NATIONAL REPORT
CANADA INDUSTRIAL

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

2Q/25

A Tempered Recovery Amid Tariff-Driven Uncertainty

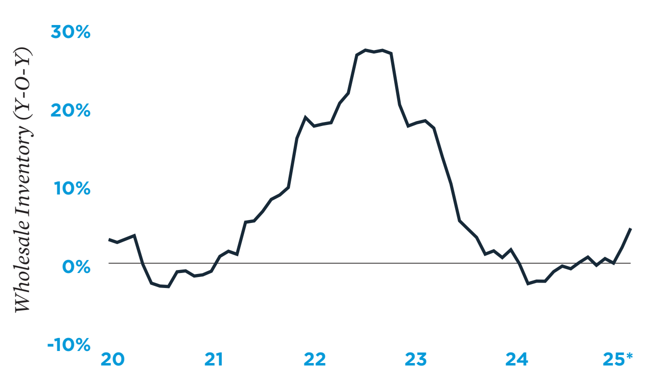
Outlook remains optimistic. The first quarter of 2025 was a tumultuous period. Intermittent tariff threats from the United States shook business confidence, prompting fears of an imminent recession. As the actual tariffs imposed were far less severe than initially feared, however, those pessimistic expectations may be overstated. This short-lived setback had limited impact on the industrial sector as a result. Fundamentals held steady throughout the quarter. Looking ahead, the outlook for 2025 is still positive, supported by easing tensions following upcoming bilateral trade negotiations with the U.S. Over the longer term, progress in liberalization of internal trade and efforts in diversifying export markets are expected to serve as catalysts for the next phase of growth in Canada's industrial sector.

Tariffs' early impact proved limited. While trade tensions have slowed activity in the manufacturing and transportation sectors, they have not led to a complete capitulation in space demand. Since the announcement of U.S. "reciprocal" tariffs, a growing number of businesses have been rerouting U.S.-bound shipments from other countries through Canada to avoid tariffs. This strategic stockpiling contributed to a notable rise in wholesale inventories in January and February, helping space demand stay firmly in positive territory in the first quarter. This strength may come under pressure heading into the summer months, however. Further weakness in production and trade activity may lead to softening absorption rates in the second quarter.

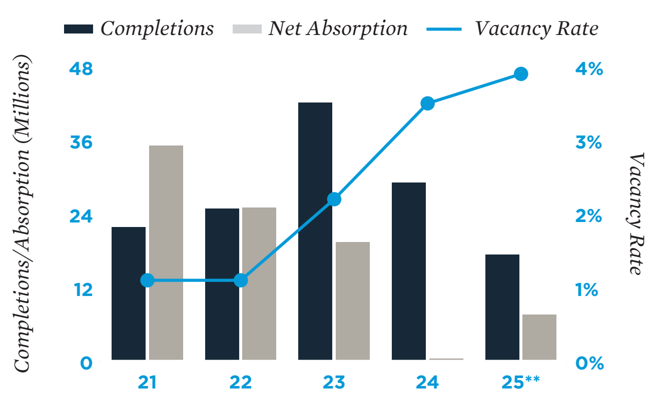
Demand and supply adjust to new market reality. After a bumpy first half, space demand is expected to return to an upwards trend. Negotiations with the U.S. will be a key development, as these may ease trade tensions and boost business confidence moving forward. Lower interest rates are also expected to support overall economic momentum, fuelling leasing activity in the industrial sector. On the supply side, developers have already slowed the pace of construction in response to rising vacancy rates over the past two years. Trade uncertainties are amplifying this trend, further reducing new industrial projects. This is particularly evident in the construction of speculative, large-bay buildings, as demand from major third-party logistics companies has diminished. As a result, construction is forecast to remain subdued through 2025 and beyond.

Vacancy to rise but will stay in check. Though space demand is expected to recover in the latter half of 2025, net absorption for the full year will inevitably fall short of initial forecasts due to trade disruptions. Even so, a softening construction pipeline should help prevent a significant rise in vacancy. Trade uncertainties remain the primary downside risk. Lower tariff rates may emerge from ongoing trade negotiations, but these talks could take years to conclude. The longer the negotiations drag on, the greater the impact – particularly on properties tied to the auto, steel and aluminum industries that are currently subject to a 25 per cent tariff.

Wholesalers Building Up Inventory



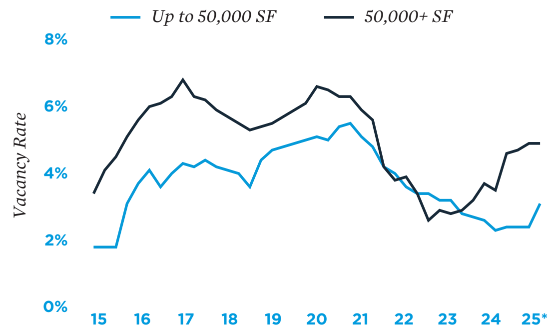
Industrial Supply and Demand



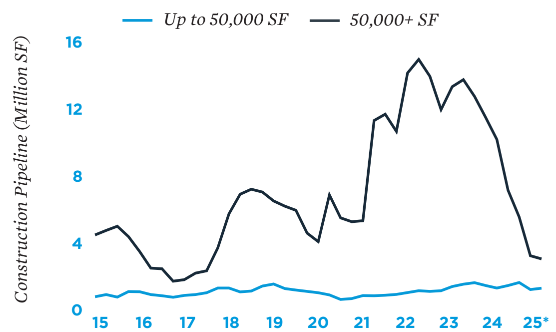
* Through February; ** Forecasts

Sources: Altus Data Solutions; Statistics Canada

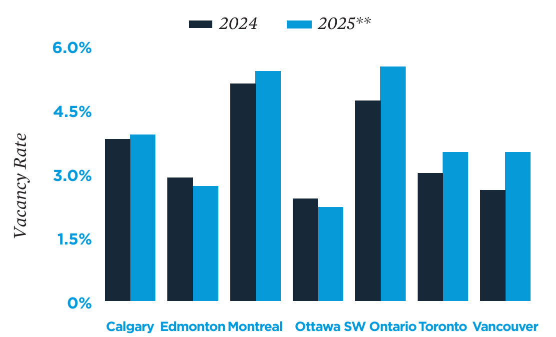
Lower Vacancy for Small-Bay Properties



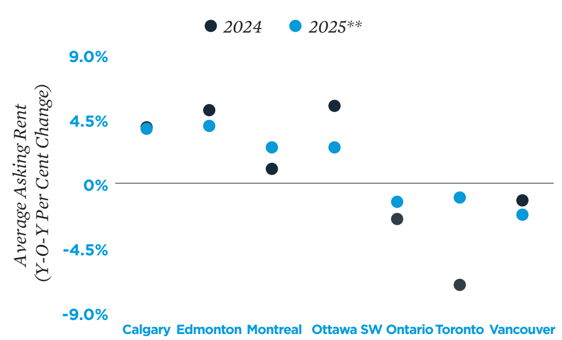
Small-Bay Historically Undersupplied



Industrial Vacancy Rate Forecasts



Industrial Rent Growth Forecasts



** Through 1Q; ** Forecasts*
Sources: Altus Data Solutions; CoStar Group Inc.

Bay Size Matters; Internal Trade Creates Future Opportunities

Small-bay segment a bright spot amid uncertainties. Despite sector-wide demand and supply rebalancing, the small-bay subsector remained tight. Over the past two years, the vacancy rate hovered below 3 per cent, strengthened by strong demand and limited inventory expansion. Small-bay properties are typically older buildings located in established industrial areas that benefit from well-developed transportation and infrastructure networks. These facilities are often multi-tenanted and primarily occupied by local distributors and wholesalers, which to some extent are insulated from global trade disruptions. The small-bay segment has also been severely under-built, largely due to its lower market sale prices relative to total replacement costs. Small-bay inventory has grown by just 3 per cent over the past five years as a result, compared with an 18 per cent increase for medium- and large-bay properties. As elevated construction costs continue to undermine project feasibility, this supply shortage is expected to persist, keeping vacancy rates at historically low levels.

Internal trade to drive future growth. Interprovincial trade barriers have been a long-standing issue in Canada, well before any recent tariff threats. Protectionist policies, however, have accelerated efforts to strengthen Canada's resilience against external shocks, prompting renewed negotiations among different levels of government. The new Liberal government has pledged to eliminate all federal barriers to interprovincial trade by Canada Day this year. Several provinces – including Ontario, Nova Scotia, New Brunswick and Prince Edward Island – have also introduced legislation to liberalize internal trade. This coordinated push could serve as a fresh catalyst for future growth in the industrial sector. Internal trade barriers are estimated to lower Canada's GDP by nearly 8 per cent, so removing them will significantly boost the nation's productivity. The industrial sector is especially well-positioned to benefit.

Major Market Overviews

Western Canada. This part of Canada is likely to experience a more limited impact from trade tensions. Vancouver's access to Asian markets and the predominance of small- and medium-bay properties serving local clients will help sustain space demand. In Alberta, preferential treatment under the USMCA for most of the province's energy products offers some protection, helping shield Calgary and Edmonton from the effects of tariffs.

Eastern Canada. As Canada's manufacturing hub, eastern metros are expected to bear the brunt of U.S. tariffs. Southwestern Ontario and Montreal – key producers of steel, aluminum, motor vehicles and auto parts – are poised to see a notable slowdown in space demand. Toronto's industrial market showed resilience in the first quarter, however, likely buoyed by lower interest rates. This strength suggests a positive outlook for 2025, assuming trade tensions do not escalate. Ottawa's industrial sector is less exposed to global trade pressures, as the metro primarily serves domestic needs. As a result, its vacancy rate is projected to decline amid a limited construction pipeline.

2025 Forecast

EMPLOYMENT

1.0% increase Y-O-Y

- Employment growth will be supported by lower interest rates this year. Headwinds from trade uncertainties and slower population growth, however, will likely result in a deceleration.

CONSTRUCTION

17 million square feet completed

- Completions are projected to fall to their lowest level since 2018 amid ongoing trade tensions. Greater clarity on trade policy will be essential for restoring developer confidence and reactivating project pipelines.

VACANCY

40 basis point increase Y-O-Y

- The vacancy rate is set to keep rising as leasing activity slows amid near-term uncertainties. That said, limited supply growth will help contain the increase, holding the rate at around 4.0 per cent.

ASKING RENT

0.3% increase Y-O-Y

- Asking rents are forecast to remain flat in 2025. A mild year-over-year decline is expected in Toronto, Southwestern Ontario and Vancouver, offset by continued increases in other markets.

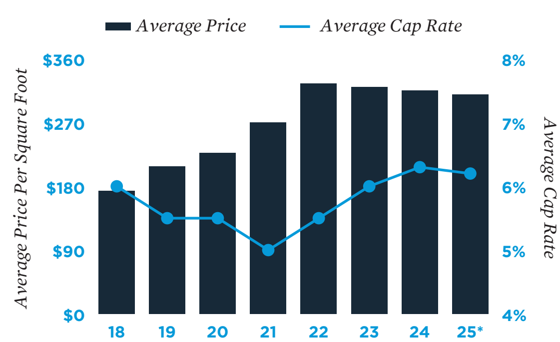
2025 Investment Outlook

- **Transaction market sees fewer but larger deals.** Trade tensions left a dent in sales activity, as expected. In the first quarter, the number of transactions fell by 20 per cent year over year, driven by a decline in deals under $20 million. Despite the overall slowdown, sales of larger assets increased in Toronto and Southwestern Ontario. This trend of fewer but larger transactions suggests that buyers are becoming more selective, focusing on high-quality properties in strategic locations. At the same time, owners of these assets are opting to sell and capitalize on gains accumulated over recent years amid ongoing uncertainty.

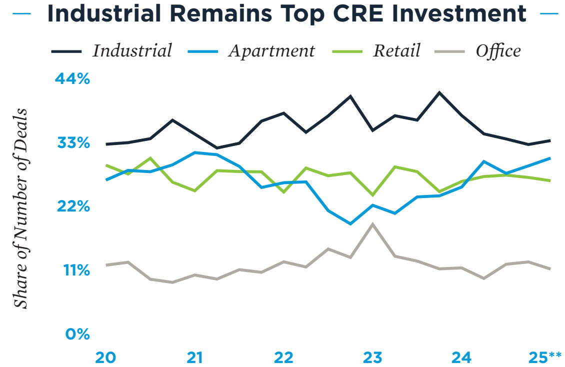
- **Cap rates inch lower alongside price drop**. Sale prices decreased slightly in the first quarter compared with the 2024 level. Trade uncertainties, combined with already-softening fundamentals, continued to weigh on valuations. Even with this price drop, cap rates also edged lower, though stayed near their recent highs. This trend aligns with the rise in sales of larger, high-quality assets, which typically come with lower cap rates due to their lower risk profile.

- **Industrial still the preferred sector for investors.** Despite the slowdown in sales activity, investor confidence in Canada's industrial market remains strong. As of the first quarter, industrial properties accounted for roughly one-third of all commercial real estate investment nationwide. They lead all other commercial property classes in both deal count and dollar volume. Multiple types of industrial properties – such as multi-tenanted, small-bay facilities and industrial condos – continue to attract buyer attention amid ongoing uncertainties.

Industrial Investment Sales Trends



Industrial Remains Top CRE Investment



** Trailing 12-month through 1Q; ** Through 1Q*

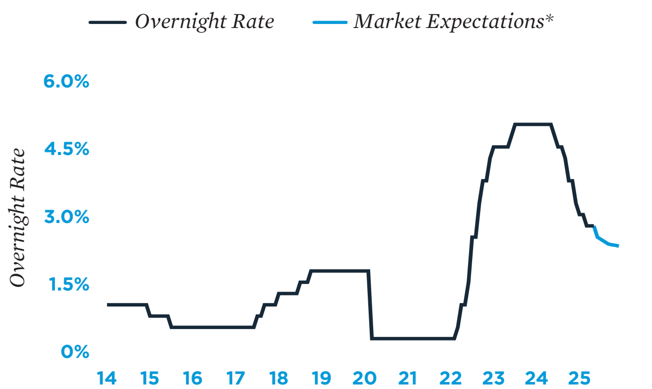
Sources: Altus Data Solutions; Statistics Canada

Financing Challenges Could Persist Despite a Dovish BoC

Bank of Canada to stay dovish, given current macro environment. At its April policy meeting, the BoC presented two scenarios for its economic outlook: one in which Canada avoids a recession, with tariffs remaining limited in scope, and another where escalating trade tensions lead to an outright decline in GDP. In both cases, inflation rises but only moderately due to downwards pressure from a weakening economy. This assumption of lower growth alongside rising – but contained – inflation seems to align with recent economic data. The latest readings on the labour market, manufacturing shipments, home sales and business sentiment all point to slowing economic growth in the first quarter. At the same time, price growth and inflation expectations have stayed well anchored. Looking ahead, this trend is likely to continue. Ongoing uncertainties are expected to weigh on investment and consumption, putting downwards pressure on economic growth. Meanwhile, the removal of the carbon tax starting in April will help offset some of the inflationary impact from tariffs for the remainder of 2025. This environment reduces the likelihood of stagflation taking hold and, in turn, provides the Bank of Canada with some breathing room. As inflation currently appears largely under control, the central bank is set to stay on its easing path, cutting rates to as low as 2.0 per cent to cushion the negative effects of trade tensions.

Access to capital may remain constrained for investors. The recent selloff of U.S. Treasury securities following the announcement of "reciprocal" tariffs has heightened volatility in the bond market. Although the subsequent 90-day tariff reprieve quickly halted the spike in long-term yields, tariff-driven inflationary pressures and concerns about U.S. government debt sustainability may continue to weigh on sentiment, raising the risk of persistently elevated long-term interest rates. Given the close correlation between Canadian and U.S. bond yields, significant declines in Canada's long-term rates may be less likely this year. As a result, long-term financing – particularly for larger deals – could remain challenging despite a dovish Bank of Canada, which will lead to a subdued recovery in the transaction market, if any.

BoC to Continue Cutting Rates Through 2025



Long-Term Rates Still Elevated

**Market consensus from June is calculated as an average of the latest forecasts from TD, RBC, BMO, CIBC and Scotiabank; ** Through May 6*
Sources: Altus Data Solutions; Bank of Canada, Statistics Canada; TD; RBC; BMO; CIBC; Scotiabank

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Sources: IPA Research Services; Altus Data Solutions; Bank of Canada; CoStar Group, Inc.; Statistics Canada; TD; RBC; BMO; CIBC; Scotiabank