



greater victoria
coalition to end
homelessness

hope has found a home

An Analysis of Policy Incentives to Encourage Private Sector Investment in
Affordable Rental Housing

Prepared for: The Greater Victoria Coalition to End Homelessness

and

The University of Victoria School of Public Administration

ADMN 598 Policy Report

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EXECUTIVE SUMMARY

This report was undertaken for the Greater Victoria Coalition to End Homelessness (GVCEH), and aims to examine and evaluate public policy measures that could be used to incentivize increased private sector investment in affordable rental housing. Specifically, the objective of this research was to produce:

- A summary of federal, provincial (British Columbia) and municipal (CRD) policy incentives and disincentives for private sector investment in affordable rental housing in Greater Victoria.
- A summary of best practice policy and legislation from other jurisdictions.
- An analysis of the relative costs to the public to house, and not house, homeless people in the Capital Region, including public policy recommendations relating to private sector investment in affordable rental housing.

The findings of this report suggest that there are a number of potential policy options that could increase private sector investment in affordable rental housing and that these measures appear to be more cost-effective than managing the effects of homelessness.

Current Incentives and Disincentives

Some government policies, particularly at the local level, help support the private affordable rental market. These policies include inclusionary zoning policies, density bonuses, secondary suite policies and partial GST rebates. Some of the policies acting as a barrier to affordable rental housing include the current capital cost allowance provisions, capital gains taxes, the small business deduction, the few allowed soft cost deductions and high parking requirements in many jurisdictions.

Jurisdiction Scan

The purpose of the jurisdiction scan was to provide a basis for comparing the current incentives and disincentives in the CRD to other relevant jurisdictions as well as to expand the list of possible smart practices that could be used to incent more private investment in affordable housing. The scope of this scan included jurisdictions across North America, Western Europe, New Zealand and Australia.

Across the surveyed jurisdictions, it was generally found that:

- Rising housing costs and affordability issues are present in most areas
- Most governments have favoured policies that encourage more homeownership
- Governments have favoured demand-side housing policies for the last fifteen years, although some attention is beginning to return to supply-side policies

More specific policies used elsewhere include:

- Low income housing tax credits, which feature prominently in the United States, Australia, France and Germany
- Accelerated depreciation rates for rental buildings which are used in Germany, France, Australia and New Zealand
- Favourable capital gains policies that support the rental markets in Ireland, the United Kingdom, the Netherlands, New Zealand, Australia and the US
- Inclusionary zoning policies, used frequently in local, regional and national jurisdictions across North America, Australia and Europe

Current Cost of Homelessness

To help evaluate the potential policy options, an accurate estimate of the cost of homelessness was desired. Ten cost-benefit and cost-effectiveness studies were reviewed to determine what the cost is to government for each homeless individual per year. From the point of view of the budgets of the governments of Canada, the cost of homelessness is estimated to be between \$35,548 and \$47,397 per homeless individual per year.

Policy Analysis

Twelve policy changes were analyzed to determine their potential effects on the private sector development of affordable rental housing. To varying degrees they were all determined to be beneficial to affordable housing, although the following measures were deemed to have the most value:

1. Increasing the Capital Cost Allowance (CCA) depreciation rate and allowing transferability of losses would improve profitability on its own, and increase the effectiveness of many other tax-expenditure based plans.
2. Allowing the rollover of capital gains taxes and recaptured CCA would not only greatly improve building owners' short term finances it would also increase liquidity in the market and encourage new investors to enter.
3. Expanding the list of soft costs that can be immediately deducted from income for tax purposes would moderately improve building profitability during the construction phase.
4. A low income housing tax credit (LIHTC) plan is a Federal investment that can have a major impact on low income housing. Lessons learned from Canadian, US and Australian experiences can help ensure a Canadian LIHTC could be efficient and effective.
5. Encouraging local governments to relax parking restrictions would greatly improve affordable rental building profitability without public sector cost. This is also one of the few planning levers that could impact affordable housing in the CRD that has not already been greatly pursued in many municipalities.

Conclusions

The findings of this research indicate that there are policies that can incent more private sector involvement in the provision of affordable housing. The priorities mentioned above should be pursued by the appropriate governments, to help ease both the current housing affordability issue and the incidence of homelessness. While many of these actions would transfer certain costs to taxpayers, paying for these increases is more cost-effective than simply managing the effects of homelessness.

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INTRODUCTION

This research is undertaken for the Greater Victoria Coalition to End Homelessness (GVCEH), a strategic alliance between governments, non-profit organizations and the private sector arising from the recommendations of the Victoria Mayor's Task Force report on Homelessness. The GVCEH recognized that while government accepts the primary burden in developing and maintaining housing options for affordable rental housing, there is an opportunity for the private sector to help as well. The purpose of this report is to review research of federal, British Columbia and municipal (within the CRD) public policy incentives and/or disincentives to private sector investment in the development of low cost rental housing. The report includes:

- A summary of federal, provincial (British Columbia) and municipal (CRD) policy incentives and disincentives for private sector investment in low cost rental housing in Greater Victoria.
- A summary of best practice policy and legislation from other jurisdictions.
- An analysis of the relative costs to the public to house, and not house, homeless people in the Capital Region, including public policy recommendations relating to private sector investment in low cost rental housing.

The analysis focuses exclusively on government policies that can positively impact the residential private sector supply of rental accommodations. While demand-side policies (such as rental assistance, income supplements and employment policies) would also have an impact on rental unit supply, this effect would be much more indirect and therefore more difficult to effectively analyze. Also, the housing market in the Capital Regional District is characterized by very low vacancy rates, which make demand-side policies much less effective. Finally supply responses to changes in demand tend to lag far behind these changes (MacLennan, 2008a). The issues of homelessness and housing affordability carry an immediacy that suggest measures that will change the situation over the next few years are needed along with measures that will have that have an effect over the long term. So the focus on supply policies reflects the fact that the GVCEH is concerned with having an impact on homelessness as soon as possible.

After reviewing the current incentives and disincentives and examining the policy responses in other jurisdictions, twelve potential policy options were selected for analysis that could be used to incent more private sector investment in affordable housing. These policy options include:

1. Increasing the Capital Cost Allowance (CCA) rate from 4% to 5%
2. Allowing rental investors to use the CCA to create income losses for tax purposes
3. Allowing for the rollover of capital gains taxes when the proceeds of a building sale are re-invested in the rental market
4. Allowing landlords access to the small business tax deduction
5. Expanding the list of "soft-costs" that can be deducted from income during building construction

6. Expanding the current GST rebate to refund all GST paid during building construction
7. Creating a low-income housing tax credit scheme
8. Expanding the use of inclusionary zoning policies in local jurisdictions
9. Expanding the use of density bonuses in local jurisdictions
10. Lowering the required number of parking spaces for rental buildings
11. Donating surplus government land for affordable rental housing developments
12. Encouraging more secondary suites in local jurisdictions

The next section of the report discusses the methodology used to produce the literature review and analysis, followed by a section that discusses the current housing and homelessness context within Greater Victoria. Next, current policy incentives and disincentives are discussed and summarized. The jurisdiction scan then expands this to examine policy incentives that are used successfully across North America, Europe, Australia and New Zealand. To put this discussion in context, a current cost of homelessness is found by reviewing relevant cost-effectiveness and cost-benefit analyses. The twelve potential policy options are then evaluated to determine their promise in incenting new private sector development of rental housing. Finally, the report concludes and provides recommendations for future action.

METHODOLOGY

This report primarily relies on a targeted literature and document review. This report begins with a review of housing policies at the federal, provincial (B.C.) and municipal (CRD) levels. The jurisdictional scan expands this search to include reports written for other national and regional housing authorities. For this scan, particular focus is given to: Canadian provinces and municipalities, the United States, Western Europe, Australia and New Zealand. Although there may be other smart practices taken from other jurisdictions, these jurisdictions are the most similar to Canada and the CRD in terms of their political systems and culture.

This report also reviews the literature on the current cost of homelessness to the taxpayer, to help inform the analysis of recommended options. This estimated cost is presented alongside the estimated costs for potential policy options to show the relative financial impacts of each course of action. More recent literature was desired in most cases, so only reports written in the last 20 years were reviewed (with a preference for literature from the last ten years). Sources of literature were confined to primarily academic (peer-reviewed) journal articles, grey literature from government and non-government housing authorities and websites from government and non-government housing authorities. Again, this literature was confined to articles written in North America, Western Europe, New Zealand and Australia. This was consistent in scope with other international housing studies found that dealt with housing and homelessness issues (such as Berry, Chamberlain, Dalton, Horn, and Berman (2003), Culhane, Gross, Parker, Poppe, and Sykes, (2008), Hofer and Gurstein (2009), Lawson and Milligan (2007), Maclennan (2008a), Maclennan (2008b) and the Metro Vancouver Policy and Planning Department, (2007)).

BACKGROUND

Currently, governments carry a significant financial burden for homelessness in the form of expensive emergency medical and ambulance services, operating homeless shelters, and providing policing, justice and incarceration services. However, research shows that providing housing for those who are homeless is less expensive to government than not providing housing (i.e.: solving homelessness is cheaper than managing homelessness) (Eberle, Kraus, Pomeroy, & Hulchanski, 2001; M. Patterson, Somers, McIntosh, Shiell, & Frankish, 2008). The GVCEH believes that there are public expectations that government should pay the majority of costs to create and maintain low cost rental housing. Although governments accept this role, they are looking to the private sector to develop affordable housing in partnership with them.

To help address this issue, the GVCEH has sought research of federal, provincial and municipal (within the CRD) policies which actually provide incentives and/or disincentives to private sector investment in the development of low cost rental housing. Also desired was research on similar policy in other jurisdictions as a reference point for comparison and an understanding of best practice. Finally, the GVCEH required an analysis of all the costs to the taxpayer, including emergency and intervention services required to manage the effects of homelessness, along with analysis of potential policy recommendations that could incent more private sector investment in affordable rental housing.

Depending on the outcome of the research, it was believed that this knowledge could be used to inform senior government staff and elected officials that new public sector investment in low cost rental housing, and possible revision to tax policy which incents private sector involvement, would reduce the costs to governments and the taxpayer.

This section describes the current housing situation in Greater Victoria, and discusses some of the pressures contributing to the shortage of affordable housing. The housing public policy context is then discussed, explaining the role governments have played in the housing market and the social housing sphere over the last few decades. Finally the discussion turns to the relationship between housing affordability and homelessness.

CURRENT HOUSING SITUATION IN GREATER VICTORIA

According to the latest Demographia International Housing Survey, Victoria is listed as the seventh most unaffordable housing market in the world (Cox & Pavletich, 2009). Furthermore, this market has been recently characterized by a net loss in rental housing units. In 2008 alone there was a net loss of 108 rental housing units in Victoria (The Victoria Foundation, 2009). This is largely due to conversions or demolitions of older rental buildings with very little replacement of the lost housing.

The current stock of affordable rental housing is influenced by a number of factors, including: the availability of labour, market demand, the cost of building materials, government subsidies, tax treatment, cost and affordability of credit, demographics and local employment (Gurstein &

Hofer, 2009; Lawson & Milligan, 2008). The actual cost of producing a rental housing unit comes down to a combination of two factors: the construction costs of building the unit and the cost of the land it sits upon. The increasing cost of land in Victoria is, therefore, one of the key factors driving up the cost of housing. Figure 1 displays the relative costs of the land and house construction in Victoria between 1981 and 2009. During this time period the cost of constructing the house has declined by more than 50%, while the average cost of land has more than doubled.

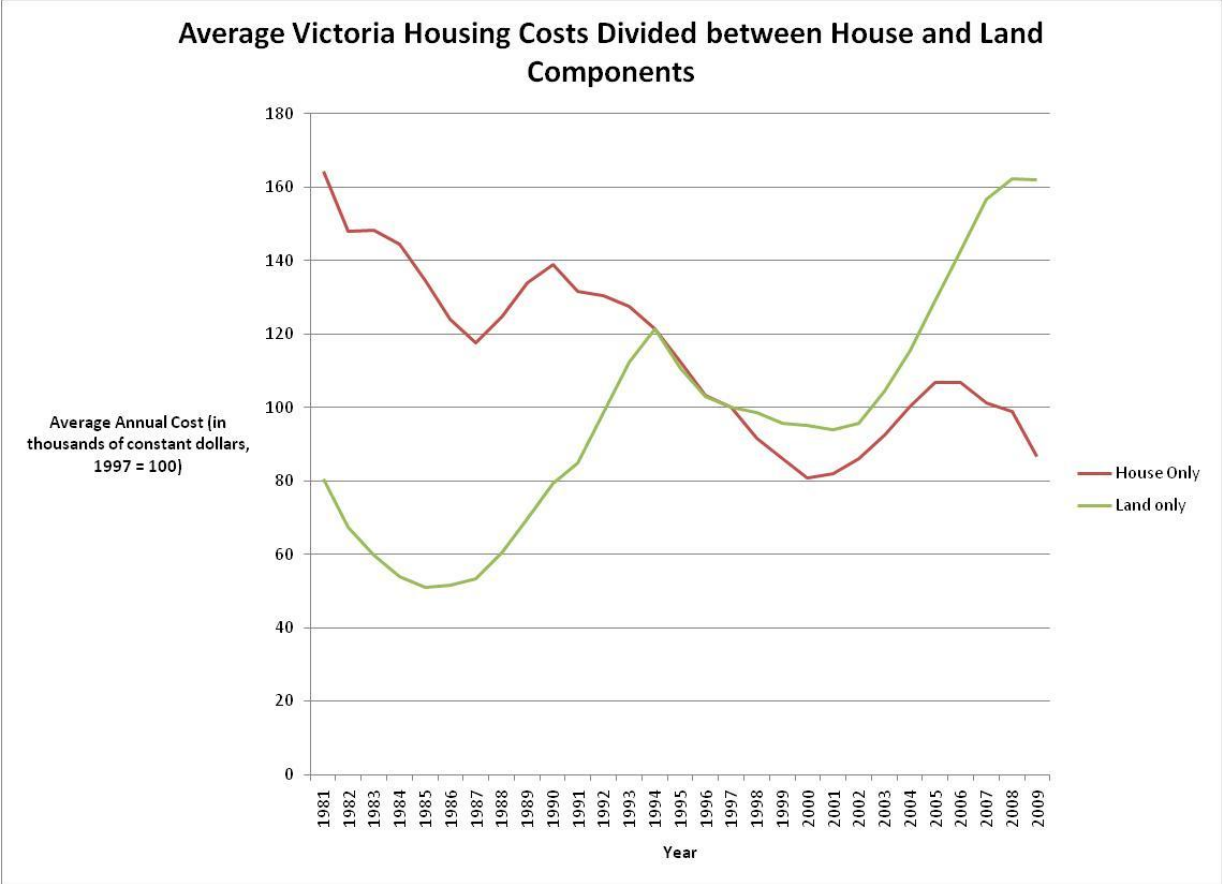


FIGURE 1: AVERAGE HOUSING COSTS IN VICTORIA DIVIDED BETWEEN HOUSE AND LAND COMPONENTS. SOURCE: (STATISTICS CANADA, 2010).

This would suggest that housing affordability in Victoria is strongly linked to the increasing cost of land. So to effectively reduce the cost of housing in Victoria, policymakers will likely have much more success if they can reduce the land costs and more limited success if they only focus on reducing the building’s capital costs.

Housing investment is also very much linked to the business cycle, which is the variation within the economy associated with periods of expansion and recession. Davis and Heathcote (2005) developed a model that shows that investment in residential property is much more sensitive to changes in the business cycle than investment in non-residential property. This model also shows that “consumption, non-residential investment, residential investment and GDP all co-move positively” (Davis & Heathcote, 2005 p. 753). What this means is that the business cycle is one

of the most influential determinants of fluctuations in the housing market. This is why Drummond (2004) argues that housing and homelessness must be viewed within the wider macroeconomic context.

Rental housing production in Victoria has declined significantly in the recent past. Figure 2 shows the rates of rental unit starts since 1991 in Greater Victoria.¹ As can be seen, there is a general trend towards far fewer rental units being created over the last two decades, relative to the number of condominiums and freehold units. This has become worse in recent years, with the market producing over 100 new rental units in only three of the last twelve years. One factor playing a role in this rise of ownership housing is population demographics. As baby boomers reach the 45 – 54 age group they tend to maintain their highest level of homeownership. Over thirty per cent of Canada’s population is made up of baby boomers, and they entered this 45 to 54 age group in the 1996 to 2006 period (Canada Mortgage and Housing Corporation, 2009). The Canada Mortgage and Housing Corporation (CMHC) points to population aging as one of the key factors that has driven up homeownership over other tenures, although admits that this is likely now past its peak. They predict that in the coming decades, the growth in renter households will begin to rise again relative to the 1996 to 2006 period (Canada Mortgage and Housing Corporation, 2009).

¹ This data includes “dwelling units in new structures only, designed for non-transient and year-round occupancy.” CMHC defines a “dwelling unit” to be “a structurally separate set of self-contained living premises

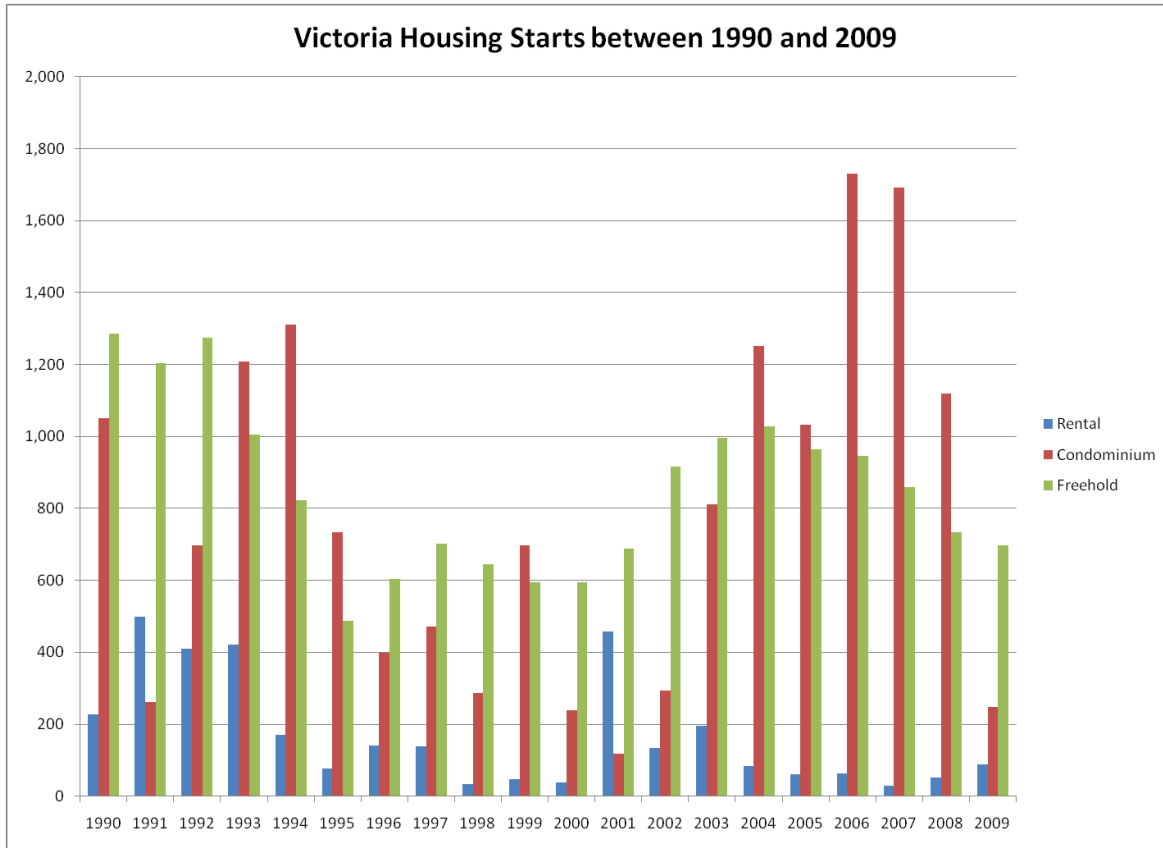


FIGURE 2: RENTAL UNIT STARTS IN GREATER VICTORIA, 1990 TO 2009. SOURCE:(CANADA MORTGAGE AND HOUSING CORPORATION, 2009; CANADA MORTGAGE AND HOUSING CORPORATION, 2010).

Figure 3 shows the average vacancy rate in Victoria, British Columbia and Canada between 1992 and 2008. Over this same period of declining construction of new rental units, the average vacancy rate has also steadily decreased. The 2009 Victoria Vital Signs report suggests that the 2009 vacancy rate is beginning to creep back up towards 1%, but this is still well below the 3% rate that experts say is needed for a healthy market (Federation of Canadian Municipalities, 2008; The Victoria Foundation, 2009).

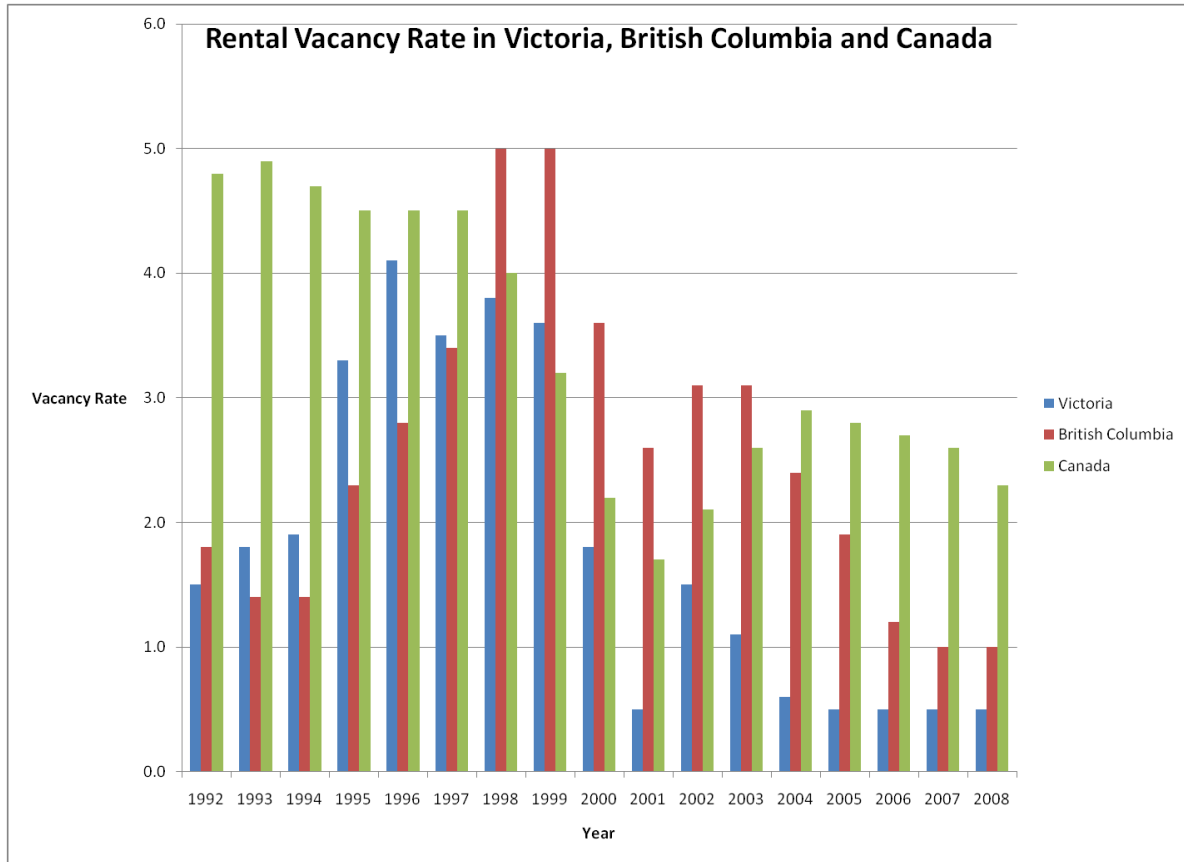


FIGURE 3: RENTAL VACANCY RATE IN VICTORIA, BRITISH COLUMBIA AND CANADA FROM 1992 TO 2008. SOURCE: (CANADA MORTGAGE AND HOUSING CORPORATION, 2009).

Both the low levels of purpose-built rental buildings and the low vacancy rate put an upward pressure on rents, as competition is increased for units that are more scarcely available. This effect is invariably felt more at the lower end of the market, where rental rates begin to climb out of reach for many in the community (Copas & Cumming, 2009b; Snow, 2008). Even when a household can manage to keep paying the rent, housing affordability continues to exert a negative influence. As affordability pressures increase it leaves less household income that can be devoted to cover food and clothing costs. Because shelter is a fixed cost, this means that families under housing stress must often simply do without (Gurstein & Hofer, 2009).

Figure 4 shows the trend in average rents (measured in constant 2002 Canadian dollars) charged between 1992 and 1998 for a two bedroom apartment in Victoria (and in British Columbia and across Canada for a comparison). All three jurisdictions show a steady increase in the average real rental rate since 1999. The authors of the *2009 Victoria Vital Signs Report* state that due to factors such as the rise in average rents and the fall of vacancy rates, housing affordability has become the primary concern they have with the status of the community (The Victoria Foundation, 2009).



FIGURE 4: AVERAGE MONTHLY RENT FOR A TWO BEDROOM APARTMENT IN VICTORIA, BRITISH COLUMBIA AND CANADA BETWEEN 1992 AND 2008. SOURCE: (CANADA MORTGAGE AND HOUSING CORPORATION, 2009).²

Despite the decline in the current stock, rental housing is still very important to the socioeconomic framework of modern cities. There is substantial evidence that demonstrates that housing costs contribute to the choices people make when migrating within a country (Maclennan, 2008a). Although purchase prices may play a bigger role, rental housing rates do affect a city's ability to attract workers, professionals and industries. In a globalised world, cities must compete internationally to attract the best and the brightest employees and businesses. A lack of suitable housing within a region can severely hurt the competitiveness of a city (McClanaghan, 2009). Furthermore, high housing costs add to the cost of living, which means businesses will often have to raise wages accordingly to adequately compensate employees, further impacting competitiveness. Having workforce housing that is affordable, adequate and

² Rent in constant dollars (2002 = 100) deflated using the CANSIM Table 3260021 (Consumer price index 2005 basket, annual). Average rents in Canada were deflated using series V41693350 (Canada, Rent) and average rents in BC and Victoria using series V41694795 (British Columbia, Rent).

nearby helps to reduce employee absenteeism and helps increase worker productivity (Allan, 2004). Rental units are also needed for housing a region's essential workers. Industries such as tourism, retail and hospitality, as well as essential service providers such as teachers, police and healthcare workers all rely heavily on the "intermediate housing" sector, which encompasses low-to-moderate income housing (Allan, 2004; Gurstein & Hofer, 2009). The trend towards favouring homeownership for this sector can also be inefficient for regional labour mobility. Buying and selling real estate is costly and time-consuming and can tend to discourage workers from relocating for better opportunities (Böheim & Taylor, 1999).

HOUSING POLICY IN CANADA

Hulchanski (2004) describes the history of social housing provision in Canada as having four general eras. The first lasts up until 1964 and is characterized by no significant government involvement in the housing sector. The second era (1964-1984) is characterized by a strong commitment to social housing as it fit within the wider social safety net. The third era (1985-1993) saw a steady decline in funding for housing assistance, culminating in the full federal withdrawal from social housing in 1993. From 1994 to present, Hulchanski contends that the government has reverted to a pre-1964 model, with virtually no federal involvement in social housing. Instead the responsibility has been turned over to the provinces. This could be beginning to shift once again, as Canada's Economic Action Plan dedicates federal funding for a number of affordable housing initiatives, including social housing renovations and retrofits, new housing units for seniors and persons with disabilities and First Nations housing projects (Department of Finance Canada, 2009).

Beginning in 1985 the federal government began negotiating cost-sharing agreements with each province to provide housing for those people in the most housing need. By 1994 the federal responsibility had again shifted, and commitments to off-reserve social housing were replaced with funding arrangements that left the provision of housing to the provinces (Snow, 2008). Another major shift was the transition from the Canada Assistance Plan (CAP) to the Canada Health and Social Transfer (CHST). Under the previous CAP, funding was provided to provinces so they could manage shelter allowances and social security. Provinces were legally required to adequately provide those shelter and social services to low-income people, or the CAP funds would be withheld. When this was replaced with the CHST the social requirements for funding were dropped, and provinces were given the freedom to spend how they saw fit (Porter, 2004).

Market housing policy has also undergone a number of shifts since the early 1970s that have led to much less rental housing construction. The first important change was legislation in the early 1970s that made condominiums legal. Prior to this land was either zoned for low density ownership or high density rental property. Allowing condominiums offered the potential for higher (and more immediate) returns for land developers. This meant that there was more competition for high-density land from higher-income consumers. This contributed to the increasing gap between renter and owner wealth levels, and to the more widespread housing affordability issue (Hulchanski, 2004).

Changes in tax policies from the early 1970s on have also had a negative effect by giving clear preferential treatment to income earned from business activity compared to income earned from rental property. Benefits that were available to rental investors, such as small business deductions and capital gains rollover provisions, were removed (F.B. Gorman & Associates Limited, 2002). Other benefits such as the expanded deductibility of soft costs and much higher Capital Cost Allowance (CCA) rates were also reformed in the early 1970s.³ These actions were taken as part of an effort to reform tax laws and curb the use of aggressive tax shelters by the wealthy. While many loopholes have been closed, an unintended side effect has been a severe drop in the construction of (and investment in) residential rental property (F.B. Gorman & Associates Limited, 2002).

The MURB (Multi-Unit Residential Buildings) program was created in 1978 as a measure to help stop the sudden market withdrawal from rental housing development. This program had two major incentives: favourable CCA treatment, and the ability to deduct expanded soft costs. MURB projects then became attractive investments. Syndicates arose that would sell MURB investment shares at between \$5,000 and \$10,000 each. This attracted a great deal of private equity to the rental market from individuals interested in the tax savings, but with little or no expertise in the development industry. In 1981 the soft-cost deductions were eliminated, and these costs had to be capitalized instead. This removed one of the primary benefits of the program. By 1987, the MURB program was completely eliminated as part of the withdrawal from housing support (F.B. Gorman & Associates Limited, 2002).

HOUSING AFFORDABILITY AND HOMELESSNESS IN GREATER VICTORIA

Housing options consist of a continuum ranging from emergency shelters all the way to market ownership housing. Figure 5 describes this housing continuum, showing the general range of housing tenures that are available to residents. From left to right the continuum is characterized by increasingly strong and more stable housing tenure. Movement along this continuum can be very fluid, especially at the left-hand side where people will often drift in and out of housing supports as their personal situations change.

³ The capital cost allowance (CCA), capital gains rollovers, small business deductions and soft cost deductions are explained further below in the Current Incentives and Disincentives section.

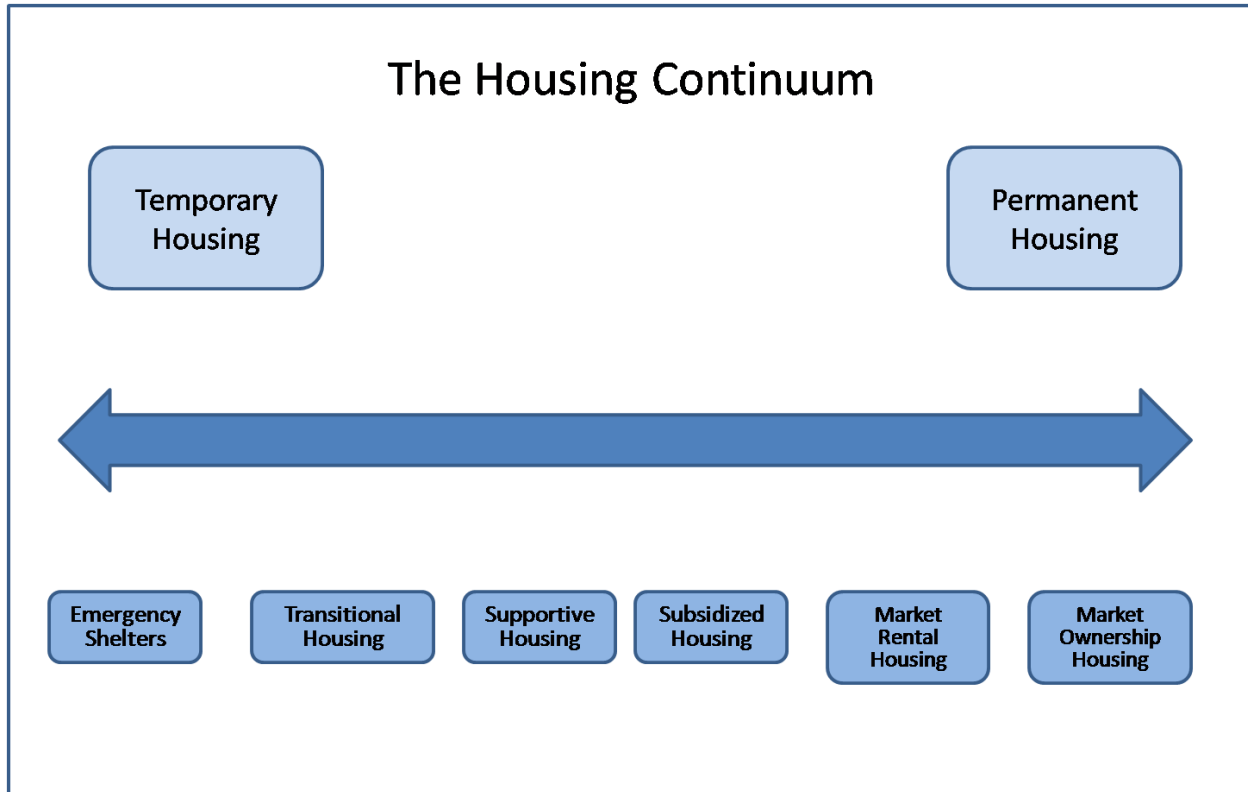


FIGURE 5: THE HOUSING CONTINUUM. SOURCE: (CANADA MORTGAGE AND HOUSING CORPORATION, 2009).

Occupying the far left-hand side of the continuum, it is estimated that there are currently about 1500 homeless persons in Greater Victoria. Of these homeless, approximately 1200 are actively on the streets or in the shelter system, while another 300 live in extremely unstable housing situations (Thornton-Joe, Kendall, Battershill, Ballantyne, Calvey, Hollstein, & et al., 2007a).

While individual situations vary greatly, there are a number of broad factors that play a role in the current extent of homelessness. The first is deinstitutionalization policies and poor discharge planning. Since the 1960s psychiatric institutions have been closing their doors, with the goal of providing more localised support for those with addictions and mental illness in their home communities. However this community support is largely absent, leaving many people in need with nowhere to turn. This is exacerbated by hospitals that need to discharge patients into the community even if they have nowhere else to go (Golden, Currie, Greaves, & Latimer, 1999; Hulchanski, 2004; Thornton-Joe, Kendall, Battershill, Ballantyne, Calvey, Hollstein, & et al., 2007a).

A second important detrimental factor has been the lack of affordable housing. As described earlier, the federal withdrawal from the funding of social housing has led to decreases in social housing commitments across the country. At the same time market rates for housing have

steadily climbed in many urban centres. As result more Canadians are spending an increasingly large amount of their household income on shelter, with many falling into core housing need. Quigley and Raphael (2001) created a model to estimate the impacts of various homelessness determinants on the prevalence of homelessness and concluded that changes in the housing market (such as fluctuations of average rental rates and vacancy rates) had the biggest impact on homelessness. The authors suggest that to address homelessness, policies that impact the housing market will tend to have the largest effects.

Related to housing affordability is the issue of poverty. The gap between the wealthy and the poor is increasing due to decreasing social assistance, restrictions in employment insurance and shifts in labour markets. Certain groups such as renters, single parents, recent immigrants and aboriginals are in particular danger of falling further below the poverty line (Golden et al., 1999). This increasing poverty gap is evident by a general rise in the Gini Coefficient. The Gini Coefficient measures how equally income is distributed between units in an economy. The coefficient ranges from 0 (income is distributed perfectly evenly between everyone in society) to 1 (where one person has all the income in society). A Statistics Canada report that discusses income in Canada notes that “using after-tax income for families, the Gini coefficient rose during the 1990s to about 0.33 in 2000, after fluctuating slightly between the 0.29 and 0.30 marks throughout the 1980s. The coefficient has remained at about 0.33 since 2000” (Statistics Canada, 2005, p. 19).

There is also evidence that the underlying causes of homelessness are more rooted in poverty than in issues of mental illness and severe addictions. Draine, Salzer, Culhane and Hadley (2002) reviewed numerous studies to determine that while mental illness does not help a person avoid homelessness, “it does not represent a distinguishing risk factor in becoming homeless” (p. 569). The authors suggest that in examining policies regarding crime and homelessness it is more useful to address root causes such as joblessness, inadequate access to affordable housing, poverty and lack of education. This finding is echoed in the 2007 *Victoria Homelessness Needs Survey* which reported that 78% of homeless respondents felt that “a lack of affordable housing” was their primary obstacle to being housed (Victoria Cool Aid Society, 2007).

Although homelessness occurs at the far left hand side of the housing continuum, there is growing evidence of the need to consider the entire spectrum of housing support as part of a single system. As Maclellan (2008a) advocates, there is a need to view housing within the wider social and economic context it is situated. From the local level planning measures to the macro-economic policy of the nation there is a need for a more complete scope and vision for the entire housing system. Inter-jurisdictional models, focussing on the entire range of housing supports are necessary for there to be any real gains in ending homelessness (Thornton-Joe, Kendall, Battershill, Ballantyne, Calveley, Hollstein, & et al., 2007a).

So while the measures discussed in this report may not directly target the homeless population, they still have a distinct impact on the wider housing system. One relevant discussion is the “filter down” effect of housing. Malpezzi and Green (1996) found that within many American markets the levels of social housing were relatively stable, and that it was the filtering down of

older residences that were supplying the majority of the affordable units. They concluded that policy interventions at any level to increase the housing stock would eventually “filter down” and lead to the increase in affordable units (Malpezzi & Green, 1996). Others critiqued this finding saying that when the market turns to producing only high-end condominiums, it takes too long for new units to filter down and that even older units become increasingly unaffordable (Skaburskis, 2006; C. T. Somerville & Holmes, 2001). Somerville and Mayer (2003) also demonstrated that when government policies constrain the development of new housing “affordable units are more likely to filter up and become unaffordable, relative to remaining in the affordable stock” (p. 53). So this suggests that policies aimed at increasing the stock of moderate to low-end of market rental housing should have positive impacts all the way to the lowest end of the housing market. However by only supporting the higher end of the market, policymakers end up doing even more harm to the affordability of low-end units. This seems to support Steele and Des Rosiers’ (2009) point that much more needs to be done to prevent the ownership market from “crowding out” the construction of more affordable multi-unit residential rental buildings (p.12).

From the Homelessness Needs Survey, the Victoria Vital Signs Report and the Mayor’s Task Force Report on Homelessness there is a general agreement that one of the crucial steps to ending homelessness in Greater Victoria is to increase the supply of housing. Governments at all levels in Canada are involved in the provision or encouragement of housing, although some to greater degrees than others. Despite the fact that the housing supply is influenced by a number of economic and financial issues outside of government influence, there are still a number of specific policies that have and could be used to support the housing system.

DEFINING TERMINOLOGY USED IN THIS REPORT

The fields of housing and homelessness research contain many key terms that can have widely varying definitions according to their use. This section provides context for some of the key terms used in this report, while also providing more specific definitions.

Affordable Housing

There are several definitions for what is considered “affordable” housing and many measures that can be used to assess how affordable it is. One very broad definition from MacLennan and Williams (1990) explains that “affordability’ is concerned with securing some standard of housing (or different standards) at a price or a rent which does not impose, in the eyes of some third party (usually government) an unreasonable burden on household incomes’ (quoted in Snow, 2008).

The most standard measure of affordability is a shelter-cost-to-income ratio (STIR). The Canada Mortgage and Housing Corporation measures the shelter cost affordability as being less than 30% of the before-tax household income. For renting households these costs include the rent itself, as well as any utilities or municipal fees that are required as well (Canada Mortgage and Housing Corporation, 2009). Another measure used increasingly by provinces is the Rent

Geared to Income (RGI) which is the same ratio except that it includes only rent and excludes any other associated housing costs (Snow, 2008)

One issue with using a ratio measure (such as STIR or RGI) is that it considers all households spending over 30% household income on shelter to be in housing need. It does not take into consideration whether the family actually *needs* to be spending that much. Households with higher average incomes may choose to spend more on higher priced housing, but they should not be considered in great need. Hofer and Gurstein (2009) escape this pitfall by defining affordable housing as “housing that does not cost over 30% of gross household income for those who make between 60% and 120% of the Average Mean Income (A.M.I.) in a locality” (p. 2). The CMHC on the other hand uses the concept of Core housing Need (CHN) which includes the 30% affordability measure but then adds to this housing size and quality measures. Housing is only considered “acceptable” if it meets this affordability threshold, and is in decent repair and has enough bedrooms for the number of occupants based on National Occupancy Standards (Canada Mortgage and Housing Corporation, 2009). Hofer and Gurstein go further and also define “workforce housing” to be a step above affordable housing, in that it is not over 30% gross household income for those with 80%-200% of the average mean income of an area. “Intermediate housing” is a term for the United Kingdom referring to housing that is priced below market rates, but still above social housing rates (Hofer & Gurstein, 2009).

For the purposes of this report, “affordable housing” is used to describe housing at the lowest end of the market rental rates. Most of the measures described in this report are meant to encourage the construction of more low-end-of-market rental units. In some cases this will still be considered unaffordable for some within the community, but because these will be the most affordable units the market can produce profitably they are the units of interest.

Social Housing

Social housing refers to rental housing that is provided at rates often significantly below the market rental rate. BC Housing makes a distinction between two types of social housing:

- Public housing - Housing that is jointly funded by the provincial and federal governments and predominantly managed by the Province of British Columbia.
- Non-profit and co-operative housing - Housing that is owned and maintained by non-profit and co-operative housing providers (BC Housing, 2007).

Supportive housing is a subset of social housing which provides stable housing alongside support services for those looking to stabilize their lives and reconnect with the community. This can include in-house support, outreach services or connection with services offered within the community (BC Housing, 2007).

Homeless

While the definition for “homeless” may seem self-explanatory, there is actually a great deal of ambiguity and nuance within this term. Patterson, Somers, McIntosh, Shiell and Frankish (2008)

make a distinction between those persons who are inadequately housed, those who are both inadequately housed and inadequately supported and those who are in absolute homelessness. Those who are currently housed, but spend more than 50% of their gross household income on shelter, or are in small or severely under-repaired residences are considered inadequately housed. Those who are living in shacks, rooming houses, substandard rental suites or transitional housing are considered both inadequately housed and inadequately supported. The absolutely homeless population includes those living on the streets, in parked vehicles, in emergency shelters or in friends' residences (M. Patterson et al., 2008).

Culhane and Kuhn (1998) reviewed the existing literature on homelessness and identified three broad categories of homeless individuals:

- First, the transitionally homeless are those that enter the shelter system only for a day or two. This population is often left temporarily without a home due to a catastrophic unforeseen event (such as an unexpected death or a sudden job loss). This group is likely to be younger, and the least likely to have mental illness or severe addictions (Culhane & Kuhn, 1998).
- Second, the episodically homeless are those that drift in and out of homelessness more frequently. This group is still typically young, although there is a much higher prevalence of addictions and mental illness. The episodically homeless will use the shelter system more than once for varying time periods, but will also spend more time in hospitals, jails and detoxification centres (Culhane & Kuhn, 1998).
- Third, the chronically homeless are those who are frequent and long-term users of the shelter system. This group is generally older, unemployed and suffering from mental illness or severe addictions. Although this group is a minority of the total homeless population, they also have a disproportionately large impact in terms of social costs on government and local service providers (Culhane & Kuhn, 1998)

For the purposes of this report, the term homeless will refer to this entire range of homelessness identified by Culhane, but will also include those who are considered unsupported and inadequately housed by Patterson et al.. This serves to cover the entire homeless population described in the Victoria Mayor's Task Force Report, including both the homeless street population and those in extremely unstable housing situations (Thornton-Joe, Kendall, Battershill, Ballantyne, Calveley, Hollstein, & et al., 2007a).

CURRENT POLICY INCENTIVES AND DISINCENTIVES

This section reviews current government policies that either actively encourage or discourage more private sector involvement in the affordable rental housing market. This is used to support the policy analysis and to inform the GVCEH and other stakeholders of the current policy environment and of potential opportunities. One thing to note is that these incentives and disincentives are almost exclusively federal or municipal policies. This is because the Province of BC is not actively involved in the market rental housing sector. Instead, the province is focused mainly on the provision and administration of social housing (Real Estate and Construction Organizations, 2006). The Province has devolved much of its authority in this area to local governments. For instance land-use planning tools that allow municipalities to implement density bonuses and inclusionary zoning are granted in the Province's *Local Government Act* (Government of British Columbia, 1996b).

CURRENT INCENTIVES

There are a number of policy incentives that encourage private developers and investors to produce affordable rental housing. Most of these are local government (CRD) measures. While there are many more policies that affect the entire housing market, the following policies are the ones that more specifically impact affordable rental housing in the private market.

INCLUSIONARY ZONING

Inclusionary zoning is the creation of zoning regulations that require developers to provide a certain mix of housing options within new developments. In most cases this is a requirement that a certain percentage of the units developed are made affordable to lower-income residents. While this is not exactly a development incentive (so much as a development requirement) it is used successfully in many jurisdictions to entice the private sector to contribute more towards affordable housing and social housing.

Specific policies vary depending on the locality. In some cases, the developer has the option of building the affordable units off-site, or avoiding building affordable units altogether in exchange for payment-in-lieu towards an affordable housing fund (Wake, 2007). When a proposed development meets a certain threshold of units (ranging anywhere from 10 to 200 units depending on the municipality's policy) a certain number of units must then be set aside for affordable housing. The set-aside rate can range from 5% to 35%, although it is typically 15%-20% (Metro Vancouver Policy and Planning Department, 2007).

Inclusionary zoning policies are often combined with other planning levers (such as expedited approvals, density bonuses or fee reductions or waivers) to further incentivize projects and to compensate developers for the burden of providing affordable housing (Metro Vancouver Policy and Planning Department, 2007)

The power to impose inclusionary zoning policies in BC is granted by the *Local Government Act* in sections (Government of British Columbia, 1996b):

- 897 (creating official community plans)
- 903 (zoning powers)
- 904 (density bonuses)
- 905 (affordable housing agreements)

Currently inclusionary zoning policies are either being used or examined in the municipalities of Victoria, Saanich, Sooke, Central Saanich, and Langford, according to the Official Community Plans of each of these communities (City of Langford, 2008; City of Sooke, 2010; City of Victoria, 2008; District of Central Saanich, 2008).

DENSITY BONUS POLICY

A density bonus policy is an agreement which allows developers to opt into higher-density projects than land-use zoning would normally allow in exchange for some sort of public amenity (such as affordable housing). As with inclusionary zoning, there are often provisions that allow the affordable units to be provided off-site if on-site inclusion is not feasible (Curran & Wake, 2008)

Power for this is granted by section 904 of *The Local Government Act* (zoning for amenities and affordable housing) (Government of British Columbia, 1996b). According to each municipality's Official Community Plan, bonus density provisions are used or recommended in Victoria, Sidney, Saanich, Oak Bay, Sooke, Central Saanich, Langford and Esquimalt (City of Langford, 2008; City of Sooke, 2010; City of Victoria, 2008; District of Central Saanich, 2008; Town of Sidney, 2007).

SECONDARY SUITE POLICIES

Secondary suite zoning policies allow for the installation of accessory dwelling units (ADUs) within or on the same property as single detached homes. These units are often called basement suites, granny-flats, coach houses or condominiums. The power to implement these zoning allowances comes from sections 903 and 904 of the *Local Government Act* as well as from the BC Building Code, section 9.36 (Curran & Wake, 2008).

Secondary suites are currently allowed in Victoria, Sidney, Sooke, Langford and Esquimalt. Data from the 2006 Census indicates that secondary suites are currently one of the most relied-upon sources of affordable housing in the Capital Regional District. Despite not officially being legal in either municipality, 75% of the rental units in Saanich, and 27% in Oak Bay are estimated to be secondary suites (City of Langford, 2008; City of Sooke, 2010; City of Victoria, 2008; Curran & Wake, 2008; District of Oak Bay, 1997; District of Saanich, 2008; Town of Sidney, 2007).

GOODS AND SERVICES TAX (GST) AND HARMONIZED SALES TAX (HST) REBATES

GST is applied at the final point of sale of a new or substantially renovated rental building (or is calculated according to current market rates if the building is retained by the builder as an ongoing property investment), and can represent a significant capital cost. Developers can claim a partial rebate of this GST up to a maximum of \$6,300 per unit (Canada Revenue Agency, 2009a). While this helps, this still leaves a significant portion of the GST to be paid, which can represent about 2% of the total capital costs of the building (McClanaghan, 2009).

Under the proposed Harmonized Sales Tax (HST) the BC Government has proposed a new rebate of 71.43% of the provincial share of the HST on new rental housing units. Rental units up to \$525,000 in value qualify for a rebate up to a maximum of \$26,250. This is designed so that on average, rental housing is subject to no new tax as a result of tax harmonization (BC Ministry of Finance, 2009).

AFFORDABILITY AND CHOICE TODAY (ACT)

Affordability and Choice Today (ACT) is a program delivered by the Federation of Canadian Municipalities, and funded by the Canada Mortgage and Housing Corporation. Its goal is to provide grants to help local governments and community groups respond to housing affordability through regulatory reform. ACT provides up to \$5,000 to help local projects that aim to reduce parking requirements, reduce restrictions on secondary suites or streamline approvals processes for affordable housing. This funding is primarily directed towards helping disseminate information and aid implementation of new regulations (Canada Mortgage and Housing Corporation, 2009).

CURRENT DISINCENTIVES

This section describes policies that exist today that act as obstacles to the creation of market affordable rental housing. These policies all either directly or indirectly introduce added burdens and costs for builders who aim to produce affordable rental buildings.

CAPITAL COST ALLOWANCE

The Capital Cost Allowance (CCA) is the percentage of the total capital cost of an asset that can be deducted as a depreciation expense when calculating taxable income. Differing types of depreciable property are grouped into classes with different CCA rates. The CCA is calculated by applying the appropriate class rate to the balance of the undepreciated capital cost (Canada Revenue Agency, 2009b).

The current CCA rate for all rental residential and non-residential buildings is 4% of the declining balance annually, although only 2% in the first year (Canada Revenue Agency, 2009b).

This used to be more favourable to rental property owners. Prior to 1978 the CCA rate was 10% for wood frame buildings and 5% for all others. This was changed to only 5% for all buildings in 1978, and then was reduced to 4% for all buildings in 1988. The tax code was also changed to introduce the 2% rate for the first year (the “half-year” rule) to guard against tax shelters (Lampert & Pomeroy, 2002).

Currently, only principal business corporations⁴ and life insurance companies can use rental losses generated by the application of the CCA on a property as a deduction from other types of income. Other investors are not allowed to use losses generated by the application of the CCA on a property to reduce their income from other sources (Lampert & Pomeroy, 2002).

Prior to 1972, there were no such restrictions to the claiming of CCA losses on rental properties. This effectively created a tax shelter for potential rental investors, who could use the CCA deductions to decrease taxes payable on any other sources of income (F.B. Gorman & Associates Limited, 2002, 23). While this was harshly criticized and viewed as a tax loophole, it did lead to far more investment in the private rental market. Still, wealthy investors could potentially pay a small down payment to acquire a rental unit and then use the CCA to reduce their taxes liability on income from other sources (F.B. Gorman & Associates Limited, 2002). Tax reforms aimed at eliminating aggressive tax shelters in 1972 closed this loophole, with the rationale that CCA benefits should not be allowed to transfer beyond real estate income. Principal business corporations may still claim CCA losses on a particular property against their other income, since all of their income comes from rental property (Lampert & Pomeroy, 2002).

CCA rules have an impact on the profitability of a rental project by determining how much of the project’s capital cost can be deducted as a depreciation expense. This has an effect over the entire life cycle of the building, but especially in the early years when the undepreciated capital cost is much higher and when profits are much lower.

CAPITAL GAINS TAX AND CAPITAL DEPRECIATION RECAPTURE ON SALE

The CCA allows taxpayers to write off the depreciable portion of their investment as it ages. The portion of the original cost of a building that has not yet been claimed as CCA is referred to as the undepreciated capital cost (UCC), which is in essence the book value of the property for tax purposes. When the property is sold, if the selling price exceeds the UCC then the difference between the selling price and the UCC is considered a gain and subject to tax. One part of this gain is the difference between the selling price and the original cost and taxed as a capital gain and the other is the difference between the original cost and the UCC, referred to in tax parlance as recapture (of CCA), which is treated as normal income (D. A. Patterson, 2007).

⁴ Principal Business Corporations (PBCs) are companies whose primary business activity is to lease, rent, develop or sell real property. These companies are afforded more favourable tax benefits than other rental property investors (Lampert & Pomeroy, 2002).

Prior to 1972, the tax policies applied to rental properties were much more favourable. Rental property owners could pool their rental investment portfolios for the purposes of CCA. This meant that if a rental property was sold, the recaptured CCA could then be deducted from the undepreciated balances of all the other buildings in the pooled portfolio. Only if the recaptured CCA exceeded the undepreciated balances of all the other buildings would the excess be subject to taxes. Even then, if the proceeds from that sale were invested in another rental building the owner could then apply the recaptured CCA to that new building and again avoid the income tax repayment (Lampert & Pomeroy, 2002). Under current rules, each rental property costing \$50,000 or more is considered in a separate class (CCH Canadian Limited, 2009).

SMALL BUSINESS DEDUCTION

The *Income Tax Act* was changed in 1972 to give preferential tax treatment to income from businesses over income from property ownership. Income from a business is considered “active-income” since it requires continuous work and action on the part of the taxpayer. Income from property (such as returns on investment from a stock or bond, or rents charged by a landlord) are considered to be “passive income” since they arise primarily from ownership over the profit-generator (F.B. Gorman & Associates Limited, 2002).

The small business deduction reduces the effective federal corporate income tax rate from 18% to 11% for the first \$500,000 of active business income. This is provided as a credit on otherwise payable income tax and is designed to help small Canadian-controlled private corporations expand by allowing them to keep more capital (Canada Revenue Agency, 2009c; Canada Revenue Agency, 2010).

This small business deduction only applies to “active” business income, which specifically excludes most rental property owners. In order to qualify as “active” income, the rental property owner must either be incorporated as a Principal Business Corporation (PBC), or they must employ over five full-time employees. To qualify as a PBC the owner must be a Canadian-controlled corporation that deals in renting and leasing land as its primary business function and must also employ more than five full-time employees (Canada Revenue Agency, 2009c). Due to these restrictions, many rental property investors do not qualify for the small business deduction since they do not exclusively deal in rental property, or they do not own enough property to require six full-time employees (D. A. Patterson, 2007).

SOFT COST DEDUCTIONS

Certain costs pertaining to the planning, construction or alteration of a residential rental building can be deducted from operating income immediately for income tax purposes. This helps to make projects more affordable in their initial years by reducing the total income tax payable during the construction and planning stages. These “soft costs” include (Canada Revenue Agency, 2009b):

- The mortgage insurance fee

- Landscaping costs

But other soft-costs used to be deductible during building construction that now instead must be capitalized and subsequently amortized. These other costs include:

- Property taxes, payable during the construction period
- Permit and development fees and levies
- Professional services (such as architectural and engineering fees)
- Accounting and legal costs
- Interest on construction financing

Prior to 1972 all of these costs were immediately deductible (Lampert & Pomeroy, 2002). Tax shelter reforms up to 1981 eliminated this benefit for most investors, and by 1992 all investors (including PBCs) were required to capitalize these costs (Lampert & Pomeroy, 2002).

PARKING REQUIREMENTS

Providing on-site parking for residents can be one of the most expensive costs for a new residential development. Depending on the parking structure required, this can represent up to \$50,000 worth of capital costs per unit (McClanaghan, 2009). Municipal zoning regulations set out how many spaces, per unit must be provided for a major residential development. For developments that are already close to amenities and public transit these requirements could likely be much lower. Initial examinations of residential parking lot use in Victoria suggest that even at peak periods few parking lots are at capacity, and many are less than half full (Litman, 2009).

Currently, only Victoria and Sidney consider relaxations of parking requirements for residential developments in their Official Community Plans (City of Victoria, 2008; Town of Sidney, 2007).

JURISDICTION SCAN

In order to expand the list of potential policies that could influence rental housing development, a range of smart practices from other jurisdictions were examined. These provide a basis for analyzing Greater Victoria and Canada's rental housing policies. One consideration to bear in mind when reviewing these practices is that housing policy is very context-specific, and it often arises due to a whole range of interacting factors. These can include elements such as: the national political system, the organization of the welfare regime, housing market conditions, building material costs, labour availability, population demographics, and the traditional roles of specific housing agents such as landlords, tenants, and non-profit providers. These contextual factors make it very difficult to simply adopt housing policies from another jurisdiction and assume they will be successful elsewhere (Hofer & Gurstein, 2009; Lawson & Milligan, 2007). With this caveat in mind, the scope of this scan was generally limited to jurisdictions in North America, Western Europe, New Zealand and Australia. These were selected because they had the most similar cultural and political systems to Victoria and Canada.

Before explaining the use of specific measures in other jurisdictions, there are some broad trends across the studied areas that set a relevant context for the discussion of smart practices.

COMMON THEMES ACROSS COUNTRIES

Rising housing costs and affordability issues feature in almost every country examined. Internationally, this is due to a number of factors, including (Yates et al., 2007):

- Shifts in housing demographics, with single-person households becoming more prevalent than ever in the rental market
- Less labour stability
- A gradual shift from collective-responsibility to individual responsibility for social programs such as healthcare, education and old age security; paying for these costs puts increased stress on paying housing costs as well
- Tax and policy incentives that have favoured higher-income earners as opposed to lower-income workers

An increasing trend towards the favouring of homeownership is another common element among most OECD countries (Maclennan, 2008a). Policies designed to do this include using favourable lending rates, tax breaks and subsidies for homeowners. There is also a distinct increase in the market demand for homeownership, which is spurred on by declining interest rates (Hofer & Gurstein, 2009; Lawson & Milligan, 2007). One interesting note is that although overall demand for ownership is increasing, among the 25 to 35 year old demographic, homeownership rates are actually falling. Evidence suggests that many of these households are being "deflected" into renting for far longer than previous generations had (Maclennan, 2008a). There does, however, seem to be a growing acceptance among academics and policymakers that full support of homeownership with no support for rental housing is a risky policy decision, especially as

demand for low-to-moderate income housing increases in almost every country in the OECD (Gurstein & Hofer, 2009).

Another common trend across many countries is that national governments tend to maintain a strong central presence in the creation and administration of housing policy. This is because in most countries taxes, mortgage insurance, social security, and housing planning are the domain of the national government. Although this is how housing has been traditionally organized, over the last two decades it is becoming more common to see local and regional governments play an increased role as housing becomes more decentralized (Lawson & Milligan, 2007; Maclennan, 2008b).

In the late 1980s and throughout the 1990s there was an increased focus on market mechanisms that could help provide more housing. This was precipitated by widespread cutbacks to social housing spending, and represented a broad paradigm shift away from supporting social housing and instead focusing on income security. This was especially evident in the United States and Australia, and to this day continues in Australia and Canada (Copas & Cumming, 2009a; Maclennan, 2008a). In approaching the private rental sector, most countries have tended to favour demand-side interventions (such as shelter allowances or income supplements), rather than favouring additions to the available stock (Gurstein & Hofer, 2009). While demand-side policies have prevailed for the last two decades or so, there has been a recent shift to begin considering supply-side policies as well (Lawson & Milligan, 2007).

Many other countries have begun to move beyond market mechanisms and are reinvesting more directly in communities. This is prevalent in the United Kingdom, Ireland, Spain, New Zealand, and to a lesser extent even in the United States (Maclennan, 2008a). Maclennan (2008a) contends that those countries that have not begun to evolve and pursue reinvestment strategies have been more affected by the negative effects of housing booms and bubbles, and experience greater housing affordability issues.

SPECIFIC POLICY RESPONSES

From here, the discussion turns to describe some of the more specific policy instruments used to support rental housing in other jurisdictions. First, some of the tax and other national measures in the United States, Western Europe, New Zealand, and Australia are reviewed, followed by a review of local and regional measures used in the aforementioned countries and in Canada.

LOW-INCOME HOUSING TAX CREDITS

Many countries use tax credits to help improve profitability of low-end-of-market rental housing, and to help direct investment into the sector. One of the most-studied housing tax credit programs is the US Low Income Housing Tax Credit (LIHTC). In many ways this program is similar to the MURB program available in Canada from 1978 to 1987 but with one important difference: developers are not guaranteed credits and instead must compete for a limited share (Steele & Des Rosiers, 2009). The program works by allocating tax credits to investors who

support low-income housing developments. These credits can then be used to create a tax shelter allowing the investors an immediate return on their investment. The credits are allocated to a rental housing project for 10 years, and investors essentially “buy” a share in the 10 years of tax credits with their investment in the project. These owners can then use these credits to decrease their otherwise payable income tax.

Qualifying LIHTC projects must then be committed to being affordable for a period of 30 years, which provides sufficient security of tenure for residents, but also allows owners to plan ahead for more profitable uses for the property (Steele & Des Rosiers, 2009). The Department of Housing and Urban Development (HUD) and the Internal Revenue Service (IRS) both monitor the building to ensure that rents are maintained at affordable levels. At least 40% of the units in a LIHTC building must be affordable (that is costing no more than 30% total household income) for someone with 60% of the area mean income or less (Steele & Des Rosiers, 2009). These LIHTC-created units also often serve low-income households that receive other housing assistance. One major study found that 37% of LIHTC households also received Section 8 housing vouchers (Burton, Nolden, Heintzi & Stewart, 2000). This overlap in assistance helps to promote the success of both housing programs, as the LIHTC provides affordable units that must accept housing voucher recipients while the vouchers provide guaranteed rents for LIHTC investors.

Tax credits are divided between the American states based on population. The states then have the power to allocate the credits as they see fit, and developers of low cost buildings must compete in order to win a share of the tax relief. The subsidy size is calculated to be 70% of the cost to build the low-income units, which then becomes the present value of the ten-years of total tax credits. In some high cost cities (such as Boston and New York) the credits are worth up to 91% of the costs of the units (Steele & Des Rosiers, 2009).⁵ Credits are only allocated for the qualifying affordable units, so if only 50% of the building is deemed affordable then credits are allocated based on 71% of the building costs for that half of the units (Steele & Des Rosiers, 2009)

OTHER NATIONAL TAX CREDIT SCHEMES

Australia has recently introduced a tax credit program called the National Rental Affordability Scheme (NRAS), which is designed to encourage more large-scale investment in affordable housing from the public, private and non-profit sectors. This plan was initiated in 2008 and intends to increase the total supply of below-market rental housing units by 50,000 by 2012.

⁵ Steele and Des Rosiers (2009) point out that Vancouver, Calgary and Toronto would all qualify as high cost cities according to the American criteria.

In 2009 the program increased the annual incentive to \$6,504 (\$6,035 CAD⁶) per below-market affordable rental unit from the Commonwealth Government, with another \$2,168 (\$2,012CAD) being contributed by state governments. These incentives are offered for a ten-year period, provided that the units are rented at 20% below market value so they are eligible to low and moderate income renters. These payments are either in the form of direct subsidies, or refundable tax offsets which help reduce the initial capital costs of large-scale rental housing projects (Australian Department of Family, Housing, Community Services and Indigenous Affairs, 2009). France also uses tax credits to encourage rental housing production. Rental unit investors may claim a tax credit equal to 10% of the interest paid on a mortgage for 2 years, as well as a credit for capital depreciation. This is all part of “Livret A” which also provides subsidized, low-interest loans to developers (Lawson & Milligan, 2007).

CAPITAL COST ALLOWANCES

Germany, France, Australia and New Zealand all have policies that positively affect the depreciation rates of capital assets in order to support the rental housing sector (Hofer & Gurstein, 2009). Germany’s system encourages affordable housing by offering a capital depreciation allowance to builders of affordable housing who plan to provide below market rental units to those in need. Immediate access to this allowance and to subsidized loans helps investors build the capital to initiate new construction projects. Losses created from the use of this depreciation allowance can also be transferred to other income (Hubert, 1993). In return for this assistance, private landlords must then accept tenants who qualify for social housing, and rent controls are placed on the units while the government loan is outstanding. This has been described as essentially the creation of social housing within the private market in Germany (Lawson & Milligan, 2007).

New Zealand and Australia also allow rental investors to use accelerated depreciation to create losses that can be transferred as credit against other income sources for tax purposes (similar to the previous MURB program in Canada). A lack of rent controls within these countries also helps to build confidence and stability within the private rental market. These are the only two national examples of a healthy private-sector rental market existing without the need for ongoing direct subsidy (Hofer & Gurstein, 2009).

The United States calculates the depreciation of rental buildings on a straight-line basis. This means that the CCA depreciation is calculated at a standard rate of 3.64% over a useful lifespan of 27.5 years. So compared to Canada’s declining-balance method of depreciation, American deductions begin slightly lower in the first few years of building ownership but stay steady, while Canadian deduction rates quickly fall lower and lower over the building’s lifespan (Lampert & Pomeroy, 2002). Individual rental building investors in America may also become

⁶ Figures are converted to Canadian funds using the Bank of Canada’s historical exchange rate converter, which uses the nominal noon exchange rate for each day. Accessed online at <http://www.bankofcanada.ca/en/rates/exchform.html>

designated as “Real Estate Professionals, which affords them more favourable tax treatment. This is not the case in Canada where only Principal Business Corporations can be considered eligible for such benefits (Clayton Research Associates Ltd, 1998). Finally, American CCA calculations pro-rate the depreciation expense for the first year a building is owned for, depending on when the building was purchased. This differs from the “half year” rule in Canada which automatically calculates the CCA as 2% in the first year, regardless of the purchase date (Lampert & Pomeroy, 2002).

CAPITAL GAINS TAXATION

Favourable capital gains taxation also features heavily in many nations’ support for affordable rental housing. In Ireland, the United Kingdom and the Netherlands, the prospect of capital gains encourages significant investment in the rental market. Often investors will enter the market with little or no concern for the rental returns of the building, motivated only by the long-term appreciation of the capital assets (Lawson & Milligan, 2007). In New Zealand and Australia, small landlords are helped significantly with large tax breaks on capital gains, and as a result they make up a relatively large percentage of the rental market (Lawson & Milligan, 2007). The United States allows capital gains to be deferred when proceeds are re-invested in comparable asset within 180 days (Clayton Research Associates Ltd, 1998).

OTHER NATIONAL INCENTIVES

A new measure in the United Kingdom reduced the Value Added Tax rate for renovations and improvements to rental suites by 2.5 %, while new housing continues to be exempt from this tax altogether (Copas & Cumming, 2009a). It is common across the European Union for new housing to be exempt from value added taxes, and in the United States there is no comparable federal tax. In both cases this brings the costs for developing rental housing down (Clayton Research Associates Ltd, 1998; Copas & Cumming, 2009a).

The United States also has the *Community Reinvestment Act, 1977* which plays a role in funneling private funds into rental housing. This act provides the basis for a records system that tracks how much a financial institution commits to community investment, and how much it has done to support low and moderate income households. This record is then taken into consideration when the institution applies for deposit facilities (such as mergers and acquisitions). This helps provide an incentive for financial institutions to partner with other private organizations they otherwise would not, and directly support the local community (The Toronto Board of Trade Affordable Housing Task Force, 2003).

And although it is outside the scope of this report, it is worth noting that rental assistance programs were the most prominent private sector support in almost all jurisdictions. The only countries that do not rely heavily on rental assistance are Canada, Belgium, Austria and Switzerland (Lawson & Milligan, 2007). Although not widely used in Canada, at least some form of rental assistance is available in British Columbia, Alberta, Saskatchewan, Manitoba and Quebec (Steele & Des Rosiers, 2009).

INCLUSIONARY ZONING

Across North America, Australia and Europe inclusionary zoning policies are widespread. In most jurisdictions it is typical to see requirements that 10% or more of the units in new developments (or substantial conversions) meet affordable housing standards (Lawson & Milligan, 2007).

In the United States there are state-wide inclusionary zoning policies in New Jersey and California. Hundreds of local jurisdictions in America also have inclusionary policies, most notably in Colorado, Florida, Illinois, Massachusetts, New Mexico, North Carolina, Vermont and Washington D.C.. Implementation of these policies varies, with differing configurations of set-aside rates, cash-in-lieu policies and mandatory on-site provisions (Lawson & Milligan, 2007; Metro Vancouver Policy and Planning Department, 2007).

In Belgium there is a national law that compels cities to ensure that at least 20% of all housing is affordable. Not every development needs to include affordable units, but most do after completing land zoning negotiations with the city (Metro Vancouver Policy and Planning Department, 2007). Mandatory national inclusionary zoning of up to 20% is also a feature in Ireland (Hofer & Gurstein, 2009)

In Britain, the *Town and Country Planning Act* gives powers to local governments to implement inclusionary housing policies. The senior government then contributes with best practices research and some strategic guidance (Metro Vancouver Policy and Planning Department, 2007). In Australia inclusionary policies are becoming more favoured. In the Sydney region, for example, there is a requirement that 4%-5% of the total floor area of new developments must be devoted to affordable housing (Metro Vancouver Policy and Planning Department, 2007).

Across Canada inclusionary zoning is used less than in other jurisdictions, although there are still many examples. Since 2005 the Ontario government has encouraged local governments to use inclusionary zoning targets as a tool to develop more affordable housing units. Montreal has a voluntary requirement that 15% of units in developments over 200 units are affordable social housing, and another 15% are affordable to moderate income households. There is nothing in Quebec law that allows the City to compel compliance, so the measure is incentives-based instead (Metro Vancouver Policy and Planning Department, 2007). There are other forms of inclusionary zoning in Canmore, Ottawa, Whistler, Vancouver, Burnaby, Kamloops, Ucluelet, North Vancouver and Surrey (Curran & Wake, 2008; Metro Vancouver Policy and Planning Department, 2007).

OTHER LOCAL MEASURES

Secondary suites are common in Canada, with many jurisdictions either allowing them or even actively encouraging their use. In an effort to reduce homelessness Calgary is testing a pilot grant program to encourage homeowners to install secondary suites (City of Calgary, 2009). Beyond that, Calgary is also requiring that all new houses within certain development zones incorporate

secondary suites as well. Other jurisdictions that allow or encourage secondary suites include Vancouver, Richmond, Burnaby, Revelstoke, and many others.

There are a number of jurisdictions in Canada that do not charge any development cost charges (DCCs) on new rental buildings (such as Moncton, St. John's, Charlottetown, Montreal, Laval, Gatineau and Quebec City). Eliminating these charges can have a significant impact on the profitability of a rental project (Lampert, 2003).

CURRENT COST OF HOMELESSNESS

This section reviews a handful of relevant cost-benefit and cost-effectiveness studies that make definitive estimates of the cost of homelessness and assesses their relevance to the BC context.⁷ The best model identified will be used to estimate how much homelessness costs the taxpayers (in terms of government expenditures). While this does not necessarily give an exact figure for the current cost of homelessness in the CRD and across Canada, it does provide a reasonable estimate that can be compared to the estimates of the costs of each policy option discussed in the next section.

A cost-effectiveness analysis (CEA) is the simplest way to assess the economic costs of homelessness. Here, the direct costs to government (and/or other service providers') budgets that can be attributed to homelessness are catalogued and then compared to the costs of providing housing. The CEA simply compares the relative costs associated with differing courses of action. Cost-benefit analyses (CBA) take this one step further and include a valued quantification of both the costs and the benefits of each course of action. This will include indirect costs and benefits and difficult to quantify elements (such as the improved quality of life due to having a home). Estimates of the wider implications for the economy are also quantified and included as part of the CBA model (Berry, Chamberlain, Dalton, Horn, & Berman, 2003).

In both cost-effectiveness and cost-benefit analyses it is important to determine what points of view are being considered. For instance, a societal point of view will incorporate the cost impacts on governments (that is costs that are borne by all taxpayers) as well as costs borne by more specific segments of the population (such as residents of a single city with a high incidence of homelessness, or local businesses impacted by homeless on their doorsteps). While this wider societal point of view gives a more complete picture, the scope of this report is narrower. This report simply seeks to demonstrate that from the perspective of the government budget it requires less expenditure to incent the development of a single unit of low-cost housing than to manage the impacts one homeless individual has on government services. In this way it is more comparable to a cost-effectiveness study than to a cost-benefit study.

To determine these impacts of homelessness on government budgets, ten studies were reviewed that made definitive estimates of the cost of homelessness. Appendix 1 contains a table summarizing the results of this review. To ensure comparability across each model, all costs have been updated to September 2009 dollars using the Bank of Canada's consumer price index (CPI) (Bank of Canada, 2010b).⁸ Costs from outside of the country were first converted to Canadian Dollars using the Bank of Canada's historical exchange rate converter, which uses the nominal noon exchange rate for each day (Bank of Canada, 2010a).

⁷ For a more exhaustive review of current homelessness cost-benefit and cost-effectiveness analyses see Berry, Chamberlain, Dalton, Horn, & Berman (2003) and Culhane, Gross, Parker, Poppe, & Sykes, (2008).

⁸ This Total CPI sets June of 2002 at 100. Found online at <http://www.bankofcanada.ca/en/cpi.html>

After reviewing the ten selected studies the report by Eberle, Kraus, Pomeroy, & Hulchanski (2001) was chosen as the superior cost estimate for a number of reasons. First, the report contained the most extensive collection of cost estimates. These cost figures were also all explained in detail (where some other studies simply aggregated “health costs” or “justice costs” with little explanation of what was included). Also, all included costs are directly attributable to the government budget, since finding the list of all relevant costs was one of the main objectives of the study. Furthermore, because the report was written for the Government of British Columbia, it is directly relevant to the homelessness context within this province. The study was conducted in Vancouver’s Downtown Eastside and the costs of homelessness there are surely more relevant to Victoria’s situation than American or Australian examples. This is also important because regional and international differences in how certain services are paid for (such as healthcare a public cost in some jurisdictions and a private cost in others) may distort which costs are being attributed to the government and which are not.

The Eberle et al. report used case histories and service use records from eighteen currently and former homeless people to develop a model for estimating the extent of government expenditures directed towards homeless individuals. Study participants were chosen so as to capture the cross section of homeless individuals in British Columbia. This included individuals of both genders, of differing ethnicities, of differing ages, with a range of time spent homeless, and with serious addictions and mental illnesses (Eberle et al., 2001).

The specific costs enumerated in the analysis included:

- Health costs: Emergency room visits, hospital and medical clinic visits, Medical Services Plan visits to doctors, Pharmacare, community mental health services, psychiatric hospital admissions, BC Ambulance services, fire department emergency responses.
- Justice Services: Provincial corrections institutions, days under community supervision, Vancouver Police incidents
- Social Services: BC Benefits, detox centre, family and child support services

To collect the data, caseworkers experienced with working in Vancouver’s Downtown Eastside were used to conduct interviews. Service providers were contacted as well to collect cost information on the above-mentioned services. Where direct costs could not be found, the authors developed estimates based on published research.

While the Eberle et al. report was considered the most relevant, it has limitations. The major limitation of the report is cost estimates were based on service utilization of only 18 study participants. These participants were specifically chosen to represent the entire spectrum of homeless and unstably housed people in British Columbia, but as the authors themselves point out the conclusions from this sample cannot be generalized to the wider population (Eberle et al., 2001). For this reason, the findings cannot definitively demonstrate the cost of homelessness in BC; rather they provide only an educated estimation. The second study limitation is that when collecting data on service utilization (and all associated costs) only service providers within a set

geographic area were included. This means the cost estimate may be somewhat conservative, since costs would not be counted if any study participants used government services outside this set area (for instance if they had attended a hospital on the other side of the city).

So while the Eberle et al. report cannot give a definitive value to the cost of homelessness (due to the limited sample size) it does provide a reasonable estimate of costs of homelessness for homeless individuals with similar characteristics as those in the sample group. This group was chosen to match the profile of the British Columbia homeless population, which is very similar to the homelessness profile described in the Victoria Cool Aid 2005 Homeless Count (Victoria Cool Aid Society, 2005).

The cost of homelessness to government, for the purposes of this report, is estimated to be between **\$35,548 and \$47,397** per year per homeless individual.

One important point worth discussing is that most of the costs of homelessness impact the budgets of provincial and local governments (due to higher service usage of healthcare services, police services and emergency shelters). However a number of the potential policy measures described in the coming analysis section are tax measures that need to be implemented by the federal government. This means that while the costs associated with investing in new rental housing will primarily be borne by taxpayers at the federal level, the cost-savings (in reduced homelessness-related costs) will primarily benefit the provincial and local budgets.

There are still benefits for federal budgets in reducing the incidence of homelessness. The Canada Health Transfer and the Canada Social Transfer allocate funds from the federal government to the provinces on an equal per-capita basis. These funds are used to support healthcare, education, social services and social assistance. While these transfers are set at certain levels, long-term reductions in the areas of health and social services could result in a reduced need for transfer payments. At the very least, financial improvements in the areas of health and social services will result in increased economic efficiency across the system. Even if government budgets are not reduced by \$35,548 to \$47,397 per year per homeless individual who is housed, there will be an increase of that much economic efficiency across the system (as for instance doctors have more time to spend with other patients, and police officers can respond to other emergencies).

Another important point is that whether these costs are paid at the federal level or the provincial level, these costs still must be paid. So if the cost of solving homelessness really is lower than the cost to manage it (as the ten cost-benefit and cost-effectiveness studies reviewed in this report suggest it is) then surely governments at all levels would benefit from contributing to solving homelessness in the most efficient way possible. Otherwise the costs of homelessness are just being imposed on taxpayers at the local level or provincial level who may not be as equipped to make a difference.

POLICY ANALYSIS

A full analysis of the implications of using public policy measures to reduce homelessness would include two elements. First, it would analyze the benefits of reducing homelessness (to individuals, society and governments) through increased housing, and second it would analyze the costs and implications of producing this increased housing (to determine the best implements to deliver those benefits). The benefits analysis would include both the monetary and non-monetary benefits associated with reduced homelessness, such as increased income and increased happiness of homeless individuals who have been housed, as well as the monetary benefits of reduced use of costly emergency and shelter services. Second, the analysis would calculate the costs of housing the homeless, which would include direct housing costs and support service costs for certain homeless individuals. The benefits and costs of housing the homeless would be added to arrive at the net benefit (or net costs) of housing the homeless over the status quo of governments continuing to pay the costs associated with managing homelessness. Due to the wide range of relevant costs and benefits that can be associated with homelessness (as well as the large data demands of such an approach) a full enumeration of benefits is outside the scope of this report. However, numerous other studies have described the benefits that result from reducing homelessness, and it is worth briefly mentioning these findings.

Housing the homeless has a number of non-monetary benefits. Housing helps contribute to increased self-confidence and stability for tenants, and to positive health outcomes such as reduced drug and alcohol abuse, fewer mental illness symptoms (such as depression or anxiety), and overall better health (Palermo, Dera, Clyne, Ternoway, & Lewis, 2006). Housed individuals also benefit from increased employment potential and increased incomes (Berry, Chamberlain, Dalton, Horn, & Berman, 2003). Nelson et al. (2005) demonstrated through extensive personal interviews that housed individuals tended to feel more independent and had increased hope for the future. Housed individuals were also found to have increased feelings of personal safety, and reported feeling more connected with their community. Housed children tend to complete much more education, which then has further positive outcomes in terms of their increased likelihood of employment, their increased lifelong earning potential, and increased societal productivity (Berry, Chamberlain, Dalton, Horn, & Berman, 2003).

Housing the homeless also benefits taxpayers by reducing the costs of providing services for homeless individuals. Many of these costs were reviewed in the previous section which estimated the current cost of homelessness. Housing the formerly homeless is shown to significantly reduce government medical expenditures, psychiatric care costs, emergency shelter expenditures, policing costs, incarceration costs in prisons and jails and legal system costs (Berry, Chamberlain, Dalton, Horn, & Berman, 2003; Culhane, Metraux, & Hadley, 2002; Eberle et al., 2001; Palermo et al., 2006). These cost reductions can benefit citizens in three ways, depending on how the government returns the savings. First, if the cost savings are passed on to taxpayers through tax reductions, then all those who pay taxes benefit. Those that pay more taxes will tend to benefit the most. Second, if these cost savings are returned in the form of improved health and justice services, then the highest users of those services will benefit the

most (such as the elderly who use more healthcare services). Finally, if these cost savings are returned in the form of increased social program spending, then the users of those social programs will benefit the most.

But to achieve the above-mentioned benefits of housing the homeless, there is the associated cost of actually constructing and maintaining the affordable units. Building affordable housing can be achieved through public housing programs, through requirements for developers to produce affordable housing, through tax expenditures that increase returns on rental housing, through land-use planning policy or through other public policy measures. It is beyond the scope of this report to determine which of these incentives are more efficient from a cost-effectiveness point of view, however, the discussion below cites any literature that was uncovered that provides evidence in this regard.

Given that the benefits of eliminating homelessness should be relatively invariant of the method used to solve the problem, or at least assuming that they are in order to make the analysis more manageable and to put the focus on the policy instruments themselves, the rest of this report's analysis evaluates the costs associated with twelve specific measures that could be used to produce more housing. Common to all the potential measures is that they would contribute to developing more affordable housing (which would reduce homelessness), albeit to varying degrees. So each measure is considered as a shift away from the status quo of taxpayers bearing the costs of simply managing homelessness. Appendix 2 summarizes the results of this analysis in a table for easier comparison across the twelve evaluated policy options.

After reviewing the literature on rental housing policy, three main criteria were chosen to evaluate the proposed policy measures: effectiveness, administrative efficiency, and equity. These criteria are discussed below and then applied to each of the twelve policy options in turn.

Effectiveness

The measure of effectiveness is essentially a determination of the extent to which the measure fulfills the short-term and long-term objectives of the policy. For each of the twelve proposed measures, the broad objective is to increase the quantity of affordable rental housing. The effectiveness measure therefore gauges to what extent the policy will increase the number of low-end-of-market rental housing units (F.B. Gorman & Associates Limited, 2002).

A large driver for the effectiveness of a measure is the value (incentive) it provides rental building investors. Where the data was available, return on equity (ROE) is used as a measure of this value. McClanaghan (2009) advocates for using return on equity as a measure of value since it indicates the point at which a building investment appears viable. Based on the model his study developed, it was estimated that a typical rental building would currently yield a return on equity invested of 4.32% (if it were wood-framed).⁹ The expected return on equity for a profitable building was estimated to be 10%, meaning there was a shortfall of 5.68%. So the extent to

⁹ Return on equity figures discussed within this report are all for wood frame buildings.

which each of these measures covers this profitability gap is representative of the value or incentive each measure would provide to individual building investors.

Administrative Efficiency

This measures how simple the policy is for governments to implement and how flexible it is to changing situations. Policies (especially tax policies) should also aim to be as simple as possible for citizens to understand and comply with. This means that the consequences of the policy change must be easily recognized and accounted for so that tax burdens are known and informed decisions can be made by those affected. Simplicity can be partially achieved by amending existing legislation or expanding current programs rather than introducing completely new measures, since it can be assumed that most professionals involved in the housing market will know about current taxes and policies that affect them (F.B. Gorman & Associates Limited, 2002).

Also part of the efficiency of the program is how much certainty and predictability it affords. As with simplicity, being able to reliably predict exactly how a tax or policy measure affects profitability is important. Certainty helps reduce imperfect information and enhance actors' ability to make informed decisions. Predictability also increases the government's ability to effectively budget, by ensuring more stable estimation of revenue sources (F.B. Gorman & Associates Limited, 2002).

Another value underlying efficiency is the flexibility a program or measure has to adapt to changing situations. For instance, if there are new economic circumstances or if taxpayers respond to the measure in unexpected ways, can the measure evolve to accommodate these shifts? Finally, the administration and compliance costs of the new measure should strive to be as low as possible. The proposed measure should be relatively easy and economical to implement and should not introduce significant compliance costs for taxpayers. This increases the taxpayer respect for the government system, which is a key requirement for a self-assessing tax system (F.B. Gorman & Associates Limited, 2002).

Equity

The equity criterion measures the underlying fairness and equality of the proposed measure. This involves both to what extent the measure is fair and equitable for those impacted by it, and to what extent the measure moves the entire tax system or policy framework towards a fairer state. By changing the way tax expenditures are used, governments are effectively altering equity by changing the relative tax burdens of differing taxpayers (Wood, 2006). In evaluating tax policies, two types of equity are typically considered: vertical and horizontal.

Vertical equity assesses the impact of a policy on individuals with varying levels of initial welfare. It is the basis for the progressive tax system and requires that as a person's initial welfare increases, so too will their share of the state's fiscal burden (Duclos, 2008). As discussed above, all the proposed measures evaluated in this report are expected to increase affordable housing. Therefore, all are expected to increase vertical equity, at least at the bottom of the

income scale, since benefits are targeted at the lower end of the income spectrum, while costs are borne by taxpayers as a whole (who tend to be at the moderate to higher end of the income spectrum). Only if the costs were also targeted at the low end of the income spectrum would vertical equity not necessarily improve. If a particular policy tends to benefit high-income earners more than typical taxpayers, there can be increased threats to vertical equity, although this would occur at the higher end of the income scale.

Horizontal equity essentially dictates that under government policy equals must be treated equally. However, despite the simplicity of this concept, there is a great deal of disagreement in the literature over how to effectively apply this (Galbiati and Vertova, 2008). To help simplify the analysis, horizontal equity for this report will focus on the source of income (that is that those with similar income levels should be treated similarly by government policy, regardless of the source of their income) (Holmes, 2001). This is also how Bankman (1989) describes horizontal equity. In his definition, Bankman states that horizontal equity is defined as the adherence to the Haig-Simons tax base. The Haig-Simons tax base is the current system of tax collection based on an individual's annual economic income. So under this definition, economic income is used as a proxy measure for likeness between individuals. Those with similar economic income before a tax should have a similar economic income after the tax (Bankman, 1989). And whether income is generated by individuals or principal business corporations, or whether similar businesses' assets are held in the rental market or other markets, policy should treat these all equally to be considered horizontally equitable. This does introduce a tension as preferences given to support the rental market exclusively may be considered horizontally inequitable, but are still vertically equitable in that they support low-income affordable housing.

Based on these definitions, how a policy shifts the tax burden, benefits, or how it affects rates of returns to individuals or groups determines how it affects horizontal and vertical equity. For instance many of the potential policies considered increase tax expenditures by decreasing the taxes payable by certain rental market investors. This decreases the total tax yield, and in turn, either overall tax rates must increase to compensate, or other government expenditures must be reduced. While tax expenditures that benefit rental market investors cause their profits to increase, they should also cause rental rates to decrease for tenants. In the long run, how benefits are distributed between rental market investors and tenants depends on the relative elasticity of demand and supply for rental units, with the side of the market that is the least elastic reaping most of the benefits. The answer to this question is particularly important because if the benefits are largely reaped by rental market investors, the consequences are that rents may not decrease as much as is needed for affordable housing to be created. That is, new units may be created, but they may only result in an increase in the vacancy rate, because potential tenants are priced out of the market. If supply is elastic in the long run and demand inelastic, then the policy will be effective and result in rental units becoming more affordable.

There is evidence in the literature that housing supply is relatively elastic. Using data from the US Bureau of Labor Statistics, Leeuw and Ekanem (1971) show that supply is more elastic and that intervention on the supply side will have a greater impact on reducing rental rates than demand-side interventions. Malpezzi and Maclennan (2001) use aggregate national data from the

US and estimate high residential supply elasticity (between 6 and 13 in the US). After reviewing the available literature, Blackley (1999) concludes that “the general notion is that housing supply is highly elastic in the long run” (p. 26). This is then confirmed by her analysis that finds the long run housing supply elasticity is between 1.6 and 3.7. This all suggests that the described policies will tend to be effective in reducing rental rates and making the market more affordable for tenants.

Also part of the equity criterion is how the measure transfers costs between taxpayers. When describing the cost of each policy option, it is also important to examine who in society primarily benefits from the measure, and who must then bear the increased burdens. Where appropriate, the size of this cost transfer is described to help compare the relative cost-effectiveness of each measure, and to help compare the cost of creating new housing against the status quo of managing the cost impacts of homelessness. As mentioned earlier, even if a measure shifts costs from the housing sector to taxpayers as a whole, this is usually not an actual transfer. Since all the measures contribute to reducing homelessness, even if an increased tax burden is passed on to taxpayers there are cost reductions for housing the homeless. So if the costs introduced to taxpayers are lower than the costs of managing homelessness, from the point of view of the taxpayer this is a cost reduction rather than a transfer.

Before moving on, it should be noted that the following analysis relies heavily on previous analyses conducted by others in the field of rental housing policy (such as F.B. Gorman & Associates Limited, 2002; Lampert & Pomeroy, 2002; McClanaghan, 2009; and D. A. Patterson, 2007). To improve the comparability of each measure, all cost estimates were updated to 2009 dollars using the Bank of Canada’s CPI (Bank of Canada, 2010b). Other than this, all cost figures and financial impacts were kept consistent with the author’s original analysis. This does introduce some limitations for their use here. Assumptions and limitations within the original analyses limit the applicability of these figures to the current rental market in Victoria. For instance, the measures in the McClanaghan report are modeled to see their impact on a typical rental building within Metro Vancouver. This means that the impacts on a low-end of market building in Victoria will not necessarily be the same (although they are considered similar enough to still be of use in this analysis). The Patterson report uses average condominium building sales as a proxy for determining the price of average rental building sales. It also assumes capital cost allowances are used to the maximum each year, and that the annual growth rate for the 20 year period is 3% per year. Another limitation pointed out in the above analyses is that all construction projects are unique. So while these figures can give indications of the impact on typical projects, there are too many other market factors to truly know exactly how effective each will be.

Despite these limitations, the analyses used for this report still give a good estimation of the relative transfers of cost bearing for each measure, as well as a decent indication of the impacts each would have on building profitability.

This would change the income tax regulations so that all rental building investors were able to deduct CCA-created losses from any other income source for tax purposes. Currently this benefit is only available to principal business corporations.

Effectiveness

This measure would be especially valuable to small, individual rental investors wishing to enter the market, and would be instrumental in bringing new funds into the rental investment sector. This would be especially beneficial if the measure were created in such a way that high-income individuals could take advantage of the tax shelter by contributing funds to developers or syndicators. This way the investors would benefit and would be more willing to invest, without needing any expertise in the intricacies of building construction (Lampert & Pomeroy, 2002). If structured this way it would be similar in scope to a low-income housing tax credit scheme. Similar tools have been used to create successful private rental markets in Germany, Australia and New Zealand (Hofer & Gurstein, 2009).

One potential limitation on this measure's effectiveness is that this benefit is already available to principal business corporations. Because these rental corporations represent a majority of the investment in the rental sector, this would not encourage them to change their behaviour in any way (Clayton Research Associates Ltd, 1998). Also, there is a recent trend toward lowering the personal income tax rate for individuals. This reduces the need for tax shelters, as less income tax is owed overall. The marginal tax rate for high income earners is still high enough that tax shelters are attractive, but the effect is lessened as the tax rate drops (Lampert & Pomeroy, 2002).

Administrative Efficiency

This is a simple change to make that would also be very understandable to taxpayers. One issue with the long-term flexibility of this option is that it can be difficult to track program costs. Because the details of each tax expenditure are buried within the tax returns of individuals, total program costs can be difficult to estimate year-to-year (compared to a direct-spending program) (Hofer & Gurstein, 2009). This lessens the predictability of the impacts for government budgeting.

Equity

In the short term this measure benefits rental investors (and through them tenants) by reducing their taxes payable. This then increases the cost burden on all other taxpayers to compensate. Over the long term, the total amount of CCA depreciation available in a building is equal to the building value, and whether that is used as a larger tax deduction early on or deducted over a longer period it is the same amount (Lampert & Pomeroy, 2002). Therefore, the only long-term

impact on government incomes from this change is the opportunity cost associated with receiving these revenues later as opposed to earlier.¹⁰

Currently, principal business corporations are not restricted in transferring losses among their investments. Life insurance companies are also given the ability to invest in rental properties and then transfer CCA losses out towards other income (Lampert & Pomeroy, 2002). This change would therefore increase horizontal equity by allowing all actors in the rental housing market to take full advantage of their tax deductions.

This option does threaten vertical equity by opening partial tax shelters to high-income individual investors. So while horizontal equity and effectiveness are greatly increased with this measure, this can come at the cost of vertical equity as some higher-income investors use the benefit to reduce their taxes payable (F.B. Gorman & Associates Limited, 2002). This was the rationale for restricting CCA-created losses during the tax reforms of the 1970's. By timing their acquisitions, building investors could keep investing in buildings with high undepreciated capital costs, and their CCA deductions would never fall below average. CCA recapture could be postponed almost indefinitely. While this practice is limited to an extent by the separate class rule (described in the Current Disincentives section above) and the requirement that the benefits only apply to new rental properties, there is a trade-off between providing an effective incentive to invest in affordable housing and providing a tax loophole to high-income earners (F.B. Gorman & Associates Limited, 2002). More progressive tax rates could be reintroduced to help offset this, although an examination of this concept exceeds the scope of this report.

Summary

The CCA deduction not only improves profitability on its own, it improves the effectiveness of a number of other tax-based development incentives (such as increased CCA rates). This is an easy change to implement, that greatly increases horizontal equity. It would be, however, primarily beneficial for individual investors who do not currently make up the majority of the market, and could lessen vertical equity by introducing large potential tax shelters.

INCREASING THE CAPITAL COST ALLOWANCE

Another potential option is to increase the capital cost allowance (CCA) rate from 4% to 5% to accelerate the depreciation of rental buildings for increased tax deductions in the earlier parts of

¹⁰ The opportunity cost is equal to the cost of the next best alternative that could be done with those committed funds. It quantifies the cost associated with taking one course of action over another. Since the CCA change would mean less taxes are collected initially, the opportunity cost is equal to the next best use those funds could have been used for if they were collected. For instance the taxes could have been invested for that period and earned interest for the government. Quantifying the opportunity cost for public investments requires applying an appropriate social discount rate. This was not done in this report due to the contentiousness of selecting a proper social discount rate (Moore, Boardman, Vining, Weimer, & Greenburg, 2003).

the investment. This deduction would reduce net income and tax liability in the earlier years of a building investment. Although changing the “half-year rule” for the first year of building ownership would also be beneficial, since the rule applies to all capital assets it is deemed too problematic to be recommended (Lampert & Pomeroy, 2002).

Effectiveness

This would greatly improve the profitability of a building in the early years of operations when revenues are at their lowest (negative cash flows usually). In order to take full advantage of this measure, it would need to be accompanied by the ability to create income losses through the CCA deduction. If there was an increase in the transferability of losses by 4%, investor’s return on equity would be increased by approximately 1.75% (McClanaghan, 2009). So the value to the rental unit investor would be that this covers about 31% of the profitability gap identified by McClanaghan.

While favourable CCA rates are used successfully to support rental markets in New Zealand, Australia and Germany, this would tend to benefit all rental housing developments not just those at the affordable end of the market (Drummond, 2004). Of course this may not be of great concern, since rental housing as a whole tends to cater to lower-income residents.

Administrative Efficiency

This is a fairly simple change to make, as it only requires increasing the current CCA rate to 5%. This option would also be highly visible and predictable from the point of view of the taxpayer.

Equity

Changing the CCA rate does not eliminate any taxes on rental buildings, it simply changes the way they are collected. A higher CCA rate means that there is a higher income tax deduction in early years of building ownership, and a lower deduction in later years. Lampert and Pomeroy (2002) estimate that at a CCA rate of 5%, the present value of the deferred taxes would be between \$8,030 and \$10,094 per unit (assuming the units have a 25 year life cycle and that there is a discount rate of 6.5% on the building).

So the present value of the change from the current 4% rate to 5% would be between \$1,032 and \$1,377 per unit (Lampert & Pomeroy, 2002). This would primarily benefit rental investors and renters, while in turn increasing the tax burden for all other taxpayers.

There are examples of favourable CCA rates in other industries that allow accelerated depreciation. Airlines for instance can claim a CCA rate of 25% on aircraft, even though their useable lifespan is much longer than four years (Lampert & Pomeroy, 2002). So this measure would help increase horizontal equity between these economic sectors. Within the housing sector there would be a horizontal inequity created between old and new buildings.

Summary

Increasing the CCA rate can greatly improve building profitability, especially if at least some transferability of losses is allowed as well. This is also a simple change to make that can be directed so it only benefits rental housing investors (which would be necessary to avoid creating a major new tax shelter).

CAPITAL GAINS ROLLOVERS

This option would allow for the rollover of Capital Gains taxes and CCA recapture when profits from a rental building sale are re-invested in the rental market.

Effectiveness

This is primarily effective because it encourages new investors to enter the rental market. Those with a lower tolerance for risk (such as pension funds, real estate investment trusts and non-profit housing providers) are able to invest in an established building, which would have a known performance history. This removes much of the uncertainty for investors who are relatively new or risk adverse (Lampert & Pomeroy, 2002). This would then free up capital for those who do have more experience building rental projects to try reinvesting in new projects. Developers could then spend more time focussing on building new projects (rather than being encouraged to maintain a large rental real-estate portfolio) which allows for further specialization (Clayton Research Associates Ltd, 1998).

This also eliminates what is referred to as the “lock-in effect,” which is when a potential tax penalty encourages rental investors to hold onto property they would otherwise sell. There is then a high opportunity-cost as the land is held in one use due to tax reasons, instead of being reallocated to a more efficient use (Canadian Real Estate Association, 2008). One local real estate observer pointed out that this phenomenon can be seen on Government Street in Victoria, where there are numerous buildings with profitable shops on the ground level, but vacant floors above (Lavoie, 2009).

There is evidence from other countries that when there is more favourable treatment of capital gains taxes, there can be many investors who are interested in purchasing a rental building for nothing more than its capital gain. The housing markets’ frequent “booms” have led many to invest in rental units with no concern for the rental yields, but only the prospect of large gains ten to twenty years in the future (MacLennan, 2008a). Although this does not help contribute to long-term stability, it is a more immediate benefit for the rental stock.

Furthermore, with the current lack of rollover provisions, there is in some cases an incentive to demolish older rental buildings rather than sell them and re-invest the proceeds. This can often happen when the land beneath an older building greatly appreciates in value. The capital gains tax then acts as an extra incentive to demolish the rental units and to rededicate the land to another use, and in some cases it can simply be more profitable to raze the building to avoid the tax loss (Lampert & Pomeroy, 2002). Given the current housing situation of net losses in rental

units, reforming the capital gains tax to help preserve existing stock is almost as important as enticing new developers to the market.

Allowing for the rollover of capital gains would have a high value for private rental building investors. A real estate analysis produced for the Ontario Ministry of Municipal Affairs and Housing concluded that the lack of capital gains rollovers was one of the most significant factors driving down rental investment returns, and that allowing the rollover would increase rental investment returns by approximately 15% (Ernst & Young, 2001). Another analysis done for the Apartment Owners' and Property Managers' Association of Vancouver Island and the Canadian Federation of Apartment Associations calculated that the lack of capital gains rollover and CCA recapture resulted in an added \$20,142.04 per unit to the cost of a building when it is sold (D. A. Patterson, 2007).

Administrative Efficiency

This measure would be simple to implement since it only requires minor change to the *Income Tax Act* (Department of Justice, 1985). Sections 13 (Recaptured Depreciation) and 14 (Eligible Capital Property) would need to be changed to reflect that proceeds from the disposition of rental property can be deferred when re-invested in similar property within one year. The current capital gains regulations are not complex, and have been in place for a long time. So the current tax rules are predictable and certain, although so too would be any changes that allow for tax deferment (F.B. Gorman & Associates Limited, 2002). The new measure would need to be carefully worded so it is clear it only applies to rental real estate and not real estate more broadly (which could open unintended tax loopholes) (Lampert & Pomeroy, 2002).

Equity

This measure involves transferring some of the short-term costs of housing from rental investors and renters to all taxpayers at the federal level. Over the long-term, there are no direct costs associated with this option. Rollover provisions allow for the postponement of taxes but not forgiveness, so the tax loss is due to a collection timing difference rather than a lower tax yield (Lampert & Pomeroy, 2002). The only true cost to government is the opportunity cost of not being able to use those tax revenues for the period they are being invested in the rental market.

In most cases, businesses can sell a capital asset and pay no capital gains provided they reinvest the proceeds into a similar asset within the same year, yet rental property owners may not (Lampert & Pomeroy, 2002). This is especially inequitable given that this provision is available to the owners of motels (who have virtually identical capital assets to rental building owners) (D. A. Patterson, 2007). So there is a strong argument to be made that the current tax treatment is disadvantageous to the owners of rental property, and allowing the rollover of capital gains would help make the system more horizontally equitable. This policy would also encourage investors to expand their real-estate portfolios and would help discourage the demolition of the current rental stock (F.B. Gorman & Associates Limited, 2002).

Summary

Not only would a capital gains rollover provide a high value to current investors, it would increase liquidity in the market and encourage new investors to enter. This also serves to preserve existing rental stock, a particular concern in Greater Victoria. There is also an equity argument that the current system is unfair to rental investors. Implementing this change would be simple (with relatively few long-term costs) although any new capital gains rollover measure would need to be worded so it only applies to rental real estate.

SMALL BUSINESS DEDUCTIONS

This would change the definition of “active business income” so that it included rental property income, or even eliminate passive income loss restrictions altogether. This would make small landlords, and rental property investors eligible to claim the small business deduction.

Effectiveness

This change would be beneficial for small individual investors, as it would allow them to access the same tax deductions that are used to help small businesses increase their capital. Small, individual landlords already make up a significant minority within the market, and this measure would encourage many more to enter. This would also open an entry-way to the market for investors who have less experience or are less risk averse, thus allowing developers with more experience to re-invest in new projects (Lampert & Pomeroy, 2002). Although this would be valuable to rental investors, it is difficult to estimate exactly how valuable since it depends so heavily on individual business situations.

One caveat is that while this would entice more investment in the rental market overall, this measure does not necessarily target low-income housing units. In fact this encourages investment, but only indirectly encourages new development (as developers have more liquidity to reinvest if they wish) (Lampert & Pomeroy, 2002).

Administrative Efficiency

This option is relatively easy to implement as it would only require a redefinition of “active business income” to include rental property returns. As Bankman (1989) argues, it may be more efficient and equitable to take this a step further and eliminate passive loss restrictions altogether. This would, however, have impacts on tax collection far beyond the housing market, and would require careful consideration before implementing.

From the perspective of the taxpayer, the small business deduction is not overly complex to comply with, since it only requires a determination of whether the rental income qualifies for the deduction and whether the corporation is Canadian controlled. The body of case law and Canada Revenue Agency interpretations of the small business deduction can help clarify these issues (F.B. Gorman & Associates Limited, 2002). The certainty and predictability of the tax

implications are also highly visible, so long as a landlord is able to accurately estimate their active business income for a given year (F.B. Gorman & Associates Limited, 2002).

Equity

Currently, rental investment is treated as a passive investment (the same way revenue from stocks or bonds is). This seems horizontally inequitable, as individual rental property owners do quite a lot of work to maintain building operations. New tenants must be screened, the building must be maintained, taxes and fees must be paid and so on. Small landlords are excluded from a valuable deduction, even though they are just as “active” in running their building as any small business is (Lampert & Pomeroy, 2002). There is also a strong argument that the broader concept of passive loss restrictions does not enhance horizontal equity. As described earlier, horizontal equity is based on those with similar levels of economic income being treated equally by a tax or policy. By imposing differing tax rates on passive income sources, individuals with similar incomes will be unevenly taxed.

Vertical equity is also achieved through small business deductions, since larger corporations tend to have higher incomes, and therefore do not qualify for the benefit (F.B. Gorman & Associates Limited, 2002). If passive loss restrictions are eliminated, this will also help serve vertical equity. While it may appear that passive loss restrictions enhance vertical equity (by imposing higher taxes on those who own capital who also tend to be of higher income) this is not the case. The impacts of passive loss restrictions tend to simply get passed on to either consumers (through higher product prices) or to labour (through lower wages). Furthermore, not all high-income earners invest in capital, so this does not uniformly draw more tax from those with higher incomes (Bankman, 1989).

The exact cost transfer of this measure is too difficult to effectively measure, since it depends entirely on the individual business situation of each small landlord who decides to create a small business to take advantage of the deduction. Furthermore, many small landlords may not even go through the trouble of incorporating simply to get this one benefit. There would however be significant reductions in Federal government revenue from income taxes if this measure were adopted (Lampert & Pomeroy, 2002). For those businesses that do take advantage, this is a tax expenditure and so benefits to individual rental investors and tenants are paid for through increased taxes for all other taxpayers.

Summary

Allowing small landlords to qualify as small businesses would improve their financial situation and is much fairer. However, since this would only impact small landlords (and not principal business corporations), and not all small landlords would necessarily take advantage, this has limited potential for significantly increasing the rental stock (although presumably this would also increase the proportion of small landlords in the market). It is also difficult to estimate what this would cost government, as year-to-year program cost details would only be found in individual tax returns.

SOFT COST DEDUCTIBILITY

This option would expand the list of “soft costs” that can be immediately deducted from income as expenses for income tax purposes.

Effectiveness

The value of this measure to investors depends on the size of the allowable soft cost deduction. Soft costs can cumulate to represent between 13% and 17% of the total cost of a new building (McClanaghan, 2009). Allowing these costs to be immediately deducted would increase profitability in the opening years of building development and operation. This period is when cash flows are at their lowest, and is the most financially volatile time in a major development. This would also have a broad impact across the industry, as it would benefit both individual investors and principal business corporations (Lampert & Pomeroy, 2002). However, for individual investors to fully take advantage of the deductions benefits, they may need to be allowed to transfer those losses over to other sources of income (McClanaghan, 2009).

Administrative Efficiency

Soft cost deductibility was severely limited in 1981 to close a loophole that allowed a tax shelter for property investors. Although re-expanding this list of soft costs would be very easy to do, care would have to be taken to ensure it is not used as an unfair tax shelter once again. Limiting this measure’s applicability to only residential rental buildings would help ensure unintended parties cannot take advantage of the benefit (such as commercial real estate investors) (Clayton Research Associates Ltd, 1998; Lampert & Pomeroy, 2002).

For builders and landlords, soft-cost deductions are not overly complex, although they can be onerous to comply with in major development projects (since careful listing of types of expenses along with times incurred is needed to prove eligibility). There can also be disagreements over what constitutes a renovation, an alteration or a maintenance expenditure (since not all of these qualify for the deduction). However, once the full amount of available soft cost deductions is known, the predictability and certainty of the tax implications are quite clear (F.B. Gorman & Associates Limited, 2002).

Equity

This is a tax expenditure that benefits rental investors and through them renters. In turn this raises the tax burden for all taxpayers overall. One study that modeled an increase of \$5,000 worth of new soft cost deductions estimated that the net present value of the total federal tax loss would be about \$802 per unit (assuming these costs would have been depreciated over a 25 year period) (Lampert & Pomeroy, 2002).

The current system of soft-cost deductibility applies equally to all in the housing sector, so changes to this would lessen horizontal equity by giving a specific tax advantage to the rental industry. Applying the benefits to only new buildings also introduces increased inequity between investors in new and old rental properties (F.B. Gorman & Associates Limited, 2002).

This change would also help to increase neutrality, since renovations and alterations are often financed by current cash flows. Forcing the capitalization of soft costs means the net cost of the construction is increased, which can negatively impact an investor's decision to pursue a project (F.B. Gorman & Associates Limited, 2002).

Summary

This measure would have a moderate effect on building profitability and would be relatively easy to implement. The impacts on government budgets would be relatively low, but any new policy would have to be worded so it only applies to rental buildings. This would limit the effects to only intended beneficiaries, although this would also lessen horizontal equity by introducing different tax rules for rental buildings compared to other capital assets.

GOODS AND SERVICES TAX REBATES

This option would expand the current GST housing rebate to include a refund for all GST paid by investors during building construction.

Effectiveness

Lowering the GST lowers the overall costs of the building initially, which means developments will have lower mortgages and lower mortgage insurance and interest cost expenses. Return on investment is heightened almost immediately and investors would need less initial equity to begin development (Lampert & Pomeroy, 2002).

Zero-rating the GST (that is making it so no GST is payable by developers as construction occurs, rather than just rebating it all later) is another potential option. This would marginally increase the effectiveness of this incentive, although it would require significantly higher administration costs to establish (Lampert & Pomeroy, 2002; McClanaghan, 2009).

The value of this measure to potential rental unit investors is that this would reduce a building's capital costs by about 2%. The McClanaghan model suggests this would increase the return on equity by 0.33% (McClanaghan, 2009).

Administrative Efficiency

This is a relatively simple measure for government to implement, since the current GST rebate program could be expanded to rebate all GST paid during development. One issue is that this would be a difficult measure to apply only to rental housing units. If the rebate was only available to rental housing developments, monitoring would be needed to ensure those units remained rental-only for a sufficient period of time. The current rebate program is somewhat

complex for builders to comply with since it requires a careful record of all GST paid during development, however expanding this to a full rebate would not introduce any more compliance complexity (F.B. Gorman & Associates Limited, 2002). Once the full purchase price for a new rental property is determined by a landlord, the tax consequences of this rebate are both clear and predictable (F.B. Gorman & Associates Limited, 2002).

The current GST rebate does require significant administration costs for government to maintain, although expanding the rebate would not significantly increase these costs. Although zero-rating the GST could be marginally more effective, it is not recommended because almost the same benefits can be achieved with an expanded rebate plan with very few new administration costs (Lampert & Pomeroy, 2002).

Equity

This change would represent a transfer of between \$2,581 and \$3,441 (net present value) per unit from the housing sector to taxpayers at the federal level. This is due to the rebating of the Federal GST charges to individual building owners (Lampert & Pomeroy, 2002).

While the application of the full GST to new rental housing construction does impose a financial burden on the development industry, this is not exclusive to this sector. A full rebate of the GST would amount to a direct subsidy to rental developers, not available to others. So this measure would decrease the horizontal equity of the system by giving tax preferences to rental property developers (and through them landlords and tenants) (F.B. Gorman & Associates Limited, 2002).

GST is, however, a regressive tax in that it impacts lower-income households more than higher income ones. By targeting GST rebates to rental housing some relief is passed on towards lower-income households (since they tend to occupy more rental housing). As described earlier, this helps increase vertical equity (F.B. Gorman & Associates Limited, 2002). At the same time, if the building investors are not monitored for compliance the units could later be sold instead of kept as rental stock. This would greatly reduce vertical equity by passing the savings from tax expenditures on to higher-income homeowners.

Summary

Fully rebating the GST has a modest effect on building profitability, but is problematic since it is difficult to apply only to rental units. Significant monitoring and compliance measures would be needed to ensure the building remained rental only. Zero-rating GST inputs for developers would be even more difficult to implement, and would only slightly improve the impact of the measure.

LOW INCOME HOUSING TAX CREDITS

This would create a competitive tax credit scheme similar to the American Low-Income Housing Tax Credit (LIHTC). The tax credits would be provided by the Government of Canada, although individual provinces could allocate their own share of the credits however they see fit.

Effectiveness

As described earlier, tax credit schemes have been instrumental in contributing significant numbers of new rental housing units in France, Australia and especially the United States. In Australia these tax credits contributed to 3,899 new units being built in a single year, while in 2007 the American LIHTC aided in the construction of 253,000 new units (McClanaghan, 2009). This measure would be particularly effective in encouraging individual investors in Canada because overall the tax system is even more lenient towards them than it is in America (Steele & Des Rosiers, 2009).

There is a concern that by subsidizing the rental sector in this way the government would “crowd-out” private rental development that would have happened naturally if no subsidy was given. However this does not seem to be a major concern in Canada right now, given that there are so few private-sector, purpose-built rental units being created (Steele & Des Rosiers, 2009).

The LIHTC program is also criticised for not catering to the very lowest of low-income housing need. It is true that this measure does tend to help low-to-moderate income households more than it does the lowest-income demographic. However this is somewhat more effective than many of the taxation-based incentives analyzed in this report which would broadly improve the entire rental sector, and not just the low-to-moderate demographic. So this measure can be used more effectively than other tax-based measures to target low-income need (Steele & Des Rosiers, 2009).

Another concern with creating a Canadian LIHTC is that as described earlier, the US LIHTC is aided substantially by its complementary relationship with the demand-side Section 8 housing subsidy. Up to 37% of the households in LIHTC units also receive Section 8 Housing Assistance (Buron, Nolden, Heintzi & Stewart, 2000). With no similar national housing subsidy in Canada it is questionable whether a Canadian LIHTC can be as successful.

A LIHTC program would have a particularly high value to rental property investors. It is impossible to estimate how many units would be created under this program since it depends entirely on how individual provinces decide to allocate the credits, as well as the size and costs of the projects that are supported with those credits. The US awards tax credits worth a present value equal to 70% of the cost of the affordable units (91% in high cost cities), however a Canadian LIHTC could have a different ratio. A lower percentage value would mean the credits could be allocated towards creating more units of housing, although a higher percentage value would entice more developers (and thus ensure 100% of the credits were used) (Steele & Des Rosiers, 2009). At a present value of 70% of the building costs of affordable units, these credits would more than cover the profitability gap in most building scenarios.

Administrative Efficiency

One of the most promising elements of a Canadian LIHTC program is the fact that it could be tailored to work very well within Canada’s federal framework. The American LIHTC is funded by the Federal government, but then tax credits are allocated to each state based on population

percentages. States then have the power to allocate the credits to developers in any way they choose. In Canada this would mirror the current affordable housing framework which provides funds to provinces to let them allocate as they need. Provinces could award tax credits according to local needs, which can allow for a great deal of regional flexibility (Steele & Des Rosiers, 2009). If desired, the funds could also be allocated to each province based on their number of households in core housing need (as measured by CMHC). This would, however, introduce measurement issues as Steele and Des Rosiers point out that census data is often more up to date than calculations of housing need.

As mentioned above, the LIHTC does not always directly target its benefits to the lowest-income households. Policies can be flexible to alter the eligibility criteria for tenancy in tax-credit supported units, to better direct benefits to low-income households. However, this introduces an efficiency trade-off as targeting the benefits through eligibility criteria requires increased administration and compliance costs to effectively manage (Wood, Watson, & Flatau, 2006). Compared to direct-funding social housing programs, tax credit schemes also incur higher transaction and syndicator costs (such as legal, accounting and administrative costs for actors who make credits available to individual investors) (Wallace, 1998). This increases the administrative costs and the complexity of the overall program.

Equity

These tax credits would be a direct subsidy for the rental unit development industry, which reduces horizontal equity in the housing market. And while this does challenge vertical equity (by giving tax preferences primarily to higher-income property investors) this also increases the affordable housing and thus increases low-income households' access to affordable housing. This measure would also introduce new administrative costs for provincial governments who would need to hold the competitions to allocate the credits.

This program is a major tax expenditure which benefits individual rental housing investors and renters, at the expense of the overall tax yield. One potential model, based on the American LIHTC, would begin costing \$47.42 million in its first year, and then gradually increase up to a total of \$474.2 million by the tenth year. The discounted value of this expenditure is estimated to be \$408.2 million for this ten year period (Steele & Des Rosiers, 2009).

The funding for the program begins at \$47.42 million as calculated by allocating provinces \$2 per capita per year (\$20 per capita for the full 10 year commitment).¹¹ The program then increases by \$47.42 million in the second year, as new allocations are made (worth \$47.42 million) and last year's commitments (worth \$47.42 million) are given their second allocation. These increases continue until the program spending plateaus at the end of the first allocations' ten-year time period (Steele & Des Rosiers, 2009).

¹¹ For comparison, this figure is more conservative than the 2008 US LIHTC allocation of \$2.40 per capita.

Summary

A Canadian low income housing tax credit scheme is one of the more promising options discussed in this report. Its high value to rental investors and its ability to fit well into the current federal-provincial fiscal framework make it likely to have a very positive impact. There are however, high program costs and some loss of efficiency compared to other housing delivery methods. Reviewing lessons learned from Canadian, American and Australian examples of similar programs can help ensure a new LIHTC would be implemented more effectively and efficiently.

INCLUSIONARY ZONING

Local governments could expand the use of inclusionary zoning policies (which mandate certain percentages of units in new developments be affordable for low-income households) to encourage more low-cost rental developments.

Effectiveness

Inclusionary zoning is effective at integrating affordable housing throughout a community as new developments arise. This creates mixed-income neighbourhoods, and also ties the issue of affordability directly to residential development growth in a community (Curran & Wake, 2008; Thibert, 2007)

In order to be truly effective, inclusionary zoning needs an expanding market. The justification for imposing affordability restrictions on developers comes from the fact that allowing rezoning of many properties for residential use would dramatically raise the property value, and thus be a major profit for the developer. So if the rezoning gain is not high enough other incentives (such as density bonuses, reduced development cost charges or tax forgiveness) are required, and these may need to be significant concessions (Chang, 2009). Otherwise there is a danger that developers will seek out other, less costly jurisdictions to do business in (Curran & Wake, 2008). There is also evidence that prescriptive land use policies (policies that guide and limit development such as inclusionary zoning) contribute to higher overall housing prices within a region (Cox & Pavletich, 2009; Maclellan, 2008a). Stringent land use planning may also encourage some landowners to not develop their property for housing, and instead keep the land off the market until conditions are better (for instance for a time when the policy is changed) (Whitehead, 2007).

This option may also have limited effectiveness within the Capital Regional District, as many municipalities already encourage, or are considering encouraging inclusionary zoning policies. Inclusionary zoning features in the Official Community Plans for Victoria, Langford, Central Saanich, Sooke and Saanich (City of Langford, 2008; City of Sooke, 2010; City of Victoria, 2008; District of Central Saanich, 2008, District of Saanich, 2008).

Administrative Efficiency

Inclusionary zoning policies do have a high degree of flexibility in implementation. As it is one of the most frequently used tools in encouraging affordable housing in North America there are numerous examples of smart practices to rely upon (Wake, 2007). Inclusionary zoning restrictions can be either mandatory or voluntary (matched with other incentives) as each local government sees fit. These same policies can also be used to support the affordable ownership market, as well as the affordable rental market as needed. There is also the flexibility to enforce affordability limits on the created units for a set amount of time (thus offering an opportunity for larger later gains for investors who eventually want to re-sell), or the units can be kept affordable indefinitely through covenants or rent controls (Metro Vancouver Policy and Planning Department, 2007). Finally, inclusionary zoning contributes to better land-use planning which can benefit the community as a whole by making the city more attractive to professionals, workers and businesses as well as raising property values (Chang, 2009).

Inclusionary zoning can be difficult to maintain, however, because of the need for constant monitoring. First, oversight is needed to ensure the promised units are actually provided by the private sector. Second, oversight is often needed to ensure the covenants are maintained and affordability is achieved over the long-term (Curran & Wake, 2008). Inclusionary policies can also be difficult to implement as they often require complex cooperation and coordination between many municipal departments (Chang, 2009).

Equity

This measure essentially spreads the cost of developing affordable housing across the housing sector as a whole. If government was originally going to provide the social housing itself, this transfers those costs from the taxpayers or general consumption to the housing sector. Also, by reducing homelessness, service cost reductions save taxpayers at the expense of increased burden on the housing sector. If the zoning policy is matched with extra incentives (such as development cost charge reductions or property tax reductions) those would of course cost government budgets accordingly.

From a city planning point of view inclusionary zoning can be desirable, as it creates mixed-income neighbourhoods. As Thibert (2007) points out, this “may not cure social exclusion, but the bulk of the evidence suggests that it can both prevent it and afford ways out of it” (p. 11). And in a similar vein, this means that new affordable projects are integrated across all new developments (rather than segregated to certain areas or projects) (Curran & Wake, 2008). If, however, off-site provision of affordable units is allowed, there is the danger that low-cost units will become segregated to certain areas, which is an effect that must be carefully managed and avoided if possible (Metro Vancouver Policy and Planning Department, 2007).

There is a perception that inclusionary zoning shifts the burden of funding affordable housing from all taxpayers to more narrowly the development sector. In some ways this can be contentious, as the imposition of building affordable units can be viewed as a removal of potentially profitable land from the developer (Chang, 2009). This then lessens the neutrality of

the government, as certain types of housing tenure are mandated for construction. Unless extra incentives such as density bonuses or planning gains are included, it can be viewed as a detriment to the development sector (Rubin & Seneca, 1991). Furthermore by raising development costs overall, this policy may alter the decision to invest in rental housing, as non-residential development may become relatively more profitable (Whitehead, 2007).

There is also a related equity trade-off from the point of view of the tenant. On the one hand, land use regulations help to ensure that housing is available to lower-income households as well as higher-income ones (thus increasing equity through a redistributive policy). On the other hand, since regulation increases the price of overall market housing, affordability is reduced and the number of households needing assistance increases (Whitehead, 2007). Also, vertical equity is lessened as the immediate effect of increasing the land prices is to shift wealth towards those who already own land (who are predominantly higher income) (Whitehead, 2007).

Summary

Inclusionary zoning is a cost-effective way for local governments to encourage affordable housing within their communities. It integrates this housing with new development, creating mixed-income neighbourhoods that lessen the effects of social exclusion. However, if the benefits to developers are not high enough (meaning the rezoned land is not worth enough or there are no density bonuses) then there is a danger that inclusionary zoning will drive development away to other areas. Furthermore, many municipalities in Greater Victoria already use inclusionary zoning policies, thus limiting its opportunity to be expanded within the region.

DENSITY BONUSES

Local governments could use their planning and zoning powers to expand the practice of allowing higher-than-normal density zoning in exchange for the provision of affordable housing units.

Effectiveness

This can encourage developers to create affordable (even below-market) rental units without costing the developer any more money, making it a more attractive option for the development community. This measure can contribute to more efficient land use, and it works especially well in high-density areas where the increased densification would not disrupt neighbourhood character in any way (Curran & Wake, 2008). Also, because density is increased more units are added to the housing stock, which then filter down to lower-income households over time (Rubin & Seneca, 1991).

The value of this measure to rental investors depends on the size of the bonus, and the nature of each development. One study found that in Vancouver a density bonus of 25% would help lower unit-costs by \$14,000 each, and represents a 1% improvement in return on equity (McClanaghan, 2009).

Density bonuses are however more difficult to implement in rural and suburban neighbourhoods as they can significantly alter the character of a neighbourhood (Wake, 2007). There are also concerns that by themselves they are often not enough of an incentive. Some developers see the added density as insufficient compensation for the provision of the social housing units (Curran & Wake, 2008). Rubin and Seneca (1991) demonstrate that when implementing a density bonus, social welfare can be improved if the policy allows a large enough bonus to afford equal or greater profits than would have been possible under the original zoning. That being said, the authors also note that it appears few density bonuses are implemented with a full understanding of the economic implications of the change.

Administrative Efficiency

While this is a simple change to make, understandability of the program objectives can be a challenge. Clear communication of the city's planning vision, the potential community benefits as well as the specific responsibilities and requirements of developers are crucial. This is especially true if there is to be a standard density bonus policy put in place, rather than individual one-on-one negotiations with each redevelopment application that is made (Curran & Wake, 2008). Negotiation of each individual project also weakens predictability and certainty for investors, who need to commit significant planning resources before learning the specifics of their project's density bonus. Also, as with inclusionary zoning, there can be issues with monitoring to ensure the promised affordable housing units remain affordable for the long term (Curran & Wake, 2008).

Equity

If implemented as a voluntary measure for developers to opt into, then no additional horizontal equity burdens are imposed on the development industry. This encourages the provision of social housing units without imposing additional land requirements on developers as inclusionary zoning does. If density bonuses are only available to certain types of housing providers (such as only rental buildings) then this weakens horizontal equity by offering a preference to only one industry.

As with inclusionary zoning, density bonuses can tend to increase the overall cost of housing. If the developer must provide 10% affordable units, then each of the remaining market-rate units effectively bears 1/10th of this cost, which will often be passed on to market renters through higher rental rates (Rubin & Seneca, 1991). This introduces the same trade-off discussed above with inclusionary zoning, as vertical equity is first improved by increasing access to affordable units, but then threatened by higher overall housing costs that put more households in affordability stress (Whitehead, 2007).

There is no direct cost to government budgets to implement this measure (although there could be indirect costs associated with supporting and servicing a denser population). Density bonuses shift the costs for providing social housing (or for managing homelessness) from government budgets to the private housing development sector. The success of this transfer is dependent

upon the developer's willingness to accept the trading of higher-density land-use in exchange for the provision of social housing units (Rubin & Seneca, 1991).

If the government later had to manage the operations of the rental units (as social housing) there would be ongoing costs for this (although rents and shelter allowances would likely cover these costs).

Summary

Density bonuses (like inclusionary zoning policies) would be effective in incenting new development, although they are already used in many jurisdictions within the CRD. A 25% density bonus could cover up to 1% of the 5.68% return on equity profitability gap. As with several of the other proposed policies, monitoring would be needed to ensure the units remain affordable. This also introduces an equity trade-off as more affordable units are created, but housing prices overall also tend to rise.

PARKING RESTRICTIONS

Local governments could use their building permit powers to relax parking restrictions and allow developments with fewer parking spaces-per-unit.

Effectiveness

Lowering the required number of parking spaces impacts the profitability of a building in many ways. Approximately 300 square feet of space is needed for each off-street parking spot (which includes the parking spot itself and associated access lanes). Providing these parking spaces for each apartment can add between \$25,000 and \$50,000 per unit to the capital costs of a building (depending on whether an above-ground or below-ground parking structure is needed), and can represent up to 20% of the developer's building costs (Litman, 2009; McClanaghan, 2009). This increased capital cost then requires more investor equity, more financing and incurs higher insurance and interest expenses (Litman, 2009). These high construction costs also impact affordable buildings more heavily than high-end of market units. Parking requirements are generally calculated on a per-unit basis, meaning that an affordable building will have the same parking costs as a high-end building with same number of units. Since this is a relatively fixed cost, it represents a larger percentage of the capital costs for an affordable building than for a higher-end one. So by taking advantage of reduced parking requirements, developers can maximize land-use and increase affordability (Hofer & Gurstein, 2009).

A policy change that lowers the required parking for a building can have a relatively high value to the rental investor. One study from the Victoria Transportation Policy Institute found that reducing parking requirements from two spaces per unit to only one space per unit reduced total building costs by 12.5% (Litman, 2009). The McClanaghan (2009) model provides a slightly more conservative estimate, as a reduction from one parking space per unit to 0.5 was estimated to reduce total building costs by 5.83%. Under this scenario the return on equity was then increased by 1.07%.

Administrative Efficiency

This is a simple change for local governments to make, and the resulting policy would remain as certain and predictable for investors as before. There are also plenty of best-practice examples from Seattle, Portland and San Francisco to help guide implementation. Vancouver's proposed NC-1 zones are another example of parking policies being managed hand-in-hand with regional transit planning (Vancouver City Planning Commission, 2008). The City of Victoria has even begun experimenting with reduced parking restrictions, most notably within the Harris Green neighbourhood (Litman, 2009).

Lowered parking requirements can also be highly flexible to implement depending upon the community needs. Specific parking restrictions can be specified in each neighbourhood, depending on the local amenities, transit options and vehicle use. In-lieu payments can be used to allow developers to provide even less parking if they contribute funds to help develop municipal parking off-site. This can contribute to better community parking management strategies that encourage location-efficient and environment-friendly development practices (Litman, 2009).

There are also no increased compliance or administrative costs associated with this measure, since there is no exchange of benefits for affordable housing provision. There would be more administrative costs to ensure compliance if the measure was worded to only apply to rental housing projects, or affordable housing projects. Care would need to be taken to ensure the promised rental units were not later sold, and remained affordable for a sufficient period.

Equity

There is no transfer of housing costs with this measure, and there is no cost to any government budget to implement this measure. This measure simply lowers the capital cost of a building to help developers increase profits and deliver more affordable rents to tenants.

In some cases, the capital costs of providing parking are factored into the rental rates building residents pay. Since low-income renters are much less likely to own a car, this can put an increased financial burden on households that are less able to afford it. Reducing the required number of parking spaces would effectively increase vertical equity as fewer capital costs associated with parking would be passed on to renters who do not own vehicles (Litman, 2009). Horizontal equity is also maintained, unless the measure is worded to only apply to rental housing projects.

One caveat about reducing parking requirements is to ensure that there are nearby amenities and transit options so that residents can thrive without reliance on a vehicle. One strategy is to conduct a parking needs survey of the community, which can ascertain current parking trends and identify areas with lower vehicle reliance (Pomeroy, 2004). Although a more rigorous study is needed, an initial examination by the Victoria Transportation Policy Institute suggests that few residential parking lots in Victoria are at capacity, and many have less than 50% use even during peak periods (Litman, 2009). One option for cities is to adopt a parking management strategy, to more efficiently allocate parking spaces to anticipated need. For instance, downtown areas can

reduce overall parking by sharing spaces between office workers during the day and residents during the evening (Litman, 2008).

Summary

Reduced parking requirements are one of the more effective ways for local governments to help incentivize the development of more low-cost rental housing. Unit costs are significantly reduced, without the need for any public subsidy. Care is needed before implementation to ensure that vehicle-use patterns are known and that neighbourhood amenities and transit options can support a car-free lifestyle.

FREE OR LEASED LAND FOR RENTAL HOUSING DEVELOPMENTS

Governments at all levels could donate (or lease) surplus land to investors who could use the property for affordable rental projects.

Effectiveness

As shown in Figure 1, the land component of housing costs has steadily increased over the last thirty years in Greater Victoria. One analysis shows that if the land was provided free of charge, it would reduce the capital costs of a building by about 21%, which would increase the return on equity by 11.6% (McClanaghan, 2009). This would be a high value measure for the developers and building investors. As mentioned earlier, 10% return on equity is needed for building profitability, so this measure would more than cover the profitability gap alone.

Administrative Efficiency

This option is simple to implement, although once the land is dedicated to housing it is not very flexible to changing situations. If desired, this policy could also be integrated with policy to help remediate brownfield sites, or public properties such as former institutions, hospitals or schools. Brownfield sites are idle or underused properties that are believed to be contaminated from previous industrial activity (Greenberg, Lowrie, Mayer, Miller, & Solitare, 2001). These types of lands could be provided to developers at significantly reduced rates, or in conjunction with other measures (such as tax reductions or fee waivers) to encourage both site cleanup and affordable housing (The Toronto Board of Trade Affordable Housing Task Force, 2003). However this would introduce significant monitoring and compliance costs in order to ensure the cleanup is sufficient, and the necessary affordable housing is provided.

Equity

There is no financial cost to government budgets for this option. However, land does represent a significant asset and so providing it freely to the rental industry amounts to a major transfer of public assets from the taxpayers to individual affordable housing investors, and therefore greatly reduces horizontal equity.

If land is simply donated to building investors, then nothing can be done later to ensure the public interest is maintained. The policy could be created in such a way that either government leases the land at lower-than-market rates or imposes covenants upon the land at the time of donation. This would allow the government to exert influence and ensure that affordability objectives are maintained in exchange for such a significant subsidy (McClanaghan, 2009). There is also an associated opportunity cost of giving up the land, compared to keeping it or allocating it to some other use.

Summary

Donating or leasing surplus government land could by itself improve the finances enough to make a building profitable, although it is a significant public subsidy to the housing sector. Monitoring and compliance measures would be needed to ensure sufficient public benefit was achieved to justify such a gift to the housing sector. Ultimately, it may prove more cost-effective to donate surplus public land to non-profit social housing providers, to help ensure the long-term affordability of the associated housing units.

SECONDARY SUITES

Municipal governments can expand the use of secondary suites policy to increase rental units. This can include policies that either legalize the existence of secondary suites, or that actively encourage the creation of secondary suites through financial incentives.

Effectiveness

Policies that support the development of secondary suites are a good short-term fix to help ease housing affordability pressures within a region. Addressing housing pressures through secondary suites allows affordable housing to be integrated across the community without requiring any increases in infrastructure. This can also help to maintain the existing character of communities, particularly in more rural or suburban areas. Secondary suites also add to the income of homeowners, thus supporting homeownership for people who may not otherwise be able to afford a mortgage (Curran & Wake, 2008).

Secondary suites are not, however, a perfect public policy solution to affordable housing issues. First, secondary suites are often of much lower quality than other housing options (although local governments could require certain standards for legal suites, or provide financial incentives to help landlords maintain quality). Secondly, there is also almost no security of tenure for residents, as individual landlords can choose not to rent the units at any time. So these suites do not necessarily add to the long-term rental housing stock (Clayton Research Associates Ltd, 1998). Third, secondary suites can only be built in larger homes, which require more property and tend to be located further from downtown centres. This increases the reliance on vehicles and can increase neighbourhood parking pressures. Finally, in areas with high tourism there is a danger that secondary suites (particularly coach houses) end up being rented at higher-than-market rates entirely for visitors, which then further exacerbate housing pressures. This

phenomenon was seen in Kelowna for instance (Curran & Wake, 2008). So while secondary suites can be an important interim measure in meeting demand for affordable housing, they cannot fully bridge the affordability gap (Copas & Cumming, 2009b). The effectiveness is further limited in the CRD by the fact that Victoria, Sidney, Sooke, Langford, Esquimalt, Colwood and the Highlands already allow or encourage secondary suites to some extent within their Official Community Plans.

Administrative Efficiency

Secondary suite policies are easy to implement and can be relatively flexible for future needs. They can be implemented across whole cities since they require no new infrastructure investments to support (Curran & Wake, 2008). They can also be updated to impose minimum requirements (such as the Langford official community plan calls for), or they can be matched with funding subsidies to help encourage more home-owners to incorporate secondary suites into their houses (City of Calgary, 2009).

Equity

There is no cost transfer involved in simply allowing secondary suites. If a grant program to encourage renovations to install secondary suites is pursued (like the one used by the City of Calgary), then this will represent a transfer of housing costs from individual property owners to regional taxpayers within the local jurisdiction (that is from property owners without suites to property owners with suites).

Secondary suite policies can help support equity by integrating affordable units across communities, rather than concentrating them in certain neighbourhoods. This also helps to maintain the character of neighbourhoods which can be particularly important in more rural and suburban areas (Curran & Wake, 2008).

As mentioned above, secondary suites have much lower security of tenure compared to other rental housing units. This presents a tension between their effectiveness and equity as an affordable housing solution. On the one hand, the flexibility of renting a suite only when needed is an attractive element for individual landlords, encouraging more to rent units. On the other hand, this introduces lower stability and security of tenure for tenants. Matching secondary suites with public policies that introduce tenure protection (such as longer eviction notice periods) increases stability but then also decreases investment attractiveness (Steele, 1993).

Because secondary suites tend to be located further from urban centres, they can impose a burden on low-income households that may need to travel further into the city. This increases vehicle reliance and can be difficult when transit options are limited (Curran & Wake, 2008). Policies that impose mandatory minimum numbers of secondary suites within houses in new developments (such as a policy in Langford does) can be horizontally inequitable by imposing restraints on developers as they build new communities (City of Langford, 2008).

Summary

Secondary suite policies are good interim measures that help create affordable market rental housing units. Secondary suites are not, however, a good long-term public policy objective. The suites are often of lesser quality and they have very low security of tenure. They also tend to increase vehicle dependence and can be used to rent to visitors rather than to house low-income persons. While secondary suites can help ease affordable housing pressures immediately, they are incapable of covering the affordability gap on their own.

OTHER IDEAS FOR CONSIDERATION AND FURTHER RESEARCH

There are a number of other potential measures that could be used to increase the supply of low-end of market rental housing. Many of these ideas lacked substantial analysis in the reviewed literature, but still could potentially be used as policy incentives. Not all of these are necessarily recommended, but further investigation of many is likely warranted.

At the federal level, one idea is to institute a public reporting measure for financial institutions similar to that of America's *Community Reinvestment Act*. This could be used to help encourage private lending institutions and other partners to get involved more in supporting affordable housing within their communities without requiring any direct spending or tax expenditures (The Toronto Board of Trade Affordable Housing Task Force, 2003).

Another federal measure would be to fully rebate the GST on building operations. Once the building is constructed, operating costs such as maintenance, supplies and professional fees all include GST. Other businesses must also pay GST on inputs (such as retailers) but then they may use the GST paid on inputs as a credit to decrease the amount of GST actually sent to Revenue Canada at the point of sale. The issue for rental building owners is that there is no GST charged to rental payment. So while the owner must pay GST on the inputs (building maintenance and cleaning supplies for instance), they cannot reclaim this since there is no collected GST to reduce from (Lampert & Pomeroy, 2002). There are other businesses in a similar situation with GST exemptions (such as daycares, educational services, financial services and health and dental services), but these businesses are not impacted as much due to far lower GST inputs on far lower capital costs (Lampert & Pomeroy, 2002). Rebating the GST paid during building operation would also help increase long-term profitability, and perhaps entice more investors to enter the rental market.

At the provincial level, many developers also feel that the provincial property transfer tax should be abolished in order to cut down the costs for when property changes hands. This measure could be targeted to only apply to "rental buildings" to help limit the effects on unintended beneficiaries, although it would be difficult to monitor and ensure that the target units were not later sold as condominiums (Hofer & Gurstein, 2009). Some of the tax measures analyzed here could also be applied by the province (although with more modest success). A tax credit plan could be implemented entirely by the province, designed to reduce provincial income taxes payable. Also rebates for the provincial portion of the HST on new rental housing could be extended to refund the entire tax, although as mentioned earlier monitoring would be needed to ensure benefitting units remained rental suites (Hofer & Gurstein, 2009).

The province could also change the BC *Assessment Act*, which would change how rental building property values are assessed and municipal property taxes are charged (Government of British Columbia, 1996a). This would however be a controversial change to make as it could significantly harm municipal revenues and may discourage local governments from participating in affordable housing programs that would create more multi-unit residential buildings (Hofer & Gurstein, 2009).

At the municipal level, costs such as development cost charges and municipal property taxes could be reduced to enhance the profitability of rental projects. The McClanaghan study noted that in Vancouver a reduction of property taxes by 50% over ten years would result in a per-unit savings of about \$38,000. This would increase the return on equity of the model building by about 0.64% (McClanaghan, 2009). Likewise municipal development cost charges (DCCs) can represent one of the largest costs in residential building development. These costs can represent up to 5% of a building's capital cost and their removal can improve rental returns by between 6.5% and 11% (Ernst & Young, 2001; McClanaghan, 2009). There are a number of jurisdictions in Canada that do not charge any DCCs on new rental buildings (such as Moncton, St. John's, Charlottetown, Montreal, Laval, Gatineau and Quebec City) (Lampert, 2003). The issue with eliminating either DCCs or property taxes on rental buildings is that this could create a disproportionately large financial impact on fiscally-challenged local governments that already have limited revenue options.

Developers often complain that delays involved in obtaining municipal approvals are another major detriment to building profitability. Some jurisdictions offer expedited approvals processes in certain cases to try to encourage certain development (such as non-profit housing). This could be extended to all rental buildings, depending on the capacity of each local government. Another recommendation is for cities to develop standardized checklists and offer training sessions on building codes to help developers prepare for building inspections. If developers can pass each inspection the first time many delays can be avoided (Fernandez & Taylor, 2007).

OTHER AREAS OF FURTHER RESEARCH

Through the course of this research, a number of other potential topics have arisen that could be pursued for further research. First a new estimate of the cost of homelessness should be produced that uses the methodology established by Eberle, Kraus, Pomeroy, & Hulchanski, 2001, but expands it to a much larger sample size. This would give a much more accurate, up to date, and generalizable figure for the current cost impacts of homelessness on the government budgets. Another area for further work is to better develop the research on how housing and homelessness fits into the wider macroeconomic picture (as advocated by Drummond (2004)). This research would help to further develop a holistic approach to homelessness, and could help identify new policy implements that can reduce homelessness.

This report has reviewed several options that can help to incent new private development of low-cost housing, and the findings indicate that it would be much more cost-effective to implement some of these options than to continue to manage the effects of homelessness. However a full cost-effectiveness or cost-benefit analysis using data from local service providers could be done to better quantify exactly how much more cost effective it would be to house the homeless in the CRD with these measures. Furthermore, some of the specific policy options discussed here could use more research to better understand their potential impacts (such as a parking needs survey that could support a parking management strategy).

LIMITATIONS

From this research it is clear that most of the policies described above will have a positive effect on the private rental market, and will contribute towards making housing more affordable. But given that the current profitability gap for low-end of market rental investment is so large, it is questionable whether this will be enough of a positive impact to change the current situation and encourage new affordable units to actually get built in Greater Victoria. One limitation of this research is that while the measures described above all help bring down the capital costs of building the housing, few contribute to bringing down the cost of land. As can be seen in Figure 1 above, the cost of land in Greater Victoria seems to be one of the primary causes of increasing housing costs. So while many of these measures will help reduce building costs, without also bringing down the costs of the land it may simply not be enough.

Another issue is that even if the policies described above could be used to incent more private development, it may not be cost-effective to use these measures instead of investing in social housing. If developers need tax incentives worth several thousands of dollars and major concessions such as free land, it may be more effective to invest those dollars in the social housing sector. The donated land option especially appears better suited to support the non-profit housing sector. Rather than needing to use covenants or penalties to ensure the related housing remains affordable in the private sector it seems to make more sense to simply use the land for non-profit housing.

And third, the measures described above all focus on reducing the capital costs of a rental unit, but for rental investors there are also ongoing operating costs to consider. This focus on construction incentives reflects this report's search for measures that will incent new construction in the short-term. However, subsidies or tax incentives that reduce an investor's yearly operating expenses will help to ensure the affordability of these units for the long-term.

The intention of this report was to show that providing incentives for market rental production is more cost-effective than managing the effects of homelessness. But a logical next step in this research is to examine whether it is more cost-effective to produce the needed housing through private sector incentives or through public sector investment in social housing. This would help guide policymakers in finding the most efficient way to expand the low-end of market rental housing sector.

CONCLUSIONS AND RECOMMENDATIONS

The affordable rental housing market is very complex. Factors as wide ranging as interest rates, financing availability, material costs, labour availability, and land availability all contribute to the decision a developer makes before going ahead with a multi-unit residential building project. Government policy is only one of these factors, but it can still play a large role in building profitability. While not all of the analyzed measures would succeed individually in reversing the market trend towards producing no rental housing units, each would have a positive impact in some way and would help to reduce homelessness.

This research sought to uncover what types of policy incentives and disincentives were currently impacting the development of affordable market rental housing in Greater Victoria. Identified policy incentives included: inclusionary zoning policies, density bonus policies, secondary suite policies and the GST/HST rebate. Identified policy disincentives included: the current capital cost allowance rules, the lack of capital gains rollovers, the lack of a small business deduction for landlords, the few allowable soft cost deductions, and parking restrictions that increased developer's capital costs.

Across the all other surveyed jurisdictions, it was generally found that:

- Rising housing costs and affordability issues are present in most areas
- Most governments have favoured policies that encourage more homeownership
- National governments tend to maintain a strong role in housing policy
- Governments have favoured demand-side housing policies for the last fifteen years, although some attention is beginning to return to supply-side policies

Among these other jurisdictions, a number of specific policy responses have been used successfully to support the low-cost rental housing market. These policies include:

- Low income housing tax credits, which feature prominently in the United States, Australia, France and Germany
- Accelerated depreciation rates for rental buildings and transferability of CCA-created losses which are used in Germany, France, Australia and New Zealand
- Favourable capital gains policies that support the rental markets in Ireland, the United Kingdom, the Netherlands, New Zealand, Australia and the US
- Inclusionary zoning policies, used frequently in local, regional and national jurisdictions across North America, Australia and Europe

Another objective of this research was to develop an accurate estimate of the costs homelessness imposes on the budgets of the governments in Canada. After reviewing ten cost-benefit and cost-effectiveness studies, it was determined that Eberle, Kraus, Pomeroy, & Hulchanski (2001) developed the most comprehensive model for determining the costs of homelessness that impact the governments' budget. The total cost to government of homelessness is estimated to be between **\$35,548 and \$47,397** per year per homeless individual. This figure should be kept in mind when reviewing the cost transfer impacts of the various proposed measures analyzed in this report.

Twelve potential policy shifts were analyzed to determine their effectiveness, administrative efficiency, and equity. The following measures are recommended as primary priorities to be examined by government because of their higher impact on the housing market, or their greater likelihood of realistically being implemented.

Priorities:

1. Increasing the CCA depreciation rate from 4% to 5% and allowing transferability of CCA-created losses would improve profitability on its own, and increase the effectiveness of many other tax-expenditure based plans. There are also cases for extending these benefits based solely on the current inequitable situation. The estimated cost to the government budget for this change is estimated to have a present value of between \$1,032 and \$1,377 per unit, and would cover about 31% of the average building investor's profitability gap (according to McClanaghan, 2009).
2. Allowing the rollover of capital gains taxes and recaptured CCA would not only greatly improve building owners' short term finances; it would increase liquidity in the market and encourage new investors to enter. This is also a cost-effective measure, as although there is an opportunity cost for delaying tax revenues this is the only long-term cost to government for this option.
3. Expanding the deductibility of more soft costs has an impact on profitability (especially in the early years of construction and operation when developer cash flows are at their lowest). These costs can cumulate to represent 13% to 17% of a building's capital cost. One estimate of the impact of this change predicted that an increase of \$5,000-worth of new soft cost deductions would result in federal tax reductions with a net present value of \$802 per unit.
4. A LIHTC-style tax credit plan is a Federal investment that could have a major impact on low income housing. Lessons learned from Canadian, US and Australian experiences help ensure a Canadian LIHTC could be efficient and effective. A Canadian low-income housing tax credit would also work well within confederation and would maintain the current housing policy paradigm where the federal government funds the program but it is directed and administered by the provinces. According to one analysis, a Canadian LIHTC could be implemented at a cost of \$474.2 million per year (Steele & Des Rosiers, 2009). Although this is a major investment this one of the few options discussed that can cover the profitability gap alone and can single-handedly create many new rental units.
5. Encouraging local governments to relax parking restrictions would greatly improve profitability without public sector cost. This is also one of the few planning levers that could impact low-cost housing in the CRD that has not already been greatly pursued in many municipalities. Particularly enticing is the fact that this policy can have a high value to building investors (reducing capital costs by up to 12% per parking space eliminated) but also involves no transfers of cost to government. While this does match

trends towards environmental sustainability and smart community planning, care needs to be taken to ensure it fits with neighbourhood vehicle use.

The following measures are recommended as secondary or more long-term priorities for government. While still beneficial, these measures are expected to be either less effective or more problematic to implement efficiently.

Secondary Priorities:

1. Allowing small landlords to qualify as small businesses would improve their financial situation and is much fairer. However, since this would only impact small landlords (and not principal business corporations), and not all small landlords would necessarily take advantage, this has limited potential for significantly increasing the rental stock.
2. Fully rebating the GST has a modest affect on building profitability (increase of return on equity of about 0.33%), but is problematic since it is difficult to apply only to rental units. Significant monitoring and compliance measures would be needed to ensure the building remained rental only. Zero-rating GST inputs for developers would be even more difficult to implement, and would only slightly improve the impact of the measure. This is estimated to cost the federal government taxpayers between \$2,581 and \$3,441 (net present value) in lost taxes per unit during the construction phase.
3. Inclusionary zoning and density bonuses are fairly effective in encouraging the construction of affordable housing, although since they are used in many municipalities within the CRD already, there is limited room for expansion beyond current use. Where these can be used, they do not directly impact the government budget.
4. Donating or leasing surplus government land could by itself improve the finances enough to make a rental building profitable, although it is a significant public subsidy to the development industry. Monitoring and compliance measures would be needed to ensure sufficient public benefit was achieved to justify such a gift to industry. It would appear as though donating the land to social housing providers may be more effective.
5. Secondary suite policies are good interim measures that help create affordable market rental housing units. Secondary suites are, however, not a good long-term public policy objective. The suites are often of poor quality, they tend to increase vehicle dependence and they have very low security of tenure. While secondary suites can help ease affordable housing pressures immediately, they are incapable of covering the affordability gap on their own.

APPENDIX 1: SUMMARY TABLE OF HOMELESSNESS COST-BENEFIT AND COST-EFFECTIVENESS STUDIES

Study Examined	Relevant Costs Included	Population Studied	Methodological Process	Limitations	Reported Cost Per Homeless Per Year	Cost in Canadian Dollars	Cost Adjusted to September, 2009 Canadian Dollars
Patterson, Somers, McIntosh, Shiell and Frankish (2008) [British Columbia]	Housing, Support, Health and Corrections costs	Those with Severe Addictions and Mental Illness who are homeless or at imminent risk of homelessness.	Computerized model developed using literature review to estimate the costs of Homeless or near-homeless SAMI population across four provincial ministries: health, housing, public safety and Income Assistance.	Primary focus on those with SAMI increases the estimated costs when applying findings to the entire homeless population.	\$57,572.37 CAD	\$57,572.37 CAD	\$58,855.18
Culhane, Metraux & Hadley (2002) [New York]	Shelter use, psychiatric hospitalization, Veteran Affairs Shelter Use, prison use, inpatient/outpatient health care	Those with Severe Addictions and Mental Illness who are homeless.	Regression analysis of data on 4,679 homeless matched with service utilization between 1989 and 1999.	Some costs not included (such as police or court costs).	\$40,451 USD	\$61,825.31 CAD	\$76,374.40

Study Examined	Relevant Costs Included	Population Studied	Methodological Process	Limitations	Reported Cost Per Homeless Per Year	Cost in Canadian Dollars	Cost Adjusted to September, 2009 Canadian Dollars
Eberle, Kraus, Pomeroy, & Hulchanski (2001) [British Columbia]	<p>Health costs: Emergency room visits, hospital and medical clinic visits, MSP visits to MDs, Pharmacare, community mental health services, psychiatric hospital admissions, BC Ambulance services, fire department emergency responses.</p> <p>Justice Services: Provincial corrections institutions, days under community supervision, Vancouver Police incidents</p> <p>Social Services: BC Benefits, detox centre, family and child support services</p>	Cross-section of entire homeless population.	Uses interviews, case histories and service use history for participants to estimate costs of homelessness to government.	Limited sample size (only 18 participants) so the results are descriptive but not generalizable. Not all local medical facilities were combed for data (only the closest ones within Vancouver study area).	\$30,000 - \$40,000 CAD	\$30,000 - \$40,000 CAD	\$35,547.52 - \$47,396.69

Study Examined	Relevant Costs Included	Population Studied	Methodological Process	Limitations	Reported Cost Per Homeless Per Year	Cost in Canadian Dollars	Cost Adjusted to September, 2009 Canadian Dollars
Lewis and Rowlatt (1996) [United Kingdom]	Police services, health care, income support and emergency services costs	Primarily focussed on youth population .	Simple model constructed to assess financial flows for young homeless, and to track costs and benefits accrued in a set period.	Estimates are based on numerous assumptions.	£2,750	\$5,601.26	\$7,224.79
Pinkney and Ewing (1997) [Australia]	Health, Welfare and Criminal Costs	Homeless and near-homeless youth.	1994 Secondary School Census data used to estimate the extent and costs associated with youth homelessness. These costs were then compared to the costs of providing intervention to youth within the school system.	Focussed only on youth homelessness.	\$22,956 Australian Dollars (1994 figures)	\$22,588.82	\$29,918.45

Study Examined	Relevant Costs Included	Population Studied	Methodological Process	Limitations	Reported Cost Per Homeless Per Year	Cost in Canadian Dollars	Cost Adjusted to September, 2009 Canadian Dollars
Weinstein and Clower (2000) [Dallas, Texas]	Health, Welfare and Criminal Costs	Entire homeless population.	Examines total costs for providing for Dallas' 4000 homeless across numerous service providers.	Some faith-based and charitable institutions are included in the cost estimates.	\$5,000 USD	\$7,254.00 CAD	\$8,723.81
Palermo (2006) [Halifax, Nova Scotia]	Shelters, jails and prisons, hospital and psychiatric hospital costs.	Entire homeless population.	Tool developed using literature review, a local homeless needs survey and data from local service providers.	Some emergency costs (such as ambulance trips) are not included in this model.	\$43,511 CAD	\$43,511 CAD	\$45,577.28
Asheville, North Carolina 10-Year Plan (2002) (in Culhane et al., 2008) [North Carolina]	County jail, EMS provider, area hospitals, county health provider, Mental health facility, shelters	Entire homeless population.	Convenience sample of 37 participants selected to track.	Convenience sample is not necessarily representative of entire homeless population.	\$39,444 USD	\$62,704.13 CAD	\$71,927.63

Study Examined	Relevant Costs Included	Population Studied	Methodological Process	Limitations	Reported Cost Per Homeless Per Year	Cost in Canadian Dollars	Cost Adjusted to September, 2009 Canadian Dollars
Seattle 10-Year Plan (2003) (in Culhane et al., 2008) [Seattle, Washington]	Jail, county hospital, detox and sobering centres	Chronically homeless users of the downtown Sobering Centre.	Convenience Sample of 20 most frequent users of the Sobering Centre.	Not necessarily representative of entire homeless population	\$54,542 USD	\$83,732.88 CAD	\$69,996.73
Perlman and Parvensky (2006) [Denver, Colorado]	Incarceration, detox, emergency room visits, outpatient/inpatient costs, shelter costs	Chronically Homeless.	Convenience sample of 19 chronic homeless selected to track.	Not necessarily representative of entire homeless population.	\$21,665 USD	\$25,083.74 CAD	\$26,367.24

APPENDIX 2: SUMMARY TABLE OF POLICY ANALYSIS

Policy Option	Effectiveness	Efficiency	Equity	Cost transfer	Summary Conclusion
Allowing the Creation of CCA Losses	High	High	Moderate	Transfers costs from housing sector to taxpayers as a whole (although long-term costs are low)	Improves profitability by itself, and improves effectiveness of other tax-based measures
Increasing the CCA	High	High	High	\$1,032 to \$1,377 per unit benefit for builders, landlords and tenants paid for by taxpayers as a whole	Simple change that can greatly improve profitability in early years, especially if increased transferability of CCA-created losses is also allowed
Capital Gains Rollovers	Very High	High	Very High	No long term direct costs (only opportunity cost of receiving deferred taxes later)	Highly effective at encouraging new investment, and helps to rectify an inequitable situation
Small Business Deductions	Moderate	Moderate	Very High	Benefits for landlords and tenants paid for by taxpayers, although exact amount is difficult to estimate	Although much fairer, this would be difficult to implement.
Soft Cost Deductibility	Moderate	High	Moderate	Transfer of \$802 (NPV) per unit from builders, landlords and tenants to all taxpayers	Moderate value to investors, although simple to implement
GST Rebates	Moderate	Low	Low	\$2,581 to \$3,441 (NPV) per unit from housing sector to all taxpayers	Modest effect on building profitability but difficult to apply only to rental units
Low Income Housing Tax Credits	Very High	Moderate	Moderate	Total program costs estimated at \$474.2 million per year, according to one potential model	High value to rental investors and high flexibility to work well within the federal-provincial fiscal framework make this a promising (although costly) option

Policy Option	Effectiveness	Efficiency	Equity	Cost transfer	Summary Conclusion
Inclusionary Zoning	Moderate	Moderate	Moderate	Costs are transferred from developers and governments to entire development sector	Cost-effective for local governments, although already in use in much of the CRD
Density Bonuses	Moderate	Low	High	No direct cost to government, although costs transferred from taxpayers to the housing sector	Somewhat effective, although already in use in much of the CRD and also monitoring needed to ensure promised units remain affordable
Parking Restrictions	High	High	High	No cost transfer	Effective method of reducing developer costs with no cost transfer to public budgets makes this a promising option for local governments
Free or Leased Land for Rental Housing	Very high	Low	Very low	No financial cost transfer, although land is a significant asset to be transferred from taxpayers to building investors	Can cover investors' profitability gap alone, although it is a major subsidy to the industry, and monitoring would be needed to ensure housing remained affordable
Secondary Suites	Low	High	Moderate	No cost transfer for legalizing secondary suites	Decent interim measure, although secondary suites do not provide the quality and security of tenure of purpose-built rental housing

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