Q3 2022

OTTAWA MARKET REPORT

By Darren Fleming, CEO & Broker of Record, Real Strategy Advisors

Data provided by CoStar

OVERVIEW

Rampant inflation and rising interest rates continued throughout the third quarter of 2022. In spite of a labour market that is still very hot, economists and business leaders are starting to believe a short-term cooling off period may be on the horizon. In addition, the city of Ottawa still lags behind other major Canadian cities with respect to 'return to work'. The idea of predicting the future may be a fool's errand but all signs currently point towards Canada experiencing a mild recession going into the new year.

Compared to a year ago, inflation both increased and is staying higher for longer than most expected. The rising cost of food, energy, goods and services, as well as wages in combination with increased cost of borrowing, have been weighing heavily on consumers and businesses. The Bank of Canada's historic move to increase rates by 300 basis points from the beginning of the year has put downward pressure on inflation which dropped from its peak of 8.1% to 7.6% in July and then down to 7% in August (Canadian Chamber of Commerce & Statistics Canada). The central bank's strategy to cool the economy quickly has been effective in slowing down the pace of inflation while hoping to avoid a deep recession.

As of September 2022, the unemployment rate in Ottawa was 4.1% which was up 0.7% from August (Ottawa Employment Trends). This unemployment rate is about 5% below the peak unemployment the city observed in August 2020 and is below the long-run average. Although Ottawa's monthly full-time job growth isn't what it was February-May, it actually stands about 2,000 jobs above its lowest points observed in July-August.

As we've noted throughout the pandemic, the strong presence of Ottawa's public sector, combined with a vibrant community of tech, not-for-profit, and professional service organizations have historically helped the city's economy to remain very stable. Not surprisingly, the sectors that saw the most fluctuation were the ones directly impacted by lockdowns (e.g. retail, food services, and manufacturing). That said, the largest commercial tenant in the city, the federal government, has given no clear sign of a full-scale return to the office. One Statistics Canada report showed that roughly 46% of Ottawa employees continue to work from home (at least part-time) compared to about only 28% nationally.

Due to the adoption of hybrid work, the major trends in the office market have been tenant downsizing and flight to quality. As tenants take advantage of a softer market to upgrade from older offices with too much space, to more modern Class A properties, vacancies in Class B and C properties rise. This domino effect is only going to continue as the inevitable reality of the federal government's portfolio rationalization looms ever closer.

LEASING

Ottawa's office market experienced an increase in overall availability in Q3 as tenants began implementing their return to work strategies, typified by a smaller, hybrid-optimized footprint. Though many organizations continue to experiment with their workplace and accommodation strategies, there was a steady uptick in the number of subleases hitting the market.

Driving the Q3 leasing activity is the strong demand for smaller (less than 2,500 SF), quality downtown office space. Availability in the capital currently sits at 6.0%, which is well below the national rate of 11.2%.

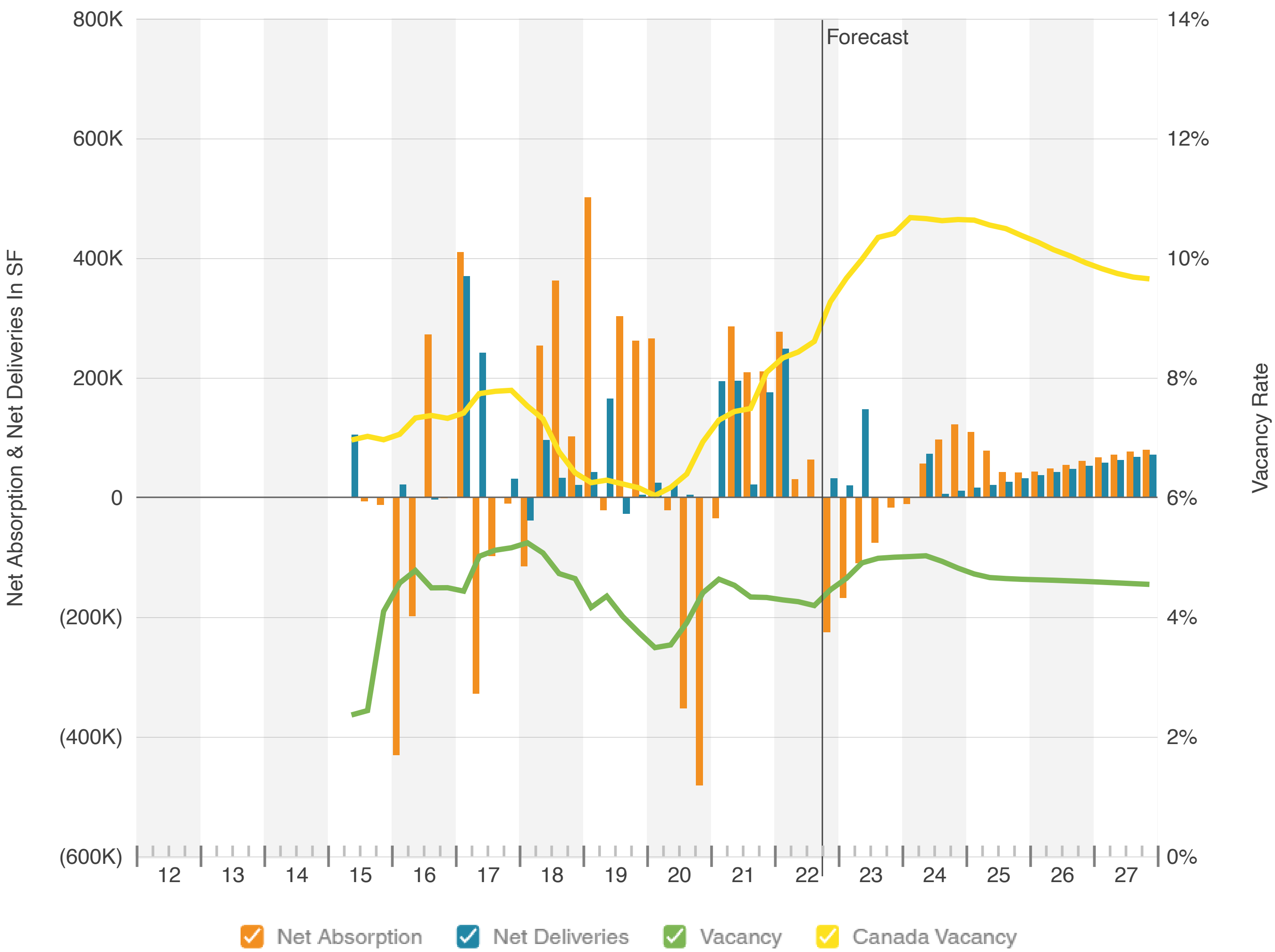
Over the past 12 months, Ottawa has seen net deliveries of new space totalling 418,000 SF and positive absorption (space being leased) of 480,000 SF. While these market fundamentals are positive, the leases being signed are generally for smaller spaces and for shorter durations.

Leasing activity was tepid during the summer months since many tenants have been holding off making big real estate decisions until there's more clarity on the economy and the willingness of employees to come back to the physical office.

While the leasing activity downtown is being driven by companies choosing to rightsize and upgrade their space, a slightly different story is playing out in the suburbs. There, the major driving forces behind leasing and space decisions are variables like proximity to housing and shorter commute times. The biggest factor looming over Ottawa's commercial real estate at the moment though is the federal government and how much office space it will give back. Between its workforce that is still primarily working remotely and the integration of co-working sites as part of its GCworkplace plans, it's no secret that the government has more space than is needed.

LEASING

NET ABSORPTION, NET DELIVERIES & VACANCY

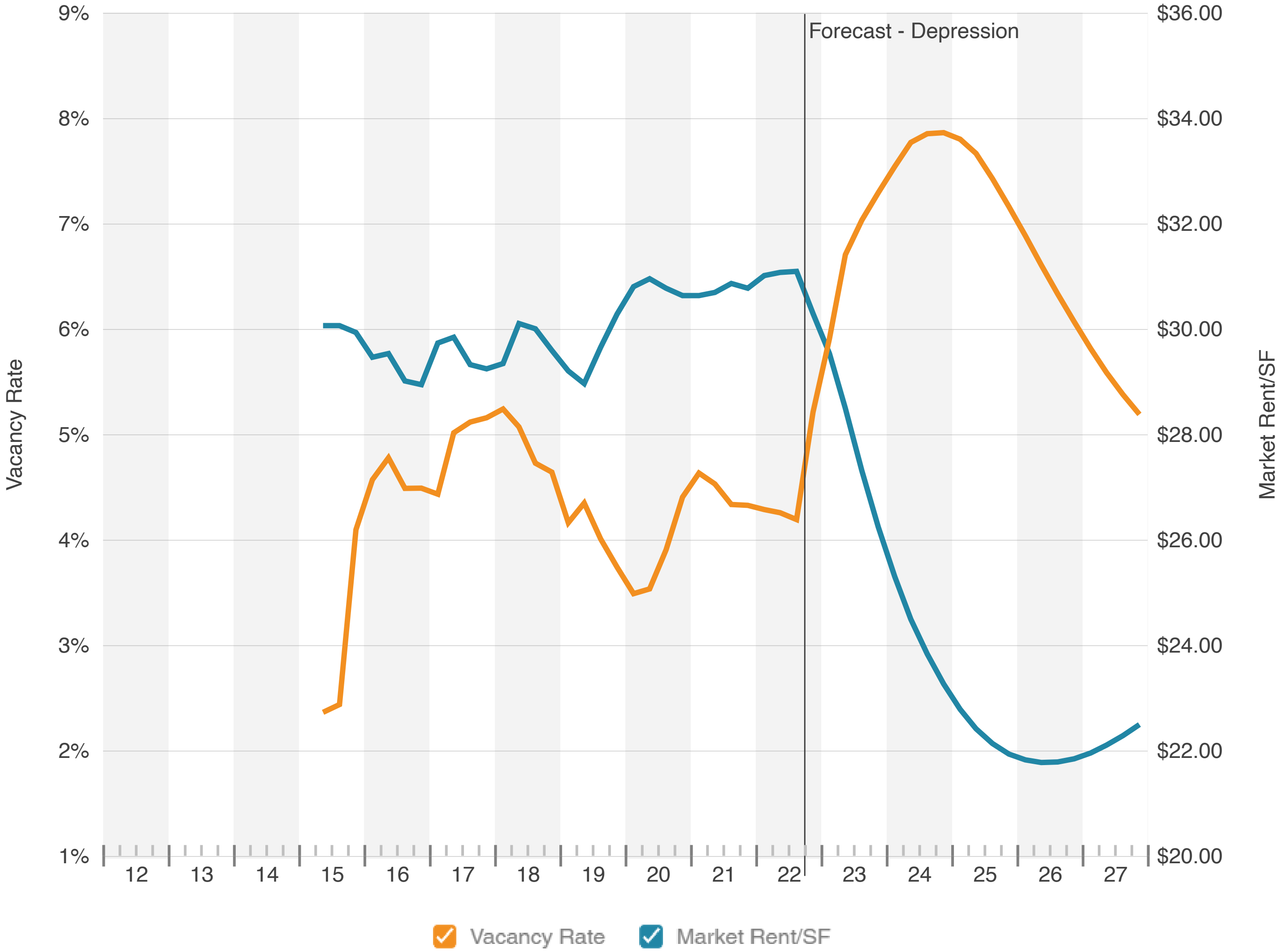


* Images provided by CoStar

The government has also committed to making its real estate portfolio carbon neutral over the coming decades and there have been talks to revamp assets downtown into residential and mixed-use spaces. With so much potential space that could come back onto the market, it's safe to say that the commercial real estate landscape in Ottawa is in flux. If millions of square feet come back on to the market, mainly downtown, what will be done with it? Depending on how the situation plays out, there may be large-scale shifts in terms of where people live and work in the city.

LEASING

VACANCY & MARKET RENT PER SF



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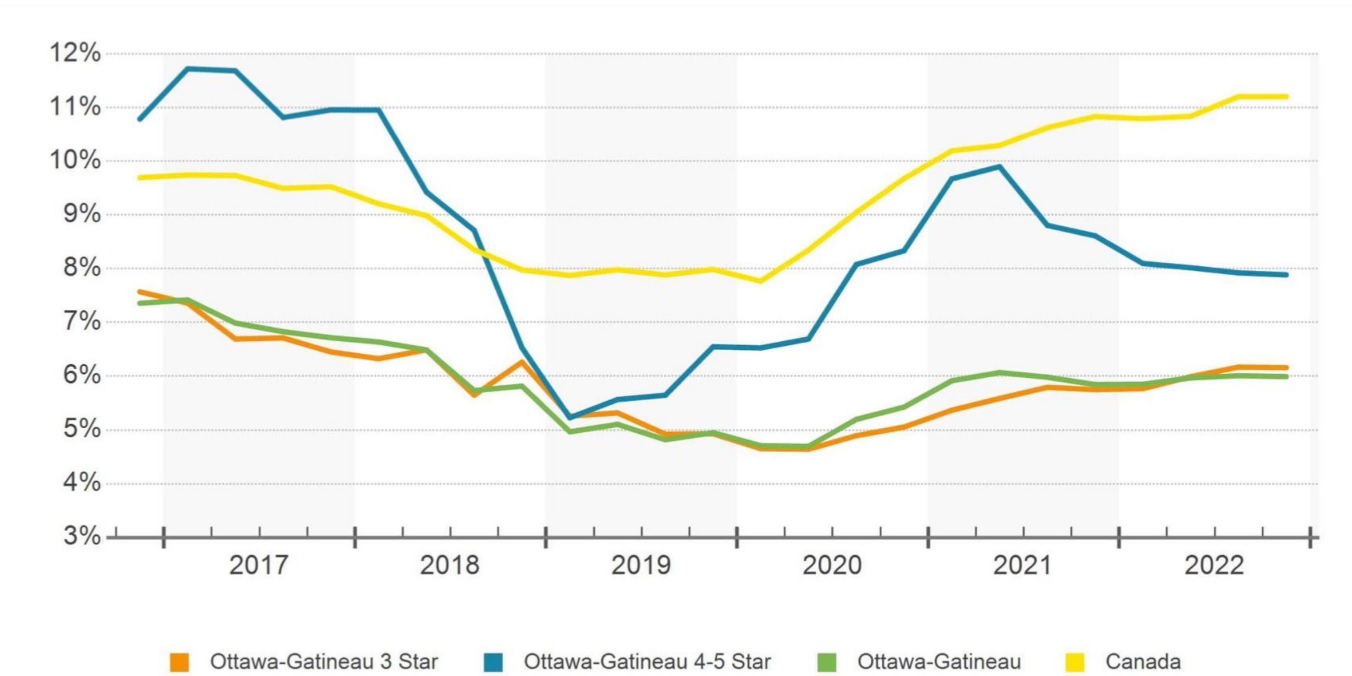
LEASING

AVAILABILITY RATE



TOP OFFICE LEASES PAST QUARTER

Building Name/Address	Submarket	Leased SF	Tenant Name
Sun Life Financial Centre	CBD	30,912	Assembly of First Nations
Place de Ville	CBD	28,166	NA
Performance Court	Centretown-Byward	16,417	TCC Canada
2500 Solandt Rd	Kanata	12,312	NA
66 Slater St	CBD	11,668	NA

* Statistics provided by CoStar

RENT

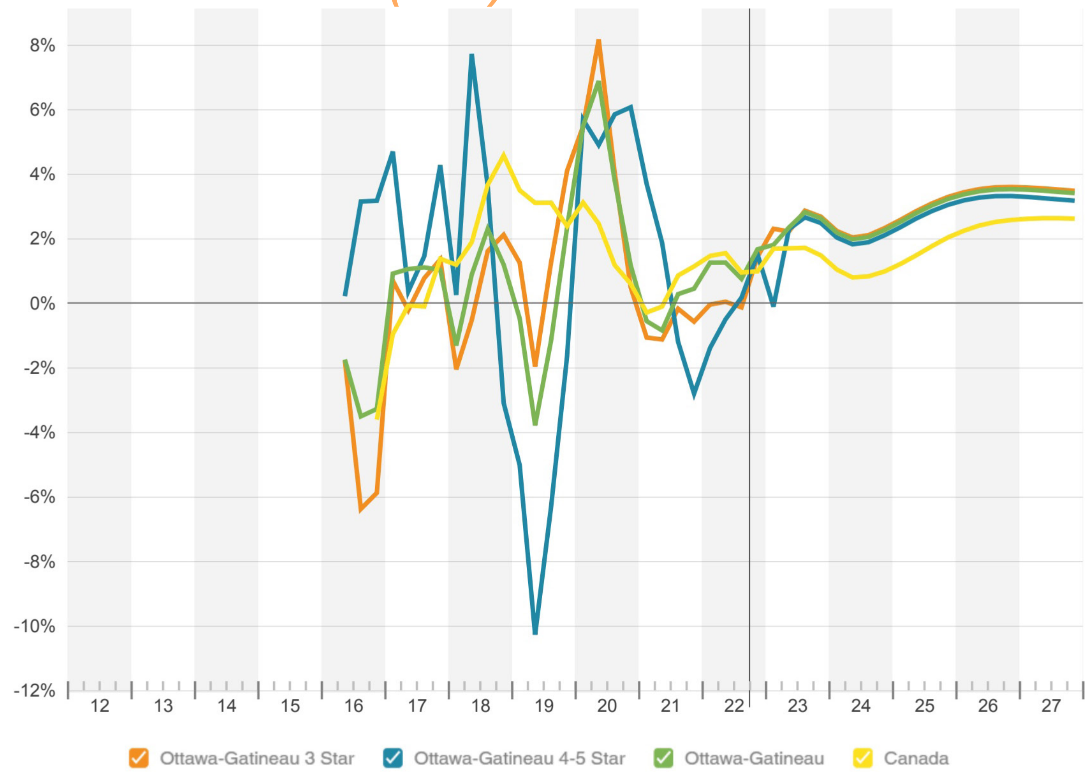
Due to a weak leasing market, rents still remain under pressure in the National Capital Region. Right-sizing or downsizing is occurring, leasing terms are shorter (less than five years), and space is continually coming back onto the market via sublease. The decline in rental rates seen over 2021 was less pronounced here than in other Canadian markets (with annual rent growth actually being positive in recent months at 0.8%) but still remains in a somewhat precarious position.

The higher rental rates in newer buildings reflect the increased cost of construction; specifically labour, and building supplies. Furthermore, Ottawa's construction pipeline, accounting for only 0.3% of the inventory (compared to 3.3% nationally) means there is relatively little new product going to hit the market which would only increase overall vacancy. If positive absorption continues (which is anybody's guess if the federal government drops millions of feet of old, excess space) Real Strategy Advisors predicts we could see rents stabilize and increase over the next year.

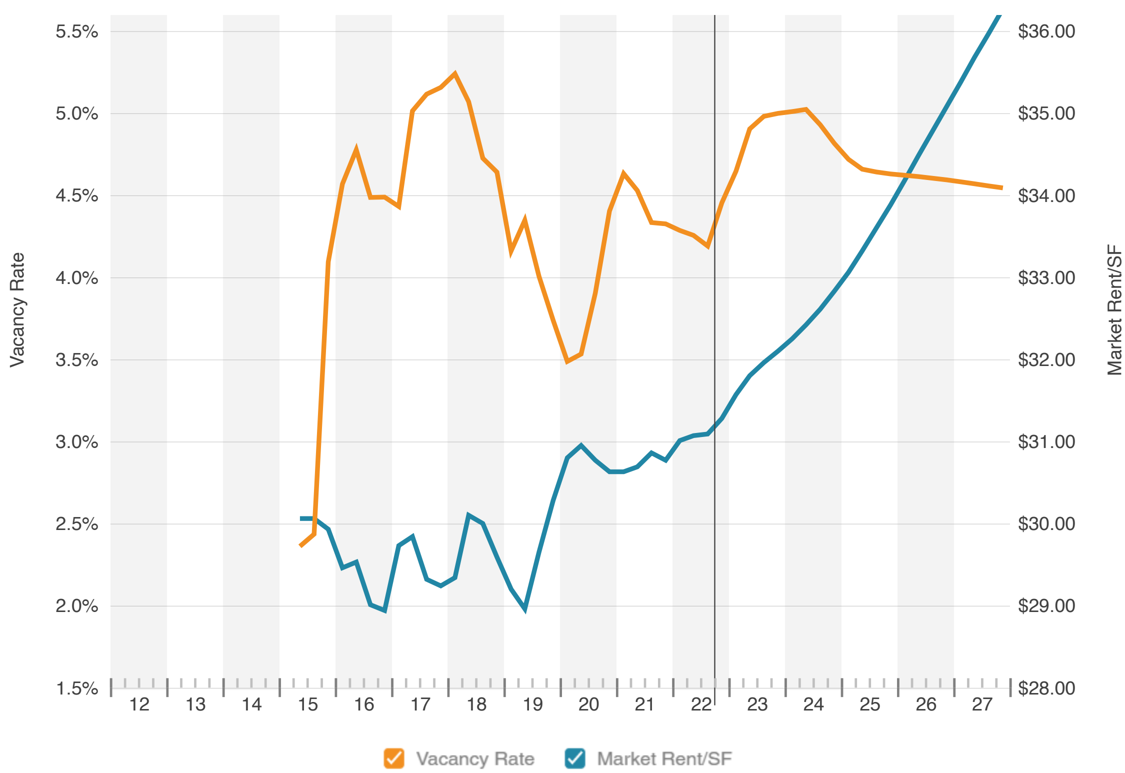
RENT

* Images provided by CoStar

MARKET RENT GROWTH (YOY)



MARKET RENT PER SQUARE FOOT



SALES

With office space now seen as a riskier asset than before the pandemic, many institutional investors have been divesting. The perceived increased risk is a result of the pandemic's continued effects alongside hybrid and remote work still being the go-to. Even still, there have been sales volumes totalling $953 million in the last 12 months with the majority being large portfolio transactions. Even if office and building usage patterns change, the owners still have the option to re-position the asset in the future if needed.

The majority of the buyers are leveraging domestic (or even local) capital and banking on tenant trends/demands like the desire for high-quality office space with proximity to amenities and transportation. For example, there was the deal that saw Crestpoint Real Estate Investments and Crown Realty Partners purchase a five-property portfolio from Brookfield Property, AIMCO, and CPP. Then there's the 24-property portfolio purchased by Woodbourne Capital Management and Epic Investment Services that included suburban properties.

In July, Rise Commercial Developments purchased a portfolio of five medical offices from Invesque for $76.54 million. Four of the five offices from the deal are in Ottawa and were 77-94% leased (at the time of sale). In addition to the modern downtown office space and dispersed suburban locations, it seems that health-related real estate is also sought after. Given the likelihood of an oncoming recession, these properties are seen as more withstanding to possible impacts.

Recent Significant Sales:

- Commonwealth Building at 77 Metcalfe St with 147,382 SF sold for $19,100,000 in mid-July

- Nepean Medical Centre at 1 Centrepointe Dr with 47,715 SF sold for $16,600,000 in late July

- Carling-Broadview Medical Centre at 770 Broadview Ave with 39,826 SF sold for $15,000,000 in late July

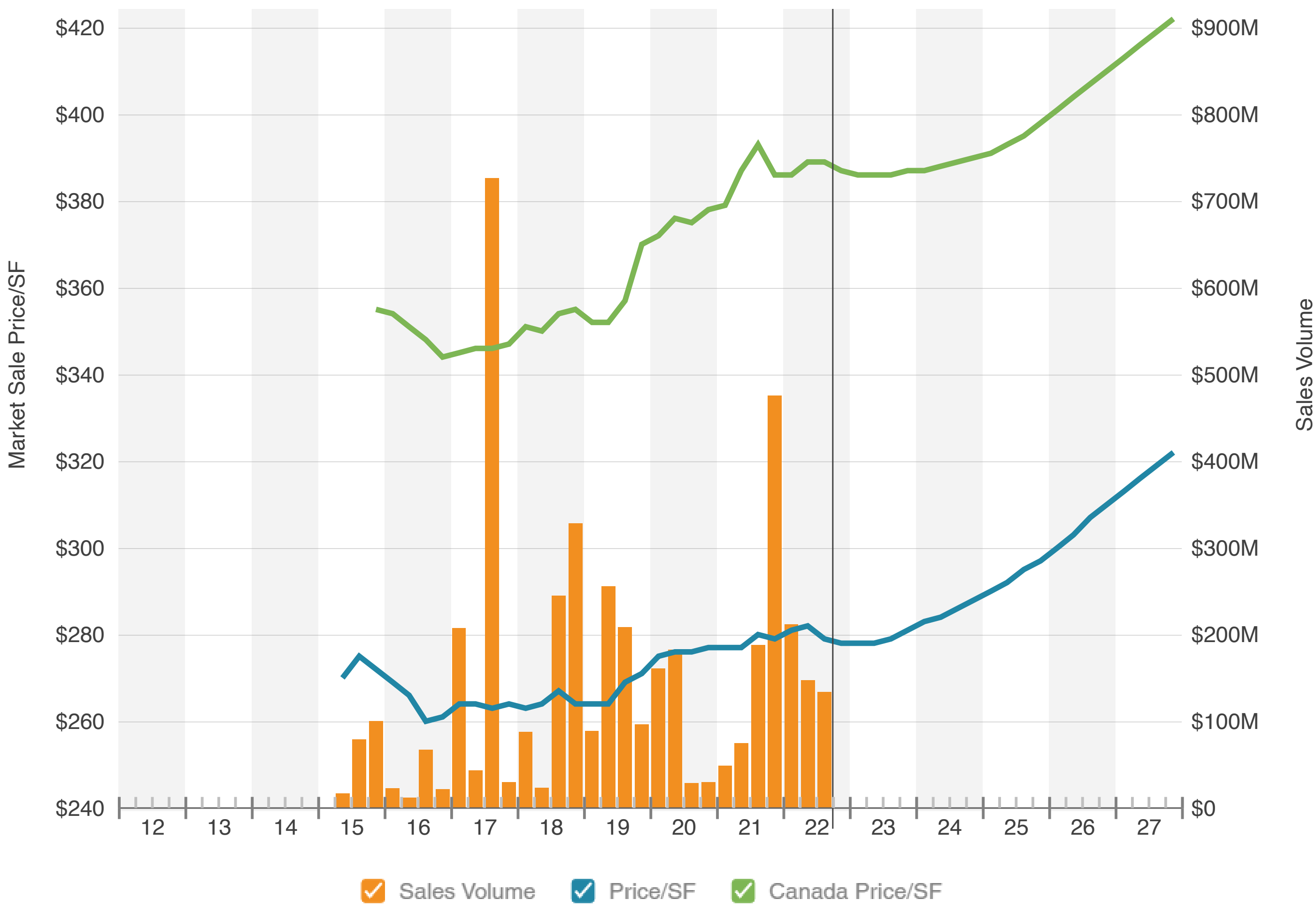
- Phenix Medical Professional Building at 595 Montreal Rd with 40,932 SF sold for $13,400,000 in late July

- Kanata Medical Arts Building at 99 Kakulu Rd with 38,483 SF sold for $11,829,091 in late July

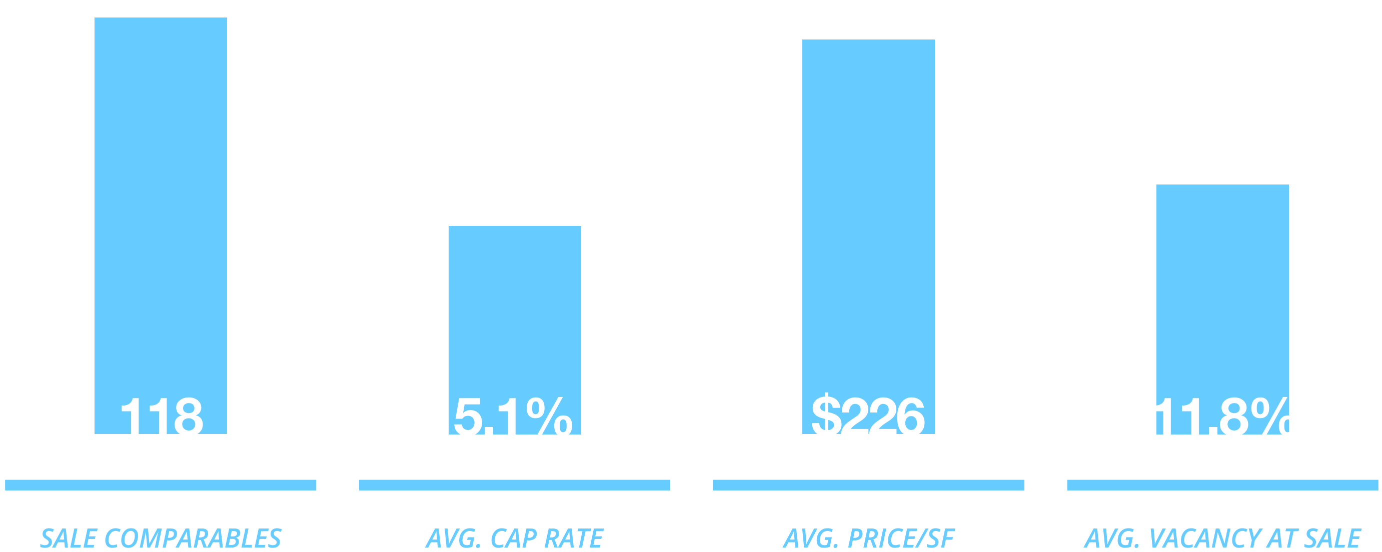
- Cumberland Place at 400 Cumberland St with 174,350 SF sold for $40,500,000 in late August

SALES

SALES VOLUME & MARKET SALE PRICE PER SF



SALES PAST 12 MONTHS



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SUBMARKETS

SUBMARKET RENT

		Market Rent		12 Month Market Rent		QTD Annualized Market Rent	
No.	Submarket	Per SF	Rank	Growth	Rank	Growth	Rank
1	CBD	$37.09	1	0.1%	9	-8.4%	8
2	Centretown-Byward	$32.59	2	0.7%	6	40.4%	1
3	East Central	$28.99	7	0.8%	5	-2.0%	4
4	Gatineau	$29	6	1.8%	2	-3.1%	6
5	Greater Kingston	$23.93	10	2.4%	1	-8.8%	9
6	Kanata	$29.11	5	0.7%	7	-9.5%	10
7	Northeast Ontario	$26.28	8	1.2%	3	-3.1%	7
8	Papineau-Pontiac	$24.60	9	-1.0%	10	21.3%	2
9	Tunney's Pasture	$30.82	3	0.5%	8	-2.5%	5
10	West Central	$30.42	4	0.8%	4	12.0%	3

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SUBMARKETS

SUBMARKET VACANCY & NET ABSORPTION

		Vacancy			12 Month Absorption			
No.	Submarket	SF	Percent	Rank	SF	% of Inv	Rank	Construc. Ratio
1	CBD	1,306,412	7.2%	9	(157,089)	-0.9%	10	-
2	Centretown-Byward	599,266	4.4%	6	936	0%	7	-
3	East Central	747,489	5.8%	7	12,211	0.1%	6	-
4	Gatineau	204,812	1.3%	2	362,093	2.3%	1	0.3
5	Greater Kingston	87,381	3.9%	5	62,308	2.8%	3	0
6	Kanata	712,463	6.4%	8	127,152	1.1%	2	1.2
7	Northeast Ontario	19,157	0.5%	1	51,942	1.3%	5	-
8	Papineau-Pontiac	-	-	-	0	0%	-	-
9	Tunney's Pasture	99,701	1.3%	3	(32,932)	-0.4%	9	-
10	West Central	388,108	3.2%	4	53,498	0.4%	4	-

* Statistics provided by CoStar