



## HOMEOWNERSHIP, RENTING AND AFFORDABILITY ISSUES

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## EXECUTIVE SUMMARY

The Canadian Federation of Apartment Associations represents the owners and managers of over one million rental suites across Canada through 17 local and provincial associations. We are the sole national voice of the rental housing industry.

For many years in Canada, public policies at all levels of government have promoted homeownership. Those policies include various explicit incentives for homeownership and several benefits under the income tax system which accrue to many homeowners. However, most of those benefits do not accrue to low income households, even if they are homeowners.

Also for many years, the tax system has been amended in ways that further disadvantage residential landlords, developers and renters. On several fronts our industry faces unfair competition. More importantly from a public policy point of view, the tax changes have meant that Canada's housing system is not providing the housing opportunities in the rental sector needed by households with low and moderate incomes. In addition, a modern economy which relies on a mobile workforce, such as Canada's, is not necessarily well served by the promotion of homeownership at the expense of rental housing.

This paper begins by addressing how renters and the rental housing industry are disadvantaged by the focus on homeownership. Many low-income families are being hurt by the policies, pressure and rhetoric promoting homeownership, even though we realize that CMHC tries to take a balanced approach between home ownership and renting. In order to promote a balanced policy, we suggest that the following be implemented:

- a) the phase-out of the 0% and 5% down mortgage programs;
- b) policy measures to promote housing quality and affordability for those whose income and wealth place them in a poor position to access the tax and other benefits of home ownership; and
- c) an improved tax situation for rental housing to provide benefits to renters analogous to those received by homeowners, so that public policy exerts a more neutral impact on the choice of tenure decision.

In the consideration of policy measures, attention should be given to the question of equity between renters and owners, as well as to addressing the income and affordability issues of renters.

On the affordability issue, CMHC should review the affordability standard with a view to raising it for small households. CMHC should also consider other affordability standards, such as income per person left after housing costs. Having a variety of pictures from different angles will provide a clearer total picture of the affordability question.

Taking into account household size, and shelter costs as a % of expenditure, through better, and more varied, measures of the extent and size of the issues would show the real areas of difficulty, and thus allow better targeted and more effective solutions for the remaining pockets of difficulty with housing affordability.

We applaud the recent changes in the rental market surveys and the extensiveness of CMHC's statistics. We want to work with CMHC's research branch to refine and extend the research and data reporting even further. We also want to work with CMHC to promote a more balanced housing policy for Canada, which will address the needs of low and moderate income earners, and anyone who chooses to rent rather than own their home.

## Who we are

Through 17 local and provincial associations, CFAA represents the owners and managers of over one million rental suites across Canada. We are the sole national voice of the \$30 billion rental housing industry. Our members are:

- British Columbia Apartment Owners and Managers Association
- Calgary Apartment Association
- Corporation des propriétaires immobiliers du Québec
- Eastern Ontario Landlord Organization
- Edmonton Apartment Association
- Federation of Rental-housing Providers of Ontario
- Greater Toronto Apartment Association
- Hamilton & District Apartment Association
- Investment Property Owners Association of Nova Scotia
- Kingston Rental Property Owners Association
- London Property Management Association
- Mobile Home Park Owners Association of British Columbia
- New Brunswick Apartment Owners Association
- Professional Property Managers' Association (of Manitoba)
- Rental Owners and Managers Society of BC
- Saskatchewan Rental Housing Industry Association
- Waterloo Regional Apartment Management Association

## THE HOME OWNERSHIP VS RENTING ISSUE

### Introduction

For many years in Canada, public policies at all levels of government have promoted homeownership. Those policies include explicit incentives for homeownership and several benefits under the income tax system which accrue to many homeowners. However, most of those benefits do not accrue to low income households even if they are homeowners.

Also for many years the tax system has been amended in ways that further disadvantage residential landlords, developers and renters. On several fronts our industry faces unfair competition. More importantly from a public policy point of view, the tax changes have meant that the housing system is not providing the housing opportunities in the rental sector needed by households with low and moderate incomes. In addition, a modern economy which relies on a mobile workforce, such as Canada's, is not necessarily well served by the promotion of homeownership at the expense of rental housing.

This paper begins by addressing how renters and the rental housing industry are short-changed by the focus on homeownership.

## Policies that favour home ownership

Longstanding policies and programs favour home ownership. Such policies and programs include the following:

- tax-free status for capital gains on principal residences
- lower property tax rates applied to owner occupied homes in many provinces
- Home Buyers Plan allowing borrowing from an RRSP for the purchase of a home
- the Ontario Home Ownership Savings Plan (OHOSP)
- the Nova Scotia Home Ownership Savings Plan
- rebates on land transfer tax for first time buyers
- tax-free treatment of the imputed income from living in an owned dwelling<sup>1</sup>
- the imputed income from living in an owned dwelling is not considered in determining the eligibility and level of payments under the Guaranteed Income Supplement (GIS) program
- the former Assisted Home Ownership program (AHOP)

Recent policies provide even more incentive for households to choose home ownership. These policies include

- mortgage insurance for very high ratio loans (95% and even 100% of value)
- programs to promote home ownership among renters in public housing through the various federal-provincial affordable housing agreements.

## Tax treatment of rental housing

By contrast, since the 1970s the tax treatment of rental housing has become steadily worse. Here is a list of the tax changes which have disadvantaged the rental housing industry and renters:

- capital gains on rental properties become taxable, with an inclusion rate of 50%<sup>2</sup>
- the ability to pool properties to delay recapture of CCA from the date of sale of properties is eliminated
- serious inflation results in illusory capital gains being taxed, in effect turning the tax on capital gains into a tax on capital itself
- the rate of depreciation (CCA) for wood frame construction is reduced from 10% to 5%, advancing significantly the date taxes are payable
- deductibility of soft costs in first year is restricted

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<sup>1</sup> For an explanation of this point, see Appendix A at the end of this paper.

<sup>2</sup> Tax becomes payable on capital gains on other income earning assets as well, but capital gains were and are a major driver for real estate investment. Setting the inclusion rate at 50%, rather than higher, is alleged to allow a reward for the risk involved; however, with the amount of inflation that has occurred since 1972, the exclusion of 50% of capital gains may not even allow sufficient adjustment for inflation, let alone any compensation for risk.

- the CCA rate is cut in half in the year of acquisition by the “half-year rule”
- deductibility of soft costs in the year of acquisition is further restricted for rental property owners not in the business of real estate.
- a lifetime capital gains exemption of \$20,000 is introduced for individuals, which is to increase to \$500,000
- MURB rules are repealed retroactively preventing the application of CCA deduction to offset income from other sources
- the lifetime capital gains exemption is capped at \$100,000; and cumulative net investment loss rule reduces the value of the exemption
- rate of depreciation (CCA) for all buildings is reduced from 5% to 4%
- the inclusion rate for capital gains is increased to 66.67% with effect retroactive to 1972 or the date of acquisition, whichever is later
- the inclusion rate for capital gains was increased to 75% with retroactive effect (this has since been reduced to 50%)
- GST introduced and applied to rental housing construction and operation
- the lifetime capital gains exemption is eliminated.

Rental housing does not have the tax benefits of ownership housing, and in addition it does not have the benefit of various tax benefits available to other businesses. For example, businesses can sell a property and buy a more expensive replacement property, and rollover their tax position, deferring tax on capital gains and recapture of CCA, but rental property owners cannot. Canadian controlled private corporations have a preferential tax rate on the first \$400,000 of income, but that preferential rate is not available for rental income.<sup>3 4</sup>

### **Misleading information about home ownership versus renting**

Numerous studies proclaim home ownership the “silver bullet” to improve the financial, social and even physical health of low income Canadians. One recent study compared the wealth that would be accumulated by renters investing the difference between their rent and their costs as owners in stocks (yielding the average return achieved on the Toronto Stock Exchange between 1979 and 2006) with the wealth of homeowners. The study finds that such a renter would accumulate 20% more wealth than a homeowner in Edmonton, Halifax, Montreal and Regina, after taxes and fees. For Ottawa, Vancouver and Winnipeg, the difference would be lower but still in favour of renters. Only for Calgary and Toronto would the wealth of owners be higher.<sup>5</sup> Despite those findings, the study endorses homeownership as “a unique opportunity for households to accumulate wealth,” in large part because of tax policy.<sup>6</sup>

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<sup>3</sup> Much more income tax is paid on rental housing than ownership housing as shown in Appendix A.

<sup>4</sup> Rental housing also faces an increasing, and increasingly unfair, regulatory burden in comparison to owner occupied housing. However that is beyond the scope of this paper.

<sup>5</sup> Tsur Somerville, Li Qiang and Paulina Teller, “Are Renters Being Left Behind? Homeownership and Wealth Accumulation in Canadian Cities”. Centre for Urban Economics and Real Estate, University of British Columbia, January 29, 2007, pp 12-13.

<sup>6</sup> Ibid, p. 2.

CMHC produces data comparing the cost of home ownership versus renting. The comparison is the average rent of a two bedroom apartment against the principal and interest required on a mortgage on a resale condo apartment.<sup>7</sup> When asked, the market analysts agree that the comparison is not an apples-to-apples comparison of all relevant costs. In addition to their mortgage payment, homeowners need to make a downpayment (for which they forego other investment opportunities), pay property taxes, insurance, repairs and utilities or condominium fees. However, the analysts say "we're just showing the trend." Our objection is that the figures are reported in the media and used in advertising as if they were an apples-to-apples comparison.

Figures are available for the costs of all the major cost components of home ownership. **We would like CMHC to revise the measure so that it is an accurate apples-to-apples comparison of all relevant costs of renting as opposed to home ownership.**

### **The benefits of homeownership**

As noted above, homeowners receive many benefits. Two largest benefits are from the income tax system: first, any capital gain on a principal residence is free of tax;<sup>8</sup> and second, the benefit of imputed income of living in the home is not taxed. That benefit varies according to how much equity a person has in their home. With a large amount of equity, the benefit is large since the household has a large amount on which it is essentially earning tax-free income in the form of untaxed housing services. With a small amount of equity, the benefit is correspondingly small since mortgage payments are not tax deductible. Moreover, both benefits also vary with the income of the household. The higher the income (and thus the higher the marginal income-tax rate), the larger the benefit for any given amount of equity in the home. Similarly, the lower the income, the smaller the benefit. In fact at a low income, there may be no such benefit at all. Consequently, the benefits of home ownership apply mostly to high income earners, especially those with a lot of capital (i.e. wealth), who are able to inject a lot of equity. The factors mean that home ownership is not necessarily an economic benefit for low-income people, and especially people with both low income and little wealth.<sup>9</sup>

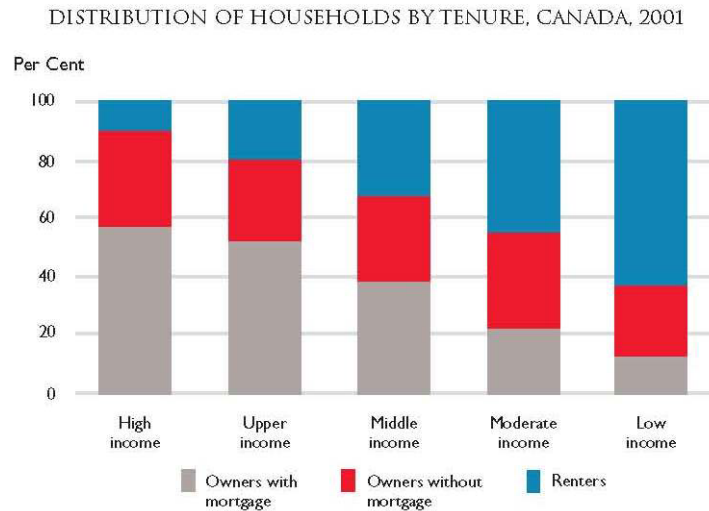
Economically rational behaviour would result in fewer low-income households owning their homes, and of those who do own, one would expect to see substantial amounts of equity. That is exactly the pattern one sees in the data, as shown in Figure 1 below.

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<sup>7</sup> For example, see Figure 3 on p.2 of the Rental Market Report for Toronto released December 2006.

<sup>8</sup> That benefit varies according to whether the home grows in value at or above the rate of inflation. If the home grows in value at below the rate of inflation, there is little if any net benefit (compared to renting).

<sup>9</sup> These policies may in fact hurt low income people since the tax expenditures implicit in these homeownership tax benefits requires higher taxes generally, including higher taxes from low income households. Since low income households pay little income tax, the extra taxes on low income households would be mostly higher consumption taxes, like the PST and GST and taxes on cigarettes and alcohol.



**FIGURE 1**

Source: Figure 58, p. 69, CMHC 2006 Canadian Housing Observer.

### The disadvantages of home ownership

Home ownership also has numerous disadvantages and risks. Any gains made through house price appreciation may be offset by the cost of buying and selling. Those transaction costs also interfere with labour mobility, with negative impacts on workers and the economy. The possible benefit due to house price appreciation is uncertain and highly variable. In many years and many markets, house prices fall.<sup>10</sup> This is particularly devastating to those with low equity, or the need to sell. For owners paying a high percentage of their income in mortgage payments, even a modest increase in interest rates can be devastating. Such an increase can raise the required payment, and at the same time will cause house prices to fall. Policy makers need to remember the foreclosures and financial losses which occurred under the Assisted Home Ownership Program (AHOP) of the late 1970s and early 1980s in order to avoid a similar policy error.

### American commentators

Numerous American commentators have recently expressed the view that American housing policy has gone too far in promoting home ownership for all households. American home ownership benefits are higher than benefits in Canada. However, American home ownership benefits are mitigated by larger tax benefits for rental housing than in Canada, which tends to keep the homeownership-cost-to-rent ratio and the effects on tenure choice in line between the two countries. Therefore, the comments are highly instructive.

In *The Crisis in America's Housing: Confronting Myths and Promoting a Balanced Housing Policy*, the National Low Income Housing Coalition says:

<sup>10</sup> For example, between 1981 and 1986 Vancouver's average house price fell by 38% in real terms, and between 1989 and 1994 Toronto's average house price fell by 32% in real terms and by 24% in current prices: Marion Steele and Rakhal Sarker, "Estimates of the Private and Societal Costs and Benefits of Homeownership in Selected Canadian Cities". CMHC, October 2005, p. 55. Given recent rapid increases in house prices, one can expect similar "corrections" within the next few years.

Veteran housing counsellors said that providing low-income homeownership was a very time- and money-intensive endeavour that required significant subsidies to help a small number of families. Homeownership cannot replace successful rental assistance programs such as housing vouchers, and many low-income families are being hurt by the pressure and rhetoric to become homeowners.

In *Rethinking Rental Housing: Expanding the Ability of Rental Housing to Serve as a Pathway to Economic and Social Opportunity*, William Apgar of the Joint Center for Housing Studies of Harvard University, and former Secretary of Housing and Urban Development, writes:

There are downsides to excessive focus on promoting homeownership. Owning a home may prove unhelpful or even financially disastrous. Many low-wealth and low-income families are being "pushed" into homeownership because they are told that homeownership is a prerequisite for economic and social success, and they perceive (or rather hope) that homeownership in and of itself will help them achieve a better life.

In fact, lower-income homeowners may become trapped in declining neighbourhoods with little access to employment, good quality schools or social services and equally limited potential for price appreciation. In these situations, all too often the dream of homeownership becomes the nightmare of a financially devastating foreclosure.

In *Who's Dreaming? Homeownership Among Low Income Families*, Dean Baker of the Center for Economic and Policy Research, writes:

Low-income families are less likely to benefit from homeownership because: (1) they have no income tax liability, so they receive no tax benefits from owning; and (2) high transaction costs from buying and selling have a greater impact on low-income families because they have shorter median ownership periods—just four years.

In a scenario in which home prices rise in step with inflation, a typical low-income homebuyer will lose an amount equal to approximately 25 percent of their total rent over the four-year median period of homeownership.

## The policy implications

The facts set out above have two main implications:

- 1) promoting home ownership to those who will need to move, or to those with low or moderate incomes, or low equity, is questionable public policy; and
- 2) the income tax system confers large benefits on homeowners with high incomes and substantial equity, without any matching benefits to renters or people with low incomes or little equity.

## Requests

We realize that CMHC tries to take a balanced approach between home ownership and renting. However, **in order to promote a balanced policy, we suggest that the following be implemented:**

- a) the phase-out of the 0% and 5% down mortgage programs;
- b) policy measures to promote housing quality and affordability for those whose income and wealth place them in a poor position to access the tax and other benefits of home ownership;
- c) an improved tax situation for rental housing to provide benefits to renters analogous to those received by homeowners, so that public policy exerts a more neutral impact on the choice of tenure decision.

In the consideration of policy measures, attention should be given to the question of equity between renters and owners, as well as addressing the income and affordability issues of renters and homeowners.

CFAA wants to work with CMHC to promote a more balanced housing policy for Canada, which will address the needs of low and moderate income earners, and anyone who chooses to rent rather than own their home.

## AFFORDABILITY ISSUES

### The 30% affordability standard

We understand that the current affordability measures were devised to determine the allocation of housing funds across Canada. They were also devised when social housing was limited to families or even families with children, and not provided to households consisting of individuals. The affordability measures may have been well suited for that purpose.

However, they are now used in the context of housing for individuals, and also to portray changes in rental affordability over time. We are concerned that the current rent-to-income measurements provide a misleading picture of housing affordability. Key factors include the following:

- Average households size has decreased over time.
- Smaller household can afford to pay a larger percentage of their income for housing than larger households, because the remaining money feeds, clothes and entertains fewer people.
- Smaller households are also more expensive per person to house because of minimum size constraints and because by modern standards every household needs a kitchen and a bathroom whether it consists of four people or one person, and those are the most expensive rooms to build and furnish.
- Rising minimum standards and the increasing quality of housing distort the current affordability measure.

From conferences we have attended, there seems to be broad agreement that the affordability standard should vary with household size, being higher than 30% for individuals and two person households. **CMHC should review the affordability standard with a view to raising it for small households. CMHC should also consider other affordability standards, such as income per person left after housing costs. Having a variety of pictures from different angles will provide a clearer total picture of the affordability question.**

## Changes in incomes and rental affordability

Recent income data shows that more Canadians are earning high incomes. In addition, the average income of tenant households appear to be stable or declining. Some advocates are trumpeting those statistics as evidence of increasing income disparity in Canada, or even of the impending disappearance of the middle class. However, we believe that tenants are not getting relatively poorer, rather the division of the population between renters and owners is changing. Because higher-income renters are transitioning to home ownership, the average income of renters is declining, even if the incomes of individual renters are rising. A trend to smaller renter households would also make the average renter household appear to be poorer, when the whole apparent effect could be due to the changes in household composition. CMHC should help clarify this issue with appropriate research.

We are concerned that the current affordability measures are presenting a misleading picture. In at least two ways the current measures can show the housing affordability situation is getting worse when in fact it is getting better.

- Decreasing rents (greater affordability) encourage household formation for low income people, which will appear as an increased ratio of shelter cost to income (lower affordability) if the propensity for lower income household formation is large.
- Increasing incomes among lower income persons (greater affordability) will encourage household formation, which will appear as an increased ratio of shelter cost to income (lower affordability) if these new low income households cause average tenant household income to decline.

Even if greater affordability does not appear as lower affordability through those mechanisms, improvements in affordability will definitely appear to be less than they actually are due to the effect of greater affordability on household formation. **CMHC should clarify this issue with appropriate research and with additional housing affordability measures that account for the effect of increased affordability on household formation.**

## Shelter cost to income or expenditure

To a number of advocates and policymakers, housing affordability is a major concern. Affordable housing is seen as fundamental to the economic, social and physical well-being of families and communities. Affordable housing is seen as essential to healthy engagement in the local community.

Using the standard of shelter cost as 30% of income produces a picture of dramatic need among low-income Canadians. The table below shows the shelter cost to income data from the Canadian Housing Observer, 2006, CMHC, at pages 65, 66 and 73, with percentage shelter cost calculations by CFAA. All figures are per month. The income levels are in quintiles, i.e. fifths. On average households in the lowest income quintile pay 52.6% of their income for shelter. See Table 1.

**Table 1: Shelter cost as % of household income – Canada 2001**

	Income level				
	High	Upper	Middle	Moderate	Low
Average monthly household income	\$11,245	\$5,836	\$3,933	\$2,439	\$1,015
Shelter costs as % of income	9.8%	15.1%	18.8%	25.1%	52.6%

Looking at the figures in Table 1 makes Canada seem a very unequal place with an enormous burden of housing costs negatively impacting the poorest 20% of the population in a very severe way. However, looking at housing costs as a percentage of expenditure produces a very different result. See Table 2.

**Table 2: Shelter cost as % of household expenditure – Canada 2001**

	Income level				
	High	Upper	Middle	Moderate	Low
Average monthly household expenditure <sup>11</sup>	\$5,723	\$3,939	\$3,056	\$2,263	\$1,456
Shelter costs as % of expenditures	19.3%	22.4%	24.2%	27.0%	36.7%

Looking at shelter costs as a percentage of expenses, the difference in the housing cost burden between high and low income Canadian households is not nearly so dramatic, and the burden of housing costs on low income households is shown to be much less.

Adding household size and labour force participation to the picture explains much of the remaining differences that exist. See Table 3.

**Table 3: Household characteristics – Canada 2001**

	Income level				
	High	Upper	Middle	Moderate	Low
% of one person households	3.9%	9.8%	20.9%	33.5%	61.9%
% of household head not in the labour force	11.6%	17.0%	25.9%	43.0%	60.3%

**Taking into account household size, and shelter costs as a % of expenditure, through better, and more varied, measures of the extent and size of the issues would show the real areas of difficulty, and thus allow better targeted and more effective solutions.**

### Recent work on housing allowances

In 2005-06 CMHC commissioned a study on housing allowances by Abt Associates. We applaud CMHC for undertaking that report. **We would like to see more work on the policy options related to housing allowances**, including

- existing provincial program designs, and the effects of them on
  - household well-being,
  - household formation and
  - mobility and labour market engagement.
- practical ways in which program eligibility limits can be combined to achieve programs which will be seen as affordable by the federal government.

<sup>11</sup> Besides drawing down savings, the additional money which low income households spend may come from government benefits not reported in income, illegal or undeclared income, gifts or other sources. On the other hand, high income households pay out large sums in income taxes, and to a lesser extent for savings, both of which do not appear as expenditures.

## **Recent work on the secondary rental market**

**CFAA applauds the recent changes in the rental market surveys. We want to work with CMHC's research branch to refine and extend the research and data reporting even further.**

## **SUMMARY OF RECOMMENDATIONS**

### **Homeownership versus renting**

1. CMHC should revise the measure comparing the cost of homeownership and renting so that it is an accurate apples-to-apples comparison which includes all relevant costs of home ownership.
2. CMHC should phase-out the 0% and 5% down mortgage programs.
3. CMHC should promote more consideration of policy measures to promote housing quality and affordability to those whose income and wealth place them in a poor position to access the tax and other benefits of home ownership.
4. CMHC should promote an improved tax situation for rental housing to provide benefits to renters analogous for those received by homeowners, so that public policy exerts a more neutral impact on the choice of tenure decision.
5. In the consideration of policy measures, attention should be given to the question of equity between renters and owners, as well as addressing the income and affordability issues of renters and homeowners.

### **Affordability issues**

6. CMHC should review the affordability standard with a view to raising it for small households.
7. CMHC should also consider additional affordability standards, such as income per person left after housing costs in order to use a variety of pictures from different angles to provide a clearer total picture of the affordability question.
8. CMHC should take into account household size, and shelter costs as a % of expenditure, to provide better, and more varied, measures of the extent and size of the issues in order to identify the real areas of affordability difficulty, and thus allow better targeted and more effective solutions.
9. CMHC should undertake more research on the policy options related to housing allowances.
10. CMHC should continue with the recently expanded rental market surveys addressing the secondary rental market.

## APPENDIX A – Homeowners’ Imputed income

We have said that the imputed income from living in an owned dwelling is free of tax. How does that come about and what does it result in?

The homeowner pays a capital sum to own a home, which entitles him or her to occupy the home without paying any rent. That occupation has a value to the homeowner, but it is not considered part of the homeowner’s income for tax purposes. The homeowner can be considered to receive imputed income, but pays no tax on it.

Set out in table 4 is an example to show the comparative situation between owners and renters, as well as landlords and the government. Section 1A shows the situation of a homeowner who owns their home free of mortgage worth \$200,000. Section 1B shows the situation of a renter who has the same wealth, but invests her \$200,000 in shares rather than a house. The difference between those sections shows the disadvantage suffered by the renter because the imputed income from the investment in the home is not taxed.

Section 1C shows the position of the landlord renting the unit to the renter in section 1B. Section 2 shows the total impact on government revenue of home ownership versus rental housing.

**Table 4 - Comparative income taxes on homeowners and renters – current law**

<b>SECTION 1: INDIVIDUAL TAX POSITIONS</b>		
	<b>1A. Homeowner</b>	<b>1B. Renter/investor</b>
Investment	\$200,000 (in home)	\$200,000 (in shares)
Imputed income (at 5%)	\$10,000	
Less tax payable by the owner	\$ 0	
Imputed income net of tax	\$10,000	
Income (at 5%)		\$ 10,000
Less tax payable by the renter		\$ - 4,000 (A)
Income net of tax		\$ 6,000
Resources applied to housing	\$10,000	\$ 6,000
Relative yearly value of home occupied with the money or value applied	\$10,000	\$ 6,000
		<b>1C. Landlord’s tax position on the renter’s unit</b>
Rent paid (landlord's gross income)		\$6,000
Landlord's expenses		\$-4,000
Landlord's net income		\$2,000
Income tax payable by the landlord		\$-1,000 (B)
Net income to landlord		\$1,000
<b>SECTION 2: COMBINED TAX POSITIONS – OWNERSHIP vs. RENTAL HOUSING</b>		
	<b>Ownership housing</b>	<b>Rental housing</b>
Tax money received by government	\$0	\$5,000 (A + B)