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Institutional interest rising in ‘missing middle’ housing

BGO is building a portfolio of four- to six-storey apartment buildings

by Matt Lamers

Institutional capital is beginning to edge into Canada’s “missing middle” housing segment as financial conditions for midrise developments slowly improve and investors remain wary of the high-rise condominium market.

Among the early movers is BGO, the real estate investment management advisor indirectly majority-owned by Sun Life Finance. BGO is building a portfolio concentrating on four- to six-storey apartment buildings, but not the triplexes and townhouses that also can fall under the missing-middle umbrella.

“We like it for a few key reasons,” Chetan Baweja, head of Canadian value-added and separately managed accounts, told Green Street News. “One, you can build it in two to three years, versus typically four or more for towers. As cities continue to progress zoning requirements, you don’t have long permitting times because you’re not asking for 20, 30, 40 storeys.

“Most importantly, we think it will help deliver more attainable housing for middle-income Canadians across our major markets.”

BGO’s strategy combines acquisitions and development, depending on the fund or client. Acquisitions made through the separately managed accounts portfolio focus more on existing housing stock, while the firm’s value-added strategy is looking at developing missing-middle housing.

“We’re currently doing both in the market today,” Baweja said. “BGO can finance projects, develop them, and we can buy existing properties. It depends on the vehicle.”

BGO has been focused on the Greater Golden Horseshoe area between Niagara Falls and Peterborough, Ont. – an area containing almost a quarter of Canada’s population – as well as Greater Vancouver, Calgary, Ottawa and Montréal.

Institutions kicking tires

Baweja said he’s observing increasing institutional interest in this product, which he sees as helping to increase supply.

Institutions typically are interested in larger projects to align with their overall scale and capital deployment needs, even though smaller projects still can offer strong fundamentals.

“That’s where BGO plays a big role,” he said. “We could build a portfolio of this product across major markets in Canada, and then partner with large institutions to invest in a portfolio, versus a single asset.”

BGO, he said, “has the ability to build this portfolio and offer it to institutional investors at a larger scale, and that’s what we intend to do.”

More housing needed

Canada faces a significant shortfall of missing-middle housing – medium-density forms that bridge the gap between single-family homes and high-rise towers. Baweja said municipalities, provinces and the federal government have work to do if

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they want more of the housing type.

"It is very important for municipalities and provinces to figure out how to make this housing come to market quicker, because it really solves the supply and affordability issue that they're concerned about," he said, noting that the federal government can provide greater financial support and incentives to provincial and local governments.

"We're looking at a missing middle development project in a part of the Greater Toronto Area that has virtually none of this product," he said. "We want to do the development, we have the capital to do it, but we can't get the project off the ground because the project is not economically feasible."

'How long will it take to sell?'

James Livingstone, managing partner of Lightwell Homes, a Vancouver-area developer of higher-end midrise housing, said more institutions and chartered banks will move off the sidelines when they see that this type of housing can be sold.

He suggested that large lenders and institutions are sitting on a lot of illiquid high-rise inventory due to the condo crash, making them cautious about having a clear exit strategy on new projects.

"There's a finite number of lenders that are investing in multiplex in the lower mainland, for the same reason institutions aren't in it yet, either. Everyone wants to see that [the developments] can go full cycle, that they can be sold," he said. "Major chartered banks are watching, too.

"If you look at the market, whether it's an institutional equity investor or a lender, it's the same problem, which is: How long will it take to sell? And the reason they're cautious is they're looking at the condo market."

Wanted: risk capital

Chris Spoke, partner at rental developer Toronto Standard, described institutional interest as more of a drip than a pour, with the unsold condos keeping the market cautious.

"More builders are focusing on this scale because the collapse of the condo market has made high-rise buildings tough to make work," he said. "One big missing ingredient in my mind is more risk capital – more equity."

Spoke noted several factors that were leading to improved economic conditions for this type of housing stock, including improved public policy, lower land costs and tax breaks on rental development.

"But you're still seeing fewer deals getting done, and a big part of that is because the equity part of the capital stack is hesitant," he said. "So, yes, I think [more institutional capital] would be a great thing."

Paula Gasparro, vice president of commercial real estate finance at CMLS, suggested the financial circumstances have to be just right to make missing-middle developments work.

"Unless it's infill or the land's already owned, and they have construction experience – maybe that would work, but I don't see it working everywhere," she said.

"It has to be in the right location, and maybe that's all you can build there – a smaller project. It could work when you're taking down an old two-plex and you're putting up a six-plex."