PRIVATE CLIENT SOLUTIONS

October 2, 2023

Market Commentary

Housing Crisis or Opportunity?

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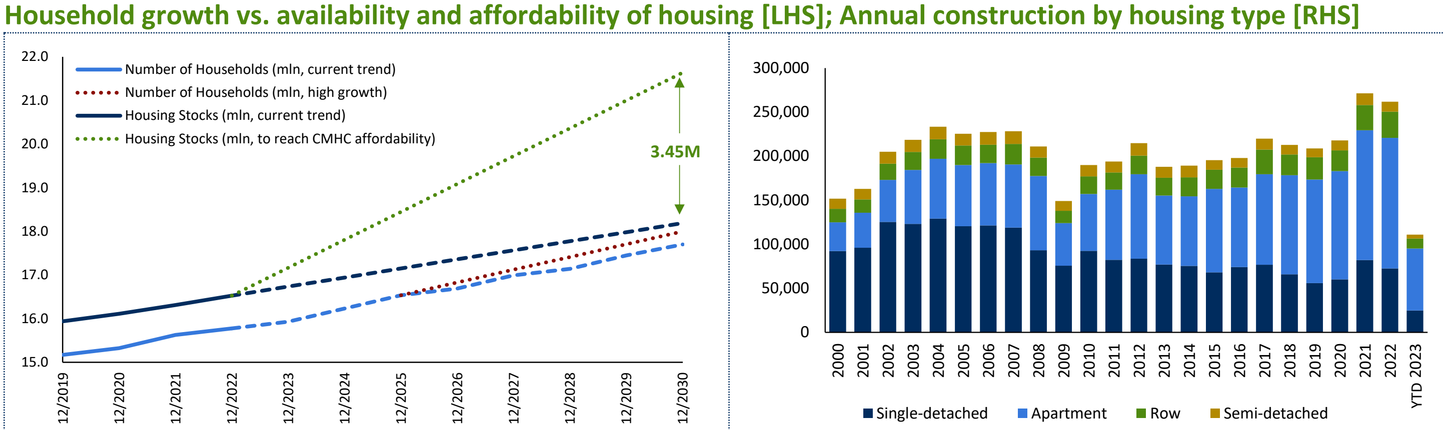
Housing Crisis or Opportunity?

According to the Canada Mortgage and Housing Corporation (CMHC) update released in September, we will need 3.45 million additional housing units, beyond current build projections, to satisfy affordability needs to 2030. To clarify that headline, this is the number of units, beyond the 1.5 million units that are already expected to be built, needed to bring housing into CMHC's "affordable" range. While there is definitely a housing affordability problem in Canada, as interest rate hikes have helped to push housing costs to 50 per cent of disposable income nationally, in Ontario and British Columbia that ratio is a staggering 60 per cent. Many readers may recall the convention in the 1970's that housing costs should be 30 per cent of disposable income, or that this ratio fluctuated in the 35-40 per cent range for much of the last 20 years on a national basis. Depending on immigration and population growth assumptions, the current housing start forecasts indicate that availability and affordability is likely to, at best, stay similar to the current environment and are perhaps more likely to get worse. To achieve the affordability objectives laid out by the CMHC, we estimate that housing starts would need to more than triple from just over 200,000 per year currently, to roughly 700,000 per year, starting immediately.

Anyone familiar with the dynamics of supply and demand should quickly realize that this implies upward pressure on housing prices, although we also have to consider how affordability affects the number of potential participants in this market. The CMHC does do extensive analysis in household incomes in various regions, migration between provinces, and makes certain assumptions about population growth, including expecting the rate of immigration to decline past 2025, but with sensitivity analysis up to 700,000 immigrants per year. So, the question remains as to whether this could become an even more dramatic housing crisis and/or if this creates any opportunities for investors. Despite potentially short-term and perhaps regional volatility or weakness in housing prices, the foreseeable trend should be one of appreciating housing prices due primarily to supply and demand. As this also creates and aggravates affordability, more households will likely have to consider renting instead of buying, which likely creates opportunities in vehicles such as multi-family housing real estate investment trusts (REITs), and other rental property assets. If we do see heightened levels of construction, towards the CMHC's targets, we could see opportunities in building equipment, supplies, and services.

Household growth vs. availability and affordability of housing [LHS]; Annual construction by housing type [RHS]



Source: [LHS] CMHC; Statistics Canada; Data as of September 13, 2023. Number of households: current trend, population growth falling back after the current immigration policy ends in 2025; high growth, current immigration trends continue to 2030. [RHS] Statistics Canada; Data as of June 30, 2023.

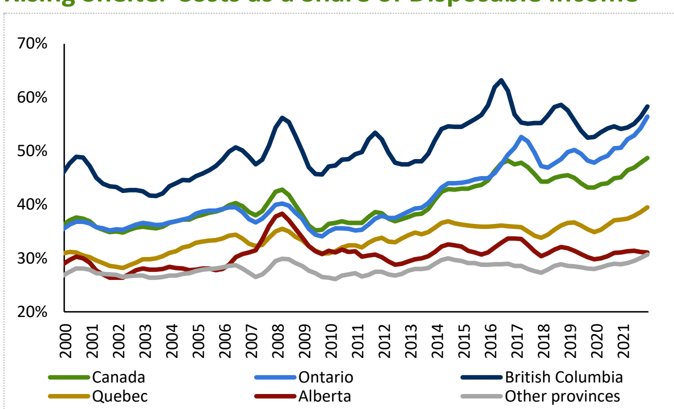
Affordability overall is an issue, and increasingly a subject of dinner party discussions, especially in certain parts of the country. Following some significant increases over the last few years, we have recently seen some (slight) softening of prices in the last 12 months, with the new housing price index pulling back from 126.1 in August 2022 to 125.0 in August 2023. This is still up considerably from the pre-pandemic 103.8 in February 2020.

As you might have guessed given the sticky wage inflation picture in Canada, the costs to build have been increasing. StatsCan's composite of building construction prices across 11 metropolitan areas showed a 7.5 per cent increase in costs from Q2/22 to Q2/23. The largest hike was in Toronto, at 13.0 per cent, with the most moderate being Edmonton at just 0.8 per cent.

The Canadian Real Estate Association (CREA), representing 160,000 realtors, is forecasting a 0.2 per cent decline in house prices in 2023, with a 6.8 per cent decline in transactions. Presumably looking towards more stable rates, and perhaps even the start of rate declines next year, the CREA is forecasting an 11.2 per cent increase in unit sales into 2024, with a 3 per cent increase in the national average home price, to around $723,250.

Regional differences can be quite dramatic when we talk about affordability. Of the 3.45 million home shortfall identified by the CMHC, two-thirds of that would be required in Ontario and British Columbia where the housing cost ratio is already 60 per cent of income.

Rising Shelter Costs as a Share of Disposable Income

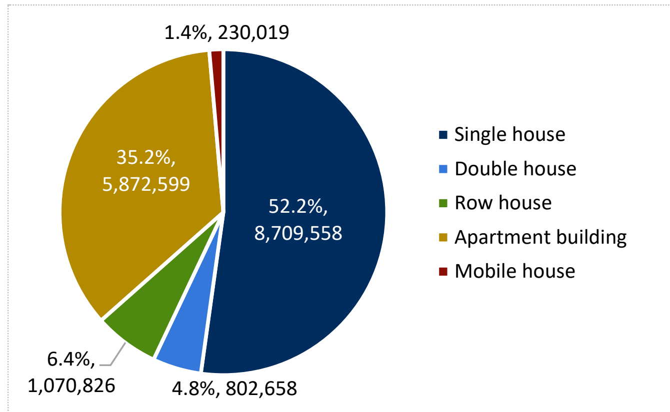


Source: CMHC; MLS; Data as of December 31, 2021.

In Q2/23 Canada had just under 15.4 million occupied private dwellings with an average of 2.4 persons per dwelling, declining steadily from 2.9 in 1981. Total private dwellings were just under 16.7 million. In the CMHC's base case scenario, this number should increase to 18.2 million by 2030, or just over 200,000 units per year.

The existing stock of housing units is mostly single-family homes, at 52.2 per cent, but apartments represent the second largest category, are growing at double the pace, and now represent 35.2 per cent of private dwellings, up from 33.9 per cent in 2016. Recent announcements from the federal government, eliminating the GST from new apartment development may further push this densification initiative to more quickly develop dwelling units.

Single Houses Remain the Majority of Dwellings



Source: Statistics Canada; Data as of June 30, 2023.

With all these moving parts, and likely more initiatives, what does affordability mean to the CMHC? The CMHC is using 2003/04, a period when the economy was stable, in neither boom nor recession, as one target for housing affordability. This would put the affordability ratios at approximately 30 per cent in most provinces, with Ontario at 37 per cent and British Columbia at 44 per cent. A second option is to achieve a nation-wide target of 40 per cent housing cost-to-disposable income ratio, translating to roughly 30 per cent of pre-tax income, and allowing housing prices to then fluctuate by region/province.

Overall, we are skeptical that new home starts will increase as dramatically as needed in the near term and that housing affordability will remain an issue for the foreseeable future. Although we may see flat or slightly weaker housing prices in certain regions for certain periods, specifically if we see weakening in the economy and/or job losses, the likely long-term tightening of supply should drive higher residential real estate prices and similarly rental costs in most regions.

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