Editorial: How to pop Toronto's housing bubble, without blowing up the economy

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The price of the average detached house in the Greater Toronto Area has shot up by 33 per cent over the last 12 months, hitting $1,214,422 in March. The average semi-detached home price has risen 34 per cent. Townhouses are up 33 per cent; so are condos. No wonder federal Finance Minister Bill Morneau this week sent a letter to Toronto Mayor John Tory and Ontario Finance Minister Charles Sousa, wanting to get together to talk about what to do. The GTA hasn't seen price increases like this since 1989 – just before the last Toronto housing-market crash.

So, as Mr. Morneau and his colleagues ponder their next moves, here's our advice.

Stop waiting, start acting: Governments have spent the last few years hoping that they could sit back and let Canada's hottest real-estate markets – Vancouver and Toronto – self-correct. The good news is that markets always do, eventually. The bad news is that a late-arriving correction can carry catastrophe in its wake. Exhibit A is the U.S. housing bust of a decade ago, leading to the worst economic downturn since the Great Depression.

It's not the economy, stupid: Canada's economy is hardly racing ahead at an overheated clip. And there's almost no inflation. Toronto housing prices shooting up 33 per cent in a year is not the result of an economic boom.

Don't blame a lack of housing supply: Despite the claims of many in Toronto's real estate and development industries, there's limited evidence of a housing shortage. Yes, the GTA has grown by nearly 400,000 people in the past five years. Yes, Metro Vancouver has added 150,000 people. Yes, all of those people need somewhere to live.

But there's been lots of new construction. Enough has been built over the last few years that the number of housing units per person in Toronto has been rising, not falling. In a recent study, Simon Fraser University professor Josh Gordon concluded that "there is little indication of 'not building enough.'"

It's psychology: With apologies to Shakespeare, the fault for the housing bubble, dear Canadians, is not in our stars, but in ourselves. Bubbles, from the tulip mania of the 17th century to the stock market's dot.com boom, are products of the fertile human imagination. Market psychology? It's all in our heads.

You've heard of the phrase *folie à deux;* a housing bubble is a *folie à millions.* It involves millions of people believing something that, in hindsight, may be very foolish. In the case of Toronto's housing bubble, it's believing that prices are forever guaranteed to go higher – so buyers must buy now, or miss out, and sellers must not sell now, or end up missing even bigger profits.

The rush to buy, and reluctance to sell, have created what feels like a housing shortage. The number of homes for sale in Toronto, relative to the number of people looking to buy, is far below the norm. Active listings have fallen from more than 12,000 a year ago to fewer than 8,000; the average home takes just 10 days to sell.

People have started to believe that supply and demand are permanently unbalanced. Government policy has to challenge that mindset, and nudge it in a different direction.

Foreign money may be part of the problem: There's never been entirely accurate information on the scale of offshore investors in Vancouver's housing market. But when British Columbia brought in a foreign buyers' tax last year, the impact was large and immediate. Vancouver housing prices, by far the country's most out-of-whack, stopped rising and actually reversed course.

It's far from certain exactly how much the tax contributed to this, or entirely why. It may have discouraged some non-resident speculators. It definitely challenged market psychology, convincing buyers and sellers that the market might not go up forever, because government might not let it.

That's why, regardless of the precise level of purchases by non-residents, a foreign buyers' tax, modelled on B.C.'s, is worth putting on Toronto's menu of options. It can always be adjusted or eliminated in response to market conditions in the years to come.

What government shouldn't do: The federal government, Ontario and Toronto can all take lessons from B.C. The province came up with a measure that helped cool the Vancouver market – and almost immediately set about undermining it.

As soon as B.C.'s foreign buyers' tax started working, its terms were watered down. And in response to a bubble making homes less affordable, B.C. introduced taxpayer-financed subsidies for first-time home buyers. That only encourages people to spend more on a home, pushing up prices. It's designed to fuel housing-price inflation. Crazy.

Another bad idea Ontario is considering: Expanding rent control. It can make housing, or at least rental housing, more affordable – in the short term.

But in the long run, a rule that forces landlords to set rental rates below market prices is going to discourage new rental construction, which is exactly what happened when Ontario introduced rent control in the 1970s. For decades after, very little new rental housing was built in Toronto.

In fact, much of the new "rental" housing in the city is individual condo units. If Ontario puts them under strong rent control, it risks simultaneously limiting rental housing supply, and discouraging condo construction – both of which would push up housing prices and exacerbate the bubble.

Ottawa, Ontario and Toronto have to act boldly but thoughtfully. Pop the bubble, gently, before it blows up the Canadian economy.