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HRM OFFICE MARKET: APOCALPSE NOW?

Demand for office space wanes as new space comes to market: will history repeat itself?

In 1989, new office buildings redefined the downtown Halifax skyline; a year later the world economy crashed and landlords found themselves paying tenants' net rent in order to recoup some of the fixed operating costs in their buildings. Fast forward to 2015: new offices are once again changing the face of Halifax, both downtown and in other areas of the city … just as the world waits for the economic fallout resulting from the financial collapse in Greece, tumbling stock markets in China, and falling world oil prices. What will be the impact on the Halifax office market? That is the question raised by the latest of nineteen rental surveys recently completed by Halifax real estate counsellors Turner Drake & Partners Ltd.

The surveys are thought to be the most comprehensive ever conducted in HRM. A team of trained researchers collected rental, operating expense and vacancy data for 155 office and industrial buildings, some as small as 5,000 ft.^{2}, with an aggregate rentable area of over 11 million ft.^{2}. The survey successfully collected information on 95% of the rental stock polled.

The overall vacancy rate increased from 11.81% in 2014 to 14.01% in 2015. While all classes of office space saw vacancy climb, Class A saw the largest jump, from 14.19% to 17.22%, largely due to new space coming to market. Class A can be considered the vanguard of the market: with just 31% of the total rentable area, it now has 38% of the total amount of vacant space. The vacancy rates for Class B and C are 12.48% and 13.41%, respectively. Vacancy will climb as more new space is added to the market over the next year and demand fails to keep pace due to the teetering economy. This is a bad omen for the net rental rate, which currently averages \$14.03/ft.^{2} overall; virtually unchanged from a year ago. Operating expenses are another story: over the last five years, Realty Taxes and Common Area Maintenance (RTCAM) costs have increased on average by 2.7% compound per year while the Consumer Price Index (CPI) has averaged an annual compound increase of approximately 2%. At the same time, net rental rates have increased on average by just 1.1% compound per annum, lagging behind the CPI. It's a double blow for landlords, who are on the hook for realty taxes and operating expenses in any unrented space. After the 1990 recession, high vacancy drove landlords in Halifax to offer negative net rental rates of \$2/ft.^{2} to tenants willing to pick up the tab on RTCAM. We anticipate that the overall vacancy rate will continue to increase, rising to 15.56% over the next year as new space is brought on stream. In the short term, the quality of the new space is likely to push rental rates up slightly, but this is unsustainable unless demand increases to balance supply. History has demonstrated one potential impact of supply outstripping demand; it remains to be seen how the market will react this time around.

Turner Drake & Partners Ltd. is a multi-disciplinary firm of real estate consultants offering valuation, property tax, counselling, planning, economic intelligence, and Lasercad® space measurement advice, throughout Atlantic Canada; together with brokerage (sales and leasing) services in Nova Scotia, New Brunswick and Prince Edward Island.

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If you would like more information about this topic, or wish to schedule an interview with Alexandra Baird Allen, please call her at (902) 429-1811 ext. 323 or email abairdallen@turnerdrake.com.