Intelligence MEMOS

From: Marion Steele

To: Canadian Housing Observers

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Re: **The Case for an Affordable Rental Housing Investment Tax Credit**

Steps to remedy Canada's rental housing crisis are urgently needed.

The federal National Housing Strategy has been a disappointment, resulting in few new housing units under construction and fewer still completed. Four years after launch, its five programs could claim projected expenditure on only 17,000 affordable units, a meagre 4,000 units a year.

These disappointing results are in line with Ottawa's housing record over the last 30 years. It has funded only a trickle of affordable housing: An annual average of fewer than 7,000 new units from 1996 to 2013 provided by the federal and provincial governments. This pales in comparison with the growing need.

Canada's poor record is in sharp contrast to that of the United States, which completed more than 3.5 million subsidized rental units from 1987 to 2021. Adjusting for population, Canada's equivalent number would near 400,000 or 11,000 per year.

How did this come about? Nearly 40 years ago, the US tightened taxation of rental real estate. At the same time, it passed the Low-Income Housing Tax Credit, to rescue low- and middle-income housing from the damage it otherwise would have suffered.

Canada did not follow this example when it passed tax reform legislation soon after the US. Now is an opportune time for Canada to implement it.

How would it work? Developers would receive a stream of tax credits. These would be passed on to those who buy shares in the development and would be used to offset their income tax. Typically, each share would be valued at the present value of this stream. Contrary to other tax credits – or tax expenditures such as MURBs – there would be a cap. Credits would be allocated annually to every province depending on population. In turn, provinces would choose the developers receiving the credits. While the tax credit would be federally funded it would be awarded according to the preferences of the provinces.

The Canada Revenue Agency (CRA) would lead this program. It would be responsible for ensuring projects meet the requirement that a set percentage of units are occupied by low-or moderate-income households. Rents would be 30 percent of the permitted maximum income of those living in the tax credit unit. Both non-profit and for-profit developers would be eligible for tax credits but some would be reserved for non-profits.

How would the project be financed? A large slice of equity would be obtained from the sale of the development's tax credits, or more precisely, its shares. The developer would usually enlist the services of a syndicator. The syndicator, in turn, would advise the developer in many ways including estimating the price that its credits would fetch; the price would in turn determine mortgage size. In Canada, developers might find it desirable to use the services of a syndicator experienced in US projects.

Syndicator fees have been a big issue. Early US fees were unacceptably high, but as syndicators gained experience and scale, they became more efficient and their fees fell. Indeed, this has converted tax-credit opponents to supporters. Furthermore syndicators' fees are now more transparent: they usually have a two-part structure consisting of a one-time acquisition fee plus an annual asset management fee.

At least two of the big six Canadian banks participate in the LIHTC market. At least one is a syndicator, has more than 1,000 affordable housing tax credit assets under administration and could plausibly apply its US experience to a similar Canadian program. Credit allocators, agencies of the provinces, would be permitted to add other requirements, such as accessibility and green conditions, and reduced income maximums. They could favour non-profits. Provinces would also be free to add a top-up.

US developers receive a 10-year stream of credits, but Canada should use 15 years to stretch the federal fiscal burden. Any longer stream would be less attractive unless the purchaser has a long period of expected tax liability. A credit in any year is valuable to purchasers in that year only if they have a tax liability at least as great as the credit; an unused credit could be carried forward but it would be less valuable than one that is immediately usable. For this reason individuals with steady and large taxable income (eg, doctors) are likely buyers; they would be a more important market for a Canadian housing investment tax credit than for the LIHTC in the US.

These design features take some of the best elements of tax policies that supported rental housing construction in the 1970s and 1980s, such as the MURB, and targets the program to affordable housing at limited immediate fiscal cost.

If it matches the US success, by its fifteenth year, I estimate such a tax credit could deliver as many as 165,000 affordable housing units in a program that spreads its costs over many years.

An affordable housing tax credit is worth implementing in Canada. It would harness the CRA's experienced oversight and the entrepreneurial drive of non-profit and for-profit developers to deliver new projects year after year.

Marion Steele is Emeritus Associate Professor in the Department of Economics and Finance, University of Guelph and co-author of the C.D. Howe Institute Commentary Building Affordable Rental Housing in Unaffordable Cities: A Canadian Low-Income Housing Tax Credit and author of related articles in the Canadian Tax Journal.