Federation of Rental-housing
Providers of Ontario

URBANATION

Ontario Rental Market Study:

Renovation Investment and the Role of Vacancy Decontrol

October 2017

Prepared for the Federation of Rental-housing Providers of Ontario by

URBANATION Inc.

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ABOUT FRPO

Since 1985, the Federation of Rental-housing Providers of Ontario (FRPO) has been the voice of Ontario's rental housing industry and the leading advocate for quality rental housing. The Federation of Rental-housing Providers of Ontario is the largest association representing those who own, manage, build and finance, service and supply residential rental homes in Ontario. We have led the rental housing industry in Ontario for over 30 years, offering public advocacy, representation and promotion, industry research, standards and best practices, education and training along with marquee industry events and awards.

ABOUT URBANATION

Urbanation is a real estate consulting firm that has been providing market research, in-depth market analysis and consulting services to the condominium and rental housing industry since 1981. Urbanation uses a multi-disciplinary approach that combines empirical research techniques with first-hand observations and qualitative information gathering through relationships built within the industry over the past 30 years. Urbanation's reports monitor the new construction, resale condominium, rental apartment and proposed development markets in the Greater Toronto Area. Urbanation also actively conducts customized research and market feasibility studies across the country for both condominium and purpose-built rental apartment projects. Urbanation's clients include the GTA's largest real estate developers as well as smaller-scale organizations, institutional investors, major lenders, government agencies, and a variety of service providers.

Data Limitations and Note to Readers

The analysis and results contained herein have been prepared on the information and assumptions set forth in this report. However, this report relies on information from secondary sources and Urbanation cannot guarantee the accuracy of this data.

1.0 SUMMARY OF KEY FINDINGS

- More than three quarters (77%) of purpose-built units in Ontario received renovation expenditures of $5,000 or more since 2012. The average per unit value of renovations was $13,745, with a total estimated investment of $5.2 billion ($4.9 billion within units built pre-1992), equal to 6% of the total value of surveyed units at $86.5 billion.

- More than half of units that were renovated received upgrades of $10,000 or more, including more than one-fifth investing over $20,000 per unit.

- The highest ranking factor motivating renovation expenditures was age of building and deteriorated quality, which is reflective of the fact that 85% of purpose-built rental apartments in Ontario are more than 35 years old. The second highest ranking factor was the ability to achieve a return on investment through higher market rents on turnover. The average rate of turnover over the past 12 months was 27%, with 79% of respondents indicating that turnover had declined over the past year.

- More than half of purpose-built rental operators reported that they would be very unlikely to invest in their units in the next five years without vacancy decontrol, with nearly three quarters indicating that the removal of vacancy decontrol would make them more unlikely to undertake upgrades.

- Demand for renting purpose-built and condominium apartments in Ontario is projected to average 34,000 units annually in the coming decade, leaving an estimated supply shortfall of over 6,000 units per year. In the absence of policies that promote an immediate doubling of purpose-built rental construction, further declines in vacancy rates and intense competition for new units is expected, resulting in increased pressure on the existing stock of purpose-built units. This will require continued high levels of investment upgrades to ensure suitable accommodations for renters will be available. The research results indicate that the ability to achieve this goal must be facilitated through the continuation of vacancy decontrol.

2.0 INTRODUCTION AND METHODOLOGY

Background

FRPO retained Urbanation to undertake a research study that measures the importance of vacancy decontrol for the Ontario rental housing industry and the overall economy through the encouragement of renovation expenditures and the upkeep of the existing rental stock.

In April 2017, the Ontario government announced new housing policies that included the extension of rent control to all rental apartments (previously applied to units built prior to November 1991). Under these changes, landlords would still be able to apply vacancy decontrol and seek above guideline rent increases, where permitted. From a market perspective, the elimination of the post-1991 rent control exemption is understood by most economists and industry analysts to result in less supply through lower turnover and by limiting new rental construction. Therefore, it is believed that investment in the existing stock of rental apartments in the province, most of which were built prior to 1975, will increase in importance in the coming years to provide suitable accommodations for the expanding number of renters.

As an additional component of the research study, overall market conditions for rental apartments in Ontario were analyzed and projected in the context of the drivers of demand and the outlook for supply growth. This exercise measured the amount of additional rental apartment development required to meet the needs of Ontario households over the next 10 years (i.e. the supply gap), under the new rent control rules and the assumption that vacancy decontrol is maintained. This research was released through a separate report on September 25, 2017 entitled “*Measuring the Supply Gap*”.

Overview of Ontario’s Rental Housing Stock

As of the time of writing, the latest available data on the total number of private renter households, occupying dwellings of all types, was reported through the 2011 National Household Survey (NHS) at 1.4 million in Ontario. An updated statistic is scheduled to be released through the 2016 Census results in October 2017. According to Canada Mortgage and Housing Corporation survey data from 2011, there was a total universe of 627,011 private purpose-built rental apartments in Ontario, equal to 45% of the province’s total rental stock. Statistics Canada also reported as part of the 2011 NHS a condominium rental apartment supply of 102,080 units in Ontario, bringing the share of total rentals represented by purpose-built and condominium rental apartment units to 52%. The remaining rental stock was mainly comprised of dwellings categorized as single- and semi-detached houses, row houses, duplex apartments and other secondary suites.

The scope of this study focuses on the supply of purpose-built and condominium apartment rentals in Ontario, due to the availability of more frequent and detailed data than reported for all forms of rental by the Census, as well as the applicability of these rental units to the business of FRPO members.

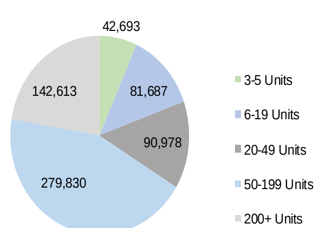
Survey Methodology

In August 2017, Urbanation, with FRPO's input, designed a 10 part questionnaire that was administered to FRPO members that own and/or manage rental apartments. FRPO members of this category are largely represented by institutional organizations with substantial purpose-built rental holdings, although also inclusive of smaller operators. The survey asked each respondent questions relating to the total size and value of their rental portfolio, the level of renovation expenditures undertaken over the past five years, reasons for investing in renovations, tenant turnover rates, and the importance of vacancy decontrol for their business.

The respondents to the survey represented a total of 91,163 units, equal to 14% of the total Ontario purpose-built rental apartment universe of 637,801 units measured by CMHC as of 2016. Furthermore, the survey respondents represented a total of 81,490 units built prior to 1992, which were already subject to rent control regulation prior to the latest rule change.

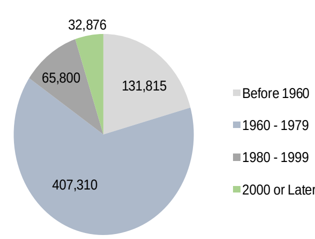
Recognizing that FRPO members are heavily weighted towards organizations that own buildings each containing 20 or more units, the survey sample can be estimated at 18%, using CMHC estimated universe counts by building size for 2016 (Figure 2.1). Furthermore, CMHC breaks down the purpose-built rental apartment universe by period of construction (Figure 2.2). Applying the ratio of total purpose-built rental apartments in buildings of 20-plus units to the stock of units built prior to 2000 (the most likely units to receive significant renovation expenditures) produces a total survey base of 486,956 units. Under this assumption, the survey response rate rises to 20%, which is consistent with the sampling of the Census long-form questionnaire.

Figure 2.1
Purpose-built Rental Apartment Universe by Building Size
Ontario: 2016



Source: CMHC Housing Market Information Portal

Figure 2.2
Purpose-built Rental Apartment Universe by Period of Construction
Ontario: 2016



Source: CMHC Housing Market Information Portal

3.0 INDUSTRY SURVEY RESULTS

3.1 Total Renovation Expenditures

The average value of units surveyed was $177,716, with units built prior to 1992 averaging 24% less at $135,294. Applying the methodology outlined in Section 2.0, the total value of surveyed units was $86.5 billion, of which a total value of $62.1 billion was estimated for units built prior to 1992.

The survey results indicated that 77% of units received renovation expenditures of $5,000 or more since 2012, producing a total of 375,875 purpose-built rental apartments in Ontario that have invested in upgrades over the past five years (354,275 units built prior to 1992). The average value of renovations per unit since 2012 was $13,745, equal to approximately 8% of the average value of units surveyed (10% of the value of pre-92 units).

The survey results and methodology used reveals a total of $5.2 billion in estimated upgrades to purpose-built rental apartments since 2012, with $4.9 billion invested within the stock of rent-controlled units.

Table 3.1.1
Total Estimated Value of Renovations of $5,000 Plus for Purpose-built Apartments
Ontario: 2012 to 2016

Average Value of Units (all)	$177,716
Average Value of Units Built Pre 1992	$135,294
Total Estimated Value of Units Surveyed	$86,539,972,730
Total Estimated Value of Units Built Pre 1992 Surveyed	$62,096,250,636
Percentage of Units Renovated at $5,000 or more since 2012	77%
Estimated Total Surveyed Units Renovated at $5,000 plus since 2012	375,875
Estimated Total Surveyed Units Built Pre 1992 Renovated at $5,000 plus since 2012	354,275
Average Value of Renovations per Unit Since 2012	$13,745
Estimated Total Value of Renovations at $5,000 plus since 2012	$5,166,551,016
Estimated Total Value of Renovations at $5,000 plus since 2012 for Units Built Pre 1992	$4,869,646,751

Source: Urbanation Inc., FRPO, CMHC

Significance for the Ontario Economy

The latest estimates for Ontario GDP indicate that investment in residential structures (comprised of new construction, renovations, and ownership transfer costs) represented 8.3% of the economy in 2016, contributing 15% to total economic growth in the province since 2012. Total investment in renovation expenditures across all forms of residential structures in the province can be estimated at $24.5 billion in 2016, equal to roughly 3% of GDP and 5% of total economic growth in Ontario during the past five years.

In the context of the entire $798-billion Ontario economy, the $5.2 billion in estimated purpose-built renovation upgrades of $5,000 or more since 2012 appears marginal in its economic impact. However, averaging estimated total renovation expenditures in the Ontario residential stock of $20.9 annually over the 2012 to 2016 period shows that an annual average of $1.03 billion per year represented 5% of this GDP component, with the potential for reaching up to 25% of total residential renovation expenditures if the value of unit upgrades in the past five years was able to be carried out over a one-year period (the timing of unit upgrades is limited by tenant turnover).

Moreover, the total increase in renovation expenditures over the past five years for the Ontario economy is estimated at $6.6 billion, or an increase of $1.3 billion per year. This would indicate that the total value spent on significant upgrades to the purpose-built rental apartment stock represented 79% of total renovation growth and nearly 4% of total economic growth in Ontario since 2012 ð adding approximately 15 basis points to annual GDP growth.

Table 3.1.2
Ontario Nominal Gross Domestic Product, Expenditure Based
In millions of dollars

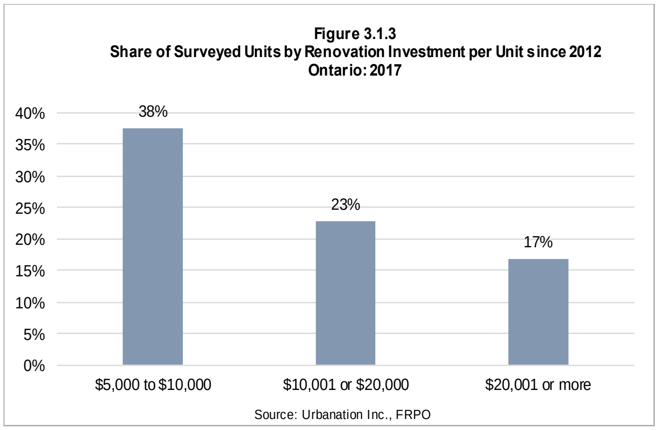
	2016	2011-2016 Change
Gross domestic product at market prices	$798,484	$138,741
Gross fixed capital formation in residential structures	$66,259	$20,279
Renovation expenditures*	$24,450	$6,550

*Data not released for Ontario. Estimated using national share.

Source: Ontario Ministry of Fianance Urbanation, FRPO

Renovation Expenditures by Investment Amount

The largest concentration of unit upgrades invested an amount between $5,000 and $10,000, representing 38% of total surveyed units and 49% of total units receiving renovation expenditures of $5,000 or more since 2012. Units that received upgrades of over $10,000 represented a 40% share of the stock surveyed, or 51% of units renovated at $5,000-plus over the past five years. While most $10,000-plus renovations were under $20,000 (23% of surveyed units and 30% of renovated units), a significant portion of units received substantial investments of over $20,000 ð 17% of total units and 22% of $5,000-plus renovations.



3.2 Reasons for Investing in Renovation Expenditures

Surveyed FRPO members were asked to rank a given list of reasons for their decision to invest in unit upgrades over the past five years. The factor most commonly ranked as of highest importance was age of building and deteriorated quality, which is reflective of the fact that 85% of purpose-built rental apartments in Ontario are more than 35 years old.

The second highest ranked factor motivating unit upgrades related to the ability to achieve a return on investment through rising market rents on turnover, understanding that 94% of surveyed units were rent-controlled and only able to recoup their renovation costs through the existence of vacancy decontrol.

Competitive pressures also ranked high as a factor behind renovation expenditures, indicating the need for purpose-built operators to upgrade units in order to attract quality tenants amid a burgeoning supply of secondary rentals offered within the condominium market. Interestingly, the availability of credit and low interest rates ranked relatively low as a factor, suggesting the motivations to invest in renovations were more out of necessity and competition than cost of capital. Other unlisted factors ranked lowest, supporting the validity of the factors surveyed.

Table 3.2.1
Factors Impacting Decision to Invest in Renovation Expenditures
Purpose-built Rental Apartments in Ontario

Rank	Factor	Average Score (1= highest 5= lowest)
1	Age/deteriorating quality	1.94
2	Rising achievable market rents at turnover	2.28
3	Competitive pressure: falling behind market standards	2.63
4	Low cost of borrowing	3.94
5	Other	4.25

Source: Urbanation Inc., FRPO

3.3 Turnover

Ultimately, the overall amount of renovation investment and the ability of rental operators to undertake significant unit upgrades is reliant on the level of tenant turnover. Surveyed FRPO members reported an average rate of turnover in the past 12 months of 27%. Moreover, 79% of respondents indicated that they experienced a decrease in turnover compared to a year ago, which thereby restricted their amount of renovation investment.

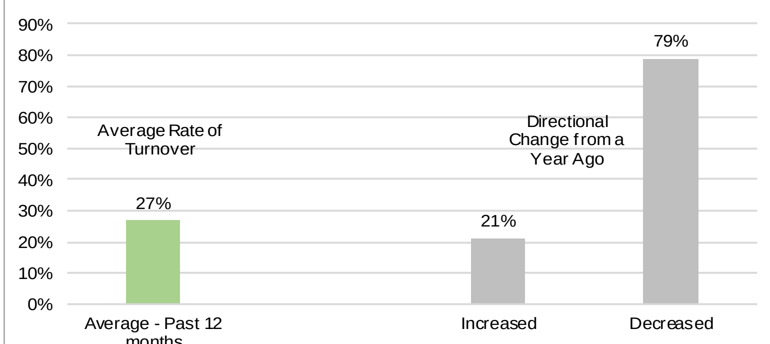


Figure 3.3.1
Average Rate of Turnover Past 12 Months and Directional Change
Ontario Purpose-built Rental Apartments: 2017

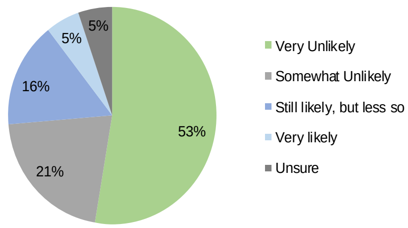
Source: Urbanation Inc., FRPO

3.4 Importance of Vacancy Decontrol in Renovation Investment

Given the age and condition of the existing stock of purpose-built rentals, and the importance of unit turnover and competitive market pressures in helping to facilitate renovation expenditures, FRPO members were asked the likelihood of investing in unit upgrades in the coming years if vacancy decontrol was removed ð meaning they lost the ability to adjust rents on vacated units to market levels following renovation.

More than half (53%) of respondents reported that they would be very unlikely to invest in renovations in the next five years without vacancy decontrol. An additional 21% were revealed to be somewhat unlikely, leaving nearly three quarters of respondents more unlikely to invest in unit upgrades under this scenario. Furthermore, only 5% of respondents indicated that they would be very likely to continue investing in renovations without vacancy decontrol.

Figure 3.4.1
Likelihood of Investing in Renovations in next 5 years
Without Vacancy Decontrol
Ontario Purpose-built Rental Apartments: 2017



Source: Urbanation Inc., FRPO

Comments from FRPO Members on the Importance of Vacancy Decontrol for their Business

“Removing [vacancy] decontrol would drastically reduce our clients' willingness to reinvest in their buildings and may negatively impact the participation of institutional investors which should be increased not decreased to ensure quality multi-family product.”

“If we had no vacancy decontrol it would have been impossible for us to carry out the renovations.”

“The [removal] of vacancy decontrol would be extremely detrimental to our operations and our ability to continue to operate and maintain our assets in a [sustainable] manner, as well provide well maintained and well operated buildings for our customers. Vacancy decontrol would create negative returns across our portfolio.”

“Vacancy decontrol is vital. It is like the hole in the lid of the kettle, it helps relieve the pressure put on us by aging buildings. The wellbeing and safety of our residents would be put at risk.”

4.0 CONCLUDING COMMENTS

The results of this research indicate that renovation activity occurring within the purpose-built rental apartment stock represents a meaningful component of Ontario's overall housing industry, and also makes a measurable contribution to the province's economic growth. The input of FRPO members made clear that building age and competitive market pressures require significant and ongoing capital investment to the existing stock. The most critical policy tool to encourage further renovation spending is strongly believed to be vacancy decontrol. The encouragement of rental operators to improve the quality of rentals in Ontario by allowing untenanted units to recoup their renovation investment through above guideline rent increases is expected to increase in importance in the coming years, as a substantial supply shortfall of new development occurs. The additional side effect of reduced turnover in a rent controlled market with low vacancy will already act as a restraint on renovation expenditures for the industry.

The results of the rental demand and supply study that preceded this report indicate an immediate need to double the annual level of rental development in Ontario. However, the prospect of this occurring under the new rent control regulations has been greatly compromised as developers are likely to scale back on their intentions to construct new rentals. Since the announcement was made in April, at least 1,000 purpose-built rentals planned for development have been cancelled. Needless to say, the supply target has virtually no chance of being achieved under a policy that removes vacancy decontrol, with significant adverse consequences for investment in renovation expenditures and the overall economy.

Market trends point clearly towards the need for policy that promotes new rental development and facilitates continued investment in the existing stock of both purpose-built and condominiums. This was evident before the new rental regulation was introduced in April, and is even more apparent now in light of the change.