



PRINCE EDWARD ISLAND

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

Dockets: LR23008

Order: LR23-14

IN THE MATTER of an appeal, under section 25 of the *Rental of Residential Property Act* (the “Act”), filed by Quentin Bevan, against Order LD23-046 issued by the Director of Residential Rental Property and dated February 10, 2023.

BEFORE THE COMMISSION ON Friday, April 28, 2023.

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

Hearing Date: Monday, March 27, 2023

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 denying a rent increase for four residential units.

Background

A landlord, Quentin Bevin (the “Landlord”), rents units located at 87 Water Street, Charlottetown, PE (the “Units”) to each of Allison Kelley, Sean McCarthy, Jesslyn MacKinnon and Phillip Messier (collectively the “Tenants”). Rent for the Units ranges from \$645.00 to \$785.00 per month.

On December 16, 2022, 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 the same date, the Landlord filed with the Director applications to increase the rent above the percentage allowed by regulation (the “Applications”) as follows.

Unit	Current Rent	Proposed Rent	Effective Date
2	\$785.00	\$869.00	April 1, 2023
3	\$645.00	\$869.00	April 1, 2023
4	\$750.00	\$831.00	April 1, 2023
5	\$750.00	\$831.00	April 1, 2023

On January 24, 2023, the Landlord filed with the Director a Statement of Income and Expenses.

In Order LD23-046 dated February 10, 2023, the Director denied the Applications and ordered that the rents for the Units will be as follows:

Unit	Current Rent	Effective Date
2	\$785.00	April 1, 2023
3	\$645.00	April 1, 2023
4	\$750.00	April 1, 2023
5	\$750.00	April 1, 2023

The Landlord appealed.

The Commission heard the appeal on March 27, 2023. As his request, the Landlord participated in person and was accompanied by his witness, Herman McQuaid. Tenants Allison Kelly, Sean McCarthy, Jesslyn MacKinnon and Phillip Messier all elected to join the hearing by way of telephone conference call.

Disposition

The appeal is dismissed.

The Issue

The Commission must decide whether the Landlord is entitled to the increase in rents for which he has applied.

Analysis

The Commission confirms that, notwithstanding recent legislative amendments to laws governing the landlord and tenant relationship, the provisions of the *Rental of Residential Property Act*, RSPEI 1998, Cap. R-13.1 (the “Act”) which were in force at the time the application was made continue to apply, and the Commission must decide the matter in accordance with the Act.¹

Part IV of the *Act* governs rent increases, and subsection 23(8) 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 Director reviewed the financial information submitted by the Landlord, made some adjustments to the Landlord’s statement of income and expenses, and concluded that the Landlord had not established that he was entitled to a greater than allowable increase in rents.

The Landlord raised several issues on appeal, which are addressed below.

¹ See section 112, *Residential Tenancy Act*, RSPEI 1988, C. R-13.11.

Equity Calculation

The Landlord submits that his calculated equity in the Premises is higher than that calculated by the Director. In support of this position he submitted into evidence a 2019 appraisal of the Premises, conducted by McQuaid & Associates, which estimated its market value at \$520,000.

At the appeal, Mr. McQuaid testified on behalf of the Landlord. He gave evidence that many similar properties in PEI have seen an increase in value, some of which have been significant, since 2019. He noted, however, that he had not inspected the Premises since having originally done so in May 2019, and could not speak to whether and to what extent the market value of the Premises may have changed since then. The Commission notes that though Mr. McQuaid has extensive experience in conducting property appraisals, the Landlord did not seek to qualify him as an expert witness, nor did he have Mr. McQuaid provide an expert report on either the current value of the Premises or on market trends generally. As such, the Commission notes Mr. McQuaid's oral evidence, but finds that the best available evidence on the market value of the Premises is \$520,000.

The 2022 tax assessed value of the Premises is \$184,000.

The Landlord submitted that the Commission's approach in taking the average or "mid-point" of the tax-assessed value of the property and the property's appraised value is not correct and does not come close to providing a true statement of owner's equity. The Commission nevertheless finds it appropriate in this case to employ the methodology of averaging the Provincial property tax assessment with the appraisal to determine the value of the Premises for the purposes of this application. The rationale behind this approach is discussed in Commission Order LR21-18 and adopted here.

The Commission agrees with the Director's finding that the percentage of non-commercial space in the Premises is 67%. As such, the Commission finds the value of the Premises for the purposes of calculating the Landlord's equity is $\$520,000 + \$184,000 / 2 = \$352,000$ $\times .67 =$ **\$235,840**.

The Commission disagrees with the Landlord's claim that the second mortgage on the Premises should be included in the equity calculation. The Commission understands that refinancing is a common occurrence in property ownership. However, the Commission must consider which expenses are appropriately assigned to rental premises in the context of an application for a greater than allowable rent increase. In this case, the Landlord acknowledges that the proceeds from the refinancing of the Premises were used to purchase a separate property. Though the Landlord may have had reason to arrange his business affairs in this manner, it is not appropriate for the Tenants to have their rents increase to carry this expense, for which they receive no benefit.

The Commission therefore calculates the Landlord's equity in the Premises as $\$235,840 - \$22,190$ (being 67% of the \$33,120 first mortgage) = **\$213,650**.

Other Expenses

The Commission agrees with the Director in respect of the other adjustments made to the Landlord's statement of income and expenses, more particularly as set out in paragraph 9 of Order LD23-046.

Since the hearing of the appeal, the Landlord has received the final 2022 invoices for water and sewer charges for the Premises. It was explained on appeal that 90% of these charges are attributed to the residential units in the Premises as the two commercial spaces do not use significant amounts of these services. The Commission therefore allows \$1,780.20 for these charges, being 90% of the average of these expenses for Periods A and B.

With respect to capital expenditures, the Commission agrees with the findings of the Director and allows \$0.00. The Commission acknowledges that the Landlord has provided a list of a variety of expenditures, including "new furnace", "flooring", "kitchen" etc., but the Landlord did not provide evidence in the form of receipts or invoices to support these expenditures. These improvements may very well have been made, but the onus is on the Landlord to substantiate these expenditures if he seeks to claim them as part of his expenses in the context of this application.

Calculation of Return on Investment

The Landlord made extensive submissions on the appropriate method of determining a landlord's return on investment. He argued that the Act entitles the landlord to a reasonable return and that regulatory risk must be taken into account in such a calculation. He argued businesses operating in jurisdictions with significant regulatory risk are entitled to a higher return on investment, and cited the Government of Prince Edward Island's recent legislative initiative to override Commission Order LR22-54 and set the 2023 allowable rent increase at 0% as an example of regulatory risk. The Landlord submits that the current approach being taken by the Director and the Commission to greater than allowable rent applications has the effect of denying landlords their "statutory right to a reasonable return".

The Landlord compared the regulation of landlords to that of public utilities and dispensers of petroleum products. These types of businesses are permitted and afforded a return (in the case of electric utilities) or a markup (in the case of petroleum wholesalers and retailers) which are set by the Commission as prescribed by legislation.

The Commission agrees that in the utility context, regulation is a way to address the monopoly position of utilities. For example, the *Electric Power Act*² sets out a scheme that sees the Commission closely regulate various aspects of the public utility's business. These functions serve as a substitute for the market forces that would provide the checks and balances if the utility operated in a competitive market. Importantly, section 24(1) of the *Electric Power Act* prescribes that the public utility "shall be entitled to earn annually such return as the Commission considers just and reasonable...".

² RSPEI 1988, Cap. E-4.

The *Rental of Residential Property Act* does not regulate landlords in the same way. No one person or corporation has a monopoly on rental housing in the Province. Landlords make independent business decisions about things like what properties to purchase or what improvements to make to those properties without the need to seek regulatory approval before so doing. Some have mortgage debt, some don't. Some own one or two rental units, some own hundreds. The business profile of each landlord is unique.

The Legislative Assembly has determined it appropriate for landlords to seek approval to increase rents over the annual allowable amount, and has tasked the Director and the Commission with adjudicating these applications on a case by case basis. As discussed in Commission Order LR21-18, the intent of the legislation is to attempt to balance the interests of landlords and tenants.

It follows, therefore, that the Act does not guarantee a landlord a particular return on investment. Instead, the landlord's "expectation... of a reasonable return on his capital investment" is but one factor of four in determining whether a greater than allowable increase is permitted. This falls far short of providing landlords with a "statutory right to a reasonable return".

The Commission further notes that the Landlord did not cite any authority for the premise that regulatory risk should be a factor that serves to increase a landlord's return on capital investment.

As the Landlord has critiqued the Commission's recent use of a 4% return on investment as a guideline, suggesting that investment in Canadian bank stocks would be a better use of investment funds so as to avoid government regulation, 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 6.16%.
- 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, where that increase is taken into account when determining equity and return on investment, and where the Commission's role is to balance the interests of landlords and tenants.

The Commission therefore calculates the current return being earned by the Landlord as follows:

Net Income	$\$10,8650 - \$1,780.20 = \$9,084.80$
Equity	\$213,650
Current Return	4.25%

The Commission therefore concludes that the Landlord is not entitled to a greater than allowable rent increase. Director's Order LD23-046 is therefore confirmed.

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 dismissed.
2. Director's Order LD23-046 is confirmed in the result.

DATED at Charlottetown, Prince Edward Island, Friday, April 28, 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.