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OFFICE REPORT

With the continuing good news across Canada in terms of employment statistics and the general health of the economy, office market occupancy levels improved significantly in most markets. Brisk leasing activity and declining vacancy rates in most markets indicate the national office market may have finally turned the corner on recovery. Calgary led the way in 2005 as the oil and gas sector drove vacancy levels to record lows in all classes of office space. Rental rates also increased significantly and inducements decreased across all classes of space. Leasing activity is strong in Vancouver, which also saw a significant decrease in both downtown and suburban vacancy in 2005. Lack of availability has pushed rental rates upwards and driven some tenants to seek space in lower quality buildings. Net rental rates have also been on the rise in Edmonton, but have not yet reached a point to justify significant new construction activity.

It has been a long road to recovery for many markets in Canada, and Toronto is no exception. Vacancy rates declined in 2005 and it is expected this trend will continue through 2006 as the economic picture continues to improve. Rental rates have begun to firm up as vacancy decreases and landlords are becoming less aggressive with inducement packages. As vacancy continues to decline, expect to see some upward pressure put on rental rates during 2006. However, those landlords carrying significant vacancy in their portfolio may continue to offer attractive leasing packages in order to fill their buildings. In Ottawa, the good news story is the suburbs where vacancy rates have begun to decline, particularly in Kanata. With companies such as Dell Computer Corporation, Abbott Point of Care, and Arvato Services Canada expanding into the Ottawa market, large blocks of vacant space are becoming scarce once again. Rental rates, which had bottomed out in the suburbs, are expected to rise slowly during 2006 as the vacant space continues to be absorbed. Montreal's office market remained quite soft in 2005 as a result of limited growth and downsizing in the financial sector. With flat leasing activity and plenty of options available to tenants, resulting net effective rents will continue to decline and favour tenants in all market sectors.

WHAT IS DRIVING LEASING ACTIVITY ACROSS CANADA?

There has been a growing demand for office space in most markets across the country resulting in declining vacancy. Western Canada is seeing increased demand from numerous fronts. In Vancouver, the ramp up to the 2010 Olympics is adding significant leasing activity and tenant demand to the market. Demand from technology and knowledge based firms is also growing as this sector continues to recover from the high tech meltdown of 2001. Global demand for resources, and Vancouver's role as a gateway to the Pacific Rim, is also driving demand for office space by forestry and other resource related companies. The energy sector is driving demand in Calgary and, to a limited extent, in Edmonton. Calgary is home to the head offices of many of the energy sector companies including Imperial Oil, which recently located from Toronto. Spin-off companies, energy related service companies, and junior oil and gas companies were also very active in 2005. Edmonton is a springboard for the energy industry and a central crossroads for logistics and technology firms that support the oil sands. Regina and Saskatoon are also benefiting from the increased demand for both energy and natural resources. Potash, oil and gas, and other minerals are now being exported to the global market and as a result, Saskatchewan is emerging as a province of growth and opportunity.

Demand in Eastern Canada is not as strong as in the West, but conditions are on the mend. In Toronto, business services firms continue to be the most active while financial firms continue to rationalize their needs and examine the cost effectiveness of moving non-core activities to less expensive suburban locations. Similar to Vancouver, Ottawa is seeing a re-emergence of demand from the technology sector, particularly in the suburban market, which was devastated in the high tech meltdown. Demand from the Federal Government, the most significant driver of office demand in Ottawa, will most likely remain soft over the near term. In Montreal, demand remains softer as a result of limited growth and financial sector downsizing. Life sciences and technology are expected to continue to be significant drivers of the Montreal office market.

Halifax continues to draw customer support centre activity. In late 2005, Research in Motion (RIM) announced a $230 million investment in a technical support centre in Halifax, creating 1,250 jobs over the next five years. Call centres have continued to emerge in other cities in the Maritimes, where english-speaking employees and lower occupancy costs have attracted many businesses. It is not unusual for these providers to seek out opportunities in cities like Waterloo, Brantford, Prince George, and Red Deer.

CONSTRUCTION MARKET HEATING UP

Office market construction activity increased 75.0% in 2005, with over 7.0 million square feet underway - two-thirds of which is located in downtown markets. Much of this construction activity is attributed to Calgary which is experiencing significant growth, with over 3.2 million square feet under construction for delivery between 2006 and 2009. The largest project on the go is Encana's new head office, which is expected to be approximately 2.0 million square feet by the time construction is complete in 2009. Other notable projects include Livingston Place, Opus 8, Centrium Place, Homburg Harris Centre, and Bankers Court.

As leasing conditions in Toronto continue to improve, and large block users become more difficult to accommodate, the rumour mill continues to churn as to who will be the first out of the ground with Toronto's newest downtown prestige office tower – Brookfield with the long awaited Bay

Adelaide Centre; Cadillac Fairview with Simcoe Place ll, located adjacent to the planned Ritz Carlton Hotel and Residences; or Menkes Development's 25 York Street, south of Union Station adjacent to the Air Canada Centre and the recently announced Maple Leaf Square development. With a few large tenants in the market looking while weighing their options, and those existing options shrinking, it appears the market may be ready for new tower construction.

Construction activity has increased significantly in Ottawa as well, with over 1.2 million square feet underway, more than half of which is located downtown. Oxford began construction on the 330,000 square foot final phase of Constitution Square. Government uses continue to drive the demand for new product in Ottawa.

The scarcity of large blocks in Vancouver may prompt the development of additional office product in the not too distant future. However, with land supply constraints and rising land prices many potential office development sites have already gone residential based purely on economics.

INVESTMENT DEMAND REMAINS STEADY

Investor interest in office property remained steady in 2005. Cap rates continued to decline sending values higher. Institutional investors, pension funds and private investors took advantage of market conditions as several premiere buildings traded hands. Notable in 2005 was the completion of the $2.0 billion acquisition of O&Y Properties, including First Canadian Place, by a consortium of Brookfield Properties and Canada Pension Plan. CPP was very active in 2005, spending an additional $1.0 billion to acquire a 50% interest in 11 properties owned by Oxford Properties, including Royal Bank Plaza.

Several large single asset transactions took place in 2005 including the sale of the 943,000 square foot 483 Bay Street to Northam Realty Advisors on behalf of DIFA Deutsche Immobilien Fonds AG for $263 million; the 497,000 square foot First Canadian Centre in Calgary to Great West Life; and the 900,000 square foot former JDS Uniphase complex to Minto Developments.

LOOKING AHEAD

The outlook for the national office market remains positive. Business confidence and investment is booming in some markets and continuing to steadily rebound in others. Job creation in the typical office sectors is slowly gaining ground. Tenant demand is on the rise, pushing overall vacancy down, a trend expected to continue over the medium term barring any unforeseen shocks to the economy.

New construction has been limited across the country and has kept conservative pace with demand and existing vacancy. The construction market is heating up in markets like Calgary and more construction will be needed over time to keep up with the increasing demand forecast in the office market over the longer term. Provided overbuilding does not prevail in the future, vacancy rates will stay relatively balanced and this asset class should continue to attract global investors wishing to benefit from the political and financial stability of Canada.

CANADIAN OFFICE VACANCY RATES (ALL CLASSES) YEAR END 2005