Multi-Residential Investment Review / Third Quarter 2020

Greater Toronto Area

Quick Stats

$575 million
Total GTA multi-residential transaction volume in the third quarter

$331,302
Average price per unit for buildings of 20 units or more – up 8% year-over-year

$2,373
Average monthly rental rate for condominium apartments in the GTA in the third quarter

3.6%
Average capitalization rate across all GTA multi-residential property types

45
Number of investment sales transactions during the third quarter, up from 42 in the previous quarter

The Greater Toronto Area (GTA) multi-residential investment market has shown significant resiliency in 2020, despite the unprecedented economic disruption caused by COVID-19. With an upturn in transaction activity in the third quarter, the market averages close to pre-pandemic levels compared to the same period in 2019. The third-quarter sales volume total of $575 million was a significant improvement compared with the previous quarter's $309-million result, reflecting the pent-up demand from investors who were unable to transact in the second quarter.

That demand is expected to continue through the fourth quarter, and the sector's full-year results in 2020 are forecasted to be strong despite the adverse circumstances of the pandemic – with the potential for new record-setting prices per unit and capitalization rates.

As investors prioritize, the multi-residential sector offers stabilized returns and is expected to attract substantial interest from both institutional and private investors. With rising valuations, more sellers are expected to come to market, motivated to advance their timelines by the potential for changes in capital gains tax regulations.

Cap Rates & Bond Spreads

At the end of 2019, spreads had begun to compress to around 220 basis points (bps), but have widened throughout 2020 as a result of low interest rates. Investment in real estate, and specifically multi-residential assets, remains an attractively priced investment. Investors in the Canadian multi-residential market have focused on primary centres with diversified economies such as Toronto, Vancouver and Montreal, and this might produce ongoing cap-rate compression, indicating that spreads could narrow in the short-to-medium term.

© 2020 Avison Young Commercial Real Estate (Ontario) Inc. All rights reserved. E&OE: The information contained herein was obtained from sources which we deem reliable and, while thought to be correct, is not guaranteed by Avison Young.

2.4%
GTA rental market vacancy rate

The spread shown in the chart below is also a reflection of positive investment conditions such as market confidence, access to financing, a strong market base, substantial available capital, and stakeholders' sentiment that multi-residential offers superior investment security to other asset classes.

Bill 204 – Effective Rent Increase Freeze

The Ontario multi-residential sector has had to adapt to the province's Bill 204, which amended the Residential Tenancies Act to freeze rent increases between January 1st and December 31st, 2021. Landlords are permitted to give notice of rent increases in 2021 as long as the increased rent will only begin in 2022. This change called for more conservative underwriting when valuing properties, as forecasted net operating income will decrease while operating costs continue to increase.

Capital Gains Tax Increase Concerns

Another mounting concern throughout 2020 has been that the delayed federal budget might include an increase in the capital gains tax on income-producing properties. At a rate of 50%, Canada already possesses one of the most favourable capital gains taxes. As the pandemic has caused an enormous increase in debt, it is widely thought that the government is considering boosting the capital gains tax in the spring budget to increase revenue.

Such a change in the tax rate would impact multi-residential owners, and could motivate some to sell their assets in advance of the possible increase.

New Construction & Development Activity

0%
Rent increase limit in 2021

On the development front, taxes, construction costs and development charges have increased steadily over the years, with the only saving grace being rents increasing at a rate at or higher than cost inflation. It remains to be seen whether any other rent restrictions or controls will be implemented in 2021, which could then have an impact on development activity.

While construction was hindered in the first half of 2020, new development proposals have steadily streamed in, suggesting that developers are optimistic about long-term pipelines. As the federal government aims for post-pandemic immigration levels of 1.2 million people over the next three years, demand for housing continues to grow. With this in mind, developers see that there is a long-term opportunity to create more supply to satisfy sizeable demand and are not being deterred by the current pandemic conditions.

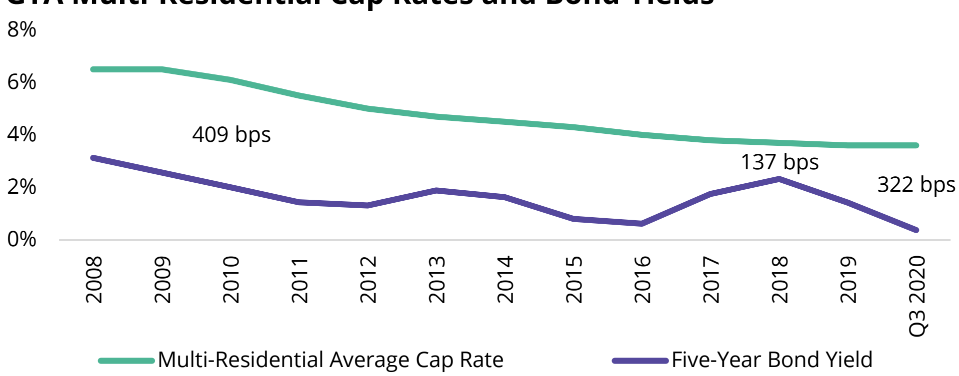
322 bps
Cap rate / bond yield spread

Urban developers hope that public transit ridership will return to pre-COVID-19 levels and that immigration will rise again. Meanwhile, suburban developers may hope to benefit from a shift in demand away from crowded downtown areas. In the student housing sector, it remains to be seen whether universities' transition to online learning will prove a lasting change and impact demand.

Projections from Urbanation show apartment projects moving into development now will generally be ready in three to five years, implying that the undersupply of rental units will persist in the short term and accentuating the supply/demand imbalance.

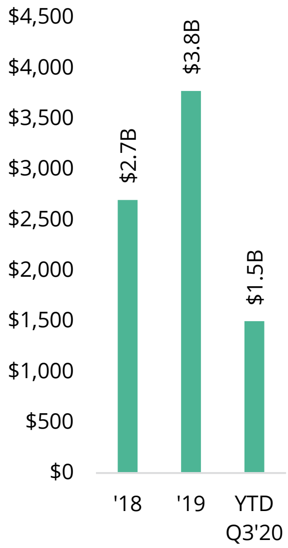
A healthy sign for future development plans came as third-quarter sales of high-density residential land in the GTA reached $601 million, only 8.1% behind last year's third-quarter total of $650 million. Government programs for affordable housing are also becoming more robust, which could bode

GTA Multi-Residential Cap Rates and Bond Yields

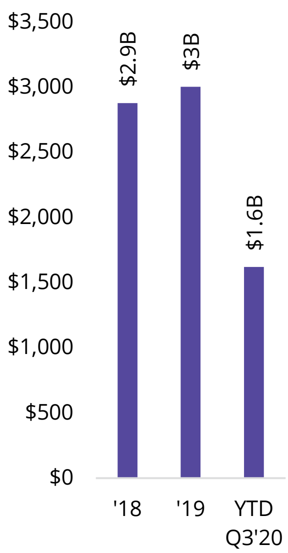


© 2020 Avison Young Commercial Real Estate (Ontario) Inc. All rights reserved. E&OE: The information contained herein was obtained from sources which we deem reliable and, while thought to be correct, is not guaranteed by Avison Young.

GTA Multi-Residential Investment Volume



GTA High-Density Residential Land Investment Volume



45
High-density residential land transactions in third-quarter 2020

well for land sales activity and an eventual increase in supply levels.

For now, the reality remains that there are far too few apartment units in the GTA and Canada's other major cities and, as a result, these cities face chronically low vacancy rates and almost super-charged rental inflation.

Leasing Activity

The GTA rental market softened during the third quarter of 2020 as a result of the pandemic, with condo rents facing further downward pressure as supply outpaced demand. While the average rent decreased by an annual rate of 7.5% to $3.16 per square foot (psf), the decline was almost entirely concentrated in downtown Toronto and average rents were still up 7% compared with three years earlier. Despite this, the third quarter of 2020 produced a record number of lease transactions, with 13,140 lease deals recorded – a 39% growth in volume year-over-year – according to Urbanation. Residential vacancy in downtown Toronto increased to 2.4% but remains near the lowest level observed in the past 16 years and is expected to remain low.

Rising home-ownership costs mean people keep renting, holding demand relatively stable in both primary and secondary markets. Continued growth in demand now depends on the recovery path for key drivers such as immigration, student housing demand, job creation, public transit use, and the re-opening of offices and businesses.

The purpose-built rental market at the end of third-quarter 2020 appeared set to remain fairly stable in the near future with limited growth in vacancy rates. Average occupancy of newly constructed purpose-built rental projects remained relatively unchanged year-over-year at 90%. Average rents for purpose-built rental projects declined by 5.8% year-over-year, falling to $3.25 psf – but were higher than condo rents for the first time in 16 years. However, Toronto remains a strong, operationally established market, which will aid in mitigating rent erosion in the short term. 5,276 new purpose-built rental units are expected to be completed by the beginning of 2021 – the highest level of new inventory recorded in 25 years.

Investment Trends

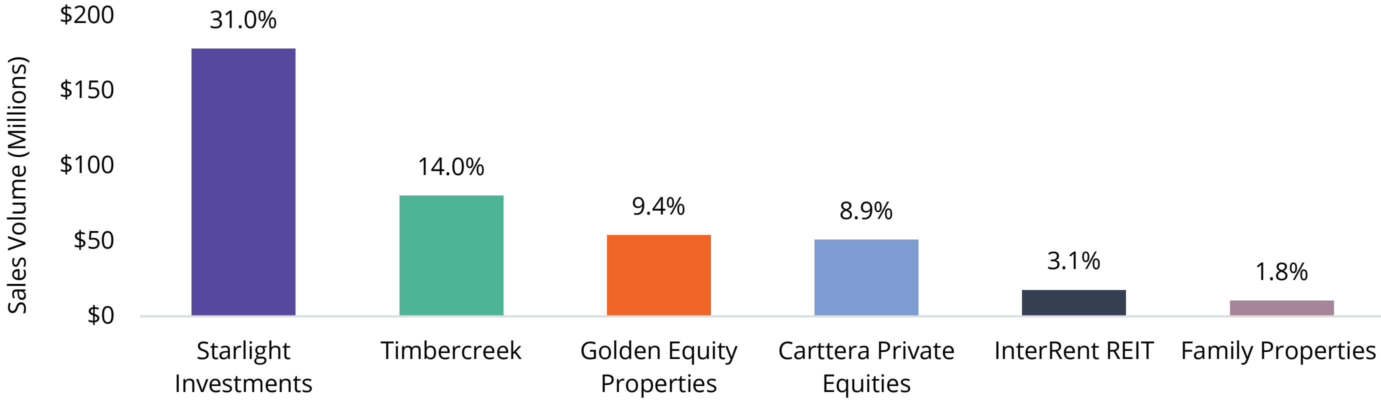
Starlight Investments has been the most active multi-residential investor in the GTA thus far in 2020, accounting for 31% of transaction volume in the third quarter and 35% year-to-date. Buyers are focusing on price per square foot, mark-to-market rent, and going-in cap rates.

Heading into 2021, the Canadian investment market is expected to attract new interest from foreign players looking for markets with less risk with assets available at a significant discount to replacement value. Long-term financing has also become increasingly popular as investors take advantage of historically low interest rates.

All things considered, investor demand is expected to remain strong in 2021 and it will be interesting to see the impact of government programs on the multi-residential housing sector.

© 2020 Avison Young Commercial Real Estate (Ontario) Inc. All rights reserved. E&OE: The information contained herein was obtained from sources which we deem reliable and, while thought to be correct, is not guaranteed by Avison Young.

Top GTA Multi-Residential Purchasers – Third Quarter 2020



Significant GTA Transactions by Sale Price

Sector				
Multi-Residential	**Total Price**	**Price per unit**	**Purchaser**	**Vendor**
Signet – Starlight Portfolio	$113,321,671	$345,393	Starlight Investments	Signet Realty
Signet – Timbercreek Portfolio	$80,428,329	$278,299	Timbercreek	Signet Realty
122 Bronte Street South	$58,500,000	$358,896	Park Property Management	GWL Realty Advisors
240 Markland Drive	$51,000,000	$451,327	Carttera Private Equities	Private individual(s) / S-K Sportswear Ltd.
4500 Jane Street	$44,570,000	$271,768	Starlight Investments	Asar Investments
High-Density Residential Land	**Total Price**	**Price psf buildable**	**Purchaser**	**Vendor**
3450 Dufferin Street	$86,500,000	$95	Timbercreek / AIMCo / Fitzrovia Real Estate	Easton's Group of Hotels
429 Lakeshore Boulevard East & 324 Cherry Street	$83,181,320	$33	Home Depot / Private individual(s)	Cityzen Developments
77 Huntley Street	$36,025,477	n/a	CAPREIT	Greenrock Property Management
840 Dupont Street	$35,000,000	n/a	Tridel	Sobeys
5203-5215 Yonge Street & 11 Parkview Avenue	$27,000,000	n/a	Immino Developments	Private individual(s)

Get more market information

David Lieberman, MBA†
Principal
416.673.4013
david.lieberman@avisonyoung.com

Jonathan Hittner*
Vice President
416.436.4417
jonathan.hittner@avisonyoung.com

Neil Musselwhite†
Vice President
289.795.4430
neil.musselwhite@avisonyoung.com

Eamonn McConnell†
Associate
416.574.4890
eamonn.mcconnell@avisonyoung.com

avisonyoung.ca

* Broker
† Sales Representative

© 2020 Avison Young Commercial Real Estate (Ontario) Inc. All rights reserved. E&OE: The information contained herein was obtained from sources which we deem reliable and, while thought to be correct, is not guaranteed by Avison Young.