Mid-Year 2021 Point of View

Suburban Office Market

An Insight into the Calgary Suburban Office Market

cresa

Mid-Year 2021 Point of View

Table of Contents

Suburban Supply

22,591,672 sf

Suburban Vacancy

21.39%

Overall Suburban Vacancy

4,833,114 sf

Q1 2021 Suburban Absorption

-87,911 sf

Market Overview

Suburban Office Market

Uncertainty continues to persist in the suburban office market amid M&A activity, growth in the tech sector and ramifications from Covid-19.

If anything is certain thus far in 2021, it is that the suburban office market has continued to perform in a prolonged state of uncertainty. With vacancy rates continuing to rise, now to 22%, continued negative absorption in all suburban sub-markets, and an increase to over 750,000 sf of sublease space now on the market, there is increased downward pressure on rental rates. In terms of purchase and sales transactions, investment capital largely remained on the sidelines in the first ½ of the year which may be a precursor to opportunistic strategic acquisitions/distressed dispositions in the later stages of the year or 2022 for suburban office assets. Consolidations within the energy sector continue as oil & gas players move to strengthen their balance sheets, reduce debt and build returns for shareholders.

Factors to Watch

1. Merger & Acquisition and Energy Pricing

High level strategic deal making in the energy and other sectors could be a harbinger of economic activity to follow which could lead to positive absorption. While M&A generally leads to attrition and the give back of space, if commodity prices continue to remain well above 2021 forecasts, (WTI has averaged over US$70 for the latter part of Q2) and revenues and cash flows increase, it will be interesting to see if corporate leadership, previously committed to more conservative expenditure approaches, will change strategy mid-stream 2021 and increase capital expenditures potentially driving up occupancy.

2. Tech Sector Growth & Incubating & Investment

Is gaining, and while small in the utilization of vacant space now, if it is sustained, the increased activity in Tech, Biotech, Life Science, AI, environment, digital marketing, and other sectors of digital transformation will be welcomed.

Calgary Suburban Notable Transactions

Tenant	Building	Area (sf)	Type
Alberta Supports	One Executive Place	26,910	Renewal
MKRT	The Parke at Fish Creek	26,000	Renewal
Cornerstone Engineering	11144 - 12 Street NE	13,747	Renewal
Work Nicer Co-working	23 Sunpark Drive SE	12,627	Headlease
Trickle Creek Homes	Woodstone Building	8,700	***
***	Third Avenue Building (former Golder Building)	7,200	***

3. Work from Home Hybrid Models

Many variations and models are going to emerge. WFH and worker flexibility is here to stay as is the conventional office space, but function and utilization of office space is being transformed. Understanding workforce requirements is leading to a transformation of workplace design. Return to work policies will be varied and there is an expectation that many corporate policies will re-shift and re-adapt to thwart the potential loss of talent if return to work policies are overly rigorous.

4. Sublease Markets

Added sublease space means negative market activity and thus far in 2021 there simply has been no sustained traction for leasing of the increased amount of sublease space coming available. There are examples of differences in expectations for rate recovery between what sublandlords are looking to recover and what potential subtenants are prepared to pay, and in the existing climate of historically weak demand, history suggests only the sharpest priced product is going to move. The upshot is that agile and patient occupiers will have increasing opportunity to transact as sublandlord costs mount on surplus space.

5. Renewals

As vacancy levels continue to increase, landlords have been aggressively pursuing early lease renewals as an added arrow in their quiver to try to maintain stable occupancy levels. Landlords attracting new tenants offer aggressive rent rates and inducement packages and to maintain valuable tenants they offer aggressive discounts in return for extended terms. Bottom line, tenants win with lower occupancy costs and Landlords stabilize their portfolio income, albeit at lower net effective rates.

6. The Covid Effect

The effects of the global pandemic continue to reach deeply into our leasing markets and are increasingly unsettling. As case counts rose in Q1 and the 3rd wave became relevant, more tenants became affected and business closures continued to mount. Figures released by the ATB suggest the hardest hit businesses have been small to medium sized firms, and these tenants are the bread and butter that drive the suburban office market. As stated in our 2020 year-end report, real estate recovery will lag medical recovery and vaccination advances so any signs of recovery in suburban office leasing markets remains elusive and out of the horizon for the next couple of quarters at least. Longer term recovery remains equally uncertain and partially dependent upon how markets and businesses respond when restrictions ease further and rent and wage subsidies are ended. Uncertainty about future waves and new Delta variant concerns also dampen market recovery as tenants continue to hold off on making back to work, office leasing and other business decisions. The continued impact of the pandemic is likely to remain a significant constraint on market demand and sentiment. As tenants navigate re-entry and operational planning, the vigor and intensity with which demand returns to the market remains to be seen, especially considering the negative demand for both direct and sublease space in recent months.

One Executive Place

Photo Credit: CoStar Group

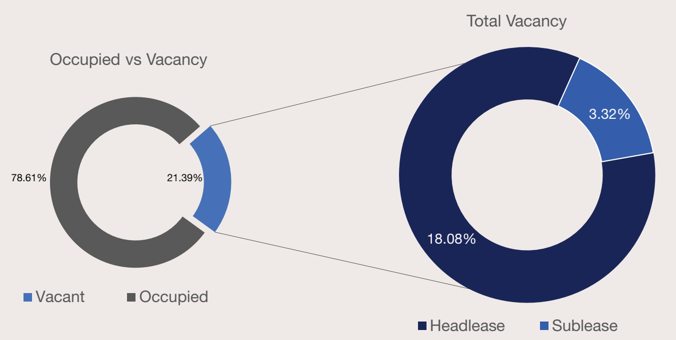
Alberta Supports Centre Renews in One Executive Place

Alberta Supports Centre has renewed their lease on two floors in One Executive Place. Alberta Supports provides social services and programmes for people and families that require assistance around homelessness, financial aid, abuse & family violence protection

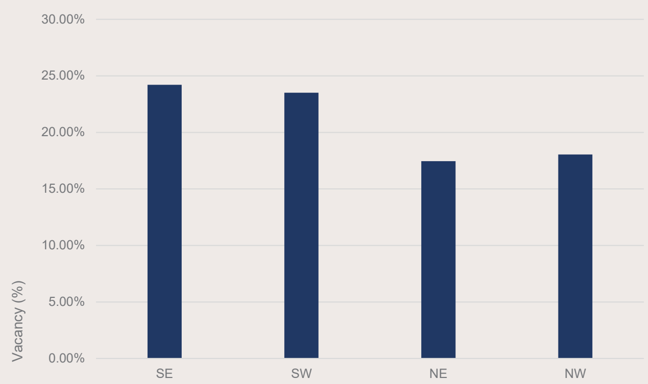
Q2 2021 Vacancy Summary, Suburban Office

QUADRANT	TOTAL INVENTORY	HEADLEASE		SUBLEASE		TOTAL	
	(sf)	(sf)	(%)	(sf)	(%)	(sf)	(%)
SE	8,539,315	1,603,570	18.78%	463,061	5.42%	2,066,631	24.20%
SW	4,971,815	1,076,749	21.66%	92,128	1.85%	1,168,877	23.51%
NE	6,866,684	1,027,529	14.96%	170,682	2.49%	1,198,211	17.45%
NW	2,213,858	375,960	16.98%	23,435	1.06%	399,395	18.04%
Total Suburban	**22,591,672**	**4,083,808**	**18.08%**	**749,306**	**3.32%**	**4,833,114**	**21.39%**

Breakdown of Vacancy: Headlease vs Sublease



Suburban Office Vacancy



Large Blocks of Contiguous Space

New Developments not included

BUILDING NAME	BUILDING ADDRESS	FLOOR	AREA (sf)	LEASE TYPE
2535 - 3 Avenue SE	2535 - 3 Avenue SE	2-8	190,393	Headlease
Sundance West I	15 Sunpark Plaza SE	1-4	171,422	Sublease
3030 Building	3030 - 2 Avenue SE	1-3	110,238	Headlease
Novatel Building	1120 - 68 Avenue NE	1-2	90,133	Headlease
Sundance Place	23 Sunpark Drive SE	1-4	89,323	Headlease
Quarry Crossing, Bldg B	50 Quarry Park Blvd SE	3-4	68,089	Headlease
Airport Corporate Centre	1601 Airport Road NE	4-6	63,507	Headlease
Quarry Park - Jacobs	205 Quarry Park Blvd SE	3	63,335	Sublease
Sundance Plaza	60 Sunpark Plaza SE	1-4	60,022	Headlease
Heritage Square	8500 Macleod Trail SE	4	56,873	Sublease
Riverview Atrium II	6025 - 11 Street SE	2-3	55,960	Headlease
Cardel Building at Quarry Park	180 Quarry Park Blvd SE	2-3	52,964	Headlease
Southland Park II	10333 Southport Road SW	4	50,506	Headlease
Heritage Square	8500 Macleod Trail SE	5	49,907	Sublease
Airstate Centre	1200 - 59 Avenue SE	2	48,397	Headlease

Market Forecast

Suburban Office Market

The energy sector and pandemic recovery, respectively and unsurprisingly, are driving year end forecasts.

Producers remain concerned about the longer-term investment climate as OPEC+ continues to withhold vast surpluses of spare production and the global investment community commitment to ESG is increasingly seen as a strategic business “new norm”. While the Canadian Association of Petroleum Producers projects total capex to increase by 13% over 2020 to $27 billion, this is well off the $35 billion spent in 2019, pre-pandemic.

Short term, through 2021 and into the first half of 2022 though, Canadian producers are generating very healthy profits and the Alberta economy is a beneficiary too, so even a subdued bounce back could generate economic recovery that could stimulate a drop in vacancy rates. Even a marginal slowing of vacancy growth would be a welcome sign accompanying the loosening grip of the pandemic.

One further positive sign though is that major Canadian Banks, including RBC have raised their 2022 average forecasts for WTI to US$72.50. If nothing else, it signifies “short term confidence” that is a good signal to the Alberta economy, and perhaps, Calgary office markets. These bank forecasts signal a thoughtful upgrading of the financial health status of the energy sector, coming back slowly from the depths of both last years devastating destruction of demand and years of struggles with weak pricing, pipeline constraints, an uncertain development environment and a global investment shift towards ESG.

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Anticipated Trends

Base Rental Rates

Declining by between 5 and 10% by year end

Vacancy Rate

Rising to 24% by year end

Sublease Vacancy

Increasing to 800,000 sf by year end

Absorption

Negative 500,000 sf +/- through 2021

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