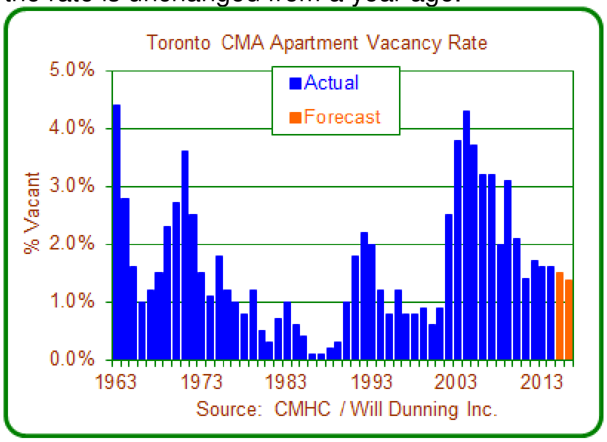
Rental Apartment Market

Toronto CMA, Fall 2014

Overview

The vacancy rate in the Toronto CMA rental market has been less than 2% since 2011. With Canada Mortgage and Housing Corporation ("CMHC") reporting a rate of 1.6% this October, the rate is unchanged from a year ago.



Rent increases eased this year, to 2.6% versus 3.1% in both 2012 and 2013.

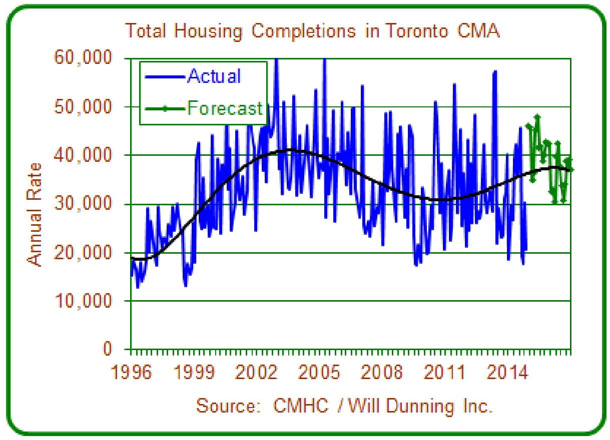
Vacancies

A 1.6% vacancy rate implies there are about 5,000 vacant rental apartments (out of just over 308,000 units in the private rental apartment market).

CMHC also estimates vacancy rates for rented condominiums. For this year, the rate is 1.3%, down from 1.8% a year ago, but similar to the 1.2% rate for 2012. Since CMHC estimates that the number of rented condominium apartments in the Toronto CMA rose from about 77,000 in 2013 to just over 90,000 this year. For the second consecutive year, the CMHC data indicates that about 13,500 condominiums were added to the rental stock. In the face of these very large expansions of supply, demand has kept pace.

Experimentation with forecasting models over many years has shown me that changes in the vacancy rate can be explained relatively well by two factors: (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.

The relatively flat vacancy rate since 2011 indicates that the housing stock has been expanding at the rate required by the population and the economic circumstances that exist. While job creation slowed this year (meaning that less new demand would be created), the volume of housing completions was at a moderate level, in line with demand.



We have been hearing arguments that housing production (in Canada as a whole and in some communities) has exceeded the "demographic requirements" (the amount of demand that "should" result from growth of the population and changes in its age composition). I disagree with that view: if housing production exceeds the amount of housing that is truly needed, the vacancy rate should rise. The flat vacancy rates for the Toronto area (and for all of Canada) indicate that supply and demand are in balance.

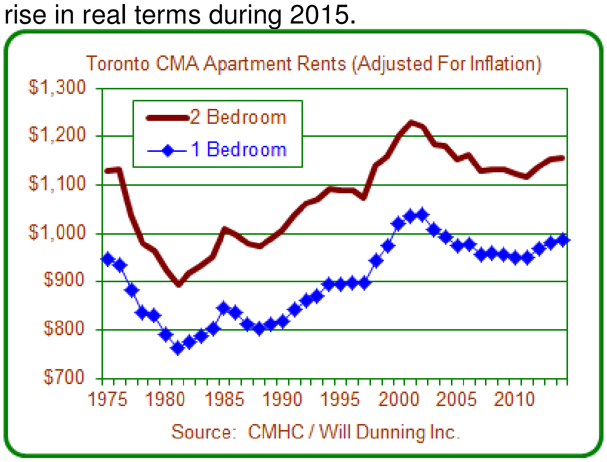
Rents

Rents increased by an estimated 2.6% this year, based on CMHC's calculation for a "constant sample" of structures that were in the sample in both 2013 and 2014. The average rent was $1,163 this year, up from the average of $1,131 in 2013 – on this basis, the rise was 2.8%. (Thus, changes in the sample appear to have caused a minor distortion of just +0.2 percentage points.)

The inflation rate for Toronto CMA was 3.0% in the year to this October. Therefore, in inflation-adjusted ("real") terms, rents fell by -0.4% on average.

The rent increase guideline for 2013 was 2.5%, followed by a 0.8% guideline for 2014. For the period covered by the CMHC survey, the average guideline was 1.1%. Overall, rents increased considerably 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%. With the vacancy rate below 2% since 2011, rents have increased in real terms. This year, the overall rate of inflation was temporarily elevated (due to a weakened dollar that raised prices of imported goods, as well as price rises for food and energy). Inflation peaked in October. The result was that while calculated "real" rents were flat this year, this may have been a temporary interruption of that trend: it is likely that inflation will subside during the coming year, meaning that rents may again rise in real terms during 2015.



The Outlook

For 2015 and 2016, my forecasting system tells me that completions will be about 34,500 and 39,500, respectively. However, the forecasts also expect that job creation will improve, as the consequence of multiple factors:

- Continued "wealth effects" from rising house prices and the stock market (although the stock market has been highly volatile of late).
- The very sharp fall in the prices of oil products, which will give consumers more discretionary income and support our manufacturing industries.
- The weakened dollar (although the impacts of this are expected to be gradual).

For the first time since the recession, employment is expected to grow more rapidly than the population, causing the "employment-to-population ratio" to rise.

This, while the housing supply will expand more rapidly, demand growth will strengthen. The vacancy rate may slip in both years, from the 2014 rate of 1.6% to 1.5 in 2015 and 1.4% in 2016.

Expected completions include about 22,000 condominium apartments in the coming year followed by 19,000. If actual deliveries remain constrained the vacancy rate would be lower than the forecast. On the other hand, more rapid completions could cause the vacancy rate to rise.

Based on the forecast of vacancy rates, and with an expectation that overall inflation will slow, I expect that rents will rise by 2.4% in 2015 and 2.6% in 2016. With inflation only about 1%-1.5%, 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=1419116849009

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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