

The Impact of COVID-19 and Government Measures (so far)

CENTURION APARTMENT REAL ESTATE INVESTMENT TRUST

These are challenging times for all Canadian households and businesses. We expect that some residents will have income interruptions due to COVID-19, but fortunately, all levels of government have stepped up with income and other support mechanisms to lessen the blow to households.

The cuts to the BOC rate has always been in our forecast. We have been calling for this for years, although we did not expect that COVID-19 would be the trigger. The exceptionally low interest rates are supportive of apartments and have substantially reduced borrowing costs, with 10-year fixed-rate mortgages now around 2%. Apartment mortgages can be government-insured via CMHC, meaning that these mortgage rates tie closely to government bonds and also ensure access to liquidity in an environment where other borrowers may be challenged to access credit. In the long run, we believe that this will further strengthen appetite for apartment investment on a relative basis to other real estate classes.

Prior to this month, our resident default rates were extremely low, at the bottom end of the lowest we have ever seen in our entire time in this industry. While we like to believe that this is because of good screening, having residents signed up to pre-authorized payment plans, and strong collection practices and procedures, these make up only a part of the explanation. A larger part, in my opinion, is that with the shortage of rental housing, which has resulted in very low vacancy rates and market rents that exceed in-place rents by considerable margins in some markets in the country, residents do not want to default, knowing that if they are evicted, they may have difficulty finding a new home at a price they can afford. Residents that choose not to pay now, will eventually be evicted, and there may be no place for them to go at a price they can afford

We have joined other large owners in pledging not to increase rents during the crisis and to work with residents experiencing hardships. We believe that the model will be one that has been in place in Ontario for years when a resident experiences an interruption, but wishes to stay and catch up on payments. It has worked successfully in keeping many residents in their homes and ultimately allowing landlords to potentially make a full recovery of delayed rents.

While we do not know how long COVID-19 will continue, we do know that the demand for rental housing is not going to go down either during or after the crisis. We believe that construction delays on condos, apartments, and houses may actually increase demand in the long term. We anticipate that revenue impacts would be temporary and manageable. While I think no industry comes out of this crisis without some bumps and bruises, we believe rental apartments will prove to be among the most resilient of businesses as we supply a non-discretionary need (housing). Given that interest rates have moved dramatically lower, and apartment mortgages are government insurable via CMHC, and still available, we believe that capitalization rates and values will be stable. We believe that some more leveraged players, including developers, may be more anxious for liquidity events and that this will present some excellent opportunities for the REIT down the road.

Student Housing

Most students go home mid-April. We already have all of their last month's rents; so even if all of them leave, we still get paid for April. Physical summer occupancy in most of our student residences is around 25% as most return home or have jobs elsewhere, with a limited number of summer students staying behind. Financial occupancy is much higher than physical occupancy. We operate two move-in lease date cycles, depending on market—May to April and September to August. We lease almost always on a 1-year basis, with some exceptions. Most of the students taking their apartments on May 1 do not actually move in, they hold it and move in the fall when classes begin. It is the market convention. Same for September to August cycle. Students pay for the full year, even if they only live there for 8 months. We assume that given September is 6 months away, schools will be going by then.

Leasing Activity

Leasing activity remains strong. In the week ended March 19, we completed 78 leases versus 96 leases the prior week. People's need for housing has not declined. We had to adapt how we lease though as many residents are now cautious about allowing visitors into their homes to tour. Fortunately, we have for years had virtual tours and plenty of photos on our rental site, and have a dedicated, well-trained call centre taking enquiries, booking appointments, and following up. We also had previously used virtual Skype/Facetime tours in the student portfolio for international students, which we now use for the apartment portfolio. We have had electronic leases for a while too. We were ready for how people in this environment would want to do tours and sign leases.

Additionally, our executive team moved early, nearly a month ago, to prepare the company for an extended work-from-home situation. With the help of our early test groups that hammered out bugs and weaknesses before full implementation, we were ready to go live and send people home from March 16 and continue to operate this way. As such, we were ready and are currently functioning well from home.

CENTURION REAL ESTATE OPPORTUNITIES TRUST

This is a kind of market disruption that provides excellent opportunities but also entails risks. We anticipate that some of our developer clients will see project delays and some cost overruns. We believe that these disruptions will be temporary, and we will work with clients, as we always have, to provide solutions. Even before COVID-19, we had many great opportunities for consideration and the team was busier than it had ever been. We anticipate that this market will further grow that opportunity set, but for the moment, we are directing our attention to existing clients and projects before looking at the many new investments that we anticipate will become available in the months ahead. Further, given that most of our investments are in the multifamily space, which is still desperately short of supply, we anticipate that these projects will complete successfully.

CENTURION FINANCIAL TRUST

CFIT, like the REOT has a huge opportunity set in front of it. For the meantime, we will focus on existing clients and investments while the market settles down before making decisions on new opportunities. Given that our strategy has been to allocate a portion of the portfolio to participating deals through interest bonuses, warrants, royalties, etc., we anticipate that CFIT will have the opportunity to reset and/or negotiate some excellent upside participation arrangements to provide potential equity upside. In the past year, due to market movements, we had already written down most of our warrant type positions which dragged down our 2019 performance, but believe that resetting the arrangements at today's values provides a potentially exciting upside down the road.

GENERAL THOUGHTS

We were very fortunate to have positioned all of our funds conservatively and that our core markets are resilient. Leverage is low in each of the funds (REIT around 30%, REOT 0%, and CFIT 0%) and liquidity positions are excellent. Occupancy is excellent, with vacancies mostly only in the newly acquired and lease up properties, which still have strong leasing momentum. We know that the months ahead will be a challenging time for all Canadians, but we believe that we have positioned ourselves to prosper and that we will find many opportunities once the market calms down a little. It is in volatile times like today that there are tremendous opportunities for long-term investors and that is what we are focused on.

Greg Romundt