PROPERTY REPORT

Downtown lights burned bright in 2010

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Despite predictions to the contrary, 2010 was not the year the Canadian office market collapsed under the weight of the recession.

In fact, 2010 will likely be remembered as a pleasant surprise. Few analysts anticipated the relatively strong – in some cases remarkably robust – performance in this economically sensitive sector, and many had to revise or completely reverse their predictions.

Driven by huge demand for office space in major centres such as Toronto and Calgary, downtown office vacancy rates, nationwide, declined from 8.5 per cent in the fourth quarter of 2009 to 8 per cent in the same quarter this year, according to data compiled by commercial real estate consultants CB Richard Ellis Canada.

In that same period, the percentage of vacant space on sublease nationwide – a telling sign of overall economic confidence across the business sector – declined significantly, from 27.4 per cent to 19.9 per cent.

“The two markets people had pegged for trouble were downtown Toronto and Calgary, not so much for lack of demand but due to the large amounts of supply coming on in both markets,” says John O’Bryan, the Toronto-based vice-chairman of CBRE Canada. “Fortunately through all of 2010, what you saw was very healthy demand in both of those markets.”

Toronto experienced what Mr. O’Bryan calls “the year of the bank.” The financial services sector and its myriad support industries back-filled existing space and gobbled a lot of the approximately 3.2 million square feet of space in new office towers, which came on stream in the city’s downtown core. All of these are approximately 90 per cent leased.

A similar story played out in Calgary, where year-over-year fourth-quarter vacancy rates dropped from 15.5 per cent to 13 per cent, despite several new office complexes, such as 8th Avenue Place, flooding the market.

What hasn’t fully recovered are downtown class-A net rental rates, which are hovering around $23.93 per square foot, according to CBRE, down from about $24.26 in 2009.

Rents may not have fully rebounded but demand for space in downtown cores did, as central business districts lured tenants away from suburban office complexes. CBRE data shows that suburban office vacancy rates hovered at around 11.2 per cent in late 2010 nationwide, more than three points higher than downtown vacancies.

In other recessions, including the tech meltdown in 2000 and the recession in the early 1990s, which devastated the Toronto market in particular, suburban markets were always quite resilient," says Paul Morse, senior managing director at Cushman & Wakefield (which, in 2009, predicted office real estate vacancy rates to increase in 2010). "But this is the first time we've seen the central business districts outperform the suburbs, largely because of the financial services sector."

But, as Mr. Morse explains, there is more to this shift in demand than merely the strength of one industry. Virtually any company that relies on attracting talented, well-educated workers either has, or is considering, setting up shop where those people are increasingly clustering – the dynamic downtowns of cities such as Toronto, Montreal, Vancouver and Calgary.

He adds that office buildings on or near transit lines have also thrived, as more environmentally conscious, commute-detesting professionals move into swank new condos springing up in Canada's largest cities and ditch their cars.

So, what will be the big stories in the Canadian office market in 2011? Industry experts offer their predictions:

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