

Nowhere to Go



Gurcharen Budwal bucks the Victoria trend and sets to work on a new apartment building on Pembroke Street

Apr 02 2008

While fortress-like clusters of up-market condos sprout around the city, the working poor crowd together in budget motels. Who's to blame for Victoria's broken rental market and what could be done to fix it?

By JASON YOUMANS

Gurcharen Budwal is doing something rarely seen in Victoria over the past three decades. On a small lot behind Quadra Street's Mohawk gas station in the North Park neighbourhood, Budwal is overseeing construction of an apartment building. Not a condominium with units that may—or may not—be rented out by their owners, and not a subsidized housing unit financed through BC Housing or other non-profit groups for those whose next available option is life on the streets. Budwal is building a bona fide 16-unit market-rent apartment complex.

"It's a long-term investment," says Budwal, bucking the get-while-the-getting's-good mentality that characterizes much of Victoria's recent building frenzy. But just because Budwal is building, don't expect others to follow suit.

"There's no incentives to build apartments," he says. "They should have more incentives for people who want to build rentals."

A 2006 report from Greater Victoria's Real Estate and Construction Organizations (RECO) says virtually no true free-market multi-family rental housing has been built in the city since the 1960s. A 21-unit Budwal-built project finished in 2000 is the only example the report's authors could recall. Everything else, the report claims, was constructed with government or non-profit backing to compensate for the basic reality that apartment buildings are a money-losing proposition as long as wealthy buyers are willing to queue for new marble-countertop condominiums with cash in hand.

The near-total absence of new multi-family rental stock in the capital region over the past three decades—combined with high property values, rising monthly rents and investor speculation—has skewed the housing market disproportionately toward the demands of wealthy buyers and left those in the expanding low-to-modest income bracket scrambling to keep a roof over their heads.

Local non-profits like Cool-Aid and Pacifica Housing have buttressed the number of rental spaces available in the region, but these purpose-built apartments have made only a small dent in the number of inadequately housed Victoria residents.

As a 2008 Federation of Canadian Municipalities report notes, "While social housing is usually thought of as the main source of affordable housing, the primary supply of relatively affordable housing has historically been created through privately constructed rental housing. This includes purpose-built rental housing, as well as apartments in homes, secondary suites that have been installed in detached or semi-detached dwellings. There is evidence that this private source of relatively affordable housing is eroding through market processes. As properties age, they are upgraded, or demolished and redeveloped."

Private rental stock, whether the much-maligned concrete box variety like downtown's View Towers or the more benign secondary suite, is a crucial component in any city's housing supply. In greater Victoria, this stock is dwindling while the population grows, with renters experiencing no significant income jump to give them hope of home ownership and government support offered only to those in most dire need.

So few rental units, so what?

That Victoria does not have enough apartment buildings is no great secret. The city's low vacancy rate—hovering at 0.5 percent for the past four years (a number that doesn't count vacancies in secondary suites)—has become the stuff of legend, a warning passed on to anyone wanting to call Victoria home on a pay-as-you-go basis.

In rare moments of compassion, the local press runs page three stories about working families living in cars or camping in hidden corners of the city because there is simply no other place for them to go.

Victoria city councillor Dean Fortin observes the upshot of this rental shortage firsthand as director of the Burnside Gorge Community Centre. His organization's homeless families outreach program helped 250 families over the past year, while staff shortages meant another 450 families were referred to other agencies. Fortin says 25 percent of the families BGCC encounters are employed.

It goes without saying that having a roof over one's head is about more than staying out of the rain.

The Canadian Housing and Renewal Association notes, "the physical quality of housing has demonstrable effects on the health of households, the capacity of children to learn, and the ability to make harmonious family life." CHRA goes on to say, "Affordable, more stable housing prices and rents will benefit the economy in the long term, raising productivity and competitiveness for communities and the nation."

Local governments too acknowledge the importance of housing to building a thriving community. The CRD states in its 2007 Regional Housing Affordability Strategy, "A range and mix of housing within urban neighbourhoods increase the potential for a variety of households, interests, skills and lifestyles to co-exist and contribute to a more inclusive, resilient community."

However, paying lip service to the benefits of secure, stable and affordable housing for everyone is not the same as ensuring its provision. In 2007 an estimated 27.5 percent of

renter households in Greater Victoria (12,500 households) were defined by the Canadian Mortgage and Housing Corporation as being in "core housing need," which is to say they "do not live in, and are unable to access, housing which is affordable, in adequate condition and of suitable size."

The CRD goes on to say the problem is particularly acute for those on social assistance where the monthly shelter allowance for a single parent family with one child is \$520, while average market rent for a two-bedroom apartment is \$837 in the region.

By the CRD's estimates, renters make up more than 33 percent of all capital region households, but account for more than two-thirds of CRD households in core housing need.

The City of Victoria's 2007 Housing Strategy is succinct in its characterization of the current housing market's failure to meet the needs of all citizens.

"The supply primarily meets the market interest and demand of middle- and upper-income households. [The market] has not responded to the housing need and demand of low- and modest-income households."

The market's the thing

Insofar as the development industry is free to chase maximum profit on its construction projects, there's little point looking to builders for solutions to Victoria's apartment woes in today's sellers market.

Several converging factors leave developers with little interest in babysitting an apartment building for the decades it would take before rent payments might enable them to pay down their construction and operational bills.

The high price of building associated with rising material, fuel and labour costs also contributes to developers' eagerness to sell off units as condominiums to buyers who can sign a mortgage on the spot.

"It's not economically feasible to build a rental," says Steve Copp, president of Canadian Home Builders' Association Victoria. "Building an 800-square-foot condo at, say, \$350 a square foot—which is what they're worth —means they're worth about \$280,000. What are you going to get for rent? Maybe \$1,000 or \$1,200 a month? Do the math. It just doesn't make any sense. Your return on your money is not even close."

Copp says developers typically look to make between \$40,000 and \$60,000 gross profit per door on multi-unit projects.

"The basic premise is it's not financially viable to do apartments, because rents are not high enough to cover the costs of building a new rental building," says Travis Lee of Victoria's Tri-Eagle Development Corporation. "Even though vacancy rates are so low, part of it can be blamed on provincial laws around rent control, or the Rental Tenancy Act that says you can't raise rents quickly enough, so a lot of rents that are out there are really below market."

But it's those very government controls that today keep rents from rocketing to the stratospheric levels they would otherwise achieve if the laws of supply and demand were

left to chart their natural course in Victoria—instead of their current pegging to the rate of inflation.

Canada Mortgage and Housing Corporation Victoria senior market analyst Lee King echoes Copp and Lee's opinions, charging that the high price of South Island land, coupled with construction and other "soft" costs, means that even in an era of low borrowing rates it's an economic non-starter for developers to put up apartment buildings.

"It's not just Greater Victoria, it's Vancouver and it's Kelowna. Virtually all multi-family new construction—whether it's townhouses or new apartments, high-rises or low-rises—virtually all of them are strata-titled for sale. In other words, the return on investment is simply more attractive on a for-sale basis than on a rental basis," says King. "Some of the units that are strata-titled and sold do come on the market as rental pool, that is, they are held by investors and rented out. However, those tend to be more expensive because they are new construction and tend to be condos with more features and generally larger units."

RECO estimated in 2006 that 33 percent of Greater Victoria condominiums were being rented out to tenants.

CHBA's Copp says federal tax policy also plays into developers lack of interest in apartments.

"If you build a building, and turn it into a rental, [the builder] has to pay back the GST," says Copp. "So on \$280,000 units, it's \$14,000 a unit you have to pay back to the government. So really, it adds \$14,000 to the cost of that unit. If you were to buy a condo from me, you would have to pay the GST, but in a rental situation, there's no GST charged on residential rent, so the government says I owe the GST."

In construction of other types of non-rental multi-unit buildings, a 100-percent GST rebate is extended to builders.

Just to illustrate the degree to which developers shun the rental world, Copp says even assuming he was gifted a plot of land for free, he still wouldn't put up an apartment.

"If you take the land out of the equation and it's still not economic to rent out and make a return on your dollar, what's a tax incentive really going to do for you?"

So as long as there are buyers for the upmarket condominiums that grow evermore pervasive in Victoria, property developers are going to leave renters on the sidelines in pursuit of the best payout, take that capital, and turn around to invest it in the next good project that comes along.

Bad policy starts at the top

While market factors like building and labour costs contribute to developers' refusal to put up rental buildings, many in the apartment industry point the finger of blame squarely at the federal government for clinging to a tax structure described as anything from "regressive" to "ridiculous."

Rental Owners and Managers Society of BC chief executive officer Al Kemp says one must look to 1972 to understand how we arrived at the present juncture, when Revenue

Canada imposed sweeping changes to its business tax structure, redefining businesses as either "active" or "passive." Apartment buildings, generally having less than five employees, were categorized under the new regime as "passive" business. The effect of this change is that anyone selling an apartment building takes an immediate—and substantial—tax hit on the appreciation of their property value. This makes potential developers less likely to sell one apartment building, turn around and buy or build more with the profits. Kemp says this capital gains rollover rule doesn't apply to those who own condominiums, hotels, motels, and warehouses that have more than five employees. On \$1-million appreciation, Kemp estimates the owner would be left with no more than \$600,000 profit to reinvest.

"If I had \$1 million to build residential units, I would build condos, without question," says Kemp. "Because some day I may want to sell that building and build another one, and I'll be able to rollover my capital gains, as long as I don't have an apartment. I would build a motel, I would build a condo, I would build a warehouse—but I would definitely not build an apartment."

Nobody Monday spoke to seemed able to explain what accounted for the 1972 change, but a concerted lobbying effort from a number of diverse organizations in both the real estate and social housing fields has yet to convince the federal powers to make a minor policy change industry says could prompt them to return to building rentals.

"It's not the apartment industry whining for special treatment. It's the broader industry saying 'Why don't you level the playing field?'" says Kemp. "Why don't you recognize the need for rental accommodation, which is becoming acute right across the country?"

But the federal government has shown no particular interest in addressing issues related to the nationwide shortage of rental housing.

"Stephen Harper, in the last federal election made several promises and he has delivered on every single one of those promises except one—the capital gains rollover. He has done nothing on that," says Kemp.

Federal housing minister Monte Solberg's office did not respond to Monday's questions on the subject by press time. Demonstrating his sterling commitment to tackling Canada's housing crisis, Solberg didn't even bother to show up at the February 2008 summit of provincial housing ministers in Vancouver.

CRD Affordable Housing Secretariat senior manager Henry Kamphof says the changes sprung on the development community in 1972 effectively brought construction of new apartment buildings to a standstill.

"Since then, rental housing—if you see it being built anywhere in the country—has been done by various provincial and federal housing initiatives where they have either done it themselves or through what we call the third sector, which is non-profits and housing societies and community organizations, or partnering with the private sector," says Kamphof. "So, for rental housing, just to be done on its own, without any subsidies or special assistance, no, that has essentially come to a stop since 1972."

In addition to the capital gains rollover and recapture and a GST rebate equal to that offered to builders of other structures, industry is also calling for shorter amortization periods for their capital costs.

Victoria NDP MP Denise Savoie says the federal government has abdicated its responsibility to ensure citizens have access to safe, secure housing.

"There are a lot of things that citizens groups are doing, like Pacifica and Fernwood NRG, but there is still one big player that's not at the table, and that's the federal government," says Savoie. "They need to listen to what citizens are saying loud and clear." To that end she and an NDP colleague will shortly put forward a notice of motion calling on the government to repeal the capital gains policy that stands in the way of new apartment construction. Savoie adds that it's high time the federal government devised a national housing strategy that addresses the needs of all Canadians.

And collects at the bottom

In its 2006 report, RECO called on local municipal government to reduce the red tape its members say impedes construction of new apartment buildings, urging the City of Victoria to develop a rental housing vision that is "ambitious, results-oriented, pragmatic and achievable."

Al Kemp, who compiled the report, says it was met with deafening silence in City Hall, despite being commissioned by the city's housing advisory committee. Kemp wonders whether it was his call for mayor Alan Lowe to demonstrate "courageous leadership" in "facing up to the need for modernizing of regulatory philosophies and policies," that tipped the scales against it.

One of RECO's principle suggestions is tax holidays for construction of apartment buildings to offset the punitive federal taxes discussed above.

"What if we had 10 years of property tax exemption for construction of new apartment buildings?" says Kemp. He points to tax holidays granted to private landowners who preserve heritage buildings in the city. "As far as I'm concerned, the precedent is there. The municipality believes it is improving the quality of life in Victoria by improving [those] buildings, but what about improving the quality of life in Victoria by allowing more rental accommodation to be built?"

However, Victoria councillor Fortin says that while the city's elected officials have pondered the idea of tax holidays for apartment builders, municipalities aren't the level of government that should be expected to swallow less tax revenue to stimulate private-sector investment in housing.

"It's sort of a continual downloading when you recognize that municipally we get eight cents of every tax dollar, and the other levels get the other 92 cents," says Fortin. "So who's in a better position to offer tax breaks? Tax holidays just wind up as another example of the senior levels of government downloading to the lower levels."

Fortin says an ace up any municipal council's sleeve is the ability to set rules regarding strata councils when a property is being rezoned.

"What city councils can do, is when a developer comes in, if it's a rezoning, we can require them to put rules in place before the strata council ever comes in, so people can buy it and rent it out," says Fortin. "It allows for more flexibility. So, we can still get rentals in our town, it's just a different way, and it recognizes that large apartment buildings are not going to be built anymore."

Though it causes grimaces within the development community, municipalities can also wrest more rental space from developers by exercising density-bonusing policies with a firm hand—demanding, rather than asking—that certain conditions be met in return for the commensurate profit increase that more saleable units provide. One of those conditions could be mandatory rental units in any new multi-unit development.

Up to this point, Victoria's bonus density provision's have been exercised haphazardly to secure such critical social goods as the waterfall that occasionally spills down the side of The Parc building in Vic West, in return for which the developer wrangled a few dozen extra units from council. However, Zink says the city has had recent success negotiating rental units in return for increased density, most recently at 819 Yates where several rental units will be managed by Capital Region Housing Corporation.

Zink adds the city's housing trust fund, established in 2004, has contributed 60 units to the municipality's housing stock, all but six of which are rentals.

The prospect of inclusionary zoning, which requires developers to set aside a certain percentage of their units for tenants within a particular income bracket, is also gaining government acceptance, though local municipalities—with the exception of Langford and Colwood—seem hesitant to tamper with the natural ebbs and flows of the housing market.

While timid steps are being taken by local government to increase the rental housing supply, they will ultimately deliver far less than could a return to the rental business by the private sector.

Where do we go from here?

Despite the acute shortage of rental units in Victoria, most people do eventually find a place to live. The downside is these places are often too small, too crowded, too dirty or too expensive. The shortage forces people who work in the core municipalities to move to outlying, expanding areas like Langford or Colwood where they contribute to the suburban sprawl creeping across the southern Island.

Finding solutions to the problem at a time when construction costs and tax policies are weighted heavily against private sector involvement in building apartments will require creative solutions on the part of local governments—given that the senior levels seem to feel no responsibility except to the most disadvantaged social segments.

A recent flurry of activity at the municipal level—evident in a growing, grudging acceptance of secondary suites—is a good start, if not one that comes about 20 years too late.

But until concrete steps are taken by all levels of government to stimulate private investment in rental housing stock, Victoria will probably have to wait another eight years until Gurcharen Budwal breaks ground on his next apartment project. M