RIGHT TO HOUSING

Proposals for Policy Changes to Enhance Private Sector Capacity
To Build Affordable Rental Housing and to Re-engage the Federal Government in the Provision of Social Housing.

Introduction

Most developed nations have a three-tier national housing policy, encompassing the provision of social housing for the poorest citizens, affordable rental housing for lower-middle income families and individuals, and market housing for the remainder. ***Right to Housing,*** representing 46 organizations in Manitoba, believes that such a comprehensive policy would be strongly in Canada's national interest, because the key bedrock of social stability is affordable, accessible, decent housing for all citizens.

In Canada at present, only one of the three aspects of a national housing policy operates effectively, namely the provision of market housing for middle and upper income families. Even here, there are serious problems of affordability in many of Canada's larger cities. In significant part, this is related to the acute shortage of social housing, where rent is geared to income, and the almost total failure of affordable market rental housing, which is the subject of this brief. Both of these aspects of housing policy can been addressed with appropriate leadership at the federal level, in collaboration with Provinces, Territories and Municipalities.

Part One - The Market Failure of Rental Housing Production

Background

Since the 1990s there have been a large number of studies and think-tank reports proposing a wide range of taxation and policy changes to enhance the capacity and responsiveness of the private sector to build rental housing. (see bibliography)

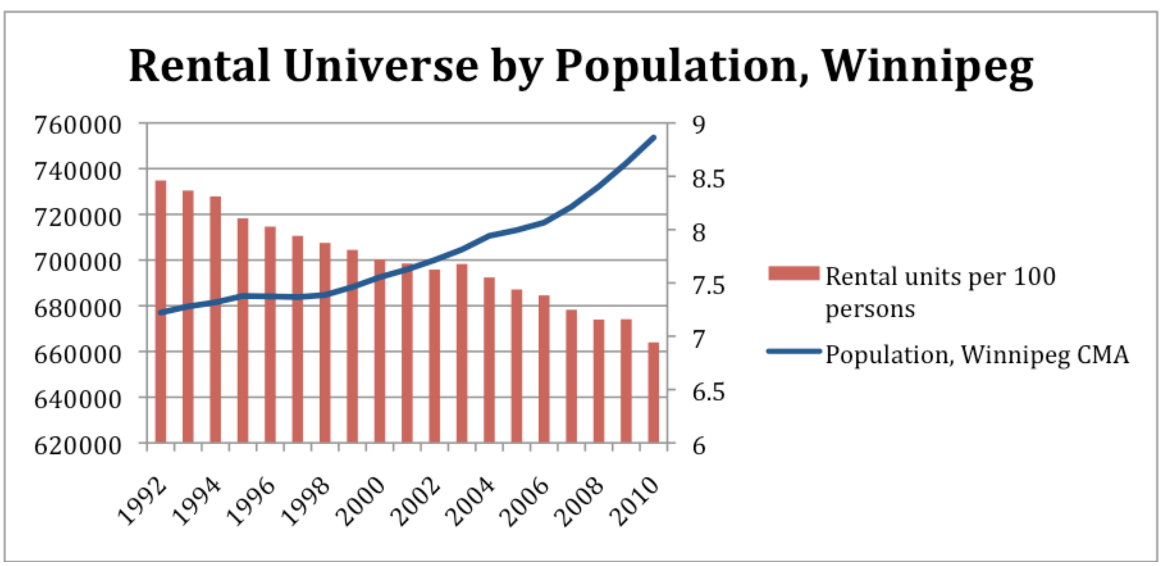
The need for such policies stems from the almost complete market failure of rental housing construction, particularly for lower income tenants, in large part stemming from the major changes to taxation laws from the 1970s to the mid 1980s. Prior to these changes, rental construction in Canada reached over 100,000 units in buildings of five or more suites in 1970, but following the cumulative effect of these changes, fell to 5,000 similar units by the end of the 1990s. Apart from a small number of units developed under the now completed Housing and Homelessness program, construction levels have not improved significantly since then, and affordability has worsened significantly.

In Winnipeg for example, the vacancy rate in below 1%. Market rent for a new 2 bedroom apartment in a frame construction building is over $1200 per month, not including utilities. This is $330 above median market rent in Winnipeg, and would require a family income of over $47,000, to keep housing costs under 30% of gross income.

Vacancy Rates In Winnipeg 2012

Monthly Rent	Vacancy Rates			
	Bachelor ($488)	1 Bedroom ($649)	2 Bedroom ($837)	3 Bedroom + ($1056)
Under $500	1.2%	1.0%	3.0%	Data unavailable
$500-599	2.7%	0.9%	1.2%	Data unavailable
$600-699	0.6%	0.3%	0.8%	Data unavailable
$700-799	2.7%	0.9%	0.4%	0.0
$800-1094	Data unavailable	1.0%	0.9%	1.3%
$1095+	Data unavailable	3.6	1.5	2.3

CMHC data on Winnipeg's rental universe, shows that in spite of the federal-provincial Affordable Housing Program,(AHI), Winnipeg has suffered a net loss of over 5700 rental units since 1992. The loss is related to the actual loss of older stock, as well as high levels of conversion of rental units to condominiums. This has also had a dramatic influence on the ratio of rental units per 1000 population, as shown in chart 1 below.



There are two underlying reasons for this failure. First, the increased cost of new construction, both from the taxation changes referenced above and from the actual costs of wages and materials, means that market rents to recover these costs are far beyond the capacity of lower income families and singles. Secondly, there is a strong tax advantage to homeowners in the form of the capital gains exemption for primary residences, whereas capital gains on rental properties are taxed at 50%. The Federal Finance Department estimated that this exemption was worth more than $7 billion in 2007 and will have increased since then because of the further sharp escalation in housing prices. Other homeowner subsidies include the recent Home Renovation Tax Credit, GST rebates for first time new homeowners and other property tax grants.

In combination, These factors have driven residential construction strongly towards single family dwellings, town houses and condominiums. While good public policy may well require support for home ownership, communities also need affordable rental housing for those who cannot afford ownership, in spite of subsidies, and particularly for those beginning their work life, as well as seniors who are downsizing as their housing needs change with advancing age. The present federal income tax system is heavily biased against rental construction and longer term ownership of rental property.

There is also wide agreement that Canada badly needs much more affordable rental housing, a problem made worse by the aging of the rental stock that was built in the 1970s and 1980s. The Conference Board of Canada states; " *Consequently, approximately 25 per cent of Canadians rely on housing subsidies or experience periods where they spend over 30 per cent of their before-tax household income on housing. This negatively affects Canadians' health, which, in turn, reduces their productivity, limits our national competitiveness, and indirectly drives up the cost of our health-care and welfare systems.*" (Building from the Ground Up, p ii)

<u>Proposal</u>

The housing industry, Chambers of Commerce, The Conference Board of Canada, Universities and other bodies have provided a long list of tools ranging from zoning and building code changes to a multitude of possible taxation changes that would shift incentives towards multi-unit rental construction. The City of Vancouver Report provides helpful tools to quantify the effects each measure would have on costs in that very expensive market. A partial list of these measures cited in various reports includes:

Federal and Provincial Tax Expenditure Measures:

1. Changes to capital cost allowances and depreciation allowances
2. Deduction of soft-costs
3. Rapid write-off in the early days of the project
4. Allowing rollover of capital gains on sale to a following purchase
5. Changing rules for passive investors

6 Use of flow-through shares
7 Eliminating capital gains tax on land or buildings donated for affordable housing
8 Implementing a Low Income Housing Tax Credit (LIHTC) similar to the US Federal Government program for affordable housing construction
9 Reduction/elimination of PST/GST/HST on affordable housing projects
10 Portioning of affordable housing projects at a lower rate for property tax purposes
11 Using tax-free bonds for designated affordable projects

Municipal Taxation and other Policy Measures

11 Property Tax Increment Financing (TIF) for affordable housing projects
12 Controlling demolitions and condominium conversions of existing rental housing
13 Zoning rules such as mandatory inclusion of affordable units
14 Reducing municipal development charges
15 Zoning density increase permission for affordable projects

Right to Housing, with great assistance from LADCO, a major land developer, has carefully examined the benefits of a combination of using just six of the above list of 16 measures. While this assessment was based upon one example of a current housing development, it provides a reasonable approximation of the significant effect that the regulatory and taxation measures have upon final costs of rental housing. The detaled calculations for these six measures are contained in Appendix 1.

Gap Bridging Measures

The staff of LADCO, a Manitoba land development and construction company has provided assistance to Right to Housing to examine the impact of six of the above list of possible taxation, regulatory and land use measures which have been suggested in this brief as measures that would materially reduce the cost of construction and ownership of rental housing.

The measures and their impacts were examined using a real project recently constructed in Winnipeg. This was a 300 unit four story frame building, with one, two and three bedroom units. Current market rentals for this building range from about $1100 - $1300 per month and do not include laundry. Parking is ground level, not covered, one space per apartment. The unit's average cost are approximately $152,000 per door.

The market gap in Winnipeg at present is estimated to be between $42,000 and $45,000 per door. This is the gap that must be closed to bring unit rentals to the current median market rent and thus begin to serve average renters.

Measure:	Effect per Door
Zero Rating on GST on building operation	$1,473
GST on Construction	$4,310
PST on Construction	$8,693
Capital Cost Allowance (at 10%)	$8,362
Tax Deferral on Sale	$4,226
Tax Increment Financing (TIF) Municipal + Provincial)	$13,878**
Total from the above six measures:	$40,942

Clearly, there is a great deal that government can do with very little loss of current revenue to reduce costs of construction very substantially. Readers should note that in Winnipeg currently, the maximum effect of city+provincial TIF is actually $40,000. However, to reach this maximum, a development must have very high taxes, which would not be the case for a residential building such as affordable housing. This estimate is based on the building project noted above.

Even when only a small number of the proposed changes are taken into account, they can reduce the costs of construction by over $40,000 per rental unit. These savings could reduce the cost of a unit by over $250-300 per month, making rental housing accessible to a far wider number of Canadian families.

Furthermore, with the current cost of capital for construction being at all-time lows, and likely to remain low for at least two more years, today offers an enormous opportunity to lock in low-cost financing for new rental construction.

As is clear from the above, there is no shortage of mechanisms available to governments to re-balance the tax system in ways which would greatly reduce the cost of construction of affordable housing. Furthermore, such construction would have many benefits to an economy that is still struggling from the recent recession. Although most of these measures are *tax expenditures* by Canada, the provinces and municipalities, such expenditures are more apparent than real. This is because there is virtually no activity in this sector now, and hence no effective revenue. New rental construction of affordable units would also take some of the excess pressure off the home owner market while maintaining the overall building trades employment and industry by shifting the product being built.

Part Two - Protecting and Enhancing Social Housing in Canada

Historical Context

From the end of World War two until 1993, the federal and provincial/territorial governments participated in funding and delivering national housing programs that supported the development and operation of social housing. In 1993, Canada discontinued support for new housing projects, and in 1997, capped its contributions to existing social housing projects. For 48 years, Canada had a national housing policy that supported social housing. This policy supported public housing owned by provinces, sponsored housing owned by churches, legions and other organizations, and cooperative housing. The reasons are many and obvious. In every society in the developed world, there are families and individuals who cannot afford even the cheapest market housing. This may stem from illness, accident or systemic or situational poverty. The social and economic costs to society of not providing such housing are equally manifold. Poor housing is strongly linked with poor educational outcomes, poor connection to the labour force, increased illnesses, especially among children and a host of other problems. Inevitably, these social costs are translated into the economic costs of poor labour force attachment, increased child welfare costs, increased health expenditures and so forth. The problem is that these costs, while very real, exist in the silos of government expenditures, and are rarely accounted for as costs of poor housing.

After 1993, the federal government abandoned social housing programs, and devolved existing programs to provinces and territories, along with a small amount of capital funding as a carrot to support devolution. As is usually the case, the funds were woefully inadequate to maintain the existing aging public housing stock. Even those provinces which may have wished to continue building social housing were faced with a very large bill for maintenance. Only British Columbia, Saskatchewan, Quebec and Manitoba have unilaterally continued to produce small numbers of social housing units. Without federal support, the numbers of new units falls far short of the need. To make matters worse and in spite of existing agreements, in 1997 the federal government unilaterally capped all subsidy support to existing projects, further shifting the burden of social housing onto provinces and territories.

In 2002, under great pressure from all provinces and territories, the federal government agree to share a new Affordable Housing Program, (AHI). While this program was helpful in supporting some low-end of market rental housing, it was time-limited and far short of the need and did not allow for new rent-geared-to-income social housing.

It is important to understand the scale of such units in Canada. Manitoba has a total of 35,000 units or 5.8% of Canada's, 600,000 units. Much of this critical housing stock is over 40 years old, and needs substantial investment to maintain basic structural elements, in order to preserve this valuable and irreplaceable resource for families, seniors and persons with disabilities.

The Present - Problems and Opportunities

The chart below shows the current reality for Manitoba families seeking rental accommodation. When coupled with the data from chart 1 above, it is clear that neither adequate access to rental units, nor affordable prices currently exist for many families.

Affordability of Average Rents in Winnipeg[1]

Household Income ($)	Monthly Affordability Range	Average Rents				Proportion of Winnipeg Households
		Bachelor ($488)	1 Bedroom ($649)	2 Bedroom ($837)	3 Bedroom + ($1056)	
Under 10,000	250	Not affordable	Not affordable	Not affordable	Not affordable	5.5%
10,000-19,999	250-500	Not affordable to households earning under 19,500	Not affordable	Not affordable	Not affordable	10.8%
20,000-29,999	500-750	Affordable	Not affordable to households earning under 26,000	Not affordable	Not affordable	11.3%
30,000-39,999	750-1000	Affordable	Affordable	Not affordable to households earning under 33,500	Not affordable	12.1%
40,000-49,999	1000-1250	Affordable	Affordable	Affordable	Not affordable to households earning under 42,250	10.5%
50,000 +	1250-1500	Affordable	Affordable	Affordable	Affordable	49.9%

The table shows that for over 16% of Winnipeg's households, *no form of housing is currently affordable.* For the 11.3% of households with incomes between $20,000 and $26,000, all they can afford is a bachelor suite. With between $26,000 and $30,000, they can afford a one bedroom suite. This is cold comfort to families with even one child. To afford a 2 bedroom apartment requires an income of $33,500, and a three bedroom unit requires $42,250. While the changes recommended in part one of this brief could bring these thresholds downwards by as much as $15,000 in family income, this still means that social housing, where rents are geared to income is needed for between 16-25% of Manitoba households.

[1] CMHC's Winnipeg CMA Rental Market Report (Fall 2010) https://www03.cmhc-schl.gc.ca/catalog/productDetail.cfm?lang=en&cat=79&itm=49&fr=1307993619930
City of Winnipeg's 2006 Census Data. http://winnipeg.ca/census/2006/default.asp

This housing can take several forms, including traditional rent-geared-to-income (RGI), Rent subsidies to individuals, rent subsidies to specific units in a non-RGI building, RGI units in a cooperative building or other alternatives. However, the principle is that rent is not at a market level, but rather geared to family income. As income changes, rents will also change, based on an annual assessment of income.

RGI housing is very costly to provide, and hence from a public policy perspective, the universe requiring such housing should be as small as possible. That is why it is critical to couple a social housing program to an affordable rental program. The latter can be largely based on tax expenditures, costs of which will be offset in part by the taxes gained on construction, but an RGI program requires actual expenditures of tax dollars.

It would be possible for these units to be provided directly by the public sector, or under contract from the private sector, in which case they should be built using all the tax expenditures noted in part one, so as to reduce the required monthly subsidies to rent by as much as possible.

Canada Mortgage and Housing Corporation - Problems and Opportunities

CMHC and the provision of social housing

Since the end of World War Two, CMHC has played two critical roles in Canada's housing sector. First and foremost, it has been the vehicle used by successive federal governments, in partnership with provinces and territories, to provide a variety of subsidies to social housing projects across the country. In the past, this has been a great policy success for Canadians, with housing for veterans after WW2, then for seniors, and finally for lower income families and singles, as well as through a vibrant co-op movement. Hundreds of thousands of units were built in every corner of the country. All that came to an abrupt end in 1993, when the federal government ended all direct involvement in new social housing provision. Subsidies to existing projects were to continue until mortgages mature, but the total subsidy levels were frozen to 1997 levels, ensuring that in real terms, they fall every year as the burden shifts more and more to provinces.

Since the mid 1970s, there have been over 40 different federal-provincial housing programs with varying methods of subsidies attached to them. This makes any discussion of how the subsidies worked, and the effect of their ending very complex. However, we will attempt to provide a basic framework for understanding this complex problem

Sponsored Housing Projects

Between about 1976 and 1985, when mortgage rates were fairly high, the primary subsidy mechanism to sponsored projects was a write-down of mortgage costs to 2%. A calculation of the actual mortgage interest and principal was made, and a similar calculation of the same amount of principal at 2% was made, and the federal and provincial governments, usually in a 75/25 ratio, provided a subsidy to the project.

Because these mortgages were mostly 35 years in duration, it is these projects, for the most part, that currently are losing their subsidies as their mortgages are paid off. It is important to understand that this would have happened in any case when the mortgage was paid off. Furthermore, it is also important to note that the province was and is a 25% funder of these subsidies, continuing to make contributions to enable these projects to be viable.

Cooperative Projects

During this same time, co-ops were built and financed using index-linked mortgages and were provided with rent supplements which allowed 25% of the units to be rent-geared-to-income (RGI). In this case, a calculation was made of the difference between the market rent which would be charged for that unit in the co-op, and the RGI rent and this amount was paid to the co-op as a direct cash subsidy, usually in the same 75/25 ratio.

Public Housing Projects

During this period from 1976-1985, public-housing projects which were built as RGI projects were subsidized either at a ratio of 75/25 or 50/50, depending upon the agreements between the federal and provincial/territorial governments.

Aboriginal Housing Projects

The aboriginal sponsored housing projects used a coupled system of mortgage write-downs to 2%, but also then provided RGI direct subsidies, making these programs function essentially as RGI public-housing programs, even though the subsidies came from two sources.

<u>Summary</u>

In the early 1990s, the federal government decided to leave the field of direct supply of social housing and signed devolution agreements with all provinces and territories, and provided a modest and quickly depleted cash fund to enable maintenance etc on the existing units. In 1997, the federal government capped its total funding for social housing subsidies at the 1997 amount. Because of this cap, the actual ratio in Manitoba is about 60/40 today, with the federal level providing 60% and the province 40%. This ratio will continue to shift increasingly rapidly towards a greater provincial share as higher annual operating costs demand higher provincial funding.

Provinces are in a very difficult situation because they face four growing pressures:

- increasing operating costs of the existing portfolio,
- escalating maintenance costs as the existing units age,
- decreasing federal subsidies in real terms, and

- the end of subsidies to sponsored housing projects, exposing these projects to higher costs, forcing them to rent to higher income tenants, thus reducing the RGI subsidy required, or have back-filled subsidies from the provinces/territories.

In addition, all new social housing projects now fall entirely on provincial/territorial funding sources.

As for CMHC, every year its costs are reduced by the end of mortgage and RGI subsidies. These savings are very large, and flow right to the bottom line of the federal government.

CMHC and support for home ownership

CHMC's second role is to act as mortgage insurer for any purchaser who has less than 25% equity down payment. This business has been very lucrative for CMHC, as Canada's mortgage default rate has been historically very low. This role has been part of Canada's strong program of subsidizing home ownership. Most Canadians may not understand that by insuring higher risk home purchasers, mortgage rates for those families are lower than they otherwise would be. Secondly, through the allowance for capital gains exemption for a principal residence, (an exemption not allowed in the USA), Canadian homeowners receive tax expenditure subsidy valued at over $7B annually. A similar exemption does not apply to any form of rental housing, which is one of the significant costs which increase rents.

Recommendations

1. That the Federal Government act immediately to substantially re-balance the Income Tax Act to enable a significant reduction in the soft costs of affordable rental housing in Canada by reversing the 1970s and 1980s changes in the Income Tax noted in this report and others cited in the Bibliography.

2. That the Federal Government invite Provinces and Territories to engage in the development of a package of taxation changes and incentives with a target of reducing the costs of affordable housing construction by at least 25% within two years.

3. That the Federal, Provincial and Territorial Governments develop a new Affordable Rental Housing Program (ARHP) by March, 2013 to enable the private and non-profit sector to build affordable rental housing based upon the changes in the taxation and other policy areas noted in this report and many other recent studies.

4. This program should require builders accessing the new taxation changes to establish initial rents at as close to median market rents as possible in each market.

5. The program should be based on provincial and territorial market conditions and administered at the provincial/territorial level.

6. That the Federal Government direct CMHC to maintain the 2010 levels of support for social housing by ensuring that when mortgage subsidies cease, support to projects is maintained so that projects do not have to evict lower income tenants to maintain project solvency.

Summary

From the above discussion, it is clear that Canada's housing market is seriously unbalanced. Very strong subsidies, both through lower mortgage rates and a $7B annual tax expenditure via the capital gains exemption for principal residences biases our market towards ownership. The result has been over-provision of ownership housing, rapid conversion of existing rental to condominiums, and severe under-provision of rental and social housing. As a consequence, about 25% of Canadian families are in core housing need, as defined by CMHC. This means that they have to spend more than 30% of their gross income on housing costs.

Canada must find ways to once again begin to provide social housing through both RGI and rent subsidies of various forms. There is simply no way that for many families, market rental housing is affordable. In the current market, rental housing is alos inaccessible in many cities, where vacancy rates hover below 1%.
Secondly, we must re-balance the rental housing sector, largely through changes to the taxation of rental construction and rental ownership and management.

Fortunately, there is a strong degree of consensus across Canada that this combination of new taxation measures is needed, and is warranted on the grounds of leveling the playing field between rental and ownership housing. While any such set of initiatives would require clear regulation so that the benefits flowed to final rents and not simply to builders/developers, such regulations are already in place for the AHI, and could be easily modified for the new ARHP program.

Given that the proponents of such changes come from all sectors of Canada, including municipal governments, the construction industry, chambers of commerce, think tanks from various parts of the political spectrum, housing advocates, housing managers, and even the recent Drummond Report in Ontario, these proposals cannot be rejected on the grounds of the special interests of any one sector. Adequate, affordable housing is widely seen as critical to the national interest across the developed world. This is particularly true for growing cities, where Aboriginal and new Canadians seek to make a good life for their families, but face a critical lack of affordable housing.

Right to Housing recognizes that few new dollars are available from most governments for social objectives. For this reason, we have focused our initial recommendations on tax expenditures for three major reasons. First, virtually everyone agrees we have a serious rental housing problem. Secondly, there is equally wide-spread agreement that the housing industry is a great source of economic stimulus. Finally, there is virtually no affordable rental housing construction at present, so new tax expenditures to support affordable housing will result in a very minimal loss of actual current revenues.

Right to Housing
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Appendix One

Gap Bridging Measures

The staff of LADCO, a Manitoba land development and construction company has provided assistance to Right to Housing to examine the impact of eight of the list of possible taxation and land use measures which have been suggested in this brief as measures that would materially reduce the cost of construction and ownership of rental housing.

The measures and their impacts were examined using a real project recently constructed in Winnipeg. This was a 300 unit four story frame building, with one, two and three bedroom units. Current market rentals for this building range from about $1100 - $1300 per month and do not include laundry. Parking is ground level, not covered, one space per apartment. The units' average costs are approximately $152,000 per door.

The market gap in Winnipeg at present is estimated to be between $42,000 and $45,000 per door. This is the gap that must be closed to bring unit rentals to the current median market rent and thus begin to serve average renters.

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