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External Research Program



Residualization of Rental Tenure:  
Attitudes of Private Landlords Toward  
Housing Low Income Households



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**RESIDUALIZATION OF  
RENTAL TENURE:  
ATTITUDES OF PRIVATE  
LANDLORDS TOWARD  
HOUSING LOW  
INCOME HOUSEHOLDS**

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March 1998

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## ***Purpose***

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The purpose of this research is to determine first whether the socio-economic profile of rental tenants has been gradually changing -- with an increasing prevalence of low income households; and second how such a change may be affecting the attraction of private rental housing as an investment.





## Acknowledgements

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Although funding was provided by both Canada Mortgage and Housing Corporation and by the BC Real Estate Foundation the views expressed are those of the author and do not represent the official views of CMHC or the BC Real Estate Foundation.

Steve Pomeroy



# Executive Summary

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The objective of this research study was to determine whether or not a gradual process of change in the profile of tenants in the private rental sector is occurring. It was hypothesized that this trend, here labeled "residualization", is evolving and that it may have important consequences for government policy.

The research has employed three approaches to this exploration: a literature analysis; a statistical analysis of existing data on household characteristics; and a qualitative survey of two subgroups of rental investors -- recent vendors and purchasers.

The literature analysis found only limited references to this phenomenon, largely in the context of social, or low income subsidized housing, and more particularly in the UK. There is some evidence in the literature that tenants with a particular profile may experience greater difficulty in accessing private rental housing. Other researchers have also noted the important distinction between discriminatory practices, and prudent management, in which some selectively is exercised in accepting new tenants. The study sought to explore these issues.

The statistical review found that there has been a long-term divergence in the income profile of renters and owners, although since 1990 both groups have, on average experienced losses in real income. Over the past two decades (1973-93), renters as a group have seen their real income decline by 7 percent while that of owners has increased by 18 percent. In 1973 the median renter income was 71 percent that of owners; by 1993 their median income had fallen to only 58 percent of the median owner.

As the term residualization is intended to portray, this divergence is not a result of different impacts on two unique and separate groups, it is in fact a

direct consequence of the tenure transfer of those households with better income prospects, who would otherwise have pulled up the average among tenants. Those unable to make the tenure jump, remain as renters. As Steele (1994) and Applebaum and Dreier (1990) have observed, rental tenure for many is a tenure of default.

The analysis also points out that this weak income growth is not homogeneous across all renters. Certain household types and age groups seem to have experienced greater difficulty in earning an income. The underlying reasons for the divergence in income patterns can be readily found in the employment outcomes experienced by each tenure, household type and age group. Both the young, new households (under 25), and those approaching retirement have clearly experienced the greatest difficulty in gaining and retaining employment and have accordingly experienced weak income levels.

The income decline among renters also reflects the growth of lone parent families, many of whom may already rent, or resort to renting upon separation. This trend is significant as those households who often have the greatest difficulty securing affordable rental accommodation -- families with children -- are also those most vulnerable to the destabilizing impact of income decline, or loss (Shlay, 1995). Such employment loss can lead to eviction for non-payment of rent, the trauma of another search for housing and inevitably to a permanent position on the poverty merry-go-round and potentially a long-term dependency on social assistance.

Trends in welfare dependency were explored using the somewhat crude measure of the subset of government transfer payments available in the HIFE data set. On this basis, dependence on transfers is significantly higher among renters than owners. Dependency among renters tripled from

8.6 percent in 1974 to 26 percent in 1994; over the same period transfers for owners have doubled, but from a lower base, from 3.7 percent to 7.8 percent.

Overall, the statistical review reveals a number of trends to confirm that some degree of residualization in the socio-economic profile of rental tenants is gradually occurring.

The study then explored the perceptions and attitudes of rental investors, specifically investigating whether they perceived the residualizing trend. Interviews were conducted with a sample of rental investors in Vancouver and Ottawa -- including both recent vendors and purchasers. The method did not undertake a survey of sufficient size to facilitate a statically representative set of data. The purpose was to pursue an initial exploration of this issue and to generate a sense of the attitudes and outlook among rental investors. It also sought to identify the implications for rental housing policy and some possible policy options.

It is important to bear in mind that the majority of the investors contacted were small-scale landlords, the majority owning only a single property that they managed themselves. The findings do not necessarily reflect the attitude of large corporate and institutional investors.

The two markets in which the interviews were conducted are substantially different. Vancouver has been experiencing a period of strong sustained economic growth and, by Canadian standards, has a very expensive housing market. Rental vacancy rates have been very low through the 1990's and remain at around 1%. With the cost of ownership among the highest in the country, the transition from rental into ownership is significantly more constrained in Vancouver than is the case in the other parts of the country.

Conversely, the Ottawa market has been impacted by the generally weaker economy that prevailed through Ontario for the first half of the 1990's

which in Ottawa has been exacerbated by various rounds of downsizing in the federal government. With some infusion of new rental development from the non-profit sector in the early 1990's, coupled with an oversupply of condominium units and relatively weak demand, vacancy rates have been soft, remaining above 4% since 1991.

Accordingly, one would expect a different perspective from investors in both markets. This proved to be the case on most issues raised with investors. Differentiation in responses tended to be stronger between the two cities than it did between recent vendors (investors exiting the market) and new purchasers (entering the market).

The overall perspective on prospects for rental investment tended toward the negative. More than half of the investors expressed the opinion that the environment for rental investment is either much worse or slightly worse than it was 5-10 years ago. This came through more strongly in Ottawa, but somewhat surprisingly, there was evidence of a souring perspective among investors in Vancouver. Looking to the future, the majority of investors expressed negative concerns about future prospects. Only three of the fifty-four investors interviewed expressed strong positive feelings about the future; fewer than one-fifth of investors were cautiously optimistic.

In terms of the central thesis, none of the investors explicitly identified with the concept of residualization, however, in an indirect way they provided some evidence that they both discern a changing profile among tenants; and that this is becoming a concern. A majority of respondents agreed that the proportion of tenants that would consider higher risk or undesirable is increasing; and that it is becoming harder to find and retain good tenants. This was not, however, a causal factor among vendors that have recently divested from the market, although, again, it appeared to be an underlying element in their concerns about a weak potential, negative cash flow and poor returns. Almost one third of the recent purchasers felt that the problem of attracting good tenants was

either a mild or serious concern in their particular property.

One in six landlord-investors confirmed that they would not accept households on welfare. Asked specifically to choose between various combinations of household types, the overwhelming choice was for a working couple. In selecting from these various combinations, none of the investors chose a welfare household and only one selected a lone parent with a young child, suggesting that such households will continue to experience difficulty as long as there is excess demand for lower priced units.

In exploring landlord attitudes about the need for affordable housing to serve lower income tenants, landlord-investors did not contest the legitimacy of social housing and a direct government role in the provision of affordable housing. Many expressed interest in demand side approaches such as shelter allowances and rent supplements, however they also saw a need for social housing, particularly to house households on low income and those on social assistance, whom some preferred not to accommodate.

The study concludes by outlining the imperative for some policy attention on the rental market. In particular, it is noted that there is not a level playing field in terms of support for ownership and rental tenure. There has long been a preoccupation with increasing access to homeownership. To the extent that the rental market and homeownership sector are closely related, initiatives to enhance access to ownership contribute to weakening demand in the rental sector and are a factor in the trend to residualization. The residualizing trend has been identified as a factor impacting the attractiveness of investment in the rental sector.

The most immediate consequence of this increasing disinterest on the part of investors is the potential deterioration of first the physical, and second the

social environment of rental housing. This can then lead to a decline in the quality of life of both the tenants and the neighbourhood with serious long-term impacts on municipal expenditures on policing, social services and infrastructure.

The need for a mixed policy approach is identified. This could include various types of demand side programs, such as shelter allowances and rent supplements, but should also be balanced with initiatives to assist the non-profit sector to acquire existing properties in which the private sector appears to be disinterested. The study found that a large number of properties are put up for sale each year and these are often available at a price that would approach an affordable level for lower income households. Currently however, non-profit organizations do not have the capital to pursue such opportunities.

The study identifies an important distinction between discrimination and prudent management. It is argued that landlords are not necessarily adverse to specific household types, they simply associate risk of default and bad debt with certain characteristics. An appropriate policy response would be to focus on mitigating risk. This could be pursued through some form of insurance program that protects investors against these risks. An insurance program does not entirely mitigate risk, nor would it necessarily eliminate selectivity. However, it would formalize an objective system of risk analysis and could help to reduce the barriers that currently confront many lower income households purely on the basis of stereotyping.

Respecting the fiscal constraints that remain on government, but which may be easing, there appear to be significant opportunities as well as a critical need to direct some policy attention to the rental part of the housing system. The policy initiatives outlined here could concurrently address concerns of both private investors, and those of affordable housing advocates.



## RÉSUMÉ

Ce projet de recherche a pour but de déterminer si le profil des locataires qui habitent des logements du secteur privé est en train de changer. Nous sommes partis de l'hypothèse voulant que cette tendance, appelée ici «résidualisation» est en évolution et qu'elle peut avoir d'importantes répercussions sur la politique gouvernementale.

Notre stratégie de recherche comportait trois volets : une analyse de la documentation, une analyse statistique des données existantes sur les caractéristiques des ménages, et enfin, une enquête qualitative auprès de deux sous-groupes d'investisseurs dans des logements locatifs - de récents vendeurs et acheteurs.

L'analyse de la documentation n'a révélé qu'un nombre limité de renvois à ce phénomène, surtout dans un contexte de logements sociaux, subventionnés pour les ménages à faible revenu, et plus particulièrement en Grande-Bretagne. Ainsi, dans la documentation consultée, on a constaté que certains locataires ayant un profil particulier peuvent avoir plus de difficulté à se trouver un logement locatif sur le marché privé. D'autres chercheurs ont également noté l'importante distinction entre pratiques discriminatoires et gestion prudente qui s'exercent, dans une certaine mesure et selon le cas, au moment d'accepter des locataires. L'étude visait aussi à examiner ces questions.

L'analyse statistique a révélé la présence d'une divergence à long terme dans le profil de revenu des locataires et des propriétaires, bien qu'en moyenne depuis 1990, le revenu réel des deux groupes ait diminué. Au cours des deux dernières décennies (1973-93), les locataires en tant que groupe ont vu leur revenu réel baisser de 7 %, tandis que celui des propriétaires s'est accru de 18 %. En 1973, le revenu médian des locataires correspondait à 71 % de celui des propriétaires; en 1993, le revenu médian des

locataires avait baissé, correspondant à seulement 58 % de celui des propriétaires.

Comme le sous-entend le terme «résidualisation», cette divergence ne découle pas de différents impacts sur deux groupes uniques et distincts; il s'agit plutôt d'une conséquence directe du changement de statut d'occupation chez les ménages les plus fortunés, qui auraient autrement fait monter la moyenne parmi les locataires. Ceux qui ne sont pas capables de faire le saut pour changer de mode d'occupation demeurent locataires. Comme l'ont déjà observé Steele (1994) et Applebaum et Dreier (1990), pour plusieurs, le fait d'être locataire est un mode d'occupation par défaut.

L'analyse fait également ressortir que la faible croissance de revenu n'est pas homogène parmi tous les locataires. Certains types de ménages et certains groupes d'âge semblent avoir connu plus de difficulté à s'assurer un revenu. On peut facilement relier les raisons sous-jacentes de cette divergence de revenus aux situations d'emploi pertinentes à chaque mode d'occupation, type de ménage et groupe d'âge. Ainsi, il ressort que les jeunes ménages (moins de 25 ans) et ceux qui approchent de l'âge de la retraite, sont ceux qui ont connu le plus de difficultés à obtenir et à garder un emploi, et qui ont conséquemment connu de faibles niveaux de revenu.

La baisse de revenu chez les locataires reflète aussi le nombre accru de familles monoparentales, dont plusieurs peuvent déjà être locataires, ou qui le deviennent au moment de la séparation. Cette tendance est importante, car les ménages qui ont souvent le plus de difficulté à se trouver un logement locatif abordable - les familles avec enfants - sont aussi ceux qui sont les plus vulnérables aux effets déstabilisants des baisses ou des pertes de revenu (Schlay, 1995). Ainsi, une perte d'emploi peut mener à l'éviction à cause du non

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paiement du loyer, à l'effet traumatisant de la recherche d'un autre logement, à un poste permanent sur le carrousel de la pauvreté et peut-être même à une dépendance à long terme de l'aide sociale.

Les tendances en matière de dépendance de l'aide sociale ont été examinées à partir d'une mesure plus ou moins raffinée, soit le sous-ensemble des paiements de transferts gouvernementaux disponibles à partir des données de l'ERMEM. On observe ainsi que les locataires sont plus nombreux que les propriétaires à dépendre de l'aide sociale. Cette tendance a triplé en vingt ans chez les locataires, passant de 8,6 % en 1974 à 26 % en 1994; au cours de la même période, les transferts versés aux propriétaires ont doublé, mais à partir d'une base plus faible, passant de 3,7 % à 7,8 %.

Dans l'ensemble, l'analyse statistique des données existantes a fait ressortir des tendances qui confirment que le profil socio-économique des locataires est en évolution et qu'un certain degré de résidualisation est en train de se produire.

L'étude a ensuite exploré les perceptions et les attitudes des investisseurs dans le logement locatif, en cherchant plus précisément à savoir s'ils avaient perçu la tendance à la résidualisation. Des entrevues ont eu lieu auprès d'un échantillon d'investisseurs à Vancouver et à Ottawa - incluant de récents vendeurs et acheteurs. Nous n'avons pas entrepris une enquête d'envergure suffisante pour obtenir un ensemble de données statistiquement représentatives. Notre but était de poursuivre l'exploration initiale de cette question et d'obtenir le point de vue des investisseurs. La recherche visait aussi à découvrir les répercussions éventuelles sur la politique touchant le logement locatif et à trouver des solutions de rechange.

Il est important de se rappeler que la majorité des investisseurs avec qui nous avons communiqué étaient de petits propriétaires, ne possédant souvent qu'une seule propriété qu'ils administraient eux-mêmes. Les observations ne reflètent donc pas nécessairement l'attitude des grandes entreprises ou d'investisseurs institutionnels.

Les deux marchés sur lesquels ont porté l'enquête sont assez différents. Ainsi, Vancouver connaît depuis un bon moment une période de croissance économique forte et soutenue et, selon les normes canadiennes, le prix des maisons y est très élevé. Depuis le début des années 1990, il y a très peu de logements locatifs vacants et le taux d'inoccupation se situe toujours autour de 1 %. Puisque le coût d'accession à la propriété y est le plus élevé au pays, il est beaucoup plus difficile de passer du statut de locataire à celui de propriétaire à Vancouver.

Par contre, le marché d'Ottawa a subi les répercussions de l'économie généralement plus faible qu'a connue l'Ontario au cours de la première moitié des années 1990, sans oublier l'impact particulier des divers mouvements de réduction du personnel au sein de la fonction publique fédérale. Compte tenu des nouveaux ensembles de logements locatifs produits par le secteur sans but lucratif au début des années 1990 et de l'offre supérieure à la demande au chapitre des logements en copropriété, les taux d'inoccupation sont demeurés au-dessus de 4 % depuis 1991.

On pouvait donc s'attendre à une perspective différente de la part des investisseurs des deux villes, et c'est effectivement ce qui s'est passé pour la plupart des points soulevés. C'est surtout entre les villes que les réponses différaient plutôt qu'entre vendeurs récents (les investisseurs qui quittent le marché) et nouveaux acheteurs (ceux qui entrent sur le marché).



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Dans l'ensemble, le point de vue sur les possibilités d'investissement dans le logement locatif avait tendance à être défavorable. Plus de la moitié des investisseurs ont exprimé l'avis que le milieu d'investissement dans le logement locatif était beaucoup moins intéressant ou légèrement moins intéressant qu'il y a 5 ou 10 ans. C'est à Ottawa que ce point de vue est ressorti le plus souvent, mais, fait surprenant, les investisseurs de Vancouver avaient une perspective de moins en moins optimiste, la majorité d'entre eux même était pessimiste quant à l'avenir. Ainsi, seulement trois des 54 investisseurs interviewés s'attendent à une forte conjoncture favorable pour l'avenir; et moins de 20 % des investisseurs ont dit qu'ils envisageaient l'avenir avec un optimisme prudent.

Revenant à notre thème central, aucun des investisseurs ne s'est rallié au concept de la résidualisation; d'une manière indirecte toutefois, ils ont indiqué qu'ils sont conscients d'une évolution dans le profil des locataires et que cette question commence à les préoccuper. Une majorité de répondants a convenu qu'il y a de plus en plus de locataires qui peuvent être considérés comme un risque élevé ou comme élément indésirable, et qu'il est de plus en plus difficile de trouver et de garder de bons locataires. Cet élément n'est toutefois pas entré en ligne de compte pour les vendeurs qui se sont récemment retirés du marché, bien que, encore là, il semble que cela ait été un élément sous-jacent de préoccupation au sujet de la baisse de potentiel, du manque d'encaisse et du rendement peu élevé de leur investissement. Près du tiers des récents acheteurs a déclaré que la difficulté d'attirer de bons locataires était un problème léger ou sérieux.

Un propriétaire investisseur sur six a confirmé qu'il n'accepterait pas de ménages recevant des prestations de l'aide sociale. Quand on leur a demandé de choisir entre diverses

combinaisons de types de ménages, les répondants ont majoritairement sélectionné un couple de travailleurs. Aucun des investisseurs n'a choisi un ménage vivant de l'aide sociale et un seul a choisi un parent seul avec jeune enfant, suggérant que de tels ménages continueront d'avoir de la difficulté tant qu'il y aura une très grande demande pour les logements à plus faible loyer.

Dans notre examen des attitudes des propriétaires quant au besoin de logements abordables pour desservir les locataires à faible revenu, les propriétaires investisseurs n'ont pas contesté la légitimité du logement social, ni le rôle direct du gouvernement pour fournir des logements abordables. Plusieurs ont manifesté un intérêt dans les stratégies touchant la demande, comme les allocations-logements et les suppléments de loyer. Ils ont aussi reconnu le besoin de logement social, particulièrement pour loger les ménages à faible revenu et ceux qui vivent de l'aide sociale, car certains préfèrent ne pas les accommoder.

Les conclusions de l'étude décrivent les priorités à privilégier pour l'élaboration de politiques sur le logement locatif. En particulier, on a noté que les règles du jeu ne sont pas uniformes concernant le soutien à l'accession à la propriété et au statut de locataire. On se préoccupe depuis longtemps de favoriser l'accession à la propriété. Dans la mesure où le marché locatif est étroitement lié à celui de l'accession à la propriété, les initiatives qui visent à améliorer l'accession à la propriété contribuent aussi à affaiblir la demande dans le secteur locatif et jouent un rôle dans la tendance vers la résidualisation. Cette tendance a été reconnue comme un facteur qui se répercute sur l'attrait que représentent les propriétés locatives pour les investisseurs.

La conséquence la plus immédiate du désintéressement de plus en plus marqué de la part des investisseurs est la détérioration

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possible de l'état des logements sociaux et de l'environnement connexe. Ceci peut entraîner une moins bonne qualité de vie tant chez les locataires que dans le voisinage, ce qui pourrait donner lieu à de sérieuses répercussions à long terme sur les dépenses municipales consacrées à la police, aux services sociaux et aux infrastructures.

On a reconnu qu'il fallait adopter des principes généraux mixtes. Ceci pourrait englober divers types de programmes du côté de la demande, comme les allocations-logements et les suppléments de loyer, mais il faudrait aussi qu'ils soient équilibrés au moyen d'initiatives pour aider le secteur sans but lucratif à acquérir des propriétés existantes qui ne semblent pas intéresser le secteur privé. L'étude a trouvé qu'un grand nombre de propriétés sont mises en vente chaque année et ces propriétés sont souvent offertes à des prix qui sont très près du niveau abordable pour les ménages à faible revenu. Toutefois, en ce moment, les organismes sans but lucratif n'ont pas le capital pour profiter de ces occasions.

L'étude établit aussi une importante distinction entre discrimination et gestion prudente. On indique toutefois que les propriétaires ne sont pas nécessairement contre certains types de ménages, ils font simplement associer les risques de défaut et de créances douteuse à certaines caractéristiques. Une stratégie valable pour trouver une solution à cette situation serait de se concentrer à réduire le risque. Ceci serait réalisable au moyen d'une sorte de programme d'assurance qui protégerait l'investisseur contre de tels risques. Un programme d'assurance ne fait pas disparaître entièrement le risque et il n'éliminerait pas non plus la sélectivité. Il permettrait cependant de formaliser un système objectif d'analyse du risque et pourrait aider à réduire les obstacles auxquels font face plusieurs ménages à faible revenu simplement sur la base des stéréotypes.

Compte tenu des contraintes financières qui existent encore pour le gouvernement, bien qu'elles soient plus légères, il semble y avoir bon nombre d'occasions, sans oublier le besoin essentiel, d'attirer l'attention des décideurs vers le volet locatif du système de logement. Les initiatives stratégiques décrites dans ce document pourraient offrir une solution aux préoccupations des investisseurs du secteur privé et à celles des organismes qui veulent favoriser le logement abordable.



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## ***Introduction and Definition of the Research Question***

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The rental housing sector is an important part of the housing system and the principal source of accommodation for many lower income households. Although social housing has played an important role in providing affordable housing, now accounting for some 6% of the total housing stock, and almost one fifth of the rental stock, the private sector remains the principal source of housing for many lower income households. In 1991, the private rental sector accounted for almost three-quarters of all rental units renting below \$400.<sup>1</sup> The core housing need model used by CMHC to measure housing problems has determined that some 1.16 million households were in core housing need in 1991, representing 12% of all households.<sup>2</sup> The vast majority of these, some 850,000, are renters. This means that almost 25% of all renters in 1991 were in core housing need and most of these households already live in private sector rental housing

Successive budgets and program decisions of both the federal and provincial governments have gradually curtailed new social housing supply. With the exception of funding for emergency shelters and aboriginal housing on reserves, all federal funding for new social housing ceased at the end of 1993 and, in Ontario, in the summer of 1995. British Columbia and Quebec are now the only provinces still providing funding to develop new non-profit housing. With fiscal constraints imposing severe limitations on any additions to social housing, the existing rental stock is likely

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<sup>1</sup> The total occupied rental stock, as recorded in the 1991 Census was 3.7 million units. Subtracting the 600,000 social housing units leaves 3.1 million private rental units.

<sup>2</sup> The core need model assesses households against standards relating to affordability dwelling condition and crowding and determines whether the household could afford appropriate housing within 30% of their income.

to become even more important as a source of housing for lower income households.

It is within this context that this research was conceived. It is hypothesized that over the past two decades rental tenure has encompassed a growing proportion of disadvantaged households - a process that, for the purpose of this study is labeled "residualization".

The research question that arises is whether this residualization of rental tenure has been, or is being, perceived by private sector landlords and how is this affecting their decisions to invest in or divest themselves of assets in the rental market. It is also unknown how the role of the private landlord may be changing -- moving beyond the traditional role of property manager to one demanding such tasks as a race relations counselor and social worker. Alternatively, unskilled in these areas, private landlords may avoid this problem by rejecting prospective tenants that may require such services.

### **Report Structure**

The report is structured to examine first the concept of residualization and its dimensions, drawing from the existing literature on tenure choice, and trends, and the literature that has explored landlord motivations and attitudes toward tenants. In part 2, key indicators of residualization are defined as the basis of a statistical review of how the profile of rental tenants and the rental housing stock has changed over the past 2 decades (1974-94). This review tests the hypothesis that rental tenure has become residualized.

Part 3 then outlines the research methodology used and presents the findings of a qualitative survey of rental property owners including current owners as well as previous owners based on a sample of rental property transactions which

## **Residualization of Rental Tenure**

**took place in 1993-1995 in Ottawa and Vancouver.**

**The study concludes, in Part 4, with a review of findings and discusses the possible implications and options for rental housing policy in Canada.**

## Part 1: The Concept of Residualization

---

As the central premise of this research, the concept of residualization requires definition and discussion. Residualization derives from the noun residual, defined by the Oxford dictionary as that remaining or left over; in mathematical terms, it refers to a quantity remaining after subtraction. It implies both change over time and decline.

Murdie (1992) uses the related term polarization, specifically to describe the increased concentration of low income and visible minority households in public housing. Murdie, has suggested that while there is some confusion or lack of clarity in the literature regarding the terms polarization and residualization, these refer, in one way or another, to social differentiation between housing tenures or between the residents of one tenure and the rest of the population. Also speaking in the context of public housing, but in a UK context, Malpass and Murie have defined residualization as:

*The process whereby public housing moves toward a position in which it provides only a safety net for those who for reasons of poverty, age or infirmity cannot obtain suitable accommodation in the private sector. It almost certainly involves lowering the status and increasing the stigma attached to public housing (Malpass and Murie, 1982).*

This perspective is echoed to a large degree in discussion of public housing in the US. In tracing the history of public housing in Philadelphia, Bauman (1987) contends that:

*public housing has evolved from a large scale community building program aimed at supplying safe and sanitary housing environments to upwardly mobile working class families, into a strategy emphasizing the delivery of welfare services to socially and psychologically demoralized tenants.*

The current study takes these definitions and generalizes them to the private rental sector. The intent is not to portray private rental tenure as the exclusive domain of the poor and disadvantaged,

but rather to explore the degree to which residualization is also occurring within private rental tenure.

Steele (1986) has conceptualized rental tenure as a tenure of default and specifies tenure choice as a household's second stage decision, following an initial step of establishing a new household. Homeownership is typically a subsequent and separate decision, involving some assessment of relative options of owning and renting. Until such time as one accumulates the prerequisite income and capital to become an owner, the default is to rent. Similarly, Applebaum and Dreier (1990) have proposed that, with few exceptions, rental tenure is "something to be endured until one can accumulate the down payment necessary to buy: permanent renting is the unhappy fate of those too economically marginal to buy" (Applebaum and Dreier 1990).

Since the term residualization is defined in terms of something remaining after subtraction, it is directly associated with the exiting of certain households to another tenure -- homeownership. Notwithstanding that empirical research assessing the relative benefit of ownership is almost nonexistent (Stryuk 1977; Rossi and Weber, 1995) a strong preference persists for ownership, or at least the features commonly associated with ownership, particularly the detached dwelling (Shlay 1985, 1986; Johnson 1993). As those renters that are capable of accessing ownership leave, rental tenure is increasingly comprised of households that have no effective demand or ability to exercise any choice in their tenure.

In short, tenure may be a choice for some, for others it is not: it is a default. Some households are simply unable to access ownership tenure, primarily as a result of their low income. This is not to say that rental tenure is the exclusive domain of the poor. Varady and Lipman (1994) have shown that a segment of households may in fact prefer to rent, even though they have the means to own. Based on an attitudinal survey

## Residualization of Rental Tenure

and factor analysis in the US, Varady and Lipman identified six distinct clusters of households, including two tagged respectively as "life style" and "elderly life-cycle" renters. In both cases, the households were older and wished to avoid what they perceived as the inconveniences of owning. In total, these two clusters made up a third (31%) of renters.

Renters and home-owners are not absolutely distinct and respectively homogeneous. There is an ongoing differentiation and fragmentation within tenures (Forrest, Murie and Williams 1990). Just as there are high income renters, there are a significant number of low income owners (in Canada, over a quarter of households in the lowest income quintile are owners). Indeed rental tenure is prevalent across all income levels, with renters comprising one fifth and one tenth of households in the fourth and highest income quintiles respectively (Statistics Canada 1994).

The central hypothesis analyzed here is that notwithstanding coexisting changes in the ownership market, there is an ongoing increase in the proportion of households that remain as renters, simply because they are unable to exercise a choice. The private rental sector may not (yet?) be stigmatized in the way that social, and particularly public, housing has been, but the incidence of disadvantaged households among renters is increasing, especially in core urban areas (other than those undergoing gentrification).

Victims of deprivation have no-where else to go, with the unsavory exception of becoming homeless -- a fate which statistics suggest is increasing (Bentley, 1995; Culhane et al 1994).

The preceding discussion infers that residualization can be broadly associated with three factors:

1. General economic restructuring;
2. Cyclical shifts in labour and housing markets that have increased access to ownership;
3. Specific policy decisions such as those promoting homeownership.

### General economic restructuring

Clearly the notion of residualization is closely associated with terms such as marginalization, deprivation, underclass, social polarization and segmentation, phrases that have become common in the literature (Hamnett 1984; Murdie 1992, 1994; Hall and Bourne 1991; Ley 1994).

Marginalization, the more common term, differentiates between individual cause, or personal problems and systemic causes (Doyle 1996). The term is used to describe the victims of broad structural and economic change. These changes include the shift to a post industrial economy in which employment in blue collar goods manufacturing jobs have been displaced by a growing service sector and associated change in required job skills. This structural change has been accompanied by increasing levels of unemployment, especially among youth; long term unemployment among the older workers; a substantial shift toward part-time, casual and non-permanent employment; and lower wages (Reich 1991, Burns 1991, Pomeroy 1995).

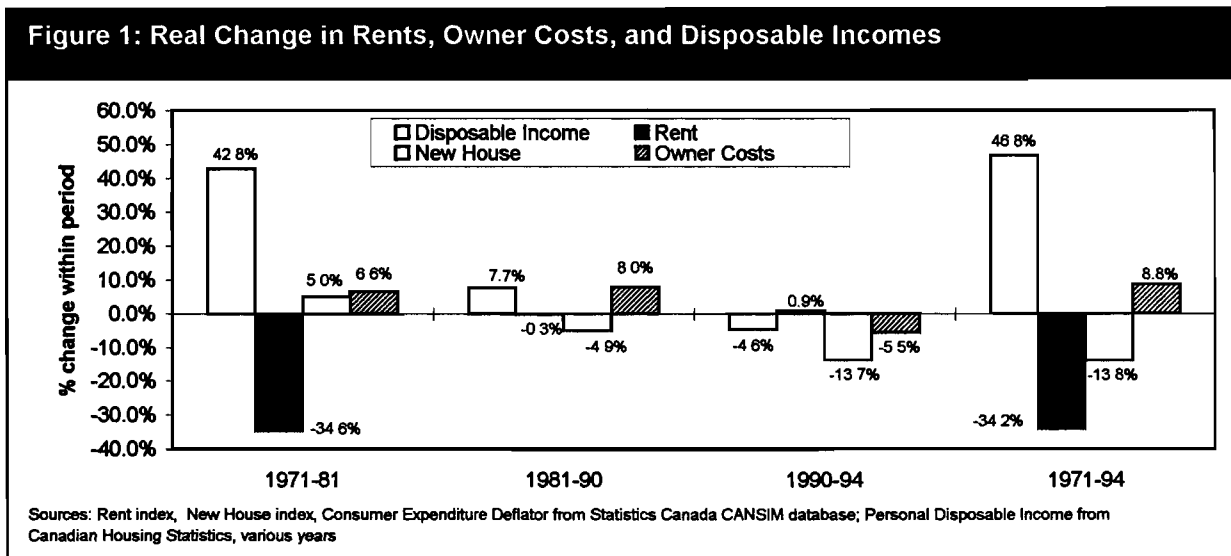
Another factor contributing to marginalization within Canadian society is the rising immigration level, especially an increase in the number of refugee class immigrants, many of whom are visible minorities who are disadvantaged as a result of discrimination in both housing and labour markets (Murdie 1994).

### Increased access to ownership

As Wilmott and Murie state:

*The more that access to owner-occupation is extended the more it is bound to pull in households just at the margin of being able to afford it. Increasingly that leaves behind a relatively pauperized group, those people who cannot afford to make the move.*

## Residualization of Rental Tenure



Access to ownership is affected by a combination of house prices relative to renting, mortgage rates, lending criteria (especially down payment requirements), and income (both current and permanent income). As rental and ownership tenure are respectively parts of a single housing system there is a flow of households between these two subsystems. The flow is influenced partly by lifestyle and lifecycle considerations, including new household formation or dissolution, and in part by the relative cost of each tenure.

Over the two decades years prior to 1990, the real price of renting has declined relative to that of owning (Hosios, 1995). Overall, between 1971-94 the cost of renting fell in real terms by 34.2%; over the same period the cost of owning (i.e. includes both price change, mortgage costs and ongoing maintenance) increased by 8.8% (Figure 1).

Meanwhile, through the seventies, society was gaining affluence with per capita disposable income rising significantly. The greater rate of growth in per capita disposable income allowed many households to exercise their desire to purchase. The benefits of ownership, together with the changing age structure of the population, the bundling of desirable design attributes with

ownership tenure and generally rising real incomes have off-set the price advantage of renting.<sup>3</sup>

The long term real cost advantage of renting reversed at the end of the 1980's. Since peaking in 1989 in most markets in the country, the cost of ownership has fallen in real terms, as too has real per capita income (Figure 1). This has been accompanied by a drop in mortgage interest rates, a key component in determining the carrying costs of ownership.

Since 1991, the real cost of renting has for the first time consistently outpaced the year-year real change in per capita disposable income. Although only rising 0.9% between 1990-94, this is a dramatic reversal of the pattern that prevailed for much of the preceding 20 years (Figure 1). Moreover, it is set in a period when real income was also declining, effectively widening the gap in rental affordability. At the same time, even though average per capita disposable incomes were not increasing in real terms since 1990, the cost of access to ownership relative to renting was improving.

<sup>3</sup> Figure 1 reflects the CPI owner index. Others have developed more sophisticated indices to measure ownership users costs, including, house price, mortgage costs opportunity costs, capital gains and tax impacts see for example, Steele (in Miron), Hosios 1995.

## Residualization of Rental Tenure

Overall, for those households who were benefiting from real income gains, the 1990's have been a period where access to ownership has been greatest in historical terms. This is evident from the CMHC index of affordability, which reports continued improvements in the level of access to ownership with almost all cities reporting historical record high levels of affordability in 1996 (CMHC 1996b).

### Specific policy decisions

Much of the discourse on residualization by tenure derives from the UK where the term is widely used among academics and analysts, especially to describe the process of social change in public (council) housing. In the UK, although often associated with the policies of the Thatcher government, this trend in fact predates this regime (Morris and Winn, 1990). Nonetheless, the process of residualization in public housing was reinforced by the policies of the Thatcher conservatives. A key element of this process was a conscious decision to focus public resources on those most in need and a concerted effort to promote homeownership. This included the Right to Buy (RTB) policy presented to existing residents of public housing.

In Canada, there has been a parallel, though generally undocumented, residualization of both public and non-profit housing.<sup>4</sup> As in the UK, this has been a consequence of the re-orientation of federal housing policy to target limited resources to those 'most in need' (CMHC 1985). This was a fundamental shift from the policy of income and social mixing which prevailed from 1973 through 1985 (and continued in Ontario until 1995 as a result of provincial policy to fund unilaterally the inclusion of non-targeted units in non-profit projects). Nationally, the incidence of households

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<sup>4</sup> Murdie has undertaken a number of studies examining the issue of segregation and social change in public housing in Toronto. He has observed that beyond the program evaluations undertaken by CMHC, which report on the socio-economic characteristics of residents at only one point in time, there is a lack of research in this area in Canada (Murdie 1994, *Social Polarization and Public Housing in Friskin*).

on social assistance has risen dramatically in public housing from 18% in 1982 to 33% by 1988, and is speculated to have risen further through the 1990's, although data is not available to substantiate this (Pomeroy 1995).

Policies of setting social housing rent as a percentage of income (rent geared to income - rgi) have effectively stimulated economic eviction -- when a household's income increased to the point where their rent is greater than private market rent, there is a natural incentive to exit social housing. The unit is then freed up for a lower income household. The use of point rating systems, which existed in public housing and were extended to the non-profit sector in 1986, also acted to select more disadvantaged households. Together, these two policies have worked in concert to increase the proportion of low-income and welfare households in social housing.

Within the private market in Canada, policy decisions have also influenced tenure choice. At various times tax-sheltered homeownership saving plans such as the Registered Home Ownership Savings Plan (RHOSP) have assisted potential owners to accumulate a down payment. More recently, two federal initiatives have further enhanced the access to ownership. These are the provision to allow withdrawal of Registered Retirement Saving Plan (RRSP) funds for the purpose of purchasing a home, and the federal First Home Loan Insurance plan which provides mortgage insurance to reduce the downpayment amount to only 5% for first time buyers.

A number of provinces have, at various times, introduced programs targeted to assist lower and moderate income households to access homeownership. Coupled with a soft real estate market, these incentives have substantially increased ownership accessibility for those households in a position to take advantage of them -- particularly young professional, with reasonable earnings potential.

At the same time, rent regulation and controls are another area of policy that have impacted the investment in the rental market. Although the type of review or control regime has varied across

## Residualization of Rental Tenure

provinces and overtime, there is a strong consensus among economists and landlords that that policies that restrict or regulate rental income are an impediment to investment, and over the long term may both reduce new supply and lead to under investment in maintenance and capital repairs. Physical deterioration of the stock can then lead to a spiral of decline. Developers who may traditionally have produced rental housing have shifted their focus to building condominium units for sale.

Together, the three contributing factors cause a dual process wherein some households experience increased deprivation and by default have little choice other than to remain in rental tenure (presuming they cannot access the very limited social housing). Meanwhile, others who have benefited from restructuring, or at least not been negatively impacted, have been able to take advantage of circumstances that have improved access to ownership. As these less disadvantaged renters are 'creamed off' by the attraction of ownership, the less fortunate carry a greater weight in the overall profile of the remaining rental sector.

Having defined and described the meaning of residualization, the next section reviews the statistical evidence to test the hypothesis that a process of residualization is ongoing within rental tenure.

## ***Part 2: Indicators of Residualization: Statistical Analysis***

---

There is an obvious association between low income and deprivation. Previous research exploring the issues of inequality, pauperization, deprivation and socio-tenorial polarization have tended to converge on a set of indicators encompassing income, occupational status, dependency on government income transfers and, in some cases, ethnicity.

In the UK, Wilmott and Murie (1988) found that between 1968 and 1983 the proportion of council tenants in the poorest 30% of all households increased from 31% to 52%. Similarly, the median incomes of public housing families in the US declined from 47% of overall family median income in 1960 to 34% of overall family median in 1979 (Murdie 1994).

Associated with the more general trend of economic restructuring, most analysts have harnessed changing occupational status as an indicator (Davies and Murdie 1994, Murdie 1994). Similarly, Harnett (1984) used the proportions of professional, intermediate, skilled, semi-skilled and unskilled employment by tenure. Unemployment and non participation in the labour force, as well as duration of unemployment have been used by the Economic Council of Canada in tracing the new face of poverty and to identify the victims of restructuring (Economic Council of Canada, 1992).

The Economic Council of Canada (1992) has also demonstrated that part of the decline in real incomes can be associated with an increasing proportion of non-standard jobs -- part-time or short term, typically low paying with few benefits and little change for career advancement. These nonstandard jobs accounted for about 44% of net job growth between 1981-89 (Economic Council 1992).

Obviously related to weak employment opportunity and extended duration of unemployment, one of the more salient indicators of deprivation is dependency on government transfers. In an analysis of the changing client base of public

housing, Murdie (1994) identified a shift in demand away from the independent poor (i.e. low-wage earners, particularly two parent families who temporarily lack the funds to afford accommodation in the private market) to the dependent poor (the long term unemployed, one parent families, the elderly and the mentally ill).

An additional dimension used in a number of studies in the US, UK and Canada is the incidence of ethnic groups and visible minorities. Members of minority groups have been identified as victims of discrimination both in the private sector as well as in public housing. Murdie suggests that social segregation in public housing is partly a result of housing managers placing tenants in projects where other members of their ethnic group reside. In addition, these visible minorities are often offered units and projects in the poorest condition because it is probable that whites will reject them (Murdie 1994).

In order to test the hypotheses of residualization within rental tenure, it is necessary to review the concurrent trends in both rental and ownership tenure. It is hypothesized that residualization in rental tenure is associated with a shift in tenure choice in favour of ownership, with a residual impact on rental tenure. Any trend that permeates both tenures is an indicator of a more general shift, not necessarily an indicator of residualization.

Consequently, it is important to place any analysis of change within tenure in the context of the more general trends. The analysis attempts to do this by juxtaposing trends for both renters and owners. The profile of each tenure is explored using the indicators found in the related literature overviewed above, respecting the constraints of available data sources.

To identify trends over time, the analysis is undertaken from the early 1970's. Data sources are primarily from the Statistics Canada Household Income and Family Equipment (HIFE) micro databases generated from annual surveys.



## Residualization of Rental Tenure

Only limited published data is available by tenure. Most analysis is therefore based on special tabulations developed from these micro databases.<sup>5</sup>

In some cases, HIFE data is supplemented by Census data using the 1971 through 1991 published series. The analysis is undertaken at a national level even though rental markets are, by nature, local. The intent at this stage is to examine the broader trend rather than focus on a specific market. Moreover, the required data are not available at a city level due to the sample size in the HIFE database.

Drawing from the literature, the following indicators are used here to explore the hypothesis of residualization:

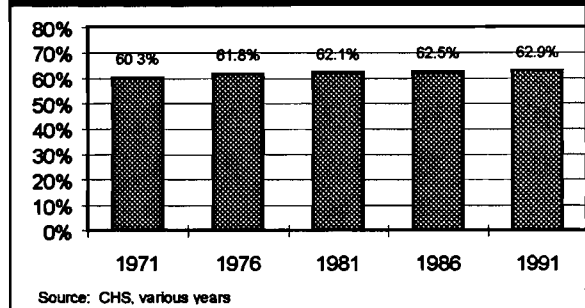
- Household composition by age
- Distribution of tenure by income quintile
- Real income -- median household income by age and tenure
- Source of income -- earnings and transfers
- Labour force profile -- labour force participation, unemployment, working full-time or part time,
- Immigrant status of household head

### Changing Profile of Renter Households.

Over the past two decades, the relative proportion of households that own and rent has remained within a very narrow range, approximating 62 per cent (Figure 2). However this overall ownership rate conceals significant shifts in the rate among certain household types and age groups (Figure 3).

<sup>5</sup> The data base contains data collected from several surveys: the survey of consumer expenditures, the Labour Force Survey and the Household Incomes, Facilities and Equipment/Shelter Cost Survey. While the sample size has varied over time, this data base reflects a sample of approximately 40,000 households. In order to provide a time series analysis, the data base for 1974-78-82-86-88-92 and 1994 was used here.

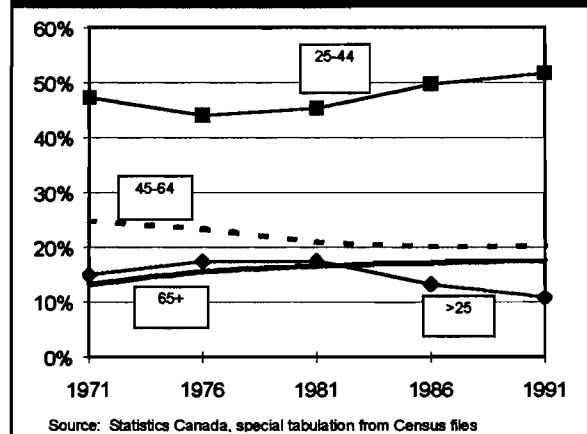
Figure 2: Home Ownership Rate 1971-91



### Age distribution

Traditionally, rental tenure has been associated with younger (under 25), and older (over 55) households. However, as is evident from Figure 3 below, renter households aged 25-44 comprise the single largest group of renters (52% in 1991), and since 1976 this group (mainly the baby boom age group) has grown at the fastest rate. Meanwhile, younger households (under 25) have declined as a proportion of all renters since their peak in 1981 and now represent only one tenth of all renters. This is entirely attributable to the small size of the age cohort born after 1964.

Figure 3: Proportion of Renters by Age Group



Consistent with the general pattern of an aging society, seniors have gradually increased their representation among renters, though not to the same degree as the 25-44 group. This more modest increase in the proportion of elderly renters is partly due to the higher propensity for seniors to own. This is facilitated by condominium tenure

## Residualization of Rental Tenure

which provides an apartment building form often preferred by seniors, while still allowing ownership and more control over long term housing costs (at least for those without a mortgage).

Housing consumption is to a large degree influenced by lifestyle, and more specifically stage of the life cycle, and is discussed in this context below.

### *Household composition and dwelling form.*

Household composition has been identified as an important determinant of tenure choice, *ceteris paribus*, although this is also a consequence of the traditional relationship between dwelling form and tenure. Until the advent of condominium tenure in Canada in the late 1960's, living in an apartment was synonymous with renting; owners typically occupied single detached dwellings. Indeed, a 1985 study of consumer preferences (Shlay 1985, 1986) found that the primary determinants of dwelling choice are location, size, design and facilities. Shlay determined that the tenure status of the dwellings was uncorrelated with these other attributes.

Shlay's analysis suggests that it is the way that housing amenities tend to be bundled together with a specific tenure status that most influences housing tenure preference.

There is a strong correlation between ownership and family status. It is not coincidental that the single detached dwelling is also commonly referred to as a *single-family dwelling*. Thus, we see a higher proportion of ownership among family

households, 72.4% in 1991 than in non-family households (Table 1 presents this from the perspective of renters, combining all family households, only 18.6% were renters in 1991). In the early 1970's, the large size of the young renter baby boom group acted to increase to proportion of renters among non-family households. Households aged 20-29 accounted for one third of the total growth of non-family households between 1971-76 and 87% of these were renters.

Examining the types of households that rent, it is evident from Table 1 that the household characteristics of renters have shifted substantially over the past two decades. Predominant in 1971, two parent families with children, especially young families, comprised the single largest group of renters (39%). The representation of this household type declined markedly through the 1970's and less rapidly since.

By 1991, two-parent families with children accounted for less than one fifth of all renter households (among all households, two parents with children declined from 50% in 1971 to 37% in 1991). The desire for a dwelling more suited to a family (single detached home) combined with substantially rising real incomes helped these young families move to ownership. The growth in renter households through this period came primarily from two household types: non-family households, single individuals in particular who almost doubled in proportion from 21% to 39% (1971-91); and from lone parent families, who rose from 9% to 13% of all renters

**Table 1: Renter Distribution by Household Type**

Census year	Family Household				Non Family Household		Total
	Couples	Couples with children	Lone Parent	Multiple family	Individual	Two or more individuals	
1971	22.3%	38.9%	9.0%	1.0%	21.3%	7.5%	100%
1976	23.9%	28.4%	9.8%	0.6%	29.8%	7.5%	100%
1981	21.7%	22.8%	11.3%	0.5%	36.4%	7.4%	100%
1986	20.2%	21.2%	12.9%	0.5%	37.4%	7.8%	100%
1991	19.3%	19.9%	13.3%	0.5%	38.9%	8.1%	100%

Source: Statistics Canada Census- Special tabulation prepared for CMHC Potential Housing Demand Model

## Residualization of Rental Tenure

**Table 2: Incidence of Renters within Household Type**

	All Households	Couples	Couples with children	Lone Parent	Multiple family	Individual	Two or more individuals
1971	40%	39%	31%	51%	20%	63%	61%
1976	38%	37%	24%	52%	16%	68%	63%
1981	38%	35%	20%	53%	18%	68%	63%
1986	37%	32%	20%	54%	17%	65%	62%
1991	37%	29%	20%	55%	17%	63%	62%

Source: Statistics Canada Census- Special tabulation prepared for CMHC Potential Housing Demand Model)

Another way of looking at these changes is to examine the incidence of rental tenure among different household types (Table 2). Rental is the predominant tenure only among non-family households and among lone parents. The incidence of renting has declined markedly for two parent families while rising for lone parents. Among individuals, the proportion renting rose through the 1970's but has fallen off since 1981.

This is partly explained by the older age profile of this household type -- older households have a higher propensity to own -- as well as the phenomenon of family separation. Individuals separating often have access to equity from former family home, which allows them to continue as owners in a smaller dwelling

Another factor that may have some impact on the growth of low-income single renters is the decline in the proportion of roomers and boarders. Partly assisted by benefits to singles, individuals have a greater capacity to maintain their own household than they did in the past. As these individuals form their own household they increase the proportion of low-income single renters.

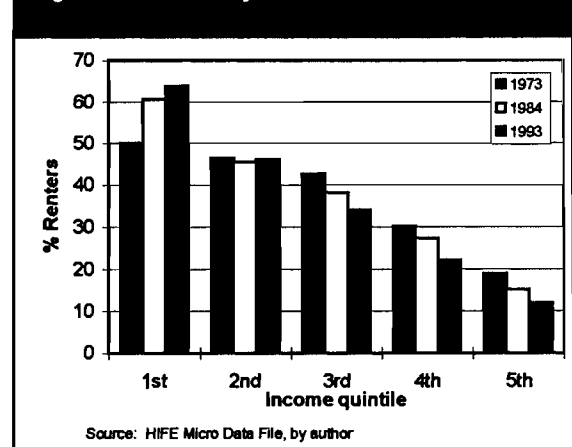
### *Distribution of tenure by income quintile*

As noted earlier, rental tenure is not the exclusive domain of lower income households although the incidence of rental tenure is much higher among this group (Figure 4). Low income limits tenure choice and rental is typically a default. However, tenure is not solely a function of income. Among moderate or higher income households who have

the ability to purchase many still choose to rent (Varady and Lipman 1994).

Even though the middle and higher quintiles have greater choice, there is a clear pattern of declining rental tenure among these households. Increasingly, they are exercising the option of owning. Meanwhile, households in the lowest income band exhibit an increasing representation among renters. In 1991 almost two thirds of

**Figure 4: Renters by Income Quintile**



households in the lowest income quintile were renters, compared to only one half in 1973.

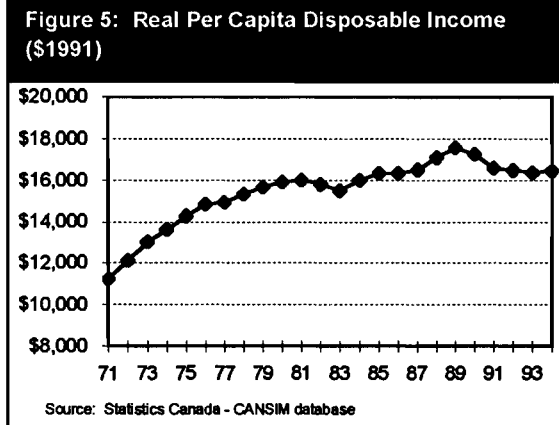
The shift in the tenure pattern among income quintiles reflects a dichotomization of households on the basis of income (Miron 1986). Given the association between income and tenure choice, this dichotomization is also manifest on the basis of tenure. In examining the subject of housing consumption and tenure, household income is far more meaningful as an indicator of

## Residualization of Rental Tenure

well being than the more general indicator, per capita income. Indeed, there has been a growing divergence in these two sets of statistics. This divergence is even more noticeable when fully dissaggregated by tenure.

### *Per capita real disposable income*

Per capita real disposable income rose substantially (43%) through the 1970's (Figure 5). After a small setback caused by the 1981 recession, per capita real disposable income continued to increase through to the end of the 1980's, albeit more slowly (8%). A more significant reversal is evident in the 1991 recession. Real disposable income fell (by 4.6% since 1990). An important factor underlying the long-term growth in real per capita income was the expanding role of females in the labour force. This provided an added advantage to traditional two parent families, a factor that substantially abetted the ownership and other consumption aspirations of this household type.

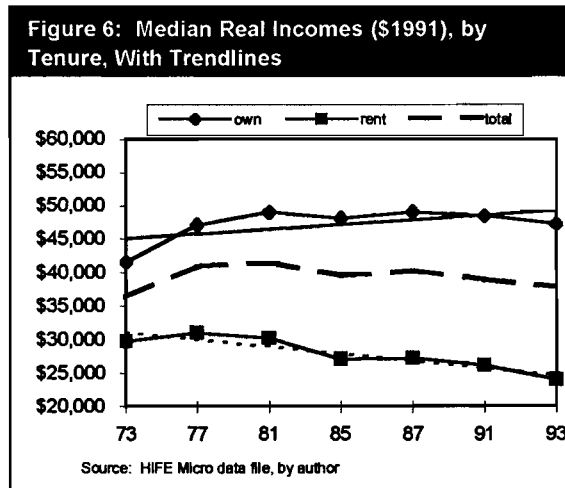


### *Household income by age and tenure*

As a general statistic that averages total income across all individuals, per capita disposable income does not reveal the actual situation of either individuals or households. Median household income provides a more meaningful indicator, especially when disaggregated by household characteristics.

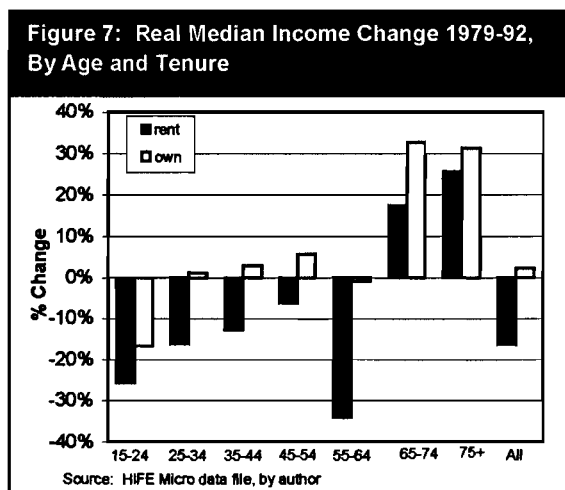
An examination of the median income trend among households over the past two decades (Figure 6) reveals a clear divergence in the trend line among owners and renters. Even though

there was some decline in the median income of owners in the post 1990 period, owners had already benefited from strong real gains in the seventies, a period when the median renter income was already in decline. Dissaggregating household income by tenure, we see that the decline in median real income since 1987 has been more evident among renters (-7.6%) than is the case among owners (-3.0%).



### *Income trends by age and tenure*

Further dissaggregating households by age, we can see from Figure 7 that income trends have not been equally spread. Although based on a slightly different time frame (1979-92) we see that the median real income for owners has been slightly positive, and is in stark contrast to that of all renters, which fell by 16% over this period.



## Residualization of Rental Tenure

Both the young, new renter households (under 25), and those approaching retirement have clearly experienced the greatest decline in income levels. For youth, many are just entering the labour force, often working part-time, in parallel with their ongoing educational pursuits. Often their jobs are in the service industries and wage levels have not risen in real terms. Higher than average unemployment levels among youth are well documented and will also act to pull down the average income. For households aged 55-64 the significant decline in the real income of renters (-34 per cent) is no doubt associated with employment loss in a period of economic restructuring and voluntary early retirement (Sheridan 1993). In contrast, the elderly 65 and over have enjoyed the greatest income gains, largely a result of significant investment gains in the high inflation period at the beginning of the decade, which enhanced their pension plans. The indexation of pensions has also acted to maintain their income levels, curtailing downward averaging.

The noted divergence in real income growth between tenures is again evident among households aged between 25-54 (Figure 7). Renters have experienced significant real decline, while owners at the median income have, over the eighties, seen small gains. In part, this trend reflects both weak employment and income levels for unskilled labour, compared with the gains enjoyed by full time employees especially in two income families in the latter half of the 1980's.

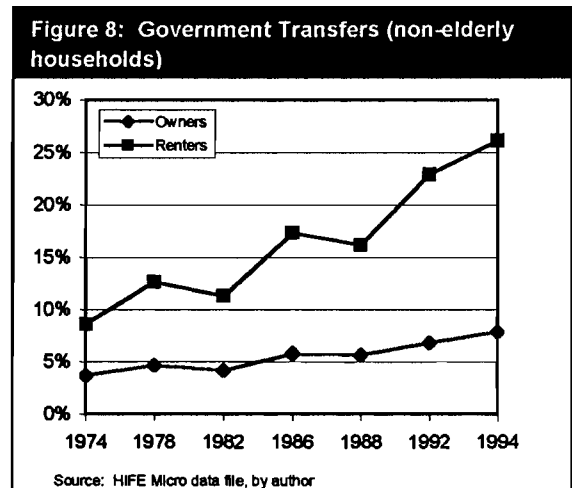
The income decline among renters also reflects the growth of lone parent families, many of whom may already rent, or resort to renting upon separation. This trend is significant as those households who often have the greatest difficulty securing affordable rental accommodation -- families with children -- are also those most vulnerable to the destabilizing impact of income decline, or loss (Shlay, 1995). Such employment loss can lead to eviction for non-payment of rent and the trauma of another search for housing.

Seniors, meanwhile, often seen as more desirable tenants, typically on the basis of their quiet

behavior, may also enjoy this reputation as more secure tenants due to their relatively strong, or at least stable, income profile (Steele 1994, Lyon 1995). Although lagging the gains of owners, seniors recorded strong real income gains through the 1980's.

### *Increasing dependency on government transfers*

Associated with weaker employment opportunities there has been an inevitable increase in reliance on transfer payment -- both unemployment insurance benefits and, when these expire, social assistance. Using the source of income as an indicator in the HIFE micro data file, the proportion of households for whom transfer payments comprise more than 50% of household income was examined over the two decades.



As would be expected, dependence on transfers is significantly higher among renters than owners. Moreover, Figure 8 shows that the level of dependency has risen more substantially for renters, tripling from 8.6% in 1974 to 26% in 1994; over the same period, transfers for owners have doubled from 3.7% to 7.8%.<sup>6</sup> Clearly

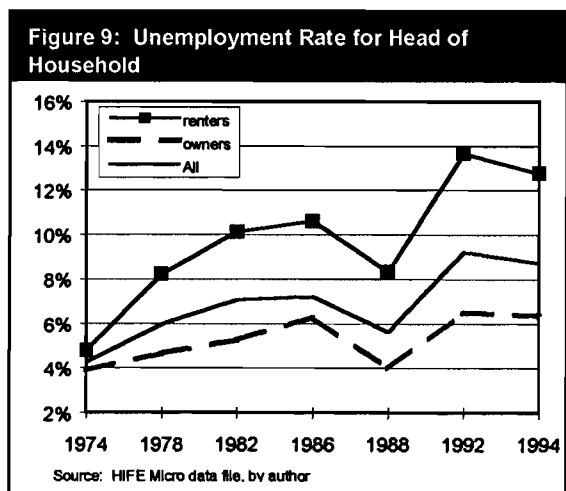
<sup>6</sup> Only households with a head under age 65 were included in order to net out seniors on pensions. Thus, for the purpose of this analysis, government transfer refers primarily to unemployment and social assistance, although some disabled assistance will be included.

## Residualization of Rental Tenure

there is a far larger representation of welfare households among renters. In 1994, 22 per cent of households living in the private non-subsidized rental sector reported that more than 50% of their previous year's income was based on transfers from government. Given the general negative perception of private rental landlords toward welfare households, the fact that one in 5 tenants is a welfare recipient is a significant potential cause of poor landlord-tenant relations.

### *Labour force characteristics.*

To further analyze the declining income profile of renter households, the employment characteristics of each tenure were examined. This included a review of employment levels over time, the incidence of full and part time work; and the occupational classification of households in each tenure. In all these investigations, the data used refers to the head of the household and include only those households with a head under age 65. The use of households as the unit of analysis is an important distinction as it results in different statistics than those normally reported which are based on individual reporting rather than households. For this reason, data presented for unemployment rates appear low in comparison to the published unemployment rate.



In the early 1970's there was only a very small difference in the unemployment rate for heads of renter versus owner households (Figure 9). However, through the 1970's the unemployment

situation for these two tenures diverged significantly. At the end of the 1981-82 recession the level of unemployment of renters (10.1%) was almost twice that of owners (5.3%). Through the economic boom of the mid-late 1980's unemployment fell for both tenures although the difference in their respective levels did not narrow.

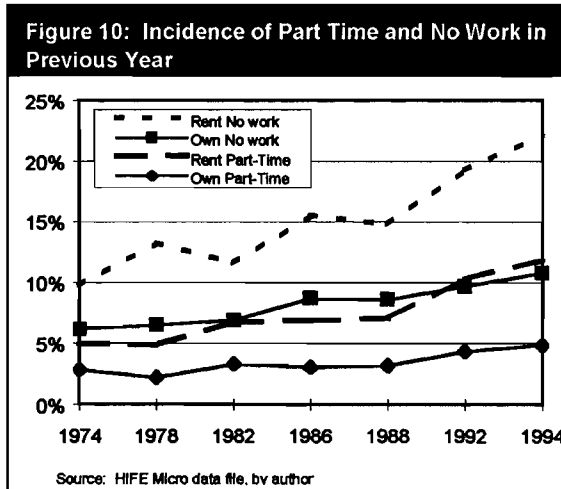
The 1991 recession appears to have had a far more dramatic impact on renters as the unemployment rate for this tenure jumped from 8.3% in 1988 to 13.7% in 1992; meanwhile, for owners unemployment rose only from 4.0% to 6.5%.<sup>7</sup> Thus, by early in the 1990's, one of every seven renter household heads was unemployed. When coupled with recorded lower savings levels of renters (CMHC 1992), this may have had a destabilizing impact on security of tenure, possibly leading to evictions due to rent arrears. In contrast, for owners, for whom far fewer experienced unemployment (one in fifteen), those with accumulated equity had more options, including, re-amortizing their mortgage and reducing their housing cost burden and selling their home to free up equity.

Together with the increasing incidence of unemployment, the 1980's brought a fundamental shift in the economy, one manifestation of which was the increased level of part-time employment. Again, the data presented here reflect the situation of the household head only. The decline in full time employment impacted all households with the number of household heads in full-time employment falling by one tenth, from 88% of all households in 1974 to 78% in 1994 (HIFE Micro data file). Notably, this decline occurred through the longest post war economic expansion, a precursor to the subsequent post 1992 "jobless recovery". Similar to the unemployment trend, levels of full time employment in 1974 were not significantly far apart: 91% for owners and 85% for renters

<sup>7</sup> The larger rise in unemployment among renters during both recession periods may, in part, be caused by former owners losing both their job and their home, and moving back to rental.

## Residualization of Rental Tenure

(HIFE Micro Data File). However, the decline in full time employment among renters -- down to 66% of household heads -- far exceeds that among owners for whom full time status declined to 84%.



Some of the losses in full-time work were reflected in increasing levels of part-time employment. For renters, the number of heads with part-time employment more than doubled from 5% in 1974 to 12% by 1994; for owners, the proportion in part-time work also grew quite substantially -- from 2.8% to 4.8%. However, owners began from a lower base (Figure 10).

The decline in full-time employment was not entirely offset by a shift to part-time work. A significant number remained without employment, most noticeably in the rental tenure. By 1994 more than one in every five (22.1%) renter households had not worked in the previous year -- doubling from one in ten (9.8%) in 1974. For owners the proportion that had not worked rose from 6% to 11%.

For those in the labour force, a shift from full-time to part-time employment would have most likely been accompanied by a shrinking income, a reality that was discussed earlier.

### *Occupational characteristics.*

Other research on the topic of residualization has identified levels of unskilled and semi-skilled

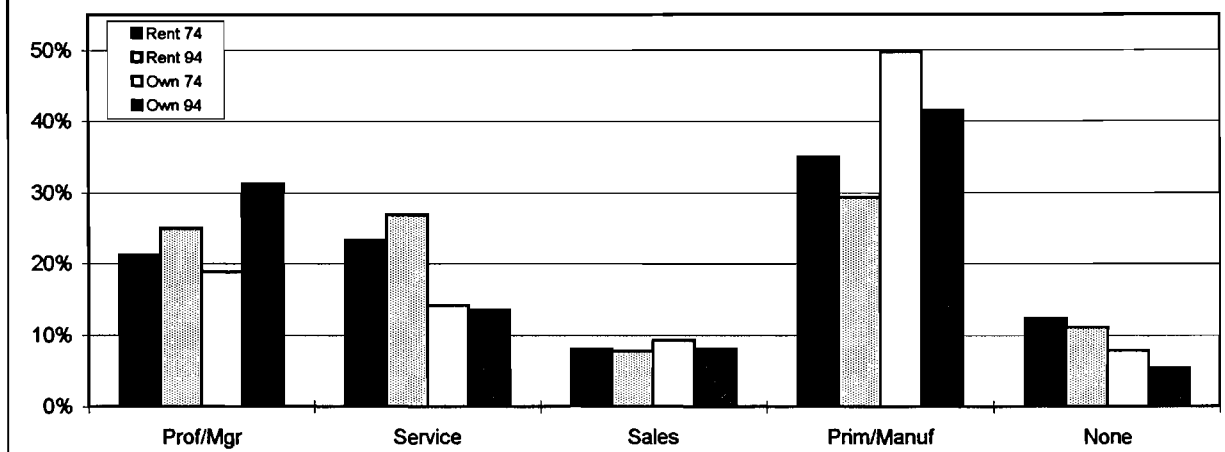
employment as further indicator (Murdie, 1994; Murie and Wilmott 1988). To explore this issue, the Statistics Canada occupational classification was utilized. This classification system has been consistent over the study period. The thirteen occupational categories reported in the database have been combined into 5 categories:

- Professional and Managerial ( including administration , teaching engineering and occupations in medicine, health and recreation);
- Service and Clerical;
- Sales;
- Primary and Manufacturing (including agriculture, forestry, fishing, mining, product fabrication, construction trades and transportation ; and
- Do not work (i.e. never worked or have not worked in past 5 years)

Notwithstanding significant differences in income levels and trends between tenures, there is no clear distinction on the basis of occupation. Most surprising, in 1974 the incidence of professional and managerial occupations was higher among renters (21%) than owners (19%) - - Figure 11). Subsequently, the proportion in this occupational category expanded in both tenures, though more so for owners (up to 32% compared with a peak of 25%, achieved in 1986 for renters). No doubt the relatively high level of professional occupations among renters through the 1970's reflects the large demographic group of young recent graduates moving into their careers -- potential move up buyers that had not yet accessed ownership.

Perhaps the most noticeable shift is the steady loss of employment in the traditional primary and manufacturing sectors, consistent with the well known pattern of decline in these occupations. This is especially noticeable for owners, for whom the percentage has fallen dramatically from 50% to 42%. For rental households, primary/manufacturing employment was also the highest single sector, representing just over

Figure 11: Occupation of Household Head (1974, 1994)



one third (35%) of all occupations in 1982 before declining to 29% by 1994. While employment in the primary and manufacturing sectors among owners declined steadily over the two decades, among renters it occurred primarily after the 1981-82 recession.

Although not always the case, many jobs in this sector are unskilled or semi-skilled, yet, as a result of unionization, they are generally paid relatively good wages, facilitating strong ownership among working class households. The real impact of this decline in manufacturing employment and unionization remains to be seen. Without these traditionally higher paying jobs, many unskilled and semi-skilled workers will not have the same success as their forebears in securing the stable and higher wage employment required to access ownership.

While the declines in manufacturing occupations was offset among owners by professional and managerial occupations, for renters the gains were shared between the professional/managerial and the service sector -- often part time and low wage employment. Renters already had a relatively high level of employment in service occupations with just over one in four renters working in this sector.

Comparing 1974 to 1994 the data show a small decline in the proportion of heads under age 65 that have never worked or did not work in the

past five years. This statistic declined both for renters and owners. Nonetheless, the proportion of renters that have no occupation in the paid labour force (11.2% in 1994 remains double that among owners (5.5%), reflecting the higher level of dependence of government transfers, discussed earlier.

*Immigrant status*

A number of researchers have noted the relatively high incidence of immigrants, and visible minorities among renter households and have discussed the issue of racial discrimination, especially in the larger urban centres (Dreier and Hulchanski 1993, Murdie 1994, Beavis 1995). In order to assess the importance of race in the Canadian rental housing context, the statistical analysis included an exploration of trends in the number of immigrants by tenure. <sup>8</sup>

In total, the proportion of recent immigrants is quite low, less than 4% of all households in 1994 were recent immigrants (i.e. arrived in Canada

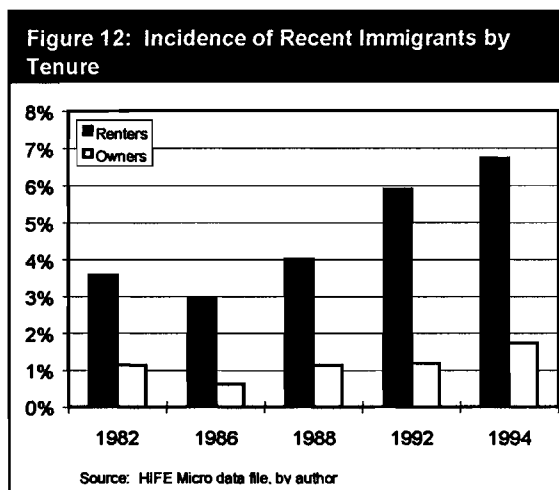
<sup>8</sup> Recent immigrants are defined as those arriving within last 5-8 years). The coding of data in the HIFE data base impose some limitations on a long term analysis. Data were grouped by immigrants arriving in certain time periods. For 1982, arrival is since 1976; for 1986 and 1988, it is arrival since 1981; and, for 1992 and 1994, since 1986. Thus some caution must be exercised in interpreting Figure 12.



## Residualization of Rental Tenure

since 1986). However, as a proportion of the total population, recent immigrants are growing in importance. Their proportion almost doubled between 1982-94. More specifically, the incidence of recent immigrants is noticeably higher among renter households.

In 1982 immigrants arriving since 1976 (the preceding 6.5 years to the survey) accounted for 3.6% of all renters; by 1992 those arriving since 1986 (a similar 6.5 year period) represented 5.9%, or almost double. Over the same period, the incidence of recent immigrants among owners hardly changed, increasing only from 1.1% to 1.2%. If examined for the large metropolitan centres where immigrants have been found in higher concentrations, it is likely that the proportions would be significantly higher (Clayton 1994).<sup>9</sup>



The representation of immigrants and especially visible minorities is expected to expand in the future, based on prevailing immigration levels combined with low rates of natural increase. While immigrants accounted for 29% of Canada's population growth over the past two decades, Kettle (1993) has projected that immigrants will be responsible for 70% of the population expansion between 1991-2031. Possibly 80% of these immigrants will continue to be visible minorities arriving from Asia, Latin America and the Caribbean. Another important

<sup>9</sup> The HIFE microdata file does not support analysis at the city level)

factor in this trend is the extent to which these immigrants will tend to be low-income renters. Since 1990, 21.5% of immigrants entered Canada under the refugee designation (Pomeroy 1996a).

## Summary of Trends in Renter Profile

This statistical review reveals a growing divergence between the characteristics of renters and owners. Renters are increasingly non-family households although the representation of lone parents has also increased noticeably. Singles and lone parents are the only household types for which the majority are renters. Throughout the past two decades, and especially in the last 10 years, the income profile of renters has continually declined with a widening income gap between tenures, especially for households in the family phase of the life cycle (25-54).

Unemployment, part-time employment, and dependency on government transfers as the primary source of income, have also risen more dramatically among renters than is the case for owners.

Among households that are employed, there is not a strong distinction between tenures on the basis of occupational classification, with perhaps the exception of a substantially higher proportion of renters in service occupations where incomes tend to be lower and less consistent.

The different and diverging income profile in each tenure is attributable more to household composition than it is to occupational status. Lone parents with young children experience greater difficulty in gaining and retaining employment and experience higher rates of non participation, part-time employment and unemployment (CMHC, 1994b).

Finally, there is a noticeable increase in the number of immigrants and visible minorities among the renter population. Comparing the late 1970's with the late 1980's immigrants have almost doubled in proportion. While still quite low at the national level is expected to be far higher and important in those centres where

## Residualization of Rental Tenure

immigration is concentrated. Many immigrants do eventually attain economic success, suggesting that it may be inappropriate to associate this characteristic with residualization. However, the reported incidence of racial discrimination indicates that barriers both in labour and housing markets may exist to marginalize these households.

## ***Part 3: Residualization and Landlord Perceptions***

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Although the statistical review provides strong evidence of a residualizing trend, it remains to ascertain whether landlords recognize the phenomenon and whether it is a concern to them. Is it a factor that is influencing the management practice and investment or disinvestment behavior of landlords?

To undertake this analysis, surveys of investors in rental properties were conducted in two Metropolitan areas: Vancouver and Ottawa.

Prior to presenting the findings of the investor survey, the literature pertaining to this issue is briefly reviewed as the issues found in this literature review were used to frame the discussion questions with investors.

The literature search found a dearth of research on the phenomenon of residualization or marginalization specific to in the private sector. However, a number of studies have discussed the related issue of discrimination, and some studies have touched on landlord attitudes.

Rental tenants are not a homogeneous group. As illustrated in Part 2, renters range in age, household composition, ethnicity, and socio-economic status. It is only specific subsets within the renter population that appear to be perceived by landlords as more risky or less desirable. Hulchanski (1994) has argued that visible minorities and women are especially likely to experience limited choice in the rental market, or to be the targets of unscrupulous landlords seeking financial gain (usually in the form of an up front premium, or 'key money').

Others have identified discrimination against families with children, especially lone parents and welfare households (Ontario Task Force on Roomers and Boarders, 1986; Ontario Human Rights Commission 1992 Annual Report 1991-92; Galster 1992). Steele (1994) suggests that landlords perceive households with children as costly to serve and therefore tend to discriminate

against them. In a specific survey of large corporate landlords in Metropolitan Toronto Hulchanski and Weir (1992) reported that six of 27 landlords (22%) representing 56% of units in the survey indicated that they would not rent to households on social assistance.

Serge (1995) explored the influence of a changing tenant profile on owner/landlords motivations in the inner city of Montreal. The study covered only small properties of six or fewer units and its primary objective was to analyze the impact of a public acquisition and renovation program. The questionnaire specifically focused on the quality of life in four districts of Montreal, and explored how this influenced the owner's motivation to invest in renovation of their investment property. Two-thirds of owners perceive the neighbourhood as deteriorating, with drugs and crime cited as serious issues.

Although Serge's questionnaire did not specifically seek out information on the characteristics of tenants, a number of owners volunteered comments. These landlords expressed concern about tenants becoming increasingly poor because higher income households were leaving to move to the suburbs.

In addition to being poor, remaining tenants are often immigrant families. Some owners openly expressed racist and anti-immigrant sentiments (Serge 1995). Serge concluded that in the core area the private rental sector is now (i.e. in the early 1990's) competing with social housing for the most under privileged client group.

In a survey in the latter 1980's to ascertain the attitudes of Québec landlords toward renting to different ethnic groups, Hilton (1989) found that 75% of landlords acknowledged that the racial/ethnic identity of applicants was important in the evaluation of prospective tenants. The study found the preferred tenants were those of a culture similar to the landlord, French Québécois. The fifty-nine landlords interviewed were neutral

## Residualization of Rental Tenure

toward English Québécois, slightly negative toward Italians and Asians and strongly negative toward renting to Haitians. Reasons for negative feelings were noise, over-occupancy of the apartment, language/communications barrier and cooking odours (especially high for Haitians) (Hilton et al 1989).

In an analysis of issues and tensions between landlords and immigrant tenants in Winnipeg, Prairie Research Associates Inc. (1992) reported a finding that 95% of landlords of immigrant tenants (referred by a settlement agency) identified immigrants as good tenants. Issues associated with 'problem tenants' (5%) included multiple tenancy, cleanliness, noise and lease violations. However, half of the landlords interviewed indicated that these problems were not unique to new immigrant tenants -- they are the same difficulties experienced with other lower income tenants.

While attempting to identify discriminatory practice, the aforementioned studies imply a combination of factors that underlie landlord attitudes towards prospective tenants. Most particularly, these involve some combination of ethnicity and low income, coupled with family composition. This limited evidence points to certain characteristics as being less desirable to landlords. Although race and ethnicity appear to have some bearing on access to rental housing in Canada, it may not be as significant an issue as income (social assistance), employment status and family composition. Clearly, any tenant associated with a combination factors that landlords consider negative will be at even greater disadvantage.

Another salient finding in the review of literature is the categorization of landlords and varying attitudes and practices between the professional or corporate landlord at one extreme and the amateur ("mom and pop") landlord at the other (Gilderbloom 1985, Lyon 1995). Gilderbloom (1985) reported that professional landlords' assessments of tenant characteristics played an important role in whether a particular unit was rented, to whom and at what price. Permanency and certainty of income together with ability to

pay rent was the critical criteria. These landlords tend to distinguish good tenants and bad tenants largely on income grounds, but also use previous references to avoid 'problem tenants'.

Amateur landlords were generally found to be less sophisticated and less probing. Often they rented to friends or family. However, in the case of small properties (such as a semi-detached house or triplex), where the landlord-owner is resident, there tends to be a high degree of selectivity, directed at identifying a compatible neighbour/tenant. In these cases, the landlords' interest is not as much on what ethnic group the applicant is from, but whether this ethnic group is compatible with his own.

Whether attitudes toward specific tenant subgroups vary between the amateur versus professional landlord is not clear from the literature. However, due the size of their holdings, professional landlords, may be better able to exercise their attitudes and preferences. Gilderbloom (1985) found professional landlords, typically with larger holdings, were more likely to hold vacancies rather than rent to less desirable tenants, while smaller scale semi-professional and amateur landlords are less able to do this as they cannot carry the vacancy loss. Also, the behavior of amateur landlords varies depending on extent to which property is mortgaged. High mortgage payments dictate minimizing vacancy and below market rents; having no mortgage permits greater flexibility.

Over the past decade, a number of Canadian cities have been characterized as relatively regulated markets with little new supply but tremendous demand (Clayton 1991). Economists have asserted that, theoretically, landlords in such markets are able to ration their scarce resource, and to be highly selective in their choice of tenants (Fallis and Smith 1985, Smith 1988, Stanbury and Todd 1990).

These assertions imply an important distinction between discrimination and selectivity. As operators of a business enterprise, landlords make decisions to protect their investment.

## Residualization of Rental Tenure

Arguably, exercising a choice between prospective tenants is not necessarily discriminatory. However, the end result is that the 'less desirable tenant' experiences greater difficulty in addressing their housing needs.

While often justified as sound business practice, Lyon (1995, p 45) asserts

*'the practice of screening tenants on the basis of minimum income criteria seems to have evolved from commonly held prejudices and attitudes, without any statistical or professional studies on which to base these practices'*

In this context, Lyon (1995) examined the impact of bad debt on the profitability of rental properties. The basis of the research was a hearing of the Ontario Human Rights Commission, in which the practice of screening tenants for minimum income (an indirect way to preclude welfare households) was being contested.

Lyon undertook a detailed analysis of actual bad debt losses in the industry (for Ontario) and, taking into account the legal and administrative costs associated with pursuing an eviction, concluded that tenant default is not a significant factor in determining the viability of a rental property. Bad debt accounted for an amount equal to 0.5% of gross income. Even if the level of bad debt doubled it would still impact capitalization rates by less than 0.2%. To the contrary, Lyon suggests that the practice may be counter productive, since vacancy loss, which is directly impacted by rejection of so called 'high risk tenants' are a more significant variable than the bad debt claims.

Similarly, a study by a Quebec landlord association determined the average annual loss associated with renting to social assistance recipients to be \$600, an amount that falls within the range determined by Lyon (Centrale Immobilière Mérite Inc. 1993).

On the basis of this assessment by Lyon, one would expect the hypothesized residualization of

rental tenure to have no impact, or at worst, a very limited impact on project viability.

Reflecting the notion of good business practice, the Property Management Handbook of the Toronto Property Management Association counsels property managers:

*'in order to keep the property leased, the property manager must attempt to obtain the highest possible rent commensurate with the selection of good quality tenants and the minimization of vacancy losses'* (Lyon 1995: *italics added*).

Although 'higher quality tenant' is discussed in the context of credit worthiness, and the intent of the guideline is to protect landlords against loss, this practice nonetheless lessens the opportunities for households not perceived to be 'good quality tenants'. Hulchanski, (1994) expresses the opinion that "this clearly discriminates against all lower income households, independent of their personal history and credit rating".

Regardless of the underlying motive of any particular landlord, if the pool of prospective tenants from whom landlords can select is becoming residualized, landlords will tend to reject a higher proportion of applicants. In theory, the consequence, over time, is that rental properties will experience higher vacancy rates, and vacancy losses. This in turn should reduce the value of properties and, theoretically attract new investors. However if investors identify with the difficulty in attracting and retaining so called "higher quality tenants" they may be less willing to enter this market.

Although vacancy rates have increased in most metropolitan areas since latter 1980's, and despite the very limited levels of rental development, it is not possible to ascertain from existing data whether the softening vacancy levels are influenced in any way by the changing profile of the tenant pool. Other factors have influenced rental vacancy rates including exiting of tenants into ownership and the trend of young adults moving back to the parents home. The relative influence of each of these factors is

## Residualization of Rental Tenure

explored in the following section on the investor survey.

### Investor Survey

The core component of this research involved a series of interviews with two groups of investors in private rental investment properties. To test the hypothesis of residualization, it was determined as part of the research design that it would be most useful to speak to investors who have exited the rental market, divesting themselves of their rental properties. It was also expected that recent purchasers would have different expectations and perceptions. The fact they have recently purchased would suggest that, at the time of purchase at least, they saw this as a viable investment, relative to alternatives.

The two markets, Ottawa and Vancouver, were selected in part based on the researcher's familiarity with these two markets, but also on the differing conditions in these two markets -- Vancouver with high demand and low vacancy rates and Ottawa with historically high vacancy levels.

The survey of investors was undertaken respectively in Vancouver and Ottawa in April and June 1997. The research was exploratory and qualitative in nature. The research plan involved the identification of 15 transactions in each centre, with interviews with both the vendor and purchaser if possible (i.e. a total of 60 interviews). This sample size is insufficient to support quantitative analysis. Nonetheless, an effort was made to select the subject properties and associated investors objectively.

In each centre, properties were systematically selected from a chronological listing of transactions of rental investment properties that had occurred between January 1993 and December 1994, in Vancouver and between January 1993 to December 1995 in Ottawa.<sup>10</sup>

<sup>10</sup> In Vancouver, the sampling frame included only the City of Vancouver and inner suburbs of New Westminister, Burnaby, and North Vancouver. The sampling frame for Ottawa was extended one year,

This sampling frame, summarized in Table 3, provided 148 transactions with a total of 3,602 units in Vancouver and 95 transactions covering 2,149 units in Ottawa. Summarizing the actual sales in each centre (Table 3), it can be seen that the majority of properties are quite small, averaging only 23 and 24 units in the two centres. Two thirds of the properties had less than 20 units. The larger properties account for few transactions but make a more substantial contribution to the overall stock. In Vancouver, 8% of the properties sold accounted for 36% of the units; in Ottawa the larger properties made up 13% of the transactions and represented just over half of the units sold.

**Table 3: Sampling Frame**

Distribution	<11	11-20	21-50	51+	Total
<b>Ottawa</b>					
units (2,149)	17%	7%	26%	51%	100%
Properties (95)	57%	12%	19%	13%	100%
Average # units	7	13	31	91	23
<b>Vancouver</b>					
units (3,602)	12%	16%	36%	36%	100%
Properties (148)	38%	27%	27%	8%	100%
Average # units	8	14	32	109	24

To generate the sample for interviews, each sixth transaction was selected and an attempt was made to identify and contact both the vendor and purchaser of each property, although this was not always possible. Where only one of the parties was contacted, these were retained. When neither party could be contacted, the next transaction below the unsuccessful one was selected. In total, 27 investors were interviewed in each city, split between vendors and purchasers (13 or 14 of each).

Reflecting the distribution of the rental property universe, a large number of transactions involving smaller properties inevitably appear more frequently in the survey of investors. In the case of the larger properties, sales typically involved either numbered companies or institutional investors. There was some

through 1995, due to difficulty in identifying and contacting vendors and purchasers.

## Residualization of Rental Tenure

difficulty in making contact with some of these numbered companies. Where contact was successful, the general response was that the purchase or sale was a result of a decision at a portfolio level. It was not necessarily based on the specific property. For example, a life insurance company had chosen to move out of rental apartment investments in Ottawa.

### Market Context

As the study explores the attitudes of investors toward the rental sector, it is critical first to place the results of the survey in context. The two CMA's used in the study provide a distinct contrast in the market conditions. This has a direct bearing on the results discussed in the next section.

Vancouver has, for some time, had one of the lowest vacancy rates in the country (Figure 13). In part, this is a function of the relatively high cost of homeownership, which causes households to remain in the rental market for a longer duration than is the case in more affordable centres.

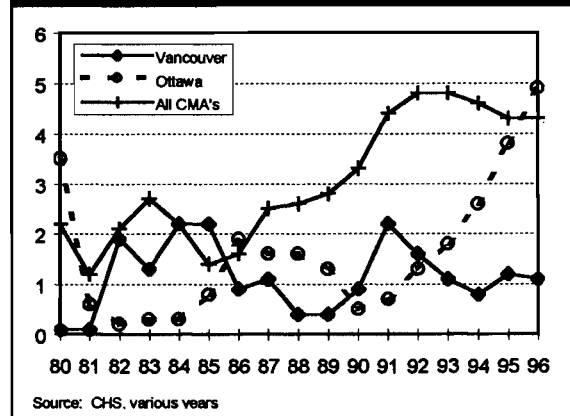
During the period under study (1993-95), the apartment vacancy rate continued to fall. This was a result of prevailing high demand, juxtaposed by both a low level of new construction and a loss of rental stock due to conversion of rental units into condominiums (CMHC 1996a). In 1992 over 8,000 rental units were converted for sale. This rate declined to only 650 units in 1996 as the condominium market softened. Although municipal bylaws regulate conversions, many properties were strata titled at construction and can thereby be readily converted. Since 1993, only 3,650 rental units have been constructed in the Vancouver CMA (CMHC 1996a).

Ottawa, in contrast, has followed the rising trend in rental vacancy rates that have characterized many centres across the country through the 1990's. In many centres, the principal cause has been attributed to the historically high level of affordability of ownership, which directly

impacts the rental market by drawing away demand. Although, like all centres, homeownership affordability has been improving in Ottawa, this is not excessively high by national standards (in 1996, it ranked 22nd out of 27 CMA's on the CMHC affordability index). However, the Ottawa home building industry has actively targeted the first time buyer with 78 per cent of new homes built in 1996 affordable to first time buyers (CMHC 1996b).

The other significant contributing factor that permeates all centres in Ontario, is the relatively high level of assisted housing starts generated by the province's non-profit housing program. Since 1990, the non-profit sector has added almost 4,000 units to the Ottawa market, with the single largest level of new starts in 1991 (some 1600 units). In the early 1990's these were augmented by a further 500 units of private rental construction each year. This level of activity has declined considerable as the non-profit program was canceled in 1995 and high vacancy rates have tended to suppress interest in private rental development.

Figure 13: Rental Vacancy Rates - Average and Selected CMA's



Transactions of existing rental properties provide a useful indicator of the general perspective of real estate investors toward rental apartment investment. Although influenced by many of the same factors impacting the economics of new development, existing properties are not impacted by development costs and levies. Moreover, while demand side influences are an important consideration in contemplating new development,

## Residualization of Rental Tenure

existing properties are already built and have usually adapted, or are in the process of adapting to these influences (e.g. conversion during a period of strong condominium demand).

The value of existing properties is derived from the current and anticipated rental cash flow, in combination with investor's desired rates of return. In larger urban centres in Canada, existing multi-unit rental properties are typically priced substantially below the cost of new production (where land costs are held up by the condominium ownership sector). As real rents increase, these existing properties will reap the benefit long before new development becomes viable. Accordingly, one would expect to see some activity in the transaction of existing rental, and, in the face of low production and anticipation of rising rents, a decline in the capitalization rate.<sup>11</sup>

In the late 1980's, capitalization rates in Toronto were in the range of 5-8%, (Lyon 1995) reflecting the speculative environment and rising real estate prices (which incidentally were not premised on the fundamentals: the future income stream; but rather on expectations of capital gain). By 1995 Royal LePage reported cap rates in the range of 9.5-10.5 in both Toronto and Ottawa. Royal LePage also reported that, in 1995-96, the price range of rental investment properties in Ottawa was between \$38,000-\$50,000 per unit.

Vancouver also exhibited very low cap rates (5.0-7.0%) through 1989-90, largely as rental supply remained very tight and both inter-provincial and international migration fueled strong rental demand. In 1995, Royal LePage's market survey identified the Vancouver cap rates between 7.0-8.0% and the price range of rental investment apartment units between \$100,000 and \$125,000 per unit. The increase in

<sup>11</sup> The capitalization is the factor used to determine the value of an existing property, based on net operating income. Lower capitalization rates are associated with properties perceived as low risk and those with expected increased revenue potential. Thus, one would expect to see a declining trend in capitalization rates in a tightening market.

capitalization rates in Vancouver is an indicator that investors are become somewhat more cautious about this market than was the case in the early 1990's.

Overall, in the period covered by the survey, the Vancouver rental market remained very tight and existing rental properties continued to command relatively low capitalization rates, indicating that they were generally seen as an attractive investment. The Ottawa was, in comparison, much softer. The weak market and consequent low values in Ottawa offered some opportunities, however, the higher capitalization rates reflect a more cautious attitude on the part of investors in general.

## Survey results

This section reviews the findings from the interviews with investors. Although some data is presented, the reader is reminded that this was an exploratory study. The sample was not large enough to draw statistically valid conclusions. However, the results do provide a flavour of the issues and a sense of the attitudes of investors about rental housing.

Table 4: Distribution of Properties Sampled

Project Size	Vancouver	Ottawa
< 11	6	15
11-30	8	2
30-50	2	3
50+	0	1

### *Characteristics of properties*

Reflecting the transaction profile, the majority of properties in the survey were small in size, especially in Ottawa where properties of 6-8 units are common. In Vancouver, the majority of properties captured in the survey were mid sized properties. A larger property (over 100 units) was captured in the Ottawa sample and both vendor and purchaser were contacted.



## Residualization of Rental Tenure

**Table 5: Property Values of Selected Sample (at recent sale)**

Value/unit	Vancouver	Ottawa
< \$30,000	0	3
\$30,000-\$50,000	1	6
\$50,001-\$65,000	3	6
\$65,001-\$80,000	5	4
\$80,001-\$100,000	4	1
\$100,000+	3	1
	16	21

Both the values per unit and rent levels provide some indication of the quality of the properties in the survey. For the most part, the cases encompass the mid-range in the market. In Ottawa, most properties were valued between \$35,000-\$70,000 per unit (the top end reflecting 3 bedroom town homes); in Vancouver the majority sold for a per unit price of \$50,000-\$100,000. The sales values of the selected sample in Ottawa were quite typical of those reported by Royal LePage, but in Vancouver the sample had values in a lower range than the Royal LePage figures.

Similarly, rent levels tended to cluster in the mid-range of rents with most bachelor and one-bedroom units (the predominant unit types) renting in the \$300-\$650 range. Two-bedroom units clustered around the \$650-\$800 rent level. At these rent levels, the properties are not generally exclusive to higher income renters, nor are they very low rent properties. In both cities, the sample was quite diverse in geographic distribution.

The majority of properties were between 20-30 years old, although the Ottawa sample tended to include a number of properties built between the wars. The newest property was a small 6-unit apartment constructed in Vancouver in 1986.

### *Characteristics of investors*

Most of the vendors and purchasers contacted in the survey were small investors owning only the subject property. Among the one third of owners that had other properties, most holdings were quite small, generally comprising only three or four small properties and generally less than 60 units in total. Eight of the 54

owner/investors contacted indicated that they were personally in the real estate business and held the property in a company whose principal business was real estate. A little more than half of the properties were owned by small partnerships involving either relatives or unrelated partners. Four owners currently or previously occupied one of the units in the property themselves.

Reflecting the small, single property investors, most undertake property management themselves, rather than contracting for the services of professional property managers. In short, the investors were predominantly non-professional "Mom and Pop type landlords (Gilderbloom 1985). This is a particular type of investor and, as a result, the findings do not necessarily reflect the views of larger corporate and institutional investors. However, the reality is that the majority of properties (albeit not units) are owned by small investors. Only five of the investors retained professional property managers, and these tended naturally to be the properties with a large number of units.

As part of the exploration of investor attitudes toward immigrants, the investor was subsequently asked to identify his/her own ethnic origin. In both Ottawa and Vancouver, immigrants represented four out of every 10 investors (split more or less evenly between vendors and purchasers). Despite the perception that Vancouver has experienced a high level of immigration and investment from Asia, there does not appear to be a noticeable difference between the two centres in terms of immigrant investment in rental properties.

### *Reasons for investment*

Investors provided a wide range of anticipated responses as the primary reasons for their initial investment. For those that owned other properties, the subject property had generally been acquired to expand the portfolio and was seen as a good investment at the time of acquisition. Generally, investors were looking for either a capital gain or a supplementary source of income. In a number of cases the

## Residualization of Rental Tenure

investment was seen as their retirement nest egg. Many of the vendors had owned the property for some time -- four for more than 25 years.

**Table 6: Years Property Owned by Vendors**

	Vancouver	Ottawa	All
Since 1990	5	4	9
1980-89	7	5	12
1970-79	1	1	2
pre 1970	1	1	2
DK/Refused		2	2
Total	14	13	27

In almost all cases, investors saw this as a long-term investment, the vast majority indicating that, at the time of purchase, they intended to hold the property indefinitely. With the exception of one case in Ottawa where a property had been held for only 3 years with the express purpose of flipping it for a capital gain, there was no evidence of a speculative interest in either of the two markets.

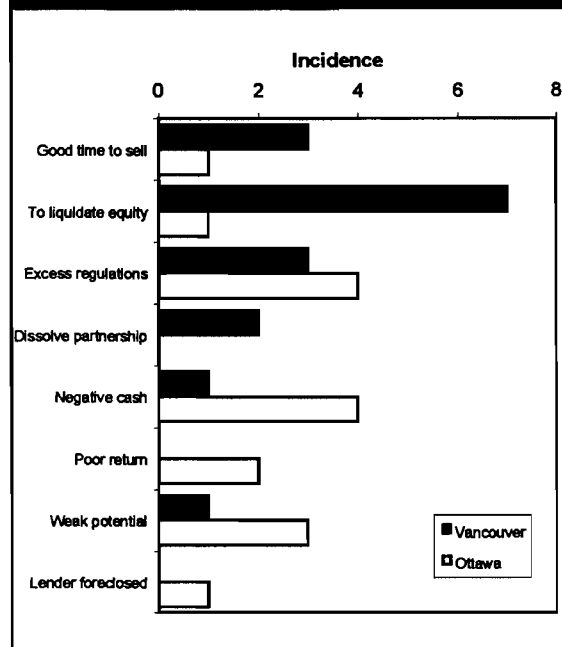
### *Reasons for sale*

A central component of the study was to determine whether investors identified with the documented trend of residualization, as defined in Part one, and whether they factored this into the decision making process. Early in the discussion, vendors were asked to indicate the reasons that they had chosen to sell their property. None explicitly identified any factor directly implicating the hypothesis of residualization. However, the majority of cases proffered relatively negative reasons for the sale -- especially in the softer Ottawa market.

Vendors identified a range of different reasons for the sale -- they were losing money; it was too much hassle (most self managed the properties); regulation was excessive (a factor in both Vancouver and Ottawa); and they saw little future potential (Figure 14). In one case, the lender had forced the sale through foreclosure.

The premise for selling in Vancouver mirrored some of the Ottawa sentiments, however the reasons for sale, in Vancouver, were stated in a generally more positive context (Figure 14).

**Figure 14: Vendor's Reasons for Sale**



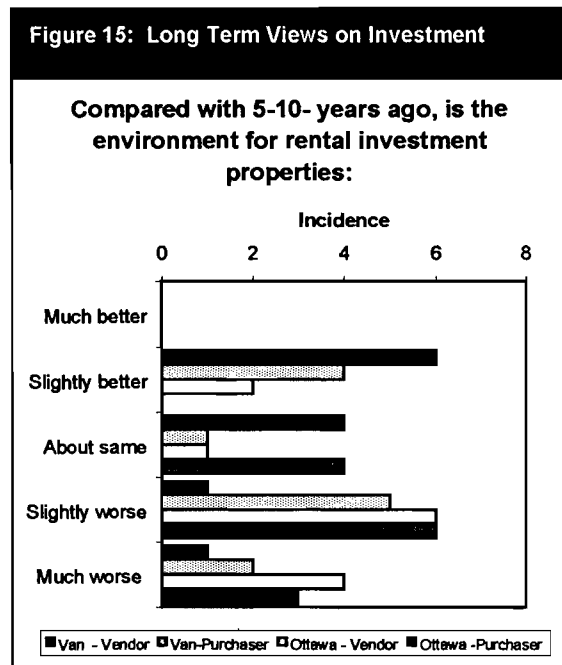
A number of investors expressed a view that it was a good time to sell. Others were less explicit in their reasons, indicating only that they wished to liquidate some equity. This included some longer-term investors who were seeking to liquidate the asset for retirement.

The motivations for sale were, in the main, economic, including both negative and positive influences in the respective rental markets.

### *Perspectives on rental market investment*

While the reasons for sale provide some insight into the particular views of vendors on rental investment, the survey sought to generate a greater understanding the degree to which both those exiting the investment and those purchasing, perceive a change in the nature of this investment opportunity. Most of the investors interviewed had owned rental properties for more than 5 years (in addition to the vendors, 11 of the recent purchasers held other properties either concurrently or previously).

## Residualization of Rental Tenure



When asked how the investment environment compared to that 5-10 years ago one quarter felt that the environment for rental investment today is slightly better and one in five believe it is about the same (Figure 15). Notably, more than half (30/54) expressed the view that the situation today is either slightly worse or much worse than 5-10 years ago. No respondents expressed a view that the situation is much better.

There was no clear distinction among vendors and purchasers. The distinctions were more evident by city, reflect the specific market context. As the previous review of the market context would suggest, the Ottawa investors tend to cluster around view that the investment environment is worse -- only one Ottawa investor felt that it was slightly better and a few felt it is about the same. The investor who felt the situation is better is a professional real estate manager who was carefully selecting sound investment properties. His positive view was based on the prevailing low level of interest rates, combined with what he perceived as opportunities for bargain investments.

The more predominant view in Ottawa was a general perception of a soft market and higher vacancy rates. A few investors cited high

property taxes and excess regulation as the primary reasons for their negative sentiment.

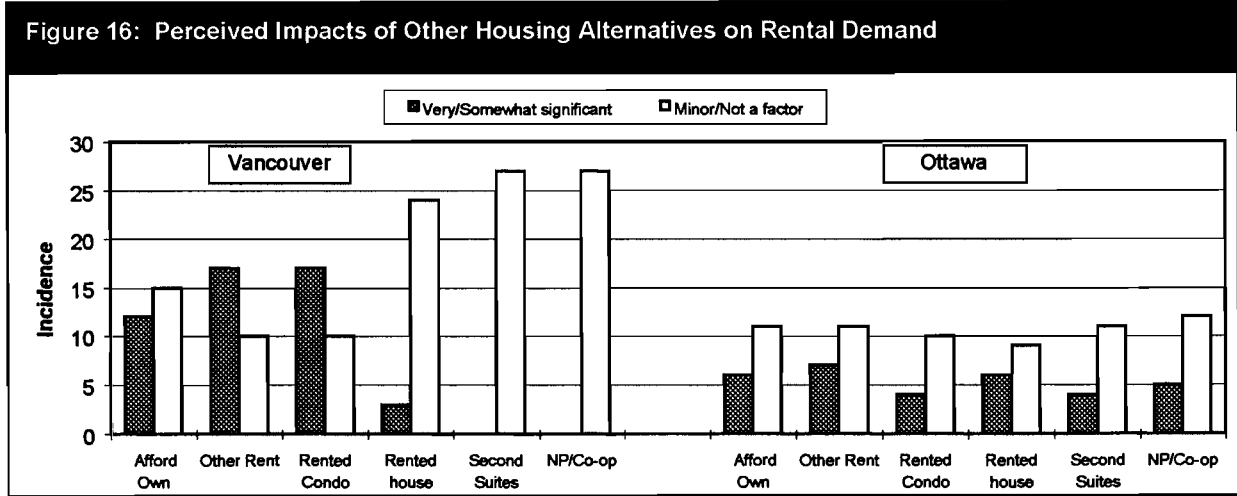
Although not overwhelmingly favourable, the Vancouver investors expressed a generally more positive view, at least on this particular question. Two thirds identified the environment as slightly better, or about the same as it was 5-10 years ago. Among the third that saw things as slightly better, the primary reason was the prevailing high level of demand, especially from immigrants, and the associated opportunities for low vacancies and a good cash flow. The principal cause of pessimism was a perceived oversupply and competition from condominiums, as well as some concerns with regulation.

Overall, two thirds of respondents said that demand had softened. All but two investors in Ottawa felt this way; in Vancouver only a small minority agreed that demand had softened.

The difference between the two markets was readily apparent in the cash flow performance of projects. In Vancouver, all but 5 investors reported positive cash flows (for vendors this was for in the last year of ownership), and the same number expressed satisfaction with the level of return. In Ottawa, however, only eight properties provided positive cash flows and met the expectations of the owners.

The rental housing sector functions in the context of the larger housing system which offers a number of alternative options that potential rental tenants may find attractive or preferable. In theory, the stability and viability of rental investment properties is influenced by these other alternatives. The study investigated the extent to which rental investors perceive certain alternatives to have an impact on the viability of their property. Specifically each investor was asked to indicate how important each alternative is in terms of affecting tenant turnover (and potentially vacancy levels).

The results of this question are presented in Figure 16. Investors in both cities were more or less split on whether or not the increasing affordability of homeownership options



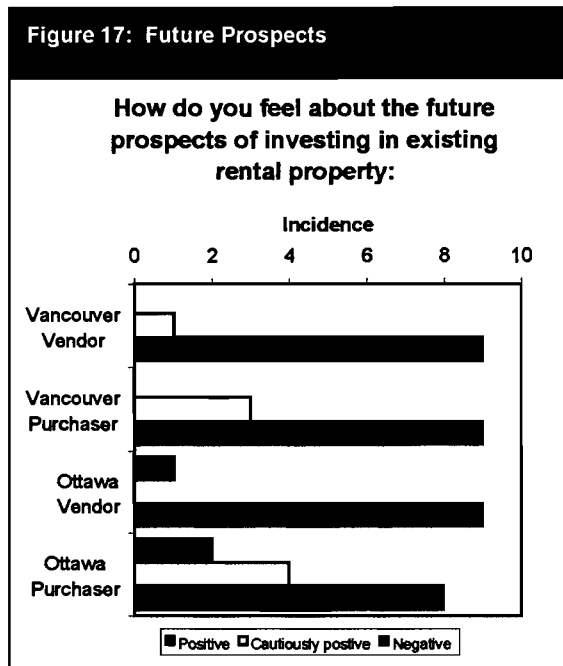
(including condominiums) is affecting their vacancy rate. Other rental properties and rented condominiums in Vancouver appear to be a well-recognized factor. Overall, investors in Vancouver seemed to have a greater appreciation of, and attach a greater level of significance to, the impact of the other options available to their clients. Despite the generally poor performance of the rental sector in Ottawa, investors there tended not to identify this with competition. In Ottawa, although landlords linked their difficulties more often than not to a weak market, they did not see the housing system as the cause of this market weakness. Rather they tended to associate their difficulties more with tenants -- both in terms of a shortage of tenants, and concerns about tenant behaviour

Although secondary suites or apartments in homes as they are referred to in Ontario, have from time to time generated considerable attention -- largely through attempts to legalize this option in both cities -- these were rarely identified as a factor. Similarly, although the high level of non-profit development in Ottawa between 1990-94 directly impacted the vacancy rate, very few landlords identified this as a factor that affected their turnover.

At the end of the interviews, investors were provided an opportunity for open-ended comment on the future prospects of investing in rental properties. This complemented the earlier question, reported on above (Figure 15), that

asked investors to compare current conditions with those 5-10 years ago.

The outlook, from the perspective of investors was not very promising (Figure 17). A generally negative outlook was consistent across both vendors and purchasers and across both cities. Even in Vancouver, where the market is much tighter, investors had a noticeably reluctant attitude about future investment prospects.



A number of investors provided comments that combined both positive and negative feelings -- in

## Residualization of Rental Tenure

Figure 17 these have been label cautiously positive. These included comments such as

- “The market is over regulated; but its a fairly safe investment”
- “If willing to put up with hassles it could be ok”
- “Need to carefully inspect property, maintenance costs could be prohibitive”
- “Lenders tough, market improving”
- “Reasonable outlook, rent controls a disincentive”

Concern about excess regulation of the rental sector was predominant in the opened-ended outlook comments. Though evident in both centres, this was especially the case in Vancouver. Most of the comments on prospects reflected investor's poor recent experience -- many were small investors and regret their investment. “Never again” was a recurrent theme, especially in Ottawa.

At the same time there was a degree of optimism among certain, more sophisticated, investors in Ottawa. Those involved professionally in the real estate business, and therefore likely to be armed with a higher level of knowledge, tended to reflect a more analytical view.

From the conversations during the interviews, it was evident that these more professional investors understood the longer term implications of very low construction activity, the strengthening trend in the Ottawa economy and the potential impacts of the pending Tenant Protection Act (which will ease rent controls in Ontario). Accordingly, they felt that prospects were good, at least for selective investment.

### *Perspectives on tenants*

Tenants are a core element of the rental investment. While technically purchasing a physical asset in the form of property, the rental investor is in fact purchasing a stream of revenues that derive directly from the rents charged to the tenants housed. The investor implicitly agrees to provide a service in return for this income stream and, as suggested in the

earlier literature review, will naturally seek to optimize the selection of tenants in order to minimize his financial costs and administrative burdens. As a consequence, landlords can be expected to be selective in accepting tenants. The survey sought to investigate whether the practices of investors tended to favour or exclude certain types of tenant.

The questionnaire first inquired about the screening criteria used by landlords. The predominant form of screening criteria, required by two thirds of landlords, was a reference from a previous landlord. Almost one third of landlords indicated that they used income as a criterion, but very few sought verification - a few asked for a letter from an employer. No doubt reflecting the small-scale non-professional characteristic of most owners, very few use a formal credit check.

Professional property managers (including contracted management firms and individual professional owners) indicated that they use the full range of screening criteria -- letters to verify income, references and credit checks.

In the case of welfare households, the source of income is the welfare benefit, and ability to pay rent is more specifically dependent on the adequacy of the shelter component of the welfare payment, and the willingness of the tenant to use this benefit to pay the rent. Asked if their rents were generally above or below the welfare allowance, approximately one third were unaware of the welfare rate. One-third knew their rents were above the welfare housing allowance and the other one-thirds knew that they were below the maximum shelter benefit.

When asked whether they accept welfare households, the majority (29) of respondents indicated that they do -- nine said they did not, and 14 chose not to respond to this question. This is a similar finding to that reported earlier for Toronto (Hulchanski and Weir 1992).

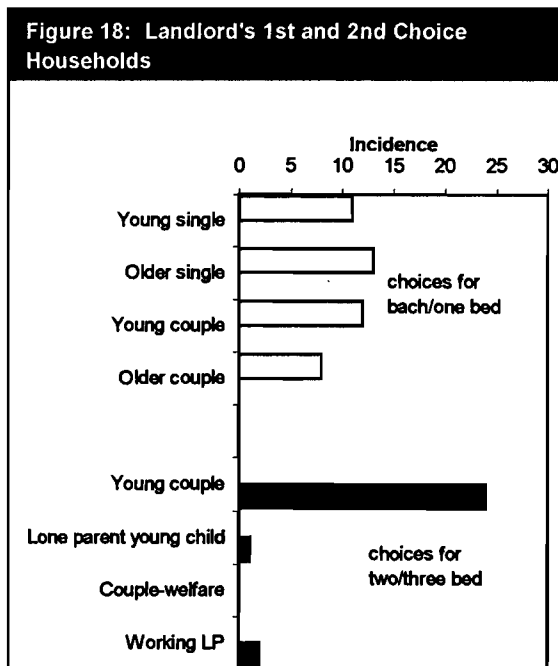
The properties associated with landlords that prefer not to rent to welfare households did not

## Residualization of Rental Tenure

share any consistent characteristics -- although all but one was in Ottawa. This may reflect a combination of a softer market, in which welfare reform cut benefits by 21% in late 1995, causing difficulties for welfare tenants, and consequently for landlords.

In the process of renting a vacated unit, landlords are often faced with a choice among occupants, especially in a tight market. Given a choice between four household types for each of a bach/one bed unit and subsequently for a 2-3-bedroom unit, the investors were asked to indicate which would be their preference (household types are identified in Figure 18).

It should be noted that a number of landlords felt uncomfortable in making this somewhat hypothetical forced choice -- in reality choice would depend on their general impression of the applicant (gut feeling) and references.



When forced to make a decision, there was no distinct preference among young and older singles and couples for a bachelor or one bedroom unit (Figure 18). For the larger unit, given a choice between:

- a young couple;
- a lone parent with a child under 5;
- a couple on welfare; and

- a working lone parent

landlords expressed a strong preference for the a working tenant -- young couple (1<sup>st</sup> choice) or working lone parent (2<sup>nd</sup> choice). In no cases did a landlord indicate that their first or second choice would be a household on welfare. Even though it was not among the choices offered for the larger unit, four respondents identified a senior couple as their preferred choice.

A further option available to landlords is that of holding a unit vacant while waiting for a 'good tenant'. Obviously there is a cost involved in the form of lost revenue. When asked, in a separate question if they would prefer to hold a unit vacant for one month to await a good tenant, or rent it to fill the unit, two thirds of the owners indicated that they would consider holding the unit vacant. A number of investors in Ottawa, articulated the opinion that it takes 2-4 months to legally evict a tenant for arrears or damages and these costs far outweigh the loss incurred in holding a unit vacant to secure a "better tenant"

To some degree, this may reflect the unanimous view that there are both good and bad tenants. Asked to identify the characteristics of a bad tenant, most identified concern about non-payment of rent and noisy or disruptive behavior. Few, however, were able to articulate how they screen for "bad tenants" beyond a reference or income check. A few responded that they used their gut feelings when showing the apartment. Physical appearance -- cleanliness was often cited as an indicator.

Pets were identified as undesirable by one third of owners. A few landlords explicitly cited children, welfare households and single parents among tenants they considered less desirable.

Asked if they felt "comfortable accepting households with children, those with lower income or on welfare, provided that they respect the property and pay the rent", very few investors disagreed with this statement (largely due to the proviso that they respect the property and pay the rent). However, in advance, a landlord does not know whether this will occur

## Residualization of Rental Tenure

and must therefore make a value judgment about the applicant.

There was some evidence that owner-investors are willing to adapt when tenants experience difficulties in paying the rent. Ten owners confirmed that, in response to a request from a tenant, they had made specific arrangements to help tenants unable to pay rent. Half of the owners said they had never had such a request and only one admitted that they had been asked but rejected the request. Another investor said in some cases he had negotiated an arrangement while in other cases he had not been able to come to a satisfactory arrangement.

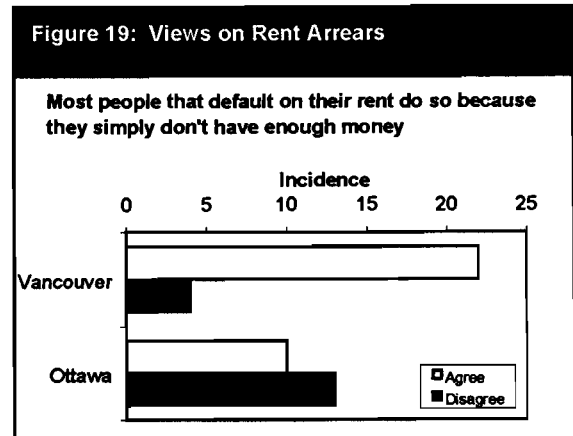
In a corroborating question, later in the survey, investors were asked to indicate their agreement or disagreement (either mildly or strongly) with the statement "*As a landlord I have no responsibility to assist a tenant that has lost their income*". Approximately one third of the investors disagreed -- implying that they feel they do have some responsibility.

Again, the willingness to work things out with tenants may reflect the small-scale non-professional landlord and small scale of many of the subject properties. As these are, in most cases, self managed, the investors often know the tenants personally and may meet with them while collecting rents, or performing building maintenance.

At the other end of the scale, a number of the investors felt that tenants abused the landlord, expecting a service without honoring their obligations to pay the rent. This was especially notable in Ottawa. Asked whether they agreed or disagreed with the statement "*most people who default on their rent do so because they simply do not have enough money*", investors in the two cities provided noticeably different views (Figure 19).

Those in Vancouver were in strong agreement with this statement. In Ottawa, however, the majority of investors disagreed. In discussing this issue they expressed a view that tenants had money but saw their rent as a lower priority. A

number noted poor money management on the part of tenants while a few said they saw tenants buying beer or cigarettes but falling into arrears in rent.



Although immigration levels have been quite high in both Vancouver and Ottawa and have included a significant number of immigrants admitted under refugee status, immigrants or minorities were not identified as an issue. Almost 60% of investors have had some experience with immigrant tenants. Of these, the vast majority said the behavior of immigrants and minorities is no different than any other tenant. A few said they were better, while others cited some bad experiences but on the whole these balanced out.

### *Residualization hypothesis*

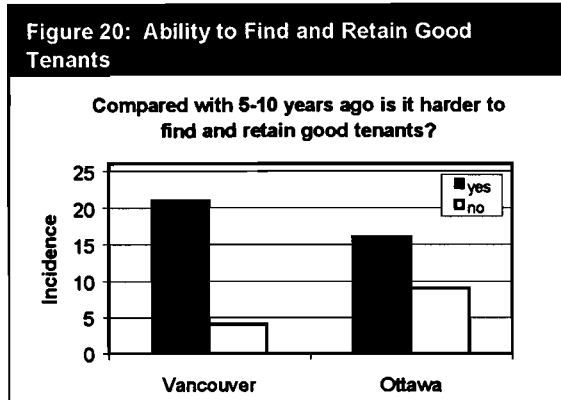
Much of the preceding discussion relating to attitudes toward tenants as well as general perspectives on rental investment experience and prospects has already provided some sense about the phenomenon of residualization, the primary focus of this research. As discussed in Part 1, the term is used in this study to refer to a negative change in the socio-economic profile of tenants, in particular lower income.

Although this concept is difficult to capture in a single indicator, a number of questions were developed and used in the questionnaire. First, early in the interviews, each investor was asked whether "*during the past 5-10 years it has become harder to find and keep good tenants*". After discussing the characteristics of recent

## Residualization of Rental Tenure

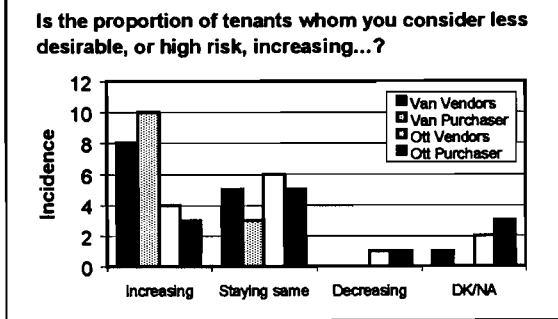
tenants and their characterization of “better” and “less desirable tenants,” investors were asked whether the proportion of tenants whom they consider less desirable, or higher risk is increasing. Immediately following this question, vendors were then asked whether the changing profile of tenants was a significant factor in their decision to sell; purchasers were asked whether this trend was a concern in their property.

In both cities, investors expressed a fairly strong view that it has become harder to attract and retain “good tenants” (Figure 20). Surprisingly, given the relatively tight rental market in Vancouver, a higher proportion of vendors in that city felt this way. Among those that said that it is not harder were the owners of properties renting at the higher rent levels. There was a fairly even mix of vendors and purchasers and also a number of owners of properties that did not have a positive cash flow.



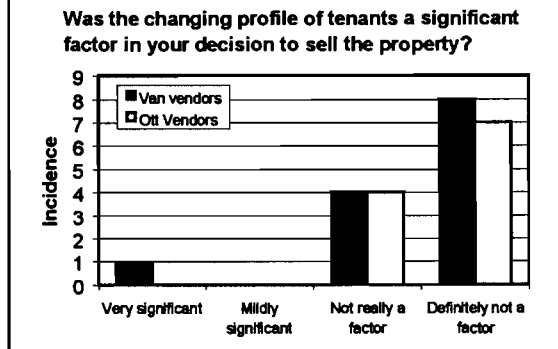
Further acknowledgment of a negative trend in the characteristics of tenants is similarly evident in the response to the question “*Is the proportion of tenants whom you consider less desirable, or higher risk increasing?*” As illustrated in Figure 21, most of the investors in both cities noted an increase in the proportion of higher risk or less desirable tenants. There was a greater degree of non-response to this question in Ottawa, but the response was noticeably consistent in Vancouver. Very few investors felt the trend was decreasing.

**Figure 21: Incidence of Higher Risk Tenants**



Note, however that this question was asked in the context of the overall market. In an earlier question that asked about the profile of tenants in their own property, the vast majority of investors responded that the profile had not changed. For the few properties where the tenant profile had changed, it was often a result of the selection and management practice -- i.e. favouring older mature tenants.

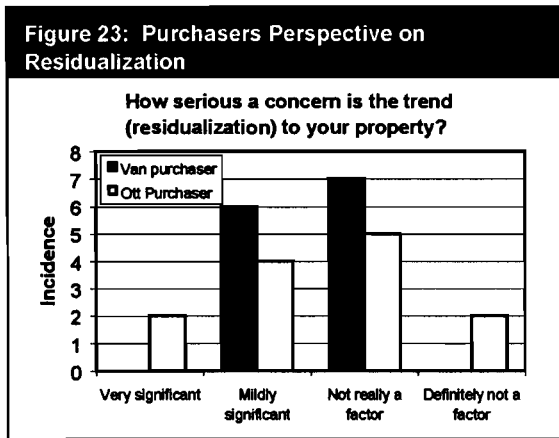
**Figure 22: Residualization Not a Concern for Vendors**



When asked whether this trend was a concern in their own property or a factor in their decision to sell, it appears that the recent vendors had not internalized this perception into their decision making process. Figure 22 reveals that, among vendors, there was a very strong view that this was not a factor in their decision to sell.



## Residualization of Rental Tenure



However, a sense that residualization is becoming a concern appears to be emerging among recent purchasers, although they were fairly evenly split on the question of whether or not this is a concern in their own property (Figure 23). A very small majority said that this is not a concern; meanwhile almost half of those that responded acknowledged that it is becoming a mildly significant concern. Two of the Ottawa purchasers held the stronger view saying that this is a very significant concern in their property. These were both long-term investors (more than 20 years) who held properties with rents at the lower end of the rent range and had high vacancy rates.

In short, while there is a mild awareness of a shift in the nature of rental demand, few investors have explicitly identified this and in general have not yet tended to factor this into their decision making process (relating to investment or divestment decisions or to screening practices).

### *Perspectives on government interventions*

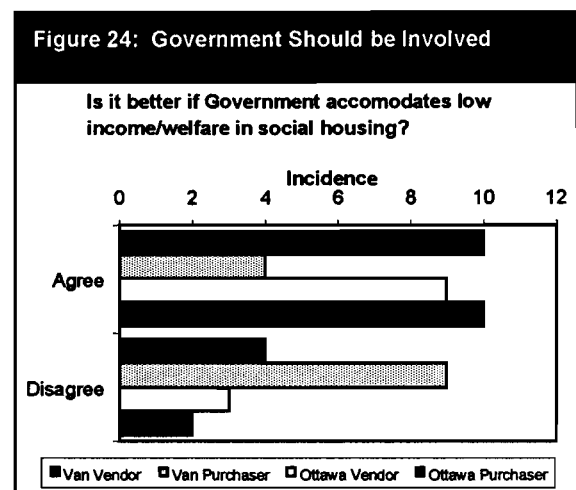
The final part of the interview explored the investor's perspectives on government intervention in the rental market. Throughout the survey, respondents referred in various sections to concerns about the extent of regulation. This seems to be a concern in both Vancouver and Ottawa. The survey did not purposefully examine this issue, as it has been the subject of extensive research and debate. Rather, the questions concentrated on potential policy options that might concurrently address concerns of both tenants and landlords -- the inability to

afford rents and consequent problems of arrears and evictions.

The questionnaire first sought to determine general attitudes of investors regarding the legitimacy of government intervention specifically to address the housing needs of low income and welfare households. Two value statements were posed and investors asked to indicate their level of agreement and disagreement.

The two statements were inverted to cross check attitudes. The first asked whether the investor believed that *"it is better if the government accommodates households with lower incomes or those on welfare in public and social housing"*. The second statement asserted that *"there is no need for social housing; private sector landlords can provide all the accommodation required, even for low income households"*.

There is a subtle distinction in the two statements. The first investigates the degree to which investors feel that it is better for the government to perform this role. The second statement takes the opposite view but is far more categorical and exclusive. It asked whether the private sector was capable of fully addressing this need, with absolutely no direct government role in the provision of social housing.

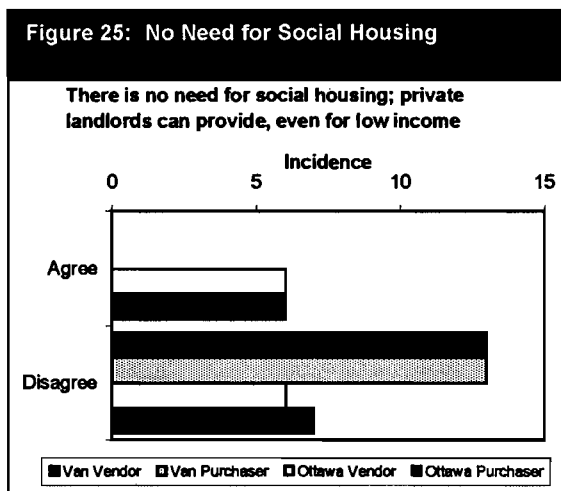


In response to the first statement, while the majority agreed with this statement, *it is better*

## Residualization of Rental Tenure

for government to accommodate low income households in social housing, there was a dissenting opinion, especially evident in Vancouver (Figure 24). Given the high level of non-profit production in Ottawa in the early 1990's one might have expected some disagreement. The outcome in Vancouver is a little more surprising. Although the province has maintained a non-profit production program, the output is relatively modest.

The second, inverted, statement yielded a substantially different view, especially in Vancouver. There was a unanimous opinion that landlords cannot alone serve the low-income demand (Figure 25). This does not contradict the earlier response in which almost half of the Vancouver investors disagreed with that statement (Figure 24). It merely clarifies their view. It suggests that Vancouver landlords believe that there is role for both the private sector and for government.



The Ottawa investors expressed mixed views on the second statement, with both vendors and purchasers split evenly (Figure 25). The fact that nearly half of the Ottawa investors agreed that there is no need for social housing reflects the negative sentiment about over regulation that permeated the interviews. The Ontario conservative government has curtailed any new social housing development and although it included shelter allowances as a replacement in its election platform, no concrete steps have been taken to move in this direction. Evidently, a

large minority of the Ottawa investors agree with the Harris government's decision to end social housing.

Another factor in the Ottawa responses is the perceived level of competition from non-profit housing. One quarter of respondents in Ottawa said that they feel they have to compete against non-profit housing for tenants. The projects developed under non-profit programs in Ontario since 1985 have a mix of tenants with a proportion of the units rented at market rent levels. This is not the case in the non-profit stock built in BC since 1985, where none of the investors expressed a concern about competing with social housing.

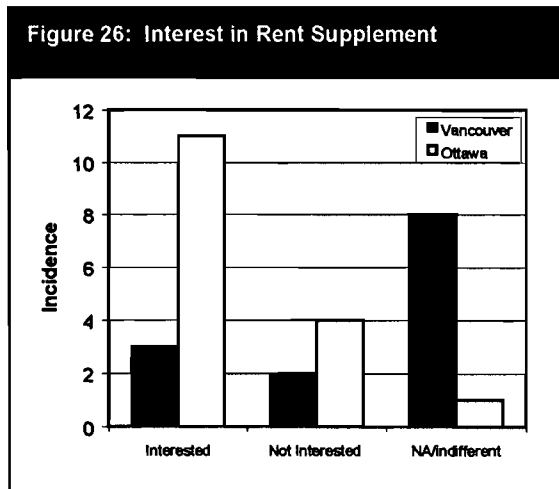
### *Attitudes on policy and program options*

Since the majority of lower income tenants live in the private rented sector, the survey examined possible policies and programs that might assist tenants living in private sector accommodation. Specifically, it explored the potential acceptability of rent supplements, shelter allowances, and the idea of some form of insurance to protect landlords against arrears and damages.

Almost 40% of the respondents were aware of the rent supplement program that already exists in their particular province.<sup>12</sup> A handful of investors had, or still do participate in this program (2 in Ottawa, 3 in Vancouver). Three investors that were aware of the rent supplement program had thought about it and rejected the idea -- two said they thought their properties would not be eligible.

<sup>12</sup> Rent Supplement programs were not explained to investor respondents in any detail. The question provided a very brief generic description: "In the past, the government offered a rent supplement program where they would contract with landlords for a number of units for a 3-5 year term and would then refer lower income households to these units. The government would guarantee payment of rent and damages up to a limited amount".

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Among those that were not aware of the rent supplement program, two thirds indicated that they would be somewhat or very interested in participating (Figure 26). Ottawa investors were especially interested in a rent supplement program, likely a reflection of the softer market. Investors in Vancouver were generally more indifferent to this option. In this case, market conditions remain sufficiently tight that vacancies are not a problem so landlords may see less need to access such a program. At the same time, neither did they express any strong objection to having such a program in place.

An alternative option presented to the respondents was the idea of a shelter allowance. This was described simply as an option that has been proposed from time to time, and is used in some provinces to provide low income households with a shelter allowance or voucher to help them pay their rent while living in privately owned rental units. All but five of the investors responded in the affirmative to the question: *"Do you feel this is a good idea?"* Those that disagreed were all vendors; while one Ottawa purchaser had no opinion.

Despite the generally strong level of support for the idea, landlords were not all ready to adapt to such a program. The investors were each asked: *"Faced with a choice between holding a unit vacant or renting to a household with a shelter allowance or voucher, would you prefer to hold the unit vacant and wait for an applicant with*

*employment/good income or accept the assisted applicant?"* Two thirds said they would accept the assisted household while one third said they would wait.

Given that the majority of the investors were small single property investors, these findings echo those of Gilderbloom (1985). He similarly found that while larger landlords had a stronger tendency, and were more able to hold a unit vacant, small "non-professional landlords" were less able to carry the vacancy loss and therefore tend to be less selective.

In the Ottawa-Vancouver survey, many did, however, qualify their answer saying that it would depend on the market at the time and on the particular applicant's references. Investors saying they would prefer to wait for a tenant with employment income tended to be predominantly vendors, split relatively evenly between Vancouver and Ottawa.

Finally, the investors were asked whether they would be any more or less inclined to accept welfare or low income households if the government provided some form of insurance program or guarantee to cover costs of damages or arrears. The basis for this question was the comparison with mortgage financing in the ownership part of the housing system. There, mortgage insurance has been used to induce lenders to accept households deemed to be higher risk borrowers. The question in the rental sector is whether a similar approach would improve access to rented accommodation.

The response was mixed. A small majority of those responding said they would be more inclined to accept welfare households if such a program were in place. The others did not reject the idea, they merely said that they would be no more inclined to accept these households than they would be in the absence of the program. However, half of those saying they would be no more inclined to accept welfare households were landlords who already did accept them.

Perhaps even more notable was the finding that seven of the investors that had said they did not

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generally accept welfare households indicated that they would be more inclined to do so if some form of insurance program were available to them. The question did not pursue the related issue of whether they would be prepared to pay an insurance premium for this service. Nor did it explore how their receptivity would be affected by some associated standards on quality and ongoing maintenance of the property.

## ***Part 4: Conclusions and Policy Implications***

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The objective of this research was to determine whether a gradual process of change in the profile of tenants in the private rental sector is occurring. It was hypothesized that this trend, here labeled residualization, is evolving and that it may have important consequences both for owners of private rental investment properties and for government policy.

The research has employed three approaches to this exploration: a literature analysis; a statistical review of existing data on household characteristics; and a qualitative survey of two subgroups of rental investors -- recent vendors and purchasers.

The literature analysis found only limited references to this phenomenon, largely in the context of social, or low income subsidized housing, and more particularly in the UK. There is some evidence, in the literature, that tenants with a particular profile may experience greater difficulty in accessing private rental housing (Gilderbloom 1985, Hilton et al 1989, Hulchanski and Weir 1992; Steele 1994; Beavis 1995). The review also highlighted the important distinction between discriminatory practices, and prudent management, in which some selectivity is exercised in accepting new tenants (Fallis 1993, Steele, 1994; Smith 1982).

The characteristic of the landlord was also identified in the literature to have an important bearing on management and tenant selection practices. In the survey conducted here, the sample of investors were largely of the small scale, non-professional genre. As such, the findings of this research must be kept in context -- they may not be as applicable to the larger corporate and institutional investor.

The research highlights the prevalence of the small-scale investor in the private rental sector. While there may be a tendency to think of the private landlord as group of large corporate entities, in the aggregate, the smaller scale

components of the rental market comprises a majority of the properties.

The review of trends in the characteristics of both renters and homeowners over the past two decades confirmed the hypothesis that there has been a gradual shift in the socio-economic status of renters, relative to owners. Trends show a divergence in the income and labour force performance of households in each tenure, especially among certain subgroups and household types. Youth, non-elderly long-term renters, and single parents are increasingly represented among the renter population.

As the notion of residualization is intended to portray, this divergence is not a result of different impacts on two unique and separate groups. It is a direct consequence of the tenure transfer of households with better income prospects who, had they remained as renters, would otherwise have pulled up the average among tenants. Those unable to make the tenure jump, remain as renters. As Steele (1994) has observed, and Applebaum and Dreier (1990) have implied, rental tenure for many is a tenure of default.

Overall, these trends have weakened effective demand for rental housing. They have also increased the need for affordable stock. Without effective demand, this has not stimulated a supply response.

Interviews with vendors and recent purchasers of rental investment properties provided an opportunity to ascertain whether investors perceive residualization. It also provided a venue to test the attitude of investor-landlords toward rental investment.

The interviews found very limited interest and, in many cases, a negative outlook among investors. This came through most strongly in Ottawa, the weaker of the two markets but, somewhat

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surprisingly, there was also evidence of a souring perspective among Vancouver investors. Overall, more than half of the investors expressed the opinion that the environment for rental investment is either much worse or slightly worse than it was 5-10 years ago.

Looking to the future, only three of the fifty-four investors interviewed expressed strong positive feelings about the future; just under one-fifth of investors were cautiously optimistic. More than two-thirds expressed negative concerns about future prospects.

None of the investors explicitly identified with the concept of residualization, however in an indirect way they provided some evidence that they both discern a changing profile among tenants; and that this is becoming a concern.

A majority of respondents agreed that the proportion of tenants that they would consider higher risk or undesirable is increasing; and that it is becoming harder to find and retain good tenants. Confirming the findings of other researchers, investors indicated that they exercise some discretion in accepting new tenants.

One in six landlord-investors confirmed that they would not accept households on welfare. Two-thirds indicated that, depending on the specific circumstances and market conditions, they would prefer to hold a unit vacant for a month in order to get a low risk ("good") tenant, rather than rent it to some-one that did not meet their criteria.

Although landlords identified with a range of screening criteria such as letters of reference or credit checks, more often than not they resorted to gut instinct. General appearance and cleanliness of the applicant was frequently cited as the primary screening criteria. While there was some reluctance to making a forced choice, when asked specifically to choose between various combinations of household types, the overwhelming choice was for a working couple. In no cases did a respondent select a household on welfare or a lone parent with a young child.

In short, there was some confirmation of findings in previous research that certain households will continue to experience some barriers in accessing private rental housing.

The discussion with investors specifically sought to explore views on the respective role of the private sector and that of government in addressing the housing needs of lower income households, one consequence of residualization.

There were mixed views on the statement that landlords have some responsibility to assist tenants who have lost their job and cannot pay the rent. Approximately half accepted the view that they had some obligation toward such tenants. Again, this may reflect the small-scale landlord who as owner and manager may come into personal contact with the tenants. A handful of investors confirmed that they had in fact been approached by tenants and had agreed to an arrangement for a period when the household was out of work.

Almost all investors agreed that government should be involved in providing housing for low-income households. They strongly rejected the view that the private landlord could serve this need without government assistance. In Vancouver, all landlords disagreed with the statement that *"there is no need for social housing; private landlords can provide enough affordable housing even for low income households"*

There was a mixed level of awareness about existing programs -- rent supplement and, in BC, shelter allowances. Among those that were previously unaware of the rent supplement programs that currently exist in both provinces, two thirds indicated that they would be interested in such a program. The fact that so many were unaware suggests that this program has in the past not been well marketed, at least not to the smaller scale landlord.

Landlords almost overwhelming agreed that shelter allowances would be a good idea, although not all agreed that they would take advantage of them.

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Faced with an applicant with a shelter allowance or voucher, one third still said that they would prefer to hold a unit vacant and see if they received any applicants with a good employment income. Here the implication is that a shelter allowance program might improve the prospects for low-income tenants but not overcome barriers for certain tenants.

The fact that landlords generally favour a shelter allowance approach comes as no surprise; the private landlord sector has often lobbied for such a program. The important finding, however, is that many of the landlords also agreed that there is a need for social housing (i.e. non-profit housing). Thus they are not advocating the abolition and replacement of non-profit housing but rather see some benefit in a complementary demand side subsidy program.

### *Policy implications*

The research has been broadly framed by the question whether the private rental sector? The introduction noted that both the vast majority of affordable housing and the vast majority of low-income households are found in the private rented sector. Given the virtual elimination of new non-profit supply programs, juxtaposed by a persisting level of need for affordable housing, it is asserted that the existing stock and, by association, the private landlord sector, is critical part of the housing system, and may become increasingly so in the future. It is imperative that some policy attention be accorded to this sector.

This study has attempted to pursue this issue by exploring a phenomenon labeled as residualization and to concurrently explore the attitudes of the investors in the private rental market as a way to identify some possible policy options.

To the extent that a residualizing trend has been statistically identified, a change in the attractiveness of rental investment should be expected. If manifest in a process of increasing disinterest on the part of investors and ongoing disinvestment in the rental sector, the most

immediate consequence of this is the potential deterioration of first the physical, and second the social environment of rental housing. This can then lead to a decline in the quality of life of both the tenants and the neighbourhood with serious long-term impacts on municipal expenditures on policing, social services and infrastructure. To the extent to which rent revenues, and growth thereof, are eroded, residualization will also impact the lenders who provided financing on these properties, as well as CMHC as a mortgage insurer.

The interviews provide some evidence that this process may be underway. The survey found that, with only a few exceptions where buildings have been upgraded (with consequences for affordability) investors were making only minimal levels of investment in capital repair. Without any reasonable expectation for a return on investment the lack of interest on pouring further capital into the properties is understandable. Arguably, rent regulation has been a factor influencing landlords' willingness to invest in repairs and capital improvement.

Despite these trends, the economics of investment in existing properties remain far more favourable than that of new properties. If there is growing disinterest in existing properties, the potential to rekindle investment in new development is even more unlikely -- except in the exclusive high rent niche market. Thus, the extremely low level of new rental construction.

In short, the negative attitude of existing investors should be an early warning of potential difficulties in the rental housing market. As this is the primary source of housing for many lower income households, this should be a matter of serious policy concern.

There may, however, be some opportunities for government housing policy to intervene to remedy some of the consequences of residualization, for the mutual benefit of lower income tenants and for the viability of the market.

## Residualization of Rental Tenure

The discussion with landlords identified a strong view among the private landlord investors that the market cannot address low-income housing need. Investors accepted the assertion that there is a legitimate role for government in this area. This in itself is an important finding. There has long been a divisive and adversarial relationship between the poverty and affordable housing advocacy sector and the private rental sector. Rather than work together to form a broader and potentially stronger lobby to push for effective government policy, the two sectors have often fought each other while government has sat on the sidelines.

In responding to the survey, investors explicitly accepted that, in the first instance, there is a problem in addressing low-income housing need; and second, they acknowledged that government has an important role. No doubt affordable housing advocates would embrace these views. There is a common ground here and thus an opportunity to work in concert.

Among the investors, there is a tacit acknowledgment that the market has limitations. Whether due to overt discrimination or to prudent business practices, there will continue to be certain households that the private rental market will simply not house. Some form of non-market intervention such as non-profit housing may be the most effective approach. In other cases, potential exists to better utilize private landlords appear willing to play a role.

### *Policy options*

Focusing on the inherent problems and characteristics of a residualizing private rental sector, there are two key areas where policy interventions could be developed. The first focuses on reducing the risk associated with the tenant selection process -- the factor that underlies behavior alternatively described as discriminatory or prudent business practice. The second explores the option of capitalizing on investor disinterest by supporting acquisition of relatively affordable existing properties by the community or non-profit sector -- thus promoting the preservation of affordable stock over the long term.

The current research does not attempt to determine the relative cost of alternative program approaches, such as non-profit versus shelter allowances.<sup>13</sup> Rather the focus here is on the potential appeal and acceptability of alternative approaches to the various stakeholders.

A policy that is focused on utilizing the market will not always be acceptable, nor will it always be appropriate, regardless of the relative cost of the program. The mixed views among investors with respect to welfare households; the practice of holding units vacant rather than accepting the first applicant; preferences for certain household types and disinterest in others are all factors that may limit market options for many tenants.

The Shelter Allowance program that exists in four provinces, including BC, provides a good example of these limitations. This has provided lower income seniors with some relief in their rental costs. Seniors are a clientele that the private landlord appears quite happy to accept. However, a shelter allowance may not work as well for lone parents with children, or for welfare households -- at least not without some assurance to landlords that the rent will be paid, and the dwelling respected.

Without this type of assurance, private landlords will inevitably continue to be selective, and in the extreme, discriminate. Certain landlords may seek to avoid all welfare households or all lone parents, based solely on stereotyping, rather than any objective risk assessment. . It is notable that the survey found that landlords who admitted to not accepting welfare households indicated that they would be more likely to do so if there was some form of assurance or guarantee to cover rent arrears and damages. These findings suggest that the aversion of investors is to risk, not specifically to certain tenant characteristics.

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<sup>13</sup> For a detailed analysis of cost effective program options see Ekos 1997 *Cost Effective Housing A comparison of Non-Profit and Market Housing*.



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In this context, one option posed to investors was some form of a guarantee or insurance program to protect against rent arrears or damages. A comparison can be readily made to the homeownership sector where a program of public mortgage insurance was introduced in the 1950's specifically to encourage lenders to grant mortgages to borrowers perceived considered higher risk. Here the borrower pays the premium to provide protection to the lender in the event of default.

It is clear that landlords, like lenders, perceive some potential tenants as higher risk. In some cases, where rejection is based on a general stereotyping, rather than the specific characteristics of the applicant, some form of insurance program may improve the rental opportunities for these tenants -- for example, lone parents or welfare households, and possibly tenants who have lost their employment and require a short term bridge.

An insurance program does not entirely mitigate risk, nor would it necessarily eliminate or selectivity. However, it would formalize an objective system of risk analysis -- something that small individual landlords cannot always do. Just as mortgage insurance has created a more efficient mortgage finance market, this could enhance the efficiency of the rental market.

The second potential area for policy intervention is one that would seek to shift ownership of some of the existing affordable stock from the private sector to the non-profit sector.

The process of drawing the sample of properties for this study yielded some useful insights on the cost of acquiring existing properties. The research found that in 1993 and 1994 a total of more than 250 transactions took place in the two cities, involving more than 5,500 rental apartment units. While no attempt was made to summarize the average cost per unit for this full set of transactions the sales price was confirmed for properties used in the survey.

The average per unit cost in Vancouver was \$55,000 while those in Ottawa averaged \$44,000 per unit. This is considerably less than the cost of new non-profit construction in the same 1993-94 period (generally well over \$100,000 in these cities).

This illustrates that many small properties transact in a relatively affordable price. Yet the interviews with investors found a relatively low level of interest in continuing in these investments as well as a pessimistic outlook, largely associated with weak demand from an increasingly lower income clientele -- the traditional clientele of the non-profit sector.

The relative disinterest of private investors creates the opportunity to introduce a small cost effective program to assist non-profit housing organizations to expand their existing portfolios through selective acquisition of existing properties. A small grant or interest free or deferred loan in the range of \$5,000 -\$15,000 to cover the down payment costs may be an effective way to facilitate non-profit acquisition of this relatively affordable stock. Moreover, the nonprofit sector is experienced and more willing to work with a residualized clientele.

Ideally, any policy response should seek to develop a balance and a mix of policies and programs to capitalize on the various opportunities within the existing stock. A single program instrument, such as reliance solely on a shelter allowance or solely on new non-profit production, is unlikely to fully address the range of need. The options suggested here seek to broaden the policy options and draw on both the non-profit and private sectors; each supported by an appropriate public policy framework.

Respecting the fiscal constraints that remain on government, but which may be easing, there appear to be significant opportunities as well as a strong need to direct some policy attention to the rental part of the housing system. At the same time, policy initiatives such as those outlined here could concurrently address concerns of both

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private investors, and those of affordable housing advocates.

By working together, these two traditional adversaries could have an impact in lobbying government to put affordable rental housing and a more effective rental market back on the policy agenda.

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