urban matters

MEMORANDUM

DATE: November 12, 2024
TO: Justine Starke, RPP, MCIP, Manager, Southern Gulf Islands Service Delivery -- Capital Regional District
FROM: Jodee Ng, RPP, MCIP and Matt Thomson – Urban Matters CCC
FILE: 1692.0059.01
SUBJECT: **Capital Regional District – Rural Housing Pilot Project Analysis Update**

1.0 INTRODUCTION

The Capital Regional District retained Urban Matters CCC to provide an expanded update to the Rural Housing Pilot Project analysis that was conducted in early 2024. This update is to understand how a grant of $40,000 will change the return expectations for potential homeowners seeking to build/renovate and rent out an accessory dwelling unit on the Southern Gulf Islands (SGIs) and Salt Spring Island (SSI) based on two different sets of maximum rents.

1.1 APPROACH TO ANALYSIS

The approach to analysis assumes that each unit cannot exceed the maximum starting rent for the corresponding number of bedrooms (i.e., bachelor/1-bedroom, 2-bedroom). The rents can be escalated annually by the permitted provincial rent increase if there is no change in tenancy[1]. There are two sets of rent levels being tested for the unit types, as defined in Table 1 below. It is important to note these rents do not differentiate between secondary suites or standalone suite (e.g., cottage).

Table 1: Maximum Starting Rent by Unit Type

	Bachelor/1-Bedroom	2-Bedroom
Rent Affordability Limits[2]	$1,400	$1,760
Below Market Rents Thresholds (SGIs, SSI)[3]	$1,000	$1,250

[1] Per Part 3 of the BC Residential Tenancy Act, landlords may only raise rents by the annual allowable rent increase in accordance with the regulations. Since 2017, the average annual increase is 2.5% with each year's increase ranging from 0% up to 4%. For example, the 2025 rent increase limit for residential tenancies is 3%.
[2] As defined by BC Housing under the Secondary Suite Incentive Program: https://www.bchousing.org/sites/default/files/media/documents/BC-RAHA-Rent-Affordability-Limit.pdf. These rents are the CMHC average rent for the Victoria Census Metropolitan Area.
[3] As defined in Section 2.2 of the Capital Regional District Rural Housing Pilot Project Analysis (2024) report: https://www.crd.bc.ca/docs/default-source/southern-gulf-islands-ea-pdf/crdruralhousingpilotprojectanalysis.pdf?sfvrsn=9f2afce_4. These below market rents are 80% below BC Housing's Housing Income Limits for Victoria (Greater Victoria Area) in 2023.

The analysis also looks at resetting the maximum starting rents at the end of Year 5 to '**market rents**'[4] which are rents based on SGI and SSI renter household incomes. This scenario assumes there would be a tenant changeover starting in Year 6. This is to compare how the 'maximum rents' compare to market rents after 5 years of tenancy.

These market rents are tailored to SGI and SSI renter household incomes of $60,000 or higher, broken out by the number of bedrooms as shown below in Table 2. Note that these market rents are based on 2021 data, and as incomes grow over time, it is anticipated that market rents will increase incrementally.

Table 2: SGI and SSI Market Rent and Rent-to-Own Guidelines by Unit Type

	Bachelor/1-Bedroom	2-Bedroom
Market Rent and Rent-to-Own Guidelines	$1,500	$1,950

1.2 ASSUMPTIONS

With the exception of the maximum rents, required initial homeowners' equity, and the grant amount tested, the remaining assumptions in this analysis remain the similar to the analysis conducted in early 2024. As a summary, the main assumptions are provided below and in Table 3 below.

Table 3: Assumed Unit Size and Construction Costs

	Cottage – New		Secondary Suite – New		Secondary Suite – Renovation	
	1-Bdr	2-Bdr	1-Bdr	2-Bdr	1-Bdr	2-Bdr
Unit Size (sq. ft.)	600	900	600	900	600	900
Construction Cost ($/sq. ft.)	$439		$368		$296	
Total Project Cost Per Unit*	$393,000	$614,000	$277,000	$448,000	$220,000	$357,000

**Rounded to the nearest thousand dollar, and includes financing fees and interest accumulated during construction period.*

Unit Type

A cottage and a secondary suite are both self-contained suites with access to living facilities such as cooking, sleeping, and receiving mail. However, a *new* secondary suite is built as part of the construction of a new single-detached house, whereas a *renovation* of a secondary suite is the addition of a legal suite in an existing single-detached house.

[4] Market rent as defined in Section 2.2 of the Capital Regional District Rural Housing Pilot Project Analysis (2024) report: https://www.crd.bc.ca/docs/default-source/southern-gulf-islands-ea-pdf/crdruralhousingpilotprojectanalysis.pdf?sfvrsn=9f2afce_4.

Unit Sizes

The financial analysis assumes that all 1-bedroom units will be 600 sq. ft. in size, and 2-bedroom units will be 900 sq. ft. in size. If there is a variation in the unit size, the capital costs to build the unit, as well as the return on the homeowner's equity would also change (note: this change in unit size variation is not tested in this analysis).

Homeowner's Equity

It is also assumed that the **initial homeowner's equity** will be set at 25% of the total capital cost to build or renovate the accessory dwelling unit.

Project Costs

The project costs for building a cottage, secondary suite, and for the renovation of a secondary suite are estimated on a square foot basis. These costs include financing fees (e.g., legal, appraisal, etc.) and interest accumulated during the construction period. The costs are estimates, and not exact figures, as it varies in each scenario depending on the amount of homeowner equity and grant is provided, as more equity decreases the borrowing costs.

2.0 ANALYSIS RESULTS

This section presents the analysis results and the estimated returns that a homeowner potentially might expect based on the assumptions around capital costs and total equity invested: **25% homeowner's equity** and a **$40k grant** amount. The results demonstrate the potential return on the homeowner's equity under three scenarios:

1. Year 1 and Year 5 returns with no change in tenancy;
2. Increasing the $40k grant to a $80k grant; and
3. A change in tenancy at the end of Year 5.

The second component of the analysis assumes a homeowner could apply and successfully be eligible for a $40k forgivable loan from BC Housing through the Secondary Suites Incentive Program[5] while stacking an additional $40k grant from another housing program.

2.1 1-BEDROOM ANALYSIS

In the first year of the unit being tenanted, the return on the homeowner's equity is positive for both the 1-bedroom new secondary suite (4.9%) and renovated secondary suite (11.3%)[6] at the $1,400 rent level. When the rent is offered at $1,000, there is still a return at 2.6% for the renovated suite, however, the new secondary suite sees a negative return of -2.1%. (Table 4 below).

Table 4: Estimated Returns on Initial Homeowners' Equity, 1-Bedroom, $40K Grant, Year 1

Target Rents	Cottage - New		Secondary Suite - New		Secondary Suite - Reno	
	Return on Homeowner Equity	Capital Cost to Build	Return on Homeowner Equity	Capital Cost to Build	Return on Homeowner Equity	Capital Cost to Build
$1,400	-2.5%	$393k	4.9%	$277k	11.3%	$220k
$1,000	-7.4%	$393k	-2.1%	$277k	2.6%	$220k

In the first year of the unit being tenanted, the return on the homeowner's equity for the 1-bedroom cottage does not bring a positive return on investment at these project costs.

When looking five years down the horizon, the same tenanted unit where rents started at $1,400 and escalated at 2.5% annually, now have higher returns as follows (Table 5):

- For the 1-bedroom new secondary suite, the return has increased from 4.9% to 6.7%.

[5] Provides a grant for both secondary suites and laneway houses/garden suite which have received a municipal building permit on or after April 1, 2023.
[6] As mentioned in Section 1.2 of this report, a *new* secondary suite is part of the construction of a new single-detached house, whereas a *renovation* of a secondary suite is the addition of a legal suite in an existing single-detached house.

- For the 1-bedroom renovated secondary suite, the return has increased from 11.3% to 13.3%.

Additionally, the 1-bedroom renovated secondary suite initially offered at $1,000 in Year 1, has increased the return from 2.6% to 4.2%. However, the 1-bedroom new secondary suite at the lower rental rate of $1,000 still sees a negative return on investment of -0.6%.

The financial analysis finds that the cottages at both levels of rent, $1,400 and $1,000, do not demonstrate a return on the homeowner's equity at -0.9% and -6.1%, respectively.

Table 5: Estimated Returns on Initial Homeowners' Equity, 1-Bedroom, $40K Grant, Year 5

Target Rents	Cottage - New		Secondary Suite - New		Secondary Suite - Reno	
	Return on Homeowner Equity	Capital Cost to Build	Return on Homeowner Equity	Capital Cost to Build	Return on Homeowner Equity	Capital Cost to Build
$1,400	-0.9%	$393k	6.7%	$277k	13.4%	$220k
$1,000	-6.1%	$393k	-0.6%	$277k	4.2%	$220k

2.1.1 Increasing the Grant to $80k

If the homeowner received an additional $40k as a forgivable loan through BC Housing's Secondary Suites Incentive Program – for a total grant amount of $80k – the Year 1 returns would increase across nearly all categories, notably (Table 6):

- From 4.9% to 8.9% for the new secondary suite at the $1,400 rent level
- From 2.6% to 7.7% for the new secondary suite at the $1,000 rent level

One-bedroom units that cost more than $393k to build, and require a rent of $1,400 see a slight return under the assumptions modelled in this analysis. Units that can be built at lower cost would see greater returns, for example, the renovated secondary suites demonstrate a return as a high as 16.4% when the capital cost is $220k per unit. The 1-bedroom cottage under the $1,000 rent is the only scenario that does not provide a positive return.

Table 6: Estimated Returns on Initial Homeowners' Equity, 1-Bedroom, $80K Grant, Year 1

Target Rents	Cottage - New		Secondary Suite - New		Secondary Suite - Reno	
	Return on Homeowner Equity	Capital Cost to Build	Return on Homeowner Equity	Capital Cost to Build	Return on Homeowner Equity	Capital Cost to Build
$1,400	0.3%	$393k	8.9%	$277k	16.4%	$220k
$1,000	-4.6%	$393k	2.0%	$277k	7.7%	$220k

2.1.2 Change in Tenancy

This section reviews a scenario where there is a tenant changeover at the end of Year 5, resulting in market rent, which is $1,500 for the new tenants (Table 7). The analysis shows that the market rent is similar to the Rent

Affordability Limit of $1,400 after 5 years (which grows to $1,545). In other words, these units that are provided grants become the SGI and SSI market rent units after 5 years.

1-Bedroom Units Targeting $1,400 in Year 1

At Year 6, rents for a 1-bedroom unit are reset from $1,545 ($1,400 plus 2.5% annual escalation for 4 years) to a SGI and SSI 'market rent' of $1,500. This means that the return on newly occupied units **is lower** than for units that already have tenants. For landlords to recover any losses, the rent in Year 6 would need to be higher than $1,500 (Table 7 below).

1-Bedroom Units Targeting $1,000 in Year 1

For the units with rents of $1,104 at the end of Year 5 ($1,000 plus 2.5% annual escalation for 4 years), the rents are reset to SGI and SSI 'market rent' of $1,500. This substantial increase in rent causes the returns **to increase** across all accessory dwelling units (e.g., cottages, new secondary suite and renovated secondary suite). However, as many of the returns are low in the first 5 years, uptake is unlikely on the units that cost more than $220k to build.

Table 7: Change in Tenancy at End of Year 5, 1-Bedroom, $40K Grant

Rent			Returns on Homeowner Equity – End of Year 5					
Year 1	Year 5	Year 6 (Market Rent)	Cottage - New		Secondary Suite - New		Secondary Suite - Reno	
	No Change in Tenancy	Change in Tenancy	No Change in Tenancy	Change in Tenancy	No Change in Tenancy	Change in Tenancy	No Change in Tenancy	Change in Tenancy
$1,400	$1,545	$1,500	-0.9%	-1.5%	6.7%	5.8%	13.4%	12.3%
$1,000	$1,104	$1,500	-0.4%	2.1%	-0.6%	5.8%	4.2%	12.3%

2.2 2-BEDROOM ANALYSIS

When looking at the 2-bedroom unit analysis, only the renovated secondary suite offered at the $1,760 rent level provides a return of 4.2%. This means that units that cost more than $357k to build struggle in seeing a return in Year 1. See Table 8 below.

Table 8: Estimated Returns on Initial Homeowners' Equity, 2-Bedroom, $40K Grant, Year 1

Target Rents	Cottage - New		Secondary Suite - New		Secondary Suite - Reno	
	Return on Homeowner Equity	Capital Cost to Build	Return on Homeowner Equity	Capital Cost to Build	Return on Homeowner Equity	Capital Cost to Build
$1,760	-6.0%	$614k	-0.8%	$448k	4.2%	$357k
$1,250	-10.0%	$614k	-6.2%	$448k	-2.7%	$357k

At Year 5, the same tenanted renovated secondary suite that was offered at $1,760 and escalated at 2.5% annually, has its return rise from 4.2% to 6.1%. In addition, the new secondary suite offered at $1,760 now shows a slight return (Table 9 below). However, the cottages are still showing negative returns. The analysis shows that units with capital costs above $357k are challenging to achieve a return under both rent levels.

Table 9: Estimated Returns on Initial Homeowners' Equity, 2-Bedroom, $40K Grant, Year 5

Target Rents	Cottage - New		Secondary Suite - New		Secondary Suite - Reno	
	Return on Homeowner Equity	Capital Cost to Build	Return on Homeowner Equity	Capital Cost to Build	Return on Homeowner Equity	Capital Cost to Build
$1,760	-4.5%	$614k	0.9%	$448k	6.1%	$357k
$1,250	-8.7%	$614k	-4.8%	$448k	-1.2%	$357k

2.2.1 Increasing the Grant to $80k

For the 2-bedroom units, stacking an additional $40k grant from the BC Housing Secondary Suite Incentive Program would impact the following changes in Year 1's returns:

- Increase the return on a renovated secondary suite at rent level of $1,760 from 4.2% to 7.3%
- Increase the return on a renovated secondary suite at a rent level of $1,250 from -2.7% to 0.4%
- Improve the return on a new secondary suite at rent level of $1,760 from -0.8% to 1.7%

Units that cost more than $448k to build, are generally challenged in providing positive returns when the rents are lower than $1,760.

Table 10: Estimated Returns on Initial Homeowners' Equity, 2-Bedroom, $80K Grant, Year 1

Target Rents	Cottage - New		Secondary Suite - New		Secondary Suite - Reno	
	Return on Homeowners' Equity	Capital Cost to Build	Return on Homeowners' Equity	Capital Cost to Build	Return on Homeowners' Equity	Capital Cost to Build
$1,760	-4.2%	$614k	1.7%	$448k	7.3%	$357k
$1,250	-8.2%	$614k	-3.8%	$448k	0.4%	$357k

2.2.2 Change in Tenancy

This section reviews a scenario where there is a tenant changeover at the end of Year 5, resulting in market rents for the new tenants in Year 6 (Table 11). Similar to the 1-bedroom analysis, the analysis shows that the Rent Affordability Limits ($1,760) are close to the market rents in Year 6 for SGI and SSI. This means that the units meeting Rent Affordability Limits will be close to market rent units after 5 years.

2-Bedroom Units Targeting $1,760 in Year 1

At Year 6, when the rents are reset from $1,943 ($1,760 plus 2.5% annual escalation for 4 years) to a 'market rent'[7] of $1,950 for a 2-bedroom unit. In this instance, the return on the newly occupied units are **equal to** the tenanted unit, signalling that 'market rents' would need to be around $1,950 in Year 6 for a landlord to recuperate any losses (Table 11 below).

At Year 6, the rent for a 2-bedroom unit is reset from $1,943 (plus 2.5% annual escalation for 4 years) to a 'market rent' of $1,950. This means that the return on newly occupied units are **equal to** the units that already have tenants. For landlords to recover any losses, the rent in Year 6 would need to be around $1,950 (Table 11 below).

2-Bedroom Units Targeting $1,250 in Year 1

For units with rents of $1,380 at the end of Year 5 ($1,250 plus 2.5% annual escalation for 4 years), the rents are reset to 'market rents' of $1,950. This substantially increases the returns across all accessory dwelling units in Year 6.

Table 11: Estimated Change in Tenancy at End of Year, 2-Bedroom, 40K Grant

Rent			Returns on Homeowner Equity – End of Year 5					
Year 1	Year 5	Year 6 (Market Rent)	Cottage - New		Secondary Suite - New		Secondary Suite - Reno	
	No Change in Tenancy	Change in Tenancy	No Change in Tenancy	Change in Tenancy	No Change in Tenancy	Change in Tenancy	No Change in Tenancy	Change in Tenancy
$1,760	$1,943	$1,950	-4.5%	-4.5%	0.9%	0.9%	6.1%	6.1%
$1,250	$1,380	$1,950	-8.7%	-4.5%	-4.8%	0.9%	-1.2%	6.1%

[7] Market rent as defined in Section 2.2 of the Capital Regional District Rural Housing Pilot Project Analysis (2024) report. These rents are used as a starting point for the analysis to test the market rents.

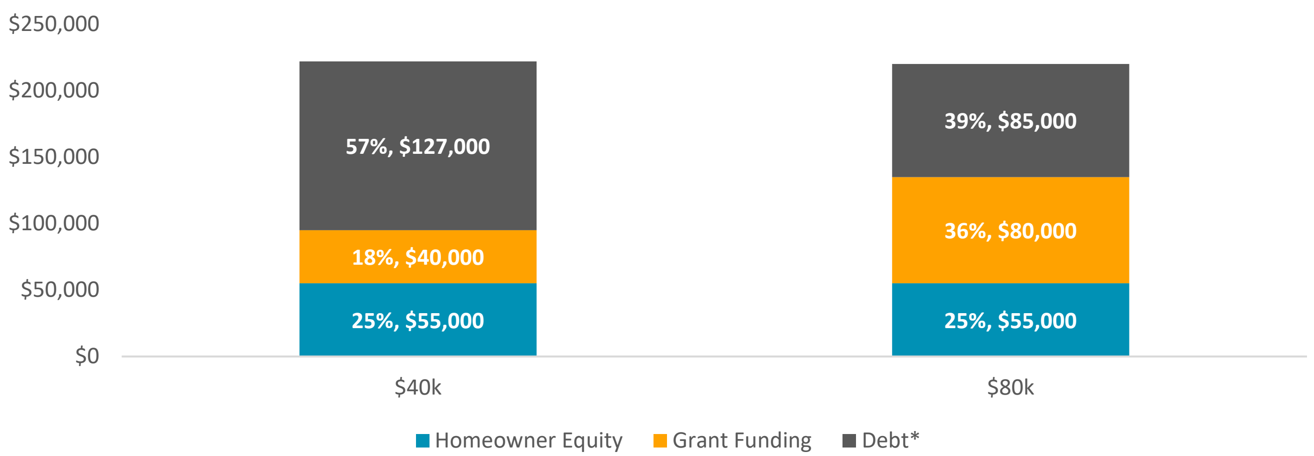
3.0 CONCLUSION

While the financial analysis shows returns across some of the scenarios as modelled, consideration should be given to the following factors that will influence the direction of the return.

- **Measuring Returns –** While some scenarios demonstrate a 'return' on the initial homeowners' equity, the amount of return and length of time should be considered. A return of 2.0% or under in Year 1 may not be enough to attract a homeowner to put forward their equity into an accessory dwelling unit, however, if this return becomes 5.0% in Year 5, then the grant option may become more of an incentive. On the other hand, if there is no return in Year 1, and an increase to 8.0% return in Year 5, this may not be attractive enough for a homeowner due to the opportunity loss on their equity in their first few years. The decision comes down to the risk tolerance and return goals of each individual homeowner.
- **Setting Rent Levels –** The financial analysis shows that the maximum rents, if set at the higher levels (e.g., Rental Affordability Limits), will enable homeowners to see a return across more scenarios. This means that this set of rents will likely encourage more housing supply across the SGIs and SSI. However, if the lower set of rents is required (e.g., Below Market Rents for SGI and SSI), the impact is not as far-reaching than the higher set of rents, as fewer scenarios show a return, which translates to fewer ADUs units being built.
- **Tenant Changeover and Market Rents** – The timing of tenant changeover within the first five years impacts the rent that can be charged, which impacts the returns a landlord might expect. These are risks that each individual homeowner will need to weigh when considering the overall attractiveness of a grant program for building accessory dwelling units. After the five year period ends, the ability to 'reset' the rents to a market-supportable rent is important for landlords so that they do not take on any losses that might offset their returns gained.
    - Further, the analysis finds that units set at the Rent Affordability Limit will reach the SSI and SGI 'market rents' after 5 years. Since these units are new, a landlord may decide to charge a higher rent than the 'market rents' after 5 years. However, true market rents are dictated by a household's ability to pay for the rents. If renter household incomes across the SGI and SSI cannot support a higher rent, landlords may find they cannot increase the rent in Year 6 beyond the 'market rent' tested here. In this instance, those units would become a new supply of market rental units for SGI and SSI renters, while maintaining a reasonable return for the landlords (under the assumptions modelled in this analysis).
- **Building Costs** – The analysis is based on traditional forms of building housing. However, there are housing innovations and opportunities emerging that will lower the building costs which will allow owners to achieve a higher return on their investment. Some of these options include using pre-fabricated materials, modular housing, leveraging economies of scale when building multiple accessory dwelling units, and accessing pre-approved designs. A lower building cost will provide a greater incentive for homeowners to build accessory dwelling units.

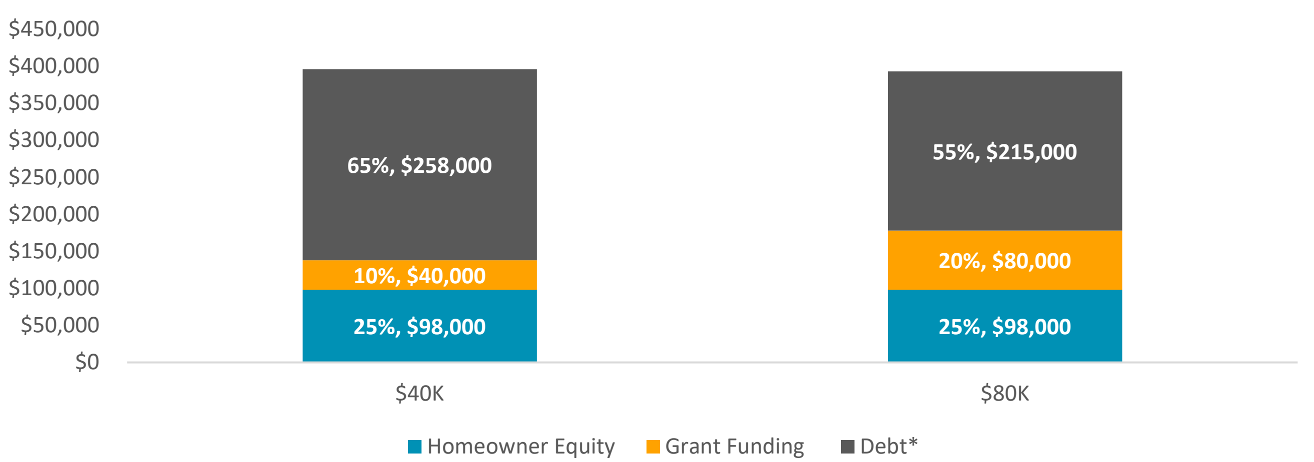
- **Grant Size** – The stacking of grants to $80,000 enable a larger number of scenarios to achieve a notable return, when compared to just a $40,000 grant alone. Cottages are still challenging due to the higher capital costs, but if construction innovation can be used to lower the costs, then the returns could be increased. The graphs below show the impact of the grant size on the debt carried in the secondary suite renovation scenario (1-bedroom) and in the cottage scenario (1-bedroom).

Figure 1: 1-Bedroom Secondary Suite Renovation, Comparison of a $40k Grant vs. $80k Grant



Includes financing fees and interest accumulated during construction.

Figure 2: 1-Bedroom Cottage, Comparison of a $40k Grant vs. $80k Grant



Includes financing fees and interest accumulated during construction.

In summary, the financial analysis demonstrates the following trends based on the data assumed:

1-bedroom unit

- **$40k grant**
  - A unit with capital costs more than $393k (modelled as a new cottage) will have negative returns in Year 1 through Year 5 at both sets of rents tested, $1,400 and $1,000, unless the project costs are decreased.
  - A unit with capital cost of $277k (such as a new secondary suite) shows a **notable return of 4.9% to 6.7%** from Year 1 to Year 5 when rents are set at $1,400.
    - On the other hand, a unit with a capital cost of $277k (such as a new secondary suite) with rents set at $1,000 show a negative return of -2.1% to -0.6% in Year 1 and Year 5, respectively.
  - A unit with capital cost of $220k (such as a secondary suite renovation) shows a **notable return of 11.3% to 13.4%** from Year 1 to Year 5 when rents are set at $1,400; and returns of **2.6% to 4.2%** from Year 1 to Year 5 when rents are set deeper at $1,000.
- **$80k grant**
  - A unit with a capital cost of $220k (such as a secondary suite renovation) shows a return of **16.4%** when rents are set at $1,400 and a return of **7.7%** $1,000 in Year 1.
  - A unit with a capital cost of $277k (such as a new secondary suite) shows a return of **8.9%** when rents are set at $1,400 in Year 1, and a return of **2.0%** when rents are set at $1,000 in Year 1.

2-bedroom unit

- **$40k grant**
  - A unit with capital cost of $357k (such as a secondary suite renovation) shows a notable return of **4.2% to 6.1%** when rents are set at $1,760 from Year 1 to Year 5.
- **$80k grant**
  - A unit with a capital cost of $357k (in this analysis, a renovated 2-bedroom secondary suite) return **7.3%** when rents are set at $1,760. On the other hand, if the rents were set at $1,250, there is a negligible return in Year 1 (0.4%).
  - A unit with capital cost of $448k (in this analysis, a new 2-bedroom secondary suite) starts showing a promising return of **1.7%** when the rents are set at $1,760 at Year 1. This return will increase if the project costs are lowered.

Cottages:

- **$40k grant**
  - A 1-bedroom unit with a capital cost of $393k does not generate any returns when the rents are set at $1,400 or $1,000 in Year 1 (-2.5% and -7.4%, respectively) or in Year 5 (-0.9% and -6.1%, respectively).

  - A 2-bedroom unit with a capital cost of $614k does not generate any returns when the rents are set at $1,760 or $1,250 in Year 1 (-6.0% and -10.0%, respectively) or in Year 5 (-4.5% and -8.7%, respectively).

- **$80k grant**
  - A 1-bedroom unit with a capital cost of $393k generates a small return when the rents are set at $1,400 in Year 1 (0.3%). The return could be increased if the project costs are lowered.
  - A 2-bedroom unit with a capital cost of $614k does not generate a return when rents are set at $1,760 or $1,250 in Year 1 (-4.2% and -8.2%, respectively). The returns could be increased if the project costs are lowered.

Sincerely,

URBAN MATTERS CCC LTD.

Jodee Ng, RPP, MCIP
Land Economics Consultant

cc: Matt Thomson, Community Housing Advisor, Urban Matters CCC