Canadian Multifamily Overview

Demand Drivers & Market Fundamentals

Mid-Year 2019

CBRE Research

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Part 1/
Setting the Stage

Canadian commercial real estate experienced an unprecedented decade of demand and returns since the Global Financial Crisis in 2008. Robust economic growth, employment gains in the technology and other high-skilled service sectors, strengthening trade, the rapid growth of ecommerce and shifting demographics have pushed fundamentals across the commercial real estate landscape to record levels. Strong property fundamentals have in turn led to commercial real estate acquisition volumes reaching a 15-year high of $49.3 billion in 2018, while cap rates have compressed to 10-year lows.

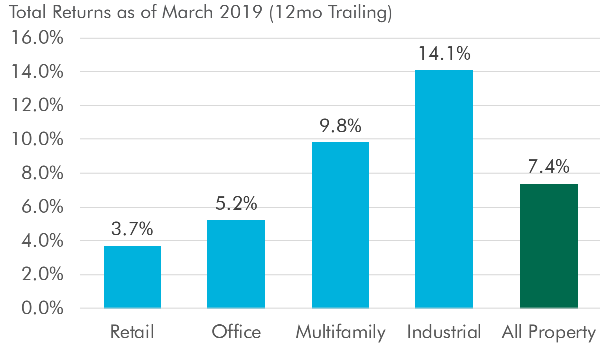
Even against a backdrop of impressive results, the multifamily sector stands out from the pack as the top performing commercial property type in North America. Based on the Canada Mortgage and Housing Corporation's (CMHC) 2018 data release, the national average multifamily vacancy rate ended the year at 2.4%. This was below the 10-year average of 2.6%, and well below the national average vacancy rate for each of the office, industrial and retail sectors, both here and in the United States.

With apartment buildings at near full occupancy in markets from coast to coast, rent growth has accelerated. Over the last two years, average rents for purpose-built rental units have grown by 4.4% annually at the national level, and by 5.0% in Toronto and by 7.1% in Vancouver. This rapid rise of rental rates has resulted in strong investment returns for landlords. Total annualized returns for the Canadian multifamily sector were 9.8% as of Q1 2019, second only to the industrial sector, which has also benefitted from a recent period of tremendous rent recalibration.

While the multifamily sector's ability to generate consistent cash flows and provide defensive positioning against economic cycle downturns has always made it an enticing option for investors, the current landscape is stronger than it has been at any other time in history. Performance drivers including a growing population, rising home ownership costs and lack of rental supply are becoming entrenched in many markets across the country, which means the appeal of multifamily assets is likely to increase.

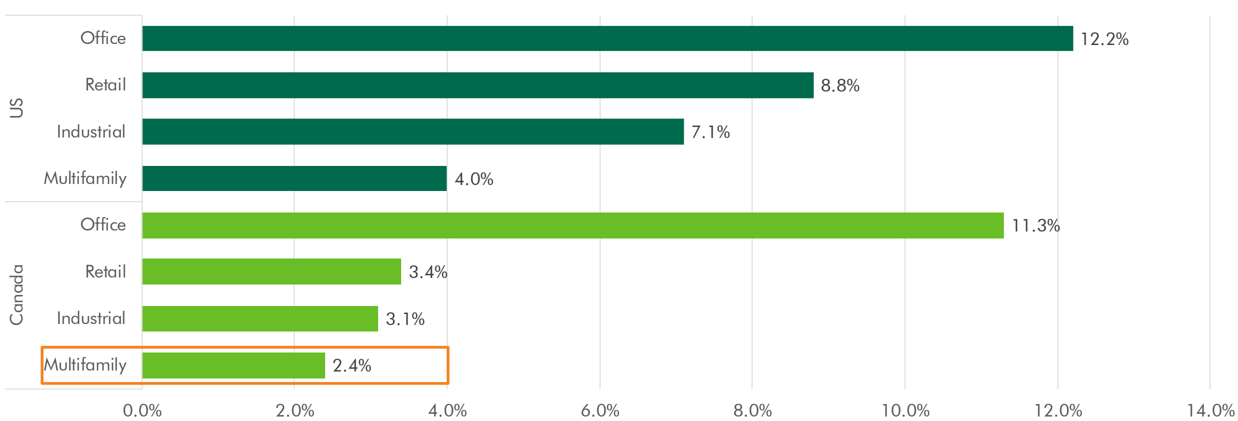
Figure 2: REALPAC/IPD Canada Property Fund Index

Total Returns as of March 2019 (12mo Trailing)



Source: MSCI, May 2019.

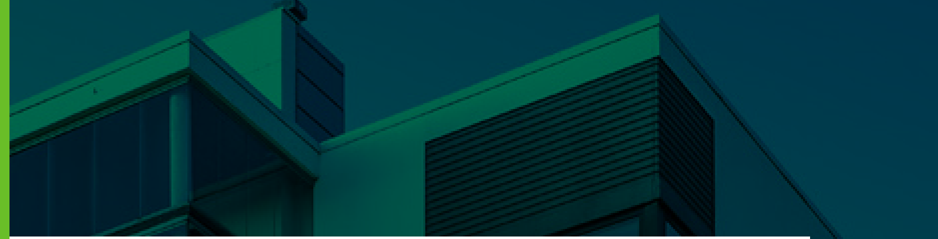
Figure 1: North American Vacancy Rate Comparison



Notes:

i) Industrial figures are availability rates,
ii) Retail rates are composite figures including Neighbourhood, Community, and Strip assets,
iii) Canadian multifamily figures as of October 2018.

Source: CBRE Research, CBRE Econometric Advisors and Canada Mortgage and Housing Corporation, Q2 2019.



Part 2/

Drivers of Multifamily

Population Growth

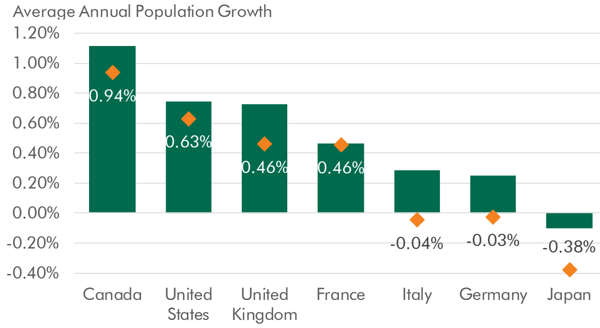
Canada's population grew by 1.1% per year from 2009 to 2018 and is expected to continue expanding at a rate of 0.9% over the next four years, outpacing all other G7 nations by a considerable margin.

Much of this momentum is being fueled by immigration due to the fact that, unlike other global leaders, Canada remains supportive of immigration as an economic imperative. The total number of newcomers has increased substantially over the last four years and immigration accounted for 80.5% of Canada's population growth in 2018.

The federal government announced a plan in 2018 to welcome one million new immigrants into the country between 2019 and 2021. While the new migrants will be admitted through a mixture of economic, family, refugee and humanitarian programs, the bulk of those admitted will be approved on skill-based or economic grounds.

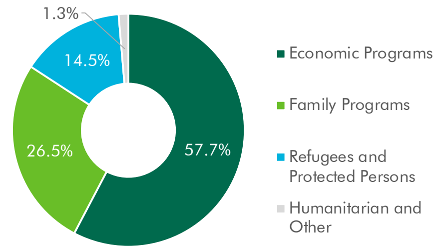
As population has grown, so too has demand for housing, particularly for purpose-built rental units. While immigration has been spread across the country, the greatest impact has been felt in major urban centres such as Vancouver, Toronto and Montreal and it is no coincidence that these markets, primarily Vancouver and Toronto, are also those which have seen the greatest increase in demand for multifamily rental options.

Figure 3: G7 Population Growth



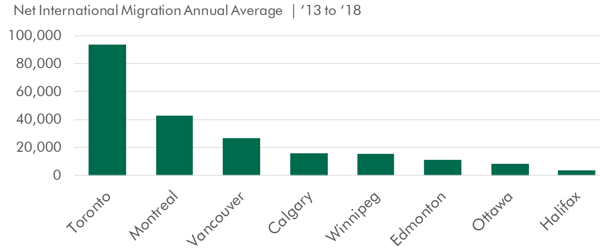
Source: International Monetary Fund, March 2019.

Figure 5: New Immigrant Targets 2019-2021



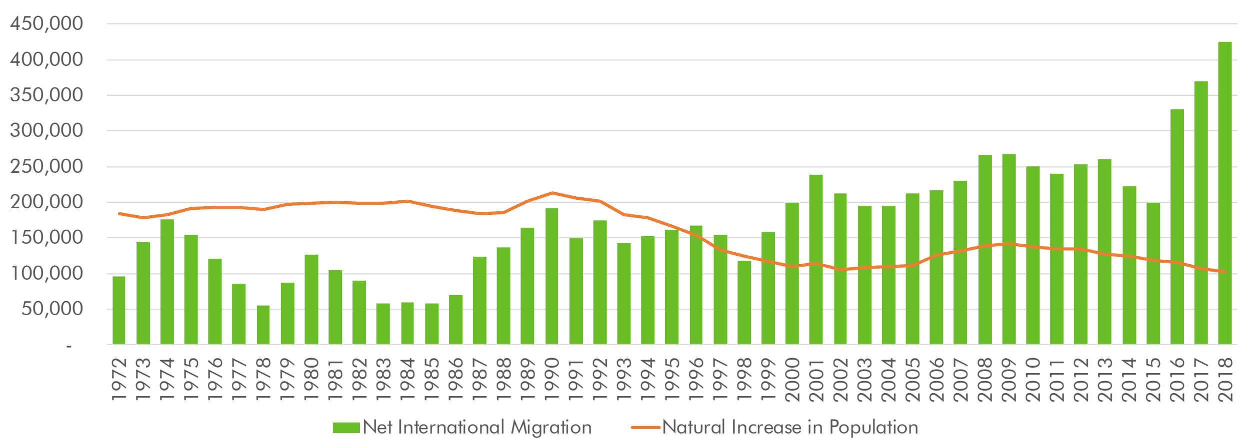
Source: Government of Canada, 2018.

Figure 6: Canadian Population Growth by Market



Source: The Conference Board of Canada, Q2 2019.

Figure 4: Canadian Population Growth Breakdown



Source: The Conference Board of Canada, Q2 2019.

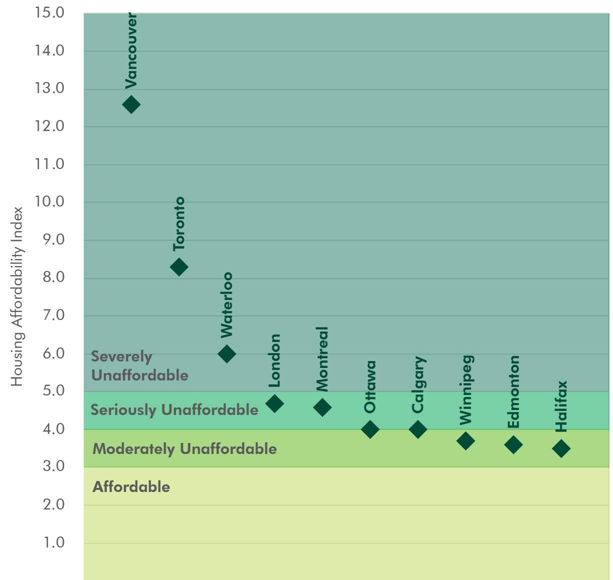
Rising Home Ownership Costs

Housing Prices have been a growing concern in Canada over the past few years. The largest effects have been felt in Vancouver and Toronto where prices for a variety of housing alternatives have grown substantially since the end of 2014. In an attempt to combat this rapid growth, each of the British Columbia and Ontario provincial governments put forth new housing regulations in late 2016 and early 2017 aimed at cooling foreign investment and speculative purchasing. While these measures, in conjunction with new federal mortgage requirements, did cool the markets, prices are still comparable to where they were at the time the regulations were implemented. Benchmark home prices in Vancouver and Toronto sit just below $1.0 million and $800,000 today.

Recent reports have shown that when comparing affordability (the relationship between average home prices and median incomes) across global cities, Canadian markets consistently rank as some of the least affordable in the world. According to Demographia's annual survey of global housing affordability, Vancouver and Toronto are ranked as the second and tenth least affordable cities in the world for housing. No major Canadian city was classified as affordable in this report, although some markets including Winnipeg, Edmonton and Halifax were close to this threshold with scores below 3.7.

While rising home prices are not necessarily a problem by themselves, the chief issue is that income growth has not kept pace with the growth witnessed in housing prices.

Figure 8 - Canadian Housing Affordability Comparison

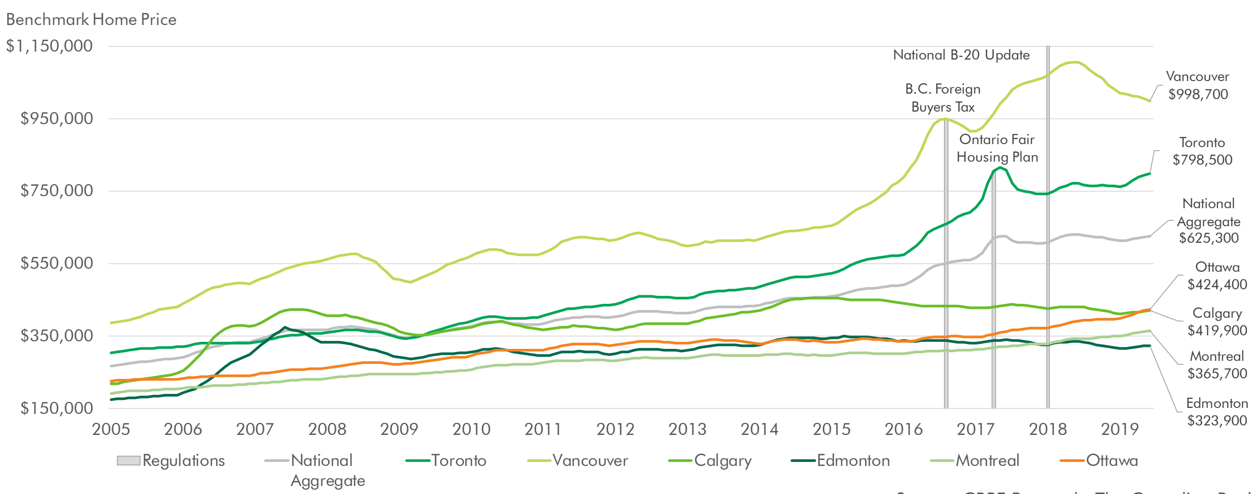


Major markets classified as metropolitan areas with more than 1,000,000 population.

Median Multiple indicator is median house price divided by median pre-tax gross household income.

Source: 15th Annual Demographia International Housing Affordability Survey.

Figure 7 - Effects of Government Regulation



Source: CBRE Research, The Canadian Real Estate Association, June 2019.

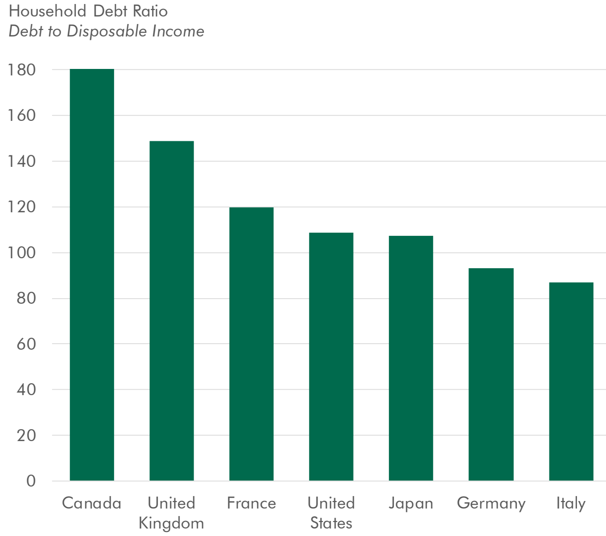
RISING HOME OWNERSHIP COSTS - CONTINUED

When looking at the 10-year period preceding the end of H1 2019, average Canadian incomes have risen by a total of 29.3% according to the Conference Board of Canada. For their part, purpose-built rental rates have grown by a slightly higher 31.1%. While these rates do differ, the gap between them is small and the growth pattern has been consistent: synchronized and linear. This however was not the case for home ownership costs. Home and condominium prices have grown by 66.7% and 68.4%, respectively, over this same time period.

Income requirements are also not the only point of consideration. A further impediment to home ownership for many Canadians is access to capital for the 10-20% down payment required upon signing. For instance, down payments for condos in large cities typically total over $100,000 at a minimum. This is complicated further by the fact that Canadians have some of the highest debt levels in the developed world. Based on the most recent figures from the OECD, the Canadian debt ratio (the ratio of National debt to disposable income) sits at 180.9. The next most indebted G7 nation, the United Kingdom, has a ratio of only 148.9.

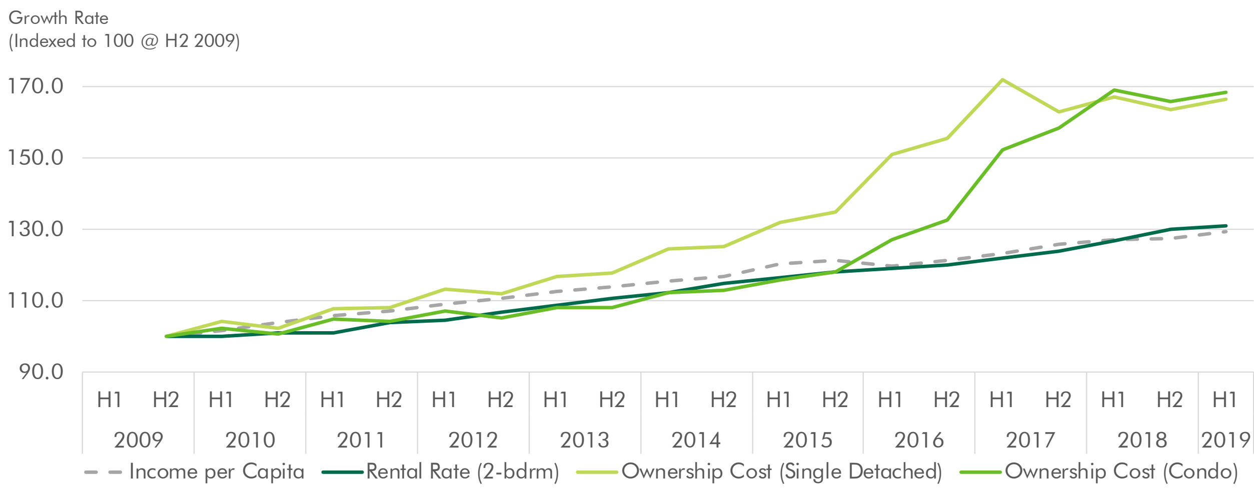
As home ownership costs have risen, an increasingly large number of Canadians have been added to the renter's pool and this dynamic, in conjunction with population growth, has driven demand for comparatively affordable multifamily units.

Figure 10: G7 Household Debt Levels



Source: Organisation for Economic Co-operation and Development, 2019.

Figure 9: Rising Canadian Home Ownership Costs



Source: CBRE Research, Canadian Real Estate Association, Canada Mortgage and Housing Corporation, The Conference Board of Canada, Q2 2019.

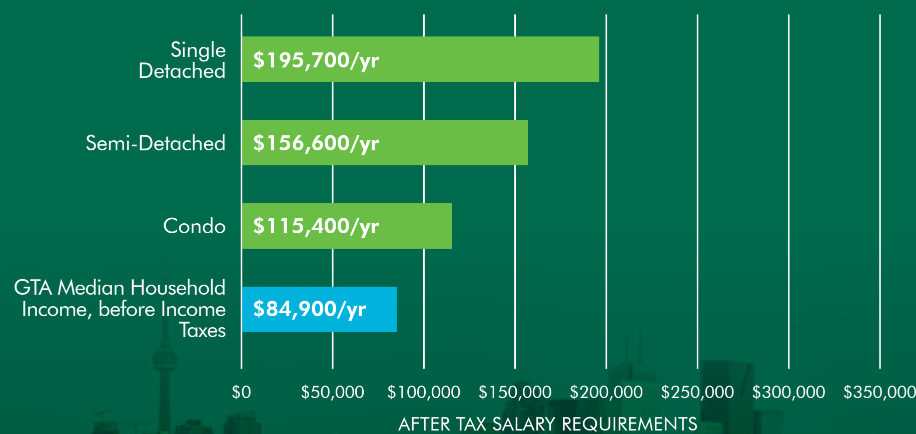
A Toronto & Vancouver Case Study

The result of this growing disconnect between income and home pricing is that home ownership has become a challenge for many Canadians living in major cities. This is especially true in Toronto and Vancouver where home prices have risen to be the highest in the nation.

Based on recent home resale prices in the City of Toronto, it would require a household income of $115,400 per year to afford mortgage payments for an average condo. For a semi-detached home, this figure rises to $156,600 and for a single detached home, to $195,700. Environics Analytics estimates 2019 median household income for region to be only $84,900 before income taxes.

In the City of Vancouver, this gap is even more pronounced. The income requirements for single detached or attached homes are $315,700 and $145,800, respectively, yet the median before-tax household income for the region is only $82,100.

Figure 11-A: City of Toronto Housing Affordability Requirements

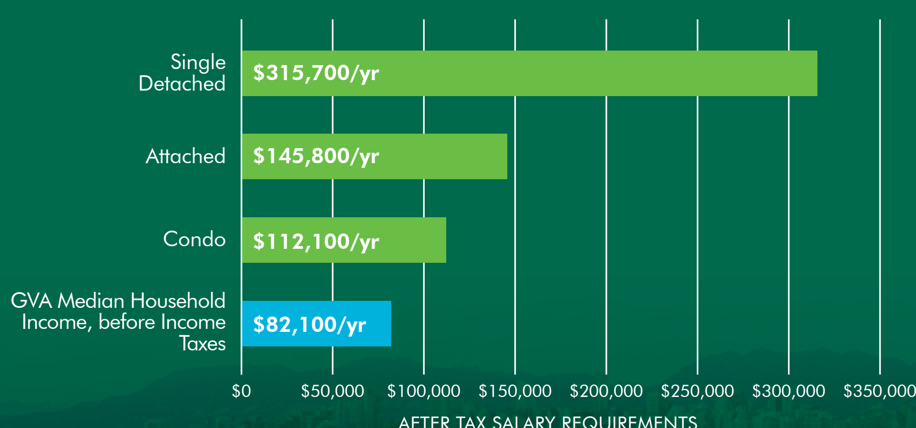


Calculated assuming a 33% allocation of income towards housing, 20% down payment, 25 year amortization period, 3.19% fixed mortgage, 2019 City of Toronto property tax rates, & typical condo fees.

Average price for 416 area for detached, semi-detached and condo apartment.

Source: CBRE Research, Toronto Real Estate Board (July 2019), Bank of Canada, City of Toronto, Environics Analytics, 2019.

Figure 11-B: City of Vancouver Housing Affordability Requirements



Calculated assuming a 33% allocation of income towards housing, 20% down payment, 25 year amortization period, 3.19% fixed mortgage, 2019 City of Vancouver property tax rates, & typical condo fees.

Average of benchmark price for Vancouver East and Vancouver West areas. Consistent with REBGV methodology, townhouse benchmark used in place of attached benchmark.

Source: CBRE Research, Real Estate Board of Greater Vancouver (July 2019), Bank of Canada, City of Vancouver, Environics Analytics, 2019.

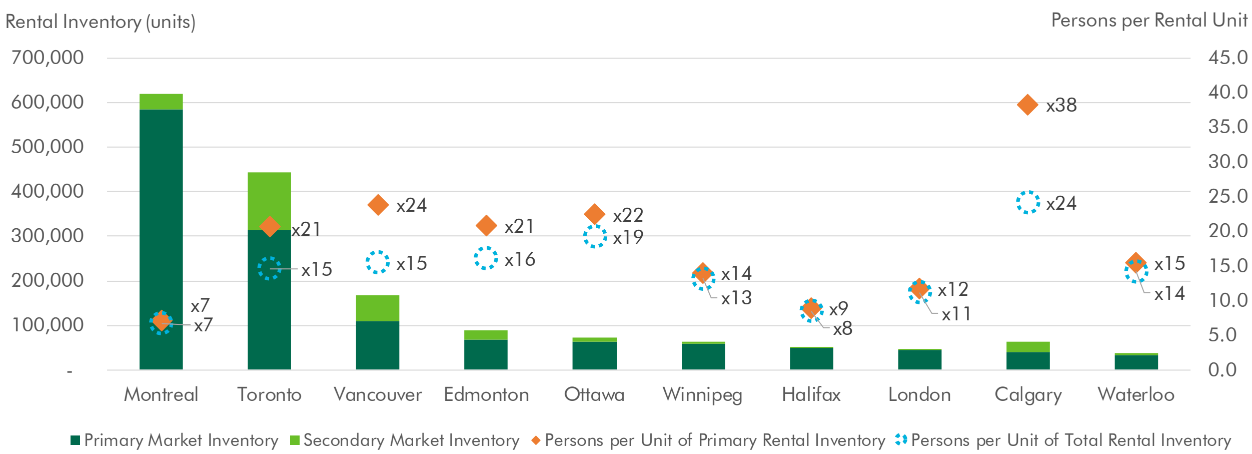
Lack of Supply

On the other side of the coin sits supply of rental units. Outside a few exceptions, rental inventories in major Canadian markets are limited compared to their global peers. The largest rental market in Canada is Montreal with just under 600,000 units, a formidable total. Toronto follows with 313,000 units, slightly over half of Montreal's total, and then comes Vancouver with only 109,000 units. Adding secondary market rental units, privately owned condominium rentals, to these totals closes the gap in certain cases, but it's clear that renters in most markets across the country remain underserved.

Factoring in the population base of each city sheds further light on the lack of rental housing. For example, there are approximately 21 people living in the Greater Toronto Area (GTA) for every unit of purpose-built rental housing. When secondary market rentals are included, this figure drops to a more reasonable, but still high, 15. These figures are similar in the metropolitan areas of each of Vancouver, Edmonton, Winnipeg, Ottawa and Waterloo. For reference, the number of persons per rental unit is 7 in New York, 9 in Los Angeles and 13 in Chicago. While this metric reflects poorly on many of the larger Canadian markets, there are some exceptions. In Montreal there are only seven people per unit of multifamily housing, while in Halifax, London and Winnipeg this ratio climbs no higher than 14.

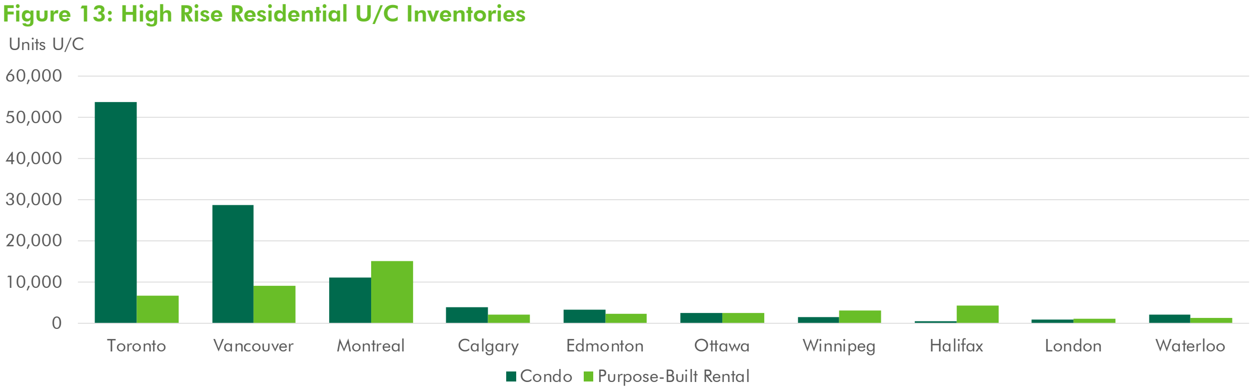
The primary reason for the low multifamily inventory levels in many Canadian cities is that high-rise developers in major markets have traditionally chosen, for a variety of reasons, to develop condominiums as opposed to purpose-built rental units. The high cost of land and other financial considerations have made rental projects comparatively less profitable in highly competitive marketplaces. In each of Toronto, Vancouver, Calgary, Edmonton, Ottawa and Kitchener-Waterloo, over 50% of all high-rise apartment units currently under construction are condominium units. In Toronto, 89.1% of high-rise units under construction are condominiums, while in Vancouver this figure is 75.9%. Unsurprisingly, markets with greater rental inventories, namely Montreal, Halifax, Winnipeg and London, have much more balanced construction environments. In Montreal, London and Winnipeg between 57.5% and 66.0% of new high-rise units under construction are purpose-built rentals, while in Halifax this number is as high as 92.4%.

Figure 12: Rental Supply-Demand Imbalance



Source: CBRE Research, Canada Mortgage and Housing Corporation, October 2018.

Figure 13: High Rise Residential U/C Inventories



Source: CBRE Research, Canada Mortgage and Housing Corporation, Q2 2019.

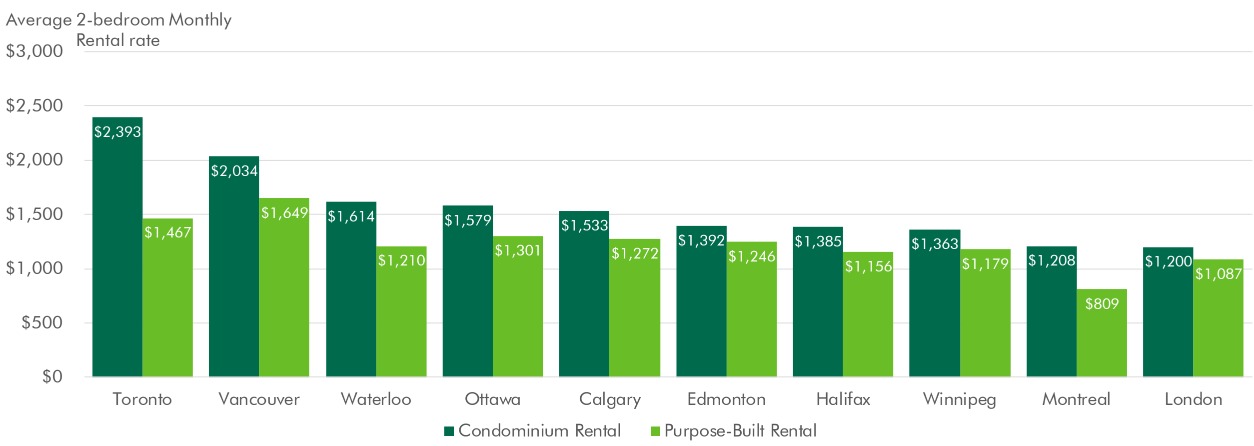
LACK OF SUPPLY - CONTINUED

With limited affordable housing options, a large share of prospective renters are being serviced by the secondary rental market; condominium rentals. In addition to being significantly more affordable than condominium rentals, multifamily units also offer better security in terms of rental tenure. The combination of lower monthly costs and increased long term security has only intensified the demand for purpose-built property units.

While supply of new rental housing not meeting demand continues to be an issue, rental rate growth along with a variety of government programs are beginning to shift the tides. The share of rental units as a percentage of the total high-rise units under construction has been increasing steadily over the last five years. While still not fully balanced, rental's share of the new construction pipeline is now 35.9% based on the most recent data.

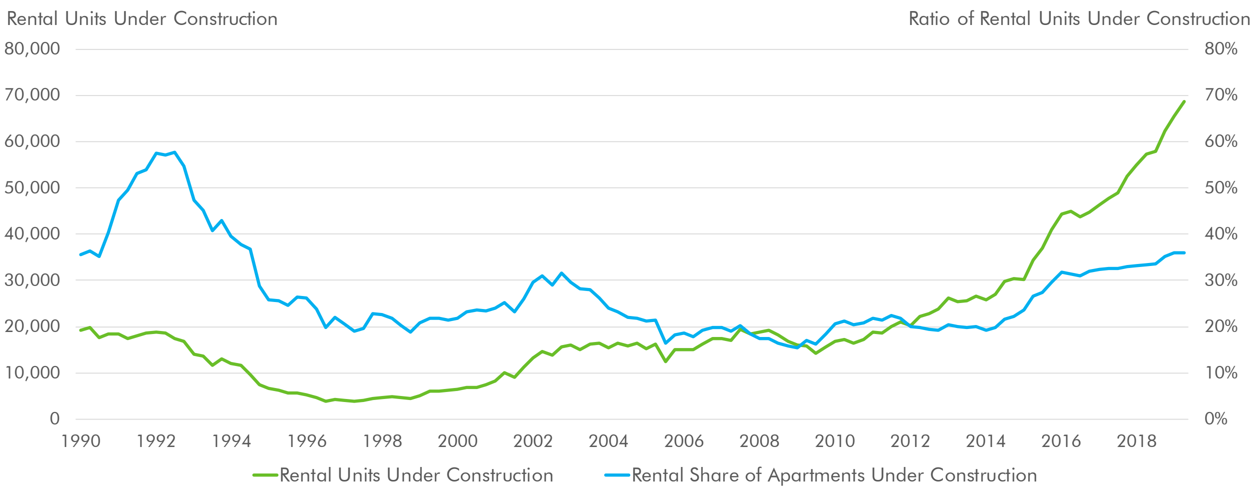
Despite this slow shift towards more rental construction, new supply is not likely to meet demand for the foreseeable future.

Figure 14: Comparison of Rental Options



Source: CBRE Research, Canada Mortgage and Housing Corporation, October 2019.

Figure 15: High Rise Residential U/C Inventory Analysis



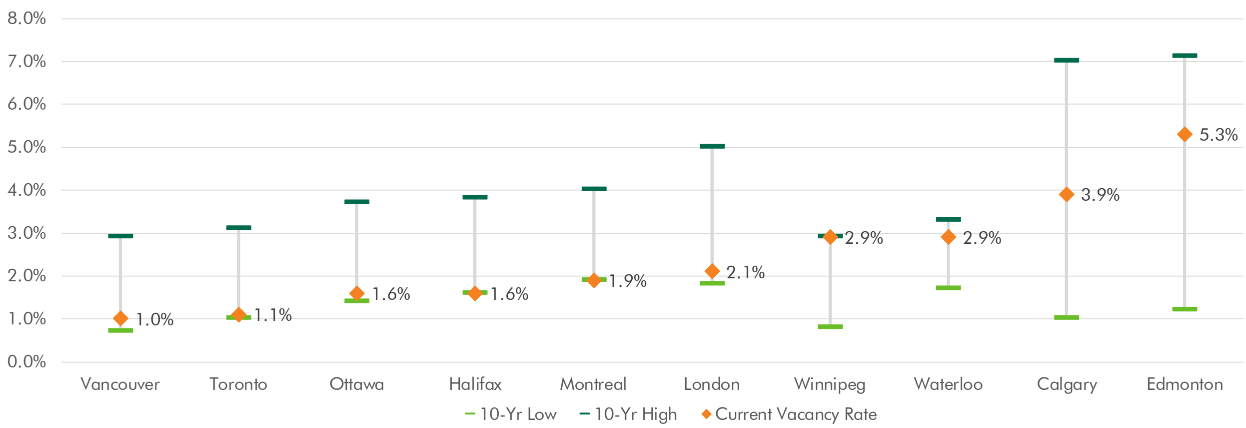
Source: CBRE Research, Canada Mortgage and Housing Corporation, Q2 2019.

Part 3/
Multifamily's Enduring Appeal

The increased demand and limited supply within the multifamily sector have led to a tightening of the market and record fundamentals across a breadth of metrics. As highlighted above, the national average multifamily vacancy rate in Canada sat at 2.4% as of the CMHC's 2018 data release. This tightening has not been restricted to select markets. Six Canadian markets are seeing vacancy rates at or within 30 basis points of their 10-year lows. Vancouver and Toronto continue to be the tightest markets in the country with occupancy rates of nearly 99.0%.

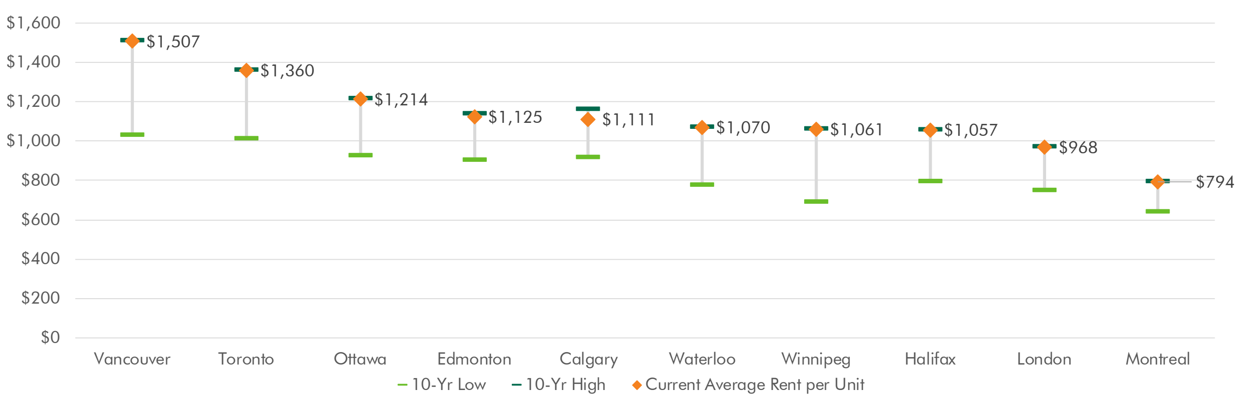
The continued tightening experienced over the last few years has resulted in rapid rent escalation. Average multifamily rental rates are at or near 10-year highs in practically every market. Meanwhile no Canadian city has seen their average rental rate figure fall since 2017.

Figure 16: Canadian Multifamily Fundamentals by Market
Vacancy Rates 10-Yr Comparison



Source: CBRE Research, Canada Mortgage and Housing Corporation, October 2018.

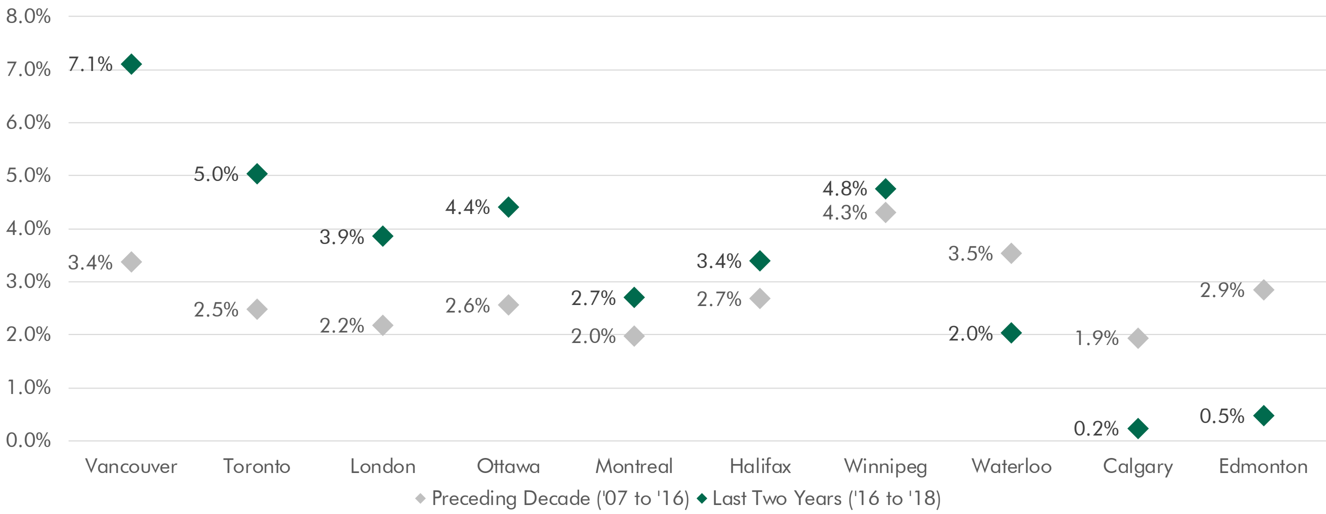
Figure 17: Canadian Multifamily Fundamentals by Market
Rental Rates 10-Yr Comparison



Source: CBRE Research, Canada Mortgage and Housing Corporation, October 2018.

Not only are rents growing, but the pace at which they are growing is also escalating rapidly. Over the decade preceding 2016, multifamily rents in major Canadian markets grew between 1.9% and 3.4% annually. Over the last two years, however, annual rent increases have averaged 7.1% in Vancouver and 5.0% in Toronto. Note that these figures include all purpose-built rental units, including those which haven't turned over, where potential rent escalations are bound by rent control regulations. In certain provinces including British Columbia, Ontario and Quebec, rent increases are capped at a prescribed value, typically linked to inflation. In units where tenants have turned over, rent growth has been substantially more pronounced than those reported by CMHC.

Figure 18: Major Market Rent Growth Trends
Annual Rent Growth Comparison



Source: CBRE Research, Canada Mortgage and Housing Corporation, October 2018.

INVESTMENT LANDSCAPE

The strong market fundamentals have naturally attracted new capital to the sector. National investment volumes for multifamily assets have escalated for four consecutive years, reaching an all-time high of $8.3 billion in 2018. Investment volumes through the first half of 2019 have also been strong and the sector is currently on pace to reach the second highest yearly investment volume total on record. Meanwhile, the buyer pool for the asset class has become increasingly institutionalized, with major groups such as Starlight, Blackstone, Timbercreek, Realstar and Akelius making substantial acquisitions over the last few years.

While this investment activity has been impressive, it is likely that these figures would be significantly greater if not for a lack of investment opportunities. Understandably, landlords have been hesitant to sell properties given the overall strength of the asset class and considerations to the capital gains implications triggered when assets are sold. Additionally, consecutive years of relatively limited new construction have contributed to pent-up demand for core multifamily assets in major markets. The lack of investment opportunities and the competitiveness of an increasingly sophisticated buyer pool has had major effects on pricing. Based on CBRE's Cap Rate Survey Report from Q2 2019, the multifamily sector had the lowest average cap rate figure of any asset class in Canada at 4.41%.

Figure 19: Multifamily Investment Volume

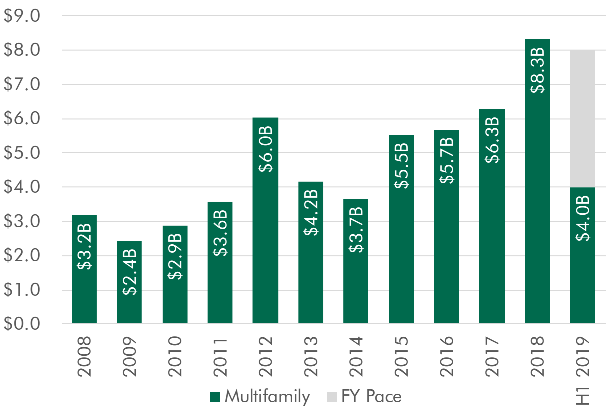
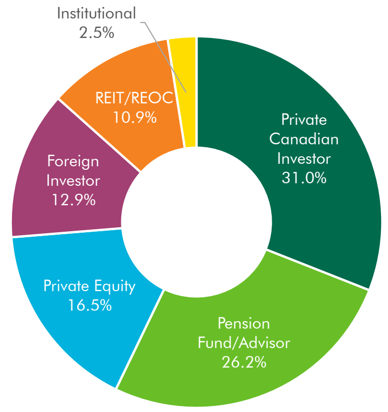


Figure 20: 2018 Purchaser Profile Breakdown



Source: CBRE Research, Realnet Canada, Real Capital Analytics, 2018.

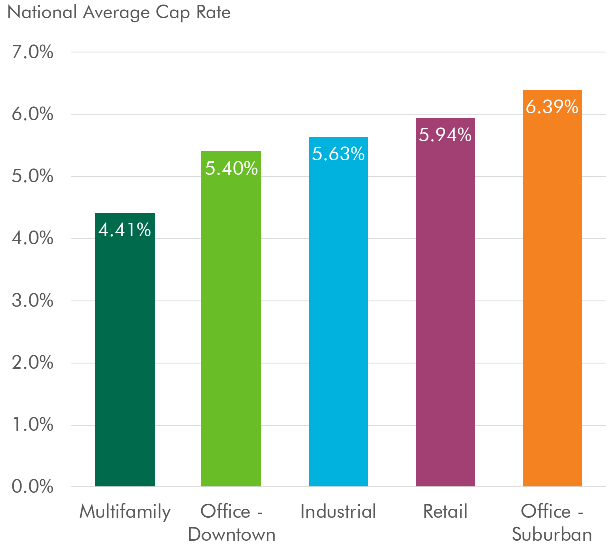
Source: CBRE Research, Realnet Canada, RealTrack Limited, Collette Plante, JLR Land Title Solutions, Real Capital Analytics, Q2 2019.

INVESTMENT LANDSCAPE - CONTINUED

In major cities, assets now regularly trade for cap rates below 3.0% due the belief that there remains additional runway for further rent increases, even despite rent control measures in the nation's three largest provinces. The downward trend in cap rates shows no signs of stopping and should be further supported by an increase in access to cheap debt brought on by the recent shift to dovish stances by central banks around the globe. Despite multifamily cap rates being the lowest in the country, the spread to benchmark bond yields is above the 10-year average and has not neared a point where it would be prohibitive for investors due to incremental upside in multifamily yields. The recent landslide in global bond markets will only intensify this dynamic further and should make investment in defensive multifamily real estate assets an enticing option for private and institutional capital alike.

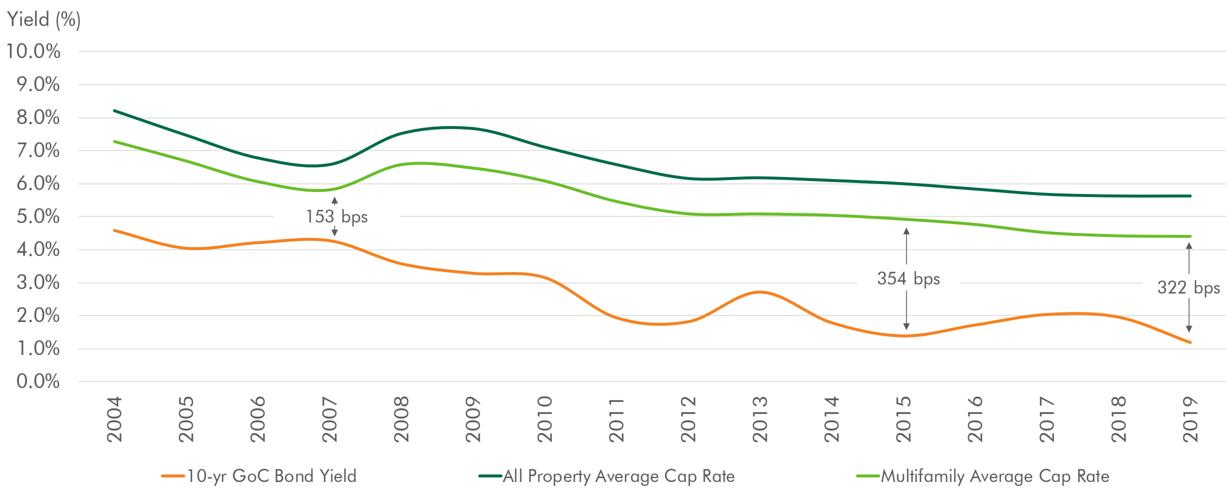
With fundamentals looking well-supported by economic and demographic tailwinds, a strong investment landscape and a sophisticated landlord community, the multifamily sector looks poised to maintain its standing as a sought-after investment vehicle for years to come.

Figure 21: Canadian Cap Rates by Asset Class



Source: CBRE Research, Q2 2019.

Figure 22: Multifamily Cap Rate vs. 10-Yr Bond Yields



Source: CBRE Research, August 2019.

Note: 1) 2019 cap rate as of Q2 2019
2) 2019 Government of Canada 10-yr Bond Yield as of August 2019.

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