Townhouses Not a Magic Bullet for GTA Ground-Related Housing Affordability

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Summary

This paper examines townhouses as an option for affordable ground-related housing in the Greater Toronto Area (GTA). While new townhouses are less expensive than new single-detached houses, they remain out of reach for many prospective buyers. This is largely because the serviced land component of new townhouses is inordinately high, not only in the GTA but in other parts of the Greater Golden Horseshoe (GGH) as well. Oakville and the southern York Region (Markham, Richmond Hill and Vaughan) in particular, have unusually high townhouse costs.

Key ways to enhance townhouse affordability include (a) greatly increasing the supply of serviced sites for both greenfield and intensification development and; (b) reducing government-imposed costs on new housing, especially development charges.

Introduction

Townhouses are often touted as an affordable alternative to pricey single-detached houses in the GTA. They are regarded as part of the “missing middle”. Townhouses not only typically have a smaller floor area, but they consume less land per unit than single-detached homes. A recent study conducted by Altus Group for the Building Industry and Land Development Association (BILD) estimated that in five GTA municipalities, new townhouses are indeed substantially less expensive than new single-detached homes.1

Unfortunately for many prospective buyers aspiring to own a new home with a front door on the ground level and a piece of private green space, even townhouses are priced beyond what they can afford.

This paper examines: (1) why prices of new townhouses in the GTA are high; (2) why prices differ so much between municipalities; and (3) what can be done to increase their affordability.

Townhouses less expensive than single-detached homes

The price of a standard new townhouse is considerably below that of a standard new single home according to estimates for five GTA municipalities prepared in a recent study by Altus Group (see Figure 1).2

Highlights:

- Prices of townhouses range from being 47-50% lower than single-detached houses in Oakville and Toronto (North York) to 35% in Markham and 28-30% lower in Brampton and Pickering.
- Part of this differential reflects the smaller square footage of the standard new townhouse (28% smaller) utilized in the Altus Group study.

Figure 1: Altus Group Estimated Prices of New Townhouses and Single-Detached Houses by Municipality in the GGH, Spring 2018

*Reflects prices in North York only
Source: CUR based on data from Altus Group Consulting
Wide variations in townhouse prices between municipalities

Prices for both new single-detached houses and townhouses (with standard construction specifications) vary considerably among the five GTA municipalities examined in the Altus Group study (see Figure 1, page 4).

Highlights for townhouse prices include:

- Economic theory suggests that as you move away from the downtown core of a region, land and home prices start to fall. For the most part, municipalities follow this basic economic rule. For example, townhouses in Pickering and Brampton are cheaper than townhouses in the City of Toronto.

- The estimated prices of townhouses in Markham and Oakville are atypically high. Townhouses in Markham are $150,000 more expensive than townhouses in the City of Toronto on a similar square foot basis. Townhouses in Oakville are less expensive than those in the City of Toronto, but more expensive than those in Brampton and Pickering, despite being further away from downtown Toronto.

Serviced land values drive differences in price of new townhouses by municipality

The variations in the final price of a townhouse by municipality can be linked to the price of serviced land and municipal regulatory costs.

A 2017 study by the Centre for Urban Research and Land Development (CUR) pointed to the mismatch between the demand and supply for new townhouses in the GTA. It blamed the shortfall in new townhouse construction on a scarcity of serviced sites. This scarcity, relative to demand, has resulted in the rapid increase in land values noted by MCAP (see Figure 2).

Townhouse serviced lot values per front foot, as estimated by MCAP, document the increase in average values between 2005 and the spring of 2018 (see Figure 3). For that period, the average value climbed from $4,663 to $15,375, an average annual increase of about 17%. For a townhouse sited on a 20-foot wide lot in the GTA, the average total lot value in the spring of 2018 was $307,500.
Rising land values have been compounded by the rise in municipally-imposed costs on the development of serviced sites, especially sharply rising development charges.

The cost of constructing new townhouses should be about the same across the region, regardless of municipality, since labour and materials are mobile across municipal boundaries. The expected profit margins of builders should also be more or less the same. This leaves one crucial factor remaining as the primary cause of municipal differences in new townhouse prices: the price of serviced sites. While distance to Toronto is a factor, the price of serviced sites is also very much influenced by the municipal land use planning system.

Figure 2 (page 5) shows MCAP estimates of townhouse lot values for sixteen municipalities in the Greater Golden Horseshoe (GGH).\(^5\) (Note that there is not an estimate for the City of Toronto and that the values include all development charges, except those dedicated to education).

Highlights include:
• All three municipalities in the southern York Region, not just Markham, have unusually high serviced land costs, which ultimately impacts the prices of new townhouses;
• The estimates also display an abnormally high price in Oakville (as do Altus’ townhouse price estimates);
• Elsewhere, the pattern of lot price declines as one moves further from the City of Toronto is in general accordance with the theory of land economics:
  - East Gwillimbury lot values are lower than the three southern municipalities in York Region and Barrie/Innisfil values are lower than East Gwillimbury;
  - Lot prices diminish in Durham Region moving from Ajax to Clarington; and
  - Kitchener-Waterloo and Guelph lot values are less than Milton.

The selling prices for new townhouses in the municipalities covered by MCAP’s land value survey demonstrate how the varying values of serviced lots carry over into the price faced by consumers (see Figure 4).

The selling price estimates prepared for this study are derived using a simplified proforma (see Appendix A for detailed cost breakdown and assumptions).\(^6\)
Highlights:

• The ranking of municipalities by the estimated selling prices of new townhouses is the same as MCAP’s land value estimates – not surprising since land is the only variable input in the proformas;

• The lowest land prices are found in the GTA, including Guelph, Barrie/Innisfil and Kitchener-Waterloo; and

• More notable is the share of the total price accounted for by the value of the serviced townhouse lots – as high as 60% in Markham and above 40% in all GTA municipalities surveyed, except for Clarington at its eastern extremity.

Loosening regulation costs and barriers key to improving townhouse affordability

1. Loosening land use planning constraints

Many observers, including politicians, media and the general public, blame demand factors for the deterioration in overall affordability in the GTA. Economics 101 tells us that housing prices are determined by the interaction of supply and demand. When supply fails to expand to meet demand, the result is high and rising housing prices or rents. To help keep a lid on prices, supply should be allowed to respond more freely to demand pressures.

Recent research published by the Canada Mortgage and Housing Corporation (CMHC) has demonstrated that the response of new housing supply to a given rise in housing prices has varied significantly by urban region. New housing supply has come on the market at much lower rates in response to price rises in Toronto and Vancouver than urban regions such as Edmonton and Montreal.

Based on research conducted by CUR and CMHC, the single largest cause of the sluggish supply responsiveness to rising prices is the land-use planning system.

The shortage in supply of serviced sites for new housing - whether on greenfield lands in the 905 regions or on redevelopment sites in built-up areas like the City of Toronto - is a particular concern.

CUR’s recently released action plan for improving housing affordability recommends a number of actions to accelerate the supply of serviced sites for new housing, including townhouses.

These recommendations include:

• Enforcing municipal compliance with Policies 1.4.1 a) and b) found in the 2014 Provincial Policy Statement, to foster an ample supply of short-term land by housing type;

• Interpreting policies in the 2017 Growth Plan for the GGH where possible in ways that encourage the construction of a range of housing types;

• Expediting the expansion of municipal sewer and water infrastructure in the 905 regions; and

• Conducting an in-depth review of Ontario’s land use planning system to improve its efficacy and minimize adverse impacts on housing affordability.
2. Lowering municipally-imposed development costs

The Ontario government and municipalities inflate housing prices – both existing and new – by imposing direct costs on the development of land for new housing in order to achieve planning goals. These direct development costs include local and regional development charges, education development charges, planning review fees, building permits, engineering and servicing fees, and parkland dedication.

While the Altus Group study quantified government charges on new single-detached and high-rise apartment housing, it did not calculate the direct costs on new townhouses specifically. The estimates for single-detached houses are taken as roughly representative for townhouses (see Figure 5).

Highlights:

• The direct costs are large in all five municipalities. Markham, Oakville, and Brampton have the highest costs (over $100,000) and Ajax and Bradford West Gwillimbury the lowest (between $47,000 and $57,000); and

• Development charges are the single largest component of the costs in all municipalities.

Conclusion

Housing affordability challenges faced by regions across the GTA largely reflect the high cost of land and regulation cost.

A key way, therefore, to reduce the magnitude of municipally-imposed costs on new townhouses (and other forms of housing) is to lower development charges. A CUR study in 2014 concluded that a major component of development charges – the financing of growth-related sewer and water infrastructure – should be financed be all users of these services, not just those living in new homes.\(^{10}\)
Endnotes


2. The standard townhouse has 1,800 sq. ft. of floor space and the standard single-detached house has 2,500 sq. ft. of floor space.


6. Hard construction costs (labour & materials) are at the midpoint range estimated by Altus Group (2018) - see footnote 14 below. Soft costs (financial, professional, etc.) are assumed to be 30% of the hard costs and a profit margin of 12% of total hard and soft costs is assumed. The estimated townhouse prices are close to the prices estimated by Altus Group in its BILD study for the four overlapping municipalities.

7. It should be noted the discussion applies equally to all ground-related forms of housing including townhouses. The text in this section is excerpted from a recent CUR paper, “Action Plan for Improving Housing Affordability in the Greater Golden Horseshoe.” (July 17, 2018) Available at https://www.ryerson.ca/content/dam/cur/pdfs/policycommentaries/CUR_Housing_Affordability_Policy_Recommendations.pdf It should be noted the discussion applies equally to all ground-related forms of housing including townhouses.


12. MCAP’s values include all development charges except for educational development charges.

13. This was not specified in Altus Group’s model, but is a reasonable industry estimate.


15. This is a standard rule-of-thumb for construction estimations.
Appendix: Estimation of the cost of building a standard new townhouse in GGH municipalities

The market price of a home is partly a function of the costs incurred to build it. This represents the value spent that the builder wants to recover through its sale, with some additional margin of profit for their effort. Price is also partly a function of the market’s demand or willingness to pay for the home.

The costs of building new housing can be broken down into four elements:

1. **Serviced site costs**: acquiring and servicing the site on which to construct a home;
2. **Hard costs**: construction materials and labour to physically construct the home;
3. **Soft costs**: planning, architectural, financing, landscaping and other costs;
4. **Profits**: typically expressed as a percentage of hard and soft costs to compensate the builder for their efforts and the risks incurred.

This analysis uses MCAP’s data from the spring of 2018 from various GGH municipal sub-markets on the value of construction-ready land (appropriately sized, zoned and serviced for townhouse construction) to make an estimate of the final cost of townhouse construction in each municipality.\(^{11}\)

To model the costs, the following assumptions were made:

- The value of the land is the midpoint of the ranges for serviced townhouse lots that MCAP provides;\(^{12}\)
- Each townhouse is constructed on a lot with a 20 foot wide frontage;\(^{13}\)
- The gross size of each townhouse is 1,800 sq. ft, as specified by Altus Group’s model;
- Average hard costs of construction is $127.50 per square foot, the midpoint of the range provided by Altus Group for Row Townhouses;\(^{14}\)
- Soft costs are equivalent to 30% of the total value of hard costs;\(^{15}\) and
- The builder obtains a 12% profit margin, calculated on combined land, hard and soft costs.

Based on our models, the price estimates are as follows:

<table>
<thead>
<tr>
<th>Municipality</th>
<th>Land Price per F.F.</th>
<th>Total Land Cost</th>
<th>Total Hard Costs</th>
<th>Total Soft Costs</th>
<th>Total Profit</th>
<th>Final Price</th>
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<tr>
<td>Caledon</td>
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Source: CUR estimates based on data from MCAP