INDUSTRIAL REPORT

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ENERGY SECTOR DOMINATES

Rising energy and commodity prices had a two-fold impact on the Canadian economy and the industrial sector in 2005 creating a growth imbalance between Eastern and Western Canada. In the West – primarily Alberta, but also British Columbia, and Saskatchewan – resource based companies have benefited from higher commodity prices resulting in strong economic growth. In the East – primarily Ontario and Quebec - manufacturers continue to be challenged by higher energy prices, coupled with the unprecedented rise in the Canadian dollar over the past three years. This has resulted in constrained economic growth and reduced attractiveness of Canadian exports on the world market.

Growing global demand for oil is driving investment in the oils sands. By 2015 it is forecast that production from the oil sands will reach 2.7 million barrels per day. Over US$85 billion will be invested in the oil sands over the next decade, which will keep the Alberta economy prospering. The unemployment rate in Canada is the lowest it has been in almost 30 years. Skilled labour shortages are occurring nation wide but are most problematic in the western provinces where shortages are restraining production output.

AUTO SECTOR WOES

Cutbacks at General Motors in Oshawa and St. Catharines will no doubt have a negative impact on the overall automotive sector production. The closure of the Oshawa Car Plant No. 2 and the St. Catharines Ontario Street West powertrain components facility in 2008, and the removal of the third shift from Oshawa Car Plant No. 1 in the second half of 2006 will translate into a loss of approximately 3,900 jobs in Canada. However, there is a multiplier effect to contend with which significantly increases the potential number of auto sector jobs lost in the economy as a result of these cuts. It is expected that Ford will also cut a portion of its workforce in order to become more competitive in the global market, further impacting the auto industry in Canada.

WHAT'S DRIVING LEASING ACTIVITY?

Warehousing and distribution users are driving demand for industrial space in today's marketplace. Vancouver's role as the export/import gateway to the Pacific Rim continues to intensify. With container traffic expected to triple over the next 20 years, the expansion of port facilities and port throughput over the longer term is expected to increase demand for warehouse space in the Vancouver area. Calgary continues to strengthen its position as a warehouse and distribution hub for Western Canada. Increased resource refinement activity in the oil sands continues to push industrial demand levels higher in Edmonton, putting added pressure on existing and new industrial product supply. Despite the softer manufacturing sector in Ontario and Quebec, demand remains relatively strong for warehouse and distribution space.

Brisk leasing activity and declining industrial vacancy rates were recorded in most markets in 2005. Vacancy rates in Vancouver, Edmonton, and Calgary have reached near record lows with quality space becoming increasingly more difficult to find as demand continues to heat up. In the Greater Toronto Area, supply outpaced absorption in 2005 resulting from a significant increase in new speculative construction coming on stream. Notwithstanding, the industrial vacancy rate in the GTA remains low by most standards. Relatively strong demand is expected to continue through 2006, which should absorb much of this new supply. Low interest rates have seen industrial tenants become owners in Montreal resulting in increasing industrial vacancy. Leasing activity will likely increase as rising interest rates and limited supply become barriers to ownership for many users.

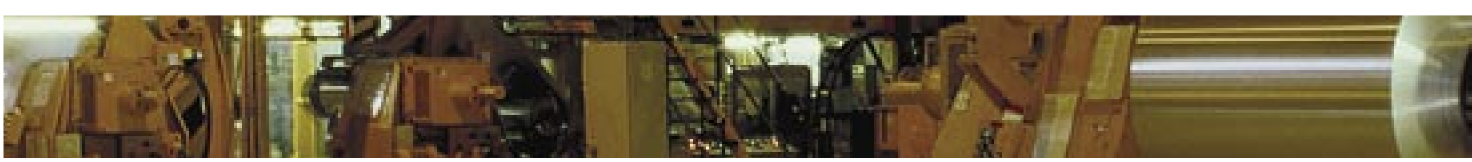
SERVICED LAND IN SHORT SUPPLY

Across the country, serviced industrial land is in short supply. Major developers with "deep pockets" have been land-banking (both short and long term) to ensure that their development programs are protected. As a result, the number of players in control of prime industrial designated land in major Canadian cities is shrinking. Under present market conditions, industrial land owners prefer to hold, or design build, having very little incentive to sell. Industrial land that does come to market is often seeing multiple bids.

Geographically constrained Vancouver has recorded some of the highest land prices in the country. Developers there are under pressure to convert industrial to residential to keep up with the housing market demand. As a result, communities outside of the Greater Vancouver Area are getting into the game as tenants and developers push farther out from Vancouver in search of inexpensive land. Edmonton and Calgary are seeing a real shortage of industrial land and prices in Edmonton have nearly doubled in the last three years. Ontario's new Green Belt Plan and Places to Grow Act have significant implications for the future development of land in the greater Golden Horseshoe area of Ontario. Land prices within the Toronto area will continue to face increasing price pressure as supplies tighten, encouraging developers to "leapfrog" the greenbelt to what were formerly considered secondary markets. Those markets such as Brantford, Cambridge, and Guelph have already attracted significant developer and user interest over the past two years due to lower land costs and development charges. In Montreal, the spectrum of land ownership is more diverse. While land supply remains limited on the island itself, developers are moving further out in search of more inexpensive land.

INVESTMENT ACTIVITY REMAINS STRONG

Industrial product remains high on investor preference lists. Purchasers continue to far outnumber sellers for industrial real estate. The current low interest rate environment has put more people into buying mode, and has tenants weighing the pros and cons of lease vs. buy. An upswing in interest rates may relieve some pressure put on the user purchaser supply, as users transition back to leasing alternatives for new space acquisition.



The lack of willing sellers is resulting in a scarcity of good quality product in many markets. Institutional buyers still dominate the market but private purchasers have been increasing their activity with the buying of one off assets or smaller portfolios. REITs have been undergoing a geographic re-balancing of their portfolios, with purchasing continuing to heat up in Western Canada while cooling off in Central Canada.

Despite the rise in construction and land costs, we have seen compression in cap rates for modern, well-located properties. Many industrial properties have traded at price points above replacement cost in many major markets.

CONSTRUCTION ACTIVITY ON THE RISE

While build to suit activity remains the dominant driver of new construction across the country, speculative activity in some markets has been on the rise. The recent influx of large entrepreneurial US developers (i.e. Higgins Development Partners, Panattoni, Prologis, Opus Group, AMB Property Corporation, and Verus Partners) will continue to shape industrial development in Southern Ontario. This activity will be evident in other markets across the country in the months to come.

The current trend in construction is “bigger is better” in order to capitalize on economies of scale and maximize investment return given rising land costs. Primarily, it is US developers who are driving the trend of larger-sized facilities. It is now more common to see facilities in the 100,000 square foot range and greater in most markets than ever before. In the GTA, in particular, we are seeing an increasing number of industrial distribution facilities over 400,000 square feet, with some as large as 700,000-800,000 square feet. In addition, while many developers are still building 28’ clear, the typical clear height is trending towards 30-32’ clear, particularly for warehouse and distribution users.

With warehousing and distribution as key drivers of industrial activity in many markets across the country, the need for trailer parking, increased room for maneuvering, larger bay size, and double loaded shipping is also on the rise.

What does this mean for the older industrial stock across the country? In many cases this stock is being rehabilitated and re-utilized for office, retail or residential uses. Allied Canadian is a prime example of a developer that has transformed and given new life to early 20th century light industrial space primarily in downtown Toronto, but also Montreal and Winnipeg, creating a new class of brick and beam office space.

LOOKING AHEAD

The prospects for the Canadian industrial real estate market look bright for 2006. High energy prices will keep economic activity in the western provinces booming, driving continued demand for industrial activity. In addition, manufacturing output will gain strength in Ontario and, to some extent, Quebec in 2006 as exporters continue to adjust to the stronger dollar.

Overall, demand for industrial real estate is expected to remain healthy in 2006. Rental rates could see upward pressure in most markets as supply of quality space continues to shrink. Also, expect to see more new construction on both the design build and speculative fronts as quality available space is absorbed. Land prices will stay strong given short supply and increased demand in most markets. As land supplies tighten in major centers, smaller markets along transportation corridors with abundant land supply will thrive. Although short-term interest rates are forecast to continue to rise, the betting is that long-term rates will decline and quality industrial product will continue to be sought after by both end users and investors alike.

CANADIAN INDUSTRIAL VACANCY RATES - YEAR END 2005