Banking and the new digital era:

What's next for Financial Services in Canada?

A Commercial Real Estate Perspective

DECEMBER 2016

A COLLABORATIVE REPORT FROM:

GWL REALTY ADVISORS

CBRE

At a Glance

1. REPORT FOCUS

This report between GWL Realty Advisors and CBRE Limited takes a detailed look at Financial Services, focusing on key trends and themes for the sector and their expected real estate impacts.

2. HOW WELL IS THE CANADIAN FINANCIAL SERVICES SECTOR PERFORMING?

Generally, the Financial Services sector is in a stage of slow but stable growth in terms of financial performance and employment. The sector added 35,200 new jobs over the last five years representing a 5.1% growth rate. This is in contrast to the pre-Global Financial Crisis total of 98,300 new jobs and 17.8% growth from 2003-2008. New risk management and compliance rules, as well as a slower Canadian economy continue to impact sector expansion. As such, a focus on operational efficiency remains a top priority for the sector with investments in technology a key aspect of that strategy.

3. WHAT IS THE REAL ESTATE GROWTH OUTLOOK FOR FINANCIAL SERVICES?

It is expected that the Financial Services sector will continue to be a key driver of demand for office space over the long term. Short term sector growth however, will be at a slower pace than what has been seen in the past. While financial institutions continue to bolster their technology and compliance staff, they are also consolidating and automating processes where possible. Financial Services will be defined by efficient growth going forward.

4. THE IMPACT OF TECHNOLOGY

Technology continues to play an important but complex role in the sector. Financial institutions are investing significant amounts of capital to modernize operations due to the rise of digital technologies and a changing consumer demographic. A new category of financial technology or "Fintech" firms have also emerged, changing the composition of the industry. As for the expected impact of Fintech, some firms are competitive to traditional financial institutions, while some are collaborative—there is no single path as to how the sector will evolve. Overall, a key expectation is that the Financial Services sector will become more technologically-oriented. Finance and technology are becoming increasingly integrated and the sector is expected to act more like technology firms in terms of innovation, employee retention/attraction and workplace strategies.

5. WHY TORONTO IS IMPORTANT

Toronto continues to strengthen as a key Financial Services hub. Over the last 15 years, Toronto has accounted for over half of all Financial Service job growth in Canada. Centralization of head office employment, a clustering of financial technology activity and new risk management and compliance functions has been driving this trend. Accordingly, Toronto will continue to be a focal point for real estate demand for the sector. In other cities, Financial Services will still be an important source of office demand, but industries such as Technology, Health Care and Professional and Business Services are expected to play increasingly larger roles.

6. WHAT ARE THE IMPLICATIONS?

For real estate managers and investors, there is a wide range of market opportunities and recommendations. A focus on accommodating changing workplace strategies will be integral. New development, as well modernization of existing office assets will be important to this strategy. With Financial Services becoming more technologically-oriented, a wider range of office space that will be in demand from tenants. This will have implications on how and where real estate investors should position themselves in the future.

Introduction: Financial Services—A Diverse and Complex Industry

This report between GWL Realty Advisors and CBRE Limited takes a detailed look at Financial Services, focusing on key trends and themes for the sector and their expected real estate impacts. Key to this report is an understanding of sector priorities and structural changes that will impact Financial Services over the long term. The Financial Services sector is comprised of three major industries (Banking, Investments and Insurance) and is a major source of office demand across Canada. Primary and secondary research, as well as interviews with leasing agents, consultants and industry experts formed the basis of our report findings.

The Financial Services sector is an important component of the Canadian economy, accounting for a major source of job growth and economic output. Accounting for over 720,000 direct jobs in Canada—4.0% of national employment—the sector also accounts for a quarter of the profits generated in the private sector (Burt, 2015). Comprised of a wide range of industries such as Banking, Securities, Portfolio Management and Insurance, the Financial Services sector plays a key role in credit intermediation and capital management activities.

Like many other business industries, a myriad of competing, diverse and complimentary factors influence how Financial Service firms are expected to operate and grow in the future. The Global Financial Crisis brought about a new era of tougher regulation and compliance for the global banking system, while the Canadian economy, in its low and slow state, continues to impact sector growth. Technological innovation is a key priority as the sector embraces a new digital economy and an increasingly online customer base. Labour retention and attraction are also important as Financial Services continue to compete with other sectors of the Canadian economy for talent, especially among the growing millennial workforce.

As a result of these factors, the Financial Services sector is expected to chart a new path with their commercial real estate occupancy needs and workplace strategies. Efficient growth will define the Financial Services sector moving forward as they focus on operational efficiency while accommodating technological advancement. For real estate investors and managers, this means positioning themselves in the right locations and assets that are best suited to accommodate this change.

DEFINING THE FINANCIAL SERVICES SECTOR

Based on Statistics Canada, three major industries comprise the Canadian Financial Services sector: 1) Banks, 2) Insurance and 3) Investment. These categories are based on standard NAICS (North American Industry Classification System) codes:

BANKS (NAICS 522): The Banking industry is the largest among the three, making up over 360,000 jobs and 51.4% of Financial Services employment. Major banks and credit unions make up a majority of this industry. Also within this category are firms involved in credit issuance, financing, lending and mortgages, and financial transaction processing and clearing.

INSURANCE (NAICS 524): The Insurance industry is the second largest within the sector with an estimated 220,000 employees making up 31.4% of the Financial Services sector. This industry includes insurance providers as well as insurance brokers and intermediaries.

INVESTMENT (NAICS 523): The Investment category has the smallest share of employment at 17.1% of total Financial Services sector jobs (totalling over 120,000 people). This industry is quite diverse and includes investment banking and securities brokerage, commodities/exchanges and portfolio management.

It is important to note that the Real Estate and Leasing industry is not formally a part of the Financial Services sector. However, at the Census Metropolitan Area (CMA) level, Real Estate and Leasing does form the larger Finance, Insurance and Real Estate (FIRE) industry sector as defined by Statistics Canada.

Source: Statistics Canada Survey of Employee Payroll and Hours (SEPH); data as of September 2016

Key Trends Driving the Financial Services Sector

With the Global Financial Crisis still a fresh memory, the Canadian Financial sector moves into a new phase defined by slow but stable growth with a focus on operational efficiency to drive profits. A relatively stagnant global economy and new rules impacting the ways financial firms conduct their lending and investment activities have shifted operational strategies. Improvements in technology, risk management and talent retention are key focus areas.

WHAT IS DRIVING THE FINANCIAL SERVICES SECTOR?

The Canadian Financial Services sector continues to witness significant change. Highlighted in this section are key trends driving the sector and their expected real estate impacts based on research and dialogue with industry experts.

A phase of slow but stable growth

In the aftermath of the Global Financial Crisis, the Canadian financial system was revered for its stability. Canadian banks, supported by high capital levels, strong balance sheets and strict lending practices, showed their resilience through the worst global recession in decades. In contrast, bail-outs, bankruptcies and mergers defined the Banking industry in many other parts of the world—a trend that still reverberates in the market today.

The years leading up to the credit crisis (2002-2007) were a period of strong financial performance for the industry - profit growth and return on equity, important metrics tracking profitability for Canadian banks, was 13.7% and 9.7%, respectively (Figure 1). This is the converse of the years during (2008-2010) and since (2011-2016) the Global Financial Crisis where growth has been more modest. Streamlining operations by phasing out inefficient or declining business lines, merging complimentary departments and consolidating labour where possible continues to be a trend for the industry given current profit patterns.

New emphasis on compliance, regulation and risk management

One factor shaping the Financial Services sector has been a heightened regulatory environment since 2010. Insolvency among major global banks due to inadequate capital levels was a common theme during the Global Financial Crisis. Since then, stricter regulations and the introduction of Basel III[1] in 2010 have resulted in banks and related groups bolstering their compliance and risk management capabilities while also adding more conservatism to lending practices. As a result, compliance and risk management employment at financial institutions has grown substantially since the Basel III introduction in 2010, phase-in in 2013 and full adoption in 2015.

> "As a whole, Canadian banks responded to the slowing economy, restructuring some operations to increase efficiencies, streamline their cost base and become fitter, faster organizations. They will most likely continue to do so by keeping their focus on core productivity measures and increased risk management."
> *– PWC (2016) Embracing the Fintech Movement*

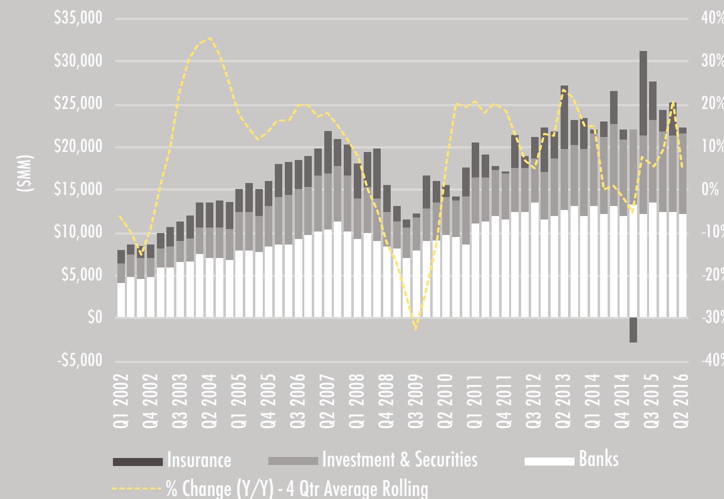
[1] Basel III is a global, voluntary framework on capital adequacy, stress testing and liquidity risk and measures the amount of capital a financial institution must hold relative to leverage, as well as the ability to convert assets to cash. Exceeding the tests suggest firms are able to withstand economic and financial market shocks in the future. Canadian Financial Institutions—although all ready well exceeding minimum standards—adopted Basel III rules for capital and liquidity officially in 2015.

FIG. 1: FINANCIAL PERFORMANCE INDICATORS: CANADIAN BANKS AND OTHER CREDIT INTERMEDIARIES

	2002-2007: Strong economic expansion in Canada	**2008-2010:** Global Financial Crisis - credit, liquidity freeze	**2011-2016:** Slow growth economy, commodity slowdown and low interest rates	**Q2 2016** Performance (12-month trend)
Average Annual Return on Equity	9.7%	7.7%	9.1%	8.8%
Average Annual Operating Profit Growth	13.7%	-3.4%	7.3%	0.1%
Average Annual Operating Revenue Growth	6.7%	-3.6%	3.6%	0.6%

Source: Statistics Canada (NAICS 5221,5222, 5223 Combined - CANSIM Table 187-0002), 2016.

FIG. 2: NATIONAL FINANCIAL SERVICES OPERATING PROFITS (ALL SECTORS)



Source: Statistics Canada (NAICS 522, 523, 524 Combined - CANSIM Table 187-0002), 2016.

Managing international exposure

A key trend for Canadian Financial Service firms over the last 15 years has been their tremendous growth internationally. Major Canadian financial institutions now derive 20 - 50% of their revenue from non-domestic sources (Figure 3). Financial institutions have achieved this through foreign direct investment, including acquisitions of existing firms or through the export of Financial Services. Financial Service exports in particular, have more than tripled since 1999. Today, Canadian financial institutions are carefully managing this expansion, recognizing that the diversification has provided a significant revenue stream, but with added risk exposure.

The digital economy

An increasingly tech-savvy customer base is changing how financial institutions think about their marketing and technology investments. In similar respects to what is happening in the retail sector, e-commerce and mobile communications are changing how customers conduct their banking, insurance and investment activities.

> "We're in the technology business."
> *- Brian Porter, CEO, Scotiabank (2016)*

Financial institutions accordingly, are starting to invest significant amounts of capital to modernize operations. Big data is allowing firms to track financial markets and their customers better. Software innovations are streamlining operating processes and automating simple analytical tasks. Innovations in digital communications are making financial transactions more efficient. While costly, financial institutions are recognizing that these investments in technology are critical in order to keep pace with their customers. Staffing efforts are also reflective of this shift—financial institutions now emphasize their need to hire roles in software, media and data science (Universum, 2016). The digital economy accordingly is shifting the Financial Services sector towards more progressive, technologically-based operational strategies.

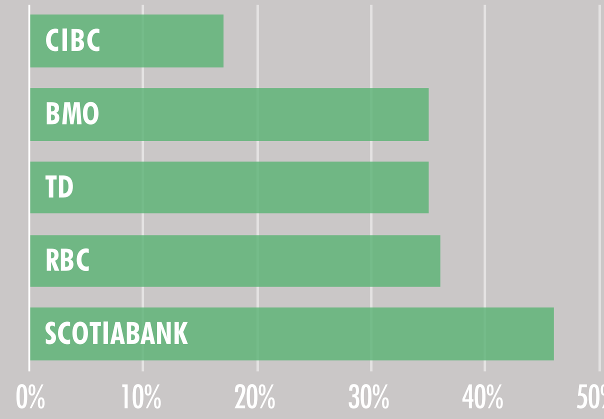
> "The digital economy is bringing a major shift to financial services. My view is that in less than five years, the financial services industry won't be the same as it is today. That puts a lot of pressure on us and the other financial institutions to adjust, adapt and change."
> *- Monique F. Leroux CEO Desjardin Group – From PWC Canadian Banks 2015*

Talent attraction and retention

Talent attraction and retention continues to be a key priority for the Financial Services sector. Recent studies highlight that emerging knowledge industries such as Technology and Life Sciences appear to be gaining ground on Finance in terms of job recruitment among graduates and millennial professionals. This poses a challenge for Financial Service firms, especially as they begin to grow their expertise in technology, digital communications and risk management (Universum, 2016).

Accordingly, the Financial Services sector is looking at a wide variety of ways to attract and retain talent with a focus on employee lifestyle, amenities and socialization. Given that office space is the physical outcome of these strategies, Financial Service firms are looking at more flexible, collaborative office environments while also embracing health and wellness and sustainability initiatives (CBRE, 2016). Collaboration is also an important consideration, and Financial Service firms are exploring new ways to attract talent—university partnerships and digital innovation labs are notable examples as will be highlighted in the next section of this report.

FIG 3: ESTIMATED SHARE OF NON-DOMESTIC REVENUE SOURCES - MAJOR CANADIAN BANKS (2014):



Source: Conference Board of Canada, 2015.

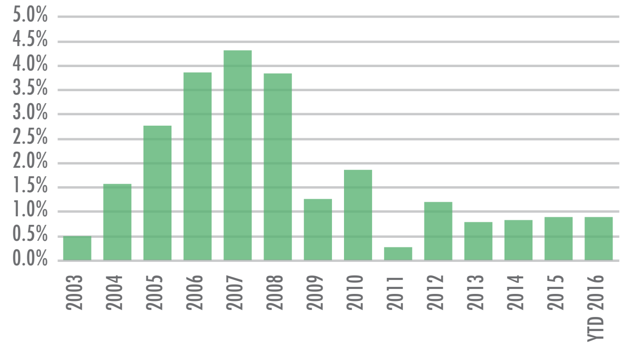
NATIONAL EMPLOYMENT TRENDS

Mirroring Financial Services sector profits and revenues, national Financial Services sector employment has grown at a slower pace in the last several years. Looking at Figure 4, which shows the annual employment growth rate of the entire Canadian Financial Services sector, growth since 2011 has averaged just 0.9% annually. This is markedly lower in comparison to the 10-year annual average of 1.9% and the pre-recession (2003-2008) average of 2.5%. With the Financial Services sector accounting for over 8.0% of all services employment, this current growth trajectory has implications for real estate demand going forward.

At the regional level however, diverging employment trends are also apparent. Financial Services in cities such as Montreal and Vancouver have been losing their share of regional employment to other faster growing service industries. In particular, Business and Professional services, Healthcare and Technology are growing faster than Financial Service employment and also now command a larger share of total employment in these and other cities. This trend is largely reflective of the ongoing shift towards creative, knowledge work across Canada. Conversely, Toronto's Financial Service sector has grown at a pace well above the national average, adding 78,000 jobs since 2006 and representing a 27.2% growth rate. Canada as a whole has only grown by 9.0% over the same time period. To put this into further context, when compared to other major cities, Toronto now accounts for 32.0% of all national FIRE employment, followed by Montreal and Vancouver with 12.2% and 8.7%, respectively (Figure 8).

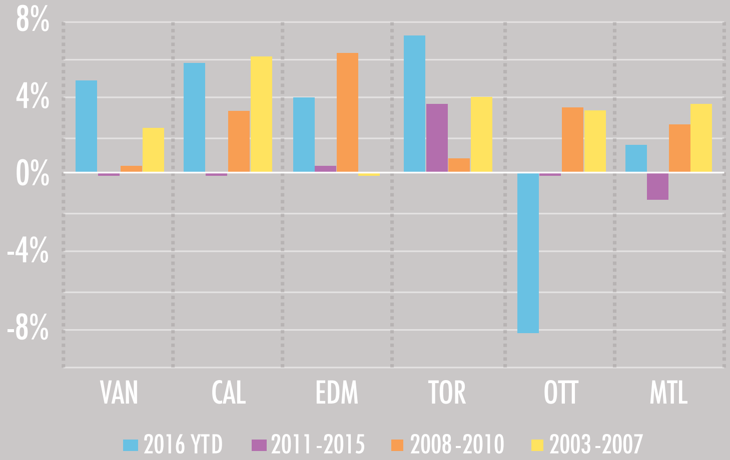
Overall, Toronto continues to reinforce itself as a major financial hub. This is mainly supported by four trends based on analysis findings: 1) ongoing consolidation nationally of head-office positions, 2) centralization and expansion for technology and digital economy roles, 3) domestic management of foreign affiliates and services exports and 4) growth in compliance and risk management functions.

FIG. 4: ANNUAL FINANCIAL SECTOR EMPLOYMENT GROWTH, CANADA (EMPLOYMENT 12-MONTH ROLLING AVERAGE)



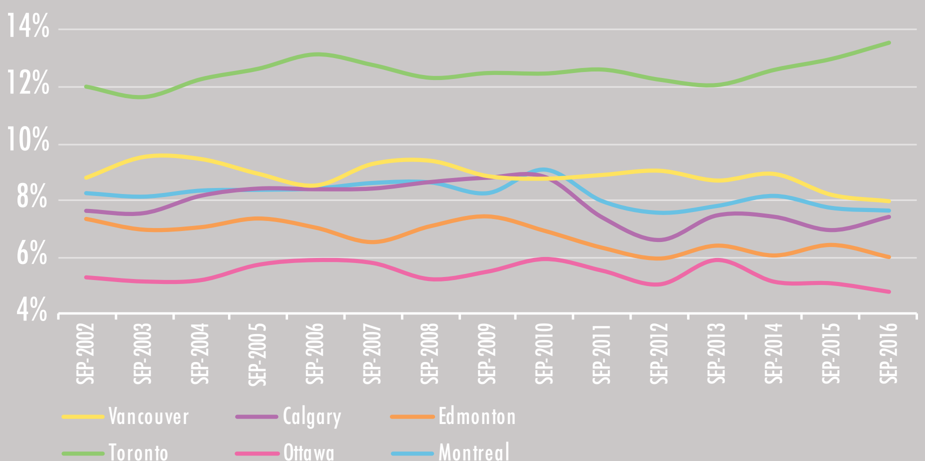
Source: Statistics Canada (CANSIM Table 281-0023), September 2016.

FIG. 5: AVERAGE ANNUAL FINANCIAL SERVICES JOB GROWTH TOP CMAS BY TIME PERIOD



Source: Statistics Canada (CANSIM Table 282-0130), September 2016.

FIG. 6: FIRE EMPLOYMENT AS A % OF TOTAL SERVICE EMPLOYMENT



Source: Statistics Canada (CANSIM Table 282-0130), September 2016.

INDUSTRY OUTLOOKS

Banking:

Banks as a whole have grown by 13.1% the last 10 years, representing a net gain of 42,000 jobs. Most of this growth took place prior to the Global Financial Crisis – average annual employment growth from 2003 to 2008 was 2.7%, compared to 0.4% from 2011 to 2016 (Figure 9). Employment data through company filings for the six largest banks in Canada confirms this trend: bank employment has slowed the last several years and is well below the pace of growth seen prior to 2009 (Figures 10 - 11). Average job growth among the major banks between 2011 and 2015 has been 3.1%, slower than the 5.0% growth experienced from 2005 to 2009.

Insurance:

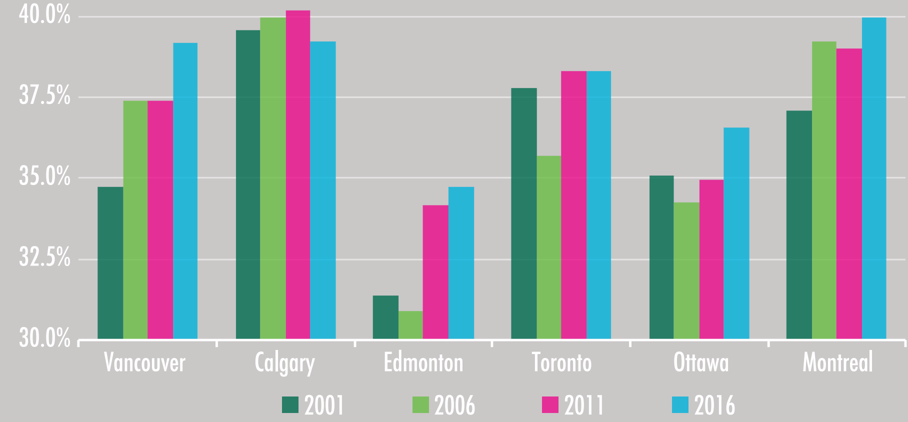
In contrast to banking, the insurance sector has grown at a much steadier pace the last decade. From 2003 to 2008, average annual employment growth was 1.8%, just above the 2011 to 2016 average of 1.7% (Figure 9). Over the 10 year period, the sector has added 33,000 new jobs representing 18.0% growth in total employment. Typically considered a more mature, stable and slow growth industry, the insurance sector has benefitted from emerging business lines such as cyber security and risk management according to PwC (2016) and EY (2016).

Investments:

Investments, the smallest industry in the Financial Services sector, posted strong 10 year total growth of 24% or 23,000 net jobs. However, in similar respects to banking, most of the growth has been prior to the Financial Crisis. Average annual employment growth between 2003 and 2008 was 3.4%, compared to 0.9% from 2011 to 2016 (Figure 9). Notably, the 12-month average (to September 2016) was -0.7% for the industry.

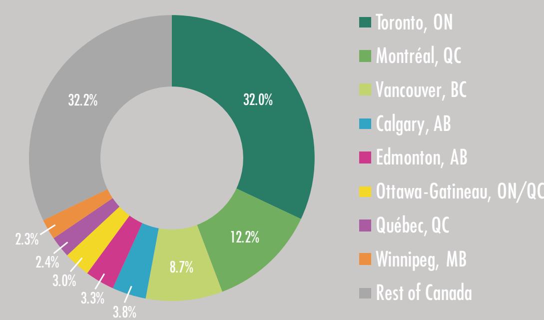
There appears to be a tale of two markets emerging within the Investments industry: groups tied to trading and securities continue to face challenges with growth, while portfolio management continues to expand. The rise of automated trading platforms putting downward pressure on fees, the rise of well capitalized traditional banks as direct competitors, and ongoing volatility in core business industries such as energy and mining continue to impact the Investment sector (Kiladze, 2016; McGee, 2016). According to data from the Investment Industry Association of Canada, 25.0% of investment firms have closed or been acquired in distress since 2013 (Schecter, 2016). Conversely, in relation to portfolio management, global assets under management will grow from $63.9 trillion in 2016 to $101.7 trillion by 2020 according to PwC (2014). Portfolio management accordingly continues to grow along with expansion of global asset management activities.

FIG. 7: SELECT INDUSTRIES AS A % OF TOTAL SERVICE EMPLOYMENT (BUSINESS SERVICES, PROFESSIONAL SERVICES, HEALTH CARE AND INFO-CULTURE)



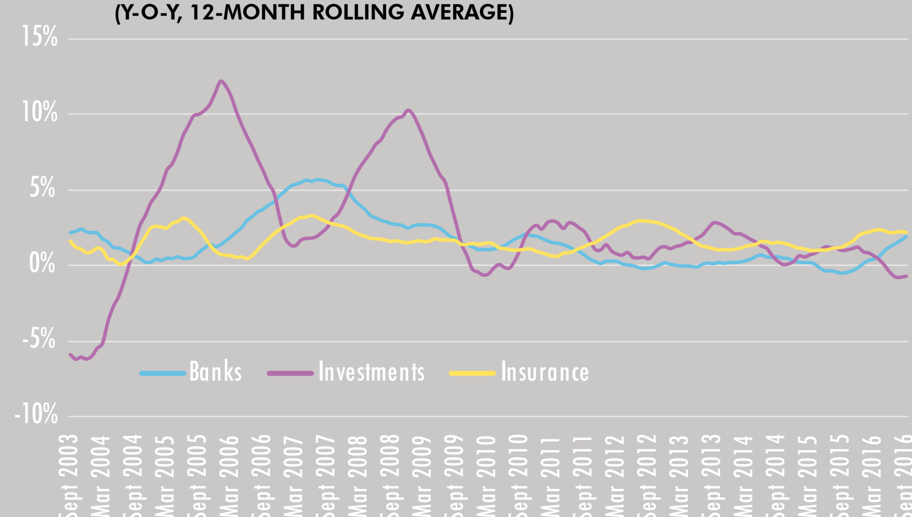
Source: Statistics Canada (CANSIM Table 282-0130 - Data as of September 2016)

FIG. 8: NATIONAL FIRE EMPLOYMENT SHARE BY CMA



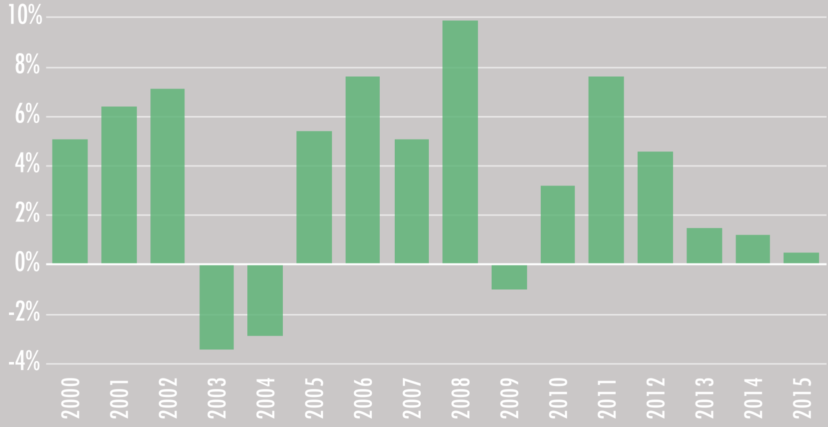
Source: Statistics Canada (CANSIM Table 282-0130, 282-0131), September 2016.

FIG. 9: AVERAGE FINANCIAL SERVICE EMPLOYMENT GROWTH BY SECTOR (Y-O-Y, 12-MONTH ROLLING AVERAGE)



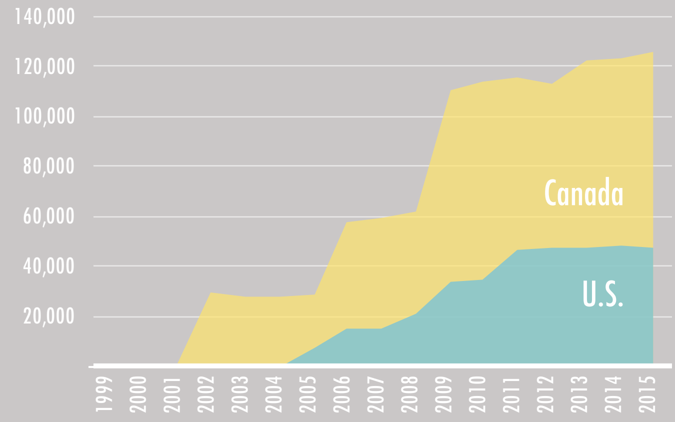
Source: Statistics Canada (CANSIM Table 282-0130), September 2016.

FIG. 10: TOP SIX CANADIAN BANKS – ANNUAL EMPLOYMENT CHANGE



Source: Company Filings, GWLRA, 2016.

FIG. 11: MAJOR CANADIAN BANK EMPLOYMENT, U.S. AND CANADA, (TD, RBC, BMO)



Source: Company Filings, GWLRA, 2016.

THE RISE OF FINTECH

Though formal definitions vary[2], Fintech refers to a new category of flexible and scalable companies focused on using technology to provide financial products and services (Figure 12). They differ from traditional financial firms such as banks due to their primary reliance on digital technologies and software to operate. Based on data from OMERS Ventures (2015), there are approximately 100 known Fintech firms existing in Canada, with over 60 located in Toronto. Funding for Fintech companies is often used as a barometer for the growth of the sector and as of 2015, total global investment in Fintech firms totaled $22.3 billion according to Accenture (2016), nearly an eleven-fold increase since 2010. Canada conversely, has attracted $1.0 billion in capital from 2010 to 2015. Many Fintech companies begin as independent start-ups through venture capital, funded partnerships or incubator programs. However, a wider range of technology companies are also entering the Financial Services sector, with Apple and other tech giants emerging as Fintech competitors (Kiladze, 2014).

The rise of Fintech is expected to influence the market in various ways. Some Fintech companies compete with traditional financial institutions in core market segments such as wealth management and payments (Castaldo, 2016). Other Fintech companies provide complimentary services such as data, security and management software that help traditional financial services firms become more efficient. Entirely new financial markets and products such as blockchain and cryptocurrency are also being created by firms in the Fintech sector.

Traditional Financial industries most at profit risk from Fintech are those where revenues are broker based such as payments, investment trading/advisory and credit lending. *Disintermediation* highlights the role of technology in replacing middle-people that traditionally brought sellers and buyers together. Industries in the Financial Services sector that face the least impact from Fintech are those that require specialization, such as corporate and institutional banking. It is expected that major banks will continue to play a dominant role in credit intermediation such as loans and deposits.

> "Everyone from Apple to Facebook is encroaching on the territory of traditional lenders, and the threat of competition from these unusual rivals has forced financial institutions to invest in a flurry of innovations..."
>
> *– Globe and Mail. (Kiladze, 2014)*

[2] Note that Fintech is a broad term referring to companies using technology to provide financial services. Good resources on defining Fintech include Daily Fintech and MaRS.

Is Fintech a disruptor as many in the financial industry claim? Yes and No. Our view is that Fintech companies will be collaborative and competitive to traditional financial institutions depending on the market segment. Fintech is not going away, but how this industry evolves will also not be linear: some firms will partner or be acquired by larger financial institutions, while others will grow independently and be major competitors to incumbents. As a result of this, financial institutions are also active developing their own competitive Fintech products and digital innovations to stay relevant to consumers.

It is important to note that the Fintech industry is relatively new and that a variety of trends will affect its growth and trajectory. Growing consumer demand for Fintech products is an obvious one, but increasing regulation of new financial technologies and marketplaces, changing economic conditions and sustainable profits are also indicators to watch. Nevertheless, a key conclusion is that the financial sector is generally becoming more technologically-oriented and diverse with Fintech and supporting innovations a key part of this shift.

NOTABLE FINTECH PARTNERSHIPS AND INCUBATOR PROGRAMS IN CANADA

- MaRS: FinTech Cluster (Toronto)
- RBC and University of Toronto: ONRamp (Toronto)
- TD Bank: Communitech (Kitchener-Waterloo)
- BMO and Ryerson University: DMZ (Toronto)
- BC Tech Association: BC FinTech Program (Vancouver)

FIG. 12: MAJOR FINTECH CATEGORIES

	Category	Technology Evolution	Example Firms in Canada
Business to Consumer (B2C)	Lending, crowdfunding & market intermediaries	Making the transaction between those seeking donations, insurance, loans, debt or equity and those giving them more efficient by moving the marketplace and transactions process online. Receivers can access digital marketplaces for money more efficiently, while providers no longer have to be corporations – they can be individuals (e.g. Peer to Peer).	Financelt, Grow., Ratehub, Kanetix
	Payments, Billing and Transfers	New technologies are allowing consumers the ability to pay for products and services or transfer money without the use of physical money or credit cards.	Apple Pay, Payfirma
	Personal Finance & Asset Management	Within the realm of investing, the development of algorithms and analytics platforms to monitor securities are shifting traditional portfolio management and advisory responsibilities to computers and artificial intelligence (e.g. Robo-advisors). Consumers looking for investment advice no longer have to rely on humans – investing advice and trading can be done digitally.	Wealth Simple, WealthBar, BMO Investor Line
	Digital Currency & Ledgers	The development of internet-based, non-physical currencies that can be used to purchase goods and services. Most common forms of digital currency are known as "cryptocurrency" which involves the use of cryptography and chains/ledgers to validate the currency.	Ethereum, Blockstream
Business to Business (B2B)	Client management, marketing & analytics	Development of client interfaces and marketing tools to enhance both a customer's experience as well as derive more information on customer habits, issues and potential business needs. Mobile technology has been key to this trend.	Zafin, D+H
	Institutional tools & "Core" Software	Software aimed primarily at making "back of house" operating processes more efficient.	Fiserv, SunGard
	Data Management/ Analytics	Software and related product solutions aimed at storing, disseminating, analyzing and optimizing vast quantities of data and information.	Data Center Inc., MarketIQ
	Cyber Security	The development of tools and processes to reduce loss, fraud or theft of data given the movement of financial activities online.	Crealogix, Securekey
InsurTech	Insurance Technologies	A emerging sub-sector of FinTech that focuses on the development of technology and digital tools for the insurance industry. Key segments included data analytics of clients and markets, as well as the development of customer facing sales and management platforms.	Clark (Germany) TruMotion (U.S.)

Source: GWLRA, 2016.

Toronto's Financial Services Footprint

This section highlights office market trends occurring in Downtown Toronto[3]—Canada's largest Financial Services hub. Directly employing over 243,000 people in the Financial sector, Toronto is home to over a third of Financial Services employment in Canada and 43.0% of all head office jobs. Furthermore, 31.0% of all Financial Service firms with offices in Canada are headquartered in Toronto (Burt, 2015). Ranked 8th globally and 2nd in North America in terms of sector importance by the Global Financial Centres Index (2015), Toronto's peers on the index include New York, London, Tokyo and San Francisco.

[3] With limited data on office trends in the relatively diverse and large suburban office market in Toronto, this report focuses on occupier trends occurring in Toronto's downtown core that is comprised of 69 million SF across seven submarkets.

With Canada's five leading financial institutions located in the city's Financial Core and surrounding area, Downtown Toronto continues to be a top choice among Financial Service firms. Access to a large workforce, high transit accessibility and a base of complementing commercial activities continue to drive location decisions. With over 200,000 people passing through Toronto's Union Station transportation hub every day and over 27,000 residential units either in pre-construction, under-construction or being marketed Downtown, urbanization continues to help drive office growth in and around the Financial Core.

Tenant data from CBRE shows that the Financial Services sector makes up 39.6% of the Downtown office market (Figure 16). This is largely concentrated within three of the seven Downtown submarkets, all of which have greater than 25% of their space occupied by Financial Service firms (Figure 17). Most notably, Financial Service firms are highly concentrated within the Financial Core, making up 52.3% of the tenant base. Other major concentrations are in the Downtown South and Greater Core, representing 41.3% and 34.6%, respectively. The major Canadian banks are a key source of office demand, totalling over 12 million sq. ft. or 17.9% of the total occupied space within Downtown Toronto.

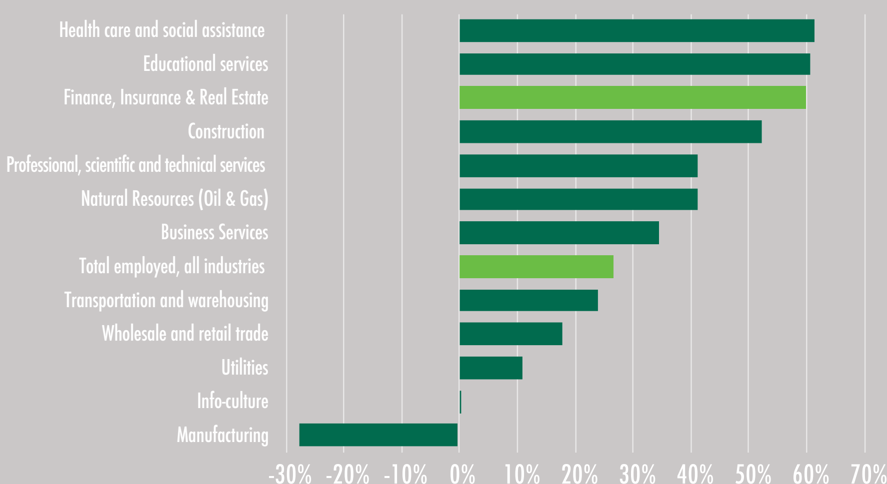
> "Toronto's advantages are numerous. For example, it has a skilled, sizable, and multicultural workforce. As well, Canada has a high degree of financial sector liberalization and solid corporate governance, further benefiting Toronto. Supporting the [Financial Services] sector is a vibrant network that includes many of Canada's top lawyers, accountants, administrators, technology firms, and academic institutions."
>
> *– Conference Board of Canada (2014)*

TORONTO AS A GLOBAL FINANCIAL SERVICES HUB: NOTABLE EMPLOYMENT TRENDS

(Fig. 13-15)

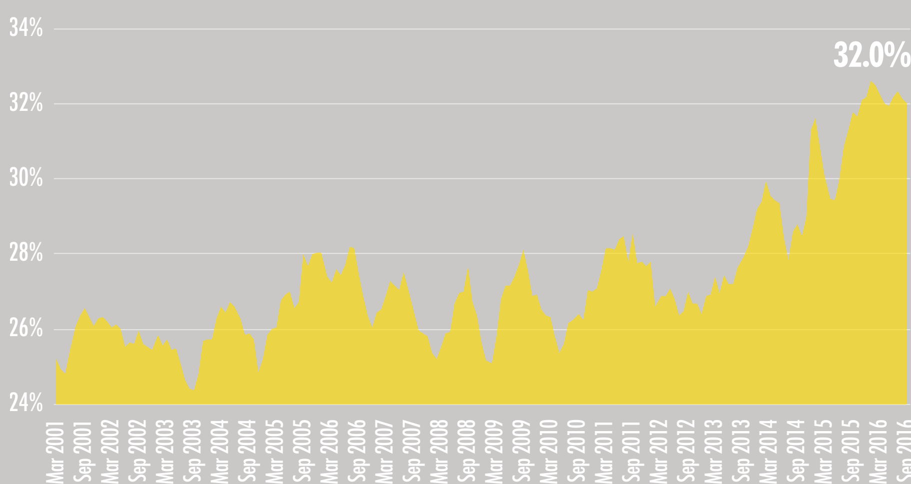
- Since 2001, Toronto's FIRE sector has grown by 60%, representing a total growth of 135,000 net jobs and is among the highest across all sectors. The five year (2011-2016) job trend is similar with Toronto's FIRE sector growing by 20% (net 60,000 jobs).
- Since 2001, Toronto has accounted for 55% of all FIRE employment growth in Canada.
- Toronto's FIRE sector as a share of all FIRE employment in Canada stands at 32%, an increase of 6.4% since 2001 suggesting a rise in sector concentration. This trend has been particularly impressive since 2014, increasing by 3.2% over the short two year period.
- Within Toronto, the FIRE sector represents 11.1% of regional employment, an increase of 2.3% since 2001.

FIG. 13: TOTAL EMPLOYMENT GROWTH, TORONTO CMA (2000 – YTD 2016)



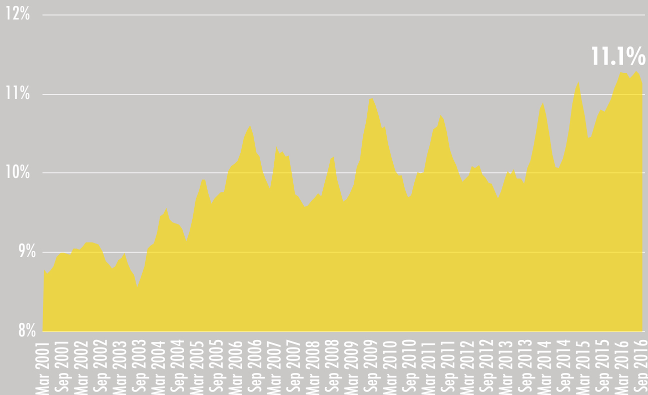
Source: Statistics Canada (CANSIM Table 282-0130), September 2016.

FIG. 14: FIRE EMPLOYMENT - TORONTO CMA AS A % SHARE OF THE NATIONAL TOTAL



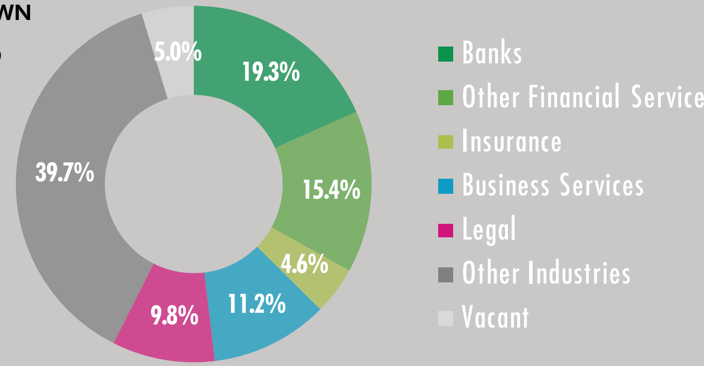
Source: Statistics Canada (CANSIM Table 282-0130, 282-007), September 2016.

FIG. 15: TORONTO FIRE EMPLOYMENT - % SHARE OF TOTAL TORONTO CMA EMPLOYMENT



Source: Statistics Canada (CANSIM Table 282-0130), September 2016.

FIG. 16: DOWNTOWN TORONTO OCCUPIED SPACE BY SECTOR (Q3 2016)



Source: CBRE Research, Q3 2016.

KEY MARKET TRENDS

Toronto is expected to remain an important location for national Financial Services employment growth. Given the large concentration of Financial Service firms in the Toronto office market, what are the trends looking forward? Our research findings point to the following themes.

Market demand from Financial Services will remain strong

Financial Service employment growth is a good indicator for office space demand. Looking at the 15 year cycle, Downtown Toronto office net absorption has generally moved in line with Financial Services sector employment growth (Figure 18). The 2004 to 2008 period was an especially strong period of both sector job growth and absorption for Downtown Toronto. Net absorption in Downtown Toronto since 2010 has also performed very well, save for a short period of negative net absorption in 2013.

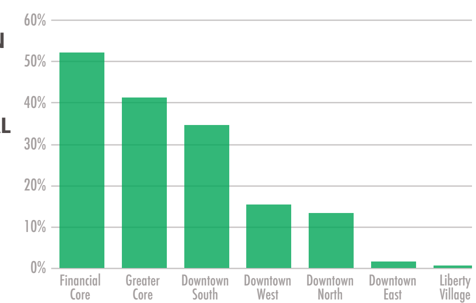
Looking ahead, the Conference Board of Canada estimates that Toronto will add another 10,000 jobs in the Financial Services sector between 2016 and 2020. Overall service sector employment is forecast to grow by 251,000 jobs over the same time period. Both numbers bode well for the office market in Toronto.

Right-sizing and a trend of "efficient growth"

Data on office-occupying[4] job growth and occupied space confirms the phenomenon of right-sizing within the Financial Services sector. From 2004 to 2008, the total occupied space in Downtown Toronto grew by 6.6 million sq. ft., compared to only 1.9 million sq. ft. from 2011 to 2015. This is despite the fact that 2011-2015 witnessed more total job growth (84,400 people) than 2004-2008 (75,600 people). As Figure 19 notes, one office-occupying job equated to 87.6 sq. ft. of office space from 2004 to 2008, decreasing to 23.0 sq. ft. from 2011 to 2016. Discussions with industry experts further confirm this finding – major banks and insurance firms continue to rationalize space by consolidating multiple offices while also focusing on workplace design and layout efficiencies.

It is important to note however, that while this trend towards efficiency continues, it is also being offset by positive job growth overall. As mentioned, Toronto's total service sector employment is forecast to grow by 251,000 people over the next five years with financial services accounting for 10,000 direct jobs alone. This total growth, regardless of ongoing space rationalization in the Financial sector will still drive expansion of the office market.

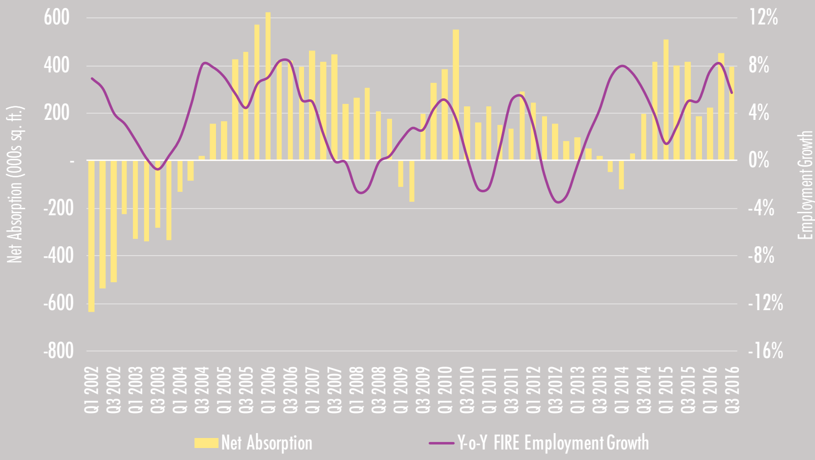
FIG. 17: DOWNTOWN TORONTO TOTAL OCCUPIED BY FINANCIAL SERVICE FIRMS (Q3 2016)



Source: CBRE Research, Q3 2016.

[4] For this report, "office-occupier" groups comprise of the following NAICS-based industries: FIRE, professional scientific and technical services, business services and info-culture.

FIG. 18: DOWNTOWN TORONTO NET ABSORPTION AND TORONTO FIRE SECTOR JOB GROWTH 4-QUARTER MOVING AVERAGE



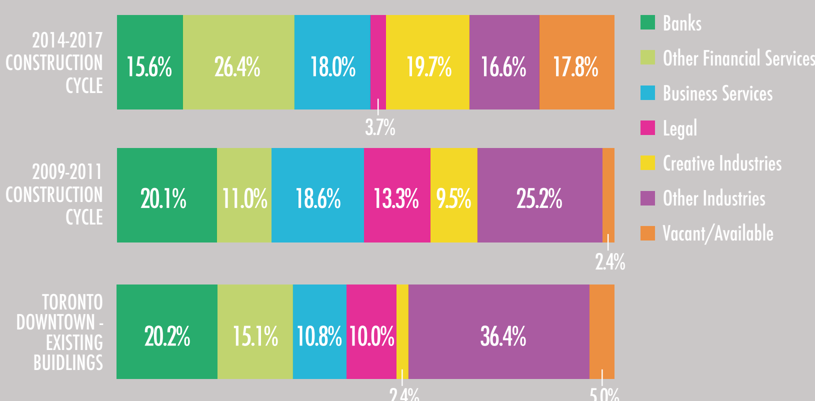
Source: Conference Board of Canada, CBRE Research, 2016.

FIG. 19: DOWNTOWN TORONTO – OFFICE-OCCUPIER AND OCCUPIED SPACE CHANGE

	Total Net Job Growth (000s)	DT Toronto Occupied Growth (SF)	Occupied Space to Jobs Ratio
2004-2008	75.6	6,621,996	87.6
2011-2015	84.4	1,938,434	23.0

Source: Conference Board of Canada, GWLRA, CBRE Research, 2016.

FIG. 20: DOWNTOWN TORONTO – PRE-LEASE COMMITMENTS BY INDUSTRY



Source: CBRE Research, Q3 2016.

New office supply impact

The Financial Services sector continues to be a main driver of new office development in Downtown Toronto. In the last two development cycles (2009-2011 and 2014-2017), banks and related groups respectively made up 31.1% and 42.0% of total pre-lease commitments (Figure 20).

Looking forward, Financial Service firms will continue looking for buildings that can provide the most efficiency and latest in technology and amenities. Corporate standards for health and wellness, as well as energy use and IT are increasingly rigorous.

New office buildings are expected to meet or exceed these standards. Landlords of existing space will accordingly need to focus on capital improvements and upgrades to remain competitive.

This trend is expected to define the Toronto office market going forward for two reasons. First, compared to other cities in Canada, tenants in Toronto are typically larger and have the physical capacity to benefit from these workplace strategies. The large size of financial firms in Toronto also limits them to a select number of market options further making new development attractive. Second, given the large concentration of Financial Service headquarters in Toronto, tenants are also better capitalized and funded to invest in their premises.

Fintech firms are not a significant driver of office space...yet

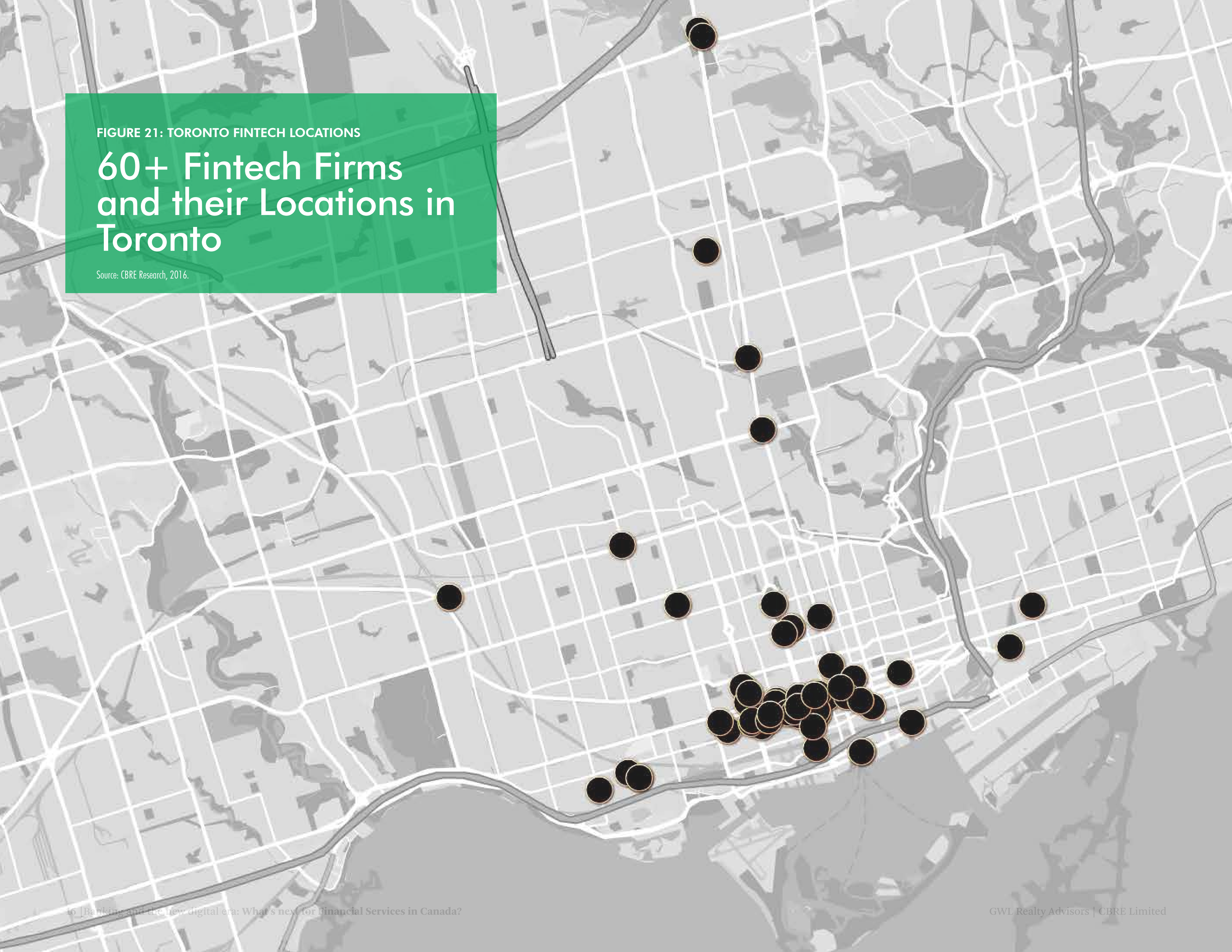
Given the relatively small size of the Canadian Fintech market, the industry is not expected to be a significant driver of office demand over the short term. According to CBRE Research, standalone Fintech companies occupy in total approximately 260,000 sq. ft. in Downtown Toronto with the average tenant less than 10,000 sq. ft. Most of these tenants are fairly dispersed across Downtown Toronto (Figure 21), with many occupying incubators and shared offices. Part of the popularity of incubators and shared office space for Fintech companies is due to their unpredictable growth. Some Fintechs scale very quickly and standard leases and covenant requirements are not always accommodative to their business structure.

Over the long term, new small to mid-sized tenant opportunities may start to emerge from Fintech companies and related technology firms as they mature. This has been the case with other technology sectors such as software and digital media. Venture capital funding is often correlated to office demand for office markets with a high exposure to technology (CBRE, 2016), and will also be a key indicator to monitor.

FIGURE 21: TORONTO FINTECH LOCATIONS

60+ Fintech Firms and their Locations in Toronto

Source: CBRE Research, 2016.



Real Estate Impacts Looking Ahead

Real estate will continue to play an integral role for Financial Service firms, especially as office space becomes increasingly used for branding and talent attraction. However, with technology, innovation and efficiency defining the financial services industry in Canada, property investors will need to take an evolved view of the sector—one defined by diversification within the industry, as well as a more modest outlook for overall growth moving forward.

MARKET THEMES

The industry will be more efficient from a growth perspective

Financial institutions will continue to be an integral part of the office market in Canada. Recent trends however, suggest slower office demand from this sector in the short term. Consolidation, automation and a focus on operating efficiency is expected to continue defining the industry. This is not to say the Financial Services sector will not grow at all—it merely indicates that the pace of growth will be slower than in past years. The typical 150-200 sq. ft. per new employee ratio accordingly, will continue trending lower.

Financial Services will be part of an increasingly diverse service economy

It is expected that cities across Canada will continue to diversify as Technology, Health Care and Professional service sectors grow in importance. Financial Services accordingly, will be part of a more dynamic office market from a tenant perspective. The growing influence of technology in financial services also highlights diversification within the sector as well—a wider range of groups will be associated with Financial Services such as Fintech, software and data management. Banks and Insurance groups will remain major players for the office market, but new leasing opportunities will also emerge with these other groups.

Toronto continues to strengthen as a global and national financial centre

Toronto is expected to strengthen as a Financial Services hub. Over the last several years, Toronto has increased its concentration of Financial Service activity and global presence. Employment growth accordingly, highlights this shift—the Toronto area alone drives over half of all Financial Sector employment growth in Canada. Looking ahead, Toronto's office market will stand to benefit from this ongoing trend.

IMPACTS ON REAL ESTATE REQUIREMENTS

Location considerations

Evolving office demand in Financial Services is expected to create additional opportunities for property investors. Downtown locations, where many major financial institutions are located, will continue to be in demand—urbanization and transit access remain positive drivers. The growth of Fintech is also driving demand for "brick and beam" spaces in urban-fringe locations. While brick and beam space is already common among other technology-oriented sectors, it does present a wider range of office investment opportunities related to the Financial Services sector.

A decentralization effect is also taking hold as firms in the industry think more broadly in terms of location. Satellite offices, incubators, co-working spaces and innovation labs near universities and other life science districts are other emerging investor opportunities. This trend is expected to drive office demand in secondary cities with burgeoning technology and education clusters as well.

MARS FINTECH CLUSTER

The MaRS FinTech Cluster is a program that connects start-ups with financial institutions and is located in the MaRS Discovery District in Toronto. CIBC, TMX Group and PayPal are notable groups that have opened permanent offices within the Discovery District to collaborate more effectively with FinTech startups.

> "The primary drivers of workplace strategy are talent attraction and retention, collaboration and cost savings. While the latter seems to be a perennial driver, the first two are certainly a direct result of a much more mobile society. – *CBRE America's Occupier Survey (2016)*"

A focus on talent: "Office as the New Brand"

Based on research findings, Financial Service firms are increasingly focused on three goals with respect to their real estate needs:

- Attracting and retaining talent;
- Corporate branding (both internal and public); and
- Optimization of technology and resources.

Office space accordingly, is increasingly used as an attraction point. Creating and utilizing space that allows employees to work independently, but also promoting interaction is an emerging priority for firms in the industry (Deloitte, 2015). Effective spaces are ones that can create the opportunity for collaboration and interaction, and leverage technology for a flexible and mobile workforce. According to Citrix's Workplace of the Future report (Citrix, 2012), 89% of global organisations by 2020 will offer flexible work options enabled by mobile technology[5]. Financial institutions will be a key part of this digital shift.

[5] This global market research report surveyed 1,900 senior IT decision makers in August 2012. They largely represent organizations with more than 1,000 employees across 19 countries across the globe.

Flight to quality and support for new supply

Consolidation, centralization and a focus on technology and talent attraction among Financial Services firms are expected to continue driving demand for new office space. Investors and managers who have a strong office development program will benefit from this, particularly in downtown and urbanizing locations. For existing buildings, capital investments in building systems and technology upgrades will be necessary to stay competitive.

Embracing tenant collaboration and partnerships

The relationship between landlords and tenants is also changing, with collaboration and partnership an emerging theme. Tenant retention is just as important as talent retention and building owners should understand both leased and common spaces are critical in fostering a positive work environment for occupants. To have a successful leasing program, investors and managers will need to collaborate with tenants on technology and amenity needs, sustainability requirements and workplace strategies.

Conclusion: A Spectrum of Opportunities

For investors and managers, the changes that are taking place in Financial Services will create a spectrum of opportunity in terms of office investment and development. On one end of the spectrum, Fintechs and technology firms will lead demand for non-traditional and non-core office in emerging urban areas and will drive new leasing models such as co-working spaces and technology clusters. On the other end of the spectrum are large, established banking, investment and insurance firms with significant downtown footprints. Property investors will need to decide what end of the spectrum they want to be in depending on size, covenant and management expertise.

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