Year-End 2020 Point of View

Suburban Office Market

An Insight into the Calgary Suburban Office Market

cresa

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Suburban Office Market

…as we have all experienced and now understand only too well, 2020 was no "normal" year and there was "no" recovery.

Calgary suburban office markets entered 2020 hoping for a fresh start to brighten the leasing malaise that has been resoundingly negative since 2015. The approval of the Trans Mountain Pipeline, followed by the announcement of a massive investment by the Alberta government in Keystone XL and a roughly 4% decrease in suburban office property taxes, would in a "normal" year, fuel that optimism and perhaps emerge as catalysts to a mild recovery. However, as we have all experienced and now understand only too well, 2020 was no "normal" year and there was "no" recovery.

2020 started with the unsettling news of the receivership of nearly 20 suburban office properties affecting over 1 million square feet of office space in January and nearly $200 million in mortgages. As significant as that was, it was all but forgotten by the end of Q1 as the crushing impact of the first wave of Covid-19 began to be felt. By the middle of Q3, Calgary, like the rest of the country, began experiencing the effects of the 2nd COVID-19 wave and by year end, both downtown and suburban office markets were feeling those effects and truth be told, there were no leading

indicators that would suggest 2021 will be a year of recovery for suburban leasing markets.

The 2020 year ended with Suburban vacancy at a historic high of 20.8%, achieved basic rent rates at all-time historic lows, and a forecast potential of a further 500,000 + sf of vacant space to be added during 2021. While the receiverships and Covid-19 are not the only causes of the current suburban market conditions they were certainly additive to the already existing pain caused by an energy commodity price collapse, accompanying global oil demand destruction, and an exodus of capital investment that had been trending for several years. The cumulative effect of these events on the energy sector has wreaked havoc on what has been the historical foundation of Calgary's office markets. Companies directly or indirectly related to the energy sector have been forced to lay off workers, shrink leasing footprints by letting leases expire, return space to the market for sublease and/or leasing much smaller premises. This includes upstream producers, engineering firms and related service firms. From a "Tenant Perspective" the market conditions are increasingly favorable for those in position to capitalize on them. Cresa forecasts continued basic rental rate erosion and increased vacancy reaching 23% through 2021 in the suburban markets.

Suburban Office Leasing - Four Factors to Watch

The Downtown Market

Suburban office leasing is often significantly and directly affected by leasing conditions within the downtown core so a basic understanding of the conditions in the core helps to understand activity in the suburbs. Currently these conditions include record high vacancy (nearly 30%), sustained negative absorption (-1.34 MSF Q2-Q4 2020), historic low rental rates (single digit basic rent rates for A class head lease space) and aggressive leasing inducements (allowances, free rent, fixturing) being offered

Suburban Supply

22,526,704 sf

Suburban Vacancy

20.78%

Overall Suburban Vacancy

4,603,722 sf

Q4 2020 Suburban Absorption

-76,513 sf

335 - 25 Street SE

Northern RNA completes deal at former CalFrac Building

Northern RNA, a bioscience research and manufacturing company, recently leased 335 - 25 Street SE in its' entirety or approximately 23,000 sf. The building, formerly occupied by CalFrac Well Services, is located just north of Memorial Drive and is also currently on the market for sale.

in an environment of weak demand. Consequently, there is an abundance of opportunity in the downtown core with extremely attractive economics attached. Prudent major suburban tenants are considering the CBD in their office space planning as the economics, leasing conditions and incentives in the downtown core attract that consideration. Downtown conditions thus will have a knock-on effect in the suburbs, as suburban landlords react and determine the extent to which they feel compelled to compete to attract and retain quality tenants.

The Energy Sector

Like it or not, the reality is that the Canadian Energy Sector drives Calgary's economy and imparts the most significant impact on office markets. While the impacts are predominantly felt downtown, the effects spill into the suburbs where there is a substantial engineering and service industry presence. With depressed conditions, featuring collapsed commodity pricing and lowered global fossil fuel demand, consolidation is taking place and companies with strong balance sheets are acquiring firms and assets at incredible values to complement their operations. Examples this past year, headlined by the Cenovus acquisition of Husky, also include major companies such as CONA, Tourmaline, Spartan Delta, Longshore, Conoco Phillips, Whitecap and CNRL, all making significant corporate acquisitions. When acquisitions take place, many redundancies occur within an organization creating a need to cull the workforce, increasing unemployment, and resulting in space being returned to the market as sublease space. With more m & a to come, Cresa forecasts a half million square feet will be returned to the suburban market in 2021. As energy sector companies continue to focus on debt reduction and asset optimization, the days of unbridled exploration growth and expansion are over and so are the office occupancy growth expectations that historically accompanied that expansion.

Energy Policy

Shifting energy policies have created uncertainty within the energy sector and have had a crippling effect on industry and the economy. Pipeline and other transportation policies affecting tanker transport have created barriers to getting Canadian fuel to overseas markets. This has hurt producers and mid-stream companies alike. The uncertainty in conducting business has led to the loss of tens of billions of dollars of investment that has fled the energy sector in Canada to operate in other jurisdictions where regulatory and operational conditions are more favorable. This translates directly to rising vacancy rates.

The COVID-19 Effect

Covid-19 has had a dramatic effect on all office markets, as work from home practices, government mandated shutdowns and health and wellness concerns wreak havoc on occupancy. Data suggests that the "Work from Home" trend decreases the need for some firms to remain downtown. Furthermore, from a Health and Wellness standpoint, multi floor stacked tenants in the CBD may begin to look to the more spacious/less densified options available in suburban campus markets as a home for offices. Significant transactions of this nature have not yet occurred in Calgary's suburban marketplace yet, but this trend has already been seen in other North American suburban markets, so it bears watching closely. Transit, specifically mass transit, may also play a role in an unintended way, impacting the leasing relationship between CBD/Suburban markets. Major occupiers of city CBD's that rely heavily on public transportation to get their staff to and from the corporate workplace, will be slowed by cautious attitudes toward returning to offices. It is possible that a satellite office for a subset of workers may be an ideal scenario for some companies, depending on their situation and location. The ability to work from home part-time also minimizes the commute time to and from the urban core, minimizes the

Notable NE Lease Transaction: 2716 Sunridge Way NE

Miskanawah Community Services Association leased 26,233 sf in 2716 Sunridge Way NE. The transaction was completed at $12-$15 per sf, as-is for a 5-year term.

The Association offers support to strengthen cultural identity for Indigenous people in the greater Calgary community.

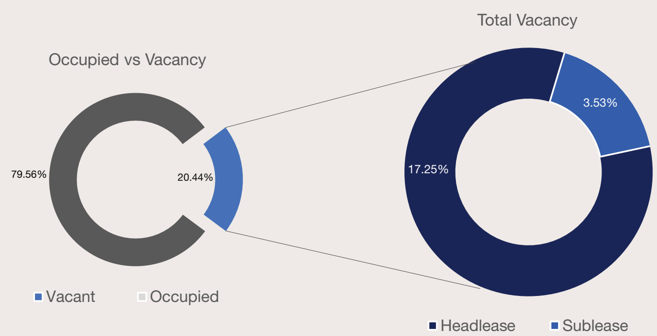
cost of parking, (if employees drive), and further reduces or eliminates the risk of transmission by taking transit.

The impact of the COVID 19 crisis continues to be highly uneven across firms and workers. Recovery in hard hit sectors including accommodation, food processing and services, and travel, continues to lag and workers face elevated levels of unemployment. Recovery is highly conditional on many factors including the unknown course of the virus and the measures needed to contain it such as extensive lockdown measures and widespread closures, behavior and adherence to health orders, the time frame in which vaccinations are fully administered and, finally, the extent of continued government support and stimulation. Economic and office leasing recovery from the uncertainty surrounding Covid-19, will lag health recovery. Consequently, the future, long-term impacts remain relatively unknown. Certainly, near term optimism reins as various vaccine candidates are approved and rolled out, locally, provincially, and beyond. However, unevenness in vaccination progress and supply turbulence in the rollout is expected to continue for months before sustained recovery in health outcomes is achieved.

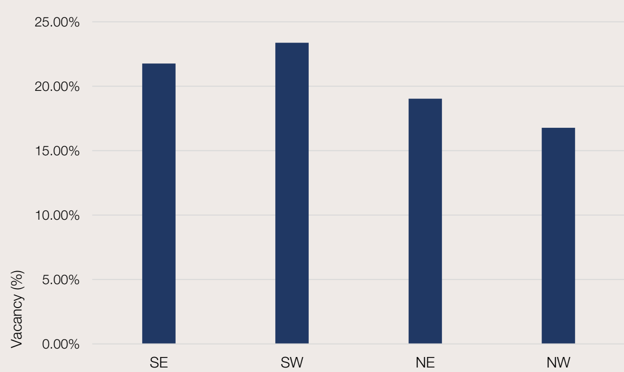
Year-End 2020 Vacancy Summary, Suburban Office

QUADRANT	TOTAL INVENTORY	HEADLEASE		SUBLEASE		TOTAL	
	(sf)	(sf)	(%)	(sf)	(%)	(sf)	(%)
SE	8,592,758	1,354,327	15.76%	494,092	5.75%	1,848,419	21.51%
SW	4,802,153	1,021,276	21.27%	92,128	1.92%	1,113,404	23.19%
NE	6,866,684	1,080,020	15.73%	159,154	2.32%	1,239,174	18.05%
NW	2,265,109	375,242	16.57%	27,483	1.21%	402,725	17.78%
Total Suburban	**22,526,704**	**3,830,865**	**17.01%**	**772,857**	**3.43%**	**4,603,722**	**20.44%**

Breakdown of Vacancy: Headlease vs Sublease



Suburban Office Vacancy



Large Blocks of Contiguous Space

BUILDING NAME	CLASS	FLOOR	AREA (sf)	LEASE TYPE
Sundance West I	A	1-4	154,922	Sublease
Telus Mobility Centre	A	1-3	110,238	Headlease
2535 - 3 Avenue SE	A	1-5	109,765	Headlease
Sundance Place	A	1-4	103,684	Headlease
Stantec Building, Quarry Park	A	1-3	97,926	Sublease
Novatel Building	A	1-2	90,133	Headlease
Quarry Crossing, Bldg B	A	3-4	68,089	Headlease
Enform Building	A	LL-3	64,100	Headlease
Sundance Plaza	A	1-4	60,022	Headlease

Market Forecast

Suburban Office Market

Anticipated Trends

Base Rental Rates

Declining by between 5 and 10% by year end

Vacancy Rate

Rising to 23% by year end

Occupancy Rate

Declining to 77% by year end

Absorption

Negative 500,000 sf +/- through 2021

"At best", by year end, office Markets may reflect a bottoming out of basic rent rates and vacancy rate, potentially setting the stage to move gingerly from a recessionary market phase to the early stages of a very mild recovery phase by mid-2022 and into 2023.

The effect of Covid-19 layered on top of conditions in the Downtown office market, the Energy Sector and uncertain Economic Policy, create a rather dim prognosis for recovery any time soon. In this environment, it is difficult to forecast any meaningful sustained economic impacts to be felt in Calgary's suburban office leasing markets in 2021.

The proof of that recovery phase (when it begins to take hold) will be seen in increased occupancy rates, steady take up of sublease space and perhaps resumption of construction projects that had been strategically stopped previously. Given that construction of the single largest infrastructure project in Calgary's history, the Green Line LRT is also now officially on "pause", the likelihood of other than "one-off" construction office starts through the 2021 year is next to none. This is not particularly inspiring when considering that overall building permit value in Calgary was down by 21.9% in 2020 versus 2019, (-$1.2 billion).

Calgary Suburban Notable Transactions

Tenant	Building	Area (sf)	Type
Shaw Communications	Hopewell Place 2728 Hopewell Place NE	128,544 sf	Headlease
Miskanawah Community Services Association	2716 Sunridge Way NE	26,333 sf	Headlease
Northern RNA	335 - 25 Street SE	22,714 sf	Headlease
Servus Equipment	Harvest Hills Office Park 333 - 96 Avenue NE	22,713 sf	Sublease
3D-P	Zurich Court 1565 - 27 Avenue NE	21,129 sf	Headlease
Genesis Land	Harvest Hills Office Park 333 - 96 Avenue NE	17,894 sf	Sublease
Klohn Crippen Berger	Hopewell Corporate Centre 2618 Hopewell Place NE	14,840 sf	Headlease

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