JLL

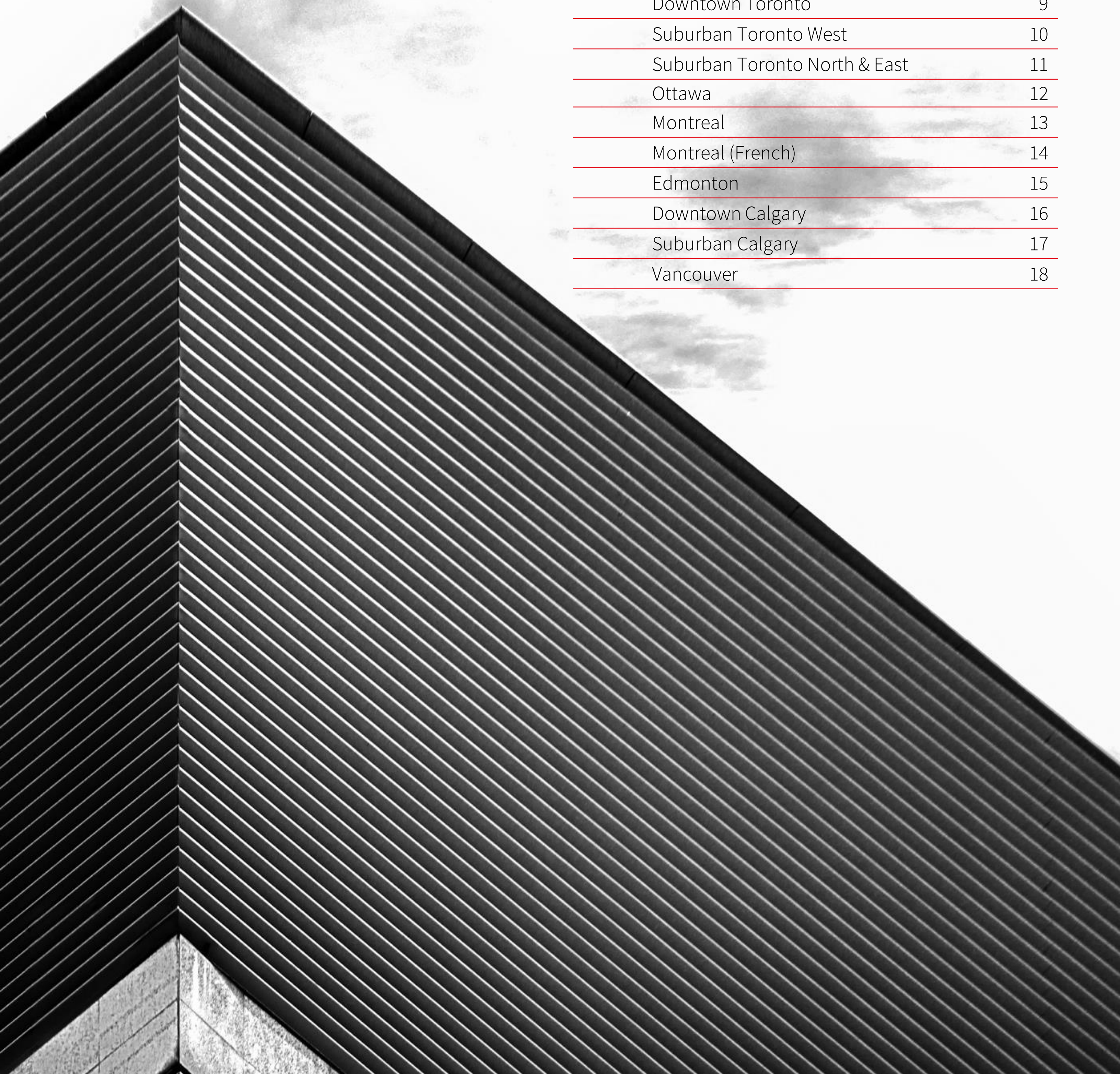
Office

Canada | Q2 2020

Office market fundamentals reveal first signs of measurable impact from COVID-19

JLL Research

Contents



3 key trends

Strong job gains in May and June

Building on an initial recovery of 290,000 jobs in May, employment across Canada rose by nearly one million in June.

Net absorption turns negative

After a relatively strong first quarter with over 1.7 million square feet of positive net absorption, the Canadian office market recorded nearly 1 million square feet of negative net absorption in the second quarter.

Sublease availability on the rise

The office market record a 1.1 million square feet increase in available sublet space from the first quarter, the majority in Class A product.

The health, policy, economic and financial disruption stemming from the COVID-19 pandemic continues to create a fluid and evolving environment for the office market. Although data from Q2 is providing greater clarity about conditions and the short-term real estate outlook, there remains significant uncertainty surrounding market dynamics and long-term trajectories and, as a result, we will continue to monitor fundamentals closely as the situation unfolds. Please feel free to contact us if we can assist.

Building on an initial recovery of 290,000 jobs in May, employment across Canada rose by nearly one million in June. This gain pushed the unemployment rate down 140 basis points to 12.3%, providing an early indication of a recovery. Accommodation and food services, and wholesale and retail trade have been disproportionately hit with the largest job losses to-date, while typical office using sectors such as finance, insurance, real estate, rental and leasing professions, scientific and technical services have seen less negative impact. In turn, the hardest hit sectors also gained the most jobs as economies slowly started to re-open, a trend we expect will continue in lockstep with increased mobility.

Leasing activity stalls as occupiers evaluate future space needs

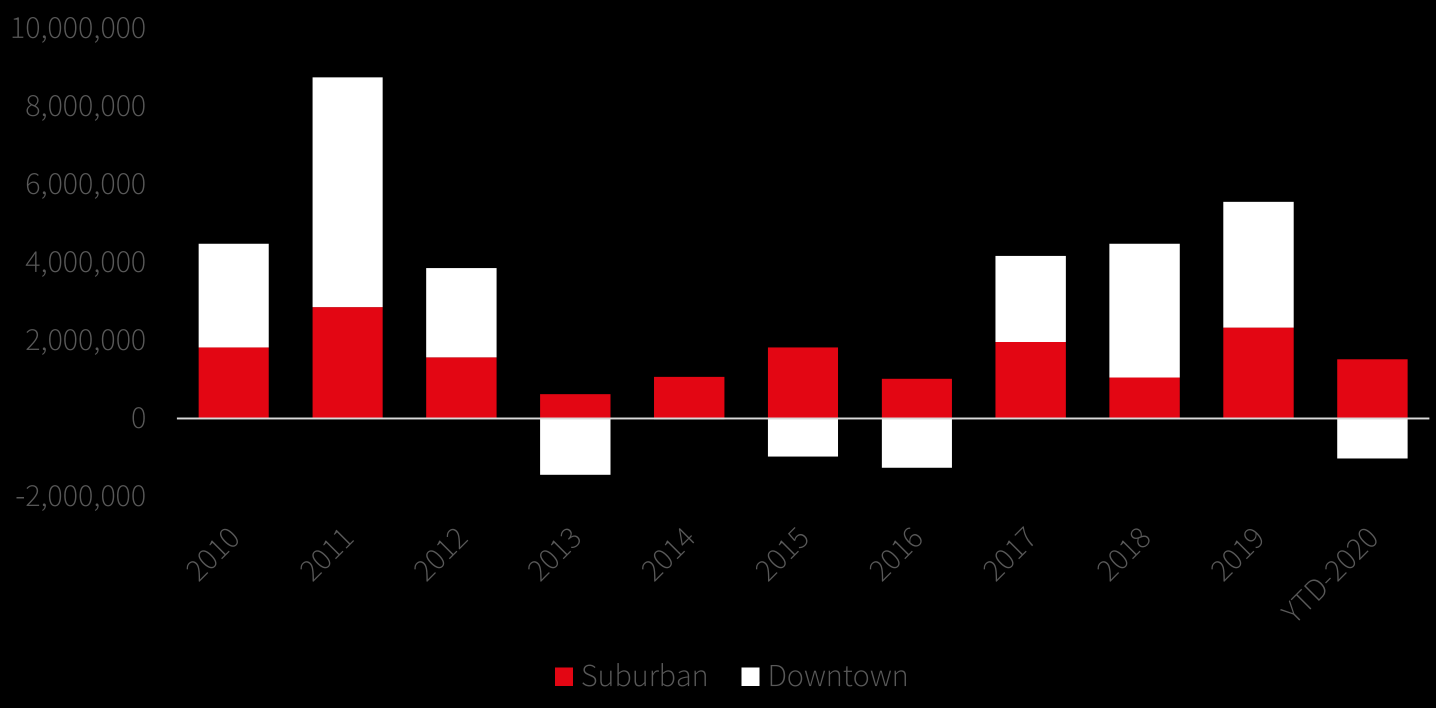
With one full quarter amidst the pandemic and subsequent widespread work-from-home programs, Canadian office market fundamentals started to reveal the first signs of measurable impact. The foremost impact has been to leasing activity where gross leasing volumes (leases >20,000 s.f.) dropped by a massive 76.7% year-over-year as occupiers are evaluating their future space needs while also focusing on capital preservation. This is inline with global office leasing volumes, which were down 60% year-over-year. Deals that did reach the goal line were for the most part expiry driven or ‘flight-to-quality’ with tenants focusing on negotiating as much flexibility into their lease as possible. A few notable deals during the second quarter were all renewals and included Fasken (86,000 s.f.) in Downtown Vancouver, Infrastructure Ontario (68,000 s.f.) in Midtown Toronto and RBC (62,000 s.f.) in Suburban Toronto. Leasing activity is expected to remain muted well into the third quarter before picking up by year-end on the back of pent-up demand from deals put on hold.

Absorption turns negative but not in all markets

After a relatively strong first quarter with over 1.7 million square feet of positive net absorption, the Canadian office market recorded nearly 1 million square feet of negative net absorption in the second quarter, the largest quarterly occupancy loss since Q1 2015. Occupancy losses varied significantly by geography with the largest losses recorded in downtown markets for a total of 1.2 million square feet, while suburban markets recorded a small gain of 84,534 square feet. On a regional basis, Toronto and Calgary were responsible for most losses, while net absorption in Ottawa, Edmonton and Vancouver stayed relatively flat over the quarter. Montreal, on the other hand, recorded 344,736 square feet of positive net absorption with occupancy gains driven by smaller moves in the Midtown North and South West submarkets. Although national year-to-date net absorption is still positive at 772,146 square feet, losses are expected to intensify on the back of muted leasing activity in the first half and currently available sublease spaces becoming vacant.

Total vacancy ended the second quarter at 10.2%, an increase of 20 basis points from the previous quarter but only 40 basis points above the long-term (20 years) average with most office markets, outside of Alberta, still near or below long-term averages. The increase in vacancy was primarily driven by Downtown Toronto where total vacant space rose by nearly 1 million square feet or a 130 basis points increase to total vacancy which settled at 3.2%. That said, Downtown Toronto remains the tightest downtown office market in North America. The most significant vacancy to hit the market this quarter was 325 Front Street West where the dissolution of incubator OneEleven has led to over 108,000 square feet of new vacancy. However, most of the negative absorption in the rest of the market is comprised of much smaller tenants and spaces, averaging 11,280 square feet per building.

Downtown occupancy losses push net absorption into negative territory in the second quarter

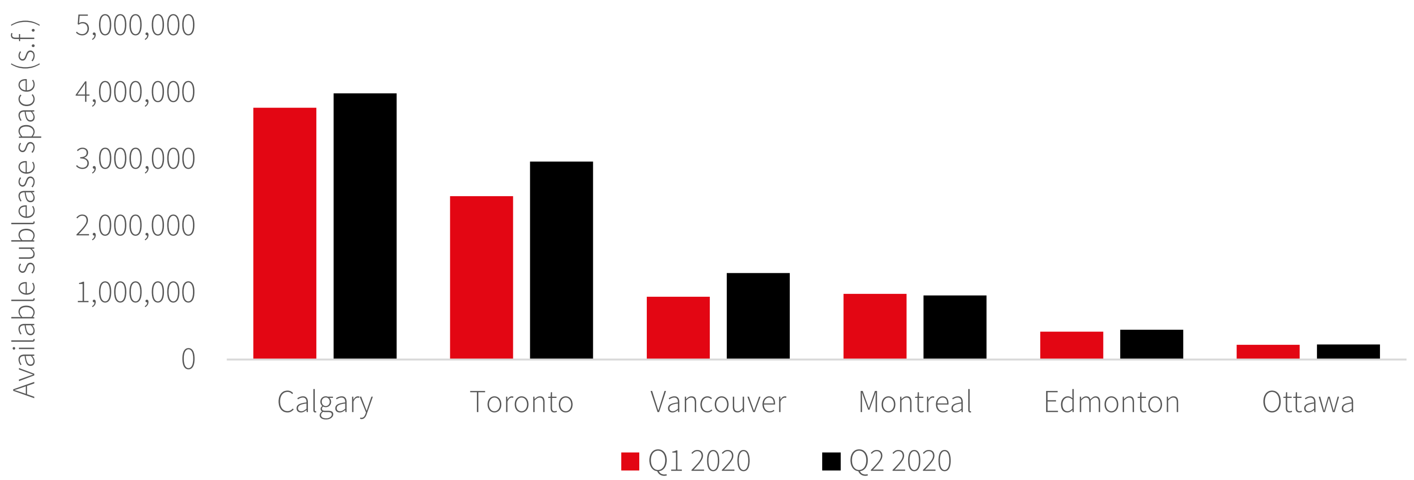


Source: JLL Canada

Sublease availability on the rise as occupiers consider future space needs

As in previous downturns, sublease spaces are being watched carefully as they act as an early indicator of market health and provide an outlook on future vacancy (and recovery). JLL is currently tracking 9.9 million square feet of available sublease space across the six largest office markets in Canada, an increase of 1.1 million square feet from the first quarter, with the majority in Class A properties. Most of the new spaces were added in Toronto and Vancouver although the largest sublease added in the second quarter was at 3636 Research Road NW in Calgary where SMART Technologies is subletting the entire 204,642 square foot building. It's still early to say how much impact COVID-19 is having on the sublease market as many subleases were already planned before the pandemic shut much of the economy down, but we will continue to carefully watch this segment of the market in the quarters ahead.

Available sublet space is increasing but not at the same rate across all markets



Source: JLL Canada

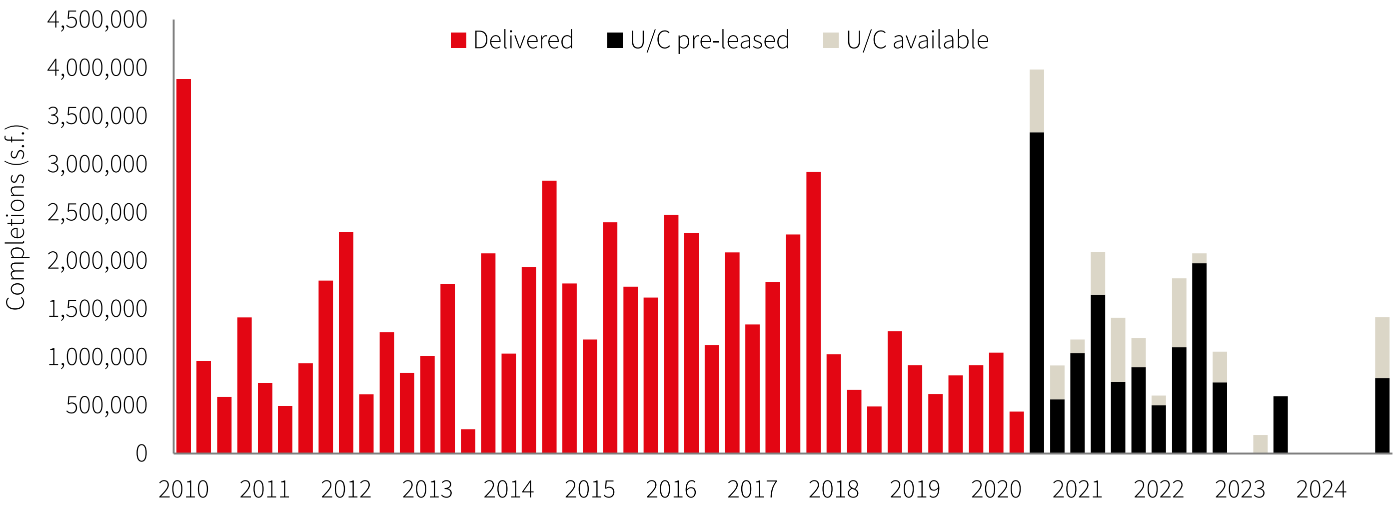
Landlords hold firm on rental rates despite an overall slowdown in activity

Despite an overall slowdown in leasing activity and an increase in sublease space, landlords are generally holding firm on rental rates. In fact, the average direct asking rent increased 5.3% year-over-year with strong rental growth in Montreal (14.5%), Toronto (11.5%) and Vancouver (6.8%). Geographically speaking, suburban markets have been flat, increasing a mere 0.7% while downtown has seen an 8.4% increase year-over-year on the back of historically tight market conditions. That said, we expect some negative movement in rents as constructions completions intensifies, adding more vacancy from backfill space in lower class buildings. There is also a typical lag in pricing versus macro economic statistics which should be considered.

Strong pre-leasing in under construction inventory will provide some supply shock cushioning

Construction activity has now resumed but the short-term shutdown pushed timelines on some 2020 completions to the second half of this year and potentially into early 2021. Significant upcoming deliveries include 16 York and CIBC Square Phase I in Downtown Toronto. These two projects alone will add 2.4 million square feet or 5.2% of total Class A inventory. Pre-leasing in both projects has been strong with only 127,492 square feet currently available at 16 York. But there is still a lot of uncertainty around CIBC's consolidation which will inevitably deliver several large pockets of vacancies in Downtown Toronto, although not necessarily all at once. With no large completions in the second quarter under construction inventory remained largely unchanged at 21.5 million square feet with almost half of total activity (48.9%) in Toronto, Vancouver (27.6%) and Montreal (17.7%).

Over 15 million square feet of office completions over the next three years. Strong pre-leasing (77.3%) and a number of 'net new tenants' should mitigate some pressure on vacancy



Source: JLL Canada

Local markets

Downtown Toronto

Vacancy spikes as leasing activity slows to standstill and availabilities turn vacant

- The market freeze continued, with nearly all firms postponing any transactions that were not driven by lease expiry.
- The market recorded substantial negative absorption, overwhelmingly driven by smaller vacating tenants averaging roughly 11,000 square feet.
- Market confidence remains stable with average direct net rents growing by 7.3 percent since Q1.

Fundamentals	Forecast	
YTD net absorption	-905,361 s.f.	▶
Under construction	10,216,013	▶
Total vacancy	3.2%	▶
Sublease vacancy	725,098 s.f.	▶
Direct asking gross rent	$66.15 p.s.f.	▶
Sublease asking gross rent	$49.04 p.s.f.	▶
Concessions	Stable	▶

As the Downtown Toronto office market continued to navigate the COVID-19 pandemic, leasing activity has stalled dramatically in the first full quarter since the provincial lockdown in late March. Large-scale leasing was essentially non-existent in Q2, with only a single new transaction over 20,000 square feet. In total, out of 386 office properties, only 27 properties recorded positive net absorption, totaling just over 143,000 square feet.

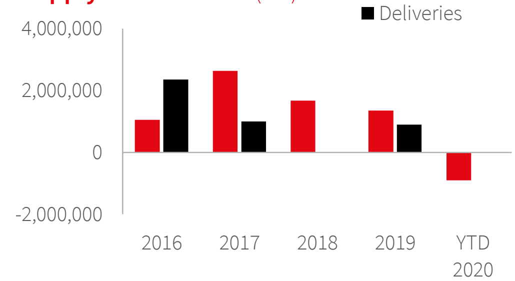
Meanwhile, 169 new availabilities have been added to the market, for a total increase in availability of 25.1 percent, or 949,285 square feet. New subleases overwhelmingly make up the brunt of the new availabilities, contributing over 553,603 square feet. Moreover, with such subdued leasing activity, previous availabilities that were already on the market have now gone vacant. The result is a notable quarterly spike in vacancy to 2018 levels, currently up to 3.2 percent.

In total, 98 properties saw negative absorption this quarter, totaling just over 1.1M square feet of negative absorption. The most significant of which is 325 Front St W., where the dissolution of OneEleven has led to over 108,000 square feet of new vacancy. However, the majority of negative absorption in the rest of the market is comprised of much smaller tenants and spaces, averaging 11,280 s.f. per building. In conversation with tenants, many of these space additions to the market were planned beforehand and were not directly COVID-related either. Consequently, Downtown Toronto remains a landlord's market, with overall average direct net rents increasing by 7.3 percent Q-o-Q and by 10.7 percent in the Class A market.

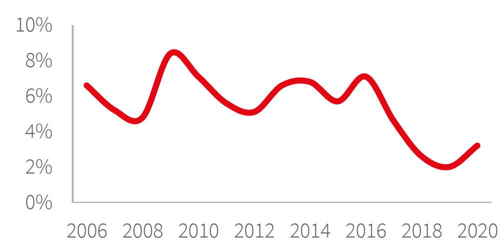
Outlook

As tenants and landlords now turn their attention to re-entry of their spaces, the market remains in triage mode. Although we continue to track sizable pent-up demand in the market, these large-scale and forward-looking requirements are still waiting for stability to return in the office market and in everyday life before transacting. It remains to be seen how quickly and how vigorously demand returns to the market as Toronto implements and monitors its phased reopening.

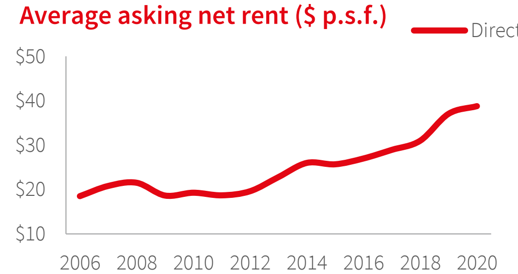
Supply and demand (s.f.)



Total vacancy



Average asking net rent ($ p.s.f.)



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Greater Toronto Area
West

Leasing activity pauses but office market fundamentals remain largely unchanged

- Leasing activity totaled 89,392 square feet in the second quarter compared to 634,000 square feet in the first quarter
- Vacancy edged up 40 basis points from 13.0 percent to 13.4 percent while asking gross rents remained stable quarter over quarter
- Hopewell's second building at Walkers Line Corporate Centre added 46,314 square feet of new flex-office space to the inventory

With the ongoing COVID-19 health crises, complexities and discussions associated with a lower density office environment and business continuity plans brought leasing activity to a halt in the second quarter. However, leases close to the signing stage were completed including Infosys (36,000 s.f.) at 5800 Explorer Drive, Capgemini (37,000 s.f.) renewal at 1605 Tech Avenue and Unisync (27,000 s.f.) at 6695 Airport Road. Whereas leases under the earlier stage of negotiation have been delayed as business leaders re-evaluate their real estate needs in a post-COVID world.

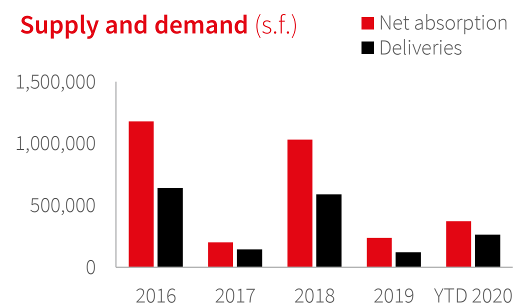
Space givebacks were minimal in the second quarter. However, vacancy increased 40 basis points from the previous quarter. This was primarily due to a lag between leasing activity and the physical occupancy by tenants. The largest quarterly move-ins came from General mills (47,000 s.f.) which left 5825 Explorer Drive for Creekside Corporate Centre, Kruger Products (27,000 s.f.) moved from 1900 Minnesota to 2-8 Prologis Boulevard while OSL Retail Inc (26,784 s.f.) moved from 2475 Skymark Avenue to 5090 Explorer Drive.

Outlook

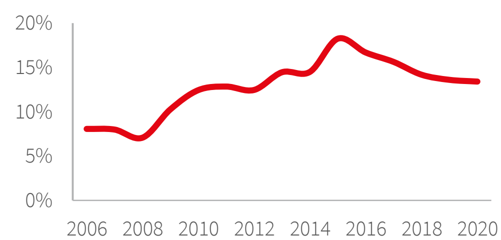
Leasing activity is expected to remain subdued as the full impact of COVID-19 becomes more apparent in the coming quarters. Businesses are considering both short- and long-term measures for re-entry into their physical workplace in light of government directives and regulations. Looking forward, a diversified tenant base and strong market fundamentals will navigate the GTA West office market through upcoming economic headwinds. Additionally, historically low new supply figures (46% has been pre-leased) will likely prevent a significant uptick in vacancy going forward, unlike Downtown Toronto which has 10.2 million square feet of office space scheduled to deliver between 2021-2023.

Fundamentals	Forecast
YTD net absorption	373,553 s.f. ▲
Under construction	322,374 s.f. ▼
Total vacancy	13.4% ▶
Sublease vacancy	585,899 s.f. ▶
Direct asking gross rent	$31.87 p.s.f. ▶
Sublease asking gross rent	$27.99 s.f. ▶
Concessions	Stable ▶

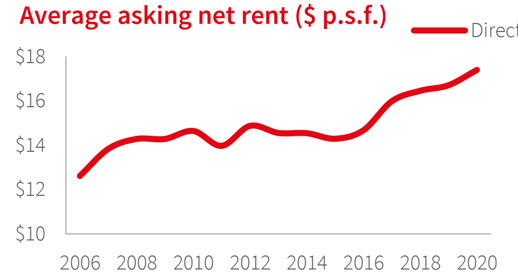
Supply and demand (s.f.)



Total vacancy



Average asking net rent ($ p.s.f.)



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Greater Toronto Area

North & East

Leasing activity hit pause as occupiers focus on reentry

- The GTA North East vacancy rate remained unchanged at 9.4 percent quarter-over-quarter
- Direct asking gross rents remained stable, while sublease gross rents decreased 7.5 percent quarter-over-quarter
- There are no new office buildings currently under construction after 6220 Highway 7 delivered this quarter, adding 69,000 square feet of new office supply

The COVID-19 pandemic has changed the world we live and work in. The mass work from home practice effecting most industries has become a new normal which many business-continuity plans hadn't envisioned. As businesses went into crisis management, suburban tenants have been holding back their real estate decisions until the dust settles from COVID-19. As a result, the GTA North East has seen a significant decrease in leasing activity, down 59 percent from the previous quarter. The few deals greater than 15,000 square feet that transacted include Waste Connections which is relocating from 610 Applewood Crescent into the top full floor at 6220 Highway 7 and RBC which renewed 62,000 square feet at 260 East Beaver Creek Road. The outlier this quarter was Amberson College which leased 40,000 square feet at 7100 Birchmount Road, a former catholic school now owned by the City of Markham.

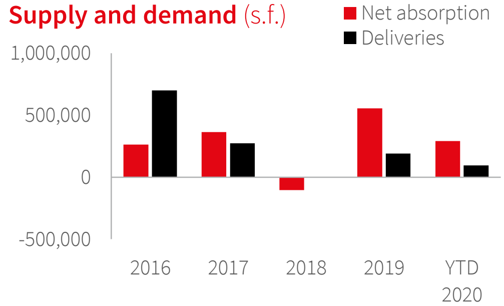
The GTA North East office market recorded 91,291 square feet of positive net absorption in the second quarter which was mainly driven by smaller tenants throughout the market. However, vacancy held steady at 9.4 percent due to newly delivered supply at 6220 Highway 7 in Vaughan.

Outlooks

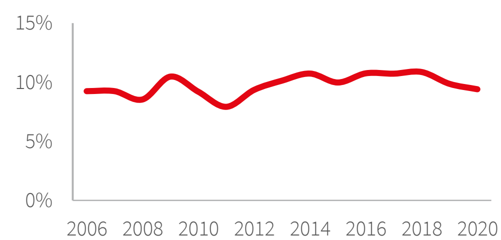
The pandemic poses unprecedented risks when dealing with human proximity in densely populated cities and will likely continue to do so until a vaccine is available. That said, the GTA North East suburban office markets could be a benefactor in the COVID-19 world, as well as in the post pandemic world due to variety of factors. These factors include maintaining social distancing in a lower density region, rents which are half the cost of downtown office space, smaller buildings reducing the long wait times for elevator trips, commuting via car instead of mass transit, access to surface parking, and more. Moreover, strong and stable market fundamentals with a non-existent new supply pipeline will help mitigate market volatility.

Fundamentals	Forecast
YTD net absorption	292,113 s.f. ▶
Under construction	0 ▶
Total vacancy	9.4% ▶
Sublease vacancy	411,755 s.f. ▶
Direct asking gross rent	$32.28 p.s.f. ▶
Sublease asking gross rent	$33.80 s.f. ▶
Concessions	Stable ▶

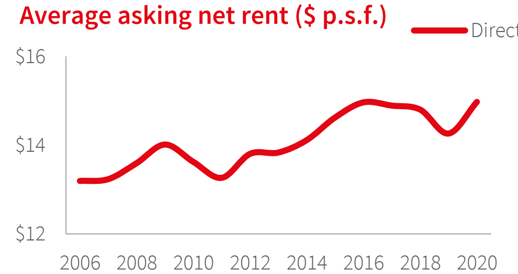
Supply and demand (s.f.)



Total vacancy



Average asking net rent ($ p.s.f.)



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Ottawa

Strong suburban growth stabilizes the Ottawa market as COVID-19 pandemic continues

- Occupancy gains in Kanata and Nepean outpaced the occupancy losses in the rest of the market.
- Overall leasing activity has slowed dramatically since Q1 with most firms now focused on reentry of their office space.
- Increasing RFP activity and the significant presence of the federal government as the leading occupier continue to bode well for Ottawa's short-term trajectory.

The suburbs of Ottawa continue to bolster the overall market, with strong gains in Kanata and Nepean. Collectively, the two submarkets posted positive net absorption of nearly 240,000 square feet, enough to keep overall market vacancy stable at 7.0 percent. We expect this trend to continue due to the high volume of suburban leasing activity in the past 12 months as tenants continue to move into new space.

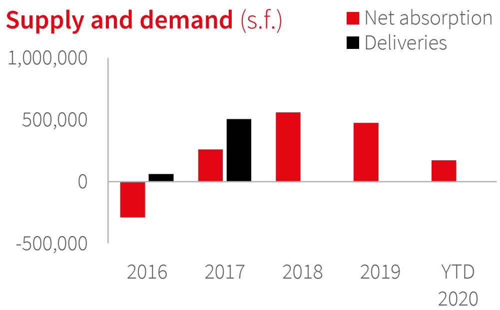
In terms of new leasing activity, like other Canadian markets, new leasing in Ottawa was largely stalled, save for expiry-driven requirements. As Ontario enters its second phase of reopening, all market participants are now focused on reactivating and returning to their existing offices, with most tenants putting forward-looking transactions on hold. Occupiers continue to gather data and information, just stopping short of transacting, as firms continue to refine and revise their real estate strategies going forward. However, re-entry remains top priority for the moment.

Outlook

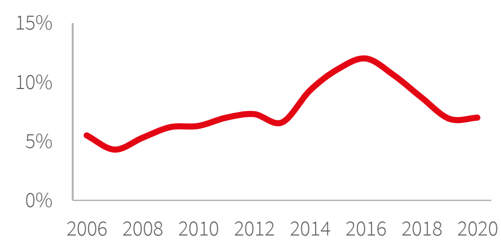
There are positive indicators for the near future, with RFPs flowing back into the market after a notable slowdown during the early days of the pandemic. Although reentry is still top of mind, confidence is beginning to return as large tenants are, little by little, looking further ahead, especially in technology and telecommunications. Ericsson recently won the Bell contract for the provision and expansion of 5G wireless coverage through Bell's cellular network. Ericsson is one of the largest tenants in the market, occupying roughly 250,000 square feet in Kanata. Meanwhile, the presence of the federal government as the leading office occupier is expected to provide some buffer to Ottawa's stability, as it has in previous downturns. However, we remain at a crucial moment as the province begins to open carefully and companies gradually return to work.

Fundamentals		Forecast
YTD net absorption	172,215 s.f.	▶
Under construction	459,845 s.f.	▶
Total vacancy	7.0%	▶
Sublease vacancy	235,642 s.f.	▶
Direct asking gross rent	$33.08 p.s.f.	▶
Sublease asking gross rent	$33.85 p.s.f.	▶
Concessions	Stable	▶

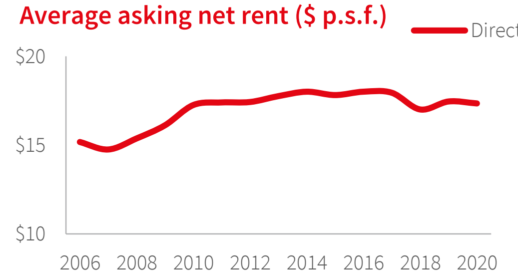
Supply and demand (s.f.)



Total vacancy



Average asking net rent ($ p.s.f.)



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Montreal

Leasing activity slows in the wake of future office demand uncertainty.

- Lowest quarterly net absorption for downtown since 2018 and second lowest since 2016
- Expect delays for delivery of new construction due to the construction shut-down
- Companies review footprints to accommodate work-from-home and social distancing

After a steady first quarter, leasing activity came to a near halt as occupiers paused their searches resulting in very limited lease transactions over 20,000 square feet in Q2. Despite the slowdown, market fundamental remain largely unchanged. The Greater Montreal Area recorded 344,736 square feet of positive net absorption in the second quarter with the majority of occupancy gains being driven by the Midtown North and Midtown South West sub-markets. This absorption was mainly driven by smaller moves throughout the market. As a result, total vacancy dropped 10 basis points from the previous quarter to 9.3 percent, 150 basis points below the long-term average. Average asking net rents continued to rise, up 3.4 percent quarter-over-quarter and 14.5 percent year-over-year to $18.08 per square foot.

The second quarter represented the lowest quarterly net absorption rate for downtown since 2018 and second lowest since 2016. In addition, 163,000 square feet of vacant sublet space came to market, of which 100,000 square feet is located downtown. The largest block of vacant sublet space added to market in Q2 was 23,000 square feet at 1100 René-Lévesque.

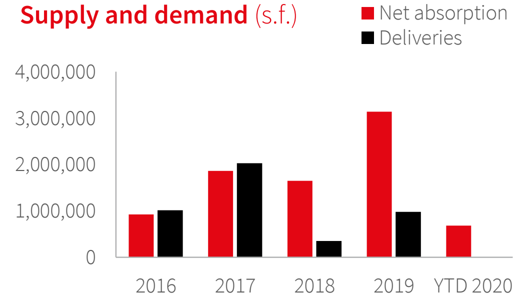
Inventory under construction remained constant throughout the quarter, however, delays are expected in completions due to the temporary construction shut-down which was lifted in mid-May.

Outlook

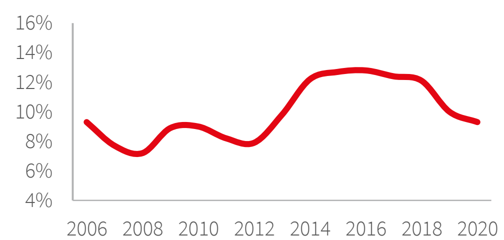
Although direct implications of the COVID-19 crisis has yet to be seen in market fundamentals it has acted as an accelerant for the "workplace of the future" discussions. Organizations across the GMA have been forced into a mandatory work-from-home experiment and many are re-considering their office strategies and re-assessing their office needs. Expect companies to review their footprints to accommodate social distancing and work-from-home strategies in the second half of the year.

Fundamentals	Forecast	
YTD net absorption	681,234 s.f.	▶
Under construction	3,811,813 s.f.	▶
Total vacancy	9.3 %	▲
Sublease vacancy	690,305 s.f.	▲
Direct asking gross rent	$32.96 p.s.f.	▶
Sublease asking gross rent	$27.01 s.f.	▶
Concessions	Stable	▶

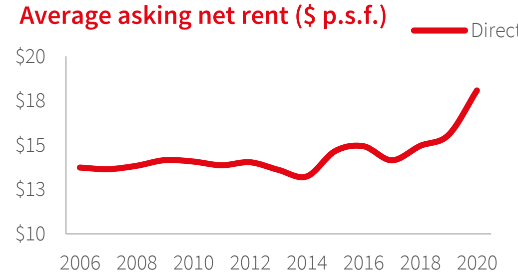
Supply and demand (s.f.)



Total vacancy



Average asking net rent ($ p.s.f.)



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Montréal

L’activité de location a été stable au cours du premier trimestre, malgré l'incertitude croissante

- Absorption nette trimestrielle la plus faible pour le centre-ville depuis 2018 et la deuxième plus faible depuis 2016
- Il faut prévoir des retards dans la livraison des nouvelles constructions en raison de l’arrêt des travaux
- Les entreprises revoient leur empreinte pour tenir compte du travail à domicile et de la distanciation sociale

Après un premier trimestre stable, l'activité de location s'est pratiquement arrêtée, les occupants ayant interrompu leurs recherches, ce qui a entraîné des transactions de location très limitées sur plus de 20 000 pieds carrés au deuxième trimestre. Malgré le ralentissement, les indicateurs de base du marché restent largement inchangés. La région du Grand Montréal a enregistré une absorption nette positive de 344 736 pieds carrés au deuxième trimestre, la majorité des gains d'occupation étant attribuable aux sous-marchés Midtown North et Midtown South West. Cette absorption a été principalement motivée par des mouvements de moindre ampleur sur le marché. Par conséquent, le taux d'inoccupation total a chuté de 10 points de base par rapport au trimestre précédent, à 9,3 pour cent, soit 150 points de base de moins que la moyenne à long terme. Les loyers nets moyens demandés ont continué à augmenter, en hausse de 3,4 pour cent d'un trimestre à l'autre et de 14,5 pour cent d'une année à l'autre, pour atteindre 18,08 dollars par pied carré.

Ce trimestre représente le taux d’absorption nette trimestriel le plus faible pour le centre-ville depuis 2018 et le deuxième plus faible depuis 2016. En outre, 163 000 pieds carrés de locaux sous-loués vacants ont été mis sur le marché au cours du deuxième trimestre, dont 100 000 pieds carrés sont situés au centre-ville. Le plus grand bloc d'espace sous-loué vacant mis sur le marché au cours du deuxième trimestre était de 23 000 pieds carrés au 1100 René-Lévesque.

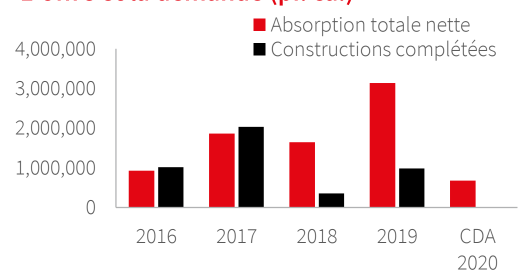
L’inventaire en construction est resté constant tout au long du trimestre, toutefois, il faut s'attendre à des retards dans l'achèvement des travaux en raison de l’arrêt temporaire de la construction qui a été levé à la mi-mai.

Perspectives

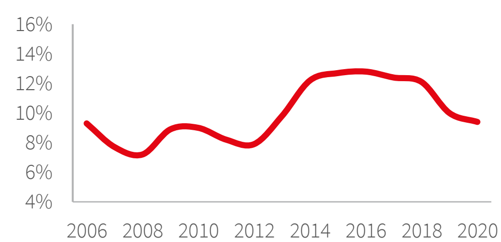
Bien que les implications directes de la crise COVID-19 ne soient pas encore visibles dans les indicateurs de base du marché, elle a agi comme un accélérateur pour les discussions sur le « lieu de travail du futur ». Les organisations du Grand Montréal ont été forcées de faire l'expérience du télétravail obligatoire et beaucoup d'entre elles reconsidèrent leurs stratégies de bureau et réévaluent leurs besoins en la matière. Il faut s’attendre à ce que les entreprises revoient leur empreinte pour tenir compte de la distanciation sociale et des stratégies de télétravail au cours du second semestre de l'année.

Fondamentaux		Prévisions
Absorption totale nette CDA	681 234 p.c.	▶
En construction	3,811,813 p.c.	▶
Taux d’inoccupation global	9,3 %	▶
Taux d’inoccupation pour sous-locations	690 305 p.c.	▲
Moyenne des loyers bruts	32,96 $/ p.c.	▶
Moyenne des loyers bruts pour sous-locations	27,01 $/ p.c.	▶
Allocation	Stable	▶

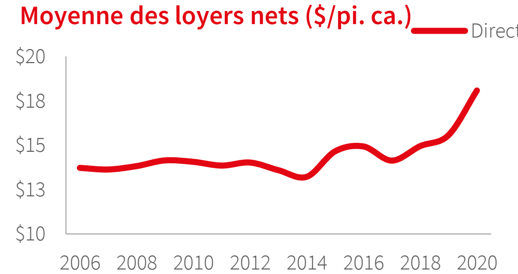
L’offre et la demande (pi. ca.)



Taux d’inoccupation global



Moyenne des loyers nets ($/pi. ca.)



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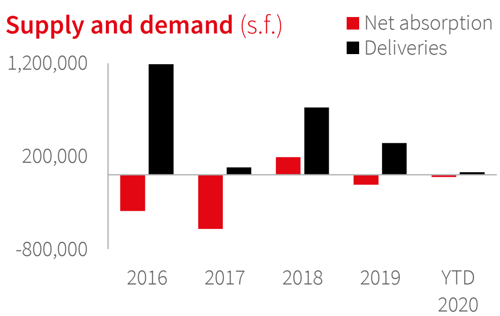
Edmonton

Interest in suburban markets accelerates as social distancing requirements prolong re-entry

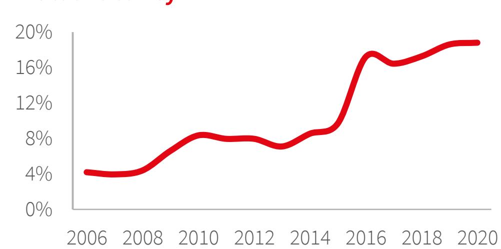
- Suburban and Downtown Class A and AA markets totaled 44,910 square feet of positive net absorption for the quarter.
- Combined Class A and AA Downtown asking net rents averaged $21.66 per square foot while Class B averaged $13.94 per square foot.
- Edmonton selected as one of two hub cities to host the remainder of the '19-'20 NHL season this summer

Fundamentals	Forecast
YTD net absorption	-18,057 s.f. ▶
Under construction	0 s.f. ▶
Total vacancy	18.8% ▶
Sublease vacancy	610,263 s.f. ▲
Direct asking gross rent	$33.23 p.s.f. ▶
Sublease asking gross rent	$23.16 s.f. ▼
Concessions	Stable ▼

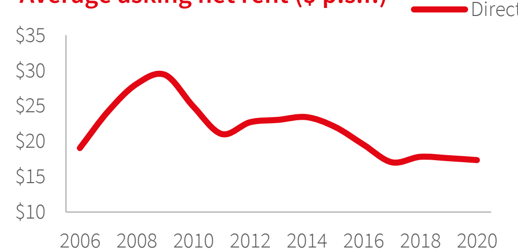
Supply and demand (s.f.)



Total vacancy



Average asking net rent ($ p.s.f.)



Edmonton net occupancy remained stable in Q2 2020 as the city entered stage 2 of Alberta's re-entry plan. The quarter gained 28,873 square feet of positive net absorption, bringing year-to-date net occupancy losses to 18,057 square feet. Downtown vacancy decreased by 0.3 percent, from 19.1 percent in Q1 2020 to 18.8 percent in Q2 2020, while suburban vacancy remained stable, quarter-over-quarter, at 18.6 percent in Q2 2020. Sublease availability increased by 11.6 percent, from 573,461 square feet in Q1 2020 to 640,130 square feet in Q2 2020. Sublease availability increased by 44,942 square feet in the CBD over the quarter, while suburban sublease availability only grew by 21,727 square feet over the same time period. This trend is expected to continue for the remainder of 2020.

Leasing activity remained steady in Q2 2020 with Barr Picard leasing 11,463 square feet on the twenty fifth floor of Sun Life Place, relocating within the Financial District, while BDO and AltaML leased 33,057 square feet and 15,853 square feet at 103 Street Centre, and the Realtors Association of Edmonton leased 13,232 square feet at CX Place on the West End. Average asking gross rent has contracted by 0.7 percent, quarter over quarter, from $33.23 per square foot in Q1 2020 to $32.98 per square foot in Q2 2020.

Outlook

Expect tenants to reconsider their footprint to accommodate social distancing requirements and prolonged work from home arrangements while landlords reduce capital expenditures, pushing concessions lower. Sublease inventory is expected to rise even with a total of 166,719 square feet of currently marketed sublease space expiring by the end of 2021. Edmonton council voted to remove minimum parking requirements throughout the city, providing developers with greater flexibility while paving the way for increased density and more efficient use of space.

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Downtown Calgary

Calgary’s changing market directly related to decreasing oil prices and COVID-19 amidst isolation

- 2020 continues to see negative net absorption
- Teck to relocate from 205 9th into The Bow
- COVID-19 implications expected to continue until year end

Calgary’s downtown recorded 72,337 square feet of negative net absorption in Q2, bringing year to date absorption to negative 305,246 square feet. Vacancy increased 20 basis points this quarter to 24.8 percent. Q2 average direct asking gross rent for Class A buildings is $35.38, Class B is $24.05, and Class C is $19.94 per square foot. The downtown market continues to be tenant favourable with its diverse portfolio of direct and sublease space.

As the price of oil decreased, downtown oil and gas tenants suffered forced capital expenditure cuts, leading to new job losses. Downtown Calgary’s rental rates continue to be the lowest of major Canadian markets. These rates appeal to suburban tenants, whilst current downtown tenants are continuing a flight to quality and relocating to the Class A segment. Class A buildings such as The Bow and First Tower that have large blocks of contiguous space offers companies the opportunity to move headquarters into downtown Calgary. Companies that transition into downtown Calgary can capture both lower rents and robust inducement packages. Out of province companies that move to Alberta as well as those that remain in the province can take advantage of the lowered 8.0 percent corporate tax rate. Coworking is facing tough decisions as users worry about social distancing and safety measures. Although representing only 550,000 square feet of Calgary’s Downtown inventory, coworking space may return to landlord’s hands, as shown by the iQ decision to walk away from their lease in TELUS Sky.

Outlook

With the volatility of the price of oil, additional vacancy is expected to be added. Tenants will favour extensions and subleases to conserve capital. Downtown head lease rates are expected to stay well below other Canadian markets until oil prices can return to economic levels. We expect that the flight to inexpensive, high quality space will continue in Calgary as tenants can take advantage of this very soft market. It is too early to report the real impact of COVID-19 isolation and forced remote work, but we suspect that this may accelerate the flight to quality as people take advantage of larger floor plates and improved mechanical systems in newer or upgraded buildings in the Centre Core.

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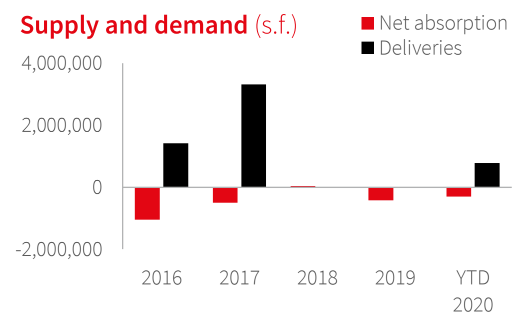
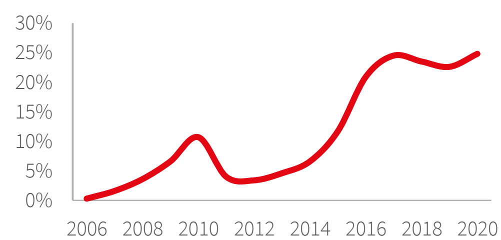
Fundamentals	Forecast
YTD net absorption	-305,246 s.f. ▼
Under construction	0 s.f. ▶
Total vacancy	24.8% ▲
Sublease vacancy	2,542,501 s.f. ▲
Direct asking gross rent	$30.77 p.s.f. ▼
Sublease asking gross rent	$28.12 s.f. ▼
Concessions	Stable ▶

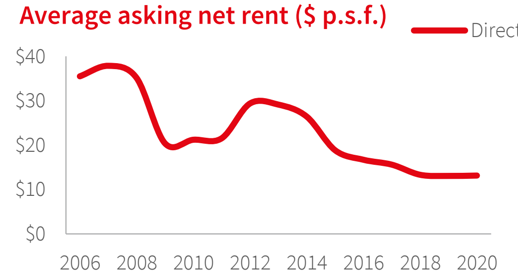
Supply and demand (s.f.)



Total vacancy



Average asking net rent ($ p.s.f.)



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Suburban Calgary

Calgary's suburban office market more resilient than expected; reopening the economy is key

- Suburban vacancy was up to 16.5 percent. Average net rents remained fairly constant at $15.64 per square foot
- Spear Street Capital broke ground on its $10 million redevelopment project The District at Beltline
- Bill 23 proposes a temporary ban on commercial evictions, rent increases, and late fees due to missed rent payments until August 31, 2020

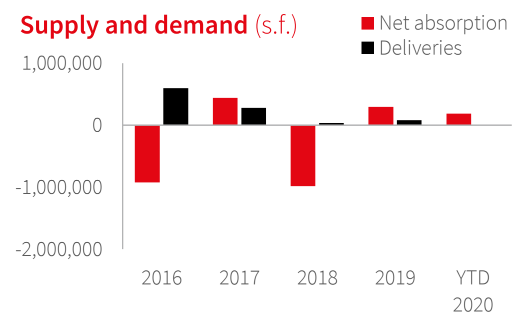
Calgary's suburbs recorded 157,091 square feet of negative net absorption in Q2 2020, effectively halting the market's slow-paced recovery started in 2018. As a result, vacancy rates increased 50 basis points to 16.5 percent. This trend is expected to continue as the effects of COVID-19 and depressed oil prices hit the city's largest tenants. Average net rents across all subclasses remained fairly constant at $15.64 per square foot. The city's South was once again the best performing submarket, registering 483,338 square feet of net positive absorption. Large deals in the suburbs included a 20,000 square foot headlease at 3016 5th Avenue NE by Alison College, and a 21,000 square foot deal in Zurich Court by an undisclosed engineering firm. In other news, Spear Street Capital broke ground for its $10 million redevelopment of The District at Beltline, converting 18,200 square feet of main floor office space into retail and adding 3,200 square feet of newly constructed retail areas.

Outlook

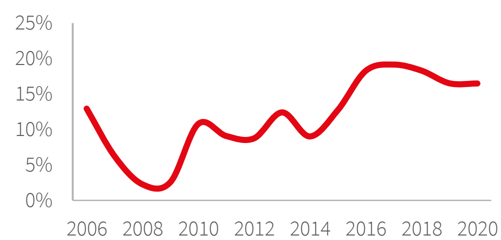
On June 12, Alberta's provincial government entered the second phase of its relaunch strategy. For the first time since March, restaurants and bars can open at full capacity, outdoor gatherings of more than 200 people are allowed, provided physical distancing is maintained. Another significant development was the proposal of Bill 23, also known as the Commercial Tenancies Protection Act (CTPA). Its approval will entail a temporary ban on commercial evictions, rent increases and late fees due to missed rent payments between March 17, 2020 and August 31, 2020. Bill 23 has already passed its First Reading in the Alberta Legislature. The effects of these measures on the overall economy remain uncertain, as fears of a second wave of COVID-19 manifest. We expect to see an increase in vacancy rates and lower asking net rents in the coming quarters.

Fundamentals	Forecast
YTD net absorption	187,240 s.f. ▼
Under construction	787,584 s.f. ▶
Total vacancy	16.5% ▲
Sublease vacancy	558,726 s.f. ▲
Direct asking gross rent	$32.24 p.s.f. ▼
Sublease asking gross rent	$24.22 p.s.f. ▼
Concessions	Increasing ▲

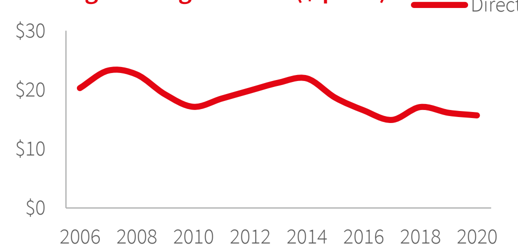
Supply and demand (s.f.)



Total vacancy



Average asking net rent ($ p.s.f.)



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Metro Vancouver

Leasing demand slows and sublease availabilities increase as tenants look to navigate the new normal

- Downtown sublet availability skyrocketed from 195,021 square feet in Q1 2020 to 594,751 square feet by the end of Q2 2020
- The Metro Vancouver market experienced 30,850 square feet of negative net absorption in Q2 2020, primarily driven by Downtown sublets
- Average asking net rental rates held steady with a modest 1.9 percent increase since Q1 2020

Like the wider North American market Metro Vancouver experienced a sudden halt in tenant demand, this of course has been brought about by the COVID-19 lockdown. Users are currently strategizing on how to move forward with their office space requirements with many opting for the wait and see approach. Those users who have been looking to lease space during this time have been hoping for reduced rates. However, this has not been the case, resulting in the spread widening between what the tenant is willing to pay and what a landlord is offering, causing a further stall in deal activity. Asking rates have in fact remained stable during this period, with the Metro Vancouver average net asking rate increasing by 1.9 percent quarter over quarter.

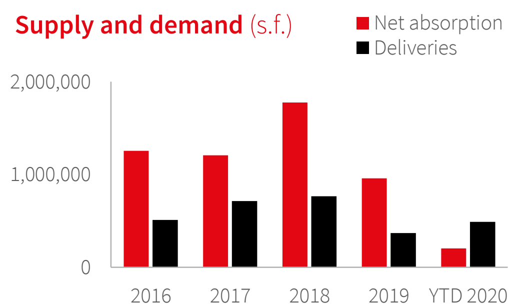
Many users have turned to the sublet market to facilitate their changing requirements, the result of which was a glut of sublet space coming to market. During Q2 2020, 343,433 square feet of vacant sublet space was added bringing the total to 853,702 square feet currently vacant and available. These spaces accounted for most of the negative absorption this quarter. This has opened up some large Class A blocks of space in the Downtown Core which are usually few and far between, offering large users looking for quality space a potential opportunity. As an example, Newmont is subletting 52,669 square feet at 666 Burrard and Mobify 20,019 square feet at 725 Granville. The combined effects of the sublet space and stalled tenant demand has resulted in total vacancy rising 40 basis points to 5.5 percent for Metro Vancouver.

Outlook

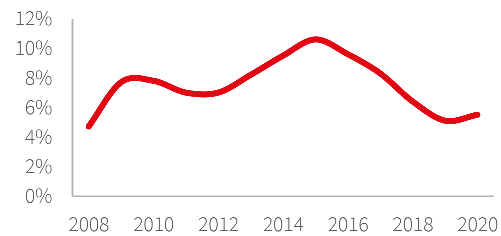
British Columbia has managed the pandemic efficiently. However, there is always the potential for a second wave and the most effective way forward is the slow and steady approach. Tenant demand may see some uptick with the recent halt to the issuing of H-1B visas for high skilled workers in the US, as Vancouver continues to define itself as a tech hotspot in North America.

Fundamentals	Forecast
YTD net absorption	204,357 s.f. ▼
Under construction	5,937,117 s.f. ▼
Total vacancy	5.5% ▲
Sublease vacancy	853,702 s.f. ▲
Direct asking gross rent	$44.16 p.s.f. ▶
Sublease asking gross rent	$47.27 s.f. ▶
Concessions	Stable ▶

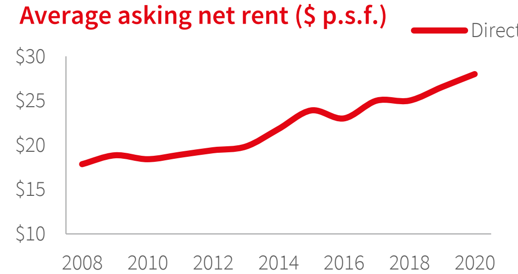
Supply and demand (s.f.)



Total vacancy



Average asking net rent ($ p.s.f.)



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