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Real estate vulnerable to Canada-U.S. trade war

High-rise development and warehouse/distribution space in line for fallout
Friday, June 1, 2018
By Barbara Carss

High-rise development is expected to be the hardest hit real estate activity in an unfolding Canada-U.S. trade war, but fallout across a wider range of consumer goods has potential negative implications for commercial warehouse and distribution facilities. Industry advocates estimate a 25 per cent surtax on construction steel manufactured in the United States — to match the tariffs the U.S. government has imposed on Canadian steel products as of today — could translate into a double-digit increase in total building costs.

"The Canadian government has to retaliate. There is no question about that," observes **Richard Lyall, president of the Residential Construction Council of Ontario (RESCON)**. "But it can retaliate on different things that aren't so damaging to the housing sector."

A list of nearly 130 products that could carry new surcharges as soon as July 1 was posted for public comment on the Department of Finance website yesterday afternoon, following a day of discord in neighbourly relations. That began when U.S. Secretary of Commerce Wilbur Ross confirmed his country would exact a 25 per cent tariff on steel and a 10 per cent tariff on aluminum imported from Canada, Mexico and the European Union.

Justification for the actions, which in most circumstances would contravene international trade rules, was set out in two reports the Department of Commerce released in mid January. They maintain steel and aluminum imports weaken the internal economy of the United States and pose a threat to national security. Canadian officials and at least 25 U.S. industry associations reject that supposition.

Earlier this year, those associations — which represent many major players in the manufacturing, agricultural and food services sectors — voiced their concern in a letter to Commerce Secretary Ross and U.S. President Donald Trump. They noted that "downstream users" of the imported products employ significantly more workers than the steel and aluminum sectors, and argued that tariffs would increase production costs, divert funds away from investment in innovation and likely trigger retaliatory measures that would be hurtful to the U.S. economy.

Flow-through penalty for condo buyers

Business and consumers' groups on this side of the border are now contemplating the same scenarios, arising from Canada's notice of intent for CAD $16.6 billion worth of "surtaxes or similar trade-restrictive countermeasures" on steel, aluminum and "other products". The list

posted yesterday includes 44 steel products subject to a 25 per cent surtax and 84 other products, which would carry a 10 per cent tariff. "The Government is also considering whether additional measures may be required," it states.

Lyall foresees homebuyers will be the ultimate losers. The flow-through cost penalty will be greatest in the housing type that has, until now, been seen as most affordable. It could also undermine housing supply at a time when the inventory of new units is already trailing demand in cities like Toronto.

"The implications for rebar translates into a huge cost increase, well into the double digits on development," he projects. "This would push some projects that are on the edge now into the cancellation zone."

Earlier in the day yesterday, he had been hopeful that retaliatory measures would be similar to the response, last year, when the Canadian International Trade Tribunal concluded that the U.S. was dumping drywall in Canada, but that imposition of punitive tariffs would be damaging to Canadian interests.

"They tempered their response because of the impact that it would have on the housing sector," Lyall recalls. "This is exactly the same thing."

Potential damper on light industrial performance

A potential chill in the cross-border trade of consumer goods comes at a time when industrial real estate is delivering impressive returns for investors in both Canada and the United States. MSCI's recently released summary of 2017 investment results in 25 countries, encompassing 85 regional markets, identifies the United States, the United Kingdom and Italy as the three countries where "outperformance was most notable" for directly held industrial assets.

Companies in the U.S. property index saw a 14 per cent return on industrial properties versus an average total return of 7 per cent across all properties. Industrial properties delivered a 10.2 per cent total return, on average, to the portfolios participating in the Canada Property Index versus an average total return of 6.7 per cent across all properties.

"The industrial sector has benefited from changing consumption patterns and the growth of e-commerce and logistics. Demand for warehousing and distribution solutions has helped drive industrial performance," Bryan Reid, MSCI's vice president of global real estate research, concludes.

"Consumer goods distribution is the main driver behind the industrial sector's recent outperformance in Canada," concurs Carl Gomez, senior vice president, research and strategy, with QuadReal Property Group. "You can't help but worry that the spirit of this tariff is a step in the wrong direction for supporting industrial demand's long-term prospects."

Notably, Calgary was alone among the 85 global cities that MSCI tracks in suffering an overall loss on value in 2017 — registering a negative total return of 0.3 per cent. Yet, industrial

properties helped to pull up that average against the far more significant loss of value for office buildings.

“One of the only positive aspects of the downturn is that we have emerged as a logistics and transportation hub,” says Lloyd Suchet, executive director of the Building Owners and Managers Association (BOMA) of Calgary. “If you drive to the industrial outskirts of Calgary, you really see this surge of brand new facilities.”

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