Greater Toronto Area Industrial Market Snapshot

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CBRE Global Research and Consulting

LOCATION, LOCATION, AND TRANSPORTATION – WHERE IS INDUSTRIAL DEVELOPMENT HEADED?

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By 2031, the Greater Toronto Area (GTA) will contain 8.4 million people. In order to accommodate and move an additional 2.5 million people, Metrolinx, an agency of Ontario's Provincial Government, has outlined a master transportation plan called *The Big Move*, which advocates for $500.0 billion worth of transportation projects to relieve congestion, improve quality of life and bolster economic growth. In order to fund transit initiatives, Metrolinx has recommended revenue tools, including two options that would significantly impact industrial development in the region.

Of the revenue options being considered, an off-street non-residential parking levy and a 15.0% increase in development charges (DCs) have the potential to reshape the GTA industrial market. An off-street non-residential parking levy, based upon the current value assessment of the parking spaces, could cost property owners $0.25 per day on average. The levy will limit the amount of parking that developers provide, but the DCs increase will have a more distinct impact.

DCs are a one-time levy paid by a developer when they apply for a building permit. A municipality is responsible for collecting the levy and determines the proportion that is used to fund both hard and soft infrastructure costs, including sidewalks, roads, and sewers. A developer will pay up to three different types of DCs in the GTA – one for the local municipality, one for the region (if applicable), and one for both the Public and Catholic School Boards. The Metrolinx proposal calls for existing DCs in all municipalities and regions to increase 15.0%, which is expected to generate approximately $100.0 million per year of added government revenue.

Metrolinx: Top Proposed Revenue Tools

A 1.0% increase to the harmonized sales tax (HST);
A $0.05 increase to the fuel/gas tax;
An off-street non-residential parking levy;
A 15.0% increase to development charges

Industrial DCs are amongst the lowest of the non-residential DCs; however, the commercial real estate industry could be in for a shock. Within the last six months, the majority of municipalities in the GTA have already increased their non-residential DCs by 1.0 - 2.0%, with the exception of the Oakville which increased its levy by 18.0%.

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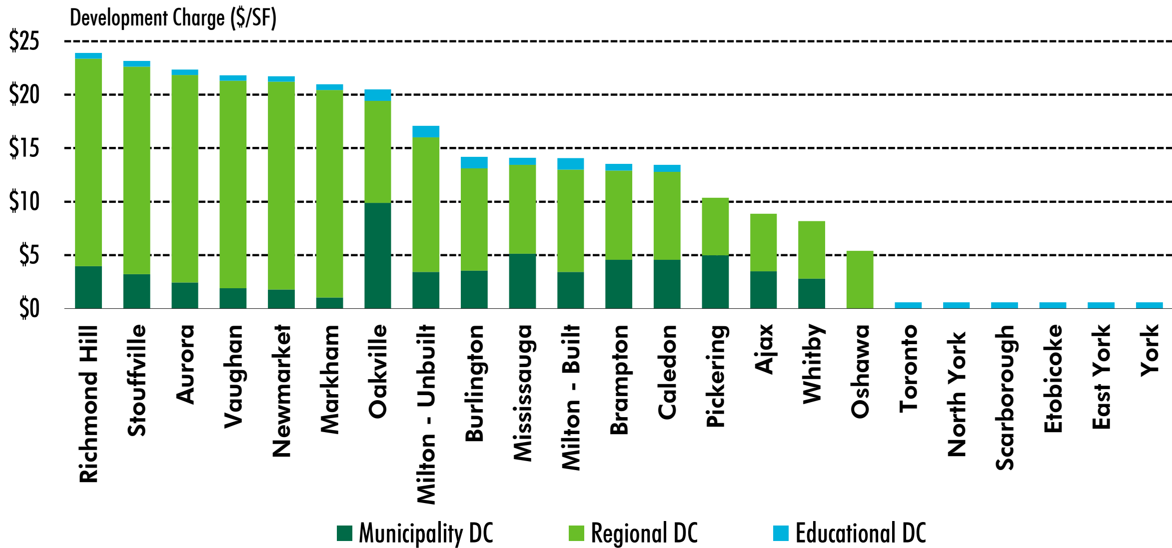
Table 1: 2013 Industrial Development Charges in the GTA



Presently, outside of the City of Toronto, Durham Region has some of the lowest industrial DCs in the GTA. While Durham Region charges $5.40 psf for new industrial development, each individual municipality has a formula that calculates their respective municipal DC. For example, Oshawa does not apply municipal and education DCs to industrial development, which provides savings. Pickering on the other hand charges an additional $4.97 psf, bringing the total along with the Regional DC to $10.37 psf for new industrial development.

The highest industrial DCs exist in York Region, as outlined in the graph above. York Region imposes a $19.41 psf levy for new industrial development. While York Region has imposed a freeze on their regional DCs until 2017, municipalities are still able to raise municipal and education fees. DCs on industrial development in York Region range between $20.96 psf in Markham to $23.89 psf in Richmond Hill.

Following York Region, the Region of Halton has the second most expensive development charges. DCs are $3.02 psf higher in greenfield sites than in built-up areas as there are higher capital costs where new services and infrastructure need to be provided.

Peel Region's DCs are slightly lower than Halton Region's, with total industrial DCs ranging from $13.44 psf in Caledon to $14.10 psf in Mississauga. Due to the relatively low DCs and the vast industrial inventory currently in Mississauga and Brampton, Peel Region is a prime location for industrial development.

The City of Toronto, due to the fully built nature of its industrial areas, does not apply municipal or regional DCs on industrial construction, leaving only the educational levy of $0.58 psf.

Industrial DCs are amongst the lowest of the non-residential DCs

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THE FUTURE OF GTA INDUSTRIAL DEVELOPMENT

The GTA could see industrial DCs rise to some degree, if not the entire 15.0% that is proposed by Metrolinx, over the next five years. As a result, a wave of new industrial construction is expected in advance of a spike in DCs. There was a similar spike in development permit issuance and construction in the third quarter of 2012, prior to a scheduled hike in industrial DCs in Peel and Halton Region. In Mississauga, the number of industrial building permits nearly doubled between the third and fourth quarters of 2012. Unlike office construction, industrial development can be scaled up or down very quickly as project timelines are shorter.

Currently, 80.0% of construction activity is located in the western portion of the GTA, primarily in Halton and Peel Region, with the remainder located in York Region. The western portion of the GTA will continue to attract industrial development due to its access to the 400-series highway network, rail lines, as well as the proximity to Toronto Pearson International Airport, Canada's busiest airport.

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There are two likely scenarios for industrial development in the GTA over the next five years. The first scenario is that industrial development will continue at its current pace with supply largely in line with demand. Large logistics and warehouse space will continue to dominate the supply pipeline in places like Caledon, Milton, and Vaughan where available land and close proximity to major transportation routes continues to provide a competitive advantage. Currently, there is over 1.0 million SF under construction in each of these markets, most of which is speculative.

The second scenario comes into play if developers cannot tolerate an additional 15.0% increase in industrial DCs. This would limit new supply and cause rental rates for Class A industrial space, buildings with clear heights greater than 26', to increase significantly as there is already limited space available in this type of building in the GTA. Currently, the availability rate in the GTA for buildings with clear heights greater than 26' is 1.1%.

Although DCs are not intended to be used as a tool to manage or direct growth and construction, they have that potential. Developers could choose to build outside of the GTA, undermining the governments potential to raise revenue from DCs, defeating the intended purpose of the rate hike.

Even in this second scenario, developers concerned about rising DCs have options. All municipalities in the GTA have a by-law that allows developers to expand the industrial gross floor area for an existing building up by to 50.0% without paying DCs. Therefore increase total inventory without incurring additional DCs. For example, much of Orlando Corporation's new industrial space in Brampton has the potential for future expansion without significant DCs. Other notable developers such as HOOPP and First Gulf Corporation are taking this into consideration as they plan for the future of their industrial portfolio.

There is a preference for large warehouse and distribution space

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The evolving transportation network, as well as the costs associated with developing it, have the potential to greatly influence the supply and demand of commercial real estate in the GTA. DCs had been climbing and impacting industrial development long before Metrolinx proposed to make industrial development up to 15.0% more expensive. For the commercial real estate community, the ongoing transit debate provides an opportunity to engage in the planning process and ensures that no unwanted impacts come from the attempts to raise revenue and move people in the region.

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