OPINION

The housing crisis is not just a supply issue. Here are two solutions to fix demand

GEORGE ATHANASSAKOS AND SCOTT GRYBA
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Real estate properties in Toronto on July 12.CHRISTOPHER KATSAROV/THE GLOBE AND MAIL

George Athanassakos is a professor of finance and the Ben Graham Chair in Value Investing at the Ivey Business School, Western University, London, Ont. Scott Gryba is a professional engineer and an international finance specialist. He also holds an MBA degree from the Ivey business school.

Housing affordability will not improve until house prices drop. If we're unwilling to face this truth, we're going to continue to make things worse.

To quote Berkshire Hathaway's Charlie Munger: "It is important to face reality – it's especially important to face reality when you don't like it."

Economics 101 tells us prices are set by the interplay of supply and demand. Regarding the housing crisis, we hear a lot about the supply issue but, other than the pressures brought on by immigration, the demand side of the equation gets very little attention. And that aspect of the housing crisis must also be addressed if we want so see a return to affordability for first-time buyers.

On the supply side, you have arguments for increasing density in residential neighbourhoods through multiunit residences, which will of course increase supply. However, the impact of this supply on prices isn't immediately apparent. For example, say an old house on a half-acre lot is redeveloped as a four-unit townhouse in south Oak Bay in Victoria. It will take about three to four years for that supply come on the market and it will be absorbed by the market at high prices because of population growth. Basically, you're tearing down a $3-million single unit and building four homes that will sell for at least $1.2-million each. It is true that this creates new supply for upper middle-class professionals, but this isn't the type of supply that will get us out of this crisis.

Proponents of increasing supply would say we should streamline the process to build new homes and flood the market. However, the on-the-ground reality is that the process can't be streamlined. There are multiple and significant obstacles that new supply must navigate before coming to market. Some of these can be mitigated by the respective provincial governments but many hard issues are beyond their control. Issues such as the lack of skilled trades, supply chain constraints and commodity availability are beyond the purview of our governments.

Furthermore, well-informed and well-organized NIMBY groups that are highly motivated will always find ways to throw sand in the gears of any potential new development affecting the character of their neighbourhood.

The cumulative result of these factors is that while supply trickles on, the market absorbs the new units and prices stay high.

To improve affordability, you don't necessarily have to try to lower prices through building more supply. Supply can be increased by tamping down demand, as the central bank has been doing through raising interest rates.

In addition to interest rates, the other main demand aspect is immigration. We agree that this is important to our economy and will be a more important factor going forward; however, it isn't what drove the prices to where they are now. The last price run-up was during the COVID-19 shutdowns when there was no immigration, so clearly there are other more dominant variables putting upward pressure on prices.

We believe that the issue of demand by investors should get more attention. According to the Bank of Canada, investors are the fastest growing mortgage segment with a 30-

per-cent share of mortgaged home purchases nationally in the first part of this year, up from 19.6 per cent in 2020. They are now a bigger segment than repeat homebuyers and, over the past few years, have taken 6 per cent of market share from first-time buyers. In the midst of a housing affordability crisis, this is not the preferred state of affairs.

On this front, there are potential interventions that would be effective in restricting demand. First, for example, a lifetime cap of $1-million on the personal residence capital gain exemption would effectively curtail demand. Such a policy would have no direct effect on people if they don’t sell their primary residence and would have very limited impact on Canadians living in less expensive communities. This policy change would limit unproductive investment in the real estate sector by discouraging retirement strategies based on the gains made from selling a house. It would also stop the investment strategy of buying a house, renovating, living in it the minimum amount of time to claim the tax credit and then flipping it for a tax-free gain.

Second, there could be a limit applied to the amount of interest that can be recorded as a business expense for single-family residences let as rental properties. Both policies would reduce demand, bring more supply to market, and lower prices and thus improve affordability.

To be clear, we are not advocating that we slam real estate investors, torch the housing market and tank the economy. We must tread carefully now that real estate is around 13 per cent of GDP. However, we are advocating that these policies, or policies that would have a similar effect on investor demand, should at least be a part of the conversation when considering options to improve affordability.