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WORKING PAPER 81-39

RENT CONTROLS IN ONTARIO:  
ROOFS OR CEILINGS?

BY

LAWRENCE B. SMITH  
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RENT CONTROLS IN ONTARIO: ROOFS OR CEILINGS?

by

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This paper describes the rent control program in Ontario and indicates the consequences of these controls. The paper indicates that rent controls caused both a small nominal decline and a large real decline in the per unit value of rental apartments, substantially reduced new rental housing starts, generated a rental housing shortage, created a dual market with significant rent differences between the controlled and uncontrolled (new construction) sectors, and imposed large costs on government in the form of foregone tax revenues and increased rental housing subsidies. The paper also indicates some of the political responses to the developing economic effects, such as the imposition of additional land use controls and increased government spending programs to stimulate new rental construction.

## Rent Control in Ontario: Roofs or Ceilings?

### I. Introduction

In October, 1975, in the midst of an election campaign, rent control was introduced in Ontario in the form of a temporary rent review program. At the end of 1980 rent control was still in effect and many of the expected consequences of rent control were beginning to appear. These consequences include the economic realities of rental housing shortages, reduced rental construction, the development of a dual controlled and uncontrolled market, the deterioration of the rental housing stock and a rising revenue and expenditure cost for government; and the political realities of further regulation and government assistance for new rental construction.

This paper describes the rent control program in Ontario and analyzes the consequences of these controls. In Section II the paper describes the major facets of the rent control program. In Section III the paper analyzes the economic implications of the Ontario rent control program and in Section IV the paper indicates the political response to these economic effects.

### II. A Summary of Rent Controls in Ontario

The general effects of rent controls are well-known and are more or less universal,<sup>1</sup> but the specific effects of any given set of controls depend upon the particular specification of the controls and local housing market conditions at the inception of the controls.<sup>2</sup> In order to properly appreciate the consequences of rent controls in Ontario it is thus necessary to understand the specific legislation and its context.

Rent control was introduced in Ontario in October 1975 and made retroactive to July 29, 1975.<sup>3</sup> The controls were originally to self-destruct on July 31, 1977, but prior to this date were extended to December 31, 1978.<sup>4</sup> In October 1978 it was announced the control program would be revised and extended, and in June 1979 the revised rent control program became law and extended rent controls indefinitely.<sup>5</sup> Because the original and revised set of controls are very similar the basic features of the controls can be assumed to have applied throughout the control period unless otherwise indicated.

Rents in Ontario may be increased only once a year by an amount which essentially equals the annual increase in costs of the landlord. This cost-pass-through concept works in two stages. In the first stage, annual rent increases are permitted up to a maximum percentage set by government statute, with the percentage being approximately that necessary to enable the typical landlord to just recover any cost increases. From the retroactive inception of the controls in July, 1975 to October, 1977 the maximum rent increase permitted by statute was 8% a year, and thereafter to the time of writing (March 1981) the maximum permitted increase was 6% a year. In the second stage, formal rent review hearings may be conducted to readjust the permitted percentage increase if the statutory maximum increase is insufficient in the particular circumstances to enable the landlord to recover his increase in costs.<sup>6</sup>

Initially, all existing rental dwellings in Ontario except Government assisted housing were subject to rent control, although new dwellings completed after the controls were introduced and previously non-rented dwellings were to be exempt from controls for five years after they were completed or

first rented. In the 1979 revision the exemption for all new dwellings (completed after January 1, 1976) was extended indefinitely and a provision for decontrol of luxury units was introduced by exempting dwellings with rentals in excess of \$750 a month.

The cost-pass-through feature of the control program through the formal hearing process operates in two ways. First, when no "financial loss" exists the landlord may apply for a rent increase equal to the year to year increase in costs. For this purpose costs are defined to include all operating costs and financing payments for financing in which the funds are directly applied to the dwelling. Repair and maintenance costs are very narrowly defined and many items acceptable as expenses for tax purposes are often deemed to be capital expenditures, and thus ineligible for the direct cost increase calculation. Cost increases associated with capital expenditures are allowed, but only in the amount necessary to amortize the expenditure over its expected future life at the rate of interest paid on borrowed funds (or the prime first mortgage rate on equity funds) used to finance the expenditure. Capital expenditures can thus be recouped over their expected life but no additional net income can be generated from these expenditures. On the other hand, if the quality of the building and services are not maintained the controls call for a rent reduction or lower rent increase. Consequently, for buildings not experiencing a "financial loss" the cost-pass-through concept of the controls virtually freezes net rents at their pre-control level, and prevents landlords from directly benefitting from capital expenditures or planned quality deterioration.

Second, when a "financial loss" exists the landlord may apply for an increase in rents sufficient to eliminate the loss over a three year period.



For the purpose of determining "financial loss" costs are defined to include all operating costs and financing payments, both interest and principal, for financing not in excess of 85% of the original acquisition costs. No provision is made for depreciation costs nor to allow for any return on invested capital, but normal principal payments on mortgage financing are considered a cost. The concept under the original legislation was thus to grant rent increases sufficient to enable a landlord to "break-even" on a cash flow basis, but the 1979 revision introduced a "relief of hardship" provision to permit a positive cash flow by allowing an additional rent increase of 2% of the total costs if a landlord is just "breaking-even".

### III. Economic Implications of Rent Control in Ontario

#### A. On Capital Values

The dominant feature of rent control in Ontario is the cost-pass-through process which essentially ties rent increases to the cost increases of the landlord. The effect of this process is that net cash flows were fixed in nominal terms at the pre-control level for all residential investments, and hence real net cash flows declined steadily throughout the control period. An indication of this can be seen from Table I which shows that monthly real gross rents declined 7%,<sup>7</sup> and the estimated real net monthly rent exclusive of financing costs declined 23% for a typical one-bedroom apartment in the City of Toronto after controls became effective in 1975.

Since the value of income-producing property is based upon its expected future income stream, rent controls reduced capital values by freezing nominal net rents (at their 1975 uncontrolled level) and causing a downward revision in net rental expectations. As Table I indicates the average price per unit for rental apartment buildings of 6 or more units in the City of Toronto declined with the introduction of rent control from the 1975 pre-control price<sup>8</sup>

Table 1

## Rental Apartment Prices, Residential and Condominium Apartment Prices and Apartment Rents, Toronto 1974-80

	Average Per Unit Price for Rental Apartment Buildings of 6 or more suites, City of Toronto <sup>2</sup>		Multiple Listing Service Average Sales Prices, Metro Toronto <sup>3</sup>		Ratio of the Per Unit Price of Rental Apartments to MLS Prices	Average Monthly Rent for 1-Bedroom Apartments, City of Toronto <sup>4</sup>		Estimated Net Monthly Rent for 1-Bedroom Apartments, Exclusive of Financing <sup>5</sup>		
	Current \$	Constant <sup>6</sup> 1975 \$	Residential Dwellings	Condominium Apartments		Current \$	Constant <sup>6</sup> 1975 \$	Current \$	Constant <sup>6</sup> 1975 \$	
1980	17,429	11,459	75,694	46,754	.230	.373	310	204	130	85
1979	16,901	12,238	70,830	43,316	.239	.390	292	211	130	94
1978	17,730	14,027	67,333	38,959	.260	.455	276	218	126	100
1977	16,766	14,441	64,559	37,596	.260	.446	256	220	119	102
1976	17,617	16,388	61,389	37,027	.287	.476	230	214	107	100
1975 <sup>1+</sup>	18,903	18,903	57,581	35,959	.328	.526	219	219	111	111
1975 <sup>1λ</sup>							238	238	130	130
1974	15,407	17,062	52,806	35,031	.292	.440	197	218	99	109

## Sources &amp; Notes

<sup>1</sup>Uncontrolled rent is at October 1975, but prior to the rent roll-back. The controlled rent reflects the roll back to July 1975. Since the 1974-80 increase was 57% and the allowed 1975-80 increase was 38.9%, the effective 1974-75 increase was 11.3%, and hence the controlled rent was estimated to be \$219.

<sup>2</sup>Apartment prices calculated from Teela Reports Apartment Surveys, Toronto.

<sup>3</sup>Multiple Listing Service Prices provided by the Toronto Real Estate Board.

<sup>4</sup>Calculated from C.M.H.C., Toronto Office "Rental Apartment Vacancy Survey". Data to 1977 were based on vacant apartments only, while data after 1977 was based on a survey of all private rental dwellings. To compensate for the upward bias in pre-1978 data, the series was spliced by assuming an 8% rental increase in 1978, and adjusting pre-1978 data accordingly. Since 1974 surveys were for other months than October, the two survey results in these years were interpolated to estimate the October rent.

<sup>5</sup>Calculated by assuming operating costs excluding finance were 50% of pre-control gross rent, and that operating costs increased according to the "household operating cost component" of the CPI after 1974.

<sup>6</sup>Constant dollars based on the Consumer Price Index.

<sup>+</sup>after rent control; rent roll-back.

<sup>λ</sup>before rent control.

of \$18,903 to \$17,617 in 1976 after controls were implemented, and then remained relatively constant averaging \$17,273 throughout the 1976-80 period. This pattern in nominal capital values is consistent with an initial downward shift in the expected future net rental stream upon the introduction of rent controls, and with the expectation of a relatively constant future net rent thereafter as a result of the cost-pass-through process.<sup>9</sup>

In real terms, rent control caused capital values to decline steadily during the control period. The real per unit price of rental apartments in 1980 was 39% below the 1975 level, and the capital value of rental apartment units in 1980 was 29% and 30% lower than 1975 relative to the Multiple Listing Service (MLS) value of all residential dwellings and condominium apartments respectively in Metropolitan Toronto.

Rent controls, therefore, clearly lowered the capital asset value of rental apartment dwellings in real terms, and to a lesser extent in nominal terms.

#### B. On Housing Starts

Rent control has substantially depressed new rental housing starts in Ontario even though newly constructed dwellings are exempt from the controls. The steady decline in the real cash flow and real capital value of existing rental dwellings under rent control greatly reduces the desirability of investing in new rental housing by changing the investment climate and creating fears that controls would eventually be extended with the same consequences to newly constructed projects. Since the expected return from rental investments in a free market has both a net cash flow component and capital appreciation component, by creating the expectation that the capital appreciation component might be lost or reduced by the extension of controls, rent control necessitates a much larger net cash flow and hence much higher rent to justify new construction. Despite the continued exemption from controls for such construction,

these fears of extension are far from groundless, as the New York City experience has indicated.<sup>10</sup> The existence of a controlled sector introduces distortions, such as large rental differences between the controlled and uncontrolled sectors (discussed below), which are likely to breed further controls.

The decline in rental housing starts is clearly evident in Table 2 since total rental starts fell from 22,260 starts in 1974, the year immediately preceding the controls, and an average of 36,846 starts annually during the four years immediately preceding the controls, to 10,394 starts in the year the controls were implemented and to an average of 14,509 starts annually during the first five years of the controls. Although the controls were not introduced until October 1975 a sharp decline in rental starts occurred in that year both because of delayed or cancelled starts and because 7,786 originally designated rental starts were shifted to condominium status.<sup>11</sup> An even larger percentage decline occurred in the purely private sector as non-government subsidized rental starts declined from 15,094 starts in 1974 and an average of 27,999 starts annually during the four years immediately preceding the controls, to 3,775 starts in 1975 and to an average of 5,512 starts annually during the next five years. Government subsidized rental and condominium starts, on the other hand, remained strong and even rose during the early control period, but this was primarily a function of federal and provincial government subsidy programs introduced at this time.

Although rent controls are a provincial responsibility, rent controls were introduced throughout most of Canada in 1975 in conjunction with the federal anti-inflation program and introduction of wage and price controls.<sup>12</sup> To encourage provincial co-operation in the housing area and partially to mitigate the effects of rent controls on new construction the federal government in 1975 reformulated and greatly liberalized its Assisted Home-Ownership Program (AHOP) and introduced the Assisted Rental Program (ARP),<sup>13</sup> and the

Table 2  
Housing Starts, by Categories, 1969-1980

	Total Row and Apartment Starts	Total Condominium and Rental Apartment Starts	Total Condominium Starts	Total Rental Starts	Non-Government Assisted Starts		Government Assisted Starts	
					Condominium	Rental	Condominium	Rental
1980	16,234	14,770	3,128	11,642	2,261	3,842	867	7,800
1979	20,727	19,266	7,328	11,938	1,560	7,711	5,768	4,227
1978	35,154	32,886	11,781	21,105	1,819	6,935	9,962	14,170
1977	40,867	37,422	22,020	15,402	3,522	5,382	18,498	10,020
1976	43,928	39,449	26,992	12,457	6,022	3,691	20,970	8,766
1975	37,756	34,703	24,309	10,394	9,247	3,775	15,062	6,619
1974	45,559	43,180	20,920	22,260	9,777	15,094	11,143	7,166
1973	59,835	56,841	19,794	37,047	9,920	25,933	9,874	11,114
1972	56,764	54,561	8,427	46,134	4,389	39,097	4,038	7,037
1971	51,497	49,597	7,652	41,945	3,586	31,873	4,066	10,072
1970	50,474	48,442	9,881	38,561	3,055	23,982	6,726	14,579
1969	45,962	44,483	3,586	39,897	1,578	27,543	2,008	12,354

Sources:

Column 1 - CMHC Canadian Housing Statistics, 1979, p. 10 and earlier issues

Column 2 - estimated by applying the 1980 proportion of freehold row starts to total starts to total row starts and subtracting from Column 1. Proportion was taken from CMHC Ontario Housing Market Report, December 1980, pp. 2-15.

Columns 3 and 4 - 1980 data are from CMHC Ontario Housing Market Report, December 1980, pp. 2-15.

- 1979 data were supplied by CMHC, Toronto office.

- 1974-78 data were estimated by interpolating starts under construction at June 30, from CMHC, Ontario Region, "Condominium Universe", Appendix to Ontario Housing Statistics, June 30, 1979 and earlier issues.

- 1969-73 data were estimated by extrapolating Toronto CMA data to Ontario, based on changes in stock and units under construction. Data estimated from CMHC Ontario Region "Condominium Universe", op.cit. June 30, 1974 and earlier issues.

Columns 5 and 7 - 1974-79 data were calculated the same as Columns 3 and 4, 1974-78. 1969-73 data were calculated the same as Columns 3 and 4.

Columns 6 and 8 - 1973-79 data were calculated by adjusting Column 1 according to the ratio of non-single non-NHA starts to total non-single starts, CMHC Canadian Housing Statistics, 1979, Table 15, and earlier issues to estimate total non-government assisted multiple starts. Column 5 was then subtracted to get Column 6. Column 6 was subtracted from Column 4 to get Column 8.

- 1969-72 data were based on adjusting Column 1 according to data for cities of 10,000 and over, CMHC Canadian Housing Statistics, 1972, Table 14, and earlier issues.

Ontario government responded with the Ontario Rental Construction Grant Program (ORCGP) in 1976.

The AHOP program was originally introduced in 1973 to encourage Canadian households to acquire their own homes. The program originally operated as a subsidy program for low and moderate income families as Canada Mortgage and Housing Corporation (CMHC), the federal government housing agency, offered 95% mortgage loans and provided annual grants of up to \$300 a year (raised to \$600 in 1974) to reduce mortgage payments to 25% of family income. In 1975 the scope of the program was considerably broadened by extending the program to loans advanced by private financial institutions, by substantially easing the borrowing terms that qualified for federal mortgage loan insurance and by providing interest reducing annual loans of up to \$1200 and additional grants(both on a gradually phasing out basis) to lower the effective first year interest rate to 8% and mortgage payment to 25% of family income. The ARP program was a somewhat analogous program introduced on the rental side in 1975. Under this program annual subsidies of up to \$900 per unit, to be phased out over 15 years, were provided to encourage the construction of moderately priced rent-controlled housing units. In 1976 the program was modified by switching the subsidies to non-interest loans to be repaid after 15 years, and increasing the initial loan to \$1200 per unit in the first year. These programs continued on a large scale until 1978 when a fast phase out began. The provincial ORCGP supplemented the ARP program by providing a non-repayable annual grant of up to \$600 per unit for new rental construction approved between 1976 and 1978, with the grant to be reduced as cash flows improved.

The effects of AHOP can be seen in Table 2 in the large increase and high level of government assisted condominium starts during 1973 to 1977, and the large drop in these starts in 1978 and 1979 as the program was phased out.

The effect of ARP and ORCGP can be seen in the bulge in government assisted rental starts in 1976 to 1978, and the sharp decline in these starts in 1979 after the programs were terminated.

The use of government housing assistance programs clearly mitigated part of the decline in total multiple unit and total rental housing starts in the early years of rent control, and prevented the declines from being even larger. However, during 1979 and 1980, after rent controls had been in existence for 4 to 5 years and the offsetting government subsidy programs had been phased out, total rental housing starts declined to approximately one-quarter of their 1971-73 level and half of their immediate pre-control level. Moreover, even under ARP and ORCGP total rental starts were substantially lower than in the pre-control period. Finally, except for some shifting of construction from rental to condominium status in 1975 and 1976, there is little indication that rent controls significantly increased condominium starts since total multiple starts declined substantially after controls were introduced, especially after AHOP was terminated.<sup>14</sup> It is, therefore, clear that rent controls were associated with a substantial decline in both rental and total multiple housing starts in Ontario, notwithstanding that newly constructed dwellings were exempt from the controls.

Moreover, the sharp decline in rental starts is consistent with a decline of only approximately 10% in the real gross rent because the controls were likely to have substantially reduced the expected rate of increase in the nominal value. Ex post, rent control basically froze the nominal net cash flow rent return at the pre-control level (column 9 in Table 1) and reduced the rate of increase in nominal capital values to zero. If these results were anticipated ex ante they would explain the sharp decline in housing starts. For example, if the total expected return consisted half of cash flow and half

of expected capital appreciation, and if controls were expected to freeze nominal capital values, rent control would have reduced the expected return by 50%.<sup>15</sup> If the expected return were more heavily weighted for expected capital appreciation, the decline in expected yield would have been even more pronounced. Since the rent control program raises the possibility of controls on new construction in the future, and since this significantly lowers the expected yield on investment for any given rent, the sharp decline in rental starts is not surprising.

### C. On Conversions

The declines in the real value of rental dwellings, and especially the declines in their value relative to non-rental housing, provide incentive to convert rental to ownership housing and thereby further diminish the rental housing stock. The scope for such conversion in Ontario has been severely limited by many municipalities imposing inhibiting regulations. The City of Toronto, for example, had a prohibition since 1974 on converting occupied or previously occupied rental apartments to condominiums when the vacancy rate was below 2½%, and many other municipalities have similar prohibitions. Nevertheless, it is clear that controls have generated some conversions in situations not caught by the prohibitions.

In 1975, after rent control was imposed, 7786 designated rental units under construction, and hence exempt from conversion prohibitions on completed dwellings, were restructured and converted to condominium status.<sup>16</sup> In 1976 an additional 2,520 designated rental units under construction were restructured and converted to condominium status. Assuming all 10,306 converted units were under construction as rental units at the time rent control was imposed, approximately 50% of all rental units under construction at the time controls were imposed were converted to condominiums.<sup>17</sup>



Further indicating the pressure to convert is the experience in the City of Toronto where the number of joint owner-tenant occupied dwellings in which the owner lived on the premises and rented one or more units to tenants declined by 10,882 units, or 23%, between 1976-79. As a result of this process in which small dwelling units in joint tenant-owner occupied buildings were combined into larger primarily non-rental units, the rental stock was reduced by 3,261 units or 12.3% of the 1976 stock in this form.<sup>18</sup> Therefore the supply of rental units in buildings that could be easily converted because of their small size from rental or joint owner occupancy-rental dwellings was substantially reduced by conversions to non-rental dwellings.<sup>19</sup> This pattern is in stark contrast to the 1960s and early 1970s when large owner occupancy dwellings were subdivided into multiple rental units. Although there are numerous causes for the reconversion process rent control, which has reduced the income potential of these properties, is a contributing factor.<sup>20</sup>

Therefore, despite local policies prohibiting the conversion of once occupied rental units into condominiums, considerable conversion from rental to ownership dwellings has occurred as a result of rent control, both in small rental or joint rental-owner occupied dwellings and in dwellings under construction at the time rent controls were imposed.

#### D. On Housing Demand and Vacancies

During the first 5½ years of rent control in Ontario the consumer price index increased 62%, per capita income rose approximately 63%, household family income rose approximately 55%, homeownership costs increased approximately 70% and apartment operating expenses increased approximately 75%. In comparison, the allowed statutory rent increase was approximately 39% and the increase in the average rent for a one-bedroom apartment in the City of Toronto was approximately 31% from the October 1975 pre-rollback rent and approximately 42% from the post-rollback rent (Table 1, column 7).<sup>21</sup> Assuming that on average rents

rose 42% (which allows for increases over the statutory amounts through the rent review process and non-compliance) rent control created a bargain in rents since the average rent declined 12% relative to the consumer price index, 16% relative to the cost of homeownership, 19% relative to apartment operating costs, and an estimated 9% relative to family household income. Increases in the expected inflation rate<sup>22</sup> and in the proportion of the population in age brackets associated with homeownership would likely have exerted downward pressure on the relative cost of rent over this period, but rent control clearly accentuated the relative decline and thereby artificially stimulated the demand for rental housing and created an apparent rental housing shortage.

The apparent shortage in rental housing can be seen from Table 3 which indicates that despite the stimulating effects of ARP and ORCGP the vacancy rate in private rental dwellings in the Toronto CMA declined to 0.5% in October 1980 compared to 1.8% when rent controls were imposed and an average annual rate of 2.2% in the first half of the decade. For all Ontario the vacancy rate declined to 1.5% from 2.0%. Another indication of the apparent shortage is the decline in the number of newly completed and unoccupied apartment and row (both rental and condominium)<sup>23</sup> dwellings in the Toronto CMA from 2,038 units in October 1975 to only 920 units in October 1980. Combining both measures, the vacancy rate for private rental apartments and newly completed row and apartment units as a percentage of the private rental universe declined from 2.6% in October 1975 and an annual average of 3.9% 1970-74 to only 0.9% in 1980.

A noteworthy aspect of the rental shortage is its lag after the introduction of rent controls. Some lag is normally anticipated because the stimulus to demand provided by the "rental bargain" effect associated with binding controls increases over time, and because the supply effects are delayed until the inventory of projects under construction or committed prior to the

Table 3  
Vacancy Rates, Toronto CMA and Ontario

	Vacancy Rates <sup>1</sup> in Privately Initiated Rental Apartment Structures of 6 or more units		All Row and Apartment Units <sup>2</sup> , Newly Completed and Unoccupied Toronto - CMA	Vacancy Rates for Private Rental Apartments and Newly Completed Row and Apartment Units as a % of the Private Rental Universe, Toronto - CMA <sup>3</sup>
	Toronto-CMA	Ontario		
	(%)	(%)	(units)	(%)
1980	0.5	1.5	920	0.9
1979	1.2	2.0	2,912	2.3
1978	0.8	1.6	3,330	2.1
1977	1.0	1.5	2,582	2.0
1976	1.2	1.5	2,692	2.3
1975	1.8	2.0	2,038	2.6
1974	1.1	NA	4,796	3.1
1973	1.5	NA	1,384	2.1
1972	2.5	NA	3,292	4.1
1971	3.6	NA	2,043	4.7
1970	2.7	NA	4,501	5.3

Sources:

<sup>1</sup>1975-80 are as at October 31; 1970-74 are as at December 31. CMHC Canadian Housing Statistics 1979, Table 21, and earlier issues.

<sup>2</sup>includes rental, condominium and owner units. 1977-80 data are for newly completed and unoccupied units for at least 12 months. 1970-76 data are for unoccupied units for at least 6 months and hence are upward biased compared to the later period. CMHC Canadian Housing Statistics, 1979, Table 18, and earlier issues.

<sup>3</sup>calculated from CMHC Canadian Housing Statistics, 1979, Table 21 and earlier issues; and CMHC, Toronto Office, "Rental Apartment Vacancy Survey", November 1980, and earlier issues.

imposition of controls is depleted. In Ontario this supply effect was further delayed by the artificial stimulus of AHOP, ARP and ORCGP, but in 1980 the impact hit and vacant units declined sharply.

Finally, in interpreting these numbers it should be remembered that the appropriate measure for assessing the impact of controls is the difference between the actual vacancy rate and the rate which would have occurred in the absence of controls, not the trend in the vacancy rate over time. Unfortunately, the appropriate measure is very difficult to estimate, given the concomitant introduction of ARP, ORCGP and AHOP. Nevertheless, we can hypothesize that the relatively low vacancy rates at the time controls were implemented would, in the absence of controls, have generated rent increases and expectations of increases which would have restrained demand and stimulated new construction.<sup>24</sup> Consequently, the vacancy rate would likely have risen in the absence of controls and the decline in the vacancy rate over time is thus a conservative indicator of the impact on vacancies.

#### E. On Dual Markets

Since the Ontario rent controls exempt dwellings constructed or first leased after January 1, 1976, the controls create a dual market -- one controlled and one uncontrolled. The basic feature of the dichotomy is that prospective tenants will usually seek to rent first in the controlled sector (assuming controls are binding in terms of the market price of dwelling attributes). Vacancies will consequently approach zero in the controlled sector and demand unsatisfied in this sector will be forced to turn to the uncontrolled sector. Rents will rise in the uncontrolled sector until the excess demand is rationed out, but a dual market will result in which rents for a standardized set of housing attributes in the uncontrolled sector will be higher than in the controlled sector, and higher than would have existed in the absence of controls.<sup>25</sup> The

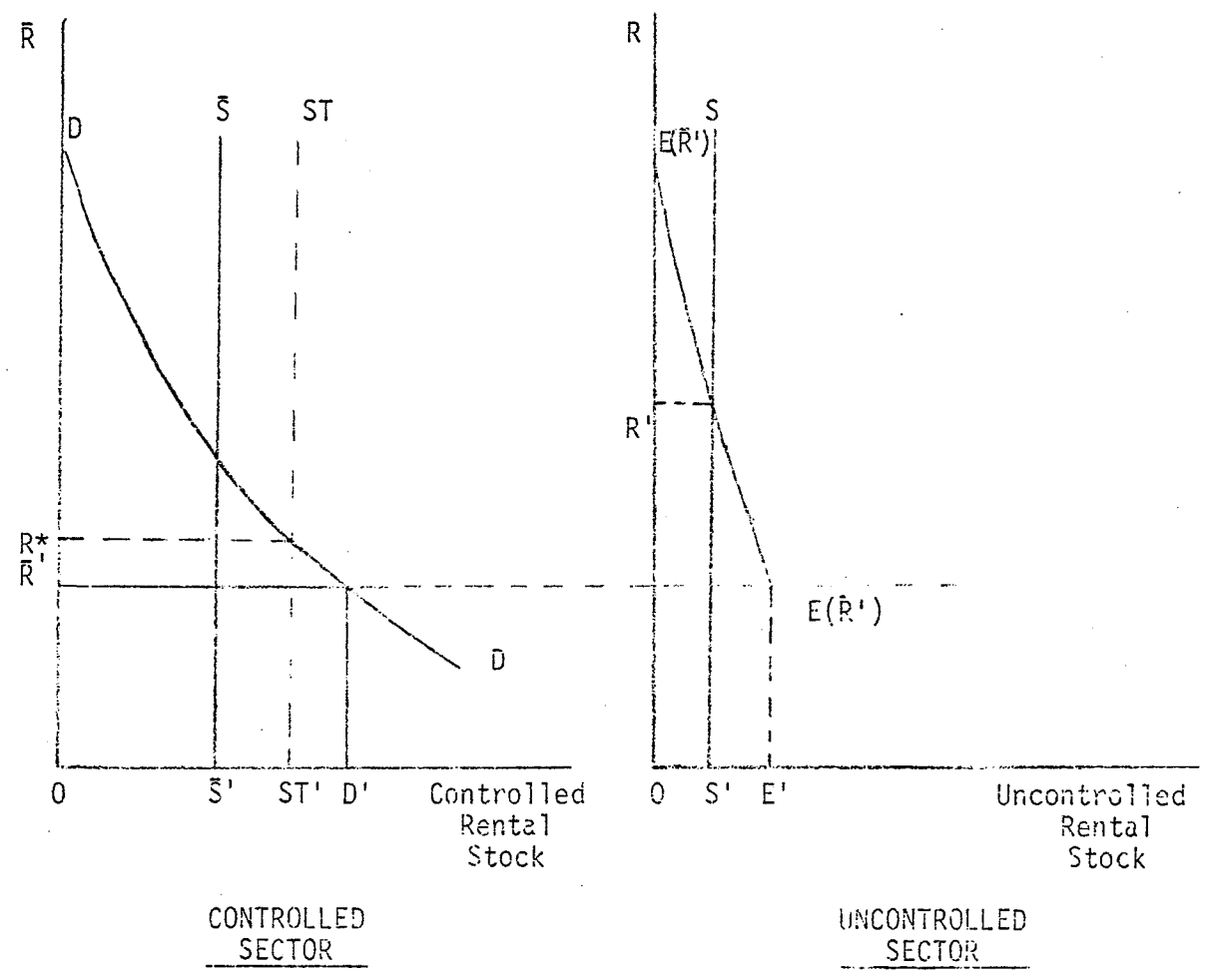
existence of these higher rents often generates pressure for controls to be extended to the exempt sector, and as the size of this sector grows this pressure increases.<sup>26</sup>

The operation of the dual market is illustrated in Figure 1, where  $\bar{S}\bar{S}'$  and  $SS'$  represent the rental stock of controlled and uncontrolled standardized units of housing services respectively,  $DD$  represents the demand for units of rental housing services and  $E(\bar{R}')E(\bar{R}')$  represents one of a series of possible excess demand curves for rental housing services when the controlled rent is  $\bar{R}'$  in the controlled sector, assuming that rationing is random in the controlled sector across different classes of renters with different individual demand curves.<sup>27</sup> At the controlled rent ( $\bar{R}'$ ),  $\bar{S}'D'$  of rental demand is unsatisfied in the controlled sector and must be satisfied in the uncontrolled sector. Since  $OE' = \bar{S}'D'$ , for any total rental stock ( $\bar{OS}' + OS'$ ) less than  $OD'$  (a rental stock less than  $OD'$  is the condition for rent control to be binding) the rent in the uncontrolled sector,  $R'$ , will not only exceed the rent in the controlled sector but will exceed the rent that would have existed in the absence of rent control. (The rent would be  $R^*$  if the total housing stock  $STST'$  were unaffected by rent control). Of course, the smaller the uncontrolled rental stock the higher the uncontrolled rent and the larger the discrepancy between the uncontrolled and free market rent. Since rent control reduces the supply of rental housing, the rent in the uncontrolled sector will be higher than in the absence of rent control because of both demand and supply forces.

An indication of the existence of a dual market is provided by the differences in rents between controlled and uncontrolled units. In the City of Toronto, in October 1980, rents for uncontrolled bachelor, one-bedroom, two-bedroom and three-bedroom units were respectively approximately 23%, 34%, 26% and 10% higher than for the equivalent controlled units, and in the Toronto CMA uncontrolled rents exceeded controlled rents by approximately 23%, 27%, 17% and 9%

Figure 1

The Dual Rental Market



respectively.<sup>28</sup> However, since the uncontrolled units were all completed after rent controls were introduced while the controlled units all predate the controls, there are likely to be qualitative differences which would cause the observed percentage differences in the average rents to exceed the quality adjusted differences.<sup>29</sup> Nevertheless, the size of the differences in the average rents on controlled and uncontrolled units strongly supports the existence of a dual market.

#### F. On Repairs and Maintenance

Rent controls in Ontario discourage repairs and maintenance expenditures, and thereby the preservation of the existing housing quality, although they attempt to avoid this by providing for compensating rent reductions if the quality of the dwelling and its services are not maintained. The deterioration problem arises because rent controls in general reduce the net return on rental housing and the attractiveness of rental housing compared to alternative investments, and this encourages investors to reduce the proportion of their investment portfolios devoted to housing. Since investors as a group cannot immediately reduce their holdings, except in the sense that the value of these holdings declines, they have an incentive to gradually reduce the real value of their investments by planned deterioration. Lower expenditures for repairs and maintenance accomplishes this by trading reduced capital values for increased net cash flows. Such a trade-off is only possible if the rent control procedures do not adequately enforce the compensating rent reduction feature, and generally this has been the case in Ontario.

Moreover, the Ontario rent controls have some specific features that discourage property maintenance. One feature is the very strict specification of repair and maintenance expenses eligible for cost-pass-through status as opposed to capital expenditure status. Many expenditures, such as painting interior halls, window caulking and repairs to the exterior, normally treated as

operating expenses for tax purposes by the Department of Revenue are usually treated as capital expenditures for rent control purposes, and hence increases in these types of expenditures are not considered to increase costs for cost-pass-through purposes. A second feature is the restriction on the return for capital expenditures to the prime first mortgage rate. This occurs because the rent determination calculation includes only the amount necessary to amortize a capital expenditure over its expected future life at the rate of interest paid on borrowed funds or at the prime mortgage rate if equity funds are used. As a result, capital expenditures financed by borrowed funds cannot increase net yield, while expenditures financed by equity generate only the prime mortgage yield. Some tax advantages might arise from capital expenditures, but the nominal return does not reflect the extra risk, illiquidity and permanently fixed yield aspect of the investment.<sup>30</sup> Financing with borrowed funds has the further disadvantage of being equivalent to borrowing short term and lending long term since there is usually only a "once and for all" rent adjustment based on the initial cost of borrowing. Consequently, the Ontario rent controls contain general and specific disincentives to property maintenance.

Unfortunately, statistical evidence is not readily available on repair and maintenance expenditures or housing quality but anecdotal evidence abounds, and the impression is clearly of sharply reduced "cosmetic" expenditures, such as painting, reduced preventive maintenance, and a substitution of initially lower-cost temporary for higher-cost permanent repairs. This reduction is supported by the results of a small survey which indicated that the ratio of repair and maintenance expenditures to total expenditures declined 9%, from 20.2% to 18.4%, between 1974 and 1980, almost entirely as a consequence of reduced painting and decorating expenditures.



### G. On Government Revenues and Expenditures

Although the direct costs of administering the rent control program are relatively small, having fluctuated between five and ten million dollars annually, the indirect government revenue and expenditure costs of rent control are very substantial. These costs arise from government programs introduced to compensate for reduced private sector expenditures, such as ARP, ORCGP and the Ontario Rental Construction Loan Program (discussed in the next section), tax concessions provided to stimulate the private sector, such as the multiple unit residential building (MURB) tax shelter, reduced government tax revenues from lower taxable net rental income and smaller taxable capital gains, and reduced municipal revenues from lower assessments on existing structures and from fewer new dwellings to assess.

The degree to which any government program can be attributed to any specific cause is uncertain but since ARP was introduced by the federal government at least in part to compensate the provinces for imposing rent control in conjunction with the federal anti-inflation program,<sup>32</sup> some portion of the costs of ARP can be attributed to rent control. During its tenure ARP financed over 40,000 housing units in Ontario<sup>33</sup> and, assuming an average subsidy of \$900 per dwelling unit in 1980, the cost of ARP assistance for Ontario approximated \$36 million. The cost of ORCGP, which supplemented ARP in Ontario, was \$4.7 million in 1980.

A similar argument arises with respect to the MURB tax shelter program. This tax shelter was introduced in late 1974 to stimulate multiple unit residential building by allowing accounting losses to be applied for tax shelter purposes against other income. Since the shelter applied only to multiple unit residential buildings a considerable tax preference was afforded this investment form. The MURB provision was originally to apply only to buildings started prior to the end of 1975, but the deadline was extended on an annual basis until

the end of 1979 when the program was terminated. The MURB provision was then reintroduced in October 1980, again on a "temporary" basis, to terminate at the end of 1981. Although the provision itself arose prior to rent control many of the extensions and the re-introduction in 1980 can, at least in part, be attributed to rent control. The tax loss from MURBs in 1979 was estimated by the Finance Department to be \$45 million,<sup>34</sup> and the amount applicable to Ontario was approximately \$15 million.<sup>35,36</sup>

Rent controls reduce government tax revenues by reducing the taxable rental income associated with rent controlled buildings. This tax loss can be estimated using a "back of the envelope" type calculation. At the commencement of rent control there were approximately one million rental dwellings in Ontario.<sup>37</sup> A study of the pre-control rental market indicated an equilibrium vacancy rate of approximately 5.0% (defined as that rate at which there is no excess demand nor supply) for both Toronto and Canada.<sup>38</sup> Assuming a stock demand elasticity for rental units of 0.4 to 0.5,<sup>39</sup> the equilibrium rent in Ontario in 1980 would have been 7 - 8 3/4% higher given the Ontario vacancy rate of 1 1/2%.<sup>40</sup> Assuming the average monthly rent in Ontario was \$300 per unit,<sup>41</sup> controls reduced gross rent rolls in Ontario by approximately \$283 million. However, the higher rent implies the higher vacancy rate of 5%, and hence the reduction in gross rents received was approximately \$154 million. Assuming operating costs would have been higher as a result of a 5% increase in repairs and maintenance expenditures (which is equivalent to approximately 0.5% of gross rents), the reduction in net rent was approximately \$136 million. Assuming an average marginal tax rate of 40%, the tax loss from reduced taxable net income was \$54.4 million.

Since rent control substantially reduced the market value of rental dwellings it also reduced capital gains tax revenue. Assuming that the proportion of apartment units sold in Toronto was 33% higher than in the province as a

whole, that the number of sales were unaffected by rent control, that the average apartment value per unit for Ontario was 75% of the Toronto value, and that the real value of apartment units would have declined by 10% in the absence of controls (as opposed to 40% under controls), rent control reduced government capital gains tax by approximately \$26 million. In addition, provincial capital taxes were reduced by \$2.3 million assuming 75% of the higher prices would have been financed by mortgages or other debt forms.<sup>42</sup>

Reduced market values should normally also lower municipal tax revenues by lowering assessed values. This reduction, however, did not occur in Ontario because municipal assessments were frozen during the relevant period.

On the other hand, municipal tax revenues were reduced by the induced reduction in total dwelling starts. Although no definitive estimate is possible without a complex econometric model for illustrative purposes we are assuming that rent control reduced the stock of residential dwelling units by 40,000 units over the control period, notwithstanding the ARP, ORCGP and AHOP programs.<sup>43</sup> Assuming an average municipal tax of \$800 per dwelling generates a municipal tax loss from reduced construction of approximately \$32 million.

If we assume half the costs of ARP and half the tax loss from MURBs are attributable to rent control,<sup>44</sup> that the MURB tax loss in 1980 was approximately the same as in 1979, and that the administrative costs of the controls were \$7.5 million, the total combined government lost revenue and expenditure costs of rent control in Ontario approximated \$152.4 million in 1980. The allocation of these costs between the different levels of government is set out in Table 4, and indicates approximately 49.3% is attributable to the federal government, 29.7% to the Ontario government and 21.0% to the municipal governments. Consequently, the level of government responsible for introducing rent control experienced less than 30% of the total government cost of the controls.

Table 4

Summary of Government Lost Revenue and Expenditure Costs  
from Rent Control in Ontario, 1980 in millions of dollars

	Combined Costs (\$ million)		Allocation Between Governments <sup>1</sup>		
			Federal (\$ million)	Provincial (\$ million)	Municipal (\$ million)
government expenditures:					
administrative cost	7.5			7.5	
attributed to ARP	18.0		18.0		
attributed to ORCGP	<u>4.7</u>	30.2		4.7	
government lost revenue:					
attributed to MURBs	7.5		4.9	2.6	
reduced taxable income	54.4		35.4	19.0	
reduced capital gains	26.0		16.9	9.1	
reduced corporation capital tax	2.3			2.3	
municipal tax loss from lower housing stock	<u>32.0</u>	<u>122.2</u>	—	—	<u>32.0</u>
total expenditure and tax loss		<u>152.4</u>	<u>75.2</u>	<u>45.2</u>	<u>32.0</u>

<sup>1</sup>This allocation assumes a federal-provincial tax split of 65-35%.

#### IV. Political Response to Economic Effects

The political response to the economic consequences of sharply reduced new rental construction and very low vacancy rates has taken two main forms, new subsidies to stimulate rental construction and additional land use controls.

##### A. New Subsidies to Rental Construction

The preceding discussion indicated the initial federal government response, to the extent it can be attributed to rent control, was the introduction of the ARP program and extensions of the MURB tax shelter program, and the initial Ontario response was the introduction of ORCGP program. As part of the federal response to a large and rising deficit as well as deficiencies in the ARP program itself, the federal government terminated new commitments under ARP in 1978 and allowed the MURB program to expire in 1979. However, the federal government reintroduced MURBs in 1980, and this can be considered a direct federal response to rent control induced rental shortages. Since the ORCGP program was a supplement to ARP it was also terminated with ARP.

The major provincial response has been the Ontario Rental Construction Loan Program introduced in January 1981 to stimulate new rental construction by providing interest-free loans of \$4,200 per unit for new rental dwellings (in buildings of at least 6 units) constructed in areas with low vacancy rates. The loans are to be repaid over a 25-year period with the first payment deferred until the 11th year. A maximum cost per unit requirement exists but, with the possible exception of the City of Toronto, it is not very restrictive at \$44,500 for one-bedroom and \$48,500 for two-bedroom apartments. At the mortgage rate prevailing when the program was introduced the \$4,200 no interest loan with deferred repayments reduces per unit monthly carrying costs by \$55 per month for the first 10 years and \$32 per month for the next 15 years, and is equivalent to a \$3,837 subsidy. The program was funded at \$63 million to provide support for 15,000 units. However, since the \$3,837 subsidy is almost universally

available and is equivalent to approximately an 8 - 10% cost reduction, the program is likely to increase rental starts by a maximum of 20-25% based on an elasticity of rental starts to construction costs of 2.5.<sup>45</sup> This program will, thus, considerably increase the cost of rent control without inducing a major housing market response.

## B. Land Use Controls

Since rent control substantially lowered the value of rental apartment units relative to condominium apartment units, (see Table 1), it greatly increased the incentive to convert rental to condominium units. Such conversions would exacerbate the effects of rent control on the rental housing market and hence were opposed by municipal governments. This opposition took the form of prohibitions on conversions and restrictions on demolition of rental apartments.

### (i) Prohibitions on Conversions

A number of municipalities have introduced conversion controls since rent control was introduced.<sup>46</sup> The City of Toronto in 1974, prior to rent control, introduced restrictions on apartment conversions to condominiums if the vacancy rate in Metropolitan Toronto was below 2.5%. Throughout the rent control period the vacancy rate remained below 2.5% making this prohibition binding.

### (ii) Demolition Restrictions

The combined effects of rent control and conversion prohibitions effectively froze the nominal value of rental buildings while land values for new condominium construction continued to rise. By the end of 1979 the value of land under rental apartments approached or exceeded the combined land and apartment building value in many cases. Consequently, demolition of rental apartment structures to build condominiums became a viable alternative in Toronto and a number of applications were made for such demolitions. In an attempt to prevent conversion by demolition and rebuilding, the City of Toronto responded by imposing

land use restrictions on land that previously contained rental apartment units. In October 1980 the City passed a by-law limiting every site in the City occupied by an apartment building 20 years of age or older to a maximum building density of one times lot area and a maximum building height of 11 metres (37 feet).<sup>47</sup> For most sites this meant replacement buildings were substantially downzoned, which reduced land values for alternative uses and reduced the likelihood of demolition and rebuilding. Buildings less than 20 years old were exempted since no demolition applications had been received for these buildings.

The by-law was meant as a stop-gap measure to permit time to devise longer term measures to protect the rental stock and prevent demolitions of buildings that would be viable in the absence of controls. This temporary "second best" approach, however, would have significant consequences if it were to be maintained in the long run because it would considerably distort the optimum use of land.

### C. Landlord and Tenant Act

The final political response that accompanied rent control was reform of the Ontario Landlord and Tenant Act. Major changes included prohibiting tenant evictions without cause, prohibiting security deposits, limiting prepaid rent to one month plus the current month, requiring interest to be paid on prepaid rent and lengthening the advance notice required for a rent increase. The major purposes of these revisions were to ensure tenant tenure security and prevent hidden or indirect charges to be introduced in lieu of rent.

### V. Summary and Conclusions

The foregoing discussion indicates that rent control in Ontario has significantly reduced the real (and to a lesser extent the nominal) value of rental apartment dwellings, substantially inhibited new rental construction, generated rental shortages, created a dual controlled and uncontrolled rental

market in which rents in the uncontrolled sector are higher than they would have been in the absence of controls, encouraged deterioration in the quality of the existing housing stock and imposed a large revenue and expenditure cost on government and hence on the non-rent controlled public. The political response to these economic consequences has included additional government spending programs to stimulate new construction, which increase the public cost and market distortions of rent control, and the imposition of additional land use controls which, if applied in the long run, lead to departures from optimum land use.



Footnotes

\*The views expressed are those of the authors and do not necessarily reflect the views of the City of Toronto Planning and Development Department or the Toronto City Council. The authors wish to thank Professors Jack Carr and George Fallis for some very useful suggestions. Part of the title is borrowed from M. Friedman and G. J. Stigler "Roofs or Ceilings: The Current Housing Problem" in Popular Essays on Current Problems, Vol. 1, No. 2 (New York: The Foundation for Economic Education, Inc., 1946), and reprinted in Rent Control: Myths and Realities W. Block and E. Olsen (ed.) (Vancouver: The Fraser Institute, 1981).

<sup>1</sup>See for example M. Friedman and G. J. Stigler "Roofs or Ceilings: The Current Housing Problem" op. cit., (for U.S. experience), and F. Kristoff "The Effects of Rent Control and Rent Stabilization in New York City" (for New York experience); F. W. Paish "The Economics of Rent Restriction" (for U.K. experience); F. A. Hayek "The Repercussions of Rent Restrictions" (for Austria); B. de Jouvenel "No Vacancies" (for France); and S. Rydenfelt "The Rise, Fall and Revival of Swedish Rent Control" (for Sweden), all in Rent Control: Myths and Realities W. Block and E. Olsen (ed.) (Vancouver: The Fraser Institute, 1981) for the effects of controls in different countries and times.

<sup>2</sup>Local market conditions primarily affect the timing of the consequences of controls rather than their ultimate effects.

<sup>3</sup>Government of Ontario, Residential Premises Rent Review Act 1975, 2nd Session 30th Parliament, Statutes of Ontario, 1975, SO 1975 Ch. 12 (Bill 20), December 18, 1975.

<sup>4</sup>Government of Ontario, Residential Premises Rent Review Amendment Act, 5th Session, 30th Parliament, Statutes of Ontario 1977, SO 1977 Ch. 3 (Bill 28), April 29, 1977.

<sup>5</sup>Government of Ontario, Residential Tenancies Act 1979, Part 11, 3rd Session, 31st Parliament, Statutes of Ontario 1979, SO 1979 Ch. 78 (Bill 163), June 21, 1979.

<sup>6</sup>Prior to the 1979 revision, tenants had the right to apply for a lower increase than the statutory maximum percentage if they thought a lower increase would be sufficient to recover cost increases.

<sup>7</sup>This is an underestimate of the decline in real rent since it is based only on five years, and the timing of the rent changes and CPI changes do not coincide. The decline from July 1975 to the end of 1980 approximates 11 - 12%.

<sup>8</sup>The Teela Report data reflect prices at the time of transfer. Since this typically lags the contract date by 2 - 3 months, 1975 prices can be considered to be purely pre-control prices.

<sup>9</sup>Capital values might change during rent controls despite the cost-pass-through procedure. Upward price pressure could arise if controls were expected to end or become less binding, if the discounted value of the land or improvements for alternative uses were to increase, or if the discount rate appropriate for these investments were to decline. On the other hand, downward price pressure could arise if negative expectations concerning controls increased, if controls were placed on the alternative use of the land and improvements or if the appropriate discount rate were to increase.

<sup>10</sup>See F. Kristoff, op. cit., p. 125-37.

<sup>11</sup>C.M.H.C., Ontario Region "Condominium Universe", Appendix to Ontario Housing Statistics, June 30, 1979 and earlier issues.

<sup>12</sup>See the Government of Canada, "Attack on Inflation" a policy statement tabled in the House of Commons by the Minister of Finance, October 14, 1975.

<sup>13</sup>For a discussion of the AHOP and ARP programs see L. B. Smith "Canadian Housing Policy in the Seventies" Land Economics, forthcoming.

<sup>14</sup>Normally an increase in condominium and other owner construction would be expected, but AHOP created excessive construction (see L. B. Smith op. cit.) during the 1974-78 period which depressed construction of this form in the late 1970s and probably outweighed the spill-over stimulus from rent control in 1979-80.

<sup>15</sup>If the elasticity of rental starts with respect to yield is 2.5 as derived from L. B. Smith The Postwar Residential Mortgage Market and the Role of Government (Toronto: University of Toronto Press, 1974) pp. 56-7, the reduction in expected yield would be consistent with an 80% decline in private rental housing starts.

<sup>16</sup>C.M.H.C. Ontario Region "Condominium Universe" op. cit., June 1979 and earlier issues.

<sup>17</sup>In 1977 there were no net rental to condominium conversions in this manner suggesting the shift in status for projects under construction when controls were introduced had been completed and that the tenure status for new projects was determined prior to construction.

<sup>18</sup>City of Toronto, Planning and Development Department, Policy and Research Division Research Bulletin #16, "Housing Deconversion" September 1980, p. 2.

<sup>19</sup>The City regulations prohibiting conversion of rental dwellings to condominiums do not apply to these small dwellings since condominium plans are not required for their conversion to ownership tenure.

<sup>20</sup>City of Toronto Planning and Development Department, op. cit., p. 3.

<sup>21</sup>Rent control was made retro-active and rents were rolled back to their July 1975 level. For details of the rent increase calculation see Table 1 and the Notes to Table 1.

<sup>22</sup>Expectations of increasing inflation shift housing tenure preferences from rental to owner because the impact of the tax benefits associated with homeownership increases as inflation increases.

<sup>23</sup>Most condominium buildings contain units that are available for rent.

<sup>24</sup>See L. B. Smith "A Note on the Price Adjustment Mechanism for Rental Housing" American Economic Review LXIV (June, 1974) pp. 478-81 for a measure of the "natural" vacancy rate and measure of the effect of vacancies on rents.

<sup>25</sup>Since newly formed households are likely to be forced to the uncontrolled sector, an income redistribution from younger (and usually lower income) households to older more established (and usually higher income) households occurs.

<sup>26</sup>In this connection it is interesting to note that one of the three major political parties in the March 1981 election campaign in Ontario advocated such an extension.

<sup>27</sup>Even if rationing is not fully random in the controlled sector and another excess demand curve is more appropriate, the following results hold unless the total rental stock is unaffected by rent control and rationing systematically eliminates those households with the weakest effective demand for

housing from the controlled sector, in which case R' may be the same as in the absence of controls. See L.B. Smith "Rent Control and Dual Market Rents" mimeographed manuscript, Toronto, April 1981.

<sup>28</sup>These differences were estimated from preliminary data supplied by C.M.H.C., Toronto Office "Rental Ranges in the Sample of Privately Initiated Apartment Structures of Six Units and Over", November 1980.

<sup>29</sup>Partially offsetting this age bias is the likelihood that newer uncontrolled units are less well located and hence have a lower locational value. This is especially likely for the Toronto CMA which covers a larger area, and probably explains the smaller differences for the Toronto CMA than for Toronto City. Further mitigating the age factor is the tendency for new dwellings to be smaller in size. An upward bias in the measure is provided by the exemption from controls of units renting over \$750. However, none of these units are included in the case of bachelor apartments, few if any are included for 1 and 2 bedroom apartments since only 3.5% and 8.6% respectively of the uncontrolled units had rents over \$500, and only 9.9% of the 3 bedroom apartments had rents over \$500. Moreover, offsetting this upward bias is the very strong downward bias introduced by the high proportion of lower priced government assisted ARP units in the uncontrolled category.

<sup>30</sup>The fact the investment is also permanently tied into the total investment in the building increases the undesirability of this expenditure.

<sup>31</sup>Foregone income or corporate taxes due to unbuilt dwellings are omitted since they are assumed to be offset by depreciation allowances in the early years; reduced taxes from unbuilt tax shelters are omitted; and lost tax revenues from reduced employment are also omitted.

<sup>32</sup>See the Ontario Ministry for Consumer and Corporate Relations "Policy Options for Continuing Tenant Protection", Toronto, 1978, p. 19.

<sup>33</sup>C.M.H.C. Canadian Housing Statistics, 1979 p. 55.

<sup>34</sup>Government of Canada, Department of Finance Tax Expenditure Accounts 1980, (Ottawa, 1980) p. 22.

<sup>35</sup>Multiple unit starts in Ontario were approximately one-third of the Canadian total during the applicable time period.

<sup>36</sup>Although it could be argued that rent control stimulated condominium construction and hence the government subsidy through AHOP, this relationship is sufficiently indirect to be ignored here.

<sup>37</sup>Ontario Ministry for Consumer and Corporate Relations "Policy Options for Continuing Tenant Protection" Toronto, 1978, p. 7.

<sup>38</sup>L. B. Smith, "A Note on the Price Adjustment Mechanism for Rental Housing" op. cit., p. 491.

<sup>39</sup>This is the stock demand elasticity for dwelling units as opposed to housing services. This is consistent with a demand elasticity for housing services of approximately 0.8 to 1.0. For a discussion of demand elasticities see F. de Leeuw "The Demand for Housing: A Review of Cross Section Evidence" Review of Economics and Statistics LIII (February, 1971) pp. 1-10, and L. B. Smith The Postwar Canadian Housing and Residential Mortgage Markets and The Role of Government, (Toronto: University of Toronto Press, 1974) pp. 30-31.

<sup>40</sup>This result is consistent with estimates of the reduction in the real rent in Toronto of between 7% and 12% in sections IIIA and IIID since the calculated estimate using this approach for Toronto would be a 9-11.25% reduction given the Toronto vacancy rate of 0.5%.

<sup>41</sup>The average rent for rent controlled units in the Toronto CMA was approximately \$315 in 1980 (calculated from data supplied by C.M.H.C. Toronto Office in "Rental Ranges in the Sample of Privately Initiated Apartment

Structures of Six Units and Over", November, 1980). Assuming that on average rents are 25% lower in the rest of Ontario, and that the mix of unit types is similar, the average rent in Ontario was approximately \$300.

<sup>42</sup>Ontario capital tax is .3% of corporate debt, so that if higher prices would have been financed with higher mortgages the capital tax would have been higher.

<sup>43</sup>This is a net estimate, after allowing for some induced increase in condominium and freehold starts.

<sup>44</sup>This is equivalent to assuming that in the absence of rent control there was a 50% probability these programs would not have occurred.

<sup>45</sup>The elasticity of rental housing starts with respect to construction costs of 2.5 was derived from regression results in L. B. Smith The Postwar Residential Mortgage and Housing Markets and the Role of Government (Toronto: University of Toronto Press, 1974) pp. 56-57.

<sup>46</sup>Some of these municipalities include Mississauga, Kitchener, Waterloo, Niagara Falls and all the municipalities within Metropolitan Toronto.

<sup>47</sup>City of Toronto By-Law 734/80, passed October 14, 1980.

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