Third Quarter 2020 / Office Market Report

Greater Toronto Area

Quick Stats

3.8%
Overall downtown office vacancy rate vs. 9.5% in the suburbs

4.4 msf
GTA total available sublease space – an all-time high

9.8 msf
GTA-wide office area under construction – equating to 5% of existing stock

50%
Year-over-year decline in GTA office leasing volume

569
Number of sublet spaces added to market vs. 88 leased year-to-date in the GTA

The impact of COVID-19 and the Great Lockdown on Canada's largest office market became more obvious in the third quarter of 2020. Despite the easing of some government restrictions and a commendable effort by landlords and employers to provide safe and healthy work environments, the return to office has been slower than initially thought. Many who have returned are on a modified work schedule with anecdotal evidence that on average, about 20% of space is being used. Others continue to work from home until at least the end of 2020. There is a growing awareness and acceptance of the idea of more "flexible" or "fluid" workplaces and longer-term remote work plans will ultimately result in a more distributed workforce going forward. However, there is also staunch support for the physical office remaining a key component in the increasingly hybrid workplace.

Lower transaction volumes reflect the mood of the market as most tenants opt to stand on the sidelines. Some tenants who had leased space not long ago have put all or part of their premises up for sublease – and this goes beyond the tech sector. Renewals, smaller expansion deals and shorter lease terms are prominent. For now, rental rates have generally held firm; however, incentives (cash and free rent) are rising – especially from landlords with notable or growing availability. By square footage, renewals outpaced new deals by two-to-one in the second and third quarters. Leasing activity in the first three quarters of 2020 totalled an estimated 4.4 million square feet (msf) – down significantly from 9.2 msf during the same period in 2019.

Unsurprisingly, third-quarter absorption turned negative as the GTA market heads for its worst performance in at least seven years. Overall availability entered double-digit territory for the first time since 2017, jumping 140 basis points (bps) quarter-over-quarter to 10.7%, while vacancy rose 100 bps to 6.6%. Available sublease space continued to climb – up a staggering 2.1 msf or 91% since year-end 2019 to an all-time high of 4.4 msf (24% of total available space). New-supply additions

35%

Downtown sublet space as a proportion of total available space – up from 20% at year-end 2019

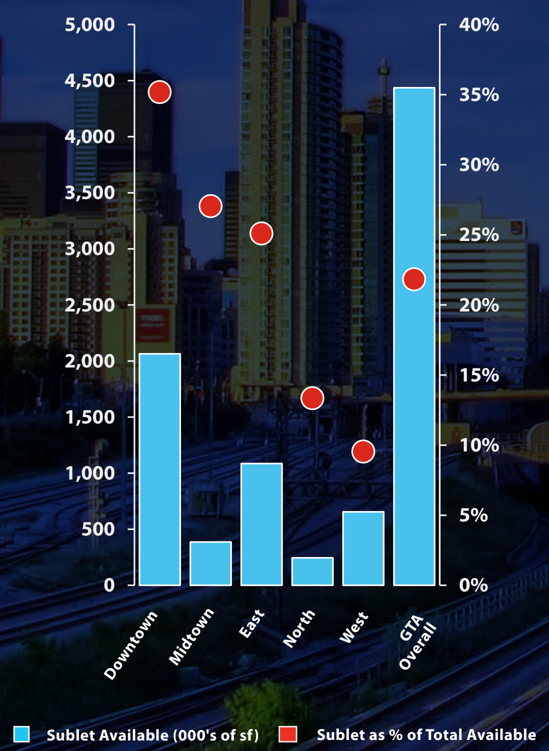
52

Suburban class A buildings with more than 50,000 sf available vs. 35 downtown

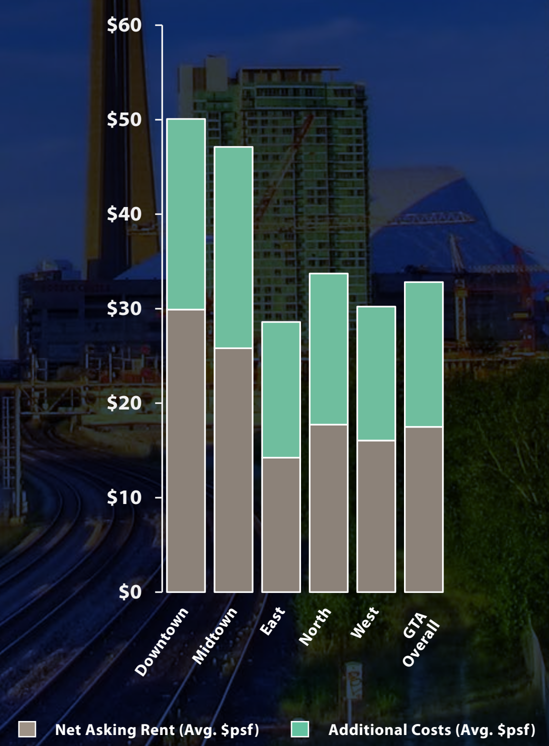
1.1 msf

Available sublease space in Toronto East – more than Toronto West and North combined

GTA Sublet Availability - All Classes

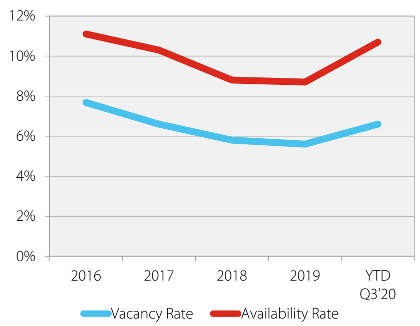


GTA Occupancy Costs - All Classes

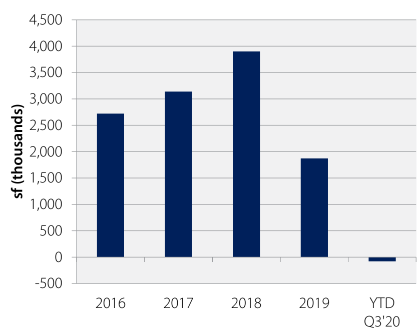


The scales will likely tip in tenants' favour as more and larger blocks hit the sublease market, forcing landlords to adjust pricing.

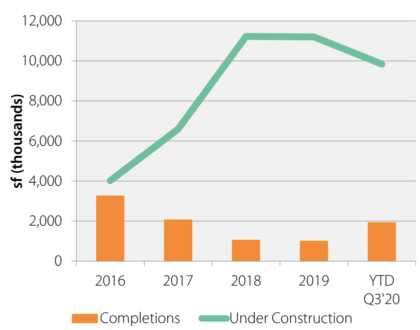
GTA Overall Availability & Vacancy Trends



GTA Overall Absorption Trends



GTA Overall New Supply Trends



totalled 1.3 msf (mostly downtown), bringing the year-to-date tally to 1.9 msf – ahead of the 804,000 sf delivered during the same period in 2019. Total office area under construction dipped to 9.8 msf (75% preleased) – below the 10-msf mark for the first time in eight quarters.

Office demand in downtown Toronto has paused, while the market continues to be flooded with sublease space, prompting higher availability (+190 bps to 7.5%) and vacancy (+130 bps to 3.8%) rates (albeit coming off historic lows). The burgeoning downtown sublease market has more than tripled (+1.4 msf or 217%) since year-end 2019 to a historic high of 2.1 msf (35% of available space downtown, and 47% of available sublease space GTA-wide). Class A buildings account for 50% of available downtown sublease space, with nearly two-thirds (61%) located in the Financial Core and Downtown West nodes. Sublease options often provide leverage for tenants to improve terms, but lease-up of subleases has been slow and rates are holding firm, on par with direct landlord space – for now. However, the scales will likely tip in tenants' favour as more and larger blocks hit the market, forcing landlords to adjust pricing.

Notable transactions downtown included a 222,500-square-foot (sf) renewal by Mackenzie Financial in two adjacent complexes (180 Simcoe St. and 180 Queen St. W.) and Shopify's 89,300-sf expansion at The Well project – part of the nearly 9 msf (77% preleased) under construction downtown. Meanwhile, Cadillac Fairview and Ontario Pension Board completed their 16 York St. development (879,000 sf / 86% leased) in Downtown South. Notable tenants include First National Financial, HSBC, Freedom Mobile and Morneau Shepell. Next quarter, Ivanhoé Cambridge and Hines will unveil their 1.5-msf CIBC Square Phase 1, almost 100% leased.

Similar conditions plague Toronto's Midtown market. Availability (+310 bps) and vacancy (+300 bps) moved up in tandem to end the quarter at 8.7% and 3.8%, respectively. Year-to-date, sublease available space has doubled to more than 386,000 sf – with almost 75% in class A product. EQ Bank has the largest sublet offering (96,000 sf over eight floors), at 30 St. Clair Ave. W. In other news, Cineplex is pursuing a sale-leaseback of its 87,000-sf headquarters at 1257 & 1303 Yonge St.

Though not as pronounced as in downtown and midtown, suburban availability and vacancy each increased 80 bps quarter-over-quarter to 13.8% and 9.5%, respectively. Toronto West posted the highest availability (14.7%) and vacancy (11.1%) and accounts for 75% of the 626,000 sf of suburban new supply completed year-to-date. Toronto North had the lowest availability (11.9%) and most suburban office space under construction (56% of 892,000 sf). Meanwhile, despite posting the lowest vacancy (7.6%), Toronto East accounted for the lion's share of available suburban sublease space (1.1 msf / 55%). Though the suburbs offer abundant and affordable options, there is little evidence so far to suggest a reverse migration of tenants from downtown or a move to a "hub-and-spoke" model.

Greater Toronto Area Market Summary

Availability Trend			Vacancy Trend			Change in Occupied Area (000's of sf)		New Supply (000's of sf)		
12 Months Ago	3 Months Ago	Current Quarter	12 Months Ago	3 Months Ago	Current Quarter	Current Quarter	YTD	YTD Completions	Under Construction	Preleased
8.9%	9.3%	10.7%	5.8%	5.6%	6.6%	-680	-79	1,906	9,843	75%

Comparison of Leasing Options for Tenants

	Available Space				Availability Rate		
Office Space in Select Districts	No. of Bldgs.	Bldgs. with more than 50,000 sf	Bldgs. with largest contiguous available area greater than 50,000 sf	Number of spaces between 4,000 sf and 8,000 sf	Direct %	Sublet %	Total %
Downtown All Classes	429	39	19	223	4.9	2.6	7.5
Downtown Class A	135	35	17	80	4.3	1.9	6.2
Midtown All Classes	142	6	1	45	6.4	2.3	8.7
Midtown Class A	39	5	1	20	8.0	4.1	12.1
Toronto East All Classes	334	22	12	107	10.0	3.4	13.4
Toronto East Class A	135	12	6	62	9.3	3.5	12.8
Toronto North All Classes	131	12	7	49	10.3	1.6	11.9
Toronto North Class A	59	11	6	27	10.1	1.9	12.0
Toronto West All Classes	530	36	15	171	13.3	1.4	14.7
Toronto West Class A	259	29	11	97	13.2	1.7	14.9

Greater Toronto Area Significant Transactions

Address	District	Tenant	Size
180 Simcoe St. / 180 Queen St. W.	Downtown	Mackenzie Financial	222,500 sf
The Well	Downtown	Shopify	89,300 sf
3100 Steeles Ave. E.	East	MNP	29,300 sf
5140 Yonge St.	North	Robert Half	11,300 sf
2095 & 2105 Matheson Blvd. E.	West	Pepsi Canada	114,200 sf

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