Office Market Report / Third Quarter 2020

Montreal, QC

Quick Stats

$34.85

average gross asking rent per square foot Greater Montreal Area

12.5%

total availability rate all asset classes Greater Montreal Area

1.3%

sublet availability rate all asset classes Greater Montreal Area

1.93

million square feet year-over-year absorption Greater Montreal Area

Downtown Montreal remains mostly deserted by office workers, as the return to the workplace is going slower than businesses had hoped for, hindered by the second wave of the pandemic that hit the Greater Montreal Area in the fall. While landlords and employers are doing everything they can to bring back employees to the workplace in a safe and efficient manner, health and wellness concerns remain a challenge for workers traveling to the office. As the second COVID-19 wave gathers force in Quebec, these concerns are emphasized by dependance on public transit, the higher density in the city centre, as well as the peak in construction work Downtown making every movement very difficult, whether on foot or by car.

Over course of the year, as several companies announced they will have their employees work from home until at least the end of 2020 – some, like Google, until the Summer of 2021, it is becoming obvious that flexible work solutions are here to stay.

Not only are telecommuting solutions working for a lot of firms, they are highly practical and increasingly appealing to the workforce, which in turn has new expectations in terms of flexibility. This pushes office users to rethink their business model and occupancy strategy, which in time will most likely give way to a marked increase in distributed work over the coming quarters.

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Under Construction

3.90

million square feet
under construction
Greater Montreal Area
17 buildings

1.03

million square feet
under construction
Midtown
9 buildings

1.47

million square feet
under construction
Downtown Montreal
3 buildings

Availability
Over the past six months, we have observed a sustained increase in availability in the Greater Montreal Area (GMA) as the impact of the pandemic on the office market became clearer and clearer. The first quarter of 2020 recorded the healthiest availability rates of the past years across most submarkets, which helped counterbalance the first impacts from COVID-19. However, the availability is now reaching a point where the first quarter's low rates are no longer enough to balance the availability to somewhat healthy levels, and we can expect the Montreal office inventory to take a serious hit over the next quarters.

In the GMA, the overall availability rate reached 12.5% at the end of the third quarter of 2020, bringing the total office availability to over 13.1 million square feet (msf). Even though the overall availability rate is only slightly higher than it was at the end of the third quarter of 2019 (12.0%), the increase in availability over the past six months is more drastic, seeing as the first quarter of the year ended with an availability rate of 10.9% (11.2 msf). Based on these numbers alone, the total availability in the GMA has increased by 17% since the end of March 2020.

To no surprise, the sublet availability in the GMA has drastically increased year-over-year, reaching 1,395,721 square feet (sf) at the end of September 2020 from 971,244 sf in 2019, boosting the overall sublet availability from 0.9% to 1.3%. This represents a 43.7% increase over the past 12 months.

Downtown Montreal recorded the lowest availability rate of all submarkets in the GMA, as the overall availability rate reached 10.7% at the end of September from 9.6% one year ago. Of the total 13.1 msf of office space available in the GMA, nearly 5.7 msf are located in Downtown Montreal.

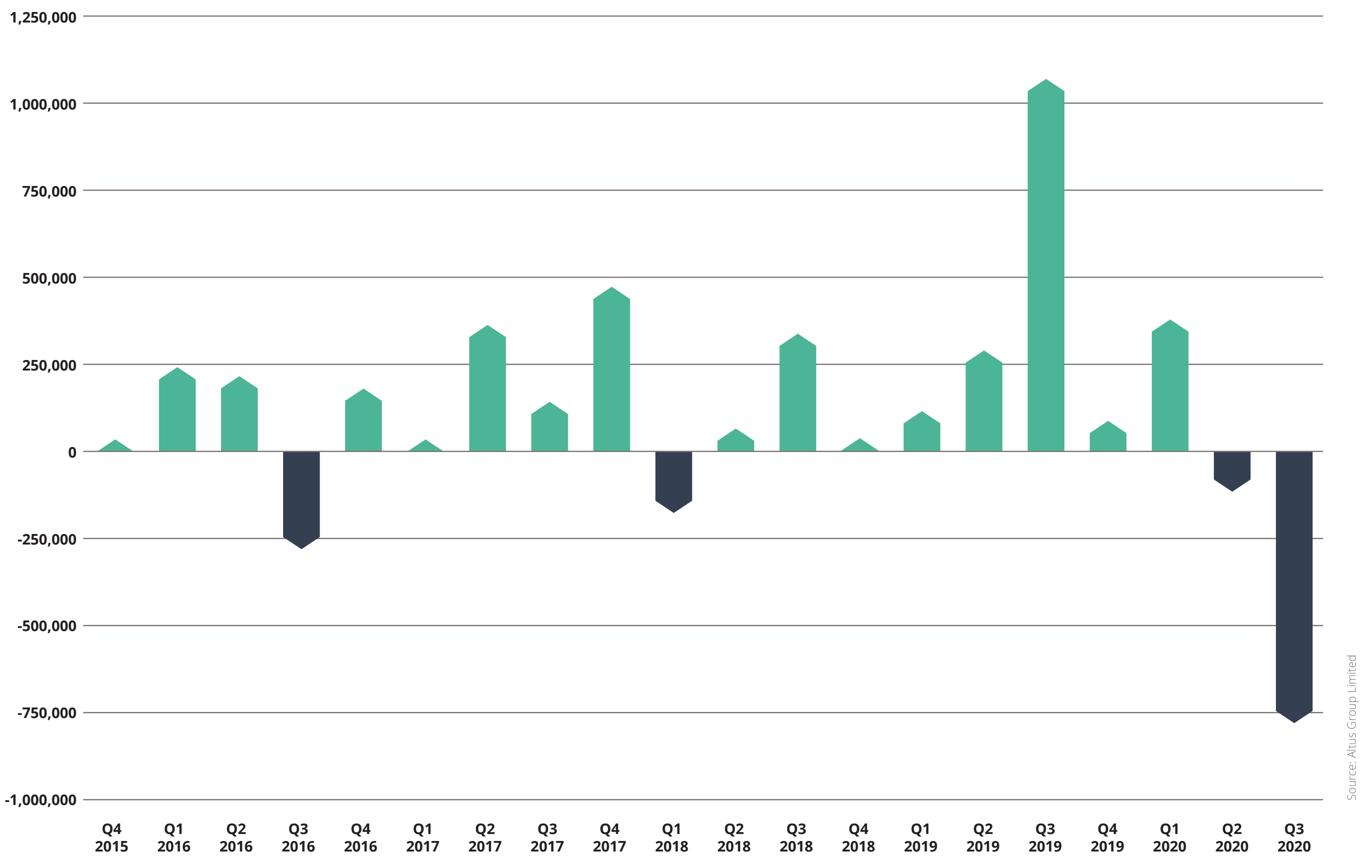
The sublet availability in the city centre has exploded over the past 12 months, nearing 570,000 sf at the end of the third quarter of 2020 from 228,000 sf at the end of September 2019, which represents a 150% increase year-over-year.

Surprisingly, the overall availability rate for Class A buildings in Downtown Montreal decreased from 9.6% at the end of the third quarter of 2019 to 9.5% at the end of September 2020, as total availability for Class A product in the city centre dropped from 2,488,643 sf to 2,486,723 year-over-year. However, as the direct availability dropped from 9.1% to 8.4% over the past 12 months, the sublet availability rose from 0.5% to 1.1%. In all, 292,409 sf of Class A office space were available for sublease in Downtown Montreal at the end of September 2020 from 129,993 sf a year ago, which represents an increase of 125%.

The Montreal submarket with the highest office availability rate is the West Island, which recorded a total availability rate of 21.3% at the end of the third quarter. The submarket's sublet availability reached 5.1% of the total inventory at the end of September (which is surprisingly lower than it was one year ago when it stood at 5.5%).

In Downtown Montreal, the total sublet availability increased by 150% over the past 12 months.

ABSORPTION, DOWNTOWN MONTREAL

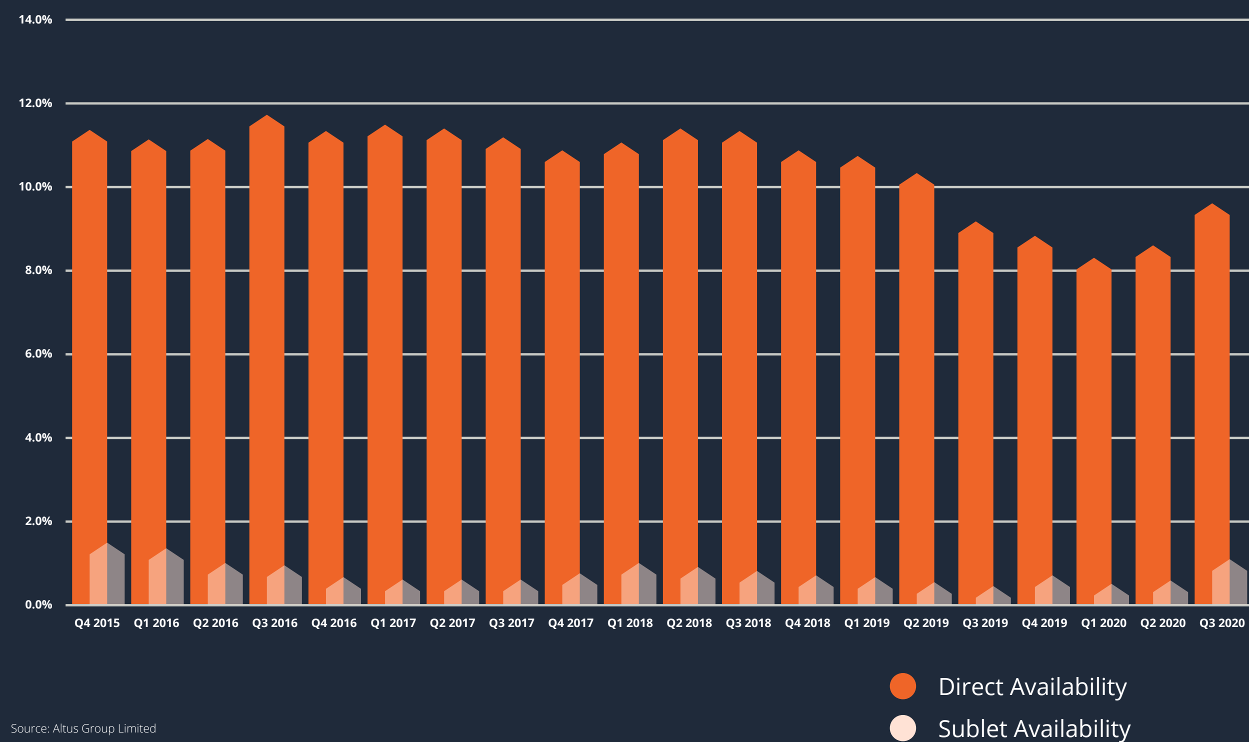


Absorption
The lower transaction volumes and slower deal velocity caused by the COVID-19 pandemic and the associated confinement had a direct impact on the absorption in all of the Montreal submarkets. Over the third quarter of 2020, the GMA recorded a positive absorption of 222,952 sf, bringing the year-over-year absorption to 1,193,716 sf, making it the lowest absorption recorded on a 12-month period since the third quarter of 2016.

Downtown Montreal recorded the lowest absorption of all submarkets in the third quarter of 2020 as well as its lowest value in the past 10 years, dipping to a negative total of 780,512 sf at the end of September. This brought the year-over-year absorption to -428,542 sf in the city centre. The East End and Laval submarkets also recorded negative absorption during the third quarter, while the South Shore showed a slight positive absorption of 19,198 sf.

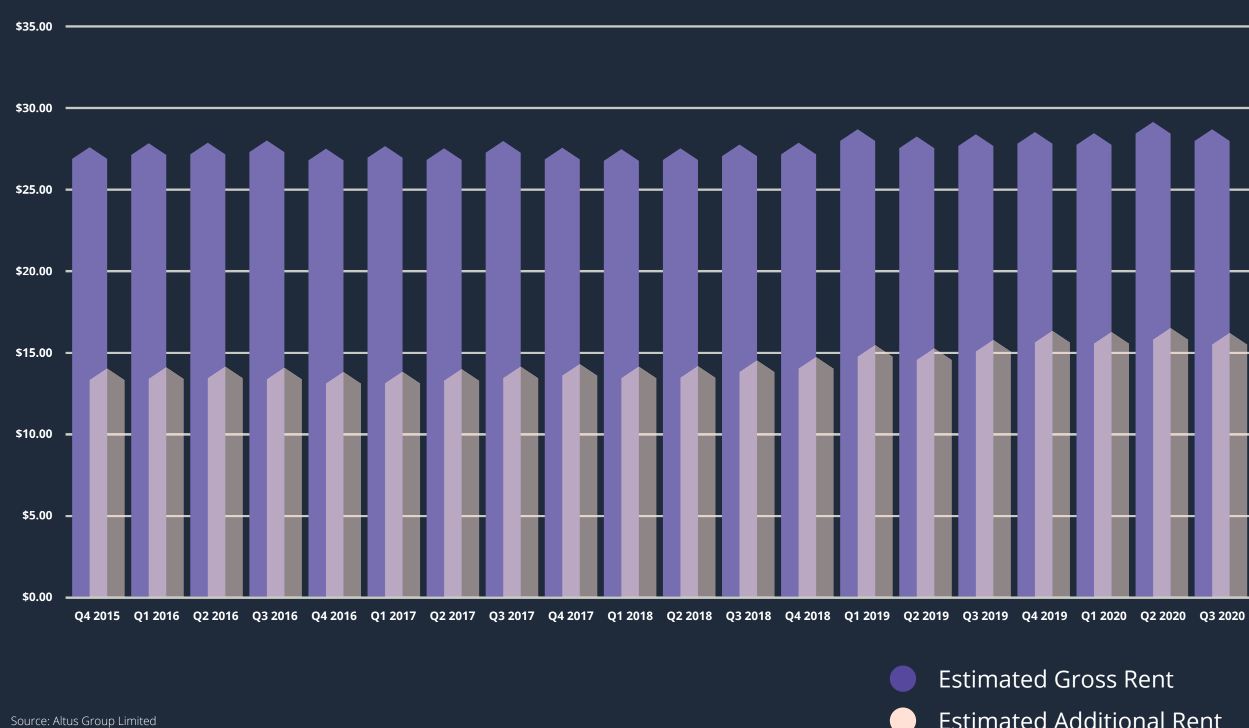
Availability GMA	Occupancy Costs GMA	Availability Downtown	Absorption Downtown
↑	↔	↑	↓
13,124,388 sf	$28.81 psf	5,693,404 sf	-780,512 sf

AVAILABILITY, GREATER MONTREAL AREA



Source: Altus Group Limited

AVERAGE OCCUPANCY COSTS, GREATER MONTREAL AREA



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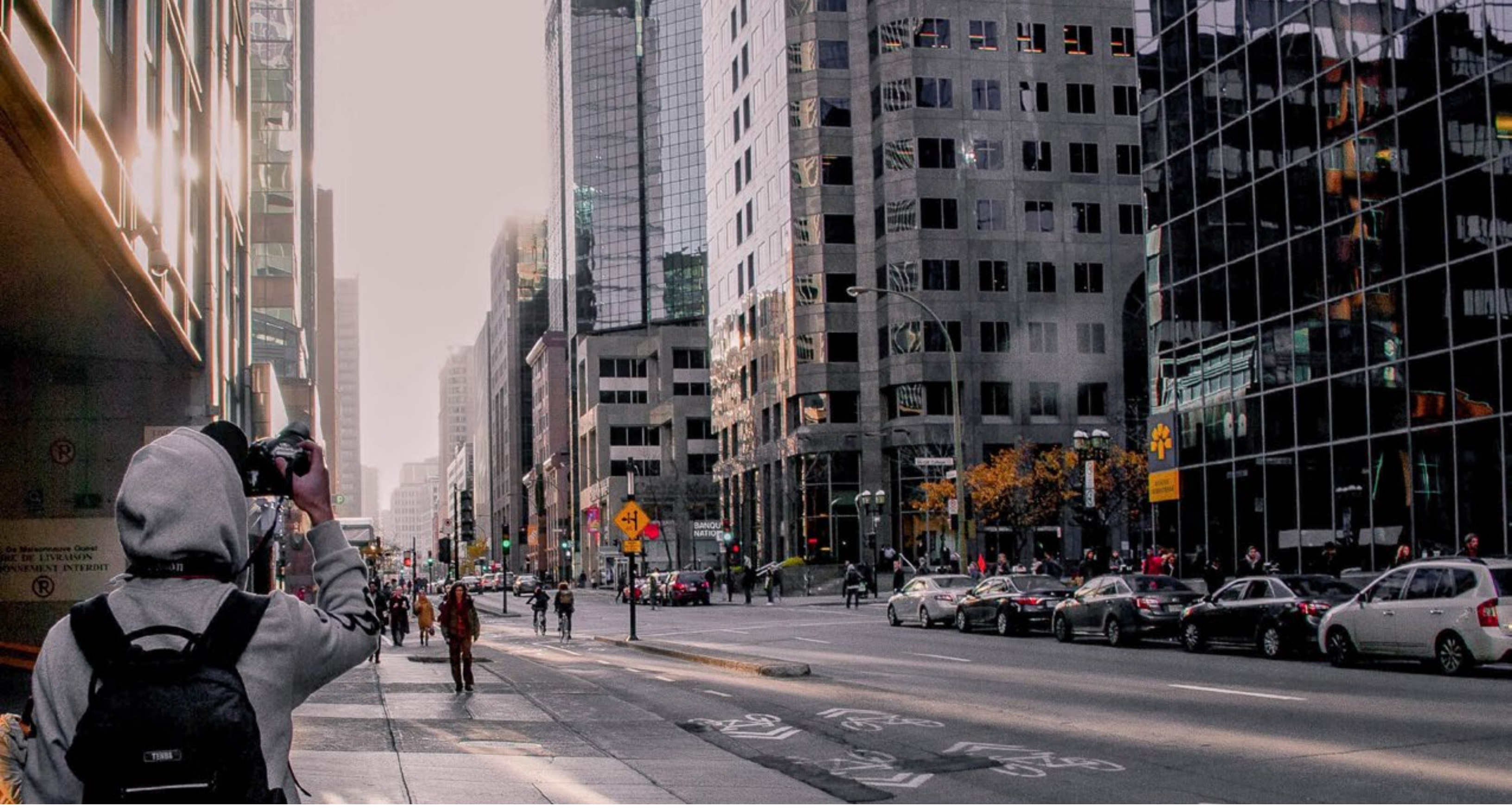
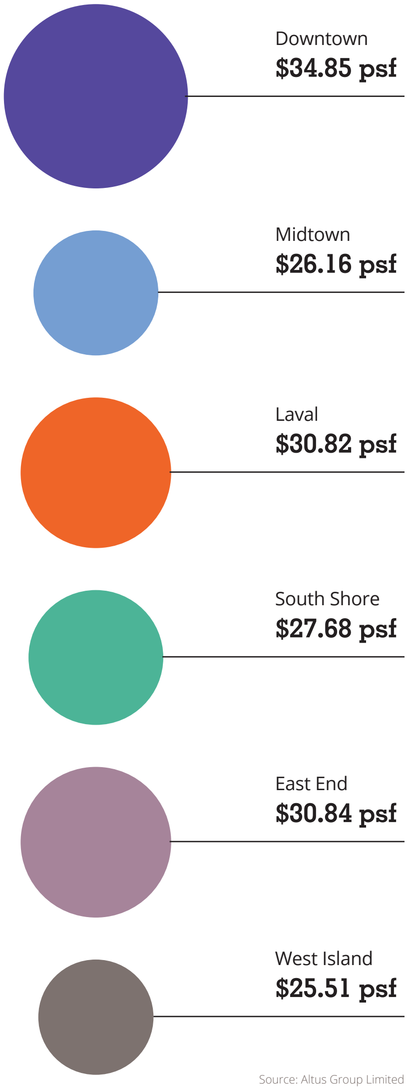


Occupancy Costs
In spite of the pandemic and the decrease in demand that subsequently occurred, average asking rates remained stable in the Greater Montreal Area. The average asking rates reached $16.29 per square foot (psf) at the end of September, down from $16.55 psf at mid-year and up from $15.85 psf one year ago. Additional rents remained very stable, averaging $12.52 psf at the end of September, down from $12.64 psf at mid-year and from $12.62 year-over year. Average estimated gross rental rates decreased from $29.19 psf at mid-year to $28.81 at the end of the third quarter, slightly above the average at the same time last year, when it stood at $28.47 psf.

Class A rental rates in the GMA generally decreased, as average asking rates dropped from $19.38 to $19.11 over the last quarter and additional rents decreased from $14.78 to $14.38 psf. Gross rental rates for Class A office buildings consequently dropped to $33.49 psf at the third quarter from $34.17 psf at mid-year and $33.61 at the end of September 2019.

In Downtown Montreal, average asking rates for all building classes reached $17.99 psf at the end of September, down from $18.97 psf at mid-year, while additional rents decreased from $17.22 to $16.87 psf. Average estimated gross rental rates dropped to $34.85 psf from $36.20 at the end of June 2020, representing a 3.7% drop over the quarter. The same goes for Class A buildings in the city centre, where average asking rates reached $25.25 psf at the third quarter, down from $25.92 psf at the end of June 2020, while additional rents decreased from $23.40 to $21.53 psf. Average estimated gross rental rates dropped from $49.32 psf at mid-year to $46.78 psf in September, representing a quarterly decrease of 5.15%.

Again, as demand fluctuations will be difficult to anticipate over the next few quarters, availability is expected to maintain its sustained increase, which in turn should apply downward pressure on the asking rates over the next months.



Source: Altus Group Limited

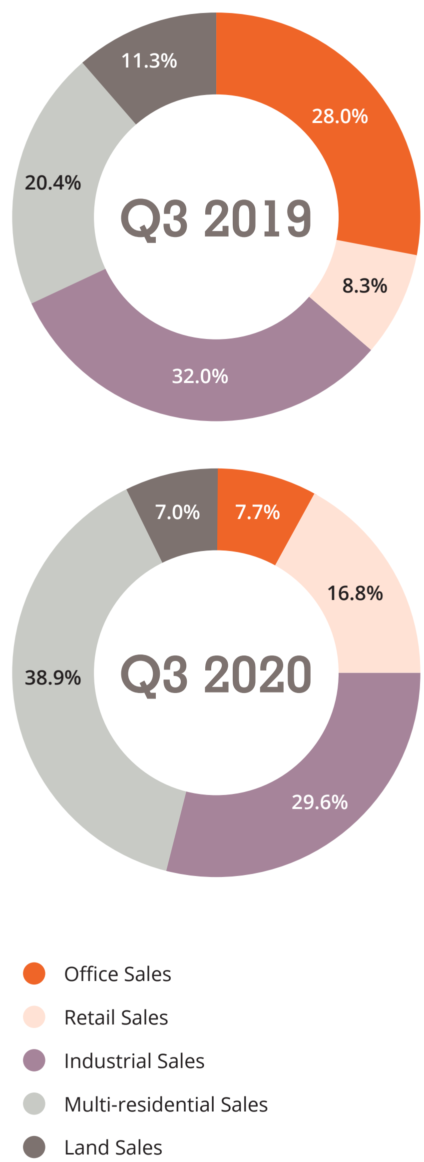
Investments

From an investment perspective, office sales have been plummeting in the third quarter. For the second quarter in a row, the investment market has been largely dominated by multi-residential sales (39% of the total investment volumes and 57% of the total transactions), as well as by industrial sales (29% of the total investment volumes and 13% of the total transactions). After dropping from $718,801,400 at the end of March to $199,833,312 at the end of the second quarter of 2020, the total office sales reached $52,436,104 for the third quarter of 2020 based on the data collected at the end of October.

At the end of September, overall capitalization rates for Class A office properties remained at 5.1% Downtown for the second quarter in a row, averaging $427.55 psf, which represents a slight increase from the previous quarter but remains quite below the $453.16 psf average from the first quarter. Overall capitalization rates for Class A office properties in Midtown Areas decreased from 5.8% to 5.7% over the course of the quarter, while average prices dropped from $287.00 psf to $281.88 psf.

As expected, the sharp decrease in office sales observed in the second quarter continued its course. At this point, it is difficult to foresee if the situation will improve before year-end as the second wave of the pandemic is still generating a lot of uncertainty in the GMA and concerns remain regarding occupier demand and the overall outlook for the economy for the months to come.

Investment Volumes



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