

Figure 1

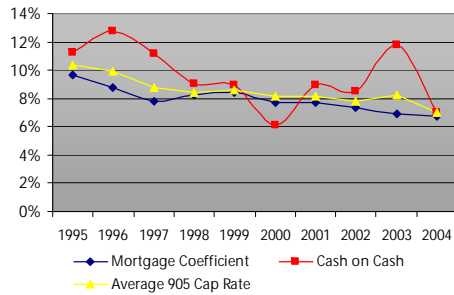


Figure 2

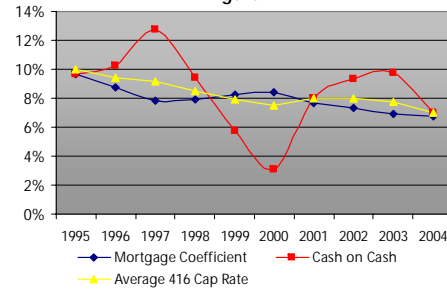


Figure 3

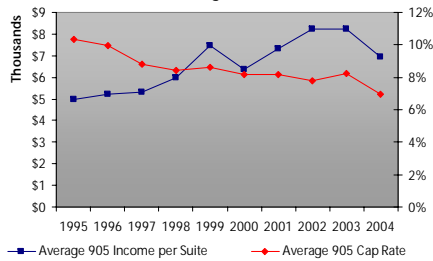


Figure 4

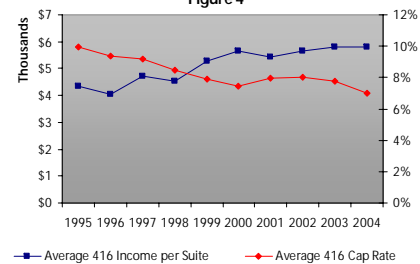


Figure 5

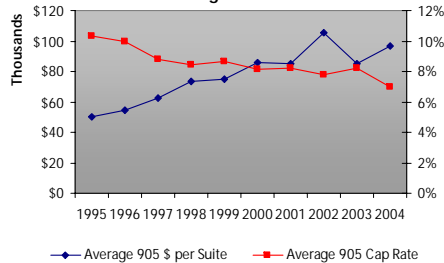


Figure 6

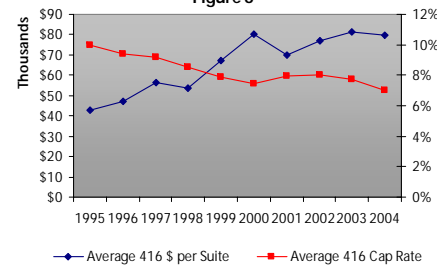


Figure 7

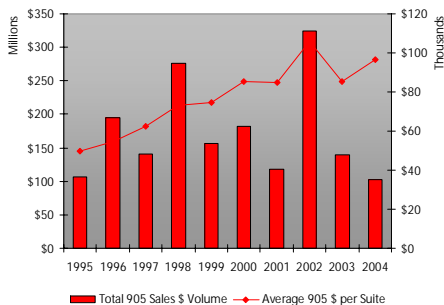
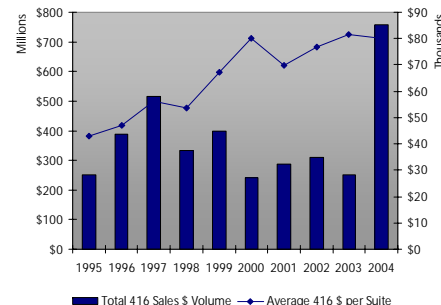


Figure 8



2004 Returns in the Multi-Unit Rental Apartment Sector Reflect Renewed Optimism

In our Report Volume #10.10 (20/10/2004), we showed that cash-on-cash returns had been steadily increasing from 2000 to 2003 in the GTA multi-unit rental sector. Cash-on-cash returns grew from 6.2% to 11.8% in the 905 area, and grew from 3.1% to 9.7% in the 416 area (see Figures 1 and 2). These findings testified to a softening of expectations. Steadily deteriorating rental fundamentals in vacancy rates and income levels were only masked by a favourable debt financing market.

However, we see that cash-on-cash returns in 2004 have returned to 7.0% in both the 905 and the 416 areas. This reversal attests to a renewed optimism regarding future financial prospects in this asset class. This optimism is confirmed by declining cap rates now standing at an average of 7.0% in both the 905 and the 416 areas, which is the lowest level for the entire scope of our analysis dating back to 1995 (see Figures 3 and 4).

Income per suite declined substantially in the 905 area from \$8,226 in 2003 to \$6,922 in 2004 and it remained relatively stable at \$5,788 in 2004 in the 416 market (see Figures 3 and 4). The accelerated decline in cap rates in the 905 area resulted in a higher average price per suite of \$96,460 in 2004, a rapid jump from the \$85,426 level in 2003. Price per suite remained relatively constant in the 416 area at \$79,924 (see Figures 5 and 6).

A more foreboding signal is that sales volumes for 2004 were very low. The \$103 million sales volume in 2004 in the 905 area is the lowest in our 10 year analysis. Similarly, when we extract the single \$605 million portfolio Q1 sale from the results, the 416 area's net 2004 volume is also the lowest of the 10 year analysis. A lower volume of sales indicates a gap between vendor's and purchaser's expectations.

Conclusion

Investment real estate, including the multi-unit apartment sector, is one of the few investment classes permitting the use of positive financial leverage, benefiting from a low interest rate environment. However, look for sign posts indicating future potential market corrections. Rising expected cash-on-cash returns is one signal and the other is lower volumes of sales. A lower volume of sales combined with volatile cash-on-cash returns might be a precursor of a forthcoming correction. I'll let you know!