

September 26th, 2008

The Goodman Report: Canadian Apartment Investment Conference

Having recently returned to Vancouver after attending the Canadian Apartment Investment Conference held Tuesday, September 16, 2008 at the Metro Toronto Convention Centre, I'm pleased to share my observations with you.

Held against a backdrop of some very dramatic events on Wall Street, the conference with 550 attendees from across Canada opened with CIBC's World Markets senior economist Benjamin Tal. He stressed that the origins of the current sub-prime crisis is the US housing crisis which he insists is not over. He commented that US housing prices are down an average of 18% over the last 2 years. Tal does suggest, however, that the rate of decline is slowing and that in another 3 to 6 months their market could hit bottom. In Tal's words, "We are in the 7th or 8th inning." He goes on to say that while in the US 600,000 jobs have been lost in the past year, Canada has performed significantly better than its US counterpart on a relative basis. Tal continues to feel that commodity prices, while having corrected as a result of global growth fears, are still very much in a rising trend, with Brazil, Russia, India, China and the Middle East oil producers being the major consumers.

With respect to US housing affordability (price to income ratio), prices will almost be back to normal once the US experiences another 5% drop. Tal insists that the US bailout was the right thing to do in view of the very difficult circumstances. This has resulted in the US government essentially controlling 50% of the housing market. He went on to state that the US housing equity withdrawals was \$700 billion 2 years ago. Now, it is \$0. This represents a huge reduction in consumer spending. Tal did go on to say that the rental market fundamentals in the US and Canada are still very positive in spite of the housing market slowdown.

He also suggests that over the next 6 months, interest rates can go lower and that inflation will not be a story. With a recovery in the last half of 2009, he insists that interest rates will rise. View his presentation by [clicking here](#).

These sentiments were echoed by Victoria Wagner Aloia, Director, Financial Institutions Ratings, Standard and Poors New York. In her presentation called *US Residential Mortgage Market: Stress*, she provided the audience with a detailed synopsis of the "whys" and "wherefores" of the US housing bubble. Further to this mortgage credit cycle, she states that this is the worst banking crisis since the depression. To see her presentation which includes the sub-prime timeline, [click here](#).

In the cross country review of the apartment market, called *Factors Influencing Current Investments*, Brett Miller of CBRES, Senior Regional Director of Western Canada, gave an excellent market overview. Essentially he stated that overall Canadian trading volumes have dipped, yet multi-family rentals are still considered a reliable and stable asset. He mentioned that lenders nationwide are still lending although spreads have widened and there is growing

evidence of a tightening in the mortgage markets. As well, cap rates in Vancouver are experiencing some upward pressure. Generally, he felt that owners across the country are not readily adjusting to cap rate compression, that major investors want Class A properties, and that these same groups are continuing to expand their portfolios. On the other hand, Miller indicated that there is a growing weakness from investors for non-trophy buildings. With many long established owners postponing capital expenditures, the “new guys” are buying these assets and quickly improving them while stressing the enhancement of income. That being said, he suggests that it is growing increasingly difficult to source product. He also stressed the relative security of apartment buildings as an investment vehicle by reminding us people still need a place to live even with the “consumer-led slowdown.” To see his perspective, [click here](#).

As attendees of *Capital Markets Perspective – Are Apartments Overpriced?*, we were treated to some insightful forecasts by various industry experts. Alan Calderon, Vice President and Senior REIT Analyst, European Investments Inc. New York, stated that in the US there is a disconnect between private and public markets. In February 2007, he mentioned that it was the high point for US REIT cap rates which were then in the 4.5% range. With the recent Lehman bankruptcy and the US government’s involvement in the banking industry, many more trades will occur at much higher cap rates as the liquidation of assets accelerates. This will likely act as a drag on values. Calderon’s view was that markets at present “aren’t rational or sane and that we are in a period of disconnect.”

Karen Macindoe, a REIT Analyst with BMO Capital Markets, indicated that she anticipates a 90 basis points increase in Canadian cap rates over the next 6 – 12 months with investors seeking a 2.5% spread over 10 year treasuries. She also went on to say that BMO regard multi-family as a clear investment preference in spite of lower cap rates, but can’t say that for other real estate asset classes.

Gregory Romundt, President and CEO of Centurion Property Associates Inc., shared his view that we are entering a period of lower vacancies, higher rents, and a growing awareness by owners to manage expenses. He’s suggesting that some owners are beginning to ask themselves, “Why sell unless I get my price and if I do sell, what do I buy?”

Dennis Mitchell, Portfolio Manager with Century Select Capital Corp., suggested that apartment investments are a secure business model where owners have some pricing power and ability to cut expenses.

Collectively the group went on to say the following:

1. CMHC, a very stabilizing effect for apartment transactions
2. Capital to continue migrating to the multi-family sector
3. It will take awhile for vendors and purchasers to accept new pricing dynamics – we will witness a standoff. The question remains, “Who will blink first?”
4. Without access to capital, “you die”, whether you’re private or public.

5. Long term forecast — after one year, multi-family will be left standing and will remain the lowest risk investment vehicle compared to other asset classes and remains the safest sector from a lender's standpoint, especially when considering a 50 to 100 unit rental building compared to a strip mall.
6. Once interest rates go up, cap rates are sure to follow.

To see their presentation, [click here](#).

A major owner of Canadian apartment buildings shared his winning formula with a small audience that I was most fortunate to be part of. When evaluating or considering buildings for acquisition, he stresses:

1. Price per square foot
2. Average rents in place
3. Price per suite

His internal analysis also asks:

1. Where will I be with this building in 2 years?
2. Will I be able to increase the cap rate by 2% in 2 years?
3. Prefers to invest in communities where vacancy rates are low and where rents can increase (i.e., \$750 to \$850 on turnover and after renovation).
4. Why does he invest in Canada?
 - I. he can buy assets at 50% of replacement value
 - II. political stability and growth
 - III. cap rates quoted are true cap rates
 - IV. enjoys being in North America, but not United States
5. Why is he investing in apartment buildings?
 - I. counter cyclical (recession proof)
 - II. relatively easy access to financing with support from lenders
 - III. likes building and geographic diversity
 - IV. has excellent management team

To sum up, once a building is acquired, they bring in a capital improvement and energy team who inspect the building and perform the necessary upgrades including additional metering, and evaluate the prospects of applying for rent increases *above the prescribed provincial limit*. Given the right situation avails themselves, they will consider developing new rentals almost anywhere in Canada.

Last but not least, I was most impressed with Jack Bernstein, Senior Partner with Aird and Berles LLP who gave a great presentation in the session, *Wealth, Transfer and Successful Planning: How to diminish capital gains tax*. This would be most worthwhile running by your tax advisor if you are interested in hearing more about business succession planning. To see his presentation, [click here](#).

During the conference the 550 attendees were polled on the following 5 questions:

1. In Western Canada, will cap rates go up, down, or stay even?
71% Up
15% Down
14% Even

2. Will cap rates in Eastern Canada go up, down, or stay even?
45% Up
18% Down
37% Even

3. Will you buy in large urban centres?
72% Yes
28% No

4. Are Canadian REITs undervalued, overvalued, or fairly valued?
44% Under Valued
34% Over Valued
22% Fair Value

5. Are apartments the safest sector in Canadian real estate?
99% Yes
1% No

To view all other presentations from the various speakers, please [click here](#).

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