2018 Ontario Rental Market Update:

The Supply Gap Grows Larger

January 2019

Prepared for the Federation of Rental-housing Providers of Ontario

by

URBANATION Inc.

INTRODUCTION

Urbanation was retained by FRPO to provide an assessment of current rental market conditions and trends in Ontario. This report is a follow-up to a study Urbanation completed for FRPO in September 2017 that provided a framework for measuring the gap in the marketplace between the demand and supply of rental apartments. The intention of the study was to raise awareness of the present and future expected factors impacting Ontario's rental market, and the need to encourage a much stronger amount of rental construction to meet the level of demand for new units. By examining the latest changes in key market drivers and the resulting impacts on rental conditions, this report will present an updated assessment of the Ontario rental market and its estimated supply shortfall.

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ABOUT FRPO

Since 1985, the Federation of Rental-housing Providers of Ontario (FRPO) has been the voice of Ontario's rental housing industry and the leading advocate for quality rental housing. The Federation of Rental-housing Providers of Ontario is the largest association representing those who own, manage, build and finance, service and supply residential rental homes in Ontario. We have led the rental housing industry in Ontario for over 30 years, offering public advocacy, representation and promotion, industry research, standards and best practices, education and training along with marquee industry events and awards.

ABOUT URBANATION

Urbanation is a real estate consulting firm that has been providing market research, in-depth market analysis and consulting services to the condominium and rental housing industry since 1981. Urbanation uses a multi-disciplinary approach that combines empirical research techniques with first-hand observations and qualitative information gathered through relationships built within the industry over the past 40 years. Urbanation's reports monitor the new construction, resale condominium, rental apartment and proposed development markets in the Greater Toronto Area. Urbanation also actively conducts customized research and market feasibility studies across the country for both condominium and purpose-built rental apartment projects. Urbanation's clients include the GTA's largest developers as well as mid- and smaller-scale real estate organizations, institutional investors, major lenders, government agencies, and a variety of service providers.

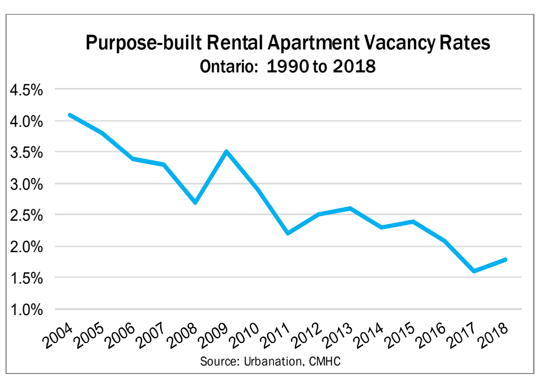
HIGHLIGHTS

- Market conditions for rental apartments in Ontario remained tight in 2018, with the vacancy rate of 1.8% staying near the 16-year low reached in 2017 (1.6%). In Toronto, vacancy rates were unchanged from the year prior at 1.1% for purpose-built units and 0.7% for condominium rentals. Within Toronto, more than 40 neighbourhoods were identified as having a vacancy rate that was lower than 1%, with several medium- and smaller-sized markets outside the GTA posting below average vacancy, strong growth in demand, and low levels of new supply.

- Rental demand in Ontario continued to be driven higher in 2018 through strong job growth and a 30-year low unemployment rate, record high population inflows to the province from young working adults, and a sharp reduction in homeownership demand caused by high prices, rising interest rates and tighter lending rules.

- The Ontario purpose-built rental apartment stock increased by 1% in 2018, or a total of 6,800 units on a net basis, which represented a slower pace than in 2017 and compared to an average rate of renter formation between 2011 and 2016 of 34,000 households per year. While some progress has been made in increasing construction activity for rental apartments in recent years, new supply per capita has been trending down. Furthermore, the annual increase in secondary condo rental supply has been declining sharply as fewer investors are holding their units in the long-term rental pool. This was compounded by lower levels of tenant turnover, contributing to record growth of 9% for condo rents in Toronto.

- The larger than expected misalignment between demand and supply levels emerging in the Ontario rental market in 2018 calls for even greater and urgent need for new rentals than originally estimated in 2017. **The total net increase in purpose-built and condominium rentals slowed to 12,214 units in 2018, which was nearly 22,000 units below the average annual rate of 33,961 renter households formed in the province between 2011 and 2016. Given the current course for demand and new supply, Urbanation projects that the Ontario rental market will experience an annual shortfall averaging at least 9,000-10,000 units per year in the next decade.** Particular attention needs to be placed on intensifying higher-density Toronto neighbourhoods close to transit and a new effort to encourage rental development across the province in markets outside the GTA.

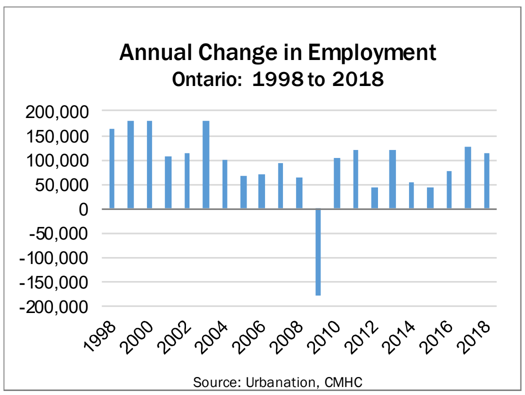


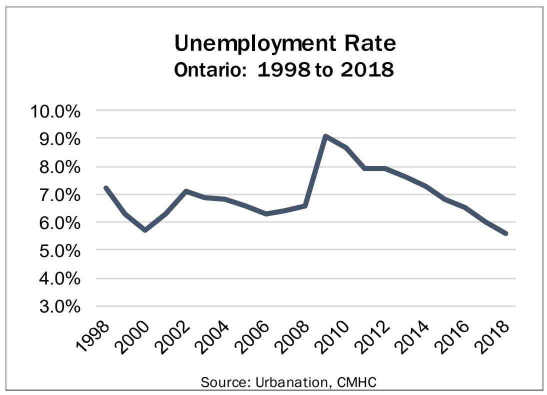
DEMAND DRIVERS

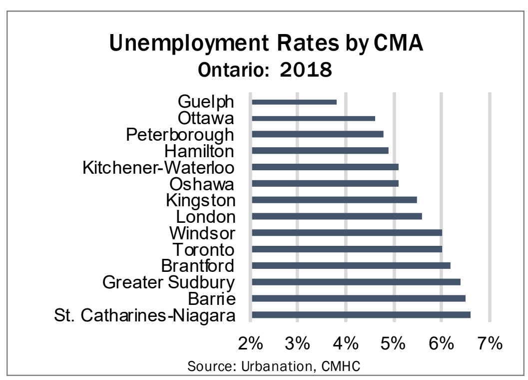
Rental Demand Soars to 45-Year High on Robust Economy, Record Population Inflows and Reduced Ownership Affordability

Economy

- The Ontario economy has been one of the best performers in Canada over the past four years, posting solid real GDP growth averaging 2.5%. Job growth in the province averaged more than 120,000 new positions over the past two years, roughly 30,000 more than the average since the 2009 recession. Despite robust growth in the labour market, the unemployment rate in Ontario continued to fall, dropping to 5.6% — the lowest level in 30 years. Increases in employment during the past two years have been led by full-time work for employees under the age of 45. Locally, job growth has been strongest in Toronto and neighbouring markets of Hamilton, Kitchener-Waterloo, and Barrie. The lowest unemployment rates were found in Guelph (3.8%), Ottawa (4.6%), and Peterborough (4.8%).

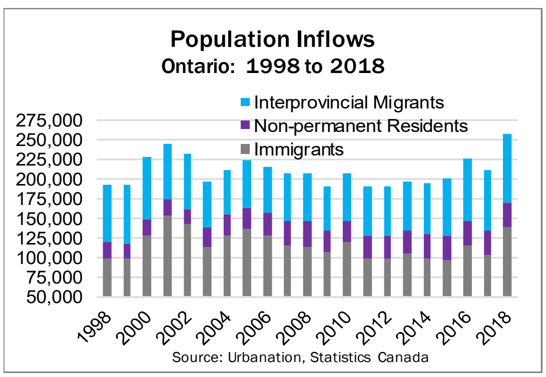


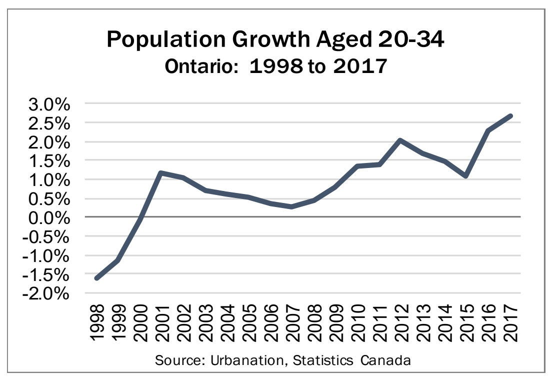


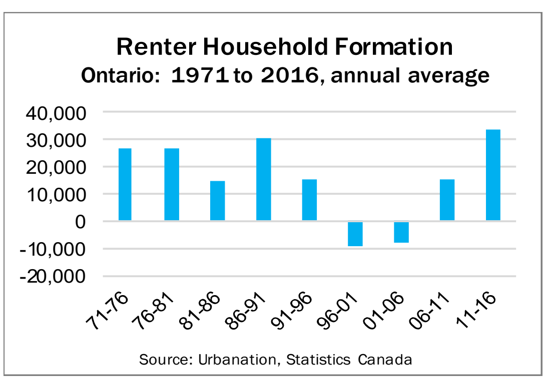


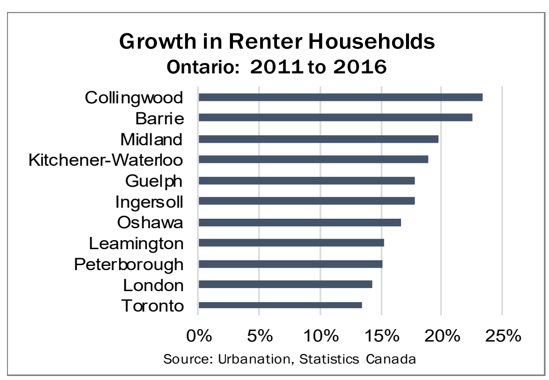
Population and Renter Household Growth

- Annual population inflows into Ontario grew to a record of nearly 257,000 persons during the four-quarter period ending Q3-2018, which was up from 210,000 in the year ending Q3-2017 and the decade average of 205,000. Population inflows surpassed the previous high set back in 2001 as the number of new immigrants increased to a 13-year high of 138,000, non-permanent residents grew to a 30-year high of 88,000, and migrants from other provinces reached 32,000 — the highest level in more than 40 years. As new residents tend to be represented by young adults, population growth within the 20-34 age group is expected to have surged by more than 3% in 2018. This uptrend in population growth is expected to have produced a large increase in renters in Ontario, which averaged gains of approximately 34,000 households per year between 2011 and 2016 — more than doubling the rate of formation between 2006 and 2011. The Toronto CMA comprised half of all renter household formation in the province during the period. However, percentage growth in renters was highest in smaller markets north of the GTA such as Collingwood, Barrie, and Midland.



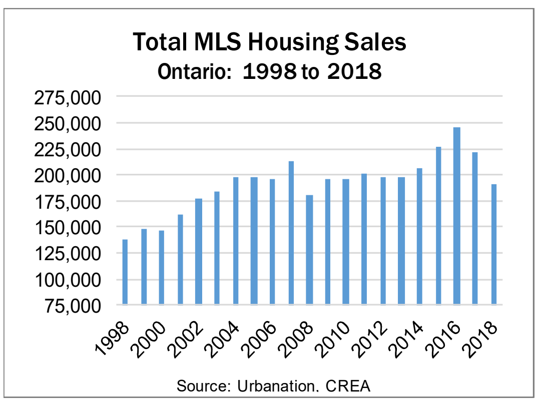


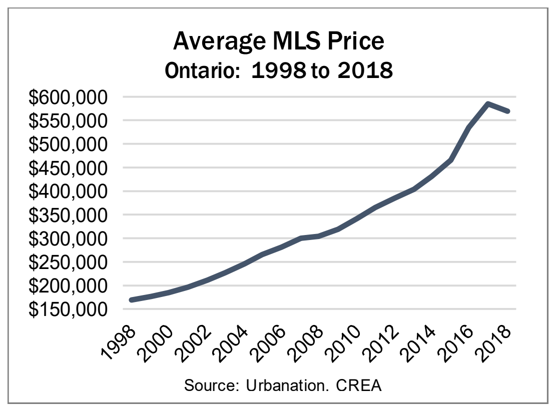


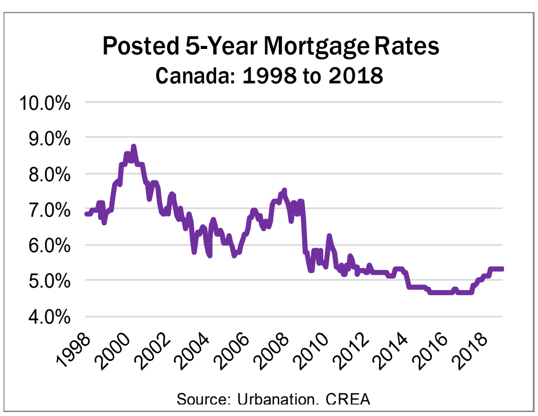


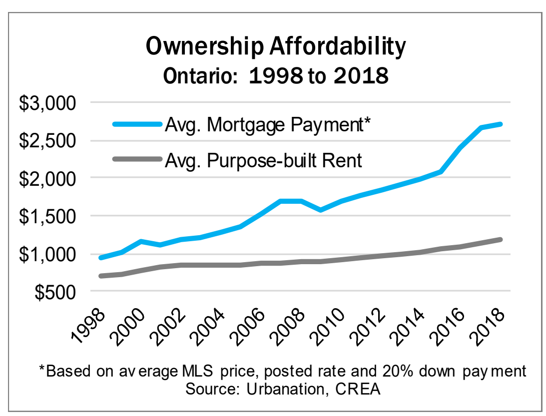
Ownership Affordability

- Rental demand has received an additional boost over the past couple years as ownership demand has slowed. Total MLS resale volume in 2018 fell by 14% from 2017 and by 22% from the high in 2016 to 190,830 homes, the lowest level since 2008. Housing sales in Ontario have declined due to a number of factors that include a surge in prices, provincial measures to cool the market such as a 15% foreign buyer's tax, rising interest rates, and stricter mortgage qualification criteria imposed for federally regulated lenders. Yet despite the sharp downturn in sales, home prices held relatively firm in 2018, declining by less than 3% to an average of approximately $570,000. Prices in 2018 were 41% higher than five years earlier and 89% higher than 10 years ago. At the same time, mortgage interest rates rose to their highest level in five years by the end of 2018 as the Bank of Canada increased its policy setting rate five times since the summer of 2017, signalling that further increases will be needed. As a result, housing affordability worsened in 2018, with the average mortgage payment associated with purchasing the average priced home growing to reach 2.3 times the average rent — the highest multiple since 1990.







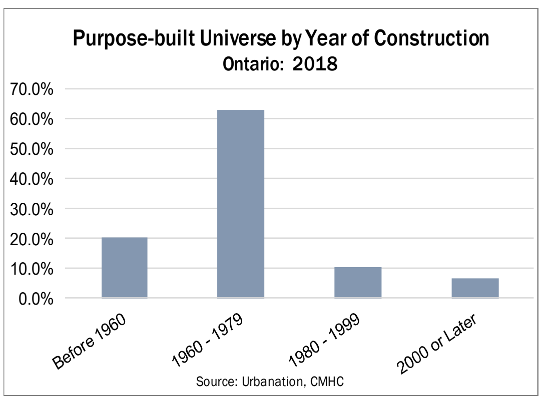


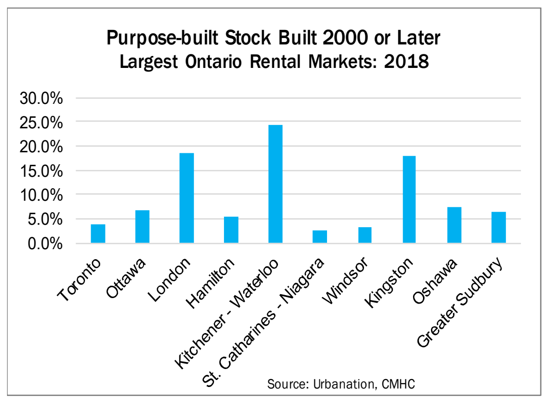
SUPPLY CONDITIONS

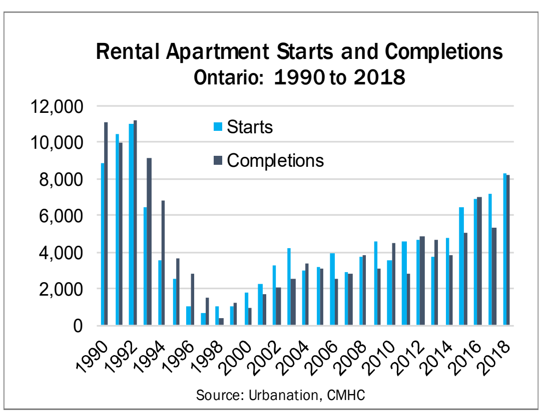
Supply Remains Tight as Higher Purpose-built Rental Construction is Unable to Offset Rising Demand and a Slowdown in Secondary Condo Rentals

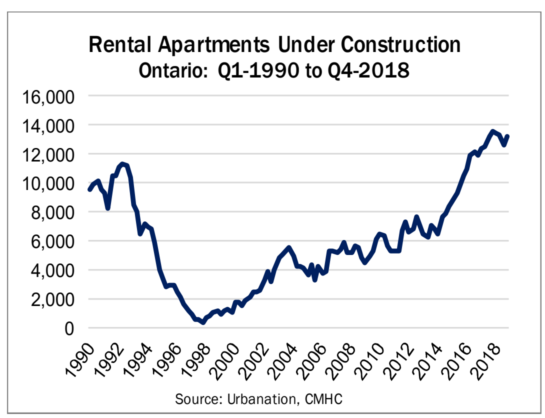
Purpose-built Rental Construction

- The total supply of purpose-built rental apartments in Ontario increased by 6,800 units in 2018 on a net basis, down from a gain of 8,500 units in 2017 but remaining at one of the highest levels over the past 30 years. Nevertheless, the minimal amount of overall new supply added has resulted in a majority stock of older rentals — 83% of purpose-built units were built before 1980 and only 7% were built since 2000. In Toronto, less than 4% of rentals were built since 2000, with the share falling as low as 2.5% in St. Catharines-Niagara. The markets with relatively high shares of newer purpose-built rentals such as London, Kitchener-Waterloo, and Kingston have catered to their large post-secondary student populations. On an overall trend basis, new supply is growing as purpose-built rental apartment construction starts and completions both surpassed 8,000 units in 2018 (the highest levels since the early 1990s). However, as a share of total housing starts, rental construction declined to a three-year low last year. Furthermore, after growing above 13,000 units in the second half of 2017, the inventory of purpose-built rentals under construction has levelled off.



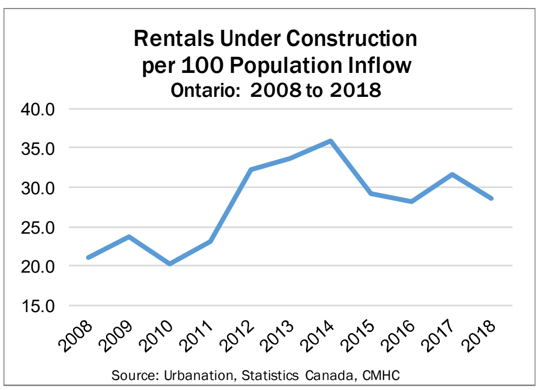


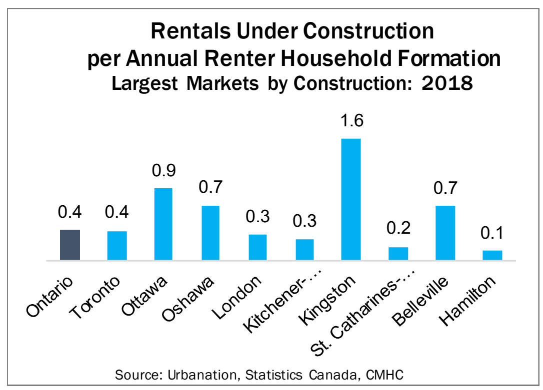


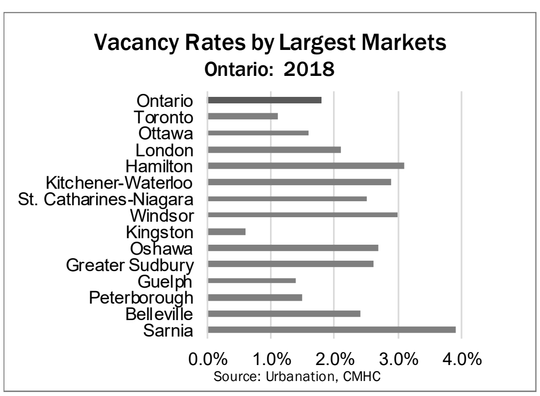


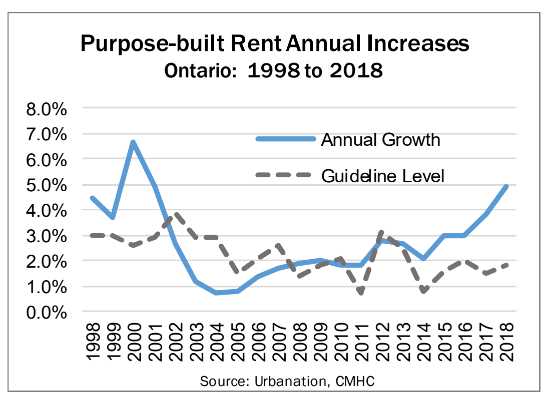
Construction per Capita and Market Conditions

- Comparing the level of rental construction to the number of new residents arriving in Ontario on an annual basis shows that per capita construction has been generally trending down in recent years. As of Q3-2018, there were 29 units under construction for every 100 people migrating into the province in the past 12 months, down from 32 units in Q3-2017 and a recent peak of 36 units in Q3-2017. Measured against the annual rate of renter household formation averaged between 2011 and 2016, there were 0.4 units per household under construction at the end of 2018 in Ontario, with markets such as London, Kitchener-Waterloo, St. Catharines-Niagara and Hamilton having ratios 0.3 or less. With supply continuing to undershoot demand, downward pressure on vacancy rates will persist across the province. In Ontario's largest markets of Toronto and Ottawa, vacancy rates were exceptionally low at 1.1% and 1.6%, respectively, as well as in medium sized and smaller markets such as Kingston (0.6%), Guelph (1.4%) and Peterborough (1.5%). The widespread undersupply of rentals has, in turn, resulted in accelerated growth in rent, in spite of rental controls. The intense competition among tenants for decontrolled units led overall rents to rise by 4.9% in 2018, almost three times higher than the guideline level applied to existing tenants of 1.8%.



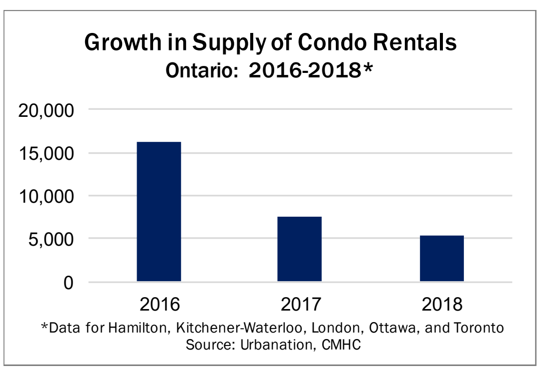


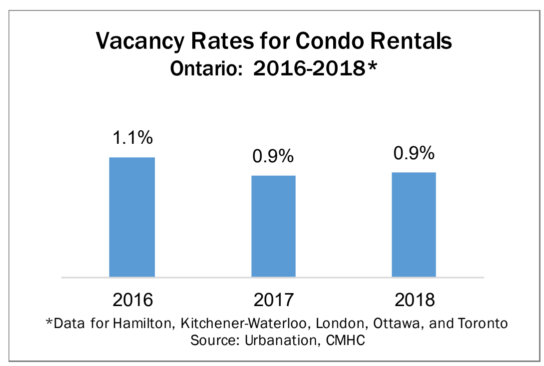


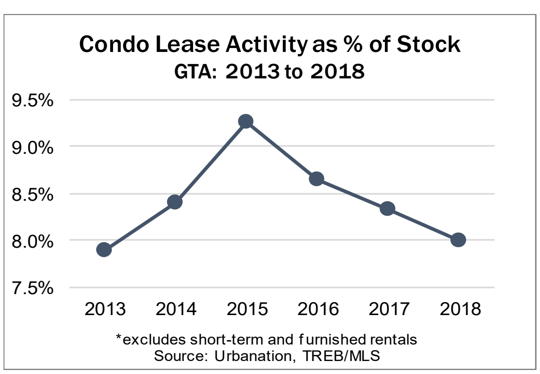


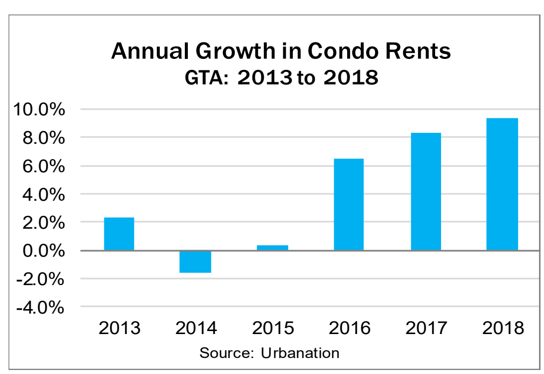
Condominium Rentals

- Condominiums have generally been relied upon to supply the majority of new rentals in Ontario over the past decade. However, last year the net increase in condos used as rentals fell to its lowest level of the past 10 years. The growth of 5,436 condo rentals in 2018 was 28% less than the 7,501 unit increase in 2017 and 67% less than the 16,293 net gain in 2016. The reduced share of condos being held in the secondary market by investors (which may have been due to an increase in units used as short-term rentals as well as an increase in investor selling) pushed down the total net increase in new rental apartment supply (purpose-built and condominium) to 12,214 units in 2018 — nearly 22,000 units below the annual level of renter household formation between 2011 and 2016. Not surprisingly, the slowdown in condominium rental supply held vacancy rates below 1% for the second consecutive year. In the GTA, condo rental vacancy rates were 0.7%. Condo rental data tracked by Urbanation has shown a sharp decline in turnover as not only fewer investors hold onto their units, but also tenant mobility drops due to rent controls and high rental costs in the open market. This has added further tightness to the market and contributed to record growth in condo rents of 9% in 2018.



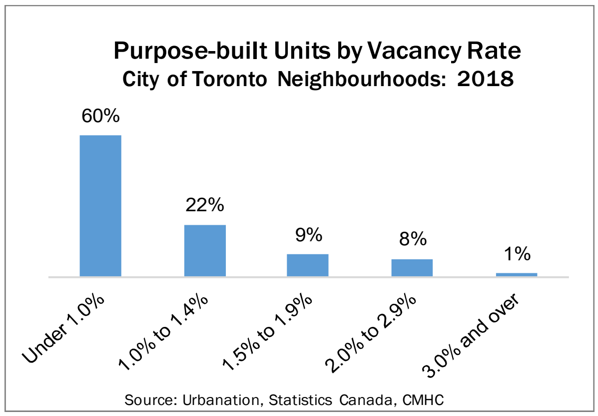






City of Toronto Vacancy Rates

- As the largest market in the province with among the tightest rental conditions, Toronto requires the most attention with respect to increasing rental supply. More than 80% of units in Toronto neighbourhoods surveyed by CMHC reported vacancy rates that were below 1.5%, including 60% of units in neighbourhoods reporting a vacancy rate less than 1%, which encompasses a total of 142,558 purpose-built rental apartments. In fact, only 1% of units were located in a Toronto neighbourhood that had a vacancy rate above 3%.



- As displayed in the table on the following page, there were 41 neighbourhoods in the City of Toronto that were identified as having a vacancy rate below 1.0% based on a high quality survey response and a purpose-built rental stock of at least 1,000 units. Several of these neighbourhoods, including the highest ranked Yonge-St. Clair with a 0.3% vacancy rate, were located in close proximity to current and planned higher-order transit stations. The market area with the greatest number of units in neighbourhoods with vacancy rates below 1% was North York Southeast (15,243), followed by North York Northwest (12,510), Etobicoke Central (11,127), North York North Central (11,001), and Scarborough Central (10,826).

Neighbourhoods with the Lowest Purpose-built Vacancy Rates

City of Toronto: 2018

Neighbourhood	Market Area	Rental Units	Vacancy Rate
Yonge-St. Clair	Toronto (North)	3,716	0.3%
Edenbridge-Humber Valley	Etobicoke (Central)	2,313	0.3%
Bathurst Manor	North York (N.Central)	1,579	0.3%
Agincourt/Malvern	Scarborough (North)	1,373	0.3%
Stonegate-Queensway	Etobicoke (South)	2,966	0.4%
Oakwood-Vaughan	York	1,712	0.4%
Bendale	Scarborough (Central)	1,217	0.4%
Victoria Village	North York (Southeast)	2,938	0.5%
L'Amoreaux/Steeles/Milliken	Scarborough (North)	2,821	0.5%
Scarborough Village	Scarborough (East)	2,249	0.5%
Brookhaven-Amesbury	North York (Southwest)	2,187	0.5%
Etobicoke West Mall	Etobicoke (Central)	1,976	0.5%
Dorset Park	Scarborough (Central)	1,851	0.5%
Bedford Park-Nortown	North York (Southwest)	1,850	0.5%
Rosedale	Toronto (Central)	1,006	0.5%
Downsview	North York (Northwest)	12,510	0.6%
Woburn	Scarborough (East)	3,771	0.6%
Mount Olive-Silverstone-Jamestown/Thistletown	Etobicoke (North)	3,427	0.6%
Broadview North	East York	3,304	0.6%
Banbury-Don Mills/York Mills	North York (Southeast)	3,175	0.6%
Eglinton East	Scarborough (Central)	2,969	0.6%
Henry Farm	North York (Northeast)	2,580	0.6%
Maple Leaf	North York (Southwest)	1,410	0.6%
Lansing-Westgate	North York (N.Central)	1,400	0.6%
New Toronto	Etobicoke (South)	1,256	0.6%
Playter Estates-Danforth	Toronto (East)	1,233	0.6%
North St. James Town	Toronto (Central)	7,038	0.7%
Thorncliffe Park	East York	5,624	0.7%
Westminster-Branson	North York (N.Central)	5,077	0.7%
Islington/City Centre North	Etobicoke (Central)	4,074	0.7%
Forest Hill North	Toronto (North)	3,359	0.7%
Willowridge-Martingrove-Richview	Etobicoke (Central)	2,764	0.7%
Ionview	Scarborough (Central)	2,469	0.7%
Wexford-Maryvale	Scarborough (Central)	2,320	0.7%
High Park-Swansea	Toronto (West)	1,816	0.7%
Parkwoods-Donalda	North York (Southeast)	6,343	0.8%
Don Valley Village/Pleasant View	North York (Northeast)	4,331	0.8%
Willowdale West/Newtonbrook West	North York (N.Central)	2,945	0.8%
Flemingdon Park	North York (Southeast)	2,787	0.8%
Bayview Woods-Steeles/Hillcrest Village	North York (Northeast)	1,604	0.8%
Morningside	Scarborough (East)	1,403	0.9%

*Neighbourhoods with at least 1,000 purpose-built units and high quality vacancy data

Source: Urbanation, CMHC

CONCLUDING COMMENTS

- As rental demand in Ontario continued to expand at its fastest rate in more than 40 years, the supply increase of purpose-built and condominiums declined to a decade low in 2018. Unsurprisingly, purpose-built vacancy rates remained below 2% for the second consecutive year — which hasn't occurred since 2000-2001 — and vacancy rates for condominiums were kept below 1%. Even more disconcerting than the vacancy statistics was the size gap between the number of rentals delivered to the market last year compared to recent rates of renter household formation, which enlarged to a difference of more than 20,000 units in 2018.

- Urbanation's 2017 study, using data made available at the time, estimated that demand for purpose-built and condominium rentals was 30,000 units a year, with a projected 10-year average level of 34,000 units. It was also projected that supply growth through new construction of rentals (primary and secondary) would undershoot demand by an average of 5,750 units per year, requiring immediate action to increase the purpose-built rental development pipeline by more than 60,000 units.

- The results of this study make very clear that the market fell into a deeper than expected supply deficit in 2018. This not only necessitates an upward revision to the previous estimated supply gap due to the further accumulation of pent-up demand last year, but also sets the market on course for an even wider gap in the coming years. Recent data have indicated that demand for rentals in Ontario has been stronger than originally projected, due to the combination of a surge in employment and population inflows, and highly reduced homeownership accessibility. While rental construction has shown notable improvement over the last couple years, the level of development will need to increase significantly above its current trend, noting that secondary supply from the condo market is beginning to decline.

- Given the latest demand and supply data analyzed, and updated projections, **it is estimated that the market will experience an annual average supply deficit of 9,000 to 10,000 units per year over the next decade.** This requires the level of purpose-built rental construction starts to more than double immediately from the 2018 total of 8,316 units.

- The recent removal of rent controls for projects that will be built going forward provides a useful incentive for developers. However, current land and development costs, and lengthy approval processes continue to present very real challenges to the economic viability of new projects. Urbanation has been carefully monitoring the pipeline of development applications for new rentals closely. While the inventory has shown consistent growth over the past three years, it remains at an insufficient level to meet the needs of today's and tomorrow's renting population in Ontario.

Data Limitations and Note to Readers

The analysis and projections contained herein have been prepared on the information and assumptions set forth in this report. However, this report relies on information from secondary sources and Urbanation cannot guarantee the accuracy of this data. Moreover, it is not possible to fully document all factors or account for all changes that may occur in the future.