Submission to the Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities

Hearings on the "Financialization of Housing"

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I am honoured to have the opportunity to submit my assessment of the financialization of housing in Canada to the Standing Committee.

Qualifications

My name Tsur Somerville. I have been a professor at UBC at the Sauder School of Business since 1993. I have a PhD in economics and both my academic and general interest research addresses a broad set of topics in real estate development, housing supply, housing markets, housing affordability, housing finance, and housing and housing finance policy. I have worked with and consulted for all levels of government on housing policy.

Defining Financialization

The term financialization as applied to housing emerged as a neo-Marxist analysis by critical urban geographers to characterize investment in housing where there is a degree of separation between the assets and investors. This is most easily characterized as the financial structure where properties are owned by a legal entity that has units or shares that are then owned by a pool of investors. These units or shares are traded without any change in the ownership of the underlying assets from which the values of the units or shares are derived. Investors returns are determined by both distributions or dividends received based on the net cash flows of the underlying assets and changes in the prices of the units and shares.[1]

Ownership Forms

The financial structure described above is not new. It is the same form as any joint stock company, from their earliest recorded development in China in the 12th century, to the *Société des Moulins du Bazacle* in France in the 14th century, to the East India Company in the United Kingdom in the 17th century, and finally to the modern form of the publicly traded corporations listed on stock exchanges around the world. In Canada, large publicly traded real estate

[1] More extreme definitions of financialization essentially include all investors, so that private ownership of housing is the problem.

corporations were a major market presence through the 1980s, before corporations such as Cadillac Fairview, Ivanhoe Cambridge, and Oxford were bought by large pension funds.

The simplest identification of financialization as a particular type of holding form, real estate investment trusts (REITs) or hedge funds (the focus of criticism in the US), reflects an intellectual slight-of-hand. Any form of real estate where investors have units that they can trade that are separate from the underlying real estate would meet the definition. This includes publicly traded real estate operating companies, REITs, and any other closed-ended real estate funds whether for individual or institutional investors. In the most general terms, this means all investors in real estate are "financialized" except private, single ownership of real estate by non-traded entities, and have been so for years. Singling out a particular ownership form, REITs in Canada, as the "financialized" is disingenuous.

Does Real Estate Ownership Form Matter?

If financialization is a problem, then it should be the case that real estate entities that fit its definition should behave differently than other real estate investment forms. First, it is not clear why a private owner of a single rental property is any less interested in earning a profit than a large, traded entity. If it possible to raise rents than both will do so. Second, it is not clear why one type of form should have the objective to treat tenants better or worse than another if both are trying to maximize profits. The term "slumlord" pre-dated REITs, the fictional Mr. Potter from *It's a Wonderful Life* gouged his tenants living in poor conditions in "Potterville", the very real Fred Trump discriminated against prospective minority tenants, and Kushner family-owned companies have aggressively evicted tenants and paid fines for excessive fees and failures to adequately maintain properties.[2] None of these meet the definition of a "financialized" landlord.

Does Real Estate Company Size Matter?

While form may not matter, firm size can be important. Small, highly leveraged private landlords are less likely to have the resources to adequately maintain properties and are less likely to know the legal rights of tenants. Larger firms have access to more varied sources of capital so that inability to maintain a property is unlikely. In contrast, the power balance between an individual tenant and a landlord is affected by the number of properties a landlord owes. If a landlord owns a single property, then the eviction of the sole tenant results in a 100% loss of net rental income. The net rental income of a company that owns hundreds of units is functionally not affected by the loss of rent from a single tenant, and a certain percentage of

[2] "'No Vacancies' for Blacks: How Donald Trump Got His Start and Was First Accused of Bias." *New York Times*, Aug. 27, 2016, https://www.nytimes.com/2016/08/28/us/politics/donald-trump-housing-race.html. "Kushner Company Agrees to Pay at Least $3.25 Million to Settle Claims of Shoddy Apartments and Rent Abuses." *ProPublica*, Sept. 23, 2022 https://www.propublica.org/article/kushner-apartments-lawsuit-baltimore-maryland-settlement. "Management company owned by Jared Kushner files to evict hundreds of families as moratoriums expire." *Washington Post*, Nov. 5, 2020, https://www.washingtonpost.com/business/2020/11/05/kushner-evictions-pandemic-westminster-management/

loss is just a line item in their financial analysis, as the vacancy and credit loss allowances. Additionally, in the event of a dispute, the large company firm is more likely to have access to better expertise than would a smaller landlord. This suggest that in theory, size is a more important factor for tenants' welfare than ownership form, though it is not clear whether they benefit more from smaller or larger landlords. For instance, in the case of violations, larger landlords are a more compelling target for government or class action activity.

An important concern regarding size is whether a company has a large enough share of the market to exert market power and set rents. Economists, generally speak of concerns of possible oligopolistic behaviour beginning when the four firm concentration ratio (share of the market held by the four largest firms) exceeds 40%.[3] Looking only at REITs in Canada, all REITs together had approximately 130,000 units out of a renter universe of 4.96 million households in 2021. This is a total share – not four largest firms – of less than 3%, far below the lowest levels for market power.[4] The wide diversity and scope of rental properties means that it is not a market easily suited for concentration. Taking August's (2022) claim that financial firms hold 20-30% of the purpose-built rental stock, this would only be 15% of all rental housing. And this group includes not only REITs, but all types of institutional investors, making any notion of effective market power inconsistent with all economic research on concentration and market power.[5] However, in smaller communities, especially in the north, where there may be a very small number of apartment buildings, it much more possible for the largest landlord(s) in a community to have the potential for market power.

Empirical Evidence

The evidence on landlord behaviour is rather scant. Raymond, et. al. (2018) find that in Atlanta, foreclosed single family homes purchased by larger landlords (owning 15 or more units) have a higher rate of eviction than do smaller landlords, and that among institutional owners, two of nine identified were more aggressive in evicting tenants than large private landlords.[6] Studying apartment buildings in Atlanta, Raymond, et. al. (2021) finds that larger landlords (those who own three or more properties), are more likely to evict tenants and be in locations where gentrification is occurring.[7] Both papers do not address the pre-purchase likelihood of eviction, i.e., different investors select different types of properties, so it is not clear if some owners evict more or buy properties where the probability of eviction is higher. In the same way, investing

[3] Recent work suggests that there should be more focus on the change in concentration levels, rather than just the levels itself: Nocke V. and M. D. Whinston. 2022. Concentration Thresholds for Horizontal Mergers. *American Economic Review*, 112 (6), 1915-48.
[4] Even if Canadian REITs held all of their units in the City of Toronto, they would have collectively a 23% market share.
[5] August, M. 2022. The financialization of housing in Canada" and "The financialization of multi-family rental housing in Canada. Reports for the Office of the Federal Housing Advocate:
[6] Raymond, E.L., Duckworth, R., Miller, B., Lucas, M. and S. Pokharel. 2018. From Foreclosure to Eviction: Housing Insecurity in Corporate-Owned Single-Family Rentals. *Cityscape*, 20 (3),159-188.
[7] Raymond, E.L., Miller, B., McKinney, M. and J. Braun. 2021. Gentrifying Atlanta: Investor Purchases of Rental Housing, Evictions, and the Displacement of Black Residents. *Housing Policy Debate*, 31 (3), 818-834, DOI: 10.1080/10511482.2021.1887318

into gentrifying neighbourhoods will results in more tenant turnover for all owner types, as the change is driven at the neighbourhood rather than property level. While not conclusive, these two papers do suggest potential differences in landlord behaviour by size rather than ownership type. It is not securitized ownership that may matters, but size.

Rental Housing in Canada and Landlord Type

As long as housing in Canada is not state-owned, the vast majority of rental housing will be provided by the private market. The high cost of investing in real estate in Canada, means that individuals who want to invest in real estate have two options: owning a single property or investing in syndicated partnerships and securitized real estate, i.e., be a small landlord or invest in a 'financialized" entity. A small landlord who owns a single property can actually put a tenant at greater risk of eviction. Canadian Housing Survey (CHS) data shows that approximately 57% of evictions occur for reasons (sale of property and owner use) that can occur with a small landlord who owns a single unit (secondary rental market) but not to a large landlord who holds a purpose-built multi-unit rental property (primary rental market).[8] In the CHS, evictions for renovation occurred only 7.5% of the time. This suggests that there may be specific reasons in Canada where large landlords are better for tenants. Additionally, for a smaller investor, securitized real estate such as REITs are better risk adjusted option to be able to invest in income-producing real estate such as residential rental properties because of the diversification they can achieve across properties and markets. Owning a single property is the least diversified, highest risk option for a small investor.

Rental Housing Affordability

The consensus among housing economists is that the primary challenge facing Canadian housing markets is the absence of supply. For instance, CMHC estimates the country needs 3.5 million additional housing units by 2030.[9] New rental housing will not occur without investors willing to commit funds to acquire properties. Any actions that make this investment more difficult or place unreasonable restrictions on investors will lower the demand to own rental properties, which will result is less new construction that the country needs to house new arrivals and address the existing shortfall. Even if new construction of rental properties occurs at the high-end with more expensive units, lower income renters still benefit. This process of filtering and vacancy chains where even expensive new construction delivers benefits to low-income renters is well supported in economic theory and in new work by Asquith, Mast, and Reed (2023), Brastu, Harjunen, Saarimaa (2023) and Mast (2023).[10]

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[8] Silas Xuereb, S. and C. Jones. Estimating No-fault Evictions in Canada: Understanding BC's Disproportionate Eviction Rate in the 2021 Canadian Housing Survey. Canadian Housing Evidence Collaborative Report, May 2023.
[9] CMHC. 2022. Canada's Housing Supply Shortages: Estimating what is needed to solve Canada's housing affordability crisis by 2030
[10] Asquith, B. J., Mast, E., and D. Reed. 2023. Local Effects of Large New Apartment Buildings in Low-Income Areas. *The Review of Economics and Statistics*. 105 (2), 359-375. Bratu, C., Harjunen, O., and T. Saarimaa. 2023. JUE Insight: City-Wide Effects of New Housing Supply: Evidence from Moving Chains. *Journal of Urban Economics*. 133.

Committee Objectives

If the committee is concerned about improving housing affordability, then finding ways to restrict investment into housing are counter-productive and undermine the stated goal of improving housing affordability. However, this does not mean that tenant protection is ill-placed, as the gains in tenure stability may well exceed the additional costs this imposes on the system. The theory and partial evidence on power imbalances between tenants and large landlords that lead to higher rates of evictions suggests room for ensuring that tenants are adequately resourced to protect their rights.

Mast, E. 2023. JUE Insight: The Effect of New Market-Rate Housing Construction on the Low-Income Housing Market. *Journal of Urban Economics*. 133