Commercial Focus Realty Inc., Brokerage
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APARTMENT DIGEST

Lending Value vs. Market Value - GTA

Economic Indicators:

Real GDP Growth Q2 2013	+1.7%
Toronto Employment Growth Sep 2013	+4.2%
Toronto Unemployment Rate Sep 2013	7.9%
Inflation Sep 2013	+1.1%
Bank of Canada Overnight Rate Oct 2013	1.0%
Prime Rate OCt 2013	3.0%
5 Year Mortgage Rate Fixed Oct 2013	5.34%

Over the past few years of living in the low interest rate environment , especially for apartment buildings, lenders have begun to reduce their exposure by "tinkering" with income and expense estimates in order to value the real estate. In the past, no one expected anything less than a mortgage of at least 75% of the value of the apartment building. Sometimes this would even go as high as 85%. These ratios still exist but the estimate of "value" has changed.

In general, the theory of estimating market value for apartment buildings has not changed. Appraisers, investors, lenders, etc. still use the same methodology. On the income side, the total gross potential income is calculated. Usually, we are given an existing rent roll and we put in market rents for vacant units and employee units to come up with the gross rent on 100% occupancy. Actual figures are used for parking and laundry. From this number we estimate vacancy and bad debt using Canada Mortgage and Housing data and historical building operations (if available) and then make an estimate based on these factors. We will also consider the rental levels and tenant profile to make our vacancy and bad debt estimate.

The expenses are generally calculated as follows (Greater Toronto Area).

Actual realty taxes for the most recent are used. We also look at the Current Value Assessment and where the actual maximum taxes should be. In the GTA realty taxes should be between 17% and 22% of the total gross income. Actual insurance rates are also used, however if they appear low (ie. due to multiple building ownership) then industry standards are used.

For apartments building insurance should be between \$130 and \$170 per unit per annum. For utilities again actual numbers for the past 12 months are used. Only in a minority of cases will reductions be used where the owner has recently put in some energy conservation measure.

For the remaining expense items such as: Repairs & Maintenance; Management; Wages & Benefits; and Miscellaneous, industry standard levels are used. These levels will vary given the building scale, tenant profile and location.

Generally speaking: Repairs & Maintenance will range from \$750 to \$850 per unit per annum; Management will range from 3% and 5% of Effective Gross Income (Gross income less vacancy and bad debt) plus HST; Wages & Benefits will range from \$400 to \$600 per unit per annum; Miscellaneous (administration, advertising, etc.) will range from \$75 to \$150 per unit per annum.

Once the expense are deducted from the income you will get the normalized net operating income of the building before mortgages. By "normalized" we mean that this is how the building should operate under normal conditions. Comparable data is analyzed the same way so that all Capitalization Rates (net income divided by the sale price) can be compared. The "actual" operations of any particular building may higher or lower but we must use normalized numbers in order to properly estimate value.

As such when we suggest a cap rate of say 6% and apply it to the property being valued it is based on supportable numbers.

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Lending Value – Cont'd

Many Buyers, especially new ones, want to use the 6% cap rate but apply it to the actual operations of the building. This cannot be done as the 6% cap rate is based on a total different set of parameters. If the comparable data were analyzed also using "actual" numbers then the cap rate could be 2%.

That being said we must return to value.

In many instances a building will sell with multiple offers given current market conditions. Let's say a building was marketed and listed for sale at $10MM. Multiple offers are obtained and the building sells for $9.5MM.

In the past a Buyer would purchase this building and expect to get a 75% loan to value for a CMHC Insured first mortgage here or $7,125,000. An appraisal would be done to support the purchase price and the mortgage would go through.

Today the picture is much different. All the above would be the same except now the CMHC underwriter will do their own "value" notwithstanding the independent appraisal already completed.

In this value they "may" do things like: use the actual rent roll with the vacancy in there already or apply a higher than market level vacancy rate; use higher than typical industry standard levels for Repairs & Maintenance; Management; Wages & Benefits; and Miscellaneous.

The result is that they will project a much lower net income. Also, they will also have internal policies of what cap rate to use depending on the location. For example, the market cap rate might be 5% (supported by comparable data) but the underwriter might only be able to go as low as 6%.

The result of the above – lower net income and higher cap rate – means a much lower "lending value". In the example, the property might be underwritten at a value of say $7.5MM. Given that the underwriter has removed the risk from the loan they will go as high as 85% loan to value (collect the higher premium as well) or $6,375,000 in the above example.

The above is the new normal in the market and we all must live in it. The problem that this approach creates is that really hurts the lower end of the market.

First time entrants into the apartment market generally purchase buildings under $2.5MM. These investors also have limited funds and every dollar counts to them. No matter how hard you try and educate them the inevitable always happens. They tie up a building for say $2.0MM having $500,000 to put into the deal.

The lender then indicates that the loan will be based on a value of $1.5MM and they will need another $275,000 to do the deal. Firstly, the additional funds are not there. Secondly, when they see the value of $1.5MM and they paid $2.0MM they believe they have overpaid.

It is our job as agents to fully inform our Buyers and Sellers of the reality of the market. This includes values and current financing practices.

Source: The Apartment Group

Rental Market Report – Q3 2013

Greater Toronto Area REALTORS® reported 6,541 condominium apartments rented through the TorontoMLS system in the third quarter of 2013. This result was up by 25 per cent in comparison to the third quarter of 2012. The number of condominium apartments listed for rent on the TorontoMLS system during the third quarter was up by 21 per cent year-over-year to 10,719.

Approximately 80 per cent of condominium apartment rental transactions took place in the City of Toronto. In addition, there was a substantial number of rentals reported in parts of Peel Region and York Region.

"Almost one-third of GTA households rent the home in which they live. Given that we have experienced sustained population growth in the region, it makes sense that rental transactions have been increasing as well. Investor-owned condominium apartments are popular because of the modern finishes and amenities offered by many of these properties," said Toronto Real Estate Board President Dianne Usher.

Third quarter average rents were up for one-bedroom and two-bedroom condominium apartments by 1.8 per cent and 3.6 per cent respectively on an annual basis.

"Competition between renters for available units increased in the third quarter. This is why we continued to see year-over-year growth in average rents for the popular one-bedroom and two-bedroom unit types," said Jason Mercer, the Toronto Real Estate Board's Senior Manager of Market Analysis.

Source: TREB

Rental Market Summary: Third Quarter 2013

Apartments[1,2,3]

	All Bedroom Types		Bachelor		One-Bedroom		Two-Bedroom		Three-Bedroom	
	Listed	Leased	Leased	Avg. Rent	Leased	Avg. Rent	Leased	Avg. Rent	Leased	Avg. Rent
Q3 2013	10,719	6,541	162	$1,365	3,538	$1,633	2,697	$2,173	144	$2,610
Q3 2012	8,845	5,232	119	$1,336	2,727	$1,604	2,247	$2,097	139	$2,660
Yr./Yr. % Chg.	21.2%	25.0%	36.1%	2.2%	29.7%	1.8%	20.0%	3.6%	3.6%	-1.8%

Townhouses[1,2,3]

	All Bedroom Types		Bachelor		One-Bedroom		Two-Bedroom		Three-Bedroom	
	Listed	Leased	Leased	Avg. Rent	Leased	Avg. Rent	Leased	Avg. Rent	Leased	Avg. Rent
Q3 2013	885	508	5	$1,170	49	$1,434	172	$1,825	282	$1,933
Q3 2012	808	416	4	$1,363	44	$1,390	134	$1,759	234	$2,014
Yr./Yr. % Chg.	9.5%	22.1%	25.0%	-14.1%	11.4%	3.2%	28.4%	3.8%	20.5%	-4.0%

Recent Sales

Address	Units	Price	Price Per Unit	Cap Rate
5-9 Stag Hill Drive. (East York)	67	$10,000,000	$149,250	4.2%
399 Vodden Street East (Brampton)	76	$14,461,400	$190,280	5.4%
Rannock/Craighton/Pharmacy (Scarborough) Portfolio	117	$14,000,000	$119,660	NA
2050 Keele Street (North York)	187	$27,750,000	$148,400	NA
3085 Queen Frederica Drive (Mississauga)	71	$9,100,000	$128,170	NA
150-160 Market Street (Hamilton)	278	$19,360,000	$69,600	NA
145-165 Queen Street South (Hamilton)	250	$16,640,000	$66,560	NA

Source: CFAS and RealTrack

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About The Apartment Group

The Apartment Group is a dedicated team of professionals specializing in the sale of multi-residential investment properties. With over 40 years of combined experience, the team brings together their strengths including strong negotiation and sales skills along with highly technical market analysis and appraisal methods.

The Group has been involved in the sale and acquisition of all types of multi residential real estate from small 10 suite walk up to portfolios over 800 suites in scale.

The Group has experience with those first time buyers and sellers who need that extra level of attention and experience with larger institutional buyers and REITs.

Their success is proven with the fact that over the past decade they have sold over $3.0 billion worth of apartment buildings across Ontario and throughout Canada.

The market today is very tight. Having the right Broker working for you is more important than ever.

Can your Broker bring you off market deals? Can they realistically analyze the deals they bring you? Can they be creative and show you the upside? Can they assist you in working through the mortgage mind field today?

Please call us to see how we can help you.

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We have a collection of seasoned Agents that can serve your needs. Whether you are buying of selling, let us show you how we can help. On staff we have appraisers, accountants, mortgage brokers and planners. **This is a total one stop real estate company that can assist you through the entire process.**

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