Development Group

Turmoil in The Housing Market And Our Commitment to Enhance Canadian Rental Housing

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Corey Hawtin,
CEO and Executive Chairman

Welcome to **Core Development Group's** *inaugural newsletter with an introduction from Corey Hawtin, CEO and Executive Chairman of Core Development Group & Avanew Inc.*

Dear Readers,

In the wake of the volatile housing landscape in Canada, we at Core Development Group and Avanew Inc., the country's largest single-family rental management group, remain dedicated to bridging the gap between housing needs and supply.

Bridging this gap requires more than empathizing with Canadians who find themselves priced out of their homeownership dreams – it is about real actions that we are taking to continue to be solutions-based in our steadfast commitment to provide attractive rental housing that fosters vibrant communities and attainability in those same neighbourhoods where families are looking to buy.

As an update on our strategy, Avanew currently owns 550 rental housing units across Ontario. On reflection as to why the default reaction to our business plan was initially negatively perceived in the media, we must understand the state of the housing market and the factors that got us here. Our analysis of the full context of the Canadian housing market ultimately concludes that the supply of new rental housing in communities is not only a good thing *but it is a necessity.*

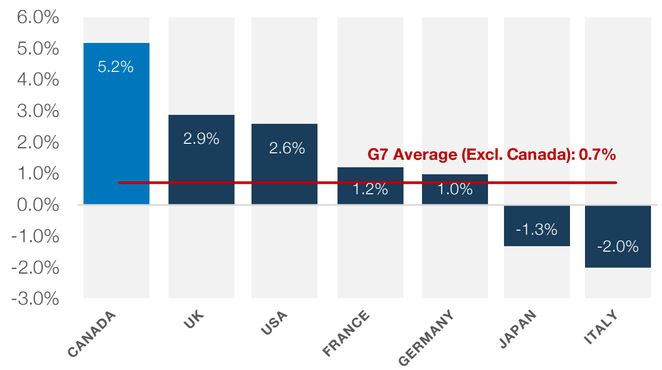
A key tenet of the classic North American dream is homeownership. However, those looking to achieve this dream face a housing quagmire with a staggering lack of affordability. Why are we in a housing crisis? Is the financialization of housing a bad thing, or a red herring that does not address the root causes of why housing affordability continues to erode? What are the impacts on Canadians and Canada's future?

In this newsletter, I will address some of these questions and intend to follow up in my next letter with others.

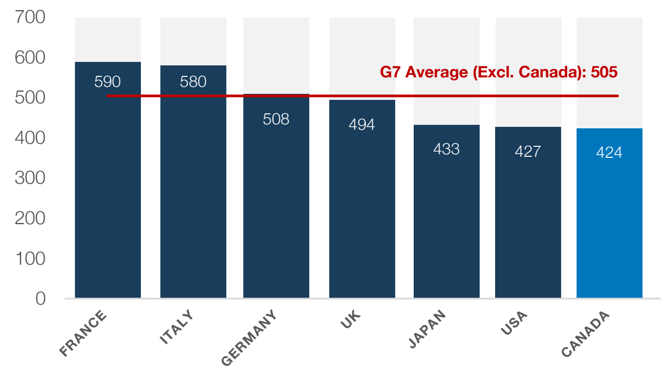
Canadian Housing Realities: The housing crisis is multi-faceted, stemming from supply constraints, population growth and inadequate policy responses, resulting in unprecedented demand for rental housing.

Understanding The Basics: How Does Canada Compare Against Other G7 Countries?

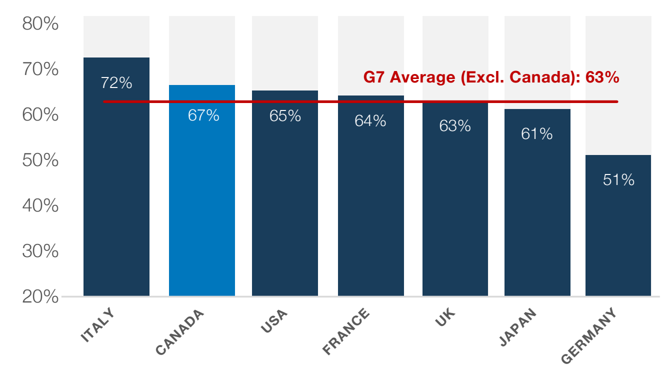
POPULATION GROWTH



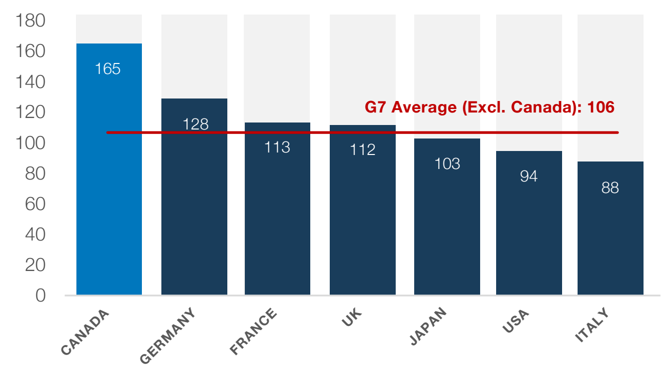
PRIVATE DWELLING PER 1,000 POPULATION



HOME OWNERSHIP RATES



HOUSE PRICE TO INCOME RATIO



Of any G7 Country, the stats for Canada are extreme. We have the **least** amount of homes per capita, and our pipeline of new housing is woefully undersupplied. With the well-identified need to construct 3.5 million new homes by 2030,[1] the reality is the Canadian housing market is nowhere close to keeping up with demand.

1. We have the **least affordable** housing market; as measured by average median income to average home price. This particularly weighs on new homebuyers, many of whom can only access the housing market with help from generational wealth.

2. We have the **highest population growth** and some of the **lowest production rates** (supply of new homes) in our market[2]. While immigration is vital to our economy, it is exacerbating our housing supply problem without corresponding public policy to spur new development to keep pace with the increase of new Canadians. Ontario alone needs 150,000 new homes per year and we are supplying less than ½ of that demand. **Simply put – the supply/demand gap is getting bigger.**

3. **We have one of the highest percentages of home ownership: on average, *67% of Canadians own a home and 33% rent***[3]. Despite headlines bemoaning the lack of access to homeownership, Canadians have one of the highest ownership rates in the G7. This is notwithstanding Canadian homes being the most unaffordable. Our "dream of homeownership" is in many ways an unachievable goal for more and more Canadians.

4. The unfortunate reality is, particularly as Canadians stretch well past the "30% rule" of household income, that not everyone can afford to own a home. This may be particularly poignant for younger homebuyers who purchased in the fervor of COVID and are now staring down a significant increase to their monthly mortgage payment.

Consider that in well-established rental markets like Vienna, Austria (pictured above), 78% of all housing stock is rental[4]. Vienna is considered a rental utopia for the partnerships that government and private and public housing play.

On the last point, it is important to understand that the biggest homeowner cohort in Canada is Baby Boomers, accounting for over 40% of all Canadian homeowners[5]. This has significant impacts on the fabric and demographics of the neighbourhoods we live in. It is no wonder that community vibrancy as it relates to young families and children is at an all-time low. The only affordable solution for those not already in the housing market is to rent or buy a condo (which offers relative affordability to detached housing).

To make matters worse, mortgage payments eat up 59% of household earnings[6], compared to the targeted 30% rule, and 25-33% of homeowners are on variable-rate mortgages. According to CREA, average home prices are up 38% from 2018 and many of Canada's **top earners would not qualify for a mortgage**[7].

To understand one of the reasons why the Canadian housing market is suffering is to consider Canadian lending policy and how it is very different from home lending in the US.

Canadian Mortgage Rates

If you are locked into a fixed mortgage rate in the US, you don't have to worry about future interest rate cycles as the term of the mortgage can match the amortization at 30 years.

In Canada, the most popular mortgage is the 5-year fixed rate, which means that every 5 years homeowners renew their mortgage at the then prevailing interest rates. Refinancing has been relatively benign over the last decade with historically low interest rates as the norm, but new borrowers today are facing mortgage rates not seen since before the 2008 financial crisis.

Many Canadian mortgages are approaching renewal, and if you bought a home in 2019 or earlier, you've been a beneficiary of a low-interest rate environment and are going to be forced to renew at a much higher interest rate. In these scenarios, depending on your mortgage balance and current rate, mortgage payments can increase by thousands of dollars per month.

Canadians in this situation may no longer be able to afford their mortgage payments and will be forced to sell their home or worse, declare bankruptcy. This event could cause Canadian wealth to erode by as much as 50% over the next couple of years.

But there is something even more concerning right now. It's a phenomenon called negative amortization. Usually, as you make mortgage payments, the principal amount you owe to the bank goes down with each payment, as those payments comprise both principal and interest. This is called amortization.

Over 20% of mortgages are now in "negative amortization"[8] – meaning the interest that's owed by the borrower *exceeds* their monthly mortgage payment and they *borrow* to cover the difference each month: increasing their mortgage balance over time. This compounding interest is working against millions of Canadians. As long as interest rates and mortgage payments remain high, the problem will compound every month, eroding billions of dollars of Canadian net worth.

If interest rates stay higher for longer, and this precipitates a wave of home sales, we could see a steep recession not unlike the 2008 financial crisis in the US.

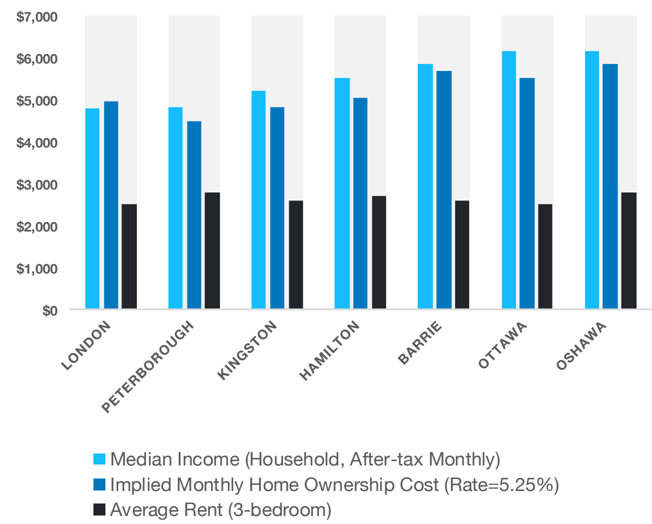
Avanew Inc. Announces the Launch of Single-Family REIT With Innovative Rental Equity Solutions Addressing Canadian Housing Challenges

Avanew believes that a stable supply of single-family rentals in neighbourhoods and a new supply of rental housing provides life and vibrancy to neighbourhoods and a viable option for renters who need or want to rent. We advocate that renters need more solutions and more housing options within the towns and cities where they want to live.

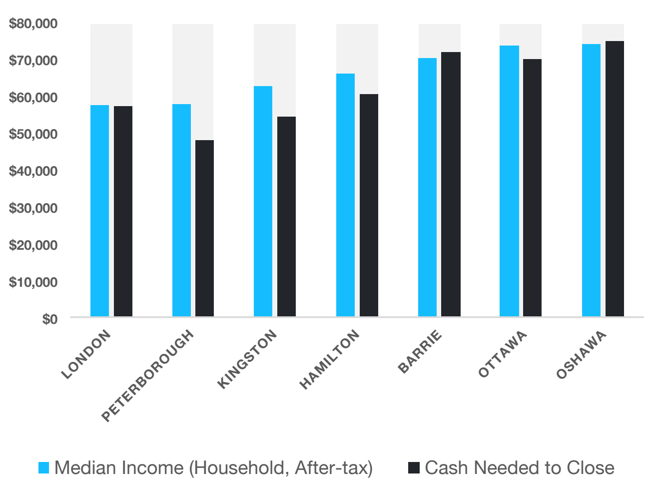
Currently, Ontario has approximately 1.2M apartment rental units and 550,000 ground-oriented rental units - a ratio of 2.2 to 1 in favour of rental apartments[9]. However, rental demand is a flipped 4:1 ratio, as ~ 80% of renters prefer a single-family home to a high-rise apartment[10,11]. When we look at the new supply of rental units ~70% are mid-rise/high-rise buildings and 30% are single-family, which further compounds the imbalance and need for more single-family rentals[12].

Avanew plans to bring an attractive solution to renters who want to live in neighbourhoods by offering 10,000 new single-family rental homes to the marketplace in the next 5 years. This alone will not address the dire need for single-family rentals in Canada, but it's certainly a big step in the right direction.

INCOMES, HOME OWNERSHIP AND RENT *(MONTHLY)*



INCOMES VS DOWNPAYMENT AND TYPICAL CLOSING COSTS



A Homeowner, Buying a Detached Home in Todays Market May Not be Feasible

When considering rent vs buy decision, there are many factors to weigh. On a monthly cash flow basis, renting is a far more economical way to achieve a low-rise lifestyle, offering lower risk and a ~50% discount over the comparable monthly costs to own detached home (rent vs mortgage payment + property tax + house insurance + upkeep costs). This does not factor in the challenge potential homeowners face of saving for a down payment and closing to purchase a home, representing tens of thousands of dollars. It also does not factor in the added benefit that renters have over homeowners to be able to generate income from their savings by forgoing a downpayment (e.g. interest from savings, dividends from investments).

Figure: Median income from CMHC, monthly homeownership costs reflect mortgage payments at a 5.25% rate, property tax, insurance, and general maintenance. Downpayment assumes 5% down on the first $500,000 and 10% thereafter, land transfer taxes and other legal costs.

Even if 5-year fixed mortgage rates declined from their current ~5.25-5.75% down to 2.5% renting would still be 20-30% less expensive than detached homeownership.

We understand the desire and dream for Canadians to own a home, so we are planning to offer a unique feature to our renters, allowing them to build equity in the homes they are renting by offering the ability to dedicate a portion of their rent payments towards equity in our portfolio of homes.

In a perfect world, our renters are part owners of the homes they are renting, accomplished by owning a share of the company that owns their rental home. We feel this will not only bring alignment with our renters but also allow them to grow their equity through their rent payments.

As such, we are offering a unique opportunity for our renters where we will give back to tenants a certain portion of their monthly rent as units in our REIT. This will allow our renters to grow equity while also enjoying greater flexibility and a lower monthly housing cost relative to homeownership.

This is an exciting and unmatched prospect for tenants and investors in Ontario to capitalize on the economic advantages of renting over homeownership - particularly in a market where home prices and interest rates are projected to remain historically high. This unique cohort of “Tenant-Owners” will be contributing to their financial well-being and adding to the vibrancy and sustainability of Ontario’s growing neighborhoods in desirable communities. Avanew aims to contribute positively to the housing market by offering innovative housing options to Canadians – and providing them with the assurance that renting from Avanew is an investment.

Stay tuned for more updates on how Avanew is reshaping the rental landscape in Canada in 2024.

Core Development Group and Avanew Inc. currently have 3,500+ units of new rental and for sale housing under development in Ontario.

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