Market Report
Office, Greater Montreal

Mid-year 2020

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Gradual **reopening**

The second quarter of 2020 brought some clarity as to the impact of COVID-19 on commercial real estate and the office market. As deal velocity and volumes generally decreased, sublease availability increased, and absorption dropped, but it seems like the past few years' strong office leasing fundamentals have softened the blow of the pandemic in the short-term. However, it remains too early to predict the impact of this change in trajectory in the Greater Montreal Area (GMA) office market, as landlords and companies are deploying safety measures and protocols for the gradual reopening of office buildings and office users are assessing the ramifications of the new normal and its impact on the workplace.

On July 15, 2020, the Quebec government announced the gradual return to office buildings by employees of private-sector businesses. From then on, private companies whose employees were telecommuting could have up to a maximum of 25% of their staff return to work as of the following week. However, government officials indicated that the 25% rate should be considered a maximum, not an objective to be attained by firms. With this, teleworking remains encouraged in the case of activities that can be carried on remotely, while companies wishing to have their employees return to the workplace must implement the recommended health measures and safety protocols.

Office leasing

Between the first and second quarters of 2020, the GMA recorded a negative absorption of 265,277 square feet (sf), which is the first negative absorption recorded in the area since the first quarter of 2018. Nearly 120,000 sf of this area are in Downtown Montreal. All Montreal submarkets recorded a negative absorption between the first and second quarters, except for the South Shore of Montreal, where a positive absorption of approximately 7,000 sf was observed. This comes as no surprise as areas in the outskirts of the central sectors are most likely to gain in popularity over the next quarters due to the lower density, allowing for better social distancing and safety measures, while benefiting from good accessibility.

From January 1st to mid-year 2020, the South Shore office market recorded a positive absorption of 95,204 sf, which is relatively healthy considering the overall slowdown in deal velocity and transactions being postponed or falling through due to the pandemic. At the end of the second quarter of 2020, the year-over-year absorption was of 194,045 sf, which is consistent with the mid-2019 yearly absorption of 180,874 sf. However, the availability in the western portion of the South Shore remains quite high, especially in terms of class A buildings, for which the total availability reached 18.9% at the end of the second quarter. This is largely due to the delivery of new class A supply over the past few years, particularly around the future Du Quartier station of the Réseau Express Métropolitain in Quartier DIX30, Solar Uniquartier and Jonxion Place d'affaires.

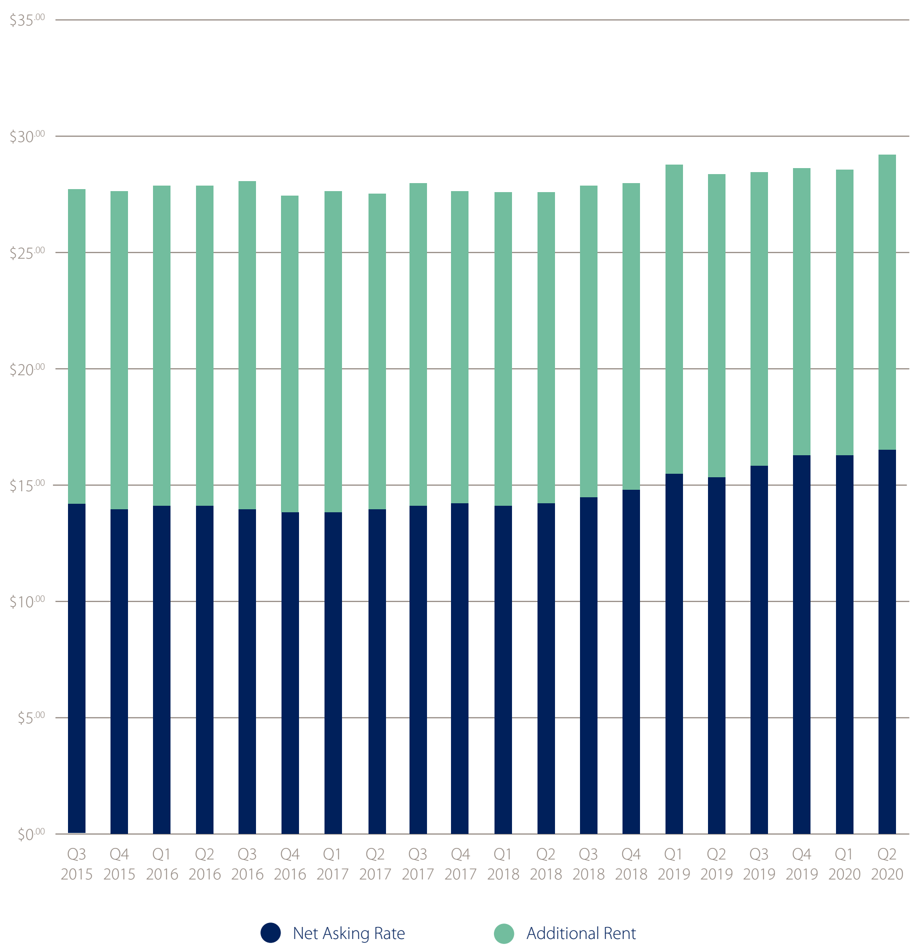
Image: Chris Liverani, Unsplash

The GMA's strong leasing fundamentals recorded over the past few years seem to have softened the blow from the pandemic in terms of availability so far, but we are expecting there will be a marked increase in available area over the next quarters as we are already seeing several spaces coming to the market, whether directly or for sublease.

In the GMA, the overall availability rate had been steadily decreasing over the past years, reaching its lowest point at 10.9% at the end of the first quarter of 2020, of which 0.9% was available for sublease. The GMA's total availability rate increased by 40 basis points at mid-year 2020, reaching 11.3%. At the same time last year, availability in the GMA reached 12.9%. The total availability rate for class A buildings did however reach its lowest point in the past five years at the end of the second quarter, dropping from 11.2% at the end of the first quarter to 10.9%, while it stood at 13.8% at mid-year 2019. However, the sublet availability rate increased by 10 basis points from the end of March to the end of June, reaching 1.3% of the total class A inventory at mid-year.

In Downtown Montreal, the total availability rate reached 9.3% at the end of June 2020 after dropping to 8.9% in the first quarter of 2020, which also represented its lowest point in the past five years. The sublet available area reached 0.6% of the Downtown office inventory at mid-year 2020, which represents just a little over 300,000 sf. Again, the availability rate increased in all Montreal submarkets between the first and the second quarter, except on the South Shore of Montreal, where it dropped by a mere 10 basis points.

Occupancy Rates, All Classes | **Greater Montreal** | Q2-2020



Quarter	Estimated Net Asking Rate	Estimated Additional Rent	Estimated Gross Rent
Q2 2020	$16.55	$12.64	$29.19
Q1 2020	$16.32	$12.21	$28.53
Q4 2019	$16.38	$12.25	$28.63
Q3 2019	$15.85	$12.62	$28.47
Q2 2019	$15.28	$13.00	$28.28
Q1 2019	$15.50	$13.29	$28.79
Q4 2018	$14.76	$13.21	$27.97
Q3 2018	$14.50	$13.36	$27.86
Q2 2018	$14.22	$13.39	$27.61
Q1 2018	$14.14	$13.42	$27.56
Q4 2017	$14.32	$13.34	$27.66
Q3 2017	$14.16	$13.88	$28.04
Q2 2017	$13.99	$13.61	$27.60
Q1 2017	$13.85	$13.81	$27.66
Q4 2016	$13.85	$13.63	$27.48
Q3 2016	$14.05	$14.00	$28.05
Q2 2016	$14.13	$13.78	$27.93
Q1 2016	$14.13	$13.71	$27.84
Q4 2015	$14.06	$13.63	$27.69
Q3 2015	$14.18	$13.61	$27.79

Source: Altus Group Limited

Photo: Jamshed Khedri, Unsplash

Occupancy costs **on the rise** (for now)

In spite of the pandemic and the decrease in demand that subsequently occurred, average asking rates increased by 1.4% this quarter, reaching $16.55 per square foot (psf) for all asset classes in the GMA, which represents a noticeable 8.3% increase from the same period last year.

The same phenomenon is observable in Downtown Montreal, where average asking and gross rental rates peaked at $18.97 and $36.20 (psf) respectively. However, as demand is not expected to increase over the next few quarters, availability is expected to increase (especially in terms of sublease availability), and asking rates are expected to drop, especially in the Downtown areas as midtown and off-island sectors will become increasingly attractive in the current circumstances.

What **now**?

At this point, office users must ask themselves: are their decisions suitable for the short term or the long term? How do they align with their real estate and workplace strategies?

Before COVID-19, several disruptors were transforming work: the rise of technology and artificial intelligence, access to unforeseen data, diversity and generational mix – along with a shift in career spans as we are living longer than ever, an increase in contingent work, etc. These trends make it quite clear that traditional workplace is no longer aligned with how people work in the 21st century, while utilization studies show that the average office space is 40-60% vacant.

The trends of coworking space, along with agile working, have become increasingly popular among many space users, while corporate occupiers had to optimize their footprint and redesign their workplace, impacting their overall employee value proposition in the war for talent in Quebec's historically-low unemployment environment (pre-COVID-19) where the workplace is increasingly perceived as a service to employees rather than a place of business per se. While technology has accelerated the way we work and the environments we work in for decades, the COVID-19 global pandemic accelerated workplace transformation toward flexibility. The recent telecommuting strategies implemented by most office users have accelerated the implantation of flexible workplace strategies. As a result, office users need to redefine the role of the workplace and office for today's environment.

In the meantime, technologies continue to transform the way that work gets done, driving productivity in new ways. With this, never has the requirement for digitally enabled talent, along with an experienced and versatile workforce, been a more crucial requirement for operations. Combined with retiring professionals and the shortage of qualified workforce in Quebec, the war for talent has become increasingly prevalent in the province, much like the rest of the country.

Over the past few years, several office users have recognized the need to use the workplace as a catalyst and a tool to both attract and retain top talent, which includes offering many innovative ways of working. With this, it is becoming evident that COVID-19 drastically accelerated the distribution of work, while eemployees and employers alike suddenly have choices in how and where work can get done.

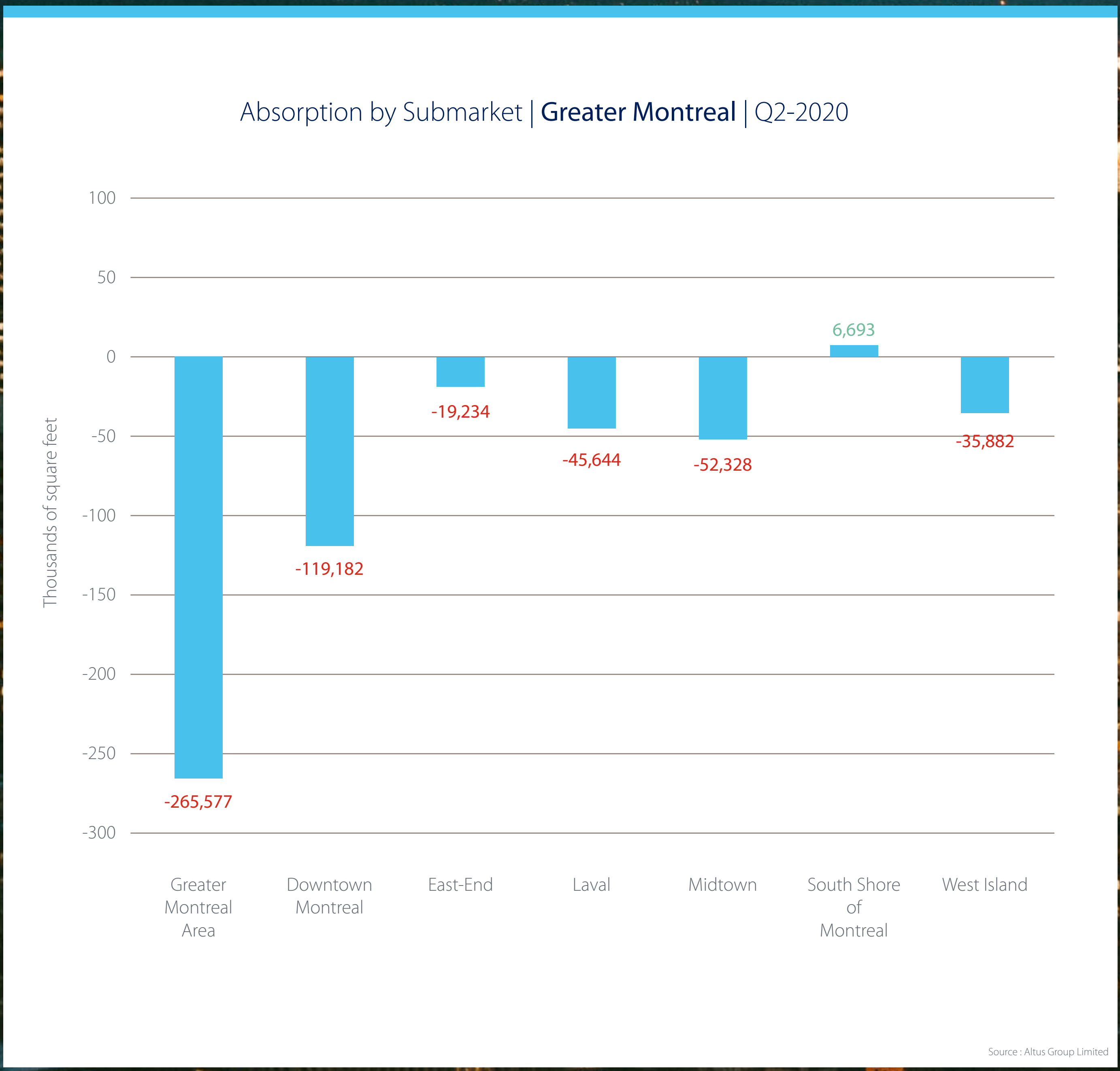


Photo: Sam LX, Unsplash

Montreal
Office snapshot

Occupancy Costs

Average asking rates increased by 1.4% this quarter, reaching $16.55 per square foot for all asset classes in the GMA, which represents a noticeable 8.3% increase from the same period last year.

Absorption

Between the first and second quarters of 2020, the Greater Montreal Area recorded a negative absorption of 265,277 square feet, which is the first negative absorption recorded in the area since the first quarter of 2018.

Under Construction

3.8 msf of office space are currently under construction across Greater Montreal, **a little under 1.5 msf of which are located Downtown.**

Availability

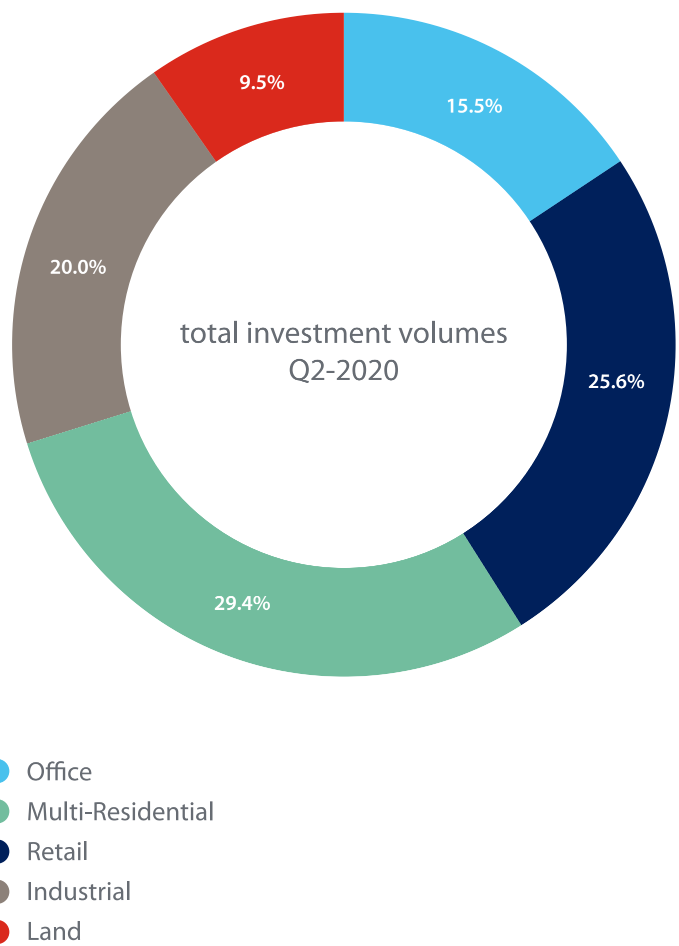
The overall availability rate had been steadily decreasing over the past years, reaching its lowest point at 10.9% at the end of the first quarter of 2020. **The GMA's total availability rate increased by 40 basis points at mid-year 2020, reaching 11.3%.**


Photo: Jamshed Khedri, Unsplash

Investments

From an investment perspective, the Montreal office market has been hit hard by the pandemic as well. Based on the data gathered at the end of July, the investment market has been largely led by multi-residential sales in the second quarter (29.35% of the total investment volumes and 53.43% of the total transactions) and by retail sales (25.61% of the total investment volumes and 22.55% of the total transactions). As expected, several investment transactions were delayed or jeopardized due to practical constraints on completion and concerns over the outlook for the economy and occupier demand.

While the first quarter showed tremendous investment volumes, reaching $753,651,400 at the end of March (compared to $132,293,912 for the first quarter of 2019), the total office sales dropped to $127,135,562 at the end of the second quarter of 2020.



Groupe Mach remained busy

Nonetheless, Groupe Mach has been very active during the second quarter, as the group was involved in the two most significant investment transactions of the trimester. The most significant sale of the quarter was the sale of 16 Place Du Commerce in Nuns' Island, which had been purchased by Groupe Mach and Saputo in December of 2016 for $16.5 million. Mach and Saputo sold the property for $48,005,430 (almost triple the price) to Lachance Immobilier and Fonds immobilier de solidarité FTQ for a redevelopment project. Since 2017, Lachance Immobilier acquired the last five mixed-use lots adjacent to the future Nuns' Island Station of the Réseau Express Métropolitain (REM) for a future commercial and residential development, including the adjacent building, 14 Place Du Commerce.

Groupe Mach also purchased the former Quebec headquarters of Loblaw at 400 Sainte-Croix in Ville Saint-Laurent for $33.7 million in June. Delivered in 2000, the 282,644-sf, class A building was built by Loblaw as a single-tenant property, but with the lack of success and eventual scaling-down of the brand in Québec, Loblaw decreased its footprint from the entire building to about 100,000 sf. It then downsized further to 35,000 sf, this time for the Provigo banner. The property still serves as Provigo's headquarters today, as the grocer remains the largest tenant in the now multi-tenant building, in which 66,952 sf of space are currently available (representing an availability rate of approximately 24%).

Groupe Mach purchased the property as part of its strategy to buy buildings that are in need of repositioning or with value upside potential and below replacement cost in order to drive value. Occupancy costs are affordable, and the campus-like property includes lots of common areas (26% of the floor space), providing potential for the development and the conversion of additional leasable areas.

Capitalization rates for class A office properties increased slightly over the second quarter, reaching 5.1% Downtown at the end of June (average of $416.44 psf, which represents a slight decrease from previous quarters) and 5.8% in Midtown Areas ($287.00 psf). Class B capitalization rates remained stable during the second trimester, reaching 5.9% for class B office properties Downtown ($276.62 psf).

After a sharp decrease in office sales in the second quarter, we can expect investment volumes in the third quarter to be impacted as well because few new transactions were initiated between April and June. However, new listing activity is picking up during the summer, which should contribute to re-establishing transaction activity and investment volumes towards the fourth quarter and early part of 2021.

The most significant sale of the quarter was the sale of 16 Place Du Commerce in Nuns' Island. Groupe Mach and Saputo sold the property for $48,005,430, which is almost triple the price paid for the property when it was last purchased in December 2016.

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