Canadian Business Magazine
Toronto, ON
January 27, 2010

Jan 26, 2010 - 11:05 EST

Despite a challenging 2009, Metro Vancouver office market shows underlying strength

<< Avison Young releases its Metro Vancouver Year-End 2009 Office Market Report: Region's vacancy rate notches up to 7.8% over past half year, but pace of increase is slowing >> VANCOUVER (CNW) - Following a steep downturn in the first half of 2009, overall economic conditions started to improve towards the end of 2009. Fewer vacant subleases were delivered to the market, deal velocity picked up considerably in the downtown core, some office projects that had been stalled recommenced, and corporate tenants were again examining properties. Institutional owners, primarily of class AAA and A buildings downtown, continued to be relatively well-positioned with vacancy rates at or below expectations. Suburban office markets, however, still face many challenges.

These are some of the key trends noted in Avison Young's Metro Vancouver Year-End 2009 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 45.5 million square feet (msf) in office space.

"The wait-and-see approach prevalent throughout 2009 may continue until after the 2010 Olympics when many leases roll over," comments Avison Young Principal Bill Elliott. "But overall, the market continues to rank among the tightest in North America with new speculative construction in check and no major downtown office tower expected to come on stream before 2014. While hesitant decision-making muted overall demand in 2009, Metro Vancouver's fundamentally-strong market continues to display stability, and renewed demand will be a function of core economic recovery and growth."

According to the report, the Metro Vancouver office leasing market witnessed a marked slowdown in leasing activity and a rise in sublease space in 2009 as companies delayed expansion plans and downsized to reduce occupancy costs in light of the global economic downturn. As a result, vacancy rates climbed, rental rates softened, and landlords, particularly in the suburbs, offered larger inducement packages to attract and retain tenants.

However, while vacancy rates continued to creep up in the latter half of 2009, they did so at a slower pace than in the first half. Metro Vancouver's overall vacancy stepped up to 7.8% at year-end 2009 from 7.4% at mid-year 2009 and 5.4% at year-end 2008.

Downtown's vacancy rate ticked up to 5.5% from 5.0% at mid-year 2009 and 2.5% at year-end 2008. Suburban vacancy remained relatively unchanged at 9.2% from 9.1% at mid-year 2009, but is up from the 7.7% recorded at year-end 2008. (Note: downtown's "availability" rate is 7.8% if you include space that is being marketed for lease but is not physically vacant.) "Smaller tenants in the downtown marketplace will continue to have options available to them; however, as we move through 2010, these tenants will begin to see rental rates increase," explains Avison Young broker Glenn Gardner. "Tenants who are able to address their leases today will be able to achieve better business terms than tenants who address them tomorrow. This is because downtown vacancy will start to trend downward, as there will be no significant new inventory coming to market in the foreseeable future, thus forcing rates to rise."

He adds: "Larger downtown tenants, however, will have limited options as the larger sublease pockets that were previously available have now been absorbed. These tenants will have to begin the process of evaluating their alternatives far in advance of their lease expiration dates in order to facilitate any growth they may have. Tenants will either have to stimulate new construction by taking a significant prelease commitment or look to other marketplaces to accommodate their needs, just as HSBC Bank Canada did by preleasing 100% of Broadway Tech Centre 4 (173,000 sf), which will complete construction in 2012 in East Vancouver."

Deal velocity increased significantly in the downtown core in the second half of 2009 over the first half, with approximately 20 lease deals completed involving spaces 10,000 sf or larger. There are few vacant and available large blocks of space greater than 25,000 sf.

Vacant sublease space in Metro Vancouver fell by 25% to 709,870 sf at year-end 2009 from 948,872 sf at mid-year 2009, but is still up 37% from 516,627 sf at year-end 2008. The recent drop is the result of fewer vacant subleases being delivered to the market, absorption of existing sublease opportunities, and termination of sublease listings as tenants take back the excess space.

Suggesting improved business confidence, the current vacant sublease offerings also represent only 20% of Metro Vancouver's total vacancy of 3.5 msf. This compares to 28% at mid-year 2009 (which was at that time the highest percentage of sublease vacancy in more than a decade), 21% at year-end 2008 and 14% at mid-year 2008. Most of the current vacant sublease space exists downtown with 307,718 sf, down one-third from 460,158 sf at mid-year 2009 but still up from 188,472 sf at year-end 2008.

While overall absorption of negative 287,650 sf in the second half of 2009 was an improvement over the first half of 2009, it brought annual absorption in 2009 to negative 1.03 msf - the lowest annual net change in occupied office space since 2001. The downtown core accounted for the brunt of the region's negative annual absorption in 2009, with tenants leaving behind 556,876 sf more space than they took up between January 1 and December 31.

Most of the net outflow took place in the first half of 2009. All submarkets posted negative annual absorption with the exception of Broadway.

The Broadway Corridor office market closed 2009 with the lowest year-end vacancy rate in the region at 5.2%. "How restrictive the market is really depends on the square footage a tenant is looking for. There are limited options for tenants looking for more than 5,000 sf, and very few alternatives available in class A buildings," notes Avison Young Principal James Lewis.

"Larger tenants looking to renew in 2010-2011 will likely need to look outside the

Broadway Corridor for options. If they can be in Burnaby or Richmond, that's where they will find real value."

He adds: "For tenants requiring less than 5,000 sf in the Broadway market, it's still a very competitive market. Landlords who understand this disconnect - and adjust expectations for smaller units accordingly - have fewer vacancies."

On the construction front, while Metro Vancouver developers delivered 600,000 sf of new supply in 2008 (mostly in the suburbs), construction slowed in 2009 with just over 400,000 sf added to the region's inventory. New construction completions are expected to meet 2008's level again in 2010.

Burnaby continues to lead the region in sod-turning activity.

GWL Realty Advisors' sale of 900 Howe to a private buyer in December 2009 represented the only sale of a class A building downtown in the fourth quarter of 2009.

Metro Vancouver's overall office vacancy rate is forecast to nudge up in 2010, encroaching 8%. "The downtown market should remain relatively strong while landlords in suburban submarkets, particularly Burnaby and Richmond, will face oversupply challenges and increased competition for tenants," says Elliott. "Accordingly, landlords are expected to face further downward pressure on rents and continuing upward pressure on inducements. There is not a lot of pent-up demand in most suburban office markets right now."

Overall, the Metro Vancouver market is still quite healthy compared to other Canadian and international markets, according to the report. "After a slight fourth-quarter 2009 uptick, the BC economy is expected to lurch at times during 2010 until employment shows consistent month-to-month improvement. The 2010 Olympics should help spur a recovery in the short term that will lead to long-term benefits," says Elliott.

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 16 offices across Canada and in the U.S. 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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