Office and Industrial Market Study

Suburban Montreal – Winter 2010

Newmark Knight Frank
Devencore

Spotlight on Suburban Montreal

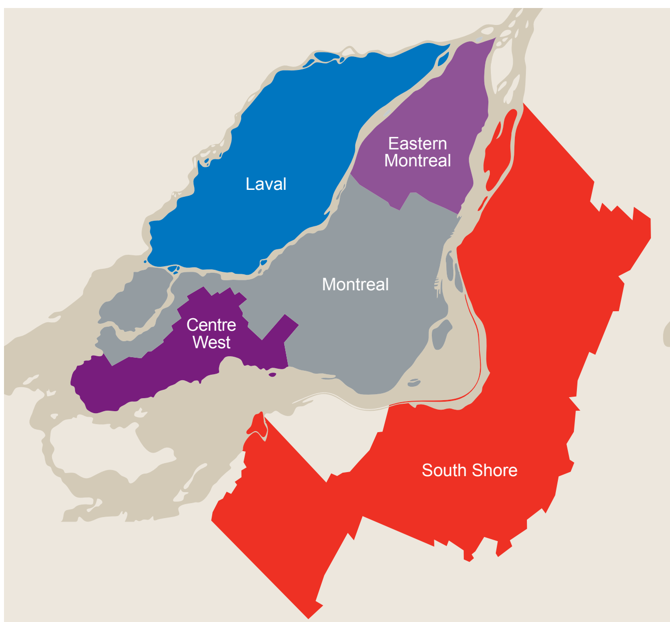
- Corporate real estate market holds relatively steady in 2009 as tenants and landlords wait out recession
- Overall vacancy rates in office and industrial properties show moderate increase
- Many tenants taking opportunity to review real estate strategies

Leasing Opportunities Remain Solid for Office and Industrial Tenants

Newmark Knight Frank
Devencore

Market Overview

Through the latter half of 2008 and the first six months of 2009, the global financial crisis made its effects felt on the corporate and industrial real estate markets across Canada. While it is true that the country wasn't as hard hit as the U.S., a number of cities saw significant upheaval in their local markets. In downtown Vancouver, for example, the amount of available office space nearly tripled over the twelve-month period, and in the Metro Vancouver region vacancy rates in quality industrial space jumped from under 3% to just over 4%. In Calgary, office vacancy rates doubled from 3.5% to 7.0% over the first six months of 2009—and it should be remembered that in early 2008 vacancy rates were virtually nil. Toronto also saw its markets shift considerably during the recessionary period, with Class "A" and Class "B" office vacancy rates in the Downtown District and Financial Core rising from 4.2% to 6.3%. In Kanata, just outside Ottawa, high-tech and start-up companies have been very hard hit by the financial squeeze and overall vacancy rates have soared to over 19%.



Most economic benchmarks indicate that Montreal—and the province of Quebec—was impacted less severely by the recession than some of Canada's other major cities. Our economy is diversified enough to be somewhat protected from sudden slumps in specific sectors, such as the resource or automotive industries. Nevertheless, corporate Class "A" and Class "B" vacancy rates in downtown Montreal rose into the 7.5% range, among the highest in the country.

To put this statistic in its proper context, it should be noted that the overall vacancy rate in downtown Montreal's Class "A" and Class "B" office buildings was only 4.9% in mid-2008, which represented an historic low for the city. On the other hand, only three years earlier, the downtown area's vacancy rate had soared to 9.4%, its highest point in the current decade.

The slowing of growth in the downtown business community has caused virtually all significant office development projects to be put on hold and we have seen tenants either retrenching or simply postponing any expansion plans that they may have had in the works until the full effects of the recession on their businesses are known. At the same time, many tenants are taking a fresh look at their real estate portfolios and working on strategies to optimize the performance of their spaces.

In much of the suburban Montreal area, the same situation holds true. A wait-and-see attitude prevails among many landlords and tenants, and while overall vacancy rates in both the office and industrial markets have risen, the increase hasn't been dramatic. Through the year, asking rental rates have remained relatively steady, though there have been slight declines in some industrial real estate sectors. We may see further downward pressure in the months ahead as the markets continue to stabilize. Further, it is generally the case that, while both tenant and developer activity has been modest, it has not come to a halt. There is also a sense that we are emerging from the worst of the recession, so a cautious optimism may begin to take hold through 2010.

Industrial Market Overview

Tenant activity in Montreal's industrial sector was relatively quiet through the latter months of 2008 and much of 2009. As was the case in the office market, many businesses took the prudent route and put growth plans on hold while the recession ran its course. There were also some companies that began to rationalize their operations, including a few larger businesses that downsized significantly. As noted earlier, while the economic meltdown did have an impact in Montreal, it was considerably less severe than what was experienced in the Toronto, Calgary and Vancouver markets. In the end, overall industrial vacancy rates in the Greater Montreal area did not rise as sharply as they did in many other regions of the country.

Our discussions with some of the major developers and landlords on the Montreal real estate scene support the statistics. While the vacancy rates they reported in their building portfolios varied between 6% and 12%, depending on the region and the category of building, most reported significantly less tenant movement than usual in 2009. Further, in the last two quarters of the year they saw the suburban real estate markets beginning to stabilize, both in terms of vacancy rates and average rental rates.

In terms of leasing activity, there was generally more tenant interest in spaces of less than 30,000 square feet. Demand for space was greatest in buildings with ceiling heights of more than 21 feet; these buildings generally also offer more up-to-date amenities and provide more high-quality office space in the mix.

Increases in overall vacancy rates over the past twelve months, on the other hand, were largely driven by the increased availability of larger industrial spaces—those exceeding 75,000 square feet. Not surprisingly, then, industrial space in the suburban Montreal market is more challenging to locate in smaller, more modern facilities where tenants have not vacated as much space, while the options are more abundant in buildings with large floorplates.

Given the current economic conditions, landlords are understandably looking for tenants with very strong balance sheets, and are more willing to negotiate advantageous occupancy agreements with these tenants. Indeed, it has become increasingly difficult for tenants without strong covenants to do deals in some of the more sought-after buildings.

A healthy number of investors are actively seeking opportunities, but often at fire sale prices. However, economic conditions have not been severe enough to spark any large decreases in pricing, so this market is also in something of a holding pattern. Simply put, we have not yet entered (and may not, if the recovery continues) what could be unequivocally termed a strong buyer's market.

On the tenant side, we are seeing a desire for shorter term transactions. Indeed, for many tenants flexibility is becoming the key factor in leasing negotiations, and while obtaining significant inducements from landlords is very difficult, there is a willingness on the landlords' side to lock in larger tenants.

Market forecast

Indicator	Forecast
Leasing activity	⬆
Rental rates Existing buildings	⬌
Operating expenses	⬆
New construction	⬌
Vacancy rates	⬌

Newmark Knight Frank Devencore

The Centre West region saw overall industrial vacancy rates rise into the 8%-10% range, largely because of tenants freeing up larger blocks of space. This region of the city is home to a number of high-tech and biotech industries, which have been hurt by the credit crunch. At the end of 2009, asking rental rates were generally in the $4.50-$5.50 per square foot range. This region has a significant inventory of buildings with ceiling heights of more than 24 feet, but the vacancy rates in these properties is generally quite low, at approximately 4%.

Throughout the region, undeveloped property is an ever-increasing challenge to find, although the land opened up for development by the Aéroports de Montréal (land that was once a part of Golf Dorval) has bumped up the inventory. Saint-Laurent's Technoparc, the largest industrial park in Canada dedicated to R&D activities, continues to court industries in the biotech, pharmaceutical, aerospace, and high-technology sectors. However, activity in the build-to-suit market has slowed somewhat over the past year, though there are at least six projects presently being constructed in Sainte-Anne-de-Bellevue, Pointe-Claire, Pierrefonds, Dorval and Saint-Laurent.

Laval has been one of the fastest growing real estate markets over the course of this decade, and the city currently has a dozen industrial parks and three additional industrial zones. Like the Centre West area, it has put a good deal of effort into drawing businesses from knowledge-focused industries, including pharmaceutical, biotech, information technology and medical technology businesses.

As recently as 2007 it seemed as though supply would be outstripped by demand as vacancy rates hovered near 1%. But the economic slowdown has restored the balance to a degree and activity slowed considerably over the past year. At present, there is almost 1 million square feet available for lease or sublet in industrial properties with ceiling heights of 24 feet and more. For businesses with specific needs, investigating the build-to-suit market is still a good alternative as well.

On the South Shore there are seven industrial parks, over 117 million square feet of available land and an inventory of approximately 35 million square feet of built space. Over the past ten years the region has emerged as a significant industrial force in the province; given its proximity to the U.S., it has been especially attractive to export businesses and transport, warehousing and distribution concerns, as well as a variety of light industries. By year end the average asking net rents here were higher than the city-wide average, and demand for space here will likely increase in the years ahead as the Highway 30 project—which will extend the existing four-lane divided highway in Châteauguay eastward through Candiac, Delson and Saint-Constant—is completed.

In Eastern Montreal average asking net rents were considerably lower, at under $5.00 per square foot, and overall vacancy rates have risen above 10%. In Rivière-des-Prairies there are five industrial parks with substantial parcels of available land, but some of it lacks the necessary infrastructure at the present time. When built, the planned extension to Highway 25, which will link with a bridge crossing the Rivière-des-Prairies and offer another direct route between Montréal and Laval, should help to raise the region's profile and reinvigorate its economic base.

Montreal's Centre West region

Montreal's Centre West region, which comprises Saint-Laurent and the West Island, is one of the most commercially diverse areas on the island. It has a broad range of office, industrial and retail properties and is home to many of the city's information technology, pharmaceutical, biotechnology, aerospace and telecommunications industries. The region has enjoyed considerable growth over the past few years, with a steady stream of new commercial, residential and industrial developments extending westward along the Trans-Canada corridor and into the off-island municipality of Vaudreuil-Dorion.

In the office market, however, overall Class "A" and Class "B" vacancy rates have risen significantly over the course of this decade. In 2001, they reached a low of 11.8%, but by the end of 2002, as the high-tech sector suffered a meltdown, these rates had jumped to 15.8%. Over the past few years the high-tech and biotech industries have continued to encounter challenges and we've seen the combined vacancy rate rise into the 19.0% range.

The largest concentration of office space in the Centre West region is found in the Saint-Laurent area, where the Class "A" and Class "B" office inventory is over 5.7 million square feet. Combined vacancy rates here are running at just over 18%, up from 17.7% in mid-2008. In the West Island area, there is a total of just under 1.2 million square feet of inventory, and overall vacancy rates climbed from 21.9% to 23.6% over the past twelve months.

Laval

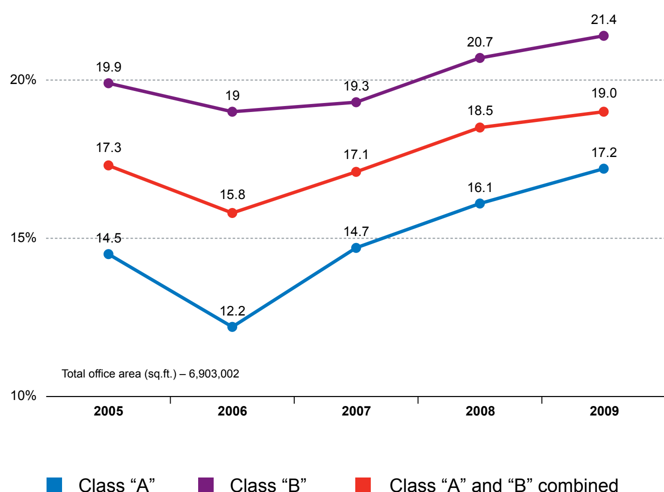
Laval is Quebec's second-largest city and a principal driver of the province's economic growth. At present, its office market is the tightest in all of the Greater Montreal area. Through its extensive Technopole initiative it continues to develop its business infrastructure and can offer corporate, commercial and industrial tenants a range of leasing or building alternatives at rates that compete very favourably with those on the island of Montreal.

The office inventory in the city totals just over 2.6 million square feet, with approximately 1.4 million square feet categorized as Class "A" space. There are three major corporate neighbourhoods in the city: the Carrefour Laval district, which has about 60% of its Class "A" inventory; the Saint-Martin West district, where there is a total inventory of just under 950,000 square feet, most of which can be found in Class "B" buildings; and the Hôtel de Ville area, where there is approximately 500,000 square feet of office space.

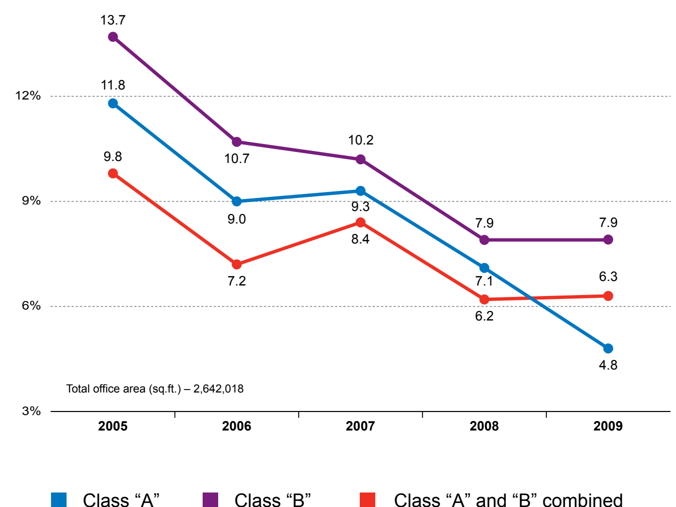
Over the past few years Laval's combined Class "A" and Class "B" corporate vacancy rate has generally followed a downward trend. In 2005 it was at its high point, at 11.8%, but is currently at only 6.3%. Indeed, since last fall, in the midst of the recession, the rate has actually dropped by 0.8%.

Space availability is especially tight in the Class "A" sector, where the vacancy rate plunged from 7.9% to 4.8% this year. At present, just over 65,000 square feet is available for lease or sublet, most of this in smaller blocks. In Class "B" buildings, vacancy rates actually rose slightly, from 6.2% to 7.9%, which represents a negative absorption of slightly more than 20,000 square feet.

Centre West Vacancy Rates, Office Space
Class "A" and "B"



Laval Vacancy Rates, Office Space
Class "A" and "B"



South Shore

No region in the Greater Montreal area has seen more construction activity in the corporate and commercial sectors over the course of this decade than the South Shore. Comprising the cities of Longueuil, Brossard, Boucherville, Saint-Lambert, Greenfield Park and Saint-Hubert, the region's business base includes high-technology, aerospace and research companies, professional offices, light industry, transportation, distribution and warehousing operations, and agrifood enterprises.

The South Shore has an office space inventory of over 2.9 million square feet, which is distributed fairly evenly among Class "A" and Class "B" buildings. Overall vacancy rates have fluctuated considerably since the beginning of the decade. In 2000, for instance, the rate was at 10.9%, and then spiked to 17.5% in 2003. Since that time it has steadily declined. At the end of 2008 the Class "A" and Class "B" vacancy rate in the region was at 7.3%, and in 2009 it climbed to 8.4%.

Longueuil has the largest concentration of office space on the South Shore, with approximately 1.3 million square feet. It also has a thriving knowledge economy, and is home to campuses of the Université de Montréal and the Université de Sherbrooke. Tenant activity was fairly limited here in 2009, and the vacancy rate was at a very low 3.2%, which is virtually the same as it was in 2008. In contrast, the overall vacancy rate in Brossard, where there is a total inventory of just over 1 million square feet of office space, was at approximately 15% at the end of 2009, up from 13.4% in 2008, so tenant opportunities are more plentiful here. Collectively, Boucherville, Saint-Lambert, Greenfield Park and Saint-Hubert have 575,000 square feet of office space, and the vacancy rate rose from 6.5% in 2008 to 7.9% in 2009.

Eastern Montreal

Eastern Montreal's corporate real estate market is driven by more traditional business interests, including government agencies and services, warehousing and distribution enterprises, oil and gas operations and environmental agencies. The region—which consists of Montreal Centre East, Saint-Léonard, Anjou and Montreal East—has the advantage of being close to the Port of Montreal, and is easily accessed from the major transportation links to both eastern Canada and the industrial corridor of the northeastern United States. Development in the region usually takes the form of commercial, build-to-suit and multi-purpose spaces.

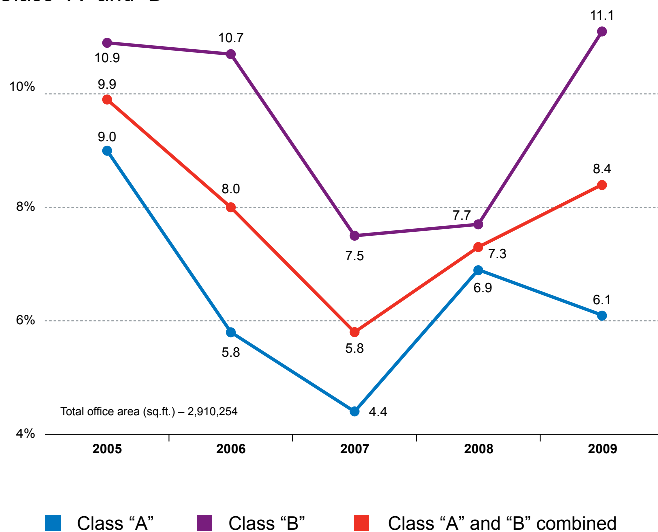
Throughout the region, there is an office space inventory of almost 6.2 million square feet. In 2009 tenant movement was modest, and the overall vacancy rate for Class "A" and Class "B" spaces edged up from 9.4% to 9.6%, which represents a negative absorption of only 72,000 square feet.

The Montreal Centre East area has the largest inventory of space, with 2.8 million square feet, and the vacancy rate was highest here at the end of 2009, at 11.3%, virtually unchanged from the previous year. Class "A" and Class "B" vacancy rates were lowest in Saint-Léonard—which has the least office space in the region, with just over 600,000 square feet—at 4.0%.

Because there are significant differences in the vacancy rates and the character of the office spaces in each of the districts that are a part of the Eastern Montreal region, tenants who wish to locate here are best served by making extensive use of the expertise and market research of their real estate advisors.

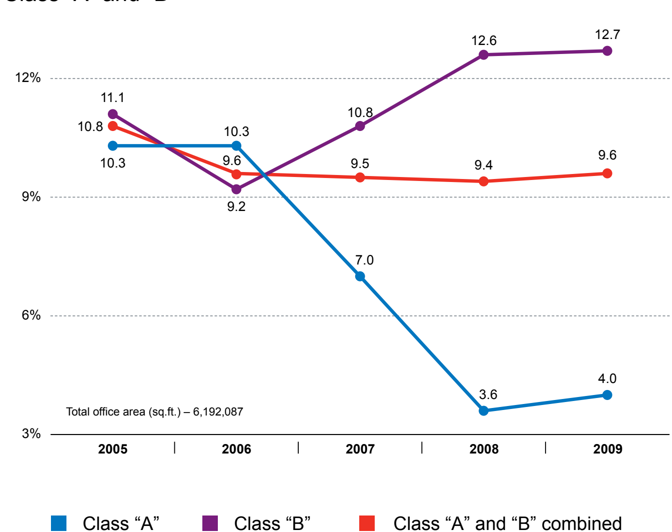
South Shore Vacancy Rates, Office Space

Class "A" and "B"



Eastern Montreal Vacancy Rates, Office Space

Class "A" and "B"



Newmark Knight Frank Devencore

On the industrial front, we will likely see vacancy rates levelling off and rental rates remaining relatively stable through 2010 as business confidence gradually returns with the recovering economy. But a resumption of growth will not be immediate. Activity in both the office and industrial real estate markets generally lags behind broader economic trends, so the recovery that's now underway will really just begin to make its effects felt in these markets in mid-2010 and beyond. Indeed, we expect to see the sublet inventory continue to increase in the months ahead, though not precipitously.

The availability of industrial space with modern specifications varies from district to district across the Greater Montreal area, but large spaces (100,000 square feet and up) are relatively plentiful at the present time. On the other hand, tenants seeking a range of options in smaller properties—particularly those in the 20,000 square foot and under category—will have their work cut out for them.

Through 2010 and 2011 we may see a slowing of development activity. A number of projects that were started within the last two years are being completed, but fewer new construction projects were initiated in 2009 in the midst of the slump, so it may be challenging to address any significant surge in demand over the short term. There is certainly an appetite on the part of investors and developers to expand their property portfolios in the Montreal region, but with cap rates remaining high and project financing difficult to obtain, new development will probably proceed at a fairly modest rate over the next year. As a result, build-to-suits will continue to be an interesting option for some businesses.

In the office markets across Montreal, the outlook is similar. Vacancy rates and asking rents will likely continue to stabilize as both tenants and landlords assess the lingering effects of the financial meltdown and monitor the pace and strength of the economy's recovery.

Aside from build-to-suit projects, very little office development is underway either in downtown Montreal or in any of the suburban areas, so the current inventory will not be significantly augmented in the immediate future.

Given that vacancy rates have risen and asking rental rates have remained stable or, in some instances, even fallen slightly, this is an excellent time for tenants to take a close look at their real estate portfolios and re-examine their real estate strategies. While landlords and building owners are not conducting fire sales, there is a desire to secure larger tenants with strong covenants and a willingness to exercise some negotiating flexibility in order to do so. For tenants seeking to expand or relocate, there are more opportunities today than there were a year ago—and probably more than there will be in a year's time when the economic recovery begins to generate renewed growth.

Seizing the opportunities that currently exist is particularly important for tenants with leases that are up for renewal in 2011 and 2012. There are excellent deals to be made, but time—and timing—is of the essence.

Newmark Knight Frank

Devencore

Montreal Office

800 René-Lévesque Blvd. West
Suite 900
Montreal, Quebec H3B 1X9
Canada

Research Contacts

Sylvie Bachand
Director, Communications and Marketing

Devencore Ltd.,
Chartered Real Estate Broker

Tel.: 514-392-1330, ext. 225
sbachand@devencorenkf.com

NKF U.S. Offices

Atlanta
Boston
Chicago
Connecticut
Dallas
Detroit
Houston
Long Island
Los Angeles
Miami
Nashville
New Jersey
New York
Orange County
Princeton
Rutherford
San Francisco
San Jose
San Mateo
Washington, D.C.
Westchester

NKF International Offices

Australia
Bahrain
Belgium
Botswana
Brazil
Cambodia
Canada
Chile
China
Czech Republic
France
Germany
Hong Kong
Hungary
India
Indonesia
Ireland
Italy
Kenya
Malawi
Malaysia
Netherlands
New Zealand
Nigeria
Poland
Portugal
Russia
Singapore
Spain
Tanzania
Thailand
Uganda
Ukraine
United Kingdom
Zambia
Zimbabwe

NKF Devencore Canada Offices

- Devencore's Regional Offices
- Geographic Locations Serviced by Devencore

New statistical criteria

Since July 2004, new criteria are being used to establish Devencore's statistical data. Therefore, any data in both this report and future market studies should be compared with caution when referring to previous publications. We include buildings that are not part of the competitive leasing market—for example, certain institutional buildings that are fully owner-occupied, and exclude lower-quality properties lacking the general appeal to office market trends. Class "A" and Class "B" are definitions used to classify competing buildings on the basis of amenities, location, age, building technology, space efficiency, tenant appeal and other qualities that determine competitive rank and achievable rents. As used in the real estate industry, Class "A" refers to the group of free-standing office properties (generally built and/or renovated after 1990) that were designed to deliver first-class occupancy standards at strategic business locations. The Class "B" group largely includes older buildings that were leaders in their day, and which have now been surpassed by newer buildings.

The full text or any part thereof may be reproduced with appropriate acknowledgement of the source.