



Attention: Mr./ Mrs. Investor

Re: 123 Investment Ave., Mississauga, Ontario

Dear Client:

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Having toured the property, reviewed the offer to purchase, leases, Phase 1 Environmental Audit, Building Condition Report, and other pertinent documentation for 123 Investment Ave., Mississauga, I have the following comments/recommendation:

Overview

This investment opportunity is comprised of a two-tower office complex, east and west tower, built in 1979 and 1980, with a link-way, built in 1997, joining the 2 buildings. It is well located in the Meadowvale node of Mississauga, close to highways 401 and 407, and it backs onto an abundance of green space with a walking trail.

- The purchase price of \$21.75M translates to \$250/ sq. ft. last year. A similar building at 6790 Investment Ave., 61,368 square feet, sold for \$16M, or \$261/ sq. ft. Although recent sale comparisons aren't an exact science, if the 2 buildings are not in a similar price range it could be a sign that more investigation is required. In this case, 123 Investment Ave. is contracted at a promising \$11/sq. ft. less.
- The lead tenant, Save the Poor Society (SPS), leases the-majority-of space, about 77% of this 87,099 square foot office complex. As SPS's lease expires in just over 2 years, a prudent investor should budget for the two possible leasing scenarios. A renewal outcome is the most likely, and SPS should be contacted at the earliest opportunity to determine their future leasing plans. Concurrently, a detailed building retrofit must be considered with costing and a detailed marketing plan.
- Once the final 2 tenants commence paying rent, June 1/18, the annual income will be \$1.24M, which translates to a 5.70% capitalization rate. However, this investment has the risk of a lead tenant nearing expiration in 2 years. Should SPS not renew, the costs associated with releasing their 67,261 square feet must be considered and costed.

Lease Review

This complex is soon-to-be 100% leased, with the remaining vacancy leased to 2 new tenants each with a June 1/18 occupancy. The remainder of this complex, that is not tenanted by SPS, totals 19,403 sq. ft. and is leased to 5 tenants varying in size from 2,000 to 6,000 sq. ft.

- **Save the Poor Society** has completed 4 lease amending agreements, 1 for storage space, 2 for expansion space, and a term extension for an expansion space at \$17 net. SPS's fourth Lease Amending Agreement, clause 7, deletes the original restoration clause requiring the tenant to remove their leasehold improvements and trade fixtures and return the leased space to its original condition. To return their space to base building condition would cost \$10/ sq. ft. for their 67,261 sq. ft. of leased space.
- **Canadian Investment Bank** leases 3,897 sq. ft. and their 3-year lease is due Nov. 30/19. They have a \$10,565 security deposit on account. Their lease provides for 4/1,000 parking. I recommend that they be approached this spring regarding their renewal plans. I'd expect they would renew for another 3 years, with no inducement at an average of \$17 net rental.
- **Cancer Awareness Society of Canada** leases 2,114 sq. ft. under contract until Nov. 30/21, paying \$15.50/ sq. ft. net. Their security deposit is \$5,556. Their lease provides for 4/1,000 sq. ft. of leased space parking spots. They have 1 renewal option a minimum of 9 months prior to expiry.
- **The Cupcake Company** is one of the yet-to-move-in tenants. They will lease 2,656 sq. ft. for 6 years. \$15 net years 1-3 and \$16 net years 4-6. They were provided a \$35/ sq. ft. inducement., which equals 2.5 years of net rent. They also have a 4/1,000 sq. ft. parking allotment, with a \$7,293 security deposit.
- **Canadian Credit Adjusters** originally leased 6,315 sq. ft., but it was reduced to 6,291 sq. ft. in an amendment dated Jan. 5/17. They are committed to a 6-year term expiring on Nov. 30/22. This December their net rental increases from \$14.50 to \$15.50. They have a \$16,823 security deposit, and an option to extend for 5-years no sooner than 12 months prior to expiry. They have a 4/1,000 parking ratio.
- **Best Vacation Travel** is the other new tenant. They are leasing 4,421 sq. ft. and have a 6-year lease term expiring on May 31/24. Their net rental starts at \$15 net escalating to \$16.25 net in years 5-6. Their security deposit is \$12,244.

Parking

Parking ratios for new tenants must also be considered. SPS has been provided 3.5 parking spaces per 1,000 sq. ft. leased, for both the west tower and the east tower expansion space. The other tenants in the east tower have 4/1,000 Parking spaces. The new building survey shows a total of 346 parking spots; the actual is 343 spots, of which there are 3 handicap parking spots. Current lease commitments for parking total 277 parking spots. New tenants may require 4/1000 to 5/ 1000 sq. ft. parking ratios; there are currently an additional 66 parking stalls. Having recently toured the property during business hours there appears to currently be ample parking.

SPS has large bi-annual meetings, during which, parking requirements are extreme; they purchase street parking permits for these meetings.

Building Condition Report

- The Building Condition Assessment Report recommends nearly \$2M of required maintenance within the first 2 years. The roof requires \$335K, the asphalt \$542K, and the mechanicals require \$271K. The budget for the next 4 years for asphalt repair is over \$1M. A mutually agreed portion of these costs should be reduced from the purchase price, and some will be allocated to building operating costs which are charged back to the tenant.

Environmental Assessment

- Effective Environmental completed a Site Assessment Report in 2011 and updated it in 2012. The purpose was to assess potential issues of environmental concern in relation to a potential sale of the site. They concluded that no environmental concerns were identified at the site or adjacent properties, and no further investigation was required. They also reported that, due to the time of construction, there is potential for friable and non-friable asbestos containing materials to be present in the buildings. In 2016 Pinchin discovered sealant containing chrysotile asbestos on ductwork in the mechanical penthouse of the west building; there was no asbestos confirmed in the east building. Pinchin completed an Asbestos Management Program recommending the proper maintenance and reporting required in-order-to contain and/or remove asbestos as needed.

Capitalization Rate

- I recommend adjusting the purchase price to formulate a more accurate capitalization rate for this investment. I would add \$1.25M for the portion of the required maintenance, adjusted for the price reduction and operating costs charged back to tenants, to the \$21.75M purchase price. At \$23M, with the current rental income of \$1.24M, which is a capitalization rate of 5.34%

Cost to Re-Lease

- It is highly doubtful that SPS's tenancy can be replaced by a similar sized single tenant. Numerous space options in varying sizes with design plans should be prepared and used for the marketing of this space. There may be interest from 10,000 sq. ft. – 20,000 sq. ft. new tenants as well as a-number-of smaller 2,500 – 7,500 sq. ft. replacement tenants. My conservative estimate for leasing a 67,000 sq. ft. vacancy with numerous new tenants, may require a lease-up period of 12 – 30 months. Marketing of the vacant space should commence 12 months prior to expiry should SPS not renew or not make-a- decision by then. However, it is more challenging to attract new tenants while the space is occupied. The office market in the GTA West has the highest vacancy rate in the GTA at 9.3%. However, the 2017 Toronto West office market had its largest year of positive absorption since 2008. There is on-going new office construction, currently 5.6 million sq. ft. are under construction and planned. These new, mostly, 'A' Class office buildings,

requiring/posting higher net rents, will not be directly competitive to this 'B' Class investment. The current average asking net rent in the GTA West is \$16.42/ sq. ft. for class A space. Marketing the vacant space at \$15 net will be competitive.

- Save the Poor Society have been tenants in this complex for the past 13 years and have twice expanded. They had a first right to purchase which expired in 2009. It is very costly to move, an average cost to move office space is \$3/ sq. ft. plus \$250/ employee, loss of business/service, new stationary, and advertising. It is especially difficult for a budget conscious not-for-profit, and the odds are in favour of negotiating a mutually acceptable renewal agreement. I would budget for a negotiated renewal rate of \$15 net years 1-5 and \$17 net years 6 – 10 should they request a ten-year renewal. Depending on whether they want to reconfigure their space or just modernize with new paint and carpet, it will cost between \$10 - \$25/sq. ft. I would expect SPS to have a mandated broker who will expect a commission of \$5/ sq. ft. for a five-year renewal and \$10/ sq. ft. on a ten-year renewal. It is possible that they may choose not to renew one or both of their expansion space as a cost saving measure. SPS may require flexibility with their future real estate requirements, if this is the case, renewing for 3 -5 years is their best option. In this scenario, \$10 in inducements and \$3 -\$5 in fees should suffice. I would budget for a five-year renewal at a cost of \$15/sq. ft, or approximately \$1.3M.
- Should SPS not renew, I have budgeted \$10 a square foot for restoration work to return their space to base building condition. I also have budgeted a \$25 tenant allowance; SPS was provided a \$30/ sq. ft. allowance with their second expansion. A new tenant may agree to a lesser inducement or agree to amortize a portion of the inducement over the term of the lease and add it to the posted lease rate. A mandated broker will expect a commission of \$10/ sq. ft. on a ten-year term. A total of \$45/ sq. ft. should be budgeted to replace SPS's tenancy, or about \$3.3M.
- In-the-event that SPS do not renew, the income projections for the next 2 years will be challenging. Their lease expires in May 31/20, and I would anticipate no new rent for the remainder of the year, as SPS's space is retrofitted back to base building and any new tenants' space is constructed. In 2020 the total income would drop to \$761K. I would anticipate 30% of the 67,734 sq. ft. leased by 2021 at \$16 net, producing net income of \$1.1M. For 2022 I would expect another 50% of the original vacancy being leased at \$16 net increasing income to \$1.297M. By the summer of 2022 the remaining 13,400 sq. ft. vacancy may be leased. Once fully leased, perhaps in 2023, the projected net annual income would be \$1.4M.

Conclusion

- 123 Investment Ave. could be a quality long term investment for a purchaser who can afford the additional \$1.5-\$2M in immediate maintenance costs. They must also be able to manage the loss of net income in the third and fourth years of ownership and can afford the \$3.3M required to replace SPS.
- Once fully occupied, this July, the annual net rental income will be \$1.229M
- In 2020, should SPS leave May 31st, the annual rental income will drop to \$761K
- In 2021, I anticipate 30% of SPS's 67K sq. ft. leased at \$15 net producing annual net income of \$1.1M
- For 2022 I anticipate another 50% leased producing net rental income of \$1.297M, with still 13,400 left vacant
- In 2023, once the remaining space is fully leased at \$16net, the projected annual net rental income will be \$1.4M

Please note that I have not provided professional tax, legal, accounting, environmental, or brokerage services. Please call should you require clarification.

Yours Truly,

Mark Burns, B.A., LEED AP, President

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