



Rental Housing Part Four
Problems with Some Current Housing Assumptions and Formulas:
The Need for Reality Based Housing Policy Solutions

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The IHC believes that access to decent, safe and affordable shelter is at the core of successful development. Governments around the world have promoted and assisted the development of homeownership opportunities but have generally failed to recognize the important role that rental housing plays. In fact rental housing is the main form of tenure in most cities, especially for low-income households. For those that don't want to or cannot afford to own a home, rental housing is generally their only option. Consequently there is a need for policy makers to direct more attention and resources to supporting rental-housing initiatives.

In this fourth note in this IHC series, we discuss and comment on some of the basic assumptions, formulas and standards that underpin the development of housing policies, plans and strategies, including those related to rental housing.

Policies makers typically use a number of beliefs, standards and formulas to formulate housing policy: for example how much of a household's income should go to housing before it becomes a burden; what the maximum relationship between median housing price and income (price income ratio) should be before housing is considered unaffordable, how a housing shortage is determined and how a government can encourage the development of affordable housing whether through public private partnerships or through supplying housing itself. These are just a few examples that are used to determine housing policies.

This series on rental housing issues has argued that perhaps the main belief that is put in practice all over the world is that homeownership should be encouraged in all cases. The series has tried to make the case that pushing homeownership boundaries too far can have highly detrimental effects when the context is not looked at and when prudent principles are not followed. We saw this in the mortgage crisis that started in the United States when brokers, lenders, wholesalers, investment bankers, rating agencies and investors got caught up in a cycle of pushing mortgages loans that simply did not make sense. Policy toward homeownership can also be distorted in countries that state that housing should be for everyone, that no one should live in poor housing conditions, and that people have the right to adequate shelter but where their policies and programs give away valuable resources to those in the upper brackets while the poor often live in horrendous conditions.

There is a need to reexamine some of the housing policy assumptions that are commonly used. For example, we can look at affordability standards that state that a family can spend 30 percent of its income on housing costs before it is considered a burden.¹ “Families who pay more than 30 percent of their income for housing are considered cost burdened and may have difficulty affording necessities such as food, clothing, transportation and medical care.”² Yet, as David Bieri of the University of Michigan noted, “It’s essentially an arbitrary number. It creates more distortions than it actually solves.”³



(Lima, Peru)

Yet some housing experts argue that the 30 percent figure can be stretched higher in developing economies. “The 30 percent measure is useful in stabilized, mature economies with functioning housing ecosystems, but in emerging economies, households can spend higher levels of their income on

housing, up to 40 percent, without being considered burdened, and up to 60 percent on housing and transportation costs combined. **The proportion of income these households spend on food and other family necessities is comparatively minimal, as opposed to those who have more disposable income.**” (Emphasis added)

¹ A Blueprint For Addressing The Global Affordable Housing Challenge, McKinsey and Company, 2014

² U.S. Department of Housing and Urban Development website.

³ Weise, K, “Housing’s 30-Percent-of-Income Rule Is Nearly Useless,” Bloomberg Business, 2014

For those living in countries with high food costs, not only is this incorrect, the actual percentage that a family can spend on housing is significantly lower. For example, in Sierra Leone a family earning Le 600,000 (\$150) would not be one of the poorest families, but would be in the second income quintile. Rice, however, costs Le 150,000 for a 50kg bag and an average household of six would use two bags in a month. Right away, half of that family's income is spent on rice alone. So when water, electricity, school costs, transportation, health care costs are factored in, it is easy to understand why it would be impossible for families in Sierra Leone to spend 30 percent of their income on rent. So they spend significantly less on housing, often only 10 percent of their salary and live in informally constructed units, often with tin walls and roofs, at peril to natural hazards, such as flooding.

The price income ratio is another example of how statistics can be misused. "A house price to income ratio is the ratio of average or median house prices to average or median gross or disposable income in a given geographical area. The ratio is used as one measure of trends in housing affordability over time."⁴ Articles on real estate in many countries quote Demographia's



(Freetown, Sierra Leone)

study by Dr. Shlomo Angel⁵ that says that when a city has a price index of five to one, that city's housing market is considered unaffordable.⁶ What this fails to take into account is what Forbes noted is the effect of high interest rates on this ratio,⁷ as well as the effect that long amortization periods will have.

If a Canadian couple earning \$50,000 is able to borrow at 4.5 percent for 30 years, they would be able to borrow \$246,701 if they spent 30 percent of their income on mortgage payments, or just about five times their income. For a Kenyan family with the same income (which would be quite high for the country) they would have to borrow at 18 percent and would only be able to borrow \$82,942, or not even twice their income. If they were only able to obtain a fifteen year mortgage, they could only borrow \$77,619, or just over 1.5 times their income.

⁴ Housing Industry Association Ltd. Economics Group, "House Price to Income Ratios in Australia," 2010

⁵ See S. Angel, "11th Annual Demographia International Housing Survey: 2015, Ratings for Metropolitan Markets," Demographia, 2015

⁶ See "Apartment Price to Income Ratio Worsens," Japan Property Central, 2012 or Zappone, C, "Melbourne Housing Now Severely Unaffordable," Domain.com.au, 2011

⁷ Zillow, "High Home Price-to-Income Ratios Hiding Behind Low Mortgage Rates," Forbes, 2013

And in the Kenyan example it may not even be possible to obtain a mortgage. For we've seen time and time again, that most people in developing countries, especially lower income people, earn their incomes informally and cannot access the mortgage markets. So if a policy maker was looking at a price income ratio of three to one and would, without doing further due diligence, believe that owned housing is affordable, the policy maker might very well make a judgment that would not benefit its low income, or even its moderate income population. In such a situation, a strategy that focused on rental housing would be much more appropriate.

Another issue is how a "housing shortage" is calculated. Sometimes there is no explanation; previously performed studies are simply quoted. For example, "Lagos, Sub-Saharan Africa's most populated city, is trying to narrow a national housing shortage that the World Bank estimates at 17-million."⁸ Sometimes a simple method is used to calculate a year-by-year shortage. An increase in population in an area is divided by the average family size. Then the number of building permits is examined. The difference between the two is then classified as the shortage.

What the method of calculating a housing shortage misses is the fact that many families live in informally built housing that is not registered. Much of this informal housing is poorly built and without proper sanitation or access to improved water. The analysis also misses the fact that many of these families are living in rental units, not owned by the government or large corporations, but by individuals who use the income as a way to improve their own living conditions.

The policy solution that is recommended from this analysis is to increase the number of units that are built and to build units for sale, not for rent. Moreover, the policy solutions utilized to achieve the goals of "affordable housing" almost never achieve these aims. Lower income people neither have the level or type of income to purchase them, so the benefit of the subsidies goes to higher income people. Meanwhile, the poor living in urban areas continue to live in squalid conditions.

So as urbanization continues and more and more people are living in cities, how can better housing policies go beyond these beliefs, standards and formulas to improve the lives of the urban poor? Five proposals are suggested:

First, understand what people earn and how they earn it. Solutions must be built on data. They must be built by understanding that most low income people living in the urban centers of developing countries are poor and earn their incomes irregularly and informally. Solutions that focus on access to mortgage markets for houses that are out of the price range of most people will continue to aggravate the problem.

Second, examine the pressures that people are under in their day to day lives. If a family spends fifty or sixty percent of its income on food and water, then spending thirty

⁸ Kay, C. and Ibukun, Y., "Housing Shortage in Lagos Reaches Crisis Level" Business Day, 2014

or forty percent of their income on housing is simply not practical. This issue goes beyond housing. Food costs are a critical element here. Are there ways in which the costs of basic commodities can be reduced so that families will have more disposable income?

Third, look at the conditions in urban neighborhoods rather than on policies that try to increase the supply and that waste precious resources. A new sewer line in a poor neighborhood is likely to have a far greater impact than new construction that is built on the city's periphery. That way, people will not have to resort to flying toilets-plastic bags filled with waste that are tossed into the street—and girls will not have to be fearful when they need to go out to the street at night to go to the bathroom.



(Nairobi, Kenya)

Fourth, understand the way that housing is built and by whom. It is built incrementally and improved as people have a little bit of money to buy materials and improve their living conditions. Government organizations and large developers do not build housing for the majority of people. Helping reduce the price of materials, finding ways to build small, safe, sturdy structures that can then be improved upon, training residents in safe standards can all help people's lives.

Finally, create strategies and policies that acknowledge and respect the role of rental housing. Yes, owning a home can be a wonderful experience, can help build people's asset bases, and can strengthen communities. But it is not possible for

everyone, or even for most people in the urban centers of developing countries. Emphasizing ownership to the exclusion of rental causes a lack of focus on the true conditions in cities. Rental housing has a place, an important place, and keeping it as a high priority will go a long way to improving the conditions in our cities.