

Inclusionary Housing: A High-End Housing Lottery

Below-market housing mandates result in a constrained market where more people will want discounted homes than developers can supply; some will receive large benefits, while others receive nothing.

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Canada's housing affordability crisis has two components: First, too many people are chasing too few homes, so rents and prices of existing housing

stock have outstripped many Canadians' ability to pay. Reducing immigration is an inadequate measure to restore balance in this market, so the simplest solution would be to build more homes – a natural job for the private sector.

However, the second issue complicates this fix: High land and construction costs have driven new-home prices beyond what many Canadian households can afford. A recent [CMHC study](#) I helped author shows that rents for new homes are typically 15% or more higher than for similar-sized older units in the same area. In isolation, market-rate new homes don't solve the crisis—many households simply can't afford them.

This problem has inspired some commentators to actually argue against housing development on the basis that the product is unaffordable – a flawed analysis on three counts. First, new homes, which are expensive when they come to market, age over time and become more affordable. Second, people occupying the new units either move from older homes, freeing up affordable options, or they choose new homes rather than competing with less affluent households for older stock. Canadians moving into new homes come from neighbourhoods with lower rents, and movers to more expensive neighbourhoods come from communities that are more affordable. Thus, as new homes become available, they trigger a chain of moves that yield vacancies in older buildings and less pricey areas. Studies in [Germany](#), [Finland](#), and the [U.S.](#) support this result. Third, market units are expensive because there are not enough of them. Further restricting supply will only make matters worse.

Still, as the federal government states in its new Build Canada Homes Market Sounding Guide: "For a large segment of the working population, students, seniors living on fixed incomes, the private market alone cannot provide affordable housing options." The ultimate solution, then, still depends upon an expansion in the overall housing stock, but it also requires a transfer of resources to people in need, a function that demands the powers of government.

Even so, there are different strategies for transferring resources, from forcing or incentivizing developers to provide homes at below-market rates to providing direct cash transfers. The first strategy is suspect. It rests, first, on a notion that the development industry is so profitable that there is an excess that government can claw back in the form of low-cost housing; if this was ever true (and developers will contest it) the situation has changed dramatically. As well, a “fundamental theorem” of economics tells us that if society is worried that real estate investment is too profitable, it is better to simply charge builders or investors money for the right to do business and let government figure out the best way to use that money to help households in need.

Yet governments at every level have imposed demands or incentives for developers to absorb the housing challenge, such as by having to price certain units below-market rents. In Vancouver, for example, several upzoning initiatives, such as the Broadway Plan, allow more density only if the developer offers 20% of housing units at below-market rents. This option is frequently inefficient and often unfair. It also puts developers in charge of implementing a public policy goal for which they are neither trained nor accountable.

In some regards, asking developers to build and manage below-market housing also gives them control over what amounts to a high-end housing lottery. In a constrained market, more people will want discounted homes than developers can supply, so some of those people will receive large benefits, while others receive nothing. That is a needlessly unfair allocation of resources. Worse, landlords who are put in charge of selecting tenants have incentives to choose households who least need assistance: self-interest dictates that landlords choose beneficiaries who have the greatest capacity to pay rent on time. [Evidence from the U.S.](#) shows that landlords in white neighbourhoods shy away from offering discounted units to Black applicants.

Developers also have an incentive to make affordable units artificially unattractive. If these homes are oversubscribed, then it makes sense to make them as small as allowable and to put them in the least desirable parts of new buildings.

Consider another example: The federal government, through CMHC, currently offers low-interest loans for qualifying projects with below-market housing. Alternatively, CMHC could raise interest rates while eliminating affordability mandates. If the loan subsidy equates to a \$200,000 rent discount, CMHC could increase interest payments by that same amount. This new revenue could then be used by the government to fund social needs more broadly and equitably, instead of the benefit being concentrated among a privileged few recipients selected by the developer.

The households receiving the benefit of below-market housing would likely be better off with cash benefits than discounts on brand-new housing units. Households in need typically do not choose luxuries; they use any increased income to cover necessities. But new homes are a luxury, so a household in need that receives \$500 per month might spend some of it on improved housing, but would likely direct most of the benefit to better food, transportation, or childcare. The household might be better off with less money, but with no restriction that the funds go to new housing.

The record suggests that imposing affordability and design requirements on the development community will lead to fewer homes being built, not more, and will contribute to inequities and market distortions. The question remains as to what government can do to increase housing supply, but imposing that duty solely on the development community clearly has contrary effects.

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