SkyPoint Market Overview

Analyzing the current macroeconomic environment is the foundation for all of SkyPoint's research

Historical Performance of Toronto Multifamily

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Getting Started

"Since the start of the millennium, Toronto condo prices have marched steadily higher (outside of a brief dip during the recession), averaging yearly gains of 4.6% and beat the more volatile TSX." notes BMO senior economist Sal Guatieri.[1] Over the past decade and a half, Toronto multifamily properties have become some of the most stable real estate assets in North America. These properties offer investors stable cash flows and the potential for large capital appreciation (Figure 1).

Mr. Guatieri also notes that investors in condos/apartments have experienced less volatility than shareholders over the last 15 years. Strong economic fundamentals coupled with Canada's low inflation environment have a resulted in a decade long rally for condo/apartment investors.

Figure 1: Toronto condo/apartment prices vs. TSX Index

Source: BMO Nesbitt Burns

In 2016, the primary rental market indicators in the Greater Toronto Area (GTA) remain favourable. Strong economic growth in the region and international immigration are providing robust demand for rentals. In addition, limited growth in the supply in recent years has vacancy rates at record lows. Historically, Toronto multifamily properties have performed outstanding relative to other real estate classes and the broader bond and equity markets. As Canada's largest city, Toronto has a strong economy that is poised to experience tremendous growth in the future. Past government legislation to protect over 1.8 million acres of land surrounding the city has severely limited supply and the city's economic conditions are creating robust demand for housing.

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Brief History – Greenbelt Plan

In 2005, the Ontario provincial government created the Greenbelt Plan to protect about 1.8 million acres of environmentally sensitive and agricultural land throughout the Greater Horseshoe Valley (Figure 1) [2]. In fact, the Greenbelt Plan surrounding the City of Toronto is the largest such protection in the world.

Since that time, regional urban planning has focused on land intensification, forcing developers to build upward rather than expand outward. As simple supply and demand dictates, by reducing the supply of land available for development, the Greenbelt Plan resulted in increased land prices. While the Ontario Government's environmental considerations were well intended, the Greenbelt Plan has had a profound impact on the Toronto housing market.

In order for typical single family housing development to remain profitable throughout the GTA, two things had to happen. Either the final sale price had to increase significantly or the land would need to be rezoned for higher density housing. As a result, the price of single detached homes throughout the GTA have skyrocketed and developers focused their attention on the lucrative high-rise condominium market.

Condo investors have outperformed shareholders for the past 15 years while experiencing less volatility

BMO Nesbitt Burns

*In 2005, the Ontario government protects **1.8 million** acres of environmentally sensitive land*

Figure 1: The Greenbelt Plan
Source: Ontario Government

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For the average resident of Toronto, the current home prices are simply not affordable. CMHC forecasts that the required income to own a home in the GTA will be about 30% more than the actual average household income in 2016 and 2017 (Figure 2).

Figure 2: Toronto's housing affordability concerns

Source: Statistics Canada, CMHC Forecast

Consequently, Canada's low interest rate environment coupled with rising home prices has led to record household debt levels.

The ratio of household credit-market debt to disposable income, the key measure of the debt load, rose to 165.4 per cent in the final quarter of 2015. In other words, each household in Canada held more than $1.65 in debt for every dollar of annual disposable income.[3]

The housing affordability issues throughout the GTA, have led to what PwC refers to as the "Rise of the Renters".4 In PwC's Emerging Trends in Real Estate® 2016 report, the authors note that attitudes about renting have changed:

"Renting is no longer seen only as temporary step on the road to homeownership, but as an alternative. Today we are seeing the rise of permanent renters—a new demographic in many Canadain markets, especially as a growing proportion of the population cannot assemble the downpayment for a new home."

This shift in demand to rental housing reflects, amongst other things, millennials preferring to live in the downtown core, but being unable to save enough for a down payment. Improving job prospects for millennials and overall growth in economic fundamentals has also helped to shift rental demand to the high-end segments of the market. In fact, new purpose-built structures and newly completed condominium rental vacancy rates dropped significantly from 3.4% in 2014 to just 1.6% in 2015.[5]

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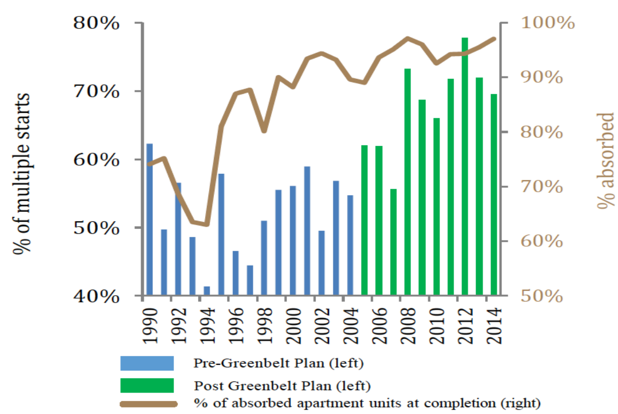
The evolving household

Following the Greenbelt Plan in 2005, developers throughout the GTA began increasingly building high-rise apartment structures in place of single-detached houses (Figure 3). From 1990-2004, the percentage of multiple starts (typically high-rise apartment structure) averaged 53%. Roughly half of the development in the GTA was single-detached homes and half was apartment structure. From 2005-2014, the percentage of multiple starts jumped to an average of 68%. The Greenbelt Plan had a profound effect on what has been developed, changing the ratio of multiple starts to single starts from about 1:1 to 2:1.[6]

Combined with municipal density and height protections, the Greenbelt Plan has led to rap-id intensification of the downtown core.

Combined with municipal density and height protections, the Greenbelt Plan has led to rapid intensification of the downtown core. In addition to intensifying the downtown core, the provincial and municipal governments have set out strategic growth areas throughout the GTA. These growth areas typically surround major transit hubs and allow for high density housing.

Figure 3: The impact of the Greenbelt Plan on Toronto's household type



Source: CMHC, SkyPoint Research

With the demand for housing having never been stronger, the percentage of absorbed apartment units in the GTA is at record levels (Figure 3). This is despite the tremendous change in the composition of building structures from single detached houses to apartment structure.

These record absorption levels suggest a few things about the Toronto housing market. First, the market is accepting of the shift to high-rise living. In fact, between 1996 and 2006, the number of households living in high-rise buildings more than doubled and has been steadily increasing since.[7] What is still unclear is if the market acceptance has been by choice or necessity.

Second, there is a trend towards luxury rentals. Approximately 30% of condos are being used as rentals, earning average rents upward of $1465.8 These condos attract tenants by offering premium amenities such as concierge service, fitness centres, and outdoor terraces.

Finally, there is a trend towards preferring to live in the downtown core. In the GTA, the downtown core commands the highest rents per square foot and also has the lowest vacancy rate. Toronto's downtown core offers an attractive "work, live, play" environment.

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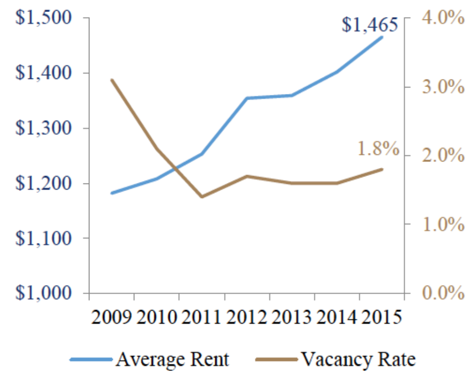
Multifamily vacancy and rental rates

Demand for multifamily purpose-built rental accommodations has been robust over the past few years. Strong rental demand combined with limited growth in supply has driven multifamily vacancy rates throughout the GTA to record lows (under 2%) and as a result, rental rates have been steadily increasing (Figure 4).

Figure 4: GTA average rent and vacancy rate



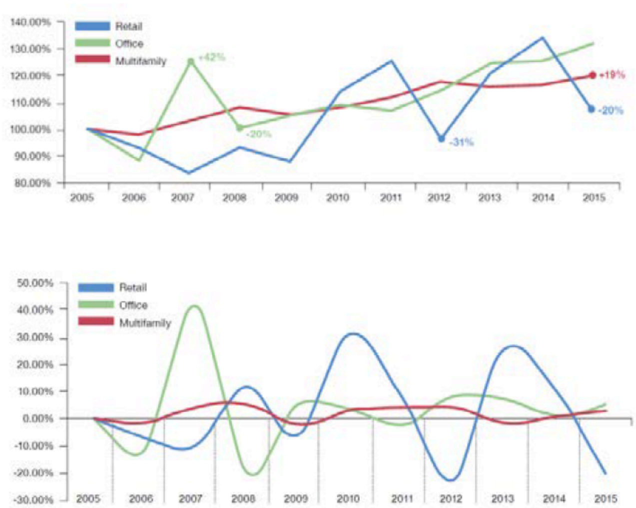
Source: CMHC

Compared to the other real estate classes, Toronto multifamily properties have historically provided greater rental rate stability for investors. This stability reflects the fact that people still need a place to live during tough economic times. When times are tough, people experience increased difficulties coming up with the money for a down payment, creating strong demand for rental housing.

Over the last ten years, multifamily rents have consistently increased, resulting in rents that were, on average, 19% higher in 2015 than a decade prior (Figure 5).[10] Multifamily rental rates have been extremely stable, showing very little year-over-year volatility.

On the other hand, despite strong economic growth in Toronto, retail rental rates have fluctuated more than 30% as recently as 2012 (Figure 5). Office rental rates have shown similar volatility to retail, dropping more than 20% during the 2008 recession. For income producing assets such as real estate, volatility both upward and downward, is an undesirable characteristic.

Figure 5: GTA rental rates indexed to 2005 and year-over-year volatility



Source: SkyPoint, TREB

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Property appreciation

Property appreciation plays an equally important role as rental income in producing strong overall real estate returns. Other than a small dip during the Global Financial Crisis of 2008, multifamily properties in the GTA have significantly increased in value over the past decade.

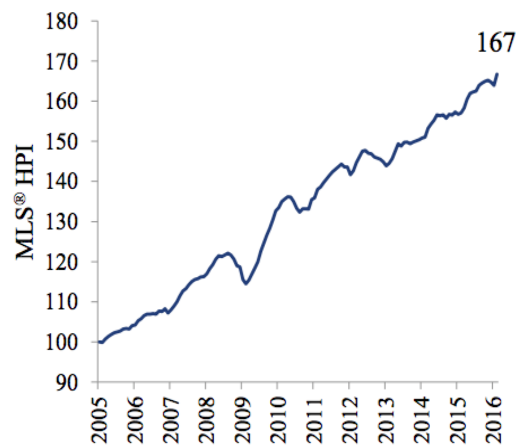
[Since the late 90s] the gain has been approximately double the rise in the TSX equity index. It is hard to think of an asset class that is so widely held by Canadians that has outperformed housing over this time."

TD Economics

Since 2005, GTA multifamily properties have increased in value by an average of 67% or 6% per annum (Figure 6).[11] It is important to note that this property appreciation is supplemental to significant rent appreciation during the same period.

In fact, it appears historically low vacancy rates and significant rent growth has induced more condo owners to convert their properties to rental units. In 2015, the percentage of condos held for rental purposes throughout the GTA edged up to 30%.[12]

Figure 6: MLS® HPI – GTA apartment

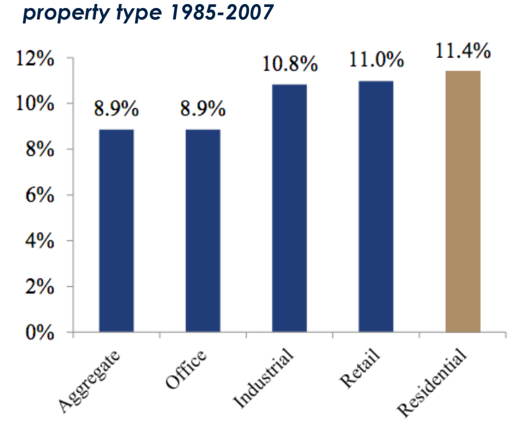


Source: CREA, MLS® HPI

Indeed, a 2008 paper published in the Journal of Real Estate Portfolio Management, found that from 1985-2007, Canadian residential properties had the highest return of any property type, returning an impressive 11.42% per annum (Figure 7).[13]

Residential real estate has created significant wealth for the Canadians who purchased property during that time. For many Canadians, their home or rental property is their single largest asset. Consequently, rising property values and rental rates translates into significant household wealth.

Figure 7: Canadian real estate returns by property type 1985-2007



Source: Journal of Real Estate Portfolio Management

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Housing Bubble?

With significant appreciation in Toronto's housing market, the questions around a housing bubble arise. Toronto's housing market remains fairly balanced despite the many housing market bears, who, for years have been calling Toronto's housing market a speculative bubble.

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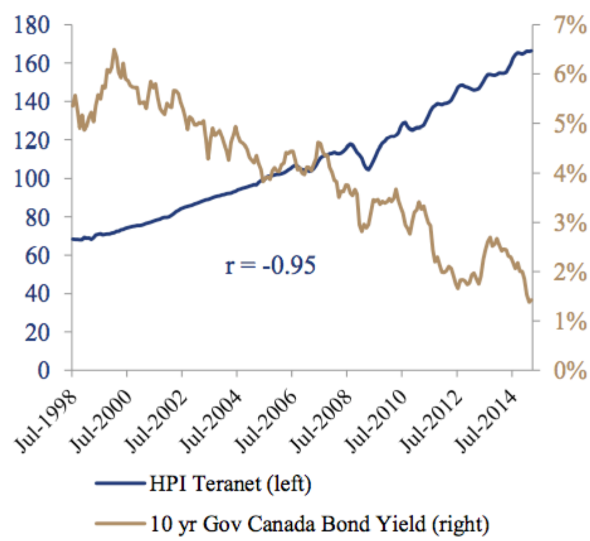
TD Economics

Many of these housing market bears argue foreign ownership and low interest rates have falsely inflated housing prices, completely ignoring the supply side of the equation. It is easy to simply compare interest rates with home prices and spot the glaring relationship (Figure 8). In fact, statistically speaking, interest rate changes account for almost 95% of the movement in housing prices. However, strong correlation is not the same as causation.

While interest rates play an important role in price determination, they are only one part of the equation. Easy access to credit, a strong economy, and healthy The available supply of land for development is limited by legislation such as the Greenbelt Plan, which drives up the price of developable land and forces developers to build upwards. As a result, the supply of single-detached homes is severely limited and prices have risen exponentially.

Figure 8: Housing prices and interest rates



Source: Teranet – National Bank HPI, Bank of Canada

In PwC's Emerging Trends in Real Estate 2016 report, the authors note, "land prices continue to rise, and many believe that provincial government policies are a key factor: greenbelt legislation in Ontario and British Columbia, for example, is limiting land supplies in an effort to promote urban densification. In addition, lengthy approval processes and significant development charges also are limiting supply and driving up costs across the country. And then there are the construction costs themselves, which continue to rise."[14]

Today's housing market in Canada is very much driven by economic fundamentals, despite the amount of media attention given to the "Canadian housing bubble". By ignoring the role that supply plays in price determination, these so called housing market "pundits" paint a bearish picture of a housing market whose prices are driven by some kind of irrational exuberance.

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ENDNOTES

1. *"Toronto condo owners outpacing TSX", BMO Nesbitt Burns*
2. *"Greenbelt Plan", Ontario Government*
3. *"National balance sheet and financial flow accounts, fourth quarter 2015", Statistics Canada*
4. *"Emerging Trends in Real Estate® 2016", PwC and ULI*
5. *"Housing Market Insight Winter 2015", CMHC*
6. *CMHC Data, SkyPoint Realty Partners Research*
7. *"Trends in Housing Occupancy", City of Toronto*
8. *"Housing Market Insight Winter 2015", CMHC*
9. *"Housing Market Insight Winter 2015", CMHC*
10. *Toronto Real Estate Board*
11. *CREA, MLS® HPI*
12. *"Housing Market Insight Winter 2015", CMHC*
13. *"Private Real Estate as an Inflation Hedge: An Updated Look with a Global Perspective", Le Moigne, Vivieros; Journal of Real Estate Portfolio Management Oct-Dec 2008*
14. *"Emerging Trends in Real Estate® 2016", PwC and ULI*

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Inspired living in the heart of Toronto's Entertainment District

40 Widmer is located in the heart of Toronto's Entertainment District. A vibrant neighbourhood, the Entertainment District is home to some of the nation's most iconic landmarks including the CN Tower, Rogers Centre, Air Canada Centre, Princess of Wales Theatre, TIFF Bell Lightbox and many more. It is the city's cultural centre for sports, dining, nightlife, and the arts.

We're not making concessions by making a more traditional, suburban-type condo.

OpArt Lofts is located in the Kerr Village neighbourhood of Oakville, one of North America's fastest growing regions. OpArt Lofts features a stunningly modern design consisting of two, eight-storey towers atop a two-storey podium. Designed by the acclaimed firm of Teeple Architects, two white towers spangled with black-framed windows in jaunty patterns reflect the eye-popping Op Art painting style of the 1960s.

About SkyPoint

SkyPoint Realty Partners (SkyPoint) is the first company to bring institutional grade multifamily real estate investments to Asia. SkyPoint was formed to provide Asian investors access to Class A North American multifamily real estate opportunities. SkyPoint combines macroeconomic fundamentals with local in-depth market intelligence to deliver trusted research on current North American real estate trends and opportunities to the international market.

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