Reprinted from

FINANCIAL POST

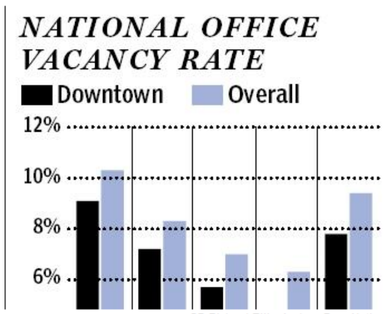
NATIONAL POST, TUESDAY, SEPTEMBER 22, 2009

REAL ESTATE

Office Vacancy Climbs

Downturn, new supply to drive rate to 9.4%

Garry Marr, Financial Post



OFFICE VACANCIES SPIKE. CB Richard Ellis, Andrew Barr, National Post

The sluggish economy and an oversupply of new office buildings are being blamed for a sudden jump in the office vacancy rate to a level not seen since 2005, according to a new study.

CB Richard Ellis Ltd. says the national vacancy rate is projected to rise to 9.4% at the end of the third quarter, a sharp jump from the 6.3% rate a year ago.

Nowhere has the increase been felt more acutely than in the boom/bust economy of Alberta, where just two years ago tenants were scrambling to find 20,000 square feet of contiguous space. Today, they have their pick. The rate in Calgary has climbed to 13.1% from 4.7%

"It's tough, it's tough. I believe over any period of time Western Canada looks better than Central Canada, but there is a dislocation right now," said Michael Cooper, chief executive of publicly traded Dundee Real Estate Investment Trust, whose holdings are heavily concentrated in Western Canada.

Mr. Cooper said Calgary's economy had been booming and that led to insatiable demand for office space. "People were getting an iPod just for showing up for work at Tim Hortons," he said, jokingly.

According to CB Richard Ellis, the party is all but over in Calgary. The city is gushing with new office space as supply is due to come on stream in the next couple of years as demand wanes because of falling commodity prices.

Commercial rental rates have begun to fall in the city. The average net rent for Calgary class A office space is expected to drop to $25.19 per square foot per year at the end of the third quarter from $35.98 a year ago. Business has been unloading space at record rates and 40.7% of the vacant space on the market is now sublet space.

Lower rates are now the way to fill a building. "It's not great," Mr. Cooper said, "but we are in it for the long term."

Most cities in Canada have been hit by the double whammy of a decrease in white-collar jobs and an increase in office supply.

"Canada's downtown office market is doubly burdened by a surplus of space, with buildings currently under construction and a swell of inventory that will continue to be added to the market," said John O'Bryan, vice-chairman of CB Richard Ellis, adding that much of the new inventory has jet to affect the vacancy rate.

"These conditions of burgeoning space are expected to negatively impact vacancy rates for some time, at least until economic fundamentals are restored and employment figures resume in sectors that typically occupy downtown office space," Mr. O'Bryan said.

CB Richard Ellis expects the vacancy rate to climb even more in the next quarter and well into 2010.

What it means for tenants is deals galore. "We are 100% in the driver's seat," said Stan Krawitz, president of Real Facilities Inc., which represents tenants. "The real driver will come for tenants with leases expiring in late 2010 and early 2011."

Toronto will see four million square feet now under construction finished by the end of 2011. About 60% of the space is already committed to tenants, but close to 90% of those so-called new tenants are just moving from one building to another.

Dean Newman, principal of Cresa-Partners, who works on behalf of tenants, said the Toronto situation is going to get a lot worse than has been anticipated. He said the current statistics do not include all that new office space.

"The numbers may show vacancy rates of 9.9%, but if you project what's going to happen, the vacancy rate looks more like 15% to 16%," he said, adding that means tenants are going to get inducements such as free rent or upgrades to their facilities. "[Based on absorption], there is 15-year to 20-year supply in Toronto's downtown core."

Benjamin Tal, CIBC World Markets senior economist, said you can forget about any quick fix for the commercial real-estate market because it will depend on job creation, which always lags an overall economic recovery. "We're just in the beginning of this. We have very limited demand and new supply. You don't have to be an economist to know what's going to happen," he said.

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