FEATURE Sell signals flashing as big buyers drive commercial real estate prices through the roof

Commercial outlook 2012

Photo: Village at Thunderbird Centre

Sunlife Financial recently bought the 318,000-square-foot Village at Thunderbird Centre, Langley, for $148 million: some realtors say it is a harbinger for institutional sales into 2012. Other major malls will see millions of dollars in renovations this year.

FRANK O'BRIEN/PETER MITHAM

WESTERN INVESTOR

When **Helmut Pastrick** took the podium to address Metro Vancouver developers in November, the chief economist at **Central 1 Credit Union** warned of "considerable headwinds" facing the commercial real estate market in 2012. His outlook for this year was far from inspiring.

"Obviously, Europe is the main risk, but I think B.C. and the Metro Vancouver area economy will perform at a kind of middling pace," Pastrick told the NAIOP meeting.

Some B.C. commercial realtors say the headwinds are already howling, and it is a cold wind indeed.

"The market is frozen," said a **Re/Max** commercial realtor on Vancouver Island. "Vendors are fine to sit and wait because they have no vacancies." Vancouver Island commercial real estate sale volumes through MLS were down more than 50 per cent in November of 2011, compared with a year earlier, reports the **BC Real Estate Association**, and most realtors say it is lack of product, not buyers, that has cooled activity.

But sell signals are flashing, even from Vancouver's rock-solid multi-family and industrial sectors, a sign that some insiders believe this may be a year to cash out before things get any worse. As one leading commercial realtor quietly told *Western Investor*: "Prices have peaked. I am telling my clients to sell, and sell now."

The valuations are up in all sectors. In a report on the Metro Vancouver industrial sector over the past year, **Grover, Ellis & Co. Ltd.**, found that the average per-square-foot sale price had shot up 22 per cent.

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In the multi-family sector, the average price of a Vancouver apartment building has soared to more than $257,000 "per door," according to a study by **HQ Realty Ltd.** Even suburban markets are seeing record-high prices, despite skinny capitalization rates in the 3 per cent to 4 per cent range. It means now may be the time to be liquidating.

"Common sense dictates that if you are contemplating selling your asset, there would not be a better time than now," said **David Goodman**, a multi-family specialist with HQ. "Demand remains robust. How long will the seemingly insatiable appetite for real estate remain with these historically low cap rates?"

High demand

Demand is certainly robust. There were more – 906 – commercial real estate sales in Metro Vancouver in the first 10 months of last year than in Calgary and Edmonton combined as Metro sales volumes reached $2 billion. This was down from $2.3 billion in same period in 2010, when a number of large retail transactions were made, reflecting intense demand from deep-pocket investors.

Real estate investment trusts (REITs) accounted for 35 per cent of all commercial sales in Canada last year, and pension fund acquisitions were up 22 per cent from 2010, according to **CBRE Ltd.**

In Metro Vancouver, "interest from Canadian institutional investors and private buyers has increased along with demand from private Asian investors," said **Mark Renozi**, executive vice-president and managing director of CBRE's Vancouver office. "The level of interest and development activity is expected to stay strong in the Vancouver market in 2012 and 2013."

REITs bought $62 millon worth of offices, $59 million retail properties and $58 million in industrial real estate across Metro Vancouver in the first half of last year alone. Institutional investors purchased $39 million of office assets, while publicly traded non-REIT companies spent almost $71 million on office and retail product combined.

Some local commercial yields are off the charts. A survey of the top 20 office buildings in Vancouver shows that net annual rental rates have reached an average of $46 per square foot in downtown towers – the highest since 2008 – and were averaging $38 per square foot in mid-rise office buildings by the end of 2011.

The strength of the office sector – three new towers will be built by 2015 – is surprising to some, who note Vancouver's biggest office tenants are law offices, not resource companies or manufacturers. As one realtor remarked, "We are doing our own laundry."

And, based on projections, there will be little growth in the resource sector to encourage office takeup this year. The **BC Economic Forecast Council** has lowered its growth projections for the province next year in light of the worsening global economy. The council expects B.C.'s GDP growth to be 2.2 per cent in 2012, unchanged from last year.

Office towers

The potential of a slower economy doesn't faze **Gordon Wylie**, senior director of development for **Ivanhoe Cambridge**, which is building the first large office building in Metro Vancouver since 2007 – its 29-storey Metrotower III in Burnaby – to complete by 2014. Wylie expects to attract even downtown tenants to his new Class AAA LEED-rated space next to Metrotown mall. "There is a lot of lease roll-overs coming up in the period before 2014 so we think we are well positioned," Wylie said.

Bill Elliott, a principal and office specialist with **Avison Young** notes that three new office towers in downtown Vancouver (see our office report in this issue) will benefit from pent-up demand from existing tenants looking for better space. Since none of the new downtown towers will be complete until 2015, this year will continue as a tight office market, he said.

"We are going to see continued pressure on vacancy downtown and continued upward movement on lease rates in 2012," Elliott said.

Elliott, however, doubts that strata office space will be strong this year in the downtown area. "It makes more sense in the suburbs," he said.

Elliott agreed that the overall commercial market is defined by "great entities chasing little product. It is very difficult to find property [for sale]," he said. He explains that owners with very deep pockets who don't need to liquidate hold much of the prime commercial property.

"[These] vendors face two problems," Elliot said. "Sure they could get a good lift but, one, there is a tax issue and, two, there is nothing to buy."

Only the unthinkable could convince such owners to sell, Elliott suggested. "It would need to be something on a global scale," he said, such as an economic crash in China.

Industrial

Metro Vancouver's industrial market also offers a sell opportunity, particularly for owners who hold less than Class AAA product. Buyers are attracted by low interest rates, vacancies in a healthy 4.5 per cent range, steady land prices and strong leasing rates.

"If you've got something that is not perfect, say a single-tenant building or an older builder,

Even second-tier industrial sites, such as Gloucester Industrial Park in Langley, are seeing record-high prices from multiple bids.

buyers will apply a lot less of a penalty now than if the market backs off," said **Michael Farrell**, an industrial specialist with Avison Young. He pointed to one recent sale: an 85,000-square-foot, single-tenant warehouse on a short lease at Gloucester Industrial Estates in Langley. The building sold for $9.5 million, which Young estimates was at least half-a-million dollars above what it would have fetched a year ago.

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> 2: there is nothing to buy.

Farrell said the message to owners of such "non-beauty-queen buildings" is blunt. "Now is the time to get rid of it, because you are going to achieve really strong pricing. Prices may back off more for this asset than a triple-A property [in 2012]," he said.

Timing could be important. According to an Avison Young report on the industrial market, property tenants and owners are keeping an eye on the economic situation in the United States and Europe as they decide on expansion or retraction this year. In other words, those who think external markets will worsen may be inclined to sell.

Retail

One real estate sector looking strong into this year is retail, despite a recent waning of U.S. retailers looking for space and a faltering of lease rate increases along some prime strolls. Retail spending in B.C. is expected to remain close to the $24.4 billion levels of 2011. **BC Central One Credit Union** also forecasts that B.C.'s unemployment rate will rise modestly to around 7.2 per cent this year, which should have little effect on consumer spending.

In Vancouver, the retail attention is focused on the Robson Street/Burarrd Street/Granville Street areas, which may be a harbinger for a retail churn in 2012.

High-profile U.S. retailers set to open stores on Robson Street include **Apple Inc.**, **Forever 21** and **Crate and Barrel**. Meanwhile, **CTV** will partially vacate 80,000 square feet this summer in the **HMV** Building at Burrard and Robson. As well, 171,000 square feet of new retail space will complete this year at Granville and Robson. Downtown leases rates have declined from the peak, agents say, with even prime Robson Street space at around $160 per square foot, annually, down from $200 in 2009.

Suburban markets are seeing a strong U.S. influence. North Carolina-based **Lowe's Companies Ltd.** opened its first B.C. store in November – two weeks after it announced store closures in the U.S. Its new 117,000-square-foot store is in the Queensborough area of New Westminster.

"We believe that there's plenty of room for good retailers in what is a good Canadian market," said **Ramona Paul**, who is the manager of the chain's Queensborough store.

Victoria industrial market strengthens

The industrial real estate market in Victoria has seen the vacancy rate fall to 3.4 per cent, but it is down to 0.4 per cent in the Esquimalt area, which is expected to see demand growing due to a new federal government shipbuilding contract.

This year will see more than 500,000 square feet of new industrial space breaking ground, led by 200,000 square feet of warehouse space for the **Department of National Defence** in Esquimalt, according to a report from **Colliers International**.

Other large American retailers are looking to follow Lowe's strategy of expanding into B.C. Some chains to watch according to retail analysts include: **Nordstrom Inc.**, **Dick's Sporting Goods**, **Kohl's Corp.** and **J.C. Penny Co. Inc.** U.S.-based giant **Walmart** is constructing a 151,000-square-foot outlet in Port Coquitlam and a 95,000-square-foot store in **Mission**, both expected to open this year.

Investments in retail property slowed last year, but appeared to be picking up steam as the year ended.

In October, for example, **Sunlife Financial** bought the 317,000-square-foot Village at Thunderbird Centre in Langley for a reported $148 million, the largest retail sale of the year Weeks earlier, a $250 million makeover of Guildford Mall in Surrey was announced, and other old malls are also being upgraded.

Again, some say that owners of retail property may look to this market as a sell opportunity. "[The retail market] is priced to perfection," said **John Horton**, president of **Shape Properties.**

But don't sell because of a potential downturn, cautions Pastrick.

"I don't expect a recession to play out in the U.S. or the global economy," he said, acknowledging the recession of 2008 had taken many unaware, too. But he made sure to tell the real estate community that even if the short term doesn't deliver dramatic gains, the future is bright: "The long-term trend is up."◆