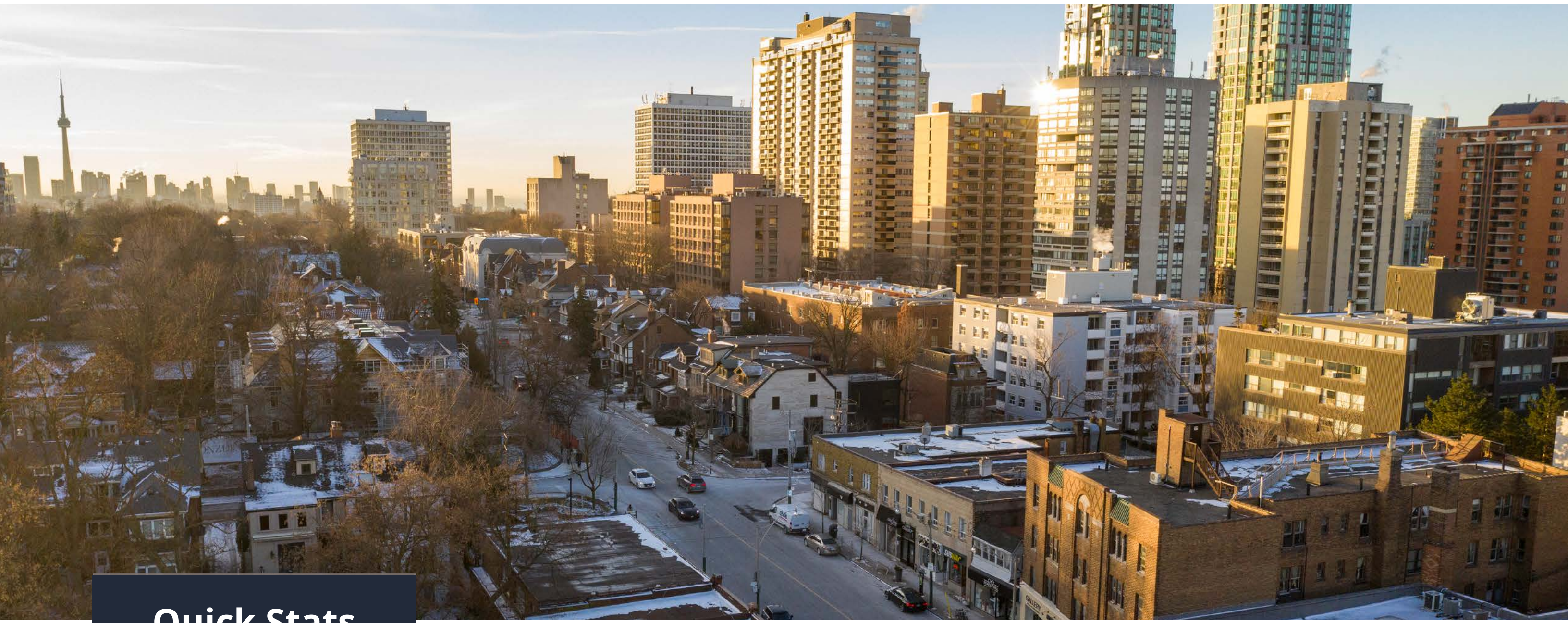
Multi-Residential Investment Review / Fourth Quarter 2020

Greater Toronto Area



Quick Stats

$877 million
Total GTA multi-residential transaction volume in the fourth quarter

$369,674
Average price per unit for buildings of 20 units or more – up 26% year-over-year

$2,302
Average monthly rental rate for condominium apartments in the GTA in the fourth quarter

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

54
Number of investment sales transactions during the fourth quarter, up from 45 in the previous quarter

The Greater Toronto Area (GTA) multi-residential market started 2020 with high expectations following record-high transaction volume in the fourth quarter of 2019. Although the lockdowns and restrictions imposed in response to the COVID-19 pandemic severely slowed investment activity in all sectors during the second quarter, pre-COVID-19 pricing returned when activity resumed in the third, and fourth-quarter pricing exceeded levels recorded before the pandemic. Overall, the sector has experienced a rapid recovery and posted solid annual results despite the adverse circumstances.

Overcoming this adversity, fourth-quarter sales of GTA multi-residential assets totaled $877 million – up 52% quarter-over-quarter. The largest transaction of the quarter and year was a two-building portfolio (491 units) sold by Soudan Investments to Q Residential for $222 million.

Overall, $2.4 billion in GTA multi-residential assets sold in 2020 – down 37% compared with 2019 sales, which included a large portfolio transaction, but nearly equal to 2018's result and higher than any other previous year. The sector's average GTA-wide cap rate remained stable year-over-year at 3.6%, while average price per unit increased by an impressive 8.2%. The fourth-quarter sales surge was a welcomed respite in a year where the unpredictability of the pandemic stymied investor appetite for select properties. Meanwhile, high-density residential land sales were down slightly from $2.1 billion in 2019 to $2 billion in 2020.

The foundation for a return to past and even better performances – low borrowing costs, plenty of capital, and fundamentals of low elastic supply and high demand for housing – remains intact and the wide distribution of vaccines should help sustain investor demand in 2021.

Leasing Activity

4.6%
GTA rental market vacancy rate

The GTA residential rental market was impacted by COVID-19 during the course of 2020, with supply exceeding demand due to several temporary factors including high unemployment, a reduction in the student population, and an effective increase in supply as short-term rentals (impractical or outlawed because of the pandemic) hit the long-term rental market. In addition, the GTA's population growth in 2020 was held back by record population outflows (mostly to other parts of Ontario) and low immigration numbers in 2020. Nevertheless, net growth was still positive, and the total number of condominium lease transactions increased 89% year-over-year to 12,111 units in the fourth quarter of 2020 – the fastest annual growth and highest fourth-quarter volume on record for the GTA, according to Urbanation.

The surge followed a spike in supply and decrease in rents, as renters looked to take advantage of discounts – mainly for downtown Toronto condos. At $2.95 psf, average GTA condo rents fell below $3 psf for the first time since first-quarter 2018; however, the 10-year average annual rate of rent growth remained above 4%. The dip in the City of Toronto rental market should give way to a strong recovery as the effects of the pandemic fade. Urbanation reports that the GTA rental market remains fundamentally undersupplied and that demand is expected to rise again as businesses re-open, students return, and new immigration targets help population growth return to normal. Pent-up demand and immigration could result in a jump in rental rates.

Urban Exodus?

0%
Rent increase limit in 2021

One of the residential real estate market's most-discussed topics is whether the emerging trend of residents exiting the downtown core for more spacious or affordable suburban options will continue beyond the end of the pandemic. Will work-from-home become the new standard, making people less inclined to live near their workplace? Despite these questions, market fundamentals remain robust and new housing development is a long-term play, not easily derailed by short-term crises. While people may adopt a more hybrid working model, the traditional office is far from gone, and there may even be opportunities to re-think residential design to better accommodate home offices.

315 bps
Cap rate / bond yield spread

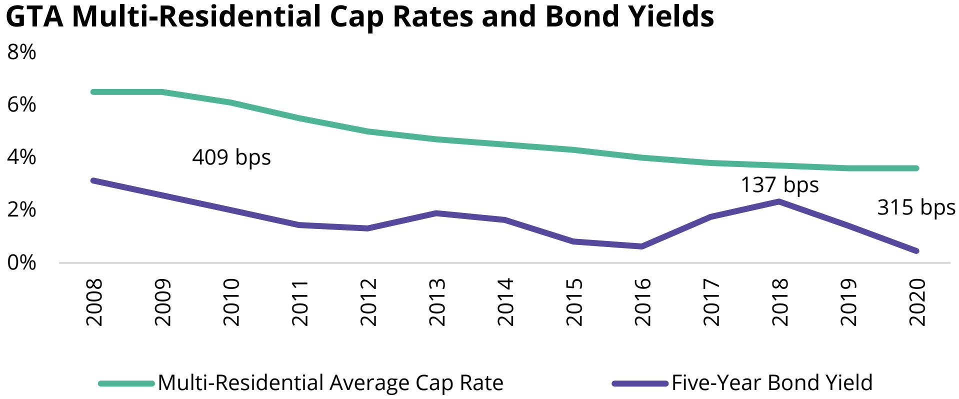
Although demand has been negatively impacted in Toronto's core for the short term, the GTA as a whole is still experiencing a drastic undersupply of rental stock, and non-core areas such as the inner Toronto suburbs and neighbouring Mississauga did not register the same short-term impacts in 2020. Demand across the GTA is expected to rebound once the pandemic passes, with the resurgence of immigration, the return of out-of-town post-secondary students and the revival of short-term rentals.

Development Activity

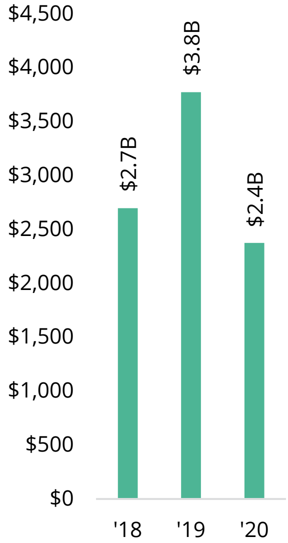
In 2020, increased institutional investment in the sector created more competition for private developers, encouraging them to be more aggressive, more creative and less risk-averse. However, for all types of investors, an abundance of both institutional and private capital is available for construction financing as lenders' outlook for the sector remains positive.

New and resale condo unit sales experienced a sharp decline in mid-2020 but posted increased price appreciation and higher absorption toward year-end. Developers were undeterred by the pandemic as new construction starts totaled 26,841 units in 2020 – a 10% increase compared with 2019. Urbanation notes that the number of condo units under construction in the GTA

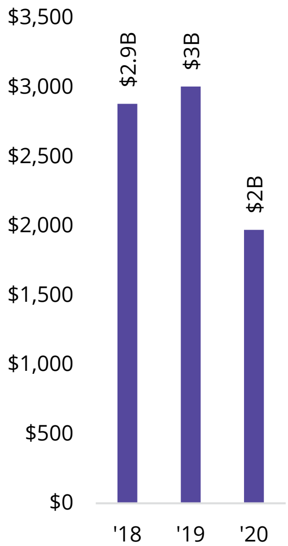
GTA Multi-Residential Cap Rates and Bond Yields



GTA Multi-Residential Investment Volume



GTA High-Density Residential Land Investment Volume



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High-density residential land transactions in fourth-quarter 2020

surpassed 80,000 for the first time ever in fourth-quarter 2020. Looking forward, condo completions are expected to remain elevated and nearly 5,000 new purpose-built rentals will reach completion across the GTA during 2021 – the most since 1993.

Affordable Housing

Affordable housing development is expected to grow in 2021 and 2022 as the federal government is stimulating the rapid construction of 3,000 new units in the GTA with its Rapid Housing Initiative, a $2-billion fund aimed at the creation of affordable and modular housing (whether through conversion of existing stock or new development).

Of this fund, $1 billion will fund private developer projects, likely resulting in an increase in demand from affordable-housing developers for residential land and non-prime multi-residential assets. The funding comes with several conditions – development of a site must be completed in a one-year timeline from the contract date and materials and labour costs are generally the same as for any other project, hence financing for these projects may become an issue. However, working with partners and lenders such as CMHC, which offers the most favourable interest rates and terms in this environment, will aid in lowering land acquisition and financing costs.

Valuation & Transactions

Underwriting for multi-residential assets has faced short-term challenges, as destabilization of the job market led to a government rent freeze and restricted tenant movement resulted in flat income growth, and it is hard to predict when landlords will be able to increase rents. However, proformas were able to offset lower income to some extent with lower expenses – primarily borrowing costs, which are hovering approximately 170 to 210 bps above 10-year bond rates (0.67% as of December 2020) for conventional financing. Important considerations in multi-residential business modeling – valuation, transaction, property and portfolio management, and net operating income – will have to factor in these short-term challenges, resulting in increased building values.

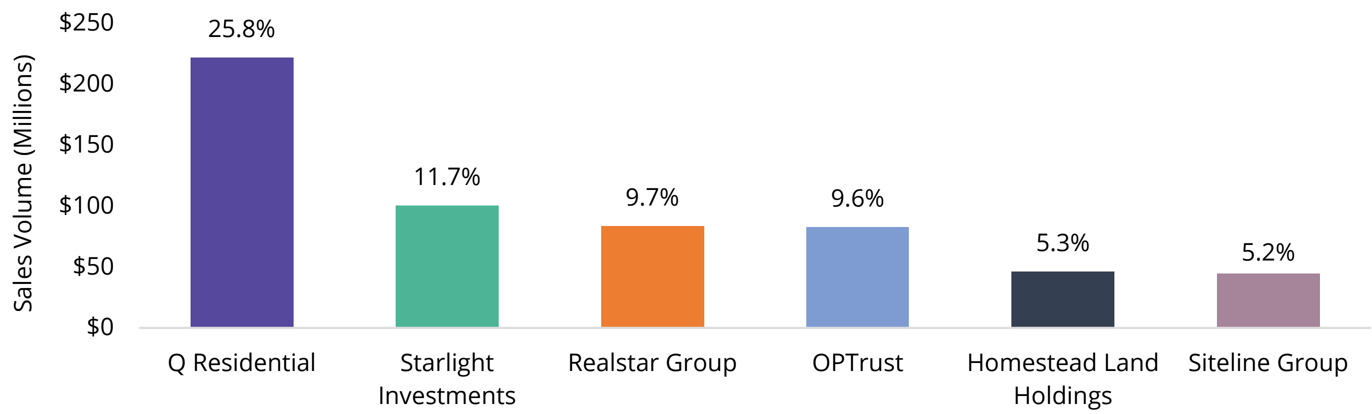
These factors will continue to be considered for valuations throughout 2021, given that Ontario's Bill 204 halted rent increases for the year, the MPAC reassessment for property taxes has yet to occur, and the looming possibility of a capital gains tax increase is still a concern. Fundamentals still suggest a compelling, supportive near-, mid- and longer-term market hypothesis for multi-residential investment and development.

Investment Trends

Economic forecasts show that Canada is poised for a robust recovery in both economic output and employment, signaling that multi-residential transaction volume will likely return to pre-COVID-19 levels. Furthermore, the Canadian government recently increased its immigration target to 1.2 million people over the next three years to make up for the reduced immigration total in 2020 due to COVID-19 – a call to developers and investors to remain highly optimistic about their pipelines and continue with the aggressive growth in development activity that has occurred in the last few years.

Demand for older multi-residential stock is supported by increased cost of housing – both to build and, for significant parts of the population, to own. Typically, older buildings trade significantly below replacement value and home ownership costs continue to skyrocket – adding to the economic strife brought on by the pandemic.

Top GTA Multi-Residential Purchasers by Market Share – Fourth Quarter 2020



Significant GTA Transactions by Sale Price

Sector				
Multi-Residential	**Total Price**	**Price per unit**	**Purchaser**	**Vendor**
Soudan Investments – Q Residential Portfolio	$222,055,000	$452,251	Q Residential	Soudan Investments GP
165 La Rose Avenue	$83,600,000	$396,209	Realstar Group	Raamco International
50 Gerrard Street East	$82,800,000	$440,426	OPTrust	Horizon Legacy Infrastructure 2008 Corp.
301 Dixon Road	$78,500,000	$348,887	Starlight Investments	Reliable Construction Co.
1130 Queens Avenue	$46,100,000	$461,000	Homestead Land Holdings	Barney River
High-Density Residential Land	**Total Price**	**Price psf buildable**	**Purchaser**	**Vendor**
480 Yonge Street	$171,926,033	$486	QuadReal	Ontario Superior Court of Justice
325 Burnhamthorpe Road West	$90,000,000	-	Holborn Group	YMCA of Greater Toronto
241 Church Street	$73,000,000	-	Graywood	Mac's Convenience Stores
263 Adelaide Street West	$69,000,000	$198	Lanterra Developments	Ontario Superior Court of Justice
224, 230, 236 & 240 Adelaide Street West	$67,000,000	-	Freed Developments	5038553 Ontario Inc. / Private individual(s)

Get more market information

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