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AVISON YOUNG

Media Release

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- **Avison Young *Spring 2009 Metro Vancouver Industrial Review*, full report:**
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**Avison Young releases Spring 2009 Metro Vancouver Industrial Review:
Healthy fundamentals offset by pause in demand;
sluggish economy slows deal activity, bumps up sublease availabilities**

Vancouver, BC— The global economic downturn continues to take its toll on Metro Vancouver's industrial market, evidenced by low deal activity, a rise in vacancy rates, and downward pressure on rental rates and land values. However, sound fundamentals bode well for the region in the long term.

These are some of the key trends noted in **Avison Young's *Spring 2009 Metro Vancouver Industrial Review***, released today.

Metro Vancouver's industrial vacancy rate, which resided under the 2% mark between early 2006 and mid-2008, skipped up to approximately 3.2% in the first quarter of 2009 from 2.4% in fall 2008 and 1.9% at mid-year 2008. The actual amount of space available (which includes head lease or sublease space that is being marketed but is not physically vacant, or new supply that is nearing completion and available for lease) is estimated to be closer to 6%, which technically still favours landlords but points to a more balanced market.

"The Metro Vancouver industrial market is characterized by healthy fundamentals offset by demand currently hitting the pause button," comments Avison Young principal **Robert Gritten**. He says the recent rise in vacancy levels is primarily due to the ripple effects of the current global economic slowdown, as well as new construction completions. "Businesses continue to exercise caution, cut costs and shed unneeded space, which has resulted in an increase in sublease space. Limited tenant demand/expansion, particularly due to the contraction in the manufacturing and export-related sectors, is another key factor. Other impediments to more activity include the lack of quality product available and onerous lending conditions."

After bringing on substantial levels of new supply of between 3 million square feet (msf) and 5 msf-plus per year between 2005 and 2008, developers are expected to curb new speculative development

activity in 2009 and delay some proposed projects until market conditions improve, according to the report.

“Despite lower construction costs, developers are generally finding it economically unfeasible to build rental space at current lease rates and land costs,” notes Avison Young principal, **John Lecky**, who says major projects recently completed include Brewers Distributor Ltd.’s 451,000-sf build-to-suit in Port Coquitlam and Hopewell Development’s 443,000-sf 16131 Blundell Road (Hopewell Distribution Centre) in Richmond, which is currently vacant. “Gloucester in Langley, which presently has three large vacancies, is a good example of an area experiencing some difficulty and where the developer/owners are motivated to lease given the buildings have remained vacant for many months.”

According to the report, average rental rates, which climbed approximately 40% between 2003 and 2008, leveled off in the latter part of 2008 and have come off an estimated 10% to 15% since fall 2008 due to the increase in vacant space. Rates for large (75,000-sf-plus) distribution centres, which averaged in the high \$7-psf range in mid-2008, have now dipped to the low \$7-psf range for new space and the mid to high \$6-psf range for existing space. Average asking rents for sub-50,000-sf spaces in Richmond, Burnaby and Vancouver, which approached the \$10 psf net mark for new and class A product in mid-2008, have declined to approximately \$8.50 psf.

“Landlords are now more aggressive in getting deals done given the economic environment and, in many cases, will consider any reasonable offers. Rates being offered for sublease space are up to 30% lower than rents for primary space direct from building owners as sub-landlords try to mitigate their exposure,” says Lecky. He adds though that landlords are generally reluctant to reduce rental rates significantly as primary vacancy rates continue to rank among the lowest in North America and speculative construction is in check.

“On a positive note, our clients are also starting to see more access to financing, thus enhancing their chances of transacting. Real time market information is at a premium right now as commercial real estate stakeholders search for market measurements on which to base their leasing or purchasing decisions,” he says.

As for land values, given the scarcity of land sales over the past half year, there is little evidence on which to base any changes in value, according to Lecky, who estimates that if vendors need to sell land, they will need to discount from values reached at the peak in mid-2008. Average land prices doubled between 2003 and 2008 to approximately \$1.3 million per acre in 2008 and reached a record \$4 million per acre in some Vancouver locations. In the latter half of 2008, land prices began cresting due in part to surging construction costs in recent years, and the fact that developers could not and cannot economically build at current land values.

“Construction costs have since eased off and newer developments, such as Campbell Heights, are witnessing downward pressure on pricing due to the abundance of land opportunities in that market. Older well-established areas are also seeing downward pressure but are not anticipated to experience any significant movement in prices,” notes Lecky. “Overall, land sales are being dramatically impacted by the capital markets and there continues to be a lack of interest in financing any land deals unless prelease commitments are in place. Generally, those who are selling are doing so out of necessity.”

“If there is weakness in the industrial market, it could be the continued disconnect between market lease rates and the cost to produce new product,” points out Gritten. “Given lease rates are on a slight decline due to tepid demand, this implies land values, together with already decreasing construction costs, must decline.”

On the investment side, deal velocity remains stagnant due to the limited supply of product available for sale and because vendors have not yet met buyers’ expectations for upward capitalization rate

movement. However, industrial investments continue to be “at the top of active investors’ product preference lists,” according to Gritten.

“While industrial properties achieved record sale prices in 2008, peaking in August and September 2008, worldwide financial turbulence began to contaminate perception in the market in late 2008. Since then, both buyers and sellers have been trying to determine the effect of the global credit and confidence crisis on Metro Vancouver industrial property values,” he says.

Over the past couple of years, the average value of an industrial building has risen considerably, with offerings in mid-year 2008 reaching a record \$150 to \$170 psf for well-situated, single-tenant buildings. The strength of the strata market was significant in 2007 and 2008 with units asking \$180 to \$295 psf in 2008— up 60% over the previous three years and 100% over the previous five years.

Gritten continues: “In 2009, average values are expected to drop moderately, with land and building costs decreasing. As capitalization rates and yields in 2008 represent pre-market collapse, an uptick of 50 to 150 basis points is anticipated in 2009, depending on location, quality and covenant strength. Affected by the lack of confidence, owner-operators are likely the most nervous right now, and user-demand is expected to remain soft until perception changes.”

He says opportunities to acquire industrial properties not normally available are anticipated to appear through 2009, but not at the discounts expected by most buyers. “Solid well-located, well-tenanted properties will continue to be most sought after, but while there were still cases of multiple offers for quality sale product in 2008, this will not be the case in 2009.”

According to the report, 2008 was the year that closed out the massive run-up in land prices, strata prices, vacant building prices and lease rates. And the major driver was land. Demand was robust, but activity was low due to lack of product available.

“Lack of confidence, hesitant decision-making, projects under construction, and longer lease-up times for newer space will likely push up the vacancy rate by year-end, with sublease space continuing to be an issue. However, the relative shortage of available quality product in the region should temper the rate of increase. Rents are anticipated to remain flat through 2009 or decline slightly,” notes Gritten. “With vacancy rates still the lowest in Canada, Vancouver remains a landlord’s market for most product type/sizes, even when you take into account the increase in sublease opportunities.”

Adds Lecky: “Infrastructure projects currently under construction, including the South Fraser Perimeter Road, Golden Ears Bridge, and the Deltaport Third Berth Project will continue to support demand. The chronic shortage of serviced and zoned industrial land will also continue to drive the market and reduce the potential of any major declines in rental rates and land prices. Sound market fundamentals will also sustain investor interest.”

“In spite of the tighter lending environment and cold recession winds from the U.S., the Canadian banking system is rated the strongest in the world, large pools of capital continue to be available to qualified purchasers, the local commercial real estate market is not overbuilt, and Metro Vancouver’s vacancy levels still rank among the lowest in North America. Once global economic recovery occurs and confidence returns, the region’s industrial market is expected to flourish once again,” says Gritten.

Founded in 1978, Avison Young is Canada's largest independently-owned commercial real estate services company and the only national, Canadian-owned, principal-managed real estate brokerage firm in the country. Headquartered in Toronto, Ontario and ranked among Canada's leading national commercial real estate organizations, Avison Young is a full-service commercial real estate company comprising more than 500 real estate professionals in 12 offices across Canada and in Chicago, IL. The company provides value-added, client-centric investment sales, leasing, advisory, management and financial services to owners and users of commercial, industrial and multi-residential real estate properties.

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