

April 2019



Understanding BC's History of Rent Controls and Tax Policy To Improve Today's Rental Housing Crisis

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LandlordBC is a non-profit association representing owners and managers of rental housing in British Columbia. As the industry leader, LandlordBC's mandate is to advocate for the betterment of the rental housing industry for the good of landlords and tenants alike. LandlordBC is committed to maintaining a proactive and positive collaborative relationship with government, media and all stakeholders to promote a balanced and healthy rental housing market in British Columbia. The association also provides education and support to landlords across the province including educational events, networking gatherings, webinars, publications, and programs like the Landlord Registry™.

Date Released: April 2019

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EXECUTIVE SUMMARY

It is generally agreed that today, British Columbia, and in particular the province's large urban centres, is challenged by a rental housing supply and unaffordability crisis. Understanding that approximately one-third of British Columbians live in rental housing, the magnitude of this current rental housing crisis is widespread and negatively impacts the province's entire economy.

The purpose of this report is to analyze the history of rent controls and tax policy to understand how the province came to be challenged by the rental housing crisis now impacting British Columbia, and what lessons can be learned from this history to improve the rental housing environment today and into the future for the benefit of British Columbians.

Analysis

While it is widely claimed that the vast majority of purpose-built rental housing was constructed due to tax benefits prior to the mid-1970s, this paper demonstrates that these benefits of deferred taxation were of far less value than believed. What has been overlooked is that at the same time that the Federal government implemented tax reform, the regulatory environment in which landlords operated drastically changed. Rent control and stringent rent regulations were introduced in the mid-1970s, permanently altering investors' view of the multi-family rental building business. In addition, the Strata Titles Act of 1966 and 1974 gave multi-family residential developers a lucrative alternative: building condominiums.

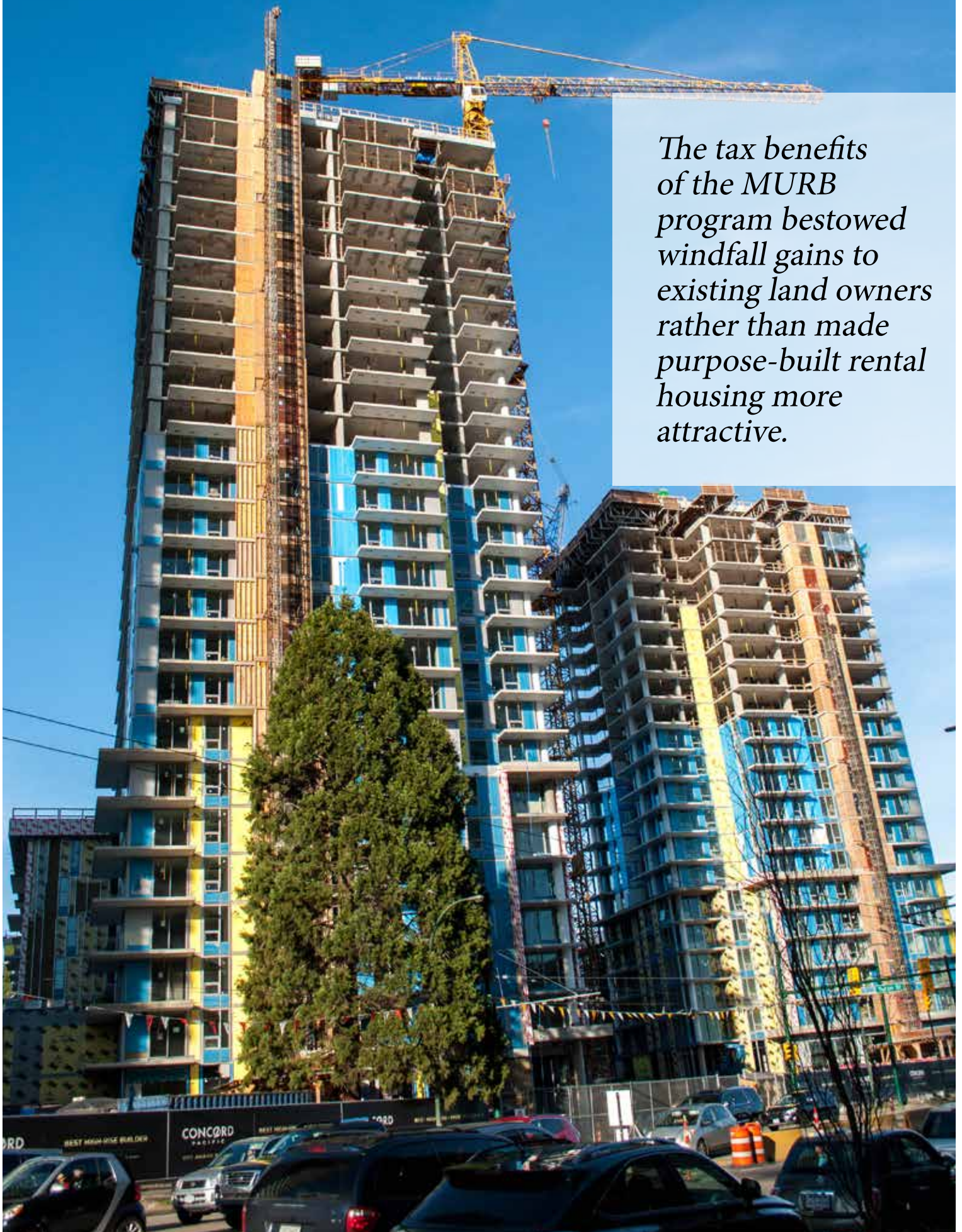
While deferred taxation offered benefits to the multi-family residential developer prior to 1972, we calculate that the present value of these benefits was less than 7.5% of a wood-framed building's value and less than 2.5% of a high-rise building's value. In contrast, today's lower interest rates offer far more benefits to the multi-family residential landlord. In the 1960s, a typical mortgage rate was about 7.5% and in the late 1970s (at the height of the

Multiple Unit Residential Building program) an average mortgage rate was about 10.5%. We calculate the present value of today's lower mortgage rate (roughly 3.5%) is a least 12% and as much as 62% of a building's value. Yet, purpose-built rental housing construction still lags tremendously behind condominium construction.

Research shows the tax benefits of the well-known MURB program were capitalized into land values and, as such, the returns on these investments were no different than non-MURB projects. As a result, the tax benefits of the program bestowed windfall gains to existing land owners rather than made purpose-built rental housing more attractive. The success of this program hinged critically upon the distinction that virtually all MURB projects

The Strata Titles Act of 1966 and 1974 gave multi-family residential developers a lucrative alternative: building condominiums.

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were strata titled, and not purpose-built rental, enabling investors to sell the units of such projects into the ownership market to reap their returns. The rental industry was free from rent control and restrictive regulations before the 1970s. Once rent controls and restrictive regulations were introduced into the rental market, investors viewed condominium development as more attractive as it was free of price controls. In fact, condominium prices were supported by a Federal capital gains tax exemption on principle residences. As a result of these factors, purpose-built rental construction plummeted in comparison to condominiums.

Conclusion

Rent controls are incredibly destructive to the rental housing industry for potential rental developers, landlords, and renters. Ninety five percent of economists believe that rent controls have a negative effect on the quality and quantity of housing in the cities that have used them. Economic studies have also

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Recommendations

To create the necessary supply of rental housing to meet the existing and growing demand across British Columbia, **without taxpayer subsidies**, the following policies are required:

1. Immediately exempt newly built market purpose-built rental buildings from all rent controls. **The exemption would only apply to newly built market purpose-built rental buildings constructed after this proposed exemption policy was implemented by Government.** Furthermore, it will only apply to those buildings which will be maintained as secure purpose-built rental housing into perpetuity. The exemption would be **guaranteed** for a minimum of 20 years;
2. Equalization of land values between condominium and rental development by granting zoning variances for market rental developments including increased density, reduced parking requirements, reduced amenity space, reduced unit sizes, and no community amenity contributions; and,
3. Removal of the tax disadvantages to rental relative to condominium development, and in particular, the Federal GST charged on a "self-supply" of new rental housing.

UNDERSTANDING BC'S HISTORY OF RENT CONTROLS AND TAX POLICY TO IMPROVE TODAY'S RENTAL HOUSING CRISIS

It has been widely claimed that favourable tax incentives resulted in the vast majority of the market rental housing development in Metro Vancouver during the 1950s, 60s, and 70s. The commonly held belief is that after such policies were withdrawn, rental housing development suffered and that has caused a market rental housing shortage. Many research papers on taxation policy have argued that tax incentives were the main reason for the rental housing construction boom of past decades and their elimination the reason for the dearth of rental housing supply since.

And there is ample evidence of the media citing various commentators arguing that tax measures produced most of the affordable rental housing found around Vancouver today.

While our industry is very much in favour of efficient tax proposals for market rental housing construction, what these research papers and commentators ignore when analyzing the stunning falloff in rental apartment supply is changes to the regulatory environment. Specifically, rent control.

Rent control was introduced in British Columbia, and across Canada, in the mid-1970s and vastly hindered the ability of

landlords to recover their cost increases just at the time inflation was spiking. It was a massive change to the business of rental housing and was met with vehement opposition by rental housing providers at the time. In addition, in 1966, the Provincial government had introduced the ability for developers to sell their apartment units as condominiums to end owner-users. This new legislation, modified and updated in 1974, gave real estate developers a lucrative alternative to rental housing construction that was free from price controls. We will show that these two changes to the business environment for housing had a massive impact and were predominant in

effect rather than changes to taxation policy, which was secondary and relatively minimal in impact.

This paper summarizes the history of taxation policy, rent control and regulation of the rental housing industry in British Columbia (see the Appendix for a simplified timeline). It offers an examination of the policies that led to rental housing construction in Metro Vancouver's past and the unfavourable policies that have resulted in its diminished new supply.

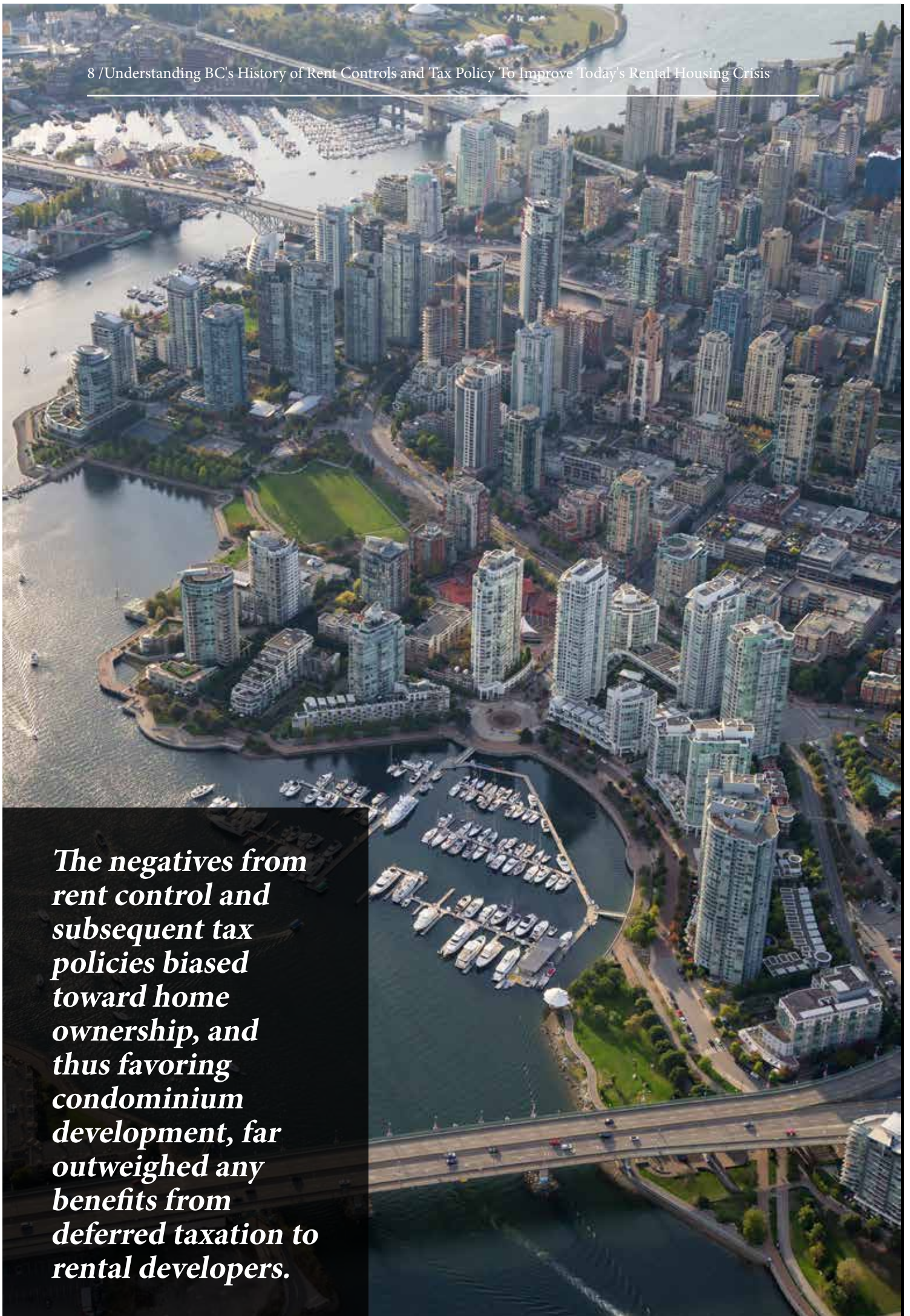
The tax benefits offered before 1972, and during 1974 to 1981 with the Multiple Unit Residential Building (MURB) program, were too modest to be responsible for the substantial rental construction during the 1950s, 60s, and 70s and its subsequent drop off until today. Rather, the absence of rent control and prohibitive regulations were

much more responsible for the high level of rental housing construction during that period. The introduction of stringent rent control and regulations in the mid-1970s created a detrimental and uncertain business environment for rental housing providers at the exact time real estate developers were given a more viable and business friendly alternative: building condominiums. As a result, after the mid-1970s the supply of new rental housing diminished drastically and condominium construction flourished. The negatives from rent control and subsequent tax policies biased toward home ownership, and thus favoring condominium development, far outweighed any benefits from deferred taxation to rental developers.

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Changes to Purpose Built Rental Supply, Households, Rents, and the Secondary Market

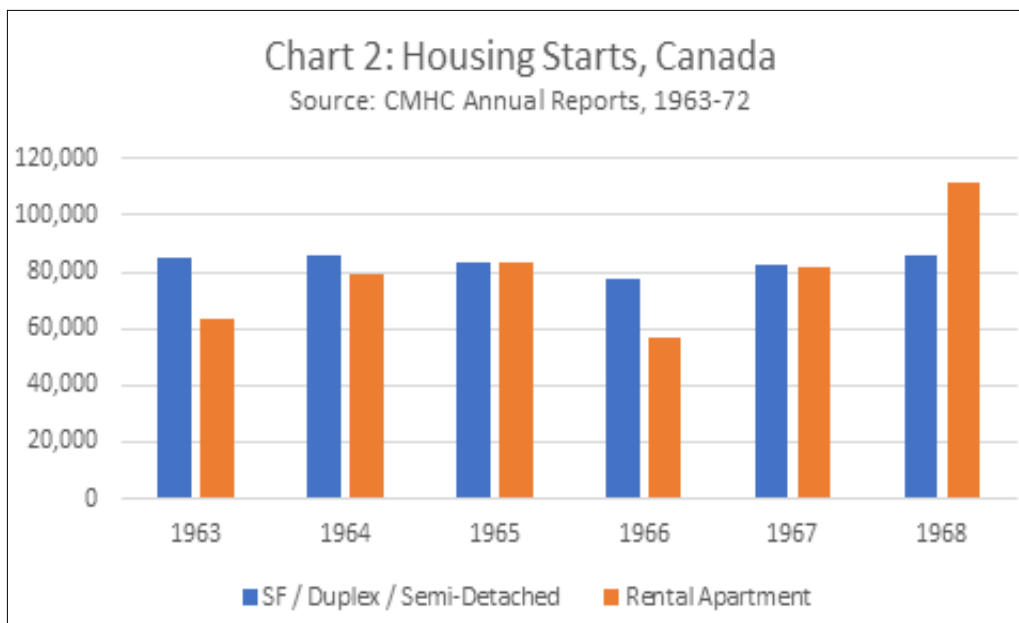
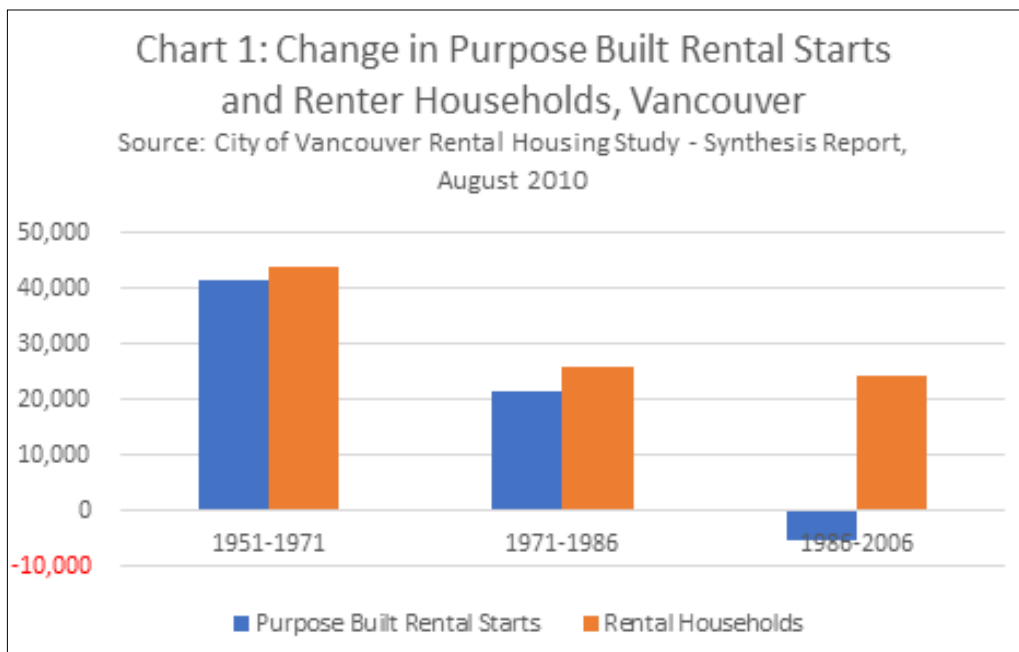
Purpose-built rental development averaged approximately 2,000 units per year from 1951 to 1971 in City of Vancouver (see Chart 1). The 20-year period from 1951 to 1971 resulted in the rental housing stock more than doubling from 37,445 to 78,985 units. Between 1958 and 1973, 35,019 rental units were added citywide in Vancouver, which by 2010 comprise 68% of the rental housing stock. In contrast, in the 36 years subsequent to 1973, only 7,121 units have been added to the rental housing pool until

2010, or 13.7% of the total rental pool¹.

Also since 1973, Vancouver's population has increased from approximately 419,000 in 1973 to approximately 631,000 today. That means only 1 new unit of rental housing was produced for every 30 new residents over the 1973-2016 period.

Chart 1 demonstrates that rental housing construction generally kept pace with rental household growth from the 1950s through the 1970s. Subsequently, rental housing construction fell off dramatically while rental households continued to grow.

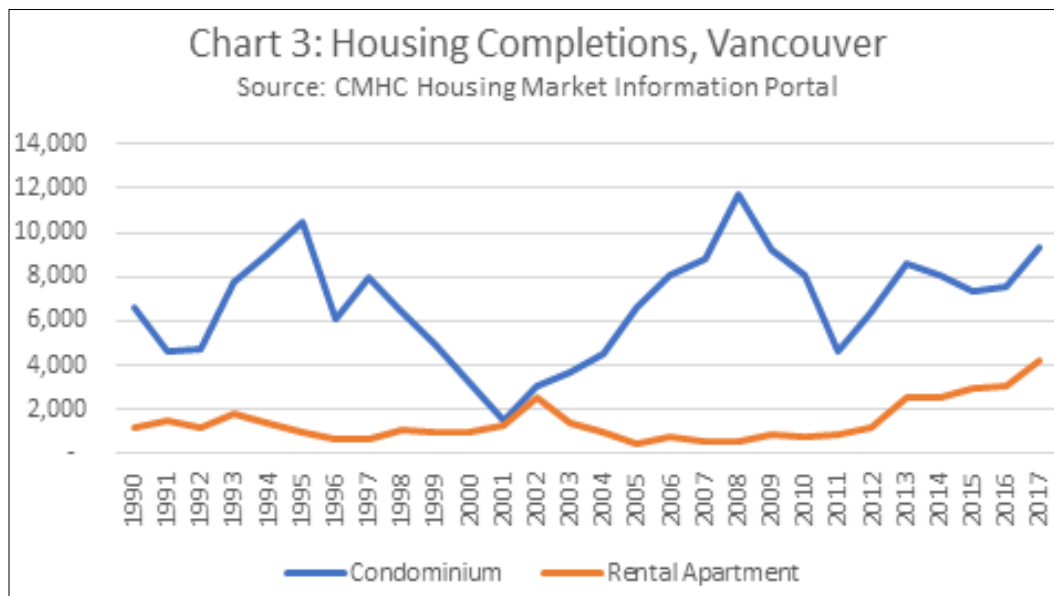
¹ City of Vancouver Rental Housing Strategy Research and Policy Development, Synthesis Report, McClanaghan & Associates, August 2010, pages 30-32



In the period before rent control was introduced in British Columbia, rental apartments throughout Canada were constructed at roughly the same rate as homes for the ownership market. Chart 2 demonstrates that between 1963 and 1968, rental apartments accounted for nearly half of all Canadian housing starts².

² Ibid, page 35

Today, the vast majority of apartment units are constructed as condominiums rather than purpose-built rentals. Chart 3 shows housing completions between 1990 and 2017. It's clear that in Vancouver rental apartments represent a fraction (roughly 21%) of condominium completions since the 1990s. In addition, that percentage has been higher in recent



Given that these policies are credited with the creation of thousands of units of rental housing before the mid-1970s, it makes sense to examine them to see what level of financial benefit they provided.



years due to changes in zoning bylaws and regulations at the City of Vancouver (and other municipalities) to encourage market rental housing development.

The increase in rental supply since the 1970s has mainly come from secondary suites, none of which are restricted as purpose-built rental units, and which therefore put tenants at risk of displacement when the homeowner sells or needs to reclaim the space for family use. The 2016 Statistics Canada Census reports that we have 960,895 private households in Metro Vancouver³. Of these households, 303,020 are market renter households or 31.5% of total households⁴. Table 1 and Chart 4 break down these rental households by type. CMHC's 2016 Rental Market Report indicates there are 107,867 purpose built rental units in Metro Vancouver⁵. As a result, 195,153 rental households are in the secondary market or 64% of total rental households. Consequently, by 2016, the vast majority of the rental households were living in secondary rental units that are not secured in tenure⁶.

³ Statistics Canada Census Profile, 2016 Census

⁴ Ibid

⁵ CMHC Rental Market Report, Vancouver CMA, 2016

⁶ The Statistics Canada Census, 2016 indicated that 32,380 single detached houses were rented as full homes. We believe this data may be subject to a reporting bias because it is likely that these homes are split into units and the units are individually rented out as suites. If that were true, then the number of illegal suites rented out in the secondary market would be two or three times this figure in addition to the 62,045 suited SDH units. It is also worth noting that CMHC estimates the number of rented condominiums as 58,089 units in 2016 (from the CMHC Housing Portal) for Metro Vancouver.

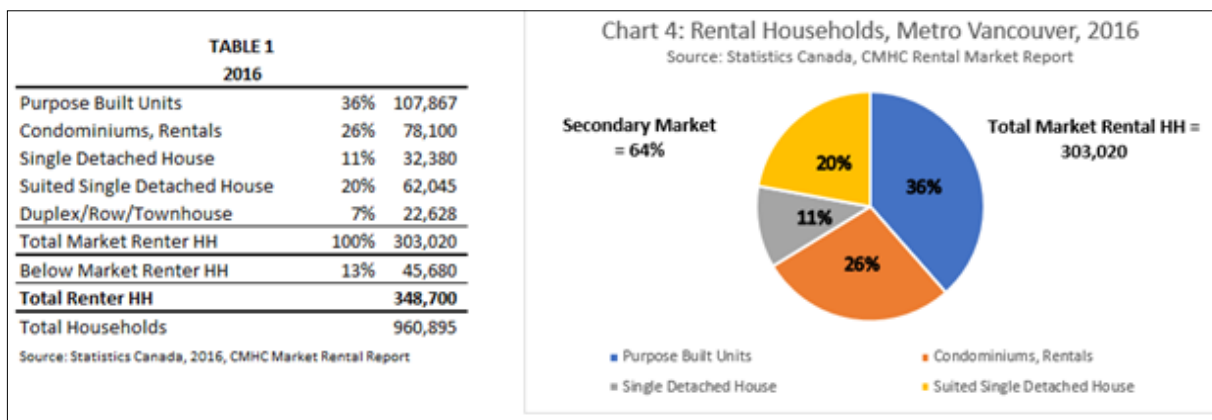
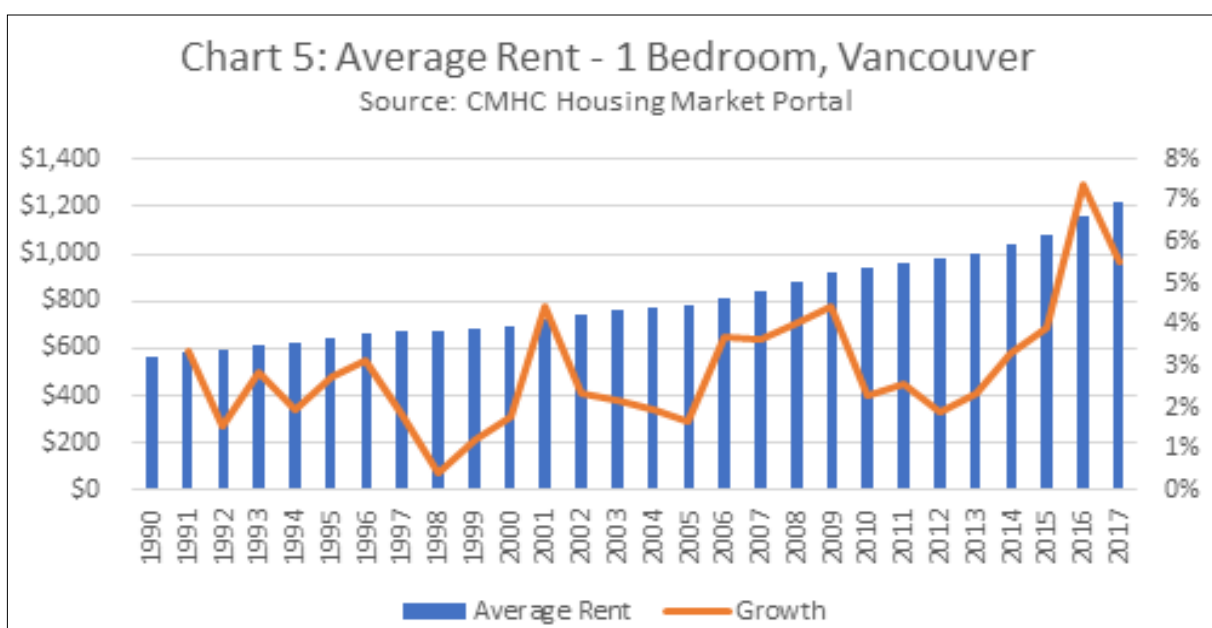


Chart 5 demonstrates that rental growth rates have accelerated while supply stagnates:



The data clearly demonstrates that new purpose-built rental supply fell off after the 1970s. Since that time rental unit growth has been dominated by the secondary market which is not actually secured as market rental housing. The question is: Why did purpose built rental housing construction fall off so dramatically? Was it tax incentives or rent control and the regulatory environment or some combination of these factors which caused investors to eschew building secured purpose built rental housing?

A Brief Overview of Historical Taxation Policies for Market Rental Housing

Market rental building operators are able to deduct depreciation claims against income for tax purposes. Prior to 1949, a straight-line basis of depreciation was generally used against income over the useful life of the property. The Capital Cost Allowance (CCA) system became effective on January 1, 1949 and allowed for accelerated depreciation such that the amount claimed against income is higher in the earlier years of a project and declines over the later years⁷.

Prior to 1972, CCA on wood framed buildings was allowed at 10% and on all other buildings at 5%. In addition, excess CCA was available to reduce non-rental taxable income. This is the so-called "flow-through" provision. No capital gains taxes existed. There were also soft cost write-offs available for new housing investment. Further, recaptured CCA was deferred if a property in the same class was acquired in the same tax year as the year of disposition for an amount at least equal to the proceeds of the sale (the "rollover" provision). Otherwise, all of the CCA claimed on a building is subject to recapture as income (at the full income tax rate) when the building is sold⁸.

After the tax reforms of 1972, the flow-through

⁷ The Capital Cost Allowance System, Israel Mida and Kathleen Stewart, 1995, page 1246-1247

⁸ Economic Impact of Federal Tax Legislation on the Rental Housing Market in Canada, Clayton Research, November

"Consequently, by 2016, the vast majority of the rental households were living in secondary rental units that are not secured in tenure."

provisions were eliminated and investors were no longer able to reduce non-rental taxable income with CCA deductions from rental property. Capital gains tax was introduced at a 50% inclusion rate for all investments including real estate. However, capital gains tax was exempted for a principal residence providing a massive tax advantage for homebuyers and, therefore, condominium developers that still exists today. The CCA rollover provision was also eliminated⁹.

From 1974-81, a tax program was offered called the Multiple Unit Residential Building Program (MURB). The main feature of this program is that it offered the "flow-through" provision so that investors could offset non-rental income with CCA deductions¹⁰. By 1978 the allowable CCA was reduced to 5% for all buildings¹¹.

The policies most frequently credited for creating rental housing are the accelerated CCA provisions as well as the flow-through provisions such that investors could offset non-rental taxable income with CCA deductions. After 1972, the flow-through policy came to an end until the MURB program in 1974 re-instated them for MURB projects.

1998, page 10-11

⁹ Ibid, page 10-11

¹⁰ An Analysis of the Effects of MURB Legislation on Vancouver's Rental Housing Market, Anne Patricia Wicks, 1982

¹¹ Economic Impact of Federal Tax Legislation on the Rental Housing Market in Canada, Clayton Research, November 1998, page 10-11

Analyzing Changes to Tax Policy

Tax Policy Prior to 1972

The most important benefit of the tax structure prior to 1972 was a CCA rate of 10% on wood framed buildings and 5% on high rise buildings as well as the flow-through provision for high income professionals, meaning losses at a rental building could be used to reduce taxable income earned through professional fees. The current CCA rate on all buildings is 4% and the flow through for high income professionals no longer exists.

Given that these policies are credited with the creation of thousands of units of rental housing before the mid-1970s, it makes sense to examine them to see what level of financial benefit they provided. In Table 2¹², we calculate the present value¹³ of the higher CCA rates prior to 1972 on a \$15 million newly constructed rental property to determine how significant the tax advantages were at that time.

The CCA tax deduction represents depreciation on the structural components of a building. These are real expenses which the tax laws permit based upon an accelerated declining schedule. When the CCA rate is higher, real estate companies can claim the tax deduction faster rather than slower. That has a cash flow benefit in the earlier years of an investment. The tax deduction is received faster and, therefore, from a present value basis, is beneficial to investors. The benefit is tempered upon sale of an asset when the CCA deductions for tax purposes are recaptured if the asset is sold for a price higher than the undepreciated cost basis at the time (and that

¹² Table 2 assumptions: 45% marginal tax rate; full recapture upon sale (building sold at higher than original cost); 3.25% discount rate (current 5-year CMHC multi-family residential mortgage rate, excluding cost of mortgage insurance); and, demolition in year 50. Discounted at 7.5%, the values in the table from top down are \$1,260,739, \$1,087,756, \$504,813, \$341,407, \$282,173, \$128,807; and, 8.40%, 7.25%, 3.37%, 2.28%, 1.88%, 0.86%

¹³ At today's estimated mortgage rate of 3.25%.

The question is: Why did purpose built rental housing construction fall off so dramatically?



| Timing of Sale | Present Value | % of Property Value |
|--|----------------------|----------------------------|
| Comparing 10% vs. 4% CCA on \$12mn Building Value | | |
| Never sell | \$1,079,574 | 7.20% |
| Sell at 25 yrs | \$785,460 | 5.24% |
| Sell at 10 yrs | \$285,290 | 1.90% |
| Comparing 5% vs. 4% CCA on \$12mn Building | | |
| Never sell | \$308,525 | 2.06% |
| Sell at 25 yrs | \$205,226 | 1.37% |
| Sell at 10 yrs | \$72,164 | 0.48% |

is frequently the case). In other words, the tax benefit typically is a deferral of taxes to later years despite the fact that depreciation is a very real expense. It is almost always the land value that has appreciated on a profitable sale rather than the building's value. This assumes, of course, that prior to 1972, the rollover provision was not used. In other words, the investor did not repurchase another rental building within the same tax year (the rollover provision is essentially the "Never sell" scenario in Table 2).

On a wood-framed building, the benefit is less than 7.25% of the building value if the building is never sold and recapture never paid. However, the market for apartment buildings is very robust and currently represents annual transaction of almost \$3bn per year¹⁴. It is somewhat rare for an investor to hold a building forever. If a wood-framed building was sold within 10 years, then the tax benefit from a 10% CCA rate was less than 2% of the building's value. It is important to note that the government reclaims all of the depreciation losses and the tax associated with the resulting income at the time a building is sold.

Table 2 also shows tax benefits on high rises

buildings that were only allowed a 5% CCA rate (compared to 10% for wood-framed buildings prior to 1972 and 4% today). The tax benefit was marginal in all cases.

Given that high-rise construction did not benefit nearly as much from these tax advantages, we address the question of whether or not high-rise development was common prior to 1978 when the CCA rate was reduced to 5% for all buildings. We have data on Metro Vancouver purpose built rental housing stock, excluding Vancouver, from a May 2012 Coriolis Consulting report prepared for Metro Vancouver¹⁵. The data in that report demonstrates that within Metro Vancouver, but outside the City of Vancouver, the existing rental inventory as of 2012 includes 47,635 units built up to 1979. Of this inventory, 31% was high-rise and the percentage was likely much higher in the City of Vancouver. As a result, the lower 5% CCA rate did not seem to slow development of these buildings.

Additionally, these CCA rates were viewed as accurate relative to depreciation timing when they were set. These were not viewed as a tax incentive.

¹⁴ Goodman Report, 2018 Mid-Year Greater Vancouver Rental Apartment Review, July 2018

¹⁵ Metro Vancouver Purpose-Built Rental Housing: Inventory and Risk Analysis, Coriolis Consulting Corp., May 8 2012

An important 1998 study indicated that “Until the mid-1970s the private market produced substantial quantities of private rented apartments without a visible explicit subsidy for rented housing. There was no rent control and there was growing demand for rented accommodation from newly forming households, including immigrants from overseas”¹⁶. The study did note, however, that CCA provisions and soft cost deductions were favourable at the time.

Lastly, the flow through provision seems of marginal value given that real estate companies today can use CCA on new rental developments to offset income from other rental properties in their portfolio, giving them the same advantages enjoyed by professionals with high incomes prior to 1972. Yet, these same companies stopped developing rental buildings after the 1970s for their own portfolio as well.

Multiple Unit Residential Building Program

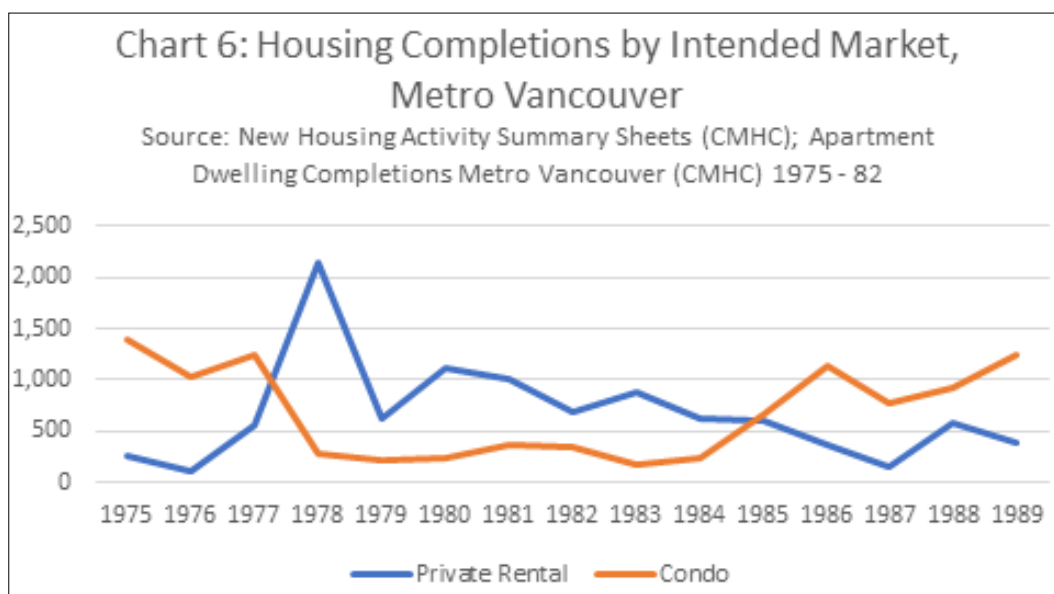
While the flow through provisions came to an end in 1972, the MURB program was introduced in 1974 and was effective through 1979 and then from late 1980 through 1981. We know that in the two decades that

preceded 1972, roughly 2,000 purpose built rental units per year were constructed by the private market in Vancouver. Chart 6 shows that the MURB program succeeded in creating multi-family housing.

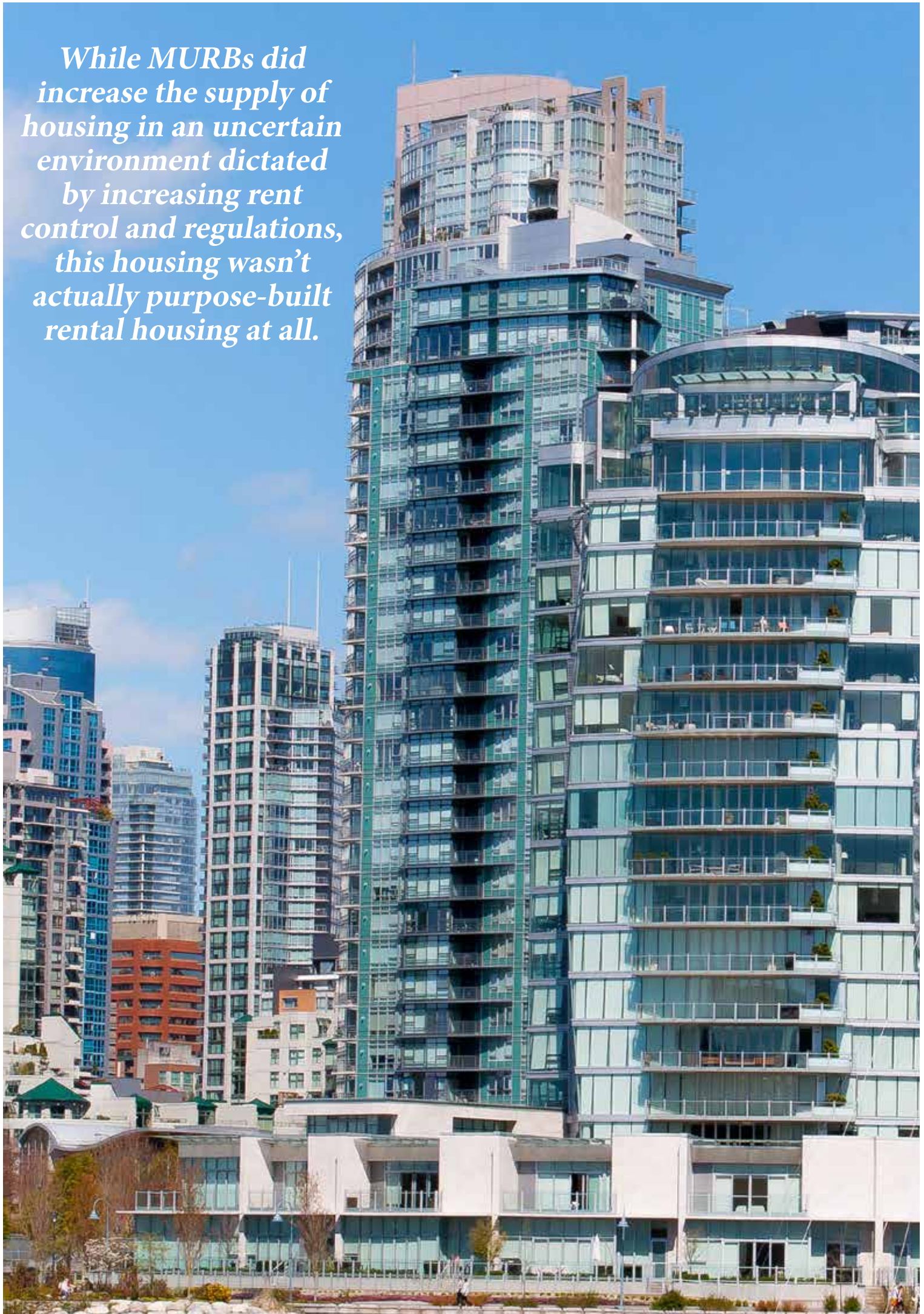
However, while the MURB program allowed for the flow-through provision, the CCA rate was reduced to 5% for all buildings in 1978 during and after which there was significant private rental housing built. As we have seen, the 5% CCA rates was of somewhat marginal benefit compared to today's 4% rate. Also, the CCA rollover provision was not re-instated for MURB buildings. Lastly, a very informative 1982 study by a U.B.C. Master's student hypothesized that the “real effect of the program was to create windfall gains for existing owners of multiple family zoned land at the time the legislation was passed....that tax shelter benefits associated with MURB properties will be fully capitalized into the value of such properties, thus preventing MURB investors from earning rates of return superior to those earned by owners of comparable non-MURB properties.”¹⁷ The study found that the average after tax returns earned for MURB and non-MURB property investments were essentially equivalent at 12.8% for MURB properties and 13.2% for non-MURB properties. It concluded, therefore,

¹⁶ Neth. J. of Housing and the Built Environment, Vol. 13 (1998) No. 3, Tony Crook, page 340

¹⁷ An Analysis of the Effects of MURB Legislation on



While MURBs did increase the supply of housing in an uncertain environment dictated by increasing rent control and regulations, this housing wasn't actually purpose-built rental housing at all.



The “success” of the MURB program depended heavily on the critical legal nuance that they were really strata condominiums that could be individually sold into the ownership market at any time.



that “future tax shelter benefits associated with MURB properties are capitalized into the market values of completed MURB buildings and that MURB investors do not earn rates of return superior to those of investors in non-MURB apartment properties...these results do not support the widely made argument that adverse tax revisions (such as reduction in tax shelter benefits) cause inferior ex ante rates of return in real estate investment. In competitive capital markets, equilibrium comparative returns among alternative investments are not determined by Government subsidies or differential tax treatments....The only way government programs effect differential returns is through any investment risk created by having a fluctuating or uncertain tax or subsidy”¹⁸.

While MURBs did increase the supply of housing in an uncertain environment dictated by increasing rent control and regulations, this housing wasn’t actually purpose-built

Vancouver’s Rental Housing Market, Anne Patricia Wicks, 1982, page ii

¹⁸ Ibid at page 65

rental housing at all. **Virtually all MURBs were strata titled creating a massive distinction from secured purpose-built rental housing stock**¹⁹. As has been noted in a 1998 study, “To ensure that their investments could be realized, these small-scale individual landlords needed to acquire dwellings that could be easily sold into owner occupation. Apartment dwellings were much less attractive to these landlords than newly constructed condominiums. This was because apartments would be less easy to dispose of than condominiums and because of the impact that rent regulation had on large apartment blocks.”²⁰

As a result, the “success” of the MURB program depended heavily on the critical legal nuance that they were really strata condominiums that could be individually sold into the ownership market at any time.

¹⁹ Rent Control and Decontrol in British Columbia: A Case Study of the Vancouver Rental Market, 1974 to 1989, Celia C. Lazzarin, page 137

²⁰ Neth. J. of Housing and the Built Environment, Vol. 13 (1998) No. 3, Tony Crook, page 336

TABLE 3
Interest Rate Comparison, \$11.25mn Mortgage / \$15mn Property

| Year | Interest Rate | Interest Cost | Interest Cost | |
|---|---------------|----------------|-----------------|--------------|
| | | Over 5 Yr Term | Over 25 Yr Amm. | |
| 1960s | 7.50% | \$3,993,494 | \$13,439,977 | |
| 1978 | 10.50% | \$5,635,434 | \$20,081,127 | |
| 2018 | 3.25% | \$1,693,257 | \$5,158,101 | |
| 1960s: Higher Interest Cost, Before Tax | | 4.25% | \$2,300,237 | \$8,281,876 |
| 1960s: PV of 2018 Interest Benefit, After Tax | | | \$1,167,479 | \$3,380,785 |
| % of Property Value | | | 7.8% | 22.5% |
| 1978: Higher Interest Cost, Before Tax | | 7.25% | \$3,942,177 | \$14,923,025 |
| 1978: PV of 2018 Interest Benefit, After Tax | | | \$2,000,225 | \$6,037,104 |
| % of Property Value | | | 13.3% | 40.2% |

Changes in Interest Rates

While tax deductions from CCA are an important and relevant expense, interest rates have fallen dramatically since the 1960s and should offer a far greater incentive for developers to build rental than the CCA provisions. Table 3²¹ compares the present value benefit of today's lower interest rates on a \$15 million property compared to the mid-1960s and to 1978 when MURB construction was at its height. We assume this \$15 million property has a \$11.25 million mortgage which is a reasonable loan to cost ratio of 75%.

We estimate that the benefit of today's lower interest rates is at least 7.8% and as much as 40% of a building's value. Comparing the results with those in Table 2 demonstrates that today's lower interest rates are at least as beneficial as CCA deductions prior to 1972 tax reform. The benefits of today's lower interest rates would be even greater with a typically higher loan to cost

ratio of up to 80%²².

Yet these lower interest rates have not been enough incentive to encourage a significant level of purpose-built rental housing development and new supply is certainly not high enough to offset demand. While it is highly likely that these lower interest rates have been capitalized into land values, recall that research has demonstrated the same was true for the higher CCA rates and other tax benefits from rental development prior to 1972.

A Brief Overview of Rent Control in British Columbia

While it's true that taxation policy changes in the mid-1970s negatively impacted residential multi-family rental buildings, it was not the only change that negatively affected the industry. Until the mid-1970s, rent control did not exist in British Columbia and regulations were minimal.

In 1969, Vancouver City Council passed a by-law limiting rent increases to one per year and a \$25 limit on security deposits among other regulatory changes. The by-law set the stage

²¹ Table 3 assumptions: 45% marginal tax rate; present value benefits calculated at current CMHC 5-year multi-family residential mortgage rate of 3.25% (excluding mortgage insurance). Scenario analysis: At 7.5%, the present value of the interest benefit from the 1960s is \$1,056,413 over 5 years or 7% of the building's value and \$2,433,836 over the 25-year amortization or 16.2% of the building's value. Similarly, at a 7.5% discount rate, the present value of the interest benefit from 1978 is \$1,809,227 over 5 years or 12.1% of the building's value and \$4,302,902 over the 25-year amortization or 28.7% of the building's value.

²² An 80% loan to value ratio, or a \$12 million mortgage, results in a present value benefit from the 1960s of \$1,245,311 over 5 years or 8.3% of the building's value and \$3,606,171 or 24% of the building's value over the 25 year amortization. Similarly, the after-tax present value benefit from 1978 interest rates is \$2,133,573 over 5 years or 14.2% of the building's value and \$6,439,579 over the 25 year amortization or 42.9% of the building's value.

for the Social Credit government to change the Landlord and Tenant Act in 1971 which incorporated the once per year rent increase limit plus limited security deposits to \$50, among other changes²³.

In 1971, the Vancouver Tenants Council led a five-month strike-boycott of 15 Wall and Redekop Properties after they had been given a 10% rent increase²⁴.

In 1972, the NDP was elected based upon a platform that included some form of rent control and changes to rental regulations. In 1973, the provincial government made one rent increase per year applicable to the premises rather than the tenancy agreement²⁵.

Due to unusually high inflation during the 1970s and in anticipation of upcoming changes proposed to the Landlord and Tenant Act, Block Brothers instituted a 25% rent increase in 1973. Other Vancouver landlords acted similarly with rent increases between 10% and 20%. In response, Vancouver City Council passed a resolution recommending (but not requiring) rent increases be limited to inflation, then at 9.2%²⁶.

Between 1972 and 1974, these rental conditions

and the strong inflation at the time resulted in a wave of conversions of market rental properties to condominiums made possible by the 1966 introduction of strata-title tenure. A 1990 research paper described the situation as follows: "Data compiled by Stanley Hamilton [at the time, a professor of urban land economics at UBC's Sauder School of Business] show that a high increase in conversions began in 1971 with 7 projects involving 119 units. In 1972, the figure jumped to 14 projects with 305 units and 114 units the following year. The NDP responded by amending the Strata Titles Act to give municipalities control over conversions of rental to strata."²⁷

With inflation spiking (in 1974, Vancouver's CPI reach 11.6%²⁸), there was mounting political pressure on politicians to control rents. With this background of intense political pressure, in 1974, rent control came into full force and effect. A rent increase limit of 8% was instituted by the hastily passed Residential Premises Interim Stabilization Act while inflation was 11.6% (see Chart 7). A Rentalsman was appointed to administer the Act and recommended the allowable rent increase be raised to 30% in 1975 to compensate landlords

²³ The Tenant Movement in B.C. from 1968-1978, Bruce Yorke, November 8, 2012

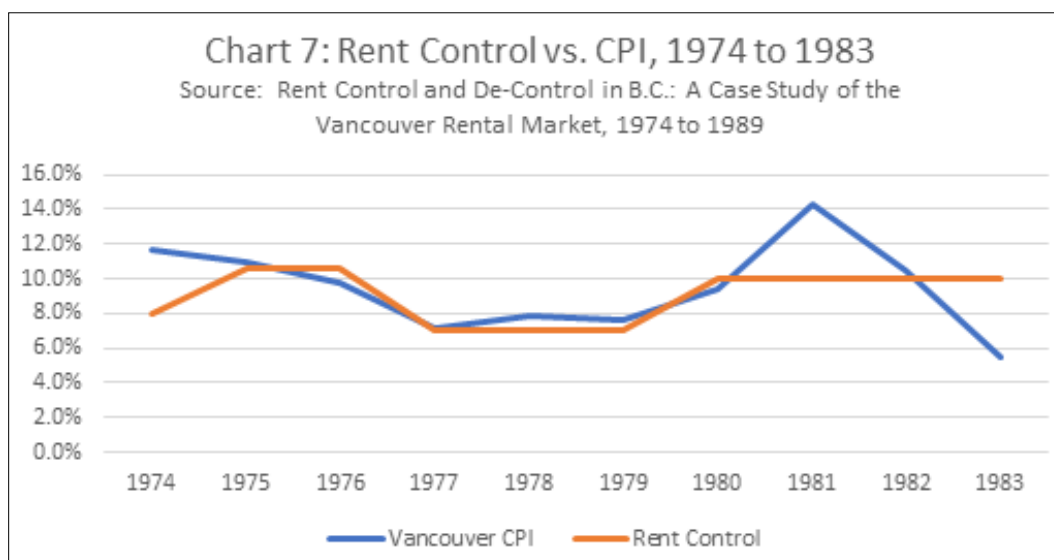
²⁴ Ibid

²⁵ Ibid

²⁶ Ibid

²⁷ Rent Control and Decontrol in British Columbia: A Case Study of the Vancouver Rental Market, 1974 to 1989, Celia C. Lazzarin, page 101

²⁸ Rent Control and Decontrol in British Columbia: A Case Study of the Vancouver Rental Market, 1974 to 1989, Celia C. Lazzarin, page 175



for cost increases from 1972 to 1974 that were not captured in rent increases. Alternatively, he recommended two rent increases of 16% and 21.2%. Both recommendations were refused by government²⁹.

In 1975, the NDP passed the Landlord and Tenant Act with a rent increase limit at 10.6%, while new construction was exempt for five years. The Rentalsman was given authority over future rent increases³⁰.

In October of that year, Prime Minister Trudeau announced a program of wage and price controls to deal with the spiraling inflation of the time. He encouraged the Provinces to implement rent control with the following features: a) limit increase to a fixed percentage, b) increases above the fixed percentage based upon cost increases, and c) new development should be exempt for five years. British Columbia's legislation at the time already incorporated all three features³¹.

In December of 1975, the Social Credit party was elected on a platform to keep rent control in place and extended the 10.6% rent increase limit for 1976³². By 1977, the rent control limit was reduced from \$500 to \$400 maximum rent and the allowable amount reduced to 7%, a limit that remained in place until 1979.³³

The Residential Tenancy Amendment Act of 1980 introduced rent control and review, allowing tenants to request a review of "excessive" rent. The maximum rent increase was limited to 10% in May of that year and remained in place until rent control was removed in 1983. By June 1984, rent review

²⁹ Ibid, pages 101-105

³⁰ Ibid, page 106

³¹ Ibid, pages 82-83

³² Ibid, pages 81-83

³³ Ibid, pages 107-108

was repealed and rent control came to an end as a means to stimulate the industry during a period of double-digit interest rates and deep economic recession³⁴.

The Alternative to Rentals for Residential Developers: Condominiums

With the Province having passed the Strata Titled Act in 1966 and amended it in 1974, there was an alternative for residential developers once rent controls and increasing regulations came into effect in the 1970s for apartment rentals.³⁵ They could develop condominiums instead of rentals.

That one change significantly benefited the home ownership market versus the rental market and enabled condominium prices to be higher, reflecting the tax advantage.

Innovations in finance resulted in changes to the Bank Act in 1967 that addressed mortgage finance by removing interest rate caps and low statutory loan to value limits.³⁶ By 1967-68, CMHC significantly increased direct lending to homeowners and ramped up their mortgage insurance program³⁷. By the early 1970s, financing became readily available to

condominium developers. Also, by the mid-1970s consumers became more accepting of buying, owning, and living in condominiums. By 1974 a new Strata Titles Act³⁸ was introduced and passed that significantly modernized the 1966 one.

Moreover, the 1972 tax reforms enacted capital gains taxes at an inclusion rate of 50%, but exempted principal residences.³⁹ That

³⁴ Ibid, page 109

³⁵ City of Vancouver Rental Housing Research and Policy Development Synthesis Report, McClanaghan & Associates, August 2010, page 32

³⁶ Ibid, page 34

³⁷ Ibid, page 34-35

³⁸ Report on Strata Property Law: Phase One, British Columbia Law Institute, November 2012

³⁹ Economic Impact of Federal Tax Legislation on the Rental



one change significantly benefited the home ownership market versus the rental market and enabled condominium prices to be higher, reflecting the tax advantage. As was noted in a research report for the City of Vancouver, "The unique capital gains exemption for owner-occupied (principal) residences combined with the advent of strata-title condominium tenure created a structural tax disparity between multi-family rental and multi-family condominium creation. The tax-exempt use, owner-occupied condominium units, has an advantage over rental use and consistently out-bid rental in the marketplace for multi-family development sites. Consequently, the disparity in tax treatment has skewed the market to ownership to the detriment of the rental sector."⁴⁰

Given that for a multi-family residential development, whether rental or condominium, the land and building structure is equivalent, the real estate developer will always choose to build condominiums. By the mid-1970s it became clear that the regulatory environment for purpose-built rentals would always be onerous, uncertain, and harmful. Governments had implemented rent controls and prohibitive regulations, initially as temporary measures, but it was clear that if rents were to rise and real estate owners made a substantial profit,

Housing Market in Canada, Clayton Research, November 1998, page 13-14

⁴⁰ City of Vancouver Rental Housing Research and Policy Development Synthesis Report, McClanaghan & Associates, August 2010, page 37-38

Almost every freshman-level textbook contains a case study on rent control, using its adverse side effects to illustrate the principles of supply and demand.

government bodies would step in and control the revenue stream and implement even more prohibitive regulations to constrain profits. Chart 2 demonstrates this fact because in the 36 years subsequent to 1973, only 7,121 units of permanent rental housing has been built by 2010 in Vancouver, or 13.7% of the total rental pool.

Rent controls were temporarily eliminated in 1984 as an incentive during a time of terrible economic recession and double-digit interest rates (In 1982⁴¹, B.C.'s GDP contracted 3.6% and in 1984, the five-year conventional mortgage rate was 13.61%, the unemployment rate in Metro Vancouver was 13.6%, and the vacancy rate 2.4%.) They were eliminated by a Social Credit government that campaigned on a pledge to keep rent controls in place and it was unclear if they would reverse this policy again. The business environment was not conducive to construction but, in addition, the uncertainty created by government intervention into the pricing mechanism for rental apartments meant every rational multi-family developer would choose to build condominiums rather than rental apartments. And that is despite the fact that condominium development is the least tax efficient business given that these developers pay full business income tax on their profits (as opposed to having their income treated as capital gains) without any flow-through provisions or unusual tax deductions or deferrals.

Why Rent Control is an Impediment to Rental Housing Supply and Affordability

In a 2012 survey of academic economists, **95% disagreed**⁴² with the following statement: "Local ordinances that limit rent increases for some rental housing units...have had a positive impact over the past three decades on the amount and quality of broadly affordable rental housing in

the cities that have used them."⁴³

Paul Krugman has explained in the New York Times, "The analysis of rent control is among the best-understood issues in all of economics, and – among economists, anyway – one of the least controversial. In 1992 a poll of the American Economic Association found 93% of its members agreeing that 'a ceiling on rents reduces the quality and quantity of housing'. Almost every freshman-level textbook contains a case study on rent control, using its adverse side effects to illustrate the principles of supply and demand."⁴⁴

A recent study on the effects of rent control in San Francisco concluded that: "Landlords treated by rent control reduce rental housing supply by 15%, either by converting to condominiums/Tenancy in Commons, selling to owner occupants, or redeveloping buildings. In the long run, we find rent control increased the gentrification of San Francisco, and the endogenous changes in the housing supply

⁴³ <http://www.igmchicago.org/surveys/rent-control>, University of Chicago, IGM Forum, February 7, 2012

⁴⁴ Reckonings; a Rent Affair, The New York Times, Paul Krugman, June 7, 2000



⁴¹ Rent Control and Decontrol in British Columbia: A Case Study of the Vancouver Rental Market, 1974 to 1989, Celia C. Lazzarin, pages 173-174 and 181, 184

⁴² <http://www.igmchicago.org/surveys/rent-control>

Investors are making a sixty to one hundred-year decision when deciding to construct new rental housing and need assurance that their ability to recover profits won't be usurped by government.



attracted higher income residents, undermining the goals of rent control... Further we find that there was a 25% decline in the number of renters living in units protected by rent control, as many buildings were converted to new construction or condos that are exempt from rent control.

The reduction in rental supply likely increased rents in the long-run, leading to a transfer between future San Francisco renters and renters living in San Francisco in 1994. In addition, the conversion of existing rental properties to higher-end, owner-occupied condominium housing ultimately led to a housing stock increasingly directed toward higher income individuals.⁴⁵

In a research paper on the rental housing market in San Francisco during the 1940s, economists Milton Friedman and George J. Stigler concluded "Rent ceilings, therefore, cause haphazard and arbitrary allocation of space, inefficient use of space, retardation of new construction and indefinite continuance

of rent ceilings, or subsidization of new construction and a future depression in residential building...Yet we urge the removal of rent ceilings because, in our view, any other solution of the housing problem involves still worse evils."⁴⁶

The Economist magazine has written that "When prices are capped, people have less incentive to fix up and rent out their basement flat, or to build rental property. Slower supply growth exacerbates the price crunch. And landlords who do rent out their properties might not bother to maintain them, because when supply and turnover in the market are limited by rent caps, landlords have little incentive to compete to attract tenants."⁴⁷ Swedish economist Assar Lindbeck once asserted, "In many cases rent control appears to be the most efficient technique presently known to destroy a city – except for bombing".⁴⁸

Stanford University, Rebecca Diamond, Tim McQuade, and Franklin Qian, August 24, 2018

⁴⁶ Roofs or Ceilings: The Current Housing Problem, The Foundation for Economic Education, Milton Friedman and George J. Stigler, September 1946

⁴⁷ Do Rent Controls Work?, The Economist, August 31, 2015

⁴⁸ Only bombing would be worse than rent control, <https://>

⁴⁵ The Effects of Rent Control Expansion on Tenants, Landlords, and Inequality: Evidence from San Francisco,



As a result, rational investors will choose to build condominiums over market rental housing.

The Canadian experience has not been any different from that of other countries. A major 1988 study conducted by the University of Toronto on the impact of rent control between 1975 and 1988 found that the "major effects" were:

1. To reduce rents on pre-1976 controlled units, but to increase rents on post-1975 units;
2. To reduce new rental and total apartment construction;
3. To jeopardize the quality and existence of the existing rental housing stock by accelerating deterioration, encouraging conversion of rental residential dwellings to other uses and other tenure forms, and fostering demolitions;
4. To contribute to a severe rental housing shortage;
5. To create the environment for the introduction of key money;
6. To inefficiently and inequitably redistribute income; and
7. To exacerbate the government budget deficit by reducing government tax revenues and inducing increased government housing expenditures.⁴⁹

The examples of the negative impact of rent controls on the quantity and the quality of housing are abundant and economists are near universal in their negative views about such policy. **As a result, rent controls, and the prohibitive regulations that accompany them, are the problem and not the solution to rental housing affordability.** Many states in the United States have come to understand this economic issue and have prohibited rent control as a result. As of 2018, there are only four states with rent control: California, Maryland, New Jersey, and New York and the District of Columbia. Thirty-seven states either prohibit or pre-empt rent control, while nine states allow their cities to enact rent control but have no cities that have implemented it.⁵⁰ Conversely, price controls are widespread in Canada with the only exception being Alberta which has no rent controls and what is generally regarded as a healthy, balanced rental market.

www.adamsmith.org/blog/planning-transport/only-bombing-would-be-worse-than-rent-control , Adam Smith Institute , Sam Bowman , January 25, 2012

⁴⁹ An Economic Assessment of Rent Controls: The Ontario Experience, Journal of Real Estate Finance and Economics, Lawrence B. Smith, Professor of Economics, University of Toronto, 1988

⁵⁰ Rent Control by State Law, National Multi Family Housing Council, Spring 2018

How to Create More Purpose-Built Rental Housing Supply

As a result of the preceding analysis, the reason for the lack of construction of private market rental housing since the mid-1970s is more complex than simply changes to tax policy. Rent control and regulatory changes played at least as important a role if not being the defining reasons that decimated new rental housing supply.

The introduction of rent control and restrictive regulations toward landlords changed the business environment for this investment dramatically. Once these changes were made, even though rent control was removed in the early 1980s during a period of recession, the mere anticipation of rent control is enough to have a chilling effect on such investment. And, in fact, investors have been correct to be worried because further rent control and restrictive regulations were introduced in British Columbia in the 1990s, again in 2004 with a revised Residential Tenancy Act, and again after the 2017 election of the NDP government. All of these changes have reinforced the notion in investors' minds that the market for rental housing is fraught with political obstacles to achieving a reasonable return on investment.



Investors are making a sixty to one hundred-year decision when deciding to construct new rental housing and need assurance that their ability to recover profits won't be usurped by government.

Multi-family developers have a unique alternative of building residential condominiums which are free of price controls and subsidized by the Federal government with a capital gains tax exemption on owner-occupied units. As a result, rational investors will choose to build condominiums over market rental housing.

To create more rental housing supply requires three major changes to the regulatory and business environment: (1) The removal of rent controls and restrictive regulations toward newly built market rental buildings; and, (2) municipal zoning bylaw changes that remove biases against market rental housing and can equate land values between rental housing development and condominium development; and, (3) elimination of Federal GST on a self-supply of rental housing.

We recommend the following actions today:

Rent Regulations

1. Immediately exempt newly constructed purpose-built rental units from all rent controls. The exemption would be guaranteed for a minimum of 20 years. More secure market rental housing supply is the real solution to stabilizing rents, not rent control;
2. Rental housing developers are making 60 – 100 year investments. Government must commit to ensuring legislative certainty for the long haul;
3. Allow more liberal rent increases for existing tenancies to better cover cost of inflation and maintenance.

Municipal Zoning Bylaw Changes for Rental Development

1. Reduce or eliminate parking minimums;
2. Increase density allowable relative to condominium development;
3. Reduce minimum unit sizes;
4. Fast track application processing and eliminate re-zoning requirement;
5. Eliminate Community Amenity Charges; and,

6. Eliminate inclusionary zoning of below market suites.

Federal Taxation

Eliminate the GST on completion of new purpose-built rental construction. The GST was introduced in 1991. While it was not part of this analysis, it is a major cost to rental housing builders who are required to pay GST, currently at 5% (with some rebates depending on unit fair market value), on the completed value of the "self-supply" of a rental building. It is an impediment which does not exist for the condominium developer and its elimination is necessary to help equate residential land value between condominium and private market rental use.

These changes would mitigate the challenging business environment in which rental housing providers must operate and would also equate land values between condominium private market rental housing development. This alone will create the environment in which businesses will build enough private market rental housing supply to satisfy demand.



Conclusions

It is quite clear that purpose-built rental housing has not been built in significant quantity since the 1970s. As a result, it makes sense to determine what changes led to the dearth of supply when demand for these units has not abated.

This analysis leads to the conclusion that the introduction of rent controls and prohibitive regulations had a major impact on new rental housing construction since that time. While rent controls were temporarily removed in 1984, the problem is the mere anticipation of rent control is enough to have a chilling effect on such investment. Investors have been correct to be concerned because rent control was re-introduced in British Columbia by the Clark government in the 1990s, strengthened by the Campbell government in 2002/04, and further strengthened by the Horgan government in 2018. When investors make the decision to build market rental housing, they are making a 60 to 100-year decision. They will, necessarily, consider the long-term risks when making that decision. Once this market changed in the 1970s to one which had caught the government's attention, it changed markedly. This was exacerbated by the introduction of strata title condominiums which gave residential builders an alternative that was free from price controls. Builders chose this alternative in earnest despite the tax disadvantaged of being taxed at full business income rates without any provisions for deferred taxes, rollovers, or flow through income.

It is imperative that the government remove rent controls and restrictive regulations toward market rental buildings. These changes as well as modifications to zoning bylaws and regulations at the municipal level, and the removal of Federal GST on a "self-supply" basis, will restore the market for building new secure market purpose-built rental housing.



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Appendix

Summary of Rent Control and Taxation Policy Toward Rental Development

| Time Frame | Taxation Policy | Rent Control & Regulation | Political Climate | Rental Development |
|--|---|---|--|--|
| 1950 to 1971 | CCA: woodframe buildings 10%; other 5%; CCA recaptured on sale but could pool with CCA on other buildings owned. | No rent control or regulations. | Federal government used "market-enabling strategies" including taxation and creation of CMHC to support housing supply. | Rental unit supply in Vancouver increased from 37,445 units in 1951 to 78,985 in 1971 or by 110% |
| | Excess CCA deductions available to reduce non-rental taxable income ("flow-through" provisions). | 1966: British Columbia introduced strata-title tenure. Readily available financing to developers not until the early 1970s. | 1969: Vancouver City Council establishes maximum of one rent increase per year, three months notice of rent increase; \$25 limit on security deposit. | Between 1963-68, rental apartments accounted for almost half of all Canadian housing starts (475,917 of 976,322 housing starts). Source: Annual Report CMHC 1963 to 1972 |
| | No capital gains tax in Canada for any investment until 1972. | 1967 Bank Act addressed mortgage finance removing interest rate caps and low statutory loan to value limits | 1970: New Landlord-Tenant Act; 1971: five month strike-boycott of 15 Wall / Redekop premises which had been given 10% rent increase. | |
| | Generous write-offs for new housing investment in form of soft cost deductibility | 1967 - 68 CMHC significantly increased direct lending to homeowners and ramped up mortgage insurance program. | | |
| 1972 | No longer able to reduce non-rental taxable income with CCA deductions from rental property. Capital Gains tax introduced at 50% inclusion; exemption allowed on principle residence. CCA pooling (rollover) removed. | | NDP elected on platform including bargaining rights for tenants and establishment of municipal rent review board (i.e. rent control) | 1972: Conversions of rentals to strata condominiums acute problem in Vancouver. 14 projects with 305 units converted in this year. |
| 1973-88 | 1974-81: Multiple Unit Residential Building Program (MURB): CCA deductions available to reduce non-taxable income ("flow-through" provision) restored for these developments. Virtually all strata -titled. | 1973: NDP made one rent increase per year clause applicable to the premises not the tenancy agreement. Also, set up Law Reform Commission to set rental policy. | 1973: Block Brothers institute 25% rent increase in anticipation of upcoming new Landlord and Tenant Act. Other landlords act similarly with rent increases between 10% and 20%. Vancouver City Council passed resolution providing for concept that rents should be limited to inflation @ 9.2% | Between 1958 and 1973, 35,019 rental units developed in City of Vancouver, roughly 68% of rental housing stock. |
| 1974: Beginning of Rent Control in British Columbia | | | | |
| | 1975-78 Assisted Rental Programme (ARP): restrictions on equity returns and rents in return for tax free grants or interest free loans. | 1974: Strata Titles Act amended to give municipalities control over conversions of rentals to strata. | Inflation in Vancouver was at 11.6%. | In the 36 years subsequent to 1973, only 7,121 units have been added to permanent rental housing pool in the City of Vancouver, or 13.7% of the total rental pool. |

| Time Frame | Taxation Policy | Rent Control & Regulation | Political Climate | Rental Development |
|--|---|--|---|--------------------|
| | <p>1978: CCA reduced to 5% all buildings; 1981: CCA half year rule in the year asset acquired; 1988: CCA reduced to 4% for all buildings.</p> | <p>1974: Residential Premises Interim Stabilization Act limits rent increases to 8%; Rentalsman recommended 30% allowable rent increase for 1975 to compensate Landlords for cost increases from 1972-74; alternatively two increases of 16% then a second one of 21.2%. Recommendation refused.</p> | <p>December 1975 Social Credit elected based on platform to keep rent control. October 13, 1975 PM Trudeau announced program of wage and price controls and encouraged Provinces to implement rent control as follows: limit to a % increase; above this increase justified based upon cost increases; new development exempt for five years. Social Credit left rent increase limit at 10.6% for another year (1976)</p> | |
| | <p>1982-84: Canada Rental Supply Programme: re-introduced ARP provision for interest free loans. In return, landlords agreed to 5% dwellings disabled and a third dwellings for low income tenants.</p> | <p>1975: NDP passed new Landlord and Tenant Act with rent increase limit at 10.6%. New construction exempt for 5 years. Rentalsman given authority to set future rent increases. 1976: Social Credit left rent increase limit at 10.6% for another year.</p> | | |
| | | <p>1977: Residential Tenancy Act (replaced Landlord and Tenant Act). New buildings exempt from rent control. Rent control limit reduced from \$500 to \$400 max rent. By 1978 these measures resulted in approximately 10% of units outside rent control. Allowable rent increase reduced to 7%. 7% limit remained through 1979.</p> | | |
| | | <p>1980: Residential Tenancy Amendment Act introduced rent control and review. Maximum rent increase 10% May 1980 and remained until rent control removed in 1983. Rent review meant tenant responsible for appealing "excessive rents". June 30, 1984, rent review repealed and rent control came to an end.</p> | | |
| 1983-84: Rent Control Removed in British Columbia until the early 1990s | | | | |

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