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

Dockets: LR22024

Order: LR22-43

IN THE MATTER of an appeal, under section 25 of the *Rental of Residential Property Act* (the "*Act*"), filed by GPS General Partner Inc. against Order LD22-078 issued by the Director of Residential Rental Property and dated March 23, 2022.

BEFORE THE COMMISSION ON Thursday, July 21, 2022.

Panel Chair - Erin T. Mitchell, Commissioner

M. Douglas Clow, Vice-Chair

Hearing Date: Friday, May 20, 2022

ORDER

Compared and Certified a True Copy

(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 two townhouses.

Background

A landlord, GPS General Partner Inc. (the "Landlord"), rents units located at 124 and 128 Elizabeth Avenue, Summerside (the "Units"), to Alfred and Laura Gallant and Dolphe and Marie Mazerolle (collectively the "Tenants"). Rent for each unit is $1,177 per month.

On November 23, 2021, the Landlord filed with the Director applications to increase the rent above the percentage allowed by regulation ("Form 12s"). On November 24, 2021, the Landlord gave formal notice to the Tenants that it intends to raise their rent to $1,400 per month. On March 7, 2022, the Landlord filed with the Director a Statement of Income and Expenses ("Form 15").

In Order LD22-078 dated March 23, 2022, the Director ordered that:

a) the maximum allowable monthly rent for the Units shall be $1,202.27 per month effective July 1, 2022.

The Landlord appealed.

The Commission heard the appeal on May 20, 2022. The hearing was conducted by way of telephone conference call. Matthew Bowness and Kevin Green ("Mr. Green") represented the Landlord, and were assisted by legal counsel, Andrew MacDonald. Dolphe Mazerolle ("Mr. Mazerolle") participated as one of the Tenants.

Disposition

The appeal is dismissed.

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 LD22-078 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 as originally proposed would amount to a return on investment of approximately 6.8%.

Mr. Mazerolle asked a question with respect to heat pumps for an additional $100 per month. Mr. Green advised that such improvements are off the table for now.

Mr. Mazerolle stated that he was happy with his unit, it was well maintained and he was pleased that there was a "system" to keep rental increases fair for both parties.

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 two (2) 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 schedules outline 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 is suggested for each unit.
…

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 particular request for a rental increase concerns two (2) units, namely 124 and 128 Elizabeth Avenue. These units do not currently have heat pumps.

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 two (2) units. Given the mortgage information provided to the Commission, also weighted and adjusted for two (2) units, the equity is determined to be $59,141.49. A return on equity of 7% would thus be $4,139.90. The Commission has calculated revised annual expenses as $23,505. Adding the 7% return on equity, the required annual revenue would be $27,644.90.

The Commission determines the calculated maximum monthly rent to be $1,151.87 per month, based on the following:

> $27,644.90 annual revenue divided by 12 months = $2,303.74 monthly revenue
>
> $2,303.74 monthly revenue divided by 2 units = $1,151.87 per month

As the *Act* does not provide a method for decreasing rent, the Commission finds that the current rent of $1,177 per month shall continue. The current monthly rent reflects an approximately 8% return on investment.

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 denied.

2. Director's Order LR22-078 is varied and the current monthly rent of $1,177 for the Units shall continue.

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.