

Property Report

OFFICE SPACE

Sign of the times: Sublease space climbs

Vancouver, Calgary and Toronto are seeing an upswing, with a cascading effect on vacancy rates and rents

BY TERENCE BELFORD

If the sublease market is the canary in the coal mine for gauging the health of commercial office space, then in Vancouver and Calgary, the bird is flopping around on the bottom of the cage and, in Toronto, it has started to breathe hard.

In Vancouver in the fourth quarter alone, sublease space available in the central core leaped to 417,000 square feet from 176,000. In central Calgary, it rose to 693,000 square feet from 522,000, according to Cushman & Wakefield LePage Inc.

When it comes to office space, both are cities where the hard-hit resource industries dominate. Cutbacks in global demand for resources have seen them immediately downsize to reduce operating costs and weather the economic storm.

In Toronto, by comparison, subleases in the central core rose by just 40,000 square feet in the fourth quarter to 718,000.

What Toronto has in its favour is that it is home to the financial services industry, which has not yet been as deeply affected by the recession.

"We are in a wait-and-see situation in Toronto," says Ian MacCulloch, vice-president of research at Colliers International.

The sublease space that came on the market late last year generally reflected companies that had reserved space in the same building in anticipation of growth this year. When the recession began to settle in last fall, they immediately sought to sublease that space to cut overheads.

Subleases shoot up when existing tenants are forced to cut back on their space needs because of such events as layoffs, mergers or acquisitions. In an effort to reduce costs, they try to find another tenant to take over their obligation to the landlord.

That, however, can have a cascading effect, says Bill Elliott, a principal at Avison Young Canada Inc. in Vancouver.

When large chunks of sublease space become available, some tenants may offer rates below what landlords might charge — and those landlords can then find themselves competing for new tenants with existing ones offering significantly lower rents, he says.

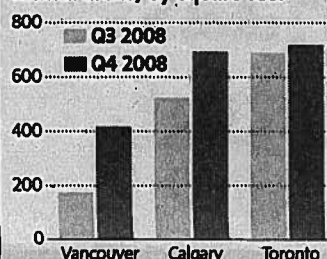
"Where landlords were charging in the high \$30s [a square foot] for base rents in



When large chunks of sublease space become available, some tenants may offer rates below what landlords might charge. PETER POWER/THE GLOBE AND MAIL

Sublease space on the rise

Sublease space availability, central areas, by square feet



KATHRYN TAM/THE GLOBE AND MAIL
 SOURCE: CUSHMAN & WAKEFIELD LEPAGE

2008 in central Vancouver, which was maybe down 5 per cent from 2007, now you see sublease space being offered in the high teens and low \$20s a square foot," he says.

There is, however, a bright spot in the gloomy skies: That growing surplus of sublease space likely means tenants looking for new or replacement office space during the next two years will be able to negotiate rental rates significantly below what they faced as little as 18 months ago, says John O'Bryan, vice-chairman of CB Richard Ellis Ltd. in Toronto.

"In essence, anyone looking to renew in 2010 or 2011 can start looking around now and cut some great deals on rates for space," he says.

"There are not only deals to be had on sublease space but landlords, to protect their positions, are starting to reduce their rents to attract tenants as well."

The effect of the rush to sublease has been cushioned by the extremely low vacancy rates in the core areas of all three cities.

In Vancouver, for example, even 400,000 square feet of new space on the market will push the vacancy rate to only

4 per cent from last year's 2.5 per cent, Mr. Elliott says.

Vancouver's situation is further mitigated by a lack of newly constructed office space about to hit the market.

"Almost all new office construction has been in the suburbs recently," Mr. Elliott says.

Calgary and Toronto do not enjoy that advantage, however. In Calgary, millions of square feet of new office space are under way, poised to come on stream over the next two years, Mr. MacCulloch of Colliers says. That new space will be forced to compete for tenants with existing subleases, driving vacancy rates up and rental rates down.

In Toronto, the greatest effect will likely be felt in the downtown business core, where about four million square feet of new space are under way, says Paul Morse, senior managing director of office leasing at Cushman & Wakefield LePage.

Those new buildings are currently between 80 and 85 per cent leased. While landlords may charge base rents in the \$30-a-square-foot range, their operating costs,

which make up almost half of the total rent that tenants pay, are considerably less than in older buildings, he says.

"Some of the older signature towers charge about \$32 a square foot on top of net rents for operating costs and taxes," he says.

"That is significantly more than what the new space is going for. Owners are under increasing pressure to cut deals to attract and retain tenants."

One industry insider says an example is 100,000 square feet now available in one bank tower.

While base rents in 2007 would have been in the \$30-plus range, the space is now on offer for \$19 a square foot, as long as the tenant is willing to take immediate possession and sign a long-term lease, among other conditions.

"What you see now is landlords working with sublease tenants to protect the revenue base of their buildings," Mr. Morse says.

"Especially in core areas, landlords are taking stop-gap measures to make certain they stay fully leased."

Special to The Globe and Mail

REIT stock mon

Biggest one-week gain
 March 6 W close, d

InterRent REIT	\$1.55
Wall Financial Corp.	\$7.75

Biggest one-week decline

Chartwell REIT	\$3.96
Homburg Invest Inc.	\$4.48

REIT watch*

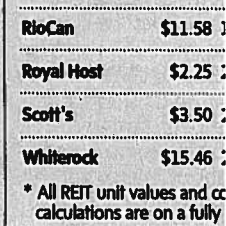
March 6 close

Allied Properties	\$11.85
Artis	\$5.60
Boardwalk	\$24.07
Calloway	\$9.06
CAP	\$12.48
Chartwell	\$3.96
Cominar	\$11.50
CREIT	\$20.10
Crombie	\$5.50
Dundee	\$11.75
Edendicare	\$3.90
H&R	\$6.49
Holloway Lodging	\$0.82
Huntingdon	\$0.19
InnVest	\$2.45
InterRent	\$1.55
InStorage	\$3.76
Lanesborough	\$2.01
Morguard	\$8.07
Northern Prpty	\$14.85
Primaris	\$8.65
Retro. Mid-Mkt	\$1.35
RioCan	\$11.58
Royal Host	\$2.25
Scott's	\$3.50
Whiterock	\$15.46

* All REIT unit values and calculations are on a fully

S&P/TSX indexes

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