

Policy in Focus

September 2011

Growing Saskatchewan's Rental Housing Supply

Core Recommendations: Eliminate the inactive tax rate on real property and use the regular small business and large business corporate tax rates, levy the same property tax on rental properties as is levied on other residential property, allow reinvested capital gains to be rolled over into a new residential project and balanced the Residential Tenancies Act.

Background

Government policies have discouraged the building of rental properties in Saskatchewan and are contributing to higher rents. As many individuals in our communities have looked at building a rental property, but have backed away as soon as they look at the tax policy on rental accommodations.

Why is this?

First, rental income is considered “inactive” income for a business with less than five employees. This so-called “inactive” income is taxed at 46.7%. Compare this to the maximum personal income tax rate of 44% and the small business tax rate of 13%.

This tax rate means that if the owner of the building borrows money to build the building, the cost to borrow this money doubles because of the federal and provincial taxes. Consider an owner who borrows \$100,000 to build a rental unit. This owner will pay \$100,000 of the principle back to the bank with after tax dollars. Assume he pays the bank \$62,000 in interest (15% for 15 year) and the federal and provincial governments cost \$87,600 in taxes. The owner will have to pay out \$249,600 in cash for this \$100,000 loan. This has a significant impact on the rental rate per apartment that must be charged just to cover the cost of borrowing the money to build the unit.

Rental units in Saskatchewan cost between \$40,000 to \$100,000 per apartment to build. The owner needs to charge between \$500 and \$1,380 just to cover cost of the capital to build the rental units. In our example of \$100,000 unit, it would cost the owner \$1,386.66 (\$249,600/15years/12 months) per month.

In addition to just the capital costs, the owner must pay for the operating the units – janitorial, repair and maintenance, insurance, vacancy months, property taxes, regulatory compliance

This situation is the core reason why rents are so high and so few rental accommodations are being built.

Those who blame the owners, as opposed to the government, for the low number of rental units being built will argue that owners can depreciate buildings. This is true; however, they will pay the 46.7% tax on any funds they recapture by depreciating the building. And, if they sell the building and have a capital gain, they pay a capital gain on any profit they make.

If this not enough, the municipal governments, wanting their fair share of this supposed cash cow, levy higher property taxes on rental units than on other residential properties.

In Saskatchewan the property tax rate on rental properties is 10 to 15% higher than on other residential properties. The result of this discrimination in property taxes is even higher rents, and the decision by many investors not to build rental apartments; but to invest in other types of property.

Finally, the Saskatchewan *Residential Tenancies Act* is biased in favour of the tenant. Landlords have few rights to protect themselves from those tenants who do not pay their rents, are disruptive to other tenants, or damage the rental property. This bias in the Act is made worse by the Office of Residential Tenancies usually acting as an advocate for the tenant.

Recommendations

- 1) The Provincial and Federal governments should eliminate the inactive tax rate on real property and use the rates and the rules that are applicable on active corporations – that is, the regular small business and large business corporate tax rates. This alone could reduce the monthly rental rates on \$100,000 worth of investments by \$385 per month.
- 2) Municipal governments should end the discrimination against rental properties and levy the same property tax on them as they do on other residential property.
- 3) The Residential Tenancies Act needs to be balanced and protect the rights of both the tenant and the owner. Further, the Office of Residential Tenancies should be charged with a regulatory enforcement ability that is viewed as unbiased to either the renter or the landlord. It is perceived that the Office represents the renter and the Office currently has a quasi-judicial role that can be easily expanded to enforce the rights of the owner as well as the tenant.
- 4) The Federal government should allow owners of rental properties to roll over capital gains if the capital gain is reinvested in a new residential project as the Tax Act is written.