Top 10 Real INSIGHTS

Housing Affordability

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ISSUE 79

HOUSING AFFORDABILITY: HOW DID WE GET HERE & HOW CAN WE ADDRESS HOUSING AFFORDABILITY

1 HOW DID WE GET HERE?

The consensus, now acknowledged increasingly by the government after years of vocalizing from the housing industry, has been a lack of supply, especially in the face of rapidly rising immigration numbers.

2 AFFORDABLE HOUSING VERSUS HOUSING AFFORDABILITY

CMHC says housing is considered to be affordable when a household spends less than 30% of its pre-tax income on adequate shelter. Market rates are disconnected from that in Canada's larger cities.

3 WHAT DOES AFFORDABILITY MEAN ACROSS THE COUNTRY

The numbers change dramatically in different areas.

4 WHAT ARE GOVERNMENTS DOING TO FIX THIS?

Virtually every province in the country sees affordability as a major issue and is attempting to address housing concerns, with municipalities also actively pursuing policy changes.

5 CANADA VERSUS THE WORLD ON HOUSING AFFORDABILITY

Canada outpaces Europe and the US on house-price to income ratios.

6 WHAT CAN THE PRIVATE SECTOR DO TO ADDRESS AFFORDABILITY, AND WHAT IS IT DOING?

Different organizations across the country are doing their best to build more, but they must be aided by governments.

7 WHAT IS BEING DONE THAT MIGHT BE HINDERING AFFORDABILITY?

Strong arguments point to government housing policy, at multiple levels, that centres around demand-side solutions instead of creating more housing.

8 THE FINANCIALIZATION OF SINGLE HOME/UNIT RESIDENTIAL

There is growing debate in some circles that real estate, at least residential, should not be financialized -- namely thought of as an investment.

9 HOW WILL REITS AND PRIVATE INDUSTRY BE SCAPEGOATED

In the runup to the 2021 election, the federal Liberals took dead aim at REITs in their policy papers.

10 WHAT'S THE OUTLOOK?

The supply problems in housing are finally being recognized in a country where immigration continues to ramp up without a coordinating increase in housing to match household formation.

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1. HOW DID WE GET HERE?

The consensus, now acknowledged increasingly by the government after years of vocalizing from the housing industry, has been a lack of supply, especially in the face of rapidly rising immigration numbers.

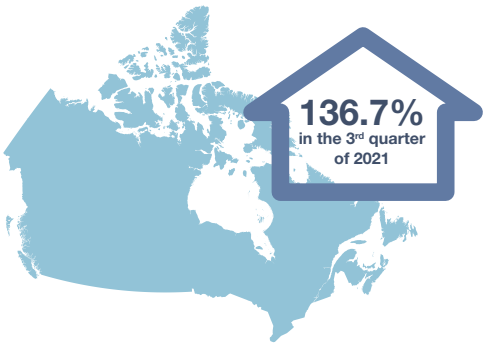
There is almost no debate that affordability has eroded in the Canadian housing market over a more than two-decade run that has seen limited corrections and escalating prices.

The evidence is clear. The average price of an existing Canadian home closed out 2021 at $713,500, albeit heavily influenced by frothy markets in the country's two most expensive cities, Toronto and Vancouver.

One only has to look south of the border to see how much prices have climbed here. Home prices were up 16.9% in America in 2021 but still only reached a median level of US$346,900, which, even factoring in exchange rates, is a far cry from where the Canadian market stands today.

Canada's house price to income was one of the highest in the world at 136.7% in the third quarter of 2021, according to Statista.com.

Canada's house price to income



The question is how we got here. The consensus, now acknowledged increasingly by the government after years of vocalizing from the housing industry, has been a lack of supply, especially in the face of rapidly rising immigration numbers.

Economist after economist has commented on the imbalance between supply and demand, fuelling prices. Scotiabank has called out the structural housing shortage in Canada, pointing to the lowest number of housing units per 1,000 residents of any G7 country, and the number has been falling since 2016.

While continuing to employ measures aimed at the demand side of the housing, like banning foreign buyers for two years, Ottawa embarked on a budget this year aimed at supply, promising $10 billion of funding in various forms to speed up construction, repairs and creation of housing stock.

The government wants to see up to 400,000 new homes built a year, a tall order considering we built about 286,000 homes in 2021, according to the Canada Mortgage and Housing Corporation (CMHC). Economists have suggested it is not even clear that Canada has the labour talent available to build that many houses.

Purpose-built rental housing stock offers some hope, with the supply under construction the highest it has been in three decades, adding 1.9% to the rental stock over 12 months between late 2020 and 2021.

Condominiums have contributed to significant supply in cities through investor-owned units rented out, but that stock tends to be for smaller apartments not designed for families.

Even with those bumps in supply, the country's purpose-built apartment vacancy rate was 3.1% in early 2022 and the condominium market 1.8% — with signs pointing to increasingly tightening rental markets in a post-pandemic world.

With Canada targeting 400,000 plus immigrants per year from 2022 to 2024, housing a larger population continues to be a fundamental issue in a constrained market.

According to Mark Kenney, the chief executive of Canada's largest publicly traded apartment landlord, the country needs policy to address the imbalance as we continue to increase immigration.

"This country does have a very serious supply problem," the CEO of CAP REIT told BNN Bloomberg. "The big driver of demand in this country is immigration, and without a responsible housing policy, we are never going to solve this problem."

2. AFFORDABLE HOUSING VERSUS HOUSING AFFORDABILITY

CMHC says housing is considered to be affordable when a household spends less than 30% of its pre-tax income on adequate shelter. Market rates are disconnected from that in Canada's larger cities.

At the core of the housing debate in Canada is what constitutes affordable housing versus housing affordability.

Housing was hotter than ever in 2021, with 666,995 existing homes trading hands. The sales set a record and then some, up 20% over 2020, according to the Canadian Real Estate Association. The sales figure was 30% above the 10-year average.

It is worth noting that the spring market in Canada may be seeing some pullback in pricing as anecdotal reports from realtors suggest rising interest rates may be taking some of the steam out of the market for now.

With a 20% down payment, the minimum consumers need to avoid costly mortgage default insurance on a principal residence, the buyer of that average home would have carried a $570,800 mortgage at the end of 2021.

At median household income of about $90,000 in 2021, based on Statistics Canada, what can a family "afford" in this country? Almost nothing, according to a CMHC affordability calculator.

The National Bank of Canada said at the end of 2021, it would take 48.6% of a typical household's income to service the mortgage on a typical home in Canada. It begs the question of how many Canadians can afford market rates.

The federal government took aim at housing in the 2022 budget, in which it said it wanted to make housing more affordable for everyone. Since much of this has been called a supply problem, Ottawa wants to see at least 3.5 million new homes built by 2031.

In Canada's largest city, Toronto, policy now suggests a targeted household income of $91,611, should be able to support the purchase of a three-bedroom home for $291,653. The reality, though, is that the cheapest dwelling in the city to meet that three-bedroom target is well over $650,000, according to the multiple listing service.

CMHC says housing is considered to be affordable when a household spends less than 30% of its pre-tax income on adequate shelter. Market rates are disconnected from that in Canada's larger cities.

While supply will impact prices, creating affordable housing will also mean subsidizing the cost of housing either through zoning rules that require a certain amount of units to be rented out below market value or a direct subsidy from the government.

Ottawa is now proposing the Rental Construction Financing Initiative, which incentivizes the construction of new rental housing by offering low-interest loans and mortgage insurance for building rental housing.

The program will now target a goal of having at least 40% of the units it supports provide rent equal to or lower than 80% of the average market rent in their local community.

The Canada Housing Benefit, developed with provinces and territories and launched in 2020, has joint funding of $4 billion over eight years. It provides direct financial support to Canadians for housing.

Ottawa is also targeting 6,000 units of cooperative housing with $500 million to a Co-operative Housing Development Program. It will also earmark $1 billion from its rental funding housing to support loans for co-op housing.

It is clear that affordable housing often means subsidized housing.

3. WHAT DOES AFFORDABILITY MEAN ACROSS THE COUNTRY

The numbers change dramatically in different areas.

Affordability is a moving target depending on where you live in the country.

All you have to do is look at the price of an existing home in Toronto and compare it to Montreal or even Winnipeg, and you get a completely different story.

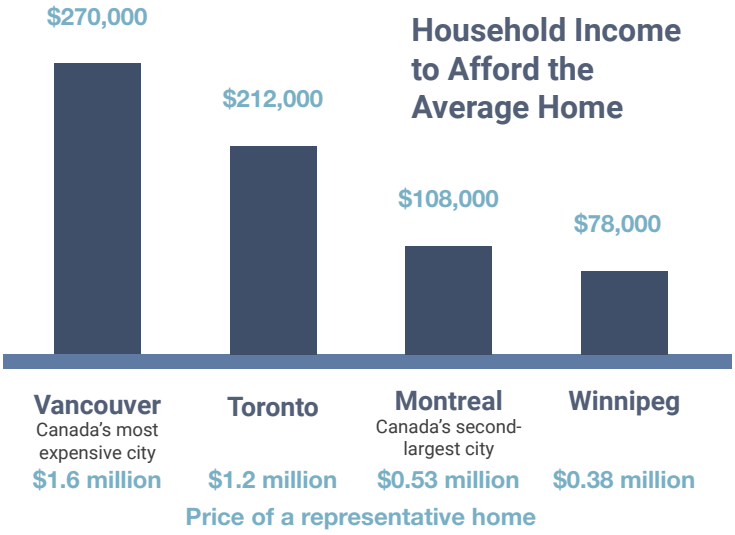
Drill down on the National Bank study on affordability and there are wide discrepancies on what a typical Canadian household needs to service the debt on a typical home in the country.

In Toronto it requires 72.4% of income to carry the mortgage on that representative home priced above $1.2 million. And that **household would need an income of just above $212,000** to afford the property.

The situation is worse in Canada's most expensive city for housing. A representative home in Vancouver priced at almost $1.6 million requires nearly 92% of household income for a monthly mortgage payment. **Household income to afford that home would be almost $270,000**, the bank said.

The numbers change dramatically in Canada's second-largest city. The typical home in Montreal dropped to about $535,000 as of the first quarter, and only 38.5% of income was needed for mortgage payments. **A household income of just over $108,000 was required for the home**.

More impressive affordability can be found in Winnipeg, where just under 25% of income is needed to service a mortgage for the $383,000 representative home, which requires just **$78,000 of household income to carry**.



The affordability by location question also applies to rental housing.

CMHC reported in February 2022 that the average two-bedroom purpose build unit was $1,167 per month a year in 2021 for the country as a whole. The average two-bedroom condo apartment, which tends to be newer with better amenities, was $1,771.

But like ownership, rental accommodation is different across the country. In Vancouver, that two-bedroom purpose build unit is $1,824 per month and the condo is $2,498. In Saskatoon, those same units rent for $1,183 and $1,208, respectively.

Even adjusting for income in different centres, the hours of work needed per month to keep monthly rent at 30% of gross income for a 2-bedroom purpose-built rental apartment vary widely from a high of 198 hours in Vancouver to 105.6 hours in Quebec City, CMHC found.

Central to the question of affordability is how important is it that people have an opportunity to live in Vancouver and Toronto, the country's two most expensive cities.

While the average price of an existing home reached $713,500 at the end of 2021, removing Canada's two priciest metros reduced that figure by $150,000 and dramatically improved affordability.

4. WHAT ARE GOVERNMENTS DOING TO FIX THIS?

Virtually every province in the country sees affordability as a major issue and is attempting to address housing concerns, with municipalities also actively pursuing policy changes.

Ontario's task force on affordability just noted in a report that house prices in the province have almost tripled in the past decade, with most remedies focused on cooling the market. But the task force concluded there are not enough homes in the province.

Ontario wants to build 1.5 million in the next ten years, incentivizing municipalities to create more housing.

For starters, the provincial task force recommended greater density, noting too many cities are protecting single-family home neighbourhoods. The task force wants to see red tape cut out of the municipal planning process, rewarding cities financially for building more housing.

In British Columbia, the government committed $7 billion over a decade to implement its affordable housing plan. BC has focused on demand-side tools like taxing speculators and foreign buyers and increasing property transfer taxes for higher-end homes.

Locally, Vancouver implemented an empty home tax. But the province has also looked to deliver 114,000 affordable homes by 2029. It has looked to build affordable rental units and provide direct rental assistance. BC said it has more than 32,000 new homes underway in 100 communities for low-income earners.

Alberta has its own 10-year plan to expand affordable housing, targeting 25,000 households to increase the total served to 82,000. As of April 2021, the province said 110,000 low-income Albertans live in affordable housing, but more than 24,000 are on a waitlist. The waitlist has doubled in the past decade.

In February of 2022, the Quebec government said it would invest $200 million to start the construction of affordable units in the summer of 2022. The program will provide financial support for affordable rental housing projects for low-income and modest-income households and people with special housing needs. Dwellings built must be offered at a maximum rent set by the Société d'habitation du Québec (SHQ), corresponding approximately to the median rent.

Even in Atlantic Canada, with low entry points for both home ownership and rent, governments are now entering the market to create affordability.

The Nova Scotia government said in October 2021, it would spend $35 million to support more than 1,100 new affordable housing units in the province and make 425 new rent supplements available immediately.

While provinces across Canada tackle housing affordability, their municipal counterparts across the country are doing the same by implementing different solutions at a local level.

For instance, Toronto is using inclusionary zoning, which will require that certain new developments in the city include affordable housing units. The city also owns Toronto Community Housing, the largest social housing provider in Canada, with about 2,100 buildings and almost 90% of units offering rent geared to income.

Meanwhile, at the federal level, the government has a National Housing Strategy earmarks $70 billion as part of a 10-year plan to make housing more affordable.

5. CANADA VERSUS THE WORLD ON HOUSING AFFORDABILITY

Canada outpaces Europe and the US on house-price to income ratios.

If Canada's housing market looks frothy and unaffordable, the Organization for Economic Co-operation and Development confirms that.

Based on the house-price to income ratio, Canada (136.7%) was a leader in the third quarter of 2021, outpacing the Euro Area's 126.2% percentage with a gaudy 136.7%, Statista.com said. The United States was at 126.2%.

House-price to income ratio in Q3 of 2021



Canada	Euro Area	United States
136.7%	126.2%	126.2%

A report from economist David Rosenberg in November ranked Canada as the second biggest bubble for its housing market, only behind New Zealand.

It's hard to go head-to-head with New Zealand, which recorded, adjusted for inflation dollars, a 7.2% compound annual growth rate over the last decade. Canada managed 4.2%.

A study from Demographia of 92 markets in Australia, Hong Kong, Ireland, New Zealand, Singapore, the United States, the United Kingdom and Canada found Vancouver the second least affordable city. Only Hong Kong was worse.

But Toronto was the fifth least affordable city of the 92 centres covered by the study released in 2021. The group found housing affordability had deteriorated in Montreal and the Ottawa-Gatineau region going back as far as 2004.

Oxford Economics weighed in by looking at 25 markets in North America and found Toronto, Vancouver, Hamilton, Ontario, San Jose, and Los Angeles were North America's five least affordable metros in May 2021.

The company's house affordability index for Canada rose to 1.34 in the first quarter of 2021, meaning a home was 34% more expensive than the median-income household could afford.

A UBS Global real estate bubble index released in 2021 that looked at 25 global cities found Toronto ranked second just behind Hong Kong.

The economic firm noted from 2000 and 2017, real home prices in Vancouver and Toronto were up almost 5% per year on average, driven by falling mortgage rates, urbanization, and international demand.

Canada continues to play catchup with the world on the supply side, running below the OECD average for homes per 1,000 persons.

A 2021 survey from the OECD found Canada at 427 homes existing per thousand persons, with an OECD average of 462. Pricey New Zealand was at the bottom of the list at 388, but Canada was a long way from the top, with France at 590.

The federal government has said housing supply is the solution, with Finance Canada and CMHC calling for 3.5 million new homes by 2031.

6. WHAT CAN THE PRIVATE SECTOR DO TO ADDRESS AFFORDABILITY, AND WHAT IS IT DOING?

Different organizations across the country are doing their best to build more, but they must be aided by governments.

Landlords, developers and the private sector generally have one response when it comes to housing affordability: Make it easier for us to build more.

The Federation of Rental-housing Providers of Ontario launched a campaign called Let's Build Ontario, making it clear that supply was a significant issue regarding affordability.

Any approach that ignores increasing supply creates a game of musical chairs—if there are not enough homes to go around, someone has to lose out, their campaign says.

The group has complained about the bureaucracy resulting in approvals taking years to get for new rental units in Ontario. Fees and delays can add up to $66,000 to the price of a new home in a high-density building, creating higher rent.

FRPO has called for changes to zoning rules to allow for more high-density projects and says rent control continues to act as a disincentive for new construction because of its ceiling on rents.

Canada's largest publicly-traded landlord, Canadian Apartment Properties Real Estate Investment Trust has touted the manufacturing housing communities as an option affordability and now owns and operates 77 MHCs in key markets across Canada, totalling 12,375 sites.

Mark Kenney, CEO of the REIT, said the sites are an affordable alternative to the high cost of home ownership across Canada.

There are other perspectives on addressing affordability.

The Canadian Federation of Apartment Associations believes federal housing policy should encourage provinces to use federal affordable housing money for portable housing allowance programs.

The Ottawa-based group believes direct assistance to low-income renters is the most cost-effective and quickest way to reduce housing affordability problems and respects the rights of low-income tenants to choose.

The Canadian Home Builders' Association has said home ownership rates are continually falling for those under 35, even as they remain close to 70% for the general population.

The CHBC has called for changes from all three levels of government to make it easier to ramp up supply but changes to mortgage rules that will allow responsible borrowers to finance homes while avoiding excessive debt.

Scott Brison, the vice-chair of BMO Capital Markets and Michael Brooks, chief executive officer of REALPAC, a national association of commercial real estate industry leaders, opined in a newspaper article that policy from all three levels of government could stimulate construction.

Their view is that policy at federal levels can be used to influence provincial governments, which can affect change at the municipal level, overcome the NIMBY-ism at local levels, and encourage more density.

The role of the private sector in creating more housing supply is clear, but the question is whether government policy will hinder or encourage the industry to build more housing.

7. WHAT IS BEING DONE THAT MIGHT BE HINDERING AFFORDABILITY?

Strong arguments point to government housing policy, at multiple levels, that centres around demand-side solutions instead of creating more housing.

The latest budget from the federal government, while proposing ideas for creating more supply, continues to be heavy on demand-side solutions like the two-year ban on foreign ownership of housing.

Ottawa proposed even more involvement in the sector with rules on the bidding process for buying a house while showing an appetite for the idea that housing shouldn't own for profit. There is little or no evidence that either will lead to the creation of more supply.

At the provincial level, provinces like British Columbia and Ontario have created a regime to tax foreign buyers at a higher level without considering whether hindering the capital flow into the country will reduce construction. Not to mention whether it will create retaliatory measures against Canadians buying vacation properties abroad.

Even the Bank of Canada has suggested cities with more inelastic rules on housing supply like Vancouver are facing prices rising faster.

That hasn't stopped cities like Vancouver from instituting more controls on housing, like a vacant home tax of 3%. The policy was created to force homeowners to rent out homes rather than speculate, but the city's rental vacancy is still stubbornly low at 1.2%.

There has been little, or no examination of why any investor seeking as high a total return as possible would leave a unit vacant with governments identifying those buyers as speculators and suggesting their actions need to be curbed.

But rent control regimes that exist within most provincial jurisdictions continue to be touted as solutions to affordability, even as the complex tenant eviction process likely encourages speculators to leave units empty.

New plateaus in rental construction in Ontario continued to be reached since Ontario relaxed rental control for buildings constructed after 2018 but the Liberal Party and New Democrats are campaigning on new control measures in Canada's largest province.

It is worth noting that the Conservatives were the original sponsors of rent control in Ontario, with many arguing the change led to a shortage of new construction for three decades from the 1970s to the 1990s.

The housing industry also has been critical of continued changes to mortgage rules which have made it harder for Canadians to access debt.

Other programs like the Home Buyers' Plan, which allows Canadians to borrow up to $35,000 from their tax-sheltered retirement savings without penalty and pay the money back over time, have been called inflationary and considered partly responsible for driving up prices.

With all three levels of governments now firmly focused on supply, eyes will be on whether there is a genuine commitment to making it easier to construct new housing faster rather than going through a bureaucratic jungle that increases costs and pricing.

8. THE FINANCIALIZATION OF SINGLE HOME/UNIT RESIDENTIAL

There is growing debate in some circles that real estate, at least single home/unit residential, should not be financialized -- namely thought of as an investment.

Prime Minister Justin Trudeau himself jumped into the fray earlier this year with his comments on the housing market.

"We will be cracking down on the financialization of the (single family) housing market," Trudeau said on April 8 during a press conference on plans for the budget. "Houses aren't supposed to be assets for wealthy investors. They're supposed to be homes where families can raise their kids."

The theme that single family/unit housing should not be paired with a profit motive has continued to gain legitimacy in government circles. CMHC is now funding a lab to examine the issue.

"While it is an essential good, housing is also a means to store and accumulate wealth. This dual nature has existed for a long time. Some, however, feel that the search for financial returns through housing are now creating barriers to accessing adequate, affordable housing," said CMHC in outlining the planned lab, which has yet to release its results

CMHC has committed to exploring how profitability may be linked to some of the housing challenges faced in Canada. The lab doesn't just look to establish a link between the issue of financialization of single home/unit residential and housing affordability but promises solutions.

The concept of financialization of single family/unit housing surfaced in 2017 in a report from the United Nations Human Rights organization issued by Special Rapporteur Leilani Farha. Her paper points to the 2008 financial crisis creating a shift from housing as a place to build a home to housing as an investment.

What started as an opportunity in the US to buy single family/unit housing out of bankruptcy has turned into a target of institutional money in the US, with CBRE saying institutional investment was worth almost US$5 billion in 2020.

Some have suggested a similar market will form in Canada, but some US jurisdiction, such as Dallas Texas, are now thinking of following a model proposed in Canada which would ban foreign ownership of homes for two years because of dwindling supply of single family homes.

9. HOW WILL REITS AND PRIVATE INDUSTRY BE SCAPEGOATED

In the runup to the 2021 election, the federal Liberals took dead aim at REITs in their policy papers.

The tax treatment trusts have received has long been a target of the government. In 2006, Canadian REITs were spared when the Conservatives ended special tax treatment for income trusts.

The rise of the REIT in Canada began in 1993. The most significant advantage is that REITs are not taxed on income and gains from property. The tax burden is passed on to shareholders or unitholders.

With REIT structures in global markets around the world, part of the reason they were exempted from a change in rules affecting business trusts by the Conservative government at the time was global competitiveness.

In the runup to the 2021 election, the federal Liberals took dead aim at REITs in their policy papers.

Large corporate owners of residential properties such as Real Estate Investment Trusts (REITs) are amassing increasingly large portfolios of Canadian rental housing, making rent more expensive, Liberals maintained.

Liberals promised to review the tax treatment of these large corporate owners and put in place policies to curb excessive profits but vowed to protect small independent landlords.

The prime minister signaled in his mandate letter to the Minister of Housing and Diversity and Inclusion that REITs could be in for a rough ride when Ahmed Hussen instructed the prime minister to support the review of and possible reforms to the tax treatment of Real Estate Investment Trusts.

The 2022 budget remains unclear on how that might impact the sector, but it is clear that large corporations are in Ottawa's crosshairs.

"Budget 2022 announces a federal review of housing as an asset class to better understand the role of large corporate players in the market and the impact on Canadian renters and homeowners. This will include examining a number of options and tools, including potential changes to the tax treatment of large corporate players that invest in residential real estate."

Further details are to be released later this year, with potential actions before 2022.

Dynamic Funds issued a report following the Liberal budget that suggested targeting REITs may reduce housing supply, the opposite goal the government hopes to achieve.

Scotiabank issued a report that noted the budget was short on specifics and not as bad as some of the worst fears some envisioned, including removing the status of residential REITs.

Instead, residential REITs now have time to educate the government on their role in creating more supply, the bank said.

10. WHAT'S THE OUTLOOK?

The supply problems in housing are finally being recognized in a country where immigration continues to ramp up without a coordinating increase in housing to match household formation.

At the core of the problem is the political reality that the federal government controls demand through immigration and tools like interest rates. Still, provinces and their municipal entities ultimately dictate supply through land-use policies.

The federal government's plans to financially incentivize lower government levels to build more housing and should increase the housing stock. Still, Ottawa's goal of 400,000 units built a year is already under criticism as impossible.

The Canadian Home Builders' Association said more skills workers will be needed with an immigration target of 451,000 immigrants by 2024. Jean-François Perrault, the chief economist at Scotiabank, said it's not clear with labour challenges and materials that construction can increase significantly.

Even the Office of the Parliamentary Budget Officer, an independent arm of Parliament, has decried housing affordability with a pessimistic view.

Yves Giroux, parliamentary budget officer, said his agency's reports suggest household financial vulnerability is elevated in several census metropolitan areas for households that have recently purchased homes, indicating that increases in interest rates will further stretch their finances.

Rising mortgage lending rates this year were also projected by the PBO to offset the increase in average household incomes, resulting in declines in borrowing capacity over the medium term.

If house prices remain close to their current levels, the PBO suggests housing will become even more unaffordable in most of the census metro areas of the country.

Supply doesn't seem to be coming to the rescue of housing affordability anytime soon.

Scotiabank noted Statistics Canada's census confirms that the supply of homes has not kept up with population growth over 2016–21. The banks say that increasing affordability lies in a better alignment of dwellings to the population.

Still, there is hope, and the bank said if all levels of government focused on supply, there will be a better balance between supply and demand over time, Scotiabank said.

The increases in interest rates from the Bank of Canada were already being felt in the spring market of 2022 as buyers held off purchases, sales stalled, and the pace of price growth declined, with some markets seeing price drops.

But even with this latest development, the RBC concludes the outlook for affordability will not change overnight. The bank said that the burden of higher mortgage rates pushes many would-be buyers out of the most-expensive markets.