

Policy Series No. 234 / JANUARY 2021

URBAN CONTAINMENT POLICY AND HOUSING AFFORDABILITY

BY WENDELL COX



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ER CENTRE



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Policy Series No. 234 • Date of First Issue: January 2021.

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Frontier Centre for Public Policy expresses its appreciation and thanks to the Lotte and John Hecht Memorial Foundation for supporting for this project.

ISSN 1491-78



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INTRODUCTION

THE ISSUE

The city of Ottawa is updating its Official Plan. Under consideration are expanding the urban boundary (urban growth boundary) and strengthening of its intensification (densification) policy. These strategies are components of urban containment policy.

This report examines the relationship between urban containment policy and housing affordability from an international perspective. For the purposes of this report, urban containment policy includes growth management, compact city policy, intensification and any measures that can materially impact the cost of land or housing by rationing or prohibiting greenfield land development (such as urban growth boundaries and intensification mandates).

THE IMPORTANCE OF HOUSING AFFORDABILITY

Housing is the largest expenditure item for Canadian households, according to the latest data from Statistics Canada (2017). Further, as a share of household consumption, expenditures on principal residences have risen 5.0 percent compared to 2010. By comparison, expenditures on transportation have declined as a share of consumption expenditures by 3.5 percent. The share of food dropped 7.9 percent and clothing dropped 16.1 percent.¹

As a matter of information, in the United States, 87 percent of the difference in the cost of living between the most expensive metropolitan areas and the overall average consists of the higher costs of housing. Other goods and services account for only 6 percent and 7 percent respectively. As Richard Florida of the University of Toronto has noted "differences in living costs are basically all about housing."

CANADA'S HOUSING AFFORDABILITY CRISIS

There has been considerable attention to the deterioration in housing affordability across Canada in the last two decades. The Frontier Centre for Public Policy (FCPP) study, *Canada's Middle-Income Housing Affordability Crisis* found that average house prices had risen three times that of before tax average household incomes from 2000 to 2015.² Other nations have faced similar housing affordability challenges (See The Middle-Income Standard of Living Crisis, pg. 13).

The seriousness of the problem is illustrated by the *RBC Housing Affordability Measure* for the Vancouver and Toronto area markets. By 2018, 117 percent in Vancouver and 90 percent in Toronto of the median pre-tax household income was required to pay the monthly costs of an average priced singlefamily detached house. Even in the least expensive housing category, the apartment condominium, 52 percent of median income in Vancouver would have been required and 47 percent in Toronto. This is more than onehalf in excess of the 30 percent affordability threshold for core housing need.³

Canada's Middle-Income Housing Affordability Crisis found that between 2000 and 2015, average house prices in the Ottawa-Gatineau census metropolitan area (CMA), were estimated to have risen at 3.9 times pre-tax average household incomes. See Figure 1.

Fig. 1: House Prices and Household Incomes

Ottawa-Gatineau CMA 2000-2015



Source: Canada's Middle-Income Housing Affordability Crisis.

RECENT HOUSING AFFORDABILITY TREND IN THE CITY OF OTTAWA

At the request of the Greater Ottawa Home Builders Association (GOHBA), this report updates house price and income data since 2015 for the city of Ottawa. It is estimated that the average house price continued to rise above that of average household income. From 2015 to 2019, house prices rose 20.1 percent, nearly one-half more than the 13.5 percent rate of household incomes (See Figure 2).⁴ Further, the most recent Ottawa Real Estate Board data indicates an acceleration in house prices, with an annual average price increase to February 2020 of 21.5 percent. This is one-half greater than the 2018 to 2019 rate of 14.1 percent (See Figure 3).⁵ In the six months from February to August 2019, house prices increased at an annualized rate of 9.6 percent, more than double the 2015 to 2019 rate. In the more recent six months from August 2019 to February 2020, house prices increased at an annual rate of 31.8 percent, triple the already elevated rate of the previous six months (See Figure 4).

Fig. 2: House Prices and Household Incomes City of Ottawa 2015-2019



Average House Price Average Household Income Source: Estimated from Statistics Canada and Ottawa Real Estate Board data.

Fig. 3: Average House Price



Fig. 4: Recent Average House Price

Acceleration Annualized Rate



Source: Estimated from Ottawa Real Estate Board data.

THE INTERNATIONAL CONTEXT

For years, the Frontier Centre for Public Policy has sponsored the *Demographia International Housing Affordability Survey* in Canada.⁶ This year's 16th Annual edition of the *Demographia Survey* includes more than 90 major metropolitan housing markets (over 1,000,000 population) in eight nations.⁷

Housing affordability is the relationship between incomes and house prices, and can be estimated by various measures. The *Demographia Survey* uses the "median multiple," (the median house price divided by the pre-tax median household income) to rate housing affordability (See Figure 5). Put another way, the median multiple indicates the years of household income required to pay the sales price of a house. Within the *Demographia Survey*, comparisons are made are between housing markets and historically within housing markets.

Historically, the median multiple was similar as recently as the late 1980s or early 1990s in nations that had not fully converted to urban containment. The price to income multiple was 3.0 or less until the late 1980s or 1990s, in nearly all metropolitan areas of Australia, Canada, Ireland, New Zealand, the United Kingdom and the United States.⁸ The lowest price to income multiple at the national level was in the United States, at 2.7, while Canada, Ireland and the United Kingdom were the highest, at 3.0.

By 2019, the national price to income multiples for these six nations had increased to 3.6 in the United States and 3.9 in Canada to 5.9 in Australia and 7.0 in New Zealand (See Figure 6).

Fig. 5: Housing Affordability Ratings

Median Multiple	
3.0 and Under	
3.1 to 4.0	
4.1 to 5.0	
5.1 and Over	

Median Multiple: Median house price divided by median household income.

Source: Demographia International Housing Affordability Survey.

Fig. 6: International House Price to Income Ratios 1987/1992 to 2019



Source: 16th Annual Demographia International Housing Affordability Survey.

0

1970

All of the 31 severely unaffordable⁹ major housing markets in the latest *Demographia Survey* have an urban containment policy.

In the 16 years of the *Demographia Survey*, the housing affordability range among Canada's six major metropolitan areas has widened measurably. In 2004/5,¹⁰ Edmonton had the most affordable market, with a median multiple of 2.8. Vancouver was the least affordable, at 5.3, while Toronto had a median multiple of 3.9. The disparity between the most and least affordable major markets expanded from 2.5 years of median household income to 8.1 years. Vancouver's median multiple was 11.9, while Edmonton was 3.8. Toronto had increased to 8.6 years (See Figure 7).

Housing affordability in Ottawa-Gatineau has deteriorated markedly. From 2005 to 2019, the median multiple rose from an "affordable" 2.9 to a "seriously unaffordable" 4.1 (41 percent), this is the equivalent of 1.2 years in median household income. However, housing affordability has not deteriorated nearly to the extent that has been experienced in Vancouver or Toronto.

Longer term market data is available in the United States starting in 1949 which shows little variation in affordability among the more than 50 major metropolitan areas (1,000,000 population or above) before the 1970s. In those years,¹¹ the maximum median multiple gap between the major markets was 1.7 years (additional years of income required to buy the median house). By 2019, the gap had widened to 6.9 years (See Figure 8). This divergence in major housing market affordability has been associated with the stronger land use policy, especially implementation of urban containment policy.

Fig. 7: Middle-Income Affordability History Canada: Major Housing Markets 1970-2019 ¹⁵ ¹² ¹² ¹⁴ ¹² ¹⁵ ¹² ¹⁶ ¹⁷ ¹² ¹⁶ ¹⁷ ¹⁰ ¹⁷ ¹⁰ ¹

Source: Derived from Statistics Canada and Demographia.

2004-2005

2019

DYNAMICS OF URBAN CONTAINMENT

Much of the justification for urban containment is to curb the physical expansion of urban areas (conversion of rural land to urban land), that is, to curb "urban sprawl," which is often equated with the suburban urban form that has continued to dominate population growth in Canada (See *Suburban Nation? Population Growth in Canadian Suburbs, 2006-2011*).¹²

In commenting on the association between London's urban growth boundary (greenbelt), and the loss of housing affordability, *The Economist* said: "Suburbs rarely cease growing of their own accord. The only reliable way to stop them, it turns out, is to stop them forcefully. But the consequences of doing that are severe" (Sections 7 and 8).¹³

As noted above, urban containment policy includes growth management, compact city policy, intensification and any measures that can materially impact the cost of land or housing by rationing or prohibiting greenfield land development (Section 1).

Planners have indicated that urban containment is characterized by "policies that are explicitly designed to limit the development of land outside a defined urban area..."¹⁴ Further, "urban development is steered to the area inside the line and discouraged (if not prevented) outside it."¹⁵

Moreover, urban containment advocates expected that land within the containment area would become more intensely developed, lowering land costs per housing unit, which was expected to neutralize any house price increasing effect.¹⁶ This has generally not occurred and urban containment has been associated with higher house prices relative to incomes.

Fig. 8: Median Multiple Range 1949-2019

Between Most & Least Affordable Major MSA's



New Zealand's Productivity Commission summarized the impact of urban containment: "Constraints on the release of land and development capacity (within and on the edge of cities) create scarcity, limit housing choice, and increase housing prices. These impacts are disproportionately felt by people on lower incomes" (Section 8).¹⁷

Toronto's house prices have nearly doubled relative to household incomes since 2005, the year before its urban containment planning system took effect. In that year, the 2nd Annual *Demographia Survey*, noted that as a result of its the new planning restrictions, Toronto "seems likely to experience severe housing affordability deterioration in the years to come." That has occurred, with the median multiple in the Toronto metropolitan market rising from 4.4 in 2005 to 8.6 in 2019, an increase of 95 percent. This is the greatest median multiple increase from 2005 to 2019 among the major markets that are now severely unaffordable.¹⁸

Toronto rates as the sixth least affordable major market with its median multiple of 8.6 and is less affordable that the San Francisco Bay area (San Francisco and San Jose markets) and London (the Greater London Authority).

For some years, Ryerson University's Centre for Urban Research and Land Development has published research on housing in Toronto.¹⁹ They have found a strong association between Toronto's rapidly rising housing costs and its urban containment land use policy, and have concluded that there is a shortage of land for "short term housing production." Such a shortage can prevent the market flexibility required to retain housing affordability.

In citing international economic research, Ryerson notes that its Toronto findings "are not new, but they have been identified and accepted by economists and planners for some time."²⁰

Urban Containment and Land Markets

Harvard University's William Alonso showed that urban land tends to rise in value (such as per acre) from the low agricultural values outside the built up urban area toward the center (or centers).²¹ This is the "land value gradient."²² Under normal circumstances (without urban containment), land values tend to rise gradually, toward the center. The "floor" value of developable land in a housing market is typically on the urban fringe. The floor land value of urban land is driven up significantly as a result of an urban growth boundary.

Portland State University professor Gerard Mildner summarized the land-value gradient, characterizing it as "Economics 101:"²³

"Land prices tend to decline from a peak at the center of a metropolitan area, until they meet the underlying value of agricultural land. At the margin, urban and agricultural land prices will equalize as farmers and developers compete for land."

This is indicated in Figure 9,²⁴ which depicts increased land values after implementation of a binding urban growth boundary, and a continuous gradual upward curve where there is no urban growth boundary. By contrast, in a market without urban containment, land values tend to rise gradually from underlying agricultural or other rural values.

For example:

 The Productivity Commission of New Zealand associated the Auckland urban containment boundary with a substantial increase in land prices. "After controlling for a range of other influences, the gradient in land prices (per hectare) from Auckland's CBD to the rural land adjacent to the city undergoes a step change at the point of the MUL" (urban growth boundary)." The differential was identified at approximately 10 times and the Commission noted that it has increased "as housing demand pressures have intensified."²⁵

- A Reserve Bank of Australia report cites data showing the value of land inside Melbourne's urban growth boundary to be from 12 to 20 times that to the outside (per hectare).²⁶
- In Portland, Mildner²⁷ identified a landvalue gap of approximately 10 times at the urban containment boundary.
- Paul Cheshire found that agricultural land could increase in value 700 times (70,000 per cent) when rezoned for residential development in Southeast England.²⁸
- Within the San Francisco Bay Area, Glaeser and Gyourko found land costs to be 10 times the share of median house value (Figure 10) that would be expected in a relatively free market with few restrictions on building (20 percent of the combined house and land value).²⁹ The San Francisco area market has some of the most severe urban containment policy in the United States, which prohibits building on considerable amounts of developable land.³⁰
- These findings are consistent with the law of supply and demand. Economists Richard Green of the University of Southern California and Stephen Malpezzi of the University of Wisconsin noted: "When the supply of any commodity is restricted, the commodity's price rises. To the extent that land-use, building codes, housing finance, or any other type of regulation is binding, it will worsen housing affordability."³¹

Economist Anthony Downs of the Brookings Institution stressed the "principle of competitive land supply." This principle is that "for land use regulation to avoid significantly

Fig. 9: Urban Containment Effect on House Prices

Urban Growth Boundary Example (Conceptual)



Source: Derived from Census Bureau, Harvard University.



Source: Derived from Glaeser & Gyourko, 2018.

increasing the final price of developed property, the total supply of land available for development in any given period must be a multiple of the amount likely to be absorbed during that period."³²

Around the world, differences in land values between metropolitan areas account for much of the difference in house prices.³³ As the amount of permitted developable land continues to diminish in urban containment markets, housing affordability is likely to worsen, along with the standard of living (Section 7). International literature on urban containment regulation is summarized in the Frontier Centre for Public Policy report, *A Question of Values: Middle Income Housing Affordability and Urban Containment.*³⁴

THE MIDDLE-INCOME STANDARD OF LIVING CRISIS

As the *Demographia International Housing Affordability Survey* indicates, there has been a significant deterioration in housing affordability in a number of nations. As is noted above (Section 2), housing costs play the dominant role in determining the cost of living.

Recent research by the Organization for Economic Cooperation and Development (OECD) documents an existential threat to the middle-class. The OECD examines the high-income world, including Canada.³⁵ In a report entitled *Under Pressure: The Middle-Class Squeeze*, the OECD noted:

The middle class used to be an aspiration. For many generations it meant the assurance of living in a comfortable house and affording a rewarding lifestyle, thanks to a stable job with career opportunities. It was also a basis from which families aspired to an even better future for their children. At the macro level, the presence of a strong and prosperous middle class healthy economies supports and societies. Through their consumption, investment in education, health, and housing, their support for good quality public services, their intolerance of corruption, and their trust in others and in democratic institutions they are the very foundations of inclusive growth. However, there are now signs that this bedrock of our democracies and economic growth is not as stable as in the past.³⁶

OECD emphasizes that the threats to the middle-class crisis are in large measure the result of costs of living that have risen at rates far greater than incomes. As a result, the *middle-class lifestyle* is under threat. OECD places much of the blame on house prices that have been growing much faster than household median income in the last 20 years: "Besides being the largest spending category, housing has been the main driver of rising middle-class expenditure in recent decades." Further, OECD found that "owned homes contributed the most to the rise in housing spending." Rents increased as well, less significantly than owned homes.

The OECD concluded that: "...the current generation is one of the most educated, and yet has lower chances of achieving the same standard of living as its parents.³⁷

INDIRECT CONSEQUENCES ASSOCIATED WITH URBAN CONTAINMENT

Beyond the direct effect of much more challenging housing affordability for middleincome households, there are also important indirect effects. These disproportionately disadvantage lower-income households.

Higher Poverty Rates

As the costs of housing increase relative to other costs, households necessarily have less discretionary income remaining after paying for essentials. The result is higher rates of poverty. This is illustrated by the state of California, which has the highest housing cost adjusted poverty rate among the 50 states. This is despite California's having the 12th highest median household income of the 50 states, and the two highest income metropolitan areas out of the 53 with more than 1,000,000 population.³⁸

Increased Need for Less Low Income Affordable Housing

Eligibility for public housing assistance is largely determined by housing costs that reach the 30 percent core housing need threshold of household income.

As the market price of housing increases, more households are unable to afford market rate housing.

These newly eligible recipients and the rising market costs of existing housing produce greater financial demands on governments. Yet many governments are unable to budget sufficient housing assistance to serve eligible households. Long waiting lists are typical, as is the case in the city of Ottawa, according to its website:

- The demand for social housing is much greater than the supply;
- There are approximately 10,000 households on the centralized waiting list for social housing;
- Wait times for social housing in Ottawa can be up to five years or more.

Increased Income and Wealth Inequality

Ryerson University research finds that "planning-caused house price increases exacerbates the unequal distribution of income within the region" and notes its effect in the Greater Toronto Area.³⁹ Ryerson cites "sizeable wealth transfer to existing owners of groundrelated homes." Bank for International Settlements economist Giani La Cava associated rising inequality in part with to "constraints on the supply of new housing in some large US cities."⁴⁰

Stunted Economic Growth

Paul Cheshire of the London School of Economics and Wouter Vermeulen of VU University in Amsterdam described the importance of housing affordability:41 "... housing being the dominant asset in most households' portfolios, there are also repercussions on saving, investment and consumption choices." Where housing is more affordable, households will have additional income available for purchasing goods and services or saving (which generates investment), both of which can contribute to a job creation and a stronger economy. Excessive land use regulation leads to diminished economic growth at the national level," $^{\prime\prime\prime42}$ as has been indicated in US research.43 This is detrimental to the entire economy, including middle-income households and especially low-income households.

CONSIDERATIONS FOR THE CITY OF OTTAWA

The city of Ottawa has a disproportionate effect on housing affordability in the CMA, due to its overwhelming share of the population.

Underlying land values could increase if there is insufficient urban boundary expansion to accommodate the demand or with increased intensification requirements. This could lead to substantially worsened housing affordability, as has occurred in markets around the world that have failed to retain a competitive land market.

- Between 2000 and 2015, average house prices in the Ottawa-Gatineau census metropolitan area (CMA), were estimated to have risen at 3.9 times pre-tax average household incomes.
- From 2015 to 2019, house prices rose 26.5 percent, nearly twice the 13.5 percent rate of household incomes.
- The most recent Ottawa Real Estate Board data indicates an acceleration in house prices, with an annual average price increase to February 2020 of 21.5 percent. This is one-half greater than the 2018 to 2019 rate of 14.1 percent.
- Housing affordability is the relationship between incomes and house prices, and can be estimated using the "median multiple," (the median house price divided by the pre-tax median household income) to rate housing affordability.
- In Ottawa, From 2005 to 2019, the median multiple rose from an "affordable" 2.9 to a "seriously unaffordable" 4.1 (41 percent), this is the equivalent of 1.2 years in median household income.

- In 2005 the 2nd Annual Demographia Survey noted that as a result of its new planning restrictions, Toronto "seems likely to experience severe housing affordability deterioration in the years to come." That has occurred, with the median multiple in the Toronto metropolitan market rising from 4.4 in 2005 to 8.6 in 2019, an increase of 95 percent.
- Ryerson University's Centre for Urban Research and Land Development has found a strong association between Toronto's rapidly rising housing costs and its urban containment land use policy, and have concluded that there is a shortage of land for "short term housing production." Such a shortage can prevent the market flexibility required to retain housing affordability.
- Underlying land values could increase if there is insufficient urban boundary expansion to accommodate the demand or with increased intensification requirements.
- Urban containment has been associated with higher house prices relative to incomes.
- Urban Containment could lead to substantially worsened housing affordability, as has occurred in markets around the world that have failed to retain a competitive land market.
- As the amount of permitted developable land continues to diminish in urban containment markets, housing affordability is likely to worsen, along with the standard of living. There are a number of indirect consequences associated with urban containment, including higher poverty rates, increased need for low income affordable housing, increased income and wealth inequality and stunted economic growth.

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