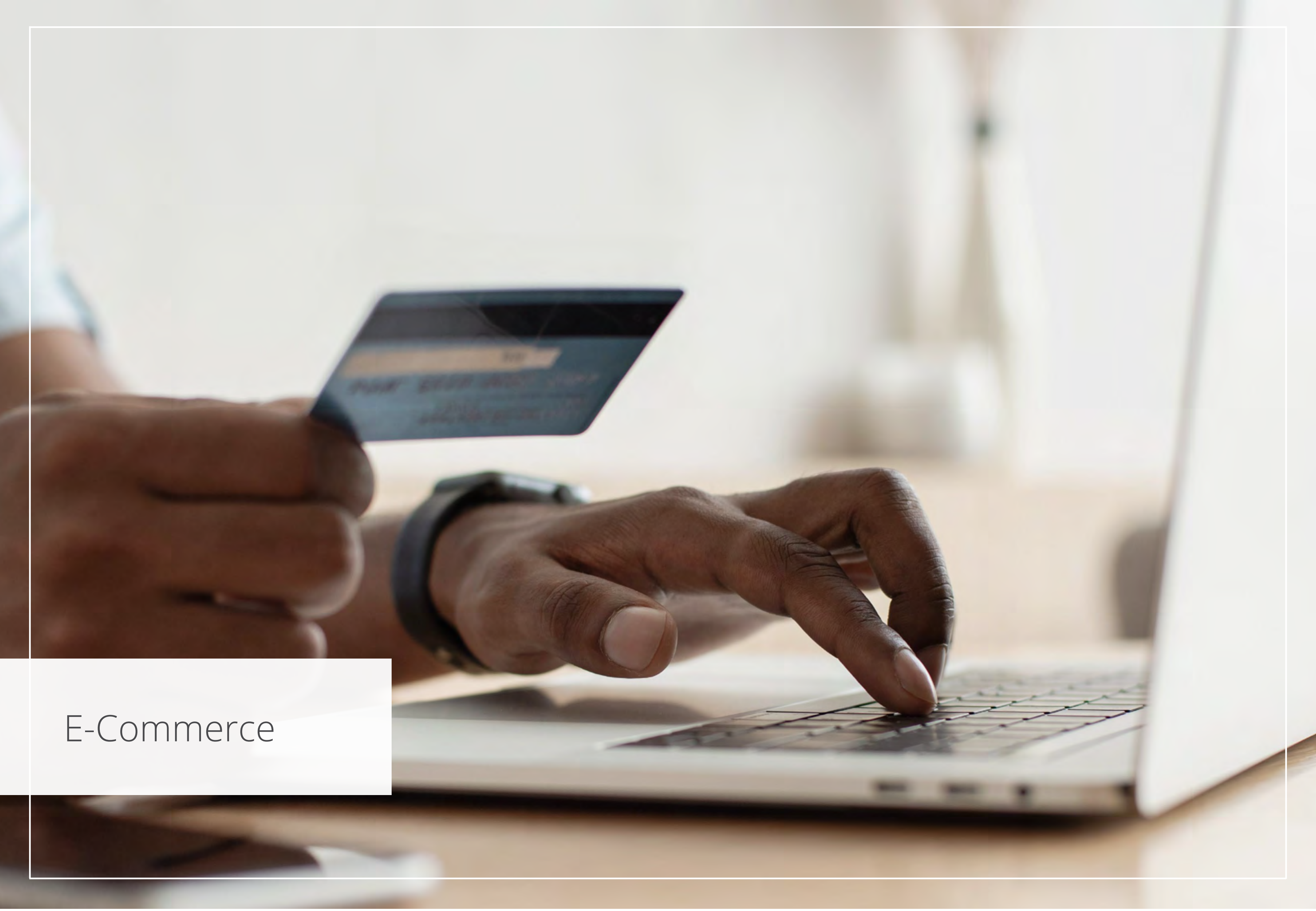
Working From Home (WFH)

One million Canadians returned to the office within 6 months of the start of the pandemic. 400,000 have returned since the end of the third wave.



Source: Statistics Canada, June 2021.

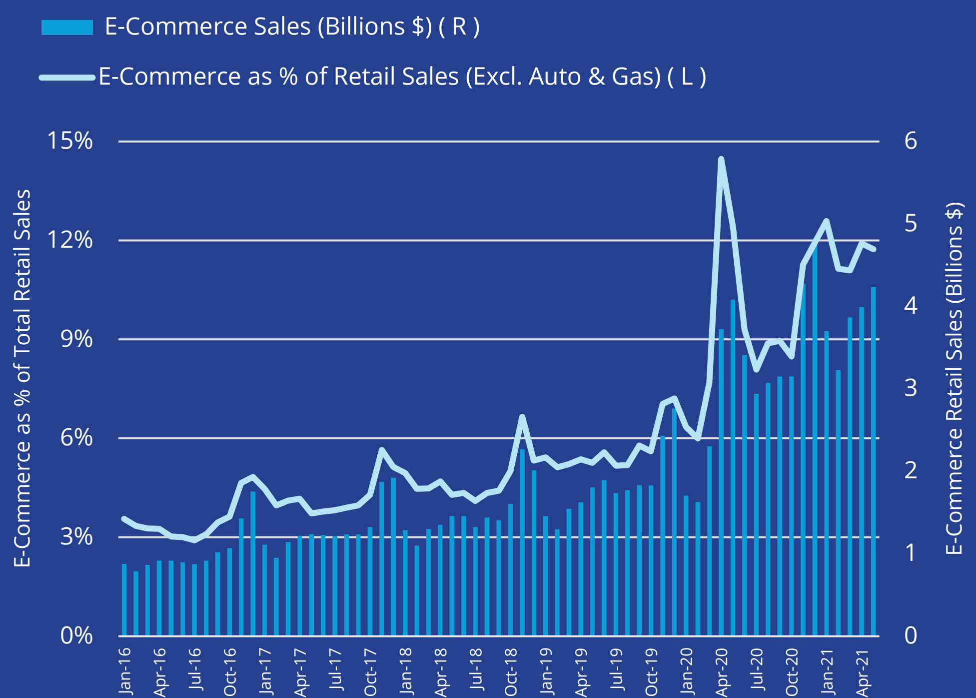
As a result, we expect more commuter focused and downtown retailers to begin to reap the benefits of this shift, whereas the more automobile focused, and suburban retail properties could see a slight slowdown in activity as a result.



E-Commerce

E-Commerce

Ecommerce as a Percentage of Total Retail Sales (excluding Automotive and Gas)



Source: Statistics Canada, May 2021, Colliers, Q2 2021.

E-Commerce is Taking a Bigger Bite Out of Total Retail Sales

Like many trends that were expedited by the pandemic, e-commerce adoption increased dramatically as lockdowns forced consumers to shop online.

E-commerce as a percentage of total retail sales excluding automobiles and gasoline, reached a peak of 14.5% in April of 2020, doubling the pre-pandemic peak of 7.2% in December of 2019, and although it has since fallen, it has averaged 10.8% throughout the pandemic, and currently sits at 11.9%. On a dollar basis, e-commerce sales peaked at $4.8 billion in December of 2020, surpassing the pre-pandemic peak of under $2.8 billion in December of 2019. Throughout the pandemic, e-commerce has averaged $3.7 billion, which is up 32.2% over the pre-pandemic peak.

Many individuals tried e-commerce for the first time, or at least tried purchasing different items online for the first time during the pandemic, and with the convenience experienced, it is clear that e-commerce penetration will not only remain at elevated levels but will continue to grow. This has clearly resulted in another hurdle for many retailers. If they were not prepared for this shift to e-commerce prior to the pandemic, then they suffered disproportionately throughout the pandemic.

E-Commerce (cont'd)

It should be noted that e-commerce and bricks and mortar retail are not mutually exclusive, as many retailers operate omni-channels, and therefore have e-commerce platforms. Despite public health measures being eased, e-commerce adoption is here to stay, and over the next 5 years, it is expected to continue growing at a faster pace than retail sales in general. As a result, many institutional retail landlords and the Federal government are helping retailers setup their online presence.

The Federal government, in their 2021 budget, announced initiatives to help small and medium sized businesses build their online presence, including initiatives such as:

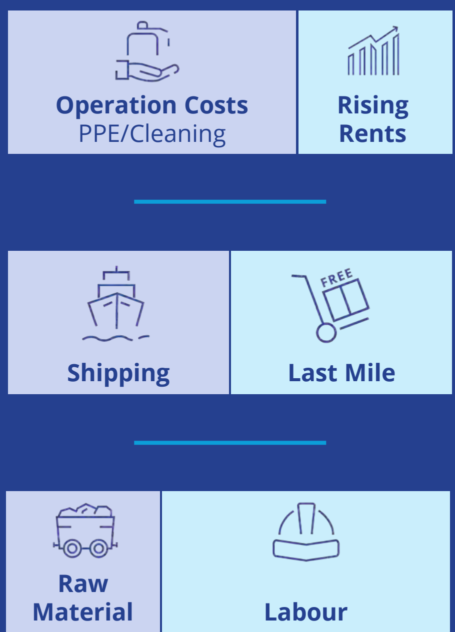
- Canada Digital Adoption Program: A tax incentive to help up to 160,000 small and medium-sized businesses adapt to e-commerce through grants and loans to buy tech and advisory support.
- Credit Card Fees Negotiation: Plans to negotiate with credit card companies about swipe fees, as this has had an outsized impact because of e-commerce, cashless transactions, and high Canadian debt levels.

As for the major institutional retail landlords, they are helping their tenants by offering programs to setup e-commerce solutions, including:

- Assistance in setting up websites
- Providing e-commerce fulfillment partnerships on site
- Providing return logistics solutions and partnerships on site

E-Commerce (cont'd)

All Costs are Increasing



Return Logistics

Returns have always been a costly issue for retailers, however, with the rise of e-commerce, return logistics is becoming even more problematic at a time when costs are increasing for all aspects of operating a business. Retailers are dealing with reduced store capacity and increased costs for personal protective equipment (PPE) and cleaning supplies, in addition to an increased cost of goods, supply chain issues as a result of shipping delays, as well as rising labour costs despite relatively higher unemployment for workers in this sector.

Dealing with returns at a bricks and mortar location, although problematic, is much simpler than through e-commerce platforms, and is less costly as well. Firstly, returns generally only account for 5% to 10% of sales at bricks and mortar stores, mainly because people can see, feel, and try on the product before purchasing, which is simply impossible to do online.

As a result, e-commerce returns are generally up to 20%, and in some cases even as high as 40% during the pandemic because consumers were unable to visit retailers for "showcasing". Even if all these returns were processed in store, when the retailer reopened, there are costs associated with housing the returns, having employees assess and restock the return, and additionally there is a depreciation and time cost, however, the total general cost of the return is still estimated to be less than 10% of the sale price.

For e-commerce, the cost of the return is much higher, primarily because there are return shipping costs, dedicated space and staffing requirements to process the returns, and it usually takes much longer for all of this to occur, resulting in significantly higher depreciation and time costs. As a result, the cost of returns for e-commerce channels could be as high as 50% or more of the original sale price.

E-Commerce (cont'd)

Because of the significant costs associated with return logistics, many institutional retail landlords are working on solutions at scale to help their tenants deal with the return logistic problems associated with increased e-commerce.

Cadillac Fairview (CF) for instance announced earlier this year that they have partnered with ReturnBear to "offer an improved return experience for Canadians coast to coast, offering the ability to return items from a number of retailers at once, either at a single drop-off location at a CF shopping centre or shipped back together in a single box to a ReturnBear processing centre."

These solutions are meant to make it easier for consumers to return the items faster, which for the retailer would drive down the cost associated with depreciation and time, as well as having to hire staff and allocate space to process the returns themselves.

Return Logistics

Bricks & Mortar	Issue	E-Commerce
5% to 10%	Returns as % of Sales	20% to 40%
N/A	Return Shipping	Yes
Before Return	Assessment of Return	After Returned
N/A or Limited	Labour & Space Dedicated	Dedicated (20% Cost Increase)
Minimal	Depreciation / Time Cost	Significant but Varied
Minimal	Returns End up in Landfill	Up to 25% of Returns
<10% of Sale Price	Cost of Return	>50% of Sale Price

Retail Outlook

Retail Outlook

Retail Fundamentals & Outlook

Although retail fundamentals across the country have taken a hit since the start of the pandemic, the impact has not been equal. As lockdowns were implemented overnight earlier in the pandemic, commuter patterns shifted and so did the fortunes of retail properties.

Downtown and more commuter centric retail properties, as well as enclosed malls suffered disproportionately, and as a result vacancy rates increased the most for these assets, and rents were most impacted.

In contrast, suburban and more automobile focused retail, such as many community, neighborhood and power centers, held up quite well, with many of these assets with large essential retailers seeing vacancy rates remaining stable or even falling.

Retail Outlook (cont'd)

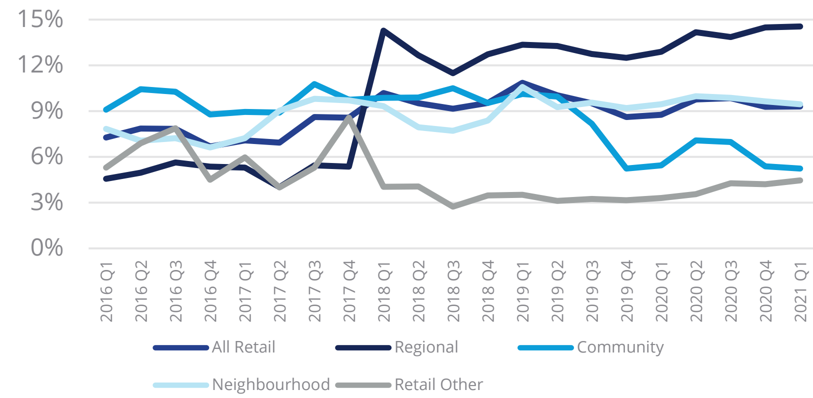
National Retail Outlook

Despite the many government support programs for rent relief, wage assistance and loans, as well as landlord support; many small retailers and restaurants are still having difficulties making ends meet and could potentially close due to the insurmountable debt being accrued, which will not go away upon full reopening.

Furthermore, many small retailers are struggling to implement digital solutions. As a result, we expect retail vacancy rates to continue increasing throughout 2021, and then either slow or even begin to reverse for some markets in mid to late 2022.

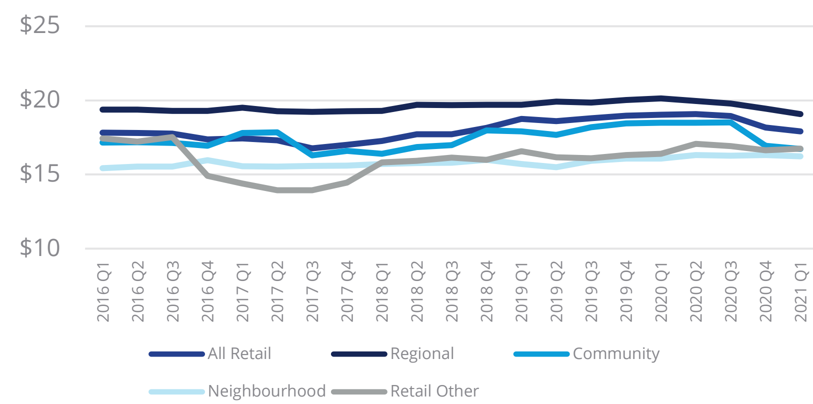
Rents have also taken a hit and are expected to continue falling until stabilizing in mid-2022. Destination properties will experience the greatest rebound, and treasure hunt retailers are looking for open air access and properties. Despite this, landlords are expected to continue working with retailers to keep occupancy rates up.

Retail Vacancy by Asset Type



Source: MSCI, 2021, Colliers, Q1 2021.

Retail Rents by Asset Type



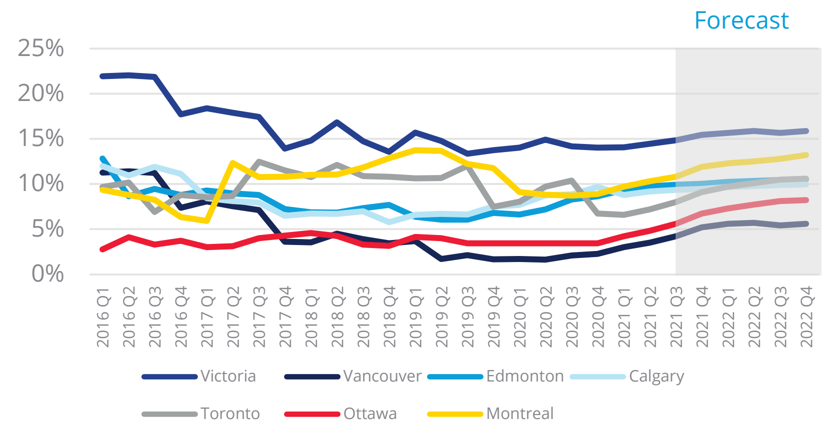
Source: MSCI, 2021, Colliers, Q1 2021.

Retail Outlook (cont'd)

National Retail Outlook

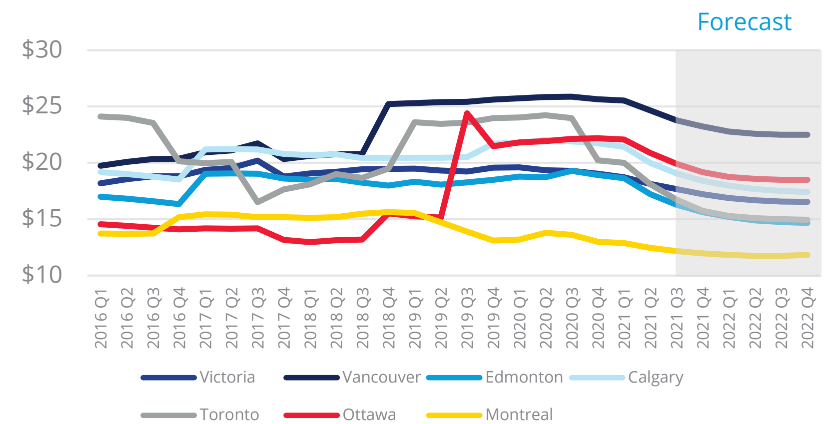
As a result, some landlords have become more open to negotiations with those tenants that are looking for space, however, this flexibility differs by landlord and by asset, and the tenant asking. Retailers and properties that specialize in commodity type goods will likely be the laggards, as they battle the continued growth of e-commerce.

Retail Vacancy by Province



Source: MSCI, 2021, Colliers, Q1 2021.

Retail Rents by Market



Source: MSCI, 2021, Colliers, Q1 2021.

Key Takeaways

Key Takeaways

Despite an expected slowdown in retail sales, the short-term outlook for the retail market is positive as a result of the end of lockdowns and the expected resumption in commuter patterns as many office workers return to the office, at least on a part-time or hybrid basis.

Ultimately consumers are social beings, and as consumers with savings burning a hole in their pockets look to get out with friends and partake in some retail therapy, experiential retail and destination properties will benefit. Further to this, developers remain optimistic, and many continue to move ahead with their retail development plans, especially if these plans are part of mixed-use projects.

Even though vacancy rates are expected to plateau, and rental rates are expected to stabilize across the country by mid-2022 , there are concerns to be aware of. These include:

- A forecasted slowdown in retail sales between Q3 2021 and Q1 2023.
- The continued threat of e-commerce and return logistics.
- Changing commuter patterns, as workers return to the office, and how that might change the future of downtown commuter centric retail versus suburban car centric retail.
- High consumer debt levels and rising interest rates in the second half of 2022 and 2023.
- Changing consumer preferences as households do more with less, and potentially transition from fast fashion to more sustainable practices. Longevity and reuse of items are key.
- The longevity of changing retailer preferences towards open air access.

At Colliers, we are **enterprising.**

We think and act differently to deliver exceptional results.

Our expert advice to property occupiers, owners and investors leads the industry into the future. We invest in relationships to create enduring value. What sets us apart is not what we do, but how we do it. Our people are passionate, take personal responsibility and always do what's right for our clients, people and communities. We attract and develop industry leaders, empowering them to think and act differently to drive exceptional results. What's more, our global reach maximizes the potential of property, wherever our clients do business.

At Colliers, we accelerate success.

Report Authors:

Madeleine Nicholls
Managing Director
Brokerage | Vancouver
+1 604 694 7267
madeleine.nicholls@colliers.com

Roelof van Dijk
Senior Director
National Research & Analytics | Canada
+ 1 416 791 7272
roelof.vandijk@colliers.com

collierscanada.com

Accelerating success.