avenueliving
asset management

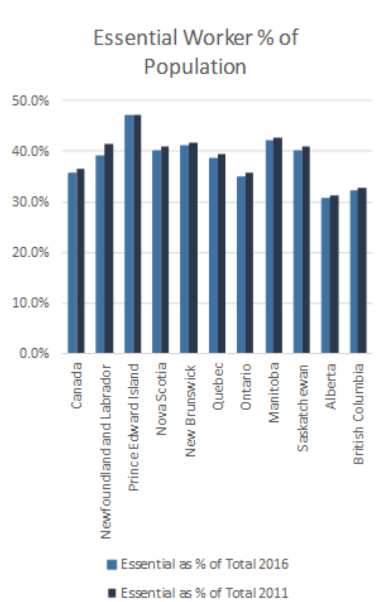
Avenue Living Explained: The Case for Workforce Housing

Avenue Living Asset Management is Western Canada's fastest growing private multifamily building owner and operator with 8,000+ units in Alberta (AB), Saskatchewan (SK), and Manitoba (MB). We have strategically positioned ourselves to be the premier owner/operator of B and C Class buildings, which caters to a niche market within the multifamily universe called Workforce Housing.

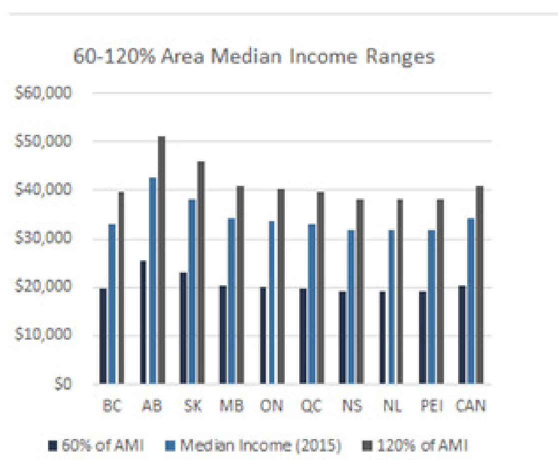
Workforce Housing is a term that has been adopted in the U.S. and is gaining traction here in Canada. The term originated from the concept of providing affordable housing in resort/ski communities where disparity in wages and the cost of purchasing/renting homes in town prevented workers from being able to afford living in town. Not to be confused with affordable housing, Workforce Housing caters to a city's "essential workers" who are overqualified for affordable housing yet may not be able to afford average market-rate homes, whether for rent or purchase.

MARKET SIZE

Essential workers are the backbone of every city. These are teachers, nurses, and city employees such as police, fire, and paramedics, farmers, and manufacturers, who make between ~60%-120% of area median incomes ("AMI"). With the economic turmoil in both Canada and the U.S. over the past decade, expenses for necessities have been rising, yet take-home pay remains stagnant compared to inflation.



According to Statistics Canada, the 2015 Canadian median income was $34,200 which equates to an essential worker AMI range of roughly $20,500 to $41,045. The average size of the Workforce Housing market (those employed in the "essential worker" segments identified above) averages 38.6% in the provinces across Canada. This is a significant portion of the population whose wages may not keep up with inflation and expenses, but will receive no housing assistance.



Source: Statistics Canada

At Avenue Living, we have strategically aligned our multifamily assets to cater to this niche market. We focus on this subset of the population as their jobs are essential to cities and not likely to be replaced or become obsolete. They make up a significant portion of the population, and with changes to factors affecting home ownership affordability, we see stable to increased demand for our B and C Class units, from this segment.

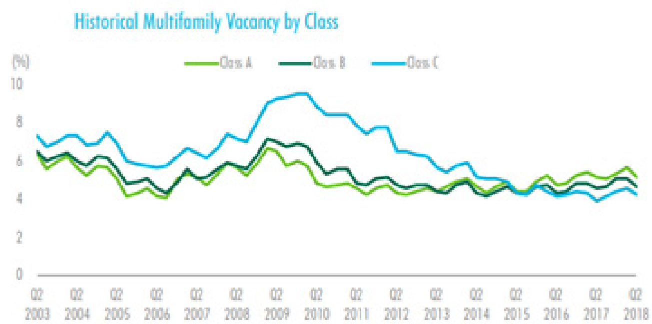
DEFINING THE ASSET CLASS

The multifamily asset is a type of residential structure with more than one dwelling residence in the same building. Each building is classified from Class A to Class C:

- *Class A: Generally, a core asset, newly constructed or fully renovated with high-end finishes and fixtures, popular location, and a full spectrum of amenities.*
- *Class B: Positioned somewhat lower than Class A; older in age, limited amenities, possible deferred maintenance, basic fixtures and finishes.*
- *Class C: Older in age compared to Class B with original/outdated/low end finishes and fixtures, deferred maintenance and/or substandard management.*

WORKFORCE HOUSING IN THE U.S.

The concept of Workforce Housing in the U.S. is well defined with numerous publications highlighting the recent superior performance of the B and C multifamily asset classes. CBRE recently reported that traditional market performance indicators (rent growth and vacancy) demonstrate that Workforce Housing assets have performed better than higher-end multifamily housing assets for the past three years. During the '08 financial crisis, Class A responded better due to the financial capabilities of renters in this class. However, Workforce Housing is expected to increase resilience during the next downturn compared to prior cycles, as current market dynamics offer fewer choices for residents of Class B and C multifamily housing, thereby mitigating some of the downside risk. We highlight the change in U.S. Occupancy rates from Q4/09 to Q2/18, in which Class B and C assets have improved occupancy significantly.



Source: CBRE

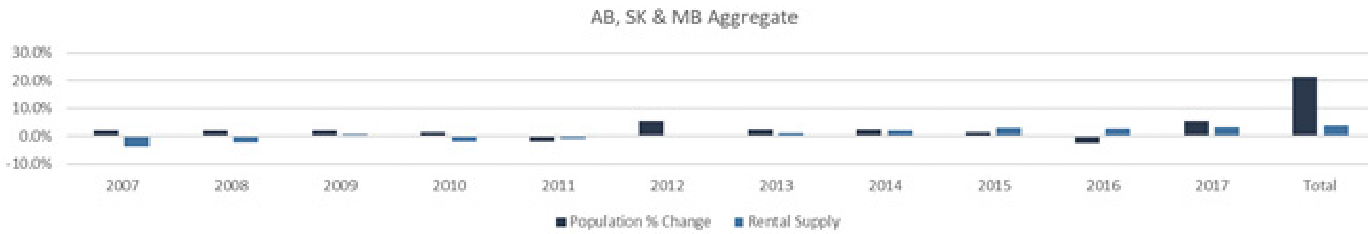
Asset Class	Q4/09 Occupancy	Q2/18 Occupancy	%Change
A	93.1%	94.8%	120 bps
B	92.6%	95.4%	270 bps
C	90.8%	95.9%	510 bps

Source: RealPage Inc.

CANADIAN PRAIRIE PROVINCES POPULATION OUTPACING RENTAL SUPPLY

The Western Canadian provinces, notably AB and SK, have been hit hard the past few years due to the downturn in Canadian energy. Since 2012, our markets have seen population growth outpacing rental supply, with 2014-2016 being the exception. This was mainly due to AB and SK's oil and gas labour force exiting the provinces in search of new opportunities. As of last year, the trend reversed with year over year improvements from the oil patch, creating new jobs and spurring economic activity in other sectors, new workers were attracted, and population growth outpaced the rental supply which we break out below.

According to the 2016 Canadian Census, AB, SK, and MB, were the second, third and fifth, fastest growing provinces by population, respectively. Furthermore, AB's population is forecast to grow by 20% by 2035, SK anticipates its growth will climb 11%, and MB at 18%. Assuming the percent of those employed in "essential worker" industries remains roughly the same (38%), we expect to see continued demand for Workforce Housing units going forward. We believe our pricing strategy combined with more essential workers from expected population growth, will create favourable supply/demand fundamentals in the B and C asset classes, which should lead to steadily increasing rents across our markets.



CANADIAN WORKFORCE HOUSING RENTAL THRESHOLDS

CMHC defines the generally accepted threshold of affordability to be 30% of gross income spent on rent. According to the Canadian Rental Housing Index's 2018 report, 40% of Canadians spend more than 30%, while 18% spend more than 50% - putting them in a "crisis of affordability." With the Workforce Housing demographic representing 60-120% of AMI and utilizing a target gross income to rent ratio of 30%, we can define the rent ranges which we believe this population subset would target.

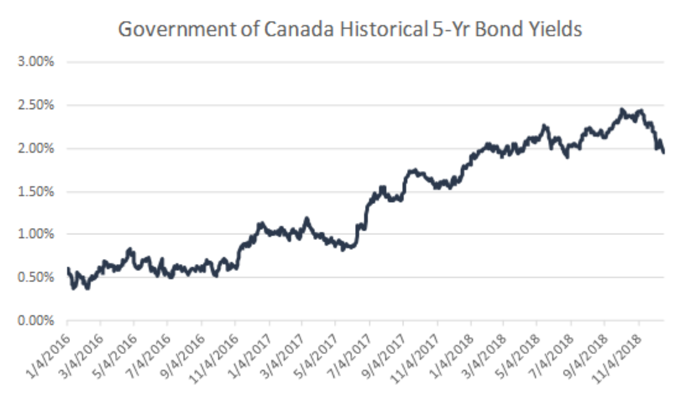
Using Alberta's 60% AMI ($25,600/yr.) and 120% AMI ($51,300/yr.) and applying 30% on rent implies a floor price of $641/mo. and a ceiling of $1,282/mo. SK ranges from $574/mo. to $1,149/mo. and MB (Winnipeg) has a floor and ceiling price of $513/mo. and $1,026/mo., respectively. This compares to Avenue Living's average asking market rents in these provinces which falls within the spectrum of the Workforce Housing rental ranges.

Province	AMI	Floor	Median	Ceiling
AB	$42,717	$641	$1,068	$1,282
SK	$38,299	$574	$957	$1,149
MB	$34,188	$513	$855	$1,026
Canada	$34,204	$513	$855	$1,026

MACRO EVENTS CREATING "RENTERS BY NECESSITY"

The Canadian homeownership landscape has changed significantly in the past few years. New Canadian regulations meant to reduce mortgage portfolio risk, now require prospective homebuyers to commit at least 10% of the down payment (previously 5%). Furthermore, lenders now must stress-test their loans adding two percentage points to applicants' current mortgages to assess whether they could continue to meet their mortgage obligations. CBC news reported that based on data from 11,500 mortgage brokers, lenders, and insurers, the group estimates that "18% of mortgage borrowers who are stress tested, would fail the current test." Based on ~700,000 homes being sold every year in Canada, most of them involving a mortgage, that means up to ~100,000 buyers would fail the new stress test, excluding them from current homeownership. Further compounding these new requirements are the BoC's increases to its current benchmark interest rates. As of October 2018, rates increased to 1.75%, the highest it's been in almost a decade, increasing individuals' mortgages and restricting more people from homeownership. The collective implications of these external factors are resulting in more and more people turning back into the rental market, boding well for improved demand factors and rental market fundamentals.

For example, in AB the average home price according to the Canadian Real Estate Association, was $374,900 as of November 2018. Assuming a 10% down payment, five-year fixed mortgage, amortization of 25-years, an average of the top six best bank mortgage rates from Ratehub.ca of 3.58% implies a monthly payment of $1,751, well outside of AB's Workforce Housing demographic's affordability rent range of $641/mo. to $1,282/mo. If we apply the same assumptions to SK with its average home price of $283,850, the result is an average monthly payment of $1,335, again outside SK's Workforce Housing demographic's rent range of $574/mo. to $1,149/mo.



Source: Bank of Canada

Province	Average Mortgage Rate	Average Monthly Payment	Workforce Housing Rent Range*	% Short of Payment**
Alberta	3.58%	$1,751	$641-$1,282/mo.	45.12%
Saskatchewan	3.64%	$1,335	$574-$1,149/mo.	35.47%
Manitoba	3.57%	$1,311	$513-$1,026/mo.	41.30%

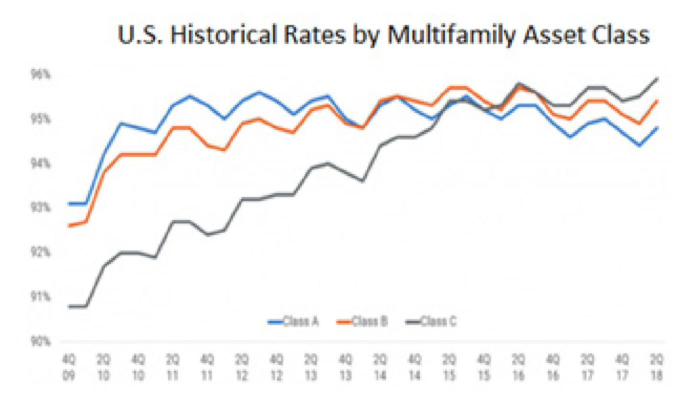
**Using 30% of 60% and 120% of AMI*

***Calculation based off the midpoint of Affordable Rent Range and Average Monthly Payment*

WRAPPING IT UP

The Canadian Workforce Housing population makes up almost 40% of provincial populations on average. A large proportion of this significant subsection of the population are likely "renters by necessity" compared to "renters by choice" as new home ownership is becoming less affordable from higher interest rates (2018) and new minimum down payment requirements (2016). The result is increased demand for the Workforce Housing asset class, as typically class A renters are less impacted by the "shocks" in mortgage rules and interest rates due to their higher incomes, while salaries earned by class B and C renters are more sensitive to these changes. In the U.S., Workforce Housing has been outperforming the multifamily asset class for several years, and it is expected to continue its performance in the near-term, based on limited new supply and higher demand from a lack of alternative housing options.

At Avenue Living we have mirrored our approach to cater to this demographic here in Canada. We see continued future population growth in our assets' geographies, implying increased demand for Workforce Housing assets, supported by a growing proportion of the population who will be pushed out of homeownership affordability. This increases the need for middle of the road affordable rental homes, namely B and C class residences, and why we believe Workforce Housing investment for value-add and stabilized assets will continue to make sense for the foreseeable future.



Source: RealPage Inc.

CONTACT US

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