CUSHMAN & WAKEFIELD

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The Planning Partnership

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NPG COMMUNITY DEVELOPMENT PLANNING

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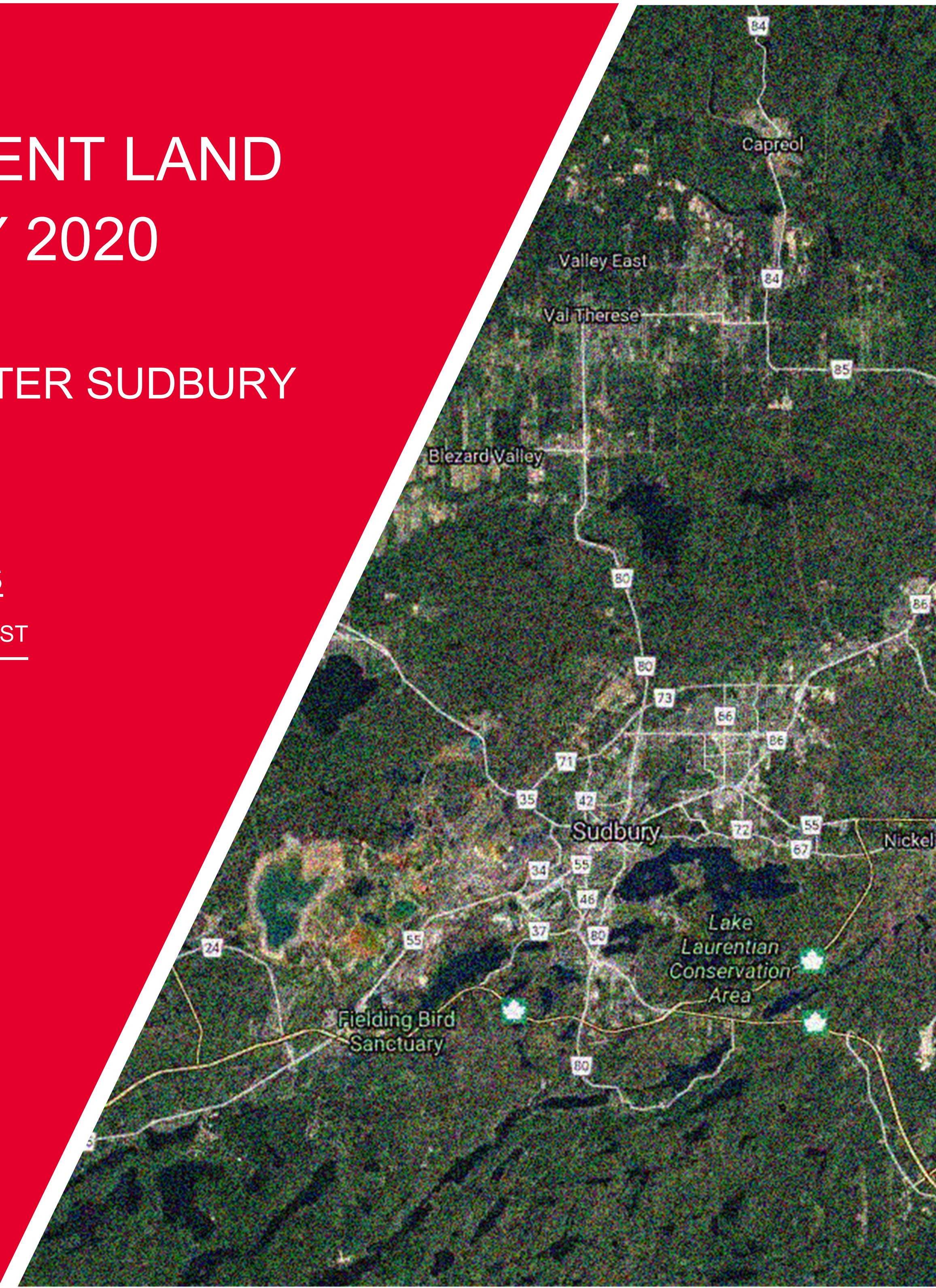
EMPLOYMENT LAND STRATEGY 2020

CITY OF GREATER SUDBURY

DELIVERABLE #3

TRENDS ANALYSIS

DRAFT AUGUST 31ST



3.0 TRENDS ANALYSIS

3.1 Office Sector Trends

3.1.1 Prevailing Trends in the Office Market

An important factor when contemplating the amount of future lands required to accommodate long-term office space demand is the densification of office space. This is a reference to the changing office workplace environment, which (pre-COVID-19) had been seeing a persisting trend towards smaller allocations of space per employee. This was driven by several factors, including:

- more efficient office building design, allowing greater utilization of floor plates;
- higher occupancy costs (net rental rates, operating costs, and taxes), contributing to a reduced space allocation on a per employee basis by firms;
- adoption of technology, enabling mobile and off-site productivity, as well as reducing paper filing and storage requirements; and,
- increased telecommuting and desk sharing practices among co-workers.

Greater Sudbury's public and private sector office space is principally located in the Downtown area, along with a significant Canada Revenue Agency/Sudbury Tax Services Office building at 1050 Notre Dame Avenue. From a site selection perspective, the following characteristics are of importance:

- Access to an educated workforce – Greater Sudbury's post-secondary facilities are a vital source of skilled workers for local businesses.
- Desire for mixed-use/"urban" environments – office occupiers that are seeking to attract employees in the competitive jobs market recognize that offering a workplace with proximity/accessibility to restaurants/bars, retail opportunities, recreation spaces, and a high-quality public realm, is critical.
- Public transportation accessibility – in many urban areas, opportunities to travel via public transit is becoming an increasingly important option as an alternative to auto-oriented commuting. However, this dynamic is not as prevalent in Greater Sudbury compared to other metropolitan markets, due to the size of the city, and the ease of commuting by private vehicle.

3.1.2 Perspectives on COVID-19

Cushman & Wakefield's Chief Economist and Global Head of Research and team have authored significant content related to the COVID-19 crisis, and the recovery process. As a worldwide firm, Cushman & Wakefield has unique insights from all parts of the globe, which are experiencing different phases of the pandemic. In this section of the report, we have extracted segments from several recent research reports and "white papers" that discuss aspects of the pandemic, and the associated impact on office markets.

- "In the near term, while retail and hospitality will be hardest hit, office demand will be restrained as well. Rising vacancy is likely to suppress office rent growth until business confidence and activity is restored."
- "Office occupiers may pause on expansions in the near term until the services sectors prove their resilience in the face of weaker near-term global demand."

- "The brief surge in remote working should not, on its own, cause office vacancy rates to rise significantly right away. It is important to note that 91% of all office leases are 2 years in length or longer; thus, even though many office buildings are sitting empty now, they are still leased. That said, clearly there is significant disruption occurring in every sector of the economy, including the office sector. We expect absorption, both gross and net, to slow substantially world-wide and turn negative in many markets. In terms of vacancy and rents, both are strongly correlated with the unemployment rate; it will be a key metric to watch going forward – including the trajectory of the improvement during the recovery."
- "Many occupiers and landlords are in 'wait-and-see' mode. Companies are distracted by the impact to current operations, and focused on figuring out how to deal with remote workers, closed locations, and disrupted supply chains."
  - After the initial disruption to business while transitioned to the stay-at-home environment, many/most employees successfully adapted to new modes of work. There is growing discussion on the extent of how permanent the work-from-home potential could be among various industries that use office space.
- "The crisis may lead to a changed perception of work-from-home. In many cases, organizations that have never had any (or any significant portion of) employees work remotely have been doing so due to shelter-in-place orders. However, it is likely that most workers will continue to access office space on a regular basis, even if they increase the frequency of remote work."
  - The importance of social interactions was highlighted during the mandatory work-from-home paradigm. Opportunities for learning and collaboration are also quite different at home versus in a communal office environment.
  - There is some sentiment that a shorter-term mandated work-from-home period would primarily reveal the upside of this lifestyle. However, in a prolonged state, the 'pains' of working from home become apparent, with many employees seeking to return to office space.
- Post-crisis… "There will be exploration of the 'office workplace ecosystem', including primary office space, co-locations, flex spaces, and work-from-home arrangements."
- "Some occupiers are considering shorter-term leases during a period of increased uncertainty, and are requesting to investigate 'blend and extend' leases, or are asking to renegotiate terms."
  - Tenants are pausing decisions on new lease commitments and plans for expansion until economic and market dynamics are better understood, and a path forward is clearer.
- "An anticipated rise in vacancy is likely to suppress office rent growth until business confidence and activity is restored. If this vacancy comes in the form of considerable sublet space in addition to headlease space, then this is problematic; it would prolong the downward pressure on rents, and make new construction even less likely."
  - Office vacancy and rents are strongly correlated with the unemployment rate. If job losses go from temporary to permanently destroyed, then the rise in the unemployment rate will be longer-lasting, causing vacancy to rise over the coming quarters.
- "Availability of sublease space is a sign of softness in the market, as occupiers look to cut costs and offload excessive space. This is where vacancy will show up first."
- "Office space planning/layouts may go through a transition in thinking. The trend towards shrinking space per worker ('densification') may reverse, to enable increased physical distancing. As well, the frequency of work-from-home may increase, and non-assigned desk office environments ('hotelling') may become more prevalent."

- "From a corporate real estate perspective, some larger firms may re-evaluate their centralized strategy (one central office) and transition to a more decentralized structure (multiple offices – perhaps a Downtown HQ with several smaller Suburban offices), in order to allow suburban-living employees to live closer to work, to give employees more options about where to work, and to mitigate risk of office closures/downtime."
  - The "centralization" strategy is underpinned in a belief that office densification and hotelling would help offset higher rent costs associated with Downtown locations versus the Suburbs. While true, if there is a reversal of the densification trend, then the occupancy cost savings disappear. Thus, Suburban office demand could be reinvigorated.
  - Some firms may seek to become owners and sole occupiers of their building, or single-tenants in a new design-build, in order to control all aspects of their premises (entry, elevators, etc.).
- "From a market trends perspective, an acceleration of work-from-home office-type employment would place downward pressure on office space demand, while a reversal in the densification of office space toward more allotment of space per worker has the counter-effect."

In summary, there is split sentiment about this asset class, from the perspectives of space demand and land needs. The effect of the competing forces of increasing work-from-home and hoteling (leading to less office space demand) versus higher allocation of space per office worker (leading to increased space demand) must be closely monitored going forward. If proven COVID-19 treatments/therapies/vaccines emerge, a reversion to denser office spaces may be anticipated. Most surveys indicate a larger share of office workers will permanently work from home. Similarly, we'll see a larger agile worker population – people who work remotely at least some of the time.

Opportunities for knowledge spillover, innovation and creativity, employee bonding, culture and brand, mentoring and training, productivity, and more, are reasons that office real estate will continue to play a vital role in the way organizations work and grow. Ultimately, office workplace and market demand dynamics will evolve as a result of the crisis.

3.2 Industrial Sector Trends

3.2.1 Prevailing Trends in the Industrial Market

Demand for the conversion of lands within designated employment areas to other uses is an ongoing issue faced by many municipalities. The nature of employment continues to evolve away from a historic manufacturing base to a more service-based economy. In permitting the conversion of employment lands to a non-employment use, these lands are highly unlikely to revert in the future back to an employment use; they are "lost" forever. A land supply to meet residential growth targets (plus lands needed to accommodate retail-commercial uses) is sufficiently available (or can be accommodated) in locations designated and planned for such uses. Therefore, a municipality must carefully weigh the benefits and drawbacks of any proposed industrial land use conversion, in order to maintain/preserve sufficient lands to accommodate anticipated long-term industrial employment demand.

The amount of industrial floor space per worker continues to increase. The growing adoption of automation is impacting traditional manufacturing employment. In some markets – although far less pronounced in Greater Sudbury – warehousing and distribution is the dominant component of growth, and it has a relatively low employment density. Due to their large building footprint (and accordingly, land cost), warehousing and logistic uses are typically attracted to large sites on the urban periphery, which feature ready access to multiple highways. The taller ceiling clear height found in modern industrial buildings means that floor space is being replaced by vertical space – without a corresponding increase in a requirement for labour.

Municipalities should encourage a range of parcel sizes, locations, and timing/levels of servicing of employment lands, in order to be responsive to occupier and developer requirements. Having an adequate supply of serviced lands can act to suppress land price inflation, by ensuring choice in the marketplace, and enabling multiple market participants (not just a small group of dominant landowners/investor). If there is too limited a supply, or an insufficient range of choices of location/size, then occupiers will look elsewhere. Industrial developers are sensitive to land pricing – it is a key component of their development pro forma model – and they will seek markets that provide lower cost options (which generally coincides with movement from the core towards the urban periphery, or beyond).

Older industrial areas with buildings that no longer meet the requirements of contemporary business (i.e. properties with lower ceiling clear height, a less functional site layout for truck movements/distribution, etc.) may convert over time to alternate uses – although there is uncertainty and complexity in anticipating the adaptive re-use of employment lands. While this may displace/replace industrial-type employment, such adaptive re-use of buildings could include more office-type functions – particularly firms seeking low-cost environments that do not need conventional office space (such as high-tech start-ups, and other "new economy" uses). Regeneration and intensification within older, established industrial areas can play a part in unlocking future employment potential. Providing flexibility in planning policy (such as permissive zoning, context-appropriate parking standards, etc.) to accommodate alternative, compatible uses will be important in attracting such opportunities for intensification of employment within established business parks, as opportunities arise over time.

3.2.2 Perspectives on COVID-19

In the following section, we have extracted segments from several recent Cushman & Wakefield reports and "white papers" that discuss aspects of the COVID-19 pandemic, and the associated impact on industrial markets.

- "The globe's industrial-logistics sector was booming before this crisis – net new leasing activity, rents, construction activity, and occupancy levels were at record highs. Given COVID-19's impact on global trade, we expect some near-term headwinds. Longer-term, COVID-19 is accelerating the shift to eCommerce out of necessity. That may induce some longer-lasting behaviors in consumers. We expect the industrial-logistics sector to come out of this crisis stronger than ever."
- "The outlook for logistics remains unadjusted, as eCommerce continues to expand structurally, and supply chains are reorganized to enable faster and more cost-efficient delivery. Even before the pandemic, the growth of online grocery sales was driving demand for cold storage warehouses."
- "Many industrial development projects have been put on hold, as developers and investors take a 'wait-and-see' approach to the market and economy. However, the industrial sector entered the crisis with extremely robust fundamentals, and is positioned to weather the crisis better than most other product types."
- "Vacancy is likely to increase, but remain extremely tight relative to historical precedents."
- "Occupier demand was very strong pre-COVID. How quickly will this disappear? There may be a halt in the rapid pace of rental rate growth seen in some markets until the economy stabilizes and rebounds. This could impact prospects for new construction for a period of time – particularly speculative building (a developer commencing construction without a lease commitment already in place)."
- "Although anticipated to be more resilient than the office or retail sectors, industrial real estate has seen challenges related to supply chain shortages. Also, a meaningful amount of industrial space is occupied by retailer/wholesalers, many of which are struggling."

- "The crisis may lead to an increase in domestic production of 'mission-critical' things – particularly linked to the health care sector. Improved supply chains are also identified as an area for future improvement."
  - Rebirth in the manufacturing sector in any form would be a good news story.

In conclusion, the majority view is that industrial is likely to perform best among the three core commercial real estate classes (office, industrial, and retail) during both the downturn and the recovery period. Potentially, space demand could even surpass the pre-COVID floor space projections on the upside, due to eCommerce and other logistics-related opportunities, and any manufacturing renaissance that might emerge.

3.3 Retail Sector Trends

3.3.1 Prevailing Trends in the Retail Market

The retail sector is a constantly evolving business, with changing store formats, shopping centre formats, anchor tenant brands, and consumer behaviour. The arrival and abrupt departure of Target; the continued expansion of Walmart; the demise of Sears and Zellers; the entry of new US department stores; ongoing consolidations in the grocery segment (Sobey's acquiring Canada Safeway; Loblaw acquiring Shoppers Drug Mart); Leon's acquisition of The Brick – these are a few of the significant changes seen across Canada's retail landscape in just the past several years.

Shopping centres constitute the major supply-side channel for the delivery of goods and services to consumers. In Canada, shopping malls emerged in the latter half of the 1950s, and challenged the long-standing dominance of stores in strips, and historic downtowns. By the end of the 1960s, sales activity in shopping centres exceeded those in stores on strips.[3]

With retail activity along retail strips giving way to malls and plazas in the 1960s, the next innovation in retail real estate took place in the 1990s with the onset of big box and power centre format shopping centres – highlighted in Canada by the entry of Walmart – which slowed the development of traditional shopping centre format development. Stores in categories such as furniture and home furnishings, electronics and appliances, general merchandise, and others located in neighbourhood, community, and regional-scale shopping centres began to experience severe pressure in the face of competition from freestanding stores operating in a big box format, or in a power centre cluster.[4]

In Greater Sudbury, among the largest shopping centres in the market today are some of the newest additions, by year opened (SmartCentres Sudbury [2010], Silver Hills Centre [2009], and RioCan Centre Sudbury [1999]) – all power centre-format developments. Notably, some of the city's largest shopping centres are also among its oldest retail-commercial stock (New Sudbury Centre [1957], and Rainbow Centre Mall [1971]). Among Greater Sudbury's 22 largest shopping centres, 45% of the inventory was built during the 1970s and 1980s, and close to one-third was added from 1999-2010.

The most pressing current trends impacting retail real estate relate to the rapid adoption of eCommerce and the transfer of shopping centre sales to the online marketplace. This is linked with an associated decline of store sizes, as retailers adapt to evolving conditions. A number of big box retailers are exploring smaller sized box stores, due to concerns over productivity, and under-utilized square footage. Also, smaller format stores are more compatible in urban environments when seeking infill sites, as prime sites are not as readily available (or in the case of higher land costs – affordable).

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[3] Assessing Shopping Centre Space Needs in Canada. Centre for the Study of Commercial Activity. 2018. p. 1.
[4] Assessing Shopping Centre Space Needs in Canada. Centre for the Study of Commercial Activity. 2018. p. 2.

The following trends are related to changing online shopping behaviour, which will impact demand for "bricks and mortar" retail space in the future:

- Increase in Online Sales – Pre-COVID-19, Deloitte had projected that by 2030, eCommerce will comprise 30% of all retail sales – up from around 10%. This is attributable to the popularity of smartphones and tablets.
- Shopping with Mobile Devices – Consumers have embraced online shopping, and savvy retailers are pursuing new ways of engaging with mobile shoppers, such as applications (apps) that track consumer locations in proximity to their stores within a shopping centre (using the GPS functionality of the mobile device) and offer targeted promotions – even based upon previous buying experiences.
- Showrooming – Online-focused retailers may open small store locations in shopping centres or other locations to showcase various products, and allow consumers to experience the merchandise – see it first-hand, try it on – but ultimately place an order electronically. The shopper does not leave with the merchandise; it is shipped directly to their home. In this eCommerce era, people are already conditioned to receiving product through the mail/by courier.

Overall, these trends point to changing consumer behaviours that will likely translate into a reduced amount of shopping centre space per capita in the future. Online shopping has emerged as a necessary sales channel for many retailers – one that is gaining increased attention and investment. While shopping will remain an experience, eCommerce is ultimately about convenience. The outlook for Greater Sudbury is a likely decline in the amount of physical shopping centre space per capita over time, along with the closure of under-performing store locations. Shopping centres are commonly a focal point and entrenched element of a neighbourhood/community, and they are invariably well located. In the future, there may be an opportunity to transform some of these more distressed assets into mixed-use redevelopment sites combining retail-commercial space with other uses, including residential. While this will not dramatically reduce the need for new greenfield residential growth in the city, it may present some opportunities to capitalize on centrally-situated sites for medium and higher density forms of residential development.

3.3.2 Perspectives on COVID-19

The following section includes retail-market focused perspectives on the COVID-19 crisis that have been extracted from several recent Cushman & Wakefield research reports and "white papers".

- "This event is likely to accelerate a trend that was already in the making: the secular shift toward eCommerce, which continues now at a faster pace. Certain aspects of the retail sector will now be more severely challenged, and we will see more store closures as a result. There's currently plenty of negative press about the retail sector, so rather than pile on, here are a few positives. Consider this: prior to this event, brick and mortar stores in Canada accounted for ~90% of total retail sales, and eCommerce just ~10%. So physical retail was still by far the dominant way people shopped. Certain concepts are going to survive this and will thrive. In fact, the retail sector is always evolving due to quickly changing consumer tastes and preferences. If any sector knows how important it is to adapt, it is retail. When this is over, people will be chomping at the bit to go out and shop, eat, play, and exercise."
- With regard to eCommerce activity… "The necessity of shelter-in-place is accelerating the long-term shift to eCommerce. It is currently the only channel connecting with consumers for many categories of retail. The current pandemic is likely to induce some longer-lasting behaviors in consumers."
- "The economic downturn will favor value: dollar stores, discounters, warehouse clubs, and lower price superstores."

- "Necessity retail (i.e. grocery, convenience, and drug stores) will be a bright spot; such sales have surged recently. The near-term economic impact of the crisis means that consumers will be focused on value and essentials – both in-store and online."
  - Although not noted in this report, this is also true of beer-wine-liquor sales – given the decline in spending in bars and restaurants.
  - Overall discretionary-type spending may be impacted for a prolonged period of time – particularly among individuals who have lost their job, and have scaled back purchases in order to prioritize food buying and mortgage/rent payments.
- "Fast food chains quickly ramped up 'contact-less delivery' and pickup strategies to adapt."
  - This is also true of the grocery sector. The long-term effect of this will be of particular interest – and potentially transformative.
- "Many retailers already struggling with high debt loads will not survive the crisis. The crisis is also accelerating the ongoing demise of the weakest shopping centres and malls."
  - It is premature to ascertain the impact of the COVID crisis and economic downturn on retail vacancy. There will be winners and losers in different retail categories. But this will be the "last straw" for some businesses that were already in a precarious position, following up significant retail bankruptcies and store closures that have taken place in recent years.
- "Enclosed malls are being hit much harder by the crisis than outdoor centres, many of which have been able to remain open due to their concentration of 'essential' retailers."
  - The clothing/apparel, entertainment, and restaurant/food court focus of many enclosed shopping centres is not aligned with shopping patterns seen during the crisis, with those tenancies listed being more oriented towards discretionary purchases.
- "Social distancing will temporarily halt some of the hottest trends in physical retail: experiential concepts, entertainment, food and beverage, food halls, fitness clubs, upstart independent brands, digital native retailers, and pop-up stores."
- "Retail is moving from being a standalone shopping destination to becoming the ultimate amenity in live/work/play communities. The crisis will accelerate the ongoing trend of malls and shopping centres adding mixed-use elements."

Some retailers will face un-budgeted expenses associated with changing their in-store architecture, in order to facilitate social distancing as public health-mandated restrictions are lifted. On a positive note, circumstances such as the current downturn present a rare opportunity for a landlord to reposition a property, upon the (previously unanticipated) departure of a major tenant. While seen as important drivers of consumer traffic, to some degree the typically long-term nature of retail anchor/major tenant leases can also encumber a property owner's ability to actively manage the asset over time.

In the office and industrial markets, *job declines* are being felt, but are anticipated to rebound through the recovery. In the retail market, *revenue declines* are the biggest hurdle to overcome (and inevitably, some businesses will not recover); job losses are a by-product of this crisis. Retailers have put the brakes on discussions of any new deals. Their present focus is on monitoring cash flows, pursuing rent relief, negotiating more favourable lease terms at existing locations, exploring lease terminations (where permitted), and capital preservation.

The COVID-crisis has had an immediate and profound impact on the retail sector, with many "non-essential" businesses suffering from a dramatic loss of income. The transition to online sales will accelerate even faster than the pace it had been on pre-crisis, and is probably the single biggest factor with respect to long-term demand for retail real estate. Sadly, there will be long-lasting/permanent effects for some businesses within this industry, with store closures and bankruptcies appearing inevitable (of course, some businesses were already at a critical tipping point pre-downturn).

3.4 Non-Residential Building Permit Activity

The Consultant Team reviewed building permit data provided by City staff for the period from January 2011 through June 2020. Over this time period, nearly 400 non-residential permits were issued across the City of Greater Sudbury, within the parameters of importance to our analysis. We have classified the permits into four categories: Commercial, Industrial, Institutional, and Civic & Cultural. Examples of these uses are as follows (note – we have identified that there is some overlap among the Institutional and Civic & Cultural categories within the building permit data):

- Commercial – Restaurant, auto dealership, fast food, offices, hotels and motels, medical offices, banks/financial institutions, shopping centre/mall/plaza, service station, supermarket, etc.
- Industrial – Manufacturing, storage, industrial plant, industrial supplies, contractor's yards, etc.
- Institutional – Elementary schools, secondary schools, college and university, hospitals, nursing homes, special schools, etc.
- Civic & Cultural – Cemeteries, airport, racetrack, municipal yard, arenas, libraries, government offices/civic buildings, courthouse, etc.

The following are notable observations from our analysis:

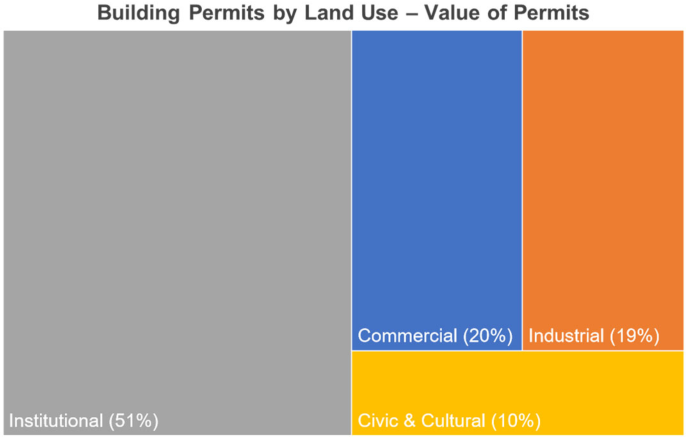
- New building permits ($384 million) accounted for nearly one-half of the total permit value during the 2011-2020 period, but represented just one-third of total permits, by count of permit.
- Permits for additions to existing properties – reflecting reinvestment in the stock of non-residential buildings – totaled $403 million, and accounted for nearly one-half of all permits, by count.
- By count of permit, the Commercial and Industrial categories each accounted for a 36% share of total permits, followed by Institutional (19%), and Civic & Cultural (10%).

VALUE AND NUMBER OF PERMITS BY LAND USE

Building Type	New Structure		Addition		Ancillary Structure		Total	
	Value ($Millions)	#	Value ($Millions)	#	Value ($Millions)	#	Value ($Millions)	#
Commercial	$108.1	48	$49.0	72	$0.5	18	$157.6	138
Industrial	$89.8	57	$55.7	63	$3.9	16	$149.4	136
Institutional	$109.5	15	$296.2	43	$1.3	14	$407.0	72
Civic & Cultural	$76.3	10	$2.1	5	$2.9	22	$81.3	37
TOTAL	**$383.7**	**130**	**$403.1**	**183**	**$8.5**	**70**	**$795.3**	**383**

Source: City of Greater Sudbury and Cushman & Wakefield

Building Permits by Land Use – Value of Permits



Building Permits by Land Use – Count of Permits