<Predicting Commercial Rent Growth in Canada>

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# About This Research

Back in 2017, when Whole Foods was acquired by Amazon, alarm bells were sounding off. Concerns of disruption in the retail landscape not just for grocery with adoption of online shopping as Amazon did with department stores and other brick and mortar operations. A retail apocalypse scenario was being painted since then and investors were wary of investing in companies that have this exposure such as mall operations. The question of the need for physical space and the reasonability of current market rents have been revived again with this current pandemic. The Canadian commercial retail real estate industry is at a crossroad wherein the physical space for stores is starting to be challenged by the e-commerce alternative. With several lockdowns and limitations of access to space, a lot of businesses have been closed for months or had limited transactions (i.e., online order for curbside pick-up, delivery) especially for non-essential businesses. Tenants have accelerated their e-commerce businesses and their online shopping presence by establishing websites and doing tie ups with delivery companies (i.e., Instacart, Door Dash, Uber). Commercial retail landlords were also impacted by lockdowns and business slow down that resulted in unpaid rents or worse, permanent closures of some of its tenants’ businesses.

Our aim is to determine if population and household income growth impacts retail rent growth. Knowing this will help identify regions that might be poised for growth and may help maximize retail rent revenues at locations of existing commercial properties. We will be able to identify other locations which may have growth rate potential where there are development opportunities.

# Other Past Research

There was various past research on predicting rental price but very few on commercial rents and more on housing market. There was also past research on rental rate growth but not in relation to household income and population as main drivers. Our research intends to shed light on the direct impact of rent growth by population and household income growth.

Wheeler 1 fine tuned use of traditional linear regression model in predicting house prices with the Bayesian spatially varying coefficient models and geographically weighted linear regression for estimation of hedonic prices.

The study of Des Rosiers, Theriault and Lavoie 2 was on extent of impact on rent levels of retail concentration at regional and super-regional shopping centres as well as categories of goods in 2 Canadian cities, Montreal and Quebec City. Among its findings are attributes to consider that have higher relationship to rent change, among which are:

* Percentage rent acts as a complement than a substitute for base rent
* Store size by far the most prominent determinant of shopping centre rents. A 10% increase in GLA negatively impact rent with a 4% rent discount
* Age of shopping centre impacts rents negatively stressing importance of renovation and enhancement strategies for the centre
* Corroboration of the study that landlords can charge higher rents to lease duration/long established tenants
* Higher agglomeration economies do not automatically translate to higher base rents. Other factors impact it
* Retail categories capture agglomeration economies where the higher retail category order the higher the base rent
* Base rent of various goods and services categories is negatively affected by a higher degree of retail concentration. However, not all categories are affected similarly by retail concentration

Zhang 3 concluded that tenant mix and retail rent have a positive relationship. The study confirms the qualitative side of the relationship touched on by other research wherein shopping districts with high tenant mix can reduce consumer’s time and transportation costs by providing them with a wider variety of goods and services thus enabling them to complete their shopping with one single trip. High foot traffic is high turnover due to more consumers. With this, tenants will be willing to pay higher rents.

The study of Hiebert 4 considered demographics but pertains to the housing markets both owned residence and apartment rentals for Montreal, Toronto, and Vancouver not commercial rents. It focused on immigrants and refugees if they were a factor in assessing growth estimation and prediction for housing prices and rent levels.

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# Methodology

## Data sources

The data sources we would need are for population, household income and commercial rent. These were publicly available from Statistics Canada. For population, we got datasets from the census in 2011 that also held 2006 census data 5. We also used a separate census dataset from the latest 2016 census 6 that contains 2011 census data as well. The dataset for household total income covered 2015 and 2005 information 7. Commercial rents services price index dataset represents the growth rate of retail rent using the 2019 base year 8. It included monthly growth rates from 2006.

Performance of data pre-processing that includes review for outliers, missing values, among others as well as transforming and data reduction of the datasets. The datasets are subjected to validation of distribution, finding correlations, and patterns.

In doing a predictive model for the transformed dataset, cross-validation used to make sure that every item in the original dataset has the same chance of appearing in the training and test sets for modeling. Using supervised learning method in modeling since the datasets are labeled.



*Figure 1. Stages for Data Mining to Build Retail Rent Prediction Model*

## Extraction, Transformation and Loading

We downloaded all these datasets directly from *Statistics Canada* website. In exploring the datasets, we encountered the following:

### Population 2016 and 2011 dataset

On review of dataset, it showed 353,914 observations and 14 variables.

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*Figure 2. Raw Population 2016 dataset in R*

The relevant columns for this dataset are:

* Geo\_Name
* DIM: Profile of Census Metropolitan Areas / Census Agglomerations (2247)
  + Needs further analysis to determine which group to limit search with
* DIM Sex (3): Member ID [1]: Total - Sex

All other columns were removed as they were completely unrelated for the study. Data types on attributes chosen were appropriate.

However, “DIM: Profile of Census Metropolitan Areas / Census Agglomerations (2247)” variable which is a character data type contains subsets, among others the following:

* *Population, 2016*
* *Population, 2011*
* *Population percentage change, 2011 to 2016*
* *Total private dwellings*
* *Private dwellings occupied by usual residents*
* *Population density per square kilometre*
* *Land area in square kilometres*
* *Total - Age groups and average age of the population - 100% data*
* *There are* ***2,239*** *other lines for EACH of 160 Geographic Name (City)*

We only need the 2 population metrics:

* *Population, 2016*
* *Population, 2011*

We pulled the 2 rows out from its current attribute to become 2 separate stand-alone attributes/columns and deleted all remaining subsets under “DIM: Profile of Census Metropolitan Areas / Census Agglomerations (2247)” variable.

***Data reduction***: After transforming raw data to the relevant columns and picking up only the relevant attributes of Geographic name (changed to “Cities”), Population, 2011 and Population, 2016. We get the following 3 attributes in the revised dataset “**Pop2016Final**” with 158 observations and 3 variables from original dataset of 353,914 observations and 14 variables.

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*Figure 3. Cleaned-up Population 2016 dataset in R*

### Population 2011 and 2006 dataset

On review of dataset, there were 73,160 observations and 14 variables.

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*Figure 4. Raw Population 2011 and 2006 dataset in R*

We identified relevant columns as:

* CMACA\_Name
* Characteristics
* Total

All other columns were removed as they were completely unrelated for the study. Data types on the remaining relevant attributes were appropriate.

However, the “Characteristics” variable which is a character data type contains subsets, among others the following:

* *Population, 2006*
* *Population, 2011*
* *Population percentage change, 2006 to 2011*
* *Total private dwellings*
* *Private dwellings occupied by usual residents*
* *Population density per square kilometre*
* *Land area in square kilometres*
* *Total - Age groups and average age of the population - 100% data*
* *There are* ***2,239 other lines*** *for EACH of 160 Geographic Name (City)*

We only need the 2 population metrics:

* *Population, 2006*
* *Population, 2011*

We pulled the 2 rows out of its current attribute under “Characteristics” to become 2 separate stand-alone attributes/columns and deleted all remaining subsets under “Characteristics” variable.

The values shown under attribute “Total “populated the separate columns of Population, 2006 and Population, 2011.

***Data reduction***: After transforming raw data to the relevant columns and picking up only the relevant attributes of CMACA\_Name (changed to “Cities”), Population, 2011 and Population, 2016. We get the following 3 attributes in the revised dataset “**Pop06\_11Final**” with 155 observations and 3 variables from the original dataset of 73,160 observations and 14 variables.

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*Figure 5. Cleaned-up Population 2011 and 2006 dataset in R*

### Household income 2015 and 2005 dataset

On review of the dataset, there were 1,440 observations and 17 variables

A screenshot of a computer

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*Figure 6. Raw Household Income dataset in R*

We identified relevant columns for this dataset as:

* Geographic name
* Household type
* Median household total income, 2005
* Median household total income, 2015
* Median household total income % change

All other columns were removed as they were completely unrelated for the study. Data types on the remaining relevant attributes were appropriate.

The “Household type” variable which is a character data type contains subsets such as:

* *Total Household Type*
* *Census-family households*
* *Households consisting of only on census family*
* *One couple, with or without children*
* *One couple, with children*
* *One lone-parent*
* *Other census family households*
* *Non-census family households*

We needed only the “Census-family households” to line up with the numeric data on the variable median household total income.

Before we can conduct our analyses, we transformed the dataset to a subset wherein said “Census-family households” is the only Household Type attribute to line up with the other identified useful attributes/columns mentioned above.

***Data reduction***: After transforming raw data to the relevant columns and picking up only the relevant attributes of Geographic name (changed to “Cities”), Median household total income (changed to “HH Income”) for 2005 and Median household total income (changed to “HH Income”) for 2015. We get these attributes in the revised dataset “**Income\_Final**” with 160 observations and 3 variables from the original dataset of 1,440 observations and 17 variables.

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*Figure 6. Cleaned-up Household Income dataset in R*

### Commercial rents dataset

On review of the dataset, there were 1,956 observations and 15 variables.

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*Figure 7. Raw Commercial Rent dataset in R*

Shown below are the relevant attributes/columns in commercial rent dataset:

* REF\_DATE
* GEO
* Building Type
* VALUE

All other columns were removed as they were completely unrelated for the study. Data types on the remaining relevant attributes were appropriate.

The “VALUE” variable is numeric. “GEO” contains a combination of individual Cities, Provinces and total Canada. While “Building Type” variable contains Total Building Type, Office, Retail and Industrial. “REF\_DATE” covers monthly data from Jan 2006 to Jun 2021, However, Jan 2006 to Jun 2021 is for “Canada” only. Data for individual cities and provinces have data from Jan 2019 to Jun 2021 only.

We require data from individual cities therefore our period will be limited to Jan 2019 to Jun 2021 only which will be 2019, 2020 and 2021 (3 years only) for our purpose.

***Data reduction***: Transformed raw data to the relevant columns and picking up only the relevant attributes of REF\_DATE, GEO, Total, Building type (from “Building type”), and VALUE. It is further refined to show only Cities under the “GEO” attribute since it currently contains total Canada and Provinces too. For the REF\_DATE, only 2020 December is required eliminating other periods. This resulted to revised dataset of “**RentSubset3**” with 390 observations and 4 variables from raw dataset with 1,956 observations and 15 variables.

### Outliers

Using R Studio, we performed statistical analysis on each dataset on all the numeric columns including boxplots. No material exceptions noted.

Chart, histogram

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*Figure 8. Check distribution of numeric data*

2005 Boxplot

Chart, box and whisker chart

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2015 Boxplot

Chart, box and whisker chart

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*Figure 9. Boxplots - Check for outliers*

### Data Integration

To have a singular list showing metrics as population, household income and rents in one dataset, the 4 datasets must be consolidated as follows:

* Left join on Population 2016 with Population 2011 to get Revised Population (both datasets with 158 observations)
* Left join on Household income (with 160 observations) with Revised population to get Combined Population and Household income (dataset with 160 observations)
* Left join on the Combined Population and Household income with Rent

However, before performing the above joins, the population and household income values had to be converted to growth values year over year since they will be compared to the dependent variable in rent.

Added growth columns for Population and Household income and revised dataset to PopCombined3 where all values of Population and Household income represent percentages (%s).

In doing the consolidation, we successfully combined Population and Household Income. Next will be Rent dataset joined with the combined Population and Household Income dataset.

#### Dataset Observation Issue

However, in preparing to consolidate the Rent dataset to the combined Population and Household Income, we noted that the 390 observations in Rent only included 12 cities for the pertinent year required and remaining were zeroes. This means that our final Combined dataset will be further reduced to how many rent observations there are as population and household income will use them as results for training and test. The Rent column is the dependent variable and will be converted to “Increase” (if value >100) or “Decrease” (if value <100).

The further reduction of observations now poses an issue as we are already too far into the process to find another public dataset to work on. We did not foresee this in our initial analyses as all datasets were rich in observations earlier. Investigating the raw datasets from Statistics Canada has been difficult and long due to how metrics were subset in columns/attributes. Unless there is clean-up and further transformation, this issue will not be easily detected by just a scan of data alone. This is specifically true with the dependent variable, rent, which resulted in an imbalance.

#### Addressing Dataset Issue

In real-world situations outside of this project, if after exhausting search for public rent dataset for additional cities required and nothing comes up, we would reach out for other sources such as companies like CBRE, JLL, Colliers, among others to get the missing rent information. However, for this project, what is required is publicly available datasets and so we will retain to use this resulting combined dataset. We proceeded with the resulting combined dataset and subjected it to the extent of modeling and validation that can be done.

# Analyses

Modeling and Validation

Supervised learning method was chosen since the dataset is labeled. We will use classification algorithm specifically k-Nearest Neighbours (k-NN) and Logistic Regression.

## k-Nearest Neighbours

We wanted to determine if there is a pattern for rent growth relating to changes in population and household income.

We normalized the numeric variables as Population, Household Income and Rent Growth are in different scales.

normalize<-function(x) {

(x – min(x)) / (max(x) – min(x)) }

Apply the normalize function to the dataset:

PopCombined3\_n<- as.data.frame(lapply(PopCombined3[2,4], normalize))

In doing the testing, we will use a 70 : 30 training and test sets split:

Set.seed(123)

train\_index<-sample(1:nrow(PopCombined3\_n), 0.7 \* nrow(PopCombined3\_n))

train.set<-PopCombined3\_n[train\_index,]

test.set<-PopCombined3\_n[-train\_index,]

Remove “Cities” column from training and test datasets

train.set3\_new<-train.set[-1]

test.set3\_new<-test.set[-1]

Store the labels for our training and test sets

PopCombined3\_train\_labels<-train.set$Cities

PopCombined3\_test\_labels<-test.set$Cities

*Prediction*

library (class)

PopCombined3\_test\_prediction<-knn(train = train.set3\_new, test = test.set3\_new, cl = PopCombined3\_train\_labels, k = 3)

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When we ran the line for prediction, it returned an **error** most likely due to the small number of observations in the combined dataset issue.

We went back further to extend exploration of data but rent information was truly limited. If the same rent data can be obtained from other sources to fill the missing cities, we may have been able to increase observations to an acceptable level and re-run prediction successfully.

## Logistic Regression

To determine relationship between our dependent variable (Rent) and the independent variables (population and household income), we will do regression analysis. Using Logistic regression since our dependent variable is categorical/binary.

The binomial logistic regression predicts the observations to fall in either increase (“1”) or decrease (“0”) in rent, category of population and household income.

The PopCombined3 dataset, outcome/dependent variable Rent Growth changed from text “Increase” and “Decrease” to binary response of “1” for increase and “0” for decrease as factors.

Graphical user interface, application, Word

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To do the testing, we created 70:30 training and test sets split

Set.seed(123)

train\_index<-sample(1:nrow(PopCombined3\_n), 0.7 \* nrow(PopCombined3\_n))

train.set<-PopCombined3\_n[train\_index,]

test.set<-PopCombined3\_n[-train\_index,]

Removed “Cities” column from training and test datasets

train.set\_new<-train.set[-1]

test.set\_new<-test.set[-1]

Creation of Logistic regression model

*Prediction Using the Test Set*

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*Coefficients*:

For every unit change in population growth, the log odd of rent growth decreases by 0.089

For every unit change in household income growth, the log odd of rent growth decreases by 0.193

Population growth (p-value = 0.584) and Household income growth (p-value = 0.564) are **not** statistically significant

*Prediction Using the Combined Dataset (with small # of observations)*

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*Coefficients*:

For every unit change in population growth, the log odd of rent growth decreases by 0.123

For every unit change in household income growth, the log odd of rent growth decreases by 0.086

Population growth (p-value = 0.314) and Household income growth (p-value = 0.423) are **not** statistically significant

*Confidence Intervals*



## Model Evaluation

Confusion Matrix was used to measure the performance of the model

### k-Nearest Neighbours Prediction

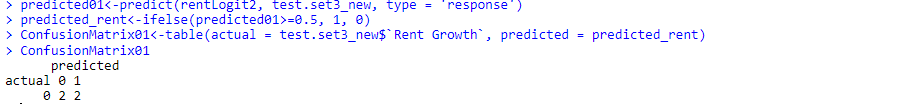
With a small number of observations in the dataset, the prediction model we built produced an error and we were not able to proceed in getting any results. Thus, we do not have any predictions to evaluate.

### Logistic Regression Using the Test Set

predicted01<-predict(rentLogit2, test.set3\_new, type = ‘response’)

predicted\_rent<-ifelse(predicted01>=0.5, 1, 0)

ConfusionMatrix01<-table(actual = test.set3\_new$`Rent Growth`, predicted = predicted\_rent)



The test set carried solely “0” or decrease in growth. Results of the prediction show 50 : 50 probability of between True Negative and False Positive



### Logistic Regression Using Combined Dataset (with small # of observations)

Sample body

predicted02<-predict(rentLogit, PopCombined4, type = ‘response’)

predicted\_rent02<-ifelse(predicted02>=0.5, 1, 0)

ConfusionMatrix02<-table(actual = PopCombined4$`Rent Growth`, predicted = predicted\_rent02)

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# Findings and Results

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## Next Steps

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# Conclusion

Including Shortcomings

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