Top 10 Real INSIGHTS

2018 Ottawa Real Estate Forum

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ISSUE 15

TOP 10 | REAL INSIGHTS | 2018 Ottawa Real Estate Forum | ISSUE 15

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1. OTTAWA ECONOMY DIVERSIFYING AND GROWING

Strong employment and GDP numbers point to an expanding economy.

Ottawa-Gatineau's unemployment rate dropped to 4.3% at the end of the first half of the year, according to Statistics Canada, the lowest it's been since 2001.

11,800 new jobs were added in Q2 alone - the public sector adding 7,700 new jobs and the tech sector adding 5,700 during the quarter.

The city posted a healthy 2.7% growth rate in GDP in 2017. It will continue to grow at a stable 2.1% through 2018 and 2.0% in 2019 according to the Conference Board of Canada.

The federal government remains the primary growth driver which the board identifies as being in 'expansion mode' growing an average of 3.1% under the Trudeau administration. Federal spending rose almost 4% in 2016 and continued to grow throughout last year.

However, the region's high-tech sector is also contributing to Ottawa's economy, as it continues to diversify away from telecommunications. As a result, output growth in Ottawa's professional, scientific, and technical services industry is expected to accelerate over the next two years, continues the board.

According to PWC, the relative affordability of the Ottawa market is attracting people from other areas. Tech companies are "expanding or moving into the market as well to capitalize on the influx of talent".

2. OTTAWA BENEFITTING FROM SUBSTANTIAL CAPITAL PROJECTS

Bolstering the City's GDP numbers are capital projects that will continue over the next two decades.

Several large construction projects means that this sector will post growth of about 1.3% in 2018 and a further 2.3% in 2019.

Renovations are complete on the West Block which will be the temporary home for the House of Commons for the next 10 years while the Centre Block gets a major overhaul. So far, $3 BB has been approved for restoring all of Parliament with $1.8 BB having already been spent, $862.9 MM of it on West Block.

Phase 1 of Ottawa's new LRT system is set to open on November 2. Costing $2.1 BB, the 12.5 km Confederation Line, has 13 stations between Tunney's Pasture in the west and Blair in the east. It will connect with the existing 5 station Trillium Line.

Construction on Phase 2 of the LRT will start in 2019. It will add another 44 km of rail and 24 new stations. It will run from Trim Road in the east to Algonquin College in the West. It will extend the existing O-Train Trillium Line to Riverside South, adding stations along the way at Walkley and Gladstone, and go all the way to Ottawa Macdonald-Cartier International Airport. Upon completion in 2023, Phase 2 will bring 70% of residents within 5 km of rail. The projected cost of Phase 2 is $3.6 BB.

Gatineau also has recently revealed its own plans for an LRT. Projected to cost $2.1 BB, the LRT would cover 26 km and include two links to Ottawa's light rail system. Its projected completion date is 2028.

23% of Ottawa residents use transit as their main way of transportation. This is more than any other city without a subway in Canada.

LeBreton Flats will be home to a new $174.8 MM library that will be built in conjunction with Archives Canada. The city is selling the current main library site on Metcalfe Street for $20 MM to Slate Properties to help pay for the new library. Construction on the new 'super' library is scheduled to start in 2021.

Ottawa Hospital planning a $2 BB new Civic campus to be built on a split-level site on the eastern side of the Central Experimental Farm. The two building facility will be 12 and 8 storeys. It is expected to have 800 to 900 beds and be 3.5 MM to 4 MM SF. It would be almost twice the size of the existing Civic campus. It is not expected to open until 2026.

3. TECH SECTOR EXPLODING

Ottawa home to 1,800 Tech firms; the industry employs more than 76,000 people.

Led by local e-commerce company Shopify and the autonomous vehicle work by BlackBerry QNX, Ottawa's tech output growth hit a six-year high of 1.5% in 2017 and is expected to accelerate to 2.8% both 2018 and 2019, the Conference Board of Canada says.

According to Statistics Canada, Ottawa's tech employment jumped 15.2% in 2016-17.

The Information and Communications Technology Council predicts the tech sector in Ottawa will need to hire more than 9,700 people by 2019.

In Ottawa, the sector is reshaping the downtown office market, where tech firms – led by companies like Shopify, Klipfolio, Telesat and SurveyMonkey – now occupy more space than legal and accounting firms combined, according to CBRE.

Ottawa also has a growing number of incubators and accelerators.

OneEleven, the Toronto-based technology startup accelerator backed by OMERS Ventures, is expanding to Ottawa and Vancouver this year.

Invest Ottawa, the capital's economic development agency, is the anchor tenant and strategic partner of Bayview Yards Innovation Hub. Its services include start up incubation, acceleration and mentorship programs for new for existing companies. The University of Ottawa's three-month entrepreneurship program, Startup Garage, runs jointly out of the university campus and Invest Ottawa. In addition, the IBM Innovation Incubator Project at Bayview Yards was launched last year. The project helps companies fast-track the launch of new technologies and products to international clients by leveraging IBM's technical resources.

Enterprise software is also fuelling the tech renaissance, and Ottawa has become a hub for software as a service (SaaS) startups. The worldwide market for public cloud services was forecast to reach $275 BB by the end of last year.

Shopify has tripled the size of its Ottawa space to almost half a million square feet. As well as employing 750 at its headquarters, Shopify employs 1,150 in different locations. It is forecasted that the Ottawa office could grow to 3,000 employees by 2021 and propel it to the largest tech employer in the Ottawa.

Ciena, which is moving into its own 425,000 SF campus on Terry Fox Drive in North Kanata, employs about 1,600 locally. It is currently one of the region's largest tech employers, along with Nokia and IBM.

Ottawa has established itself as an autonomous vehicle hub. As well as being home to BlackBerry QNX's Autonomous Vehicle Innovation Center, more than 70 companies contributing to AV technology are located in the city.

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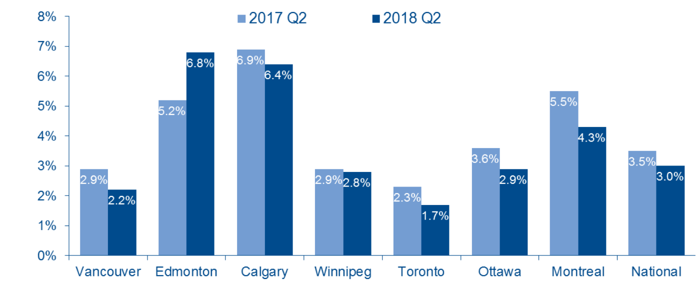
Ottawa is the first Canadian city to launch testing of an on-street autonomous vehicle (AV) communicating with live City infrastructure. The test area loops around the Kanata North Technology Park.

Recently, UK Based Aurrigo has chosen Ottawa as its North American Headquarters. The company builds driverless pods that seat up to four people and can travel in pedestrian areas.

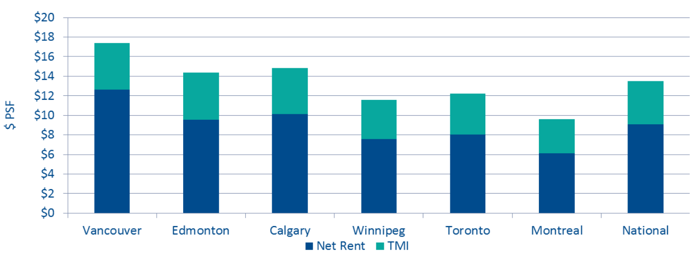
4. INDUSTRIAL SPACE SCARCE

Industrial Vacancy Rates Remain Tight Altus Group



Source: Altus Group

Industrial Rental Rates Continue to Creep Up Altus Group



Source: Altus Group

Rents keep rising as vacancy rates dips below the national average.

Ottawa's Q2 2018 vacancy rate has dipped to 2.9%, a 70 bps decrease since Q2 2017, lower than the national vacancy rate of 3.0%.

Average net rental rates have increased for the fourth consecutive quarter, and currently stand at $10.01 PSF according to Altus Group.

Rapid growth of e-commerce has sparked huge expansion in the logistics and distribution sector creating strong demand for industrial space globally and the effects can be felt in the Ottawa area.

Cushman & Wakefield estimates that 25% to 30% of industrial leasing can be traced to e-commerce needs. On a global basis, e-commerce enterprises take up 20% of new leases, up from less than 5% five years ago, according to Prologis Inc.

In the US between 2013 and 2017, developers added about 848 MM SF of warehouse space, or more than double the roughly 300 MM SF built over the five previous years, Cushman & Wakefield reports.

Broccolini has begun construction on Amazon's new 1.02 MM SF warehouse at 5381 Boundary Road which is set for completion in the second half of 2019. This distribution centre will create approximately 600 full time permanent jobs including 1,500 construction jobs.

UPS has just completed its 40,579 SF distribution facility in Kanata.

Investors Group sold a portfolio of 5 buildings totaling 554,065 SF to Desjardins Financial for $68.15 MM. The portfolio has an occupancy rate of 90% and includes properties in the Ottawa Business Park.

Some of the recent lease transactions that occurred in Q2 2018:

- 311 Legget Drive – 17,974 SF to BMT Fleet Technology
- 2477 Kaladar Avenue – 14,703 SF to Canadian Property Stars
- 1570 Laperriere Avenue – 14,000 SF to Capital Collision

As reported by Cushman & Wakefield

5. RESIDENTIAL VACANCY NEAR ROCK BOTTOM

Employment and Immigration growth are contributing to record low vacancy rates – CMHC.

Ottawa has one of the lowest vacancy rates in the country. CMHC reported that the overall rental vacancy rate decreased to 1.7% in 2017 from 3.0% in October 2016.

The average rent for a two-bedroom unit increased by 2.1% to $1,232.

Two bedroom condominiums are renting at a 27% premium. Approximately 30% of condos are rental units, according to the CMHC

The Canadian Real Estate Association reports that Ottawa is one of the strongest real estate markets in the country, with home sales up more than 10% so far in 2018, even as sales have dived by more than 23% nationally.

The City reports that Ottawa's population grew 1.1% in 2017, rising from 968,580 to an estimated 979,173 residents. Migration was an important factor in that growth, with 9,888 people moving to Ottawa – an increase of 69.7% over the previous year. To help accommodate that growing population, Ottawa saw a 36.5% increase in new housing starts in 2017, adding 6,849 households across the city. Housing starts for all unit types increased, with apartments making up 40.8% of all starts in 2017, compared to 24.8% in 2016.

The share of foreign buyers is increasing in Ottawa, RBC says. In a three-month period ending mid-February, foreign buyers accounted for 2.5% of home sales in Ottawa, compared to 1.6% in Greater Toronto.

At the end of Q2, year-to-date condo unit sales were up 16.5% from the same time last year. Furthermore, the price of single family detached homes have increased by 5% since July 2017 while the price of condos has increased by 5.3% according to OREB.

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6. OTTAWA A HOTBED OF DEVELOPMENT ACTIVITY

Low vacancy rates and increasing prices propelling development in the nation's capital.

According to BuzzBuzz Home, there are 162 new home developments in Ottawa. Of these, 69 are condo developments and 5 are apartment developments. There are 10 townhouse developments and 78 single family home developments.

The Canada Lands Corporation is currently remediating lands on a 6.5-acre parcel of land on Booth Street that was once contained labs used by the Mines and Resources Branch of Natural Resources Canada. The complex has been vacant for almost 20 years. The CLC is currently applying to rezone the land to permit buildings up to 24 storeys. The property will be sold to developers between 2020 and 2022 according to the CLC.

The National Capital Commission has partnered with RendezVous LeBreton Group to redevelop a 51.9-acre portion of LeBreton Flats. The Senators-backed Rendezvous LeBreton Group, which includes Trinity Developments, wants to build a new NHL arena, an accessible community centre, 4,000 units of housing, a French-language public school and public space. The investment for the entire proposed development is estimated at $4 BB.

Trinity Development Group and Timbercreek's purchase of Main + Main Urban Realty portfolio – a JV lead by First Capital - for $298 MM included six Ottawa properties that will likely be redeveloped:

- Richmond Road and Churchill Avenue
- Richmond Road and Island Park Drive
- 381 Kent St., at James Street
- 216 Elgin St., at Lisgar Street
- Preston and Pamilla streets
- 236 Richmond Road

Construction has not yet started on 900 Albert Street. In a JV between Trinity Developments, InterRent REIT and PBC Real Estate Advisors, this mixed-use development will include the tallest building in the city and one of the tallest buildings east of Toronto on the 3.5 acre site. The plan includes three towers 65, 56 and 27 storeys that will contain 1,241 residential units 115,000 SF of retail space, 365,000 SF of office space and 1,059 parking spaces on 6 underground levels and over 700 bicycle parking spaces.

The Domtar building will be demolished this fall to make way for the new $2 BB Zibi development. The site has been industrial since the 1800s and will need significant remediation. In June, the city of Ottawa agreed to a $60 MM grant to clean up the contaminants.

The JV between Dream Unlimited and THEIA – a subsidiary of Windmill Developments - is planning a mixed-use development with waterfront parks and pathways on the 37-acre site, which spans both the Quebec and Ontario sides of the Ottawa River. The first residential building will be ready for occupancy this fall.

The 45 storey Claridge Icon is scheduled for occupancy in October 2020. This 320 unit building in Little Italy is the tallest tower currently under construction.

Claridge Homes has plans to build 1,950 units in the next phase of their development on the east end of LeBreton Flats. The plan is for 5 mixed-use buildings ranging in from 25 to 45 floors on a 5.2-acre site it purchased from the Nation Capital Commission in 2005. The development would contain approximately 1.5 MM SF of residential space and 230,000 SF of commercial space.

The Residences at Island Park Drive is the first development outside of Toronto by developer Sam Mizrahi. The 12-storey luxury condo at 1451 Wellington St. W., designed by IBI Group, is going up in Westboro. Its 93 units were over 60% sold as of this summer. The estimated completion date is June 2021.

Construction finished this summer on the 23-storey ArtHaus, the first mixed-use hotel/art gallery/condo building in North America. Adjacent to the Rideau Centre shopping ArtHaus features an art gallery, 14 floors of Ottawa's first Le Germain Hotel, and eight floors of condos.

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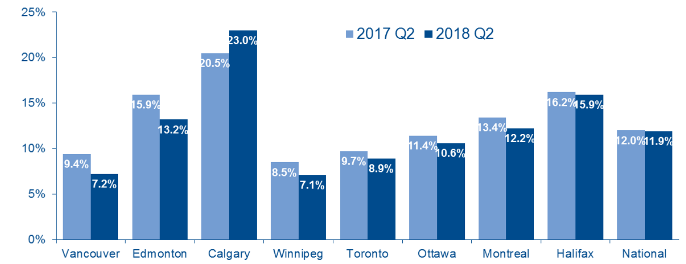
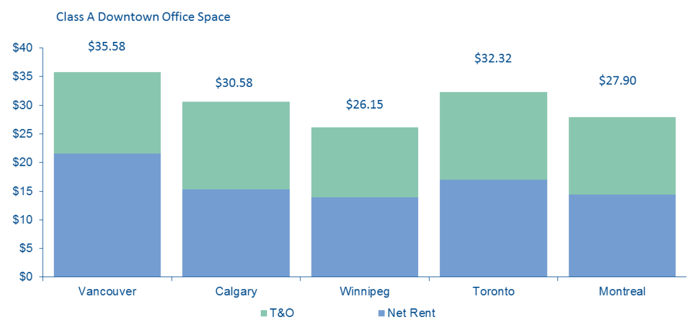
7. DOWNTOWN OFFICE VACANCY THE LOWEST IN 5 YEARS

Office Vacancy Rate in Balance Across Canada for the most part



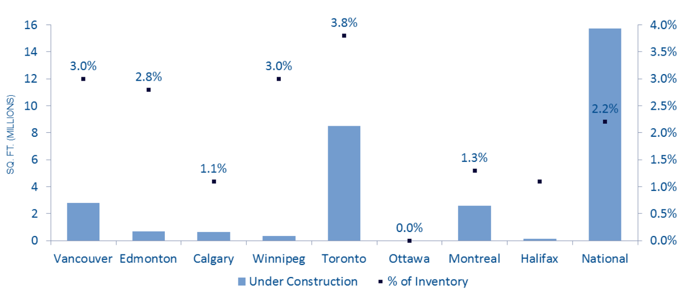
Source: Altus Group

Rental Rates Continue to be Pressured Downtown



Source: Altus Group

New Office Construction, as % of Inventory



Source: Altus Group

Positive absorption is being driven by expanding Tech and Government sectors.

The availability rate of office space in the city's downtown has gone below 10.1% for the first time since 2016 as both government and private-sector tenants look to snap up more space in the core, Altus Group says.

Ottawa's downtown availability rate dropped 9.8% at the end of the Q2, down from 11.0% compared to a year ago, reports Altus Group. Vacant A Class space is half that number.

With Kanata office vacancy rates almost at a 10 year low, KRP Properties, one of the largest developers in the area is in the planning phase of developing a new 150,000 SF office building.

During Q2 2018, there was about 180,000 SF of absorption in the CBD due mainly to tech firms. Telesat leased 75,000 SF at 160 Elgin Street and SurveyMonkey leased 50,000 SF at 200 Laurier Avenue W.

The Department of National Defense has begun to move its headquarters from downtown to Kanata. 9,000 of its employees will be housed in the former Nortel space which they acquired for $800 MM. Construction will begin in the next few years on its new $1.1 BB building that will accommodate an additional 4,500 civilian and military personnel. This will eventually free up about 800,000 SF of mostly B and C class space. The relocation process is behind by two years and only 3,600 people have moved into the Nortel space to date.

LaSalle has acquired one third interest in Minto Place for a reported $135 MM. Minto Capital, Investors Group and LaSalle now each have one third interest in the complex. Minto's three buildings range in height from 14 to 19 storeys and has 945,030 SF of retail and office space.

The expanding Federal government will put pressure on an already tight market. The government is Ottawa's largest user of office space occupying approximately 38 MM SF of space.

While new large developments – LeBreton Flats, Zibi, 900 Albert will provide more inventory to the office market, relief will not be felt for the next few years.

Some of the key leasing transactions that occurred in Q2:

- 700 Palladium Drive – 62,700 SF leased to Ford Motor Co. – New Tenant
- 151 Slater Street - 133,862 SF leased to NAV Canada - New Tenant
- 1135 Innovation Drive - 48,994 SF leased to Ottawa Automotive - New Tenant
- 160 Elgin Street - 19,984 SF leased to PWGSC - New Tenant
- 255 Albert Street - 13,727 SF leased to PWGSC - New Tenant
- 160 Elgin Street - 18,735 SF leased to Gowlings - Expansion

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8. CO-WORKING SPACES EXPANDING IN OTTAWA

This global trend has the capacity to represent 20% of the overall office market in Canada within the next 10 years, Cresa reports.

Coworking office space is increasing in Ottawa. Cushman & Wakefield states that this market occupies approximately 200,000 SF of space.

According to a recent study published by Cresa, there is one million SF of co-working space at 85 locations in Toronto. In Vancouver there is 790,000 SF in 59 locations. Toronto's downtown core has 69% of the locations while Vancouver's core has 56%.

Flexible office inventory in the US currently stands at over 51 MM SF. Flexible workspace and shared amenity spaces are projected to encompass approximately 30% of the office market by 2030.

Last October Hudson's Bay Company sold off its Lord & Taylor property in New York City to a joint venture between WeWork and private equity firm Rhone Capital. As part of the $1.6 BB deal, HBC will also lease out office space in its other locations, including floors of its downtown Toronto and Vancouver stores.

Even before the Lord & Taylor purchase, WeWork was the 11th-largest tenant in New York City, with over 2.1 M SF of office space, surpassing Goldman Sachs, according to a PwC report on real estate trends released Thursday.

Co-working companies have targeted larger corporate customers as a new path of growth. Corporations may "outsource" larger pieces of their core headquarters and regional offices to co-working operators.

Such initiatives have the potential to hurt office landlords because co-working facilities typically require less space - about 75 SF per worker compared with roughly 175 SF in traditional offices. Also, co-working leases for big tenants tend to be six months to five years, much shorter than the typical lease term of five to 15 years.

However, the desire for co-working spaces has the potential to generate income for companies whose spaces sit vacant for a good part of the day.

Spacious, monetizes dormant daytime restaurant spaces by turning them into a network of managed co-working locations. Its capital expenditures are 30 times lower than WeWork, and it has enjoyed exponential membership growth over the past 12 months in New York City. Toronto startup Flexiday operates under the same concept and has 14 locations in restaurants around town since it began in October 2017.

9. MARIJUANA DEMAND FOR CRE INTENSIFIES

PC policy shift is generating new interest among pot retailers.

Colliers says that cannabis growers, warehouses and distributors are actively searching for space in advance of legalization this fall. However, the firm says landlords remain leery as they determine how their policies towards the emerging sector.

RioCan said it's anticipating a "gold rush" from Canada's legalization of recreational marijuana in October, bringing premium rents and boosting demand for retail real estate across the country's biggest markets.

A Cannabis production plant has been proposed for the former Nestlé plant in Chesterville. Lead by CannabisCo, the proposal is to convert 100,000 SF of the 373,000 SF space into cultivation with an option to expand to 300,000 SF of cultivation space. The proposal is expected to create 200 jobs.

Another proposal near Greenly on Ramsayville Road, by Artiva, is to convert 549,000 SF of greenhouse space into cannabis cultivation. Another building on the site would be used for packaging and storage. Future phases proposed adding another 646,000 SF, including converting existing greenhouses and building new ones. Approximately 80 new jobs will be created during the first phase.

Ontario's PC government has announced that it would allow private retailers to sell marijuana starting April 2019.

This policy shift has lead Second Cup, in partnership with National Access Cannabis to review more than 130 of its Ontario locations for potential conversion to pot stores.

Aurora Cannabis and Alcanna have scouted more than 100 possible retail locations in Ontario.

A CBRE industrial market study for Denver indicated that the average effective lease rate for grow facilities was $14.19 psf, two to three times higher than the average warehouse lease rates in the four top cultivation submarkets. Property lease and sale rates are substantially higher due to the massive electrical, plumbing, HVAC, drainage and security upgrades made to an industrial property converted to a major indoor cultivation operation.

In Canada, the federal government estimated that Canadians would spend $4.2 BB in 2018 alone. This is equivalent to about 0.2% of the GDP on pot.

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10. RETAIL SECTOR SHOWS SIGNS OF LIFE

Retailers are finding ways to thrive despite the challenges of e-commerce, minimum wage increases and store closures.

In a surprise move, Shopify announced that it will open its first bricks and mortar store this year.

Shopify's physical space will cater to small business owners. Shopify figures that most of the people who visit the location will be developer partners or merchants seeking information to collaborate, but they also envision that the space could be used for events or opened to merchants to sell their products. "The (companies) who do really well are the ones that realize we don't actually have to sell anything at our bricks and mortar store, it's just an extension of our brand, maybe it's a way for us to communicate with our community," Harley Finkelstein, COO of Shopify says.

Many brands espouse a Bricks and Clicks retail strategy. This allows their customers to see goods in person and assess their quality, and fit and engage with knowledgeable staff. Customers will often bring returns back in person and reduce shipping costs.

Ottawa's largest development landowner, Taggart Group of Companies, is currently developing a number of retail centres.

- Kanata West Centre, a 300,000 SF site anchored by Cabela's and Princess Auto
- Shops of Eagleson Road, a 60,000 SF site in Kanata South which will include a 200 unit retirement home
- Shops of Tenth Line Road, a 100,000 SF site in Orleans anchored by a 48,000 SF Sobeys
- Cardinal Creek Centre, a 350,00 SF mixed-use development also in Orleans that will be serviced by the Confederation Line.

RioCan is looking to modernize many of its retail sites. It is in the process of redeveloping Gloucester City Centre in conjunction with Killam Apartment REIT incorporating purpose built apartment buildings and a significant retail component. It is also looking to redevelop Westgate Shopping Centre, Lincoln Fields and Elmvale Acres shopping centres in Ottawa.

The traditional mall food court concept is getting a facelift. Gone are poorly lit spaces with the usual vendors. They are being transformed into Food Halls – spaces that offer a wider variety of food and even grocery items and a variety of seating configurations. Food Halls often serve alcohol and emphasize local restaurateurs and healthier eating options. 40% of consumers today will pick a mall to visit primarily based on the restaurants located there, according to a report from Jones Lang LaSalle. Shoppers who eat at the mall will then spend 35 minutes more there and spend 12% more money at stores there, JLL found.

"Food halls are about so much more than just real estate," said Garrick Brown, the US national retail research director at Cushman & Wakefield. "No other retail category has generated as much aggressive expansion over the past few years as food-related retail. ... Food halls offer consumers a definitive experience — and for that reason, they're largely e-commerce-proof."

Cushman & Wakefield is predicting that by 2020, there will be three times as many food halls across the U.S. at retail properties. The firm is currently tracking more than 200 existing and planned food halls.

A host of new brands are expanding into the Canadian market while other brands are looking to increase the number of their locations.

MUJI's Canadian President, Toru Akita, said that he expected MUJI to operate between 15 and 20 stores in Canada by the year 2020. The retailer has 8 locations in the GTA and GVA.

UNIQLO has announced that it will open four stores in Canada in the fall of 2018 doubling its current number of locations. It is ramping up its Canadian expansion that could see as many as 100 stores open over the next several years.

Australian eyewear retailer Bailey Nelson hit the Canadian market last fall. Canada could see as many as 40-50 Bailey Nelson stores open over the next four years. Stores will be in the 1,000 SF to 2,000 SF range.

Value priced Chinese retailer MINISO is opening stores in Canada at a faster rate than was originally anticipated. It anticipates having about 100 locations coast-to-coast by the end of 2018 and 500 stores in three years.

Mastermind Toys is expanding its footprint across the country at the fastest pace in its history — aiming to grow from 56 stores to 60 by the end of the year and 90 by the end of 2020.

Ottawa based Farm Boy opened its 25th location in this year and plans to open another 12 to 15 stores in southwestern Ontario and the GTA in the next three years.

Co-founder of Sporting Life, David Russell says that that the closing of Target and Sears has made it easier for them to expand into some locations. It plans to open eight more stores across the country.

With the completion of the Confederation Line along with new multi-family development, retail demand is expected to grow over the next few years.

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