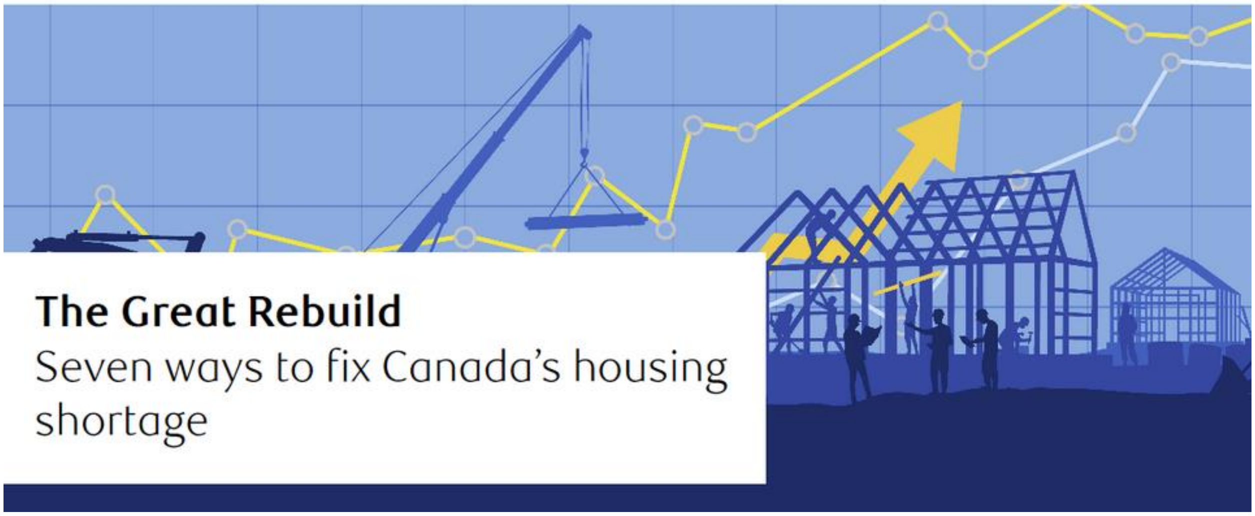
RBC

Economics

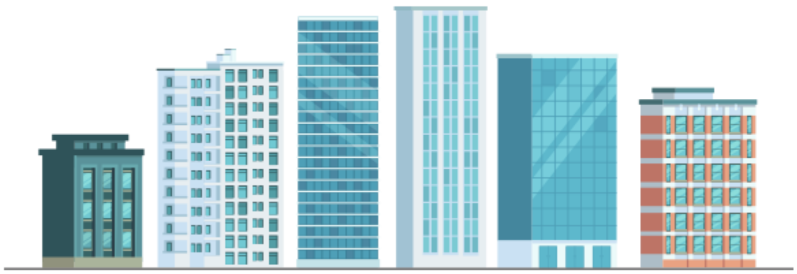


Too many Canadians are struggling to find a home they can afford—making housing a defining issue of this country’s politics and economics.

The crisis now affects middle-income Canadians and extends beyond major cities. It strikes at the core of the Canadian dream of owning a home and is creating intense inter-generational tensions.

This predicament will reach even more alarming levels if not enough is done now.

More than half—one million—of 1.9 million new households by 2030 will not be able to buy a home, according to our estimates. That’s equivalent to almost all the households in Atlantic Canada right now.



1 Aggressively expand the construction sector's labour pool by prioritizing immigrant skills, recognizing credentials from other jurisdictions and setting ambitious targets for trade enrollments.

2 Develop and adopt innovative designs, building techniques and technology to boost productivity through prefabricated housing and pre-approved building designs.

3 Speed up housing project approvals by reducing regulatory requirements, harmonizing building codes and prioritizing projects with faster turnaround times.

4 Ease zoning restrictions to allow more density in cities and diversify the types of houses built to make more productive use of land.

5 Lower the cost of building new housing by using more cost-efficient materials and modulating government charges.

6 Change the housing supply mix with incentives to build purpose-built apartments by waiving development charges and using publicly owned land.

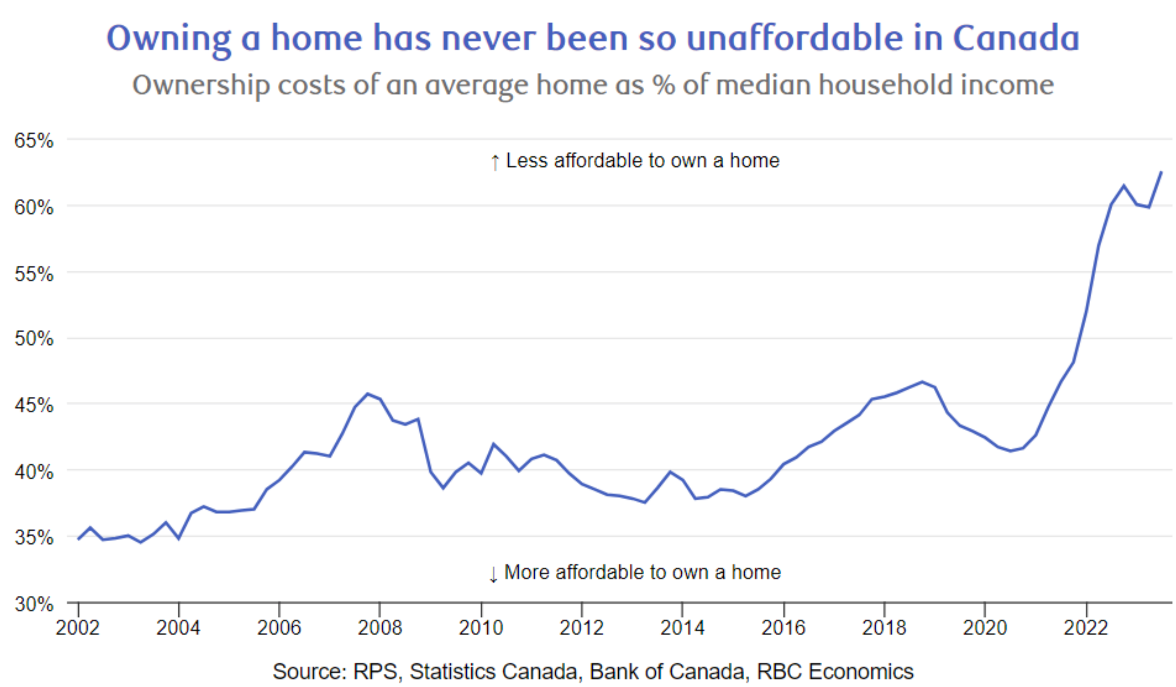
7 Expand the housing stock from within by reclaiming units from short-term rental businesses, making it easier to build secondary suites and convert non-residential buildings.

Solving the housing crisis will require greater collaboration between governments, industry and other stakeholders because none of them can do it alone. Efforts will have to go beyond what's been done so far to achieve meaningful and sustained progress toward rebalancing supply and demand.

Homeownership and rent costs hit records

Canada's housing market took a troubling turn for the worse during the pandemic. The cost of home ownership skyrocketed from mid-2020 across Canada. RBC's housing affordability measure reached its worst-ever level last year. It's no longer a story of high prices in Vancouver and Toronto. Ownership costs in roughly two-thirds of urban markets we track now exceed 35% of the median household income—indicating an excessive level.

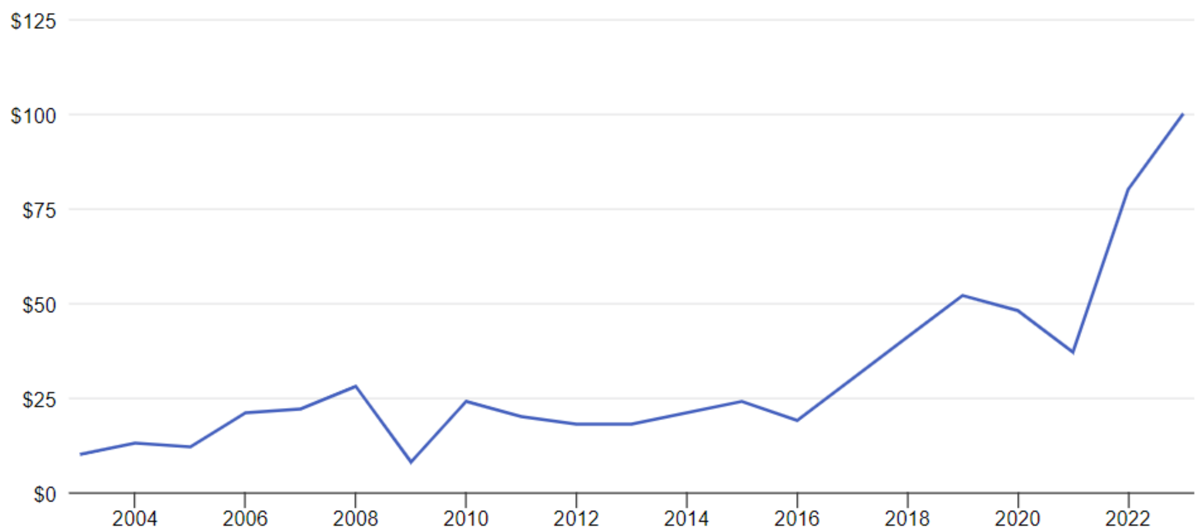
The share of Canadians who can afford to buy a home has shrunk markedly. We estimate only 45% of all households would have the income to own a condo and a smaller 26% have enough for a single-detached home at today's prices and interest rates. That's down from 61% and 49% two decades ago, respectively.



It's become even tougher for renters and never been more difficult to find an apartment. The rental vacancy rate dropped to 1.5% nationwide in 2023—a historical low. Every single urban market but one (Belleville) has a vacancy rate below what's considered balanced (3%). And rent has gone through the roof. Canadian renters paid $100 more on average a month last year—that includes tenants living in rent-controlled apartments—or nearly four times the average annual increase in the decade preceding the pandemic.

Rent increases have gone through the roof

Change in the average rent for all apartment sizes in Canada, $ per month



Source: CMHC, RBC Economics

If affordability remains close to where it is today, many renters won't be able to afford rent in the future. More than 40% of the one million new households that can't buy a home by 2030 will also not earn enough to afford rent at the market price.

What led to the housing crisis

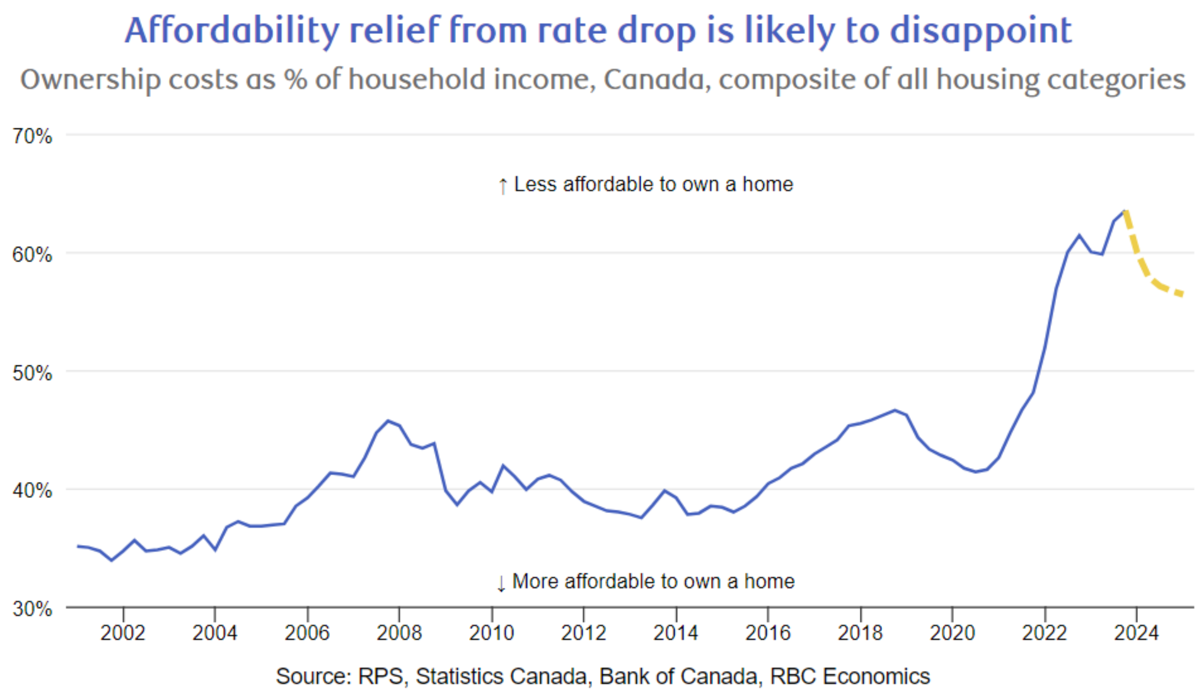
A mix of historic policy responses, structural shifts, inflation flare-ups and irrational buying and selling butted against supply constraints, which took housing demand, prices and rent to unprecedented levels. Elements developed in a specific sequence that made the perfect storm in the housing market extremely powerful. Here’s how we got here in five phases.

- 1. Storm Clouds Gather: Tensions mount for a decade before pandemic
- 2. Pandemic Lightning Strikes: Government aid, low interest rates electrify market
- 3. Cyclone of Emotions: Irrational buying and selling push prices higher
- 4. Flood in Immigration: Border reopening unleashes wave of newcomers
- 5. Temperatures Plummet: Aggressive interest rate hikes spark affordability crisis

Lower interest rates will help—but just a little

Some relief from high ownership costs is in sight as interest rates start to ease but it won’t be enough to make a meaningful difference.

The encouraging news is the Bank of Canada has likely done enough to win its battle against inflation. We expect it will start cutting its policy rate in the middle of this year, taking it down 100 basis points to 4% by the end of 2024 and an additional 100 points to 3% in 2025. The outlook for long-term rates is more tempered, in part because bond markets have already priced in future central bank cuts. Our rate forecast has five-year Government of Canada bond yields easing a total of about 75 basis points by early 2025. This would pave the way for moderate mortgage rate drops but affordability will still be a significant challenge.



Under our base case scenario, the share of an average household income needed to cover ownership costs would fall to mid-2022 levels by 2025—still extremely taxing. We think access to the housing ladder (albeit improving) will remain limited, which wouldn't relieve much tension in the rental market.

Stabilizing immigration will take some steam out of demand

The federal government is taking steps to reduce immigration, but the measures will not shrink housing demand.

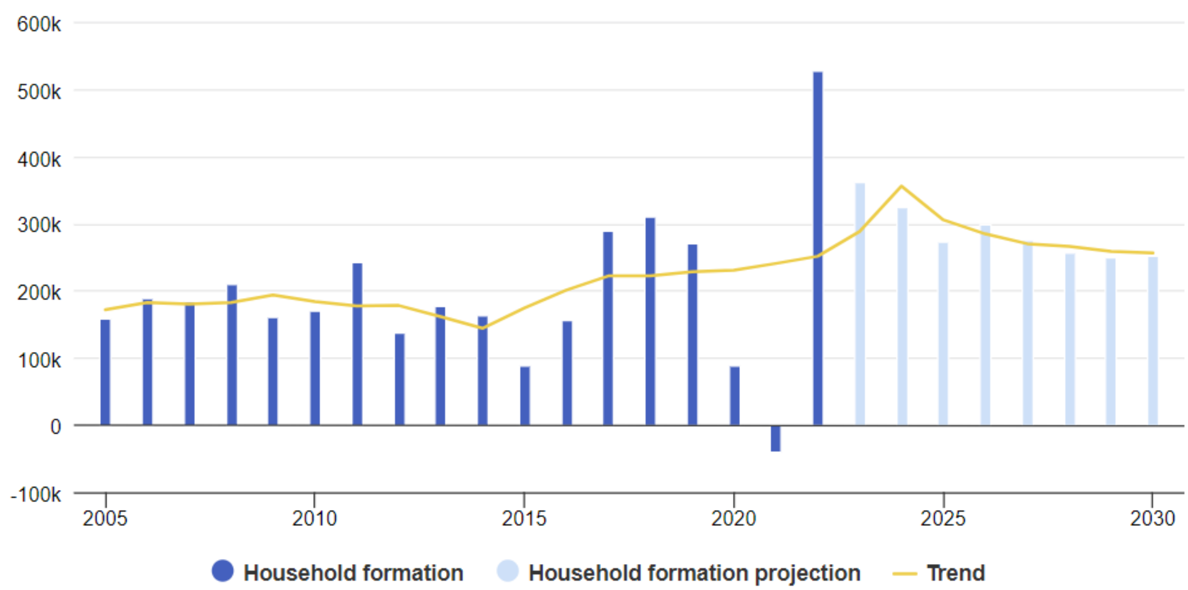
In November, it announced keeping the permanent immigration target in 2026 unchanged from 500,000 in 2025. This will still be up from the 2024 target level of 485,000. In January, the government further said it would cap the issuance of study permits for international students for two years starting in September 2024. And in March, it indicated it would reduce the proportion of temporary workers in Canada from 6.6% to 5% by 2027—which is a 20% decrease in the non-permanent resident population.

These measures will curb Canada's record population growth in the years ahead, but average growth between now and 2030 will still be faster than in any of the 25 years before 2018.

Under our base-case projection, population growth would ease from a six-decade high of 3% in 2023 to about 1.3% by 2030. This would add 3.6 million more Canadians by 2030 (from 2023 levels), with much of the increase coming from new permanent residents. We estimate this would lead to the formation of 1.9 million new households over that period or an average of just over 275,000 per year. That's a more than 15% increase from the 2016-2022 average. Demographic pressures on housing demand may come off the boil, but it won't entirely subside anytime soon.

Strong underlying demand growth to gradually moderate

Canada



Source: Statistics Canada, RBC Economics

Cutting immigration more aggressively would also not instantly restore affordability. It would slow down the growth in housing demand, not shrink it. It would ease upward pressure on home prices and rent only as long as the increase in demand undershoots the expansion of the housing stock—reducing the supply gap.

However, the downside of significantly cutting immigration would be considerable for Canada's economy over the long run. The population is aging rapidly with at least 500,000 baby boomers reaching retirement age each year until the end of this decade. Our economic growth potential would be hampered if their departure from the labour force isn't replaced by newcomers.

A tall order for homebuilders

The pace of housing construction would need to jump by nearly half in Canada just to meet future demographic growth.

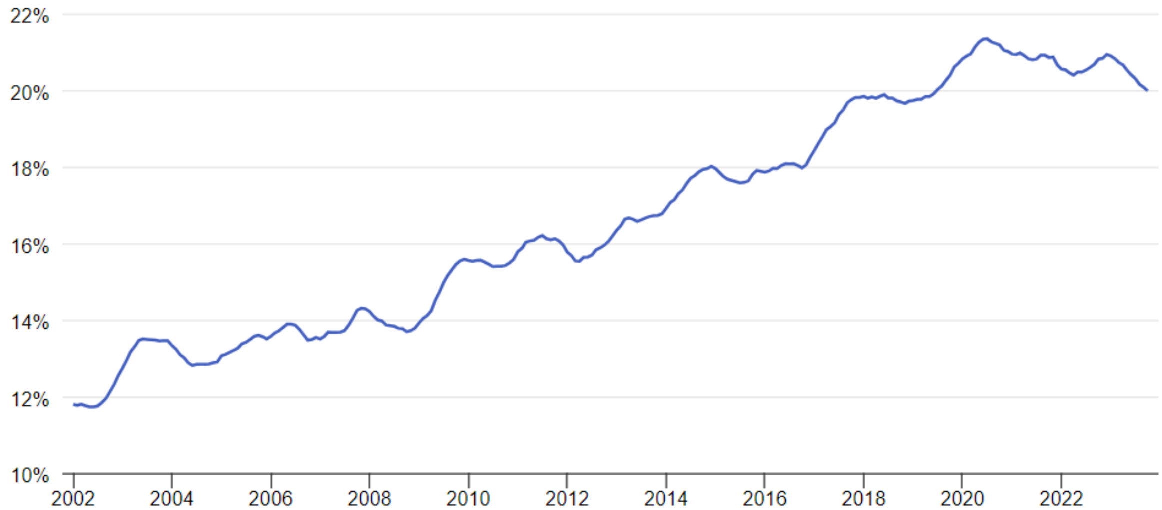
If building new housing were only relied upon to meet future demand, housing completions would have to rise from an average of 218,000 in the past three years to about 320,000 annually over the 2023-2030 period (accounting for a normal rate of attrition in the existing stock). Higher deliveries would need to happen in the near term given our expectation for peak population growth in 2023-2024.

However, the construction industry has a capacity issue. The level of housing production needed is far above anything ever achieved in Canada. The all-time peak for completions was 257,000 in 1974. The 47% increase needed from recent levels would seriously conflict with production capacity limits. Much of it has to do with labour constraints. Builders already struggle to attract and retain workers. The job vacancy rate in the construction sector (5.1% in Q3 2023) is among the highest across Canadian industries. This could be difficult to resolve over the longer term.

The sector's aging workforce risks perpetuating the labour shortage. One in five construction workers are at or will reach retirement age within the next 10 years. This represents 330,000 workers to replace if they do retire, making it that much harder to expand the sector's production capacity.

A fifth of construction workers are within 10 years of retirement age

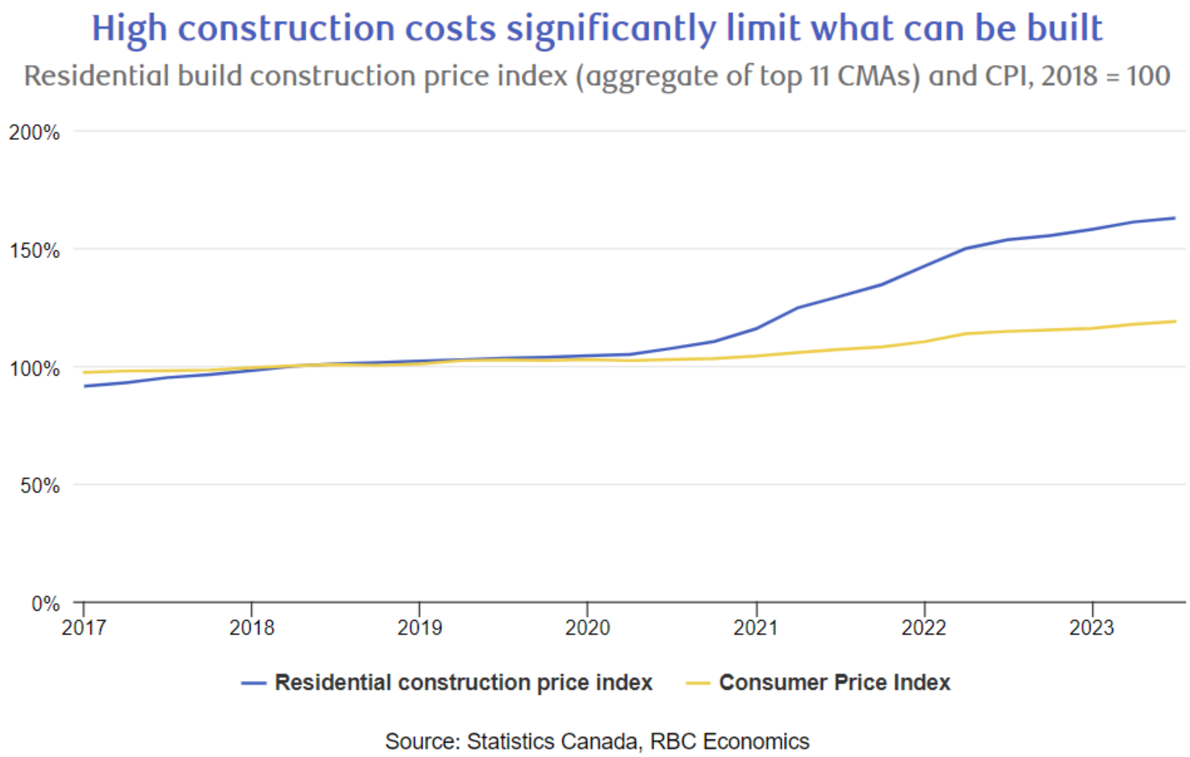
Workers aged 55+ as % of all construction industry employees, Canada



Source: Statistics Canada, RBC Economics

End of interactive chart.

Meanwhile, housing starts have moderated since rebounding strongly in 2021. Not only have earlier supply chain disruptions during the pandemic led to soaring prices for materials but the spike in inflation, high interest rates and labour shortages have seriously increased project costs and uncertainty in the sector.



Buyers negatively impacted by higher interest rates, a loss of affordability and growing economic uncertainty is why pre-construction home sales (destined for owner-occupants or condo investors) have plummeted in many parts of Canada (including Ontario) since spring 2022.

The construction industry must also build a lot more homes while reducing greenhouse gas emissions. Canada's building stock accounts for 13% of the country's emissions, making homebuilders key in implementing change to achieve the Net Zero climate target.

Seven recommendations to take on the supply and affordability challenge

Addressing Canada's housing needs will largely rest on the ability to significantly expand the stock of housing. Multi-pronged actions will be required to address capacity issues and build homes Canadians can afford. Here are recommendations to scale up housing construction, lower building costs, and ensure we build the right mix of housing while getting the most out of what we already have.

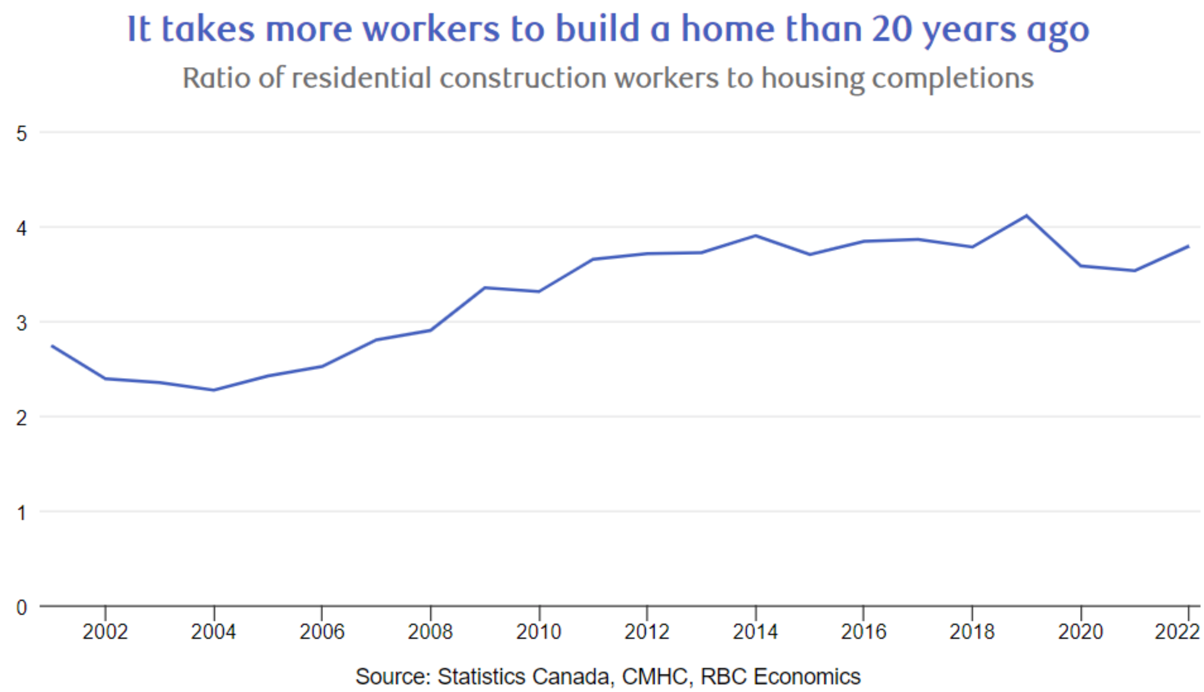
1. Aggressively expand the construction sector's labour pool.

Canada could need more than 500,000 additional construction workers on average to build all homes needed between now and 2030—and even more than that in the short term to meet peak growth in demand. All avenues should be pursued to get more people working in the sector.

- Prioritize construction skills among new immigrants
- Set ambitious targets for skilled trade school enrolments
- Incentivize aging construction workers to remain in jobs longer

2. Develop and adopt innovative designs, building techniques and technology.

Continuing to build homes the same way it's done in the past will make it more difficult to ramp up construction to the level needed and meet GHG emissions targets. New approaches must be pursued to increase the number of homes produced per worker. This won't be easy. The construction industry has a lackluster track record on productivity. There are more residential construction workers per housing completion today than there were two decades ago. This trend must reverse.



- Foster wider adoption of prefabricated housing
- Create a catalogue of pre-approved building designs

3. Speed up project approvals.

The rules and regulations governing housing development and construction—often well-meaning when introduced—have accumulated greatly over the years. They now represent a complex and cumbersome set of rules that add tremendous time and costs to projects. Project approval timelines in Canada can be among the lengthiest in the world. Streamlining permitting processes, implementing artificial intelligence tools, and speeding up conflict resolution mechanisms would help bring new housing faster to market and reduce development costs and uncertainty. These would make a better investment environment for private or non-profit participants.

- Streamline approval processes
- Legislate timelines for approvals and make approving bodies accountable for meeting requirements
- Prioritize housing projects with quicker turnaround time
- Reward municipalities that use best practices
- Sharpen conflict resolution mechanisms
- Slim down and harmonize building codes

4. Ease zoning restrictions to make a more productive use of land.

Toronto had 69% of its (net) residential land area restricted to low-density detached and semi-detached homes before recent rule changes by provincial and municipal governments. This represented a very inefficient use of its land base and costly infrastructure. Allowing multiple residential units to stand on single residential lots—as Ontario (and Toronto) and B.C. (and Vancouver) did not long ago—will encourage a more productive use of land over time.

- Modernize zoning regulations to allow more density and diverse housing mix
- Ease restrictions against converting commercial properties to residential or mixed-use

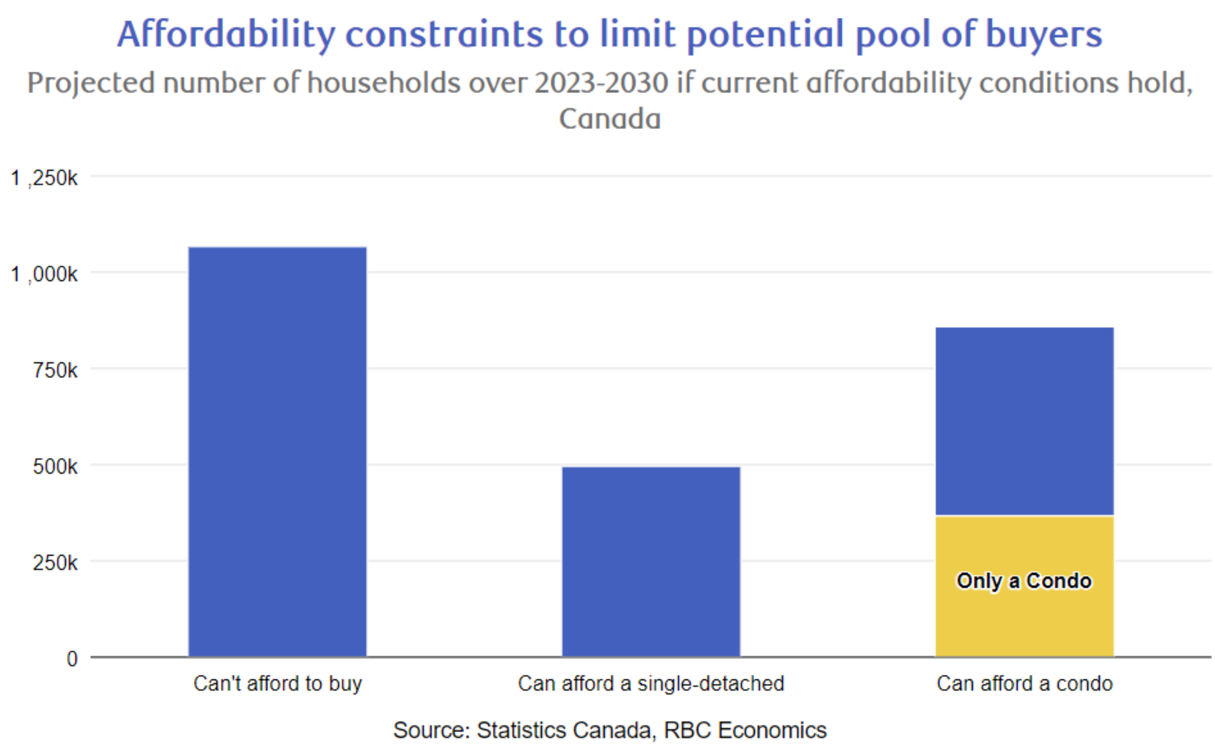
5. Lower the cost of building new housing.

Canada’s challenge is not only to massively expand our housing stock but to do so at prices people can afford. The cost of building new homes has soared and poses serious obstacles to increasing the supply of affordable housing. It’s estimated that materials and labour account for roughly half the costs of new units in most cities. Government charges can represent more than 20% of the cost and the remainder (30% or so) is taken up by land. Efforts should be dedicated to lower or at least contain every cost item.

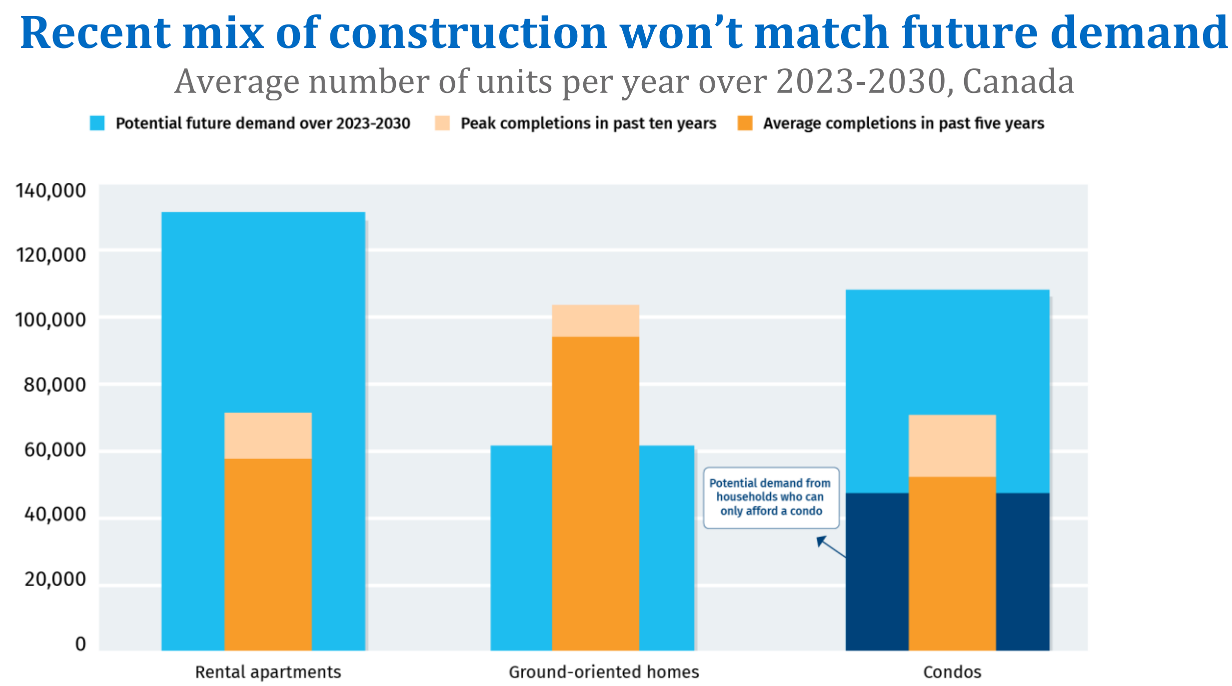
- Allow, and make greater use of cost-effective materials
- Modulate direct government charges
- Reduce indirect costs arising from regulation
- Optimize existing land for best use

6. Change the mix of housing being built.

Stretched affordability will drive up rental housing demand to the point where housing construction must almost be entirely dedicated to the sector. Potential condo buyers would outnumber buyers of single-family homes by two to one by 2030. An eventual normalization of monetary policy and various policy measures should help more households become homeowners than estimates suggest. But the buying environment may remain challenging. Canada's ownership rate (66% in 2021) is likely to drop.

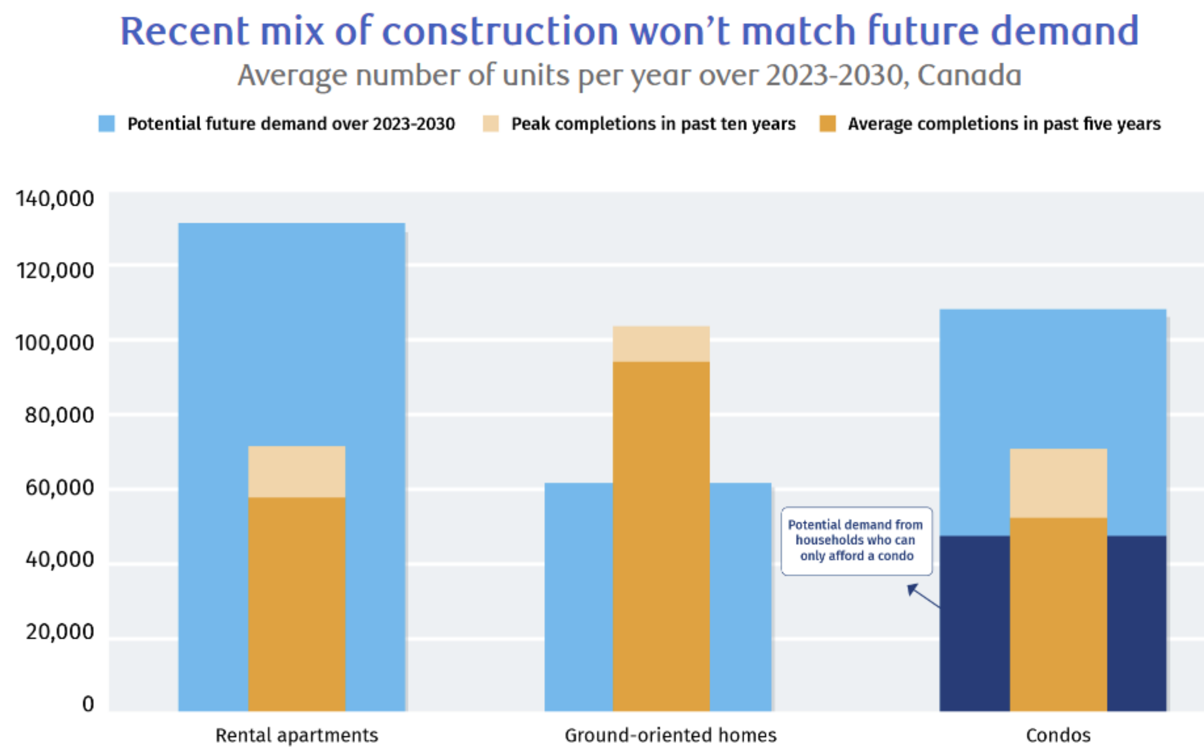


Responding to growing rental demand requires a shift in the mix of housing Canada has been producing. Canada’s land development and building industry has a strong capacity to produce single-family and other ground-oriented homes like duplexes. The pace of ground-oriented home completions over the past decade would be able to match future demand for this housing type. Even recent condo completions could meet future demand from owner-occupants. But past completions for rental units where demand is poised to skyrocket are way off.



Source: Statistics Canada, CMHC, RBC Economics

Increasing the social housing stock is also necessary. The magnitude of growth in social housing units needed to meet demand if affordability conditions don’t improve meaningfully is staggering. We estimate the 14,000 annual average addition to social housing stock since 2016 needs to jump more than four-fold to 57,000 every year to meet potential demand between 2023 and 2030.



Source: Statistics Canada, CMHC, RBC Economics

- Eliminate disincentives to building rental apartment projects
- Waive development charges for affordable housing projects
- Use publicly owned land to help affordable housing project economics
- Grow the student housing stock
- Avoid rent control
- Hit the right balance in protecting tenants and landlords

7. Expand the housing stock from within.

There's potential to unlock capacity from existing housing structures and properties even though new construction needs do the heavy lifting. In many cases, this would be the quickest way to address the housing shortage. It's hard to tell how many housing units could be created from our existing stock. However, if only 3% of the ground-related housing stock added a suite, it could possibly cover one-third of the future rental demand. Here are a few ideas to get more out of what we have.

- Reclaiming units from the short-term rental businesses
- Creating new units out of the existing housing could be done relatively quickly and cost-efficiently
- Office or other non-residential building conversion holds some potential
- Over-housed Canadians have rooms to spare

Time is running out

Solving Canada's housing crisis is a massive undertaking. It will take time and tremendous resolve by governments, industry, communities, and other stakeholders to reset the path we've been on for decades and address the policy missteps that caused house prices and rent to skyrocket.

The good news is many of the steps we outlined in this report have started to take place.

Governments in Ontario and B.C. are pursuing ambitious plans to grow their provincial housing stock by reducing the regulatory burden, speeding up approval processes and removing obstacles to build a more diverse housing mix.

Many cities—including Vancouver and Toronto—have set bold targets for new housing, including social housing, while reforming urban planning practices and development approval processes.

The federal government's National Housing Strategy and programs such as the Housing Accelerator Fund should be creating positive changes that will result in more homes for Canadians.

Developers and builders are also showing more flexibility in working with authorities and partners to build homes people can afford amid capacity constraints and cost challenges.

However, more progress is needed and fast. Canada must grow its housing stock like never before, especially at the affordable end of the spectrum in rental and social housing.

If affordability remains close to where it is today, about 455,000 new social housing units would have to be created from now to 2030. That's equivalent to all rental units built in Canada since 2018.

Improving Canadian's quality of life will depend on bringing significant home and rent price relief.

For more, go to thoughtleadership.rbc.com/economics

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