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Examining Canadian commercial real estate and how central banks use gold bullion

Central banks are buying more gold in their reserve portfolios as an inflation hedge—what you need to know

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As central banks buy more gold for their reserve portfolios, you may wonder whether gold could offer value as an inflation hedge in your investment portfolio. Including some gold in your long-term investment strategy could help to preserve the purchasing power of your savings over the long run.

The World Gold Council's latest Gold Demand Trends report reveals in the first quarter of 2023, central banks globally bought a combined 228 tonnes of gold. That's a first-quarter record high.

Gold retains its value over the long term and is considered a safe-haven investment

Central banks in developed and developing economies have been buying gold because gold is considered a safe-haven asset for investors who want a potential hedge against inflation. As a finite physical commodity whose supply can't easily be increased—like any other limited natural resource—gold tends to retain its value over the long term.

Gold is highly liquid and carries no credit or counterparty risks, reducing the risk of financial loss in holding it. Gold is also one of the few assets with no correlation to stocks, meaning it's unlikely to fall in value in tandem with the stock market. As such, gold is a store of value that could act as a potential hedge in times of heightened equity market volatility or persistent inflation.

Gold can help investors hedge against inflation risks

Gold has been an essential holding in the financial reserves of nations for centuries, helping to facilitate economic and financial stability. Central banks increased their purchases of gold in the first quarter of 2023 as global economic uncertainty increased and inflation remained elevated.

Volatility from US regional bank failures added another element of uncertainty to financial markets. Since gold is considered a hedge against inflation, more investors have considered including it in their long-term investment portfolios to help preserve the purchasing power of their savings over the long run. There are many ways to invest in gold. These include purchasing physical gold (such as coins or bars) or buying mutual funds, ETFs, or the stocks of companies involved in the mining or production of gold.

Talk to us about the role gold could play in your overall investment strategy. We can tell you how to gain exposure to gold and how much of your portfolio you should consider allocating to it.

Why Canadian commercial real estate could prove relatively resilient compared to the US

By David Andrich, CFA
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Although investors and lenders are facing several challenges in the Canadian commercial real estate (CCRE) market, when compared to similar commercial properties in the US, our real estate market north of the border may prove to be generally more resilient. There are several reasons for this. First, lenders of Canadian commercial mortgages have the ability to seek recourse. Second, Canadian owners have access below-market rates for certain asset classes, such as multi-family via CHMC financing. Third, the ownership of CRE in Canada is more consolidated, particularly for office properties.

Let's take a look at some of the challenges facing the Canadian commercial real estate market and some of it's advantages relative to the US.

Current challenges in the Canadian commercial real estate market

The first challenge for CCRE is the widespread adoption of hybrid or remote employment since the pandemic and the decline in demand for office space it is causing. The spike in vacancy rates is strong evidence of a shift in the demand curve for office space.

Increased vacancies occurred during a strong economy with near-record employment. Typically, spikes in office vacancies occur during economic downturns. If Canada sees a softening of the economy over the next 12-18 months, it will only push vacancies higher—never mind that new supply is still coming online in markets such as Toronto.

Vacancies are increasing in Canada's two largest office markets.

In Canada's two largest office markets, Toronto and Vancouver, vacancies have increased from 4% and 4%, respectively, at the end of 2019, to 18% and 15% currently. In certain cities such as Calgary, vacancy in downtown office space has risen to 27%.

What happens when properties get refinanced at higher commercial mortgage rates?

On top of a reduction in demand for office space, and some office-related retail segments, many property types will face challenges as they get refinanced at materially higher commercial mortgage rates.

We see the impact of higher financing costs in the US, where some CRE owners are walking away from assets when the cost of the interest payments exceeds the revenue generated.

Recourse available to lenders should help to support commercial real estate values in Canada.

In the US, commercial property loans typically have little or no recourse. As a result, owners can make a purely economic decision to walk away from a negative-yielding asset. In Canada, however, that is usually not an option. In Canada, there is typically some recourse available to the lender, and a borrower cannot simply walk away. This will limit the number of liquidation sales by banks, and it should help to support asset values in Canada.

Advantages of Canadian commercial real estate

Another reason why CCRE should prove to be more resilient during economic uncertainty is because of the consolidated ownership of office space by large institutional owners that can afford to carry some assets at a negative yield for longer than private owners. Alternatively, they could fully finance a property via internal cash flows if the interest cost is similar to their long-term target return. Either way, the consolidated ownership of CCRE should provide resiliency in times of stress.

In summary, while Canada's Commercial real estate faces several challenges over the months and years ahead, it could still prove relatively resilient compared to the US.

Investors typically invest in this sector through commercial estate investment trusts (REITs), which trade like stocks on public exchanges, or through mutual funds or ETFs.

Talk to us about whether commercial real estate could be a good fit for your long-term investment strategy.

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We provide our clients with our research insights and expertise on industry issues and themes that matter most to them.

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