Office Market Report / Fourth quarter 2021

Montréal, QC

Highlights

$40.77

average gross rental rate per square foot Downtown Montréal

16.5%

total availability rate all asset classes Greater Montréal

2.4%

sublet availibility rate all asset classes Greater Montréal

-1.68

million square feet annual absorption Downtown Montréal

After two long years of pandemic marked by disruptions and postponed decisions, a sense of predictability has gradually set in and tenants' intentions regarding the return to the office are coming into focus. The remote work imposed by the provincial government after the holidays has only deferred the implementation of return-to-office plans that had been developed or in design. Regardless of the workplace strategies elaborated, there is a sense that these will materialize in the near future. Employers are determined to rally the troops and bring collaboration, corporate culture, and *joie de vivre* back to the workplace.

The recovery in activity that seems to be taking shape for 2022 is not yet reflected in the most recent market statistics. Indeed, key statistics for the fourth quarter of 2021 paint a mixed picture of office market conditions. If we have started to see an uptick in leasing activity over the past months in certain nodes, low demand for office space overall is a concern. As tenants implement their strategies to optimize their workplace for post-Covid, we will be in a better position to appreciate the medium-term impact on office space demand.

Availability

The availability rate for the office market in the Greater Montréal area (GMA) has increased again during the fourth quarter of 2021, reaching an all-time high of 16.5%, up from only 10.9% just before the pandemic. And after showing encouraging signs of stability in the first half of 2021, availability rates started trending upwards again in the second half of the year.

The Downtown market, which makes up half of the GMA's office inventory, is the hardest hit by the low level of leasing activity. The availability rate for the Downtown market jumped by 1.6% percent between Q3 and Q4, which is the most significant increase since the third quarter of 2020. The increase in availability rate in Q4 was almost as significant in Montréal East (+1.4%) and in Laval (+1.4%). The Laval market had shown signs of improvement in 2021, but several large spaces, including two new sublets, were listed on the market in November and December. On the other hand, availability rates in the Midtown and West Island areas have remained stable in Q4, for a third consecutive quarter. The South Shore is the only node which has seen a decrease in availability, from 15.5% in the third quarter to 14.3% in the fourth quarter.

Availability rates in Q4 2021 are obviously much higher compared to 2020 pre-pandemic levels, especially in Laval (+7.8%) and Downtown (+7.3%), but also in Midtown (+4.1%), Montréal East (+4.1%) and the South Shore (+3.1%). Only the West Island market shows a decrease of availability (-1,6%) since March 2020. We have since seen a few signs of improvement throughout 2021 in some suburban markets where the availability rates decreased year-over-year, namely on the South Shore (-0.7%), in the East-End (- 0.8%) as well as the West Island (-1.2 %). The availability rate in Laval also followed this downward trend during most of 2021, up until the fourth quarter, when a major increase in availability wiped out the 80-percentage-points decrease cumulated since Q1. Overall, the positive variations in availability seen in the suburbs mostly favored B-class buildings.

The situation has been stable in the past year in Midtown which saw fewer conversion projects from former industrial to lofts office space. Class-A buildings, which represent only 13% of the Midtown inventory, have the lowest availability rate of all markets, as has been the case throughout the pandemic.

While the few signs of improvement in these submarkets are encouraging, the situation for the Downtown office market remains a concern across all building categories. Unlike other submarkets, the amount of space available for lease and sublease Downtown has been steadily increasing since March 2020 and there is no sign indicating when this trend will end.

Sublease
Sublease space represents an increasingly large portion of the total available supply. In the first few months of the pandemic, the initial reaction from several companies was to try to sublease their unused space. Every quarter since March 2020, an average of over 225,000 square feet (sf) was added to the sublease market. The volume of sublets on the Montreal office market grew from 8.3% of total available space just before the pandemic to 14.7% in Q4 2021 – an unprecedented proportion.

For the Downtown market, that share of total availability increased from 6.2% in March 2020 to 14.8% in Q4 2021, the highest since the 16.0% peak reached in 2013. Since then, sublease availability in the Downtown market had gradually tightened, to a point where less than 250,000 sf of sublet space was available in early 2020, which is five times less than what is listed on the Downtown sublease market today. For Downtown class-A buildings alone, a total of 550,000 sf for sublease was listed in the fourth quarter, which represents 13.0% of the total available space, and three times more than before the pandemic.

Although this soaring volume is concerning, it's important to put things into perspective. For starters, the share of available space from subleases is lower in Downtown Montréal than in Downtown Toronto (21.2%) or Downtown Vancouver (23.5%). Moreover, the amount of sublease space in the heart of those cities has been steadily decreasing since the beginning of 2021, which means that the situation could also stabilise in Montréal in 2022. Considering that most of the unused space put up for sublease by companies during the pandemic is still available, nothing prevents sublessors from taking their space back, in part or in whole, if and when they need it. The workplace strategies developed amidst the uncertainties of 2020 have since been reviewed many times, especially as we better understand the adverse effects of remote work on a full-time basis for various types of jobs and employees. That said, we know that several large blocks of space currently on the sublease market are part of a space-reducing program of a permanent nature and are not likely to be reclaimed by the sublessor.

Absorption
The greater Montréal market saw a negative absorption again in the fourth quarter of 2021, which accounts for slightly over 100,000 sf, attributable mostly to the Downtown market. The other three submarkets which saw negative absorption this quarter – Montréal East, Laval, and Midtown – had modest quarterly variations relative to their total inventory, ranging from 50,000 to 70,000 sf.

Under construction

2.70

million square feet under construction
Greater Montréal
12 buildings

2.09

million square feet under construction
Class A
Greater Montréal
5 buildings

1.62

million square feet under construction
Downtown Montréal
5 buildings

Conversely, the absorption was positive in the West Island and on the South Shore, with gains of nearly 30,000 sf each in Q4. Moreover, absorption on the South Shore has been positive since March 2020, especially in the Solar Uniquartier and DIX30 nodes. This small pocket of the market boasts a net growth of 130,000 sf of leased space in the fourth quarter, which is significant, considering that it only represents 5% of the total GMA inventory. The 3400 de l'Équinoxe project, a new tower of 230,000 sf that will be delivered in 2022 in Solar Uniquartier, is already nearly 50% leased, which seems to confirm that access to the REM is an attractive feature for tenants. This new address offers a high-quality work environment with good connectivity to transit for the growing pool of workers residing on the South Shore and expending further since the pandemic.

Occupancy costs

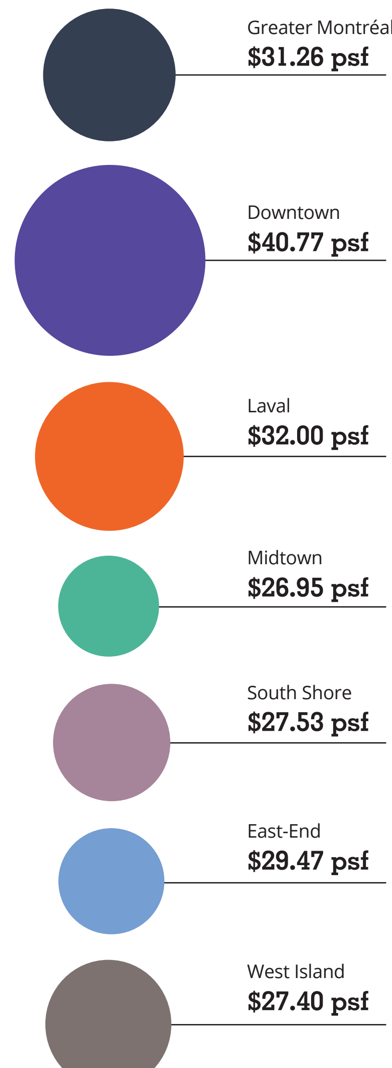
The average gross asking rent has remained relatively stable in the past quarter and over the course of the year, as did the average net asking rent and the additional rent (taxes and operating expenses). Since the average net asking rent only applies to spaces listed as available, they can present gaps with the average in-place rents, or contractual rents. The average asking rent can however provide a good baseline for comparing occupancy costs from one market sector to another and according to building class.

Based on average gross asking rents, occupancy costs are the highest in Downtown class-A buildings, standing at around $45.00 psf, compared to $30.00 psf for class-B buildings.

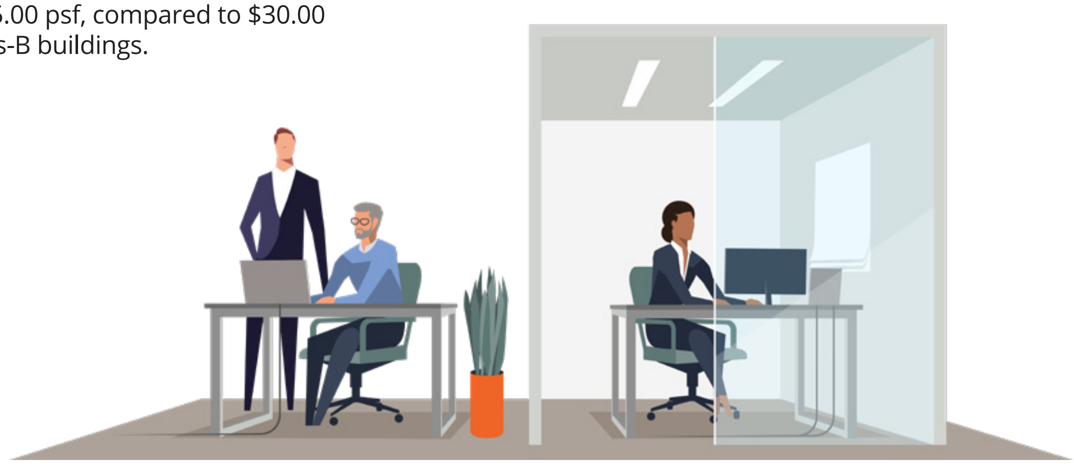
In suburban markets, the difference between gross asking rent averages for class-A and class-B buildings is not very significant. The same can be said about differences between Downtown class-B gross asking rents and averages for good quality class A and B suburban buildings.

In the current market, a building's class is no longer the ultimate measure of attractivity. While the prestige and attractiveness of an office building is still tied to the quality of its architecture and design, there are now many more criteria that come into play such as environmental footprint and other factors relating to employees' wellness like air quality, an inclusive layout, and access to a mix of commuting options. Office space design and access to amenities have also become a powerful lever for attraction and retention of employees. More than ever, cost-benefits site-location analyses are taking into account the labor shortage factor. The cost per square foot is no longer the end-all, be-all it once was. Behind every transaction, complex negotiations are underway regarding free rents, amenities and other leasing incentives. These are particularly generous in the context of decreasing demand whereby the market favors tenants.

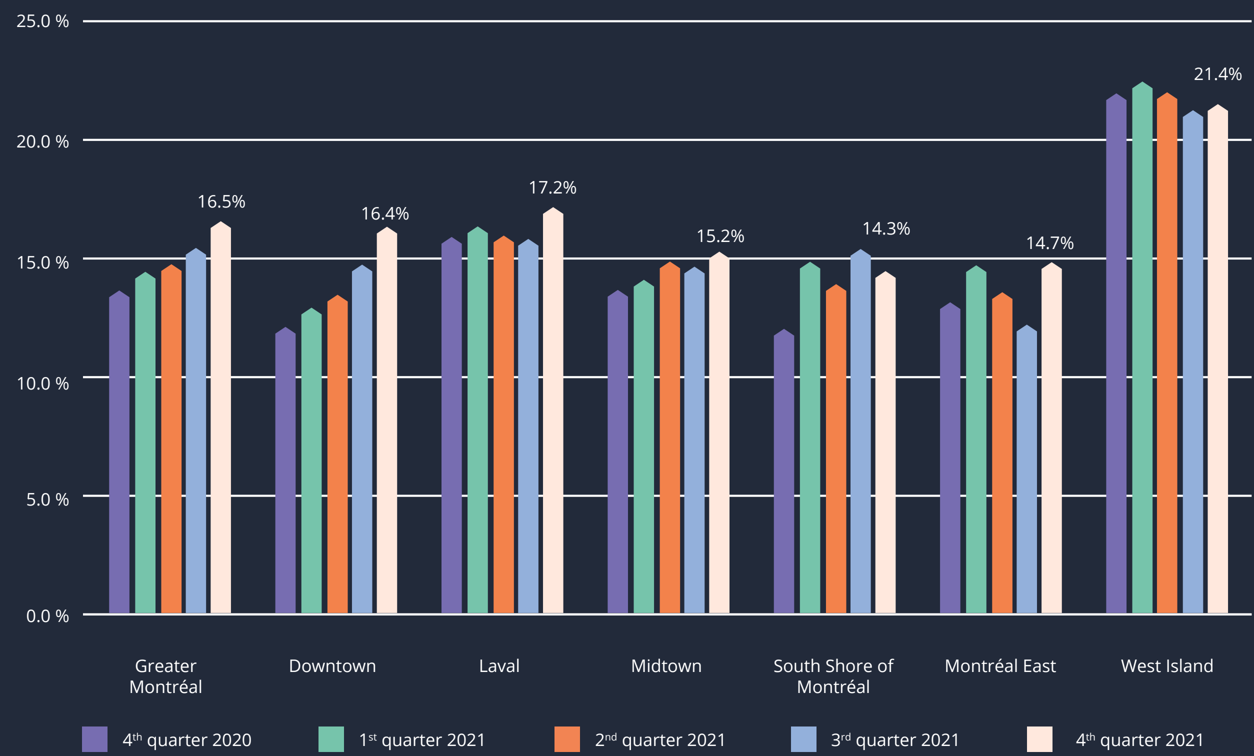
Average gross rent



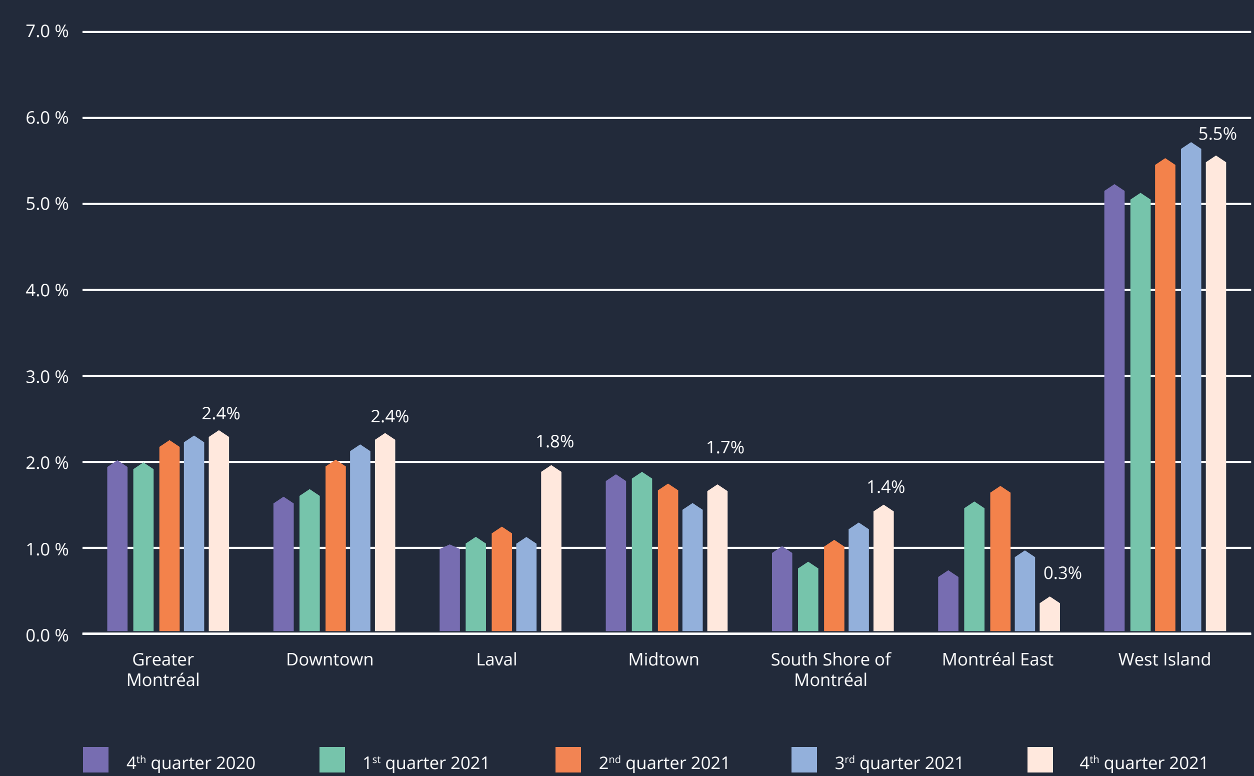
Source: Altus Group Limited



TOTAL AVAILABILITY, GREATER MONTRÉAL



SUBLET AVAILABILITY, GREATER MONTRÉAL



Behind every transaction, complex negotiations are underway regarding free rents, amenities and other leasing incentives.

Availability Downtown	Absorption Downtown
↑	↓
8,803,271 sf	-109,043 sf

Availability Greater Montréal	Occupancy Costs Greater Montréal
↑	↑
17,634,871 sf	$31.26 psf

Construction

There is a total of 2.7 million square feet currently under construction in Greater Montréal, including the 1.1 million square foot head office being erected for National Bank's headquarters. Other projects being built downtown include 700 Saint-Jacques (320,000 sf), right next to National Bank, 1300 Sherbrooke West (100,000 sf), and further East, 700 Saint-Hubert (150,000 sf) on the Gare Viger site. Nearly 60% of the office space currently under construction is located downtown.

The supply of new office space in Midtown will be improved this year with the delivery of more than 600,000 sf, including the Royalmount project, a 340,000 sf office building at 8400 Décarie Boulevard. Although the conversion of former industrial buildings into lofts office space has slowed down in the central neighbourhoods of Midtown, two projects, one on Saint-Urbain and the other on Rue du Canal, should be completed this year.

In the suburbs, the majority of the development activity is related to Transit Oriented Development (TOD) projects. In Laval, the only office supply underway (200,000 sf) is part of the mixed-use TOD Espace Montmorency project. The other TOD project currently underway, 3400 De l'Éclipse, will add 230,000 sf of office space on the site located around the future REM station at Solar Uniquartier. Two other buildings were delivered in this sector shortly before and during the pandemic.

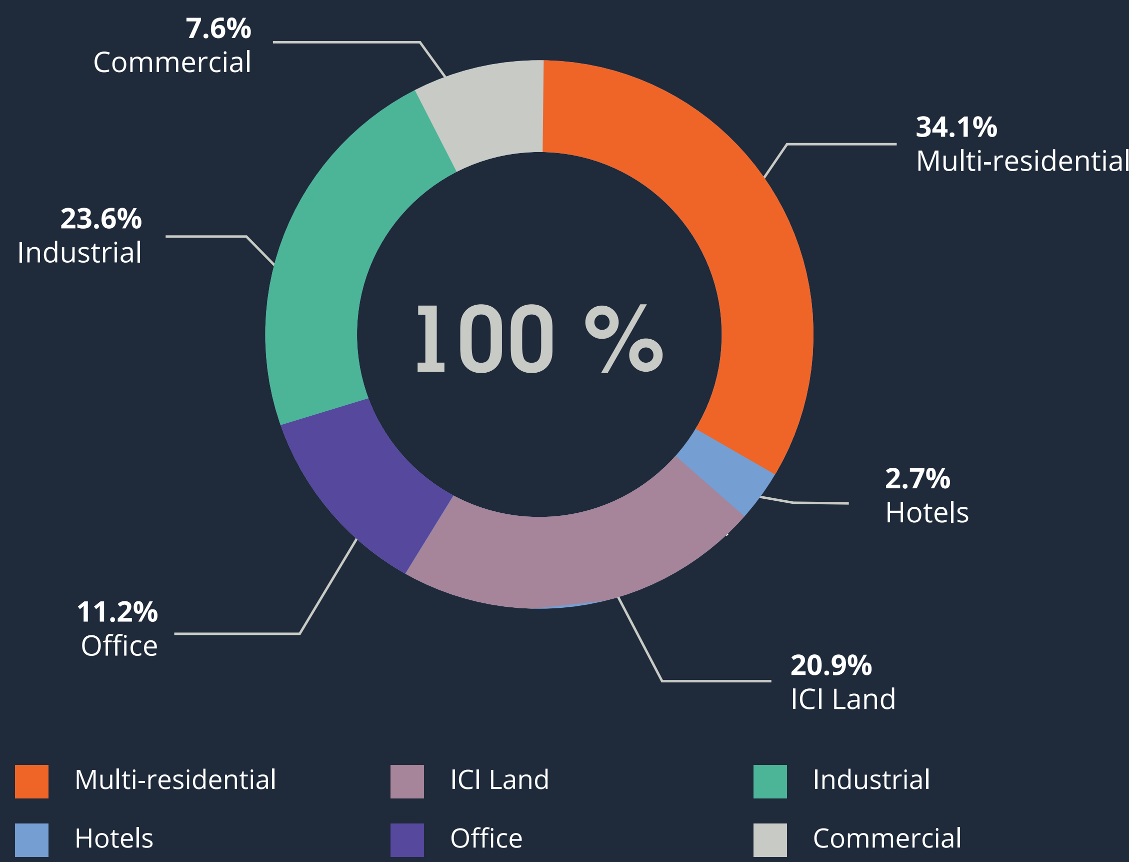
Investments

Over 550 real estate transactions across all categories of assets were closed in Montréal during the fourth quarter of 2021, for a sales volume of $2.8 billion, compared to $3.6 billion (673 transactions) for the third quarter. Investors' appetite for the multi-residential segment remains strong. This segment still makes up a third of the total investments this quarter, at $970 million. The industrial market follows the same trend, with total transactions of $670 million during the fourth quarter, which represents 24% of the total sales volume. The 22 office transactions that closed during the fourth quarter only constitute 11% of the total transaction volume, or $320 million.

After the sale of 1000 De La Gauchetière to Groupe Mach and Groupe Petra during the third quarter, for $482 million, and the acquisition of 275 Viger East by Allied REIT for $74 million, another major tower, 600 De Maisonneuve West, has also changed hands. The purchaser, Groupe Petra, thus concluded the largest office acquisition of the fourth quarter for $195.5 million. Another major transaction in the last quarter of the year was the purchase by BTB REIT of two office buildings on Alfred-Nobel in Technoparc for $72 million.

It's worth noting that the shareholders of Cominar REIT have approved the sale of the company for $5.7 billion to the consortium led by Canderel. Consequently, in early 2022, the assets owned by Cominar, the largest office and industrial building owner in Montréal, will be divided among Canderel, Groupe Mach and Blackstone.

INVESTMENT ACTIVITY, 4th QUARTER 2021



Source : Altus Group Limited

$2,846,417,909

Total commercial sales volume
Sales of 1 million dollars and more
4th quarter 2021

$320,110,001

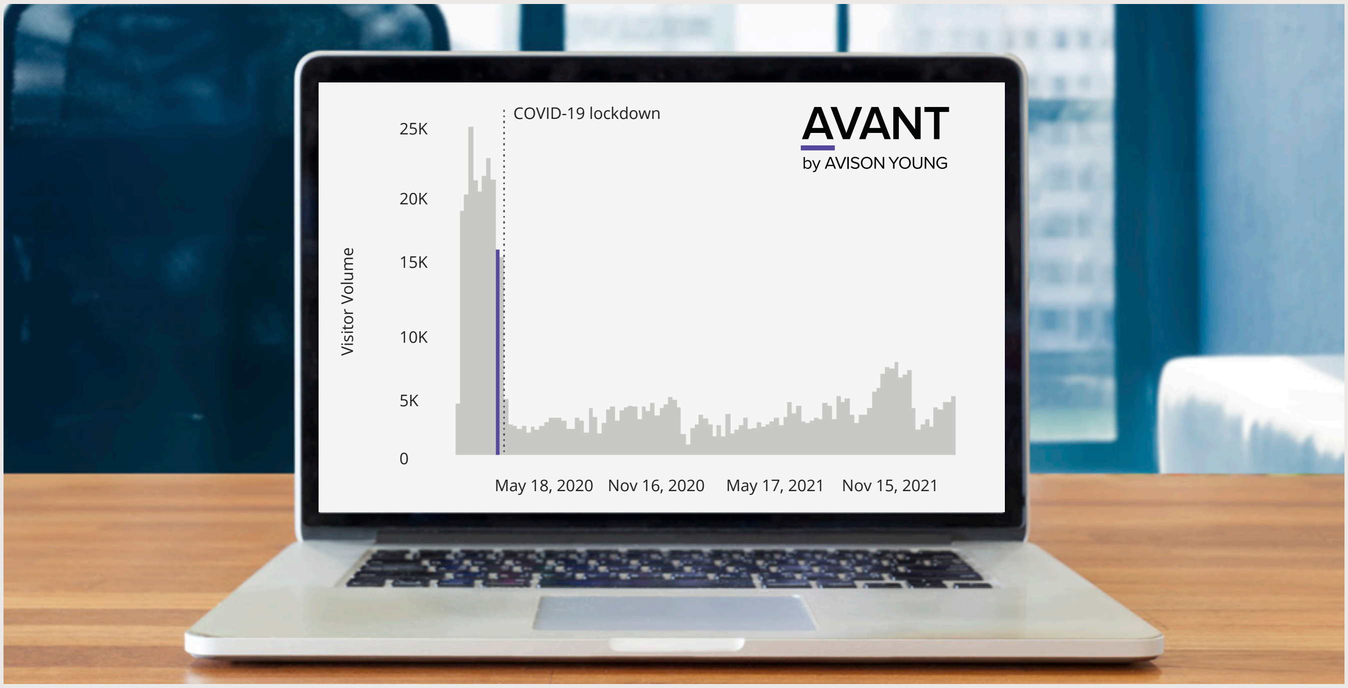
Total office building sales volume
Sales of 1 million dollars and more
4th quarter 2021

554

Total number of commercial sales
Sales of 1 million dollars and more
4th quarter 2021

22

Total number of office building sales
Sales of 1 million dollars and more
4th quarter 2021

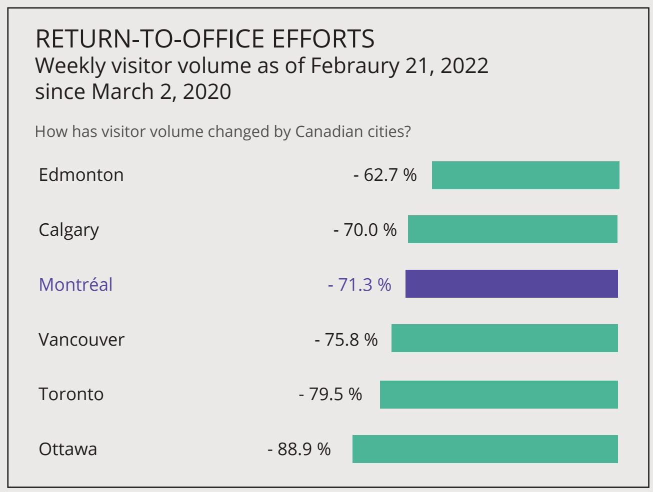


Recovery in the works

At the beginning of the fourth quarter, as the Delta variant seemed to be under control thanks to mass vaccination, companies had started to implement their plans to bring workers back to the office. A gradual return to work, mostly in hybrid form, was in clear view for the first months of 2022. The rapid spread of the new Omicron variant, however, took everyone by surprise, forcing governments and businesses to back down. The Covid era is not over yet, and in the meantime, life goes on, two steps forward, one step back. As hard as this step back may be, there is a sense that the variant has only postponed the recovery by a few months and that a return to normalcy is within reach.

We are not there yet, however, as illustrated by Avison Young's Vitality Index. Based on cutting-edge technology using anonymized geo-tracking data emitted by cell phones, Avison Young's Vitality Index tracks the daily volume of foot traffic for selected locations in 23 major cities across North America. By tracing the evolution in real-time of foot traffic in the various office hubs since in March 2020's lockdown, the Index shows that Canadian cities where very strict health measures were imposed after the holidays to limit the spread of Omicron were the most impacted in terms of foot traffic declines.

In Montréal, the Index also shows a significant increase in visitors in mid-September, followed by a steady increase, week after week, up until mid-December.



This indicates that the next lifting of restrictions should also have a direct positive impact on visitor volume, since people who are tired of remote work will, in theory, make their way back to the offices, whether full-time or part-time. However, the date recently announced by the Government of Québec for a physical return to work is not necessarily the same as those planned by companies. Guidelines vary between organizations. Some prefer a gradual return while others aim for March, April, or even June. Plans for the second half of the year could also change. Avison Young's Vitality Index will allow us to follow this evolution in real time, tracking the pulse of life in the city.

The end of remote work as a health measure

As of February 28, remote work will no longer be mandatory, even if Public Health continues to recommend it across the board, encouraging employers to postpone one more time the application of return-to-office policies that were planned before the onset of Omicron. Resorting to remote work as a health measure has helped companies in the early days of the pandemic, even allowing some gains in productivity while most office employees accommodated quite well.

However, as weeks turned into months, the adverse effects of full-time remote work have become more prominent. A recent global study by Microsoft confirms that, if remote workers were as or more productive during the year, it was at a significant human cost. Fifty-four percent of responders admitted feeling overwhelmed and 39% were exhausted. Time spent in Microsoft Teams meetings more than doubled (2.5 times) around the world, and the average meeting lasts 10 minutes more than before the pandemic. Studies on the adverse effects relating to an overuse of virtual meeting platforms and the "Zoom fatigue" phenomenon are surging. According to a comprehensive study by the *Stanford Virtual Human Interaction Lab*, the additional effort that the brain requires to send and receive non-verbal communication signals, which happen unconsciously and naturally in person, add to this mental fatigue. This form of communication also forces users to remain relatively inactive, in front of their monitor's camera, which is unhealthy.

Furthermore, the idea of favoring remote work at all times seems to make less sense when 90% of office workers are vaccinated and can, at any time, attend various public sites and entertainment venues. Many are starting to question whether this measure is still relevant at this point, as office tenants are ready to take action and implement their new workplace strategy. Remote work is here to stay, as it has become part of the new reality, but it will not be as widespread as it was during the lockdown. While there seems to be a consensus in favour of the hybrid model, there are as many hybrid formulas as there are corporate cultures. Tenants need to ensure they find the hybrid formula that best suits their company culture – one that creates unity within the teams and allows people to regain a sense of enjoyment from working together again.

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