GETTING MORE RENTAL HOUSING ONTO THE MARKET - NOW

ISSUE

In many parts of Canada, rental housing is in desperately short supply. Whether it is due to explosive population growth, the crisis in affordability of home ownership, or the aging and disrepair of existing rental stock, it is undeniable that the supply of rental housing is greatly outstripped by demand.

The shortage of rental housing is not news. Demand has exceeded supply for years. How is it that at the end of one of the longest booms in real estate construction that our country's major and mid-sized cities have ever seen, that there is still a shortage of rental stock?

BACKGROUND

The answer is simple economics. Those in the market with the capacity to build new housing, prefer to build units for sale, not rental. The reason for this preference is that the investment returns on housing built for sale is better than the returns on purpose-built rental stock. Given the tremendous increase in the cost of land and construction, this is no surprise. What developer would not prefer to get its investment and profit immediately after construction, as compared to waiting an average of ten years[1] just to get back the money it has sunk into a rental building?

Affordable housing solutions generally fall onto the shoulders of provincial and municipal/regional government bodies. Through their interventions in the market, the viability of rental housing for developers waxes and wanes with successive governments.[2]

SOLUTION

The federal government has acknowledged that it, too, has a role to play in housing Canadians. With housing security of low- and now middle-income Canadians a pressing issue, increasing rental stock is perhaps the most impactful change the federal government can aim for. For the past 15 years, 63% of Canadians have owned homes. In recent years, home ownership rapidly increased to 69% and many

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[1] Institutional investment into existing residential properties highlights the low-cost of entry compared to new construction. The price of investment is sometimes 60% the price of new development. There is an opportunity to develop new housing units at currently unmet price points as new housing unit developments are frequently priced at 140% of average market rent and affordable units are frequently developed at less than 90% of average market rents. For non-profit organizations that develop affordable housing, the opportunity to finance affordable housing through generated revenue exists by developing market housing units at 120-130% of average market rents to subsidize affordable housing units. Source: *New Opportunities in Rental Housing Financing CANADIAN HOUSING AND RENEWAL ASSOCIATION May 3rd, 2017: Setting the Context; Steve Pomeroy, Principal, Focus Consulting Inc.*

[2] The risk-to-cost profile of development changes over time. Risk of failure is high in the beginning of projects, making the low financial investment in this phase extremely high risk. As projects move forward and confirm land, zoning, and other aspects, the risk decreases and the financial investment increases. For these reasons, early projects are best explored by working with external stakeholders, such as Canada Mortgage and Housing Corporation. Source *New Opportunities in Rental Housing Financing CANADIAN HOUSING AND RENEWAL ASSOCIATION May 3rd, 2017; Development Discussion and Examples Simon Davie, Chief Operating Officer, Terra Housing (BC)*

renters were able to transition to homeownership, reducing demand on the existing rental market and available units.[3]

The federal government can play its proper role in this by incentivizing the construction of new purpose-built rental stock with simple adjustments to the *Income Tax Act* and the *Excise Tax Act*.

Accelerated depreciation under the Income Tax Act for purpose-built rental housing

Presently, multi-unit residential buildings acquired before 1980 and 1987 respectively, qualify for capital cost allowance (CCA, *i.e.*, depreciation expense) in classes 31 and 32.[4] These classes have rates of 5% and 10%, respectively. A higher CCA rate allows an owner of property used to generate income (e.g., rental units) to write off a larger part of the undepreciated capital cost (in simple terms, the cost of the property less its accumulated depreciation) against income each year. The result is that higher CCA rates make capital investments (*e.g.,* the construction of purpose-built rental housing) more profitable in the near term.

Creation of an additional accelerated allowance for new rental housing stock would make investments in rental housing relatively more attractive to owners of new, purpose-built rental housing, and, by extension, land developers. Incentivizing investments in this way is well-established in the Income Tax Act (most of the text in section 1100 (1) of the Income Tax Act deals with additional accelerated allowances for property used in manufacturing, film production, etc.), and a proven tool for spurring investment.

In “Homes for BC” February 2018, the BC Government introduced a 30-point plan for housing affordability in BC. In that document fully 13 of the 30 points deal with rental housing in some form. Two of the points specifically deal with the province working more closely with the federal government to better enable affordable housing. Thus, the request that the province and the federal government work hand in hand to promote increased rental stock through modified capital cost allowances would provide a triple win for the province, the federal government, and the Canadian renter.

Lifting the GST burden on rental housing

Section 191 of the *Excise Tax Act* requires builders to pay Goods and Services Tax (GST) on their costs to build or substantially renovate rental housing units. The rationale for this policy is that builders who self-

[3] *New Opportunities in Rental Housing Financing; S Pomeroy, op.cit.*

[4] Class 31 (5%) and Class 32 (10%) include multiple unit residential buildings (MURB) certified by the Canada Mortgage and Housing Corporation (CMHC) to which all the following conditions apply: they are located in Canada; they contain two or more units; they provide their occupants with a relatively permanent residence. If the whole building qualifies as a Class 31 or Class 32 rental property (a MURB), then each unit within the building is a Class 31 or Class 32 rental property. To be included in Class 31 with a CCA rate of 5%, the building must have been acquired after 1979 and before June 18, 1987. To be included in Class 32 with a CCA rate of 10%, the building must have been acquired before 1980. For 1994 and following years, taxpayers can no longer create or increase a rental loss by claiming CCA on a Class 31 or Class 32 property. When a MURB no longer qualifies as a Class 31 or Class 32 rental property, it must be transferred to the correct class. Source: *Government of Canada: Rental – Classes of Depreciable Property 2019*

supply rental housing should pay GST[5] in order to remove the potential tax advantage a builder would have in constructing or substantially renovating a residential complex and then offering the residential complex for rent. A person who is not a builder who wanted to do the same would have to purchase the new or substantially renovated residential complex in a completed state from a builder and would have to pay GST/HST on the purchase.

Instead of penalizing both builders and those who purchase purpose-built rental housing, the federal government should level the playing field by making purpose-built rental housing GST-exempt. For example, the federal government could implement a rule whereby buildings having a minimum number of self-contained suites (e.g., ten or more) are presumptively treated as rental housing, and exempted from GST. To avoid abuse, the federal government could adopt approaches pioneered by municipalities on the front lines of the affordable housing crisis. To take one example, Vancouver has implemented a program whereby purpose-built/renovated rentals are subject to restrictive covenants on title. The federal government could require GST registrants to provide proof of such a covenant to establish the eligibility of the subject building for GST exempt status.

In addition, the federal government should act to lift the burden of the GST from landlords' operating costs. Currently, landlords must pay GST on operating costs of rental housing buildings, while rent is GST exempt. This GST burden reduces the return on rental housing and causes landlords to increase rent. Amending the *Excise Tax Act* to allow landlords to recover GST on operating costs will help increase the supply of affordable rental housing by reversing both of these effects.

THE CHAMBER RECOMMENDS

That the Provincial Government work with the Federal Government to:

1. Immediately modify the CCA so that federal legislation incentivizes investment in new, purpose-built rental housing stock by providing for additional accelerated capital cost allowance on new rental housing property.

2. Amend the *Income Tax Act* to encourage, rather than discourage, private investment in purpose-built rental housing.

3. Amend the *Excise Tax Act* to lift the GST burden that discourages investment in rental housing and drives up rents.

Submitted by the Kelowna Chamber of Commerce; supported by the Greater Vernon Chamber of Commerce, the Greater Westside Board of Trade, the Peachland Chamber of Commerce, the Summerland Chamber of Commerce, the Penticton & Wine Country Chamber of Commerce, and the Surrey Board of Trade.

[5] GST/HST memorandum 19.2.3, June 1998; available online: https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/19-2-3/residential-real-property-deemed-supplies.html#P53_1524