

Intelligence MEMOS



From: Jeremy M. Kronick
To: The Hon. Bill Morneau, Minister of Finance
Date: March 13, 2019
Re: **WHAT TO DO ABOUT HOUSING?**

With the budget fast approaching, your department is under pressure to address housing affordability in Canada.

The conundrum for you, or any policymaker trying to address affordability, is that in seeking to make housing more affordable, you often support the same demand for housing that others, concerned about rising household debt, seek to quell. As a result, well-meaning policies may offset each other.

This conundrum can be solved by focusing instead on policies that can help boost housing supply.

A classic economics graph pictures demand against supply, with their intersection telling you the price and quantity of a good and/or service. Anyone who argues that an overpriced housing market is entirely the result of one or the other misses the point: both are critical.

However, policies aimed at demand can often feel like a tug of war, with affordability the red team, and household debt the blue team.

For example, we often hear of Canada's mounting household debt problem. IMF data show Canada has one of the world's highest household debt to GDP ratios. The result is a series of policies aimed at slowing down the accumulation of debt.

A perfect example is OSFI's revisions to its stress test last year, which essentially forces uninsured homebuyers to prove they can afford a mortgage at a significantly higher mortgage rate than the rate they are being offered. Going back to our basic economics graph, this policy shifts demand down, as the stress test makes housing more unaffordable. However, the fall in demand reduces aggregate household debt.

Similarly, with house prices having grown exponentially in Toronto and Vancouver over the last decade, we hear of repeated claims of unaffordability, especially for millennial homebuyers. [Rumour](#) has it that one policy under consideration at the Department of Finance is an increase in maximum amortization length from 25 to 30 years. Increasing amortization from 25 to 30 years means a homebuyer will get five extra years to pay down a mortgage, resulting in smaller monthly mortgage payments. In terms of our Econ 101 graph: demand shifts up, because smaller mortgage payments make housing more affordable. But that increase in demand will increase household debt.

While a more formal study would be necessary in this example to determine which policy dominates the other, the point is that demand-focused policies all contain this tension between household debt accumulation and affordability.

Fortunately, if we turn our focus to the supply-side curve, we can put in place policies that ease this tension. A policy that increases supply will lower prices and increase quantities, improving both household debt and affordability.

Much can be done on the supply side, from better infrastructure to more intelligent zoning to easing regulatory red tape. While the barriers to increased supply span all levels of government, your department can play a direct role.

On infrastructure, debates - at least in Ontario - surround whether there is enough land for new construction outside of already built-up areas. The reality is that plenty of land is [earmarked](#) for development, but we often lack the necessary infrastructure. Without water, sewage, and highways, why would a developer build? Getting these infrastructure projects going, in tandem with other levels of government, should be job Number 1.

Updating zoning and intensification targets is also necessary in order to provide a greater mix of options to Canadians. There has been some movement on this front in both the [city of Vancouver](#) and the [province of Ontario](#), but more is necessary. The federal government can contribute in part by making the use of federal funds conditional on increasing density around mass transit in Toronto and Vancouver.

The National Housing Strategy and infrastructure commitments were two of the signature policies of your government. However, household debt and affordability continue to be major concerns for Canadians. Focusing on supply means you can support one without sacrificing the other.

Jeremy Kronick is Associate Director, Research, at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

The views expressed here are those of the author. The C.D. Howe Institute does not take corporate positions on policy matters.