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More renting and less home ownership won't solve the housing affordability problem

Haider-Moranis Bulletin: Canadian cities with worsening housing affordability are also the ones where renting is more pronounced

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Is an increase in the number of renter households the answer to Canada's housing affordability challenges?

A number of recent commentaries have suggested that if Canada were to follow the example of certain European countries, where renting is more common than it is here, perhaps Canada would be able to better cope with its housing affordability challenges.

Implicit in such suggestions are several assumptions, including that housing affordability is a Canada-wide challenge.

The RBC Housing Affordability Index, however, reveals that while homeownership costs relative to income have increased over time, the significant increases are confined to a select few cities in British Columbia and Ontario.

At the same time, Canadian cities with worsening housing affordability are also the ones where renting is more pronounced.

If renting were to be the answer to housing affordability, then Montreal should be more affordable for home buying than, let's say, Calgary or Edmonton. Unlike the two most populous cities in Alberta, renters far outnumber owners in Montreal. Yet, the share of median pre-tax household income needed to cover homeownership costs in Montreal at 44.5 per cent is higher than Calgary at 40.3 per cent and Edmonton at 34.8 per cent.

If there is an implied correlation between the overall prevalence of renting and affordability, the evidence is missing in Canada.

But what about the European fascination with renting? Is renting that much more pronounced in Europe than in North America? The answer is no. Most Europeans own their homes. The highest homeownership rates (more than 70 per cent) are found in Spain, Ireland, Greece and Romania.

Even in Germany, which has one of the lowest home ownership rates in Europe, 51.4 per cent of the population lives in housing they own. Germany sometimes is cited as an example for Canada to follow. What is often missing in such comparisons is a full recognition of the unique historical circumstances that led to the present-day makeup of the German housing market.

Writing in the journal *Housing Studies*, Professor Michael Voigtländer of the German Economic Institute explained why homeownership has been lower in Germany. The Second World War left the former West Germany with a severe housing crisis. The war destroyed 2.25 million homes (20 per cent of the housing stock) and damaged another 2.5 million. An influx of 12.3 million refugees further exacerbated the housing shortage, which was estimated at 4.5 million dwellings in 1950.

What is worthy of learning from the German experience in housing is not just the outcome of lower homeownership, but the mechanisms introduced by the German government to address housing shortages. Contrary to what the supply skeptics in Canada believe, the German government dealt with the housing crisis by building more housing.

The government encouraged the private sector to partner with the state agencies to supply millions of new homes that “marked the beginning of ‘social’ or subsidized assisted housing in Germany.”

The supply-side solutions worked. By 1962, the housing shortfall was down to 658,000 units.

Also important to note is that unlike the United Kingdom, where the government subsidies for rental housing were targeted only at public sector initiatives, the German government encouraged the private sector to build and maintain social housing by offering extensive tax incentives in return for keeping rents at affordable levels for 15 to 30 years.

The post-war credit crunch left Germany with a struggling financial system. As a result, mortgage markets did not develop as extensively in Germany as they did elsewhere. That homebuyers were expected to put down 30 per cent or more in equity further subdued the demand for owner-occupied housing. On top of that, subsequent German governments chose not to subsidize homeownership, something that was common in other countries, especially the United States.

It is also important to note that Germans have increasingly embraced homeownership in recent years. In 1993, 38.8 per cent of Germans lived in owner-occupied housing. By 2002, the share of owner-occupied households had increased to 42.6 per cent. The latest estimate is more than 51 per cent.

The increase in homeownership happened even though housing prices have remained flat or fallen in Germany. Rising housing prices provide an impetus for households to buy to hedge against future increases in housing costs. Falling prices usually have the opposite effect.

The 1990 reunification is another distinguishing feature of Germany’s housing markets. Housing in East Germany was dominated by prefabricated apartment blocks, a hallmark of Communist architecture. But the East Germans turned their backs not just on the ideology, but on the housing structures that came with it. In 2000, the former East Germany had almost one million vacant

apartments — meaning there was an oversupply in one half of the country and an undersupply in the other.

Another aspect of the German experience was its liberal approach to rent controls. Unlike in the U.K., where stringent rent-control policies caused a gradual deterioration and the subsequent decline of the rental stock, German rental policies were flexible, such that rents in subsidized housing, though lower, were not utterly out-of-step with market rates. Landlords in Germany could also pass on reasonable costs of property improvements to tenants.

In Canada, meanwhile, purpose-built rental construction has declined since the seventies. The Canadian Federation of Apartment Associations, an industry group representing the owners and managers of rental properties, identifies changes in tax regulations (capital gains tax) and rent control (vacancy decontrol) as factors that have adversely affected the profitability of constructing new purpose-built rentals, thereby choking the supply of new rental units.

If the German housing model is to be emulated in Canada, the private sector must be incentivized to produce new purpose-built rentals and reverse the decline in rental construction. Germany was able to build millions of rental units by partnering with, and incentivizing, the private sector — not the other way around.

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