



Canadian
Federation of
Apartment
Associations

Fédération
canadienne des
associations
de propriétaires
immobiliers

Federal Budget 2017

Pre-budget Submission to the Federal Finance Committee

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EXECUTIVE SUMMARY

Too little purpose-built rental housing is being built in Canada. That interferes with economic growth since workers often cannot obtain housing that is affordable in locations where employers are looking for workers. It also disadvantages low-income Canadians, who rely on rental housing. Encouraging more purpose-built rental housing would promote business prosperity and economic growth, both directly and indirectly.

Policy measures to address the problems

1. Improving returns on existing purpose-built rental housing

- tax reform such as
 - a tax deferral on sale and reinvestment (or the reinstatement of pooling)
 - higher CCA rates
 - recognizing residential rental income as active business income
- grants or low-cost financing for major repairs or retrofits.

2. Improving returns on newly constructed purpose-built rental housing.

- tax reform,
- new construction incentives for market rent rental housing,
- direct investment (subsidies),
- federal development bond financing.

Investment in existing rental housing and in new construction will both create economic growth, directly and through the earnings of the workers and the revenue of the suppliers.

3. Direct financial assistance to renters

“Portable housing allowance” or “housing benefit” programs include many advantages, including:

- Allowing recipients choice
- Allowing flexibility to address local needs
- Better labour-market attachment than with RGI subsidies attached to units or new social housing construction

Portable housing benefits enable low-income people to move to take jobs, which is good for them, for businesses and for taxpayers.

4. Addressing homelessness

In particular, through Housing First.

5. Federal programming

Federal initiatives should avoid laying requirements on top of provincial ones. Federal policy may achieve the best results if it provides funding and knowledge about best practices, sets targets, and aggregates the plans of the provinces to achieve the targets.

Who CFAA is

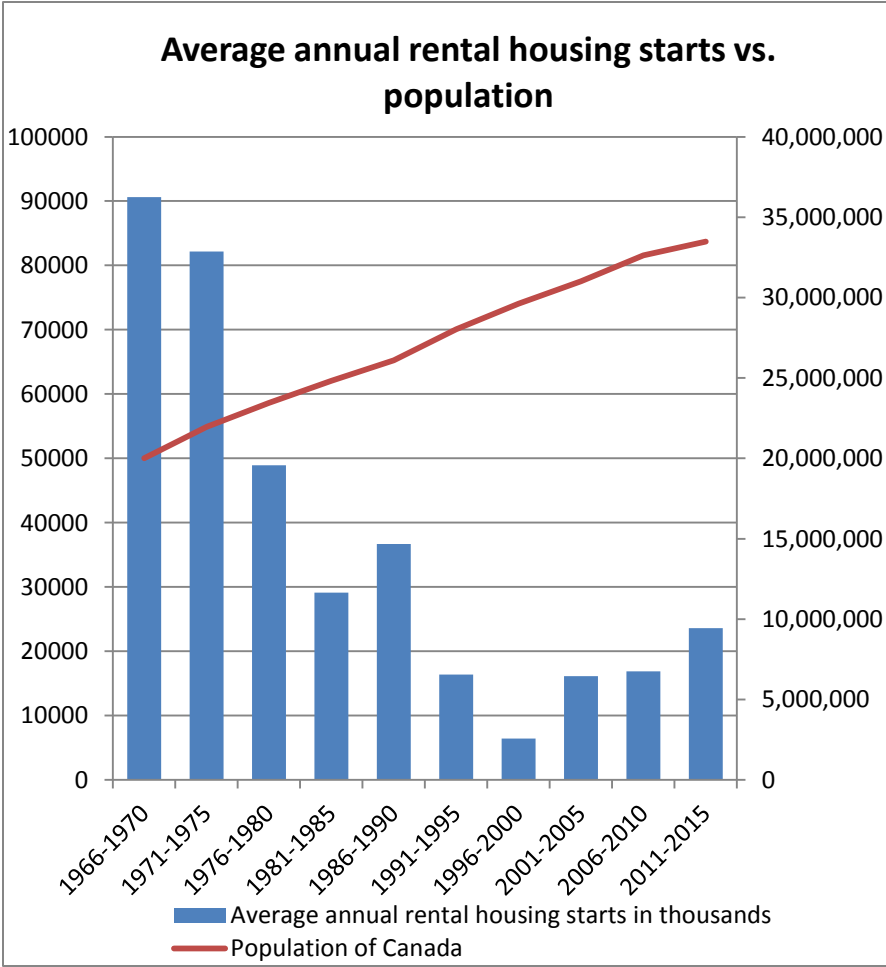
The Canadian Federation of Apartment Associations (CFAA) represents the owners and managers of rental homes across Canada, ranging from the owners of one or two rental units to public companies and REITs with up to 50,000 rental units. CFAA’s members own and manage rental homes of all types (single family, duplexes, row houses, walk-up apartments and high-rises) in every province and in cities and towns of all sizes. Much of what we advocate for would support businesses and economic growth, and assist residential tenants, who are often disadvantaged.

The focus of this submission

The rental housing market is directly linked to the needs of prosperous and secure communities, and to maximizing the availability of jobs for Canadians, and their ability to take up those jobs. As the most affordable housing available, rental housing is the housing of choice for large segments of the population, including disadvantaged groups.

The state of Canada’s rental housing market

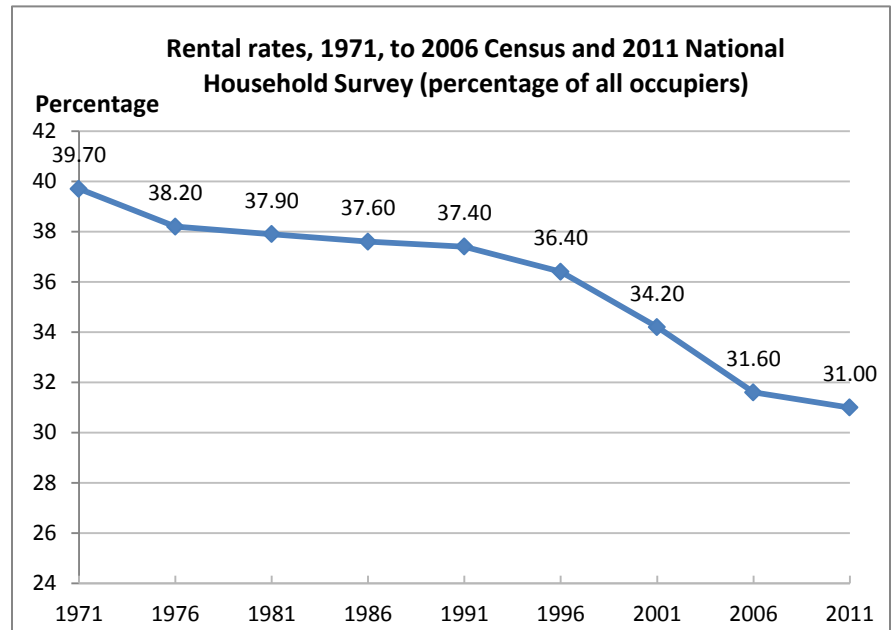
More than 30% of Canadians rent their homes, but for the last 35 years, less than 10% of all new housing has been built for the rental market. In Canada outside Quebec, the rate is even lower. This contrasts dramatically with the rental construction rates of the 1960s and even the 1970s and 1980s.



The overall rental rate has also declined as shown on the table below.

Because of the economies of scale and other savings in land, services, construction costs and professional fees, rental housing is the most affordable housing which can be built and operated. But Canada is not building enough new purpose-built rental housing.

Rental housing is the housing of choice for most workers moving to Canada or within Canada, for many newly-formed households, for new Canadians, for low-income households and for many seniors. The negative impacts of insufficient new rental housing include these:



- High growth communities cannot attract an optimal labour force to grow as they could
- Many communities see rising rents throughout the rental market, much to the disadvantage of low-income people (and of governments which support many of them)
- Housing of all types is becoming less affordable (apart from today's low interest rates, which will not last forever)
- People lack choice in addressing their housing needs
- Shortages of rental housing interfere with labour mobility
- Rentals by landlords with no on-site staff (such as condos) are creating community problems in condo buildings and in established neighbourhoods
- Excess home-ownership rates raises unemployment

What about low interest rates?

In the last one or two years some rental starts have been triggered by the combination of increases in rents and low interest rates. Low financing costs make rental development more feasible than it would be at more normal interest rates, but it has not enabled construction of the number and type of new rental units needed. When interest rates rise, even the current modest level of rental development may well dry up.

Yet that same rise in interest rates may very well impact demand for rental housing, as people who previously gave up renting and bought houses may no longer find that affordable, and may seek to move back to rental homes.

What about the new supply through condo units?

The rental of condo units has mitigated the shortage of new purpose-built rental units. However, condos are expensive to build, and are offered at high end rents. Renters in condos lack of security of tenure, and on-site management staff. That can lead to behavioural problems which the landlord is not well placed to address, and the condo boards are not well placed to address. Relying on the flow of condo rentals brings its own problems and is not the best solution.

What about incenting new supply, especially affordable supply?

Often when people talk about a lack of affordable housing, the reaction is that the solution is to subsidize the construction of affordable housing. However, since building new housing is inevitably expensive, a large subsidy is required to reach rents that are affordable. The more economic approach is to make it more attractive to build at the high-end for high-end rents, and thus enable the move-up effect to make affordable units available to low-income tenants.

Moreover, subsidies for new social housing crowd out existing affordable housing, often as much as one-to-one. Crowding out occurs because the subsidized construction uses up available land, construction labour and contractors, and takes up the effective demand. Subsidies to build “affordable housing” are extremely expensive, and often work poorly.

How the rental housing market works

What we usually call the rental market is the market for a stream of services, namely the right to live in a rental unit for a period of time. In addition, there is a market for rental housing assets. Rents are converted into asset values based on long-term interest rates, the risks, the future prospects of the asset and the tax system. If rental asset values are below the replacement cost, then assets are taken out of the market (perhaps being converted to hotels or condos, or demolished so that the land can be used for other uses); whereas if rental asset values are above replacement costs, then new rental housing is built to meet the demand from investors who want more rental housing assets.

The investor’s return comes from the stream of net income (gross rents, less operating expenses and taxes), and also from capital gains (less taxes). Rental owners almost always invest capital in the rental assets they own, and must make a sufficient return on that capital to justify keeping it in that use (rather than buying shares or bonds, etc.) If rental owners are making any abnormal profit, other investors will come into the market to buy assets, and thus stimulate new rental construction. If rental owners are making below normal rates of return, then they will want to pull out of rental housing, or at a minimum will not buy more rental assets, and so few new rental assets will be built.

The cause of insufficient rental housing production

The fact that few purpose built rental assets are being built reflects the fact that rental owners are not making a high enough return to justify more investment. The cause of the problem is largely the current tax system and its impact on the after-tax rate of return and the incentive to invest or divest.

The impact of the tax system is felt by renters, who end up being treated unfairly compared to home-owners. Within the broader housing sector, home-owners do not pay tax on the capital gains of their homes. However, capital gains tax is charged on the value gains made within rental housing. Since the after-tax rate of return is determined by the market, tenants must pay enough rent to pay the capital gains tax on their homes (over time through their rents.) On average, tenants have half the income of home-owners, but yet they have to pay a tax which home-owners are spared.

Policy measures to address the problems

CFAA recommends the following policy measures to address the various existing housing problems.

1. Improving returns on existing purpose-built rental housing

Improving returns on existing purpose-built rental housing will increase the stock of rental housing which investors want to hold. That will draw out new rental housing construction. That can be done through

- tax reform such as
 - a tax deferral on sale and reinvestment (or the reinstatement of pooling),
 - higher CCA rates,
 - recognizing residential rental income as active business income (to open it up to the middle corporate tax bracket, not the small business rate),
- grants or low-cost financing for major repairs or retrofit, or
- other cost reduction measures.

2. Improving returns on newly constructed purpose-built rental housing.

Improving returns on newly constructed purpose-built rental housing. That can be done through

- tax reform (as above),
- new construction incentives for market rent rental housing,
- direct investment (subsidies),
- federal development bond financing, or
- other cost reduction measures.

Investment in existing rental housing and in new construction will both create economic growth, directly and through the earnings of the workers and the suppliers. CFAA is developing a suite of measures that should produce the best results at the least cost to government. We look forward to addressing the details in future presentations.

3. Direct financial assistance to renters

Direct income support for households not tied to a specific unit or building should be expanded, whether through a federal program or through funding for an expansion of the Provincial programs. Such “portable housing allowance” or “housing benefit” programs provide many advantages, including:

- Allowing recipients choice,
- Allowing flexibility to address local needs, and

- Better labour-market attachment than with rental subsidies attached to units or new social housing construction.

Portable housing benefits enable low-income people to move to take jobs, which is good for them, for businesses and for taxpayers, because it will drive economic growth.

4. Addressing homelessness

Addressing homelessness, and in particular making Housing First work, and getting enough supportive housing. Housing First is more effective than traditional approaches for a range of homeless individuals, including those with serious mental illness, veterans, youth, and individuals with substance addictions. CFAA expects to provide further input on this issue once more work has been done in preparation for the consultation about the National Housing Strategy.

5. Federal programming

National programs need to be flexible since housing market conditions vary greatly across the country. Some cities and towns are in decline: those places do not need any new housing construction. Other cities and towns are booming and need more of most kinds of housing. Still other cities and towns need particular types of additional housing. Federal funding for housing should leave open to the provinces whether to use the funding for new construction, repairs and rehabilitation, rent subsidies, homelessness initiatives or other approaches.

Federal initiatives should avoid laying additional requirements on top of existing provincial ones. Federal policy will achieve the best results if it provides funding and knowledge about best practices, sets targets, and aggregates the plans of the provinces to achieve their part in the targets.