

Above Guideline Rent Increases in the Age of Financialization

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RenovictionsTO

3. Landlords and AGIs

THE INCREASE in AGI applications over the past several years has happened in the context of increasing financialization in housing and the growing concentration of purpose-built rental units in the hands of large financialized and corporate landlords. This section begins with a brief introduction to financialization, before examining how financialized and corporate landlords view AGIs, the share of AGIs these landlords are responsible for, and landlord profits. This section draws on landlord annual reports and investor documents, and on discussions from industry events.

The Rise of Financialized Landlords

In Toronto and across Canada, the ownership of apartment buildings and other rental housing has been changing in recent decades. While most properties and units are owned by independent landlords who own one building or a few, a growing number have been acquired by large corporate owners and by large financial firms.

Many large corporate owners are family-owned private firms, often third-generation firms that emerged after the Second World War. In Toronto, many of the biggest landlords are family-owned and private real estate corporations. These include companies like Medallion, Greenrock, M&R Holdings, O'Shanter, Homestead, Crestview, and Hollyburn.

Since the late 1990s, there has been a rise in financialized ownership of apartment buildings, in which financial firms acquire and manage apartments as products for investors. This trend has emerged as part of financialization in the global economy, in which finance capital has taken on an increasingly dominant role in the operations of the economy and everyday life. In terms of apartment buildings, financialization involves the acquisition of apartment properties by financialized landlords, such as private equity firms, asset management companies, pension funds, insurance companies, and real estate investments trusts (REITs). These types of firms have been actively acquiring apartments over the past two decades. As of 2019, an estimated 18% of Canadian apartments are owned by financial firms. REITs alone have risen from owning zero suites in 1996, to 194,000 in 2019.²³

Financial firms have attracted attention because of their extreme focus on driving value for investors. REITs, for example, state that their main objectives are to raise the value of

their assets and deliver returns to investors. While private landlords of all types have historically pursued apartment ownership as a profit-making enterprise, financial firms appear to be more single-mindedly focused on extracting profits. In addition, these firms have advantages associated with their size, sophistication, and access to capital markets. As such, they have created new ways to extract greater profits from old apartment buildings.

To generate higher revenues and profits, financialized landlords actively manage their buildings using an approach called “repositioning.” This means that they reposition a building in the market to be more profitable. Repositioning involves reducing expenses by investing in energy efficiency upgrades, firing superintendents, harmonizing property management, and capitalizing in other ways on economies of scale. Repositioning also involves generating more revenues by charging higher fees and rents. Landlords can charge higher fees by monetizing amenities like parking, laundry, storage, party room access, sub-metering utilities, and so on. Perhaps most importantly, firms drive revenue by increasing tenants’ rents. A “value-add” strategy to repositioning, in particular, focuses on raising rents to close gaps between existing rents in a building and market rents. There are three ways this can be done in Ontario in purpose-built rental buildings subject to rent control: (1) raising rents on sitting tenants according to the guideline amount; (2) raising rents on turnover, capitalizing on vacancy decontrol; and, (3) applying for AGIs. Applying for AGIs can serve a dual purpose, not only securing rent increases above the guideline but also displacing tenants unable to afford the increase, thus achieving turnover and enabling even larger rent increases.

AGIs as a Profit-Making Strategy

AGIs are therefore one of the revenue-generating approaches adopted by financialized landlords to drive higher profits for investors. Financial firms openly describe AGIs in this manner, as a tool to drive higher revenues. CAPREIT, one of the largest private landlords in Canada, discussed AGIs in their annual reports in the context of how they drive growth. The REIT put it this way: “In line with its focus to maximize average monthly rents, CAPREIT continues to pursue AGIs where it believes appropriate.”²⁴ AGIs are pursued not because of a need to maintain buildings or because there is a need for

²³ Martine August, “The Financialization of Canadian Multi-Family Rental Housing: From Trailer to Tower,” *Journal of Urban Affairs*, 2020. Updated with current ownership figures.

²⁴ CAPREIT, 2017 Annual Report, p. 71.

certain repairs, but when it is their financial interest to do so. As they noted, “Management continues to pursue applications in Ontario for AGIs where it believes increases above the annual guideline are supported by market conditions to raise monthly rents.”²⁵

Centurion REIT’s annual reports discussed AGIs in a section titled “Revenue Opportunities,” making it clear that the firm views AGIs as a tool for revenue generation.²⁶ Similarly, Northview REIT described AGIs as one of five “value creation initiatives.” Notably, Northview’s plan to create value by applying for AGIs was to capitalize on repair costs that they had not even spent. Northview described how “[t]he significant capital that was invested in the assets prior to [acquisition and the company’s formation] has enabled management to submit applications to the Ontario LTB to increase rents by more than the regulated annual increase.”²⁷ In Northview REIT’s case, the firm applied for AGIs to recoup costs from prior to its own formation.

InterRent REIT has similarly framed AGIs as a strategy for driving higher revenues. The firm’s 2017 annual report noted that “there are two ways to capture the upside from capital invested in the REIT’s repositioning programs. The first way is achieving market rent on suite turnover, and the second way is through AGIs for existing tenants.”²⁸ AGIs are clearly not understood in relation to the need for certain repairs or a desire to maintain buildings, but as a way to capitalize on (and profit) from investment, over and above its costs. In company reports, InterRent REIT spelled out how AGIs are a revenue-generating strategy, including detailed forecasts for rolling out planned AGI applications to deliver \$1.1 million in revenue generated from rent increases.

The decision to apply for AGIs has more to do with a firm’s investment strategy than it does with the need for repairs or the funding of vital upgrades. As the REIT documents reviewed above reveal, AGIs are seen as a tool for revenue generation. George Van Noten of Minto Properties and Minto REIT, however, described AGIs as something “to think through” in terms of “where does it fit in your investment strategy?”²⁹ Some investment strategies, such as a short-term plan to buy and then “flip” a property, may not include AGI applications, since the profits from AGIs may only be realized over a longer time frame. As he explained: “If you’re buying a value-add asset and you’re playing to a short-term hold—and [seeking] to drive up the terminal value—then doing an AGI

is not material in that equation.” These comments underline how financial firms view apartment ownership as a game to play, in which AGIs are simply one tool to increase revenues, in line with certain investment strategies.

The decision to apply for AGIs has also been discussed by landlords as a political calculation. Van Noten described how some investors, such as pension funds, are wary of the negative political attention that can occur if tenants fight back against AGI applications. He explained:

We think very carefully about that. We think about our partners, if we think it’s going to be a contentious exercise. We think about our pension partners and how this might land on them—they have a high degree of sensitivity to people showing up on their front door.

Such comments reveal that AGIs are totally optional for financial firms; they’re a tool that generates more income, but that income may not be worth the negative impacts associated with tenant protests or bad press.

Fear of negative press has not, evidently, held Minto back from applying for AGIs—the firm was among the most aggressive in applying for AGIs in our study. From 2012-2019, they applied for AGIs affecting approximately 5,100 suites, despite having only 2,300 suites in their Toronto portfolio.³⁰ In other words, the firm applied for AGIs affecting more than twice the number of suites in their portfolio. Three of Minto’s properties (111 Pacific, 740 York Mills, and 7 Richgrove) were subject to four AGI applications each in these years.

By comparison, Park Property Management—another large firm—filed only one AGI application from 2012-2019 impacting fewer than 200 units, despite owning a similarly large (1,900-suite) portfolio of aging post-war towers. This shows that landlords clearly do not *need* to apply for AGIs, and that applying is a choice based on a firm’s business strategy and appetite for negative press. The CEO of Park, Margaret Herd, underlined these points herself, explaining that: “we probably do two AGIs a year at the most. We’re very specific about what we’ll take to the LTB for an AGI.”³¹ In particular, the firm avoids applying for AGIs to cover the costs of things that tenants would see as deferred maintenance. As Herd explained: “We don’t take cosmetic improvements because the residents will claim that those are just deferred maintenance. We want to make sure they can have no claim that what we were doing was neglect.” These comments suggest that it is a practice of other

²⁵ CAPREIT, *2019 Annual Report*, p. 25.

²⁶ E.g. Centurion Apartment REIT, *2017 Annual Report*, p. 25.

²⁷ Northview REIT, *2018 Annual Report*, p. 26.

²⁸ InterRent REIT, *2017 Annual Report*, p. 43.

²⁹ These comments were made at an event hosted by the Federation of Rental-Housing Providers of Ontario in Toronto on March 7, 2019, entitled “How to Handle Crisis, Rent Strikes, Protest.”

³⁰ We estimated the number of units impacted by each AGI. See Appendix for more information.

³¹ These comments were made at an event hosted by the Federation of Rental-Housing Providers of Ontario in Toronto on March 7, 2019, entitled “How to Handle Crisis, Rent Strikes, Protest.”

While our data includes Toronto only, Park owns buildings elsewhere in Ontario.

landlords to apply for AGIs after making repairs resulting from neglect. This allows landlords to capitalize on saving money (while they neglect needed repairs), and then derive profits from maintenance when it is finally completed.

Park Property Management also selectively applies for AGIs based on if the company thinks tenants can afford the rent increase. While this may seem charitable, it signals that AGIs are not being used to recoup costs of needed repairs, but are a way to extract more from tenants in markets where they see that opportunity. As CEO Herd explained:

In some buildings we don't do it at all. We spent \$5 million at Thorncliffe Park putting in new windows and a [inaudible] system, but recognizing that it's considered a priority neighbourhood and that people there are the ones that could least afford having an AGI going up 3% per year, we just said, 'we're not going to do it—it's not worth having the tenants leaving because they can't afford the increase in rent.' It's not worth the media that goes along with it.

This once again underlines that, for landlords, applying for an AGI is a choice about whether to try to extract extra payments from tenants to increase profits. While Park Property Management may choose not to apply for AGIs in certain situations, other landlords may choose differently. Recall how AGIs are merely one way landlords in Ontario may try to increase revenues. Vacancy decontrol allows landlords to increase rent as high as they want when units turnover. For many landlords, the possibility that an AGI may price some tenants out is an incentive to pursue the increase, not a disincentive. Financialized landlords are driven to turnover units and maximize their profits by increasing rents.³² The strategies they employ have also been adopted by many corporate landlords. For these landlords, the question is not whether tenants in the building can afford the rent increase, but whether there are tenants in the market that will pay closer to market rates.

Types of Landlords and AGIs, 2012-2019

As discussed above, the use of AGIs in Toronto has increased substantially in recent years. A closer look reveals that this impact is driven primarily by financialized and corporate landlords, which accounted for 64% of AGI applications in Toronto between 2012-2019.³³

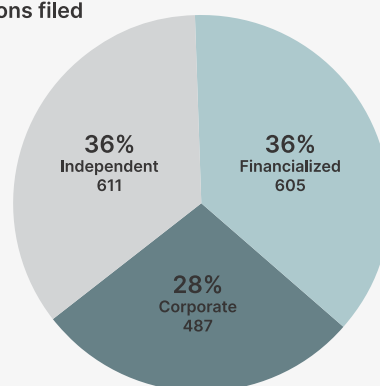
We can best appreciate the impact these landlords have on tenants and the affordability of housing in Toronto by looking at their share of AGIs in terms of units impacted. Although most AGI applications are for purpose-built rental

buildings and are intended to impact all units in a building, some AGIs apply only to particular units, to individual condos, or to houses. If we consider only applications filed, an AGI impacting a home with two rental units is equivalent to an AGI impacting hundreds of units in a high-rise apartment building.

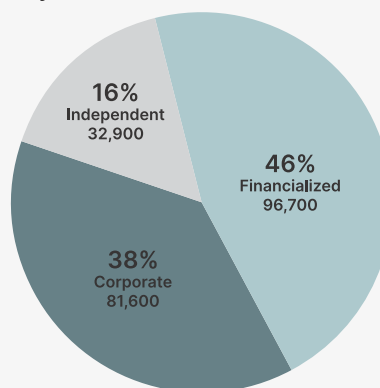
In order to calculate the share of AGIs by financialized and corporate landlords in terms of units impacted, we estimated the number of units impacted by each AGI in our data set.³⁴ Financialized and corporate landlords were responsible for 84% of AGIs in Toronto from 2012-2019, when considered as a percentage of the units impacted by AGIs. This means that of all the apartments subject to AGI applications in Toronto during this time, 84% of these apartments were owned by a financialized or corporate landlord at the time of the application. Figure 2 shows the share of AGIs by corporate and financialized landlords in Toronto from 2012-2019.

Figure 2: Toronto AGIs by landlord type, 2012-2019

AGI applications filed



Units impacted by AGIs^a



a: Number of units impacted are estimates. See Appendix for more information.

³² August, 2020.

³³ LTB data and publicly available information about building ownership and acquisitions. See Appendix for information about the data discussed in this report.

³⁴ L5 applications list the units an AGI is intended to apply to. Lacking access to actual L5 applications for the AGIs in our data set, we estimated the number of units impacted by each AGI in our data set, relying on information about the number of units in each building included in our data set. It is reasonable to assume that the margin of error for these estimates is consistent across applications from different types of landlords, thus does not impact the percentage reported here. See Appendix for more information about these calculations.

Major financial players and big corporate firms make up the list of top 20 AGI-filing landlords by units impacted, shown in Table 5. In fact, these 20 companies alone were responsible for over 60% of AGIs in Toronto between 2012-2019, in terms of units impacted. The list is dominated by financial firms, including CAPREIT, Starlight, GWL Realty Advisors,

Realstar, and BCIMC. Together, financialized landlords were responsible for 46% of Toronto AGIs during this time. Large corporate firms were responsible for 38% of Toronto AGIs in this time period, led by Greenrock, M&R Holdings, O'Shanter, and Homestead.

Table 5: Top 20 landlords applying for AGIs, by units affected, 2012-2019

	Landlord	Type	Filings	Units Affected ^a
1	CAPREIT	Financial	115	22,600
2	Starlight Investments	Financial	205	16,100
3	Realstar ^b	Financial	32	9,400
4	GWL Realty Advisors	Financial	21	9,100
5	BCIMC	Financial	27	7,200
6	Greenrock	Corporate	14	7,200
7	M&R Holdings	Corporate	26	5,600
8	O'Shanter	Corporate	36	5,300
9	Homestead	Corporate	24	5,300
10	Minto	Financial	24	5,100
11	Greenwin ^c	Corporate	28	4,900
12	Medallion	Corporate	17	4,600
13	H & R / Princess Management	Financial	20	4,500
14	Timbercreek	Financial	27	4,300
15	Barney River	Corporate	15	3,600
16	Hollyburn	Corporate	42	3,500
17	Continuum REIT	Financial	11	3,000
18	Oxford	Financial	15	2,400
19	Centurion REIT	Financial	27	2,200
20	Sunlife Financial	Financial	10	2,100

a: Rounded to the nearest 100. Number of units affected are estimates; see Appendix for more information.

b: This includes data for certain Realstar-managed properties, some of which may indeed be owned by separate financial firms (e.g. Hardit Corporation and Talisker Corporation). For these properties it is difficult to determine ownership.

c: Greenwin manages a number of buildings for other landlords. AGIs included here are only for buildings where we believe Greenwin has an ownership stake or is affiliated with the identified owner.

In contrast, independent landlords were unlikely to apply for AGIs. Despite owning the majority of units in Toronto, independent operators represented 36% of filings, affecting 16% of units from 2012-2019. Property management companies appear to have large role in determining which independent landlords apply for AGIs, according to our data. Briarlane, for instance, filed at least 91 AGI applications on behalf of landlords between 2012-2019. While some of these applications were on behalf of corporate clients, many were for independent landlords. Firms like Briarlane bring the expertise, scale, and know-how found in bigger firms, which allows small-scale operators to adopt their techniques.

Landlord Profits

We have seen how financialized landlords pursue AGIs as a revenue-generation strategy. We have also seen that large financialized and corporate landlords are the most active in applying for AGIs in Toronto. As we will argue that AGIs are not needed for landlords to survive, we turn in this section to the profit margins of some of the biggest applicants for AGIs in the city.

Investor returns are one way of understanding how profitable financialized landlords can be. BCIMC manages investments for British Columbia's public sector, including public sector pensions. Their investments in domestic real estate, which includes purpose-built rental buildings in Toronto, provide investors with annual returns of around 8%.³⁵ Centurion, a private residential REIT, delivers annual returns of around 10% for its investors.³⁶ GWL Realty Advisors is part of the Great-West Life insurance company's real estate group, with a variety of real estate investment funds. Their Canadian Real Estate Investment Fund No. 1, which allows pensions, group savings plans, and individuals to invest in Canadian residential and commercial real estate, provides investors with 9% annual returns.³⁷ Akelius, which describes itself as "a long-term investor in residential real estate," has seen average annual returns of 11.5%.³⁸ Meanwhile, InterRent REIT, a publicly traded residential REIT, noted that an individual who invested in the REIT in 2014 would have tripled their money by the end of 2019.³⁹

These kinds of returns mean that investors are seeing their wealth increase by more than 8% each year by entrusting their money to these landlords. How and when investors access their increased wealth depends on the nature of their investment (i.e. whether they own shares of a REIT, have a stake in real estate through their pension, or have invested some other way). In the case of REITs, for example, returns for investors come in the form of dividends and the increase in value of their units of the REIT—shares of a REIT are called "units," and those who own units of a REIT are called "unitholders." REITs often refer to the amount paid in dividends to unitholders over a period of time as a "distribution" made to investors.

Investors in residential real estate are receiving these considerable returns because financialized landlords are extremely profitable. In 2019, CAPREIT reported \$778 million in revenues. After paying utilities, property taxes, and other operating costs, CAPREIT had a net operating income (NOI) of \$508 million, giving it margins of 65%. REITs typically report NOI, which they view as a good measure for determining the profitability of their investments. Although REITs may differ slightly in how they calculate NOI, it is typically revenues (i.e. rent and fees charged to tenants) minus property taxes, utilities, and other operating costs like maintenance, employee salaries, and advertising. A large share of a REIT's profits are distributed directly to unitholders. In 2019, CAPREIT distributed around \$220 million to its unitholders, or around 28% of its total revenues.⁴⁰

Other Canadian residential REITs report similar margins, and our review of financial reports reveals that NOI margins of 60-65% are standard for Canadian residential REITs. On revenues of \$145 million in 2019, InterRent REIT had an NOI of \$96 million and distributed around \$33 million to unitholders.⁴¹ Also in 2019, Minto Apartment REIT had an NOI of \$65 million and distributed around \$20 million to unitholders, from its \$104 million in revenues.⁴² In 2018, Northview REIT had an NOI of \$212 million and distributed \$100 million to unitholders, while reporting \$364 million in revenues.⁴³ On operating revenues of \$68 million in 2018, Centurion had an NOI

³⁵ BCIMC, *Corporate Annual Report 2018-19*.

³⁶ Centurion Apartment REIT, *Investing in Apartments for Income and Stability*, 2017.

³⁷ GWL Realty Advisors, *Canadian Real Estate Investment Fund No. 1 2019 Annual Report*.

³⁸ Akelius, *2019 Annual Report*, p. 10.

³⁹ InterRent REIT, *2019 Annual Report*.

⁴⁰ CAPREIT, 2019. There are a variety of metrics that may be considered to indicate the true profits of a REIT, and NOI is sometimes referred to as "gross profits." Due to the complexity of the operations of these companies, their acquisition and sale of buildings, and the nature of accounting, it can be difficult to determine precisely what their net profits are for some time period. We believe that NOI is a useful indicator of profits that provides some consistency across landlords and across time spans. A portion of NOI may go towards interest payments or funding acquisitions, and a large share goes towards paying dividends to unitholders. The amount distributed to unitholders can be seen as a floor for determining profits for a given year.

⁴¹ InterRent REIT, 2019.

⁴² Minto Apartment REIT, *2019 Annual Report*. Note: not all buildings owned by Minto are part of the REIT's portfolio or were at the time of the AGIs in our data set.

⁴³ Northview REIT, 2018.