



CBI POLICY PAPER

Making Cents of Ontario's Rent Regulation:

Assessing the Financial Impact of Rent Control and Developer Incentives

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The provincial government recently announced its Fair Housing Plan¹, a suite of measures meant to help protect housing affordability in Ontario. A key component is the new Rental Fairness Act², which, among other changes, extends rent control to all rental units in Ontario. The new rules aim to protect

1. Ontario Government (2017). Ontario's Fair Housing Plan. Available at: <https://news.ontario.ca/mof/en/2017/04/ontarios-fair-housing-plan.html>

2. Ontario Government (2017). News Release: Ontario Introduces Bill to Protect Tenants from Unfair Rent Increases. Available at: <https://news.ontario.ca/mho/en/2017/04/ontario-introduces-bill-to-protect-tenants-from-unfair-rent-increases.html>

tenants from unfair rent increases and to create a healthier and more stable housing environment for those who cannot afford to purchase a home in an increasingly expensive real estate market.

While the Fair Housing Plan has introduced measures to help protect current tenants the long-term success of the plan will require that developers remain motivated to build new rental supply, ensuring future residents can find a suitable and affordable place to live. Ultimately, the incentives put in place must offset the risks and costs taken on by rental building owners via the re-introduction of rent control.

In the weeks leading up to the Fair Housing Plan, and even the day following it, many raised concerns that introducing any form of rent control on units built after 1991 would harm our rental market^{3,4}.

3. McFarland, Janet (2017). 'Exact opposite of what is needed': CIBC slams Ont. rent-control rules. *The Globe and Mail*, April 4, 2017. Available at: <http://www.theglobeandmail.com/real-estate/toronto/new-ontario-rent-control-rules-exact-opposite-of-what-is-needed-analyst-warns/article34569276/>

4. Gee, Marcus (2017). Rent control isn't the solution to Ontario's housing problem. *The Globe and Mail*, April 19,

While these concerns are valid, Ontario’s own history with rent control suggests that factors other than rent control have had a significant influence on the rental market.

Rent control was previously applied to all rental units in the Province until 1992, when it was eliminated for new buildings with the hope that this change would spur new purpose-based rental construction. From 1992 through 2016, an average of 4,000 new purpose-based rental units were built in Ontario per year—a decline from the years preceding the elimination of rent control (see figure 1). Instead, over this period, condo construction boomed and the number of condos on the rental market increased. While this did increase the number of rental units available, condos do not offer an equal substitute for purpose-built rental; condos offer less stable long-term tenancy since condo tenants are more easily evicted due to resale, Ontario’s “landlord’s own use provision”, and renovations⁵.

The fact that the amount of purpose-based rental construction decreased after rent control was eliminated suggests that other factors, such as

market demand, property taxes, development charges and other fees, and land costs are also having significant impacts. The Province’s Fair Housing Plan addresses some of these factors.

Second Generation Rent Control

When discussing Ontario’s rent control regulations it is important to understand the full details of the program. Ontario’s rent regulations do not put a hard cap or freeze on rent, instead they tie annual rent increases to inflation. Above-inflation increases can be approved for unusually high property tax increases and for capital expenses including repairs, renovations, and replacements⁶. Further, when vacant between tenants, rents can be increased back to market rates. Rent control programs with features such as these that help protect landlords from some risk and permit regular rent increases are often referred to as “second generation” rent control or tenancy rent control⁷. Economists view these programs differently than strict rent control programs and there is an argument that such rent control programs can be beneficial⁸.

An economic study from Manitoba assessed its rent regulations, which are similar to Ontario’s own⁹. It found that well-designed rent regulations can improve the stability of tenants and market efficiency. Further, the study found no evidence that

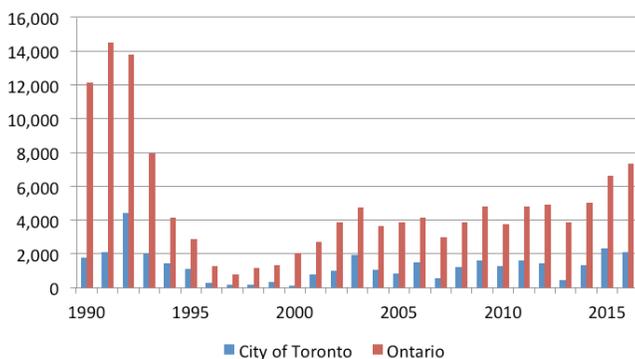


Figure 1: Annual Rental Market Starts City of Toronto and Ontario (data from CMHC)

2017. Available at: <http://www.theglobeandmail.com/news/toronto/rent-control-isnt-the-solution-to-ontarios-housing-problem/article34753102/>

5. Cardoso, T. and Gray, J. (2017). Rent asunder: Landlords using evictions, hikes to circumvent rent control, Toronto tenants say. *The Globe and Mail*, March 24, 2017. Available at: <http://www.theglobeandmail.com/real-estate/toronto/toronto-rental-landlord-eviction/article34414723/>

6. Community Legal Education Ontario (2016). Increases Above the Guideline. Available at: <http://www.cleo.on.ca/en/publications/rentincs/increases-above-guideline>

7. Arnott, Richard (2003). Tenancy Rent Control. *Swedish Economic Policy Review*, 10 (2003), 89-121. Available at: <http://www.government.se/49b73b/contentassets/6e57e1d818bb4b289ac512bb7d307fa5/richard-arnott-tenancy-rent-control>

8. Arnott, Richard (1995). Time for Revisionism on Rent Control. *Journal of Economic Perspectives*, 9 (1), 99–120. Available at: <http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.9.1.99>

9. Grant, Hugh (2011). An Analysis of Manitob’s Rent Regulation Program and the Impact on the Rental Housing Market. Available at: http://www.gov.mb.ca/cc/pubs/rental_report

Manitoba's rent regulations have unduly restricted the rate of rent increases, nor has the program had a negative impact on rental supply.

Providing Benefits to Renters and Building Owners

With demand for rental units in Ontario on the upswing as house prices climb, it is important to seize this momentum and provide developers with the tools needed to support ongoing development of new purpose-built rental buildings. To this end, it is important to understand the impact of rent control and the Province's incentives.

These incentives include changing property tax regulations so that new apartment buildings will be taxed at the residential rate rather than the commercial rate. Many municipalities, such as Toronto and Hamilton, have already made this change. But for those that have not, like Peel Region, it will improve the annual financial performance of new apartments.

Additionally, the Province is offering \$125 million in development charge rebates to reduce the upfront costs for rental projects in areas of high demand throughout Ontario. Details of this program have not yet been announced. Finally, the Province has committed to unlocking provincial land for rental and market supply, which could further reduce up-front costs for new rental projects.

Our analysis, using data from Toronto's rental market, found that in the absence of these incentives, the 25-year income expectation for a rent controlled apartment was 98.5 per cent of that for a non-rent controlled apartment, with similar income in all years.

Some context for this analysis—according to Toronto Real-Estate Board data, the average rent for one-bedroom condos has increased by 2.29 per cent per year on average since 2004^{10 11}. Over the same

10. Toronto Real Estate Board (2017). Rental Market Report: Fourth Quarter 2016. Available at: http://www.trebhome.com/market_news/rental_reports/pdf/rental_report_Q4-2016.pdf

11. Toronto Real Estate Board (2005). Rental Market

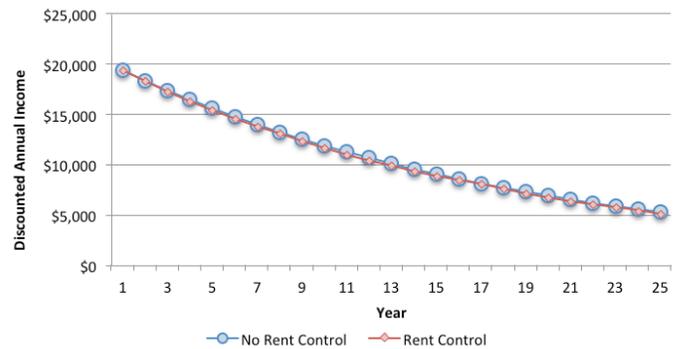


Figure 2: Expected Annual Income Per Unit - Rent Control vs. No Rent Control

period, the effective annual Ontario rent guideline increase was 1.85 per cent¹². Finally, Toronto's rental turnover is 16 per cent¹³.

While the non-rent controlled apartment will earn slightly more rent, the rent controlled apartment keeps up due to similar rent increases achieved over the past 10 years, and the fact that when rent controlled units turn over they can catch up to market rates.

While the financial performance is similar with rent control in place, landlords and developers are likely to be concerned about the transfer of additional risk. For example, if costs rise and they are not able to raise rents in a timely manner. Or low turnover in their apartments, which would keep rents lower, harming financial performance. To ensure that developers are motivated to build new rental buildings it will be important to have appropriate incentives in place that balance these new costs and risks.

Report: An Analysis of January 1, 2004 - December 31, 2004. Available at: http://www.trebhome.com/market_news/rental_reports/pdf/rental_report0501.pdf

12. Government of Ontario (2017). Ontario Rent Increase Guideline. Available at: <https://www.ontario.ca/page/rent-increase-guideline>

13. Gadon, Sean (2017). Rental Housing Update; Presentation to Affordable Housing and Tenant Issues Committees. City of Toronto. Available at: <http://www.toronto.ca/legdocs/mmis/2017/td/bgrd/backgroundfile-102563.pdf>

Rental Pro Forma Assumptions

To keep things simple, this analysis only considers the things that are changing under Ontario's new rules for Toronto to determine the net impact to new rental building owners. We looked at how expected rental income would change based on the new rules. We have used a value of \$2,500 for the development charge rebate—although, as previously noted, details have not yet been announced for this program. Finally, the impact of the change to property tax rules were not examined since they vary from municipality-to-municipality, and in many cases municipalities (e.g. Toronto and Hamilton) have already made the required changes.

Here are the main assumptions in our work:

- 2017 rent of \$1,800 per unit, in line with going rates for one-bedroom units on MLS¹⁴.
- Annual rent controlled increases of 1.85 per cent based on annual increases since 2005¹⁵.
- Annual non-rent control increases of 2.04 per cent: Between 2004 and 2016 (Q4) rent for one-bedroom condos rose from \$1353¹⁶ to \$1776¹⁷, equivalent to a 2.29 per cent per year increase.
- When a rent control unit turns over it resets to market rent.
- 16 per cent unit turnover based on City of Toronto information¹⁸.
- Each turned over unit is vacant for one month;

14. Toronto Real Estate Board (2017). Rental Market Report: Fourth Quarter 2016.

15. Government of Ontario (2017). Ontario Rent Increase Guideline.

16. Toronto Real Estate Board (2005). Rental Market Report: An Analysis of January 1, 2004 - December 31, 2004.

17. Toronto Real Estate Board (2017). Rental Market Report: Fourth Quarter 2016.

18. Gadon, Sean (2017). Rental Housing Update; Presentation to Affordable Housing and Tenant Issues Committees.

this leads to an expected annual vacancy rate of 1.33 per cent, in line with the Toronto average¹⁹.

- A development charge rebate of \$2,500 applied two years before rent collection begins. This would allow the Province to fund 10,000 units/year over the next five years.
- Discount rate of 8.0 per cent. This discount rate was used for concrete apartments in a report commissioned by the City of Mississauga and Region of Peel²⁰.

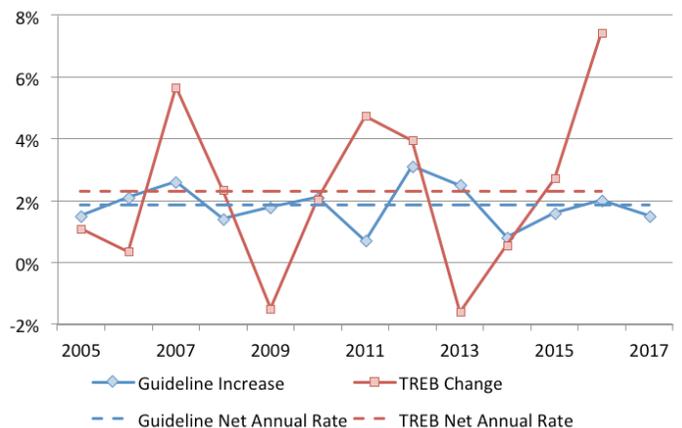


Figure 3: Annual Rent Increases (2005-2017) 1-Bedroom Condos vs. Ontario Guidelines

Financial Analysis Results

To understand the effects of the new rules, we simulated the performance of a hypothetical new 13-unit building 25 different times under both the new rules and old rules over a 25-year period. For each simulation unit, turnover was randomly distributed across all units and years.

In more complicated terms we carried out a small Monte Carlo simulation randomly distributing unit turnover—under this simulation there are years

19. CMHC (2016). Rental Market Report: Greater Toronto Area. Available at: https://www.cmhc-schl.gc.ca/odpub/esub/64459/64459_2016_A01.pdf?fr=1492712902881

20. N. Barry Lyon Consultants (2016). Affordable Housing Program: Understanding the Cost of Incentives. City of Mississauga, Region of Peel. Available at: <https://www7.mississauga.ca/documents/pb/main/2016/appendixoneOct2016.pdf>

where buildings may have no turnover, and other years where turnover will be above 16 per cent; scenarios that include units which turnover regularly and units which do not turnover at all. By generating a number of random simulations we are able to understand the range of probable outcomes.

It is important to note that our analysis applies to an “average” apartment as defined by the factors in the assumptions section—for units outside of this average, our financial analysis may not apply. For example, in buildings with low turnover, or where higher rental increases have been achieved or are planned for, the impact of the new rules would be more significant than we have found.

The analysis shows that while rent control will have an impact on revenue, the impact is small based on the expected increases in rent under both scenarios. In all of the simulations the discounted cumulative income earned by the rent controlled building was between 98.5% and 99.0% of that earned by the non-rent controlled building.

Including the development charge rebate brings the two scenarios even closer together. The rent controlled building earned between 99.4% and 99.9% of that earned by the non-rent controlled building. Overall, the long-term benefit of the development charge rebate is small, but it does make a difference in the early years.

If we assume annual rental increases of 3 per cent for the non-rent controlled apartment, instead of the 2.29 per cent achieved, the new rules will have more of an impact. In this situation, the rent controlled apartment would earn 95.9 per cent to 97.9 per cent of what it would have earned without rent control after accounting for the development charge benefit. Under this scenario there may be concerns about projects remaining financially viable.

In municipalities such as Peel Region, where multi-unit residential buildings are currently charged a higher property tax rate (0.66 per cent versus 0.41 per cent), there are more financial benefits. In these municipalities the Province’s requirement to align property tax rates will lead to annual cost savings

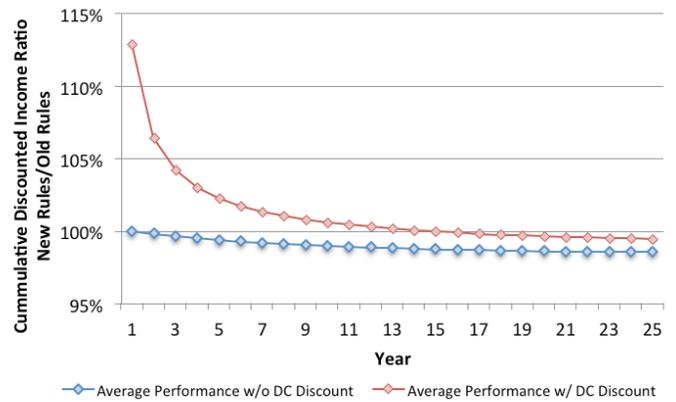


Figure 4: Cumulative Discounted Income Ratio

benefiting building owners, further improving pro formas.

With the financial performance of apartments being similar with and without rent control, and the new development charge rebates offering an immediate financial bonus, there should be optimism that major rental developments such as Toronto’s Mirvish Village project will remain financially viable.

Benefits of New Purpose-Built Rental Supply

With no immediate Federal funding for affordable housing²¹, Ontario’s Fair Housing Plan carries even more importance. Building new rental supply, and driving vacancy rates back up to healthy levels (at least 3 per cent²²), will help ensure that new renters of all incomes will have access to more suitable and more affordable options. Without new supply and healthier vacancy rates, the market will remain restricted and increasingly competitive²³.

21. Hulchanski, David (2017). Trudeau’s housing spending is smoke and mirrors. *Spacing*, April 5, 2017. Available at: <http://spacing.ca/national/2017/04/05/hulchanski-trudeaus-housing-spending-smoke-mirrors/>

22. The Wellesley Institute (2010). Precarious Housing in Canada. Available at: http://www.wellesleyinstitute.com/wp-content/uploads/2010/08/Precarious_Housing_In_Canada.pdf

23. Bula, Frances (2016). High rent and low vacancy are squeezing renters in Canada’s largest cities. *The Globe and Mail*, July 11, 2016. Available at: <http://www.theglobeandmail.com/news/british-columbia/rent-series->

Spurring new purpose-based rental activity will also help reduce our reliance on the secondary rental market—units owned by individuals rather than commercial landlords. In the absence of significant new purpose-based rental activity over the past two decades, we have increasingly relied on the secondary market, condos in particular.

The secondary market offers less secure tenancy making it less attractive for long-term renters. In specific, tenants in the secondary market are more easily evicted as a result of renovations, resale, and the “landlord’s own use” provision. The issue is compounded by concerns that the “landlord’s own use” provision has been abused in some circumstances²⁴. Moving away from this form of supply towards new purpose-built rentals will be a positive step for the housing stability of Ontario tenants.

Getting Ontario’s Rent Regulations Rights

Extending rent control in Ontario comes with immediate benefits for current tenants. Ensuring benefits are extended to future tenants is more complicated. Analysis shows that rent control will lead to some revenue loss for building owners. Additionally, with the re-introduction of rent control, developers are taking on added risk. To ensure rental construction remains attractive, the Province may want to consider additional incentives such as:

- Providing more details around the development charge program and committing to extending it beyond the next five years.
- Considering above inflation rent increases (e.g.

inflation +1 per cent or 2 per cent) in some market segments (e.g. luxury apartments, apartments above a certain price threshold).

- Offering other financial incentives for new rental buildings (e.g. property tax incentives).
- Offering exemptions from Section 37 fees and/or Section 42 parkland contributions.
- The Province may want to consider targeting some incentives towards specific rental market sectors, such as family-sized units, to ensure they remain viable and attractive to developers.

While the Fair Housing Plan and Rental Fairness Act offer some immediate benefits for today’s tenants, long-term success will be judged based on the Province’s ability to maintain a healthy rental market by working with developers to spur new rental construction where and when it is needed.

[part1/article30832544/](#)

24. Balkisoon, Denise (2014). When the landlord asks for your apartment back. The Globe and Mail, October 10, 2014. Available at: <http://www.theglobeandmail.com/news/toronto/how-the-hot-housing-market-is-leaving-renters-in-the-cold/article21059114/>

