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Housing Policy in Areas of Significant Growth – Avoiding Counter Productive Measures

In areas of rapid economic growth, sudden increases in the demand for housing can result in housing shortages, and substantial price and rent increases. This policy statement addresses that situation. The most appropriate policy response is to enable a matching increase in supply. That will produce more housing, which will alleviate both the shortages and the price increases. In jurisdictions where the free market is not understood or where property rights are not respected, the reaction to sudden increases in housing demand is sometimes to impose **rent control and/or conversion control**. Those measures limit some price increases in the short term, but they **make the housing shortages worse in both short term and long term**. Rent control and conversion control also reduce the quality of affordable housing in both short term and long term. Rent control and conversion control are counter-productive public policies, and are to be avoided.

As Nobel Prize winning economist James M. Buchanan wrote in 2001:

Rent control is one policy that economists universally would oppose. It is a grossly inefficient way of allocating housing space and, of course, it **inhibits construction and creates the very thing it is supposed to alleviate [namely housing shortages]**. It is one of those things where people simply don't understand simple economics and, therefore, put in for political reasons what will damage the very people that it is designed to help. Conversations from the Frontier (Frontier Centre for Public Policy, October 25, 2001. (Our emphasis.)

If rent control is imposed, new supply is discouraged, and excess demand is created.

Supply Effects

If the market is allowed to work, the supply of housing can increase rapidly. Increased housing prices are needed to pay the cost of retaining and adding workers and other resources in the face of the increased demand from other sectors. The optimal resources will flow into new housing construction and renovation, unless government regulations get in the way. Our policy statement on positive measures, dated August 2006, lists some of the regulations that can be reviewed to promote increased supply.

As long as undue regulations do not prevent it from happening, higher rents can, in a matter of weeks or months, call forth:

- Room rentals in single family homes, row houses or apartments
- Secondary suites in single family homes, or row house
- New apartments in underused warehouse or light industrial space
- Converted apartments or multi-unit rooming houses to accommodate 6 to 12 people from single family dwellings where 2 to 4 people lived before.

As long as undue regulations do not prevent it from happening, higher rents can, in a matter of 4 to 12 months, call forth:

- Secondary suites in new construction
- New units in former government buildings

- Denser development, providing more units
- More developments, providing many more units.

Demand Effects

Rent controls also create excess demand. Under rent controls, people in existing rental units do not face the real cost of their units, and helpful demand reduction effects do not take place. To illustrate demand effects, suppose the current universe of rental units consists of two 2 bedroom units and one 1 bedroom unit, with rents and occupants as follows:

Unit	Size	Occupant	Rent	Rent per Person
#1	2 Bedroom	Andy	\$800	\$800
#2	2 Bedroom	Susan	\$800	\$800
#3	1 Bedroom	Jamir	\$650	\$650
Average rent per person:				\$750

If rents are not allowed to rise, Andy, Susan and Jamir have no incentive to reduce their housing consumption, and no unit becomes available to serve the increase in demand. However, if rents are allowed to rise, the new situation is likely to be:

Unit	Size	Occupant	Rent	Rent per Person
#1	2 Bedroom	Andy & Jamir	\$1,000	\$500
#2	2 Bedroom	Available for new immigrants to the City		
#3	1 Bedroom	Susan	\$800	\$800
Average rent per person for continuing residents:				\$600

As a result of the price mechanism being allowed to work, housing consumption by current residents has decreased, and housing is available to address the increased demand by those migrating to the City. Note also that the cost burden on the current consumers has decreased rather than increasing; they use less space, but pay less for it.

Controls on conversions to condominiums

Controls on conversions to condominiums are also counter-productive. In areas of rapid growth, demand increases for both ownership and rental housing. If it is allowed to work, the market will balance the supply of the two types of housing at the optimal point. In many condo conversions, numerous units are sold to investors, who continue to rent the units. Even if units are bought by owner occupiers, those occupiers will likely have moved out of a rental unit elsewhere, thus reducing the demand for rental units as well as the supply. Apartments converted to condominiums are usually economical, which allows people to move from rental to ownership at lower income levels.

Conclusion

For the fastest supply effects, planning and land use regulations should be relaxed. Some benefit will flow from temporary revisions, but the most benefit will flow from revisions that permit the expanded housing uses permanently. However, the most important policy decision to obtain all these beneficial demand and supply effects is to avoid all forms of price and rent control, and to avoid conversion controls. All of those policies interfere with the working of the housing market, and slow or stop the adjustments that manage demand and lead to increased supply.