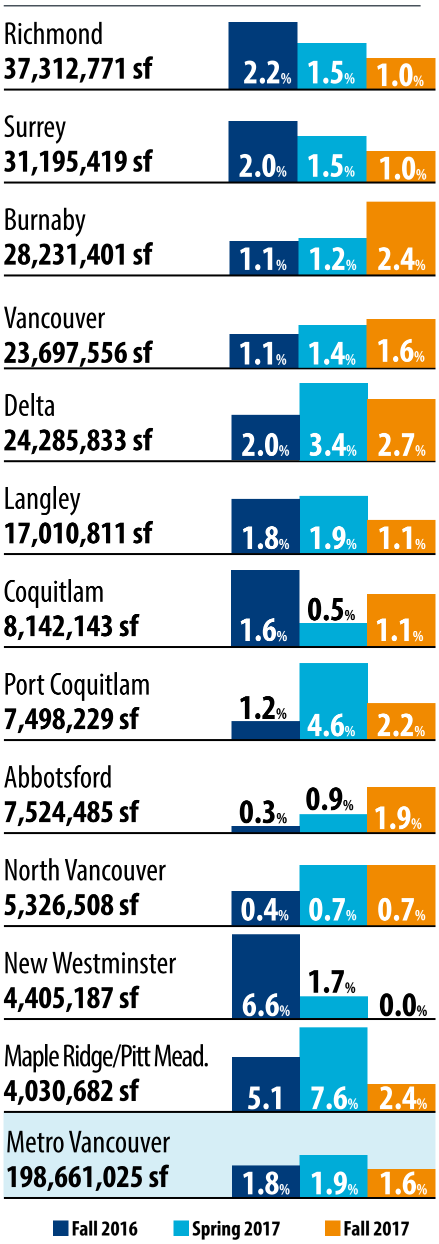
AVISON YOUNG

Fall 2017 Industrial Overview

Metro Vancouver, BC

METRO VANCOUVER INDUSTRIAL MARKET VACANCY



Metro Vancouver industrial market under pressure as rising costs, low vacancy redefine expectations

EXECUTIVE SUMMARY

- Metro Vancouver's industrial vacancy lowest in Canada and still tightening
- Interest rate increases impacting investment sale financing terms
- Significant new supply not expected to relieve tight vacancy through 2018
- Lease rates rising and exerting greater cost pressures on larger users of space
- Strata developers and end users playing an increasingly larger role than investors in the market as pricing climbs and supply tightens further
- Metro Vancouver's industrial market will surpass 200 msf in 2018 amid record sale prices and double-digit lease rates in many markets.

Metro Vancouver's rapidly expanding industrial market has continued to record robust and rapid increases in absorption, lease rates and pricing during the past 12 months against a backdrop of near-record low vacancy, changes in government, rising interest rates and swelling construction and land costs.

Industrial vacancy in Metro Vancouver was1.6% at the end of the third quarter of 2017, down slightly from the 1.8% recorded 12 months earlier. Vacancy continued to tighten further in 2017 despite the addition of 3.1 million square feet (msf) of new inventory. Metro Vancouver's industrial market has consistently expanded on an annual basis in recent years as vacancy has continued to decline. Metro Vancouver's industrial inventory grew to 198.7 msf at the end of the third quarter of 2017 and has been adding approximately 3.1 msf per year since the third quarter of 2014, but vacancy still tightened over that period to the near-record lows of 2% or less recorded regionally since at least 2016. Metro Vancouver's industrial market will surpass 200 msf in 2018 amid record sale prices and double-digit lease rates in many markets.

Only four Metro Vancouver markets recorded vacancy higher than 2% in the third quarter of 2017: Burnaby (2.4%), Delta (2.7%), Maple Ridge/Pitt Meadows (2.4%) and Port Coquitlam (2.2%). More remarkable is that four Metro Vancouver markets recorded vacancy at 1% or less: Richmond (1%), Surrey (1%), North Vancouver (0.7%) and New Westminster (0.0%).

With almost 3.3 msf of absorption recorded in the first nine months of 2017 alone, demand for space – lease, freehold or strata – remains exceptionally strong with owners obtaining peak pricing for industrial land and assets. The majority of absorption has occurred in just two markets: Surrey (1.3 msf) and Delta (1.05 msf). Maple Ridge/Pitt Meadows (312,000 sf) along with Port Coquitlam (278,000 sf) and Coquitlam (152,581 sf) also registered significant absorption.

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ABSORPTION	CAP RATES	RENTAL RATES	VACANCY	CONSTRUCTION	RETAIL SALES	CONTAINER SHIPPING VOLUME
↗	↔	↗	↘	↗	↗	↗

Updated regulations change provincial landscape and could lead to increased costs related to remediation of contaminated sites

Recent updates to the province's contaminated sites regulations are likely to add further delays and costs for property owners and developers seeking to develop, purchase or sell land deemed polluted and that requires a "Ministry instrument" such as a certificate of compliance (COC) or a determination in order to obtain construction and/or financing approval.

"The primary impact is that previously clean sites may now be classified as contaminated due to lowering of some standards and introduction of new standards for previously unregulated substances," says **Jason Wilkins** of **Hemmera Envirochem Inc.** "Conversely, some previously contaminated sites may now be classified as clean where standards have increased. However, the single biggest change, in my opinion, is an overall lowering of metals standards in soil and groundwater."

Effective November 1, 2017, the BC Ministry of Environment & Climate Change Strategy started using "currently available science on chemical toxicity, transport, and land use, and BC MOE's environment protection goals, both the regulation and many of its standards, for chemicals in soil, water, and soil vapour," in order to update its Contaminated Sites Regulation (CSR), according to the **Business Council of British Columbia's** April 2017 *Environment & Energy Bulletin (Volume 9, Issue 2)*.

Wilkins adds: "For the most part, the process for land transactions, notifications and redevelopment has not changed, although some potentially positive changes are being discussed by the Ministry, including: a simplified soil relocation process based on source and destination site land use, implementation of site-specific standards, and a new site profile process."

The **Contaminated Sites Approved Professionals (CSAP) Society of BC** funded a study comparing various sites' data against the old and new standards and focused on three site categories: gas stations, dry cleaners, and metals. The following is a summary of the CSAP study's findings:

Gas station sites (petrochemical hydrocarbon substances): Service station sites have a greater number of contaminated soil, groundwater, and vapour samples under the updated standards. Like groundwater, soil vapour is also likely more contaminated.

"There are a few hydrocarbon groundwater standards that have become more stringent for service stations that could result in increased costs for delineation and an increase in the potential for contamination to have migrated off-site," says **Raminder Grewal** of **Keystone Environmental**.

Dry cleaner sites (chlorinated solvents): Dry cleaner sites have a similar number of contaminated samples of soil and groundwater. However, the CSAP study found a lesser number of contaminated samples for soil vapour under the updated standards.

"One of the primary concerns with dry cleaners was the low vapour residential standard for trichloroethylene. This often resulted in vapour mitigation systems," according to Grewal. "The residential and parkade vapour standards is an order of magnitude higher. This will be seen as a positive change."

Metal sites: Sites with metals have a greater number of contaminated samples of soil and groundwater under the updated standards. The increase in the number of contaminated samples for metals is largely driven by more stringent drinking-water-based standards.

Grewal adds: "Many of the dissolved metal standards have become more stringent, which will result in increased delineation and potentially remediation or risk assessments costs."

He concludes: "Given that standards are becoming more stringent, there will likely be more risk-based COCs in the future."

According to the bulletin, the CSAP study concluded that sites contaminated with chlorinated solvents may benefit from the upcoming regulatory changes. However, sites contaminated with petroleum hydrocarbons or metals (where drinking water use is applicable) are likely to see more complex issues as a result of the adoption of more stringent standards.

"On commercial and residential development sites in urban areas there should be an overall cost savings if you are dealing with traditional service station and dry cleaner sites due to the new parkade vapour standards," according to Wilkins. "The overall direction seems to be more risk based and site-specific, which should also lead to lower remediation costs. However, at metals contaminated sites, the cost to investigate could increase substantially. Unfortunately, the short answer is it depends on the site specifics. It will most certainly depend on the current operations and uses, type of contaminants, and the intended future use if redevelopment is being contemplated."

NOTABLE INDUSTRIAL LAND SALES BY TOTAL PRICE IN METRO VANCOUVER SINCE SPRING 2017

ADDRESS	VENDOR	PURCHASER	SALE PRICE	SITE AREA (ACRES)	PRICE/ ACRE
1331-1371 McKeen Avenue; 5-99 Senator Road, North Vancouver	McKeen & Wilson Ltd.	Wesbild Holdings Ltd. (DNV Waterfront Holdings Ltd.)	$115,021,310	27.528	$4,178,339
4403 Eton Street & 335 North Willingdon Avenue; 4779 & 5201 Penzance Drive; 789 Glasgow Avenue, Burnaby	Chevron Canada Ltd.	Park Fuel Corporation	$91,685,000	138.84	$660,364
137-139 & 141 East 4th Avenue, Vancouver	Conwest Group of Companies (Triple Main Properties Ltd.)	1099300 B.C. Ltd.	$16,300,000	0.267	N/A
2919 & 2967 188th Street, Surrey	Cornelis Flokstra	188 St. Lands Ltd.	$10,000,000	16.17	$618,429
26090 30A Avenue, Langley	JLasco Investments Ltd.	La Terra Development Ltd.	$8,650,000	10	$865,000
830 Clark Drive, Vancouver	Reliance Properties Ltd.	Alliance (Clark Drive) Project Holdings Ltd.	$7,600,000	0.422	N/A
31708 Marshall Road, Abbotsford	Fraser Valley Farms Ltd.	1921415 Alberta Ltd.	$7,500,000	9.805	$764,916
23402 & 23450 Fisherman Road; 23552 River Road, Maple Ridge	Target Products Ltd.	Kerr Properties 002 Ltd.	$7,000,000	10.293	$680,074

Sources: AY Research & RealNet

NOTABLE INDUSTRIAL LEASE TRANSACTIONS IN METRO VANCOUVER SINCE SPRING 2017			
MUNICIPALITY	**ADDRESS**	**SQUARE FEET**	**TENANT**
Richmond	7031 York Road	330,540	IKEA
Surrey	18899 28th Avenue	214,155	DSV Solutions Inc.
Burnaby	7260 Winston Street	146,732	SSH Bedding Canada
Delta	6845 Tilbury Road	194,700	Varsteel Ltd.
Delta	9410 River Road, Units #130 & #140	133,870	Triumph Express Service Canada Inc.
Burnaby	8340 Fraser Reach Court	92,032	Canada Post
Burnaby	8355 Riverbend Court	82,080	The Crossing Studios
Pitt Meadows	19055 Airport Way, Units #606-#609	75,156	Olympia Tile International Inc.
Burnaby	5595 Trapp Avenue, Units #103-#109	73,698	Sustainable Produce Urban Delivery Inc.
Chilliwack	44688 South Sumas Road	66,000	Clean Energy Compression Corp.
Richmond	7415 Nelson Road	65,212	Kuehne + Nagel Ltd.
Richmond	16111 Blundell Road	64,926	Archway Canada
Delta	1344 Derwent Way	64,522	Moe's Home Collection
Coquitlam	1615 Kebet Way	61,400	Park's Bread 'n' Buns Factory
Burnaby	6228 Beresford Street	59,400	Waverider Films
Port Coquitlam	1435 Broadway Street	57,251	LTS Infrastructure Services Ltd.
Coquitlam	1311 United Boulevard	54,550	Moe's Home Collection
Richmond	13231 Delf Place	53,800	TriGlobal Capital

NOTABLE INDUSTRIAL INVESTMENT SALES BY PRICE IN METRO VANCOUVER SINCE SPRING 2017					
ADDRESS	**VENDOR**	**PURCHASER**	**SALE PRICE**	**$/PSF**	**BUILDING/ SITE AREA**
6845 Tilbury Road, Delta	Varsteel Ltd.	Dayhu Investments	$47,925,000	$255	194,700 sf / 22.64 acres
1305 & 1375 Kingsway Avenue, Port Coquitlam	Consolidated Fastfrate (B.C.) Holdings Inc. & Canadian Pacific Express & Transport Ltd.	Port of Vancouver Ventures Ltd.	$39,950,000	$714	55,988 sf / 17.65 acres
6064 Spur Avenue & 8335 Meadow Avenue, Burnaby	Spur Investments Ltd.	KingSett Capital (KS Meadow Spur Inc.)	$33,850,000	$121	279,900 sf / 12.42 acres
1020 Derwent Way, Delta	Bosa Development Group Inc.	Glassman Property Management (0789907 B.C. Ltd.)	$32,955,000	$131	251,222 sf / 8.98 acres
10077 Grace Road, Surrey	Vitran Express (Vitran Express Canada Inc.)	GWL Realty Advisors	$30,900,000	$672	46,000 sf / 13.33 acres
11480 River Road, Richmond	PCI Developments Corp.	Vancouver Fraser Port Authority	$28,700,000	$129	222,755 sf / 9.46 acres
9255 194th Street, Surrey	Pure Industrial Real Estate Trust (PIRET (194th Street) Holdings Inc.)	Greystone Managed Investments Inc. (194th Street Equities (Nominee) Inc.)	$27,525,000	$149	185,123 sf / 7.00 acres
9920 River Drive, Richmond	All Stars Motor Inn Ltd.	Cheung Kong Infrastructure Holdings Limited (1884901 Alberta Ltd.)	$27,200,000	$342	79,538 sf / 8.87 acres
2751 Production Way, Burnaby	Candina Holdings Ltd.	Conwest Group of Companies	$15,400,000	$146	105,229 sf / 5.14 acres
800 Carleton Court, Delta	GWL Realty Advisors	1117250 B.C. Ltd.	$12,500,000	$136	91,872 sf / 4.09 acres

NOTABLE INDUSTRIAL LAND SALES BY PRICE PER ACRE IN METRO VANCOUVER SINCE SPRING 2017					
ADDRESS	**VENDOR**	**PURCHASER**	**SALE PRICE**	**SITE AREA (ACRES)**	**PRICE/ACRE**
1331-1371 McKeen Avenue; 5-99 Senator Road, North Vancouver	McKeen & Wilson Ltd.	Wesbild Holdings Ltd. (DNV Waterfront Holdings Ltd.)	$115,021,310	27.528	$4,178,339
12084, 12092 & 12106 90th Avenue, Surrey	0926614 B.C. Ltd.	Partap Holdings Ltd.	$1,950,000	1.072	$1,819,030
13577 115th Avenue, Surrey	Highland Van & Storage Ltd.	Dakash Investments Ltd.	$6,550,000	3.626	$1,806,398
7857 Huston Road, Delta	Beedie Group (Beedie (Huston Road) Holdings Ltd.)	North Delta Seafoods (Wick Trading Ltd.)	$4,286,400	2.669	$1,605,995
583 Nicola Avenue, Port Coquitlam	Foursquare Gospel Church of Canada	Euro Kitchen Appliances Inc.	$1,700,000	1.066	$1,594,747
10651 No. 6 Road & 13751-13851 Steveston Highway, Richmond	Port Metro Vancouver (Port Metro Vancouver Holdings Ltd.)	Vancouver Fraser Port Authority	$21,500,000	13.484	$1,594,482
7808 Beedie Way, Delta	Beedie Group (Beedie (Huston Road) Holdings Ltd.)	Sunrise Soya Foods (1109056 B.C. Ltd.)	$4,452,000	3.188	$1,396,487
2195 Peardonville Road, Abbotsford	Rajmohinder Singh Khela	Sarbjit Singh Virk	$1,750,000	1.328	$1,317,771

Sources: AY Research & RealNet

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This lack of available industrial space for lease compounded by a limited supply of industrial assets to acquire and rare (and expensive) opportunities to acquire industrial land for development have provided a powerful lift in industrial lease rates across Metro Vancouver. The weighted average asking net rent in Metro Vancouver was at $9.99 psf at the end of the third quarter of 2017, up from $9.45 psf just six months earlier (a 5.7% increase) and up from $9.07 psf (a 9.7% increase) a year ago.

Five industrial markets in Metro Vancouver now have average net lease rates in the double digits: North Vancouver ($16.32 psf), Vancouver ($15 psf), Coquitlam ($11.07 psf), Burnaby ($10.33 psf) and Port Coquitlam ($10.01). Only four markets had average net rental rates less than $10 psf: Langley ($9.28), Surrey ($8.85 psf) and Delta ($8.83 psf). Maple Ridge/ Pitt Meadows had the lowest average net rental rates in Metro Vancouver at $8.41 psf. Additional rent averaged $3.89 psf in Metro Vancouver.

Rising lease rates have been accompanied by rapidly rising pricing for industrial assets, which have created an ideal time for owners to sell as indicated by industrial sale volumes during the past 12 months. There were 242 transactions valued at $694 million in BC during the first six months of this year. This followed the record second half of 2016, which included 270 industrial transactions in BC valued at $873 million. While deal volume has remained comparable with previous years, pricing continued to rise in the first half of 2017. Industrial sales activity in BC has been growing steadily since 2015 and is trending toward another record year in 2017, but the window of opportunity to realize the strong pricing recorded in the past 12 to 18 months may be coming to a close as the range of factors indicated previously start to have an impact on purchasers.

Prices in Metro Vancouver for industrial land have also continued to climb amid strong demand from owner-operators and developers and a diminishing supply of industrial land suited for development. These higher land costs, combined with rising construction costs and a lack of industrial product available for purchase, have driven pricing for strata industrial projects to new heights, particularly those few developments located in Vancouver or the inner suburbs north of the Fraser River. The impact of rising prices during the past two years in all aspects of the industrial development cycle – land costs, financing and construction costs – may be approaching the upper threshold of what most businesses are able to afford.

Metro Vancouver's industrial development pipeline remains robust, but limited by a constrained supply of available industrial land. Tenants seeking to expand or relocate should be in the market at least 12 to 24 months in advance of their lease expiry and will have to consider preleasing as an option. With slightly more than 5 msf of industrial space currently under construction in Metro Vancouver, more than 1.2 msf is located in Surrey. Burnaby and Richmond each have more than 600,000 sf underway, while Vancouver, Delta and Tsawwassen each feature more than 500,000 sf. More than 84% of new industrial construction is located in those six markets.

Strata industrial sales (including presales) continue to remain exceptionally strong with pricing rising in subsequent development phases and entire projects sold out in weeks rather than months. For local owner-operators there are few, if any, readily available options other than acquiring strata. Owner-operators, who had previously supported much of the strong pricing being obtained for industrial properties, face increasing challenges to continue to meet those pricing expectations with financing costs starting to rise as interest rates increase. Uncertainty around government policy and tax reform at the provincial and federal levels and the fate of major infrastructure projects province-wide also contribute to heightened risk. Potential trade issues involving the renegotiation of NAFTA and the softwood lumber dispute with the U.S. muddy the waters further for many owner-operators.

Developers of strata are now increasingly more likely to be involved as a purchaser when it comes to freestanding industrial buildings and industrial land. These purchasers can offer the strong pricing that vendors are seeking and have the liquidity to transact on virtually all properties that have development/redevelopment potential. The strata rates now being achieved have generally caught up to the value of industrial land and made the development of industrial strata projects feasible at higher land costs. However, this has led to fewer industrial projects being developed for lease. Costly industrial land has also resulted in more flex space/showroom/office developments that can charge higher rents. Even with the delivery of additional 2.4 msf of new inventory by the end of the first quarter of 2018, vacancy is not anticipated to increase in a meaningful way in 2018. While Metro Vancouver's industrial market remains healthy and strong in 2017, there are indications of uncertainties on the horizon that may have an impact on continued price increases moving forward and should be taken under consideration. ■

Vancouver Industrial Team

Hayley Adams
hayley.adams@avisonyoung.com

Kyle Blyth
kyle.blyth@avisonyoung.com

Russ Bougie*
russ.bougie@avisonyoung.com

Kirstin Campbell
kirstin.campbell@avisonyoung.com

Jennifer Devlin
jennifer.devlin@avisonyoung.com

John Eakin
john.eakin@avisonyoung.com

Michael Farrell
michael.farrell@avisonyoung.com

Rob Gritten
robert.gritten@avisonyoung.com

Kevin Kassautzki
kevin.kassautzki@avisonyoung.com

Ryan Kerr*
ryan.kerr@avisonyoung.com

Mackenzie Leyland
mackenzie.leyland@avisonyoung.com

John Lecky
john.lecky@avisonyoung.com

Joe Lehman
joe.lehman@avisonyoung.com

Ben Lutes
ben.lutes@avisonyoung.com

Gord Robson
gord.robson@avisonyoung.com

Shon Sahota
shon.sahota@avisonyoung.com

Githa Selamet
githa.selamet@avisonyoung.com

Chelsea Stringer
chelsea.stringer@avisonyoung.com

Mathew Sunderland*
mathew.sunderland@avisonyoung.com

Angus Thiele
angus.thiele@avisonyoung.com

Terry Thies*
terry.thies@avisonyoung.com

Matt Thomas
matt.thomas@avisonyoung.com

Ian Whitchelo*
ian.whitchelo@avisonyoung.com

Garth White*
garth.white@avisonyoung.com

Cally Zering
cally.zering@avisonyoung.com

** Personal Real Estate Corporation*

For more information please contact:

Michael Keenan, Principal & Managing Director
Direct Line: 604.647.5081
michael.keenan@avisonyoung.com

Andrew Petrozzi, Principal & Vice-President, Research (BC)
Direct Line: 604.646.8392
andrew.petrozzi@avisonyoung.com

Sherry Quan, Principal & Global Director of Communications and Media Relations
Direct Line: 604.647.5098
sherry.quan@avisonyoung.com

Avison Young
#2900-1055 W. Georgia Street
Box 11109 Royal Centre
Vancouver, BC V6E 3P3, Canada

avisonyoung.com