

we should see stability in the second half of **2009** and recovery in 2010."

According to the **2009 Forecast**, the national office vacancy rate remains tight at 5.2% (as of November 2008) but is anticipated to notch up to 6.7% by year-end **2009**, due mainly to curtailed demand across the board and significant new supply, particularly in Toronto. The national industrial vacancy is **forecast** to tick up to 6.4% by the end of **2009** from 5.4% in November 2008 as a result of new construction completions and limited tenant expansions, caused in part by the downturn in some manufacturing and resource-based industries. Of the 11 regions surveyed, most are anticipating slight increases in their office and industrial vacancy rates by year-end **2009**. Only Montreal is forecasting a slight decline in office vacancy while Regina and Quebec City are expecting their respective industrial vacancy rates to dip slightly or hold steady. Halifax anticipates its vacancy rates will remain unchanged.

Office markets are witnessing an increase in sublease space, suggesting a rise in overall vacancy rates through **2009**. Vacancy rates for class A space are generally expected to remain stable, while some landlords of class B and C properties are already seeing a softening of their face rents. "The cautious economic climate muted overall demand in 2008 and absorption will likely remain below recent historical averages as companies delay or cancel expansion plans in light of cooling domestic conditions," says Rose. "In suburban markets across the country, vacancy may edge up as new buildings come into inventory and more sublease space enters the market. Correspondingly, inducements may increase as landlords compete more vigorously for fewer deals."

In the industrial sector, land sales generally began to soften in 2008 and construction activity is anticipated to moderate in **2009**, given the uncertainty in the market. Supply will outpace demand and rental rate increases are expected to curtail in **2009**. "Tenants will be scrutinizing their budgets and landlords may have to offer concessions," adds Rose. "Some tenants will be looking at reconfiguring their space to address alternative workplace strategies and to maximize efficiencies. Others will be offering sublease space to the market. In the near-term, the market may also witness the 'greening' and retrofitting of some older buildings and an upswing in sale/leaseback transactions."

On the investment side, the barriers to more sales activity in 2008 included the lack of prime product available for sale and the bid-ask gap for non-prime property, a problem exacerbated by debt market volatility. "**2009** will be a volatile year with major swings in asset pricing, the availability of debt, and equity for real estate investing," points out Rose. "Distressed debt and projects will be the assets of choice in the first half of **2009**. We expect decision-makers will take their time and that this pause, coupled with weakening fundamentals and new debt underwriting standards, will drive all asset classes lower with price declines of up to 30% in some markets."

Class A assets will likely be held for the long-term as owners seek to preserve the value of those assets in their portfolios. Class B assets and assets in tertiary markets are beginning to decline in market value and as mortgages on these properties mature, underwriters may refrain from renewing. Hence, some uptick in volume may occur over the next 12 to 18 months. Rose adds: "Dislocation is a natural part of cycles and the revaluing of commercial real estate assets will create significant opportunities for the next wave of investors."

On the retail front, falling consumer confidence in the latter half of 2008 challenged retailers and shelved a number of development projects across the nation. Grocery, drug and other staple goods retailers are anticipated to weather the storm, but discretionary spending will drop significantly, even before factoring auto sales into the equation. Consumers will be looking for value in **2009**, and discount retailers will have the opportunity to build market share and loyalty.

The following is a snapshot of the Office and Industrial markets in some

of the major regions:

VANCOUVER

Office

The Metro Vancouver office leasing market remained relatively steady and tight in 2008, with overall vacancy hovering in the 5% range. "However, leasing activity moderated through 2008 due to the shortage of available quality space

prices

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as well as some tenants putting their real estate decisions on hold while awaiting economic clarity. The region also witnessed a significant rise in sublease space in the latter half of 2008, particularly in the downtown core, as businesses repositioned themselves to adapt to the changed economic environment. Some development projects have been halted or delayed," comments Douglas McMurray, Managing Director of **Avison Young** (Canada)'s Vancouver office.

The downtown core affords little room for movement, with only 2.5% vacant. No major downtown office tower is anticipated to come on stream before 2013. "Landlords were able to capitalize on the dearth of prestige space in 2008 as rents for top-end premises hit a record \$50 per square foot (psf). Going forward, absorption will likely remain below recent historical norms and landlords may need to adjust their rent expectations," says McMurray. "Construction machinery will remain active in some suburbs in **2009**; hence, vacancy may notch up and inducements may increase as landlords compete for fewer deals."

Industrial

After residing under the 2% mark since early 2006, the industrial vacancy rate ticked up at the end of 2008 to 2.4%, which still ranked among the lowest in North America. "The increase was mainly due to fewer tenants expanding and recent new construction completions. Slowed exports to the U.S. in 2008, which caused some BC manufacturing and export companies to downsize, also resulted in an upturn in sublease space," explains McMurray.

Construction remained active in 2008. Rents have climbed approximately 35% over the last four years, and the shortage of industrial-zoned and serviced land has doubled average land prices over the past five years to approximately \$1.25 million per acre today, with some Vancouver locations fetching \$4 million per acre. "Land sales began moderating in the latter part of 2008 and some areas will likely see a price correction in **2009**," adds McMurray. "Strata units, most recently seeking \$180 to \$295 psf, saw prices climb 60% in the last three years, and sales will likely moderate over the next while with the lending market in disarray." Overall, industrial vacancy may nudge up in **2009** depending on buyer/tenant perception, sublease activity and the number of bankruptcies, he says.

CALGARY

Office

With the addition of 3.3 million sq. ft. (msf) to the overall office space inventory in 2008, the Calgary office market witnessed a climb in vacancy from a mere 1.8% at the end of 2007 to 3.4% by the end of 2008. "Sublease space rose above the 1% mark for the first time in more than two years and small decreases in rental rates for class B and C properties were also noticed," comments Todd Thronson, Managing Director of **Avison Young** (Canada)'s Calgary office.

"Nonetheless, the overall outlook for the Calgary office market remains cautiously positive. Due to the level of uncertainty in the market as we begin **2009**, tenant negotiations will likely be aggressive for both new space and renewals," he says. "A further retreat in class B and C class rental rates is expected, with class A properties also anticipating some negative momentum through **2009**." Thronson adds that activity levels will be uneven through **2009**, resulting in only "moderate vacancy rate increases" until several large new development projects come on stream at the end of the year.

Industrial

"Average industrial lease rates ended 2008 on an up note for all types of property. Meanwhile, the 3.8 msf of new industrial inventory added to the Calgary marketplace matched the 3.5% increase in total space available in the market," notes Thronson. "However, Calgary remains among the top 10 cities in North America with the lowest industrial vacancy rates. Thus, asking rates are anticipated to maintain their current levels in **2009**, but with higher incentives."

"As new development continues to add to the amount of available space,

vacancy will continue its rise through **2009**, but demand should remain steady. New options released in **2009** will also provide the opportunity to capture modest price reductions for serviced industrial land," Thronson says, adding that there will be more developable commercially-zoned land available for purchase in **2009** than there has been for several years.

EDMONTON

Office

"2008 proved to be a year of stabilization for both the downtown and suburban office markets," notes Cory Wosnack, Principal, **Avison Young** (Canada), Edmonton office. "With vacancy rates downtown remaining strong at 5.6%, net rental rates marginally trended upwards in 2008." The most significant movement in net rental rates occurred in class A and B buildings downtown, which reached \$30 psf for class A buildings and \$22 psf for class B buildings. Rents for class AA properties remained essentially unchanged over the past 12-month period, holding at \$34 to \$36 psf.

In the suburban office market, the vacancy rate rose from 6.8% at year-end 2007 to 8.1% at year-end 2008, mainly due to the addition of new office buildings that are only partially leased, says Wosnack. "Nonetheless, newly-constructed office buildings have raised the bar for net rental rates as economic rents in the high \$20-psf range are now required for these developments. Meanwhile, existing class A properties are now achieving \$21 to \$22 psf." Net rental rates are anticipated to remain static over the upcoming six-month period, provided the overall vacancy rate holds at a healthy sub 7% (the current City of Edmonton vacancy rate is 6.5%). "One trend we are anticipating is an increase in the inducement allowances provided by landlords to tenants to help offset their renovation and moving costs," adds Wosnack.

Industrial

"The fundamentals of the Edmonton industrial real estate market remained strong throughout 2008 and Edmonton continues to be the service hub for the mega projects of Northern Alberta," comments Rob Iwaschuk, Principal, **Avison Young** (Canada), Edmonton office. "New construction remained steady in 2008 with a significant number of new projects commencing or completing. However, reduced activity in the market resulted in lower absorption levels, which bumped up the vacancy rate to a still sparse 1.5% by December 2008 (the lowest industrial vacancy rate in the country among all major regions). Looking ahead, some of the anticipated new projects will come on stream to meet the ongoing demand for industrial space."

"Following many years of upward pressure on land values, prices began to plateau in 2008, and land prices will begin to correct in **2009**. Rental rates are also expected to hold steady in **2009**, except for new developments," adds Iwaschuk, who says the "wait-and-see attitude will extend at least through the first half of **2009**," and "those developers who are still building on a speculative basis will be rewarded as the **forecast** for Edmonton remains positive."

TORONTO

Office

"The office vacancy rate for all classes of space across the Greater Toronto Area (GTA) remained surprisingly low throughout 2008 at approximately 6.8%, maintaining a landlords' market. However, this landlords' market will be short-lived," comments Mark Fieder, President and Managing Director of **Avison Young** (Canada)'s Toronto office. "Companies are adjusting for deteriorating business conditions and sublets are on the rise in the GTA, having increased significantly through the fourth quarter of 2008." Fieder says this sublet trend is expected to continue and, combined with the pending delivery of new office projects over the next 24 months, will swing the market strongly in favour of tenants in **2009**.

Developers are planning to add approximately 3 msf of new class A office space to Toronto's financial core toward the end of **2009** and into early 2010, which will provide tenants (particularly those who have been seeking larger blocks of contiguous space) with more options. As vacancy rates begin to rise in late **2009**, asking rental rates will correspondingly decline.

Industrial

Meanwhile, industrial users in the GTA were hit hard in 2008. "The manufacturing sector was hurt by the appreciation of the Canadian dollar, lower-cost manufacturing in Mexico and China, and the suffering automotive industry. The warehousing and distribution sector continued to pick up the slack, absorbing most new product that came to market throughout 2008," points out Martin Dockrill, Managing Director, **Avison Young** (Canada)'s Mississauga office.

In **2009**, supply is anticipated to exceed demand and rental rate increases are expected to retreat. "Tenants will look for savings in their real estate costs and landlords will be forced to lower their rental expectations and provide greater flexibility," states Dockrill. "Proactive tenants will look to achieve efficiencies by modernizing their real estate while others will focus solely on gross rents, capitalizing on a tenants' market."

OTTAWA

Office

Ottawa's overall vacancy rate grew marginally in 2008 over 2007 due to continued uncertainty in the technology sector. "The downtown core's vacancy continues to be tight and recent RFIs (Request for Information) by the Department of Public Works and Government Services Canada (PWGSC) suggest this situation will continue in **2009**," comments Michael Church, Managing Director of **Avison Young** (Canada)'s Ottawa office. "Of note is that the last RFI issued by PWGSC included a 300,000-sq.-ft.-plus requirement in the Kanata submarket, which marks the first time this market was included in the information call for a requirement of this magnitude. This is a positive development going forward into **2009**."

Industrial

Ottawa's Industrial market continued in transition through 2008 with former low-ceiling product being converted to flex office space in a number of locations. New development was limited to Morguard's Kanata development of 62,500 sq. ft. in 2008, which is still currently vacant. "Development costs, financing issues and land prices will impact speculative development in **2009**," states Church. "Such development seems to be limited to self-storage projects being undertaken by Dymon Capital among others in the region with several locations scheduled for openings in **2009**."

MONTREAL

Office

Significant demand for office space in downtown Montreal pushed its vacancy rate down to 5.4% at the end of the third quarter of 2008. This represented a significant reduction in available downtown space as Montreal has not seen a vacancy this low for years. "As a result, quality space has become increasingly more difficult to find and options for tenants are limited as we begin **2009**," notes Tom Godber, Managing Director of **Avison Young** (Canada)'s Montreal office.

"Currently, Montreal is the only major city in Canada with no major office construction projects. However, given the tight market and limited options for tenants, we anticipate the start of at least one or two construction projects in

2009," confirms Godber. A number of office projects have been announced in Montreal but those most likely to move forward include Candere's development of 1201-1215 Phillips Square, Hines' development of 900 de Maisonneuve, Magil-Laurentienne's proposed office or mixed-use building at 701 University, and Westcliff's phase two of Place de la Cite Internationale.

Industrial

Meanwhile, Montreal's lagging manufacturing industry has moved the industrial market away from manufacturing to logistics and distribution industries. "Because these latter industries require smaller buildings with larger clear heights, vacancies have decreased for smaller buildings and increased for older, larger buildings that were once appropriate for manufacturing facilities," explains Godber. Many developers are demolishing or renovating older buildings as land is limited. As a result, companies now have the opportunity to build custom facilities that will have all the amenities they require."

Godber says industrial vacancies are anticipated to increase slightly in 2009 as older, larger buildings linger on the market due to the fact that demand for such buildings is no longer there. Vacancies for smaller buildings, on the other hand, are expected to decrease as demand from logistics, distribution and aerospace industries remains strong in 2009. He further comments: "We anticipate a general slowdown in industrial construction activity as financing becomes increasingly difficult to come by."

Founded in 1996, **Avison Young** is a full-service commercial real estate company and the only national, Canadian-owned, partner-managed real estate brokerage firm in the country. With offices in Vancouver, Edmonton, Calgary, Regina, Winnipeg, Mississauga, Toronto, Ottawa, Montreal, Quebec City and Halifax, **Avison Young** ranks among Canada's leading national commercial real estate organizations. The firm 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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