FINANCIAL POST

NP Geoffrey Morgan, The Canadian Press
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# Landlords scramble to fill near-empty skyscrapers dotting Calgary skyline: 'We're not overbuilt, we're under-demolished'

Commercial real-estate firms estimate the overall vacancy rate in the city core to be close to 22 per cent — double what developers call a market in balance — but a handful of buildings, such as bankrupt Sanjel Corp.'s old headquarters, are virtually empty.

CALGARY — Near-empty skyscrapers and rising vacancy rates are pressuring landlords to offer big incentives – such as a year of free rent or money for renovations – to keep a shrinking number of tenants in their downtown Calgary towers.

And with more than two million square feet of new construction set to become available, the soft market for Calgary landlords is expected to last for as long as a decade.

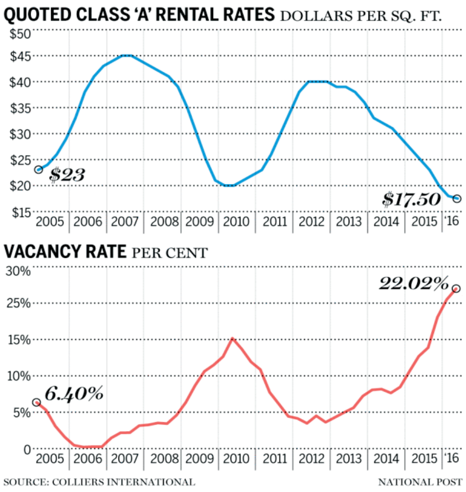
"Not only are the rental rates lower, but the inducements to individual tenants for improvements and/or free rent are all going up," said Randy Fennessey, president and partner with Colliers International in Calgary.

Fennessey said that landlords would rather sign a lease with higher contractual rental rates and then give tenants the option of moving in a year early free of charge rather than drop their prices. Tenants in the energy sector currently looking for space, he said, have been taking those deals with the expectation that the worst of the downturn is over.

"That's a common negotiating tool today because a lot of tenants, particularly in the energy sector, are trying to control their general and administrative costs," Fennessey said.

Calgary Economic Development president and CEO Mary Moran said 25,000 people that had been working in the city's downtown core have lost their jobs in the past two years, which has contributed to the city's empty office towers.

CALGARY DOWNTOWN OFFICE MARKET




Moran said she was concerned about those buildings that are more than half empty and her organization is actively trying to encourage companies outside the province to relocate to Calgary now to capitalize on falling rental rates and available labour.

Commercial real-estate firms estimate the overall vacancy rate in the city core to be close to 22 per cent — double what developers call a market in balance — but a handful of buildings, such as bankrupt Sanjel Corp.'s old headquarters, are virtually empty. That will increase the city's overall vacancy rate and put pressure on landlords to offer big incentives to fill the space.

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This week, TransCanada Corp. put 11 floors of office space back on the market in an attempt to find a tenant to sublease their office space in a 25-floor building. As TransCanada moves out and consolidates its staff at or closer to its headquarters, the older building's vacancy rate will rise to over 50 per cent, with more floors available in 2017.

It's far from the only building with sky-high vacancy.

A few blocks south, Brion Energy Corp. is poised to move out of Encana Place and into a new tower, which would leave its current address more than 90 per cent empty and only the building's landlord, Aspen Properties Ltd., in the 30-storey tower.

Many other towers are over half empty and energy producer's efforts to control real-estate costs is putting pressure on landlords at both old and new buildings.

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Only one tenant, for example, has moved into Eau Claire Tower, a 25-floor building completed in 2015. Peyto Exploration and Development Corp. occupies two floors in the glass tower, which is fully leased but currently sits 90 per cent empty.

Corine Bushfield, senior vice-president and chief financial officer at Long Run Exploration Ltd., said he company is planning to move into the Eau Claire Tower next summer but noted that Long Run, like other oil and gas producers, is looking "at all dollars and costs that the company has, and if there are ways to save we are looking to do that."

Dan Harmsen, partner and vice-president at Calgary-based Barclay Street Real Estate said, "this is a tenant business, this is not a building business. Landlords have been doing everything possible to keep tenants and keep tenants positive in these trying times."

The clamshell bucket being used to excavate the future site of the Telus Sky building hangs from its crane with the Calgary Tower in the background.

At the same time, he said, "there will be a flight to quality," as has happened in many other energy and commodity price cycles.

He said some landlords have reinvested their money in older buildings, doing renovations and maintaining upscale office amenities in order to hold onto tenants as brand new buildings have opened. Those that haven't face more challenges.

"It's those landlords that have rested on the fruits of the oil and gas industry for the last 15 years that haven't felt the need to reinvest in their properties that are going to be hit the hardest," Harmsen said.

Vacancy rates are projected to rise further as three new towers – Telus Sky, Brookfield Place and Manulife's 27-floor building on 7th Avenue – will add close to 2.5 million square feet of space to the market by 2018. Each of those buildings could open to the market with large blocks of un-leased space.

"There's all these different pressures all compounding on each other and, the point is, the Calgary office market is going to be soft for a while," said Sandy McNair, a data curator and analyst with real-estate market research firm Altus Group.

A second quarter market update from Colliers notes that "at historical absorption rates, it could take five to 10 years before returning to a balanced downtown market vacancy rate of eight per cent to 10 per cent." If energy prices rise, and activity returns to 2012 levels, the report said the market could return to balance sooner.

"I think what we'll hopefully see is some of those older buildings, the ones built between '78 and '82, will go looking for another life," McNair said.

Given the number of older buildings that are well over 50 per cent vacant, Moran said her organization is concerned and is discussing plans with real-estate executives to turn older office towers into condos or apartments.

She also notes that some in the real estate industry have discussed tearing down older buildings given vacancy rate projections.

"There are a lot of people in Calgary that would say, 'We're not overbuilt, we're under-demolished.' So there are some products that probably could go," Moran said.