2024 Residential Market Update

IZ policy review for Municipal Partners:
Kitchener, Waterloo & Cambridge

NBLC

October 2024

nblc
N. Barry Lyon Consultants Ltd.

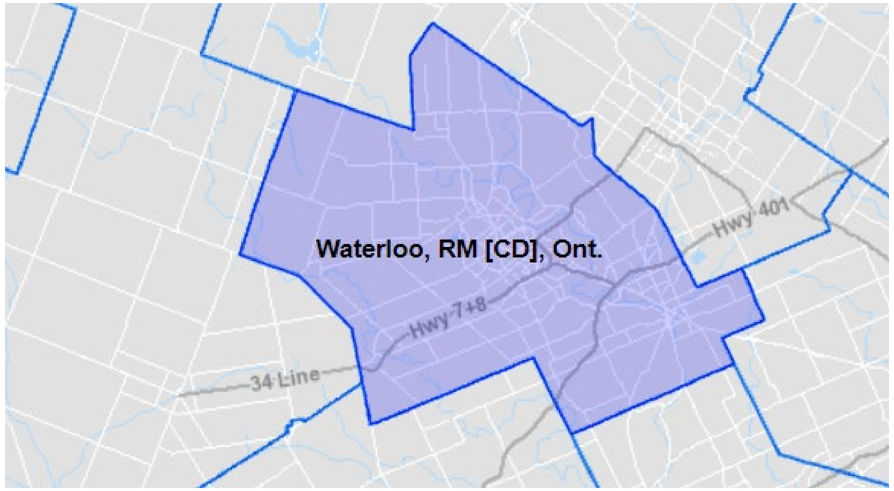
Demographic Overview
Kitchener-Waterloo-Cambridge

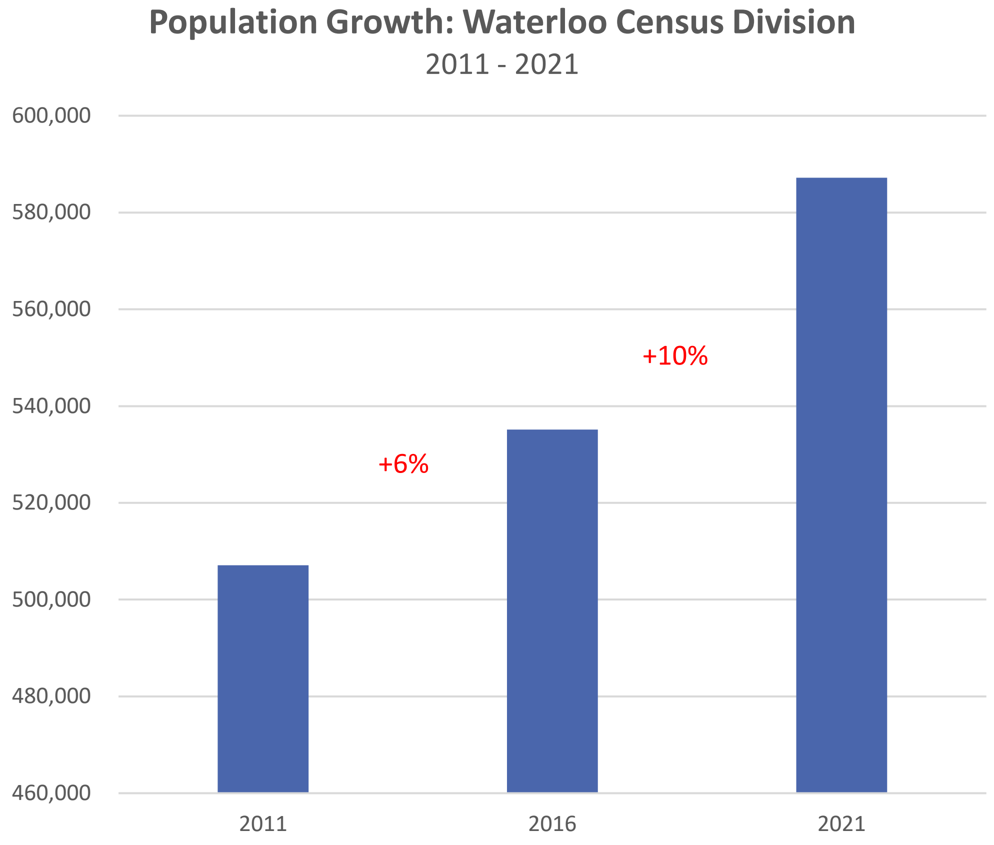
Demographics: Population Growth

Rapid Population Growth in Recent Years

Strong Population Growth Recorded: Between the 2016 and 2021 Census Period, the population of the Waterloo Census Division (CD) rose 10% (52,000+ persons), well above the 4.6% growth rate in the City of Toronto and 5.8% in Ontario.

Why? Strong tech industry, proximity to Toronto, post-secondary institutions, and immigration fuel Kitchener-Waterloo's population growth.





Data source: Statistics Canada

Demographics: Population Growth

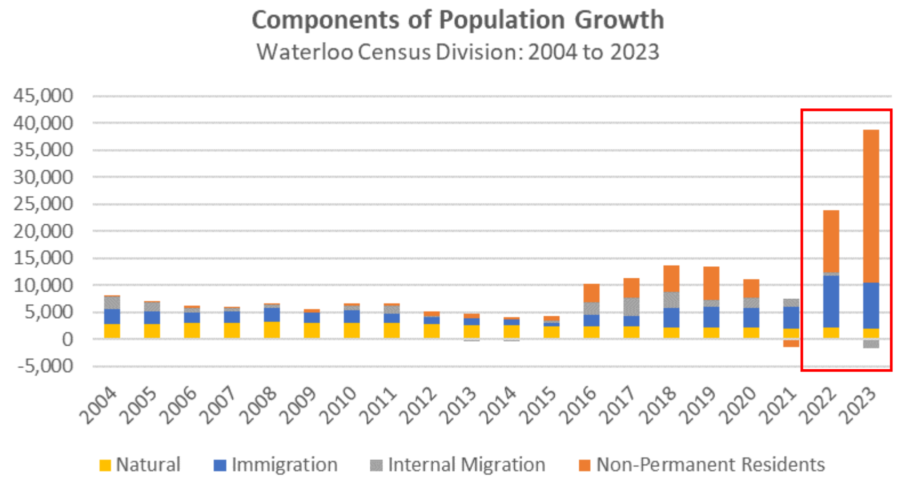
Non-Permanent Residents Driving Population Growth

Population Growth Pre-COVID: The Waterloo CD population growth before 2020 was driven by immigration, internal migration, non-permanent residents (NPRs), and natural increase. Growth was significantly higher from 2016 to 2020 compared to the previous decade.

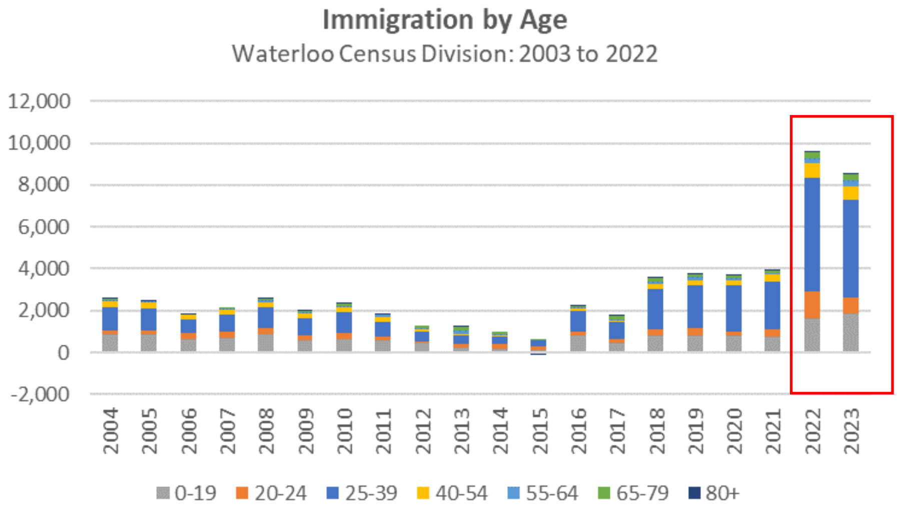
Impact of COVID-19: The pandemic caused a sharp decline in population growth in 2021, especially among non-permanent residents, largely due to the decrease in international post-secondary students.

Post-Pandemic Recovery: In 2023, the Waterloo CD saw record-high population growth, with 8,580 immigrants and 28,175 non-permanent residents, surpassing pre-COVID figures. Internal migration, however, fell below the 10-year average.

Changes to come: Notwithstanding this growth, very recent Federal announcements could have a meaningful impact on the trajectory of population growth in the near term. Canada's 2025–2027 Immigration Levels Plan is expected to result in a marginal population decline of 0.2% in both 2025 and 2026 before returning to a population growth of 0.8% in 2027.



Data source: Statistics Canada



Data source: Statistics Canada

Residential Market Overview
Kitchener-Waterloo-Cambridge

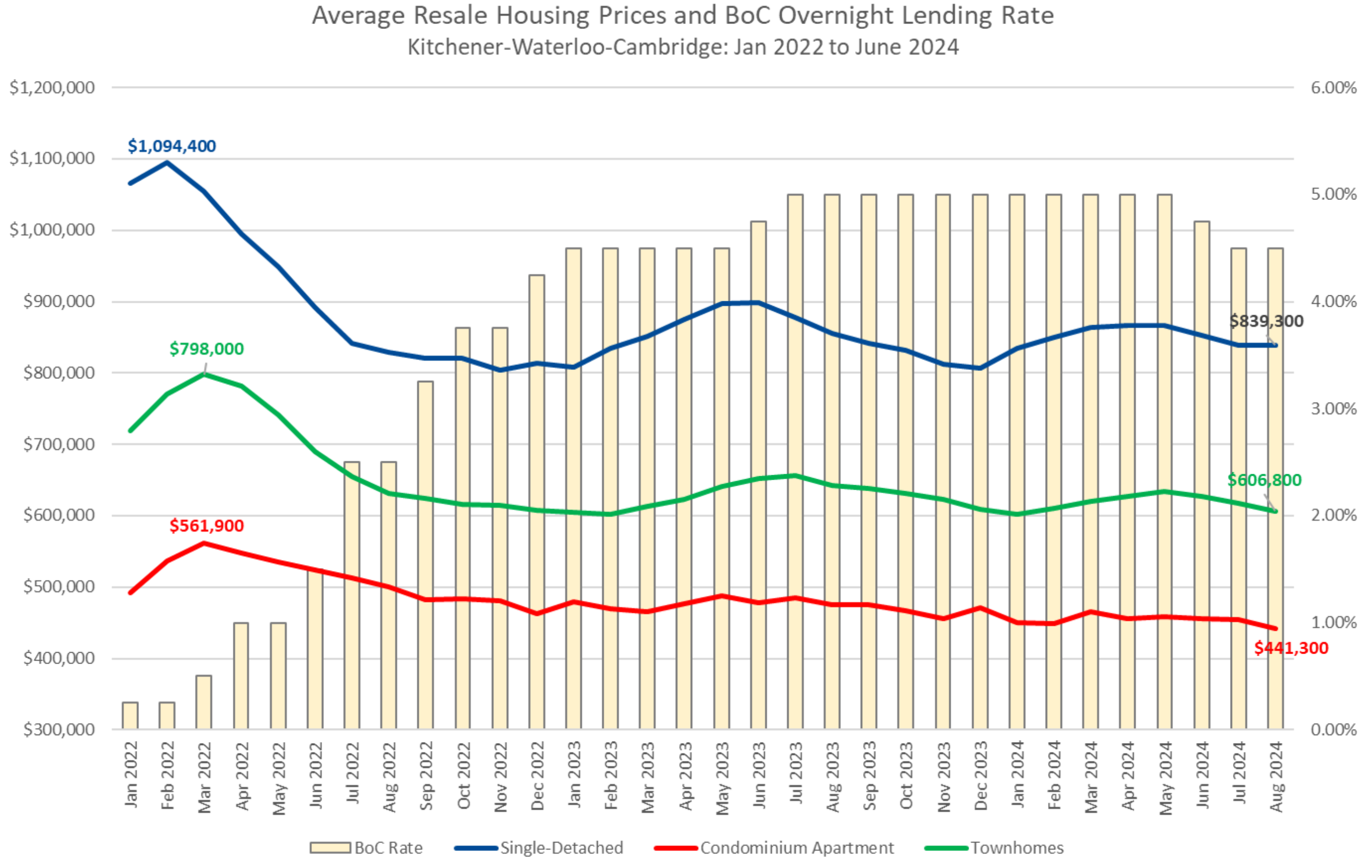
Residential Market Overview

Interest Rates Had Substantive Impact on Demand

Impact of Interest Rate Hikes: The Bank of Canada raised interest rates seven times in 2022 and three times in 2023, leading to higher borrowing costs and a decline in housing prices in KWC—single-detached homes, condos, and townhomes fell by 27-30% between early 2022 and June 2024.

Effect on New Development: Higher interest rates (borrowing costs) and weaker new sale demand has eroded feasibility of new projects.

Recent Rate Reductions: The Bank of Canada lowered the overnight rate to 4.75% in June 2024, followed by another reduction in July and again in October. However, both the new and resale market have yet to recover and the timeline for a rebound remain remains uncertain.



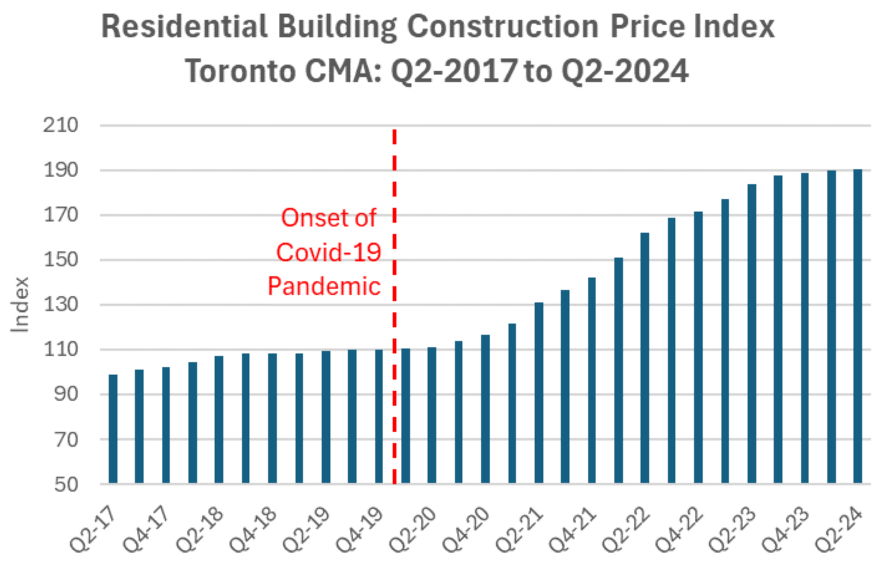
Data source: CREA, Bank of Canada

Residential Market Overview

Rising Construction Costs Across Ontario

Post-Pandemic Surge: After a period of relative stability, hard construction costs surged by 18% in 2021, 24% in 2022, and 13% in 2023, driven by supply chain disruptions, material costs, skilled labor shortages, and rising borrowing costs.

Broader Impact: Construction costs are 92% higher than in 2017, affecting housing development feasibility across Ontario, including KWC, with limited expectations for a return to pre-pandemic costs.



Data source: Statistics Canada

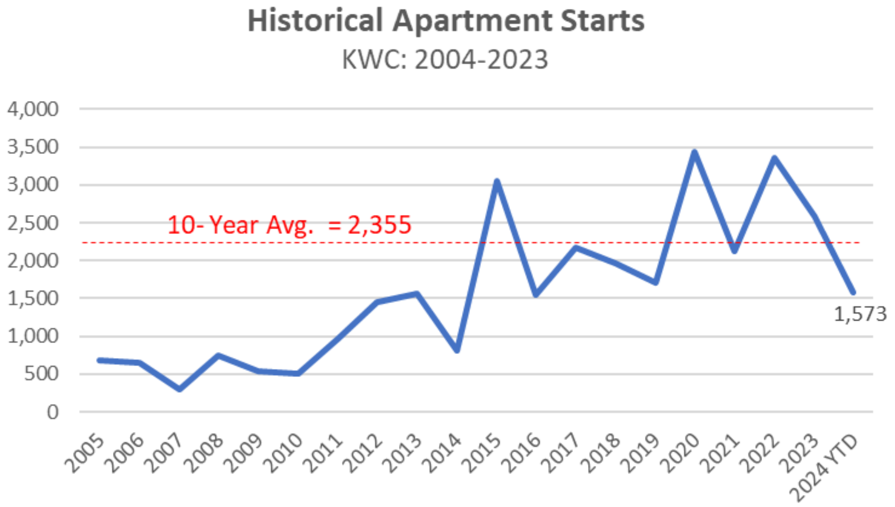
Apartment Market Context

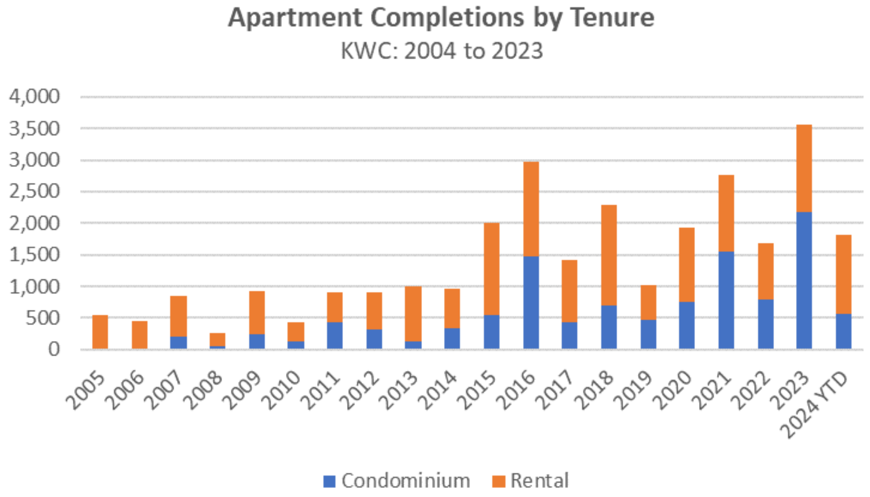
Impacts of Rising Costs and Falling Demand

As of 2023, apartment starts began to trend downwards in KWC; largely a function of suppressed demand and broader economic challenges that have eroded development feasibility.

During 2023, there was a record high level of apartment completions for both condominium and rental tenure in KWC, totaling 2,171 condo completions and 1,397 rental completions. These completions have contributed to softness in the market, adding new supply and choice to both the private rental and resale market.

As construction starts decline, completions are expected to taper off in the coming years. Combined with anticipated population growth, this will present challenges for meeting demand in future years.





Data source: CMHC

Apartment Market Overview
Kitchener-Waterloo-Cambridge

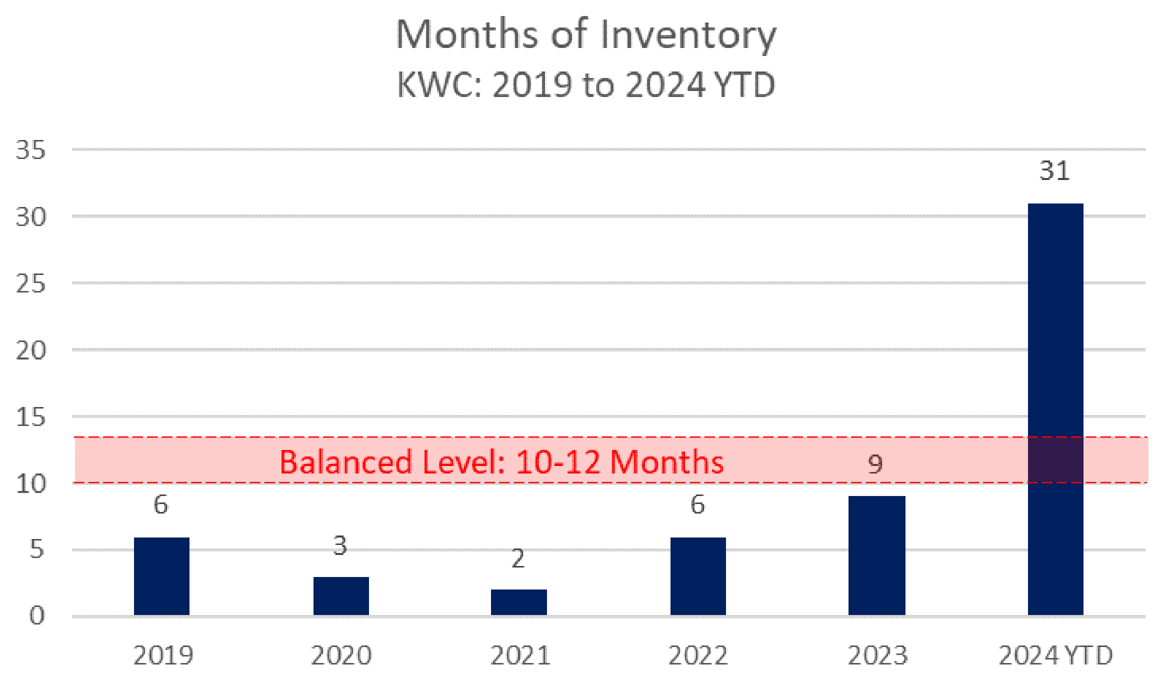
New Condominium Apartment Market

Sluggish Absorption in 2024

During the 12-month period to August 2024, the KWC market had just under 2,500 active unsold condominium units, representing 31 months of supply, about three times-higher than a balanced level of 10-12 months.

Between 2019 and 2023, the market generally had less than 10 months of unsold supply.

This significant increase in available units throughout pre-selling and recently completed projects with standing inventory highlights a major shift in market conditions.



Data source: Altus Data Studio

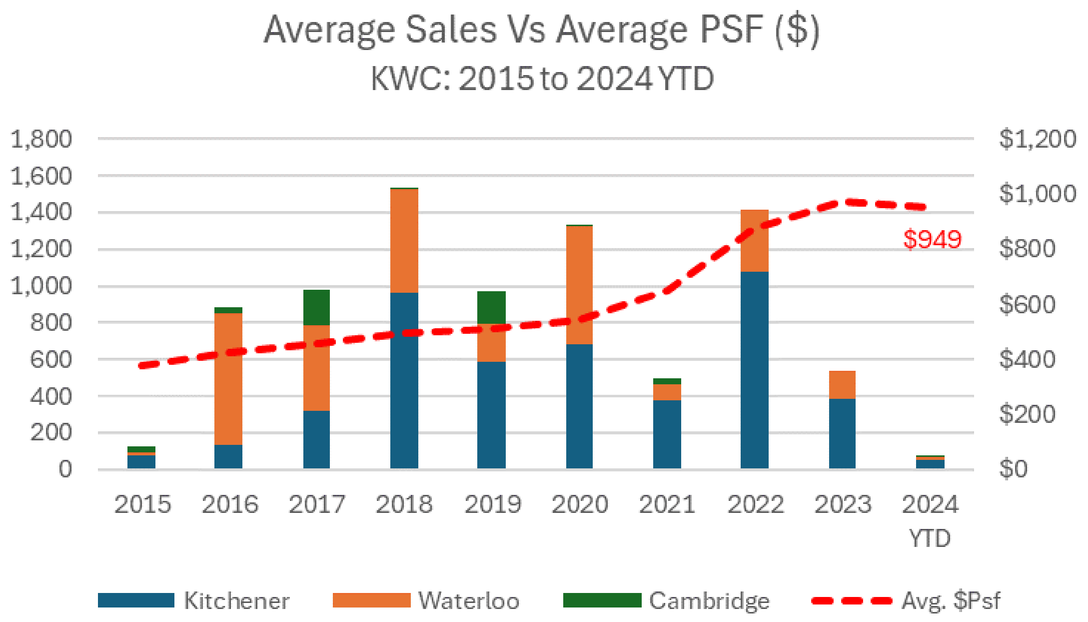
New Condominium Apartment Market

Soft Market Conditions in 2024

New condominium apartment sales in KWC have significantly declined since 2022, reflecting dampened demand and rising construction costs across the region. There were only 80 sales recorded during the first three quarters of 2024, down from 539 sales in 2023, and 1,412 in 2022.

The average price-per-square-foot (PSF) peaked in 2023, averaging $973 psf, dropping to $949 psf during 2024 YTD.

The pre-construction condominium market in KWC has been heavily reliant on investors, but rising purchase prices and carrying costs have made investment units less profitable. High purchase prices, interest rates and a glut of recent completions have put investors on the sidelines until market conditions improve.



Data source: Altus Data Studio

New Condominium Apartment Market

Spotlight on Condo Launch Activity

Despite average pricing trending upwards, there have been few new condominium project launches in 2024.

High initial pricing across 2024 project launches are not indicative of demand, as sales have been very slow. However, developers will be reluctant to adjust pricing for reasons related to financial viability and market confidence.

The prices being sought at recent launches reflect what is required from a pro forma standpoint to support a viable project. However, with 556 new units launched in 2024, only about 10% of these units have sold. This dynamic suggests that market demand is not currently available at pricing approaching $1,000 per square foot.

	2019	2022	2024 *YTD*
New Launches:	11	10	2
Total Units:	1,327	2,241	556
% Sold:	100%	93%	~10%
Initial PSF($):	$598	$931	$977

Data source: Altus Data Studio

Resale Condominium Apartment Market

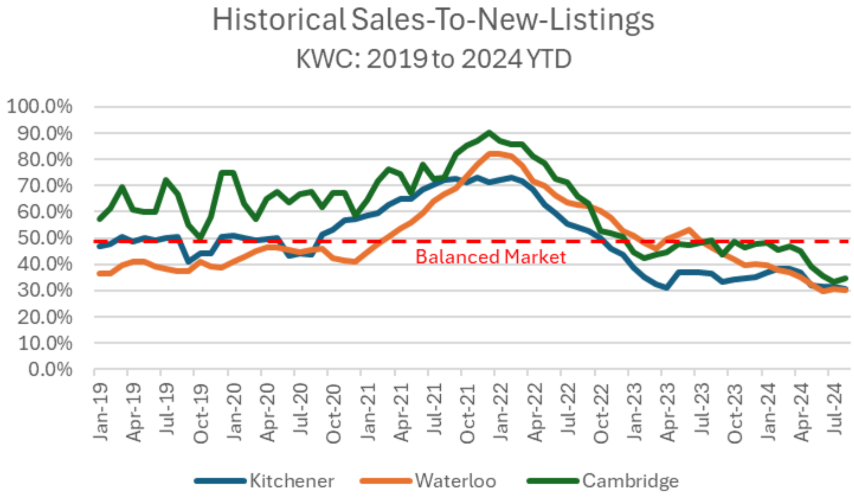
Soft Market Conditions

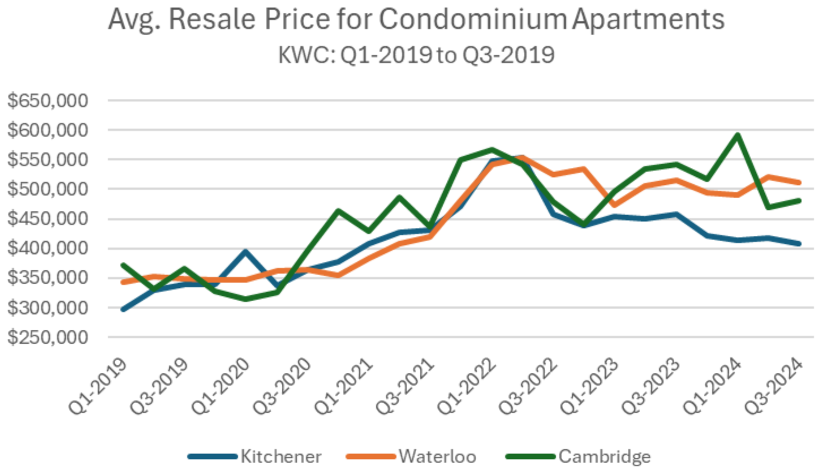
The resale apartment market in KWC peaked in early 2022, prior to monetary policy changes to curb persistent post-pandemic inflation. Following aggressive interest rate hikes, the resale market steadily declined throughout the summer of 2024.

During 2022, the average sales-to-new-listings ratio surged to 70-90%, but by July 2024, it had dropped to 30-40%, well below the balanced market threshold of 50%.

Average prices for resale apartments fell from a peak of approximately $550,000 during Q1-2022, to $467,000 during Q3-2024, representing a price decline of approximately 15%.

With a large number of recent new apartment completions and softness in the resale market, there is little incentive for prospective purchasers to consider a new pre-construction unit at pricing well above that of a recently constructed resale unit.



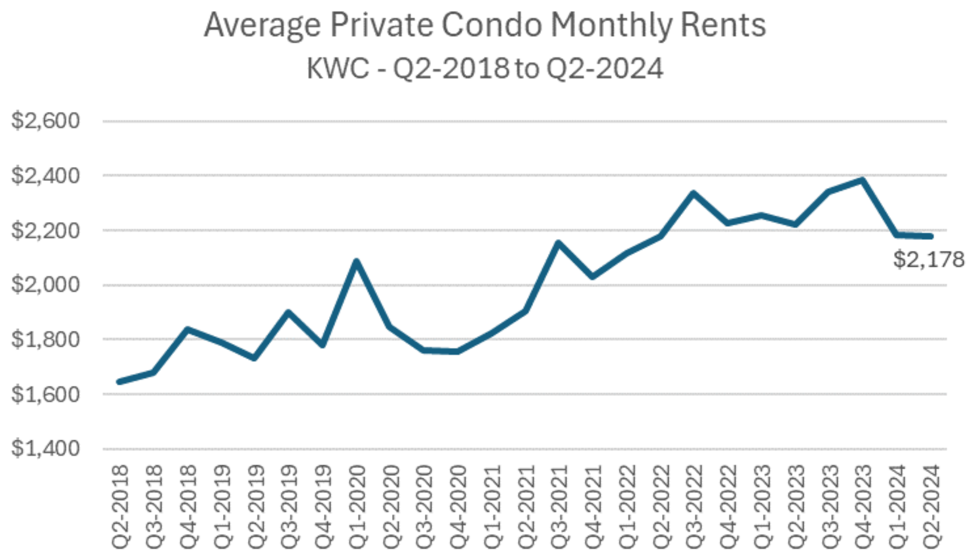


Data source: TRREB

Rental Apartment Market

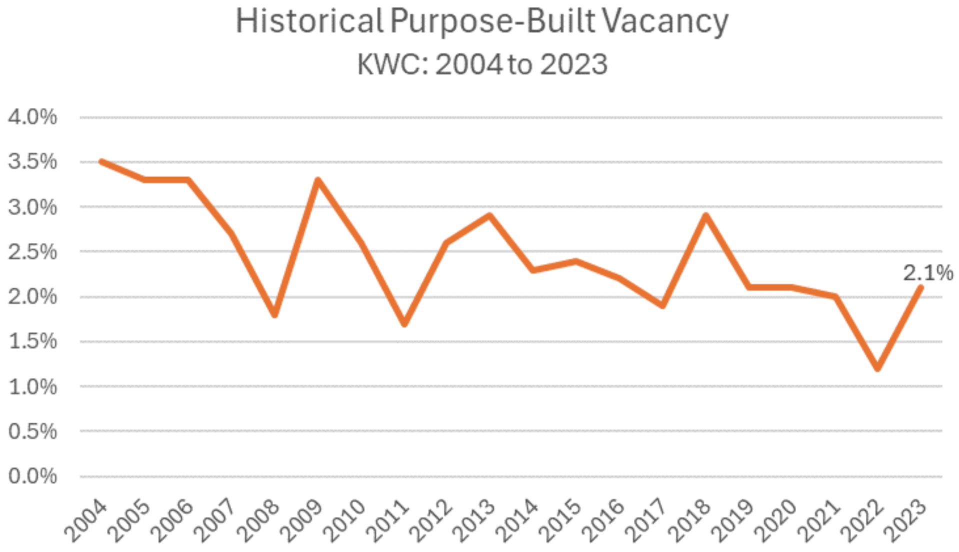
Average Rents Dampened in 2024

After hitting a peak in Q4-2023, average rents in KWC began to soften leading to Q2-2024. This softening was largely a function of record-high apartment completions during 2023 which Increased supply coupled with weakened demand due to a decline in international student permits.



Data source: CMHC

The rental market has historically remained tight, with a vacancy rate generally below a balanced level of 3-5% between 2004 and 2023.



Data source: CMHC

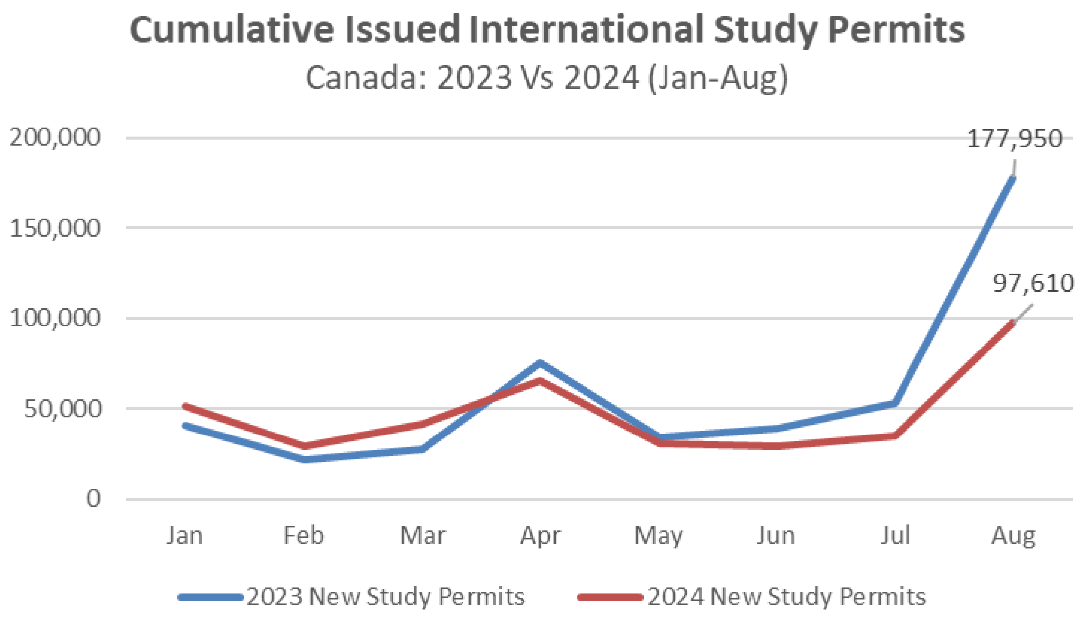
Rental Apartment Market

Recent Sharp Decline in International Study Permits

Recent data shows a significant decline in Canadian international study permits ahead of the September 2024 school year. By August 2024, total permits reached 97,610, a 45% decrease from 177,950 in the same period in 2023. This drop correlates with stricter financial requirements and government-imposed institutional capacity limits.

Effective January 1, 2024, study permit applicants were required to demonstrate they had $20,635 in funds, in addition to covering their first year of tuition and travel costs. This was an increase from the previous threshold of $10,000, which had remained unchanged since the early 2000s. The update aimed to better reflect the rising cost of living and prevent students from facing financial hardship upon arrival in Canada.

While the decline in international student permits may soften rental demand in the near term, KWC still faces tight rental market conditions. The region continues to experience population growth, low vacancy rates, and sustained demand from other tenant groups, such as young professionals and domestic students.



Data source: Statistics Canada

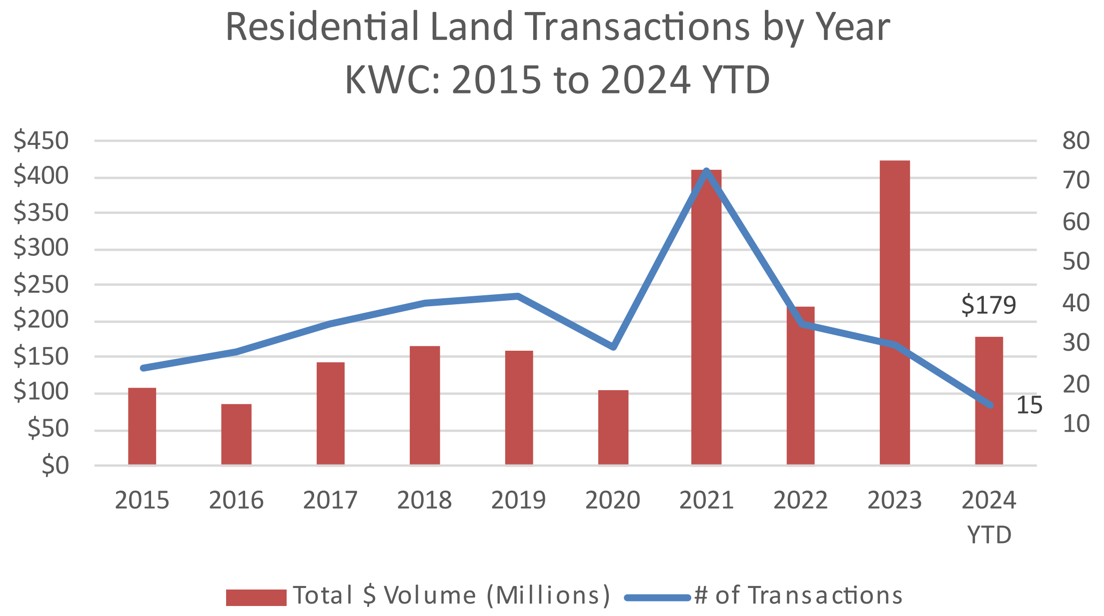
Land Transaction Activity

Residential Land Sale Activity Trending Downwards

The frequency of residential land transactions in Kitchener-Waterloo-Cambridge (KWC) peaked in 2021, with 73 transactions totaling $410 million in sales volume. Since then, market softness has led to a reduction in overall investment within the market.

A general slowing in land acquisition activity speaks to overall market confidence and availability of investment capital to place in new apartment developments. Rising costs have constrained the feasibility of most new developments, making it more difficult to acquire land at the prices that vendors would have previously commanded. From a proforma perspective, the confluence of softening demand and rising construction costs has put downward pressure on land value.

Examining transactions occurring to date throughout 2024, the largest transactions by dollar volume have occurred in suburban locations away from the ION LRT corridor where IZ policies would not be a factor in future development plans.



Data source: Altus Data Studio

Summary & IZ Implications
Kitchener-Waterloo-Cambridge

Market Summary

Challenges Affecting Today's Apartment Market

Population Growth: Kitchener-Waterloo-Cambridge (KWC) has continued to see strong population growth, largely driven by non-permanent residents. Signals indicate that this growth could slow as a result of recent Federal policy announcements related to cuts and caps to permanent and non-permanent resident targets.

Development Feasibility: Rising interest rates and a 92% increase in construction costs since 2017 have significantly reduced the feasibility of new housing projects, leading to limited new launches and building permits in 2024.

Condominium Market Trends: New condo sales are sluggish, with only 10% of units released in 2024 sold – largely attributed to compressed demand. Relative affordability and choice in the resale market has eroded the attractiveness of purchasing in a pre-construction project.

Rental Market Outlook: Although vacancy rates remain low, rental price growth has been dampened by record-high completions in 2023 and a decrease in international student visas.

Considerations for IZ Implementation

The Economic Context has Shifted

NBLC's initial IZ assessment report was completed in 2019/20, a period in which the high-density market was strengthening on a year-over-year basis and market momentum demonstrated some capacity to absorb inclusionary housing without adversely impacting market rate supply.

This 2024 review of market conditions demonstrates that across multiple key indicators, the market and economic context for investing in new high density residential development is markedly more challenging than it was five years prior.

Unless an IZ policy was coupled with offsetting measures, the policy – which at its core substitutes market revenue with a measure of affordability – would likely delay the recovery of transit-oriented sites and exacerbate current challenges in delivering market-rate housing in these areas.

At present, there is no market rationale for reclassifying submarkets along the ION corridor given the overall dearth of actively marketing projects and land transaction activity. While the timing for market recovery is unknown, broader market fundamentals do suggest that there is likely to be a return to strength, over time.

For these reasons, we would not suggest that IZ policies be abandoned altogether. It also remains critical that market participants price IZ into their investment decisions.

Considerations for IZ Implementation

Reframing a Policy Response

A range of policy choices remain available to reframe IZ policies within the current economic environment. Generally, it is our view that the timeline for IZ's implementation should be extended until favorable market dynamics return to the region, unless offsetting measures are introduced in the near term to allow for improved project performance.

Given current market fundamentals, the granting of additional density will not be a powerful offset in the short term. We also understand the Partners have eliminated parking minimums and taken strong steps to improve development approval timelines. Offsetting measures would therefore require some form of financial incentive to offset the impact of providing affordable housing until market feasibility improves.

As the Partners look to reframe IZ policies and update supporting technical work, key high-density market indicators to monitor as part of policy planning include, among others:

- New pre-sales / pre-leasing activity
- Absorption rates and pricing
- Interest rates
- Construction costs

In monitoring market variables, it is important to note that these dynamics are interrelated. For instance, falling interest rates alone may not trigger a market rebound if hard construction costs remain elevated and population growth stagnates.

In general terms, we would look to see signals of returned market strength and viability throughout new market-rate projects in order to suggest that there might also be capacity to include below-market units.

After all, without economically viable market-rate developments, affordable units cannot not be delivered via an IZ policy.

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