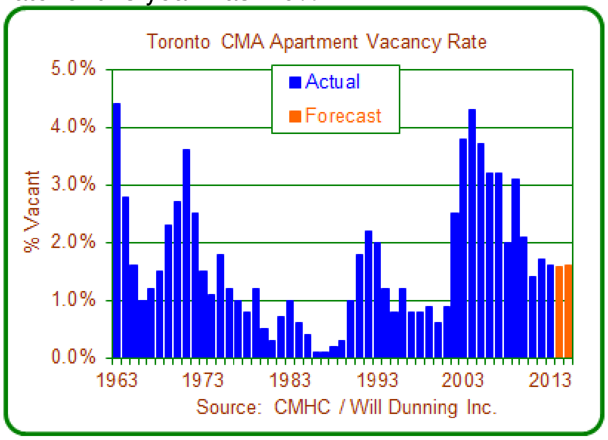
Rental Apartment Market

Toronto CMA, Fall 2013

Overview

The Toronto CMA rental market has not provided many surprises during the past year. A year ago my forecasting system said that the vacancy rate for October 2013 would be unchanged from the 1.7% seen in 2012. Canada Mortgage and Housing Corporation ("CMHC") reports that the rate for this year was 1.6%.



Rents increased more rapidly this year: for apartment buildings that were in the survey in both 2012 and 2013, the average rent rose by 3.1%.

Vacancies

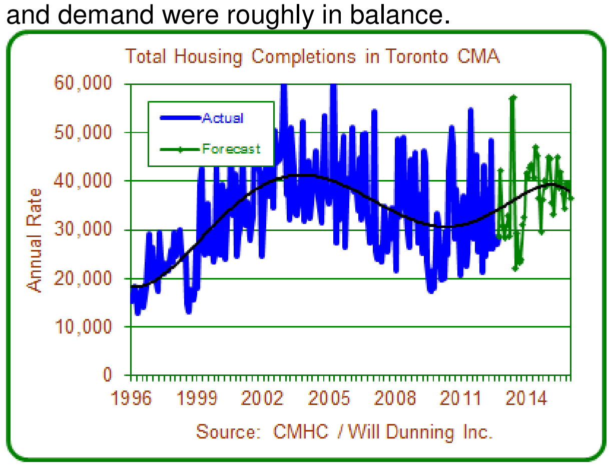
A 1.6% vacancy rate implies there are about 5,000 vacant rental apartments (out of just over 300,000 units in the private rental apartment market).

CMHC also estimates vacancy rates for rented condominiums. For this year, the rate is 1.8%, up from 1.2% a year ago. Since CMHC estimates that about 77,000 condominium apartments were rented or available for rent, the data implies that there were about 1,400 vacant rental condominiums this year.

Comparing data for 2012 and 2013, it appears that about 13,600 condominiums were added to the rental stock during the past year. This includes new units that were immediately made available for rental as well as existing units that were previously owner-occupied but are now tenanted.

I have been known to say that "forecasting doesn't work". But, I also believe that the exercise of building and testing models can lead to insights about how the market works. Experimentation over many years has persuaded me that the most important factors influencing vacancies are (1) job creation during the past year and (2) total completions of new housing during the past year. Initially, I thought that completions of new rental units must be more important than total completions (which include ownership units). The statistics persuade me otherwise. I can justify this to myself: the addition of any type of new housing expands the housing opportunities in the community: through "chains" of moves, eventually somebody moves out of a rental.

My interpretation of a flat vacancy rate for 2013 is that job creation created a certain amount of housing demand; the housing supply increased by almost exactly the same amount as the increase for demand. Referring back to the first chart, and adding the insight that comes from this model: the reason the vacancy rate vacancy rose sharply during 2001 to 2004 was that there were too many housing completions compared to the amount of housing demand that was generated by job creation. On the other hand, vacancies fell during 2004 to 2011 because there weren't enough housing completions compared to the growth of housing demand. For both 2012 and 2013, supply and demand were roughly in balance.



Another way to look at this is to compare the demographic requirement for housing (the amount of demand that "should" result from growth of the population and changes in its age composition) versus actual housing production. If production exceeds the requirement, we expect vacancies to rise; conversely, a shortfall of production compared to the requirements should lead to reduced vacancies.

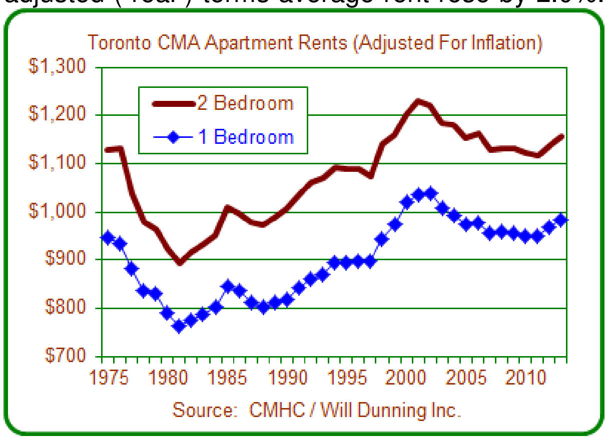
For the current 5-year period (2011 to 2016) my demographic model places the requirement for

Toronto CMA at an average of 32,600 dwelling units per year. Actual production (completions) has been at almost exactly that level (averaging about 32,900 units per year during 2011 to 2013). This approach also tells us that the vacancy rate should have been essentially flat during 2011 to 2013, or perhaps rise fractionally, which it did.

Rents

Rents increased by an estimated 3.1% this year, based on CMHC's calculation for a "constant sample" of structures that were in the sample in both 2012 and 2013. The average rent was $1,131 this year, up from the average of $1,102 in 2012 – on this basis, the rise was 2.6%. (Thus, changes in the sample appear to have distorted the average rent change by 0.5 percentage points.)

The inflation rate for Toronto CMA was 1.1% in the year to this October. Therefore, in inflation-adjusted ("real") terms average rent rose by 2.0%.



The rent increase guideline for 2012 was 3.1%, followed by a 2.5% guideline for 2013. Thus, for the period covered by the CMHC survey, the effective average guideline was 2.65%. Overall, rents increased more rapidly than the guideline.

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 about 2%. During 2002 to 2010 the vacancy rate was above that threshold most of the time. Therefore, rents fell in "real" terms. But, with the vacancy rate below 2% since 2011, rents are now increasing in real terms.

The Outlook

For 2014 and 2015, my forecasting system tells me that completions will be about 37,000 and 38,000, respectively. This should mean that the vacancy rate will tend to rise in both 2014 and 2015. I also expect that job creation will be strong, more rapidly than the pace of population (causing the employment-to-population ratio to rise). This should mean that housing demand would be a bit stronger than is suggested by the demographic model. Therefore, once again, the growth of supply and the growth of demand should be in balance and the vacancy rate should be flat during 2014 and 2015, at 1.6%.

Expected completions include about 24,000 condominium apartments per year. If actual deliveries remain constrained the vacancy rate would be lower than the forecast.

Based on the forecast of vacancy rates, I expect that rents will rise by 2.2% in 2014 and 2.4% in 2015. With inflation only about 1%, rents will continue to rise in real terms.

CMHC Report

CMHC's excellent report contains a lot of data and some different interpretations. CMHC did not publish a forecast in this year's report. The reports for the GTA and elsewhere in Canada are here: https://www03.cmhc-schl.gc.ca/catalog/productList.cfm?cat=79&lang=en&fr=1388259040919

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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