Toward a Comprehensive Affordable Housing Strategy for Canada

by

Steve Pomeroy

Steve Pomeroy is President of Focus Consulting Inc.

October 2001

ISBN – 1-894598-94-6

Table of Contents

Introduction

The issue of affordable housing and homelessness has become increasingly prominent in recent years, highlighted by deaths of homeless individuals on the streets of major Canadian cities and efforts by municipalities and housing advocates for action by the federal and provincial/territorial governments.

Earlier this year, the federal government announced a proposal for a new Affordable Housing Program. Since then, discussions have been under way with provinces and territories about program design and cost-sharing. The proposal involves a capital grant of up to $12,500 per unit, with the expectation that the provinces and territories will match this level. The grants would be provided to both private and nonprofit corporations to help cover the cost of new rental development. This investment is expected to stimulate construction of 12,000 to 15,000 new units annually.

Following a meeting of housing ministers on August 16, 2001, the federal Housing Minister stated that the Canada Mortgage and Housing Corporation (CMHC) is prepared to increase the maximum federal grant level, but within an overall budget cap of $680 million over four years, and to allow the provinces and territories some flexibility in program design.

This Affordable Housing Program is proposed as a short-term strategy, aimed at increasing new rental construction to address the problem of low vacancy rates. It is not a social housing program, but provides a platform for provinces/territories to add funding in order to assist households in need. The Minister stated that he will continue to work with his provincial and territorial counterparts toward longer-term solutions.[1]

The purpose of this paper is to present an overview of the issues underlying the affordable housing problem and to set out a series of options that should be considered as part of a comprehensive national housing strategy.

This paper is structured into four sections:

- In Section 1, the nature of housing need and contributing causes are described.
- Section 2 describes one set of measures intended to increase the supply of new housing and related ways to ensure that this new supply creates units that are affordable.
- Section 3 presents a similar discussion of ‘demand-side’ approaches – measures intended to help households that pay too much relative to their income better afford housing in which they already live.
- Section 4 offers some concluding observations and emphasizes the need for a comprehensive policy, drawing from both the supply and demand options to create an effective response to housing need and the predominant problem of affordability.

Defining the Problem – The Nature of Housing Need

The primary basis for social housing policy is the presence of circumstances (housing need) in which individuals or families are not able to meet their shelter needs through their own resources. The appropriate choice of policy instruments depends on the nature of the housing problem being addressed.

Housing need in Canada has been defined in terms of adequacy, suitability and affordability. These three problems are the basis for the definition of housing need established by the federal housing agency, the Canada Mortgage and Housing Corporation, and are used in defining and measuring need by all provinces and territories. This need measure is called *core housing need*.

Table 1
Core Housing Need 1996

Total	**1,725,655**	
Renters	1,172,270	68%
Owners	553,385	32
Unattached Individuals	**878,415**	51%
Single female	245,950	28
Single male	149,330	17
Living with others	52,705	6
Families	**847,235**	49%
Two parents with children	144,030	17
Couples, no children	110,140	13
Female lone parent	144,030	17
Male lone parent	16,945	2
Multiple family	8,475	1

Source: CMHC; 1996 Census

'Core housing need' means that a household is experiencing at least one of three housing problems, based on established housing standards. Furthermore, the household has insufficient income to resolve this problem without assistance.

The three norm standards used in the core need assessment are:

- *Suitability*: This standard uses national occupancy standards to determine if households have a sufficient number of bedrooms based on the family composition (effectively a crowding measure).
- *Adequacy*: A standard that measures housing condition to determine if the dwelling is safe, has basic plumbing and is in a reasonable habitable state of repair.
- *Affordability*: A standard based on a ratio of housing expenditures to total household income; a household paying more than 30 percent of its income for housing is considered in need.

If a household is found to be below one or more of these standards, a second test is applied to determine if its income is sufficient to afford a suitable and adequate dwelling in its community within 30 percent of the household's income. This measure uses the median rent of an appropriately sized private rental unit and converts the rent to an annual income required to afford this unit based on spending 30 percent of income for rent.[2] A household with gross income below this level, and living below any of the three housing standards, is defined as being in core housing need.

This formal housing need measure is based on data collected by Statistics Canada through the Census and during the intercensal period through another Statistics Canada survey. Prior to 1996, the Household Income, Facilities and Equipment database was used; since 1996, the Survey of Household Spending has been used to collect data, but CMHC has not published updated housing need data since the 1996 Census. Thus 1996 Census data remain the most recent official basis for housing need statistics, and are used here to indicate housing need.

CMHC reports that a total of 1.7 million households or 7.6 percent of the total were in core housing need in 1996. This figure compares to 1.2 million households or 12.2 percent of the total in 1991.

These core need problems are divided almost evenly between unattached individuals (51 percent) and families (49 percent). Single females make up more than one-quarter (28 percent) of all households in need.

Seniors comprise just over one-fifth of households in need, distributed between unattached individuals and family couples. Among families, lone parents are the largest category in need.

More than two-thirds of households in need are renters (68 percent), even though renters comprise only 35 percent of the population. Most often, renters experience an affordability problem; owners in need tend more often to experience adequacy problems (e.g., poor condition of dwelling).

Affordability is, by far, the most serious problem: 95 percent of core need among renters relates to affordability. Not surprisingly, low income is a key determinant of core need: 85 percent of households with incomes below $10,000 and 61 percent of those with incomes below $20,000 are in core need.

In the 1990s, heightened awareness about homelessness added a new dimension to these housing need categories – absolute homelessness and households at risk. To date, there are no official statistics measuring the extent of these problems.

Absolute homelessness means living without four walls and a roof, and perhaps more important, without a door that one can lock to create private living space and security. The number of chronically homeless persons is not accurately known, as there is no easy way to count this population. Proxy counts of shelter and soup kitchen use as well as efforts by street workers suggest, however, that this group is growing and becoming more diverse. Homelessness is acknowledged as a complex social issue – related to mental and physical illness, but often exacerbated by a lack of access to affordable housing and appropriate support services.

'At risk' has emerged as a term in the 1990s to identify families and individuals that have formal shelter, but whose circumstances are precarious. They are deemed at risk for one of a range of reasons – the cost of shelter consumes such a large part of their income that they are vulnerable to rent arrears and eviction; they are temporarily living with a friend or relative but have no permanent place of residence; they are personally at risk of physical or mental abuse; or they have disabilities that may cause them to lose their shelter.

One measure used to help determine the number of households at risk is a very high shelter cost burden – paying more than 50 percent of income for shelter. In the United States, the 50 percent benchmark is used as an indicator of 'worst case need,' also labelled 'severely burdened households.' These terms have not traditionally been used in Canada, but recent efforts by advocates to highlight the severity of the affordable housing issue have begun to cite the number of households paying greater than 50 percent. In the 1996 Census, some 830,000 renters were identified above this benchmark – 22 percent of all renters.[3]

Understanding the affordability problem

Clearly, affordability problems are created by a combination of two key factors – low incomes and high relative rents. With a deep and lingering recession and slow economic recovery, the 1990s were characterized by stagnant income, especially among renters. Between 1991 and 1996, the average real income of renters declined by 12.4 percent.[4]

Incomes have grown since 1996, although most renters have not shared in the gains. As higher-income renters exercise the option of moving into ownership, the renter profile is dominated by the remaining lower-income households.

Another important factor underlying trends in income and core housing need is the high incidence of households that receive social assistance. In most provinces and territories, social assistance benefits include an explicit shelter component, which is always more than 30 percent (and often greater than 50 percent) of the total benefit cheque. Thus these households are captured under the measure of core need, even if they have been able to obtain housing within the shelter component provided to them.[5]

Estimates suggest that more than half of core need households are recipients of social assistance (commonly known as 'welfare'). The percentage varies by household type and region, in part reflecting wide variations in the level of welfare benefits.

Recently, analysts and advocates have begun to use a shelter-cost-to-income ratio of 50 percent as a more extreme indicator of affordability problems. As the shelter component of welfare often makes up as much as 50 percent of the total welfare payments, social assistance

Table 2
Social Assistance Families as Percentage of All Families in Core Housing Need

	Family %	Lone Parent %	Non-family %	Total Non-senior %
Atlantic	65	87	55	68
Quebec	64	80	68	70
Ontario	46	75	42	52
Prairie	40	54	39	44
BC	37	65	27	38
Canada	49	74	49	56

Source: Statistics Canada, HIFE 1996 data file.

caseloads affect the number of households with serious affordability problems.

Between 1990 and 1995, the number of households in core housing need increased by 47 percent and the number of households paying greater than 50 percent of income for rent grew by 43 percent. During the same period, there was a marked increase in welfare caseloads, associated in part with the 1990 recession and slow recovery – especially in central Canada. In March 1990, welfare cases totalled 1,056,000. The caseload peaked at 1,675,900 in 1994 and in 1995 stood at 1,659,200, a rise of 57 percent since 1990 – and a larger increase than the number of households in core housing need.[6] So the rising welfare caseload appears to have an important impact on housing need statistics, especially in assessing households with a high shelter cost burden.

Since 1995, welfare cases have followed a steady decline, in part due to reduced benefits (e.g., Ontario), more restrictive eligibility (especially for single people and youth) and the improving economy. Total cases have fallen back below their 1991 levels – from 1,659,200 in 1995 to 1,198,200 by March 2000, a reduction of 461,000 (28 percent).[7]

Reflecting the decline in welfare caseloads, data from the Statistics Canada 1998 Survey of Household Spending indicate that the number of renter households paying more than 50 percent of income for rent has fallen significantly from 830,000 in 1995 to 464,000 households in 1998. At the same time, the number of renters paying between 30 and 50 percent of income on shelter increased by 250,000 households – suggesting that while incomes may have improved marginally, possibly as households moved into work, most are still paying well over 30 percent for shelter and continue to experience affordability problems.[8]

The broad measure of renter households paying more than 30 percent also appears to have declined by 1998, but only marginally compared to the 50 percent benchmark. This suggests that core housing need may too have declined, although CMHC has not undertaken an analysis of core need using the more current data files.

A more refined measure and data source is required to track these important trends – ideally, one that separately tracks the circumstances of social assistance recipients and the working poor (although these are not distinct groups due to transitions back and forth). The relatively high incidence of welfare households in the core housing need population also suggests that solutions should include an examination of ways to improve this component of social assistance programs.

Shifting factors underlying affordability problems

As noted in the first half of the 1990s, the primary causes of rising core need were growing welfare rolls and stagnant income among lower-income Canadians. Between 1991 and 1995 real rents declined, although quite marginally (-2.5 percent), so the primary cause of increased affordability problems was weak income.

The cause of core housing need appears to have shifted through the second half of the 1990s and into the new millennium. Since 1996, increasing rents have become the more important factor – rising by as much as 25 percent between 1996 and 2000 in some centres. This percentage varies across the country, with the largest increases evident in Alberta, Saskatchewan and Ontario. Rents in Alberta jumped more than 20 percent in only three years, while those in Ontario grew by more than 10 percent.

While rising rents in Ontario have been identified as a consequence of removing rent controls, the more important factor in Ontario and other provinces has been the persisting low levels of new supply and the consequent decline in rental vacancy rates. As the supply of available units declines (and fails to keep pace with population and household growth), the natural result is upward pressure on rents. This problem is especially apparent in the lower levels of the rental sector, where low-income households seek accommodation.

Low levels of new construction

The vast majority of housing in Canada has been produced and operated in the private market. The social housing stock – i.e., units built and operated by public agencies, nonprofit corporations and co-operatives under various social housing programs – accounts for roughly 700,000 dwelling units in a total stock of just over 10 million dwelling units. Rental housing accounts for just under four million units, so social housing constitutes less than one-fifth (18 percent) of the rental housing stock.

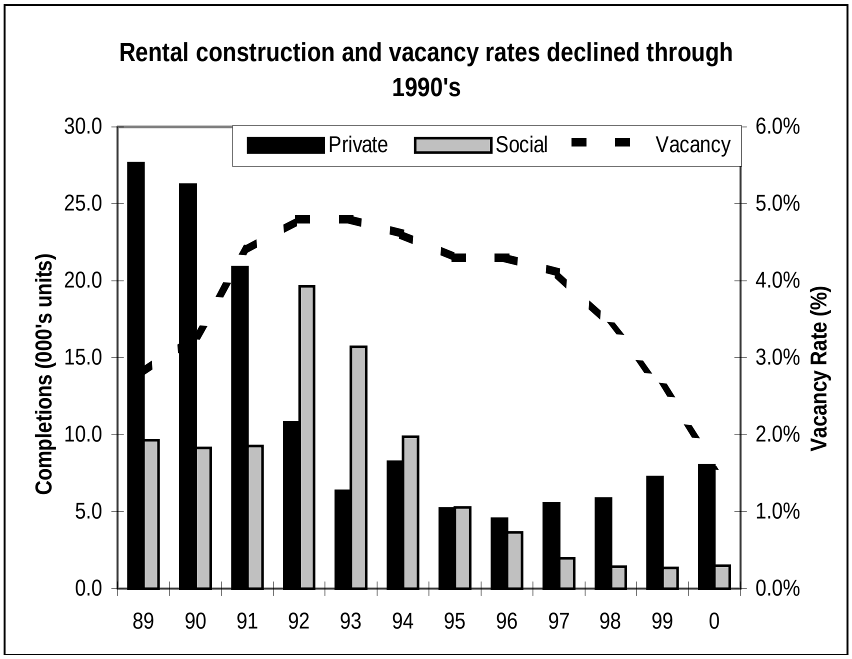
Some of these social housing units are in mixed-income projects and provided at market rent, although most have subsidized rents. The 1996 Census reported a total of 1.6 million units renting below $500 a month (affordable at 30 percent of income for households with income of $20,000; this $500 rent/$20,000 income benchmark is used here as a crude benchmark of affordability to illustrate the relative size of existing social housing stock and to highlight recent changes). So social housing comprises roughly one-third of the existing affordable stock. By comparison, two-thirds of affordable units are in the private rental sector and include older apartments (many smaller units) and apartment suites in homes.

These statistics reveal the important role played by the private sector in contributing to a stock of housing that, over time, has remained or become affordable. But the stock in this sector is also susceptible to erosion. As rents rise with inflation, the number of private units renting below affordable benchmarks declines. In other cases, units are demolished or the property is converted to ownership (condominiums) and the units may no longer be available at moderate rents.

Between 1991 and 1996, the total number of renter households in Canada increased by 180,000. This figure reflects net growth in rental households, since some moved to ownership, but this growth was not matched by new production. During these five years, a total of 111,000 new rental units were constructed with just over half of these (54 percent) built as social housing. The other half, produced for the private sector, were typically at higher rents, far above affordable levels. The shortfall in new production (roughly 70,000 units) was taken up by vacancies in the existing stock, which were relatively higher (nationally almost 5 percent) through the early 1990s but declined substantially to a national overall average of only 1.6 percent (much lower in some centres).

Following a building boom in the late 1980s, the level of private rental development already had slowed by the early 1990s, and privately initiated development has continued to fall. New private rental housing construction fell from an average of well over 30,000 units annually in the 1980s to only 13,000 between 1990 and 1995 and subsequently to only 6,000 annually from 1995 to 1999.

The 1991 to 1996 period brackets the era in which new social housing programs were almost entirely eliminated, although completion of projects approved in 1994 and 1995 (Ontario,



BC and Quebec) stretched into 1996.[9] As a result, the decline in private rental construction was exacerbated by the cessation of social housing construction (except a little in BC and Quebec).

Lack of new rental construction worsens problem of affordability

This decline in new supply – both private and social – has been a critical factor driving the affordable housing crisis. As rental construction has failed to keep up with new household growth and demand, the rental market has become increasingly constrained. Although lower rental apartment vacancy rates and increasing rents are a prerequisite to new rental investment, recent analysis of rental markets has found limited interest in new construction from developers and investors. Risks to investors and developers remain high while the rate of return on investment is poor and uncompetitive. Notwithstanding recent increases in rent levels, new production of rental units is not expected to increase in any significant way.[10]

Low supply and persisting demand inevitably applied pressure to rents, directly exacerbating the affordability problem. This has become especially acute at the lower end of the market where there are already far more households seeking lower priced units than there are units. As noted, the 1996 Census reported a total of 1.57 million units renting below $500. In comparison, there were 1.68 million households with incomes below $20,000 that can theoretically can afford no more than $500 at 30 percent of income – indicating an absolute shortfall of almost 110,000 lower rent units.

In addition, of the 1.57 million units renting below $500 per month, just fewer than 600,000 of these are occupied by households with incomes above $20,000. This means that 600,000 lower-income households in need of affordable units do not have access to the lower priced stock – and must occupy higher priced units and pay a larger proportion of their limited income for housing.

Constrained access to affordable units

The low availability of modest rent units underpins one of the core problems in the area of affordable housing. The problem is not solely an issue of absolute shortage. A related concern is limited access for lower-income renters.

As a rational entrepreneur, a landlord seeking to rent out a vacant unit typically will try to minimize risk – he will prefer tenants *perceived* to have greater probability of paying the rent. Lower-income households, especially those living beyond their means, have a greater risk of not paying the rent. Inevitably, they will face a greater challenge in securing housing – especially if due to their inability to pay high rents, they previously have been evicted or are in arrears and do not have a sound reference.

In a tight rental market in which there are few units available and landlords can be selective, tenants with good jobs will tend to be preferred. While there is a fine line between prudent landlord behaviour and discrimination, the bottom line is constrained access for low-income tenants, especially those stereotyped as 'poor tenants' – which often includes social assistance recipients and lone parents with children. One way to address this issue is by facilitating nonprofit acquisition and increased ownership of this existing stock, as nonprofit landlords will tend to be more sympathetic to needy households.

Erosion of the existing affordable housing stock

While the level of new production is not keeping up with demand and need, and constrained access contributes to persisting affordability problems, this situation is worsened by a process of ongoing erosion of the existing privately owned affordable stock.

Between 1991 and 1996, the number of rental units renting below $500 declined by 310,000 (roughly 10 percent of the total rental stock). At a time when new rental construction was falling toward an all-time low level, the erosion of lower priced stock is perhaps the most serious issue facing the affordable housing sector. Policy options need to examine ways to preserve this asset.

Consolidation – The context for housing policy

The preceding section has provided an overview of the key issues that underpin the affordable housing problem and help to frame the context for which solutions must be sought. In summary:

- Low levels of new rental investment and production (and limited investor interest). CMHC projections of household growth indicate a requirement of 45,000-50,000 new rental units annually through the next decade to meet new demand. This compares with current production of less than 9,000 annually.

- Erosion of the existing lower priced rental stock. Between 1991 and 1996, in excess of 300,000 units renting below $500 were lost due to rent inflation, conversion and demolition.

- A 'crowding out' effect in which households that are employed and otherwise perceived by landlords as less risky tenants are occupying modestly priced units, leading to constrained access to the lower rent part of the market for working poor and welfare households.

- Very limited funding to support new social housing initiatives. Most provinces followed the federal cut in 1993 and there has been no funding for new development outside of small programs in BC and Quebec.

- Predominance of affordability problems due to both low and stagnant income and rising rents. Low income was the main cause in first half of the 1990s; rising rents have become the more significant factor in the second half of the 1990s.

- A high proportion of welfare households among core need households affects both the total count of core need households and possible solutions.

Responding to the need – Possible policy options

The goal of social housing policy is to assist low- and moderate-income households to obtain adequate and suitable housing at a price they can reasonably afford. This goal can be achieved through two general approaches:

1. By reducing or subsidizing the construction cost of housing so that it is inherently more affordable. This approach typically involves actions related to production and accordingly are labelled as 'supply measures' (i.e., the primary focus is on influencing the cost of building so that the rent charged can be lower). These measures include direct public or nonprofit production, measures to lower the costs of production and stimulative measures to induce private production with conditions on the level of rents.

2. By increasing a household's ability to pay (i.e., increasing or supplementing its income). These are referred to as 'demand-side measures' as they affect the household's effective demand. Such measures include rent supplements or allowances and income assistance.

3. A third approach involves measures to influence the price of existing rental housing. It includes controlling rent levels to protect affordability, diverting demand (e.g., by helping households buy a home) to reduce pressure on a limited rental sector and capturing the existing affordable stock by encouraging a transfer in the ownership from private-for-profit owners to not-for-profit owners. These approaches have a more limited scope and are not discussed in any detail, except where they relate to the two main categories.[11]

The following potential approaches are discussed in the next two sections. Each measure is first outlined and key terms are explained. The advantages and disadvantages of each measure are then reviewed. The concluding section of the paper considers the potential integration of these measures into a comprehensive strategy.

1. Supply measures

   - Direct support for public/nonprofit production
   - Incentives for private rental unit development
   - Creating a level playing field for rental development

- Reducing development costs
- Encouraging lower cost forms of development – single-room occupancy, secondary suites
- Shifting patterns of ownership (facilitating nonprofit ownership).

2. Demand measures

- Rent supplement
- Shelter allowance
- Reform of welfare shelter benefits.

Each general set of approaches, and the individual measures in each set, are not mutually exclusive. There are many cases in which supply and demand measures can effectively complement each other. This complementarity is examined within each approach.

Supply Measures

Supporting public/nonprofit production

Direct public supply of housing has been the predominant program response in Canada through the postwar period. Although various program designs have been employed, the essential elements of this approach include:

- A public or not-for-profit owner/operator with a specific mandate to operate housing for low-income households.[12]

- Some form of subsidy, either as a capital grant, favourable mortgage rate or ongoing subsidy, so that the rents charged to tenants are affordable. Generally, the project is governed by an operating agreement that specifies the obligations of the operator and requires the provider to continue serving lower-income eligible households.

- Typically, operating agreements and any ongoing subsidy match the amortization period of the mortgage. Once the mortgage is fully paid off, the project rents are required only to cover operating costs and it is assumed that even at low rents, the operator will be able to continue serving lower-income households (in very poor 100 percent targeted projects, this may not be feasible with some renewal of subsidy).

- In most nonprofit approaches, 'affordable rents' are established on a rent-geared-to-income ('rgi') basis. Although earlier programs used a 25 percent ratio, most currently employ a ratio of 30 percent against gross income.

- Assisted projects may be fully targeted – meaning that 100 percent of tenants have lower incomes and pay rent on a rent-geared-to-income basis – or mixed income (where some portion of units are rented at market rent levels, rather than at subsidized rents based on a percentage of income). A mixed income approach generally is preferable as it avoids the concentration of very poor households that was characteristic of earlier public housing and contributed to the stereotyping of projects.

advantages

Nonprofit production helps create a permanent stock of units specifically to serve lower-income households – a long-term investment in a permanent asset. This form of ownership also provides some assurance that rents will remain affordable over the long term.

Even after operating agreements and subsidies cease, the public investment remains in place as the nonprofit charter restricts ongoing use to provide affordable housing and most nonprofit providers retain this initial motive.

Nonprofit programs address both supply issues and affordability within a single program, which is one reason why they appear to be quite costly, compared to alternatives that seek to address only one issue (either supply or affordability).

It is possible, however, to separate the supply and affordability objectives. One such approach involves using a nonprofit organization to develop housing at market rent level, then stacking rent supplement assistance (described below) as a separate mechanism to specifically address affordability.

Another variant is to assist nonprofit housing corporations to purchase existing privately owned rental properties. This approach does not add to new supply, but it does ensure that long-term affordability is preserved and helps stem the ongoing erosion of the relatively more affordable existing private rental stock.

Supply programs respond directly to low levels of production (as prevail currently) and, in so doing, have a beneficial effect in moderating the inflationary impact of low supply (i.e., in the absence of new construction, there is pressure on rents in the existing stock).

Through the development process, units can be designed specifically to meet particular needs – e.g., accessible or supportive housing. New supply funding can be geographically targeted to markets with acute supply problems.

weaknesses

New construction costs and the associated subsidy costs tend to be quite high on a per unit basis. Most recent versions of nonprofit housing involve long-term (35-year) subsidy commitments. As new commitments are layered on in each year, the subsidy cost mounts exponentially. This problem raises the concerns of finance officials and makes these programs a vulnerable target in times of fiscal restraint.

The alternative is to 'front-end' the cost with a capital grant. Again, however, this option tends to be expensive due to the high cost of new development compared with relatively low revenues at rent-geared-to-income rents (the latter limit capacity to cover operating and mortgage payments).

Income mixing improves the viability of the projects and lowers the average capital grant requirement. But it increases the grant cost per rent-geared-to-income household assisted.

Relative to the volume of housing need – more than one million renters in core need and more than 450,000 paying more than 50 percent of their income for housing – incremental new supply programs can assist only a very small number of households in need (at their peak, nonprofit programs produced only 25,000 to 30,000 units annually).

Incentives for private rental development

In building new rental housing, a developer is faced with a range of costs and, in return, creates an asset that generates a cash flow in the form of rents. The value of the property to a potential investor is determined not by its cost but by the level of revenue it can generate. The market value of the new property is based on the value of future income flows.

In the same way that an investor in government bonds is prepared to pay a price for a bond based on an expected rate of return, the rental investor converts future income to a current price based on a similar expectation of an annual return on his equity. The main difference is that a government bond is a secure investment, easily traded for cash and the annual interest payments are guaranteed. For the rental investor, the asset is more difficult to trade for cash; it must be listed for sale and await a willing buyer. In addition, the annual cash flow is not guaranteed. The property may experience vacancies with no revenues produced or regulations (such as rent controls) may be introduced or modified and thus constrain the ability to increase rental income and achieve anticipated cash flows.

Compared to alternatives, rental investment is relatively high risk and, as such, demands a much higher expectation on rate of return. The critical issue in the rental market is that the rates of return remain far below those expected by potential investors. Costs are too high relative to potential rent revenue, mainly because the costs of production are set outside of the rental sector. Ownership housing and condominiums establish land values while construction labour costs and materials are established in the wider market that includes commercial development.

In the past, stimulus programs have been used to encourage private development. These include programs that provide a grant or interest-free loan to a developer in return for modestly designed units (which should command lower rents than luxury development) and temporary tax measures that provide favourable tax treatment to investors (namely, creating eligible costs that can be used to reduce taxable income).

Effectively, these programs replace some portion of the investor's own equity with government funds without affecting the rental revenue. So the investor's rate of return increases to a level that can make development more attractive.

Currently, potential rates of return on modest rental housing have been estimated to be less than 5 percent, compared with a minimal expectation of 12 to 15 percent. Increasing a private investor's rate of return to this level likely will require a capital grant or interest-free deferred loan in excess of $15,000 to $20,000 per unit; this amount will vary significantly between cities and depend on the type of unit being developed.

advantages

Any type of new supply can have a beneficial effect in releasing the pressure of low supply. Even new development at the higher end of the rental market will draw *some* households out of lower priced stock (a so-called 'filtering' or 'trickle down' effect).

Household growth and new demand cover a spectrum of incomes, including higher-income households. Without new development, these households occupy lower priced units and crowd out lower-income households.

Depending on the development economics in a particular city, stimulus measures leverage private investment and will cost less than assisting nonprofit development (since, unlike private developers, nonprofits typically have little, if any, equity to invest).

weaknesses

Stimulus measures have been controversial. Even the housing industry has argued that this type of intervention creates an artificial stimulus and disrupts market equilibrium, taking many years to rebalance.

The expenditure does not create permanent affordable housing, although it can be designed to do so through certain conditions in exchange for the assistance.

Once operating agreements enforcing the conditions and targeting expire, the units are no longer available as affordable housing (the so-called 'expiring use problem').

No long term public asset is created in return for the government investment.

Creating a level playing field for rental development

The poor economics of rental investment are attributable, in part, to the current tax treatment of rental housing, which is seen as unfair compared with other sectors and investments.

Current inequities in the tax system include:

- GST on rental housing. Rental landlords cannot charge GST on rents, yet unlike other goods, rental housing is not zero-rated. So landlords pay GST on supplies and services but cannot claim input tax credits as they do not collect GST and have no GST remittance against which to claim credits.

- Small rental investors are not currently considered as 'small businesses' and therefore are not eligible for the lower small business tax rate on the first $200,000 of income.

- Elimination of 'pooling' provisions that previously encouraged reinvestment in new rental projects.

Explanation of pooling provisions

When a rental project is sold, investors must pay tax on the difference between the sale price and the depreciated value of the project – i.e., the original cost of the project less the Capital Cost Allowance (CCA) deductions. 'Recaptured depreciation' (the difference between the depreciated value – which applies only to the building, not to the land – and the original cost) is taxed at full income tax rates. Capital gains taxes apply to the increase in value above the original cost.

Prior to 1972, rental investors could defer paying income taxes on recaptured depreciation on buildings sold by 'pooling' the recaptured amount with CCA from other buildings. For example, if they acquired another rental project in the same year, they could avoid recaptured depreciation by transferring the excess CCA to reduce the depreciable value of the newly acquired project.

The restoration of pooling (also called 'roll-over') does not eliminate tax liability. It simply postpones the tax penalty on recaptured depreciation and capital gains for owners of rental properties *who invest the proceeds in another rental property*. Thus restoring this provision creates opportunity for existing investors/ owners of fully depreciated properties to leverage the existing assets without facing large tax impacts.

Ironically, in some cases it is more beneficial from a tax perspective to demolish the property and thereby eliminate the recapture of depreciation. Under this approach the existing units, which may be relatively affordable, are lost.

advantages

These three possible measures could correct inefficiencies in tax treatment and, while imposing an expenditure on government, do not constitute a temporary disruptive measure – unlike short-term stimulus measures.

The measures may improve after-tax feasibility of new production (at least for higher rent properties) and can stimulate new construction with a positive moderating impact on the market, thus easing rent pressures.

Most tax measures would apply only to private developers. However, any reduction in GST also would benefit nonprofit providers.

weaknesses

Federal finance officials have strongly resisted expanding tax expenditures and are reluctant to implement tax changes unless a clear case can be made on equity grounds.

These measures have a direct impact upon the production of affordable housing but may stimulate market rent development at higher rent ranges.

Reducing development costs

One of the most critical issues confronting both private and not-for-profit development is the relatively high cost of producing new housing, which is a function of land costs, labour and material costs. Total development costs also have been increasing as a result of layers of taxes and fees on development.

While costs vary across the country and depend on the type of development, new rental housing in a typical urban center will cost in the range of $65,000 to $105,000 for one-bedroom apartments and from $90,000 to $160,000 for three-bedroom family units.

Land costs generally will account for 15 to 30 percent of the cost. In most markets, land values are established by the more dominant condominium market (ownership apartment) and rental developers typically are unable to compete against condominium development for land. Land is zoned based on use (e.g., residential) and density (units per hectare or as a ratio of the total site area); land cannot be zoned for tenure. Provincial enabling legislation to empower municipalities to bonus densities specifically for rental development could help to address this situation. Such a provision could increase density for rental (compared to condominium) use so that the net residual value of the land, per unit, would equate to the values created by lower density condominium development.

Labour and material costs are established in a competitive market place. Currently, a booming construction industry in many parts of the country has resulted in shortages of both labour and materials with an inevitable upward pressure on prices. An affordable housing strategy with a long-term vision might seek to direct assistance on a countercyclical basis, supporting development in markets that are in a downturn to take advantage of lower input costs and to help offset the costs of an underutilized labour force (e.g., lower income tax revenues and higher Employment Insurance payments).

Finally, the trend over the past two decades has been toward a pay-as-you-go approach to funding the cost of municipal infrastructure related to new development rather than covering this expense from general property tax revenues spread across all existing development. This practice has resulted in the imposition, by municipalities, of development cost levies on new construction. Concurrently, the GST added another new cost to development and has carried provincial sales taxes with it in the Atlantic region where federal and provincial consumption taxes are harmonized.

advantages

Measures to lower land costs for rental housing and development charges can have a critical impact in reducing the cost of new development. A number of municipalities already have waived development fees for certain housing types and, in certain areas such as the inner cities, as a mechanism to encourage residential development in the core and minimize suburban sprawl.

Reduced fees and charges will help to encourage private development and new supply while also marginally narrowing the development cost gap faced by nonprofit organizations seeking to build.

weaknesses

Without other complementary measures, these cost-reducing approaches will not lower costs sufficiently to enable development to be viable at affordable rents without some subsidy. Even with free municipal land, nonprofit development for lower-income households is not viable without additional subsidy.

Requiring municipalities to lower or remove development costs eliminates municipal revenue and requires the municipalities alone to shoulder the burden of new development, while the province and federal government gain income tax revenues from the construction labour and ongoing operations (if for-profit).

Encouraging lower cost forms of development

Another way to address the relatively high cost of new development is to encourage alternate, lower cost building forms.

Two such options are secondary suites in single detached homes (which are already being created but often in contravention of local building regulations) and small unit or ‘single room occupancy’ (SRO) accommodation.

The formal approval and explicit encouragement of secondary suites is a controversial option in many municipalities. Such suites have been created in basements or by subdividing the upper floors of existing homes. Distinct from a rooming house, secondary units typically are created in a home in which an owner occupant is also resident so there is close management of tenants (unlike an absentee landlord). The most bothersome issue from neighbours’ perspectives is the absence of on-site parking and the resulting use of limited street parking space. The concern from municipalities is one of health and safety. Often suites are self-built and have not benefited from a permit process that requires inspections to ensure that the units are safe (especially regarding electrical wiring).

Some municipalities have sought to legalize secondary suites, but few have explicitly promoted this use either through encouraging statements in official plan policies or through small grants to existing owners. A demonstration project under Homegrown Solutions (a federally funded seed grant program administered by the Canadian Housing and Renewal Association) did provide funding to the town of Sidney, BC, for a small homeowner grant of $5,000 to help offset installation costs of an adaptable suite for a person with physical disabilities.

The SRO approach involves development of very small bed-sitting rooms, which generally range in size from 150 to 300 square feet (a typical bachelor/studio suite is usually 350 to 400 square feet). Well-designed small suites can provide cost-effective options for urban singles and have become popular in a number of US cities. Given that almost half of core need households are low-income single individuals, this building form potentially could respond to significant demand.

SRO type development can be cost-effective since the total floor area per suite is much less than that required in a typical bachelor or one-bedroom apartment. Few residents can afford to own a car, so parking requirements and costs can be reduced when located in areas served by public transit if municipalities agree to this regulatory relaxation. A study for the Ontario Ministry of Housing in 1999 found that suites could be developed in large urban centers at a cost of 40 to 50 percent of the typical new one-bedroom unit.

advantages

Alternate building forms such as secondary suites (apartments within homes) and SRO units have significant cost advantages and can effectively augment more traditional building forms.

These approaches could stretch any limited subsidy funds further since per unit costs are lower.

weaknesses

Regulatory barriers and neighbourhood resistance ('Not In My Backyard' or NIMBY) may limit opportunities.

There are few proponents pushing this approach. It is a new concept and, as such, even more risky than conventional rental, for which there remains limited investor appetite.

Shifting patterns of ownership and facilitating not-for-profit ownership

Much of the effort of the nonprofit housing sector is focussed on building new housing. Without subsidies, the costs are prohibitively high and, even with subsidies, the subsidy requirements per unit remain significant.

In other sectors, where poverty similarly limits access to necessities, the solution is to seek lower cost options. Food banks provide food at no cost, and used clothing stores make available clothing at affordable prices. If lower-income households can afford a vehicle, or must have one for transport to work, most lower-income households also drive older used cars. While many households seek housing in the older existing rental stock, the practice of drawing upon older depreciated assets is not frequently utilized by nonprofit providers, even though a large housing stock already exists and properties often are provided for sale – typically at values far below the cost of building new.

This dismissal of property acquisition as an option is, in part, a legacy of former nonprofit programs. A number of nonprofit housing providers did pursue acquisition/rehabilitation, and typically expended more than the cost of building new because the properties were in serious state of disrepair. Few providers went out to find a reasonably sound 20- to 30-year-old apartment that needed merely minor repair and painting. The second factor that acted to preclude this option was that the social housing funding programs required all tenants to be in core housing need, with incomes below specified thresholds. It was problematic to acquire buildings that already were occupied with some tenants not in core need, as this would require evictions. So providers avoided this option.

Far more multiple unit rental properties are sold each year than the number of nonprofit units that were constructed by the programs of the early 1990s. Although not all properties will be appropriate, due to poor condition or high price, a significant number of existing properties are regularly transacted (and this could be increased if rollover provisions of the tax system were revised as discussed under a separate option above). Tax reform would encourage existing owners to sell to nonprofit buyers without incurring significant income tax impacts and would provide a source for selective acquisition by nonprofits.

Currently, as these properties are offered for sale, new private investors (including institutional investors and Real Estate Investment Trusts or REITs) are the purchasers. Typically, new investors upgrade the property with the intent of increasing the rental cash flow and these acquired properties move beyond affordable levels. The alternative – purchase by nonprofit organizations – effectively can preserve and potentially expand the remaining stock of housing that is relatively affordable to lower-income households. With nonprofit providers, access to lower-income households would be improved as they no longer would be competing against 'better' higher-income tenants.

Any such nonprofit acquisition will require some subsidy, ideally a capital grant to facilitate down payment. But because the total cost per unit typically is much lower than building new (40 percent to 50 percent lower), the grants can be more effectively used and stretched to secure more units.

In lower cost markets – such as Prairie cities – existing detached homes can be acquired for as little as $20,000 to $30,000. Some communities are exploring options for purchasing a portfolio of existing homes as a rental portfolio instead of constructing new buildings.[13]

This acquisition approach also can provide opportunities for lower-income households gradually to become homeowners. A critical element of an assisted ownership program is counselling and ongoing mentoring as well as linkage to employment and human resource training to enhance employability. Despite low house costs, these lower-income households generally would be unable to qualify for a mortgage, even though the ongoing ownership carrying costs may be less than paying rent on an apartment. With modest assistance – such as nonprofit mentoring, a loan guarantee and a modest down payment grant of up to $7,500 – low-income households can be assisted in obtaining a home of their own with no ongoing subsidies.

advantages

The primary advantage of an acquisition approach is the relative cost effectiveness of the properties, compared with new construction.

Because the properties already exist, purchasers do not have to contend with NIMBY type challenges.

Acquisition permits the retention of an existing mix of market tenants while slowly introducing lower-income tenants on unit turnover. Acquisition with existing tenants remaining can effectively facilitate a mixing of income without added cost (since market rents cover breakeven rent).

Homeownership and scattered rental portfolios offer options to access existing rehabilitation programs to upgrade dwellings.

weaknesses

There appears to be reluctance on the part of many providers in the nonprofit sector to pursue acquisition. Most prefer new construction, as they are concerned with adding to the supply.

The acquisition option is limited by the availability of properties offered for sale on the market and requires careful selection and assessment of potential properties.

The option is well suited for market downturns. The best window for an acquisition approach in many cities already may have passed, as currently the rental market is under high pressure from low vacancies and rising rents (which tend to raise the value of existing properties for sale).

Demand Measures

The brief overview of housing need highlighted the predominance of affordability problems. Low-income households cannot find housing at low enough costs (rent) to match their low income and 90 percent of core need problems are related to affordability. In 1998, more than 1.5 million renter households paid more than 30 percent of their income for housing and roughly 500,000 paid more than 50 percent [Statistics Canada Survey of Household Spending].

While supply approaches can play an important role in moderating the market pressures that exacerbate affordability problems, supply initiatives cannot be implemented on a sufficient scale to tackle the large backlog of these problems. Some form of rental assistance is necessary to address the affordability gap.

This section describes two alternative program approaches to assist households facing affordability problems – rent supplements and shelter allowances – as well as a variant on shelter allowances applied to existing welfare benefits.

Rent supplement

A rent supplement approach involves an agreement between a public funding agency and a landlord in which the landlord agrees to enter into contracts to provide rental units for low-income tenants on specified terms. Usually, the tenant's out-of-pocket rent will be based on a rent-geared-to-income basis. The contract will make up the difference between the tenant-paid rgi rent and the actual market rent on the units. During the term of the agreement, there may be an inflationary index to allow the market rent to increase annually, increasing the landlord's rental income but leaving the tenant protected at the rgi rent. As assisted tenants leave, during the term of the agreement, the funding agency has the right to place a new low-income tenant into the unit.

Rent supplements are dependent on securing the interest of private landlords. However, there is a poor history of rent supplement success in most provinces, despite efforts advertising for landlords to participate. Even for properties for which rent supplements have been negotiated, many landlords have elected not to renew these contracts when terms expire. Initial terms for agreements in the 1970s were generally for 15 years with renewals now usually on a 3- to 5-year term.

In cities with low vacancy levels, which currently predominate in much of the country, landlords generally can fill their buildings with private market tenants, without the difficulties related to having their tenants selected by a third party. In addition, administrative requirements associated with this approach generally are seen by landlords as a deterrent. Thus, there may not be significant opportunities to use and retain rent supplements as a means of providing assistance to low-income tenants living in privately operated rental housing.

While there are difficulties in applying a rent supplement program in the private market, there has been a long tradition of stacking rent supplements on nonprofit projects.

A number of existing older nonprofit projects are not rgi based, but include units with rents slightly below market levels. This approach facilitated either by a capital grant or a favourable mortgage rate that helped to lower the breakeven rent below market levels. Allocating rent supplements to these units to allow rgi assistance to tenants with very low incomes could provide a low-cost rent supplement option; over time, breakeven rents will not rise as quickly as market rents.[14]

A further option is to utilize a rent supplement program in conjunction with nonprofit acquisition of existing properties. This option is discussed in the next section on preserving and expanding the affordable housing stock.

advantages

This option addresses affordability problems.

A rent supplement agreement is specific to contracted units, so thier condition and quality can be verified.

It can be stacked on nonprofit supply but focussed only on the affordability issue (separate from supply).

Over the long run, it is more cost-effective to stack rent supplements on nonprofit housing as the annual rate of increase in nonprofit break-even costs has been found to inflate more slowly than market rents.

weaknesses

A rent supplement does not address lack of supply.

The options is dependent on a willing landlord and available units – but few landlords are interested.

Lack of renewal at term can result in difficulty for existing tenants.

Historically, there has been low landlord take-up of rent supplements due to administrative burden and to restricting use and rent on the contracted units.

Shelter allowance

Unlike a rent supplement in which the landlord is implicated directly in a formal agreement, shelter allowances are direct payments to the tenant and, as such, overcome the necessity to negotiate agreements with landlords.

A feature of shelter allowances, as opposed to both rent supplements and social housing supply programs (in which the number of units is limited by the size of the existing stock and any new production), is that *all* tenants who are in need and eligible for assistance potentially can receive it. There would be no waiting lists (and unmet need) with shelter allowances. This option also implies a potential expansion of beneficiaries and higher levels of total expenditure.

With a shelter allowance, the assistance is formula-based; it takes into account both income *and* market rent for the unit.[15] Maximum levels of assistance (i.e., up to a maximum rent level) can limit overconsumption (i.e., the risk that a household will choose a unit that is larger and more costly than necessary) but also are used to constrain program benefits and manage the overall budget.

The structure of the assistance formula is the primary means of public cost control. By encouraging tenants to select units with low market rents, costs are minimized for *both* the government *and* the tenant. By contrast, rent supplements and social housing provide a subsidy to reduce the tenant's rent to 30 percent of income, regardless of the quality or amenity of the unit occupied or the associated market rent. One very low-income household may live in a 40-year-old apartment while a similar household may receive a new townhouse.

An immediate concern with respect to adoption of a potentially major new program (such as a universal shelter allowance) is the scope and cost of the program: Potentially as many as 1.5 million households might be eligible. A number of approaches are available to manage this problem.

The earlier analysis highlighted the significant number of renter households identified as being in core need that receive social assistance (including a shelter component). Since social assistance already includes a shelter allowance, it would be most practical to separate welfare recipients in this analysis. The options for welfare households are either to reform the existing shelter benefits within welfare (which are already conditionally linked to actual shelter costs up to a maximum) or to limit social assistance to income support and address shelter needs under a separate but linked shelter assistance program.

A review of the 1996 HIFE database reveals that, among 1,172,000 core need households, seniors account for about 240,000 households, welfare cases number 530,000 and the working poor account for the remaining 400,000. Excluding welfare recipients, the target group for a new shelter allowance program would be roughly 640,000 households (55 percent of the 1996 core housing need population).

A recent costing analysis of a shelter allowance initiative (undertaken for the Federation of Canadian Municipalities National Affordable Housing Strategy) estimated the cost of an incremental shelter allowance program, assisting 40,000 households annually. The first-year cost for 40,000 households was determined to be between $30 and $60 million. To address the needs of 400,000 working poor households would therefore cost in the region of $300 to $600 million annually. Adding the 240,000 seniors to this estimate would raise costs to between $500 and $950 million annually.

The wide range of the estimate reflects two differenct benefit formulas. The lower cost estimate reflects a program targeted only to households in severe need, paying more than 50 percent of income on shelter with benefits geared to lower this rent burden to roughly 37 percent of income. The more expensive option reflects a benefit formula that lowers household shelter costs to 30 percent of income, equivalent to the assistance levels in social housing.

The actual costs of a shelter allowance program could be reduced by a variety of means, including restricting potential client groups (e.g., welfare recipients), phasing in the benefits or using lower levels of benefit. Initially, eligibility criteria could be relatively restrictive and benefits could be established at minimum levels to address very high shelter cost burdens (e.g., paying less than 50 percent). Gradually, with experience in program takeup, the criteria could be relaxed and benefits enhanced to levels that allow tenants to obtain adequate accommodation at a maximum of 30 percent of income, while still ensuring that public program costs are managed and contained.

Although shelter allowances typically are seen as entitlement programs, with broad eligibility, it is possible to limit enrollment. For example, the approach used in the US involves using certificates or vouchers, which are limited in number. Like nonprofit housing, there would be a waiting list. Households are required to reapply annually to ascertain continued eligibility. When households currently served by vouchers are no longer eligible (due to improvements in income or success in finding lower cost housing), the voucher can be reallocated to a household on the waiting list.

advantages

The option directly addresses the affordability issue and helps to ease very high shelter burdens.

The allowance can be broad based or rationed.

The benefit formula allows the mechanism to be targeted and to provide varying levels of assistance to differing target groups and households facing more severe affordability problems.

Used in combination with nonprofit supply, a stacked shelter allowance reduces the challenge for new nonprofit supply, as it is necessary only to get breakeven rents down to market levels.

weaknesses

The option does not address low levels of supply, and subsidy costs are impacted by inflating rents (caused by low supply relative to demand).

It does not create a long-term asset.

The allowance may be perceived by poverty advocates as a benefit to landlords by subsidizing private sector rents, with no long-term retention of units.

Reform of welfare shelter benefits – A transitional shelter allowance

Almost half of core need households and those facing high shelter-income ratios are social assistance recipients. Various data sources suggest that just *under* half of core need households and *over* half of households spending more than 50 percent of income for rent in 1996 were in this category. This points to a need to examine the adequacy of welfare benefits – at least the portion linked specifically to shelter assistance.

The shelter component of welfare is not objectively related to actual rental costs and is not indexed to the cost of living. During the first half of the 1990s, this practice was not a problem. But with very significant levels of rent increase in the last few years in a number of centres, the calculation of the shelter component will become an increasingly serious issue.

Using the illustrative case of a single-parent family, the accompanying chart shows that the maximum allowance for shelter falls far short of average market rents. This shortfall forces recipients to seek units renting well below the average level – a difficult challenge given the

Table 4
Welfare Shelter Maximum, Market Rents and Affordability Gap

Illustrative case of lone parent with one child less than 5 years old, selected provinces, 1999

	Max. Shelter Component of Welfare	Average Market Rent	Welfare Shelter Max. as % Average Market Rent	Affordability Gap (rent less allowance)
BC	$610	$778	78%	$168
Manitoba	$387	$521	74%	$134
Ontario	$511	$851	60%	$340

1999 rents averaged for a 1- and 2-bedroom unit
Welfare maximums from provincial ministries, 1999 rates

Source: CMHC rent survey.

previously noted crowding-out effect wherein higher-income working tenants tend to have better access to these lower rent units.

Clearly, there is a need to realign intended shelter assistance benefit levels with true shelter costs, and ideally to index benefits to actual market rents (e.g., the median or 40th percentile).

In addition to addressing the inadequacy of current welfare rental assistance levels, it would be effective to link revised benefit levels to ongoing welfare policies that seek to encourage and facilitate the transition from welfare to work.

A shelter allowance for the working poor (as outlined in the previous section) could be adapted to create a transitional benefit for welfare households. While most provinces and territories have implemented reforms intended to help welfare recipients acquire skills and work experience to make the transition back to work, these approaches have not recognized the critical role that stable and affordable housing can play in this process. Other than existing social housing (where there is only a finite stock and long waiting lists), there are currently no transitional mechanisms that enable households to move off welfare, accept low wage work and still be able to afford to pay their rent.

Welfare households considering work are discouraged because as soon as they leave welfare, they lose their shelter benefit. Because shelter costs account for such a large part of the household budget, welfare reforms without ongoing housing assistance are less effective. A shelter allowance, separate from welfare, can be a valuable complement to other initiatives to enable households to move back into the labour force.

Providing ongoing support to assist with the rent provides greater stability for low-income parents with children, helping to avoid the arrears and evictions that often cause families to move continually and disrupt children's development and schooling.

In the case of families with children, a modest shelter allowance in combination with minimum wage work and the new Canada Child Tax Benefit can leave a household with more income than it would receive on welfare, at a cost to government significantly lower than the cost of full welfare benefits.

Typically, shelter allowances are designed to provide relief against excessive rental costs while leaving an incentive for the household to economize, limiting program costs. As discussed in the previous section, this is achieved by a formula that covers part of the gap between a specified percentage of income and actual rent, up to a rent maximum.

The precise formula can be adjusted to ensure that the recipient does not pay more than a specified percentage of income for rent. The formula can be varied by household size and composition, since larger households have higher food budgets and also must pay higher rent for larger units. A shelter subsidy of roughly $150 to $250 per month, depending on the market, effectively can reduce a rent burden of 55 percent down to a more reasonable proportion of income (30 to 35 percent).

In the case of a person leaving welfare to return to work, such an allowance, costing government less than $3,000 per year, would leave households in a much better financial position than welfare benefits that may cost government in excess of $12,000 to $15,000 annually. The level of the shelter assistance would phase out as earned income improves. The phase-out can be designed to be gradual and thus avoid the inherent tax back disincentives that often undermine assistance programs when participants seek to earn an income.

advantages

A transitional and separate shelter allowance for social assistance recipients could ensure that they are less at risk of losing their housing when moving off welfare into work.

Such a mechanism would support other work incentive policies.

The costs of this transitional initiative would be significantly lower than ongoing full welfare benefits.

The shelter allowance formula is based on actual rent and earned income and benefits reduce as income increases. The slope of the reduction can be controlled through the formula design.

weaknesses

Over time, more households may remain on assistance and costs could expand – unlike welfare, which tends to be more intermittent and transitional.

Implementing this approach requires significant commitment to welfare reform.

Some Concluding Observations – Toward a Comprehensive Housing Strategy

This overview has outlined the nature of the affordable housing challenge and described an array of policy/program options. While the general advantages and disadvantages of each approach are noted, this overview was not undertaken within a formal comparative frame-work, which would evaluate each option against common criteria. Such a formal evaluation requires more precise details on the specific design of the alternative programs and associated costs, which depend on geographic allocations and respective market conditions.

It is important to stress that, alone, none of the identified options is sufficient to address the full array of housing issues. The nature and magnitude of housing problems vary geographically and depend on prevailing local market conditions.

That said, the vast majority of problems relate to affordability – households spending too large a proportion of an already inadequate income for shelter, leaving little for other necessities.[16] Even households not experiencing an affordability problem face the indirect consequences of an insufficient number of lower rent units since some make a trade-off between price and quality, sharing a dwelling with another family (overcrowding) or accepting poor conditions (inadequate housing). Lowering the cost of producing housing is not a realistic option; much effort has been expended on this approach and most feasible options have been tried – save reducing the various taxes fees and levies imposed by all levels of government. The greatest potential lies in approaches aimed at increasing ability to pay.

Improving the ability to cover shelter costs for most households would be the fastest and most desirable way to reduce their shelter cost burden. This can be addressed through a conditional income transfer, linked to actual housing costs – such as a rent supplement or a shelter allowance or simply through additional income. Increasing household income, either through supplements or through increased earning capacity (e.g., higher minimum wages, employment training) also would serve to reduce high shelter-to-income ratios and leave more income for other necessities.

This conclusion suggests that income-based options outside of the traditional housing policy toolbox merit serious examination. Tax credits or other means of improving income with some conditional link to housing consumption must be explored. The most fertile option is likely the reform of the shelter component of welfare, since this subpopulation is highly over-represented among households in core housing need.

Although affordability problems predominate, simply tackling the demand side of the equation would not be sufficient. It would not address the lack of new supply that is the root cause of rising rents and worsening affordability and which cause cost inflation in a demand-side subsidy. Nor would a demand measure alone curb the ongoing erosion of the existing limited affordable housing stock outside of social housing or improve access for those stereotyped as 'less desirable tenants.'

To control for inflating rents in an undersupplied market, some form of supply response to support new construction is a necessary complement to any demand-side initiative. Any form of new construction will help ease upward pressure on rents, so measures to stimulate private rental development can play an important role.

By the same token, an exclusive nonprofit supply option would be equally insufficient, mainly as it costs much more to address two problems (supply and affordability) within the same solution and because a very large scale production program would be required to meet current need.

It would be impractical to tackle the level of outstanding housing need (in excess of one million households) entirely through a new supply program. However, as population and the number of households grows, some new supply is required to meet new need – much of which derives from lower-income households with limited effective demand.

If new supply were to be subsidized, nonprofit supply likely would generate better public investment in creating a lasting asset and addressing issues of access than stimulative subsidies directed to private development. At the same time, impediments to private rental development, particularly the tax treatment of rental investment income, need to be identified and remedied if the necessary volume of new rental production is to be achieved.

This overview has not provided any detailed comparative cost assessment. The issue of relative cost-effectiveness is a highly contentious one and is not examined in detail here. However, any assessment of policy options should consider carefully this aspect.[17]

The gradual erosion of lower priced relatively affordable existing rental stock is perhaps the most serious issue contributing to affordability problems. Measures to mitigate this phenomenon are critical. Combining the longer-term benefits of nonprofit ownership (less inflationary pressure on rents and long-term preservation of affordable units) with the inherent lower cost of buying existing rental properties – through an active program to support nonprofit acquisition of existing rental properties – may be the more effective way to expand the affordable stock than building new. The key advantage of the nonprofit sector is not its ability to build new affordable housing. The benefit of this sector comes in the form of ongoing ownership and management of assets. The long-term objective is to maximize affordability rather than return on investment.

While an acquisition strategy can help to preserve the existing stock of affordable housing, other measures are required to enhance the ability of renters to meet their rental costs and to broadly stimulate new supply.

The key point here is that demand and supply measures are not substitutes for each other – although each is preferred and promoted by particular interest groups for differing reasons. They are complementary measures that, when combined in a well considered comprehensive strategy, can help tackle the persisting affordable housing problem.

In responding to the current crisis of low rental vacancy rates, it is critical that the federal-provincial/territorial housing ministers and their officials look beyond just a short-term, relatively small-scale new construction program. In particular, the prevailing nature of the affordability problem – inadequate income and ineffective income assistance benefits – must be embraced as part of the solution. This implies the need for a broader dialogue including ministries responsible for income assistance.

Endnotes

1. *Minister Gagliano meets with P/T Ministers Responsible for Housing*. CMHC Press Release August 16th, 2001. The Ministers plan to meet again in November to discuss progress.

2. For example, a lone parent with two children of the same gender aged 5 and 8 would require a two-bedroom unit. If the median monthly rent of a two-bedroom apartment is $640, the income required to afford this appropriate unit is $25,600 ($640*12 months/.30). Similar households with an income above this level would not be in core need.

3. By comparison, the number of renter households paying more than 30 percent was counted in the Census at 1.67 million. This method does not exclude households with incomes above the CMHC income thresholds. Because the CMHC core need method is more specific in applying an income filter, it generates a lower number. CMHC reports a similar 1.66 falling below their three standards, but only 1.17 million of these were categorized as being in core housing need.

4. Statistics Canada, *The Daily*, Cat. No. 11-001E, Ottawa.

5. The key issue here is that someone who receives an income assistance benefit specifically to help with shelter (e.g., $615) may spend more than 50 percent of total benefit income on shelter, even though rent might be within the $615 allowance. Under current CMHC definitions, this household would be defined to be in core housing need. However, if this household can secure housing within the amount of the shelter allowance, it should be excluded from a count of housing need (or at least included in a separate group defined to encompass welfare recipients, as opposed to the working poor).

6. Data from the National Council of Welfare. *Profiles of Welfare: Myths and Realities*. Ottawa: Minister of Public Works and Government Services, 1998.

7. Data from Quantitative and Information Analysis Division, Social Policy, HRDC.

8. Another reason for the apparent decline is a shift in Statistics Canada survey methodology. Both the Census and former HIFE datafiles used current year rent compared to previous year income. The SHS has improved on this methodology by collecting data on income and rent for the same period. So comparison across the two data sources may be inappropriate.

9. Federal funding for new nonprofit housing commitments ended effective December 31,1993 and since programs were cost-shared with provinces and territories, almost all new social housing development ceased. Ontario maintained a unilateral program until it, too, was cut in 1995. Only BC and Quebec have maintained modest social housing programs (the Quebec programs are more focussed on acquisition and rehabilitation than on new construction).

10. One of the critical risks for potential investors is the regulation of the rental sector. While rent regulation has been relaxed in a number of provinces, investors still fear reintroduction. It is not rent controls themselves that scare investors away, but the uncertainty about future regulatory regimes that increases risk.

11. Mention should be made about the omission of rent regulation/control from this discussions. Rent controls impose specific limits on the level and frequency with which rents can be increased. In the context of serious affordability problems, caused in large part by rising rents, some advocates have pointed to the removal of rent controls as the cause of growing affordability problems. A regime of tenant protection continues to exist in all provinces, but focusses more specifically on consumer protection – defining the rights and relationship between existing tenants and landlords. Many provisions of former regimes that also sought to control rents have been revised and largely eliminated in favour of this more specific level of consumer protection. Proponents of the former controls point to their impact in preserving affordability; opponents (largely landlords) counter that controls are discriminatory and place undue burden of public policy on one specific sector (rental landlords). Rent controls also have been identified as a key deterrent to new rental investment – although, arguably, it is the uncertainty associated with a regulatory regime rather than the controls themselves that underpin this deterrent. Overall, rent controls are a blunt policy instrument with undesirable outcomes, as argued by opponents. More specifically, while controls may limit levels of rent and annual increases, they cannot ensure that this controlled resource is made available to the intended beneficiaries. In fact, controls benefit many households that do not require assistance. The previous review identified a substantial portion of the low rent housing stock occupied by households with incomes theoretically able to pay higher rent, while those most in need continue to face severe affordability conditions.

12. The generic term 'nonprofit housing' is used in this report. This term can also include co-operative housing – a variant that seeks to assist lower-income households and operates on a not-for-profit basis – although the

management structure and philosophy are different (encouraging active resident participation).

13. Such options are not necessarily restricted to lower cost markets, although the viability is obviously greater. An analysis of real estate listing for one month in 1999 in BC found more than 1,000 dwellings (including duplex and townhome units) for sale outside of the two major cities for under $90,000 – affordable to working poor households at a payment of less than $600 a month.

14. Previous research has examined the cost trends of private rent supplements over a 20-year period compared with the comparable cost of stacked rent supplements in nonprofits and found that, over time, nonprofit breakeven rents increase at a slower rate than market rents – suggesting a cost benefit to stacking rent supplements on properties under nonprofit ownership.

15. For example, a shelter allowance may provide assistance equal to 85 percent of the difference between actual rent and 35 percent of income. So if income is $1,500 and rent is $600/month (40 percent of income), a shelter allowance may provide relief of [$600-($1500x35 percent)]*.85 percent = ($600-$525)*.85 = $64. This lowers net rent to $536 or 36 percent of income. This formula can be adjusted so the net effect lowers the shelter to income ratio to 30 percent, equivalent to social housing rents. A maximum rent, say $600, might be imposed to prevent households selecting expensive units – although there is already an incentive to seek a reasonably priced unit, as the household pays a share of the higher rent.

16. Notably, Statistics Canada has recently published a research study on 'food insecurity.' This is defined as a situation where household members are forced to compromise on the quality of their diet because they have insufficient income to cover the cost of basic necessities. High housing costs may be an important factor contributing to this phenomenon. See Statistics Canada, "Food Insecurity in Canadian Households." *The Daily*, August 15, 2001.

17. The key tradeoff is between paying a premium for new supply with the benefit of nonprofit ownership, a lower rate of subsidy inflation and long-term availability of the affordable unit, versus low initial costs but inflating subsidy costs in a shelter allowance as market rents inflate into the future. The comparable present value is very sensitive to the initial cost gap and assumptions of rent inflation and discount rates.

Glossary of Terms

Adequacy Problem	A measure of poor physical condition of a dwelling unit. A household has an adequacy problem when the dwelling occupied is in need of major repair and is in an unsafe condition.
Affordability	Not defined as a specific income or rent, affordability refers to a relative situation in which income is deemed insufficient to pay for rent. Typically, the affordability benchmark used in housing analysis is 30 percent of income spent on shelter.
Affordability Gap	Difference between the amount a household can afford at a specified percentage of income (e.g., 30 percent) and the actual rent paid or market rent.
Bonusing	Used by some municipalities as a development incentive to encourage a specific outcome, such as affordable housing. Bonusing refers to the practice of allowing a higher density on a development site in exchange for providing a public or social benefit. Instead of a three-storey building, for example, a developer may obtain a bonus of one additional floor (or some percentage of allowable floor area) to four storeys with the condition that a specified amount of the floor area or units produced meet certain criteria.
Breakeven Rent	The rent that would have to be charged to cover all operating costs and mortgage payments related to the cost of building.
CMHC	Canada Mortgage and Housing Corporation is the federal housing agency that implements federal housing policy and programs.
Condominium	A form of ownership tenure associated with a multiple unit building (apartment or townhome). The occupant owns the individual unit and shares common space such as foyer, halls and outdoor space.
Co-operative Housing	A form of tenure, common in social housing, in which the residents are co-op members and participate in the management and operation of the property. Much of the co-operative housing that has been built in Canada is owned on a not-for-profit basis – the occupants have no or limited equity share. Some equity co-ops also have been built outside of social housing programs.
Core Housing Need	A measure developed by the CMHC to determine housing need. See detailed discussion in section 2 of report.
Debt Service	The monthly or annual payments of principal and interest associated with a mortgage loan.
Demand Approach	An approach that is focussed on the consumer/tenant with the objective of increasing ability to pay rent and thus improving effective demand.

Household	The primary unit of analysis in housing research. The term household is used generically and can include unattached individuals, a group of unrelated people occupying the same dwelling, a family or a combination of these groupings.
Leverage	The use of a small amount of capital to support or obtain the use of a larger amount. For example, using the future rental income to secure a mortgage loan is often referred to as leveraging the mortgage. Using the value of existing assets to secure a mortgage loan is referred to as leveraging the asset.
Mixed Income	The practice of accommodating a range of households with different income layers. Income mix is seen as a way to avoid concentration of very low-income households that can lead to stigmatization or ghettoization of certain projects and residents.
Nonprofit	An incorporated association with the objective of operating without gain or profit for members or board members. Much social housing in Canada is operated by not-for-profit agencies or corporations. These may be a private corporation, such as a subsidiary of a faith group or service club, or they might be a public nonprofit corporation – an arms-length subsidiary to a municipality incorporated specifically to own and operate housing for low- and moderate-income households.
Provider	A nonprofit corporation that owns and manages housing (a label for a nonprofit landlord or co-operative).
Public Housing	Housing owned and operated by a provincial or municipal agency – formerly used as a generic term for assisted housing, now largely replaced by the more encompassing term 'social housing.' See below.
Rent Supplement	A form of assistance paid to a landlord to provide units to low-income tenants usually over a contracted term. Payment to landlord is based on the difference between actual negotiated market rent and a rent geared to income (rgi) paid directly by tenant (typically 30 percent of income).
Rgi	Rent-geared-to-income (usually based on 25-30 percent of gross income, as verified by the administering agency).
Shelter Allowance	A form of assistance paid directly to tenant, based on the difference between actual negotiated market rent and an rgi rent paid by the tenant. Shelter allowance payments are calculated by formula and often pay only a percentage of the gap (e.g., 75 percent of the difference between full market rent less 30 percent of income).
Shelter Component/ Shelter Maximum	Portion of income assistance calculation that uses an explicit shelter variable. Typically, this component represents one part of the income assistance and is paid up to a maximum amount (varying by household size and composition) based on actual verified rent.

Social Assistance	Popularly known as 'welfare,' social assistance is the income support of last resort for people who do not qualify for or have exhausted other income programs and other sources of income.
Stacking	Combination of two different types of assistance or programs. For example, a rent supplement may be stacked with nonprofit supply assistance to ensure that rents are affordable at a specified percentage of income.
STIR	Shelter to Income Ratio.
Suitability Problem	Term used to define an overcrowded dwelling – CMHC used very specific criteria to determine an appropriate unit size – based on national occupancy standards. Parents and children have separate rooms and children over age 5 of opposite gender are assigned separate rooms; those under 5 may share up to two per room.
Supply Approach	A program response focussed on providing a dwelling – usually involves new construction but may include acquisition and rehabilitation.
Supply Gap	The difference between breakeven rent and market level rents. The supply gap reflects the cost or subsidy amount necessary to stimulate or support new supply (since typically breakeven rent on new construction exceeds potential market rent).
Targeting	Specifying the maximum percentage of units that must be made available to households meeting certain income criteria. Public housing is 100 percent targeted – all tenants are generally below income thresholds and receive subsidized rent. Some nonprofit developments cap the number of targeted households at 60 percent to encourage a degree of income mix and avoid concentrations of very low-income households.
Vacancy Rate	A measure of the availability of rental units. Distinct from a turnover rate (when one tenant moves out and a new one is ready immediately to move in), the vacancy rate (as measured and reported in the CMHC annual rental survey) measures the percentage of units that are vacant and available for rent as of a specific date. Typically, a vacancy rate of three percent is accepted as a benchmark of a healthy rental market (sufficient units to meet demand without excess pressure on rents).
Welfare Dependant	A household whose main source of income over a continuing period is social assistance.
Working Poor	Households in which one or both adults are employed, but family income is below Statistics Canada low income cut-offs.