



PRINCE EDWARD ISLAND

Regulatory & Appeals Commission
Commission de réglementation et d'appels
ÎLE-DU-PRINCE-ÉDOUARD

Dockets: LR22010 and LR22011

Order: LR22-40

IN THE MATTER of an appeal and cross appeal, under section 25 of the *Rental of Residential Property Act* (the “Act”), filed by the Tenants of 107-111, 113-115, 117, and 118 Elizabeth Avenue, Summerside, and GPS General Partner Inc. against Order LD22-031 issued by the Director of Residential Rental Property and dated February 7, 2022.

BEFORE THE COMMISSION ON Thursday, July 21, 2022.

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

Hearing Date: Wednesday, April 27, 2022

ORDER

Compared and Certified a True
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(Sgd.) Susan Jefferson

Commission Administrator
Corporate Services and Appeals

This appeal asks the question of whether the Director of Residential Rental Property (the “Director”) erred in the calculation of greater than allowable rent increase for ten (10) of twelve (12) townhouses located in two, six-unit buildings.

Background

A landlord, GPS General Partner Inc. (the “Landlord”), rents units located at 107 - 111, 113-115, 117, and 118 Elizabeth Drive, Summerside, PE (the “Units”), to each of Rena Profit, Allison and Edith MacLean, Corrine Gaudet, Joan Cairns, George Thomarat, Wendell Currie, Carolyn Taylor, and Sylvio Legault (collectively the “Tenants”). Rent for the Units in question ranges from \$987 to \$1,087 per month.

On October 22, 2021, the Landlord gave formal notice to the Tenants that it intends to raise their rent to an amount that was set out in each notice. On October 26, 2021, the Landlord filed with the Director an application to increase the rent above the percentage allowed by regulation. On December 1, 2021, the Landlord filed with the Director a Statement of Income and Expenses.

In Order LD22-031 dated February 7, 2022, the Director ordered that:

- a) the maximum allowable monthly rent for the Units shall be as follows:

Unit	Rent	Effective Date
107	\$1,151	March 1, 2022
108	\$1,151	March 1, 2022
109	\$1,151	March 1, 2022
110	\$1,151	March 1, 2022
111	\$1,151	March 1, 2022
113	\$1,151	March 1, 2022
114	\$1,151	May 1, 2022
115	\$1,151	June 1, 2022
117	\$1,234	March 1, 2022
118	\$1,151	March 1, 2022

The Tenants appealed and the Landlord cross-appealed.

The Commission heard the appeal on April 27, 2022. The hearing was conducted by way of telephone conference call. The following Tenants were present: Rena Profit, who also represented Douglas Profit; Edith MacLean, who also represented Allison MacLean, Wendell Currie and Carolyn Taylor. The Landlord was represented by Matthew Bowness and Kevin Green. Andrew MacDonald acted as legal counsel to the Respondent.

Disposition

The appeal is allowed and the cross-appeal is denied, providing an increase in rent less than that awarded by the Director.

The Issue

The Commission must decide whether the requested rent increases are justified.

Analysis

Part IV of the *Act* governs rent increases, and sets out the factors the Director shall consider in determining whether a rent increase beyond the annual allowable amount is justified. Subsection 23(8) reads:

Factors considered

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.*

One additional matter is set out in the *Rental of Residential Property Act Regulations* (the "Regulations"):

20. Additional factors

The following additional matter is to be considered under subsection 23(8) of the Act: The date and amount of the last rental increase. (EC10/89)

The Landlord presented evidence on expenses and submitted that their proposal would phase in their requested increases over time for existing tenants only. The Landlord's representatives referenced an eight-page written submission where they submitted that the Director had erred in Order LD22-031 and that the Commission had erred in recent previous appeal Orders. In particular, they opposed the 4% return on investment referenced in recent Commission Orders, submitting that the Commission in Order LR14-02 found that a reasonable return on equity, after taxes, would be between 8% and 9%.

The Landlord submitted that, in the present appeal, an increase of monthly rent to \$1,400 for nine (9) units and \$1,500 for Unit 117 as originally proposed would amount to a return on investment of approximately 7.5%.

The Tenants submitted that the increases requested by the Landlord are too high and that even the increases awarded by the Director are still too high. They submitted that even a 10% increase is too much. They stated that they pay their own electricity, that the electricity expense claimed by the Landlord should be very small as it would be only for one streetlight and the very minimal turnover of units, that inflation hits landlords and tenants alike and only one person has a heat pump (Unit 117).

As the Landlord has critiqued the Commission's recent use of a 4% return on investment as a guideline, stating that the dividend yield of blue chip stocks, such as Canadian bank stocks, would give a roughly equal rate while not requiring active management, the Commission offers the following:

- Blue chip stocks offer a dividend that varies but is relatively reliable. Blue chip stocks may also offer share value accretion that is generally quite favourable over time, but are subject to day to day fluctuations in the market, and are also subject to general economic downturns and recessions.
- Residential real estate rentals may offer an annual profit but also offer the possibility of appreciation in the value of the real property asset.
- A recent check of annual dividend yields for the "Big 5" Canadian banks indicates a range of from 4.08% to 5.23% which is an increase over recent past yields.
- Real property values on Prince Edward Island are generally increasing at a significant rate and, in recent years, at a very significant rate. While this current rate will likely level off to more modest growth, such growth is favourable over time.
- Unlike stocks, including blue chip stocks, residential real estate is moderately isolated from negative market conditions, especially when demand for housing is high and vacancy rates are low.
- While the Commission's current 4% return on investment guideline is calculated before taxes, dividend yields are also before taxes. In addition, dividends may be subject to fees.
- Dividend yields do not include the costs of financing the acquisition of shares. The Commission's current 4% return on investment guideline is calculated after including any financing e.g. mortgage costs required to purchase the rental real estate asset.

Accordingly, the Commission, in the absence of a professional analysis filed by the Landlord setting out an appropriate rate of return on investment for residential rental properties, concludes that a rate of 4% is appropriate in an environment where the real estate market value is increasing at a significant rate and that increase is taken into account when determining equity and return on investment. A leveling off of real estate market values or continued rising interest rates could potentially warrant a raising of the 4% rate.

The Commission has recently allowed the averaging of the tax assessed value of a residential rental property with an appraisal of said property when calculating a landlord's return on investment. Such an appraisal must be based on the then current value of the property using current income conditions.

The Landlord submitted a detailed professional appraisal report dated September 17, 2021. This appraisal report considered the valuation of 24 townhouse-style residential rental suites, including the 10 units which are the subject of this present appeal. The appraisal report was prepared "... for the purpose of providing an estimate of the market value for the subject property denoted herein." The appraisal report also states:

The market value opinion found within this report assumes the value "As If Rents Have Been Adjusted to Market Rent" as is fully utilized as a multifamily residential townhouse/garden home development.

[Note: quotation marks and capitalization of words are as contained in the appraisal report]

The above quote was stated in both the extraordinary assumptions and limiting conditions section of the report, as well as the hypothetical conditions section of the report.

The appraisal report goes on to state:

The provided schedule outlines the current rent roll for the subject property legally identified as PID #767681. All of the (24) residential suites are leased exclusive of heat, hot water and electricity. Residential tenants are responsible for payment of their own in unit utility costs. The projected base rent of \$1,400.00 is suggested for each unit. A number of units have heat pumps which would decrease the in-unit electric bill. Therefore, the projected overall rent is suggested to be \$1,400.00 plus \$100.00 for units with heat pumps to capture some of the cost savings from electric heat costs.

...

The purpose of this report is to calculate the market value based on market rents for the property. It is the appraisers understanding the property owner will use this report to apply to (IRAC) for a rental increase.

As noted at the beginning of this Order, this request for a rental increase only concerns 10 out of the 12 units, and one of the 10 units has a heat pump while the other 9 do not. However, the income and expenses data provided by the Landlord was based on 12 units.

The Commission wishes to emphasize again that market value is not a factor listed in subsection 23(8) of the *Act* or in section 20 of the Regulations.

The Commission finds that it cannot use the appraisal report for the calculation of return on investment as the appraisal report is based on market value and projected rent. Accordingly, the Commission is left with the tax assessed value of the property and information establishing the actual purchase price.

In Director's Order LD21-304, referenced in Commission Order LR21-51, the Director referred to a return on capital investment of 5.62% and then went on to state:

This rate of return is below what would be considered reasonable for residential rental premises (typically between 6.0 and 8.0%).

Given that the valuation is limited to the tax assessed value of the property and information establishing the actual purchase price, both of which are conservative valuations of the real estate rental property owned by the Landlord, the Commission will proceed to calculate equity and then determine the appropriate rents based on a 7% return on investment.

As the actual purchase price was higher than the tax assessed value of the property, the Commission calculates equity using the actual purchase price, weighted and adjusted for 12 units. Given the mortgage information provided to the Commission, also weighted and adjusted for 12 units, the equity is determined to be \$340,686.94. A return on equity of 7% would thus be \$23,848.09. The Commission has calculated revised annual expenses as \$139,158. Adding the 7% return on equity, the required annual revenue would be \$163,006.09.

Although this Order determines rent for only 10 of the 12 units, the data and all calculations are for 12 units. The Commission determines the calculated maximum monthly rent to be \$1,131.99 per month, based on the following:

$\$163,006.09$ annual revenue divided by 12 months = $\$13,583.84$ monthly revenue

$\$13,583.84$ monthly revenue divided by 12 units = $\$1,131.99$ per month

Unit 117 has a heat pump, and the Landlord paid the cost of purchase, installation and continues to pay the cost of maintenance for said heat pump, while the tenant in Unit 117 pays the electricity for said heat pump, but presumably pays less in electricity for conventional electric heat. The Landlord seeks an extra \$100 per month for Unit 117. The Director awarded an extra \$83 per month for Unit 117. The Commission views both figures as excessive, and awards an additional \$60 per month for Unit 117.

Accordingly, the maximum allowable rent for Units 107, 108, 109, 110, 111, 113, 114, 115 and 118 is \$1,131.99 per month. The maximum allowable rent for Unit 117 is \$1,191.99 per month.

As for the effective date of the rental increase, the Director used March 1, 2022 for eight (8) of the units, May 1, 2022 for one (1) unit and June 1, 2022 for one (1) unit. While the Director determined these dates on a rational basis, the Commission wishes to avoid a pattern of retroactive rent payments, which for some of these units would be quite significant. The Commission also wishes to avoid the confusion among tenants that different effective dates may cause. Accordingly, the effective date of the increases set out above is determined by the Commission to be August 1, 2022 for all 10 affected units.

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 and the cross-appeal is denied.
2. The maximum allowable rent for Units 107, 108, 109, 110, 111, 113, 114, 115 and 118 is \$1,131.99 per month.
3. The maximum allowable rent for Unit 117 is \$1,191.99 per month.
4. The effective date of the increases is August 1, 2022 for the above 10 units.

DATED at Charlottetown, Prince Edward Island, Thursday, July 21, 2022.

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.