



# CURE



## About the Center

The Centre for Urban Research and Education (CURE) is a multi-disciplinary network of researchers, primarily from Carleton University, who share an interest and commitment to strengthening municipal and urban affairs. With diverse experience, expertise and perspectives, the CURE network carries out collaborative research in areas including community governance, citizen engagement and local capacity building around planning for infrastructure to support social, economic, and environmental sustainability.

## Vision and Goals

We are committed to strengthening governance, policy making, and management in urban areas through collaborative research, community engagement, and education.

## Exploring how the COVID-19 Pandemic may impact Ottawa's rental housing market

By Steve Pomeroy, Senior Research Fellow

In this brief I argue that recent tight rental market conditions in Ottawa will be reversed, with a period of weak rental demand creating some breathing room for the rental sector. This may create some challenges, especially for small investors with only one or two properties, as well as those relying on revenues from short-term rentals (like Airbnb) to cover their mortgage costs.

Ottawa has three large post-secondary institutions and a large student population approaching 100,000 creating substantial rental demand. With universities providing primarily on-line course delivery, at least through the winter term, there will be less incentive for out of town students to come to Ottawa, and international students, not already in country, may face travel restrictions.

It is estimated that few in-town students might reduce demand by 10,000 student households, which in a rental market totalling 111,000 units would translate to vacancy rates approaching 10% (compared to 1.8% in 2019).

In addition, weak tourism and regulatory change affecting short-term rentals will cause some of these operators to either reposition the units back to longer term rentals, or in the face of weak demand, seek to dispose of these units.

Similar weak demand may present itself in other cities, especially those with large post-secondary student populations, and effects may be more acute in smaller markets (e.g. Kingston, Peterborough).

Weak demand, coupled with a surge in new rental construction in Ottawa and significant increase in rental vacancies, will impose some caution on landlords that have tenants with accumulated arrears due to lost and reduced wages during the pandemic-imposed shut-down. This may reduce risk of eviction for some tenants with accumulated arrears, at least in the short-term.

That said it would be desirable to create some form of federal-provincial government-funded arrears relief to alleviate both landlords and tenants from difficult situations and to minimize evictions that will contribute to growing homelessness for more vulnerable tenants.

## Background

As the pandemic persists, with concern about a second wave, it has broad implications across society and the economy, notably including the housing market. This brief examines the key factors that typically influence market conditions and trends and how these have in turn been impacted by the current and persisting situation.

The fundamentals of housing markets are underpinned by total demand and capacity to pay (incomes and interest rates), coupled with the type and quantity of new housing supply, augmented by sales of existing properties. Pre-Covid (March 2020) recent trends in these fundamentals were having a notable impact on what has historically been a relatively stable housing market.

Over the past few years both rents and home prices in Ottawa have exhibited substantial rates of increase (Figure 1), among the highest in the country, which is unprecedented. And these are substantially higher than the prior five years, when increases tracked close to the rate of inflation. In 2018-19 both rents and home prices increase at four-times the rate of inflation.

### A resurgent rental market

Typically such a dramatic change in prices is related to a change in either demand or supply.

Looking first at new supply (Figure 2 presents completed homes, as these more realistically reflect impact on supply available to buy or rent) there is a small upturn in new housing construction in 2018, but a return to just above average levels (5,600) in 2019.

The more significant change, however, is the shift in type of starts, with a noticeable increase in rentals and substantial fall in condominium apartments.



Figure 1: Yr-yr change in rents and prices, Ottawa

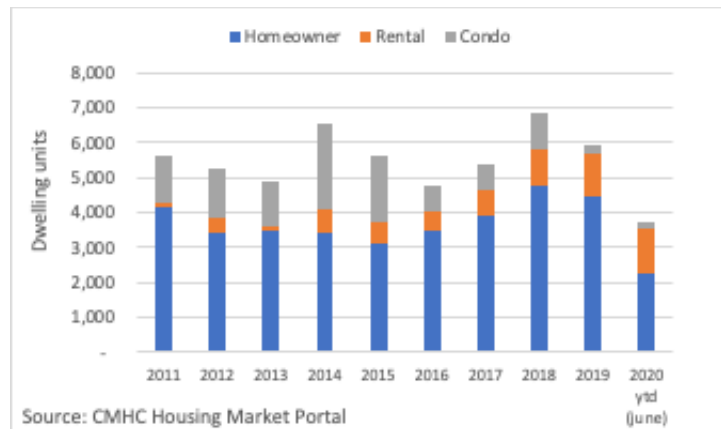


Figure 2: Annual new housing completions

After averaging fewer than 10% of all new housing between 1995-2015, rentals expanded starting in 2016, and by 2019 represented 20% of all completions, while condo apartments declined from over one-third of all new construction to only 5% in 2019. CMHC estimate that roughly 30% of condominium units are purchased by investors and indirectly become rental units, so this reduction will reduce this source of indirect supply.

The revival of rental construction has continued into 2020, with completions in only the first six months (to June) exceeding annual levels in every preceding year since the early 1990's. This volume of completions represents 35% of all new housing constructed in Ottawa. And by year end this will increase further as there remain 2,264 units under construction as of June 30<sup>th</sup>.

Perplexingly, despite this doubling of new rental construction, the vacancy rate in the primary purpose-built rental market as well for investor-condominiums that are rented (secondary market), have both fallen.

For most of the past decade, vacancies hovered near a healthy level, typically benchmarked at 3%, and this no doubt helped to moderate annual rates of rent increase until 2017, as shown in Figure 1 above.

The substantial reduction in new condo completions will have contributed to a decline in vacancies in the condo-investor part of the market, but the substantial increase in purpose built rentals has not translated into improved vacancies.

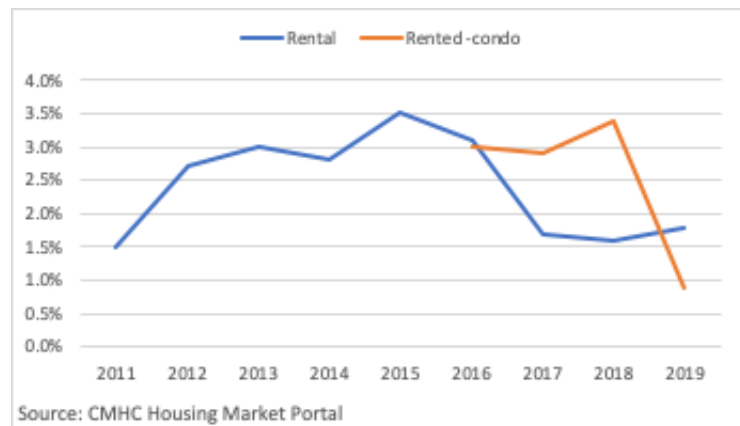


Figure 3: Rental vacancy rates, Ottawa

So why have vacancies and rents not declined?

The surge in rental construction would, in theory, add supply and help to moderate vacancies. This is however offset by two factors – expanding short-term vacation rentals and migration.

While precise data are elusive, national research suggests that substantial numbers of long term rentals (including apartments in homes and condo units) have diverted into the short-term rental Airbnb market.<sup>1</sup> Data on investor property sales in Ottawa since 2015 identify more than half of transactions are in properties with 8 or fewer units and many have been converted into STR offerings. This use is also favoured by investors in condominium units, who have purchased mainly to secure capital gains and in meantime benefit from a revenue stream to cover mortgage and condo fees.

This has reduced permanent rental stock and offset the gains from new rental construction. It has also contributed to a decline in investor condo units directed to the long-term rental market. This phenomenon is however directly impacted by both the COVID pandemic as well as recent regulatory changes on short-term rentals (Airbnb), as discussed below.

Significant increase in demand – from migration

The primary factor offsetting increased rental supply and placing pressure on both rents and home prices has been substantial population growth. This is generated by high levels of net migration to Ottawa, with a combination from other parts of Canada, other parts of Ontario as well as international (Figure 4).

There has been a very noticeable increase in international migration, for new permanent residents as well as non-permanent residents – which includes refugees (significant in 2015-16) and international students. Ottawa's universities, like those in other cities have substantially increased enrollment of foreign students as a way to increase university revenues in the face of funding constrains, and this has had significant impacts on rental demand.

<sup>1</sup> <https://www.mcgill.ca/newsroom/channels/news/airbnb-removing-rental-housing-canadian-cities-and-rural-areas-297920>

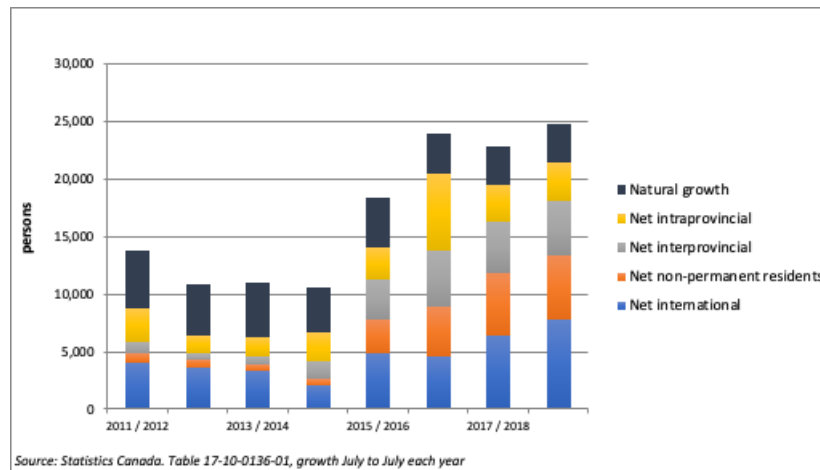


Figure 4: Ottawa net migration = new housing demand

In total, comparing 2011-15 to 2015-19 immigration from all sources has increased by 270%. This has clearly been the key determinant of demand pressure, reducing vacancies and adding demand for both rental and home purchasers.

#### Erosion of the existing stock

In addition to these supply and demand trends, the existing stock of low-rent more affordable units is contracting. Between 2011 and 2016 the number of rental units in the combined purpose-built and secondary rental market with rents below \$750 (and thus affordable to those with incomes below \$30,000) declined by 7,717 units. And against this loss, only 1,033 affordable units were added under the City delivered affordable housing programs. The lost units included many that still exist, but now rent at levels above \$750. But some have been lost through demolition, a phenomenon impacted by municipal intensification policies (most lower rent units are in older inner cities areas where intensification is focused).

This erosion can be determined using the CMHC universe of purpose built rentals in its annual survey, which provides a 100% sample. In 1990 this Ottawa universe totalled 72,465 units; over the subsequent 30 years, new rental starts totalled just over 17,000 suggesting that the universe should have grown to reach over 89,000 rental units. In fact in 2018 the universe is only 71,210, so over 18,000 rental units have been removed via demolition or conversion to condo (more frequent during the 1990's). So the low level of rental supply, combined with these losses has culminated in a net loss of rental units, despite new construction, and substantially lagging demand.

#### Offsetting effect of ownership accessibility

The rental sector was largely saved from catastrophic condition of low vacancies and pressure on rents because for much of this period access to ownership was relatively easy, abetted by strong employment and income growth and steadily declining mortgage rates. This enabled many renters to transition to ownership and create vacancies that removed rental pressure. Between 1996 and 2011 the homeownership rate in Ottawa increased from 58.2% to 67.9%. Had ownership not become more accessible and households remained renting at the rate of 58.2%, this would have left 35,600 households in the rental market. The fact that they did transition out of renting had the same effect as building 2,400 new rental units each year, completely offsetting the low rate of new rental construction over that period.

So how will these trends be impacted by COVID?

Given the fundamentals, highlighted above, the critical questions related to the COVID pandemic are how this will impact aggregate demand – driven mainly by immigration, especially in recent years international, including non-permanent residents (many of whom are students); and how will reduced work and thus incomes affect housing demand and stability.

To a large degree wage subsidy programming has at least temporarily stabilized wage loss, although the duration of this support remains uncertain. Some have had some difficulty sustaining mortgage and rent payments (nationally it is reported that 16% of mortgage holders are deferring all or a portion of monthly payments). And an unknown number of renter households are accumulating rental arrears, although in April the Canadian Federation of Apartment Associations reported that rent revenues were in aggregate reduced by 20%.

An inevitable result of reduced employment, income and migration suggests that there will be some reduced rental demand, some households will double up, and youth, facing unemployment of over 25%, may move back with parents.

The student population is a substantial cohort and has a significant impact in the rental market.

In Ottawa the two universities (Ottawa and Carleton) enroll around 75,000 students (2019-20). Algonquin College adds a further 20,000, totalling almost 100,000.

Examining addresses at registration identifies those coming from outside the Ottawa region (including over 13,000 international) and thus requiring accommodation. Some local students may also seek private rentals, but it is assumed here that these stay home and therefore have no additional local demand.

Data from Algonquin suggest that 27% of full-time enrollment comes from outside the Ottawa Region; at Carleton the ratio of non-local students is 53%. Data was not obtained from Ottawa U, but it is assumed to have a similar local/non local split. Together the universities provide just over 7,000 beds of campus housing.

Using non-local enrollment, and discounting for those able to secure a place in residence, this leaves an estimated 38,000 out-of-town students seeking accommodation in the local rental market. Often a group of students will share a house, so assuming 3 per household this translates into demand for 12,500 rental properties.

The range is likely 10,000 to 15,000 units, including purpose-build rentals as well as rented houses, and this excludes any local students that have moved out of family home into shared student houses.

Comparing this demand to the existing stock the CMHC universe of purpose built rentals is 71,000, while the remaining private secondary market (includes entire homes, apartments in houses and rented condominiums) adds a further 40,000 for a total of 111,000 rental units (excludes social housing).

With all post-secondary institutions operating with on-line course delivery, there is less incentive or need for out of town students to return to Ottawa. And international students, who account for roughly one-third of the estimated 38,000 may not be permitted to enter Canada (although many were here in March and may have remained in Canada).

If the lower estimate of 10,000 student households do not return and thus do not seek local rental accommodation this could increase the rental vacancy rate dramatically, potentially up to 9% to 14% of all rentals.

It is likely that for social reasons many students may return, but inevitably many will not, especially if

unable to earn sufficient income over the summer. Even if half of the conservatively estimated 10,000 remain away this will raise rental vacancies (which were 1.8% in Oct 2019) to well over 5%.

#### Additional factors weakening demand

In addition to weak student demand, household formation among young age cohorts (i.e. leaving family home) is directly correlated with earning capacity. As a cohort that often works in the service and hospitality sector, which is especially impacted by COVID, many have reduced or no income and thus no capacity to pay rent, and will remain in the family home, again reducing new household rental demand.

The short-term rental sector (Airbnb and other platforms) adds a further dimension, with a double impact. First new bylaws seek to regulate this sector and now prohibit use of self-contained units (apartments in houses and condo units from being used as STR). In addition travel restrictions and low tourism will also reduce demand for STR units.

Finally a recent upsurge in new rental starts is adding higher volume of new units to the market – with a record setting level of completions in the first six months of 2020 and a further 2,200 units under construction, augmenting that supply.

The result may be that owner operators may consider disposing of the property (potentially a house price effect, especially in the condo sector), or returning the units to the long term rental sector. The latter strategy will be challenging at a time of potentially increased vacancies.

This will inevitably result in a very competitive (buyers) rental market.

While the focus here is on the rental sector, housing analysts and, notably CMHC, have undertaken modelling and suggest a similar softening in ownership demand and prices. Many recent condo investors were anticipating substantial capital gains due to high levels of recent property appreciation, and those that purchased more than 2 years ago, have likely already generated these gains, at least on paper. Faced with no mortgage helper (tenant or STR demand) they may seek to dispose of property, potentially accelerating price weakness in the ownership sector, although this may also reduce some rental supply.

The critical question is how much the market will soften, and how long this weakened demand will persist. In the event a vaccine is created and administered by mid 2021, it may be a short-lived respite (although the regulatory impact on the STR sector will remain as a negative impact for investors; and a positive one for the rental sector).

#### Potential implications for arrears and evictions

One of the important features of the COVID response was a moratorium on rental eviction. As these policies and wage supplements begin to be phased out there is concern that a wave of evictions may be triggered against those that have accumulated arrears. This includes more vulnerable households, including those on fixed income and income assistance, already struggling to make their rent, and many of whom were ineligible for wage supplement as they were not working.

If indeed there is substantially weaker rental demand and a spike in vacancies this will create a disincentive to landlords to pursue eviction. Most reasonable landlords will prefer to have a tenant paying some rent, or resuming rent, albeit with arrears, over evicting to create a vacancy with limited opportunity to secure a new tenant.

Under these circumstances, prior to phasing out wage subsidy programs and lifting moratoria of evictions it would be prudent to design and implement a program of arrears relief. This may entail some cost sharing between the landlord and government, and could potentially be linked to forbearance and rescheduling of existing mortgage loans held by landlords.