Canadian Federation of Apartment Associations
Fédération canadienne des associations de propriétaires immobiliers

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Pre-budget submission

Improving Rental Housing Affordability in a Post-COVID-19 Reality

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RECOMMENDATIONS

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Introduction

The Canadian Federation of Apartment Associations ("CFAA") is pleased to provide a rental housing industry perspective on what measures the federal government could take to restart the Canadian economy, as it recovers from the COVID-19 pandemic.

CFAA represents the owners and managers of close to one million residential rental suites across Canada. The private rental housing sector provides four million rental homes for nine million Canadians of all ages, incomes and situations. Of those nine million Canadians, about three million are considered to live in low-income households in any given year. Every year, about two out of every three low-income renters live in for-profit rental housing, mostly at the affordable end of the rental market. However, due to their low incomes, they struggle to pay their rent.

CFAA and our members believe that a healthy rental market contributes greatly to Canada's national well-being and economic prosperity. We believe that the policies we advocate will benefit not only landlords, but also taxpayers, low income renters and other vulnerable populations.

CFAA and our members believe that landlords and renters share a common interest in flexible and responsive rental markets, fair taxation of residential rental property, high industry standards for customer service, and housing assistance that supports tenants' rights to choose their housing and to move when and if they please. CFAA advocates reasonable government support for those who cannot adequately address their own housing needs.

Economic Impact of Canada's Rental Housing Sector

According to the economic impact study of Canada's rental housing sector by KPMG in 2016, Canada's rental housing industry:

- Contributed $69.3 billion to Canada's GDP;
- Generated labour income of $30.6 billion and 436,306 Full-Time Equivalent ("FTE") positions in Canada; and
- Generated more than $25.8 billion in government revenues in Canada.

The rental housing industry has grown significantly since 2016, particularly through new purpose-built rental housing construction in major centres.

The economic impact of the COVID-19 pandemic on rental housing

Compared with several other economic sectors, the rental housing industry as a whole has managed reasonably well during the COVID-19 shut downs. Most working people kept most of their income, and most of those who did not were supported by CERB, and then later by CEWS. Other tenants still received their pensions or their social assistance payments. As a result, most tenants were able to pay their rent, and did pay their rent.

However, some tenants were not able to pay their rent, and some who could pay, did not pay their rent or broke their leases. That situation had particular adverse effects on owners of one or two units, where non-payment was devastating. The sub-sector most badly affected is rental housing for students. To return to normal and retain such housing units in the rental supply, the rental providers who suffered significantly need help.

Recommendations

The recommendations contained herein all aim to promote a healthy rental housing sector adapted to a post-COVID-19 reality, encourage construction of new rental supply, and improve rental housing affordability.

COVID-19 RELIEF

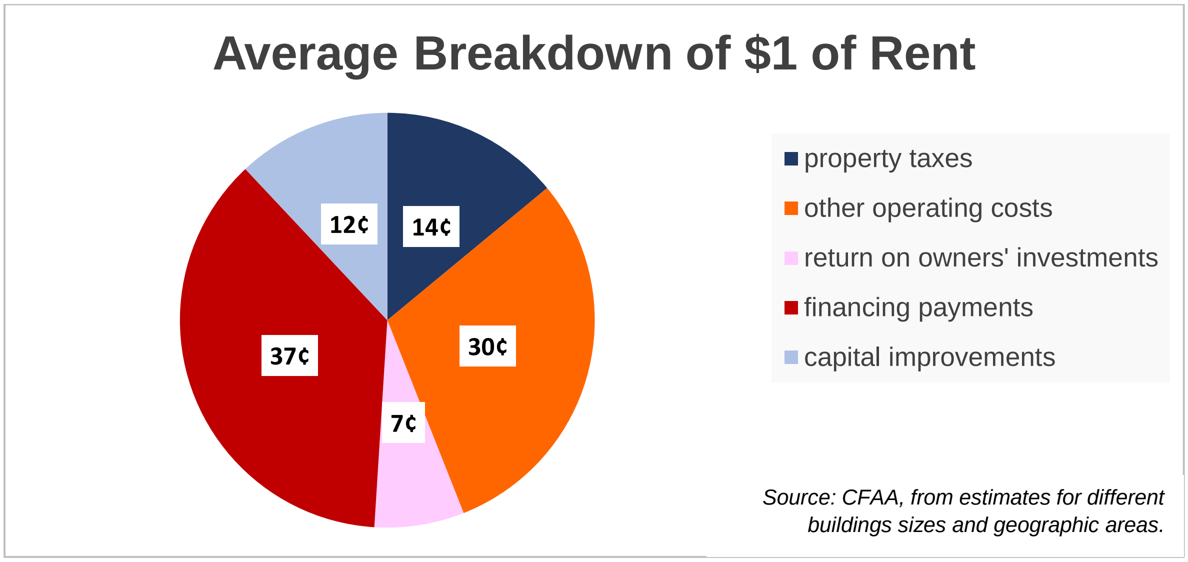
Recommendation 1: Accelerate the delivery of the Canada Housing Benefit (CHB) or other forms of rent subsidy

CERB was a critical factor in sustaining the rental housing sector by sustaining the ability of most tenants to pay their rent. However, CERB was less effective than it could have been in that regard because of being a flat rate payment. In Edmunston, NB, with an average rent of $450 per month, $2,000 goes very far. In Toronto, with an average rent of $1,500, $2,000 does not go very far.

Now and in the long run, when supports can be fine-tuned to need, income support would be more effective if it takes into account the rent that people need to pay in the communities in which they live. CFAA suggests expanding the Canada Housing Benefit as the most convenient way to move in that direction. Funds have already been committed to the CHB in the National Housing Strategy. The application of those funds could well be accelerated.

Recommendation 2: A tax credit to help severely affected rental housing providers

Where does a dollar of rent go?



Of every $1.00 of residential rent, an average of about 7 cents is return on owners' investments. The other 93 cents are costs of operating, maintaining and financing the rental property. As a cushion for government, and to use a round number, let us use 10 cents as the average return.

Only a subset of rental owners are experiencing a shortfall that takes away all their return, but, for those rental providers, the impact of COVID-19 has been devastating. To retain such housing units in the rental supply, the owners in that situation need help.

CFAA proposes a refundable tax credit of 50% of the shortfall beyond 10% of the average revenue an owner collected in 2018 and 2019. **On average, that will not pay for any return on investment (profit), and it will compensate the owner for only one half of their expenses which were not recovered through rental revenue.**

With that formula, all rental providers have a strong incentive to collect as much revenue as they can. Rental providers who have much equity invested will be treated equitably with rental providers who are highly leveraged. The formula will also manage the cost of the program.

Here are samples of the result of such a tax credit:

Situation	2018/2019 revenue	2021 revenue	Shortfall	Shortfall beyond 10%	Tax credit
A	$10,000	$9,000	$1,000	0	0
B	$10,000	$8,000	$2,000	$1,000	$500
C	$10,000	$5,000	$5,000	$4,000	$2,000

Arrangements should be made for rental providers who began operations after January 1, 2018, who could easily be the most affected. An example would be using the 2019 revenue as the base amount.

LONGER TERM SUPPORT FOR RENTAL AFFORDABILITY

Recommendation 3: No interest deductibility limitation

Before March 2020, the government was contemplating an interest deductibility limitation of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA). That was recommended by the OECD as a means of avoiding base erosion and tax shifting. However, other than in Canada and the U.S., the OECD does not have a purpose-built rental housing sector, or a major rental office and industrial sector. Therefore, the OECD did not address the special situation of rental housing and all real estate.

Rental housing and all real estate are capital intensive. More than virtually all other business sectors, the rental business use a great deal of capital, and thus pays a comparatively high amount of interest. In adopting its interest deductibility limitation, the U.S. has exempted companies with less than $25M of income per year, and even for larger companies has effectively given an exemption to real estate.

CFAA urges the government not to go forward with any expansion of the interest deductibility limitations. At the least, we urge the government not to apply an expanded test to the real estate sector, and in particular, not to apply an expanded test to the rental housing sector.

Recommendation 4: No Capital Gains Tax increase

CFAA urges the government not to raise capital gains taxes on any property, and, in particular, urges the government not to raise capital gains taxes or the capital gains inclusion rate on rental housing.

Rental housing and other real estate assets are usually held for long periods of time. Over long periods of time, a substantial amount of the apparent capital gains is actually compensation for the effect of inflation. The current inclusion rate was brought in, in 1972 before inflation took off, as a compromise between the full taxation of capital gains and no taxation of capital gains. Since 1972, the inclusion rate (rather than full inclusion of capital gains in income) has been critical to prevent the capital gains tax from being a tax on capital.

As noted above, the rental business uses a great deal of capital. Therefore, the cost of capital, including the taxation of capital gains, is a significant factor in determining the volume of rental housing investment. Increasing the inclusion rate on capital gains would raise costs in rental housing, which would tend to reduce investment in rental housing. Government policy is stated to seek to encourage rental housing development to moderate rents and make rental housing more affordable. It would be much less of a drag on the economy (and less of a drag on rental housing investment) to pay the interest on the government debt rather than to raise taxes to seek to pay off the debt.

Recommendation 5: Subsidies for energy saving retrofits - Assist with economic expansion as well as climate change goals

It is well known that transportation and buildings are the two sectors which use the most energy and produce the most GHGs. The rental housing sector would like to contribute to Canada's goals of reducing energy consumption and GHG emissions. CFAA is already working with NRCan on programs to develop building materials with better energy saving characteristics. What is needed, in addition, is subsides to make more extensive building alterations more attractive than the mid-level retrofits which are optimal now, given today's energy prices and today's building materials.

Recommendation 6: Other Tax Levers to increase affordability through the move up effect

The government can improve housing affordability through income tax measures:

a. Reducing the GST/HST charged on new rental buildings.
b. Increasing the Capital Cost Allowance rate for new rental housing.

The GST/HST is a large and uncertain cost which is imposed all at once when new rental construction is finished. Reducing or eliminating the GST/HST on new rental construction would facilitate more rental supply, and that would improve affordability across the housing spectrum.

Increasing the Capital Cost Allowance (CCA) would improve the economics of rental development, with little or no impact on current government revenue. That reform would also encourage more rental supply, and that would improve affordability across the housing spectrum, through the move up effect.

CFAA's website includes material on both issues.

The move up effect

The move up effect is the following: when housing at the higher end of the housing market becomes available, people in the middle of the market move into it, thus making available units in the middle of the market. In turn, people occupying units at the lower end of the market move into those units, thus making available units in the lower end of the market. Units at the lower end of the market are affordable housing. Steps that facilitate or attract higher end development make available affordable housing, through the move up effect. The move up effect takes place as quickly as new units can be constructed, plus a month or two (or even less time) for each move in the vacancy chain. Filtering is the term housing economists often use for the move up effect.

Conclusion

CFAA seeks to work with the government, and with all of Canada's political parties, to sustain the rental housing industry and to make rental housing affordable, accessible and energy efficient, to serve more households better.

CFAA would be pleased to appear before the Finance Committee to expand on the issues and recommendations, and to answer any questions.