CANADIAN PERSPECTIVE ON THE CHANGING INDUSTRIAL MARKET

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It's no secret that Canada enjoys a vast and expansive geography in which cities are widely spread out. Yet, most of our economic activity takes place within 100 miles of the U.S. border. Today, the landscape of the Canadian industrial real estate market is changing—not only is the physical form of traditional industrial space being re-imagined, but the geographic spread of this inventory is shifting as well. For American companies with Canadian operations, making assumptions about the market based on past experience or current U.S. trends can result in lost opportunities and potential value.

HOW IS THE CANADIAN INDUSTRIAL MARKET CHANGING?

The demand for industrial real estate is at peak levels in most major Canadian cities. On a national level, Canadian businesses are experiencing increased pressure on their ability to expand, relocate, or secure new space. A lack of supply combined with evolving business practices is leading to some fundamental changes in the physical form of industrial buildings and the geographic distribution of industrial users.

THE EVOLVING PHYSICAL FORM OF INDUSTRIAL BUILDINGS

In the unrelenting pursuit for competitive advantage, companies are optimizing their supply chains to reduce overhead and create efficiencies. This is leading to major growth in the use of robotics and automation systems in warehouses and distribution centers across Canada. The majority of Canada's existing industrial inventory is not suitable to house these modern requirements as they typically demand much higher ceilings. Fifteen years ago, ceiling heights of 24 feet were becoming the popular choice for distribution centers as companies looked to maximize cubic volume. It was not too long ago that 30-foot ceilings became the new standard, and today we are seeing users looking to accommodate automation systems that demand clear heights of 40 feet and up. As a result, we will begin to see buildings getting much taller as new developments are designed to accommodate this trend.

Powerhouse cities such as Toronto and Vancouver are forced to develop new space as they try to manage economic growth in markets with less than 2% industrial vacancy. Vancouver is a prime example of creative solutions to practical problems regarding shortage of industrial space and a lack of physical land to build on. Constrained by the Rocky Mountains, the Pacific Ocean, and the U.S. border, industrial land anywhere in the Greater Vancouver Area (GVA) is at a premium, while demand continues to increase. Combine this with a growing population and significant foreign investment, and Vancouver industrial finds itself with the lowest vacancy rate and one of the highest industrial rental rates in North America.

For same-day delivery purposes, e-commerce companies are generally unwilling to settle their warehouse and distribution centers outside the city. Primely located industrial space is seen as a prerequisite for last mile fulfillment centers. With no industrial availability in proximity to Vancouver's downtown core, construction will most likely be going vertical in the very near future. Multistory industrial buildings have been a staple in China for decades, and they started appearing in North American cities like Seattle and New York just last year. Recently, Vancouver's commercial real estate sector has become more creative, rezoning certain areas to allow for building stratification, such as flex buildings with industrial use on the ground floor and office/residential use above. However, this diversification is unlikely to provide enough relief to such a tight industrial market. While increased vertical construction costs will materialize in the form of higher rents, absorption of centrally located industrial space in Vancouver will be immediate. Some predict it is only a matter of time before vertical industrial development infiltrates the GVA.

GEOGRAPHIC DISTRIBUTION OF INDUSTRIAL NODES IS SHIFTING

While last mile deliveries and tight drive-time requirements will force many companies to remain within the traditional industrial sectors of major markets, not all business will remain confined to areas struggling with sub-2% vacancy. Strong demand is pushing out traditional market boundaries and businesses who enjoy greater flexibility with their geographic constraints are moving into secondary—and even tertiary—markets. These areas provide cheaper rent, lower property taxes, and are quickly becoming more accessible as a result of increased government spending on major infrastructure projects.

For example, in Alberta we are seeing tertiary markets such as Medicine Hat (300 kilometers South East of Calgary) attracting the marijuana industry with Aurora Cannabis planning to build a 1.2 million square foot production facility. The municipality is now piloting a project to offer tax exemptions and abatements in an effort to attract redevelopment of certain brownfield properties.

This movement away from the traditional industrial parks surrounding major urban centers is creating entirely new ecosystems of economic activity. Major industrial development projects in these smaller markets spawn the creation of residential and commercial development and subsequently smaller industrial developments to support new commerce.

WHY IS THE CANADIAN INDUSTRIAL MARKET CHANGING?

Increasing demand and lack of supply are the obvious factors, but what is the underlying cause driving demand, and why now?

ECONOMIC INFLUENCES

Economic factors such as the growth in e-commerce play an important role. Industrial real estate is forced to evolve as the e-commerce revolution takes the country by storm. Investment from large tech companies has contributed to increased demand for flexible and remodeled industrial spaces in major cities across the country.

TECHNOLOGICAL INFLUENCES

Technological factors have led to the transformation of retail and this has major supply chain and real estate implications, generating tremendous demand for clean and semi-automated distribution centers.

POLITICAL INFLUENCES

While Canadian politics are not quite as polarized as our neighbors to the south, much of Western Canada remains diametrically opposed on a few key disputes. A bevy of issues relating to Western Canada's energy sector will be at play in the upcoming October federal elections, where Canadians will collectively weigh their environmental conscience against the country's economic prosperity. As with most business in Alberta, the industrial real estate market is significantly impacted by the state of the oil sector, an industry the recently elected United Conservative Party of Alberta has pledged to protect at all costs. This past June, Canadian Prime Minister Justin Trudeau approved the expansion of the Trans-Mountain pipeline, a transportation system that runs from Edmonton to the Pacific Coast. This long-awaited and hotly contested decision to triple the pipeline's capacity bodes very well for Alberta's industrial real estate sector and many tertiary markets throughout Central British Columbia.

Other political factors such as the legalization of marijuana have created entirely new industries that all come with a large appetite for industrial space. This is putting increased pressure on already scarce availability and pushing large footprint facilities further out from the primary urban centers.

WHAT DOES THIS MEAN FOR AMERICAN USERS?

These changes bring about some key considerations for American companies who are trying to enter the market or relocate already existing facilities within the market:

MARKET KNOWLEDGE: A cursory knowledge of primary markets is no longer sufficient. In order to understand the true opportunities in a market, one needs to understand the surrounding sub-markets; the intricacies between each municipality, city controlled industrial parks/lands, transportation modes between each area. A deep and comprehensive regional knowledge is needed.

MANAGE EXPECTATIONS: Despite Canada's size, there is an extreme shortage of industrial land and buildings in most major markets. Identifying and securing the appropriate real estate will take time. Additionally, rental rates are generally higher in Canada than they are in many U.S. markets, and for major cities such as Vancouver, Toronto, and Montreal, rental rates have been increasing at an alarming rate. Budgeting for projects must account for this.

ZONING & PERMITTING: Each municipality is different, has unique requirements. and various zoning restrictions. Furthermore, certain municipalities have restrictions relating to indigenous rights that could impact project timelines significantly. A thorough understanding of permitting requirements should be obtained while preparing project timelines.

CULTURAL & LEGAL DIFFERENCES: There are vast differences in business practices among various parts of the country which can have an impact on real estate negotiations. Additionally, there are different legal systems within the country; essentially, all of Canada follows Common Law except for Quebec, which practices Civil Law. This has major implications on how lease agreements and purchase & sale agreements are drafted.

For best results, international companies and their respective advisors must view Canadian real estate through a Canadian lens. As the economic climate continues to evolve, and industrial real estate markets continue to adjust, every real estate strategy will need to be calibrated accordingly. ▽