Feeling the Squeeze

By Conrad Fox

Tighter markets, higher rents pushing businesses out of downtown

It's getting cramped in downtown St. John's, and you can feel the irritation. "We've been looking for suitable class A space for about two years now," complains one partner of a major professional services firm that, like many in this booming oil and gas town, has outgrown its office. "To date, we've come up empty handed."

It's an unusual situation to be in at the tail end of a recession. Elsewhere in Canada, there is a glut of office space as manufacturing and export-dependent industries turned out the lights and went home. Nationwide, the average office vacancy rate jumped from 7.5 per cent to 10.5 per cent in the last year, according to recent figures from real estate company CB Richard Ellis. Downtown Calgary was the worst hit, with vacancies at 15.2 per cent. Rents have plummeted accordingly.

In contrast, Atlantic Canada's office rental market has weathered the recession well. A greater proportion of relatively secure government and service sector jobs have kept the market dull but dependable, with little of the jumpiness seen out West. "Most tenants are opting to renew in place. There hasn't been a lot of moving around," says CBRE's Paul Moore. "Some tenants are getting larger. Some have shrunk. (But) if there is growth they are trying to do it on site. It's the least cost solution." There have been a few high profile departures, notably of financial service firms from Nova Scotia and call centres from New Brunswick. Even so, Halifax and Fredericton, as well as St. John's, all have vacancy rates in their central business districts below the five per cent that brokers deem "functionally full." Space exists, but is fragmented across so many locations as to be impractical for large offices. Other cities like Moncton and Saint John have rates closer to the national average but theirs did not change dramatically during the recession.

While rental costs have been climbing in most places in Atlantic Canada, they still remain well below those in the rest of Canada. Asking net rental rates in Saint John and Moncton hover around $12.00 per square foot, and $14 in Halifax. In comparison, a square foot can fetch $18.10 in Toronto; up to $24.80 in Vancouver. And while the recent rate rise has caused uneasiness among some tenants seeking to renew their licenses, a study by Turner Drake and Associates shows that rates in Halifax, at least, are still 50 per cent below 1989 levels.

Increases in St. John's, however, have been more dramatic. Jerry Kirkland, senior partner with real estate appraiser ARA Kirkland, Balsom and Associates, estimates that tenants are seeing rates go between three and six dollars per square foot. But, he says, that has to be seen against the context of Newfoundland's exceptional growth. "Until our offshore oil started maturing, the small firms had it pretty good. The reality is they are going to have to pay more... but they are able to because they are doing better."

If they can find space, that is. The downside to tight rental markets is the congestion, and this has business communities across the region alarmed. Hopes for relief were dashed in St. John's this March when construction firm Fortis withdrew a proposal for a 15-storey downtown tower. The decision was made after a bitter public battle with city council over aesthetics that still has many upset. "If there is no space for people to move here, or hire here, perhaps they (businesses) will go to Calgary or Halifax or Houston," says Jo Mark Zurel, vice-Chair of the St. John's Board of Trade. "Our sense is that if there is no space ... that slows development and slows progress."

Creating new downtown space has been fraught with difficulties in Halifax too. Armour Group's 85,500 square foot Waterside Centre was narrowly approved last year after an initial rejection by council. A 14-storey office tower and adjoining hotel in front of the historic Citadel has been the subject of four separate studies so far without a final decision. The media has widely reported business leaders decrying the slow pace of growth, but some wonder how viable those projects really are.

"There are a couple of development agreements that can be acted upon tomorrow, but no one is sticking their shovel in the ground," says Tom Carpenter of real estate broker DTZ Barnicke. "They're hesitant ... because in order to build new buildings, people are going to have to pay higher rents. And developers are asking if people are willing to pay those kinds of rents in downtown Halifax?"

In fact, for the last decade, companies have been fleeing the downtown in droves, and heading to the tarmac'd pastures of suburbia. In the first quarter of this year alone, an additional 149,000 square feet of office space was leased in outlying regions like Bayer's Lake, Bedford and Dartmouth. Far from overflowing, the centre, meanwhile, lost almost 20,000 square feet of rented space.

One of those to go was Carpenter's own company, which moved across the Halifax Harbour to Dartmouth. The building is newer and of better quality than the downtown's ageing suites, he says. Plus, taxes are cheaper. But the attraction is not just the deal you can cut with your landlord. Many tenants are now factoring in drive times, parking, and all the stress that goes with them when they seek a location, he says.

"We are in and out of the office multiple times in a day and (downtown) we were losing up to an hour and a half a day just walking back and forth to the car. And for that privilege ... it was over a hundred dollars a month to park."

Does he miss the bright lights? “I tell you, I am just a five minute walk to the ferry (a 12-minute ride from downtown Halifax).”

There are signs that even the relatively mild influence of the recession on Atlantic Canada office space is waning. In Halifax, sublet space as a percentage of total vacancy is declining, meaning businesses already locked into leases are not trying to unload as much space. In New Brunswick, Paul Moore is hopeful. “In the last three months, we are starting to see people arrive. I don’t mind saying there was a flurry in the (call centre) industry and that was nice to see.”

Even if Atlantic Canada made it through the recession relatively unscathed, one thing is not likely to improve soon: easy credit for developers. Banks are nervous, says Greg Brewster, vice president of Office Leasing at Colliers International (Atlantic) Inc. “They really need bums on seats. They need to see physical people in place,” says Brewster. “It can’t be any part of any formula about what it might be when it leases up.”

Which makes landlords more anxious than ever to get tenants in through the door. Even though prices are rising, they may be more open to negotiate inducements such as renovations and retrofitting. That, says Brewster, is where media attention on the city centre can be a distraction for tenants. “It’s a bit of an anomaly right now. It’s really a tenants’ market. If it’s a smart tenant. If it’s not a smart tenant, landlords can certainly, easily, make it look like it’s a landlords’ market. All they need to do is get sound bites from the media, and most of the sound bites are ‘we’re tight, we’re tight, we’re tight’.”

Other cities in Atlantic Canada may soon find themselves in the same situation, but the transition won’t be easy. Back in St. John’s, Jerry Kirkland admits: “We are very proud of (it). If you ever get to come here, it (downtown St. John’s) is very small. It has the hill going down to the harbour. That’s where the better restaurants are. And that’s where the major firms are.”

Then he adds: “There *is* a move afoot. There has to be a move to the uptown area. Land is cheaper. The road works are better. That will happen.” | **ABM**