

**The Rental Housing Problem in Ontario and
What To Do About It**

The Rental Housing Problem in Ontario and What To Do About It

Prepared for:

The Fair Rental Policy Organization

Prepared by:

Clayton Research Associates Limited

1580 Kingston Road, Scarborough, Ont. M1N 1S2

Phone: (416) 699-5645 Fax: (416) 699-2252

e-mail: clayton@clayton-research.com

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EXECUTIVE SUMMARY

There are obvious problems with the rental housing market in Ontario. With governments not treating rental housing fairly in their tax systems and their withdrawal from construction assistance programs, there is a shortage of private rental housing in many parts of the province.

To gain a better understanding of the rental housing problems in Ontario, the Fair Rental Policy Organization (FRPO) commissioned Clayton Research to undertake this study that focuses on Ontario, the Greater Toronto Area (GTA) and the Rest of Ontario.

The purpose of the research is to provide an independent examination of the rental housing market situation in Ontario and appropriate government initiatives for dealing with the key problems.

THE KEY FINDINGS OF THE STUDY

The Rental Housing Problem is Severe

- Privately-initiated rental housing starts have been extremely low since the 1970s after changes to the tax and regulatory environment.
- In recent years there has been a plunge in publicly-initiated rental housing projects in Ontario, the GTA and the Rest of Ontario.
- The non-conventional rental housing sector (e.g., basement and accessory apartments and single-family homes and condominiums being rented out by the owner) has been satisfying a sizeable component of rental demand. However, non-conventional supply sources are not sufficient to fill the gap

between demand and the supply of new purpose built rental housing in the future.

- The main problem for a segment of existing renters is that they have insufficient incomes to afford adequate and suitable accommodation. The lack of affordability is by far the dominant problem of renters in core housing need in Ontario.

Rental Housing Demand Strong

- There is strong demand for housing of all tenures being fuelled by the robust economy and population growth.
- Immigration is the major component of population growth in Ontario and the GTA.
- The projected growth in Ontario for renter households during the 2001 to 2011 period is expected to be sizeable, between about 17,000 to 24,000 households annually, based on Canada Mortgage and Housing Corporation (CMHC) projections.

Rental Housing Construction Economics are Presently Unfavourable

- The current economics of new privately-initiated rental construction are unfavourable, as new privately-initiated rental investment simply does not generate competitive returns commensurate with the financial risk.

- The problem is particularly acute in the GTA, but also exists in the Rest of Ontario.
- In order to generate significant new private rental housing construction, returns have to be enhanced.

With Benign Tax Provisions and Incentives in the United States Rental Housing Gets Built

- Much higher levels of new purpose-built rental housing have been completed in the United States over the last 30 years than in Canada, far beyond the 10 to 1 standard often applied to the two countries.
- Canada's rental housing production has lagged the United States, especially in the early 1980s and the mid to late 1990s.
- Higher levels of rental production have occurred in the United States because of a more favourable taxation system (more favourable income tax provisions and no GST).
- Tax incentive provisions in the United States have stimulated privately-initiated rental housing, while a voucher system increases the affordability of existing rental housing stock for households in need.

What Could Be Done

- The returns for new rental housing for private developers and investors need to be increased.
- In the absence of significant rent increases, which would worsen the affordability problem of renters, returns can only be improved

by effectively decreasing development, financing, and operating costs and taxes.

- There are benefits of stimulating new rental production, even when it is high-end product because of the filtering process of rental housing.
- The Federal and Ontario Governments are becoming aware of the need to decrease development costs and have made some initial moves, such as the GST rebate and the Provincial Sales Tax Grant Program.
- More has to be done, even after these initial moves to reduce the public costs associated with rental construction.
- The following policy options to reduce projects costs are offered to spur the development of privately-initiated rental housing.

Federal Government

Potential changes to Federal income tax that could be considered include:

- Permitting investors to defer capital cost allowances (CCA) recapture and capital gains on the proceeds from the sale of rental property when the proceeds are reinvested within a reasonable time frame in another rental property (the U.S. Federal tax system allows for this);
- Permitting investors to pool assets, treating more than one asset within a particular class as one unit for depreciation purposes;
- Permitting all investors in rental housing (and not solely Principal Business Corporations) the chance to deduct CCA losses against

other income, as well as to qualify for the “active business income” Small Business Deduction; and

- Expanding allowable ‘soft costs’ that can be deducted in the first year of operation of new rental properties.

Provincial Government

- The Provincial Government could consider removing the size limits intended to create affordable housing from the current Provincial Sales Tax Grant Program. Grants for only 500 units a year will not have a significant impact. The program could be expanded to cover all new rental construction units.
- The new Provincial legislation for the same property tax rate for new rental and new ownership residential development could be required for all municipalities, and be made permanent through the removal of the 8-year limit.
- The affordability problem for renter households in Ontario is an income problem, whereby incomes are too low relative to market rents. To further address the gap between what renter households with affordability problems can afford to pay and market rents, the Provincial Government could consider expanding the current Rental Supplement Program or introducing a shelter allowance.

Municipal Governments

- Municipal governments could consider the waiving or reduction of development charges for rental construction, which would have a significant impact on raising the return on project costs.
- The waiving of Section 37 contributions on new rental housing construction could be considered by the City of Toronto. Section 37 contributions lead to cost increases for new rental housing construction, which in turn raise the required rents to achieve a competitive rate of return.

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1 INTRODUCTION

BACKGROUND

There are obvious problems with the rental housing market in Ontario. With governments not treating rental housing fairly in their tax systems and their withdrawal from construction assistance programs, there is a shortage of private rental housing in many parts of the province.

To gain a better understanding of the rental housing problems in Ontario, the Fair Rental Policy Organization (FRPO) commissioned Clayton Research to undertake this study that focuses on Ontario, the Greater Toronto Area (GTA) and the Rest of Ontario.

PURPOSE OF THE RESEARCH

The purpose of the research is to provide an independent examination of the rental housing market situation in Ontario and appropriate government initiatives for dealing with the key problems.

SCOPE OF THE ANALYSIS

The research covers the following:

The demand and supply of rental housing;

Rental housing needs of lower income households;

The feasibility of new rental housing investment;

The United States rental housing production experience; and

Identification of various rental housing policy options.

The report focuses on Ontario, and where possible, separates the GTA (approximated by the Toronto CMA¹ or the Toronto CMA and the Oshawa CMA combined) from the Rest of Ontario (approximated by the residual of the GTA from Ontario).

APPROACH

The assessment presented here is based in large part on readily available existing documents, reports and data sources. The extensive experience of Clayton Research personnel in assessing the rental housing problem and in conducting studies of rental markets is an important input as well.

REPORT STRUCTURE

The report contains five chapters in addition to this Introduction:

- Chapter Two explores the background and issues related to rental housing problems in Ontario;

¹ Census Metropolitan Area.

- Chapter Three considers market-wide demand and supply and explores the feasibility of new private sector rental construction;
- Chapter Four assesses the Canada and United States comparative experience;
- Chapter Five explores how to stimulate new privately-initiated rental housing; and
- Chapter Six discusses the enhancement of rental housing affordability.

The appendix contains the bibliographic sources used for the report.

INFORMATION SOURCES

The study draws on a variety of information sources including:

- Census of Canada;
- Statistics Canada;

- Canada Mortgage and Housing Corporation (CMHC);
- Government of Ontario, Ministry of Municipal Affairs and Housing (MAH); and
- U.S. Census Bureau and Department of Housing and Urban Development (HUD).

CAVEATS

This report relies on information from a variety of secondary sources. While every effort is made to ensure the accuracy of the data, we cannot guarantee the complete accuracy of the information used in this report.

2 BACKGROUND AND ISSUES

This chapter begins with a discussion of recent rental housing market trends and reviews how the rental market operates, as well as the various sources of supply of rental housing. Next the housing problems of lower income renters are examined. The last section outlines the nature of rental housing problems in Ontario.

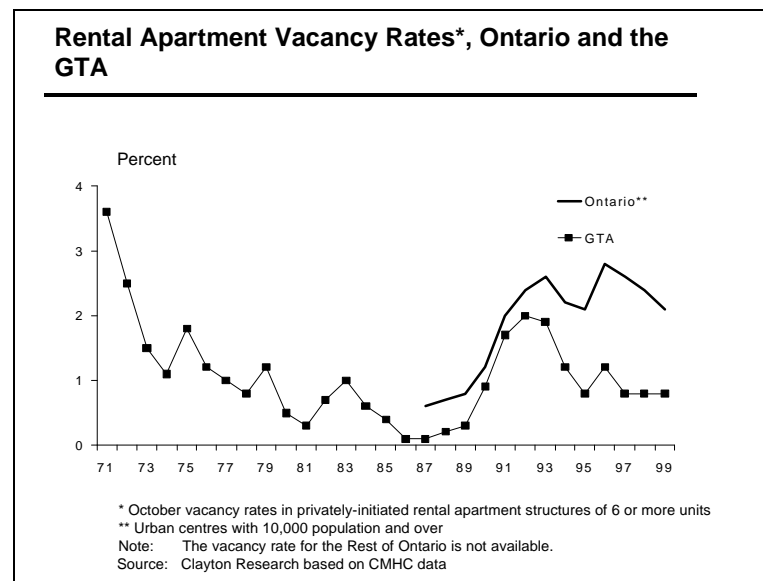
RENTAL MARKET TIGHTENING

The vacancy rate is much higher for Ontario as a whole than for the GTA,² which implies that the Rest of Ontario has an even higher vacancy rate. However, for the past three years, the trend for Ontario has been downwards, to 2.1 in October, 1999 from 2.8 percent in October, 1996.

The GTA rental market is currently an undersupplied or “tight” market, with a vacancy rate that has been steady at 0.8 percent since October, 1997 (Figure 1).³ A “tight” market is characterized as having a vacancy rate less than 1 percent.

The latest rental market data available is from October, 1999. Since then, the GTA market has remained tight, while the vacancy rate of the Rest of Ontario is estimated to have been falling.

Figure 1



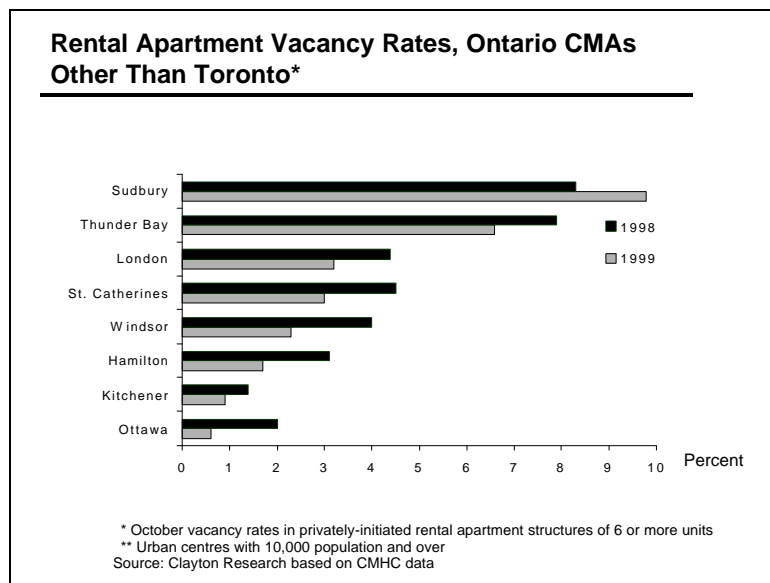
Rental markets tightened between 1998 and 1999 in most other large urban centres in Ontario as well. Ottawa and Kitchener had particularly low vacancy rates, at about 0.6 and 0.9 percent, respectively (Figure 2). Ottawa and Kitchener have become increasingly “tight” with the growth in demand due to the strengthening computer economies of the regions.

In Ontario, only Sudbury saw an increase in its vacancy rate in 1999 from 1998.

² Vacancy rates over time are not available for the Rest of Ontario.

³ It should be emphasized that the vacancy rates presented in this report are CMHC vacancy rates for privately-initiated rental apartment buildings of 6 or more units. While this covers the majority of the rental stock in any particular market, CMHC does not cover the “non-conventional” stock (e.g. basement apartments, single-family homes and condominiums being rented out) in its vacancy survey. “Tight” conditions in the CMHC stock, therefore, may not necessarily indicate similar conditions in non-CMHC stock. The vacancy rate also excludes publicly-initiated rental stock.

Figure 2



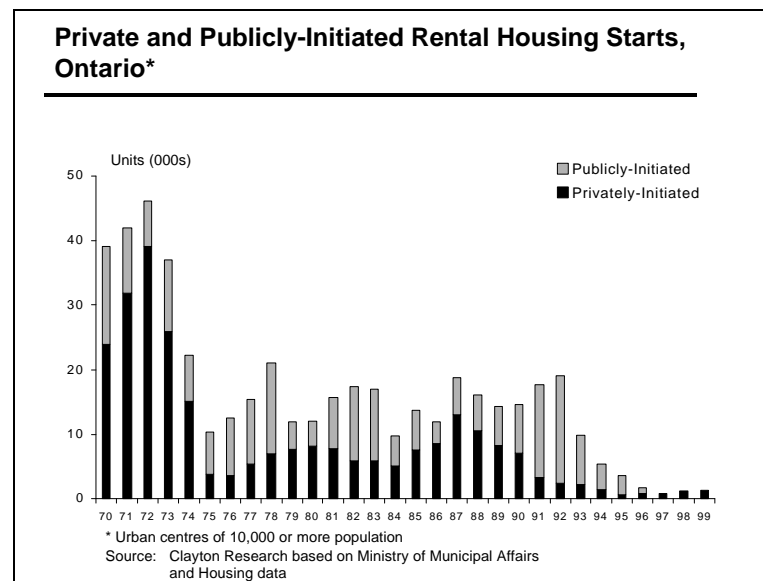
ECONOMIC CONDITIONS, DEMOGRAPHICS AND PROGRAMS OF GOVERNMENT ARE FACTORS BEHIND RENTAL HOUSING STARTS PATTERNS

Rental housing starts are characterized by two categories of purpose-built starts (i.e., intended market is rental):

- **Publicly-initiated** rental housing starts include all new construction through social housing, including cooperative and non-profit housing; and
- **Privately-initiated** rental housing starts include all construction by the private sector, including starts financed partially through grants, programs or other incentives from government.

Figure 3 shows private and publicly-initiated starts in Ontario since 1970. Three distinct periods can be observed: 1970-1974; 1975-1992; and 1993-1999. The factors behind these patterns of rental housing construction activity are examined below.

Figure 3



1970 to 1974 – High Production of Private Rental Housing

Rental Housing Starts

- Between 1970 and 1974 rental housing starts in Ontario were extremely high, averaging about 37,000 units per year.

Economic Conditions

- The first five years of the 1970s saw mostly strong economic growth, albeit with rapid inflation.

- Between 1971 and 1973 Canada and Ontario had very strong economic expansion and strong job creation, particularly in 1973.
- By 1974, economic growth had slowed considerably, pointing towards the recession in 1975, while the inflation crisis had begun, with a rate of inflation close to 11 percent.
- Other factors in addition to the tax reform changes that became effective in 1972 caused the drop in rental starts in 1974, including a sharp rise in interest rates, a growing fear of rent controls, and uncertainties about construction and land costs.

Demographics

- The early 1970s were characterized by the rise in demand as baby boomers entered the rental housing market.

Major Government Programs

- **Loans to limited dividend (LDs)** corporations were the major Federal Government incentive for private rental housing construction at the time. Private groups that were prepared to limit their return on equity were provided low interest, long-term loans to finance low rental housing between 1946 and 1975. According to the Canada Mortgage and Housing Corporation (CMHC) about 55,000 units were subsidized under the program between 1970 and 1975.

Major Federal Tax Reform Policy

- Prior to 1972, rental housing was treated much more favourably than the current situation. All rental housing investors could deduct capital cost allowance (CCA) losses against other income. Since 1972 losses due to CCA have not been permitted except for Principal Business Corporations (PBC) investors. Any unclaimed CCA because of the restriction is added to the underpreciated capital cost (UCC) base. Also the loss of pooling, whereby the taxpayer can treat more than one asset within a particular class as one unit for depreciation purposes was removed. The reforms effectively removed most investors from rental investment markets, and the reforms were a factor in the major reduction in rental housing starts after the early 1970s.

1975 to 1992 – Much Lower But Still Significant Rental Construction

Rental Housing Starts

- During the period of 1975 to 1992, rental apartment starts averaged about 15,000 units per year, a sharp decline from the boom times of 1970-1974.

Economic Conditions

- The booming economy of the early 1970s had severely deteriorated by 1975, while the rapidly rising rate of inflation was increasing cause for alarm.
- The decline in economic strength recorded in 1975 led to a technical recession for the Ontario economy.

- In 1982, the Canadian and Ontario economies went into recession, as severe job losses, high inflation, high mortgage rates and high interest rates took their toll.
- Economic conditions improved greatly in 1983, and strong growth followed until 1989, when economic growth slowed.
- The recession of the early 1990s began in 1990 and persisted through to 1991, and was followed by low economic growth in 1992.

Demographics

- Baby boomers continued to enter the housing market in the late 1970's pushing vacancy rates down even further.
- The recession of the early 1980s forced young people to double up or move back in with parents.
- By the mid 1980's, baby boomers were moving into ownership housing.
- The 1990 to 1991 recession resulted in a drop in the demand for new rental housing as a result of job losses and the poor economic conditions.

Rent Controls

- Rent controls were first introduced in Ontario in December, 1975 in response to public pressure regarding large rent increases and a call by the Federal Government for provinces to impose temporary rent controls as part of the Federal anti-inflation program. New construction was exempt, as well as existing units with above \$750 per month rents.

- Rental housing markets were generally very tight in Ontario at the time.
- Rent controls as imposed were in themselves a disincentive, but changes and revisions over the next two decades made them even more of a deterrent to the production of new privately-initiated rental housing construction.

Major Federal Government Programs

- **The Assisted Rental Program (ARP)** gave developers financial incentives (at first grants, but later interest-free loans) for new rental housing construction between 1974 and 1978. About 122,000 units were approved in Canada under ARP, with about 41,000 units in Ontario.⁴
- **The Multiple Unit Residential Building Program (MURB)** allowed owners of newly constructed multi-unit buildings to claim losses resulting from capital cost depreciation (CCA) against other income between 1974 and 1981. Close to 384,000 certificates were issued under the MURB program in Canada between 1974 and 1981,⁵ although none were issued in 1974.⁶
- **The Canadian Rental Supply Plan (CRSP)** provided interest-free loans where payments were not required for 15 years to

⁴ Clayton Research, *Understanding Private Rental Housing Investment in Canada*, 1999, p. 30.

⁵ *Ibid*, p. 30.

⁶ It is difficult to estimate the number of rental units stimulated by the MURB program. Many MURB projects did not proceed though certificates were issued; some were owned by real estate companies which could utilize the capital cost provisions in any case; and some projects also obtained financial assistance through other programs. Virtually all ARP projects were MURBs as well.

developers between 1981 and 1983. About 25,000 units were developed under this program in Canada.⁷

Major Provincial Programs

The Ontario Provincial Government used the following construction assistance programs and incentives during the period:

- The **Ontario Rental Construction Grant Program** provided provincial grants to ARP developers in 1977;
- The **Ontario Rental Construction Loan Program (ORCL)** gave rental housing developers interest-free second mortgages in 1981;
- Under the **Canada Ontario Rental Supply Plan (CORSP)**, the Ontario Government extended (through provincial funding only) the cancelled Federal Canada Rental Supply Plan for one more year in 1984;
- Loans to **co-operatives and non-profits** provided long-term subsidies to developments to reduce the gap between operating costs and rental revenues between the early 1980s and 1994;
- **Renterprise** gave up to \$15,000 a unit in interest-free second mortgages for private rental housing development in 1985; and
- **Homes Now** initiated in 1988 funded 30,000 new units by 1991, and **Jobs Ontario** boosted social housing starts in the early 1990s.⁸

⁷ *Ibid*, p. 30.

⁸ Sewell, John, *Houses and Homes*, 1994, p. 174.

1993 to 1999 – Very Low Rental Housing Production

Rental Housing Starts

- Beginning in 1993, total rental starts in Ontario began to fall, reaching a 30-year low in 1997, especially with the end of the **Homes Now** and **Jobs Ontario** programs in 1996. Between 1993 and 1999 rental housing starts averaged about 3,300 units per year, although by the late 1990s, only about 1,000 units per year were started.

Economic Conditions

- The after effects of the early 1990s recession continued through the mid 1990s, until 1997 when stronger, more continuous economic growth began.

Demographics

- As the country moved out of the early 1990s recession and job growth increased, more persons entered or re-entered the rental housing market.

Rent Controls

- Rent controls were further tightened for much of the period with the *Residential Rental Control Act* introduced in 1992.

Tenant Protection Act

The Conservative Government's *Tenant Protection Act* (TPA) became effective in June, 1998. The TPA replaced the *Residential Rent Control Act*, the *Landlord and Tenant Act* and the *Rental Housing Protection Act*.

Under the new TPA, the major changes include:

- A maximum annual guideline (currently 2.6 percent) is in place for annual rent increases for tenants who remain in their units;
- Above-guideline increases (currently a maximum of 4 percent above the 2.6 percent) are permitted for capital improvements;
- For vacated units, “market rents” can be set for new tenants. However, annual rent increases may not rise above the provincial guidelines as long as the same tenant occupies the unit;
- New rental buildings are completely exempt from rent controls;
- The provisional “moratorium” on converting rental buildings to other uses (from the Rental Housing Protection Act) was removed; and
- A new quasi-judicial system was set up for landlord and tenant disputes.

Provincial Programs

- The **Homes Now** and **Jobs Ontario** programs continued to boost social housing starts until the programs were cancelled in the mid-1990s.
- There are currently no government programs in place to encourage new privately-initiated rental housing in Ontario.

PRIVATELY-INITIATED RENTAL HOUSING STARTS SHOW MODEST RECOVERY IN THE LATE 1990S IN ONTARIO

A modest recovery in the construction of new purpose-built rental housing units has occurred in Ontario in the late 1990s:

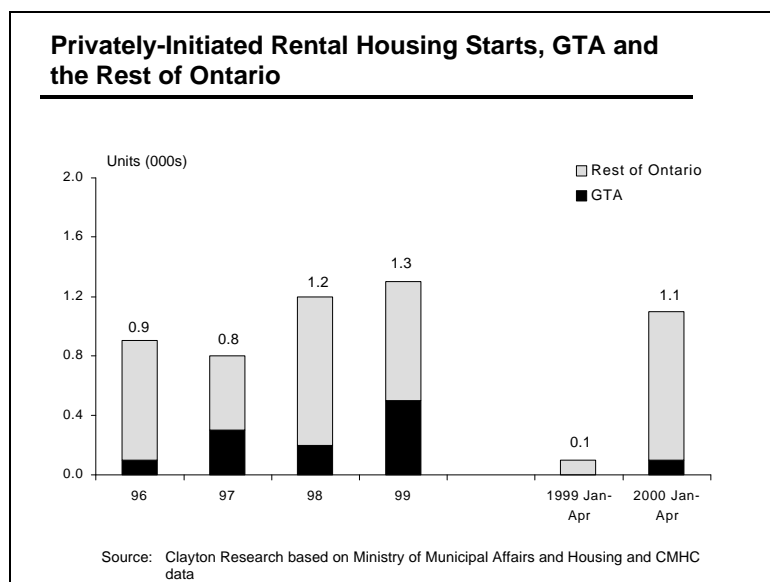
- Total starts fell from about 1,700 units in 1996 (of which about 900 units were privately initiated) to 800 units a year in 1997;
- In 1998 total rental housing starts began to modestly recover and increased to about 1,200 units per year. All of the starts were privately-initiated; and
- Between January and April 2000, total starts in Ontario were up by 1,100 units, up from 1,000 units over the same period last year. All of the starts were privately-initiated.

Since 1996, the GTA has seen comparatively less privately-initiated construction than the Rest of Ontario (Figure 4):

- Between 1996 and 1999, privately-initiated starts in the GTA represented about 25 percent of Ontario’s privately-initiated starts;
- Since 1996, the GTA has seen a modest increase in the number of privately-initiated starts, from about 150 to almost 500 units in 1999; and
- The year-to-date data for the GTA and the Rest of Ontario show modest increases over the same period last year, particularly in the Rest of Ontario where starts have increased from 119 to over 1,000 units. This is a sign that privately-initiated rental construction is increasing, but the numbers are still historically

small and the activity is still mostly outside the GTA

Figure 4



HOW THE RENTAL HOUSING MARKET WORKS

New private construction is only one source of additions to the rental housing supply. Figure 5 gives an overview of how rental housing markets operate.

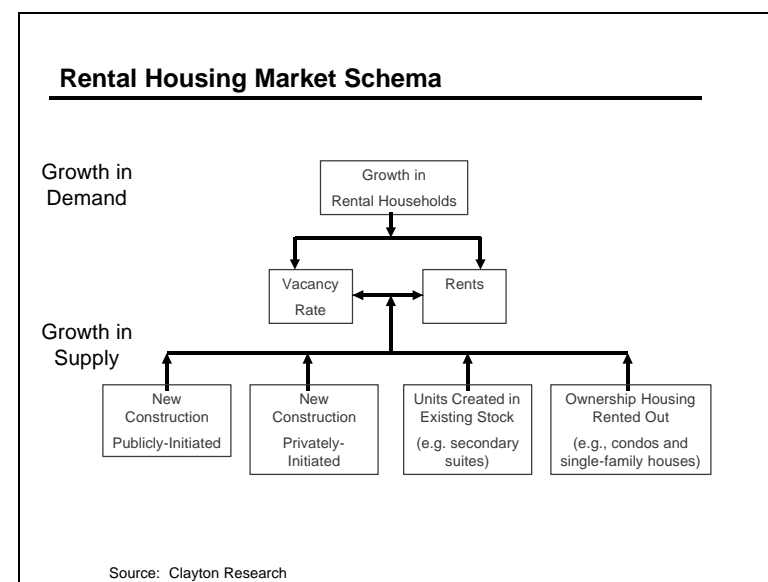
Growth in demand is created through growth in the number of renter households. This in turn puts downward pressure on the vacancy rate and upward pressure on rents. The growth in supply is satisfied through four sources:

- New publicly-initiated construction;

- New privately-initiated construction;
- Units created in the existing housing stock (secondary suites and basement apartments); and
- Ownership housing rented out (condos and single-family houses).

Rents and vacancy rates are the result of the interaction of the forces of demand and supply.

Figure 5



THE FILTERING PROCESS OF RENTAL HOUSING IS A CHAIN OF TRANSACTIONS

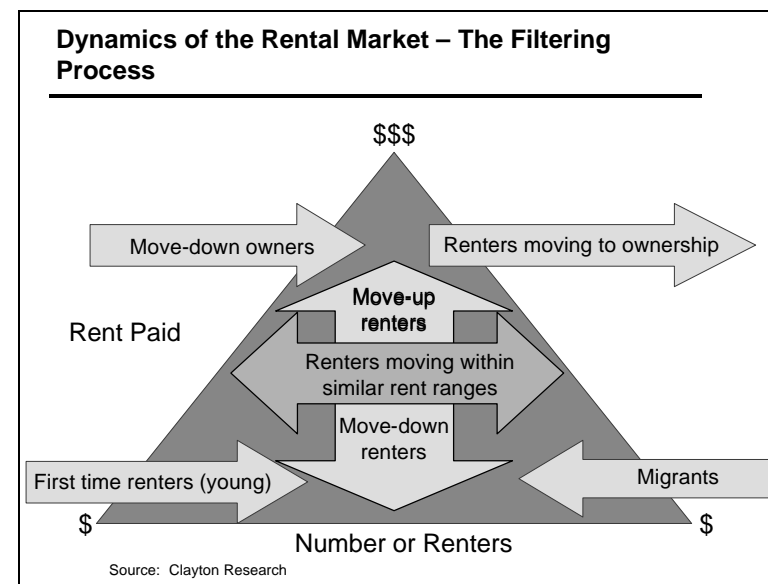
Filtering is a desirable part of dynamic real estate markets. The concept is explained in Figure 6. Conceptually, the triangle is the rental supply, with rents rising from the wide bottom to the narrow top end of the triangle:

- First time renters (usually younger persons) and migrants enter at the bottom end (i.e., the cheaper units);
- Renter households within the rental market usually move up, to consecutively more expensive units, but also down to less expensive units. Renter households may also move within a similar rent range;
- Move-down owners enter the rental market into units at the higher rent end; and
- Renter households move into ownership housing usually from the higher rent end of the rental market.

The filtering process entails that as households move up to more desirable units, or leave the rental market for ownership housing or because of the disintegration of the household, lower rent units are made available for move-up renter households, or at the bottom of the rental market to migrants and first time renters.

Consequently, the result of building new higher rent units means that lower rent units are made available as tenants in the new higher rent units vacate lower rent units.

Figure 6



SIZEABLE COMPONENT OF RENTAL DEMAND SATISFIED BY NON-CONVENTIONAL SOURCES OF SUPPLY

During the 1991-1996 period, the construction of new purpose-built rental apartments accounted for a large proportion of the total growth in the rental stock in Ontario, the GTA and the Rest of Ontario (Figure 7). Publicly-initiated housing units were the major contributor to renter household growth (accounting for more than three-quarters of the growth). Most of the remainder was filled by non-conventional units (i.e., growth in basement apartments and single-family homes and condominium apartments being rented out by their owners). Thus a sizeable component of rental demand was satisfied by non-conventional supply sources.

There is no up-to-date data on other non-conventional sources, but a 1998 study for the Homelessness Task Force in Toronto estimated that about 3,000 units were created per year during the late 1990s in the GTA.⁹

Figure 7

Sources of Rental Supply, Ontario, GTA and the Rest of Ontario, 1991-1996			
	Ontario	GTA	Rest of Ontario
	<i>Units</i>		
Average Annual Demand			
Rental Household Growth	15,550	8,775	6,775
Demand Satisfied by:			
New Rental Construction	11,350	5,075	6,250
Privately-Initiated	2,050	425	1,625
Publicly-Initiated	9,275	4,650	4,625
Non-Conventional Construction*	6,875	3,425	3,450
Decrease (Increase) in Vacancies	(2,675)	275	(2,925)
Total	15,550	8,775	6,775

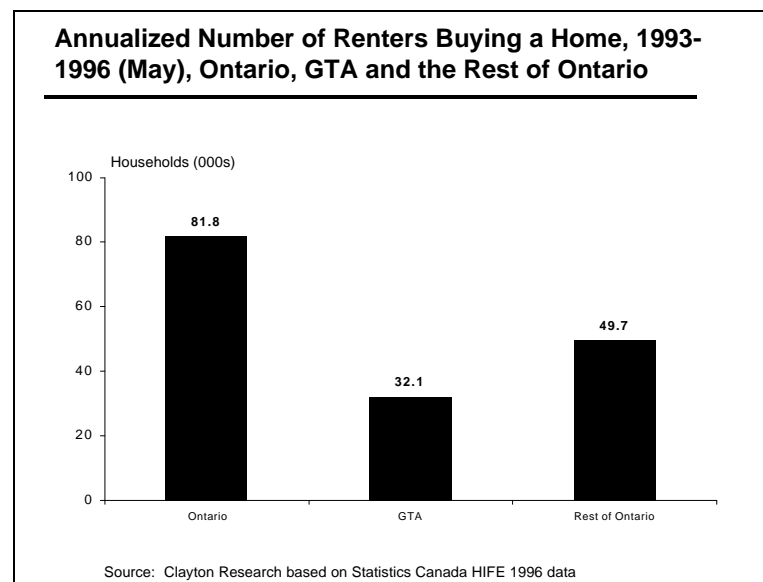
*Includes secondary suites created in existing single-family houses, houses being rented out and condominiums
 Source: Clayton Research based on Census of Canada and CMHC data

At the same time, thousands of rental units became available as renters bought homes or dissolved their rental household (i.e., death, moving into long-term care, etc.), which is part of the filtering process (Figure 8).

- In 1996 the annualised number of renter households buying a home between 1993 and May 1996 in Ontario was about 82,000.

- The majority of the Ontario renter households that bought a home were situated in the Rest of Ontario, outside the GTA.

Figure 8



RENTAL UNITS IN NEW CONDOMINIUM APARTMENTS ON THE RISE

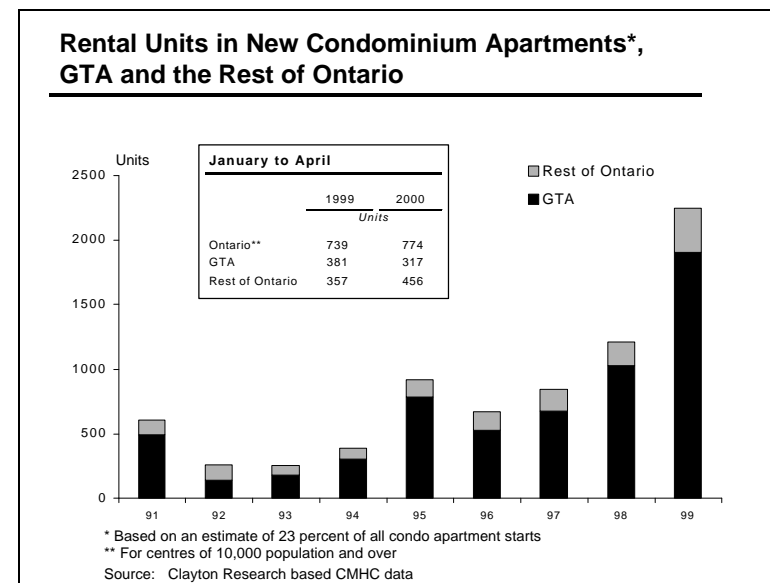
Through the 1990s condominium apartments have acted as a source of non-conventional supply of rental housing as investors rent out condominiums (Figure 9).

⁹ Genier, Rob, *Trends in the Conventional Rental Market*, August, 1998, p. 4.

- It is estimated that about 23 percent of all condo apartment units are rented in Ontario and the GTA.¹⁰
- Between 1991 and 1999, the majority of rental units in new condominiums were in the GTA.
- The percentage of rental condos in the GTA is generally higher in the City of Toronto core than the Rest of the GTA and the Rest of Ontario.
- With the pick-up in condominium apartment starts in Ontario and the GTA through the last five years of the 1990s, the estimated annual number of rental units in new condominium apartments in the GTA increased between 1996 and 1999, to about 1,900 from 490 units.
- Condominium apartment starts during the first five months of 2000 have increased modestly over the same period last year in Ontario and the Rest of Ontario.

Rental units in new condominium apartments are not a reliable source for rental housing. When condominium resale markets improve, rental condominium apartments can easily move into the ownership market.

Figure 9



MAJORITY OF RECENT IMMIGRANT HOUSEHOLDS LIVE IN RENTAL ACCOMMODATION

Recent immigrants¹¹ tend to reside in rental accommodation (Figure 10). In fact, about three-quarters of households headed by recent immigrants in Ontario, the GTA and the Rest of Ontario lived in rental accommodation in 1996.

¹⁰ A recent study by N. Barry Lyons Consultants, **Rental Apartments Are Not The Only Affordable Housing Option**, June, 2000 estimated that 23.2 percent of condominiums are rented in the Toronto CMA.

¹¹ Households headed by a person immigrating to Canada between 1991 and June, 1996.

Figure 10

Tenure of Immigrant Households, Ontario, GTA and the Rest of Ontario, 1991-1996*			
	Ontario	GTA	Rest of Ontario
	<i>Households (000s)</i>		
Renter	89	63	26
Owner	33	23	10
Total	<u>122</u>	<u>86</u>	<u>35</u>
	<i>Percent</i>		
Renter	73	73	72
Owner	27	27	28
Total	<u>100</u>	<u>100</u>	<u>100</u>

* Households headed by a person immigrating to Canada between 1991 and June, 1996
Source: Clayton Research based on Census of Canada data, Custom Tabs, 1996

Figure 11

Immigrant Renter Household and Total Renter Household Average Annual Growth, Ontario, GTA and the Rest of Ontario, 1991-1996*			
	Ontario	GTA	Rest of Ontario
	<i>Households (000s)</i>		
Gross Immigrant Led Renter Households	18	13	5
Total Renter Household Growth	16	10	6
	<i>Percent</i>		
Immigrant Led Renter Households as Percent of Total Renter Household Growth	114	130	88

* Households headed by a person immigrating to Canada between 1991 and June, 1996
Source: Clayton Research based on Census of Canada data, Custom Tabs, 1996

Immigrant led household growth is a sizeable component of total renter household growth (Figure 11):

- The rental household growth for recent immigrants is higher than the total rental household growth for Ontario, the GTA and the Rest of Ontario. In fact, rental household growth of recent immigrants as a percent of total rental household growth was over 100 percent for Ontario and the GTA in 1996.¹²

PROPORTION OF HOUSEHOLDS IN CORE HOUSING NEED SIZEABLE IN ONTARIO

Core housing need refers to renter households needing to spend 30 percent or more of their income to attain adequate and suitable rental accommodation. It includes:

- Renter households paying 30 percent or more for adequate (not requiring major repairs) and suitable (has enough bedrooms) accommodation;
- Renters paying less than 30 percent for inadequate or unsuitable accommodation; and

¹² The growth in total rental households is a net concept as it reflects both the creation of new renter households and the loss of renter households due to the movement to ownership tenure or dissolution.

- Renters paying more than 30 percent for suitable and adequate accommodation.

Core housing need estimates excludes renters paying 30 percent or more if over housed (more than enough bedrooms).

More Than a Third of Renters Are In Core Housing Need

Significant numbers of renters are having difficulty securing adequate and suitable accommodation at a rent they can afford (Figure 12):

- More than a third of renters in Ontario, the GTA and the Rest of Ontario were in core housing need in 1996; and
- About 450,000 renters were in core housing need in Ontario, of which 196,000 were in the GTA and 254,000 were in the Rest of Ontario.

Figure 12

Renter Households in Core Housing Need*, Ontario, GTA and the Rest of Ontario, 1996			
	Total Renter Households	Renters in Core Housing Need	Percent of Renters in Core Housing Need
	<i>Households (000s)</i>	<i>Households (000s)</i>	<i>Percent</i>
Ontario	1,242	450	36
GTA	555	196	35
Rest of Ontario	687	254	37

Source: Clayton Research based on CMHC data

Most Renter Households In Core Housing Need Have an Affordability Problem Only

The lack of affordability is by far the dominant problem of renters in core housing need in Ontario (Figure 13) as shown by:

- Of the 450,000 households in Ontario in core housing need, over 70 percent have an affordability problem only;
- In the GTA, of the 196,000 households in core housing need, 62 percent have an affordability problem only, while 29 percent have an affordability and adequacy/suitability problem; and
- In the Rest of Ontario, 254,000 households in core housing need, 78 percent have an affordability problem only.

Figure 13

Renters in Core Housing Need* by Nature of Problem, Ontario, GTA and the Rest of Ontario 1996			
	Ontario	GTA	Rest of Ontario
	<i>Households (000s)</i>		
Affordability Only	321	122	199
Affordability and Adequacy/Suitability	100	57	42
Adequacy/Suitability only	29	16	12
Total	450	196	254
	<i>Percent</i>		
Affordability Only	71	62	78
Affordability and Adequacy/Suitability	22	29	17
Adequacy/Suitability only	6	8	5
Total	100	100	100

Source: Clayton Research based on CMHC data

Affordability Deteriorated in the Early 1990s

The deterioration in affordability in the first half of the 1990s was income based (Figure 14):

- Between 1986 and 1991 average annual gross rents in Ontario increased annually by about 7.3 percent, while average rental household income almost kept pace at around 6.7 percent. Both increases were somewhat higher than the annual inflation of 5.6 percent during the period;
- By the period of 1991 to 1996, average annual gross rent in Ontario had only increased annually by around 2.1 percent, but average rental household income had actually decreased by

about 0.5 percent annually. At the same time, rents still rose faster than annual inflation of 1.3 percent; and

- Since 1986 the rent to income ratio in Ontario has increased from about 21 percent to just over 24 percent by 1996. Most of the increase occurred between 1991 and 1996.

Figure 14

Annual Rents and Renter Household Incomes, Ontario				
	Average Annual Gross Rent	Average Rental Household Income	Rent to Income Ratio	
	<i>Dollars</i>		<i>Percent</i>	
1986	5,436 (453)	25,843	21.0	
1991	7,416 (618)	34,510	21.5	
1996	8,184 (679)	33,590	24.4	
	<i>Percent Change</i>			
Average Annual	Rent	Income	CPI*	
1986-1991	7.3	6.7	5.6	
1991-1996	2.1	(0.5)	1.3	

* From June 1986-June 1991 and June 1991 to June 1996
Source: Clayton Research based on Census of Canada and Statistics Canada data

RENTS ARE RECOVERING IN THE LATE 1990S

Average annual rents in the GTA have started to increase again during the late 1990s according to CMHC data (Figure 15):

- During the period of 1986 and 1991, the average rent for 1 bedroom and 2 bedroom apartments in the GTA rose by about 6 percent annually;

- By 1991 to 1996, with the lowered demand and economic recession, the average rent for 1 bedroom and 2 bedroom apartments increased by only about 3 percent per year; and
- Between 1996 and 1999, the average rent for 1 and 2 bedroom apartments increased by about 4.0 to 4.7 percent per year.

Figure 15

Annual Rent Increases, GTA			
	Census Average Monthly Gross Rent	CMHC	
		1 Bedroom	2 Bedroom
		<i>Dollars</i>	
1986	532	463	553
1991	747	590	725
1996	785	674	817
1999	n.a.	770	916
<u>Average Annual</u>		<i>Percent Change</i>	
1986-1991	8.1	5.5	6.2
1991-1996	1.0	2.8	2.5
1996-1999	n.a.	4.7	4.0

Source: Clayton Research based on Census of Canada and CMCH data

THE RENTAL HOUSING PROBLEM IS SIGNIFICANT

The rental housing problem is really two-fold:

- There is a lack of new purpose built rental housing construction; and

- Many renters have an insufficient income to afford adequate and suitable accommodation.

These are distinct, though interlinked problems. For example, affordability becomes more severe in tight rental markets such as the GTA.

While the lack of new rental construction is most severe in the GTA, the affordability problem exists throughout the province.

CHAPTER SUMMARY

- Privately-initiated rental housing starts have been extremely low since the 1970s after changes to the tax and regulatory environment.
- In recent years there has been a withdrawal from publicly-initiated rental housing projects in Ontario, the GTA and the Rest of Ontario.
- The non-conventional rental housing sector (basement and accessory apartments and single-family homes and condominiums being rented out by the owner) has been satisfying a sizeable component of rental demand. However, non-conventional supply sources are not sufficient to fill the gap between demand and the supply of new purpose built rental housing in the future.
- The main problem for a segment of existing renters is that they have insufficient incomes to afford adequate and suitable accommodation. The lack of affordability is by far the dominant problem of renters in core housing need in Ontario.

3 MARKET-WIDE DEMAND AND SUPPLY

This chapter begins with a discussion about market-wide demand and supply, including employment and population growth in Ontario, the GTA and the Rest of Ontario and ends with a review of the economic feasibility of rental housing construction in the GTA.

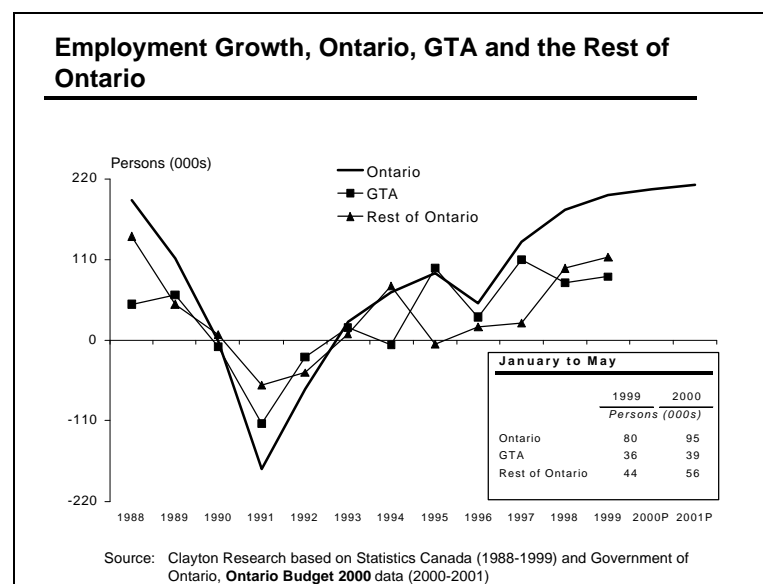
STRONG EMPLOYMENT GROWTH NOW OCCURRING THROUGHOUT ONTARIO

Strong employment growth is now occurring throughout the province (Figure 16):

- The sharp decrease in the number of jobs in the early 1990s reflected the recession of the early 1990s. Both the GTA and the Rest of Ontario fared poorly;
- A sharp recovery has occurred in Ontario since 1996. The growth was first located primarily in the GTA, but was joined in 1998 by the Rest of Ontario;
- The first five months of 2000 showed an increase in the number of jobs over the same period in 1999, with the Rest of Ontario fairing particularly well (up to 56,000 from 44,000 during the same period last year); and
- Buoyant employment growth is expected to continue in Ontario. The Government of Ontario's projections for employment growth

from the 2000 Ontario Budget anticipate that about 205,000 and 211,000 new jobs will be created in 2000 and 2001.¹³

Figure 16



PERSONAL DISPOSABLE INCOME RISING AGAIN

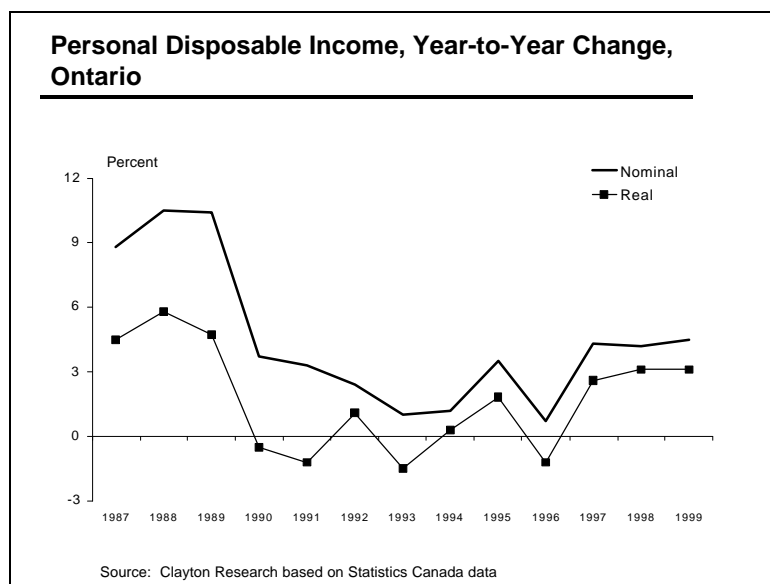
Personal disposable income (the difference between total income and income taxes) growth has recovered over the last three years¹⁴ (Figure 17):

¹³ Government of Ontario, *Ontario Budget 2000*, p. 6.

¹⁴ Income data is not available by tenure.

- During the 1988 and 1991 period the year-to-year change in real personal disposable income fell sharply from about 6 percent in 1988 to negative 1 percent in 1991;
- There was marginal year-to-year change in real personal disposable income during the period of 1992 to 1996; and
- Incomes have been on the rise since 1997, with positive year-to-year growth in real disposable income increasing by about 3 percent per year between 1997 and 1999.

Figure 17

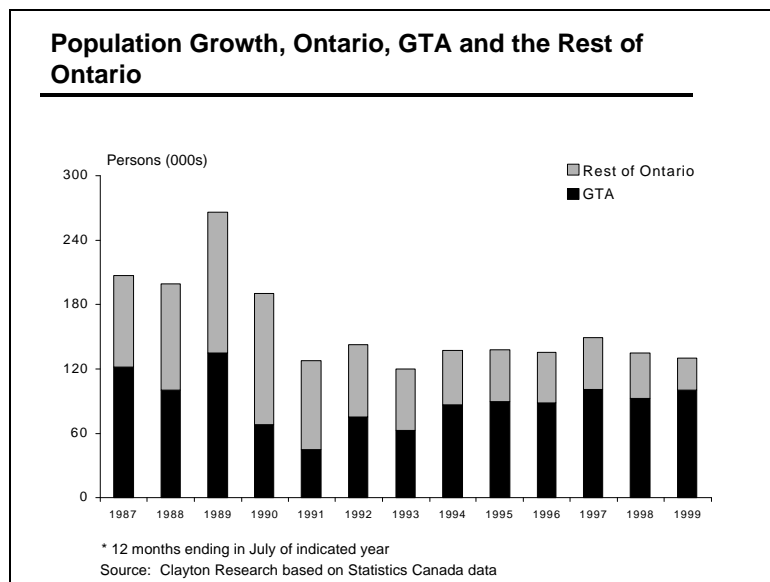


THE GTA ACCOUNTS FOR MOST OF ONTARIO'S POPULATION GROWTH

Additions to the population apply upward pressure on the rental and ownership markets (Figure 18):

- Population growth slowed after the gains in the late 1980s when the economic boom lured job-seeking migrants to Ontario and the GTA;
- With the recession of the early 1990s, annual population growth slowed in Ontario, as migrants were attracted to Western Canada (mainly B.C.) where the economy was performing much better;
- Since 1994, population growth in Ontario has been fairly steady, averaging about 137,000 persons per year; and
- The GTA has generally had a greater share of Ontario's population growth since 1993, rising from about 53 percent to close to 78 percent in 1999.

Figure 18



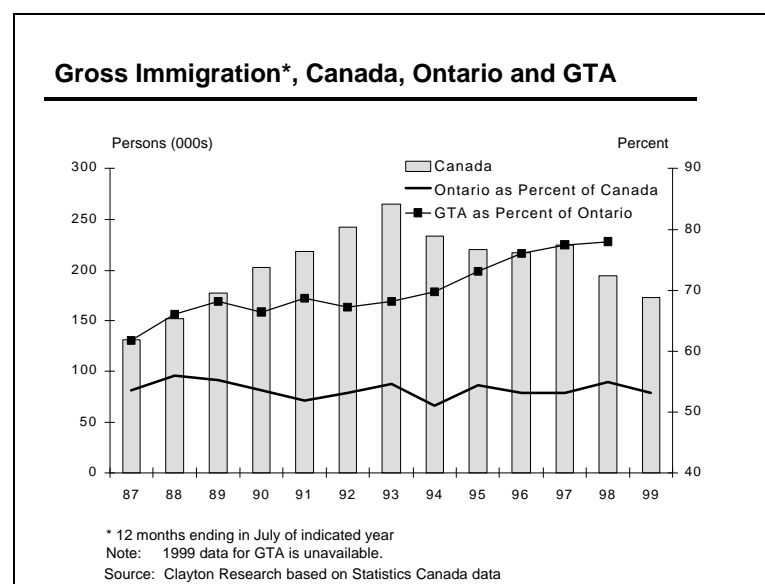
ONTARIO AND THE GTA CONTINUE TO ATTRACT A HIGH PROPORTION OF CANADA'S IMMIGRATION

Immigration has played a major role in population growth since 1987 (Figure 19).

- Between 1987 and 1993, immigration in Canada increased steadily from about 130,000 to 265,000 persons per year. Since 1993, immigration to Canada has been generally decreasing, and is well below the 200,000 persons per year target set by the Government of Canada. In 1999, immigration reached only 175,000 persons, well below the target.

- Ontario has historically attracted a high percentage of Canada's immigration. Between 1987 and 1999, Ontario received about 54 percent of Canada's immigration.
- At the same time, the GTA has increased its share of Ontario's immigration from about 62 percent in 1987 to 78 percent in 1998. Data for the GTA in 1999 is unavailable.

Figure 19



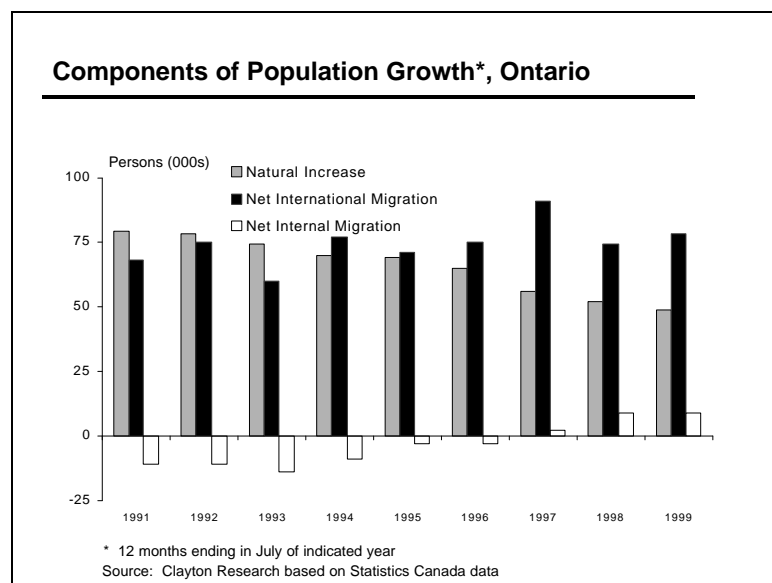
INTERNATIONAL MIGRATION HAS BEEN THE MAJOR COMPONENT OF POPULATION GROWTH OVER THE LAST SIX YEARS PARTICULARLY IN THE GTA

Net international migration is now the largest component of population growth in Ontario and the GTA.

In Ontario (Figure 20):

- Net international migration has been the largest population component over since 1994;
- Natural increase (births less deaths) has been on a downward trend in Ontario since 1991;
- Ontario suffered losses of population to the west in the early 1990s, when B.C.'s economy was faring better than Ontario's; and
- Since 1997, net internal migration in Ontario (i.e., within Canada, between the provinces) has been positive as Ontario's economy has improved and the situation reversed from the early 1990s.

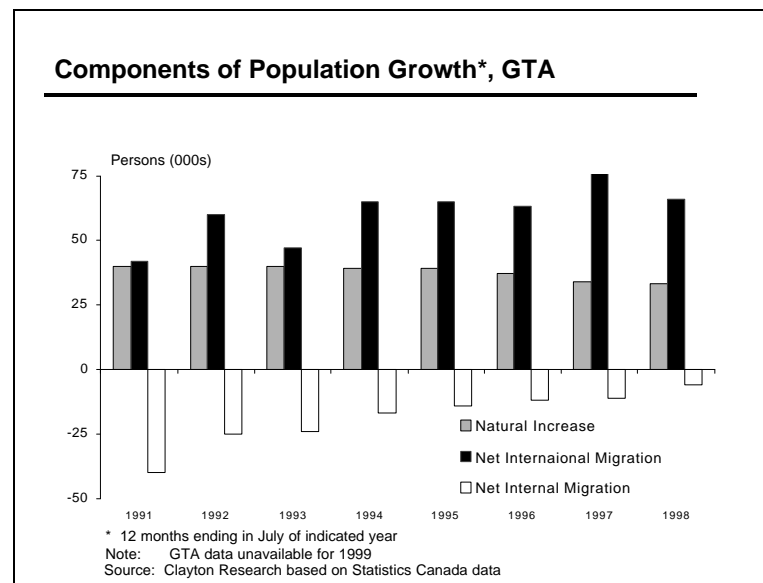
Figure 20



In the GTA (Figure 21):

- The major component of population growth is net international migration (persons moving in and out of the GTA from other countries), especially since 1994 as the economy has rebounded from the recession of the early 1990s;
- Since 1991 decreasing negative internal migration (i.e., persons moving within Canada between provinces and within Ontario between Census Metropolitan Areas) has occurred; and
- At the same time, natural increases (births less deaths) have remained fairly constant.

Figure 21



TOTAL RENTER HOUSEHOLD GROWTH EXPECTED TO BE SIZEABLE IN ONTARIO

Growth in renter households is a function of three key factors:

- The amount and age composition of the population;
- The willingness of people to form households; and
- Households' propensities to own vs. rent.

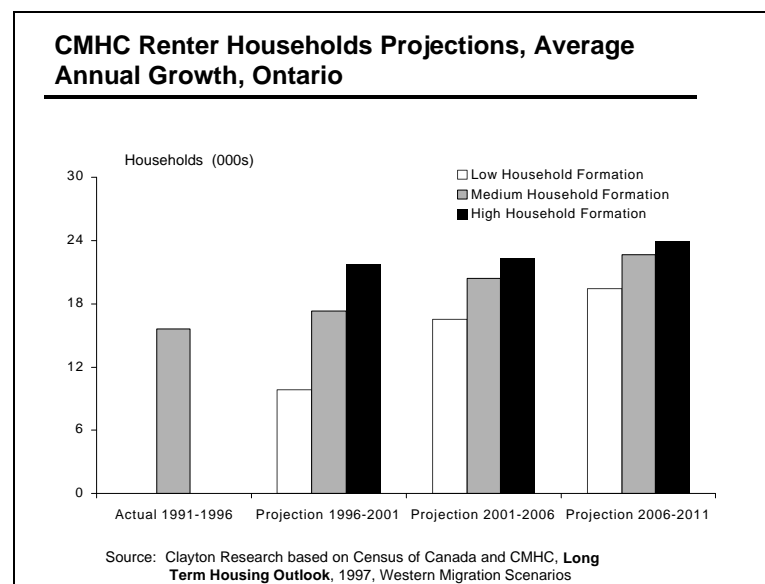
Between 1991 and 1996 about 16,000 new renter households were created annually in Ontario.

Ontario is expected to experience significant renter household growth (Figure 22):

- According to CMHC projections, about 17,000 to 24,000 new renter households are anticipated annually between 2001 and 2011.

Such high renter household growth will place increasing pressure on the rental housing supply in Ontario, particularly in the GTA.

Figure 22



NEW RENTAL CONSTRUCTION IS NOT ECONOMICALLY FEASIBLE

The Proforma Approach is Used for Comparative Analysis

The use of proformas is the approach typically used in the analysis of the economics (viability) of new rental construction. Proformas look at the key cost components of development, the revenues expected and the investor returns.

The proformas used in this study are from the December, 1999 Lampert Report, *Update on the Economics of Investment in Rental Housing In*

Toronto. The proforma approach allows for comparisons to be made of the economics of private rental development between different locations and different product mixes. It also allows for “what if” type analysis – that is, how do changes in any of the input assumptions affect the final outcome?

The Key Components of the Proforma

Developers may use different approaches to assess the economic viability of building a particular development. However, there are certain factors that are critical to the assessment and are typically be part of any proforma analysis.

Development Costs and Financing

The part of the proforma that includes the development costs of the project and the financing arrangements.

The project development costs in Ontario include:

- **Land** – the cost of a serviced block of land before development charges;
- **Development charges**
- **Construction** – hard construction costs plus soft costs; and
- **GST** – now 4.5 percent applied to both the land and construction costs (after the 2.5 percentage point rebate). The GST was 7 percent in December, 1999.

The project financing arrangements include:

- **Equity** – the funds invested directly into the project by the developer;
- **Mortgage** – the difference between total project costs and the equity;
- **Mortgage interest rate and terms;** and
- **Mortgage insurance premium** – the amount of the insurance premiums assumed to be added to the mortgage principal.

Revenues and Costs

The part of the proforma that deals with the on-going revenues and the operating costs of the development.

The **revenues** analysis includes:

- Rental income – the monthly rent multiplied by 12 months; and
- Parking and related revenues.

The **costs** analysis includes:

- Operating costs including utilities and management costs; and
- Property taxes.

Net Operating Income (NOI)

- The difference between total income and total operating costs.

Return on Project Cost

- Net operating income as a percent of project development costs.
- The required return on project costs is the minimum return desired by developers to proceed with construction and is generally 10 percent.

DOWNTOWN TORONTO AND SUBURBAN RENTAL PROJECTS ARE NOT ECONOMICALLY FEASIBLE

Two of the proforma results from the December, 1999, Lampert Report *Update on the Economics of Investment in Rental Housing in Toronto*¹⁵ are summarized in Figure 23. A Downtown Toronto high-end, high-rise project is compared with a Mississauga medium-quality, low-rise project, as of December 1999.¹⁶ The results are generally better outside the GTA (evidenced by the increase in starts in the Rest of Ontario over the last year), but are still on the margin in many cases.

Typically, developers would be seeking a minimum of 10 percent return on project cost. As can be seen, the returns for new rental construction of 7.8 for the Downtown Toronto project and 7.2 percent for the Mississauga project are well below the 10 percent threshold.

Consequently, the returns on new rental construction are presently too low to stimulate new privately-initiated construction in the GTA.

¹⁵ Prepared for the Rental Housing Supply Alliance.

¹⁶ The proformas are based on the situation as of December, 1999. The situation has changed since then. The Federal Government has initiated the New Residential Rental Property Rebate on the GST of 2.5 percentage points is in place, while five-year mortgage rates have gone up – to 8.35 percent in April, 2000 from 8.25 percent in December, 1999.

Figure 23

Proforma Comparison, Privately-Initiated Rental Projects GTA, December, 1999		
	Downtown Toronto High-End High-Rise	Mississauga Medium- Quality Low-Rise
	<i>Dollars per Unit</i>	
Development Costs and Financing		
Land	35,806	17,462
Construction	126,500	87,287
GST ¹	11,361	7,332
Project Costs	173,667	112,081
Equity	38,147	36,307
Financing	135,520	75,774
Mortgage Insurance Fee	4,066	2,273
Mortgage	139,586	78,047
First Year Revenues, Costs and Cash Flow		
Revenues	18,480	12,368
Maintenance and Operations	3,160	3,060
Property Taxes	1,768	1,257
Total Operating Costs	4,928	4,317
Net Operating Income	13,552	8,051
Return on Project Cost² (%)	7.8	7.2
Required Return on Project Cost² (%)	10.0	10.0
¹ Does not reflect GST rebate ² Net operating income as percent of project costs Source: Clayton Research based on data from Lampert, Update on the Economics Of Investment in Rental Housing In Toronto , December, 1999		

REITS ARE MORE ATTRACTIVE TO INVESTORS THAN NEW CONSTRUCTION

Not only are returns on new rental housing development typically below the 10 percent return on project cost that developers are seeking, but

they are also not attractive in relation to the return on investment of residential Real Estate Investment Trusts (REITs) (Figure 24):

- The potential return on project costs for the Downtown Toronto, high-end, high-rise and the Mississauga medium-quality, low-rise scenarios from the December, 1999 Lampert report were 7.8 and 7.2 percent, respectively; and
- In June, 2000 for example, the yields (dividend over unit share price) for the two Canadian residential real estate investment trusts, Residential Equities REIT and Canadian Apartment Properties REIT, were both 9.1 percent.

Consequently, investors achieve better returns from investing the same amount in a residential REIT than in new rental housing, but with much less risk.

Figure 24

Comparison of Yields and Returns for Residential REITs and Private Rental Projects	
	Yield* <i>Percent</i>
REITs	
Residential Equities	9.1
Canadian Apartment Properties	9.1
	Return on Project Cost** <i>Percent</i>
Lampert December 1999 Proformas	
Downtown Toronto High-End High-Rise	7.8
Mississauga Medium-Quality Low-Rise	7.2

* Annual dividend rate, June 17, 2000
 ** Net operating income as percent of project costs as of December, 1999
 Source: Clayton Research based on Lampert, *Update on the Economics of Investment in Rental Housing in Toronto*, December, 1999 and The Financial Post

CHAPTER SUMMARY

- There is strong demand for housing of all tenures being fuelled by the robust economy and population growth.
- Immigration is the major component of population growth in Ontario and the GTA.
- The projected growth in Ontario for renter households during the 2001 to 2011 period is expected to be sizeable, between about 17,000 to 24,000 households annually, based on Canada Mortgage and Housing Corporation (CMHC) projections.
- The current economics of new privately-initiated rental construction are unfavourable, as new privately-initiated rental investment simply does not generate competitive returns commensurate with the financial risk.
- The problem is particularly acute in the GTA.
- In order to generate significant new private rental housing construction, returns have to be enhanced.

4 THE CANADA AND UNITED STATES COMPARATIVE EXPERIENCE

This chapter begins with a comparison of new rental construction apartment units in the United States (U.S.) and Canada followed by more detailed elaboration on U.S. privately and publicly-initiated apartment completions. Finally, a discussion regarding U.S. tax provisions and incentives is presented.

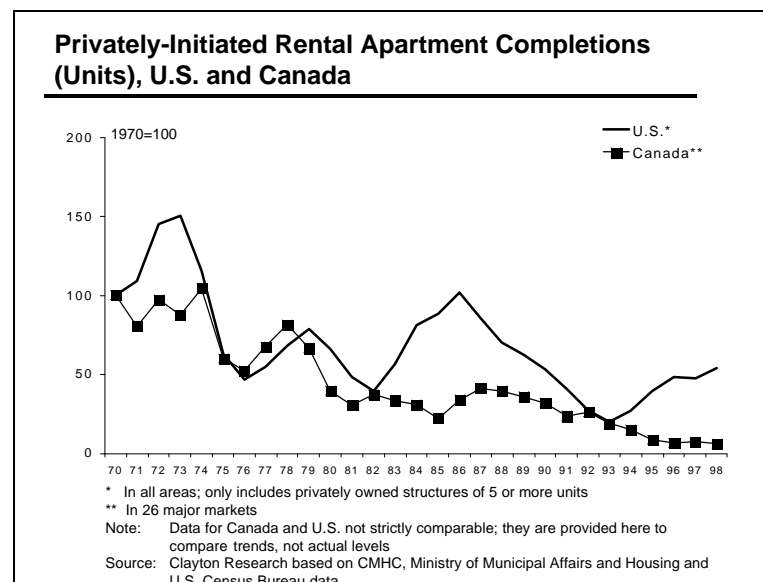
U.S. RENTAL HOUSING CONSTRUCTION OUTPACES CANADA BY WIDE MARGIN SINCE THE 1970S

With the many similarities that exist between Canada and the U.S. a comparison can be made of past trends in private rental housing production. Figure 25 shows annual privately-initiated rental apartment completions for Canada and the U.S. The data are indexed, with 1970 equal to 100 (thus a variable of 50 for a year means that completions in the year are half of what they were in 1970).

The following can be observed:

- Except for the period between 1976 to 1978 when the MURB and ARP programs in Canada were peaking, U.S. private rental completions have been relatively higher than in Canada; and
- The gap has been pronounced almost continuously for every year since 1983, which is the period when the Canadian Federal Government disbanded its private sector assistance programs.

Figure 25



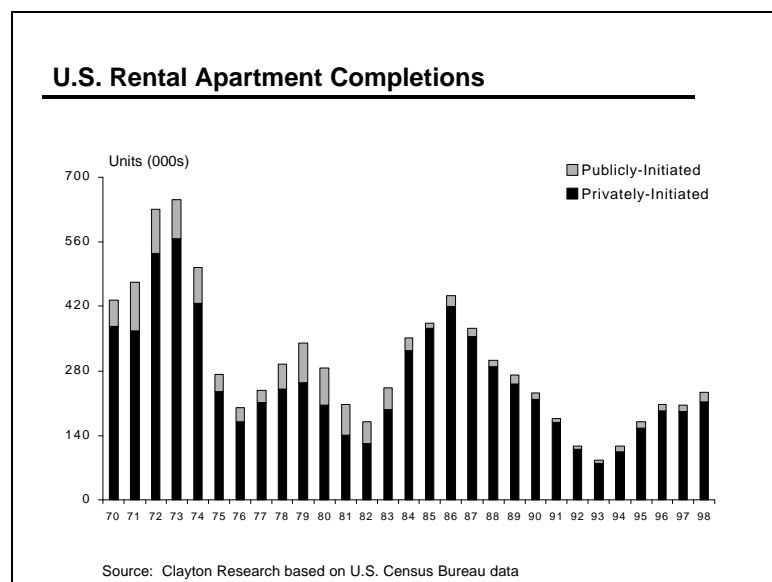
Of note is that U.S. rental apartment completions have been dominated by privately-initiated rental housing (Figure 26):

- In the 1990s, U.S. rental apartment completions recovered, and were mostly privately-initiated. At the same time, Canada has seen relatively little rental housing construction.

The contributors of the differences between the U.S. and Canada that do exist – economic performance, the taxation system, demographics, rent controls, and governmental assistance programs – are difficult to quantify. However, the Federal tax treatment on private rental housing investment and the various incentive programs have been considerable factors in the

lower levels of rental completions in Canada compared to the U.S.

Figure 26



U.S. TAXATION SYSTEM MORE FAVOURABLE TO RENTAL CONSTRUCTION

The U.S. taxation system affects the provision of new rental housing:

- **Federal Income Tax** – there are more favourable tax deductions in the U.S. for depreciation (CCA), losses (including depreciation), and the deferral of tax on recaptured depreciation and capital gains on the sale of rental property if another property purchased; and
- **Federal Sales Tax** – the U.S. does not have a Federal sales tax (i.e., there is no Goods and Services Tax (GST)).

U.S. INCOME TAX PROVISIONS SPUR AFFORDABLE RENTAL CONSTRUCTION

The U.S. taxation system affects the provision of affordable new rental housing through two major initiatives, the Low Income Housing Tax Credit and Tax Exempt Bonds.

Low Income Housing Tax Credit (LIHTC)

- Since 1986 U.S. investors in qualified new rental housing projects for low or moderate-income renters can claim a tax credit over 10-years.
- The credit is equivalent in present value terms to 70 percent of the cost of new construction and 30 percent of acquisition costs.¹⁷
- More than 500,000 rental units have been completed under the program.¹⁸

Tax Exempt Bonds

- Issued by State housing finance agencies to raise capital for affordable non-profit and private for profit housing.
- The bonds are exempt from Federal income tax and from State income tax in some States.

¹⁷ McClure, Kirk, *The Low-Income Housing Tax Credit as an Aid to Housing Finance: How Well Has It Worked*, 2000, p. 93.

¹⁸ *Ibid*, p. 91.

- Financing continues to be available, but after the LIHTC was introduced in 1986, the volumes of rental housing produced with tax exempt bonds are low compared to the early 1980s.
- The National Council of State Housing Agencies estimated that at the state level, multi-family housing tax exempt bonds financed over 40,000 expected rental housing units in the U.S. during 1999.¹⁹

U.S. MAINTAINS A HOUSING SUPPLEMENT FOR HOUSEHOLDS IN EXISTING HOUSING STOCK

The U.S. subsidy system affects the affordability of units in the existing housing stock through Section 8 vouchers.

Section 8 Vouchers

- Provide on-going assistance to bridge the gap between low-income rents (based on 30 percent of income) and approved project rent.
- Units must meet minimum standards of health and safety.
- A household issued a voucher is responsible for funding and selecting a suitable rental unit of their choice, which may include their present dwelling. The subsidy is paid directly to the landlord and the household pays the balance between the market rent and the subsidized amount.

- In 1998, Section 8 vouchers and certificates subsidized about 1.4 million units.²⁰

CHAPTER SUMMARY

- Much higher levels of new purpose-built rental housing have been completed in the United States over the last 30 years than in Canada, far beyond the 10 to 1 standard often applied to the two countries.
- Canada's rental housing production has lagged the United States, especially in the early 1980s and the mid to late 1990s.
- Higher levels of rental production have occurred in the United States because of a more favourable taxation system (more favourable income tax provisions and no GST).
- Tax incentive provisions in the United States have stimulated privately-initiated rental housing, while a voucher system increases the affordability of existing rental housing stock for households in need.

¹⁹ National Council of State Housing Agencies, 1999 Multifamily Bonds Summary Table 3. Units created through local housing agencies are not included.

²⁰ U.S. Department of Housing and Urban Development, Data Sets, **A Picture of Subsidized Households**, 1998.

5 STIMULATING NEW PRIVATE SECTOR RENTAL CONSTRUCTION

The lack of new purpose-built rental housing construction in Ontario was the first aspect of the rental housing problem outlined in Chapter 2.

This chapter begins with an analysis of the rents paid by renter households and the required rents for new rental construction in the GTA. A review of the public sector costs follows. Finally, recent government initiatives aimed at enhancing the attractiveness of new rental construction and further options are discussed.

RENTS PAID BY THE MAJORITY OF RENTERS ARE BELOW REQUIRED RENTS FOR PROJECTS IN THE GTA

The required monthly rent for all rental projects is higher than what the majority of renters can afford in the GTA (Figure 27). Four projects from the December, 1999, Lampert Report *Update on the Economics of Investment in Rental Housing in Toronto* were used to compare the required monthly rent to achieve a 10 percent return with the number of renter households in 1996 at ranges of rent paid adjusted to 1999 rents. The total project costs include land costs, construction costs and GST as of December, 1999.

The required monthly rent for all four projects was higher than what the majority of renter household could afford in 1996. In more detail:

- A medium-quality, low-rise rental apartment building in Mississauga was estimated to have a total project cost of \$112,081. At this cost, the required monthly rent to achieve a 10 percent return was \$1,294. Only about 19 percent of renter

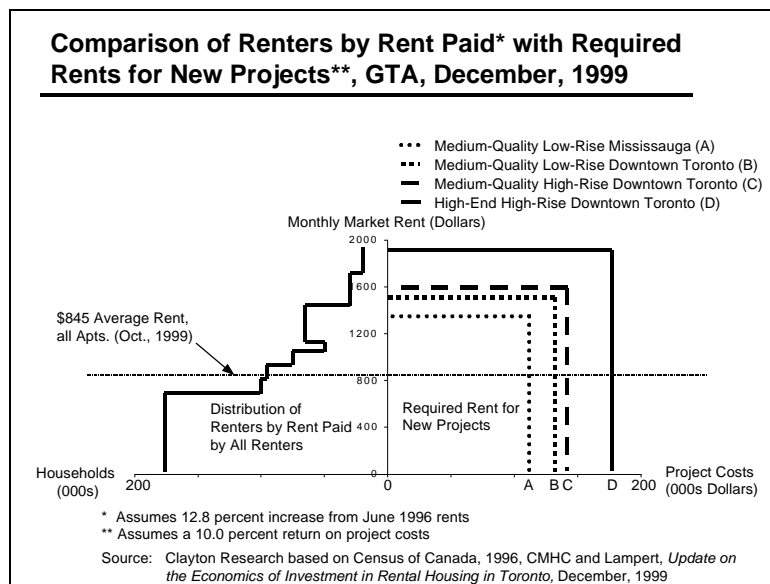
households in 1996 were paying rent in the range of \$1,294 or above;

- A medium-quality, low-rise apartment building in Downtown Toronto was estimated to have a total project cost of \$133,598. The required monthly rent to achieve a 10 percent return was \$1,496. Only about 8 percent of renter households were paying in this range or above in 1996;
- A medium-quality, high-rise apartment building in Downtown Toronto was estimated to have a total project cost of \$140,684. In order to achieve a return of 10 percent at this project cost, the required monthly rent was \$1,526. Only about 8 percent of renter households in 1996 were paying in the range of \$1,408 and over; and
- A high-end, high-rise rental project in Downtown Toronto was estimated to have a total project cost, of \$173,667 per unit. At this cost, the required rent per month to achieve a 10 percent return was \$1,858. The rent of \$1,858 is well above what the majority of renters were estimated to be paying. In fact, only about 4 percent of renter households were estimated to be paying above \$1,691 in 1996.

A second comparison can be made between the required rent from the four projects with the October, 1999 average rent for all apartments in the GTA:

- At \$845, the average rent for all apartments is well below all of the required rents for the four projects (Figure 27).

Figure 27



income renter households will move into new projects at the higher rents, freeing up apartments of lower rent and quality. Thus any new construction, even at the high-end scale, is positive for the whole rental market. Consequently, if project costs can be reduced further, rental construction at the higher-end of the market will become economically feasible and create movement throughout the rental market.

GTA PUBLIC SECTOR CONTRIBUTION TO COSTS ARE HIGHER OUTSIDE DOWNTOWN TORONTO

Total project costs are largely determined by the costs of land and construction, which are determined in the marketplace. As a result, very little can be done to decrease these costs. One area where costs can be changed is the costs due to the public sector.

The public sector costs from the December, 1999 Lampert Report proformas for a high-quality, high-rise building in Downtown Toronto and a medium-quality, low-rise building in Mississauga were reviewed.

Details on the public sector costs included in the calculations are as follows:

- Development charges:
 - In Toronto the development charge includes the 1 percent public art charge; and
 - For Mississauga, the charge includes educational development charges.
- Provincial Sales Tax is payable on materials used in construction.

THE TENANT PROTECTION ACT CANNOT ALONE SPUR RENTAL HOUSING

The *Tenant Protection Act* (TPA) has helped improve the investment environment of new privately-initiated rental housing projects in Ontario, but with the required rents being higher than what the majority of renters are paying, the gap between market and economic rents²¹ remains too large, even at the high-end.

Much of the new rental construction will be at the higher-end of the quality and rent scale. With the filtering process (see Chapter 2), higher

²¹ *Economic rent is the rent required to cover all costs and provide competitive returns on investment.*

- The Federal Goods and Services Tax (GST).

For both municipalities, building and development applications are excluded, as well as municipal land dedications (5 percent for parkland). For the City of Toronto, Section 37 costs are also excluded although they can add considerably to costs.

Referring to the proformas in the Lampert Report, December, 1999, project costs have to be significantly reduced to generate the threshold 10 percent return on project costs (Figure 28).

Figure 28

	Downtown	
	Toronto	Mississauga
	High-End High-Rise	Medium-Quality Low-Rise
<i>Dollars per Unit</i>		
Total Project Costs	173,667	112,081
Return on Project Cost (Percent)	7.8	7.2
Reduction in Project Cost to Produce a 10 Percent Return	38,147	31,571
Public Sector Costs		
Municipal (Development Charges)**	2,206	11,162
Provincial (Sales Tax)	3,500	2,400
Federal (GST)	11,361	7,332
Total	17,067	20,894

* Excludes municipal building and development application fees, municipal land dedications (e.g. parkland) and Section 37 (City of Toronto)
 ** Includes "public art" and for Mississauga only, School Board charges
 Source: Clayton Research based on Lampert, *Update on the Economics of Investment in Rental Housing in Toronto*, December, 1999

- For the Downtown Toronto, high-end, high-rise project, costs would have to be reduced by about \$38,000; and
- For the Mississauga medium-quality, low-rise project, costs would have to be reduced by about \$32,000.

Even if all public sector costs were removed, the two projects would still not reach the threshold of 10 percent return on project costs. Thus, even further action is necessary.

Figure 29 reveals that the public sector contribution to costs are relatively high, especially in Mississauga. With the new GST rebate of 2.5 percentage points, the GST costs were adjusted after the rebate:

- For the Toronto project, public sector costs are about 8 percent of total project costs; and
- With public sector costs at about 17 percent in Mississauga, a reduction in public sector costs in the areas outside of the City of Toronto is even more important.

Figure 29

	Downtown	
	Toronto	Mississauga
	High-End High-Rise	Medium-Quality Low-Rise
<i>Dollars per Unit</i>		
Development Charges**	2,206	11,162
Provincial Sales Tax	3,500	2,400
G.S.T.***	7,305	4,714
Total	13,011	18,276
All Other Costs	156,600	91,187
Total Project Costs	169,611	109,463
Public Sector Costs as Percent of Total Costs	7.7	16.7

* Excludes municipal building and development application fees, municipal land dedications (e.g. parkland) and Section 37 (City of Toronto)
 ** Includes "public art" and for Mississauga only, School Board charges
 *** After the G.S.T. rebate of 2.5 percentage points
 Source: Clayton Research based on Lampert, *Update on the Economics of Investment in Rental Housing in Toronto*, December, 1999

RECENT GOVERNMENT INITIATIVES ARE NOT ENOUGH

In the absence of higher rents, to achieve a significant upturn in private sector rental construction requires the removal of public sector project costs.

The Federal Government has made one recent initiative to lower development costs, the **New Residential Rental Property Rebate**:

- A GST rebate of 2.5 percentage points from the 7 percent tax (a reduction of 35.7 percent) is allowed for rental units valued up to \$350,000;
- The rebate will be gradually phased out for rental units valued between \$350,000 and \$450,000, while units valued above \$450,000 will not be issued a rebate; and
- The rebate applies to rental property and leased land used for long-term rental accommodation, and is equal to the GST rebate given for ownership housing.

The Provincial Government has made one recent initiative, the **Provincial Sales Tax Grant Program**:

- A grant of \$2,000 per new rental unit completed by March 31, 2002 is available for 'affordable' units;
- To be eligible as 'affordable' units must conform to size limits;²²

²² The size limits for units to be eligible under the program are: 500 sq. ft. for bachelor units; 650 sq. ft. for 1 bedroom units; 850 sq. ft. for 2 bedroom units; 1,000 sq. ft. for 3 bedroom units; and 1,200 sq. ft. for 4 bedroom units.

- With \$1 million allocated per year for the program, a maximum of 500 'affordable' units per year will be eligible; and
- The grant is paid upon completion.

The Federal and Provincial initiatives listed above are a start, but much more is needed to reduce project costs.

CHANGES TO THE FEDERAL TAX TREATMENT OF RENTAL HOUSING INVESTMENT COULD MAKE INVESTMENT IN RENTAL HOUSING MORE ATTRACTIVE

Potential changes to Federal income tax that could be considered include:

- Permitting investors to defer capital cost allowances (CCA) recapture and capital gains on the proceeds from the sale of rental property when the proceeds are reinvested within a reasonable time frame in another rental property (the U.S. Federal tax system allows for this);
- Permitting investors to pool assets, treating more than one asset within a particular class as one unit for depreciation purposes;
- Permitting all investors in rental housing (and not solely Principal Business Corporations) the chance to deduct CCA losses against other income, as well as to qualify for the "active business income" Small Business Deduction; and
- Expanding allowable 'soft costs' that can be deducted in the first year of operation of new rental properties.

ADDITIONAL PROPERTY TAX CHANGES COULD LOWER PROJECT COSTS

Property taxes vary by municipality. In general, they have been increasing in order to compensate for reduced provincial funding. A further issue is the relative rate of taxation between rental properties and condominiums. In Ontario, property tax rates for rental properties are typically at least twice that for condominiums.

Ontario recognized the detrimental impact on rental housing investment of the relatively higher rate of taxation. In early 1997, as part of the *Fair Municipal Finance Act*, changes were introduced that include:

- Municipalities are allowed to tax existing rental properties at a rate consistent with owner-occupied condominiums or single-family homes. However, there is no requirement for municipalities to do so;
- Municipalities are permitted to create a separate property class for new rental buildings, allowing rental buildings to be taxed below the rate for existing rental buildings for 8-years. However, municipalities are not required to do so. In the fall of 1998, the City of Toronto created the New Multi-Residential class under the Provincial legislation; and
- The education portion of the property tax was equalized for rental and ownership housing.

The Ontario Government could consider making property tax rate on new rental housing equal to that of ownership housing permanent, instead of the 8-year limit on new construction that is presently in place.

REDUCTION OR ELIMINATION OF DEVELOPMENT CHARGES ON RENTAL HOUSING COULD LOWER PROJECT COSTS

Development charges reduce the attractiveness of investing in all kinds of housing, including new purpose-built rental housing. They add to the total project cost, thus decreasing the return on project costs.

Development charges outside the City of Toronto in the GTA are high compared to those in the Ottawa Region (Figure 30):

- Development charges exist in the older, central cities of Toronto and Ottawa²³ even though infrastructure is mostly already in place;
- Suburban development charges are much higher. Both Mississauga and Vaughan have development charges of over \$10,000 per unit for apartments with more than 1 bedroom. Ottawa Region suburban municipalities also have high development charges, although they are lower than in Mississauga and Vaughan; and
- For the Mississauga medium-quality, low-rise project in the December, 1999 Lampert Report, development costs represent just over 10 percent of total project costs.

The waiving of development charges for rental construction would have a significant impact on raising returns on project costs closer to the 10 percent threshold.

²³ There are only Regional development charges for the City of Ottawa.

Figure 30

Apartment Development Charges, GTA and Ottawa Region, 2000		
	Small Apartments ¹	All Other Apartments
	<i>Charge per Unit (Dollars)</i>	
Toronto ²	1,692	2,644
Mississauga ³	6,460	10,451
Vaughan	10,746	12,873
Ottawa ⁴	3,164	4,973
Gloucester ⁵	5,801	7,927

¹ Includes bachelor and 1 bedroom apartments (generally a gross floor area of 70 sq. m. (750 sq. ft.) or less)
² Highest charge as of Sept. 1, 1999
³ Does not include storm drainage
⁴ Includes Regional charge only, outside the Greenbelt
⁵ Highest area specific charge, includes Regional Charge for Urban Areas outside the Greenbelt
 Note: Includes all Regional and/or School Board charges.
 Source: Clayton Research based on Municipal data

SECTION 37 COSTS COULD BE WAIVED

Section 37 of the Planning Act allows municipalities to pass zoning bylaws authorizing increases in height and density in return for the provision of public benefits. The City of Toronto is the main municipality that makes use of Section 37. The City of Toronto had proposed to utilize Section 37 for Official Plan amendments for all large-scale projects greater than 10,000 square meters or 100 units when increased density exceeds 1,500 square meters or 15 units.²⁴ A 30 percent share of density benefits for the City of Toronto was proposed in July 2000.

²⁴ *Urban Development Services, City of Toronto July 4, 2000 Report on Section 37 of the Planning Act.*

As a result of an Ontario Municipal Board (OMB) ruling in August 2000, the proposed City-wide policy is not currently in effect.

Section 37 contributions lead to cost increases for new rental housing construction, which in turn raise the required rents to achieve a competitive rate of return. The City of Toronto could consider waiving Section 37 contributions on new rental housing construction, regardless of any further changes to the process through which Section 37 is applied.

CHAPTER SUMMARY

- The returns for new rental housing for private developers and investors need to be increased.
- In the absence of significant rent increases, which would worsen the affordability problem of renters, returns can only be improved by effectively decreasing development, financing, and operating costs and taxes.
- There are benefits of stimulating new rental production, even when it is high-end product because of the filtering process of rental housing.
- The Federal and Ontario Governments are becoming aware of the need to decrease rental housing development costs and have made some initial moves, such as the GST rebate and the Provincial Sales Tax Grant Program.
- More has to be done, even after these initial moves to reduce the public costs associated with rental construction.

- The following policy options to reduce projects costs are offered to spur the development of privately-initiated rental housing.
- Potential changes to Federal income tax that could be considered include:
 - Permitting investors to defer capital cost allowances (CCA) recapture and capital gains on the proceeds from the sale of rental property when the proceeds are reinvested within a reasonable time frame in another rental property (the U.S. Federal tax system allows for this);
 - Permitting investors to pool assets, treating more than one asset within a particular class as one unit for depreciation purposes;
 - Permitting all investors in rental housing (and not solely Principal Business Corporations) the chance to deduct CCA losses against other income, as well as to qualify for the “active business income” Small Business Deduction; and
 - Expanding allowable ‘soft costs’ that can be deducted in the first year of operation of new rental properties.

The Provincial Government could consider:

- Removing the size limits intended to create affordable housing from the current Provincial Sales Tax Grant Program. Grants for only 500 units a year will not have a significant impact. The program could be expanded to cover all new rental construction units.

The Provincial Government and Municipal Governments could consider:

- The new Provincial legislation for the same property tax rate for new rental and new ownership residential development could be required for all municipalities, and be made permanent through the removal of the 8-year limit;
- The waiving or reduction of development charges for rental construction, which would have a significant impact on raising the return on project costs; and
- The waiving of Section 37 contributions on new rental housing construction could be considered by the City of Toronto. Section 37 contributions lead to cost increases for new rental housing construction, which in turn raise the required rents to achieve a competitive rate of return.

6 ENHANCING RENTAL HOUSING AFFORDABILITY

The second aspect of the rental housing problem outlined in Chapter 2 is that many renters have insufficient incomes to afford adequate and suitable accommodation.

This chapter discusses how the affordability problem in Ontario is actually an income problem. The current Ontario Rent Supplement Program is discussed, along with options to enhance rental housing affordability.

THE AFFORDABILITY PROBLEM IS REALLY AN INCOME PROBLEM

Provincial and Federal Governments have pulled out of publicly-initiated housing programs in recent years. Since 1996, there have been no publicly-initiated housing starts in Ontario. The required rents for privately-initiated rental starts were shown to be substantially above what the majority of renter households pay in the GTA (see Chapter 4).

The problem is even more severe for renter households in core housing need. Privately-initiated rental housing construction simply cannot be built at rents that will be affordable to households in the lowest income ranges without subsidies or public-private partnership programs.

The filtering process, whereby existing rental units become available as renters move to ownership or higher-quality rental housing (see Chapter 2), is the way the private marketplace provides more affordable housing.

Referring back to Chapter 2, household incomes have not kept up with rent increases and inflation. In fact, average rental household incomes decreased between 1991 and 1996, and since 1996 as well.

Thus, the affordability problem is actually an income problem.

RENTS ARE REASONABLE IN ONTARIO

- In Ontario, about 55 percent of renter households with incomes lower than \$30,000 were paying less than an estimated \$600 per month according to the 1996 Census of Canada (Figure 31). For the GTA, the percentage decreases to about 45 (Figure 32).
- Renter households at higher income levels, above \$50,000 per year, pay higher rents. For example, in the GTA, around 67 percent of renter households with incomes over \$50,000 paid over \$800 per month in 1996 according to the 1996 Census of Canada.
- Rents have increased in Ontario between 1996 and 1999 by about 10 percent in Ontario and about 12 percent in the GTA, but incomes are up as well.

Figure 31

Average Gross Rents and Average Renter Household Incomes, Ontario				
1996 Rents	Ontario Rental Households by Income Range in 1995			
	< \$30,000	\$30,000- \$50,000	\$50,000 and Over	Total
	<i>Households</i>			
Under \$600	422,015	101,830	46,545	570,390
\$600-\$800	217,615	133,885	80,045	431,545
Over \$800	124,240	106,665	159,495	390,400
Total	763,870	342,380	286,085	1,392,335
	<i>Percent</i>			
Under \$600	55	30	16	41
\$600-\$800	28	39	28	31
Over \$800	16	31	56	28
Total	100	100	100	100

Source: Clayton Research based on Census of Canada Custom Tabs, 1996

Figure 32

Average Gross Rents and Average Renter Household Incomes, GTA				
1996 Rents	GTA Rental Households by Income Range in 1995			
	< \$30,000	\$30,000- \$50,000	\$50,000 and Over	Total
	<i>Households</i>			
Under \$600	136,810	29,480	13,970	180,260
\$600-\$800	97,080	64,030	37,675	198,785
Over \$800	71,470	63,905	104,110	239,485
Total	305,360	157,415	155,755	618,530
	<i>Percent</i>			
Under \$600	45	19	9	29
\$600-\$800	32	41	24	32
Over \$800	23	41	67	39
Total	100	100	100	100

Source: Clayton Research based on Census of Canada Custom Tabs, 1996

The data show that rents in the existing stock are, for the most part, quite reasonable. But, there is a large component of renter households in core housing need, who only have an affordability problem (see Chapter 2). New rental construction cannot be built at market rents that will be affordable to renter households with affordability problems, since new purpose-built rental housing is expensive compared to the rents in the existing rental housing stock. Households simply do not have high enough incomes to afford newly constructed private market housing, which have higher rents than the existing stock.

RECENT GOVERNMENT INITIATIVES TO CLOSE THE GAP ARE NOT ENOUGH

In January 2000, the Ontario Government announced the **Rent Supplement Program**.²⁵

- The program is for tenants in private rental units, and the supplement covers the difference between the rent paid by the tenant (based on income) and the full rent of the unit; and

²⁵ A rent supplement program operated in Ontario between 1971 and 1985, through funding by the Federal and Provincial Governments.

- The \$50 million dollar initiative is aimed at providing over 5,000 households with rent supplements, with about 2,700 household supplements allocated to the GTA.

Two concerns exist about the **Rent Supplement Program**:

- The program is not substantial enough to help out a significant number of renter households with affordability problems. With over 196,000 households in core housing need in the GTA alone, the program will only help out a small percentage of households in core housing need; and
- Rent supplement programs can also only be effective in an environment where there is sufficient housing supply, which is not the current environment in Ontario. Rent supplement programs should be enacted at the same time as measures to increase the returns for new rental housing construction.

EXPANSION OF THE RENT SUPPLEMENT PROGRAM OR A SHELTER ALLOWANCE COULD HELP BRIDGE THE GAP BETWEEN MARKET RENTS AND AFFORDABLE RENTS

By expanding the current Provincial Government's **Rent Supplement Program** or introducing a shelter allowance, the gap between market

rents and rents affordable to households in core housing need could be bridged for a greater number of households.

The United States has had success with the Section 8 Vouchers that bridge the gap between low-income rents and approved project rent in existing units (See Chapter 4). The program has been active at the same time as other rental housing incentives, and as privately-initiated rental housing completions have been on the rise.

CHAPTER SUMMARY

The affordability problem for renter households in Ontario is an income problem, whereby incomes are too low relative to market rents. To further address the gap between what renter households with affordability problems can afford to pay and market rents, the Provincial Government could consider expanding the current **Rental Supplement Program** or introducing a shelter allowance.

APPENDIX

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Appendix