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Avison Young releases 2010 national real estate forecast for Canada, U.S. January 13, 2010

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Canadian real estate market fundamentals, though shaken, remain relatively intact while U.S. markets continue to shoulder the brunt of the downturn with recovery expected to be longer and drawn out.

TORONTO, Jan. 13 /CNW/ - Recessionary headwinds took their toll on real estate markets on both sides of the border in 2009, with the U.S. continuing to shoulder the worst of the storm. Now several quarters into it, 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.
These are some of the key trends noted in Avison Young's 2010 National Forecast, released today. The annual report 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.

"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

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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."

CANADA
According to the report, the national vacancy rate for office space in Canada is up 270 basis points (bps) to 9.0% since the close of 2008 and is poised to climb to the 10% 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%) and Toronto (vacancy rate +340 bps to 10.5%), 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% and 5.4%, respectively, from 1.2% and 4.8%.

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%. With the exception of Montreal (vacancy +200 bps to 8.0%) in the east, the most notable change in vacancy occurred in the western markets of Edmonton (+300 bps to 4.2%), Vancouver (+200 bps to 4.4%) and Calgary (+140 bps to 5.2%). 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% over the next year.

Investment sales transaction volume was down 55% 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."

U.S.

Mounting job losses in the corporate arena and the corresponding fall in the demand for office space have led to higher vacancy rates in markets across the U.S. Avison Young's coverage of its two U.S. markets of Chicago and Washington, DC revealed vacancy rates of 15.3% and 13.5%, respectively, up from 13.2% and 11.3% in 2008. These rates are indicative of the double-digit vacancy rates in other major US markets. For the year ahead, vacancy is expected to stabilize, trending slightly higher for Chicago (+50 bps) while falling marginally in Washington, DC (-50 bps).

A sharp decline in retail sales, the result of conservative spending from consumers, has driven up nationwide vacancy rates for retail space.

Occupancy of industrial space is also down, with some markets harder hit than others. While Washington, DC will see its vacancy rate retreat to 10% this year, Chicago's is anticipated to rise slightly above 12%. In all, demand for industrial space is variable by location even within a given market, and demand for certain types of well-located industrial property remains robust.

In the investment market, asset values continue to drop, particularly when compared to peak values experienced in 2007, and financing remains difficult to secure. It appears 2009 may very well mark the trough for real estate investment volume in the U.S.

The prognosis for the coming year is not overly optimistic. Many indicators appear to have hit cyclical lows; however, the recovery process remains slow and drawn out, and significant progress is not projected for 2010.

"The U.S. market continues to be in a falling-value state where asset values have dropped from their peaks in 2007 by between 35% and 50%, depending on the type of property and the market," explains Earl Webb, President, U.S. Operations, Avison Young. "Sales transaction volume has continued to decline, down approximately 70% from 2008 which, in itself, was down almost 80% from 2007. Financing continues to be scarce for office, industrial, retail and hotel properties, especially when seeking loans in excess of $50 million. Multi-family assets continue to attract significant industry attention due to the available financing through U.S. government-sponsored enterprises (GSEs) (i.e. FNMA and FHMC, also known as "Fannie Mae" and "Freddie Mac")."

"We expect 2010 to be another difficult year for real estate fundamentals, although the dramatic drop in transaction volume has undoubtedly reached a cyclical low-point. Rents, while remaining well below their peaks in 2006-2007, appear to have settled out at cyclical lows in most markets and asset classes," he says. "The good news is that the construction of new supply was relatively contained in the prior up-cycle and there will not be a significant overhang of new deliveries in the next several years as (it is hoped) absorption picks up."

Webb adds: "Employment statistics are the leading indicator of real estate recovery, and the U.S. has yet to see any uptick in employment. Should the economy continue to lose jobs during 2010, real estate fundamentals will continue to feel pressure. Even with moderate employment gains, there will be sufficient shadow vacancy in most markets to absorb any additional employees without the need for additional space, at least through 2010."

– Click here to view Avison Young's 2010 National Forecast, full report :

http://www.avisonyoung.com/library/pdf/National/forecast2010.pdf

– Click here to view Avison Young's national office and industrial vacancy rate graphs (3 graphs):

http://www.avisonyoung.com/library/pdf/National/forecast2010mediagraphs.