Home Ownership in Transition – A Canada-California Comparison

This Discussion Paper was prepared for the Global Initiatives Committee of Lambda Alpha International (LAI), an international society devoted to the study and application of land economics. The paper provides background for a webinar scheduled for October 26, 2023. The paper was prepared by Ken Cameron (LAI Vancouver and former CEO of British Columbia's Homeowner Protection Office), Rick Cook (LAI Vancouver, co-chair of LAI Global Initiatives Committee and Principal of Jorden Cook Associates land use planners, North Vancouver) and Tim Youmans (Founder and Managing Principal Economic and Planning Systems, former Lambda Alpha International President and Sacramento Chapter President). The authors gratefully acknowledge the assistance of Tamara L. Boeck, (Partner, Stoel Rives LLP), Wendy Moir (CEO, Ontario Home Construction Regulatory Authority), Kerry K. Nagy (VP-Underwriting, New Home Warranty, Travelers Canada) and Michael Klein, LAI Phoenix, CEO, Freedom Financial Funds LLC.

A pillar of North American society

For decades, the fulfillment of the desire of North American households for ownership and quiet enjoyment of a family home has been a pillar of our society. Home ownership provided security of tenure and a sound investment for individual households. It supported a vast industry devoted to the development, construction, financing and maintenance of family housing as well as a vibrant market in the buying and selling of resale homes. The use of private funds to support the building and acquisition of housing reduced the pressure on the public sector to provide capital and operating funds for housing and permitted a more targeted focus on the needs of households unable to participate in the home ownership market.

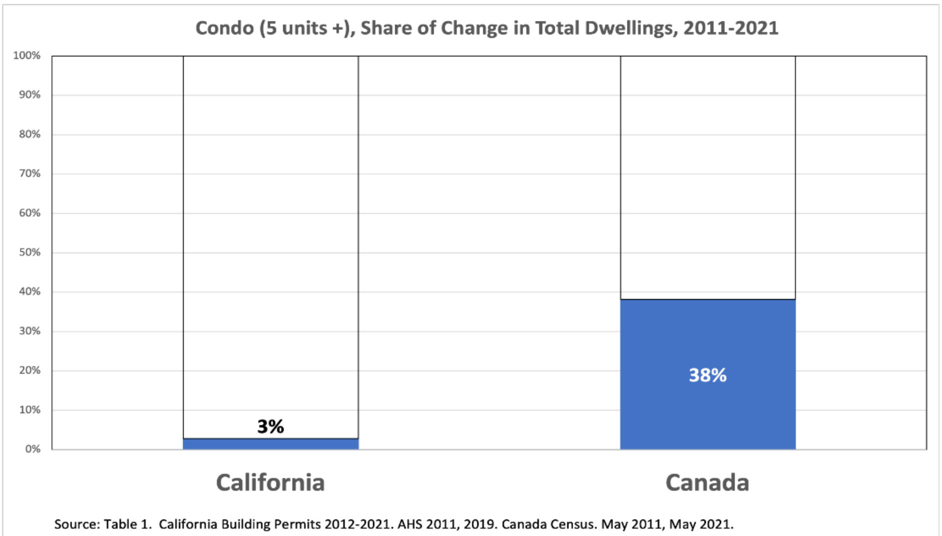
Until the 1950s and 1960s, ownership housing meant almost exclusively single-family homes. As the use of the private automobile grew, affordable single-family housing was increasingly a suburban phenomenon, resulting in the conversion of large areas around cities to low density development. As cities grew and land became scarcer, a traditional single-family home began to be beyond the financial reach of many households. It was also increasingly clear that housing in multiple-family developments was a better solution for many households, including young adults, singles and the aging.

Condominium home ownership was one of the solutions developed to respond to the needs of those who wanted the benefits of home ownership but found the single-family home an unsuitable option for any number of reasons. The result was the growth of new housing developments featuring condominium ownership.

Condominiums in new market housing: California vs. Canada

Notwithstanding the benefits of condominium development in new market housing, the actual experiences in various North American jurisdictions have been markedly different. For example, 38 percent of the new housing added in Canada between 2011 and 2021 was in the form of multi-family condos (5 or more units), compared to an estimated 3 percent in California (see Figure 1 and Appendix A).

Figure 1: Condo units' share of change in total dwellings in California and Canada, 2011-2021, Five and more units



<u>The explanation for the difference between California and Canada in the take-up of home ownership in multiple family developments lies primarily in the risk profile for each of the participants in the condo building process and the measures available to offset the risks to the extent necessary for each participant to become involved.</u>

Construction of new ownership homes is a capital-intensive process requiring all participants to commit significant resources years in advance of the realization of the benefits of these commitments. This is true of any new home construction process from the single home on a single lot on up to single-family subdivisions, but the risks and relationships become even more complex at the scale of multi-family condominium projects.

For most consumers, the purchase of a new home is by far the largest financial transaction they will ever undertake. Any failure to complete the home or the transaction could leave them without a place to live.

Developers of new multi-family housing projects must commit funds to acquire and hold land through an approval process that may be affected by political or economic factors which may have been unforeseen at the time of commitment. In most cases, developers rely on lenders to provide project financing, and developers will often seek insurance coverage such as insuring deposits or insuring against construction defect claims to protect their funds as a project proceeds through the development process. Deposit insurance runs about 1% per year in BC, compared to bonding in California at prevailing market interest rates (currently 7-8% in Canada). The availability and cost of such insurance will depend on the risk that the project will encounter problems with completion. Ideally, greater certainty of completion of the sale to the ultimate consumer is provided by a consumer commitment that begins with a deposit and grows over time as the project nears completion.

The difference between the experiences of Canada and California can be attributed to the ways in which two types of risk are handled: construction defect risk and project financing risk. Lenders, developers and buyers in both jurisdictions must gauge both types of risk.

Construction defect risk

In Canada there are provisions in place that provide assurance to consumers that a home will be built competently and be free of construction defects for up to 10 years. These include licensing systems for residential builders that ensure that they are qualified to build and sell homes, impose conditions for entry and set requirements that builders continue to maintain and upgrade skill levels. Programs of research and education for builders are provided to assist with this. Complementing the licensing requirement is the requirement that residential builders arrange for warranty coverage for new homes to ensure that a defined set of construction defects will be rectified by the builder and the warranty provider if and when they occur.

California also regulates and licenses builders and trades to minimize construction defects, but the onus for quality control and assurance in design and construction lies with general contractors. There is a statutory warranty of "fit and finish" of a new home for one year, but this is not backed by performance bonds or insurance. California has legislation establishing the builder's right to repair a defect which is designed to require the homeowner or their association to go to the builder for repairs before taking any further action, but the timelines are short and most builders are not set up to respond in a timely way. The range of actionable defects narrows as the 10-year window for identifying defects approaches.

This legislation has spawned a response from the legal profession that offers to litigate, on a contingency basis, any defects on behalf of a homeowners' association. It appears that almost every ownership multi-family project attracts this litigation as a "best practice," and attorneys have been known to argue that the executives of homeowners' associations themselves might be subject to litigation by their residents if they fail to litigate for construction defects[1]. Given the limitation periods in California and other states, homeowners associations feel they need to start litigation to preserve their rights. The result is a significant increase in risk for all those involved in building multi-family condo projects, especially in comparison with rental projects.

Project financial risk

The pre-sale, secured by a deposit, is the beginning of the relationship between a potential home buyer and the developer of a multi-family condo project. Ideally, the financial commitment would grow over time as the project proceeds through the approval process to construction and occupancy. Such a commitment provides some of the financing needed for project completion as well as an assurance to the developer and lenders that the consumer intends to complete the purchase when the project is ready for occupancy.

[1] See https://www.woodlitigation.com/blog/2021/may/is-a-homeowners-association-under-a-duty-to-insp/

Sales Centre and full-size unit model for Condo Pre-sales in a 15-building, 340-unit project, North Vancouver, BC, 2023

Experience in Canada varies by province, but there are broad similarities between provinces. In British Columbia, for example, pre-sales typically occur prior to issuance of building permits. The process is governed by a disclosure statement which the Real Estate Development Marketing Act requires a developer to file before beginning to offer units for sale. The statement triggers a 12-month window of time in which the developer must market the project and confirm with purchasers that it is proceeding, otherwise a purchaser has a right to cancel a sales contract and get their deposit back.

Typically a buyer puts up an initial deposit of 10 percent of the sales price which becomes non-refundable after an initial 7-day rescission period. The required deposit increases to 15 percent one year after the pre-sale and to 20 percent after 18 months. Depending on market conditions, deposits can range from 10 to 25%.

Developers in good standing may receive deposit insurance from private insurers and use the pre-sale deposits to fund project pre-construction or construction costs. The percentage of pre-sales and level of deposits for a project are determining factors for construction lenders, with pre-sales of 30 to 50% of the units sufficient to cover the construction loan cost In British Columbia, critically, the pre-sale contract is binding on the buyer after the 7-day rescission period; not just for the deposit but potentially more (if housing prices declined by more than the deposit amount, for example).

In a California pre-sale, unless the buyer contracts out of consumer protection, their maximum exposure for terminating the contract is limited by legislation to 3 percent of the contract price as liquidated damages[2]. Any deposit over 3 percent must be fully refunded to the buyer if they decide to terminate a deal between the time of the deposit and closing of the sale at occupancy. This limited financial exposure for buyers makes the California system more of a purchase reservation. It encourages speculation on the part of buyers and can lead to situations where large numbers of buyers in a project cancel their contracts, resulting in reduced prices and putting project financing in jeopardy. There can be other effects: if a project fails to sell more than 50 percent of its units to owner-occupiers, financing from the Federal National Mortgage Association becomes unavailable as the project is deemed a "failed condominium."

Why does this matter?

In the light of the risks with construction defects and construction financing that characterize multi-family condominium projects, it is not surprising that so few are built in California, particularly when developers can revert to a rental project which does not have these risks.

<u>Household and community benefits of condominium ownership in multi-family developments.</u>

As a result, a significant number of California households do not have access to the potential benefits of home ownership that can be obtained through investment in multi-family condominiums. These are summarized in Table 1 and include lower cost entry into building household equity, ownership choice for smaller households, improved security of tenure and equitable access to the tax benefits of home ownership.

[2] See California Civil Code Section 1675. In 2014, an exception was passed for a newly constructed attached condo, within a structure of 10 or more units, in the event of a buyer's default (see Section 1675 (f) (1) (B)). Our understanding is that this is a theoretical that has not been used in practice in part due to the difficulty of the developer proving damages beyond the 3% level.

Table 1: Potential benefits of a home ownership option in multi-family projects

Lower priced entry to building household equity.	Lower land and construction costs per dwelling unit than an average single family detached dwelling, providing a lower price threshold for buyers to enter the real estate equity market.
Ownership choice for smaller households	- More appropriate in size and location for 1 and 2-person households, enabling these households to build equity.
Improved security of tenure	- Better security of tenure typically than a rental option, with less need for government oversight to protect tenure.
Community roots	- Ownership can be a step toward social commitment to a community beyond your dwelling unit. You are invested financially and psychologically in your immediate physical unit, and from that into the community that surrounds and touches daily life. Without accounting for equity factors such as poverty, broadly speaking, housing tenure of owners tends to be longer than renters[3].
Reduced Material Footprint	- Can mean a more compact living space, less use of personal vehicles for mobility, more amenities and services within a walk or cycle commute, more riders for transit and shared vehicles, less extension of roads and utilities --- overall a lower energy and material footprint on the land.
	- The corollary to a more compact community is if someone wants to own their own home, but a multi-family option is deterred or not available, society drives housing consumers out to fringe areas with lower land prices; aggravating dependence on cars and extending costly infrastructure.
Ladder to financial stability	- As of 2021 more than one-fifth of Canada's total national wealth (22.9%) was attributable to the housing market. According to a 'Survey of Financial Security' the net worth of homeowners in 2019 was 28 times the net worth of renters of all ages ($685,400 compared to $24,000). While there are routes to financial security other than real estate ownership (e.g stocks, REITs, bonds, money market funds), direct ownership of real estate is a practical, proven path for many households over many decades and, in Canada, condos are increasingly a gateway to homeownership.[4] .
Equitable access to common tax benefits	- If multi-family ownership is not enabled as an option for housing consumers, then the tax expenditure benefits of mortgage interest deductibility (US), or principal residence capital gains exemption (Canada) are denied to those unable to meet the threshold to purchase a single-family dwelling.
Community safety	- When equity ownership generates more interest in the future of the neighbourhood beyond their dwelling, this helps build a more engaged, potentially safer and better maintained community.

[3] A quick Google search suggests in the US housing tenure for an average homeowner is 13 years, while for a tenant it is between 2.5 and 3 years. May differ by state, region, local area, income. Homeowners: https://www.thezebra.com/resources/home/average-length-of-homeownership/#:~:text=47%25%20of%20Americans%20have%20lived,homeownership%20years%20is%20eight%20years . Tenants : https://tenantplanet.com/blog/how-long-does-a-tenant-stay/#:~:text=So%2C%20how%20long%20does%20a,which%20to%20judge%20your%20performance

[4] https://www.statcan.gc.ca/o1/en/plus/2357-national-housing-day-look-homeowners-and-renters.

Benefits for smart growth and climate action goals

Many of California's smart growth and climate action policies focus on building denser residential communities, especially building high density units near transit centres. Encouraging home ownership options in these high density communities will assist in meeting these goals.
As shown in Table 2, new condominiums can contribute to meeting California's smart growth policies in a number of ways, by promoting compact development, transit-oriented development, mixed-use development, affordable housing, sustainable design and green building.

Table 2: Smart growth benefits of home ownership in multi-family projects

Compact Development	New condominiums involve higher density development that maximizes land use efficiency.
Transit Oriented Development	New condominium projects located within or near transit corridors provide residents with convenient access to public transportation options, such as buses, light rail, or subway systems. This accessibility encourages the use of public transit and reduces the need for private vehicles, thereby promoting sustainability and reducing traffic congestion.
Mixed Use Development	New condominiums often incorporate ground-floor commercial spaces or are located within mixed-use developments that include retail, office, or community facilities. This mixed-use approach promotes walkability, reduces the need for long commutes, and fosters vibrant, livable communities where residents can live, work, and access amenities in close proximity.
Affordable Housing	Certain cities and counties have inclusionary housing policies that require developers to include a percentage of affordable units in their projects. New condominium developments can help meet these requirements by incorporating affordable housing units, ensuring a mix of housing options for a diverse range of income levels.
Sustainable Design and Green Building	New condominium projects can incorporate energy-efficient features, such as solar panels, efficient HVAC systems, and low-flow fixtures, to reduce energy and water consumption. Additionally, developers may adopt sustainable construction practices, use eco-friendly materials, and prioritize landscaping that promotes water conservation and biodiversity.

A broader perspective: the general decline in home ownership

A recent study[5] examined broader home ownership trends in California. Among its key findings are:

- Home ownership in California continues to be eroded: 44 percent of people aged 25-75 were homeowners in California in 2021, down from 50 percent in 2000.
- Home ownership in California is increasingly out of reach compared to the rest of the United States, with the share of adults who own their own home more than 15 percentage points lower than in the rest of the country. Affordability is the prime reason for this gap.

In Canada, there has also been a decline in home ownership rates, as measured by the percentage of households that are owner occupied, but it has been more modest, from 69 percent owner-occupied in 2011 to 66.5 percent in 2021. In British Columbia, the equivalent figures are 70.0 percent and 66.8 percent[6].

It is difficult to escape the conclusion that in California the virtual non-existence of condominium ownership homes, with their greater affordability than single-family homes, has played a significant part in the erosion of access to home ownership.

Conclusion

To be viable, new multiple family home ownership projects must offer an acceptable risk profile to participants, be they consumers, developers, lenders or insurers. The key areas of risk are construction defects and project financing.

Without appropriate protection against construction defects, consumers will be unwilling to undertake a home purchase, which for most households is both the largest financial commitment in their lives and involves the basic requirement for shelter.

An analogy to the automobile industry may be illustrative here. The North American automobile industry thrived after World War II until it was challenged by cheaper imports from Asia and Europe. Then quality problems emerged with the imports and domestically produced vehicles which resulted in a decline in overall consumer appetite for new vehicles. The industry responded by developing quality control standards, introducing multi-year bumper-to-bumper warranties and offering leasing and other financial incentives to new vehicle customers. Governments became involved, prescribing requirements for vehicle safety and fuel efficiency. These measures resulted in unprecedented demand and sales success for the entire industry. The lesson is that overall consumer confidence is a key factor in the success of any product that represents a significant outlay for individual households. As with cars, so with homes.

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[5] D. Shoag, Issi Romem and David Garcia. The First Step is the Hardest: California's Sliding Homeownership Ladder. Terner Center for Housing Innovation UC Berkeley, May 2023. https://ternercenter.berkeley.edu/research-and-policy/homeownership-ladder-california/

[6] Statistics Canada Map 1: Homeownership rate declines from 2011 to 2021 in all provinces and territories, except in the Northwest Territories. https://www150.statcan.gc.ca/n1/daily-quotidien/220921/mc-b001-eng.htm .

The other players who must be comfortable with their risks are the participants in the home construction process: developers, builders, lenders and insurers. Construction financing works best when there is a progressive level of financial commitment on the part of the home purchaser that can provide assurance to the other participants that will enable them to provide financing for construction and marketing of new homes. If, as is the case in California, a purchaser can walk away from a commitment with minimal cost, these other participants find their risk exposure escalating if and as a project proceeds.

The authors acknowledge that all is not well in the Canadian home ownership scene and there are differences in culture, land availability in metro regions and historic market experience with apartment/townhome condos that impact the acceptance of condo ownership today in California. There is a common interest in housing availability/affordability in both Canada and the United States. California and the US more broadly can offer lessons for Canada. But the key recommendation coming from the above analysis is that California consider the systems in place in Canada that could assist with development of ownership multi-family housing (apartment and townhome condominiums) in the California context.

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Appendix A

Table 1: Housing Stock by Ownership Type:
California 2020, Building Permits 2012-2021;
Canada 2021, Change 2011-2021.

	California USA					**Canada (1)**			
	Dwelling Units, 2020 (2)	% of Total Dwellings, 2020 (2)	Building Permits Change 2012-2021 (3,4)	% of Change		Dwelling Units, 2021	% of Total Dwellings, 2021	Housing Stock Change 2011-2021	% of Housing Stock Change
Structure Type									
< 5 units	10,936,400	76%	533,191	54%		9,661,025	64%	761,130	46%
Estimated Multi-family 5+ units	3,453,600	24%	454,285	46%		5,317,915	36%	892,245	54%
Total Occupied Private Dwellings (5)	14,390,000	100%	987,476	100%		14,978,940	100%	1,659,690	100%
Estimated MF (5+ units), Part of a condominium (1,2,6,7)	611,234	4%	27,836	3%	est.	2,248,275	15%	632,790	38%
Average Units built per Year (est.)			2,784					63,279	
2021 Population	39,240,000					36,991,981			

1. Source: Statistics Canada Census Condo Status Extract (courtesy Rennie Intelligence, Andrew Ramlo). Data as of May 2011 and May 2021. See note 6 for definition of Condominium.

2. California MF (5 + units), part of a Condominium estimated from US Census, American Housing Survey estimates, 2019, for three Metro Areas (LA, SF, Riverside). 3 Metros are 61% of all California condos. In 3 Metros, 5.1 % of total 5+ units were condos. Apply 3 Metro figure to all California for a high estimate.

3. CA New Privately-Owned Housing Units Authorized by Building Permits in Permit-Issuing Place by State. Data for calendar year.

4. https://www.census.gov/construction/bps/pdf/annualhistorybystate.pdf (1960-2021)

5. A private dwelling occupied by usual residents refers to a private dwelling in which a person or a group of persons is permanently residing. Also included are private dwellings whose usual residents are temporarily absent on May 11, 2021.

6. From Stats Canada, Condominium status refers to whether the private dwelling is part of a condominium development, where a condominium is a residential complex in which dwellings are owned individually while land and common elements are held in joint ownership with others. US Cenus definition of Condominium status: A type of ownership that enables a person to own an apartment or house in a development of similarly owned units and to hold a common or joint ownership of some or all of the common areas and facilities such as land, roof, hallways, entrances, elevators, swimming pool, etc. Condominiums may be single-family houses as well as units in apartment buildings.

7. In Canada, Multi-family of 5+ units is estimated as a total of Apartment in building of 5 or more stories, Apartment in a building of under 5 stories, and Townhouse.

Appendix B
Table 2: Comparison of Terms – Canada and California

Criteria	Canada (or BC)	California
Condominium (also known as 'condo')	Canada Census: Condominium status refers to whether the private dwelling is part of a condominium development, where a condominium is a residential complex in which dwellings are owned individually while land and common elements are held in joint ownership with others..	Condominium: A type of ownership in which each owner owns the interior walls of the unit. The owner of each unit also holds a common or joint ownership in all common areas and facilities associated with the unit; such as, land, roof, exterior walls, hallways, entrances, elevators, lobbies, etc. Condominium ownership may apply to single-family and multifamily structures. A condominium apartment building is classified with apartment buildings in structures with five units or more, despite the fact that each unit is individually owned.
Home Owners Association (HOA)	Strata, regulated under Strata Property Act, BC.	HOA, Condominium Association
Multi-family 5+ units	In Canada census, includes apartment buildings 5-storeys and over, … under 5-storey, townhouse. Does not include Apartment (up and down) which may also be thought of as a Single Detached unit with a basement suite, nor a Duplex or Semi-Detached unit.	US Census category.
Governing Legislation	Strata Property Act, Real Estate Development Marketing Act,	
Bare Land Strata	Roads, utilities and common land areas are managed by a Strata Association, but the units including exteriors are owned and maintained by the individual strata title holders.	Typically, a single family home ownership association, where units are owned and maintained by individual HOA members, and certain roads, utilities or other common facilities are maintained by the HOA. These are very common in California and Florida, with an estimated 36% of California households belonging to a Homeowners Association, Condominium Association or Cooperative Association, of which only a small fraction (4 of the 36%) are in multi-family projects of 5+ units.