Business Outlook '84

In the office market, it's another tenants' year

By JAN RAVENSBERGEN
of The Gazette

"I haven't seen a tenant's market like this in 20 years," says Gordon Peters, vice-president and manager, office leasing, A.E. LePage Ltd., Montreal.

"There's extra space available all over town.... I figure it'll take three years to fill it all up," says John Sullivan, president of the Eastern Canada chapter of the Society of Industrial Realtors.

"The fact is, it's a tenant's market," says Stephen Leopold, owner of Leopold Properties Ltd., a consultant to the corporate space user.

Those comments tell most of the tale about Montreal's commercial real-estate front as 1984 begins.

The old-fashioned horse-trading which characterized the city's office-space market during the last 12 months will continue this year and beyond, say these experts — but not quite at the intense pitch it reached in mid-1983.

The huge addition of Class A office space to the city's core since 1981 — estimated at 7 million square feet by Louis Burgos, LePage's vice-president and manager for investment and commercial sales — will continue to hang over the market, helping hold rental prices down.

But the pace of absorption of space will accelerate for the next three years anyway, at least pulling current vacancy rates down somewhat from the 20-per-cent area. Major new projects are at least 18 months away from completion, allowing the current combatants to fight it out — for the time being — without the additional burden of fresh competition.

Trading up

The prospects provide good news for companies that want to trade up to higher-class premises without swallowing a huge rent increase. But they bring discouragement for the construction industry as well as for the developers who launched ambitious building plans when the city's office-vacancy rate was down around 2 per cent in 1981.

That key rate has since mushroomed to around the 16.5-per-cent level, estimated Peters, which translates to more than 4 million square feet of empty space. A 5-per-cent vacancy level is where developers start to actively consider breaking ground.

The basic yearly rental rate for Class A space — top-notch offices at a prestige address — dropped about 15 per cent during 1983 to the $15-a-square-foot level, said Peters, although prices appear to have bottomed out and are now "beginning to firm up."

In fact, space in the Place Ville Marie tower — which after more than two decades remains Montreal's most visible corporate beacon — that cost $24 a square foot in 1981 can be obtained today for as little as $16 a square foot and sometimes less, industry sources say. PVM is also said to be offering generous turnkey or tenant's improvement allowances, moving expenses and the takeover of existing leases. But some tenants who signed new leases in 1981 are on the hook for $35 a square foot in the years beyond 1987.

Heating, insurance, and janitorial costs as well as taxes add another $5 to $7 a square foot to annual costs paid by corporate tenants.

Blue-chip prospects

Industry sources say that PVM in some cases is trying to lure some blue-chip prospects for $16 a square foot gross, that is, including taxes and operating expenses.

Class B space — older, less prestigious buildings in non-prime locations — is going for a base of $12 or $11.50 a square foot, down a touch from a year ago.

"Prices there are as low as they'll ever get" and are also showing signs of firming up, said Sullivan.

Some new buildings are landing tenants only by slashing first-year leasing costs almost suicidally, to less than $10 a square foot. In an effort to lift their projects eventually above the break-even level, owners have chosen to write sharp rent escalations into the later years of leases.

"Some are losing money and some are not making the kind of money they did" in years past, according to Peters.

With the exception of the Esso/BNP tower and Place Mercantile, the new buildings on the de Maisonneuve Blvd. axis east of McGill College Ave. have fared the worst; the beleaguered owners of one new structure at 425 de Maisonneuve W. have even resorted to putting up large For Rent signs on the building.

Place Victoria, on the southern fringe of the prime business district, has sustained a steady exodus of tenants simultaneous with the shift of the downtown business core to the north and slightly west.

Real-estate brokers have been able to survive, however, because many smaller companies have discovered they "can relocate from a relatively old Class B building to new Class A premises with an acceptable rent increase," as a recent LePage survey noted.

Peters, one of the survey's authors, figures that occupants of more than 3.5 million square feet of Class A and B office space have shifted locations in the last year, while total space occupied has edged up between 250,000 and 300,000 square feet.

The pace of total movement will drop to between 1.5 million and 2 million square feet this year, he figures, while net occupancy will climb between 450,000 and 500,000 square feet.

And in 1985, he estimates, total movement will amount to between a million and 1.2 million square feet, while occupancy will increase by roughly 600,000 square feet. He stressed these are ballpark estimates: "There are too many intangibles."

The Bell Canada/National Bank twin-tower complex, Place Mercantile and Place Air Canada opened last year.

"Like most major North American urban centres," said Leopold, Montreal "is overbuilt." The vacancy cycle last peaked in 1977, he added.

Local developers weren't expecting a recession of the length and depth the latest one turned out to have. But with the economic recovery under way, said Leopold, "the deal achievable today (on the Maisonneuve strip west of McGill College) is less attractive to the tenant than it was six months ago." He calculated that roughly 8.5 per cent of the approximately 1.75 million square feet of office space in that area is vacant.

These days, "the landlord isn't as hungry to make a deal" as he was six months ago, added Burgos of LePage: "Still, generally speaking, it is a buyer's market."

And owners of office properties are still offering substantial incentives aside from relatively low rental rates.

Several months or more of free rent on a long-term lease appears to be the most popular tactic in the battle to persuade clients to "trade up" to higher-class business premises.

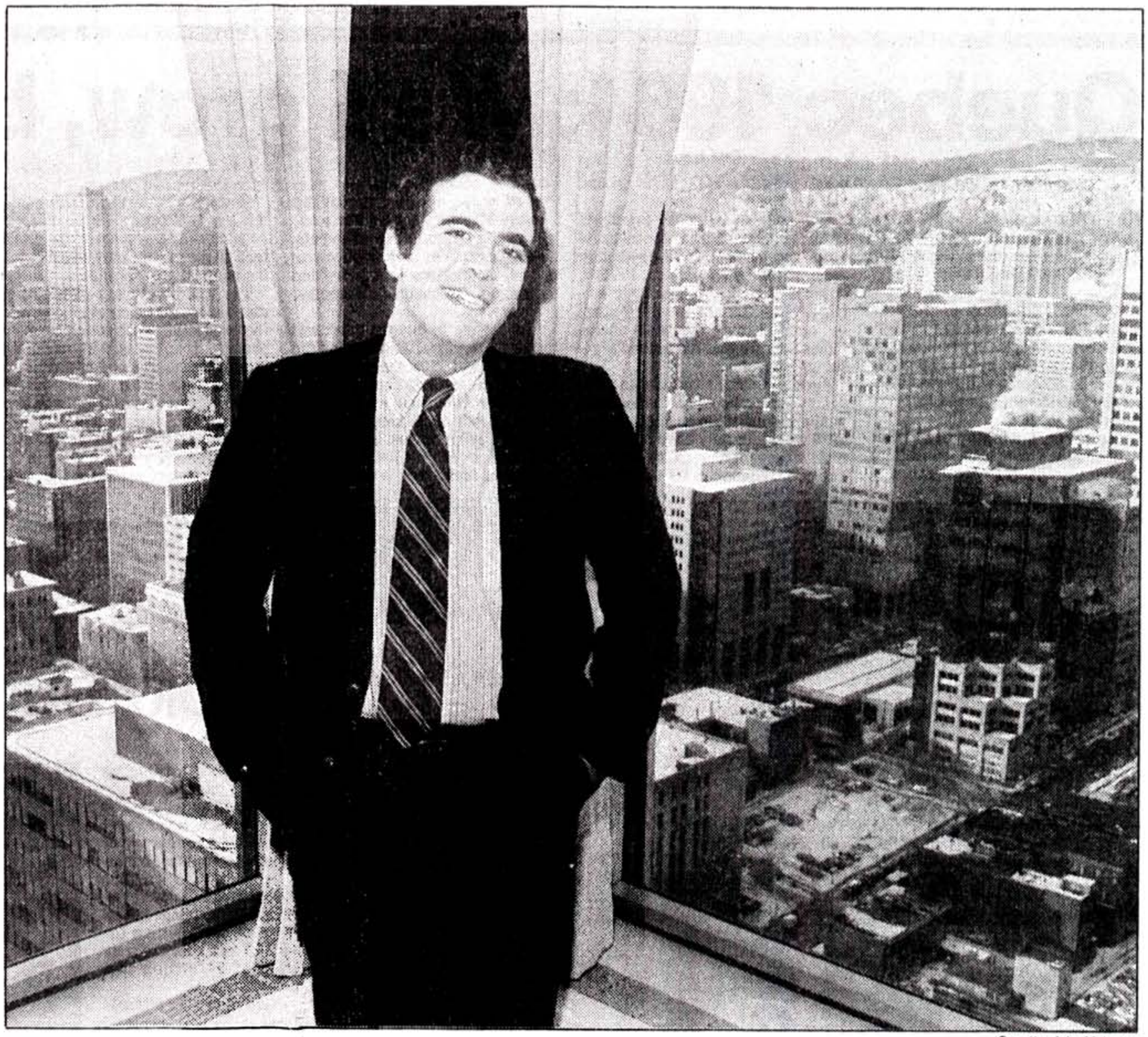
The older Class A office structures around the city core have been hit badly by the trend; apart from PVM, Place Victoria is one of the most obvious victims.

"Of course the building owners are never going to tell you" their vacancy rates, Sullivan counselled. "It's not good policy."

On the industrial front, Sullivan noted that base rentals of $3.75 a square foot were the rule a year ago, but prices have dropped to the $3-a-square-foot range.

In the current economic climate, added Gilles Dagenais, LePage's manager for industrial leasing, "two years starts to be long-term." There remains, he added, some 10 million square feet of industrial space available on the Island of Montreal, which translates to an estimated vacancy rate in the 10-per-cent area.

However, that market is also showing signs of firming, with construction of several owner-occupied industrial buildings under way. "It's a good sign," he added, "one we hadn't seen in the past three years."



Gazette, John Mahoney

Consultant Stephen Leopold says Montreal, like most major North American urban centres, is overbuilt.