AFFORDABLE HOUSING IN CANADA: IN SEARCH OF A NEW PARADIGM

TD Economics

Special Report

June 17, 2003

TD Bank Financial Group

AFFORDABLE HOUSING IN CANADA: IN SEARCH OF A NEW PARADIGM

Executive Summary

Housing is a necessity of life. Yet, after ten years of economic expansion, one in five households in Canada is still unable to afford acceptable shelter – a strikingly high number, especially in view of the country's ranking well atop the United Nations human-development survey. What's more, the lack of affordable housing is a problem confronting communities right across the nation – from large urban centres to smaller, less-populated areas. As such, it is steadily gaining recognition as one of Canada's most pressing public-policy issues.

This report, *Affordable Housing in Canada: In Search of a New Paradigm* represents the fourth in a series by TD Bank Financial Group that have focused on the challenges facing Canada's urban areas. In April 2002, the Bank released *A Choice Between Investing in Canada's Cities or Disinvesting in Canada's Future*, which examined some of the challenges the country's large metropolitan areas confront. Two more reports have since been produced, chronicling issues specific to the Greater Toronto Area (May 2002) and the Calgary-Edmonton Corridor (April 2003).

These studies stemmed from a number of speeches delivered in 2001 and 2002 by A. Charles Baillie, former TD Bank Financial Group Chairman and CEO, in which he put forward a formidable challenge for Canadians – to surpass the U.S. standard of living (or the level of real income per person) within 15 years. In issuing this call, Mr. Baillie highlighted the critical importance of Canada's cities in meeting this goal, since urban areas now comprise a staggering 80 per cent of Canadian economic activity and employment.

We are used to thinking of affordable housing as both a social and a health issue. This is not altogether surprising, given the fact that many social housing tenants receive their main source of income from government transfer payments. As well, in study after study, researchers have shown that a strong correlation exists between neighbourhoods with poor quality housing and lower health outcomes.

However, working to find solutions to the problem of affordable housing is also smart economic policy. An inadequate supply of housing can be a major impediment to business investment and growth, and can influence immigrants' choices of where to locate. Hence, implementing solutions to resolve this issue ties in well with the TD goal of raising Canada's living standards and overall quality of life.

This is not a report on homelessness *per se*. But, it is important to recognize that a significant number of the homeless are without shelter because they cannot afford it. Clearly, any successful efforts to alleviate the problem of insufficient income and/or increase the supply of affordable housing will help relieve homelessness – particularly among the working poor and people who have the capacity to work but cannot find employment. At the same time, there are others who are homeless because they are struggling with mental illness, addiction or other serious challenges. These individuals are often in need of supportive housing, but they also require other services and accordingly, encompass a dimension of the affordable housing problem that is beyond the scope of this report.

The dimensions of the affordable housing problem

The good news is that most Canadian households are properly housed. According to the Canada Mortgage and Housing Corporation (CMHC), as of the 1996 Census, roughly two-thirds of households surveyed – 6.7 million – lived in dwellings that met all three of the national housing agency's standards for shelter conditions. That is, their shelter was in *adequate* condition, it was *suitable* in terms of size, and it was *affordable*, meaning that it was not costing households 30 per cent or more of their pre-tax income. An additional 1.4 million households resided in dwellings that did not meet all three standards, but had the financial means to rectify the situation by moving to alternative housing within their market area.

Still, that left a substantial 1.7 million households, or about one in five, that CMHC deemed to be in *core housing need* in 1996. In other words, these households could not find adequate and suitable housing without spending 30 per cent or more of their pre-tax income. In fact, CMHC found that a disturbing 656,000 households – or 7 per cent of the total – spent at least half of their before-tax income on shelter in 1996, up from 422,000 households, or 5 per cent, in 1991. While some of these households lived in dwellings that were inadequate or unsuitable, the vast majority were in core housing need because of a problem with affordability.

Those struggling the most to pay the housing bill tended to share certain characteristics. Not surprisingly, about two-thirds were low-income households (those earning less than $20,000 per year). Furthermore, while accounting for only 35 per cent of all households, almost 70 per cent of those in core need were renters. And, individuals living alone – notably, young adults and elderly females – as well as lone-parent families with children, especially female-headed lone-parent families, make up a disproportionate share of those who pay a high proportion of their incomes on housing. Lastly, the proportion of off-reserve, non-farm aboriginal households in core need was twice that of the national-average rate.

2001 Census data contain a modicum of good news

CMHC has yet to update its analysis on core housing need to include the results of the 2001 Census. However, 2001 Census figures on income and housing costs, while not presenting the full picture, provide some good insights as to likely trends regarding the proportion of Canadians in core housing need as the 1990s drew to a close. The news was decidedly mixed. Thanks to a marked pickup in economic growth and the prevalence of low interest rates, the percentage of households spending at least 30 per cent (and 50 per cent) of their income on shelter dropped between 1995 and 2000. Still, these ratios remained well above the levels recorded in 1990. Furthermore, while estimating the size of the homeless population precisely is no easy task, most observers agree that the number of individuals without shelter was showing few signs of improvement heading into the new millennium.

A two-edged challenge …in every community

A shortage of affordable housing is commonly thought to be predominantly a problem affecting large urban centres. However, shelter-cost ratios for renter households outside of Canada's census metropolitan areas (CMAs) are more or less on par with those of the CMAs. Moreover, among the nine major markets we studied, Halifax and Regina – two medium-sized CMAs – ranked first and third in terms of the share of renter households suffering from an affordability problem.

Two important developments account for the persistence of the housing affordability problem across Canada in the second half of the 1990s.

First, most low-income families continued to fall further behind during the second half of the 1990s. After falling in the 1991-95 period, total family income for the lowest 20 per cent of income earners in Canada began to grow again in real terms in the 1996-2000 period, particularly for lone-parent families and seniors. But, in virtually every region of the country, gains of lower-income families paled in comparison to those chalked up by households further up the income scale. And, poverty rates among new immigrant families continued to worsen. In short, there is only spotty evidence that a rising tide lifted all boats – though, it is certainly superior to a situation in which all the boats are sinking.

Second, the overall supply of rental housing in Canada has stagnated in recent years, and has actually been receding at the lower end of the rent range – the segment of the market where lower-income individuals with affordability problems are concentrated – causing rents to rise accordingly. The lack of rental supply has something to do with the strong allure of home ownership in Canada, which developers have sought to satisfy with a string of new single-detached homes and condominiums – sometimes, produced through conversions and/or demolitions of existing rental stock. But, there have also been significant changes in the policy landscape over the last several decades that have weighed on the supply of rental housing. These include federal tax reforms that made the tax treatment of rental properties less attractive for investors; declining federal and provincial government spending on housing; provincial downloading of responsibilities to municipalities; a tightening in CMHC's mortgage underwriting practices for rental properties; and, the existence of rent controls in a number of provinces. In some markets, the secondary market – the universe of basement apartments, apartments over storefronts, flats in single-and semi-detached homes and row houses, and rented condominiums – has acted as an important safety valve. But, it is a less stable source of supply, and so by itself cannot provide a long-term solution to the affordable housing shortage.

How much are low incomes falling short?

The combination of strong demand for affordable housing and limited supply of such housing has created a large wedge between what poorer Canadian households can afford to pay for shelter and the price of the available stock. How large is this gap? By our conservative estimates, the "shelter gap" is roughly $2,500 per year for households in the bottom 20 per cent of the income range – ranging from $1,700 in Edmonton to $4,000 in Toronto and Vancouver. For the bottom 40 per cent of income earners, the gap shrinks to $800 nationally, but remains particularly lofty – around $1,500-$2,000 – in Vancouver, Toronto and Ottawa.

Some encouraging signs of late …

Recent developments have provided some encouragement that the affordable housing crisis may have reached a nadir. For one, vacancy rates in most markets rebounded noticeably in 2002, suggesting that the affordability crisis may have eased slightly last year. And, the severity of the problem has prompted all three levels of government to take action. In 2001, the federal government announced a new cost-sharing program with the provinces – the Affordable Housing Framework agreement – aimed at boosting the supply of rental housing, and allocated new funds for homelessness and the renovation/rehabilitation of existing housing stock. CMHC has announced that it will offer increased flexibility in its underwriting practices. And, after studying the issue at length, several provinces and municipalities have forged ahead with new programs of their own and/or have introduced regulatory changes to improve the inner workings of the market.

… but much work left to be done

At the same time, however, there is good reason to be cautious about proclaiming a turning point in the affordable housing crisis. Not only did overall vacancy rates across the nine major markets remain below 3 per cent last year, but vacancy rates in the bottom 40 per cent of the rent range slipped further on average in Canada compared to 2001, highlighting the fact that much of the improvement in rental market conditions overall reflects rising vacancies at the higher end of the rental spectrum. Meanwhile, rents continued to climb last year. And, in reality, most government initiatives to date have been modest in scope, with some provinces dragging their feet on the much-publicized cost-sharing agreement with the federal government.

A new affordable housing paradigm

As encouraging as it is to see the attention now being paid to the affordable housing problem in Canada, we have another concern – namely, that many of the recent government initiatives are not grounded in a proper analysis of the problem. Much of the analysis, advocacy and action on affordable housing suffers from three flaws, in our view:

- Income levels are taken as given. Too little thought is given to ameliorating the root cause of the affordable housing problem – that there are simply too many low-income households in Canada
- The focus has primarily been on measures to boost supply, with an emphasis on incentives to increase the overall rental supply – which has only a limited impact at the affordable end of the scale.
- Many of the measures that have been recommended as a means of stimulating this new supply (whether expenditure-based or tax-based) are inefficient, which is to say that they entail a high public cost per unit of affordable housing created.

TD Proposal

We argue that the ultimate solution to the affordable housing problem is to raise market incomes and develop a more effective and equitable income transfer regime to help lower-income households avoid the perils of the proverbial low-income trap. However, as these are necessarily longer-term objectives, complementary actions will be required in the interim to:

(a) improve supports for lower-income individuals

(b) address the current supply shortage

(c) remove market imperfections that contribute to the supply shortage.

1. The Ultimate Solution: Raise market incomes at the lower end

A. Get the macroeconomic context right:

Over the past few years, Canadian governments have been successful in implementing policies that have placed the country on a more competitive footing, including slaying deficits, lowering taxes, and investing in productivity-enhancing health care, research and development, and infrastructure. At the same time, the Bank of Canada's success in quelling inflation has led to a prolonged period of comparatively low interest rates. And, while the filtering down of the overall economic growth has been spotty, many lower Canadians have benefited from increased job opportunities and access to home ownership. Furthermore, it is undeniable that *nobody* benefits when all boats sink. The conclusion should be that getting the macroeconomic context right is a necessary, but not sufficient condition for easing the affordable housing crisis.

TD Recommendation:

- Continue to put a high priority on maintaining a strong and stable economic environment characterized by low inflation, which permits low interest rates.

B. Build safeguards against a low-income trap

Over the past decade, income disparities have widened, due to both the changing structure of the Canadian economy – which has favored highly-skilled professional occupations – and reductions in federal and provincial support under social assistance programs. On the latter front, many of the current programs aimed at helping lower-income individuals actually create disincentives to seek higher market incomes and save for retirement. In particular, social benefits are scaled back as market income rises, resulting in punishingly-high effective marginal tax rates. On the education front, Canada's high-school drop-out rate is exceptionally high for a developed country, and access to post-secondary education for many lower-income individuals has been reduced by cutbacks in government funding and skyrocketing tuition fees. Lastly, the Canadian population and workforce have become increasingly reliant on new immigrants. Yet, language barriers and problems with foreign-credential recognition continue to prevent these individuals from finding higher-paying jobs.

TD Recommendations:

- Adjust the design of federal and provincial benefit and tax systems to "make work pay" by reducing the claw-back rate for benefits for low-income households. Programs such as the federal-provincial National Child Benefit (NCB) initiative have dealt with the poverty trap to some extent by effectively combining income support with social services. However, the high tax-back issue remains.
- Provide a complementary new incentive for retirement savings to encourage low-income households to save for retirement. There is considerable merit to a system where there is no tax benefit when the savings occur, but an exemption from taxes for the ultimate return on the savings.
- Consider "best practices" undertaken around the globe that aim to move individuals off social assistance or raise their earning prospects. Examples include U.S. efforts to establish a "living wage" (i.e., where the onus is placed on the private sector to pay reasonable wages in return for public subsides) and individual development accounts (which encourage people to save by offering matching deposits).
- Recognize the critical role that education plays in helping all Canadians participate in the knowledge economy. This must address all facets of the educational system – including improving early childhood education, lowering the drop-out rate, enhancing apprenticeship programs, building strong colleges and universities, and developing lifelong training systems.
- Improve immigration-settlement services for new Canadians and continue to work with bodies to speed up foreign-credential recognition.

2. Interim Complementary Actions

A. Income subsidies to plug the gap in the short term

Working to lift market incomes at the low end will take time. In the interim, income supports, both housing-related and general, represent an efficient way to assist households in core housing need.

There are two kinds of housing-related income subsides – rent supplements and shelter allowances. *Rent supplements* involve an arrangement between the government (through a public financing agency) and a landlord, whereby the latter agrees to provide rental units for low-income tenants. *Shelter allowances* – like the Section 8 voucher program in the United States – are direct payments to tenants.

We generally favour the shelter-allowance option, since it is less disruptive to the market and gives individuals freedom of choice. Still, it has its flaws. There is no guarantee that the income support will be used to obtain adequate housing. And, in an environment of tight supply, the benefits generally flow upward to the landlord in the short-to-medium term, as competition among tenants drives up rents.

Virtually all provinces use rent supplements and shelter allowances in some form, but there are a number of improvements that could be made to the system to target the needs of lower-income individuals. In particular, any attempt to improve income supports must be attentive to the problems associated with targeting selected segments of the population. As households receiving a subsidy use the additional income to compete for a fixed supply of rental units, rents are bid up, leaving unsubsidized households – frequently, the working poor – relatively worse off.

TD Recommendations:

- Provincial shelter allowance programs are often restricted to welfare recipients. Governments should consider adopting a transitional benefit for welfare households that would help welfare recipients acquire the skills and work experience they need to make the transition back into the workforce.
- Little effort is made to align shelter benefits with the cost of market rents. In Ontario, for example, welfare families in Kingston receive the same shelter component of welfare as families in Toronto, despite a wide gap in rent rates. This should be addressed.
- Re-evaluate the adequacy of benefit programs for seniors under programs such as the Canada Pension Plan (CPP), Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). As discussed above, for lower-income households, they provide little or no incentive to save. Moreover, current systems may also result in considerable hardship upon the death of a spouse, as public income support is cut in half, whereas the cost of living declines more marginally.

B. Measures to boost supply

The potentially inflationary impact of income subsidies means that income supports must be complemented by measures to boost supply – both bringing new supply onto the market, and forestalling any further loss of existing stock.

There is no disputing the fact that public subsidies are needed to bridge the gap between the private cost of developing new rental supply and the amount low-income individuals can afford. The question, rather, is how best to deliver these funds. In recent years, most of the recommendations have tended to focus on tax incentives – in the main, proponents advocate reinstating the tax regime for rental properties that existed prior to 1972, when the federal government began to eliminate various provisions that they argued unduly benefited higher-income investors. These provisions include:

1. Giving corporations with fewer than 6 employees access to a small business deduction.
2. Allowing Capital Cost Allowances (CCA) losses to be deducted against other income.
3. Allowing "pooling" of CCA across buildings.
4. Enriching the rate of CCA for rental buildings.
5. Allowing immediate deductibility of development soft costs.
6. Eliminating capital taxes.
7. Lowering or eliminating the GST on rental properties.
8. Equalizing property tax rates on multiple-unit and owner-occupied housing

The main goal of taxation should be to raise revenues for governments. Taxes should do this with the least distortion to economic activity. That means that recommendations on the tax front should be judged according to the following criteria:

- First, are there tax changes that would correct market distortions, or do the recommendations largely amount to an alternative form of a housing subsidy?
- Second, how effective would tax changes be in improving the situation for affordable housing?
- And, third, how effective would tax changes be relative to alternative forms of subsidies to improve the affordable housing situation?

Apart from two notable exceptions – namely, eliminating the capital tax and removing the imbalance in the property tax system – most of the tax changes listed above fail these tests. They are not directly focused on affordable housing, although advocates argue that by increasing overall rental housing supply, some benefits will flow to the lower end of the income scale. In addition, they do not address existing tax-related distortions. For all intents and purposes, they are tantamount to grants or subsidies. Therefore, they should be evaluated on the basis of whether they are efficient in achieving the goal of improving the affordable housing situation.

On this score, there is no compelling reason to think that tax breaks would work more effectively than direct capital grants targeted at affordable housing. Of course, direct spending and grant programs have their inefficiencies, too. In particular, they have administrative and other overhead costs that reduce the funds actually devoted to affordable housing. But, the question is where the degree of leakage is worst. We think it is on the tax side. Certainly, that appears to be the lesson from the United States, where a substantial portion of the government support directed through the Low-Income Housing Tax Credit – frequently touted as a model for Canada – has been diluted by investor syndication profits and fees. The problem is that it is very difficult to ring-fence tax incentives to particular needs. The tax measures listed above would apply to all forms of rental housing in Canada – indeed, in some cases, all forms of multiple-unit housing, including higher-end condominiums. It is true that a healthier supply of multiple-unit housing would bring benefits throughout the range of rents, but the impact at the low end would be muted relative to the total cost of the measure. As such, the biggest "bang for the buck" would come from capital grants directed to affordable housing, specifically – both to creating new supply and preserving existing supply.

TD Recommendations:

- Eliminate tax provisions that are genuinely distortionary. At the top of this list are capital taxes and the inequities in the property tax system that privilege owner-occupied housing at the expense of rental housing.
- Given the high degree of leakage associated with most policy tax changes, focus on capital grants targeted toward the production of affordable housing, specifically. This is a more efficient way to deliver support to the lower end of the rental spectrum.
- Promote the renovation and rehabilitation of existing rental properties as a cost-effective way of increasing the stock of affordable housing.

C. Remove market imperfections

The final piece of the new affordable housing paradigm we propose involves addressing the root causes of the supply shortfall – the various market imperfections that prevent the creation of an adequate supply of housing at a price lower-income households can afford. These imperfections include everything from property tax biases, to rent controls, to a lack of available land in reasonable-cost locations, to low-density zoning regulations that prevent low-cost construction. Zoning regulations present an interesting case of a market-distorting measure that may be doing more harm than the problem it was intended to solve. A common tool for dealing with housing affordability externalities – namely, dilapidated buildings and pockets of urban poverty – these restrictions may be ruling out an important housing option for affordable housing consumers.

As the statistics on core housing need make clear, affordability is not a problem that affects all households in Canada equally. It is overwhelmingly a problem for individuals at the lower end of the income spectrum. By definition, these individuals are not average. They earn below-average incomes, drive below-average cars (if they have a car), and have below-average expenses – except when it comes to the share of their household budget they have to devote to shelter, in which case they are often alarmingly "above-average". Given that low-income households are not average in so many other respects, we argue that it is not reasonable to expect that they should be able to achieve average housing conditions. One housing option that can play an important role for individuals at the lowest end of the income spectrum – especially, those trying to transition out of the shelter system – are rooming houses or single-room occupancy (SRO) units. Often, this kind of housing is prohibited by municipal development codes, due to NIMBY (not in my backyard) sentiment, yet for many low-income individuals, the availability of these units can make the difference between being housed and being homeless.

TD Recommendations:

- Provincial and municipal governments should step up their efforts to eliminate regulations that distort the proper functioning of the housing market. At the top of the priority list, regulations on rent increases should be steadily phased out; imbalances in the property-tax system should be eliminated; and government should resist the urge to place restrictions on secondary market housing.
- While remaining committed to the laudable objective of ensuring that no one should have to live in sub-standard housing because of insufficient income, Canadian governments should consider whether they may have gone too far in trying to provide an average standard

of housing for Canadians who have not achieved "equality of condition" in other respects. In particular, municipal governments should take a closer look at zoning restrictions to see if they may be squeezing out an important affordable housing solution.

What governments need to do

The market imperfections that contribute to the shortage of affordable housing implicate all levels of government, which means that any effort to remove them will be part of the broader web of inter-governmental relations. And, this is quite appropriate, because a solution to affordable housing will clearly require the full cooperation of all three orders of government.

To begin with, provincial governments need to step up their efforts and become a leading contributor within the Affordable Housing Framework agreement. There also needs to be more recognition of the fact that municipal governments are currently in no position to live up to their side of the bargain. New responsibilities have been laid at their doorstep in recent years, as a result of provincial and federal downloading and offloading of services. Yet, municipalities have few revenue tools to draw on beyond the slow-growing (and flawed) property tax. As we have stated in all of our reports on Canada's cities over the past year, municipalities need a more sustainable funding arrangement, which arms them with increased flexibility.

At the same time, governments need to take a closer look at what policy areas are appropriate for downloading. In and of itself, the idea of downloading programs from the federal and provincial level makes a lot of sense, since municipal governments are better positioned to tailor services to their communities' unique needs. However, in areas where there are income-distributive aspects and/or where the targeted recipients tend to be highly mobile – affordable housing being a prime example – programs may be more effectively run under the auspices of provincial governments. Ontario is the only province to have downloaded responsibility for social housing to municipalities in return for increased property tax room, as part of its Local Services Realignment.

TD Recommendations:

- Give municipalities a wider array of revenue sources – notably, the flexibility to levy their own excise taxes.
- Upload responsibility for social housing from municipalities back up to the provincial level in Ontario.

With Canadian governments still in the early stages of developing a new strategy to combat the affordable housing problem, the time is ripe to rethink the premises of that strategy. We argue in this report that the conventional affordable housing paradigm is flawed and propose an alternative paradigm that we believe would provide a better solution to the problem. That paradigm suggests that the optimal policy for addressing the affordable housing problem is a combination of demand- and supply-side measures. Over the long term, a key goal must be to raise market incomes at the bottom end of the scale. But, in the interim, governments need to build better safeguards against the low-income trap. And, they must complement these efforts with measures to boost income subsidies for vulnerable segments of the population and rectify the shortage of supply – by funding new supply, preserving existing stock, and removing the market imperfections that contribute to the supply shortage.

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AFFORDABLE HOUSING IN CANADA: IN SEARCH OF A NEW PARADIGM

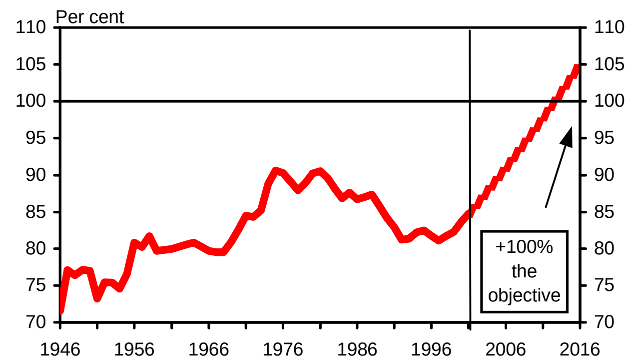
Housing is a necessity of life. Yet, many households in Canada cannot afford acceptable shelter. In fact, at last count, roughly one in five Canadian households were considered to be in this situation. Even more troubling, ten years of economic expansion have barely put a dent in the problem. As Canadian households struggle to find shelter and still make ends meet, their plight is spawning a series of related social problems in communities all across the country – making the shortage of affordable housing one of the nation's most pressing public policy issues today.

This study represents the fourth in a series of TD Economics reports addressing the challenges Canada's urban areas face. In April 2002, the Bank released *A Choice Between Investing in Canada's Cities or Disinvesting in Canada's Future*. This was followed by two reports that focused on specific issues within the Greater Toronto Area (May 2002) and the Calgary-Edmonton Corridor (April 2003). These studies were undertaken on the heels of a number of speeches in 2001 and 2002 by A. Charles Baillie, former TD Bank Financial Group Chairman and CEO, who focused on the need to raise Canada's standard of living above U.S. levels within 15 years. Mr. Baillie cited improving living conditions in metropolitan areas, where an increasing share of Canadians are both working and playing, as vital to achieving this ambitious goal.

The public policy case for addressing the problem of affordable housing could not be more transparent. Given that shelter is a necessity of life, we tend to be less toler-

RELATIVE GDP PER CAPITA*

Canadian GDP per capita as a share of U.S. GDP per capita



* Nominal gross dom. product per person, converted to U.S. dollars at purchasing power parity (PPP) exchange rates. Source: Centre for the Study of Living Standards, Statistics Canada, U.S. Bureau of Economic Analysis, TD Economics

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ant of huge disparities in housing arrangements than we are of income and other disparities. But, there are also a number of obstacles – created by current government policy and by the market itself – that prevent the creation of an adequate housing supply in the price range that lower income households can afford.

We are used to thinking of affordable housing as both a social and a health issue. That makes considerable sense. First, a large portion of residents of social housing receive their main source of income from government transfers, such as welfare, Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). Since public subsidies of rental accommodation can be seen as a complement to, or substitute for, social assistance payments, affordable housing should be viewed as only one piece – albeit a key one – of the social policy universe in Canada. Second, public health authorities have long recognized good quality, affordable housing as a basic determinant of health, with many studies showing a strong correlation between neighbourhoods with poor housing and lower health outcomes.

However, working to find solutions to the problem of affordable housing is also smart economic policy. An inadequate housing supply can be a roadblock to business investment and growth. And, a high cost of housing certainly plays into immigrants' decisions of where to locate. This is not to mention the negative impact on overall quality of life that would come from an eroding housing stock. Hence, implementing solutions to resolve this issue ties in well with the TD goal of raising Canadian living standards.

This is not a report on homelessness *per se*. However, it is important to recognize that a significant number of homeless people in Canada are without shelter because they cannot afford it – our report very much does address this aspect of the problem. Clearly, any successful efforts to alleviate the problem of insufficient income and/or increase the supply of affordable housing will help relieve the growing problem of homelessness – particularly those cases involving either the working poor or people who have the capacity to work but cannot find employment. At the same time, there are other people who are homeless because they are struggling with mental illness, addiction or other serious challenges. These individuals are often in need of supportive housing, but they also require other services, and accordingly, encompass a dimension of the affordable housing problem that is beyond the scope of this report.

QUANTIFYING THE DIMENSIONS OF THE PROBLEM

I. DEFINING THE TERMS OF THE DEBATE

As part of its mandate – to be "committed to housing quality, affordability and choice for Canadians" – Canada Mortgage and Housing Corporation (CMHC), the country's national housing agency, has developed a measure of housing conditions that reflects prevailing societal norms about what constitutes acceptable housing in Canada. The measure is called "**core housing need"**, and it is assessed in relation to the three standards of adequacy, suitability and affordability. **Adequacy** refers to the physical condition of a dwelling; a dwelling is deemed to be inadequate if it needs major repairs or lacks proper plumbing facilities. **Suitability** pertains to the size of a dwelling – chiefly, whether or not the number of bedrooms is sufficient for the size and composition of the occupant household. **Affordability** refers to the cost of a dwelling as a share of household income; the rule of thumb – a familiar benchmark in household budgeting – is that households should not have to spend 30 per cent or more of their pre-tax income to obtain shelter that is adequate and suitable.[1]

CMHC deems a household to be in core housing need if its dwelling fails to meet one of these three standards ***and*** the household would have to spend 30 per cent or more of its income to pay the median market rent for alternative local market housing that does. In other words, the

1996 CENSUS RESULTS

6.7	million households	(68%)	dwellings are adequate, suitable and affordable
1.4	million households	(14%)	dwelling fails at least one test, but could be rectified without spending more than 30%
1.7	million households	(17%)	core housing need
	656,000 households	(7%)	spend more than 50% on shelter costs
	up from		
	422,000 households	(5%)	in 1991

assessment is a two-step process. First, households' dwelling situations are evaluated against each of the three standards separately. Then, if a household is found to have fallen below at least one of the standards, a means test is applied to determine whether or not the household could find an acceptable alternative for less than 30 per cent of its before-tax income. If not, the household is said to have fallen into core housing need.

CMHC does not have an official category for households who pay at least *half* of their income to fix the problem, but they have conducted research on this segment of the population, which is generally considered to be "severely burdened".[2] And, while there has been some debate as to whether the 30-per-cent cut-off is a reasonable threshold – given, say, differences in geographical locations, family structures and stages in the life cycle – there is no doubt that at 50 per cent, a household would be extremely squeezed financially. Households paying fifty per cent or more of their income on housing are almost certainly living from pay cheque to pay cheque or from transfer payment to transfer payment and are unlikely to have a pool of savings built up. Any interruption in their income flow would put them at high risk of becoming homeless.

The process of determining core housing need is a complicated one. CMHC submits its tests for housing standards to Statistics Canada, which combines those tests with its own data on household income and shelter costs to obtain an estimate of the number of households in core housing need. Major surveys are done every five years, using the extensive household income and expenditure data collected by Statistics Canada in the national Census. Given the time lag required for Statistics Canada to re-tabulate CMHC's housing standards against the new Census database, an updated report on core housing need as of the 2001 Census is not yet available. However, 2001 Census figures on income and housing costs – while not presenting the full picture – provide some insight as to likely trends in core housing need as the 1990s drew to a close.

II. WHAT IS THE SITUATION IN CANADA TODAY?

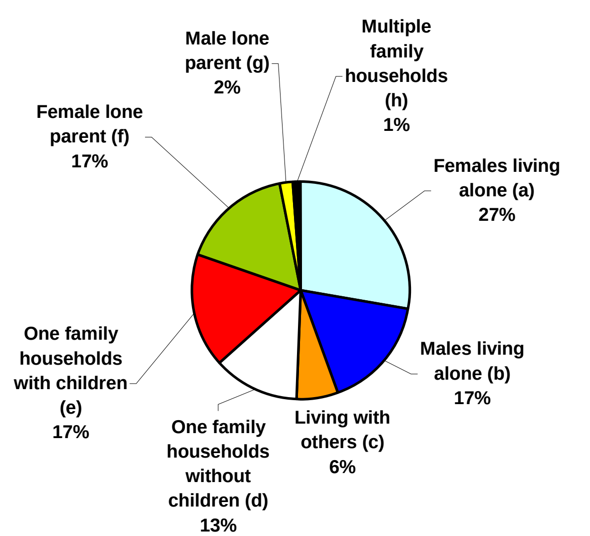
The good news is that, as of the 1996 Census, the lion's share of Canadian households were properly housed, which is not altogether surprising in light of Canada's status as an advanced industrialized economy, which has ranked near the top of the United Nations human-development survey for the past several years. According to CMHC, roughly two-thirds of households surveyed (6.7 million) lived in dwellings that were adequate, suitable *and* affordable. Moreover, although an additional 1.4 million households resided in dwellings that did not meet all three standards, they had the financial means to rectify the situation by moving to alternative housing in their local market.

However, that still leaves a substantial 1.7 million households – or about one in five of the Canadian total – that were deemed to be in core housing need. That is, they were already earmarking 30 per cent or more of their pre-tax income for adequate and suitable housing, or would have had to spend 30 per cent or more of their income to fix any adequacy and/or suitability problem by relocating. *Either way, the problem for these households was overwhelmingly a financial or affordability problem.* And, in a still-significant number of cases, the picture is particularly dire. In fact, CMHC found that 656,000 households in core need – or 7 per cent of total Canadian households – spent at least *half* of their before-tax household income on shelter (i.e., were severely burdened) in 1996, compared with 422,000 households, or 5 per cent, in 1991.[3]

Who are experiencing affordability problems?

In their research, CMHC found that the incidence of core housing need is highest among specific groups. About two-thirds of **low-income** households (those earning less

CANADIAN HOUSEHOLDS IN CORE HOUSING NEED IN 1996



Total	1,725,655	
Unattached Individuals (a, b, c)	878,415	51%
Families (d, e, f, g, h)	847,235	49%

Source: CMHC, TD Economics

Seniors Suffer from Affordable Housing Problem

- Seniors are 21 per cent of households, and 26 per cent of those in core housing need
- But, seniors are 17 per cent of those in severe core housing need (i.e., paying more than 50 per cent of their income on shelter)

than $20,000 per year) were affected – not surprising, given the primary role affordability plays in driving core housing need. Moreover, while making up only 35 per cent of all households, 68 per cent of those struggling to pay the housing bill were **renters** of accommodation. At the same time, **individuals living alone** – notably young adults and elderly females – as well as **lone-parent families** with children – especially female-headed lone parent families – made up a disproportionate share of those who pay an unacceptably high proportion of their incomes on housing. Lastly, roughly 1 in 3 **off-reserve, non-farm native households** – almost twice the national average – were in core housing need. [4]

2001 Census shows a hint of improvement

The 2001 Census figures on income and housing costs provided a smattering of good news regarding the proportion of Canadian households in core housing need, but certainly not enough to warm the heart. After rising sharply in the first half of the 1990s, the percentage of households spending 30 per cent or more of their income on shelter declined between 1996 and 2001. And, even more notably, the downward movement was led by a 3.5-percentage-point decline in the renters' share. Both trends also obtained for households spending more than 50 per cent of their income on shelter. Still, both the overall ratio and that for renters remained well above the levels recorded in 1990. Moreover, as we will discuss in more detail later in this report, income growth at the lower end of the spectrum was minimal, at best, during the latter half of the 1990s. At the same time, data from CMHC show that rental rates rose during this period – all of which suggests that we should be cautious about proclaiming a turning point in the problem of core housing need in Canada.

PROPORTION OF HOUSEHOLDS WITH AN AFFORDABILITY PROBLEM*

	Census Years		
	1991	1996	2001
Owners & Renters			
30% or more	22.7	26.6	24.1
50% or more	9.4	12.0	10.6
Owners			
30% or more	15.4	16.9	16.0
50% or more	5.4	6.5	6.2
Renters			
30% or more	34.8	43.2	39.6
50% or more	16.0	21.6	19.0

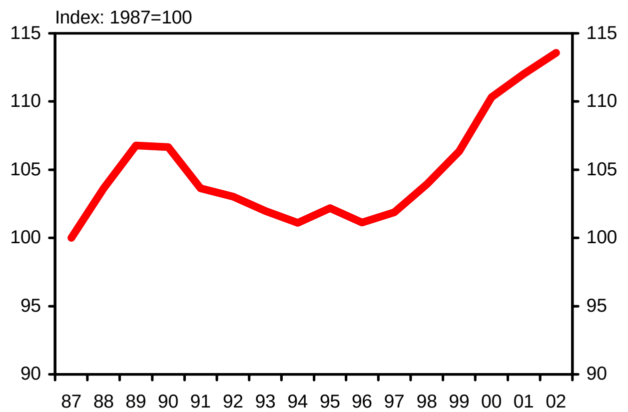
* Proportion of household income devoted to shelter costs. Shelter costs refer to gross rent for renters and owner's major payments for owners
Source: Statistics Canada (1991, 1996 & 2001 Census), TD Economics

No magic from 1990s expansion

Economic developments in Canada go a long way in explaining the recent – albeit limited – improvement in the overall proportion of households suffering from an affordability problem in the second half of the 1990s. In contrast to the first half of the decade – which began with a severe recession in the 1990-91 period and was then followed by a limp recovery in 1993-95 – job market conditions in Canada finally began to heat up in the 1996-2000 period, sending the nation's unemployment rate tumbling to a 24-year low of 6.8 per cent by 2000. Personal income promptly followed suit. Still, given the slow start to the 1990s economic expansion, real personal disposable income (PDI) per capita had posted only a modest increase over its 1990 level as of 2000 – the latter year coinciding with the collection of the 2001 Census data.

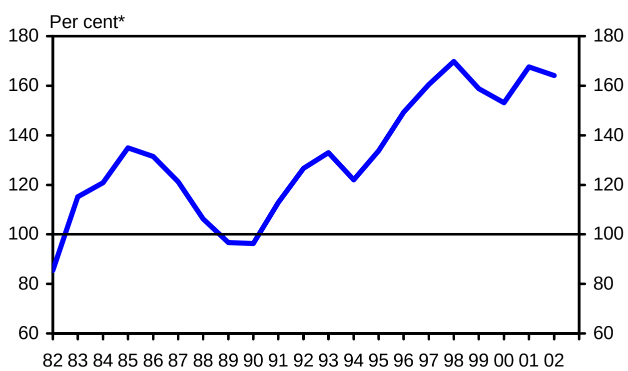
Furthermore, affordability in the home-ownership market remained extremely favourable in the second half of the 1990s. Inflation stayed subdued, which paved the way for interest rates to remain extremely low. With affordability levels for home purchases holding at close to historical highs, many middle-to-lower income families were lured into the housing market, pushing up home-ownership rates to record levels across the country. At the same time, developers stepped up their pace of building in order to satisfy the growth in demand for single-detached homes and condominiums.

REAL PERSONAL DISPOSABLE INCOME PER CAPITA



Source: Statistics Canada, TD Economics

RATIO OF HOUSEHOLD INCOME TO MORTGAGE SERVICE COSTS



*Ratio of average household income to average cost of servicing a mortgage. An increase in the index represents an improvement in affordability; Estimate by TD Economics as at April 2003

A two-sided challenge

Undeniably, the favourable mix of a strong economy and low interest rates since the mid-1990s has delivered significant benefits to the average Canadian household. But, therein lies a problem – most Canadian households are not "average". And, hence, interpreting these results at face value can lead to a distorted picture. For many – especially the vulnerable groups identified above – two important developments put a damper on the progress achieved in the second half of the 1990s:

- Most low-income families continued to fall further behind during the second half of the 1990s. Although total family income in real terms for the lowest 20 per cent of income earners began to grow again in the 1996-2000 period (by 0.5 per cent per year) after falling by an annual average rate of 0.8 per cent in the 1991-95 period, these gains were one-quarter of that chalked up by the average Canadian family. And, for those who did fare better, rising incomes were often outstripped by rent-cost increases.
- The overall supply of rental housing has stagnated in recent years, and has actually been *receding* at the lower end of the rent range – which is the segment of the market where lower-income households with affordability problems are concentrated – causing rents in this spectrum to jump accordingly.

Variations exist across Canadian markets

Just as it is important not to put too much weight on "average" tallies, painting with one brush the affordable housing situation facing Canada's regions is also a dicey game. In examining the regional dimension, we focus our discussion on nine of Canada's large urban markets – Vancouver, Calgary, Edmonton, Regina, Winnipeg, Toronto, Ottawa, Montreal and Halifax – which were chosen on the basis of size, as well as good regional representation. (For summary statistics for Canada and these metropolitan areas, see the Appendix beginning on page 40.)

A shortage of affordable housing is commonly thought to be predominantly a problem affecting large urban centres. This is not just because disadvantaged individuals from other parts of the country tend to migrate to cities. It is also because the limited availability of land near employment centres in cities drives up overall real estate costs and rents relative to incomes. So, it is perhaps not surprising to see that, among the nine Census Metropolitan Areas (CMAs) we studied, the three largest – Vancouver, Toronto and Montreal – finished one, two and three, respectively, in terms of having the highest percentage of households (owners and renters combined) experiencing affordability problems in 2000.

However, a closer look shows the extent to which almost *every* community is grappling with the need for affordable housing, and especially on the rental side. For example, when CMAs are ranked based on the share of *renter* households suffering from an affordability problem, Halifax – one of the smaller metropolitan areas on the list – jumps into first place ahead of Toronto, and Regina places third, while Montreal and Ottawa are home to the lowest

PER CENT OF ALL HOUSEHOLDS EXPERIENCING AFFORDABILITY PROBLEMS IN 2000	30% or more spent on shelter	50% or more spent on shelter
Canada	**24.1**	**10.6**
CMA	25.9	11.3
Non-CMA	20.9	9.2
Vancouver	31.4	14.5
Calgary	22.9	8.9
Edmonton	22.4	9.2
Regina	21.0	9.4
Winnipeg	20.7	8.4
Toronto	29.1	12.3
Ottawa	21.4	9.2
Montreal	26.1	12.2
Halifax	24.7	11.5

Source: Statistics Canada, TD Economics

PER CENT OF RENTER HOUSEHOLDS EXPERIENCING AFFORDABILITY PROBLEMS IN 2000	30% or more spent on shelter	50% or more spent on shelter
Canada	**39.6**	**19.0**
CMA	39.7	19.2
Non-CMA	39.3	18.5
Vancouver	43.2	22.3
Calgary	36.5	16.0
Edmonton	37.3	16.9
Regina	42.6	21.1
Winnipeg	37.9	16.1
Toronto	42.2	20.0
Ottawa	36.4	17.1
Montreal	36.4	18.1
Halifax	43.7	22.0

Source: Statistics Canada, TD Economics

share of renter households experiencing financial difficulties. *In fact, shelter-cost ratios for renter households in non-CMAs were roughly on a par with those in CMAs. But, wherever you live, if you rent, you have a much higher risk of facing affordability problems. Indeed, as the tables above make clear, roughly one in five or six renter households across Canada is experiencing a severe affordability problem – i.e., paying 50 per cent or more of their income for shelter.*

In the sections that follow, we will delve more deeply into the two drivers of the affordable housing crisis – the failure of groups at the lower end of the income scale to do better, and the reality of a shrinking supply of lower-priced housing.

III. A PROBLEM OF LOW INCOME

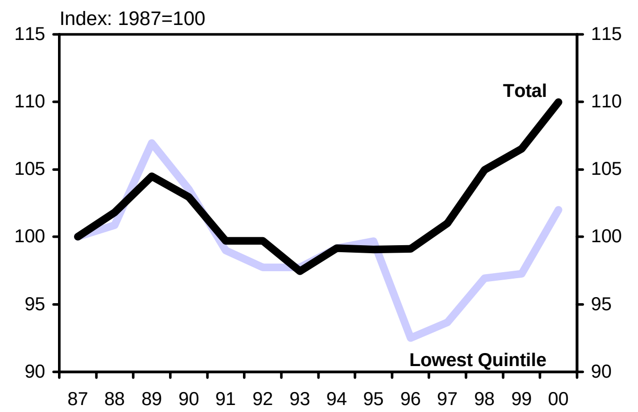
The May 13th release of income statistics from the 2001 Census revealed that pre-tax *median* family income in Canada – after adjusting for inflation – rebounded in the second half of the 1990s, but still ended the decade only a shade above its 1990 level. Regionally, the picture was similar across major markets, with most experiencing weak showings in the 1990-95 period and then recoveries in the 1996-2000 period. However, Calgary was the only market that managed to chalk up growth in real median family income in both the first and second halves of the decade. In contrast, four CMAs – Vancouver, Toronto, Montreal and Halifax – saw incomes fall during the decade.

Is there evidence that a rising tide lifts all boats?

While the data on median income tallies on balance give little cause for celebration, a more important question from the standpoint of the housing affordability problem is whether the rewards of robust economic growth in recent years have made their way down to those Canadians households most in need.

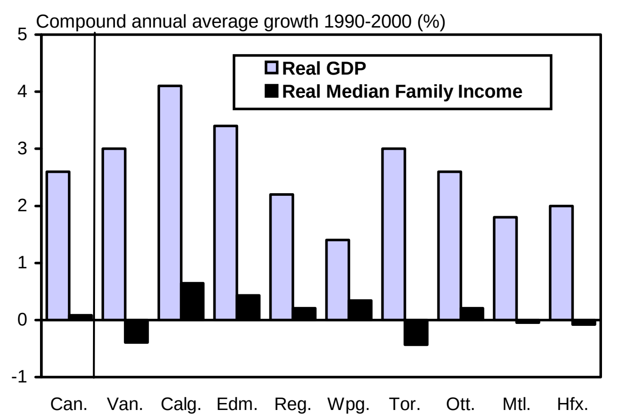
There is no short answer to this question. On an aggregate basis, the bottom 20 per cent of families enjoyed a modest rebound in real total income in the 1996-2000 period. But, at 0.5 per cent per year, this growth rate paled in comparison to the 2-per-cent annual rate of growth recorded by Canadian families on average. Moreover, the fastest rate of real income growth was posted by the top 20 per cent of earners (2.7 per cent per year). And, while a breakdown of income gains is not available by CMA, provincial figures show that income performances for those in the bottom 20 per cent of the spectrum lagged behind province-wide averages in all regions except Newfoundland and Labrador, with the largest gaps in New Brunswick, Alberta and British Columbia. While the second lowest quintile of families recorded income increases in the 1996-2000 period more in line with their higher-income counterparts, they still fell well short in all provinces except New Brunswick, Nova Scotia, and Newfoundland and Labrador.

CANADIAN REAL MEDIAN FAMILY INCOME



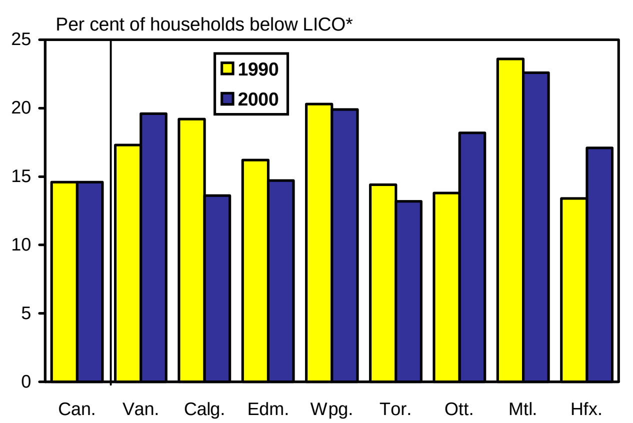
Source: Statistics Canada, TD Economics

CANADIAN INCOMES AND GDP BY CMA*



* Census Metropolitan Area
Source: Conference Board of Canada, Statistics Canada, TD Economics

LOW INCOME-RATE



*LICO: low-income cut-off; Source: Statistics Canada, TD Economics

Given the disappointing showing of low-income earners relative to their higher-income counterparts, Canada's low-income rate (i.e., the proportion of individuals with incomes below Statistics Canada's Low Income Cutoff) tipped the scales at a still sizeable 14.6 per cent in 2000, the same level where it stood in 1990.[5] Among the markets, Vancouver, Halifax and Ottawa-Hull saw low-income rates increase between 1990 and 2000, while Calgary was the only market to experience a sizeable improvement.

Lone-parent families and seniors doing better…

Not all the news flowing from recent income data has been discouraging. Notably, two of the most vulnerable groups in society – lone-income families and seniors living alone – actually posted increases in real median income above the national average and declining low-income rates. Single elderly females, who record among the lowest of median incomes across demographic types, experienced increases from coast to coast. And, while the drop in seniors' low income rate may be largely a function of the stock-market bubble in the late 1990s – one that has since fizzled – the improvement in the lone-parent category provides compelling evidence that many struggling households are benefiting from the buoyant conditions in the nation's job market. What's more, gains in lone-parent family incomes were reasonably broadly-based across the country, although certainly in cities where job markets outperformed – namely Calgary, Toronto and Ottawa-Hull – the tallies were the most impressive. And, with the job market remaining hot overall in the 2001-02 period, there is good reason to believe that this trickle-down effect has continued from coast to coast into the new millennium.

Another bright spot was the fact that median incomes of renter households, after losing ground to owners in the 1990-95 period, actually rose faster during the second half of the 1990s. Growth in renter incomes was especially strong in Calgary, Edmonton and Montreal, although all markets examined turned in healthy showings on this front.

…but new immigrants fall further behind...

Unfortunately, progress on these fronts was counterbalanced by news that other groups continued to fall further behind in the second half of the 1990s. Although Statistics Canada has not released the full set of Census income data by family type, it has reported that new immigrant households continued to record among the weakest income gains and sharpest increases in low-income rates during the late 1990s. And, with immigrants comprising an increasing share of Canada's population growth, the rising low-income rate among newcomers was a key reason why Canada did not record more success in reducing poverty during the 1996-2000 period.

...and homelessness still pervasive

Estimating the number of homeless in Canada with precision is no easy task. Since Census counts assume individuals have a fixed address – rendering them useless in this respect – projections are heavily sensitive to how homelessness is defined. Applying a narrow definition to the term – such as "those using emergency shelters and those sleeping on the street"– yields estimates in the 35,000-40,000 range on an average night in Canada.[6] But, given that homelessness is often episodic, with individuals cycling between having shelter and not, there is good reason to believe that the number of people experiencing homelessness at one time or another over the course of a year is several times that level. In any event, most observers agree that, even as the Canadian economy expanded in the late 1990s, a growing number of Canadians found that tough income and rental market conditions virtually slammed the door on their hopes of finding any shelter, whatsoever.

Indeed, contrary to popular belief, low income is a major driver of homelessness. In the 1998 Pathways study of homelessness in Toronto, researchers at the Clarke Institute of Psychiatry, the Queen Street Mental Health Centre and Wellesley Hospital conducted clinical assessments over the course of a year with a representative sample of approximately 300 people in downtown Toronto.[7] Respondents cited the following reasons for being homeless:

- job loss, inadequate income, or eviction (45 per cent)
- abuse and/or divorce (26.7 per cent)
- drug or alcohol addiction (17.7 per cent)
- mental illness (3.7 per cent)

As Dr. Don Wasylenki, one of the principal investigators noted, "If you read studies in the mental health literature, they tend to repeat that 30-50 per cent of people who are homeless have a mental illness, and that mental illness must be a major causative factor of homelessness. What our findings say is that mental illness is not a major precipitating cause of homelessness in metro Toronto."[8] A study done by Marybeth Shinn et al., on predictors of homelessness, reached similar conclusions. After following 568 families in the New York City hostel system over a five-year period to determine what helped them achieve stable housing, the authors concluded that "subsidized housing is a necessary and sufficient condition to 'cure' homelessness for families."[9] Clearly, there is a significant segment of the homeless population whose problems are related to low income and inadequate housing supply, and in Canada, their situation worsened in the 1990s.

In sum, the evidence that a rising tide lifts all boats is spotty at best – though, certainly, it is superior to a situation where all the boats are sinking.

IV. SUPPLY OF AFFORDABLE RENTAL UNITS UNDER PRESSURE

As the preceding discussion makes clear, low income is the main driver of demand for affordable housing in Canada. But, the problem is also one of supply. There are not enough dwellings available for Canadian households today at a price they can afford on their current income – and, that is at least partly because the rent that lower-income households can afford to pay is not high enough to elicit new private sector supply or refurbish existing stock. In this section, we will examine the factors that have led to the current shortage of affordable housing.

Rash of new supply targeted at homeowners

It is not as if there has been a dearth of new overall housing supply on the market. Supported by a healthy economic climate and low borrowing costs, residential developers have been breaking ground at a feverish clip in recent years, with the number of new residential starts soaring to 13-year highs. In fact, total starts have been trending up in *all* major markets over the past 5-10 years, pushing the total stock of housing from 10.0 million units in 1991 to 11.6 million units in 2001.

That's the good news. The bad news is that Canada's stock of rental housing – which is the segment of the market wherein those in core need are largely situated – has been shrinking for years. New private sector rental construction began tapering off in the 1970s, and the stock of rental housing in Canada has virtually stagnated since the mid-1990s. What's worse, the lower end of the market – which is to say, *affordable* rental housing, as measured by rent levels – has been particularly hard hit in most of Canada's major cities.

Why has rental supply hit the wall?

Clearly, the dwindling share of rental housing owes something to the strong allure of homeownership in Canada. But, this is not the only factor. There have also been significant changes in the policy landscape over the last several decades that have progressively weighed on supply, in both the private and publicly-funded rental markets.

Declining government support

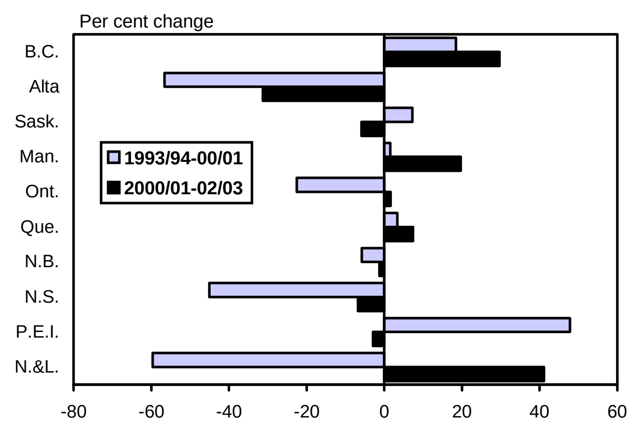
Beginning in the 1970s, the federal government introduced a series of tax reforms that made the tax treatment of rental properties less favourable for investors. As the economics of rental construction worsened, developers turned toward more lucrative segments of the market – chiefly, higher-end rental properties, owner-occupied units and commercial real estate.[10] The problem was compounded in the 1990s, when the federal and provincial governments took aggressive steps to eliminate deficits. This affected the supply of affordable rental housing in two ways:

First, the onset of federal and provincial belt-tightening, which began in the mid-1980s, resulted in significant cuts to government support for rental housing. Historically, the bulk of the affordable rental housing built in Canada in the post-war period has been subsidized by the government.[11] That support has been delivered in three forms: direct spending on government-owned public housing; subsidies to non-profit organizations and cooperatives; and, subsidies to private developers to build affordable rental housing, mainly in the form of grants and interest-free loans.[12] All three types of funding were slashed in the mid-1980s and mid-1990s.

After peaking in the 1980s, federal funding for housing began to decline, and the federal government withdrew all funding for new assisted housing in 1993 (though it continued to provide almost $2 billion per year in interest subsidies for the existing stock). And, as the accompanying chart shows, about half the provinces – Alberta, Ontario, Newfoundland & Labrador, Nova Scotia, and New Brunswick – slashed spending on housing between fiscal 1993-94 and 2000-01, while only two provinces – British Columbia and Prince Edward Island – increased spending significantly. The statistics on social housing tell the tale. With the notable exception of Vancouver, virtually no new social housing has been built in Canada's largest CMAs since 1995. However, since fiscal 2000-01, some provinces have reinvested modest amounts in housing.

Second, the 1990s were marked by a period when Canadian municipalities were required to take on new spending demands in a raft of areas. Notably, the federal and provincial governments downloaded responsibility for a number of new services directly (in Ontario's case, this included housing) or indirectly, by vacating certain fields. While Ontario's municipalities received some property tax room as part of the downloading exercise, in most cases, there was no commensurate increase in municipal governments' revenue-raising abilities – a problem we discussed in two major reports on Canada's cities last year. This placed corresponding upward pressure on non-residential property taxes and development charges, which further increased the costs to developers of building new units.

CHANGE IN HOUSING EXPENDITURES* BY PROVINCE



* 2002-03 estimates are those shown in prov. budgets, rest are final figures provided by the provinces; Source: CMHC, TD Economics

CMA STARTS: SOCIAL HOUSING*

CMA	1986	1991	1996	2001
Vancouver	1,226	583	180	1,272
Calgary	0	0	0	0
Edmonton	9	0	0	0
Regina	110	0	0	0
Winnipeg	133	62	0	0
Toronto	1,035	1,012	782	0
Ottawa	509	357	0	89
Montreal	606	630	0	0
Halifax	23	4	0	19
9 CMA TOTAL	**3,651**	**2,648**	**962**	**1,380**

*Social housing incl. activities under the following programs of the Nat'l Housing Act: Loans to Non-Profit Corporations, Public Housing, Federal-Prov. Rental and Sales Housing Projects, Approved Lender Non-Profit and Provincial Unilateral Assisted Units (10,000 Pop.+). Source: CMHC Canadian Housing Statistics, TD Economics

LEVIES, FEES CHARGES AND TAXES: MODEST RENTAL APARTMENTS: 2002
Dollars Unless Otherwise Indicated

Municipality	Devel. Cost	Infrastr. Charges	Land Dedic.	Dev. Appl. Proc. Fees	Build. Permit Fees	Prov. Sales Tax	GST*	Total	Per cent of cost**
Vancouver	125,000	2,865	0	182	609	3,171	5,360	12,186	10
Edmonton	90,000	1,407	759	79	599	0	4,032	6,875	8
Calgary	95,000	582	1,092	29	471	0	4,256	6,430	7
Regina	83,500	1,035	397	0	353	2,200	3,741	7,725	9
Winnipeg	83,500	428	366	0	629	2,805	3,580	7,808	9
Ottawa	100,000	9,565	72	86	851	3,331	4,288	18,192	18
Toronto	120,000	3,223	839	53	909	3,746	5,376	14,146	12
Montreal	84,000	0	850	0	579	4,213	3,763	9,405	11
Halifax	66,000	1,500	650	0	311	5,280	2,957	10,697	16

* After rebate; ** Total levies, fees, charges and taxes as per cent of total development costs.
Source: CMHC, TD Economics

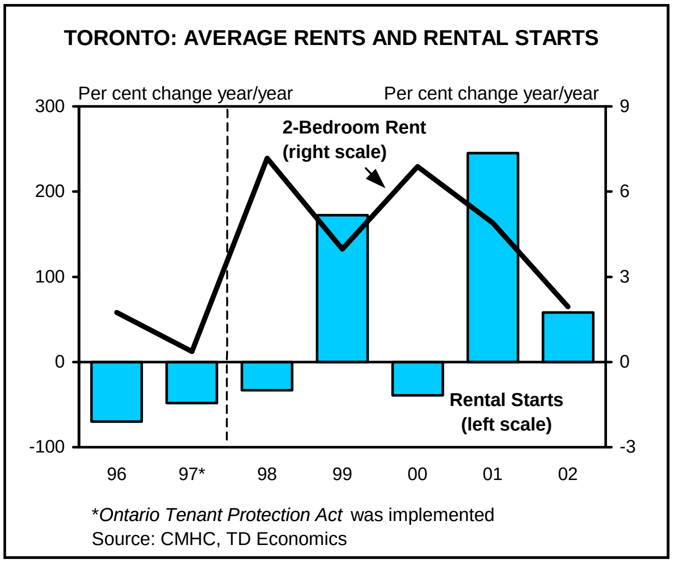
CMHC tightens policies

Another factor that depressed private sector rental construction in the 1990s was a change in CMHC's mortgage underwriting practices for rental housing projects. In Canada, chartered banks are prohibited by federal statute from offering mortgages worth more than 75 per cent of a property's estimated value. To lend more than this amount – a so-called "high-ratio" mortgage – banks have to insure themselves against the risk that a borrower may default on a mortgage.[13] There are only two providers of mortgage default insurance in Canada – CMHC and General Electric Mortgage Insurance Canada (GEMICO) – and only CMHC offers insurance for rental projects.

For decades after their introduction, the availability of CMHC-insured high-ratio mortgages for rental housing projects played a significant role in stimulating new rental construction in Canada. However, after sustaining heavy losses in the 1980s and 1990s, as rising interest rates led to an increase in defaults, CMHC hiked insurance premiums and applied more conservative estimates of capitalization rates for new projects.[14] The first measure made mortgage insurance more costly. The second reduced the size of the mortgage borrowers could obtain, by lowering the base lending value of the prospective project – thereby increasing the initial equity investment required. Together, the two measures cut back the supply of financing available for rental construction. In 1998, CMHC eased mortgage insurance terms for existing rental properties, making them a more attractive investment for pension funds and real estate investment trusts, and it changed the criteria for new rental units – where capital was really needed – in 2001.

Rent controls an obstacle

An additional factor that weighed on rental market supply to differing degrees across the country was the existence of provincial rent controls and other regulations. In the mid-1970s, all provinces had adopted rent controls as part of a fight against rising inflation. At the same time, many lacked any kind of controls on the demolition and conversion of existing rental properties. As we noted earlier, the worsening climate for private sector rental investment induced many developers to maximize the return on their



urban properties by converting them into higher-end , owner-occupied units and/or non-residential units. Indeed, gentrification pressures caused by demolitions and conversions have been behind much of the decline in affordable rental housing supply in many Canadian CMAs.

While a number of provincial jurisdictions have since amended their legislation to lessen restrictions on rent increases (notably, Ontario's Tenant Protection Act of 1997), many still have rent restrictions in place in some shape or form. That is a concern, because the legacy of rent controls on private investment can last for years to come. The public typically focuses on how lifting rent controls boosts rents, hurting low-income tenants. But, the corollary is just as important – i.e., that rent controls discourage new construction, and encourage demolitions and/or conversions of existing rental stock into owner-occupied units. As the chart above shows, both rental supply and rents have risen in Toronto since rent control legislation was eased in 1997.

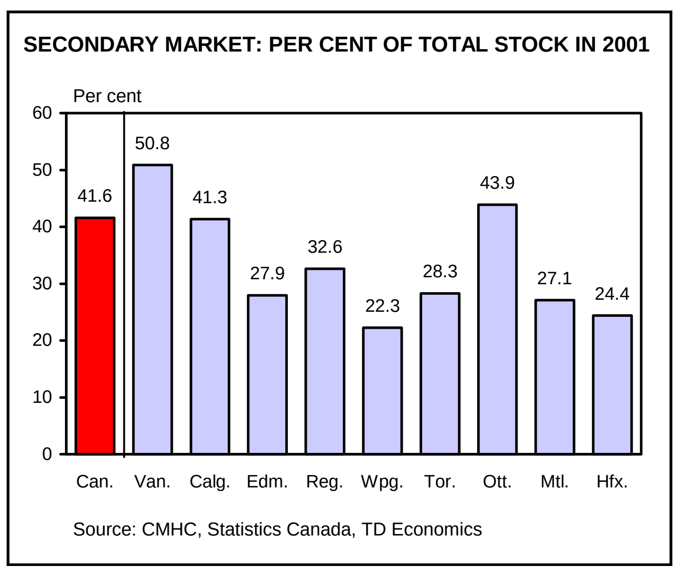
Secondary rental market provides "some" solace

One factor that has helped ease tight rental market conditions across the country over the past year is the increasing size of the "secondary" rental market. This market comprises basement apartments, apartments over storefronts, flats in single- and semi-detached homes and row houses, and rented condominiums. Unfortunately, data on existing stock of non-conventional units are scarce, so it is difficult to discern trends in supply. That is partly because some units are illegal – for example, basement flats – so owners do not report their existence.

Still, inferences can be made about the size of the secondary market by comparing Census data on the total rental stock, which includes non-conventional units, with CMHC data on the public and private rental stock, which does not. As the chart below demonstrates, the secondary market makes up a large share of the overall rental market in most CMAs – from one-fifth in Winnipeg to a high of one-half in Vancouver. And, anecdotal reports suggest that – with the important exception of the condominium segment – it is an especially important source of supply at the lower end of the income scale.

According to a recent report on the secondary market in Toronto by the Starr Group, it has represented an effective "safety valve."[15] However, the report also cautions that most forms of secondary rental housing are "highly elastic." As such, the supply tends to fluctuate with economic conditions and can't be counted on for a stable long run supply. For example, homeowners may rent out a self-contained flat in their home during difficult economic times, but withdraw it from the market when conditions improve and they no longer need the rental income.

Moreover, it seems reasonable to deduce that the construction and subsequent renting out of new condominiums is behind much of the growth in secondary market supply of late. Given that these types of rental units tend to be priced at or above market levels, this would not be expected to boost the supply of genuinely affordable rental housing. So, it is perhaps not surprising to see that vacancy rates remain below 2 per cent in the lower rental quintiles in most urban markets, indicating that supply remains tight.



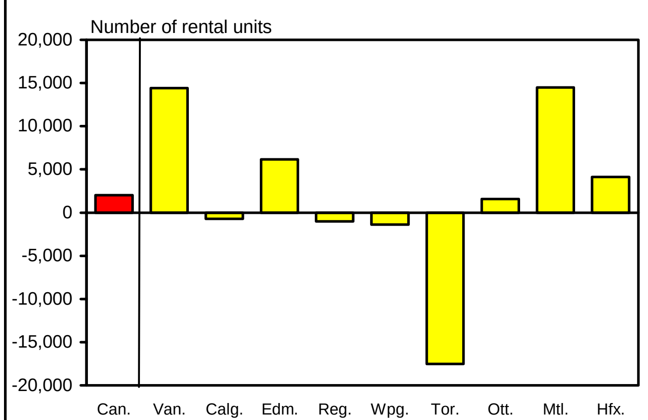
Adding it all up

To quantify the impact of the decline in private and public sector rental market construction on the supply of affordable rental housing, we obtained data from CMHC on rental market conditions in the nine CMAs previously cited, as well as Canada overall. Many of the figures referred to are shown in the summary tables pertaining to housing in the Appendix on page 41. An exhaustive review of the results is beyond the scope of this report, but a few key details are worth noting:

- The strength in the owner-occupied housing market cited earlier – reflecting strong personal disposable income growth at the upper end of the income scale, as well as rising housing affordability – led to a shift in the composition of the housing stock in Canada throughout the last decade. In every CMA we studied, the stock of rental housing either expanded at a slower pace than the stock of owner-occupied housing, or actually declined outright, as existing rental units were demolished or converted into owner-occupied housing.

- Between 1996 and 2001, the total number of rental units (including secondary apartments, such as basement units) rose by a scant 2,000 units across Canada, following growth of 186,000 units during the previous 5-year period. Only Vancouver, Edmonton, Montreal, Ottawa and Halifax recorded any increase in rental supply between 1996 and 2001, while the number of units dropped in Calgary, Regina, Winnipeg and Toronto, with the latter losing more than 17,500 units.

CHANGE IN RENTAL STOCK: 1996-2001



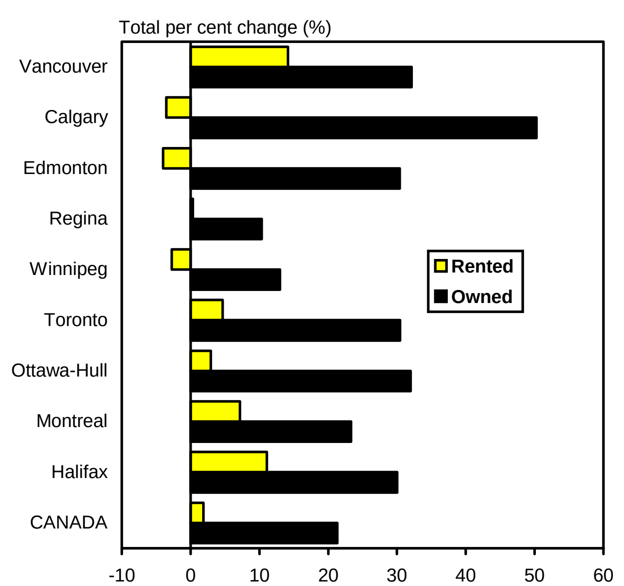
Source: Statistics Canada, TD Economics

- Over the same 1996-2001 period, the total number of primary 1-bedroom and 2-bedroom rental units in Canada rose by almost 13,000 units, but the increase was concentrated in the most expensive units by rent range (top 20 per cent). In contrast, the bottom 20 per cent of the rental market experienced a decline of 1,300 rental units.

- Not surprisingly, rental vacancy rates plummeted across the country in the late 1990s. In Canada as a whole, the vacancy rates for 1-bedroom and 2-bedroom units dropped to 2.3 per cent and 2.0 per cent, respectively, in 2001, less than half the levels recorded in the early 1990s. (In contrast, most estimates of a "balanced" market are in the 2.5-3.0 per-cent range.) The drop in vacancy rates has been most pronounced at the lowest end of the rental spectrum.

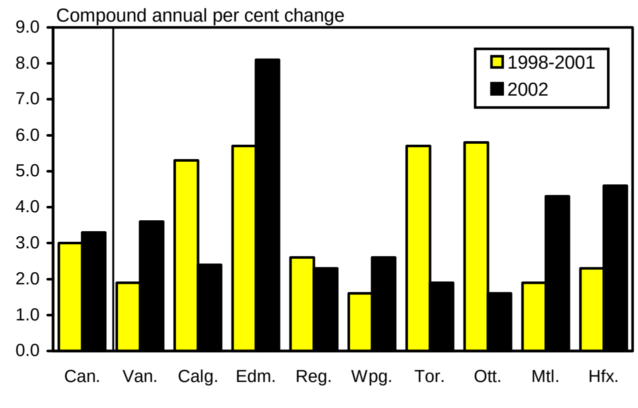
- In 2001, the tightest rental markets, where overall vacancy rates slipped to 1 per cent or lower for 1- and 2-bedroom units, were found in Montreal, Ottawa, Toronto, Edmonton and Vancouver. At the lower end of the market, rates in all of these CMAs except Vancouver were also sub-1 per cent in 2001. In contrast, overall vacancy rates in Regina and Halifax were the highest, although at 2.0-3.5 per cent they remained low.

STOCK OF HOUSING BY TENURE: 1991-2001



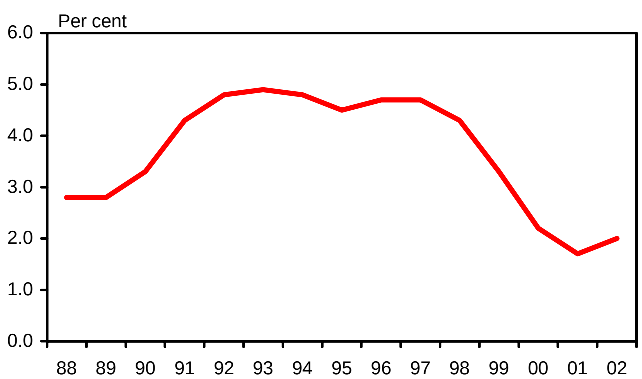
Source: Statistics Canada, TD Economics

TWO-BEDROOM APARTMENT RENTS



Source: CMHC, TD Economics

VACANCY RATE:
AVERAGE 2-BEDROOM APARTMENT IN CANADA



Source: CMHC, TD Economics

- Montreal stands out as experiencing the most significant tightening in rental market supply in recent years – with its vacancy rates falling from roughly 9 per cent in 1992 to 0.5-1 per cent in 2001.

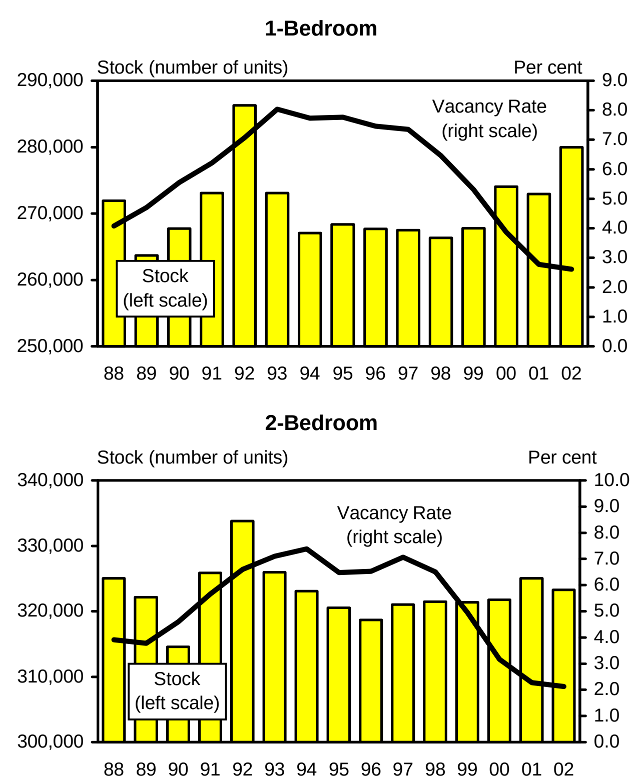
- Predictably, tight supply has put upward pressure on rents, particularly since 1998. Between 1998 and 2001, the average rent for a 2-bedroom apartment in Canada has risen at a compound annual rate of 2.9 per cent, yielding 2.0 per cent per year for the decade as a whole. The average rent for a 1-bedroom apartment climbed even faster, rising by 3.7 per cent per year – or 2.1 times the rate of inflation.

- At 6 per cent per year in the 1998-2001 period, rent increases have been particularly pronounced in Edmonton, Toronto and Ottawa, although above-average gains have also been chalked up in Calgary. And, Regina has seen the largest rent increases for units in the bottom 20 per cent of the rent range.

- The rental market crunch may have reached a nadir in 2001. In most markets, vacancy rates rebounded noticeably in 2002, suggesting that the affordability crisis may have eased slightly last year. And, new rental construction starts have crept up in recent years, likely prompted by low vacancy rates and rising rents – indicating that the private sector is not completely unresponsive to the laws of supply and demand.

- However, overall vacancy rates across all the major markets remained below 3 per cent in 2002 (with Montreal's mired at a strikingly low 0.7 per cent). And, the average vacancy rate in Canada for rental units in the bottom 40 per cent of the rent spectrum continued to slip compared to 2001, highlighting the fact that much of the improvement in rental market conditions reflects

STOCK AND VACANCY RATES BY ACCOMMODATION
IN CANADA FOR BOTTOM 40% OF RENT RANGE



Source: CMHC, TD Economics

rising vacancy rates at the higher-end of the rental spectrum. Moreover, the slight easing in rental market pressure overall did not stop rents from climbing even further in 2002. Rents for 1- and 2-bedroom apartments rose by more than 3 per cent on average, and closer to 4 per cent in the bottom 20 per cent of the rent range. In Edmonton, Montreal and Halifax, rent increases for a 2-bedroom apartment were above 4 per cent in 2002.

TD Economics estimates the shelter gap

Thus far, we have studied the two main drivers of the housing affordability problem in isolation – first, examining trends in income, and then looking at trends in the supply of affordable rental housing. Here, we link the demand and supply sides of the problem, in an effort to quantify just exactly what the shortage of affordable housing means for lower-income households in dollar terms.

An idea of the gap between what poorer Canadians can afford to pay for shelter and the price of the available stock is useful context for the debate on the affordable housing problem. This gap is often portrayed as the difference between what the poor can afford and either average rents or the cost of building new units. As would be expected, the gap is very substantial. This may not be a realistic portrayal of the situation, however. As discussed above, society is rightly troubled by the notion that there is a huge disparity in the quality of the shelter that various segments of Canadian society can afford. Yet while it is a laudable objective to ensure that the poor have adequate shelter, striving for the average rental unit seems unrealistically ambitious.

We present two alternative funding gaps here. For each of the large urban markets, the first compares what the poorest 20 per cent of Canadians can "afford" (taken to be 30 per cent of gross household income) with two-thirds of the average rent. On average, the funding gap is $2,503 per household on an annual basis. The gap varies widely across the country from roughly $1,700 in Edmonton, Winnipeg and Montreal to a high of around $4,000 in Vancouver and Toronto, with Ottawa not too far behind. The disparities across the country arise because incomes at the low end of the distribution tend to be more evenly spread than rents (because so much of this income comes from government transfer payments, including Old Age Security and the Guaranteed Income Supplement, which are constant regardless of location).

The second funding gap compares the average income of the bottom 40 per cent of the income distribution with three-quarters of the average rent in each market. The Canada-wide funding gap is reduced to $801. Edmonton

ESTIMATED SHELTER GAP 2000
Case 1: Average of Bottom 20 per cent of Families

	Average Family Income Bottom 20%*	30% of Average Family Income	Annual Rent Payment**	Utility Costs***	Total Housing Cost	Gap
Canada	**12,071**	**3,621**	**4,924**	**1,200**	**6,124**	**2,503**
Vancouver	11,701	3,510	6,352	1,200	7,552	4,042
Calgary	13,322	3,997	5,400	1,200	6,600	2,603
Edmonton	12,981	3,894	4,368	1,200	5,568	1,674
Regina	11,475	3,443	4,056	1,200	5,256	1,814
Winnipeg	12,422	3,727	4,244	1,200	5,444	1,717
Toronto	14,956	4,487	7,236	1,200	8,436	3,949
Ottawa	14,184	4,255	6,416	1,200	7,616	3,361
Montreal	11,238	3,372	3,868	1,200	5,068	1,696
Halifax	12,351	3,705	4,752	1,200	5,952	2,247

* Estimated by TD Economics as at May 2003; ** Calculated as two thirds of the average rent for 1 bedroom and 2 bedroom units. Assumes an even distribution between appartment sizes. *** Although some rents include utilities, this is often not the case, especially for telephone services. As a conservative estimate, we assumed $100 per month.
Source: Statistics Canada, CMHC, TD Economics

ESTIMATED SHELTER GAP 2000 Case 2: Average of Bottom 40 per cent of Families						
	Average Family Income Bottom 40%*	30% of Average Family Income	Annual Rent Payment**	Utility Costs***	Total Housing Cost	Gap
Canada	**19,797**	**5,939**	**5,540**	**1,200**	**6,740**	**801**
Vancouver	19,720	5,916	7,146	1,200	8,346	2,430
Calgary	22,125	6,638	6,075	1,200	7,275	637
Edmonton	21,560	6,468	4,914	1,200	6,114	-354
Regina	18,674	5,602	4,563	1,200	5,763	161
Winnipeg	19,264	5,779	4,775	1,200	5,975	195
Toronto	24,452	7,336	8,141	1,200	9,341	2,005
Ottawa	23,189	6,957	7,218	1,200	8,418	1,461
Montreal	18,247	5,474	4,352	1,200	5,552	77
Halifax	19,337	5,801	5,346	1,200	6,546	745

* Estimated by TD Economics as at May 2003; ** Calculated as three quarters of the average rent for 1 bedroom and 2 bedroom units. Assumes an even distribution between appartment sizes. *** Although some rents include utilities, this is often not the case, especially for telephone services. As a conservative estimate, we assumed $100 per month.
Source: Statistics Canada, CMHC, TD Economics

(negative), Regina, Winnipeg and Montreal do not have significant gaps. However, at around $2,000 per household per year, the calculation still paints a troubling picture for Vancouver, Toronto and to a lesser degree, Ottawa.

V. RECENT AFFORDABLE HOUSING INITIATIVES

As the 1990s drew to a close, declining rental vacancy rates and rising rents saw Canadian governments come under pressure to tackle the shortage of affordable housing, and poverty more generally. The momentum has gained pace in the last two years, spurred by two reports – from the Federation of Canadian Municipalities (FCM) in 2000, and the Prime Minister's Task Force on urban issues in 2001 – calling on the federal government to move back into the housing arena by developing a national strategy.[16]

And, the urgency with which advocacy groups have pursued their campaign reflects not just the severity of the problem today, but also expectations that the need for affordable housing will only grow more acute in the coming years. At last count, CMHC had projected that 45,000 new rental units would be required annually this decade – and, based on current trends, at least half of these new renter households will be low-income households in need of affordable units.[17] Advocacy groups foresee even greater demand. To put a real dent in the problem, the FCM has called for a 10-year program that would provide 20,000 new or acquired affordable units per year, 10,000 rehabilitated affordable units per year, and enough income-rent assistance to 40,000 incremental households per year to make their units affordable.[18] The FCM estimates the total cost of their recommendations at $1.6 billion per year, while the One Percent Solution, conceived by Michael Shapcott and David Hulchanski, of the University of Toronto's Centre for Urban & Community Studies, calls for all governments to double their spending on housing, which would effectively boost the share that housing commands in government budgets by one percentage point – hence, the 'One Percent' moniker.[19] The resulting $2 billion in additional federal spending would bring spending on new housing units back to where it was in the late 1980s.

Governments are beginning to respond

The need to address the problem of affordable housing has not fallen on completely deaf ears. The federal government has since announced a new cost-sharing program with the provinces aimed at boosting supply of rental housing, as well as new amounts for homelessness and the renovation/rehabilitation of existing housing stock. Moreover, the federal government has reduced the Goods and Services tax payable on the development of affordable rental housing. And, after studying the issue at length, several provinces and municipalities have forged ahead with some new programs of their own, especially in the regions that face the gravest difficulties with respect to affordable housing. Still, as the following review of recent policy initiatives reveals, there is much work to be done.

A. Income support measures

Raising the Canada Child Tax Benefit

In this year's budget season, there were some new measures aimed at helping the working poor and those on welfare. Most notably, armed with a large surplus, the federal government will gradually increase benefits under the Canada Child Tax Benefit (CCTB) program over the next few years, providing an additional $965 million annually to low-income families in 2007. And, it has offered up an additional $900 million over the next five years to assist provinces and territories in improving access to quality child care and early learning opportunities, as well as as additional $35 million for First Nations children, primarily on reserve. The federal government has already provided $2.2 billion over five years under the September 2000 Early Childhood Development Agreement. To the extent that these measures deliver direct benefits to lower-income households in Canada, they represent an important step toward helping to ease the affordability problem. However, most of the provincial announcements this year were modest in scope, and most did not take any action whatsoever on assisting low-income families. Instead, new investments in health care, education, and infrastructure dominated the list of new measures.

B. Measures to spur rental supply

i. Governments agree on an Affordable Housing Framework (AHF)

In November 2001, the Federal, Provincial and Territorial Ministers agreed on a five-year $680 million framework – formally named the Affordable Housing Framework (AHF) – within which bilateral agreements on affordable housing programs can be negotiated. Since the AHF is designed as a cost-sharing program with the provinces and territories (who have primary responsibility for housing), the federal government has entered into negotiations with each jurisdiction to reach bilateral agreements over the past year and a half. British Columbia and Quebec were first to sign on in December 2001, and all provincial and territorial governments are now on board. The main criteria of the AHF are as follows:

- The maximum federal contribution is $25,000 per unit over the duration of the program.
- Provinces and territories have to match the federal contributions overall in the form of capital or non-capital assistance, through cash, or in kind. Contributions may also be made by a third party (i.e., municipalities, not-for-profit, and/or for-profit entities).
- The initiative must create affordable housing for low to moderate income households.
- Units created under the program must remain affordable for a minimum of 10 years. The agreement sets the average market rent in each market as the benchmark for affordability.
- Depending on each federal-provincial agreement, initiatives may extend to renovation (beyond the existing RRAP program), rehabilitation, conversion, home ownership, supportive housing programs, and rent supplements.

In its 2003 budget, the federal government increased its investment in the AHF by an additional $320 million over five years, yielding a total outlay of $1 billion by fiscal 2007-08. The government has estimated that as many as 30,000-35,000 units could be created over the life of the program across Canada depending on the overall amount of capital contributions.

The AHF is the first major initiative on the affordable housing front in several years, but already, it has drawn

Federal-Provincial
Affordable Housing Framework (AHF)

- Established in 2001
- $1 billion in federal investment by 2007-08
- Matching funds required by provinces and territories
- Housing must be affordable for at least 10 years
- As many as 35,000 units could be created

criticism. First and foremost, the criterion for affordability is average market rents. As our shelter gap calculations demonstrate, these rents are currently far from affordable for low-income households. By choosing this benchmark, the program fails to target the needs of low-income households specifically. Second, apart from a few notable exceptions, most provinces have either been slow to act on the new program, or have used provisions within the agreement to avoid anteing up their share of the funding – for example, identifying municipal resources as part of their contribution. That is not a problem if the resources represent new municipal funding, but this has not always been the case. And, third, even if the AHF achieves its target of creating 35,000-odd units, this new supply will still fall well short of the number of Canadians households already in severe core housing need, quite apart from any new cases that may emerge over the program's five-year life.

Finally, the AHF agreement overlooks a significant demographic group. Aboriginal people are over-represented among the homeless and those at risk of homelessness in most parts of Canada. Yet, as the National Aboriginal Housing Association and other aboriginal housing and service providers have pointed out, the AHF does not contain any specific targets for off-reserve aboriginal housing. The federal affordable housing program that was cancelled in 1993 had an Urban Native Housing strategy built into it, and several provinces had targeted programs, as well. Currently, there are some 10,000 units of off-reserve aboriginal housing in Canada under aboriginal control, but that number falls short of the actual need.[20] In its latest Speech from the Throne and its 2003 budget, the federal government highlighted Aboriginal concerns, but there has been no recognition of the need to restore a targeted off-reserve Aboriginal housing program under aboriginal control.

ii. Homelessness Strategy extended for three years

In 1999, the federal government introduced a three-year $753 million strategy to combat homelessness, the National Homelessness Initiative (NHI). The main pillars of the program were $135 million per year for the Supporting Communities Partnership Initiative (SCPI), which includes measures to stem homelessness, and $128 million annually under the Residential Rehabilitation Assistance Programs (RRAP), to provide support to all existing housing types from owner-occupied homes to rooming houses.

Federal Homelessness Strategy

- Established in 1999
- Original 3-year, $753 million initiative renewed for 3 years in the 2003 federal budget
  - $135 million per year for the Supporting Communities Partnership Initiative (SCPI)
  - $128 million per year for the Residential Renovation Assistance Program (RRAP)

Both programs have given rise to multiple new projects aimed at providing services to the homeless. A smaller tranche – $10 million over three years – was allocated to the Surplus Federal Real Property for Homelessness Initiative (SFRPHI), which transfers federal properties to non-profit organizations or lower levels of government for the purpose of assisting homeless people. Under this program, several former Department of National Defense properties have been turned over for affordable housing.

Although these programs had been due to expire on March 31, 2003, the federal government elected in its 2003 budget to keep the programs running for at least another three years, maintaining funding at its previous levels. However, agencies that provide services to homeless people in a number of communities have noted that, even though new money has been promised, the new funding has not materialized. And, as of late May 2003, there were reports that a number of agencies had either laid off or were about to lay off as many as 300 frontline workers in Montreal and a number of other communities. The City of Toronto has offered a limited form of bridge funding to help homeless service providers in that city stay open for the summer, but concern regarding the transition remains.

And, the needs of urban aboriginals appear to have been overlooked here, as well. While the original 1999 NHI strategy included enhanced funding for the Urban Native Program – an existing federal program for shelter and services for off-reserve Aboriginal people – this enhancement was not renewed as part of the extension accorded SCPI in the 2003 federal budget. That means that funding under this program will fall back to 1999 levels.

iii. Provincial and municipal housing initiatives

Over and above their participation, or lack thereof, in the AHF, provincial governments – especially in central and western Canada, where the rental situation is worst – have been making or looking at changes aimed at boosting the supply of affordable housing. Provinces have been focusing their attention on implementing regulatory changes. These range from improving the overall private investment climate for housing – for example, by scaling back regulations on rent increases – to "watering down" legislation to protect the existing rental stock. Moreover, some provinces have also handed over increased powers to local governments so that they could implement policy changes themselves, such as altering provincial building codes. For example, in Ontario – the only province that has downloaded responsibility for social housing to municipalities, as part of its Local Services Realignment – the provincial government introduced changes to the Ontario Municipal Act that will allow municipalities to provide "bonusing" or special tax incentives as a lure to the private sector.

Not all provincial jurisdictions have shied away from introducing affordable housing programs in recent years. Three, in particular, – Quebec, Manitoba, and Saskatchewan – have designed and administered new programs aimed at preserving existing stock.[21] Quebec, faced with a relatively low ownership rate compared to other provinces, has offered financial incentives to encourage tenant residents to convert existing rental stock into owner-occupied condominium buildings. Manitoba has established "Neighbourhoods Alive", which is targeted specifically towards inner city neighbourhood housing and affordable housing, as well as the Winnipeg Housing and Homelessness Initiative, a tripartite agreement between the federal, Manitoba and City of Winnipeg governments that, at last count, had produced 700 housing units. Finally, Saskatchewan has set up two innovative programs targeted at ensuring the maintenance of quality and affordable rental stock in its four largest cities.

Confronted with increased cost pressures and weak growth in their revenue base, municipalities in Canada have been forced to be innovative in tackling affordable housing programs on their front doorstep. Many have either adopted, or are increasingly looking at, a number of options to make rental housing development more attractive to the private sector, many of which are being used south of the border. These include:[22]

- Waiving or reducing development charges, fees and property taxes in return for approval of affordable housing construction.
- Establishing direct capital assistance funds to provide grants to housing providers.
- Providing land at a reduced cost through sale or long-term land lease.
- Reviewing zoning by-laws and standards governing secondary suites, and often, relaxing them, and establishing by-laws to encourage the retention of existing affordable rental housing.
- Allowing "alternative development standards", like lot sizes and right of way widths, without compromising safety, and reducing the length of approvals.
- Using "inclusionary" housing policies, such as density bonusing, to encourage more rental properties.

Provincial and Municipal Initiatives

Provincial:

- Participation in the Affordable Housing Framework
- In some provinces:
    - measures to improve business climate
    - restrictions eased on rent increases
    - more flexibility granted to municipalities to provide incentives or alter regulations

Municipal:

- Adopting policies to spur rental supply, such as:
    - waiving/reducing property taxes, fees and charges
    - providing public land at lower cost
    - offering "density bonuses"
    - improving zoning by-laws and standards

iv. CMHC increasing insurance flexibility

CMHC recently announced that effective June 2003, it will offer increasing flexibility in its underwriting practices to spur new affordable housing production in both the rental and owner-occupied markets. These changes include allowing larger rental loans, reducing mortgage insurance premiums and providing greater flexibility related to cash flow requirements, loan advancing and repayment terms. For example, over the next three years, a borrower will now be able to obtain a loan of up to 95 per cent of the project's underlying value, if the project will provide affordable rents. CMHC will also offer increased financial assistance to potential housing providers who are in the very early stages of developing an affordable housing proposal, as well as increased training and consultation services. Some housing advocates have further called on CMHC to re-invest the Corporation's "operating surplus" in new affordable housing projects, but as we discuss below, this suggestion fails to recognize CMHC's new mandate to conduct its insurance and securitization operations on a more commercial basis.

Understanding CMHC's "Operating Surplus"

In 1996, the federal government directed CMHC to view its mortgage loan insurance and guarantee operations as commercial tools in a competitive environment to achieve public policy objectives. The equity in CMHC's insurance operation comprises appropriated and unappropriated retained earnings. Appropriated retained earnings are funds set aside consistent with the capital adequacy standards established by the Office of the Superintendent of Financial Institutions (OSFI). Those standards require CMHC to accumulate reserves to support its C$220 billion in outstanding mortgages. As of December 2002, CMHC's capital adequacy for commercial business initiated since 1996 exceeded 50 per cent of OSFI standards. In recognition of the ultimate federal support of CMHC's insurance and guarantee operations, the Corporation pays the government annual fees.[1]

The appropriated retained earnings surplus is the sum that some housing advocates refer to as an operating profit that CMHC should direct toward new affordable housing projects. But, while this amount is accounting profit for the purposes of a financial statement, it is not an appropriate measure of CMHC's profitability as an insurer. Insurance is a cyclical business, involving long-term risk – in CMHC's case, the 25-year life of the mortgages it insures. The relevant issue is the Corporation's ability to remain profitable over this time period, and that cannot be inferred from its short-term operating results. Rather, the appropriated retained earnings should be viewed as capital, which does not yet fully meet OSFI standards. CMHC only began operating under the new mandate in 1999. Reaching full OSFI capital adequacy is clearly a goal that will take years, not months, to achieve.

Some housing advocates maintain that CMHC should set aside all its retained earnings for capital purposes each year, as opposed to its current practice of leaving a share unappropriated, for other uses the government may authorize. By hastening the process of meeting OSFI standards, they argue, CMHC will reduce its risk exposure more quickly, allowing it to boost support for affordable housing. However, CMHC is already appropriating in excess of 80 per cent of retained earnings each year, and the projections in the 2003-07 Corporate Plan Summary reflect plans to continue on that basis. It is doubtful whether increasing the share of appropriated retained earnings to 100 per cent would achieve a meaningful acceleration in the timetable for meeting OSFI targets.

In fact, the confusion over CMHC's retained earnings reserve reflects a deeper misunderstanding over the Corporation's now-dual mandate – of fulfilling public policy objectives, while aligning its operations with those of its private sector competitors. In fact, CMHC will never be on equal terms with its private sector competitors, because of its status as a Crown Corporation – yet, its public policy role in providing mortgage default insurance for rental housing projects is critically important, given that no private sector firm is currently willing to play this role. The only other mortgage insurer in Canada – General Electric Mortgage Insurance Canada (GEMICO) – offers default insurance for owner-occupied properties exclusively. That is a testament to the high-risk nature of the mortgage default insurance business – suggesting it may be appropriate to retain this function in a Crown Corporation. This would be consistent with the practice in the United States, where, of nine private mortgage insurance providers, none operates outside the owner-occupied market. Only the Federal Housing Administration (FHA), an arm of the U.S. Department of Housing and Urban Development (HUD), offers mortgage insurance for rental properties.[2] So, the hybrid structure may be unwieldy, but it looks like the best solution for now.

1. For more information, see CMHC's 2002 Annual Report, available on the CMHC website at http://www.cmhc-schl.gc.ca/en/index.cfm.
2. Greg Lampert and Steve Pomeroy, "Promoting a Positive Mortgage Insurance Environment for New Rental Construction," prepared for the Research Subcomittee of the Housing Supply Working Group, Ontario Ministry of Municipal Affairs and Housing, March 2002, p. 24.

PART TWO:

A NEW AFFORDABLE HOUSING PARADIGM

I. THE CONCEPTUAL FRAMEWORK

It is encouraging to see the attention now being paid to the affordable housing problem in Canada. Governments are beginning to act and various advocates have recommended further measures. However, in our view, some of the approaches are not grounded in a proper analysis of the problem. Accordingly, we will begin Part Two of this report by taking a step back from the mass of data and the whirl of recent policy developments to examine the foundations of affordable housing policy in Canada.

Conventional analyses of the problem of housing affordability in Canada rest on similar foundations. The problem is commonly diagnosed as one involving an inadequate supply of housing priced at a level that lower-income households can afford. And, the solution typically recommended is to employ one or more of a vast array of subsidies to stimulate construction of new multiple-unit properties.

We believe this approach is flawed in three important respects. **First**, it treats income levels as given. **Second**, it focuses primarily on supply-side measures, and emphasizes those aimed at increasing rental housing supply overall – which has only a minimal impact at the affordable end of the scale. And, **third**, many of the measures recommended as a means of stimulating this new supply (whether expenditure-based or tax-based) are inefficient, which is to say they entail a high public cost per new unit of affordable housing created.

Below, we will suggest an alternative paradigm for affordable housing – one that situates the problem in its larger economic and social context. This broader perspective makes it clear that a comprehensive solution to the affordable housing problem will require a two-pronged approach to address the demand- and supply-sides of the equation.

TD Diagnosis:

There are too many low-income households in Canada. Market-generated incomes at the low end are not rising quickly enough, and transfers have been only partially successful in alleviating this problem.

CONVENTIONAL PARADIGM ON AFFORDABLE HOUSING PROBLEM

↓

Diagnostic

Too little supply at price lower-income households can afford

↓

Solution

Vast array of subsidies to encourage supply of multiple units

PROBLEMS WITH CONVENTIONAL PARADIGM

↓

1. Treats income levels as given

2. Encouraging overall supply of multiple units has small impact at affordable end

3. Many of the recommended subsidies (expenditure and tax) are inefficient (high public cost per new unit of affordable housing)

TD Proposal:

The ultimate solution is to raise market incomes over the long term and develop a more effective and equitable income transfer regime to help lower-income households avoid the perils of the proverbial low-income trap. As these are necessarily longer-term objectives, complementary actions will be required in the interim to:

- improve supports for lower-income individuals
- address the current supply shortage
- remove market imperfections that contribute to that supply shortage

The rationale behind this formulation of the problem

The first criticism we levelled at the conventional model of affordable housing was that it treats income levels as given. Indeed, much of the existing literature on affordable housing assumes *a priori* the existence of a stratum of low-income individuals who are perpetually in need of assisted housing. Rather than accepting this as inevitable, we argue that a comprehensive affordable housing strategy should seek to ameliorate this underlying cause of the problem. This is the only way to achieve a permanent reduction in the need for affordable housing.

The conventional perspective on income issues is to be concerned by the income distribution. That is, how the groups at the bottom end of the distribution are faring relative to the higher-income groups. That is not the relevant issue here. Unfortunately, someone will always be at the bottom end of the distribution. Our concern should be with the absolute welfare of those groups. The goal should be to lift the incomes of the poorest Canadians.

Ideally, the incomes of the poorest Canadians should be raised through market mechanisms – more and better-paying jobs. Realistically, the income transfer regime will always be required to play an important, supportive role. That transfer regime has already accomplished a great deal. Old Age Security, the Guaranteed Income Supplement and the Canada and Quebec Pension Plans have done a great deal to alleviate poverty among the elderly. The Canada Child Tax Benefit is doing the same for families with children. However, the regime still leaves much to be desired. In its present form, the system is inadequate to meet the needs of many lower-income households; it is inequitable, in that it treats households with similar incomes unequally; and, it is inefficient, in that it often creates a low-income trap with a dependency upon social assistance because very little financial incentive is provided to households to improve their situation through increasing their market incomes or savings.

Why interim measures are needed

Ultimately, addressing the plight of lower-income households is about tackling the problem of poverty. However, the measures needed to address that problem – more funding for education, reform of the tax and transfer systems, and social policy initiatives targeted at vulnerable populations – involve complex changes that cannot be implemented overnight. We will discuss these measures in more detail below, but given the lengthy timetable involved, progress in achieving the ultimate goal of poverty reduction will likely be measured in years, if not generations.

A BROADER PARADIGM FOR AFFORDABLE HOUSING PROBLEM

↓

Diagnostic

Too many low-income households

Market-generated incomes at the lower ends are not rising

Transfers have only been partially successful
- **inadequate in some circumstances**
- **welfare/poverty wall**
- **unequal treatment of households with similar incomes (raises demand/rents, hurts those without the transfer)**

↓

1. Ultimate Solution

A. Strong macroeconomic environment

B. Build safeguards against a low-income trap
- **strong education system**
- **reformed income transfer regime to help break the poverty cycle**
- **specific measures to aid vulnerable populations**

↓

2. Interim Complementary Action

A. Raise/improve income support at the lower end

B. Efficient supply enhancements

C. Remove market distortions

In the interim, measures must be taken to ease the burden for low-income households. We identify three such measures. The first – enhancing **income subsidies** – is the medium-term corollary of the longer-term focus on poverty reduction. Lower-income households need improved income supports today to help them bridge the gap between their total income – their market income plus the transfer payments they receive from the government – and their shelter costs. And, as with the transfer system overall, reforms to the income subsidy system must be informed by the principles of efficiency and equity. That is, income subsidies need to be targeted more carefully, to ensure that they go to those genuinely in need, and that they fully meet that need. This will require striking a delicate balance, because providing subsidies to selected groups means those left unsubsidized will be relatively worse off. As we note below, subsidies tend to fuel rent inflation in the short term, as subsidized tenants use the additional income to enhance their ability to compete for a fixed supply of rental properties. That leaves tenants not receiving a subsidy relatively worse off. This does not mean that targeted subsidies are a bad idea – just that they need to be used with care and deliberation.

At the same time, measures to boost income cannot be introduced in isolation. Because of the time lag involved in bringing new supply onto the market, the benefits of income subsidies often filter upward to the landlord initially because of competition among tenants for the existing supply of units. Accordingly, income supports must be accompanied by measures to **enhance supply**. And, this brings us to the other two criticisms we levelled at the conventional paradigm – that the supply-side measures it favours are inefficient, both with respect to their stated goal and their cost-effectiveness. The conventional paradigm calls for measures to stimulate construction of rental housing in general. Theoretically, the argument goes, any increase in the supply of rental housing is desirable, even at the higher end of the rental spectrum, because some households occupying existing units will move into the new, higher-quality units. That will free up space at the lower end of the rental scale, as well as relieve the upward pressure on rents overall that bite hardest at the lower end of the income scale. However, in practice, the "trickle down" benefits for lower-income households from the production of higher-end rental units have been limited.

If the objective is to stimulate production of *affordable* rental housing, doing so indirectly, via measures to boost the supply of rental housing overall is an inefficient – not to mention costly – way to proceed. The supply of new affordable housing units created relative to the total number of new units is small, and the per unit cost is higher. Instead, a more sensible approach would be to target the construction of affordable rental housing, specifically, and take steps to preserve the existing stock of affordable rental housing – a far less costly approach than building brand new supply.

Finally, our exhortations to provide demand- and supply-side supports should not be interpreted as an excuse to leave existing **market imperfections** in place. As a general rule, measures that distort the market should be eliminated, wherever possible. But, doing so will sometimes entail a cost to the public treasury. Given the reality of scarce resources (i.e., limited public funds), if the principal goal is to produce more affordable housing, we would argue that removing market distortions that are only tangentially related to this segment of the market may not represent the most efficient use of public funds.

With this new paradigm in mind, we will now take a closer look at the affordable housing environment in Canada, evaluating current policies in relation to what our model would suggest are the key areas requiring action.

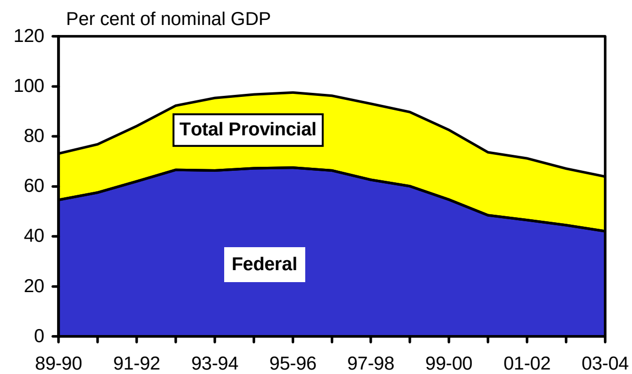
II. TURNING THEORY INTO PRACTICE

1. The ultimate solution: Raising market incomes at the lower end

A. Getting the macroeconomic context right

Over the past few years, Canadian governments have been successful in implementing policies that have placed the country on a more competitive footing internationally. In aggregate, Canada's governments have reined in $66 billion in deficits since fiscal 1993-94, and Canada is now the only nation among the G-7 major industrialized countries to be paying down debt. The ensuing fiscal dividend has allowed personal and business income tax rates to be

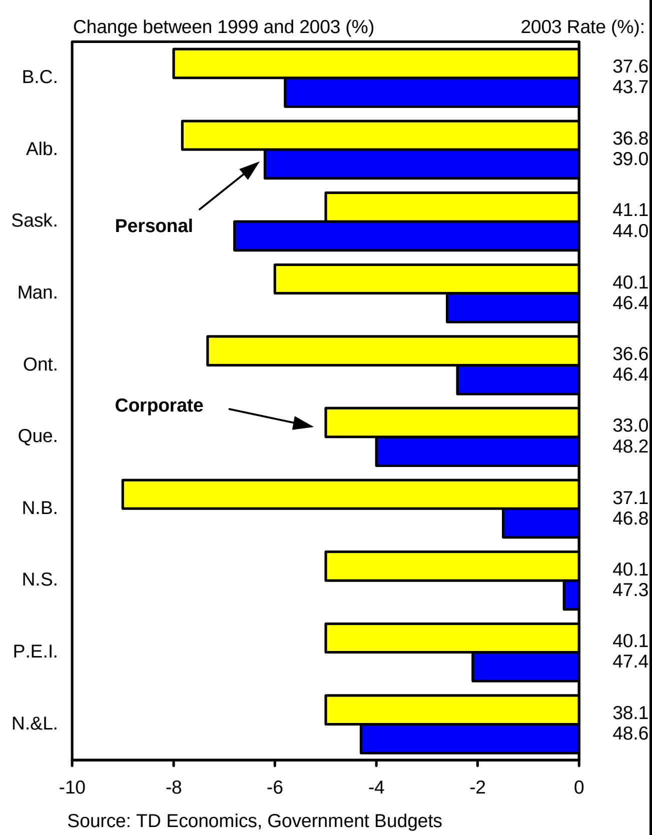
CANADIAN FEDERAL AND PROVINCIAL GOVERNMENT NET PUBLIC DEBT

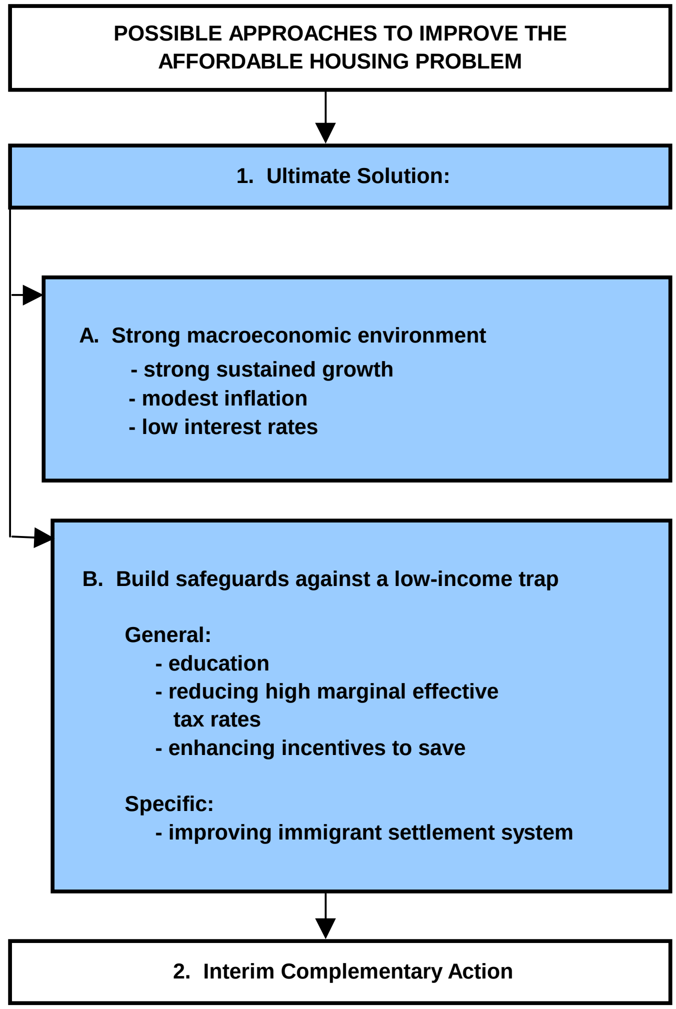


GDP: Gross domestic product; Nominal GDP forecast by TD Economics as at May 2003; Source: Federal and provincial governments, Statistics Canada, TD Economics cut over the past half decade, and governments have made significant investments in productivity-enhancing health care, R&D and infrastructure. These efforts have played a positive role in fuelling economic growth in Canada since the mid-1990s. At the same time, the Bank of Canada's success in quelling inflation has led to a prolonged period of comparatively low interest rates.

The combined effects of robust economic growth, low inflation and low interest rates have boosted the fortunes of Canadian households across the income spectrum. The benefits have been particularly apparent in the housing market. Reductions in the cost of home ownership have enticed a lot of renters into becoming property owners, increasing rental vacancy rates across the country and containing pressures on rents. While vacancy rates have risen most at the high end of the rental spectrum, there has unquestionably been some improvement in the affordable rent range, as well. As we discussed in Part One, the filtering down of the overall economic growth to the lower end of the income distribution has been somewhat spotty. There

TOP PERSONAL AND CORPORATE MARGINAL TAX RATES





is considerable debate as to whether a rising tide lifts all boats. Still, it is undeniable that nobody is lifted when the tide runs out. The conclusion should be that getting the macroeconomic context right is a necessary but not sufficient condition for easing the affordable housing problem.

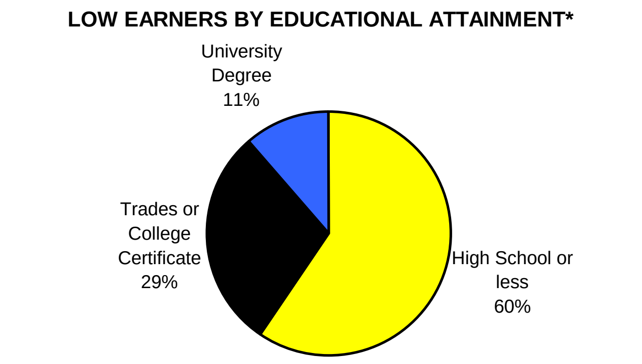
TD RECOMMENDATIONS:

- Continue to put a high priority on maintaining a strong and stable economic environment characterized by low inflation, which permits low interest rates.

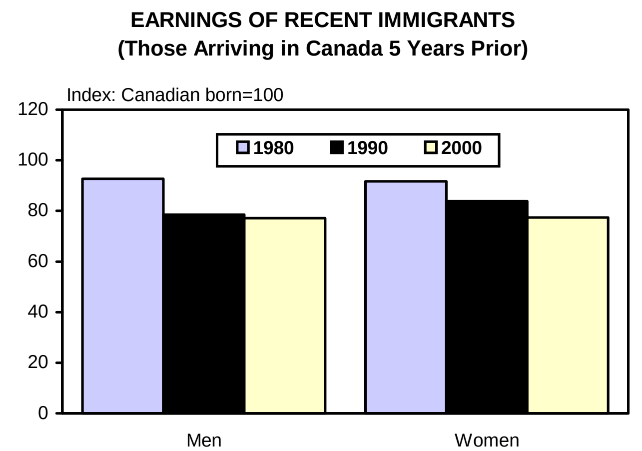
B. Build safeguards against a low-income trap

Why have lower-income Canadians failed to make up any ground? Three main factors appear to be at play:

First, over the past decade, disparities in earnings from employment have widened in tandem with the changing structure of Canada's economy. New job creation has been concentrated in a number of highly-skilled professional



* Those who worked full time in 2000 and who earned less than $20,000
Source: Statistics Canada, TD Economics



Source: Census 2001, TD Economics

occupations, with educational requirements rising in lockstep. At the same time, globalization has seen lower-wage occupations shift to developing countries. This has widened skills differentials across job types, reduced opportunities for low-skilled workers, and increased returns from post-secondary education relative to high school.

Second, federal and provincial governments have implemented steep cuts in transfer payments since the 1990s, resulting in a significant difference between pre-tax and after-tax incomes for low-income families. Notably, eligibility requirements have been tightened and benefit levels frozen, not only for programs such as provincial welfare and federal employment insurance, but also for a number of other subsidies that have assisted low-income households including child care and shelter programs. The extent of welfare cuts across the provinces is shown in the table below. Although gains in market income have actually more than offset cuts to transfer payments over the last five years, after-tax incomes for the bottom 20 per cent have actually fallen, dealing a harsh blow to the working poor. This is because market income is taxable, whereas transfer payments are tax-free. And, for those who have remained reliant on transfer payments (and particularly the lowest 10 per cent of working-age families) the past half-decade has been particularly rough.

Third, the Canadian population and work force have become increasingly reliant on new immigrants to Canada, who, in turn, are struggling the most to realize their true potential. Paradoxically, immigrants – and primarily the

SOCIAL ASSISTANCE BENEFITS*

	Single Person		Person with Disability		Single Parent with One Child		Couple With Two Children	
	2002 Level dollars	% change 1989-2002	2002 Level dollars	% change 1989-2002	2002 Level dollars	% change 1989-2002	2002 Level dollars	% change 1989-2002
N.&L.	3,088	-38.0	8,680	-13.5	11,740	-7.4	12,632	-13.9
P.E.I.	5,717	-38.0	8,712	-19.3	9,814	-23.3	14,823	-22.2
N.S.	4,980	-36.7	8,580	-17.1	9,205	-26.8	12,610	-21.2
N.B.	3,168	-15.7	6,696	-32.0	9,922	-2.7	11,328	2.7
Que.	6,444	37.1	9,312	10.2	10,637	-6.8	12,388	-16.9
Ont.	6,623	-21.2	11,466	-5.5	10,708	-29.0	13,146	-30.9
Man.	5,352	-33.5	8,117	-7.2	9,636	-18.0	12,849	-32.6
Sask.	5,808	-10.6	8,436	-20.3	9,687	-27.0	13,076	-29.0
Alb.	4,824	-24.9	7,380	-7.1	8,565	-28.9	13,073	-26.3
B.C.	6,251	-13.7	9,522	-4.7	10,543	-19.4	12,973	-20.6

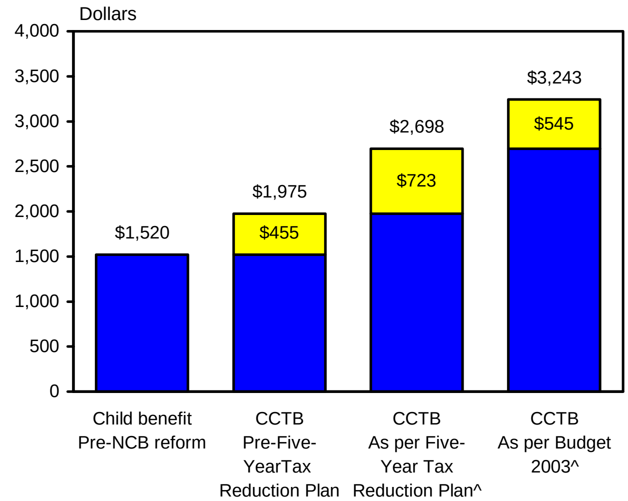
*All data, including per cent changes, are in 2002 constant dollars.
Source: National Council of Welfare Reports Spring 2003, TD Economics

25 per cent odd brought into Canada under the economic class – tend to be among the best-educated members of the population. Yet, language barriers and problems with foreign credential recognition continue to prevent these individuals from finding higher-paying jobs.

Together, these three roadblocks are effectively limiting any potential widespread improvement at the low end of the income scale. In her report, "Smart Social Policy – Making the Work Pay", Judith Maxwell of Canadian Policy Research Networks highlights the risk to Canada's economy from large numbers of workers in Canada trapped in a so-called low-wage "ghetto".[23] That is, people working for $8 to $10 per hour in many sales and service occupations, who, because of huge barriers to improving their income prospects, will likely remain in low-paying jobs. The barriers she cites are Canada's punishingly high marginal effective tax rates, which penalize individuals at the lower end of the spectrum by scaling back their social benefits in line with any incomes gains they secure, and high out-of-pocket costs for quality child care and supplementary health insurance. Furthermore, individuals in low-wage employment face major obstacles to acquiring new skills, since employers are reluctant to pay for training, while programs offered by federal and provincial governments are usually restricted to the unemployed.

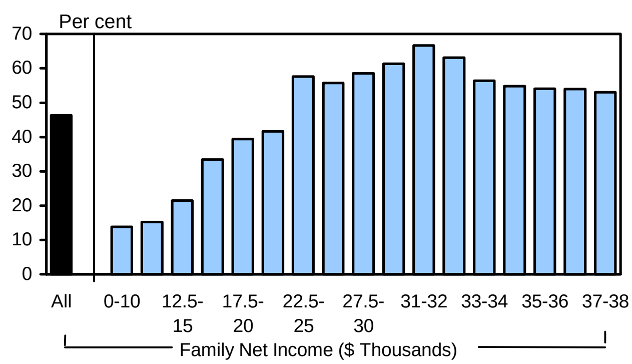
These kinds of inequities and inefficiencies contribute to the formation of a welfare/poverty wall, which many households are finding it increasingly difficult to scale. Removing these barriers is essential if lower-income Canadians are to have a genuine opportunity to improve their situation. At the October 2002 TD Forum on Canada's Standard of Living, we compiled a list of recommendations for reforms to the social policy and income transfer system that would deliver significant benefits to vulnerable populations. Here, we reiterate our top four recommendations for the federal and provincial governments.

ENHANCEMENTS OF FEDERAL CHILD BENEFITS SINCE THE CREATION OF THE NATIONAL CHILD BENEFIT (NCB) SUPPLEMENT (First Child - age 7 and over - for the 2007 benefit year)*



* Additional Canada Child Tax Benefit (CCTB) for children under 7 years of age not included; ^ Projection; Source: Federal government, TD Economics

MARGINAL EFFECTIVE TAX RATES (METR*) BY INCOME FOR CENSUS FAMILIES: ALL PROVINCE AVERAGE



* METR data derived via Statistics Canada's Policy Simulation Database and Model, Release 8.1; responsibility for the results and interpretation lie with the author. Source: Finn Poschmann, C.D. Howe Institute

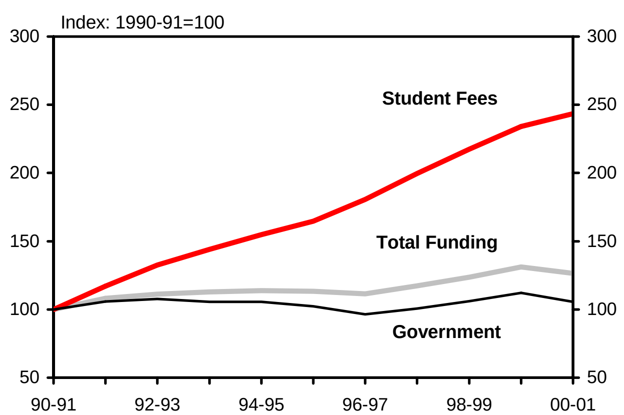
TD RECOMMENDATIONS:

- Adjust the design of federal and provincial tax systems to "make work pay" by reducing the rate at which benefits for low-income households under programs such as the **National Child Benefit Supplement (NCBS)** portion of the **Canada Child Tax Benefit (CCTB)** are taxed back. In many respects, the federal government's CCTB program and the joint federal-provincial National Child Benefit (NCB) initiative introduced five years ago, are "landmarks in Canadian social policy".[24] For one, by providing income support and social services for children – including child care, early childhood services, and drug and health benefits – to working and social assistance families alike based solely on their income, they address many of the roadblocks faced by the working poor. And, second, the NCB initiative represents an example of effective collaboration between the federal and provincial governments. While the jury remains out on its long-term effectiveness, we recommend ongoing federal and provincial support for this program to assist low-income individuals in their quest to improve their financial prospects.

- It would be ideal if the incomes of the elderly cohort were raised over time by people setting aside greater savings over their lifetime. Yet, that is not feasible under the current incentives for **retirement savings**. In fact, low-income households could actually be left worse off in retirement if they set aside savings. Extreme sacrifices are required for low-income households to save, but the tax benefits they receive at the time the savings are set aside could be swamped by the ultimate loss of government benefits – income and in-kind – if they retire with a higher private income. In the February 2003 Budget, the federal government said that it was studying a complementary form of retirement income incentives to address this disincentive. There is considerable merit to a system where, instead of providing a tax benefit at the time the savings are generated, there is an exemption from taxes for the ultimate return on the savings.

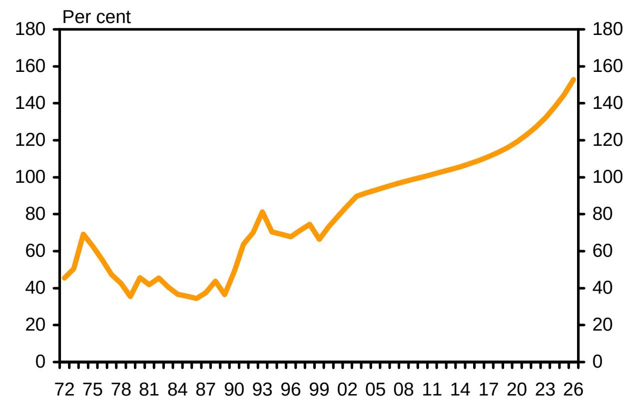
- Consider best practices that aim to move individuals off social assistance or raise their earning prospects. U.S. governments are currently experimenting with programs, including "**living wage**" requirements (i.e. which place the onus on the private sector to pay reasonable wages in return for public subsidies) and individual development accounts (i.e., which encourage people to save by offering matching deposits).[25]

TOTAL EXPENDITURES ON UNIVERSITY EDUCATION BY DIRECT SOURCE OF FUNDS



Source: Statistics Canada, TD Economics

PER CENT OF THE TOTAL CANADIAN POPULATION INCREASE ACCOUNTED FOR BY IMMIGRATION



Source: Statistics Canada, TD Economics

- Recognize the critical role that **education** plays in helping all Canadians participate in the "knowledge" economy. Although most provinces increased funding for education in their latest budgets, educational institutions across the country are still reeling from the cutbacks in the mid-to-late 1990s. At the post-secondary level, tuition fees have been on a steep upward trend in most parts of the country, leaving students with huge debt levels upon graduation. The rising cost of education has reduced its accessibility to many Canadians from low-income families, and made it more difficult to break the generational cycle of poverty. Interestingly, even small steps on the educational front can make a big difference. Studies suggest that a high school education provides the biggest marginal benefit. Against that backdrop, Canada's low literacy rate – astonishingly low for a developed country – and high secondary school drop-out rate are disturbing signs.

- Improve **immigration**-settlement services for new Canadians, and continue to work with bodies to speed up foreign-credential recognition.

2. Interim complementary actions

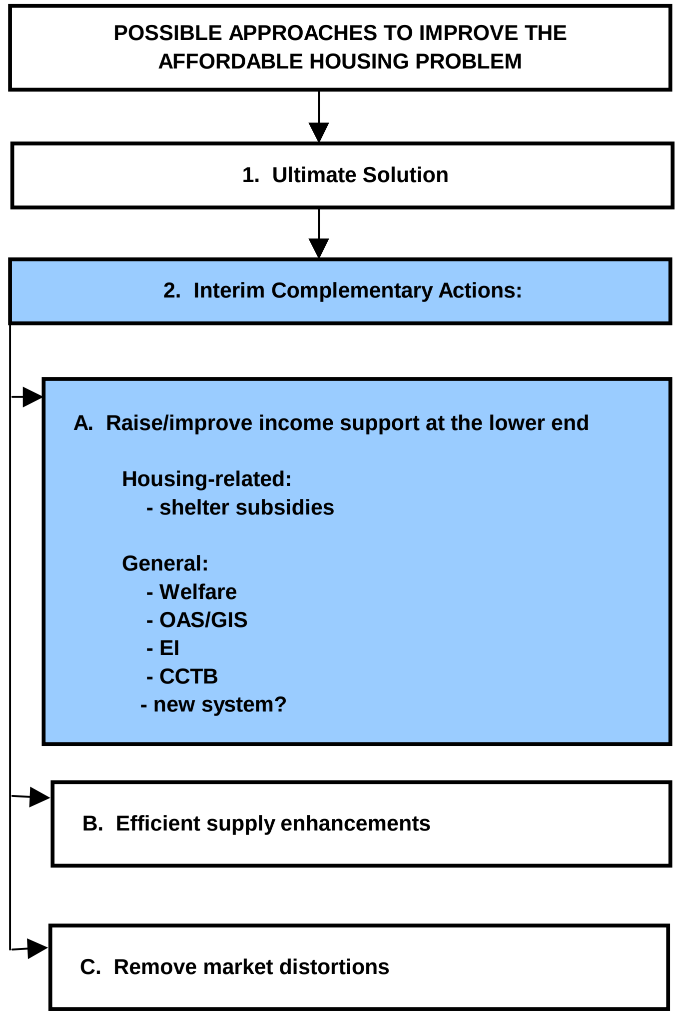
A. Income subsidies to plug the gap in the short term

Working to lift market incomes at the low end will take time. In the interim, shelter subsidies represent an efficient way to assist households in core housing need. There are two types of subsidies – rent supplements and shelter allowances. We assess the pros and cons of each as a way to help low-income households plug the shelter gap.

Rent supplements involve an arrangement between the government (through a public financing agency) and a landlord, whereby the latter agrees to provide rental units for low-income tenants. In most cases, the tenant is required to pay what he can afford, or a "rent-geared-to-income" (RGI). A number of provinces – British Columbia, Manitoba, Quebec, New Brunswick and Nova Scotia – currently have limited rent supplement programs in place, with many targeted to special-needs groups such as the disabled. Some experts – including Steve Pomeroy of Focus Consulting Inc. – point out that public rent supplement programs have had a less-than-stellar track record in Canada.[26] In particular, the administrative burden and restrictions on rent associated with rent-supplement arrangements have resulted in low landlord demand, or in many private landlords opting out at renewal time, leaving tenants in limbo. Other housing advocates counter that rent supplements provide protections for tenants – namely, that landlords must avoid predatory rent practices and maintain proper building standards. And, they note that, with rental vacancy rates beginning to creep up again, especially at the higher end of the rental spectrum, landlords may be more willing to enter into this kind of arrangement.

The other kind of shelter subsidy is a **shelter allowance**. In contrast to rent supplements, these are direct payments to the tenant, and accordingly, get around the need to negotiate agreements with landlords. The shelter allowance concept, supported by the FCM, is akin to the U.S. Section 8 Voucher (see topic box on next page). We tend to favour this option, because it is less disruptive to the market and provides individuals with freedom of choice. For example, shelter allowances preserve mobility, allowing individuals to move elsewhere if job opportunities change. In addition, the structure of the assistance formula takes into account both income and market rent for a unit, and thus can be better targeted to a selected definition of need. Lastly, they can be designed to keep costs down not only because benefit limits can be imposed per family, but also because they are primarily applied to rents on existing units, which tend to be cheaper than new units.

Still, shelter allowances have their flaws, as well. In an environment of tight supply, the benefits generally flow upward to the landlord in the short-to-medium term, as low-income tenants use the subsidy to compete for a fixed supply of rental units. That drives up rents across the board – and, if the income support system privileges some groups at the expense of others, the latter can end up worse off in relative terms, as well. In the long run, higher rents should stimulate the creation of new supply – but, in practical terms, this can take a very long time to occur. In the interim, the "trickle up" economics of income subsidies can actually worsen the affordability problem, as tenants bid up the rents of existing units beyond the amount of their subsidy.



Moreover, simply providing households in need with income support is no guarantee that they will use that support to obtain adequate housing. There are segments of the population – people suffering from mental illness, people coping with drug or alcohol addiction, or adolescents living on the street – who may be unable to make responsible decisions about income. In some cases, these problems can be addressed through public trusteeships or "rent-

How does a Section 8 Voucher Work?

In the 1930s, Congress passed the U.S. Housing Act, which introduced several programs to enable low-income households to obtain subsidized rental housing. Among these programs was the Section 8 voucher program. Administered by the U.S. Department of Housing and Urban Development (HUD), it set the stage for low-income households to rent apartments of their choice from private landlords, as well as project-based subsidies that were tied to the property-owner rather than the tenant. In the 1960s-1980s, several other programs were introduced to create affordable rental housing.[1]

HUD spends about $13 billion annually on housing vouchers. To qualify for a voucher, an applicant must:

- have a household income worth 50 percent or less of the area-wide median income, as determined by HUD. Virtually all people with disabilities receiving Social Security and Supplemental Income Security benefits are income-eligible for Section 8 because their incomes are well below 50 percent of median income
- be a citizen or non-citizen with eligible immigration status
- meet HUD's definition of "family", which includes most individuals with a disability and households with an adult member who has a disability

Beginning in the late 1980s, contracts for subsidies on much of the nation's regulated affordable housing stock began to expire, and many HUD-assisted properties chose to exit government-sponsored programs. In the 1990s, the federal government introduced a number of new programs aimed at stemming this loss.[2]

A study by Professor Scott Susin, in the American Journal of Public Economics, suggests that the U.S. voucher system has had the feared inflationary impact on rents across the spectrum – and, not just on the rents of those receiving vouchers. After examining the impact of rent vouchers in 90 U.S. metropolitan communities, he reached the following conclusion. "Considered as a transfer program, this result implies that vouchers have caused a US$8.2 billion increase in the total rent paid by low-income non-recipients, while only providing a subsidy of US$5.8 billion to recipients, resulting in a net loss of US$2.4 billion to low-income households."[3]

1. Canadian Housing and Renewal Association, "Municipal Initiatives - Stemming the Loss of Rental Stock," October 2002, pp. 18-26.
2. *Ibid.*
3. Scott Susin, "Rent Vouchers and the Price of Low-Income Housing," *Journal of Public Economics*, 83 (2002), p. 146.

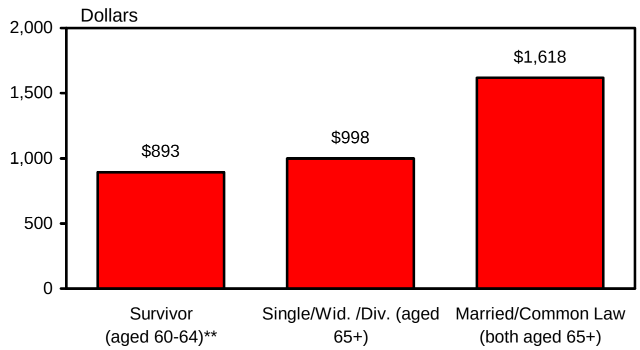
direct" arrangements, whereby the shelter portion of an existing shelter allowance subsidy or income transfer is paid directly to the landlord. But, other individuals and households may divert income subsidies to other uses out of necessity – for example, because they do not have enough money left over after covering their shelter costs to pay for other essentials, like food. Either way, the result – pockets of severe poverty and urban decline – creates problems for everyone in the community. As we will argue in the next section, this is why it is essential to combine income subsidies with measures to boost supply.

Virtually all provinces use rent supplements and shelter allowances in some form, but there are a number of improvements that could be made to the system to target the needs of lower-income households more efficiently.

TD RECOMMENDATIONS:

- Most shelter allowance programs are currently restricted to welfare recipients. Some housing pundits have advocated a transitional benefit for welfare households, to assist welfare recipients acquire skills and work experience to make the transition back to work.[27] Currently, welfare recipients lose their shelter benefit as they begin to earn market income.
- Another problem with the current design is that little effort is made to align the welfare shelter benefit with the cost of market rents. Take Ontario, for example. Welfare families in Kingston receive the same shelter allowance as families in Toronto, despite a wide gap in rent rates. This should be addressed.
- Just as the affordability burden varies by region, so too does it disproportionately affect certain demographic groups – such as **senior citizens living alone**, particularly women. A large proportion of female seniors do not qualify for the same CPP benefits as their male counterparts because of their history of lower workforce participation. As such, benefits un-

OLD AGE SECURITY PENSION: COMBINED MAXIMUM MONTHLY PAYMENT*



* As of April 2003. Payments include the basic pension, Guaranteed Income Supplement, and the allowance for the survivor; ** allowance for the survivor; Source: HRDC, TD Economics

der the OAS and GIS programs, which are a maximum of just under $1,000 per month, constitute total household income for many seniors.

However, it is time to re-evaluate the adequacy of these benefit programs. As with the working poor, seniors at top end of the low income threshold are hit with extremely high tax rates, as additional investment income is clawed back from public pensions they would otherwise have received. They may also suffer considerable financial hardship upon the death of a spouse. When one spouse passes away, the cost of living for the surviving one does not drop by half – more likely, it declines to 65-75 per cent of its previous level. Yet, public income support is cut in half, as is support from a private pension plan, should seniors have one.

B. Measures to enhance supply

As we have already discussed, the potentially inflationary impact of income subsidies in an environment of tight supply means that income supports must be complemented by measures to boost supply. Given the extent of the shortage of affordable rental housing today – as we documented so starkly in Part One – those measures will have to include efforts to bring new supply onto the market. But, it is equally important that steps be taken to forestall any further loss of existing stock. A comprehensive supply-side solution to the affordable housing problem should encompass both of these objectives.

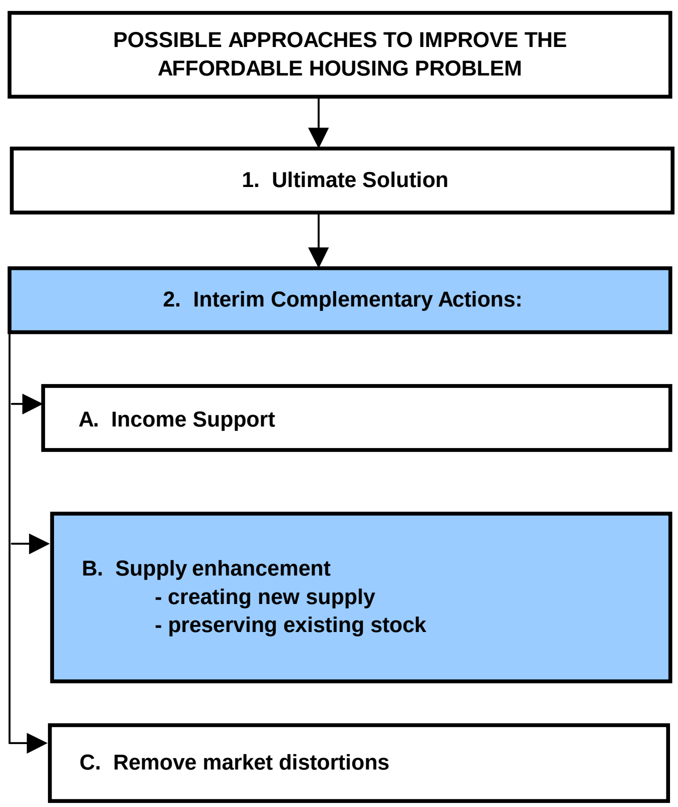
i. Creating new supply

Changes to federal, provincial and municipal taxes are often recommended as part of an approach to increase the supply of affordable housing. A number of reports provide detailed descriptions of the provisions most directly affecting the supply of rental housing and how they could be changed.[28] We will not replicate this level of detail, but rather focus on some basic questions.

The main goal of taxation should be to raise revenues for governments. Taxes should do this with the least distortion to economic activity. So the first question must be:

Are there tax changes that would correct market distortions, or do the recommendations largely amount to an alternative form of housing subsidy?

Many of the studies that advocate tax changes have as their clear mandate increasing the supply of rental accommodation. They are not directly focused on affordable housing, although they note that by increasing the overall supply, some benefits will flow to the lower cost end of the rent spectrum. Hence our second question is:



How effective would tax changes be in improving the situation for affordable housing? Effectiveness encompasses not only the likely supply response of affordable housing, but also the net cost to governments. Do tax changes give the biggest "bang for the buck" to affordable housing?

To the extent that tax changes are a form of housing subsidy, they must be evaluated by the following criterion:

How effective would tax changes be relative to alternative forms of subsidies to improve the affordable housing situation?

First, we will briefly describe the main tax changes that have often been recommended. Many of the recommendations amount to reinstating provisions that existed prior to 1972, when the federal government began to eliminate various items they argued unduly assisted higher-income investors. Of course, the coincidence in timing of these tax-tightening measures with the decline in the supply of rental housing has been cited by those advocating the measures be reversed. Further ammunition is drawn from the observation that some of the U.S. tax provisions for real estate are similar to those in place in Canada prior to 1972.

(a) Give Corporations With Fewer Than 6 Employees Access to the Small Business Deduction

- The lower small business corporate income tax rate is not available to corporations engaged in the rental of real property if they have less than six full-time employees. This rule flows from the decision to classify rental housing as a "passive investment", which also denies landlords access to the $500,000 small business lifetime capital gains exemption.

(b) Allow Capital Cost Allowances (CCA) Losses to be Deducted Against Other Income

- Individuals and non-real estate companies cannot apply CCA losses against income from other sources.

(c) Allow "Pooling" of CCA Across Buildings

- Rental properties cannot be pooled to recapture CCA on the sale of a building – hence capital gains taxes have to be paid when one building is sold and another is purchased. Pooling is allowed in the U.S., and capital gains are deferred where a property of equal or greater value is bought.

(d) Enrich the Rate of CCA for Rental Buildings

- Some have argued that the 4 per cent annual tax depreciation rate for rental buildings should be increased to the 5 per cent rate that was in place prior to 1988.

(e) Allow Immediate Deductibility of all "Soft Costs"

- In recent decades, tightening provisions have been put in place for those not in the business of real estate, dictating that certain costs, such as legal and accounting fees, promotion costs, et cetera, must be capitalized and depreciated over the life of the building rather than written off for tax purposes immediately.

(f) Eliminate Capital Taxes (or Exempt Rental Housing)

- Capital taxes are levied on the asset value of the building regardless of any income that flows.
- In recognition of the distortions they cause, the federal government, in its 2003 budget, is legislating the elimination of its capital tax over 5 years, and a number of provinces have either already dropped theirs or have promised to do so.

(g) Lower or Eliminate the GST on Rental Properties

- As of 2000, rental units qualify for the same GST rebate as owner-occupied housing, implying an effective rate of around 4.5 per cent. Finance Canada argues that this puts roughly the same tax burden on real estate as under the pre-1991 Manufacturers Sales Tax. Some advocates do not accept this and argue for a lower effective rate. Others argue that the GST should be entirely removed from new rental housing.
- As residential rents are GST-exempt, landlords cannot claim a GST input tax credit on their taxable purchases.

(h) Equalize Property Taxes on Multiple-Unit and Owner-Occupied Housing

- In many municipalities, property taxes can be several times higher on rental properties. There are some ad hoc attempts to deal with this – such as in Ontario, where municipalities now have the right to bring the property tax rates on new rental housing down to the owner-occupied level for up to 35 years.
- Property taxes remain much higher on existing rental buildings than for owner-occupied housing.

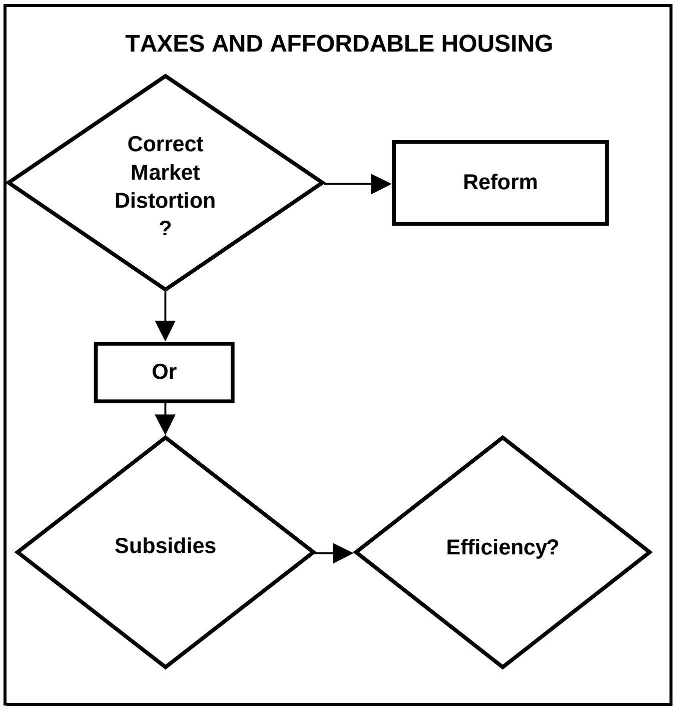
(i) Introduce New Tax-Related Incentives to Encourage Rental Housing

- The U.S. Low-Income Housing Tax Credit (LIHTC) is often the focus of such recommendations. Created in 1986, the program is one of the main tools for developing affordable housing in the United States. Under the LIHTC, U.S. states are authorized to issue federal tax credits for new construction, or the acquisition and rehabilitation of affordable rental housing. The credits are typically shared among equity investors brought together by syndicators. They can be used by property owners to offset taxes on other income or sold to outside investors to raise funds for a new project. Depending on the property, tax credits can generate 50 per cent to 60 per cent or more of the cost of development. The rest of the funding typically comes from market-rate first mortgages and low- or no-interest second mortgages. To qualify, a certain number of units must be set aside for low-income households. The program is called a tax credit, but in essence, it operates very much like a grant.
- A new tax credit modelled after the Labour Sponsored Venture Capital Corporations, whereby investors would receive a tax credit for putting their money into rental housing.
- Provide a tax exemption for bonds used to finance rental housing. This would be along the lines of the tax-free municipal bonds in the United States. The rate on the bonds could be below market values because bondholders would be exempt from income taxes. (The current Ontario Opportunity Bonds do not include housing).

In assessing the relative merits of the above proposals, a priority should be assigned to changing those tax parameters which are highly distortionary. Capital taxes would be high on this list. As mentioned, many Canadian governments have recognized this and are acting accordingly. The others should quickly follow suit. The much higher property taxes on rental as opposed to owner-occupied housing are also highly distortionary. As soon as feasible, more comprehensive solutions than the availability of time-limited corrections in some markets should be implemented.

The suggestions of new tax breaks for rental housing do not address existing tax-related distortions. For all intents and purposes they are tantamount to grants or subsidies. Therefore, they should be evaluated on whether they are efficient in achieving the goal – improving the situation for affordable housing. Of course, direct spending programs and subsidies are not 100 per cent efficient, either. They have administrative and other overhead costs that reduce the funds actually applied to affordable housing. Still, the question is where the degree of leakage is worst.

On this score, there is no compelling reason to think that tax breaks would work more effectively than grants targeted at affordable housing. While the Low-Income Housing Tax Credit does channel substantial assistance to low cost housing, studies have documented that a good part of the U.S. government support delivered under the program is diluted before it gets to affordable housing, as discounts are applied in selling the credits and syndicators charge a fee.[29] Programs such as labour sponsored venture capital funds do elicit private sector involvement, but since much of the financing is ultimately from the foregone revenue collections of governments, they have some attributes of grants. In the case of tax-free bonds, the lower borrowing cost is roughly equivalent to the foregone income taxes. In fact, the U.S. experience is that the savings fall short of the foregone taxes; in other words, investors get a higher rate of return on tax-free bonds than on taxable bonds. It is argued that this gap would be even larger in Canada because foreigner investors are influential in setting Canadian bond prices and they would pay tax on them. Finally, some of the benefits are lost to transaction fees paid to brokers and bond traders.[30]



Interestingly, the call to increase the rate of depreciation on rental housing is seldom accompanied by any evidence that this is warranted on the basis of the useful life of the buildings. In fact, the economic depreciation rate on multiple-unit buildings is most likely below the current 4-per-cent tax depreciation rate. As such, the recommendation to raise the 4 per cent rate to 5 per cent does seem like a plea for a subsidy, which again should be viewed in the context of its relative efficiency compared to grants.

Judging whether the other common tax changes address distortions is a bit more subjective. For example, if one accepts the notion that rental income is "passive" and should be treated differently than "active" business income, then many of the current tax provisions can be defended. Questions could be raised around this notion, however.

There is no doubt that the tightening of the tax provisions on rental housing has lowered the rate of return to developers and investors. Hence, there has been a curtailment of supply. However, this alone is not enough to justify going back to the old tax regime. There would be a cost to the federal and provincial treasuries so the question must be asked as to whether these tax changes would be an efficient way to deliver support to affordable housing.[31]

Virtually any action on the tax side would have only an indirect and modest impact on affordable housing. It is very difficult to ring-fence tax incentives to particular needs. The tax measures would support all forms of rental housing – indeed, in some cases, all multiple-unit housing including condominiums. It is true that a healthier supply of multiple-unit housing would bring benefits throughout the range of rents, but the impact at the low end would be muted relative to the total cost of the measure. As such, the biggest "bang for the buck" would come from directing the support to affordable housing.

Of all the tax recommendations cited above, only the U.S. Low-Income Housing Tax Credit is targeted at affordable housing. As explained above, while described as a tax program, it is really the equivalent of a grant. And a substantial part of the government support is diluted through the syndication process. Indeed, in his assessment of the LIHTC, McClure asserts that "the most efficient mechanism for providing government aid to the development of low-income housing…is a capital grant".[32]

It has been argued that an advantage in the Canadian context of using tax measures is that they largely avoid the need for formal federal-provincial agreements – which, as in the case of the AHF, tend to be tricky. There is some, but only limited, merit to this notion. Technically, if the federal government changes something in the tax base, then the change automatically applies to the taxes of provinces in the Tax Collection Agreement. For personal income tax changes, that would exempt only Quebec from the federally-imposed change. However, for corporate income tax changes, Quebec, Ontario and Alberta would all be exempted. Further, while provinces under the Tax Collection Agreement do not have a veto on federally-imposed changes, in recent years there has been an increasing understanding that the tax base is to be commonly managed. Therefore, federal-provincial dynamics would not be avoided by using the tax system to stimulate housing. That is not to say that all provinces would object to some of the tax recommendations cited above. Indeed, some have been pushing for several of these items. There may be a fiscal angle to this tactic. Whereas the provinces are typically required to ante up 50 per cent of any expenditure program, their share of the cost of tax measures is considerably lower.

In conclusion, tax changes are unlikely to bring the biggest "bang for the buck" to affordable housing. Some of the provisions, such as the capital tax and the distortion between property taxes on rental and owner-occupied housing, should be fixed for their broad merits. The other recommendations would no doubt increase the supply of rental housing, but the benefits would be diluted across the full spectrum of housing and have a limited "trickle down" effect to affordable housing. A greater benefit-cost ratio could be realized through initiatives to directly target the lower cost segment of the market.

ii. Preserving existing stock

In Part One of this report, we cited the worsening climate for private sector investment in rental properties as one of the factors behind the dearth of new privately-initated rental construction in Canada. This factor has also been responsible for the loss of existing rental units, as owners and developers have found that they can earn a better return on their investment by replacing older properties with new, higher-end rental or owner-occupied units. Thus, the shrinking supply of affordable rental housing in Canada is a function not just of a lack of new construction, but also of the erosion of existing stock. And, with the share of rental housing in Canada in need of major repairs still on the rise – a natural corollary of the ageing of the housing stock – the prospect of more demolitions and/or conversions poses an ongoing threat to affordable housing supply.

There are significant gains to be realized from halting or slowing this process. As numerous housing advocates have noted, creating new affordable housing supply by refurbishing existing stock offers a number of advantages over new construction:[33]

- Renovating an existing building is generally more cost-effective than new construction, with some estimates suggesting that existing units can be converted into affordable housing for 40-50 per cent of the cost of building from scratch – meaning funding could be stretched almost twice as far.
- Converting or rehabilitating existing properties can be done more quickly than building new properties from the ground up.
- For abandoned and derelict buildings, their renovation and rehabilitation into affordable housing has the salutary side effect of contributing to urban renewal and revitalization.
- For properties already functioning in some capacity as rental housing, facilitating their purchase by a non-profit provider who will convert the property into affordable housing units can run into less resistance from neighbours than launching a new social housing venture. And, if the property in question is already occupied, it may be possible to preserve a greater mix of tenants than is typically the case with social housing projects.[34]

RENTAL STOCK IN NEED OF MAJOR REPAIRS

	Share of Total Per cent		
	1991	**1996**	**2001**
CANADA	**9.0**	**9.2**	**9.3**
Montreal	8.1	8.0	8.2
Ottawa-Hull	8.4	9.2	9.4
Toronto	10.1	10.8	10.8
Vancouver	7.6	8.6	9.1
Halifax	7.8	7.4	9.0
Winnipeg	8.3	8.9	9.9
Regina	7.7	9.1	10.0
Calgary	7.1	8.1	8.9
Edmonton	8.1	7.8	8.8

Source: Statistics Canada (1991, 1996 and 2001 Census, TD Economics

The Residential Rehabilitation Assistance Program (RRAP) – funding for which was renewed in the 2003 federal budget – has been one of the chief instruments through which existing housing stock has been renovated and transformed into affordable housing. The RRAP program does not actually target the problem of housing affordability directly. Rather, it was conceived in the 1970s as a means of addressing the problem of sub-standard housing in Canada – housing that fell short of the adequacy dimension of core need we described in the opening section of this report. While adequacy is not the main driver of core housing need in Canada, a significant number of low-income households occupy dwellings that are considered physically sub-standard in some respect, and they face a greater risk of health and safety problems as a result.

Accordingly, RRAP was introduced to help households bring their dwellings up to standard, and it has since grown to encompass individual programs aimed at addressing specific objectives. For example, Rental RRAP and Rooming House RRAP provide assistance for affordable housing landlords and rooming house owners to pay for repairs to units occupied by low-income tenants. These programs help prevent further loss of existing affordable housing stock. Meanwhile, RRAP for Conversions provides assistance for converting commercial or industrial buildings into affordable housing, which has allowed some synergies to be realized in the domain of boosting affordable housing supply. RRAP for Conversions offers funds to private entrepreneurs, non-profit corporations and First Nations groups to convert and rehabilitate non-residential properties into affordable rental housing or bed-units for low-income tenants.

As Focus Consulting's Steve Pomeroy has noted, the involvement of non-profit corporations is a particularly attractive option. Because their operating charter commits them to keeping units affordable over the long term, affordable housing projects created under their auspices tend to remain affordable – which has not always been the case with social housing programs in Canada in the past. Pomeroy cautions that there are limits to the volume of *new* housing that can be generated by non-profits. Indeed, non-profit corporations have been involved in the provision of social housing in Canada for decades, but even at their height, they produced only 25,000-30,000 units annually – as compared with a population of households in core housing need that numbers more than a million.[35]

But, what this approach lacks in quantity, it may more than make up for in quality. Because of their roots in the community, non-profit corporations are uniquely placed to develop housing solutions that are tailored to communities' distinct needs. Recognizing these distinct needs is a critical aspect of a comprehensive affordable housing solution. As our analysis of rental markets indicated in Part One, housing markets differ markedly from one city to the next in Canada. Different problems require different solutions, and non-profits can play a valuable role in crafting those distinctive solutions, as a recent report from the Canadian Housing and Renewal Association (CHRA) makes clear. It documents numerous cases of non-profits using funding programs like RRAP and the Supporting Communities Partnership Initiative (SCPI) to develop innovative ways to preserve existing stock and/or develop new affordable housing based on communities' individual needs.[36]

At a minimum, renovation and rehabilitation can help preserve the existing stock of affordable rental housing, thereby stemming any further loss of supply. Whether it can also contribute to the creation of new affordable housing supply will likely vary from one municipality to the next. Converting buildings into new affordable housing implies the initial purchase of a property, and this can be an expensive proposition in cities where land and property values are high – Toronto springs to mind. But, in other Canadian cities – notably, in the Prairie provinces – lower property values have made conversions a very viable option.[37] While this will never be a substitute for new construction, given the magnitude of the supply shortage at present, more attention to existing stock is a key component of any strategy for enhancing the supply of affordable housing.

TD RECOMMENDATIONS:

- Eliminate tax provisions that are genuinely distortionary. At the top of this list are capital taxes and the inequities in the property tax system that privilege owner-occupied housing at the expense of rental housing.
- Given the high degree of leakage associated with most tax policy changes, focus on capital grants targeted toward the production of affordable housing, specifically. This is a more efficient way to deliver support to the low end of the rental spectrum.
- Promote the renovation and rehabilitation of existing rental properties as a cost-effective strategy for preserving and maintaining affordable housing supply.

C. Removing market imperfections

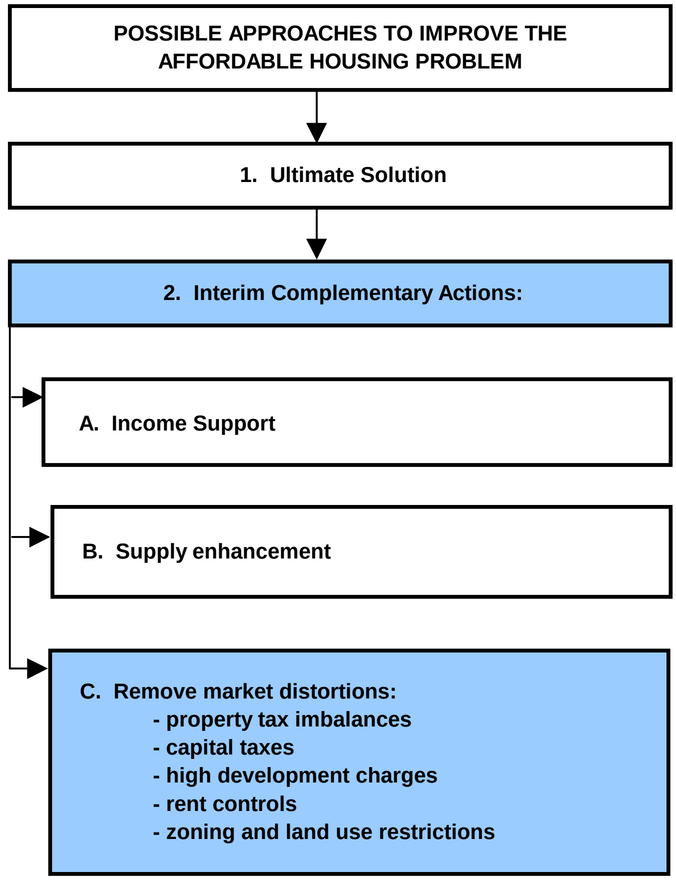
Given the severity of the affordable housing crunch in Canada today, it is clear that significant new funding will be required to plug the supply shortfall. But, it is also important to ask whether more can be done to address the root causes of that shortfall – the various market imperfections that prevent the creation of an adequate supply of housing at a price lower-income households can afford in the first place. These imperfections – the last element of our new affordable housing paradigm – include everything from property tax biases, to rent controls, to a lack of available land in reasonable-cost locations, to low density zoning that prevents low-cost construction.

We have discussed a number of these imperfections elsewhere in this report. In our evaluation of the relative merits of tax breaks and capital grants as a means of boosting affordable housing supply, we urged governments to eliminate **capital taxes** and redress imbalances in the **property tax system** that create disincentives for the production of rental housing. And, in our review of recent developments on the policy front, we noted that provinces and municipalities are becoming more pro-active about addressing market imperfections that impede the production of affordable housing. Provincial governments are scaling back **regulations on rent increases** – trading off some pain for lower-income tenants in the short run to achieve an improved climate for private sector rental construction that will help boost supply over the long run. Similarly, municipalities have begun to recognize that **land costs** and **development charges** are so high in the downtown core that developers cannot earn an acceptable return on properties aimed at lower-income tenants, while non-profit housing providers are simply priced out of the market. Accordingly, they have begun providing land at a reduced cost and waiving or reducing development fees and charges for providers willing to produce new affordable housing. To this list, we would add the suggestion that provincial and municipal governments resist the urge to **regulate secondary market units** – the often-illegal flats and basements apartments that are an important source of supply at the lower end of the rental scale. Informal secondary units are the lowest-cost form of affordable rental housing to create, even cheaper than renovating or rehabilitating existing stock. However, introducing legislation governing their existence – even legislation legalizing them in jurisidictions where they are currently prohibited – could spawn a new set of regulations that would greatly diminish the cost advantages they currently offer.[38]

In many cases, the regulations listed above were introduced to correct some other market distortion, only to become distortionary influences themselves. **Zoning requirements** present another interesting case of a market-distorting measure that may be doing more harm than the problem it was intended to solve. A common tool for dealing with housing affordability externalities – namely, dilapidated buildings and pockets of urban poverty – zoning restrictions may be ruling out an important housing option for affordable housing consumers.

One size doesn't fit all

In Canada, housing policy has generally been informed by the principle of equity – the idea that all individuals and households, regardless of their income level, should have access to housing that meets certain basic standards. For the most part, this has resulted in a boilerplate approach to producing new affordable housing, with government-subsidized housing being built to conventional rental market standards of size and quality, and studies of affordable housing measuring supply pressures in relation to conditions in the rental market as a whole.



But, housing affordability is not a problem that affects all households in Canada equally. It is overwhelmingly a problem for individuals at the lower end of the income spectrum – and, by definition, these individuals are not average. They earn below-average incomes, likely drive below-average cars (if they have a car), and have below-average expenses – except when it comes to the share of their household budget they have to devote to shelter, in which case they are often alarmingly "above-average". Given that low-income individuals and households are clearly not average in so many other respects, is it reasonable to expect that they should be able to achieve average housing conditions?

In a completely free market, lower-income households would seek below-average accommodations, and the market would provide that housing. In Canada, however, as in many advanced, industrialized countries, governments –

St. Clare's Multifaith Housing Society

For a project that brings together many of the strands of the new paradigm for affordable housing we have presented in this report, consider St. Clare's Multifaith Housing Society, a transitional facility in downtown Toronto for individuals exiting the shelter system. Originally a four-story, medical office complex at 25 Leonard Avenue, across the street from Toronto Western Hospital, the building that now houses St. Clare's became vacant in the late 1990s after Toronto Western merged with Toronto General. St. Clare's purchased it in 2001 and converted it into one-bedroom apartments, which are rented to people who were formerly homeless.

25 Leonard was an ideal candidate for conversion into affordable housing. The building contained more than 20,000 feet of useable space and was in good repair, meaning that rehabilitation costs were minimal. It had an elevator and was wheelchair accessible. And, it was located at the corner of Dundas and Bathurst Streets, beside Toronto's bustling Kensington Market and close to public transit. The one-bedroom apartments retain the modest, 330-square-foot dimensions of the doctor's offices that preceded them, and each has its own kitchenette and bathroom – achievable at a relatively low cost, because the rooms already had sinks and running water, courtesy of their previous incarnation as doctors' offices. The building has a live-in superintendent to act as a first line of support for tenants, and St. Clare's has established referral arrangements with local social service agencies and shelters to provide more extensive assistance to residents, as needed.

St. Clare's was as resourceful in financing the project as they were in conceptualizing it. The typical practice among non-profit corporations is to wait to secure government funding before launching a project. In 1998, with no such funding on the horizon and the homelessness problem worsening daily, St. Clare's took the unusual step of obtaining a line of credit from a local credit union, which enabled it to bid on existing properties in spite of its limited cash base. It also forged partnerships with private

(continued on next page)

uncomfortable with the notion of segments of the population being forced to live in sub-standard housing because of insufficient income – have using zoning restrictions to control the supply of this kind of housing. But, the process may have gone too far – as governments tried too hard, perhaps, to deliver an average standard of housing to Canadian households who have not yet achieved "equality of condition" in other respects.

At a recent conference on affordable housing, a survivor of the mental health system who is currently living in a social housing unit that does not conform to conventional standards of size and design described herself as having housing 'wants', but no longer having housing 'needs'. If affordable housing consumers are prepared to accept this distinction, perhaps providers should be, too.

In this respect, one housing option that can play an important role for very low-income individuals and/or people transitioning out of the shelter system is the rooming house or single-room occupancy (SRO) unit. Because of their smaller size – generally, 150-300 square feet, as compared with bachelor or studio apartments, which are usually 350-400 square feet in size – rooming houses and SROs can be built at a lower cost. A 1999 study for the Ontario Ministry of Housing found that suites could be developed in large urban centres for 40-50 per cent of the cost of the typical new one-bedroom unit.[39] They are suitable for single individuals, who make up a large share of the households in core housing need, and because many of the residents do not own a car, parking requirements are minimal.[40] And, while they are most common in urban centres, as long as they are in an area served by public transportation, they need not be situated right in the downtown core, where land costs are highest.

Of course, rooming houses and SROs are not without their problems. In some units, kitchens and bathrooms are shared, reducing privacy and safety for tenants, and necessitating a fairly high operating budget to ensure that shared quarters are properly maintained. And, in the broader community, rooming houses and SROs carry a social stigma, often due to a well-earned reputation for being poorly maintained, over-crowded and/or home to an "undesirable" element of the population. As a result, NIMBY (not in my backyard) sentiment can make it difficult to remove restrictions on this kind of housing from municipal development codes.

St. Clare's Multifaith Housing Society *(continued)*

sector consultants, who managed the project through its early stages, waiving their fees until funds were available. By the time 25 Leonard was purchased, new government funding for social housing had come on stream, and St. Clare's was able to proceed with the conversion of the building into affordable housing by drawing on a number of different funding sources. Key components included a grant from the Supporting Communities Partnership Initiative (SCPI), GST and PST rebates, waived municipal taxes and development charges, and a 5-year rent supplement commitment that covers the gap between the market rents St. Clare's charges and the Ontario Works single shelter rate. The St. Clare's Society also obtained a conventional first mortgage from First National Financial Corporation and a second mortgage from the Canadian Alternative Investment Co-op, which are amortized over the term of the rent supplement program. The conversion was completed in December 2001 and the building is now fully occupied.

The St. Clare's example is instructive in many respects. Because of the capital costs associated with construction, building new affordable housing generally requires substantial government funding. St. Clare's avoided many of those costs by converting an existing facility. And, they took an unusually entrepreneurial approach to assembling and deploying the public funds they did use – formulating a sound business plan, bringing in private sector stakeholders, and aiming from the start to develop affordable housing units that could eventually operate without ongoing government assistance. The non-profit organization chose as its namesake St. Clare, the 13th century nun and sister of St. Francis of Assisi, who was canonized for her work with the poor and homeless in medieval Italy. As her example was an inspiration for the St. Clare Housing Society, so, too, does their project at 25 Leonard offer a model for a new approach to building social housing aimed at identifying innovative and cost-effective solutions to community-specific needs.[1]

[1] For more information on the St. Clare's Multifaith Housing Society, please see the Homegrown Solutions page on the Canadian Housing Renewal Association website (http://www.chra-achru.ca/) or contact St. Clare's directly, at st.clare@sympatico.ca.

However, there has been some progress on this front. The Residential Rehabilitation Assistance Program (RRAP) provides support to all existing housing types, and CMHC's new flexibilities, which specifically target units of modest size and design, include rooming houses and SROs. Since many properties of this sort are older and/or in a state of disrepair, increasing funding for renovation and rehabilitation will help address some of the problems that have prompted governments to restrict their supply.

At the same time, more could be done to improve conditions in this kind of housing by bringing enhanced income supports into the mix – in particular, allowing welfare households to maintain their shelter benefits as they transition back into the workforce. This was one of the recommendations of a study done by the University of Winnipeg's Institute of Urban Studies, following a lengthy series of interviews with rooming house tenants in Winnipeg. In "Out of the Long Dark Hallway: Voices from Winnipeg's Rooming Houses", the authors suggest that income subsidies would help plug the shelter gap for rooming house tenants newly employed in part-time or low-paying work, thereby reducing the "revolving door" reality of this kind of housing.[41] Rooming houses and SROs may never be a popular option, either with tenants or the surrounding community, but for very low-income individuals, they can make the difference between being housed and being homeless. As such, they represent an important element in a comprehensive affordable housing strategy.

TD RECOMMENDATIONS:

- Provincial and municipal governments should step up their efforts to eliminate regulations that distort the proper functioning of the housing market. At the top of the priority list, regulations on rent increases should be steadily phased out, and, as we have already stated previously, imbalances in the property-tax system should be redressed and capital taxes should be eliminated.
- Municipal governments should take a closer look at zoning restrictions to determine if they are squeezing out an important affordable housing solution.

III. WHAT GOVERNMENTS NEED TO DO

The market imperfections that contribute to the shortage of affordable housing implicate all levels of government, which means that any effort to remove them will be part of the broader web of inter-governmental relations. And, that is quite appropriate, because a solution to the affordable housing problem will clearly require the full co-operation of all three levels of government.

Provinces need to step up to the plate

Over the last two years, as federal-provincial negotiations under the AHF agreement have gotten underway, a number of provincial governments have been dragging their feet. Following the April 2003 federal-provincial-territorial housing ministers' meeting in Winnipeg, federal housing minister David Collenette appeared to sound a warning signal in this regard, suggesting that the federal government would consider bypassing recalcitrant provinces and dealing directly with willing municipalities and other housing providers. Certainly, there is nothing to stop the federal government from taking such an action – and, it might help expedite affordable-housing development, especially in the short run. But, without a key funding partner, it would certainly reduce the scale of the overall program. Thus, while we recognize the fiscal strains the provinces are under, it is vital that they step up their efforts, and become a leading contributor within the AHF.

Municipalities need a new funding arrangement

At the same time, municipalities, which must be a key ingredient in any solution to the affordable housing crisis, are in no position to live up to their side of the bargain. On the one hand, new responsibilities have been laid at their doorstep by the provincial and federal governments as a result of downloading and offloading in recent years. Yet, on the other hand, municipalities currently have few revenue tools to draw on beyond the slow-growing (and somewhat flawed) property tax. This has placed them at a relative disadvantage compared to their federal and provincial counterparts with respect to their ability to meet taxpayer needs. As such, we now echo a call we have made in our earlier reports on urban issues that municipalities need to be given a more sustainable funding arrangement, one that will arm them with increased flexibility to tackle their own individual needs. In particular, municipalities should be given the power to levy their own municipal excise taxes, provided that the federal and provincial governments agree to free up the room by lowering their corresponding levies.

In and of itself, the idea of downloading programs from the federal and provincial governments to the municipal level makes a lot of sense – assuming commensurate funding is provided – since services can be better tailored for communities' unique needs. However, in areas where there are income-distributive aspects and/or where targeted recipients tend to be highly mobile – certainly the case with affordable housing – programs may be more effectively run under the auspices of provincial governments. As such, we see a need for the Ontario government to consider taking back funding responsibility for housing, as well as other social services. Nonetheless, there is a good argument that municipalities should continue to be involved in the actual delivery of social services.

TD RECOMMENDATIONS:

- Give municipalities a wider array of revenue sources – notably, the flexibility to levy their own excise taxes.
- Upload responsibility for social housing from the municipal level back up to the level of the provincial government in Ontario.

CONCLUSION

With Canadian governments still in the early stages of developing a new strategy to combat the affordable housing problem, the time is ripe to re-think the premises of that strategy. We have argued in this report that the conventional affordable housing paradigm is flawed and have proposed an alternative paradigm that we believe would provide a better solution to the problem. That paradigm suggests that the optimal policy for addressing the affordable housing problem is a combination of demand- and supply-side measures. Over the long term, a key goal must be to raise market incomes at the bottom end of the scale, but in the interim, governments need to provide adequate support at the lower end of the income scale. In the interim, these efforts must be complemented by measures to boost income subsidies and rectify the shortage of supply – by funding new supply, preserving existing stock, and removing market imperfections that contribute to shortages.

Interestingly, almost all of the literature on affordable housing focuses on supply side subsidies. And, most authors try to break down the required subsidies into so many elements – tax and expenditure. Is that necessary or even desirable? We think not. For the most part, capital grants are probably the most efficient way to go on the supply side. And, we would add that the focus should be directly on *affordable* rental housing, rather than the rental market more generally. There is no doubt that housing affordability would improve if the rental market as a whole worked better – certainly, higher overall supply would be unequivocally a good thing. But, for this to make an appreciable difference to the supply of affordable rental housing relies heavily on a belief in "trickle down" economics, for which the historical record provides little empirical support. In fact, for every dollar of public support for the overall market, the impact at the bottom end will be marginal. Accordingly, while market imperfections that hold back the general market should be removed, subsidies should be targeted at the bottom end for efficiency. That conclusion takes off the books a large number of recommendations from other studies – such as almost all of the tax recommendations, which do not address particular market failures and do not concentrate benefits at the affordable end.

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APPENDIX: FAMILY INCOME

FAMILY INCOME*

	Median Total Income (Constant 2000$)				**Median Total Income Current ($)**				**Median Market Income Current ($)**				**Average Household Income Owners Current ($)**				**Average Household Income Renters Current ($)**			
	Level	Compound Annual Growth Rate (%)			Level	Compound Annual Growth Rate (%)			Level	Compound Annual Growth Rate (%)			Level	Compound Annual Growth Rate (%)			Level	Compound Annual Growth Rate (%)		
	2000	91-95	96-00	91-00	2000	91-95	96-00	91-00	2000	91-95	96-00	91-00	2000	91-95	96-00	91-00	2000	91-95	96-00	91-00
Canada	44,036	-1.4	1.6	0.1	44,036	0.8	3.3	2.0	38,484	0.1	4.0	2.1	70,340	1.2	3.5	2.3	36,008	-0.4	3.3	1.4
Vancouver	44,889	-2.3	0.7	-0.8	44,889	0.9	1.7	1.3	39,852	0.6	1.8	1.2	76,940	1.0	3.0	2.0	41,220	0.9	2.6	1.8
Calgary	50,537	0.2	2.5	1.4	50,537	2.7	5.0	3.8	45,852	1.9	5.7	3.8	87,185	1.2	4.6	2.9	42,605	-0.2	5.3	2.5
Edmonton	49,245	-2.4	2.5	0.0	49,245	-0.1	4.6	2.2	44,834	-0.6	5.5	2.4	74,859	0.6	4.0	2.3	36,350	-0.8	4.4	1.8
Regina	---	---	---	---	---	---	---	---	---	---	---	---	69,187	1.6	2.8	2.2	29,741	-0.7	2.6	1.0
Winnipeg	42,000	-1.2	1.3	0.1	42,000	1.5	3.3	2.4	36,636	2.0	3.0	2.5	67,083	1.5	3.3	2.3	29,989	-0.3	3.2	1.5
Toronto	54,107	-1.4	2.7	0.6	54,107	0.4	4.6	2.5	49,525	0.5	4.9	2.7	94,589	0.5	4.4	2.4	45,285	-1.1	3.8	1.3
Ottawa	51,312	-2.7	1.4	-0.7	51,312	-0.3	3.2	1.5	47,000	-0.6	3.4	1.4	88,966	0.8	4.1	2.4	41,927	-1.0	4.3	1.6
Montreal	40,326	-2.1	2.5	0.2	40,326	0.0	4.2	2.1	34,899	-0.4	5.3	2.4	72,903	0.6	3.4	2.0	34,410	-0.8	3.7	1.5
Halifax	41,790	-2.3	1.9	-0.2	41,790	-0.3	3.8	1.7	36,607	-1.5	4.4	1.4	70,428	0.8	3.2	2.0	33,689	-1.2	2.5	0.6

* All figures are from Statistics Canada's Survey of Labour Income and Dynamics with the exception of the owner/renter breakdown, which are from the Census.
Source: Statistics Canada Survey of Labour Income and Dynamics; Census 2001; TD Economics

FAMILY INCOME (Current Dollars)

	Median Total Income				**Low-Income Rate**		**Lone-Parent Families Median Total Income**				**Elderly Families Median Total Income**				**Single Median Total Income**			
	$ Level	Compound Annual Growth Rate (%)					$ Level	Compound Annual Growth Rate (%)			$ Level	Compound Annual Growth Rate (%)			$ Level	Compound Annual Growth Rate (%)		
	2000	91-95	96-00	91-00	1990	2000	2000	91-95	96-00	91-00	2000	91-95	96-00	91-00	2000	91-95	96-00	91-00
Canada	44,036	0.8	3.3	2.0	14.6	14.6	30,088	3.4	7.0	5.2	36,723	2.1	1.2	1.6	16,686	3.0	2.8	2.9
Vancouver	44,889	0.9	1.7	1.3	17.3	19.6	29,615	3.5	2.4	3.0	43,140	3.3	1.4	2.3	23,208	1.7	7.0	4.3
Calgary	50,537	2.7	5.0	3.8	19.2	13.6	40,937	0.4	14.4	7.1	36,723	4.1	-3.2	0.4	18,358	5.5	4.2	4.9
Edmonton	49,245	-0.1	4.6	2.2	16.2	14.7	29,204	1.6	6.9	4.2	40,470	-1.9	1.9	0.0	19,664	3.9	2.9	3.4
Regina	---	---	---	---	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Winnipeg	42,000	1.5	3.3	2.4	20.3	19.9	26,794	5.8	3.9	4.9	40,606	-0.2	1.1	0.5	17,209	4.1	1.8	2.9
Toronto	54,107	0.4	4.6	2.5	14.4	13.2	39,358	7.0	12.7	9.8	42,052	3.1	-2.2	0.4	19,064	1.3	5.5	3.4
Ottawa	51,312	-0.3	3.2	1.5	13.8	18.2	42,765	2.3	15.6	8.7	46,110	2.5	-1.0	0.7	18,673	-7.4	5.3	-1.3
Montreal	40,326	0.0	4.2	2.1	23.6	22.6	30,907	9.4	2.0	5.6	35,736	0.5	0.9	0.7	16,613	4.0	3.9	4.0
Halifax	41,790	-0.3	3.8	1.7	13.4	17.1	20,442	5.1	2.0	3.5	34,765	3.5	-2.7	0.4	16,250	-1.1	1.1	0.0

Source: Statistics Canada Survey of Labour Income and Dynamics; Census 2001; TD Economics

HOUSING STOCK IN 2001*

	Thousands of Units					Composition of Total Rental Units								
						Primary Rental Market					Secondary Market^			
	Total	Owned	% Share	Rented	% Share	Total	Share of Total Rented	Private bach & 1 bdrm	Private 2+ bdrm	Public	Total	Share of Total Rented	Rental Units in Need of Maj. Repairs	% of Total
Canada	11,517.6	7,610.4	66.1%	3,907.2	33.9%	2,283.5	58.4%	792.2	1,007.3	443.8	1,623.7	41.6%	364.4	9.3%
Vancouver	758.4	462.6	61.0%	295.7	39.0%	145.4	49.2%	77.4	31.0	35.2	150.4	50.8%	27.0	9.1%
Calgary	356.1	251.5	70.6%	104.6	29.4%	61.4	58.7%	24.0	25.3	11.5	43.2	41.3%	9.3	8.9%
Edmonton	355.9	236.3	66.4%	119.6	33.6%	86.2	72.1%	36.1	36.3	13.2	33.4	27.9%	10.5	8.8%
Regina	76.7	52.3	68.2%	24.3	31.8%	16.4	67.4%	6.0	6.3	4.0	7.9	32.6%	2.4	10.0%
Winnipeg	269.9	176.8	65.5%	93.1	34.5%	72.4	77.7%	31.8	21.9	17.8	20.7	22.3%	9.3	9.9%
Toronto	1,634.7	1,033.5	63.2%	601.3	36.8%	431.2	71.7%	147.8	156.2	121.1	170.0	28.3%	64.7	10.8%
Ottawa	415.9	256.4	61.7%	159.5	38.3%	89.5	56.1%	33.2	33.8	21.4	70.0	43.9%	15.0	9.4%
Montreal	1,417.4	711.5	50.2%	705.9	49.8%	514.6	72.9%	177.0	273.2	52.1	191.3	27.1%	58.2	8.2%
Halifax	144.4	89.2	61.8%	55.2	38.2%	41.8	75.6%	16.4	18.9	5.8	13.5	24.4%	5.0	9.0%

* Excludes band housing; ^ Comprises basement apartments, apartments over storefronts, row houses, and rented condominiums. Estimated as difference between Census count on rental stock, and that from CHMC's Rental Market Survey, of which the latter only includes primary rental units.
Source: Census 1991, 1996, 2001, CMHC, TD Economics

CHANGE IN HOUSING STOCK 1991-2001 *

	Total				Owned				Rented			
			Comp. Ann % change				Comp. Ann % change				Comp. Ann % change	
	1991	2001	1991-96	1996-01	1991	2001	1991-96	1996-01	1991	2001	1991-96	1996-01
Canada	9,991.6	11,517.6	1.5	1.3	6,272.0	7,610.4	1.9	2.0	3,719.5	3,907.2	1.0	0.0
Vancouver	609.3	758.4	2.6	1.8	350.2	462.6	3.3	2.4	259.0	295.7	1.7	1.0
Calgary	275.8	356.1	2.1	3.1	167.4	251.5	3.6	4.7	108.5	104.6	-0.6	-0.1
Edmonton	305.8	355.9	0.9	2.2	181.2	236.3	2.6	2.8	124.6	119.6	-1.9	1.1
Regina	71.7	76.7	0.8	0.5	47.4	52.3	0.8	1.2	24.3	24.3	0.9	-0.8
Winnipeg	252.2	269.9	0.8	0.6	156.4	176.8	1.4	1.1	95.8	93.1	-0.3	-0.3
Toronto	1,366.7	1,634.7	1.7	1.9	792.1	1,033.5	1.9	3.5	574.6	601.3	1.5	-0.6
Ottawa	349.3	415.9	2.0	1.6	194.3	256.4	3.2	2.4	154.9	159.5	0.4	0.2
Montreal	1,235.7	1,417.4	1.7	1.1	577.0	711.5	2.4	1.8	658.7	705.9	1.0	0.4
Halifax	118.3	144.4	1.5	2.5	68.6	89.2	2.2	3.2	49.7	55.2	0.6	1.6

* Excludes band housing. Source: Census 1991, 1996, 2001, CMHC, TD Economics

APPENDIX: VACANCY RATES AND RENTS

VACANCY RATES AND RENTS

	ALL RENT LEVELS								BOTTOM 40% BY RENT LEVEL							
	Average Vacancy Rate				Average Rent Level 2002	Comp. Ann. Change (%)			Average Vacancy Rate				Average Rent Level 2002	Comp. Ann. Change (%)		
	1989	1992	2001	2002	$	1990-97	1998-01	2002	1989	1992	2001	2002	$	1990-97	1998-01	2002
1 bedroom																
Canada	3.1	4.9	1.8	2.3	626	2.3	3.6	3.3	4.7	7.1	2.8	2.6	435	1.4	2.2	3.6
Vancouver	0.4	1.7	1.0	1.6	743	3.1	2.0	2.3	0.3	2.3	3.0	2.3	625	3.4	1.2	3.8
Calgary	1.4	5.4	1.1	2.6	656	1.1	6.2	2.4	0.9	3.7	0.9	2.2	575	2.1	6.7	4.5
Edmonton	2.6	4.0	0.8	1.8	575	1.3	5.8	7.1	4.3	4.8	0.9	1.5	485	0.9	5.9	10.2
Regina	7.2	3.9	2.2	2.5	480	1.0	2.8	0.8	9.4	5.3	3.5	3.0	400	0.9	2.7	0.0
Winnipeg	7.6	7.7	1.6	1.5	490	1.0	1.6	2.9	8.1	8.0	3.1	2.1	400	1.2	1.7	3.1
Toronto	0.5	2.0	1.0	2.8	891	3.3	6.0	2.9	0.1	0.9	0.7	2.3	774	4.2	5.7	5.0
Ottawa	1.4	1.5	0.9	2.3	767	2.9	6.0	0.7	1.5	1.1	0.4	1.7	679	3.0	5.2	4.5
Montreal	5.6	9.1	0.6	0.7	505	0.7	2.5	6.1	5.7	10.4	0.7	0.6	375	0.7	1.4	4.2
Halifax	3.4	5.9	2.5	2.3	572	1.0	2.3	3.2	6.2	7.0	4.7	4.1	450	0.5	2.0	0.0
2 bedroom																
Canada	2.8	4.8	1.7	2.0	695	2.0	3.0	3.3	3.8	6.6	2.3	2.1	475	1.4	1.1	3.3
Vancouver	0.5	1.6	1.0	1.3	955	2.5	1.9	3.6	0.2	1.9	1.2	1.7	750	2.7	1.2	2.7
Calgary	0.8	6.0	1.2	3.2	802	1.9	5.3	2.4	0.8	7.2	1.5	3.4	700	1.8	5.7	3.7
Edmonton	1.5	4.0	1.0	1.7	710	1.2	5.7	8.1	2.2	3.1	1.4	1.6	600	1.5	5.5	7.7
Regina	6.5	3.3	2.0	1.6	584	0.9	2.6	2.3	9.4	4.4	2.6	2.5	520	0.9	2.9	3.0
Winnipeg	5.4	4.3	1.1	0.8	621	1.1	1.6	2.6	4.6	4.6	2.2	1.2	506	1.4	1.9	2.0
Toronto	0.4	2.2	0.8	2.4	1047	3.0	5.7	1.9	0.0	0.5	0.5	1.7	895	4.3	5.0	5.3
Ottawa	1.4	1.1	0.8	1.6	931	2.3	5.8	1.6	1.2	0.5	0.2	1.7	800	3.1	4.4	3.9
Montreal	4.1	7.5	0.5	0.5	552	0.8	1.9	4.3	4.3	8.0	0.8	0.6	425	0.8	1.2	1.2
Halifax	3.6	6.2	3.5	3.4	705	1.4	2.3	4.6	5.2	7.0	6.5	5.6	560	1.1	2.4	1.8

Source: CMHC, TD Economics

ENDNOTES

1. Canada Mortgage and Housing Corporation, "Special Studies on 1996 Census Data: Canadian Housing Conditions," *Socio-economic Series, Issue 55-1.*

2. Canada Mortgage and Housing Corporation, "Special Studies on 1996 Census Data: Canadian Households in Core Need and Spending at Least Half Their Income on Shelter," *Socio-economic Series, Issue 55-7.*

3. *Ibid.*

4. *Ibid.* For the data on off-reserve, non-farm aboriginal households, see Canada Mortgage and Housing Corporation, "Special Studies on 1996 Census Data: Housing Conditions of North American Indian, Métis and Inuit Households in Canada," *Socio-economic Series, Issue 55-10.*

5. LICOs (Low Income Cutoffs) are popularly described as the income level where a family will tend to spend a significantly higher proportion of its income on food, shelter and clothing than the average family. When this measure was first developed using 1959 Family Expenditure Survey data, the average household spent 50 per cent of its pre-tax income on food, shelter and clothing. Twenty percentage points were added to this figure, on the rationale that a family spending over 70 per cent of its income on essentials could be regarded as being in "straitened circumstances". This 70 per cent threshold was then converted to a set of Low Income Cutoffs that vary by family size and community size. Citation from Maryanne Webber, Income Statistics Division, "Measuring Low Income and Poverty in Canada: An Update," Catalogue No. 98-13, Statistics Canada, May 1998, p. 1.

6. Barbara Murphy, *On the Street: How We Created Homelessness,* J. Gordon Shillingford Publishing Inc., 2000, p. 12.

7. Unpublished transcript, "Mental Illness and Pathways into Homelessness Conference," January 16, 1998, p. 6.

8. *Ibid.*, p. 5.

9. Mary Beth Shinn, Beth C. Weitzman, Daniela Stojanovic, James R. Knickman, et al., "Predictors of Homelessness Among Families in New York City: From Shelter Request to Housing Stability," *American Journal of Public Health*, vol. 88. no. 11, pp. 1651-1657.

10. Beginning in 1972, the federal government introduced a series of reforms that changed the treatment of rental housing under the tax code. The changes were introduced to dampen speculation in real estate markets, which was rife at the time, but their impact was more far-reaching. The principal reforms affected the tax deductibility of depreciation on rental properties. Prior to 1972, all investors in rental housing were permitted to treat depreciation on a building – often referred to as a capital cost allowance (CCA) – as an expense that could be deducted from their taxable income. And, when the sale of a property triggered the recapture of this depreciation, investors could avoid the tax penalty if they applied the proceeds of the sale toward the purchase of another property of equal or greater value – a feature known as "pooling".

    After 1972, the use of "pooling" was prohibited for all investors in rental housing, and only principal business corporations were eligible to use depreciation as a deductible expense. Other changes followed, including new restrictions on the use of "soft costs" incurred during the construction, renovation or alteration of a rental building as a deductible expense (essentially, costs not related to the acquisition of land, building or equipment), and the introduction of capital gains taxes on rental properties. These reforms reduced the appeal of investing in rental properties for all investors, but especially for "casual" ones – investors not principally in the real estate business. And, the combined effect was not limited to quelling speculative buying and selling of existing rental properties – it also dampened construction of new properties for decades to come.

    For more information, see Housing Supply Working Group, "Affordable Rental Housing Supply: The Dynamics of the Market and Recommendations for Encouraging New Supply," Interim Report, May 2001, pp. 19-21; also, see Clayton Research Associates Limited, "The Rental Housing Problem in Ontario and What To Do About It," prepared for The Fair Rental Policy Organization, September 2000, p. 5.

11. *Ibid.*, p. 7.

12. At the federal level, the 1974 Assisted Rental Program (ARP) gave developers grants, and later interest-free loans to build new rental housing. The Canadian Rental Supply Plan (CRSP) provided interest-free loans where payments were not required for 15 years to developers between 1981 and 1983. The Multiple Unit Residential Building (MURB) program allowed owners of newly constructed multi-unit buildings to claim losses resulting from capital cost depreciation (the capital cost allowance referred to

in endnote 10, above) against other income between 1974 and 1981. Strictly speaking, it was a tax incentive program to support affordable housing, but many MURB projects were partially financed through ARP, making it difficult to disentangle the two. See Clayton Research Associates, "The Rental Housing Problem in Ontario," p. 6 and footnote; J. David. Hulchanksi, "Housing and a Sustainable Social Fabric," Review Draft, CPRN Project F-83, p. 7; Michael Shapcott, Housing for All Canadians: A Nation-Wide Crisis Requires a National Solution," submission to the TD Forum on Canada's Standard of Living, August 28, 2002, p. 2.

13. Several major changes were introduced. First, CMHC doubled the premium for a high-ratio mortgage, from 2.5 per cent to 5 per cent. Second, it applied a minimum 9 per cent capitalization rate to new projects, instead of the prevailing market rate – which, typically, varies by projection to reflect different local market conditions and perceived risk. This reduced the base lending value of the property, thereby reducing the size of the available mortgage. Third, it required a minimum 1:1 debt-coverage ratio for all new mortgages, based not on prevailing mortgage rates, but mortgage payments assuming a 9-per-cent mortgage rate amortized over 35 years. While not particularly onerous initially, these criteria became progressively more burdensome over the ensuing years, as falling capitalization and mortgage rates in the broader market opened up an ever wider gap with CMHC's fixed terms. See Greg Lampert and Steve Pomeroy, "Promoting a Positive Mortgage Insurance Environment for New Rental Construction," prepared for the Research Subcomittee of the Housing Supply Working Group, Ontario Ministry of Municipal Affairs and Housing, March 2002, pp. 5-10.

14. *Ibid.*

15. The Starr Group Inc. "Secondary Rental Market Study," prepared for the Ontario Ministry of Municipal Affairs and Housing & CMHC, April 2000.

16. Federation of Canadian Municipalities, "A National Affordable Housing Strategy," October 2000; Prime Minister's Task Force on Urban Issues, "Canada's Urban Strategy: A Blueprint for Action," Final Report released November 2002.

17. Federation of Canadian Municipalities, "A National Affordable Housing Strategy," Section 3.

18. *Ibid.*

19. Shapcott, "Housing for All Canadians," pp. 7-8.

20. Congress of Aboriginal Peoples website, section on Urban Native Housing Program, at http://www.abo-peoples.org/programs/housing.html.

21. Canadian Housing and Renewal Association, "Municipal Initiatives - Stemming the Loss of Rental Stock," October 2002.

22. See Canada Mortgage and Housing Corporation website, "Improving Housing Quality and Affordability," at www. cmhc-schl.gc.ca.

23. Judith Maxwell, "Smart Social Policy - Making Work Pay," submission to the TD Forum on Canada's Standard of Living, August 28, 2002, Executive Summary, p. 2.

24. *Ibid.*, p. 11

25. *Ibid.*, pp. 11-12

26. Steve Pomeroy, "Toward a Comprehensive Affordable Housing Strategy for Canada," Caledon Institute of Social Policy, October 2001, pp. 18-21.

27. *Ibid.*, p. 21.

28. Examples include "An Evaluation of Housing Taxation Measures," Canada Mortgage and Housing Corporation, and Housing Supply Working Group, "Affordable Rental Housing Supply."

29. See, for example, Kirk McClure, "The Low-Income Housing Tax Credit as an Aid to Housing Finance: How Well as It Worked?", Fannie Mae Foundation, 2000.

30. These arguments against tax-free bonds are summarized in, Jack Mintz, "Why Tax-Exempt Municipal Bond Financing is Bad Policy," National Post, May 14, 2002.

31. Indeed, some argue that the tax loss would be minimal and that under some assumptions of the supply response, governments

might not lose any tax revenue and could even be fiscal winners. A healthy dose of skepticism should be applied to such claims – they were very common in the era when governments were building up massive deficits. Unless the tax change addressed a market distortion, it can be argued that if governments fully recovered the direct revenue loss, the tax change was not needed at all – private market participants would likely have come together to bring about the new activity on their own.

32. McClure, p. 111.

33. Ontario Non-Profit Housing Association, “Response to CMHC Public Consultation on Housing Renovation Programs,” August 2002, p. 5.

34. Steve Pomeroy, “Toward a Comprehensive Affordable Housing Strategy for Canada,” p. 17.

35. *Ibid.*, p. 11

36. See Canadian Housing and Renewal Association, “Municipal Initiatives - Stemming the Loss of Rental Stock.”

37. Steve Pomeroy, “Toward a Comprehensive Affordable Housing Strategy for Canada,” p. 16.

38. For an excellent defense of this proposition, see Michael Poulton, “Affordable Homes at an Affordable (Social) Price,” in *Home Remedies: Rethinking Canadian Housing Policy*, The Social Policy Challenge 6, eds. John Richards and William G. Watson, C.D. Howe Institute, Renouf Publishing Company Limited, 1995, pp. 50-122.

39. *Ibid.*

40. *Ibid.*

41. Jino Distasio, Michael Dudley and Mike Maunder, “Out of the Long Dark Hallway: Voices from Winnipeg’s Rooming Houses,” Institute of Urban Studies, University of Winnipeg, November 2002, p. 58.