



Rental Housing in the 2015 Federal Budget

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Who we are

CFAA is the sole national organization representing the owners and managers of rental homes across Canada. Our member rental owners and managers include landlords of all sizes, from the owners of one or two rental units to public companies and REITs with up to 35,000 rental units (the largest landlords in Canada). CFAA's members own and manage rental homes of all types (single family, duplexes, walk-up apartments and high-rises) in every province and in cities and towns of all sizes.

Over the years we have found that much of what we advocate for would assist residential tenants, not just apartment owners. That is true of this submission.

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.

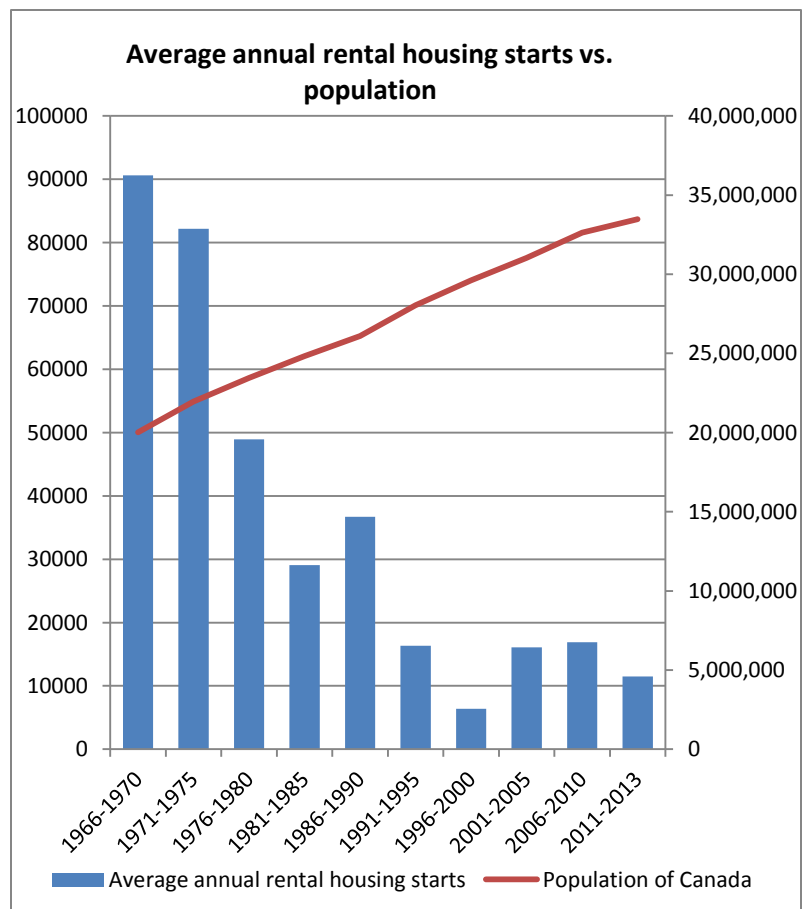
Rental housing is the most affordable housing available. It is the housing of choice for large segments of the population of Canada.

Canada has problems in the residential rental housing market. Many people are aware of some of the problems, but little concern is shown for other problems, and for the potential for the situation to worsen in the foreseeable future.

Tackling these problems will be costly and it will take time for the full benefits to emerge. But it is important that the problems be recognized as an important public policy issue, and that a dialogue take place about why these problems exist, and about what is required to fix them.

The state of Canada's rental housing market

More than 30% of Canadians rent their homes, but for the last 25 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 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.

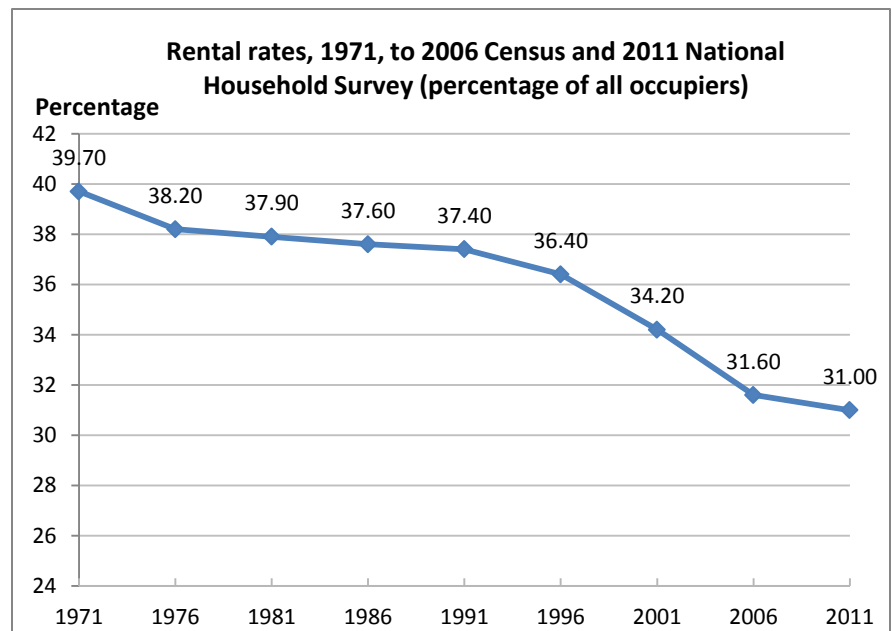
Rental housing is the housing of choice for most workers moving to Canada or within Canada, for many newly-formed households, for new Canadians, for low-income households and for many seniors. The negative

impacts of insufficient new rental housing include these:

- High growth communities cannot attract an optimal labour force to grow as they could
- High growth and new communities face high housing costs and difficulty attracting the young workers they need to provide government services such as fire, police and hospitals
- 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

As to the last point, the U.S. National Bureau of Economic Research (NBER), a highly respected, non-political economic research institute, recently published a working paper on the relationship between homeownership and the labour market. The paper found that a doubling of the homeownership rate is associated with an increase of more than double in the unemployment rate.

Through detailed statistical analysis, the authors studied homeownership and unemployment rates in all 48 continental states, since the 1950's. The U.S. housing



and labour markets are very similar to Canada's; and so, the results are almost certainly transferable to Canada.

The authors found:

- High levels of home-ownership are tightly linked to high levels of unemployment (3 to 5 years later)
- Both within and across states, high home-ownership areas have lower labour mobility
- States with higher rates of home-ownership have longer commute times
- States with higher rates of home-ownership have lower rates of business formation.

The study also noted that not all rental housing is equal. In public housing, labour mobility tends to be low and associated joblessness high. As a result, private rental housing is key for low unemployment.

Isn't the issue rent controls?

Rent control is a factor that makes it less attractive to invest in rental housing. However, the number of rental starts is extremely low in all provinces, including growing provinces which do not have rent control, like Alberta, Saskatchewan and Newfoundland, while the federal tax rules apply nation-wide.

Is the problem everywhere or localized?

Naturally the problem of a lack of new supply is more acute in areas in which rental demand is growing. However, little new supply is being built anywhere, so that the problem is widespread. (Just because unemployment is less of a problem in some places does not mean we do not address it everywhere through the EI system.)

What about low interest rates?

In the last one or two years some rental starts have been triggered by the combination of relatively high 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 low level of rental development may well dry up.

Yet that same rise in interest rates may very well impact demand for rental housing, as those people who have eschewed renting and bought residential accommodation may no longer find it 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 rental units and the rental housing availability issue. 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. The lack of on-site management staff 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?

Whenever 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 affordable rent levels. 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

The rental housing market is really two markets. 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. That market is in most ways a normal consumer market: consumers will buy (rent) more housing if the price (rent) is low, and will rent less if the rent is high. Likewise producers will sell (rent) less housing if the price (rent) is low, and will rent more if the rent is high. Rents rise or fall, moving toward equilibrium at each point in time.

In addition, there is a market for rental housing assets. Rents come to be converted into asset values based on the 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).

The purpose-built rental housing market is highly competitive, both inside the rental market and with close substitutes. Rather than renting an apartment in a purpose-built rental building, many households or individuals can rent a condo, rent a single family home, rent rooms in a house or buy a house. Individuals often live in a room in a house. Young people move back and forth between their parents’ houses, and rooms in other people’s houses and apartments, either alone or in groups of several people. Seniors sell their homes, and rent apartment or move into retirement homes.

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.

Conclusion

Providing a sufficient number and type of rental units at a reasonable level of profit is the challenge undertaken by the industry. Canada is not seeing enough new purpose-built rental housing to meet the housing needs of workers moving to new jobs, low-income Canadians or large families.

Increasing the rate of return on purpose-built rental housing will increase the stock of rental housing which investors want to hold. That will draw out new rental housing construction. The result of such reforms, and the resulting new construction, would inevitably be

- more rental supply, especially in high growth communities, enabling them to attract more workers
- to reduce rents from what they are now, or would otherwise become, thereby:
 - helping high cost communities to attract the young workers they need to provide government services such as fire, police and hospitals
 - moderating housing costs for low-income people (and for governments which support many of them)
- more choice for everyone to address their housing needs
- fewer community problems in condo buildings and in established neighbourhoods
- a stabilization of the declining home-ownership rate, thus maintaining strong employment rates, and
- greater tax fairness for residential tenants.