The Land Economist

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Photo courtesy Ottawa Tourism and Convention Bureau

Photo courtesy Ottawa Tourism and Convention Bureau

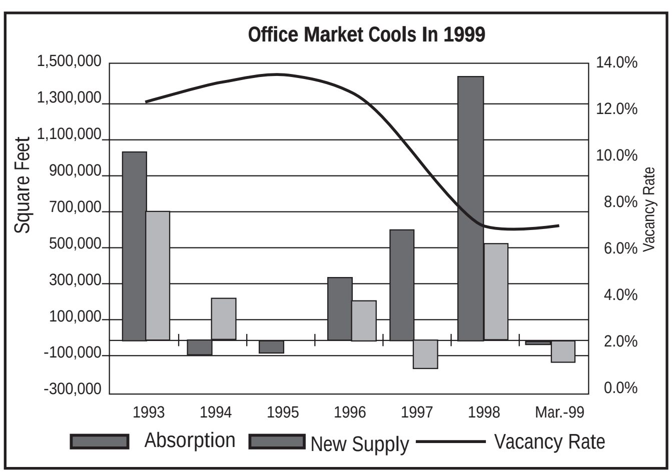
Ottawa office market turns turbulent

After a strong 1998, Ottawa's office market performance cooled during the first quarter of 1999. A number of factors came into play:

- The cyclical slowdown in leasing activity in the first half of the year.
- The addition of several blocks of vacant space in the Core due to tenant downsizing, space rationalizations and relocations.
- A lack of space for immediate occupancy in the suburban market.

The remainder of 1999 is expected to be somewhat turbulent for metro Ottawa's office market. Downsizing and space rationalizations will continue to add space to the market; as a result, vacancies are expected to trend upwards throughout the year.

- Public Works Canada is anticipated to vacate over 800,000 s.f. of leased space in 1999, largely in obsolete space. They are, however, currently active in the "B" market.
- Approximately 90,000 s.f. of space is still expected to become available at the yet to be renamed MetLife Centre (acquired by Mutual Life).
- In addition, an undefined number of leased office properties are expected to be returned to the market upon completion of build-to-suit projects by Nortel and JDS Fitel.
- Vacancies will rise in the Core and Fringe office markets, with significant increases in the "B" and "C" sub-markets.



- The release of better quality space, particularly in the suburbs, will help to ease the current supply restrictions within the "A" market.
- Given the continued strong demand for quality suburban office space, much of the space slated to be vacated may be fully committed prior to delivery.
- A number of tenants are currently looking for quality space, including Public Works Canada.
- Suburban construction activity continues to gain momentum.

Core office market

The Core office market began the new year on a low note as over 135,000 s.f. of previously occupied space was released onto the market. Of particular significance, this newly vacated space came predominately out of Class "A" buildings. As a result, market performance stumbled:

- Class "A" vacancy rate increased to 3.6%, the first recorded increase since Q1'96, but still below "normal" market conditions.
- Overall Core vacancy rose one percentage point to 6.1%.

Suburban office market

Suburban vacancies continued to dwindle as expansions and start-up high-tech firms exhausted the available supply of vacant space.

- The overall vacancy rate fell by more than one point in the past quarter to 7.6%.
- The tight Class "A" market led to a marked rise in activity in Class "B" buildings. More than 100,000 s.f. of "B"market space were absorbed Q1'99; however, this resulted exclusively from leasing activity at 400 Cooper Street where Nexacor and Public Works Canada combined to lease 150,000 s.f.
- The "C" market reported a drop in vacancy despite no significant absorption, due to one demolition and a residential conversion

The scoop on rental rates

Colliers' survey confirms that rental rates are on the rise in all markets, however, some "bargain basement" prices still exist.

In the downtown Core, proposed "A" Class office rental rates range from $19-$24 psf net, inclusive of leasehold allowances, on a five year term. These rent proposals are a marked increase from the $16-$19 psf net range submitted to tenants during 1996-98.

Class "B" rents in the Core have remained relatively flat over the past several years resulting largely from the Federal Government space rationalization program. Tenants have received rental rate proposals in Class "B" space for between $9 and $14 psf, net. Class "C" space is renting at rates below $9 psf net where the physical condition of buildings is suspect. All quotations include leasehold improvement allowances. Allowances for interior fit-up work typically range between $12 and $25 per square foot in Class "B" and "A" buildings respectively.

Outside the Core, rental rates are peaking in the busy Kanata market. Kanata North business park commands rents in the $13 - $15 psf net range on five year deals. Leasehold improvement allowances typically do not exceed $15 psf without a proportionate increase in rent added to the lease. Build-to-suit proposals fall in the $12 psf net range.

Ottawa's east and south "A" markets boast rental rates in the $10-$13 psf range, net. Lower quality buildings are asking in the $15-$19 per square foot range gross, but the best Class "B/C" buildings are in short supply. One low-cost option is Class "C" sub-leases, typically between $7-12 psf.

This article is adapted from the Colliers International first quarter Ottawa report.

... but housing is up

Housing starts in Ottawa are up 74 per cent for the first four months compared to the same period in 1998. That's way ahead of the national pace (-2%), and the Ontario results (+11%).

While a lot of the increase is a statistical anomaly -- last year's ice storm devastated first quarter starts -- Canada Mortgage and Housing Corporation has upped its forecast of 1999 housing starts for the Ottawa CMA to 4,000 from the previously anticipated 3,600.

Canril Corporation proposed tower at 181 Queen St.

Growth in Ottawa's housing is being supported by continued job creation in the region. So far this year, the local economy has generated 6,900 jobs in high tech manufacturing, construction and public administration. With job stability, more people are willing to commit to major purchases.

The improved market is also bringing higher local prices. The median price for a new single detached house has reached $190,000, up $15,000 from two years ago.

The biggest issue for industry is development charges, says Richard Lee, executive director of the Ottawa-Carleton Home Builders' Association.

"We have 11 municipalities, four school boards and the regional government, all looking at increases," Lee says. "The Region alone wants to increase its levies by $5,000, bringing its total to $11,850 for the average house."

Projecting office vacancy rates

by Michael S. Cane, FRICS, AACI, PLE
and Douglas N. Robertson, COM, PLE

Based on past characteristics of the office development cycle (prolonged recovery, low vacancy rate, cheap money) construction of offices in Downtown Toronto should be taking place. However, there are other factors that play an important role in determining the future market for offices in the downtown. This article will examine the characteristics of this market and explore some of the important factors that affect office space requirements.

Historical Perspective

Like many real estate markets, the Toronto office sector experienced an enormous boom during the 1980's. Between 1980 and 1990 the office space inventory in the Toronto CMA almost doubled from 67.7 million square feet to 132.3 million square feet. During this decade the development community provided as much new office product as had been created in the 50 years prior to 1960.

As the 1990's arrived, the Canadian economy headed into economic difficulties which proved to be longer and more severe than even the most pessimistic observers had forecast. This, in turn, had a significant impact upon the real estate market, particularly in the office sector.

Demand all but disappeared as companies downsized, amalgamated or filed for bankruptcy or creditor protection. The inventory expanded, however, largely as a result of decisions to build and finance that had been made during the heady years of the boom. These two concurrent trends created a massive oversupply of space in a weak market.(Figure 1)

The consequences were soaring vacancy rates, reaching a peak of nearly 19% by the end of 1992, and a substantial decline in attainable rents, both face rents and Net Effective Rents (NERs). This caused a decline in cash flows and values that ultimately led to the demise of many developers who were unable to support the debt on their properties.

Downtown Toronto Office Market

The oversupply was exacerbated by the huge lag between the decision to build and the time a building finally comes on stream. On reflection, could we have been able to predict the sudden downturn in the economy and thus the requirement for less office space? Were there any signs in 1989 that could have indicated to us the drastic change in demand for office space that occurred?

If we ask ourselves the fundamental question: "What drives the requirements for office accommodation?", can we detect new methods of analysis to reasonably predict the future requirements of office space? We believe the answer, in

Figure 1

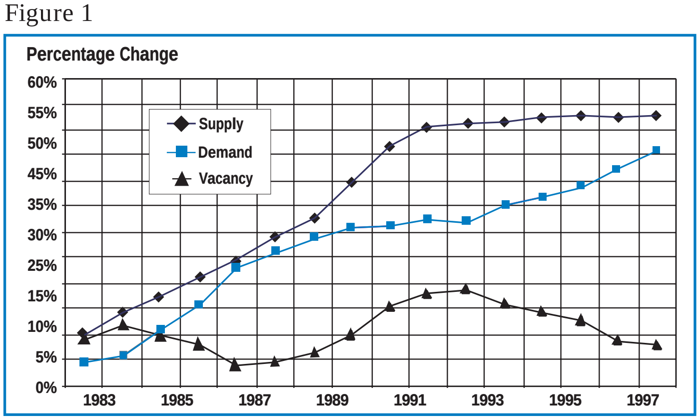


Figure 2

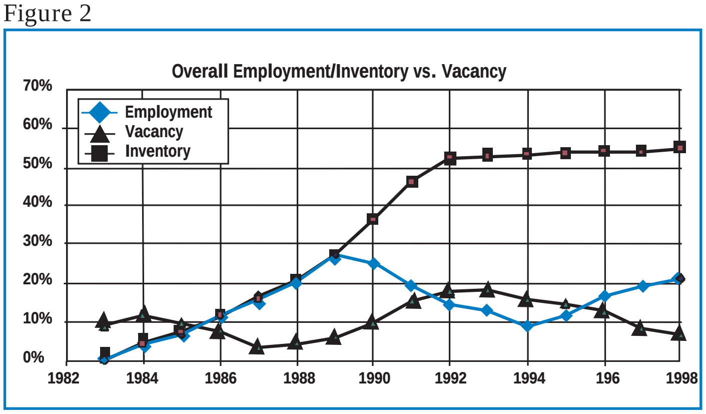


Figure 3

DOWNTOWN TORONTO EMPLOYMENT FIGURES BY SUB GROUPS					
Employment	**1983**	**% of Total**	**1997**	**% of Total**	**% Growth**
1) Finance (FIRE)	65,509	31.23%	78,984	33.91%	20.57%
2) Business Services	38,891	18.54%	48,491	20.82%	24.68%
3) Head Offices	37,306	17.79%	25,164	10.80%	-32.55%
4) Government	32,303	15.40%	37,674	16.18%	16.63%
5) Technical Services	4,176	1.99%	3,447	1.48%	-17.46%
6) Media	11,945	5.70%	16,245	6.98%	36.00%7)

part, is connected to the total number of office employees in an area.

A comparison of office absorption in the downtown with corresponding employment figures from the detailed Employment Surveys prepared by Metropolitan Toronto Planning Department indicates some interesting results (Figure 2).

From 1982 to the start of 1989 new office supply and employment increases moved hand-in-hand, after which employment started to decline rapidly. But the building momentum was in full flight and continued for another three years.

If we break down these employment figures into their various components we see the following trends:

- The table above (Figure 3) indicates the dominance of the finance sub-group. It accounts for more than one third of total downtown employment. The first four groups: finance, business services, head offices and government account for 82% of total employment.
- Between 1983 and 1987, finance, business services and government have increased their share, but head offices have declined

During the years 1996 and 1997 we saw a significant improvement in the Toronto Office Market with rapid lowering in vacancies and increases in net effective rents. This followed employment figures for downtown Toronto, which increased in 1995 over 1994, and continued to increase to the end of the first quarter of 1998.

Since then, there has been a substantial cooling off in both employment and the Downtown market. According to Royal LePage Statistics, net absorption in the Downtown for the past 12 months (April 1, 1998, to March 31, 1999) has been negative 46,000 sq. ft. overall. Absorption for Class "A" space has been negative 300,000 sq. ft. As of this writing, the downtown market has remained extremely soft, especially the Class "A" space.

Unfortunately, we do not have the luxury of official 1998 employment figures for downtown Toronto. However, with the sudden downturn in the stock market in the fall of 1998, and the continued amalgamations among large companies and institutions in spite of the recovery, staff reductions appear to be continuing. In addition, during most of 1998 we were faced with the possibility that four of our major banks might soon become two. The Intervention of Paul Martin has now put a stop to this, albeit temporarily.

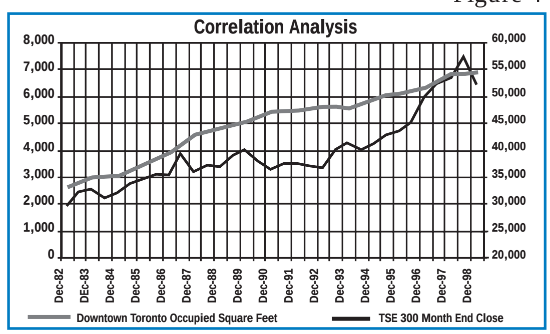
The layoffs in the financial community and the "wait-and-see" attitude of the banks, probably explains in part the softening of the downtown office market in 1998.

Now that the stock markets appear to have got over their panic and the banks know their position, will we see a return to more normal market growth, particularly in the Class "A" office space? Will the big five banks start leasing more space to deal with their rumoured pent-up demand? Will the Finance Minister relax the rules for Class B banks which would see an increase in bank space requirements in downtown Toronto? Or will there be a significant drop in the finance sector of the employment group?

Are there other factors that can be linked to office space requirements? After looking at a number of financial and stock market indices, we found that most of them were so volatile that a meaningful correlation with space demand could not be determined. However we did have some success with a correlation analysis between Downtown occupied office space and the TSE 300 index (Figure 4). Statistically speaking, this indicates a relatively good correlation with an R squared of 0.75. (1.0 is Perfect)

We do not expect this correlation analysis to be definitive, although it does tend to confirm the relative importance of the Finance Employment Sub-group in the Downtown. Actual employment figures are the best indicators. However, they are, at best, 6 to 12 months out of date

Figure 4



Now, the new City of Toronto is cutting back on its collection of employment data. I think it is incumbent on all of us to contact the city and explain how important accurate employment figures are to us for predicting future office development, as well as the variety of other reasons which affect every land economist. Rather than cutting back, the City should be improving the timeliness of its data collection.

Michael S. Cane, FRICS, AACI, PLE, is senior vice president with Drivers Jonas, a firm of international real estate advisors. Douglas N. Robertson, CPM, PLE, is vice president, real estate investments, with Canadian Pacific Investment Management Limited. Amy Cheong, also of CPIM, acted as research assistant on the data base.

OMB supports industrial area

by Ian Brown, MBA, PLE

A recent Ontario Municipal Board decision has rejected residential encroachment on industrial land.

In the southwest corner of Toronto, formerly the City of Etobicoke, there is a growing battle between owners of vacant "brownfield" properties (who are seeking redesignation from industrial to residential land) and viable industry (who do not want complaints about noise and odours from new residential neighbours).

Industry has fought the first of the rezoning applications and won (see OMB file number R970327) and decision No. 0219).

The South Etobicoke Industrial Employers' Association (SEIEA), formed with the assistance of the author, consists of seven firms whose properties surround the 15-acre site in question.

Four years ago, these firms told the city that they had invested almost $100 million over the previous five years, based on the city's industrial zoning and a new Official Plan that kept the area industrial.

While they were still competitive, the industries argued, failure to maintain a viable industrial zone would result in declining investment, declining employment and eventually the same fate as had befallen the now-vacant properties.

The city ignored these concerns and approved the application for 154 townhouses, suggesting that on-site buffering and mitigation measures would be adequate. Both SEIEA and CN Rail appealed. Solicitor Jane Pepino (Aird & Berlis) presented the case.

The OMB denied the rezoning and redesignation, based on two factors:

1) the long-term feasibility of industrial uses for the site, and

2) compatibility with the surrounding area.

In addition, the city had failed to comply with both its own Official Plan criteria for conversion of industrially zoned land and the Ministry of Environment and Energy Land Use guidelines (see Diane Saxe's February newsletter at www.envirolaw.com).

The Official Plan criteria had been developed in 1990-91 for the city by planning consultant Warren Sorensen, with help from the author (then-director of Economic Development in Etobicoke). SEIEA hired Sorensen to provide planning evidence in the case, as well as Jade Acoustics (noise) and Phyper and Associates (air quality).

Keys to SEIEA's success in this case may be useful to economic development professionals:

- Official Plan provisions preventing rezonings detrimental to existing industry
- United action by industry at the beginning of the process
- Willingness to hire top quality expert advice and to "go the distance" if needed.

Ian Brown is a Toronto-based economic development consultant. This article is adapted from one which appeared in the March 17 version of EDCO exchange.

Gardiner proposal chugs along

by Herb Ware

It may be a while yet before the rubber hits the road on the latest proposal to bury Toronto's Gardiner Expressway. But the next big decision is coming up soon.

After a turbulent reception at the February city council meeting, city staff were asked to review several aspects of the $1 billion proposal by Canadian Highways International Corporation (CHIC) to bury the Yonge to Dufferin section, using private funds and toll collection.

Outstanding issues include: toll charges on a highway that has always been toll-free and whether the project can be completed in six years as CHIC contends, considering that a 12-foot diameter storm sewer, a high voltage electrical line, a filtered water intake, and a below-grade streetcar line all have to be dealt with. Cost of the second half of the reconstruction, from Yonge St. to the Don Valley Parkway is also an issue.

Questions about expropriation and categories of land use that will be made available for development have been raised but not dealt with in any detail.

CHIC's desire to start construction next year is very optimistic, according to Rod McPhail, Director Transportation Division. "There's so much you have to do between where we are (reviewing the concept) and construction that it's highly unlikely we could ever get under construction in 2000. It takes a while just to bid on a project of this magnitude."

The City also wants to include the privately funded Gardiner project in the megacity's new Official Plan. Urban Planning and Development Committee Chair Joe Pantalone doesn't see a timing problem: "The official plan is well on the way. It's supposed to be completed by spring-summer of the year 2000. The two can still come together."

The committee is expected to send the issue to Council in July. A request for proposal could follow shortly thereafter.

Herb Ware is a Mississauga-based communications consultant and freelance writer.

Condo Act promises new options, controls

by Rowena Moyes

When Ontario's new Condominium Act gets proclaimed, it will allow for some really useful new options and safeguards, say top legal experts. However, it also contains some costly new requirements.

Harry Herskowitz of DelZotto, Zorsi and Mark Freedman of Harris, Shaeffer gave OLE members and guests an overview of the new legislation in March. There are four new condo alternatives:

Keith hobcraft photo

Vacant land condominiums allow developers to register land with no buildings. "It's equivalent to a plan of subdivision, except that instead of lots, you have 'units', and instead of municipal roads, you have private roads," Freedman said. And that allows for increased density. Once the vacant land condominium is registered, homes can be built and conveyed one at a time. Units/lots can be sold to other builders.

Common element condominiums don't include any homes, Herskowitz explained. This might be used in a freehold subdivision with special amenities, such as a golf course. Or it might be used to create private lots with common services, such as a water system, sewer system, recreation centre, etc. A declaration is registered against each of the homes in the geographic area affected. Shares can be allocated differently for each lot. A lot of developers would really like to be able to build a common sewage system under condominium tenure, Herskowitz said, in places where municipalities don't want to assume responsibility for them.

Phased condominiums were intended to allow subsequent phases of a large project to be added to one condominium corporation. However, he said, the disclosure rules are more complex and "it provides so little flexibility, that you're better to stay with the current system" (i.e. -- register a new condominium corporation for each phase).

Leasehold condominiums are intended for land owned by universities, hospitals and other entities which can't sell outright. Instead of buying the land, the condominium corporation will lease it, for a minimum of 40 and a maximum of 99 years. At the end of the lease, the buildings will revert back to the lessor. An appropriate amount of the reserve fund will be allocated to repair any damages, and the balance (if any) will get distributed among the unit owners. Initial prices should be well below standard condominium ownership, Freedman said, "although the common expenses will go up." One audience member pointed out that a similar system in Britain had created problems – after 30 years, purchasers couldn't get mortgages.

The new Act also allows for **amalgamations** of existing condominium corporations, as long as 90% of the owners agree in writing.

To ensure adequate funding, it requires initial **reserve fund studies**, with periodic updating. Appraisers can't just look at an individual unit to determine its value, Freedman said. "You have to look at the financial statements and the reserve funds to see what is needed."

In addition, the **disclosure requirements** are more extensive -- with 27 different items – and disclosure now applies to commercial as well as residential condominiums.

Despite strong lobbying. the new Act requires a **Performance Audit** for all residential condominiums. For highrise condominiums, this may duplicate the requirements of the Ontario New Home Warranty Program (Bulletin 19 audit). And the powers given to the person doing the new audit are "intrusive", Herskowitz said.

If the Conservatives win on June 3, they are expected to complete the regulations and proclaim the new Act within about three months. The Liberals would probably still pass the law, but after some review.

OLE member John Blackburn is assisting the two lawyers in preparing a book and CD-Rom on the new system..

Rowena Moyes is a Toronto-based consultant, and editor of this Journal.

Welcome New Members!

AOLE extends a warm welcome to the following people:

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by M. A. Barker, director, Helyar & Associates

The Legislative Beat

Provincial Election

By the time this issue reaches you, the June 3rd election campaigns will be in full swing. Premier Mike Harris called the election on May 5th, the day after Finance Minister Ernie Eves tabled the Budget. The vision of the Progressive Conservatives has been articulated in the Blueprint document, a follow up to the widely-read Common Sense Revolution election platform released in 1994. The Liberals' 20/20 Plan, issued just before the Throne Speech, received scant media attention.

In addition to this election campaign being of shorter official duration at 28 days, the number of ridings has been reduced to reflect the federal boundaries; there are now103 ridings, as compared to 130 under the old system.

The NDP may lose seats to the Liberals if the union leaders' policy of strategic voting is followed; i.e., "cast your vote with the party that has the best chance of defeating Harris".

Budget '99

The 1999 Budget, subtitled "Foundations for Prosperity", was released on May 4th and focuses on Ontario's strong economic record, particularly on job creation. Total employment has risen by 539,000 since the Government's first Throne Speech in September 1995. The reduced tax and regulatory burden, and strong consumer confidence are cited as factors in the job growth.

Among the budget announcements:

- a 20 per cent cut in the residential education tax rate over five years
- a personal income tax cut of 20 per cent over five years

by Andy Manahan PLE

- a continuation of the Land Transfer Tax refund program for first-time new home buyers (the maximum refund is increased to $2,000)
- enhancement of the capital tax exemption for small business
- a temporary retail sales tax rebate of up to $3,000 on building materials for heritage properties.

The Ontario Chamber of Commerce, however, was disappointed that the Government missed an opportunity to eliminate the deficit which is forecast to be $2.1 billion for the 1999 – 2000 fiscal year. OCC points out that Ontario is going to be one of the last provinces to eliminate its deficit. The Province's target to balance the budget is 2000 – 01.

Road Map to Prosperity

The Premier also released a report this spring which was prepared by the Ontario Jobs and Investment Board (OJIB). A Road Map To Prosperity: An Economic Plan For Jobs In The 21st Century is a result of consultations and regional conferences which were undertaken by David Lindsay, President and CEO of the OJIB. The report documents strategic goals and 21 priorities, and is available at the following web site: www.ontario-canada.com/jobgrow.

Fairness is a Two-Way Street

The Province of Ontario wants to ensure that there is a level playing field in competition for construction jobs between Quebec and Ontario. The program was announced by the Minister of Labour last December and the measures were put forward by the Premier on March 31. The legislation, which came into effect May 22, bans government ministries or agencies from awarding construction contracts to Quebec firms, and forces Quebec companies bidding on private sector construction projects to register with a "Jobs Protection Office", to post a $10,000 security, and to provide detailed financial statements. The system reflects the obstacles Ontario workers and firms face in working on Quebec projects.

Rent Reductions

Municipalities are issuing Notices of Rent Decrease to tenants in multi-residential properties where property taxes decreased by more than 2.49% between 1997 and 1998. Tenants are entitled to rent reductions, retroactive to January 1, 1999, if they were tenants of the unit on December 31, 1998. Landlords who want to contest the calculations must do so within 90 days after the notices are issued.

Development Charge Bylaws

The Development Charges Act set a September 1, 1999, deadline for school boards and municipalities to have their new bylaws in effect. Experts predict a mad scramble in many areas this summer, as Boards and Councils try to meet the deadline – leaving little or no opportunity for meaningful comment.

Andy Manahan is Executive Vice-President of the Council of Ontario Construction Associations.