MARKET REPORT

Industrial

Montreal Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS
A DIVISION OF MARCUS & MILLICHAP, BROKERAGE

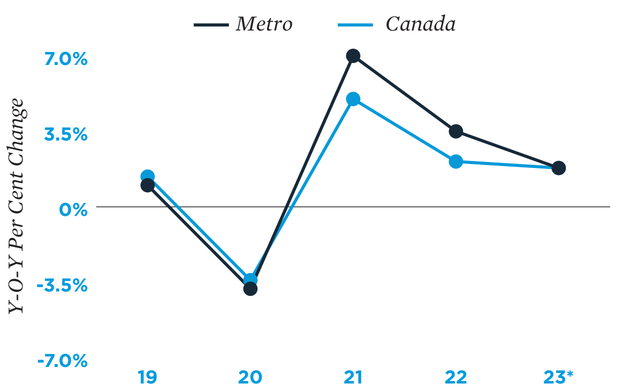
4Q/23

Artificial Intelligence Stoking Hot Demand; Vacancy to Climb Amid Elevated Construction Activity

New supply providing more options for tenants. Montreal's industrial vacancy rate was already low entering the pandemic, sitting at 2.1 per cent by the end of 2019. Strong demand over the course of the global health crisis pushed vacancy down further, and by the end of 2021, the rate reached 1.5 per cent. Since the onset of 2022, vacancy has been on an upward trajectory, due to elevated levels of new supply entering the market and a slowdown in leasing activity as a result of rising interest rates. Despite these near-term headwinds, Montreal's industrial sector has remained resilient, as the metro's vacancy rate has only returned to its 2019 level as of September. Additional vacancy pressure is expected for the remainder of the year amid a further moderation in demand. At the same time, greater space availability will provide some relief to tenants who struggled to find rentable spaces over the past few quarters. While metro vacancy is forecast to rise this year, rents are on track to hit a record level and see the highest annual growth rate among Canada's major metros.

Expansion of data centres boosting long-term demand. Montreal has long been a key hub for Canada's data centres, thanks to its cool climate and the abundance of affordable and low-carbon energy. With the recent boom in the artificial intelligence industry, demand for data centres and related industrial space is rising rapidly in the metro. In the first half of 2023, multiple data centres were announced or established from companies that include Wiz, Cologix and Equinix. The tech industry will likely be a rising source of demand for high-quality industrial spaces in Montreal over the upcoming years.

Employment Trends



* Forecast

Sources: Altus Data Solutions; CoStar Group, Inc.; Statistics Canada

Industrial 2023 Outlook

43,000 JOBS *will be created*

EMPLOYMENT:

Montreal's labour market will continue to create jobs, due to elevated population growth from immigration. Rising interest rates, however, will cause the pace of hiring to slow notably compared to the 2022 level.

3.8 MILLION SQ. FT. *will be completed*

CONSTRUCTION:

Spurred by strong demand, construction activity will remain elevated, adding 1.1 million more square feet of new industrial space compared to 2022. Most deliveries will be medium- to large-bay facilities off the island.

40 BASIS POINT *increase in vacancy*

VACANCY:

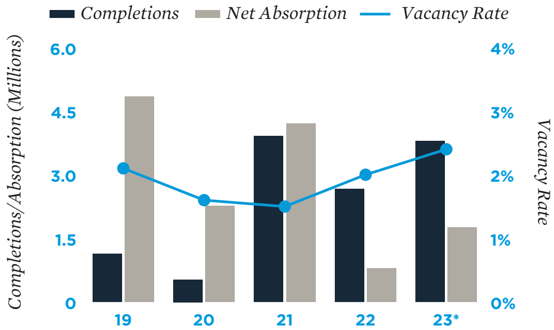
Vacancy has started to climb since the end of 2021, and will continue on an upward trajectory amid easing demand and elevated development activity. Despite this increase, the metro's industrial market will remain tight in the near term, with sub-3 per cent vacancy.

16.1% INCREASE *in asking rent*

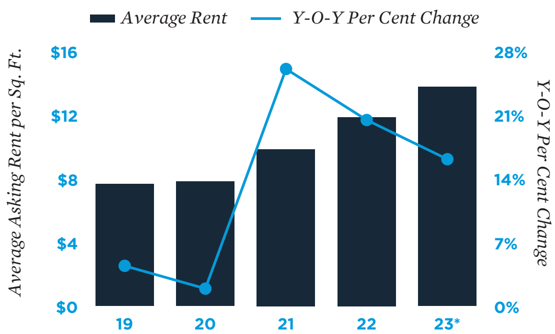
RENT:

New high-quality supply, coupled with a still-low vacancy rate, will continue to put upward pressure on industrial rents. As leasing demand has eased, the rate of rent increase has likely plateaued, with the year-end asking rent forecast to sit just below $14.00 per square foot.

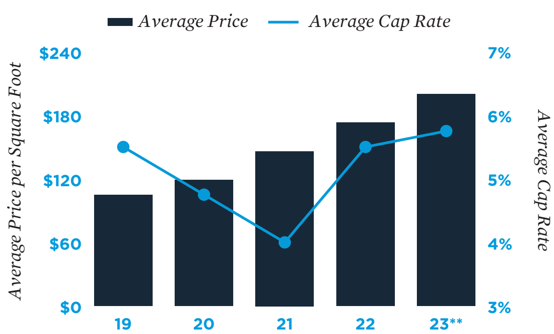
Supply and Demand



Rent Trends



Sales Trends



* Forecast ; ** Through 2Q

Sources: Altus Data Solutions; CoStar Group, Inc.; Statistics Canada

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3Q 2023: Trailing-12-Month Period

CONSTRUCTION

2,740,000 sq. ft. completed

- Construction activity slowed between October 2022 and September 2023, due to rising construction costs. Completions bounced back in the second quarter of this year, however, as some delayed projects were delivered.
- North Shore-Lanaudière saw the greatest amount of square feet delivered, followed by the Laval and North-Shore Laurentides submarkets.

VACANCY

30 basis point increase in vacancy Y-O-Y

- Softening demand resulted in negative net absorption between the third quarter of 2022 and the first quarter of 2023, which pushed up vacancy.
- Despite the overall increase, the vacancy rate fell 90 basis points in Laval, followed by a 30-basis-point decline in the West Island submarket and a 10-basis-point contraction in Midtown North.

RENT

16.6% increase in the average asking rent Y-O-Y

- A strong rebound in leasing activity in the second quarter of 2023 led to a 20 per cent annual increase in rents as of September. This has added over $1 per square foot to the average asking rent compared to the first quarter.
- The Montreal East and the North Shore-Lanaudière submarkets experienced the highest annual rent growth, approaching 50 per cent annually.

Investment Highlights

- Investors acted quickly to capitalize on low financing costs and robust rent growth before interest rates started to increase. This led to an exceptionally strong year of investment in 2022. However, as monetary conditions began to tighten, investment activity slowed significantly. The trailing 12-month total dollar volume decreased 54 per cent year-over-year as of the second quarter, led by an almost 80 per cent drop seen in the first quarter alone. Investment fell the most in the $10 to $20 million category.
- The trailing 12-month average sale price rose roughly 15 per cent compared to the 2022 level. Elevated construction costs and increasing land prices continued to be the main drivers for this large price gain. Relative to the 2019 level, the average sale price has nearly doubled. Cap rates remained on an upward trajectory, despite the price increase, and inched above the pre-pandemic level at the end of June. This is mainly due to historic rent increases, which have on average outpaced the rise in sale prices.
- As financing costs rose to a multi-year high, Montreal saw a notable increase in sale-leasebacks. These transactions allow property owners to raise capital at a lower cost, and benefit buyers with future rent growth and appreciation in property value expected in the industrial sector.

Price: $250