Global News – May 30, 2023

Renters might soon feel the pain as their landlords post losses. Here's why

Craig Lord || Global News
May 30, 2023

There's a huge shift happening in the hottest rental markets across Canada. More than half of Greater Toronto Area condo investors are losing money on their properties, according to Urbanation. As Anne Gaviola explains, this trend is likely to make renting in these markets even less affordable.

Many renters in some of Canada's biggest cities have already been paying record-high amounts to their landlords as of late, but a new report suggests pressure facing real estate investors might ratchet up the pain in the rental market in the coming years.

The report, released Monday from CIBC and Urbanation, shows that for a majority of real estate investors in the Greater Toronto Area (GTA), the business case for their rental properties is falling apart. Industry observers say similar pressures are being felt in other major cities like Vancouver.

While tenants might have little sympathy for the landlords who, in many cases, have been rapidly raising their monthly rents in recent months, experts who spoke to Global News say investors are critical to the supply of units in the rental market.

rest rates are squeezing real estate investors

With investor demand for new builds potentially dampening, renters could face even steeper costs in the year ahead, says Urbanation's Shaun Hildebrand, one of the authors of this week's report.

Urbanation and CIBC found that, for the first time since it undertook the annual study in 2017, the majority of investors (52 per cent) in the GTA were cash flow negative for their properties in 2022.

What that means is that the income generated by rents didn't cover off the owner's mortgage, property taxes and condo fees, and the investor likely loses money on a month-to-month basis.

Hildebrand says while Urbanation's formal probe into these questions only began in 2017, last year was likely the first time in the "modern era" of condo investing over the past two decades or so that most investors started to see negative cash flows.

He tells Global News there was one fundamental shift in the market that led most investors to swing to a loss: the Bank of Canada's rapid rise in interest rates, which has seen borrowing costs soar for many mortgage holders.

A Royal LePage survey published last week showed that nearly one in three investors are considering selling off a property amid higher interest rates.

While 2022 marked a tough year for Toronto's investors, Hildebrand expects 2023 has been even worse so far.

Investors typically agree to purchase property at market prices when they buy and pay that price a few years later when the unit is completed. The hope is that property values rise over the course of the construction period, and that an investor ends up paying below market value and renting the unit at today's rates, netting them a solid cash flow.

But with a steady housing correction over the past year and rising interest rates, and investors taking out mortgages today on properties they agreed to buy at the market's peak, Hildebrand says the business case is much harder to square.

At this point, most renters might be calling foul, as rent prices have surged across Canada in recent years at the same time as landlords adjust to higher interest rates.

Rentals.ca data for April showed average rents in Canada were just over $2,000 monthly last month, up nearly 10 per cent year over year and 20 per cent from the pandemic low in April 2021. Ontario saw the steepest annual rent inflation last month, up 16.7 per cent year over year to an average of $2,421; British Columbia's increase was the lowest for any province at 5.6 per cent.

ent'flation'

While Hildebrand acknowledges rents have risen quickly to offset the pain facing landlords with variable-rate mortgages or those renewing their fixed terms, it simply hasn't been enough to sustain the business model for most, he says.

"Even with rents reaching all-time highs and then rising extremely quickly over the last couple of years, unfortunately it hasn't been enough to offset those ownership costs," he says.

Why are investors so important for the rental market?

Investors being confident that they can profit off of their properties isn't just a concern for them — it matters for the health of the rental markets in Canada's biggest cities, experts say.

Rental investors account for nearly three of every five condo units built in Toronto from 2016 to 2020, up 20 percentage points from a decade earlier, according to Statistics Canada. For Vancouver, the rental investors account for almost half of all condo builds with a similar increase over the timeframes.

The Urbanation-CIBC report says investors are crucial for Toronto's rental supply, with a lack of purpose-built rentals to accommodate renters in the GTA.

"Investor demand is therefore of critical importance for the supply outlook – if investors aren't buying, developers aren't building," the report reads.

Hildebrand says that if investors are turned off from the pre-construction market as their cash flows worsen, they might be less keen to put money down on new builds or could sell off their existing properties.

Most investors buy pre-construction rather than from the resale market, according to Urbanation, meaning if an investor sells, that property is likely going to enter the ownership market.

While that might be welcome news for buyers struggling to break into Toronto's expensive housing market, Hildebrand doesn't think there will be a flood of investor properties up for grabs that would meaningfully boost supply and lower prices in the city.

Housing crisis plans from Toronto's mayoral hopefuls

"The bigger issue that it will have is an increase in rents because there's going to be a restriction in the amount of supply. And unfortunately this is going to cause further affordability issues for renters," he says.

It's not just a problem in Toronto, either. Andy Yan, director of the city program at B.C.'s Simon Fraser University, says Vancouver landlords are "very much so" facing similar pressures to their Toronto counterparts.

The "secondary market," which Yan says includes condos and other units rented out in an owner's home, now makes up the bulk of Vancouver rentals as well.

Both Yan and Hildebrand say there are not enough purpose-built rental apartments in the construction pipeline to offset a possible drop in investor-driven activity.

"Purpose-built for rental housing hasn't necessarily caught up with the demand for rental housing across the country," Yan says.

"There is now profound pressure in our rental market."

Immigration a constant pressure on the rental market

Thomas Davidoff, real estate economics professor at the University of British Columbia's Sauder School of Business, tells Global News that while the business case for investors has worsened in recent years, in the long run, it has been and should continue to be strong.

Constrained housing supply in both the rental and ownership markets of Vancouver has kept upward pressure on rents, Davidoff says. Those who have been able to hold on to their properties in the long term, as property values and rents rise, are likely making "fantastic returns," he says.

Tenants who are unable to keep pace with higher borrowing costs in Canada's most expensive markets are therefore likely to be stuck in the increasingly crowded rental market, Davidoff says, which is expected to keep ratcheting up the pressure on rents and improving the business case for investors.

"That means you've got affluent people who'd like to get into the ownership market unable to do so and are put into the rental pool, which is lousy for the people competing with them," Davidoff says. "But great for landlords."

As investors' business models deteriorate in the short term, however, experts such as Yan and Hildebrand say there will be a reckoning for renters.

Yan says much of the pressure is going to come from Ottawa's lofty immigration targets. Canada welcomed a record number newcomers in 2022, with urban centres acting as major immigration hubs for the country.

oronto celebrates Newcomer Day

Yan says newcomers are more likely to rent than own when they first arrive in Canada and are set to face "tremendous challenges" between rental rates in the cores of big cities or transportation costs to commute to their jobs from further afield.

Immigrants come to Canada "to really start their Canadian dreams," he tells Global News.

"And the fact of the matter is we're exposing now them to the Canadian housing nightmare."

Hildebrand says there's an "intention" from larger, institutional investors to build more rental housing in Canada, but the high interest rate environment and cost pressures in the development process are turning them off.

Governments at every level will have to take a look at where they can address the pain points, Hildebrand argues, whether it be through reducing fees, taxation, or speeding approval processes or allowing for greater density in cities to sweeten the business case in the near term.

"It's not just individual mom-and-pop condo investors that are seeing challenging times to buy and hold rental investment. It's the larger institutional organizations as well," he says.

"And if they aren't building, we're going to end up with a significant supply gap."