

Calgary Office

Q4 2018 Point of View



Office Market

cresa

Market Overview



Downtown Supply

43,940,358 SF

Downtown Vacancy

25.06%

Downtown Average Rent

\$36.48/SF

2018 Downtown Absorption

-43,825 SF

Arrows Indicate a One Year Change

Downtown Market

As the dust settles, it is fair to say that 2018 was again a challenging year with respect to office leasing in the downtown core. Though the year witnessed tempered optimism in the second and third quarters, that hope was quickly dashed in the fourth quarter, as sentiment in the energy industry dropped rapidly. According to some, sentiment is at a peak negativity in the energy sector, which says a considerable amount, given what Calgary has been through in the last four years. This negativity is attributable to collapsing oil prices, coupled with pre-existing transportation issues – which created a significant discount for Western Canadian Select crude – and it simply sucked the life out of Alberta's oil economy. Despite climbing gas prices on the NYMEX, AECO differentials hurt Canadian producers and the gas business was unable to help balance oil price deficiencies.

There is not a lot to be said in the fourth quarter that was not said throughout the year. Calgary still has a major vacancy issue and relief will not come until sustainable, believable confidence returns to Calgary. Market equilibrium, which is a 10% vacancy rate, will be nearly impossible to achieve without some or all of the following:





1. Material job creation;
2. Major investment in the energy industry; and
3. Demolition or re-purposing of office supply.

With respect to the job creation, using an average ratio of one employee for every 375 square feet, Calgary requires almost 20,000 jobs to get back to a vacancy rate of 10%. This is a staggering number and to get anywhere close to it, Calgary would need a full, sustainable recovery in order for capital to return to the market, leading to improved confidence, new projects and associated personnel.

Despite moderate-to-high global energy prices through most of the last year, and several building re-developments in the downtown core, vacancy still climbed higher in 2018. Though the city has made some strides recruiting new industries to Calgary - namely within the technology sector - those minor

acquisitions cannot offset the bleeding from the energy industry. With workplace trends pushing more companies to utilize open space, and more employees working from home, it should only get more difficult to absorb vacancy in the downtown core.

Annual and Quarterly Changes from Q3 2018

Absorption (Quarterly):	-330,846 sf	
Change in Vacancy Rate (Qrtly):	0.47%	
Absorption (YTD):	-362,156 sf	
Change in Vacancy Rate (YTD):	0.68%	

AA Class

Headlease vacancy increased by a raw 1%, while sublease vacancy declined marginally. With vacancy at 17.33%, the AA Class remains the most competitive of the classes, albeit with vacancy 7% above equilibrium.

A Class

Headlease vacancy in the A Class increased by nearly 2% – almost 325,000 sf – while sublease vacancy dropped by a over 1% - which was approximately 200,000 sf – and now sits at 5.81%. Total A Class vacancy sits at 25.73%, which is slightly above the general market average.

B Class

The B Class stayed almost completely flat in the fourth quarter of 2018 and continues to be the most vacancy-plagued of the class segments. B Class sublease vacancy, however, remains low at 2.44%.

C Class

The C Class vacancy rate sits a little above the market average at 27.54%, having increased over 3.5% in the last quarter. Anticipate this number to climb as the flight to quality continues.

Market Overview

Beltline and Fringe Markets

The fourth quarter of 2018 was somewhat of a bright spot for the Beltline market when compared to downtown. Vacancy declined by approximately 0.7%, which is about 50,000 sf. The Beltline market outperformed downtown largely due to leasing in the area's higher-end buildings and character buildings segments. Few vacancies over the 4,000 square foot threshold now exist in the Beltline with respect to brick and beam space. With respect to high-end space, very few alternatives exist under 10,000 square feet.

In each of the Kensington, Inglewood, and Mission neighbourhoods, vacancy saw a slight uptick, though not of a noteworthy amount in any of those areas. Kensington and Inglewood continue to experience vacancy rates below the traditional 10% equilibrium, while Mission's vacancy rate is higher at 16.48%. Sublease vacancy in the fringe markets is near-zero, and large vacancies – over 10,000 square feet – are almost non-existent.

Table 1:
Q4 2018 Vacancy Summary

BUILDING CLASS	TOTAL INVENTORY (sf)	HEADLEASE (sf)	(%)	SUBLEASE (sf)	(%)	TOTAL (sf)	TOTAL (%)
Downtown							
AA	16,390,873	1,122,830	6.85%	1,718,041	10.48%	2,840,871	17.33%
A	17,451,204	3,476,696	19.92%	1,013,955	5.81%	4,490,651	25.73%
AA/A	33,842,077	4,599,526	13.59%	2,731,996	8.07%	7,331,522	21.66%
B	7,511,907	2,785,369	37.08%	183,059	2.44%	2,968,428	39.52%
C	2,586,374	612,249	23.67%	100,115	3.87%	712,364	27.54%
Total Downtown	43,940,358	7,997,144	18.20%	3,015,170	6.86%	11,012,314	25.06%
Beltline and Fringe Area							
Beltline	6,780,453	1,066,432	15.73%	512,830	7.56%	1,579,262	23.29%
Kensington	604,702	52,705	8.72%	0	0.00%	52,705	8.72%
Inglewood	461,985	20,516	4.44%	21,199	4.59%	41,715	9.03%
Mission	937,532	135,807	14.49%	6,509	0.69%	142,316	15.18%
Total Beltline & Fringe Area	8,784,672	1,275,460	14.52%	540,538	6.15%	1,815,998	20.67%

Table 2:
Large Blocks of Available Contiguous Space, Downtown Calgary

Buildings	Type	Area (sf)	Building	Type	Area (sf)
The Bow	Sublease	455,210	Brookfield Place Calgary - East	Headlease	184,583
Brookfield Place - East	Sublease	320,869	Gulf Canada Square	Sublease	183,470
Telus Sky	Headlease	278,051	FIRST TOWER	Headlease	177,352
707 Fifth	Headlease	261,066	Hanover Place	Headlease	120,376
Penn West Plaza - East	Sublease	196,539	Lavalin Centre	Headlease	119,366
Stephen Avenue Place	Headlease	189,228	The Edison	Headlease	98,568





The Bow Tower

Market Forecast

It has been over four years since Calgary's energy industry was hammered by plummeting oil prices. After June of 2014, Calgary's downtown core lost tens of thousands of jobs and vacancy started its climb to our current rate of 25.06%. During that time frame, the broader market did not mirror the struggling economy in Calgary; with respect to North American oil prices, WTI rebounded from a low of US\$29.42 to reach US\$74.34, and in both the US and Canada, the stock market experienced the longest run of positive years in its history, with each of the major indices reaching all-time highs. Misery loves company, but it appears this prolonged downturn is now primarily a localized issue, which only adds to the problem.

At the risk of sounding alarmist, after reviewing what has transpired over the past few years, it is difficult to foresee any material recovery for Calgary's downtown office market when looking at the next several years. While we have called for the stabilization of vacancy rates in the past – and are still doing so – we do not anticipate any positive absorption in the near term. While we keep looking for the bottom of the real estate market, it may have yet to be found.

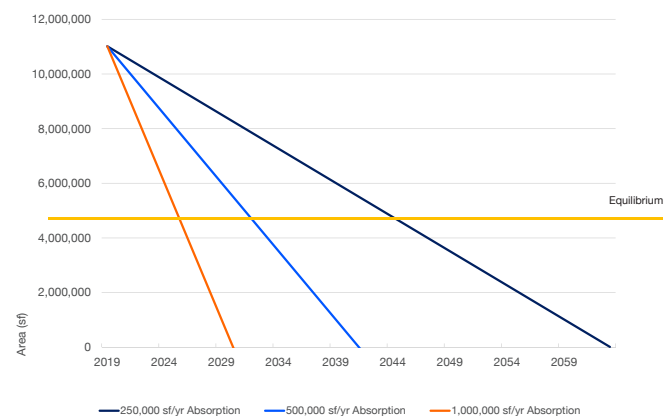
For 2019, we are forecasting the downtown market to experience negative absorption to the tune of 350,000 square feet, which would increase vacancy approximately 0.75%. Though the last inventory adjustment was made in Q4 of 2018, as Telus Sky was delivered to market, we still foresee further bleeding within the downtown core. Between active merger and acquisition activity, financial failures, and anticipated pockets of ghost space, we have line of sight to nearly 250,000 square feet reaching the market. Given general market sentiment and the likelihood of further energy industry consolidation this year, we anticipate vacancy will be higher come the end of 2019 than today. The next question to answer: will we find the bottom in 2019? Or, whether due to commodity prices, political shifts, pipeline announcements, or other macroeconomic events, will the current environment change again during the upcoming year?

Given our short and long-term forecasts, it is certain we will remain in a tenant's market for the foreseeable future. However, what foreseeable means is a relative term. The graph

below [Figure 1.0] illustrates how many years it would take to return to 10% vacancy given differing levels of absorption.

It is worth noting that Calgary never absorbs space in a linear fashion – it is either very good or very bad. We have seen years of both positive and negative absorption in Calgary, ranging from 1,000,000 – 3,000,000 square feet within the last decade. For example, between 2010 and 2012, there was over 6.5 million square feet of positive absorption. On the other hand, between 2013 and 2016, there was over 6.4 million square feet of negative absorption. Let us hope that the next major year of absorption is due to a bull market, because if the bear continues its current reign, the recovery timelines will defer until such time it hibernates.

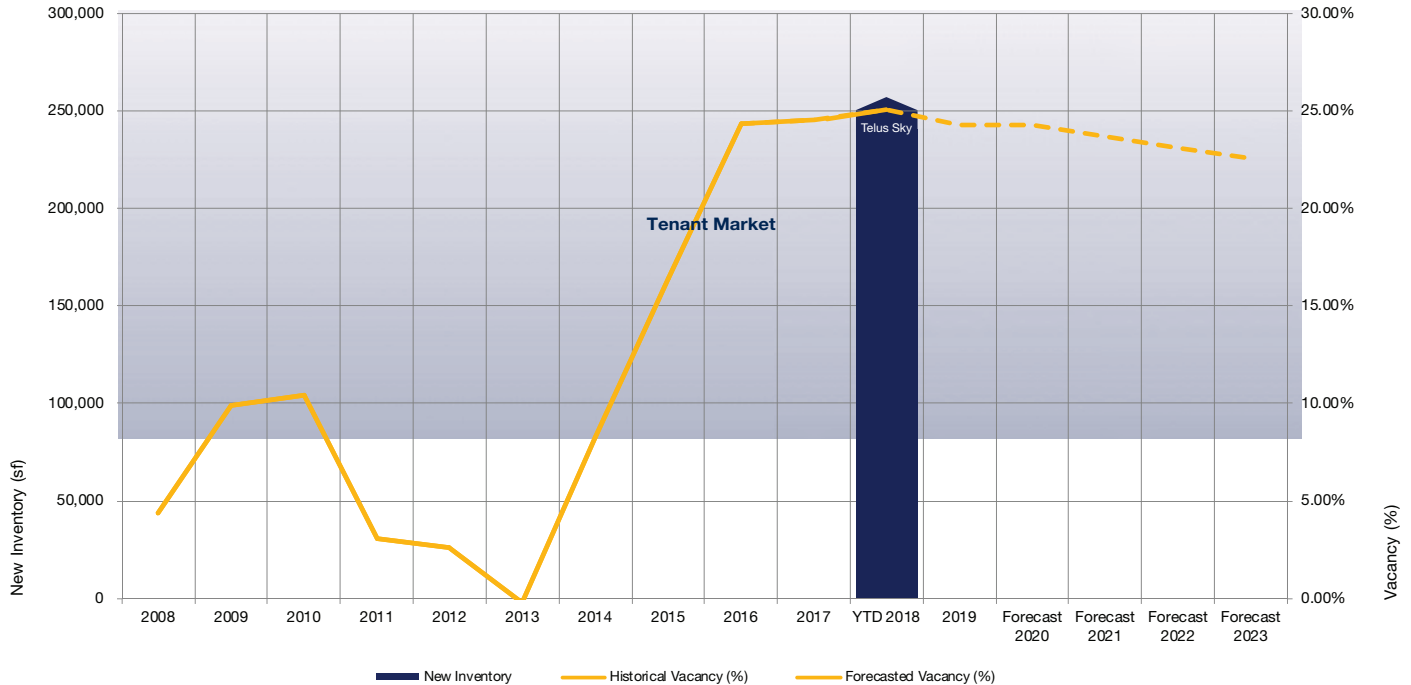
Graph 1:
Absorption Scenarios: Time to Equilibrium



Tenants will continue to hold the upper hand when negotiating new leases but need to be aware of where the opportunity lies within the market, as certain assets are occupied while others are crippled with vacancy. The majority of landlords will need to continue to find new, creative ways to court tenants into their buildings. Barring a major economic shift, our current state feels like it will be the “new normal”.

Market Forecast

**Graph 2:
Forecasted Vacancy**



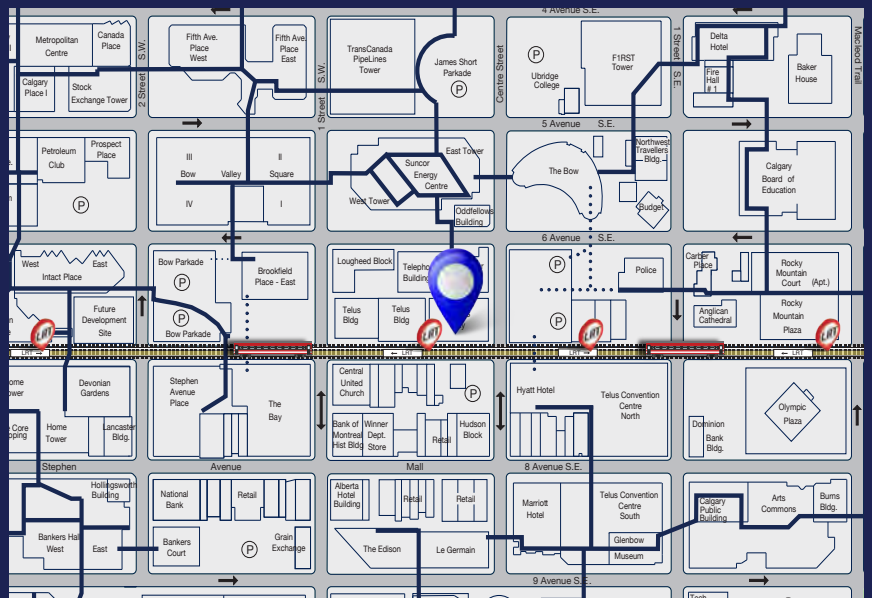
Addition to Inventory: TELUS Sky

430,000 sf
Total sf

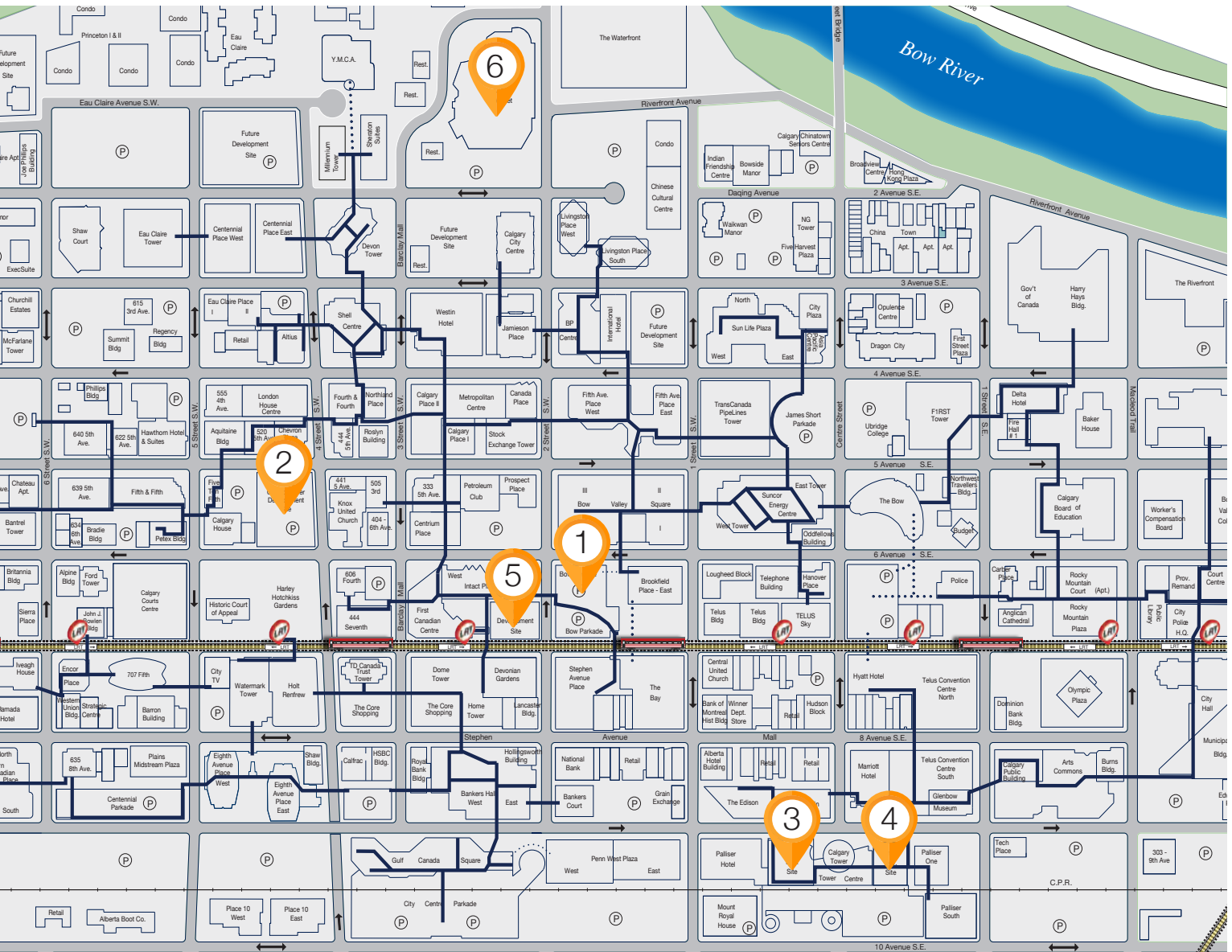
Headlease
Currently Available
264,000 sf

Features and Amenities

World-class fitness and wellness centre
Constructed to LEED Platinum standards
Atrium featuring a green wall & cafe/wine bar
Secured bike parking, showers & lockers
Direct access to Plus 15 and CTrain



Development Pipeline - Downtown

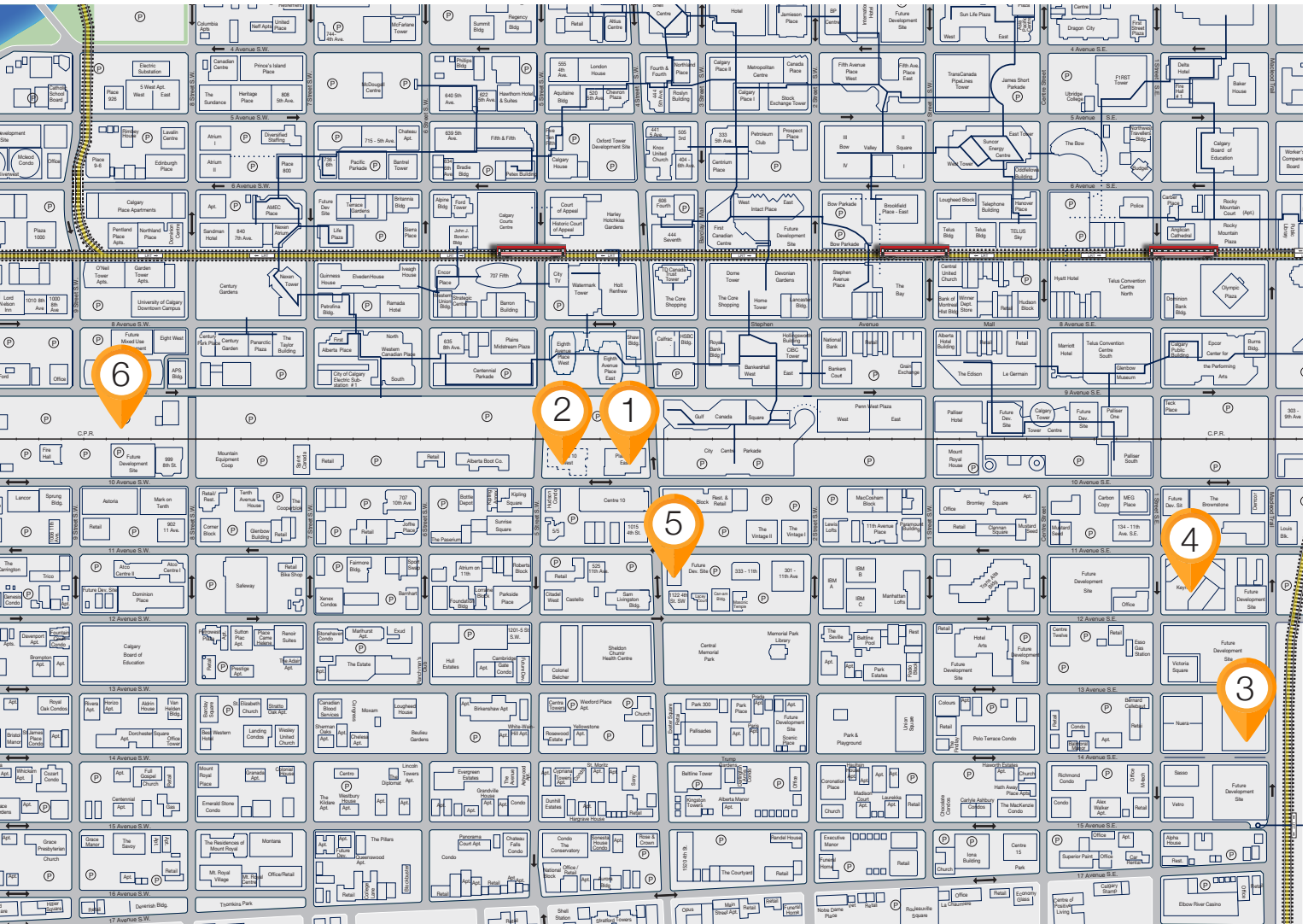


Anticipated Completion

● Pending

Development	Landlord	Size (sf)	Avg Floor Plate (sf)
1 Brookfield Place Calgary - West	Brookfield Properties	1,000,000	27,500
2 Oxford Tower	Oxford Properties	1,200,000	26,000
3 Palliser West	Aspen Properties	620,000	23,500
4 Palliser East	Aspen Properties	620,000	23,500
5 First Canadian Centre - East	GWL Realty Advisors	698,000	27,400
6 Eau Claire Redevelopment	Harvard Developments	555,000	13,800

Development Pipeline - Downtown



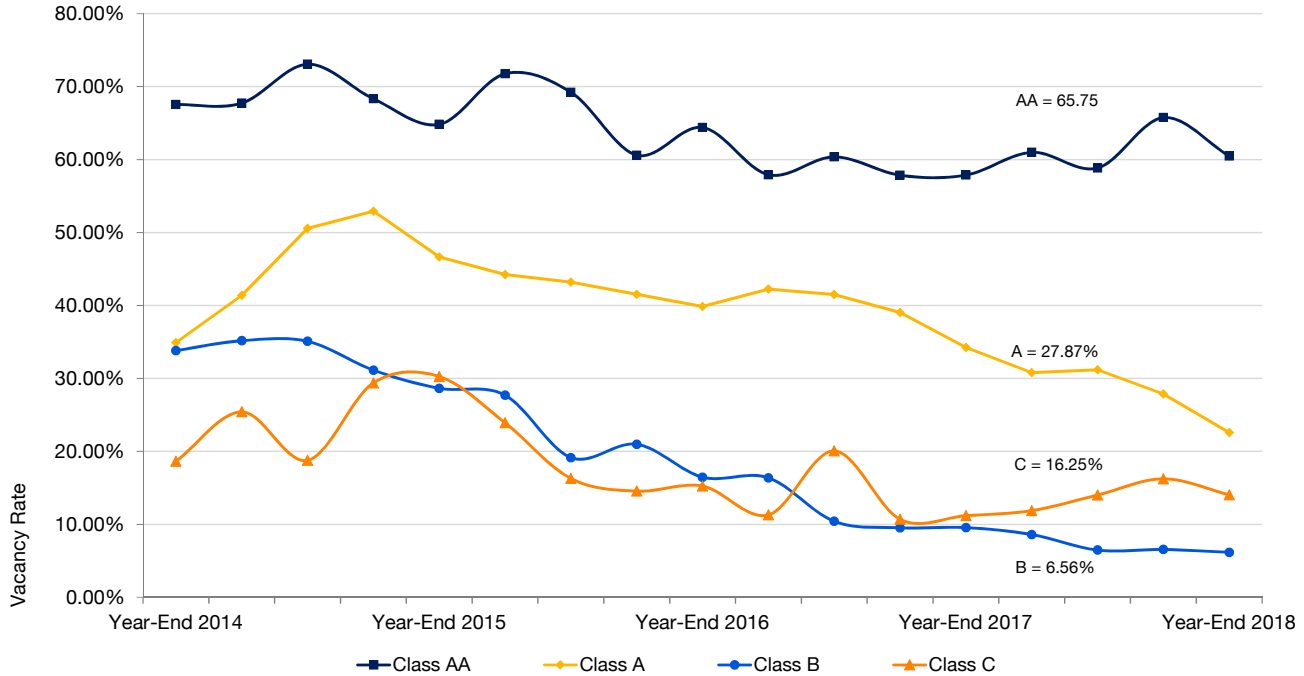
Anticipated Completion

● Pending

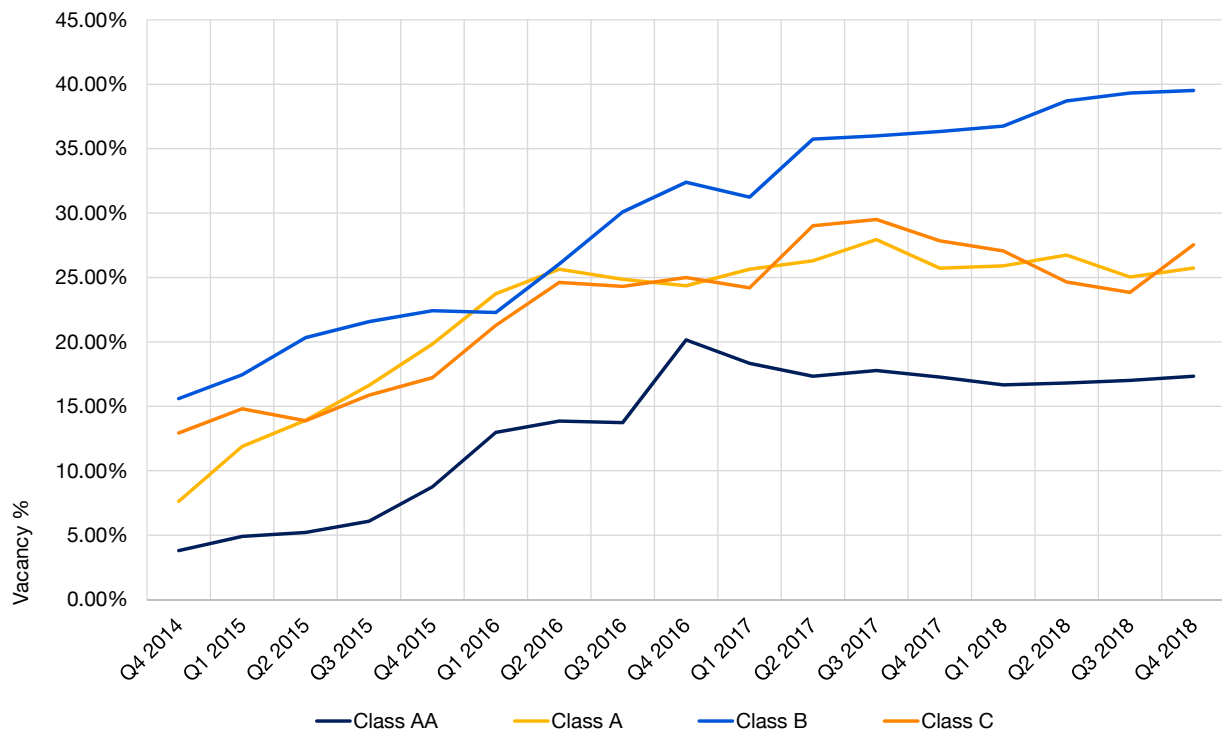
Development	Landlord	Size (sf)	Avg Floor Plate (sf)
1 Place 10 - East	Centron Developments	316,500	24,850
2 Place 10 - West	Centron Developments	300,000	23,350
3 Stampede Station, Phase II	Artis REIT	315,400	22,600
4 Keynote 4	Triovest Realty	340,000	20,900
5 1108 - 4 Street SW	Genco Developments	186,600	15,400
6 999, Phase II	Triovest Realty	224,000	16,800

Downtown Office By the Numbers

Graph 3 :
Sublease Vacancy Index

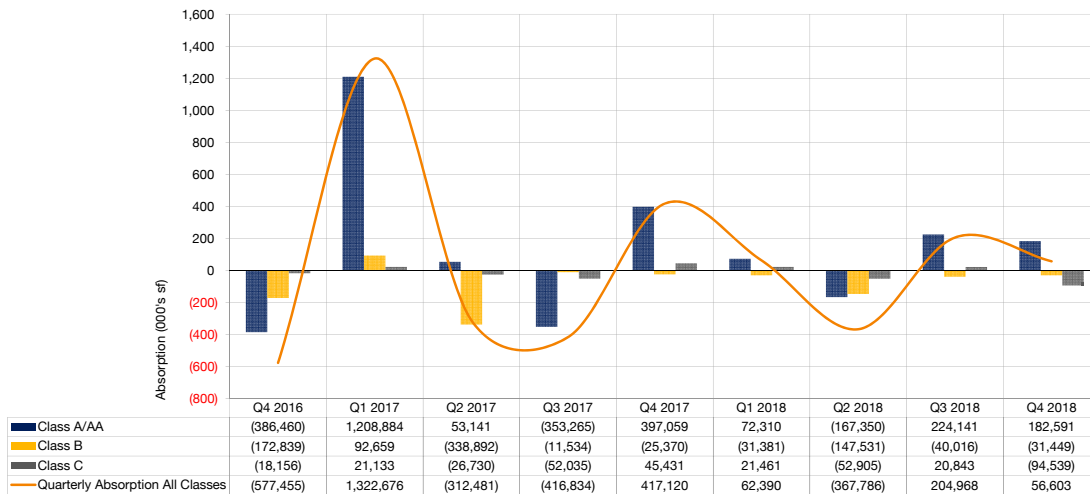


Graph 4 :
Comparative Vacancy

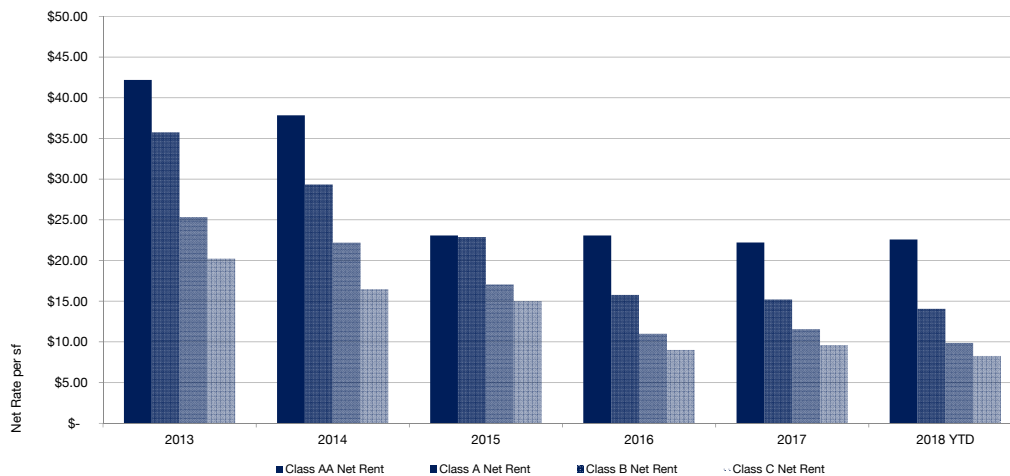


Downtown Office By the Numbers

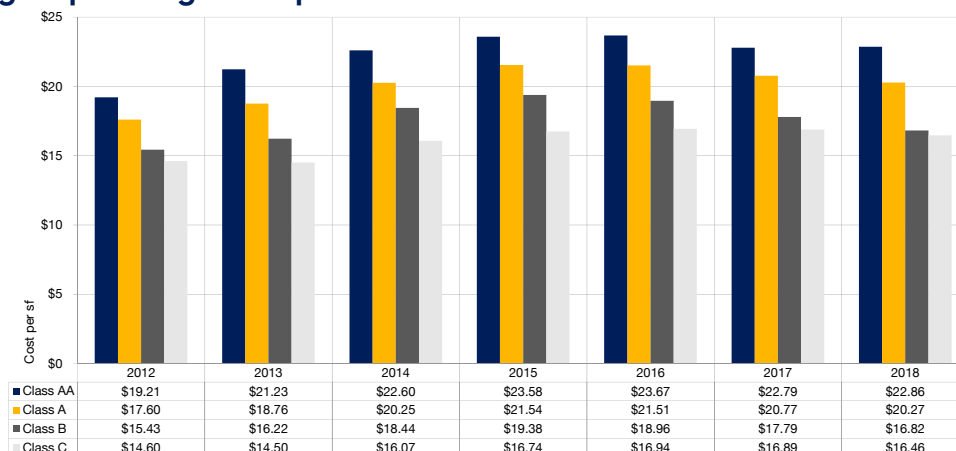
Graph 4:
Historical Downtown Office Absorption



Graph 5:
Average Headlease Net Rental Rates per sf, All Classes



Graph 6:
Average Operating Costs per sf



About Cresa

Cresa is the world's largest commercial real estate advisory firm that exclusively represents occupiers and specializes in the delivery of fully integrated real estate solutions. Delivered across every industry, its services include Consulting, Facilities Management, Global Portfolio Solutions, Investment Banking, Lease Administration, Location Strategy & Economic Development Incentives, Project Management, Transaction Management and Workplace Intelligence. With over 1000 employees in more than 80 offices globally, Cresa partners with occupiers everywhere. For more information, please visit cresa.ca

Contact

For more information about Cresa and the Calgary Market, please contact:

Cresa Calgary
606 Fourth Street SW
Calgary, AB T2P 1T1
403.571.8080
cresa.ca

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