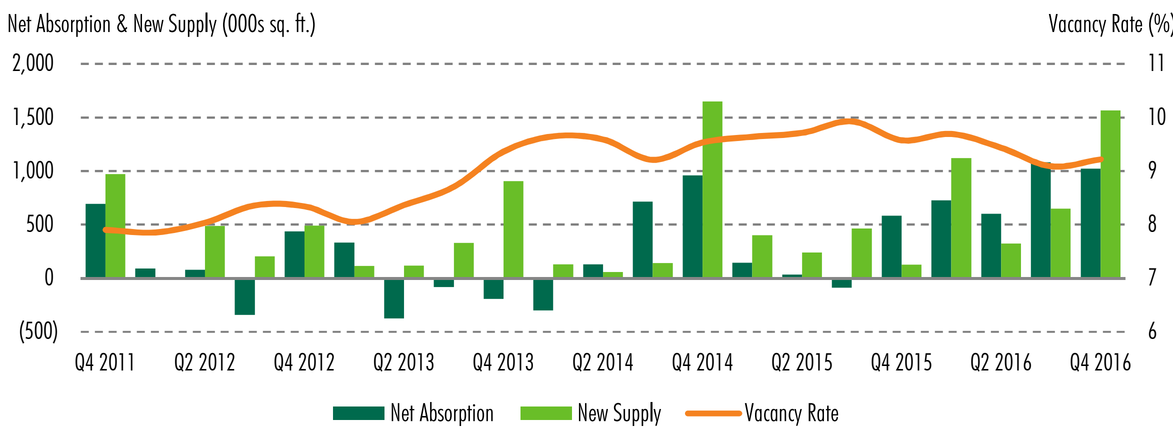
Toronto Office MarketView, Q4 2016

2016 market conditions signal need for next development cycle in Downtown Toronto

Vacancy Rate	Asking Net Rental Rate	Net Absorption	New Supply
9.2%	$17.53 PSF	1,020,693 SF	1,563,358 SF

*Arrows indicate change from previous quarter.

Figure 1: GTA Office Market Fundamentals – All Classes



Source: CBRE Research, Q4 2016.

- Demand for office space in Downtown Toronto continues to outpace new supply, resulting in particularly tight market conditions.
- These market conditions are expected to continue for the next several years, with no significant office developments currently under construction other than the forthcoming completion of EY Tower which is 87% leased in April 2017.
- Large occupiers currently in the market for office space are finding themselves with limited alternatives and are having to lease space in a competitive environment.
- Given these market conditions, we expect that 2017 will spur the next development cycle.
- Toronto's Midtown and Suburban market conditions weakened in the fourth quarter.

Office conditions in the GTA ended 2016 with signs of market bifurcation. While suburban markets showed year-over-year stability, fourth quarter results were negatively impacted by vacancies in new supply that were mainly built on spec. In contrast, the office market in Downtown Toronto completed a year that saw conditions tighten further. With enormous demand from non-traditional sectors, the Downtown Toronto vacancy rate is the lowest rate seen in 10 years, and yet its pipeline of office developments currently under construction will be all but complete by Q2 2017.

The last time that Downtown Toronto vacancy rates were this low, both in Q2 2008 (4.2%) and in Q1 2013 (4.4%), there were 3.8 million and 5.6 million sq. ft. of office space under construction, respectively, in the core.

Throughout the latest development cycle, from 2014 – 2017, over 5.5 million sq. ft. of new office space was added to the Downtown Toronto market. This cycle will come to a close in April 2017 with the forthcoming completion of the 900,000 sq. ft. EY Tower by Oxford. Following this, no other large scale office developments are currently in the ground in Downtown Toronto. Even the King-Portland Centre by Allied REIT has already achieved a current preleasing status of 75% with the recent announcement that Indigo Books & Music Inc. has leased 79,000 sq. ft. This development will not be completed until 2019, and will only provide an additional 250,000 sq. ft. of office inventory to Downtown Toronto.

This tightness in the market has left large occupiers currently in the market for space in a precarious situation, as there are a lack of suitable options. For growing occupiers in particular, this means either having to choose between leasing space that does not fully meet their expectations, densifying, or relocating to other submarkets.

Resulting from this strong tenant demand and constrained supply, we can expect 2017 to spur the next development cycle. Further, while business service firms such as Deloitte and EY anchored previous developments, we expect that finance, insurance and real estate ('FIRE') firms will play a more significant role in triggering the forthcoming development kick offs.

In contrast to Downtown Toronto, Toronto's Midtown and Suburban markets did not fare as well in the final three months. These markets saw negative net absorptions of 77,152 and 152,070 sq. ft., respectively in Q4. In spite of a weak fourth quarter, both markets closed out the year with positive net absorptions and lower year-over-year vacancy rates.

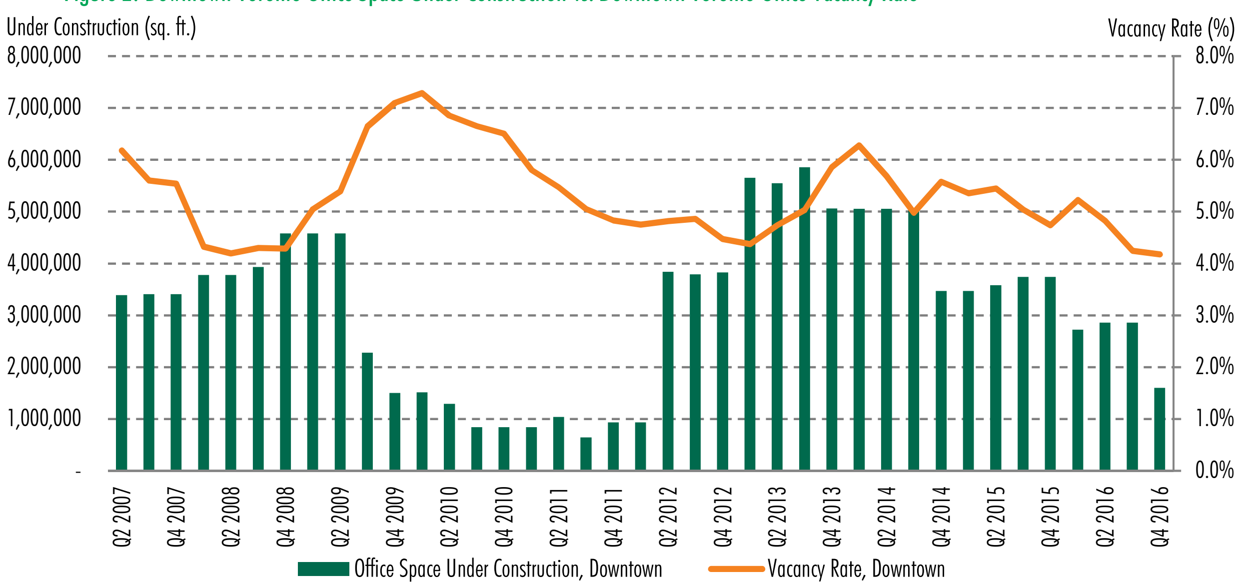
TORONTO OFFICE INVESTMENT SUMMARY

In 2016, Toronto's office investment market performance paralleled its leasing market conditions. Of the $3.3 billion of office assets that transacted in the GTA, Downtown Toronto accounted for a 63% share of this amount.

Remarkable cap rate declines year-over-year were realized in every office category, coinciding with downtown vacancy rate trends. Yields for Downtown Toronto A-class assets settled at a market low of 4.38%, while the sharpest year-over-year cap rate declines were seen in Downtown-B assets. These compressed by -100 bps compared to the prior year, reaching cap rates of 5.25%.

This trend is expected to continue as a mix of institutions, pension funds, as well as foreign investors continue to vie for limited available assets.

Figure 2: Downtown Toronto Office Space Under Construction vs. Downtown Toronto Office Vacancy Rate



Source: CBRE Research, Q4 2016.

Figure 3: Downtown Toronto New Office Developments

1 **BAY ADELAIDE CENTRE EAST**
Brookfield Properties
1,018,000 sq. ft.
Q1 2016

2 **ONE YORK ST**
HOOPP, Menkes Developments
794,358 sq. ft.
Q4 2016

3 **GLOBE AND MAIL CENTRE**
First Gulf
462,000 sq. ft.
Q4 2016

4 **20 WELLINGTON ST E**
Concert Properties
43,425 sq. ft.
Q2 2017

5 **DANIELS WATERFRONT**
Daniels Capital
398,000 sq. ft.
Q2 2017

6 **EY TOWER**
Oxford Properties
905,720 sq. ft.
Q2 2017

7 **KING PORTLAND CENTRE**
Allied Properties REIT & RioCan REIT
253,865 sq. ft.
Q1 2019

8 **16 YORK ST**
Cadillac Fairview
800,000 sq. ft.

9 **160 FRONT ST W**
Cadillac Fairview
1,280,000 sq. ft.

10 **25 ONTARIO ST**
First Gulf
360,000 sq. ft.

11 **30 BAY ST**
Oxford Properties, CPPIB, Toronto Port Authority
1,000,000 sq. ft.

12 **ATRIUM ON BAY EXPANSION**
H&R REIT
295,000 sq. ft.

13 **BAY ADELAIDE NORTH**
Brookfield Office Properties
500,000 sq. ft.

14 **BAY PARK CENTRE I**
Ivanhoe Cambridge
1,500,000 sq. ft.

15 **BAY PARK CENTRE II**
Ivanhoe Cambridge
1,500,000 sq. ft.

16 **QUEENS QUAY PLACE**
Hines
400,000 sq. ft.

17 **THE WELL**
Allied Properties REIT, RioCan REIT, Diamondcorp
1,058,000 sq. ft.

18 **UNION CENTRE**
Allied Properties REIT
1,070,000 sq. ft.

19 **LCBO TOWER**
Menkes Developments
600,000 sq. ft.

20 **WATERFRONT INNOVATION CENTRE**
Menkes Developments
400,000 sq. ft.

Development Categories	Inventory	Leasing Status
2016 Completions	2,274,358 sq. ft.	Preleased at Completion: 83.6% Currently Leased: 91.2%
Currently Under Construction	1,601,010 sq. ft.	Currently Preleased: 80.4%
Potential Development Sites*	10,763,000 sq. ft.	-

*Note that the above Potential Development Sites are the developments considered most likely to kick off in the near future. Further Downtown Toronto development proposals exist and have not been included in the above list.

Source: CBRE Research, Q4 2016.

DOWNTOWN

In 2016, the Downtown Toronto office market saw 2.65 million sq. ft. of positive net absorption. This was the combined result of the completions of Bay Adelaide Centre East, the Globe and Mail Centre and One York, and strong tenant demand for space in the Downtown core.

As of Q4 2016, the Downtown Toronto's office market vacancy rate was 4.2%: this is the market's lowest vacancy rate in recorded history, and the lowest downtown vacancy rate in North America. With limited developments currently under construction, potential tenants risk being faced with a lack of suitable options in the coming quarters.

In the fourth quarter of 2016, significant transactions over 100,000 sq. ft. included the Department of Justice's direct lease at 120 Adelaide St W and Aird & Berlis LLP's renewal at 181 Bay St.

MIDTOWN

Despite negative net absorption of 77,152 sq. ft. in the fourth quarter, the Midtown market's overall vacancy rate closed at 5.8% as of Q4 2016, 120 basis points below the market's 10-year average of 7.0%. The Midtown year-to-date net absorption was 192,229 sq. ft.

Of the 828,474 sq. ft. of current availabilities, sublet availabilities accounted for 25% of these availabilities by sq. ft. Notable larger sublets include TD Bank's 38,000 sq. ft. sublease at 77 Bloor St W and World Wildlife Fund Canada's 16,000 sq. ft. sublease at 245 Eglinton Ave E.

While the net effect of tenant relocations has been from Midtown to the Downtown Core, overall tenant demand has outpaced these relocations and driven up the average net asking rental rates from $18.85 p.s.f. seen in 2015 to $19.74 p.s.f. as of Q4 2016.

We anticipate this market to be more active as a result of the tightening market conditions in the Downtown Core and the Downtown North submarket.

FINANCIAL CORE

The vacancy rate in the Financial Core rose from 5.5% to 5.8% quarter-over-quarter in Q4 2016. This increase is the result of space vacated by tenants moving into new buildings coming onto the market.

While we expect the vacancy rate to trend upwards in the coming months as future availabilities continue to become current availabilities, the Financial Core and Toronto Downtown market conditions are very tight. Other than EY Tower which is due for completion in April 2017, no significant further office developments are currently under construction.

Given these market conditions, we expect that both net asking rental rates and achieved net effective rates will continue to increase in this submarket.

DOWNTOWN NORTH

Strong demand for space by the healthcare and government industries in the Downtown North submarket has steadily driven down the 8.5% vacancy rate that was seen in 2013. As of Q4 2016, the submarket boasts the second lowest overall vacancy rate in the GTA at just 2.2%.

Consistent with last quarter, there are no blocks of contiguous space greater than 30,000 sq. ft. With 661 University Ave (MaRS Phase II) now fully leased and no significant large block availabilities, tenants looking for space will find this market to be tight.

Given this tightness, we expect that net rental rates will continue to increase in this submarket, and foresee an increased likelihood that the Atrium on Bay expansion (295,000 sq. ft.) will kick off.

SUBURBAN

For the previous 5 consecutive years, the suburban market's overall vacancy rate has risen year-over-year from 11.1% in 2011 to 14.7% in 2015. This year, the vacancy rate held steady at 14.7% with marginal fluctuations around this range over the course of the year.

In 2016, the suburban market also experienced the highest delivery of new supply to the market since 2007: nearly 1.3 million sq. ft. of new office developments were completed this year.

These trends, coupled with a lack of supply in the Downtown Toronto market, point to improving market conditions in Toronto's suburbs.

TORONTO EAST

For three consecutive quarters the vacancy rate decreased, currently at 11.5%, the lowest rate since Q1 2013. The Markham South market saw the largest decrease, reaching a low of 6.9% in Q4 2016, largely based on a single transaction with GM Canada.

While net rental rates remained stable throughout 2016, taxes and operating costs increased each quarter. In Q4 2016, taxes and operating costs averaged over $15.00 per sq. ft.

A lack of large available blocks of office space in the East market may encourage developers to consider building on speculative development.

TORONTO WEST

In the fourth quarter, the Toronto West market experienced 180,000 sq. ft. of negative net absorption which wiped out the year-to-date positive net absorption the market had seen as of the third quarter. Net absorption for 2016 was a near-zero 1,059 sq. ft.

Two significant new office developments were delivered this quarter in the Oakville and Mississauga markets. First Gulf's 610 Chartwell Rd development (102,000 sq. ft.) was delivered 70% preleased, contrasting Carttera's 2727 Meadowpine Blvd development (150,000 sq. ft.) which was delivered with no preleasing. Both developments were built on spec.

Apart from Spectrum Square Phase II which is scheduled to begin construction in Q2 2017, there are no significant developments on the horizon.

TORONTO NORTH

Net absorption was close to a negative 115,000 sq. ft. in Q4 2016, which increased the overall vacancy rate to 9.0%, the highest rate since 2006. The North Yonge Corridor node has experienced negative absorption of 150,000 sq. ft. over the last two quarters.

With the increase in vacancy rate, the gross rental rate has decreased by almost $1.00 per sq. ft. to $37.86 in Q4 2016. Both Vaughan and North York West rental rates saw the majority of decline while the North Yonge Corridor had only a slight decrease.

The Vaughan market is experiencing increased leasing activity with the expected completion of the TTC extension in 2017. Positive absorption and new development projects are expected in early 2017.

Figure 4: Q4 2016 Office Market Statistics

Submarket	Inventory (SF)	Vacancy Rate (%)	Sublease as % of Vacant (%)	Q4 Net Absorption (SF)	YTD Net Absorption (SF)	Q4 New Supply (SF)	Under Construction (SF)	Net Rent ($/SF)
CENTRAL	85,625,773	4.4	22.4	1,172,763	2,841,176	1,256,358	1,601,010	24.85
Downtown	71,281,736	4.2	21.7	1,249,915	2,648,947	1,256,358	1,601,010	26.53
Financial Core	25,728,303	5.8	21.8	(89,287)	819,234	-	905,720	30.68
Greater Core	19,449,473	2.7	41.0	(33,455)	108,814	-	43,425	23.64
Downtown South	6,213,648	1.9	41.5	847,329	784,951	794,358	398,000	25.13
Downtown North	7,515,044	2.2	13.5	73,288	227,411	-	-	18.83
Downtown East	3,167,373	3.2	6.6	464,689	495,468	462,000	-	23.50
Downtown West	7,046,263	5.5	5.8	(16,110)	231,495	-	253,865	21.75
Liberty Village	2,161,632	8.1	0.9	3,461	(18,426)	-	-	26.84
Midtown	14,344,037	5.8	24.6	(77,152)	192,229	-	-	19.74
Bloor / Yonge	7,259,412	5.5	24.0	(45,201)	29,072	-	-	23.04
St. Clair / Yonge	2,193,893	5.4	15.7	(38,338)	9,205	-	-	19.57
Eglinton / Yonge	4,890,732	6.4	28.7	6,387	153,952	-	-	16.33
SUBURBAN	75,018,522	14.7	12.5	(152,070)	584,625	307,000	293,000	15.91
East	25,611,302	11.5	11.4	140,895	587,158	-	20,000	14.16
Scarborough	3,632,665	9.1	6.8	18,841	39,730	-	-	12.42
Markham N. / R. Hill	7,871,803	12.3	15.7	(24,433)	376,721	-	-	17.15
Markham South	3,167,526	6.9	2.3	154,463	218,485	-	-	14.32
E. York / D. Mills S.	2,639,147	14.4	21.1	19,557	(15,007)	-	-	12.06
Don Mills North	2,822,278	7.0	5.7	30,224	97,376	-	-	11.56
Consumers Road	3,868,867	14.1	10.1	36,606	7,962	-	20,000	13.00
G. Baker / Vic. Park	1,609,016	18.9	2.9	(94,363)	(138,109)	-	-	13.00
North	12,422,810	9.0	11.4	(113,315)	(3,592)	-	234,000	19.79
North Yonge	7,707,955	9.0	14.6	(52,475)	(113,255)	-	-	19.08
North York West	2,170,968	7.0	8.1	(35,743)	(36,495)	-	-	15.15
Vaughan	2,543,887	10.7	5.1	(25,097)	146,158	-	234,000	23.58
West	36,984,410	18.8	13.2	(179,650)	1,059	307,000	39,000	16.04
Bloor / Islington	1,868,560	21.5	2.6	(19,433)	34,040	-	-	13.19
427 Corridor	2,433,408	20.4	5.7	(5,584)	(131,628)	-	-	13.72
Airport Strip	3,313,874	26.6	8.4	(3,980)	16,951	-	-	13.93
Airport Corp. Centre	6,321,866	14.3	28.4	42,040	43,107	-	-	14.59
Mississauga South	1,993,374	4.4	1.9	13,610	(9,214)	35,000	39,000	13.00
City Centre	3,808,582	14.5	7.0	(46,272)	55,777	-	-	17.13
Hwy 10 / Hwy 401	4,378,984	15.2	19.1	(94,502)	(3,355)	-	-	14.30
Meadowvale	4,589,204	22.2	22.9	(83,293)	87,556	150,000	-	18.86
Brampton	1,157,318	22.7	28.9	29,437	(3,597)	-	-	15.61
Oakville	3,765,413	25.6	3.0	(17,461)	(69,569)	122,000	-	18.89
Burlington	3,353,827	21.5	5.6	5,788	(19,009)	-	-	16.61
GTA	160,644,295	9.2	15.0	1,020,693	3,425,801	1,563,358	1,894,010	17.53

Source: CBRE Research, Q4 2016.

Figure 5: Q4 2016 Significant Lease Transactions

Size (SF)	Tenant	Address	Submarket	Type
135,500	Symcor Inc.	1625 Tech Ave	Airport Corp. Centre	New
127,500	Home Depot	1 Concorde Gate	E. York/D. Mills S.	New
113,000	Department of Justice	120 Adelaide St W	Financial Core	New
112,000	Aird & Berlis LLP	181 Bay St	Financial Core	Extension
102,000	CGI Systems Integration and Consulting	150 Commerce Valley Dr	Markham N./R. Hill	New
74,000	Canadian Institute for Health Information	4110 Yonge St	North Yonge	New
73,000	Nestle Canada Inc.	25 Sheppard Avenue West	North Yonge	New
68,000	Lowe's Companies of Canada	5150 Spectrum Way	Airport Corp. Centre	New
62,500	Livingston International Inc.	401-405 The West Mall	427 Corridor	New
57,000	Engage People Inc.	1380 Rodick Rd	Markham N./R. Hill	New

Source: CBRE Research, Q4 2016.

GLOSSARY

Net Absorption: A measure of the net change in occupied space over a given period of time.

Net Rental Rate: The asking rental rate not including taxes and operating costs.

Class RC Space: Renovated and retrofitted, brick-and-beam, industrial/warehouse-style space converted to office use.

Vacancy Rate: The percentage of total office space in a given area that is currently vacant and available for occupancy.

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