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Rental Housing in Canada's Cities: Challenges & Responses

BY STEVE POMEROY AND DUNCAN MACLENNAN

April 2019

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Acknowledgments

We wish to thank the **Urban Project Volunteer Advisory Working Group** for their assistance in guiding this research.

- **Derek Ballantyne**, Board Chair, CMHC
- **David Crenna**, Outgoing Director of Urban Issues, Canadian Home Builders Association
- **Sean Gadon**, Director, Affordable Housing Office, City of Toronto
- **Dan Garrison**, Assistant Director of Housing Policy, City of Vancouver
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Executive Summary

Rental Housing in Canada's Cities: Challenges and Responses

Housing affordability pressures are a clear *national* challenge. They shape Canada's ability to compete for talent, to grow sustainably, and to provide an inclusively high quality of life. Moving forward requires deliberate national commitments to ensure Canadians can find a place to call home.

Yet the experience of these pressures is profoundly *local*—felt most deeply in our communities and neighbourhoods. So too are effective housing solutions, which respond to concrete local needs and fuel the progress of integrated plans for community development.

This paper was prepared for the Urban Project event in Vancouver on May 2, 2019: *Rental Housing in Canada's Cities: Challenges and Responses*. The paper is informed by an Advisory Working Group of subject matter experts from across the housing sector and focuses on the growing housing challenges in Canada's cities and metropolitan areas, particularly related to the affordability of rental housing.

Changes and Challenges

For much of the last century, Canadian policy and programming have focused on facilitating access to ownership and on providing non-market social/affordable housing for low-income households. The nature and scale of current housing pressures in Canadian cities now demands a broader approach.

Canadian cities, much like cities in other OECD countries, are facing a trio of housing pressures including a growing need for subsidized housing for low-income households; persistent—and in some cases rising—homelessness; and sharply growing housing affordability pressures extending up to median-income households.

All three challenges must be tackled, but it is the third—housing affordability pressures faced by lower and median-income households, particularly renters—that is the focus of the paper. Addressing this challenge will have a direct and significant effect on the ability of cities, and by extension the nation, to attain the goals of economic growth, inclusion and environmental sustainability.

Economic Growth and Housing Pressures

In the recent decades, Canadian cities have experienced accelerated economic, population and employment growth. Canadian cities are the high-productivity components of the national economy, with fully half of Canada's jobs located in the Census Metropolitan Areas of Toronto, Montreal, Vancouver, Ottawa-Gatineau, Edmonton and Calgary. This growth has generally led to rising incomes, rising housing demands and affordability pressures.

As the proportion of income a household needs to spend on rent increases, local economies are impacted. Labour market needs go unfilled as households are forced further away from job locations in cities to find rental housing they can afford, and the consumption of non-housing items by residents is reduced. This can inflate the costs of income security programs to governments and has an impact on congestion, transportation and transit systems.

But while cities and metropolitan areas are at the core of economic growth, they do not have the commensurate autonomy, tax revenues and partnerships needed to address housing pressures.

The Current State of Rental Housing

Almost one-third of households in Canada are renters, yet fewer than one in ten new homes built in the last 20 years were “purpose built” as rental homes. The limited development of rental housing, starting in the mid-1980s, was the result of demographic trends, high development costs relative to rent revenue, unattractive tax treatment and the impact of condominium competition for multi-residential land.

The mismatch between proportion of renters and levels of rental construction was sustained by the historic stock of rental homes, most of which were created prior to 1990. Moreover, the homeownership rate jumped dramatically in the decade 1996 to 2006, such that many renter households transitioned to being owners, which removed demand pressures from the rental sector.

More recently, the steady homeownership upward trend ended. In 2016—for the first time ever—the homeownership rate declined in the context of sharply rising prices and macro-prudential policy that has limited access. And while rental construction has increased since 2014, it remains well below one-third of all construction. At the same time, the existing rental stock is being eroded through demolition and, more often, through the increase of rents above relatively affordable levels.

The combination of low levels of construction, the erosion of lower rent units and shifting demand (where would-be homebuyers are priced out and remain renters) is resulting in declining vacancy rates, which is pushing rents upwards. While vacancies in Edmonton and Calgary remain high, even here the last two years has seen a decline in vacancies.

So in most cities today there is an emerging rental crisis characterized by an absolute shortage of lower rent units compared to the number of lower income renters seeking housing, which is also affecting median-income renters, especially as new rental developments and investor-rented condominiums tend to rent units at well above affordable levels relative to the average renter income.

Considerations for the Way Forward

Ensuring cities have the tools to do their part in meeting housing affordability challenges requires that they have the fiscal resources and partnerships to underpin actions. Given that tax dollars earned in cities are largely captured by provinces and Ottawa, but housing pressures are fundamentally local, a more integrated series of city-led but provincially and federally supported housing investment partnerships will be required. In particular, creating a policy environment that incents rental investment to increase the total and relative supply is essential, complemented by locally appropriate approaches that ensure a better mix of unit sizes at modest rents.

Approaches to Improve Affordability

A range of approaches can drive greater affordability in rental housing. Just as different cities have different economic and demographic challenges, there is no one solution to addressing rental housing supply. Different approaches will require action—direct, enabling and complementary—by different actors; cities, other orders of government, non-profit and private sector actors. The required timeline to implement and the potential impact on affordability varies with each potential mechanism. The full paper outlines in greater detail the approaches and mechanisms summarized below.

Type of Approach	Potential Mechanisms
Reduce Capital Costs	Reducing cost of land; innovative design; waiving fees and charges, expediting approval process.
Reduce Operating Costs	Utility costs; align property tax rates; reform tax treatment of rental income.
Low cost financing/favourable underwriting criteria	Low-rate loans; finance aggregator.
Planning and regulatory mechanisms	Inclusionary policy; accessory suites and small infills; reduced parking requirements; expedited development approvals.
Municipal Land Banking	Cities acquire properties, especially near future transit/LRT; establish land trusts.
Targeting certain types of investors/developers	Incent and attract institutional investors; small investors in secondary market; enable non-profits to create intermediate market product.
Address erosion of existing median-level rents	Implement rental replacement bylaws; enable non-profit acquisition.
Indirect mechanisms	Enable First-Time-Buyer access in order to remove rental demand; promote and support student housing.

Conclusion

Cities in Canada and around the world are undergoing a major transformation. Understanding the critical roles that housing plays in the broader economy and in productivity is the key to driving the strategic solutions needed to ensure cities remain productive, inclusive and sustainable. This will place housing at the centre of a range of critical municipal activities, especially economic development, infrastructure investment, transit development and planning.

While the paper focuses on rental housing given the affordability pressures renters in cities are increasingly facing in Canada, it remains critical to take a system-wide perspective when considering the potential solutions outlined in the paper. Otherwise, actions in the ownership sector can have significant repercussions in the rental sector.

A number of potential mechanisms that cities might draw on to expand the production of affordable rental housing, as well as to address the critical issue of the erosion of the existing affordable rental stock, are described in the paper.

1. Changes and Challenges

Safe, decent and affordable housing is the bedrock of liveable, competitive cities—and the country—that we all aspire to build.

Leaders at every level of government in every region of the country have identified housing as a critical challenge to Canadians' quality of life and economic prospects in 2019.

Housing affordability pressures are a clear *national* challenge. They shape Canada's ability to compete for talent, to grow sustainably, and to provide an inclusively high quality of life. Moving forward requires deliberate national commitments to ensure Canadians can find a place to call home.

Yet the experience of these pressures is profoundly *local*—felt most deeply in our communities and neighbourhoods. So too are effective housing solutions, which respond to concrete local needs and fuel the progress of integrated plans for community development.

In short, *local solutions tackle national challenges*. And among Canada's urban challenges and solutions, this paper focuses on the affordability of rental housing.

For much of the last century, Canadian policy and programming have focussed on facilitating access to ownership and on providing non-market social/affordable housing for low-income households. Yet policy-makers have paid less attention to broader housing outcomes—including how they shape, and are shaped by, local economies.

The nature and scale of housing pressures in Canadian cities now requires a broader approach. This approach must consider the role of housing as essential economic infrastructure. It must also recognize that affordability pressures are not limited to low-income households: lasting, systematic solutions must extend beyond non-market social/affordable housing.

1.1. Changes

For two decades, much of the focus has been on cities across the OECD economies. In Canada, this was the focus of the 2008 Harcourt report (Advisory Committee on Cities and Communities), which was followed by a decade of significant growth in population and economic output in metropolitan areas.

Canadian cities are recognized as high-productivity components of the national economy (OECD 2009), with fully half of Canada's jobs located in the Census Metropolitan Areas (CMAs) of Toronto, Montreal, Vancouver, Ottawa-Gatineau, Edmonton and Calgary. In that context, urban opportunities and challenges significantly define the nation.

At the same time, over the last decade, federal urban and housing policies were relatively weak. Since 2016-17, significant federal investment in city infrastructure, particularly transit, and the emergence of a well-funded National Housing Strategy has changed that trajectory.

Economic growth has changed, not diminished, housing affordability pressures. Since the early 1990s, growth in employment, income and population has coincided with widening income and wealth inequality. There is strong evidence that rising house prices and rents have helped drive those growing inequalities. Many believe that housing pressures are compromising the economic growth potential of cities, and thus the nation (Maclennan and Miao, 2019).

1.2. Challenges

Canada's urban housing pressures are complex in origin and impact. There is a trio of housing challenges typical of cities in growing OECD economies such as Australia, the USA, New Zealand, the UK—and certainly Canada¹:

- a growing need for subsidized housing for low-income households
- persistent—and in some cases rising—homelessness
- sharply growing housing affordability pressures extending up to median-income households (renters, owners, prospective buyers).

Addressing this third challenge, particularly as it relates to renters —this paper's focus—will directly influence cities' ability to drive economic growth, inclusion and environmental sustainability. There is growing awareness that housing outcomes—including the quality, size, location, tenure and cost of homes—shape economic growth and productivity within metropolitan areas (Maclennan, 2018). City responses to housing pressures therefore must be set within a wider understanding of how housing shapes urban progress.

1.3. Responses

In 2017, the federal government launched Canada's first National Housing Strategy (NHS)—a 10-year, \$40-billion federal re-entry into the housing affordability space. Together with provincial and municipal responses to acute housing pressures—especially in Vancouver and Toronto—this has sparked a renaissance of housing policy innovation in Canada.

This renaissance is fuelled by growing anxiety among households at a range of income levels regarding the affordability of housing in cities. All of these factors are driving a new political economy for housing policy innovation in Canada. This is the context in which Urban Project participants will meet in Vancouver—to

¹ For a comparative discussion of the problems and possibilities see the *Shaping Futures Report* (Maclennan et al, 2019b) that discusses Canadian, Australian and British housing policy developments. It is available online at <https://shapingfutures.gla.ac.uk/wp-content/uploads/2019/03/ShapingFuturesChangingtheHousingStory.pdf>

creatively tackle the complex issues driving the disconnect between rent and income levels.

1.4. This Paper

Canada's public discourse on housing pressures has emphasized younger households being priced out of home-ownership; the equity sharing initiative in the 2019 federal budget are one response. This paper focusses on the growing and connected—and less examined—affordability pressures in the rental sector.

Section 2 surveys broad developments in housing systems and outcomes over the last decade. **Section 3** provides additional detail on the rental sector in Canadian cities. **Section 4** identifies key considerations that policymakers should consider before moving forward. **Section 5** sets out possible approaches for improving the affordability of rental housing. (These are also outlined in chart form in Annex I). All parts of the paper are summarized in **Section 6**.

2. Economic Growth and Housing Pressures

Canada’s big cities are leading the country in population and productivity growth, while lacking the autonomy and fiscal tools to address resulting housing pressures. Where construction does not increase in response to price growth, home prices can rise quickly. Rising demand for middle-income housing disproportionately impacts lower-income renters as rents rise faster than their sluggish incomes. And rising demand and prices both fuel speculation that compounds upward pressure on rents.

2.1. Growth

There have been two key developments in city economies in the OECD in recent decades. The first, and widely recognised, is that urban scale and density appear to have played significant roles in improving the efficiency of labour markets and innovation systems. This has led to rising productivity in most large cities such that by the start of the millennium, productivity rates in cities were rising above national averages (Glaeser and Gottlieb, 2009).

Second, for the very largest cities, new communications technologies as well as freer trade and financial deregulation have led some cities to effectively dominate the global economy (de Scott, 2001). This is most true of London, New York and Paris but it also applies to other metropolitan areas. Toronto, Vancouver and Montreal all display some of these key features. That is, growth may have occurred across all Canadian cities, but the scale and the sources of that growth vary by Canadian city. Related, there is some statistical evidence that the housing markets of Vancouver and Toronto have now ‘unlinked’ from the growth patterns in their provinces and indeed Canada as a whole, but are more connected to the global context (IMF, 2018).

These growth patterns are important for housing policy. First, they place the city and metropolis at the core of economic growth, but not with the commensurate autonomy and tax revenues needed for addressing housing pressures. Secondly, that in some cities where growth is truly driven by global factors, addressing housing pressures and enabling urban progress broadly is more complex (Maclennan and Miao, 2019). This means that intervention by other orders of governments, whether in tax policies or financial stability measures, must recognise that urban economies and local housing markets are not homogenous.

Consistent with the accelerated economic growth experienced by Canadian cities, population, household and employment growth have risen fastest in existing metropolitan areas. The largest metropolitan areas have, with some exceptional periods, grown fastest and other metropolitan areas have nonetheless grown

faster than regional or rural areas. This growth has generally led to rising incomes and rising housing demands.

2.2. Supply Responses

Growing housing demands impact local housing supply systems. There are several studies that estimate the price elasticity of the supply of housing for metropolitan areas in the United States (Glaeser and Gyrko, 2018). These studies effectively indicate the extent to which growth results in either increased prices or increased housing supply, and results are mixed. There are few empirical studies for Canada but Kahler (2014) estimates that housing supply elasticities for Canadian metropolitan areas are low, at 0.2. The implication is that the housing construction sector is largely insensitive to house price changes and that growth will mean rising housing costs.

The US supply-side research on housing elasticity has drawn strong policy conclusions by laying the blame for inelastic supply and growing prices at the door of municipal and metropolitan planning authorities (Glaeser and Gyrko, 2018). These policy conclusions challenge cities to relax planning regulations. The Glaeser-Gyrko argument is powerful, but it is not proven. Restrictive regulations may hamper supply but there are a range of other potential causes of inelasticity including speculation, local building sector monopolies and market failures, and shortages of infrastructure investment (Maclennan and Miao, 2019). More broadly, municipal regulations serve important policy purposes in reducing uncertainties facing developers and shaping the nature of the growth and density that a city wants. In the absence of definitive research in the Canadian context in this area, the question of the relationship between local planning regulation, housing supply and price growth needs to be explored in order to understand the role of the housing supply chain on housing affordability.

2.3. System Pressures

Where population and employment grew fastest in Canada in the recent period, housing prices and rents rose fastest too (CMHC 2018). In particular, the inflation rate of the price of homes in major metropolitan areas has run ahead of other cities, towns and rural areas for sustained periods. That divergence has slowed but not disappeared. The growth of home prices is related to growing rental rates, as will be more fully explored in the next section of the paper.

2.4. Implications for Renters in the Economy

Rising home prices are usually only the first sign of housing market challenges. Growth in middle-income demand for housing typically disproportionately impacts low-income renters as rental rates rise much faster than the sluggish incomes of households in lower income deciles. Indeed, the proportion of income needed for rent has increased most for those at the lower end of the income scale. This has a major impact on the productive economic capabilities and participation of low-

income individuals and households² (Von Scheel 2017; Fitzpatrick, et al., 2018; Pawson, et al., 2018).

For households forced further away from job locations to find rental housing they can afford, this imposes significant reductions in labour market productivity (Maclennan, 2019) and household income potential. Statistics Canada reported in the 2016 Census that 10 percent of households living in CMAs had commuting trips of an hour or more. Additionally, as renters spend a greater proportion of disposable income on rent, their ability to consume non-housing items is reduced, impacting local economies. At a higher level, this phenomenon inflates the costs of income security programs to governments (Parsell, et al., 2017). These economic and environmental costs driven by the unaffordability of housing need to be at the forefront of housing policy-making.

2.5. Housing as an Investment Tool

The growth of housing demand and rising prices in cities have meant that homeownership not only serves a residential purpose with an element of savings/income-earning, to now a more speculative investment venture.

Households with savings and retirement income are now viewing the purchase of a home in order to rent it as a rational investment strategy as housing shortages drive up rental returns making renting easier. CMHC (2018) reports that the share of tax-filing households with rental property income has increased over the last decade, and more rapidly than for other sources of income. The combined price growth of home and rental income returns usually exceed returns on other available financial assets. This augmented demand for homes to rent raises competition (and thus prices) for smaller properties, especially those which would typically be the target of first-time homebuyers. The implication is that affordability pressures for renters are exacerbated in lockstep with their inability to compete with investment-buyers in order to move into ownership, which would free up rental units and moderate price pressures.

The growth of short-term rentals in cities is also relevant here, especially through Airbnb, which has created a further flow of demand for properties in metropolitan markets that would otherwise be available for renters or, in some cases, first-time buyers.

The overconsumption of housing is a related element. The speculative reasons homeowners over consume housing—that is, they buy or hold onto owned property that has an excess of rooms and space relative to their needs—may be largely the same as trends noted above in that they view housing as their best investment. Addressing the speculation in under-used property could make substantial gains for renters but has largely been unexplored by policy-makers.

² Key references, homelessness since 2000.

The ability of capital to flow to housing investment and purchase across national boundaries has risen markedly in the last 30 years (Smith and Searle, 2010). In the UK, Canada and Australia, Chinese investors are regarded as key sources of speculation in, for example, in London, Vancouver, Toronto, Sydney and Melbourne. RBC identified neighbourhoods-submarkets within the major metropolitan areas in Canada that displayed foreign purchase rates of between 7 and 10 percent (RBC 2017). Vancouver, Toronto, Montreal and Halifax are the cities in Canada with the largest shares of non-resident purchases. Recently CMHC announced revised figures for Vancouver that suggest foreign ownership rates are more than double those recorded in the figures initially provided. While Canadian house price booms are not manufactured in Beijing, tightened housing markets in Canada are now drawn into global flows of housing finance and demand in ways that further reinforce home price increases that are at odds with the local tax and resource tools needed to address this aspect of the housing challenge.

3. Current State of Rental Housing

In 2016, the proportion of Canadians who rent rather than own their home grew for the first time. Almost one-third of households are renters, yet considerably less than one-third of construction is purpose-built rental housing. Rental housing that's affordable to mid- to low-income households largely remains in buildings constructed in the 1960s and 1970s. But as older buildings fall into disrepair, are demolished or are rehabilitated with corresponding rent increases, not enough rental housing that those households can afford is being constructed.

Canada's housing system is comprised of three interrelated sub-sectors: the ownership market (70 percent), the rental market (25 percent) and the non-market sector (5 percent), which is predominantly rental and targeted to lower income households that cannot afford housing in the market.

There is a strong symbiotic relationship between each part of the system. In particular a policy and consumer pre-occupation with home-ownership has, over time, had profound impacts on the rental sector, and knock-on effects on affordable and social parts of the system. This analysis focuses primarily on the rental sector, but it is important to acknowledge that this tends to conceal the important impacts that access to—or constraints on—ownership can have across the system.

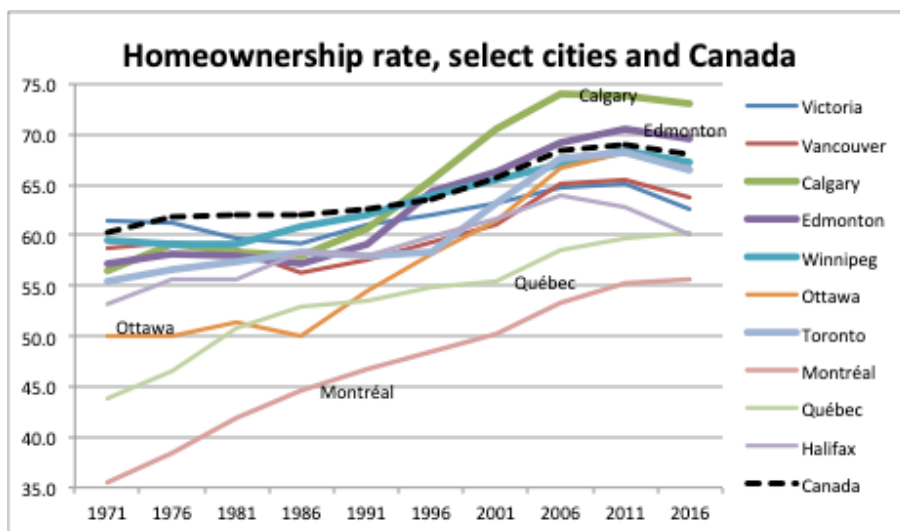
In the last two decades, cities and metropolitan areas have had a disproportionate role in growth of the economy and population. But this fast-paced urban growth has been accompanied by persistent sluggishness of supply systems. This is especially evident in the rental sector, where there is a persistent mismatch between the proportion of households that rent their home and the production of rental housing.

While the percentages vary across and within cities, on average almost one-third of households are renters; yet fewer than one in ten new homes built in the last 20 years were “purpose built” as rental homes. The scale of renting has been substantially sustained by the historic stock of rental homes, most of which (74 percent) were created prior to 1990. And many were a legacy of the 1960s apartment boom, a market response to the demographic demands of the baby boom generation, abetted by pro-active policies to incent and stimulate rental development in the 1970s and early 1980s. More recently, it has been augmented by a new form of “supply” wherein small investors purchase a home—or, increasingly, a condominium—as an investment property.

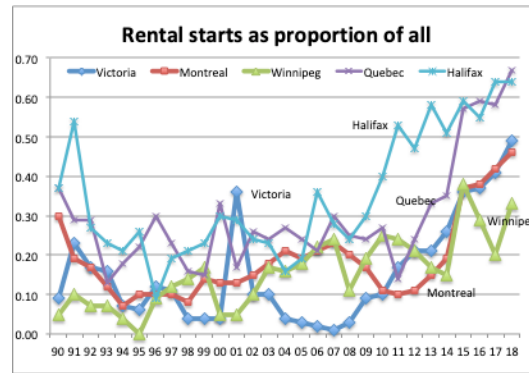
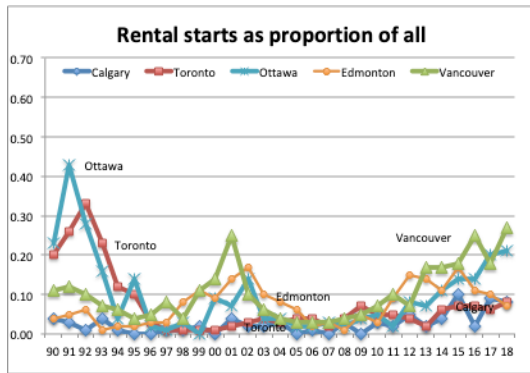
Since the mid 1980s, rental housing has been subject to policy indifference and complacency. This disinterest is now coming home to roost and has placed Canada’s housing system in a precarious state of imbalance (Pomeroy and Lampert 2017). Housing in Canada has become predominantly an ownership system, and it is poorly equipped to respond to a more diverse and growing need for rental housing. This responsiveness is crucial for addressing the basic housing needs of lower and increasingly moderate-income households, but also as a key factor in the economic well-being of individual households and of the national economy (as discussed in section 1).

The key overall indicator is the rate of ownership (and implicit inverse, rate of rental tenure). Ownership rates have steadily increased over the past four decades, with a notable jump seen since 1996. Accompanying this rise has been spatial remixing, whereby the inner areas of many larger cities—which were historically rental areas and, to varying degrees, still are—is being diluted by extensive condo development and associated gentrification. Meanwhile, minimal volumes of new rental are being built in suburban communities (with a few exceptions, such as Abbotsford, BC).

Nationally, in the decade 1996 to 2006 the ownership rate jumped dramatically from around 63 percent to 69 percent. Compared to a unchanged rate of ownership (i.e., if it stayed at 63 percent), this means that over 800,000 renter households transitioned from being renters to owners—the equivalent of building 80,000 new rental units annually.



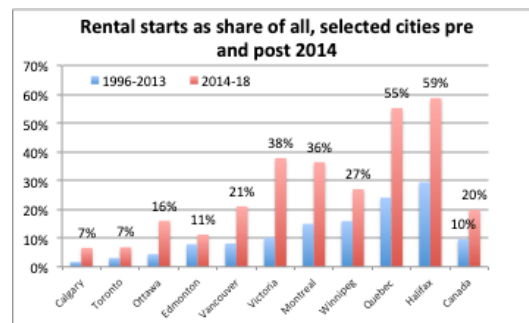
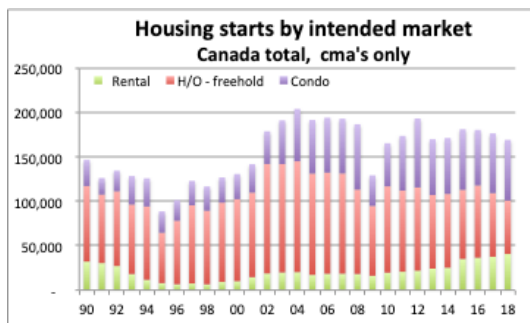
Not surprisingly, this removed demand pressures from the rental sector, and contributed to policy complacency. More recently, however, the steady upward trend ended. In 2016—for the first time ever—the home ownership rate declined, both nationally and in almost all cities, outside of Quebec.



Against the backdrop of expanding ownership, purpose built new rental construction declined substantially from peaks in the 1960s to 1970s, when much of the current formal rental stock was built. This was partly sustained by social housing construction until 1994, but from the mid-1990s until 2015 rental construction has been consistently low. Over this period, the rental sector accounted for less than 10 percent of all housing construction nationally, despite the fact that almost one-third of households rent.

This pattern of disproportionately low rental construction has been replicated in most cities. However, some municipalities stand out for a higher proportion of rentals, including many in Quebec as well as Halifax. In part, this reflects the relative affordability of detached ownership and thus weak demand for condos. Thus, multi-residential land has not been pressured by condo demand in these areas and it remains more feasible to build rental. Unique demand factors in areas like Halifax—where a large military presence and three post-secondary institutions create high demand for rental housing—can help explain these different trends across cities.

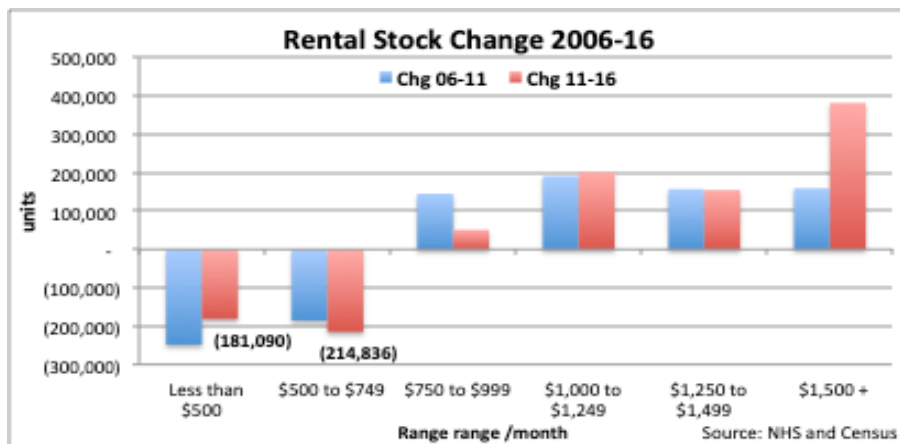
In other cities, social housing has propped up rental housing starts. This is particularly evident in Ontario where, from the late 1980s to early 1990s, a large unilateral provincial program stimulated much social housing activity. A similar situation unfolded in Victoria and Vancouver in 2001 when a large infusion of social housing funding peaked rental starts.



In the past few years in the selected cities included in the table above, there has been an upsurge in the volume of rental housing constructed and the proportion of total housing starts that this represents. Nationally, comparing the annual pre-2014 average with starts since 2014, rental starts have doubled as a proportion of all starts, although still remain well below one third. However certain cities— notably those in Quebec, which have always had a much stronger rental market, as well as Victoria and Halifax—have surged well over 30 percent.

As discussed further below, it is not just explicit rental policy (or lack of) that has influenced this situation, but the impact and influence of activity and policy in the ownership part of the housing market. The higher proportions of rental tend to be in the less large cities and those where there is a lower volume of condominium construction. In turn, there is much less rental in cities with high home prices, which tend to attract more condominium development that then crowds out rental, as it cannot compete for multi-residential land. Notably there is a very high positive correlation between the share of condo development and the median home price.³

The recent increase in both the absolute number (up from around 20,000 to 40,000 units per year) and proportion of rental starts reflects the changing context in the ownership sector. Rising prices together with macro prudential policy change act together to constrain access to ownership; large inventories of unsold and planned but not started condominiums and the bottoming out of capitalization rates on existing rental investment properties have shifted developer and investor interest into the rental sector.⁴ Additionally, to a minor degree, the new CMHC Rental Construction Financing Initiative (RCFI) may also abet this. But even this rise still leaves rental construction well below the proportion of renters. And most new construction is facilitated by high rents: typically at least 150 percent or more above average.



³ Comparing the proportion of all starts that are condo against home prices in this cross section of 10 cities generates a Pearson coefficient of 0.9358. While not as strong as price there is also a positive correlation between CMA population and the proportion of condo development, (Pearson coefficient of 0.6374).

⁴ As discussed further the capitalization rate is based on the net operating income (NOI) and sales price of investment properties. The lower the rate the higher the value.

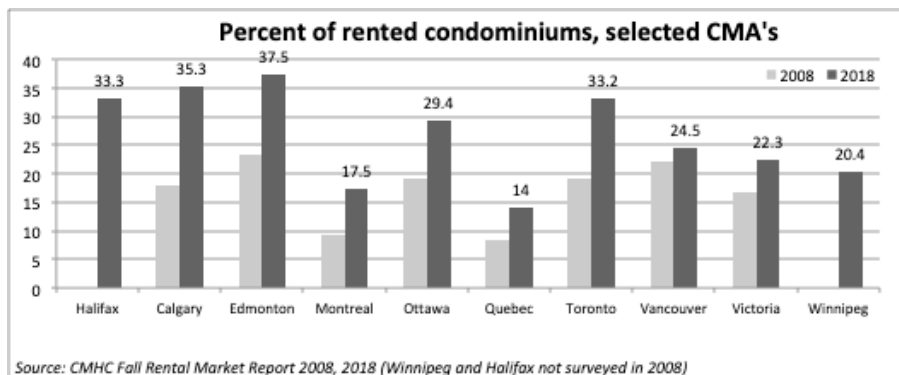
At the same time, the existing rental stock is being eroded. This occurs in two ways: First, some is lost in absolute terms as properties are demolished to accommodate new development (often the result of municipal smart growth, intensification strategies). Second, and more often the case, the units remain, but the rents have increased above affordable levels. The latter is associated with institutional (pension funds, life insurance companies) and Real Estate Investment Trusts (REIT) investors purchasing existing assets and then pursuing property upgrades and rent increases to enhance investment returns.

The consequence is that the number of lower rent, affordable units is being squeezed down. Over 800,000 rental units below \$750 (affordable to incomes below \$30,000) were “lost” in the decade between 2006-2016. When these units shift to higher rent bands, more households pay over 30 percent and many over 50 percent to afford the remaining homes.

3.1. New Forms of Renting

CMHC’s rent survey has historically tracked a specific subset of rental units: “purpose built” properties with three or more units. This is only a portion of all rentals. In 2018 the CMHC purpose built universe was 1.9 million units; the 2016 Census however identified 4.3 million renter occupied units. So the purpose built segment represents only about 40 percent of all rentals.⁵

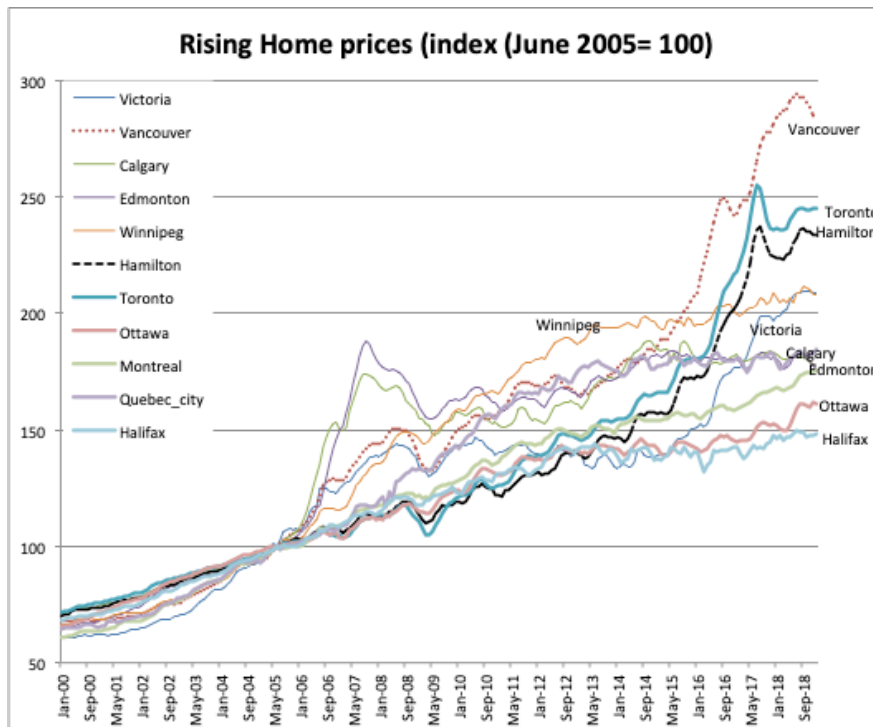
While purpose-built rental housing starts have historically been relatively low, a new type of rental supply has gradually emerged over the past decade or more in the form of investor-owned condominiums. CMHC surveys a selection of CMA’s and this reveals that rented condominiums now account for one-quarter or more of all condominium starts in most major markets.



⁵ The term “purpose built rental” is a statistical construct unique to Canada. No other country tracks construction statistics exclusively for rental units, mainly because in many countries the stock is fluid and tenure neutral. At different times purchasers may be investors (who then rent it out) or owner occupants. The growth of the secondary market (i.e. other than purpose built rentals) in Canada suggests Canada too is moving in this direction

3.2. Ownership Part of the Housing System

A parallel set of trends has pervaded the ownership part of the housing system, most particularly a substantial rise in home prices and increasing concerns about ownership affordability and access. These issues are heightened in the “pressured markets,” especially Vancouver and Toronto where foreign investment has had a distorting impact on the fundamentals and relation between resident incomes and prices, especially after 2014. These issues are well documented elsewhere⁶ and are not within the scope of this paper. Nevertheless, it should be noted that constraints on access to ownership have a profound impact on the rental part of the system.

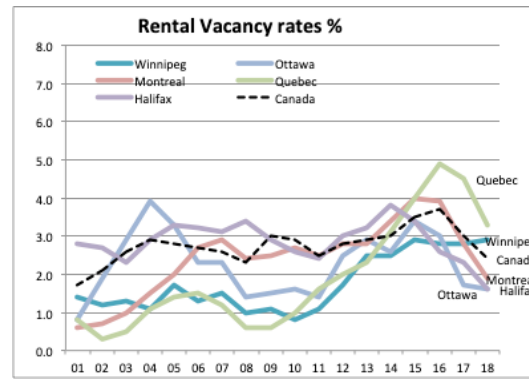
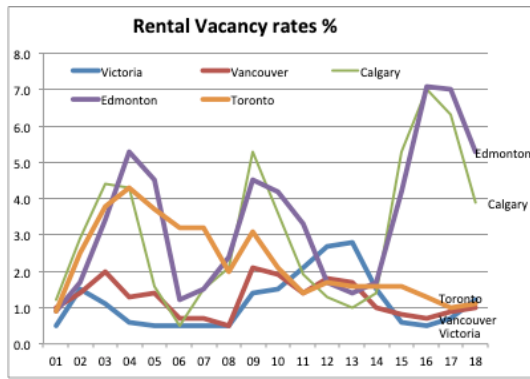


3.3. The Pattern of Path Dependency

The housing system is a classic case of path dependency: many of the characteristics and issues within the system today are a legacy of historic circumstances, institutions, policies and outcomes. As noted, the majority of rental stock (74 percent) was constructed prior to 1990 and it is this legacy of earlier periods that is now the primary source of low-moderate rent options in the rental market.

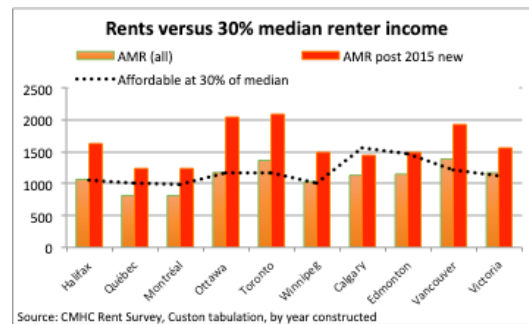
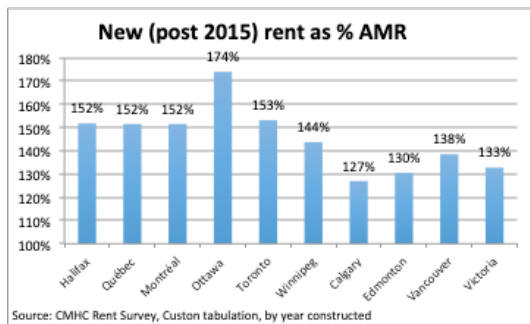
The high volume of rental construction in the late 1960s and 1970s was a market response to growing demand from the baby boomer generation leaving their parents’ home and creating new “non-family” households—both as individuals

⁶ For example see Idaliya Grigoryeva & David Ley (2019) The price ripple effect in the Vancouver housing market, *Urban Geography*, DOI: 10.1080/02723638.2019.1567202; Josh Gordon 2016 *Vancouver's Housing Affordability Crisis: Causes, Consequences and Solutions* (SFU)



So today in most of the mid-large metropolitan areas of the country there is an emerging rental crisis. This is characterized by an absolute shortage of lower rent units, compared to the number of lower income renters seeking housing. It is exacerbated by an ongoing process of erosion in the lower rent stock, a function of the financialization of housing, further diminishing affordable options. And in the more recent three to four years, the combined effect of high home prices and macro-prudential policy change have constrained access to ownership, closing off the former pressure release valve (renters shift out to own) that saved rental sector in the 1990s and early 2000s in the era of policy indifference. Against these challenges, there remains an insufficient volume of new rental construction.

While there are promising signs that the volume of new development has increased, rent levels in newly built rentals tend to be well above affordable levels, relative to the average renter income. In most cities the average rent on new units is well above 30 percent of the median renter income.¹²



So it is not just low income renters that face a challenge—it's the median renter. For example, in Ottawa the median renter household income is just under \$47,000, so can afford to pay \$1,165 at 30 percent. Meanwhile the average market rent (AMR) is just affordable (\$1,174), but the post 2015 units are at 174 percent of AMR (\$2,042). Ottawa has the highest differential over the average. At

¹² The differential in the two BC cities is surprisingly low. This may be influenced by a high volume of assisted rentals, under BC programs, which are enumerated by CMHC as rental (there is currently no social-affordable indicator in the CMHC starts and completions survey).

most, the average for rentals constructed post 2015 is roughly 140 percent of AMR.

3.5. Caveat on a Supply Approach for Lower Income Renters

It should be noted that the issue of housing affordability exists at the confluence of two sets of circumstances: higher shelter costs (rents) and low incomes. As a group, renters tend to include a large proportion of low-income persons and families. The average and median incomes of renters are, in most cities, less than half those of owners. This is largely a reflection of capacity and aspiration, whereby households with higher income and especially those with families seeking more space have translated their higher purchasing and leverage (ability to carry a mortgage) power into purchasing a home. To an increasing degree, the products offered in the rental sector are less attractive (few family sized, older, lower quality) and provide less security of tenure than purpose built. As higher income households exit rental tenure the residual lower income households pull down the renter average.

While not all renters are low income¹³, many renters are characterized by low income, and incapacity to purchase. As a consequence, the incidence of core housing need, CMHC's official housing need measure, is four-five times higher (varies between cities) among renters than owners (nationally in 2016, 26.7 percent vs. 6.3 percent).

The predominant problem for renters in need is one of affordability: 89 percent of renters' experiencing core housing need¹⁴ are associated with affordability (alone or in combination with adequacy and suitability), and only 11 percent face an adequacy and/or suitability problem only.

Digging more deeply, two thirds of renters core needs are dependent on income assistance benefits. So the inadequacy of income assistance and benefit programs, and endemic poverty is at the root of affordability issues.

Accordingly, alongside any supply initiatives, responses to affordability issues must encompass ways to supplement and augment income. This can include targeted income measures, like the Canada Child Tax Benefit, assistance to acquire labour market skills to secure improved income, enhanced income assistance, as well as housing related measures like rent supplements, vouchers or housing benefits (all effectively conditional income transfers related specifically to shelter cost burdens). Supply initiatives play an important role in revitalizing distressed communities, but it is important to clearly define the problem and associated policy objective. There are situations when demand measures are appropriate and effective, and others where supply can be more useful (especially place making).

¹³ Increasingly mid-high income households elect to rent (especially those with more fluid employment locations, that want to maximize labour market mobility).

¹⁴ <https://www12.statcan.gc.ca/census-recensement/2016/ref/dict/households-menage037-eng.cfm>

The focus of this paper is primarily on supply and that is the main feature of the next section. But it is critical to set the context for supply-based initiatives. When a supply mechanism (such as the pre-1994 non-profit program) incorporates a low rent feature (e.g., rents geared to income, RGI) it has conflated two distinct problems—supply and affordability—into a single solution. As a result of seeking to achieve dual objectives, solutions become more expensive (e.g., it requires far more subsidy to reduce rents to a \$500 RGI rent, than to create supply at a market rent approximating \$1000 or higher).

To be effective, supply responses should focus exclusively on stimulating new construction. These should seek to encourage rents at more modest levels (e.g., 80-100 percent average market) than current market based construction is producing, but should not alone seek to address the separate issue of affordability that impacts some households. This will then create a more modest cost platform to address modest (median income demand).

Where there is a desire to also assist very low-income households (for whom 80 percent is still too high) rental assistance can be stacked on to facilitate deeper affordability. This is a model that is more pertinent to non-profit providers, who traditionally created mixed income mixed rent buildings. It simply pushes some units slightly higher, but in doing so strengthens the financial viability of the non-profit corporation (and provides additional revenues to lever finance or to cross subsidize their affordable mission).

3.6 Responding to the Intermediate Rental Market

The National Housing Strategy has announced a number of new funding and financing initiatives that primarily target traditional social-affordable housing. These include funds to retrofit, redevelop and sustain existing social housing (and it is more cost effective to extend the life of these assets versus building new low-rent development). Additional grant and financing is available to support some growth of the affordable stock (with rents set circa 80 percent of the average market rent, AMR). This is expected to create up to 10,000 to 12,000 affordable units annually (roughly one quarter of current total rental production, and double that of the pre 2014 era).

There is one specific financing initiative explicitly designed to stimulate new rental construction at close to market rents (requires a rent set 10 percent below full market potential, a foregone revenue offset through favourable financing conditions). The quantum of financing announced in the 2017 and 2018 budgets for the Rental Construction Financing Initiative (RCFI) was sufficient to support only 2,500-3,000 rental units per year. This was increased three fold (adding \$10B to previous \$3.75B) and is anticipated to assist around 5,000 units per years, but remains less than one eighth of current production levels—additional measures are needed to augment this program. More importantly, the processing could be simplified and streamlined to ensure it is taken up.

So there is currently a bi-polar distribution in rental construction. Units created under the NHS affordable programs will target rents at or below 80 percent (100 percent of AMR). The market is currently producing new rentals in the order of 170 percent+ above AMR. This leaves a large gap, only minimally addressed by the RCFI.

It is this intermediate market (roughly 100-150 percent of AMR) serving renters ranging from median incomes to 140 percent of median income that is the main target of the exploration in section 3. That said, where there is a desire to address deeper affordability issues, responses can draw on non-profit partners, municipalities and provinces to layer on assistance to more specifically address affordability (separate and aligned with supply objective).

4. Considerations for the Way Forward

Identifying how the affordability of rental housing can be improved is crucial for cities—but cities also need tools and partnerships so they can effect change. Housing is a national challenge, and municipalities need fiscal and planning resources to enable solution-oriented investments. Mayors must ensure that the right frameworks are in place to build for the future, and this includes rental housing that a range of households can afford.

4.1. Rethinking Frameworks

The importance of cities in national growth and innovation is now widely recognised. It is also increasingly apparent that high cost housing outcomes in major growth centres are now encouraging skilled workers and firms to seek lower cost, but also lower productivity, localities. There needs to be a new national priority on ensuring that cities have the tools and resources to adequately manage the congestion and affordability costs that arises from the growth sources that they are ‘home’ to.

Ensuring cities have the tools to do their part in meeting housing affordability challenges, requires that they have the fiscal resources and borrowing capabilities to underpin actions. Given how tax dollars earned in cities are largely captured by provinces and Ottawa, but housing pressures are fundamentally local, a more integrated series of city-led but provincially and federally supported housing investment partnerships will be required. In both Australia and the UK, multi-order financed but locally controlled ‘city deals’ have been put in place to address similar infrastructure issues and have increasingly included housing projects. If the housing pressures resulting from city growth are to be quickly and fairly dealt with, does there need to be a new series of Housing Investment Deals/Partnerships to address pressured housing systems?

If these arrangements might be led by cities, they should not be restricted to single core cities. The growing evidence highlights how that it is at metropolitan or city-region scales that housing, employment, transport and other infrastructure systems operate and cohere. Effective management of city housing issues may require a metropolitan perspective and investment strategy.

It is also clear that housing investment decisions in cities have to be integrated, from their very conception, with planning for jobs, transport and other services. This requires cities to develop new integrated planning and budgeting strategies to put in place the major scale investments (private as well as public) that will really address the scale of the shortages now prevalent in many major cities. In that sense more entrepreneurial, strategic planning for city change may be needed and not less. At the same time cities will increasingly have to refute the

Glaeser-Gyurko (2018) accusation that it is municipal planning regulations that create the city housing crisis. This will require cities to review the outcomes of the regulations they do have but also evidence the other factors inducing sluggish housing supply responses. Cities have a key role in the education of other orders of government, and especially their economics-finance ministries, about how housing markets actually function.

There is a wide variety of rental sector policy measures that cities can pursue. To do so effectively they need a better big-picture framework to plan and fund investment strategies. We now turn to more detailed measures.

4.2. Rental Aims

Ideally we want to create a policy environment that incents rental investment to increase total and relative supply. Separately, we also want to establish some mechanisms or approaches that not only stimulate new construction, but also help to generate a better mix of unit sizes and at modest rents—defined here as the intermediate rental market. As revealed in the statistics for newly constructed rentals, the market is pricing new development at roughly 130 percent-170 percent of AMR (varies across cities). If the policy objective is to encourage rents in a lower range (e.g. 120 percent to 150 percent) AMR, what would it take to incent a developer to produce at that rent (i.e. forego a high rental revenue)?

To the extent that a key metric for investors is their return on equity (RoE), lower rents will have a negative and unattractive effect. To sustain a minimally acceptable RoE will require either that the Net operating income (NOI) is compensated for lower revenues; or that the level of investor equity is reduced, such that RoE is preserved.

The former requires a reduction in operating expenses, for example reduction or exemption from property taxes; the later a reduction in input costs, such as reduced land cost, waived fees and charges, mechanisms already used to support affordable development.

A critical consideration is the policy outcome and how each municipality prioritizes general rental construction (at intermediate market rent) against lower rent (affordable) production. With limited resources or capacity to forego fee revenues, will municipalities be willing to utilize any portion of this to incent market-rate, which may then limit ability to support more affordable lower rent development?

Another consideration is the producers-investors that are targeted.

- For market, profit-seeking developers it is necessary to find ways to offset reduced rents and preserve an acceptable RoE.
- An alternative is to target non-market producers—non-profits that traditionally built only lower affordable rents. There is a business case for these non-profits to extend their activity into the intermediate market, building mixed rent developments. As noted earlier, the higher

intermediate market rent revenues can help such organizations diversify and strengthen revenues and to cross subsidize their primary mission.

In addition to targeting producers, a separate option is to examine the characteristics and motivations of different types of investors. As noted earlier, institutional investors and REITs are significant actors in this asset class, but traditionally have only acquired existing assets. Can they be attracted to construct new intermediate rent product?

And small-scale investors, purchasing a dwelling or condo unit as investors are also a significant participant in larger cities (as shown earlier in percentage of renter occupied condominiums). This group of small investors may respond to different incentives than corporate developers and institutional investors. Indeed, investors may be the more important target—builders will build tenure neutral properties—it is the purchasers that ultimately determine tenure: some buy to own, some buy to rent.

A third group of investor-providers are owners or builders of homes that can accommodate accessory units either within the existing structure or as accessory structures, such as laneway homes and garden suites. Here the municipalities have important regulator roles, but can also introduce incentives to not only permit but to encourage this type of small-scale infill (and incentives can be linked to affordable rent levels).

The preceding options focus on the financial feasibility of rental development. A parallel consideration is the regulatory treatment of rental investment. Even when development may be viable, certain developers/investors may avoid rental due to perceived (or real) risk about the impact of rent regulation impacting downstream rental income, or adding excessive costs (i.e. legal cost associated with eviction).¹⁵

The next sections review possible measures to increase rental supply and to achieve rents in the intermediate market range. To the extent that this objective involves setting rents below full market potential, each section examines options to provide an offset or compensation for sub-optimal rent levels.

¹⁵ There is a widely held view among housing economists that rent regulation suppresses investment. Canada offers an interesting natural experiment where-in Quebec has had the longest standing and most rigorous regulatory regime and produces a disproportionately large number of rental units; Alberta with no controls produces only a small volume of rental (especially in Calgary). Arguably a key factor is market certainty. Quebec's regulations have been consistent and have become capitalized into the market. Jurisdictions with no regulation are more uncertain – a change in government could introduce controls.

5. Approaches to Improve Affordability

A range of approaches can drive greater affordability in rental housing. Just as different cities have different economic and demographic challenges, there is no one solution to addressing rental housing supply. Here, nine strategies present a broad spectrum of actions that can respond to desired outcomes and available resources. These are outlined in a series of tables in Annex I.

5.1. Capital Cost Reductions

Capital costs are market based, and there is limited potential to reduce these. Certain building types may provide lower costs, especially wood-frame versus masonry (roughly 20 percent more expensive). Recent demonstration initiatives have highlighted potential to achieve lower costs via modular or manufactured homes. Current building codes and or zoning regulations may preclude or constrain these options, and these may require revision.

There is already a common practice of reducing or waiving development charges and/or permit fees to help achieve more affordable rents. This approach could similarly be applied, to intermediate rent projects. However municipalities may prefer to reserve this approach for more deeply targeted affordable rentals.

Also, expediting the planning and development permitting process can help to reduce carrying costs. Some cities have adopted a priority tagging process to move affordable housing to the top of the list in reviews (e.g. adopted to facilitate Vancouver’s development of temporary modular homes targeting the homeless). Through its Open Doors program to incent affordable development, the City of Toronto has adopted a process to expedite approvals of proposed affordable developments.

Reducing Land Costs

One area that arguably has the greatest potential impact is the land cost. Typically this accounts for 15 percent-20 percent of capital cost. Deeply discounted or free land via donation of public lands can have a substantial impact in assisting affordability. However this is rare even for deeply targeted affordable initiatives—as most public bodies seek some payment and often seek to sell land at market value. Few if any public land owners are likely to provide land at no cost for market development.

In the case of private land, public policy, through the development approval process can have a significant impact on land cost and thereby creates opportunities to share in the associated “planning gain.” This draws on the

mechanisms of density bonusing or inclusionary policy. Zoning regulation, particularly zoning for rental can also have a positive effect in lowering land cost. And these are especially relevant in Transit oriented development (TOD) areas, where there is an inherent land value uplift directly associated with public investment. These public gain options are discussed further below (planning and regulatory mechanisms).

5.2. Reduced Operating Expenses

The main effect of reduced operating costs is to improve net operating income (NOI). This in turn increases potential to lever financing (the additional cash flows can carry more debt), which reduces the amount of developer equity required, thereby enhancing return on equity (ROE).

Most operating expenses are market driven prices and therefore difficult to reduce. Some are a function of public policy—notably property taxes and utility costs.

Reducing utility costs: Building to more efficient standards may have a small impact on capital cost (although wide-scale adoption is helping reduce cost of energy efficient components and equipment) but will lower downstream utility expenses. A critical issue in rental housing, however, is that increasingly units are individually metered. This separates the party that incurs the cost (developer-owner) from the beneficiary (tenant-consumer). Ideally consumers will value more energy efficient units and be willing to pay a higher rent, so over the long run the developer-owner is compensated for higher construction cost. As such this does not necessarily translate into an offset for lower rent setting. If however the landlord pays all utility costs, the benefit of reduced energy bills flow directly to his bottom line.

Reducing property taxes: Typically rental properties are assessed and taxed at commercial rates and the result is a higher property tax rate than rates on comparable owner-occupied condo units. The rate differential is partially offset by lower valuation as rental, but still often results in higher taxes. Some jurisdictions, such as Ontario have required municipalities to equalize property tax rates for new rental and condominium development. BC has equal tax rates, but provides a homeowner tax grant to owners effectively creating a differential rate. Equalized rates might reduce monthly property taxes by \$100/month which flows either to increase finance capacity, or to enhance RoE so can help to incent moderate rate rental, however, it is not practical (or legal?) to only provide the reduced tax rate in exchange for rent concession—it can only be applied to a class of assets—such as all new rental development (regardless of rent level). This would incent supply but be indifferent to the rent levels resulting.

Reforming tax treatment of rental income and capital gains: While not directly impacting NOI, the income tax treatment of rental investment income does impact after tax income and RoE. As noted, prior to 1972/86 tax treatment for rental investment was very favourable and substantially enhanced after-tax rates

of return. The development community has for many years pursued an unsuccessful campaign to re-introduce all or some of those tax regulations.¹⁶ The critical issue with a broad scale of tax change is that this would apply across all rental housing (some 4.3 million units) and expose the federal treasury to a very large impact. If the policy objective is to stimulate new rental construction, this imposes a large cost for a small impact. This might be addressed by applying any measures only to newly constructed rentals.

Department of Finance officials have consistently opposed changes to tax policy, arguing that this is an indirect and inappropriate approach. They further assert that if the policy objective is to stimulate new construction, the proper approach is to design a specific incentive program and seek an appropriation via a budget process. Accordingly there is limited appetite to further pursue this area, with the exception of a change in the H/GST treatment of rental development.

GST/HST is not charged on residential rents, and thus rental developers cannot negate the H/GST charged on inputs and operating expenses. This is distinctly different from other commercial tenancies (office, industrial), where they charge HST/GST on rents and thus can deduct input tax credits. The 2015 Liberal election platform, as well as the mandate letters for the Minister of Finance and the Minister responsible for CMHC, committed to removing the HST/GST from rental development. Notwithstanding this political commitment, finance officials remained resistant, and proposed the RCFI as a preferred program option over tax change, so this measure was never pursued.

The flipside of reducing operating expenses is increasing rent revenues. It was proposed at the outset that the policy goal is to incent lower (intermediate) rents, so this suggestion seems antithetical. It is however possible to reduce rents on an average unit by expanding the number of units on which rent is generated, via some form of density bonusing. This option is explored further below under planning and regulatory mechanisms.

5.3. Low Cost Financing or Favourable Underwriting Criteria

Financing costs are only a small component of a capital budget (interest costs during construction on pre-purchased land and incremental construction draws). However financing costs have an important impact on net cash flow and on equity requirements. And it is not only the cost of capital (interest rate) but also the terms of lending that impact equity required and thus RoE.

The CMHC Rental Construction Financing Initiative (RCFI) is a good illustration of how both lower rate and favourable underwriting can improve the attractiveness of rental investment. The key features of that initiative are a low interest rate (BoC 10-yr bond plus 35-50 BPS); 50 year amortization with a 10-

¹⁶ For detailed discussion of these options see Lampert and Pomeroy (2016) *Encouraging Construction and Retention of Purpose-Built Rental Housing in Canada: Analysis of Federal Tax Policy Options* for the Canadian Home Builders' Association and Greater Toronto Housing Action Lab.

year term, covering both the construction finance period and initial operating years; up to 100 percent loan to cost ratio (depending on achievement of energy efficiency, accessibility and affordability criteria) and exemption from mortgage insurance fees. The potential for close to 100 percent loan to cost means minimal investor equity and thus substantially enhanced ROE (infinite if 100 percent cost are financed). The quid pro quo for this advantageous financing is that rents be set at 10 percent discount to full market potential (e.g. 153 percent AMR vs. 170 percent); with a further 20 percent of units required to be at more affordable rents, closer to 100 percent AMR.

A second option, more aligned with non-profit (non-market) providers is aggregating financing for small providers to improve access to financing. This role is now being taken on by the newly created Canadian Housing Finance Agency, a specialized financing intermediary established with the support of a number of provincial housing agencies to assist small non-profits and co-ops seeking financing to either renew existing assets, or to build new units.

5.4. Planning and Regulatory Mechanisms

Among the various options examined here, the greatest potential may lie in leveraging municipal planning and development approval roles.

Levering City Role in Creating Land Value

It is the process of establishing development rights—via zoning and the development approval process that creates and enhances land value. Bare land on which no use is permitted has no commercial value. If the municipality permits that land to be used for parking, the value is created on the basis of the capitalized value of downstream parking revenues; if it is then rezoned to allow a revenue generating use such as commercial office or residential, the value is further enhanced. And the more saleable/rental floor area that is permitted, the greater the value that is generated.

In short, zoning and development approval are the critical elements that underpin the alchemy of land value. In many cities these powers are being further enhanced by large-scale investment in transit infrastructure. LRT and other transit systems improve access and thereby enhance the value of locations. Separate from zoning this further adds to land values. The combination of transit investment and planning approval therefore create tremendous power for municipalities.

In the absence of strategic policy, the land value uplift caused by the public investment and decision process generates a windfall gain to existing landowners—with no public or community benefit. To the extent that value is a function of a public process, it should be possible to extract a share of the uplift to achieve public purpose—such as ensuring that TOD development includes and promotes affordable and intermediate market rental.

Outside of LRT/TOD sites, the same concept of uplift related to planning approval can also be used. This is a standard feature of large site development approval (Planning permission) in the UK, where the obligation to include affordable housing is well accepted and capitalized into land values. By firmly establishing this as a principle (public gain) and being explicit about the obligations that will be imposed as a condition of planning approval, the planning system sends a clear signal to the development industry and more particularly land speculators. The cost of the conditions (e.g. to include some prescribed percentage of units at specified affordable rents) is explicit and thus becomes capitalized into land values and developers purchasing sites for development will accordingly adjust (downward) the amount they are willing to pay for the land.

Currently in Canadian cities the Official Plan identifies areas for future intensification, and thereby emits a signal to the market that land values will be enhanced. Without concurrent conditions or identification of the obligations associated with rezoning to the OP density land speculators and developers anticipate the new density and bid up land values based on those expectations. There is little room for the municipality to come in after the fact and insist on inclusion or other community benefit. And planners are typically ill equipped to negotiate a share of land value uplift. Municipalities must adopt more pro-active strategies to manage this process and to extract a fair share of the land value planning gain.

One of the key path factors noted in earlier framing is the impact of condominium tenure in establishing land values. This relates to the greater profitability (yield) from condo versus rental development. To enable rental development to be viable it is necessary to reduce land cost. Again, this can be achieved by explicitly pre-zoning certain sites (especially TOD sites) for rental (or at least a minimal percent rental). Because the potential yield is lower for rental than a condo development, this will similarly be capitalized into land price.

An alternate approach is to pre-zone with explicit options for a prescribed density bonus associated with reserving a specified percent of units for rental (including 100 percent). As an example if a property is zoned to permit 80 residential units and assuming a developer plans to build rental at full market potential with rents at \$2,200 month (assume this is 170 percent of the local AMR). The pre-zoning might permit a 30 percent increase in density (to 105 units), provided that 20 of these rent at no more than 100 AMR (\$1,300), and an extra five at full market (\$2,200).

The other effect of density bonusing (or inclusionary zoning) is to reduce the land cost per unit by spreading that cost across more units. If the land cost was \$40,000 per units (x 80 units = 3.2 million). With a policy that explicitly requires the inclusion of 20 affordable units, there is no capacity to bid up the land value and land cost averages down to 30,000 per unit. However in the absence of an inclusionary requirement, but ability to add 25 units the profitability will increase and a developer would then bid more for the land, up to \$4.2 million.

Bonusing or inclusionary policies with explicit conditions can effectively reduce land costs on a per unit average basis (in this case by 25 percent). And this is achieved with no cost to government and no negative impact of the developer. This does mean that the current landowner foregoes a windfall gain, but he had done nothing to earn that in the first place (other than anticipating to impact of a potential higher density).

The same principle that is used to capture land value uplift for a public benefit would apply in the case of zoning for rental tenure. If the yield on rentals (net present value of downstream NOI) is lower than that for condo development (capital receipt on sale) the *potential* land value will be lower. Negative impacts on current landowners can be reduced or avoided by linking to increased density as a way to compensate. While the future value as rental is less than what potentially might have been the value in current owner unconstrained, the potential as condo was only an anticipated gain, assuming he could get approval to same density as condo.

The key in both of these examples is a planning process that sends an explicit and early signal about what future use will be permitted. Under this approach reduced potential and any obligations are fully capitalized into land prices, and unearned windfall gains eliminated.

Aggregating Small Scale Initiatives—Small Scale Infill

Another way to create moderate and affordable housing is through accessory units. While a small more incremental approach, in the aggregate this can add up to a significant volume (especially given the minimal number of affordable units being created in many cities. The current “default” for infill is a large semi-detached dwelling that are well above what is affordable for households below the median income. A substantial shift to more modest infill products (e.g. four units at 1,250 sq. ft., versus two at 2,500 sq. ft.) could help meet the needs of modest-income households, and in particular meet a gap in family housing. Similarly, various forms of secondary dwellings—accessory, coach house, basement etc. -- could make a modest but important contribution to meeting the need for affordable units for smaller households.

This involves both regulatory change to permit such uses over a wide array of zones (especially in traditional single detached zones) and incentives that not only permit but also encourage small scale and affordable infill. Supportive programs have been successful in other jurisdictions, including Surrey, Saanich, Edmonton and Montreal. Frequently these attach incentives (capital grants, interest free loans, reduced fees and charges, relaxed parking requirements, property tax abatements) in exchange for more affordable rents. As such this type of infill can help to meet demand in both the affordable (below 100 percent AMR and intermediate market).

These programs can also help new home-buyers as the income from the suite provides revenue to help cover mortgage costs (although here some mortgage underwriting flexibilities may be required).

5.5. Municipal Land Banking

While the regulatory process and inclusionary zoning can have some impact in influencing the form, scale and price/rent of development, the ultimate way to control development and ensure affordable outcomes is through land ownership. All cities have surplus land holdings, as well as access to surplus provincial or federal lands. This is a critical resource in both lowering cost and in controlling development. It can be especially effective in locales such as new transit corridors where there is often surplus land, initially assembled to facilitate station construction.

The recent Vancouver experience in “selling” city lands into a Land Trust to both develop new housing as well as becoming a mechanism into which to transfer pre-existing non-profit and coops shows how this form of land disposition can be effective in place making as well as in perpetuating affordability through terms and conditions of a land lease.

5.6. Customizing to Different Developer-Investors

There is a range of potential developer-investors, each with differing characteristics and investment appetites. Such different agencies can each play a role in different parts of the system. In particular institutional investors with large masses of patient capital; and non-profit providers, that may have traditionally focused mainly in the social rent space, but have new imperatives to expand their reach.

To date institutional investors have focused on purchasing existing assets and have avoided new build. With reduced cap rates removing the price differential between new and existing and limited availability of existing assets on the market some might now be more amenable to investing in new rental development, provided appropriate risk mitigation measures are available to manage construction risk. Some of the largest pension funds are those of the public sector including municipal employees. Is there an opportunity to encourage investment in the rental sector?

Attracting private developers to build at sub-optimal rent levels is a challenge, even with the various incentives and offsets suggested above. By contract, non-profit providers have a different level of motivation and willingness to accept sub-optimal intermediate rents. The non-profit corporations and providers range in scale and expertise. All evolved in an era of federal and provincial-territorial programs which largely prescribed their role and targeting, and as a result many adopted a culture of social service and helping, with a distinctly different skill set from that required to optimize asset leverage and asset management. Now, as funding programs have ended or been substantially cut back and operating agreements end, there are emerging opportunities, especially in the inner areas of mid-large cities where the properties are at low density in intensifying areas. There is significant potential to redevelop, and draw on the underused land asset—as has been done in Toronto’s Regent Park. And in the absence of

funding programs providing deep subsidy, it will be necessary to build with a mix of social-affordable and market rents, in order to make (re) development feasible.

Many mid-size and larger non-profit housing corporations have both the capacity and in many cases the asset base to take on development in the intermediate market. There is further potential among many small providers, but most lack expertise and capacity. Technical assistance entities (such as exist in Quebec—through the groupes de ressources techniques (GRTs) or potentially the to be established national Technical Resource Centre under the NHS can be a critical piece of the institutional infrastructure to enable asset leverage.

And while many want to expand the stock of truly affordable housing, a business model that includes building at market rate alongside more affordable units can have a positive financial impact—both at the individual project level and as a way to strengthen and diversify their revenue base.

Many of the mid-large size providers are municipal non-profit subsidiaries (for example Metro Vancouver Housing, Capital Region Housing in Edmonton, Peel Living, Winnipeg Housing and Renewal Corp, Toronto Community Housing, Office municipal d’habitation de Montréal). Municipal councils can help by revising shareholder agreements and mandate directives to evolve into the intermediate market.

And as highlighted earlier the RCFI is a potentially effective mechanism to enable such activity with minimal equity contributions, so these organizations can reserve their equity for more targeted developments.

5.7. Addressing Erosion and Displacement

While the main focus here has been on incenting new supply, the background context highlighted a critical issue of erosion, wherein the existing relatively affordable stock is being lost—either in absolute terms, or via inflating to rents above affordable ranges. Indeed, it was noted that the effect of erosion is to negate new affordable development—in Ottawa since 2011, it was found that for every new affordable unit created under the fed-prov Investment in Affordable Housing (IAH) program, seven existing modest rent units were lost. In part this is fueled by the financialization of real estate—with REITs acquiring existing properties.

This is a natural market process and difficult to prevent. However there are opportunities to partly address erosion. Options include adopting rental replacement bylaws—such as that adopted in Surrey, BC and in Toronto. Toronto requires that any existing rental units being demolished under intensification must be replaced, at similar rent levels and similar bedroom count, as part of the new development. This bylaw has a dual effect—it tends to either prevent demolition, or where there is potential for substantial density increase, as necessary to cover the replacement cost, results in a form of rental inclusion.

Another approach is to enable non-profit housing corporations to emulate the behavior of institutional investors and REITs and purchase existing assets (usually priced below the cost of building new). While not adding to supply, that helps prevent erosion and shifts the asset into non-market ownership where rents can be help at more affordable and gradually, below full market levels.

Few, if any non-profits have the cash resources to undertake such acquisition, so it is necessary to create loan funds or acquisition programs to facilitate the process. Acquisition has historically been a more common practice in Quebec and in Montreal the City crated a fund specifically to do this. Separately a labor union investment fund was created to support non-profit acquisition—Le Fonds d'investissement de Montréal (FIM).¹⁷ One option to explore is the creation of similar funds in other jurisdictions (either at City scale, as in Montreal, or province wide). This might be pursued with partners including union pension funds as well as community foundations.

5.8. Indirectly Reducing Demand for Rentals to Remove Inflationary Pressures

In describing the back ground context, it was noted that low levels of new rent construction post 1994, were compensated by a large scale shift of renters into ownership, effectively creating rental vacancies. During that period this occurred as a natural market response to favourable fundamentals—strong employment and income growth, increasing labour force participation, steadily declining mortgage rates, demographics and consumer preference. There was minimal policy intervention, beyond some favourable lending policy change (extending amortization to 40 years, reducing down payments to zero).

The recent context has reversed those favourable conditions—income growth has been weak, interest rates have bottomed out and may be poised to increase, and home prices in many cities have moved out of reach. Thus the release of rental demand via ownership is constrained. The previous suggestions have all focused on mechanisms and incentives to facilitate moderate rent construction.

Explore ways to increase access to ownership for FTBs: this option returns to the concept of housing as an interrelated system. One way to reduce pressure in the rental market is to reinvigorate and enable access for ownership for first time buyers. The recent federal budget seeks to pursue this through a new Home Buyer Incentive (a shared equity mortgage, which trades off a share of future appreciation for a temporary interest free loan) and by increasing the amount of RRSP that can be used as a down payment. This could also be extended further by expanding the non-profit affordable ownership programs that have employed

¹⁷ In a 1996, a summit of representatives of trade unions, public and private sectors, and the social economy create a new investment tool. FIM's objective was to purchase and renovate 50,000 privately owned apartments over ten years, through financial contributions from various private and institutional actors interested in housing renovation, and improving Montreal neighbourhoods. Private and public institutions, as well as labour organizations, invested substantial amounts of capital in viable community housing projects, generating a return of 5.5 percent, and no losses.

discounted pricing and shared appreciation mortgages to facilitate access to moderate income first time buyers.

Encourage student housing development: Another way to indirectly impact demand for rentals is to divert demand within the sector. As previously discussed, it is challenging to encourage/incent developers to bring rental units on stream at sub-optimal rents. Purpose built student housing avoids this problem. While more widespread in the US, the concept of private off-campus purpose-built student housing has been pursued in a number of cities. These developments are typically large (200 rooms plus) and involve a shared living concept (e.g. 3-4 private rooms with own bathroom with a shared living/kitchen area). Rents are set by the room (vs. by the unit) and usually in the \$700-\$800/month range, so the rents per square foot are very healthy and generate strong returns. That is this is a very viable market product with no need to incent discounted rents. In the absence of such purpose built student housing students seek out and occupy lower rent accommodations in the market—housing that would otherwise be available to low-moderate income households and families. By focusing on the student market segment, developers can achieve very favourable returns with an indirect knock effect of creating vacancies in the moderately priced existing stock for others for whom building is less profitable.

5.9. Consolidating Options and Mechanisms

This array of potential initiatives are summarized in table A. This lists the initiative and assesses its potential impact in terms of how it can improve affordability, the time frame to implement and the actions required.

This assessment suggests that while all mechanisms can contribute, those with the greatest potential to create affordable rental development are:

- Land related mechanisms either via banking or supplying surplus public lands;
- Planning mechanisms related to up-zoning and extracting public gain, especially around transit TOD sites;
- Planning policies to permit and incent small scale infill (with unit size maximums) and secondary suites
- Partnerships with institutional investors seeking to place long term patient capital; and
- Facilitate a non-profit community sector role in developing market rate or income mixed product (dual benefit if overcoming disincentives for private investors at sub-optimal rents; and diversifying and strengthening existing low rent asset base)

6. Conclusions

Cities in Canada and around the world are undergoing a major transformation. Understanding the critical roles that housing plays in the broader economy and in productivity is the key to driving the strategic solutions needed to ensure cities remain productive, inclusive and sustainable.

6.1. Reframing the Challenge

This paper has made the case to reframe the arguments and business case in advocating to the federal and provincial levels about housing.

Policy has generally focussed upon poorer households and paid scant attention to how the housing outcomes in a city shape, as well as are shaped by, economic change. Typically city policies have addressed housing as a social policy concern rather than as essential economic infrastructure. There is a new awareness emerging that housing outcomes, ranging across the quality, size, location, tenure and cost of homes, can have significant impacts on productivity growth within metropolitan areas

Federal policies have to recognise the 'city' base of the nation and that their prospects and difficulties largely define the prospects for the nation as a whole. Effective management of cities, by all orders of government, must be a core policy concern not just for cities but also for provinces and the Government of Canada

And in making responses, city (and metropolitan governance partnerships) governments have to recognise that modern patterns of economic development make provinces and nations, in terms of economic performance, 'creatures of their major cities'. Arguably a bottom-up lens is now needed to shape top-down actions. In addressing the issues raised in this report, and looking to the future, there is a need not only to understand the wider housing system and its pervasive effects but that more effective management of housing systems may need stronger autonomies and capacities for making housing policies at city metropolitan scales.

A key task for the modern management of housing in cities is to understand not just how economic and population growth will drive demands for and supplied of owned and rental housing but also to comprehend how housing outcomes are impairing productivity and growth. CMHC and cities, jointly, need to understand real system functioning and their innovative modeling work for Vancouver needs to be the basis of a revival of such work in Canadian cities. Cities need a new narrative of how housing is essential economic infrastructure for growing metropolitan economies.

Thus there is a need to rethink and to restructure policy approaches, especially in metropolitan regions with a multiplicity of municipalities, each pursuing policy initiatives and in some cases investment. There is also a need to place housing at the centre of a range of critical municipal activities, especially economic development, infrastructure investment, transit development and planning.

6.2. Identifying and Implementing Responses to the Rental Challenge

The broader arguments in reframing apply across the larger housing system, and it remains critical to take a system wide perspective. Otherwise actions in the ownership sector, notably macro prudential policies aimed at managing national financial stability can have both city-specific repercussions as well as shifting problems into the rental sector (which is not concurrently being monitored by the Office of the Superintendent of Financial Institutions, nor by the Department of Finance).

That said, the remit for this paper was on the rental part of the housing system, so the analysis and identification of responses has focused more narrowly on this sector. Nevertheless, both low rent “affordable” as well as market “affordable” (framed here as the intermediate market, extending roughly between 100 percent to 150 percent of the CMHC surveyed average market rent, AMR) were included.

Section 5 detailed a number of potential mechanisms that cities might draw on to expand the production of affordable rental development as well as to address the critical issue of eroding affordable rental stock. The most promising in terms of practical short term impactful measures are identified as:

- Land related mechanisms via banking or supplying surplus public lands;
- Planning mechanisms related to up-zoning and extracting public gain, especially around transit TOD sites;
- Planning policies to permit and incent small scale infill (with unit size maximums) and secondary suites
- Partnerships with institutional investors seeking to place long term patient capital; and
- Facilitate a non-profit community sector role in developing market rate or income mixed product (dual benefit if overcoming disincentives for private investors at sub-optimal rents; and diversifying and strengthening existing low rent asset base)

Annex I: Summary of Potential Measures to Enhance the Affordability of Rental Housing

Initiative	Key Actor Federal, Provincial, Local, and/or Other	Key Action	Potential Impact on Affordability	Implementation Timeframe Short = 6 mo. Med = 6-18 mo. Longer = 18 mo.+	Comment Barriers and examples where already used.
Reduce Capital Costs					
Land	Developers/speculators/City in establishing zoning regulations Public land owners	Pre-zone with explicit inclusionary requirement Donate at below market of zero cost	Significant. Effectively eliminates land cost for additional units	Short -medium	Also discussed below - planning mechanisms
Innovative design (e.g. woodframe or modular)	Industry, Federal via National Building Code. City at approval stage	Establishing code acceptance (e.g. for wood-frame above 3 storeys); City: ensure innovation does not slow approvals	Small (e.g. Vancouver modular no reduced cost compared to stick built on site)	Short -medium	Innovative designs may face hurdles in approval process at City. Vancouver modular is positive example of a streamlined/coordinated approval process
Waiving fees and charges	City (potential role of province to legislate)	Waive or defer city fees and development charges	Small	Short	Already extensively used for targeted affordable and core housing need projects
Expedite approval process	City	Prioritize specific planning applications	Small	Medium	Implemented in Vancouver (modular); Toronto (affordable)
Reduce Operating Costs					
Utility costs	Utility financed energy retrofit, federal/provincial grant or loan	Incentives for energy retrofit; or new build features for better energy performance	Small	Short	Already required under NHS initiatives, incl Rental Financing Construction Initiative (20% below code for energy efficiency)
Align property tax rates	Municipality (potential for Province to require)	Municipality adopts new tax class with lower tax rate for new rentals	Small-medium	Short	Ontario enacted for new rental effective 2002
Reform tax treatment rental income	Federal	Exempt new rental construction from H/GST, and potential other tax reforms	Small-medium	Longer (18 mo+)	Finance Canada has opposed (the Rental Construction Financing Initiative is seen as a more targeted alternative)
Low Cost Financing or Favourable Underwriting Criteria					
Low rate loans	Federal (CMHC); either non-profit or for-profit developers	Existing CMHC Rental Construction Financing Initiative (RCFI) can be an effective mechanism for NP providers—but may need technical support	Medium	Already in place	RCFI is very beneficial to investor-developer, but achieves only marginal impact on rent affordability (10% below full market potential and only for a minimum of 10 years)
Finance aggregator	Canadian Housing Finance Authority (CHFA); Financial markets	Mainly assists small non-profits by aggregating small loans into single large bond issue	Small – rates not really competitive	CHFA initiated business in 2018	New approach in Canada; implemented in Australia 2 years ago

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Planning and Regulator Mechanisms					
Inclusionary policy	City (potentially facilitated by provincial regulation)	Can include inclusionary zoning as well as density bonusing	Significant - Effectively eliminates land cost for additional units	Short -medium	Implemented in many jurisdictions in US/UK; also Montreal, Richmond BC.
Accessory suites and small infills	City (potentially facilitated by provincial regulation)	Go beyond permitting to incenting via loans/grants Blanket "upzone" single detached areas + max unit size	Can be significant per unit; and in aggregate	Short -medium	A number of cities have implemented, including Surrey, Edmonton. Portland, and Minneapolis
Reduced parking	City (parking requirements in bylaws)	Reduce parking rations for affordable, and for Transit Oriented Development sites	Reduced parking especially cost impactful if underground	Short -medium	Many municipalities already reducing
Expedited development approvals	See above - reduced capital cost	Affordable (and potentially rental) developments red tagged for priority processing	Minor (reduced carrying costs)	Short	Vancouver, Toronto have versions of this. Can create some friction with market projects which are "leapfrogged"
Municipal Land Banking¹⁸					
Cities to acquire properties, especially near future rapid transit stations	City -potential via Federal finance	Could be effective way to control development at/near rapid transit stations	City could dictate development mix (rental and affordable, better than via inclusionary zoning regulation)	Short-medium	Previously (1960s/70s) CMHC played a significant role in enabling municipal land banking
Establish Land Trusts	City and community housing sector	Create a legal framework for transfer of surplus public land with leasehold restrictions on use (e.g. rental and perpetual affordable)	Affordable levels can be prescribed in lease conditions	Short-medium	Land trusts have existed for decades, but are rare. Recent examples in Saint John (existing co-ops) and Vancouver (new lands).

¹⁸ As an alternate or complementary to regulating via inclusionary policy.

Annex I: Summary of Potential Measures to Enhance the Affordability of Rental Housing

Initiative	Key Actor Federal, Provincial, Local, and/or Other	Key Action	Potential Impact on Affordability	Implementation Timeframe Short = 6 mo. Med = 6-18 mo. Longer = 18 mo.+	Comment Barriers and examples where already used.
Targeting Specific Types of Investor/Developer (Different Horses for Different Courses)					
Incent and attract institutional investors	Large Institutional Investors	Traditional institutional investors purchase existing investment properties – only recently have they built new. Can they be incented to take on stronger role	Potential way to add into intermediate market	Short-medium	These investors seek to avoid development risk – so require intermediary developer. Vancouver previously partnered with union funds using city land to add rental (Concert Properties)
Small investors in secondary market	Small investors City via infill zoning (see above – planning)	Already participating, but may be constrained by lending policy. Could also be incented (loan/grant)	Small developments, but in aggregate can add up	Short	Can involve accessory units in existing; but also permit & incent new small multi unit (e.g. 4-plex) in existing single family zones.
Enable non-profits to create intermediate market product	Non-Profits; CMHC City can help facilitate	Traditionally non-profits only build social-affordable. Opportunity to diversify	Potential way to add into intermediate market and mixed income	Short	CMHC-RCFI can be an effective financing source and requires little or no equity
Address Erosion of Existing Affordable-Moderate					
Implement rental replacement bylaws	City	Adopt replacement bylaw to either protect or replace existing affordable-moderate stock	Preserved or replaces existing	Short	Toronto has bylaw requiring replacement with same unit size and rent levels
Enable non-profit acquisition	Non-profit providers	Most lack cash to purchase and existing NHS programs processing too slow – so require a new nimble fund to enable	Significant	Short-medium	Existing funds create for this purpose in Quebec and in Montreal
Indirect Mechanisms (To Remove Demand Pressure from Rental)					
Enable first-time-buyer access to moderate rental demand	Federal	Specific programming to offset effects of macro-prudential policy constraint	Significant - can be a low cost effective way to create rental vacancies	Medium (monitor new federal initiative)	New First Time Home Buyer Incentive (2019 federal budget) may do this; will be rolled out this summer
Promote and support student housing	City planning policy/interested developers Potential to pursue fed financing	Creating specialized student housing is more profitable and attractive to developers; but has positive effect of freeing up existing lower rent stock for non-students.	Significant - can be a low cost effective way to create rental vacancies	Medium	Specialized of campus private student housing popular in Waterloo; two new developments in Ottawa.