Office market report / First quarter 2021

Montréal, QC

Highlights

$34.33

average gross rental rate per square foot Downtown Montréal

14.5 %

total availability rate all asset classes Greater Montréal

2.0 %

sublet availibility rate all asset classes Greater Montréal

-1.64

million square feet annual absorption Downtown Montréal

Already heavily impacted by the second wave of the pandemic and the reintroduction of mandatory remote work in mid-December of 2020, the Montréal office market has taken several hits over the past few quarters. The first quarter of 2021 was no different, but the extent of the damage seems to be abating, at least on some level.

Over the past three months we have observed an uptick in market activity. Although some tenants are still waiting to make decisions regarding their office space, others are showing more determination and are looking to benefit from a tenant-favorable market. Generally, those who choose to relocate are reducing their office space by 15% to 30%. Moreover, the conditions brought on by the pandemic are pushing many businesses to prefer quality over quantity. Consequently, tenants are choosing smaller footprints that are better adapted to the new pandemic reality and the prospect of flexible work environments. This flight to quality has benefitted the higher quality buildings of the Greater Montréal Area.

Due to the uncertainty surrounding the short- and medium-term, decision making for the long-term remains complex and intimidating for some occupiers and varies from one industry to another. However, the rollout of the vaccination campaign might signal a gradual return to work for employees later in the year, making it easier for companies to commit to longer terms and to prepare for close-to-normal conditions.

Availability

The market was hit hard by the pandemic, and its impact from one year to the next is palpable. Between the first quarter of 2020 and the first quarter of 2021, the total availability rate for Greater Montréal rose from 10.8% to 14.5%, the available area increasing from 11,076,321 square feet to more than 15,357,537 square feet (sf). Year over year, this represents a 38.7% increase in the total availability for Greater Montréal.

Under Construction

3.59

million square feet
under construction
Greater Montréal
16 buildings

2.72

million square feet
under construction
Class A
Greater Montréal
8 buildings

1.59

million square feet
under construction
Downtown Montréal
3 buildings

The availability in class A buildings in Greater Montréal reached 13% at the end of the first quarter of 2021, which represents an increase of two percent over the past 12 months. The increase in availability in class B buildings is much more significant. It reached 16.5% at the end of March 2021 compared with 11.4% a year before and 15.5% at the end of 2020.

This indicates that tenants of less prestigious buildings are less resilient to the current conditions, as these buildings are often home to start-ups or small and medium-size companies. In contrast, tenants in more prestigious buildings, often large, well-established businesses, or multinationals, seem to fare better in the current pandemic circumstances.

The availability rate in downtown Montréal reached 12.8% at the end of the first quarter of 2021, compared to 8.8% 12 months before. Nevertheless, of all the markets in the Greater Montréal Area, downtown is now showing the lowest availability rate. The South Shore, which was doing well thus far, seems to have gotten caught up by events, while total availability rose from 12.1% to 15% in the last quarter. Availability has gone up in all markets without exception.

Since the end of March 2020, availability rates in office sublease more than doubled, from 981,245 to 2,146,044 sf, a 118.7% increase. It is important to note, however, that the drastic increase of available area for sublease has slowed significantly in the last quarter, while only 76,627 sf were added on the sublease market between January 1st and March 31st, which resulted in maintaining the sublease availability rate at 2% for the second consecutive quarter.

Comparatively, between the second and third quarters of 2020, the subleasing market saw an increase of 673,696 sf while the market only recorded 436,120 sf between the first quarter of 2021 and mid-year 2020. This lull might foreshadow that the deterioration of market conditions is slowing down, but the breadth of this slowdown is still to be determined.

Absorption

The Greater Montréal Area recorded a negative absorption of -631,657 sf in the first quarter of 2021. Since the first quarter of 2020, the annual absorption was sitting at 412,851 sf. The downtown sector was hit the hardest during the first quarter, with an absorption that sank to -661,535 sf, for a yearly total of -1,644,798 sf for the sector. As expected, the South Shore saw the largest absorption for the quarter in Greater Montréal, with a positive absorption of 150,145 sf at the end of March 2021.

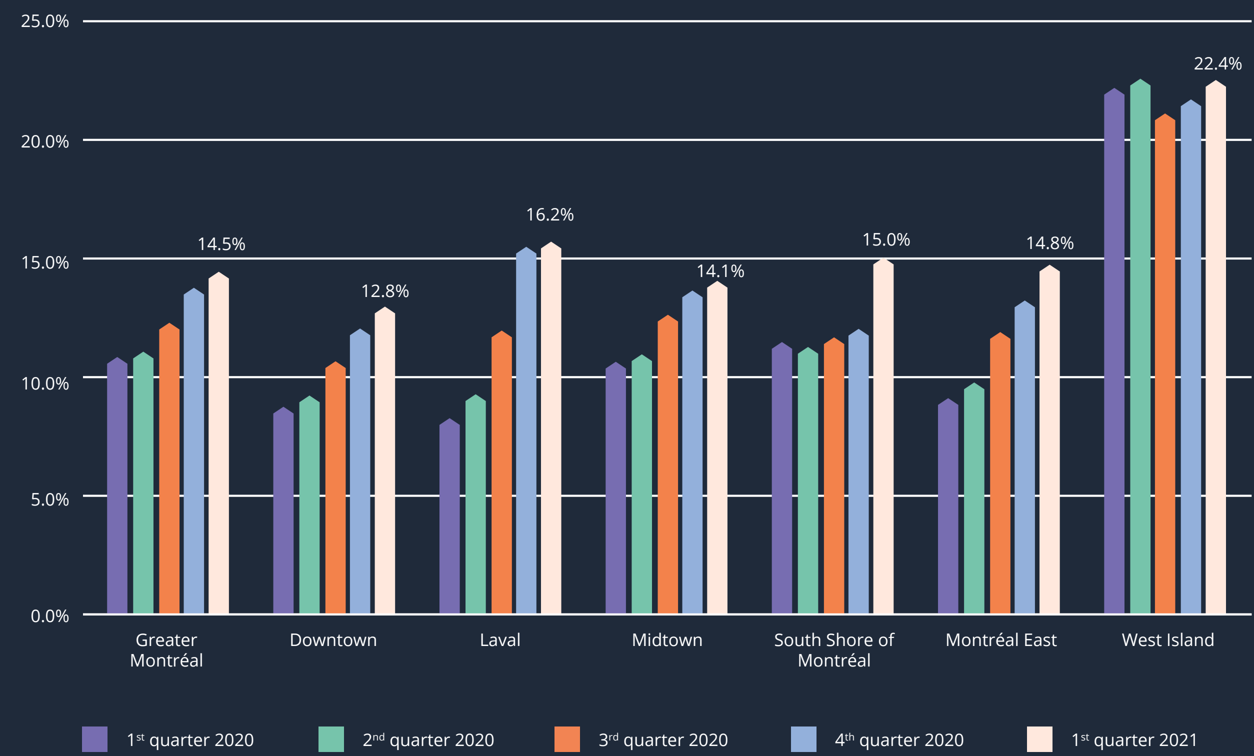
Occupancy Costs

Occupancy costs have faltered in the Greater Montréal Area between the end of 2020 and the end of March 2021, falling to $28.08 per square foot (psf) after increasing to $28.92 psf three months earlier, while they sat at $28.52 psf a year before. The average asking net rent gradually increased over the last quarters, reaching $16.92 psf at the end of March, while additional rents decreased to stabilise at around $11.16 psf.

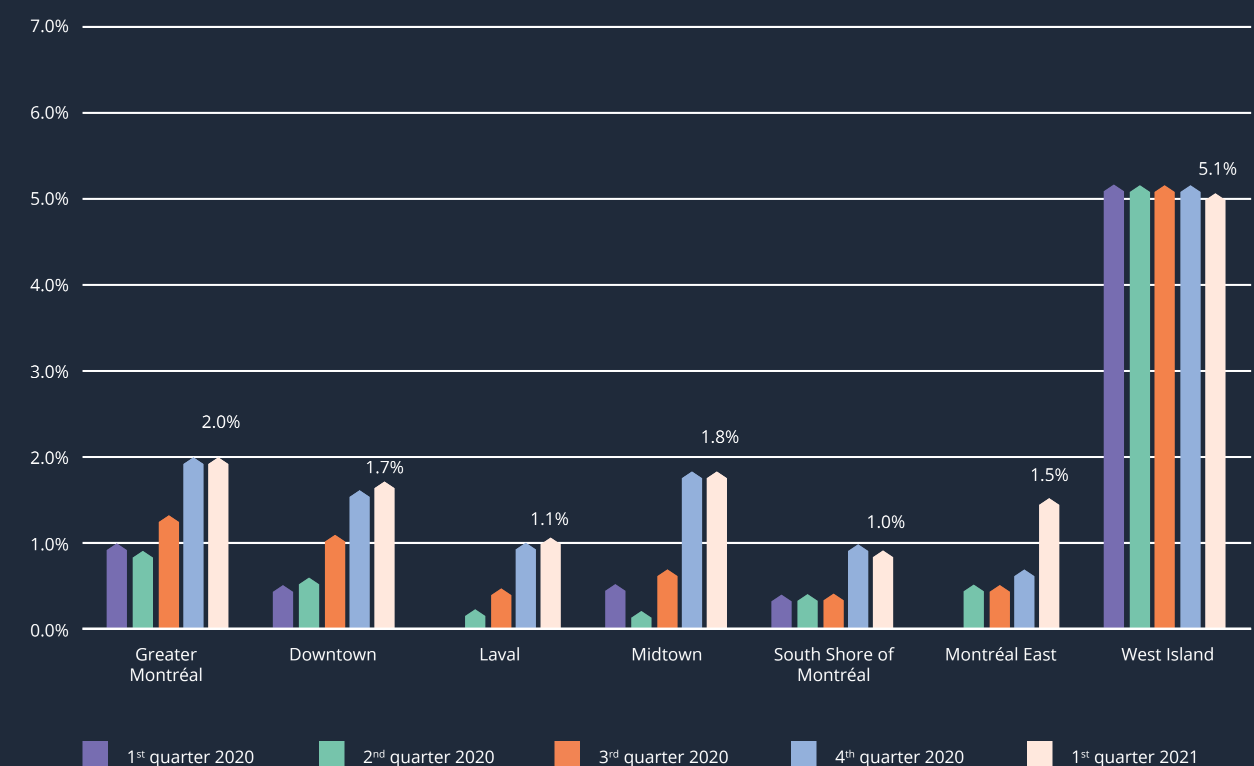
Average gross rents in class A buildings of Greater Montréal showed little fluctuation, reaching $33.67 psf while they stood at $33.64 psf at the end of 2020 and at $33.31 psf a year before. A slight decrease was observed in class B buildings of Greater Montréal, where average gross rents reached $27.30 psf down from $27.52 psf at the end of 2020 and at $27.64 psf a year before. If this trend continues in the coming quarters, it could be an effect of the notable increase in availability within that asset class.

In downtown Montréal, asking net rents (all categories combined) have increased from $18.65 psf to $19.93 psf during the last quarter, while additional rents decreased from $15.57 psf to $14.40 psf, causing an increase of the average gross rent from $34.22 psf to $34.33 psf. At the same time last year, the average gross rent for downtown was at $34.37 psf, which confirms that occupancy costs have not fluctuated significantly in the sector.

TOTAL AVAILABILITY, GREATER MONTRÉAL



SUBLET AVAILABILITY, GREATER MONTRÉAL



The drastic increase of available area for sublease has slowed significantly in the last quarter.

Availability Downtown

6,851,109 sf

Absorption Downtown

-661,535 sf

Availability Greater Montréal

15,357,537 sf

Occupancy Costs Greater Montréal

$28.08 psf

Construction

At the end of the first quarter of 2021, 16 office buildings were under construction in Greater Montréal, totalling 3,590,519 sf. Of those 16 buildings, five are located downtown, including a new project in the Golden Square Mile. In fact, Groupe Quint is investing close to $20 million to convert the former Holt Renfrew building at 1300 Sherbrooke West, into a mixed-use complex combining prestigious commercial spaces and offices. 73,530 sf of offices will be available in the complex once the renovations are completed.

Meanwhile, another downtown project could be launched soon, with RioCan and the Hudson's Bay Company confirming that The Bay store on Sainte-Catherine Street, erected in 1891, will gradually be transformed into a 25-storey office tower, extending towards the back of the current building that runs along De Maisonneuve Boulevard West.

This project would add close to a million square feet of class A office space downtown, where availability rates are reaching their highest point of the last several years. Capitalizing on a return to normalcy over the long term, the project aligns with the company's goal of maximizing the value of their downtown properties across North America while diversifying their assets portfolio by adding retail, residential and office space. If the City of Montréal approves the project as it is presented, construction of the new tower could begin in 2023 with a completion date in 2027, according to current projections.

Investments

Total commercial sales reached $2,595,875,102 for the first quarter of 2021, all asset categories combined, while 551 transactions exceeding a million dollars were recorded. Unsurprisingly, sales in the first quarter were largely dominated by the multi-residential sector ($992,938,781, or 323 transactions and 38.3% of the total sales volume) and by the industrial sector ($873,376,471, or 89 sales and 33.6% of the total volume).

Only 23 transactions can be associated to office building sales in the first quarter, which represent a mere 4.2% of sale transactions. The office investment volumes in the first quarter reached $243,105,000, which equates to 9.4% of the commercial investment volume for the first three months of 2021.

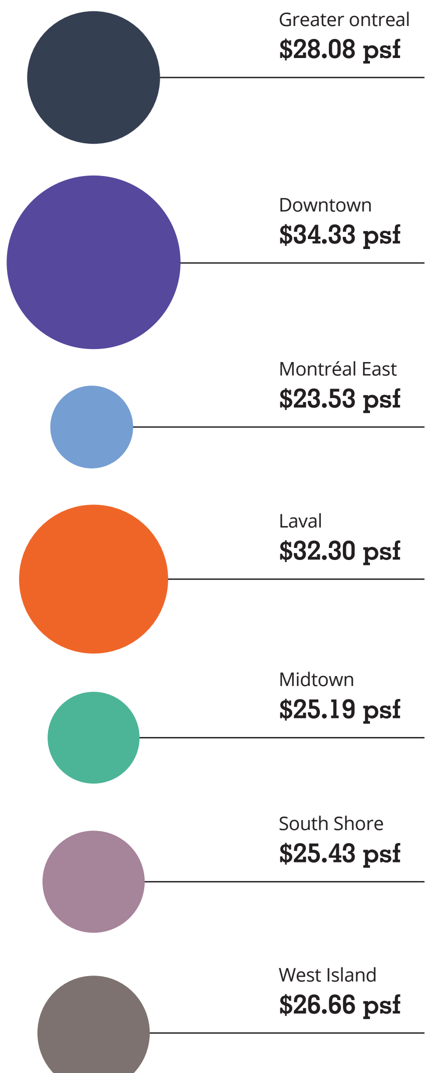
However, of that total, $172,400,000 resulted from the non-arm's length sale transaction of Maison Alcan, on Sherbrooke Street West between Stanley and Drummond. The size of transactions also plummeted; of the 23 office transactions of more than a million dollars recorded in the first quarter, only four exceeded $5 million: the sale of 2115-2125 De La Montagne ($5.25 million, a transaction completed by Avison Young), 300 Marcel-Laurin Boulevard in St-Laurent ($7.35 million), 4940-4964 Queen-Mary Road ($11.5 million) and, of course, Maison Alcan.

At the end of March, the overall capitalization rates (OCR) of class A office buildings downtown remained at 5.1% for the fourth consecutive quarter, despite showing an average price per unit of $464.86 psf, which is a slight increase compared to the previous quarters, whereas the average price per unit for the first quarter of 2020 was $453.16 psf.

Revitalizing the Economy

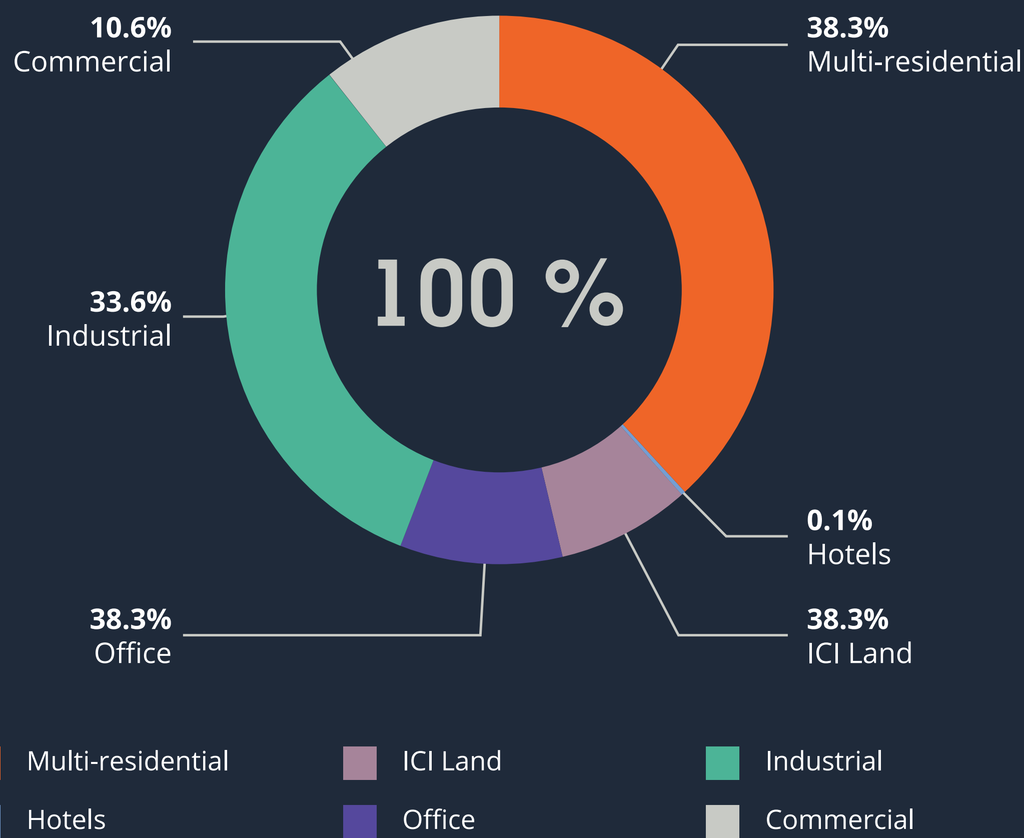
The acceleration of the vaccination rollout, the stimulus package from governments to revitalize the economy, the high savings rate of Canadians during the pandemic and the low interest rates are all factors that should kickstart the recovery of the economy in the coming months.

That said, several organizations are working on the recovery by developing initiatives that aim to support and guide businesses through this new reality.



Source: Altus Group Limited

INVESTMENT ACTIVITY, OFFICE BUILDINGS, 1st QUARTER 2021



Source: Altus Group Limited

$2,595,875,102

Total commercial sales volume
Sales of 1 million dollars and more
1st quarter 2021

$243,105,000

Total office building sales volume
Sales of 1 million dollars and more
1st quarter 2021

551

Total number of commercial sales
Sales of 1 million dollars and more
1st quarter 2021

23

Total number of office building sales
Sales of 1 million dollars and more
1st quarter 2021

One of the main players in this recovery is the Chamber of Commerce of Metropolitan Montréal (CCMM). The CCMM launched the Relaunch MTL program, which aims to mobilize all players within the business ecosystem in Greater Montréal to participate in revitalizing the major strategic industries of the city. The objective of this initiative is to achieve a thorough understanding of the issues faced by these industries, find solutions and guide decision-making within businesses and levels of government, to propel the revitalization of the Montréal economy.

The City of Montréal also set up an advisory committee to reflect on the recovery and economic relaunch of Montréal and to coordinate efforts through various social and economic players within the city. The mandate of this committee is to gather economic data pertaining to the recovery of Montréal, to recommend "ready to start" recovery projects and to guide recovery initiatives that will be undertaken by various government levels to ensure they answer to the needs and requirements of the community.

Simultaneously, this committee will be tasked with discussing various economic aspects to be taken into account in the new reality, and addressing topics such as the resilience of supply chains, the circular economy within the territory, the ability to inject private capital within the framework of the recovery, as well as other avenues deemed relevant. The committee should also identify economic sectors or key players in Montréal that can make concrete contributions to the issues highlighted by the crisis and find solutions to preserve Montréal's international reach in terms of culture, tourism, economic exchanges, and international organizations.

Remote work is losing its edge

The rollout of efficient vaccines showing some promise, businesses could be more optimistic towards the return of their employees to the workplace, thus slowing down the flooding of office space to the market. Meanwhile, many businesses are delaying their decisions to see which trends will arise from now until mass vaccination is achieved, especially those pertaining to back-to-office safety practices.

Meanwhile, studies have shown that, after more than a year of forced remote work, employees in general are less interested in working from home full time. This reinforces the idea that a hybrid model of in-office work and remote work will probably be the norm in the coming years, which reinforces the necessity of maintaining office spaces.

According to the second edition of "The State of Downtown" (socioeconomic activity report for the Montréal downtown core published by the Urban Development Institute of Québec in February), a survey completed in the fourth quarter of 2020 stated that 67% of respondents wished to keep working from home most of the time after the pandemic, a decrease of 9 percent compared to the second quarter of 2020. Almost half of employees interviewed felt it is harder to establish and maintain relationships with colleagues, while a third of them stated that remote work impairs problem resolution.

Furthermore, according to a U.S. survey carried out by PwC at the beginning of 2021 on the impact of remote work, the majority of employers were conscious of the importance of collaborating with colleagues and building relationships in a physical work environment such as the office. However, it was also clear in the survey that the role of the office was set to evolve to offer greater flexibility and more benefits to workers.

Nonetheless, a survey done by Abacus Data in March 2021 for the Canadian Chamber of Commerce showed that almost half (45%) of 2,000 Canadians believe their work environment will not return to normal until 2022.

Investissement Québec is another organization that has provided front-line support, playing an active role in financing, and granting loans to organizations over the past months and bringing creative support to numerous projects and businesses in their development as well as their management of the pandemic.

Thanks to these programs, Montréal businesses will be well equipped to continue their reflection on the next steps in resuming their activities in the new normal, while the ongoing rollout of the vaccine and the resilient economic factors, although impacted by the pandemic, will ensure a strong economic recovery in the long run. Moreover, according to a report from Montréal International, the Greater Montréal Area has continued to attract many investors, international organizations, entrepreneurs, as well as international students and workers in 2020, despite the pandemic and the closing of borders. These remarkable results show that the city boasts a vast amount of assets that will help it recover from the pandemic, both at a local and international level.

For more market information, please contact:

David Major-Lapierre
Senior Marketing & Research Manager
Avison Young
+1 514 905 5443
david.major@avisonyoung.com

Get in touch with one of our local offices:

Downtown Montréal
Avison Young
800 René-Lévesque West Boulevard
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