PREPARED BY
Stormont Partners

DATE
21/11/2023

# Take a Realistic Look at Canada's Housing Crisis

At this time, it is widely recognized that Canada's housing market is critically undersupplied. CMHC published a study in 2022, that reported that the country will need to produce 3.5 million more housing units than are currently in the delivery pipeline by 2030, in order to restore housing affordability. They have since updated the study to account for the passage of time, some disparities in regional migration, and new immigration data, but the target number of housing units hasn't really changed, we are just a year closer to 2030. Media outlets and governments at various levels all talk about this number, but unfortunately, they do not state the very obvious conclusion that we will not be able to correct this situation by 2030, and probably not even by 2040. It would have taken an urgent response on multiple levels at least 15 years ago to have avoided the situation we are now in, and it will now take the same type of response immediately and on all levels, in order to address our housing crisis.

Without debating "affordability" as the yardstick against which we measure required housing supply, CMHC's 3.5 million units is a useful number to illustrate the magnitude of the challenge we are facing. We are now 7 years from CMHC's 2030 timeframe. Simply put, this means we would need to produce 500,000 more housing units in each of the next 7 years than are currently in the pipeline. Over the last decade or so, Canada has produced an average of about 250,000 housing units each year. So, we would need to triple our historic rate of housing production in a system that is probably at full capacity. This is not going to happen by 2030, and nor is it going to happen at all unless we address the capacity problem at all levels and all at once. Housing does not magically appear when there is demand for it. It takes time, infrastructure needs to be built to support it, the construction industry needs to have the capacity to deliver it, and there needs to be enough money to fund it. Let's look at each of these factors, in order to understand what needs to happen to solve this problem.

## Housing Takes Time to Produce

Land needs to be acquired. Canada is a very large place, but in reality, our cities don't have enormous supplies of land that is readily developable, which is to say vacant and approved for housing development. As an example, Toronto just announced a major affordable housing initiative aimed at producing 65,000 new housing units over the next seven years, all on city owned land. The list of development sites that accompanies the announcement identifies 52 separate parcels, only 8 of which are ready to start construction within the next

12 months, and which land will only produce about 2,000 housing units. The balance of the lands will take up to 3 more years to be shovel ready. This, in Canada's largest city.

It takes time to create developable land. It may mean replacing a lower order land use such as a few storefronts on a main street with an apartment building, or a small factory occupying a large parcel of land in an old suburb with some townhomes. But the businesses occupying these properties need to relocate, and before this happens, the land needs to be acquired by its future housing developer. This is easier said than done. Generally, the owners of properties that are in the path of future higher order development – those owners of storefronts on main streets or factories in old suburban areas – understand that they are in the path of development, and therefore are valuable, and it takes time to negotiate their purchase.

Next, development approvals must be obtained. This is relatively easy and quick in some smaller municipalities, but in places like Vancouver and Toronto, it generally takes at least 2-3 years and often much longer. Large cities that experience really significant population growth each year cannot process development applications any faster than they currently do. And city councils far too often let politics get in the way of speedy and good decision making on approvals.

Once approved, construction takes time. Wood frame housing can be built fairly quickly, but large buildings aren't built of wood, they are built of concrete and steel, and they take much longer.

Large amounts of housing supply can only be delivered in large cities. Small cities, where land may be relatively plentiful and planning approvals quick, cannot absorb large increases in population. Large cities are where most of CMHC's 3.5 million housing units will be created, and on average it takes 5-7 years from the start of the land acquisition and entitlement process, through construction, for a finished housing unit to be delivered. Think about the construction cranes you have been staring at in your neighborhood – they have been there for several years and will be for several more.

Putting this part of the challenge in context, to meet CMHC's 2030 timeframe, we needed to start all 3.5 million additional units this year. We did not do this, and we will not do it next year either.

## Housing is Only Part of the Equation

Infrastructure is another part. Schools, healthcare facilities, emergency services and policing, public transit, water and sewer capacity, power grids all must accompany these 3.5 million additional housing units. And we need people to operate this infrastructure – teachers, nurses, firefighters, bus drivers. Canada has a shortage of these people. And just as the would-be housing developer cannot snap his or her fingers and make the factory owner agree to sell, it takes time to address shortcomings in infrastructure and people to operate it. Training in our colleges and universities is a big part of the answer, as is an immigration policy that encourages people with these skills to come to Canada, but this all takes time.

There is another not so subtle problem within the staffing aspect of the infrastructure part. While delivery of some parts of infrastructure services can happen through virtual means, for the most part it is a job site specific thing, and in large cities, like Toronto, Vancouver or Montreal, workers in these critical facilities often cannot afford to live anywhere close to where they work. This slightly hidden aspect of the housing affordability problem becomes an infrastructure problem, because it makes it much harder to find the people needed to fill these jobs.

## Canada Lacks the Capacity to Build Housing More Rapidly

Without delving into numbers, there are not enough cranes, forming crews, electricians, plumbers, drywallers, window installers, etc. This is known anecdotally, but the numerical proof is the dramatic escalation in the cost of construction in Canada over the past decade. And this is not a problem that is Canada's alone. We are aware of similar cost increases in major markets around the world. Some of this can be attributed to supply chain disruptions during COVID-19, but the direction of costs was established well before this.

In Canada, an aging baby boomer population that once provided much of the country's skilled labor is retiring and we are not producing enough young people with these capabilities through apprenticeship programs and colleges. Instead, we have been producing a lot of university graduates with degrees in humanities and social and behavioral sciences, which two areas combined make up the largest field of study by enrolment, according to Statistics Canada.

One recent construction industry study reported that we could be as much as 29,000 skilled construction workers short of what is needed (presumably just to meet the building that is already in the pipeline, not the extra 3.5 million housing units) by 2027.

Clearly, emphasis on training and immigration is again the answer, but just like in the infrastructure argument above, this takes time.

## Finally, We Do Not Have Enough Money

This is an area where the media and governments need to think very hard. The demonization of capital in the housing market is perhaps headline or vote grabbing populism, but it is not based in fact, and it is counterproductive. Words like "financialization" and "commoditization", often applied by observers of the housing market as a means of inflaming sentiment against ownership or investment in housing by anyone other than homeowners, are used by people who are ill informed about the reality of how housing needs to work. And taxes and outright bans on foreign investment in our housing market accomplish nothing productive.

To illustrate the seriousness of this challenge, below are some very rough numbers, applied to CMHC's target 3.5 million housing units. But first, let's make the simplifying assumption that most, if not all. of the financial capital necessary to produce the housing we do build (the ~250,000 units each year) is fully employed and that there is not a lot of money sitting around idle.

To be clear, there is enough money in the system to produce 3.5 million more units, just not enough to do so while we are producing the other 250,000 units each year. This money needs to be returned to its owners (the banks, insurance companies, pension funds, public companies, private developers and individual investors) before it can be reinvested in the next cycle of supply. Referring back to the time it takes to produce housing, this means that about 250,000 housing units worth of capital is returned to its owners every year and can be redeployed. So where does the extra funding needed to produce CMHC's target come from and how much is needed?

As mentioned earlier, the kind of housing that is produced in large buildings, which is the form of development needed to produce a lot of housing, is in concrete and steel, mostly high-rise buildings. In Toronto and Vancouver, these cost about $800,000/unit to produce, inclusive of land, financing costs, development charges, etc. There are cheaper cities in which to build, and less expensive forms of construction, so we will use a simplifying assumption that a new housing unit costs an average of $600,000. This is quite possibly a significant understatement, but it's still useful in the overall example, because it is not going to change the answer – there is not enough money.

$600,000 multiplied by 3.5 million is $2.1 trillion. Approximately 75% of this cost will be funded with debt. We know that this is well beyond the capacity of the banking system, even with the magic of CMHC's Canada Mortgage Bond program, but let's just focus on the equity portion of equation, which is 25% or roughly $500 billion.

Total pension fund assets in Canada are roughly $2.1 trillion. Insurance assets are about $1.3 trillion. Both of these groups allocate small percentages of their assets to real estate, generally not exceeding about 15%, and of that allocation, an even smaller number would be directed at development versus real estate with in-place income. Within these numbers, funds are allocated to various sectors like office, retail, industrial and residential, and within these allocations, investments outside of Canada make up a significant proportion, so the amount of money directed at Canadian housing is a fraction of total assets.

While most pension funds in Canada invest in rental housing, most generally do not invest in "for sale" housing development, as under Canada's pension rules, doing so may endanger their tax exempt status, and also because most invest for longer term liability matching than development inventory provides. CPP, which is Canada's largest pension fund, does not presently invest in housing in Canada in any way.

So, the pension and insurance sector numbers get whittled down quite significantly.

The size of the publicly listed real estate sector in Canada is about $85 billion. There are REITs and corporate entities that focus solely on housing and others that invest in housing among other asset classes, but of the $85 billion, it is safe to say that not much more than about ¼ is focused on housing. Furthermore, the REITs which make up the majority of the publicly listed real estate owners are only able to allocate a small percentage of their capital to development, so this sector is not able to contribute massively to funding housing development in Canada.

We need to be careful when thinking about private equity funds, as a lot of their capital comes from other Canadian institutional investors and would therefore be double counted in this simple analysis, but let's give them credit for having $75 billion focused on real estate. Again, a lot of this is not directed at development, but rather at properties with in-place income, and not all of this money is focused on housing.

Canada's National Housing Strategy has earmarked $82 billion over 10 years for housing. This makes a dent in the number.

Purely private investors, including some extremely well capitalized housing developers make up the balance of the equity capital market for housing. But while the profits generated from one successful cycle of development and construction will result in the growth of those developers' balance sheets, this capital needs to be invested into the next cycle of development and construction, where the escalation of costs will erode some of the power of those larger balance sheets.

Here is some more math. If it takes an average of 6 years to produce a housing unit, and we produce about 250,000 units each year, that means that there is something like $225 billion in investor equity within the housing market at any given time (assuming 75% debt financing). So, to fund CMHC's target, we would need to more than triple the amount of equity in the Canadian housing development market.

None of the above adds up to the needed $500 billion, so where does the rest need to come from? Tax changes for publicly listed companies to encourage development, allowing pension funds to invest in development without endangering their tax-exempt status, encouraging foreign investment through tax incentives rather than demonizing and disincentivizing it, tax incentives to encourage more private investment. Changing the narrative in the media and coming out of government about the evils of foreign investors in our housing markets would go a long way. There are a lot of massively well capitalized global investors who are watching the Canadian growth story and want to be part of it, but they don't feel welcome, partly because of tax inefficiencies, but significantly, because of fear of negative publicity and public sentiment. Canada has an increasing share of the world's population and we need more of the world's money to go with it.

## It All Needs To Happen

The land location and acquisition process will not speed up, but the municipal approvals process can and must.

Infrastructure delivery needs to match the hoped-for pace of housing delivery. Canada has been a global leader in the use of public-private-partnerships to encourage investment of private capital into our roads, bridges, transit systems and healthcare facilities. Global infrastructure investment from private sector sources continues to grow and investors in this sector want more.  Let's attract this capital in a rapid build program for the infrastructure we know we need for our growing population.

Construction capacity needs to increase dramatically.  Training, immigration, tax incentives to stimulate growth of capacity, including from foreign sources, rapid adoption of construction innovation and building technology all are necessary.

The collective balance sheet in the housing economy must grow.  Let's quickly develop taxation changes to allow this.  Let's welcome foreign investors.  Let's change the mindset around investment in housing because we cannot build it without money.