NATIONAL REPORT

CANADA INDUSTRIAL

IPA INSTITUTIONAL PROPERTY ADVISORS

A DIVISION OF MARCUS & MILLICHAP, BROKERAGE

4Q/24

Market Rebalancing Continues to Run Its Course; Sales Recovery Already Underway

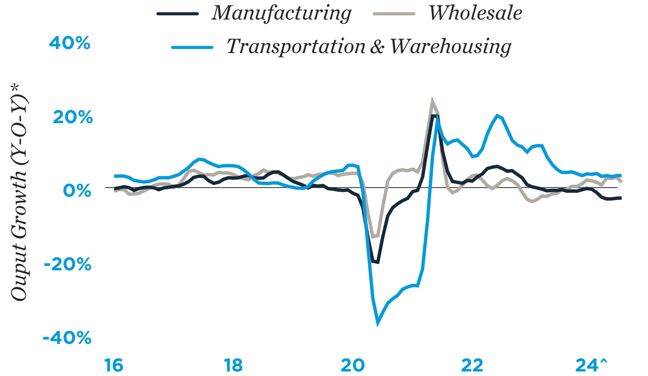
Industrial market heading towards new equilibrium. With the first three quarters of 2024 now in the rearview mirror, Canada's industrial sector continues its anticipated path of calibration. Space demand is softening amid restrictive interest rates slowing growth in industrial-intensive sectors. Construction activity remains elevated as a wave of speculative projects reach completion. The consequent higher vacancy rates across Canada are providing tenants with more options, particularly in markets that experienced near-full occupancy over the past two years. While vacancy across all metro areas is expected to continue rising, the national average is forecast to hold below 4.0 per cent by the end of 2024, still indicating some degree of tightness. Due to rising vacancies, rent growth has moderated and is projected to stabilize at a more sustainable level in the coming quarters.

Growth slowing in industrial-related sectors. As higher interest rates impact private consumption and investment, output growth in industrial-intensive sectors has slowed. In the manufacturing sector, softening sales and new orders have resulted in consecutive quarters of year-over-year declines since early 2023. In the transportation and warehousing sector, although output continues to expand, the rate of growth has moderated significantly, dropping from over 10 per cent year over year in the first quarter of 2023 to the current range of 3.0 per cent. In the wholesale sector, although growth has bottomed out and currently maintains at a modest pace, its relatively small share of the industrial-intensive sector – less than 30 per cent of the total – lacks the influence to reverse the overall deceleration trend.

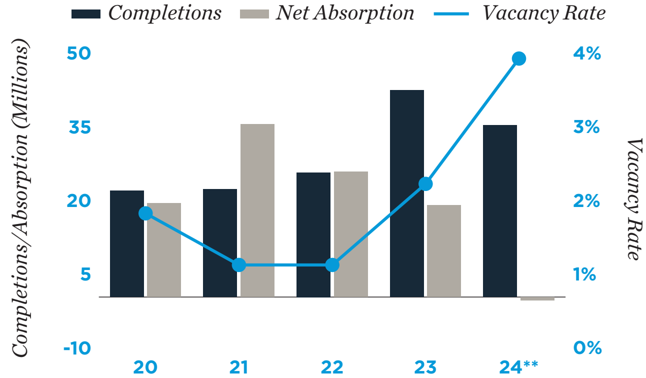
Space needs continue to cool amid heightened new construction. The slowdown in economic activity has prompted many businesses to reconsider their current space needs and future expansion plans. This has resulted in two consecutive quarters of negative net absorption in the first half of 2024, with advance estimates indicating further softening in the third quarter – a trend not seen since 2010. The large-bay segment, in particular, is bearing the brunt of this normalization, as demand for third-party logistics services cools amid slowing economic activity. In contrast, smaller-bay properties have remained more resilient, likely due to less supply growth, lower costs, greater flexibility and their ability to serve more local areas. Additionally, the current market rebalancing has proceeded at a faster pace in larger metros like Vancouver and Montreal, which accounted for a combined net total of 6.0 million square feet vacated in the first half of the year.

Construction pipeline unwinding but remains elevated. Following record completions in 2023, construction activity is expected to taper off this year. Rising vacancy rates have become a growing concern for builders, leading to a slowdown in speculative development. As of the third quarter of 2024, roughly 27 million square feet were under construction, down from 40 million square feet in early 2023. Even so, completions are estimated to stay above historical norms this year, marking the second-highest level on record. With just 30 per cent of the unfinished projects pre-leased, upward pressure on vacancy rates will persist as new projects are delivered unless demand picks up meaningfully, which would not manifest until 2025 at the earliest.

Industrial Production Growth Slowing



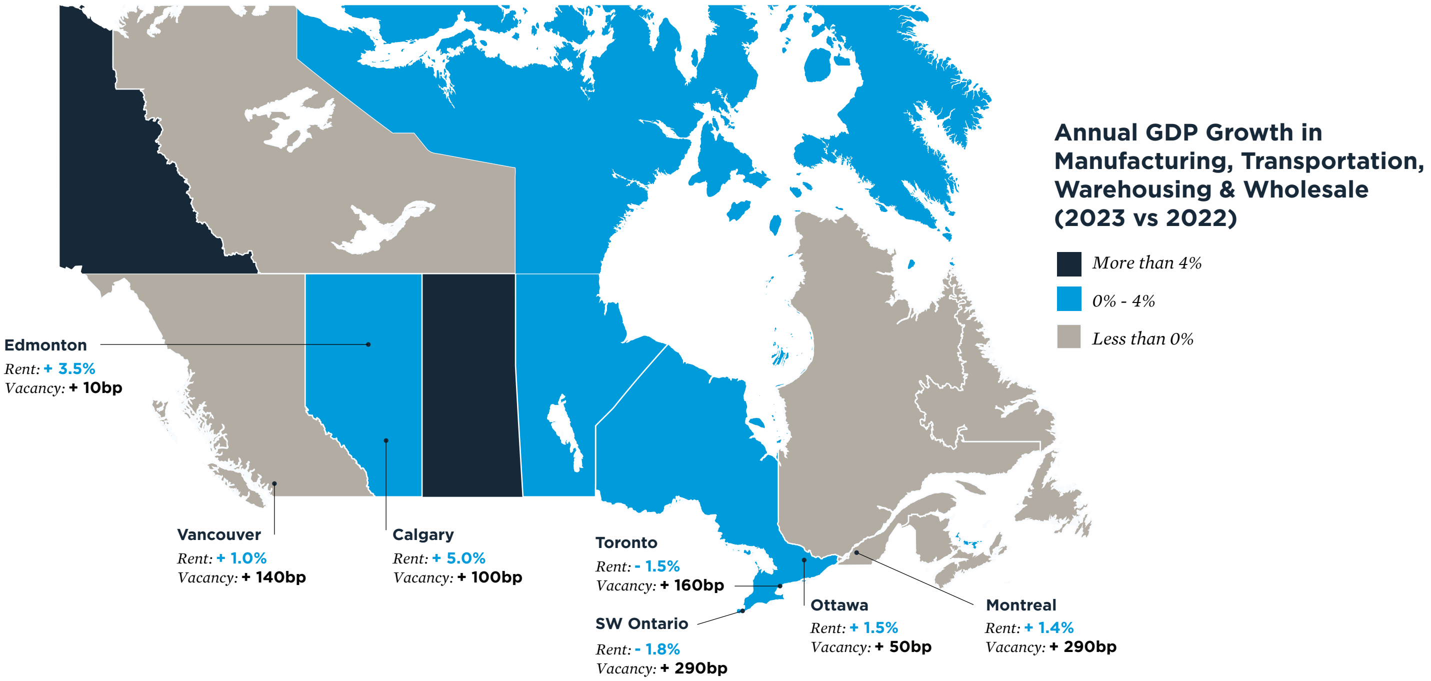
Industrial Supply and Demand



** 3-month moving average; ^ Through July; ** Forecast*

Sources: Altus Data Solutions; Statistics Canada

2024 Forecasts



Sources: Altus Data Solutions; Statistics Canada

WESTERN CANADA

- **Calgary, Alberta:** As tenants reevaluate space needs amid elevated borrowing costs, Calgary's industrial vacancy rate has risen by nearly 220 basis points since its pandemic low. Nevertheless, investors continue to favour the metro, as it remains a major distribution hub for Western Canada. Meanwhile, on the supply side, although most new construction has focused on large-bay facilities, tenants and investors have been targeting smaller-format development opportunities in Balzac and the Northeast.

- **Edmonton, Alberta:** Despite softening net absorption, long-term demand is expected to be supported by higher oil production, increased trade activity and the emergence of the clean energy sector. The vacancy rate is projected to stay low and comparatively more stable than in other metros, as builders have shown greater restraint in speculative logistics projects.

- **Vancouver, British Columbia:** Raised borrowing costs have curbed business investment and consumer spending, causing space demand to trend lower in the first half of 2024. This pushed the vacancy rate above 2.0 per cent, restoring some balance to the industrial market. Given its direct access to the Pacific Ocean, however, the metro is poised to play a key role in global trade, supporting long-term industrial demand prospects.

EASTERN CANADA

- **Montreal, Québec:** Elevated interest rates have softened space demand, leading to an increase in vacancy. That said, current market conditions have created opportunities for tenants and investors to enter the market and capitalize on future growth potential.

- **Ottawa, Ontario:** Although demand for large-bay facilities has moderated, Ottawa's industrial market stays resilient, driven by steady demand for small-bay spaces amid minimal inventory expansion. The metro remains an under-invested market, with dollar volume accounting for less than 2.0 per cent of the national total.

- **Southwestern Ontario:** Despite an overall increase in the vacancy rate, cities like Brantford, Guelph, St. Catharines and Waterloo continue to experience tight market conditions. In areas where vacancy rates have risen, the increase has been primarily driven by new supply rather than an outright decline in net absorption.

- **Toronto, Ontario:** The rebalancing of the industrial sector has been more pronounced in Mississauga and Brampton, with 1.4 million square feet becoming vacant in the first half of 2024 in these submarket combined. Space demand fared better in the Toronto North submarket, likely due to lower costs for tenants. Although the vacancy rate is expected to continue rising, it is projected to remain below 4.0 per cent, indicating persistent market tightness.

2024 National Forecast

EMPLOYMENT

1.0% increase Y-O-Y

- Job creation has slowed as challenging financial conditions curb business hiring. With population expansion outpacing job growth, the unemployment rate will likely rise to a post-pandemic high.

CONSTRUCTION

35 million square feet completed

- Completions will remain above the historical norm but decrease from last year's level. This slowdown is more pronounced in Toronto and Calgary as the current construction pipeline winds down.

VACANCY

170 basis point increase Y-O-Y

- Vacancy rates are rising in all metro areas due to softening demand amid elevated supply growth. The national average rate is projected to reach 3.9 per cent by year-end, marking a nine-year high.

ASKING RENT

0.5% increase Y-O-Y

- The average asking rent continues to climb as the vacancy rate across Canada holds below 4.0 per cent. As demand moderates, however, the rate of increase is expected to slow to its lowest level since 2015.

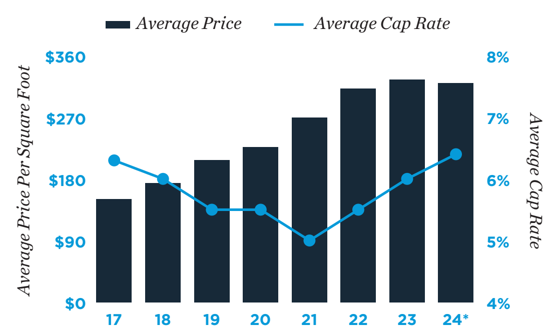
2024 INVESTMENT OUTLOOK

- **Recovery taking shape as transaction volume rises.** In anticipation of lower financing costs, investment activity improved in the first half of 2024. The total number of transactions rose by 11 per cent year over year during this period, driven by an increase in deals valued under $20 million. Properties in this category tend to be smaller-bay facilities, which have seen lower vacancy rates and typically require less financing compared with larger facilities. With interest rates remaining at restrictive levels, investment activity for properties over $20 million remained subdued, resulting in an overall year-over-year decrease in total dollar volume for the first half of the year.

- **National price and yield trends influenced by major markets**. The trailing 12-month average sale price edged down to $320 per square foot in the second quarter, driven by declines in Toronto, Montreal and Vancouver. Alongside falling prices, the national cap rate rose to 6.4 per cent, marking a 20-basis-point increase from the first quarter. In metros with lower prices, such as Edmonton, Ottawa and Southwestern Ontario, however, cap rates have largely stabilized.

- **Industrial properties a top focus for investors.** Despite softening leasing activity leading to slower rent growth, industrial properties remain a top choice for investors. Over the 12 months ended in June, more than 40 per cent of dollar volume was directed towards industrial. With market consensus indicating that rent growth will outpace inflation in the coming years, investor sentiment is expected to stay positive, potentially driving further increases in sale volumes.

Industrial Investment Sales Trends



Industrial Sales Reaching All-Time High Share

* *Trailing 12-month through 2Q*

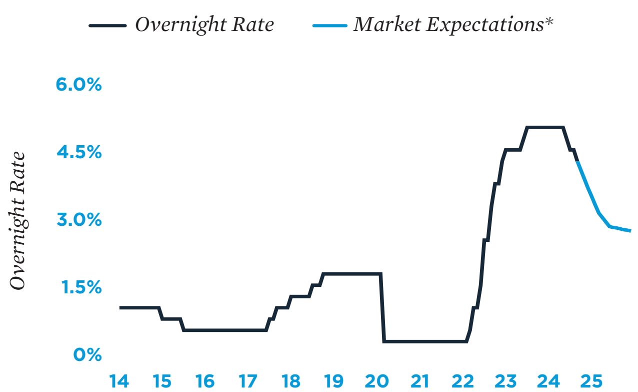
Sources: Altus Data Solutions

Declining Interest Rates to Usher in Broad-Based Investment Recovery

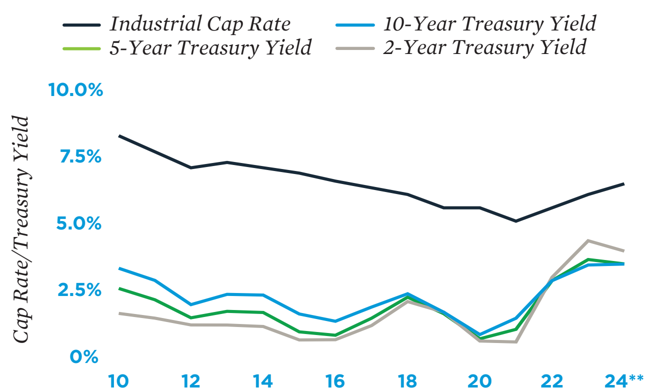
Backstopping a slowing economy now the main goal for the Bank of Canada. Over the summer, rising unemployment and slowing economic growth increased the risk of a weaker-than-expected economy, which has become a central focus in the Bank of Canada's monetary policy deliberations. The unemployment rate has risen by 90 basis points this year, reaching 6.6 per cent in August – the highest level since September 2021. Joblessness has been particularly pronounced among the younger generation, indicating a shortage of entry-level positions and higher barriers to entering the labour market. With elevated population growth, job creation is likely to continue lagging behind the expansion of the labour force, putting further upwards pressure on the unemployment rate in the near term. Alongside the weakening job market, the economy grew by just 0.2 per cent in July and is estimated to remain flat in August. This suggests third-quarter GDP growth will likely fall well below the Bank of Canada's July projection of a 2.8 per cent annualized gain. With headline inflation falling to the BoC's target in August, the central bank has shifted its focus toward supporting economic growth. Additional rate cuts are anticipated through at least mid-2025 as a result. While gradual reductions are the most likely scenario, risks are skewed towards larger cuts if the economy weakens significantly.

Lower interest rates to boost industrial investment. With smaller-sized deals already experiencing pent-up demand this year, declining interest rates are expected to spur a recovery in larger transactions moving forwards. Because these deals typically require more financing, they will benefit more significantly from lower borrowing costs. In addition to the anticipated increase in direct property ownership, a rising risk premium – the widening gap between returns on real estate investments and treasury yields – will likely drive growth in indirect ownership, such as investment in REITs, commercial real estate mutual funds and private equity funds. With industrial properties remaining one of the best-performing and most invested asset types, investors are expected to continue targeting logistics, warehousing and manufacturing facilities.

BoC to Cut Rates Through Mid-2025



Cap Rates and Treasury Yield Trends



** Market expectations are calculated as an average of the latest forecasts from TD, RBC, CIBC, Scotiabank and National Bank; ** Cap rate as of 2Q; treasury yields through September 26.*
Sources: Altus Data Solutions; Bank of Canada; Capital Economics; TD; RBC; CIBC; Scotiabank; National Bank

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