Canadian Rental Housing | Economics of New Development

2023 Rental Housing Supply Survey

Prepared for CMHC

EY

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Important Notice

Ernst & Young Orenda Corporate Finance Inc. ("EY" or "we") has been engaged by Canada Mortgage and Housing Corporation ("CMHC") for completion of a Rental Housing Supply Study (the "Study" or "the Report").

This Study was prepared on CMHC instructions and at their request and under their direction solely for the purpose of CMHC. It should not be relied upon for any other purpose.

The Study is based on desktop research, interviews with rental housing developers and an anonymous survey of rental housing developers and does not necessarily represent EY views, comments, conclusions and opinions.

In preparing this Report, EY relied upon unaudited data and consultations with third parties in addition to independent market research. Third-party market research from public and subscription-based services such as Altus Data Studio, CoStar, CMHC reporting, Statistics Canada and others identified herein may also been relied upon.

EY assumes the supporting information to be accurate, complete, and appropriate for the purposes of the Report, and as such, reserves the right to revise any analyses, observations or comments referred to in this Report if additional supporting information becomes subsequently available to us. EY did not audit or independently verify the accuracy or completeness of the supporting information. Accordingly, EY is not liable for any impacts stemming from the conclusions of this Report due to the accuracy of the supporting information. EY expresses no opinion or other form of assurance regarding the supporting information. We have not sought to verify the accuracy of the data, or the information and explanations provided.

This report has been prepared strictly for advisory purposes for CMHC.

Glossary of Terms

AMR = Average Market Rent

Development Yield[1]**:** Development yield, or yield on cost, is a benchmark that investors utilize to assess a project based on its cost and potential return. To calculate it simply divide the net operating income by the project's total cost. Development Yield = Net Operating Income/Total Project Cost

Cash-on-Cash Return[2]: Cash-on-cash return is a rate of return ratio that calculates the total cash earned on the total cash (equity) invested in a deal. It is defined as cash flow before tax (i.e., cash flow after financing) in a given period, divided by the equity invested as of the end of that period. Cash-on-cash return is a levered (i.e., after-debt) metric, whereas the "free and clear" return is its unlevered equivalent. Cash-on-cash return is a metric used by real estate investors to assess potential investment opportunities. It is sometimes referred to as the "cash yield" on an investment.

Cash-on-Cash Return = Annual Net Cash Flow / Invested Equity

CPI = Consumer Price Index

DSCR = Debt-Service-Coverage-Ratio refers to the permitted level of free-flow cash that a project is required to project in order to meet funding eligibility requirements.

ESG = Environmental, Social & Governance

G7 = International Group of Seven – intergovernmental political forum consisting of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States

HNW = High Net Worth

Internal Rate of Return (IRR)[3]**:** The IRR calculation is based on projected free cash flows. The IRR is equal to the discount rate which leads to a zero Net Present Value (NPV) of those cash flows. Important therefore is the definition of the free cash flows. There are two main types of free cash flows which can be referred to:

> **Unlevered free cash flows (free cash flows to firm):** EBIT * (1-tax rate) – CAPEX + Depreciation – Change in Net Working Capital
>
> **Levered free cash flows (free cash flows to equity shareholders):** Unlevered free cash flows + change in financial debt – interest + correction for effective taxes paid
>
> **EBIT** = Earnings before Interest and Taxes
>
> **CAPEX** = Capital Expenditures

KPIs = Key Performance Indicators

MLI = Mortgage Loan Insurance

NHS = National Housing Strategy

Overall Project Margin[4]**:** Project margin is the profit ratio that remains after sales completion and the payment of all the expenses.

RGI = Rent-Geared-to-Income: RGI is a type of subsidized housing where rent is based directly on the tenant's income.

RoI = Return on Investment

RCFI = Rental Construction Financing Initiative

SF = Square Feet

YTD = Year-to-date

Executive Summary

Over the last decade, housing affordability has become one of the most critical issues facing Canadians. As CMHC notes in their June-2022 Housing Supply Shortages study, **"There have been a multitude of reports on Canada's housing system over the last few years. Government panels have been struck and the answer is now clear: we need more housing supply."** Purpose-Built Rental Housing is a core building block required to achieve CMHC's aspiration of a home for every Canadian by 2030 that is both affordable and meets their needs. Attainable housing is a critical form of infrastructure required for successful, growing urban economies.

Purpose-Built Rental provides stable housing for essential workers (e.g., teachers, nurses, tradespeople), transitional occupants (e.g., students, new immigrants), seniors and young professionals. Adequate supply of rental housing is critical for many segments of the local population. As communities grow, so too should the supply of rental housing. Over the last two decades, construction of new Purpose-Built Rental has not met the demand for rental housing in the market. To better understand industry perspectives on the motivations that lead to new rental construction projects, EY was engaged by CMHC to undertake a 2023 Rental Housing Supply Survey. Our work was structured around the following three-phased approach:

Phase I: Initial Market Research → *Phase II: Market Outreach Interviews* → *Phase III: Electronic Market Survey*

Summary Research Conclusions

Outlined below are a series of summary remarks expanded upon in Section 4 of this report.

Short-term response to market conditions will worsen a long-term structural housing supply challenge.

Developers today are responding to a 'perfect storm' over the last 3 years in Canada – construction costs are up by over 50%, conventional lending rates have more than doubled and government fees in markets such as Vancouver and Toronto have increased to over 25% of construction budget costs. Rental housing affordability is well understood as a supply-side challenge; an adequate level of new construction has not kept up with demand (i.e., population growth and rising ownership cost). Developers are responding to the shorter-term impact of current market conditions despite exceedingly strong market demand for rental housing – vacancy rates remain below 1% in markets such as Toronto and Vancouver.

Survey results indicate a sense of conservatism among developers who are holding projects longer and often won't be motivated to undertake new construction without favorable incentives or financing (e.g., HST relief).

- 15% of respondents indicated today less than 10% of projects are contemplated under a shorter-term 'Develop to Sell' strategy. Historically, this approach accounted for 25% of projects.
- A pronounced shift in the availability and cost of financing was noted with over 60% of respondents identifying the current market as 'very difficult'.
- Historically, availability and cost of financing perceived as 'not difficult' by nearly 50% of respondents.
- While a long-term investment, sensitivity to input costs may explain – in part - why 90% of respondent rely on basic return on creation cost metrics such as Development Yield and Overall Project Margin.

An August-2022 market survey[5] of residential developers indicated that:

- Nearly 40% will reduce the number of future projects while over 30% will pause new projects.
- Over 44% will adjust revenue assumptions to maintain feasibility (i.e., increase price or rent).
- Nearly 30% will decrease unit size while over 10% will use lower cost finishings to maintain feasibility.

Acknowledging opportunities for scaled solutions: impact of large-scale rental housing developers.[5]

The majority of Purpose-Built Rental projects are owned and developed by the private sector, and developers will only proceed when they will meet investor profit targets. Unlike condominium projects, the construction of rental housing requires the entire cost of the project to be financed upfront (i.e., deposits from unit pre-sales are not applicable). This may limit potential market participation to more well-capitalized developers; these firms play an outsized roles in the construction of rental housing.

Localized programs that leverage scale in contexts such as Vancouver and Toronto may be required where more acute affordability challenges persist.

- 120,000+ units were identified in the pipeline by survey respondents; developers of scale represented over 75% of this development yield despite comprising 43% of responses.
- Over 90% of survey respondents indicate new rental construction as a long-term investment strategy. This is consistent with inter-generational mandates for institutional investors who seek opportunities for stable, accretive cashflow and asset appreciation over time.
- Given today's market environment, smaller, less capitalized developers are more likely to pause projects under a 'wait and see approach' and to avoid exposure to higher-cost debt.
- Developers of scale (1,000+ units) comprised 90% of respondents who indicated a focus on leveraging public-sector financing. This may also help to explain a link to the similarly high focus of respondents on building new affordable housing given certain program characteristics.

The importance of CMHC programs; high-level recommendations from industry that may be considered.

The 'Peak 1970s' period of rental construction was possible with federal tax subsidies and the Canada Rental Supply Plan; a similar co-ordinated program design is needed today. Several industry-informed solution(s) at the federal level may be led by CMHC, aligning housing supply, economic growth and affordability outcomes.

- The least expensive option for affordable housing often may already exist today. Supportive financing programs are needed to preserve rental housing when non-profits, co-operatives, and community land trusts acquire existing rental housing with in-place, below-market rents. This could indirectly increase housing supply if coupled with reinvestment of proceeds into new rental unit construction by seller.
- Over 50% of survey respondents have used MLI financing programs.

  When stacked with other financial incentives, adjusting program design considerations could make returns with mixed-income rental under MLI equally or more advantageous to market construction with higher-cost conventional financing in certain contexts (i.e., affordability thresholds, decreasing DSCRs and/or reducing fees). This could centre industry participants around a financially prudent understanding of building mixed-income rental under MLI-Select as the logical option for future projects.
- A federal directive empowering all levels of government to address the challenges specific to construction of Purpose-Built Rental could also explore:
  - Working with municipalities and provinces on solutions to finance upfront infrastructure that could accelerate development and reduce initial costs on the builder;
  - Assessing new and/or expanded options to waive, defer, extend or lower PST/GST, financing, and development charge costs for all units in mixed-income projects in certain contexts;
  - Leveraging land use policy to prioritize and/or designate areas for rental housing, tying population targets to development timelines and priority financing approval processes; and,
  - Tying incremental federal funding to depth and duration of affordability targets, density level and speed-of-approval objectives to promote alignment with municipalities and provinces.

The importance of CMHC programs; high-level recommendations[6] from industry that may be considered.

- Explore additional new rental supply financing that is longer-term and tied to BoC rates, an approach commonly understood to active developers and partners. This could be achieved through allocation of community or social infrastructure funding, issuing affordable housing bonds or buying down rates offered through affordable housing funds created by banks and credit unions.

- Many provincial and federal housing programs aim to increase the supply of homes that are simultaneously affordable, physically accessible and sustainable. While goals are important, meeting rigid accessibility and environmental requirements often adds substantial costs to new construction and redevelopment. Working with other orders of government, aligning affordable housing program requirements with those of other providers may enable affordable housing delivery across the country on a greater scale granting CMHC with greater flexibility. This may include:
  - Federal programs deferring to provincial and/or municipal building and environmental codes,
  - Streamlined underwriting for projects funded by provincial funding and CMHC programs; and,
  - CMHC granting conditional approval for projects under review for rezoning and, in some cases, actively sponsoring such applications.

EY is committed to advancing this research as market conditions evolve; an annual update to this survey has been committed to and will commence in 2024. This annual survey is intended to act as on-going mechanism for future market outreach and independent, objective monitoring of industry trends in the rental construction market.

RÉSUMÉ

Au cours des 10 dernières années, l'abordabilité du logement est devenue l'un des enjeux les plus importants pour la population canadienne. Comme la SCHL l'indique dans son étude sur la Pénurie de logements au Canada de juin 2022, une « multitude de rapports sur le système de logement du Canada ont été publiés au cours des dernières années. Des comités d'experts gouvernementaux ont été formés et la réponse est désormais claire : l'offre de logements est insuffisante ». Les logements destinés à la location sont indispensables pour la réalisation de l'aspiration de la SCHL : faire que d'ici 2030, tout le monde au Canada pourra vivre dans un logement abordable qui répond à ses besoins. Le logement abordable est quant à lui une forme d'infrastructure essentielle pour la prospérité et la croissance économique des régions urbaines.

Les logements destinés à la location offrent un hébergement stable aux travailleurs essentiels (par exemple, corps enseignant, personnel soignant et gens de métier), aux occupants temporaires (par exemple, population étudiante et personnes nouvellement immigrées), aux personnes âgées et aux jeunes professionnels. L'offre adéquate de logements locatifs est fondamentale pour de nombreux segments de la population locale et devrait augmenter au rythme de la croissance des collectivités. Ces 20 dernières années toutefois, la construction de logements destinés à la location n'a pas répondu à la demande sur le marché. La SCHL voulait mieux comprendre les perspectives du secteur sur les motivations qui mènent à la construction d'ensembles résidentiels locatifs. C'est pourquoi elle a retenu les services d'EY pour réaliser l'Enquête sur l'offre de logements locatifs de 2023. Notre travail était structuré selon une approche en 3 phases :

Phase I : Étude initiale sur le marché

Phase II : Entretiens avec des acteurs du marché

Phase III : Enquête électronique sur le marché

Résumé des conclusions de la recherche

Une série de remarques sommaires, détaillées dans la section 4 du rapport, sont présentées ci-dessous.

La réaction à court terme aux conditions du marché aggravera le problème structurel à long terme de l'offre de logements.

Actuellement, les promoteurs immobiliers réagissent à une combinaison de facteurs qui se sont concrétisés au Canada au cours des 3 dernières années. En effet, les coûts de construction ont augmenté de plus de 50 %, les taux des prêts ordinaires ont plus que doublé et les droits gouvernementaux dans certains marchés comme Vancouver et Toronto sont passés à plus de 25 % des coûts du budget de construction. On le comprend bien, la question de l'abordabilité des logements locatifs est un défi lié à l'offre. Le niveau de construction résidentielle a été insuffisant : il n'a pas suivi le rythme de la demande (issue notamment de la croissance démographique et de la hausse des coûts d'accession à la propriété). Les promoteurs réagissent aux répercussions à

court terme des conditions actuelles du marché, malgré une demande extrêmement forte de logements locatifs. Les taux d'inoccupation demeurent inférieurs à 1 % dans certains marchés, comme Toronto et Vancouver.

Les résultats de l'enquête indiquent un sentiment de prudence chez les promoteurs, qui conservent leurs ensembles résidentiels plus longtemps qu'autrement. En l'absence de mesures incitatives ou de conditions favorables de financement (par exemple, allégement de la TVH), les promoteurs ne sont souvent pas enclins à entreprendre de nouveaux projets de construction résidentielle.

► Parmi les répondants, 15 % ont indiqué que, dans les conditions actuelles, ils envisageraient de construire les immeubles en vue de les vendre à court terme pour moins de 10 % des projets d'ensembles résidentiels. Par le passé, cette stratégie était utilisée pour 25 % des projets.

► Un changement important dans la disponibilité et le coût du financement a été observé : plus de 60 % des répondants ont indiqué que le marché actuel était « très difficile ».

► Par le passé, près de 50 % des répondants considéraient comme « pas difficiles » les conditions créées par la disponibilité et le coût du financement.

► Bien qu'il s'agisse d'un investissement à long terme, la sensibilité aux coûts des intrants peut expliquer, en partie, pourquoi 90 % des répondants comptent sur des mesures du coût de base liées au rendement, comme le rendement du développement et la marge globale de l'ensemble de logements.

Une enquête sur le marché réalisée en août 2022 auprès des promoteurs immobiliers a révélé ce qui suit :

► Près de 40 % des répondants réduiront le nombre de projets d'ensembles de logements à l'avenir, tandis que plus de 30 % interrompront leurs projets.

► Plus de 44 % des répondants modifieront leurs hypothèses de revenus pour maintenir la faisabilité des projets d'ensembles résidentiels (par exemple en augmentant le prix ou le loyer).

► Près de 30 % des répondants réduiront la taille des logements, tandis que plus de 10 % opteront pour des éléments de finition à faible coût afin de maintenir la faisabilité des projets d'ensembles résidentiels.

Reconnaître les possibilités de solutions à grande échelle : incidence des promoteurs de grands ensembles de logements locatifs.

La majorité des ensembles de logements destinés à la location sont l'œuvre et la propriété du secteur privé. Les promoteurs n'iront de l'avant que s'ils atteignent les cibles de profit des investisseurs. Contrairement à la construction de logements en copropriété, la construction de logements locatifs exige que le coût total de l'ensemble résidentiel soit financé dès le départ (les dépôts provenant des ventes sur plan ne s'appliquent pas). Cette contrainte pourrait limiter la participation potentielle au marché d'un plus grand nombre de promoteurs bien capitalisés. Ces entreprises jouent un rôle important dans la construction de logements locatifs.

Il pourrait être nécessaire d'adopter des programmes de mise à l'échelle conçus selon les réalités locales dans certains marchés comme Vancouver et Toronto. En effet, les défis en matière d'abordabilité demeurent importants dans ces régions.

► Les répondants à l'enquête ont fait état de plus de 120 000 logements en cours, dont plus de 75 % sont attribuables aux grands promoteurs, bien qu'ils représentent 43 % des répondants.

► Plus de 90 % des répondants à l'enquête ont indiqué que la construction de logements locatifs est une stratégie d'investissement à long terme. Ce constat est conforme aux mandats intergénérationnels pour les investisseurs institutionnels qui cherchent des occasions d'obtenir une croissance stable des flux de trésorerie et une appréciation de l'actif sur une certaine période.

► Compte tenu de la conjoncture du marché, les petits promoteurs moins bien capitalisés sont plus susceptibles d'interrompre les projets d'ensembles résidentiels selon une approche « attentiste » et d'éviter de s'exposer à une dette à coût plus élevé.

► Les promoteurs d'envergure (1 000 logements et plus) représentaient 90 % des répondants qui ont indiqué mettre l'accent sur le financement par le secteur public. Il pourrait y avoir un lien entre ce résultait et le fait qu'une proportion assez élevée de répondants se concentrent aussi sur la construction de logements abordables, compte tenu de certaines caractéristiques des programmes.

L'importance des programmes de la SCHL : des recommandations générales du secteur qui pourraient être prises en compte.

La forte construction de logements locatifs dans les années 1970 a été possible grâce aux subventions fiscales fédérales et au Régime canadien de construction de logements locatifs. Une coordination semblable de la conception des programmes est nécessaire aujourd'hui. Plusieurs solutions au niveau fédéral, éclairées par le secteur, pourraient être dirigées par la SCHL. Ces solutions pourraient permettre d'harmoniser l'offre de logements, la croissance économique et l'atteinte de résultats en matière d'abordabilité.

► Dans bien des cas, l'option la moins coûteuse en matière de logement abordable pourrait être une solution qui existe déjà. Afin de préserver les logements locatifs, il faut offrir des programmes de financement pour soutenir les organismes sans but lucratif, les coopératives et les fiducies foncières communautaires qui achètent des immeubles de logements locatifs existants où les loyers sont déjà inférieurs au loyer du marché. De tels programmes pourraient indirectement accroître l'offre de logements si le vendeur réinvestit le produit dans la construction de logements locatifs.

► Plus de 50 % des répondants à l'enquête ont eu recours à des programmes de financement liés à l'assurance prêt hypothécaire (APH).

Conjugué à d'autres incitatifs financiers, l'ajustement de la conception de programmes pourrait être bénéfique pour le rendement des ensembles locatifs à revenus mixtes qui bénéficient de l'APH. Dans certains cas, ce rendement pourrait être aussi avantageux ou même plus avantageux que la construction de logements du marché avec un financement traditionnel plus coûteux (seuils d'abordabilité, réduction des exigences en matière de coefficient de couverture de la dette ou réduction des frais). Ainsi, pour la construction d'ensembles locatifs destinés à des ménages à revenus mixtes, les parties prenantes du secteur pourraient arriver à la compréhension commune que le financement au moyen du produit API Select est l'option logique et prudente à l'avenir.

► Dans le cadre d'une directive fédérale habilitant tous les ordres de gouvernement à relever les défis propres à la construction de logements destinés à la location, on pourrait également explorer les possibilités suivantes :

o Collaborer avec les municipalités et les provinces pour trouver des solutions visant à financer les infrastructures, pour accélérer le développement en plus de réduire les coûts initiaux pour le constructeur.

o Évaluer les options de mesures nouvelles ou élargies visant l'élimination, le report ou la réduction de la TVP/TPS ou des coûts de financement et des droits de développement pour tous les logements dans des ensembles résidentiels pour ménages à revenus mixtes, dans certains contextes.

o Tirer parti de la politique sur l'utilisation du territoire pour prioriser ou désigner les secteurs pour la construction de logements locatifs, en liant les populations cibles aux calendriers de développement et aux processus d'approbation du financement prioritaire.

o Lier le financement fédéral supplémentaire à la portée et à la durée des cibles d'abordabilité, au niveau de densité et aux objectifs de rapidité d'approbation afin de promouvoir l'harmonisation avec les municipalités et les provinces.

L'importance des programmes de la SCHL : des recommandations générales du secteur qui pourraient être prises en compte.

► Pour l'offre de nouveaux logements locatifs, il faudrait envisager un financement supplémentaire à long terme qui serait lié aux taux de la Banque du Canada — une approche généralement comprise par les promoteurs et les partenaires actifs. On pourrait y arriver en affectant des fonds aux infrastructures communautaires ou sociales, en émettant des obligations pour le logement abordable ou en offrant le rachat de taux par l'intermédiaire de fonds pour le logement abordable créés par les banques et les coopératives de crédit.

► De nombreux programmes provinciaux et fédéraux de logement visent à accroître l'offre de logements à la fois abordables, accessibles (sans obstacles physiques) et durables. Bien que ces objectifs soient importants, le respect des exigences strictes en matière d'accessibilité et d'environnement entraîne souvent des coûts supplémentaires importants pour la construction et le réaménagement. En harmonisant les exigences des programmes de logement abordable avec celles d'autres fournisseurs, on pourrait permettre la création de logements abordables à grande échelle partout au pays. Un tel projet nécessiterait la collaboration avec les autres ordres de gouvernement et accorderait plus de souplesse à la SCHL. On pourrait notamment envisager ce qui suit :

- Les programmes fédéraux s'en remettent aux codes provinciaux ou municipaux du bâtiment et de l'environnement.
- La souscription est simplifiée pour les ensembles résidentiels financés par des programmes provinciaux et les programmes de la SCHL.
- La SCHL approuve conditionnellement des projets d'ensembles résidentiels en cours d'examen pour le changement de zonage et, dans certains cas, est le promoteur actif de ces demandes.

EY s'engage à faire progresser la recherche dans ce domaine à mesure que les conditions du marché évoluent et à fournir une mise à jour annuelle de l'enquête à partir de 2024. Cette enquête annuelle vise à servir de mécanisme continu pour les activités futures de consultation des intervenants du marché et la surveillance objective et indépendante des tendances du secteur de la construction de logements locatifs.

1. Rental Housing Supply: Market Context

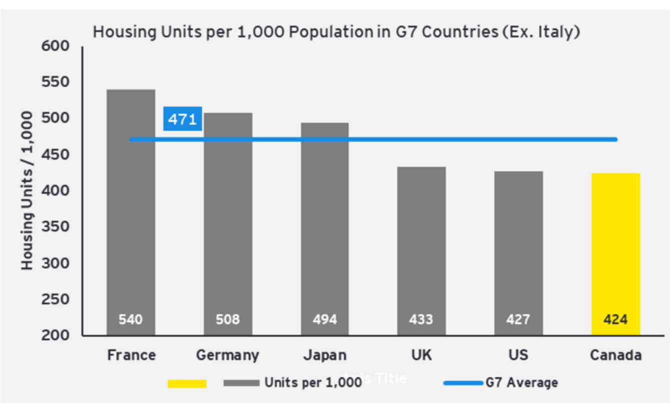
Adequate supply of permanent, secure Purpose-Built Rental Housing ("**Rental Housing**") is a core building block required to achieve CMHC's aspiration of a home for every Canadian by 2030 that is both affordable and meets their needs. It is critical that communities provide a sufficient range of rental housing to house many segments of local population and that this supply expands as the population grows.

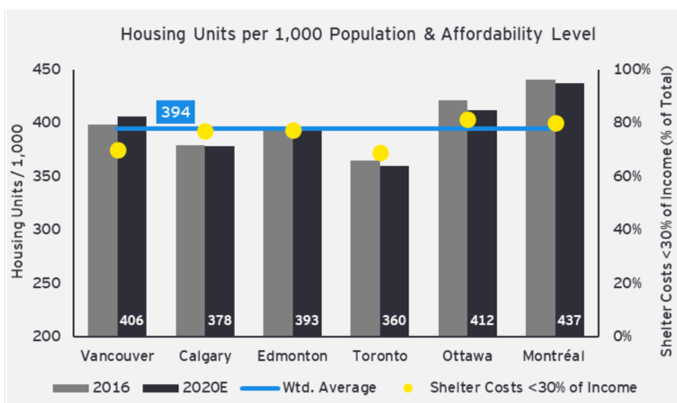
Benefits for All: Purpose-Built Rental Housing	
Lifestyle Needs	Affordability
✓ Flexible housing without the burden of maintenance. ✓ Ability to scale up or down depending on circumstance. ✓ Creates communities for new immigrants and students. ✓ Accessibility for mobility-challenged (i.e. seniors).	✓ Secure tenure less susceptible to economic conditions. ✓ Typically, rent is lower than the carrying cost and maintenance for comparable unit ✓ Upfront development costs financed by developer who may access low-cost funding through CMHC.

1.1. National Housing Shortage is Well Established

Over the last decade, housing affordability has become one of the most critical issues facing Canadians. Major economists, housing agencies, and governments at all levels have reported on the chronic insufficient level of housing supply as a key contributor to affordability challenges. As CMHC notes in their June-2022 Housing Supply Shortages report, "There have been a multitude of reports on Canada's housing system over the last few years. Government panels have been struck and the answer is now clear: we need more housing supply." According to CMHC, 3.5 million more housing units are required beyond what is currently projected for construction by 2030 to restore affordability. Canadian housing starts averaged nearly 200,000 units per year over the last three years.

Relative to international peers, Canada has the lowest per capita housing supply in the G7.[7] Variation in the level of housing supply also exists across the country. As illustrated below, this doesn't necessarily correlate to affordability. **Among Canada's largest urban areas, Vancouver was the only city to see growth in the per-capita housing supply from 2016 to 2020.8 However, with Toronto, it remains the least affordable.**

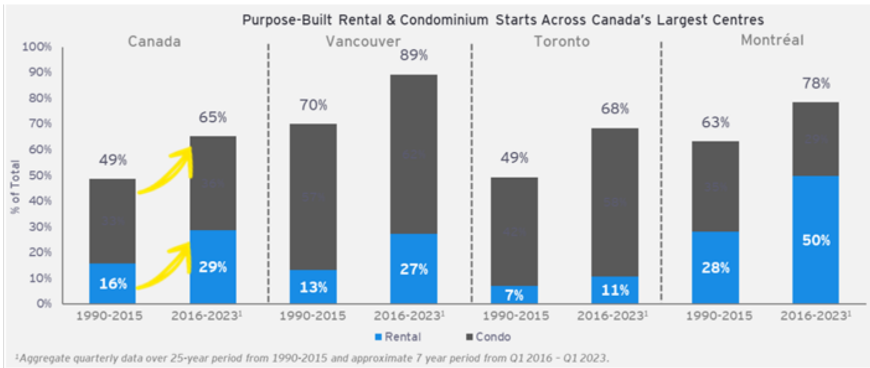


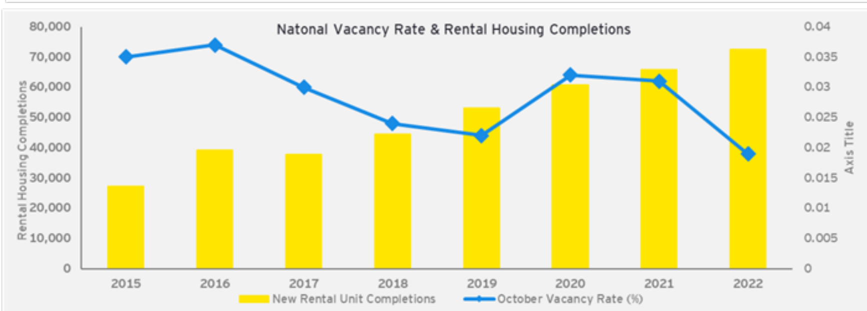


Source: Scotiabank Economics, StatsCan, OECD, US Census

Rapidly growing immigration targets will boost demand for rental. **From 2011-2016, 30% of immigrants settled in Toronto, 15% in Montreal, and 12% in Vancouver.9 As new Canadian residents typically rent for the first 5-10 years in Canada, 56% were living in rented accommodation in 2018 – nearly two-times the national average.** Increases in the proportion of senior and single-person rental households are also increasing.

Despite a generational increase of rental housing construction, vacancy rates have declined. This illustrates the scale of pent-up demand for rental housing in Canada.





Source: StatsCan, CMHC, EY Research

Multi-Unit Housing Starts

- From 1990-2015, annual multi-unit starts, averaged nearly 57,000 units.
- Since 2016, production has more than doubled to 120,000 units per year.
- Today, multi-unit housing represents over 65% of total housing starts.
- This is an increase of 15% relative to the 1990-2015 period.

Rental Housing Starts

- Purpose-built rental has comprised an increasing share of production, now representing 30% housing starts.
- Nearly 375,000 rental housing starts since Q1 2016 is a 10%+ increase over 1990-2015 period – combined.

With affordability challenges continuing to worsen, real estate development activity becomes an economic growth imperative supporting a government focus on rental.

The generally accepted definition of housing affordability is when less than 30% of gross household income is consumed on shelter. According to a 2021 Statistics Canada survey, 1 in 5 households are spending more than 30% of income on shelter.[10] Relative to other major cities, in Vancouver and Toronto there is an additional 1 in 10 households who overspend on shelter according to this 30% threshold of spending on shelter.

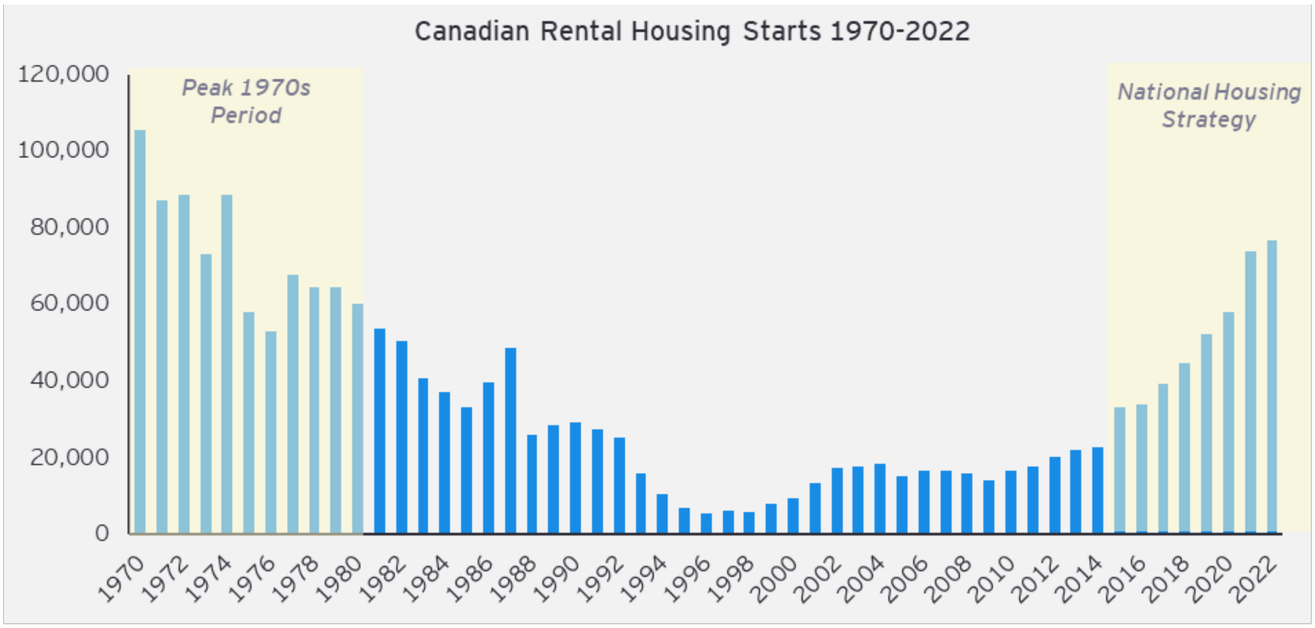
When broken out by housing tenure, the results indicate a further imbalance: occupiers of rental housing spend a much more disproportionate amount of income on housing relative to those who own a home. [11]

Proportion of Households Spending More Than 30% on Shelter (2021)[11]						
Tenure	Vancouver	Calgary	Edmonton	Toronto	Ottawa	Montréal
Owned	24%	17%	16%	25%	11%	13%
Rented	38%	34%	36%	40%	32%	28%

Differences in household composition and average income level may explain part of this imbalance between owners and renters. However, localized supply and demand are also at play. Over the past decade, the number of renters has increased three times as quickly as the rate of owners. The supply of units has not caught up.[10]

1.2. Government Intervention in Rental Housning

Government policies during the "Peak 1970s Period", mainly at the federal level, enabled construction for the vast majority of Canada's rental housing stock. Successful interventions included tax incentives through the Multiple Units Residential Building legislation, as well as two construction supply stimulus programs: the Assisted Rental Program and the Canada Rental Supply Program.[12] **Successful program design included a mix of grants, interest free loans and a graduated payment mortgages – all of which were designed to reduce upfront investor equity while also ensuring a market-accepted rate of return.**[12] Changes in federal policy in the late 1980s favored home ownership, fuelling a dramatic shift throughout the 1990s-2000s from rental to condominium housing for the Multi-Unit sector.



Data amalgamated from a variety of sources including CMHC, StatsCan, the Canadian Encyclepedia & the Tyee.

Rental starts have picked up greatly since 2015, coinciding with re-entry of the Federal government and launch of the National Housing Strategy, as well as other market forces. As market conditions evolve, this outlook is increasingly uncertain.

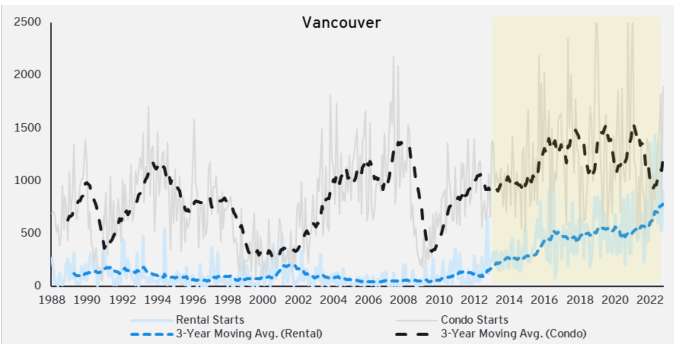
As outlined on the following page, across most major Canadian cities, purpose-built rental starts have increased. The launch of the National Housing Strategy coupled with the entry and/or increased allocation from new market participants such as pension funds and publicly traded developers who have been more actively involved with new rental housing is helping to support growing demand fundamentals such as increased immigration:[13]

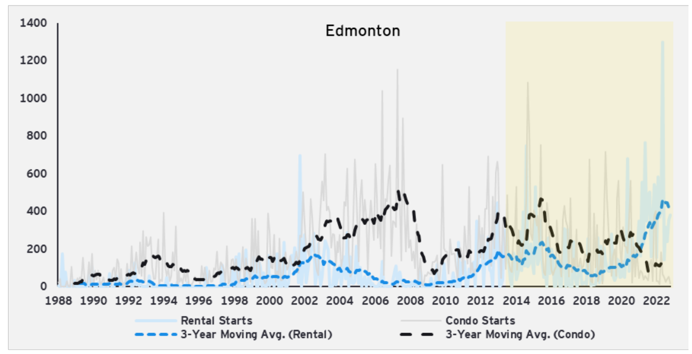
Multi-unit construction – whether purpose-built rental or condominium– continues to grow across Canada. As a share of total, multi-unit construction starts exceeded the 5-year average in each urban area in 2022, representing over 70% in Toronto and Vancouver, and nearly 87% in Montréal. Growing developer interest in Ottawa led to increased multi-unit market share from 36% to 50% of all starts in 2022.

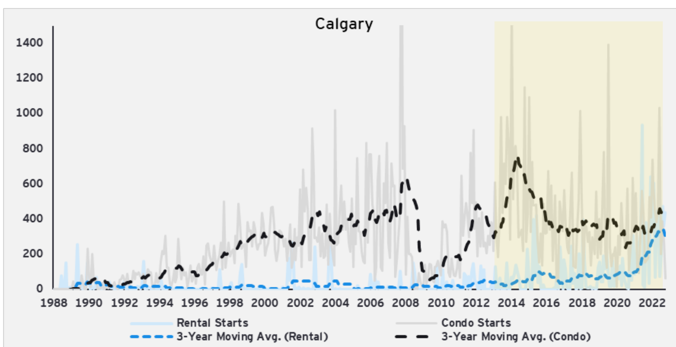
Apartments are increasingly being developed in cities like Calgary and Edmonton, which have traditionally grown through lower-density expansion of the urban periphery. This growing trend toward densification is an important consideration for both improving housing affordability and increasing long-term sustainability of new housing stock.[14]

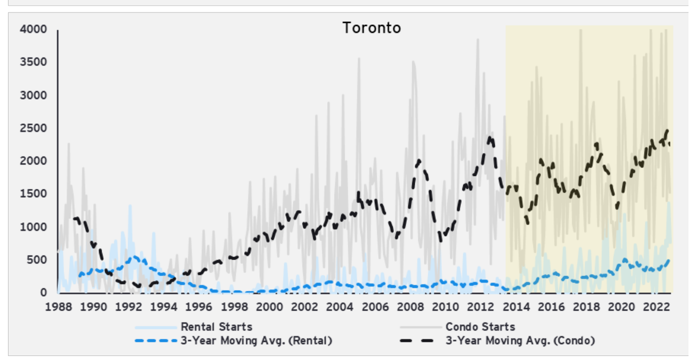
The current housing affordability situation in Canadian housing markets has been exacerbated by pandemic-related impacts of record-low mortgage rates and a shift in preferences for housing by type and geography. The limited supply of 'workforce rental housing' has been cited by regional growth authorities across the country as challenge to economic growth and livability.[15] Demand for rental housing will only increase with immigration targets and increasing affordability concerns for teachers, nurses, trades and young professionals. Adequate rental housing is foundational to a well-functioning and thriving landscape across Canada's urban areas.

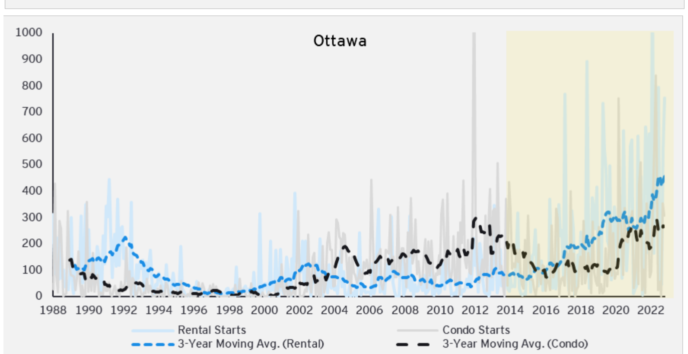
Given the level of end users occupying condominiums that were acquired by investors with the intent of renting units out, the secondary rental market's impact from a decline in pre-sale investor activity cannot be ignored. Condominium builders also represent a significant amount of the knowledge and capital within the real estate development community.

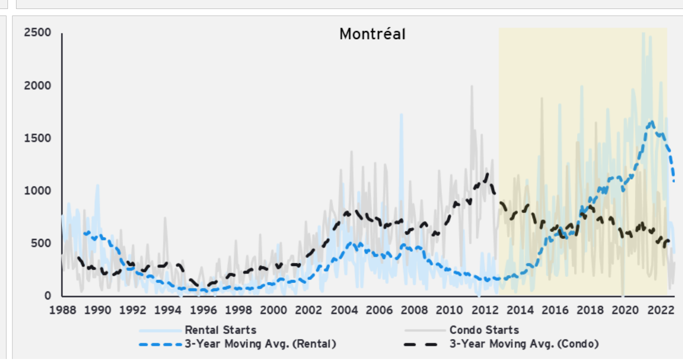












Market response to the National Housing has been strong, with rental starts now at par or surpassing condo starts in all major centres except for Toronto.
Looking ahead, challenges pertaining to program scale and access should be a priority.

2. CMHC Research Question(s)

Past studies have often concluded that new construction of purpose-built rental housing is generally not as profitable as condominium housing. However, as illustrated over the last 5 – 10 years, construction of new rental housing supply has increased across Canada. Several factors may explain this, such as:

- Developers and/or partners hold unencumbered land, sites acquired at below current market value, or underutilized sites with intensification potential;
- Different goals and objectives exist for new development across residential builders;
- Alternatives return metrics or investment horizons are considered across residential builders;
- Increased allocations to purpose-built rental from institutional investment groups; and,
- Funding challenges faced by housing developers of condominiums are pivoting developers to purpose-built rental housing.

To better understand the motivations that guide residential developers, EY's survey intends to better understand current industry perspective on approaches to evaluating new multi-unit rental projects. This includes assessing current market conditions, identifying Key Performance Indicators ("**KPIs**") used to evaluate projects, and seeking perspectives on lending programs, including approaches used to measure Environmental, Social and Governance ("ESG") criteria. Affordable housing developers have traditionally faced funding challenges, which are now more acute given the current housing environment resulting in more dependencies from donations or subsidies to achieve financial viability.

With a better understanding of risk, return and funding challenges, CMHC may better positioned itself to evaluate future design of its product offering and advise on the design of policy-related programs.

To that end, the following focus areas were identified:

Residential Development Strategies
- *What strategies are being used by residential developers respond to current market conditions?* - *How does rental housing fit into overall business strategy? What approaches are used?*
Investment Decision-Making
- *What project return metrics are most important? Other than financial returns, what KPIs are used?* - *How do the different goals of market participants influence what metrics are used?*
Project Funding
- *Across developer typologies, do preferred capital stacks vary to finance new construction?* - *How is the current market impacting financing strategies – how are residential developers responding?*
CMHC Programs
- *What is the level of knowledge and understanding for CMHC programs?* - *What feedback and improvements can CMHC undertake? How would you suggest we improve?*
Environmental, Social & Governance ("ESG") Considerations
- *How do ESG factors play a role in investment decisions?* - *What are preferred ESG options when considering viability and project economics?*

The survey was released in December 2022 and remained open until January 2023. Responses from each participant are anonymous but identifying questions were included to categorize responses by geography, size of organization and developer typology.

EY received 83 responses to the survey. Of those 83 responses, about 40 responses were given to each question or approximately 50% of respondents answered each survey question.

3. Summary Takeaways & Survey Results

RENTAL HOUSING DEVELOPMENT STRATEGIES:

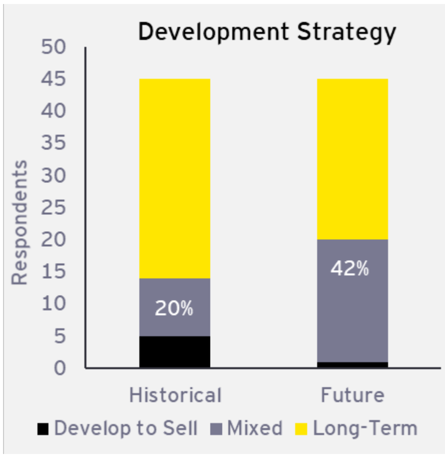
How does rental housing fit into overall business strategy?
What strategies are being used by developers to respond to current market conditions?

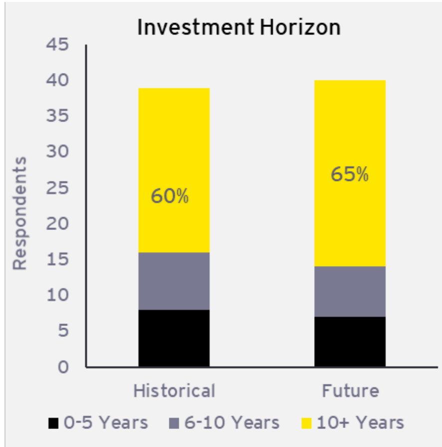
2023 Summary Observations – Rental Housing Development Strategies

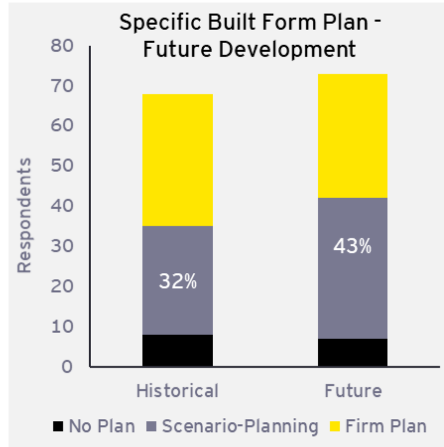
- ✓ *During the pre-pandemic period most organizations were looking to development as a major source of growth – outsized returns relative to existing asset acquisitions and/or repositioning programs were driving increased allocation to real estate development, particularly for multi-family assets.*
- ✓ *Rental housing requires developers (and their investors or capital partners) to maintain a long- term strategic view. Unlike residential condominium construction, the value creation under a rental scheme is inherently tied to long-term, accretive revenue growth. An ability to source upfront equity, and strong demand for completed assets from well-capitalized institutional investors are also key drivers.*
- ✓ *Developers with a well-capitalized partner (i.e., Pension Fund), historically, could consider land acquisition however other groups such as Public REITs will focus more on-site intensification due to limitations with the current interest rate environment and more conservative lending strategies.*
- ✓ *With extraordinarily strong rental market fundamentals across major Canadian markets, rental developers continue to act on long-term growth strategies, creating value over the lifecycle of newly built apartment assets. Market demand for rental product is more prominent in secondary markets of gateway cities such as Vancouver, Toronto and Montréal. These locations are also often targeted as they're well-positioned to achieve rental rate growth and value accretion over time.*
- ✓ *Government incentive programs such as low-cost mixed-income debt financing, public partnerships and/or ground lease structures, as well as municipal development charge relief. Many of the core programs from the launch of the Federal government's National Housing Strategy successfully illustrated the merits of combining multi-level government incentive programs over the 2017-2019 period – however, market conditions today have fundamentally changed, narrowing potential returns.*
- ✓ *Given today's environment, smaller developers with greater debt exposure are more likely to take a 'wait and see' approach to pursuing new rental projects in the near-term. Recent discussions with market participants indicate that a broader-based slowdown now upon us, where only the strongest and most well-capitalized developers that may leverage scale and equity will move forward.*
- ✓ *Many are hopeful for different forms of relief – without significant government intervention, conditions today will generally not entice developers to undertake rental housing construction. Some developers have initiated strategies such as increasing expected rental revenue, reducing the level of finishings and/or increased the project's height or density.*
- ✓ *It is more common to pause the project launch while firms undertake development scenario-planning and feasibility analysis. Investment motivations are not expected to change over the near to medium term as cost, process and labour challenges that exist today are well beyond the level of profitability for a development site strategy that only 3 years ago would highly feasible.*
- ✓ *Industry responds to current environment with several strategies identified in August-2022 survey[16]:*
  - *Nearly 40% will reduce the number of future projects while over 30% will pause new projects*
  - *Over 44% will adjust revenue assumptions to maintain feasibility (i.e., increase price or rent)*
  - *Nearly 30% will decrease unit size while over 10% will use lower cost finishings to maintain feasibility*

Developers are adjusting investment horizons with a longer-term view, amortizing project costs while accounting for greater risk over the project lifecycle.

Historically, survey respondents indicated 25% of units built were to a 'Develop & Sell' strategy. Today, less than 10% of units are targeted for this strategy. This has increased the number of 'Long-Term Hold' units planned over the next 3-5 years by nearly 15%.







Source: EY CMHC 2023 Rental Survey Data

- For those firms who have shifted course, a trend towards conservatism is noted where developers are responding to changing market condition by anticipating the need for more flexibility in project design (i.e., to shift from rental to condo) and/or considering a more prolonged investment horizon.[16]
- The motivation to hold for the long-term is consistent with motivation of institutional developers seeking long-term cash flow and private developers or family offices who, in many cases, view multi-family rental projects as a means of generating inter-generational wealth.

With reduced upfront costs and access to alternative funding sources, Joint-Ventures and other partnerships are increasingly leveraged to build new rental housing.

This includes alternative tenures (e.g., ground leases), an increasingly common tool used by governments to help spur new rental housing construction.

- While the acquisition of sites with excess density was most relied upon strategy in the last 5–10 years, looking ahead Joint Ventures and other partnerships will be most prominent over the next 3-5 years.
- **As opportunities of scale become increasingly limited, priorities across government and/or the private sector are aligning through various partnership structures. While many participants noted these new structures were a way forward for the industry – new market realities exist.**
- Examples include the 2023 BC Housing and Metro Vancouver MOU, the Alberta Housing Amendment Act, and development projects such as the 3600 Block in East Vancouver, the Vancity Land Trust model, the West Donlands and Bloor/Kipling HousingNow sites in Toronto and Ottawa's LeBreton Flats.

EY CMHC Rental Housing Survey: Most Impactful Development Strategy Identified by Developer's Future Unit Pipeline[17]

	Joint Venture Partnerships	Excess Density Sites	Raw Land Acquisition	Site Intensification	Reposition Aging Assets	Acquire Assets
Strategy Identified as "Very Important" to Development						
Future Planned Units	32,100	30,550	30,600	27,300	20,500	13,750

Joint-Venture Partnership were identified by survey respondents as the most impactful strategy to motivate developers to undertake the construction of rental housing, followed by traditional land securement strategies.

'Builders of scale' – developers with a pipeline of 1,000+ units – will contribute over 75% of the new units among survey respondents.

The local mid-market segment was the most common product strategy among respondents.

The prevalence respondents self-identifying 'Affordable Housing' as a core strategy may be an indication of various interpretations of affordability.

- When asked to identify rental housing development pipelines by product segment, survey data indicated nearly 90,000 units in the pipeline across respondents.
- The volume of 'Affordable Housing' respondents may also indicate variability in the use of CMHC products among respondents that require affordable units to be included in their project.
- Builders of scale – developers with at least 1,000+ units in their pipeline, represent over 75% of all units being built for each market segment. This illustrates the impact large firms have on rental housing supply.

EY CMHC Rental Housing Survey Respondents: Firm Profile by Level of Future Construction Activity[17]

Rental Pipeline (# of Units Indicated)	Total	<300 Units	300-1,000 Units	1,000+ Units
Development Yield - Survey Respondents				
Local Mid-Market	30,250	23,750	23,750	30,250
Affordable Housing	22,800	17,500	17,500	22,800
Luxury Rentals	16,100	12,500	12,500	16,100
Senior's Housing	7,550	5,000	5,000	7,550
Student Housing	6,700	3,750	3,750	6,700
Social Housing	4,800	3,750	3,750	4,800
Total	88,200	2,400	19,550	66,250

EY CMHC Rental Housing Survey Respondents: Firm Profile[17]

Market Segment (# of Firms)	Total	Pension Fund	Private DevCo	Public DevCo	Asset Manager	Non-Profit	Crown Housing	Other
Focus / Market Segment								
Local Mid-Market	38	3	26	2	3	1	1	2
Affordable Housing	28	-	17	2	2	2	2	3
Luxury Rentals	20	2	13	2	1	-	-	2

As market conditions evolve, respondents prefer greater optionality in project design to adapt with market. A shift towards more conservative, smaller design is noted.

- Over the next 5 years, more flexibility in project design is indicated by a decreasing certainty in built form.

EY CMHC Rental Housing Survey: Respondent's Identified Approach to Project Scale & Design[17]

Respondents Approach to Design & Scale (# of Storeys)	Low-rise (1-3)	Mid-rise (4-11)	High-rise (12-40)	Skyscraper (40+)	PROJECT & DESIGN TREND
HISTORICAL: Focused on Specific Building Type	1	9	12	-	
FUTURE: Focused on Specific Building Type	2	7	7	-	DECREASE
HISTORICAL: Flexible. Focus on Scenario-Planning.	6	10	10	1	
FUTURE: - Flexible. Focus on Scenario-Planning.	4	16	14	1	INCREASE

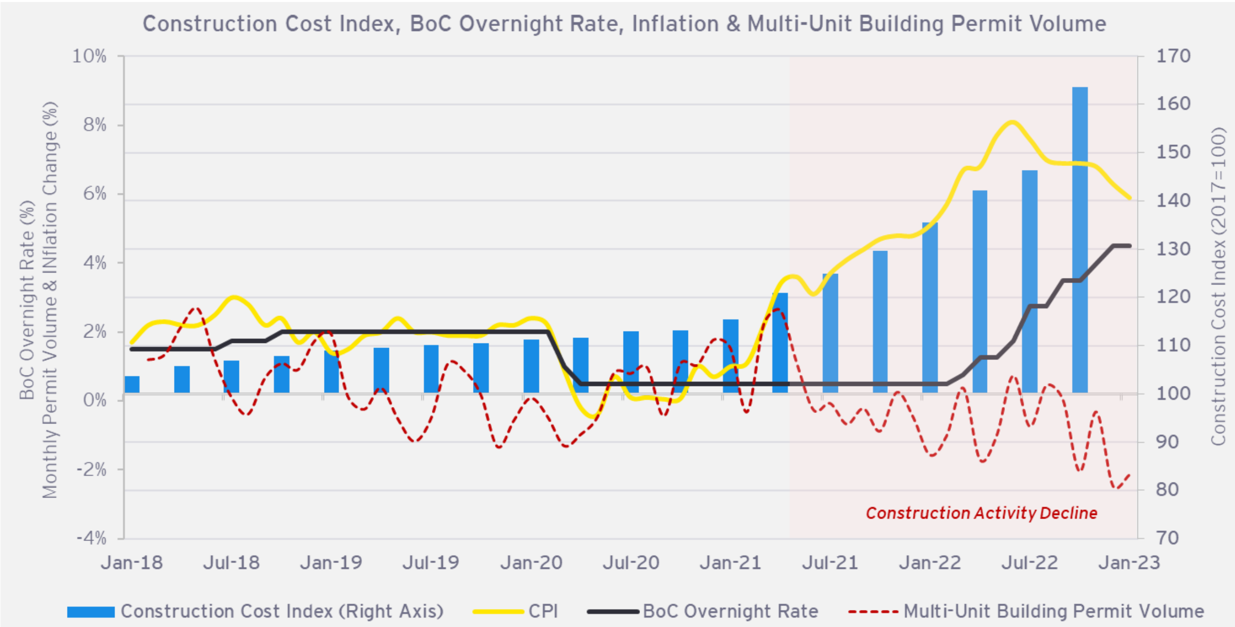
STRUCTURAL SHIFT IN KEY INVESTMENT DECISION-MAKING CRITERIA:

What project return metrics are most important? Other than financial returns, what KPIs are used? How do the different goals of market participants influence what metrics are used?

2023 Summary Observations – Key Investment Decision-Making Criteria

- ✓ *EY considered the following KPI metrics, all have which are defined in the upfront section of this Rental Housing Supply Study; 1) Development Yield, 2) Overall Project Margin, 3) Cash-on-Cash Return, 4) 10-Year/3-Year Leveraged IRR, and 5) 10-Year/3-Year Unlevered IRR.*
- ✓ *For Private DevCos, cash-on-cash returns remain very important. This metric reflects the 'cash out-cash in' mindset of more direct investors where returns may often be distributed back into a family office, shorter-term fund commitment, or invested personally.*
- ✓ *Additional considerations noted by institutional real estate investment professionals include:*
  - *Land cost consideration: How is land priced? Is pricing at point-of-entry for the project?*
  - *With a particular focus on imputed equity, consideration of any expected value uplift from advancements in public investment, local planning and land use controls, as well as sites with beneficial co-location.*
  - *A Discounted Cashflow Analysis that contemplates the Net Present Value of future cashflow is often a preferred method to allow for the calculation of land value, ideally with Class D level cost estimate. For pre-development feasibility, participants remain largely reliant on Development Yield and IRRs but will also look at other metrics.*
  - *Development Yield calculates a ratio of Total Development Cost – use of funds to complete the project – to the Subject Property's Net Operating Income. This can be completed on an un-trended basis before asset stabilization or market maturity, at stabilization and/or refinancing at take-out. Additional consideration of pre- and post-HST payments is often undertaken for rental projects.*
  - *Development yields compared to Capitalization Rates assess the spread between new construction and acquiring an asset that is already built (i.e., and with a significantly lower risk profile). Even if acquiring existing assets at a 3.0% yield, developers often require at least a 150-bps spread to Development Yield to meet investor requirements.*
- ✓ *While development yield is consistently cited as one of the most relied-upon metrics, with higher interest rates and longer investment horizons, organizations have an increased IRR focus – most expect development yields today to be in the high-4% range and levered IRR of 10% - 15% to consider a project.*
  - *Current conditions can often yield single-digit IRRs. During the pre-pandemic period most organizations were looking to development as a major source of asset base growth – outsized returns relative to acquisitions and/or repositioning programs drove increased allocations to real estate.*
  - *IRRs on a 3, 5, and 10-year basis from the time of project inception through to an assumed terminal sale on both levered and unlevered basis will be considered. Unlevered target ranges from 10%+ and levered targets are 15%+.*
  - *One unique benefit to using IRRs is that is allows you to compare investment options of different scales and characteristics, particularly important for institutional investors.*
- ✓ *Once a reasonably reliable cashflow statement may be prepared, Cash-on-Cash returns consider the direct annual yield from rental operations relative to the total equity that was invested into development.*
  - *Return on Investment / Margin on Cost is used where stabilized income is capitalized to estimate value-upon-stabilization and then compared to total development costs. Target of 15%-20%.*
  - *The cash available for distribution (NOI less debt repayment and any capital funding) is divided into the initial equity investment and may consider principal repayment over time.*

In <5 years, a 50% rise in construction costs coupled with interest rate increase has caused a structural shift in homebuilding. Residential permit activity has fallen across Canada.



Data was compiled from Statistics Canada, Bank of Canada, and CMHC.

Over 75% of respondents use development yield to evaluate new construction returns relative to yields acquiring existing apartments.

The spread between development yield and market capitalization rates is an important metric that represents the return premium to entice developers to engage in new construction. Given the associated risk and uncertainty of construction, a higher rate of return is required.

- As development costs rise, development yields decline, all else equal. This narrows the spread between development yield and capitalization rates, reducing the premium for new construction.
- A decline in the premium return of construction relative to acquisition motivates decisions to pause, cancel, or convert to condominium tenure.
- All respondents agree a minimum 125 bps spread between development yield and capitalization rate is required to stimulate construction; 50% believe this spread is 175 bps.
- Basic return metrics such as Project Margin and Cash-on-Cash yield preferred to better reflect impact of rising cost of development.
- When evaluating alternative options to invest with different asset classes and/or timelines, IRR analysis is most appropriate.
- Levered IRR consider the Return on Equity for invested capital while free flow operations of the project will commonly use unlevered IRR.

Summary Respondent Survey Data : Key Performance Indicators

Rank	Investment Metric	Preferred Range
#1	Development Yield	4.0% - 5.0%
#2	Overall Project Margin	15.0% - 30.0%
#3	Cash-on-Cash Return	4.5% - 12.0%
#4	10-Year Levered IRR	7.0% - 15.0%
#5	3-Year Levered IRR	8.0% -22.5%
#6	10-Year Unlevered IRR	6.0% - 10.0%
#7	3-Year Unlevered IRR	6.75% - 8.0%

Source: EY CMHC 2023 Rental Survey Data

When making investment decisions, an approach that considers a variety of metrics is preferred. Reliance on a specific one will typically vary based on the stage of a project or when subject to a specific audience.

Choosing one investment metric over another for rental housing development depends on various factors, including the goals, priorities, and specific circumstances of the investor or developer. Considerations include:

- **Financial Goals:** Different investors may have varying financial objectives. For example, some may prioritize maximizing cash flow in the short term, while others may focus on long-term capital appreciation. The choice of investment metric should align to specific financial goals of the investor.
- **Risk Tolerance:** Investors have different risk tolerance. Some may prefer metrics that prioritize steady cash flow and income stability, while others may be more comfortable with higher-risk, high-reward metrics such as potential capital gains. The chosen metric should align to investor risk appetite.
- **Time Horizon:** The time horizon for the investment can influence the choice of metric. Short-term investors may prioritize metrics that provide quick returns and cash flow, such as cash-on-cash return. Long-term investors, on the other hand, may focus on metrics like IRR and appreciation potential.
- **Financing Structure:** The financing structure of the project can impact the choice of investment metric. If the project involves significant debt financing, metrics like Debt Service Coverage Ratio (DSCR) become crucial to ensure the property generates sufficient income to cover debt payments.
- **Market Conditions:** The state of the local housing market and broader economic conditions can also influence the choice of investment metric. For example, in a market with high demand and low supply, metrics like occupancy rate and rent growth may potentially carry more weight.
- **Investor's Expertise:** The investor's knowledge and experience in the rental housing market can affect metric selection. Investors who have a deep understanding of rental property operations may prioritize metrics like Net Operating Income (NOI) and construction costs, as they are familiar with these aspects.

Over the medium to long term, changes to immigration will have an immediate impact on rental demand in gateway centres like Toronto and Vancouver.

- Arriving residents have a higher propensity to rent at 64% and 74%, respectively. While immigrants also tend to have high home ownership, this transition takes time. Over several years, work experience, savings, and credit are established that induce significant demand for rental housing.[18]
- As ownership affordability is eroded based on market pricing and financing cost, the transition from rental to ownership is becoming delayed and/or no longer feasible.

Municipal fees in Vancouver & Toronto now comprise over 20% of project budgets. The application and timing of Development Charges is one of few tools for government to control input costs.

- **The impact of upfront costs has a greater impact on viability for rental due to critical differences in project financing.** This is particularly challenging for non-profit developers who are also subject to the same upfront costs unless exempt through programs such as the OpenDoor program in the City of Toronto.
- **Rental construction is subject to the same upfront costs (e.g., Development Charges, HST) as condominiums but without the capital afforded by advanced sales or an ability to pass through taxes to the end user.** This effectively treats either form of housing the same despite significant differences in how projects are funded.
- Because of these "access to capital" challenges, rental development of any major scale is pursued largely by firms with access to institutional capital.

FINANCING RENTAL CONSTRUCTION PROJECTS IN 2023:

- **Across developer typologies, do preferred capital stacks vary to finance construction?**
- **How is the current market impacting financing strategies – how can developers respond?**

2024 Summary Observations – Project Funding Mechanism / Gaps

- ✓ *Developers rely heavily on their own cash resources, capital partners, and loans from banks or other financial institutions to finance new rental construction projects. Few respondents identified VTBs, syndicated loans or capital markets financing as sources of capital.*
- ✓ *The biggest barriers to development were consistent among participants and survey responses with the following routinely identified: development charges, approval timeline, tax policy (i.e., GST/PST), and in some instances, rent control was noted.*
- ✓ *All three levels of government currently have major programs that treat housing as a necessity. In particular, these policies also often target purpose-built rental construction as one strategic tool to help re-build equitable and fair housing for all Canadian that is affordable and meets their needs.*
- ✓ *Rental housing developers' capital stack is fairly consistent and simple. While condominium typically sees debt-to-equity ratios of 80%-20%, due to the deposit structure, rental construction requires significantly more equity. Purpose-built rental developers require more equity with ratios of 60-70% debt and 30-40% equity, subject to provisions in the loan document and/or programs under the NHS.*
- ✓ *GST/PST was noted as being particularly punitive to rental buildings. While a condominium project would view this charge as a pass-through to the unit purchaser, rental developers must charge this cost early and upfront in their investment lifecycle. Many described this as a "phantom transaction", further suggesting that GST/PST should only be payable once an actual transaction occurs. A zero-rating for new rental housing – or other form of capital cost tax relief is defensible in a similar manner as groceries, according to many respondents; housing is a right to all, and this form of housing should not have the same level application of fees and other charges as condos. Rental housing should be treated differently, even if a moderate affordability provision would be required.*
- ✓ *Interest rates for loans that have been funded under the RCFI program ranged between 1%-3%, up to 3% lower than conventional financing, depending on interest-rate environment and project specifics.*

Interest rates are impacting viability of new rental housing construction.
Over 90% of respondents indicated projects are not feasible with conventional loans today.[19]

This is consistent with Altus Annual Investment Trends Survey results for multi-residential assets, outlined below, with inferred minimum borrowing cost based on BoC bond yields over the last 3 years:

Altus InSite Investment Trends Survey:
3-Year Multi-Residential Conventional Debt Parameters - Q1 2023 Survey Data

Year (Q1)	Max. LTV	Max. Amort	5-Year Spread	5-Year BoC	Borrowing Cost	10-Year Spread	10-Year BoC	Borrowing Cost	Preferred Term Years	Preferred Term Cost	Debt Availability Poor	Debt Availability Good	Debt Availability Excellent
2023	79%	41	0.97%	3.59%	4.56%	1.00%	3.41%	4.41%	6	0.32%	29%	69%	-
2022	79%	35	0.97%	2.43%	3.40%	1.07%	2.42%	3.49%	9	0.16%	11%	36%	53%
2021	81%	36	0.96%	1.24%	2.20%	1.11%	1.62%	2.73%	9	0.20%	21%	54%	25%

Accessing private lenders (i.e., CMLS, FirstNational) and major banks was typically limited to refinancing transactions and other capital-preservation strategies.

Over 90% of respondents indicated that it would not be feasible to construct rental housing with conventional debt financing. With alternative financing (i.e., low-cost CMHC programs), 60% would still believe that rental construction is not feasible based on current market return expectations.

Nearly two-thirds of survey respondents indicated financing was "Very difficult" or "Not feasible" today. Historically, unanimous sentiment in the market was that financing was not a major concern.

Among large developers (1,000+ units), all respondents noted a negative shift in financing availability. Developers of scale represented over 90% of respondents who leveraged Public-Sector Financing.

- **Even with alternative capital sources such as lower-cost CMHC financing, nearly 2/3rds of respondents indicate new projects today are not feasible.** This survey took place months ahead of the most recent BoC overnight interest rate increase in June-2023.
- **With a further 50 bps increase from the Jan-2023 rate environment, 70% of developers indicated market conditions would not support a profitable rental housing development.**

EY CMHC Rental Housing Survey Respondents: Capital Partner(s)

Rental Developer Pipeline (next 2-3 Years)		<300 Units	300-1,000 Units	1,000+ Units
Development Yield - Survey Respondents				
Bank Loan(s), or other Financial Institutions	33	6	10	17
Firm's / Stakeholders' Cash Resources	30	7	8	15
Public Sector Financing	13	1	1	11
Vendor Takeback Financing	8	4	3	1
Syndicated Loan	4	1	1	2
Capital Market Financing	2	-	-	2
Offshore Financing	1	-	-	1
Total	91	19	23	49

For developers of scale (1,000+ units), there are more capital options available (i.e., Capital Markets, Syndicated Loans). Public-sector Financing has almost exclusively been leveraged by developers of scale; VTBs, as well as conventional debt and equity generally serve clients with smaller-scale projects.

- In 2016, purpose-built rental construction financing options expanded with launch of NHS programs such as RCFi as well as the introduction of MLI-Select, an update to the former MLI-Flex lending program.

Relative Challenge to Secure Financing	Historical	Current
	Total	Total
Not difficult	18	2
Somewhat difficult	19	13
Very difficult	1	19
Not feasible	-	5

Expected Loan-to-Cost Ratios: How have they changed?	Historical	Current
	Total	Total
<60%	4	12
70%-80%	15	15
80%+	18	14

CMHC's ROLE IN SUPPORTING NEW RENTAL HOUSING SUPPLY:

- **What is the level of knowledge and understanding of CMHC programs?**
- **What feedback and improvements can CMHC undertake? How would you suggest we improve?**

✓ *Over two-thirds of the survey respondents have explored or used CMHC programs. Overall, the sentiment was that CMHC is an innovative and a helpful partner. Participants noted that timelines can be slow and there is often uncertainty of success until very close to construction start. Some noted that RCFI & MLI Select program is challenging to use given there is more flexibility with a commercial bank and CMHC will be more bureaucratic in nature for conducting business.*

✓ *Long-term products (e.g., 20-year term on construction loans) were also suggested to protect against future uncertainty similar to what was previously offered by CMHC in 60s/70s.*

✓ *The MLI Select program is enticing given longer amortization periods, a lower DSCR minimum of 1.1 and higher LTV ratios. Some respondents (i.e., Public DevCos) noted that given internal structures, they are unable to take on higher LTV ratios, but others see this as a benefit. Some participants felt unclear about what would score well and the impact of each category on each other.*

✓ *Across all interviews participants expressed that more rental housing will not get built without alignment from federal, provincial and municipal government. Several participants noted that CMHC is the right organization to take on the role of facilitator given their more progressive and flexible models and federal oversight. This is a central and core common goal among all industry stakeholders. CMHC's role is certainly as convenor, acknowledging the ability for CMHC to impact costs is limited.*

Over 50% of survey respondents believe CMHC's role could be expanded. With the need for more centralized and co-ordinated efforts to tackle the housing supply challenge, a clear focus on solutions and recommendations from industry is required.

- **Acting as a 'inter-governmental broker' to advance Municipal-Provincial program alignment, with a single point of contact to connect other Federal government ministries.** 30% of respondents identified CMHC as having a role in leading intergovernmental collaboration at the federal, provincial and municipal level. Participants indicated that the industry would benefit from streamlined and complimentary processes with incentives and programs coordinated across government. [20]

- **Exploring infrastructure financing to unlock more opportunities for rental housing.** Approximately 30% of respondents agree that CMHC's mandate should expand t include exploring infrastructure financing. Areas considered included longer amortization periods (e.g., life of the building) on Mortgage Loan Insurance programs, a broader definition of what can be financed under the RCFI program and inclusion of land value as an equity contribution.

- CMHC's involvement earlier in the process through **financing upfront infrastructure costs and early works** was noted as an opportunity to support more housing construction.
  - Upfront costs (e.g., development charges) can alter the feasibility of the project and ultimately puts upward pressure on the cost of each new home which further exasperating the shortage of affordable housing options.
  - Where the delivery of infrastructure is critical to growth in associated residential development, the loss-leading construction of municipal and transit infrastructure may be considered a component of development that is eligible for Canadian Infrastructure Bank ("CIB") financing.
  - Acknowledging that individual projects may not be of an appropriate scale of investment for the CIB, pooled opportunities on a new transit line, for example, could be bundled together and form part of a larger offering for the CIB.

Market participants agree CMHC's role in facilitating new rental housing is critical. Programs offer targeted relief, proven to motivate new construction.

- Lower-cost loans were most attractive according to respondents, with rates noted in market interviews as 1.0% - 3.0% lower than conventional lenders, in addition to amortization periods and loan-to-cost ratios. The least attractive aspects of CMHC's programs are prolonged timelines and inflexible conditions.

Most Attractive CMHC Program Attributes	Survey Score	Less Attractive CMHC Program Attributes	Survey Score
Low-cost loans (low interest rates)	196	Prolonged timelines	200
Long amortization periods	172	Inflexible conditions	180
High loan-to-cost ratios	166	Scoring of ESG criteria	105
Debt coverage ratio	121	Future mortgage administration outsourcing	102
Enables social initiatives	73	Construction bonding conditions	93

Note: 'Survey Score' is aggregate, summed response from participants for each attribute (i.e., rank of 6=6 + rank of 2=2).

The MLI-Select program is most preferred among survey respondents.

Comprising 70% of respondents leveraging MLI-Select, a greater reliance for this program offering is notable from larger developers of scale.

- As outlined below, the level of market penetration for both MLI-Select and RCFI programs indicates the need for this type of funding support across Canada and developer typologies.
- Developers with larger pipelines and multiple projects (i.e., 500+ units) represent a greater proportion of MLI-Select and RCFI program users. The higher-density environments in BC, Alberta, Ontario and Quebec would support this geographical distribution.

Geography		BC	Alberta	Territories	Prairies	GTA	Ontario	Quebec	Maritimes
RCFI	12	6	3	1	-	5	5	3	2
MLI Select	22	16	10	2	4	10	9	11	3
MLI Standard	10	7	7	1	1	4	4	1	1
Seed Funding	5	4	1	1	1	3	3	2	2
Total	49	33	21	5	6	22	21	17	8

Respondents could select multiple markets in which they're active.

Typology		Pension Funds	Private DevCo	Public DevCo	Asset Manager	Non Profit	Crown Housing	Other	
RCFI	12	-	9	2	1	-	-	-	
MLI Select	22	2	14	1	3	1	-	1	
MLI Standard	10	1	8	1	-	-	-	-	
Seed Funding	5	-	2	-	-	1	-	2	
Total	49	3	33	4	4	2	-	3	

Development Pipeline		No Units Planned	<100 Units	100 - 300 Units	300 - 500 Units	500 - 800 Units	800-1,000 Unit	1,000+ Units	
RCFI	12	-	1	1	2	1	-	7	
MLI Select	22	1	2	-	3	1	-	15	
MLI Standard	10	1	-	-	1	-	-	8	
Seed Funding	5	1	-	1	2	-	-	1	
Total	49	3	3	2	8	2	-	31	

ESG FACTORS INCREASINGLY IMPORTANT – GREATEST INTEREST IN ENERGY EFFICIENCY:

- **How do ESG factors form part of investment decisions?**
- **What are preferred ESG options when viability when considering project economics?**

✓ *ESG is important to all organizations. It is naturally aligned to long-term rental housing ownerships given operational efficiencies. Unlike commercial development, tenants are not willing to pay more for "E" designations, so this cost is carried by the developer.*

✓ *Participants noted fatigue with tracking multiple ESG categories such as LEED and Toronto Green Building Standards. Any opportunity to streamline CMHC eligibility requirements with existing standards would be well received by participants.*

✓ *Many would like to do more affordable housing, but conditions make it untenable – margins are thin and current policies are punitive leaving little room for affordable housing. If affordable housing is desired, more co-ordination, funding and other support from public sector is needed.*

Nearly two-thirds of respondents indicated Affordable Housing was an area of focus. Interpretations of that definition may vary, however, representing more attainable market housing to some and below-market affordable (to varying degrees) to others.

- Affordable housing was a priority across all developer typologies, either directly or through partnerships.
- Income-based models are generally either structured through Rent-Geared-to-Income ("**RGI**") programs or the provision of a cap on household incomes for different unit types and rental cost. Often associated with Social and/or Community Housing, RGI programs are structured with rental agreements whereby they're only responsible up the proportion of market rent that represents 30% of total income, for example.
- Affordable Housing is defined by total cost at or below CMHC's Average Market Rent ("**AMR**") and equal to less than 30% of household pre-tax income.
- Based on survey results, the majority – 78% of respondents – indicate local market context is required for defining affordability; 50% prefer a mixed approach where income-based and market-based guidelines are subject to local market conditions and 28% prefer a market-based approach. The duration of affordability (i.e., 25 years vs. 99 years) is another important consideration.
- A universal definition is not recommended as affordability should reflect local market context given the variation in average rent-to-average income ratio, supply of housing, and available data.

It has become difficult, and in many cases impossible, to build affordable housing using NHS programs. Housing simply cannot be created fast enough – or at all – to meet demand with current federal support.

- Participants also pointed to the requirement for government collaboration particularly in developing more affordable housing. This means that support is required from all three levels to unlock opportunities to deliver more affordable units particularly in markets with very high cost of living such as Toronto and Vancouver.

Tracking of ESG measures appears limited to "off the shelf" information.

- Tracking of ESG-related measures at the property level is generally focused on rent-to-income ratios and the number of affordable units, followed by GHG emissions reduction relative to national building codes and the percentage of units meeting accessibility standards.
- This may suggest that investors/developers are not measuring ESG-related metrics in a deliberate way (e.g., except where such information is readily apparent or tracked).

ESG initiatives that respondents are most incentivized to work into rental projects include energy efficiency features and GHG reduction. Many social initiatives tracked and actioned used as leverage for financing (ability to secure low-cost loans)

- Energy efficiency initiatives are of most interest, while lack of financial incentives/motivation appears to limit interest in social impact initiatives. In terms of ESG initiatives that respondents are incented to incorporate in their projects, the highest rated was energy efficiency features and GHG reduction.
- The appeal of energy efficiency initiatives is a combination of financing incentives, reputation, and financial return, whereas other topics which received lower ratings, carbon footprint, affordable housing, accessibility and community consultation, are perceived as largely based on social good/reputation.
- Expedited municipal approvals often cited by respondents when as about motivations for the following:

ESG Motivations (# of Respondents)	Financial Return	Financing Incentives	Social Good / Reputation
Energy efficiency and associated GHG reduction	17	25	23
Affordable housing	6	16	23
Embodied carbon footprint	4	8	28
Accessibility (for people of all abilities)	1	9	28
Community consultation at design stage	2	1	24

4. Research Question Insights

1) **Future surveys:**
Targeted surveys will support an ongoing opportunity for feedback. While this market survey targeted a broad set of typologies, geographies and set of questions, future targeted surveys may offer CMHC an opportunity to receive very specific feedback from certain subsets of the market.

2) **Performance Metrics:**
There is not a single performance metric universally identified as the most important by rental housing developers. Most track a number of metrics for internal and reporting purposes. Although development yield and cash on cash were most identified as important, a broad set of metrics is typically considered.

3) **The role of ESG:**
While ESG often plays a fundamental role for well capitalized institutional investors and REITs, smaller players will struggle to meet meaningful ESG objectives. Rental housing developers are yet to see ESG as standard practice across all developments like you might see in the Class A office space.

4) **CMHC continues to have an important role in the industry:**
The market continues to view CMHC as playing an important role in delivering rental housing in Canada. The largest barriers to development noted were typically outside of CMHC's core mandate but the industry is hopeful CMHC can play a role in unlocking opportunities and removing barriers that persist.

References

[1] Source: DealPath, 2022

[2] Source: Reliant, 2022

[3] Source: eFinancialModels, 2022

[4] Source: ProfitCo, 2022

[5] Altus Group, *The impact of rising interest rates on Commercial Real Estate*. (August 2022)

[6] Numerous sources include Canadian Rental Housing Providers for Affordable Housing, CMHC, the City of Toronto, British Columbia's Expert Panel on Housing Supply and Affordability, Scotiabank and other EY research.

[7] Sourced from Scotiabank & Statistics Canada

[8] Sourced from Scotiabank & Statistics Canada

[9] Sourced from Scotiabank & Statistics Canada

[10] Sourced with data from CMHC & Statistics Canada

[11] Sourced with data from CMHC & Statistics Canada

[12] Sourced from the Canadian Encyclopedia, the Tyee, and CMHC

[13] Sourced with data from CMHC & Statistics Canada

[14] CHMC Housing Supply Report

[15] Sourced from GVBOT, TBOT

[16] Altus Group, *The impact of rising interest rates on Commercial Real Estate*. (August 2022)

Industry survey included responses from 27 rental housing developers.

[17] Source: EY CMHC 2023 Rental Survey Data

[18] Urbanation, *Purpose-Built Rental White Paper*. (February 2023)

[19] Market standard assumptions include a typical 75%/25% debt-to-equity and a prime rate of 6.0%.

[20] Source: City of Calgary

[21] EY research from a variety of sources including CoStar, Real Estate News Exchange, Altus Group

[22] SHARE, *Investors for Affordable Housing.* (October 2021)

[23] SHARE, *Investors for Affordable Housing.* (October 2021)

[24] Sourced from the 2023 EY CMHC Canadian Rental Housing Survey Results

[25] Sourced with data from CMCH & Statistics Canada

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