



Federation of Rental-housing
Providers of Ontario

URBANATION

Ontario Rental Market Study: Measuring the Supply Gap

September 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.

1.0 SUMMARY OF KEY FINDINGS

- Rental demand in Ontario has reached multi-decade highs, driven primarily by robust economic and population growth, job creation for prime renter cohorts, and a decline in homeownership affordability. At the same time, supply growth for rentals has been almost entirely comprised of secondary units offered by investors in the condominium market. Purpose-built vacancy rates have fallen to a 15-year low of 2.1% across the province and 1.3% in Toronto as of 2016, with condo vacancy rates in Toronto dropping to a seven-year low of 1.0%.
- The recent increase in purpose-built rental construction combined with elevated levels of condominium development are expected to lead to above-average growth in rental supply in the next few years. However, the extension of rent controls to new buildings will eventually cause supply growth to stall, as fewer projects ultimately decide to proceed as rental and condo investors opt to hold their units in the rental market for shorter periods of time than in the past.
- Demand for renting purpose-built and condominium apartments in Ontario is projected to average 34,000 units annually in the coming decade, leaving a supply shortfall of over 6,000 units per year under the baseline development outlook. Without an immediate doubling of rental construction from current levels, further declines in vacancy and intense competition for available units is expected. The delayed increase in required rental development to offset demand could result in an annual supply gap reaching over 10,000 units within 10 years. Without any changes in the supply outlook, a cumulative deficit of 62,500 rental units is expected to be amassed in the coming decade.
- The expected market outcome will lead to increased pressure on the existing stock of purpose-built rentals in Ontario, 85% of which are more than 35 years old. This will require increased levels of investment upgrades to ensure suitable accommodations will be available for a quickly growing population of renters in Ontario. Forthcoming research to be released by FRPO and Urbanation reveals that rental owners spent over \$5 billion in significant renovations over the past five years, representing a meaningful component of Ontario's overall housing industry and making a measurable impact on the province's economic growth.

2.0 INTRODUCTION AND METHODOLOGY

Background

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.

This research study analyzes and projects overall market conditions for rental apartments in Ontario in the context of the drivers of demand and the outlook for supply. The goal of this exercise being the measurement of required rental apartment development to meet the needs of Ontario households over the next 10 years (i.e. the supply gap) under the new rent regulations.

In a forthcoming research report, the results of a study undertaken by Urbanation and FRPO will be released that measures the value of renovation investment within the existing purpose-built rental stock. In light of the results of the supply gap study contained within this report, the importance of capital upgrades for the Ontario rental housing market and the overall economy will be examined, along with the role of vacancy decontrol in encouraging such investment.

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, bringing the share of total 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.

Demand and Supply Methodology

This study provides a framework for analyzing and projecting rental demand and supply levels for Ontario. The model employs key factors impacting rental demand and their relative significance as market drivers, and examines supply trends and household formation rates within the purpose-built and condominium rental apartment stock. Other forms of rental housing are excluded, given the infrequent and highly estimated nature of the data releases, which lack annual changes in supply and occupancy rates.

The basic premise used to estimate demand was to first calculate aggregate annual levels of change in the occupied stock of purpose-built and condominium rentals in Ontario. Next the factors that have impacted changes in rental household formation levels over the past 10 years were analyzed. Then using trend-level estimation for key variables including economic growth, job creation, immigration and demographic changes, and ownership affordability, demand for rental apartments was projected each year out to 2026.

Rental supply growth was measured historically by calculating annual changes in the total universe of purpose-built rental apartments, in addition to the stock of condominiums and the share of units used for rental. Shorter-term supply projections were made using recent trends for construction of both forms of rental, with the medium-term outlook based on growth in the proposed inventory of purpose-built rentals and pre-construction condominium activity, with longer-term supply influenced by expected changes in the construction cycle for condominiums, the willingness of individual investors to continue holding units in the rental market, and developer willingness to proceed with new rental projects under the new rent control regulations.

Data Limitations and Note to Readers

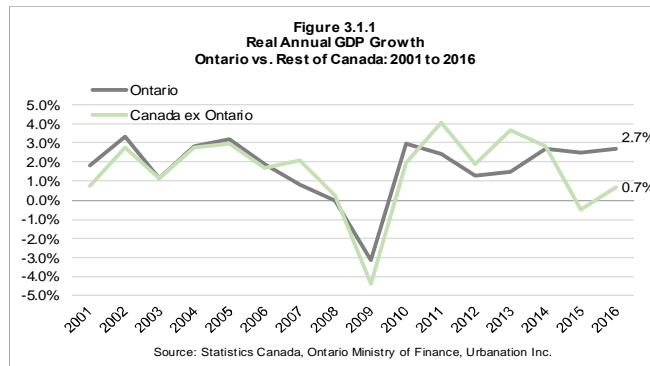
The analysis and projections contained herein have been prepared on the information and assumptions set forth in this report. However, this report relies on information from secondary sources and Urbanation cannot guarantee the accuracy of this data. Moreover, it is not possible to fully document all factors or account for all changes that may occur in the future.

3.0 ONTARIO RENTAL MARKET OUTLOOK

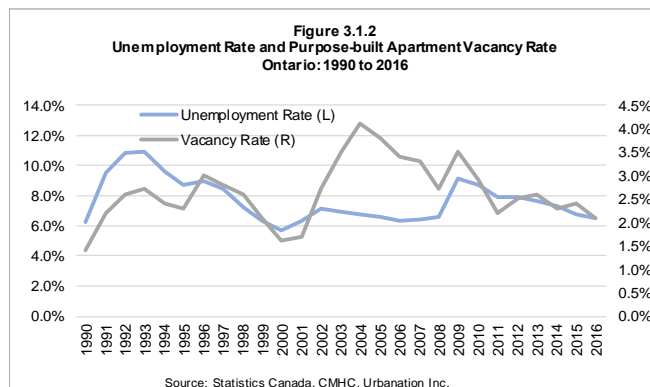
3.1 Rental Demand Drivers

Ontario Economy

The capacity for a market to experience an expansion in rental demand is rooted in the growth of its economy, which underpins job creation and the formation of new renting households. The Ontario economy has been a growth leader in Canada, with real GDP growth of 2.7% in 2016 – nearly four times the rate of growth for the rest of the country. Ontario's economic growth has been outstripping the Canada average since 2015, and is expected to continue to do so in 2017 and through to 2019, with growth exceeding 3% this year for the first time in over a decade. Toronto is projected to be the fastest growing Metropolitan area in Canada in 2017.



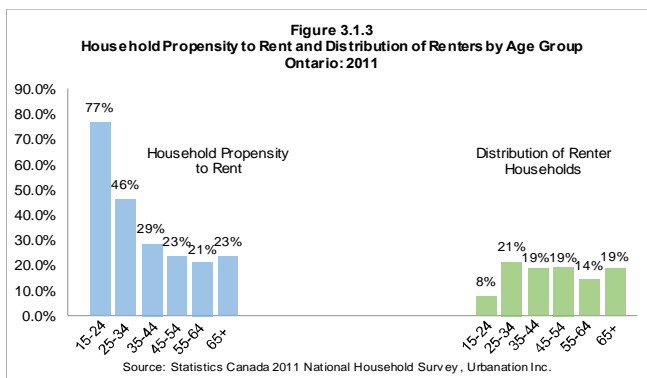
The Ontario unemployment rate fell to 6.5% in 2016, its level lowest since 2007. The rental vacancy rate has been highly correlated with the jobless rate, aside from the 2001-2007 period that witnessed a sharp rise in homeownership rates. Since 2009, the two variables have shown a very close relationship, with each basis point decline in unemployment leading to a 0.6 basis point decline in vacancy. The vacancy rate as of 2016 was 2.1% for Ontario and 1.3% for Toronto, with unemployment expected to fall below 6% by 2018.



Age Profile of Rental Demand

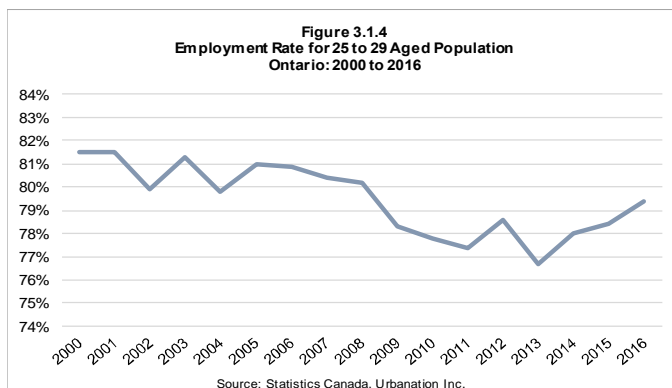
The latest data released through the 2011 NHS reported household propensities to rent and the distribution of renter households by age range. While households in the 15 to 24 age group were 77% likely to rent, they represented only 8% of total renter households. The propensity to rent dropped off to 46% among 25 to 34 year olds, who represented the highest share of renter households by age segment at 21%. The remaining cohorts had substantially lower propensities to rent, with most representing nearly equal shares of total renters.

With a 30% share of total renter households, the youngest adult segment aged 15 to 34 represents the largest source of new renter household formation.



As the 15 to 24 age group is largely comprised of students, the direct impact of economic growth on rental demand for private units can best be viewed through employment conditions for new graduates aged 25 to 29. The employment ratio (share of population employed) for this age group reached a post-recession high of 79.4% in 2016, representing a substantial rebound after a deep and prolonged decline was suffered between 2009 and 2013.

The expected expansion for the Ontario economy in the next few years should therefore lead to further increases in the employment ratio for younger workers, with lower unemployment contributing to rising rental demand and downward pressure on vacancy rates.

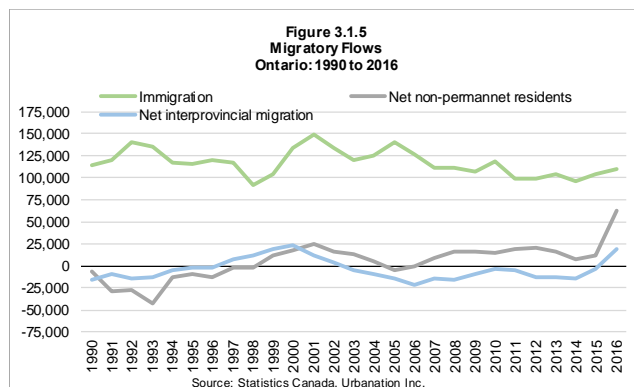


Population Projections

Immigration to Ontario reached an estimated 110,000 in 2016, the highest level since 2010 and 10,000 persons above the level averaged between 2011 and 2015. Higher immigration last year came amid increased economic attractiveness to the province, as well as higher total immigration targets for Canada set at 300,000, an increase of 40,000 over the 260,000 annual base target that was in place between 2011 and 2015, and a level that will be maintained as the target for 2017. At over 90,000 persons, immigration to the GTA last year represented 81% of the provincial total and 30% of the national total.

Other migratory flows to Ontario comprised of net interprovincial migration and non-permanent residents witnessed a surge in 2016. Net flows from other provinces turned positive at 20,000 persons for the first time in 14 years, while non-permanent residents (many of which are foreign students) reached nearly 63,000 in 2016, a 28-year high.

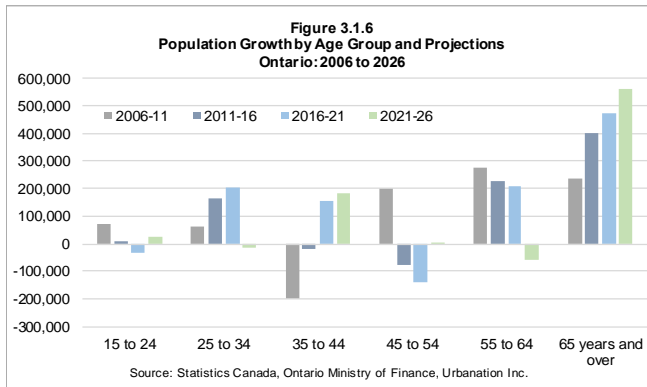
As the majority of migrants rent upon arrival, the increased inflows to Ontario has acted as a large contributor to rental demand in the province.



Under a medium growth scenario for migration, Ontario's population is projected to increase by an average of 184,000 persons annually over the next 10 years - an increase of 50,000 persons per year compared to the past 10 years. The 15 to 24 cohort (with the highest propensity to rent) is expected to experience flat growth, while the prime renter age segment between 25 and 34 will see accelerated population increases in the next five years, becoming the largest cohort between the ages of 15 and 64 by 2021. Of note, should in-migration prove higher than estimated under this scenario, projected population growth for the 15 to 34 segment will directly benefit.

Of equal importance will be the population changes caused by the aging of the millennial and echo boom generations, as well as the movement of baby boomers into their retirement years. In five years, the 35 to 44 population will become the fastest growing age cohort under

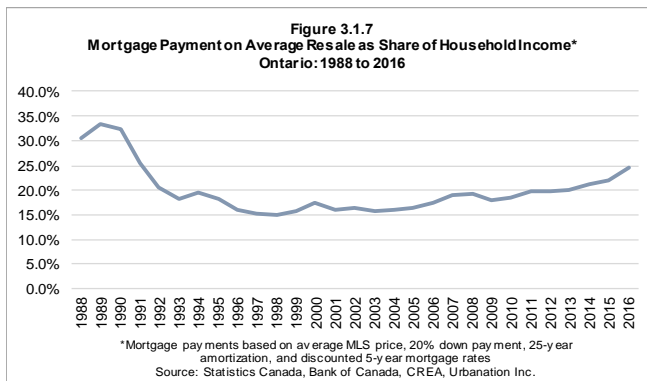
the age of 65, with the 65-plus population accelerating quickly in the next decade. With both cohorts representing high percentages of renter households, demand for renting, particularly larger two and three bedroom units, is well positioned to increase from these demographic shifts.



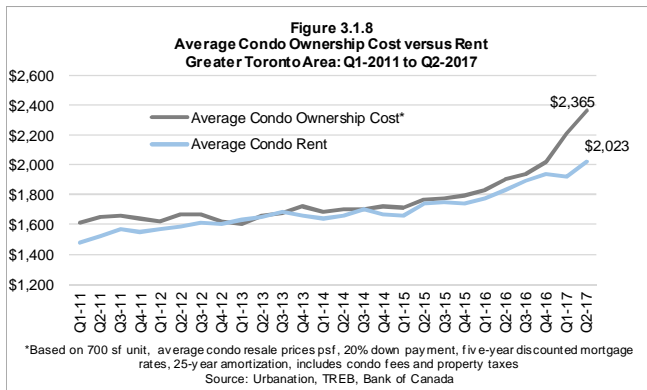
Ownership Affordability

While projections place a rising share of the population in their first-time buying years in the next decade, affordability challenges should temper home buying demand and lead to a greater share of renter households. Following cumulative growth of 47% in average Ontario MLS prices over the five year period to 2016 (57% in the GTA), mortgage payments associated with buying the average valued home increased to 25% of average household incomes (30% in the GTA) - the highest level since 1991. Furthermore, over the past several years policies designed to encourage homeownership have been replaced with stricter mortgage insurance qualification criteria that have made it more difficult for first-time buyers to enter the market, compounded by quickly rising down payment requirements as average prices surpassed \$500,000 at the provincial level and \$700,000 in the GTA last year.

Having reached a five decade high of 71.4% in 2011, it is reasonable to assume that homeownership rates in Ontario will either flatten or decline in the next 10 years due to high prices, tighter mortgage policy, and increasing interest rates.

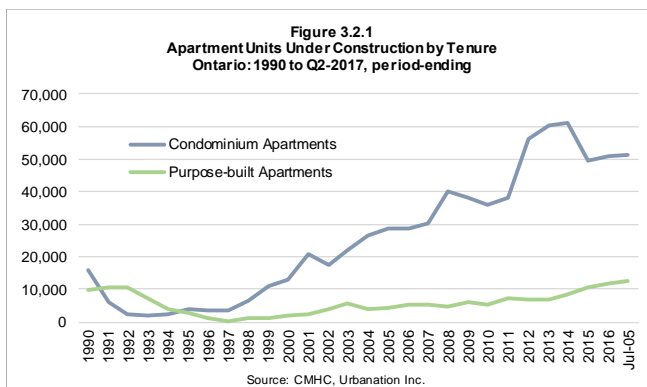


In the GTA, the comparative cost of owning and renting the same sized unit can be calculated, showing that the cost of renting condominiums has fallen notably below the cost of owning as of mid-2017, even at an average monthly rent of over \$2,000. Home prices in the GTA have soared by over 25% in the past year. While condominium price have levelled off in recent months following the Ontario government's Fair Housing Plan, the cost gap between renting and owning remained at its highest level in over five years.

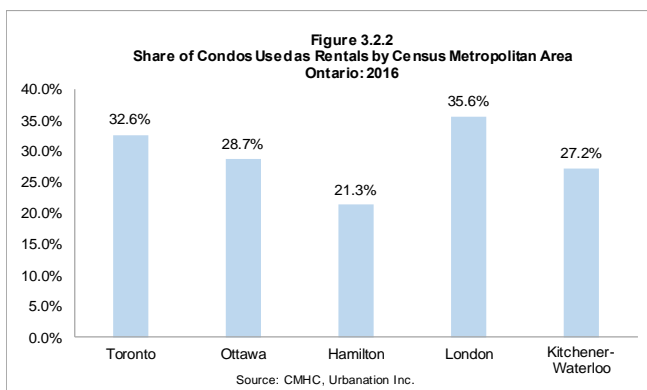


3.2 Rental Supply Outlook

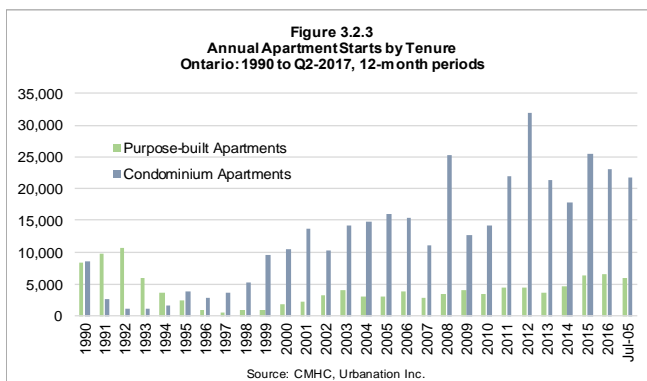
Purpose-built rental apartment development in Ontario reached 12,500 units under construction as of mid-2017 (5,800 in the GTA), more than doubling over the past decade and reaching its highest level since the 1980s. Nonetheless, the recent rental construction boom remained dwarfed by the volume of condominiums under development. While moderating from a peak of over 60,000 units in 2014, more than 50,000 condominiums were under construction as of Q2-2017 (45,000 in GTA), more than four times the level of purpose-built construction. The condominium boom has been ongoing since the early part of the new millennium, overtaking low-rise construction as the dominant form of new home development in the province due to changes to housing affordability, land availability, provincial policies targeting intensification, and an increased presence of investors.



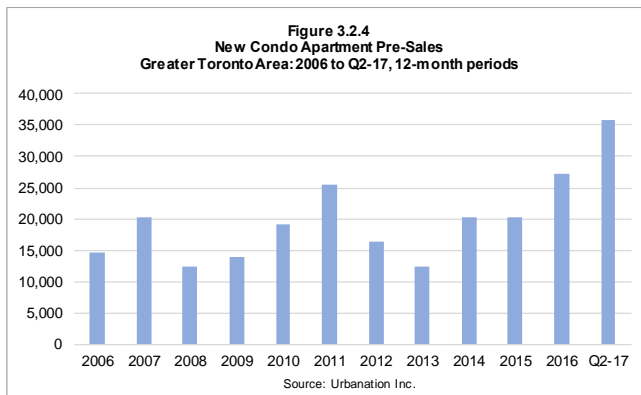
Although condo development continues to far outnumber purpose-built rental construction, a significant share of secondary rental units are found within the condominium stock. According to 2016 survey data reported by CMHC, one-third of all condos in the Toronto CMA were used as rentals, equal to 117,000 units or 38% of Toronto's total purpose-built rental stock. It's been noted in CMHC's rental reports and Urbanation's own research that upwards of 50% of all newly completed condominiums in recent years in Toronto were used as rentals. CMHC also began surveying the stock of condo rentals in other major metropolitan areas in Ontario, with rental shares ranging from 21% in Hamilton to 36% in London. Across the five CMAs surveyed, the total number of condos used as rentals was 135,000 units, which compares to a total purpose-built rental apartment universe of nearly 638,000.



The near-term outlook for rental construction in Ontario can be seen through housing starts trends for both purpose-built and condominium units. As of Q2-2017, 12-month starts for purpose-built rentals fell below 6,000 units for the first time since 2014, after averaging 6,500 units per year in 2015 and 2016. Meanwhile, condominium starts declined to under 22,000 units - below the five year annual average from 2012 to 2016 of 24,000 units. While starts for both forms of apartments remained near recent highs in mid-2017, the recent slowdown indicates construction volumes and completions are set to moderate in the near-to-medium term.

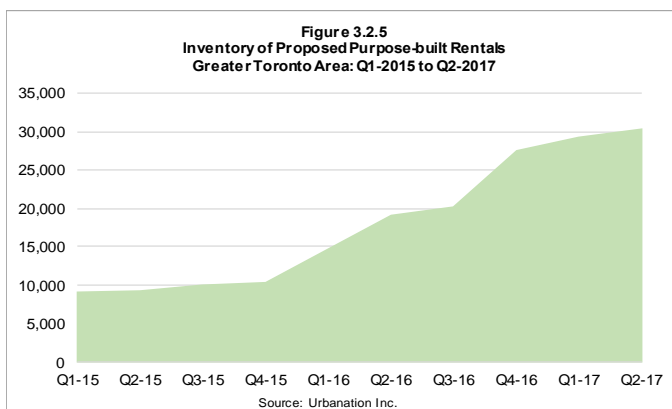


Somewhat longer-term construction trends for condominiums at the GTA level can be seen through new condominium apartment sales levels, as the majority occur early in development at the pre-construction stage. In the 12 months to Q2-2017, new condo sales reached a record high of 36,000 units, building off the year-end high of 27,000 sales in 2016 and representing 80% growth over the 10-year annual average of 20,000 sales. With investors believed to be the driving force behind the surge in pre-sales, a rising share of new units intended for the rental market can be expected. The GTA represents 85% of condos under construction in Ontario.



Longer-term purpose-rental construction trends is also tracked at the GTA level through development applications. As of Q2-2017, the total proposed inventory of purpose-built rental projects reached 30,400 units, which was 58% higher than a year ago (19,207) and more than three times higher than two years ago. Following the announcement of the extension of rent controls to new buildings, the number purpose-built rentals proposed for development continued to increase in Q2-2017, although at a much slower rate than previous quarters.

Since the data was compiled in early July, preliminary information indicates that at least four projects totalling approximately 1,000 units that are either under construction or proposed for development have indicated a change in tenure from purpose-built rental to condominium.



3.3 Rental Demand vs. Supply Projections

Reflecting the demand and supply factors addressed in the previous sections, the estimated level of total rental apartment household formation can be calculated on an annual basis to 2016 using CMHC survey data. The 29,000 rental households formed through the purpose-built and condominium sectors in Ontario last year represented a multi-decade high, comprised of a gain of 22,600 condominium renters and 6,700 purpose-built renters. Total renter household formation exceeded the increase in supply by nearly 3,000 units.

The growth in condo rental household formation in Ontario, which has averaged an estimate of 20,000 units per year since 2013, reflected continued growth in the stock, an increase in the share of units used as rentals to 40%, and a drop in vacancy to a seven-year low of 1.1%. Condominiums have represented 88% of the net growth in rental supply over the past decade in Ontario, and 97% in the GTA.

Demand for purpose-built rental apartments notably outweighed growth in the stock last year, as supply increased by 4,900 units and household formation totalled 6,700 units. Over the past decade, the annual level of purpose-built rental household formation has surpassed the level of supply growth by an average of 1,000 units per year.

	Purpose-built Rental Apartments	Vacancy Rate	Change to Stock	Purpose-built Rental Household Formation	Condo Rental Apartments	Share of Condos used as Rentals	Condo Rental Vacancy Rate	Change to Rental Stock	Condo Rental Household Formation	Total Purpose-built and Condo Rental Household Formation
2006	622,648	3.4%	3,094	5,467	76,756	26.1%	0.4%	11,810	12,055	17,522
2007	622,283	3.3%	-365	270	71,140	23.4%	0.7%	-5,616	-5,795	-5,525
2008	622,465	2.7%	182	3,911	75,991	23.8%	0.4%	4,851	5,027	8,937
2009	625,086	3.5%	2,621	-2,450	84,187	25.3%	0.9%	8,195	7,735	5,285
2010	624,051	2.9%	-1,035	2,746	86,332	24.6%	1.7%	2,146	1,427	4,173
2011	627,011	2.2%	2,960	7,263	102,080	27.5%	1.6%	15,748	15,619	22,883
2012	628,005	2.5%	994	-912	108,274	28.1%	1.4%	6,194	6,342	5,430
2013	627,635	2.6%	-370	-988	130,544	32.4%	1.9%	22,270	21,203	20,215
2014	629,522	2.3%	1,887	3,727	151,471	36.1%	1.3%	20,927	21,451	25,177
2015	632,938	2.4%	3,416	2,704	168,205	36.9%	1.8%	16,734	15,643	18,347
2016	637,801	2.1%	4,863	6,660	189,743	39.8%	1.1%	21,538	22,620	29,280

Source: CMHC, Statistics Canada, Urbanation Inc.

A key consideration with respect to the projected growth of both purpose-built and condo rental supply is the extension of rent control to new units. While it is unknown how exactly developers and investors will ultimately respond to this change in the long-run, the immediate impact is expected to be a slowdown in purpose-built rental development applications and a conversion of some planned projects to condominium, which will limit rental starts and completions levels in the next few years. Condo rental investment and the share of units used as rentals will likely edge up slowly going forward, as the large volume of investor-owned units coming to completion in the coming years starts to become offset by increased investor sales as ownership carrying costs exceed allowable rent increases.

Supply Gap Projections

In consideration of the factors affecting the demand and supply for rental apartments in Ontario outlined in previous sections, Urbanation has estimated the annual level of demand across both forms of rental against projected increases in supply for the province during the next 10 years.

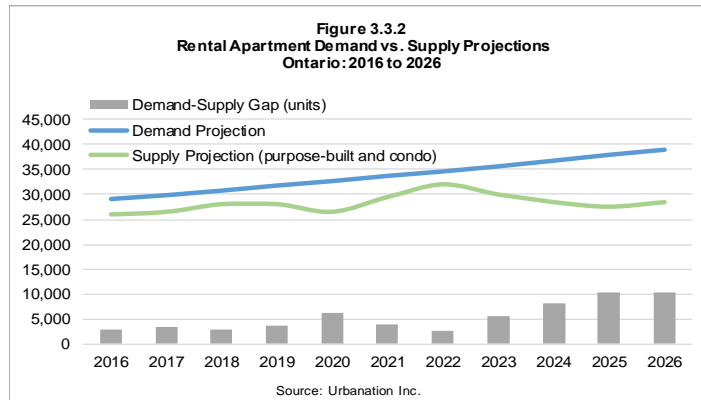
Using 2016 household formation rates as a launch pad for demand (which can be viewed as conservative given the low levels of vacancy), an annual rate of growth is projected at approximately 3% over the next 10 years, leading to an annual average level of demand for roughly 34,000 purpose-built built and condominium rentals. Supply levels are expected to see some growth in the next couple years due to the elevated inventory of apartments currently under construction, before retreating for a short period due to the recent moderation in construction starts. However, the surge in new condo sales witnessed during the past two years will lead to higher completions by 2021 that will almost close the gap between rental demand and supply temporarily. As new condo construction inevitably converges to a more sustainable pace and investors experience an accumulation of cost increases that make it difficult to continue holding rentals under controlled revenue growth, supply will moderate in the second half of the forecast period, again widening the gap between demand.

The outlook for rental supply is expected to continue to be heavily influenced by construction cycles in the condo sector. It is assumed that purpose-built rental supply will experience modest and steady growth over the forecast period, reflecting general hesitation amongst developers in a rent-controlled environment, but also attractive market rents for units reaching the open market through the application of vacancy decontrol.

Over the entire 10-year forecast period, rental demand is projected to outweigh supply by approximately 57,500 units, or 5,750 units annually, potentially reaching as high as 10,000 units in 10 years. It's important to note that the projected levels of demand are unlikely to follow a consistent linear path, and there will be periods where demand may meet, fall below, or further exceed supply beyond these trend levels. The demand projections also won't necessarily translate into household formation rates, as growth in renter households is ultimately restricted by available supply, which is dependent upon vacancies, completions, and turnover, all of which are expected to be restrained.

It's also important to note that the supply gap of 5,750 units per year does not necessarily represent the level of additional rental development required to bring the market into a state of balance, but rather represents a level that keeps conditions from worsening over time. At present, the market would need a minimum of an additional 5,000 rentals to raise the vacancy rate back up to its long-term average. As such, it can be argued that the total required amount of additional rental supply over the next decade is at least 62,500 units (6,250 per year).

Although the gap between rental demand and supply is expected to widen across the province, the GTA will experience a disproportionately large imbalance due to stronger demand forces relative to supply. While representing 90% of condominiums under construction in Ontario, the GTA has less than a 50% share of the province's purpose-built rental development underway. In fact, there is currently only one rental unit under construction per 1,000 population in the GTA, compared to a ratio of over three units in Vancouver and two units in Montreal.



Market implications

The projections indicate a substantial imbalance between rental demand and supply in the Ontario marketplace over the next decade, which could potentially reach crisis levels in the absence of a meaningful increase in new purpose-built development. Already low vacancy rates will face further compression, leading to intense competition among households seeking rental accommodations and resulting in declines in turnover rates and delays in household formation.

The projections call for an average annual increase in purpose-built rental development of 6,250 units per year to satisfy demand (the majority required in the GTA), which means the level of rental starts averaged over the past few years would need to double immediately and eventually triple as growth in demand compounds.

Under the baseline scenario presented, the majority of supply growth and new rental household formation will remain concentrated in the condominium market. In this regard, the encouragement of investment in the existing stock of rentals will be vital. Lost future purpose-built rental development caused by the extension of rent control to new buildings, and a less predictable secondary market, will inevitably squeeze supply and result in rising premiums within the newer stock, pushing demand towards older and more affordable rental buildings. Therefore, significant investments in upkeep and renovation expenditures will be needed to ensure Ontario's renting population has suitable accommodations.

4.0 CONCLUDING COMMENTS

The results of this study indicate that the factors supporting growth in rental demand are projected to continue strengthening in the next decade. At the same time, supply will face headwinds due to the recently introduced policy to extend rent control, affecting both purpose-built construction and the ability for condominium investors to supply rental units. With less growth in purpose-built rental development than otherwise would have occurred in an unregulated environment, the secondary market will continue to represent the majority of new supply. The heavy reliance on a market segment that generally lacks professional management and security of tenure for renters, which will become further compromised by rent control, will add to the difficult market conditions that will be faced by the quickly growing number of renters in the years ahead.

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. The encouragement of rental operators to improve the quality of rentals in Ontario and remain invested in the market by allowing untenanted units to offset above-inflation costs through unregulated rents is expected to increase in importance in the coming years, as a substantial supply shortfall of new development occurs.