MARKET REPORT

OFFICE

Calgary Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS
A DIVISION OF MARCUS & MILLICHAP, BROKERAGE

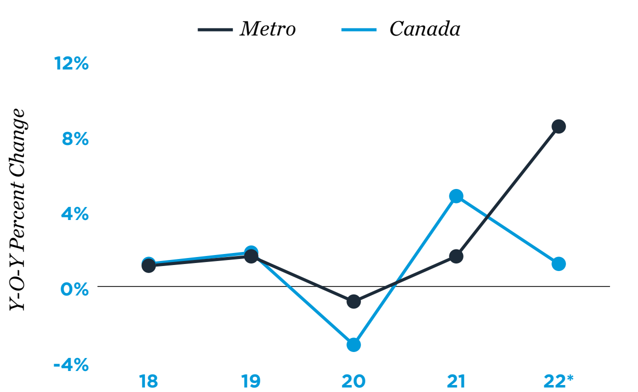
3Q/22

Economic Diversification to Play a Key Role in the Recovery of Calgary's Office Market

Impact of oil and gas decoupled from office performance. Due to Alberta's vast amount of natural resources, Calgary has historically been home to head offices and capital management divisions for multinational energy corporations. When oil is above $100 per barrel, economic activity and office leasing tend to be robust, but when the price declines, economic momentum follows. However, the price per barrel of oil reached the $100 threshold in early 2022, yet office fundamentals remain bleak. These unfavourable outcomes can be attributed to the uncertainty regarding in-person work, plus the slowdown in capital spending from oil and gas companies. Many of these firms are using increased profits for share buybacks and higher dividends, instead of expanding operations, as new efficiencies have dampened the need to re-hire. Although office fundamentals are weakening, owners are continuing to invest in their buildings, and others are getting creative by finding alternative uses for their assets. These may not have an immediate impact on office vacancy, but it is resulting in some cautious optimism toward the future of the Calgary office market.

Calgary economy gradually diversifying. In an attempt to become less dependent on oil, the city has begun offering grants and tax incentives to attract technology firms. This appears to be working, as Amazon will be opening a new AWS computer hub, and IBM will be opening an innovation hub in 2023. These new tenants entering the market are beginning to offset the consolidation from energy companies. Although net absorption remains negative, the magnitude is beginning to soften and leasing activity is strong, returning to pre-pandemic levels, again resulting in some cautious optimism.

Employment Trends



** Forecast*

Sources: Statistics Canada; CoStar Group, Inc.; Altus Data Solutions

Office 2022 Outlook

EMPLOYMENT:

70,700
JOBS
will be created

Employment growth is well above 2021, largely due to the spike in oil prices caused by the war in Ukraine, coupled with more reliance on Canadian energy. Also, with tech innovation hubs opening, employment should remain robust and be less influenced by oil price volatility.

CONSTRUCTION:

0
SQ. FT.
will be completed

No developments are expected to enter the market in 2022. At the same time, various office properties are being repositioned to multifamily, self-storage and vertical farms. This stems from the city's Downtown Development Incentive Program.

VACANCY:

170
BPS
increase in vacancy

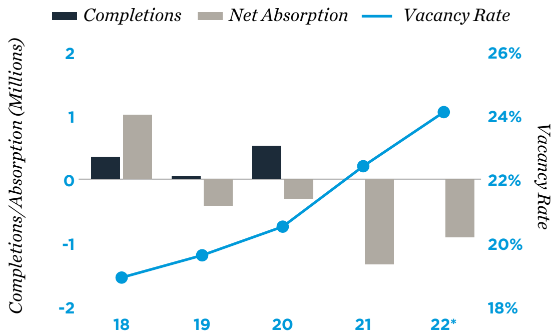
Net absorption has been negative thus far in 2022, and vacancy will rise to 24.1 per cent by year-end. This increase is being driven by energy companies consolidating, such as Shell, who downsized its office footprint by roughly 300,000 square feet.

RENT:

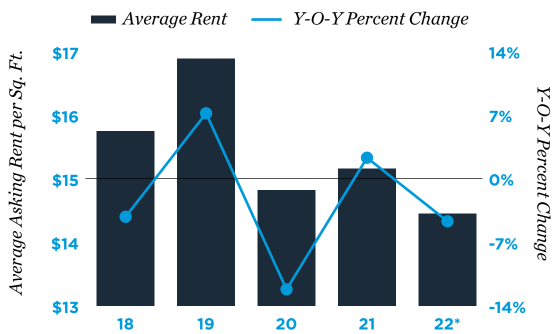
4.7%
DECREASE
in asking rent

The average asking rent is expected to end the year at $14.45 per square foot. This is mainly due to lower-tier assets returning to the market and limited availabilities in upper-tier, Class A assets. Calgary is also experiencing the flight-to-quality trend, resulting in more obsolete and harder-to-lease assets coming to market.

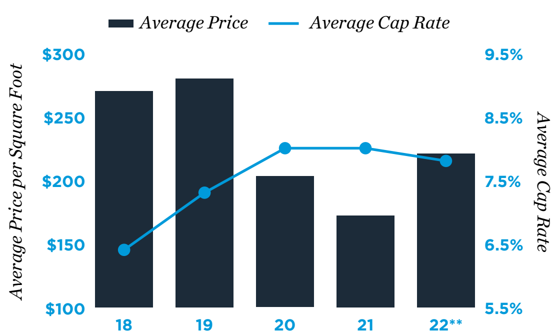
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Altus Data Solutions

2Q 2022 - 12-Month Period

CONSTRUCTION

0 sq. ft. completed

- Calgary has experienced double-digit office vacancy since 2015, prompting builders to remain on the sidelines. In 2021, the government started its Incentive Program, attempting to convert office space into alternative uses.
- Over the past year, five properties, totaling 665,000 square feet, have been approved for conversion, with the hope of removing some obsolete stock.

VACANCY

180 basis point increase in vacancy Y-O-Y

- The suburbs experienced the largest increases in vacancy throughout the first half of 2022. North and South Calgary saw negative net absorption of roughly 370,000 square feet and 360,000 square feet, respectively.
- Downtown, which still has the highest vacancy rate, saw 300,000 square feet of positive absorption, causing vacancy to decrease over the past year.

RENT

5.2% decrease in the average asking rent Y-O-Y

- The average asking rent fell over the trailing 12-month period, which was mostly driven by the large decrease seen in the North Calgary market.
- Increased availability in lower-tier assets is driving average asking rates down. Although vacancy is still elevated in the higher-tier downtown properties, the metro is experiencing the flight-to-quality trend.

Investment Highlights

- Investment activity has remained relatively quiet during the health crisis. However, the first two quarters of 2022 saw an uptick, with an 80 per cent increase in total transactions from the first half of 2021, and a nearly 40 per cent increase from pre-pandemic times in 2019. Like all other major metros, private Canadian investors hold the largest share of office purchases, with just over 60 per cent of total dollar volume so far this year. Developers are second at 20 per cent, which could be attributed to the Development Incentive Program to convert obsolete assets into alternative uses.
- The average price has decreased by roughly 35 per cent over the previous five years. This stems from weak underlying fundamentals, such as high vacancy due to the city's reliance on the oil and gas industry, but also because of the global health crisis causing vacancy to rise even further. With these falling prices, cap rates have also risen, increasing by 280 basis points since 2018. Calgary has the highest cap rate of all major metros, but has started to compress slightly as energy prices rebounded following the health crisis.
- The government recently announced a $1 billion revitalization plan for the downtown core, consisting of infrastructure projects, green space and cultural expansion. These improvements should benefit the future investment outlook as the downtown will be more desirable to potential tenants.

IPA Office

Al Pontius

Senior Vice President, Director

Tel: (415) 963-3000 | apontius@ipammi.ca

Prepared and edited by:

Luke Simurda

Director of Research, Canada | Research Services

For information on national office trends, contact:

John Chang

Senior Vice President | Director, Research & Advisory Services

Tel: (602) 707-9700 | jchang@ipausa.com

Price: $250