



**THE ISLAND REGULATORY AND
APPEALS COMMISSION**
Prince Edward Island
Île-du-Prince-Édouard
CANADA

Docket: LR21009

Order: LR21-18

IN THE MATTER of an appeal, under section 25 of the Rental of *Residential Property Act* (the "*Act*"), filed by Ryan Grant, against Order LD21-080 issued by the Director of Residential Rental Property and dated March 8, 2021.

BEFORE THE COMMISSION ON Thursday, May 20, 2021.

Panel Chair - Erin T. Mitchell, Commissioner
M. Douglas Clow, Vice-Chair

Hearing Date: April 22, 2021

Compared and Certified a True
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(Sgd.) Susan Jefferson

Commission Administrator
Corporate Services and Appeals

ORDER

This appeal asks the question of whether the Director erred in ordering a greater than allowable rent increase.

BACKGROUND

Ryan Grant (“Mr. Grant”) rented the premises located at 1361 Route 19, New Dominion, PE (the “Premises”) from Joel Dennis (“Mr. Dennis”). Rent for the Premises was \$750 per month and has not increased since August 2010.

On December 30, 2020, Mr. Dennis served Mr. Grant with a Notice of Increase in Rent of Residential Premises (the “Form 10”) to be effective April 1, 2021. On January 8, 2021, Mr. Grant filed with the Director of Residential Rental Property (the “Director”) an Application by Lessor for Approval of Rent Increase Exceeding Percentage Allowed by Regulation (the “Form 12”).

On February 5, 2021, Mr. Dennis filed with the Director a Lessor’s Statement of Income and Expenses (the “Form 15”) for the Premises.

The Director heard the matter on February 16, 2021. In Order LD21-080 dated March 8, 2021, the Director ordered that effective April 1, 2021, the maximum allowable monthly rent for the Premises shall be \$1,350.

Mr. Grant appealed.

The Commission heard the appeal on April 22, 2021. Both Mr. Grant and Mr. Dennis participated by way of telephone conference call. Ryan Cawley (“Mr. Cawley”) represented Mr. Grant. Cleve J. Myers, FCPA, FCA (“Mr. Myers”) represented Mr. Dennis.

Disposition

The appeal is allowed and the rental increase set out in Order LD21-080 is varied to \$1,200 per month, effective June 1, 2021.

The Issues

The issue before the Commission is whether the Director properly ordered a greater than allowable rent increase. In this case, the key question is whether the Director correctly calculated what is a reasonable return on Mr. Dennis’s capital investment.

Analysis

Section 23 of the *Rental of Residential Property Act* (the “Act”) and section 20 of the Regulations set out what factors the Director may consider in evaluating a proposed greater than allowable rent increase. They read as follows:

23. (8) At the hearing both parties are entitled to appear and be heard and the Director shall consider the following factors:

- (a) whether the increase in rent is necessary in order to prevent the lessor sustaining a financial loss in the operation of the building in which the premises are situate;
- (b) increased operating costs or capital expenditures as advised by the lessor;
- (c) the expectation of the lessor to have a reasonable return on his capital investment;
- (d) such other matters as may be prescribed by the regulations.

20. The following additional matter is to be considered under subsection 23(8) of the Act: The date and amount of the last rental increase.

These factors are the only factors the Director, and in turn the Commission, are able to consider in the evaluation of an application for a greater than allowable rent increase.

As is required by Section 17 of the Regulations, Mr. Dennis filed a statement of income and expenses (“Form 15”) in advance of the hearing before the Director. The Form 15 asks for detailed financial information relating to the rental premises, such as the amount of rental income received in a 12-month period, any and all mortgage payments, insurance costs, property taxes, maintenance fees, and capital expenditures. The Form 15 also asks for the following information:

OTHER INFORMATION

- | | |
|--|---------|
| 1. Value of Property as per Provincial Assessment: | \$..... |
| 2. Amount of Outstanding Mortgages, Loans:
(Include only outstanding principal amounts) | \$..... |
| 3. Owner’s Equity in Property:
(Subtract #2 from #1) | |
| 4. Year Property was Purchased: 20..... | \$..... |

This portion of Form 15 has been the subject of recent debate as to the proper figure to use for the valuation of premises. The figure used for the value of the Property has a direct impact on the “Owner’s Equity in Property”, and therefore upon calculation of a “reasonable return” on one’s capital investment.

Neither the Act nor the Regulations define “reasonable return”, nor is there guidance beyond the wording of Form 15 as to what may be considered as the “value of property”. In this case, Mr. Myers submitted on behalf of his client that “the Provincial Tax Assessment does not fairly or reasonably represent the Landlord’s investment” (Exhibit E-12), and instead seeks to rely upon a “Desktop Residential Appraisal Report” conducted by Landmark Valuation Inc. in respect of the Premises (Exhibit E-7(l), the “Desktop Appraisal”). Mr. Myers further stated:

The Landlord engaged a qualified appraiser in order to indicate, as best he could, the market value of the property on which to calculate a reasonable rate of return. Calculating a rate of return based on the tax assessed value of the property is an unsupportable concept.

[Exhibit E-12]

Mr. Cawley, on behalf of Mr. Dennis, argued that it was not appropriate to use the Desktop Appraisal as the basis upon which to determine the value of the Premises. He noted that it was labelled “Desktop Residential Appraisal Report” and it stipulated it was “completed for the purpose of estimating the market value for internal decision making purposes”. He

argued that the Form 15 clearly called for the Provincial Assessment value, which is a standardized measure, and that the Desktop Appraisal did not use appropriate comparisons.

More significantly, Mr. Cawley noted that the intent of the Act is to provide a measure of protection for tenant's rights. To permit a landlord to refinance a property using a market valuation, and then not using the proceeds to improve the property, could unfairly pass the cost of the refinancing along to the tenant.

In Order LR95-04¹, the Commission considered the methodology used to calculate allowable increases in rent. The Commission noted that "[t]he Act is designed to balance the interests of landlords and tenants, with a perhaps greater emphasis on the protection of tenants". The Commission quoted subsection 23(8) of the Act (which is identical to the excerpt quoted above), and concluded:

What the cases make clear is that while these matters need to be considered, they do not determine the outcome of any hearing. Even if the lessor suffers an operating loss, there may be good reason not to allow the increase applied for. If capital and operating costs have increased there may be good reason not to allow an increase to offset these costs. The balance of interests means the landlord may have to suffer a loss so that the tenants aren't subjected to unreasonable increases.

More recently, in Order LR14-02, the Commission dealt with an appeal relating to an application for a rent increase wherein the provincial assessment differed significantly from the market value of a property. The Commission held²:

The Commission is mindful that the Form 15, under the heading of "Other Information" seeks the value of "property" as per Provincial assessment, the amount of outstanding mortgages and loans – principal portion only, and from those two figures determines the owner's equity in "property." ...

The Commission is of the view that the above "formula" should be considered as it is contained within a form set out in the Regulations. However, there is an important distinction between considering such specified information and deciding that such information shall exclude other evidence pertaining to the same issue. The Commission does not accept the view that such a "formula" was ever intended to exclude other germane evidence presented to the Commission that would assist the Commission in determining the owner's equity of a lessor's rental business, in this case the Appellant's mini-home park. If the legislature intended that the "formula" bind the Director and bind the Commission on appeal, surely the calculation of "owner's equity in property" would have been included in section 18, the definition section, of the Regulations, or elsewhere in the Regulations or in the Act itself.

The Commission went on to calculate the owner's equity in the subject property as the average of the provincial property tax assessment and the current market value assessment, minus the principal value of the outstanding mortgage.

¹ Dated April 19, 1995.

² At page 5.

Legislative Intent

The intention of the Legislature is one of the key considerations in any exercise of statutory interpretation. The *Rental of Residential Property Act* was first passed in 1988. Second reading of the Bill was debated by Committee of the Whole House on April 22 and 26, 1988. Subsection 23(8) as it reads today is the same as was passed in 1988. The relevant portions of the second reading debate are as follows³:

Q. *Mr. Minister, now in this, this covers the whole business of rent increases, they've never been known for a rent decrease. Even when the price of oil went way down and interest rates went you know, it's always going up. Now if a person happens to buy a property and it's a very bad investment and pays an awful lot more for it then he should and he says to the rentalsman that, you know, my interest on this is "X" amount of dollars. Is that the kind of, how do you know what's a reasonable return? I mean some people, a reasonable return is a very greedy return and for other people, reasonable is reasonable.*

Minister: *I guess if the director is going to have to view that type of request against other similar requests that no doubt have been made the province or regionally or across the country. We have to weigh it against something. But that in particular (8)(c), the expectation of a lessor to have a reasonable return on capital investment is put in as a result of a decision of the Court of Appeal in this province which said that existing legislation didn't contemplate or allow a lessor the right to expect a return on his investment and it was felt, that was one of the recommendations to the committee that we should recognize that it's fair game for a landlord or a lessor who made an investment to get a quote/unquote reasonable return on his investment.*

Q. *What is um, is there a percentage increase now or is it different all across, or how do they, for instance how would you, what are the increases now? Does everyone that is renting have to [inaudible]?*

Minister: *Allowable increases?*

Q. *Allowable. Yes.*

A. *Anyone who asks for more than that must apply for approval.*

...

Q. *Say for instance an individual, you know, bought an apartment house and there is a fixed rent there now, but he probably would want reasonable or she or whoever it is would have reasonable expectation on that apartment. Could he, whoever owns it, apply to the rentalsman and it's already rented and these are expecting only 4%? Might they, might they go up to whatever, 8 or 10%?*

A. *One of the things that the committee again recommended was that there be some guidelines provided to both landlords, or lessors and lessees, about what does constitute reasonable return. What kind of things can you take into account? The problem of someone buying a building and obviously buying it for more than it was likely worth [inaudible] their expectation of reasonable return on that may*

³ The Hansard service for the Legislative Assembly of Prince Edward Island was established in 1996, therefore there is not an official transcript for debates in the House prior to that date. The excerpt produced here was prepared on behalf of the Commission using an official audio recording of those proceedings which is available in the Public Archives and Records Office of Prince Edward Island.

have to be adjusted. Obviously as I say if the building was being financed for \$200,000.00 and they paid \$400,000.00 you can't expect the tenant the following year to pay twice the amount of rent. I don't think that's fair.

Q. Exactly.

A. The problem, Ontario had a lot of problems with this and [inaudible] I'm not sure they've got a solution and I'm not sure we will get one either but you try your best. They actually have said that people cannot charge any more than 5% of whatever their investment was above and beyond a reasonable level. To be plugged onto the rent in a particular year so they just can't pass the whole thing through.

Minister: Just to follow in on that. I would expect that the director in hearing this case out would make that type of inquiry if it's not already disclosed. Let's say the example of purchasing a \$200,000.00 property for \$400,000.00, you can't, I would suggest, put that on the back of the lessee and say that you are going to have to pay more because I made a bad deal. But that's a factor that the director [inaudible].

Q. But you could pass on the increase in electricity and the increase in oil and all these kinds of things to the lessee.

A. Some of the capital will appreciate in value.

Q. Yes.

...

Q. Ok, I just have one other question now. I was talking about this earlier this morning between market value and assessed value. When a landlord is, you know, you must have some sort of formula worked out in terms of what the costs should be, you know, to the tenant.

Minister: Are you talking about increased rent now?

Q. Yeah, right. When he increases rent, does he base it on what the actual market value is? Say he has a building that is valued at the market level or at the assessed level to try and find a level where he would charge rent on. What is that based on, market value or assessed value?

A. Ideally it would be the market value if everything was working as it should work.

Q. So your judgment then, do you see a great difference between the market and the assessed value anyway?

A. It can be [inaudible]

Q. [inaudible] why can't it be? How does the Minister of Finance sit there and let those opportunities slip by?

Minister: He's been doing pretty good, because, you know, speaking to the Charlottetown area, I can remember when I started practicing law in 1975, but the tax assessment on a piece of property had no bearing on the market price. It was so far below. But now, in a lot of areas in Charlottetown, that gap is narrower. But at the same time, he has to, he has expanded his period of time that these assessments are made to five years because they can't possibly get around to re-assess everybody in the legislation in the three years. And it's just, it's a time problem.

Q. Just so what your director said, it would be preferably be based on market value and if you say there can be a huge discrepancy there that certainly would reflect quite a bit one way or the other what that tenant had to pay for his rent.

Minister: But I ask you, what is market value?

Q. Well, whatever the market will bear

Minister: So, whenever you have a willing buyer and a willing seller.

Q. Well, that's it.

Minister: That's it. If you say it has a \$100,000.00 market value but if nobody will pay you that for it, that's pie in the sky.

Q. But if an individual goes out and buys something and pays what he thinks it is worth and pays more than what he should have paid, is it up to the tenant then to pick that up?

Minister: No, we addressed that earlier, I guess Honourable Member when you were out. We are saying that we think the intention of this legislation is that the lessor can't put that on the back of the lessee if he or she has made a really bad deal. It's a factor to be considered. Just one, but there is a whole series of factors that the director would take into account.

...

Q. What about refinancing costs?

A. There's a number of soft costs, there's a number of taxation breaks, like you say, do they count as income or don't they count as income?

Q. Perhaps it was discussed here a minute ago, the standard practice is if somebody is to keep - because of the reasonable return on investment - to keep the properties mortgaged to the hilt.

A. I think remortgaging, for instance, after the fact would be looked upon very unkindly.

Q. Ok, that's the point.

A. Simply to take out capital and pass it on.

Q. Does this section give the rentalsman or the director the ability to take those kinds of things into consideration?

A. We believe so.

Q. You are fairly comfortable that it does? What do you consider reasonable rate of return or reasonable return on the capital investment- is a kind of airy-fairy concept and it's not defined anywhere?

Minister: I would say in a lot of cases it's going to turn on a particular case. I don't know how you would [inaudible].

Q. You can't define it.

Minister: You remember that case, I don't know what the name of it was, but the Supreme Court said they weren't even entitled to that according to existing legislation.

Q. CADC case?

Minister: *They weren't entitled to a capital return on their investment at all. I think that is unfair to the lessor if you can't expect some return on investment.*

Clearly the legislators in 1988 intended that the calculation of a reasonable rate of return on investment was not to be determined based on a specific prescribed formula. The Commission therefore concludes that the Director may take into account any reliable and relevant evidence in determining what an appropriate rate of return should be for the purposes of calculating a greater than allowable rent increase.

How should Return on Investment be determined?

The Director's Approach

As the Premises are one side of a semi-detached residence, the Director attributed 47.2% of the renovation costs to the Premises. The Director also removed the capital expenditures expense for the 2020 renovations. The Director had in evidence both the provincial property tax assessment for both sides of the building, as well as the Desktop Appraisal filed by Mr. Dennis. The Director appears to have accepted the Desktop Appraisal by itself to establish the present day valuation of the Premises and the other side of the building combined. The Director approved a monthly rent of \$1,350, finding that this would provide Mr. Dennis with a 5.63% return on investment.

The Commission's Approach

The Commission takes a somewhat different approach than the Director. In the absence of an on-site appraisal, which would have allowed a comparison of the interior finishing of both sides of the Premises and thus a more accurate and objective valuation of each side, the Commission agrees with Mr. Myers' submission that is appropriate to employ a 45/55 split in the present day valuation of the Premises, the lesser proportion attributed to the tenant side.

Mr. Myers, on appeal, advised the Commission that the Premises had been appraised by CIBC in 2019 (the "Bank Appraisal"), which was somewhat more conservative than the Desktop Appraisal.

The Commission is reluctant to accept the Desktop Appraisal without further context, as the actual site was not visited in its preparation. While it may provide a "ballpark" valuation, it was prepared based solely on information provided by Mr. Dennis, and an actual on-site appraisal could provide a more detailed and objective valuation. The Commission notes that the Director did not have evidence of the Bank Appraisal at the original hearing.

The Commission takes notice of a general and indeed quite dramatic rise in the value of residential properties on Prince Edward Island within the last few years, a trend that seems to have continued during the ongoing COVID-19 pandemic.

The Commission also takes notice that historically provincial property tax assessments tend to be quite conservative. It could be said that such a conservative approach represents a 'trend over time' approach rather than reflecting short term 'peaks and valleys'. There is some merit in the argument that provincial assessments provide a standardized measure for the value of properties in Prince Edward Island, however as discussed above, this is not necessarily to the exclusion of other relevant evidence of a property's market value.

It is important to note that while there is a mechanism under the *Act* to lawfully increase the maximum rent, there is no counterpoint mechanism to see a reduction of rent. Thus an increase in rent is permanent, while the valuation of a property may increase, and later decrease.

The Commission favours taking a balanced approach in this case, whereby the Bank Appraisal and the provincial property tax assessment are averaged to determine the value of the Premises. The Commission's averaging approach together with the 45% apportionment for the Premises result in a reduced owner's equity for the Premises. The Commission also has considered the revised (lower) expenses presented by Mr. Myers at the hearing before the Commission.

There is no one formula to be used in the calculation of the rate of return, and each case must be evaluated based on the available evidence. The Commission considers that, given the evidence provided, current market conditions, and the fact that there have been no rent increases over the last 10 years, an appropriate return on investment in this case is 4%. Based on this return on investment, the Commission calculates a rate of \$1,200 per month.

The Commission recognizes that even the reduced increase from \$750 to \$1,200 per month still represents a significant increase to Mr. Grant. The Commission has attempted to balance the impact of the interests of the parties in the overall context of the rental arrangement. That said, there had been no increase in rent for over 10 years, and, in the Commission's view, a return on investment of 4% is reasonable in this case.

NOW THEREFORE, pursuant to the *Island Regulatory and Appeals Commission Act* and the *Rental of Residential Property Act*,

IT IS ORDERED THAT

1. **The appeal is allowed.**
2. **The Commission varies Order LD21-080 to allow an increase in the rent to \$1,200 per month, effective June 1, 2021.**

DATED at Charlottetown, Prince Edward Island, Thursday, May 20, 2021.

BY THE COMMISSION:

(sgd. Erin T. Mitchell)

Panel Chair - Erin T. Mitchell, Commissioner

(sgd. M. Douglas Clow)

M. Douglas Clow, Vice-Chair

NOTICE

Subsections 26(2), 26(3), 26(4) and 26(5) of the *Rental of Residential Property Act* provides as follows:

26. (2) A lessor or lessee may, within fifteen days of the decision of the Commission, appeal to the court on a question of law only.

(3) The rules of court governing appeals apply to an appeal under subsection (2).

(4) Where the Commission has confirmed, reversed, or varied an order of the Director and no appeal has been taken within the time specified in subsection (2), the lessor or lessee may file the order in the court.

(5) Where an order is filed pursuant to subsection (4), it may be enforced as if it were an order of the court.