Office Market Report / Second quarter 2021

Montréal, QC

Highlights

$37.60

average gross rental rate per square foot Downtown Montréal

14.9%

total availability rate all asset classes Greater Montréal

2.2%

sublet availibility rate all asset classes Greater Montréal

-1.84

million square feet annual absorption Downtown Montréal

As the government and public health authorities are gradually lifting many of the health restrictions throughout Québec, it seems the Montréal office market is already seeing some positive impacts from the more favorable pandemic conditions. The second quarter of 2021 saw a continued improvement in market conditions that had been observed in the first quarter.

While remote work is still largely in place across the province, companies are having more serious discussions about a possible return to the office in September. While at the start of the health crisis, several companies made the decision to return a portion of their office space to the market in an attempt to cut down on spending, this trend has seen a marked and continuous slowdown since the beginning of the year.

It is still early to say, but the vaccination campaign and the easing of health restrictions seem to have given companies renewed confidence that economic activities will pick up. However, it is clear that the hybrid and flexible model of work will remain the norm for some time to come. The crisis has been an opportunity for many companies to rethink their workplace strategy to offer more flexibility to their employees. In general, this initially translated into a 15-30% reduction in office space, but as employees begin to return to offices on a more regular basis, this trend is set to change in the coming months.

Availability

Between the second quarter of 2020 and the second quarter of 2021, the total availability rate in the Greater Montréal Area climbed from 11.1% to 14.9%, with the total available area increasing from 11,495,885 square feet to 15,834,892 square feet.

Year over year, this represents a 34.2% increase in total availability in Greater Montréal. However, the increase in availability showed a marked slowdown compared to previous quarters.

The availability in class A buildings within the Greater Montréal Area reached 13.3% at the end of the second quarter of 2021, which represents an increase of 2.5 percent over the past 12 months. The increase in availability in class B buildings was more significant; it reached 17.2% at the end of June 2021 compared to 12.1% a year earlier and 16.6% in the first quarter of 2021.

With availability on the rise, the higher-class buildings seem to be faring better thanks to the quality of their tenancy which is made up mostly of large companies and multinationals. Some companies that performed well during the pandemic also took advantage of favorable conditions to relocate to more prestigious buildings.

The availability rate in downtown Montréal reached 13.5% at the end of the second quarter of 2021, up from 9.2% 12 months earlier. However, while downtown availability is still on the rise, the increase is less pronounced compared to previous quarters. Furthermore, a few other sectors such as Laval, the South Shore, the East-End and West-Island even saw a slight drop in availability during the second quarter.

From June 2020 to June 2021, the availability rate in office sublease in Greater Montréal more than doubled, from 959,601 square feet to 2,328,989 square feet, representing a total increase of 142.7%.

For the second quarter of 2021, nearly 182,945 square feet were added to the Greater Montréal sublease inventory, the availability rate for office sublease reaching 2.2%. Interestingly, however, some companies that had initially decided to sublease a portion of their space at the start of the health crisis recently decided to take those same spaces off the market. The loss of flexibility in terms of occupancy as well as the costs associated with subleasing space are some of the factors contributing to this change of direction as companies anticipate that more employees will return to the office.

Absorption

The Greater Montréal Area recorded a negative absorption of -382,763 square feet in the second quarter of 2021. The Midtown area took the biggest hit as absorption plunged to -207,497 square feet.

Downtown Montréal, meanwhile, experienced negative absorption of -195,430 square feet during the second quarter, which still represents an improvement over the first quarter when absorption reached -661,535 square feet.

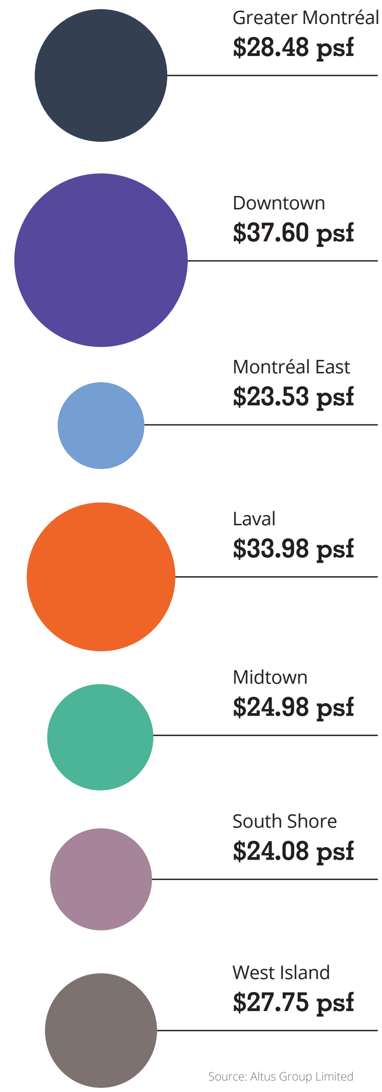
As was the case in the first quarter, it was the South Shore that saw the most favorable quarterly absorption in Greater Montréal, registering a positive absorption of 48,969 square feet at the end of June 2021. The advancement of the Réseau express métropolitain (REM) as well as the increased interest for satellite offices seem to have played a role in the positive absorption of the sector.

Occupancy costs

Occupancy costs dipped slightly in Greater Montréal between the end of June 2020 and the end of June 2021, dropping to $28.48 psf from a low of $29.22 psf one year ago. Despite the high availability rates, it seems that landlords are remaining firm when it comes to asking rents, especially for class A buildings. Their preference is to offer more flexibility to tenants by offering months of free rent and more substantial incentives to attract new occupants.

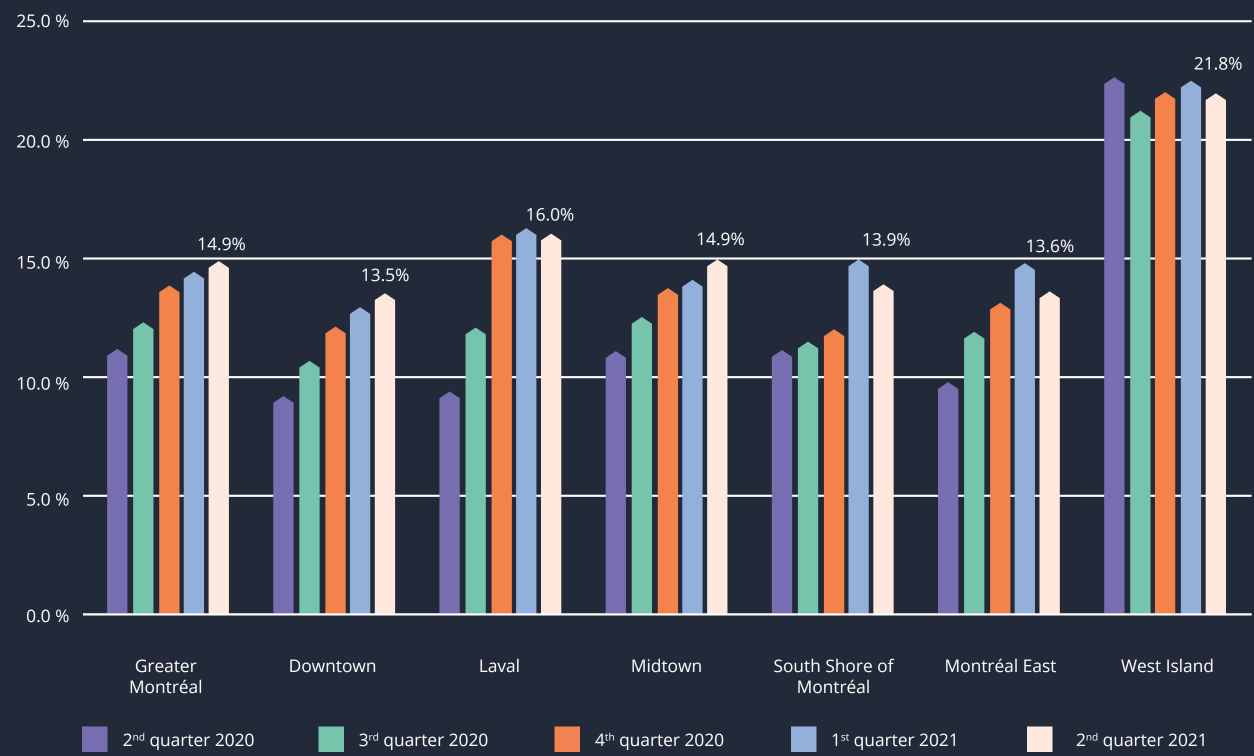
Therefore, for companies looking to relocate to higher quality buildings, these conditions may prove quite favorable, especially since many landlords are open to creative approaches. Some landlords are offering very competitive packages, especially when it comes to larger tenants.

Average gross rent

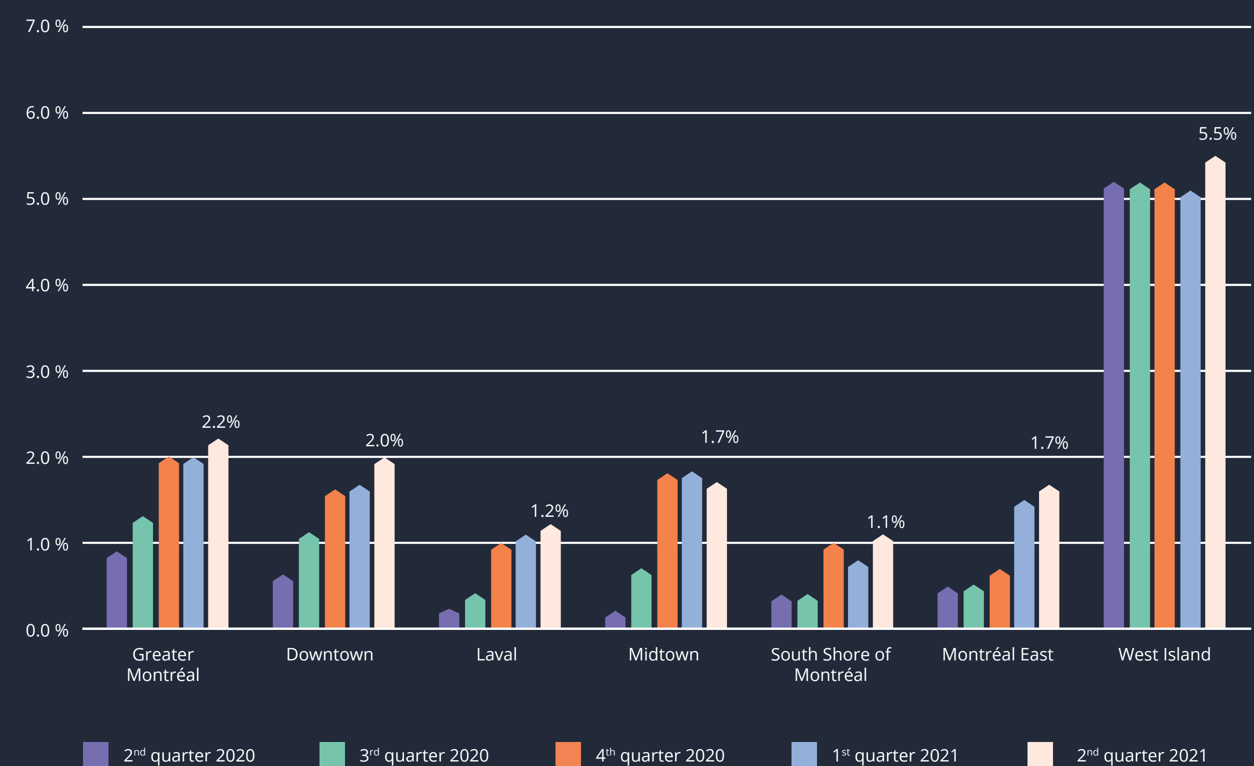


Source: Altus Group Limited

TOTAL AVAILABILITY, GREATER MONTRÉAL



SUBLET AVAILABILITY, GREATER MONTRÉAL



The level of activity in the construction industry has been at an all-time high for some time now and a longer planning period is now an absolute must.

Availability Downtown	Absorption Downtown
↑ 7,185,837 sf	↓ -195,430 sf

Availability Greater Montréal	Occupancy Costs Greater Montréal
↑ 15,834,892 sf	↑ $28.48 psf

Some of the large building owners are also investing in their office buildings to retain and attract occupants by offering additional tenant services such as concierge services and uniquely distinctive food courts. With the changes taking place in the industry, some landlords are positioning themselves to provide an enticing tenant experience while also providing tenants with incentives to attract talent.

Construction

13 office buildings are currently under construction in Greater Montréal (including five located downtown) for a total area of 3,353,970 square feet. According to initial projections, five buildings are scheduled for delivery by the end of 2021, including the new Gare Viger development at 700 Saint-Hubert Street for 147,000 square feet as well as 1720 Canal Street for an area of approximately 148,000 square feet. The pharmaceutical firm Novartis has recently signed for approximately 35,000 square feet at the upcoming office tower at Gare Viger.

Although the availability of office space continues to increase in Greater Montréal, the appetite is still present for new construction projects. Prével's Esplanade Cartier is well underway and should begin the final phases of the project which will be home to 2,000 housing units, office spaces and retail on the ground floor.

A new energy-efficient business district project was also announced by real estate developer MET-HB in Montréal-East. The site covers six million square feet of land and is bordered by Henri-Bourassa Boulevard to the north, the Metropolitan Expressway to the south, the Esso Imperial lands to the east and Auger Street to the west.

Known as *40NetZERO*, this project is intended to be a hub that would bring together businesses from various sectors such as the food industry, clean technology, health, transport, logistics and e-commerce. The business park would be partially or fully self-sufficient in energy thanks to a potential agreement with Hydro-Québec to benefit from their "net metering" option.

It should be noted that the level of activity in the construction industry has been at an all-time high for some time now. This makes it even more important to allow for a longer timeframe for construction and redevelopment projects due to longer construction delays compared to previous years. A longer planning period is now an absolute must.

Investments

During the second quarter of 2021, the total amount of commercial sales across all asset classes reached $2,827,200,887, with 781 transactions valued at $1 million and over. Second quarter sales were once again largely dominated by the multi-residential sector (for a volume of $862,707,348, or 389 transactions representing 30.5% of total sales volume). The industrial sector recorded 104 transactions for a volume of $554,395,920 representing 19.6% of the total volume).

Sales of office buildings remained relatively low with 33 transactions over $1 million, which constitutes only 3.6% of sales transactions in the second quarter. Office investment volumes reached $101,040,585, which is much lower than the first quarter when the sale of Maison Alcan ($172,400,000) accounted for almost half of the total volume.

The size of office transactions also saw a decline: of the 33 office transactions recorded in the first quarter, only six exceeded the $5 million mark, namely the sale of 10 Gaston-Dumoulin Street in Blainville ($5.55 million), 44 Saint-Antoine Street West ($5.7 million), 5580-5588 des Rossignols Boulevard in Laval ($5.7 million), 3664-3670 de la Montagne Street ($5.975 million), 519 Curé-Labelle Boulevard in Blainville ($9.94 million) and 2350 Cohen Street ($14.9 million).

At the end of June, the overall capitalization rates (OCR) for class A office buildings downtown remained stable at 5.1% for the fifth consecutive quarter, with an average price per unit of $445.67 psf, which is a slight decrease from the previous quarter which stood at $464.86 psf. A year earlier, the average price per unit was $416.44 psf.

There is a sense that we should see larger transactions in the coming months as the economy picks up and workers return to the office. In July, Groupe MACH and Groupe Petra announced the acquisition of 1000 de la Gauchetière West, which was owned by Ivanhoé Cambridge, a real estate subsidiary of the Caisse de dépôt. The sale of the iconic 51-story building in Montréal represents one of the most important transactions of 2021. MACH and Petra have made several acquisitions in recent years, including the purchase of 1100 René-Lévesque West in 2020.

A major transaction is also underway between Allied Properties REIT and the Jesta group for the acquisition of various components of Place Gare Viger which would include Gare Viger (known as Le Château), the new office tower development as well as the adjacent land.

Under construction

3.35

million square feet under construction
Greater Montréal
13 buildings

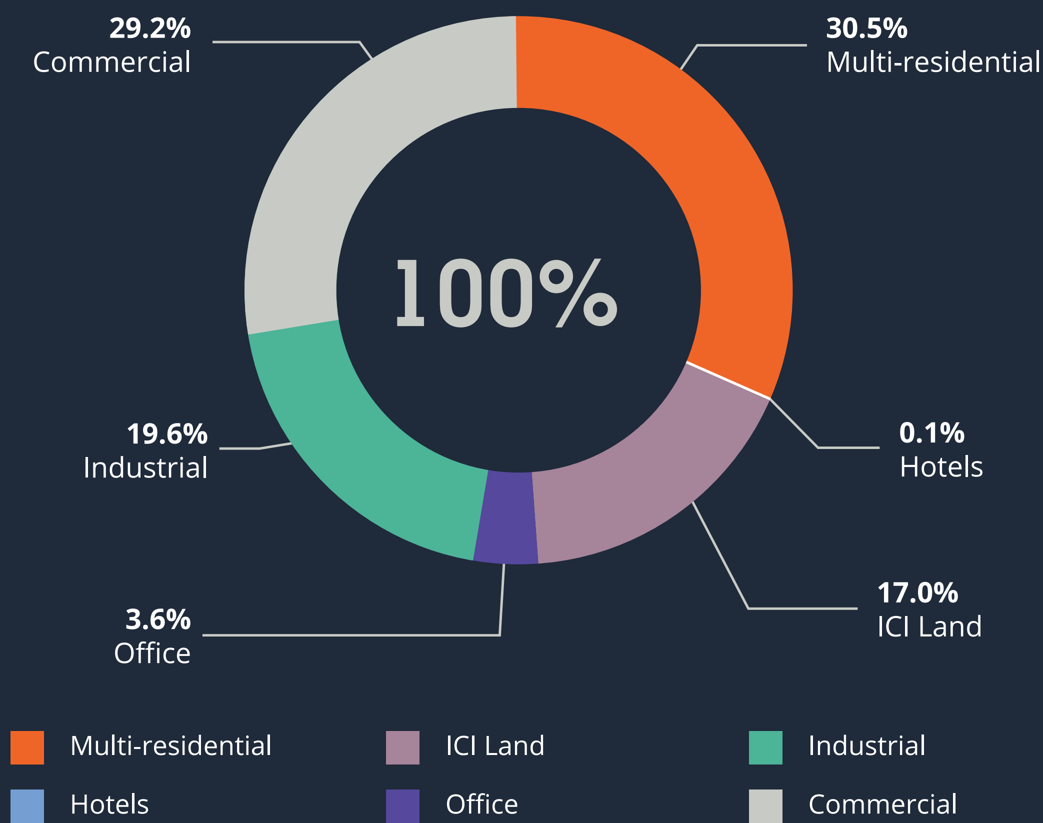
2.72

million square feet under construction
Class A
Greater Montréal
6 buildings

1.59

million square feet under construction
Downtown Montréal
5 buildings

INVESTMENT ACTIVITY, OFFICE BUILDINGS, 2nd QUARTER 2021



Source : Altus Group Limited

$2,827,200,887
Total commercial sales volume
Sales of 1 million dollars and more
2nd quarter 2021

$101,040,585
Total office building sales volume
Sales of 1 million dollars and more
2nd quarter 2021

781
Total number of commercial sales
Sales of 1 million dollars and more
2nd quarter 2021

33
Total number of office building sales
Sales of 1 million dollars and more
2nd quarter 2021

The hybrid model of work

The last year and a half have been a global experiment on the reality of remote work. Now, with the whole of Québec transitioning to the green zone, the easing of health restrictions and the reopening of Canadian borders, it is a first signal that a certain return to normalcy is on the horizon. The provincial government recently announced a gradual return to the office for city servants as of September under a hybrid model which translates into two days in the office and three days from home.

According to surveys done by the Institut de développement urbain (IDU), remote work had declined in popularity at one point, but with the news of a possible return to the office, interest in remote work has rebounded with 76% of respondents saying they would prefer to work from home more than half of the week if they were to return to the office. This popularity is mainly due to the benefits associated with work-life balance and the time savings related to reduced commuting between home and the workplace.

The challenge now resides in finding the right balance for employees and employers. Effective communication between employers and workers needs to be established to find a consensus. Several considerations must be addressed to plan for a safe return to the post-pandemic office. The health and safety of workers remain the priority in the eventual reopening of activities. Managers will therefore have to ensure compliance with public health regulations and precautions will also have to be taken in the event of a fourth wave in the fall. Landlords, for their part, must review the quality of their HVAC systems to ensure proper air quality.

For companies that are looking to adopt the hybrid model of work, questions arise both on an operational as well as on a workplace level. According to a survey by the Ordre des conseillers en ressources humaines agréés, nearly 50% of organizations surveyed plan to make significant changes to their current office space in the next year or so. Most companies are conscious of the importance of creating work environments that will promote exchanges, meetings, collaboration, and the sharing of information. There is a sense that a workstation would no longer be assigned to a single employee, but that workstations would serve a variety of purposes for a variety of employees.

It is clear that the function of the office is set to evolve. With the generalized adoption of remote work, certain individual assignments can be easily performed from the comfort of your own home. Offices therefore take on an entirely different role which tends towards collaborative work, team building, innovation, corporate culture, collective productivity, and a sense of belonging. The considerations associated with the so-called hybrid working model is an opportunity for organizations to be bold and innovative in planning for the future. The labour shortage is currently a huge challenge faced by many businesses and the office has the potential to play a critical role in attracting talent in the months and years to come.

The challenge for managers will be to develop the future model of workplace and to establish new standards for offices. The “one seat per employee” model will undoubtedly be revisited; expect that 20% to 70% of the workspace will be made up of unassigned seats. Of course, this approach will evolve over time and will certainly depend on each and every company’s vision as well as the corporate understanding between employer and employee.

The return to a new normal

The second quarter was marked by a progressive return to normalcy which indicates that there is a light at the end of the tunnel. The acceleration of the vaccination rollout, the lifting of certain restrictions and the gradual reopening of social, cultural, and economic activities are all indicators that a return to normal is within reach.

A report by Montréal International published in July also offers a glimpse of positivity. Despite the impacts of the health crisis and border restrictions, foreign investment from January to June in Montréal broke records with a total of 40 projects worth $1.86 billion. These results show that Montréal is very well positioned at a global level to attract large-scale companies in sectors such as video games, cybersecurity and artificial intelligence. The organization has high hopes that this injection of foreign investment will contribute to the economic recovery of the downtown area, which suffered greatly during the pandemic.

Furthermore, in an effort to revitalize downtown, the Montréal Chamber of Commerce has put forth an initiative dubbed the "I love working downtown" project which will act as a catalyst to support the city's economy and drive the relaunch. This initiative will act on four main components which involve the return to office towers, workspace solutions, creative projects to enhance downtown as a place to work and the strengthening of strategic business sectors.

The next few months will be crucial in establishing the first steps towards a return to a new normal. Over the past few months, public health authorities have done a remarkable job through the vaccination rollout to enable the business community to plan for a comeback. The situation is still fragile, especially with the risk of variants, but it seems that the city is now entering a new phase in this ongoing crisis which has lasted for more than a year. It is certain that there will be new challenges for businesses as we embark on this new reality, but if there is one thing the last year has taught us, it is that Montrealers are resilient in the face of adversity.

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