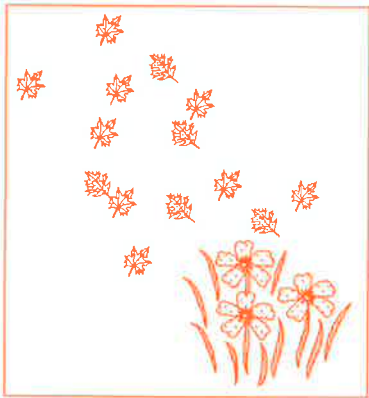
TURNER DRAKE & PARTNERS

Newsletter

Vol. 2 No. 43 (Late) Summer 1992

UPDATE



Uh oh! The leaves are turning; it's the Fall, we must have had summer! Let's face it, the past few months have had a dampening effect on even the most gregarious Atlantic Canadian: the recession like the rain, refuses to go away. Oh well, onward and upward. Let's see how we can assist you squeeze some benefit from the present economic climate. First though, we would like to welcome those readers who are receiving this epistle for the first time. Congratulations on joining the crème de la crème. We have to warn you though, this is serious stuff, we need your undivided attention (and business) so inform your secretary that you are not to be disturbed, grab a coffee, close your office door and read . . .

Our Spring issue (Vol. 2 No. 42) reviewed the sorry state of the hospitality industry in Atlantic Canada and identified how property owners could prise some value adding opportunities out of the current recession. (One client saved themselves $75,000 in taxes by taking our advice . . . there is a silver lining to every cloud . . . well some clouds anyway). This issue attempts to answer the question of whether the ethnocentric (Toronto) view of the world, as expounded by the national media, really reflects the situation in Atlantic Canada. It also reviews the industrial real estate market in the region. All of the articles have been researched with our usual meticulous care and months of navel gazing (through a haze of wacky baccy) . . . And, if you are not richer and wiser as a result of reading them . . . read the damn things again.

Since we are buoyed by delusions of grandeur and have convinced many of you in the far flung corners of the Empire to seek our professional assistance, we have installed a toll free number 1-800-567-3033. Don't be shy; if you have a real estate problem, give us a call . . .

PROPERTY TAX DIVISION

Courtney Bay Inn, Saint John, N.B.
($75,632 in tax savings)

Appeal periods in all four Atlantic Provinces have expired for 1992. If you haven't appealed your current assessment, you are out of luck for this year. Smarten up! Gear up for next year. It is advantageous for us to review your assessment **prior to the appeal** since this eliminates the possibility of the Assessor revising it upwards if you are actually underassessed (some unscrupulous Assessors have been known to do this . . . fortunately they are rare). It has been a rotten two years for business in general and real estate in particular: properties in general are worth only 25% to 75% of their pre-recession value. Overbuilding (thanks to ACOA), cross border shopping, the restructuring of the economy due to the Free Trade Agreement and globalized competition, and the recession, have combined into a potent cocktail which has devastated demand for real estate. Your property assessment is based on its market value, so take advantage of the present situation and **turn the recession to your advantage by using it to reduce your tax load.** We are now saving clients about $1 million a year (imagine what that is going to do to **your** taxes unless you appeal too). If you haven't appealed your assessment since the recession began and you fall into any of the following categories you are probably overassessed:

- **(a)** **Hospitality industry** i.e. hotel, motel, restaurant, amusement park.
- **(b)** **Shopping centre** - especially if it is close to the U.S. border, or is a mall which has suffered sustained loss of rental income, eg. due to the retail bankruptcies.
- **(c)** **Industrial properties** especially in areas where ACOA has been active.
- **(d)** **Automobile dealerships**
- **(e)** **Office buildings** where the vacancy rate or bad debts have increased substantially over the past twelve months.

Provincial and municipal governments are strapped for cash so you can expect to see further increases in your tax rate in the future. New Brunswick and Prince Edward Island have already incorporated their occupancy tax into the real estate tax rate and Nova Scotia's Department of Municipal Affairs has now adopted the recommendation "that municipalities be given the option to cease collecting business occupancy tax" . . . which is newspeak for saying that property owners in Nova Scotia are to shoulder the burden of the business occupancy tax too. **It is anticipated that commercial tax rates will increase by 30% as a result**. The aggregate tax load borne by a tourist orientated facility (which currently pays a low rate [25%] of business occupancy tax), or a property with vacant space, will be greater under the new system than the old. Overall, the impact will be to increase the risk of owning commercial property since the tax load on vacant space will increase by 30%. We anticipate that there will be a downward adjustment in real estate values as a result and that this will be particularly marked for properties rented on a "gross lease" basis unless legislation is introduced to allow the landlord to amend the lease.

The moral of this tale? Don't delay, take preventive action, get us to review your assessment **now**.

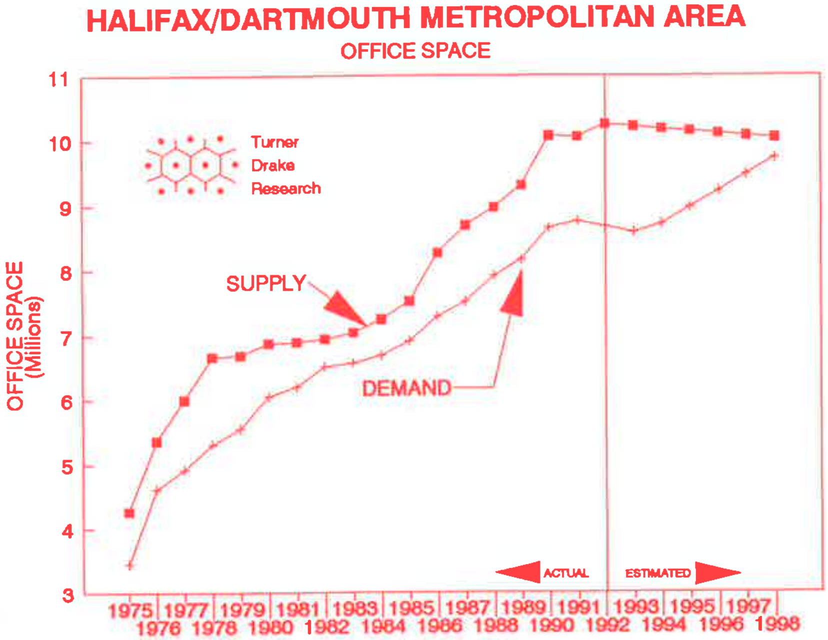
CONSULTING DIVISION

REAL ESTATE - THE LAST SUPPER?

It is not difficult, after a steady diet of Toronto's NATIONAL NEWSPAPER, to reach Chicken Little's conclusion that the sky is falling in; insofar as real estate is concerned anyway. First we had the Campeau saga, nicely timed to coincide with the fruits of the United States' Savings and Loan fiasco. Having been served with this entrée, the recession was dished up as the main course with a Free Trade Agreement, and the concomitant restructuring of the Canadian economy, as the side order. The Head Table, Olympia and York, developed a severe dose of food poisoning and their guests, Bramalea, Cadillac Fairview, et al, doubled over with indigestion. Institutions, such as the life companies and pension funds, who had blithely followed the smart money into real estate found that it was a lot more difficult to leave the table, than to join it. Dessert for them, came flambéd. What a meal!. No wonder nobody has the stomach for coffee (or can afford liqueur). And this apparently is only the beginning: from now on it's strictly french fries and hamburger (without the relish). Bacchanalia is out, Calvinism is in. We can look forward to declining demand for goods and services from an aging workforce grimly intent on saving for retirement. Zero inflation, high public and private debt, will mean less of us can afford real estate: and the ubiquitous cellular phone will mean more of us will need less of it. All of that surplus space will stay, well . . . surplus, until the 21st Century. Oh dear! It does sound a mite depressing . . . but is it realistic? We thought that you would like to know, so we did a little research of our own . . .

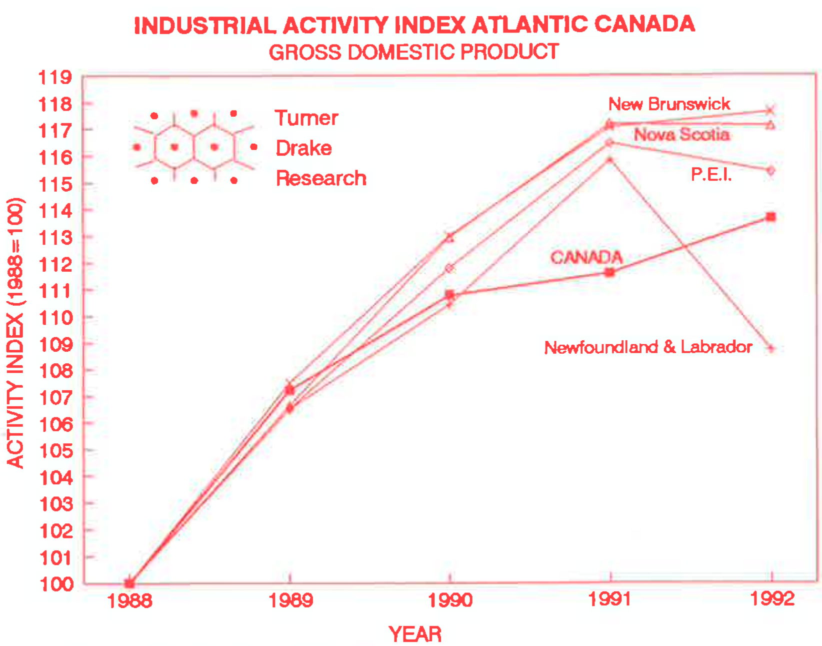
The Office Market - Quo Vadis?

In order to test the worst case scenario, we chose the office market in the Halifax - Dartmouth Metropolitan Area. This real estate market has suffered the greatest impact from the recession, of any market in Atlantic Canada. Net effective rents for some office space in the Halifax Central Business District have fallen from $18/ft.^2$, to a low of $0.64/ft.^2$ in certain instances for triple A tenants such as the Provincial Government. The market collapsed under the combined weight of the recession, a change in office leasing policy by the Provincial Government in favour of open tendering, and the development of several projects for which there was insufficient demand. The Metropolitan Area's ills then, are symptomatic of many major centres in North America: office real estate is accordingly viewed as a "basket case". To test the validity of this assumption we reviewed market absorption rates for office space and set out to forecast when the market would return to equilibrium. (Historic data indicates the latter to be the point at which the vacancy rate is 6%. This is the vacancy rate that triggers an expansion in supply). At April 1992, the Metro vacancy rate stood at 16.2% (Halifax C.B.D. 15.4%) and was climbing: net absorption last year was a negative 86,819 $ft.^2$. We reviewed market absorption rates for the fifteen years prior to the current recession. The evidence clearly indicates no decreasing (or increasing) trend in demand. In other words there is no sign at all of the sky falling in! However, as the graph on the next page shows, whilst demand continued to increase steadily, supply grew inexorably at a greater rate. **It is difficult to arrive at any conclusion other than that a major portion of the present problem could have been avoided if investors had required a more disciplined analysis of each project. Office developments were created to supply a demand that did not exist!** True, the change in Provincial Government policy with respect to tendering for its space requirements and the recession, exacerbated the situation but the basic problem is self made: there **are** no mysterious external forces at work.



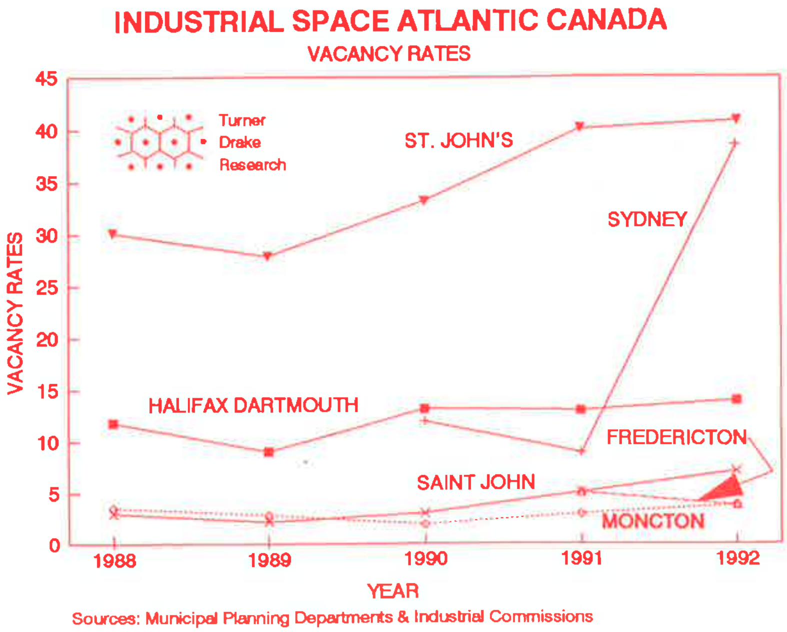
Let us assume that 1992 will be as bad as 1991 and that the economy will extricate itself from the recession only slowly, so that net absorption in 1993 will be half of the annual average rate of the previous ten years, but that the market absorption will recover to its pre-recession state by 1994. Let us also assume that common sense will re-assert itself and that no new space will be built until market rents climb back to the point where it is economic to create it, and that older space will continue to be retired from the market at the same rate as before the recession. By April 1997 the vacancy rate for the Metro Area will have fallen to 6% and rental rates will be at their pre-recession levels. It will be time to expand supply. We predict however that investors, especially the pension funds, seared by their earlier experience, will be slow to respond and that a shortage of space will develop in 1997 and 1998 resulting in an abrupt increase in rental rates. Overbuilding will then occur, and come on stream in time for the recession in the year 2000 . . .

VALUATION - INDUSTRIAL PROPERTIES: A REGIONAL PERSPECTIVE



Sources: Statistics Canada & 1992 Estimates.

If Gross Domestic Product is used as the surrogate for industrial activity, the region has weathered the recession rather better than Canada as a whole. Even Newfoundland was surviving quite well until this year when the slowdown in the Hibernia offshore oil project occasioned by Gulf Canada pulling out, and the failure of the cod fishery, "pulled the plug". This is not to pretend, of course, that the region is not suffering. All real estate markets have been hit, to a degree unprecedented in post war recessions. However, the fact remains that many other areas of the country are affected to a worse degree. Unfortunately there is a school of thought which opines that if things are bad in Ontario, they must be desperate in Atlantic Canada. Since much of the investment in major real estate projects, and virtually all of the financing, emanates from Toronto, the real estate markets in the Atlantic region are catching pneumonia from the cold remedies being taken by Ontario based financial institutions. The result is a self fulfilling prophesy: the property markets in the Atlantic region continue to deteriorate as mortgage financing becomes increasingly scarce. (Some real estate brokers now refuse to handle loans over $1.5 million because they have to be authorized in Toronto). Markets, especially for investment properties worth ≥ $5.0 million have effectively ceased to function: there are no purchasers. This type of property usually sells to institutional or mutual fund purchasers. Those funds that are still buying have opportunities available closer to home or discount this region because individual investments are below their purchase price thresholds. Industrial properties worth less than $5.0 million have also been badly hit. They transact primarily to local purchasers. However, the financial institutions have cut back on the availability of funds and have lowered the loan to value ratio to 60% (versus 75% before the recession). In some areas there is an oversupply of industrial/warehouse space, partly as a result of the downsizing that is taking place with many companies, and the centralization of distribution, resulting from the recession and the restructuring of the economy. Outside the major metropolitan areas of the region, the overbuilding of industrial space which resulted from the activities of the Atlantic Canada Opportunities Agency (ACOA), devastated values and many large (≥100,000 ft.^{2}) buildings have little value. (We warned of the adverse effect of the ACOA grant system on industrial property values, over three years' ago, Newsletter Vol. 2 No. 32).



Nova Scotia - Sydney (Industrial Cape Breton) has been particularly hard hit. Government funding (ACOA) designed to encourage the influx of new industry has contributed to the oversupply of industrial space. Unfortunately much of this new industry had a disturbing tendency to melt away, like snow in the spring, once the grants had been spent. It left behind a plethora of industrial buildings in the 50,000 ft.^{2} to 100,000 ft.^{2} range: far too large to satisfy the requirements of local entrepreneurs who now have to compete with this unhappy legacy and have experienced considerable decline in the value of their property assets as a consequence. A keen sense of humour is a necessary (and common) attribute for any industrial property owner here. We recently valued fourteen industrial properties in Industrial Cape Breton and as part of that exercise undertook a comprehensive analysis of property transactions in the region. The buildings that had sold averaged 16,004 ft.^{2} in size and had an absolute range of 3,200 ft.^{2} to 34,400 ft.^{2}. Their selling price, excluding land, averaged \$20.31 per ft.^{2} of unfinished space, with an absolute range of \$3.80/ft.^{2} to \$38.59/ft.^{2}. External obsolescence, the depreciation in building value due to oversupply resulting from the recession and government grant induced overbuilding, averaged 48% (range 0% to 78%, median 52%). The vacancy rates shown in the graph, are derived from two of the major industrial parks. However, since their total inventory is just under 1.0 million ft.^{2} the failure of a few major occupiers, such as Barkley Systems Limited (121,000 ft.^{2}) in the Sydport Industrial Park, has had a dramatic effect on the vacancy rate. In **Halifax - Dartmouth** much of the rented industrial space is owned by institutions such as Sun Life, London Life, Great West Life, etc. and mutual funds (MD Realty is a major landlord). Whilst their vacancy rates have not scaled the same dizzy heights as those in Cape Breton, there is much gloom and doom abroad in the land. Net effective rents have fallen over the past 12 months by \$0.50 - \$1.00/ft.^{2} and a review of current leasings indicates that landlords are now being forced to offer tenant inducements, such as free rent and leaseholds, equal to a 10% to 30% reduction in the pre-recession rental levels. There is a very soft sales market for industrial properties in the ≤ \$1.0 million range and those properties that do transact, do so at an average discount of 29% (standard deviation 11%) against their pre-recession base line. The market has virtually ceased to function for properties > \$1.0 million. Roycom, a mutual fund, purchased the Remax Building in the Burnside Industrial Park in the spring of this year, but we are not aware of any activity beyond that sale. Since there have been so few sales, especially of institutional property, it is becoming difficult to establish capitalization and other discount rates that will trigger a sale. Vendors are unwilling to sell, except at pre-recession prices, and purchasers will not buy at these figures. The result is a stand-off. Institutional purchaser and mutual funds exhibit little interest at present in investing in Atlantic Canada. Only two of the twenty-four funds we surveyed in August are actively seeking investment properties in the Halifax-Dartmouth area.

New Brunswick - is weathering the recession better than the other Atlantic Provinces, in part due to a pro-active stance by Premier Frank McKenna. He is credited with luring a number of companies to the province. **Moncton**, whose strategic location at the crossroads of the three Maritime provinces has benefited it in the past as a distribution centre, is experiencing something of a renaissance, this time as a communications centre. Its bilingual workforce, largely non-union environment, and wage levels which are well below the provincial average, have allowed it to net a host of companies including Federal Express, Purolator, Camco, Com Dev Ltd., Michelin, Livingston Distribution, Drug Trading, Baxter Drugs and possibly Unitel. C.N. is also bringing about 100 jobs to the area. In total these new industries are expected to add between 1,200 and 1,400 jobs. Despite this activity, industrial property prices have fallen, in part because the majority of the demand emanates from owner occupiers and it is possible to build a pre-engineered steel building for 20% less than its pre-recession cost.

Saint John Industrial space has experienced a fall, both in rental rates and market value over the past twelve months but the consensus is that the market has now bottomed out. There has been a thin market for sales and leasing and there is no indication that this will improve over the next 12 months. **Fredericton** rents have also fallen over the last year, as have market values. Rents have probably bottomed out, but little sales activity is foreseen during 1993 and a further erosion in market values is possible.

Prince Edward Island is praying for the "fixed link": the bridge to the mainland that is widely viewed as the economy's salvation, as much for the short term activity it will generate as anything else. A positive announcement is expected this Fall with a go-ahead in the Spring of 1993. **Charlottetown** rents have been relatively stable over the past twelve months and are expected to remain so, even if the "fixed link" is not built. Sales activity has been very limited and the dearth of purchasers is expected to continue well into 1993. Market values are probably stable. **Summerside** is awaiting the opening of the G.S.T. centre in August 1993 since it will provide 450 jobs. The town also hopes to capture much of the island based manufacturing for the "fixed link". Rents have been stable over the past year on a thin market. Sales too have been limited but industrial property values have probably held their own.

Newfoundland's hopes hinge on Hibernia. The devastation wrought by the closing of the cod fishery and the slowdown in the Hibernia project have had their impact on rents and sales prices and all eyes are now on the Federal government as it seeks to save the Hibernia offshore oil project. **St. John's** has enjoyed limited leasing and sales activity during the past 12 months and the 1.8 million ft.^{2} of industrial space actually in the city has a vacancy rate of 41% (see graph). Rental rates and market values have dropped over the past year and are only expected to recover on positive news about Hibernia. Most companies are in a holding pattern or are downsizing.

We polled the sales and leasing community in each of the metropolitan areas in an attempt to establish the direction each of the markets was taking:-

INDUSTRIAL REAL ESTATE TRENDS									
	Leasing Activity				Sales Activity				
	Net Effective Rents		Leasing Activity		Market Value		Sales Activity		Marketing Period (Months) (Single Occupancy Building)
	Past 12 Months	Next 12 Months	Past 12 Months	Next 12 Months	Past 12 Months	Next 12 Months	Past 12 Months	Next 12 Months	
NOVA SCOTIA									
Halifax/Dartmouth	Down	Stable	Limited	Limited	Down	Down	Limited	Limited	11
Sydney	Down	Stable	Limited	Limited	Down	Stable	Limited	Limited	12
NEW BRUNSWICK									
Saint John	Down	Stable	Limited	Limited	Down	Stable	Limited	Limited	9
Moncton	Stable	Stable	Limited	Limited	Down	Stable	Limited	Active	9
Fredericton	Down	Stable	Limited	Limited	Down	Down	Limited	Limited	11
P.E.I.									
Charlottetown	Stable	Stable	Limited	Quite Active	Stable	Stable	Limited	Limited	12
Summerside	Stable	Stable	Limited	Limited	Stable	Stable	Limited	Limited	8
NEWFOUNDLAND									
St. John's	Down	Stable	Limited	Limited	Down	Stable	Limited	Limited	10

Sources: Real Estate Brokers & Industrial Development Agents, Sept '92.

BROKERAGE DIVISION

Our Brokerage Division focuses its efforts on leasing retail, office and industrial space and selling I.C.I. (industrial, commercial, investment) property and raw land for development. Although we primarily concentrate our efforts on the Halifax - Dartmouth Metropolitan Area we also work with brokers throughout Atlantic Canada and can provide them with additional marketing reach if you wish to buy, or sell a property elsewhere in the region.

Sales - Industrial Properties: Now is the Hour!

We have an excellent selection of industrial properties available ranging in price from $215,000 to $5,200,000. High ratio financing is available (up to 85% of the purchase price) on several of these properties. Mortgage rates, at 8.875% on a five year term, are the lowest that they have been for over 20 years. Given the recent fracas in the European money markets and the fact that both the U.S. and Canadian dollars are under pressure, we anticipate that these rates may start to rise. This may well be the optimum time to buy! Purchasers for industrial properties worth less than $1.0 million have

Photograph courtesy of SunDancer Photo Communications

started to return to the marketplace over recent weeks but most will only consider Burnside Industrial Park, Dartmouth since it is the premier park in the Metro Area. We have a number of properties available there. However, Bayers Lake Industrial Park in Halifax is also worthy of consideration. Prices are lower than Burnside and the park will no longer be an industrial backwater once the Price Club opens (November 1992) and the Lacewood Drive Extension is completed (December 1993). Grubbing for the latter, a four lane highway, is to start this winter and the highway is scheduled to be completed by December 1993. As well as providing a main entrance, the highway will effectively "move" the park into Halifax's burgeoning Mainland North residential area: Bayers Lake will have finally come in from out of the cold. We have a number of properties for sale in this park too.

If you are interested in exploring the possibility of acquiring industrial property, for occupation or investment, call Verna at 429-1811. She has a selection of retail, office and apartment properties available too.

Leasing - Tenants: Think of Us as Your Space Agent

Photograph courtesy of SunDancer Photo Communications

There are now tremendous opportunities for any firm, or individual, interested in renting retail, office or industrial space in Metro. Rents are the lowest they have been in years and landlords are prepared to offer creative leasing packages tailored to specific tenant requirements. Prospective tenants have never had so much choice . . . and therein lies the snag. It is extremely difficult to assess whether you are indeed getting the best deal: it is necessary not only to look at all of the leasing opportunities, but also to interpret and relate them to a common base. It is a source of some wonderment to us, that people will utilize a travel agent to select the best travel plan rather than approach the airline direct, but will risk the direct route when attempting the much more complicated and costly exercise of renting retail, office or industrial space. Less comprehensible still is the practice utilized by some prospective tenants, of approaching several leasing brokers!. Virtually all of the leasing in Metro is on an "open listing" or "co-broker" basis. Most landlords feed information to the brokerage community on a regular basis and details of available space flows into our computer daily. **We offer "one stop shopping" for tenants** and can prepare a Master Leasing Prospectus detailing the alternate spaces that fall within your leasing parameters. We will also get proposals from the landlords on the spaces that interest you. Like your travel agent we are paid by the landlord. However, when you go through a broker like ourselves, you will actually get a better deal than by going direct because the landlord knows that he is actively competing against other spaces for your business. We will also assist you in interpreting the various leasing proposals to ensure that you arrive at an **informed** decision. Leasing can be quite intimidating, especially if you are a new business and we are very cognizant that you need to be in control: you should be the person making the decision. Most tenants only require 1,000 ft.^{2} to 1,500 ft.^{2} of space and we take great pains to make sure that they are as comfortable with us, as somebody who wants 30,000 ft.^{2}.

If you are a new business, or wish to downsize, expand or relocate anywhere in the Metro area, give Russ a call at 429-1811.