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Metro Vancouver office leasing market continues to strengthen

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Avison Young releases its Mid-Year 2010 Metro Vancouver Office Market Report: region's vacancy rate notches up to 8.3% due to new supply in Burnaby, but business is moving forward at normalized pace

VANCOUVER, July 21 /CNW/ - Continuing a trend that began in the latter half of 2009, the Metro Vancouver office leasing market continues to show signs of improvement. With the worst of the credit debacle and crisis of confidence behind us, and the feared post-Olympics hangover never materializing, business is moving forward at a normalized pace. Leasing activity is steady, business confidence is up, developer confidence has improved, the volume of sublease space continues to decrease and, at least in the Downtown market, rental rates are trending upward.

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These are some of the key trends noted in Avison Young's Mid-Year 2010 Metro Vancouver Office Market Report, released today. The semi-annual survey covers vacancy, absorption and new construction trends in the Downtown, Yaletown, Broadway, Burnaby, Richmond, Surrey, New Westminster and North Shore submarkets, which total just under 46 million square feet (msf) in office space.

"While the economic downturn and tumultuous credit markets stifled demand for office space 18 months ago, boosting sublease offerings in all eight submarkets and delaying some new construction projects, the story is very different today," comments Avison Young Principal Matt Walker.

However, the market continues to be a tale of two cities, he says. "Vacancy in the Downtown core, Yaletown and Broadway submarkets remains tight with signs that those markets will continue to strengthen. Rental rates are slowly trending back up, especially for class A and AAA spaces due to increasing demand from tenants, minimal large-block opportunities and the limited supply of new quality product."

Meanwhile, vacancy rates in Burnaby and Richmond have returned to historical high levels, which have contributed to the softening of rental rates over the past 12 months. "As tenants have a variety of space options from which to choose, suburban landlords competing for tenants may have to be more creative, such as by offering higher-than-typical inducements. Some growing Downtown tenants may also begin to explore suburban office space alternatives."

Despite the very encouraging signs in the market, the region's vacancy rate continued its upward trek during the first half of 2010, reaching 8.3% (or 3.8 msf) at mid-year from 7.8% at year-end 2009, 7.4% at mid-year 2009 and 5.4% at year-end 2008. While the rate of increase slowed during the second half of 2009, the main reason for the current uptick is the addition of three new buildings in Burnaby totalling 295,018 square feet (sf), most of which sits vacant.

"Once the market has time to absorb some of the new inventory, the overall vacancy rate is expected to trend downward over the next 12 months," adds Walker. "Tour and deal activity, especially in Burnaby, has already increased significantly over the past six months."

According to the report, Downtown's vacancy rate slid back to 5.1% from 5.5% at year-end 2009 after surging up from 2.5% at year-end 2008. Meanwhile, the overall suburban vacancy rate rose to 11.1% from 9.1% at year-end 2009 and 7.7% at year-end 2008. Overall, five of the region's eight submarkets witnessed a decline in vacancy over year-end 2009, with Downtown and Surrey registering the lowest vacancies at 5.1%. Richmond continues to hold the region's highest vacancy rate at 21.6%. (Downtown availability is 7.2% when including the space availability factor (SAF), which refers to 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.)

After posting a 2009 annual absorption level of negative 1,034,999 sf, tenants in the Metro Vancouver office market occupied 85,206 sf more space than they left behind between January 1 and June 30, 2010.

"While this amount may be viewed as minimal in a normal market, the positive absorption is very favourable when compared to the negative 674,349 sf experienced only one year ago at mid-year 2009," says Avison Young Broker Brian Pearson. "Moreover, while

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only one of the eight submarkets experienced positive absorption in 2009, five submarkets recorded a positive net change in occupied space during the first half of 2010, with Yaletown taking the lead at 166,173 sf."

The pace at which sublease space is being delivered to market also continues to taper as tenants occupy the existing surplus space or pull listings in anticipation of future growth. With the exception of Burnaby, few new sublease offerings are being delivered to the market - a good indicator of improving tenant confidence and demand.

As of mid-year 2010, 511,181 sf of vacant sublease space exists - down 28% from 709,870 sf at year-end 2009 and down 46% from 948,872 at mid-year 2009. Vacant sublease premises now represent only 13.4% of Metro Vancouver's total vacancy, equivalent to the mid-year 2008 level.

After delivering just over 400,000 sf of new product to the Metro Vancouver office market in 2009, developers will add nearly 600,000 sf to the office stock in 2010, which mirrors 2008 levels. Burnaby and Broadway will host most of the new supply. No new Downtown office tower is expected to grace the skyline until at least 2013.

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Downtown

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The Downtown market continues to show signs of improving business confidence. Engineering, legal and financial services firms have contributed to much of the recent activity. The pace at which sublease space is being delivered to the market is also abating. Vacant sublease space fell by 50% to 151,853 sf at mid-year 2010 from 307,718 sf at year-end 2009.

"With most of the sublease vacancies now absorbed, sublease space no longer leads the market," states Pearson. "In fact, vacant sublease premises now represent only 15% of Downtown's total vacancy (versus 29% at year-end 2009, 47% at mid-year 2009, and 39% at year-end 2008)."

Overall, with 997,348 sf of its 19.5 msf in inventory vacant, and few large-block ((greater than) 25,000 sf) leasing opportunities, the Downtown core remains tight. Class A space also tightened further at mid-year 2010 to 2.1% (or 137,229 sf) from 3.5% at year-end 2009.

"Available supply appears to be transitioning from the higher end of the market (class AAA and A buildings) to the lower end," observes Pearson. "Deal activity during the first half of 2010 was consistent with that of the latter half of 2009."

Pearson says 15 transactions involving space greater than 10,000 sf completed (totaling 487,917 sf) although the figure is skewed by the Public Works and Government Services Canada's renewal at 1166 West Pender Street for 140,000 sf. Eight of the recent large deals were renewals.

The Downtown core witnessed positive absorption during the first half of 2010, with tenants occupying 67,974 sf more space than they left behind between January 1 and June 30, 2010. This is in contrast to the negative 69,100 sf recorded in the last six months of 2009, which resulted in a 2009 annual absorption of negative 556,876 sf.

"The Downtown core is expected to continue tightening over the next six to 12 months and may see its vacancy rate drop by 50% due to incremental expansions within the existing tenant base and the limited amount of new supply under construction," says Pearson. "While a decreasing vacancy rate will enhance landlords' negotiating leverage, we expect net effective rents for unimproved space to hold steady in the near term."

Given the diminishing supply and few large blocks of contiguous supply, Pearson says a new challenge is emerging for landlords and tenants - providing/securing sufficient expansion premises. As a result, the market may begin to see traditional downtown tenants explore suburban office space alternatives for some portion, or all, of their tenancy.

"It is important to note that the region's vacancy rate still ranks amongst the lowest in North America. Coupled with the consensus that the worst of the global economic storm is over, the outlook for the Metro Vancouver office market is optimistic," says Walker. "Over the next 12 months, given the renewed confidence, we will likely see a relatively significant increase in downtown office leasing activity and signs of positive momentum in the suburban markets."

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 700 real estate professionals in 21 offices across Canada and in the U.S. The company provides value-added, client-centric investment sales, leasing, advisory, management, financing and mortgage placement services to owners and occupiers of office, retail, industrial and multi-residential properties.

- Click here to view Avison Young's Mid-Year 2010 Metro Vancouver Office Market Report:

http://www.avisonyoung.com/library/pdf/Van_Research/OMR_MID_YEAR_2010_WEB.pdf

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