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Avison Young releases 2010 national real estate forecast for Canada

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Several quarters into the recession, the Canadian real estate sector has not been entirely immune but appears to be weathering the downturn thanks to relatively sound, though shaken, market fundamentals, according to Avison Young's 2010 National Forecast, which covers the Office, Industrial, Retail and Investment markets in 13 regions: Vancouver, Calgary, Edmonton, Regina, Winnipeg, Toronto, GTA West/Mississauga, Ottawa, Montreal, Quebec City, Halifax, Chicago and Washington, DC.

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"If anyone needs to be reminded, commercial real estate is a cyclical industry," comments Mark E. Rose, Avison Young's Chair and CEO. "In our 2009 Forecast last January, we predicted one overriding theme - decision-making would grind to a halt until key metrics stabilized and new trends appeared. The dislocation in real estate lending and investing was so severe in March and April that the markets looked to be on the verge of collapse. Canada weathered the storm better than the U.S. and activity was down, but transactions were executed."

Rose continues: "Due to government intervention, the concept of distressed selling and buying did not materialize anywhere in North America. The U.S. government put money into the major banks, which in turn extended every loan they could to avoid realizing losses. The Securities and Exchange Commission watched from the sidelines and allowed the impacted lenders to postpone the inevitable."

"2010 is shaping up to be more of the same, but with a slightly positive bias," he says. "Fundamentals have firmed, decision makers are getting their sea legs back and the second half of 2010 should produce favourable comparisons to 2009. This, in turn, will drive the confidence we have been sorely missing and allow for activity to return to more normal levels. With that said, before recovery can occur in 2010, private markets must solve their own problems, even if that means capitulation; the bid and ask spreads need to narrow; and we must see job growth in North America."

According to the report, the national vacancy rate for office space in Canada is up 270 basis points (bps) to 9.0 per cent since the close of 2008 and is poised to climb to the 10 per cent range by year-end 2010. Markets nationwide have experienced increases in vacancy as a result of less than stellar leasing velocity, which muted overall demand levels. The two strongest markets in Canada recently, Calgary (vacancy rate +410 bps to 10.1 per cent) and Toronto (vacancy rate +340 bps to 10.5 per cent), turned in the poorest performances, largely impacted by the delivery of new supply. In contrast, two of the smallest markets, Regina and Winnipeg, witnessed nominal increases in vacancy, rising to 1.5 per cent and 5.4 per cent, respectively, from 1.2 per cent and 4.8 per cent.

The leasing market for industrial space was also hit hard, experiencing escalating vacancy rates on average across Canada. With nearly 1.9 billion square feet (sf) of space distributed across Canada's 11 largest cities, the national industrial market saw its vacancy rate climb 110 bps from year-end 2008 to close 2009 at 6.3 per cent. With the exception of Montreal (vacancy +200 bps to 8.0 per cent) in the east, the most notable change in vacancy occurred in the western markets of Edmonton (+300 bps to 4.2 per cent), Vancouver (+200 bps to 4.4 per cent) and Calgary

(+140 bps to 5.2 per cent). This was tempered by the relative performance of the Ontario markets (Toronto, Mississauga and Ottawa), which witnessed marginal increases in vacancy of between 20 and 70 bps. As the industrial market continues to recalibrate, the national vacancy rate is expected to push beyond 7.0 per cent over the next year.

Investment sales transaction volume was down 55 per cent to $5.4 billion through the first nine months of 2009 as investor caution, a scarcity of willing lenders, and owners' increased reluctance to sell devalued assets in the current climate proved to be barriers to the flow of transactions. Interest from foreign investors, especially the Germans, remained a key factor in the investment sales market, demonstrating Canada's relatively strong real estate fundamentals and enduring appeal to overseas capital. This international interest, along with a surge in capital raisings and a number of notable acquisitions in the closing months of 2009 by the domestic REIT community, is perhaps a good omen of things to come.

On the retail front, consumer spending was more resilient in Canada than south of the border through 2009. While some national chains fell victim to the recession, extensive discounting by retailers attempting to lure customers was common, especially in the months leading up to the all-important holiday shopping season. Though the final tally has yet to be determined on the overall performance in 2009, the outlook for the retail market is for stability or modest growth this year.

"Opinion remains divided on the question of whether Canada's economy will see the beginning of a sustainable recovery in 2010, or whether a further correction is to come before things start to look up," notes Bill Argeropoulos, Avison Young's VP and Director of Research (Canada). "Notwithstanding this, Canada remains in better shape than its neighbour to the south and many other real estate markets around the world, and is poised for a more rapid recovery. Ultimately, markets are expected to rebound as the economic cycle starts its next upswing."

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