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British Columbia Multi-Family Investment Report

Spring 2013

AVISON YOUNG Intelligent Real Estate Solutions

Strong demand, pricing and compressed cap rates define BC multi-family market

Strong pricing for multi-family assets in BC began to approach the upper limits in 2012 as ongoing compression achieved new capitalization-rate lows and buyers began questioning some vendors' sale expectations.

A dwindling supply of product in primary markets pushed many purchasers – private investors, REITs and institutional buyers – to secondary markets in search of acquisitions (and yield). However, with 43 transactions totalling $629.7 million completed in 2012, multi-family properties still remained one of the most coveted commercial real estate asset types in BC and recorded the greatest deal and dollar volumes since at least 2008.

Record annual deal and dollar volume in 2012

Similar to other commercial real estate asset types in 2012, the majority of sales activity was recorded in the first half of 2012 ($385.9 million/25 transactions) but activity remained steady through the last half of the year ($243.8 million/18 transactions). The sales of **Lougheed Towers** in Burnaby and **Pacific Point** in Vancouver, along with the dispositions of **Camosack Manor** and **Whitgift Gardens**, skewed dollar volume significantly and contributed to a new high-water mark in 2012 in terms of both dollar volume and the number of deals completed. The previous dollar volume record was set in 2009 with $481 million (24 transactions) in total proceeds, but was heavily influenced by the $274-million sale of the Wosk portfolio, which consisted of **Beach Towers** and **Langara Gardens**.

Purchasers seek acquisitions in secondary markets

The combination of a lack of product, smaller deals and the absence of larger institutional transactions in the second half of 2012 impacted overall market activity. A number of deals during the second half occurred outside Metro Vancouver in markets such as Campbell River, Victoria and Nanaimo, while Vancouver and Burnaby remained the most active markets on the mainland. Single transactions in Langley, Port Moody, North Vancouver, Port Coquitlam, Coquitlam and New Westminster rounded out the second half. **Northern Property REIT** was especially active in the latter half of 2012, acquiring four properties on Vancouver Island, including three in Nanaimo and one in Campbell River. This followed Northern Property REIT's acquisition of four Metro Vancouver assets in the first half of 2012, including three multi-family properties in Abbotsford and one in Mission. **TransGlobe Property Management Services** sold five properties in 2012, including four to Northern Property REIT, which itself disposed of only a single property it owned in Burnaby to another REIT.

Market Trends

Multi-Family Investment Sales
(> $5 million) January 1 to December 31

	Number of Transactions	Total Dollar Volume	Average Price
2012	43	$630 million	$14.6 million
2011	35	$377 million	$10.8 million
2010	20	$264 million	$13.2 million
2009	24	$481 million*	$20 million
2008	18	$164 million	$9.1 million

Sources: Avison Young and RealNet Canada
**Includes sale of $274-million Wosk portfolio consisting of Beach Towers and Langara Gardens*

Many of the largest deals of 2012 involved developers who wanted redevelopment sites or cash flow-generating portfolio holdings or to reposition the asset for resale. Developers who acquired multi-family assets in 2012 included: **Bosa Group** ($78M), **Concert Properties** ($57M), **Ledingham McAllister** ($27M) and **Polygon** ($17M) .

Demand for multi-family product to moderate

Capitalization rates are anticipated to remain low but steady in 2013 with compression easing due to increasing reluctance on the part of purchasers to acquire assets with minimal upside. However, demand will moderate compared to 2012 but remain steady from both institutional and private investors, particularly for well-located product in primary markets. While interest rates are expected to remain low in 2013, bond rates have seen some slight upward movement and may indicate the increasing likelihood that interest rates could move to match in the latter half of the year.

Purpose-built rental buildings continue to break ground in Vancouver as city programs such as the Rental 100: Secured Market Rental Housing Policy, and its predecessor: the Short Term Incentives for Housing (STIR) program, encourage developers to proceed with construction plans. As more purpose-built rental is constructed and comes to market, it is anticipated that pricing for multi-family assets may start to shift with a premium applied to new stock.

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Metro Vancouver rental vacancy rising

The rental vacancy rate in the Vancouver census metropolitan area (CMA) increased to 1.8% in October 2012 from 1.4% in October 2011, according to the **Canada Mortgage and Housing Corporation (CMHC)**. Vacancy rates also increased in Nanaimo (6.7%) and the Victoria (2.7%) CMA but declined substantially in the Abbotsford-Mission CMA. While vacancy in the Vancouver CMA did increase, the rate remained one of the lowest among the 26 centres surveyed in the province. Demand for rental housing was supported as people moving to Vancouver from other countries added almost 29,000 permanent residents in 2011. Rental market conditions eased in most urban British Columbia centres surveyed in October 2012. The apartment vacancy rate in the province as of October 2012 was 2.7%, compared with 2.4% in October 2011.

Interest rates are almost identical from this point last year; however, rates have been anything but flat, according to **James Paleologos** of **Realtech Capital Group**. While a March 2012 to March 2013 comparison shows similar bond yields, they are up ~70 basis points from a dip in June 2012. In the four calendar years since the fall of 2008 the average annual bond yield fluctuation has been ~125 basis points from high to low. These dramatic swings have enticed many savvy borrowers to pre-qualify for refinancing in an attempt to forward fix their rate during one of these downward "swings". For the most part, economists predict more of the same until the global economy shows signs of long-term recovery, particularly in the U.S. and Europe.

Current rates for CMHC-insured mortgages are ~2.25% for five years and ~2.95% for 10 years. Conventional rates start 100 basis points higher for properties. ■

This 84-unit multi-family highrise at 1035 Belmont Avenue in Victoria was one of seven properties in excess of $5 million that transacted on Vancouver Island in 2012. Other transactions occurred in Nanaimo, Esquimalt and Campbell River.

Q&A

Avison Young speaks with Amy Spencer, president and CEO of the Rental Housing Council in BC, on the effectiveness and impact of the City of Vancouver's efforts to encourage construction of purpose-built rental buildings

The City of Vancouver created two new programs, STIR and Rental 100, to encourage development of purpose-built rental buildings in order to meet the City's affordable housing targets for market rental housing. How effective have the two programs been in relation to stimulating such development?

The STIR program ran from July 2009 to December 2011 and the Rental 100 program was introduced in May 2012. Rental 100 intends to encourage the development of 100% purpose-built rental developments, whereas the STIR program largely saw new condo developments being built with some rental units included.

The city's programs are working – the STIR program is creating 1,648 units of purpose-built rental housing through to 2014. No purpose-built rentals were approved in 2008 and 2009, before the city's programs were implemented.

Meanwhile, since 2006 the stock of secondary rental (largely privately-owned rented condos) has increased by nearly 1,300 units per year. So why don't the numbers work for purpose-built rental compared with condos? Landlords and developers agree, the costs to build purpose-built rental are too high, while market rents are too low.

How have these programs impacted the rental housing market in Vancouver, BC? In Metro Vancouver? Have they been a success?

Despite the increased construction of purpose-built rental units, vacancy rates remain low. According to Canada Mortgage Housing Corporation, Vancouver's current vacancy rate is 1.8%, well below what is considered to be a healthy vacancy rate of 3%.

Meanwhile, the pressures of increasing home ownership costs and migration continue to drive rental-housing demand. The city estimates it needs an additional 16,000 new rental units by 2021 to meet demand, and of those the city wants 5,000 units to be contained with purpose-built rental buildings.

Will the city be able to continue subsidizing development to create an extra 500 units per year for the next ten years? The city estimates the overall financial incentive to create units in 100% rental buildings was $5,000 per unit, while the incentives needed to make a mixed strata/rental building work were $70,000 per unit.

The city's decision to step up and tackle a problem was notable, but is it sustainable for the long term?

The City has used a number of "tools" to encourage construction of purpose-built rental buildings (such as waiving DCLs, reductions in parking requirements, additional density, smaller unit size and

Amy Spencer, president and CEO of the **Rental Housing Council**: "Provincial rent controls do not allow rents to be adjusted to market realities or for the pass-through of escalating costs, which continues to scare investors away."

expedited permitting processes). Are these sufficient tools for the City to achieve its desired outcome? What other "tools" might be useful that the city should consider? What have been the programs' successes and failures?

Provincial rent controls do not allow rents to be adjusted to market realities or for the pass-through of escalating costs, which continues to scare investors away. Meanwhile, federal tax policies continue to favour home ownership. Had the city not made these tools available to build rental, developers would have continued to build strata condos because otherwise, the economics just do not work.

The perception has been that these incentive programs are only for "big" developers who have the time and money to navigate the complex application process. The Rental 100 program could be expanded to allow increased density in existing rental buildings through the building permit process, opening the program to smaller building owners.

Many of Vancouver's rental buildings have unused space that could be safely converted to rental units. Allowing one or two more units in hundreds of small buildings across the city would add a substantial number of new suites without disruption to tenants.

Several lessons were learned from STIR: it was more effective to create 100% rental buildings than mixed-tenure buildings; STIR, as it was structured, tended to create studio and one-bedroom units; and that density bonusing had to be implemented in a way that respected neighbourhood character. Were there any other lessons learned? Did Rental 100 take into account any issues that property owners and managers wanted to see addressed? Have your members been satisfied with the programs put forward by the city?

The mixed-tenure buildings were generally concrete towers, which in turn were more expensive to build; the rental component was achieved mostly through increased density. Increased density resulted in increased land value, which meant developers had to provide Community Amenity Contributions.

The Rental 100 program will involve less financial incentives for the city because 100% rental buildings will likely be smaller, wood-frame construction that will not result in increased land value. It will be interesting to see how many people are willing to take on 100% rental buildings, given land scarcity in the city.

The city needs to investigate the impact that Rate of Change policies have had on rental construction. Many existing rental buildings are at the end of their life cycle and are on land that is under-utilized. There are many examples of how landlords have renovated or redeveloped buildings to bring them up to current building code, or rebuilt to create new density, while at the same time ensuring minimal disruption to tenants.

Up until the early 1970s, federal government tax incentives made the construction of rental stock a viable investment. Since those incentives were phased out, rental building construction

Multi-Family Investment Sales (> $5 Million) July 1, 2012 to December 31, 2012

MULTI-FAMILY

PROPERTY (units)	MUNICIPALITY	PRICE	$ PER UNIT	VENDOR TYPE	BUYER TYPE	DATE
5895 Barker Avenue (48)	Burnaby	$12,500,000	$260,417	Private	Private	December 2012
2121 Alma Street (43)	Vancouver	$12,800,000	$297,674	Private	Private	December 2012
Discovery Village (65)	Campbell River	$5,192,375	$79,883	Private	REIT	November 2012
Berry Road Apartments/ Creek Park Townhouses (92)	Langley	$11,300,000	$122,826	Private	Private	November 2012
443 Superior Street (71)	Victoria	$10,500,000	$147,887	Private	Private	November 2012
Silverbelle Apartments (42)	Burnaby	$6,900,000	$164,286	Private	Private	October 2012
St. Johns Apartments (41)	Port Moody	$5,535,000	$135,000	Private	Private	October 2012
Prideaux Manor (51)	Nanaimo	$5,151,000	$101,000	Private	REIT	September 2012
Cecil Park Mews (23)	Vancouver	$6,825,000	$296,739	Private	Private	September 2012
Seacrest Apartments (125)	Nanaimo	$13,300,000	$106,400	Private	REIT	September 2012
Twin Lakes Estates (57)	North Vancouver	$17,110,000	$300,175	Private	Private	August 2012
Mount Benson Arms Apartments (52)	Nanaimo	$5,512,000	$106,000	Private	REIT	August 2012
Park Strand Apartments (50)	Vancouver	$14,925,000	$298,500	Private	Private	August 2012
Chateau Delon (47)	Burnaby	$6,100,000	$129,787	Private	Private	August 2012
Northview Place & Dominion Estates (79)	Port Coquitlam	$26,800,000	$339,240	Private	Private	August 2012
2476 York Avenue (61)	Vancouver	$18,300,000	$300,000	Private	Private	July 2012
Whitgift Gardens (311)	Coquitlam	$57,500,000	$184,887	Private	Institutional	July 2012
Cameron Manor Apartments I & II (82)	New Westminster	$7,550,000	$92,073	Private	Public	July 2012
Total deals/investment	**18**	**$243,800,375**				

Sources: Avison Young and RealNet Canada

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stagnated. The City of Vancouver recently stepped in to address the issue at a municipal level. What, if any, responsibility and/or role should senior levels of government have to ensure an adequate, affordable and safe supply of rental stock that fits the needs of individuals and families?

The federal government needs to ensure that the tax system is balanced between rental tenure and ownership tenure. The income tax treatment for homeowners is far more favourable for homeowners.

The Canadian Federation of Apartment Associations is a national group that advocates at the federal level for:

- Tax deferral on sale and reinvestment in rental housing (a rollover);
- The elimination of the GST/HST on rental housing operations; and
- An increased rate of capital cost allowances (CCA).

In the long term, the rental housing industry would like to see the federal government:

- Reduce the inclusion rate for capital gains;
- Allow rental housing to qualify for small business tax treatment;
- Allow actual cost-plus as a basis for assessment for GST/HST self-supply; and
- Allow CCA deductions against other income.

What are considered affordable rental buildings today are those very buildings that were built in the 1960s and 1970s as a result of federal tax programs intended to encourage rental-housing construction. ■

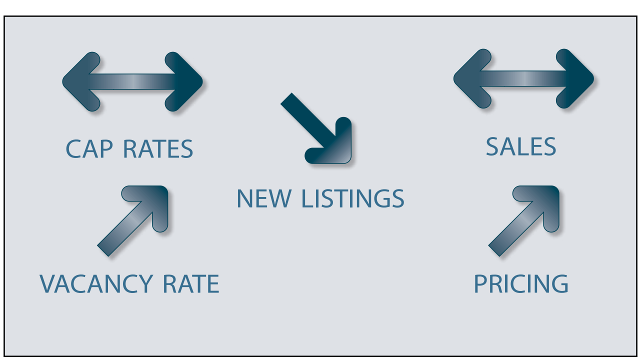
Snapshot of BC vacancy rates

Area	October 2012	October 2011	% Change
Vancouver CMA	1.8%	1.4%	0.4%
Abbotsford CMA	4.2%	6.7%	-2.5%
Chilliwack	5.6%	3.9%	1.7%
Victoria CMA	2.7%	2.1%	0.6%
Nanaimo	6.7%	6.3%	0.4%
Kelowna CMA	4.0%	3.0%	1.0%

Source: CMHC; CMA: census metropolitan area

2013 Market Outlook

- *Vacancy rates to remain neutral*
- *Rents likely to increase, especially in East Vancouver*
- *Sales volume in 2013 likely lighter than 2012*
- *Purpose-built rental sales and forward sales of pipeline product likely to increase*
- *Capitalization rates to remain low, between 3% and 4% for most product types*



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