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## Investors find solid foundation in apartments

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Presented by



Brett Gundlock/National Post

Apartments on Isabella Street in Toronto, Ont. Apartment buildings generally held their value through the recession. Brett Gundlock/National Post

Ugo Bizzarri's Timbercreek Asset Management Inc. already owns 9,000 apartment units, mostly in southern Ontario, but also in Ottawa, Halifax and Montreal. The company is in expansion mode, but the last place you'll see it raising money is in the

public markets.

"Apartments are very predictable and very stable," says Mr. Bizzarri, who has been investing in the apartment sector for about 10 years on behalf of institutional investors.

While stock markets have been anything but stable, apartment buildings generally held their value through the recession because of steady financing, low vacancy rates and a supply constrained environment created by government regulations.

All the water cooler talk may be about the red-hot housing market, but as apartment owners are quick to point out, about one-third of Canadians still don't own.

Apartment vacancy rates across the country remain relatively low - 2.7% in April 2009, according to Canada Mortgage and Housing Corp. The rate was slightly up from the 2.6% of apartments that were vacant a year earlier.

"Unlike an office building, you don't have one big tenant like a bank that goes away, you have 1,000 tenants with a thousand leases. They are not going to all leave at once," says Mr. Bizzarri.

At the same time, government rules such as rent control mean few apartments will be built, leaving the existing stock in high demand. Moreover, mandated rent increases are part of the landscape in most rent controlled environments. The average two-bedroom apartment was renting for \$827 a month in April, up about 2.9% from a year ago.

"But it's also hard to find product because they don't often come up for sale," says Mr. Bizzarri, who recently bought a 10-building portfolio in London, Ont.

Derek Lobo, chief executive of Burlington, Ont.-based Rock Apartment Advisors Inc., says the

apartment sector has quickly turned into a seller's market with multiple offers and, in some cases, buyers even pre-inspecting property so they can go in with firm offers.

Statistics back up his claim. Research firm RealNet Canada Inc. said the apartment market has seen four straight quarters of increases in transactions of more than \$1-million, based on total dollars. The fourth quarter of this year has already seen \$277-million in deals, a sharp jump from the \$117-million in activity in the first quarter, but a far cry from the peak of \$799-million in fourth quarter of 2006.

Mr. Lobo said some landlords don't want to sell in this environment because of the steady cash flow. "Apartments trade less because of their stability," said Mr. Lobo, who has spent the past two years building a massive database of apartment buildings across the country partially for the purpose of approaching landlords to sell. His company wants to hit the sellers even before they list their properties.

Although there are large, publicly traded entities in the game, such as Boardwalk Real Estate Investment Trust and Canadian Apartment Properties REIT, approximately 90% of the apartment buildings in the country are still in the hands of "mom and pop" owners.

CMHC has made it relatively easy to finance the ownership of an apartment building for Canadians. The agency backs loans for individuals who sign a personal guarantee with as little as 15% down. That means you can buy a small \$1-million building with just \$150,000.

Availability of credit is one thing, but it's the cheap money that makes most transactions work. The interest rate on a CMHC-backed loan is as little as 3.5% for a five-year mortgage or 4.5% for a 10-year. A conventional mortgage, if you could find one, would be about 200 basis points higher for both terms. If you are borrowing at 3.5% and your return on that cash is 6% to 7% - the average in the Toronto area - that spread is making you money.

"During this whole credit crisis we've been quite busy because we are one of the only ones to have funds available," says Peter Cook, assistant vice-president of commercial lending of First National Financial LP. "From a company standpoint we've had our biggest year ever."

Mr. Cook said he's seeing a wide variety of people coming through his doors. Some are refugees from other real estate classes, such as retail or office space, but he is also seeing lots of individual investors, like the provincial police officer who recently bought an apartment building in a small town in Ontario.

"You get four or five guys together and you can get into a small building because of the financing. It doesn't take a lot to get into the market," says Mr. Cook.

The other reason people keep buying apartment buildings in Canada is because it is still too expensive to build them. In Vancouver's hot apartment market, where investors at one point were willing to accept a rate of return as low as 4%, it still makes sense to buy, says David Goodman, a commercial realtor with Macdonald Commercial Realty.

"Nobody can build rentals unless they can get \$3.50 a square foot for rent," says Mr. Goodman. Existing apartment buildings can be bought for as little as 50% of the cost of new buildings in some cases.

In Vancouver, buyers figure they can put some money into their buildings, get higher rent and ultimately boost their rate of return to justify the high price they paid originally.

Buying on an individual basis always comes with risks which is one of the reasons privately-run REITs are beginning to take off. You get all of the tax advantages of REIT status with none of the exposure to capital markets.

Greg Romundt, president of Centurion Apartments, a private REIT, says his 1,200 apartments have an asset value of \$90-million, with mostly institutional investors backing him. But now he's taking aim at individual investors. Each province has different rules on who can invest in a private fund based on wealth or income.

The upside to investing in a private REIT versus buying a building is there are none of the headaches of building management. Mr. Romundt said his fund delivers an 8% cash return and 3% to 5% long-term capital growth annually. Management does take 5% of profits and charges a 1.5% fee on the assets under management - in range with any mutual fund.

"I remember after the last stock market crash there was a very large influx into the apartment building [market] because people threw their hands down and said. 'I'm done with stocks.' There has been like three crashes in 10 years," said Mr. Romundt, who sees it happening again after this crash. "We're seeing investors like professionals, dentists, teachers. They're looking for stability and we can offer that."

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