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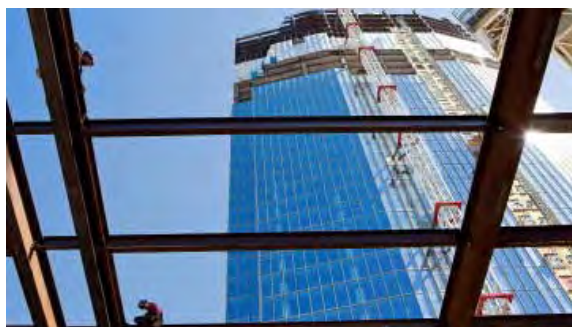
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Towers built on confidence give tenants the upper hand



Calgary's Eighth Avenue Place is part of an avalanche of new office space about to hit the city in the next year.

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Calgary — Globe and Mail Update

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When work started on Eighth Avenue Place in downtown Calgary two years ago, the 49-storey skyscraper was dubbed "the tower built on confidence."

Designed to the highest environmental standards and destined to be among the greenest office buildings in North America when it opens at year's end, the million-square-foot tower will have everything a company could want for employees – stunning mountain views, an accessible downtown location and a plethora of nearby shopping options.

But there's one thing the building doesn't have: tenants. Not a single occupant has signed a contract, with the doors to open in eight months.

"We've got some potential deals on the go but there's really nothing to announce," says John Smith, vice-president of 20 Vic Management Inc., which manages the building on behalf of the real estate arm of the Caisse de dépôt et placement du Québec and Alberta Investment Management Corp.

"The ownership group is strong and has been through cycles before, and are confident they will sign tenants before the building opens."

Eighth Avenue Place, commissioned on speculation before the recession's depth was apparent, is part of an avalanche of new office space about to

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hit Calgary in the next year. Ten buildings are nearing completion, including a 1.8-million-square-foot headquarters for Encana Corp. That's five million square feet, and 37 per cent of it is being built without any tenants secured.

Analysts say Eighth Avenue Place will drive down lease rates elsewhere in the city, pressuring landlords who grew used to the fat cheques they received when vacancy rates hovered near zero just a few years ago amid the peak of Alberta's energy boom.

"This will be a dog fight for tenants through 2012," said Michael Cooper, chief executive officer of Dundee REIT, which owns downtown Calgary buildings. "Tenants don't have to wait for the new buildings to open to know they can get a bargain."

A building as modern as Eighth Avenue Place will act as a magnet, attracting tenants from older buildings on the edge of the downtown by offering lower lease rates and better features, said Colliers International's Calgary managing director Joe Binfet. Those buildings already have vacancy rates in the high teens, a rate that's bound to increase as better, cheaper space floods the market.

"We call it a flight to quality," said Mr. Binfet, whose office handles leasing for the tower. "There's a real opportunity to upgrade, and once a few large tenants make a move, I think it will really open up."

It's a pitch destined to make smaller landlords flinch, and it's something few want to talk about publicly because they worry it will hasten an exodus. Glenn Simpson, the principal of Avison Young's Calgary office, said these smaller players know what they're up against.

Eventually, "Eighth Avenue Place will be filled, I'm quite sure. But I know the landlords of the older assets are worried. And they should be."

The buildings under construction are asking about \$33 a square foot, according to Avison Young, almost three times as much as older buildings, but down significantly from \$55 reached at the market's peak in 2007.

Vacancy rates will hit 20 per cent, but older buildings are in for a bigger hit, said Michael Smith, managing director of real estate equity research at Macquarie Securities Group. "It is a virtual certainty that vacancy rates for [lower quality space] will exceed 30 per cent," he said. "Perhaps by a lot."

Mr. Smith said the city's top-tier landlords – such as Bentall Corp. and Oxford Properties Group Inc. – have managed to sign longer-term deals with their tenants to keep their occupancy rates high. That leaves smaller players with buildings that will need to be renovated and updated if they are to attract tenants to replace those who move to shinier digs.

But to undertake that kind of work, many would need to borrow money – not an easy undertaking without the steady revenue high occupancy rates provide.

"Because of high operating costs and taxes office vacancy is very expensive," he said. "If a landlord has debt, even if it is not at excessive levels, at 30 per cent vacancy he is probably in the red."

Calgary's vacancy rate stood at 11 per cent through the first quarter, double Toronto's and just a smidgen above New York City. But as markets improve across North America, even the most optimistic of analysts are calling for the rate to sail above 15 per cent. Those with a more pessimistic view think with unemployment still heading higher in the province, 20 per cent is more likely.

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"The thing that is remarkable is Calgary will add 20 per cent to its inventory in the next year or two," said Mr. Smith.

While the market is undoubtedly tough, there have been signs that the city's meltdown may not be as imminent and unavoidable as some predicted. As goes oil and gas, so goes the economy – and while gas prices continue to languish, oil has held steady above \$80 a barrel.

For the first time in two years, companies leased more space than they gave up in the first quarter. It's good, but there's a catch: Colliers said most of the gains came from companies taking 1.2-million square feet of sublet space off the market.








Meanwhile, the city's vacancy rate decreased to 11 per cent in the first quarter from 11.6 per cent in the fourth. While there's little doubt that will head higher in the coming quarters, it leaves just enough hope that the city can pull off a quick turnaround. A slew of recent deals in the oil patch, including state-owned China Petroleum & Chemical Corp. buying a 9 per cent stake in Syncrude Canada Ltd., have also fuelled optimism.

"While this is still a difficult market, vacancies are nowhere near the levels seen during the previous economic downturns when vacancy rates were well over 20 per cent," said Avison Young's Todd Thronson.

A small consolation perhaps, but maybe enough to carry the city through to the next boom.

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