Green Street News

Q+A: Capreit's Schonfeldt on the firm's portfolio evolution

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And what to expect from the multifamily market in the near future

The multifamily market may be holding strong, but finding nationwide success still requires a sharp eye and an ever-evolving portfolio. Canadian Apartment Properties REIT knows that better than most.

As Canada's largest publicly traded housing provider, the firm's portfolio has grown and changed significantly – domestically and internationally – over its 28-year history.

Green Street News sat down with Julian Schonfeldt, Capreit's chief investment officer, to discuss the firm's recent dispositions, what assets Capreit would consider buying, and how rent prices and capitalization rates are expected to change in the near future.

Capreit has been making a lot of dispositions recently. What goes into deciding which assets to sell? Is there a specific goal in mind for your portfolio right now?

The answer to this question lies in the history of Capreit. We IPO'd in 1997, and, for the first couple of decades, it was very much a growth story and scaling up the company. We now find ourselves in a position where we're the largest publicly traded REIT in the country, and rather than focusing on growth, we're looking inwards at how we can improve the overall portfolio composition. For the first time, over the last couple of years, we've transitioned toward being a fairly active seller, in addition to buying.

Generally speaking, there are criteria we look at when we're deciding what to sell. These include buildings that have higher capital expenditure, lower growth profiles, punitive regulatory environments, properties with operational challenges, limited synergies with the existing portfolio, or noncore markets where we don't see ourselves in the long term.

Additionally, through the expansionary period of Capreit, we had invested in properties that are not at the core of our Canadian apartment business. We had investments that were in Europe, where we do not have the same competitive advantage that we have in Canada, as well as we had a manufactured housing community portfolio that, again, wasn't core to the business.

Can you give an example of those punitive regulatory environments?

A good example of an anti-housing regulatory environment is Prince Edward Island. That's a province where we were, I believe, the second-largest residential housing provider. They have full rent control there, including on turnover, and they also have a property tax that is punitive to out-of-province owners. Full rent control really limits growth.

For the past few years, the government allowed very minimal rent increases. In fact, in 2023, it was 0%. Unfortunately, our expenses don't grow at 0%. From our

point of view, that type of environment makes it very challenging to earn reasonable returns – resulting in the disposition of the majority of our PEI portfolio, and I wouldn't be surprised if you see us completely exit the province.

Having bought high-rise to low-rise in different markets all across Canada, what is the common theme you're looking for when you want to acquire a building?

We're now focused on new construction properties. The portfolio that we've built over the last couple of decades was primarily older apartments. Now we're trying to focus on well-built, newer construction apartments in major markets.

We tend to focus on properties where we think we'll have operational efficiencies, where the suite layouts are efficient and livable and of a good size, where the regulatory environment is at least reasonable, buildings that we think will have low capital expenditure requirements, buildings where there's good NOI margins through smart designs and operational efficiencies and where there's energy efficiency. Favorable financing will come into play. Pricing relative to replacement cost is also something that we factor in.

What asset would be a no-question-about-it slam dunk for you?

Strong consideration factors include good construction quality, an attractive major market, mid-market rents per foot so they're less economically sensitive, a property with enough scale or at least proximity to existing sites – all would be ideal. We made a number of acquisitions in 2024, close to $700m, that have a lot of these factors included.

And how about the opposite of that – is there anything you wouldn't touch right now?

Reputation of the developer and quality of the construction represent two factors that are most crucial to decision-making and where we are cautious. When you're buying a new construction building, it hasn't necessarily stood the test of time, so how well it's built is very important. We also wouldn't consider properties outside of the major markets we are currently in.

We tend to avoid properties that are too niche. Those could include micro suites, too focused on student housing or extreme, very amenitized buildings in the sense

that it becomes less of a standard apartment and more of an ultra-luxury-type offering. We're trying to keep our large company relatively simple.

When it comes to making those investments, what's lender sentiment like toward multifamily acquisitions?

Lenders have been strong for new acquisitions for the right transactions and the right borrowers. There's still a very active market for financing on multifamily. I also think for us, as a large operator with very low leverage, we're the ideal borrower. It's not something that we consider a major issue or risk at all.

We haven't seen much multifamily construction break ground in the last couple of years. How do you foresee that playing out several years down the line? Are you predicting any rent growth or changes to cap rates?

In various markets, there's a lot of supply coming in the next year or two that's matched with changes to population growth patterns, specifically with respect to non-permanent residents that the government announced in the fall of '24. You'll have lower population growth than we've seen in the past couple of years, as well as a significant amount of supply coming in certain markets. Naturally, that's been putting some pressure on market rents.

Now, around the time the non-permanent resident changes are worked through in the next couple of years is when we think a lot of that supply will have been worked through as well. We expect to find ourselves in a position where there will be less supply coming online while population growth strengthens, in which case we would fully expect to see the housing shortage start to worsen again. Rent growth and cap rates are inversely correlated. When you see rents start to grow again and the sentiment gets positive, you fully expect cap rates to go down and building values to go up.

What are you seeing with cap rates right now in terms of either movement or stabilization?

I'm going to speak to the new construction properties because that's where we've been most active. On the acquisition side, it certainly moved up since rates increased a couple of years ago, but we haven't seen any very wide movements or changes. On the value-add properties, I'd say cap rates have been creeping up.

Where are they right now relative to where you'd want them to be, ideally?

On trades that we see and act on, cap rates tend to be in the fours, but oftentimes they'll be marketed at tighter cap rates based on vendor expectations/hopes. On occasion, vendors have spent more on constructing a building than it is worth on an income basis, which explains why we frequently see a substantial bid-ask spread and less liquidity, unless the vendor is motivated to sell.

Are there any markets in particular you're looking at right now that seem promising?

We're fortunate in that we have a pan-Canadian platform and that we are in all the major markets. We will look at anything in any of those markets. Our appetite with respect to each individual market is different and it's based on a bunch of different factors that each market has, such as the existing supply, the supply growth, regulatory environment, cost of renting versus homeownership, how easy it is to add more supply, forecasted economic growth, forecasted population growth and many other factors.

We look at all these factors, and we also look at how much existing exposure we have, if we're overweight or underweight in each market, and we mash that all together to form our appetite on a market.

Are there any new international markets that Capreit is considering?

No, in fact, we're going the opposite way. We're moving towards pure-play Canadian residential. The reasons justifying that transformation are that, as a public company, our investors have a strong preference for us to be pure play with a view that they can diversify by country or by asset class as they see fit.

In addition, the core of our business, our head office and our skillset is Canadian, and we are exceptional at what we do here in Canada. We are a very small piece of a large, fragmented market, so there's quite a lot of opportunity for us to grow in Canada where we are best operationally.

Is there anything else you're seeing in the market right now that we didn't touch on yet?

We find ourselves in a housing crisis where living is unaffordable for many Canadians in ways that it wasn't before. Despite this, it's very challenging to make the math work on adding new supply. There's a large amount of demand for new supply, but you can't make it work. That doesn't sound like the typical supply-demand dynamic that one would expect, and a lot of that has to do with undue and significant government intervention, be it from rent controls that harm the end value of the product you're building, or the various levels of regulatory hurdles and taxes that are paid on new developments that inflate the cost.

I think we, as Canadians, would love to see less government intervention, so that the private sector can try and fix this unfortunate dynamic that has caused the housing crisis. There's a narrative that this is caused by "greedy" residential housing providers, but from our point of view, it's definitely a supply-demand issue that is being artificially exacerbated by excessive government intervention. What's happened over the last many years has proven that this government intervention is counterproductive, and we think it's important for a change of direction on this front.