

Remarks on “Financialization of Housing”

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1. Canada faces two major problems related to housing affordability, neither of which can be solved with an attack on the loosely defined issue of “financialization”. The first problem is that too many people are chasing too few homes, leading to escalation of prices and rents.
2. The second problem related to housing affordability is that some Canadians do not have sufficient income to pay for housing even at market rents that would prevail even after a surge in supply.
3. Part of the attack on “financialization” comes from a peculiar assumption that these two problems of insufficient supply and insufficient income must be linked. That is, there is a popular view that the only housing that improves affordability is social housing. One problem with social housing as the sole means of addressing housing affordability is misallocation of housing units: some beneficiaries would prefer to spend the economic benefit on a variety of goods, not just housing in a particular location (hence the B.C. case of recipients renting out their allocated units on Airbnb <https://vancouversun.com/news/local-news/bc-housing-investigating-affordable-housing-units-airbnb>). Also, social housing alone will not solve the affordability problem. The 2022 Housing Data Book for Metropolitan Vancouver shows that there are roughly five times as many households in core housing need as there are social housing units. CMHC (2022) estimates that 3.5 million new homes would have to be completed by 2030 to restore affordability to the levels of the early 2000s.
4. A committee tasked with addressing housing affordability should thus be focussed on the separate questions of how to add housing units and how to handle income inequality. Two pieces of low-hanging fruit in that way are to eliminate single family zoning and to address our tax system. In terms of zoning, put funding pressure on Provinces that enable municipalities to mandate that new homes be detached single family homes with yards. The overwhelming majority of land zoned residential in Canada requires that only that type of unaffordable and environmentally unsustainable use be built. This is indefensible, and with the power of the purse that practice could be ended by parliament in short order. Fortunately, BC and Ontario are moving in a positive direction already. In terms of our tax system, relative to the United States, Canada has high income and sales taxes and low property taxes. Encouraging Provinces and Territories to rely more on residential property taxes and including owner homes in capital gains tax calculations are obvious ways the federal government can shift taxes in a sensible direction. In Greater Vancouver, I have shown in work with Paul Boniface Akaabre and Craig Jones that the owners of the most expensive homes typically pay absurdly low levels of combined income and property tax given their wealth. A minimum income tax based on property value could raise billions of dollars per year in the highly unaffordable Toronto and Vancouver

metropolitan areas. That money could provide significant benefits or tax cuts to households struggling to afford housing.

5. The claim that “financial” firms such as REITs and pension funds are worse landlords in terms of tenant outcomes than “mom and pop” or partnerships is unproven, and on its face seems unlikely. Institutional investors are subject to more scrutiny than small partnerships or sole proprietors, and as the report of Martine August to the Housing Advocate (2022) observes, these firms likely have significant economies of scale in management. These economies may provide tenants with superior services for similar rents. It could be true that long-time owners of buildings perform better in some ways than newer owners (notably by not “renovicting” tenants), but the relevant comparison would be between “financial” and “non-financial” owners purchasing similar buildings at roughly the same time.

More generally, the idea that “financial” firms have worse motives than “non-financial” firms, such as “(‘mom and pop’ landlords), private rental housing companies, syndicates of owners, and larger corporate landlords’ (August, 2022) is not persuasive on its face. It is entirely plausible that a pension fund would have as much or more interest in providing good service to tenants (both from a direct mission and a profit maximization) perspective than a couple that purchased a unit in a presale building to rent out until the time is right to flip.

As I understand definitions in August’s 2022 report, the Trump Organization or partnerships controlled by Jared Kushner would not count as “financial”, but we know that they are guilty of poor treatment of under-represented groups and of aggressive efforts to raise rents.

6. I have not seen data indicating that leverage ratios on acquisition or development of rental apartment buildings have risen over time. Graybar Syndications, a very old Harvard Business School case describes a highly involved acquisition and securitization of a sub-groundlease and sub-sub-groundlease position by syndicators in the 1950s featuring 90% leverage.

Even if leverage by apartment owners has risen over time, this is not altogether a bad thing. Expanding capital availability to investors increases demand for rental properties. This provides a signal to builders to create more rental homes and more condos, hence improving the critical problem of undersupply.

7. I am unaware of evidence that concentration of ownership is problematic in residential real estate in Canada, and available evidence suggests otherwise. August (2022) observes that “financial firms hold 20–30% of the country’s purpose-built rental housing stock.” This would represent something like 15% of all rental housing units, recognizing the secondary market, and of course, there are many institutional players in the industry. This suggests that the level of concentration, and likely changes in concentration are far below thresholds that would typically make regulators worry (see, e.g. Nocke and Whinston, *American Economic Review*, 2022). If government is in search of Canadian industries in which concentration is a problem,

there are of course many better candidates. Admittedly, it is concentration within markets that matters, and this concentration must be greater regionally than nationally, but there is little evidence of a problem here.

- a. Some have discussed the possibility that rental data provider YieldStar provides a focal point for collusive behaviour among landlords (ProPublica, 2022). The idea would be that the software might encourage landlords to hold out for higher rents (good for all landlords) at the expense of higher vacancy rates (a loss only to the individual landlord). A problem with this theory is that each individual property owner has an incentive to deviate and charge a lower rent than advised, imposing a negative externality on fellow landlords by bringing down market rent, but enjoying the private benefit of lower vacancy. Software like YieldStar might be more attractive to small landlords who lack market knowledge than to larger landlords who can invest in market knowledge, and see more activity through their holdings. So this channel of anti-competitive behaviour is not clearly more serious with institutional than other investors.
8. REITs do not enjoy particularly favourable tax status relative to other real estate owners. As with limited liability companies, there is no corporate tax if certain conditions on operations and dividends are satisfied. REITs do enjoy favourable status relative to taxed corporations outside of the real estate sector, but that may not be the relevant comparison. Owner occupiers enjoy particularly favourable tax treatment and commonly outbid any type of rental investor. Making REITs less able to compete for land against condos would reduce the number of rental homes and the number of homes overall. Generally speaking, subtracting capital from investment in residential real estate is likely to have adverse impacts on affordability.

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