National Report

CANADA INDUSTRIAL 3Q/26

IPA INSTITUTIONAL PROPERTY ADVISORS

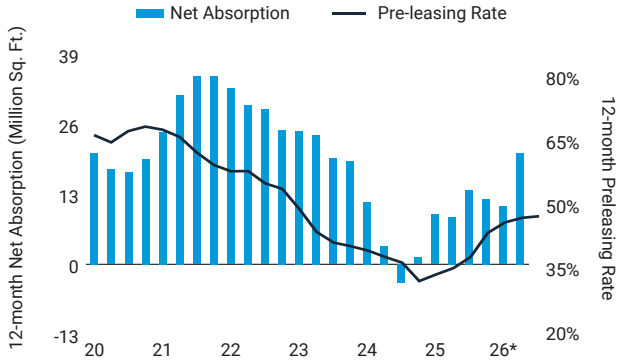
Industrial Market Reaches Inflection Point as Vacancy Begins to Move Lower

Market conditions improve amid broadening tenant demand. The industrial sector is expected to strengthen through 2026 as resilient space demand converges with slowing supply growth. Rising leasing activity is on track to support a second consecutive year of accelerating absorption, while strengthening preleasing momentum points to further occupancy gains in the years ahead. Combined with declining completions, these trends are expected to drive the first annual decline in the national vacancy rate since 2022. The construction pipeline has begun to expand, however, suggesting deliveries could gradually accelerate from 2027 as the operating environment continues to improve. Investment market conditions are also showing signs of recovery. Deal count and dollar volume increased through the first half of the year, led by a rebound in larger and higher-value transactions. Rising medium- to long-term yields will likely tighten financial conditions and dampen near-term investment activity. However, the sector's positive long-term outlook is expected to continue supporting investor confidence.

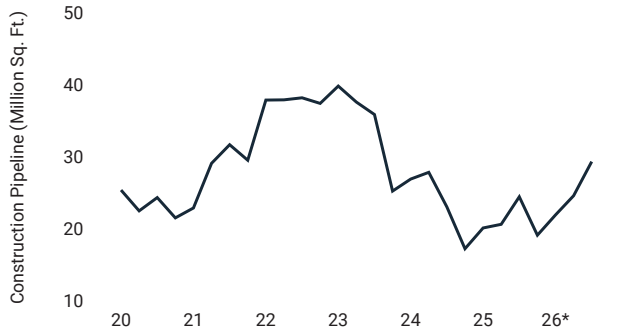
Space demand remains on recovery path. The resilience in occupier demand seen last year amid elevated trade tensions has continued into 2026. Net absorption exceeded 10 million square feet in the first half of the year, roughly in line with the same period in 2022. Forward-looking demand indicators have also improved. Preliminary data shows that close to 50 per cent of space under construction in the third quarter was preleased, up from just 28 per cent in the final months of 2024. While the latest escalation in Canada-U.S. trade tensions has created additional challenges for industries such as food, paper, and metal manufacturing, its limited scope suggests that space demand will likely remain resilient as firms continue to diversify their customer bases and supply chains. As a result, net absorption is expected to remain positive through the rest of 2026, with the annual total expected to post a second consecutive year of growth after reaching a cyclical low in 2024.

Delivery pace could bottom out this year. Over the past two years, developers have responded to softening space demand by scaling back new supply. As a result, completions fell 33 per cent in 2025 and are expected to decline again this year. This slowdown will be concentrated in Toronto and Southwestern Ontario and is projected to more than offset modest increases across Western Canada. Combined with the ongoing recovery in net absorption, this decline in completions is expected to drive the first annual decline in the national vacancy rate since 2022. Looking beyond 2026, sustained improvements in occupier demand could prompt a renewed increase in development activity. Preliminary third-quarter data shows the national under-construction pipeline has expanded to 29 million square feet, up from just 17 million square feet at the end of 2024. This growing pipeline suggests completions could begin to accelerate again over the coming years.

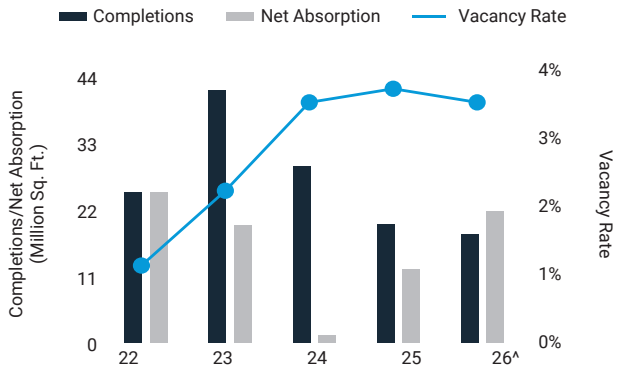
INDUSTRIAL SPACE DEMAND RECOVERING



CONSTRUCTION PIPELINE BOTTOMED OUT



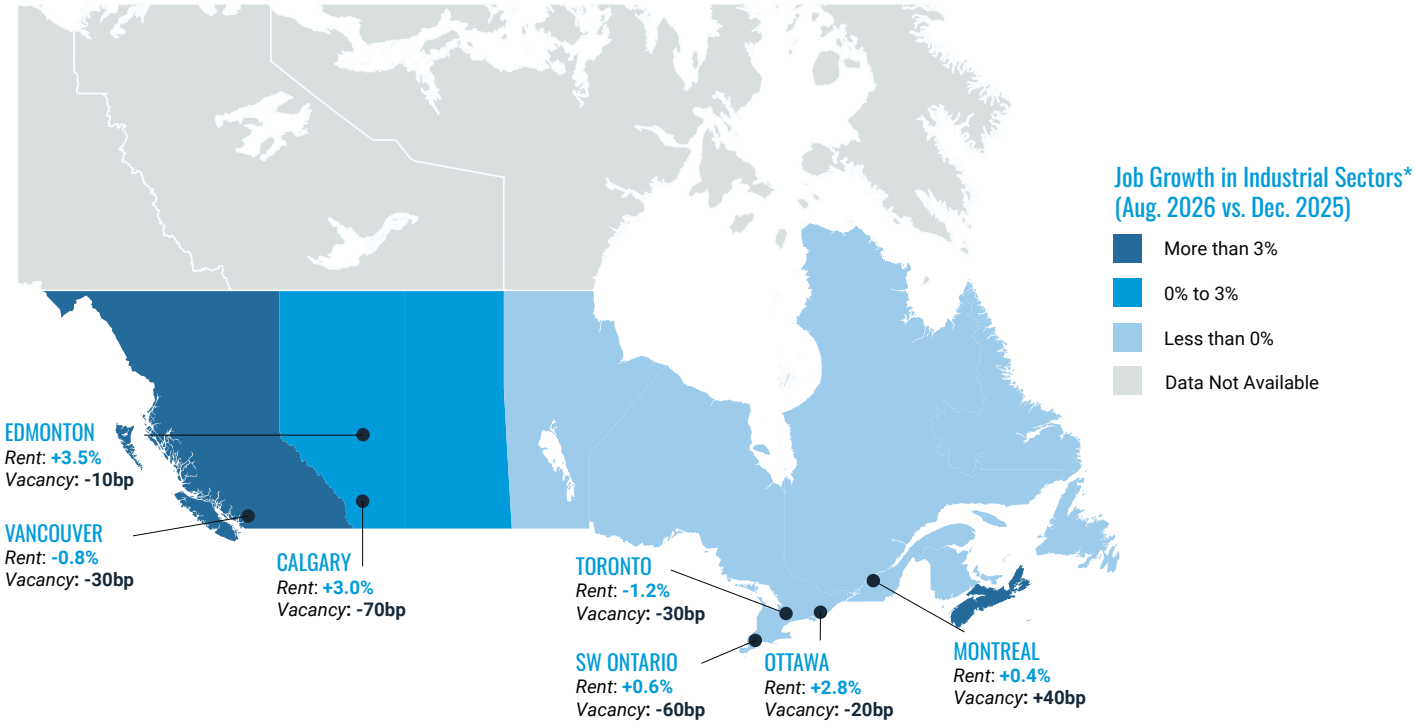
SPACE DEMAND AND SUPPLY TRENDS



* Through 2Q; ^ Forecast

Sources: Capital Economics; CoStar Group Inc.; Oxford Economics; Statistics Canada

Major Market Overviews



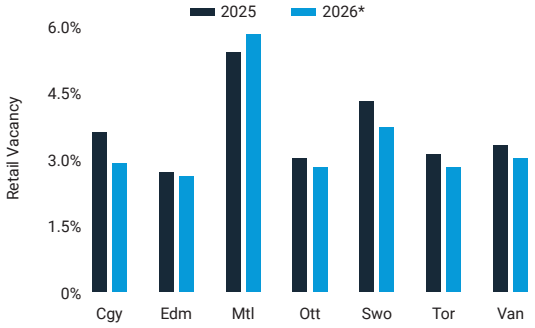
* Includes transportation, warehousing, manufacturing, and wholesale sectors

Sources: Altus Data Solutions; Statistics Canada

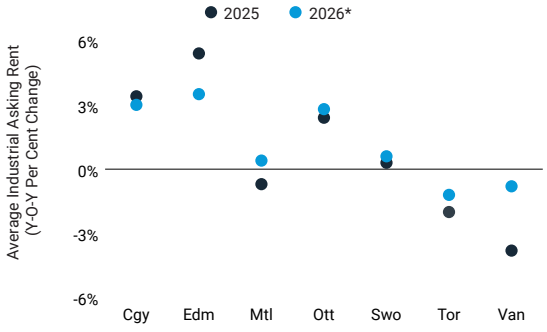
Western Canada is expected to strengthen through 2026 as demand continues to recover and the pace of new supply moderates. Vancouver is showing clear signs of improvement, with leasing activity and net absorption rebounding from recent lows, supported by the region's entrenched role as a gateway for trade and distribution and its highly constrained land supply. In Alberta, both Calgary and Edmonton are benefiting from strong economic fundamentals, population growth, and expanding logistics networks. Calgary's recovery is driven by improving leasing activity and easing supply pressures. Edmonton's outlook is underpinned by major transportation and cargo infrastructure investments that reinforce its position as a key logistics and energy hub. While economic and trade uncertainty may temper short-term occupier decision-making, improving demand and disciplined supply should support gradually tightening market conditions across the region.

Eastern Canada's industrial landscape is expected to remain stable through 2026, though performance will vary across markets. Toronto is showing signs of recovery as absorption strengthens and vacancy declines, supported by its role as Canada's largest distribution and consumption hub. Ottawa remains resilient, with stable demand, limited exposure to trade disruptions, and a minimal construction pipeline helping preserve healthy fundamentals. Montreal continues to face headwinds from relatively elevated vacancy and trade uncertainty, but subdued development activity should allow demand to gradually absorb existing inventory. In Southwestern Ontario, leasing activity has improved from last year's slowdown, although the region remains the most exposed to cross-border trade risks due to its manufacturing-oriented economy. While economic and trade uncertainty may continue to weigh on tenant sentiment, restrained construction activity and steady demand should help stabilize fundamentals and support a gradual recovery across much of the region.

VACANCY RATES BY METRO



RENT GROWTH BY METRO



* Forecast

Sources: Altus Data Solutions

2026 FORECAST

EMPLOYMENT

0.5% increase Y-O-Y

Slower population growth is expected to moderate employment gains, with hiring concentrated in health care, education, and other domestically focused industries. Meanwhile, trade uncertainty is likely to constrain hiring in manufacturing and transportation, particularly among export-oriented businesses.

CONSTRUCTION

18 Million sq ft to be completed

Completions are projected to soften this year, led by a notable decline in Ontario. Looking ahead, a growing development pipeline may drive an increase in deliveries; however, the average project size remains roughly 10 per cent below those completed between 2020 and 2022, indicating a still-cautious development environment.

VACANCY

20 basis point increase Y-O-Y

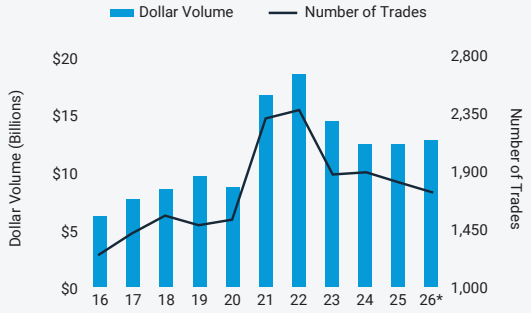
Recovering space demand and a decline in completions are projected to drive the first annual decrease in the national industrial vacancy rate since 2022. This trend is expected across most major markets, with Montreal remaining the key exception as occupier demand continues to lag deliveries.

ASKING RENT

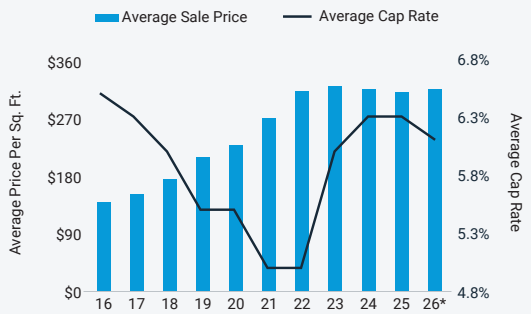
0.1% increase Y-O-Y

The national average asking rent is expected to edge higher this year after declining 0.6 per cent in 2025. The recovery will be driven by a gradual stabilization in Toronto and Vancouver, where rent declines are projected to moderate as demand improves, alongside continued rent growth in Calgary and Edmonton.

PROPERTY SALES TRENDS



SALE PRICE AND CAP RATES



* Trailing 12-month total through 2Q

Sources: Altus Data Solutions

INVESTMENT HIGHLIGHTS

Investor activity improved through the first half of the year amid strengthening space demand, with trailing 12-month dollar volume rising 13 per cent year over year in the second quarter alongside a 5.2 per cent increase in transaction count. Ontario led the recovery, as Ottawa and Southwestern Ontario recorded year-over-year increases in dollar volume of 76 per cent and 48 per cent, respectively. Toronto also posted gains, albeit at a more moderate pace, while still outperforming the national average. Notably, transactions valued above $10 million outpaced smaller deals in both dollar volume and deal-count growth, pointing to improving confidence in market fundamentals despite ongoing uncertainty around trade policy and geopolitical developments.

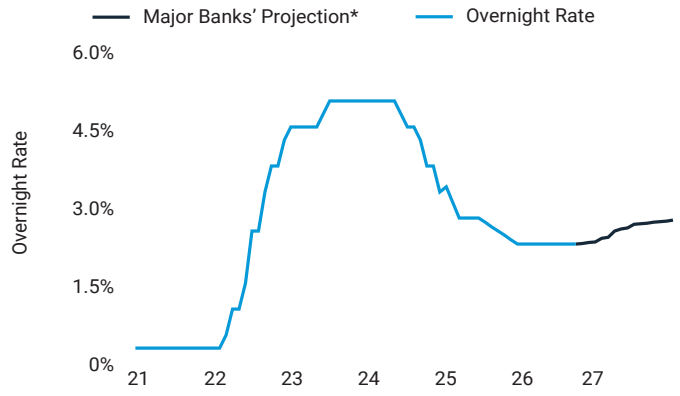
Compared with last year, the national average sale price edged higher in the first half of 2026, reaching approximately $315 per square foot. Much of this increase was driven by a greater concentration of higher-value transactions in Montreal, Edmonton, and Southwestern Ontario. In contrast, Vancouver continued to experience pricing pressure, with average sale price falling to its lowest level since 2022 amid softer investment activity. Meanwhile, the national average cap rate declined 20 basis points to approximately 6.1 per cent, suggesting that investors are assigning lower risk premiums as market conditions stabilize. Despite this improvement, cap rates remain well above the roughly 5.0 per cent recorded in 2022, indicating that asset values have yet to fully recover to pre-correction levels.

Higher Borrowing Costs Present Near-Term Investment Headwind

External forces pushing long-term rates higher. Supported by within-target inflation and a recovering economy despite ongoing geopolitical tensions, the Bank of Canada's monetary policy outlook remained largely unchanged entering the final quarter of the year. However, external developments have pushed long-term borrowing costs higher and tightened domestic financial conditions. In particular, U.S. Treasury yields rose sharply at the end of the third quarter as stronger-than-expected economic growth, persistent inflation concerns, and expanding fiscal deficits reinforced expectations that interest rates could remain higher for longer. Additional upward pressure stemmed from rising capital requirements tied to AI-related investment, as substantial funding needs for data centres, power generation, and supporting infrastructure intensified competition for investor capital. Given the close integration of Canadian and U.S. capital markets, these pressures spilled over into Canada, lifting domestic bond yields, despite an unchanged Bank of Canada policy rate. By the end of September, the 10-year bond yield in Canada had climbed to roughly 4.0 per cent, while the 5-year yield approached 3.7 per cent, marking their highest levels since October 2023 and May 2024, respectively. The rise in long-term rates has raised financing costs for businesses and investors, tempering some of the benefits of a stable domestic monetary policy environment.

Improving fundamentals to support sales despite higher rates. As borrowing costs rise, investors are likely to adopt more conservative underwriting assumptions, requiring higher yields and placing upward pressure on cap rates, particularly for secondary assets or properties with limited near-term rent growth potential. This could widen bid-ask spreads and lengthen transaction timelines as buyers and sellers adjust pricing expectations. At the same time, higher financing costs may discourage speculative development and reduce the feasibility of projects with thinner profit margins, contributing to a more disciplined supply outlook over the medium term. Nevertheless, improving market fundamentals should partially offset the impact on investment activity. Space demand has continued to recover, while development activity has moderated and vacancy rates are expected to stabilize or decline across many major markets. These trends support stronger income growth prospects, which can help offset some valuation pressure from higher interest rates. Consequently, while rising bond yields may temper transaction activity and limit near-term price appreciation, Canada's industrial sector remains well positioned due to its favourable near-term supply-demand dynamics and long-term structural demand drivers.

OVERNIGHT RATE TREND



* Average of the latest projections from RBC, TD, BMO, CIBC, National Bank, Scotiabank
Sources: Bank of Canada; BMO; CIBC; National Bank; RBC; Scotiabank; TD

GOVERNMENT BOND YIELD TRENDS



** Through September
Source: Bank of Canada

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