THE GLOBE AND MAIL
Tuesday, February 21, 2012

Property Report

Virtual buying pushes warehouses to new heights

Construction of vast high-ceiling distribution centres, like Best Buy's, follows online retail trends

By Chris Atchison

If the insiders are right, Canada's commercial property market is about to get an industrial-level facelift.

Their prediction: a slew of shiny new 500,000-square-foot-plus facilities will be constructed in the next five to 10 years featuring ceiling heights of at least nine metres, in large part to accommodate high-tech automated materials handling systems.

The reason developers will move toward building more of these large-scale distribution facilities, explains Stan Krawitz, president of Toronto-based commercial real estate consultancy Real Facilities Inc., is tied to changes in the way Canadians are shopping for everything from books to electronics.

In Mr. Krawitz's view, the growth of e-commerce is driving the need for an increased supply of high-tech distribution centres across the country as retail sales move increasingly from the brick-and-mortar model of high-street or mall shopping, to virtual browsing and buying.

"Online shoppers spent about $16-billion in Canada last year," Mr. Krawitz says. "If we look at the U.S. model, where Web sales account for about eight per cent of their retail sales, then you could start to do the math that if we approached eight per cent in Canada, we would need to triple or quadruple the number of distribution-based warehouses we'll need to accommodate that demand.

"Canadians are by definition slower adopters of technology and changes in retail habits, but we do get there."

Demand for those large distribution facilities is also being driven by an influx of space-hungry international retailers such as Target, but Mr. Krawitz stresses that it's largely the growth of online shopping - which is being fuelled in part by an explosion of mobile devices that allow for easy in-store price comparisons and online purchasing - that will push commercial developers to meet the facilities needs of major online retailers.

Market circumstances may be right for a property development boom on the distribution front.

A recent report by commercial property consultancy CB Richard Ellis noted that fundamentals in Canada's industrial property sector remain strong. The firm predicts that availability rates will drop to 6 per cent this year from 6.5 per cent in 2011, while net rental rates will experience a year-over-year increase from $5.37 to $5.45 per square foot. But the strongest growth opportunities - aside from facilities to support the energy sector - are the large, next-generation warehouse properties, the report concluded.

This trend toward building more distribution facilities doesn't mean that traditional manufacturing in this country is dead, according to David Bowden, CEO of commercial property consultancy Colliers Canada. On the contrary, he sees a continued need for highly specialized advanced manufacturing facilities.

"Especially where goods are bulky, we're seeing a return to domestic manufacturing as opposed to having to deal with the cost of shipping those bulkier items such as furniture [overseas]," Mr. Bowden explains. "I think we're going to see a balance between distribution warehousing as well as manufacturing-specific buildings, but the weighting will be towards the former."

What does that mean for the lower-ceilinged stock of industrial buildings that were designed largely for light manufacturing use and simply can't accommodate a distribution-focused conversion? "For some existing stock, it might mean lower rents, but for others the real estate might be cast into entirely different commercial uses," Mr. Bowden says.

Jeff Flemington, a senior vice-president with commercial property brokerage Avison Young Inc. in Toronto, points to Ontario towns such as St. Thomas and Cornwall as examples of former manufacturing centres that are seeing a repurposing or demolition of their old supply of light industrial buildings for other commercial uses. Those former factories are being converted into everything from retail spaces, to residential lofts in the case of trendy turn-of-the-century brick-and-beam buildings.

Even in cases where companies do need traditional manufacturing space, he says, many are opting to build new facilities rather than upgrade older stock due in large part to increased relocation costs as land prices continue their steady climb.

As Mr. Flemington points out, firms are not only looking for industrial space with everything from higher ceilings to accommodate their high-tech racks and materials handling systems, but also larger loading docks and secured yards to meet U.S. customs requirements.

Just don't expect to see this trend playing out in downtown Vancouver or Toronto. Expensive land and higher tax rates will mean a proliferation of distribution centres in the suburban areas surrounding Canada's largest cities.

"Those areas that have the infrastructure in place will benefit the most, such as the Greater Toronto Area," Mr. Flemington explains. "The reason is you have a significant intermodal presence with the CN and CP rail yards, you've got major highways, relatively abundant land, and this is where most of the population is."