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An Open Letter to CMHC from a Vancouver PBR Owner and Developer

Subject: Multi-family Equity Take Out Restrictions Will Ultimately Harm Renters

I am writing in regard to the recent change to equity take-out provisions under the standard multi-family rental apartment insured loan program.

I have been involved with the ownership and operation of multi-family rental buildings in Vancouver for ten years. During this time, I have participated in one CMHC insured loan funding, and explored others via proforma to determine a project's viability. These were all for smaller buildings (between 11 and 43 units). The ownership of these buildings was almost always comprised of individual investors or a pair of such investors.

The idea of having one's equity locked into an asset indefinitely over the course of a 25 to 35 year time horizon without the possibility of a return of capital beyond monthly income is highly influential in the decision on whether or not to invest in a rental apartment building. Investors do have options. The inability to sell a building quite as easily because some buyers have decided to pursue other, higher-yielding investments in order to access equity take out (admittedly at higher rates) will have an impact upon the supply of new buildings and product in the marketplace, to say nothing of retro-fitting older buildings which are past their useful life and need systems replacement. Most of the multi-family rental buildings in the City of Vancouver and indeed across the country are outmoded and in need of major capital upgrades. This is thanks to changes in taxation and rent control which were enacted in many jurisdictions in the 1970s. These changes caused a dearth of new purpose-built rental for many decades. We are now experiencing the results of such policy changes with rock-bottom vacancy rates that restrict the ability of tenants on a budget to find suitable housing in their community of choice.

There is enormous risk involved in renewing significant building systems due to the regulatory oversight from municipal authorities - some existing investors will decline to take on such risk knowing the only 'reward' would be to recoup a portion of one's costs in the form of an equity-take and possibly a higher monthly rent. I would suggest that few owners of such buildings would want to take that risk given the meagre 'reward'.

I understand the CMHC's position is that equity take-out needs can be met by the private sector. While this is true, it is important to note such private sector rates will be hundreds of basis points higher than a CMHC first mortgage insured rate. In today's low rate environment that is a deeply meaningful difference. Moreover, the capitalization rates of assets of multi-family rental buildings in major markets is low precisely because of the availability of CMHC first-mortgage insurance. To mix and match the financing on a stabilized multi-family rental building will diminish the return of capital available and/or the monthly income after interest and principal repayment. This is an outcome which again diminishes the desirability of the asset in the eyes of potential purchasers. That, in turn, diminishes the incentive of existing owners to invest in upgrades and of developers to build and deliver to market new multi-family rental housing. It becomes a vicious circle fairly easily. As with the major policy changes introduced in the 1970s, we can see that the effects could take years to manifest. When they do, it will be renters and vulnerable populations who bear the brunt of the impact in being unable to secure the housing they need a price they can afford. That hardly seems fair.

Finally, there are many smaller communities which do not benefit from easy access to mortgage financing due to fluctuating vacancy rates that historically have reached into the double digits as recently as the past decade. To remove the option of equity take out for these properties removes the incentive to buy or build multi-family rental in these communities. Locating a purchaser can be difficult at the best of times and equity-take out is a viable way to return capital while still ensuring CMHC's exposure remains within guidelines. Given that many small BC communities now suffer from ultra-low vacancy rates, this is particularly troubling. It will, over time, discourage investment in communities that need it. Who would buy or build knowing that, when it comes time to sell, buyers will shy away or have to account for the additional cost of capital to do a return of capital?

Finally, I would add that aging multi-family rental buildings do need significant maintenance from time to time that cannot be put off. A new roof, for example, in a 75 suite 3 storey low rise complex could easily be half a million dollars or more, even if the property itself is only worth several times that much. If the owner has just renewed his/her mortgage recently when the roof needs to be done, he/she will have to wait years before being able to recoup the costs via the provision to reimburse for capital upgrades. This is just one more example of the mismatch of the cash flow timing that owners have to deal with - and what potential owners will simply elect not to deal with by simply selecting a different asset class for their investments. If equity take out were restricted only by the operating strength of the property, the owner in this example would have the resources needed to fund the roof due to an equity-take out occurring several years prior.

If it is CMHC's goal to encourage the maintenance, supply and construction of multi-family rental housing, then the restriction on when an owner can remove equity from the building is harmful to this goal. CMHC's presence sustains a market that continues to be assailed by regulation and popular opinion, unlike other real estate asset classes. This change will be one more nail that makes rental housing more expensive for renters, even if the effects take years to show themselves. The current crop of multi-family rental housing being built has been years in the planning, all of that predicated on the return of equity. I realize you are offering an exemption for new construction at the time of completion but how long will that last? Owners have a right to question the ongoing provision of this feature. Moreover, it is not a feature which assists owners who want to retain the asset for years into the future nor buyers who elect to buy the asset brand new or a few years after construction. In short, this feature restricts the amount of capital available for the supply rental housing (notwithstanding the exception to allow for the purchase of another multi-family asset or the reimbursement for construction or maintenance costs). This seems to be at counter-purposes with the intent of CMHC's involvement in the multi-family market, which is to stimulate the supply and maintenance of rental housing.

I appreciate there are many political headwinds blowing at the moment. In particular, the idea of owners removing money insured by the federal government to spend at will is a concept that certainly requires a response. I think that the history and track record of multi-family mortgages issued by CMHC would speak to this particular characterization. Diminishing the desirability of multi-family rental housing as an asset class is not, in my opinion, going to achieve the goal of providing more and better quality rental housing in British Columbia and Canada. In fact, the effect may well be the opposite, notwithstanding the fact of having satisfied the political sensibilities of some actors.

I trust these comments are useful to you.

Best Regards,

(Name withheld at the request of the writer)
Vancouver, BC