Western INVESTOR
COMMERCIAL REAL ESTATE, FRANCHISES AND BUSINESS OPPORTUNITIES
MARCH 2016

Year of the real estate deals in big-city Alberta

FEATURE | Discounted lease rates available for even Class A office space but – as during the last downturn – they may not last for long in either Edmonton or Calgary

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With a glut of space on the market and a gloomy outlook for oil prices, this may be the year to land a towering deal in the markets of both Calgary and Edmonton.

Edmonton saw more than 207,000 square feet go dark in 2015, driving the overall office vacancy rate to a 15-year high of 11.7 per cent, according to **Colliers International**.

But Colliers, like others, contends the downturn will not last.

"[The glut] does not appear to a result of layoffs and downsizing, but rather a temporary pause in tenant growth," according to the real estate agency's most recent report.

In Calgary, the downtown office vacancy rate has shot up to 14 per cent and net rents have plunged. Insiders say that office tenants are being offered generous incentives to take or retain space.

But others say Calgary's current slump – and recovery – could mirror what happened in the city nearly a decade ago.

"What is very similar in comparing January 2009 to January 2016 is the amount of inventory in the office market that was under construction," said **Dan Harmsen**, vice-president and associate broker for **Barclay Street Real Estate**, which recently released reported on Calgary's office sector for the final quarter of 2015.

More than three million square feet of Calgary office space was returned to the market last year and seven million square feet is vacant in its downtown towers. | SHUTTERSTOCK

"Back then we had Eighth Avenue Place, which was another million square feet. We had a few other buildings under construction, as The Bow Building was nearing completion. Now we've got Brookfield Place I, the TELUS Sky tower and the Manulife building (707 Fifth)."

Over 3.9 million square feet of office space in downtown Calgary was returned to the market in 2015 as the vacancy rate soared by 9.82 per cent year-over-year from the fourth quarter of 2014 – finishing 2015 at 17.29 per cent, according to Barclay's report.

"We are going to be having inventory coming on the market when we don't need it," said Harmsen. "As a result, as in January 2009, people are anticipating that this office space won't be absorbed for a very long period of time.

"There's an assumption that office rental rates will be discounted for the foreseeable future. Boy, were they wrong in 2010," Harmsen said.

A-class downtown office rates have been affected the most as a result of subleasing and contraction in the oil and gas sectors, which are heavily concentrated in the premier buildings downtown.

"Most junior and mid-caps are in A-class buildings downtown," said Harmsen. "They're the ones that are shedding most of their space in the form of subleases, which then impacts the ability of A-class landlords to do transactions."

The most attractive incentives are being offered on the sublease market, as there are lots of landlords that don't have expiries or headlease exposure for a number of years and aren't yet in a position where they need to offer steep discounts, Harmsen explained.

Still, he expects "some continual fantastic opportunities" for renters in the sublease market.

Harmsen has seen office rents drop from 30 per cent to 50 per cent on a net basis.

Office properties in the Beltline and suburbs aren't as dependent on the oil and gas sectors. Some buildings are still taking hits, however.

Harmsen said there are no subleases available for 1,000-square-foot spaces in the Beltline, and headlease deals are in the mid-teens dollar-wise. Meanwhile, three-year subleases for spaces of 10,000 square feet or more can be obtained for less than $10 per square foot.

Buildings already under construction will continue and those in the pre-lease stage will move forward as long as they hit their target rates, according to Harmsen. While labour costs have come down, the low value of the Canadian dollar has increased the price of materials, so construction costs aren't dropping.

"In order to build a building, rental rates in the suburbs still need to be in the mid- to high-20s, and it depends on what type of building you're building in the downtown core," said Harmsen.

Harmsen can envision the repurposing of certain assets if the current economic situation continues for the long-term.

Despite the current fog hanging over the Calgary office market, Harmsen believes the city still offers great opportunities. "Our occupancy costs are at an all-time low and our labour costs are going down for the first time in 20 years."

Edmonton does not have the sublease problems of Calgary, with just 1.4 per cent of sublease vacant, compared to 7.5 per cent for its southern neighbour, according to Colliers. ■

With files from Steve McLean, Property Biz Canada