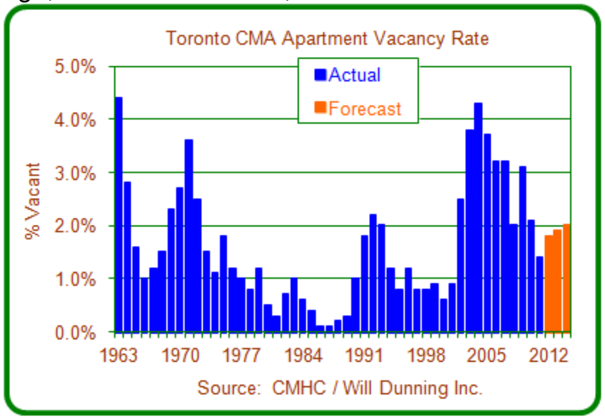
Rental Apartment Market

Toronto CMA, Fall 2011

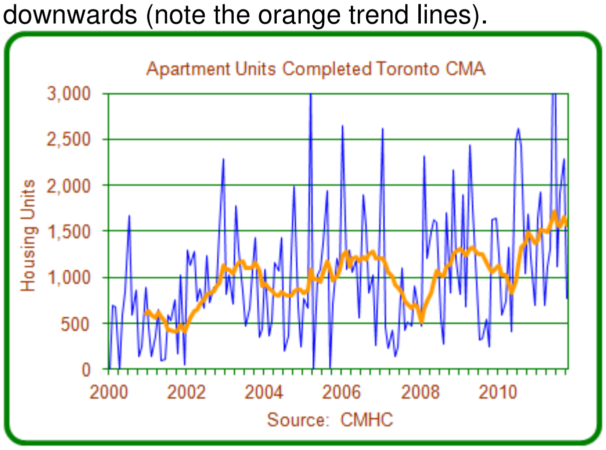
Overview

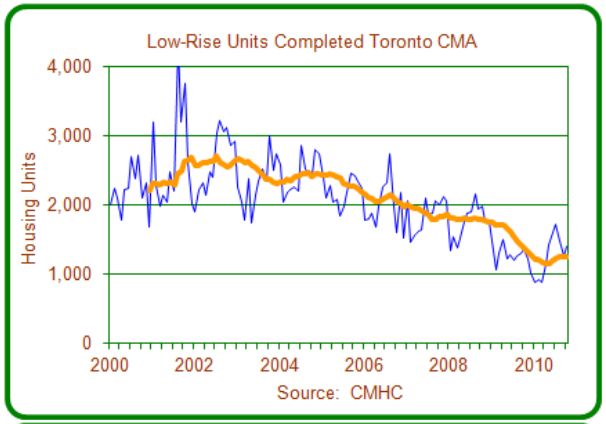
The apartment vacancy rate in Toronto CMA dropped substantially during 2011, for the second consecutive year. The October rate of 1.4% was the lowest seen since 2001. As of this October, Canada Mortgage and Housing Corporation ("CMHC") found about 4,300 vacant units in the conventional rental apartment market. Two years ago, there were about 9,400 vacant units.

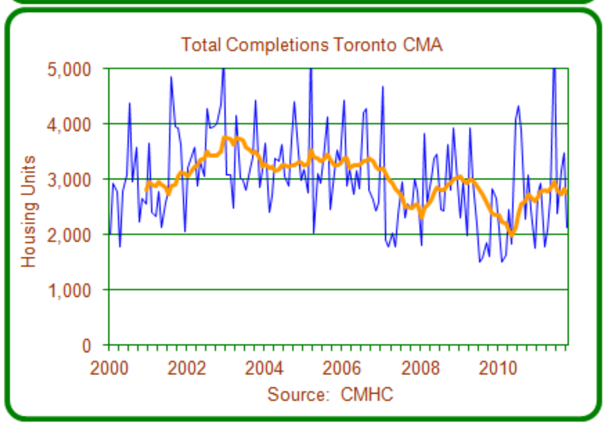


As I commented earlier this year (in the April and July editions of *Housing Market Digest*) the era of high vacancies has ended. I attribute this to a cause that we might not seem very relevant to you – a shortage of supply in the low-rise market.

My analysis tells me that there are two critical factors that influence changes in the vacancy rate: job creation and total completions of housing (not just rental supplies, but all housing). As the next three charts show, while completions of apartments are very high, there has been a large reduction in the low-rise sector, with the consequence that total completions have trended downwards (note the orange trend lines).

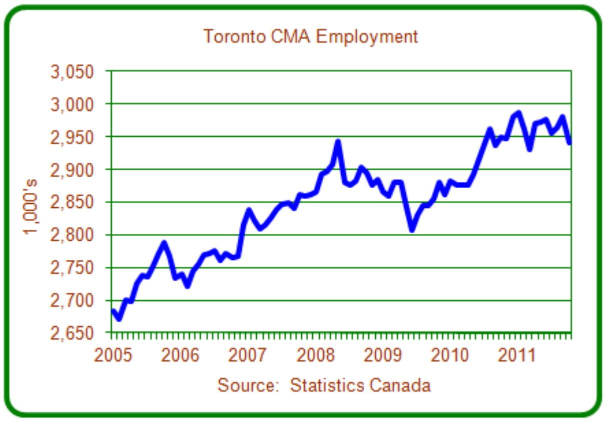






Moreover, apartment completions have surged recently. Burt, CMHC counts buildings as completed before they are actually ready to be occupied. Therefore, the recent surge in apartment completions was not available to affect the vacancy rate as of October (but it will affect the 2012 results).

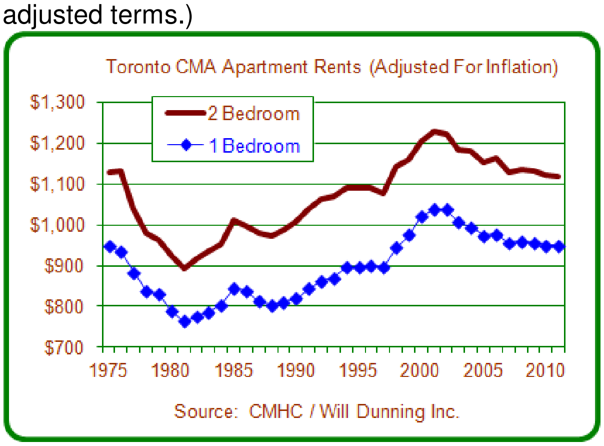
For the other major factor, job creation was quite strong during 2010 (see the chart on the next page). This would have resulted in a high volume of new household formation this year and thereby contributed to the fall in vacancies. Looking forward, job creation has slowed sharply this year, but probably not in time to materially affect the 2011 vacancy rate: this factor may have different implications for 2012.



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 fell to 2.9% this year, from 3.9% in October 2010 and 5.0% in 2009. There are currently about 9,000 rental apartments available, versus about 15,000 two years ago.

Rents increased by an estimated 1.8% this year, based on CMHC's calculation for a "constant sample" of structures that were in the sample in both 2010 and 2011. The average rent was $1,066 this year, up from the average of $1,040 in 2010 – on this basis, the rise was 2.5%.

The overall inflation rate for Toronto CMA was 2.9% in the year to this October (due largely to rising energy and food costs). Therefore, in inflation-adjusted (or "real") terms, the average rent fell by 0.4%. (However, if we use CMHC's estimate that rents increased by 1.8% for the constant sample, rents fell by 1.1% in 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. During the past decade the vacancy rate has been above that threshold most of the time, with the consequence that rents have eroded (by about 9%) in "real" terms. But, with the vacancy rate now below 2%, rents are likely to start rising in real terms.

The Outlook

Looking forward, I expect that the dominant factors will remain job creation and housing completions.

While housing completions have surged recently, the number that were effectively available in time to affect the vacancy rate may have totaled about 33,000 during the past year, versus more than 40,000 in the prior year. For 2012, the effective supply of completions should increase, possibly to 37,000. Meanwhile, the slowdown in job creation can be expected to reduce demand. This combination of increased supply and reduced demand is likely to result in increased vacancies.

Given the current uncertainty in the world economy, I can imagine a wide range of scenarios for job creation and housing completions for 2012 and beyond, which imply different scenarios for the Toronto rental market. For 2012, the scenario I have selected results in a rise of the vacancy rate to 1.8%, but I can see other scenarios with rates ranging from 1.5% to 2.0%.

I think the most likely scenario is for employment to be flat in 2012, followed by only moderate job growth for 2013 and 2014 (perhaps 1% per year). This should result in a slowdown for housing completions (mainly in the low-rise sector, as high-rise completions are largely pre-determined by sales that have already occurred). Effective completions might be as low as 30,000 per year during 2013 and 2014.

With the Ontario economy weakening but the resource-based provinces doing better, the rate of population growth in the GTA is likely to slow further.

The combination of weak job creation, slower population growth, and limited supply is likely to result in a more-or-less flat vacancy rate for 2013 and 2014: the scenario illustrated in the first chart on page 1 suggests modest rises in both years.

As for rents, my forecasting system expects increases at slightly faster than overall inflation. Assuming inflation at 2%, annual rent increases would be 2.1% in 2012, 2.4% in 2013, and 2.3% in 2014.

CMHC Report

For an alternative set of opinions, I suggest that you look at CMHC's excellent report.

The reports for the GTA and elsewhere in Canada are available here: https://www03.cmhc-schl.gc.ca/catalog/productList.cfm?cat=79&lang=en&fr=1323824488250

CMHC expects that the GTA vacancy rate will slip to 1.3% for 2012 and that rents will rise "by a somewhat higher amount than the Ontario Rent Review Guideline of 3.1 per cent."

CMHC doesn't forecast for the subsequent years.

CMHC also provides estimates of rentals within the condominium inventory. It estimates that the number of rented condos increased by 19% this year, and that 22% of condos are rented. I suspect that the actual share may be slightly (a few percentage points) higher than the 22% estimate.

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.

Disclaimer of Liability

How to Reach Will Dunning

For more analysis of housing markets, contact Will Dunning at:

Telephone: 416-236-5115
Email: wdunning@sympatico.ca
Web site: www.wdunning.com