# THE GOODMAN REPORT

FOR APARTMENT OWNERS


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*NEWS AND VIEWS FROM*

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**HIGHLIGHTS IN THIS ISSUE**

- THE ECONOMY AND VACANCIES
- HISTORICAL PERSPECTIVE
- PRICES – ARE WE NEAR THE PEAK?
- TAX CONSIDERATIONS – POTENTIAL SAVINGS
- STRONGER INDUSTRY VOICE


# It's A Whole New Ballgame

Twenty-one years ago I had an epiphany. I determined that a report for apartment owners was required in order to fill an information void existing in the industry. Having refocused my career on the purchase and sale of multifamily buildings and development sites, it seemed appropriate to me that an in-depth newsletter devoted to industry issues would be a welcome addition to your reading and in turn, help you make key business decisions. It would be original in thought providing useful intelligence from the "street", while accessing micro and macro economic indicators.

We are very proud of our 21 years of publishing the Goodman Report. Our sales statistics, property management tips, market forecasts and commentaries on various trends have proved illuminating to our readers. We've utilized empirical and anecdotal data to give you the best snap shot of the market. For those of you who have read our newsletters since 1983, a special thank you. We appreciate your interest and feedback these many years.

## THE ECONOMY & VACANCIES

One cannot look at the rising vacancy factor without understanding the macroeconomics of British Columbia and the North American economy at large. Interest rates have been driven down by a stronger dollar. This rise in our Loonie versus the US dollar has negatively impacted our ability to export. Each added cent of value to the Canadian dollar costs millions in export revenue, not to mention the corresponding job loss. However, British Columbia is somewhat insulated as a natural resource-based province and although the value of our currency drives up the prices of our resources, they are for the most part still in strong demand. Of critical importance to you is the continued decrease in interest rates which allows more of your tenants to become home owners. The serious byproduct of low interest rates is vacancies.

### Condo Fever

Local headlines of late are filled with "condo mania" returning to Vancouver. People are buying condominiums with an almost reckless abandon, financing at 4%-5% for 5 years, and in some cases, camping out overnight at a project's grand opening to secure a unit. With mortgage rates so attractive, it doesn't take long to realize that a 2-bedroom condominium costing $180,000 somewhere in the suburbs would cost less to own than paying rent. To add more fuel to the fire, CMHC has just announced easier equity requirements allowing qualified individuals to acquire ownership with zero cash down. This will result in still more tenants vacating rental suites for condos.

### "For Rent" Signs Abound

As first discussed in the June 2003 Goodman Report (Issue 27), vacancies have become a deep rooted problem that simply will not go away. Frankly, we do not see much improvement in vacancies over the next 12 - 30 months and must caution that a large vacancy factor in the 4 – 6% range may be the rule rather than the exception, perhaps with ever higher vacancy rates further away from the city core. CMHC confirms this by reporting the 2003 vacancy rates. Here is a sampling: Delta 6%; Surrey 5.9%; Kits and West Vancouver .08%. Talk about the old adage of "location, location, location." Paradoxically, the West End, often regarded as a microcosm in Vancouver's Lower Mainland, is currently experiencing unusually high vacancies said to be well over 5%. Tenants from the West End, many of whom are already working in the downtown core, are a major force in the downtown condo market. Also interesting is CMHC's average rents. They reported overall increases of 1.9%, well below our 2.3% inflation rate:

**GREATER VANCOUVER AVERAGE**

| | 2003 | 2002 | Increases |
|---|---|---|---|
| Bach | $654 | $638 | 2.5% |
| 1-Bedroom | $759 | $743 | 2.1% |
| 2-Bedroom | $965 | $954 | 1.1% |

Furthermore, CMHC also reported that most landlords were reluctant to increase rents in 2004. I'm aware of buyers, lenders, and appraisers discounting 2003 operating results and 2004 proformas by increasing the vacancy factor. In fact, vacancy expenses previously ignored by buyers are now being carefully scrutinized. Overall, CMHC is reporting only 2.2% in vacancies in metro Vancouver for 2003, up from 1.5% the previous year. Many of my clients, however, are reporting much higher rates than those official quotes. One only has to read the Saturday classifieds in The Vancouver Sun. The volume of ads is staggering.

Let's take a deeper look at this phenomenon. We all know that people are moving out and buying houses and/or condos. Fierce competition for renters will not necessarily be from other apartment buildings but from newer condominiums that have been bought by investors as rental units. Reports of tenants breaking leases and landlords reducing rents are rife in the industry. Don't think that Vancouver is alone. Toronto landlords are offering incentives to attract new tenants as their vacancy factor in the core area is running in the 4-5% range. A prominent Toronto landlord, Beau Properties International, states in *National Post's Business Magazine* March 2004, that better days are not in sight. He goes on to say, "My estimates show that vacancy rates should rise to 6-7%." While Vancouver is a vastly different market, I know that we are in trouble when the local media headlines the fact that simple investors with limited earnings can borrow enough money to go out and buy 1 or 2 condos, adding still more rental units to an already over supplied and weak rental market.

### Service Your Client

With existing rent levels soft, maintaining them tends to be a landlord's and property manager's immediate challenge. The more savvy owners will fight fire with fire. Attracting new tenants and retaining existing tenants will occur only when each apartment owner adopts West Jet's philosophy of calling and treating their customers as their "guests". Accept the fact that your valued guests are major assets. Vacancy is a cancer that you need to eviscerate!

One Should Consider:

- Cosmetic as well as mechanical upgrades
- Caretakers who care, dress appropriately and smile rather than scorn
- Timely repairs
- High speed Internet
- Security
- Clean grounds
- Competitive rent levels

Those owners who work at reducing vacancies will be the big winners. Those who simply put out their old cablevision vacancy sign, leave debris around the building and haven't upgraded their lobby in 15 years will certainly pay the price for their indifference.

## HISTORICAL PERSPECTIVE

To fully understand and appreciate the nature of the apartment business in Greater Vancouver, one needs to reflect on the history of our industry, especially the post-Expo period. After Expo 86, we experienced 4 years of wild exuberance tantamount to a shark-feeding frenzy, particularly so in the apartment sector. This was fuelled by post-Expo visitors (offshore and mostly from Asia) snapping up properties at times sight unseen and at prices that were absolutely beyond belief. Between 1987 to 1991, apartment prices rose on a per suite basis to 60% in Vancouver's East Side and to a whopping 103% in Kitsilano, with the other areas of South Granville, North Vancouver, Burnaby and New Westminster falling somewhere in between. Furthermore, speculation was running rampant, flipping was common practice, and buildings often received multiple offers. New buyers, owners and yes, some real estate agents, simply perceived that continuing capital appreciation well into the 90's would compensate investors willing to coexist with negative cash flow from their real estate holdings. Remember, all this frenzy took place during an era of 10% to 12% mortgage rates while cap rates were running at 5% to 7% – talk about negative cash flow!

## A Time of Reckoning

The early 90s brought profound changes to the investment climate in BC, particularly as it related to multifamily rental apartments. It was more than just the NDP's policies that impacted our economy. Ongoing national budget deficits combined with the Feds trying to wrestle inflation to the ground with higher interest rates caused a very dramatic slowdown in the apartment market. For example, in one year from 1989 to 1990, sales volume dropped from 353 buildings sold to just over 100 transactions the following year. An astonishing 70% decline. From 1994 to 2000, only 50-70 buildings sold yearly. Getting anyone greatly motivated to act, be it sellers or buyers, during this market lull was a tall order indeed – certainly a far cry from the late 80s.

## Market Finds Its Footing

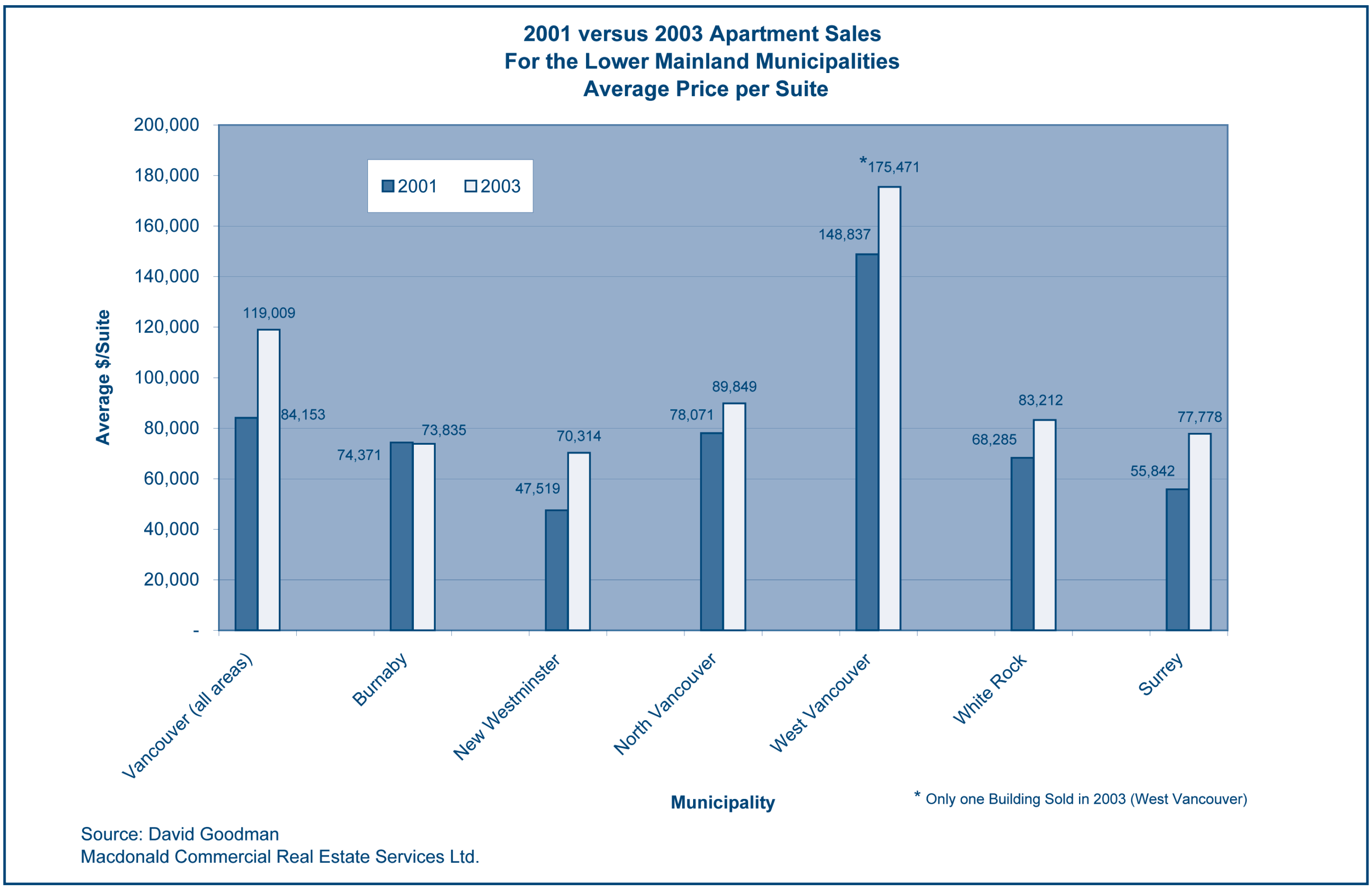
The year 2001 was a turning point which had positive implications for the industry. What finally occurred was a long overdue realignment of a number of positive factors which contributed to a more optimistic investment climate. We should call this phenomenon a convergence – "to cause a trend toward one point." The NDP government no longer being in power (albeit, Gordon Campbell seems to be doing everything in his power of late to reverse that occurrence), income taxes lowered, more favourable treatment of capital gains and historically low mortgage rates all provided impetus to the stalled apartment rental market.

To further illustrate the resurgence of prices, let's visit 8 areas in the Vancouver's Lower Mainland and review prices over a 3 year period:

| | 2001 | 2003 | Change |
|---|---|---|---|
| East Side, Vancouver | 58,007 | 78,795 | +35.8% |
| Kitsilano, Vancouver | 119,050 | 140,500 | +18.0% |
| South Granville, Vancouver | 105,828 | 126,722 | +19.7% |
| Marpole, Vancouver | 74,161 | 92,582 | +24.8% |
| Burnaby | 74,371 | 73,835 | -0.64% |
| New Westminster | 47,519 | 70,314 | +47.9% |
| North Vancouver | 78,071 | 89,849 | +15.0% |
| White Rock | 68,285 | 83,212 | +21.8% |

As predicted in earlier newsletter and email advisories, wherein we highlighted Vancouver's East Side, Marpole and New Westminster as having the biggest upside potential, these areas have shown the most significant advances in average prices per suite since 2001.

For a comprehensive synopsis for 2003 market activity, get the full story by visiting:
www.goodmanreport.com/markettrends.asp



### Prices – are we near the peak?

For those of you who are thinking of selling, you will have benefited from a remarkable increase in values since 2001. In profiling today's market, vacancies have become a growing concern, interest rates are likely at or near bottom and buyers are literally inundating us with inquiries. In July 1997 (Issue 22) we took the unprecedented step of recommending that owners not sell because of the high taxes on capital gains and low demand. The tide has changed.

> ***We are now strongly suggesting for those of you contemplating a sale of apartment asset(s) to act over the next six months in order to take full advantage of this red hot market.***

### Mortgage Rates – Near the Bottom?

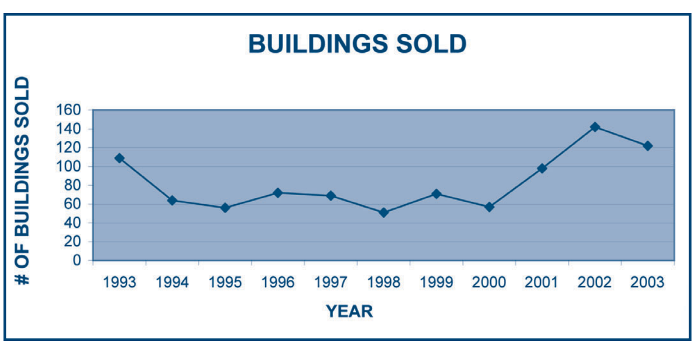
Commercial lending rates have never been lower and are probably near or at the bottom of the trough. In a recent commentary, financial writer Michael Campbell of *The Vancouver Sun* cautioned that higher interest rates may be on the horizon suggesting that the willingness of foreign bond holders of US debt may wane. Campbell asserts that foreign investors of these vehicles are being hurt by the fall of the US dollar. At some point, he continued, investors may sell their US debt holdings to avoid further currency losses thus sending bond prices lower and pushing long-term interest rates sharply higher. No one can say where the bottom of the trough is – but hasn't it often been the case, when rates move up, they do so very quickly? It's their decline that seems so excruciatingly slow.

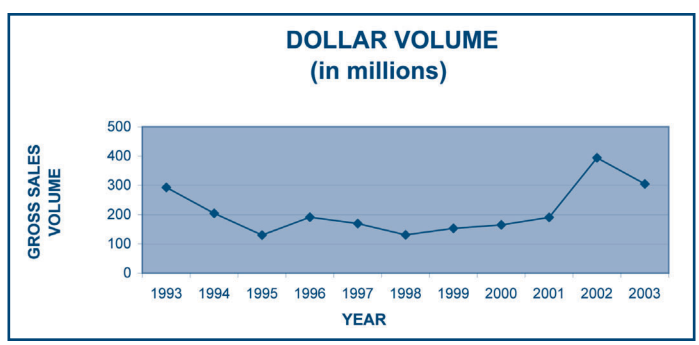
With this in mind, wouldn't it then make good sense to refinance your property(s) and expand your real estate holdings, or as any good financial advisor would suggest, diversify your holdings? They may recommend investing your funds in either another property and/or other market driven securities such as Real Estate Investment Trusts (REIT). There are some excellent REIT's yielding somewhere between 7% and 7.5% which have shown remarkable stability, are rated in the top 50 or so in Canadian Income Trusts, have instantaneous liquidity and are tax efficient investments; some of the monthly cash flow you receive is principal and sheltered by capital cost allowance. What a great way to use positive leverage.

## AREAS TO WATCH

Many clients call me to discuss what areas I see as undervalued or underrepresented in apartment owners' portfolios. If I had to choose 5 areas, the first would be the Great Northern Way area because of the change of use to the old Finning Tractor site where SFU, UBC and Emily Carr Institute of Art and Design are establishing campuses. I expect to see major gentrification in and around this area. The second would be Southeast False Creek. This area seems ready to undergo some exciting urban development with a massive new mixed-use community now in the planning stages. Thirdly, the Mount Pleasant area. The city has done everything in its power to change this area and like Great Northern Way, a major push on gentrification. Many young professional families are moving into this centrally located area because of the affordability. Fourthly, the "S" word: Surrey; even Walley seems to be an area that investors should take some interest in. A few months back, the Goodman Team sold a site near Surrey Place to a group who are committed to building two 70 suite rental buildings. Yes, rental! They firmly believe that the Walley area with the two SkyTrain stations, Surrey Place Shopping Center (the Central City office tower) and with an SFU campus being added will experience rapid growth. Finally, an area that I highlighted a year ago: the Middlegate area. Bosa Ventures purchased the Middlegate Mall through the Goodman Team and is now building a new shopping center of 100,000 square feet and four 30-storey towers. (Apparently, the 3rd tower is almost pre-sold). In 4 to 5 years the Middlegate area will be unrecognizable by virtue of the intense redevelopment spin-off.

## GREATER VANCOUVER APARTMENT BUILDING MARKET




Source: David Goodman
Macdonald Commercial Real Estate Services Ltd.

### Today's Buyers – Who Are They?

Over the past few years we have seen a new wave of investors made up of first time buyers and others with real estate savvy who are focused, sophisticated and interested in adding value. Another relatively new phenomenon is strong buying interest being generated from our neighbours in Alberta. Seeking larger multifamily complexes including strata buildings, investors have been actively recycling petro dollars in our provinces the past 12 months. The local, older established families, with a few exceptions, who have built up large portfolios in the 60's and 70's, have not been particularly aggressive. Instead, they are quite content to sit on their assets and pass on the wealth with their own estate planning and/or family holding company mechanisms. Not surprisingly, the bulk of the buying stems from existing smaller to mid size owners expanding their portfolios. Offshore buyers are not active. What a change from the early 90s!

## PROPERTY MANAGEMENT TIP

### Exit Survey

What is an Exit Survey? An Exit Survey is a brief questionnaire that you ask a departing tenant to complete. This might tell you why the tenant is moving out. Perhaps the caretaker is alienating your tenants or possibly, the hot water isn't hot enough or takes too long to warm up for the morning shower, or they don't like the color of the carpet. It doesn't matter what the reasons are. One can react very quickly on making the necessary changes once a trend has been identified. I would recommend that an Exit Survey be given to each departing tenant with a self-addressed envelope that goes directly to you or the management company, not to the caretaker. I also suggest you put a stamp on the self-addressed envelope, an email address, or a fax number so that there is no cost to the tenant in completing this survey. Here is a sample questionnaire:

1. Is there anything that management might have done to keep you from moving out?
2. Did you perceive your rent was too high?
3. Have you decided to purchase your own apartment/house?
4. Was management not responsive to your needs in the apartment?
5. Have you out grown this apartment building and looking for something larger or more modern?
6. Did the pet policy displease you?
7. Other comments:

Questions such as these will give you great insight as to why a tenant is moving; an important factor to know in this volatile market. It has been my experience that solutions to problems are easier than determining what the problem is. Exit Surveys may help this process.

## TAX CONSIDERATIONS – POTENTIAL SAVINGS

I recently sold a property for a client who had owned it since the early 90s. Prior to listing, I suggested that a financial advisor be retained to review the history of the property to determine whether recapture could be avoided. The advisor asked the following questions: What was the assessed value of the property when purchased (through the eyes of the BC Assessment Authority) versus the assessed value today? How did the client set up the division between land and building?

It is essential that one looks at the breakdown between land and building. In this particular case, I will use the example of the assessed value at date of purchase of $1,450,000 of which land was $450,000 and building was $1,000,000. Let us assume that the purchase price was equal to the assessed value, which was a fair reflection of the market in 1990. My client sold the property in 2003 for $2,750,000.

However, the assessed value showed an entirely different picture than what the normal recapture and capital gain generally appear, all being very positive for my client. The assessed value in 2003 had the building at $250,000 and the land at $2,200,000, so in effect, over the last 10 years, the building had gone down in value, whereas the land had increased 5 times in value. From a tax standpoint, the most interesting scenario was the details of how this recapture was treated. In most cases, the sale of a property recaptures all the depreciation (CCA) it has taken over the ownership period; and that is taxed, in effect, at 100% as straight income. However, in this particular situation, since the brick and mortar had depreciated in value, there was a terminal loss on the building portion (there was no recapture) and in fact, the recapture of depreciation was transferred from straight income to a capital gain and taxed at only 50%. The following example highlights how important it is to look at these details.

CCA claimed 1990-2003 = $42,356

| | |
|---|---|
| **Tax Treatment upon sale** | |
| Land (ACB) | $ 450,000 |
| Land (Sale) | $2,200,000 |
| Capital Gain | $1,750,000 |
| **Recapture** | |
| UACC | $ 570,643 |
| Building | $ 250,000 |
| Terminal Loss | ($ 320,643) |

$1,000,000 - $57,643 = $420,357 of previously claimed CCD

From a tax perspective, the taxpayer would declare $875,000 of income (one-half the capital gain) and then declare a terminal loss of $320,643 making the net taxable event equal to $540,857 with tax (assuming the highest MTR) of $238,373. The total real gain was $1,000,000. Total CCA to be recaptured would have been $420,357 with potential tax equal to $395,753. This scenario resulted in a tax saving of $157,396.

The lesson is to do your homework. During the listing process, have a skilled financial advisor review the purchase details and all income tax filings since ownership to determine whether additional tax dollars can be saved.

It is important to actually define these details in the Offer to Purchase and Sale to clarify any audit issues with CCRA. Not all properties will have such an anomaly, but many might. Yes, it may cost you $1,000 or so for a review, but can you imagine the savings if you could even shelter $300,000.00 of recapture? In my client's situation, he saved nearly $160,000 of taxes – not bad for a $1,000 - $2,000 investment!

## BITS AND BYTES

1. Did you know that CCRA, formerly Revenue Canada Taxation (that change cost Canadian taxpayers $50,000,000) has announced another name change? Yes, pending approval by Parliament, CCRA will be officially known as Canada Revenue Agency.
2. President Bush and Democratic contender John Kerry are both members of Yale's very exclusive and secretive Alumni club called Skull and Bones. And we thought the 2000 election seemed fishy.
3. Vancouver's Election Reform Committee is holding public meetings to see if Vancouver should continue with its "at large system" or change to 14 wards. I can understand why New York would function better with districts, but Vancouver? Just imagine the politicking that would go on. Dunbar's council member trades votes with Point Grey's to secure a new picnic table in exchange for a new tennis net. Cope, Vancouver's left wing party's argument is that since Westside voters turn out in larger numbers than the Eastside, the current system is undemocratic. Please, would someone like to explain that logic to me? Westsiders get penalized for exercising their franchise!
4. Most of the problems in the private rental housing market would appear to be somewhat income tax driven. The most onerous tax disincentive is not to allow rollovers. Our southern neighbour has what is commonly referred to as a 1040K rollover which allows a liberal amount of time to take a profit and buy a larger property. This adds liquidity, as well as incentive for builders to undertake large rental housing complexes, hold, then sell. It is common in the United States for builders doing 300 - 600 units. When was the last time we had a project of this magnitude for the rental market?


It should be noted again that hotels and farms are granted "roll over" status. Try convincing an owner of an apartment building that the daily, if not hourly, management requirements are not that of an active business. The Canadian Federation of Apartment Associations have been actively lobbying the Feds. Perhaps the P.M. will see the light.

## THE BIGGEST ISSUE FACING OWNERS

There are fundamental and structural changes occurring in our housing markets caused by low interest rates and Vancouverites rekindled love affair with condos. So please forgive me if I've belaboured this vacancy business, but I must add that the "good ol' days" of opening your door in the morning, hanging out a "For Rent" shingle and being deluged with calls and showings from qualified tenants is a thing of the past. Many landlords believe that the housing market will price itself out of reach and tenants will suddenly reappear. Don't be fooled into believing that housing prices are so expensive that young people cannot afford them. That is simply not true. In 1976, an 1800 sq. ft. Richmond split-level sold for $71,500 new. Buyers would scrape together 25% ($17,875) and finance $54,625 at the then going first mortgage rate of 12%. Their monthly payment was $565 - far more than rent was. Today, that same $564.00 will service $96,600. Given salaries have increased at least 4 fold in today's terms, that equivalent $565 in 1976 dollars could service $290,000 in 2004 dollars. This is overwhelming evidence that landlords will be required to start marketing their product and compete in the market place for tenants as many of the younger market will opt for ownership.

## A STRONGER INDUSTRY VOICE – YOU ARE NEEDED!

What is the apartment industry's importance to our economy? You may be surprised to learn that the capital value lies somewhere between $9 billion and $10 billion. That figure takes into account the approximately 115,000 rental suites in Greater Vancouver. There are approximately 3,100 buildings with about 2,000 owners – say an average of $80,000 per suite – the math is rather simple, keep in mind this does not include smaller revenue properties, illegal suites or rented condos.

If one concurs that 35% of every rental dollar is directed to operating expenses and if we can assume that the average suite (in the Lower Mainland) rents for $750/month, one can estimate that $82,500,000 per month is paid in rent with $28,875,000 flowing through our economy providing goods and services. The balance of $53,625,000 is going to you, the owners and debt service. Based on just the capitalized value, it is my view that apartment owners require a still stronger voice. How is that achieved, you ask? If you are an apartment owner and are not a member of the BCAOMA, I would strongly recommend you join. The B.C. Apartment Owners and Managers Association does phenomenal work, representing a vital industry in the Vancouver Lower Mainland. The multiplier effect is enormous.

Not many other industries in the Lower Mainland generate this much cash flow on a monthly basis without a greater voice in government. This is not to suggest that our leadership is poor. On the contrary, it suggests that we are underrepresented and that we need more owners and service providers to join this outstanding association to become a stronger, still more effective lobby group at the municipal, provincial and federal levels. If you think this is a free plug for the British Columbia Apartment Owners and Managers Association, you bet it is. For those of you who are not members, we need you. Now is the time to join. Call BCAOMA today at (604)733-9440. For those of you who are members, congratulations – your involvement is greatly aiding our industry.

# WHAT'S HOT – WHAT'S NOT

## What's Hot

- CMHC First Mortgages at 4.25% - 4.5%
- Multifamily development sites (still)
- Refinancing opportunities
- Condition inspection forms – now mandatory
- New Privacy Act
- www.goodmanreport.com – industry's top website
- Gastown's soon to open Storyeum
- BCAOMA's Lynda Pasacreta's excellent education seminars for caretakers
- RAV Line – Airport to Downtown – Marpole to win big

## What's Not

- "Combined Right" – so where are they?
- Vacant rental units – drive through the West End lately?
- Discriminating tax burden on landlords
- Soaring insurance rates up 300% in 2yrs
- U.S dollar's decline – could have serious repercussions
- Feds shocking spending habits – the scapegoat game begins
- Owners of condos being plagued by tenants breaking leases
- City engineers' inability to synchronize traffic lights, especially downtown – must be rocket science
- Hey Prime Minister – Clear up your own mess – Let the NHL handle theirs

## Good News for a Change

Vancouver is again being recognized, accordingly to the Economist Intelligent Unit, as one of the world's most liveable cities tied with Vienna and Melbourne. We've been awarded the Olympics, World Junior Hockey Tournament, United Nations Urban Forum in 2006 and Police and Fire Games in 2009. The positive spin-offs from these and other events are huge.

*David and Mark Goodman*

N.B.C. after the Winter Olympics in Turin Italy must, by their contractual obligation to the I.O.C., start advertising the 2010 games. Don't underestimate what this event will do for Vancouver and the province. We are indeed fortunate to live here.

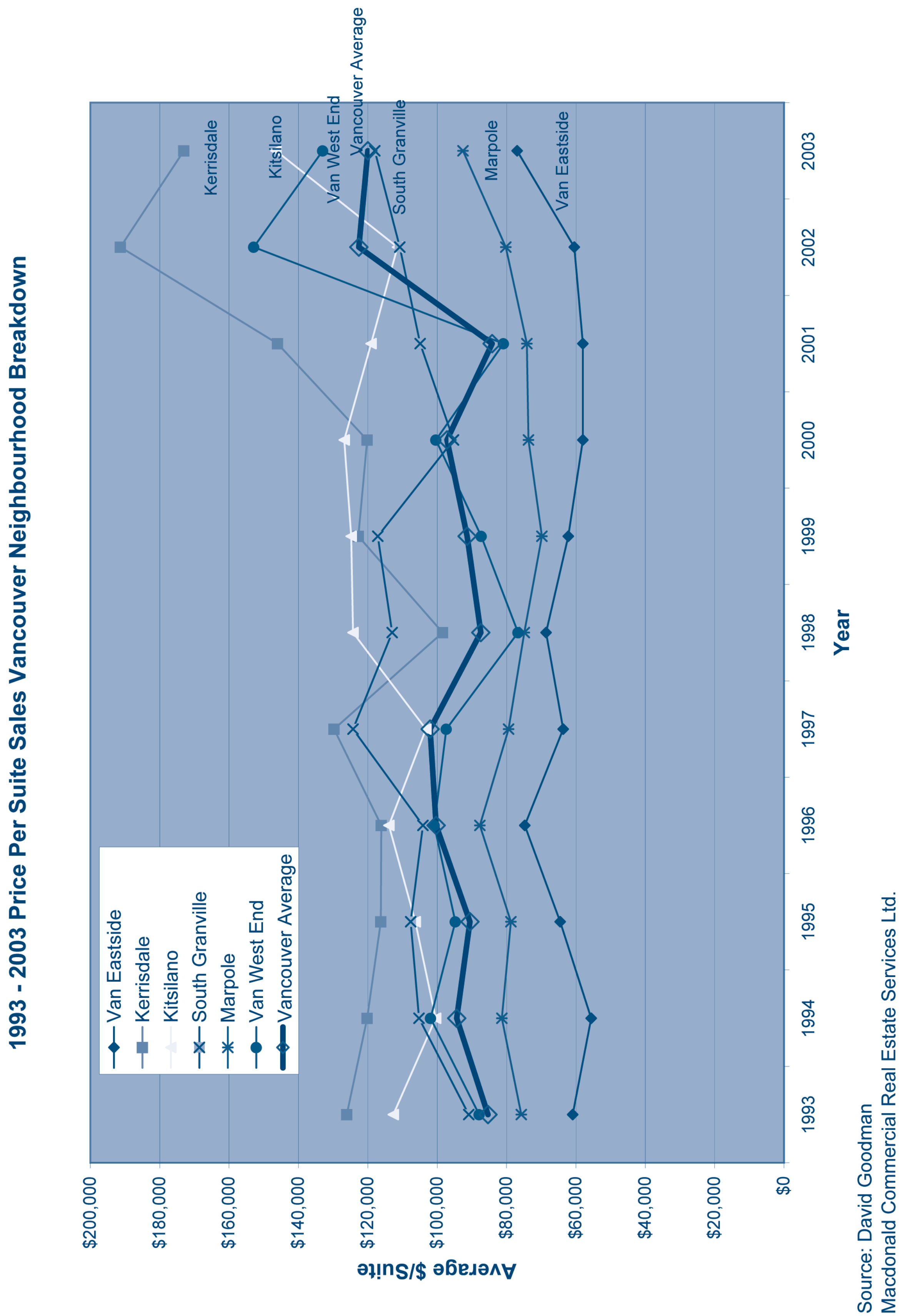
# THE GOODMAN TEAM

What is the Goodman Team? What do we do and what is our raison d'être? The easiest way to describe who we are is rather simple – we are problem solvers. What could be more simple and more to the point? To be your problem solver requires our team to be information purveyors. We accomplished that through our web page, our newsletter, and by far still the most important, our personal service and contact with you, our clients. We live in an on-demand world. Information technology has demanded that information be available quickly. For those who are online, waiting for snail mail is no longer your only option. Instantaneous answers are demanded – anything less is unacceptable. My son Mark joined our team some 2 years ago. I am very proud of the progress he has made. Our clients, and I use the word "our", have reacted very positively to his enthusiasm, his knowledge, and his skill. He has adapted quickly to this industry in a very short time. What took me years to learn, Mark seemed to have acquired almost overnight – scary sometimes. If I am not available, Mark can handle almost all of your needs as if I were in his shoes. Please remember, that all decisions of the team always go through me and until such time that I am in a rest home with a bib on, I will remain the captain of this ship.

Please visit our site: www.goodmanreport.com. Mark and I would love to hear from you.

*Since a politician never believes what he says, he's always astonished when others do.*

– Charles de Gaulle

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