Leadership.
Influence.
Impact.

REALPAC

77 King St W
TD North Tower
Suite 4030 PO Box 147
Toronto ON M5K 1H1
Canada

t 416.642.2700
tf 1.855.732.5722
w realpac.ca

Parliamentary Budget Office
Ottawa, Ontario
Canada K1A 0A6

Attention: Mr. Eskander Elmarzougui

Subject: Request for Meeting to Discuss Concerns with PBO Report on REITs

Good Day Mr. Elmarzougui

REALPAC represents Canada's institutional real estate sector, with over 130 member entities, and over $1 trillion in assets under management in all asset classes, located both in Canada and around the world. We also represent the Canadian REIT industry.

We are writing to express our industry's concerns regarding the recent Parliamentary Budget Officer's (PBO) report on Real Estate Income Trusts (REITs) {"Report"). **We conclude requesting the initial report be reconsidered, and a discussion be held to correct it.**

With respect, we believe the Report to be incorrect in several instances. We do not believe it is ready yet to be relied upon as a strong evidence base for policymakers federally.

How the report can be improved

We provide for your benefit below our detailed comments on the Report. We also attach or link to commissioned reports from tax and accounting firms KPMG and EY Canada which come to different conclusions than the Report.

We also enclose more reliable data sets to work from, including the Altus report on the economic impact of Canadian REITs, and the Royal Bank of Canada Capital Market's daily market indicator, showing the size of the REIT market in Canada and particularly the apartment REIT market.

Suggested Corrections

1. **Being Clear on Scope: Limited to Apartment REITs only**. We presume MP Morrice was only focused on the residential REITs. The Report narrative jumps around between data on "financialized" landlords (not defined) (p.6), to all REITs, to "investors" in residential, to "private" owners. This is problematic and risks misleading decision makers. Everyone who owns an income producing property is an investor. We think this background narrative is confusing, unnecessary and shows bias. Exaggerating the size of the apartment sector, or confusing it with REITs of all asset classes, inflates the report's

revenue projections, and risks misleading decision makers. We suggest you confirm with MP Morrice that his request pertained only to the apartment REITs.

2. **Being Clear on Apartment REIT Market Size.** Assuming a scope limited to the multi-familyREITs only, the Report overestimates the number of residential REITs by including non-residential REITs such as office, retail, industrial and self-storage. Even so, there are not 110 residential REITs in Canada as of 2021 to our knowledge. There are only 37 REITs listed on the TSX. See the RBC report attached. There are only five REITs focused on Canadian multi-family residential properties (the five apartment REITs: Canadian Apartment Properties REIT, Boardwalk REIT, Killam REIT, InterRent REIT and Minto Apartment REIT) listed on the TSX. The rest only own foreign properties, or in the case of Morguard, primarily foreign properties) See the Daily Market Indicator attached from RBC Capital Markets. The total number of suites owned by those five REITs is approximately 121,000, excluding foreign suites and manufactured home communities. And that's after 30 years of REITs.

3. **Being Clear on Current Taxation**. REITS are not tax exempt.as stated in the Summary. As trusts they are subject to tax on income they retain at the top personal tax rate. Income they distribute to a beneficiary in the year it arises may be excluded from the trust's income but it is then included in the income of the beneficiary. The taxation of the income in the beneficiary's hands will depend on the beneficiary's status, such as being taxable as ordinary income to individuals and taxable resident corporations, subject to withholding tax in the hands of nonresidents, being nontaxable to registered plans or pension funds but subject to full taxation ultimately on distribution.

4. **Being Clear on Market Share**. REITs own far less than 20% of the purpose-built rental market and far less than 200,000 units as of 2021. From the Altus Report attached, we have the multi family REITs owning in total 137,621 residential units (inclusive of Morguard's Canadian units and manufactured homes owned), accounting for at most about 6% of the primary rental housing universe, which Altus Group estimates to be 2.4 million units (as of 2021). The total apartment stock in Canada is estimated to be 4.9 million suites[1] including both purpose built rentals and the secondary market. REITs would own less than 3% of the total market.

5. **Being Clear on Market Capitalization.** The market capitalization of the Canadian REITs overall is indeed approximately $77 billion, down from close to $100 billion in 2019. But the vast majority of this figure is comprised of REITs that operate in the office, retail, industrial and self-storage sectors. Many multi-family REITs are also net sellers these days, redeploying capital in building new apartment supply. And to put this into perspective, there are single pension funds in Canada whose real estate assets (debt and equity) are larger than the entire market capitalization of all REITs on the TSX today.

---

[1] https://www150.statcan.gc.ca/n1/daily-quotidien/220921/dq220921b-eng.htm?indid=32991-3&indgeo=0

6. **Quoting Correct Dates.** The legislative change to REITs occurred as of October 31, 2006 under then Finance Minister Flaherty's watch, with the introduction of the SIFT rules to eliminate income trusts. Not 2011.

7. **Avoiding Bias and Activist's Perspectives.** The foundational evidence for the need for the Report seems to rely on advocates complaining about the linkage between REITs owning purpose built rental and rental rates across the country. See Figure 2.1, which is a classic example of unrelated data travelling the same path. It's mixing home sales data with REIT suites ownership data. Apples and oranges. There is no point in including that kind of a chart as it's clearly out of scope and brings into question the impartiality of this Report. The actual causation of that home price inflation is something entirely different than the number of REIT units existing, but that's not the implication from the chart. It's completely misleading, dramatically overestimates the number of suites owned by the REITs, and reflects the confirmation bias of that author.

8. **Using Incorrect Tax Rate Numbers in the Future Analysis.** The PBO report refers to the federal corporate tax rate as being 38%, but that is before the provincial tax abatement of 10% and the general tax reduction of 13% that applies to public companies. The actual federal corporate tax rate applicable is 15%, combined approximately 26.5%. Please consult with the Department of Finance to confirm the correct tax percentages.

9. **Correctly identify and calculate for tax-deferred's from non-taxables**. The report treats registered accounts (eg RRSP's RESP's) as non-taxables as opposed to tax-deferred accounts. Tax is payable sooner or later.

10. **Identify challenges with assumptions and therefore reliability of conclusions.** It is a challenge for everyone to pin down percentage ownership of REITs by taxable, non-taxables and non-residents. It could change daily. That is why the EY report gives a range of tax outcomes, both positive and negative to the treasury of Canada. Yes it is possible that elimination of the apartment REITs would actually ***reduce*** Canada's tax revenues. MP Morrice and colleagues need to know that, and we believe quoting a range or a number that's only a net gain in total taxes payable is irresponsible.

11. **Being realistic about behavioural responses**. The behavioural response assumed is very likely completely wrong. Some REITs who were subject to the SIFT rules after 2006 still operate as trusts but their tax liability is greatly diminished by interest expense and depreciation allowance. Other options for REIT portfolios who might have a corporate tax rate imposed include assets purchased by a pension fund (which is also a flow-through vehicle), remain as a taxable trust (as many did after 2006), or transfer to a limited partnership (no tax payable), or a mutual fund trust or fund manager (also not taxable). There is no law in Canada requiring anyone to own apartment buildings through a corporation, and it's an unreasonable assumption to presume that any potentially taxed REITs will do so. Everyone does tax and risk planning, including apartment owners.

12. **Being realistic around nonresidents and nontaxable ownership responses.** Moreover, the behavioural response ignores the potential reaction of certain types of

investors, in particular non-residents and non-taxables. The sensitivity analysis considers scenarios where non-residents and non-taxables own greater interests in the REITs. In fact, if changes are made to the tax rules to subject the REITs to corporate-type tax, there could very well be less, not more ownership by these investor groups. The results of the sensitivity analysis are therefore likely exaggerated and unrealistic.

13. **Look at the scale of what you're dealing with.** Even a back of envelope calculation shows that it's near impossible to find the apartment REITs would generate this much corporate tax if apartment REITs were somehow banned. The five apartment REITs total Market Capitalization as at April 6th was only $15.6 B (we exclude Morguard REIT as it is mostly US assets). At an average 3% distribution rate (which has to be <u>all</u> taxable income), that is a maximum distribution of ~$470 M per annum, taxed in individual hands at high marginal tax rates. Remember corporations don't have to distribute anything to shareholders, unlike REITs.

14. **Acknowledge there could also be a loss of total tax revenues.** This is the critical point made in the E&Y report, that within that range of potential outcomes, there is the possibility of an actual tax loss to the federal government. This needs to be clearly identified in the range of possible outcomes in the PBO Report

Additional Considerations: Social Benefits: Jobs, Taxes Paid, Retirement Income for Pensioners

While we realize you weren't asked to opine on this, we thought you should have some context for your commentary, in place of that sourced from academics who may be biased.

REITs are income vehicles. In the 42 countries around the world where REITs exist, including all G-7 countries, they are specifically designed to own income producing assets and flow the net cash flows through to unitholders as a return on their investment. Corporations active in real estate are often perceived to be growth vehicles since they have the ability to retain their net income and redeploy it into new developments. They are not forced to make dividend payments.

The Report does not seem to explicitly acknowledge that the profits REITs generate and distribute to thousands of Canadians are in fact already taxed. Under existing federal law, any taxable income must be distributed as a distribution to individual or institutional unitholders, or be taxed at the trust level. The taxable income is thus taxed.

Changing this tax treatment may simply change the method of collection, not necessarily the amount collected as the EY Report shows. As currently configured, REITs attract investment into Canada's rental housing market. Eliminate a return on that investment, and funds will be pulled out of the housing sector and invested elsewhere. This threatens to further destabilize the housing supply system and remove capital needed to invest in the supply of additional housing.

The PBO report misrepresents and misunderstands the importance of REITs in the housing market. See the Altus report attached. The foundation of a healthy Canadian real estate environment is the ability to attract investment, maintain and update existing buildings and to build new rental stock.

The five REITs focused on Canadian multi-family properties currently have 10,000 new suites in their development pipeline. The broad REIT industry, including diversified REITs, have over 200,000 units in their development pipeline (see TD Securities Report). This is approximately equivalent to one full year of housing starts in Canada. To realize on this development pipeline, the housing sector requires capital, which comes from one of three primary sources: rent, debt or equity (investor) capital. Making the Canadian real estate market less attractive to investors would limit access to investor capital and inadvertently increase rent prices, which in turn, would exacerbate the ongoing housing crisis and make it even more challenging for families to find suitable living arrangements.

We have already seen this effect in action—the discussion surrounding changes to the tax treatment of REITs from 2021 has already caused some investors to hesitate in financing construction, which is likely to impact the country's much-needed housing supply. All rental housing development requires financing and investment.

Conclusion and Request

In conclusion, the Report we believe can be made more accurate and improved. It is contradicted by two leading Canadian tax and accounting firms, who understand corporate taxation.

While we recognize that the PBO was not asked to opine on the merits of Canadian REITs, this is important context for your work, and is likely a better context than that offered by the articles quoted, some of which reflect continued confirmation bias, and a lack of objectivity and the contested "financialization" negative connotation.

We would respectfully request that the report be reconsidered, and be re-written with the additional resources and comments provided, for re release at a later point.

We would be pleased to coordinate meetings with the EY and KPMG tax professionals and any other resources that you need to assist in your reconsideration and analysis of this important issue.

Overall we believe government, housing advocates, non-profits, cooperatives and the private sector must work together to be part of the solution. Picking on one small player in the market as a political villain is not constructive. It will just drive capital away from building more housing.

REALPAC is prepared to work with everyone to be part of the solution, for the benefit of existing and future residents of Canada.

Please let us know if and when we can have a discussion on this topic.

Sincerely,

Michael Brooks
CEO, REALPAC
mbrooks@realpac.ca

enclosures/links;

Altus Report: Economic Impact of Public MF REITS in Canada
KPMG Report: 2022-10-03 Taxation of Canadian REITs
EY Report: Analysis and commentary on the tax treatment of residential Real Estate Investment Trusts
https://static1.squarespace.com/static/633217840123934701804030/t/6351bdf2d9bf417fb95f7b94/1666301427413/EY+Analysis+and+commentary+on+the+tax+treatment+of+residential+Real+Estate+Investment+Trusts.pdf

RBCCM DMI April 12th 2023
TD Research Report on the REIT apartment development potential

CC

Xiaoyi Yan, Director, Budgetary Analysis (xiaoyi.yan@parl.gc.ca)
Yves Giroux (pbo-dpb@parl.gc.ca)

About REALPAC. REALPAC is the leading national association representing Canada's commercial real estate industry. Our 130+ members include publicly traded real estate companies, real estate investment trusts ("REITs"), private companies, pension funds, fund managers, banks, and life insurance companies, with cumulative real estate assets under management of over $1 trillion CAD. In over 50 years of existence, we have provided policy background and advice to governments at all levels. We pride ourselves on being well researched, respectful, and thoughtful.