Toward Evidence Based Policy: Assessing the CMHC Rental Housing Finance Initiative (RCFI)?

*Steve Pomeroy, Senior Research Fellow, CURE **

The Rental Housing Finance Initiative (RCFI) has emerged as a centrepiece of the federal government's National Housing Strategy (NHS). This market supply initiative has seen three increases in its budget and now at $25.75 billion accounts for almost 40% of total NHS funding.

The NHS places an emphasis on addressing housing need for the most vulnerable (NHS p 1). It has two primary targets: to remove 530,000 families from housing need and to reduce chronic homelessness by half.

The RCFI design and purpose does not align with these goals. So why has it emerged as the centrepiece? Chapter 8 of the NHS commits to evidence based policy. This brief reviews the evidence and suggests it may be time to re-align or replace this initiative.

Announced in advance of the National Housing Strategy in Budget 2016 (initially at $2.5 billion over five years), the intent and design of the Rental Housing Finance Initiative (RCFI) was as a loan program intended to stimulate purpose built market rental construction. It targets middle income renter demand and, distinct from the thrust of the NHS, was not designed to meet the needs of vulnerable households, nor to target affordability issues, despite a token criteria to include a degree of affordability (discussed further below).

Against the persisting low level of rental construction since the early 1990's, there was a strong evidence based rationale to introduce the RCFI in 2016. While almost one-third of Canadian households are renters, rental construction has been substantially lagging. Only 10% of new home construction between 1995 and 2015 was intended as rental.

* I wish to acknowledge helpful comments and suggestions on an earlier draft provided by Marion Steele, Patricia Streich, Greg Suttor and Nick Falvo. Any errors, however, remain those of the primary author.

About the Center

The Centre for Urban Research and Education (CURE) is a multi-disciplinary network of researchers, primarily from Carleton University, who share an interest and commitment to strengthening mu- nicipal and urban affairs. With di- verse experience, expertise and perspectives, the CURE network carries out collaborative research in areas including community governance, citizen engagement and local capacity building around planning for infrastructure to support social, economic, and environmental sustainability.

Vision and Goals

We are committed to strengthening governance, policy making, and management in urban areas through collaborative research, community engagement, and education.

This low level of rental construction meant that persisting rental demand is concentrated on a small existing stock, causing vacancy rates to decline and rents to inflate. The consequence is a decline in rental affordability, and this impacts lower income households, who are predominantly renters (the median income of renter households in the 2016 census is less than half that of owners).

Any new rental construction helps to improve rental vacancies and thereby lessens pressure on the existing market, but this is a very indirect way to respond to the primary goals of the NHS. At best the RCFI is a parallel market initiative to complement the NHS (as currently configured and targeted) and rather than the most vulnerable, targets the middle class (a political priority).

Despite this untargeted parallel aspect, the RCFI has emerged as the centrepiece, and single largest financing program in the NHS. While the NHS has expanded from the initially announced $40 Billion to $67.5B, this is primarily due to increased budget for the RCFI.

The RCFI alone accounts for 85% ($23.25B) of the total increase of $27.5 billion in the NHS budget. [1]

Given its tenuous link to the overarching NHS targets and goals, what has compelled CMHC and the government to place such a substantial commitment to this particular program? Because this a non-budgetary loan program government does not incur any budgetary expenditure (loans are repaid and cover the interest expense plus CMHC administrative fees) government can make large announcements without increasing expenditure – in short, it is politically attractive. But is it good policy?

Understanding the impetus for the RCFI

The rental development industry and affiliates (Canadian Home Builders Assoc., Canadian Federation of Apartment Associations, Canadian Real Estate Assoc.) have persistently argued that low levels of rental construction since the early 1990's are associated with the tax treatment of rental investment.[2] They have lobbied hard to restore the tax treatment that prevailed in earlier decades, when rental construction was much higher, and for removal of the GST on rental housing, suggesting that with such change a higher volume of purpose built construction would result.

This advocacy has been continuously spurned by officials at the Dept of Finance. In part this opposition stems from a concern that implementing tax policy change across the larger rental sector (some 4 million units nationally, representing one-third of all housing) would impose a substantial revenue hit on the federal treasury. And if the objective is to stimulate more construction, a more targeted measure focusing only on new rental would limit the tax expenditure cost. In addition, it is unclear that it is tax treatment alone that is the deterrent to rental construction (see for example Lampert and Pomeroy 2017; Pomeroy and MacLennan 2019).[3]

---

[1] Announced initially in 2016 at $2.5 billion over 5 years the RFCI budget has been increased three times: by $1.25 billion in Budget 2018 (over 3 years to 2021), $10 billion in Budget 2019 (over 9 years to 2028) and a $12 billion increase in the Fall Economic Statement 2020 (for 8 years to 2028). And as a loan program it is a non-budgetary expenditure (distinct from grants and contributions).

[2] Prior tax treatment includes a range of measures including higher accelerated capital cost allowances, soft cost write offs, rollover provisions. Current concerns focus on the application of GST on new rental construction.

[3] Pomeroy, S and Duncan McLennan (2019). *Rental Housing in Canada's Cities: Challenges & Responses* for FCM/Maytree Foundation Urban Project; Pomeroy, S and Greg Lampert (2017) Analysis and Assessment of Recently Announced Federal Rental Housing Construction Finance program, for Canadian Home Builders Association.

But more importantly, as a general principle, Finance officials believe that program outcomes should be pursued through targeted programs and a parliamentary appropriation process, not by revising (or as they might say, distorting, the tax code). Finance is reluctant to change tax rules unless there is a clear case of unfair treatment and unintended effects (and evidently low rental construction was not perceived as such).

In late 2016 the various national associations again pursued tax change and specifically the exemption of new rental from GST in their pre-budget consultation briefs. This would lower construction costs by the GST rate and improve viability of new construction. Officials in the Dept of Finance sustained their intransigence to tax change. As a result, CMHC was directed to design a program that would meet the intent of stimulating new purpose built rental construction, but circumvent tax measures. The result is the RCFI.[4]

The design of the RCFI

Given the reported low level of rental construction, as a pure supply stimulus, the RCFI was well conceived. It addresses some critical issues that discouraged rental construction: weak viability of new rental construction especially short-term viability and an uncompetitive return on equity in the early operating years.

Design features include: a loan at a very favourable below market interest rate for a 10 year term, amortized over a 50 year duration only once the project achieves full stabilized rent up; and pre-approval for a private lender insured loan at the 10 year renewal with no insurance premium. In addition, depending on achieving a set of social outcomes relating to energy efficiency, accessible design and a very minimal affordability criteria it is potentially possible to secure financing for 100% of cost, although in practice a maximum of 90% is more likely.

All told, these create an attractive financing package for developers – the low interest rate and long amortization and absence of a loan to cost constraint reduce the amount of developer equity required, so combine to improve cash flow and to boost potential return on investment.

And for non-profits seeking to build market rate to diversify their low income portfolio, the high loan to cost ratio (minimal equity) is very helpful.[5]

RCFI creates a new market based criteria for affordability

With the objective to encourage rental construction (supply) it would be counter-productive to include an affordability outcome, and arguably doing so can have the effect of discouraging private developers and undermining the primary objective – to incentivize construction. Despite the primary purpose of RCFI as a supply initiative, and the fact it involves no subsidy expenditure, when submitted for cabinet approval political pressures apparently came to bear and directed CMHC to add an affordability requirement.[6]

---

[4] *"It [RCFI] was designed by us [CMHC] in place of the idea of a GST cut for purpose built rental".* Personal correspondence from CMHC senior official, March 2020. A working paper prepared for the CHBA in 2016 compared the newly announced RCFI design against removal of GST and found that the design of RCFI does ion fact generate an equivalent impact on project viability as would exempting new rentals from the HST. See Pomeroy and Lampert (2016), Purpose-Built Rental Housing: Assessing Potential Federal Program Design Options, prepared for CHBA.

[5] While data releases are not fully transparent and do not distinguish for profit from non-profit, it appears that from proponent name of projects announced to date around 1 in 5 (19%) have been non-profits.

[6] Confirmed in personal correspondence with CMHC senior officials, March 2020

So it appears that creating a new affordable benchmark was an attempt to address the Cabinet directive while not adding a disincentive effect.

Rather than simply adopt long standing affordability benchmarks (rents at or below the market median, or sometimes below 80% of median) the criteria adopted in RCFI were set very differently than in the case of targeted programs under the other NHS programming (social outcomes scoring grid) – where affordable has been defined as rents at or below 80% of the median local rent (by unit size).

Under RCFI a new benchmark of affordability was implemented, at 30% of area median family income based on a Statistics Canada data series that reports the median total income of all families for the area.[7]

Affordability: You must meet one of the following affordability requirements and it should be maintained for at least 10 years.

A: At least 20% of units must have rents below 30% of the median total income of all families for the area, and the total residential rental income must be at least 10% below its gross achievable residential income.

B: The proposal has been approved under another affordable housing program or initiative from any government level, such as capital grants, municipal concessions or expedited planning processing.

CMHC RCFI Guidelines, Project requirements.
https://www.cmhc-schl.gc.ca/en/nhs/rental-construction-financing-initiative

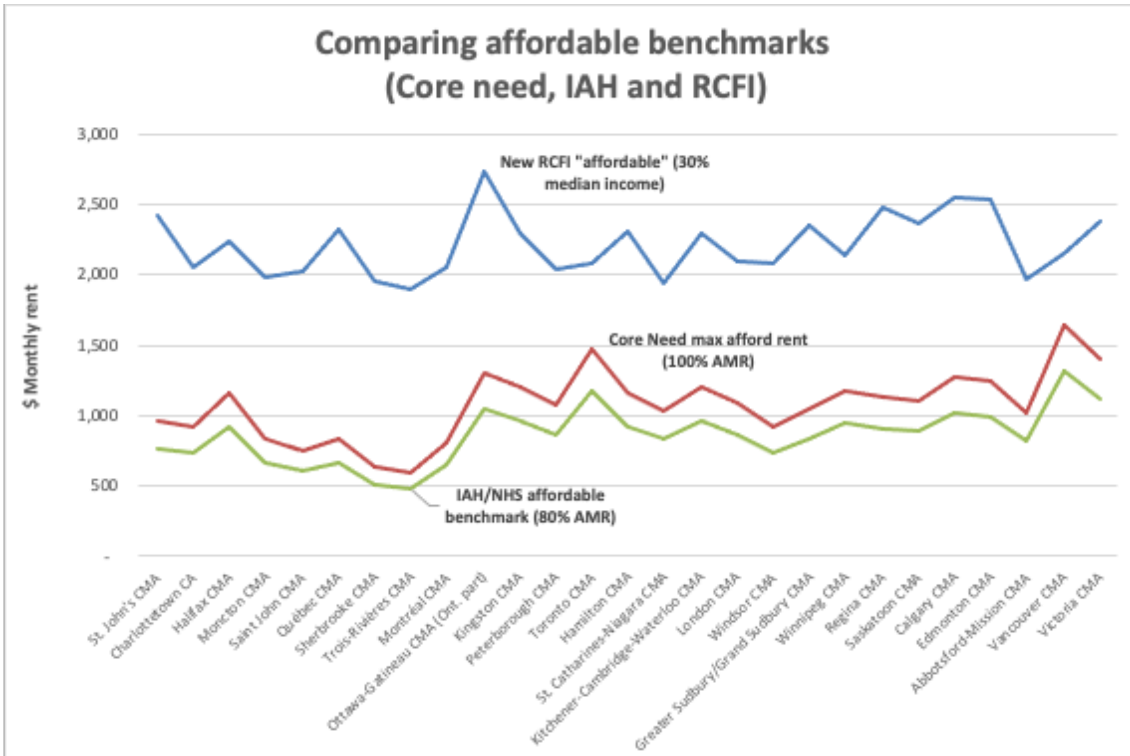
On the surface a criteria of 30% of median income appears to be a reasonable criteria, and it's likely that cabinet and the Minister's office believed this met their intent. **But in practice it is extremely modest with minimal, if any, negative** impact on the developer incentive to build.

It is only when one refers to the Statistics Canada data series to identify the median incomes and calculate 30% of these incomes that one realizes that this is a very poorly designed criteria and is far in excess of any reasonable definition of affordable.

Extracting the family median income from the designated Statistics Canada data set and calculating rents at 30% of these medians generates the required benchmark for affordability under RCFI. The chart below compares this new RCFI benchmark to both the maximum rent affordable to someone in core need (100% median rent) as well as the benchmark used in the previous Investments in Affordable Housing (IAH) program and in the new NHS co-investment fund criteria (80% median rent).

Comparing the new RCFI benchmark to median rents, as reported from the annual CMHC Market Rent Survey, as illustrated in the chart below, reveals that in almost no city in Canada is the RCFI affordable rent benchmark less than $2,000/month, nor is it remotely close to the median rent in any city. The lowest comparable rents are in the highest rent cities with Vancouver at 131% and Toronto at 141% of the median (i.e. 31% and 41% higher than median rents). In most cities this affordable criteria results in rents that are more than double the median rent (see appendix A).

[7] https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110000901



Souce: Median income Statistics Canada; AMR from CMHC Rent Survey

While developers may initially have been wary about RCFI imposing challenging criteria and thereby suppressing revenue potential, this reveals that the criteria were not onerous and did not act as a disincentive (again as noted the positive features more than offset this perceived impact).

One explanation for introducing this new soft definition (or benchmark) might be that the CMHC program architects were seeking to balance the Cabinet requirement to include some affordability criteria with the desire to avoid undermining the attraction and intent to stimulate new rental construction.

The nature of this RCFI affordability benchmark has been drawn to the attention of CMHC officials in both written submissions and in meetings, but to date no revision has been made.[8] In their responses, CMHC officials have pointed out that RCFI is a supply program not an affordable housing program, implying that the affordability criteria are merely incidental. And as noted, setting a modest affordability criteria may reflect an attempt to fulfill the directive without nullifying the primary intent to attract and stimulate rental construction.

CMHC officials also advised that despite this definition, the social outcomes matrix prioritizes projects that exceed this benchmark. Indeed many projects do exceed these criteria – but even here rents remain

[8] The submissions included suggestion to implement a single fix to recalibrate the criteria at 60% of median income (versus 100%), and then use the 30% affordability metric. Requiring rents at 30% of the 60th income percentile is well established standard benchmark used in the US especially in the single largest affordable housing program there, the Low Income Housing Tax Credit Program.

well above truly affordable levels.[9] For example, a press release announcing funding for a new RCFI financed project in Ottawa in February 2020 noted that this project was both adding to rental supply and adding much needed affordable housing. The announcement stated that the developer was "providing 65 units at only 21% of median income". That sounds like it should be very affordable – and the media reported it as such – but it is not.

The RCFI eligibility page on CMHC website links to a Statistics Canada file with these incomes. It turns out that in Ottawa the median income is $109,700 (2017) so that affordable at 30% is $2,750 per month. In this specific case, where the project substantially exceeded the benchmark to achieve 21% of median income, this means the "affordable" rents are $1,907. Meanwhile the average of one- and two-bed rents in Ottawa (2019) is $1,294. So this affordable rent is 148% of the average market rent (AMR). This is 48% greater than the 100% AMR which is widely accepted as the benchmark for calculating core need and an established affordable quantum.

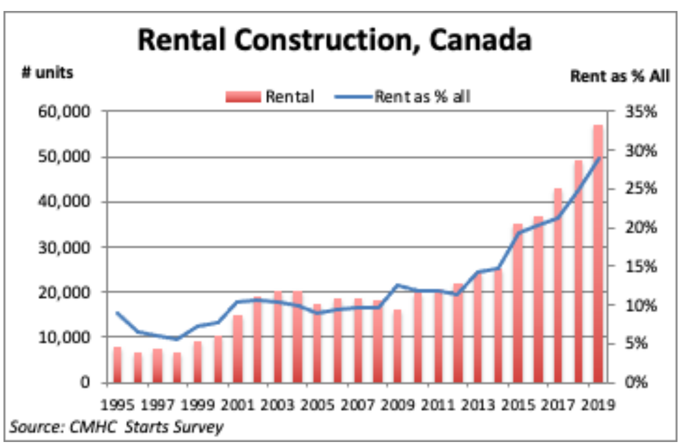
Does the rental market still need the RCFI?

Given this poor affordability outcome and minimal alignment with the primary NHS objectives, is it perplexing to see RCFI loan program not only sustained, but massively enhanced (from original $2.5 billion to $25.75 billion. This compares to minimal increases announced for the more targeted mainstream NHS programs (increasing by only $4.5 billion).

The most recent bump of $12 billion for RCFI in the Sept 2020 Fall Economic Statement was in response to reported high demand from developers and the fact that it is oversubscribed.

Despite this recent excess demand the evidence suggests that the RCFI has had minimal impact in stimulating new rental construction; it is simply a bonus to opportunistic developers that were already planning to build rental.

While there was a strong rationale for this financing initiative in 2016 (i.e., over 20 years of insufficient rental construction), it is debatable that this remains the case today. The market appears to have already responded to demand signals and no longer requires this type of stimulus.



[9] The assessment grid developed by CMHC awards points to prioritize projects that exceed minimal requirements. For affordability, maximum points are earned when rents are at or below 70% of the 30% of median income. As shown in Appendix table, only in Vancouver and Toronto does this deeper 70% calculation get rents down to or just below median rent.

The evidence for this assertion lies in the data on new housing starts. As noted, purpose built rental construction was exceedingly low through 2014, accounting for only 10% of all housing starts since 1995. However there is a notable upswing post 2015 and over the last few years a new record high has been reached every year, with 2019 starting over 57,000 rental units. This represents 29% of all new home construction.

And in 2020, despite anticipated slowdown in home construction (which did not materialize) rental starts to the end of the 3rd quarter are up 7% above the same period in 2019, suggesting another record year is likely. And the year-to-date number in 2020 represents 30% of all housing starts.

Market response versus RCFI Stimulus

One might be tempted to attribute this dramatic increase in rental starts to a successful RCFI program. But this is not actually the case. The market is responding to tightening vacancies, increasing rents and a shift to rental demand. In part this is associated with macro-prudential policy changes (mainly since 2015) that in combination with excessive home prices have constrained access to ownership (leaving this demand in the rental part of the housing system).

The RFCI was implemented only in April 2017 and the processing and approvals have been relatively slow, such that by Sept 2020, only 38 projects, containing a total of 6,842 have been approved and funded.[10] Some may not yet have started, as they may have only recently concluded the financing approval, so this is the upper estimate to RCFI output.[11]

This output of 6,842 can be compared to total rental starts since the 2nd quarter of 2017 (184,136).

Such a comparison shows that RCFI has had a minimal impact in stimulating new rental construction. At most, 4% of all starts since April 2017 can be attributed to RCFI.

Clearly market dynamics and demand are the primary driver. And to the extent that the market is responding to demand, the need for ongoing stimulus initiative is highly questionable.

So what should government do?

Given persisting core need and homelessness, both have which have been exacerbated during the COVID-19 pandemic, there is a strong case to increase funding and assistance to those programs more directly aligned with the NHS primary objectives to remove 530,000 families from housing need and to reduce chronic homelessness by half (and the Fall Statement implied that this homeless goal has now been elevated to reducing chronic homelessness by 100%).

This suggests that the new $12 billion in loan authority allocated to RCFI in the Fall Economic Statement

---

[10] As an indication of this slow processing, in an update on the 1st anniversary of the NHS, November 2018, CMHC reported that “since the launch of the RCFI (April 2017), more than 50 projects have been prioritized to receive a loan via this initiative. Five projects have been announced publicly since June 2018 representing close to 500 rental units and totalling up to $112 million in loans” Now two years later only 38 projects (including those original 5) with 6,842 units have been announced.

[11] CMHC officials note that there are many additional projects in the approval pipeline, and these exceed the current funding budget, thus the declaration that the RCFI is over-subscribed.

be redirected to more targeted programing addressing the needs of the most vulnerable or to address critical challenges in the housing system that are undermining efforts under the NHS to reduce need.

Three options are suggested:

- Option 1: Use market competition to lever better outcomes from the RCFI;
- Option 2: Redirect the $12 billion into a new modest rental acquisition program;
- Option 3: Place RCFI on hold and cease new applications until there is empirical evidence that there is a need to add stimulus for new purpose built rental construction.

Option 1: Use market competition to lever better outcomes from the RCFI

The rationale for the $12 billion increase in the RCFI budget was predicated on the fact that this is an attractive program which is over subscribed. This situation is similar to the US Low Income Housing Tax Credit (LIHTC), implemented in 1986 and the single largest affordable rental production program in the US. The LIHTC leans strongly to using market mechanisms and competition. Without getting into the details of the LIHTC, like the RCFI it is an attractive program to developers seeking to build rental and has become highly competitive. In allocating credits under the program, the LIHTC uses a detailed scoring matrix and rewards those proposals that best meet and exceed the program goals of both depth of affordability and duration of affordability.

At inception the LIHTC had a requirement that units remain affordable to households at or below 60% of median income (a far more stringent affordability criteria than the RCFI) for a minimum 15 years. Under the LIHTC scoring system, more points are earned for longer duration of affordability and greater depth. The result is that to be successful in winning an allocation project, proponents commit to 40 or more years (in a few cases over 50 years) of affordable compliance, and often with rents affordable at 50% of the area median income (i.e., 30% of 50% of the median income).

Another significant feature is that the LIHTC is frequently stacked with the Section 8 voucher housing allowance, which further reduces rents to very affordable levels. This works because the LIHTC already reduces rents to a moderate level. Potentially stacking the Canada Housing Benefit (CHB) with RCFI could achieve the same outcome. However this only works when the base rents are reasonably low. It would be extremely expensive to bridge from the RCFI affordable benchmark down to 30% of tenant income. And the current average CHB of $2,500 ($210 per month) would still leave these rents above the median level in almost all cities.

The RCFI already has a point-based scoring system and attempts to similarly incentivize proponents to exceed the minimum affordability (as well as the accessibility and energy efficiency) criteria. But the current metrics in the RCFI are weak and do not push deep nor longer term affordability to the extent done in the LIHTC. The excess competition for RCFI financing suggests that there is plenty of room to push the scoring to a far more aggressive level, emulating the approach and impact of the US LIHTC. And doing so would then help to enable feasible stacking of RCFI and CHB.

Taking this approach would also enable non-profit proponents, more likely to include deeper affordability to increase their share of this funding source to add permanent moderate rent and affordable supply.

Option 2: Redirect the $12 billion into a new modest rental acquisition program

Between 2011 and 2016, for every new affordable unit that was created under the FPT Investments in Affordable Housing (IAH) and provincial initiatives, 15 existing lower rent affordable units (i.e. renting below $750/month in nominal terms) were lost. During this time the number of such affordable rental units in Canada declined by 322,000. This erosion of affordable housing massively negates the efforts of the NHS to reduce housing unaffordability for tenants and decrease homelessness.

Despite investment in new housing production, unless we can curtail the attrition of existing affordable rental units, there may be a steady rise in households in core housing need, facing eviction, or at-risk of homelessness. Much of this loss is associated with financialization of the rental market, which involves capital funds and particularly Real Estate Investment Trusts (REITs) seeking out properties with lower rent units (defined by REITs as “under-performing properties) and seeking to raise rents to generate increased yield to investors.

Proposals have been submitted to CMHC and many associations have advocated to address this issue by creating a funding mechanism to enable non-profit housing corporations to similarly identify and purchase existing assets where rents are currently affordable (i.e. below the local median levels). By shifting properties into non-profit ownership, the existing affordability can be preserved, and the erosion of such properties slowed. Because these existing properties have positive income, much of the acquisition cost can be financed, although some small capital grant or equity investment also required.

This would be a far more effective use of the $12 billion loan facility.

Option 3: Place RCFI on hold and cease new applications

Given its minimal impact to date and the strong market performance of rental construction without the RCFI, it is clear that this financing initiative is not needed to stimulate new purpose built rental. Nor does it address the primary objectives of the NHS. Accordingly, RCFI should be terminated or placed on hold (in the event that the market does not continue to produce).[12]

[12] A sub option might consider sustaining a non-profit version of this initiative. Under the RCFI affordability criteria option B qualifies a project that is already accessing other affordable programs so RCFI simply becomes a low cost loan program that can stretch these benefits. A portion of the budget could be retained and made available to non-profit providers seeking to build at market rents, with some modest affordability. This would strengthen the balance sheet of non-profits whose existing stock is deeply targeted and over time these units can transition to more affordable levels, by limiting rent increases over time (and rents would then lag inflation in the overall market to become relatively more affordable over time). Or as noted this outcome might be achieved by revising the point rating system as discussed in option 1 with greater priority given to proposals that have deeper and longer affordability.

Appendix A Table 1

Examining the "Affordable rent" Benchmark in RCFI

	Median total income, all families (2017)	RCFI "Affordable" max rent = 30% median income/mo	Average Market Rent (2 bed) 2018	RCFI "Affordable" as percent AMR	RCFI "Affordable at 70% of 30% median income) to max point score	Deeper 70% "Affordability" as percent AMR *
St. John's CMA	97,110	2,428	961	253%	1,699	177%
Charlottetown CA	81,970	2,049	921	223%	1,434	156%
Halifax CMA	89,510	2,238	1,156	194%	1,566	136%
Moncton CMA	79,460	1,987	831	239%	1,391	167%
Saint John CMA	80,760	2,019	755	267%	1,413	187%
Québec CMA	92,690	2,317	839	276%	1,622	193%
Sherbrooke CMA	78,120	1,953	639	306%	1,367	214%
Trois-Rivières CMA	76,050	1,901	601	316%	1,331	221%
Montréal CMA	82,000	2,050	809	253%	1,435	177%
Ottawa-Gatineau CMA (Ont. part)	109,550	2,739	1,301	211%	1,917	147%
Kingston CMA	91,790	2,295	1,200	191%	1,606	134%
Peterborough CMA	81,410	2,035	1,077	189%	1,425	132%
Toronto CMA	83,020	2,076	1,467	141%	1,453	99%
Hamilton CMA	92,090	2,302	1,158	199%	1,612	139%
St. Catharines-Niagara CMA	77,870	1,947	1,036	188%	1,363	132%
Kitchener-Cambridge-Waterloo CMA	91,580	2,290	1,210	189%	1,603	132%
London CMA	83,880	2,097	1,087	193%	1,468	135%
Windsor CMA	83,210	2,080	915	227%	1,456	159%
Greater Sudbury/Grand Sudbury CMA	93,860	2,347	1,052	223%	1,643	156%
Winnipeg CMA	85,660	2,142	1,179	182%	1,499	127%
Regina CMA	99,240	2,481	1,130	220%	1,737	154%
Saskatoon CMA	94,810	2,370	1,110	214%	1,659	149%
Calgary CMA	102,060	2,552	1,272	201%	1,786	140%
Edmonton CMA	101,190	2,530	1,246	203%	1,771	142%
Abbotsford-Mission CMA	78,660	1,967	1,022	192%	1,377	135%
Vancouver CMA	86,140	2,154	1,649	131%	1,507	91%
Victoria CMA	95,250	2,381	1,406	169%	1,667	119%

* The scoring grid allocated higher points and thus priority if rents achive this beter affordability benchmark.

Source for rents - CMHC 2019 Rental Market Survey (Canada table 1.0)

Source for income (as linked to CMHC RCFI page) - here use 2017, this has recently been updated to add 2018

Statistics Canada. Table 11-10-0009-01 Selected income characteristics of census families by family type

https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110000901