Greater Montréal investment review

H2 2023

AVISON YOUNG

What is happening in Greater Montréal?

In 2023, Montréal's commercial real estate market experienced a banner year for rental fundamentals, marked by positive absorption rates, rent growth, and low vacancy rates. However, capital markets faced some challenges: the bond market exhibited significant volatility as the 5-year Government of Canada (GOC) bonds rose from 3.0% in January 2023 to a peak of 4.5%, in October, before ending the year at 3.2%. The overnight rate also increased from 4.25% in December 2022 to 5.0% in July 2023, and remained at that level since.

Investment volumes saw a significant decline due to market uncertainty and larger transactions were scarce. Developers and office owners, including prominent entities like Réseau Sélection, Groupe Huot, Brivia, Slate Office, Northview Health Care, and Brookfield were among those hit hardest, leading to strategic reviews or liquidation.

As we transition into 2024, the commercial real estate outlook for Montréal reflects a more stabilized capital markets environment which is expected to stimulate deal activities. Despite challenges in the Canadian economy, including rising unemployment rates and overrun government deficits, positive real estate fundamentals are anticipated to maintain valuations at or above 5-year averages.

Private investment into Québec is poised to reach new benchmarks, suggesting a continued interest in this market, despite broader economic headwinds. That said, there are both opportunities and challenges to real estate investments, including the ongoing transformation of the industrial sector, the limited supply of apartment construction to address the housing shortage, and the expected rise in office vacancy. The notion that office vacancy rates may continue to rise throughout the year is creating both challenges and opportunities for investors.

In summary, while Montréal's commercial real estate market is expected to benefit from a stable capital markets environment and positive fundamentals, stakeholders should remain vigilant in the face of economic uncertainties and industry shifts. The need for careful monitoring and strategic decision-making is emphasized to navigate potential challenges and capitalize on emerging opportunities in this rapidly evolving landscape.

Mark Sinnett
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Investment market trends

01

Rate cuts coming into view

After ten consecutive hikes over 18 months, the current overnight rate is at its highest point since 2001. The pace of transactions in 2023 declined significantly as investors paused to allow for price adjustments.

Rates have remained stable since Q3 2023, infusing cautious optimism into the investment community. While it will take a few more months to materialize, there is a sense that the market is bouncing back. Hints of a rate cut in the next 6-12 months should further enhance investment activity.

02

Financing at the core of the investment strategy

Prevailing market dynamics have prompted lenders to adjust their strategies, emphasizing safeguarding capital (rather than growing it). Anticipating a prolonged economic deceleration in 2024, lenders are maintaining a cautious stance until there is a notable change in circumstances.

Despite this, robust capital remains available for well-qualified assets and creditworthy borrowers, with a particular preference for industrial and multi-residential asset classes. Additionally, as declining bond yields are making current cap rates more attractive, we expect more opportunities to arise for investors.

03

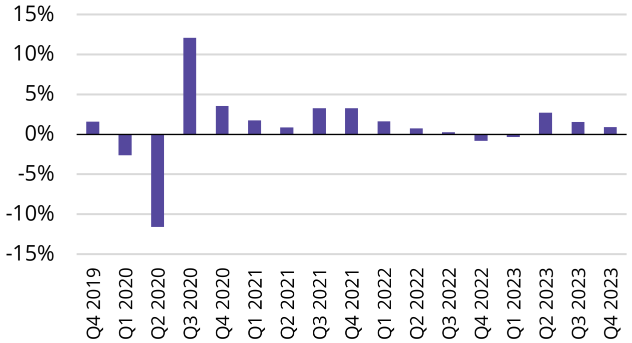
Dry powder ready for deployment

Last year, the volatility of debt markets instilled uncertainty and had a significant impact on investors' willingness to deploy capital. Many adjusted their investment and asset allocation strategies to consider the increased transactional risk, with several pension funds and institutional investors temporarily side-lined. This opened up the opportunity for private investors to add to their portfolios.

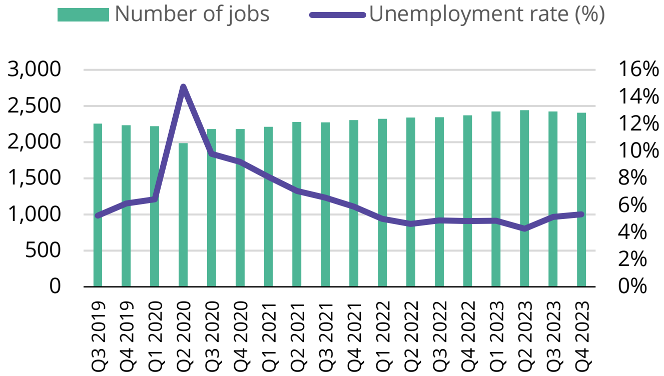
Most investors remain well-capitalized with ample dry powder ready to deploy. As the market settles, it is expected that transactional activity should pick up, especially when the first rate cut comes into effect. Investors sidelined in 2023 are preparing to execute and rapidly deploy capital in 2024.

Greater Montréal economic snapshot

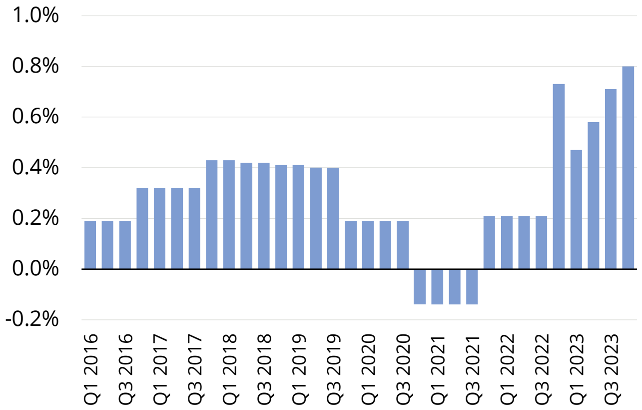
GDP growth (%)



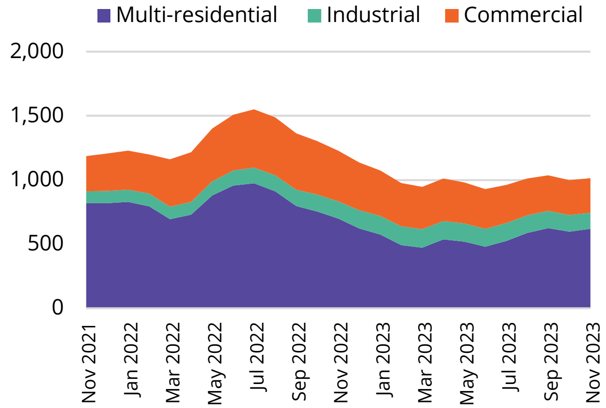
Employment growth (000 and %)



Population growth (%)



Investment in construction (millions $)



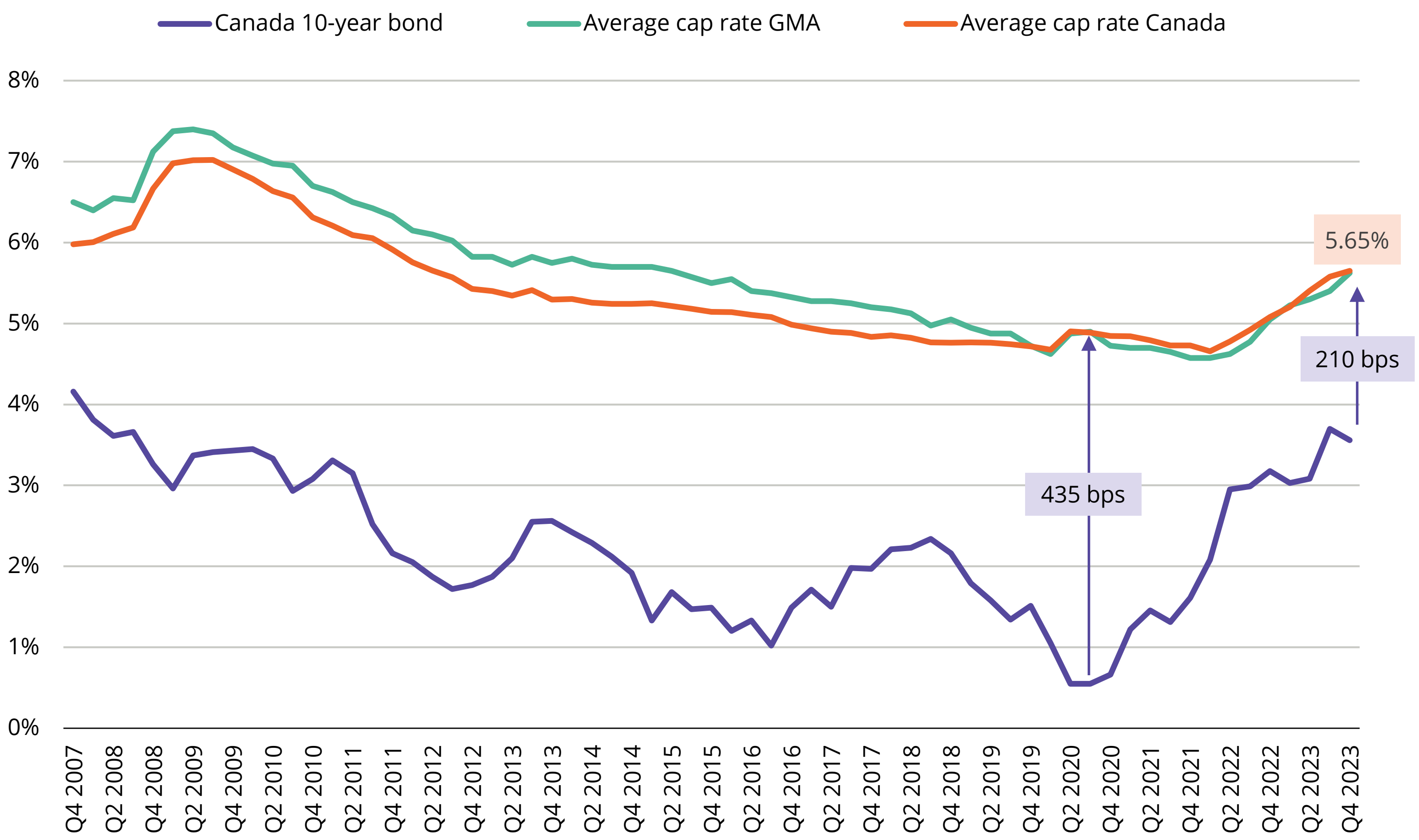
Source: Oxford Economics and Statistics Canada

Though Montréal's GDP growth slowed during the fourth quarter of 2023, it still achieved a modest but positive annual growth of 0.6%. The mild downturn is expected to persist into the first half of 2024, as consumers rein in spending and the business services sector faces headwinds.

However, the second half of 2024 should herald a resurgence of growth in Montréal, with GDP, employment, and consumption all poised for a rebound.

Greater Montréal investment market indicators

National cap rate trends



Source: Altus ITS and Bank of Canada

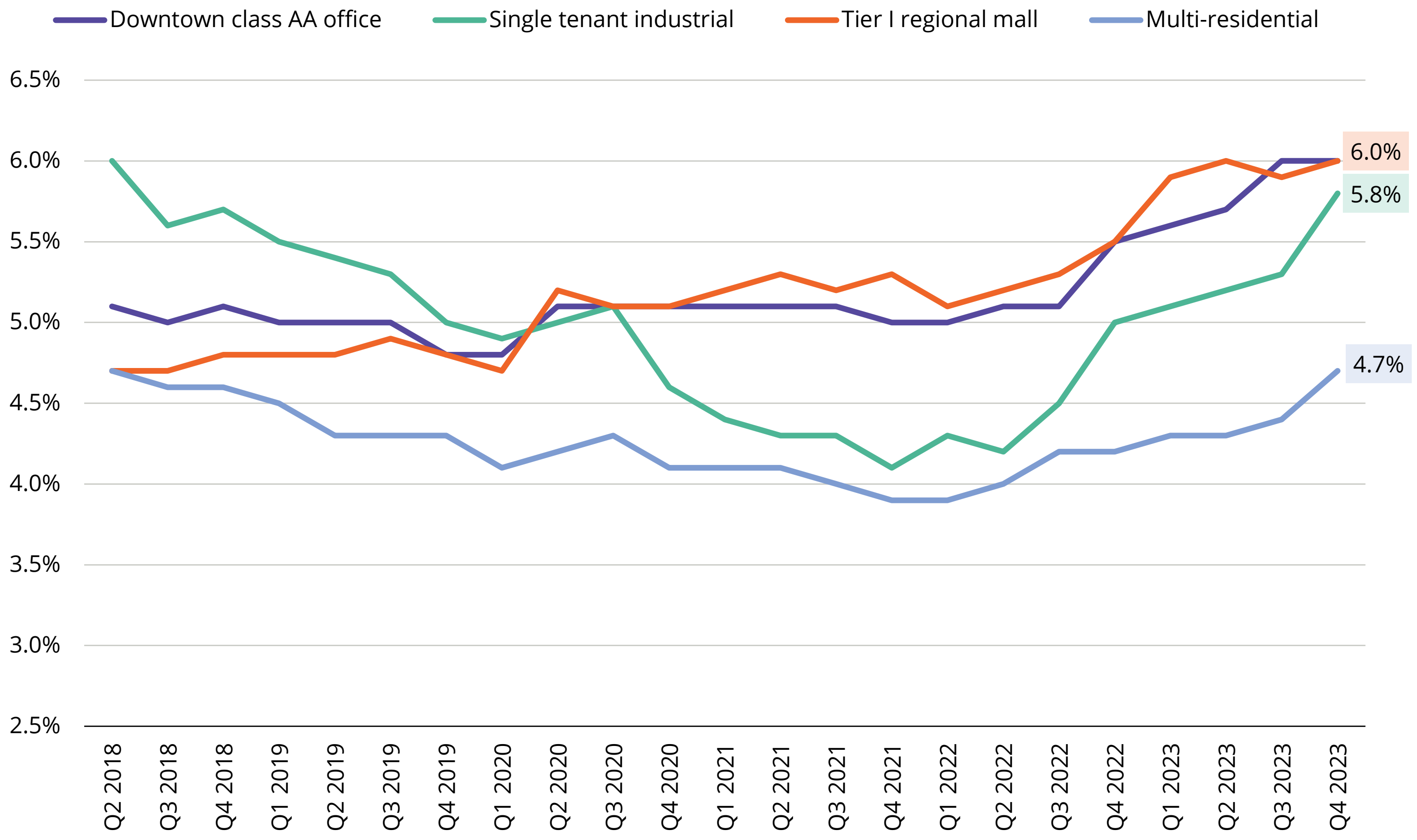
National and local average capitalization rates have been trending upward since 2022. However, the historical 25-50 bps risk premium associated with Montréal has subsided since 2020 and expected returns have been aligned with national trends, reflecting the increasing attractiveness of this market for Canadian and foreign investors.

Average cap rate trends however do not reflect the significant variations of investors' expected returns specific to property types and building quality.

It is expected that further capital coming back to the market could, over the next year, bring back downward pressure on cap rates and shift their trajectory once interest rates decline.

Greater Montréal investment market indicators

GMA capitalization rate trends



Source: Altus investment trend survey Q4 2023

Market volatility, particularly of the 5-year and 10-year bond yield, caused a decline in transaction volume and a concurrent expansion of cap rates across all asset classes. The trend is most noticeable in the industrial and multi-residential sectors – the investment community darlings – which experienced significant activity in recent years and are now being corrected.

With strong fundamentals, a stabilizing capital markets environment, and a rate cut on the horizon, we expect transactional activity to pick up and cap rates to stabilize or contract.

Greater Montréal investment activity

34%

Year-over-year drop in Greater Montréal area (GMA) investment volumes

Investment volumes across the GMA dropped by 34% year-over-year (YoY), as volatility roiled the debt markets. The industrial sector saw the biggest change, with a 53% drop in sales, as a result of a market correction following two years of record activity. Industrial sales volumes in 2023 remain above historical averages. Despite a more challenging lending environment, multi-residential transactions accounted for 38% of all GMA sales, testifying to the resilience of this sector. Private buyers accounted for the majority of transactions, as institutional capital was sidelined given tighter lending conditions.

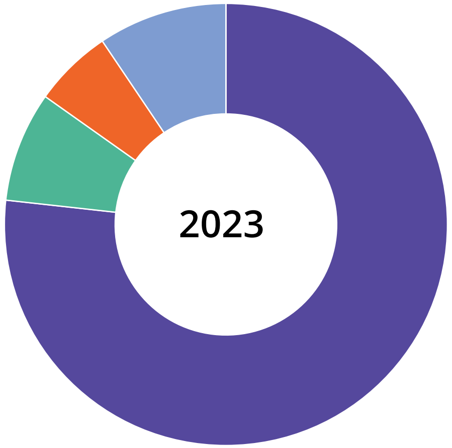
Transaction by investor profile – GMA

Canadian private investors
76.76%

Canadian institutional investors
8.06%

Foreign investors
5.76%

Other (developers, users, government)
9.42%



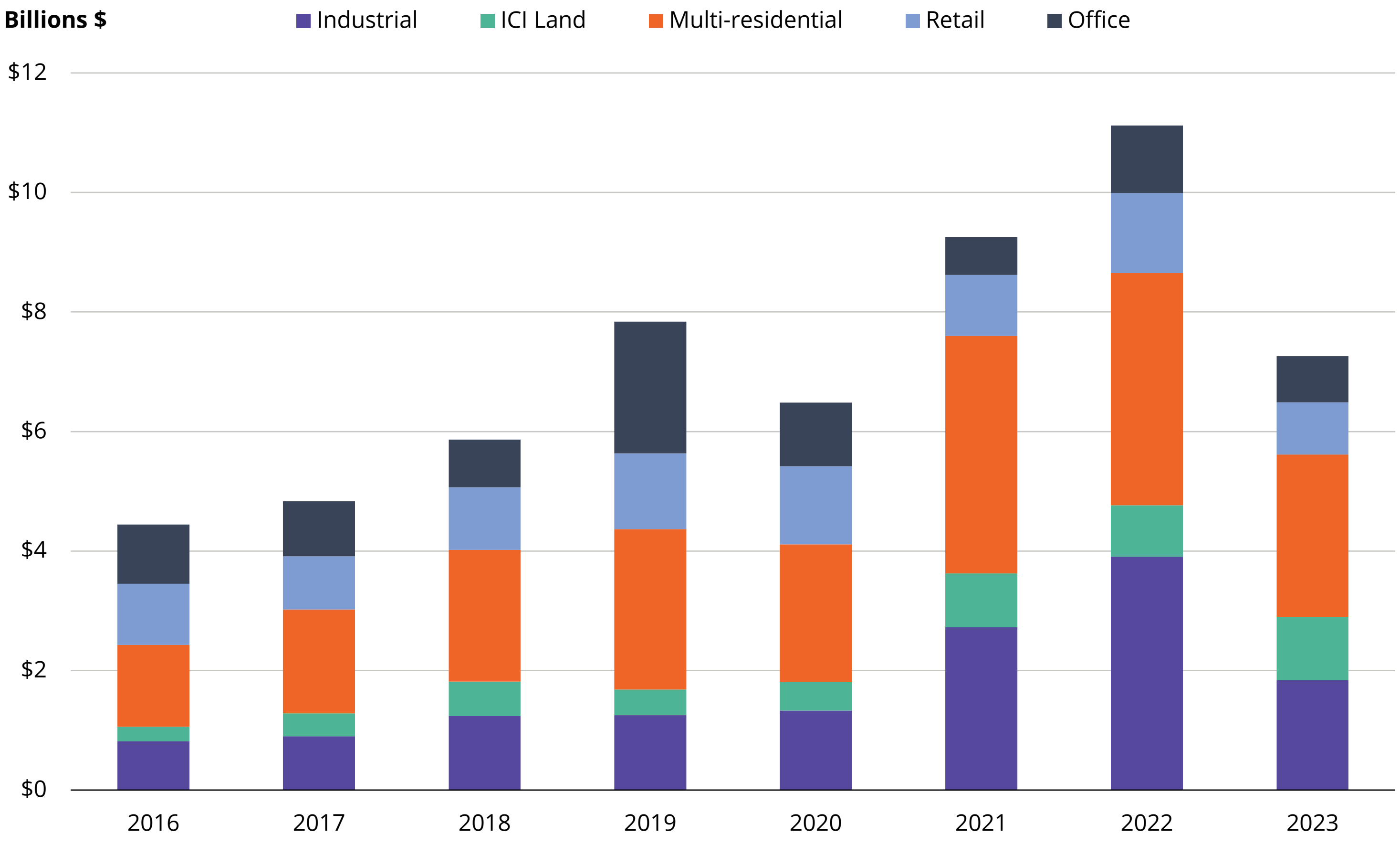
Annual sales volumes

Sales volume ($)	2023	2022	Change YoY
Industrial	$1.83B	$3.90B	**-53%**
ICI Land	$1.05B	$861M	**22%**
Multi-residential	$2.71B	$3.88B	**-30%**
Retail	$872M	$1.33B	**-34%**
Office	$775M	$1.05B	**-26%**
Total	$7.237B	$11.021B	**-34%**

Source: Altus Data Studio

Greater Montréal investment activity

Transaction by asset class



Source: Altus Data Studio

2023 sales activity returned to more normalized transaction levels from its recent post-pandemic highs. Investors are adjusting to a new reality of higher cost of capital.

The multi-residential and industrial sectors remain the preferred asset classes among real estate investors.

Industrial

Market cools off in 2023

2023 industrial investment volumes slowed considerably compared to 2022, totaling just $1.8 billion this year versus $3.9 billion the previous year. According to Avison Young's proprietary cap rate survey, class A industrial assets in the GMA trade between 5.60% and 5.70% while class B properties trade between 6.45% and 6.65%.

Across the industrial market, demand for space softened, as consumer spending and online sales volumes stabilized. After 18 months of supply chain dysregulation, balance is finally returning, leading to a slight uptick in vacancy rates, attributed to a slowdown in absorption and the introduction of new sublet spaces.

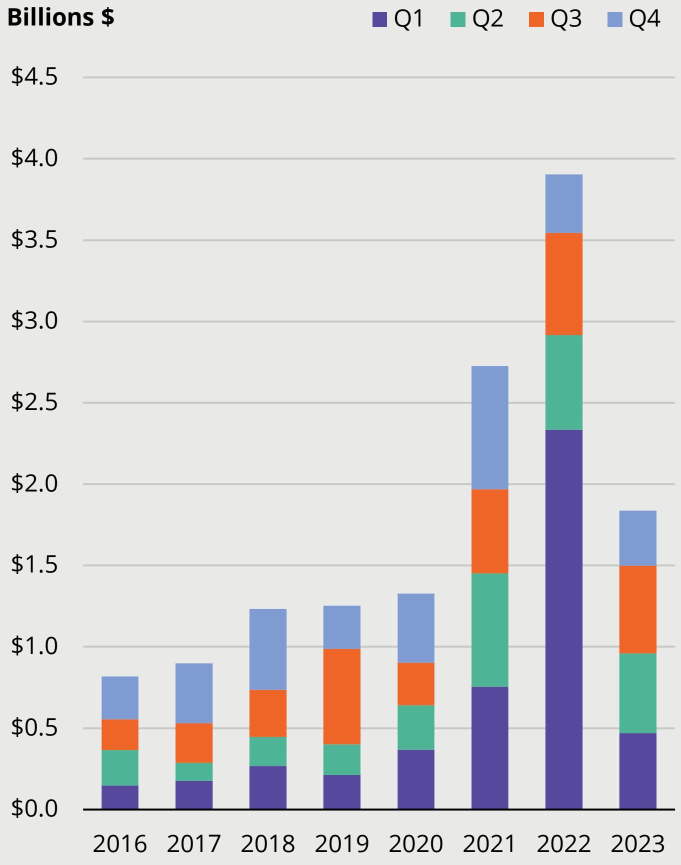
Nonetheless, private and institutional investors remain actively interested in industrial investments. For instance, Equinix REIT acquired 9200 TransCanada in Saint-Laurent for $121 million or $211 per square foot (psf). Industrial is the asset class in which institutional investors remain the most active.

In navigating uncertain times, investors place a premium on tenants with financial stability, long-term commitments, or those operating in sectors resilient to economic fluctuations, recognizing these attributes as crucial safeguards against potential risks.

Significant sale transactions

Address	District	Sale price / $ psf	Buyer	Seller
9200 TransCanada Highway (A-40)	Saint-Laurent	$121,500,000 / $211	Equinix REIT	Hypertec Immobilier Inc.
715 Dubois Street	Saint-Eustache	$69,700,000 / $152	Adesa Montréal Corporation	Cox Automative Canada Company
8550 Montview Road	Mont-Royal	$53,218,326 / $227	Cosa-Nova Fashions Limited	Brasswater
5400 Thimens Boulevard	Saint-Laurent	$43,600,000 / $185	BentallGreenOak	Manulife
650 Lee Avenue	Baie-d'Urfé	$28,000,000 / $157	Panoptic Properties	Industries Rehau Inc.

Industrial investment volume



Source: Altus Data Studio

ICI land

Transaction volume correlate to supply and demand

ICI land sales accounted for 15% of all GMA transactions in 2023, for a total of $1.06 billion, a 23% surge compared to 2022.

Land purchased for industrial use made up 66% of total sales, which is indicative of a continued high demand and scarce supply and the trust and confidence investors and developers place on industrial assets across the GMA.

Prices for on-island industrial land sales hovered around $40-45 psf, which explains why developers choose to maximize their development projects. In peripheral sectors, prices vary based on industrial use and zoning.

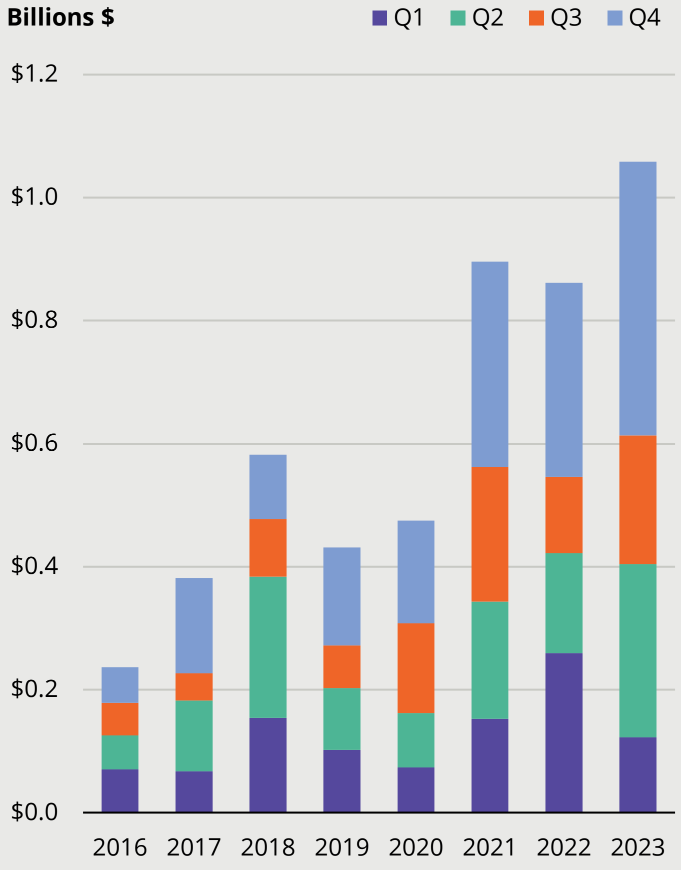
Headwinds include the elevated cost of capital as well as rising construction costs, which make development proformas more challenging to execute. This will have profound effects on pricing for new projects in the coming years.

The most notable transaction involved Northvolt's acquisition of 18.5 msf in Saint-Basile-le-Grand. This site was previously purchased in 2015 by Quartier MC2, before a change in zoning, at the cost of $20 million.

Significant sale transactions

Address	District	Sale price / $ psf	Buyer	Seller
De Richelieu Road (Industrial)	Saint-Basile-le-Grand	$240,000,000 / $13	Northvolt AB	Quartier MC2 Inc.
Côte de Liesse Road (Commercial)	Saint-Laurent	$87,269,591 / $168	Dollarama S.E.C	Carbonleo
De la Pinière Boulevard West (Industrial)	Terrebonne	$84,987,840 / $35	Rosefellow	Centre de Golf, Le Versant Inc.
Cléroux Boulevard (Commercial)	Laval	$33,000,000 / $19	Triovest	Investissements Elmag Inc.
Hochelaga Street (Industrial)	Mercier-Hochelaga-Maisonneuve	$26,054,177 / $26	Ville de Montréal	Hydro-Québec

ICI Land investment volume



Source: Altus Data Studio

Retail

The resurgence of retail

After an overcorrection in recent years, retail investments are back in vogue, buoyed by a demographic boom, limited new construction, and sustained in-person shopping.

Retail investments totaled $872 million in 2023, down from the $1.3 billion in 2022, but in line with overall investment trends.

Needs-based retail remains highly sought-after. According to Avison Young's proprietary cap rate survey, cap rates for grocery-anchored neighbourhood strip malls average between 6.25%-7.40%, whereas single-tenant retail trade around 6.35% to 7.40%.

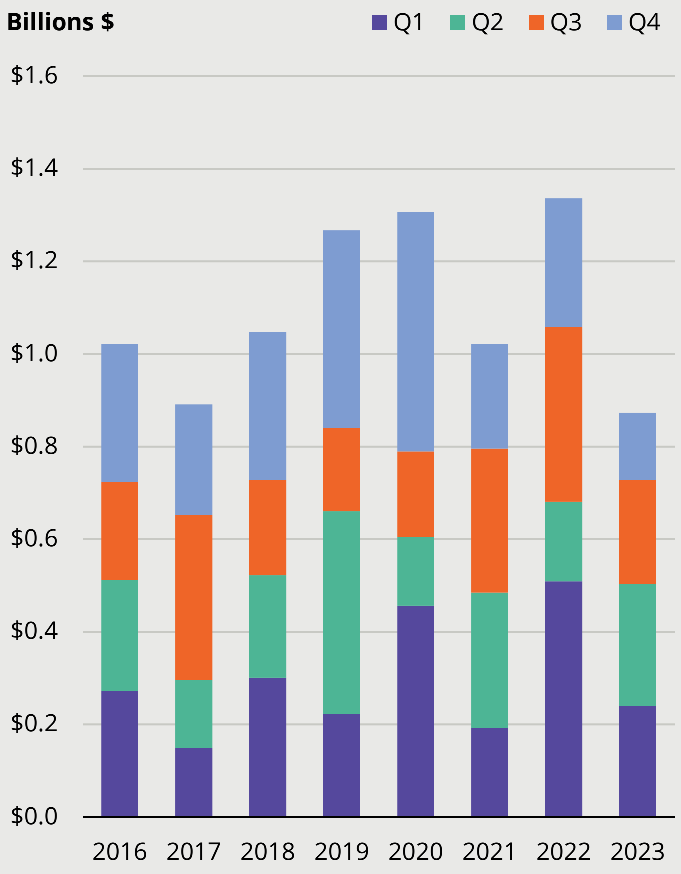
Robust rental growth, driven by increasing sales volumes and a scarcity of new inventory, combined with limited investment opportunities, is effectively curbing upward movements in cap rates for retail properties, despite facing elevated capital costs.

Investors have been venturing out of the Montréal core to get closer to population growth in the peripheral and secondary markets.

Significant sale transactions

Address	District	Sale price / $ psf	Buyer	Seller
Rainbow Capital Investments Limited, GMA Retail 2023 Portfolio	Montréal	$68,000,000 / $142	Rainbow Capital Investments Limited	H&R REIT
Loblaw-Development CP FPI PPL Quebec Ltee GMA Retail Portfolio 2023	Montréal	$29,485,000 / $227	Developments CP FPI PPL Quebec Ltee	Loblaws
600-790, 850 Saint-Maurice	Trois-Rivières	$14,375,000 / $128	Pava Corp	Skyline REIT
655 des Promenades Boulevard	Saint-Bruno-de-Montarville	$11,843,673 / $281	1000481270 Ontario Inc.	Fairfax Financial Holdings Ltd.
132-136 Lépine	Gatineau	$5,500,000 / $258	Private (D. Di Francesco)	Fiera

Retail investment volume



Source: Altus Data Studio

Office

An uncertain market

Office investment sales represented the slowest performing asset class in 2023, at $775 million. As demonstrated by Avison Young's latest cap rate survey, office cap rates have seen the largest expansion among all asset types. As of Q4 2023, class A downtown and suburban office range from 6.85% to 7.85%, while class B downtown and suburban properties trade between 7.35% to 8.65%.

Office real estate is undergoing a profound transformation, transitioning from a mere workplace to an immersive experience. The post-pandemic era is shaping a new equilibrium with the evolution of the hybrid work model.

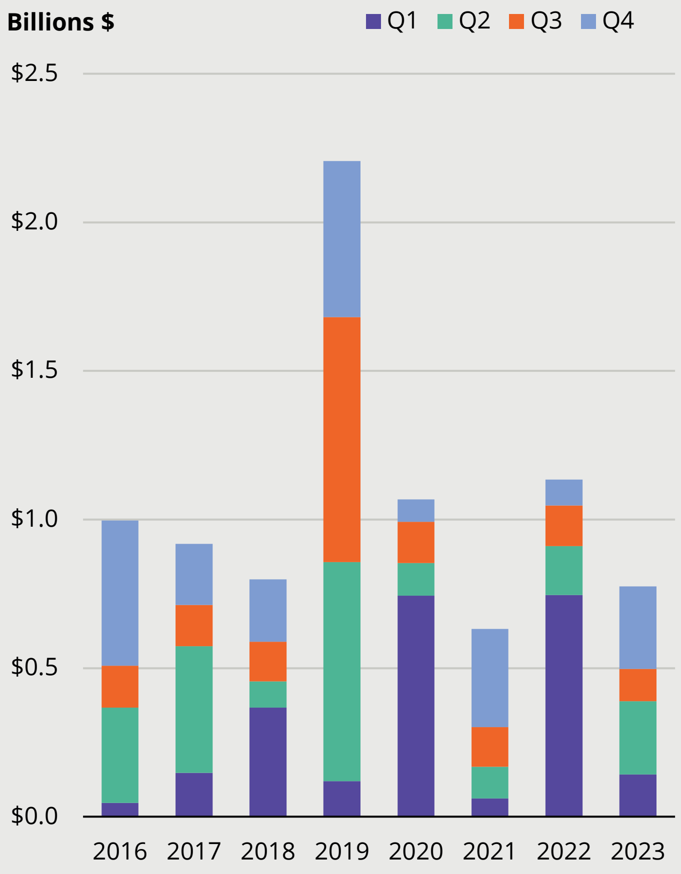
This shift opens up opportunities for owners and developers to craft spaces that are not only flexible and collaborative, but also rich in amenities. The goal is to entice tenants and their employees back to the office by creating an environment that aligns with the changing dynamics of work, fostering a sense of flexibility and collaboration.

The recent sale of 700 Saint-Jacques Street from Broccolini to National Bank showcases the differentiation advantage that trophy assets have compared to their lower-quality, less amenitized counterparts. By securing this space for its potential future needs, the Bank also confirmed the allure of downtown high-end spaces.

Significant sale transactions

Address	District	Sale price / $ psf	Buyer	Seller
700 Saint-Jacques Street	Ville-Marie	$149,200,000 / $452	National Bank	Broccolini
400 Armand-Frappier Boulevard	Laval	$36,302,739 / $182	HarveyCorp	Cominar REIT
4855 Marc-Blain Street	Saint-Laurent	$23,000,000 / $315	Brasswater	Canderel
8 Place du Commerce	Nun's Island	$20,000,000 / $334	Group Mach	Allied Properties REIT
625 René-Lévesque Boulevard West	Ville-Marie	$16,225,000 / $135	Group Mach	Sun Life Assurance Company of Canada

Office investment volume



Source: Altus Data Studio

Multi-residential

A hedge against uncertainty

The multi-residential sector remains the most attractive to investors, representing 38% of all GMA investment sales. That said, cap rates remain aggressive, ranging from 4.5% to 5.0% for new, purpose-built rental while vintage products traded between 4.25% and 4.75%.

Multi-residential assets continue to act as a hedge that shields capital from market volatility. Macroeconomic fundamentals, such as high immigration and demographic growth as well as limited construction activity, continue to support aggressive multifamily rental growth – 9% year-over-year – low vacancy, and significant asset appreciation.

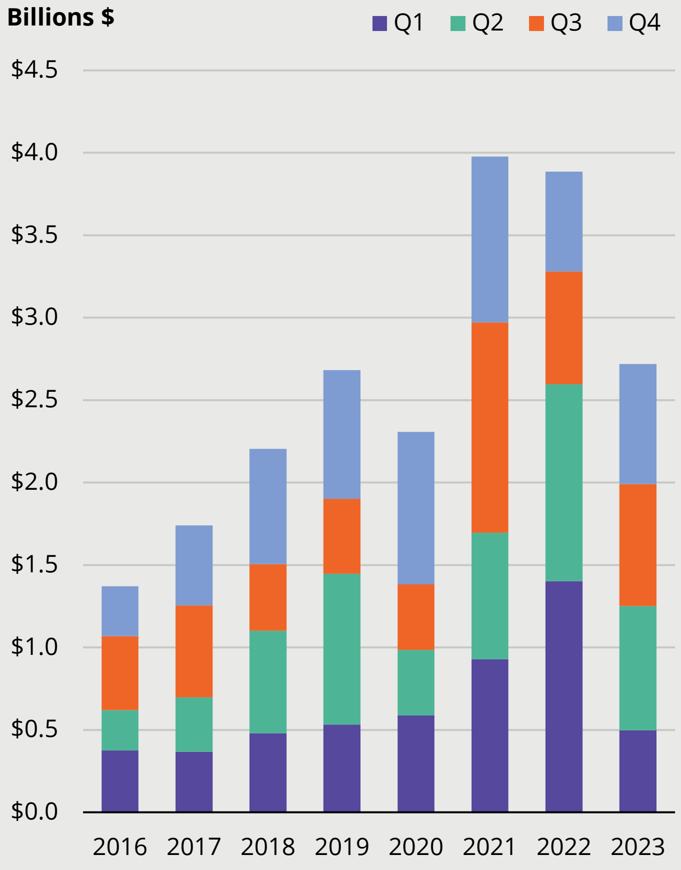
Though financing has been impacted by recent rates hikes, government emphasis on housing supply through initiatives and the CMHC MLI Select program may have softened the blow. It is expected that multi-residential assets will remain an important component of investors' capital allocation strategy.

With the rise in financing costs having significantly slowed construction activity, the pipeline of products available on the investment market remains limited. The expected fall in interest rates should help to revive housing starts and broaden investment opportunities.

Significant sale transactions

Address	District	Sale price / $ per unit	Buyer	Seller
14005 Sherbrooke Street East	Rivière-des-Prairies-Pointe-aux-Trembles	$102,000,000 / $141,667	Société Immobilière Mainbourg	Greenwin
2051 Stanley Street	Ville-Marie	$69,000,00 / $387,640	Maddox Stanley Inc.	Brivia Group
10 Vermont Avenue	Pointe-Claire	$65,000,000 / $297,727	Global General	Realstar
1180-1900 du Fort	Shaughnessy Village	$26,550,000 / $188,296	Leyad	CIF Montréal
4875-4905 des Érables	Pierrefonds	$20,300,000 / $165,041	Empire Building Management	Village Towers

Multi-residential investment volume



Source: Altus Data Studio

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