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Executive Summary

GTA HOUSING BOOM MASKS GROWING STRUCTURAL CHALLENGES

Deteriorating Affordability, Lack of Housing Choice and a Strained Transportation System Require a Regional Policy Approach

The stakes are high surrounding the fortunes of the Greater Toronto Area (GTA) housing market. A healthy housing system is critical a region's economic fortunes. And with the GTA key to Canada's economic engine, the success or failure of housing in this region carries significant national importance.

All eyes have been on a housing boom in the region that has lasted more than a full decade. Supported in part by growing in-migration to the region, housing activity and prices have embarked on a rally that has surpassed that of most other major global markets. We've calculated that as much of one-quarter of Toronto's job creation over the past 10 years has flowed from the direct and indirect effects of the housing boom.

That being said, there are two sides to every coin. The strength has concealed some growing challenges that have been percolating under the surface, of which include deteriorating affordability, an increasingly weak diversity of housing choice and a transportation system that is struggling to keep up. Addressing these challenges through a more collaborative regional approach will be critical to securing economic, social and environmental prosperity in the future.

Deteriorating affordability

The affordability challenge has traditionally been heavily concentrated among low-income residents within the rental market. And, in many respects this remains the case. Average rents amount to almost half of household income for earners in the bottom 40% and the share of those in core housing need remains unacceptably high. However, the problem of affordability has spilled over to residents in higher income levels and to those in homeownership. Higher land costs and restrictive government regulations that have stretched out development project time lines to as much as seven years have made it increasingly difficult to supply housing at an affordable cost across the GTA. What's more, rising costs have been instrumental in driving up average debt-loads in the region, leaving households vulnerable to any unanticipated negative economic shock.

Shrinking diversity of the housing stock

Rising costs and other incentives have not only tilted new development in the GTA towards condo towers but to shrinking unit sizes. The focus of supply on small multi-residential units has resulted in growing price premiums for both townhouses and single-detached units across the region, thus contributing to poorer housing choice and reducing mobility of residents. This widening cost divergence between small and larger homes is also a major challenge in the rental market. Furthermore, the stock of

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purpose-built rental units in the region is aging and requires substantial new investment. While increased densification has been a laudable goal of the provincial and municipal governments in recent years, it can reasonably be argued that the pendulum has swung too far in favour of units that are typically tailored for shorter-term living. It raises the question of how the GTA will accommodate the future changing housing needs of both the echo generation who will begin families as well as the growing population of seniors.

Inadequate infrastructure, notably transit

A mix of continued rapid growth in the 905 area code and revival of Toronto's downtown core has been placing increasing strains on the region's infrastructure. The most visible challenges are in transit, where an inadequate regional system has led to growing congestion and costs in terms of foregone productivity. While there have been some notable investments in roads and transit infrastructure in recent years, progress in the GTA to construct a regional transportation system for the 21st century has been slow.

Little reprieve from eventual housing slowdown

To the extent that the housing boom has been a culprit in driving the longer-term challenges of reduced affordability, shrinking housing diversity and pressures on infrastructure, one might reasonably expect that a long-awaited housing slowdown might help to halt these trends. However, any relief is likely to be modest at best:

- With household formation rates likely to stay strong, few forecasters have been calling for anything more than a moderate cool down in home prices. And, any correction is likely to be concentrated in the condo sector, leading to a further widening in the price gap between small units and other types of dwellings.
- The influx of an expected 60,000 condo units to the market over the next several years point to a further shrinking in housing diversity.
- Prospects for moderately higher interest rates over the next several years are likely to lead to some increased financial hardship for a growing share of the region's residents.
- Renting is expected to become a more popular choice, leading to a further tightening supply in the purpose-built rental market. At the same time, ongoing government restraint and soft income growth promises to sustain the struggles of residents in core housing need.

Policy recommendations

As such, the greatest challenges facing the GTA housing market are structural in nature and won't be addressed without concrete actions on the part of policy makers in the region. Housing policies that bring down the cost of construction, speed up delivery and improve the economics of investing in a broader array of housing types – including rehabilitation – would translate into lower costs for residents over the longer run. Importantly, the GTA needs to start thinking like a region with respect to housing. This would entail much greater regional coordination and synergies across the three levels of government, municipalities, not-for-profits, private developers and investment community.

Strengthen and better align housing policies

Housing policies appear to be falling well short in achieving a balance between affordability, environmental protection and smart land use decisions. Developers complain of lengthy permitting processes, while zoning regulations and bylaws are complex and can be out of sync with the official plans. Other unnecessary costs are imposed on new development projects. For example, in the City of Toronto, a certain square footage is allocated for parking within new high-rise developments despite the high cost and the fact than an increasing number of residents work within a transit ride or walk. Other policies are detrimental to the diversity of the housing stock. Property tax systems continue to disadvantage multi-residential properties relative to single-detached properties, while the positive differential between multi-residential taxes between 416 and 905 properties is substantial. In some municipalities, development fees are higher on two bedroom units than they are on one bedroom units regardless of the size of the project. The list goes on. More efforts should be made to tie building permit approvals based on demographic need. Recently, the Ontario government approved the development of six story wood-framed housing, which will go some way in decreasing costs of new development. The region must look for more of these opportunities.

Ease rent regulations

Provincial rent regulations are still targeted at buildings constructed prior to 1991, which remain an important part of the rental stock. While well intended, these regulations are likely inflicting longer-term damage on the housing system by raising uncertainty and stifling renewal investment. We encourage the Ontario government to consider other models for rent regulations – notably that used in New York City – which build in rising costs to landlords and that provide good protection of tenants' rights.

Unlock cheaper land

Rising land costs reflect a significant amount of underutilized land in the GTA. Land owners continue to hold on to significant idle land, likely with the aim of earning a higher profit on sale due to appreciating values. These holdings are located across the GTA and within the private, public and quasi-public sectors. In cases where surplus land is being unlocked – such as public lands in the City by Toronto – movement to sell land parcels has been slow. Some countries have turned to tax incentives to encourage property owners to unlock idle lands for development. In addition, there exist opportunities for the region to take better advantage of infill development, particularly close to social housing and public transit hubs.

Often the cheapest land is available in the suburbs, but the challenge is a lack of infrastructure. As the Ontario government revisits its growth plan, focus should not just be placed on building up along transportation corridors, but building more transportation corridors. An underdeveloped transit system has become one of the most pressing issues facing the GTA economy. Support from municipalities and their regional transit commissions will be crucial in ensuring that a long-term regional transit plan becomes reality.

Address low-income housing needs

Removing costs and barriers to new supply will help alleviate affordability issues in the region, particularly for the large population of moderate income households. But there is still a segment of the most disadvantaged residents that will continue to struggle. Helping these individuals most in need will require government subsidies, either through incentives to increase the supply of lower-cost housing or through targeted income support. One example would be to create a new income-tested housing benefit that is portable and is not tied to the welfare system.

Scarce government resources to address affordable housing will remain a significant challenge, especially at the provincial level, where large deficits are still being run. The recent plunge in oil prices and resulting hit to revenues will limit the federal government's leeway to implement new measures as it continues to set its sights on a balanced budget by next year. Our hope is that as oil prices likely recover over the next few years, the federal government will be better positioned to take on a growing leadership role in this space, while recognizing that challenges are local in nature and best addressed by municipalities.

Private and not-for-profit sectors critical

Limited government resources and a growing interest in the private sector to become involved in housing-related challenges provide significant upside potential within the GTA. The involvement extends from private-sector investment in the aging social housing and rental stocks to social impact investing to philanthropy and volunteering.

The importance of the not-for-profit sector in delivering housing and other services to disadvantaged residents cannot be overstated. The region boasts some 250 organizations in the housing space – which despite ongoing funding challenges – have emerged to address growing demands. While many of these entities target specific local needs, there may be opportunities to reduce overlap and boost efficiency through a more coordinated approach. The private sector has a comparative advantage in the development and supply of rental units, while the not-for-profit sector enjoys comparative strength in the management and provision of supports to low-income tenants. Thus, there is a natural synergy.

With interest rates expected to remain relatively low, there is the potential for capital market vehicles to fill an increasing share of the sizeable investment financing needs in the coming years. In particular, investors in real estate investment trusts (REITs) and pension funds are looking for opportunities to earn moderate and stable annual returns. In the current cost environment, however, these vehicles would be hard-pressed to generate the required returns. All the more reason for governments to step up efforts to bring down land costs in part through smarter regulations.

Bottom Line

There is little doubt that the housing boom enjoyed in the GTA over the past decade has benefitted many in the region. Yet the boom has been hiding some growing issues within the housing market, chief among them include deteriorating affordability, an increasingly weak diversity of housing choice and a transportation system that is struggling to keep up. Addressing these challenges through a more collaborative regional approach will be critical to securing economic, social and environmental prosperity in the future.