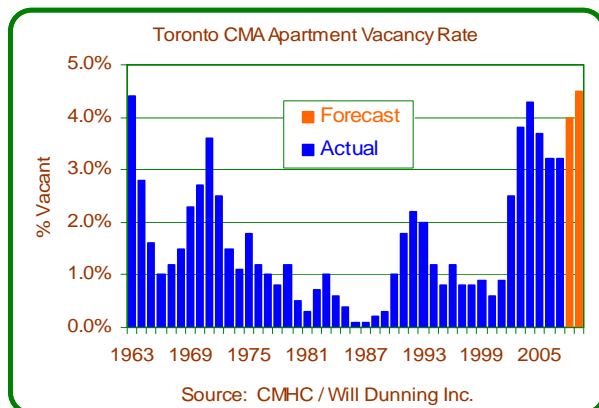


Rental Apartment Market

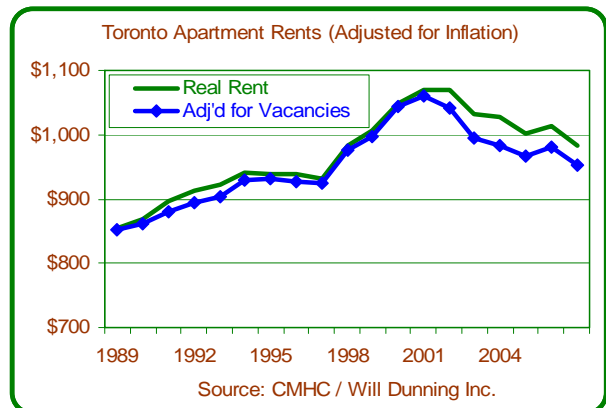
Toronto CMA, Fall 2007

Overview

The apartment vacancy rate in Toronto CMA is unchanged from a year ago. CMHC reports that the vacancy rate was 3.2% in October 2007. During the past year, the vacancy rate increased (to 3.7% in April) then fell in October. Just under 10,000 units (9,721, out of 306,407) were vacant this October.



Another perspective (the blue line, which may reflect the view of landlords) shows that rents in real terms, after adjustment for vacancies, peaked in 2001/2002 and has fallen by 10%. “Effective rent” is now at the lowest level since 1997, although it remains slightly above figures from the mid-1990s.



CMHC also reports on availability of rental housing – this includes units that are vacant as well as units for which notice has been given and the unit has not yet been leased. The availability rate for October 2007 was 5.0%, also unchanged from the October 2006 rate. The availability of more than 15,000 rental apartments confirms that a great amount of rental housing is available in the Toronto CMA rental market.

High vacancy rates continue to result in sluggish rents in the Toronto area. The average rent fell by \$5 (-0.5%) to \$984 versus \$989 a year ago. With overall inflation at 2.5%, the average rent fell by 2.9% in “real” (inflation-adjusted) terms. There is a concept of “natural vacancy rate” - the vacancy rate at which rent increases match overall inflation. For Toronto CMA, I estimate that the natural vacancy rate is 2% or less. This is the sixth consecutive year that the vacancy rate has exceeded 2% (and the fifth that it has exceeded 3%). The consequence of these high vacancies is that rents have lagged behind the inflation rate – during the past six years the average rent has increased by just 3.7%. With total inflation of 12.6% over the same period, the average rent has fallen by 7.9% over the same period in real terms.

Interpretation

The flat vacancy rate is contrary to my previous forecast. I had forecast (in my Fall 2006 report) that the vacancy rate would “be in the range of 3.5% to 3.75% in both April and October 2007”. The April vacancy rate (3.7%) was in that range, but the reduction in the fall was unanticipated.

Reasons for the change in the rental market during 2007 include the following.

The rise in the spring vacancy rate was due to:

- A moderate level of completions of new housing, especially for condominium apartments (5,150 units were completed in the 6 months prior to the survey) and for rental apartments about 500 units were completed.
- There may be a “seasonal effect”, by which rental demand may be stronger in the fall than the spring. But, we can’t know for sure, since it had been many years since CMHC conducted a spring survey.

The drop in the vacancy rate this fall can be related to sharply reduced completions of condominium apartments (to about 2,800 units in

the 6 months prior to the survey) and rental apartments (just 75 units). The result is that there was much less out-movement from existing rentals.

As was discussed earlier, rents are soft. This is also contributing to current trends in the vacancy rate. With rents flat-to-falling, and definitely slower than wage growth and overall inflation, improved rental affordability is undoubtedly generating some growth in rental demand.

Employment growth is another key factor. According to Statistics Canada data, employment in Toronto CMA expanded by the moderate amount of 55,000 (2.0%) in the year prior to the survey.

If you've been following the discussion in *Housing Market Digest*, you know my opinion that employment growth is very strong in the service industries that are centred in the City of Toronto and much weaker in manufacturing (much of which is located in "905" as well as inner-suburban "416"). The implication is that at present demand for rentals is strongest in the area where there is the most rental supply. Tellingly, the vacancy rate is low in downtown Toronto (just 1.3% in CMHC's Zone 1) and 1.8% in the former City of Toronto. Vacancy rates are highest in inner-suburban areas (north Etobicoke at 13%, north-west North York at 8.2%).

Vacancy rates are low in "905" (averaging 2.3%, versus 3.4% in the entire City of Toronto and 3.2% for the CMA). Rental supplies are limited in many areas of "905". Thus, while rental demand may be weak in "905" due to on-going movements to home ownership and weakening job markets, there continue to be shortages of rental supply.

Population growth is another factor. Data on current growth of the population is not available. However, Statistics Canada does produce estimates of the number of adults (which it uses in the Labour Force Survey). The data in the right-hand column of the following table, which is taken from the estimates in the Labour Force Survey, suggests that the rate of population growth is in the process of slowing. If these estimates are right – and I expect that they are in the right ballpark – slowing population growth can be expected to result in weakening demand for rentals.

Key Factors Affecting the Toronto CMA Rental Market			
Year	Housing Completions		Growth of Adult Population (1,000s)
	Low-Rise	Apartments	
1996	11,355	3,752	70.8
1997	18,511	4,475	71.2
1998	20,251	2,881	68.3
1999	23,137	3,732	70.8
2000	26,533	7,907	90.1
2001	29,858	5,004	117.4
2002	31,095	10,134	110.4
2003	28,368	13,405	79.7
2004	29,500	9,694	93.1
2005	27,267	12,966	96.3
2006	25,333	15,113	89.0
2007	21,456	8,502	77.2

Sources: Statistics Canada, CMHC, Will Dunning Inc.

Competition from Rental Condominiums

During the past five years, there has been an expansion of the inventory of investor-owned condominium apartments. We don't know with any certainty how large this inventory is or how it has changed over time, but piecemeal information suggests that it has grown rapidly. This has contributed to the rise in the vacancy rate over the period. However, with the slowdown in completions of apartments during the past six months, the competitive pressure from condominiums has been reduced.

With on-going construction delays, the supply pipeline for condos has gotten very fat – at the end of September there were 26,000 condo apartments under construction in the Toronto CMA, plus 2,940 purpose-built rental apartments. Many of those projects are now close to completion, and many of these pending projects have large investor components. The extent of competition from new rentals (conventional as well as investor-owned) and from movement into owner-occupied condos will soon escalate sharply.

The Outlook

Looking ahead:

- The rate of job creation can be expected to slow during 2008 and 2009 (to 1% per year or less) due to the effect of the strong dollar on export industries, but also because the financial sector and related industries can be expected to grow much more slowly.
- The evolving slowdown of population growth can likewise be expected to continue.

- Slower growth of employment and population means fewer new households will be formed and there will be less movement into rentals.
- Meanwhile, movements out of rentals will accelerate soon, due to the pending wave of completions of new apartments.

In consequence, I expect that the vacancy rate in Toronto CMA will rise to at least 4% by April 2008 and be at a similar level in the fall.

For 2009, I expect a further rise of the vacancy rate, to at least 4.5%.

Given these vacancy rates, rents should be expected to increase by less than the overall inflation rate, or no more than 1% to 1.5% each year.

Forecasting is often a humbling activity – what’s happened during the past two years in the rental market has given me a strong reminder of this. Might I be wrong again? Of course. But, when I look at the huge volume of pending condo completions, as well as the evolving economic slowdown, I can see only a rise in the vacancy rate for the next two years.

CMHC Report

CMHC has produced a detailed and very good report on the rental market (although of course we agree on some points and disagree on others). The CMHC report for Toronto and other major markets across Canada can be found at:
https://www03.cmhc-schl.gc.ca/b2c/b2c/init.do?language=en&z_category=0/0000000059.

About Will Dunning Inc.

Will Dunning specializes in analysis of the GTA housing market. His main services are to produce market feasibility studies of proposed housing developments and to provide expert witness testimony on housing market issues.

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