Sales down, optimism up in property market

Quiet period in commercial real estate market a positive sign that balance has returned; owners hold on, expecting further price gains

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A year-long frenzy of activity in Canada's commercial real estate market has ground to a halt, for a simple reason: building owners don't want to sell.

After three quarters of sharp growth, sales of office, industrial and retail properties in Canada's largest market, Toronto, fell in the first quarter.

It's a phenomenon playing out across the country as cash-rich real estate investment trusts hunt for properties to add to their portfolios, but find themselves negotiating with building owners who are content to hang on longer.

The standoff is likely to benefit property owners, who will be able to demand more for their buildings as the industry transitions to a more balanced market.

Real estate trusts raised more than $1-billion through the downturn and have felt pressured by their boards to get that money out of the bank and into real investments.

However, the amount invested in buildings fell by 11 per cent in the first quarter from the fourth quarter in the Greater Toronto Area, according to numbers to be released today by RealNet Canada Inc., while the number of transactions fell by 10 per cent.

"Nobody wants to sell into a rally," said John O'Bryan, vice-chairman of CB Richard Ellis. "We're in a lull period here, where everyone wants to wait a quarter or two to see where things go. This is happening around the world as the recovery takes hold."

The trend highlights the growing optimism in Canada's real estate sector that the rebound is sustainable and that property prices will rise further from current levels.

When the recession hit, many had expected a wave of heavily discounted properties to hit the market as distressed sellers tried to clean up their balance sheets.

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Distressed properties could increase

» That, in turn, would drive down values, putting stress on a financial sector that is heavily exposed to domestic real estate.

But those fears have not materialized, and there has been little in the way of court-ordered distressed selling. Distressed sales accounted for just 8.7 per cent of the $1.95-billion of transactions in Toronto in the quarter, and much of that was tied to a single downtown building, sold by creditors through the courts to an American investor for $118-million.

The number of distressed properties could increase, however, as banks and other financiers opt to move on customers who have fallen behind on their payments now that prices have firmed up.

"They may have wanted to move on these properties in the past but were nervous about what would happen," said RealNet president George Carras.

"They may choose to deal with some of their problems through sales now with a little more confidence. It's something to watch for in the coming months."

But if you take that deal out of the equation, the number of distressed sales held steady at 2.5 per cent. That's similar to the level held throughout 2009.

"The concept of distressed selling just never materialized in Canada," said Mark Rose, chief executive officer of Avison Young.

"What the data tells me is that if you are looking to pay a distressed price for something, then please take it off your screen and get back to real investing."

While volumes and dollar amounts fell overall, the office sector in Toronto has shown resilience as real estate investment trusts begin to deploy cash amassed last year on the equity markets. The dollar value of deals jumped 10.2 per cent to $593-million.

Two deals accounted for most of the volume, however, with Dundee REIT paying $211-million for one tower and Whiterock REIT spending $214-million for three buildings in a portfolio.

Any levelling off in activity should be welcomed, Dundee chief executive officer Michael Cooper said, because it will help keep the sector from overheating.

"You don't want to see the recovery get so strong that people start getting carried away," he said.

"We're in an operating environment where most of the bad news is behind us. Things may be a little soft, but I think most everyone believes that they are getting better overall."

Investment in Toronto buildings fell 11 per cent in the first quarter. JENNIFER ROBERTS FOR THE GLOBE AND MAIL

U.S. VALUES DROP

U.S. commercial property values dropped for the first time in four months in February as the share of distressed sales rose, according to Moody's Investors Service. The Moody's/REAL commercial property price index declined 2.6 per cent from January. Prices slid 26 per cent from a year earlier and are down 41.8 per cent from a peak in October, 2007.

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