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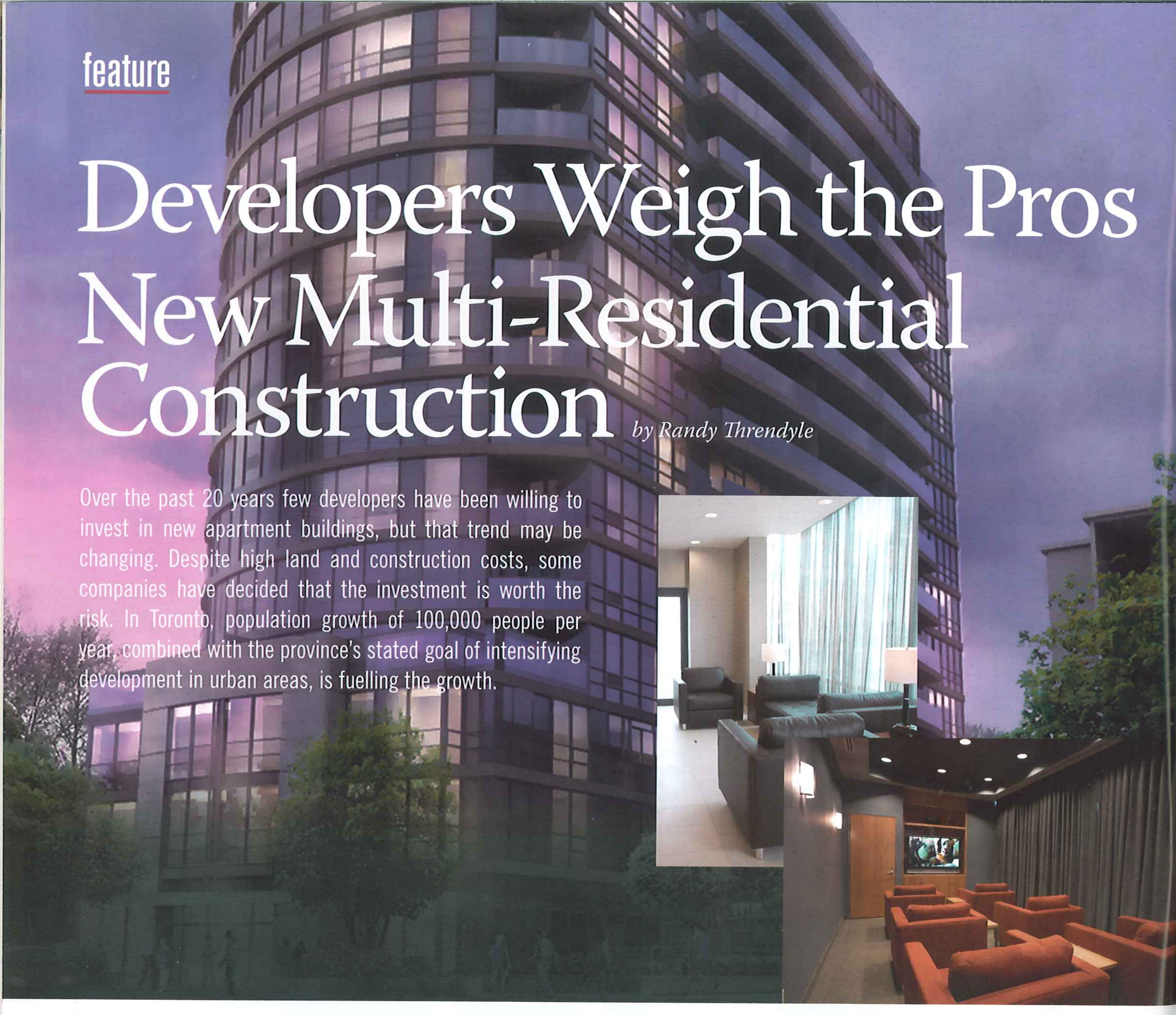

Developers Weigh the Pros New Multi-Residential Construction

by Randy Threndyle

Over the past 20 years few developers have been willing to invest in new apartment buildings, but that trend may be changing. Despite high land and construction costs, some companies have decided that the investment is worth the risk. In Toronto, population growth of 100,000 people per year, combined with the province's stated goal of intensifying development in urban areas, is fuelling the growth.

After decades in the doldrums, Canadian multi-residential developers are sticking a tentative toe in the apartment construction market.

In Ontario, were the aftertaste of rent control legislation kept new apartment construction at near zero levels for over 20 years, several developers have tested the waters by investing in new buildings. And in Western Canada, boom times fuelled by high energy prices, have led investors to take a close look at the economics of building new apartment units.

Some companies have taken the route of building new apartment buildings, while others have purchased newly completed buildings and taken over management of them. Both pension-fund controlled and privately-owned developers are involved in the trend.

In Toronto, where several new buildings have either opened or are contemplated, developers are looking to their existing portfolios as a route to expansion. In most cases it makes sense to build on a site you already own, as there will likely be little or no land costs.

Given the relatively slim margins in the multi-residential sector and ever increasing construction costs the strategy can be a cost effective way to add to a company's portfolio. The approach has two other advantages. It makes a good fit in with the Ontario government's policy of intensification in urban areas and, in many cases, existing properties are in demand areas that are either close to subway lines or in popular neighbourhoods.

Long-Term Opportunity

With a population growth in the Greater Toronto Area of over a 100,000 people per year, many companies see a long-term opportunity in new rental projects.

While many developers have expanded through acquisition of older properties, there are some advantages in building or purchasing a newly completed building. Since the buildings are new, there is little, is any capital expenditures required for repairs or renovation and there is strong leasing demand and therefore low vacancy rates for the newer suites.

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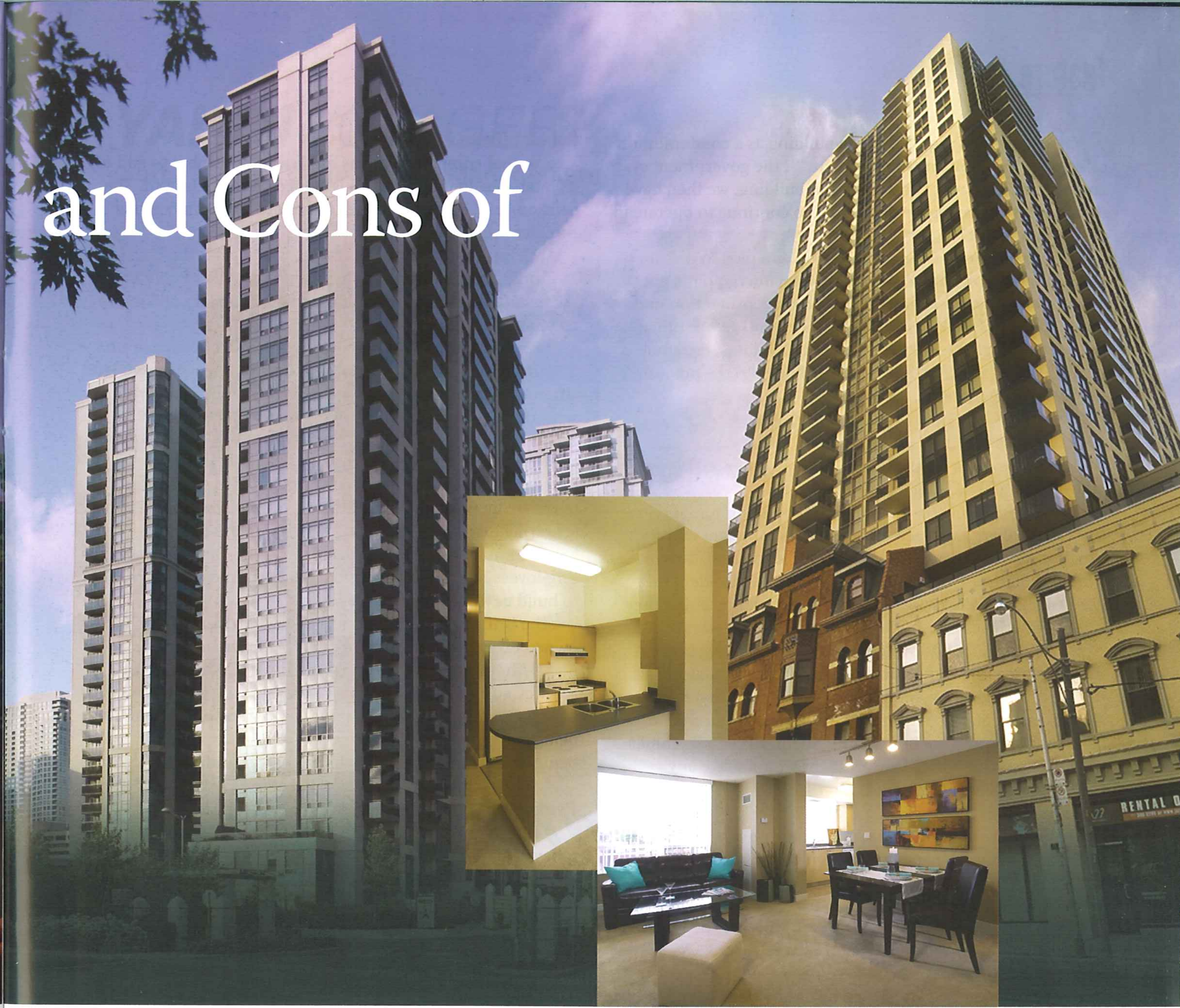

In addition, new buildings command premium rents, which help compensate for development risk.

But of course there is risk in building new units, especially in Ontario where the spectre of rent control legislation is still very real for many developers. In an effort to minimize the risk, some developers have adopted novel strategies.

Several have chosen to protect themselves by entering the high-end market or aiming the building at seniors, a relatively wealthy demographic. Other companies have decided to register the buildings as condominiums, but maintain them as rental buildings. With condominium registration the developer has a way to sell the units should new legislation be announced.

The disadvantage to going the condominium route is that it increases costs. Units must be registered and there is little if any tax advantage.

The only real advantage to registering a building as a condominium is that it gives the building owner a form of insurance, which allows them to sell the building as individual units, rather than as a complete apartment building.

Condo Registration Seen as Insurance

One company that has taken out insurance, in the form of registering rental buildings as condominiums is Minto Urban Communities Inc. Its President, Alan Greenberg, says the reason for doing so is very simple.

"It's called insurance. In 1976 the provincial government took away our property rights. At the time we owned 8,500 apartments and they were all rental units. All of a sudden the government said you cannot convert them to condo and sell them as individual units.

"Ever since then, every rental we've built has been a condominium. That way we can, at any time, instead of being an investor in a condominium, go out and sell the individual condominium to someone else, either to live in or as an investment."

The Ontario-based company recently completed a new building at Roehampton and Redpath, in the Yonge and Eglinton area of Toronto. In mid-February the first tenants moved in, shortly after the 148-suite building had completed the condo registration process.

Greenberg says registering the building as a condominium safeguards the company's investment. "If the government ever comes and puts a rent control on that building, we then have the flexibility of saying we don't want to continue to operate in that environment."

While some might view the method as a ploy to defeat or short circuit government legislation, Greenberg points out that tenants who rent condo units have the same protection under Ontario's Residential Tenancies Act as tenants in any other type of building. The only difference is, buildings, or rental units, constructed after 1991 are not subject to the province's rent control legislation.

Customers Protected

"Our customers are protected, like any other customer living in a rental building," says Greenberg.

While registering the building as a condominium increases costs, Greenberg says each developer has to weight that expense against the possibility of future legislation. "Anyone who is building a rental building today, has to decide if they want to take insurance by registering the building and if they want to take insurance there is a certain cost," he says.

As a private, family-owned business, Greenberg says that the company would not build a rental unit today unless it was registered as a condominium. And, given that there are thousands of individual investors who have purchased condominiums and are now renting them, Greenberg thinks it's unlikely the provincial government would make any changes to condominium legislation.

Despite the fact that condo registration allows Minto to sell any or all of the units at any time, Greenberg says, "Our present strategy is that we are keeping that building for the long term. But we have paid insurance so that if any government takes away our property rights. We have an exist strategy."

As to his customers, Greenberg says whether the building is condo rental or conventional rental is largely irrelevant as the features being offered in a condo rental are no different from those that would be offered in a conventional rental building.

Concert Opens Two Properties

Another company that has made a commitment to add to its multi-residential portfolio is Concert Properties Ltd. The pension-fund owned company has about 2,600 units either completed or under construction.

In Toronto Concert has completed two projects. One is 26-storey 306-unit building in North York called Prelude. The second is a 28-storey 388-unit building called Jazz at Church and Shuter.

In Etobicoke two more buildings are under construction. The first is a 21-storey, 278 unit building that will be complete later this summer and the other is an 11-storey, 168 unit seniors independent and assisted living rental community expected to be completed in early 2008.

Brian McCauley, Executive Vice President of Concert Properties Ltd., says the company made a decision in 2001 to construct new buildings rather than going the route of acquiring existing properties. At that time the Vancouver-based company formed an alliance with the Ontario Municipal Employees Retirement System, commonly known as OMERS, to build new multi-residential units.

The British Columbia-based Concert Properties Ltd. is owned exclusively by BC union and management pension plans. They represent over 200,000 British Columbians.

McCauley says in 2001 the vacancy rate in Toronto was less than one percent. In addition, a lot of existing apartments were being converted to condominiums. With little new rental stock being added to the market, the company saw an opportunity.

Pension Funds Invest $600 million

"The economics, certainly at that time, and to some extent today, were achievable. The rental rates were high enough to support the cost of land acquisition and construction in this marketplace," says McCauley.

In 2001 Concert and OMERS agreed to invest $300 million in new rental buildings. They recently announced that they have doubled that amount to a total potential investment of $600 million.

The economics of a retirement building, says Balahood, are better than for a standard apartment building. That's because the building will be aimed at upscale retirees who are looking for a higher level of service.

CALGARY IS SLIGHTLY DIFFERENT SITUATION. CONSTRUCTION COSTS ARE HIGH.

Given the size of the investment, Concert looked at registering the new buildings as condominiums.

"We were warned when we came here about the challenges of the Ontario government and changes over the last couple of decades with rent control. What we're doing is getting all approvals necessary with the city to register them as condominiums, but our decision to register them is really dependent on where the marketplace is at that time."

McCauley says the company did the numbers on condo registration and found there was an economic advantage in not registering the units.

First, says McCauley, there is the cost of registration and maintaining the condominium corporation on an annual basis. Secondly, under the new multi-residential property taxation classification in Toronto there still is an advantage for rental buildings.

The only advantage in registering units as condominiums is, if the marketplace changes, or rent controls were imposed, the units can be sold individually, something McCauley describes as "a good exist strategy."

McCauley, however, sees very little possibility that Concert would need a quick exit strategy. as the intent of the investment is to create income properties that will meet the needs of the pension groups the company represents.

"It's very unlikely we would sell these assets, but if we sold them we would likely sell them as entire buildings as opposed to individual units.

"If we took a proposal to our board today, to sell rental apartments, we would not be looked at favourably," he says.

Higher Costs Block Western Development

Concert also owns about 1,450 multi-residential units in Western Canada but is currently not adding to its portfolio in that region.

"We would be very keen to build more rental in Calgary or Vancouver, but the numbers just don't make sense today," says McCauley. The problem is that land and construction costs in both of those locations make it uneconomic to build rental properties.

The land values in downtown Toronto, he says, are about $35 a square foot buildable, whereas land values in downtown Vancouver are in excess of $100 per square foot buildable.

Construction costs for a typical highrise in downtown Toronto are in the order of $150 to $160 per square foot to build. Construction costs for a similar highrise in Vancouver would be in excess of $250 per square foot, says McCauley.

Added to that are rental rates, which average about $2.25 per square foot in Toronto but only about $2.10 in Vancouver. "Doing the math you can see that the economics just don't' make sense today."

Calgary, he says, is a slightly different situation. Construction costs are high, but an even bigger obstacle is the availability of labour. "For anyone considering doing multiunit residential in Calgary today is very difficult. The economy is so strong that the availability of trades is just not there."

Little Opportunity for Market-Priced Units

With 25,000 units under management, Greenwin Property Management is one of Ontario's largest landlords. The company's CEO, Mike Bolahood, says Greenwin has, over the years, looked at the economics of building new rental units but has seen little opportunity to build new market-priced units.

Balahood says "To go out and buy the land and build the buildings, we just couldn't get the rents to get a decent return."

The only project the company is considering is a proposal to build a rental building aimed at retirees. The project would be an intensification project on one of the company's existing sites in the Yonge and Eglinton area of Toronto.

The economics of a retirement building, says Balahood, are better than for a standard apartment building. That's because the building will be aimed at upscale retirees who are looking for a higher level of service.

"If you look at the economics of that operation, it made sense, to do a retirement/nursing facility as opposed to a conventional apartment rental," says Balahood.

A conventional rental building, he says, would have to command rents that, while not stratospheric, would certainly have been near the top end of the market. And, in what is already a highly competitive market for high end condo-style rental product, Greenwin felt the retirement type of facility was a better investment. CAM