White Paper: *Stratification of Industrial Land in Metro Vancouver*

Prepared for:

Metro Vancouver, Regional Planning

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1 Introduction

1.1 Purpose of Paper

Metro Vancouver is coordinating the development of a Regional Industrial Lands Strategy. The Strategy will provide a vision for the future of industrial lands in Metro Vancouver and actions for achieving the vision.

As an informational component, this paper has been prepared to explore the extent, trends, drivers, benefits, challenges, and implications of increased stratification of industrial lands in the Metro Vancouver region. This paper documents the extent of industrial stratification by geography and sector, drivers of stratification, and potential implications (immediate and long-term) of these trends on industry sectors and the industrial economy of the region. The results can be used to inform regional and municipal plans and policies related to industrial lands.

This paper is based on review of publically available information, research, and 25 interviews with stakeholders, specifically industrial developers, brokers, business associations, agencies, and other experts. These interviewees were targeted for structured informational interviews to receive their diverse and informed insights, opinions, and comments about industrial stratification issues. The interviews and paper were largely completed during August 2018.

1.2 Industrial Lands Description

Metro Vancouver defines industrial in the Regional Growth Strategy[1]:

> *"Industrial areas are primarily intended for heavy and light industrial activities, and appropriate accessory uses. Limited commercial uses that support industrial activities are appropriate. Residential uses are not intended."*

However, it is important to also acknowledge that there is a wide range of different types of industrial and quasi-industrial uses, and accordingly they have different locational and space needs. Metro Vancouver regional planning recognizes this through the below description of industrial uses[2]:

> *"Metro Vancouver's industrial lands are used mainly for transportation/warehousing, wholesale trade, retail trade, manufacturing and professional/technical services. Many of the activities on the region's industrial lands provide for the local day-to-day needs of the region's population, providing locations for services like regional utilities, vehicle repair, hotel laundry services, catering companies, couriers, breweries, small scale manufacturing, and craft/artisan design space. In our port-based region, a significant amount of land is also needed for container storage, warehousing, freight forwarding, and other distribution functions that keep the region connected to Canada and the rest of the world."*

1.3 Stratification and Intensification

The Metro Vancouver region is experiencing a severe shortage of industrial land supply, which is manifesting itself in various forms: increasing land prices, very low vacancy rates, and higher lease

[1] Metro Vancouver - Regional Growth Strategy: Shaping our Future, 2011
[2] Metro Vancouver - http://metrovancouver.org/services/regional-planning/industrial-lands/regional-strategy

rates. These factors also impact the industrial real estate market, spurring more development of industrial projects (within the limitations of land supply) and more intense / dense forms of industrial development. In some cases, that means new higher density industrial developments that may also include increased accessory or offices uses, and in some cases these new developments are in the form of strata (condo) tenure -- often these two trends are associated with each other.

2 Metro Vancouver Industrial Lands Context

This section of the paper provides a contextual overview of the industrial real estate market in Metro Vancouver, based on published market reports. These factors influence and spur industrial development, both in the form of strata and non-strata.

2.1 Industrial Land Inventory Supply

The Metro Vancouver 2015 Industrial Lands Inventory[3] quantified the amount of industrial lands in the region as 28,000 acres, of which 80% was 'developed' and only 20% or 5,586 acres was 'vacant'. Furthermore, the inventory noted that not all vacant lands are ideal for industrial uses, and that a notable amount of developed industrial lands have non-industrial uses on them.

2.2 Industrial Market Conditions and Values

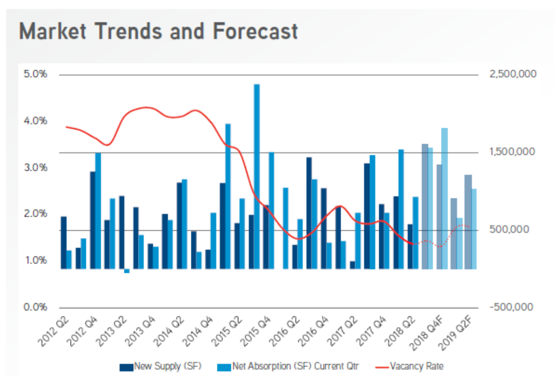
Metro Vancouver's industrial market continued the trend of growth after five years of consistently positive quarterly space absorption, with new supply still struggling to meet demand. With over 200 million sq ft of industrial building floor space, over the past five years the average annual new supply was 2.9 million sq ft, but the average absorption was 3.5 million sq ft, indicating demand has been outstripping supply.[4] The chart and table shows the downward trend in vacancy rates since 2014, and summary of the current market.

Demand for industrial space continues to set new records as both owner-operator and investor interest in industrial assets strengthen amid low vacancy, constrained land supply, and rising rental rates throughout Metro Vancouver.[5] Regional industrial space demand has more than doubled in the last three years, a result of growth in GDP, population, and consumer spending.[6]

Market Indicators
Relative to prior period

	Q1 2018	Q2 2018	Trend
INVENTORY (SF)	202,234,067	202,810,402	↑
VACANCY	1.5%	1.4%	↓
NET ABSORPTION (SF)	1,537,751	931,295	↓
NEW SUPPLY (SF)	937,645	576,335	↑
UNDER CONSTRUCTION (SF)	4,660,525	4,701,644	↑
AVERAGE ASKING NET RENT*	$10.39	$10.73	↑

*Average Asking Net Rent is calculated using a weighted average



Source: Colliers: Metro Vancouver Industrial Market, Q2 2018

[3] Metro Vancouver - Metro Vancouver 2015 Industrial Lands Inventory, 2016
[4] Colliers - National Dashboard Report, Industrial Metro Areas Population > 1 Million, Q1 2018
[5] Avison Young - Metro Vancouver, Industrial Overview, Spring 2018
[6] Vancouver Sun, Evan Duggan - Industrial lease rate surge in Metro tops global study, August 22 2018

Currently there is the greatest amount of industrial space under construction in the history of Metro Vancouver, but so far new supply has provided limited relief to the lack of vacant space, leading to significant increases in lease rates.[7] Many new developments are already preleased -- while the substantial amount of new strata product is likely to stabilize strata prices, the lack of new lease product will not address vacancy in a meaningful way.[8]

Metro Vancouver's industrial vacancy rate stands at 1.4%, well below the five-year average of 2.8%[9], and among the lowest in North America. The year-over-year increase in the prime taking or 'achievable' rent in the region increased by 29%, more than in any other market in the world during the past year.[10] Rental-rate appreciation is expected to continue (albeit at a slower rate), which will support higher land valuations.[11]

Metro Vancouver's average industrial asking net rental rate hit a record $10.91 per sq ft in early 2018, up 15% from $9.50 psf just 12 months earlier. Vancouver ($17.94 psf) and North Vancouver ($15.30 psf) were the most expensive, while Delta ($9.01 psf) and Surrey ($9.11 psf) were the lowest rates in the region.[12] Capitalization rates for industrial properties in the Metro Vancouver market range from 3.75-4.75% for single tenant A buildings, to 4.00-5.00% for multi tenant B buildings. These rates are the lowest in Canada of major markets, with the next being Toronto, at 100 to 150 basis points higher.[13] This indicates strong demand; investors are willing to pay a premium, and thus accept a lower rate of return, for industrial investments in Metro Vancouver compared to other city-regions in Canada.

2.3 Industrial Demand by Sector

Metro Vancouver is still showing a strong industrial forecast across all asset types and market areas. Warehouse/Distribution and Tech space appears to have the greatest likelihood of rent and tenant demand appreciation.[14] Last-mile delivery has also been a key focus, requiring well-located urban logistics space.[15]

According to market reports: The majority of demand continues to be driven by distribution of consumer goods, food/beverage, building supplies, technology users and film production. In core locations, increasing prices force a transition to more specialized light manufacturing, tech, office and showroom-type uses. The change in Metro Vancouver's competitive and constrained industrial market is ahead of other Canadian markets and generating innovative building forms.[16] Notably, a number of these uses are not conventional industrial, reflecting the changing nature of the economy and more non-industrial uses on industrial lands.

Also mentioned by broker interviewees were: small scale, artisanal businesses, such as custom manufacturing, small batch production, and food processing, some relating to the sharing economy,

[7] Colliers - Metro Vancouver Industrial Market, Q2 2018
[8] Avison Young - Metro Vancouver, Industrial Overview, Spring 2018
[9] Colliers - Metro Vancouver Industrial Market, Q2 2018
[10] CBRE – Global Industrial & Logistics Prime Rents, 2018
[11] Avison Young - Metro Vancouver, Industrial Overview, Spring 2018
[12] Avison Young - Metro Vancouver, Industrial Overview, Spring 2018
[13] Colliers - Canada Cap Rate Report, Q2 2018
[14] Colliers - Advisor Sentiment Survey, Vancouver, Q1 2018
[15] CBRE – Global Industrial & Logistics Prime Rents, 2018
[16] Western Investor, Russ Bougie - Industrial real estate: Changes afoot, May 1 2018

such as facilities with common kitchens. Much of these businesses require small space, and are local serving, benefiting from close proximity to the consumer population.

Growth also in tech companies in urban light industrial areas, noting the diverse types: high tech, bio tech, software, and digital. These businesses often need high ceiling, studios, labs, storage, and power, with various activities including, R&D, packaging, and distribution on site -- industrial space meets their needs. Furthermore, different types of tech companies have different abilities to pay, in terms of both wages and accommodations; most small and young companies cannot afford high rents and to purchase space.

For logistics related activities, distribution models are shifting throughout North America. Instead of a retailer having a large regional distribution centre to serve several stores, the forecast for many retailers includes fewer and smaller stores but additional warehouse facilities for return centres and smaller pick-up facilities close to downtown centres, supported by a local distribution network.[17]

2.4 Unique Lands - Port and Airport

Lands located within Port of Vancouver (Port) and Vancouver International Airport (YVR) jurisdictions are unique and not under municipal regulation, with market forces to some extent tempered by the respective roles and objectives of the agencies. With the duel functions of regulator and landlord, and in accordance with their respective federal mandates, these agencies consider more than financial factors for leasing.

Both authorities have Land Use Plans that facilitate various commercial and industrial activities, and these portfolios are part of the regional real estate inventory. The Port and Airport facilitate a multiplicity of synergistic entities and activities, which reciprocate with the associated supply chains and terminals. The facilities on Port and Airport lands may be associated with off-site distribution facilities located within municipal jurisdictions on industrial lands, linked by truck drayage.

In the case of YVR, the federal government is the landowner, with the Airport administering tenant leases. Airport lands thus cannot be stratified in a conventional sense. However, within 'Cargo Village' headquarters with over one million sq ft of cargo and warehouse space, smaller units are leased to multiple tenants, including air carriers, freight forwarders, customs brokers, trucking and courier companies. Given lease rates, use restrictions, investment levels to support air cargo, and the scarcity of available sites, tenants tend to be limited to those that need to be located close to the terminal for specific operational purposes. This includes integrators (such as UPS and FedEx) who require access for aircraft as well as Cargo Village tenants. For several cargo and logistics operators on Sea Island, there are economies of scale in co-locating activities, such that more than half of the cargo tonnage transiting on Sea Island is truck-to-truck (i.e.: it is processed there by an operator that handles air cargo, but is not transported by air).

YVR and the Port encourage investments in infrastructure and intensification that support more efficient use of lands and facilities to advance growth in capacity, some of which require significant

[17] Western Investor, Russ Bougie - Industrial real estate: Changes afoot, May 1 2018

capital and long-term planning. However, at YVR some airside sites are height restricted owing to runway transitional surfaces, radar, and instrument landing systems, which limit densification of cargo and logistics buildings.

In the case of the Port, lands are leased for the best value and user from the Port's perspective, rather than necessarily the highest financial value. Ground lease lengths can vary up to 60 years depending on the scale of infrastructure and investment by the tenant. 'Off dock' lands typically must be occupied by users preliminary engaged in the movement of goods through the Port. The head / master lease may be 'owned' by an investor, such as a pension fund, who wants stability and regular revenue, with sub-tenant leases for shorter periods, and potential partitioning of buildings into smaller units, all subject to approval by the Port.

The Port Land Use Plan includes eight use designations across the Port's 3,600 acre jurisdiction. Specifically, the industrial lands are in the form of two major categories: Port Terminals and Industrial (including 'off dock' uses such as logistics warehousing). The Port is active in land acquisitions, reviewing opportunities to purchase strategically important industrial lands, with the Land Use Plan updated accordingly.

For YVR, the six Land Use Plan designations correspond to a hierarchy – with airfield taking precedence, followed by terminal and airside, then ground access, groundside, etc (there is no "industrial" designation, per se). Over time, as passenger numbers and aircraft movements grow, priority uses such as runway and terminal will consume land (including future new runways) currently dedicated to other purposes (including cargo, logistics, and ground transportation) requiring these to relocate. Thus, while there may appear to be vacant land at YVR, much of it will be absorbed by the relocation of uses in the future.

3 Extent of Industrial Stratification

According to available figures for 2016, the Metro Vancouver commercial strata market recorded nearly $700 million in total sales volume through approximately 600 transactions. The industrial market represented 40% of the sales volume, followed by retail at 38%, and office at 22%.[18]

The total square footage of strata space traded in 2016 reached 2.3 million sq ft. The industrial market represented 62% of the area sold, followed by retail at 23%, and office at 15%.[19]

There continues to be an increase in industrial stratification in Metro Vancouver, which is also occurring in the office and retail real estate markets. Whereas in other city-regions in Canada, based on limited anecdotal input, strata industrial development and pre-sales does not seem to be as widespread.

[18] Colliers - Metro Vancouver Commercial Strata Market Overview, Q1 2017
[19] Colliers - Metro Vancouver Commercial Strata Market Overview, Q1 2017

3.1 Tenures of Industrial Development

Like residential housing, strata is a form of tenure, and is distinct from fee simple ownership and rental / lease with a tenant-landlord relationship that may be in the form of a multi-tenant building. As stated by the Province of British Columbia[20]:

> *"A strata development can be buildings or land, divided into separate units, called strata lots. This allows for individual ownership of a strata lot. All the strata lot owners together own the common property as a strata corporation. The strata corporation is, in law, an artificial person that can do everything of a legal nature that a real person can do."*

The corporation operates the property on behalf of the strata unit owners. Just like residential, as industrial uses become more intense, a larger proportion of new developments are attached units, to use the land more efficiently. There need not necessarily be a significant physical difference between strata and non-strata buildings. Attached units could either be all one property owned by a single landlord with individual units rented to multiple tenants, or stratified and owned by individual buyers/businesses.

From the onset, it is important to remember this distinction about tenure and form, while noting that they are often related. For example, many of the new developments are high density and strata. In theory, these same developments could be high density and lease; however strata are generally higher values than lease and thus could better support higher building construction costs associated with higher density forms of developments.

3.2 Industry Comments About Industrial Stratification

Generally speaking, the industrial real estate is made up of two types of markets: those that are strata owned and those that are not. There are differing opinions about strata within the industry[21]:

- *"The strata market is alive and well, but I'm personally not a fan because it limits tenants," said Jeff Miller, Vice President of Industrial in Oxford Properties Group. "Strata is uniquely Vancouver. It's not as ingrained or important anywhere else."*
- *For Lee Hester, Senior Vice President of Industrial Sales and Leasing at JLL and Beth Berry, Director of Industrial Development at Beedie Development Group, strata ownership allows small and medium sized business to grow, and creates a more stable market.*
- *"Strata is good thing for the industrial market," said Hester. "We are an owner based city, we all want to own. It's a Vancouver phenomenon." According to Hester, 90% of industrial buyers are businesses with less than 10 employees who prefer to live within 20 minutes of their property.*
- *"I love strata," said Berry. "Strata buyers are typically private and family owned companies with a succession plan, not big distribution companies who need flexibility to grow. These types of buyers make the market steady and strong."*

These comments recognize the different perspectives on the needs and solutions for industrial tenants, and that different industrial developers have different investment objectives.

[20] BC Government - www2.gov.bc.ca/gov/content/housing-tenancy/strata-housing/understanding-stratas/kinds-of-stratas
[21] NAIOP Vancouver Chapter - Regional Industrial Cost Survey, Fall 2017

3.3 Notable Strata Industrial Projects

There are a number of notable new higher density strata industrial development projects in the region. These profiles (Appendix C) are intended to provide a flavour of the new and increasingly common forms of industrial and quasi-industrial strata development occurring in the Metro Vancouver region.

The first few are conventional smaller-format and flex-space industrial buildings, with accessory office / mezzanine. The latter ones include significant or nearly entirely office and commercial uses, with limited industrial uses. These profiles reflect the growing demand for both strata units, but also smaller industrial units and with increasing amounts of accessory or non-industrial uses, and in many cases higher densities, especially in the more urban locations.

It is notable how some of these projects are marketed, with many references to the features of the work space and area amenities, which are desirable for workers.

According to brokers, making buildings comfortable for employees has taken on increased significance in the current labour market. Tenants want amenities, including break rooms with games, televisions and other leisure equipment, etc, to help attract and retain employees.[22]

A number of these projects are by PC Urban, using the 'IntraUrban' brand for their projects, and describing them as such:[23]

- *It's the perfect combination of location and design.*
- *At these prime locations, best-in-class architects and designers create brand new space specifically designed for the needs of business.*
- *With flexible unit sizes and attractive pricing, property ownership is now accessible to more businesses.*
- *Efficient interior space and contemporary storefront for increased warehouse and office potential.*
- *Almost too good to be industrial.*

3.4 Growth of Industrial Strata Development

Based on published market reports, most of which cover the industrial market in general, and a few by JLL and Colliers on the strata market in particular, below are relevant excerpts over the past two years. Statements from these publications provide a clear and consistent trend of both increasing supply and increasing demand for strata industrial developments.

2016[24]

- As one of the more stable of the commercial strata assets, the industrial strata market is largely owner-occupied and has seen significant increases in demand over the last 24 months.

[22] National Real Estate Investor, Patrick Kirk - What Industrial Tenants Want, July 27 2018
[23] PC Urban - https://intraurban.ca
[24] Colliers - Metro Vancouver Commercial Strata Market Overview, Q1 2017

- Through 2016, the industrial strata market experienced $278 million in sales volume across 343 transactions and 1.4 million sq ft. The majority of the volume occurred in Surrey (24%), Richmond (21%), and Burnaby (20%).

Spring 2017[25]

- A low interest rate environment, rising lease rates, and a lack of industrial land are among the factors pushing strata units to be sold at record prices. The weighted average price per sq ft has increased 69% over the past five quarters.
- Developers are actively building strata units to capitalize on high sales prices.

Fall 2017[26]

- Comparing the weighted average price per sq ft of strata sales in the first half of 2016 to the first half of 2017 for the region, prices increased 16%. The increase was even larger in some sub-markets.
- Pre-sales illustrate demand - developers typically arrange contracts before construction is completed. And increasingly, more units might be pre-sold when the developer launches pre-sales.

Spring 2018[27]

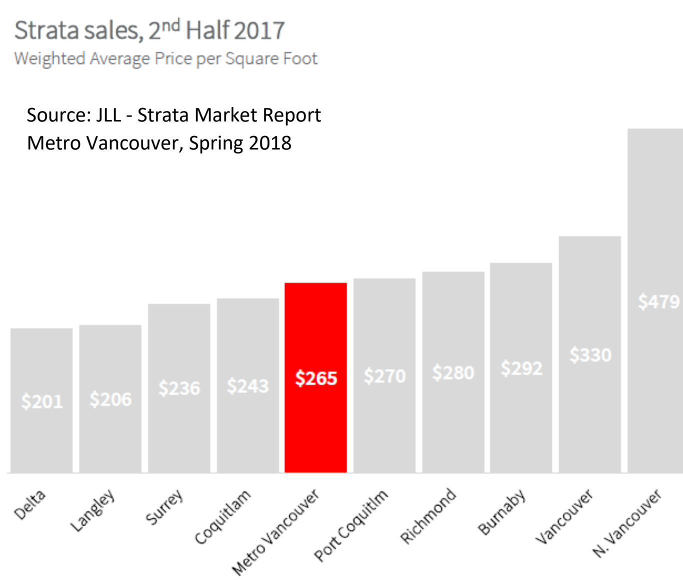
- This clear level of demand has led to an increase in the amount of strata developments in Metro Vancouver, both planned and under construction.
- In Q2 2017, there were 9 developments under construction and 8 planned. In Q4 2017, there were 11 developments under construction and 12 planned.
- Year-over-year increases in average weighted price in Metro Vancouver from 2015 to 2017 were 39%.

Summary

This sentence summarizes the situations well:

> *"With every strata development being sold out before completion, it seems that developers really can't build strata fast enough."*[28]

The chart shows the latest available summary data for strata values in the region, as of the second half of 2017[29]. Average industrial strata sales prices per sq ft were at $265, and much higher in Vancouver and North Vancouver. Since then, prices have further increased to the $400+ range in some markets.



[25] JLL - Strata Market Report Metro Vancouver, Spring 2017
[26] JLL - Strata Market Report Metro Vancouver, Fall 2017
[27] JLL - Strata Market Report Metro Vancouver, Spring 2018
[28] JLL - Strata Market Report Metro Vancouver, Spring 2018
[29] JLL - Strata Market Report Metro Vancouver, Spring 2018

According to Colliers' most recent (as of August 2018) internal database of industrial development projects in the Metro Vancouver region[30] (limited historical data by tenure is available):

- In the construction stage, with completions in 2018 and 2019, there are currently 12 industrial strata projects, representing 1.1 million sq ft of floor space. These projects range in size from approximately 50,000 sq ft to 250,000 sq ft. Strata represents 26% of the number of industrial construction projects in the region, and 28% of the floor space (total: 47 projects with 4.0 million sq ft of space).
- The largest strata projects under construction are IntraUrban Rivershore on Mitchell Island by PC Urban at 256,000 sq ft, and Delta Link Business Park with two phases by Beedie totalling 248,000 sq ft.
- In the planning stage, there are currently 11 industrial strata projects, representing approximately 1.1 million sq ft of building floor space. These projects range in size from approximately 25,000 sq ft to 300,000 sq ft for the three-building Graybar Road Richmond complex by Beedie.

3.5 Industrial Strata by Geography

Based on the latest market reports, below are some summary observations about the distribution of strata development activity by sub-region, and in some cases notable current projects.[31]

Vancouver

- Hungerford's two recent land acquisitions along Marine Drive (396 SW Marine Drive and 86 SE Marine Drive) marks the beginning of the transformation of this traditionally industrial area (although the form and tenure of these future developments are not yet known).[32]

Burnaby

- Burnaby had the second highest year-over-year price increase (31%) amongst all the submarkets. Because of its immediate proximity to Vancouver, demand remains very high.[33]
- PC Urban's latest strata development, IntraUrban Brentwood, is now 50% under contract. Pricing is in the range of $430 to $460 per square foot. The strong interest in project pre-sales, despite completion not planned until 2020, demonstrates that strata product remains in high demand.[34]
- Beedie's Crescent Business Centre 2 in Big Bend, a 10-unit strata development, recently completed construction. The project was 100% pre-sold prior to completion.[35]

Delta

- PCI Group recently acquired a two-building, partially stratified, multi-tenant complex on Annacis Island in order to stratify and market individual units.[36]
- Beedie announced a new strata development at Delta Link Business Park on Tilbury Island.[37]

[30] Colliers - Industrial Inventory Database, Q2 2018
[31] JLL - Strata Market Report Metro Vancouver, Spring 2018
[32] Colliers - Metro Vancouver Industrial Market, Q2 2018
[33] JLL - Strata Market Report Metro Vancouver, Spring 2018
[34] Colliers - Research & Forecast Report, Metro Vancouver Industrial Market, Q2 2018
[35] Colliers - Research & Forecast Report, Metro Vancouver Industrial Market, Q2 2018
[36] JLL - Strata Market Report Metro Vancouver, Spring 2018

Richmond

- The region's two largest strata developments are in Richmond - PC Urban's on Mitchell Island and Beedie's on Graybar Road, total a combined 522,770 sq ft.[38]
- PC Urban's IntraUrban Rivershore project has only six units remaining for pre-sale, demonstrating sustained demand for strata product.[39]

Port Coquitlam

- Port Coquitlam has two strata developments under construction.[40] Conwest's latest strata development 'HUB' is continuing the trend of strong pre-sales. Pricing is in the range of $325 to $330 per sq ft.[41]

Surrey

- Surrey remains the most active submarket for strata sales. There were a total of 105 strata sales in Surrey for 2017 - over twice the next most active market of Richmond with 47 sales.[42]

Langley

- Only three units remain at Beedie's latest Langley strata development, Gloucester North. The remaining units are priced at $250 to $260 per sq ft.[43]

3.6 Industrial Strata by Sector

Strata units tend to be smaller, and thus attract associated types of business tenants. Smaller operators, often local serving, require smaller spaces, and thus (and due to other factors) more likely to be attracted to strata. Buyer types may also want units with showrooms and mezzanine office space for their businesses.

A high proportion of strata units are filled by owner-occupier. Small businesses can often pay a premium and want to have a Vancouver address, and be closer to suppliers and customers. This may not be the case for other types or sizes of businesses.

Specific sectors common in strata include local serving businesses, smaller scale manufacturing, and contractors. A notable number of new and expanding businesses are also in the food processing sector. Food processers need to make a greater investment in the equipment, special features such as floor drains and refrigeration, and 'food certified' processing facility, thus want long-term tenure provided by (strata) ownership.

[37] JLL - Strata Market Report Metro Vancouver, Spring 2018
[38] JLL - Strata Market Report Metro Vancouver, Spring 2018
[39] Colliers - Research & Forecast Report, Metro Vancouver Industrial Market, Q2 2018
[40] JLL - Strata Market Report Metro Vancouver, Spring 2018
[41] Colliers - Research & Forecast Report, Metro Vancouver Industrial Market, Q2 2018
[42] JLL - Strata Market Report Metro Vancouver, Spring 2018
[43] Colliers - Research & Forecast Report, Metro Vancouver Industrial Market, Q2 2018

Larger format tenants, including distribution and logistics users, are not typically attracted to strata industrial for a number of reasons: they require larger spaces, need highway-accessible locations in the suburbs where values are lower, and prefer to lease rather than own their accommodations.

3.7 Characteristics of Strata Industrial Development

Stratification of industrial buildings is not a new concept, but has increased significantly in the past 5-10 years. During this period there have been increased acceptance by tenants of strata – previously they had concerns about strata tenure, but no longer, and in some cases their experiences with strata have been better than they expected, and they build relationships with other businesses in the same complex.

Typical industrial strata unit sizes are 4,000-8,000 sq ft, with wider ranges extending from 1,500 to 15,000 sq ft. For larger units, with higher value per sq ft associated with strata, the total price becomes out of reach for many businesses. Note that flex space units (both strata and non-strata) are often designed such that abutting units could be partitioned to allow potentially a single larger tenant to occupy multiple units (some businesses buy an extra unit for possible expansion).

Some of the units may have loading at grade, whereas others have loading docks, which will impact the types of tenants that can optimally utilize the space (independent of tenure). Smaller format spaces often have a correlation with flex space and small bay formats. Generally speaking, larger units are more likely to have loading docks.

Noted by multiple interviewees, flexibility is needed to accommodate the evolving nature of business and work, increasingly blurring the lines between traditional uses, including amount of accessory uses and amenities, etc.

In terms of the geographic extent of industrial stratification, it appears to be strong throughout the Metro Vancouver region, with an increasing number of developers building strata projects that are readily absorbed, with Surrey, Richmond, Delta, and Burnaby being the largest industrial markets. Yet, some of the more high profile strata projects are located in the inner city areas of Vancouver, closer to commercial and residential centres, and are associated with forms of industrial intensification and considerable non-industrial components.

3.8 Strata Industrial Occupant Considerations

While strata industrial can provide accommodations for many types of industrial tenants, it is not conducive to all sizes, forms, and types of industrial users. Limitations to strata development can include the following factors, impacting certain tenant types more than others:

- Strata units are generally smaller, and can have a higher proportion of office and mezzanine space.
- Strata is generally smaller format design, with limited loading bays.
- Strata units have no yard space for truck manoeuvring, trailer parking, or storage.
- Strata may have a limited amount of vehicle parking.

- In cases where strata buildings have multiple levels, that form may not be desired for certain tenants.
- Some types of users with nuisances or externalities (fumes, noise, vibrations, etc) may not be appropriate in areas with close tenants, such as automotive, painting, or other very specialized users.
- Uses that need quiet space, such as film and recording, may not be appropriate for strata units.
- Strata bylaws may limit uses within the units beyond the uses permitted in the zoning bylaw.
- Strata bylaws may limit the owner-landlord from renting out space, although apparently it is generally not that restrictive.
- Strata costs more and requires a greater commitment to the property.
- Property taxes may be higher for strata compared to non-strata, if all else being equal, the assessed value of the property is higher.
- Strata owners/occupants need to pay strata fees and maintenance costs for the complex.
- A strata project may lack the cohesive operation / management of the property, as provided by a single landlord, which can be a concern for some tenants.
- Most industrial users need associated transportation access, including for truck deliveries, but congested transportation networks are at limits. This can be a challenge for all forms of industrial, but particularly ones located in inner city locations.

Some of these issues can be addressed in a number of ways, outlined as follows:

- The developer will likely be interested in the harmony of projects and having a positive company brand. Thus, they may try to control the tenant mix. When selling strata units, preference may be given to owner-occupiers, rather than investors, and tenant types that are more likely to conform to desired use.
- Purchase / sale agreement will include a draft strata bylaw with some limitations on uses (beyond zoning bylaw), to try to control uses and avoid potential noxious tenants.

Ultimately, occupants will need to understand that they are sharing space in a multi-tenant building / complex, and that reasonable efforts are needed to avoid conflicts. The result is that strata and multi-tenant industrial units are not suitable for every user type.

It is worth noting what industrial sectors are not attracted to the trend towards stratification. Larger industrial tenants such as warehousing and distribution typically do not want smaller spaces and strata tenure. They prefer a stand-alone building on a larger property, which provides them a dedicated facility for their operations, without potential conflicts with other tenants. These types of larger users also want large sites that are accessible to the regional highway network, thus sites in the inner city areas are not desirable.

Financially, for the business the benefits to leasing are a reduced long-term commitment to the property, and a reduced capital obligation. Leasing provides greater flexibility for evolving business needs, rather than ownership. Larger tenants, especially logistics related, tend to prefer investing their capital in business operations rather than real estate, such that leasing rather than ownership is desired.

4 Drivers of Industrial Stratification

Based on research and focused interviews with key industrial participants, there are a number of identified reasons for the increasing interest in industrial strata development, along with the other considerations when selecting space[44]. Following these trends, more can be expected in the future. Ownership can be financially advantageous thanks to low interest rates and property appreciation, provide control of over the business's space, and other factors as stated in the following sections:

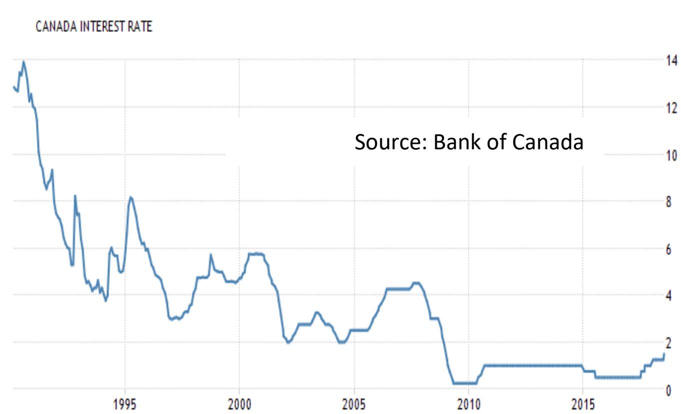
> *"Metro Vancouver's industrial market is undergoing a rapid change – a shift that has been underway since at least 2015 and is powered by a combination of rising land costs, low interest rates, rental-rate appreciation, relative economic stability and an appetite to own in a market where options to lease are increasingly difficult to secure."*[45]

Some of these development patterns are not unique to strata, but are often associated with it. There are differing opinions on the benefit/dis-benefit and validity of this trend, and its primary drivers. Nevertheless, low interest rates and availability of capital, a strong ownership preference with limited alternative options, and the evolving nature of industry and needs of businesses, are most often cited.

4.1 Low Interest Rates / Capital Financing

The Bank of Canada's multi-year record-low interest rates have put many businesses in a position where it makes more sense to own space rather than to lease space, for both industrial as well as commercial real estate.[46] Low interest rates and current lending practices provide easy access to capital. Although one interviewee noted that buying industrial assets was common long before interest rates were low.

The chart shows the Bank of Canada Interest rate between 2005 and 2018, with a notable decline in 2009. Mortgage rates for business real estate loans are tied to this prime rate.



Strata units can be purchased with financing from a number of different sources. Some non-traditional lenders can provide up to 90% financing, depending on the case. Usually loans with an amortization period of 20-25 years and interest rate in the 3.5%-5.0% range. To qualify

[44] Colliers - Industrial Leasing Guide, 2016
[45] Avison Young - Metro Vancouver Industrial Overview, Spring 2018
[46] JLL - Strata Market Report Metro Vancouver, Spring 2018

for the loans, applicants need to have an established operating business, and satisfy other lending criteria.

Strata allows businesses to purchase units with a relatively low financial contribution. In terms of deposit for pre-sale purchase of industrial strata units, the typical deposit structure is 10% up front, and sometimes another 10% at a construction milestone.

Nevertheless, even with currently low interest rates, the mortgage payment would be significantly higher than lease payments for an equivalent space, however owners are paying down a mortgage and building capital, as well as other considerations.

Low interest rates were the most often referenced driver of strata development by interviewees. In terms of the impacts of likely future increases in interest rates, it is widely expected that demand for strata would slow down, reflecting a reduction in readily available capital (and potentially evolving lending criteria). Likely the same form of development (i.e. flex space) would still be constructed, but as lease product rather than strata tenure. But for now, occupants are paying a premium for ownership.
As an example to compare the costs of ownership and lease, the below calculations illustrate the difference for a typical industrial flex space unit, based on the following assumptions:

- Unit size: 5,000 sq ft
- Strata price: $450 per sq ft
- Financing: 90% (10% down payment)
- Amortization period: 25 years
- Loan interest rate: 4.0%

As a simplistic calculation, the strata unit would cost $2.25 million (plus property transfer tax, and GST). The down payment would be $225,000, and the mortgage would be $2.025 million. The monthly mortgage payment would be $10,650, or $127,800 per year. There is also the opportunity costs associated with the down payment.

On a per sq ft basis, this works out to a mortgage of approximately $25 per year. The comparable property could be leased for approximately $17 per sq ft year. (This provides for a capitalization rate of approximately 3.5% = $17 divided by $450.) Renting the unit at market rate would not cover the mortgage payments. However, if the down payment were larger, the differential would be less. For a business that owns and occupies the unit, over time they would be paying down the mortgage and accumulating equity.

Also the responsibility of the tenant is the additional costs (i.e. property taxes, property management, building operations), which could total $6 to $8 per sq ft. These costs may differ depending on the size of the complex and features, with lease product typically having slightly higher operating costs (due to asset management fees and capital reserve contributions), but lower property taxes, as compared to strata.

4.2 Business Investment / Tax Considerations

There are also business investment and taxation considerations when evaluating the merits of ownership vs lease. Increasing lease rates make ownership, including strata, relatively more desirable for businesses. The main advantage of ownership being the opportunity to build financial equity. Many businesses prefer to own and pay a mortgage, than to pay rent.

Assuming continued increases in property values, over time the owner will benefit from both paying down the mortgage and asset appreciation, with the result being increased equity. When owners eventually sell or refinance the property, they can extract the difference between the remaining loan amount and the current market value as equity for their business. Whereas with leases, payments go to the landlord and no principle is paid down.

Some businesses buy an extra unit in case of future business expansion, and then lease it out until they need the space. Financing allows them to make that investment and transaction, but rental income would not fully cover the mortgage payment.

The following expenses can be deducted when calculating tax payments: interest fees, depreciation, and non-mortgage related expenditures.[47]

In addition, the 20% foreign buyer tax does not apply to industrial properties. The recently introduced foreign buyer tax on residential properties could result in more foreigners purchasing commercial and industrial (strata) properties.[48] This perception or concern, and associated land speculation, was mentioned by a number of interviewees.

4.3 Ownership Preference / Security of Accommodations

Another key driver mentioned by many interviewees is security of accommodations. For certain businesses, ownership of space is strongly desired. Reasons range from stability provided by ownership of the property, long-term investment value appreciation expectations, and desire to own space for their business. By owning the property, the businesses are not at the mercy of lease renewals at higher rates or possible eviction from a landlord. This owner-occupier segment is driving most of the demand for strata space.

Business owners may have extra capital that they wish to invest, and ownership of a strata unit for their business is an ideal opportunity for possible investment appreciation (and sometimes with family business, legacy, and estate planning considerations). A holding company may be set up to own the real estate, separate for the operating business occupying the space. As a noted benefit, through ownership of real estate the value increase accrues to the local businesses and stays within the community, rather than going to an out-of-town investor.

[47] Western Investor, Cecilia Tse - Better to buy than lease, May 1 2018
[48] BC Business, Kerry Gold - How Vancouver's industrial land crunch is pushing businesses out of town, December 6 2017

Other factors referenced in interviews include: control over their destiny, sense of security, pride of ownership, benefiting from a new facility, appeal to lifestyle, and strong ownership culture in Vancouver.

4.4 Business Expansion / Few Alternative Space Options

Most industrial space demand is driven by business growth in the region. Specifically, local businesses that are expending and need more space. Some of these businesses are moving from lease flex-space, and some from fee-simple buildings that they owned.

Given the very low vacancy rates, there are very few options, both in terms of availability and price, to find industrial space, particularly if they want to stay close, or if they want a large space.49 Reflecting strong demand, pricing for industrial space -- both lease and ownership -- continue to rise as investors and owner-operators compete for the limited supply. Given the limited lease options and high rents (along with low interest rates), strata ownership becomes more attractive relative to leasing.50 When businesses decide to purchase space, many purchase a strata unit versus a freestanding building, because there is limited availability of freestanding buildings of comparable size.51

Also noted by an interviewee was the possible fear of missing out, as prices escalate fast and limited supply, a phenomenon that has been seen in the residential real estate market.

4.5 Evolving Nature of Industry / Business / Economy

For some sectors of industrial, the economy and businesses are changing and thus also their accommodation needs. Even the definition of industrial and manufacturing is changing, to include craft breweries, software manufacturing, etc. Reflecting this change in the economy, there are increasing references to the evolving future of work and workspace, with amenities for workers being increasingly important. Furthermore, there is much reference to 'employment lands' or 'employment generating space' which also includes office and retail, rather than purely industrial. This is in parallel with the ongoing evolution of cities, and corresponding changes to the economy, transportation, technology, society, etc.[52] Nevertheless, there could still be said to be two main categories: large trade-related distribution, and smaller local serving.

Some types of businesses that may have a significant office component often prefer not locating in the downtown central business district as it is 'too corporate', and instead prefer a light industrial-type area such as Mt. Pleasant, which is also close to workforce housing and commercial amenities.
As another example, the nature of the logistics business is ever-evolving and demand for warehouse efficiency means that new logistics tenants increasingly require more cubic volume / space within their facilities through higher ceilings. However, that does not necessarily mean stratification, but in other industrial sectors with smaller scale businesses, new forms of industrial buildings are increasingly flex space strata.

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[49] Vancouver Sun, Evan Duggan - Industrial lease rate surge in Metro tops global study, August 22 2018
[50] Avison Young - Metro Vancouver, Industrial Overview, Spring 2018
[51] JLL - Strata Market Report Metro Vancouver, Spring 2018
[52] Vancouver Economic Commission - Industrial Insights Vancouver, 2018

Reflecting a shift for some businesses from traditional forms of industrial to modern forms, such as light industrial with higher proportions of office-like functions, a number of interviewees stated that small format strata were responding to this demand. Accordingly, an interviewee wanted to change the dialog to be more about urbanism and transit access, including possibly innovative forms of development, such as higher density (including industrial) uses at good locations, and integrating small scale industrial within commercial and residential developments, where appropriate. While on the other hand, other interviewees expressed concerns about residential occurring on or near industrial areas and potential use conflicts.

Along with these changes in the nature of industry and uses, are in some cases changes in municipal policies and zoning bylaws -- some say responding to it, while others say driving it.

As stated by Avison Young[53], the City of Vancouver's policy of amending the meaning of industrial will continue to drive sale prices higher as supply tightens further and conventional industrial activity relocates:

> *"This pressure has had two key impacts: many local operators are closing up shop; and the adoption of new construction forms featuring mixed-use developments that include industrial space in various formats as well as multi-storey 'industrial' buildings that take advantage of the evolving definition of what qualifies as industrial use in the city."*[54]

4.6 Municipal Zoning

Some municipal zoning bylaws allow for a wide range of uses within their 'industrial' zones, in some cases to recognize the various uses that did not fit the old definition and uses that were already in place. In the case of the City of Vancouver, some industrial zones allow office and in I-4 'creative products manufacturing', encouraging redevelopment of older industrial buildings to higher densities. This has led to the change, or loss, of traditional industrial activities in certain areas as redevelopment and higher values take hold.

The evolving nature of what the City of Vancouver considers industrial is demonstrated in the changes to industrial zoning in traditional industrial areas. Not wholly due to stratification, but associated, these changes are profiled in an Avison Young report[55]:

- Mt. Pleasant's rapid transformation, traditional industrial activity (with few exceptions) has largely been pushed out of the neighbourhood. Much of the remaining "industrial" activity is based on the City's evolving conception of what industrial use means in the 21st century.
- The City of Vancouver also altered the zoning in two other industrial nodes in 2017: False Creek Flats and Railtown. An additional conditional approved use was manufacturing (expanded to include 'creative products manufacturing (CPM))' - a term coined by the City that is defined as the "creation, development, prototyping, and ancillary marketing of products produced in a physical or digital form that are a result of a customised design process."

[53] Avison Young - Vancouver Industrial Report, Winter 2017
[54] Avison Young - Vancouver Industrial Report, Winter 2017
[55] Avison Young - Vancouver Industrial Report, Winter 2017

- Zoning density allows up to 4.0 Floor Area Ratio[56], which can include 3.0 FAR of creative products manufacturing, with other specific use requirements for the 1.0 FAR.
- These changes have triggered a significant shift away from the traditional industrial uses in the area and opened the door to erosion of traditional industrial activity to more desktop-focused businesses.

According to another source[57], the City of Vancouver's original industrial districts next to the Port will now house an increasing number of design firms, showrooms, studios and light manufacturing companies. Sales activity and development applications in the neighbourhood started 'immediately' after the zoning was changed; "The value of the land changed, so now you could have more users." Responding to the zone, developers appear to be building office space, rather than CPM space focused on tech as envisioned in the zoning bylaw.

4.7 Accessory and Non-Industrial Uses

More recently in urban areas, industrial strata has morphed into quasi-industrial uses, with more retail / office (as either accessory or non-industrial uses) as a means to gain the 'highest and best use' of the site.[58]

In most industrial zones, accessory office on the second floor is permitted; also allowable may be a showroom at the front of the unit. Typically, these accessory uses must be associated with the permitted primary industrial use within the unit. Although limits are stated in bylaws, for smaller units, these accessory uses can be a proportionally larger amount of the floor space as compared to larger industrial units.

This type of accessory use differs from a separate office space, which in some cases is allowed. For example, some of the new strata projects design units such that the office space could be rented out as a separate business, or used in combination with the industrial unit. Furthermore, these industrial strata units are being marketed as having features / amenities desirable for office workers, rather than as conventional industrial space. Also noted by interviewees is that the office component in strata industrial buildings is not traditional office; these types of uses would not fit in a conventional office building. While another interviewee questioned the depth of market demand for office space within industrial buildings.

4.8 Growth of Smaller Format Businesses

For certain industrial tenant types, smaller spaces are desired, such as small production businesses that serve the local population. These may include light-industrial flex-space units that have a loading bay and mezzanine at the front that can allow an accessory office and retail/wholesale component. These types / sizes of spaces, for efficiency purposes, necessitate a multi-tenant building (rather than free-standing). It is not possible to (efficiently) construct a small building that is fee-simple. Rather, to increase efficient use of land, smaller units are clustered together in a single larger building. Required

[56] Floor area ratio (FAR) is the ratio of a building's total floor area (gross floor area) to the size of the piece of land upon which it is built.
[57] Vancouver Sun, Evan Duggan - Commercial Real Estate: Railtown zoning change spurs redevelopment, August 7 2018
[58] Colliers - Metro Vancouver Commercial Strata Market Overview, Q1 2017

building setbacks and landscaping features, plus parking requirements, often make small stand-alone single-purpose buildings inefficient. This does not necessitate strata development (it could be lease), but there is a strong association / correlation between these types of units and tenure (especially for the newer and higher value developments).

4.9 Construction Costs / Building Efficiencies

Along with increasing land values, increasing construction costs have an impact on the form of development. Industrial warehouse construction costs are estimated at \$85-135 per sq ft, and low rise office buildings at \$200-265.[59] Accordingly, opportunities for economies of scale through larger projects to drive down the average cost per sq ft are sought by developers. This can result in a single larger building, rather than multiple smaller buildings, being more efficient in terms of costs, as well as land and resources (this is a function of building form, rather than tenure, per se). On the other hand, buildings with multiple levels (and additional facilities / amenities, or higher proportions of office space) generally cost more to construct. Overall, new strata buildings, which are often associated with high density (and intensification), can be constructed more efficiently per sq ft, yet sold at high prices, thus being financially viable to develop.

4.10 Increasing Property Values

Under the current market environment, strata industrial space (and also commercial) is achieving considerably higher sales values than would be expected based on current market lease rates divided by capitalization rates. Effectively, businesses are paying a premium to own rather than lease. Accordingly, developers are responding by building and selling this type of product, especially in more urban locations.

In some cases, higher land values are driven by zoning that allows more uses and higher densities. This in turn spurs industrial redevelopment and increasing demand and higher prices for industrial lands. The changes to industrial zoning encourages the acquisition of industrial properties by investors and developers to redevelop and places increasing pressure on industrial properties.[60]

4.11 Development Profit

The higher values for strata are more profitable from a developer's perspective (and pre-sales help with development financing and reduce risk); but increasingly, these higher sales values are required given the higher land values. Lease and strata economics are very different - the pro forma often does not work for rental.

With increasing land prices, the value of the end product must be higher to support the financial feasibility of a development project; thus in many cases non-strata industrial development is no longer financially possible -- the most viable form of development is strata (the new highest and best use). Thus, higher densities are pursued, and strata tenure, along with more non- or quasi-industrial components such as office/retail, which have higher values. These are usually needed to make the pro

[59] Altus Group - Canadian Construction Cost Guide, 2018
[60] Avison Young - Vancouver Industrial Report, Winter 2017

forma work with the higher land costs in the market.[61] Effectively, in a mixed-use building, the office part of the project helps the economics of the industrial part of the project, to make it all viable. New development must be supported by increased rents to keep up with the rising land costs and the rising construction costs.[62]

From a merchant developer's perspective, typically there is a desire to build strata to sell, and move on to the next projects (to turn over money in about three years). Whereas institutional investors want to buy and hold properties for long-term cash flow / holding revenue. Also, the shortage of suburban office space and potential appreciation has attracted smaller investors to light industrial projects.[63] Currently, developers are able to pay a premium for lands based on the expected form of development being strata.

4.12 Real Estate Investors

There are also (again similar to commercial) investors who seek to purchase strata industrial space as an investment. Based on past performance, industrial investments have been good performers.

According to multiple interviewees, most buyers of strata industrial units are owner-occupiers. However, this varies by geography, with a higher proportion of investors (both local and foreign) in more urban locations like Vancouver, as compared to outer locations like Surrey. These investors may plan to purchase a unit (often through pre-sales with a 10% deposit) and then either sell it later at a capital gain or rent it for holding revenue. For such possible investments, interviewees believe that the buyers are predominantly looking for capital appreciation, as rental return is low at only approximately 3-4%. Buyers are effectively willing to accept a low rental rate for possible capital upside.

As stated by one interviewee, small business and industrial strata is not a glamorous investment, but is being bought by owner-occupiers who need it. Whereas, is some higher value locations such as Vancouver, more investors are attracted to buy units as real estate investments. Nevertheless, according to one developer interviewee, most units are pre-sold to owner-occupiers, and few of those units are reassigned (flipped) to other parties for profit before completion.

Also, speculators may be attracted to commercial and industrial properties, as the foreign buyer tax only applies to residential properties. There appears to be increasing interest from foreign investors in Metro Vancouver’s industrial real estate market.[64]

Another interviewee noted the desire, independent of tenure, to ensure that the space is used for a true business activity and values add – not just a shell – and contributes to the economy and workforce.

[61] Avison Young - Vancouver Industrial Report, Winter 2017
[62] Vancouver Sun, Evan Duggan - Industrial lease rate surge in Metro tops global study, August 22 2018
[63] Business in Vancouver, Frank O'Brien - Industrial strata reflects suburban demand, July 14 2018
[64] Colliers - Research & Forecast Report, Metro Vancouver Industrial Market, Q2 2018

5 Immediate Implications of Industrial Stratification

Based on the drivers and trends associated with industrial stratification development, the following section identifies some of the immediate implications on industrial lands, businesses, real estate, land use planning, and government policies. While office strata development has received some attention by planners, due to concerns about it driving up prices, industrial strata has not. A number of these items are interconnected, and in some cases part of a reinforcing cycle.

Although strata industrial provides needed accommodations for new and growing businesses, redevelopment of industrial lands can in some cases displace existing businesses, the latter being more traditional forms of industry. Yet, at the same time, strata industrial units are often a more intensive use of the lands, although in some cases with a larger proportion of accessory and non-industrial uses.

5.1 Capital Commitment

As stated by one interviewee, industrial businesses can be classified into two broad categories: owners (strata or stand-alone), and leasers, the latter who do not want or not able to invest capital, but rather leases their buildings, trucks, equipment, etc.

Ownership, rather than renting / leasing, is a strong form of commitment to the property. Some businesses prefer this greater control, however it does reduce flexibility, in that businesses must sell or rent the premise if they wish to relocate, rather than simply terminating a lease agreement.

This ownership comes with an associated capital obligation to real estate for the owner-business. These monies are invested in real estate, rather than the operation of the business. Effectively, they are becoming real estate inventors along with operating their primary business, and will be affected by the real estate market and interest rates for their mortgage. This could lead to over-investing in real estate and under-investing in operations.

Ownership may be desired in a rising property market, but during a shifting economy and/or increasing interest rates, may pose a financial challenge. If interest rates increase or strata unit values decrease, there may be an associated impact on the real estate market in general, and the finances of owner-businesses in particular. Interviewees were unsure of the depth or duration of the run in industrial strata demand, but generally expect it will slow down once interest rates rise. This may have wider negative economic impacts, and would likely see industrial strata replaced with a trend back towards leasing.

5.2 Unit Sizes and Features

Strata impacts the use and design of the building as well, not just tenure. Strata buildings are generally small bay, smaller format, etc, whereas non-strata are larger buildings for larger tenants, which are a different type of industrial user. This may limit the potential pool of tenants.

For businesses needing a larger space, there may be fewer options. New large industrial buildings that are 150,000 sq ft size are often being subdivided into smaller units. In the past, 15,000 sq ft industrial buildings could have been standalone, but with limited land and high land prices, it is more efficient to construct as a multi-tenant single building.

One interviewee expressed concerns about the right-sizing of units -- too small or too big -- to ensure scalability of units for flexibility and future possible alternative uses. Even though in some cases multiple abutting strata units can be combined together (internal partitions could be removed), they will be higher cost because of their individual small sizes (generally, all else being equal, the price per sq ft is higher for smaller units than larger ones).

Conversely, a large fee-simple industrial building owned by a single landlord with units leased to multiple tenant users, effectively controlled by one party, may actually allow for greater flexibility. Units can be (within reason) partitioned to create smaller spaces or consolidated to create larger spaces, as market needs evolve (including as individual businesses expand / contract within the complex). Leases are shorter term and more flexible or scalable; if units are individually owned through strata, this is less likely to occur.

5.3 Accessory and Permitted Uses

An observation is that smaller industrial units and owner-occupied units tend to have a higher proportion of accessory uses, although are still generally industrial. This is a function of two variables: the unit is smaller, so any accessory component is thus a large proportion of the total unit size, and the type of tenants / uses.

Many of the noted industrial strata projects have a considerable amount of accessory and non-industrial uses. These uses may be permitted under the zoning bylaw and accommodated in the building design as envisioned by the development project. However, after construction and occupancy, there is the potential that the amount of non-industrial uses further increases to the detriment of the industrial, as commercial users can typically pay higher rents than industrial. Responsible governments and agencies should respond by providing greater clarity about what is permitted or not by land use plans and zoning. The proliferation of non-industrial uses on industrial lands is the concern - this risk should be monitored and enforced.

At the other end of the use issue, is that strata bylaws may further restrict uses beyond a zoning bylaw -- this could limit the potential for businesses and uses to evolve over time if the strata complex is dominated by certain types of controlling owners, whereas leasing could be more flexible.

5.4 Space for New Businesses

While strata may be fine for businesses that want to buy space, it is not for those that cannot afford it. New businesses tend to not be well capitalized or have a strong financial track record, nor have as stable of an operation. This may preclude them from being a match for a strata unit purchase and financing. Instead, a lease, which requires no capital and a lesser commitment, may be more appropriate for them. However, if strata becomes increasingly common, what would have otherwise been lease flex space units are now strata flex space units, and thus fewer lease options are available.

This shift in tenure may make it more difficult to find accommodations for new businesses. Also, old space is more affordable, and often desired by some businesses. This is particularly the case for incubator / start up businesses and social enterprises such as art co-ops, that need affordable accommodations, which could benefit from space targeted for new, small, emerging, and local businesses.[65] In a complex with multiple industrial tenants, there is the potential cluster of related / linked users (eco-industrial, co-location, co-working, sharing economy, makers), which could be a form of innovation and efficiencies.[66]

5.5 Displacement of Existing Businesses

Space affordability is the biggest issue for many businesses, both in terms of the rent and property taxes. As costs increase, the results are: some businesses leave, some accept the higher costs, and some sell their property and close. With not enough space for traditional industry users, such as manufacturing, some move to other parts of the region, into bigger newer facilities. But for others, like city-servicing businesses, they cannot move far away, as they need to be close to suppliers, customers, and employees in more urban areas and other links in the region.

5.6 Intensification and Specialization

If higher values per sq ft of industrial space can be achieved (through strata in this case), it will drive greater efforts and investments to intensify industrial land uses. Some interviewees see stratification is a natural progression of densification. Although tenure is not really changing the physical type of development in many cases, but is often associated. Yet it is also noted that the buildings being replaced are often old and under-utilized, whereas the new developments have much more intensity and activity, as well as jobs. Generally, new spaces are more efficient than older ones.

As prices continue to increase, it forces users to operate more efficiently; some businesses are reducing their footprint, investing in technology, and increasing productivity within their space, which are all forms of intensification. Distribution centres are bigger, ceiling heights are higher (often 36-40 ft clear), racking and lift systems continue to evolve, and multi-storey industrial buildings are being considered.[67] However, building density or site coverage is often limited by minimum parking requirements (either functional needs or imposed by zoning bylaws).

(This combined stratification and intensification may be in the case of multi-level industrial buildings, although these are often more accurately called multiple level buildings with light industrial at grade, and office / accessory uses on the upper levels. Note there are two ways of looking at multi-level industrial - separate users on each floor (such as a split grade building) vs one tenant on multiple floors who needs to get access between the two via cargo / freight elevators, and wider hallways for loading.)

Many industrial users are rather generic and content with a standard space, whereas others have a very specialized operation and require a custom space (and/or significant investment in the equipment / machinery, rather than the building, per se).

Highly specialized buildings, for a specific user, are the opposite of standard generic buildings that are flexible and can be more easily used by another tenant. Developers are less inclined to build specialized spaces, as unique properties are harder to lease or sell unless that is pre-arranged for a specific tenant. If occupants own their space they may be prepared to make a greater commitment to it through investments in equipment/machinery, knowing that it can be amortized over a longer period and no

[65] UBC SCARP Planning Studio Course - Industrial Innovation Spaces: Enhancing Industrial Economies in Vancouver, March 2018
[66] Vancouver Economic Commission - Industrial Insights Vancouver, 2018
[67] Western Investor, Russ Bougie - Industrial real estate: Changes afoot, May 1 2018

potential disruption of moving. Long-term tenure is required to justify significant capital investments. Accordingly, (strata) ownership may be more appropriate where there are significant investments in equipment, whereas for more generic space with less specialization, rental (lease) may be a more appropriate option.

5.7 Land Speculation / Property Taxes

Speculation is occurring on some industrial lands. This is associated with rising land values, where new landlord-owners will want higher rents, but those higher values may not be supported by tenants.

If the land has redevelopment potential, the landowner may not want to provide a long-term lease or insists on a demolition clause, which is less desirable for the business tenant, who may be disinclined to remain. Also, a landlord may be hesitant about a longer term lease as it would preclude them from fully enjoying medium term rent increases (lease escalation clauses are typically modest and below market increases), or investing in the building upkeep.

Yet in other cases, where there are pre-existing tenants with long-term leases that limit immediate redevelopment potential, some developers buy lands as an investment with longer term redevelopment intended when the leases expire.

Also mentioned is the difficulty to purchase land: landowners do not want to be sellers, because prices are supposedly 'always' going up. They do not want to risk selling too low or too early, so they have no incentive to sell.

Increased interest in industrial lands for redevelopment purposes is leading to higher market values. These higher values are reflected in increased property assessment values by BC Assessment Authority. Higher assessed values generally result in higher property taxes, and in most cases the terms of leases (i.e. triple net) stipulate that property taxes along with property management costs are the responsibility of the tenant. Thus, as land values rise, the costs for tenants increase, sometimes significantly, which can challenge the financial viability of some businesses and push them out of the area.[68]

5.8 Off-Site Impacts

Different types and sizes of businesses may generate different off-site impacts, such as truck traffic. Although those impacts are more accurately associated with the type of business than building tenure, but if smaller businesses are more likely to be strata, there could be a correlation. The same can be said for employee density, which may have impacts on commuting traffic, parking, transit, and demand on area amenities. More intensive forms of land uses, including high density strata industrial, may place greater demands on infrastructure, such as water, sanitary, as well as the electrical grid.

[68] Vancouver Courier, John Kurucz - Vancouver’s small businesses struggle amid tax, property crunch, January 18 2018

6 Long-Term Implications of Industrial Stratification

While generally it could be said that government should be indifferent about ownership and tenure, there are some implications of increasing industrial stratification. This section outlines the most evident potential long-term implications of industrial strata development, including future redevelopment of industrial lands, and wider economic impacts.

6.1 Future Redevelopment Potential of Land

As an example from the residential sector, a strata condo apartment building is much more difficult to assemble/acquire to redevelop by a developer, compared to a purpose-built rental apartment building with a single owner. The same can be expected for industrial properties, with multiple or fractured ownership. Strata is seen by some interviewees as being too small scale or granular to allow future redevelopment potential, potentially locking in that form for a very long time. Although desirable now when new, decades from now when these properties are nearing their physical / functional / financial obsolescence, how readily they can be redeveloped will be the question. A developer trying to acquire numerous strata units to redevelop a site will likely be in for a challenge, with many different owners having different interests.

6.2 Wider Economic Impacts

Wider implication on the regional economy are more speculative, and somewhat reflective (responding to, rather than causing) of the fact that the Metro Vancouver economy is very diverse (also known as fragmented), aside from the focus on transportation / logistics activities given the gateway role of the region. Concerns identified by interviewees are outlined as follows:

- Logistics or trade enabling users are larger operators, and tend to lease large spaces. They are not attracted to or directly impacted by stratification, however if the supply of industrial lands are increasingly consumed by strata small size industrial development, there will be less industrial lands available for larger format non-strata industrial logistics users. The focus and growth of industrial strata development (which tend to be smaller scale units), may outcompete space for new development of larger facilities such as distribution centres, with macro-economic regional implications.
- Logistics is generally a less valuable use compared to other allowable uses in industrial zones, and strata industrial is an even higher value use. Strong demand for strata makes developers willing to pay more, driving up land prices, and outbidding logistics users. One suggested solution was to have a logistics-only designation or zoning, rather than logistics simply being one of many allowable uses within industrial zones, or consider zones that only allow rental/lease tenure.
- Concern that the industrial land shortage in the region is a larger problem - compromising the trade potential for Canada.
- Concern about the loss of industrial space on the regional economy. With the very low vacancy rates, many businesses have challenges finding industrial accommodations, not matter the tenure. Lack of industrial space may be limiting business growth in the region and associated employment. In some cases, industrial lands are so expensive that industrial businesses, and associated economic

and employment activity, are moving out of the region. According to one survey, as many as 50% of businesses are considering relocating in the next two years due to these issues.[69]

6.3 Other Concerns

Other possible concerns identified through interviews include:

- Worry that although strata may be popular now, there could be a potential over-supply or glut of it in the future, if interest rates increase or the economy shifts. Planning should consider long-term implications and need for future-proofing and resiliency of industrial space.
- Although there is demand for strata space, some of this interest may be driven by developers, brokers and bankers who like strata for the profits and fees.
- Uncertainty about what sorts of spaces new / emerging business sectors may need, such as high tech, but a desire to be flexible and adaptable.
- Suggestion that there might be a public interest in encouraging a range of industrial unit types and sizes, comparable to residential apartments where cities require a certain number of family-size housing units.
- Concerns about increasing 'employment lands' references, and apparent focus on jobs and other forms of development occurring on industrial lands, which are not industrial. These other uses take away from the industrial land supply -- potentially displacing traditional industrial users. On the other hand, organizations/associations that support business growth tend to focus on economic and employment aspects of industrial development.
- Concerns about non-industrial uses in industrial areas, including sports / recreational / entertainment types of uses. Suggest that these activities should be clustered in one location with its own zone.
- Also mentioned by interviewees were challenges associated with the development approval process to bring new industrial projects to market in a timely manner.
- Industrial intensification may be possible, but is only part of the solution and its potential differs by sector and geography. Intensification is no substitute for an increase in the supply of industrial land required to satisfy the persistent demand.

[69] Vancouver Economic Commission - Industrial Insights Vancouver, 2018

7 Conclusion

This paper documents, based on available information and key informational interviews, the extent, trends, drivers, benefits, challenges, and implications of industrial stratification in the Metro Vancouver region to help inform development of a Regional Industrial Lands Strategy.

There are a number of reasons identified for the increasing interest in industrial strata development. Many of these drivers are interconnected, and in some cases part of a reinforcing cycle.

- Low Interest Rates / Capital Financing
- Business Investment / Tax Considerations
- Ownership Preference / Security of Accommodations
- Business Expansion / Few Alternative Space Options
- Evolving Nature of Industry / Business / Economy
- Municipal Zoning
- Accessory and Non-Industrial Uses
- Growth of Smaller Format Businesses
- Construction Costs / Building Efficiencies
- Increasing Property Values
- Development Profit
- Real Estate Investors

There are differing opinions on the benefit/dis-benefit and validity of this trend, and its primary drivers. Nevertheless, low interest rates and availability of capital, a strong ownership preference with limited alternative options, and the evolving nature of industry and needs of businesses, are most often cited.

The implications and considerations of increased stratification for industrial lands, businesses, real estate, land use planning, and government policies, include the following:

- Capital Commitment
- Unit Sizes and Features
- Accessory and Permitted Uses
- Space for New Businesses
- Displacement of Existing Businesses
- Intensification and Specialization
- Land Speculation / Property Taxes
- Off-Site Impacts

Although strata industrial provides needed accommodations for new and growing businesses, redevelopment of industrial lands can in some cases displace existing businesses, the latter being more traditional forms of industry. Yet, at the same time, strata industrial units are often a more intensive use of the lands, although in some cases with a larger proportion of accessory and non-industrial uses. Following these trends, more can be expected in the future.

As stated by a recent market report:

> *"While owner-occupiers have traditionally played an active role in Vancouver's industrial market, the purchaser profile of free-standing industrial buildings has shifted in the past 18 months to include many more investors and developers. Owner-occupiers are now largely relegated to acquiring strata units (or relocating to another market or shutting down their*

business entirely) as rapidly rising prices for free-standing industrial assets have priced many business owners out of the market."[70]

In the longer term, increasing stratification of industrial lands may limit or challenge the future redevelopment potential of the lands when the functional lives of the buildings are at their end, and diminish the amount of industrial land available for larger format industrial and logistics users.

Considerations about the wider economic impacts reflect both the need to respond to a changing industrial economy, and concerns about the limited availability of industrial space compromising the growth potential of businesses and employment in the region, along with the trade / transportation of goods through the region serving the national interest.

[70] Avison Young - Vancouver Industrial Report, Winter 2017

Appendix A: Interviewees

Thank you to the following participants who were interviewed as part of this research project, for providing information, insights, opinions, and comments about industrial land development matters.

Organization	Name	Title
Avison Young	Andrew Petrozzi	Principal & Vice-President, Research (B.C.)
Avison Young	Russ Bougie	Principal - Industrial Brokerage
Beedie Group	Beth Berry	Director, Industrial Development
CBRE	Chris MacCauley	Vice President - Industrial Lands
City of Richmond	Neonila Lilova	Manager, Economic Development
City of Vancouver	Matthew Bourke	Citywide - Planner II
City of Vancouver	Chris Clibbon	Citywide - Planner II
Colliers	Scott Sutherland	Market Intelligence Coordinator
Colliers	Roy Pat	Associate Vice President - Industrial Sales & Leasing
Conwest Group	Ben Taddei	Chief Operating Officer
Cushman Wakefield	Andrea Welburn	Manager, Information & Research
Dayhu Investments Ltd	Paul Tilbury	Chief Operating Officer
Emerson Real Estate Group	Ron Emerson	Principal Developer
Eric Vance & Associates	Eric Vance	Principal Consultant
Greater Vancouver Gateway Council	Michael Henderson	Managing Director
Hastings North (East Village) BIA	Patricia Barnes	Executive Director
Hungerford Properties	Tegan Smith	Director, Planning
JLL	Ben Wedge	Senior Analyst - Industrial Division
PC Urban	Dan Cupa	Director, Development
PCI Developments	Tim Grant	Vice President - Development
Port of Vancouver	Jennifer Natland	Manager, Real Estate
Port of Vancouver	Marc Ballard	Manager, Real Estate
Roynat Capital	Joey Tai	District Director
SFU Urban Studies Program	Peter Hall	Professor and Director
Surrey Board of Trade	Anita Huberman	Chief Executive Officer
Vancouver Economic Commission	Pietra Basilij	Manager, Industrial Initiatives
YVR Airport Authority	Peta Wolmarans	Manager, Engineering Planning

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Colliers - Metro Vancouver Industrial Market, Q2 2018

Colliers - National Dashboard Report, Industrial Metro Areas Population > 1 Million, Q1 2018

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PC Urban - http://pcurban.ca/intraurban-brentwood-burnaby-bc

PC Urban - https://intraurban.ca

PC Urban - https://intraurban.ca/business-park

PC Urban - https://intraurban.ca/rivershore

Rendition - http://renditiondevelopments.ca/portfolio/the-maker-exchange

The Province Newspaper, Evan Duggan - New industrial park to open in Burnaby's Brentwood neighbourhood, June 19 2018

UBC SCARP Planning Studio Course - Industrial Innovation Spaces: Enhancing Industrial Economies in Vancouver, March 2018

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Vancouver Economic Commission - Industrial Insights Vancouver, 2018

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Appendix C: Example New Strata Industrial Projects

IntraUrban Rivershore on Mitchell Island by PC Urban[71]

> *"IntraUrban Rivershore brings a proven combination of central location, smart architectural design and the kind of control that only true ownership can provide."*

The project is promoted as a riverside business park, tailor-made for the flexibility of the new economy, with direct access to Knight Street Bridge and regional highways, and enjoying riverside views. The complex includes 260,000 sq ft of industrial space, with units ranging in size from 3,600 to 12,500 sq ft. Features include 26 ft ceilings, upper floor flex space, dock and grade loading, and the ability to combine spaces.

HUB in Port Coquitlam by Conwest[72]

> *"HUB offers contemporary industrial space with built-in flex mezzanine area to meet the needs of your growing business. The space you want in the location you deserve."*

The project is marketed as being centrally located in Port Coquitlam with easy access to everywhere in the region via the highway network. Building features include: 26 ft ceilings, 500 lb ground floor load capacity, and both dock and grade loading for every unit, with unit sizes 6,200 sq ft and up.

IntraUrban Business Park in South Vancouver by PC Urban[73]

> *"For small and medium sized companies that want to own a place of business in Vancouver, this centrally located commercial site at 8811 Laurel Street, offers unequalled access, long-term vision and a prime location."*

Promoted as the best location for businesses, next door to Marine Gateway, a quick trip to downtown via the Canada Line, and accessible to employees, customers, and suppliers. Building features include: 22 ft ceilings, air conditioned second floor mezzanine, grade level roll-up loading doors, and contemporary storefront and generous glazing. The complex includes three buildings ranging in size from 44,000 to 69,000 sq ft, with units from 1,200 to 3,200 sq ft in size.

IntraUrban in Brentwood by PC Urban[74]

> *"A business real estate opportunity fueled by smart density, transit growth, and an evolution in the design of light industrial strata space."*

The project is promoted as being adjacent to Brentwood Town Centre and associated shops and amenities, with convenient SkyTrain and highway access. The project includes 100,000 sq ft of industrial space, with units starting at 2,700 sq ft. Units have 24 ft ceilings, grade level loading, and upper floor flex space.

Coverage of the project in the media[75] references interest by a variety of tenant types, ranging from tile companies, lighting outfitters, service commercial companies and contractors, snack-food businesses, and even a craft brewery. The developer is quoted as saying that a lot of small business owners want to get a foothold in the commercial real estate market so they can control their own destiny in the region's

[71] PC Urban - https://intraurban.ca/rivershore
[72] Conwest - http://hubworks.ca
[73] PC Urban - https://intraurban.ca/business-park
[74] PC Urban - http://pcurban.ca/intraurban-brentwood-burnaby-bc
[75] The Province Newspaper, Evan Duggan - New industrial park to open in Burnaby's Brentwood neighbourhood, June 19 2018

challenging leasing environment. About 80% to 85% of the buyers of the strata industrial units are owner-users, and the balance investors.

Evolution Block in False Creek Flats by PC Urban[76]

> *"Strategically located in the False Creek Flats of Vancouver, Evolution Block is the perfect blend of urban development and industrial density. Evolution Block re-imagines the concept of vertical industrial, proving that what is old can become new again."*

The project is promoted as being well-situated, with quick access to Vancouver's downtown core, surrounding thriving neighbourhoods, major commuter and transportation routes, as well as the Port of Vancouver. The I-2 zoned project includes 104,000 sq ft of industrial and office strata over three storeys. Efficient floor plates with a variety of demising options and abundant glazing mean open and flexible workspaces. Dock and grade loading doors are served by a modern freight elevator system to provide access throughout the building.

IRONWORKS in Port Town East Vancouver by Conwest[77]

> *"From corporate offices, to industrial manufacturing and warehouse facilities, the floor plans of Ironworks' Pandora and Franklin buildings allow for a mix of flexible, functional spaces that work, without sacrificing amenities and with an ambiance that just feels right."*

Promoted as being centrally located in Port Town, the 188,000 sq ft project provides office spaces, mixed with industrial, warehouse and showroom space, within innovative stacked building layouts. Features include freight and passenger elevator, modern design with practical specifications, end-of-trip bike facilities, a common roof deck to enjoy views, and ample retail and restaurants within walking distance.

34 W7 in Mt. Pleasant by Chard Developments[78]

> *"Own a space that reflects your progressive brand. Own in Vancouver's hottest neighbourhood. Invest in the location. Enjoy the amenities and accessibility. Own a space that's designed to work for you and your team."*

The project is marketed as high-quality work space and largely office style floor plans, with the ground floor having 17 ft ceilings and dock loading. The project also has many amenities and features, such as architectural and views, with numerous references to lifestyle benefits.

Coverage of the project in the media[79] refers to the project as having units at grade for light industrial users, with offices suitable for tech companies on the upper levels. The developer states: "We're really trying to play on that and get the creative class to be in the area."

The Lightworks Building in Mt. Pleasant by PC Urban[80]

> *"A multi-purpose business hub that would attract visionary entrepreneurs and build on the City's vision for Mount Pleasant ... a larger, modern commercial building, integrated with a restored historic façade that would connect the past and the future of Mount Pleasant in a relevant and meaningful way."*

[76] PC Urban - http://pcurban.ca/evolution-block-vancouver-bc
[77] Conwest - http://ironworksvancouver.com
[78] Chard - http://34w7.com
[79] Business in Vancouver, Peter Mitham - Strong demand brings industrial strata to Mount Pleasant area, February 14 2017
[80] PC Urban - http://lightworksbuilding.com

The redevelopment of the historic building includes 54,000 sq ft of workspace in a six storey structure: 7,200 sq ft of ground floor commercial, four storeys of office with 11,700 sq ft floor plates, two levels of parking and loading, accessible from the rear lane offering covered and secured parking.

The project is within the I-1 zone, however includes a Heritage Revitalization Agreement which changes the normally required use allocation, i.e. less than 1.0 FSR for industrial, and more than 2.0 FSR for office.

The Maker Exchange @ 488 Railway in Railtown by Rendition Developments[81]

> *"Ideally situated in the centre of Railtown, the Maker Exchange is an innovative eco-system, where progressive thinkers and skilled makers converge over business."*

The office/retail spaces will be home to technology, digital media, content creation, advanced and traditional manufacturing, rehearsal studios, as well as showroom and retail/restaurant space.

The project is promoted as having exceptional views of the waterfront and mountains, soaring ceiling heights and premium finishes, with meeting spaces for collaboration. The project includes: 152,000 sq ft of workspace, seven floor plates from 12,188 to 27,500 sq ft, multiple common areas, and efficient elevators.

As reported in the media and stated by the listing broker[82], land values are lower in Railtown than in Mt. Pleasant, and higher zoning density translates into a less expensive cost per sq ft of commercial space.

[81] Rendition - http://renditiondevelopments.ca/portfolio/the-maker-exchange
[82] Western Investor Frank O'Brien - Developers making tracks to Vancouver's Railtown, February 14, 2018