Mortgage rules won't lower prices

The high cost of housing is the result of provincial and municipal land -use restrictions in urban areas; Troy Media

BY WENDELL COX, VANCOUVER SUN JULY 6, 2012

There is considerable concern about rising house prices in Canada. Some fear a housing bubble like the one that decimated the U.S. housing market and spilled over into the worldwide Great Financial Crisis.

Moreover, there is legitimate concern that household debt has reached new heights at 152 per cent of discretionary income. The Bank of Canada considers it a principal risk to the country's financial stability.

In response, Ottawa has announced tightened lending rules, reducing maximum loan terms from 30 years to 25 years and maximum loan amounts from 85 to 80 per cent of house values for mortgages insured by the Canada Mortgage and Housing Corporation (CMHC). This is the third tightening of mortgage rules in the past four years, but they will likely have no effect on rising prices Tinkering notwithstanding, house prices have continued to rise. More-over, the classic policy instrument of interest rate increases by the Bank of Canada is being avoided because of the damage it could cause to the economy. This is just as well, since interest rate increases in Australia and New Zealand had little impact on rising house prices. Tweaking demand, whether through mortgage rule changes or monetary policy, is not the answer because demand is not the principal driving factor in higher house prices.

The problem is provincial and municipal land-use restrictions with such catchy labels as "smart growth," "growth management" and "compact city policies." In some of the country's largest metropolitan areas, it has become virtually illegal to build detached housing on or beyond the urban fringe.

It should not be surprising that this rationing of land raises house prices. No one disputes the fact that artificial supply restrictions in other economic sectors raise prices. It is the reason, for example, that the world shudders at the thought of OPEC oil supply restrictions and their impact on the price of gasoline.

Regrettably, this economic principle - that severe restrictions on sup-ply are associated with higher prices - was ignored as the restrictive land-use policies were adopted. "Sustain-ability" emerged as the near-exclusive objective of urban planning. This one-dimensional approach that ignores economic reality has brought us the higher house prices that we now find to be a problem.

However, "sustainability" requires no such policies. A new study led by Cam-bridge University researchers finds little longer-term difference between the more liberal land-use regulations that continue to produce historic housing affordability and the smart-growth restrictions that can more than triple house prices relative to incomes.

Other than Hong Kong, the 8th Annual Demographia International Housing Affordability Survey shows Vancouver to be the most unaffordable of 325 metropolitan areas. Its house prices are more than 10 times house-hold incomes, far higher than the historic norm of three. Toronto's house prices have risen to more than 75 per cent above the norm, while Montreal's prices are 70 per cent higher. In each of these three cases, prices have escalated strongly in response to land sup-ply restrictions.

Things could get worse. In Toronto, Montreal and Vancouver, land rationing measures are being tightened. In addition, regulations that lead to increases in house prices are spreading to metropolitan areas such as Calgary, Edmonton and Saskatoon (yes, Saskatoon).

All of this bodes poorly for the Canadian economy. Paying more than necessary for housing reduces the discretionary income of households. It means that jobs are not created that would produce goods and services, which smart growth's higher prices consume instead.

Cities are economic organisms, created and justified by the opportunities they make possible. More than 80 per cent of the population now lives in urban areas. As a result, these areas are crucial to national economic growth.

Wrong-headed housing policy can extinguish economic opportunity, as research in the Netherlands, the United Kingdom and the United States shows. There, lower levels of economic growth have been associated with smart growth's land rationing.

Restoring and maintaining housing affordability requires accurate diagnosis. The tools available to CMHC and the Bank of Canada have little potential to contain house price increases so long as the supply of housing is severely constrained by single-dimension policies that deny the impact of economics. Land-use restrictions need to be intelligently loosened, consistent with reasonable environmental standards. While this is a significant matter of national economic concern, the solution can only begin with action at the provincial, regional and city level.

Wendell Cox is principal of Demographia (St. Louis) and co-author of the Demographia International Housing Affordability Survey. He is a senior fellow at the Frontier Centre (fcpp. org).