FIERA REAL ESTATE

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Small Bay, Big Potential: Unlocking Canada's Industrial Underdog

The Introduction & Key Highlights

The Canadian industrial market is vast, but not all assets are created equal. While large-scale distribution centres and logistics hubs often steal the spotlight, it is the Small Bay segment, generally characterized by industrial properties 50,000 square feet ("sf") or less, that quietly powers the backbone of Canada's economy. This segment is driven by rapid population growth and the essential businesses that sustain local communities. Representing approximately 30% of total industrial inventory, these spaces serve industries that remain resilient throughout economic cycles.

Small Bay industrial has five key pillars that underpin its strong investment fundamentals: *non-cyclical tenant nature, strong demand, hardened income streams, persistent supply shortages, and lack of institutional ownership.* With population growth fueling leasing activity and a projected 3 million sf supply deficit over the next five years, the sector is primed for rising rents and valuations.

However, institutional investors have largely overlooked Small Bay industrial properties in part due to scale constraints, leaving a fragmented market ripe for professional management and value creation. As the fundamentals continue to tighten, this segment stands out as one of the most mispriced yet resilient investment opportunities in Canadian real estate. Simply put, Small Bay is nearing a catalyst moment – one where its valuation gap relative to larger industrial assets and replacement costs must close. If not, the pressure will only build, creating even greater upside potential. Savvy investors recognize this imbalance and are capitalizing on elevated income returns while awaiting the inevitable repricing to more stabilized valuations.

Profile Of The Total Canadian Industrial Market

Before zooming in on the Small Bay industrial segment, it is useful to first understand the inventory profile of the Canadian industrial market. Using CoStar's data from February 1, 2025, Canada's total industrial market is approximately 2.4 billion sf – composed of 30% Small Bay and 70% Non-Small Bay.

Figure 1 – Canadian Total Industrial Inventory Profile (2.4 Billion sf)[1]

	Small Bay (<=50K sf)		Non-Small Bay (>50K sf)	
Industrial Use	Size (sf)	% of Segment	Size (sf)	% of Segment
Distribution	31M	4%	299M	18%
Warehouse	386M	54%	715M	43%
Manufacturing	124M	17%	356M	21%
Truck Terminal	5M	1%	7M	0%
Food Processing	7M	1%	32M	2%
Refrigeration/ Cold Storage	2M	0%	16M	1%
Service	70M	10%	30M	2%
Showroom	14M	2%	11M	1%
Telecom Hotel/ Data Hosting	1M	0%	8M	0%
Other	77M	11%	191M	11%
Total	**717M**	**100%**	**1,666M**	**100%**
% of Total Industrial Stock	**30%**		**70%**	

Pillar 1 – Small Bay Industrial Has Less Cyclical Demand, Lowering Its Investment Risk

A key metric in real estate is *net absorption*, which measures the space that becomes occupied less the space that becomes vacant. Historically net absorption is a key indicator of shifts in demand which can help identify the impact of market cycles. Using the quarterly changes in net absorption, dispersion can be calculated for both the Small Bay and Non-Small Bay segments in the following formula:

Dispersion = (Largest Net Absorption Quarter – Smallest Net Absorption Quarter) / Standard Deviation of Quarterly Net Absorption

Lower scores show less dispersion of demand and are therefore more predictable or defensive. Higher scores show more dispersion and more cyclicality. Not surprisingly, these were the results, confirming Fiera Real Estate's thesis:

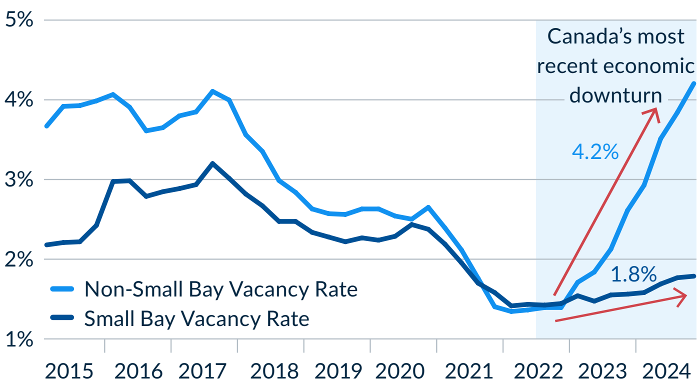
Figure 2 – Cyclicality Measures (Dispersion) by Segment from Q1 2015 to Q4 2024[2]

Small Bay (<=50,000 sf)	Non-Small Bay (>50,000 sf)
Measure	Measure
4.07	4.26

The Small Bay segment has shown less historical dispersion in its quarterly net absorption over the last 10 years relative to the Non-Small Bay segment. Demand is more stable and predictable, anchored in strong tenancy and real estate fundamentals, which has in turn lowered its investment risk relative to other segments or real estate sectors.

For example, heating, ventilation, and air conditioning ("HVAC") repair companies and plumbing supply distributors, such as Wolseley Canada, require Small Bay properties to house inventory and service equipment.[3] As a result, investors in Small Bay industrial assets benefit from lower turnover rates and consistent rental income. Unlike Non-Small Bay industrial properties that are more dependent on global trade patterns and supply chain dynamics, Small Bay industrial spaces are well-designed to serve local businesses that provide essential goods and services given their small unit sizes and close geographic proximity to population hubs. These characteristics make the sector far more resilient during economic downturns and in the face of the current trade wars. The period from Q1 2022 to Q4 2024 provides empirical evidence of this resilience (**Figure 3**).

Figure 3 – Small Bay is More Defensive During Economic Downturns[4]



While Canada's overall economic growth slowed significantly due to rising interest rates and inflationary pressures, Small Bay industrial vacancy rates remained stable, moderately rising from 1.4% to 1.8%. Non-Small Bay, on the other hand, experienced a noticeable weakening as its vacancy rate rose from 1.3% to a more balanced 4.2%. This segment faced a period of softening demand as e-commerce growth plateaued[5] and global trade headwinds intensified. The divergence underscores the defensiveness of the Small Bay segment, positioning it as a favourable segment amid economic volatility due to its inherently lower investment risk profile.

Pillar 2 – Small Bay Industrial Has Strong Demand

The Backbone of Canada's Core Economy

Small Bay industrial real estate is vital to Canada's core economic framework, providing critical space for manufacturers, wholesalers, service providers, and other essential businesses. Unlike Non-Small Bay industrial properties, which cater to logistics giants and large distribution centres, Small Bay industrial assets accommodate a diverse tenant base, including:

- Durable home goods manufacturers, wholesalers, and service providers that rely on Small Bay spaces for light manufacturing, local warehousing, and distribution.
- Automotive parts suppliers and service centres lease Small Bay industrial units for distribution and service operations.
- Service providers and quasi-retail businesses, including local gym chains, flooring showrooms, and last-mile distribution hubs, leverage Small Bay's lower rents as a cost-effective alternative to traditional retail spaces.

Resultingly, there has been very strong historical demand for well over a decade:

Figure 4 – Small Bay Industrial Gross Absorption % of Inventory[6]

Small Bay (<=50,000 sf)	
Q1 2013 - Q4 2024	
Gross Absorption (sf)	187,662,460
Total Inventory (sf)	717,504,577
Gross Absorption % of Total Inventory	**26.9%**

Over 187 million sf was absorbed on a gross basis in the Small Bay segment from Q1 2013 to Q4 2024, which represents 26.9% of its current inventory (**Figure 4**). This raw measure of demand excludes space vacated, sublet space, and lease renewals, unless a lease renewal includes the leasing of additional space – the additional expansion space is then counted in gross absorption.[7] The 26.9% figure eclipsed Canada's population growth of 18.9% over that same time period.[8]

Population Growth is a Key Underlying Demand Driver

Canada boasts the fastest-growing population among the Group of 7 ("G7") nations,[9] driven by robust immigration policies and strong urban expansion. The country added nearly 2.2 million new residents in 2022 and 2023 combined, fueling demand for local services.[10] Even with reduced non-permanent resident ("NPR") targets,[11] demand for essential services is likely to remain elevated, sustaining Small Bay industrial real estate occupancy. Unlike other commercial real estate sectors that experience fluctuations based on economic cycles, *Small Bay industrial demand is closely tied to population growth*. A growing population increases demand for the diverse businesses typically found in Small Bay industrial spaces.

Figure 5 – Small Business Formation from Population Growth is Correlated to Small Bay Net Absorption

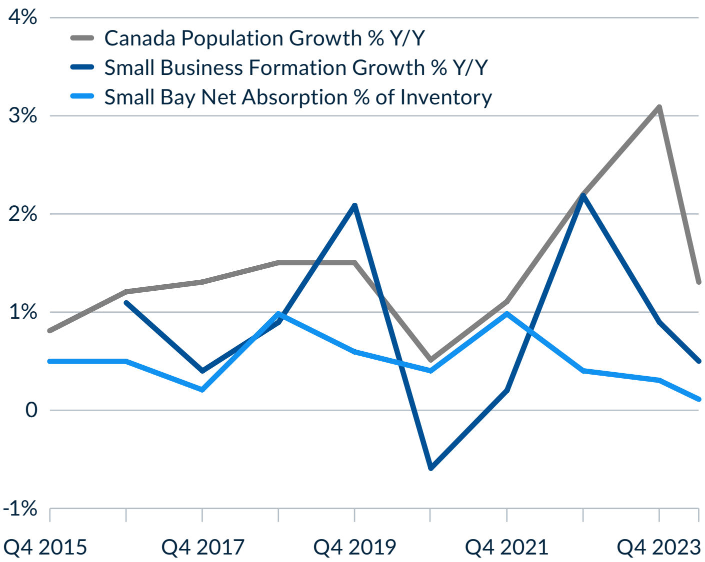


Figure 6 – Population Growth vs. Small Bay Net Absorption, Last 10 Years (Q1 2015-Q4 2024)

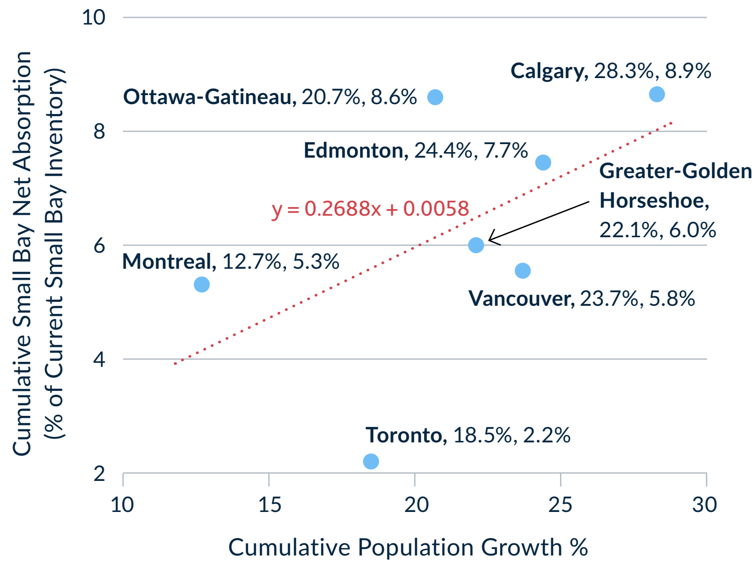


Figure 5[12] depicts the strong correlation among Canada's population growth, small business (less than 20 employees) formation, and Small Bay net absorption as they tend to ebb and flow together over time. This observation strengthens the thesis that Small Bay net absorption is closely tied to small business formation from population growth, reinforcing these as more foundational leasing drivers than the Canadian economic cycle. If population growth and small business formation are the underpinning drivers, this would suggest that Small Bay tenants are more "local" or insulated from global trade, which is a key advantage given the uncertainty of how long existing United States trade tariffs will be kept in place.

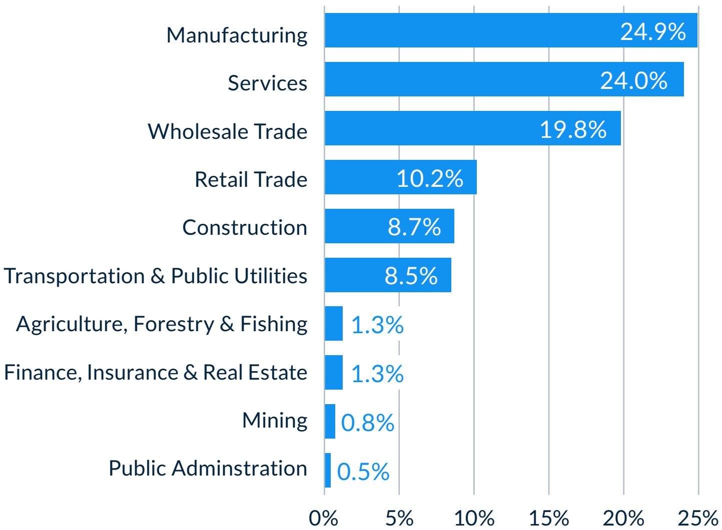
Figure 6[13] shows further nuanced proof by Canada's major industrial markets that population and Small Bay net absorption are positively and closely linked. As shown in **Figure 6,** Calgary has grown its population the fastest (28.3%) in the last 10 years, which translated to the greatest Small Bay net absorption. Toronto's population grew by 18.5% (second last) and experienced the weakest Small Bay net absorption percentage of its inventory – although it is the largest Small Bay market by far, making it difficult to move the needle on a percentage basis. Logically, access to growing population clusters bodes well for Small Bay demand. The trendline and its equation illustrates the positive relationship here. Remember this **Figure 6** equation which can be titled "Population Regression Demand Forecast for Small Bay", as it will be referred to later. To sum up this section, Canada's robust population growth has and will likely continue to remain a fundamental driver of strong Small Bay demand.

Pillar 3 – Hardened Income – Small Bay Industrial Is Multi-Tenanted With Leasing Depth & Shorter Weighted-Average Lease Terms

Multi-Tenanted, Strong Leasing Depth, and Velocity

Small Bay tenants are typically engaged in industries that fulfill essential consumer needs, such as home maintenance, auto repairs, and local logistics. Each property is usually multi-tenanted as well, which adds a level of income diversification, in case a tenant turns over. Looking at Canada's industrial leasing deals under 10,000 sf from 2015 to 2024 (**Figure 7**), there were well over 20,000 leases inked compared to just over 2,000 leases completed over 50,000 sf (more typical of mid-to-large bay properties). With nearly 10 times the leasing depth and its multi-tenanted nature, Small Bay properties are more *income hardened* or diversified than the rest of the industrial universe providing lower investment income volatility. The marginal leasing occurring in the under 10,000 sf segment in Canada is as follows (**Figure 7**):

Figure 7 – Small Bay Tenant Industries[14] (Lease Deals 10,000 sf or less from 2015-2024)



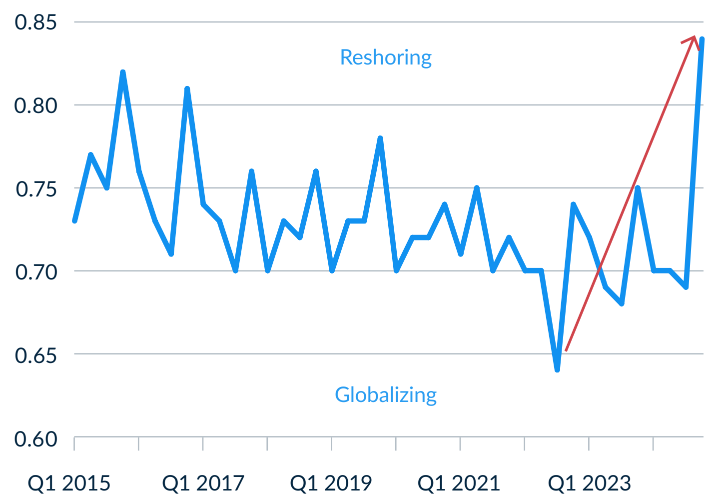
Over the past decade, the largest marginal lessors in this segment have been manufacturing, services, and wholesale trade. Small Bay manufacturing supports light production and small-scale assembly operations.[15] Service-based tenants thrive in metro-centric locations, where land scarcity limits new Non-Small Bay supply. Finally, wholesale trade users typically operate as "infill" or "last-mile" facilities, bridging the final supply chain gap.[16] This diverse tenant mix strengthens the Small Bay ecosystem. As concluded earlier, small businesses (less than 20 employees) are integral to Canada's economy, comprising 87% of all employer businesses and employing 5.2 million individuals, which accounts for 30% of the total labour force.[17] The current trade war is creating short-term uncertainty for small businesses, but this is expected to ease once further clarification is provided. Resultingly, Small Bay tenants offer landlords a more resilient income stream than large bay single-tenant facilities, where outcomes are more binary and limited leasing depth and velocity can delay income recovery when vacancies occur.

Reshoring May Fuel Increased Leasing Depth

The United States ("US") has beat Canada to the punch for investing in its domestic manufacturing after the pandemic supply-chain shocks during 2020 and 2022. To date, the US Commerce Department has announced over $30 billion in proposed private sector investments via the *Creating Helpful Incentives to Produce Semiconductors ("CHIPS")* Act, spanning 23 projects in 15 states with the intention to create over 115,000 manufacturing and construction jobs across the country.[18]

In August 2022, the Royal Bank of Canada ("RBC") released a report about how Canada was lagging in its own "manufacturing renaissance."[19] Today, however, similarly to south of the border, Canada also looks to be substantially *reshoring* (manufacturing more of its economic inputs at home) for the first time in 10 years, possibly due to more persistent threats of global trade wars, recently ignited by the Trump Administration (**Figure 8**).

Figure 8 – Ratio of Manufactured Exports to Imports ($ Volume)[20]



If small, local manufacturers are pressured to expand the scope of their volumes to provide other Canadian businesses with vital components that used to be available from US producers, reshoring may add a boost to local manufacturer operations in the Small Bay segment as well.

Shorter Weighted Average Lease Term Helps to Protect Against Inflation

Of the referenced Small Bay lease deals in **Figure 7**, the weighted average lease term ("WALT") was 3.5 years, compared to 7.2 years for deals over 50,000 sf. Small Bay properties also stay vacant for a shorter window of time (5.1 months on average compared to 9.1 months) relative to Non-Small Bay properties, highlighting the benefits of *leasing velocity* and the resulting shorter downtime in this segment.

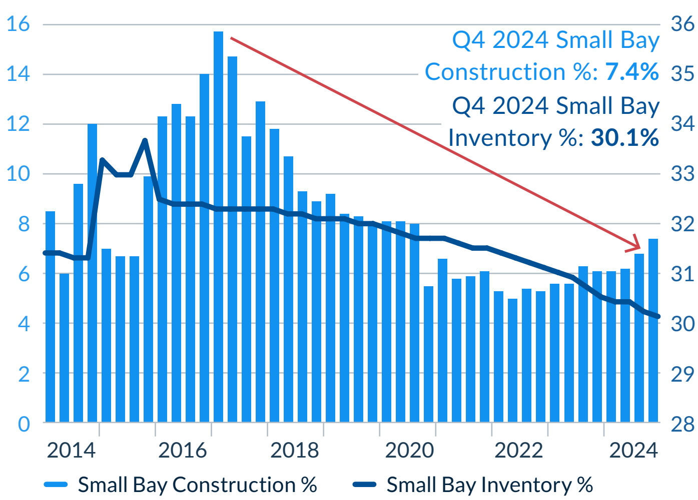
Herein lies another overlooked benefit of the Small Bay industrial segment – if inflation remains structurally higher in the 2020s relative to the 2010s, a shorter WALT allows landlords to adjust rents more frequently, capitalizing on market increases and enhancing property values. Shorter lease terms also provide strong inflation protection, preventing rent stagnation seen in long-term fixed leases. All of this points to shorter WALTs as a key strategic advantage in the evolving macroeconomic landscape in 2025 and beyond.

Pillar 4 – Small Bay Industrial Has Persistent Lack Of Supply

Small Bay Industrial Rental Receives Limited New Development

Despite strong incremental demand linked to Canada's robust population growth, the supply of Small Bay industrial properties remains critically constrained. **Figure 9** below shows that the Small Bay industrial segment used to represent 33% of the total industrial stock in 2015 but has since fallen to 30%.

Figure 9 – Small Bay % of Inventory & % of Under Construction[21]



The main reason is that there has been a secular decline in the proportion of Small Bay industrial product as a percentage of total industrial construction. Larger bay sizes have been the development targets as e-commerce continues to drive the need for more warehouse and distribution space. This same story is playing out across the major US industrial markets of Chicago, Dallas, Los Angeles, New York, Atlanta, and Houston. In these markets, Small Bay vacancy rates are much tighter than their Non-Small Bay peers because they represent 28% of these total markets but only 8% of the current new supply.[22] This North American trend is even more pronounced in Canada, where Small Bay industrial's share of new construction peaked at 15.7% in Q1 2017 but has since remained constrained, fluctuating between a mere 5 to 8% over the past five years:

Several factors have contributed to this issue:

- **Values Below Replacement Cost:** The construction costs associated with developing Small Bay industrial assets often exceed the market value of existing properties, making speculative development unattractive.
- **Lack of Available Land:** Prime industrial land in major metropolitan areas is scarce and typically reserved for larger distribution centres.
- **Preference for Industrial Condos:** Developers are increasingly favouring industrial condominiums over Small Bay rental properties due to the higher profitability of selling units to owner-occupiers rather than leasing them. Projects like Heart Lake Industrial Condominiums, a joint development by Fiera Real Estate and Berkshire Axis in Brampton, Ontario[23], demonstrate this shift, as units sell for premiums compared to traditional lease rates. According to CoStar, industrial condominiums account for just 1.0% of total stock in Canada yet have captured $2.3 billion (4.7%) of total industrial sales volume from 2015 to 2024, significantly outperforming their market share. Additionally, with 555,000 sf currently under construction – representing 16.8% of the total Small Bay development pipeline – it's clear that developers favour industrial condominiums relative to its inventory proportion[24], which is cannibalizing the new supply of Small Bay industrial rental options.

The factors outlined above have collectively led to a supply shortage struggling to meet rising demand. To underscore this point, investors should consider replacement cost relative to market value. This key metric is currently prohibitive for new development.

Figure 10 – Replacement Cost Estimates for Small Bay Industrial Markets

	Land Costs per Buildable SF[25]	Hard Costs[26]	Soft Costs	Total Replacement Cost (PSF)	Market Sale Prices (PSF)[27]	Market Value vs. Replacement Costs %
Small Bay Industrial	*50% Coverage Ratio		*25% of Hard Costs			
Vancouver	$230	$343	$86	**$659**	**$526**	**80%**
Calgary	$34	$300	$75	**$409**	**$214**	**52%**
Edmonton	$31	$300	$75	**$406**	**$190**	**47%**
Winnipeg	$26	$295	$74	**$395**	**$147**	**37%**
Toronto	$138	$330	$83	**$551**	**$414**	**75%**
Ottawa	$51	$305	$76	**$432**	**$220**	**51%**
Montreal	$87	$300	$75	**$462**	**$200**	**43%**
Halifax	$39	$288	$72	**$399**	**$166**	**42%**
TOTAL				**$464**	**$260**	**56%**

Using extremes to inform the means, with every market showing a discount to replacement cost, the suggested remedy would be that Total Replacement Costs must fall 44% to Market Sales Prices or Market Sale Prices must rise 78% to Total Replacement Costs. Given there are now new tariffs in place on steel and aluminum, labour shortages for skilled trades in Canada, and given the strong fundamentals that were revealed throughout this paper, it is more likely that Market Sales Prices will dramatically rise to do the heavy lifting.

Impact of Supply Shortages on Market Dynamics

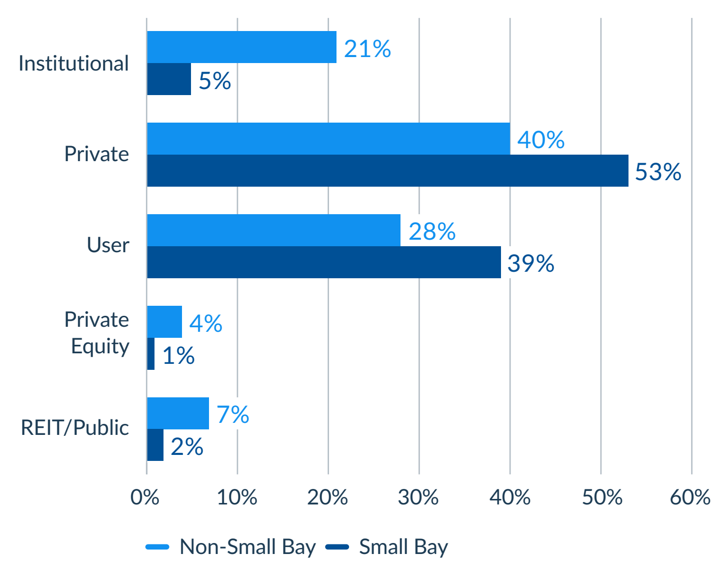
Chronic lack of supply has contributed to the national market asking rent for Small Bay space growing from $8.37 per sf in Q1 2015 to $17.52 per sf in Q4 2024, a staggering 7.9% annualized growth.[28] For tenants, this creates challenges in securing affordable space, while for investors, the constrained supply ensures strong pricing power and minimal vacancy risk. Unless development economics shift in favour of new supply, the structural undersupply of Small Bay industrial properties will persist, further reinforcing the sector's value proposition.

Pillar 5 – Small Bay Industrial Is Mismanaged And Mispriced

Institutional Absence Creates Opportunities

Unlike Non-Small Bay industrial real estate, which attracts institutional investors due to scalability and capital deployment efficiency, Small Bay assets remain largely in the hands of Privates and Users (~92% combined for Small Bay) – see **Figure 11**.

Figure 11 – Ownership Profile by Industrial Segment[29]



This ownership structure results in a fragmented market that is often mismanaged and mispriced, presenting significant opportunities for professional investors who understand the sector's nuances.

Potential for Institutional-Level Management

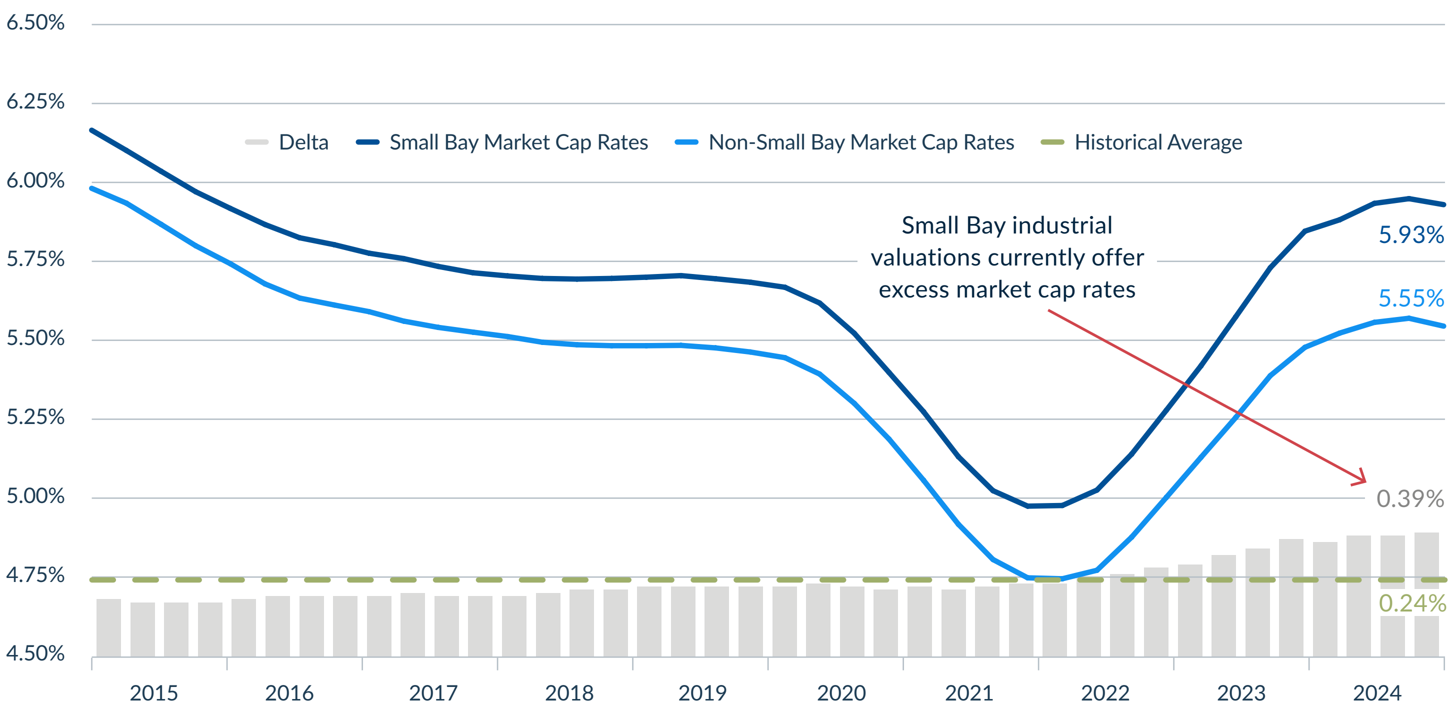
Applying institutional asset management strategies to Small Bay industrial properties presents a compelling value opportunity.

Many of these assets are second-generation or older stock, requiring capital investment and strategic planning to extend their lifespan and maximize returns. Institutional investors can drive value through enhanced property management, optimized lease structures, and strategic repositioning, attracting tenants willing to pay premium rents. Over time, these improvements could reignite institutional interest, elevate valuations, and spur new development, positioning investors to capture market-rate rents and unlock the full potential of this overlooked asset class.

Small Bay is Mispriced

At a valuation level, mispricing and bifurcation exist between Small Bay and Non-Small Bay properties in Canada. **Figure 12**[30] uses market capitalization rates from CoStar as an indicator of valuations and shows that currently, Small Bay industrial offers 0.39% of excess market cap rate over Non-Small Bay compared to its historical average premium of 0.24% from 2015 to 2024. Given the segment's strong fundamentals, the market cap rate premium is expected to compress over time as institutional investors increasingly recognize its value. This would be beneficial for first-mover investors.

Figure 12 – Small Bay vs. Non-Small Bay Relative Valuations – Market Capitalization Rates



The Math – Will The Market Balance Over The Next 5 Years?

This paper highlights the numerous investment characteristic benefits of the Canadian Small Bay Industrial market. It further connects population growth as the primary driver of Small Bay leasing demand, while market valuations below replacement cost remain the key barrier to new supply. By using this framework, one can assess the likelihood of continued supply-demand imbalances, which may grow rents and valuations, potentially aligning with replacement costs in the coming years.

According to Oxford Economics, Canada's population is expected to grow by 0.6% annualized over the next five years to the end of 2029, or 3.04% cumulatively. Fiera Real Estate believes anchoring off population growth is the more logical connection here. Therefore, if the Population Regression Demand Forecast for Small Bay equation in **Figure 6** is utilized, the projections are:

Figure 13 – Calculating Small Bay Industrial Demand vs. Supply Over the Next 5 Years

NEW DEMAND
FRE Calculation – Population Regression Demand Forecast for Small Bay (see Figure 6):
Y = 0.2688X + 0.0058

X = Cumulative Population Growth Next 5 Years
= 0.6% per year as per Oxford Economics
(3.04% cumulative over 5 years)
= 41,465,298 x 3.04% = 1,260,545 new people

Y = Cumulative Small Bay Demand sf
= (0.2688 x 3.04%) + 0.0058
= 1.4% more demand = 1.4% x 717 million sf
= 10.0 million sf

Calculation	Data Point	Q4 2024	Q4 2029F	Annualized Δ%
–	A. Canada Population [Statistics Canada & Oxford Economics][31]	41,465,298	42,725,843	0.6%
B+E	B. Small Bay Industrial Inventory (sf) [CoStar][32]	717,504,577	724,420,199	0.2%
B/A	C. Small Bay Industrial Space per Capita (sf)	17.3	17.0	-0.4%
–	D. Small Bay Cumulative Net Absorption (sf) [Fiera Real Estate][33]	–	10,000,000	
–	E. Small Bay Industrial Cumulative Net Deliveries to Inventory (sf) [CoStar][34]	–	6,915,622	
E-D	F. Small Bay Industrial Supply Deficit (sf)	–	**-3,084,378**	

A Small Bay industrial supply deficit of 3 million sf is projected over the next five years. With this segment already experiencing a sub-2% vacancy rate, the anticipated deficit – representing over 0.4% of current stock – should act as a catalyst for rent and value growth, aligning with replacement costs to help close persistent supply gaps. Reshoring momentum could accelerate the cumulative net absorption, but conservatively, no adjustments were made for this early trend that may or may not materialize substantially over the next five years, especially given the duration uncertainty that tariff policies are causing. Furthermore, land scarcity near major population clusters, such as the Greater Toronto, Montreal, and Vancouver areas, will continue to create significant constraints, making it increasingly difficult for supply to keep pace in a meaningful way. The Small Bay industrial segment continues to demonstrate strong fundamentals, with investors benefiting from its historically wide cap rate premium over Non-Small Bay assets. *As demand continues to outpace supply, the cap rate spread and discount to replacement costs will need to narrow to incentivize new development—meaning existing investors stand to earn excess income and capital returns until market normalization.*

The Conclusion – Small Bay, Big Potential

Canada's Small Bay industrial market is not just resilient – it is a rare opportunity to generate strong income while unlocking long-term value. With a recession-resistant tenant base, multi-tenant diversification, and rapid leasing velocity, investors should continue to benefit from a superior, inflation-protected yield as market inefficiencies correct towards a more stabilized equilibrium.

Institutional capital has mispriced and overlooked this segment, creating a historically wide cap rate premium over Non-Small Bay assets and a valuation discount to replacement cost. Yet, with rising demand and constrained new development on the near horizon set to drive a 3 million sf supply deficit, savvy investors recognize this imbalance and are capitalizing on elevated income returns while awaiting the inevitable repricing higher.

Fiera offers exposure to this Small Bay opportunity through its *Fiera Real Estate Industrial Fund*. To learn more about our fund and how we navigate these market dynamics, please visit: https://ca.fierarealestate.com/strategies/small-cap-industrial-fund/

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Endnotes

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