

The housing problem isn't supply, it's unsustainable foreign demand

By Josh Gordon

June 10, 2016 – *The Globe and Mail*

A debate about supply and demand is not something people typically worry about. In the debate about housing affordability in Toronto and Vancouver, though, you should. If we misdiagnose the cause of the surge in prices, policy action may not only fail to fix the problem – it may make it worse.

Influential voices in the real estate industry in both cities have adopted the position that sharply rising prices are the result of housing supply constraints. In Vancouver, that position is expressed most loudly by Bob Rennie, a prominent condo marketer. In the lead-up to his annual address to the Urban Development Institute, a developer-funded group, Mr. Rennie repeatedly stated that the problem was “all about supply” and that he opposed any actions to curtail or regulate foreign demand for Vancouver housing.

This is the same line taken by the British Columbia government (perhaps not coincidentally, some say – Mr. Rennie is the provincial Liberals' lead fundraiser). When the Toronto debate reaches the same intensity as Vancouver's, this will be a tempting position for the Ontario government to adopt, too. So it's important to understand the weaknesses of these arguments in the Vancouver context.

Consider the claim that it's “all about supply.” This claim suggests that we are not building enough new housing to meet the demand from a growing population. But is there any evidence of that? No. In fact, the ratio of population to housing units in Greater Vancouver has been falling for the past 20 years or so. Even the UDI said in a late 2015 report that housing starts were in the “healthy range” given population growth, and had been for several years. And housing starts have surged recently, to their

highest point in over 25 years, even while net migration (international and domestic) into Vancouver has declined somewhat in recent years.

So how can a spike in housing prices, including condo prices, be explained by supply? As anyone with a basic familiarity of Economics will tell you, they can't. It has to be a surge of demand.

In industry-oriented publications, the UDI recognizes it's not mainly a supply problem, but with the general public, in order to press the developer agenda, the problem is suddenly “all about supply.”

This is why almost anyone without a vested interest in the supply story isn't buying it. Leading national columnists and academics have dismissed this view, recognizing the central role of foreign demand. Canada's big banks, which might have money at stake if they get the diagnosis wrong, are also being clear that foreign demand is a major issue and urging policy action to regulate it.

The Bank of Nova Scotia has gone to the exceptional step of curtailing its mortgage lending in Vancouver (and Toronto) because it recognizes the market surge is not mostly based on local fundamentals, such as supply constraints, but rather on large flows of volatile international capital (and the bubble mentality it has generated). The Bank of Canada now seems to be intimating a similar view.

Vancouver does have a longstanding land supply issue, yes. But it can explain neither the recent surge in prices nor the extreme prices relative to the region's incomes, as I documented in a recent report. The approximately \$1-trillion (U.S.) flowing out of

China can largely account for the past year's surge, and a continuous flow of foreign money through the Business Immigration Program can mostly explain the "decoupling" of the housing market from local incomes before that.

Why does the diagnosis matter? Couldn't rapidly expanding supply bring prices down, too?

Yes, expanding supply dramatically can help bring down prices. But the danger with that strategy is what will happen if all of the "excess" demand suddenly dries up, either because it's based on a bubble mentality or due to an unsustainable credit bubble in China. In that case, then the housing correction will be even deeper and more damaging.

This is what happened in many U.S. cities during their housing adventure: Subprime credit spurred a surge in demand and prices, which builders took to mean "expand supply rapidly," and then when the subprime lending inevitably undermined itself and overbuilding had occurred, the housing market tanked (and brought the American financial system to its knees).

The policy levers to curtail foreign investment exist, should we wish to use them. Properly

implemented, they will address the root cause of the recent price surges without setting us up for an even worse price correction. It is simply a matter of political will.

During his talk, Mr. Rennie suggested that opponents of densification and condo building forfeit their right to talk to young people about affordability in Vancouver. I suggest, tongue in cheek, a different rule: If you're not willing to recognize the emerging consensus about the role of foreign capital and are not willing to propose steps to address its impact, then you have no business talking to the younger generation about affordability.

Young Vancouverites (and Torontonians) are currently being put into competition with massive amounts of foreign money, sometimes of dubious origin, which is something older generations never faced. Please don't tell us where to move or what our expectations should be until you acknowledge those facts and help us address them. We know it will be harder to buy a detached house than it was before, but first, put us on a level playing field.

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