2018 Mid-Year Commercial Real Estate Update

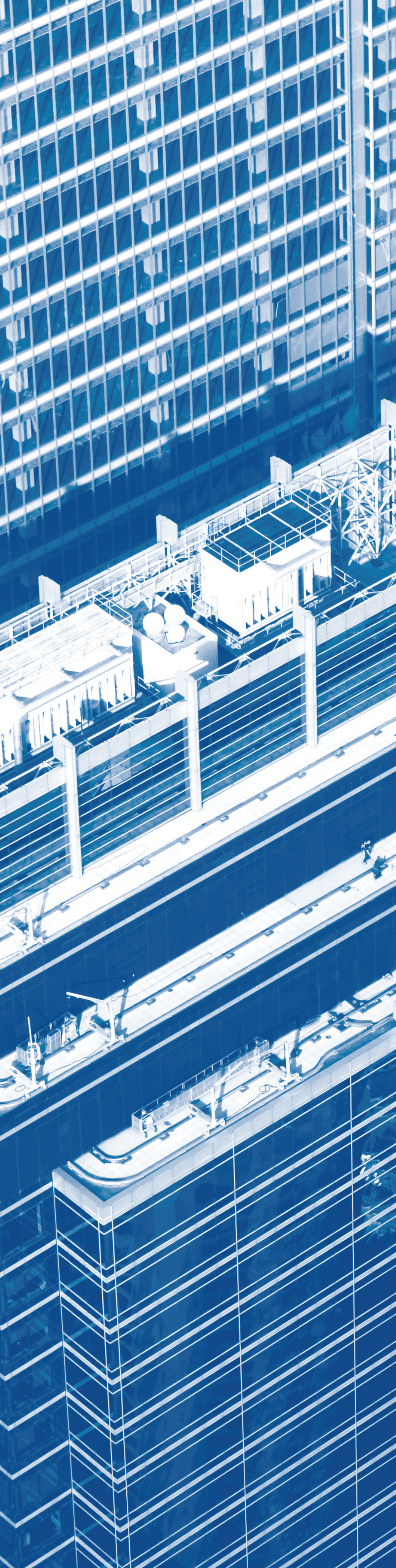
NATIONAL OVERVIEW

The first half of 2018 brought plenty of drama on the economic, financial markets and real estate fronts. The new reality of on-again/off-again trade wars, cold wars and Twitter wars has put economists and analysts in a seemingly "special place in hell" where they are constantly trying to keep up and keep their analysis and conclusions accurate and relevant.

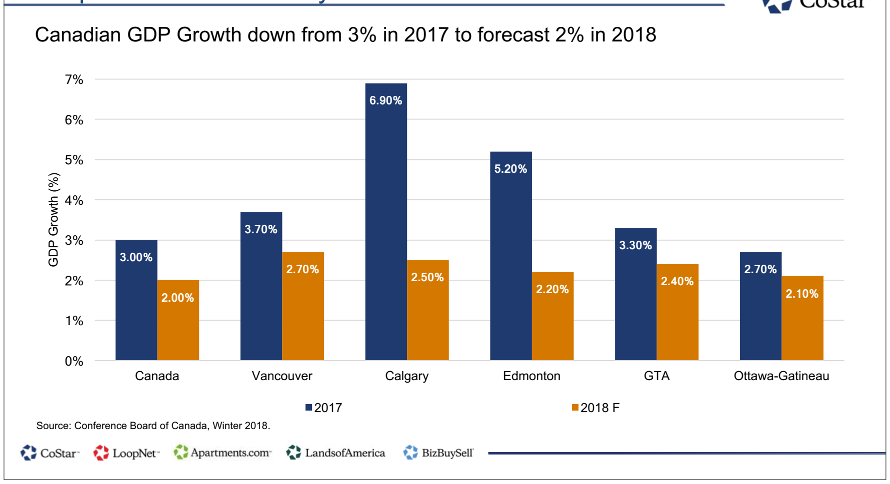
Internationally, the ongoing drama with the renegotiation of the North American Free Trade Agreement (NAFTA) continues to weigh heavily on the economic outlook for Canada as a whole. With shots being fired over softwood lumber, steel and aluminum tariffs and potentially the automobile sector, the renegotiations seem to be taking two steps back for every step forward.

The U.S. tax reform that came into effect in January 2018, known as the "Tax Cut and Jobs Act", which lowered corporate tax rates and allows for immediate expensing, has made the U.S. economy and companies located there much more competitive when compared to Canada. These changes are expected to result in a drain of investment from Canada into the U.S. at a time when capital investment into Canada was already on the decline.

Domestically, the Canadian economy continues to slow across the country. GDP growth came in at 3.0% in 2017, and so far in 2018, Q1 growth has come in at 1.3% annualized. Much of this slowdown in Q1 2018 can be attributed to slowing consumer spending and the housing market, much of which was driven by rising interest rates, but also new mortgage rules for the housing market. Although strong employment and rising wages will counteract rising interest rates, any expectation of a rebound to strong retail sales should be taken with caution. Expectations are for the economy to grow by approximately 2.0% in 2018, and 1.8% in 2019, with the Bank of Canada (BoC) expecting growth as high as 2.1% in 2019. Although all markets have slowed dramatically from last year, Vancouver, Calgary and Toronto will lead the pack and are expected to perform above trend in 2018.



Graph 1: GDP Growth by CMA

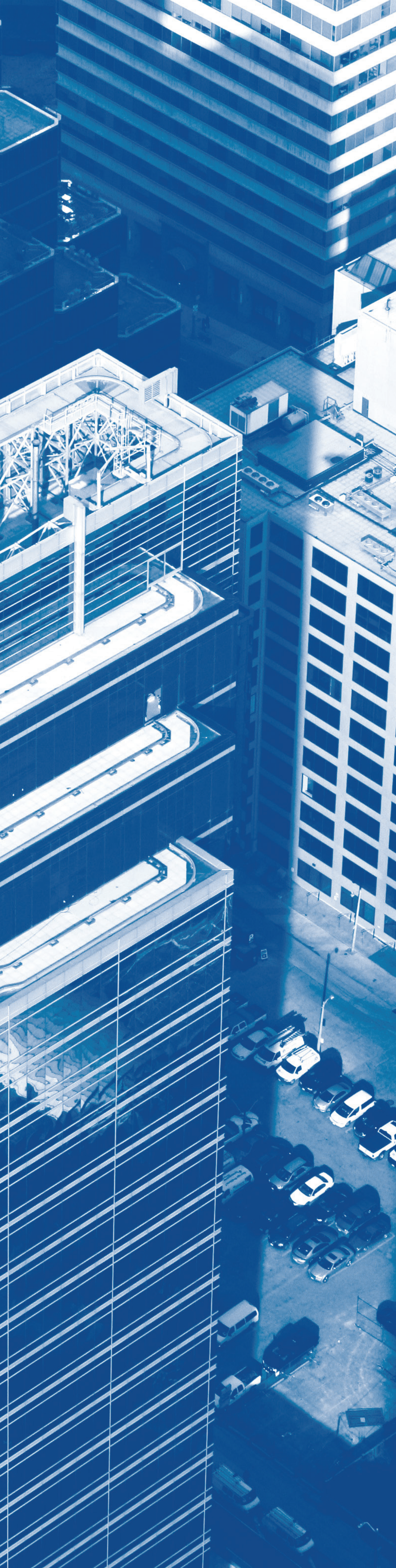


Source: Conference Board of Canada, Winter 2018.

The federal Liberals and Alberta NDP parties have successfully worked together in favour of the Alberta oil interests. The Liberal federal government is backing the Trans Mountain pipeline with a $4.5 billion investment, indicating that this project is 'vital' to the economic wellbeing of Canada, but also, as Finance Minister Bill Morneau said, to demonstrate to potential "investors considering Canada as a place to build big, important, transformative projects like the Trans Mountain expansion, we want you to know that you have a partner in Ottawa".

In the Ontario election, the call for change was dramatic. The provincial Liberals, who have been in power since 2003, not only lost the election, but went from a majority government to losing official party status. Doug Ford and his Progressive Conservatives (PC) won the election with a commanding majority, as voters look to the PC party to reduce income taxes, reduce energy costs and be fiscally responsible and eliminate government waste.

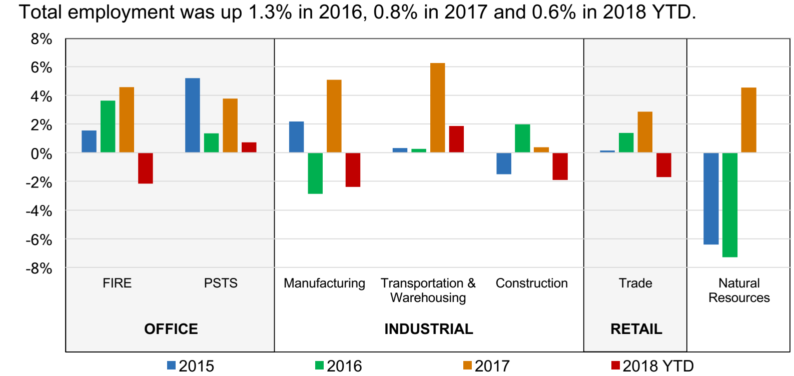
It should come as no surprise that with a slowdown in economic activity, employment growth has also weakened in 2018. However, with the unemployment rate at 5.8% at the end of May, employment growth will be hard to come by when it is near 40-year lows. The office using employment sectors, specifically Finance, Insurance and Real Estate (FIRE) and Professional, Scientific and Technical Services (PSTS) have been mixed, with the FIRE sector down 2.2% in 2018, up to May, and the PSTS up only 0.7% year-to-date. Many of the FIRE sector job losses can be attributed to the slowdown in the residential real estate market, with the new mortgage qualifying rules and higher interest rates appearing to be more persistent as opposed to just delaying



sales. The industrial market continues to be driven by transportation and warehousing, and the distribution activity for retail (both bricks and mortar and e-commerce), and as a result, Canada has seen strong employment growth of 1.9% in this sector. Manufacturing on the other hand has experienced 43,000 job losses in 2018 year-to-date, resulting in -2.4% in employment growth. This sector continues to face hardships, due to high energy costs, specifically in Ontario, and Canada's relative uncompetitiveness in productivity and now corporate tax rates.

Graph 2: Employment by Sector & Type of Real Estate Use

Total employment was up 1.3% in 2016, 0.8% in 2017 and 0.6% in 2018 YTD.

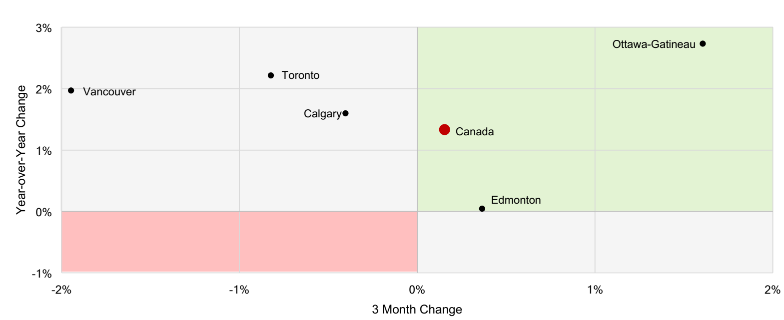


Source: Statistics Canada, May 2018.

Year-over-year, all markets tracked across Canada have experienced relatively strong employment growth, with the exception of Edmonton, which still remained positive. Not surprising, on the shorter 3-month term, both Vancouver and Toronto have performed the worst, with -1.9% and -0.8% employment growth, respectively. Again, much of this weakness is due to the slowdown in the real estate markets.

Graph 3: Employment by CMA

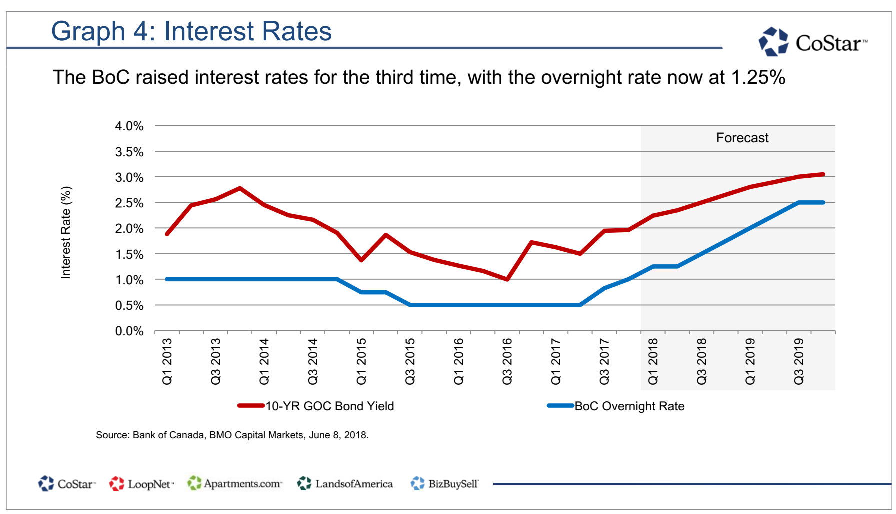
Employment up 0.16% QoQ and 1.3% YoY, but by market ...



Source: Statistics Canada, May 2018.

The BoC is projected to raise its overnight lending rate again in July, by 25 basis points(bps) to 1.50% and again in Q4 2018 to 1.75%, but they will be very cautious with any policy adjustments due to the unpredictability in the current trade environment. There is a lot of economic uncertainty circling NAFTA's renegotiation, with one of the current issues at play being the decision made by the U.S. to impose steep tariffs on Canadian steel and aluminum products. The tariffs were also levied on both Mexico and the European Union. Approximately 90% of Canadian steel and aluminum exports go to the U.S.; therefore the tariffs will have a significant impact on these trades. Canada has already retaliated by announcing their intentions to levy tariffs on $16.6 billion worth of goods from the U.S., which matches the value of the Canadian 2017 exports impacted by the U.S. tariffs. Overall, this will not impact the consumer price that drastically. The higher prices for Canadian imports will only amount to 2% of Canada's annual imports.

The U.S. has justified these tariffs as both an issue of national security and also due to Mexico and Canada not being able to come to an agreement on NAFTA before the end of May. The uncertainty of not knowing which industry could be the next target of tariffs may be an issue for investors. In regards to bond yields, the 10-Year BoC bond yields have moved more dramatically from a low of 2.04% on January 1st, 2018 to a high 2.52% on May 17th and back down to approximately 2.30% in mid-June. This volatility has impacted mortgage rates as well, ultimately impacting new and renewal mortgages, as well as those with variable rate mortgages.



LOOKING FORWARD TO THE SECOND HALF OF 2018

The key economic indicators to look out for in the second half of 2018 are:

- Consumer Price Index (CPI): Inflation in general, but specifically energy prices (which are expected to see an over 11% increase in 2018) and inflation due to a weaker Canadian dollar, trade wars and the pass through of tariffs.
- Interest Rates: mortgage rates and regulatory measures have dramatically slowed the housing markets of both the Greater Toronto and Greater Vancouver Areas, but record high household debt and rising interest rates will take a bite out of retail sales.
- Wage Growth: Is wage growth keeping up with inflation and rising interest to allow households to stay above water?
- Retail Sales, Discretionary Spending and Disposable Income: Inflation and rising interest rates will put household discretionary spending under even more pressure later this year, which will lead to slowing retail sales growth.

VANCOUVER

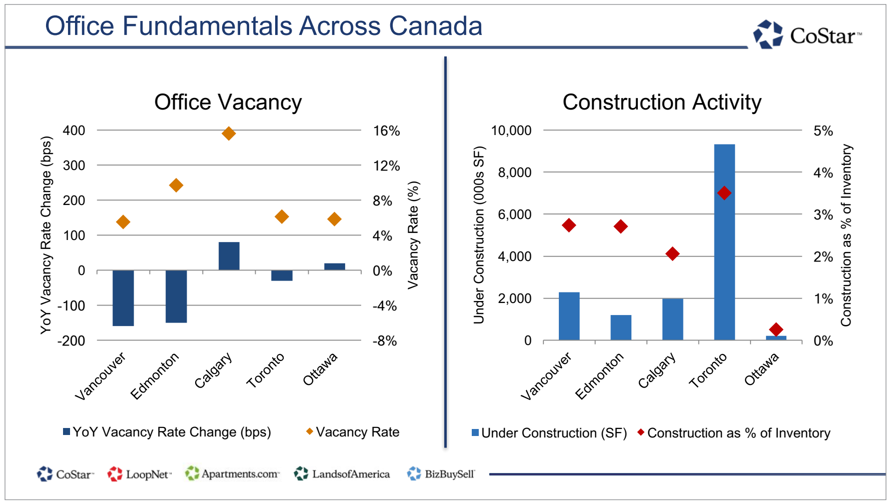
British Columbia & Vancouver Economic Overview

British Columbia (BC) and Vancouver are projected to be leaders in economic growth in 2018. BC managed to maintain GDP growth of over 3% for the past couple of years and is now expected to slow to a normalized rate of 2.4% this year and 2.1% in 2019, with Vancouver's economy expected to grow by 2.7% in 2018. Vancouver continues to experience affordability issues, with sales activity on the residential side weakening in the month of April due to market cooling measures, such as the expansion of the foreign-buyer tax and speculation tax that were announced in the 2018 BC budget back in February, but also as a result of more stringent mortgage rules and higher interest rates. The implementation of these policies are expected to contribute in stabilizing the market this year. Although sales activity dropped, prices were still up by 14.3% from a year ago.

Year-over-year Vancouver has seen employment increase by almost 2.0%, however, this includes the 1.9% pullback experienced over the last 3 months, which was partially due to the slowing real estate market. Employment growth is also expected to slow to 1.2% this year, which is inline with the national average of 1.2%. This slowdown will play a factor, along with the high cost of living, in the decrease of interprovincial migration. However, the unemployment rate is expected to end 2018 at 4.8%, well below the current national average of 5.8%.

Vancouver Office Overview

The office market in the Greater Vancouver Area remains deeply embedded in favour of landlords. With high tech companies, such as Amazon, and coworking companies, such as WeWork, continuing to announce new and expanded operations in the Vancouver market, this dynamic is not expected to change any time soon. The office market vacancy rate decreased by 70 bps year-to-date to 5.5% in Q2 2018, and down 160 bps year-over-year. The average net asking rental rate, at $23.79/SF per annum, is up 1.1% year-to-date due to this strong demand and limited space on the market. Although construction activity has picked up, with approximately 2.3 million SF currently under construction, this only represents 2.7% of the existing inventory. These projects will be delivered over the next three years, in a market that will grow by approximately 2.7% this year and 2.5% over the next few years, this new supply is likely not enough to change the market dynamics.



Source: CoStar Group, June 2018

It is important to note that downtown vacancy remains exceptionally low, at 3.9%, down 140 bps year-to-date and 170 bps year-over-year. There are minimal options for tenants looking for larger spaces downtown, and as a result downtown net asking rental rates continue to edge up, moving up 2.3% year-to-date to $29.44/SF per annum.

Office Market Contiguous Space

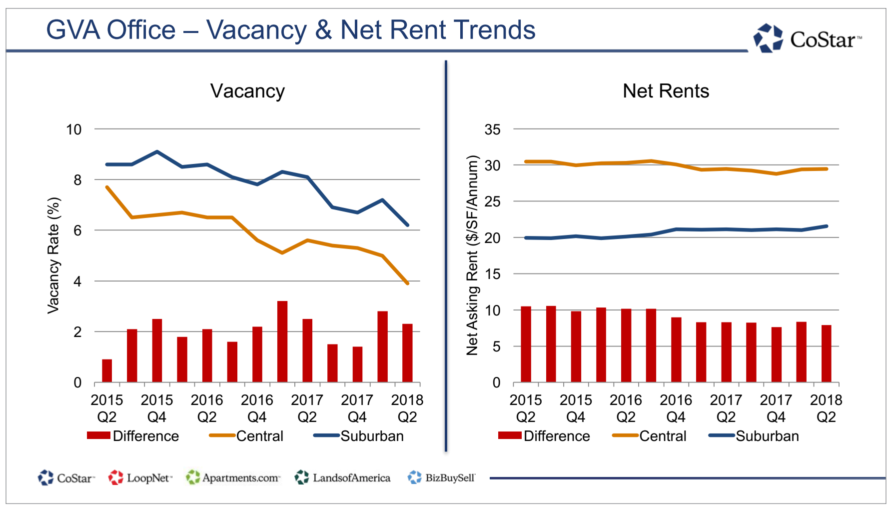
If you are looking for 100,000 SF of office space in Vancouver or Edmonton … good luck!

MARKET	BUILDING STATUS	VANCOUVER	EDMONTON	CALGARY	TORONTO	OTTAWA
>100,000 SF	Existing	1	1	16	12	3
	Under Construction	2	0	3	8	0
	Total	**3**	**1**	**19**	**20**	**3**
50,000 SF < 100,000 SF	Existing	7	6	41	38	8
	Under Construction	2	0	2	10	0
	Total	**9**	**6**	**43**	**48**	**8**

CoStar LoopNet Apartments.com LandsofAmerica BizBuySell

Source: CoStar Group, June 2018

Due to the limited options currently available downtown, demand is spilling over into the suburban markets, with average suburban vacancy down 190 bps year-over-year to 6.2%. The suburban vacancy rate is now falling faster than downtown vacancy, with the spread between the two falling from 280 bps in Q1 2018 to 230 bps in Q2. Suburban rents are also on the move, increasing by 1.9% year-to-date to $21.56/SF per annum, however, with downtown rents increasing by 2.3% over the same period, the spread between downtown and suburban rents has widened by $0.25/SF to $7.88/SF. With limited new supply expected in the short term, expect this dynamic of low vacancy, rising rental rates to increase, and demand spilling over into the suburbs to continue. These dynamics are also feeding into the office condo market, where recent sale prices per square foot, at approximately $2,000/SF, have been exceeding all expectations.



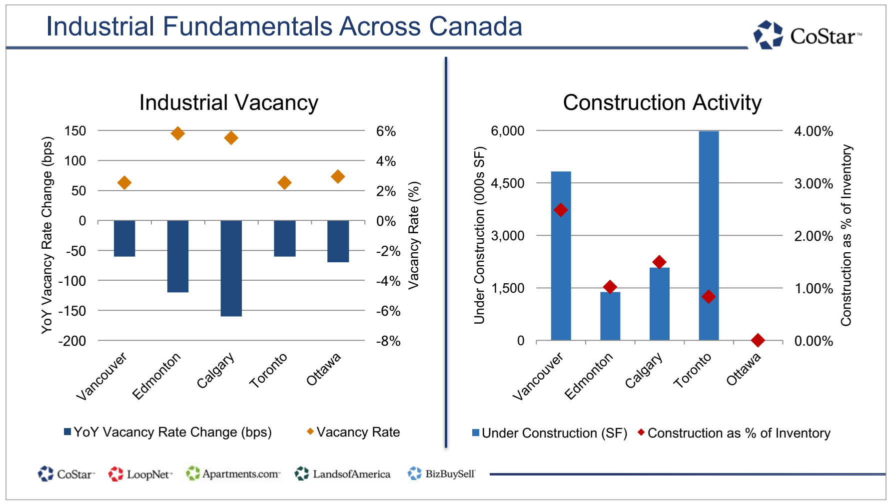
Source: CoStar Group, June 2018

Vancouver Industrial Overview

Like the Vancouver office market, the industrial market remains deeply entrenched in the favour of landlords. The industrial market has also experienced strong demand for space from both owner users on the sale side, who are driving up prices as they look to extricate themselves from the strong landlord controlled market, and transportation and warehousing on the leasing side. As a result, the industrial vacancy rate has experienced a 90 bps drop year-to-date, to 2.5%, however, this only represents as 60 bps drop year-over-year. There was a spike in vacancy in Q4 2017 due to approximately 1.8 million SF of new supply that came online. As a result, the average net asking rental rate continued to increase, up 5.7% year-to-date and 11.4% year-over-year to $10.23/SF per annum.

For a land constrained market, Vancouver is experiencing strong construction activity to feed the demand in the market. Even though there has been approximately 2.9 million SF of new supply delivered

over the last year, construction activity has increased from 3.9 million SF under construction at mid-year 2017 to 4.8 million SF under construction now. This increase in construction activity is welcomed in a market that is expected to see economic growth and demand for space remaining strong, however, the dynamic of low vacancy and high rents is expected to remain in place.



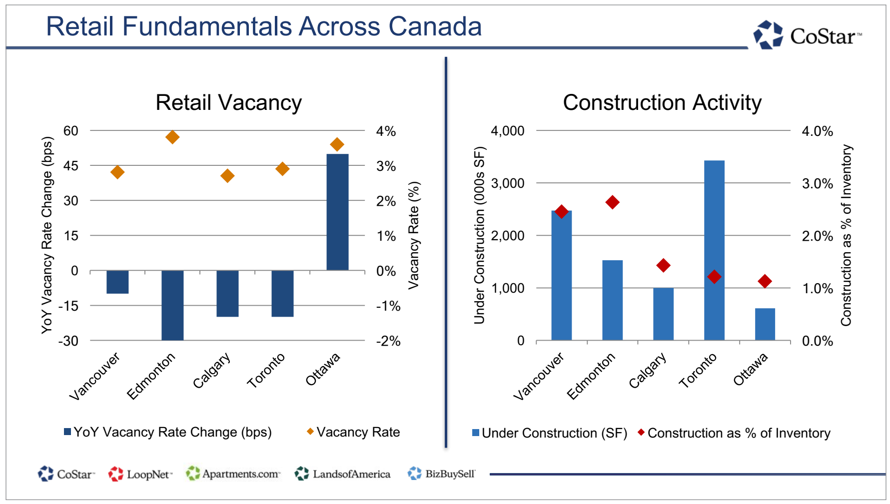
Source: CoStar Group, June 2018

Vancouver Retail Overview

The Vancouver retail market continues to receive new international retailers who are either looking to enter the Vancouver market, or are using Vancouver as a launching pad to the rest of Canada. Even with the recent departure of Sears, and the vacancy left in its wake, the Vancouver retail market has experienced a 30 bps decrease in vacancy year-to-date to 2.8%, however, on a year-over-year basis this only translates to a 10 bps decrease to vacancy due to a spike in the second half of 2017 partially as a result of new supply. The average net asking rental rate has increased by 14.0% year-to-date and 21.4% year-over-year, to $31.88/SF per annum. New construction activity has moved up from 1.5 million SF last year to 2.5 million SF as of mid-year 2018, representing 2.4% of existing inventory. This new supply will be a welcomed addition for tenants who are struggling to find space amid low vacancy and increasing rents.

The retail market remains bifurcated with the have's and have not's. As the landlords of premier quality properties continue to work on improving their properties, making them an experiential destination in order to combat the e-commerce threat, they are further differentiating themselves from the rest of the pack in order to attract more shoppers as well as new and better retailers. Expect to see this, along with more intensification and repurposing of parking lots in suburban malls, such as the redevelopment of Oakridge Centre and Brentwood Town Centre, going forward.

Although retails sales growth is expected to remain positive, higher interest rates, which are expected to continue increasing in the second half of 2018, along with increasing debt service costs will take a bite out of retail sales. As a result, Vancouver retail sales are only expected to increase by 1.7% in 2018 and 1.1% in 2019, compared to 12.1% in 2017.



Source: CoStar Group, June 2018

ALBERTA

Alberta Economic Overview

Alberta and British Columbia continue to be leaders in economic growth as they outperform the rest of the country. Alberta's 2017 real GDP growth, at 4.9%, was the highest amongst all other provinces, however, it has stabilized and the province is expected to grow by a more reasonable 2.2% in 2018 and 2.1% in 2019. As Alberta's unemployment rate declines, interprovincial outmigration may also decrease. The improvement of the labour market will result in employment growth of 1.9% this year and 1.3% in 2019, however, this is still forecasted to be the highest growth rate in comparison to all other Canadian provinces.

By comparison, Calgary and Edmonton are expecting GDP growth of 2.5% and 2.2% in 2018, respectively, well above the 2.0% expected for Canada as a whole. On the job front, Calgary has experienced strong job growth of 1.6% year-over year, well above the 1.3% for Canada, and the virtually unchanged 0.04% for Edmonton, however, looking at the 3-month employment change for these markets, Calgary has experienced a -0.4% pullback, compared to Canada and Edmonton that have seen a stronger job market in the short term, at 0.2% and 0.4% job growth, respectively.

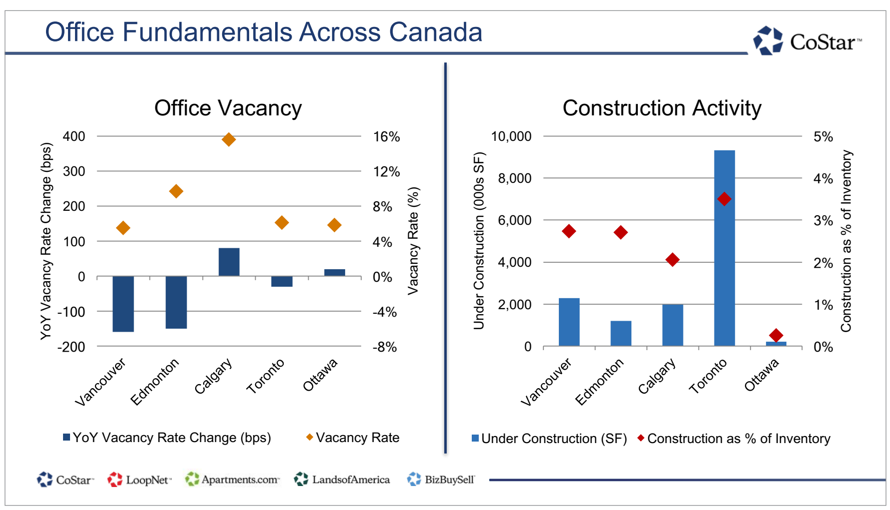
The increase in oil prices will continue to be a key factor to economic growth in both Canada and Alberta specifically, as it will support job creation and consumer spending. Alberta can expect to see a decrease in investment spending as a result of a sluggish housing market and the political turmoil surrounding the Trans Mountain pipeline expansion, which was one of the reasons that the federal government decided to financially back the project. The federal Liberals and Alberta NDP parties successfully worked together in favour of the Alberta oil interests. The Liberal federal government is backing the Trans Mountain pipeline with a $4.5 billion investment, indicating that this project is 'vital' to the economic wellbeing of Canada, but also, as Finance Minister Bill Morneau said, to demonstrate to potential "investors considering Canada as a place to build big, important, transformative projects like the Trans Mountain expansion, we want you to know that you have a partner in Ottawa".

Oil production has been increasing for years, but the failure to simultaneously build pipelines has created a spread between the Western Canadian Select (WCS) and West Texas Intermediate (WTI) oil. In terms of the WCS-WTI spread, the difference sat at approximately USD$18/barrel in mid-June, while WTI oil prices were at approximately USD$66/barrel. There is the ability to reduce the spread by transporting oil on rails, however, rail transport is costlier per barrel in comparison to transporting via pipeline. A positive thing to note is that approximately half of Western Canada's oil production isn't selling at a large discount. The oil output consists of light crude oil and heavy oil, the latter is discounted as it is more difficult to refine.

Even with lower oil royalties, resulting from the discounted pricing for heavy oil and non-upgraded bitumen, the total government revenues are still projected to rise about 2% this year. Canadian oil prices have increased as a result of the U.S administration withdrawing from the Iranian nuclear deal. This has supported the economy for oil producing provinces, including Alberta, yet economic growth is projected to taper down to normalized rates. The outlook for WTI oil prices are wide ranging, however, the U.S. Energy Information Administration (EIA) projected on June 12, 2018 that the price of WTI oil would be USD$63/barrel at year-end 2018 and USD$61/barrel at year-end 2019. With these relatively flat prices, the opportunity is in a potentially lower Canadian dollar (which is expected to fluctuate between USD$0.79 and USD$0.81 in 2019), lowering production costs or lowering the WCS-WTI spread.

Calgary Office Overview

The Calgary office market vacancy rate continued to increase in the first half of 2018, up only 10 bps year-to-date and 80 bps year-over-year to 15.6% in Q2 2018. Furthermore, the vacancy rate is expected to continue increasing this year with the delivery of TELUS Sky, a 761,000 SF office tower, in Q4 2018. TELUS Sky is the last major downtown office development from the last construction cycle, and although it is currently 64% preleased, it will be drawing tenants from other properties. As a result, overall vacancy is expected to increase from the 15.6% in Q2 2018 to approximately 16.2% at year-end 2018.

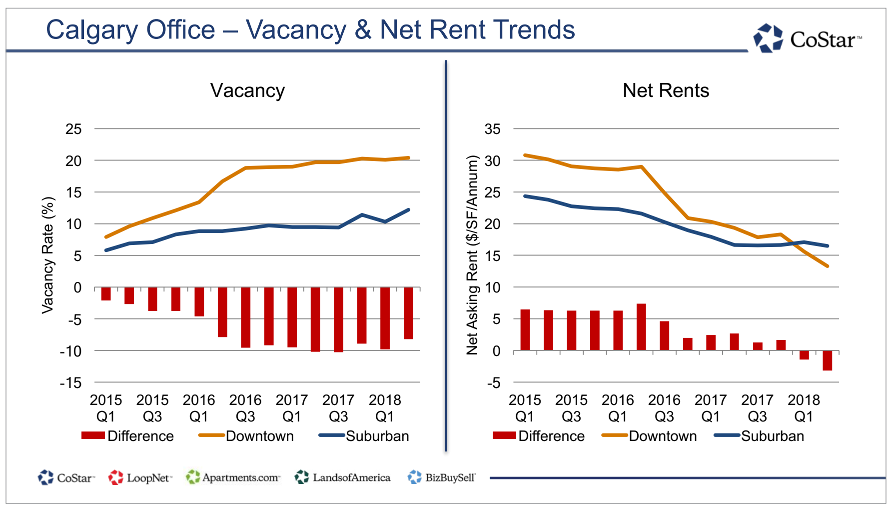


Source: CoStar Group, June 2018

Since TELUS Sky is a downtown development, it is worth examining how it will impact the downtown market. Current vacancy downtown is 20.4%, as of Q2 2018, and by year-end 2018 it is expected to increase to 22.6%. Although total vacant space continues to increase, sublet space accounted for only 27.6% of total vacant space, compared to 32.6% in Q2 2017, however, this does not account for shadow vacancy, which will likely push the vacancy rate, and the proportion that is

sublet, much higher. Looking at the availability rate, overall market availability has moved up 50 bps year-over-year to 19.7%, however, downtown availability has moved up 70 bps to 23.9%. Overall net asking rental rates continue to fall, down 14.6% year-to-date and 16.2% year-over year, at $15.42/SF per annum in Q2 2018.

Calgary is the only major market in Canada where downtown vacancy, at 20.4%, is higher than suburban vacancy, at 12.2%, and the downtown net asking rent, at $13.30/SF per annum, is below the suburban rent, at $16.49/SF per annum. With the current level of demand and the amount of vacant and available space in the market, this dynamic is expected to continue for the foreseeable future. This is creating opportunities for tenants, who normally wouldn't be able to consider downtown office space, to now move into Class A downtown buildings.

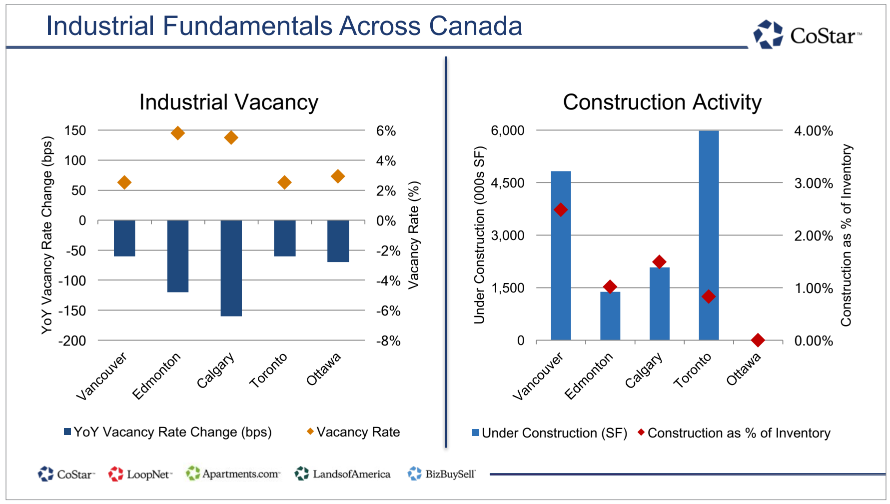


Source: CoStar Group, June 2018

Calgary Industrial Overview

On the industrial side, the Calgary industrial market remains healthy, and has been the safe and steady asset type in Calgary primarily due to its status as a key Western Canada distribution centre. A perfect example of this status is the new 600,000 SF Amazon Western Canada distribution centre currently being fitted out in Balzac, just north of Calgary and slated to open later this year. Once construction is complete, this project is expected to bring an additional 1,000 permanent jobs to the Calgary market.

Calgary's industrial vacancy rate has decreased by 50 bps year-to-date, and 160 bps year-over-year to 5.5% in Q2 2018, however, net asking rents were also down by 1.9% year-to-date and 3.1% year-over-year to $9.19/SF per annum. There is currently only 2.1 million SF of industrial space under construction, representing only 1.5% of current inventory, and although the vacancy rate is expected to creep up a little in the second half of 2018, to close to 6.0%, expect it to move back down in 2019 to approximately 5.1%.



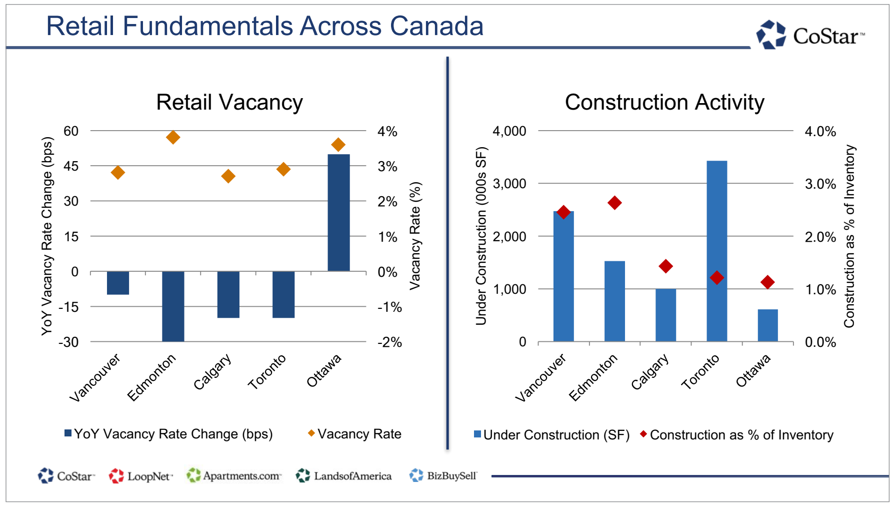
Source: CoStar Group, June 2018

Calgary Retail Overview

The Calgary retail market remains tight, with vacancy at just 2.7% in Q2 2018, and although this is up 10 bps year-to-date, it remains down 20 bps year-over-year. Similarly, net asking rents are up 0.8% year-to-date to $26.18/SF per annum, they are down 0.7% year-over-year. There has been approximately 1.7 million SF of new supply delivered through 23 properties year-to-date, with an additional 1.0 million SF currently under construction. This new supply has been a welcomed addition for tenants looking to find space amid low vacancy.

The retail market remains bifurcated with the have's and have not's. As the landlords of premier quality properties continue to work on improving their properties, making them an experiential destination in order to combat the e-commerce threat, they are further differentiating themselves from the rest of the pack, attracting more shoppers and the new and better retailers. Expect to see this along with more mixed use intensification and repurposing of parking lots in suburban malls going forward.

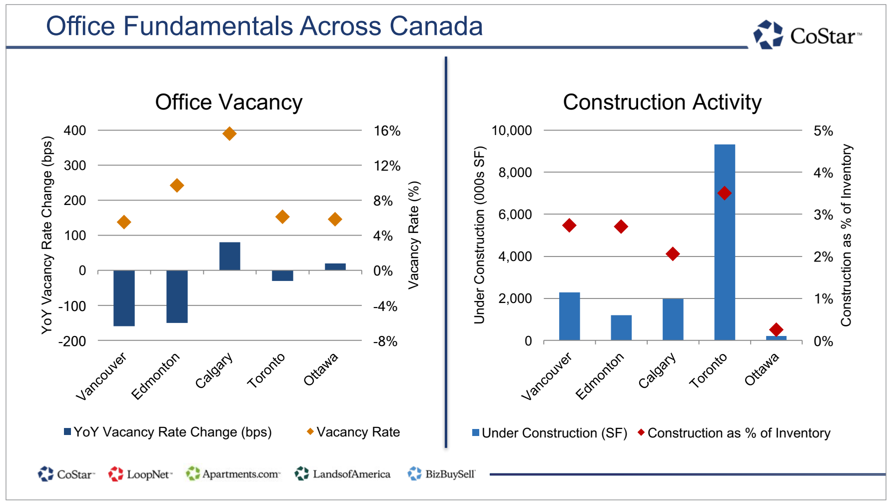
Households are still trying to get their budgets back in order, and higher interest rates, which are expected to continue increasing in the second half of 2018, along with increasing debt service costs will take a bite out of retail sales. As a result, Calgary retail sales are expected to decrease by -1.9% in 2018 and -0.4% in 2019, compared to a 7.8% increase in 2017.



Source: CoStar Group, June 2018

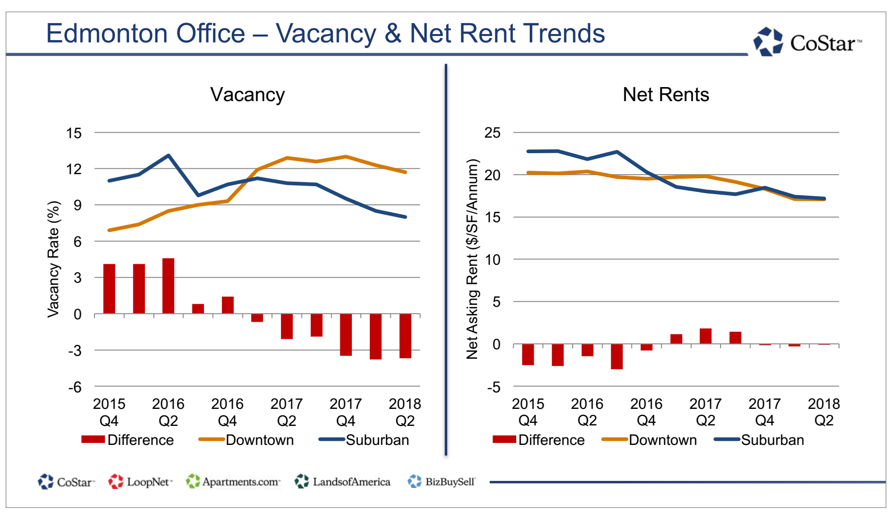
Edmonton Office Overview

Unlike Calgary, which is heavily reliant on oil and gas, the Edmonton economy is much more diversified with government (provincial), health and technology playing a bigger part. As a result, the Edmonton office market continues to perform well, with vacancy down 140 bps year-to-date and 210 bps year-over-year to 9.7% in Q2 2018, however, net asking rents for the office market have decreased by 6.7% year-to-date and 8.1% year-over-year to $17.15/SF per annum. Edmonton's downtown has changed dramatically, becoming more dynamic and attractive, with both Enbridge Centre and Edmonton Tower being delivered in 2017 totaling almost 1.2 million SF. The office portion of the Stantec Tower, makes up the majority of the office space under construction at approximately 800,000 SF, and is expected to be delivered later this year. The building is already the tallest in Edmonton, but once the residential portion is completed in 2019, it will be the tallest building in Western Canada. The Stantec Tower is 98% preleased, and as a result it by itself will not impact the office market, however, as tenants complete their moves to this new tower, expect vacancy to increase in the older buildings. As a result, downtown landlords of the older stock properties will need to either invest in renovating their properties to bring them up to the standards in the three new towers, repurpose their properties, or suffer higher vacancy.



Source: CoStar Group, June 2018

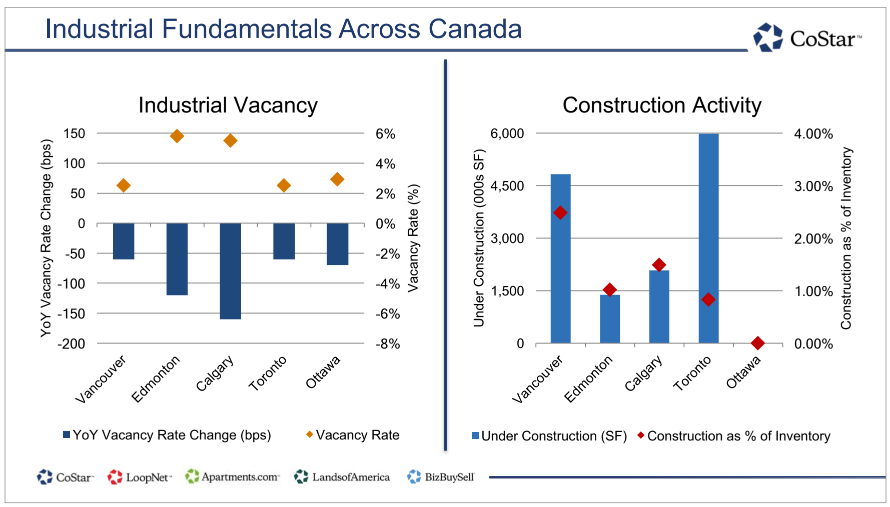
Like Calgary, Edmonton is one of a few markets, where downtown vacancy, at 11.7%, is higher than suburban vacancy, at 8.0%, however, unlike Calgary where downtown net asking rents are lower than suburban rents, Edmonton downtown and suburban net asking rent are virtually identical, at $17.09 and $17.19/SF per annum, respectively. This dynamic of higher vacancy and relatively low average rents downtown is primarily due to the older stock properties, mentioned previously, that are either in need serious capital investment in order to renovate them up to the standards of the three new towers or they need to be repurposed or demolished.



Source: CoStar Group, June 2018

Edmonton Industrial Overview

The Edmonton industrial market has experienced a 30 bps decrease in vacancy year-to-date and a 110 bps year-over year decrease to end Q2 2018 at 5.8%, however, the average net asking rental rate moved down at the same time, down 0.4% year-to-date and 2.3% year-over-year to $9.49/SF per annum. The industrial market is experiencing increased tenant demand from the oil sector, but also an increase in demand from both the cannabis industry and cryptocurrency miners due to the low cost of energy in Alberta. Looking forward, the Edmonton industrial market should benefit from the expansion of the Trans Mountain pipeline once completed, but more immediately from tenants seeking industrial space for high energy uses. There has been minimal (365,000 SF) new supply delivered in the last year, however, there is currently 1.4 million SF under construction, up from 1.1 million SF in Q2 2017. With the current level of demand in the market and with the pace of construction activity, expect the industrial market to stay relatively balanced.

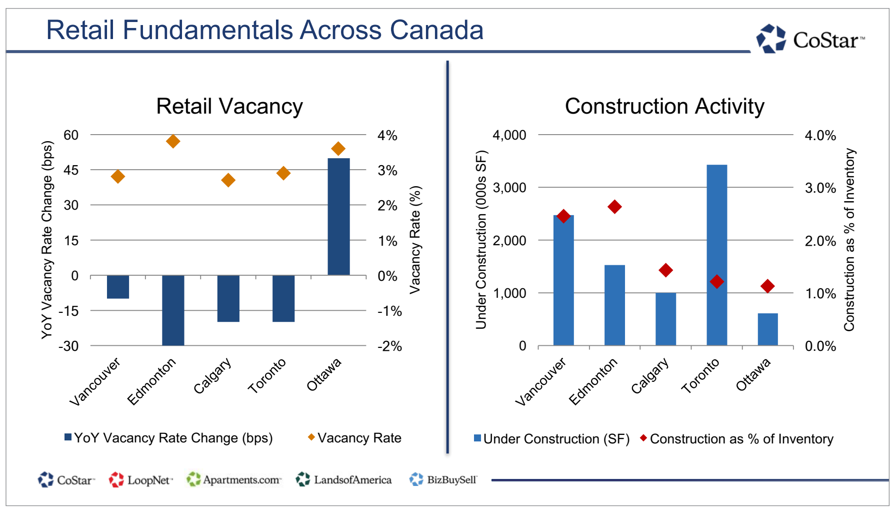


Source: CoStar Group, June 2018

Edmonton Retail Overview

The Edmonton retail market remains strong, with retail vacancy down 30 bps year-to-date and year-over-year to end Q2 2018 at 3.8%, with the average net asking rental rate up 8.6% year-to-date and 14.3% year-over-year to $22.97/SF per annum. Landlords continue to battle e-commerce, making their properties more experiential destinations. Construction activity remains strong, with 1.5 million SF currently under construction, up from 889,000 SF in Q2 2017. There has also been approximately 950,000 SF delivered over the last year, mostly comprised of smaller properties.

Despite higher interest rates, which are expected to continue increasing in the second half of 2018, along with increasing debt service costs, which will both take a bite out of retail sales, Edmonton retail sales are expected to increase by 1.7% in 2018 and 2.4% in 2019. This does seem subdued compared to the 7.8% increase in 2017, but it is still well above the Calgary retail sales growth, which will be negative 1.9% and 0.4% in 2018 and 2019, respectively.



Source: CoStar Group, June 2018

ONTARIO

Ontario Economic Overview

Ontario saw its economy grow by 2.8% in 2017, and like the rest of Canada, it is expected to slow in 2018 and beyond, with 2018 and 2019 GDP growth expected to come in at 2.0% and 1.9%, respectively. Similarly, the Greater Toronto Area (GTA) and Ottawa-Gatineau region are expected to see a slowdown from 3.3% and 2.7% in 2017 to 2.4% and 2.1% in 2018, respectively, however, both markets will see economic growth remain above both the Ontario and Canadian trend rates. In addition to just a general slowdown in the economy, the slowdown seen in Q1 2018 can be partially attributed to slowing consumer spending and the housing market, much of which was driven by rising interest rates, but also new mortgage qualifying rules for the housing market in general and the non-resident speculation tax that was applied to the GTA specifically.

The renegotiation of the North American Free Trade Agreement (NAFTA) and the ongoing on-again/off-again trade wars, which are definitely on again, continue to weigh heavily on the economic outlook for Ontario. With shots being fired over steel and aluminum tariffs and potentially the automobile sector, the renegotiations seem to be taking two steps back for every step forward.

It should come as no surprise that with a slowdown in economic activity, employment growth has also weakened in 2018. However, with the unemployment rate at 5.7% at the end of May, employment growth will be hard to come by. Much of the pullback in employment has occurred in the Finance, Insurance and Real Estate (FIRE) sector, specifically attributed to the slowdown in the residential real estate market, for the above noted reasons, and the Manufacturing sector, which continues to face hardships partially due to high energy costs in Ontario. Even with these sectors experiencing pullbacks, Ontario is expected to see employment grow by 1.6% in 2018 but slow to 1.2% in 2019. Inflation in Ontario for 2018 is expected to come in at 2.5%, well above the 2.2% expected for Canada.

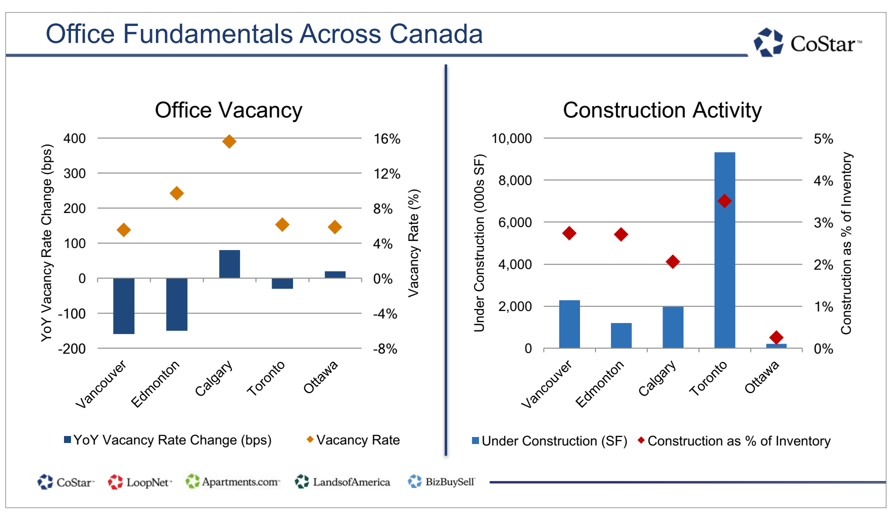
In the Ontario election, the call for change was dramatic. The provincial Liberals, who have been in power since 2003, not only lost the election, but went from a majority government to losing official party status. Doug Ford and his Progressive Conservatives (PC) won the election with a commanding majority, as voters look to the PC party to reduce income taxes, reduce energy costs and be fiscally responsible and eliminate government waste.

The BoC is widely expected to raise its overnight lending rate once again in July based on the strong economic fundamentals, employment growth, inflation data and to prop up the Canadian dollar. There are continued concerns about high consumer debt, and newer concerns about inflationary pressures being brought on by trade wars/tariffs and the weak Canadian dollar, and the uncertainty being brought on by the weakening economic situation in Europe that is driving investors to safety and the U.S. dollar, all of which could put a pause to potential future rate hikes. High consumer debt and inflation could weigh down the performance of commercial real estate. As seen with FIRE employment, a drag on consumer consumption will likely create a drag on retail sales and retail performance. Although strong employment and rising wages will counteract rising interest rates, any expectation of a rebound to strong retail sales should be taken with caution.

GTA Office Overview

The GTA office market is performing exceptionally strong and is deeply entrenched in landlord control, with the overall market vacancy rate down 20 bps year-to-date and 30 bps year-over-year to end Q2 2018 at 6.1%, and the average net asking rental rate down 1.3% year-to-date and 2.0% year-over-year to $18.07/SF per annum.

The good news on the supply front is that construction activity continues to increase, with 9.3 million SF now under construction, representing 3.5% of existing inventory. The 9.3 million SF includes: CIBC Square at just under 1.6 million SF with CIBC as the lead tenant; the 1.2 million SF office project at 160 Front St. W., which was announced by Cadillac Fairview on June 13, 2018 with the Ontario Teachers' Pension Plan as the lead tenant; as well as the 829,910 SF speculative project at 16 York St. also being developed by Cadillac Fairveiw. Furthermore, Oxford Properties continues to market their proposed 1.4 million SF (60-storey) office tower, The HUB, at 30 Bay St.



Source: CoStar Group, June 2018

With strong demand from finance and technology companies that continues to drive vacancy down, rental rates are expected to increase, and this new supply will do nothing to alleviate the tight market conditions until they start being delivered between 2020 and 2022. There are currently only 12 existing properties in the GTA that can accommodate a tenant looking for 100,000 SF or more of contiguous space.

Office Market Contiguous Space

CoStar

If you are looking for 100,000 SF of office space in Vancouver or Edmonton … good luck!

MARKET	BUILDING STATUS	VANCOUVER	EDMONTON	CALGARY	TORONTO	OTTAWA
>100,000 SF	Existing	1	1	16	12	3
	Under Construction	2	0	3	8	0
	Total	**3**	**1**	**19**	**20**	**3**
50,000 SF < 100,000 SF	Existing	7	6	41	38	8
	Under Construction	2	0	2	10	0
	Total	**9**	**6**	**43**	**48**	**8**

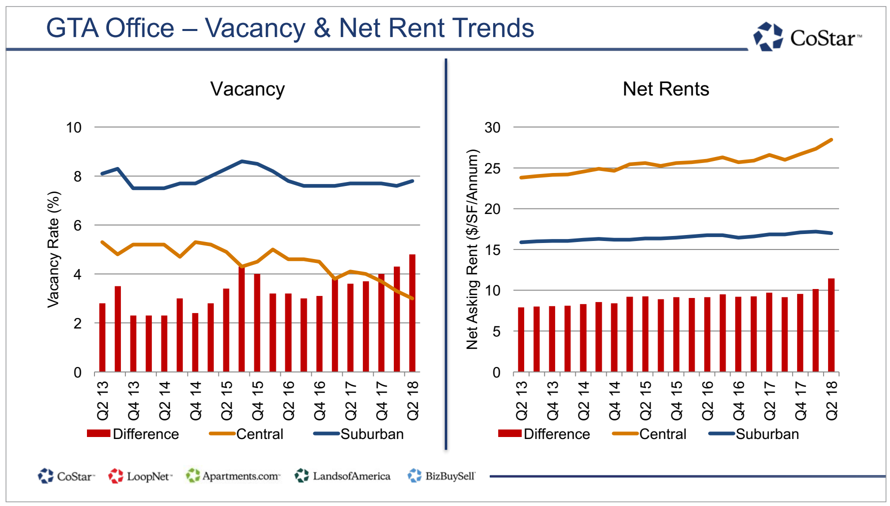
CoStar LoopNet Apartments.com LandsofAmerica BizBuySell

Source: CoStar Group, June 2018

Downtown vacancy remains exceptionally tight, moving down 70 bps year-to-date and 110 bps year-over-year to just 3.0% at the end of Q2 2018. With downtown vacancy moving down, and suburban vacancy edging up 10 bps year-to-date, the delta between downtown and suburban vacancy rates has increased to 480 bps, which is a record high. As a result of the tight downtown market with limited options, tenants will likely need to pay more attention to the suburban markets if they need a large amount space before 2020. The delta between downtown and suburban net asking rental rates is equally impressive. Downtown rents averaged $28.45/SF per annum at the end of Q2 2018, whereas suburban rents were at $17.01/SF per annum, representing a spread of $11.44/SF per annum. This is not indicative of the suburbs being in peril, as there remains strong demand for space in the more urbanized suburban locations, such as Mississauga City Centre, Vaughan Metropolitan Centre and Downtown Markham, however, the demand being experienced downtown is even stronger. With demand remaining strong, and new supply limited in the short term, expect rental rates to continue edging up.

The wild card for the GTA office market outlook remains Amazon's upcoming decision on their HQ2. If Toronto were to get the go ahead, it would immediately impact the office, housing and employment markets. The immediate need for the office market would be for 500,000 SF of space in 2019, followed by an additional 7.5 million SF,

likely campus style space, over the next decade. Although the office market is very tight, it could accommodate this short term need in the existing stock, and the long term demand through construction. As for the housing market and employment, Amazon is projecting that in total they would employ approximately 50,000 people in their HQ2 by the time it is fully up and running. Assuming it takes at least a decade, it implies 5,000 new hires each year. The GTA receives approximately 100,000 new immigrants (international and domestic) to the area each year, and although, Amazon's hiring is a big ask, the GTA economy is more than capable of providing the skilled talent at quantity needed, as well as providing housing for them to live, without this increased demand upending either the labour or housing markets.

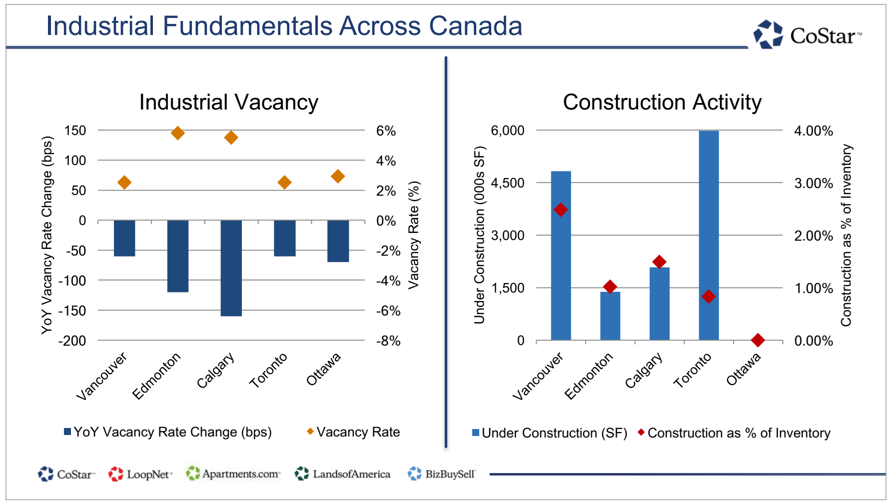


Source: CoStar Group, June 2018

GTA Industrial Overview

Despite the strong rhetoric regarding trade and the renegotiation of NAFTA, the GTA industrial market, which is being driven by the transportation and warehousing sector, has experienced continued strong demand. Overall GTA vacancy has by 40 bps year-to-date and 60 bps year-over year to end Q2 2018 decreased 2.5%.

To keep up with demand, construction activity has been strong. There has been approximately 7.0 million SF of new supply year-over-year, with an additional 5.9 million SF currently under construction. Unfortunately this construction activity has not been enough to keep up with demand, and projections show that the GTA industrial vacancy rate will continue edging down to the almost 2.0% by early 2019. As a result of this strong demand and limited supply, the average net asking rental rate continues to increase, up 3.9% year-to-date and 8.9% year-over-year, to $6.73/SF per annum.



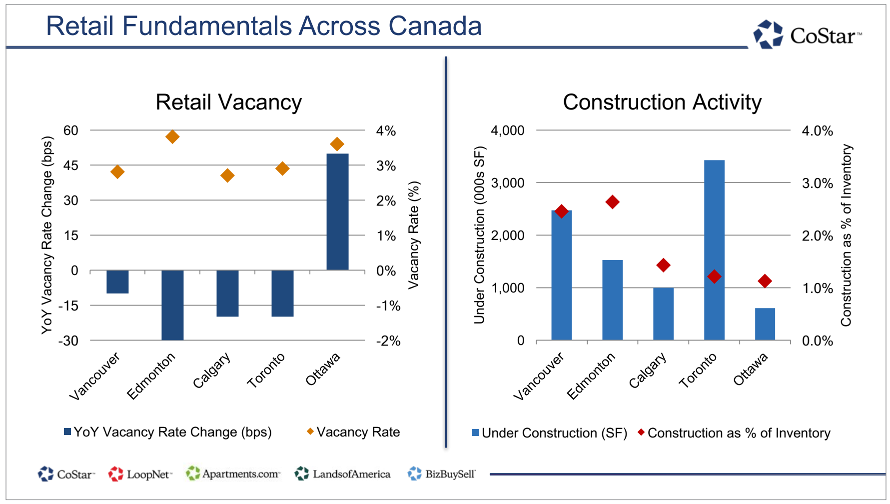
Source: CoStar Group, June 2018

High costs of energy are one of the reasons being cited for the pullback in manufacturing, and the newly elected PC party pledged to reduce energy costs. However, unless there is a complete failure to renegotiate NAFTA, like the pullback in the Canadian dollar, the benefits from lower energy costs will likely not result in a wholesale return to manufacturing the GTA.

GTA Retail Overview

Similar to Vancouver, the GTA retail market continues to receive new international retailers who are either looking to enter the GTA market, or are using the GTA as a launching pad to the rest of Canada. The GTA retail market vacancy rate has edged down slightly, and is now down 30 bps year-to-date and 20 bps year-over-year to end Q2 2018 at 2.9%, however, even though the average net asking rental rate is up 2.9% year-to-date, it is down 1.9% year-over year to end Q2 2018 at $24.94/SF per annum.

Construction activity has been relatively slow, with only 1.9 million SF of new supply delivered since Q2 2017, and although construction activity has moved up from 2.6 million SF last year to 3.4 million SF as of mid-year 2018, it only represents 1.2% of existing inventory. Despite the new vacant space that came to the market as a result of Sears Canada closing in Q1 2018, the limited amount of new supply is not enough to satisfy the demand from tenants who are struggling to find space amid low vacancy and increasing rents. As a result of this demand, vacancy is expected to actually decrease to approximately 2.6% by year-end 2019.



Source: CoStar Group, June 2018

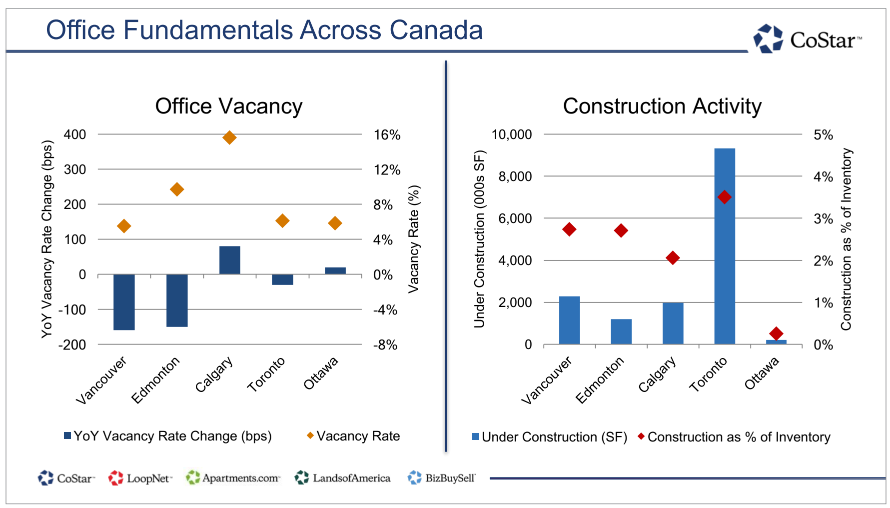
In order to combat the effects of e-commerce on the retail market, landlords of premier quality properties continue to work on improving their properties, making them an experiential destination. The making of an experiential destination goes beyond just having more restaurants and services in malls, and can include ventures such as Ivanhoe Cambridge and Cirque du Soleil teaming up to offer family entertainment centres in shopping centres, which is due to launch in 2019. Landlords are looking at ways to further differentiate themselves from the rest of the pack in order to attract more shoppers as well as new and better retailers. Expect to see this, along with more intensification of retail properties and repurposing of parking lots in suburban malls, as seen at properties such as Yorkdale Mall, and Aoyuan's redevelopment plans for Newtonbrook Plaza.

Although retails sales growth is expected to remain positive, higher interest rates, which are expected to continue increasing in the second half of 2018, along with increasing debt service costs will take a bite out of retail sales. As a result, GTA retail sales are only expected to increase by 0.6% in 2018 but then rebound to increase by 1.4% in 2019, compared to 5.0% in 2017

Ottawa Office Overview

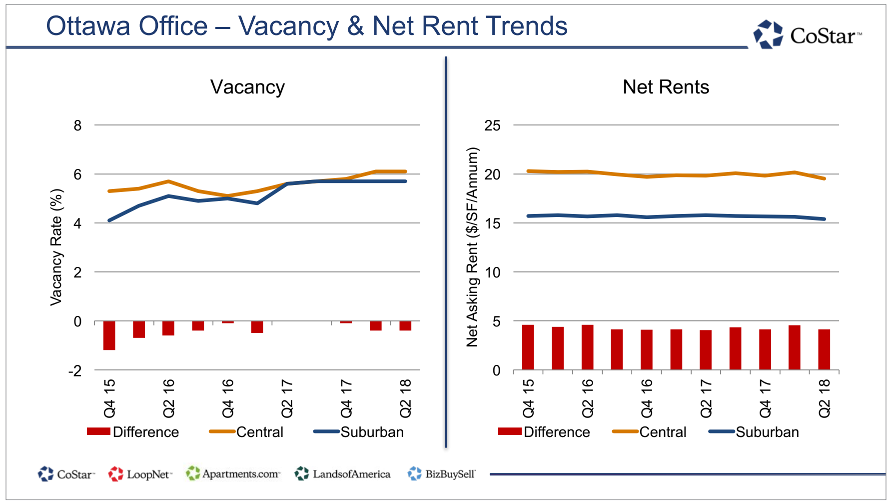
Ottawa commercial real estate has experienced a slow first half to 2018 in general, and the Ottawa office market was not immune. The Ottawa office market experienced a 10 bps increase year-to-date and 20 bps increase year-over-year, to 5.8% in Q2 2018, with only 148,000 SF of new supply coming to the market over that period. As for net asking rents, rents have decreased 2.0% year-to-date and 2.9% year-over-year to $16.98/SF per annum.

There is limited office construction activity occurring in the market right now, and much of the office space that is under construction, or planned, is part of larger mixed-use projects, with only a portion slated to be office space. The largest example of this currently being 900 Albert St., which is a mixed-use and transit oriented development comprised of 200,000 SF of office space, as well as 125,000 SF of retail space, along with residential. Like many of these projects, 900 Albert St. is this located along the new Confederation LRT Line.



Source: CoStar Group, June 2018

Although high-tech companies and the Federal government have long been part of the office market tenant mix in Ottawa, with the Federal government choosing to occupy more space in the suburban markets over the last few years, it has resulted in higher vacancy downtown. This has created opportunities for high-tech tenants downtown, with the likes of Shopify occupying approximately 320,000 SF in 234 Laurier Ave. W. in late 2017 and Telesat leasing approximately 76,800 SF at 160 Elgin St. Like in other markets across Canada, these high-tech tenants are looking for more urban locations with access to public transit. Downtown vacancy has been either slightly above or on par with suburban vacancy over the last few years, however, with high-tech tenants driving downtown demand, this could potentially change the dynamics of the office market as a whole.

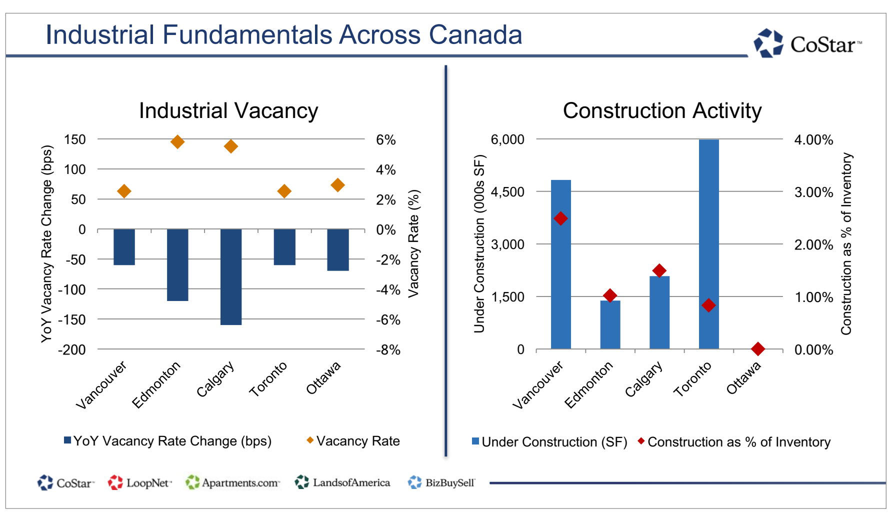


Source: CoStar Group, June 2018

Ottawa Industrial Overview

The Ottawa industrial market has experienced relatively strong demand, but only 232,000 SF of new supply over the last year, which is very limited for a 48.4 million SF market. As a result, the vacancy rate has decreased by 40 bps year-to-date and 70 bps year-over-year to end Q2 2018 at 2.9%. As a result of this strong demand and limited supply, the average net asking rental rate continues to increase, up 1.5% year-to-date and 10.2% year-over-year, to end Q2 2018 at 10.70/SF per annum.

Tenants in the market continue to be construction companies, but also microbreweries and cannabis companies looking ahead and preparing for the legalization later this year. Looking forward, there are currently no projects under construction to satiate the demand, and therefore tightening market conditions and increasing rents are expected to continue, however, expect new projects to begin breaking ground in the second half of 2018.

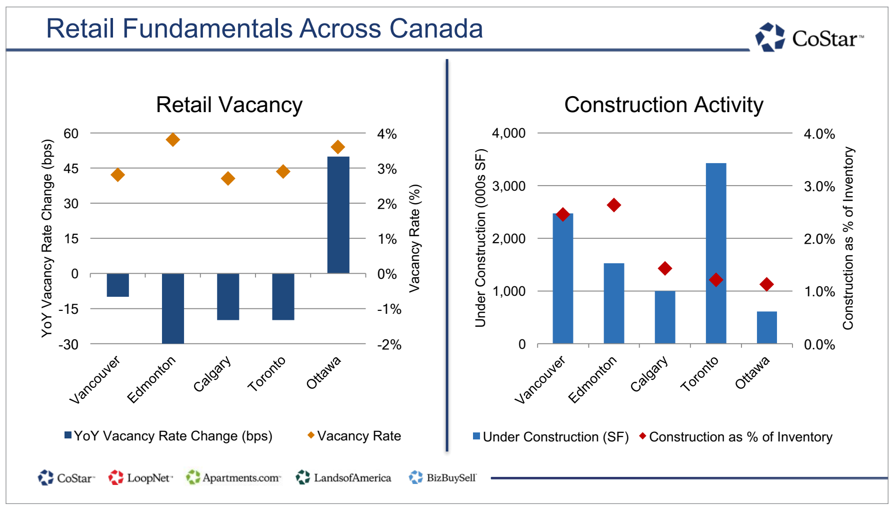


Source: CoStar Group, June 2018

Ottawa Retail Overview

The Ottawa retail market has experienced an uptick in vacancy this year, primarily as a result of Sears vacating three locations earlier this year. Vacancy is up 60 bps year-to-date but only 50 bps year-over-year to end Q2 2018 at 3.6%. As a result, average net asking rental rates have decreased, down 1.3% year-to-date and 4.5% year-over year to end Q2 2018 at \$20.16/SF per annum.

Construction activity has been relatively slow as well, with only 545,000 SF of new supply delivered since Q2 2017 and only another 600,000 SF currently under construction, mainly as part of the podiums of mixed use residential projects along the new LRT lines. The limited amount of new supply will likely not be enough to satisfy the demand from tenants looking for space.



Source: CoStar Group, June 2018

Landlords continue to look for ways to differentiate their properties and make them more experiential destinations in order to combat the effects of e-commerce on the retail market, and the Ottawa market has not been immune to this. Expect to see more intensification of retail properties and repurposing of parking lots, specifically along the LRT lines in the coming years.

Ottawa's retail sales growth is expected to be relatively strong this, at 4.1%, before slowing slightly to 2.2% and 2.4% in 2019 and 2020, respectively. Higher interest rates, which are expected to continue increasing in the second half of 2018, along with increasing debt service costs will take a bite out of retail sales, however, this will not be felt as dramatically in Ottawa as compared to other markets such as the GTA and Vancouver, which have experienced much higher residential price appreciation and the resulting increases in the mortgage debt associated with home buying.

Roelof van Dijk

About the Author:

Roelof van Dijk is a commercial real estate research professional, with over 10 years of experience covering the Canadian commercial real estate market. Prior to his career in commercial real estate, he worked as a project manager and urban planner in the Greater Toronto Area. He is currently CoStar Canada's Market Economist.

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