

NEW FOUNDATIONS 2.

A SYSTEMS APPROACH TO HOUSING POLICIES

HOUSING AS A SPATIAL, ECONOMIC SYSTEM: KEY OUTCOMES

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1. Missing the System, Missing the Point?

Policy interest in housing in Canada still focusses on the provision of affordable housing for lower income households. That emphasis is a necessary part of a nation's housing policy, but it is not sufficient for the nation's housing system to function effectively for all. Nine out of ten Canadians find their housing with different, and more or less adequate outcomes in the market sectors of the housing system. That market(s) system has a significant effect on Canada's social and environmental outcomes, but it also comprises one of the major systems in the Canadian economy. Housing outcomes shape consumption, savings, wealth, debt, economic instability, productivity, and shifts in the distributions of incomes and wealth. Aside from boosting housing output to stimulate demand in downswing phases of the cycle there is scant attention to the complex and recursive interactions between housing outcomes and economic change. ***There is a stark gap in Canadian policy regarding the roles of housing system outcomes in national, regional, and metropolitan economic development. Neither housing nor economic policies are as effectively designed as they could be.***

2. Canada's Housing is a System of More Local Sub-Systems

Housing is geographically fixed capital and provides immediate access to neighbourhood quality, local infrastructures, services and more or less active neighbours. Beyond the neighbourhood, residential location shapes accessibility to all the activity sites that households use on a regular basis, such as places for working, playing, shopping, and learning. ***Neglect people's homes and you neglect how Canadians organise their lives.***

The housing market always has a geography of flows of people and patterns of outcome differences, such as differential house price changes. Local markets are best defined by these flows and differences and comprise what are called 'functional housing market areas. These areas within which most people search and move homes are not sharply defined and have permeable boundaries. Usually, the boundaries of local housing systems do not match the hard boundaries of political jurisdictions and they often spread well beyond municipal (sometimes Provincial) boundaries. For example, travel to work patterns that define local housing systems reveal these complex local systems or spatial sub-markets. ***There is relatively weak evidence, compared to Australia and the UK, on Canadian patterns of local and metropolitan housing markets and how they change, despite the real estate industry accumulating market databases.***

The geography of economic change is always unbalanced and with demand systems always faster than supply chains this leads to differential housing market pressures and price changes where

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major submarkets exist. The dynamics of commuting flows, interregional migration flows and incomplete equalisation of (quality adjusted) house prices and rents across the country reveal a complex, restless, changing, and recursive system of systems. ***This is what the housing system is.***

3. Governing The Housing System Effectively is the Challenge

Housing policy should be about managing or governing this system of systems and its multiple outcomes and not be cut down to a fragmented focus on a subset of primarily social outcomes. Dealing with homelessness, unduly high rental burdens and inadequate housing quality are critically important housing system outcomes, but they are not the only ones that matter. The system of systems perspective is important for sensible policy framing (discussed In Foundations 4). Notably:

- The housing system drives more than social outcomes and economic and environmental outcomes have to be major elements in housing system governance to meet local and national goals. ***Housing system policy is more than social policy.***
- Real, local housing systems are impacted by local but also regional and national market drivers and policy levers, for instance monetary policy does not have identical effects in all markets and regional influences may be important (such as changing oil prices); and local housing outcomes may have regional and national as well as local effects (poor Indigenous children concentrated into problematic urban neighbourhoods will have education and health outcomes that erode not only their lifetime capabilities but the nations capacity to raise labour productivity), or GHG produced in your street may impact Florida or Sub-Saharan Africa. ***This means that, typically, housing drivers and outcomes are ALWAYS LOCAL, but they are also MORE THAN LOCAL, so that local understandings and autonomies are essential to capture system difference and policy preferences, but they must always be used with insights and inputs from other orders of government. Housing system policy requires coordinated and collaborative action across orders of government.***

The geographic reach of housing market outcomes and the origins of change drivers have complex, multi-level geographies that do not coincide with the hard, formal boundaries of structures of government (whether the boundaries of policy silos or the geographic limits of jurisdictions). Housing systems are built from sub-systems of different spatial scales and they have economic effects. ***It cannot be said more clearly, if housing policy is assumed to be social in nature and controllable, primarily, at the order of Provinces, then government and governance for Canada will use last century thinking to address the increasingly adverse outcomes of the housing market.***

4. Housing Systems Can be More than National, Even Global

The review reports increasing flows of housing demand into Canada from across national boundaries, and there was a rising flow of transnational housing investors and increased financial flows to support investment. Inward flows of both financial and human capital were not evenly spread but were usually highly concentrated in particular localities, at both metropolitan and neighbourhood scales.

- Geographically concentrated inflows of global capital may decouple local housing prices from local wage rates, may inhibit labour mobility from Canada's less housing pressured places, and make an effective implementation of monetary policy more difficult. Monetary and prudential regulation policies designed for 'hot markets' may not always be appropriate for more balanced local systems.
- Inter-regional migration flows within Canada also focus on and pressurise particular local markets. For instance, in recent years half of new home purchasers in Victoria BC came from

elsewhere in Canada. Whilst inflows of ‘residential investor capital’ are very visible they typically constitute a small share of the inflows pressurising markets.

- Immigration is the major source of augmented housing demand in Canada: from 2016 to 2021, immigration accounted for four-fifths of Canadian labour force growth. Of that flow, nine out of ten immigrants, by 2021, lived in a CMA. There is a spreading geography of housing market pressures arising from immigration and, although the dominant destinations remain the 3 largest CMAs, increasing shares of recent immigrants have settled outside of Toronto, Montreal, and Vancouver. With housing costs and availabilities diverting immigrants to previously slower growing localities what will be the effect on productivity growth and employment of these housing choices. In smaller markets, modest scale inflows of new demand may constitute relatively large shocks to local housing supply systems, and this outcome is evident in the housing markets of all the Atlantic Provinces. ***Canada’s housing prices and rents are not set in Beijing, or Washington, but are largely driven by domestic demand growth and high immigration rates aimed at raising national productivity, but that ignore the productivity losses from housing price rises and imbalances.***

5. Shifting System Structures

Since the early 2010’s, and well before (but reinforced by Covid-19) there have been growing flows of households cascading out from larger metropolitan areas to nearby towns, to second tier cities, and to remoter rural regions, thus spreading core city pressures across the Canadian housing system. There is no obvious regional housing-economic policy response to these now sustained patterns and the trinity of major housing problems (outlined in Foundation 1) can be seen in Canada’s rural towns as well as metropolitan cores. ***The nation, all of it, is failing to manage Canada’s market led housing systems to attenuate these difficulties and achieve wide benefits.***

- Despite geographic spread, Canada’s main demographic changes and migration, and immigration patterns will drive metropolitan led growth in the decades, albeit it in more diverse patterns.
- Global city synchronisation, driven by city-level connectivity between large and international cities, also impacts particular neighbourhoods and sectors.
- The delinking of housing submarkets within metropolitan areas, and indeed rural areas, when more affluent in-movers and second home-owners concentrate may have long term effects on economic and social segregations and mobilities in Canada.

6. Rethinking the Policy Framing

Reinforcing the points made in 3(above):

- The evidence presented on diverse, separated but connected, spatial housing markets suggests that, for most policy and research purposes, seeing Canada’s housing as an aggregate system serves only as a statistical artefact. It is not a conceptual framing to explore and reveal housing-economy processes. The System of systems needs to be recognised and known.
- The merit of seeing larger orders of government, such as Provinces, Metropolitan areas or Federal Canada, as a connected set of local sub-systems is that it allows a recognition of housing system influences and outcomes, such as metropolitan agglomeration economy effects and neighbourhood social spillovers, that matter in economic change. Usually such effects disappear in more reductionist ‘macroeconomic’ perspectives at the Bank of Canada or in Federal and Provincial Finance Ministries. The review found, for instance, little research

and coherent thinking on housing and labour market interactions at labour market area levels:

- Households now have to balance not a simple trade-off between CBD employment and lower suburban land costs, but accessibilities to dispersed employment localities, major service, and retail concentrations.
- The effective alignment of labour markets, employment opportunities, housing opportunities, and transport systems in these complex local systems has become crucial to the achievement of inclusion, carbon reduction and productivity goals.
- A starting point for provincial, metropolitan, urban, and rural Canada is to develop a more robust understanding of how, where, and why their local housing systems are changing and how they change, and are changed by, the local economy.
- This also applies within metropolitan economies, and in understanding housing effects on economic outcomes, it is essential to see neighbourhoods as subsystems within the wider spatial structure of metropolitan housing, transport and labour markets and not just points of service delivery.

Covid-19 has reinforced already existing tendencies for households to work either exclusively or partially at home, and shifting communications technologies, the changing nature of jobs and new imperatives to reduce travel mean that the home is increasingly the workplace. In this review there was no housing policy discussion material that explored the economic, environmental, and social implications of the home as workplace. ***For many Canadians, the future economy will begin in the home and the neighbourhood, more than it already does. Governments need to think about this.***

7. Consequences of Housing Outcomes for Stability, Wealth, and Productivity

These issues are discussed at length in Paper 2 and the points below are highly summative in nature. The Paper used an important distinction between housing related ‘Activities’, such as constructing, financing and selling housing, that have attracted attention because of their employment and consumption effects, and ‘Attribute’ outcomes, such as housing locations, tenures etc, that have attracted much less attention from policymakers (and researchers).

Stability

Economic policy in Canada has focussed on the ‘stability’ effects of housing, using the sector as a route to fiscal stimulus to abate downturns, and addressing potential effects of mortgage debt on overall financial system stability. The review found that:

- The importance of housing construction and other ‘activity’ processes, such as higher turnover, as a stimulus for economy recovery are widely understood and empirically estimated at Canadian and more local scales. Construction and renovation, through backward and forward linkages, are connected to other industrial sectors. In consequence policy expenditures on new housing construction and renovation are usually comparable to, or even larger than, other types of infrastructure spending, such as construction of highways
- Housing demand levels, and their likely enhancement through significantly raised immigration inflows and major energy retrofits of existing homes, are currently raising major concerns about medium term construction sector and house price inflation, and potential system instability.
- The well-established approach to monetary policy, with the BOC rightly well respected by international peers, has an asymmetry and approach that is problematic for the housing sector. When monetary policy is loosening the broad approach is to not influence particular

asset prices, and that means that housing prices ahead of income and the diversion of investment into existing housing stock (fuelling rentier sector returns) are perhaps not adequately addressed. When monetary policy reverts to a contraction phase it becomes very focussed on household mortgage debt that had, of course, grown rapidly in the loose phase. There is no easy solution to this dilemma. Strengthening 'prudential borrowing' stress tests have undoubtedly reduced financial sector 'systemic' risks but they have had negative effects on boosting pressures in rental housing markets that have raised rents and financial and housing risks for poorer and younger Canadians. ***It has become clear that wicked issues, such as heightened income inequalities and housing system difficulties, have been exacerbated by 'asset blindness' in monetary policy.***

- It would be unrealistic to argue that the Bank of Canada should have a house price inflation target, but a case can be made that there needs to be a wider, and econometrically informed, consideration of monetary policy impacts on the major housing sub-systems of Canada when decisions are made. Similarly, any extension of prudential borrowing measures by OFSI should be based on a full, and published, audit of how measures will affect the housing system. It is time to strengthen the national understanding of more local system impacts on housing market stability and performance by developing coherent, appropriate scale of national to local system effects. ***The macro-economic policy dilemmas would be significantly reduced if the flexibility of supply systems were enhanced, or demand increased, in more elastic housing markets (raising a different dilemma).***

Supply

Observations on supply are as appropriate in discussions of growth and productivity as they are in stability issues but are usefully noted here. The review concluded that:

- The supply of new housing and major renovations, as elsewhere in the world, depends on complex supply chains that include land, development skills, other infrastructure, construction labour, multiple trades and small firms, raw and manufactured materials, finance, planning, and more. They tend to be 'sticky' and slow in nature, are fractured by market instabilities, they have relatively low labour productivity. Their real nature, with market failures, high system transaction costs as well as policy and planning failures all in play, lies at the core of the major problematic outcomes of the housing system. ***The limitations of local supply systems are increasingly apparent as the housing demand system has speeded up over the last three decades with financial deregulation, rising housing equity and asset demands for housing, as housing supply systems have been relatively immune to innovation, market failures un-addressed and growing regulations in aspects of construction. Canada has embraced (and there are many merits in this approach) without having many coherent local, metropolitan, provincial or supply side strategies.***
- Much of the material available to policymakers is strongly ideological in nature and relies on, sometimes, assessing delays against land capacity and 'regulation' (however measured) whilst ignoring other supply chain blockages, the demand side shifts that accompany price changes, and the marked variation from city to city. Some senior policymakers have subscribed to the view that Canada's housing crisis arises in municipal planning departments. Maybe in some, and rarely in isolation, but speeding up planning will not be a solution for everywhere and always. ***Governments need to accompany the needs estimates they make for shaping investment bids with a five year forward audit of local/metropolitan supply chains (and the near absence of such audits reveals a core misunderstanding in how to govern housing effectively).***

- The limited number of econometric estimates, with the BOC producing the most recent and technically sound research, of metropolitan scale elasticities, highlight the low flexibilities (elasticities) of supply in CMA's with the lowest (predictably) in the largest metropolitan areas, most impacted by likely future demand growth. Metro Toronto and Metro Vancouver have been regularly ranked among the 'biggest property bubbles in the world' and Federal economic policymakers need to have regard to the national spatial patterns of new housing demands.

The Canadian housing supply system is close to past peak capacity through 2022. Meeting existing new supply requirements, providing homes for the sharply increased numbers of immigrants and raising major renovations to the pace needed for net zero targets for 2030 requires the sector to more than double. ***To achieve the major housing investment requirements now implied by governments policy goals without major tensions that will reinforce inequalities and social tensions, all governments in Canada now need to achieve what they have failed to deliver these last three decades and put in place a modern flexible construction and governance sector. Otherwise, the housing system will not deliver the expected social and net zero goals and economic opportunities will be lost.***

Distributional Outcomes

The review findings are brief, in relation to distributional and productivity outcomes.

- Rising housing costs, increasing faster than incomes, are clearly consuming discretionary income and undermining living standards and exacerbating Canadian poverties. Shelter cost as a share of disposable income for average homes across Canada reached 60% of the median income in 2021, and the income share of housing expenditure rose disproportionately for the bottom income quintile and fell for the top quintile.
- Housing price increases have exacerbated wealth inequality through intergenerational inequality and spatial disparities, with affluent metropolitan Canadians the greatest beneficiaries from unearned housing wealth gains.

Productivity

The review, that set out a framework by which governments might begin to assess housing effects on productivity, gathered together evidence that:

- Households choose a set of housing attributes, including dwelling size, structure, quality, neighbourhood amenity, and location relative to household activity sites, and associated price and (for owners) asset characteristics. These linkages between housing attributes, household capabilities and the growth drivers of human capital, business capital and creative/innovative systems constitute the complex interface between housing and productivity. ***They exist. Look for them and you will find them.***
- A few major metropolitan and, in different ways, rural regions, have begun to look for these effects. ***In general, the productivity effects of the largest capital asset that households possess are not discussed in shaping economic development strategies.***

There is much to do to deliver as possible better, and still market-led, housing system governance for Canada and within that forward looking approach the distributional and productivity benefits of affordable housing outcomes can be recognised and supported.

Presently they are not.