CBRE NATIONAL INVESTMENT TEAM
VANCOUVER

2020

Downtown Vancouver Office Market: COVID-19 Edition

INTRODUCTION

It has now been approximately twelve weeks, or the equivalent of one quarter, since we were all asked to work from home and social distance to help stem the spread of the COVID-19 pandemic. From that surreal beginning, few of us would have predicted the efficacy of the global mobilization that shuttered businesses, sporting events, air travel and international borders. Nor could we have predicted the myriad of government support programs, from interest-free loans to commercial rent relief. In the long term, all of us will be asked to repay this government largess in some form of higher taxation, but that is a topic for another study.

For now, the short-term deep freeze that has idled our economy is beginning to melt as we slowly return to work, and with businesses haltingly reopening, we are finally getting a glimpse into our new normal. Accordingly, we are pleased to provide you with our Q1 study on the effects of the health crisis on the downtown Vancouver office market.

Some highlights:

- While demand has diminished for now, we expect the pre-COVID demand trend to resume to a large degree as the economy begins to open up, given the strong underlying macro-economic fundamentals.
- With only four headlease spaces greater than 20,000 square feet available in existing downtown product, the Vancouver office market is uniquely positioned to weather short-term volatility stemming from the COVID-19 pandemic.
- COVID-19 has resulted in a proliferation of subleasing activity, from 37 opportunities at the end of Q4 2019 to 90 today. These subleases represent just over 500,000 square feet of space and increased the overall vacancy rate to only just over 4%. This makes it one of the strongest office markets in the world from a vacancy perspective.
- With current low vacancy rates, coupled with the long lead time before new office buildings under construction are complete, we expect a minimal negative short-term impact on office rental rates throughout Greater Vancouver.
- A conservative forecast scenario, including the newly-delivered sublease space, would place vacancy rates at a peak of only 7% by 2024, still under the 8% that represents a balanced office market.
- Global quantitative easing should result in a long-term low interest rate environment resulting in capitalization rate compression, with yields for Vancouver office product remaining at or below pre-COVID levels.

This study was done in collaboration with our CBRE teams globally and nationally, as well our local office research team.

To frame our analysis of how the local and global actions of business and government have impacted and how they will impact the performance of the Vancouver office market, one of the most fundamentally sound asset classes pre-COVID, we will begin our study, appropriately, at the beginning.

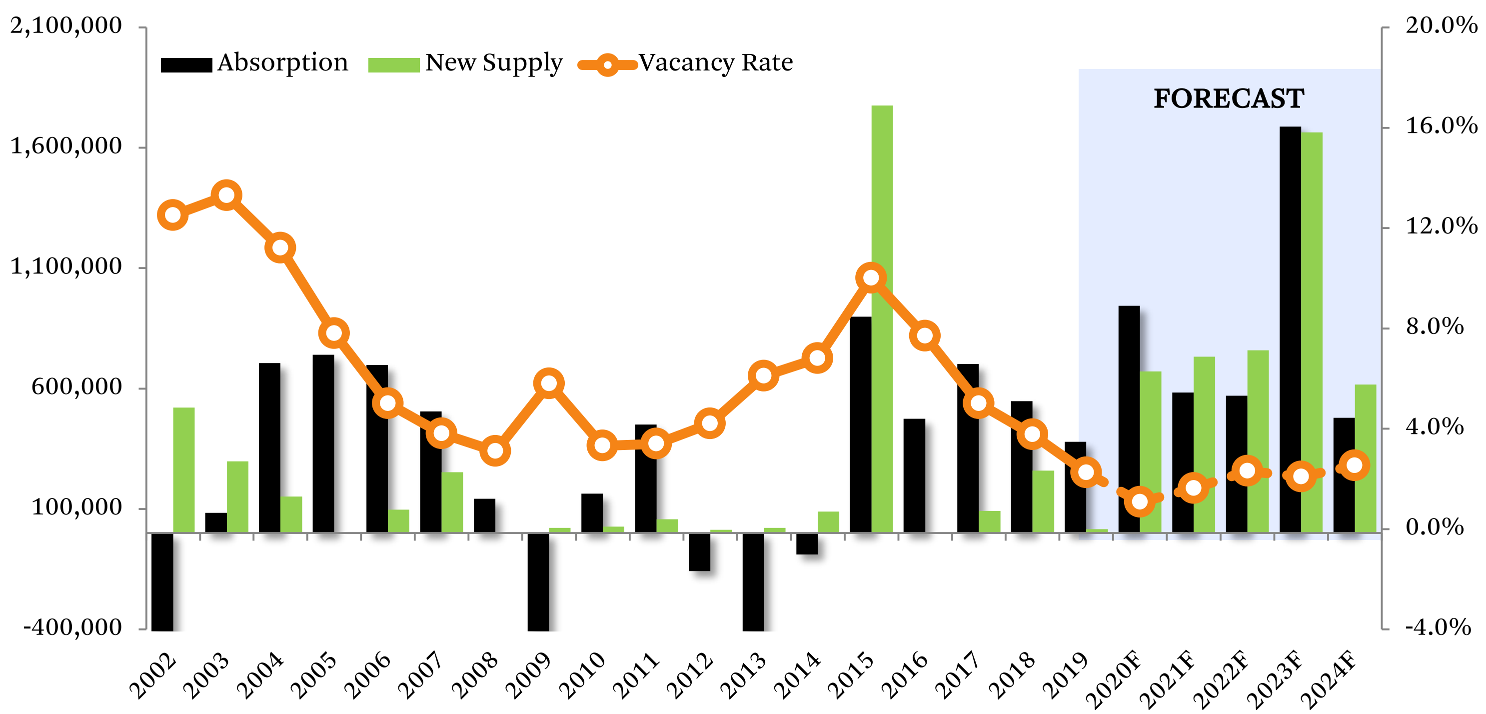
VANCOUVER ENTERS THE CRISIS WITH ONE OF THE STRONGEST OFFICE MARKETS IN HISTORY, INSULATING IT FROM SLOWING DEMAND

Downtown Office Vacancy, Q1 2020

Q1 2020	All Classes	Class AAA	Class A	Class B	Class C
Inventory (SF)	24.0 M	5.7 M	6.9 M	6.8 M	4.5 M
Vacancy Rate	2.2%	1.5%	2.1%	1.5%	4.3%

With a vacancy rate of 2.2%, the Vancouver office market was well positioned pre-COVID to absorb the future supply of the 3.9 million square feet of new office space under construction. This construction continued unabated throughout the lockdown and represents 16% of the downtown Vancouver office market, with a remarkable 66% pre-leased prior to the crisis. This strong pre-leasing activity occurred as much as three years in advance and underscored the significant pent up demand that existed when construction of these buildings commenced. Moreover, of the 66% of pre-leased space, more than 78% was new absorption, and with up to three years left to fill the new pipeline and existing stock virtually full, our leasing teams were forecasting vacancy rates would stay below 4% until the completion of the new office spaces in 2024.

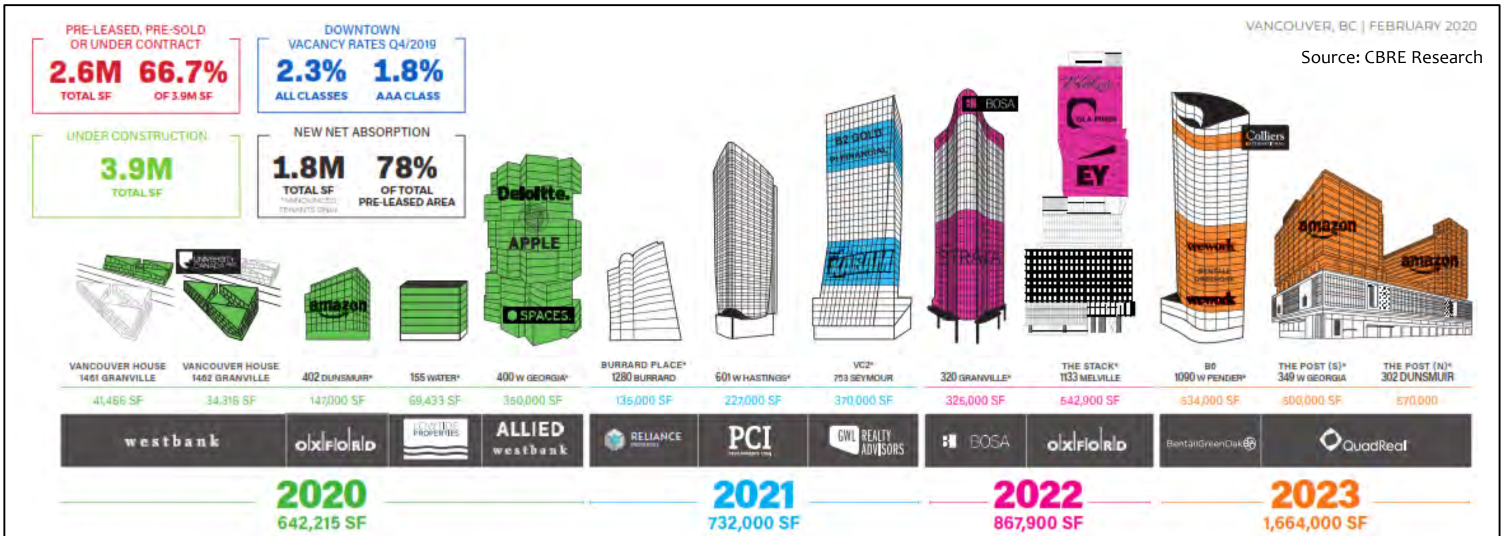
Downtown Vancouver Historical Vacancy and Pre-Pandemic Forecast



Source: CBRE Research

While demand has diminished for now, we expect the pre-COVID demand trend to resume to a large degree as the economy begins to open up, given the strong underlying macro-economic fundamentals.

The high level of pre-leasing for new product, coupled with the fact that there are only four headlease opportunities greater than 20,000 square feet available in existing downtown product, means that the Vancouver office market is uniquely positioned to weather short-term volatility stemming from the COVID-19 pandemic.

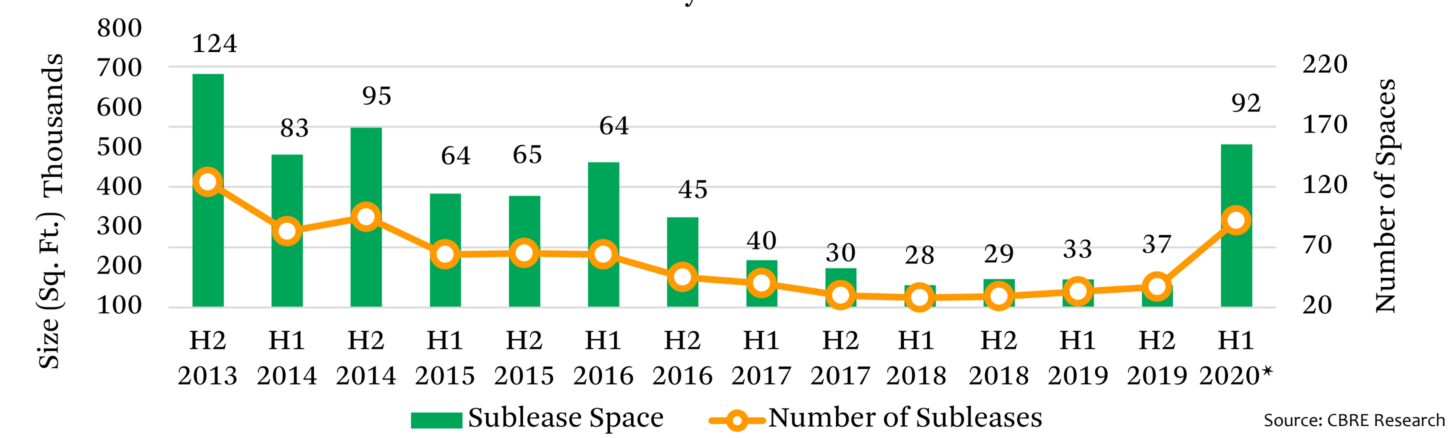


FIRST SIGN OF IMPACT

The first sign of market stress was felt this quarter on the demand side. Few tenants are looking to move into new space, and many want to reduce short-term costs. The first real shockwaves to hit the market were delivered via the downtown Vancouver sublease market. Uncertainty pushed some tenants to withhold from moving forward with leasing contracts, with some refusing to take occupancy. This has resulted in a proliferation of subleasing activity.

While the number of subleases available in the market has swollen from 37 opportunities at the end of Q4 2019 to 90 today, the delivery of these subleases represents just over 500,000 square feet of space and increased the overall vacancy rate to only just over 4%.

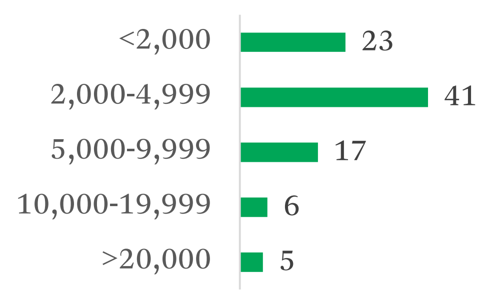
Downtown Vancouver Historical Sublease Availability



Source: CBRE Research

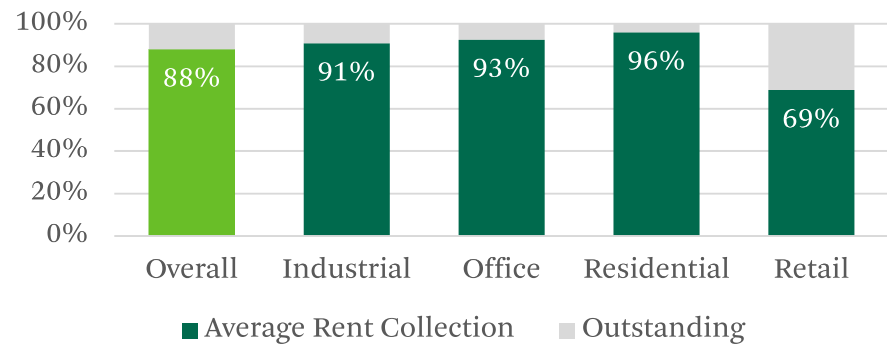
By any historical measure, and in comparison to most markets around the globe, Vancouver remains fundamentally one of the strongest office markets anywhere. Furthermore, only six of the available sub-leases currently available in the downtown Vancouver office market are greater than 10,000 square feet, and only five are greater than 20,000 square feet. With current low vacancy rates, coupled with the long lead time before the new office buildings under construction are complete, we expect a minimal negative short-term impact on office rental rates throughout Greater Vancouver. While some smaller users may benefit from potentially lower rental rates in short-term sublease space, the integrity of the overall market is expected to remain very stable.

Downtown Vancouver Sublease Sizes



Source: CBRE Research

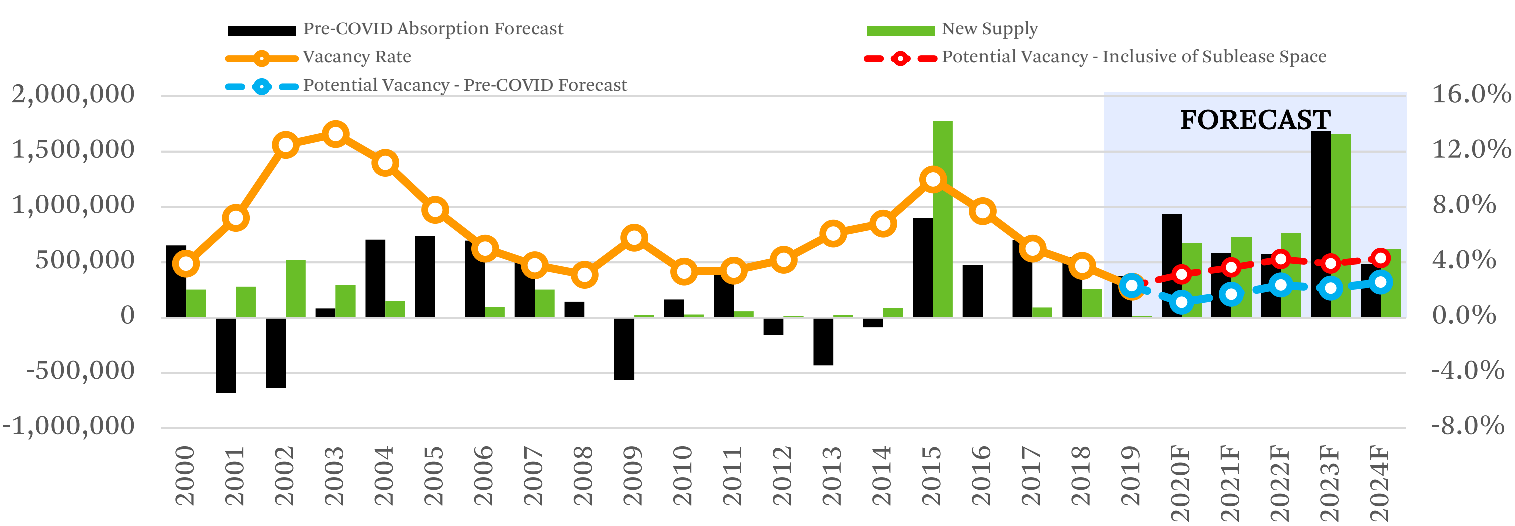
Canadian REIT Rent Collection by Sector, April 2020



Source: CBRE Research

Landlords are well-positioned with long-term leases at fixed rental rates. As such, it would take a prolonged downturn before there is any noticeable impact on head lease rental rates or landlord revenues. By now, landlords are aware of those tenants who will be unable to operate post-COVID, and many of our clients are reporting office rent collections well into the 90 percent range and rising through the worst of the pandemic-driven shutdown. Accordingly, we expect minimal impact on office building values from reduced future cash flows. We are heading back to work, businesses and offices are reopening, and the inclusion of the recent sublease space being delivered to the market has only had minimal short-term impact on the overall vacancy rate.

Downtown Vancouver Vacancy Including Subleases



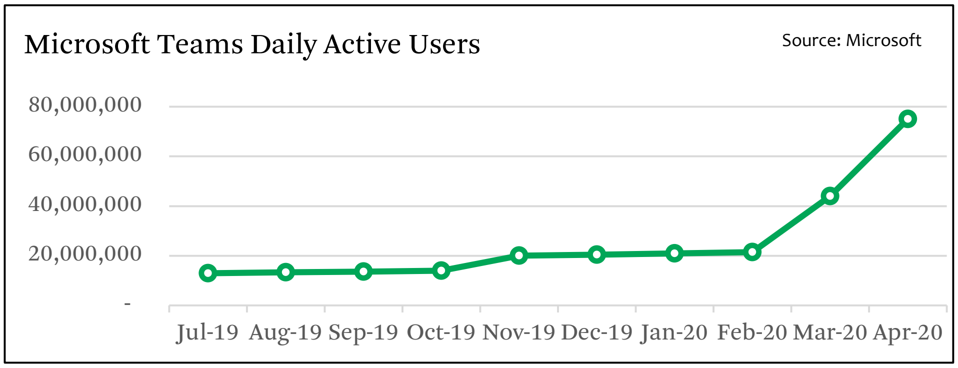
Source: CBRE Research

Now let's Zoom our attention to a narrative gaining traction as a direct result of most of us being ordered to work from home to help prevent the spread of COVID-19.

WORK FROM HOME

The success of remote work technology has been an unqualified success thus far. In addition to the strong performance of work from home technology, much of the success of our new work from home arrangement is due to the fact that the entire workforce is operating under the same circumstances.

With the work from home order now being lifted in B.C. and employees slowly returning to the office, the effectiveness of a hybrid model of a workforce split between office and home remains in question. Issues such as whether those at home will get passed over for promotion, the difficulty of onboarding new staff and continued high performance results are starting to arise.



> **"We aren't engaged in a work from home experiment, but rather a remote work technology experiment."**
> - Mary-Anne Tighe, CEO, CBRE New York Tri-State Region

THE RESPONSE FROM BIG TECH

Major technology companies like Twitter, Shopify and Facebook have all announced new, long-term work from home protocols, quoting increased levels of productivity, access to a larger labour pool and clear cost savings. These announcements have fueled speculation regarding the notion that work from home will become the new norm and drive down the long-term demand for the office environment.

> **"Office Centricity is Over"**
> - Tobias Lutke, CEO, Shopify

OUTCOMES RESULTING FROM WORK FROM HOME

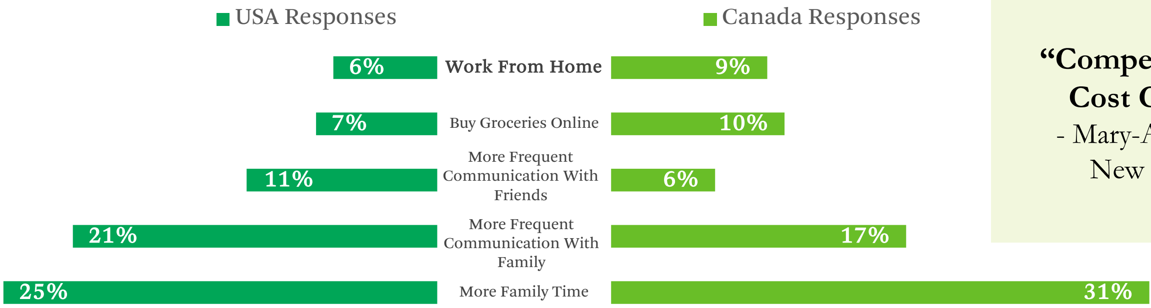
According to an empirical study on the productivity of work from home models conducted by professor Nicholas Bloom of Stanford and James Liang, CEO of CTrip, "performance of the home workers went up...increasing by 13% over the nine months of the experiment...improvement came mainly from a 9% increase in the number of minutes they worked during their shifts (i.e., the time they were logged in to take calls)."[1] Several findings from the study indicate that working from home produced superior results, justifying the current response from big tech. However "one downside appears to be that, conditional on performance, it reduced rates of promotion by about 50%."[1] This trend weighed heavily on the study's work from home group, and at the end of the experiment, when CTrip, a Chinese travel agency, planned to introduce a new flexible work from home arrangement, "two thirds of the control group (who initially had all volunteered to work from home 10 months earlier) decided to stay in the office, citing concerns over the loneliness of home working and lower rates of promotion."[1] The intrinsic human competitive factor.

A recent survey by the American architecture firm Gensler of more than 2,300 full-time, office workers revealed that "only 12% of U.S. workers want to work from home full-time."[2] This telling statistic reflects a clear disconnect between management and employees. While the new work from home reality appears to have some short-term, positive effects on corporate top and bottom line growth due to increased productivity and decreased real estate costs, it comes at the expense of employee satisfaction and advancement, potentially damaging a corporation's competitive advantage in talent acquisition and retention.

[1]Bloom, Nicholas, and James Liang. *DOES WORKING FROM HOME WORK? EVIDENCE FROM A CHINESE EXPERIMENT*. 2013, *DOES WORKING FROM HOME WORK? EVIDENCE FROM A CHINESE EXPERIMENT*, www.nber.org/papers/w18871.pdf.

[2]Cohen, Andy, and Diane Hoskins. "Insights From Gensler's U.S. Work From Home Survey 2020: Dialogue Blog: Research & Insight." *Gensler*, 26 May 2020, www.gensler.com/research-insight/blog/insights-from-genslers-u-s-work-from-home-survey-2020.

Another revealing survey of over 1,850 Americans and 1,850 Canadians recently conducted by consumer research company, ValueGraphics, shows that only 6% of Americans and 9% of Canadians want to continue working from home after self-isolation. Of note, this is a one percent increase over the percentage of employees that were asked this same question pre-COVID-19.



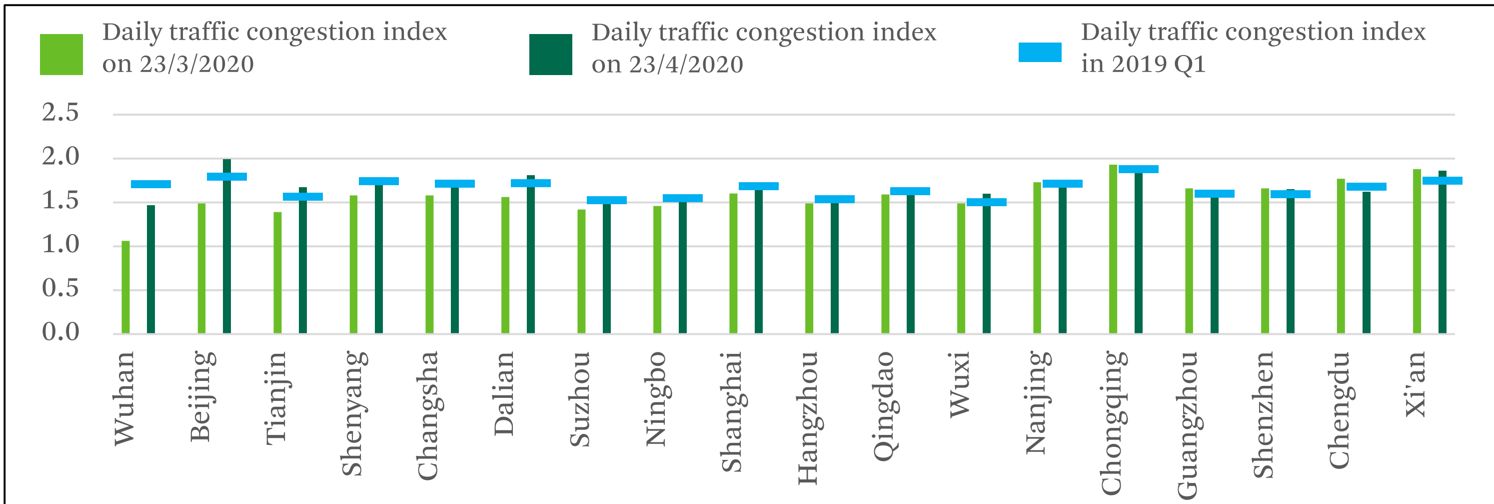
Source: ValueGraphics Database, David Allison

> **"Competitive Advantage Beats Cost Cutting Every Time"**
> - Mary-Anne Tighe, CEO, CBRE New York Tri-State Region

With decreased rates of promotion for those working from home and survey results highlighting less desire to work from home than originally anticipated, a corporation that has transitioned to a work from home model may lose a competitive advantage over corporations offering office positions in recruiting top tier talent with ambitions for career advancement.

APAC AS A BELLWETHER

Analyzing the Asia-Pacific market can shed further light on the return to office trends after social distancing measures are lifted. Comparing workplace mobility in March and April of 2020 to pre-pandemic levels reveals that employees in the Greater China markets are now largely returning to work, with traffic mostly returning to normal and some cities even exceeding pre-pandemic benchmarks.



Source: amap.com, CBRE Research, 24 April 2020

PHYSICAL WORKSPACE REQUIREMENTS

The consequences of COVID-19 will have a lasting effect on the physical workspace as landlords and tenants adjust to new wellness protocols. Physical distancing measures will be top of mind as office layouts undergo a transformation to ensure employees are adequately spaced from one another to curb the potential spread of the virus and to adhere to health and safety guidelines. The transition to reduced employee density throughout the office could likely result in the requirement for a greater amount of office space per employee, which could partially offset the increased demand for remote work.

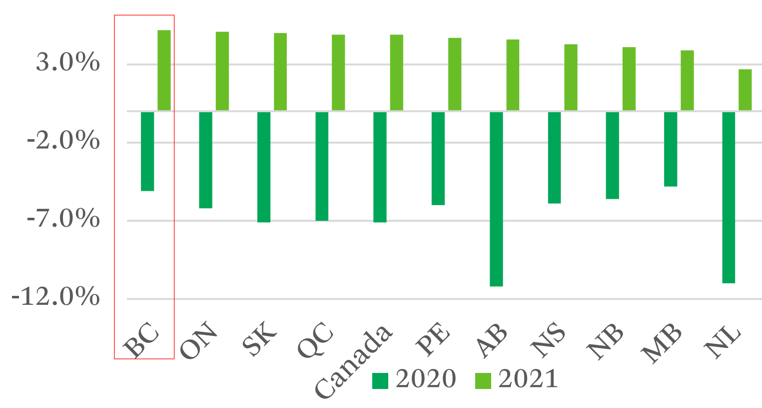
MACRO DEMAND DRIVERS

While the Vancouver market is currently experiencing negative demand shocks stemming from a COVID-induced frozen economy, there are several macro fundamentals that will contribute to a rebound in demand. While B.C. GDP is projected to contract by -5.1% in 2020, it is also projected to lead the national rebound at +5.2% in 2021. Easing restrictions and the continuation of capital projects, such as LNG Canada's $40 billion natural gas export project, will be the catalysts for economic recovery in 2021. B.C. is poised to lead all provinces with the largest national rebound, but it is also worth noting the strength of the Canadian economy. Despite two months of COVID-19 fueled layoffs, Canada added 290,000 jobs in May, a surprise shift as businesses began to reopen and economic activity began to pick up.

Vancouver's robust technology sector will continue to be a significant driver of demand for the office market. Vancouver's standing as a technology hub will continue to fuel the city's population growth through the attraction of highly-skilled immigrants. As a testament to the strength of the Vancouver market, the city ranked #1 in high-tech software/services job growth out of the top 30 tech markets across North America, beating out cities such as San Francisco and Seattle.

B.C. had one of the strongest years for migration in 2019, adding 78,025 residents, the highest growth rate in over 35 years. This will remain a key driver behind the strength of the B.C. office market post-pandemic. Ranked the world's 6th most livable city in 2019 by Forbes, Vancouver's livability continues to fuel both inter-provincial and international migration. We expect the overall desirability of Vancouver to new residents will be further enhanced by the global recognition of Dr. Bonnie Henry and her team, and how effectively and successfully they handled the medical fallout from the pandemic.

Provincial Real GDP Growth, Revised 2020/2021 Forecast



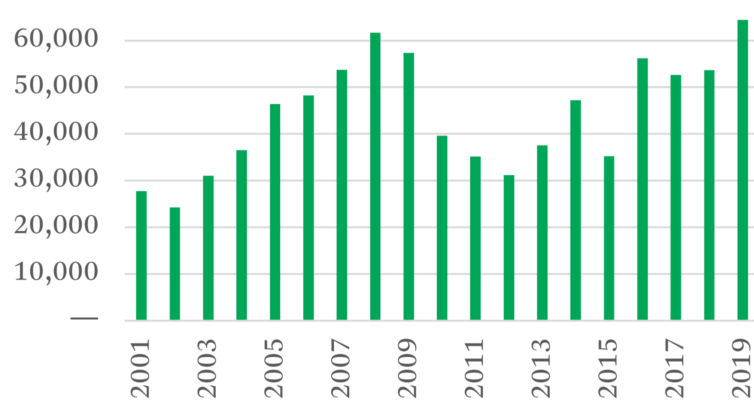
Sources: Statistics Canada, RBC Economic Research

High Tech Software/Services Job Growth

Market	GROWTH RATE Current Period 2017 & 18	GROWTH RATE Previous Period 2015 & 16	NEW HIGH-TECH JOBS New Jobs Added 2017 & 18	NEW HIGH-TECH JOBS As a % of New Office Jobs 2017 & 18
1 Vancouver	29.5%	17.9%	13,600	55.5%
2 San Francisco	24.7%	38.5%	19,947	84.7%
3 Toronto	23.9%	17.7%	30,200	72.6%
4 Seattle	23.7%	19.1%	34,536	131.2%
5 Austin	22.5%	22.8%	10,517	60.4%

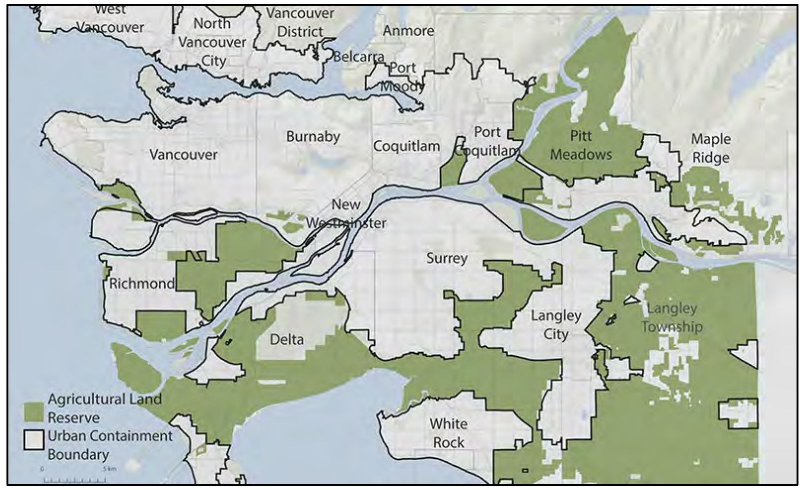
Source: U.S. Bureau of Labour Statistics, Statistics Canada, CBRE Research, Q2 2019

Net International Migration



Source: Statistics Canada

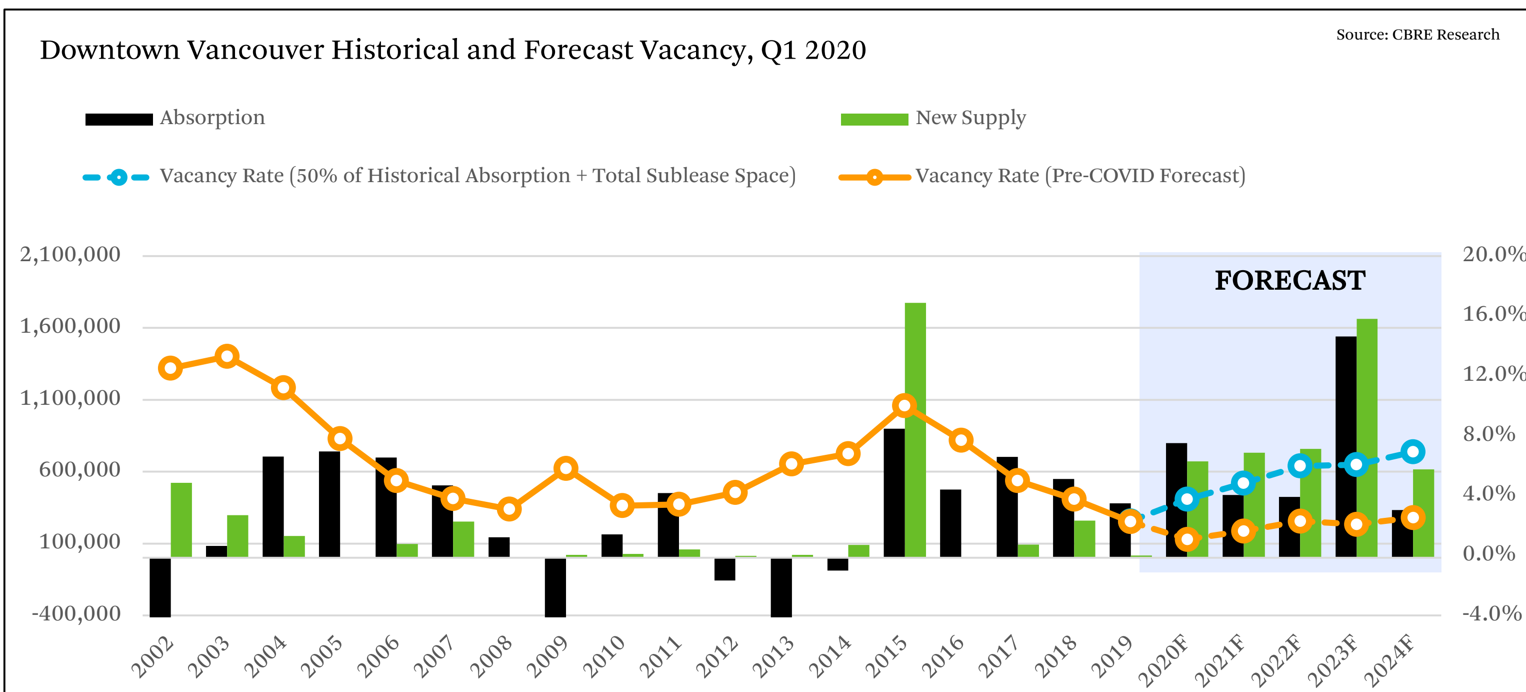
Vancouver has an abundance of natural supply constraints that will contribute to returning occupancy to pre-pandemic levels. Mountains to the north, ocean to the west, U.S. border to the south and the agricultural land reserve (ALR) to the east all render much of the surrounding geography undevelopable, continually focusing demand and density into existing suburban buildings and the downtown core. Sublease space will be absorbed as business rebounds; Vancouver will continue to attract new technology companies; and, employees will embrace a return to a new, more balanced home and office existence.



VACANCY FORECAST

With the recent delivery of sublease space having only a marginal impact on overall vacancy rates, a short-term pull back in overall demand should have little to no effect on net effective rents for quality headlease space, particularly for larger premises. Over the longer term, B.C. GDP is expected to rebound strongly at 5.2% in 2021, completely offsetting the forecast decline for 2020. Immigration is forecast to remain strong, due to the high livability of Vancouver. And the city will continue to attract new technology tenants.

As such, we do not expect any diminishment in future office demand. Viewed from a fundamental approach, if we assume a very conservative forecast scenario where office demand (absorption) is calculated at 50% of the 10-year historical average (and half of the pre-COVID prediction), inclusive of the newly-delivered sublease space, vacancy rates will still only reach a peak of 7% by 2024.



EXECUTIVE SUMMARY

Although most employees are anxious to return to work, a partial work from home model will likely be a new structural component of white-collar work as companies adopt a new "fluid workspace." Accordingly, companies will likely be able to reduce their office footprint. Some of this reduction will be offset by new design requirements for greater space to accommodate social distancing and innovative configurations that allow for employees to gather in teams and collaborate on projects.

The fallout from companies that do not recover from the economic impacts of the pandemic will reduce demand in the short term, but demand will return as the economy recovers. A balanced market for office space is typically represented by an overall vacancy of around 8%. Even under an extremely conservative forecast, assuming only 50% absorption, vacancies will not exceed the 8% mark, assuring Vancouver's continued position as a landlord's market well into the future. Additionally, given the incredibly strong overall Vancouver office fundamentals entering the global health crisis, we do not believe there will be major trauma to the office market.

Capitalization rates are expected to remain relatively stable at pre-pandemic levels, with stability supported by the quantitative easing measures implemented by central banks around the world in an effort to stimulate the economy and inject liquidity into financial markets. With capitalization rates offering healthy comparative returns when compared to the bond market and an over-zealous stock market, yields for Vancouver office product should remain at or below pre-COVID levels.

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