

# Residential Rental Tenure Zoning: The Economic Effect on the Delivery and Maintenance of Rental Housing

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# Research Questions

- ▶ Spot RRTZ
  - ▶ Impact on pace of redevelopment?
  - ▶ Impact on debt capacity for maintenance?
- ▶ Blanket RRTZ
  - ▶ Impact on pace of construction?
  - ▶ Impact on density bonus revenue?
- ▶ Discussion: “bonus RRTZ” per Burnaby

# Spot RRTZ

- ▶ Existing property value
  - ▶ Continuation value of existing rental building
  - ▶ Discounted Value of land at date of redevelopment: max of
    - ▶ NPV of rental construction
    - ▶ **NPV of condo construction**
- ▶ Date of redevelopment roughly when benefit=cost of delay:
  - ▶ current rental dividend = (interest rate - growth rate)  $\times$  land value
  - ▶ Should come sooner if land value is greater
  - ▶ Concern: coming very soon on depreciated buildings
    - ▶ And need to protect tenants
  - ▶ Solution? Reduce land value by forbidding condo
    - ▶ If rental NPV growth  $<$  condo growth, could *accelerate*
    - ▶ Consider kaput presales today – not purely academic

# Spot RRTZ and Mortgage Capacity for Maintenance

- ▶ Loan to value tests
  - ▶ Land residual value falls
  - ▶ LTV rises for given loan amount
  - ▶ So debt capacity falls
- ▶ Debt service coverage ratio test
  - ▶ Land residual falls
  - ▶ Property tax should fall
  - ▶ Net income increases
  - ▶ Hence *could* see increased LTV
  - ▶ BC Assessment behavior important in this way
  - ▶ Irrelevant for non-profits exempt from land tax
    - ▶ How common? You tell me

# Are cap rates low enough that debt capacity could rise?

- ▶ IF  $LTV \approx 75\%$ ,  $DSCR \approx 1.2$ 
  - ▶ If cap  $<$  loan constant: DSCR will bind
  - ▶ If cap  $>$  loan constant: LTV will bind
- ▶ Loan constant appx 5.5% at 3% interest, 25 year amort
- ▶ Suburban Vancouver, Victoria cap rates in range of 3.5-5%
  - ▶ Vancouver commonly lower caps
  - ▶ Victoria land/structure grew a lot 2019/2018
- ▶ So cap rate less than loan constant realistic
- ▶ But rent control, new supply, and RRTZ should raise cap rates
- ▶ Depending on CMHC vs conventional loans
  - ▶ Loss of LTV not clearly a general risk
  - ▶ Could be, particularly if building requires significant work

## Other concerns regarding maintenance

- ▶ RRTZ should delay wholesale redevelopment
- ▶ But *could* lead to strategic mark-to-market major repair

# Blanket RRTZ and Land / Bonusing Value?

- ▶ *Plug for 2nd Welfare Theorem: \$ vs targeted units*
- ▶ This is context-specific
  - ▶ Coriolis: Kingsway, Burnaby
    - ▶ 1.5 FSR wood frame: small condo vs rental land gap - both  $\in$  [\$100, \$200]
    - ▶ 5.3 FSR concrete: larger wedge (concrete condo premium)
  - ▶ Coriolis: Vancouver high FSR
    - ▶ \$300 for condo
    - ▶ \$200 for MIRHPP, but that includes giveaways
  - ▶ Timing:
    - ▶ Condo presales have weakened since Coriolis report
    - ▶ Newly generous CMHC financing
  - ▶ Remark on cap rates: what does government need?
    - ▶ So “taking” land via RRTZ not crazy?
  - ▶ Coriolis point correct:
    - ▶ Decently high existing use high to replace with PBR  
Even at market, hard to get to \$200/sqft land
    - ▶ Low value existing can get new rental+not condo via RRTZ

## Burnaby: bonus RRTZ

- ▶ In some instances
- ▶ Extra density in strata project given as RRTZ
- ▶ Generates rental as land is free
- ▶ Wood frame rental building on site with tower



# Summary

- ▶ RRTZ likely to slow pace of redevelopment
- ▶ RRTZ may replace condo with PBR now
  - ▶ Likely in low land value settings
  - ▶ PBR feasibility broadening
    - ▶ Condo presale slowdown in Vancouver (Victoria?)
    - ▶ Public appetite for subsidy
    - ▶ Public should surely invest equity at 3% caps
- ▶ Spot RRTZ can limit debt capacity in some circumstances
- ▶ RRTZ may raise risk of mark-to-market renovations