



Summary Report and Analysis: Allowable Percentage Rent Increase for 2011

Pursuant to Section 23 of the
Rental of Residential Property Act

September 9, 2010

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I. INTRODUCTION

The following report has been prepared in order to provide the Commission with background information to establish the allowable percentage rent increase for 2011. This report contains information which outlines the statutory requirements pursuant to the ***Rental of Residential Property Act (the “Act”)***, an overview of the current housing market situation, the average rent increase in other jurisdictions proposed for 2011, analysis of increase factors including an assessment of the Consumer Price Index (CPI), and analysis of projected operating cost increases for the 2011 allowable percentage rent increase.

II. STATUTORY REQUIREMENTS

- A. Subsection 23(1) of the ***Rental of Residential Property Act*** indicates:

Except as provided in subsection (3) and notwithstanding the terms of any rental agreement, the amount of any rent increase between January 1 and December 31 of any year shall not exceed the percentage amount which is established by an order of the Commission and published in the Gazette.

- B. The prescribed rent increase should be published in the Royal Gazette no later than September 30, 2010 in order that the lessor will have the minimum three (3) months notice period required for a rent increase to be effective January 1.
- C. Pursuant to subsection 23(3) of the ***Act***, the lessor has the opportunity to recover extraordinary costs incurred by making an application to the Director for approval of a rent increase greater than the annual prescribed percentage rent increase.
- D. As required under subsection 23(2) of the ***Act***, the Director has requested written representation from lessors and lessees to assist in establishing the recommendation of the prescribed rate for the coming year. The request

was advertised in *The Guardian*, *the Journal-Pioneer*, *La Voix Acadienne*, *Island Press* (*Eastern Graphic* and *West Prince Graphic*), the Royal Gazette and the Commission's web site.

The Director received one letter from lessors/landlords and one from lessees/tenants. The landlord identified the following concerns:

1. Uncertainty concerning future price of oil and electricity costs represent a major concern. In the past two years both items increased significantly and although they have reduced somewhat, the 2% allowable increase in 2010 did not adequately compensate landlords for the overall increases.
2. In addition, rising costs associated with sewer and water infrastructure, waste management and increased property tax assessments have taken substantial increases.

The tenant comments related to mobile home lot rental and pointed out to the Commission the cost responsibility breakdown between landlord and tenant for mobile home lot rental.

III. CURRENT INDUSTRY SITUATION

Housing Starts

CMHC Housing Market Outlook, third quarter 2010 indicates that PEI single housing starts will increase slightly in 2010. Record high PEI employment is helping to maintain PEI home demand, however, the significant part-time employment moderates this demand. The significant 2009 multiple unit housing starts has not been repeated in 2010. Rising apartment vacancy rates expect to reduce new multiple unit construction in 2010 and 2011 from 2009.

Vacancy rates

The CMHC Rental Market Report released in the spring of 2010 indicates the overall average vacancy rate has reduced to 3.3 per cent from 3.4 per cent for the same period last year. CMHC notes that although a small decline in vacancy was experienced in 2010 there were considerable differences experienced between Charlottetown and Summerside. Charlottetown experienced a slight vacancy rate decline while Summerside experienced a vacancy increase of double last year's rate.

It is expected the vacancy rate for Charlottetown will rise as the significant number of rental units under construction enter the market. However, this is

expected to be mitigated somewhat with the PEI population migration to urban centres such as Charlottetown and immigration to PEI.

The CMHC survey states the average Charlottetown two-bedroom rental unit in April 2010 was \$722 as compared to \$695 in 2009. In Summerside the average two-bedroom rental was \$633 in 2010 as compared to \$617 in 2009.

Statistical Overview

Statistical information (as shown on Table 1) provided by CMHC indicates the following vacancy rates for the Charlottetown and Summerside area from 1992 - 2010:

TABLE 1

<i>YEAR</i>	<i>CHARLOTTETOWN</i>	<i>SUMMERSIDE</i>
1992	6.40	4.90
1993	6.40	9.30
1994	6.20	7.90
1995	7.10	7.60
1996	4.00	7.50
1997	4.10	6.90
1998	6.10	8.80
1999	5.00	5.50
2000	2.60	5.50
2001	1.80	5.50
2002	2.10	6.00
2003	3.40	4.60
2004	4.20	4.20
2005	4.40	4.40
2006	4.80	7.80
2007	4.30	7.80
2008	5.20	3.60
2009	3.40	3.20
2010	3.30	6.70

IV. ECONOMIC OUTLOOK

In September of 2010, the Bank of Canada increased the overnight interest rate to one percentage point (1%). The Bank of Canada suggests the global economic recovery is slowing and is occurring at different rates in the various global economies. Economic activity of emerging markets is offsetting somewhat weaker growth in the more advanced economies of North America and Europe.

The Bank of Canada noted a somewhat slower level of Canadian economic activity in the second quarter of 2010 but consumption growth is expected to remain solid due to supportive credit conditions in Canada. The Bank revised its estimates of real GDP growth for Canada to 3.3% in 2010 (from 3.6%) and 3.2% in 2011 (from 3.5%).

Overall, the Bank of Canada expects the economic recovery in Canada to be slightly more gradual than it previously had forecast earlier this year. This slowing of the economy has kept inflation in check with the actual CPI rate for 2010 staying under the 2% target inflation rate.

Prince Edward Island's economy is still being impacted by the significant public infrastructure spending. The strong spending in the non-residential sector has offset a softening in residential investment. PEI's unemployment rate has improved year over year from 2009 due mainly to the public infrastructure spending.

Traditional industries in PEI are showing positive economic signs in 2010. Early tourism numbers show increased visitation in 2010 over 2009. The agricultural sector is also showing improvements with the commodity prices showing gains along with an excellent cropping season on PEI.

The Royal Bank of Canada is forecasting 2011 Real GDP growth to be 2.8% (2.6% in 2010 and 0.9% in 2009) due mainly to the continued public sector infrastructure spending and improvements to traditional agricultural and tourism industries.

V. OTHER JURISDICTIONS

Across Canada, the only other provinces with rent control are Ontario, Manitoba and British Columbia.

A. Ontario

The 2010 rent increase guideline is calculated under the *Ontario Residential Tenancies Act*, which created a system of rent regulation that includes linking the rent increase to the Ontario Consumer Price Index. This calculation results in a rent control guideline for 2011 of 0.7%.

The rent increase guideline for 2010 was 2.1%, 1.8% in 2009, 1.4% in 2008, 2.6% in 2007, 2.1% in 2006 and 1.5% in 2005.

B. Manitoba

The rent increase guideline for 2011 is 1.5%. The rent increase for 2010 was 1.0%, 2.5% for 2009, 2.0% for 2008, 2.50% for 2007, 2.50% for 2006 and 1.50% for 2005. This guideline applies to apartments or houses renting for less than \$1,120.00 a month as of December 31, 2010.

C. British Columbia

The rent increase guideline for 2011 is 2.3%. The rent increase for 2010 was 3.2%, 2009 was 3.7%, 2008 was 3.7%, 2007 was 4.00%, 4.00% in 2006 and 3.80% in 2005.

VI. ANALYSIS

In determining the annual percentage rent increase, two main factors were taken into consideration. The first involved an assessment of the CPI All Items and CPI Shelter indexes for the 2010 period.

The second set of factors included an assessment of the specific operating expenses and anticipated component cost increases for rental units.

A. CPI Analysis

A **consumer price index** (CPI) is a measure estimating the average price of consumer goods and services purchased by households. A consumer price index measures a price change for a constant market basket of goods and services from one period to the next within the same area. The percent change in the CPI is a measure estimating inflation or price changes.

Although somewhat simplified, an analysis of CPI changes should reflect anticipated changes in building operating costs as measured by price changes. As CPI represents price changes for a "basket" of goods and services, this indicator should include all factors involved in the operation of a building.

Tables 3 and 4 provide additional detail on the actual percentage change in the CPI for Prince Edward Island for 2005 to July 2010, as well as the various sub indexes measured by Statistics Canada. The strengthening economic conditions in PEI in 2010 over 2009 can be seen in the rising CPI inflation index. In addition, both shelter and energy indexes have increased above the overall average CPI rate.

TABLE 3

Year	CPI
2005	3.1%
2006	2.3%
2007	1.8%
2008	3.4%
2009	-0.2%
2010	0.9% (July 2009 to July 2010)

TABLE 4

Consumer Price Index, by province (monthly) (Prince Edward Island)					
	July 2009	June 2010	July 2010	June 2010 to July 2010	July 2009 to July 2010
	2002=100			% change	
All items	118.4	119.2	119.5	0.3	0.9
Shelter	122.7	124.8	124.8	0.0	1.7
Household operations, furnishings and equipment	113.5	112.9	112.8	-0.1	-0.6
Special aggregates					
All items excluding food	116.9	117.6	117.9	0.3	0.9
All items excluding energy	114.8	114.9	115.2	0.3	0.3
Energy	148.8	155.6	156.1	0.3	4.9
Source: Statistics Canada, CANSIM, table (for fee) 326-0020 and Catalogue nos. 62-001-X and 62-010-X . Last modified: 2010-08-20.					

The Bank of Canada's monetary policy and Government of Canada's policy is to target inflation at 2.0%. The July 2010 inflation was 1.8% nationally as reported by Statistics Canada. Recent Bank of Canada interest rate decisions have noted inflation control as an item requiring monitoring as current inflation levels are occurring even though the economic recovery has slowed and excess supply exists in Canada.

The Royal Bank in its June 2010 Economic and Financial Market Outlook is suggesting that core rate of inflation will hold just below the 2% Bank of Canada target.

B. Key Rental Cost Components

Heating Costs

The impact of heating costs either from electricity or petroleum products continue to be a significant factor for landlords. In previous submissions, many landlords have suggested to the Commission previously approved increases have not covered their actual energy cost increases.

Many energy forecasters are suggesting that energy prices will remain relatively stable at current rates over the next year as there still remains uncertainty over economic recovery through 2011. The US Energy

Information Administration (EIA) Short Term Energy Outlook Report issued September 8, 2010 is forecasting a 5.7% heating fuel price increase in the 2010/11 heating season over the previous year. However, EIA suggests that historical price volatility of petroleum product prices due to supply and demand dynamics makes price forecasting difficult.

Property Taxes

The property tax section of the Department of Finance and Municipal Affairs has provided information on these taxes. Essentially, property values have not increased significantly - around 1-2%. These increases are well within CPI level increases.

Waste Watch

There was a slight increase in these fees of \$4.85 per residential unit/year in 2010. Unsorted residential material drop off tippage fees were proposed to increase, however, this was deferred by Commission Order WM09-01. IWMC and the residential rental community were to review the issue and return to the Commission with a proposal. No such submission has been received by the Commission as of this report date.

Electricity

Although not a major factor for many landlords, as most property owners do not provide electricity except for common areas, current Maritime Electric projections as filed in the recent rate application before the Commission indicate these costs are not expected to increase above current rates for the remainder of 2010 and 2011.

Maintenance Costs

These are rising associated with CPI increases and the rising cost of energy overall. At a minimum, a CPI level of increase can be expected.

Interest

Interest rates have not changed significantly over the past year and pronouncements from the Bank of Canada indicate rates will not change in the foreseeable future.

VII. CRITERIA FOR INCREASE

The statutory criteria to be considered in approving a rent increase are set out pursuant to subsection 23(8) of the *Act*:

(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.

Key factors to be considered include:

- information regarding the current state of the housing and rental unit industry,
- the change in operating costs for a residential rental building during the year, and
- the uncertainty in the cost of heating oil and electricity.

Once the allowable percentage rent increase for 2011 has been determined by the Commission, the allowable increase shall be published in the *Royal Gazette*, advertised in the local newspapers and inserted on the Commission's web site.