An Analysis of Manitoba's Rent Regulation Program and the Impact on the Rental Housing Market

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Executive Summary

Introduction

1. Manitoba has experienced a significant decline in the vacancy rate for rental accommodation, from over 5% in 1995 to 0.9% in October 2010. This has led to some commentators on the housing market to identify the province's rent regulation program as a major contributor to the tight rental market: by restraining monthly rental rates below what market conditions would dictate, supply is reduced and a shortage of accommodation results.

The Economic Literature on Rent Regulations

2. Many of the criticisms of rent regulations are ill-founded on both theoretical and empirical grounds. Well-worn myths about rent regulations—that they reduce the quantity and quality of rental accommodation--derive from a simple textbook model of "rent controls" applied to first-generation programs that existed in the 1950s. More sophisticated analysis of second-generation programs--such as that which exists in Manitoba—indicate that well-designed rent regulations can improve the economic security of tenants and, at the same time, have a beneficial effect on the market's efficiency. An assessment of rent regulations must, therefore, proceed on a case-by-case basis.

Rent Regulations in Manitoba

3. Manitoba is by no means unique in Canada by virtue of having a rent regulation program: 56% of the Canadian population lives in a province with rent regulations and, when Quebec's rent arbitration system is included, this figure rises to 79%.

4. Manitoba's regulations are based on a guideline/cost pass-through approach. An annual guideline is established and rents may be increased up to this guideline without administrative review. Landlords may apply for an increase above the guideline based upon a review of their operating costs, capital expenditures and any financial loss experienced.

5. Exemptions from rent regulations are extended to units that: a) rent above a specified dollar threshold; b) have undergone an approved rehabilitation scheme; c) are in buildings with three units or less and become vacant; or d) are newly-constructed.

6. Manitoba's regulations are broadly similar to those in place in British Columbia, Ontario and PEI. Although the annual rent guideline in Manitoba has tended to be lower, it considers a greater range of factors eligible for cost pass-through. Otherwise, the main difference is with respect to "tenancy rent regulations": in BC and Ontario, all units that become vacant are exempt from rent regulations for the new tenant's first lease; in Manitoba, this provision applies only to buildings with less than three rental units.

7. The government's annual cost of administering the rent regulation program is surprisingly small, roughly \$1.7 million or less than \$2 per capita.

The Impact of Rent Regulations on the Manitoba Rental Housing Market

8. There is no evidence that rent regulations have unduly restricted the rate of rent increases in the province. Because landlords are able to pass-through increases in operating costs in the form of higher rents, regulations tend to stabilize market rents at a level consistent with what

would exist in a competitive market under equilibrium conditions. By preventing unwarranted increases--associated with a temporary disequilibrium characterized by excess demand or with non-competitive conditions--rent regulations improve market efficiency.

9. There is no evidence that Manitoba's rent regulation program has a negative impact on the supply of rental accommodation, either in the conversion of existing units to condominium ownership, or in slowing the rate of construction of new rental units. Specifically, the rate of condominium conversions has fallen sharply since the mid-1990s, and exemptions on rent regulations for newly-constructed units largely removes any effect on the rate of return on investment.

10. There is no evidence that rent regulations have contributed to deterioration in the quality of rental housing stock. To the contrary, the treatment of capital expenditures in cost pass-through calculations offers an incentive for landlords to undertake expenditures on maintenance, repair and capital improvements.

11. A further virtue of Manitoba's rent regulation program is that it has maintained a stable policy environment, an important consideration for entrepreneurs when considering a large investment in an extremely durable capital asset.

The Dynamics of the Rental Housing Market

12. Manitoba's relatively low vacancy rate reflects a market disequilibrium created by a rapid increase in demand and a relatively slow supply response, a situation not unusual in the housing market. Manitoba experienced a sharp, and largely unanticipated, increase in population mainly associated with the province's highly-successful Provincial Nominee Program that has attracted a large inflow of immigrants. The associated population growth has resulted in a significant increase in demand for housing, including rental units. The supply response has been slow relative to the increase in demand because of the time lag involved in the planning-to-completion of new rental projects and uncertainty regarding the likelihood that the relatively high rates of population growth in the province will persist.

13. It is precisely under such disequilibrium conditions that rent regulations are important in preventing rent "gouging," or unwarranted increases in rents above the cost of supplying the unit because of excess demand.

Achieving Balance in the Rental Housing Market

14. The principal purpose of a rent regulation policy is to provide tenants with greater security of tenure by protecting them from an unwarranted increase in monthly rent. At the same time, rent regulations should not interfere with the landlord's claim to an adequate rate of return on investment, nor remove market incentives that ensure an adequate supply of rental accommodation. Rent regulations in Manitoba achieve an appropriate balance between these competing objectives and, in doing so, enhances the efficiency of the rental housing market. Moreover, it does so at relatively little administrative costs.

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1. Introduction

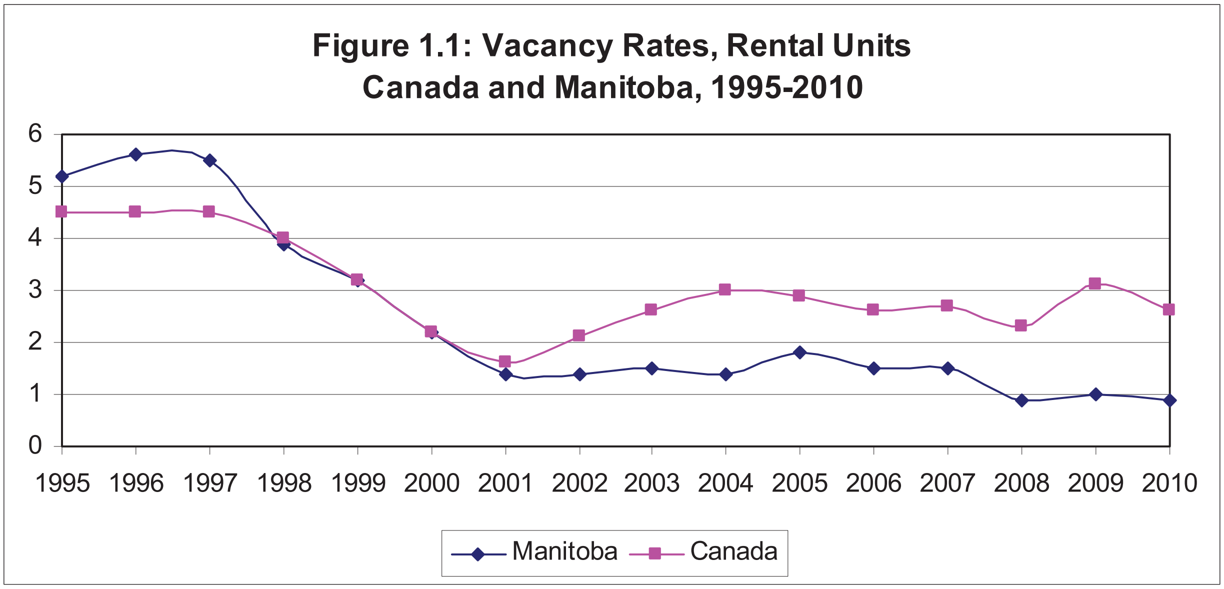
Manitoba has recently experienced a significant decline in the vacancy rate for rental accommodation. Between 1997 and 2001, rates in both Manitoba and Canada fell precipitously from over 4.5% to under 2%. The rate in Canada subsequently rebounded to the 3% range, but has remained low in Manitoba, falling to 0.9% in October 2010 (Figure 1.1). With the exception of Portage la Prairie, low vacancy rates exist throughout urban centres in the province (Figure 1.2).

The apparent tightness in the rental market in Manitoba has prompted renewed attention to the province's rent regulations. Some critics have argued that the regulations are to blame for the rental housing shortage: by reducing the rate of return on housing investment, the abandonment of existing rental units or their conversion to condominium ownership has accelerated, and the rate of new construction has slowed. In contrast, tenant organization and social policy advocates have called for policies complementary to rent regulations–including greater control over the conversion of rental units to condominium ownership–as a means of maintaining an adequate supply.[1]

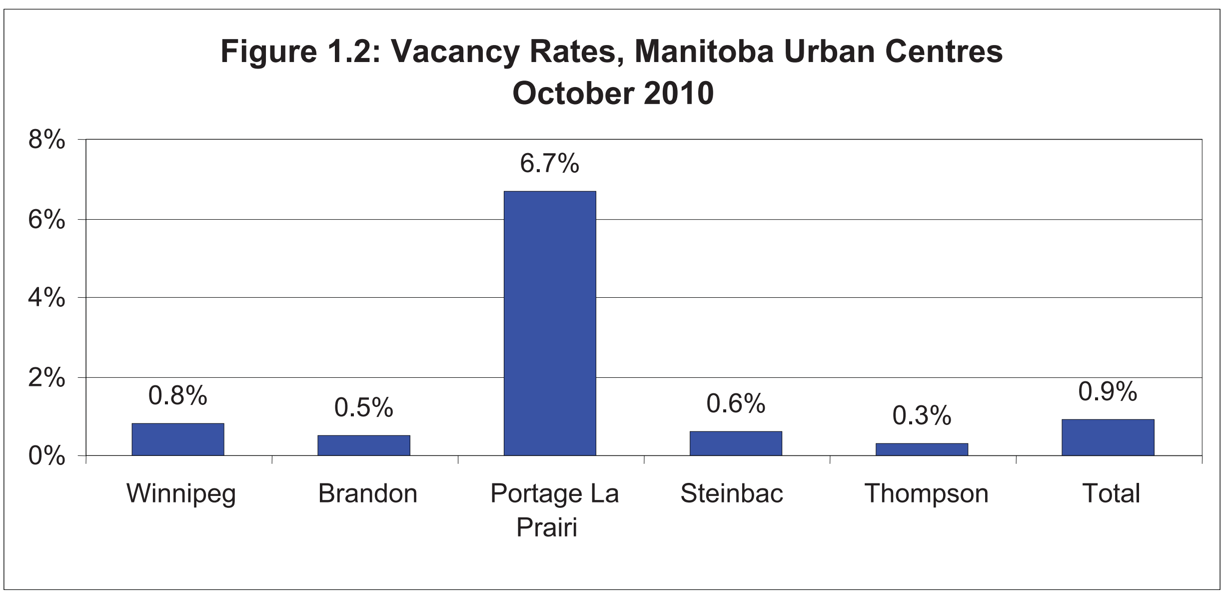
In light of these concerns, this study considers the impact of the Manitoba rent regulation program (The Residential Tenancies Act, Residential Rent Regulation) on the rental housing market in Manitoba. The objectives are to:

- review the economic literature of rent regulations and their implications for the rental housing market;
- describe Manitoba rent regulation program and compare it to similar programs in other Canadian provinces;
- assess the impact of Manitoba's rent regulation on the rental housing market;
- provide a broader account of the factors influencing the market for rental housing in Manitoba; and
- conclude by examining the role of Manitoba's rent regulations in achieving an appropriate balance between the tenant's security of tenure and the landlord's claim to an adequate return on investment.

[1] For example, "Rent Controls Cause Rental Unit Shortage," *Winnipeg Real Estate News*, 5 November 2010, and Canadian Centre for Policy Alternatives, Manitoba Office, "Rising housing prices and low rental vacancy - a perfect storm for condo conversion," *Fast Facts*, 10 October 2010.



Note: 2005-2010 figures are for October in each year. Data is limited to buildings with 3 or more rental units
Source: CMHC, *Rental Market Report – Manitoba Highlights, various years.*



Source: CMHC, *Rental Market Report – Manitoba Highlight.* Fall 2010.

2. The Economic Literature on Rent Regulations

The attention paid to rent regulations in North America has waxed and waned with broad trends in the rental housing market, increasing during times of relatively tight supply and decreasing as supply pressures eased. The literature, with a particular bearing on Canada, can be loosely grouped into three periods:

- "First-generation" rent regulations were adopted throughout Europe and North America to address a housing shortage after World War II. The literature that followed, almost without exception, was based on a simple model of an inflexible rent "freeze" imposed on a competitive rental housing market and emphasized the detrimental impact of interfering with the market mechanism.

- High inflation rates associated with the energy crisis in the mid-1970s led many jurisdictions to implement second-generation rent regulations, characterized by a specified guideline for rent increases and a review process that permitted increases above the guideline. Canada was no exception with all provinces introducing rent regulations to complement the Federal Government's Anti-Inflation Program of 1975-78. The design of second-generation rent regulations, to the extent that they maintained incentives for renovating existing units and for investing in the construction of new units, removed or ameliorated many of the objections to earlier "hard" rent regulation regimes. Most of the analysis, though still largely opposed to rent regulations, acknowledged that, if properly designed, they had a more benign effect on the supply of rental accommodation.

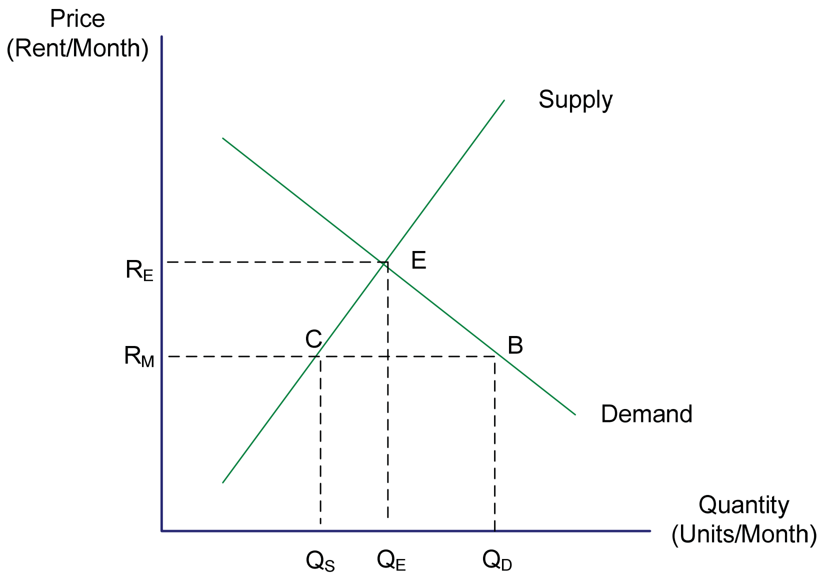
- Since the mid-1980s, more sophisticated analysis has emphasized several features of the rental housing market that make the application of a simple, perfectly-competitive model inappropriate. By depicting the rental market as a series of sub-markets (based on either quality or spatial location), this analysis suggests that rent regulations may counterbalance the market power exercised by landlords and, if properly designed, play a beneficial role in improving market efficiency.

2.1 The Simple Model of a Perfectly-Competitive Rental Housing Market

Early treatments of "first-generation" rent regulations were based on a "hard" rent ceiling imposed upon what was perceived to be a perfectly-competitive rental housing market.

Familiar to all first-year university students in economics is the argument that "rent controls" create a market "distortion" that yields several inefficient outcomes. Begin by assuming that the rental housing market is composed of homogeneous apartment units offering identical housing services. The demand for housing services, which depends on the size of the population, average disposable income and conditions in the home-ownership market, is downward-sloping in terms of the monthly rent. The supply of housing services can be depicted as either fixed in the short-run or increasing with respect to monthly rent (as in Figure 2.1), depending upon the time horizon over which landlords may adjust supply. Monthly rents will adjust to equilibrate supply and demand such that the market will "clear": all tenants willing to pay the equilibrium rent will find an apartment, and all landlords willing to supply rental accommodation at the equilibrium rent will find a tenant. Vacancy rates will be at a "normal" level consistent with the regular turnover of tenants. This equilibrium is depicted as point "E" in Figure 2.1.

Figure 2.1: Simple Depiction of the Impact of "Rent Controls"



The introduction of government rent regulations is portrayed as a maximum legal rent (R_M) set below the equilibrium rent (R_E). In response, more potential tenants are induced to seek an apartment at this relatively low monthly rent (point *B*), but some landlords are induced to withdraw apartment units from the market because the maximum allowable monthly rent falls below their marginal cost of supplying the unit (point *C*). A shortage of rental units results, with a long queue of potential tenants unable to find accommodation (*B*-*C*). This shortage (or excess demand) is evident in a fall in the vacancy rate below the normal rate.

Other undesirable effects are also predicted to occur. In an effort to evade rent regulations, "key money" and other side payments may become prevalent since there are tenants and landlords willing enter into a rental contract above the legal monthly rent. Tenant mobility is also reduced because households are encouraged to remain in a rent-protected unit long past the time that the services it provides are ideally suited to their needs, while the shortage of units forces other households to remain in equally ill-suited apartments. This mismatching of tenants to rental units is often depicted in the image of the elderly widower remaining in a rent-protected four-bedroom apartment, while a family of four is crowded into a two-bedroom unit.

In the long-run, the situation is exacerbated because the rent ceiling lowers the rate of return on rental units. The quality of the existing rental stock deteriorates because of reduced maintenance and repair expenditures, units are removed from the market through abandonment or conversion to owner-occupied condominiums, and new construction is discouraged. The upshot is that "rent controls," designed to protect tenants, actually harms many, if not most, by creating a shortage of accommodation.

This simple abstraction, in large part because of its simplicity, provides powerful arguments against rent regulations that are frequently voiced by interest groups in the housing industry. But as one economist admitted in 1950, “The theoretical analysis of rent control rests on some principles which are quite elementary, indeed distressingly so. They are so obvious that one would feel the greatest reluctance to repeat them in a professional journal were it not that a great public policy has been erected upon either ignorance or a repudiation of them” (Grapp, cited in Turner and Malpezzi, 2003). While this literature tended to be more polemical than analytical, it was not without value in emphasizing the potential impact of a hard rent freeze on market incentives for the supply of rental housing. Indeed, “second-generation” rent regulation programs throughout North America adopted features designed to address many of the potential harmful effects on the supply of rental housing.

2.2 Empirical Analysis of Second-Generation Rent Regulation Programs

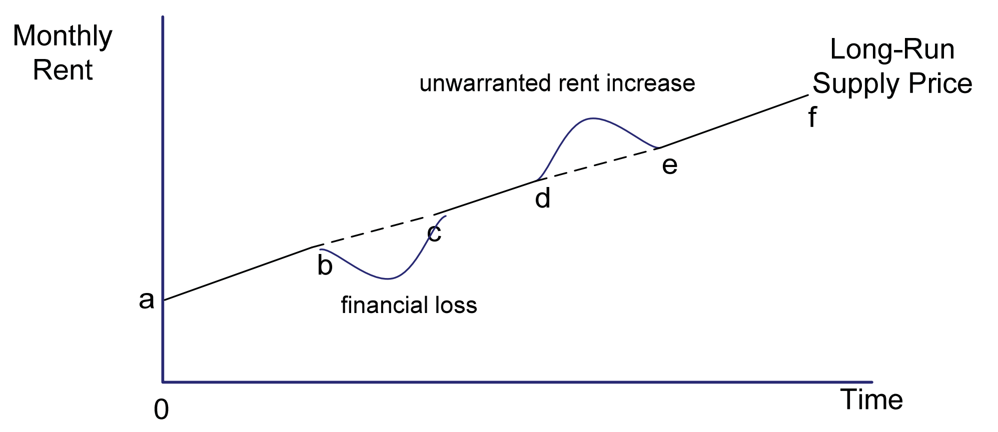
The primary feature of most second-generation rent regulation programs that emerged in the 1970s is the establishment of an annual guideline for rent increases and a review process triggered by the application of a landlord for an increase above the guideline. (Most programs also extend to tenants the reciprocal right to apply for a rent increase below the guideline.) The review process is primarily based upon an assessment of the landlord’s operating expenses and the extent to which increased costs may be converted or “passed-through” to tenants in the form of a higher monthly rent. Several empirical studies highlighted different aspects of rent regulations and their implications for the rental housing market.

2.2.1 Cost Pass-Through and the Impact on Rents and Rates of Return

In a perfectly-competitive market, rents in the long-run should adjust to the operating cost of supplying a rental unit and, in doing so, ensure an adequate rate of return on investment. In the short-run, however, fluctuations in demand may result in rents rising above or falling below the landlord’s average cost, and thus yield either abnormally-high profits or financial losses. In theory, regardless of how high the rent guideline is set, if the review process allows landlords to pass through all increases in operating costs and includes a “hardship provision” in the event of a financial loss, the rent on a unit should follow a trajectory proscribed by equilibrium conditions in a perfectly-competitive market. Rent regulations allow rents to increase at a rate commensurate with long-run supply costs but prevent unwarranted increases during periods of excess demand and offset financial losses during periods of excess supply.

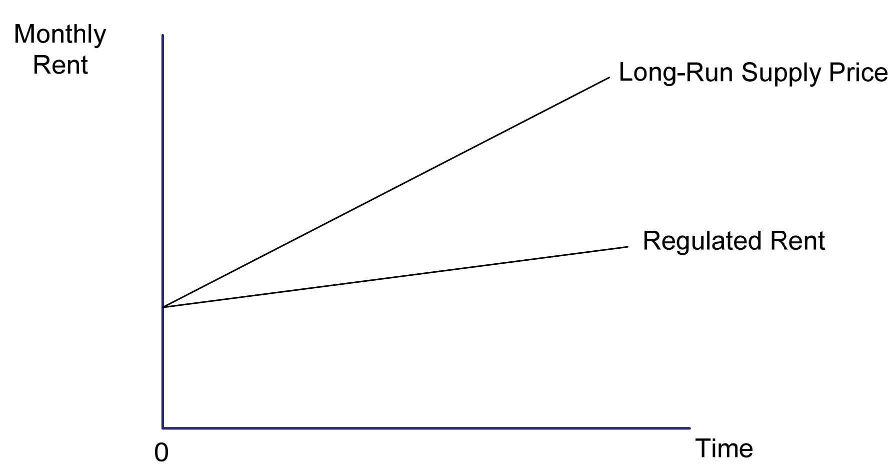
For this reason, rent regulations were often referred to as rent stabilization. In Figure 2.2, the market rent tends to fluctuate around the long-run supply price: during period of excess supply (b-c), the market rent falls and financial losses occur, while during periods of excess demand (d-e) rents rise above what is warranted by the long-run supply conditions. By compensating landlords for financial losses and preventing unwarranted increases during periods of excess demand, rent regulations stabilize the rate of rent increases along the path a-f.

Figure 2.2: Rent Regulation as Rent Stabilization



The important empirical question is the extent to which rent regulations were “binding” in the sense that they tended to reduce rents below the long-run supply price. If cost pass-through is too narrowly applied, landlords are unable to recoup all of the increase in their marginal costs; moreover, the effects are cumulative such that the gap between the regulated rent and the long-run supply price grows over time (Figure 2.3) In Ontario, for instance, it was found that average gross rents lagged well behind the rate of inflation and net operating revenue fell by 20%, adjusting for the rate of inflation, between 1975 and 1986 (Smith, 1988). Evidence of this nature, although based on casual observation of broad price trends, suggested that that rent regulations were restricting average rents below what the market would dictate under equilibrium conditions in a perfectly-competitive market. In such instances, it follows that the rate of return on rental housing investment is also reduced and is inadequate to bring forth an adequate supply.

Figure 2.3: Rent Trajectories with Binding Rent Regulations



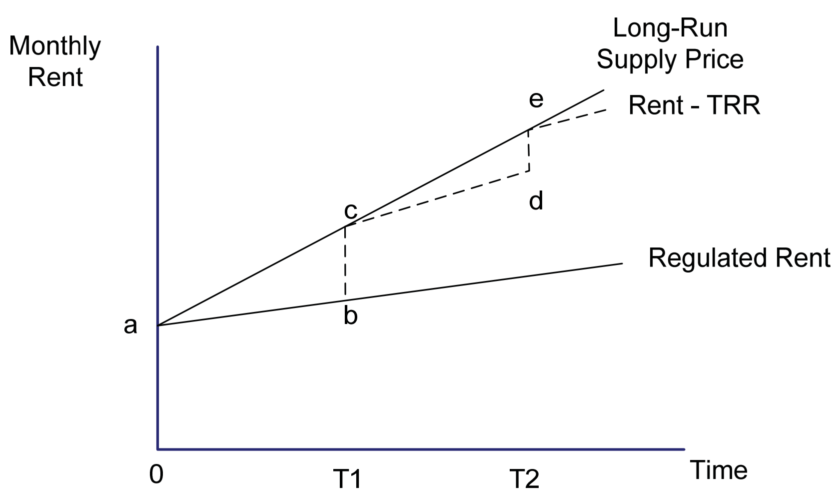
2.2.2 Inter-Tenancy Deregulation or "Tenancy Rent Regulations"

In response to this concern, many jurisdictions adopted inter-tenancy deregulation (or "tenancy rent regulations") in which rents are subject to regulation for a sitting tenant, but allows the landlord to be free to set rents for a new tenant after the unit becomes vacant. Once the monthly rental rate for the new tenant is established, the unit is again subject to rent regulations.

Such an approach has desirable attributes in instances where rent regulations are binding and thus tend to lower rents below the long-run supply price. If the rent review process does not allow a sufficient percentage of operating costs to pass through, the gap between actual rents and the market rate increasingly widens over time. Tenancy rent regulation thus provides a "safety valve" by allowing rents to adjust to the long-run supply price upon units becoming vacant and a new tenant secured (Arnott, 2003).

This operation of tenancy rent regulation is depicted in Figure 2.4. At the beginning of the period, the regulated rent and the long-run supply price are identical, at point a. If, however, rent regulations prevent rents from increasing at a rate consistent with changes in operating costs, the two paths diverge. When the first tenant vacates the unit at time T1, the landlord is free to adjust the rent upward from b to c. During the tenure of the second tenant, regulations are re-imposed and the paths again diverge. When the second tenant leaves the apartment at time T2, the rent can again be adjusted to the long-run supply price (d-e).

Figure 2.4: Rent Trajectories with Tenancy Rent Regulations



Tenancy rent regulation, however, has some undesirable effects. Landlords have an incentive to select tenants who are expected to be temporary and, of greater concern, are encouraged to find grounds to evict tenants. This will increase the cost of monitoring and enforcing compliance with other aspects of the landlord-tenant act designed to protect the tenant's security of tenure. Tenants, on the other hand, are encouraged to remain in the unit long after its attributes are less than optimal because of the relatively low monthly rent. If this results in lower mobility among individuals where, in the extreme case that they forego better job opportunities elsewhere, there may be undesirable consequences for the labour market.

2.2.3 Capital Expenses, Renovations and Maintenance

A major objection to first-generation rent regulations was that they caused deterioration in the quality of the rental housing stock.[2] By reducing the landlord's rate of return and contributing to a long queue of potential tenants for existing vacancies, the landlord had little incentive to undertake repairs or major renovations.

In response to this criticism, many second-generation programs included capital expenditures in the determination of cost pass-through. Since capital expenditures are amortized over the life of the improvement, a generous cost-pass through provision, such as allowing a $1.50 increase in rent for every $1.00 spent on upgrades, can make it profitable for landlords to undertake renovations (Olsen, 1988). Many rent regulation regimes, therefore, provide an incentive, rather than disincentive, for maintenance, repair and capital improvement expenditures.

2.2.4 Exemptions on Newly-Constructed and Rehabilitated Units

Stabilizing rents on existing units does not address the objection that rent regulations reduce incentives for the construction of new units by lowering the expected rate of return. Accordingly, most second-generation rent regulation programs include an exemption on newly-constructed units, with landlords free to set the annual rent increase for a specific period before rent regulations apply.

The impact of such an exemption obviously depends upon the duration of the exemption period. In both Ontario and Manitoba, the exemption was initially set at five years. The impact of a five-year exemption on the present value of a durable asset with a life expectancy of fifty years or more, while not insignificant, could be expected to have only a marginal effect on new investments. In response, Manitoba extended the exemption to 15 years in 2001 and then to 20 years in 2005 and, in so doing, maintained and extended a consistent policy approach. In contrast, the exemption in Ontario was extended indefinitely in 1979, but then removed entirely in 1982 (Smith, 1988). As many commentators observed, frequent changes in the rules governing newly-constructed units tend to undermine positive incentives they are intended to create: investors desire a stable policy environment upon which to base their decisions and frequent rule changes simply create uncertainty over future rules.

Exemptions, however, may pose other potential problems by creating a regulated and an unregulated sector in the rental market. If rent regulations are binding, the excess demand in the regulated sector may spill over into the unregulated sector and drive up rents there. Fallis and Smith (1984, 1985) considered the situation in Toronto in the early 1980s and estimated that relative to what rents would have been in an unregulated market, rents were raised in the unregulated sector and were roughly 20 per cent higher than those in the regulated sector (after

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[2] It is important to distinguish between the housing services provided by a rental unit and the rental unit itself: early rent regulations were imposed on the rental unit, while tenants' demand, and landlords' supply, rental services which vary according to the quality of the rental unit. In response to rent regulations, landlords forego maintenance and renovation work and the quality of the rental unit deteriorates until the demand and supply of housing services is equilibrated. For a formal treatment of this argument, see Frankena (1975) and Arnott (1995).

controlling for differences in quality). Others note the need for caution in analysis of this sort, for it rests upon assumptions about the relationship between the regulated sector, the unregulated sector, and associated markets such as owner-occupied housing, for which relatively little is known (Turner and Malpezzi, 2003).

2.2.5 Policy Objectives: Security of Tenure vs. Affordability

An important finding in the literature on second-generation rent regulations is that the effect on income distribution is anything but straightforward. The common perception that income is transferred from landlords to tenants is complicated by many factors. For instance, it is unclear how rent regulations affect the homeownership market: if a shortage of rental housing results, this may increase the demand for owner-occupied dwellings and increase housing prices; alternatively, relatively affordable rental accommodation may suppress housing prices.

Where regulated and unregulated markets coexist, the distribution effects of binding rent regulations are particularly complex. Tenants are better off in the regulated sector and worse off in the unregulated sector, while landlords are worse off in the regulated sector and better off in the unregulated one. Other distributional effects also follow. Because of the queue of tenants seeking a regulated apartment, landlords are able to screen applicants in order to select those with the most desirable features (such as financial stability), while “bad tenants” spill over into the unregulated sector. Similarly, regulations have different implications for long-term and temporary or newly-arrived tenants. Permanent or long-term renters that are able to secure a rent-protected unit benefit from regulations, while temporary or newly-arrived renters are made worse off to the extent that they tend to end up in unregulated units where higher rents prevail (Epple, 1998). Others note that if rent regulations lower property values, they have a detrimental impact on the government’s tax base (Slack, 1987).

The general conclusion is that rent regulations are not an efficient means of redistributing income. If affordable rental housing is the primary objective, this can best be achieved through other policy initiatives, such as rent subsidies or public housing, which address the issue more directly. Instead, the primary objective of rent regulations should be the tenant’s security of tenure.

2.3 Characteristics of an Imperfectly-Competition Rental Housing Market

More recent treatments of the impact of rent regulations have focused on non-competitive features of the rental housing market. While there is no fully-articulated model of an imperfectly-competitive rental housing market, this literature focuses on the implications of the heterogeneity among rental units. Apartments differ in size, age, design, amenities, location and a host of other factors, while potential tenants differ according to their set of preferences for characteristics that different apartments may offer. One implication of heterogeneity is that it confers a degree of market power to the landlord. Since no two units are alike, the landlord exercises greater control over the rent charged, and can set the rent above the marginal cost of supplying the unit in the expectation of attracting a tenant willing to pay the higher rent because the apartment’s unique features are deemed particularly desirable (Arnott, 1995; for an early treatment of this issue, see Sweeney, 1974).

To illustrate, consider the market for automobiles. A perfectly-competitive model assumes that all automobiles are identical. The price of all cars would also be identical, for individual sellers have no incentive to raise the price since buyers would simply purchase an identical car at a cheaper price from another seller. Now consider a more realistic model in which automobiles differ according to size, horsepower, colour and style. The heterogeneity among automobiles confers greater market power to suppliers to the extent that product differentiation reduces the number of comparable choices. Competition in the market for sports cars may still exist but is significantly reduced in scope. Sellers of a particular automobile, such as the BMW X5M, have an incentive to increase the price above its marginal cost, with the hope of attracting an individual with the idiosyncratic tastes that make that particular model particularly attractive.

The rental market has been similarly characterized as a collection of sub-markets based on quality or location. In terms of quality, at the higher end of the market there may be viable alternatives to a two-bedroom apartment located on Wellington Crescent with a view of the river, but the range of choice is much less than implied by a perfectly-competitive model with homogeneous rental units. In terms of location, for an individual living near the perimeter of the city there may be several basic two-bedroom apartment units available to choose from in the core area of the city, a vacant apartment in the core area is not a realistic option given the high commuting costs. In both cases, the market is much "thinner" than implied by a model with homogeneous units. Tenants do not search for accommodation from all large number of identical apartments (as implied in the simple competitive model) but from a subset of units of the appropriate size, location and host of amenities. This reduction in the range of alternatives gives the landlord greater power in setting the monthly rent above the cost of supplying the unit.

Arnott (1995) thus describes the rental market as monopolistically competitive. In the short-run, landlords are able to charge a rent above the marginal cost in the expectation of attracting a tenant who finds its amenities ideal; however, in the long-run, the high profitability of existing rental units encourages the construction of new rental units with similar features which will eventually bid down rents to the long-run supply price consistent with a perfectly-competitive market (Figure 2.5). Rent regulations, therefore, play an important role in countervailing the market power exercised by landlords in the short-run by preventing them from advancing monthly rents above the marginal cost of supplying the unit.

Heterogeneity among rental units also has implications for how the market "matches" tenants to available apartments. Since not all apartments are alike, it takes time for tenants to search for a suitable accommodation and for landlords to find a suitable tenant. There are costs associated with searching for an apartment (or searching for a tenant) and also with turnover for the landlord and moving for the tenant; however, this cost may be justified in terms of the benefits from matching appropriate tenants to appropriate apartments. Nonetheless, in the presence of heterogeneity, the vacancy rate is expected to be higher.

2.4 Reassessing Secondary Rent Regulations

In the most extensive empirical examination of rent regulations in Canada, commissioned by Canada Mortgage and Housing Corporation, Denton *et al* (1993) conclude that "there appears to be no convincing evidence that rent regulations, as they existed in various provinces in Canada from the early 1970s through to the early 1990s, had significant effects on rents, on the construction of rental units, or on vacancy rates." The authors also find some evidence that rent regulations tended to increase the ratio of renters to home owners, but find no evidence that they resulted in a lower quality rental housing stock.

These findings point to one over-arching conclusion: second-generation rent regulations have been more akin to rent stabilization, where the pass-through of operating costs, capital expenses and considerations for financial loss have generally allowed rents to increase at a rate dictated by long-term supply costs in a perfectly-competitive market. Moreover, other features of regulation programs have ameliorated concerns with the potential disincentives for investing in the quality of existing rental units (generous treatment of capital expenditures) and for investment in new rental buildings (exemptions on newly-constructed units).

Despite a softening in the attitude of economists towards rent regulations, their general opposition is largely grounded on the conviction that a perfectly-competitive market yields the most efficient outcome. In reviewing the state of the economics literature on rent regulation in the mid-1990s, Arnott warned against maintaining such an assumption: "Economists appreciate the virtues of free markets more than the average citizen. The knee-jerk reaction of almost every well-trained economist to price controls therefore provides balance in policy debate. Nevertheless, the case against second-generation rent controls is so weak that economists should at least soften their opposition to them. A degree of revisionism is certainly in order." (Arnott, 1995: 118). Yet despite the evidence that rent regulations have, at worst, a benign effect on the quantity and quality of the rental housing stock, such myths continue to persist.

As Arnott states the case, "a *well-designed* rent control program can improve on the unrestricted equilibrium of an imperfect market." (Arnott, 1995: 108) An assessment of rent regulations must proceed on a case-by-case basis, and consider the following criteria:

a) the objective is to provide greater security of tenure and should not be viewed primarily as a vehicle for more affordable rental accommodation;

b) the establishment of the annual guideline and increases above the guideline should be based on changes of operating costs in order to stabilize rents at a level consistent with the long-run supply price or, in other words, with equilibrium conditions in a perfectly-competitive market;

c) exemptions from regulations, though not expected to have a significant impact on the rate of return on investment, may encourage the construction of new rental units by reducing uncertainty as long as a stable policy environment is maintained; and

d) improvements in the quality of the rental housing stock can be encouraged by providing appropriate incentives for repair, maintenance and capital improvements.

3. Rent Regulations in Manitoba

With the exception of the period between 1980 and 1982, rent regulations have been in place in Manitoba since 1976. A brief chronology is as follows:

1976. rent regulations were introduced in association with the Federal Government's Anti-Inflation Program of 1975-1978, and applied retroactively to 1975. A guideline/cost pass-through approach was adopted. Units built or first occupied after 1976 were exempted from regulations for five years (Manitoba, *The Rent Stabilization Act* S.M. 1976, ch. 3 – Cap. R85).

1978. planned deregulation was implemented.[3] In Brandon and Winnipeg, units that became vacant, or with a monthly rent above $400, were no longer subject to regulation, while blanket deregulation was instituted in all other areas (Muller, 1987).

1980: all regulations were removed and replaced by a rent arbitration system in which tenants and landlords could apply for binding arbitration in the event that they were unable to agree upon a rent increase (Muller, 1987).

1982: rent regulations were reintroduced, again based on a guidelines/cost pass-through basis.

Since 1982, the same framework has remained in place; however, modifications have extended the range of exemptions, including those on newly-constructed buildings, on some units upon being voluntarily vacated by the tenant, and on units that have undergone renovations.

3.1 Current Legislation

Manitoba's residential rent regulation program is defined in Part 9 of The Residential Tenancies Act (C.C.S.M. c. R119) and in the Residential Rent Regulation, Regulation 156/92. Its principal features are summarized below.

3.1.1 Rent Guideline

The monthly rent may only be increased once in a 12-month period. The maximum allowable increase in rent on non-exempt units is set annually (effective January 1, 2011, by no more than 1.5% of the last rent charged). A tenant has the right to object to a rent increase at or below the guideline.

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The annual guideline is set after considering the change in utility costs, property taxes and other costs associated with the operation of a rental property. Between 1993 and 2000, the guideline was set at 1%, but since 2001 has varied, closely approximating the previous year's increase in the consumer price index for Manitoba. Between 2001 and 2006, the annual guideline lagged behind the change in the previous year's rate of inflation, but since 2007 has tended to exceed it (Figure 3.1).

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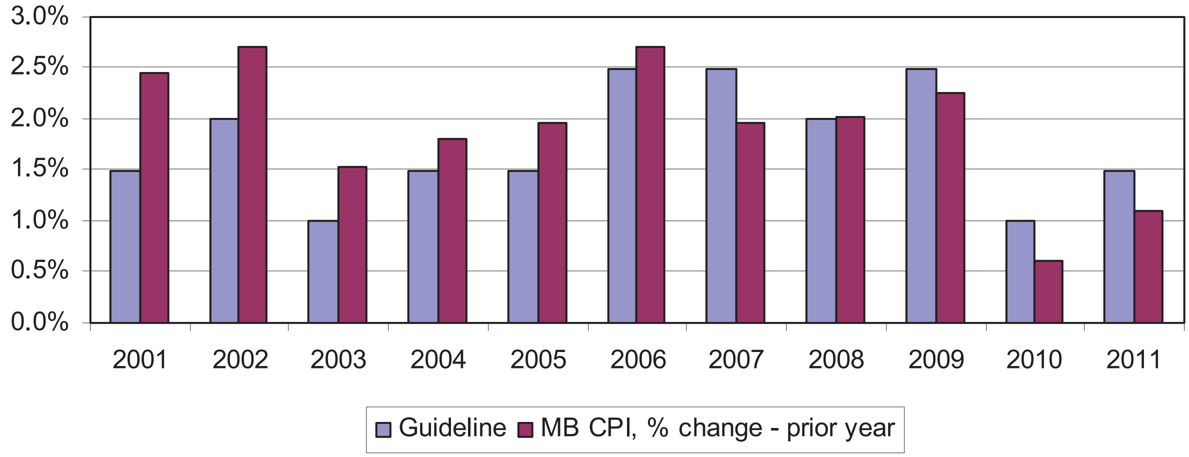
[3] Deregulation occurred despite an evaluation undertaken in 1978 that found that regulations had contributed to housing affordability by moderating rent increases while there was no evidence of deterioration in the quality of rental housing or in the rate of new construction (Manitoba, 1978).

Figure 3.1: Annual Rent Guideline and the Percentage Change in the Manitoba Consumer Price Index, 2001-2010



3.2.2. Rent Review

A landlord may apply for a rent increase above the guideline, which results in a review being initiated based on information on the unit's or building's costs over the preceding two years. A rent increase above the guideline is determined by the sum of the following four items:

(a) change in operating expenses (excluding mortgage interest charges, non-recurring or extraordinary expenditures and depreciation), which may be a positive or negative figure;

(b) capital expenses incurred in acquiring or replacing appliances, services and facilities or furnishings, or for capital improvements or major repairs that have a lasting and long-term benefit to the residential complex. Either 1/6, 1/4 or 1/3 of the cost of capital expenditures may be passed through, depending on the type of improvement.

(c) the dollar value of any change in services and facilities and other amenities, which may be a positive or negative figure;

(d) financial loss and the economic adjustment factor: the greater of (i) one-third of the amount by which the total of operating expenses and mortgage interest expenses exceeds revenue; and (ii) the economic adjustment factor set annually (0.8% effective January 1, 2011) multiplied by the building's revenue. The economic adjustment factor is based upon the expected impact of inflation on the landlord's net revenue.

The review determines the rents that may be charged for all of the rental units in the residential complex, with any approved increase apportioned to individual units on an equal percentage or dollar basis.

3.2.3 Exempt Units

Rent regulations do not apply in the following cases:

(a) public and subsidized housing units.[4]

(b) units located in a hotel or other similar accommodation; a caretaker's or employee's unit; a room in a boarding house; and, except in limited cases, rental units occupied under a life lease;

(c) rental units for which the monthly rent payable is at or above a specified amount ($1,120 on December 31, 2010);

(d) newly-constructed buildings: units built or first occupied after March 2005 are exempt for 20 years; units built or first occupied between April 2001 and February 2005 are exempt for 15 years.

3.2.4 Rehabilitation

Landlords may apply for the approval of a rehabilitation scheme that undertakes major structural improvements designed to increase substantially the life expectancy and the quality of the building and its rental units. The units upgraded are exempt for up to 5 years depending upon the costs of the improvements according to the following schedule.

Expenditure per Unit	Period of Exemption
$6,000-7,999	2 years
$8,000-9,999	3 years
$10,000-11,999	4 years
$12,000 or more	5 years

Under a separate program introduced in 2007, landlords may apply to rehabilitate a single unit upon it becoming vacant, and the unit may be exempted from rent regulations for up to 2 years. In this instance, the total number of rental units granted an exemption in a given calendar year cannot exceed 3,000 and no more than 5,500 can be exempt at any given time.[5]

3.2.5 Tenancy Rent Regulations or Inter-Tenancy Deregulation

For a unit in a residential complex containing 3 rental units or less, the landlord is free to determine the rent upon turnover, but rent regulations apply during the period of tenancy. When a unit becomes vacant in a residential complex with 4 or more rental units, the landlord may increase the rent for that unit to a level not more than the average rent for comparable units in the same residential complex.

[4] This applies to rental units that are owned and administered by or for the Government of Canada, the Government of Manitoba or a municipality, or where the rents charged are fixed with the approval of either Canada Mortgage and Housing Corporation (CMHC) or the Manitoba Housing and Renewal Corporation.
[5] Subject to the maximum yearly limit, up to 10% of the rental units in a residential complex may be exempted (or, in the case of a building with less than 10 units, one unit may be exempted).

3.2.6 Other Considerations

The Act also governs instances where a landlord wishes to create a furnished rental unit upon an unfurnished unit becoming vacant; where the landlord undertakes an improvement requested by the tenant; to charges for laundry facilities provided by the landlord; and to life leases in non-profit residential complexes.

3.3 Comparing Manitoba to Other Canadian Jurisdictions

Currently, three other provinces (British Columbia, Ontario and Prince Edward Island) have explicit rent regulations. In addition, Quebec has an arbitration system which provides guidance for calculating rent increases, and then issues binding orders for rent increases when a landlord and tenant are unable to reach an agreement.[6] In all, 56% of the Canadian population resides in a jurisdiction with rent regulations and, when Quebec is included, 79% reside in the jurisdiction with some form of rent oversight.

While each provincial program has unique features, rent regulations in BC, Manitoba, Ontario and PEI are more amenable to comparison because of the similar guideline/cost pass-through approach. Two aspects are of particular note: a) the annual guideline and the items considered for cost pass-through; and b) units exempt from regulations.

3.3.1 Annual Guideline and Cost Pass-Though

British Columbia has historically set a higher annual guideline than the other three provinces and recently adopted an “inflation + 2%” rule. This higher guideline, however, must be seen in the context of a more limited set of items considered for cost pass-through in the event that a review is undertaken. Specifically, an increase in operating costs are only considered in the event that they result in a financial loss, while only extraordinary and unanticipated capital expenditures are eligible for cost pass-through. Landlords, however, may apply for an increase above the guideline if it is deemed that the monthly rent on the unit is below that for comparable units in the same geographical area.[7]

Ontario’s annual guideline is set according to the previous year’s increase in the consumer price index. Items considered for pass cost-through include extraordinary increases in municipal taxes and utilities, the cost of contracted-out security services, and capital expenditures. There

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[6] Under Quebec’s rent arbitration system, no annual guideline is issued; however, it issues a formula for calculating rent increases based upon item-by-tem changes in the cost of utilities, property and school taxes, insurance, maintenance, service and management costs plus an economic adjustment allowance (0.5% of net revenue in 2010). The landlord informs the tenant of a proposed rent increase and, if the tenant objects, a tribunal establishes the rent change. Units in buildings constructed within the past five years are exempt (Quebec, 2010).

[7] “The rent for the rental unit may be considered ‘significantly lower’ when (i) the rent for the rental unit is considerably below the current rent payable for similar units in the same geographic area, or (ii) the difference between the rent for the rental unit and the current rent payable for similar units in the same geographic area is large when compared to the rent for the rental unit. In the former, $50 may not be considered a significantly lower rent for a unit renting at $600 and a comparative unit renting at $650. In the latter, $50 may be considered a significantly lower rent for a unit renting at $200 and a comparative unit renting at $250” (British Columbia, *Residential Policy Guideline*, page 37-7, April 2007.

is no provision for financial loss. The maximum increase is restricted to 3% above the guideline in a given year, with any increase above this level deferred to subsequent years.

PEI is unique in issuing separate guidelines based on whether or not the monthly rent on a unit includes the cost of utilities. The guidelines are set with reference to past and anticipated changes in the provincial consumer price index, as well as expected changes in shelter costs (PEI, 2010). Increased operating costs and capital expenditures are eligible for cost pass-through, as well as an allowance for a reasonable rate of return on investment.

Table 3.1: Annual Rent Guideline, 2005-2011

Year	BC	Ontario	PEI		Manitoba
			Heated	Unheated	
2005	3.8%	1.5%	2.0%	2.0%	1.5%
2006	4.0%	2.1%	7.5%	3.5%	2.5%
2007	4.0%	2.6%	3.0%	3.0%	2.5%
2008	3.7%	1.4%	1.0%	1.0%	2.0%
2009	3.7%	1.8%	5.0%	3.0%	2.5%
2010	3.2%	2.1%	2.0%	2.0%	1.0%
2011	2.3%	0.7%	2.0%	1.0%	1.5%

In comparison, Manitoba has set a relatively low annual guideline; however, this is offset by a more complete consideration of operating costs, capital expenditures and financial losses eligible for cost pass-through. In addition, the “economic adjustment factor,” set annually, provides for a certain margin based upon the anticipated effects of inflation on the landlord’s net revenue. The implication is that while Manitoba’s relatively low annual guideline likely results in a larger proportion of covered rental units being subject to administrative review, it exercises greater flexibility with respect to the determination of rent increases above the guideline.

3.3.2 Exemptions

Each of the four provinces exempt public housing, subsidized units and a limited number of other units (such as hotel accommodation and caretakers’ suites) from rent regulations.

Both Ontario and Manitoba provide exemptions for newly-constructed units, while Manitoba is the only province to exempt units that undergo an approved rehabilitation program or for which the monthly rent is above a specified threshold.

An important distinction is in the application of tenancy rent regulations. In Ontario and British Columbia, when any non-exempt unit becomes vacant, the landlord and new tenant may negotiate a new monthly rent. The unit is then again subject to rent regulations for subsequent annual increases. In Manitoba, tenancy rent regulations are limited to units in buildings with 3 units or less. When a unit becomes vacant in a building with 4 or more rental units, the rent may increase above the guideline if it would otherwise fall below the average rent for comparable units in the same building.

Table 3.2: Summary of Rent Regulations in Canadian Provinces			
Province	**Rent Guideline**	**Cost Pass-Through Considerations**	**Exemptions***
British Columbia	Inflation Rate + 2%	(a) the current rent is “significantly lower” than for rental units in the same geographic area; (b) significant repairs/renovations that could not have been reasonably foreseen; (c) a financial loss from an extraordinary increase in operating expenses, or from financing costs of purchasing the residential property, if the financing costs could not have been reasonably foreseen; (d) the landlord, as a tenant, has received a rent increase for the same rental unit.	(a) vacated units for the first tenancy agreement; subsequently non - exempt
Ontario	Inflation Rate	(a) an extraordinary increase in the cost for municipal taxes and/or charges for utilities; (b) eligible capital expenditures incurred; (c) operating costs related to security services by persons not employed by the landlord. *maximum of 3% above guideline in a given year	(a) buildings constructed after 1991; (b) vacated units for the first tenancy agreement; subsequently non - exempt
PEI	Considers past and anticipated inflation rate and the shelter cost price index	(a) whether the increase in rent is necessary in order to prevent a financial loss in the operation of the building in which the premises are situated; (b) increased operating costs or capital expenditures; (c) the expectation of the landlord to have a reasonable return on his capital investment.	
Manitoba	Considers change in utility costs, property taxes and other costs relevant to the operation of the residential complex	(a) change in operating expenses; (b) allowable portion of capital expenses; (c) change in the value of services and facilities and other amenities; (d) The greater of (i) one-third of the amount by which the total of operating expenses and mortgage interest expenses exceeds revenue; and (ii) the annual economic adjustment factor (0.8% in January 1, 2011) multiplied by the revenue.	(a) units with monthly rent over $1,120 (on December 31, 2010); (b) newly constructed buildings (exempt for 20 years); (c) rehabilitation of building (5 years) or single unit (2 years); (d) residential complexes with less than 3 units upon becoming vacant

* All four provinces have similar exemptions on public housing and similar types of dwellings.
Sources: BC Residential Tenancy Act [SBC 2002] Chapter 78; Residential Tenancy Regulation; Ontario, Residential Tenancies Act, [S.O. 2006, Chapter 17]; PEI, Rental of Residential Property Act, Chapter R-13-1; Manitoba, The Residential Tenancies Act (C.C.S.M. c. R119) and in the Residential Rent Regulation, Regulation 156/92.

3.4 Cases, Fees and Administrative Costs

3.4.1 Cases

Table 3.3 summarizes the activities of the Residential Tenancies Branch with respect to Part 9 of the *Residential Tenancies Act* that deals with rent regulations.

Between 2003 and 2009, the annual number of applications for a rent increase above the guideline ranged from 217 to 347, and covered between 12,000 and 20,000 rental units each year. In contrast, tenants' objections to rent increases below or at the annual guideline did not exceed 150 in any year.

The number of applications for an approved rehabilitation scheme for an entire building has risen in the past two years to over 50, covering some 1,800 units.

3.4.2 Application Fees

Landlords are charged a fee when applying for a rent increase above the guideline: $500 when the application covers four or more rental units and $150 where three or fewer rental units are concerned. While this implies that the fee can be as much as $125 per unit (in the case of an application covering 4 rental units), in practice it is substantially less. In 2009, for instance, there was an average of 58.1 rental units covered per application, such that the average fee per unit is in the range of $10. It is worth noting, however, that the fee structure may discourage owners of small buildings from applying for a rent review.

3.4.3 Administrative Costs

The cost of administering rent regulations can be crudely approximated. In 2009, the operating expenses of the entire Residential Tenancies Branch were slightly less than $5 million. Roughly one-third of this, or $1.7 million, is attributable to the administration of Part 9 of *The Residential Tenancies Act*. This cost can be placed in perspective by expressing it on the basis of (a) the total number of rental units in the province (roughly 125,000 or $13.60 per unit); or (b) the population of the province (1,219,600, or in the order of $1.30 per capita).

3.5 Summary

Manitoba introduced rent regulations in 1976 and they have been in place continuously since 1982. An annual guideline for rent increases is set and applications for increases above the guideline are reviewed on the basis of changes in operating costs, allowable capital expenditures, financial loss and the "economic adjustment factor" that anticipates the effects of inflation on the landlord's net revenue. A range of exemptions exist, including units renting above a specified threshold, newly-constructed buildings, units that have undergone an approved rehabilitation scheme, and inter-tenancy deregulation for buildings with 3 or less rental units.

Manitoba's rent regulations are broadly similar to those in place in BC, PEI and Ontario. Each province establishes the annual guideline with reference to the local cost of living index. The annual guideline has tended to be lower in Manitoba; however, it considers a broader range of factors eligible for cost pass-through.

Manitoba differs from Ontario and BC with respect to the application of tenancy rent regulations: in Ontario and BC, they apply to all units covered under the regulations; in Manitoba they are limited to buildings with 3 units or less.

Perhaps due to the relatively low annual guideline, the Residential Tenancies Branch deals with a larger volume of applications for a rent increase above the guideline. Application fees on a per unit basis are modest (in the range of $10), while the Province's annual cost of administering rent regulations is also small, in the range of $1.30 per capita.

Table 3.3: Cases Opened under Part 9 of the Residential Tenancies Act, 2004-2009

	2004		2005		2006		2007		2008		2009	
	Bldgs	**Units**	**Bldgs**	**Units**	**Bldgs**	**Units**	**Bldgs**	**Units**	**Bldgs**	**Units**	**Bldgs**	**Units**
Applications for Laundry Increases	14	459	18	960	15	636	18	597	12	403	23	1,041
Application for Rehabilitation – Whole Complex	29	851	24	779	21	550	15	454	53	1,306	50	1,793
Application for Rehabilitation - Specific Unit[1]							16	24	146	146	125	125
Application for Rent Increase	347	19,783	303	16,886	334	16,870	217	12,001	286	18,213	328	19,041
- average units per rent application	57.0		55.7		50.5		55.3		63.7		58.1	
Application for Service Withdrawal	11	221	11	256	14	539	15	942	18	789	14	141
Application for Tenant Request for Improvements	24	51	21	48	14	21	38	43	38	38	76	76
Compliance[2]	546	1,326	405	1,227	467	1,304	461	1,290	353	969	1,376	4,434
Life Lease - Request for Rent Review									7	341	6	177
Rent Status Reports	191	2,773	226	5,417	176	4,785	196	4,886	149	5,289	167	6,972
Tenant Objections to Guideline Increase or Less	97	104	100	107	143	159	150	182	111	111	110	110
Totals	1,259	25,568	1,120	25,982	1,184	24,864	1,126	20,419	1,173	27,605	2,275	33,910

Notes:
1. This program was introduced in 2007
2. The sharp increase in the number of compliances cases in 2009 reflects the introduction of an electronic monitoring system for rent increases and a backlog of cases from the prior two years.

Source: Manitoba. Residential Tenancies Branch. *Annual Report*, 2004-2009.

4. Assessing the Manitoba Rent Regulation Program

A well-designed rent regulation program should have as its primary objective the enhancement of the tenant's security of tenure. To accomplish this, while at the same time improving market efficiency, it should have the following features:

- allow monthly rents to adjust with changes in operating expenses and thus ensure a fair rate of return on investment, but prevent unwarranted rent increases arising from the market power of landlords or during periods of excess demand;

- maintain market incentives for an adequate quantity of rental units;

- maintain incentives for capital expenditures on maintenance, repair and renovation to improve the quality of the rental housing stock.

Manitoba's rent regulations can be assessed using these criteria. In doing so, however, there are two important caveats to the analysis. First, rent regulations are but one of a host of factors influencing the rental housing market. A formal econometric analysis would attempt to control for these other factors in an effort to isolate the impact of rent regulations, but such is not possible given the inadequacy of the data available. For this reason, the best that can be achieved is to examine general trends in the data for evidence consistent with the argument that rent regulations have had an impact, positive or negative, on outcomes in the rental housing market.

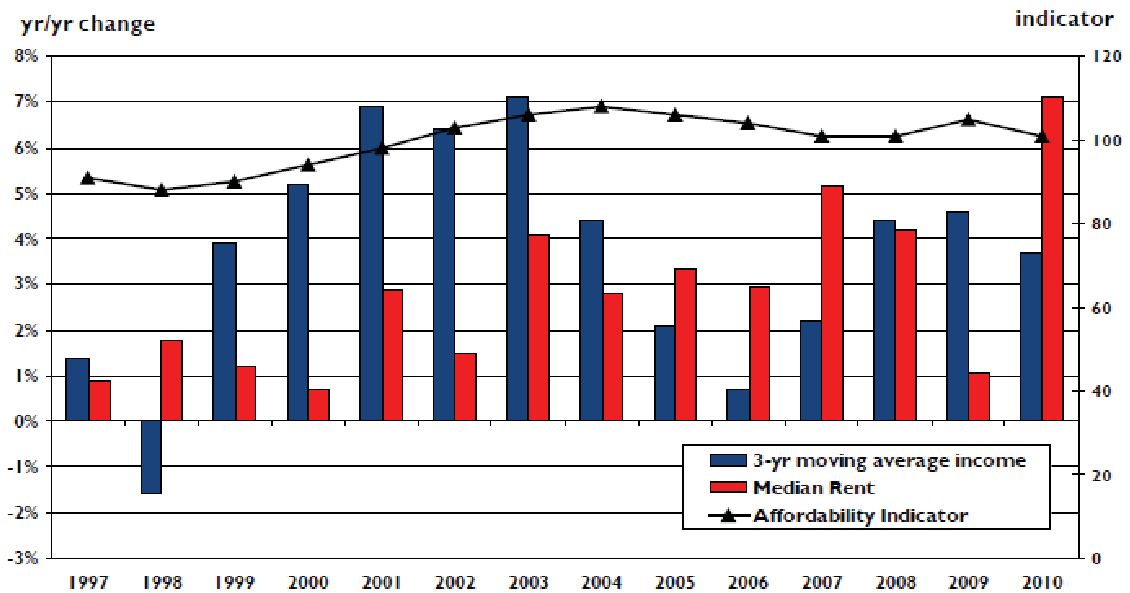
Second, there is insufficient information to examine some specific aspects of the market. The most serious omission in this regard is the interaction between regulated and non-regulated (or exempt) sectors of the rental market, and between the rental market and home ownership market. When discussing the impact of regulations of monthly rents, for instance, it is possible to refer changes in the average across all units, but not possible to consider how the change in average rents may differ between regulated and unregulated units.

4.1 Average Rent Increases

Rents in Manitoba have historically been below the national average and this situation persists. CMHC data, for instance, indicate that the average rent for a two-bedroom apartment in Manitoba was roughly 2.5% below that for the country as a whole (excluding areas with less than 10,000 people), and the same gap existed between Winnipeg and the average for Canadian Census Metropolitan Areas with a population of over 100,000 (CMHC, *Rental Market Survey – Canada Highlights*, October 2010). Statistics Canada data comparing the cost of rental accommodation in a selection of representative cities across the country show a much greater difference. In 2009, the cost of rental accommodation in Winnipeg was 16 per cent lower than the weighted average for other cities (Statistics Canada, CANSIM Table 326-0015).

Viewed from a different perspective, a longstanding benchmark is that housing is deemed to be affordable if a typical household spends no more than 30% of its pre-tax income on rent. The CMHC's rental affordability indicator for larger Canadian centres adopts this standard. It compares the median income of renter households and the median rent for a two-bedroom apartment and assigns a value of 100 where the median rent is 30% of the median income. A higher number indicates a more affordable rental market.[8] The index for Winnipeg has hovered around the 100 benchmark: rental accommodation became more affordable as incomes grew faster than rents between 1997 and 2004, and since there has been a small erosion in affordability (Figure 4.1). The remarkable feature, relative to other Canadian cities, is the general stability of the index for Winnipeg over the entire 24-year period. Census data for 2006 indicate that the percentage of renter households spending less than 30% of their gross income on shelter costs was 62.7% in Winnipeg, 64.5% in Manitoba, and 59.7% in Canada (Statistics Canada, Census of Population, 2006).

Figure 4.1: CMHC Affordability Indicator, Winnipeg, 1997-2010

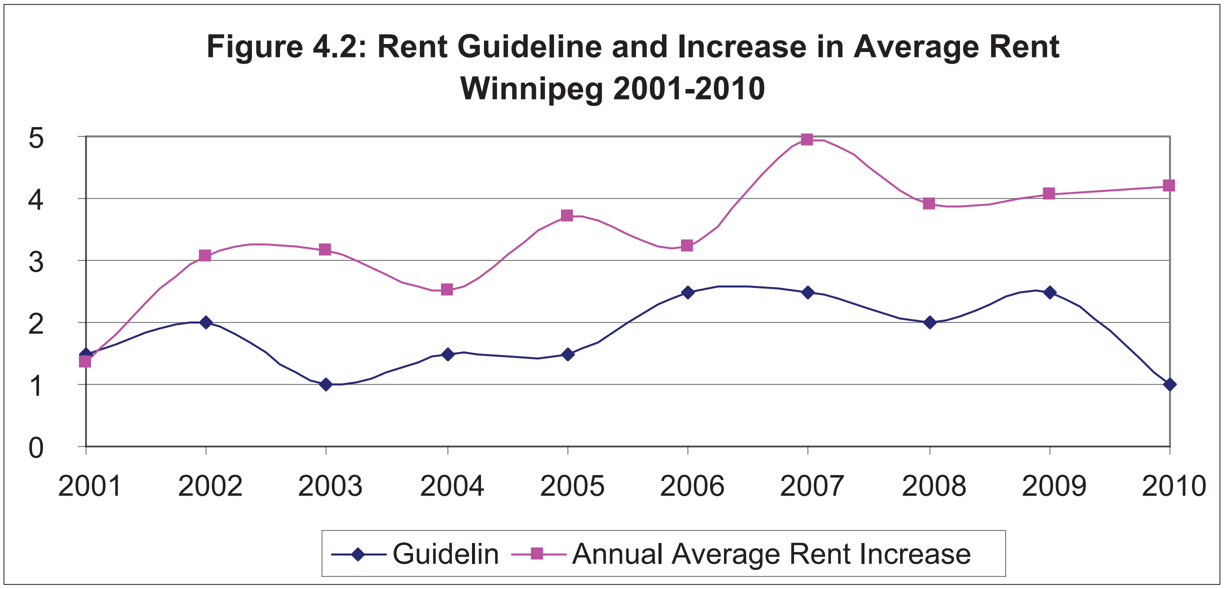


Source: CMHC, *Rental Market Report – Winnipeg Highlights*, October 2010.

Average rents and the affordability of rental housing depend on many factors such that the impact of various policy initiatives cannot be easily determined; however, some inferences about the effects of rent regulations can be drawn by examining the rate of increase in rents.

Figure 4.2 compares the annual rent guideline and the average rent increase in Winnipeg (using CMHC data on the year-over-year change in rents on existing units in buildings with 3 or more units). Manitoba's annual guideline has closely approximated changes in the previous year's consumer price index for the province, while the average rent has increased at a faster rate, in the range of 1% to 3% above the guideline. This is to be expected: although the majority of units has seen an increase at or below the annual guideline, the number of units covered by an application for an increase above the guideline has approached 20,000, while many units are exempt from regulations.

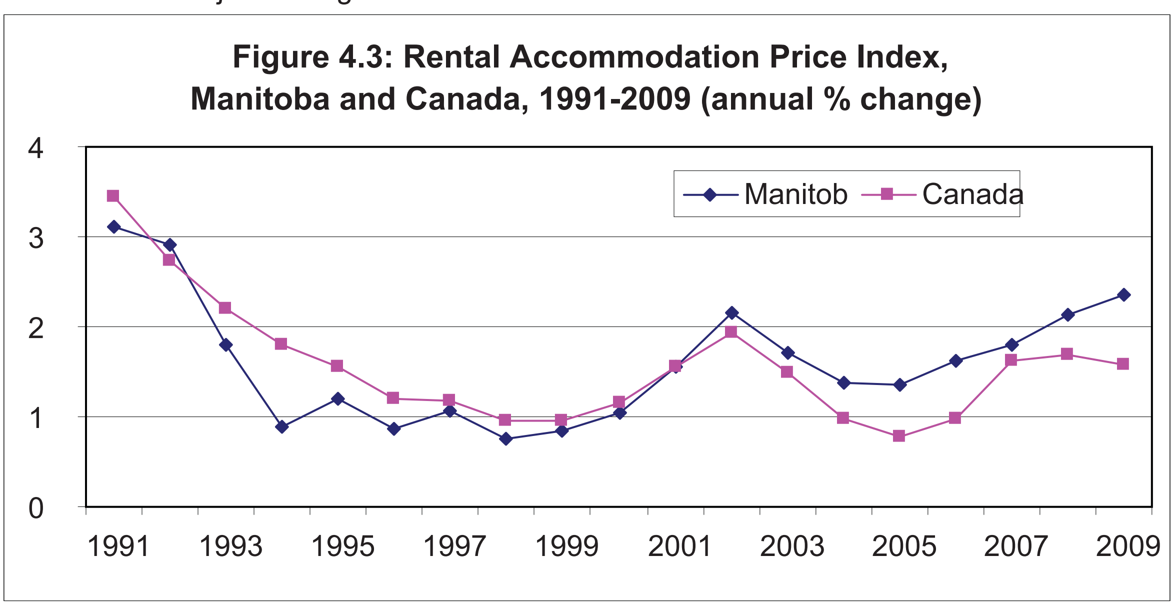
[8] The index is calculated as (Median Income/Median Rent) x 30. For a critique of traditional affordability measures, see Belsky, et al., 2005.



Note: The CMHC's estimate of average rent increases is based on existing structures (common to the survey sample in the previous year and the current year).

Source: CMHC, *CHS - Rental Market Survey*, various years; *Rental Housing Report – Winnipeg Highlights*, various years; *Rental Market Report – Canada Highlights*, October 2010.

Statistics Canada's price index on rental accommodation indicates that the average increase in rents has been broadly similar in Manitoba and Canada as a whole: prior to 2001, rent increases in Manitoba lagged slightly behind that for Canada and since 2002 have increased faster than the national average (Figure 4.3). Since the latter period coincides with the tighter rental market conditions in Manitoba, the data are consistent with the view that rents in the province have adjusted to general market conditions.



Source: Statistics Canada, CANSIM Table 326-0021

Based upon the general pattern on rent increases in the province, therefore, there is no evidence that rent regulations have restricted rents below what would prevail in a perfectly-competitive market under equilibrium conditions. By requiring owners of regulated units to justify any increases above the guideline based on operating costs or reinvestment in the property, regulations have prevented unwarranted increases associated with period of excess demand or with non-competitive conditions. To this extent that has had a moderating effect on the overall rate of increase in the province; however, this has not prevented rents in Manitoba from adjusting to general market conditions prevailing throughout the country.

4.2 The Supply of Rental Accommodation

A second question concerns the extent to which regulations have affected the stock of rental housing in the province. As is often asserted, rent regulations reduced the rate of return on investment on rental housing, causing an accelerated rate of demolition, and a rise in the conversion of units to condominium ownership, and a slower rate of construction of new buildings.

4.2.1 Measuring the Stock of Rental Units

The decline in the CMHC's count of the "universe" of apartment rental units in Winnipeg has attracted significant attention. This measure is based on the number of privately-initiated apartment units in buildings with 3 or more units. Since 1995, the number has fallen steadily, from over 55,000 to slightly more than 52,000 in 2010 (Figure 4.4).

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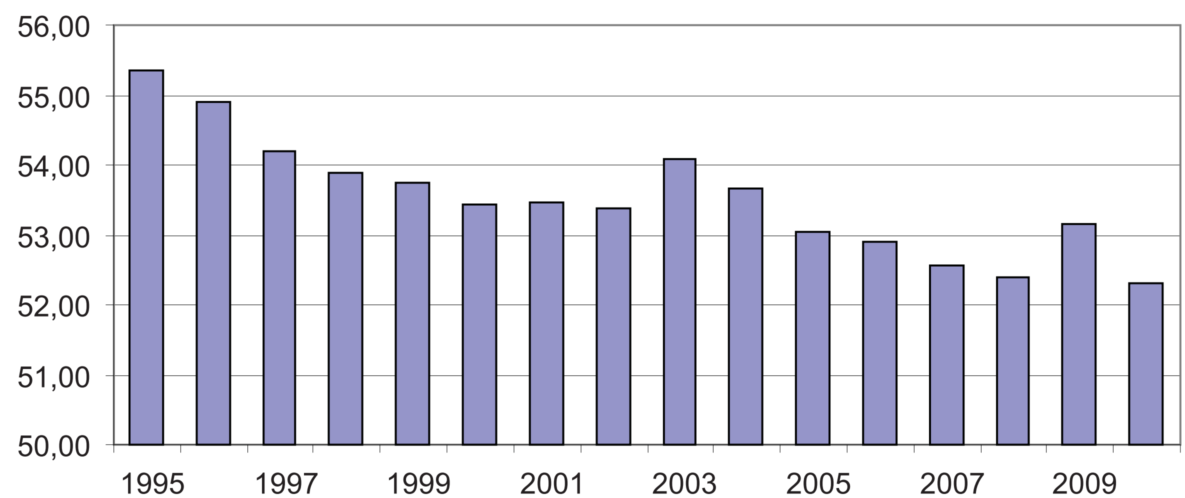
Figure 4.4: Privately-Initiated Apartment Rental buildings with 3 or more units, Winnipeg, 1995-2010



This data, however, must be interpreted with caution. As the CMHC notes, its definition of the universe of apartment units represents only a portion of the rental housing stock. Excluding from this measure are various components of the secondary rental market, including public housing, row housing rental units, rented houses, units in buildings with 2 units or less; and condominiums that are rented by the owner.

In 2006, Statistics Canada counted 92,455 renter households in Winnipeg of which roughly 70,000 were in apartment buildings. This suggests that the CMHC measure of the rental housing "universe" captures less than 60 per cent of all rental dwellings in the city. The large secondary market in Winnipeg is probably evenly divided between publicly- and privately-initiated dwellings.[9]

Table 4.1: Census Count of Renter Households, by type of unit, Winnipeg, 2006

Apartments	
- in buildings with five or more storeys	31,185
- in buildings with fewer than five storeys	39,115
- duplexes	3,140
Houses	
- row	5,630
- single-attached	135
- single-detached	10,130
- semi-detached	3,005
Movable dwelling [2]	115
Total	92,455
Source: Statistics Canada - 2006 Census. Catalogue Number 97-554-XCB2006026.	

Although little is known about the changes in the secondary market, it is unlikely that it has grown at a sufficient rate to offset the decline in the "core" market captured by the CMHC measure.

But the decline in rental stock is by no means unique to Winnipeg, as other major urban centres have seen a similar decline; indeed, the total number of renter households in Canada fell between 1996 and 2006 despite steady population growth, and this pattern has likely continued (CMHC, Canadian Housing Observer 2010, Table 14). The decline in Winnipeg's rental housing stock reflects a long-term trend towards home ownership evident throughout Canada.

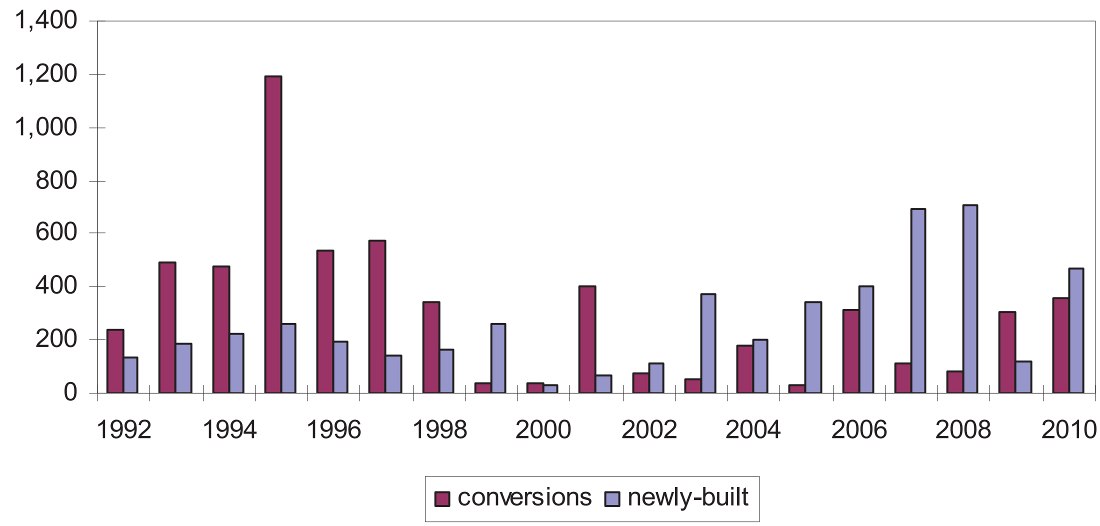
[9] Manitoba Housing currently manages 13,100 rental units across the province, while the number of all social housing units in Winnipeg is estimated to be in the range of 20,000.

4.2.2 Condominium Conversions

One aspect of the trend towards home ownership has been the conversion of rental units to condominium ownership. Across the country, condominiums as a percentage of owner-occupied dwellings in Canada rose from 3.3% in 1981 to 10.8% in 2006 and in more recent years has accounted for nearly one-quarter of new residential construction (CMHC, Canadian Housing Observer, 2010). The striking feature is the extent to which Winnipeg has lagged behind this national trend: in 2006, condominiums represented only 7% of the owner-occupied dwellings (compared to 15% for all Canadian CMAs) and the growth in condominiums between 2001 and 2006 was similarly low in Winnipeg (17% compared to 38% for Canada).

Accordingly, the impact of condominium conversions on the rental housing stock in Winnipeg has been exaggerated. Figure 4.5 displays the annual number of rental units converted to condominium ownership in Winnipeg since 1992. Annual conversions have fallen significantly since the 1990s and have been outstripped by newly-constructed units. Moreover, many rental units converted to condominiums reappear in the secondary rental housing market. While the percentage in Winnipeg is not known, throughout Canadian Census Metropolitan Areas outside of Quebec (where the home ownership-to-rental ratio is quite distinct), the percentage of condominiums on the rental market ranges from 15.2% in Regina to 28.7% in Edmonton (CMHC, *Rental Market Report – Canada Highlights*, October 2010).

Figure 4.5: Condominiums Units, Conversions and Newly-Built, Winnipeg, 1992-2010



Source: CMHC, unpublished data.

This suggests that factors other than conditions in the rental housing market generally, or rent regulations in particular, can explain the trend in conversions; instead, they are related to the broad shift towards home ownership.

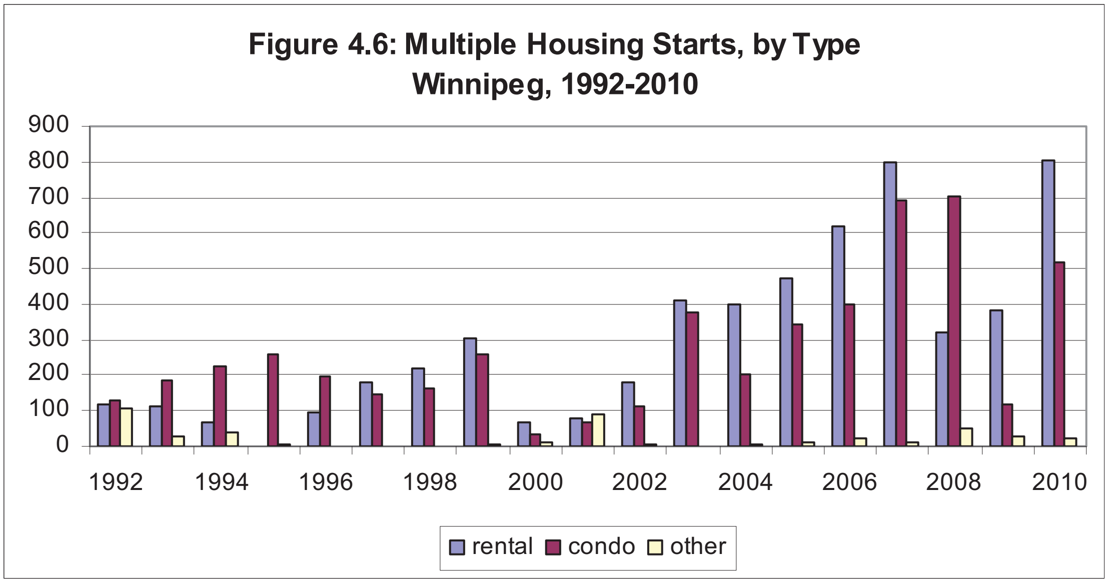
4.2.3 Construction of New Rental Units

An obvious market response to a tight rental housing market is the construction of new apartment buildings. In Winnipeg, the number of new rental unit housing starts was particularly low throughout the 1990s, rarely exceeding 200 new units per year. Beginning in 2002, however, the pace of new construction increased sharply with total rental housing starts reaching 800 in 2007. Rental starts subsequently fell to under 400 annually in 2008 and 2009, part of a nation-wide trend in part due to tighter mortgage credit conditions (CMHC, Canadian Housing Observer, 2010). In 2010, however, the construction of new rental units in the province rebounded to 807, the strongest performance in over 20 years.

Human Resource Development and Skills Canada (HRDSC) uses the number of new rental units constructed per 10,000 people as one indicator of social well-being. Such a measure can be misleading when drawing comparisons across provinces because of different rates of population growth; however, despite the relatively slow population growth in Manitoba relative to the rest of the country, its performance in terms of the construction of new rental units has been impressive. Taking the annual average over the past five years, in Winnipeg there have been 7.7 new units constructed per 10,000 people, well above the average for larger Canadian urban centres (HRDSC, 2010). Moreover, CMHC forecasts the continued strong performance in the construction of multi-family units in the province (CMHC, *Housing Market Outlook: Canadian Edition*, 2010).

In this context, rent regulations in Manitoba are unlikely to have a measurable impact on new construction. To the extent that they moderate the rate at which rents increase, they would, in theory, reduce the rate of return on a new apartment building. In practice, the 20-year exemption from rent regulations on newly-constructed units largely removes such an objection. Applying any reasonable rate of discount, the application of rent regulations 21 years into the future would have only a marginal effect on the present value of an investment project.

An important consideration, in this respect, is the consistency in Manitoba’s rent regulation program. Frequent changes in the policy environment can lead to greater investor uncertainty, especially where the capital good has such a long expected life span. Manitoba’s exemption on newly-constructed units has existed since 1984 and the extension on the exemption period–from 5 to 15 and then to 20 years–has only offered greater incentives for private construction.

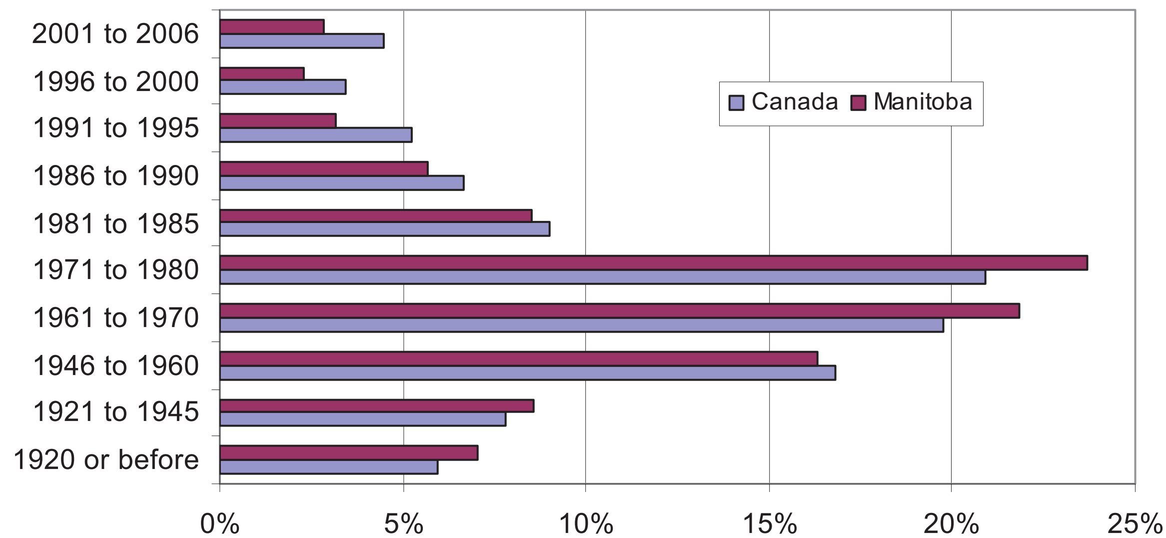


4.3 Quality of the Rental Housing Stock

The third consideration is the quality of the rental housing stock. Little information exists on the state of repair of the rental housing stock in Manitoba. Data from the 2006 Census indicates that the percentage of rental units in need of repair was higher in Winnipeg and in Manitoba, than for the country as a whole. This overall measure, however, largely reflects the relatively old rental stock in the province. For instance, in 2006, only 22.5% of rental dwelling units in Manitoba were built after 1980, compared to 28.8% in Canada (Figure 4.7). When controlling for the period of construction, a different pattern emerges. For buildings constructed since World War II, the percentage of dwelling units requiring minor and major repair in Manitoba tends to be lower than for the rest of the country (Figure 4.8).

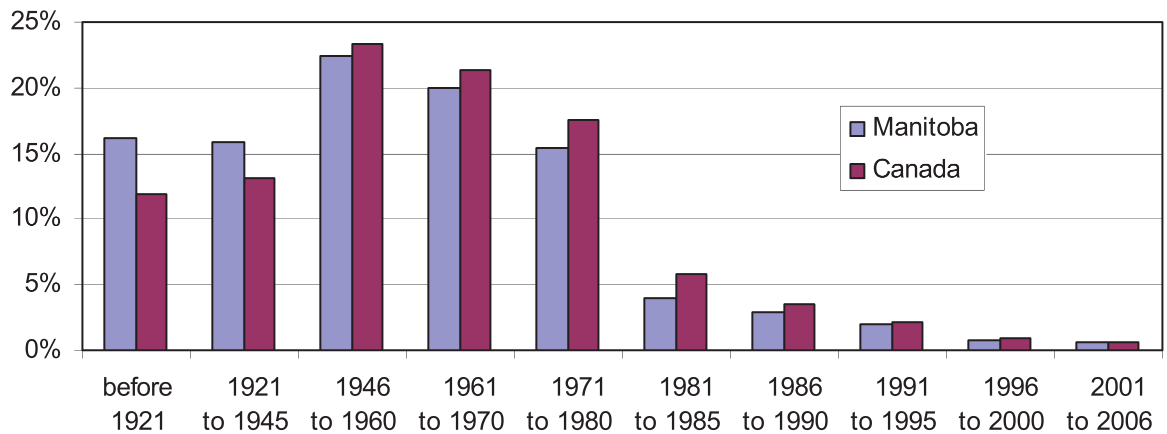
To the extent that rent regulations have a bearing on the quality of rental housing, the contribution has been positive rather than negative. Two features are important in this regard. First, two rehabilitation programs extend exemptions from regulations ranging from 2 to 5 years, thus allowing the landlord to adjust the rent to a level commensurate with the enhanced quality of the unit. Second, and more important, is the treatment of capital expenditures eligible for cost pass-through in the regular review process. When a landlord undertakes capital expenditures on a rental unit, the rent is allowed to increase by 1/3 (largely for furnishings), 1/4 (primarily for appliances) or 1/6 (in the case of major structural improvements) of the cost of a capital improvement. This provision is tantamount to an accelerated depreciation allowance since the cost of the improvement is recouped long before the life of the normal amortization period. For instance, if a landlord undertakes a $10,000 investment in upgrading the plumbing in an apartment building, one-sixth of the cost can be passed through in the form of a rent increase. Both programs, therefore, creative an incentive for landlords to invest in maintenance, repairs and other capital improvements.

Figure 4.7: Rental Housing Stock, by period of construction, Manitoba and Canada, 2006



Statistics Canada - 2006 Census. Catalogue Number 97-554-XCB2006022.

Figure 4.8: Rental Housing Stock in Need of Major Repair, by period of construction, Manitoba and Canada, 2006



Statistics Canada - 2006 Census. Catalogue Number 97-554-XCB2006022.

4.4 Summary

From the information that exists, Manitoba’s rent regulations meet the main criteria for a well-designed program.

First, there is no evidence that rent regulations have unduly restricted the rate of rent increases in the province. Rents have increased in a pattern largely consistent with national trends, but have not risen as sharply as might be expected given the tight market conditions in the province.
In this respect, they conform to description of “rent stabilization” outlined in Part 2 of this report: rents have risen with the increase in long-run operating costs, but unwarranted increases, or gouging” that might be expected in a period of excess demand, have been prevented.

Second, there is no evidence that rent regulations have caused a reduction in the stock of rental accommodation. The decline in the size of the “primary” rental housing sector as defined by the CMHC reflects a national-wide trend towards home ownership. This trend is particularly evident in the growing share of condominiums in the home ownership market throughout the country. The rate of conversion of rental properties to owned condominiums has declined markedly in Manitoba. Further, the rate of construction of new apartment units has increased substantially in Manitoba, such as the additions to the rental stock over the past five years, has been well above the national average on a per capita basis.

Third, incentives provided in the rent regulation program encouraged, rather than discouraged, capital improvements to existing units. This may be reflected in the relatively good state of repair of the post-World War II rental stock in Manitoba.

5. The Vacancy Rate and the Dynamics of the Manitoba Rental Housing Market

The point of departure for this discussion was the low vacancy rate for rental accommodation in Manitoba. Because CMHC estimates of the vacancy rate data are restricted to the primary market (buildings with three or more rental units) and do not consider the secondary rental market, its estimates likely overstate the degree of "tightness" in the market. Nonetheless, there is little question that adequacy of supply is a significant concern. In the absence of any evidence that rent regulations have contributed to a shortage of rental accommodation in Manitoba, it is important to understand the potential causes of the low vacancy rates in the province.

The dynamics of the rental housing market is extremely complex, especially in terms of its interaction with the home ownership markets. It is appropriate to consider broad trends in the demand for housing generally, the relationship between the rental and home ownership sectors, and then the manner in which the rental housing stock adjusts to changes in demand.

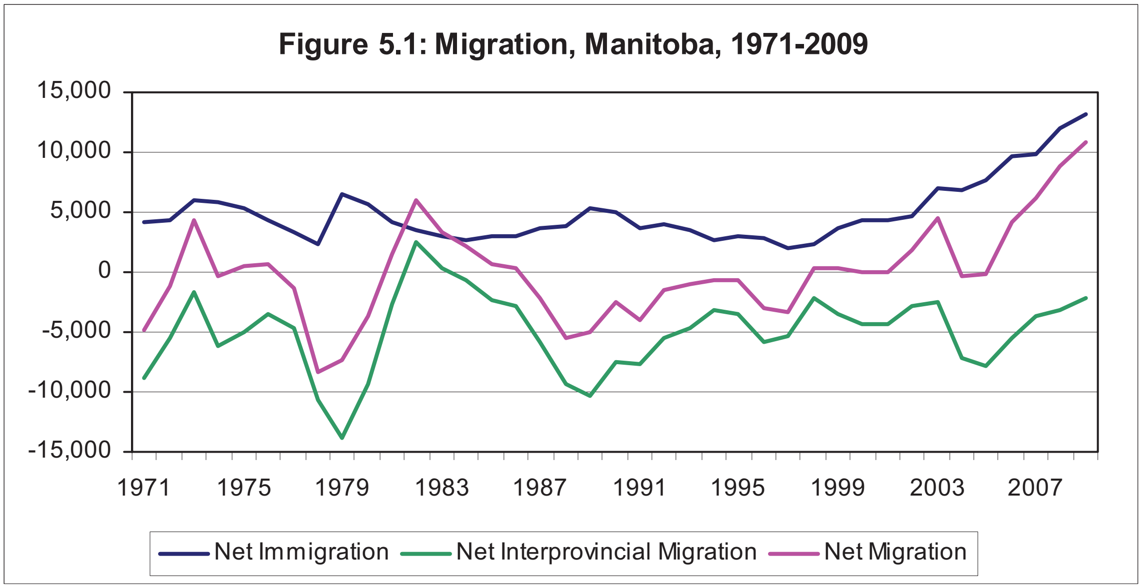
5.1 Demand for Housing

The demand for housing varies with many factors, including population growth, the age distribution of the population, and the average level of income.

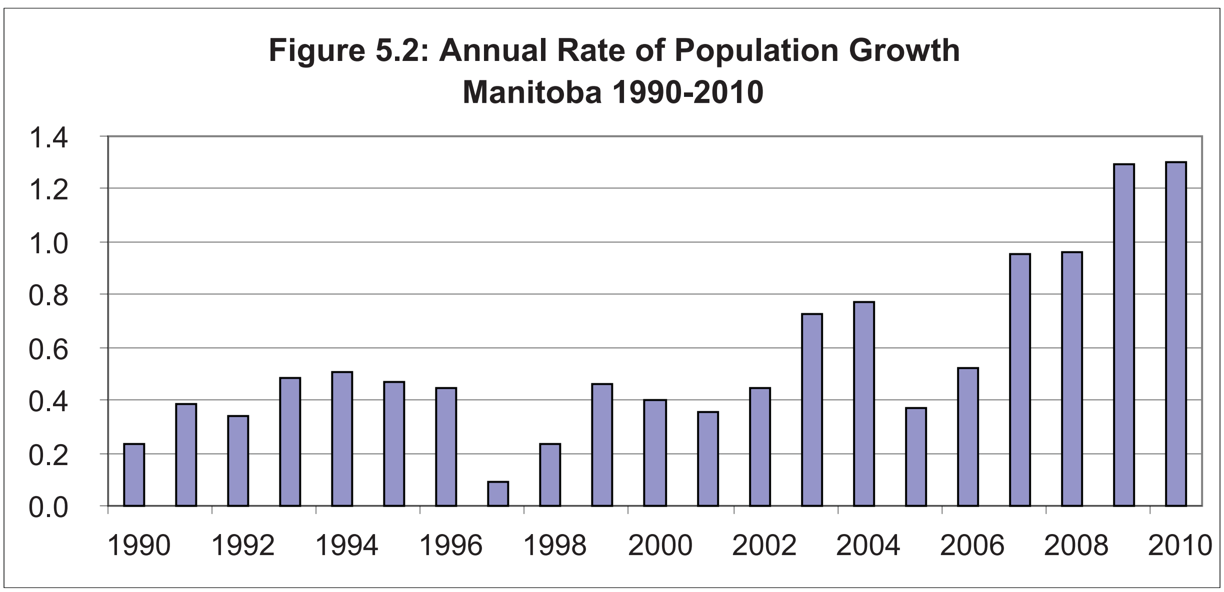
Following many years of sluggish population growth, Manitoba has experienced a rapid increase over the past decade. Much of this is attributed to the province's Provincial Nominee Program (PNP), introduced in 1999 in an effort to redress the regional imbalance in the settlement pattern of immigrants to Canada. By establishing entry criteria that are less stringent than the Federal Government's selection criteria, and by offering expedited processing times, immigration to Manitoba has risen from 4,207 to 14,086 between 1999 and 2009. Moreover, the rate of retention in the province of immigrants admitted under the PNP has been high (Carter, Pandey and Townsend, 2010).

The success of the PNP has had a marked impact on the province's net migration and population growth. Prior to 1998, with rare exception, Manitoba witnessed a net outflow of migrants as the net gain in immigrants (immigrants less emigrants) was insufficient to offset net loss in interprovincial migration. After 1998, this pattern was reversed. By 2009, the net inflow of migrants exceeded 10,000, an amount not experienced since at least 1971 (Figure 5.1). This change has had a marked effect on the rate of growth in the province's population, reaching over 1% per annum in 2009 and 2010 (Figure 5.2).

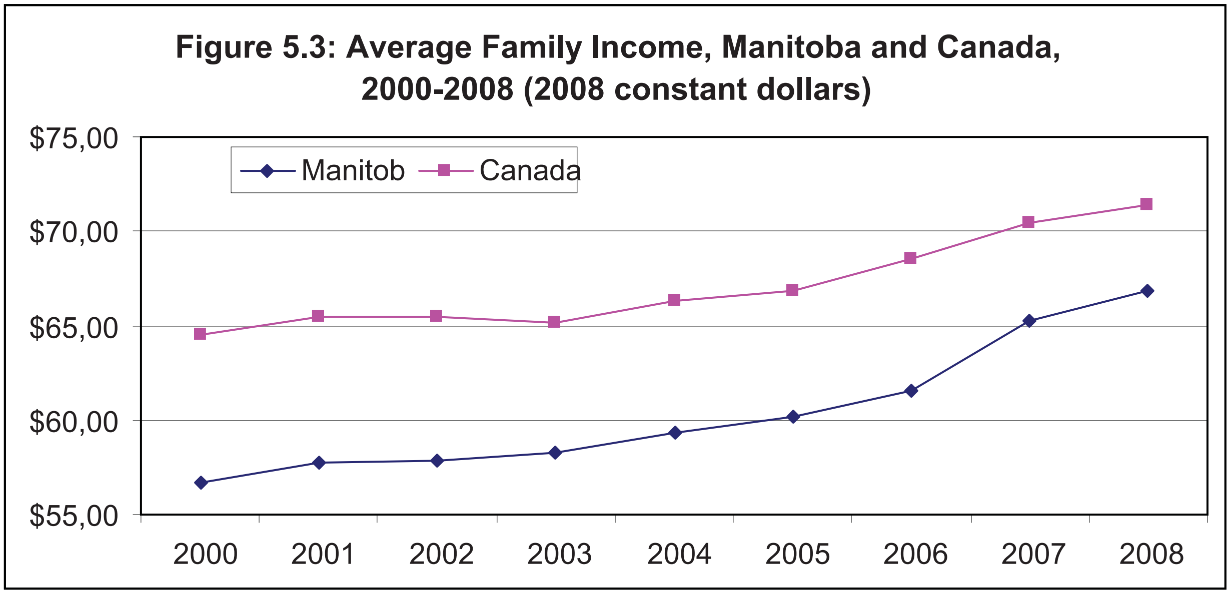
Further increasing the demand for housing has been the relatively good performance of the Manitoba economy over the past decade. Not only has the average income in Manitoba increased in absolute terms–rising from $56,700 in 2000 to $66,900 in 2008 measured in 2008 constant dollars–but the gap between Manitoba and Canada has gradually narrowed (Figure 5.3) This trend, however, had an ambiguous impact on the rental sector. On the one hand, it increases demand for rental units if it encourages younger people to move away from home at an earlier age; on the other hand, it brings home ownership within the financial reach of more families and may thus reduce the demand for rental accommodation.



Source: CANSIM Table 51-0004



Note: Figure for 2010 is the percentage change between September 2009 and September 2010.
Source: Statistics Canada, CANSIM Table 051-0005.



Source: Statistics Canada, CANSIM Table 202-0403

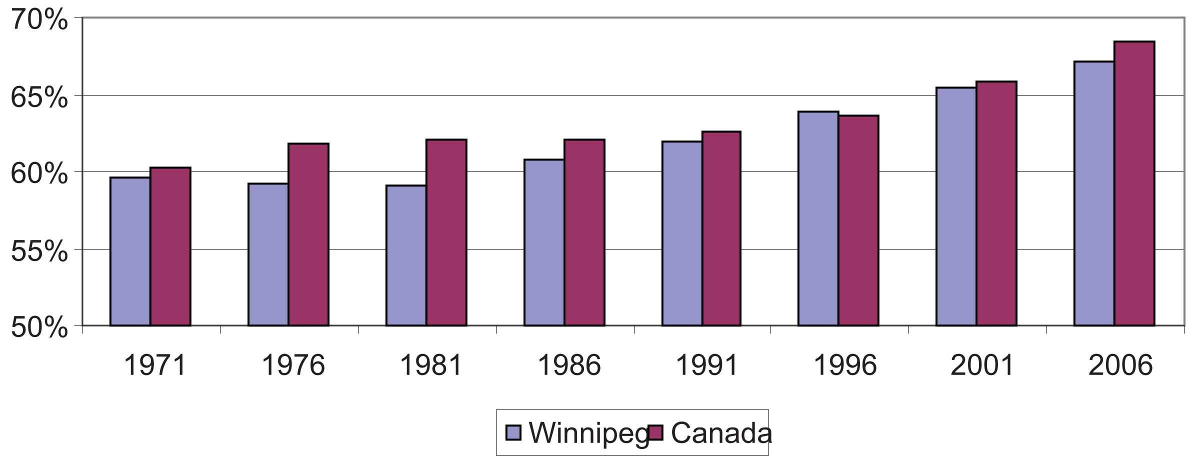
5.2 Renting versus Home Ownership

The increasing demand for housing associated with recent increases in the rate of population growth and in average family income comes in the context of a long-term secular trend towards home ownership. Since 1971, there has been a steady increase in the owner-to-renter ratio throughout the country, and this trend has been more pronounced in Winnipeg where the percentage of households owning their dwelling has risen from 59% in 1981 to 67% in 2006 (Figure 5.4).

The trend towards home ownership has been in part due to population aging. The prevalence of home ownership tends to be the lowest among those aged 25-34 and highest among those between the age of 45 and 74. Since 1988, the proportion of the Manitoba population most likely to be renters (aged 18-34) has declined from 40.5% to 35.6%, while those with the highest propensity for home ownership (aged 45-64) has increased from 17.1% to 24.0%.

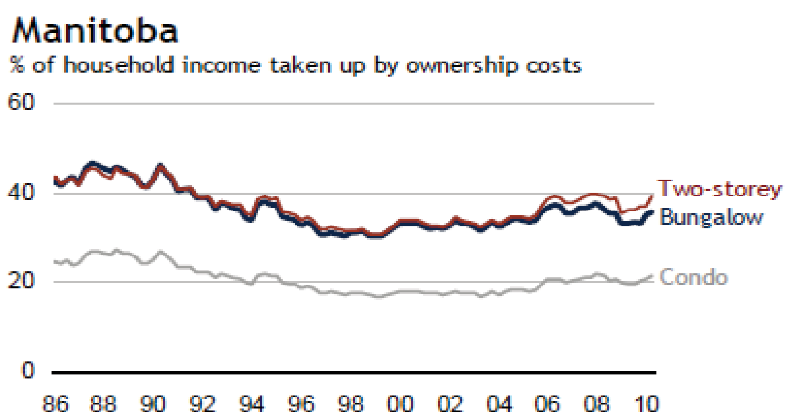
A second factor has been the relative affordability of home ownership in Winnipeg relative to other Canadian urban centres. Despite the recent rise in housing prices in Winnipeg, the RBC "Housing Affordability Measure" indicates that home ownership remains within the grasp of a large proportion of households. In Winnipeg, the annual cost of owning a standard two-bedroom house (including mortgage payments, utilities and property taxes), represented 37.4% of a typical family's pre-tax income, compared to 48.9% in the country as a whole (RBC, 2010). In Manitoba generally, housing affordability increased steadily throughout the 1990s and, despite a recent decline, remains low by national standards (Figure 5.5).

Figure 5.4: Home Ownership Rates
Winnipeg and Canada, 1971-2006



Source: CMHC, *Canadian Housing Observer, 2010*. Table 8. Derived from Census data.

Figure 5.5: RBC Housing Affordability Measure,
Manitoba, 1986-2010



In light of these trends, the number of renter households in Manitoba declined between 1990 and 2005 and the stock of rental accommodation declined in response. It is in this context that the recent increase in demand for rental housing needs to be interpreted. The sudden increase in demand for housing generally has been particularly notable in the rental housing sector. This is largely attributed to the greater propensity of recent immigrants to be renters rather than home owners (Carter, Pandey and Townsend, 2010).

5.3 Adjustments in the Rental Housing Stock

The capacity of the supply of rental accommodation to adjust to an increase in demand is distinguished by two principal factors. The first is the lack of symmetry between the movement of existing housing units from the rental to the ownership market and vice versa. Condominium conversions, as witnessed in Winnipeg in the mid-1990s, facilitate a rapid shift from rental to ownership status, but the reverse is untrue. Moreover, to the extent that condominiums are converted back to rental status, this is not reflected in vacancy rate statistics which do not include the secondary rental market.

The second, and more important, reason is the inelasticity in the supply of rental accommodation. Rental housing is an extremely durable capital good such that additions to the stock occur very slowly in response to current changes in rents, income and other factors. As with any other capital asset, the present value (*V*) of a rental property expected to last until year *n*, depends upon the discounted value of its expected future net rental stream:

$$V = \sum_{t=0}^{n} \frac{(R_t - E_t)}{(1-d)^t}$$

where R_t is the expected future gross revenue in period *t*, E_t is the expected operating cost in year *t*, and *d* is the discount rate.

Where the capital asset is extremely durable, such that *n* is many years into the future, the decision to invest depends less on current market conditions as it does on the forecast of future market conditions, as well as the cost of borrowing. The long cycles observed in new construction (both of rental and owner-occupied units) are largely a reflection of the durability of housing as an asset. Construction booms tend to be closely linked to long-term demographic trends, from rising birth rates to more rapid immigration, that are expected to persist over a long period. A sudden increase in demand may be a relatively unimportant inducement to invest if the entrepreneur’s expectations about future market conditions are uncertain. For instance, the sudden and largely unanticipated growth in population associated with a higher rate of immigration may have only a modest impact on the inducement to invest in new rental accommodation unless the higher rate of immigration is expected to persist long into the future.

5.4 The Role of Rent Regulations When Vacancy Rates are Low

The recent increase in demand for rental accommodation, associated with the success of the PNP, has resulted in a decline in the vacancy rate throughout Manitoba. Any response in the secondary rental market, particularly through an increasing number of condominiums being rented out, is not reflected in the data, but there is little question that the rental market remains tight. The supply response has been slow, but not unusually so. The rate of construction of new rental units in the province over the past five years has been much higher. These factors, quite independent of rent regulations, are likely the primary cause of relatively low vacancy rates in the province.

Because of the slowness with which the rental housing stock adjusts to an increase in demand, disequilibrium in the market can be expected to persist for a long time. It is precisely under such conditions that rent regulations become particularly important in preventing unwarranted rent increases.

6. Achieving Balance in the Rental Housing Market

A rental unit is both a home to the tenant and an investment to the landlord. An expressed objective of the Residential Tenancies Branch is “to create a rental marketplace that serves landlords and tenants fairly.” (Manitoba, Residential Tenancies Branch, *Annual Report,* 2009).

From the tenant’s point of view, fairness entails reasonable security of tenure. Moving costs are high, both in monetary and psychic terms. Rent regulations enhance the security of tenure by preventing “economic evictions.” Other provisions in the Residential Tenancies Act define the circumstances under which a landlord may justifiably evict a tenant; however, these protections may be of little value if the tenant is subject to large and unwarranted increases in rent (Fallis, 1988).

From the landlord’s perspective, fairness requires a reasonable rate of return, particularly given the high carry costs and the risks entailed in investing in an asset that has a large sunk cost and an expected life of an extremely long duration. Rent regulations must not, therefore, reduce the landlord’s revenue to the point that operating costs are not met and a fair return on investment is not possible.

From a social perspective, the commitment to shelter as a human right requires that an adequate quantity and quality of the rental stock is maintained and is affordable. To the extent that a private market is relied upon to achieve this goal, there must be appropriate market incentives for maintenance and repair expenditures, and for the construction of new rental units.

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Rent regulations are but one aspect of housing policy. Their primary role is to increase the security of tenure while maintaining market incentives governing supply. Manitoba’s rent regulation program is well designed to accomplish this goal.

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