Doane Grant Thornton

2025 Real estate market summary

Last year's real estate outlook was filled with uncertainty. There was initial uncertainty about economic conditions, about interest rates, and about the path forward for the real estate industry. While some uncertainty remains, especially regarding both domestic and United States politics, there's growing confidence that we've moved beyond the dire conditions experienced coming out of the pandemic and the subsequent economic challenges that caused turmoil across the globe. There are still concerns facing investors, owners, developers, lenders, and property managers, but many industry leaders are optimistic that those challenges can be met, and there are opportunities to be found throughout the industry.

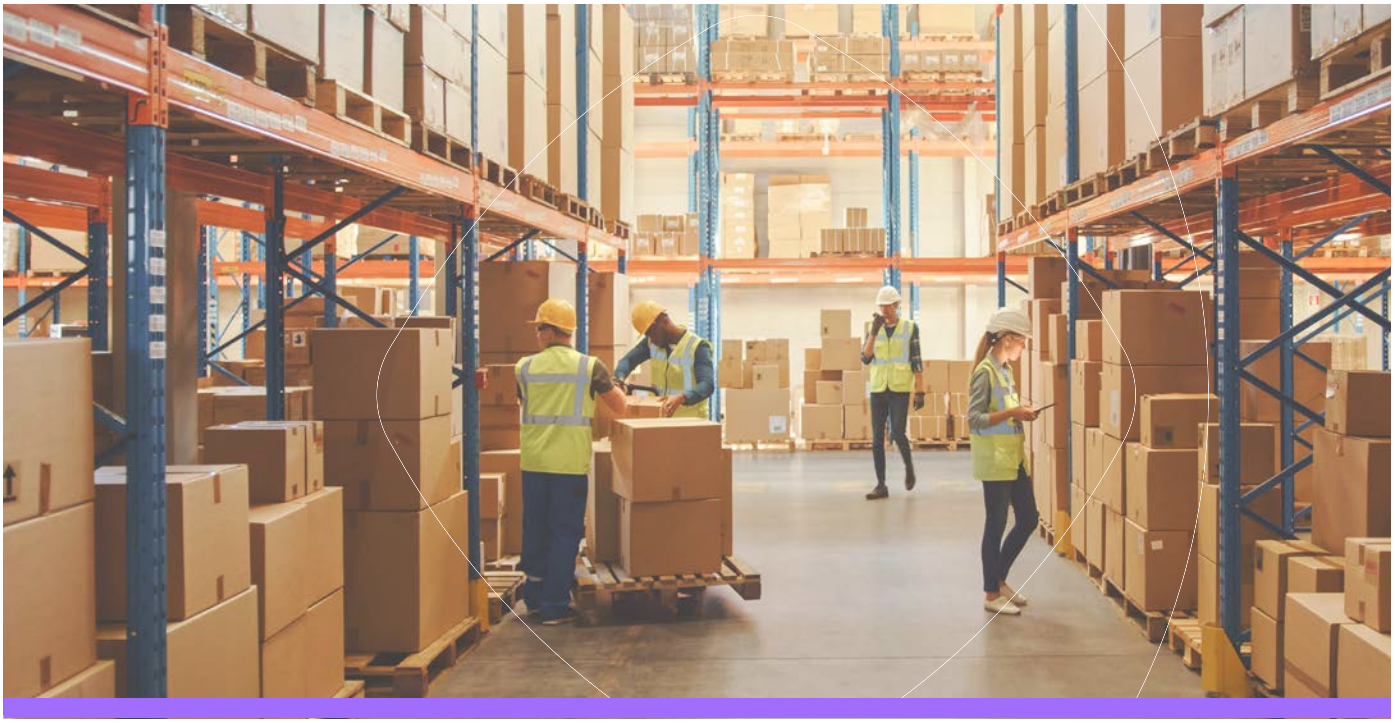
Perhaps the biggest economic development of 2024 was the significant interest rate reduction that commenced in 2024 to bring inflation back within The Bank of Canada's (BoC) inflation-control target range of 1 - 3%. The BoC introduced an interest rate cut in June 2024, followed by subsequent cuts, bringing the rate down to 3.0% by the end of January 2025. According to the BoC's Monetary Policy Report – October 2024, inflation dropped to approximately 2% by the end of 2024 and is expected to remain there in 2025.

The Business Development Bank of Canada (BDC) anticipates additional rate cuts throughout 2025, finishing the year with a forecasted rate of 2.5%. We note that prediction may be complicated by threatened United States tariffs as well as the upward trend in bond yields seen in Q4.

The BoC is also predicting that the overall Canadian economy will grow by

2.1% in 2025

with consumer spending and business investment strengthening because of lower interest rates.



Though the economic picture is broadly positive for 2025, political uncertainties could impact growth. If the US proceeds with tariffs, Canadian businesses relying on the US market will find themselves in danger, potentially threatening overall GDP growth. As US President Donald Trump takes power and his policy agenda—and its effect on Canada—becomes clearer, the industry's approach to current conditions will solidify.

Additionally, changes to Canada's immigration policies in 2024, including reductions to both the temporary and permanent immigrant programs in Canada could end up limiting both demand as well as growth potential if builders are unable to meet labour demand. As the BDC notes, growth in recent years has largely been driven by the growing population—without that economic driver, we don't know how the economy will fare.

With falling interest rates and predictions for reasonable, though not spectacular, growth in 2025, the real estate industry appears to be shifting from the defensive stance of recent years and is now switching to a more offensive-minded approach, focusing on sustainable growth and strategic opportunities. While the government can provide additional measures to help support a stronger rebound, at the 2024's Real Estate Forum in Toronto, industry leaders were largely bullish on the sector and are expecting institutional investors to return. If this holds, 2025 could be viewed as a pivot point from the COVID-era to a phase of renewal.

Key trends

US and Canadian politics driving uncertainty

From implementing a general 25% tariff on Canadian goods and services to using economic warfare to annex the entire country, President Trump's policies will undoubtably influence the Canadian economy in 2025 and beyond and, as a result, the real estate industry. The general approach is to assume something will be implemented, that it will somewhat negatively impact the Canadian economy, but that there will be some type of negotiated settlement to mitigate the damage. No matter the outcome, the lack of certainty will complicate long-term planning and investments for at least the next four years.

Adding to the uncertainty is the Canadian political landscape. With Prime Minister Trudeau stepping down and proroguing Parliament, the legislative process had stalled. This includes proposed legislation to increase the capital gains inclusion rate that the government had pledged to institute but has not yet passed. Additionally, the government's recent changes to immigration policy are expected to have an effect on the labour supply in the construction industry as well as demand for housing, especially in major urban centres. While the policies will presumably remain in place, it's uncertain for how long—a new Prime Minister, whether the new Liberal leader or a member of the opposition, may have different plans. While we'll have to wait and see what influence the political situation will have on policy, trade, and investor confidence, the current situation presents opportunities for governments, industry leaders, and private sector stakeholders to come together and collaborate to advance the industry's interests in the coming months.

Capital structuring

The outlook for 2025 reveals a capital market in transition. After taking a conservative approach in recent years, lenders are loosening their purse strings and investing in more projects. They remain cautious, prioritizing AAA buildings and paying close attention to covenants, cash flow, and cross-guarantees, but there is a clear shift underway.

With interest rate cuts—and lower GIC rates—over the course of 2024, institutional investors are hunting for better returns, leading to growing investment activity. If this trend continues, it could position the real estate sector for a period of future growth and renewed activity.

Artificial Intelligence (AI)

While industry interest in AI is apparent, it remains a curiosity rather than a revolutionary tool. At the Real Estate Forum, Ajay Agrawal of The Creative Destruction Lab noted that the benefits of AI in the industry will be improved prediction capabilities. The large language models used in today's AI are built on the power of statistical prediction, which is foundational to real estate. If AI tools are able to decouple prediction work from strategy development, then prediction work can be farmed out to AI models while strategy—i.e., how to respond to the predictions the models produce—will be taken on by analysts and executives. Presumably, this resource re-allocation will lead to productivity gains as people increasingly focus on value-added work.

As part of his breakout session, Agrawal detailed his top 10 opportunities for AI to enhance productivity in commercial real estate:

1. Price optimization
2. Lease management
3. Predictive maintenance
4. Energy consumption analytics
5. Market trend analysis
6. Customer relationship management
7. Space utilization analytics
8. Fraud detection
9. Construction management
10. Accessibility enhancement

Asset class overview

While there are always variations in demand within an asset class, those divisions appear to be more pronounced heading into 2025. As detailed in the sections below, some asset classes are bifurcating into those segments which significantly outperform, and those which significantly underperform. There's no indication that this will be a permanent feature of these classes, but it's something that will need to be monitored.

Residential

As noted above, the residential asset class looks vastly different depending on whether you're looking at the condo market or other segments. The condo market—especially in the Greater Toronto Area—is facing an oversupply that has driven sales and, in some cases, prices lower. According to a RE/MAX report, of the seven markets they tracked only two saw an increase in sales despite inventory increasing in each market. Edmonton and Calgary bucked the decline in sales, but that may be the result of lower average prices. The glut of inventory, high interest rates and reduced immigration targets has led to fewer new projects, and with few projects in the pipeline we could see shortages in the future.

As inflation came under control and interest rates dropped in 2024, Canadian home sales picked up in the latter half of the year and should continue into 2025. Even so, affordability issues in the British Colombia and Ontario markets are expected to limit price growth.

According to CBRE, the overall National office vacancy rate in Q4 2024 was

20%

Office

The office asset class has undergone significant transformation that stemmed from challenges such as the adoption of remote and hybrid work, downsizing trends, and changing tenant demands. Entering 2025, the office market is showing signs of recovery, signaling a potential turnaround. Building off last year's trends, the office market continues to see a deep division along quality lines, which can be characterized as a "flight to quality". Demand for best-in-class buildings in good locations offering high-quality amenities remains high whereas other buildings aren't as in demand. According to CBRE, the overall national office vacancy rate in Q4 2024 was 20%. When broken down by segment, it could be as high as 25.2% for B/C Class buildings and as low as 10.5% for "Trophy" buildings. CBRE Canada Chairman Paul Morassutti summarizes the Canadian office market as "not oversupplied but under-demolished", emphasizing that the issue is not excess inventory but in the outdated and less desirable office spaces that no longer meet tenant demands. The division of demand also breaks along geographical lines with prime downtown facilities seeing the greatest interest.

These gaps in demand may see a shift in coming years as the current slate of new builds wraps up with few new projects in the pipeline. Lenders are still being very selective about the projects that they support, which means that there's no concrete timeline for the next batch of supply. That lag could push tenants to look for space among the A and B/C class properties or to look outside of downtown space. This will be especially true for tenants that are more price sensitive. More companies across Canada and the US are implementing return to office (RTO) mandates, requiring their employees to come in more days or full time, and this trend is expected to continue with many leaders emphasizing face to face collaboration and productivity. As companies have landed on their policies, they're now looking for ways to draw employees back to the office (or reduce the friction preventing them from coming in), which continues to drive demand for amenities, prime locations, and a sense of community.

Industrial

Industrial remains a leading asset class despite a pullback from its incredible performance in recent years. Driven by the demand of recent years, 35.6 million sq. ft. of new supply came online across the country in 2024. Additionally, at this year's Real Estate Forum, Gord Cook of Colliers noted that millions of square feet per month of second-generation space came back to market over the year. That's put pressure on availability and impacted performance with industrial rents seeing a decline of 4.6% year over year. Looking forward, development is slowing with activity as a share of inventory dropping to 1.2% in Q4 2024 and roughly 25 million sq. ft. of supply expected in 2025 according to CBRE. In recent years, third-party logistics have played a lead role in driving the hot market for industrial space, those organizations either already have the capacity they need or have actually over-committed and are looking to offload. Food and beverage, and data centres have provided some demand in that space, but not to the level that logistics had in recent years.

In general, 2025 is expected to see a moderate correction in the market with industrial rents declining. As supply comes online and is absorbed, trends will shift back to a more balanced market. While some markets are facing downward pressure on rental growth and increased vacancy rates, demand for high-quality and functional assets remains strong in major markets such as Toronto and Vancouver.

Retail

A few short years ago, people were predicting the death of the retail market, yet, as we saw last year, retail has mounted a significant comeback as consumers looked to head back to the shopping spaces they had been denied over the course of the pandemic. However, little supply has been added in recent years and the market is constrained by that lack of supply. As a result, tenants are having a hard time finding space, vacancy rates are low, and rents have been rising across the country.

In terms of trends, there appears to be a move to greater integration with mixed-use residential spaces—high-quality retail is seen as an amenity that draws people to a building. This has led landlords to seek out experiential tenants to anchor a property and draw additional tenants and guests. Moving forward, it's expected that landlords and tenants will work more closely to design retail offerings that will increase demand in a property.

Opportunities on the horizon

As the Canadian real estate market is patiently entering a phase of renewal, it also presents opportunities for growth and re-strategy for those ready to take advantage of the changing market. Whether it's exploring tax efficiencies, restructuring, getting ahead in planning your financial strategies, or even if you're not sure, connect with us!

Our national real estate team is here to guide you through this evolving market.

Alternative assets

The alternative asset class continues to offer opportunities for growth, with investors being drawn in due to their counter-cyclical qualities and those seeking diversification. Although market dynamics, region and sector-specific risks should be considered, overall, key sectors such as data centres, senior housing, and life science facilities are expected to thrive due to their alignment with long-term trends.

Storage facilities have seen a decade of consistent above market performance, which has in turn made lenders more willing to finance projects. The aging population and the shortage of long-term care and retirement facilities, has led to increased demand in that segment. Alternative assets continue to be a vital component of a future-focused real estate portfolio in Canada.

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