CBC News – August 28, 2023

Apartment REITs see higher revenues amid tight rental market. Will this spur new supply?

Boardwalk CEO says building new is too expensive, top priority is to reinvest in existing units

Paula Duhatschek || Aug 28, 2023

Sam Kolias is chairman and CEO of the Boardwalk Real Estate Investment Trust. (Paula Duhatschek/CBC)

The Calgary-based Boardwalk Real Estate Investment Trust (REIT) is among the REITs posting higher year-over-year revenues amid a stubbornly tight rental market.

In the first half of the year, the trust — which owns more than 33,000 apartment units, most of them in Alberta — saw its same-property net operating income (NOI) grow by 13 per cent compared to the same period last year.

Same-property NOI is a popular measure of profitability in the real estate sector that looks at revenues from properties, minus operating expenses, and controls for events like acquisitions and dispositions that might skew the numbers.

Boardwalk says its growth was driven in part by the surge of people who have moved to Alberta in the last year, leading to higher occupancy rates and the ability to phase out discounts used in tougher times to coax renters into signing leases.

"When demand increases and supply does not increase proportionately, we're seeing no discounts [are] needed to keep our occupancy at high levels," said Sam Kolias, the trust's chairman and CEO.

It's a trend happening across the industry, as all five of Canada's largest publicly traded apartment REITs — Boardwalk, Killam, Minto, CapREIT and InterRent — saw their net operating incomes grow somewhere in the neighbourhood of seven and 13 per cent year-over-year in the first half of 2023.

The healthy results come as REITs face criticism for their role in what advocates describe as the "financialization" of housing, which they say is contributing to the high cost of apartments in this country.

The industry, for its part, has pushed back against that characterization, saying investment is needed to build and maintain rentals, and that REITs provide a key source of affordable housing.

Whatever your perspective, experts say the sector as a whole is in a strong position relative to the rest of the commercial real estate market, as migration trends, inflation and high borrowing costs boost demand for rentals and spur investment in apartment REITs.

That level of demand and profit could spark a wave of new apartment construction, though so far this hasn't quite materialized.

Investment growing

The tight rental market is boosting revenues for apartment REITs in Canada. (Paul Sakuma/Associated Press)

As a tightening housing market boosts apartment REITs' revenues, these trusts have also started attracting a "significant" amount of capital from investors, said commercial real estate consultant John Andrew.

"Not just individual investors, but the large institutional investors like pension funds and life insurance companies and so on," said Andrew, who said industrial REITs are also faring well. "They're flooding into these REITs, no question about it."

Andrew said this investment, along with higher rental revenues, will likely be used to maintain and renovate these trusts' existing properties, and to develop new ones — though it isn't clear yet how that balance will shake out.

At Boardwalk, for example, developing new apartments wasn't previously part of the company's growth strategy. This has recently changed owing to a surge in demand for affordable rentals, according to the trust's latest annual information form.

At the moment, it has projects in development in Brampton and in the Greater Victoria Area, and two others planned on Vancouver Island.

Killam, for its part, recently announced it had reached substantial completion of two projects in Halifax and Kitchener this quarter, and has a stake in a Calgary development that's expected to wrap up its first phase of development next month.

InterRent is in the final stages of interior construction on an office-to-apartment conversion in Ottawa.

Minto plans to add more units to excess land at three of its existing properties (though construction at one of them has been delayed).

And CapREIT has said it's submitted "a number" of applications to build new homes in the Greater Toronto Area, and is "actively working on several more projects in our entitlement pipeline."

'Expensive, challenging and difficult'

A sign is pictured outside a Boardwalk-owned apartment building in Calgary. (Paula Duhatschek/CBC)

Still, Boardwalk's Kolias said building new stock is less of a priority for his company than is maintaining and upgrading its existing properties.

"It's so expensive, so challenging and difficult to really make economic sense with new supply — it really requires a much longer term perspective and expectation for returns have to be a lot more patient and longer term," he said.

"We've got a much smaller allocation of our capital for brand new supply."

Equity research analyst Matt Kornack echoed that point. He said setting aside money for future development can be a tough sell for REITs because of how time-consuming and expensive it is to build homes.

"There's a long period of time [in development] where a lot of money goes out the door, but you don't bring anything, and so the ability to fund that distribution during that period becomes a little bit more constrained," said Kornack, who covers the real estate market for National Bank.

"They do need to ultimately generate income to pay out to their investors."

Kornack also noted that while REITs are in a healthy position now, they're facing cost pressures from higher interest rates as their mortgages come to maturity.

And while the rental market may be tight right now, these companies also don't want to wind up in a position where they overdevelop and wind up with property no one wants, said Andrew.

"Historically, one of the biggest risks to real estate valuations is the building of oversupply in a particular market, which results in significant corrections of property values market wide," Boardwalk also noted in its annual information form.

REITs lobbying for friendly policies

Still, Boardwalk and other publicly traded REITs say they want to play a role in meeting Canada's demand for affordable housing. Last fall the group launched a website called ForAffordable.ca, which pushes policies they say would help boost supply and affordability, such as lowering municipal property taxes and exempting the HST on all rental housing.

While it could be a tough sell to convince some renters to see REITs as part of the housing solution, rather than part of the problem, Andrew said it is important for all players — REITs and other developers included — to be part of that conversation.

"Government needs to make it cost effective for private developers, REITs and so on to provide that [affordable housing] because it currently isn't, and that's why there's such a shortage of it out there," he said.

As for the future of the industry, Kornack expects that as migration to Canada continues to ramp up and the rental market remains tight, these trusts continue to perform well in the months ahead, especially if interest rates eventually do start to fall.

"In the fullness of time, I still think owning apartments is a good investment."