



THE GLOBE AND MAIL\*

## Rental rush: pension funds flock to apartment buildings

October 11, 2017



After the financial crisis battered the U.S. economy in 2008 and 2009, the real estate investing team at Quebec's public-sector pension manager noticed an interesting trend in its portfolio of holdings.

The Caisse de dépôt et placement du Québec owned a group of apartment buildings in New York, the epicentre of the global financial meltdown. Yet, despite that proximity to chaos, demand in the buildings was virtually unchanged, even as companies cut office space and consumers curtailed trips to malls.

"We found out that our investments were very resilient," says Sylvain Fortier, who heads residential investment at Ivanhoé Cambridge, the Caisse's real estate investing arm.

"We felt like our overall occupancy of our buildings remained about the same, the rents stayed about the same."

A review of that experience helped to persuade the pension plan to launch a new apartment strategy in 2011 to capitalize on low-risk returns where rental supply is tight. Six years and a spate of deals later, Ivanhoé owns more than 40,000 apartment units worth about \$12-billion, accounting for about 20 per cent of its total real estate holdings.

After spending two decades acquiring many of Canada's largest malls and office towers, many other major pension funds and insurers are also turning their formidable buying power toward the old-school world of rental apartment buildings.

Such institutions are searching for alternatives to diversify and reduce their exposure to retail

malls, which face an uncertain future as online shopping bites into store traffic.

But interest has also climbed in response to high demand for apartment rentals, which is outstripping supply in some major cities across North America, sending rents soaring and creating almost bullet-proof investments for risk-averse pension plans.

"There's always demand for housing," said Tyler Seaman, who heads the multifamily residential group at Oxford Properties Group Inc., the real estate arm of the Ontario Municipal Employees Retirement System.

"Your risk in a 300-unit building is spread over 300 residents, versus a couple of tenants in a commercial development."

Oxford has built a 9,000-unit apartment portfolio over the past 10 years through holdings in Ontario, Quebec and Atlantic Canada – about half in the Greater Toronto Area.

"It is absolutely an asset class we want to grow," Mr. Seaman says, forecasting the holdings will double over the next 10 years.

Canada has received comparatively less of the investment in apartment buying, however.

Many big institutions are focused primarily on U.S. markets and cities in Europe because Canada's biggest cities do not have enough to buy that fits their demand, says Tony Manganiello, a broker at Cushman and Wakefield in Toronto who helps clients buy and sell apartments.

Mr. Manganiello says his institutional clients are disciplined shoppers who want large buildings near transit hubs that can attract high rents that provide a high rate of return on their investment. To make the math work, most want higher-end tenants who will pay more rent, he says.

"A lot of these institutions are looking for that institutional-grade product and it's just not there," he says.

Insurer Manulife Financial Corp. has major plans for U.S. growth, boosting its apartment holdings over the past five years by acquiring buildings in eight core U.S. markets.

Ted Willcocks, Manulife's head of real estate asset management, says Canada has far fewer buying options than the United States, where his team sees an average of about 10 new buildings offered for sale every day. And compared to Canada, U.S. properties are typically newer and have more amenities such as pools and exercise facilities.

"The U.S. market is so large and so diverse and so broad," he says. "It allows you to quickly scale up and ramp up. It's very difficult to acquire multifamily [residential properties] in Canada."

Institutional investors are also disciplined buyers and soaring prices in the Toronto and Vancouver markets – tracking housing market booms in both cities – have become a deterrent to investment.

Prices in Toronto have climbed 60 per cent over the past five years, according to CBRE Canada, with apartment buildings selling for an average of \$204,738 a unit in the first half of 2017, compared with \$127,172 a unit in 2012. Prices are even higher in Vancouver, climbing to a peak of \$282,848 a unit in 2016.

Concert Real Estate Corp., a developer owned by 19 Canadian pension plans, is growing

apartment assets aggressively, but believes it has become cheaper to build new apartments in markets such as Toronto than to buy at current prices.

Concert chief executive Brian McCauley says new construction can be more energy-efficient, sustainable and will not need major retrofits for decades. Concert has developed 5,000 units in British Columbia and Ontario, and plans to add another 3,000 over the next five or six years – as soon as it can get them built and on the market.

"We're very bullish on continuing to grow our presence in rental residential, for sure," he says.

The cloud on the horizon is a new rent-control rule the Ontario government announced in April that will limit owners to increases at about the rate of inflation, currently less than 2 per cent annually.

Some major developers have already announced they will convert planned apartment projects into condominiums. But as long-term investors, pension funds do not shift their plans on a dime, says Daniel Argiros, CEO of Conundrum Capital, which buys and manages apartment buildings in Toronto, creating apartment funds for institutional investors.

He believes institutions will not quickly abandon apartments because rents can still go up when tenants leave, allowing slow increases across a large portfolio. But, he says investment could slow if more regulatory change continues the "death by a thousand cuts."

One problem that giant pension funds have in the apartment sector is quickly building a large enough portfolio of buildings to create a meaningful investment.

To get the billions of dollars needed, the Caisse has grown through partnerships with large partners, says Mr. Fortier at Ivanhoé.

In 2015, for example, the Caisse teamed up with U.S. private-equity giant Blackstone Group LP to buy Stuyvesant Town-Peter Cooper Village, an apartment development in New York, for \$5.3-billion (U.S.).

The collection of 55 red-brick buildings, housing 25,000 residents, allowed the Caisse to buy the equivalent of a small town in a single deal.

Mr. Fortier says he is not done yet. He plans to invest long-term in the sector, hoping to ride a wave of changing attitudes in North America about home ownership. More people in major urban centres are renting by choice and the Caisse wants to capture that demographic shift.

"There is a demand for rental apartments globally in major cities and there is an acceptance that it's okay to rent, you don't have to own a bungalow in the suburbs with two cars and a dog," he says.