CANADIAN COMMERCIAL REAL ESTATE OUTLOOK

TD Economics

February 9, 2017

REMNANTS OF PAST BUILDING BOOM TO CURB CRE INVESTMENT IN KEY MARKETS

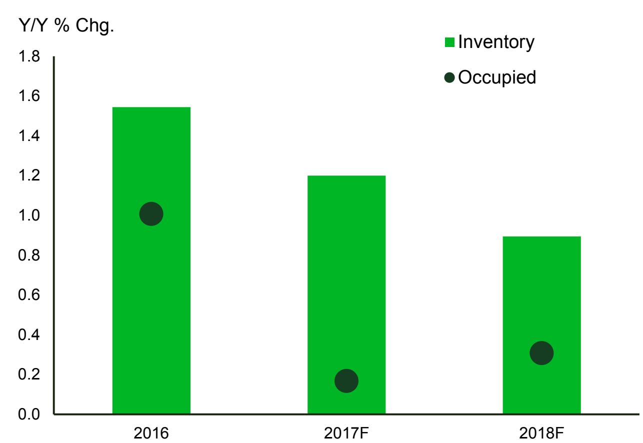
Highlights

- The recent trend of softening within Canada's major commercial real estate (CRE) markets is expected to continue in 2017-18 as remnants of this decade's building boom continue to drive up inventory of space that outstrips further gains in demand.
- Underneath this overarching story lie significant variations across major markets and segments. Office markets are expected to face the most challenging conditions, particularly in the energy-driven regions of Calgary, Edmonton and to a lesser extent Halifax. On a plus note, prospects for a continued recovery in energy prices will help to mitigate any further erosion in these markets.
- In contrast, strong upward momentum in activity in the Toronto and Vancouver CRE markets looks poised to continue well into the New Year, before ultimately cooling in the latter part of 2017 and into 2018 in line with overall economic activity. Growth opportunities will likely shift to the industrial segment within these regions.
- Among the markets, Ottawa may see the most notable medium-term upside potential in light of federal government spending plans as well as decent prospects for the region's high-tech sector.
- Since the U.S. Presidential election, the potential for sharp and sustained increases in North American bond yields has emerged as a leading downside risk to CRE activity. On a positive note, CRE market fundamentals are likely to remain favourable for the most part, which would help to mitigate the impact on asset prices and investment under a scenario where yields rise more significantly than expected.

In this report, we present the 2017-18 outlook for eight regional Canadian commercial real estate (CRE) markets across their key segments. In broad strokes, the recent easing in conditions observed across most markets over the past few years is likely to extend over the forecast horizon, as the remnants of this decade's building boom leads to moderately rising supply that outstrip gains in occupancy. As such, vacancy rates, which for the most part remain well within their historical ranges, are likely to edge up further, putting downward pressure on rents.

Underneath this over-arching story lie significant variations from coast to coast. Among the segments, office markets are likely to continue to face the slackest condi-

CHART 1: CANADIAN CRE SUPPLY VS. DEMAND



Source: CBRE, forecast by TD Economics as of Feb. 2017.

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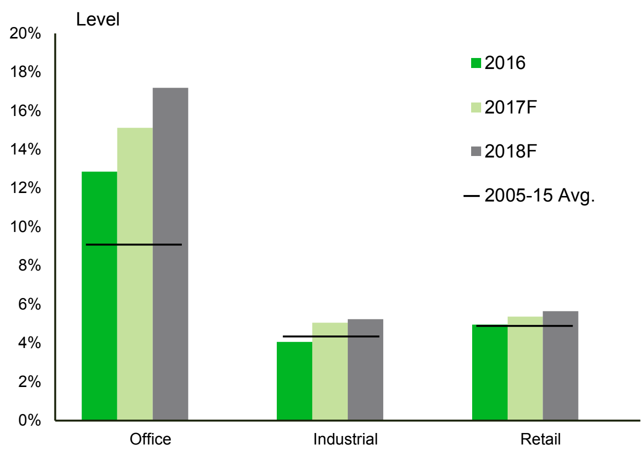
CHART 2: CANADIAN CRE VACANCY RATES



Source: CBRE, forecast by TD Economics as of Feb. 2017.

tions, while industrial markets see more balanced conditions and somewhat better growth prospects. On the regional front, the energy-driven markets of Calgary, Edmonton and to a lesser extent, Halifax, will continue to face particularly challenging backdrops, though prospects for a continued gradual recovery in crude oil and natural gas prices will help to limit any further erosion. In contrast, strong upward momentum in CRE activity in Vancouver and Toronto looks poised to persist well into 2017, before these markets likely embark on a softer trajectory in late 2017 and 2018. And in Ottawa, the outlook for increased federal spending is expected to generate medium-term growth opportunities across CRE segments.

No outlook report is devoid of risks, and indeed the near-term CRE picture contains its fair share of uncertainties. A key concern this year is on the interest rate front. Since the fall, Canadian bond yields have followed U.S. yields higher as investors have built in higher growth and inflation expectations surrounding the U.S. economy post-election. To the extent that rates surge above forecasted levels, there could be more erosion in Canadian capitalization spreads and this could lead to a more pronounced softening across the spectrum of CRE types. Foreign investment in Canadian real estate markets ramped up considerably in 2016 and is one source of capital that could flee quickly in the event of a further backup in bond yields.

2016 ends on a balanced note across most segments

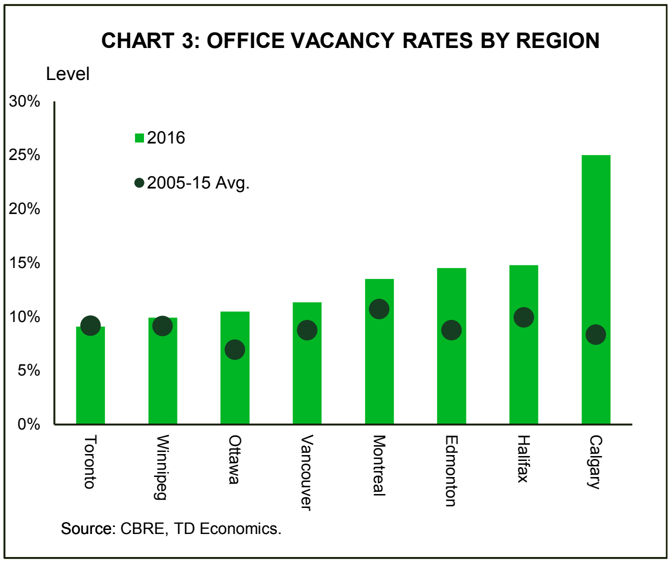
The recent softening in market conditions needs to be considered within a longer-term context. For the better part of the past decade, CRE markets were underdeveloped, with vacancy rates across most segments nearing record lows and rents growing at a rate considerably faster than inflation. In response to healthy capitalization rates, declining interest rates and a growing "search for yield", development accelerated sharply after the financial crisis, helping to restore balance to most markets. In 2016, overall average Canadian vacancy rates for industrial and retail segments edged up but remained well within spitting distance of their 10-year averages.

The exception to this rule was the office category, where the national aggregate vacancy measure (see charts 2 & 3) jumped well above its longer-term benchmark, primarily reflecting a spike in rates to 15-23% in Calgary, Edmonton and Halifax. While the fundamental picture remained sounder in other regional office markets last year, a broad softening in rents was still recorded.

This rise in the national average office vacancy rate last year concealed a further increase in occupancy. Indeed, demand for all types of CRE remained strong, but was still outpaced by new supply for several years in a row. An estimated 30 million square feet of new space was added last year, bringing the total over the past two years to 60 million – almost two thirds of which was destined for office and retail markets. Because this new supply was met with strong rental demand, the development spree over the last several years barely placed a dent in vacancy rates and rent growth.

The lure of Canadian CRE to domestic and foreign investors picked up sharply this past year. Money flowing

Canada CRE Outlook					
	Level	Year-over-Year % Change *Unless Otherwise Stated**			
	2016	2016	2017F	2018F	Avg. 2005 to 2015
Office					
Inventory (Mil Sq Ft)	453.2	2.3	2.4	1.3	1.3
Occupied (Mil Sq Ft)	394.9	0.9	-0.3	-1.2	1.1
Avg. Net Rent /Sq Ft	20.5	-3.8	-2.9	-3.1	2.6
Vacancy Rate (Level)*	--	12.9%	15.1%	17.2%	9.0%
Industrial					
Inventory (Mil Sq Ft)	1764.1	1.1	0.9	0.7	0.9
Occupied (Mil Sq Ft)	1687.0	0.8	0.1	0.5	0.8
Avg. Net Rent /Sq Ft	6.5	2.6	-0.6	-1.1	1.8
Vacancy Rate (Level)*	--	4.1%	5.1%	5.2%	4.4%
Retail					
Inventory (Mil Sq Ft)	294.1	2.9	1.0	0.7	2.1
Occupied (Mil Sq Ft)	279.5	2.6	1.5	1.2	2.1
Avg. Net Rent /Sq Ft	36.7	4.6	3.0	1.9	3.9
Vacancy Rate (Level)*	--	5.0%	4.5%	4.0%	4.8%
Source: CBRE. F. by TD Economics as of Feb. 2017.					



into CRE was up an estimated 34%, roughly two-fifths of which reflected foreign transactions. Much of these flows were directed to the retail and office markets in Vancouver and Toronto, supporting asset prices and weighing on capitalization rates.

Many Canadian markets remain more balanced than their U.S. counterparts, with vacancy rates in Canada's major markets the lowest across North America. The exception is the office market. Depressed capitalization rate spreads can be a tell-tale sign of amassing froth. It is important to point out that prevailing spreads in Canada remain above those witnessed in major U.S. markets with the exception of industrial space (chart 4). The differential between U.S. capitalization rates and U.S. 10-year government bond yields narrowed considerably through 2016, reflecting strong demand and rising asset prices.

Higher interest rates a key risk for 2017

Still, developments of the past several weeks have highlighted what could be the number one risk facing Canada's CRE outlook over the coming years – the possibility of higher interest rates. Since the early November U.S. Presidential election, Canadian 10-year government bond yields have shot up alongside U.S. Treasuries, as global investors priced in the possible boost to U.S. growth and inflation from the potential policies of the new U.S. administration. With asset prices rising sharply and rents stable, the rise in interest rates led to a further narrowing in capitalization spreads at the end of 2016. While the majority of CRE segments had enough cushion to absorb this rise in interest rates, spreads in the office sector are now estimated to be below historical averages.

A continuation of the rapid rise in yields in 2017 would present a meaningful risk to asset prices and future investment in Canada's CRE sector. These risks naturally grow when a market is in the latter stages of a cycle. However, in our latest Dollars & Sense, we argue that further increases in government bond yields from current levels are likely to be limited. Investors will probably be underwhelmed by the extent of forthcoming U.S. fiscal stimulus and its impact on U.S. economic growth.

Expect more of the same from demand and supply

Even a modest further increase in bond yields would represent a greater headwind than we had envisaged a few months ago. Other factors that will put the brakes on activity include prospects for relatively tepid job creation from coast to coast, a ratcheting down in housing markets in recently white-hot Vancouver and Toronto, and perhaps most importantly, additional supply coming on the market.

Economic growth across the regions is expected to run at a modest 1-2% rate over the forecast horizon, with job creation likely to grow by a more lackluster sub-1% pace. As such, occupancy gains are likely to clock in at below 1% across most market segments.

Housing markets are likely to lose steam over the next several quarters on the back of recent increases in borrowing rates and tightening in federal mortgage regulations. A housing slowdown will ultimately spill over to demand for office and retail space through reduced employment and household spending. That said, provided that further interest rate increases are limited in scope, we anticipate a moderate and orderly cool down. Within the relatively frothy Toronto and Vancouver housing markets, prospects

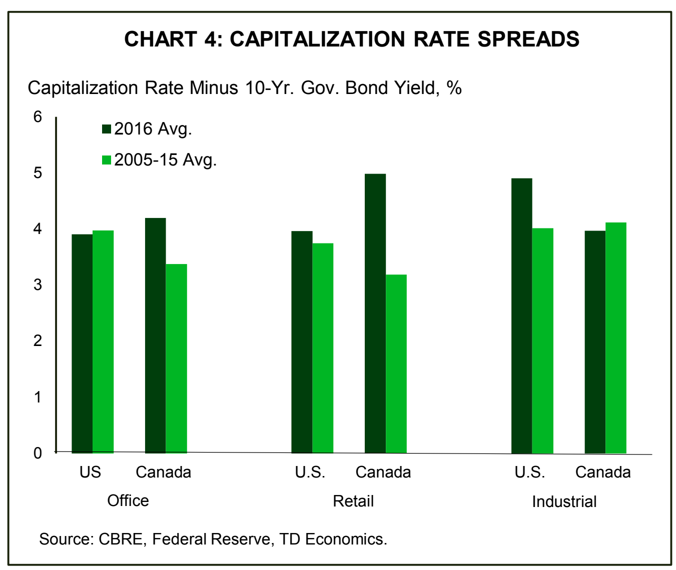
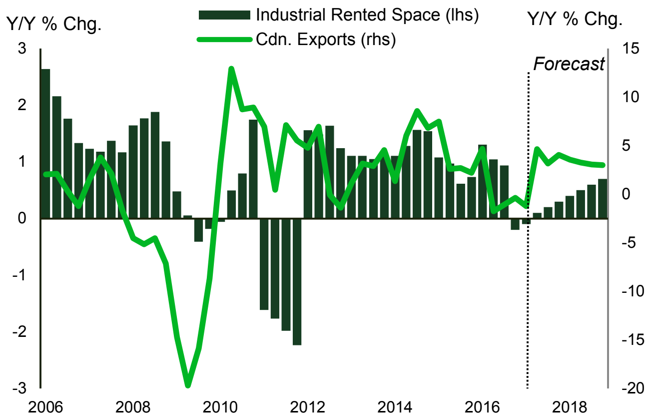


CHART 5: DEMAND FOR INDUSTRIAL SPACE VS. EXPORT GROWTH



Source: CBRE, Statistics Canada, forecast by TD Economics as of Feb. 2017.

for comparatively strong employment and population gains are likely to limit the potential for a steeper correction.

At the same time, we expect to see more heavy lifting on the growth front carried out by industries tied to rising U.S. demand (i.e., goods exports and tourism) and government stimulus in Canada (chart 5). The former development augurs well for increased growth opportunities within the industrial sector, although U.S. policy uncertainty surrounding NAFTA and trade more generally will limit near-term CRE investment. Increased Canadian federal outlays are likely to be included in the 2017 budget and will provide a modest boost to economic activity across the country, but particularly in the nation's capital.

Despite an outlook for resilient CRE demand, the more notable upward influence on vacancy rates will continue to emerge on the supply side. Over 90% of the roughly 40 million square feet still under construction is expected to reach completion by 2018. The retail sector is poised to account for about 25% of this new inventory, pushing the industry into a position of excess supply. Most of this new space is destined for Western Canada, with more retail space under construction in each of Calgary and Vancouver than in Canada's largest retail market of Toronto.

Different strokes for different folks

That is the big story facing Canada's CRE market from the 50,000 foot level. Over the subsequent pages, we delve into the outlooks of eight major CRE markets across the country, with each displaying a number of unique elements.

VANCOUVER - VULNERABILITIES ARE RISING

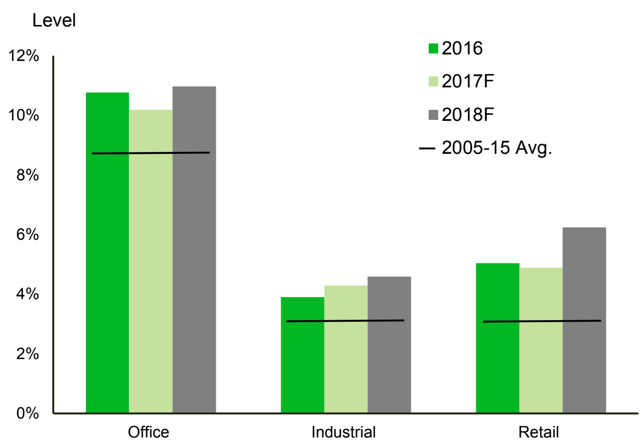
Among the major Canadian markets, Vancouver has been a growth leader in demand for commercial space over the past two years. Areas tied to tourism and start-up tech sectors have generated considerable net new retail and office occupancies. Still, record construction activity over the last three years has far outstripped that demand. While the construction boom appears to be winding down and demand fundamentals in the region remain favourable, the office and retail segments are left grappling with rising vacancy rates and downward pressure on rent growth.

Anecdotal evidence suggests that the foreign residential buyer's land transfer tax implemented by the B.C. government last August encouraged foreign investors to shift their focus from housing to commercial real estate. According to CBRE, non-residents accounted for over 30% of total CRE investment in Canada last year (up sharply from about 5% historically), with a whopping three quarters of that amount destined for the Vancouver market. The majority of the foreign outlays went into the purchase of existing property, pushing asset values up sharply and capitalization rates lower. Rates of return remained favourable when compared to other risk-free assets such as the 10-year GoC bond yield, but spreads began to narrow in 2016, particularly in the retail and office sectors.

Vancouver CRE Outlook					
	Level	Year-over-Year % Change *Unless Otherwise Stated**			
	2016	2016	2017F	2018F	Avg. 2005 to 2015
Office					
Inventory (Mil Sq Ft)	47.2	2.1	2.3	2.9	1.8
Occupied (Mil Sq Ft)	42.1	2.4	3.0	2.0	1.8
Avg. Net Rent /Sq Ft	24.5	-1.6	-0.5	-0.2	4.7
Vacancy Rate (Level)*	--	10.8%	10.2%	11.0%	8.7%
Industrial					
Inventory (Mil Sq Ft)	186.6	2.0	1.6	1.3	1.7
Occupied (Mil Sq Ft)	179.3	2.5	1.2	1.0	1.4
Avg.. Net Rent /Sq Ft	9.0	6.4	5.0	2.0	1.9
Vacancy Rate (Level)*	--	3.9%	4.3%	4.6%	3.6%
Retail					
Inventory (Mil Sq Ft)	40.7	8.5	1.0	1.9	2.3
Occupied (Mil Sq Ft)	38.9	7.9	0.5	0.5	2.2
Avg.. Net Rent /Sq. Ft	47.7	4.5	2.0	-2.0	2.6
Vacancy Rate (Level)*	--	5.0%	4.9%	6.2%	3.6%

Source: CBRE. F. by TD Economics as of Feb. 2017.

CHART 1: VANCOUVER CRE VACANCY RATES



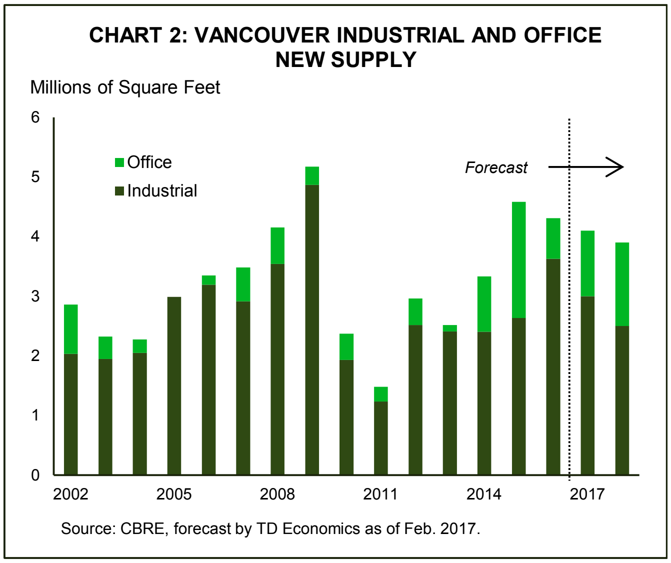
Source: CBRE, forecast by TD Economics as of Feb. 2017.

The office market is the most vulnerable of them all

Put simply, the office market in Vancouver is overbuilt. After surging in the 2012-14 period, construction activity geared down somewhat in 2015 and 2016 (chart 2). However, office-related building looks poised to reaccelerate over the forecast horizon. Development of approximately 2.3 million square feet is on tap for the 2017-18 period, with potenital for construction to begin on another 5 million square feet of planned space. The largest of these projects is 3030 East Boradway, with a total of one million square feet, but this project is not expected to be completed until after the forecast horizon. Of the projects planned and under construction, only four have 80% or more of the property pre-leased.

Despite the strong outlook for project development, we see limited upside risk around the office vacancy rate in 2017. This year, demand for space will continue to ride on the coat-tails of last year's 3% jump in net new employment. As the pace of hiring moderates and supply increases, the vacancy rate is expected to rise to a lofty 11.6% in 2018, resuming its upward trek and almost double the low hit in 2008. Office vacancy rates have been on a trend increase in markets across the Greater Vancouver Area, but the biggest uptick has been observed in suburban markets like Burnaby and Richmond, where inventory has risen sharply but absorptions have decreased as demand gravitated towards more central, downtown locations.

In addition, the sharp increase in foreign buying of office property has increased risks. It has been estimated



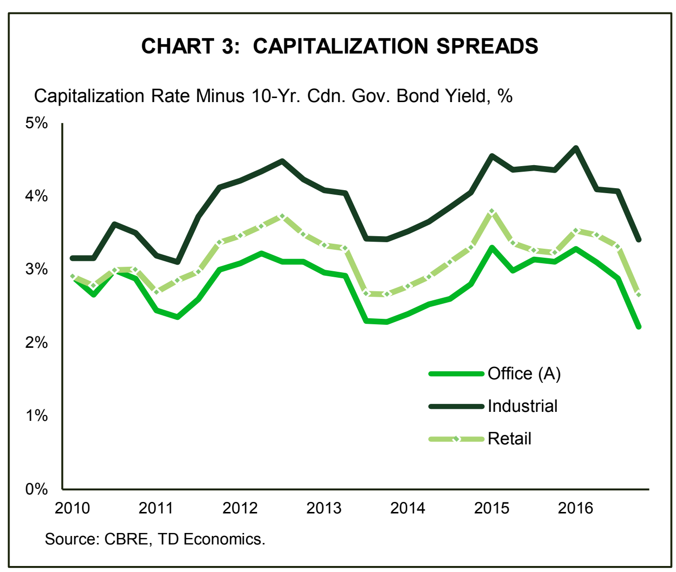
that about 60% of the foreign money flowing into CRE has been earmarked for the office segment, which has pushed asset prices up, and capitalization spreads down. The recent increase in the 10-year government bond yield since early November led to further capitalization rate spread compression at the end of 2016, pushing the spread over the risk free rate below its long-run average. As rates inch higher and rents lower, we can expect a further narrowing in spreads and/or downward pressure on sale prices.

Retail to lose its shine

Similar to the office market, the retail sector has recorded robust growth in new space in recent years. Retail construction activity hit new records between 2013 and 2016, supported by the arrival of several new international retailers. Retail sales have been red hot in the city, and despite the record amount of space being delivered, the number of retail sales per square foot of leased space has been climbing rapidly. Cash registers have benefitted from strength in tourism and, until recently, surging housing activity. Looking ahead, prospects for a cooling in housing-related demand is poised to put a meaningful but not dramatic dent in retail spending gains. The building boom is winding down and there is just roughly 1.1 million square feet of new space expected to be delivered in 2017 and 2018, with over half of this new supply concentrated in one project – the Brentwood Town Centre Redevelopment in Burnaby. The vacancy rate, which hit a record high 4.4% in 2016, and will likely climb to 6.2% by the end of 2018. After rising sharply during the 2013-15 period, average retail rents grew at a more moderate rate last year, with a further slowdown projected over the forecast horizon. The combination of slowing rental growth and rising interest rates will act as a deterrent to additional developent in the retail sector going forward.

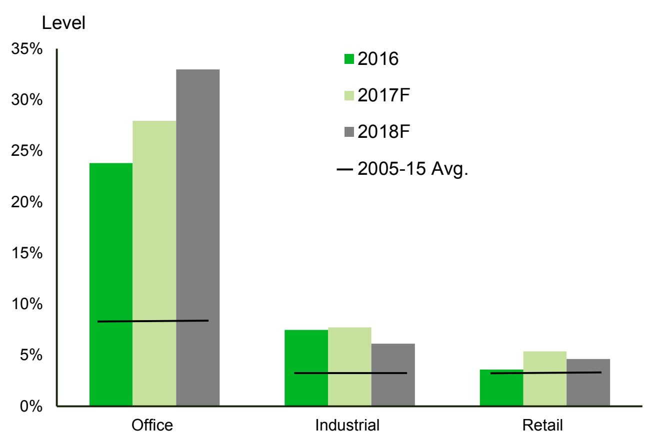
Industrial to witness significant new supply

The industrial segement is one where sluggish demand has been met with even weaker supply, keeping vacancy rates low and under pressure. Demand for industrial space is expected to pick up this year, as commodity prices improve and exports both to the U.S. and Asian regions pick up. Still, strengthening demand is expected to occur alongside rising supply. There is roughly 3.1 million of square feet of industrial space under construction and expected to be completed over the next two years, with a further 3 million square feet currently in the planning stage. About half of the expected supply over the forecast horizon is expected to be attributable to the Delta Link Industrial Park that will deliver 1.5 million square feet of new space in 2017. Ground is also expected to be broken on another large project, the Richmond Industrial Park (2.1 million square feet), with completion anticipated beyond 2018. While the industrial market is likely to remain comparatively tight, new space in the pipeline is projected to lead to a gradual increase in the vacancy rate. Rents grew at a double-digit pace in 2015 and 2016, but are likely to record a more moderate advance this year and next.



CALGARY - STILL ABSORBING OIL WOES

CHART 1: CALGARY CRE VACANCY RATES



Source: CBRE, forecast by TD Economics as of Feb. 2017.

Few areas of Calgary's economy have been immune to the weakness in oil prices including the CRE sector. Since oil prices fell from their recent peak in 2014, the city has seen a substantial 11,500 jobs vanish, propelling the unemployment rate to 10.1% in December. Still, the damage has not been uniform. The office segment has stolen the headlines with an eye-popping rise in vacancies. Not far behind is the industrial market, where downward pressure on rents has been particularly notable. On the other side of the coin, Calgary's retail market has held up relatively well, supported in part by housing activity, which has proven to be relatively resilient.

Looking ahead, the economy is likely to move back into expansion mode this year as oil prices likely continue to gain some modest traction towards US$60 per barrel. Having said that, the pace of recovery is expected to pale in comparison to recent recessions, thus limiting the upside potential for CRE. The office market faces a particular struggle to work through a major overhang of past development. On the flip side, near-term prospects for a rebound appear brightest in the industrial market.

Retailers remain optimistic

Retailers haven't given up on Calgary despite the economic slump, as the city still boasts the highest income per capita in the nation. This, taken together with home prices that have displayed resilience, has allowed the sector to withstand the downturn better than other CRE segments. The retail vacancy rate even managed to decline slightly, and average net rent expand in 2016. Moreover, investment in Calgary retail space is estimated to have grown last year, partially owing to a rise in capitalization rate spreads. Several retailer expansions are in the queue, requiring over 1.2 million square feet of space in the next two years. The vacancy rate is still poised to back up to a relatively high 4.6% by 2018 as not all of the new supply is fully absorbed. Future development will likely be stalled by muted expansion in consumer spending markets, continued softness in housing and ongoing economic uncertainty.

Office-space pain to swell in coming years

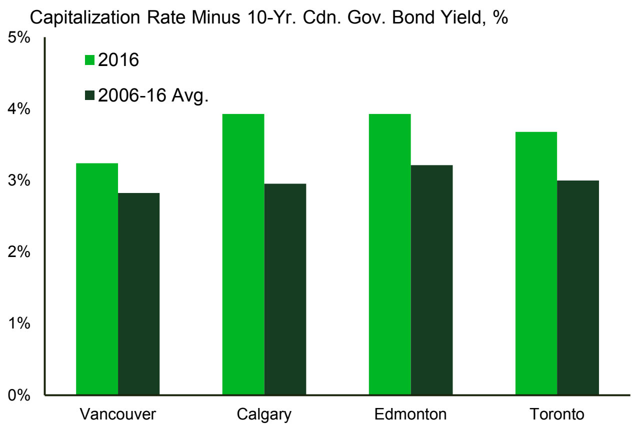
Calgary's office towers have been emptying out since the latter part of 2014, as oil firms have consolidated. And with the price of oil unlikely to bounce back to previous highs, this trend is unlikely to stage a meaningful reversal any time soon. Last year, the overall office vacancy rate spiked to a new cyclical high of 23.8%. And the completion of projects that began during the heady oil days of 2010-14 are adding to the already-elevated inventory. Indeed, the total amount of office space has grown by a sizeable 3.1 million square feet since 2014 and despite the forecast for an economic pickup over the next two years, further business efforts to improve efficiencies and reduce costs will continue to weigh on space

Calgary CRE Outlook

	Level	Year-over-Year % Change *Unless Otherwise Stated**			
	2016	2016	2017F	2018F	Avg. 2005 to 2015
Office					
Inventory (Mil Sq Ft)	65.1	3.2	2.6	1.7	3.4
Occupied (Mil Sq Ft)	50.8	-4.8	-5.3	-5.4	2.4
Avg. Net Rent /Sq Ft	17.0	-19.7	-20.0	-21.2	1.9
Vacancy Rate (Level)*	--	23.8%	27.9%	33.0%	8.3%
Industrial					
Inventory (Mil Sq Ft)	131.2	3.1	0.2	0.3	2.2
Occupied (Mil Sq Ft)	119.0	0.4	1.9	2.0	2.1
Avg. Net Rent /Sq Ft	7.2	-7.3	-8.3	2.1	0.9
Vacancy Rate (Level)*	--	7.5%	7.7%	6.1%	3.1%
Retail					
Inventory (Mil Sq Ft)	30.5	2.8	3.7	1.5	3.1
Occupied (Mil Sq Ft)	29.4	3.7	1.8	2.3	2.9
Avg. Net Rent /Sq Ft	43.4	0.5	-0.4	0.2	5.2
Vacancy Rate (Level)*	--	3.6%	5.4%	4.6%	3.4%

Source: CBRE. F. by TD Economics as of Feb. 2017.

CHART 2: RETAIL SECTOR CAPITALIZATION RATE SPREADS



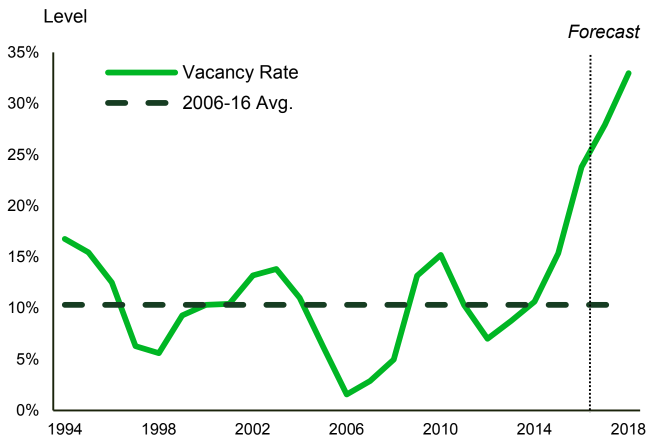
Source: CBRE, TD Economics.

requirements. Compounding these ongoing headwinds are expected future additions to new inventory, especially in 2018 with the completion of a 1.4 million square foot office tower. The new supply, combined with significant existing space offered for sub-lease, will keep capitalization rates under pressure and plans for further office development at bay for some time to come.

Industrial CRE to ascend

Calgary's central role in Western Canada's distribution network is set to help alleviate some downward pressure on the industrial CRE sector over the next few years. A flurry of new development added almost 6 million square feet to the market over the past two years, causing the vacancy rate to surge. But the vacancy rate is likely to edge down over the next two years, led by strong growth in the transportation and warehousing industries, where output is set to increase by 3% annually. We estimate that some 4.7 million square feet of space will be required to facilitate expansion in distribution. The recovery is already beginning to materialize as business capital expenditures in this sector likely grew last year on the heels of a drop in 2015. This pickup in industrial demand will lead the vacancy rate to retreat to 6.1% in 2018, down from its current level of around 7.5%. Capitalization spreads narrowed in 2016 after rising in 2015, signalling that the building frenzy is long over.

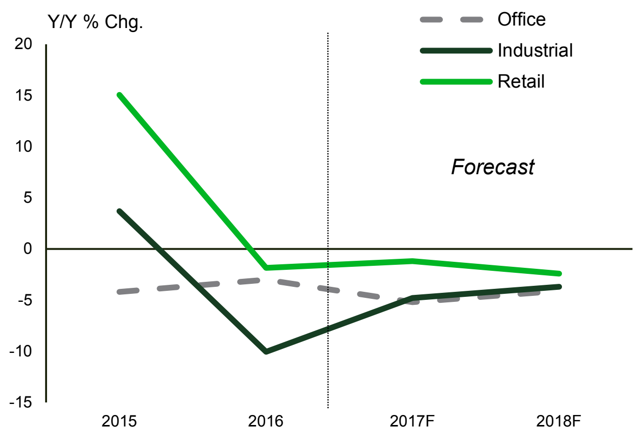
CHART 3: CALGARY OFFICE VACANCY RATE



Source: CBRE, forecast by TD Economics as of Feb. 2017.

EDMONTON - WEAK MOMENTUM STALLS CRE

CHART 1: EDMONTON CRE RENT GROWTH



Source: CBRE, forecast by TD Economics as of Feb. 2017.

While more diversified than its counterpart to the south, Alberta oil is still the key fuel for Edmonton's economy. Without this momentum, the city's CRE sector is running on empty. Given the prospects for only a modest economic recovery, a return to CRE prosperity, as seen during the peak oil price days of 2014, is out of reach over the forecast horizon. This weakness is already prevalent in the CRE sector as rents have begun to decline, and vacancy rates have reached record-highs. But CRE will have more on its plate next year as continued additions to supply combine with weakening demand to lead a further loosening in market conditions. As goods-producing occupations have become scarcer in the past few years, growth in government-related jobs in the region has provided some offset to the general downside pressure on CRE demand. Despite capitalization rate spreads reaching the higher end of the spectrum in many categories, negative rent growth is poised to weigh on spreads moving forward, keeping the risk of further overbuilding at bay.

Industrial parks still slipping on oil shortfall

Edmonton's industrial space will continue to feel the lasting effects of the oil sector's slump for the next two years. At almost double its long-run stable level, the vacancy rate has trended steadily upwards since the latter part of 2014. We calculate that the market would require additional occupancy of almost 3 million square feet in 2017-18 relative to our baseline forecast in order to return the rate to its pre-2014 level. Investor confidence in the segment diminished last year, as investment dropped sharply in the aftermath of the boom in 2015, when a record 4.6 million square feet of new supply was added to the market. The effects of this past building binge are most apparent in Edmonton's industrial parks that manufacture and service oilfield equipment. In this region, the vacancy rate is at an all-time high, standing at almost 10 percentage points above its long-run average level of 2.1%. And these trends aren't likely to change substantially in the near future amid only modest recoveries in the oil and natural gas industries. The vacancy rate will likely show some improvement, but not enough to generate a firming in rents, which are expected to decline 4.3% annually in 2017-18. Weakness in rents is expected to delay the start of a new development cycle until after the end of the forecast horizon.

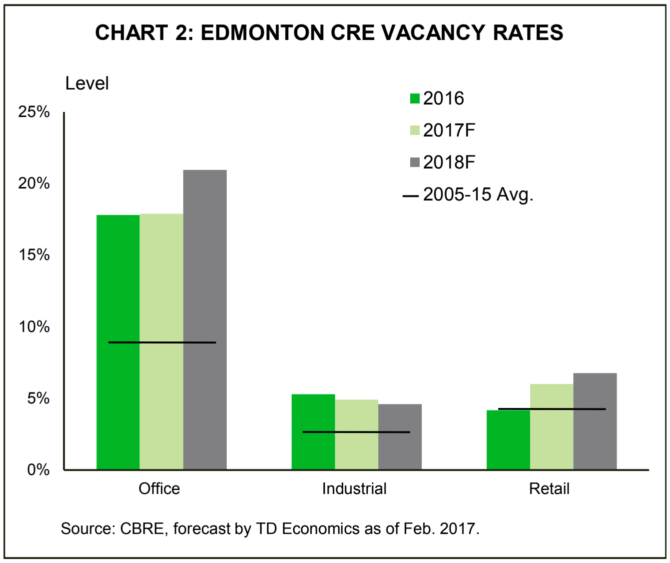
Retailers scaling back

Retail sales in Edmonton have been subpar since the price of oil tumbled in the latter part of 2014. Through this down period, retailers have remained committed to servicing the Edmonton market, as evidenced by a further estimated increase in retail occupancy last year, albeit at a muted pace relative to historical norms. This trend is juxtaposed, however, with the effects of weak business conditions that caused some tenants to close their doors.

Edmonton CRE Outlook

	Level	Year-over-Year % Change *Unless Otherwise Stated**			
	2016	2016	2017F	2018F	Avg. 2005 to 2015
Office					
Inventory (Mil Sq Ft)	25.3	2.7	0.7	2.4	2.1
Occupied (Mil Sq Ft)	21.6	-0.5	-3.2	-1.4	1.7
Avg. Net Rent /Sq Ft	18.4	-3.0	-5.2	-4.1	7.4
Vacancy Rate (Level)*	--	17.8%	17.9%	21.0%	8.8%
Industrial					
Inventory (Mil Sq Ft)	114.3	3.2	0.8	0.9	3.3
Occupied (Mil Sq Ft)	108.8	1.4	0.6	1.2	3.3
Avg. Net Rent /Sq Ft	10.1	-10.1	-4.8	-3.7	8.7
Vacancy Rate (Level)*	--	5.3%	4.9%	4.6%	2.6%
Retail					
Inventory (Mil Sq Ft)	31.7	0.9	0.2	0.0	3.8
Occupied (Mil Sq Ft)	30.3	1.6	-1.7	-0.8	3.6
Avg. Net Rent /Sq Ft	46.0	-1.9	-1.2	-2.4	3.5
Vacancy Rate (Level)*	--	4.2%	6.0%	6.8%	4.1%

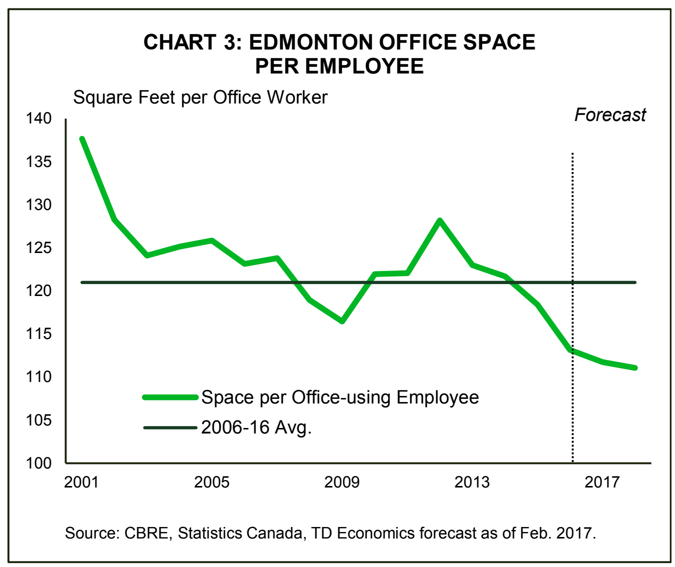
Source: CBRE. F. by TD Economics as of Feb. 2017.



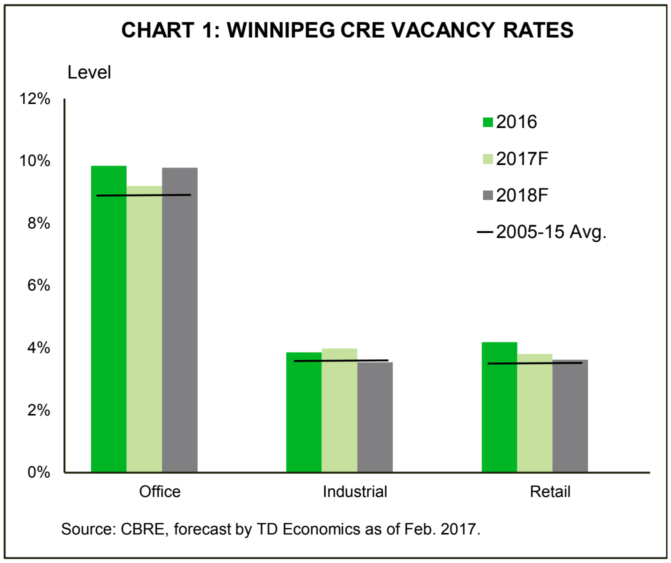
Over the near term, we expect a mix of soft demand and modest declines in net occupancy to push the vacancy rate up higher. With retail sales in the region expected to grow moderately at around 3% annually over the next two years, the vacancy rate will likely settle at 6.8% in 2018, while rents continue to contract (-2.4%). In the medium term, a tapering in new supply will ultimately help the market to stabilize but not before 2019.

Office sector adjusting to new normal

Despite reliable demand for office space from government agencies, current cost consolidation trends along with new supply additions have left Edmonton's office market oversupplied. Since the latter part of 2014, the vast majority of employment gains have been in government-sector areas as the economy has become increasingly service oriented. These gains have been offset with the predominant trend of reducted space per worker, however, with square feet per employee declining by 12.3% since 2012. And the lagged effects of the recent cooling in the scientific services and finance, insurance, and real estate sectors will draw demand down even further in the near term. The effects of waning demand will be magnified by the 1.0 million square feet of new office space set to hit the market over the next two years. Although these developments are largely pre-leased, as firms consolidate and move, their old spaces will be left unoccupied, resulting in a rise in net vacancies. These trends will lead the vacancy rate to reach 21.0% by 2018, pulling rent growth down to -4.7% annually on average over the next two years. A stabilization in the office sector will likely occur thereafter, balancing out alongside a future measured pace of economic growth. This will be facilitated by a narrowing of capitalization rate spreads as rents fall, limiting new investment.



WINNIPEG - THE WORST IS OVER



The gradual softening trend in Winnipeg's CRE market that took shape in 2015 extended through 2016. Vacancy rates climbed across all segments. Rents continued to expand at a brisk pace in 2016, but that primarily reflected a shift in demand towards higher quality, more central locations. The Winnipeg market differs from most other key markets in that building activity over the past few years has been more concentrated in the retail segment. The development of True North Square in Winnipeg city centre – a project that comprises more than one million square feet of office, residential, retail and hotel space – is poised to shake up the status-quo, not least of which to revitalize the downtown core. One of the four towers is scheduled to open its doors by mid-2018, with a possibility of a second tower completion sometime in 2019. While the new supply will place upward pressure on the region's vacancy rate, prospects for solid economic growth in Winnipeg will help to mitigate these impacts.

Office space well ahead of its time

The Winnipeg office market has been grappling with elevated vacancy rates since a boom in construction ended in 2013. On top of the delivery of a lofty number of units, the market has also felt pressure from government spending cuts. The government sector, which accounts for almost 15% of office employment in Winnipeg, has shed roughly 2,400 jobs since the 2008/2009 recession. Even as the government continues to tackle its budget deficit, upward momentum in the economy more broadly are likely to result in higher demand and a reduced vacancy rate this year, before new supply associated with the True North Project pushes the rate up moderately over the medium term. The average transactional rental rate has increased over the last few years, due to a shift in preference for more expensive downtown office space away from the suburban market. But on a quality adjusted basis, rents for both suburban and downtown office space have not grown since the beginning of the construction boom and are expected to remain flat for most of the outlook period.

Industrial space - much like the rest

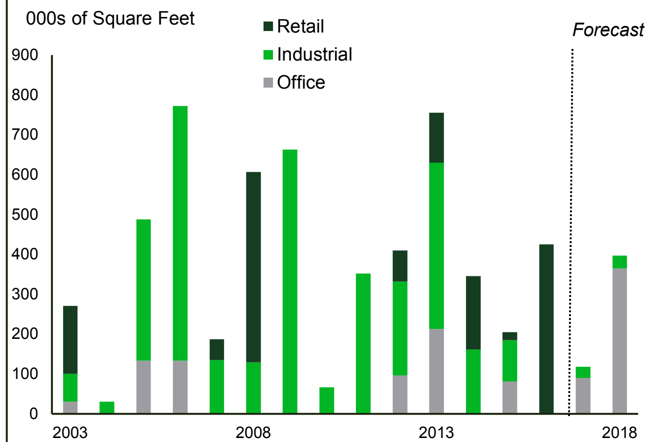
Much like the rest of Canada, construction activity in the Winnipeg industrial market has remained relatively muted, with very little supply in the pipeline as economic uncertainty has held back investment in new stock. However, underlying fundamentals are fairly balanced. Interest in investment has been perking up recently, however, with a number of new project proposals that could kick off next year and beyond. Until then, construction activity is likely to remain depressed. Meanwhile, demand is likely to grow at a modest pace. While risks surrounding increased trade protectionism south of the border are real, prospects for an acceleration in U.S. economic growth this year bode well for a near-term pickup in the region's export and trade-oriented

Winnipeg CRE Outlook

	Level	Year-over-Year % Change *Unless Otherwise Stated**			
	2016	2016	2017F	2018F	Avg. 2005 to 2015
Office					
Inventory (Mil Sq Ft)	11.5	0.0	0.8	3.2	2.1
Occupied (Mil Sq Ft)	10.3	1.4	1.5	2.5	1.7
Avg. Net Rent /Sq Ft	5.0	-40.9	2.0	0.5	1.2
Vacancy Rate (Level)*	--	9.8%	9.2%	9.8%	9.0%
Industrial					
Inventory (Mil Sq Ft)	77.3	0.0	0.0	0.0	-0.2
Occupied (Mil Sq Ft)	74.1	0.7	0.2	0.5	-0.3
Avg.. Net Rent /Sq Ft	7.4	-0.9	3.9	4.0	4.1
Vacancy Rate (Level)*	--	3.9%	4.0%	3.5%	4.2%
Retail					
Inventory (Mil Sq Ft)	13.6	3.9	0.0	0.0	1.3
Occupied (Mil Sq Ft)	13.1	4.1	0.1	0.2	1.4
Avg.. Net Rent /Sq. Ft	36.5	3.1	0.6	1.2	6.7
Vacancy Rate (Level)*	--	3.9%	3.8%	3.6%	3.7%

Source: CBRE. F. by TD Economics as of Feb. 2017.

CHART 2: NEW SUPPLY BY CRE SEGMENT



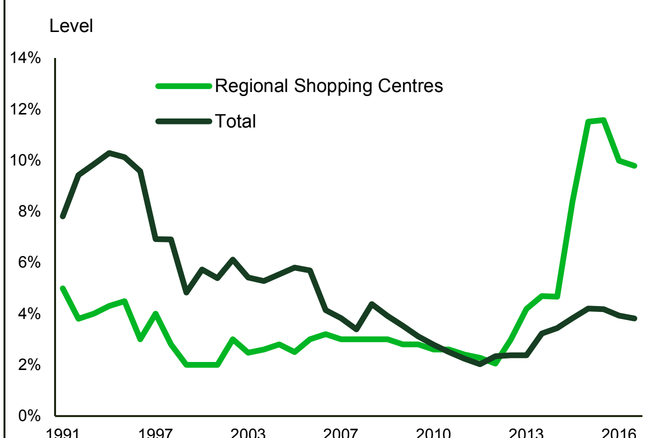
Source: CBRE, forecast by TD Economics as of Feb. 2017.

industries. In particular, transport and warehousing activity is the city's second largest source of demand for industrial space and is expected to grow by 14% this year, following a modest setback in 2016. It is estimated that over 250,000 square feet of new space will be leased this year and next, helping to absorb some of the vacant space. The vacancy rate, which hit a record high of 4.9% in 2016, is expected to nudge lower.

Retail sector gets record investment

Investment in Winnipeg's retail sector picked up in 2016 as several years of fairly muted construction activity had led to a tightening in market conditions. Two major projects reached completion in the second half of 2016 – the Outlet Collection of Winnipeg (400,000 square feet) and the Bridge Water Town Centre (118,000 square feet). Most of this space has been leased, with Saks Fifth Avenue signing up as the anchor tenant for the outlet mall. While the overall retail vacancy rate is expected to remain stable, performances within the sector are not uniform. Case in point, the vacancy rate for shopping malls recently moved above 11%, more than double the segment average. Regional shopping centers have seemingly been harder hit by a recent softening in occupancy demand, as potential tenants appear to exhibit caution surrounding the outlook for consumer spending growth. In particular, employment growth in Winnipeg stagnated in 2016 and net interprovincial migration remained negative. Looking ahead, net job creation is expected to resume in 2017, but with housing market activity likely to ratchet down somewhat amid new mortgage rules and an uptick in interest rates, consumer spending fundamentals are projected to remain lacklustre. There remains a number of projects in the pipeline, including the continued development of the Seasons of Tuxedo Mall and two major plazas as part of the True North Square. But, these are not expected to reach completion until after TD Economics' two-year forecast horizon. The next phase of the True North Project, which includes a plaza will not be completed until 2019. The addition of relatively little supply in 2017 and 2018 will help to stabilize retail vacancy rates.

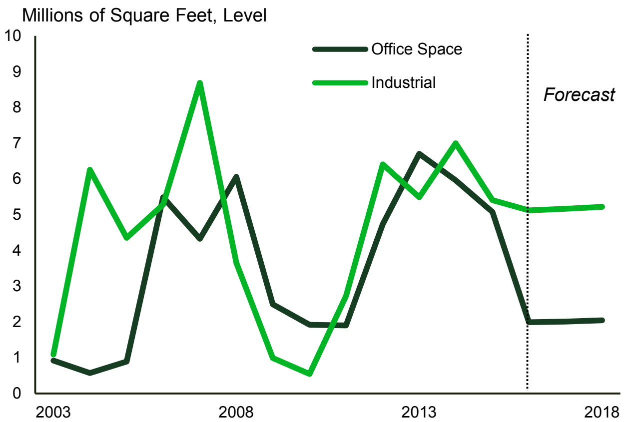
CHART 3: WINNIPEG RETAIL VACANCY RATES



Source: CBRE, TD Economics.

TORONTO - BUILDING BINGE WINDING DOWN

CHART 1: TORONTO OFFICE AND INDUSTRIAL UNITS UNDER CONSTRUCTION



Source: CBRE, forecast by TD Economics as of Feb. 2017.

Both investment and building activity picked up in the GTA office and retail markets over 2014 and 2015 and much of this new inventory reached completion in 2016. Despite concerns of some overbuilding, most of the new supply was absorbed. The labour-intensive service sector in the region has been flourishing and, combined with a recent rejuvenation of downtown cores across the GTA, has boosted office and retail demand. However, these segments of the market have probably peaked. As activity in financial, professional services as well as the homeownership market cools in 2017-18, investment momentum within CRE is likely to rotate towards the relatively underdeveloped industrial segment. From a risk perspective, we do not see evidence of extreme froth, as even the hottest areas of concentrated building in recent years continue to record average vacancy rates and supply gains. Our forecast of a soft landing in the office and retail markets assumes that bond yields move up only gradually from current levels. The risk of a sharper and sustained move higher in interest rates, however, is not immaterial.

The office space hangover lingering

Years of rapid additions to the GTA's stock of office space have spurred concerns of a correction. But, as these units have reached completion, they have been met with strong demand. The office vacancy rate remained near 9% in 2016, halting what had been four straight years of increases. Toronto is one area where there has been a large divergence between the downtown office market, where vacancy rates range between 4% and 6%, and the subburban markets, where rates range from 15% to 27%.

Looking forward, our expectation of continued solid economic and demographic expansion in the GTA will provide some support to office leasing demand. However, over half of the job creation in office-related jobs in the GTA since 2014 has been tied to finance, insurance and real estate, an area that is likely to lose steam along with a cooling existing home market over the next two years. Meanwhile, many businesses have been moving toward smaller and more efficient work space environments, which will continue to weigh on demand for new space. While the peak in construction activity is now behind us, there are almost 5 million square feet of new space still under construction, with two new downtown office towers (30 Bay Street and Union Centre) to be completed over this year and next. The combination of slowing demand, shrinking work spaces and rising inventory will likely pressure the vacancy rate up slightly in 2017 and 2018 send rents lower. Given the recent rise in bond yields, the spread between the capitalization rate and the 10-year government bond yield narrowed to below historical averages and below that of most other CRE segments, likely limiting further investment and leaving this segment particularly vulnerable to further upward pressure on interest rates or other shocks.

Toronto CRE Outlook

	Level	Year-over-Year % Change *Unless Otherwise Stated**			
	2016	2016	2017F	2018F	**Avg. 2005 to 2015**
Office					
Inventory (Mil Sq Ft)	160.6	3.6	2.2	1.5	0.9
Occupied (Mil Sq Ft)	145.8	4.0	1.2	0.6	1.0
Avg. Net Rent /Sq Ft	17.5	-0.9	0.6	-0.2	1.6
Vacancy Rate (Level)*	--	9.2%	10.1%	10.9%	8.7%
Industrial					
Inventory (Mil Sq Ft)	764.3	0.6	0.4	0.4	0.8
Occupied (Mil Sq Ft)	738.8	1.3	0.6	0.9	0.8
Avg. Net Rent /Sq Ft	6.5	5.3	2.0	2.0	-1.3
Vacancy Rate (Level)*	--	3.3%	3.1%	2.6%	3.9%
Retail					
Inventory (Mil Sq Ft)	107.6	2.2	1.5	1.4	1.6
Occupied (Mil Sq Ft)	102.3	2.4	1.0	1.2	1.5
Avg. Net Rent /Sq Ft	27.2	2.1	1.1	0.9	1.0
Vacancy Rate (Level)*	--	4.9%	4.8%	5.5%	6.1%

Source: CBRE. F. by TD Economics as of Feb. 2017.

CHART 2: TORONTO OFFICE VACANCY RATE

Source: CBRE, forecast by TD Economics as of Feb. 2017.

Construction of retail space to slacken

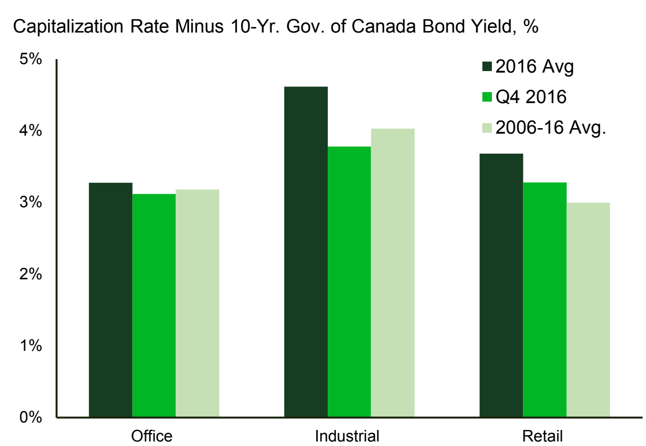
The retail sector in the GTA is in the midst of significant expansion with more than 3 million square feet either added since late 2016 or on tap to be completed in 2017. This includes the expansion of a number of existing malls, including the addition of 2 million square feet to Yorkdale Mall, The RioCan Sheppard Centre and Yorkvile Village (formerly Hazelton Lanes). The majority of this space has been developed to accommodate the entrance of major international retailers, such as Nordstrom and Saks Fifth Avenue, into the GTA's largest malls. Despite these additions, the vacancy rate in this segment of the market has fallen to 4.8% in 2016 – a decade low. The trend among retailers has been to give up street store space for mall space. As these new projects reach completion, the overall vacancy rate may edge higher as retailers vacate older spaces. Meanwhile, gains in demand for retail space is likely to moderate. A strong housing market has been a boon to housing-related retail sales in the region. At the same time, highly-indebted consumers have been shying away from bigger department and general merchandise stores, where much of the expansion has taken place. Total retail sales were up 4.5% year-to-date in September in Toronto, but down 2.5% for general merchandise stores. Looking ahead, fundamentals for retail spending are poised to weaken as the housing market begins to cool in mid-2017. As such, vacancy rates will probably edge moderately higher and rent growth moderate.

Rising supply to take edge off industrial

Demand for the export-orientated industrial space has been lacklustre, with strength in the Toronto economy more tied to service producing jobs in recent years. Transportation and warehousing activity in Toronto has not experienced the same rapid growth as other major Canadian cities. Retail distribution centres tend to be attracted to other, lower-cost jurisdictions. New supply has also remained constrained in recent quarters, helping to contain the vacancy rate at around 2% last year, its lowest level in over a decade.

This supply dynamic is likely to shift going forward, as the market receives a hefty amount of new space. There currently is 23 million square feet of new space under construction or in the planning stages, 5 million of which is expected to reach completion in 2017 and 2018. With a low Canadian dollar and rising U.S. demand expected to fuel a moderate acceleration in export growth in 2017 and 2018, demand for industrial space is likely to pick up in tandem and help to absorb most of this new supply. The vacancy rate is still likely to nudge higher, reaching a 3% by 2018. As market conditions loosen somewhat, annual rent growth is projected to cool to a more sustainable 2% clip over the next two years, following three years of close to an average 7% per year.

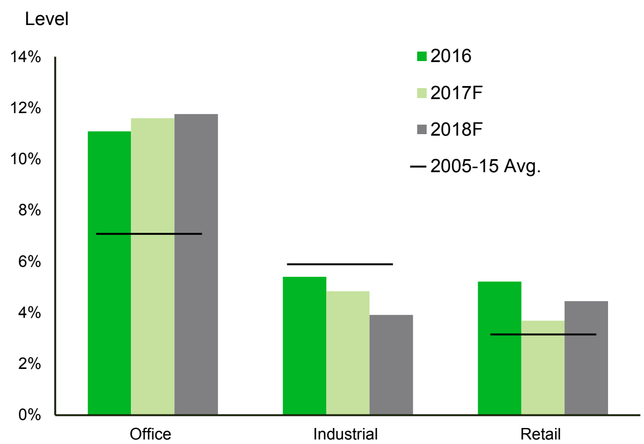
CHART 3: CAPITALIZATION RATE SPREADS



Source: CBRE, TD Economics.

OTTAWA- LONG ROAD TO RECOVERY

CHART 1: OTTAWA CRE VACANCY RATES



Source: CBRE, forecast by TD Economics as of Feb. 2017.

The weakness in CRE markets in Ottawa has been a long-term story, with both a faltering tech sector and government restraint having taken a toll on demand. Vacancy rates have risen to elevated levels across the board, with particular weakness observed in the office market. However, prospects for the Ottawa region market have more recently brightened in tandem with the federal government's plans to loosen the fiscal purse strings over the next several years. Furthermore, retail activity is expected to receive a boost, albeit a temporary one, from increased tourism activity associated with Canada's 150th birthday this year. Significant investments in infrastructure, including a $3 billion light rail project, is expected to attract more businesses and individuals into the city. As such, we expect vacancy rates for retail and industrial segments to fall over the coming years, driving rents higher. And, within the beleaguered office market, we expect the multi-year uptrend in the vacancy rate to stabilize.

Industrial space curing the hangover

Following a decade of strong construction activity, increased global uncertainty has appeared to take some toll on investment in the industrial sector over the last two years. But, demand fundamentals appear to be improving. Manufacturing has been fastest growing sector in Ottawa outside of the federal government. This strength is partly tied to renewed growth in the city's all-important high-tech industry, which has benefitted from significant tax incentives and a low Canadian dollar. A recent Ottawa business outlook survey showed that businesses in this field are particularly optimistic about future economic prospects. With demand for occupied space rising faster than supply, the vacancy rate edged down in 2016 to a level more in line with its long-run average. Looking ahead, we expect it will continue to trek lower. While construction activity has picked up recently, the pace of development will be limited by a lack of available land and high prices. Rent growth is expected to pick up to an average annual pace of close to 4%.

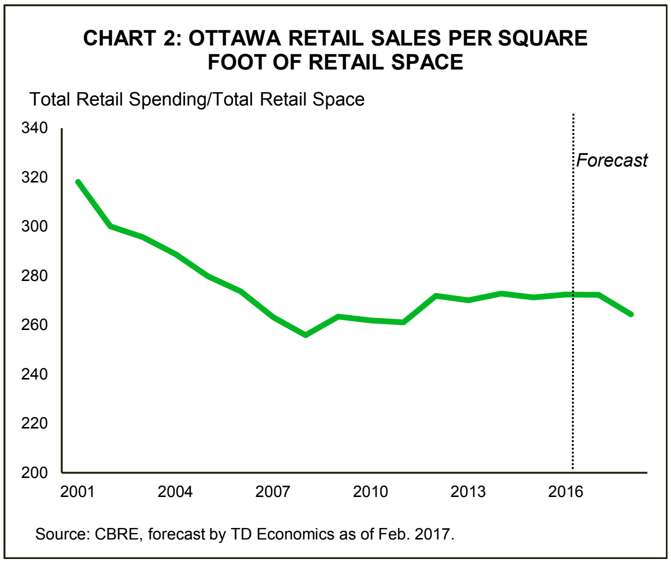
Retail boost to be temporary

Over the past few years, the retail sector has recorded more construction activity than the other CRE segments, partly reflecting attractive rents. Rental rates have been rising at an average annual pace of 9% since 2011, faster than virtually all other major markets over the comparable period. This pressure does not appear sustainable. Even with consumer spending running at decent clip, sales per square foot in 2016 have actually been edged down. Moreover, the vacancy rate has moved up to 5.2%, slightly above its long-run average. Rising vacancy rates are expected to take some steam out of rent growth. The building boom seems to now be behind us, with just 183,000 square feet of new space under construction, all in the development of a new mall in Barnhaven. To put this into perspective, almost 800,000 square feet of new space was added to the market in 2015. Ottawa is hosting a number of celebrations this year

Ottawa CRE Outlook

	Level	Year-over-Year % Change *Unless Otherwise Stated**			
	2016	2016	2017F	2018F	Avg. 2005 to 2015
Office					
Inventory (Mil Sq Ft)	40.6	0.2	1.1	1.0	-2.2
Occupied (Mil Sq Ft)	36.1	-0.4	0.5	0.8	-2.6
Avg. Net Rent /Sq. Ft	16.3	0.2	-0.5	-1.0	13.5
Vacancy Rate (Level)*	--	11.1%	11.6%	11.8%	6.9%
Industrial					
Inventory (Mil Sq Ft)	29.9	0.1	0.2	0.2	2.4
Occupied (Mil Sq Ft)	28.3	1.0	0.8	1.2	2.2
Avg Net Rent /Sq. Ft	9.2	17.1	4.2	4.4	0.1
Vacancy Rate (Level)*	--	5.4%	4.8%	3.9%	6.1%
Retail					
Inventory (Mil Sq Ft)	22.5	4.5	1.9	1.3	3.5
Occupied (Mil Sq Ft)	21.3	4.4	3.5	0.5	3.4
Avg Net Rent /Sq Ft	46.8	5.7	2.2	1.5	6.3
Vacancy Rate (Level)*	--	5.2%	3.7%	4.5%	3.3%

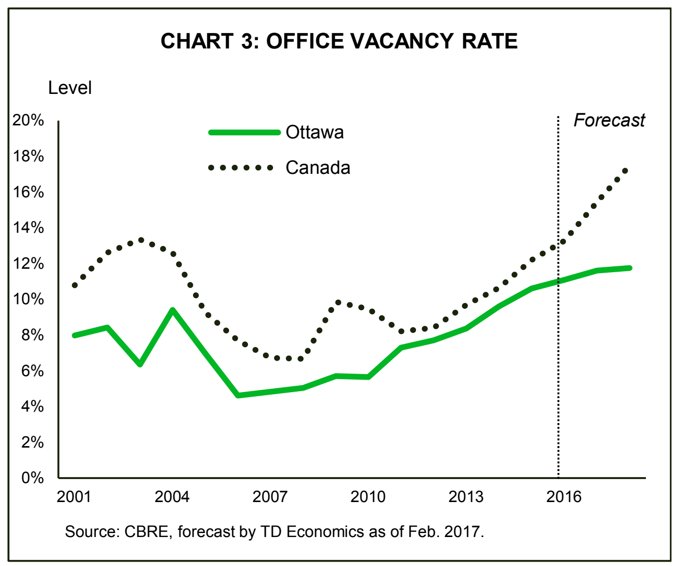
Source: CBRE. F. by TD Economics as of Feb. 2017.



to celebrate Canada's 150th birthday, which is expected to provide a strong one-off boost to retail spending. This may lead to some additional demand for space in the very near term as retailers prepare for the festivities, helping to bring the vacancy rate down. But, this boost will be temporary, with the vacancy rate expected to bounce back to 4.5% in 2018, remaining indicative of a balanced market.

Office – it has been a long hangover

The office market in Ottawa has not shaken off the impacts of the large federal deficits post-crisis and subsequent efforts to rein in the shortfalls under the former government. In fact, both demand and supply of office space still sit 27% and 23%, respectively, below their 2007 peak. The vacancy rate has been on an upward trend since 2008, reaching a record high of 10.5% in 2016 and a level almost four percentage points above its long-run average. Construction activity managed to pick up modestly in 2014 and 2015, but is largely a result of a few projects that are set to be completed in 2017. Despite past restraint, the biggest source of demand for office space in Ottawa remains the federal government. The government is poised to embark on a period of deficit spending over the next five years, with positive spill-overs to demand for office space in the Ottawa region. Still, given the aim to reduce office space per worker to improve efficiency – a project labelled Workspace 2.0 – the increased government demand may only absorb 363,000 of the 4.4 million square feet of office space sitting empty in Ottawa. This would contribute to stabilizing rather than reducing the city's still-elevated office vacancy rate, while focus on renovations of existing space remains a priority. High vacancy rates will likely continue to put downward pressure on rents.



MONTREAL - STEADY AS SHE GOES

The outlook for commercial real estate in Montreal mirrors that of the region's overall economy – modest growth but with some near-term upside. Overall, most market segments appear well balanced, especially relative to other major Canadian cities. Vacancy rates are near or below their long-run averages, rents are rising slowly and rates of return are relatively favorable. The sole exception is office space where overbuilding has put pressure on rents. Looking forward, an anticipated pick-up in export growth, solid consumer spending and increased public infrastructure spending are expected to be key strengths for the economy, supporting demand for most types of commercial real estate. But these trends will vary by market segment, with industrial space poised to post the most notable rise in activity. Despite the recent jump in government bond yields, capitalization spreads in Montreal's CRE market remain above their long-run average levels with the exception of office space. However, any additional narrowing in spreads from these levels would start to deter further development.

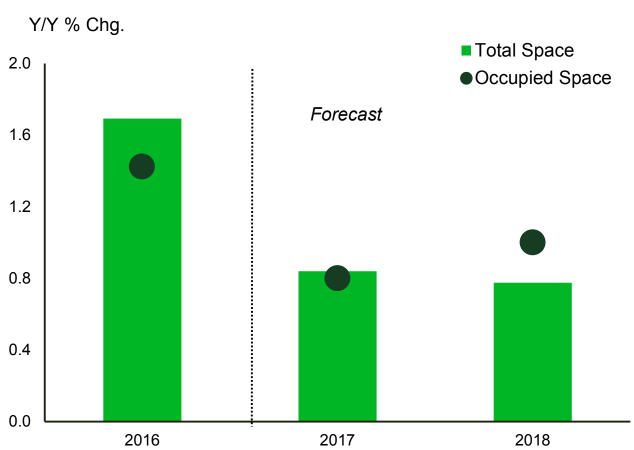
Industrial fortunes to improve in the New Year

Disappointing demand for Quebec's manufacturing exports and elevated uncertainty have held businesses back from investing. This has been most evident in the region's industrial market. The gap between capitalization rates and the risk free rate remains elevated, suggesting that investors have already priced in a high degree of market uncertainty. New supply in 2016 fell to just over a fifth of the previous year's level, helping keep the vacancy rate below historical levels. But while uncertainty still prevails around U.S. trade policy following the U.S. election, we still expect the industrial market to strengthen over the next 1-2 years owing to growing U.S. demand to the region's exports and and a relatively low Canadian dollar. Our forecast of 3% growth in manufacturing activity is projected to translate into a need for over four million square feet of industrial space. And with the building boom now winding down, additional demand from manufacturing activity will help bring vacancy rates down further in the coming years, thus pushing rents up. Vacancy rates are expected to edge down to 6.4% by 2018, while rents are expected to increase by 2.0% on average over the next two years.

Strong fundamentals guide retail growth

Steady employment gains this year have put more money in Montrealers' pockets, and the city's retail space will continue to reap the benefits. The retail market saw a sharp influx of supply last year with completions over twice the amount of new space than in the previous year. However, retailers snapped up most of this new space, limiting the upward pressure on the vacancy rate. Consumer spending has been one of the strongest drivers of economic activity in the city recently, following strong employment growth in 2015 and 2016. This has enticed new retailers to the region including recently-opened Victoria's Secret and Saks Off

CHART 1: MONTREAL RETAIL MARKET



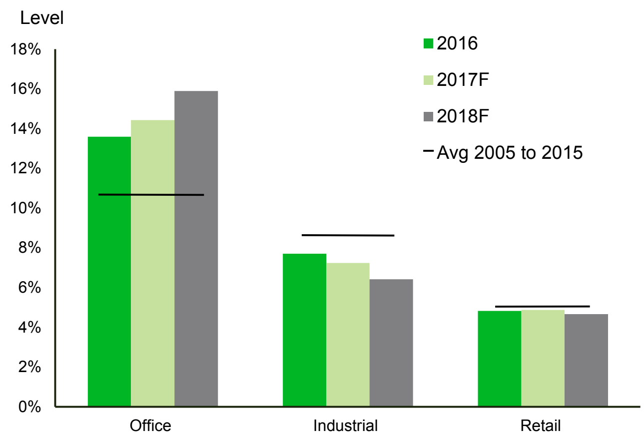
Source: CBRE, forecast by TD Economics as of Feb. 2017.

Montreal CRE Outlook

	Level	Year-over-Year % Change *Unless Otherwise Stated**			
	2016	2016	2017F	2018F	Avg. 2005 to 2015
Office					
Inventory (Mil Sq Ft)	72.7	0.7	1.5	1.2	1.4
Occupied (Mil Sq Ft)	62.8	0.5	0.5	-0.5	1.4
Avg. Net Rent /Sq Ft	16.3	-0.6	0.5	0.7	1.4
Vacancy Rate (Level)*	--	13.6%	14.4%	15.9%	10.7%
Industrial					
Inventory (Mil Sq Ft)	300.5	0.5	0.1	0.0	2.0
Occupied (Mil Sq Ft)	277.3	0.2	0.6	0.9	2.0
Avg. Net Rent /Sq Ft	5.4	1.3	1.8	2.2	0.5
Vacancy Rate (Level)*	--	7.7%	7.2%	6.4%	8.6%
Retail					
Inventory (Mil Sq Ft)	37.7	1.7	0.8	0.8	1.4
Occupied (Mil Sq Ft)	35.9	1.4	0.8	1.0	1.4
Avg. Net Rent /Sq Ft	31.2	2.0	1.2	1.5	3.3
Vacancy Rate (Level)*	--	4.8%	4.9%	4.7%	5.0%

Source: CBRE. F. by TD Economics as of Feb. 2017.

CHART 2: MONTREAL CRE VACANCY RATES



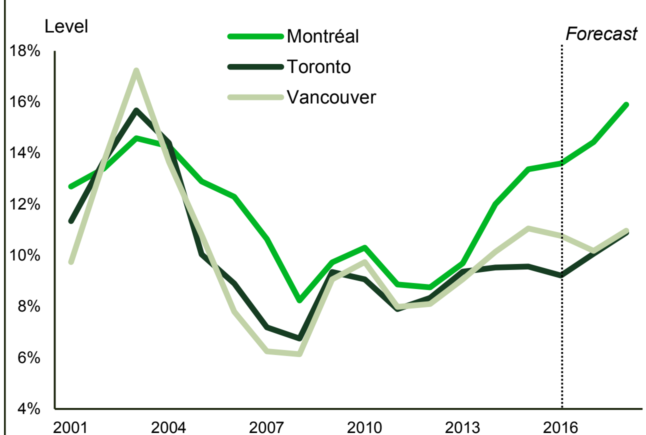
Source: CBRE, forecast by TD Economics as of Feb. 2017.

5th. A relatively low loonie is expected to encourage rising tourism traffic, which together with domestic spending, will help drive a cumulative 5% increase in retail sales per square foot in 2018. An aging population will also require additional space for less-discretionary spending items and services oriented toward seniors. The share of the population over age 65 has increased and is projected to continue its upward trajectory. This will require more space for grocery stores and pharmacies located in close proximity to senior living facilities. Capitalization rate spreads declined recently, limiting the risk of overbuilding in the near term.

Office space malady: Incurable for the time being

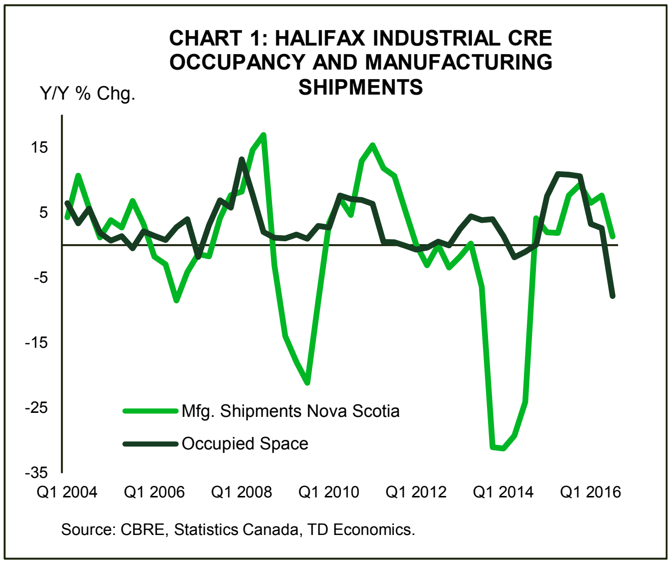
Spurred by the rise in capitalization spreads, Montreal's office commercial real estate sector has added a significant amount of new supply in recent years. Since 2015, new supply has been met with sluggish demand as output in industries tied to office demand weakened. One area of notable softness has been the high-tech sector, where a scaling back of provincial tax credits prompted a number of companies to relocate outside of the city. This weak demand for office space combined with overbuilding has led Montreal's office vacancy rate to rise above both its long-term average and levels observed in other major Canadian markets. One bright spot for office space in the coming years will be gains from rising employment in finance, insurance and real estate. These gains will partially make up lost ground following large contractions in recent years. This is expected to help generate demand for an additional 325,000 square feet in 2017, but it won't come close to absorbing the 1.1 million square feet that is slated to be completed this year. As such, vacancies are likely to edge up further and constrain growth in rents to 0.6% annually. While ample unoccupied space in this market will weigh on rents, the impact on rates of return will be more significant in Toronto and Vancouver, where overbuilding has been more pronounced.

CHART 3: OFFICE VACANCY RATES



Sources : CBRE, forecast by TD Economics as of Feb. 2017.

HALIFAX- INDUSTRIAL SPACE LEADS CRE ADVANCEMENT



After years of subpar growth in Halifax, the tides are changing, and rising economic activity over the next two years will benefit CRE. Stemming from employment gains in manufacturing, transportation and warehousing, demographic shifts and international migration, a rise in demand for most types of space is expected in the coming years. However, CRE markets in the region will enter 2017 from a position of excess supply, and even in light of the firming occupancy picture, vacancy rates are likely to remain elevated and rent growth subdued. In the near term, the industrial space is set to lead growth. Capitalization rates in the region will likely continue to exceed those of all other major Canadian cities across CRE categories but that is more a reflection of the relatively small size of the economy than a harbinger of future investment. To the contrary, investment in CRE is likely to remain sluggish over the next two years as the city is left to soak up a substantial amount of new supply.

Rising shipments to support industrial space

After being on shaky ground in recent years, economic growth over the next two years is expected to be led in part by rising manufacturing exports. Following a substantial development cycle, when 384 thousand square feet were added to the market in 2013, the industrial vacancy rate has remained above long-run average levels, but this will start to reverse in the coming years. Large ship-building contracts, in addition to automotive parts manufacturing, will likely result in a pickup in demand for industrial space. Notable progress has already been made, with jobs tied to goods-producing sectors expanding by 1.4% in 2016 after a contraction in 2015. Rising international and interprovincial demand is anticipated to underpin a 3.1% expansion in manufacturing on average over the next two years, which we estimate will require an additional 250 thousand square feet of industrial space. This will likely push the vacancy rate down to 9.7% by 2018, and support a modest pickup in rent growth to 2.0%. And with the decline in industrial capitalization rate spreads in 2016, it looks like investors' appetite for further industrial building has been satiated for now. Investment in this space has already started to unravel, posting a 55.5% retrenchment in 2016.

Rise in spending will benefit retail CRE

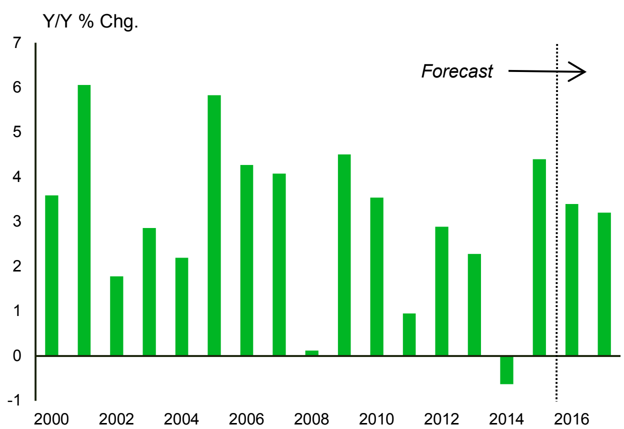
After a weak showing in 2015, retail sales in the region are on track to turn in a stellar 3.8% growth performance in 2016. Retail sales in Nova Scotia are expected to moderate in 2017-18, but to a still-healthy rate of 3.3% per year. Helped by spending associated with employment growth, an aging population and increased tourism, the retail space is projected to expand by over 175 thousand square feet as retailers take advantage of the rise in sales activity. Seniors' relatively high disposable incomes will supplement household income gains from employment growth and this will

Halifax CRE Outlook

	Level	Year-over-Year % Change *Unless Otherwise Stated**			
	2016	2016	2017F	2018F	Avg. 2005 to 2015
Office					
Inventory (Mil Sq Ft)	12.5	3.1	2.9	0.0	3.0
Occupied (Mil Sq Ft)	10.6	2.2	1.3	0.8	2.6
Avg. Net Rent /Sq Ft	14.5	-4.4	-2.1	-2.3	1.6
Vacancy Rate (Level)*	--	14.9%	16.2%	15.6%	9.9%
Industrial					
Inventory (Mil Sq Ft)	12.2	3.0	0.1	0.0	2.7
Occupied (Mil Sq Ft)	10.8	0.6	1.2	1.1	2.4
Avg. Net Rent /Sq Ft	7.7	1.8	1.9	2.1	2.0
Vacancy Rate (Level)*	--	11.4%	10.7%	9.7%	6.2%
Retail					
Inventory (Mil Sq Ft)	10.4	0.8	0.7	1.0	2.0
Occupied (Mil Sq Ft)	9.8	0.2	0.5	0.7	1.8
Avg. Net Rent /Sq Ft	20.1	0.6	0.4	0.3	1.5
Vacancy Rate (Level)*	--	5.7%	5.9%	6.1%	4.9%

Source: CBRE. F. by TD Economics as of Feb. 2017.

CHART 2: NOVA SCOTIA RETAIL SALES



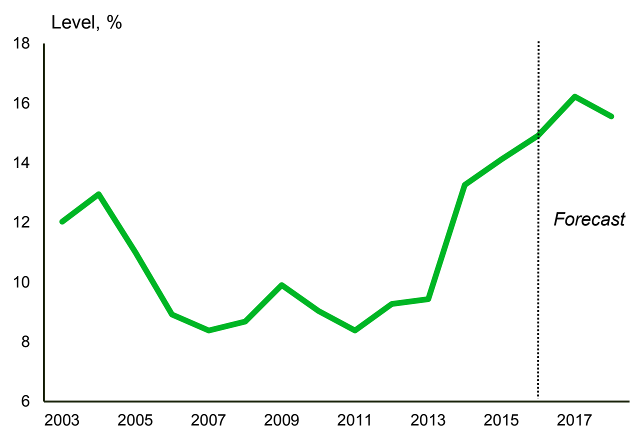
Source: Statistics Canada, forecast by TD Economics as of Jan. 2017.

be helped further by strong cruise ship traffic. Retailers have responded to these trends with optimism, and leasing activity is expected to pick up over the next two years. However, the vacancy rate is still likely to edge up to 6.1% by 2018 as new supply is brought to the market, pressuring rent growth down to 0.4% annually. Capitalization rate spread compression that is likely to occur in the near future will lean against new investment.

Office space to underperform

Mirroring last year's trends, growth in office-intensive service occupations in Halifax is expected to underperform goods-producing occupations over the next two years. And this trend is already apparent in the office CRE space. After a record 594 thousand square feet of office space was brought to the market in 2014, the vacancy rate shot up and has been rising ever since. Of this space, 63% was developed in the suburbs, and as firms migrated to these new buildings from the downtown core, a glut of supply has been left behind. The over 300 thousand square feet of new supply set to hit the market over the next two years will lead the vacancy rate to rise to 15.6% by 2018– well above its long-run average level of 9.9%. Declines in rent in the downtown office space will erase gains in the suburban market, and rents overall are likely to decline a further 2.2% per year over the next two years. The softening in rents is expected to erode capitalization rates in this segment, keeping new office investment at bay in the near future.

CHART 3: HALIFAX OFFICE VACANCY RATE



Source: CBRE, forecast by TD Economics as of Feb. 2017.