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British Columbia commercial real estate investment activity rebounds as bid-ask gap narrows

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Avison Young releases Year-End 2009 BC Real Estate Investment Review - retail sector enjoys renaissance while REITS have become big players

VANCOUVER, Feb. 22 /CNW/ - After a slower first half of 2009, British Columbia's commercial real estate investment market made a strong comeback in the second half of the year as after-shocks from the global economic downturn began to subside and the bid-ask gap narrowed. Capitalization rates remained below those in other Canadian markets.

These are some of the key trends noted in Avison Young's Year-End 2009 British Columbia Real Estate Investment Review, released today. The semi-annual report tracks office, industrial and retail investment sales in BC greater than $5 million.

REITs, conspicuous by their absence during most of 2009, have raised significant capital and become dominant players since the latter half of 2009 and into 2010. As a result, secondary markets are back in vogue - unlike in 2009 when buyers were mainly chasing prime product in Metro Vancouver.

"Transaction volumes rebounded during the second half of 2009 as REITs and pension funds rejoined the private buyers in seeking commercial and industrial income investments," comments Avison Young Principal Bob Levine. "Improving fortunes in the stock markets and yield compression in all income-producing assets have improved availability and liquidity of debt and equity in BC's commercial real estate market, allowing for greater transaction volume over the first half of 2009."

Levine adds that liquidity has also returned to secondary commercial real estate markets in BC: "Private investors, who primarily raise equity through syndications, and REITs have returned to purchasing commercial properties in smaller BC communities as they seek returns that they cannot match in Metro Vancouver or Victoria. This has resulted in many more sales in outlying markets compared to the previous 12 months."

The retail sector enjoyed a renaissance in the latter half of 2009, accounting for most of the transactions and dollar volume after lagging in the first half. In November, RioCan REIT and the Canada Pension Plan partnered to purchase Surrey's Grandview Corners outdoor shopping centre for $182 million (the largest retail deal in the province in 2009) and Primaris REIT acquired 50% of Woodgrove Centre from Ivanhoe Cambridge in Nanaimo for $103.1 million. Together, the two deals (for a combined total of $285.1 million) accounted for more than half of the total value of second-half 2009 retail deals closed.

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The 16 second-half retail transactions represented a fourfold increase from just four deals in the first half. The increase could be attributed to sellers' perception that retail posed the biggest risk to their portfolio values. Meanwhile, buyers saw strategic opportunities that offered leverage as they acquired properties located next to strongly-anchored shopping centres owned by deep-pocketed investors who likely plan to expand in the future. Throughout 2010, as in the second half of 2009, retail investors' biggest challenge will be to minimize the loss of tenancies, especially in the case of shopping centres anchored by large U.S. chains.

Strong demand for office product carried over into the second half of 2009 from the first half. However, unlike in the first six months of 2009, which witnessed the sales of Bentall V and the Grosvenor building in downtown Vancouver for $297 million and $84 million, respectively, large unsolicited deals did not occur in the second half. An absence of available trophy-class buildings tempered activity even though investors were hungry to acquire office assets. 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. Demand for downtown Vancouver office product should remain strong as rents are expected to trend upwards due to a lack of leasing supply. Low capitalization rates have not deterred purchasing activity.

Industrial dollar volume rose slightly in the second half over the first half of 2009, but activity remained relatively unchanged. Due to the lack of available quality product, vendors have held their position on prices when compared to discounts in other parts of the country. In the Metro Vancouver area, buyers are receiving yields that are 50 to 100 basis points higher than at the peak in mid-2008. In the second half of 2009, the industrial market witnessed larger transactions as six notable deals exceeded $10 million whereas only two transactions surpassed that mark in the first half. Overall, pure investors now realize that they can obtain better returns from real estate than bank-based investments. REITs and institutional investors have also become more active players.

"The market's overall increases in dollar volume and number of transactions in the second half of 2009 can be attributed to increased investor confidence, a reduced bid-ask gap, and healthier REIT and private-company balance sheets," says Avison Young Principal Michael Gill. "Buyers and sellers have come to the realization that Canadian pricing is less likely to follow trends south of the border, where many distress sales have occurred. Accordingly, executive decision-making on BC commercial real estate has increased."

Gill continues: "Sellers are showing more willingness to part with quality assets while buyers are acknowledging that few trophy properties are available - especially in the coveted office class - and are therefore adjusting their yield targets."

"Overall, the market will rise and fall on buyers' ability to raise funds, access conventional debt and meet vendor expectations - not concerns about the global economic outlook," says Levine.

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In the second half of 2009, the total volume of office, retail and industrial sales rose 11% to $715 million from $643 million in the first half of 2009. Total volume for 2009 reached $1.36 billion, up from $1.27 billion at the end of 2008 when provincial investment activity was caught in the eye of the global economic storm.

In the second half of 2009, completed transactions climbed to 37 from 23 in the first half, which at that time marked the lowest first-half deal count in seven years. On an annual basis, completed deals decreased to 60 in 2009 from 68 in 2008, but 2009's total is still up from 47 in 2007 and 54 in 2006.

Overall, retail deals (16) dominated in the second half of 2009 after lagging in the first half. The remaining trades were evenly split between office (11) and industrial (10). For all of 2009, trades were evenly divided between office (19), retail (20) and industrial (21). On an annual basis, office deals comprised 32% of transactions (19 of 60) and 49% ($660 million) of dollar volume while retail accounted for 33% of transactions (20 of 60) and 37% ($499 million) of dollar volume. Industrial deals represented 35% (21 of 60) of all transactions in 2009 and 15% ($199 million) of total sales.

Private buyers dominated both the buying and selling sides in the last six months of 2009. Retail properties were at the forefront of transactions after industrial property trades led in the first half.

"Most 2009 transactions involved buyers and sellers who cautiously returned to the market after sitting on the sidelines during the storm delay. After lurching through the first half of 2009, deal activity rose in the second half of 2009 as equity markets improved significantly, credit became more widely available, and investors came to realize that investment-grade real estate compares favourably to other investment alternatives," points out Avison Young investment broker Michael Keenan.

According to the report, the availability of quality sale product continues to improve early in 2010. Benchmark prices, hard to find in 2009, are becoming easier to pinpoint as the commercial real estate market and global economy in general continue to stabilize. Buyers have cleaned up their balance sheets and are eager to invest ample amounts of cash that they have accumulated over the past six to 12 months.

"It is important to note that the second-half increase in investment activity occurred despite the region's traditionally low capitalization rates," adds Keenan. "BC capitalization rates are usually lower than those in the rest of the country and many international markets. As demand slowly increases, capitalization rates are expected to nudge downward, especially in the downtown Vancouver office sector where demand is high but supply is generally scarce."

"However, lower capitalization rates are not dissuading investors from re-entering the market," adds Levine. "Many prospective buyers are preparing to submit unsolicited offers in order to build up their real estate portfolios."

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 600 real estate professionals in 17 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 occupiers of office, retail, industrial and multi-residential properties.

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- Avison Young Year-End 2009 British Columbia Real Estate Investment Review, full report:
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