



PRINCE EDWARD ISLAND

Regulatory & Appeals Commission

Commission de réglementation et d'appels

ÎLE-DU-PRINCE-ÉDOUARD

Docket: LR22020

Order: LR22-44

IN THE MATTER of an appeal, under section 25 of the *Rental of Residential Property Act* (the "Act"), filed by SSG3 Limited Partnership against Order LD22-063 issued by the Director of Residential Rental Property and dated March 7, 2022.

BEFORE THE COMMISSION ON Thursday, July 21, 2022.

Panel Chair - Erin T. Mitchell, Commissioner

M. Douglas Clow, Vice-Chair

Hearing Date: Wednesday, May 4, 2022

ORDER

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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 a unit in a four-unit building.

Background

A landlord, SSG3 Limited Partnership (the “Landlord”), rents a unit located at 17 Greenway Heights, Stratford, PE (the “Unit”), to Elmer and Shirley Clow (the “Tenants”). Rent for the Unit is \$1,696 per month.

On November 25, 2021, the Landlord gave formal notice to the Tenants that it intends to raise their rent to \$1,875 per month. On the same date, the Landlord filed with the Director an application to increase the rent above the percentage allowed by regulation. On January 26, 2022, the Landlord filed with the Director a Statement of Income and Expenses.

In Order LD22-063 dated March 7, 2022, the Director ordered that the maximum allowable monthly rent for the Unit shall be \$1,713 per month.

The Landlord appealed.

The Commission heard the appeal on May 4, 2022. The hearing was conducted by way of telephone conference call. Matthew Bowness and Kevin Green represented the Landlord, further assisted by legal counsel, Andrew MacDonald. The Tenants did not participate.

Disposition

The appeal is denied and the outcome of Director’s Order LD22-063 is confirmed.

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 LD22-063 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 \$1,875 as originally proposed would amount to a return on investment of approximately 9%.

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 sought to use a detailed professional appraisal report dated May 17, 2021, prepared for 19 units located in 9 buildings in a development located off of Aintree Drive in Stratford ("Aintree Development"). However, the Unit is not located in the Aintree Development. The Commission rejects the use of the appraisal for the Aintree Development for attempting to determine a valuation for the Unit as the Unit is not part of the Aintree Development.

The property tax assessment for the Unit originally filed by the Landlord was \$112,692. The Landlord advises that the property tax assessment has increased to \$123,684. The estimated cost for the Unit is \$129,600. The outstanding mortgage is \$139,946.

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 for a different set of properties owned by the Landlord. 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. Given the mortgage information provided to the Commission, the equity is determined to be -\$10,346 (purchase price of \$129,600 minus outstanding mortgage principle of \$139,946). Accordingly, there is no equity at present and thus a return on equity calculation is non-applicable.

The Director found in Order LD22-063 that a rent increase above the allowable percentage was not established by the evidence. The Director did, however, award a rent increase by the allowable percentage of 1%, effective April 1, 2022. Although the Commission rejects the appraisal, for reasons explained earlier, the Commission agrees with the Director's end result, and thereby confirms the rental increase and effective date established by the Director.

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 LD22-063 is confirmed with respect to its end result, specifically: the monthly rent for 17 Greenway Heights shall be \$1,713 per month, effective April 1, 2022.

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.