Brief to the House of Commons' Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities (HUMA) regarding their study of the financialization of housing

June 30, 2023

Introduction

The Minto Group ("Minto") is a Canadian real estate firm that develops and manages residential real estate. Since its inception in 1955, Minto has built more than 100,000 new homes and currently manages over 10,700 residential rental units including over 8,200 units in Minto Apartment REIT, which is publicly traded on the Toronto Stock Exchange. Minto manages apartments in Canada's six largest cities and has active development projects in Ottawa, Toronto, Calgary and the Greater Vancouver Area. Minto Apartment REIT is also a member of *Canadian Rental Housing Providers for Affordable Housing*.

Canada has succeeded in increasing its rate of population growth in recent years. This growth is helping us to address challenges from an aging population and to benefit from increased scale in many areas, including health care, education, business centres and major infrastructure. Unfortunately, the production of new housing has not kept pace with increased demand resulting in affordability challenges in both rental housing and home ownership. People with the lowest incomes are suffering the worst.

The solution to the problem is more housing supply. We need policies that can speed up production, ensure adequate supplies of labour and materials, and provide incentives to develop affordable housing. The high cost of developing housing in urban environments means that affordable housing is not economical without some form of government support. This brief will provide cost details for two active rental developments to demonstrate the cost pressures developers face and will provide an example of the types of government supports that can lead to the development of rental housing. It will also provide information about an affordable housing fund that would complement any new development programs.

Cost Data and Analysis from Active Projects

The cost data set out in Table #1 on the following page are from two active Minto development projects.

Project #1

Minto is about to break ground on Project #1, which is a 325-unit building located in Toronto. Project #1 will have a mix of unit types (bachelor, 1-bedroom and 2-bedroom), and the average unit size is 688 square feet. See section 1.0 in Table #1 for details.

Table #1

	Project #1 Toronto			Project #2 Ottawa		
1.0 Project Details						
Total suites	325			227		
Gross leaseable area (square feet)	223,518			159,086		
Average suite size (square feet)	688			701		
2.0 Costing Information	**Cost**			**Cost**		
	Total (000s)	per suite (000s)	per leaseable square foot	Total (000s)	per suite (000s)	per leaseable square foot
Land acquisition	$18,291	$56	$82	$8,355	$37	$53
Land transfer taxes	705	2	3	156	1	1
Total land cost	**$18,996**	**$58**	**$85**	**$8,510**	**$37**	**$53**
Hard construction costs	**$141,222**	**$435**	**$632**	**$88,023**	**$388**	**$553**
Soft costs						
Development and municipal charges	$22,906	$70	$102	$5,257	$23	$33
HST self assessment (net of rebates)	26,490	82	119	13,054	58	82
Property taxes during development	590	2	3	154	1	1
Other soft costs	26,742	82	120	6,673	29	42
Total soft costs	**$76,728**	**$236**	**$343**	**$25,138**	**$111**	**$158**
Total development cost	**$236,946**	**$729**	**$1,060**	**$121,671**	**$536**	**$765**
3.0 Analysis of Taxes						
Land transfer taxes	$705	$2	$3	$156	$1	$1
Development and municipal charges	$22,906	$70	$102	$5,257	$23	$33
HST self assessment (net of rebates)	$26,490	$82	$119	$13,054	$58	$82
Property taxes during development	$590	$2	$3	$154	$1	$1
Total taxes	**$50,691**	**$156**	**$227**	**$18,620**	**$82**	**$117**
Taxes as a % of total costs	**21%**			**15%**		
4.0 Revenue, Income and Return Analysis						
all amounts are average per unit						
Forecasted monthly rent	$3,000			$2,550		
Annual rent	$36,000			$30,600		
Less: Property operating costs						
including property taxes and utilities	9,720			9,180		
Net operating income (NOI)	**$26,280**			**$21,420**		
Cost per unit (from above)	$729,000			$536,000		
Annual return (NOI/Total Development Cost)	**3.60%**			**4.00%**		
Government of Canada (GOC) Bond Yield[1]	3.37%			3.37%		
Premium over GOC	0.23%			0.63%		

1. As at 29 June 2023.

The total development cost of Project #1 is $237 million dollars or $729,000 per unit. See section 2.0 in Table #1 for details.

Although lease-up is several years away and the rental rates that we will achieve are uncertain, the average expected rent for the units in Project #1 is $3,000 per month.[1] This rental rate produces annual revenue of $36,000 per unit. After allowing for property operating costs, property taxes and utilities ($9,720 per unit for all three costs), each unit delivers $26,280 of net operating income. See section 4.0 in Table #1 for details.

To calculate a simple financial return, we divide annual net operating income per unit by total development cost, which provides an annual cash-on-cost return of 3.60%.

Project #2

Minto is under construction for Project #2, which is a 227-unit building located in Ottawa. Project #2 will have a mix of unit types (bachelor, 1-bedroom and 2-bedroom) and the average unit size is 701 square feet. See section 1.0 in Table #1 for details.

The total development cost of Project #2 is $122 million dollars or $536,000 per unit. See section 2.0 in Table #1 for details.

Although lease up is several years away and the rental rates that we will achieve are uncertain, the average expected rent for the units in Project #1 is $2,550 per month.[2] This rental rate produces annual revenue of $30,000 per unit. After allowing for property operating costs, property taxes and utilities ($9,000 per unit for all three expenses) each unit delivers $21,420 of net operating income. See section 4.0 in Table #1 for details.

To calculate a simple financial return, we divide annual net operating income per unit by total development cost, which provides an annual cash-on-cost return of 4.00%.

Rapidly rising rents have not offset increasing costs, halting new supply

The design and level of finishes in these projects are high quality and attractive but are at a lower level than what would be specified in a condominium project where units are being offered for sale. Although these units do have modern amenities expected in a new apartment building, including in-suite washer and dryer and air conditioning, these are not luxury condominiums.

The expected financial returns on these projects are low. The cash-on-cost return is 3.60% for Project #1 and 4.00% for Project #2. To put these returns in context, the current yield on a 10-year risk free Government of Canada bond is 3.37% (see section #4 in Table #1 for details). Although we do expect rental rates to increase over time, the initial financial returns are a slim 0.23% above the risk free Government of Canada rate for Project #1 and 0.63% for Project #2.

Generally, developers need higher premiums over the risk-free rate to compensate for the substantial risks inherent to housing development. Risks include schedule delays and cost overruns relating to

[1] The average monthly affordable rent in Toronto is $1,348 per month, based on 30% of local 2019 median renters' household income (per CMHC).

[2] The average monthly affordable rent in Ottawa is $1,535 per month, based on 30% of local 2019 median renters' household income (per CMHC).

delayed municipal approvals, site excavation and construction, material and labour supplies, interest rates and the final lease-up rates achieved on the project.

The principal reasons for the lower-than-expected returns are rapidly rising construction costs and interest rates. Over the past 24-month period, construction costs have increased by 33% in Ottawa and 49% in Toronto.[3] Most construction loans are based on floating interest rates tied to the prime borrowing rate, which has increased by 4.50% since March 2022 to 6.95% and has materially increased interest carry costs. In normal interest rate cycles, adding debt financing to the project enhances returns on the equity invested. However, the recent rise in interest rates to a level higher than the expected project return means that using debt financing is actually dilutive to returns.

Government charges from all levels of government also contribute to rising development costs. Transfer taxes on the acquisition and disposition of property, development charges, property taxes during development and HST applicable at completion contribute substantially to the cost of a new home. In the examples above, the combined taxes were $156,000 per unit (or 21% of the total cost) for Project #1 and $82,000 per unit (or 15% of the total cost) for Project #2. See section 3.0 in Table #1 for details. Some analysts have estimated the total tax burden on certain types of housing is as high as 31%.[4]

Rising rental rates improve forecasted financial returns, but rapidly rising rents have not offset the swifter rise in development costs. Despite the forecasted rents for Project #1 and Project #2 being at very high levels, financial returns are slim. Given the challenge of developing market-rate units, without government support, it is not economical to develop affordable rentals in Canada's urban environments without some type of government assistance. In fact, pricing pressures are resulting in the cancellation of many market-rate projects as they are no longer economically viable. This will only exacerbate the housing affordability crisis.

Substituting affordable rental rates for market rates in these projects would result in financial returns well below the risk free rate. Private investors would never pursue a project on this basis.

Example of Governments and the Private Sector Working Together

Minto Apartment REIT is constructing a new 225-unit affordable apartment building at 610 Martin Grove Avenue in Toronto with the assistance of the City of Toronto's Open Door Program and CMHC's Rental Construction Financing Initiative (RCFI). The project commenced construction in 2022 and is expected to be completed in 2026.

This project is being developed on surplus land at an existing Minto Apartment REIT rental property (620 Martin Grove), so the incremental land cost is zero. The Open Door program covers 100 units (out of 225 units) in the project and provides a capital grant of $45,000 per unit, a waiver of development charges and a waiver of property taxes for the units once the project is operational. The RCFI construction financing provides approximately 80% of project costs on favourable terms.

In exchange for these benefits, Minto must offer and maintain units at affordable rents. For the units covered by the Open Door Program, rents must be 25% of median household income (as defined in the agreement) and must be maintained at that level for 25 years. The remaining 125 units are covered by

---

[3] See Statcan table 18-10-0276-01 (https://www150.statcan.gc.ca/t1/tbl1/en/cv.action?pid=1810027601).

[4] See CANCEA, An Uncomfortable Contradiction: Taxation of Ontario Housing (https://www.cancea.ca/index.php/2023/04/27/an-uncomfortable-contradiction-taxation-of-ontario-housing/).

the requirements of the RCFI program[5], and affordability must be maintained for at least 10 years. The landlord's obligations under both programs are secured by a specific mortgage charge on the property.

The combination of free land (through the intensification of an existing site), government incentives and favourable financing terms made this project financially feasible. The project proforma was reviewed and approved by CMHC and is subject to monthly project monitoring throughout construction.

This project is a good example of the public and private sectors working together to produce socially desirable outcomes.

A Short-Term Solution

As noted above, increasing supply is the long-term solution to Canada's housing affordability challenges. Cost pressures and high-interest rates are making this a challenge. Regardless, the right mix of government incentives can deliver new affordable housing.

However, the development of new projects takes time. The project at 620 Martin Grove will take four years to construct. Given the challenges around municipal approvals in large cities, any new project of scale that is started today would likely take five years or longer to complete.

Canadian Rental Housing Providers for Affordable Housing, along with other advocates, have suggested an additional strategy to help preserve affordability while supply is being developed. Many older, existing rental properties with affordable in-place rents can be acquired at a much lower cost than new development. The federal government could create a fund and financing program to allow nonprofits, cooperatives and community land trusts to acquire these properties and keep rents at affordable levels in perpetuity. A discussion paper setting out many important considerations for the establishment and operation of such a fund has been shared with the government.

Conclusion

Canada needs population growth to flourish. Housing policy needs to ensure that everyone has an adequate place to live. The rapidly increasing development costs and interest rates are making the development of market-rate rental housing a challenge. Developing new affordable rental housing requires government incentives. There are funding models that work and should be scaled up, but new development takes time. Federal funding for an affordable housing fund could preserve the affordability of existing rentals immediately and would be an excellent complement to any development program.

[5] RCFI eligibility requirements can be found at (https://www.cmhc-schl.gc.ca/professionals/project-funding-and-mortgage-financing/funding-programs/all-funding-programs/rental-construction-financing-initiative).