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Why Isn't Rental Housing Being Built?

What Needs to Change?

A report to the Advisory Housing Committee of the City of Victoria

Prepared by Al Kemp, CEO, Rental Owners and Managers Society of BC

Submitted by Greater Victoria's Real Estate and Construction Organizations

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Introduction

The Advisory Housing Committee of the City of Victoria requested the Real Estate and Construction Organizations (RECO) to lead the examination of two questions:

Why isn't rental housing being built?

What needs to change?

RECO is an informal affiliation of representatives of all the major organizations in Greater Victoria whose members have an interest in some or all facets of planning, developing, constructing, managing and operating real estate. RECO's raison d'être is to present periodic events that inform and educate more than 5,000 collective members of the RECO organizations.

When members of the Advisory Housing Committee approached RECO, it was determined that the most effective approach to attempting to answer these questions would be to invite a small group of knowledgeable and influential people to participate in an informal brainstorming session, with a view to examining the current scene in Victoria. From that examination and their considerable expertise and experience, the objective would be to obtain a series of recommendations, ideally ones that could be implemented by the City, independent of other levels of government.

The following people agreed to participate in this brainstorming discussion, held March 7, 2006:

Linda Lee Brougham, President, Canadian Home Builders Association

Casey Edge, Executive Officer, Canadian Home Builders Association

Rob Hunter, President, Devon Properties

Lee King, Corporate Representative, Canada Mortgage and Housing Corporation

Art Kool, President, First Island Financial Services Ltd.

Shelagh Rinald, Chartered Accountant and Partner, Grant Thornton LLP

Cedric Steele, President, Cedric Steele and Associates Ltd.

Andrew Turner, Managing Director, Colliers International

Glen Wilson, Searidge Management Inc., President, Urban Development Institute

The Advisory Housing Committee and the City of Victoria owe a sincere thank you to the participants for readily agreeing to donate their valuable time to this discussion and for candidly and professionally offering their expertise, opinions and recommendations.

Al Kemp, CEO of the Rental Owners and Managers Society of BC (ROMS BC) organized the discussion on behalf of RECO, served as recorder, and compiled this report. He takes full responsibility for its content, including any errors or misinterpretations he may have made in recording the discussions.

Executive Summary

Given that it is the City of Victoria that is looking for answers, most of the discussions concentrated on municipal policies. It was pointed out that the City can do only three things to encourage more rental housing:

- increase density;
- reduce red tape;
- reduce taxes.

Many of the recommendations flow from this fact.

However, a major barrier to the private sector electing to develop purpose built rental properties continues to be taxation disincentives implemented by the federal government in 1972. The current policy essentially moves anyone interested in developing a multi-unit residential or commercial building toward condominiums, hotels or warehouses and away from rental properties. The City of Victoria needs to add its voice to those of the many organizations that continue to press the federal government to remove these irrelevant barriers and tax all multi-unit developments equally and equitably.

Why isn't rental housing being built?

The broad answer to this question is a combination of archaic federal taxation policies, a perception that rental properties or units are less desirable than owned properties and the existence of municipal regulatory barriers that at worst preclude development, at best impose unrealistic requirements and delays that have the same effect.

What needs to change?

More accommodation can be provided in only one of two ways: building on new land or increasing densification. There is of course a dearth of developable land in the City of Victoria, which means attitude and policies must change – through both regulation and education – resulting in increased densification becoming practically and politically acceptable. This change is a major opportunity for the City, but requires clear and courageous leadership to accomplish.

Paramount among the recommendations is that the City must develop a rental housing vision that is ambitious, results oriented, pragmatic and achievable. The Mayor in his leadership position, supported by Council and senior staff must then implement a plan to achieve the vision. This will require courageous leadership and facing up to the need for modernization of regulatory philosophies and policies. It must also be recognized and accepted that the Mayor and Council are elected to proactively lead in the best interests of all citizens, not to reactively follow the vocalization of neighbourhood interests by those who are not elected, but purport to represent small groups of citizens.

Background

Federal Taxation

Virtually no rental apartment buildings have been built by the private sector in a true free market sense since the late 1960s. There is only one known building in Victoria, a 21 unit building constructed about 6 years ago! Various federal programs have attempted to stimulate multi-unit construction, usually resulting in owned condos rather than rental units. One example was the MURB program in the late 1970s; another a government subsidized program intended to stimulate apartment construction, but that actually depressed market rents by about \$150 a month, making any rental development uneconomical.

In 1972, the federal government dramatically changed tax policies pertaining to the residential rental industry, based on a conclusion that the residential rental industry is a “passive” business! The result for the past 30 years has been almost a complete disincentive to build apartment buildings. It is important to note that simply applying the same taxation rules to the construction and operation of apartment buildings as are applied to condos, hotels or warehouses would remove this disincentive.

Development

It is a fundamental principle that over time land will be developed to its highest and best use. For the past few decades in Victoria, this has meant condominium development. Particularly important is that many apartment buildings are nearing the end of their useful lives, being 30 to 50 years old. From a pure economic perspective, the highest and best use of the land under many of these properties is to demolish the building, take a terminal loss and build condominiums.

No developer will embark on a project unless a reasonable return on the investment of time, expertise and money can be anticipated. Developers need to feed their families also! One developer can access a specific parcel in Victoria that would support a 60 unit apartment building. The owner would contribute the land at no cost, yet the numbers still don't justify embarking on the project! There is another parcel that contains a 40 unit apartment building. The appraised value of the land for an apartment building is \$2.1 million. If it were used for condominiums, its value would be \$3.0 million.

In 2005 alone, construction costs in the area rose about 15%. Provincial rent controls limited rent increases to a maximum of 3.8%.

Public Sector Housing

Public sector rental housing has tended to be of a higher quality than private sector housing, meaning an even greater cost to the taxpayer than other forms of shelter assistance. However, this appears to be changing somewhat under current BC Housing Management policies. When considering public sector provided housing, ghettoization is a decided social disadvantage – and definitely undesirable from the perspective of the renters in that form of housing.

Market Realities and Trends

“Vacancy rates” are generally misunderstood. While the widely known CMHC survey reported a vacancy rate (apartments vacant and available for rent) of 0.4% in the City of Victoria last fall, this does not reflect the market. The availability rate (apartments vacant or occupied and available for rent) was three times that at 1.4%. However, CMHC reports only those buildings with three or more units, whereas a significant portion of the Victoria market is made up of secondary suites, houses and duplexes. Further, CMHC does not survey strata buildings, even if a significant number of units are rented.

Even more significant is that the ability to find a unit to rent is directly linked to turnover, not vacancy or availability. The average renter stays in a unit for about two years, meaning that about 50% of all rental units become available for rent each year. Simply stated, if a qualified person or family is looking to rent, a suitable unit can be found.

Demographics

Many members of the baby boomer generation are now turning to owning condos rather than single family dwellings, for security and downsizing reasons, or as second residences in the desirable Victoria climate. Both this generation and the young professional generation might consider renting, however their lifestyles are such that they demand a unit with ensuite dishwasher, clothes washer and dryer. Most existing apartment units cannot be retrofitted to meet this demand.

New rental demand tends to be at the high end of the market. In the last few years, several purpose built rental apartment buildings have been constructed in the Coal Harbour area in Vancouver, however they rent in the \$2500 to \$4000 range. If similar buildings were constructed in Victoria, they would represent a net increase in supply, with people moving up the spectrum from mid to high range and from low to mid range, freeing up units in the low range.

This need is being met to a certain extent through the building of condominiums. It is estimated that about one third of new condominium units are being rented – at least initially.

Federal Policies

As mentioned, federal tax policy since 1972 has discriminated against the residential rental industry by:

- prohibiting the rollover of capital gains and recapture should an owner wish to sell a rental building and either buy or build a new one;
- prescribing longer periods to amortize capital costs than for other types of investments;
- rebating only a portion of GST, rather than 100% as is the case with other multi-unit buildings.

The Canadian Federation of Apartment Associations continues to seek change to these policies, not to provide more favourable tax treatment to the residential rental industry, but simply to level the field by applying the same rules to all types of buildings.

One of the objections posed by federal bureaucrats is that any change would lead to “budget creep” and lost taxes. In fact, the reverse would be true, as owners are not selling now, primarily because of the rollover prohibition. Indications from the new federal government are that positive movement in this direction may be planned.

Provincial Policies

The provincial government appears to have little direct influence – positive or negative – on development within the residential rental industry, other than through policies directed toward social housing and income assistance. It is noteworthy that there is nothing in the current budget to encourage rental development or assist renters.

The amount accruing to the government from the Property Purchase Transfer Tax has more than doubled in the past few years.

Municipal/Regional Policies

Property Taxes

Ten to thirty percent of operating costs in a typical apartment building go to pay property taxes. Tax holidays are one method of encouraging specific development. An example is the ten years tax holiday given to the A Channel, based on the restoration of a heritage property.

Secondary Suites

Recognizing/legalizing secondary suites is a key contributing factor to encouraging expanded supply of rental accommodation. The “legalization” of secondary suites, accompanied by regulation, taxation or fees defeats the objective of encouraging more secondary suite development.

Additional suites could be constructed in many existing apartment buildings, again if regulations were relaxed to encourage such development.

An often ignored facet of the complex issue of recognizing secondary suites is that they have an impact on transfer of monies from senior governments. When a census taker arrives at an apparent single family dwelling s/he may be told no one else lives there, as the owner fears the “official” might inform the city that there is an illegal suite. The result is that the residents of the suite are excluded from the census, with a cumulative effect of undercounting the population by several hundred or perhaps more. The transfer of funds to the City from the federal and provincial governments is often based on the population. Thus today the City is receiving less funding than that to which it would be entitled if all citizens were counted during the census.

Regulation

Strata Titling causes assessments to rise by as much as 50%.

Victoria generally does not permit increased densification; resists zoning changes or demolition for development.

“No one in their right mind will tackle the red tape barriers to development. I have been waiting since last July to get a permit just to build a deck on my house,” commented one participant.

An Alberta example was cited where a property was rezoned in three weeks and in the ground one month later. The project was to develop 2,000 housing units!

Developers are loath to commit to a project because of the combination of lengthy permitting/rezoning processes and the proclivity of the City Council to be led by neighbourhood associations.

Neighbourhood associations in Victoria are at best a perceived impediment to rental development. These associations tend to be a few people who have assumed the rights to stop any development, while rejecting any responsibility to contribute to the overall quality of life in Victoria. Perception is reality and the overriding perception is that some neighbourhood associations literally dictate to City Council their demands, based on their narrow view of what they consider to be best for their immediate neighbourhood.

There is no advocate within City staff for innovative solutions to rental housing needs. The City has abandoned the use of professional advisory planning committees.

On the positive side, the Cool Aid Society's Mike Gidora Place and the Jolly Knight Motel conversion are examples of the relaxation of regulations that permitted a rental need to be met – and economically so. The units in Mike Gidora Place are small with bedroom lofts that are “officially” storage areas. The City approved units smaller than the minimum allowed area, in order to make that project viable – and provide more rental units.

The fire protection standpipe regulation is a typical example of over regulation. Building owners are being required to either meet high pressure standards for internal standpipe systems, or remove the systems (the latter alternative only available in buildings of less than five storeys). Cost to meet this requirement in larger buildings can easily exceed \$50,000. Yet no other municipality in the Capital Region is imposing this standard – indeed the participants know of no municipality in BC with this requirement.

The stormwater protection regulation, albeit imposed by the CRD, is another example of burdening owners with high costs that at best represent intangible or marginal improvement to our community, at worst, no improvement at all. The City of Victoria is a major player at the CRD board table.

When considering new regulations it must be remembered that additional costs to apartment building owners can only be recovered from one source – rents.

Conclusions

The example of Langford was often quoted in the discussions, particularly the fact the Langford Mayor and Council developed a vision for their community and the Mayor has been a consistent and visible leader in pursuing the vision.

As one participant observed, “The City can only do three things: increase density, reduce red tape and reduce taxes.” Most of the following recommendations flow from that statement.

Another participant stated, “I have been to dozens of these type of meetings over the years. Our recommendations are always similar – and nothing ever happens. We need vision and we need leadership.” There was consensus that, lacking any definitive action, the situation of no new rental housing will only get worse as some buildings pass their useful life. The consequences will inevitably include increased rents as supply dwindles.

Victoria's economy, in contrast to Vancouver and many other major centres, is primarily service industry based with employees in that industry generally earning relatively low incomes. Many of the people employed in high tech, education and essential services must plan on renting their homes – at least for several years. This means increasing demands for rental accommodation, coupled with less locally based demand for home ownership.

Recommendations

Vision and Leadership

1. First and foremost the City Council must develop a vision for rental housing. This should encompass all forms of housing from apartment buildings and condominiums to single family houses and secondary suites. This vision needs to be carefully thought out and articulated so that most citizens can at best agree with it and support it, at least understand and accept it.
2. Victoria City Council must provide courageous leadership to staff, neighbourhood representatives, developers and the general public in pursuing the vision.

Regulation and Taxation

3. The City should appoint a rental housing advocate within City staff. This person should be knowledgeable of regulations, zoning issues, permitting, development cost charge rules, etc. Acting at a senior managerial level, this person would have the authority to make decisions that remove or reduce red tape, are consistent with the rental housing vision and are reviewable only by the City Manager.
4. Because of market volatility and escalating construction costs, any proposal for a project including significant rental units should immediately be placed at the top of the list for consideration by City staff and Council and be fast tracked through the approval process.
5. Change the regulations pertaining to strata titling. The City needs to permit some form of tax incentive that will discourage conversion of rental units/buildings to stratas.
6. Typically one third of the new condos being built are being rented and these attract the high end renters, thus relieving pressure on the rest of the rental spectrum. Consequently, the City should continue to approve condominium developments as well as remove its barriers to apartment development.

Public Private Partnerships

7. Provide City controlled incentives to develop or redevelop properties as apartment buildings by offering property tax abatements, rebates or tax holidays in return for commitments that meet the City's vision for rental accommodation. Use the A Channel project as a model, substituting "rental preservation/enhancement" for "heritage preservation."
8. Many of the social housing developments of the 1960s and 1970s should now be fully amortized. Some may offer an opportunity for public private partnerships designed to increase density as well as provide more contemporary units.
9. Unused or underused public lands, such as school properties (e.g. S. J. Willis lands), BC Hydro lands, and city owned lands represent major development opportunities. Large tracts could be rezoned, with developers invited to submit proposals that are consistent with the City's rental housing vision. Alternatively partnerships could be entered into with the City as a partner with the developer. Such projects, if of sufficient size, could economically justify including below market housing components.

Secondary Suites

10. So-called illegal suites in single family dwellings are a perennial issue that should be solved by the City deciding as part of its rental housing vision to recognize all such suites, provided they meet acceptable standards for rental accommodation (as distinct from full Building Code compliance). Such standards have been enunciated in a draft bylaw put together by ROMS BC and the Burnside-Gorge Association several years ago.

11. In conjunction with the recognition of secondary suites in houses, they should also be recognized in apartment buildings. There are many buildings in which X suites are authorized, perhaps from a permit issued half a century or more ago. Fully acceptable suites could be added in these buildings, for example in an area previously occupied by a large boiler and stockpile of coal.

Provincial and Federal Taxation

12. Make the case to the provincial government to redirect, say, 20% of the Property Purchase Transfer Tax into portable housing allowances and public private partnerships, the latter allowing for more below market units in major projects.

13. Mayor Lowe should arrange to meet with Honourable Gary Lunn to reinforce the need for the federal government to remove the rental housing disincentives from federal tax policy. The Mayor should stress that removing these barriers will in fact generate more tax revenue, not less as sales will increase which in turn generate economic activity for realtors, appraisers, lawyers and accountants among others.

14. The City should also encourage the federal government to reduce write-off periods. Currently equipment can be written off in three to five years; the period for buildings is typically ten to twenty years.

Final Comment

While the participants encourage the City adopt innovative approaches, to remove archaic regulations, and to work in collaboration with the private sector, it must be remembered that, in the words of one participant, “The bottom line is the bottom line. Unless a developer can achieve a realistic return on the investment of considerable time, expertise and financial resources, no project will proceed.”

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