

## Market Commentary

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### Housing Crisis: Looking Back and Forward

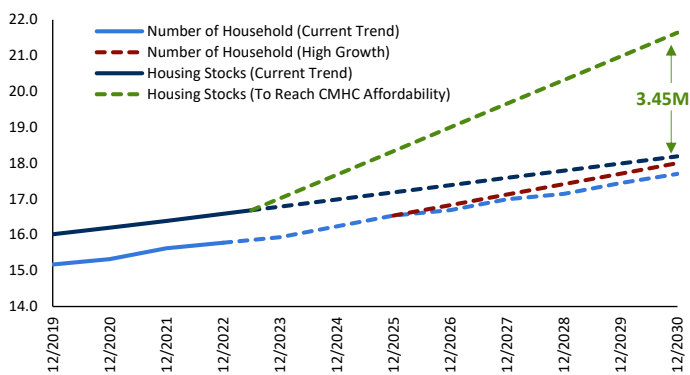
The Canada Mortgage and Housing Corporation (CMHC) provides data and forecasts on housing availability and affordability both nationally and in the six largest metropolitan areas in Canada. In our October 2023 Insights & Strategies report ([Housing Crisis or Opportunity?](#)), we cited CMHC forecasts for new home builds required to achieve the same level of affordability that Canadians enjoyed in the 2003-04 period, when the economy was stable, in neither boom nor recession. This established an affordability target of 30 per cent in most provinces, defined as “shelter cost as a share of disposable income”, with the exceptions of Ontario at 37 per cent and British Columbia at 44 per cent.

The takeaway, cited in our October report, was that Canada would need to build 3.45 million more housing units by 2030, above and beyond the 1.5 million that were already expected to be built, to bring housing prices to an “affordable” range (Chart 1). We estimated in October that housing starts would need a substantial boost to roughly 650,000 per year, starting immediately, which was much higher than the average of 208,000 housing starts recorded annually from 2000 to 2022.

So, how are we doing six months later? Looking back at what we’ve learned since then, we actually see an even more challenging situation. First, the population growth, largely driven by immigrants and temporary residents, reached around 1.3 million in 2023 (Chart 2), surpassing both the average annual increase under the current trend assumption and the high-growth assumption from the CMHC forecast of 700,000 new residents per year. While the federal government has acknowledged this additional strain and proposed corresponding policies to align immigration with housing capacity in Budget 2024, the recent surge in population growth will only intensify the housing shortage issue and make catching up to a reasonable affordability level all the more difficult.

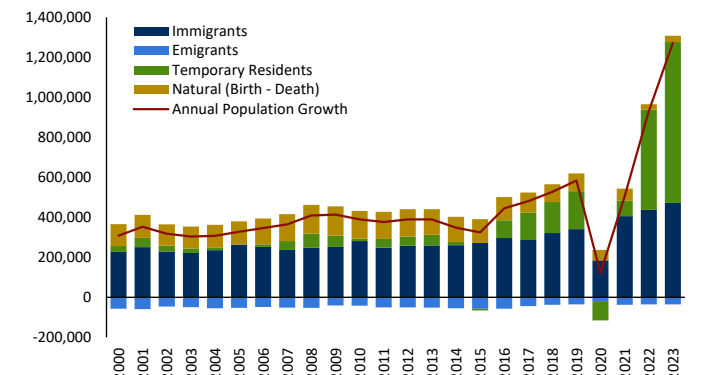
Despite the government trying to exert better control over the number of new immigrants and temporary residents entering the country each year, a structurally more concerning issue remains in housing starts, which determine the future supply. Housing starts in 2023 stood at around 240,000, only meeting approximately 36 per cent of the required housing starts to reach the CMHC affordability goal by 2030 (Chart 3). The recent trend has also not been good as housing starts in 2023 were lower than those in both 2022 (262,000) and 2021 (271,000). When comparing to 2022 specifically, we observe a decline in housing starts across all housing types except for apartments, which were up to 151,000 from 148,000, but still a far cry from where they need to be. The CMHC credited government support and unprecedented demand for half of that record number of purpose-built rental starts in 2023.

**Chart 1 - Household Growth vs. Availability and Affordability of Housing (June 2023 Forecast)**



Source: CMHC; Statistics Canada; Data as of September 13, 2023.

**Chart 2 - Two Consecutive Years of Record High Population Growth**



Source: Statistics Canada; Raymond James Ltd.; Data as of December 31, 2023.

Please read domestic and foreign disclosure/risk information beginning on page 5

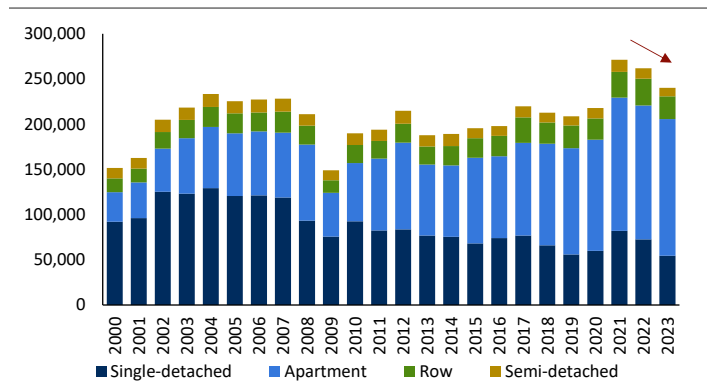
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One of the main reasons for the sluggish housing starts is the current restrictive financial conditions, put in place by the Bank of Canada (BoC) to rein in inflation. Elevated interest rates can affect housing starts by increasing financing costs and disincentivise developers. Since 2021, we have seen a rapid decline in starts of single-detached homes (Chart 3), while the number of apartment starts has grown modestly. This can be attributed in part to the fact that as much larger projects, apartment builds are planned further in advance, and with financing likely secured before the recent rate hike cycle. This lagged impact would then imply that we should expect a slowdown of apartment builds in the coming years as developers have been putting off commitments as they wait for a better financing environment. This effect is also cited in the CMHC's most recent Housing Market Outlook report<sup>1</sup>, which highlighted "Expecting lower housing starts in 2024. There is a slight improvement forecasted over the next two years. Supply challenges, notably the lagged effects of higher interest rates, mean that new construction in 2025 – 2026 won't reach 2021 – 2023 levels."

Another significant factor likely to continue exerting pressure on developers' capacity to build new homes and extend construction timelines is the surge in construction costs. Residential building construction costs surged by an average of 43 percent during the 2-year period from the pandemic outbreak, and although the upward trend has been normalizing since mid-2022, it continues to increase at a faster pace compared to the pre-COVID period (Chart 4). House construction costs are more sensitive to supply chain and labour market dynamics compared to apartment construction. This sensitivity arises because home builders operate on a smaller scale, have less substantial relationships with materials suppliers, and rely on on-demand labour.

Therefore, unless developers see signs of improvement in any of these circumstances, they are likely to scale back or pause their projects due to limited return premiums. The ongoing shortage of new supply, coupled with a steadily increasing population, is likely to drive house prices even higher than previous peaks. This will further worsen the affordability of homeownership for many, leading to increased reliance on rental options among families and consequently putting upward pressure on rental prices as well. This CMHC analysis was delivered before the housing initiatives were revealed in the 2024 Federal Budget. A slew of government initiatives have been put forward in order to alleviate these pressures, although the rollout of these programs could take significant time.

**Chart 3 - Housing Starts Declined Due to Elevated Borrowing Cost**



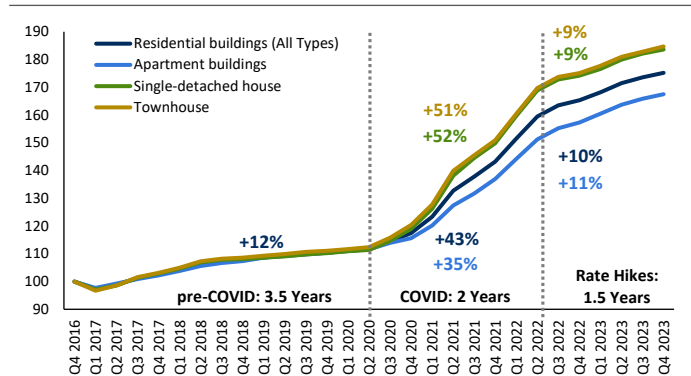
Source: Statistics Canada; CMHC; Raymond James Ltd.; Data as of December 31, 2023.

### Government Initiatives

The housing shortage in Canada has persisted for years, making government investment and policy in housing increasingly critical, particularly given the current unfavourable macroeconomic conditions affecting developers, buyers, and renters. The federal government initiated a ten-year, \$82+ billion plan known as the National Housing Strategy (NHS) in 2017, with most ongoing programs falling under this ambitious strategy. However, the key lies in the execution of this plan; mere numbers on paper will not solve the problem. Effective implementation requires collaboration across all levels of government, from federal to municipal, which has been a significant challenge in expediting construction timelines. Encouragingly, there appears to be a growing emphasis on this issue in Budget 2024, offering hope that real progress in construction may begin to catch up and align more closely with the ambitious targets set forth.

Looking broadly at Budget 2024, it addresses the housing crisis through three main approaches: (i) building more homes, (ii) making it easier to own or rent a home, and (iii) investing in more housing for vulnerable Canadians (Table 1). The first and third approaches mainly support the supply side, involving most of the funding programs, while the second approach focuses on managing demand, primarily through tax benefits and policy actions. Budget 2024 also gravitates towards prioritizing apartment buildings over other types of construction, highlighting the importance of

**Chart 4 - Construction Costs Surged Since COVID Outbreak, Trend Has Been Moderating But Remains Strong**



Source: Statistics Canada; Raymond James Ltd.; December 31, 2023.

density and affordability, with apartment buildings receiving the most significant funding support. Together, Budget 2024 and Canada's Housing Plan from fall 2023 aim to build 3.87 million new homes by 2031, including at least two million net new homes on top of the 1.87 million homes expected to be built by 2031. Although this target falls short by 1.08 million units compared to the level defined as affordable by the CMHC and over a slightly longer timeframe, it remains quite ambitious, especially considering the progress of previously announced programs.

**Table 1 - Summary Table for Budget 2024 - Housing**

High-level Strategic Approach	Channel	Funding/Tax/Policy	Budget 2024 Proposal	Highlight(s)
Boosting Supply - Building more homes	Rental apartments (provincial/territories)	Funding (Apartment Construction Loan Program)	+\$15 billion, announced reforms	More favourable financing terms than private financing
		Tax	Increasing the capital cost allowance rate from four per cent to ten per cent, estimated cost \$1.1 billion	Incentivize builders with increased after-tax returns on investment
	New homes (municipal)	Funding (Housing Accelerator Fund)	+\$400 million, over four years	Red tape reduction, speed-up approval times
	Infrastructure	Funding (Canada Housing Infrastructure Fund)	+\$6 billion, over ten years	Invest in infrastructure to keep pace with growth and encourage densification
	Housing technologies innovation, housing design, and etc.	Funding	~\$600 million, over various time frames	Invest in ideas and technology like prefabricated housing factories, mass timber production, panelization, 3D printing, and pre-approved housing design catalogues
Managing Demand - Making it easier to own or rent a home	Skilled trades workers	Funding	+\$150 million, over two years	Keep apprenticeships remain affordable, recognize foreign construction credentials
	Immigration, International students	Policy	Aligning immigration with housing capacity	Reduce the share of temporary residents to five per cent of the overall population over the next three years
	Legal support for tenants	Funding (new Tenant Protection Fund)/Policy	+\$15 million; Canadian Renters' Bill of Rights	Raise awareness of renters' rights, protect renters from unfair practices, make leases simpler, and increase price transparency
	Mortgages	Policy	Up to 30-Year amortizations for first-time buyers purchasing new builds; Credit for paying rent	Reduce barriers for first-time buyers; Strengthen one's credit score with on-time rental payment history; Home Buyers' Plan withdrawal limit increase from \$35,000 to \$60,000, intention to temporarily extend the grace period.
Helping Vulnerable Canadians	Downpayment	Tax	Increase in Home Buyers' Plan withdrawal limit, estimated cost \$90 million	
		Affordable housing	Funding (Affordable Housing Fund)	+\$976 million over five years, +\$24 million in the future years
		Funding (Canada Rental Protection Fund)	+\$477.2 million over five years, and \$147.8 million in future years	Acquire affordable housing units and preserve rents at a stable level for decades to come
	Reducing Homelessness	Funding (Reaching Home)	+\$1.3 billion over four years	Infrastructure Canada for reaching home: Canada's Homelessness Strategy
Building Homes in Indigenous Communities	Funding	+\$918 million over five years	Narrow First Nations, Inuit, and Métis housing and infrastructure gaps	
	Asylum Claimants	Funding	+\$1.1 billion over three years	Extend the Interim Housing Assistance Program

Source: Department of Finance Canada; Raymond James Ltd.

In Budget 2024, there are a few programs worth highlighting. First, the Apartment Construction Loan Program (ACLP), previously known as the Rental Construction Financing Initiative (RCFI) when it was first announced in 2016 as a cornerstone of the NHS, receives an additional \$15 billion in new loan funding, starting in 2025-26. This adds to previous commitments totaling \$40 billion, aimed at facilitating the construction of more rental apartments. A loan program it is not actually a budgetary expenditure, as the loans are expected to be repaid with interest and fees to cover CMHC administrative costs. This program reflects the federal government's intent to collaborate with provinces and territories, as exemplified by the recent project, BC Builds. The ACLP sets an ambitious target of constructing over 131,000 new homes by 2031-32, which is quite aggressive given its track record. After almost seven years since its inception, by December 2023, according to National Housing Strategy<sup>2</sup>, CMHC had committed \$18.19 billion in loans to support the creation of 48,298 units. However, only 11,208 (23 per cent) of these units have been built, while 21,369 (44 per cent) were under construction, and the remainder were still at conditional or financial commitment phases. With just over seven years remaining until 2031-32, achieving the goal of completing the construction of over 100,000 new homes will remain extremely challenging unless significant improvements are made in various aspects such as the approval process, productivity, and construction costs.

There is also a new Canada Housing Infrastructure Fund of \$6 billion to be launched. The fund will invest in effective and reliable water, wastewater, and stormwater infrastructure in order to keep pace with housing supply growth and encourage densification.

In addition to the initiatives outlined in Budget 2024, another government measure aimed at boosting housing supply with a focus on densification was announced in September 2023 indicating that the government would eliminate the goods and services tax (GST) from new apartment development to help push developers.

When it comes to managing demand, tax benefits for down payments and extensions to amortization limits proposed in Budget 2024 are expected to enhance affordability for first-time homebuyers. However, there is concern about the timing mismatch between the increase in supply and demand. As we discussed earlier, housing starts in 2024 are likely to remain subdued due to the macroeconomic environment. Even with government support programs, achieving a significant boost in housing supply in the short term seems unlikely. Initiatives such as RRSP withdrawal limits and extended amortization periods may provide more opportunities for first time home buyers, but still insufficient supply, coupled with greater purchasing power, may ultimately lead to buyers competing at higher prices.

### Summary

In 2024, overall housing starts are expected to continue declining from the record high levels of 2021 due to the high-interest-rate environment and surging construction costs. A more noticeable rebound in housing starts will likely occur when interest rates are lower, construction costs are normalized, and buyers' confidence levels and financial health are restored, probably in 2025 or 2026. Looking further ahead, apartment buildings are likely to experience a larger boost in supply, given the government support and greater control over construction costs. However, we still anticipate that demand growth for apartment buildings will outpace supply growth, considering the progress of government programs. As for single-detached houses and townhouses, they are expected to become increasingly valued due to the scarcity of land in desirable locations and high construction costs. Finally, while funding from government programs can incentivize developers to build more homes, in less favourable macroeconomic conditions, other factors such as costs and market confidence may have a greater impact on builders' plans.

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<sup>1</sup>Canada Mortgage and Housing Corporation (2024), 2024 Housing Market Outlook, Canada Mortgage and Housing Corporation, <https://www.cmhc-schl.gc.ca/professionals/housing-markets-data-and-research/market-reports/housing-market/housing-market-outlook>

<sup>2</sup>National Housing Strategy (2023), Quarterly Progress Reports December 2023, National Housing Strategy, <https://www.placetocalhome.ca/progress-on-the-national-housing-strategy>

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