

# LANDLORDBC

## British Columbia Rental Housing Task Force

A Residential Tenancy Act Public Consultation to Ensure a Viable Private Rental Sector and Secure Housing Options for British Columbians

### A Submission From LandlordBC

#### Introduction:

LandlordBC is the province-wide voice of the rental housing industry in British Columbia representing both owners and managers of rental housing. LandlordBC's primary mission is to facilitate the professional and responsible provision of safe, secure, sustainable long-term rental housing for British Columbians.

British Columbia's private rental housing sector is critical to the BC housing market and to the entire BC economy as well. In a November 2014 study published by KPMG Canada entitled *Economic Impact Assessment Study – British Columbia's Rental Housing Sector*, it was estimated that the rental housing industry provides homes for over 30% of BC households in approximately 550,000 units of rental housing. This same report confirmed that our industry's GDP contribution in BC was in the order of \$10.6 Billion, which is greater than forestry and mining combined. Furthermore, Statistic Canada/Census Canada reported that in the City of Vancouver renter households as a share of all new households rose from 40% in the 2000 – 2011 census period to 76% for the 2011 – 2016 census period, a startling 36% increase. Needless to say our industry's long-term viability and success has huge social and economic consequences for British Columbians.

LandlordBC appreciates and supports the high priority government has placed on housing. We have been actively collaborating with government and supportive of the legislative changes to the Residential Tenancy Act enacted in recent months including eliminating fixed term tenancies with a vacate clause, eliminating geographic increases and, the providing of additional protections for tenants in the event renovation or repairs to a rental unit requires the rental unit to be vacated. These are substantial changes and reflective of government's strong commitment to consumer protection. LandlordBC also appreciates government's significant additional funding commitment to the Residential Tenancy Branch and its decision to create a new Compliance Unit.

#### Overview:

In the past, renting was primarily considered a housing option to meet rising demand and to promote flexibility and better alignment to a more mobile labour market. Renting made it easier for individuals and families to pursue job opportunities or adapt their accommodation to changing family circumstances. Rental housing's role has evolved to become a critical housing option for an increasing percentage of our population.

In the ground-breaking study entitled *Code Red, Generation Squeeze* the authors concluded that it now takes 12 years for the typical 25 – 34 year-old Canadian to save a 20 per cent down payment on an average home (up from five years in 1976). In Vancouver that same Canadian would need 23 years to save a 20

per cent down payment! Home ownership rates are steadily dropping, and the implication is that many more younger Canadians than ever before will be renters for life when compared with preceding generations. The reality is that home ownership will likely become less common for generations of younger Canadians and this is especially true in British Columbia. A perfect example of this phenomenon can be seen in the Victoria CMA where Statistic Canada/Census Canada reported that during the 2011 – 2016 census period household growth in the Victoria CMA recorded fewer young homeowners and more renters with an increase of 1,975 owners and 7,385 renters or almost a 4-fold difference between young renters and owners.

Given this new reality, it is critical that the government create an environment in which the private rental sector can offer a viable, sustainable and attractive alternative to home ownership. This in turn can only happen if private sector rental property investors can be assured of safe, secure and stable long-term returns on their investment, and a balanced and fair legislative regime.

This government ought to be recognized for taking recent bold action, with the support of LandlordBC, for addressing the acknowledged anomalies within the rental market and **Residential Tenancy Act** that were negatively impacting both responsible renters and landlords. It will take time to know the full impact of these measures on the private rental sector as they “work through the system”. Other government measures which are having a marked impact on the private rental sector include tax changes introduced in the February 2018 Budget which will increase the cost of building new rental housing and, recommendations by the **Office of the Information and Privacy Commissioner of BC**, which will increase operating costs for landlords. It is critical during this review process that the Task Force consider the significant impact on the private rental sector of actions and measures government has already taken.

It is LandlordBC’s view that the **Act** as it is currently enacted, strikes an effective and fair balance between protecting tenants and allowing landlords to recover expenses and generate modest revenue surplus. However, in the context of the current high tax and expense environment, it does not provide any mechanism for either generating adequate contingency funding for or financing of the major investments required to make sure that the aging rental stock keeps up with current environmental and safety standards. As a consequence, owners have not been able to establish reserves for upgrading the aging stock and the condition of much of it has languished, resulting in poor quality, less energy efficient housing. Compounding the challenges in British Columbia is the fact that the private rental sector is disproportionately represented by the secondary market to provide rental homes for British Columbians. It is this secondary market; small, generally less knowledgeable or sophisticated landlords, with mortgage helper basement suites and the like, who are particularly vulnerable to legislative change.

The government, both in its words and recent actions, has acknowledged that the chronic shortage of rental supply, purpose-built rental housing in particular, is the primary contributor to today’s rental housing crisis in BC. In this context it is important for the government to implement tax incentives and legislative change supporting current owners of long-term, purpose-built rental housing and prospective investors to make development of rental housing as competitive as market condominiums. Notwithstanding some recent growth in purpose-built rental housing development, primarily driven by record low interest rates, the rental housing market in BC is highly volatile and we are on the cusp of our worst nightmare, the steady inching up of interest rates. Higher interest rates will turn the challenging economics associated with building new purpose-built rental housing into untenable economics and cause developers to retreat to condo development.

## **The Residential Tenancy Act – Balanced and Effective**

LandlordBC's view is that the current legislative framework is balanced and effective, which in turn begs the question, why modify in any way something that is not "broken"?

The continuing concern expressed by all parties about timely access to accurate and timely justice at the Residential Tenancy Branch (the Act), is an administrative and financial matter, not a legislative one. Those delays appear to be exacerbated by irresponsible tenants who repeatedly prey on small landlords. Furthermore, while LandlordBC has long held the view that rent controls do not truly help renters and can ultimately contribute to inferior and poorly maintained rental housing, we accept that in the current environment, until perhaps such time as we can achieve market balance for a consistent period of time (ie: vacancy rates of 3-5%), that it would be untenable for the government to phase them out. We get that.

It is a universal and strongly held view on both our organization and our industry that the government must retain two critical elements of the current Residential Tenancy Act; 1) the Annual Allowable Increase of 2% + CPI (we note some stakeholders suggesting the Annual Allowable Increase should be changed to just CPI) and, 2) rent controls tied to the tenant not the unit ie: the ability for a landlord to negotiate a new tenancy at tenant turnover on the basis of the market and the actual cost to deliver safe, secure rental housing. Any reconfiguring of either of these existing provisions under the Act, in whole or in part, will cause irreparable long-term harm to both renters and landlords. The economics of continuing to provide rental housing will unravel, as will the incentive and ability to invest in one's property. Further, it will be impossible to build any or any business case for the construction of new purpose-built rental housing. This in our view is the only way in which the private sector can address the critical shortcoming in supply.

The net effect of any changes to these two provisions in the Act would in effect be a mirroring of what we've witnessed for the past three plus decades with the disappearance of progressive federal tax policy. Market condos will continue to be the dominant form of multi-unit residential housing at a time when home ownership is unattainable for more and more British Columbians. It is for these reasons that we urge the government not to make any changes to these two critical provisions of the Act.

We would also like to take this opportunity to express our strong opposition to any potential consideration to enact mandatory pet legislation under the **Act**. In the view of both our organization and our industry that the decision to offer a pet-friendly rental unit must remain at the discretion of the landlord. We view this as a basic property right. Furthermore, landlords have a responsibility to deliver safe and healthy homes to their residents and to ensure that all residents can experience the quiet enjoyment of their homes. While LandlordBC encourages landlords to consider providing pet-friendly homes, and we are encouraged that most new purpose-built rental housing appears to be adopting such policy, at the end of the day the decision to offer pet-friendly rental homes or not must be at the discretion of the owner of the property.

The balance of this submission will focus on the critical importance of these two provisions to maintaining a viable rental housing industry and to the building of new rental homes for British Columbians.

## **The Problem With A CPI Based Maximum Rent Increase**

The problem with basing a rental rate increase on the Consumer Price Index is that the rental market is not based on CPI. We have prepared a CPI analysis (Appendix "A") to illustrate that those items of the All Item CPI Index which are directly applicable to the operation of a rental apartment building represent only 10.0% of the CPI. Therefore, the majority of CPI (90%) is not applicable to the operation of a rental apartment building and therefore the All Item CPI does not form a legitimate base to establish maximum rental rate increases.

Whereas the All Items CPI is being used to establish increases in market rents for a residential rental property, only 10% of the All Items CPI is actually applicable to the cost of operating a residential rental property. The correlation between maximum rental rate increases tied to CPI and the changes in operating expenses is very weak.

## **Renovation Investment and the Role of Vacancy Decontrol\***

In the October 2017 study prepared for the Federation of Rental Housing Providers of Ontario by the highly respected real estate consulting firm Urbanation (copy will be provided upon request), the highest ranking factor motivating renovation expenditures in a rental apartment was age of building and deteriorated quality, which is reflective of the fact that 85% of purpose-built rental apartments in Ontario are more than 35 years old. The second highest ranking factor was the ability to achieve a return on the investment through higher market rents on turnover, understanding that the units studied were rent-controlled and only able to recoup their renovation costs through the existence of vacancy decontrol. **\*Vacancy decontrol regulations set rent at market or near market levels when a unit is vacant.**

The study continued to explain that ultimately, the overall amount of renovation investment and the ability of rental housing providers to undertake significant unit upgrades is reliant on the level of tenant turnover. It then added that given the age and condition of the existing stock of purpose-built rentals, and the importance of unit turnover to help facilitate renovation expenditures, in the order of three quarters of the study participants (representing approximately 90,000 units or 14% of the total Ontario purpose-built rental apartment universe) revealed that they were unlikely to invest in unit upgrades in the next five years without vacancy decontrol; the ability to set rent at market or near market levels when a unit is vacant.

This study mirrors British Columbia's reality. While LandlordBC has not engaged Urbanation to conduct a BC specific study, our rental stock is overwhelming old and deteriorating in quality and our industry is faced with the same challenges as Ontario when considering investment in our rental buildings.

LandlordBC recently collaborated with the City of Vancouver to prepare a soon to be released policy report to Council. While we cannot share the full report at this time, it was noted that 52 per cent of the city's existing rental stock was constructed between 1950-1970 and is nearing fifty to seventy years of age today. The study further stated that this is notable because many of the major original components of these buildings such as the building enclosure, drainage, piping, central heating apparatus and, electrical may be near or beyond their projected service lives, particularly in wood-frame buildings. In this same policy report, findings from a recent City-commissioned study of rental building reinvestment needs were summarized and clearly indicated that low-rise, wood-frame rental buildings constructed in this time period may require significant capital upgrades to these and other systems in the next 10 years

or so, as well as energy-efficient upgrades to improve their energy performance. These investments will not occur if the ability to set rent at market or near market levels when a unit is vacant. It is our industry's view that the health and safety of tenants will be put at risk if these critical investments do not take place.

Similarly, new construction of purpose-built rental housing will be negatively impacted if either of these provisions are in any way reconfigured. The risks are substantial to British Columbians as investment in new purpose-built rental housing will evaporate. For context, a CMHC report published in October 2017 identifies the existing scenario for rental housing and some of the greater challenges in cities with high land costs, such as Vancouver. The report findings indicate that, even at above-market rates, "the 10-year average annual cash-on-cash returns were found to be negative in most cases when land costs were included in the analysis."

Banks and pensions funds have a fiduciary responsibility to mitigate risk and maximize investment returns. They will seek out the best returns by investing in more favourable jurisdictions. This is already happening as we witness growing purpose-built rental housing investment in the United States by some of our key rental housing owners and managers including the likes of British Columbia Investment Management Corporation, the provider of investment management services for BC's public sector pensions. If there is no return to market on tenant turnover, capital is going to look elsewhere.

**So we respectfully reiterate, it is a universal and strongly held view on both our organization and our industry that the government must retain two critical elements of the current Residential Tenancy Act; 1) the Annual Allowable Increase of 2% + CPI (we note some stakeholders suggesting the Annual Allowable Increase should be changed to just CPI) and, 2) rent controls tied to the tenant not the unit ie: the ability for a landlord to negotiate a new tenancy at tenant turnover on the basis of the market and the actual cost to deliver safe, secure rental housing. Any reconfiguring of either of these existing provisions under the Act, in whole or in part, will cause irreparable long-term harm to both renters and landlords. The economics of continuing to provide rental housing will unravel, as will the incentive and ability to invest in one's property. Further, it will be impossible to build any or any business case for the construction of new purpose-built rental housing. This in our view is the only way in which the private sector can address the critical shortcoming in supply.**

Finally, LandlordBC would like express its appreciation to the Rental Housing Task Force for the opportunity to present this submission. We are a constructive partner with government and if we can be of any assistance to the you, please contact our CEO, David Hutniak at [davidh@landlordbc.ca](mailto:davidh@landlordbc.ca) (604-744-9440 Ext 202).

## Appendix "A"

### The Problem With A CPI Based Maximum Rent Increase

The problem with basing a rental rate increase on the Consumer Price Index, is that the rental market is not based on CPI.

#### Components of the All Item CPI Index (September 2017)

The All Item CPI is based on the following components and weightings:

<u>Item:</u>	<u>CPI Weighting %</u>	
Food		16.23
Shelter	27.15	
Household operations, furnishings & equipment		12.97
Clothing & Footwear	5.44	
Transportation	19.70	
Recreation, education and reading	10.88	
Health and Personal Care	5.00	
<u>Alcoholic Beverages and tobacco products</u>	<u>2.63</u>	
Total	100.00	

It is noted that many of the components of the CPI **are not** related to the operation of a rental apartment building. Although substantial changes in some components of the CPI may have a substantial impact on a renter, these changes may have no impact on the operation of the rental building. Conversely, substantial changes in some components of the CPI may have a substantial impact on the operation of a rental apartment building but have no direct impact on the rent that a renter will pay.

The section of the All Item CPI that most directly relates to the operation of a rental apartment building is Shelter. The Shelter component of the CPI is based on the following items and weights:

#### Components of the All Item CPI Index Which Relate to a Rental Apartment Building

<u>Item</u>	<u>CPI Weighting %</u>	
Rental Accommodation		6.7
Rent	6.5	
Tenants' Insurance Premium	0.1	
Tenants' maintenance, repairs and expenses	0.1	
Owned Accommodation		16.1
Mortgage Interest Cost	3.5	
Homeowners' replacement cost	4.8	
Property Taxes and other special charges	3.4	
Homeowners' home and mortgage insurance	1.3	
Homeowners' maintenance and repairs	1.4	
Other owned accommodation expenses	1.6	
Water, Fuel and Electricity		4.3
Electricity	2.4	
Water	0.6	
Natural Gas	0.9	
Fuel oil and other fuels	0.3	
Total Shelter		27.1

The total Shelter component of the CPI reflects 27.1% of the total CPI, however, even within the Shelter component, there are items which are not applicable to the operation of a rental apartment building.

Those items which **are applicable** to the operation of a rental apartment building are as listed below:

Item:	CPI Weighting %	
Owned Accommodation		6.1
Property taxes and other special charges	3.4	
Homeowners' maintenance & repairs	1.4	
Homeowners' home & mortgage insurance	1.3	
Water, Fuel and Electricity		3.9
Electricity	2.4	
Water	0.6	
Natural Gas	0.9	
Total Shelter applicable to a rental apartment building		10.0

Those items which are directly applicable to the operation of a rental apartment building represent 10.0% of the CPI, therefore, the majority of CPI is not applicable to the operation of a rental apartment building and therefore the All Item CPI does not form a legitimate base to establish maximum rental rate increases.

#### Relative Weighting between the CPI Index and Rental Apartment Building Expenses

The cost to operate rental apartment buildings vary due to size, location, construction, tenant base, wind and sun exposure, renovations, energy efficiency upgrades, as well as a large number of other factors. LandlordBC conducted a review of analysis of typical expense levels for a variety of rental apartment buildings in the Lower Mainland (predominantly Vancouver) and then compared these expenses with the All Item CPI, as well as with the Shelter Component of the CPI to establish relative weightings.

Item:	CPI Weighting %	% of Operating Expenses for Rental Building
Property taxes & other special charges	3.4	17.3
Homeowners' maintenance & repairs	1.4	22.9
Homeowners' home & mortgage insurance	1.3	4.9
Electricity & Natural Gas	3.3	16.9
Water	0.6	3.8
Total	10.0	65.8

The above components represent 10.0% of the All Item CPI however, they represent approximately 65.8% of the operating expenses for a typical rental apartment building. The percentage of operating expenses varies widely depending on location within the province, with northern and central communities experiencing substantially higher Electricity and Natural Gas costs.

**Therefore, whereas the All Items CPI is being used to establish increases in market rents for a residential rental property, only 10% of the All Items CPI is actually applicable to the cost of operating a residential rental property. The correlation between maximum rental rate increases tied to CPI and the changes in operating expenses is very weak.**