

# Goodman report:

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## The 2014 Canadian Apartment Investment Conference Creating New Purpose-Built Rental Developments



## A changing urban landscape

Since making our pilgrimage in September to the 2014 Canadian Apartment Investment Conference, held at the Metro Toronto Convention Centre, we've been eager to share with our readers the latest trends and forecasts in the multi-family rental industry.

Each year, the conference gathers experts to offer cross-country perspectives from their fields and reflect upon prospects in our business. Panelists this year included developers, realtors, investors, lenders, economists, architects, engineers and institutional representatives.

Between 2011, when we last attended, and this year, two additions to the conference's regular program have come into discernible focus.

One is the recognition amongst organizers, speakers and delegates that the foreseeable future will be all about the creation of new purpose-built rental buildings. After a 40-year hiatus, our industry is finally witnessing a rare convergence of factors allowing for the acquisition of land along with the design, financing and construction of new market rentals across Canada. Recognizing at last that very little purpose-built rental stock has been added over the last four decades, cities and suburbs have been relaxing fixed municipal charges, providing density and height bonuses, reducing parking requirements and allowing for smaller suite sizes.

Demand for these new buildings among investors and tenants alike appears almost limitless, while low financing and mortgage rates provide strong incentives for construction. Given sharply escalating condo prices, many potential buyers are instead turning to new purpose-built rentals that feature all the modern and elegant amenities while providing today's discerning tenants new found financial flexibility. Normally residing either in condo rentals or in aging 50-year-old structures devoid of amenities, tenants are now seeing the clear advantages of the newer purpose-built rentals, where they may enjoy superior caretaking and management, party rooms, gyms or pools and a sense of community, without the risk of being dislodged by condo owners.

A second significant addition at the conference is an emphasis on the impact of technology on both landlords and tenants. Presenters described the new technologies and managerial strategies through which savvy owners and property managers are increasingly attracting and retaining tenants.

## The market, the market

The conference opened with speaker Benjamin Tal, deputy chief economist, CIBC World Markets Inc., who offered an overview of the Canadian economy as it affects real estate markets.

Tal forecasts that rates, especially in the United States, will start moving up during the first quarter of 2015. Canada's timing, according to Tal, may lag somewhat behind that of the U.S. as Canada's agenda is to maintain the lower rates and thus encourage a weaker Canadian dollar. Ostensibly, Canada's exporters will benefit. Tal cautions that China's economy, a key business barometer, is still rebounding but with less vigour, as housing headwinds throughout China mount. Moreover, he characterizes the looming "shadow banking" issue as "scary." The term shadow banking is a basket for all sorts of lending and borrowing activity that are outside of the usual, traditional bank loan.

Citing the CIBC Canadian Financial Monitor, Tal points out the rate of homeownership amongst young Canadians (ages 25–34) has declined from a high of 55% in 2012 to approximately 50% in 2014. This upwardly mobile group is showing a strong interest not just in older traditional rentals but in the higher-end offerings found in new purpose-built rentals and rental condos.

Tal reports that young people are gravitating to downtown areas now much more than 10 years ago. He forecasts that immigration will continue to be a major driver both for condo purchases and for rental apartments and that "the propensity to rent will be higher than ever."



*David Goodman and Mark Goodman*

## The condo factor

Many speakers at the conference focused on the impact of the condo market as it relates to the rental industry. A frequent theme was the impact of the availability of rental condos has on the construction of purpose-built rentals. Some presenters also looked at the attractions of renting as an alternative to homeownership.

George Carras is president of RealNet Canada Inc., which delivers detailed research, analysis and insights on commercial real estate and residential development. According to Carras, the Greater Toronto Area and Greater Vancouver have experienced the building of a record number of highrise condos over the past 10 years. Traditionally, this new construction has been satisfying increases in the demand for rentals. Of late, however, developers, investors and owners are increasingly attracted to the prospect of developing purpose-built rentals across these markets as consumer appetite grows in this housing sector. This trend is particularly apparent in condo sites where poor sales have resulted in conversions of the condo projects to rentals.

Carras also points out that the multi-family rental market has increased in complexity, with highrises and mixed-use buildings becoming more and more common. In this connection, the presentations underscored regional distinctions within the Canadian markets. While Toronto, the Prairies and even Eastern Canada are witnessing burgeoning new purpose-built markets, says Carras, Greater Vancouver continues to underperform in this space despite strong tenant demand and investor interest, as the chronic shortage of sites, municipal bureaucratic barriers (some might say political expediency) and the cost of land remain deterrents. As an aside, Carras reports that approximately 40% of condos built in Vancouver from 2006 to 2011 are in the rental pool, while 65% of new rental units in Canada overall are condos.

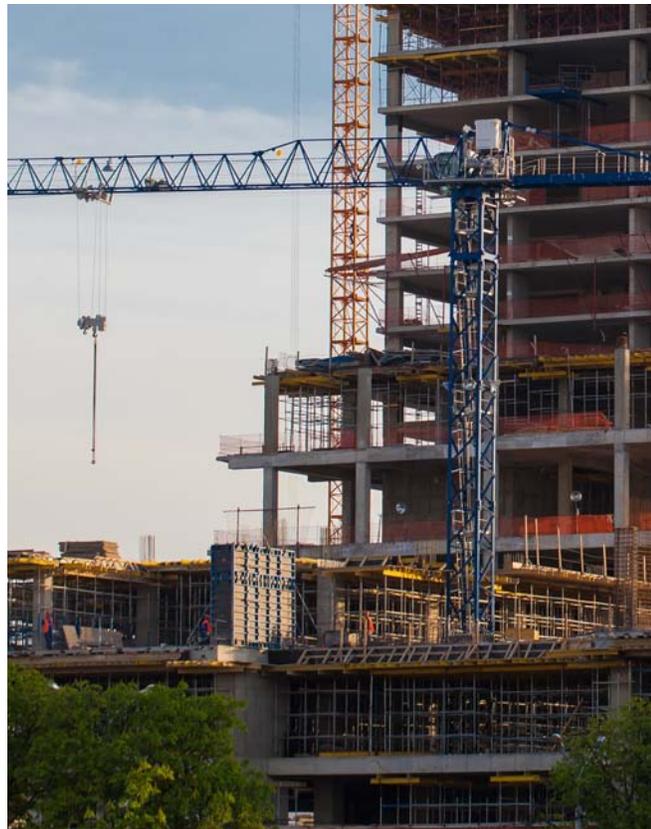
Paul Morassutti, EVP and senior managing director, valuation and advisory services, CBRE, Inc., observes that as Toronto's ever-soaring population clogs highways and mass transit alike, people there are increasingly opting for condos rather than single-family houses. Densities in Toronto have risen sharply, as evidenced by the city's extraordinary highrise condo boom.

For developers, immigration has been the secret saviour. Morassutti aptly describes Vancouver as one of the most "stable investor markets in the world," with intensification finally happening in the traditionally marginal areas.

While a year ago there was some skittishness in the markets because of the expectation of higher interest rates, Morassutti describes Vancouver today as "stable, boring and consistent" and asserts that an increase in rates is not imminent.

CAPREIT is a growth-oriented investment trust and one of the country's premier residential landlords, owning interest in 41,249 units across Canada and in Dublin, Ireland. When asked in a recent interview about competition from the condo market, president and CEO Tom Schwartz commented that the "wide price gap" had "made apartments more obviously affordable" and that it was having "a positive impact on CAPREIT." Schwartz asserts that CAPREIT generally benefits in recessions as people stay in their rentals longer rather than jumping into homeownership.

Roberto Geremia, president of Boardwalk REIT, spoke as well. He states that in Canada, where so many apartment buildings are over 40 years old, the fact that the condo market accommodates the needs of new renters obliges older purpose-built rentals to follow suit. For example, party rooms in older buildings are now being retrofitted as gyms. Comments Geremia, "The condo upper-scale development is actually forcing us to provide more common-area amenities, which are resulting in better returns for us."



## From granite to green: Exciting new rental developments

In a very well-attended session called “Competing with the condominium market?”, presenters shared case studies from amongst the high-end new rentals. These specific examples served to bolster the business case for developing these types of assets, to compete both with condos and with older rental buildings.

The session opened with Barry Lyon, senior partner and president of N. Barry Lyon Consultants Ltd., a leading multi-disciplinary real-estate consulting firm involved in virtually all aspects of land development. The company serves major organizations across Canada, such as pension funds and larger developers seeking to build new rentals. It also provides consultation to owners with excess land seeking infill opportunities.

Lyon detailed the growing impact and attractiveness of the newer, larger projects, often situated close to rapid transit, with better finishings and amenities such as washers and dryers, social areas and gyms, as well as superior and more responsive management. Many of the downtown projects are often strategically located in the prime core areas. In Toronto, the new purpose-built rentals cater to the move-down market and have no three-bedroom units, which are deemed uneconomical. They allow younger couples to walk to work and avoid car purchases, while providing excellent access to cultural venues, shopping and restaurants.

Brian Athey, vice-president, Canadian operations, at Morguard North American Residential REIT, provided an example of a major new successful rental development by Morguard in Toronto: the Heathview at St. Clair and Spadina. What was originally a 12-storey, 246-unit structure built in 1962 on 2.3 acres has been transformed over the three and a half years of its reconstruction into a prime project targeting LEED Gold, with 596 units divided into two towers of 30 storeys each. The suites have nine-foot ceilings, laminate flooring, granite or quartz kitchen countertops, stainless steel kitchen appliances and in-suite washers and dryers. Amenities are an outdoor terrace, a fitness room, a party room with kitchen and bar, a dining room, a theatre room and guest suites.

Reflecting on market conditions, Athey comments that the Heathview represents a rare case of infill development in midtown Toronto, where there are limited opportunities for new highrise rentals and where demand for new rental projects is insufficiently met. He underscores that the Heathview exemplifies higher sustainable design, featuring energy cost savings of 32% as compared with older



buildings. Suites offer heat recovery units (HRVs) and dual-flush toilets, while the building overall boasts a stormwater retention and irrigation system, a car-share program and green roof areas, while still being fully sprinklered.

The group also heard from Philip Fraser, president and CEO of Killam Properties Inc., which is the apartment leader of Atlantic Canada, with a 14% market share there as well as a presence in Ontario. Fraser states that new purpose-built rentals are a viable option for tenants because of professional management, on-site staff, security of tenure and a strong sense of community. For investors, Fraser believes, these projects offer many advantages: attractive yields, a high-quality tenant base and the opportunity to target empty nesters and seniors. All these benefits plus low maintenance costs, no deferred maintenance and high operating margins are realized.

Killam’s buildings feature warm, friendly and inviting common areas with ample, elegant entrances, beautifully appointed spaces and large, bright gyms. Construction ranges from wood framing to structural concrete, precast concrete panels and steel frame with concrete.

In its LEED-registered projects, Killam includes solar panels that heat a portion of the hot water. In addition, recovery systems send drain water to a tank in the building; once treated, the water is reused for the toilets. These approaches result in significant water savings. (Vancouver, are you listening?)

A case study from Killam was the Saginaw Gardens project in Cambridge, Ontario. On completion in May 2015, this Quaker-style building will have 122 units in its seven stories, with a fitness room and large party/amenity room. In developing this project, Killam faced such challenges as the timing of municipal approvals, access to skilled labour, construction delays, environmental issues from contamination and noise, and the determination of lease expirations. From this project, Fraser stresses the importance of maximizing energy efficiencies, establishing contingencies in budgeting and scheduling, deciding which design features and amenities matter most, managing cost overruns and having good processes for establishing when leases are up.

Meanwhile, in Halifax, Killam is working on a mixed condo/rental development called Southport, consisting of 142 units in six storeys and featuring a fitness room, a rooftop amenity room and retail space. With construction beginning in the fourth quarter of 2014, the condo portion (representing 50% of the overall project) was totally sold out in one week.

In a particularly illuminating session called “With all the development on the horizon, who is actually building today and what are they constructing?”, a select group of investors, developers and architects helped demystify the new purpose-built rentals by discussing the hurdles and opportunities encountered in creating these assets. They surmised that in many cases, the projects are now becoming viable and the numbers actually do add up.

This session included Mark Humphreys, CEO of the architectural firm Humphreys & Partners Architects, L.P., which is currently designing 34,000 rental suites, or 12% of the total number of rental suites under development in the U.S., and about 4,500 units in Canada, with 2,000 in the East and 2,500 in the rest of Canada.

Current developments by Humphreys include two projects in Edmonton. Century Tower, consisting of a 24-storey building plus a six-storey midrise, offers 559 units and 8,500 square feet of amenities, while the three-storey Century Park contains 11,200 square feet of retail in addition to rental units. In Kamloops, Humphreys is working on Columbia Street, a three-storey building offering 308 suites of student housing, while in Ottawa, the firm’s project at 1218 Norberry Crescent will be a 191-unit, four-storey building with underground and surface parking.

Without exception, Humphreys’ designs stress functional and inclusive amenity areas. In one of the company’s new projects in the U.S., the leasing agent has no formal office; when meeting with a prospective tenant, he or she sits in an inviting open clubhouse setting located next to the gym area. Humphreys also supports new trends in highrise construction that feature light gauge metal building systems, which save 20% in cost over concrete. With its wealth of experience in purpose-built rental design in the U.S. market, Humphreys would appear to have a competitive advantage over many Canadian architectural firms that are relative newcomers to this asset class.

Adrian Kozak, director, investments, at Vancouver’s own Concert Properties Ltd., shared details on the very successful Motion project at 570 Bay Street in Toronto, a 29-storey, 463-unit building with 10,000 square feet of retail development. Completed in 2013, Motion is the largest new

rental tower in Canada, and it took Concert only one year to rent out. Vancouver’s developers would be interested in knowing that buildable land cost was only \$35 per square foot and that average suite size is 601 square feet. The project features two open terraces, with amenity areas elegantly finished and furnished; management anticipates high tenant use.

Also in Toronto are two purpose-built rentals by KingSett Capital, Canada’s leading private equity real-estate firm, represented at the conference by William Logar, vice-president, development. Each building consists of 251 units, with four levels of underground parking. Suite mix is 49% one-bedrooms, 41% two-bedrooms and 10% three-bedrooms. With each building, KingSett will include party rooms, boardrooms and an outdoor amenity space with barbecue area. Wi-fi will be available in all the amenity areas.

And what of Vancouver? In 2013, Concert completed the Axis, a 15-storey, 174-unit rental at the University of British Columbia, which was 100% leased by the time of first occupancy. Lee Warren, managing director, real estate, at Sun Life Investment Management, described a rare, 12-storey rental tower infill project the company is developing on the 1700 block of West 14th Avenue in South Granville, as well as an eight-storey rental in Toronto called the Alto. Sun Life intends to add the two buildings to its investment portfolio, passing the property management to outside parties.

On the whole, the panelists at this session agree that we can expect a welcome influx of new high-quality rental buildings across Canada.



## Marketing goes high-tech

The digital revolution has ushered in an increasing emphasis on the integration of mobile, social media and other online vehicles into marketing strategies.

Established in 1984, Yardi Systems, Inc. is a leading provider of high-performance software for the real-estate industry. In an excellent presentation, Yardi outlined the compelling benefits to owners and property managers that result from mobile and social media penetration.

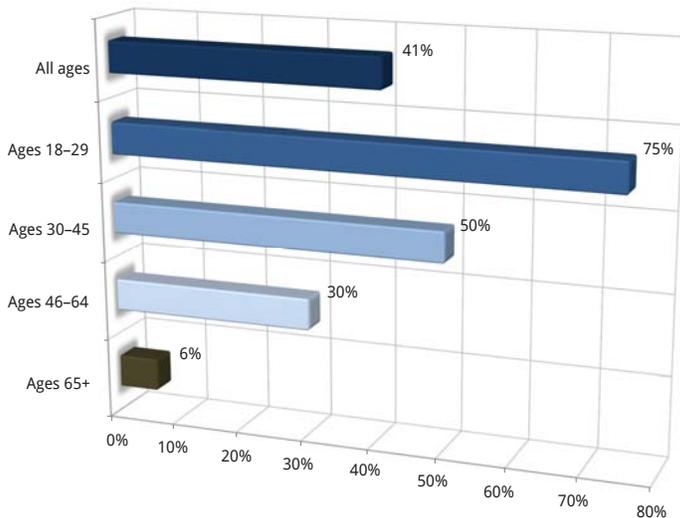
Yardi emphasized the presence on digital channels of an overwhelming majority of the world population. Of the seven billion people living, a full 6.6 billion, or 93%, subscribe to mobile phone service, while 2.5 billion, or 35%, have access to the Internet.

Mobile/Social media penetration	
World population	7 billion
Mobile subscribers	6.6 billion (93%)
Internet users	2.5 billion (35%)
Social media users	1.9 billion (26%)
% of North Americans on Facebook	59%

Sources: U.S. Census Bureau, Internet World Stats, CNNIC, Tencent, Facebook, ITU, CIA

According to Yardi, 84% of millennials (born 1983–2003) report that user-generated content has at least some influence on what they buy, as compared to 70% of baby boomers.

### Do you have a profile on Facebook?



Source: <http://www.pewsocialtrends.org/>



To attract and retain tenants, Yardi reports, owners and property managers are embracing multi-layered approaches that combine social media and websites with advertising and reputation management. They are converging their media strategies by combining media they own themselves with both paid and earned media.

In its panel presentation, Morguard described the exceptional marketing and leasing program it developed for promoting its Heathview project in Toronto as well as other developments. In establishing the Heathview as a brand, Morguard combined the traditional approaches of hoarding, signage, editorial, marketing materials, lease documentation and advertising including transit ads with online strategies: a full website presence as well as marketing via Facebook, Twitter, YouTube and Vimeo. The campaign stressed the Heathview's floor-to-ceiling windows, stainless steel appliances, in-suite washers and dryers, 24/7 concierge, party room, fitness centre with yoga studio, outdoor terrace, subway entrance across the street, on-site car share and indoor bicycle storage. From the review event and public opening in March 2014, occupancy began on July 1.

## Upgrading to upscale

At a time when new purpose-built rentals provide apartment seekers with a number of advantages over condo purchases, they also lure tenants away from older apartment buildings that stand in need of extensive upgrades.

At a session called “Repositioning and developing older assets: What you need to know to succeed and what to look for!”, panelists outlined strategies for enhancing the attractiveness of existing buildings.

Both Greater Vancouver and the Greater Toronto Area have a number of rental buildings about 45 to 60 years of age requiring major capital expenditures. This is why, for the first time in a long while, many large institutional pension funds are considering new purpose-built rental developments. The panelists addressed the challenges and opportunities they’ve faced with older properties and how they’ve attempted to compete with the shiny new offerings.

Sarah Gray, an engineer with Halsall Associates, assists owners by creating multi-year plans for upgrades, repairs and maintenance. Recommending proactivity in managing older buildings, she contends that the biggest challenges in repositioning them are capital expenses such as curtain walls, windows, building envelopes and garage upgrades, followed by energy and utility costs.

Owners typically focus on interior upgrading, window replacement and energy use reduction, but Gray often begins an inspection by documenting evidence of visible deterioration such as loose concrete on garage ceilings that may lead to public safety risk. Next she inspects elevators, generators, and roof and balcony railings, flagging potential repairs.

Gray makes the following recommendations:

- **Utilities:** Replace single-pane windows to reduce cold drafts. While a high capital expense, this upgrade means long-term savings.
- **Roof:** Replace roof membrane and, if necessary, insulation. Consider a high reflective coating.
- **Garage:** It may not be a sexy area, but you can improve building image by sealing leaks, repainting, replacing old fluorescent fixtures and installing motion detectors. A bright, tidy garage goes a long way with tenants.
- **Halls and stairwells:** Improve with low-energy light fixtures.
- **Suites:** Install low-flow toilets.
- **Balconies:** Often these are eyesores or outright hazards for tenants, so upgrade as required. Safe, usable balconies make tenants happy.



Jeff Hutchison, managing director, asset management, for Timbercreek Asset Management, describes how the company repositions its older holdings. Timbercreek owns and manages over 100 multi-unit residential buildings containing an approximate total of 16,000 suites in cities across Canada. Generally 40 to 50 years old, the buildings are in varying degrees of repair.

In assessing each, Timbercreek takes a detailed look at the area's demographics and the nearby competition, as each market is unique. The company considers how far up-market to take the building and whether to add amenity space, a dedicated management office and, if possible, additional suites. It reviews the capital expense requirement against the benefits of a new upgraded lobby, renovated suites and especially the curb appeal. As tenants demand more customer service, Timbercreek's management teams prioritize this aspect of operations.



Brent Merrill, president and CEO of MetCap Living Inc., spoke about this issue as well. The company controls 20,000 units in four provinces, primarily in the Maritimes, where there's less opportunity to reposition than elsewhere. In that region, according to Merrill, it's often better to build a new rental as land costs are low, especially as compared with Ontario.

When MetCap does carry out a repositioning, it prefers to start with curb appeal by improving such elements as the landscaping, exterior, balconies, lobby, hallways and lighting. On a suite turnover, while it will commit to an upgrade of \$15,000 to \$25,000 and push up rental rates by \$500 per month, its corporate strategy generally is to carry out upgrades in the common areas and enhance curb appeal first.

### On the horizon

Overall, the market has thrived against a backdrop of low financing and vacancy rates at a time when municipal governments are finally willing to encourage new rental initiatives. With cap rates still generally above five to 10-year mortgage rates and seemingly endless opportunities for enhancing net rental income via rigorous retrofits, delegates left the conference appreciating that the industry remains in the midst of a golden age.



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