A Spectacular Year So Far for Centurion Apartment REIT

The Centurion Apartment Real Estate Investment Trust ("REIT") is having its best year ever. As at the end of Q3, the REIT has earned, on a year to date basis, more than twice of what it earned in all of 2016, which was previously our best year ever, and we still have three more months to go! On a trailing twelve-month ("TTM") basis, we have increased top line revenues by about 6.86%, increased same store Net Operating Income ("NOI") by 10.04%, and increased our NOI ratio to 63.86% from 62.01% in the same period last year. We have also gotten the portfolio to 94.1% stabilized, up from about 85.1% at Q3-2016 and 53.9% at Q3-2015. On a year to date ("YTD") to November 1st basis, the REIT has returned 16.07% and 18.63% on a TTM basis.

Many things are driving these results. Getting a much larger portion of the portfolio stabilized has driven occupancies higher and vacancy and stabilization costs lower. Having more stabilized properties with higher occupancy rates has permitted the REIT to achieve much better rents on unit turnover, allowing us to harvest some of the returns from the significant capital investments that have been made over the years. Changes in the home ownership market have also driven rental demand through the roof. Absolute home value levels are pricing many out of the market, increasing rental demand. Regulatory changes both in Ontario and federally are further reducing the ability of purchasers to buy into the market, which is further driving demand for rentals. The Ontario regulations will also reduce long-term supply as the number of people willing to rent their units will drop as many condo investors barely have cash flow and with rent control, may see little path to positive cash flow, reducing their willingness and ability to carry the units long-term. The implications for long-term supply are unknown, but certainly negative for renters. It is also apparent that developers have changed a number of sites that were supposed to be purpose-built rental into condo buildings that will be sold. The rental industry has also traditionally seen a certain percentage of residents move to home ownership or move up the chain to condo rentals. But because of market conditions, turnover velocity has declined, meaning units that may have come on to the market no longer do, and this is driving down availability for all renters. The rental market is exceptionally tight because of these factors; tighter than I've ever seen and this seems to be a medium-term issue not a short-term one.

One measure of how much upside we have in rents is our gap of "market rents" to "in-place rents" ratio which has jumped from 3.20% ($1.7 million in dollar terms) in 2016 YE to 11.1%, which is about $8.2 million in dollar terms, right now. This is the largest gap to market rent we ever had. If current market conditions continue, which I believe they will, this is a significant amount of revenue that can be added to the bottom line and could provide a strong pipeline for future returns, all else being equal.

Not all of our gains came from just moving NOI. The shortage of quality investment opportunities and low investment yields have continued to drive capital into the markets in general and apartments have seen the same trend. Capitalization rates have continued to trend lower. I happen to believe that growth in the economy will soon taper off and that the uncertainties posed by the small business tax

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changes and a renegotiation or cancellation of NAFTA will only exacerbate this trend. Given the size of deficits that governments continue to run, I believe that the only tool that can be brought to bear for the next recession will be monetary policy as a result. Given that when we enter the next recession, we will be going in with the lowest starting interest rates in history (in Canada and the world) and given that we have about 19 countries in the world with negative interest rates already, that Canadian interest rates will also potentially go negative or substantially lower than they are now, which will drag capitalization rates even lower. As such, it seems that in many respects, this is a potentially great period ahead for apartment returns (if you are lucky enough to own them).

Greg Romundt