Paper presented at the
International Sociological Association Conference
Housing in the 21st Century, Alexandria, Virginia, June, 1997

The Use of Minimum Income Qualifications by Landlords in Selecting Tenants: Recent Human Rights Litigation in Canada

J. David Hulchanski

Centre for Applied Social Research
Faculty of Social Work, University of Toronto

June 1997

Outline

1. History and Evolution of the "Rule of Thumb" Housing Affordability Measures
2. Minimum Income Criteria as Statistical Discrimination
3. What is "Income" in the Rent-to-Income Ratio?
4. The Potential for Undue Hardship on Owners of Rental Housing
5. Conclusion

Introduction

With the smallest social rented sectors among major western nations, the Canadian and U.S. housing systems have relied extensively on the private market to house low income renter households. The proportion of households in the social rented sector in Canada is 5.6% and the United States 2.0%, compared, for example, to 40% in the Netherlands, 22% in the UK and Sweden, and an average of about 12% in Germany, France, Finland and Ireland. Low income households must rely on a relative large private rented sector in Canada (32%) and the United States (34%) (Freeman, Holmans & Whitehead, 1996). Both countries have now ceased funding new social housing, leaving disadvantaged households almost entirely reliant on the private market's ability to provide appropriate housing they can afford.

This extensive and increasing reliance on the market raises important questions about the mechanisms landlords use to screen and select applicants. How do vulnerable groups fare in terms of access to the available rental vacancies? What mechanisms account for the observed disparities in housing cost and quality, in which the many disadvantaged households pay more for less? While explicit forms of illegal discrimination on grounds such as race, family and marital status are certainly a factor, this paper reviews the larger question of the systemic effect of common business practices with regard to tenant selection.

A now common business practice among larger landlords and rental property management firms is the use of minimum income qualifications as a means of attempting to assess the ability of a household to pay the rent. In a recent survey of the largest rental property management firms in Metropolitan Toronto 70% reported that there are income requirements imposed on prospective tenants. The rent-to-income ratio used ranged from 25% to 40% (the median was 31%) (Hulchanski & Weir, 1992b:2). A 1994 survey of apartments for rent found that minimum income qualifications were used most frequently by large property managers, meaning that “the impact of such practices in terms of the number of units affected is significant” (N. Barry Lyon Consultants Limited, 1995:42). Many landlords in the public, non-profit and private sectors use household income as criteria in selecting tenants. There is a difference, however, between maximum and *minimum* income criteria.

In the public and non-profit sectors, *maximum* income criteria are used in the process of defining eligibility for rent geared-to-income (RGI) housing subsidies. The aim is to exclude higher income households so as to target a particular type of housing subsidy to households in greatest need. Even the term, “rent geared-to-income” makes it clear that income criteria are being applied. They are being used in two ways: to exclude households above a certain income level and to define the amount of subsidy eligible households will receive. The assumption is that the

use of maximum income criteria is an objective, *valid* and *reliable* measure of housing need. Those in need of housing assistance are by definition eligible, and those not in need are by definition excluded.

The use of maximum income criteria as part of the process of defining eligibility and subsidy levels for government programs has a long and relatively undisputed history. Debate takes place over the nature of the measure and the specific cut-off points used in defining eligibility and subsidy levels. There is no reasonable grounds for dispute in the cases where public sector *needs-based* subsidy programs are involved, rather than universal subsidy programs. In needs-based subsidy programs eligibility criteria defining the need are required and a formula based in part on household income is often appropriate.

The use of *minimum* income criteria in the private rental housing market, on the other hand, is subject to a great deal of controversy. In 1993, for example, the Ontario Human Rights Commission estimated that active complaints related to discrimination in housing represent about eight percent of the Commission's total caseload. Many of the housing complaints are connected to the use of minimum income criteria. Private sector landlords are currently using minimum income criteria in evaluating prospective tenants. Does this use of minimum income criteria constitute an objective, valid and reliable measure of whether a landlord will be able to collect rent from a prospective tenant? Or is it a seemingly objective ‘rule of thumb’ selectively applied to tenants a landlord does not want to rent to – on the basis of their ‘race,’ ethnicity or other protected characteristics in violation of human rights legislation?

The use of minimum income criteria, in contrast to maximum income criteria, presents a number of difficulties for researchers. Even though it is apparently a widespread practice today, the history of and the rationale for the use of minimum income criteria in the residential rental market is difficult to determine. There is no body of literature debating the merits of the practice of using minimum income criteria in Ontario and no systematic analyses examining and defining alternative options for determining the best income measure or measures to use, if this were indeed possible and desirable. From a business standpoint it may appear to be quite rational to select tenants on the basis of perceived ability to pay. But the societal and ethical implications of practices which deny low income households access to a basic necessity such as housing are immense.

A recent human rights case in Ontario (*Kearney et al. v. Bramalea Limited et al.*), involving 59 days of hearings over a two year period and complex economic and statistical analysis, dealt with claims by three low income women that the use of minimum income criteria to deny them access to available rental housing violate their rights under human rights legislation to freedom from discrimination because of age, receipt of public assistance, marital status and a number of other grounds. All were denied access to the most affordable, appropriate housing they could find because they would be paying more than 25 or 30 per cent of income on rent. The claim is that the use of income criteria provides a loophole for landlords who want to violate the protections offered by the *Human Rights Code*. Section 2(1) of Ontario’s *Human Rights Code* states that: “Every person has a right to equal

treatment with respect to the occupancy of accommodation without discrimination because of race, ancestry, place of origin, colour, ethnic origin, citizenship, creed, sex, sexual orientation, age, marital status, family status, handicap or the receipt of public assistance" (Revised Statutes of Ontario, 1990). Twenty-three organizations representing Children's Aid Societies, young mothers groups, refugees and immigrants, disabled women, tenants' associations and poor people were granted intervenor status by the board of inquiry.

This paper examines the implications of landlords' use of income based screening criteria. It traces the history of the use of a rent-to-income ratios as "affordability criteria" and assesses any evidence available justifying their use as valid and reliable predictors of default. It then examines one of the key assumptions, the nature of "income" in the rent-to-income ratio. Finally the paper examines the cost implications for landlords of relinquishing the use of income criteria and compares these to the social costs of allowing their continued use. The paper argues that there is no empirical validity to the rent-to-income ratio as a measure of ability to pay and that its use by landlords constitutes a form of direct discrimination.

1. History and Evolution of the "Rule of Thumb" Housing Affordability Measures

> *"The Right to a Home. Social welfare demands for every family a safe and sanitary home.... These fundamental requirements for normal living should be obtainable by every family, reasonably accessible from place of employment, at a rental not exceeding 20 per cent of the family income."* – U.S. National Conference of Charities and Correction, 1912 (quoted in Wood, 1919:10)

Various rules of thumb about housing affordability have been used since the 1850s. They must, therefore, one could reasonably assume, have some empirical basis. A household is said to have a housing affordability problem, in most formulations of the term, when it pays more than a certain percentage of its cash income to obtain adequate and appropriate housing. This formulation has its roots in nineteenth century studies of household budgets and in the commonly used expression "one week's pay for one month's rent." By the 1880s a week's wage for a month's rent was a widely used rule of thumb for referring to the housing expenses of some tenants, though there is no record of exactly how and why this usage came about. This late nineteenth century adage about "one week's wage..." continued into the twentieth century becoming an adage about 20%, 25% or 30% of income as somehow representing the upper limit of what households can afford to pay for housing. These adages are based on little more than assumptions about what average households tend to spend mixed with beliefs about what they ought to spend on housing. When and why and by whose authority is the ratio changed? The changing of the ratio is as cloaked in mystery as is its origins and its empirical basis. Housing researchers over the past few decades have dismissed the rule of thumb measures as misleading and invalid indicators of either housing need or affordability (see, for example, Donnison, 1967:255-256; Lane, 1977:iv-v; Fallis, 1985:20; Stone, 1990:50-51; and Kearns, 1992:540). The inadequate definition of "income" in conventional housing expenditure-to-income measures helps explain why it is so difficult – most experts would say impossible – to construct a simple but empirically valid statement to describe the relationship between housing expenditure and income. Households can pay the monthly rent by calling on a variety of resources, not just the easy to measure cash income of the household. Part of the answer can also be found in the very definition of what a "rule of thumb" is. It is, by definition, not based on scientific knowledge. According to the *Oxford English Dictionary*, a rule of thumb is a "method or procedure derived entirely from practice or experience, without any basis in scientific knowledge; a roughly practical method. Also, a particular stated rule that is based on practice or experience." (2nd edition, vol. XIV, p.232)

The Search for an "Economic Law" on Housing Expenditure. The use of income ratios in housing analysis has its origins in the empirical work on consumer behaviour by a nineteenth century German statistician, Ernst Engel (1821-1896) and a number of other lesser known nineteenth century analysts of household budgets. In his history of the use of the housing expenditure-to-income rules of thumb for the U.S. Department Housing and Urban Development, Lane (1977:5-6) states that Ernst Engel "proposed an 'economic law' which included the proposition that the percentage of income that households spend for lodging and fuel is invariably the same what ever the income." In contrast Herman Schwabe "suggested that, as total family income rises, the amount allocated to housing increases at a lower rate." In 1868 Schwabe published the first detailed research on the housing part of the household budget, proposing a "law" related explicitly to housing. His law stated: "The poorer anyone is, the greater the amount relative to his income that he must spend for housing" (Stigler, 1954:100). Lane implies that even though Engel was wrong and Schwabe was closer to being correct, the contemporary use of the 25% or 30% rule of thumb defining affordability is closer to Engel's position. To add to the confusion, Margaret Reid, in her 1962 book *Housing and Income*, a work quoted by many neo-classical economists who write about the elasticity of housing demand (e.g., Winger, 1968), finds "very substantial evidence" for the "rejection of the Schwabe law on rent," even though, Reid notes, the Schwabe law "has long been accepted and many predictions and policies have been formulated with such expectation." To add further to this intellectual disarray over which "law" was or is *the* "law," Economist George Stigler (1954:99) notes that towards the end of Engel's career (in 1895) he recognized, based on further empirical evidence, that his earlier formulation of the housing part of his (Engel's) "law" was indeed wrong. So there is, then, the early Engel law and the late Engel law to choose from, and one can find Engel quoted both ways.

The problem with Engel's work and that of some of his followers is that the relationships he identified and the predictions he made were peculiar to food. In retrospect, we can see that they were easy relationships to identify -- that is, easy to make regarding food but more difficult in the case of the much more complex budget category, housing. Attempts to demonstrate similar laws for categories of expenditure other than food, especially for housing, therefore, had much less success. Housing presents numerous conceptual and practical difficulties. What is to be included in "housing" costs: cash rent, some or all utilities, maintenance, furnishings? What is meant by "income": gross or net, one or all adults' income, children's income if any? What about sharp temporary fluctuations in income and non-cash sources of goods and services which would otherwise have required expenditure of cash income? What about income from roomers, if any? As a result, numerous other laws of consumption related to housing flourished from a growing number of academics and government officials, using analyses of additional sets of budget data. Zimmerman (1936) lists 36 different laws or theories about the relationship of household expenditure and specific budget categories, many related to housing but with eight specifically focused on housing.

It is not unfair to conclude, in agreement with economist George Stigler in his 1954 review of this "scientific" body of work on household budgets, that none of this constitutes a

solid contribution to either theoretical or empirical understanding of consumer behaviour. Rather, this history of attempts to study household consumption is largely a comedy of errors, all kinds of errors -- conceptual, theoretical, empirical and methodological -- in all kinds combinations and permutations. Zimmerman refers to all of this as "fog which shrouds theories of the relation between rent and the standard of living." There is, he writes sarcastically, "a series of so-called budgetary laws of rent such as the one by Schwabe, the rent law erroneously attributed to Engel, the revised rent law developed by the critics of the spurious law of Engel, and the several other alternative theories ..." (1936:180). By the 1930s the attempt to define "laws" of housing consumption had run out of steam. Zimmerman's 1936 text on household consumption is one of the last major works to examine and, in doing so, dismiss this approach to understanding consumption patterns. After clearing away the fog Zimmerman concludes, "no absolute laws can be postulated" about the relation between income and housing.

> "Now we must conclude that there are no fundamental general relations between income and the proportion used for rent .... The values classified under 'rent' are so complicated and so many influences come to bear upon the rental paid for or imputed to a house that each time and each social situation leads to unique results." (p.194)

> "Rent-paying, either in an economic or popular sense, is an expression of the general culture and cannot be understood except for its specific results under given conditions and at particular times.... In general, it appears that the relations between income and expenditure in the field of housing are so unpredictable and so varied that no absolute laws can be postulated." (Zimmerman, 1936:197)

The assertion that rents should not exceed a certain percentage of income permeates housing discussion throughout the twentieth century. Yet it is difficult to find its users offering any empirical basis for this forthright declaration. There is no study, set of studies or body of literature concluding that a particular ratio or any ratio is an appropriate measure of what a household ought to spend. The assertion that a certain ratio represents too much for certain households seems to be based on ad hoc observations by social reformers and local public health and social welfare officials about what lower or average wage earners can pay without affecting their ability to pay for food and other necessities. This has been turned around in recent decades and used in the rental housing market as a measure for determining which households it is best not to rent to -- on the assumption that they do not, as a group, have the ability to pay the rent. A practical rule of thumb used to try to assist lower than average income households has been turned upside-down and is now used against them.

Six Contemporary Uses of Housing Expenditure-to-Income Ratios. The debate associated with both scholarly and practical attempts to generalize about the relationship between the level of household income and housing expenditures which started in the mid-nineteenth century was largely settled in scholarly circles by the 1930s. Zimmerman's (1936)

and Greenway's (1938) work are examples of the conclusions reached by the 1930s about the fruitlessness of attempts at making "laws" -- broad universal generalizations -- about the relationship between such complex aspects of human behaviour as housing expenditure patterns and household income. In the late 1940s, Humphrey Carver summed up this rich human complexity quite nicely:

> "It must be confessed that the attempt to reduce family needs to a classified budget is a denial of the manifold varieties of human nature. While the desire for security persuades us to accept the conventional standards of our community, the equally vigorous urge for freedom of individual expression makes us all resist such uniformities. The idiosyncrasies, vanities, pleasures, and generosities that make life worth living cannot be accounted for in scientific budgets and economic formulae. But even this cold examination of minimum family needs has shown the many variable factors that must enter into household plans; it is clear that simple generalizations and rules-of-thumb for calculating a family's capacity to pay for housing may be quite misleading." (Carver, 1948:85-86)

Yet the use of a simple expenditure-to-income ratio continued. Some the ways in which it is being used are appropriate, while others are not.

In the post-war housing literature it is possible to find the housing expenditure-to-income rule of thumb being used in six distinct ways:

(1) *description* of household expenditures;

(2) *analysis* of trends and comparison of different household types;

(3) *administration* of public housing by defining eligibility criteria and subsidy levels in rent geared-to-income housing;

(4) *definition* of housing need for public policy purposes;

(5) *prediction* of the ability of a tenant household to pay market rent; and

(6) *selection* of tenants who can afford to pay market rent.

Much of the continued contemporary use of the housing expenditure-to-income ratio, as this list indicates, relates to the problem of defining housing "affordability." This list helps in the process of distinguishing between appropriate and inappropriate uses of housing expenditure to income ratios (for a more extensive discussion, see Hulchanski 1995).

The list can be divided into two categories. The first three uses of housing expenditure-to-income ratios – description, analysis and administration – can be considered quite valid and helpful when used properly by housing researchers and administrators. By "used properly" it is meant that the research methods and the statistical analysis techniques are properly carried out, i.e., no significant methodological errors are made. This leads to valid and reliable descriptive and analytic statements about the expenditures on housing of the

different types of households being studied. This type of description and analysis of household expenditure patterns can also be helpful in defining administrative rules about eligibility for housing subsidies which are distributed on the basis of need (as opposed to universal programs).

The improper use of housing expenditure-to-income ratios, leading to invalid and unreliable results, is due to theoretical and conceptual errors. Uses four, five and six – definition, prediction, and selection – *are all invalid uses for they fail to measure what they claim to be measuring*, even if the research methods and the statistical analysis techniques are properly carried out. The ratio is faulty when used to define housing need and predict affordability due to a faulty conceptualization of the income part of the ratio. The additional conceptual problem arises because it applies a statistical average of a particular specific aggregate group of households to an individual household, leading to the problem of statistical discrimination.

2. Minimum Income Criteria as Statistical Discrimination

> *"Although most types of discrimination (racial, sexual, religious, etc.) affect specific groups, statistical discrimination is a phenomenon that affects everyone. It occurs whenever an individual is judged on the basis of average characteristics of the group or groups, to which he or she belongs rather than upon his or her own personal characteristics. The judgements are correct, factual, and objective in the sense that the group actually has the characteristics that are ascribed to it, but the judgements are incorrect with respect to many individuals within the group."* (Thurow, 1975:172)

Statistical discrimination is a specific form of discrimination which receives special attention in literature on economic and marketplace discrimination, including the large body of literature on housing discrimination. As Galster (1992) notes in his review of the literature on housing market discrimination, a considerable amount of theoretical work has been carried out in developing models which seek to explain why agents and landlords might discriminate in housing markets (Becker, 1959; Yinger, 1978, 1979, 1981, 1986; Galster, 1990a, 1990b; Newburger, 1989; Galster and Constantine, 1991). He divides these theories into a number of variants, four of which relate to the rental sector (the others to the ownership market): landlord prejudice, customer prejudice, expected discrimination, and inferior tenant (1992:653).

The fourth, the "inferior tenant" theory, is most pertinent to the use of minimum income criteria. This theory argues that landlords exclude tenants from certain groups because their experience or beliefs indicates that group identity correlates with unstable rent payments, poor maintenance, severe damage, disruptive behaviours, etc. Some landlords refuse to rent to certain tenants from certain groups because of *statistical discrimination* – the belief that *group*

identity correlates with being a bad tenant. No doubt there are “inferior tenants.” The issue is whether all members of a particular group or groups should be excluded on the basis of some members of the group being presumed to be or known to be “inferior” tenants. The device used to exclude the “inferior” tenant is minimum income criteria -- a presumption that statistical correlation is valid and that it applies to everyone in the group. It is difficult to determine the extent to which any statistics were *ever* systematically collected and analyzed, not that this is the issue. Research on housing discrimination, Galster points out, indicates that the dominant cause of housing discrimination is stereotyped beliefs about the inferiority of certain groups (1992:654).

Statistical discrimination is, therefore, a term used to describe the judgement of individuals based on averages instead of individual characteristics. Some alleged propensity of a group is applied to all members of that group. When statistical discrimination is practised against groups who are already disadvantaged, it makes it even more difficult for members of that group to improve their status. As Thurow points out,

> “Statistical discrimination serves as a powerful conservative force. If a group starts with inferior background characteristics (for whatever reason), statistical discrimination will retard the group’s acquisition of better background characteristics and will prevent individuals from escaping from discrimination on an individual basis.” (Thurow, 1975:181)

This is why the application of measures based on the *average* characteristics of a group is so damaging when applied to an individual, and why it is not surprising to find such individuals claiming they are targets of discrimination. Discrimination in one market, such as housing, cannot be separated from discrimination in other markets, such as the job market. This points to the interlocking nature of different types of discrimination. Each type makes it easier to enforce other types. In the labour market, all forms of discrimination lead to lower incomes. No matter what type of discrimination is employed it is reinforced by the other types. “They exist in a system of mutual support” (Thurow, 1975:170).

The use of minimum income criteria is a very simple, convenient, seemingly valid and easy to use rule of thumb for screening out individuals who happen to belong to groups identified as “inferior tenants” – groups defined as such based on stereotypes and prejudice. It is more difficult and time consuming to assess each applicant on individual merit. A rule of thumb applied to all the individual members of certain groups makes the process easier. The use of minimum income criteria in the rental housing market constitutes the use of an easy to use statistical measure to discriminate against many of the groups protected by human rights legislation. They are protected by legislation because many in society already consider them “inferior” people, not just “inferior” tenants. Black people, women, and single mothers, for example, earn proportionately less because of their colour, or gender or marital status. In part this is due to discrimination in the labour market. Taking average group characteristics and using it against individuals in the rental housing market is simply adding to the disadvantaged situation of these groups. Those who use minimum income criteria need not intend to add to the disadvantaged status of these groups. They do so nevertheless. According to Galster:

"discrimination must be seen as embedded in a web of interlocking, mutually supportive causal connections wherein proximate 'consequences' of discrimination lead to still other negative effects, which ultimately feed back to intensify discrimination itself." (Galster, 1992:662-663)

3. What is "Income" in the Rent-to-Income Ratio?

"Of much bigger magnitude than excluded market transactions, though, is the value of nonmarket output. This includes, in particular, a vast amount of household activity. The work of paid domestic servants is counted in the official accounts; that of housewives or other unpaid workers in the home is not. The preparation of meals in restaurants and the washing of clothes in laundries or Laundromats are included; home-cooked meals and the services of user-owned washers and dryers are not. And the transportation services of taxis, buses, and rented cars are included while those of the family car are not." – Robert Eisner (1989:3)

The housing expenditure-to-income ratio relies on a definition of "income." What is household "income"? What is meant by "income" in minimum income criteria? The ratio fails to be a valid measure of housing affordability because it relies on the easiest to measure income, money income. It ignores other sources of support, both cash and non-cash, by which households meet their needs.

In market-based economies, securing adequate cash to obtain necessities in the marketplace is the way in which theoretical and practical discussions frame the issue of how households ensure their survival and well-being. The lack of a cash income or a low cash income relative to other households is the predominant method by which the public and private sectors define "affordability" measures – various rules of thumb. The cash income requirement has come to be seen as the method by which a household meets its needs even though it is generally recognized that income, as a concept, is much more complex than just the sum of cash income. Theory and day-to-day practice often require the use of simplifying assumptions. The question must always be asked: how valid and reliable are these simplifying assumptions?

Since households do not exist in isolation from the broader forms of societal organization, formal economic relations in the cash-based marketplace are but one method for meeting needs. While the reliance on markets may be quite extensive in western, advanced-industrial economies such as in Canada, households by no means rely exclusively upon the marketplace to secure the goods and services they need. The public and private sectors must recognize that a household's *total resources* consist of a range of sources and strategies for meeting needs. Rather than the relatively simple concept of "household income" and the "household budget," the concept of "total household resources" offers a more

accurate method for describing and assessing the ability of a household to obtain life's necessities.

The question of *what constitutes income* extends well beyond the very minor question of whether gross or net income should be used in the income part of the housing expenditure-to-income ratio. In the case of *household income* it is the *money* income, the *cash* resources which are easiest to measure and, as a result, the easiest to use as a convenient rule of thumb to measure housing affordability (CMHC, 1991; Gyourko and Linneman, 1993). This convenient measure, however, goes much too far in simplifying reality to the point that it does not reflect the reality of most households. Minimum income criteria fail to meet the tests of validity and reliability for a number of reasons. The inadequacy of the measure of the "income" used in the "income criteria" test is by itself ground for rejecting its use. The use of the very narrow definition of income as cash income from the formal market economy leads by definition to discrimination against households with limited cash income resources from the formal market economy, such as the unemployed and those in low-paying jobs. It favours those who have a great deal of cash income from this source.

Theory and empirical evidence both point to the fact that households meet their basic needs though a variety of methods. There are five economic spheres by which households can obtain resources (cash and non-cash) for meeting their needs:

(1) *the domestic economy*, internal to the household;

(2) *the informal economy*, the extended family and close acquaintances;

(3) *the social economy*, neighbourhood and community-based groups and agencies;

(4) *the market economy*, the formal marketplace; and

(5) *the state economy*, government (Hulchanski and Michalski, 1994).

This typology is drawn from the vast body of theory and empirical evidence of how people meet their needs (cf. Offe and Heinze, 1992). The empirical evidence indicates that households survive and even thrive in a complex intermingling of different economic spheres with their attendant webs of social relationships. When households find themselves in temporary situations of financial duress, most have other options for substituting certain types of self-provisioning and non-cash exchanges, especially to ensure that their basic needs are met (Uehara, 1990; Wellman, 1992). Indeed, the one general proposition that seems to emerge from the many studies of sources of social and economic support may be stated as follows: *net of market earnings (wages, interest, investments, etc.) and government transfer payments, households rely upon an extensive network of socio-economic relations to ensure that their basic needs are met.*

Research on how households obtain their basic needs indicates that they may rely on a substantial amount of self-provisioning and upon informal networks of extended kinship,

friendships, neighbours, and acquaintances (e.g., Rose, 1985; Felt & Sinclair, 1992; Martin & Martin, 1985). In addition, resources are often obtained through linkages established in the social economy and nurtured in civil society, including charitable organizations, community groups, collectives, and co-operatives (Quarter, 1992). For the most part the exchanges in these non-market, non-governmental spheres are not formally recorded, although some segments of the social economy tend to be somewhat more formalized.

A more inclusive definition of income must be based on an assessment of how households *actually* meet their needs. Recognizing the full range of methods by which households meet their needs requires keeping in mind the severe limitations of the conventional measure of affordability based on the narrow definition of income. It also requires the development of improved measures. The proposed concept, *total household resources*, represents the total amount of *cash*, of *goods*, and of *services* received in a given period of time (e.g., monthly). It is a much better starting point for defining and measuring need and affordability.

The key policy and program implication of the fact that households obtain their basic needs by shifting between the use of cash and non-cash resources and by drawing on all the economic spheres to which they have access is that simple rules of thumb about cash income are not valid measures of ability to pay. Furthermore, the use of such rules of thumb benefits higher income households which have significant cash resources and thereby easily satisfy the criteria currently in use. By making erroneous assumptions about a household's ability to pay, such rules of thumb harm the general well-being of lower income households by excluding them from certain options.

The interesting point about residential rent is that it is the one basic need households have which *requires* cash. Rent is the largest single *cash* outlay for most households which *must* be met each month. Non-cash resources can only rarely be used in paying the rent, such as in the case of an agreement to serve as the building's superintendent or carry out some share of maintenance in lieu of some or all of the monthly rent payment. Virtually all the other needs which a household must meet can either be postponed or met in other ways from the other support networks (any of the five economies). Most households can shift between using cash to obtain certain goods and services, if the need arises, to relying on their networks of extended kinship, friendships, neighbours, and acquaintances to meet their needs, including borrowing money from someone in this extended network to help pay the rent.

The inadequacy of the conventional measure of income as cash income, combined by the recognition of the reality of how households actually meet their needs, explains why many more households do not default on their rent payments. This helps explain why, on a continual basis, for as long as such data has been collected, a substantial number of Canadian renter households have managed to spend a *huge* percentage of their cash incomes on rent (see historic trend data in Hulchanski, 1994a, Appendix B). The 1991 Canadian census reports that one third of Ontario’s renter households, or 430,000 out of the

1.3 million renter households, paid more than 30% of the household income on rent. Fifteen percent (195,000 renter households) paid more than 50% of their income on rent. How can they manage to do this if the only resource these households had to meet their needs was their cash income? They would either starve or be evicted. If the housing expenditure-to-income rule of thumb, based as it is on 30% or 35% of income, is a valid and reliable measure of housing affordability and ability to pay rent, why is Ontario not facing a crisis of historic proportions – close to 200,000 households facing eviction for inability to pay rent (i.e., the 195,000 households paying over 50% of their income of housing)? Close to a third of all homeowners with mortgages are paying over 30%, with 10% (115,600) of these households paying over 50%. Why are these 115,000 owners not defaulting on their mortgage? How do they manage to "violate" the rule?

The reason for the absence of massive defaults is abundantly known. It has been well established in the housing literature for at least two decades. The housing expenditure-to-income ratio is a poor estimate of the household's ability to meet its basic needs and a misleading indicator of a household's ability to pay for what it needs. The minimum income criteria based on a ratio is just one of many housing indicators. "Given the variety of circumstances facing different households," Baer writes in his study of housing indicators, "rules of thumb about the percent of income to be devoted to housing can be extremely misleading in individual cases and therefore in aggregate data as well." He adds that a " rent-income ratio for one kind of household may not be appropriate for another, and that imposing the same standard for all households is unrealistic" (Baer, 1976:383-384).

> "Whereas simple ratios of housing cost to income seem sufficient as indicators, a sophisticated standard needs to incorporate considerations of age of the head of household and household size before an appropriate ratio standard should be applied. Otherwise appropriate variations in household behaviour will be ignored, all circumstances will be mistakenly judged by a single criterion, and estimates of deprivation or need will be in considerable error." (Baer, 1976:386-387)

There is, therefore, no fear of hundreds of thousands of households failing to pay their rent and getting evicted simply because they are paying more than 50% of their household income on rent. The housing expenditure-to-income ratio is simply not a valid and reliable indicator of ability to pay rent.

In short, the inadequacy in the definition of income used in the standard housing expenditure-to-income ratio is itself enough to invalidate the use of minimum income criteria by landlords in the rental marketplace. It is not a valid and reliable indicator of what it claims to measure. There is no evidence to support its use as a measure of housing affordability or ability to pay. There is a great deal of evidence to the contrary – evidence that many households are paying more, much more, than the prescribed ratio. The reality of how households manage to meet their needs, including the need to have the cash to pay their rent, is too complex and diverse to be summarized in one simple measure.

4. The Potential for Undue Hardship on Owners of Rental Housing

> *Rationale for Government Intervention: "Imperfections in both the housing and mortgage markets could arise because of discrimination against certain groups. As an example, in the housing market, some landlords may refuse to rent units to students or single parent families. Similarly, in the mortgage market, discrimination may exist against some borrowers such as women or native people and against some rundown neighbourhoods, which lenders feel are undesirable. To the extent that discrimination does exist, government efforts should be directed toward removing the source of the problem."* – Task Force on Canada Mortgage and Housing Corporation, Government of Canada, 1979.

Will the owners of rental housing suffer financially if they are prohibited by human rights legislation from using minimum income criteria in the decision to rent? Ontario's *Human Rights Code* contains a provision which allows discrimination in accommodation *if* "the needs of the person cannot be accommodated without undue hardship on the person responsible for accommodating those needs" (Sec 17(2), Revised Statues of Ontario, 1990). A complainant must first demonstrate that discrimination is taking place and then must demonstrate that no undue hardship will be imposed on landlords if they are ordered to cease a certain discriminatory practice. It is left up to the Human Rights Commission or a court to assess what is meant by "undue hardship" in each case.

If the housing expenditure-to-income rule of thumb is not a valid and reliable measure of ability to pay rent, as argued above, it simply does not measure what the users claim or believe it measures. It combines two conceptual errors: a narrow focus on only the cash income resources of a household, and the application to individual households of a unscientific rule of thumb based on an aggregate average.

Not using an erroneous, invalid measure as part of the criteria in the decision to rent to a particular household means, of course, that landlords will either be unaffected or that they will be better off. Landlords will be unaffected because the measure they are using to assess the ability to pay does not actually measure the ability to pay. Nothing changes when an erroneous measure ceases to be used. Landlords will profit by not using this (or any) invalid measure in that, if they have vacancies which they delayed filling due to rejection of tenants based on the use of an invalid measure, they will fill vacancies more quickly.

During the hearings the lawyers and expert witnesses representing the landlords failed to produce evidence of harm. A study for the Human Rights Commission assessed whether the risk of tenant default on rent in Ontario is a significant factor impacting on the profitability or viability of a rental apartment business (N. Barry Lyon Consultants Limited, 1995). The study

found that compared to most investment options, investment in existing rental apartment buildings is a relatively favourable one. There is solid demand, a predictable income stream, and compared to other sectors even within the real estate industry, residential rental businesses weathered the recession of the early 1990s relatively well. Risk of tenant default was found to be "relatively insignificant as a determinant of the viability of a residential rental business." Bad debt was found to be less than 1% of gross revenue which is normal for most wholesale and retail businesses, and that default on rent is not a significant cause of business failure. The cost and inconvenience of evicting tenants for arrears is also relatively insignificant. Court fees and eviction service fees represent about 0.1% of gross rental income and arrears in these cases represents about 0.3% of gross rental income. "There is no apparent justification for suggesting any greater exposure to the risk of bad debt" in apartment renting, the report concluded, "than in most others" (N. Barry Lyon Consultants Limited, 1995:44-45).

> "When we considered the effect of a typical level of bad debt on profitability and on return on investment, we found that the effect was relatively insignificant. Underscoring this is the finding that eliminating an average level of bad debt altogether would only increase the rate of return by about one tenth of one percent. Similarly, doubling the average level of bad debt would only reduce the rate of return by one tenth of one percent. Indeed, a minor fluctuation in property tax rates, mortgage rates, or an unexpected repair bill, pose equal and potentially more serious risks for landlords than is the risk of increased default." (N. Barry Lyon Consultants Limited, 1995:44)

The study concluded that "tenant default is not a significant factor in determining the viability of a landlord's business" and that "restricting applicants to apartment buildings on the basis of income in the hopes of reducing default, may be counter-productive to the landlord." The practice may create additional costs "by restricting demand and increasing vacancy, rather than creating any significant savings in the area of bad debts" (N. Barry Lyon Consultants Limited, 1995:45).

Nonetheless, the association representing landlords in Ontario wants to maintain the right to use income qualifications and are attempting to do so by political means. Following the election of a neo-conservative provincial government in June 1995, and fearing that they will loose at the Human Rights Commission, they successfully had a provision which amends the Ontario Human Rights Code included in a bill which abolishes rent controls and abolishes legislation protecting rental housing from demolition and condominium conversion. Section 200 of Bill 96, the *Tenant Protection Act*, which is before the Ontario Legislature during 1997, will allow landlords to refuse to rent to people on the basis of "income information." A new subsection in the Human Rights Code would read:

> "The right under section 2 to equal treatment with respect to the occupancy of residential accommodation without discrimination is not infringed if a landlord uses in the manner prescribed under this Act income information, credit checks, credit references, rental history, guarantees or other similar business practices which are prescribed in the regulations made under this Act in selecting prospective tenants."

The problem with the amendment is limited to the words “income information.” The rest, credit checks, rental history, and so forth, are standard practices and are not in dispute. The Chief Commissioner of the Ontario Human Rights Commission, Keith Norton, who was appointed by the new conservative government, has written to the Premier (March 10, 1997) stating that the ‘income information’ part of Section 200: “will raise serious human rights issues for seniors, single parents and persons who are receiving public assistance” and that “significant numbers of these individuals and their families will find themselves without affordable housing” and that “regulations that purport to allow the use of tenant screening based on income information will effectively authorize discrimination against people on public assistance” and that this “will wipe out the protection provided by the Code on the ground of public assistance for all practical purchases” and that the proposed amendment means “the government will have granted the right to equal treatment on the ground of receipt of public assistance with one hand and will take it away with the other.” The Chief Commissioner’s letter makes clear that “landlords have legitimate business reasons for requesting information such as credit checks and rental histories.” There is no business case, he notes, for including the words “income information.” On May 21, 1997 the Metropolitan Toronto Council adopted a motion calling for the words “income information” to be deleted from Section 200 for the same reasons and authorized Metro to intervene in the public hearings on Bill 96 scheduled for July and August 1997.

5. Conclusion

Housing researchers over the past few decades have dismissed the rule of thumb measures as misleading and invalid indicators of either housing need or affordability. A review of their origins and evolution finds that there is no empirical or even logical basis for the rule. It is a rule which, it turns out, has its origins in the mid-nineteenth century, in attempts by early social scientists to define laws of human behaviour similar to the laws of nature that natural scientists were busy discovering. The attempt to even try to define such universal laws about household budgets faded away by the early decades of this century.

It is not clear when the practice of using minimum income criteria in Ontario’s residential rental market began and when its use became so widespread. At its most fundamental level, the issue of using minimum income criteria in the private rental market is an issue related to the differential treatment of groups in the marketplace based on the level of income, specifically a lower than average level of income. The use by entrepreneurs of a minimum income test on potential customers in a marketplace for one of the basic human necessities is quite rightly controversial. It is controversial in our free society because it relates to whether it is an acceptable practice for the private use of a privately selected rule of thumb to be the basis for making distinctions between groups of people. Individual households are not being assessed on the basis of their individual characteristics but on their group characteristic – as part of a very

large group with the aggregate characteristic of having a lower than average level of cash income.

What makes the use of minimum income rule of thumb criteria so significant for public policy consideration and review are:

- *the personal characteristics of the individuals and groups*, generally individuals from disadvantaged groups protected by human rights legislation;
- *the nature of the measure*, the use of a rule of thumb based on the average of group characteristics, rather than a measure of the individual attributes of the individual applicant, and
- *the nature of the market item involved*, access to housing, a fundamental necessity for human well-being, in a marketplace where there are few other options for applicants.

All households make choices as to how to allocate not only their *cash* income but also their "total household resources," of which cash from the market is but one important part. In the case of the application of minimum income criteria in the decision to rent, however, an authority outside the household is imposing its determination of what it considers to be an "appropriate" budget allocation of the cash income of a particular household. All households with higher than average cash incomes can, of course, easily meet the minimum income criteria. The rule of thumb measure is not being applied to them. All households with higher than average incomes are, by definition, automatically exempt from that potential constraint on exercising their freedom of choice in the marketplace. All households who fail to meet the minimum income criteria are automatically denied the ability to exercise their freedom of choice in the marketplace and their freedom of choice in allocating the cash portion of their total household resources. The use of a rent-to-income screening device perpetuates and exacerbates the disadvantaged position of already disadvantaged groups in society.

Differential treatment of groups on the basis of group characteristics which are irrelevant to the situation is the starting point for the definition of the type of discrimination human rights charters and codes condemn and seek to eliminate. A measure of a prospective tenant's ability and willingness to pay rent based on group characteristics can simply be irrelevant, as in the case of skin colour. A measure of a tenant's ability and willingness to pay rent can *appear* to be relevant, and even be widely *assumed* to be relevant, yet, under closer scrutiny, can prove to be irrelevant. In this case, for example, the minimum income criteria asks an economic question (about income) which indeed makes it appear to be relevant to the economic question about ability/willingness to pay rent.

In summary, the evidence and arguments presented in this paper demonstrates that use of minimum income criteria is not a valid measure of ability to pay and, as such, no harm is done to landlords if they ceased to use it. The continued use of the measure, however, does clearly cause harm to the tenant households to which it is applied and who face rejection from

apartments for failing to meet the criteria. The use of minimum income criteria is directly perpetuating and exacerbating the hardships endured by the already disadvantaged groups and individuals that human rights legislation seeks to protect. It does not matter to these disadvantaged households whether the criteria is being applied in honest belief that it is valid or dishonestly as the excuse for discrimination. To these households, discrimination against them is the result. Landlords exclude them from accommodation they feel they can afford. Their search for housing is extended, adding to the search costs both emotionally and financially. These households are likely to end up paying more for worse quality housing. This is because they are restricted to a rental submarket where demand is very high and the quality is likely to be lower. The better quality apartments are more likely to go to those households that prejudicial attitudes and stereotypes deem to be "better." Minimum income criteria automatically define all higher than average income households as part of the "better" pool of tenants while all lower than average income households are labelled as part of an "inferior" pool of tenants. Having a lower than average income does not automatically make a person better or worse, more or less responsible, more willing or unwilling to pay the rent, than someone with a higher than average income.

References

Baer, William C. (1976) “The Evolution of Housing Indicators and Housing Standards: Some Lessons for the Future,” *Public Policy*, 24(3), Summer, 361-393.

Becker, Gary S. (1957) *The Economics of Discrimination*, 2nd ed., Chicago: University of Chicago Press, 1971.

Becker, Gary S. (1968) “Economic Discrimination,” in *International Encyclopedia of the Social Sciences*, David L. Sills, ed., NY: Macmillan & The Free Press, Vol 4.

Borland, Homer (1968) "Rent-to-income formula for public housing," *Urban Renewal and Public Housing*, 4(3), 18-25.

Burke, Paul, Connie Casey, and Gerd Doepner (1981) *Housing Affordability Problems and Housing Need in Canada and the United States: A Comparative Study*, Washington and Ottawa, a joint HUD/CMHC paper, February.

Canada, Minister Responsible for CMHC (1985) *A National Direction for Housing Solutions*," Ottawa, December.

Canada, Task Force on Canada Mortgage and Housing Corporation (1979) *Report on Canada Mortgage and Housing Corporation*, Ottawa: CMHC.

CMHC (1991) *Core Housing Need in Canada*, Ottawa: CHMC.

Carver, Humphrey (1948) *Houses for Canadians*, Toronto: University of Toronto Press.

Donnison, D.V. (1967) *The Government of Housing*, Penguin Books.

Dreier, Peter and J. David Hulchanski (1993) “The role of non-profit housing in Canada and the united states: some comparisons,” *Housing Policy Debate*, 4(1), 43-80.

Eisner, Robert (1989) *The Total Incomes System of Accounts*, Chicago: University of Chicago Press.

Fallis, George (1985) *Housing Economics*, Toronto: Butterworths.

Feins, Judith D. and Terry S. Lane (1981) *How Much for Housing? New Perspectives on Affordability and Risk*, Cambridge, MA: Abt Books.

Feins, Judith D. and Charles S. White, Jr. (1977) *The Ratio of Shelter Expenditures to Income: Definitional Issues, Typical Patterns and Historical Trends*, Cambridge, MA: Abt Associates.

Felt, Lawrence and Peter Sinclair (1992) “'Everyone does it:' Unpaid work in a rural peripheral region,” *Work, Employment, Society*, 6, 43-64.

Freeman, A.J.M., A.E. Holmans and C.M.E. Whitehead (1996) *Is the UK Different? International Comparisons of Tenure Patterns*, London: Council of Mortgage Lenders

Galster, George C. (1990a) “Neighborhood racial change, segregationist sentiments, and affirmative marketing policies,” *Journal of Urban Economics*, 27, 344-361.

Galster, George C. (1990b) “White flight from racially integrated neighbourhoods in the 1970s: the Cleveland experience,” *Urban Studies*, 27(3), June, 385-399.

Galster, George C. (1992) “Research on discrimination in housing and mortgage markets: assessment and future directions,” *Housing Policy Debate*, 3(2), 639-683.

Galster, George C. & P. Constantine (1991) “Discrimination against female-headed households in rental housing,” *Review of Social Economy*, 49, 76-100.

Gyourko, Joseph and Peter Linneman (1993) “The Affordability of the American Dream: An Examination of the Last 30 Years,” *Journal of Housing Research*, 4(1), 39-72.

Hulchanski, J. David (1988) “The evolution of property rights and housing tenure in post-war Canada: Implications for housing policy,” *Urban Law and Policy*, 9(2), June, 135-156.

Hulchanski, J. David (1990) “Canada,” Chapter 9 in the *International Handbook of Housing Policy and Practices*, Willem van Vliet, editor, Greenwood Press, New York and London, 289-325.

Hulchanski, J. David (1993) *Barriers to Equal Access in the Housing Market: The Role of Discrimination on the Basis of Race and Gender*, Toronto: Centre for Urban and Community Studies, University of Toronto, Research Paper 187, November.

Hulchanski, J. David (1994a) *Discrimination in Ontario's Rental Housing Market: The Role of Income Criteria*, a report prepared for the Ontario Human Rights Commission.

Hulchanski, J. David (1994b) *The Use of Percent of Income “Rules of Thumb” in Housing Analysis: Origins, Evolution and Implications*, a report prepared for the Ontario Human Rights Commission.

Hulchanski, J. David (1995) “The Concept of Housing Affordability: Six Contemporary Uses of the Housing Expenditure-to-Income Ratio, *Housing Studies*, 10(4), October, 471-491.

Hulchanski, J. David & Eric Weir (1992a) *Survey of Apartments for Rent in Metro Toronto: Requirements for Last Month's Rent Deposit*, Faculty of Social Work, University of Toronto.

Hulchanski, J. David & Eric Weir (1992b) *Survey of Corporations Owning or Managing Large Numbers of Rental Apartments in Metro Toronto: Requirement for Last Month's Rent Deposit*, Faculty of Social Work, University of Toronto.

Hulchanski, J. David & Peter Dreier (1993) “Non-profit housing in Canada and the United States: A comparison,” *Housing Policy Debate*, 4(1), 43-80.

Hulchanski, J. David and J Michalski (1994) *How Households Obtain their Basic Needs: The Shifting Mix of Cash and Non-Cash Resources*, a report prepared for the Ontario Human Rights Commission.

Kearns, Ade (1992) “Affordability for housing association tenants: a key issue for British social housing policy.” *Journal of Social Policy*, 21(4), Oct., 525-49.

Lane, Terry S. (1977) *What Families Spend for Housing -- the Origins and Uses of the “Rules of Thumb,”* Cambridge, MA: Abt Associates.

Martin, Joanne M. and Elmer P. Martin (1985) *The Helping Tradition in the Black Family and Community*, Silver Spring, MD: National Association of Social Workers.

Metropolitan Toronto Planning Department (1993) *Metro's Changing Housing Scene, 1986-1991*, Toronto: Metropolitan Toronto Planning Department.

Newburger, H. (1989) "Discrimination by a profit-maximizing broker in response to white prejudice," *Journal of Urban Economics*, 26, 1-19.

N. Barry Lyon Consultants Limited (1995) *The Impact of Rent Arrears on the Viability of Residential Landlords' Businesses*, a report prepared for the Ontario Human Rights Commission.

Offe, Claus and Rolf G. Heinze (1992) *Beyond Employment: Time, Work and the Informal Economy*, Translated by Alan Braley, Cambridge, UK: Polity Press.

Quann, Dorothy (1979) *Racial Discrimination in Housing: A Discussion Paper on the Type of Prejudices and the Recent Incidence of Racial Discrimination in Rental and Ownership Housing Across Canada*, Ottawa: Canadian Council on Social Development.

Quarter, Jack (1992) *Canada's Social Economy*, Toronto: James Lorimer & Company.

Rapkin, Chester (1957) "Rent/Income Ratio," *Journal of Housing*, Vol 14, January, p.8-12. Reprint in: Wheaten, W.L.C., G. Milgram and M.E. Meyerson, eds. (1966) *Urban Housing*, NY: Free Press, 168-175.

Ray, B. K. & Moore, E. (1991) "Access to homeownership among immigrant groups in Canada," *Canadian Review of Sociology and Anthropology,* 28, 1-27.

Reid, Margaret (1962) *Housing and Income*, Chicago: University of Chicago Press.

Rose, Albert (1949) *Rental Income Study*, Ottawa: Canadian Welfare Council, Family Welfare Division. 13 pages.

Rose, Albert (1980) *Canadian Housing Policies (1935-1980)*, Toronto: Butterworths.

Rose, Richard (1985) "Getting By in Three Economies: The Resources of the Official, Unofficial and Domestic Economies," in *State and Market: The Politics of the Public and the Private*, Jan-Erik Lane, ed., London: Sage Publications, 103-141.

Schwabe, H. (1868) *Die Verhältnis von Miethe und Einkommen in Berlin*, Berlin.

Stigler, George J. (1954) "The Early History of Empirical Studies of Consumer Behavior," *The Journal of Political Economy*, LXII(2), April, 95-113.

Stone, Michael E. (1990) *One-Third of a Nation: A New Look at Housing Affordability in America*, Washington, D.C.: Economic Policy Institute.

Thurow, Lester C. (1975) *Generating Inequality: Mechanisms of Distribution in the U.S. Economy*, NY: Basic Books.

Uehara, Edwina (1990) "Dual exchange theory, social networks, and informal social support," *American Journal of Sociology*, 96, 521-557.

Wellman, Barry (1992) “Which Types of Ties and Networks Provide What Kinds of Social Support?” *Advances in Group Processes*, 9, 207-235.

Winger, A.R. (1968) “Housing and Income,” *Western Economic Journal*, June.

Wood, Edith Elmer (1919) *The Housing of the Unskilled Wage Earner: America’s Next Problem*, N.Y.: The Macmillan Company.

Yinger, John (1978) “The Black-White Price Differential in Housing: Some Further Evidence”, *Land Economics*, 54:187-206.

Yinger, John (1979) “Prejudice and discrimination in the urban housing market,” in *Current Issues in Urban Economics*, P. Mieszkowski & M. Straszheim, eds., Baltimore: Johns Hopkins University Press, 430-468.

Yinger, John (1981) “A search model of real estate broker behaviour,” *American Economic Review*, 71, 591-605.

Yinger, John (1986) “Measuring racial discrimination with fair housing audits: caught in the act.” *The American Economic Review*, 76, Dec., 881-93.

Zimmerman, Carle C. (1936) *Consumption and Standards of Living*, NY: Van Nostrand.