Q4 2022

OTTAWA MARKET REPORT

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Data provided by CoStar

OVERVIEW

The final quarter of 2022 experienced notable downward financial pressure and the outlook for Canada's economy continues to be precarious. Although inflation fell from 6.9% to 6.6% over Q4, it still remains high.[1] As a result, the target overnight interest rate was raised twice over the quarter, from 3.25% to 3.75% on October 26th and then up to 4.25% on December 7th.[2] With Canada's economic growth having slowed to 1.6% in Q4, which is half of what was observed in Q3, many economists are expecting Canada's economy to experience a mild recession in 2023.[3]

Looking at Ottawa specifically, we closed out 2022 with an unemployment rate of 4.6%, an increase of 0.2% from November.[4] The good news: Ottawa is well below the peak unemployment from the summer of 2020, is still below its long-run average, and had net positive job creation in December.[5,6] This increase was due to (mostly seasonal) part-time positions,[7] while there was actually a loss of about 1,600 full-time positions.[8] The combination of public, tech, and professional services sectors makes the city economically resilient but certainly not immune from impact.

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1: https://tradingeconomics.com/canada/inflation-cpi
2: https://www.bankofcanada.ca/core-functions/monetary-policy/key-interest-rate/
3: https://www.bnnbloomberg.ca/q4-economic-growth-slows-to-1-6-as-aggressive-hikes-bite-1.1877179
4: https://www150.statcan.gc.ca/n1/daily-quotidien/230106/t007a-eng.htm
5: https://obj.ca/ottawa-gatineau-employers-add-2300-jobs-in-november/
6,7,8: https://www150.statcan.gc.ca

Speaking of the public sector, the federal government announced its return-to-office directive in December. Starting in late March 2023, civil servants will be in-office two to three days a week.[9] There are numerous exceptions within the guidelines,[10] and certainly won't yield the same results as a 'full-scale' return, but was still welcomed news from the city's downtown business community. The announcement also reassured office building owners with a more concrete direction for the immediate future concerning their public sector tenants.

The trend we see emerging is that hybrid work is being more widely adopted. Hybrid work, so far, has unfolded with organizations almost universally choosing to downsize their office footprints. The office market, in turn, will continue to have a more drawn-out recovery with increased vacancies for the next year to year and a half. While the federal government (Ottawa's largest office tenants) will continue to need space, the amount of space they will need is significantly less than what they have currently.

Real Strategy Advisors has observed a flight-to-quality trend in the market since 2021 when leasing activity finally started to resume. Many downtown and fringe core office tenants moved from Class B to Class A buildings due to the tenant-friendly market. This favourability has given tenants the option to simultaneously upgrade and downsize their space to something that accommodates a hybrid model, all with landlords offering increased incentives!

9: https://www.cbc.ca/news/canada/ottawa/hybrid-model-federal-government-1.6687390
10: https://ottawa.ctvnews.ca/some-federal-government-it-workers-exempt-from-return-to-office-plan-1.6239010

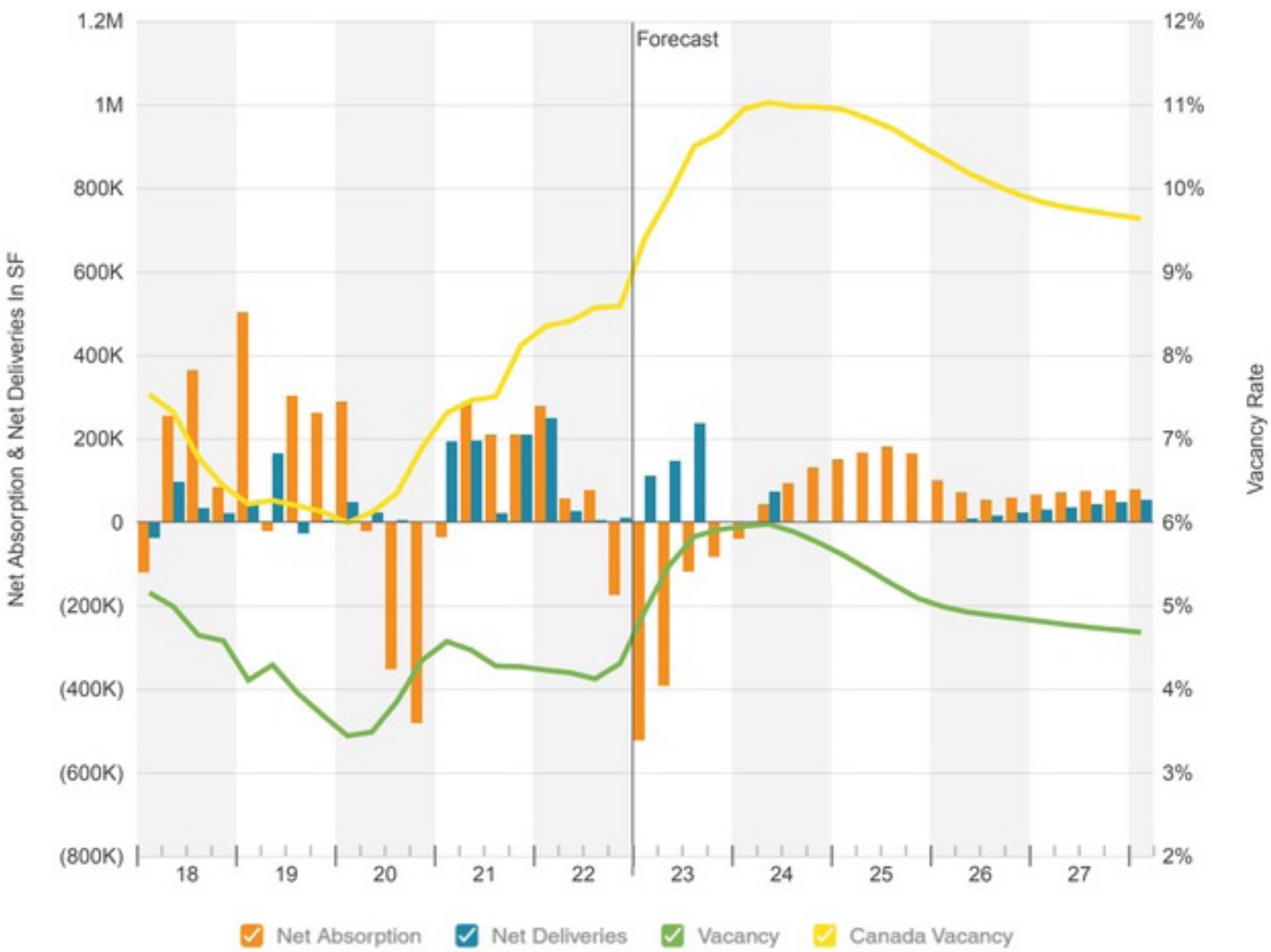
LEASING

The end of 2022 saw about 175,000 SF of office space return to the market, contrary to the rest of the year where vacancies decreased. Net absorption throughout 2022 was 190,000 SF but, while the number is positive, the leasing market still remains under pressure. As a result, the leasing story in Q4 was one of shorter lease terms, smaller spaces, and increasing vacancies.

The final quarter of 2022 experienced a sharper increase in vacancy alongside a minuscule increase in market rent. Although Ottawa's overall vacancy rate, which stands at about 4.5%, is roughly half that of the national average, we're expecting another large dump of square footage into the market in early 2023 due to the federal government downsizing. Vacancies will therefore continue to increase even though we expect Ottawa to continue outperforming the national average for the next 12-18 months.

LEASING

NET ABSORPTION, NET DELIVERIES & VACANCY

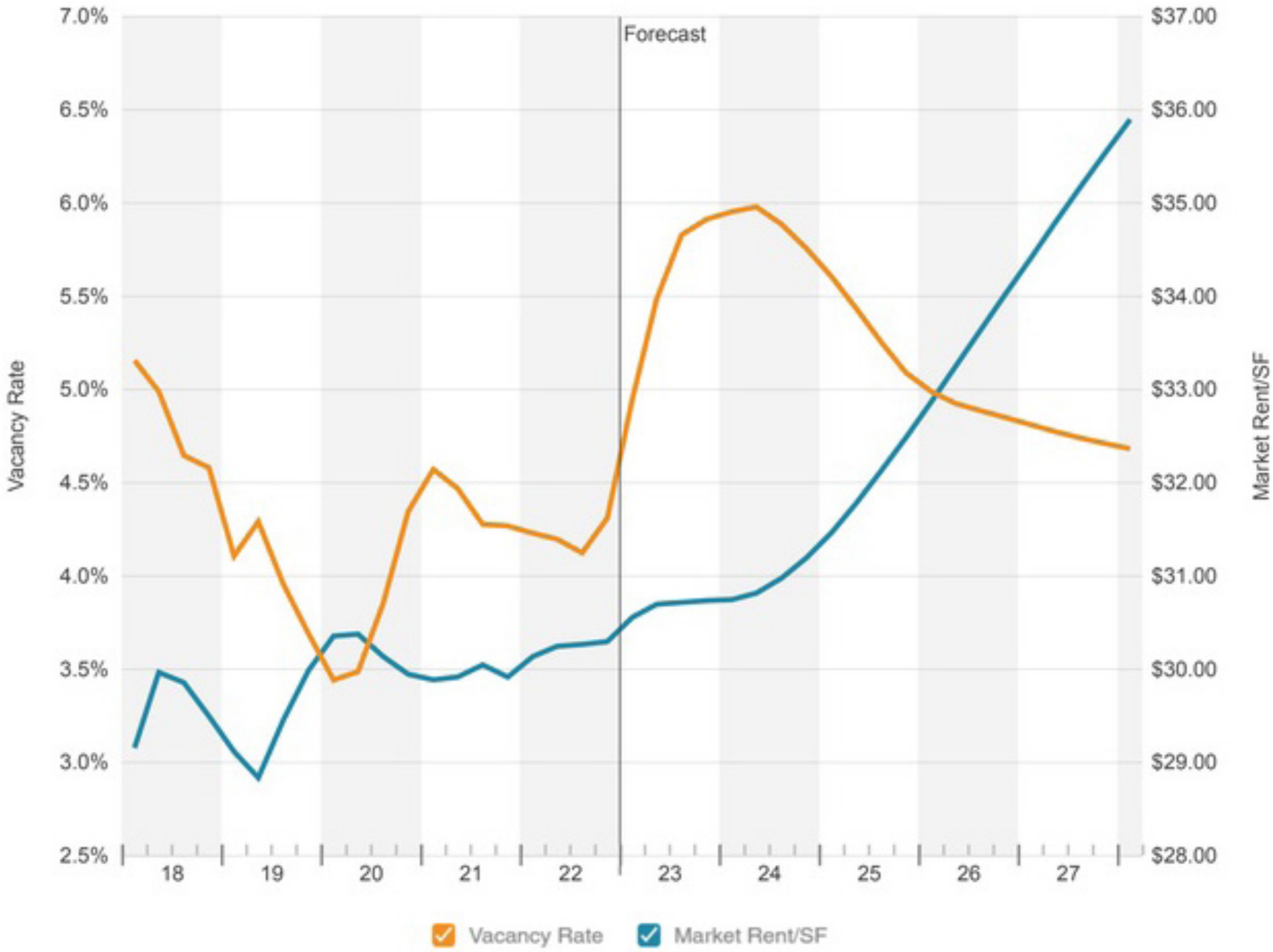


* Graph provided by CoStar

The leases that are being signed now are averaging one to three years in length. The average amount of space in these leases is around 3,300 SF (only two-thirds of the 5,000 SF average from the last couple of years). The tenants that are signing longer-term leases tend to be in the spheres of public administration, non-profit, and associations. All of this suggests that tenants are taking advantage of the market to navigate their hybrid work approaches with less financial risk.

LEASING

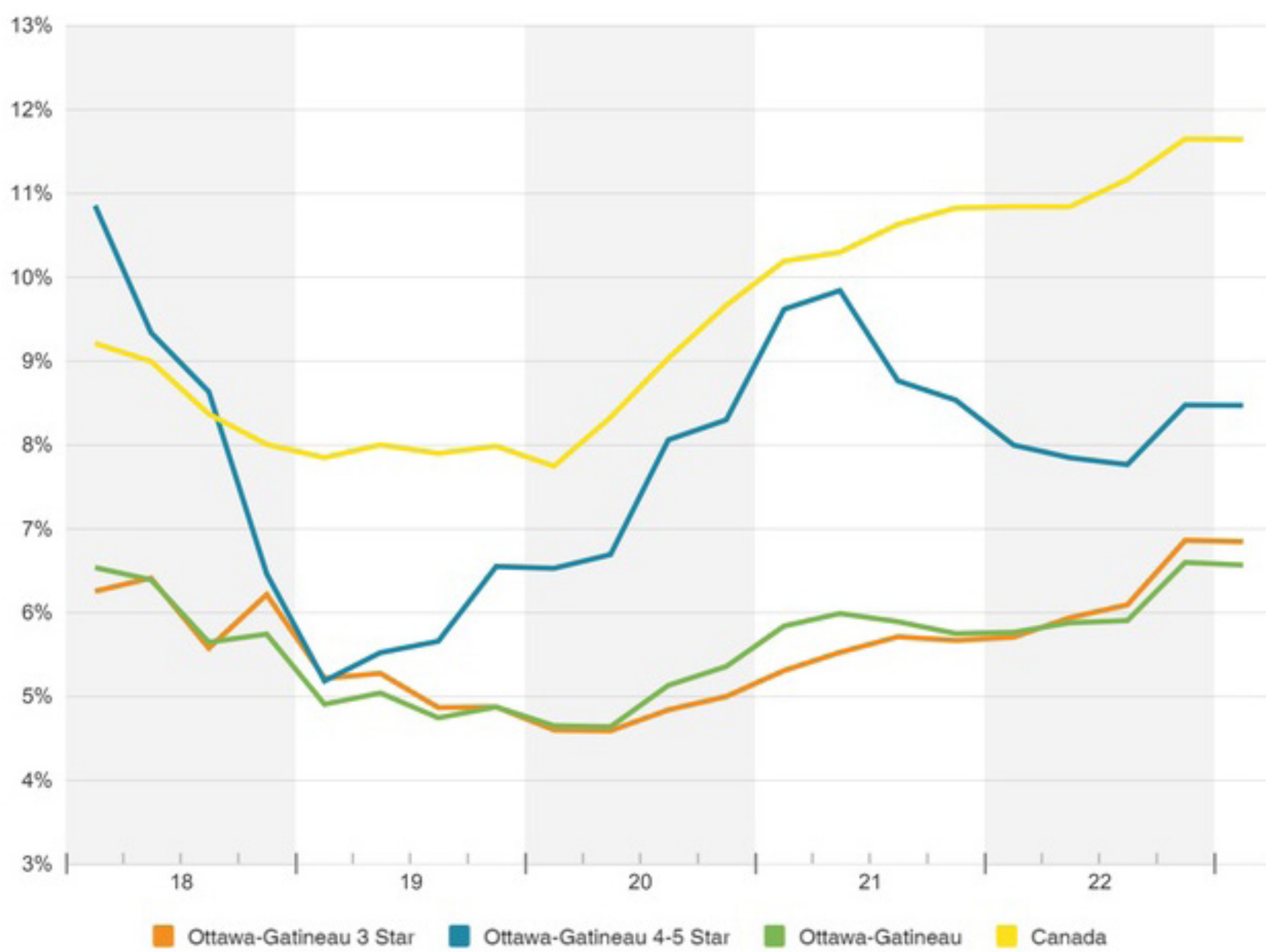
VACANCY & MARKET RENT PER SF



* Graph provided by CoStar

LEASING

AVAILABILITY RATE



Building Name/Address	Submarket	Leased SF	Tenant Name
Kanata Research Park	Kanata	44,990	NA
425 Legget Dr	West	18,000	Innovapost
YMCA-YWCA	East Central	17,325	NA
1431 Merivale Rd	West Central	11,663	NA
Constitution Square Tower III	CBD	11,653	First Nations Financial Management Board

* Graph & statistics provided by CoStar

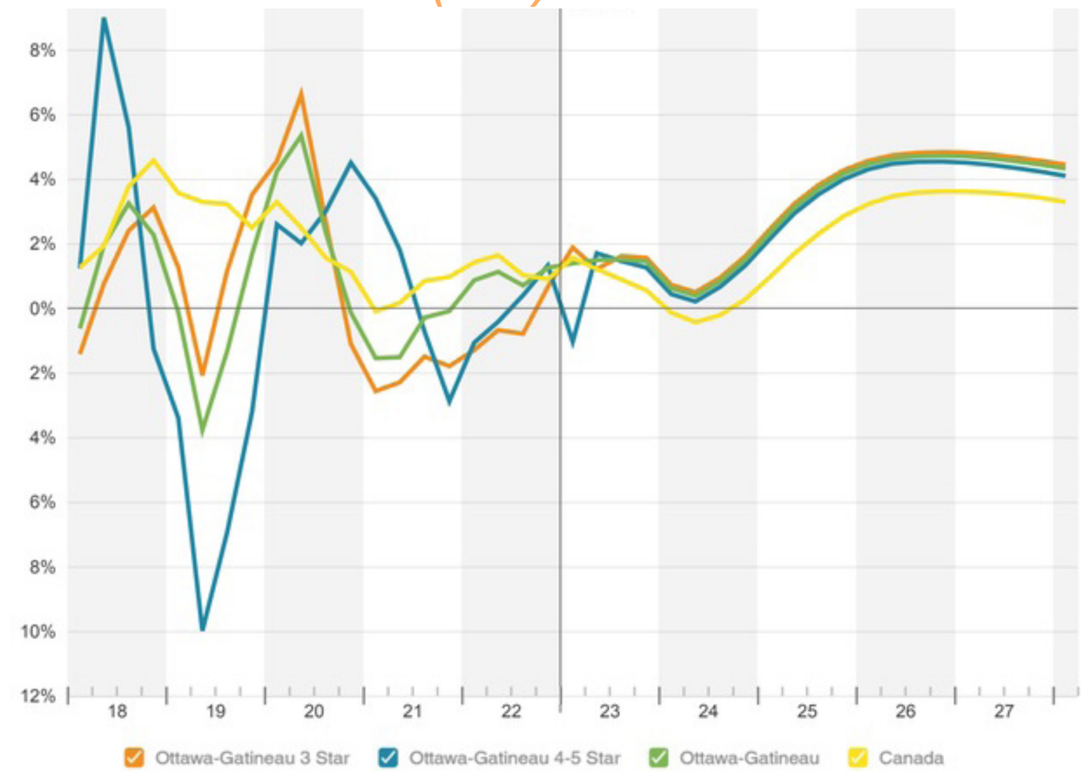
RENT

As a reflection of the leasing market, rental rates continue to remain fairly stable in Ottawa. Even as vacancies continue to increase, rent is not decreasing. Landlords have been able to resist lowering rates, opting for cash inducements and more tenant-favourable terms instead. The lease terms for the deals being signed are also shorter (one to three years) than what has traditionally been the case (five or more).

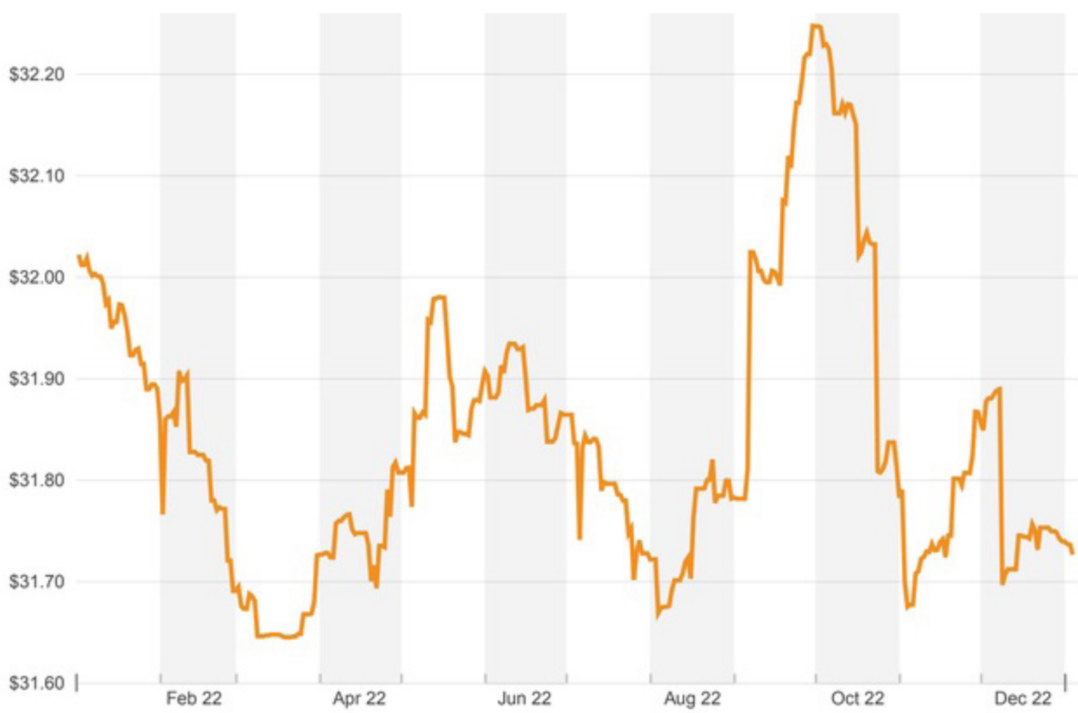
Since Ottawa is home to a huge portion of the public sector, the impacts of the pandemic on the local economy, and therefore rent, have been far less than other major Canadian cities. In recent months, annual rent growth has been positive at 1.2% (this remains behind CPI however). With the current average asking rent at $31.75/SF, we expect rates to continue to rise slowly in early 2023.

RENT

MARKET RENT GROWTH (YOY)



DAILY ASKING RENT PER SF



* Graphs provided by CoStar

SALES

Investment activity in commercial real estate has finally returned from the historic drop in mid-2020 through mid-2021. The universal adoption of remote work during the peak of the pandemic meant that office buildings were no longer the secure investment they had been before. Since then, sales have picked up with Q4 being the strongest quarter of 2022 in terms of sales. That said, the quarter's sales volume upwards of $250M was only half that of Q4 2021.

Many institutional investors (e.g. AIMCO and CPP) have now been replaced by domestic and local capital buyers who are trying to reposition office assets for the future. For example, Groupe Mach (a real estate developer/manager out of Montreal) bought two properties (one downtown and one in Gâtineau) from Cominar's office portfolio in October for $110M ($206.23/SF). Likewise, the Regional Group purchased the Qualicum Centre (a three-tower suburban office complex) in November from Manulife Investment Management for $43M ($209.82 per SF).

The average sale price per SF fell across 2022 in Ottawa from about $275/SF to $260/SF. Even though this is a small decline, the average price per SF is expected to continue to go down in 2023 as vacancies increase. In the years to come, the federal government is also likely to unload millions of square feet of currently held space. Although these assets will not hit the market all at once, this will undoubtedly have a huge impact on the region's commercial real estate market.

Significant Sales from Q4 2022:

- 222-230 Queen St with 212,644 SF sold for $61,650,000 ($411/SF) in mid-October

- 550 de la Cité with 320,742 SF sold for $66,000,000 ($206/SF) in mid-October

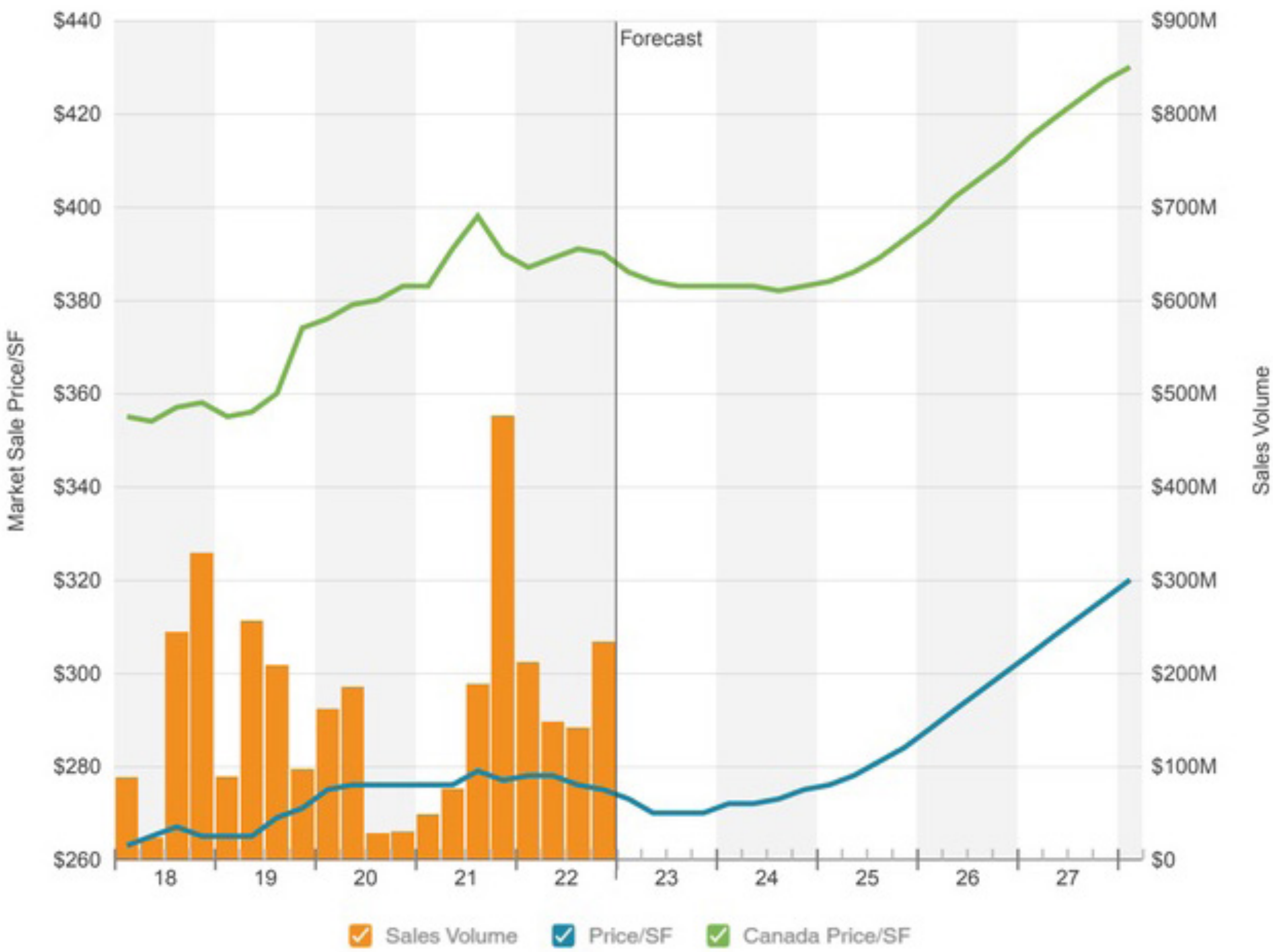
- Tower A at 2936 Baseline Rd with 68,622 SF sold for $12,931,015 ($188/SF) in mid-November

- Tower B at 2934 Baseline Rd with 91,883 SF sold for $19,109,369 ($208/SF) in mid-November

- TELUS House Ottawa at 209-215 Slater St with 115,766 SF sold for $28,123,781 ($486/SF) in late December

SALES

SALES VOLUME & MARKET SALE PRICE PER SF



120
SALE COMPARABLES

4.8%
AVG. CAP RATE

$228
AVG. PRICE/SF

9.5%
AVG. VACANCY AT SALE

* Graph & statistics provided by CoStar

SUBMARKETS

SUBMARKET RENT

		Market Rent		12 Month Market Rent		QTD Annualized Market Rent	
No.	Submarket	Per SF	Rank	Growth	Rank	Growth	Rank
1	CBD	$35.09	1	0.9%	9	-0.8%	5
2	Centretown-Byward	$31.94	2	1.0%	8	-12.4%	9
3	East Central	$28.21	6	1.0%	6	4.7%	3
4	Gatineau	$29.32	5	2.3%	2	-1.8%	8
5	Greater Kingston	$24.42	10	1.0%	7	10.4%	1
6	Kanata	$28.17	7	0.6%	10	0.6%	4
7	Northeast Ontario	$25.50	9	1.5%	3	-1.4%	6
8	Papineau-Pontiac	$26.11	8	5.5%	1	-39.6%	10
9	Tunney's Pasture	$30.30	3	1.2%	4	-1.6%	7
10	West Central	$29.42	4	1.2%	5	5.0%	2

SUBMARKET VACANCY & NET ABSORPTION

		Vacancy			12 Month Absorption			
No.	Submarket	SF	Percent	Rank	SF	% of Inv	Rank	Construc. Ratio
1	CBD	1,385,279	7.5%	9	(66,494)	-0.4%	10	-
2	Centretown-Byward	673,372	5.0%	7	(45,109)	-0.3%	8	-
3	East Central	552,119	4.3%	6	160,189	1.3%	1	0.1
4	Gatineau	241,808	1.5%	3	116,931	0.7%	2	0.1
5	Greater Kingston	82,023	3.1%	5	63,825	2.4%	3	-
6	Kanata	777,484	6.8%	8	46,145	0.4%	4	0.3
7	Northeast Ontario	58,046	1.5%	1	(24,181)	-0.6%	7	-
8	Papineau-Pontiac	-	-	-	0	0%	-	-
9	Tunney's Pasture	110,966	1.5%	2	(53,764)	-0.7%	9	-
10	West Central	394,083	3.1%	4	(5,629)	0%	6	-

* Statistics provided by CoStar