Industrial Tenant Survey Report
June 2021

Where do we grow from here?

Prepared by Colliers
Real Estate Management Services

There has been a significant increase in industrial lease rates over the past few years, paralleled by a rapid rise in e-commerce. Now, industrial tenants are starting to reevaluate their real estate needs.

Colliers Real Estate Management Services surveyed a sample of our tenant base to understand how asset classes have fared and how industrial spaces will respond to changes in product demand, supply chains, lease rates, and cost of delivery.

This report is the second of a three-report series on the recovery of each asset class: office, industrial, and retail.

What's Inside

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Methodology

To analyze our portfolio, we surveyed a stratified sample of tenants out of our 16 million square foot national industrial portfolio based on geography, business size, and industry. The survey contains responses from 103 companies, with a 95% confidence level.

This is the third survey that has been issued to industrial tenants since the beginning of the pandemic: July 2020, December 2020, and June 2021.

Key takeaways

1. **Industrial lease rates are expected to increase over the next three years, yet the net rate of growth could decline depending on how tenants respond. For 58% of tenants, affordable lease rates are more important now than before the pandemic.**

   With one of the lowest availability rates on record, we expect industrial lease rates to continue increasing from current levels, albeit the rate of growth depends on how tenants respond to market shifts. All tenants surveyed indicated that lease affordability is critical to their success, with 58% saying it was more important now than before the pandemic. Should tenants decide to move locations or purchase, rather than rent, their spaces in response, the rate of growth could decline.

2. **62% percent of tenants would consider moving locations in response to increasing lease rates. The vast majority (85%) of those tenants say they would move to a more affordable suburb, with no desire to relocate to a new province.**

   Industrial lease rates have seen historic growth over the past few years and are expected to keep rising, particularly in B.C. and Ontario. Should rates continue to rise, 62% of tenants would consider a move and of those tenants, the vast majority (85%) would move to a more affordable suburb. There is no desire to relocate to a new province. This could spark a rise in “secondary suburbs” that extend further beyond the city centre.

3. **E-commerce is expected to grow from approximately 7% to 10% of total Canadian retail sales by 2024, yet 53% of retail/e-commerce fulfillment tenants are dissatisfied with the functionality of their current space.**

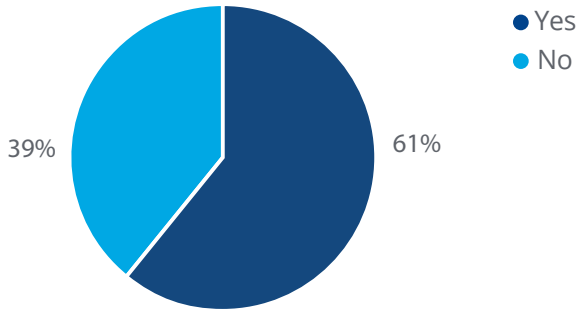
   With e-commerce expected to grow by 32% and account for approximately 10% of total retail sales by 2024, retail/e-commerce fulfillment tenants are projected to occupy a more prominent part of the industrial market. However, the majority (53%) of these tenants are dissatisfied with the functionality of their current space; believing it does not meet their needs. This could be attributed to restricted clear heights and limited bay space. There is a prime opportunity for developers and landlords to consider how best to repurpose existing spaces to meet the evolving needs of this sector.

Findings

1. **Almost two-thirds of manufacturers have faced supply chain interruptions during the pandemic.**

   The majority (61%) of manufacturing tenants said the pandemic has caused supply chain interruptions, likely due to national lockdowns that have slowed and/or halted production around the world. This finding parallels a survey conducted by Ernst & Young LLP in late 2020, where 57% of U.S.-based executives said their company had witnessed severe disruptions in their supply chain.

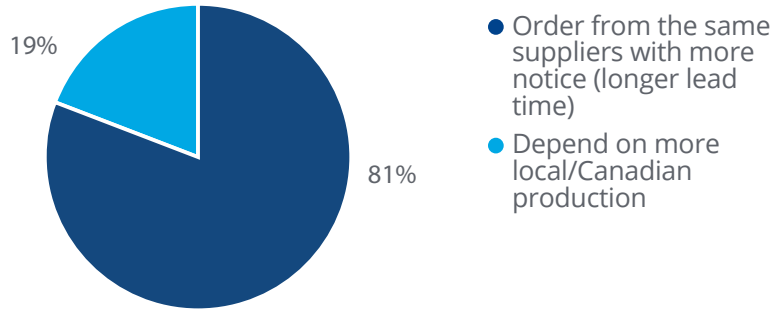
Figure 1: Manufacturers who have experienced supply chain interruptions.



2. **Almost one-fifth of Canadian manufacturers plan to rely on more local production post-pandemic.**

   Supply chain interruptions have prompted 19% of manufacturing tenants to plan on moving more of their supply chain to Canada. And while the majority (81%) of manufacturers indicted a desire to remain with the same suppliers, they plan on providing longer lead times to accommodate for delays that may persist as the world rebuilds from COVID-19.

Figure 2: Response to supply chain interruptions.

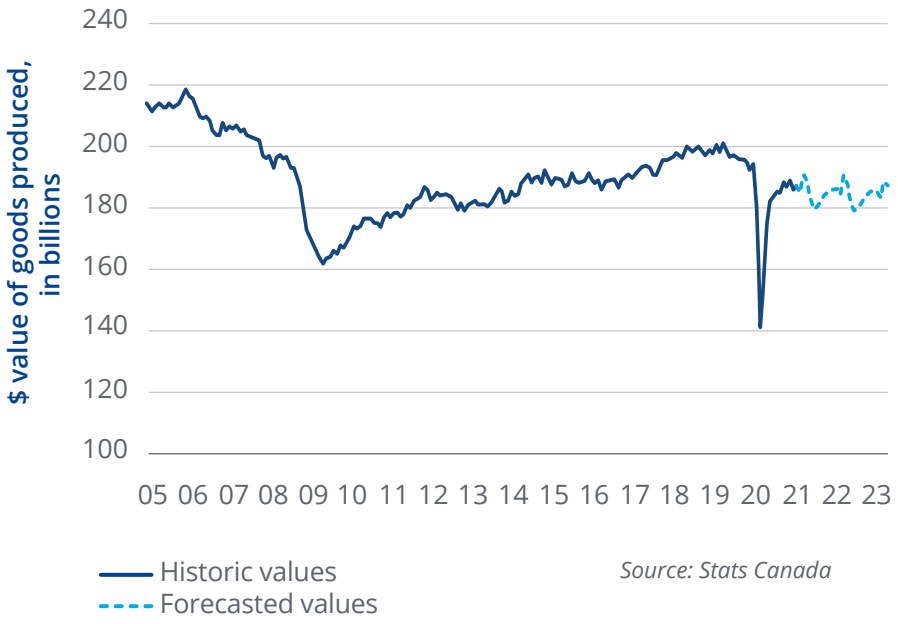


3. The Canadian manufacturing industry has rebounded from a historic low in 2020.

Rebounding from a historic low in April 2020, the dollar value of manufacturing goods produced today is only 4% lower than pre-pandemic levels. An increase in demand for industrial space and growth in local production will further accelerate the rebound. Any change in the 2018 tariffs imposed by the United States, which contributed to ending years of growth, would affect the rebound as well.

"Manufacturing demand and supply are currently not aligned. Demand is rising, while supply chains are not keeping pace."

Figure 3: Forecasted growth in manufacturing.



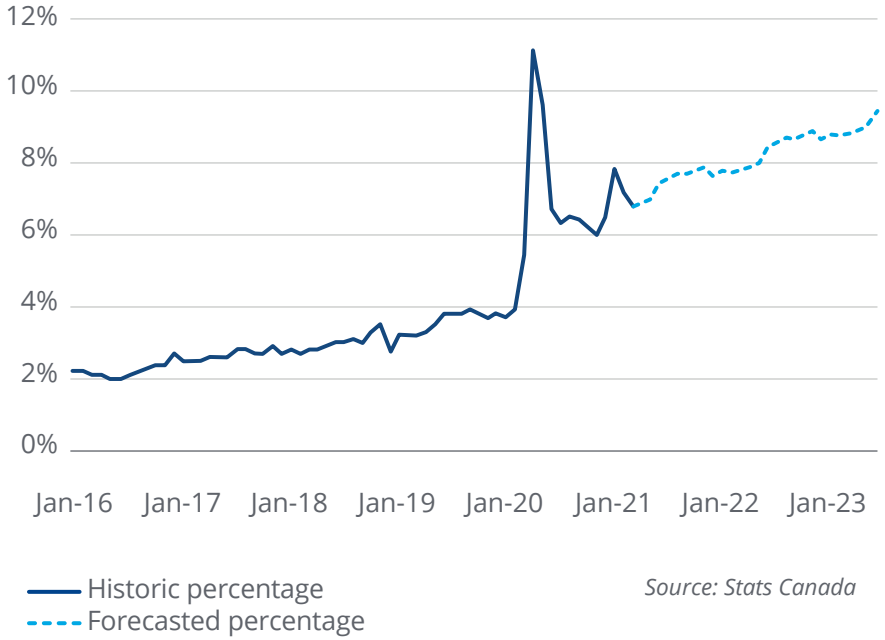
Source: Stats Canada

4. **E-commerce is expected to reach 10% of total Canadian retail sales by 2024.**

The pandemic has accelerated the growth in e-commerce, which has resulted in low vacancy rates for industrial fulfillment centres and increased lease rates for these properties. This trend is expected to continue, as e-commerce is projected to reach 10% of total Canadian retail sales in early 2024, up from 7% currently.

"We are going to see a blending of e-commerce and traditional retail post-pandemic, with e-commerce accounting for an increased percentage of total retail sales."

Figure 4: Forecasted growth in e-commerce as a percentage of total Canadian retail sales.



Source: Stats Canada

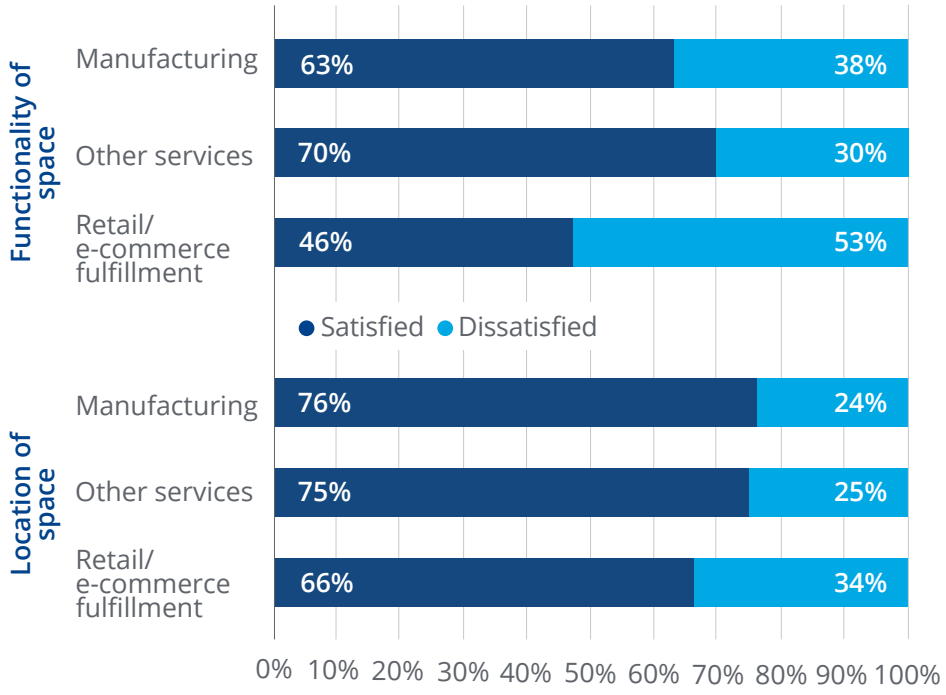
5. **The majority (53%) of retail/e-commerce fulfillment tenants are dissatisfied with the functionality of their current space.**

Tenants were asked how satisfied they were with the (i) functionality and (ii) location of their current space. 37% of tenants are dissatisfied with the functionality of their current space, saying it does not fulfill their business needs. Meanwhile, 24% said they were dissatisfied with the location of their current space.

Notably, retail/e-commerce fulfillment companies were the least satisfied with the spaces they lease. For this set of tenants, 53% said they were dissatisfied with the functionality of their current space and 34% said they were dissatisfied with the location. This is likely because demand has grown rapidly in a short period of time and owners have had little opportunity to reconfigure their spaces to suit evolving needs.

"37% of tenants are dissatisfied with the functionality of their current space, with the majority of these tenants being in retail/e-commerce fulfillment."

Figure 5: How industrial tenants rated their level of satisfaction with their current space.

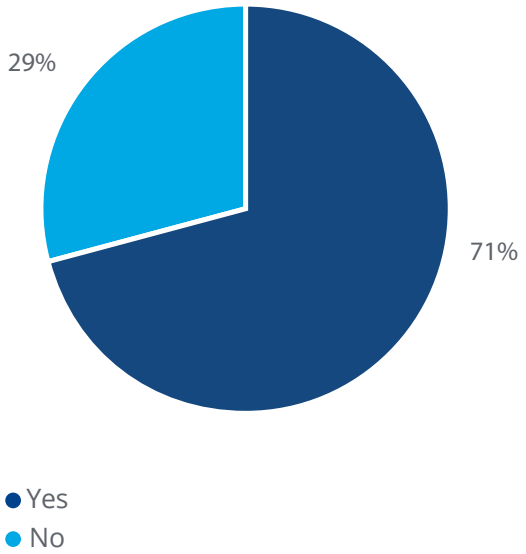


Tenants indicated their level of satisfaction on a scale of 1-10, with 1 being extremely dissatisfied and 10 being extremely satisfied. A rating of 7 and above is considered satisfied.

6. The high cost of "last mile delivery" has forced almost a third of companies to consider alternative real estate solutions.

"Last mile delivery" – the final step in getting a product from the warehouse to a customer's doorstep – is the most expensive part of the delivery process. According to Business Insider, it is estimated to account for 53% of the total shipping cost. This has led 29% of companies surveyed to explore how best to lessen this financial constraint. Alternative real estate solutions are being considered, including using vacant retail space to bring distribution centres closer to consumers. Some tenants are also considering purchasing, rather than leasing, their spaces.

Figure 6: Tenants who are considering alternative real estate solutions due to the cost of last mile delivery.

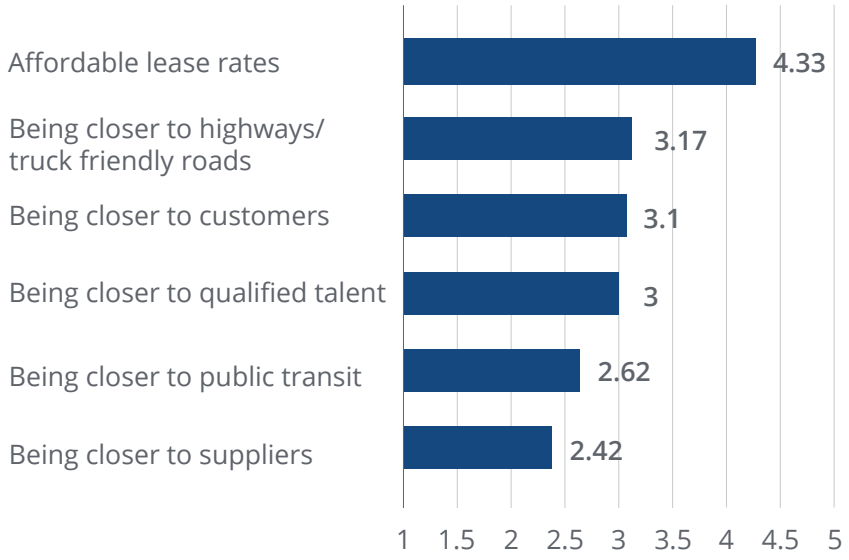


"By using vacant retail space to bring distribution centres closer to consumers, tenants are hoping to reduce the cost of last mile delivery."

7. **Affordable lease rates deemed the most important criteria when moving to a new industrial space.**

The majority (58%) of tenants indicated that lease affordability was more important today than before the pandemic. They ranked affordable lease rates as 52% more important to them, over and above factors like access to highways, customers, or qualified talent.

Figure 7: How tenants will evaluate the suitability of a new space.

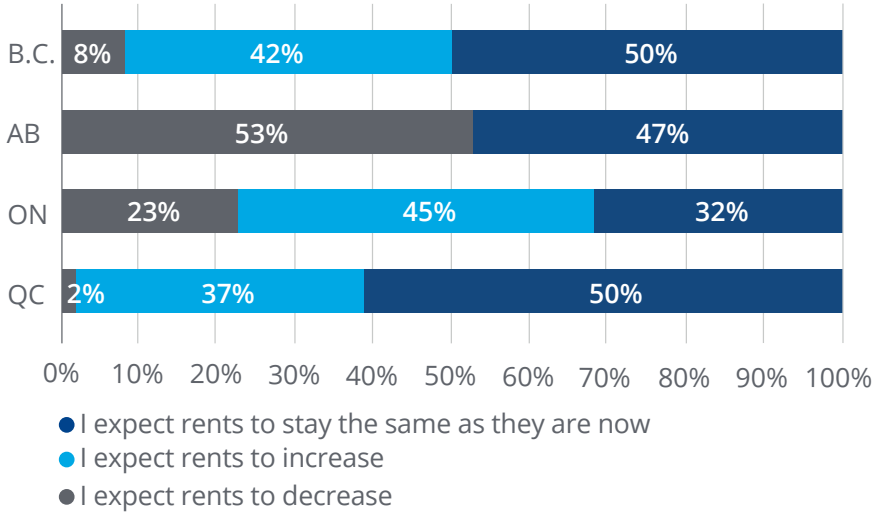


"Affordable lease rates were 52% more important to tenants than other factors when evalauting the suitability of a new space."

8. **Most tenants across Canada are anticipating industrial lease rates to increase or stay the same over the next three years, with tenants in Alberta anticipating a decrease.**

The largest proportion of tenants in Ontario anticipate industrial lease rates to increase over the next three years. Conversely, in Alberta, the majority of tenants expect a decrease, with not one tenant anticipating an increase. In B.C. the majority believe rates will stay consistent, with a slightly lower percentage thinking rates will increase. In Quebec, the majority of tenants anticipate lease rates to stay the same.

Figure 8: Tenant expectations on industrial lease rates over the next three years.



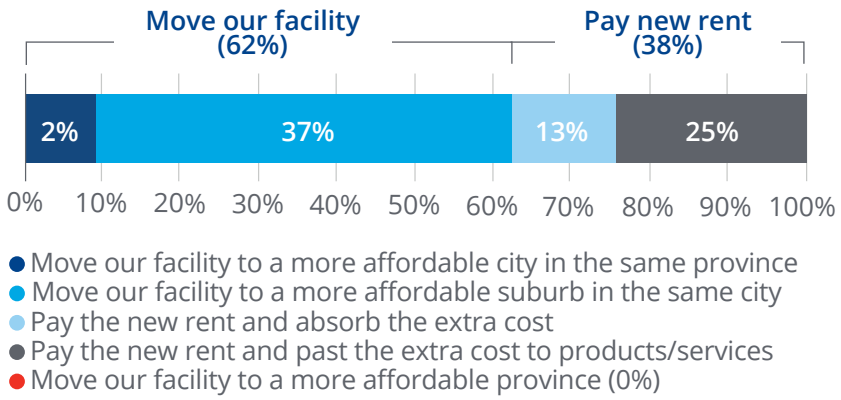
9. Secondary suburbs stand to benefit from an increase in industrial lease rates, with tenants showing no intention of moving provinces.

If lease rates continue to rise, industrial tenants will need to determine how best to adjust their operations in response. The majority (62%) of tenants indicated they would move their facility. The vast majority (85%) of those considering a move would choose a more affordable suburb, sparking the rise in "secondary suburbs" that extend further beyond the city centre.

The other 38% of tenants indicated they would pay the increased lease rate, with 66% of these respondents saying the higher rate would be reflected with an increase in the cost of their products and services, and 34% saying they would absorb the higher lease rate.

"Rather than accept a continued increase in industrial lease rates, 62% of tenants would look to move their facility."

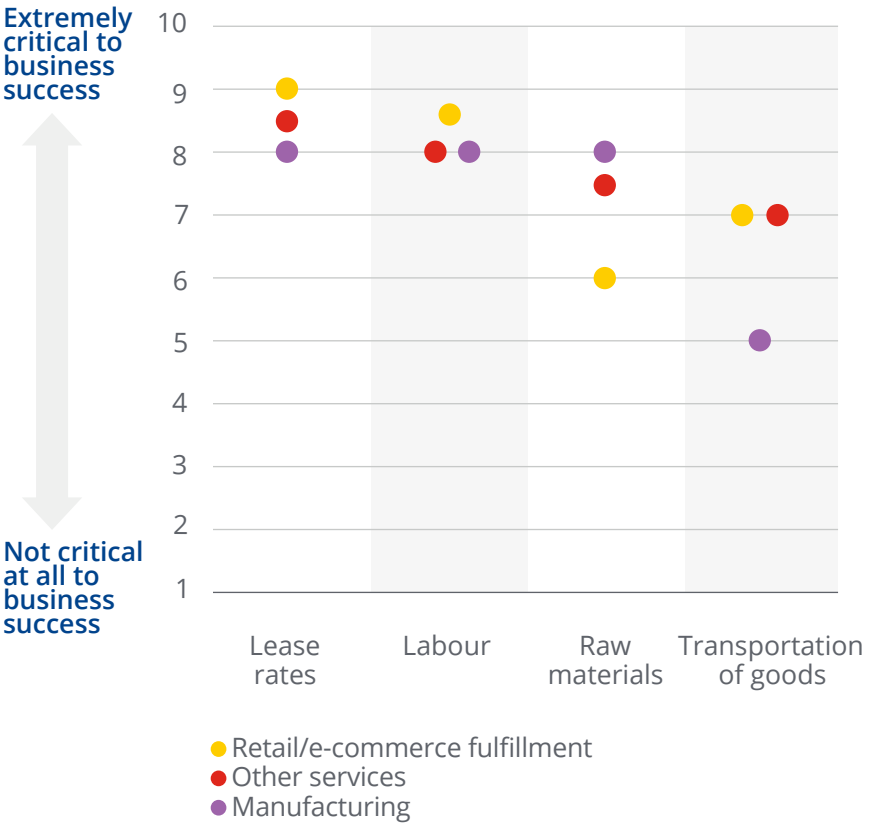
Figure 9: Anticipated response to rising industrial lease rates.



10. Tenants believe that an increase in industrial lease rates would have a critical impact on the success of their business, particularly retail/e-commerce fulfillment tenants.

Tenants were asked to rate how critical they believe an increase in lease rates, labour, transportation, and raw materials would be to the success of their business. Tenants in both retail/e-commerce fulfillment and other services said lease rates were their most vital factor, while manufacturing tenants said it was the cost of raw materials, followed by the cost of labour. We will continue to monitor tenants prevailing views on the subject.

Figure 10: How critical an increase in each expense is to business success.



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