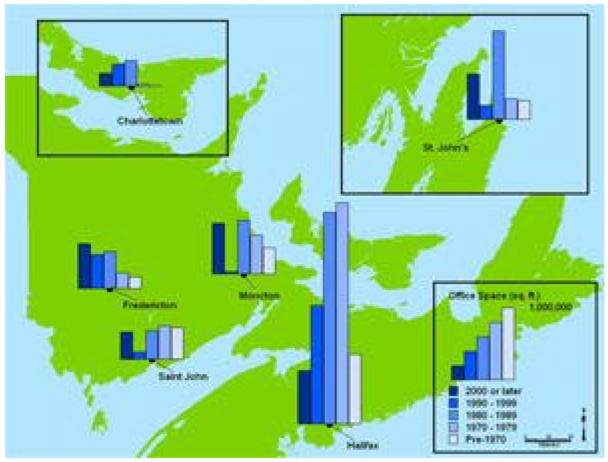
OCEANS OF OPPORTUNITY (Newsletters Spring 2006, Winter 2006/2007)



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Or Temples to a Dying Deity?

On July 15th we completed the most comprehensive study ever undertaken of the Atlantic Region's office and industrial real estate markets. The study was conducted by our Counselling Division's Economic Intelligence Unit. Over a five month period, our ten person team of researchers, data entry staff and a programmer, surveyed 30 million square feet, spread over 606 buildings, located in six urban agglomerations (Moncton, Saint John, Fredericton, Charlottetown, Halifax, St. John's). They had great support from the real estate community and were able to capture information on the building sizes, occupancy levels, rental and operating expenses, for virtually every building surveyed in the Maritime Provinces, and 86% of those in St. John's, Newfoundland. (We are still working on the hold-outs in St. John's and have now hired very tall, muscular and mean researchers … and when we say "mean" we mean, *mean*. So wait for that call and say 'sir' dammit). If you participated willingly in any of the twelve surveys we will be pleased to send you a copy of the raw data in .pdf format, by email.

Public Works & Government Services Canada (PWGSC) commissioned the market survey to assist their leasing officers. They provided us with data from similar surveys, on a much smaller population of buildings, undertaken during the past five years. Some of these surveys were on a six month cycle, the remainder were conducted annually. In order to combat the missing data and missing surveys, we developed heuristic algorithms which allow us to create a time series based on a consistent twelve month cycle. The algorithms (1) compensate for the missing data, and (2) ensure that the historical data will improve with the subsequent market surveys we are to conduct as part of an ongoing program.

In order to best utilise the information from the market surveys, we designed, built and populated an intelligent, geocoded database. This Market Survey Database has now been integrated into our proprietary Compuval™ family of intelligent databases (they chat to each other; really!). Together they provide our Valuation and Property Tax consultants with an unsurpassed knowledge of the property markets in the region.

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Reading the Tea Leaves

Part of our mandate in undertaking the assignment, was to project future supply and demand for office and warehouse space in each of the six communities. This exercise required that we analyse economic conditions over the past five years and the response of the office and industrial markets to them, take stock of current conditions, and utilise the foregoing data to project ahead for the next five years. This analysis took place in the face of two events which have, and may, forever change the face of real estate in Atlantic Canada: the 1990 recession, and the escalating outward migration of population to more friendly economic environments such as Alberta.

Offices

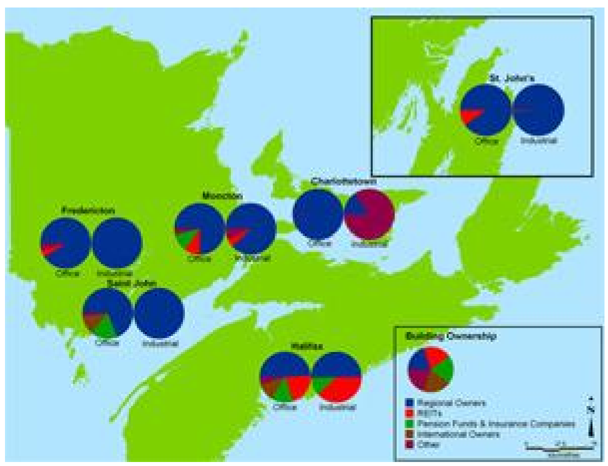
The 1990 recession hit real estate markets east of the Rockies, hard. It also resulted in a systemic shift in the way business was to operate; flash was out, function was in! For offices, this meant that accessibility and flexibility assumed as great, or greater, importance as prestige and a presence in a Central Business District (CBD). The growth of broadband Internet and mobile phone use during the 1990s gave workers greater mobility. An accessible location with free on-site parking often outweighed the advantage of a downtown location. Shareholder concerns about lavish office space, which had surfaced during the recession, resulted in a more Calvinistic attitude: firms that had sought prestige office space now preferred something less ostentatious, and the rental premium captured by this type of space melted away. The more vigorous economic environment engendered by the recession, and the improvement in, and lower cost of, communications spawned outsourcing and the relegation of “back office functions” to call centres. The latter were better located in business parks because of lower land and construction costs, the availability of ample free on-site parking, and their proximity to residential areas favoured by their usually younger and less affluent staff. In 2005, the rapid rise in energy costs once again focussed tenants’ minds on conservation; “green” buildings started to rise in prominence (Newsletter Vol. 2 No. 82). Design requirements now favour unostentatious lobbies and a secure, pleasant working environment with sprinkler systems, natural light, windows that open, and energy efficient climate control mechanisms such as heat pumps. Broadly speaking, the older the building, the less likely it is to reflect the design and locational requirements desired in today’s business environment. Buildings erected prior to 1990 in particular, are unlikely to do so. Our surveys uncovered the following age ranking of office stock, by size, in each of the communities polled, together with the current vacancy rate and average annual change in demand since 2001:

Urban Area	Date Built		Average Annual change in Demand	Current Vacancy
	≥ 1980	≥ 1980	(2001 to 2006)	
Greater Charlottetown	55%	95%	- 1.80%	7.50%
Greater Fredericton	55%	81%	- 0.99%	4.97%
Greater Moncton	40%	67%	- 2.15%	12.84%

Greater St. John’s	32%	79%	1.38%	6.04%
Greater Saint John	27%	50%	- 1.09%	10.96%
Greater Halifax	26%	57%	0.07%	6.53%

Source: Turner Drake & Partners Ltd. Field Survey May to July 2006.

Ownership



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The commercial property market meltdown in 1990 initiated the demise of some local dynasties, exorcised the banks and remaining trust companies from the mortgage market, panicked pension plans and life companies into liquidating their assets, convinced open ended partnerships to slam the door on redemptions, and caused real estate consultants to question their role in life. The situation was exacerbated in Atlantic Canada by the ill advised antics of government agencies such as ACOA and its provincial copy cats who, in the 1980s, exhibiting all the finesse of bulls in a china shop, managed to destabilise markets by encouraging over-building in sectors identified as needing their “help”. Alas some things never change! But local entrepreneurs are a hardy breed, born of adversity, and it was they who, in the mid to late 1990s, stirred the markets back to life. It has been a remarkable and heartening event to witness. As demand picked up the hotel/motel market started to recover in 1995, followed by apartments in 1997, industrials in 1997/1998, offices in 1998 and retail in 1999. Local entrepreneurs were quick to meet the challenge first buying, and then as rents recovered, building new stock. They were joined by a trickle of investors from outside the region. During the past three years that trickle has strengthened to a flood: real estate has again assumed the mantle of the Holy Grail it last wore during the late 1980s. Since investors now hunger for product, we have analysed its ownership in the six urban centres which are included in our rental survey. We have allocated the space into one of five ownership categories: (1) International i.e. investors domiciled outside Canada, (2) REITs, wherever domiciled; (3) Pension Funds, wherever domiciled; (4) Regional Owners i.e. individuals who invest locally, or companies who invest locally and have their Head Office in Atlantic Canada; (5) Other, i.e. anybody but the foregoing, including the non-profits, government and banks. It bears repeating that our survey excludes owner occupied buildings. Category 4 (Regional Owners) potentially present the softest target for investors with deep pockets from outside the Atlantic Region. The result of our research is shown on the map.

National and International investors prefer the largest urban market, Halifax, probably assuming that the food is edible, they won't have to share their hotel bed with strangers, the natives do not bite … and the office and industrial markets have depth. It is true that the smaller markets may be vulnerable to the idiotic antics of the political establishment, and their coterie of civil servants, some of whom favour flash over fact, and as a consequence may fund new construction in the happy anticipation that tenants, and employment, will somehow materialise to fill the empty space. But it is also true that the smaller centres have fewer landlords, and they are less likely to indulge in the deep discounting of rents that occurred for example, in HRM in the early 1990s.