



Canadian
Federation
of Apartment
Associations

Fédération
Canadienne Des
Associations
De Propriétaires
Immobiliers

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BY E-MAIL – February 1, 2008

The Honourable Rich Coleman
Minister Responsible for Housing
c/o Ms. Heather Brazier
Housing Policy Branch
P.O. Box 9844 Stn. Prov. Govt.
Victoria, BC V8W 9T2

Dear Minister Coleman:

Re: CFAA Submission for the February 2008 Meeting of the Provincial-Territorial Ministers Responsible for Housing

The Canadian Federation of Apartment Associations ("CFAA") represents the owners and managers of close to one million residential rental suites in Canada, through 17 organizations across Canada. CFAA is the sole national organization representing the interests of Canada's rental housing industry, which houses almost four million Canadian households.

CFAA appreciates your invitation to make a written submission to the Provincial-Territorial Housing Ministers' Conference taking place in Vancouver in February. Due to time constraints CFAA is writing this on behalf of itself and on behalf of the Real Property Association of Canada (REALpac) and the Canadian Real Estate Association (CREA).

CFAA supports federal housing programs that:

- are long term and predictable;
- allow flexibility in the use of funding;
- encourage the growth of private-sector rental housing;
- focus on supportive housing to end homelessness; and
- address affordability, which is the predominant housing need apart from homelessness.

The two key issues we wish to address are:

tax deferral on real estate reinvestment; and
portable housing allowances.

Tax Deferral on Real Estate Re-Investment

In the year 2000, CFAA, the Real Property Association of Canada (REALpac) and the Canadian Real Estate Association (CREA) were encouraged when the

Provincial/Territorial Ministers recognized that tax policy posed a barrier to rental housing development, and agreed to "formulate action plans" to address both tax and regulatory barriers. In 2003 the Ministers' communique said, **"the Ministers agreed to work together to examine possible tax measures, including capital gains roll-over provisions, for consideration by their respective Ministers of Finance."** Regrettably, nothing seemed to come of that agreement. However, CREA, REALpac and CFAA have researched the application of a rollover to encourage reinvestment in real property. Attached is a CREA Bulletin giving the highlights of the research conducted by two of Canada's leading academic authorities on real property and tax policy. The Bulletin includes detailed cost estimates and explanations of the benefits of the proposed tax reform. What follows are the key benefits, and some additional comments on the equity of the proposed reform.

Under the current federal income tax rules, when a rental real estate property is sold, the owner must pay tax on the recaptured CCA (at up to 48%) and on any nominal capital gains (at up to 24%). (Capital gains are not adjusted first for inflation, and therefore much of any gain may be eaten up by inflation, even before the tax is applied.) Due to the tax impact, an even trade of properties of the same value is not possible. The inability to defer the tax burden on the sale and reinvestment in rental real estate creates numerous economic problems and inequities.

Allowing tax deferral on real estate reinvestment would:

1. Reduce the cost of rental housing, and improve affordability and housing supply

When producers of a product are more heavily taxed, the price charged to consumers is increased. Rental property is no exception. Because rental property owners cannot defer taxes, they incur immediate tax costs on any property reinvestments, and in the long run those costs are passed on to tenants in the form of higher rents. Lower costs will result in lower rents (i.e. improved affordability) and a larger supply of rental housing.

Allowing tax deferral would facilitate rental property sales and purchases. Because they come with "fresh eyes," new owners frequently see ways to improve rental properties. With the ability to defer tax on capital gains upon reinvestment, existing owners will likely become buyers of new rental properties for several reasons: they may want to buy a building in a new area; to acquire a property with fewer maintenance requirements or to change the size of their holdings. That will tend to improve the use and maintenance of both the property that is sold and the property that is bought.

2. Promote efficient capital allocation across the economy

The absence of a tax deferral on reinvestment creates a "lock-in" effect; in other words, to avoid tax consequences, investors retain real estate assets when other assets would provide a higher return. That is a drag on the economy, and results in lower economic growth and less productivity across Canada. Allowing tax deferral would eliminate that effect.

3. Promote more compact, environmentally sound urban redevelopment

The lock-in effect also inhibits the redevelopment of land in urban areas. It discourages the redevelopment of significant pieces of land into their most productive uses, contributing to urban decay and to urban sprawl.¹ Allowing tax deferral would facilitate the rehabilitation of brownfield sites and compact, environmentally sound redevelopment in cities.

4. Help small investors and middle-income families

Investment rental property is very widely held, much more widely held than shares in public or private companies. For example in 2005, 66% of those who reported capital gains on rental real estate had less than \$50,000 per year in income other than those gains. For those people the gains averaged \$40,000 each.

5. Permit relocation by owner-managers

Rental property owners have the same relocation needs as other investors. If a person moves across their province or across Canada, they can easily take their stocks and bonds with them, but the owners of rental property cannot move their rental buildings. To be able to manage their property in their new location, rental property owners have to sell one property and buy another. Enabling investors to do that more freely would reduce absentee ownership and improve communities, as well as improving labour mobility across Canada, which is important for economic productivity.

6. Level the rules between rental property and other businesses

People who own small business corporations can defer taxes on sale of their business and reinvestment in another small business now, but people who own rental real estate do not have any ability to defer taxes upon reinvestment.

7. Level the rules between businesses which rent and which own their premises

To relocate, downsize or expand, business owners who own their premises can defer taxes on sale and reinvestment in their premises now. For example, the owners of a print shop operating in a building worth \$500,000 can sell it, buy a building worth

¹ In this regard, Mayor Hames of the City of Chilliwack wrote this to the Chilliwack & District Real Estate Board in November 2007:

“The City of Chilliwack has been working to rejuvenate its aging downtown for many years. We have ... attempted to assemble property in order to facilitate development. Unfortunately, some property owners have owned their properties for many years and are not willing to sell their rental properties even at prices above market value because they would have to immediately pay significant taxes on the capital gains created. The proposed change that would allow a property owner to defer capital gains by transferring the gain to a new property would greatly assist the City of Chilliwack in stimulating the redevelopment of its aging downtown.”

\$1,000,000, and roll over their tax position to defer tax until the latter building is sold. However, if the business owner rents their premises, the property owner cannot defer taxes, they incur immediate tax costs on any property sales. In the long run that raises the rents real estate investors need to charge to their business renters.

8. Level the rules between rental property and shares in companies

Three quarters of company shares are held in tax deferred vehicles such as pension plans and RRSPs. Real estate is not eligible for RRSPs. Allowing a tax deferral would result in between 50% and 75% of real estate gaining tax deferral, which would still be less than the deferral level which exists in company shares.

The proposal is a deferral only

To allow tax deferral on reinvestment is not a tax reduction; rather it is merely a tax deferral. The tax on capital gains and the recaptured CCA will ultimately be paid. The proposal is only to defer the tax, and only if the proceeds of a sale are reinvested in a replacement property within 12 months of the sale. On that basis, no capital gains have been realized; only an exchange of properties has taken place. Moreover, given that a lower undepreciated capital cost will apply, the taxes received on the income from the replacement property will be higher than they would be without the deferral.

The deferral cost of the proposal is reasonable

The government revenues that would be deferred by the proposal in the first year after implementation are approximately the following:

	Federal	Total Provincial/ Territorial
Deferred tax on capital gains	\$ 258M	\$ 129M
Deferred tax on recapture of CCA	<u>\$ 157M</u>	<u>\$ 79M</u>
Total revenue deferral	<u>\$ 415M</u>	<u>\$ 208M</u>

In the years that follow the first year, the direct deferral amount should decrease given that taxes payable (deferred from the first and subsequent years) would appear as an additional tax payable thereafter. Besides that, the increase in transactions resulting from reducing the lock-in effect would generate increases in economic activity and thus higher taxes on that activity. Increased income and capital gains from reducing the lock-in effect would also tend to raise tax revenue in future years. Over time, the deferral “cost” would decrease toward zero, while the economic benefits would quickly make the overall impact on government revenue positive.

Other supporting associations

Besides CFAA, CREA and REALpac other major associations endorse the tax deferral proposals, including

- Canadian Home Builders Association
- Federation of Canadian Municipalities

- Ontario Non-profit Housing Association
- Canadian Chamber of Commerce

The comments of those organizations are noted on the enclosed sheet entitled "What other organizations say about tax deferral."

Conclusion

Permitting rental property owners to defer capital gains tax and the recapture of capital cost allowances when they reinvest in real estate would increase rental housing supply and improve affordability, as well as benefiting residential tenants, Canada's economy, Canada's cities, business renters and small, middle-class investors, and move the tax system toward greater equity and fairness. We urge you to promote tax deferral on reinvestment as a key first step in tax reform to facilitate the expansion of the supply of private rental housing. CFAA, REALpac and CREA ask you and all Provincial/Territorial Housing Ministers to endorse the proposal and to work together with us to enlist the support of the Provincial, Territorial and Federal Finance Ministers to make the proposal a reality.

Portable housing allowances

Many groups are calling for portable housing allowances as a key method of addressing affordability. Those groups include:

- Canadian Federation of Apartment Associations
- Real Property Association of Canada
- Canadian Home Builders Association
- Centre for Equality Rights in Accommodation
- Federal Liberal Women's Caucus and
- Federation of Canadian Municipalities

In the background document to its 2008 Housing Action Plan FCM says, "the analysis of housing need clearly documents the predominant problem as one of affordability. ... Affordability problems account for 93% of core housing need. ...[portable shelter allowances] (i.e. linked to a household, not contracted to a unit) can be effective in helping to reduce these high shelter burdens."

FCM's costing shows the value-for-money feature of portable housing allowances. In its 2008 Housing Action Plan FCM estimates a Canada-wide average cost per household of \$38,000 for housing allowances as opposed to \$107,000 for new construction (p.24). That means that **2.8 households can be helped through housing allowances for each household which is helped by construction subsidies**. FCM also notes housing allowances are well suited to payment of part of the affordability gap, which means that yet more households can be helped at the same total cost.

The FCM recommendation lines up with the recommendations of numerous other organizations from all sides of the housing and poverty reduction debate, as listed on the attached sheet, "What do various organizations say about housing allowances?"

CFAA has long advocated portable housing allowances, since portable housing allowances:

- allow tenants to choose where to live;
- use the existing economical housing stock, rather than expensive, newly built housing;
- achieve income mixing without the cost of subsidizing middle income tenants;
- avoid the stigma associated with public or social housing;
- allow tenants to keep their housing assistance when they move to take a new job;
- can easily be used both in and outside major cities;
- can be tailored to different provincial needs and resources;
- can be administered quickly and at very low cost; and
- allow help to be provided equitably among many more low income tenants.

Ensuring that future federal funding can be used for portable housing allowances would benefit tenants and taxpayers. CFAA and REALpac urge you to promote the ability to use federal housing funding for portable housing allowances.

Conclusion

CFAA urges the Provincial-Territorial Housing Ministers to call on the federal government to provide long-term housing funding to address the support needs of the chronically homeless, as well as addressing affordability through portable housing allowances, and renewing their call on the federal government to provide tax deferral on reinvestment, as a means of encouraging the private rental housing sector.

Yours truly,



John Dickie
President, CFAA