AVISON YOUNG

Office Market Report / Third quarter 2021

Montréal, QC

Highlights

$39.64

average gross rental rate per square foot Downtown Montréal

15.5%

total availability rate all asset classes Greater Montréal

2.3%

sublet availibility rate all asset classes Greater Montréal

-1.79

million square feet annual absorption Downtown Montréal

A year and a half after the pandemic first hit Canadian shores, the commercial real estate landscape has undergone quite a transformation. Individuals and companies alike have had to adapt to a string of changes involving lockdowns, remote work and vaccination while, at the same time, managing their families. From a workplace perspective, the biggest disruptor has been the general adoption of remote work as companies were forced to operate around the lockdown restrictions imposed by provincial health authorities.

The impact on the commercial real estate market has been significant, more so for the office market with companies having to re-evaluate their overall workplace strategies. In the face of uncertainty, companies have remained cautious while they wait and see how things unfold in the new normal.

As the general population now embarks on a new phase in the recovery efforts and companies start bringing employees back to the office, the consensus seems to be that the hybrid model will be a part of the corporate strategy, and not only on the short term.

Availability

Compared to pre-pandemic levels, the availability rate in the Greater Montréal Area (GMA) has sky-rocketed and is now sitting at 15.5% compared to 10.8% at the end of March 2020. This represents an additional 5 million square feet of office space now available for lease. However, between the 2nd and 3rd quarter of 2021, availability in the GMA only saw a minimal increase from 14.9% to 15.5%. This is consistent with the trend over the past two quarters where availability maintained an upward trajectory but at a slower rate than what was recorded at the peak of the pandemic.

In Downtown Montréal, availability for all office classes has increased by 67% compared to what it was before the lockdown in March 2020.

Quarter over quarter, however, availability in Greater Montréal only increased by 0.6 percentage point in the third quarter of this year, which seems to indicate that the market is starting to level off.

The biggest casualty has been the B-class office buildings where availability went from 8.8% to 15.9% in the span of 18 months across the GMA, but it's interesting to note that over the last quarter, all sub-markets except for Downtown Montréal saw a dip in availability for B-class space. In fact, Midtown recorded a significant decrease in availability dropping from 19.8% to 18.1% over the past 3 months.

The sublease market has also seen a lot of activity since the start of the pandemic with the availability rate for sublease spaces jumping from 1% at the beginning of 2020 to 2.3% in the last quarter. During the early stages, companies instinctively looked to reduce their footprints by putting a portion of their office space on the sublease market, but as the situation progressed, they also faced the reality that the sublease route was not always the best option.

Sublease availability now seems to be tapering off, either as a result of lease expiries or companies needing their space back to cater for employees coming back to the office. Some companies are realizing that the workplace optimization that had been done pre-pandemic is no longer realistic and that they must review their employee occupancy to meet health concerns. The biggest challenge is to determine the optimal hybrid model (remote and in-person work) especially since the model will evolve in the coming years.

Absorption

The Greater Montréal Area saw a total negative absorption of – 369,137 square feet in the third quarter of 2021. The biggest negative absorption was recorded in Downtown Montréal with -713,603 square feet while East-End, Laval, Midtown and West-Island all experienced a positive absorption this quarter. Midtown had the biggest positive absorption with 176,147 square feet.

This might indicate that the idea of satellite offices could slowly be taking root among some space users. While Downtown Montréal still maintains its allure for corporate users, it seems that some companies are favoring the suburban areas and midtown to be closer to their employees.

The advancement of the REM is certainly a consideration as the new transit system will provide an effective and attractive mode of transport for employees to get to their offices.

Currently, decision-makers are in the process of re-assessing their workplace strategy to reach the optimal balance between corporate vision, location, size, and workplace requirement. While there is no one-size-fits-all approach, there are certain benchmarks that should be considered when it comes to identifying the right mix. With so much availability on the market, there are opportunities for tenants to take advantage of the market and secure spaces that fit with their long-term plans.

Occupancy costs

Availability rates have gone up in most sectors, but rental rates have remained relatively stable over the past 18 months. The average gross rent in the GMA for the third quarter was $28.88 psf which is almost the same as what it was at the beginning of the pandemic. Instead of adjusting the rental rates, landlords' preference has been to offer more incentives to tenants by offering months of free rents and advantageous tenant improvement allowances.

Generally speaking, class A buildings have fared better during the pandemic. As companies look to reduce their footprint, we are seeing a flight to quality among space users. This means that landlords that possess higher-quality assets are better positioned to perform well over the next few months. Accessibility, air quality, amenities, and other tenant services such as concierge service and distinctive food courts will certainly be attractive options for tenants looking to level up. In the current war for talent, exciting work environments could play a big role in retaining and attracting employees.

Under construction

2.74

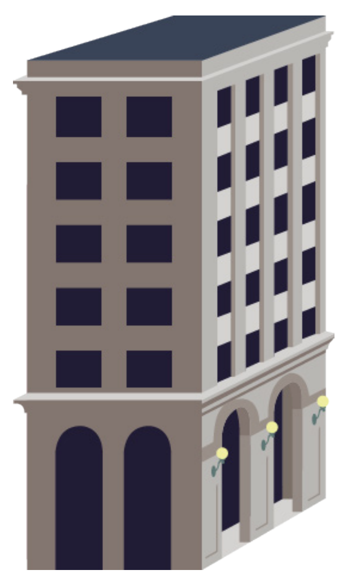
million square feet
under construction
Greater Montréal
12 buildings

2.10

million square feet
under construction
Class A
Greater Montréal
5 buildings

1.62

million square feet
under construction
Downtown Montréal
5 buildings



In some cases, tenants are choosing to sign shorter term leases. This is an indication that companies are still cautious about making long-term decisions and want to have some flexibility as they navigate the new normal.

Construction

12 office buildings are currently under construction in Greater Montréal for a total of 2,735,929 square feet. 5 of the 12 development projects are located in Downtown Montréal and account for almost 60% of the total area under development. This is a clear indication that the appetite for Downtown office buildings is still strong despite the challenges associated with the pandemic.

Amidst the increasing availability of office space Downtown, developers are still investing top dollars into new and existing buildings. Kevric is going ahead with the redevelopment of two of their office buildings, namely Place Bonaventure and 600 de la Gauchetière West. Place Bonaventure boasts 1.3 million square feet of office space and has been undergoing major renovations since 2015, while 600 de la Gauchetière will undergo a major transformation when National Bank vacates the building to relocate to their new head office at 800 Saint-Jacques Street.

Further East, Prével's Espanade Cartier is underway and will offer 70,000 square feet of office space once the first phase is completed in 2023. Another major project that recently launched is the Quartier des Lumières which is located at the old site of Radio-Canada. Groupe Mach announced in October that the office portion of the project would be bumped to 1.5 million square feet, another show of confidence in the office market on the long term.

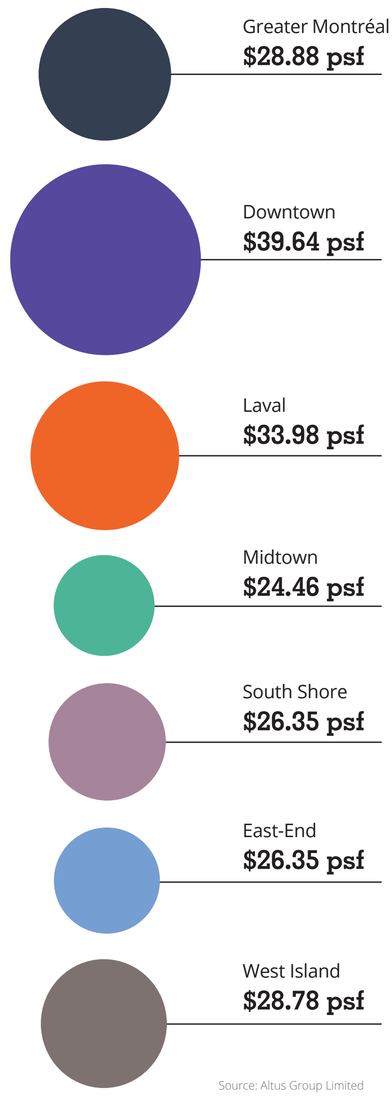
All this construction activity coupled with recent shortages in labor and materials is creating challenges and significant delays for anyone undertaking construction projects including office renovations and buildouts. The good news however is that the situation is starting to stabilize.

Investments

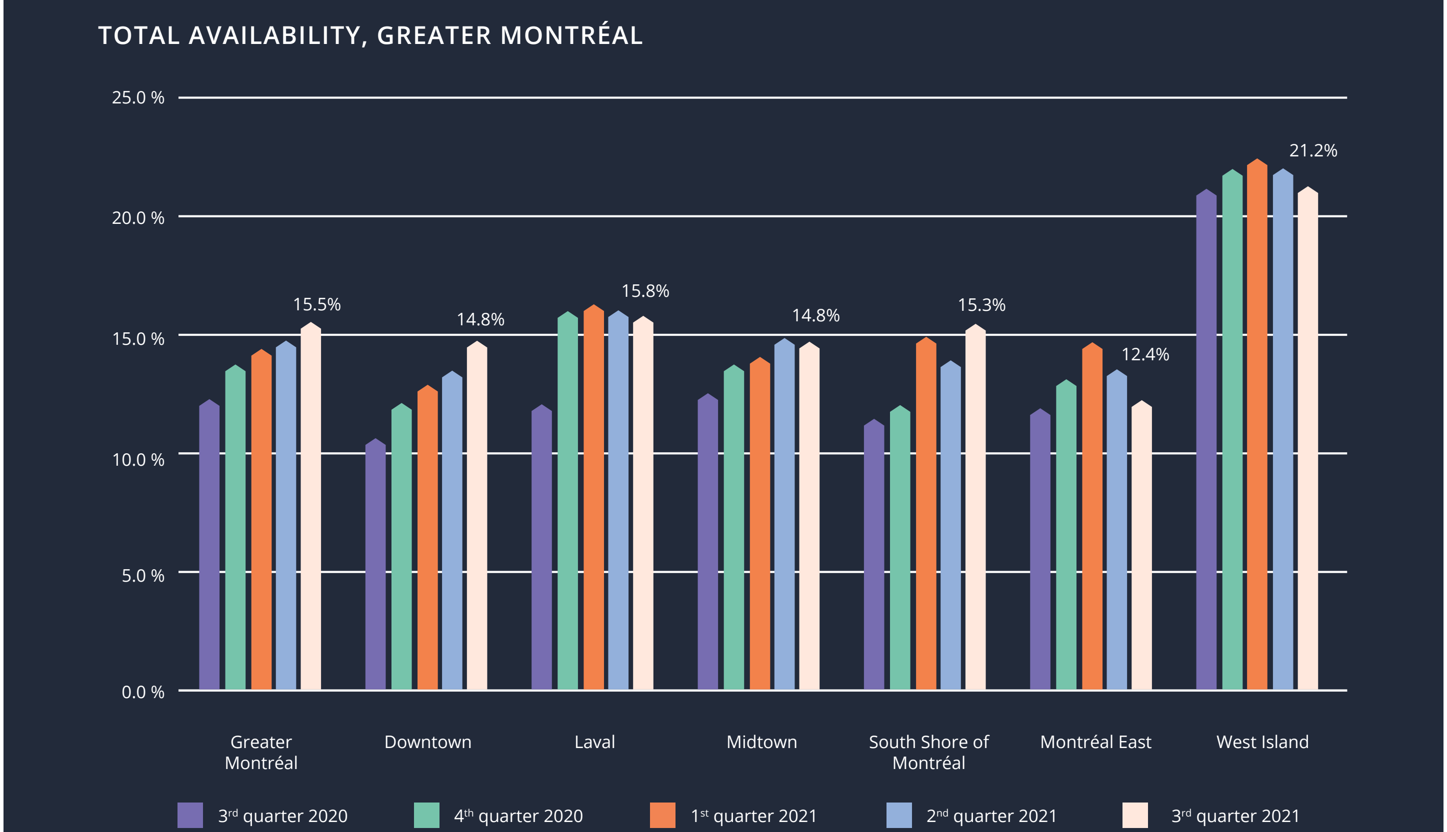
During the third quarter of 2021, the total amount of commercial sales across all asset classes reached $3,507,931,635, with 673 transactions valued at $1 million and over. The multi-residential sector continues to be the most active asset class with 37.9% of all investment activity for a total value of $1,328,961,182, followed by the industrial sector which accounted for 18.6% of all activity with a total value of $653,051,073.

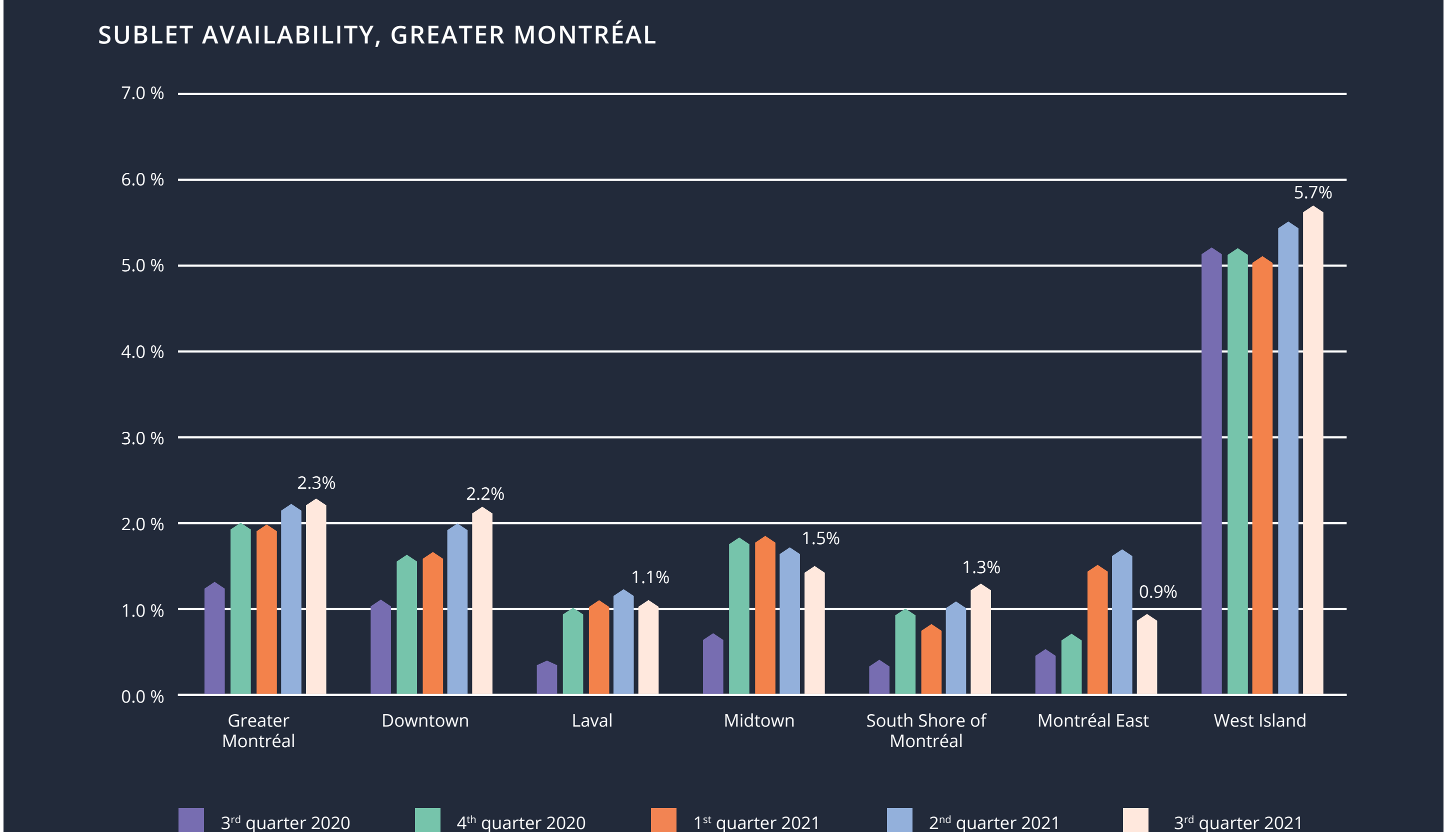
Only 19 office sale transactions were recorded this quarter, but with the sale of the 1000 de la Gauchetière to Groupe Mach and Groupe Petra for a value of $482,094,466, the office investment volume reached $617,501,715 compared to $101,040,585 the previous quarter. The other notable office transactions included the sale of 275 Viger East in Montréal ($74,000,000), 385 Bouchard Boulevard in Dorval ($15,000,000), 334 Avro Avenue in Pointe-Claire ($10,000,000), 8777 Transcanada Highway in Saint-Laurent ($6,300,000) and 200 Saint-Paul Street West in Montréal ($5,060,000).

Average gross rent



Source: Altus Group Limited


TOTAL AVAILABILITY, GREATER MONTRÉAL
25.0 %
20.0 %
15.0 %
10.0 %
5.0 %
0.0 %
15.5%
14.8%
15.8%
14.8%
15.3%
12.4%
21.2%
Greater Montréal
Downtown
Laval
Midtown
South Shore of Montréal
Montréal East
West Island
3rd quarter 2020
4th quarter 2020
1st quarter 2021
2nd quarter 2021
3rd quarter 2021


SUBLET AVAILABILITY, GREATER MONTRÉAL
7.0 %
6.0 %
5.0 %
4.0 %
3.0 %
2.0 %
1.0 %
0.0 %
2.3%
2.2%
1.1%
1.5%
1.3%
0.9%
5.7%
Greater Montréal
Downtown
Laval
Midtown
South Shore of Montréal
Montréal East
West Island
3rd quarter 2020
4th quarter 2020
1st quarter 2021
2nd quarter 2021
3rd quarter 2021

This level of activity on the office investment sector is a clear indication that investors remain confident in Montréal's economy and recovery.

Availability Downtown	Absorption Downtown
↑	↓
7,903,610 sf	-713,603 sf

Availability Greater Montréal	Occupancy Costs Greater Montréal
↑	↑
16,531,156 sf	$28.88 psf

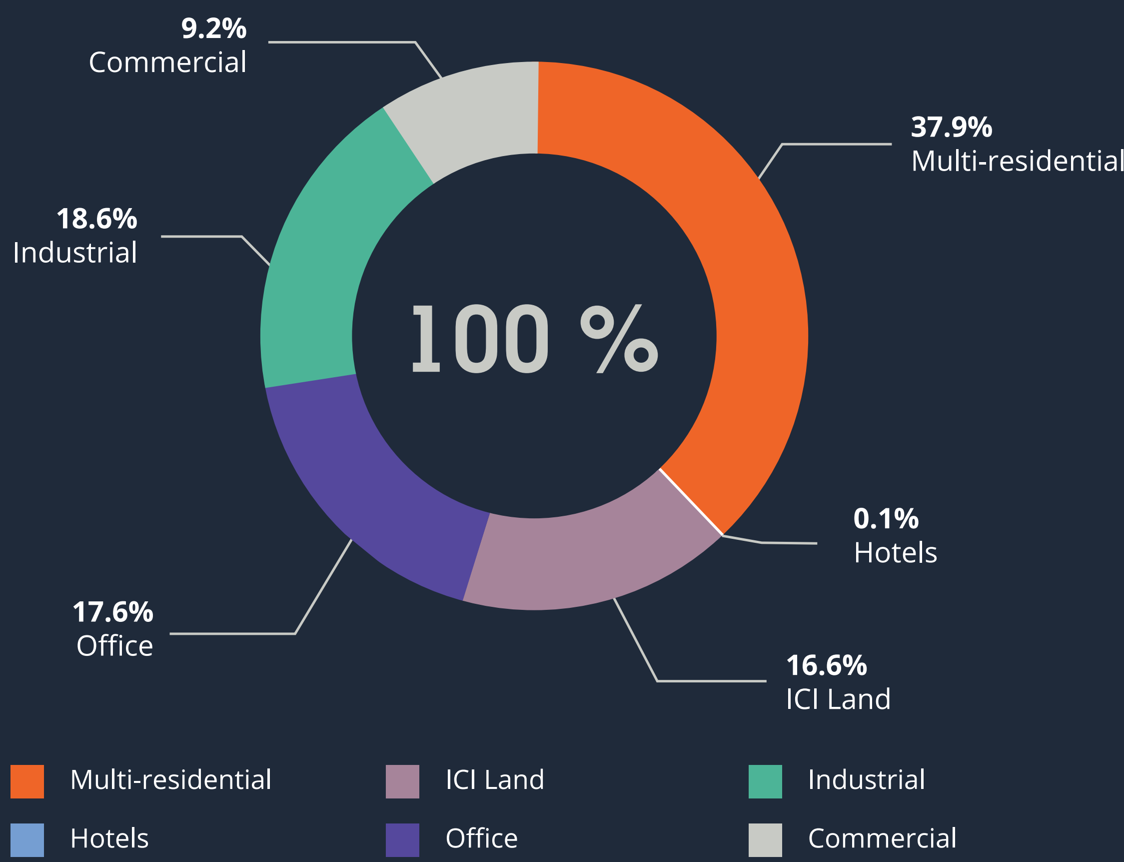
The overall capitalization rates (OCR) for class A office buildings in Downtown Montréal have remained at 5.1% since the second quarter of 2020, with an average price per unit of $438.00 psf in the third quarter compared to $445.67 the previous quarter. This is up from $427.55 psf a year ago.

While the transaction is yet to be finalized, the major news comes from Canderel in partnership with Groupe Mach, Blackstone and other partners looking to buy Cominar REIT in what could be one of the largest real estate deals in Québec history if the deal goes through. The transaction would encompass the whole Cominar portfolio including office, retail and industrial properties valued at $5.7 billion.

Allied Properties REIT announced back in August that they had completed the acquisition of Gare Viger and the adjacent developable land, representing the existing urban office component of Jesta Group's Place Gare Viger. The forward purchase of the urban office building under construction is expected to close in the second half of 2022, subject to various conditions of closing.

Another notable announcement was the sale of the 600 de Maisonneuve West (also known as the KPMG Tower) to Groupe Mach and Groupe Petra in November. This level of activity on the office investment sector is a clear indication that investors remain confident in Montréal's economy and recovery.

INVESTMENT ACTIVITY, OFFICE BUILDINGS, 3rd QUARTER 2021



Source : Altus Group Limited

$3,507,931,635
Total commercial sales volume
Sales of 1 million dollars and more
3rd quarter 2021

$617,501,715
Total office building sales volume
Sales of 1 million dollars and more
3rd quarter 2021

673
Total number of commercial sales
Sales of 1 million dollars and more
3rd quarter 2021

19
Total number of office building sales
Sales of 1 million dollars and more
3rd quarter 2021

The Vitality Index

As we approach the end of 2021, companies are faced with a long-anticipated question: is a return to the office still on track? If it is delayed, for how much longer? Will office occupancy ever look the same again?

There are, of course, no certain answers to these questions. COVID-19 continues to throw curve balls our way, with wide variations in infection rates. At the same time, the dynamic between employers and employees regarding where to work has shifted, likely for good.

But what if there was a real-time window into exactly what was happening in major cities and leading industries across North America? What if we could see the volume of foot traffic updated constantly and compare it to pre-pandemic levels?

Now, you can. Avison Young has launched The Vitality Index, a database that creates daily foot traffic estimates from representative office occupiers located in 20+ different cities*.

The Vitality Index utilizes data from Orbital Insight, Avison Young's geospatial intelligence and location analytics partner. Orbital Insight aggregates anonymized cell phone location data geofenced to unique locations, to estimate total foot traffic in each city and industry. The data goes back to the beginning of 2020 in Canada, which allows comparisons to pre-pandemic levels. Leveraging Orbital Insight's data, Avison Young has created an interactive AVANT by Avison Young dashboard that allows easy, real-time access to useful information to guide users through uncertain times.

Since fall of 2021, the Vitality Index has shown a slow but steady increase in foot traffic in Montréal. At the end of October, the data indicated that the average traffic was the highest it's been since the beginning of the first lockdown back in March of 2020. While the situation is still volatile, it does provide some valuable clues as to how things are evolving.

Everyone is looking for the Goldilocks position – companies don't want to move too early or too late. The Vitality Index is wildly important for people looking to understand what is happening in real-time and over time in major markets. It measures the pace so that leaders can make decisions based on concrete information and analytics.

As the recovery from the pandemic continues and companies chart an uncertain future regarding the physical workplace, any insight from real-time information like The Vitality Index will be critical.

** Austin, Boston, New York, Montréal, Edmonton, Houston, Los Angeles, San Francisco, Chicago, Washington (DC), Philadelphia, Denver, Atlanta, Calgary, Dallas, Toronto, Oakland, Silicon Valley, Nashville, Vancouver, Ottawa, Miami*

The recovery begins

While the office market continues to be impacted by the pandemic, there is a sense that companies are starting to look ahead and plan for the new normal. In recent weeks, there's been growing interest from employers to bring workers back to the office, albeit on a hybrid model basis.

It seems that companies are starting to see the limits of remote work when it comes to overall performance and efficiency. In fact, according to a recent survey by the Urban Development Institute (UDI), remote work seems to be losing its appeal with less than 50% of respondents now working partially or fully at home compared to 77% back in April. It will be interesting to see how the situation evolves over the next few months since the efforts to bring employees back to the office are not in full swing yet. Since November 15, Quebec civil servants have returned to the office two days a week, while Quebec aims to bring 50% of public service personnel back to hybrid mode by January 14.

Nonetheless, thanks to the gradual lifting of restrictions, malls and retailers have already noticed a jump in foot traffic over the past few months, which bodes well for the city's recovery.

Downtown Montréal continues to maintain its level of attraction for corporate users despite office availability being on the rise. As lease expiries come to term, many companies are taking advantage of the market conditions to relocate to better quality offices while reducing their footprint. It's interesting to note that in most cases where companies decided to relocate, they chose to remain in Downtown. They also tend to sign shorter term leases but the optimal solution is to secure flexible conditions.

As the recovery efforts continue, the key driver will be employee experience. Companies are in the delicate position of having to balance performance, safety and employee engagement, and the workplace is at the center of those decisions. For the time being, companies are making significant workplace changes to allow for the safe return of their employees. This is a clear indication that employers still value their physical workplaces when it comes to collaboration and work culture. As the war for talent rages on, companies are realizing that the work environment has a crucial role to play.

For the first time in history, five generational groups are working side-by-side, and companies will need to adapt their strategies based on the different working styles and workplace preferences. These factors posit complex possibilities for organizations and employees to consider as they navigate through the recovery.

For more market information, please contact:

Richard Breton
Principal
Vice President, Brokerage Services
Avison Young
+1 514 392 9702
richard.breton@avisonyoung.com

Get in touch with one of our local offices:

Downtown Montréal
Avison Young
800 René-Lévesque Boulevard West
Suite 900
Montréal, Québec
H3B 1X9
+1 514 392 1330

Avison Young
1200 McGill College Avenue
Suite 2000
Montréal, Québec
H3B 4G7
+1 514 940 5330

Pointe-Claire
Avison Young
1 Holiday Avenue
Suite 520, West Tower
Pointe-Claire, Québec
H9R 5N3
+1 514 940 5330

Avison Young
Commercial Real Estate Services, LP
Commercial Real Estate Agency

AVISON YOUNG

avisonyoung.com