



# **Understanding Shelter Affordability Issues: Towards a better policy framework in Ontario**

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Paul Smetanin

President and CEO, CANCEA

**CANADIAN CENTRE FOR  
ECONOMIC ANALYSIS**

# Understanding Shelter Affordability Issues: Towards a better policy framework in Ontario



An independent study funded by:



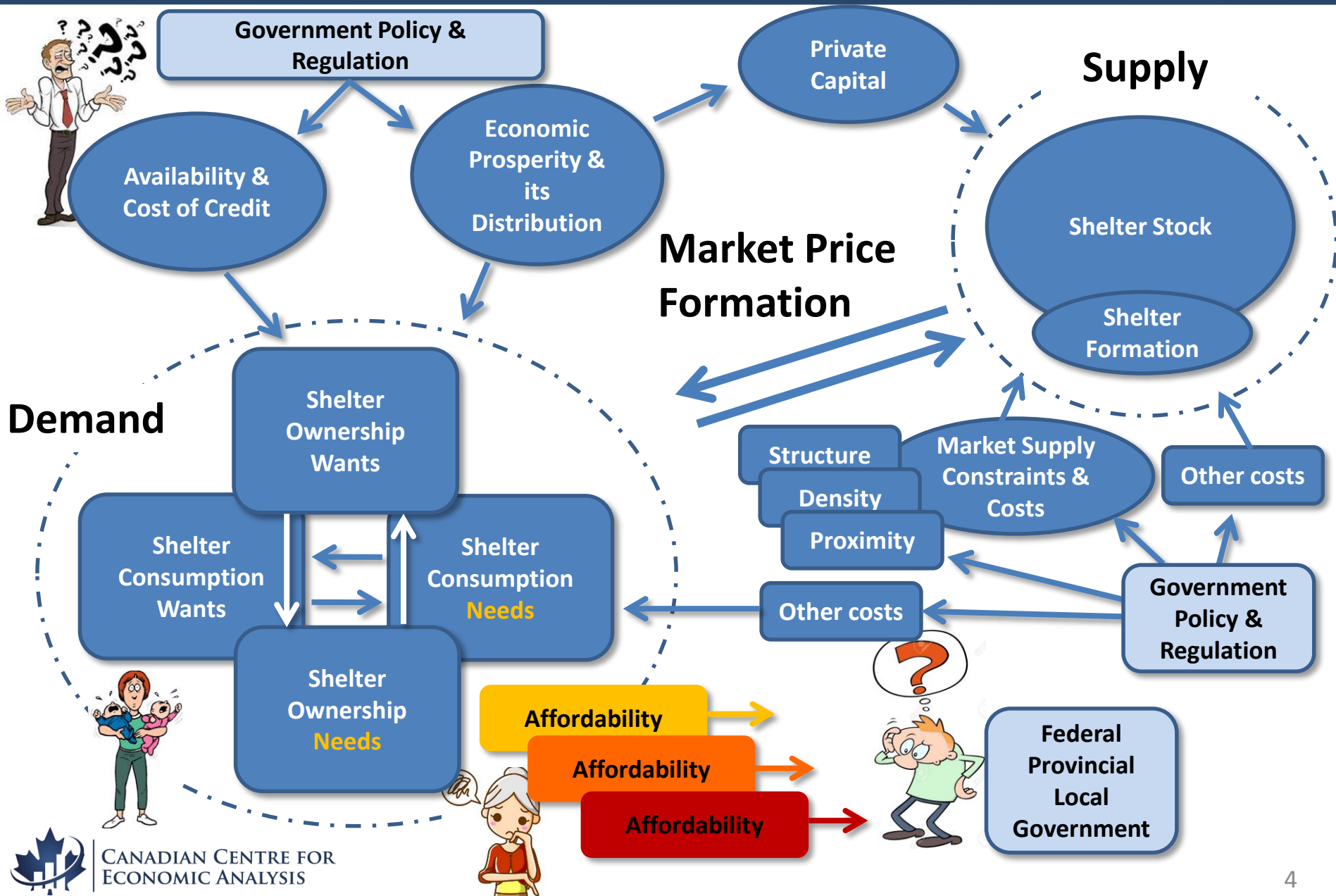
RESCON  
25 North Rivermede Road, Unit 13, Vaughan, Ontario L4K 5V4  
Richard Lyall, President  
[lyall@rescon.com](mailto:lyall@rescon.com) p 905.760.7777 w [rescon.com](http://rescon.com)



# Research Agenda

- Housing affordability: increasing problem for a growing number of Canadian households
- Growing public profile and media interest with limited appreciation of:
  - broad range of forces creating this problem
  - complexity of their interaction
- No recent comprehensive study of the full range of demand and supply factors that determine affordability
- Research objective:
  - Qualitatively identify the key concepts and factors to better understand what drives the affordability of shelter in Ontario
  - A framework that is a necessary precursor to our next endeavour, which is a state-of-the-art computer simulation of the GTHA housing markets and affordability issues

# Affordability: It's a symptom of something complex



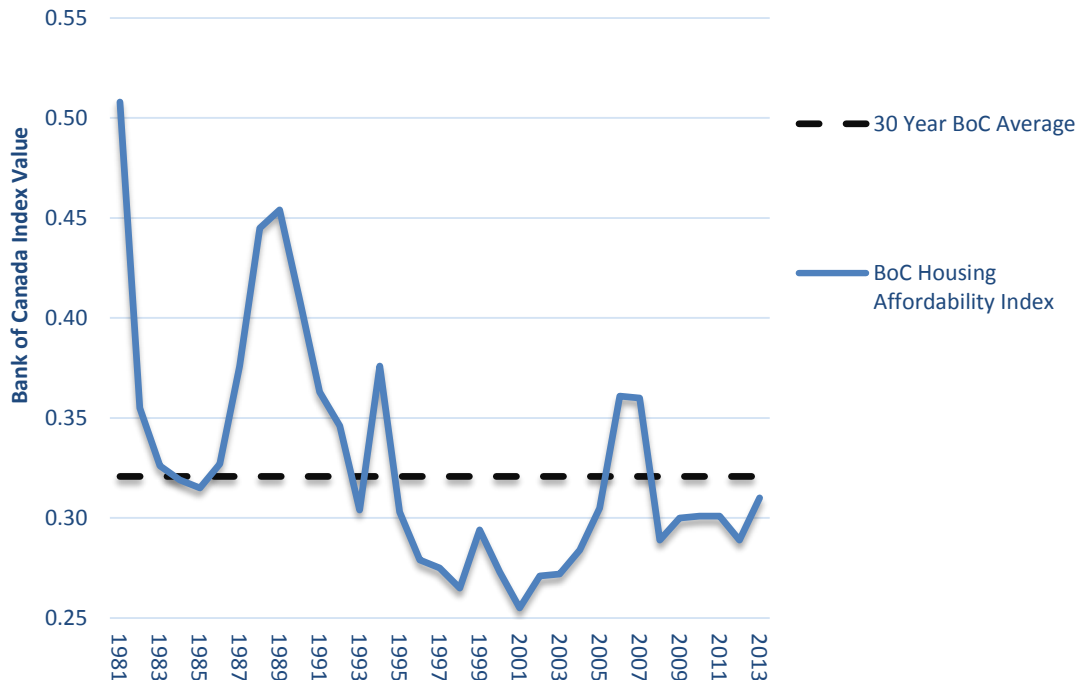
# Current affordability indices and debate

- Importance of the housing market, and therefore shelter, is evidenced by its ability to affect virtually all facets of the economy
- Emergence of a number of different “affordability indices” that have shortcomings
  - **Focus on Home Ownership:** Overlooked is the “need” component of affordability, consumption costs of shelter as well the costs of accessing shelter (transportation)
  - **Complexity of shelter is ignored:** Structure, bedrooms, density, proximity to other necessities; “needs” versus “wants”; use versus investment; policy
  - **Averages, aggregates, silos and incomplete data:** overreliance upon generalizations that ignore important details
  - **Different Stakeholders, Different Indices:** Different stakeholders have different points of view of affordability.
    - Existing Indices do not comprehensively reflect the extent or the nature of the problem

# Affordability in Canada

Bank of Canada Housing Affordability Index: Aggregate measures of affordability and an environment of low interest rates implies current affordability levels are sustainable

**Bank of Canada Housing Affordability Index**



- **Affordability Concepts:**

- Before tax income
- Rent
- Mortgage payments
- Municipal services

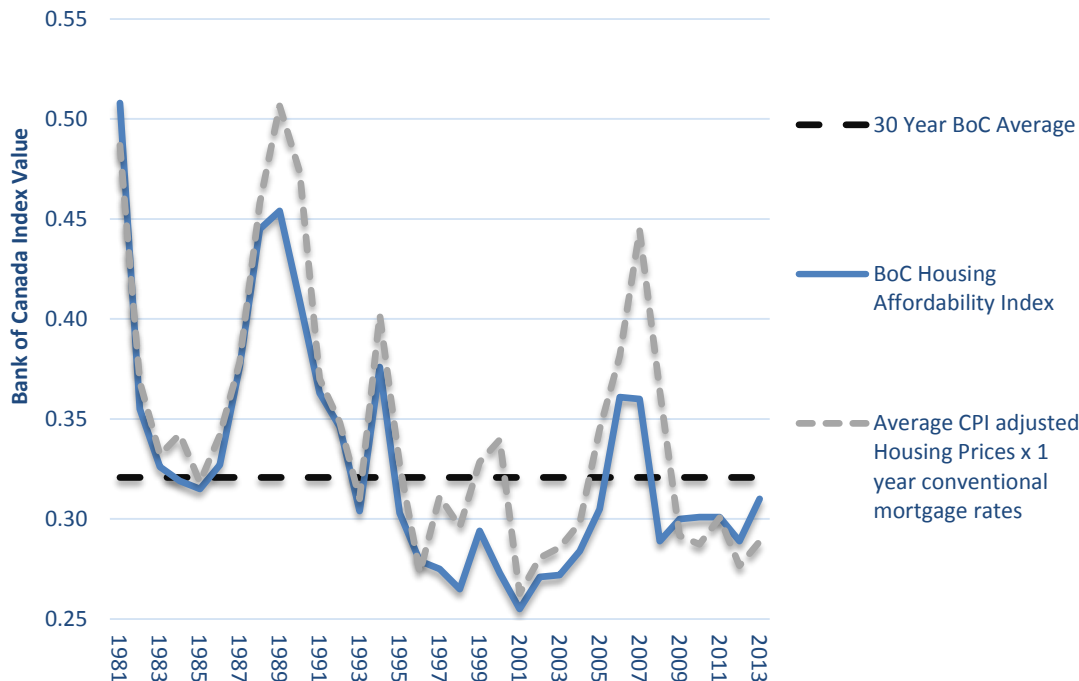
- **Need Concepts:**

- Adequacy: no major repairs
- Suitability: enough bedrooms
- Affordability: no more than 30% of before tax income

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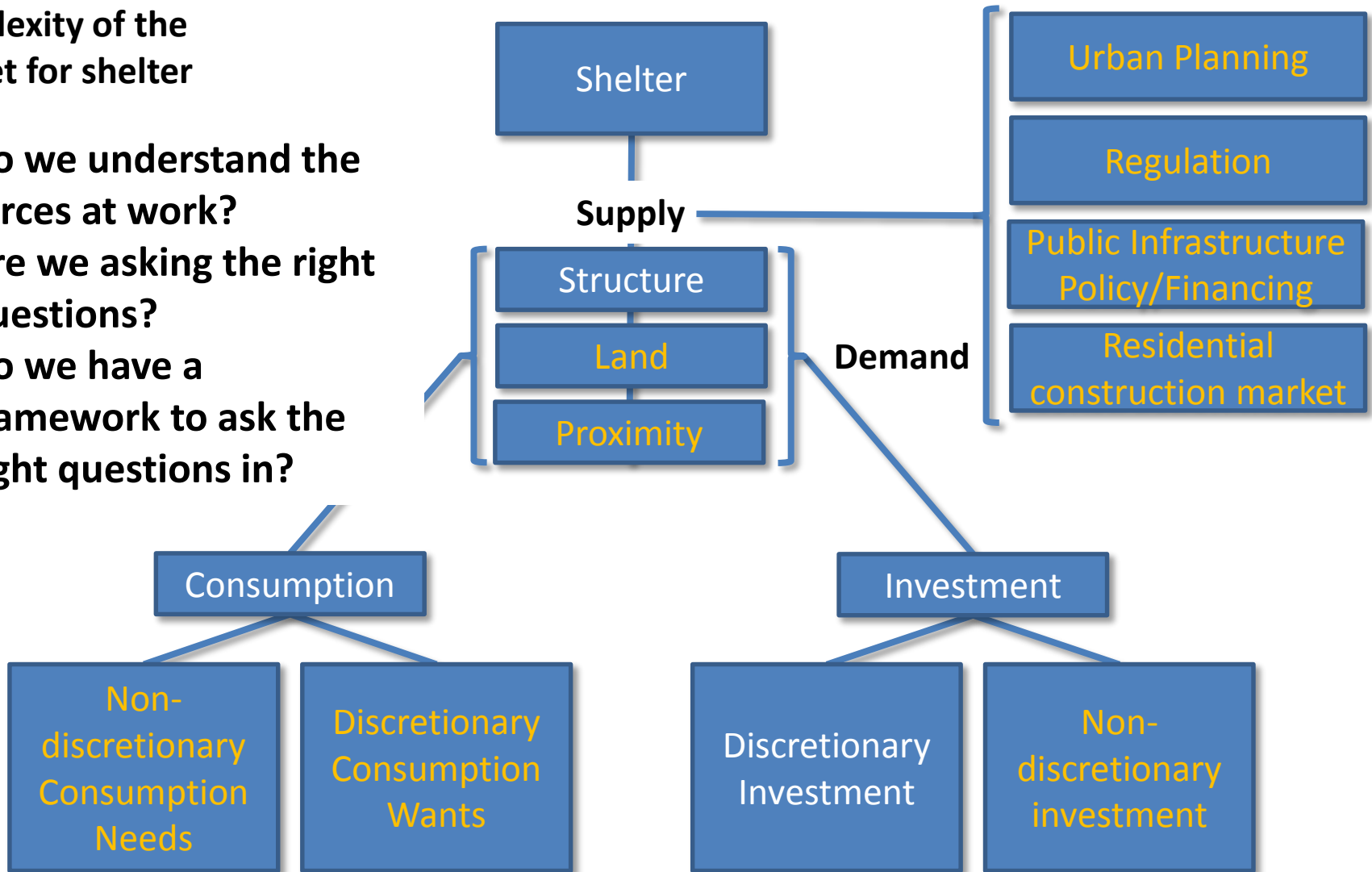
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# Shelter Characteristic Concepts

Complexity of the market for shelter

Do we understand the forces at work?  
Are we asking the right questions?  
Do we have a framework to ask the right questions in?



XXX Concepts generally ignored

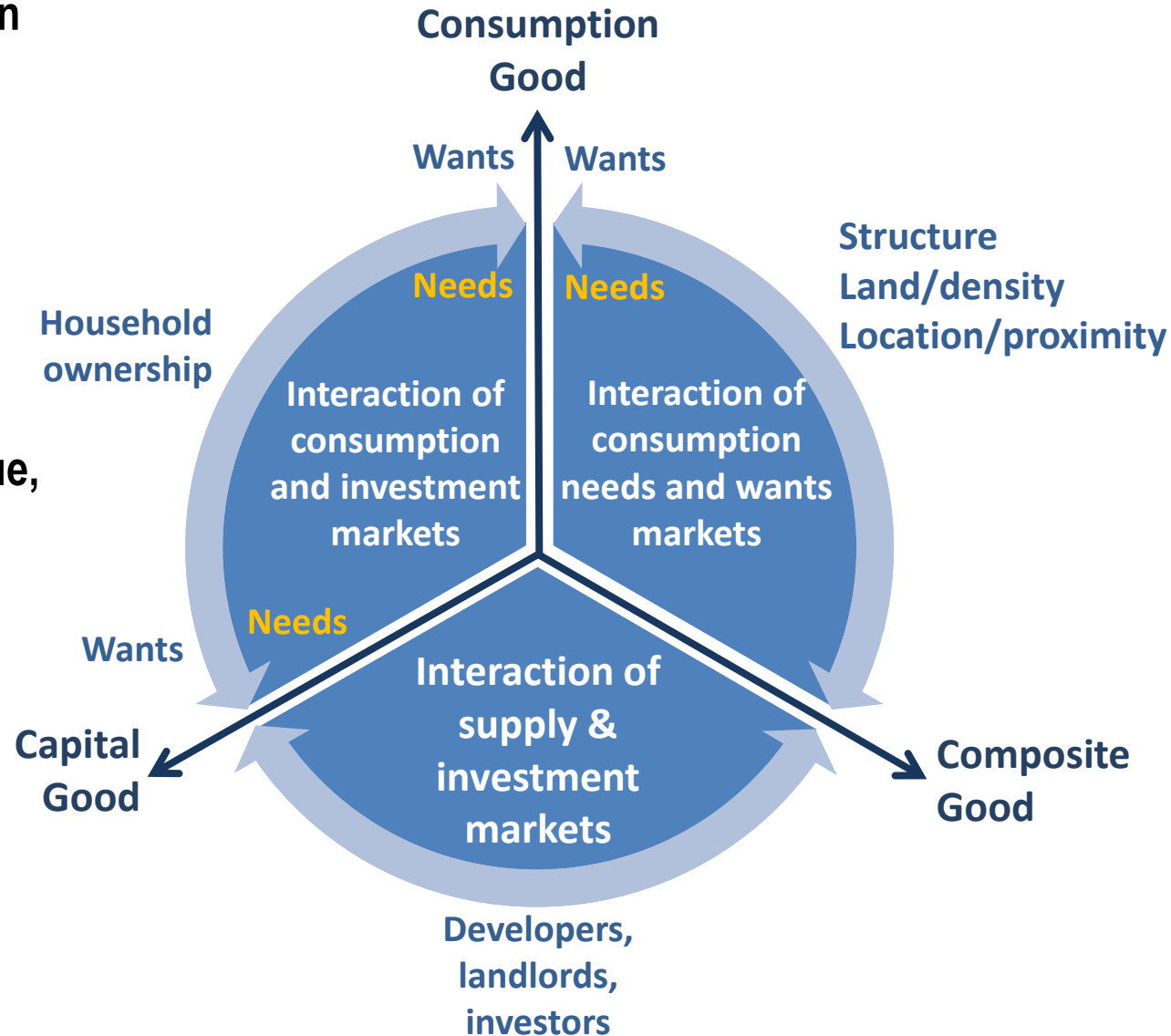


# Current affordability indices and debate

- Housing affordability is a complex issue
- Considered narrowly as our ability to purchase a home
- It is much more than that
- To understand housing affordability, must look at the true:
  - **Cost of using shelter** (renting from a landlord or renting from yourself). This takes into account several factors including the proximity to employment options, transportation access, amenities and other related costs such as utility rates and insurance.
  - **Ability to pay for it** (after covering taxes and other essential expenses). This takes into account several factors including food, clothing, personal health care expenses, and essential costs of employment
- Simply put, housing affordability is not well understood and therefore not well measured.

# Affordability Conceptual Framework

1. Shelter as a consumption good
2. Shelter consumption needs and wants
3. Shelter as a composite good
4. Shelter as a store of value, an investment asset
5. Demand, supply and substitution effects
6. Needs, wants, and crowding out
7. Public policy and role of government



# Shelter Consumption Affordability Ratio: SCAR Index

*Cost of satisfying the need for shelter*

**Shelter  
consumption costs**

$$\text{SCAR} = \frac{\text{Shelter consumption costs}}{\text{Discretionary net income after other necessities}}$$

*Ability to pay for shelter*

- Actual rent
- Imputed rent
- Maintenance, repair
- Insurance
- Utilities
- Transportation costs

- 
- Income from all sources

less

- Taxation
- Finance obligations
- Food
- Clothing
- Private health care
- Other essential employment costs

# Factors that influence SCAR

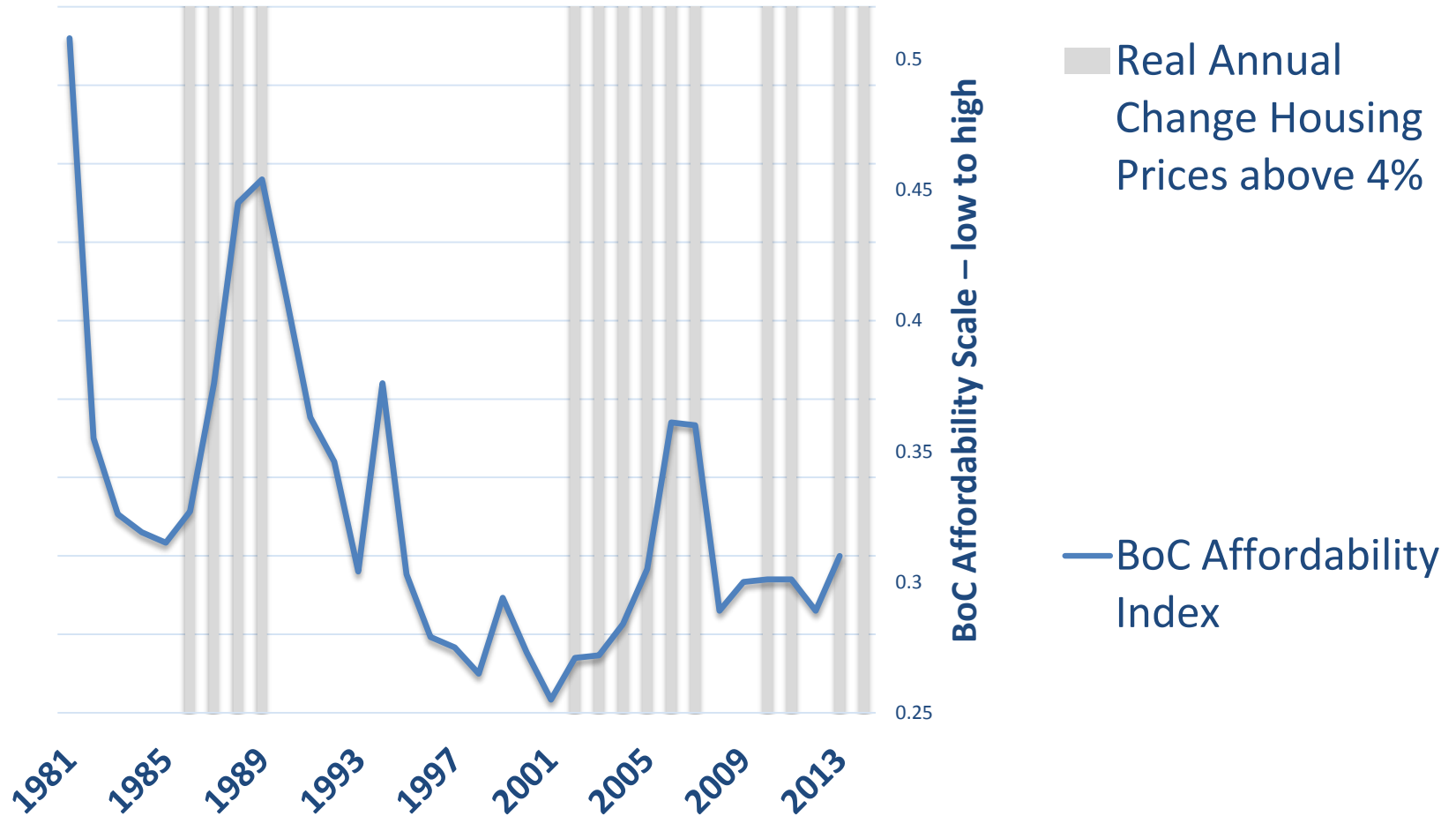
## SCAR Index

**Shelter  
consumption  
costs**

**Discretionary  
net income  
after other  
necessities**

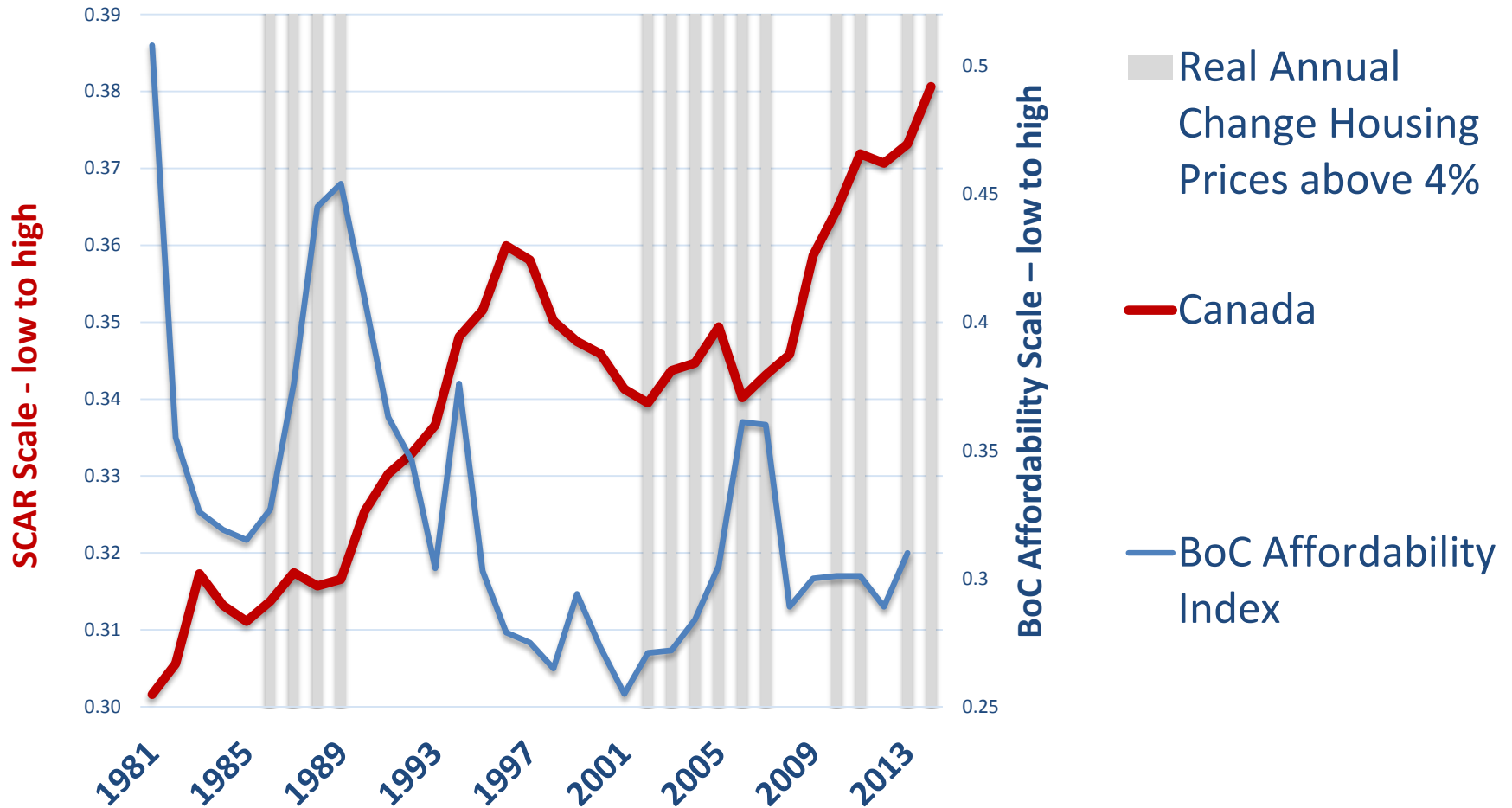
# SCAR as a Measure of Affordability Pressures

## Bank of Canada Affordability Index



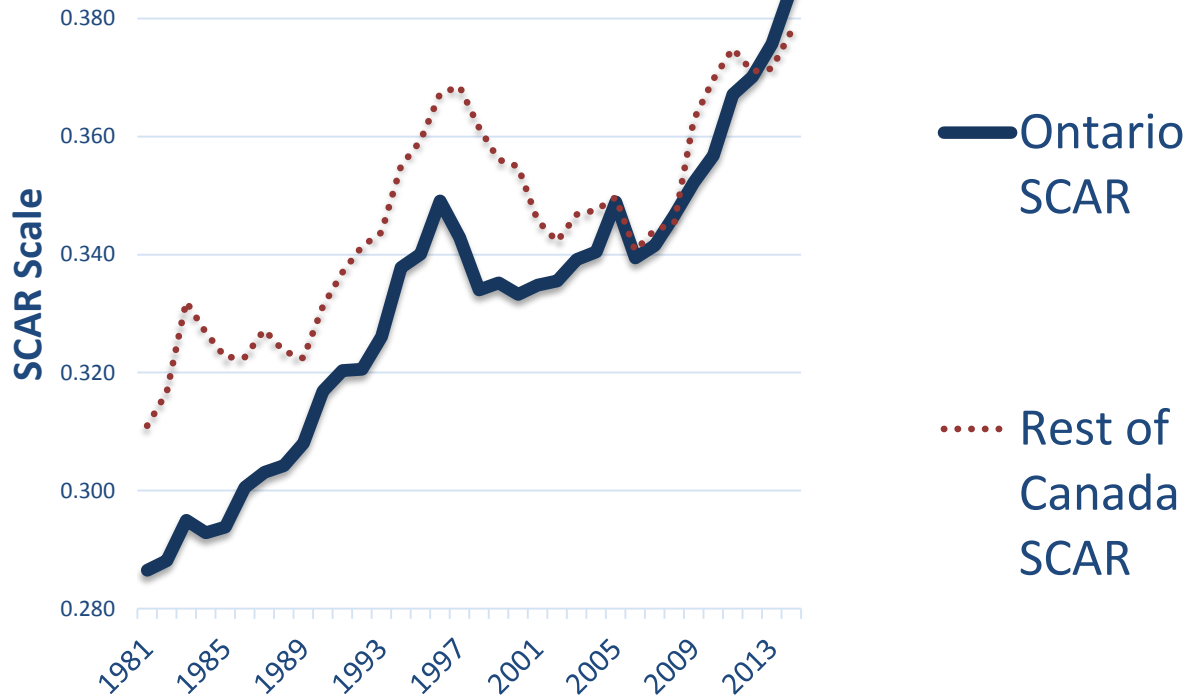
# SCAR: Growing nationally

## Comparison of SCAR with Bank of Canada Affordability Index



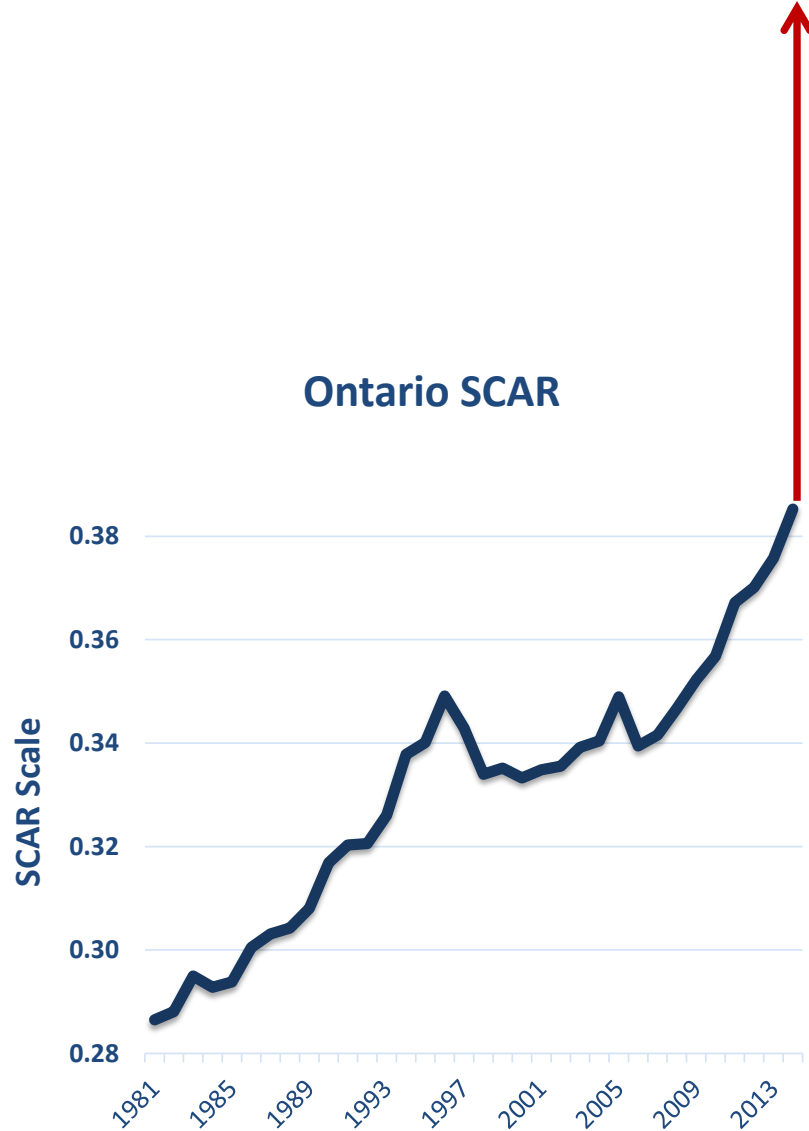
# SCAR: Growing in Ontario

## Comparison of Ontario SCAR with the rest of Canada



- **Ontario affordability pressures are at an all-time high**
- **SCAR index shows that affordability pressures have grown by 13.5% since 2006**

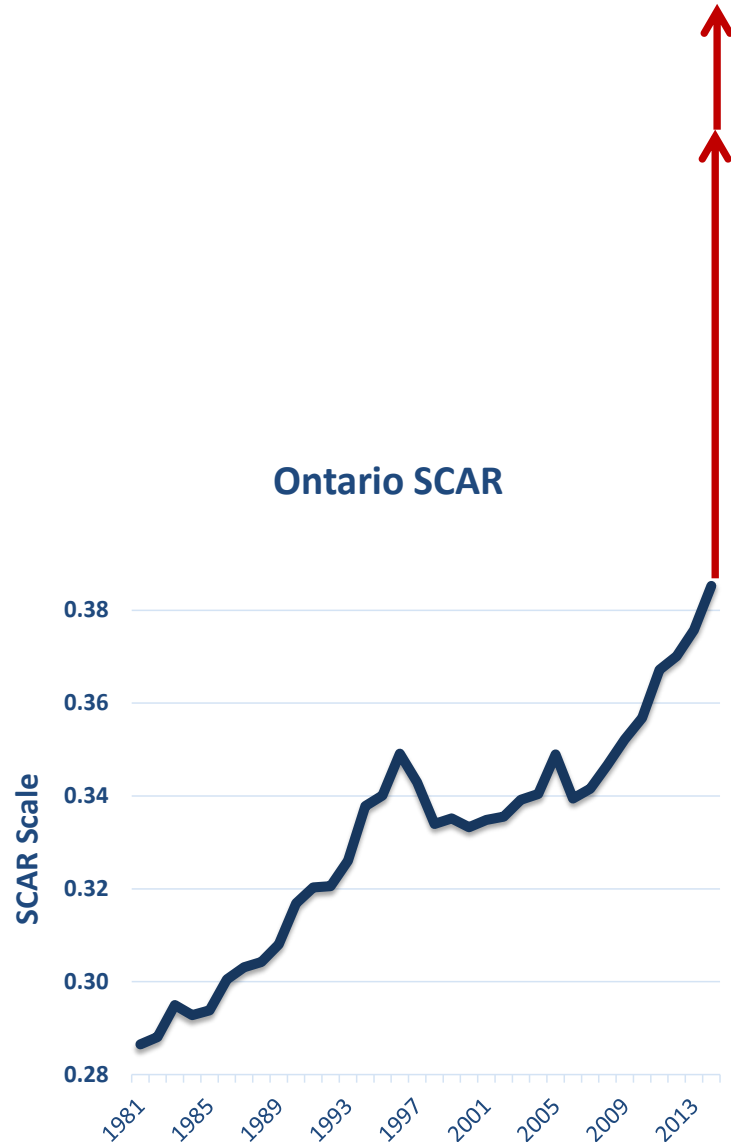
# SCAR: Growing in Ontario



- **Averages are dangerous**
- **Preliminary analysis**
  - **At least 1.2 million households under significant affordability pressure**
  - **At least 26% of Ontario households**



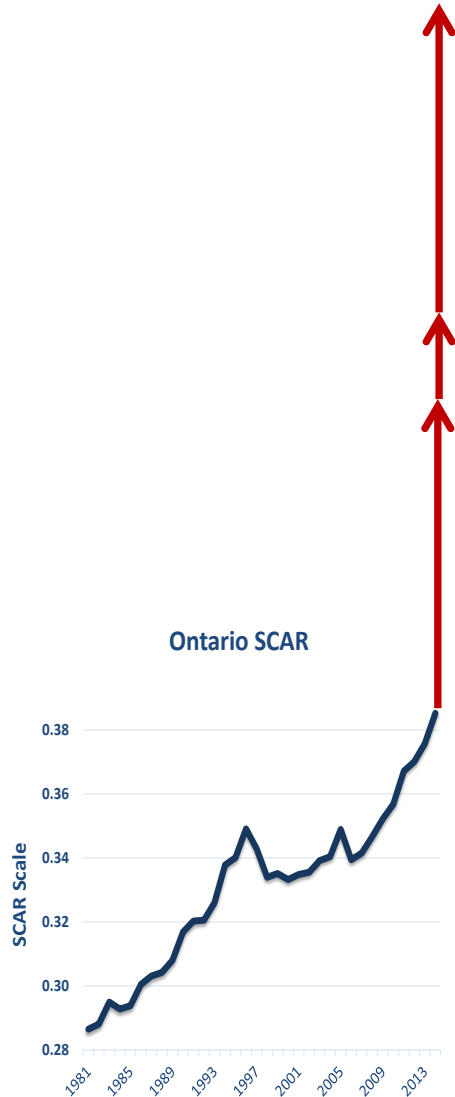
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# SCAR: Growing in Ontario

SCAR = 62%

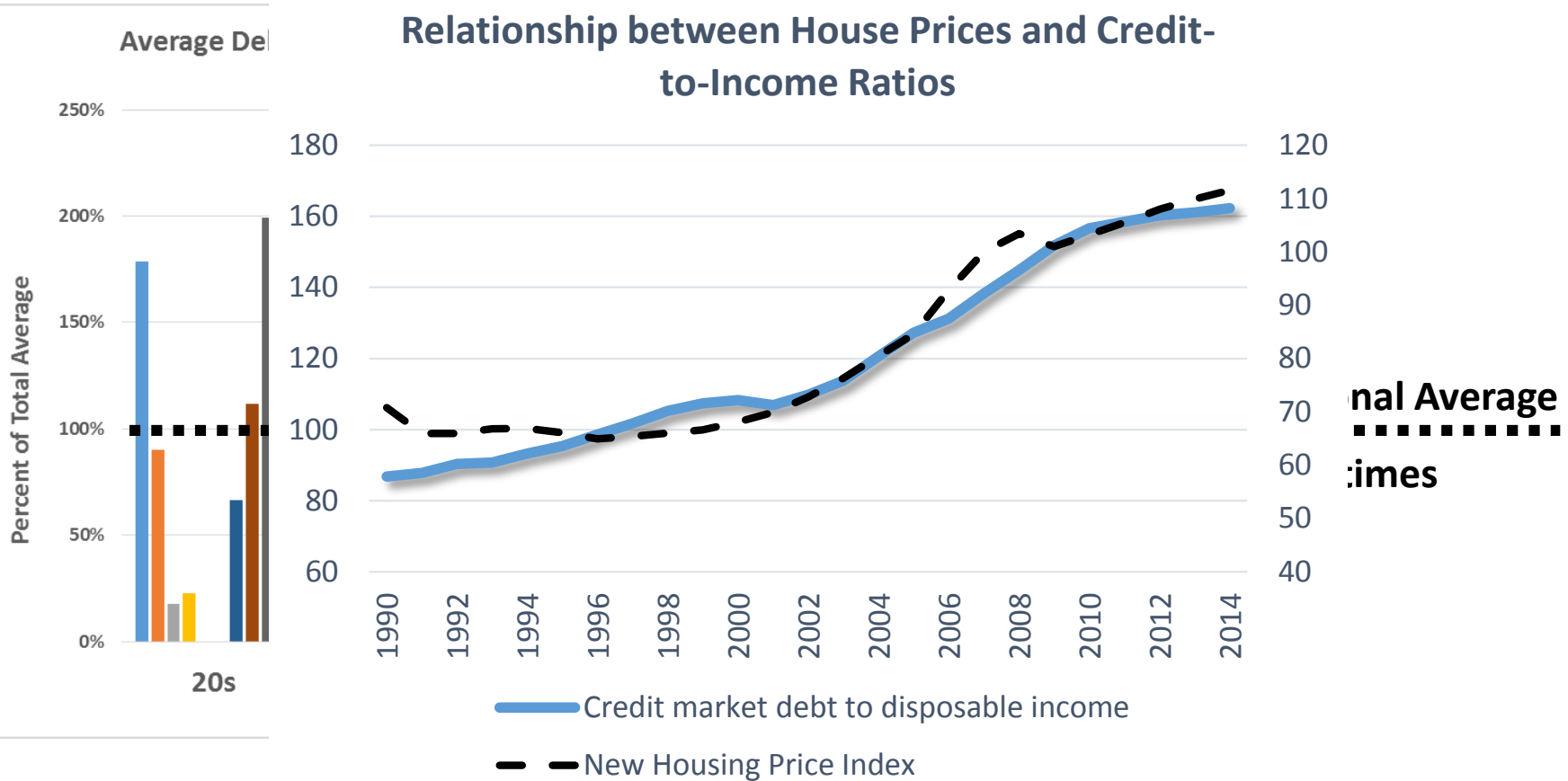


- **Averages are dangerous**
- **Preliminary analysis**
  - **At least 1.2 million households under significant affordability pressure**
  - **At least 26% of Ontario households**
- **840,000 homeowners**
- **480,000 of those homeowners under age of 45**
- **Another 380,000 renting households yet to be considered**

# Sneak peak at debt

**Average debt to income = 1.63 times**

**Relationship between House Prices and Credit-to-Income Ratios**



**Averages are dangerous**

# Affordability: It's a symptom of something complex



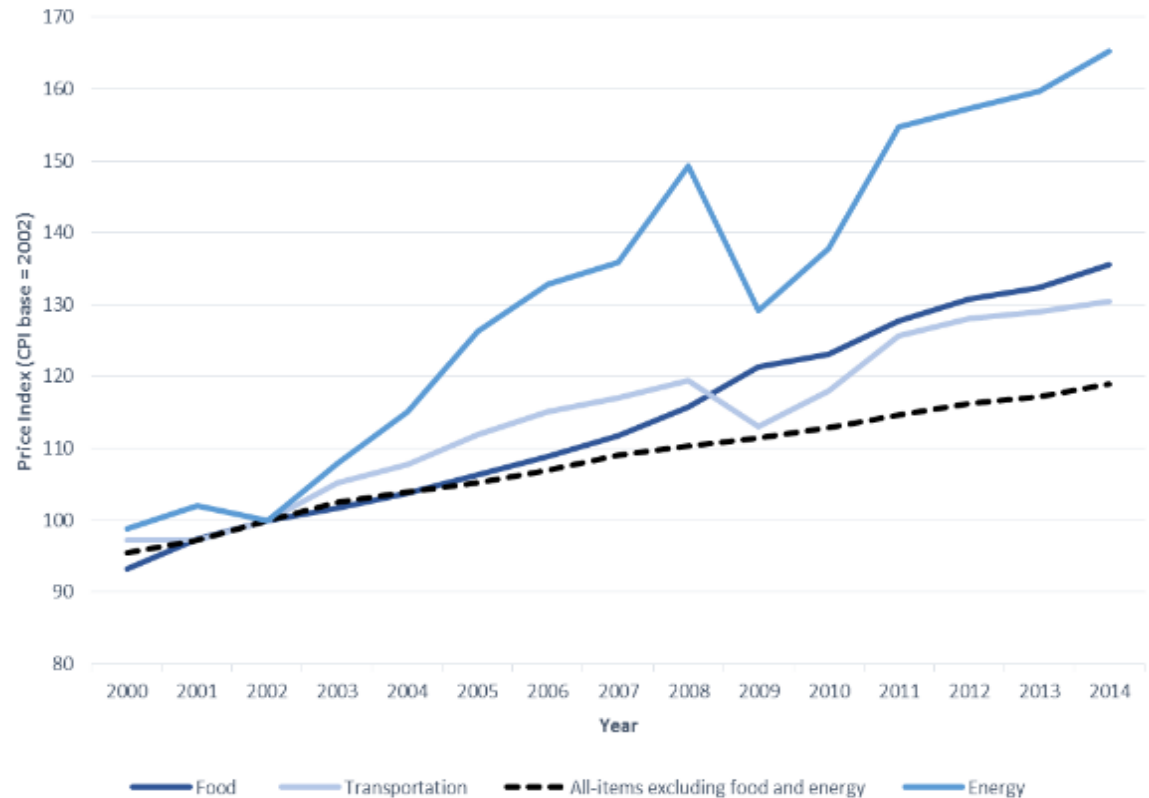
# Ability to Pay: Generation and distribution of economic prosperity

$$\text{SCAR} = \frac{\text{Shelter consumption costs}}{\text{Discretionary net income after other necessities}}$$

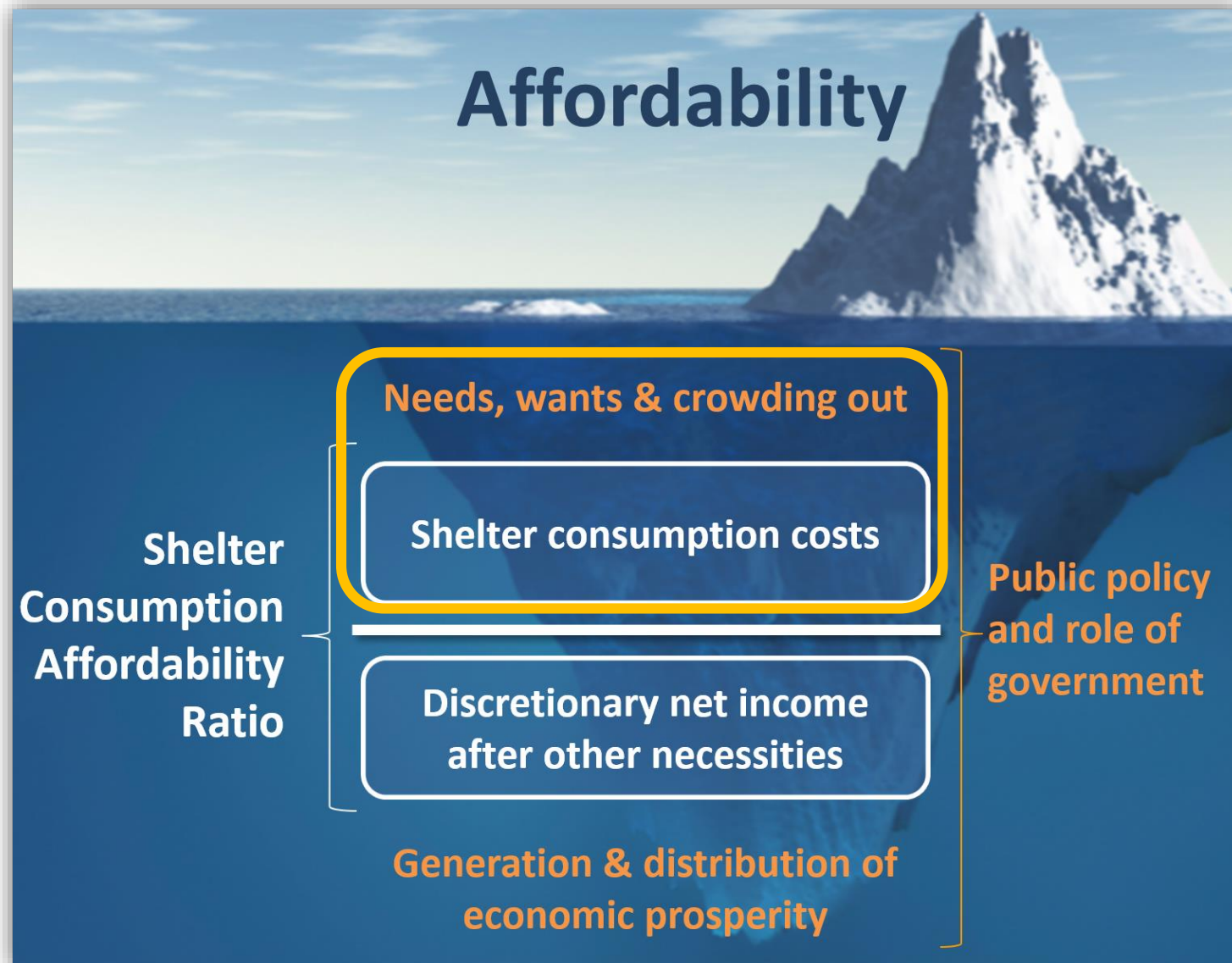
- Corporate and labour share of income
- Labour income not keeping up with productivity
- Industry Wage inequality
- Part-time jobs
- Income inequality
- Wealth inequality
- Expenses rising faster than inflation

- Stagnating wages and worsening job quality: Particularly for workers under the age of 45
- Income and wealth inequality have increased, accelerating substantially since the financial crisis of 2007.

CPI relative to Food, Transportation, and Energy Costs



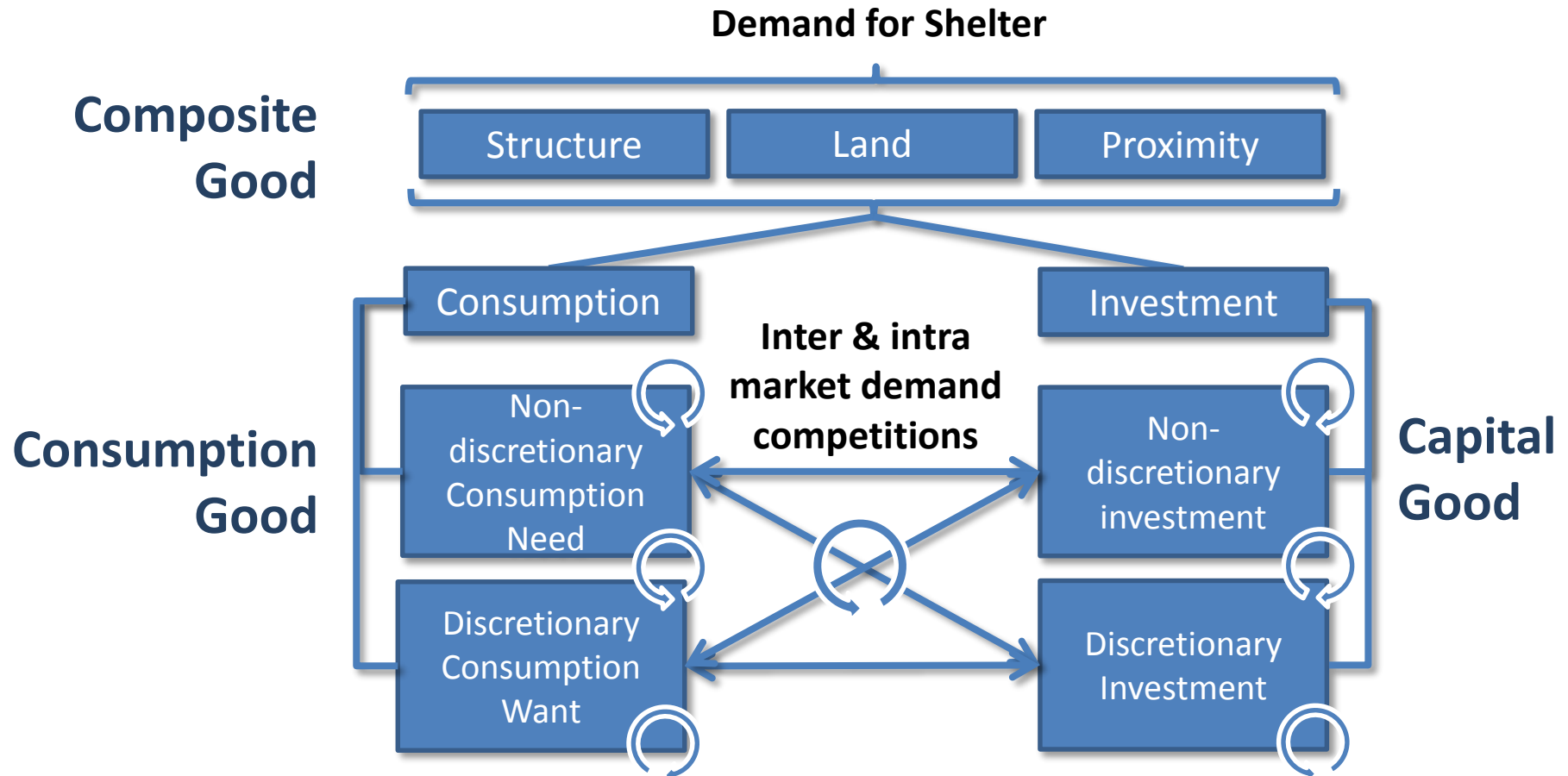
# Affordability: It's a symptom of something complex



# Needs, wants, and crowding out

- Crowding out occurs when the consumption and/or investment behaviour by one group reduces the ability of others to access the market
- For traditional economic approaches, this is not a problem:
  - Households will participate in a market to the extent of their willingness to pay
  - Correspondence with WILLINGNESS TO PAY and ABILITY TO PAY
  - Households will take RATIONAL RISKS & are responsible for the risks they take
- **BUT: Shelter is a NEED**
  - Can't just “leave the market” or opt out of it
  - Households looking to satisfy “needs” have a greater willingness to pay more than households looking to satisfy “wants”
  - WILLINGNESS & ABILITY TO PAY CAN DIVERGE, AND IT HAS
  - VERY ESSENCE OF THE AFFORDABILITY PROBLEM (assuming sufficient housing stock)

# Needs, wants, and crowding out





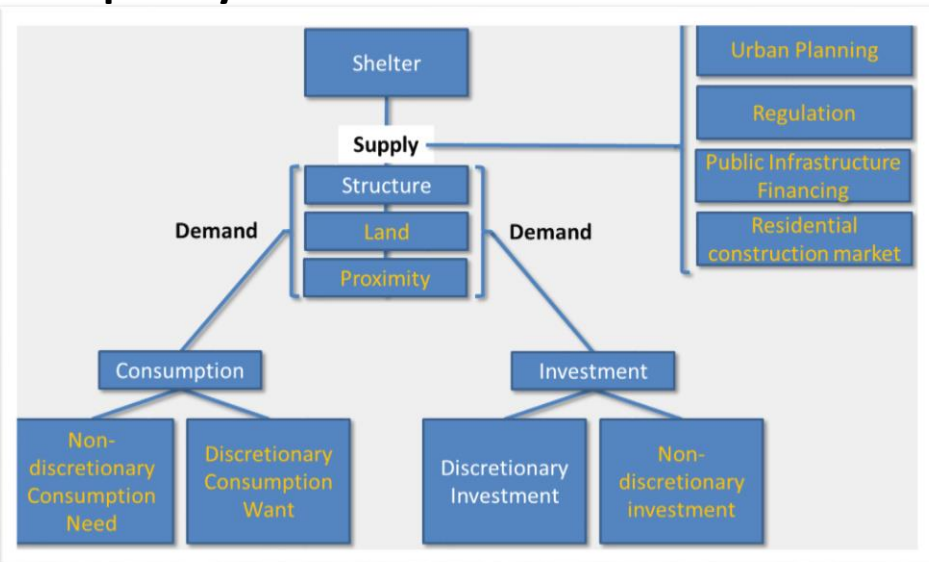
# Needs, wants, and crowding out

- Causes of crowding out
  - ✓ – Differences in motivation to compete for housing
  - ✓ – Differences in ability to pay
  - ✓ – Differences in housing desirability
- Symptoms of crowding out
  - ✓ – Increasing share of middle-income households in core housing need;
  - ✓ – Rising share of households engaging in risky financing activities
  - ✓ – Affordability pressures for a growing proportion of the population
- Canadian investor wants
- Foreign investor wants
- “Want” housing formation
- Income inequality
- Job inequality
- Government transfers and support of social housing
- Labour and product market regulations
- Public infrastructure deficits
- Public infrastructure stock
- Growth policies
- Co-ordination across government tiers and agencies
- Density
- Proximity
- Interest rates & monetary policy

**Public policy and  
role of government**

# Public policy and role of government

## Complexity of the market for shelter



**Do we understand the forces at work?**

**Are we asking the right questions?**

**Do we have a framework to ask the right questions in?**

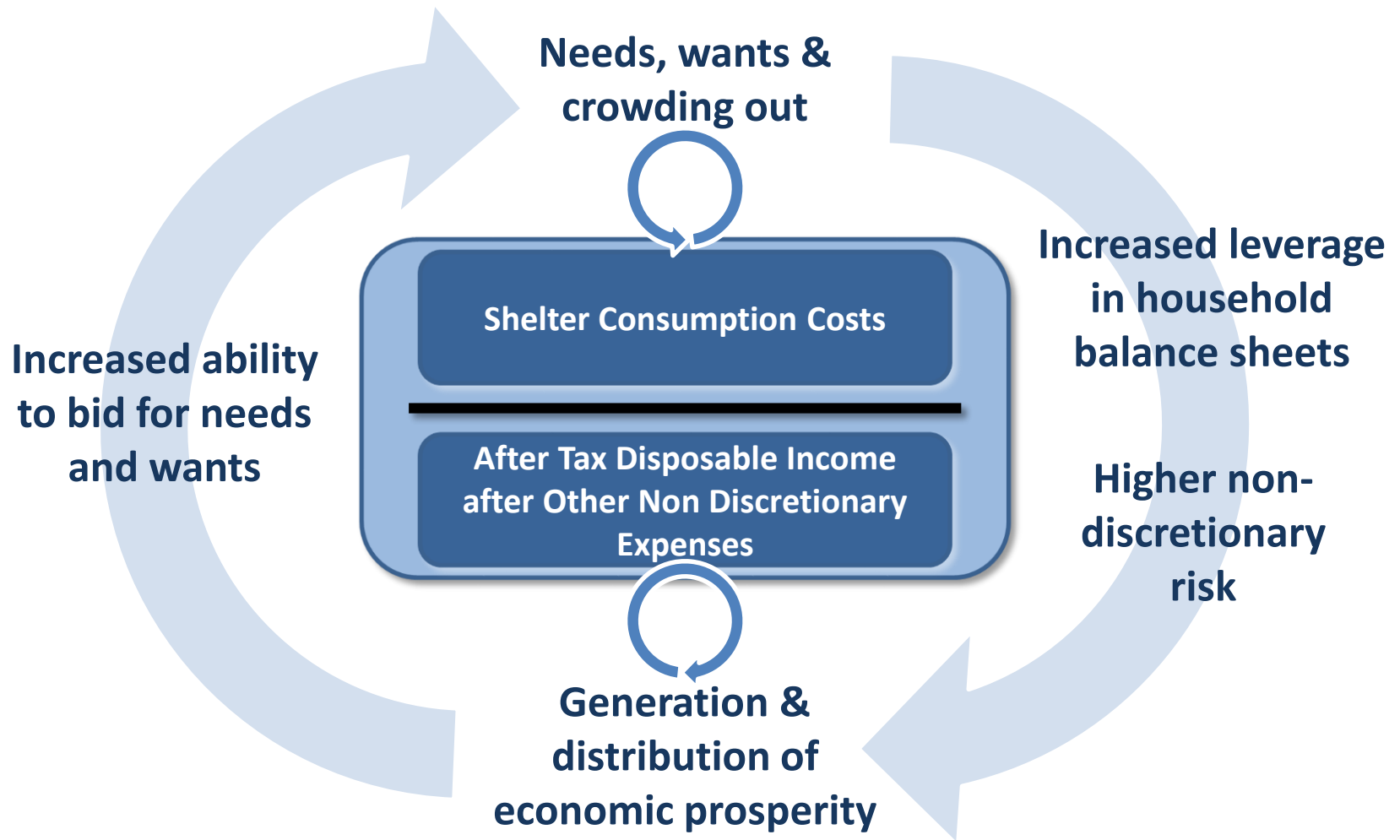
## Affordability challenges:

- Satisfaction of housing wants should not:
  - restrict meeting others' needs and
  - put major segments or the whole system at risk
- Expectation of Policy-Makers and Regulators to protect availability of shelter to meet needs and effectively manage systemic risk to the economy

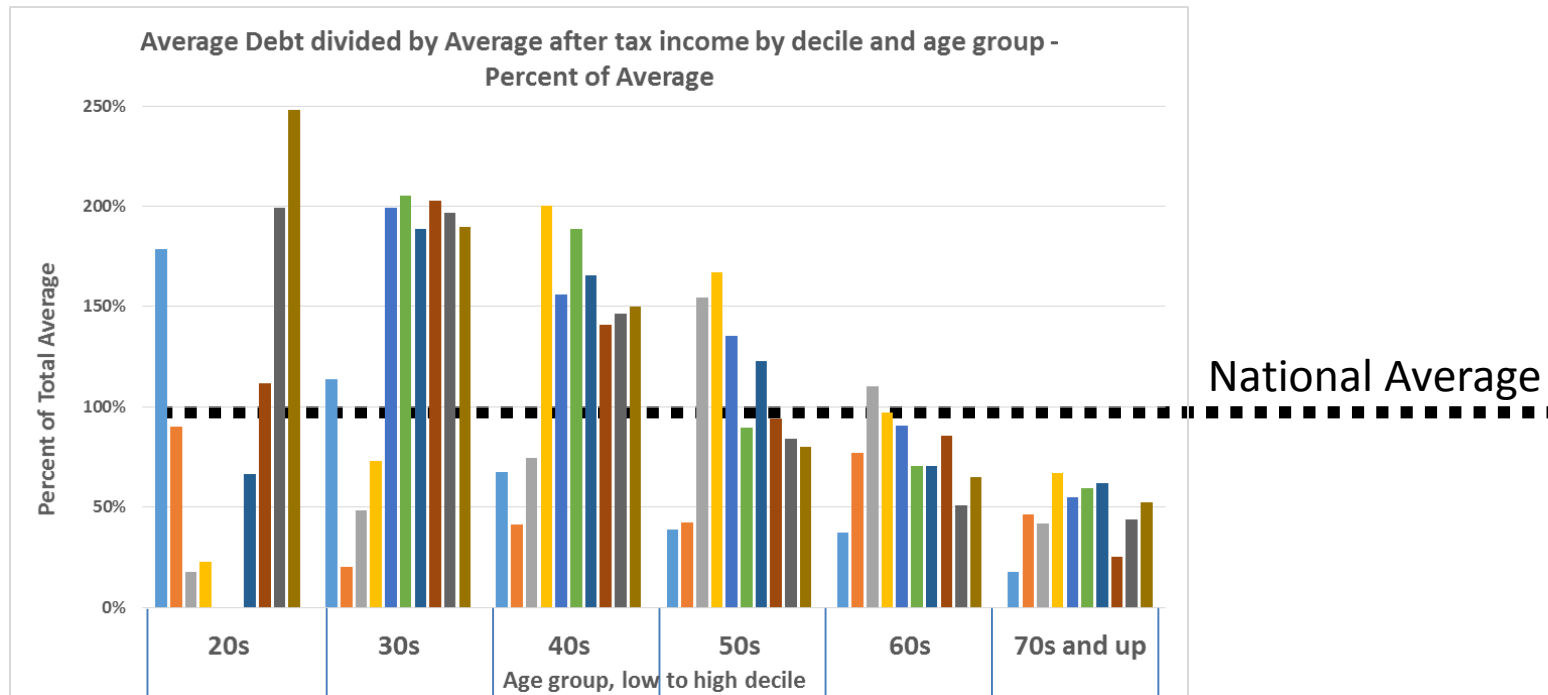
**Interaction of free market forces and 3 levels of government and many government agencies**

**Who has the tools to understand this?** ←

# Systemic Risks: Intersection of Affordability Issues with Cheap credit



# Average Debt divided by Average after tax income by decile and age group



20s	30s	40s	50s	60s	70s & up	Age group
40%	70%	70%	40%	10%	n.a.	Percent above the average
<b>184%</b>	<b>185%</b>	<b>164%</b>	<b>145%</b>	<b>110%</b>	n.a.	Average debt to income above the average
25%	40%	30%	75%	100%	n.a.	Percent below average income

# Needs, wants, crowding out and Systemic Risk

- “[borrowers and lenders] bear the ultimate responsibility for their own decisions at the individual and firm level. It is not the role of monetary policy to protect individuals from making bad choices”
  - Bank of Canada Governor Poloz, Remarks in Lima, Peru, October 10<sup>th</sup> 2015
- Economic theory
  - Households will participate in a market to the extent of their willingness to pay
  - Correspondence with WILLINGNESS TO PAY and ABILITY TO PAY
  - Households will take RATIONAL RISKS & are responsible for the risks they take
- BUT: Shelter is a NEED
  - Can’t just “leave the market”
  - Complex consumer behaviours around NEED
  - HOUSE HOUSEHOLDS IN NEED CAN TAKE “IRRATIONAL” RISKS
  - WILLINGNESS & ABILITY TO PAY CAN DIVERGE, AND IT HAS
  - VERY ESSENCE OF THE AFFORDABILITY PROBLEM (assuming sufficient housing stock)

# Affordability - Symptom of something complex: Systemic Risk

- With “needs”, lower-income, middle-class and younger households are increasingly reliant on cheap credit
- Economic growth has become more precarious as these groups are now significantly vulnerable to adverse changes:
  - interest rates, job-market pressures, and inflation
- An uncomfortable “status quo” may hinder future economic growth: significant debt burdens and future consumption
- Smaller economic shocks could lead to contagion: economically vulnerable homeowners makes the risk of contagion more likely
- Risk to the economic contribution of residential construction
- Significant implications for fiscal policy and taxpayers

# Final Remarks

- Housing prices and wants
- Agenda is SUSTAINABILITY
- Not dictating what to think.... Information to think about
- Current research: More questions than answers
- Complexity of the system needs to be understood
- Need further research to quantitatively measure the forces affecting affordability as well as the costs and risks – crucial to have more precise and timely metrics
- Not the same way as before, but different and more sophisticated approaches are required
- **Definitely a role for greater understanding and co-ordination by public and market policy authorities**



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