

COVER Changes in Vancouver market can make owning a downtown office smarter than leasing for first time in years

Strata offices

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The current shortage of office space in downtown Vancouver has thrown a golden lifeline to owners and investors of office stratas, who are suddenly seeing double-digit price appreciation and rents that would make a Class A tower landlord envious.

Office stratas, however, have had a chequered history, and even major players say the sector remains a challenge for investors.

Farhard Eberhimi, senior investment officer with **Palagon Ventures**, Vancouver, who has bought 27 strata offices over the past 12 months in the city, cautions that the recent surge in prices is making it more difficult to make the numbers work.

"There is a lot of hype [in the office strata sector]," he said, suggesting that vendors have to take a hard look at their pricing. "There is no lineup down the block of buyers."

Eberhimi believes that owning an office, rather than leasing, remains a solid strategy for owner-occupiers who are seeking stability in Vancouver's overheated office market. When you own the office, you can't be forced out because the landlord wants to make changes, he noted. "Moving can disrupt a business for three months," he said.

Once confined to small, flexible investors, office stratas are gaining traction with major developers.

The only new office space coming to downtown Vancouver, for instance, will be **Foster & Partners'** Jameson House, with 55,000 square feet of Class AAA offices as part of a mixed-use residential and retail tower. In a marked difference for a prime building, all of the office space will be sold, not leased.

Jameson's office floor plates are 7,300 square feet, with prices expected to average \$750 per square foot, according to **Jeff Rank** of **Cushman Wakefield Lepage**, which marks a high point in office strata prices in the city.

Such prices are not a benchmark: new **Concert Properties** office strata projects on the North Vancouver waterfront are selling north of \$800 per square foot.

Rank explains that, unlike a residential condominium, office space doesn't come with fancy granite countertops, hardwood floors or stainless steel appliances. Buyers get the HVAC, T-Bar dropped ceiling, sprinklers, and other office systems in place, perhaps even carpeting, but the finishing is left up to the buyer.



Photo: Cushman Wakefield Lepage



Photo: Colleen Flanagan

LEFT: Outline shows where strata offices will be worked into the 37-storey Jameson House tower on West Hastings: \$750 per square foot sets a record for city office prices. **ABOVE:** Loic Jeanjean, investment analyst with Palagon Ventures, Vancouver.

Rank expects buyers for the Jameson House, a LEED-rated building, will be a mix of owner-occupiers and investors, but he believes most of the buyers will be existing office tenants from Vancouver.

Tough financing

For investors considering buying a strata office, there are risks involved – primarily the chance of losing a lot of money – according to one agent who has sold both residential and office strata in the core for many years.

First, there is difficulty in financing, said **Les Twarog**. Most banks are reluctant to lend for strata offices, meaning that buyers have to come up with all cash or with a down payment of at least 50 per cent of market value, with interest points well above prime.

Second, it has been very difficult to make an office strata pay for itself as a rental investment, since most of the strata space in Vancouver is in Class B buildings, which until recently rented for less than \$18 per square foot net, annually. Third, unlike residential condominiums, there is a small pool of buyers when it comes time to sell; and fourth, the market price of the space is dependent on the current office vacancy rate.

"It is hard to make an office strata cash flow," concludes Twarog of **Re/Max Crest Realty (Downtown)**. "From a financial standpoint, they haven't made sense for investors."

tors."

However, the supply will likely remain tight, since it is difficult to turn an older rental office building into a strata complex.

Palagon has looked at buying older Class B office buildings and converting them to stratas, but a strategy that works well in other markets is tough in Vancouver, Eberhimi said. "The prices [vendors are asking] are crazy, and then you have legal fees and the whole rezoning process," he said. Palagon is now scouting such opportunities in Saskatoon, Toronto and Quebec City, he said.

Smarter play

A realtor close to the local strata action says that the Vancouver office market has changed so dramatically in the past year that stratas are now a much smarter play, especially for owner-occupiers.

According to **Mark Kurdjiane**, a commercial strata specialist with **Barclay Street Real Estate**, even investors can now make money.

Kurdjiane explains that there are only about half a dozen office strata buildings in downtown Vancouver, which makes for a tight inventory to begin with. Add in the current low office vacancy rate – 1.6 per cent for Class B buildings – plus rising lease costs, and suddenly more people are looking to buy.

The way space is being sold and rented in strata buildings, he said, upsets all the old ideas about office lease rates.

One client, he said, frustrated about not being able to lease space near the Vancouver law courts, recently paid \$410,000 for a 600-square-foot office on Howe Street.

In turn, again due to Vancouver's 25-year low in office vacancy rates, strata owners are

getting \$30 to \$40 per square foot, triple net, for Class B office space, higher than some big institutional owners are getting in the best downtown towers.

Fears of low price appreciation also no longer apply, Kurdjiane said. As an example he points to 515 West Pender Street, where office space sold for \$143 per square foot in 2002. Today, offices in the same building are trading at \$384 per square foot, and one sold recently at more than \$500 per square foot. In the Electra on Burrard St., offices now sell for an average of \$350 per square foot, compared with \$232 per square foot just two years ago.

Across the downtown, the average price per square foot of office stratas increased from \$300 in 2005 to \$480 in 2007 and, Barclay Street forecasts, will top \$500 this year.

Outlook

"In the last three years, in some towers, the price appreciation has been incredible. We believe that market prices will continue to increase, but we cannot project 25 per cent to 30 per cent increases, but rather steady increases. There is no supply and increasing demand," he said.

The key demand, Kurdjiane said, is from small office tenants, looking for 200 to 300 square feet of space, because such small tenants simply don't have much other choice in that they want to stay downtown. Larger landlords don't like to lease such space, opting to hold it instead to accommodate expansion of their top clients. Yet these small footprints are common in office strata buildings.

For a small-business owner, buying the office, rather than renting, can be the best, and perhaps only, option in downtown Vancouver, he said. ♦

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