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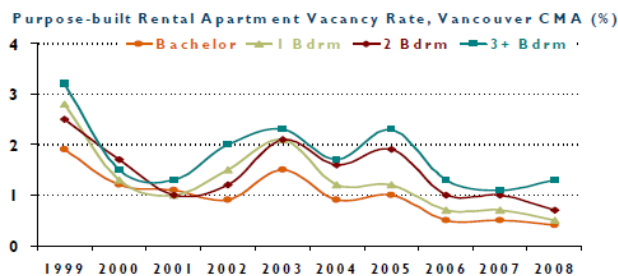
### 2009 Newsletter – Multiple Family Apartment Market

Predicting what will happen in Greater Vancouver's real estate multi-family marketplace in 2009 may be a fool's errand! In preparing this newsletter, interviews were held with a variety of people familiar with the market from developers, mortgage providers, financiers, insurers, appraisers, and real estate agents; we found different perspectives on what to expect in the coming months. At this time last year Greater Vancouver was in the midst of a historic real estate boom; record prices, an unprecedented volume of sales, low vacancy rates, high rental/lease rates, and a record number of new housing starts. This all began to change with the sub-prime mortgage crisis in the US, accentuated by the failure of Lehman Brothers and other financial institutions in September 2008. At the onset of our research we hoped to provide some detailed predictions about what to expect with the multiple family apartment market in Vancouver, and in particular, the outlook for new rental construction in the city. We spoke with a number of professionals and examined factors ranging from supply and demand to the upcoming provincial election. Unfortunately at the end of all of our discussions and analyses there is no clear forecast to be made.

In 2008, private apartment **vacancy rates** in the City of Vancouver continued to decrease; averaging 0.3%, a decrease from the previous year's average of 0.5%. There are a number of factors that contributed to such low vacancy rates in 2008. As **housing prices** continued to climb early in the year fewer people could afford to make the shift from the rental market to become first time buyers. According to the Canada Mortgage and Housing Corporation (CMHC) the Vancouver Census Metropolitan Area (CMA) recorded the lowest level of first-time buyer intentions of all the major Canadian centres surveyed in their Renovation and Home Purchase Survey for 2008. However, with the massive upheaval in the global economy housing prices began to fall in late 2008; a trend that has continued into 2009. According to the B.C. Real Estate Association's chief economist, the "benchmark price for a two-bedroom condo in Metro Vancouver was \$334,602 in January [2009], 11.5 per cent less than the \$378,336 the same condo would have sold for 12 months earlier".<sup>1</sup>

Although home prices in Vancouver have declined substantially over the last few quarters, the general uncertainty with the economy has made some potential first-time buyers cautious about becoming home owners. "Residential sales dollar volume on B.C.'s Multiple Listing Service dropped 61 per cent to \$873 million in January, compared to the same month in 2008 when sales totalled \$2.25 billion, according to a housing survey released Monday (February 16, 2009) by the B.C. Real Estate Association".<sup>2</sup> Some observers expect that the lower volume of sales will place downward pressure on

#### Demand for Rental Keeps Vacancies Low



Source: CMHC Rental Market Survey, Oct Survey

<sup>1</sup> Vancouver Sun: "Home sales volume plunges 61 per cent ... so is this a good time to buy?" – Morton, Brian – February 16, 2009

<sup>2</sup> Vancouver Sun: "61-per-cent decline in value of B.C. real estate sales in January" – February 16, 2009

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**rental vacancy rates** as people financially ready to buy remain in the rental market, either uncertain about their job, waiting for the housing market to stabilize, or both.

Another factor that contributed to **rental unit demand** was the more than 30,000 people that moved into the Vancouver CMA over the last year. Typically migrants coming from other parts of the country or province, and those coming from other countries seek rental accommodation upon arrival. Once they are established in the community they may consider home ownership.

John Lynch, Business Development Manager for CMHC Multi-Unit Mortgage Insurance, suggested that there are 20,000 condo units still under construction in the lower mainland. He indicated that many of the owners who may have been hoping to flip these units will now add them to the rental pool until the condo market recovers. In addition, Mr. Lynch said he had talked with a number of developers who are looking to convert existing projects or planned projects from condos to rental units. According to CMHC's Rental Market Report – Fall 2008, there were 148,512 rental units in the Vancouver CMA in October 2008; and 32,378 (or 22%) of those units were being rented.<sup>3</sup> So if the same percentage of the 20,000 units is added to the rental market, these additional 4,400 units would potential increase the condo rental unit supply by over 13% in 2009. This is quite a significant increase in supply compared to the 4.3% increase from 2007 to 2008. Such a dramatic change in supply would suggest that **vacancy rates could actually increase in 2009**, with commensurate negative pressure on rents.

The anticipation of higher vacancy rates was echoed by David and Mark Goodman in their 2008 Year in Review report: "We in turn forecast that owners will experience a more challenging rental market due to a **lessening of demand**. Having been in contact with owners on a continuous basis throughout Greater Vancouver, we have learned that fewer people are responding to 'for rent' ads, more tenants are vacating their suites because of financial hardship, and significant numbers of tenants are moving into their recently purchased condos. Finally, expect significant numbers of frustrated investors, unable to sell their vacant condos, to 'throw in the towel' and tenant their suites."<sup>4</sup>

Another factor on the supply side of the rental market is **new construction**; "new rental construction in the CMA has been low for many years, with builders focusing on apartment condominium construction rather than new rental projects".<sup>5</sup> Spurred by the high returns for condominium sales in the downtown area over the last few years, purpose-built multi-family developments and office buildings were being purchased and converted to condominiums; one of the most prominent conversions being the renovation of the Westcoast Transmission building in 2004. The City of Vancouver has now stepped in to help reverse this trend as office space is not meeting the demands as evidenced by the 25% increase in lease rates for prime office space.<sup>6</sup>

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<sup>3</sup> CMHC - Rental Market Report - Vancouver and Abbotsford CMAs - Date Released: Fall 2008

<sup>4</sup> Mark and David Goodman – 2008 Year End Review – Issue 37, January 2009

<sup>5</sup> CMHC - Rental Market Report - Vancouver and Abbotsford CMAs - Date Released: Fall 2008

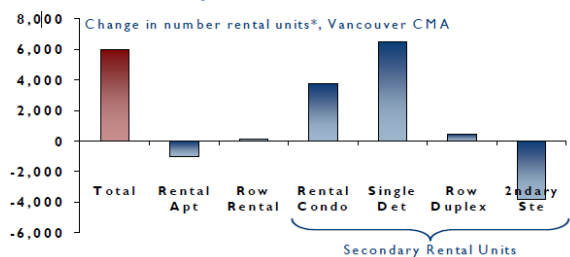
<sup>6</sup> Report on Business - Condos, costs squeeze Vancouver office space; Ebner, David; June 29, 2008

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According to CMHC, the traditional **purpose-built rental buildings** are providing 104,315 suites while there are an additional 129,334 units broken down as follows: 31,382 condos are being rented; there are 33,724 single detached homes, 30,285 row/duplex units, and another 33,943 accessory suites all of which are classified as the non-measured factor.<sup>7</sup>

**Purpose-Built Rental Stock Declines, Secondary Rental Stock Grows**



Although the **stock** of purpose-built rental units has decreased the number of condominium rental units in the Vancouver CMA has increased, but only marginally; from 31,382 condo rental units in 2007 to 32,758 condo rental units in 2008. In fact, on a percentage basis the number of condo rental units actually decreased from 28.1% in 2007 to 27.1% in 2008.<sup>8</sup> In addition, condo rental units are generally priced at the higher end of the rental spectrum, making them unaffordable for the majority of renters. According to CMHC, for condo rentals it is estimated that one must charge \$2.50 to \$3.75 per square foot to cover strata fees, taxes, and mortgage payments. This means charging between \$1,375 and \$2,060 for a 550 square foot one-bedroom apartment.<sup>9</sup> In the City of Vancouver rental apartments averaged \$985, whereas rental condo units averaged \$1,481.<sup>10</sup>

Although vacancy rates in 2009 seem to be a matter of perspective, **rents are likely to continue to increase**. However, they will not increase at the rate they have in the past few years. Due to decreased turnover, landlords will be unable to increase rents to market levels. Instead they will only be able to increase rent by the provincially mandated maximum rent increases, 3.7% in 2008. In addition there has been increased pressure from the City of Vancouver to maintain affordable housing. In fact, City Council is currently entertaining a proposal that would require landlords that make significant renovations to bring back tenants at pre-renovation rental rates. Such a policy would have serious ramifications on the rental market in Vancouver... a discussion best left to a future newsletter.

Any consideration of new residential rental construction must consider new ownership starts, as the supply of non-rental housing influences both the supply of, and demand for, rental suites. **New housing starts** for Metro Vancouver (which does not include Surrey, Langley, White Rock, and North Delta) have been fairly consistent over the past four years, peaking in 2007 with 20,736. In 2008 this number decreased to 2008, and is predicted to decrease more significantly in 2009. CMHC predicts that there will be only 12,500 new housing starts in 2009.<sup>11</sup> This is a decrease of 39.7% since 2007. This decline can be partly attributed to developers not wanting to add more units to the increasing inventory of unsold new homes.

<sup>7</sup> The Goodman Report – Issue 36, August 2008

<sup>8</sup> CMHC - Rental Market Report - Vancouver and Abbotsford CMAs - Date Released: Fall 2008

<sup>9</sup> The Goodman Report – Issue 36, August 2008

<sup>10</sup> CMHC - Rental Market Survey, Secondary Rental Market Survey, October 2008

<sup>11</sup> CMHC – Housing Market Outlook – Canada Edition – Date Released: First Quarter 2009

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Such a significant decrease in multiple family housing starts would be unexpected if one were only to consider increased rental rates, **decreasing construction costs** and the low mortgage/financing rates. Brad Marko, of Boffo Developments, has seen bids from front-end trades people decrease by up to 5% over the past couple of months, and is expecting to see additional decreases as demand for building trades decreases as the year progresses. In fact, John Lynch from CHMC expects construction costs to decrease by 10 to 15% in 2009. However, even with decreasing construction costs developers are taking a wait and see attitude as they are hesitant to add units to an already saturated condo market. Some speculate that low North American levels of residential and nonresidential development activity, combined with declines in the price of essential commodities such as steel and concrete arising from global slowdown, could lead to construction cost declines in the order of 25% by the end of 2009.

In the course of our research we talked to a number of lenders in Vancouver, some in commercial banks and others with private mortgage/financing companies. Unfortunately, no one wanted to go “on record” with the policies or practices of their particular institution. So although they would not say it directly, there was the perception that most lenders are now “less willing” to lend. **Financial institutions are far more selective**; insisting on higher debt coverage ratios, more equity, a greater number and scrutiny of presales (for condo developments), and the requirement of personal or corporate covenants in some circumstances.

In a dated Globe and Mail article from October 2008, VanCity Credit Union CEO Tamara Vrooman said speculator investment is something her institution decided a year ago was a cause for concern, along with the early signs of credit tightening and problems in the housing market. The credit union, which has about \$1-billion lent out in its construction portfolio, decided at that point that it would raise its requirements for presale levels, make higher demands on security for projects and monitor them more carefully.<sup>12</sup>

Even with **low interest rates** and construction costs on the decline, developers are hesitant to embark on any new condo projects in Vancouver. In the last few years developers have been able to secure financing without a large equity investment by having a strong number of presales for their projects. However, with fewer people looking to enter the market and a significant amount of existing stock, presales have slowed to a trickle. There are reports of people backing out of presale agreements willing to accept a loss of their deposits and any payments they have made; under the impression they can buy back into the depressed market and ultimately save money, even when taking their losses into account.

Over the past few years in Vancouver the potential profit from development and redevelopment projects has lead to large number of condominium units being constructed; even with the record high construction costs in the City of Vancouver. As condominium prices continue to fall there will be less interest in the development of new condominium units, in fact as CMHC’s John Lynch indicated, many multifamily projects now in the development pipeline entail proposed rental accommodation. The developers will have the buildings **strata titled and built to condominium standards** so that they are

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<sup>12</sup> The Globe and Mail; [Vancouver construction boom levelled by skittish lenders, high costs](#); Bula, Frances; October 9, 2008

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able to sell the units when that market recovers. Observers report that such projects entail the larger unit sizes and finishes characteristic of the condominium ownership market; as such, these projects would only impact the availability of affordable rental housing indirectly, through 'trickle down'.

**So what should we expect for the multi-family housing market in Vancouver?** Construction costs will be decreasing over the year, quite possibly in the neighbourhood of 15% or more, with reductions seen in the front-end trades first. The cost of borrowing money is likely to remain "relatively inexpensive" but equity requirements have increased. Rental rates in the city are likely to maintain their level with stronger markets continuing to increase, albeit likely not at the rates that we have seen over the past few years as rental unit turnover is expected to slow. Thus significant rent increases will be less frequent as landlords will only be able to increase rents for sitting tenants by the percentage established by the provincial government.

The greatest uncertainty in the multiple family residential market is on the supply and demand side. There is disagreement about the number of suites that will be added to the market and the amount of demand in new condos coming to the market. For those condos that are going to be added to the market in 2009, it is difficult to predict the intentions of the people who pre-purchased these units. Are they intending to move in? Will they be adding them to the rental market? Or were they hoping to flip these units? Unfortunately, it is these uncertainties that are likely to have the greatest influence on both the condo and rental markets in Vancouver. Without any clear indications of what the market is going to do, most participants in the multi-family housing market are taking a wait and see attitude.

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