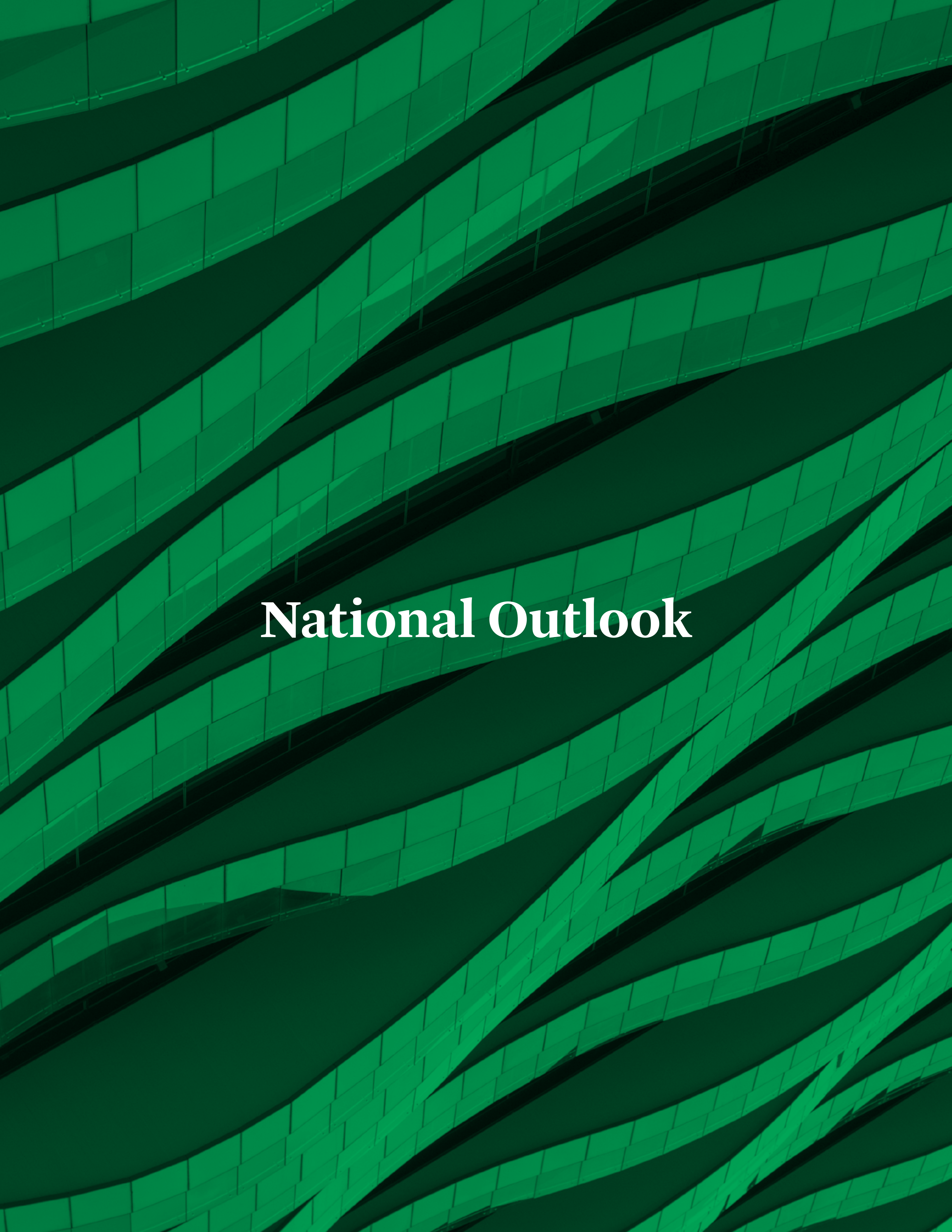
CBRE RESEARCH

# REAL ESTATE MARKET OUTLOOK

# 2017

# Canada

CBRE



# National Outlook

# KEY TRENDS

## 1. CANADA AT THE FOREFRONT

Canada is coming off a record-setting $34.7 billion in commercial property sales in 2016. Canada's two major gateway cities, Vancouver and Toronto, will continue to absorb the majority of the new foreign capital entering the country and with cap rates on trophy office product below 4.00%, valuations in our major cities will be on par with New York, Paris, London and Shanghai. Investment activity in 2017 is expected to total $31.9 billion across all sectors, representing the third best year in Canadian history.

## 2. FOREIGN INVESTMENT APPETITE

Foreign capital accounted for 27.0% of all commercial real estate sales in 2016. National cap rates ended the year at record lows for most commercial property types and rising prices are causing some domestic investors to take pause; however, the continued influx of foreign capital has the potential to propel values even higher in 2017. Capital flows will have to navigate new regulations implemented by both the Chinese and British Columbia governments.

## 3. TORONTO ENVY

Toronto enters 2017 on the A List as far as commercial real estate performance from a North American perspective. Toronto's downtown office vacancy rate is the lowest of any major market in North America, its industrial availability rate is the second lowest, and its retail sector is a top destination for new entrants. Strong demand is likely to initiate a wave of development, including a potential 10.0 million sq. ft. of new office space.

## 4. PLANNING ANOTHER DEVELOPMENT CYCLE

Rising prices and the pursuit of yield will encourage investors to consider developing new product. With the previous development cycle trailing off, multiple sectors are primed to turn the tide and planning will ramp up in 2017. Firms that bring quality product to the market efficiently will be rewarded by this highly liquid environment. Mixed-use will be the gold standard as owners look to maximize properties and create environments that appeal to tenants.

## 5. LAND CONTINUES TO OUTPERFORM

One of Canada's biggest real estate stories in 2017 will be the rise in land prices as residential housing markets remain robust and commercial development gears up. A lack of developable land, especially in Vancouver and Toronto, will increase competition for prime urban redevelopment sites in major markets, especially along transit nodes. Overall land investment will remain robust in 2017, and volume will either meet or exceed last year's record high.

# INVESTMENT

## KEY TRENDS

- At $31.9 billion, commercial real estate investment volume is expected to log the third highest annual total in Canadian history in 2017. Activity will be driven by demand for commercial property in Toronto and Vancouver as their stature on the global stage continues to grow and attract foreign and domestic capital. These two markets will account for almost two-thirds of the total national investment volume.
- The Greater Toronto Area will be the leading investment market in Canada in 2017. Activity will focus on a robust office market and growth in the increasingly influential industrial and land sectors. Investment volumes in the GTA are expected to reach a new annual record total of $12.6 billion, 3.2% higher than 2016.
- Even with the potential for interest rate hikes south of the border in 2017, Canadian bond yields should remain at historical lows which will maintain the current spread with cap rates. Furthermore, an influx of foreign capital and the perceived lack of risk in the Canadian markets will protect against any sudden drop in asset pricing and will ensure that commercial real estate yields remain attractive in 2017.

**NATIONAL AVERAGE CAP RATE**

**5.85%**

Record low cap rate reflects strong fundamentals and demand for commercial property

**2017**

**$31.9 billion**

**10-YR AVERAGE**

**$25.4 billion**

Top 3 finish for investment predicted

- Foreign investment reached new highs in 2016, led by Chinese capital. While capital controls have the potential to limit out-flows from China, investment activity from European investors is expected to increase as investors seek safety in a changeable environment. Sustained foreign interest, coupled with strong demand from private domestic investors, will produce one of the best investment years on record.

### National Investment Statistics

| INVESTMENT VOLUME (MILLIONS $) | 2015 | 2016 | 2017 F | YoY |
|---|---|---|---|---|
| Office | $5,022 | $7,752 | $7,335 | ▼ |
| Industrial | $4,634 | $5,794 | $5,888 | ▲ |
| Retail | $4,593 | $6,780 | $5,746 | ▼ |
| Multifamily | $5,532 | $5,682 | $4,842 | ▼ |
| ICI Land | $4,280 | $5,149 | $5,195 | ▲ |
| Hotel* | $2,060 | $3,548 | $2,930 | ▼ |
| Total | $26,121 | $34,705 | $31,936 | ▼ |

* Market and surrounding region and portion of portfolio deal
Source: CBRE Limited, 2017.

NATIONAL OUTLOOK

# OFFICE

## KEY TRENDS

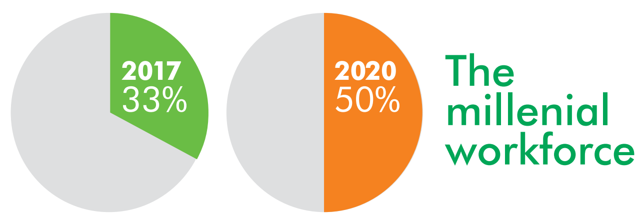
- Over 9.0 million sq. ft. of new supply combined with a depressed energy sector led to an increase in the national office vacancy rate in 2016. In 2017, a 25.0% decrease in new construction completions and stabilization in the energy sector will begin to slow the rise in vacancy.
- The Alberta vacancy rate stood at 22.1% in 2016 and will continue to drive up the national average in the year ahead. Excluding Calgary and Edmonton, the Canadian office vacancy rate would be 11.1%, down from 13.3% when included. Alberta currently comprises one-third of total national office construction activity, 78.0% of which is downtown. As such, vacancy rates outside of Alberta signal the potential for a new office development cycle.
- Prospective office tenants will face a disconnect between the small, less desirable configurations that are available in major markets and the large, well-located, quality spaces that they require. Demand for space in the downtown cores of Toronto and Vancouver will remain strong in 2017, as tenants continue their flight-to-quality and enhance the gap between downtown and suburban office markets.
- Office solutions will increasingly evolve to reflect different corporate cultures, company brands and business goals. Employers are realizing that that they do not have a binary choice between closed offices and open, co-working environments. In 2017, the challenge will be to understand and satisfy the needs of a multigenerational workforce while maintaining a focus on the growing portion of millennial office workers.

OFFICE CONSTRUCTION IMBALANCE

33.0%

Bulk of national office construction coming on line in Alberta

- Technology companies will account for 25.0% of tenants actively seeking space in Canada and will increasingly anchor new office developments. This prominent role will allow the tech industry to shape the overall design of new office towers and mixed-use developments in accordance with their preference for innovative office designs and workplace strategies. In addition to the large technology firms that are locating in top-tier office towers, smaller technology firms, startups and boutiques will continue to drive demand in the Class B and C office markets across Canada.




### National Office Statistics

| CENTRAL (ALL CLASSES) | 2015 | 2016 | 2017 F | YoY |
|---|---|---|---|---|
| Vacancy Rate | 10.1% | 11.2% | 12.2% | ▲ |
| Class A Net Asking Rent (per sq. ft.) | $24.29 | $21.82 | $21.54 | ▼ |
| Net Absorption (million sq. ft. ) | (1.29) | 0.49 | 1.03 | ▲ |
| New Supply (million sq. ft.) | 3.49 | 4.70 | 3.89 | ▼ |
| Under Construction (million sq. ft.) | 9.90 | 6.65 | 5.46 | ▼ |
| **SUBURBAN (ALL CLASSES)** | | | | |
| Vacancy Rate | 14.8% | 15.8% | 16.2% | ▲ |
| Class A Net Asking Rent (per sq. ft.) | $17.96 | $18.24 | $18.33 | ▲ |
| Net Absorption (million sq. ft. ) | (0.81) | 1.07 | 1.65 | ▲ |
| New Supply (million sq. ft.) | 2.82 | 4.34 | 2.89 | ▼ |
| Under Construction (million sq. ft.) | 6.77 | 2.73 | 3.24 | ▲ |
| **OVERALL (ALL CLASSES)** | | | | |
| Vacancy Rate | 12.2% | 13.3% | 14.0% | ▲ |
| Class A Net Asking Rent (per sq. ft.) | $20.79 | $19.97 | $19.98 | ▲ |
| Net Absorption (million sq. ft. ) | (2.10) | 1.56 | 2.68 | ▲ |
| New Supply (million sq. ft.) | 6.31 | 9.05 | 6.78 | ▼ |
| Under Construction (million sq. ft.) | 16.67 | 9.37 | 8.70 | ▼ |

Source: CBRE Limited, 2017.

NATIONAL OUTLOOK

# INDUSTRIAL

## KEY TRENDS

- Vancouver and Toronto will remain two of North America's most competitive industrial markets and account for the majority of Canada's industrial sales and leasing activity. Limited availabilities and robust demand will continue into 2017, driving leasing and investment activity to outpace the prior year. Sale prices and rental rates will reach new highs in many markets.

- The e-commerce induced expansion of the distribution and logistics industry will drive industrial leasing and investment activity. In 2017, the emphasis will turn to perfecting 'Last Mile' delivery. Retailers will increasingly choose to partner with third party logistics providers or retrofit existing assets to include online order fulfillment centres. Other businesses will strategically identify new, smaller urban locations close to urban populations.

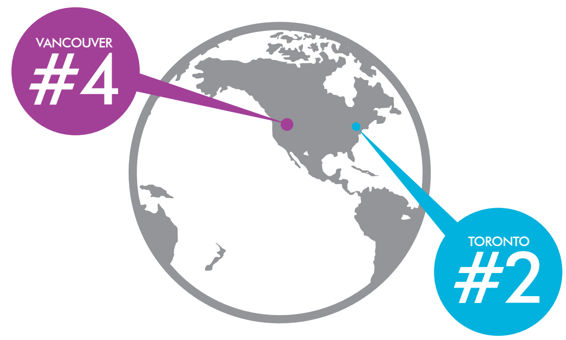
- The amount of industrial space under construction is at a seven-year low of 9.5 million sq. ft., which will support record low availability rates in 2017, especially in gateway markets. Although tenant demand for Class A inventory will continue to increase, limited development land and high construction costs will force developers to be highly selective before they initiate new construction.

UNDER CONSTRUCTION

11.3 million sq. ft.

New supply at a three-year low

### Canadian industrial markets among the tightest in North America




- The lack of available opportunities for tenants, particularly in gateway markets, will encourage many to consider renewing in existing space. Competitive market conditions will continue to put upward pressure on rental rates across the country, particularly for Class A space located within proximity to urban centres. However, landlords with new large bay product in more remote areas may choose to forego higher rental rates in favour of longer lease terms.

- In 2017, two wild cards could impact the Canadian industrial market. Firstly, businesses will be forced to react to changing environmental regulations, particularly in Alberta and Ontario, where there are new costs for carbon emissions. Secondly, the potential renegotiation of NAFTA could alter the free flow of goods across the world's most integrated manufacturing and transportation logistics network.

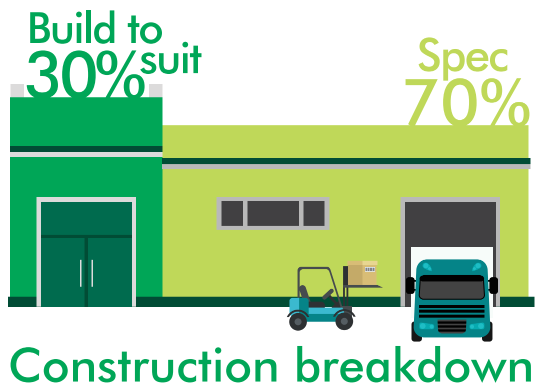
### National Industrial Statistics

| | 2015 | 2016 | 2017 F | YoY |
|---|---|---|---|---|
| Availability Rate | 5.7% | 5.3% | 5.0% | ▼ |
| Net Asking Rent (per sq. ft.) | $6.48 | $6.60 | $6.65 | ▲ |
| Sale Price (per sq. ft.) | $110.39 | $120.80 | $122.86 | ▲ |
| Net Absorption (million sq. ft.) | 17.17 | 17.89 | 13.54 | ▼ |
| New Supply (million sq. ft.) | 23.20 | 13.14 | 9.65 | ▼ |
| Under Construction (million sq. ft.) | 13.73 | 11.35 | 9.51 | ▼ |

Source: CBRE Limited, 2017.

# Regional Outlook

# TORONTO - INDUSTRIAL


## KEY TRENDS

- On average, developers have added 5.1 million sq. ft. of new supply per annum for the past five years. The GTA currently has 5.1 million sq. ft. of industrial space under construction, 70.0% of which is being built speculatively. Only 15.0% of the speculative development is currently subleased, making 2017 a pivotal year in defining the direction of market fundamentals.

- Demand for properties in the 18'-26' clear range has been strong. With no substantial new product in the pipeline and growing e-commerce demand, availability should remain limited, while rents will face upward pressure.

- Support for robust sale prices will likely remain in place due to low availability, favorable interest rates, as well as the large number of cash-laden buyers; however, leasing will likely gain appeal once sale prices exceed a $200.00 per sq. ft. tipping point.

- As the third largest industrial market in North America, the GTA is the logistics hub for many national and regional distributors. Tenants from the transportation, distribution, and logistics sector will continue to drive demand with manufacturing and automotive, as well as retail and wholesale trades, likely to follow.

- Amid historically low availability rates and rising rents, landlords are very optimistic about 2017. Meanwhile, investors are trying to find ways to be more creative and look for value-add scenarios.

- The shortage of industrial land for development in core areas, coupled with the lack of availability for existing product for sale has put upward pressure on land prices, which now exceed on average $700,000 per acre. Owners of land with favourable zoning that permits outside storage can expect a 15.0% premium on the selling price in 2017.

**$200 per sq. ft.**

**Rising sale prices to increase leasing appeal**

REGIONAL OUTLOOK

# TORONTO - INDUSTRIAL

## PROJECTS TO WATCH

### *Highway 427 Expansion*

Road widening, northern expansion and the addition of High Occupancy Toll Lanes will get underway as part of a three-year project to enhance Highway 427 starting in 2017.

### *6 Cleve Court, Halton Hills*

This 564,824 sq.ft. state-of-the-art logistics facility is situated in Halton Hills between CP Rail Terminals, CN Rail Terminals and the Milton Go Station. Construction is expected to be completed in fall 2017.

Click here for more information

### *11400 Steeles Avenue, Halton Hills*

Phase one of this 639,839 sq. ft. development will offer 36' ceilings and is conveniently positioned near Pearson Airport and the CN Rail terminal. It will be completed in January 2017, followed by phase two in October 2017.

## MARKET STATISTICS

### *Office*

| CENTRAL | 2015 | 2016 | 2017 F | YoY |
|---|---|---|---|---|
| Vacancy Rate | 5.1% | 4.4% | 5.1% | ▲ |
| Class A Net Asking Rent (per sq. ft.) | $28.94 | $27.97 | $28.25 | ▲ |
| Net Absorption (million sq. ft. ) | 0.78 | 2.84 | 0.75 | ▼ |
| Class A Cap Rate (%) | 4.75-5.25 | 4.25-4.75 | 4.25-4.75 | ◀▶ |
| New Supply (million sq. ft.) | 0.29 | 2.39 | 1.35 | ▼ |
| Under Construction (million sq. ft.) | 3.74 | 1.60 | 2.15 | ▲ |
| **SUBURBAN** | | | | |
| Vacancy Rate | 14.7% | 14.7% | 14.5% | ▼ |
| Class A Net Asking Rent (per sq. ft.) | $16.97 | $17.73 | $17.90 | ▲ |
| Net Absorption (million sq. ft. ) | (0.12) | 0.58 | 0.35 | ▼ |
| Class A & B Cap Rate (%) | 5.75-7.50 | 5.75-7.25 | 5.75-7.25 | ◀▶ |
| New Supply (million sq. ft.) | 0.94 | 1.27 | 0.29 | ▼ |
| Under Construction (million sq. ft.) | 1.68 | 0.39 | 1.09 | ▲ |
| **OVERALL** | | | | |
| Vacancy Rate | 9.6% | 9.2% | 9.5% | ▲ |
| Class A Net Asking Rent (per sq. ft.) | $20.25 | $20.14 | $20.87 | ▲ |
| Net Absorption (million sq. ft. ) | 0.67 | 3.43 | 1.10 | ▼ |
| New Supply (million sq. ft.) | 1.23 | 3.65 | 1.64 | ▼ |
| Under Construction (million sq. ft.) | 5.42 | 1.99 | 3.24 | ▲ |

Source: CBRE Limited, 2017.

### *Retail*

| | 2015 | 2016 | 2017 F | YoY |
|---|---|---|---|---|
| Total Retail Sales (YoY) | 4.4% | 5.1% | 3.5% | ▼ |
| Neighbourhood Cap Rate (%) | 5.25-6.25 | 5.00-6.25 | 5.00-6.25 | ◀▶ |

Source: CBRE Limited, 2017.

### *Industrial*

| | 2015 | 2016 | 2017 F | YoY |
|---|---|---|---|---|
| Availability Rate | 4.0% | 3.3% | 3.1% | ▼ |
| Net Asking Rent (per sq. ft.) | $5.41 | $5.98 | $6.15 | ▲ |
| Sale Price (per sq. ft.) | $105.72 | $140.82 | $144.50 | ▲ |
| Net Absorption (million sq. ft.) | 10.14 | 9.33 | 6.00 | ▼ |
| Class A & B Cap Rate (%) | 5.00-7.50 | 4.50-6.50 | 4.50-6.50 | ◀▶ |
| New Supply (million sq. ft.) | 7.32 | 4.71 | 4.00 | ▼ |
| Under Construction (million sq. ft.) | 5.41 | 5.12 | 4.50 | ▼ |

Source: CBRE Limited, 2017.

### *Multifamily*

| | 2015 | 2016 | 2017 F | YoY |
|---|---|---|---|---|
| Overall Vacancy Rate (%) | 1.6% | 1.3% | 1.7% | ▲ |
| Apartment Cap Rate (%) | 4.25-5.00 | 4.00-5.00 | 4.00-5.00 | ◀▶ |

Source: Canada Mortgage and Housing Corp., CBRE Limited, 2017.

### *Investment*

| INVESTMENT VOLUME (MILLIONS) | 2015 | 2016 | 2017 F | YoY |
|---|---|---|---|---|
| Office | $3,298 | $3,318 | $3,200 | ▼ |
| Industrial | $2,004 | $2,476 | $2,800 | ▲ |
| Retail | $1,893 | $2,288 | $1,700 | ▼ |
| Multifamily | $1,631 | $1,160 | $1,200 | ▲ |
| ICI Land | $1,113 | $1,906 | $2,000 | ▲ |
| Hotel* | $816 | $1,064 | $1,700 | ▲ |
| Total | $10,755 | $12,212 | $12,600 | ▲ |

*Market and surrounding region

Source: CBRE Limited, 2017.