

# RENT FOR CLASS A OFFICE BUILDINGS IN DOWNTOWN MONTREAL

Lessons from the past 30 years

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## Executive Summary

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The performance of Montreal's downtown Class A office market has been disappointing over the past 30 years. Rather than just repeating this well-known fact, which would add nothing new, this study quantifies the impact of various phenomena on the market's performance. An oversupply and, to a lesser extent, the relatively modest growth of Montreal's economy are the main reasons for the poor performance.

### **First recommendation: Avoid an oversupply at all costs**

The most important lesson is that the impact of oversupply on the market is catastrophic. On average, an oversupply requires an adjustment period of about seven years. This impact is significant, especially as the study shows that Montreal's downtown Class A office market is showing signs of nonlinearity in its performance. This means that periods of oversupply are not counterbalanced by periods of excess demand. Therefore, the market cannot anticipate excess demand at the end of the seven-year adjustment period to compensate for the underperformance triggered by an oversupply.

The market must, therefore, avoid oversupply at all costs. With this in mind, all market participants—whether in the public or private sectors—should thoroughly analyze the market before making investments. The Urban Development Institute (UDI) is certainly not against investment, but maintains that investment should be made in line with market conditions to avoid the detrimental impact of oversupply.

**Second recommendation: Property tax increases must take into account market conditions**

The second recommendation is addressed to municipal authorities. The UDI fully understands the financial reality of Quebec municipalities, and has commented several times on the importance of providing municipalities with new revenue streams because cities depend too much on property tax. However, the study also shows that the way owners have been taxed, particularly over the last 10 years, has reduced the competitiveness of Montreal's downtown Class A office market. In fact, it clearly reveals that downtown Class A office building owners were taxed, particularly in the 2000s, as if the Montreal economy were growing at the same rate as the Canadian economy and as if the market were not dealing with an oversupply due to significant government investments in the early 2000s. In the long term, this decline in competitiveness could make Montreal less attractive and cause companies to leave the area or make companies choose other places than Montreal to set up their businesses. The UDI therefore encourages municipal authorities to take market conditions into consideration before setting the annual increase in property tax.

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### **Economic health is essential**

The study showed the importance of a healthy economy for the real estate market. Based on the Conference Board of Canada's economic projections, the study indicates that the market will thrive over the next 20 years even though economic growth will slow down in the long term due to the ageing population. This is, of course, if the industry manages to avoid oversupply. However, a stronger economy than expected by the Conference Board would generate even better results. The UDI therefore hopes to become increasingly involved in the debate on improving economic performance in Quebec.

To this end, immigration will be a key ingredient in Quebec's economic performance in the future and needs to be addressed. The ageing population is not a phenomenon unique to Quebec—far from it. Most industrialized countries will be focusing on immigration over the next few years and Quebec should do the same. The UDI intends to join this important debate and support organizations already deeply involved.

UDI also encourages all levels of government to intensify their efforts with respect to transportation infrastructure, whether it is for public transit, sea, rail, road or air transportation. This would help Montreal strengthen its role as a hub for transportation, distribution and trade, and thereby increase the city's economic potential further. Improving the flow of movements for goods and people would also reduce congestion and its related costs, and make Montreal even more attractive to people and businesses.

Immigration and transportation infrastructure are just two examples. Economic growth is essential to real estate development and UDI intends to make its voice heard in public discussion on this important matter.

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