Housing Affordability in Canada

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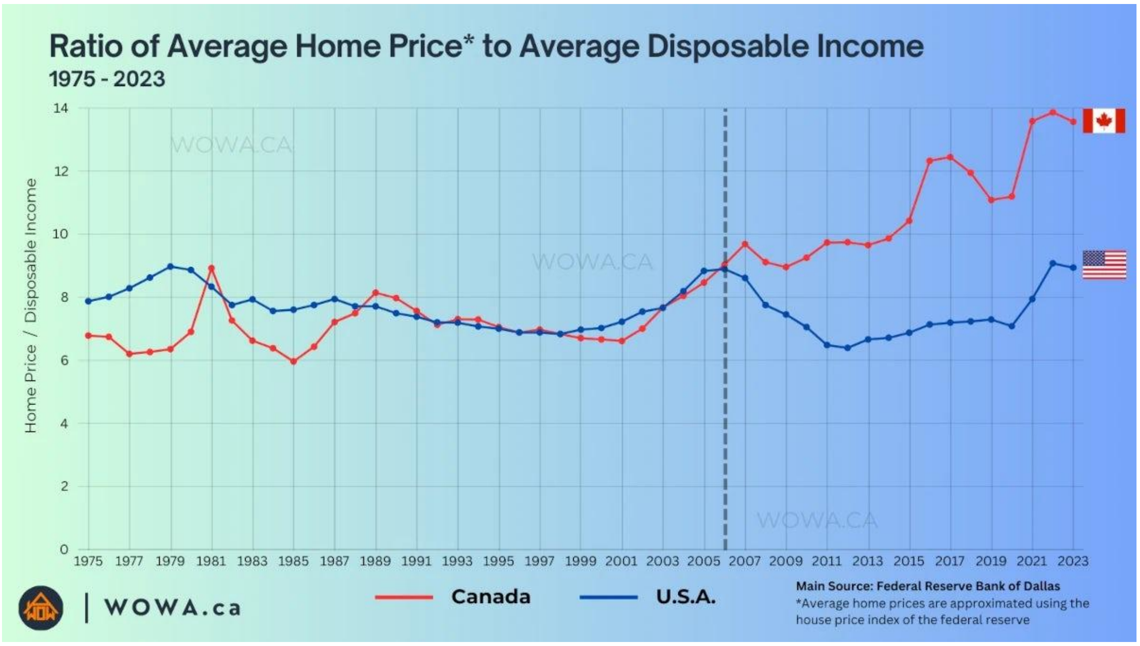
What You Should Know

- Housing affordability refers to the cost of housing as a share of income.
- Housing affordability reduces when home prices increase disproportionately to the income growth.
- The housing affordability issue in Canada is caused by a myriad of factors, such as very high demand, shortage of supply, high cost of construction and speculative purchasing.

Housing is generally considered affordable when households spend less than 30% of their monthly income on housing, including rent or mortgage payments and utilities. However, as per the **CMHC (Canada Mortgage and Housing Corporation) housing supply shortage report from June 2022**, an average household would be allocating 60% of their disposable income to cover housing costs if they were to buy an average home in Ontario or British Columbia in 2021.

Home Prices vs Income in Canada

Home affordability has been a rising concern in Canada due to unprecedented home price growth in recent years. Benchmark home prices have risen by 86% over the past decade and by more than 200% over the past two decades. Meanwhile, the increase in disposable income is nowhere near, with the average disposable income in Canada increasing by a meager 21% between 2013 and 2023. The graph below shows the change in the ratio of average home prices to average disposable income in Canada and the USA from 1975 to 2023.



As can be understood from the graph, the average home price in Canada has increased much more than the disposable income over the past 15 years, with an average home now costing about 14 times the average disposable income. In comparison, the average home in the USA costs nine times that of the average disposable income.

Furthermore, a **report on housing affordability measures released by RBC in December 2023** highlights that the share of median household income required to cover ownership costs in Canada is 62.5%. The percentage is a whopping 102.6% in Vancouver and 84.1% in Toronto.

The disproportionate rise of average home prices over disposable income paints a rather bleak picture of the housing crisis in Canada. There are several underlying factors to the housing affordability issue in Canada, such as shortage of supply and increase in demand. Read below to find out how each of these factors has been a contributor to the issue.

Factors Affecting Housing Affordability

The housing affordability issue in Canada is multidimensional and a product of government policies and economic factors.

Increased Demand

The demand for housing has witnessed unprecedented growth over the past few years due to a combination of factors, such as very low borrowing rates and high population growth. Let us examine these factors in detail.

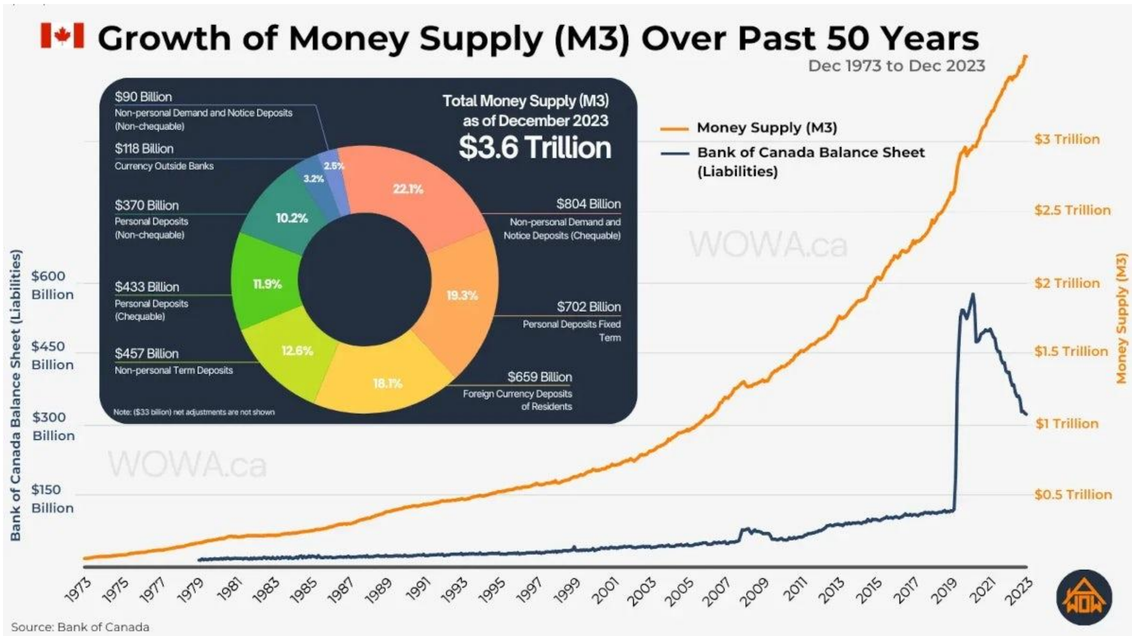
1. **Growing population:** Excluding the pandemic years, the recent years have witnessed Canada's population grow much faster than the preceding decades. In fact, Canada's population grew by 3.2% in 2023, the highest annual growth since 1957. The record growth of over 1.2 million people in 2023 is fueled by international migration, with temporary and permanent immigration accounting for 97.6% of the population growth. This simply means that there were over a million people looking for homes in Canada in the past year alone.

   Most immigrants look to settle in urban centres, especially Toronto and Vancouver, due to more employment opportunities, adding to the demand for more housing in such cities.

2. **Monetary policy:** Low mortgage rates and increased money supply have contributed to the demand for housing in recent years.
   - **Low mortgage rates:** Canada's mortgage rates history reveals that mortgage rates in the country were very low for over a decade, roughly from 2009 to 2022, making borrowing affordable for a large population and driving demand.

     Furthermore, when the pandemic hit at the beginning of 2020, the Bank of Canada cut its overnight rate from 1.75% to 0.25%. This caused Canadian mortgage rates to drop to historical lows, attracting many buyers to the market, including aspiring homeowners and institutional investors. As a result, the competition in the market increased, with many buyers entering bidding wars to buy a home. This caused home prices in the markets to rise sharply.

   - **Increased money supply:** The last two decades saw money supply in Canada increase exponentially. The money supply (M3) quadrupled from January 2005 to December 2023, as seen in the graph below.



An increase in the money supply in the economy stimulates more investment and boosts spending. As a result, demand from both homebuyers and investors increased.

3. **Foreign investment and speculative purchasing:** The housing markets in Canada have financialized due to real estate being a popular investment stream in Canada, offering better returns than some other types of investments. The S&P TSX, the headline index for the Canadian equity market, had an average annualized return of just over 4% over the past decade, while the S&P 500, a market index representing the top companies in the United States, had annualized returns of over 10% in the same period. On the other hand, home prices in Canada have risen by 65% in the same time, which converts to an annualized return of 5.1%. Thus, many Canadian investors have long preferred investing in the real estate market for better returns.

   For a long time, foreign and local investors have been purchasing residential real estate in Canada, competing in the market with those looking to buy a home to live in, which has intensified the price rise. In 2023, the federal government banned foreign nationals and enterprises from buying homes in Canada for a period of 2-years so that houses could be used as homes for Canadians instead of becoming a speculative financial asset class. In 2024, the ban was extended for another two years.

The ban overlapped with the increase in mortgage rates, which also caused the demand for housing to drop. Thus, the actual effect of the ban is not very clear yet. Meanwhile, even though the ban would restrict speculative purchases from foreign investors, it will not curb domestic speculative purchasing.

4. **Homebuyer incentives:** For years, the Canadian government has been offering incentives to homebuyers to buy homes, such as land transfer tax rebates for first-time buyers, Home Buyers' Plan, and First-Time Home Buyers' Incentive enabling more people to buy homes and boosting the demand. While this is a good practice in most cases, it has a detrimental effect on Canadian housing markets that already have a lot of demand but not enough supply. The federal government discontinued the First-Time Home Buyers' Incentive on Mar 21, 2024.

   Till 2008, CMHC allowed insured mortgages with an amortization of up to 40 years, which was later reduced to 25 years by 2012. Longer amortization periods allowed Canadians to get insured mortgages with lower monthly payments, making borrowing affordable for more people and thus increasing the demand. While 40-year mortgages are no longer common in Canada, Equitable Bank recently started offering a 40-year mortgage.

Supply Shortage

In the last couple of decades, the gap between the supply and demand of housing has widened. The housing supply has been unable to keep up with the rising demand. The graph below shows the population growth compared to new residential units constructed in Canada over the years.

While the population growth has increased recently, the new constructions have remained stable, which clearly demonstrates inadequacy in supply. The September 2023 housing shortages report from the CMHC (Canada Mortgage and Housing Corporation) projected that in order to restore affordability, Canada will need another 3.5 million units on top of those that would be built under the "business-as-usual" (BAU) scenario. 60% of this projected shortage is in Ontario and British Columbia alone, while Alberta and Quebec will also need to boost supply to keep up with the demand. The shortage of housing supply can be attributed to the factors listed below.

1. **Restrictive zoning laws:** Since the early 1900s, most residential land in major Canadian cities has been exclusively zoned for single-family homes, permitting the construction of only detached or semi-detached homes. This type of regulation was invented as a way to prevent people of colour from entering white neighbourhoods, as most of them could not afford single-family detached homes without having explicitly racist regulations. However, the regulations continued even after the societal reforms.

   As a result, the single-family zoning accounted for roughly 62% of Toronto's and 81% of Vancouver's residential land area till last year. Such zoning restricts higher-density, lower-cost residential development in cities, such as townhouses, duplexes and multifamily housing. Such zoning restrictions limit the availability of land for new construction in the cities. As a result, the supply of new housing is low, and the cost is high.

Vancouver has the highest percentage of single-family zoning among major Canadian cities, which has caused it to become the most expensive housing market in the country. In late 2023, the Vancouver City Council approved a new zoning bylaw allowing multiplexes on single-family residential lots, allowing construction of up to eight dwellings on a single lot. Toronto City Council also approved the construction of multiplexes across the city in spring 2023.

What makes Montreal's Housing Market Cheaper than Other Major Canadian Cities?

The effect of single-family zoning can be seen in the difference in home prices between Toronto and Montreal. Toronto is the largest city in Canada, and Montreal is the second largest city in terms of population. Yet the average home price in Montreal is nearly 50% lower than in Toronto as of February 2024. One of the key reasons is that Montreal's development policies allow the construction of multifamily lower-cost housing types such as townhouses, multiplexes and low-rise apartments on almost 54% of its residential land area, as opposed to 38% in Toronto.

Meanwhile, the development policies in Montreal also support smaller developers who build more affordable multifamily dwellings. Unlike most other cities, Montreal does not levy impact fees on developers. This enables smaller developers to compete in the market. Data also demonstrates that Montreal's building permit approval times have been shorter than Toronto's, and fewer projects require zoning changes. About three-quarters of Montreal's residences are plexes, attached homes and low-rise apartments that are much more affordable than detached homes.

2. **High construction costs:**
    - **Material and labour costs:** Construction costs have been on the rise due to an array of factors, such as excess regulation, a shortage of skilled labour, rising material costs and the effects of high interest rates. As per Statistics Canada's building construction price index report, the construction cost for residential buildings in the 11-

census metropolitan area composite increased by 6% year-over-year in Q4 2023. The top gainer was Toronto, where residential construction costs increased by 12.7% annually. Builders pass on the high cost of construction to the homebuyers, making purchasing newly constructed homes increasingly unaffordable.
    - **Taxes and fees:** In addition, various local fees and development charges levied on the construction of new houses add anywhere between 20% to 25% to the cost of the new units in many cities, which are also passed on to homebuyers.
3. **Shortage of purpose-built rental units:** Due to a shortage of purpose-built rental units, many renters in Canada depend on privately owned condos for rental purposes. The landlords of these properties tend to charge rents in accordance with the monthly costs incurred by the property. As home prices and mortgage rates increase, landlords tend to hike up rent to cover their mortgage costs, leading to inflation in rental prices. According to CMHC, Canada experienced a record-high average annual rent growth of 8% in 2023. Meanwhile, vacancy rates are at a record low, making rental markets extremely competitive.

Impacts of Housing Unaffordability

Housing unaffordability can have a detrimental effect not just on the people but also on a city's economic development. Listed below are some negative consequences of housing unaffordability.

1. **Wealth gap:** Homeownership has been one of the key ways for less affluent families to build wealth. However, home prices have increased faster than incomes in recent years, which has made purchasing a home very difficult for low-wealth households. One major reason is that their savings aren't enough to make a downpayment on a home.

   In such a scenario, the wealth gap widens as those who already own homes become richer due to an increase in home prices, usually including older generations. Meanwhile, younger people with lower incomes and no family wealth tend to be the worst affected.

2. **Migration and its effect on the economy:** The cost of housing is among the major expenses for many families. When the housing cost in a city increases, people tend to move away from there, either to more affordable

adjacent areas or to other cities. This acts as a hindrance for local businesses trying to hire and retain workers, which impacts the local economy negatively.

In fact, Canada as a whole has witnessed a surge in emigration in the recent past, with a vast majority of them leaving from Ontario and British Columbia. For many such emigrants, the U.S. is a first choice, as many cities offer more affordable housing and better incomes.

There is no single solution to addressing the housing affordability issue in Canada, and the policymakers, communities and all stakeholders will have to take several coordinated measures to improve housing affordability.

1. **Changing the zoning bylaws to respect property rights and accommodate more affordable housing:** Allowing the construction of more dwellings on formerly single-family lots, similar to what Vancouver City Council did and beyond that by allowing higher floor area per area of the lot, may be key in improving the supply of affordable housing in cities.
2. **Removing parking requirements:** The current regulations in many municipalities require developers to provide a certain number of parking spaces per residence, which results in higher construction costs (and fewer units per lot). Removing this requirement for new builds located near public transit will allow builders to decide how much parking to provide based on the market requirements. The Ontario government tabled a new bill addressing this issue in April 2024.
3. **Removing height restrictions:** Many neighbourhoods have restrictions on the height of buildings. One of the key ways to deal with the housing supply shortage is to build up. This allows developers to build more units on a relatively small footprint. Allowing the construction of taller buildings in some areas may help increase the housing supply within the city and, in turn, aid housing affordability.
4. **Incentivizing builders:** Giving tax incentives to builders for building affordable housing can encourage them to construct more affordable housing. Development fees are a major source of revenue for municipalities. Thus, reducing municipal spending through cutting operating costs and streamlining processes can also help lower development fees.
5. **Expediting building permits:** The time taken to get building permits is a major problem faced by developers in major municipalities. Finding ways to reduce permitting timelines can be very helpful for them.

6. **Deregulation:** Some municipalities have regulations stating that certain tasks should be performed by a journeyman electrician, a journeyman plumber, or a red seal carpenter. Allowing more tasks to be performed by homeowners relieves tradespeople from the upkeep of old homes and redirects their time toward building new houses.
7. **Urban planning:** Planning urban development and public transport to improve access to amenities and employment from and within the suburbs can improve affordability.
8. **Increase purpose-built rental supply:** Enhancing purpose-built rental supply can help curb rent inflation in major Canadian cities. Incentivizing developers to build more purpose-built rentals may be useful for the same.
9. **Population growth proportional to new housing supply:** By ensuring that the population growth is in line with the new housing supply, the inflated demand for housing can be lessened. This would help shrink the gap between demand and supply.
10. **Promote economic development:** Focusing on economic development will help improve affordability, especially in major urban centres that face high demand. Improving economic growth can help increase the incomes of the local population and improve their affordability.

In 2023, the Canadian government announced the Housing Accelerator Fund of $4 billion to increase the annual housing supply in Canada. As per the Liberal Party's website, the fund will enable the construction of a million new middle-class homes in Canada by 2024-25.

On April 2, 2024, the Prime Minister announced a $6 billion Canada Housing Infrastructure Fund to expedite the building and renovation of homes. Of that, $1 billion would be allocated to municipalities to address urgent infrastructure needs, and the rest would be given to provincial and territorial governments to build homes for the middle class. A top-up of $400 million was also announced for the housing accelerator fund. A top-up of $15 billion to the Apartment Construction Loan Program was also announced.