OPINION

These two fixes for the housing crisis have a bigger impact than Ottawa's policies

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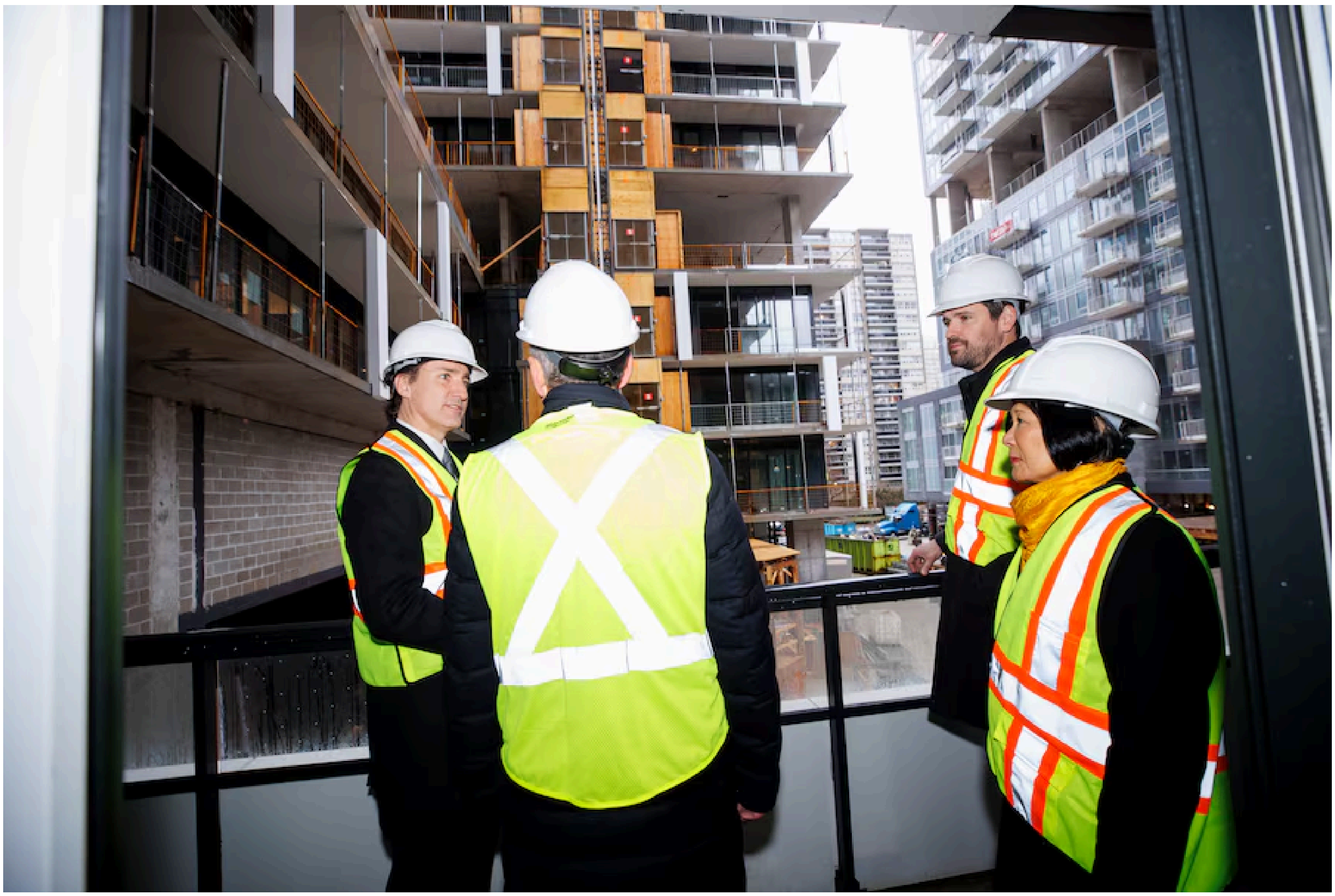

Prime Minister Justin Trudeau, alongside Housing Minister Sean Fraser (back right) and Toronto Mayor Olivia Chow (right), tour an under-construction condo tower in midtown Toronto on April 3.

COLE BURSTON/THE CANADIAN PRESS

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Governments at all levels are finally treating the housing affordability crisis with the urgency it deserves. The latest federal budget produced the most aggressive array of housing policies in generations.

The decision to tackle the demand side of the equation by capping the number of non-permanent residents is a giant step in the right direction. Governments are also showing more openness to dramatically changing the role of rental activity in the country's housing mix. Simply put, the propensity to rent in Canada must rise, and the market should realign to increase the supply of rental units. Better availability of low-cost financing for purpose-built rentals along with the recent removal of the GST/HST on the construction of rental units are already starting to change the math.

But that's not enough. Here are two changes that would have an even bigger impact.

The first is the treatment of the capital gains tax upon the sale of a commercial property, such as an apartment building. In the United States, 1031 exchange is a mechanism whereby a gain on the sale of a commercial real estate asset may be deferred for tax purposes by acquiring a new "like-kind" property. That reinvestment incentive can be used by investors of all types: individuals and trusts to businesses of all sizes.

The logic here is that 1031 exchange creates a more dynamic environment as U.S. developers move quickly from one project to another in order to avoid the tax. Importantly, developers that build and sell improved real estate, as well as "flippers," cannot take advantage of a 1031 exchange – their real estate is considered inventory and is specifically excluded from tax-deferral treatment under the code.

A 2022 study by Ernst and Young quantified not only the direct impact on U.S. taxpayers engaged in 1031 exchange, but also the additional stream of indirect economic activity. Over all, 1031 exchange generated close to an estimated 600,000 jobs, US$30-billion of labour income along with US$55-billion in value added GDP in 2021. In addition to contributing to federal, state and local tax revenue owing to increased activity, the study found that the code works to reduce the cost of capital and therefore increases capital spending in a faster and more efficient way.

Unfortunately, with some exceptions, that mechanism does not exist in Canada. The current tax environment in Canada discourages such dynamism. Adopting the U.S. model would not only incentivize the development of rental units in Canada but also, at the margin, it would improve economic growth and efficiency.

Another way to dramatically increase rental supply is to rely heavily on the concept of a secondary rental suite.

The government of Canada intends to introduce a Canada Secondary Suite Loan Program, enabling homeowners to access up to $40,000 in low-interest loans. That's a positive development. But what we really need are incentives for developers to build homes with secondary suites.

This will result in a market-driven dramatic change in our current collective mindset into one that treats the house as a money generating business by adding accessory dwelling units, or ADUs, to the property. This is a win-win-win-win.

Win No. 1 one is the homeowner's affordability as rental income supports the mortgage payment. SVN Rock Advisors, which formalized that concept in a recent book series titled *The Self-Funding House*, estimates that the income requirements for mortgages can drop by 30 per cent to 60 per cent.

Win No. 2 is for the renter, since the average rent on those units is estimated to be 20 per cent lower than that of conventional apartments.

Win No. 3 is for the environment, since existing infrastructure is getting both a house and rental in the footprint of one house.

Win No. 4 is safety, as those new units will be built to code as opposed to many existing secondary units where safety is unfortunately compromised.

Granted, this is not exactly optimal. Home buyers would ideally prefer not to be landlords. But the reality is that given the fundamentals of the housing market, the choice is increasingly between a self-funding house or no house at all.

Common sense suggests that demand for such units will only rise. Developers will have a golden opportunity to capitalize on this trend. The concept is already being tested successfully in areas such as Ontario's Niagara region, Ottawa, Southwestern Ontario and Alberta.

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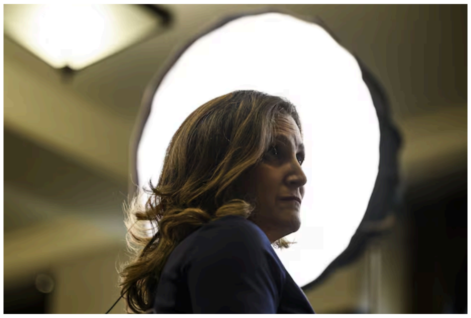

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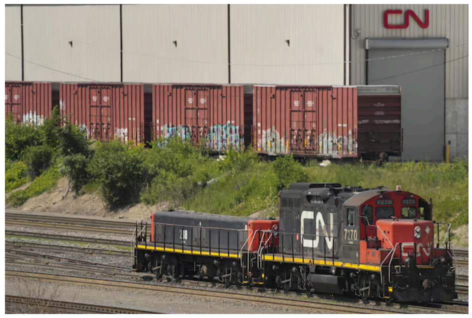

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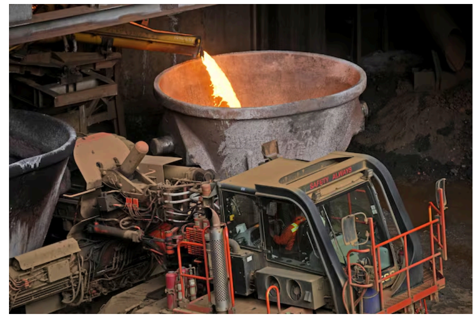

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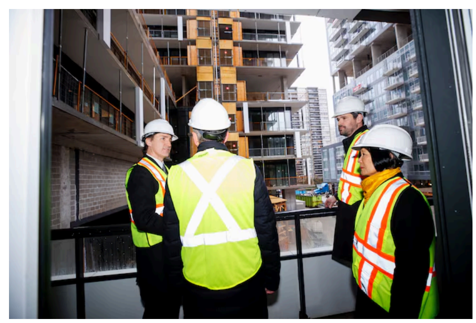

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