Ideas for a More Prosperous Society

VIEWPOINT

REGULATION SERIES

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HOW REGULATION MADE MONTREAL UNAFFORDABLE

By Vincent Geloso, with the collaboration of Gabriel Giguère

A statement often heard about the housing crisis is that the market is unable to provide solutions. Such a statement is frequently used to divert attention away from the true culprit in this crisis: regulation.

First of all, it must be understood that we are not really dealing with a housing crisis, but rather with a housing affordability crisis. This crucial distinction draws attention to the fact that the price of housing—which is at the heart of the matter of affordability—is determined by the interplay of supply and demand.

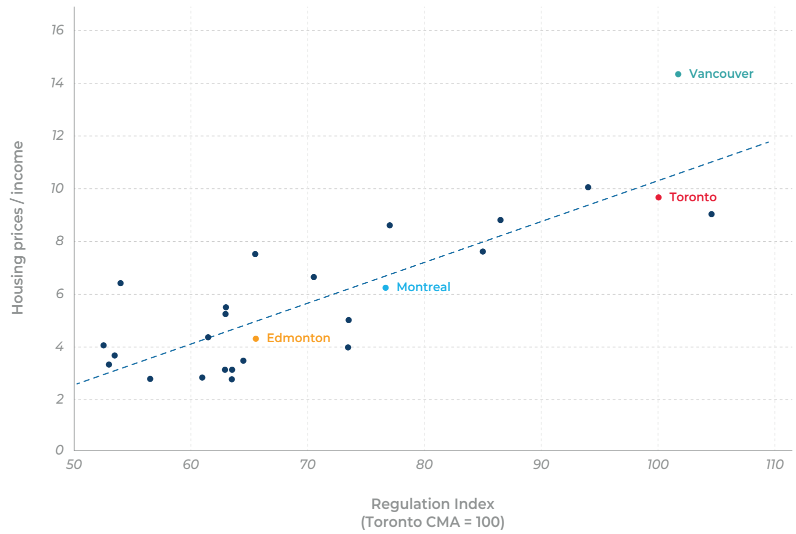
Generally speaking, if prices are rising, as they currently are, it is because demand is growing faster than supply. However, this can be the result of ill-advised government policies that prevent supply from increasing. In such a case, the problem is not the market, but rather the obstacles put in place that are hindering its proper functioning.

REGULATORY HURDLES

There are a whole slew of regulatory obstacles that act as a drag on increasing the supply of housing.[1] These include density limits, parking-to-customer ratio rules for retail spaces, overly strict zoning regulations and restrictions on building characteristics (height, dimensions, materials), mandatory permits, property taxes, rent control, and so on.

Figure 1

Regulation and unaffordability of housing, Canada's large cities and provinces, 2023



Source: Canada Mortgage and Housing Corporation, Approval delays linked with lower housing affordability, July 13, 2023.

These obstacles have three kinds of adverse effects:

- First, they increase housing construction costs, and maintenance costs once units are built. This reduces the incentive to build new units, thus lowering housing starts. Ultimately, this leads to a permanent increase in the cost of housing, all else being equal.
- Second, they make supply more rigid, meaning that it responds more slowly to increasing demand. Thus, when there is a

demand shock, such as a rapid increase in the size of the population, normally temporary price increases last longer.

- Third, these regulations tend to affect certain kinds of housing more than others, such that the remaining market orients itself to serve a different clientele. In general, what we see is a reorientation toward richer households.[2]

Together, these three effects create permanent price increases, more frequent price shocks (more volatility) that last longer, and supply that is skewed against less well-off households.

These negative effects of regulation are confirmed by a vast empirical literature.[3] One simple way of observing this is to use indices of regulation for different metropolitan areas, and to compare them to measures of affordability like the ratio of median house prices to median income. As the literature clearly shows, the stricter the regulation, the higher this ratio, and therefore the less affordable housing will be.[4]

Large Canadian cities are no exception to this rule. The Canada Mortgage and Housing Corporation (CMHC) compiles data measuring housing affordability in relation to administrative approval delays and municipal land use regulation in 26 different areas of Canada (see Figure 1). These data show again that the most heavily regulated places are those that are the least affordable (which is to say, they have a higher ratio).[5]

In Canada, Montreal is now among the jurisdictions that regulates the sector the most heavily. Montreal's level of regulation was higher than 73% of Canadian cities and provinces surveyed by the CHMC.[6] Whereas the historical ratio between median house prices and median income remained stable at around 3 between the 1970s and the middle of the 2000s,[7] it had reached 6.18 in 2022.[8]

Montreal's housing affordability crisis is not due to a failure of the market, but to the excessive regulation that acts as a drag on supply and increases costs, thus penalizing less well-off households and those wanting to become property owners. Instead of accusing market actors of not delivering the goods, Mayor Valérie Plante should stop putting hurdles in their way, in order to liberate the supply of housing.

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7. Wendall Cox and Hugh Pavletich, *Demographia international housing affordability surveys: 2020*, Demographia, 2019, p. 19.
8. Canada Mortgage and Housing Corporation, *op. cit*., endnote 5.

This Viewpoint was prepared by **Vincent Geloso**, assistant professor of economics at George Mason University and Senior Economist at the MEI, in collaboration with **Gabriel Giguère**, Senior Policy Analyst at the MEI. The MEI's Regulation Series aims to examine the often unintended consequences for individuals and businesses of various laws and rules, in contrast with their stated goals.

910 Peel Street, Suite 600, Montreal QC H3C 2H8 - T 514.273.0969
150 9th Avenue SW, Suite 2010, Calgary AB T2P 3H9 - T 403.478.3488
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