# *Canadian Housing Industry – Performance and Trends*

**CANADIAN HOME BUILDERS' ASSOCIATION**

**November 2010**

# *CANADIAN HOUSING INDUSTRY – PERFORMANCE AND TRENDS*

The Canadian Home Builders' Association is the voice of Canada's residential construction industry.

The CHBA's membership includes new home builders, renovators, developers, suppliers, trades, manufacturers, lenders and other professionals. The CHBA has over 50 Local Home Builders' Associations and 8 Provincial Associations.

The CHBA's Standing Committees and Councils oversee the work of the Association in areas as diverse as technical and economic research, education and training, renovation, the environment, urban issues, warranty and marketing.

Through the voluntary efforts of its members, the CHBA serves both consumers and producers of housing by supporting quality, affordability and choice in housing for all Canadians.

## *Structure of This Report*

The following pages review housing performance and trends in Canada – with charts to illustrate key issues. The analysis is structured into the following sections:

1. **New Housing Activity**

   New housing activity in Canada has increased from the very low level of 149,000 starts in 2009. Nevertheless, starts remain well below the unsustainably high average of over 220,000 units annually during the 2002-2008 period.

   Following a very strong performance in the first half of the year (over 195,000 starts, seasonally adjusted at annual rate), housing starts have eased somewhat and are forecast by Canada Mortgage and Housing Corporation (CMHC) to ease further in the fourth quarter. CMHC's 'point forecast' for 2010 is 184,900 starts.

   In 2011, CMHC forecasts that starts will be between 146,900 and 210,500 units – with a point forecast of 176,900 in 2011. The wide range of housing starts forecasts reflects the high degree of economic uncertainty in Canada at the present time.

   With the gradual decline in new housing activity since the middle of this year, the spur to growth in Gross Domestic Product (GDP) provided by the housing sector has waned.

   Longer-term, CMHC forecasts that starts will average 185,000 units over the 2012-2014 period. While below the average annual housing starts during the 2002-2008 period, this is a very robust level of housing activity – well above the average starts levels in the 1990s, and in line with projected housing requirements.

2. **Residential Construction and the Economy**

   Expenditures on new housing and residential renovations have grown throughout the past four decades. With the marked drop in new housing activity in 2009, spending on new residential construction declined significantly – and pulled total residential construction spending lower, despite continued strength in renovation spending.

   Total residential construction spending accounted for over 6.5% of Canada's GDP during 2007 and 2008, but fell during the recession due to the decline in new housing activity.

Residential construction spending comprises only part of the overall impact of housing on the economy. According to estimates from CMHC's *Canadian Housing Observer, 2010*, housing-related spending accounted for over one-fifth of total GDP in 2009. In addition to construction spending, this includes consumption-related spending – "the amount that households spend on shelter, including heating and lighting, utilities, and maintenance and repairs. For renters, estimates of actual paid rent are used. For homeowners, an imputed rent is used instead of payments for mortgage interest, taxes and maintenance." (page 17)

Spending on residential renovations tends to be more stable from year to year than spending on new residential construction. Renovation spending has been greater than spending on new residential construction since the early 1990s, and has increased steadily during the past two decades.

Reductions in residential construction expenditures during 2008 – and especially in the fourth quarter of 2008 and the first quarter of 2009 – helped to put the Canadian economy in recession. Similarly, spending on residential construction was a major factor behind Canada's strong economic performance in the second half of 2009 and the first half of 2010. Now, the spur to the overall economy provided by the housing sector is waning.

Due to the uncertain economic outlook, CMHC has provided a range of possible starts forecasts for 2011. CMHC's point forecast of 176,900 starts for 2011 is lower than recent levels of activity – and would be a drag on overall economic growth.

## 3. Drivers of Housing Activity

*Employment*

The strong Canadian economy was a key factor driving the recovery in housing activity in Canada this year. Families who have lost jobs or are in danger of losing jobs do not buy homes. Employment levels have increased dramatically and job growth has surpassed the number of jobs lost during the recession.

**While most forecasters expect continued though slower employment growth over the next few years, the outlook is far from certain.**

While overall employment has recovered to pre-recession levels, the recovery has been uneven. The job losses during the recession were much more pronounced among young people (aged 15-24) than among workers aged 25+. And, the jobs recovered since the end of the recession have been predominantly among older workers.

**Employment levels among those aged 15-24 are only marginally above the depth reached during the recession. Also, the slowdown in job growth in recent months appears to be affecting the younger age cohort more than older workers.**

These young people are in the household-forming age groups – and in the early part of the first-time homebuyer age groups. Reduced employment in this age cohort can have significant implications for housing demand in the future – and, if not redressed, can affect the economic well-being of this cohort far into the future.

*Interest Rates*

Record low interest rates have also been a major factor behind the recovery in housing. Many potential buyers with secure jobs likely accelerated their home purchase decision to take advantage of the extremely low interest rates in Canada over the past year and a half.

The low interest rates, and high levels of home purchases, have contributed to a worrying increase in the debts of Canadian households.

*Household Debt*

Most economic forecasters, and both the Minister of Finance and the Governor of the Bank of Canada, have expressed concerns about the high debt levels of Canadians – and the dangers of high household debt to the Canadian economy.

The debts of Canadian households have increased from less than 100% of personal disposable income during the early 1990s, to recent levels of almost 150% of personal disposable income. These debts include credit card debt and personal loans, but they are predominantly mortgages.

Debt has also increased as a share of Canadians' net worth. The ratio of debt to net worth is almost 25% – well above the levels of the 1990s and earlier this decade.

While the current extremely low interest rates have made debt more affordable, large debts will become more burdensome when interest rates inevitably rise from their current levels. This will increase the drag on the economy (and the housing sector).

## 4. Projections of Housing Demand

While there is uncertainty about near term future economic conditions and their impact on the housing sector, over the longer term, high levels of immigration and positive demographics will underpin continued demand for housing in Canada.

The CHBA commissioned Altus Group Economic Consulting to prepare long-term projections of housing demand. All other things being equal, the projections indicate that housing demand will remain at robust levels for the next two decades.

The rate of household growth is projected to be 188,000 annually over the 2011-2016 period – slightly higher than the average for the 2006-2011 period. Household growth is projected to decelerate somewhat to 177,000 annually during the 2016-2021 period, and to average 158,000 annually during the 2021-2031 decade.

## 5. Housing Prices

With the strong housing markets of the past year, *resale* housing prices reclaimed the losses suffered during the recession and have reached new highs in most markets.

At present, the resale housing market in Canada is balanced. This would suggest that changes in housing prices will be relatively modest on a national basis. However, housing prices in any particular market will depend on the supply and demand balance in that market.

*New* house prices peaked in mid-2008 and declined in the early part of 2009. Since the spring of 2009, new house prices have increased modestly and are currently back to near their 2008 peak in most major markets.

There are concerns that housing prices may soften (as they have in the U.S.) in response to lower levels of demand in coming months. **However, Canadian housing markets are not subject to anything remotely close to the oversupply that continues to plague U.S. housing markets.**

6. **The State of Homeownership Affordability**

Affordability deteriorated significantly during the 2006-2007 period due to the substantial increase in housing prices during this period.

Homeownership affordability has improved substantially in the past 18 months due mainly to the current extremely low interest rates. The improvement in affordability was a significant factor behind the housing recovery.

Even at current interest rates, homeownership affordability is not as positive as it was during the period between the late 1990s and 2005, due to higher housing prices.

When interest rates rise from their current levels, homeownership affordability will again become a major concern.

7. **Challenges Facing Homeownership Affordability**

Rising government-mandated costs continue to be a significant threat to homeownership affordability. In particular, increased municipal charges (especially development cost charges – DCCs) are raising costs for home builders – with follow-on impacts on housing prices and homeownership affordability.

**When municipalities impose DCCs on new homebuyers, they effectively transfer public sector debt into household mortgages, which itself is a cause for concern from a public policy perspective. This transfer has taken on additional importance given the increased burden of household debt discussed earlier. Also, the 'tax on tax' nature of the GST/HST means that municipalities are not accountable for the full impact on homebuyers of their tax policies.**

The fact that the GST rebate phase-out thresholds have been frozen for the past 19 years is another serious impediment to housing affordability.

The threshold at which the federal GST New Housing Rebate begins to be phased out is currently $350,000. The rebate disappears entirely at $450,000. This important measure of tax relief is effectively being phased out over time because the price thresholds, especially in Canada's most costly urban centres, have been overtaken by rising housing prices.

When the GST was introduced in 1991, the federal government made a commitment to adjust the thresholds to reflect changes in housing prices, and thus to protect housing affordability over time. As stated in the *Goods and Services Tax Technical Paper,* August 1989 (page 19):

> *"The government will review these thresholds at least every two years and adjust them as necessary to ensure that they adequately reflect changes in economic conditions and housing markets."*

It is not only new home buyers who are disadvantaged by the lack of adjustment of the thresholds. Since new and resale homes are similar, competitive products, the higher (GST-included) prices of new housing are reflected in higher prices in the resale market as well.

Over the period since the GST was introduced in 1991, Statistics Canada's New House Price Index has increased by over 50%. Had the GST New Housing Rebate thresholds been adjusted to take account of this increase in new house prices, the thresholds would be roughly $535,000-$690,000. Freezing the thresholds has meant that an increasing number of households no longer receive a full or even a partial rebate.

***The purpose of the federal government's commitment to adjust the GST thresholds was to protect housing affordability over time. With almost all new houses in many major centres now ineligible for the GST rebate, action by the federal government to fulfill its commitment to housing affordability is urgent.***

Since the thresholds have been frozen for the last 19 years, the CHBA is recommending that the federal government adopt the rebate model for new housing that is being applied by the provincial governments of Ontario and British Columbia for their new harmonized sales taxes. This model is designed to protect housing affordability through one price threshold. Below the threshold, housing is taxed at a lower rate. The amount of the rebate at the price threshold is available to all housing priced above the threshold. Application of this approach to the GST New Housing Rebate would achieve substantially the same result as the indexation of the current thresholds for the new housing rebate.

Based on the rebate model for new housing under the harmonized sales taxes in Ontario and British Columbia, and a rebate threshold of $400,000, the federal government would have received roughly $350 million less in GST revenues in 2010.

***In order to protect housing affordability, the CHBA calls upon the federal government to adopt the rebate approach in Ontario and B.C. with a commitment to adjust the threshold in the future, in line with rising housing prices.***

## 8. Challenges Facing the Renovation Sector

Across Canada, homeowners who undertake renovations pay an unfair level of sales taxes under the GST and, in those provinces where it is in place, under the HST. This unfair level of taxation adds significantly to the cost faced by Canadians when they invest in maintaining or enhancing their homes.

It also helps to fuel a large and growing underground 'cash' economy that undermines housing quality, harms legitimate tax-paying contractors, and costs federal and provincial governments billions of dollars each year in lost revenues.

Prior to the introduction of the GST, the 9% FST applied only to the materials portion of home renovation expenditures. Estimates prepared for the CHBA indicate that the FST represented approximately 2.5% of the delivered cost of a contracted home renovation. The current GST taxes the same project at 5% – twice the previous amount. In provinces where the HST is in place, the tax burden is much much greater.

***The CHBA calls upon the federal government to introduce a permanent Home Renovation Tax Rebate equal to 2.5% of the total cost of a home renovation. This will restore fairness to how home renovations are taxed by the federal government.***

The temporary Home Renovation Tax Credit (HRTC), implemented as part of the federal government's Economic Action Plan, proved very successful. Clearly, consumers have shown that they are very receptive to action by the federal government to reduce the cost of home renovations.

The HRTC also provided another important benefit. By requiring homeowners to have receipts to back up their HRTC claims, the federal government dealt a major setback to underground 'cash' operators. Consumers intending to take advantage of the HRTC required documentation when they hired a renovator, placing cash operators at a significant disadvantage. This also resulted in increased government revenues as legitimate tax-paying contractors gained business that would otherwise have been lost to tax-evaders.

Governments at all levels are losing billions of dollars annually through the activities of underground 'cash' operators in the residential renovation sector especially. For example, the Ontario Construction Secretariat estimates that average annual government revenue losses from underground activity in construction average $1.4-$2.4 billion in Ontario alone.

The main Canada Revenue Agency (CRA) response to the growth of the underground economy in residential construction has been the Contract Payment Reporting System (CPRS). An evaluation of the CPRS by the Agency itself concluded that it is "not effective in that segment of the underground economy where transactions are purposefully hidden by both the contractor and sub-contractor to circumvent tax laws and other legal obligations (commonly known as the 'cash' economy)." Underground operators, by definition, operate in cash only, outside the legitimate economy. The CPRS simply makes such cash-only operators even more careful about the ways in which they conduct their activities.

Clearly, current initiatives are not effective in addressing the underground cash economy in residential construction. A new approach is required. Initiatives aimed at reducing underground activity in other countries should be examined for application in Canada.

***As part of the federal government's strategy to address the underground economy, all firms and individuals in the construction industry should be required to register for a Business Number, even if they wish to take advantage of the GST exemption for companies which operate below the $30,000 annual sales threshold.***

The proposed permanent Home Renovation Tax Rebate would complement these efforts, and bring a much larger proportion of renovation projects 'above ground'.

## 9. Challenges Facing the Rental Sector

The national rental apartment vacancy rate is within the 2-3% range indicative of a 'balanced' rental market. Few major centres have *very* tight rental markets and most major centres have vacancy rates within or above the 'balanced' range.

However, the predominance of oversupplied and/or balanced rental markets in most parts of Canada is only temporary. New rental construction is well below the level of projected demographic requirements.

The combination of high demand for rental housing and low volumes of rental construction will lead to tightening rental markets in future years.

Changes in the federal income tax treatment of purpose-built rental housing during the 1970s and 1980s significantly reduced the attractiveness of rental investment, as did the introduction of the GST in 1991.

The negative effect of the GST on rental housing was reduced by extending the GST rebate to private rental housing (in 2000), and in the reduction in the general rate of GST from 7% to 5%. However, more fundamental changes are needed in the federal tax regime for rental housing.

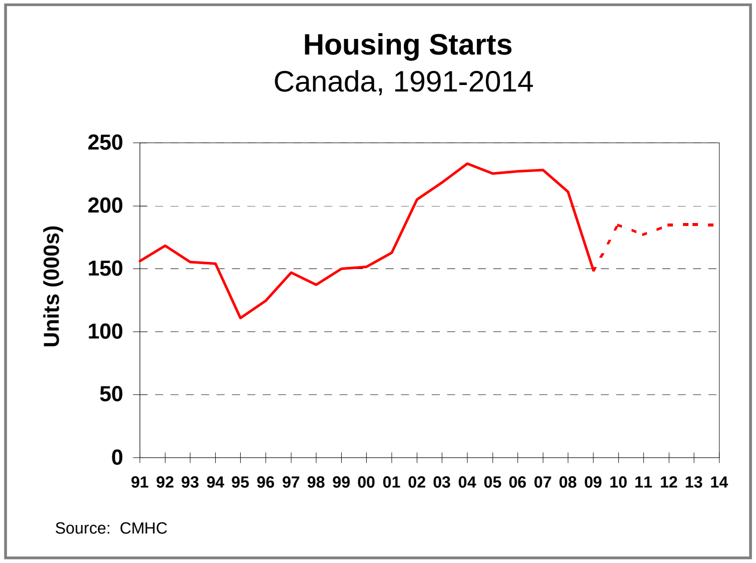
***The CHBA calls for reforms to the federal tax treatment of purpose-built rental housing, including consideration of:***

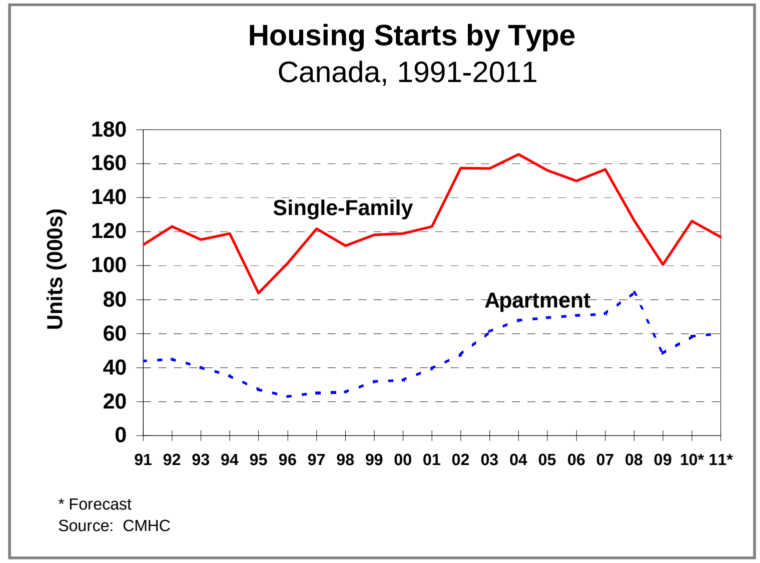
- ***Deferring capital gains and recaptured depreciation deductions upon the disposition of rental properties if the proceeds are used to invest in new rental properties.***
- ***Extending eligibility for deductions of rental losses created by capital cost allowance against income from other sources.***
- ***Relaxing restrictions on the deductibility of soft costs.***
- ***Allowing small businesses with rental properties to be eligible for the favourable tax rate which applies to other types of small businesses.***
- ***Zero-rating rental housing for the purposes of the GST/HST – because residential rents are GST/HST exempt, the GST/HST paid by businesses investing in rental housing should be refunded, as is effectively the case with other similar types of businesses which pay GST/HST on inputs.***

The CHBA does not support proposals for grants or tax preferences for low-cost rental housing production or renovation, favouring instead direct financial support to low-income households to meet their needs.

## 1. NEW HOUSING ACTIVITY

### *New Housing Activity Has Recovered from Low Level of 2009 – Increased Starts for Both Singles and Multiples*

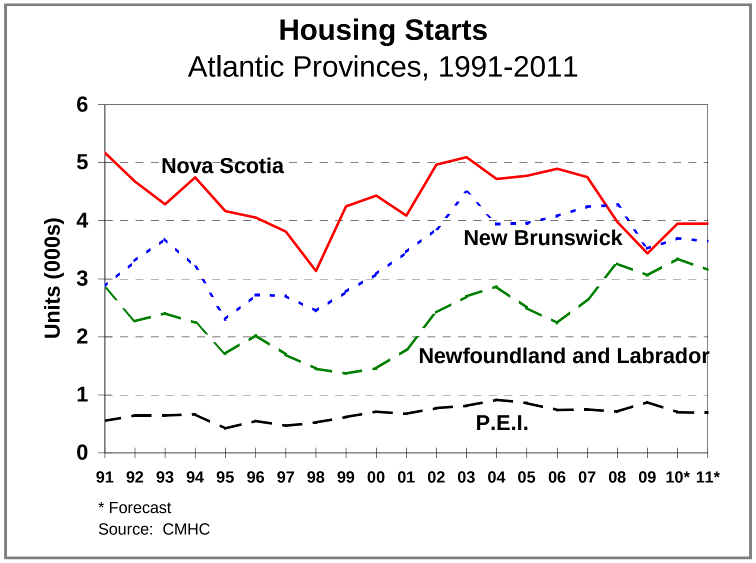


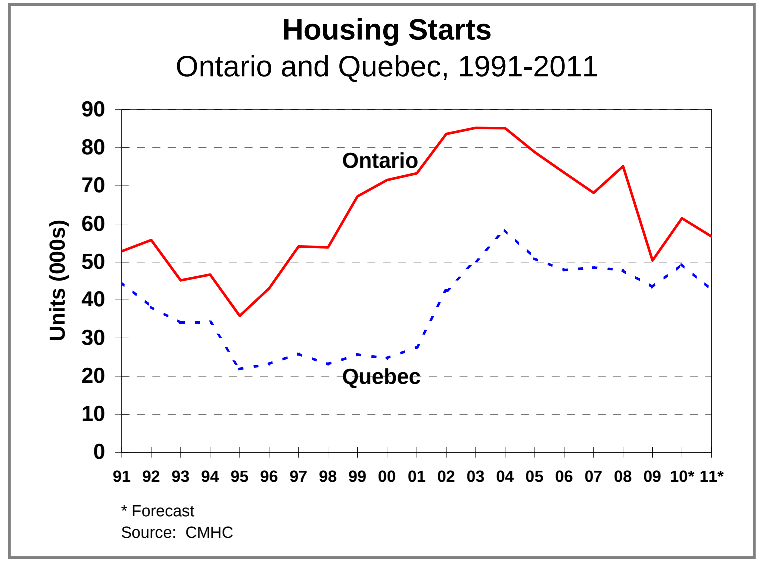




- Housing starts were above 220,000 units annually during the 2002-2008 period – an unsustainably high volume of activity. Prior to the surge in housing starts after 2001, new housing activity was very low.
- In 2009, due to the recession, starts dropped to 149,000 units.
- CMHC forecasts that starts will total 184,900 in 2010. In 2011, due to the uncertain economic environment, CMHC has forecast that starts will be in the range between 146,900 and 210,500 units – with a point forecast of 176,900 units.
- Starts are projected to be in the 185,000 range during the 2012-2014 period.

- Condominium apartments accounted for a progressively higher proportion of housing starts in Canada during the past decade. While the data shown here include both condominium and rental apartment units, condominiums account for the majority of the starts – and all of the increase over the past decade.
- The volumes of both apartments and single-family starts declined in 2009 from the high levels of 2002-2008, but are expected to recover gradually over the next few years.
- Apartments (mainly condominiums) are expected to comprise slightly more than 30% of total starts in 2010 and 2011. This is similar to their proportion of starts in the latter years of the decade – except for 2008, when apartments jumped to a 40% share of total starts.

## *Higher Starts in 2010 in All Eastern Provinces Except PEI – Modest Decline in 2011 in All Provinces Except Nova Scotia*

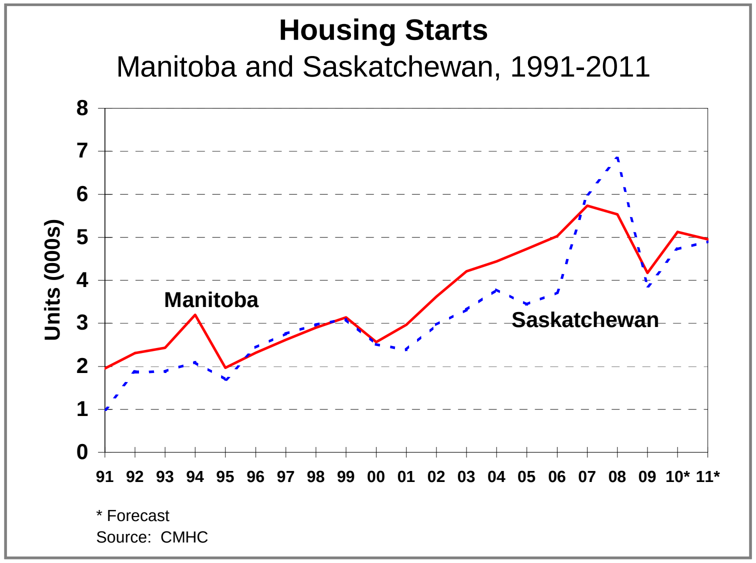


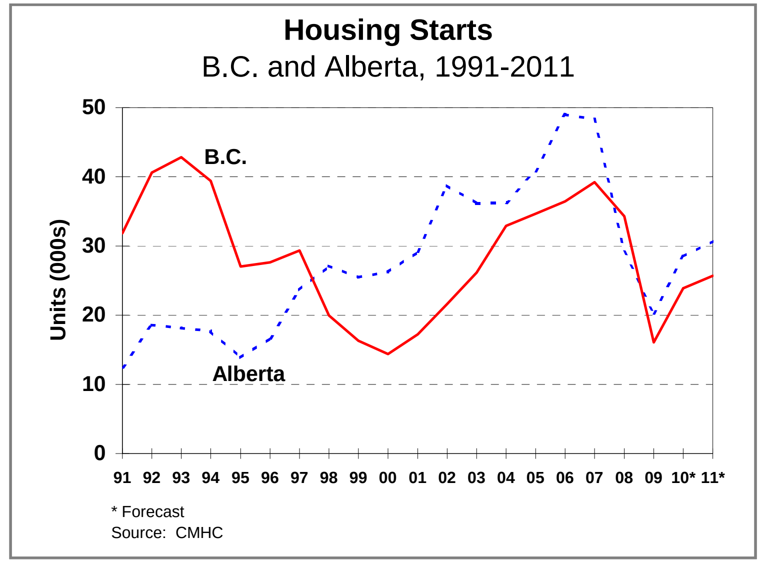




- Housing starts in the four Atlantic Provinces as a whole are forecast to increase by 7% in 2010 compared to 2009, according to CMHC. Starts are forecast to decline modestly by 2% in Atlantic Canada in 2011.
- In Nova Scotia, 2010 starts are forecast to total 3,950 units – up from 3,438 starts in 2009. In 2011, starts are forecast to stay steady at the 2010 level of 3,950 units.
- New Brunswick starts are forecast to be 3,700 units in 2010 and 3,650 units in 2011, compared to 3,521 units in 2009.
- Starts in Newfoundland and Labrador are forecast at 3,350 units in 2010 and 3,150 units in 2011 – compared to 3,057 units in 2009.
- In Prince Edward Island, 700 and 695 starts are forecast in 2010 and 2011, respectively – down from 877 in 2009.

- Ontario starts are forecast to increase to 61,525 units in 2010 – an increase of 22% from 50,370 starts in 2009, but well below the average of 74,000 starts annually during 2005-2008. In 2011, Ontario starts are forecast to total 56,700 units.
- Starts in the Toronto CMA, the largest housing market in Canada, are forecast to total 33,200 units in 2010 and 31,600 in 2011 – compared to 25,949 starts in 2009.
- Quebec starts are forecast to total 49,425 units in 2010 – up 14% from 43,403 starts in 2009. Starts in the province are forecast at 42,600 units in 2011.
- While lower than in recent years, starts in Ontario and Quebec are expected to remain well above the levels of the mid-1990s.

## *Starts Up Substantially in All Four Western Provinces in 2010 – Continued Increase in Starts in All Provinces Except Manitoba in 2011*



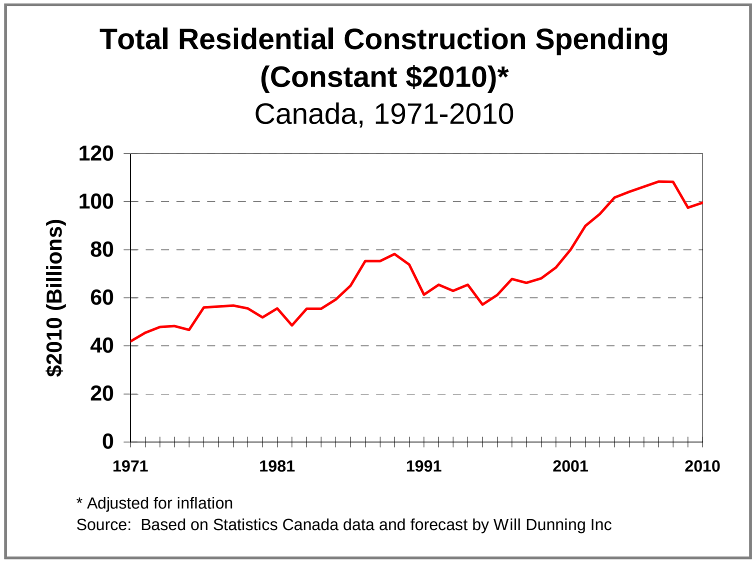



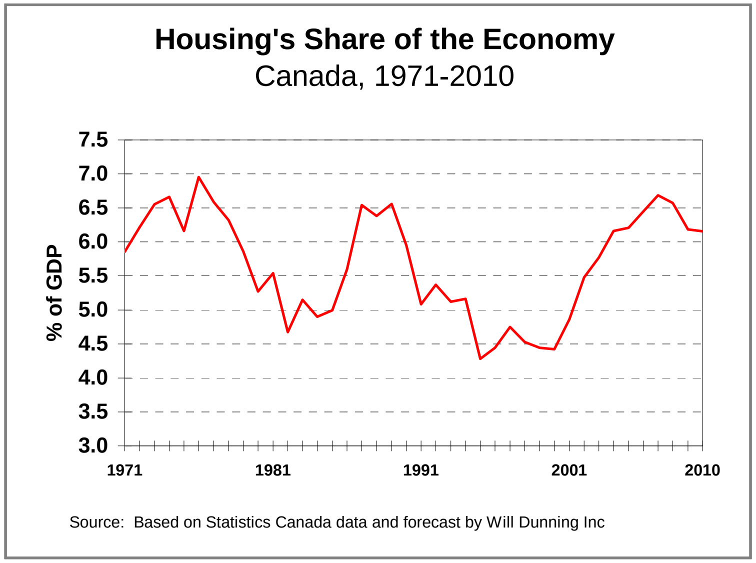

- In Manitoba, starts are forecast to increase by 23% to 5,125 units in 2010 – from 4,174 units in 2009. Starts in Manitoba are forecast to decline slightly to 4,950 units in 2011.
- Saskatchewan starts are forecast to increase by 22% in 2010 to 4,725 units, compared to 3,866 units in 2009. Starts in Saskatchewan are forecast to increase to 4,900 units in 2011.
- Starts in both Manitoba and Saskatchewan continue to be well above the levels of the 1990s, but well below the peaks reached in 2007-2008.

- Starts in Alberta are forecast to increase by 40% to 28,450 units in 2010 – compared to 20,298 starts in 2009. Alberta starts are forecast to increase slightly to 30,700 units in 2011.
- B.C. starts are forecast to increase by 49% to 23,900 units in 2010 – compared to 16,077 starts in 2009. Starts in B.C. are forecast to increase to 25,700 units in 2011.
- Starts in Alberta are well below the levels of recent years but are above the levels of the 1990s.
- In B.C., starts are also below the recent peaks. Starts in the province are below the levels of most of the 1990s.

## 2. RESIDENTIAL CONSTRUCTION AND THE ECONOMY

### *Residential Construction – A Strong Contributor to Canada's Recent Economic Growth – Spending on Housing Accounts for Over 6% of the Total Economy*

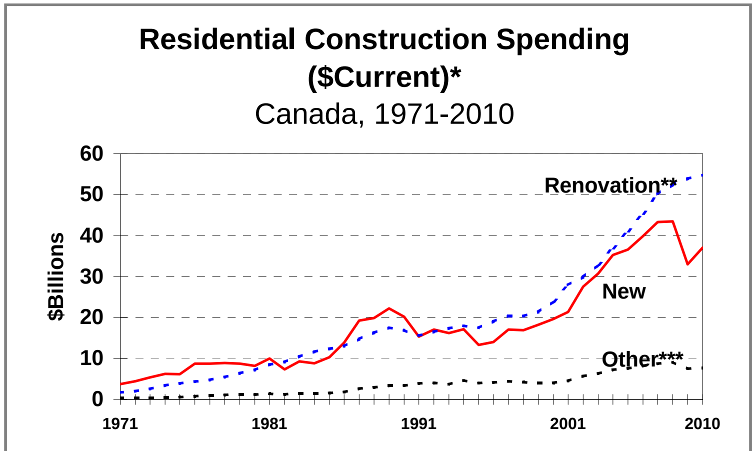


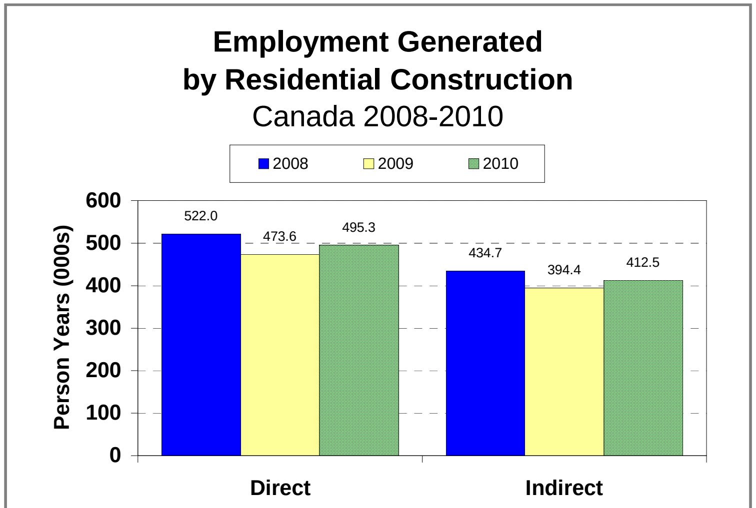

- Real spending on residential construction has grown throughout the past four decades. In terms of constant (inflation-adjusted) 2010 dollars, the value of residential construction spending increased from $42 billion in 1971 to over $100 billion annually during the 2004-2008 period.
- With the downturn in new housing activity in 2009, real residential construction spending dropped to $98 billion.
- Residential construction spending includes new housing, renovations to existing dwellings, cottages, conversions and acquisition costs for new housing.
- With the recovery in new housing activity in 2010, and continued growth in renovation spending, total spending on residential construction in 2010 is forecast to reach almost $100 billion.

- The housing sector is a key component of Canada's economy.
- After lagging during most of the 1990s, housing's share of the economy increased strongly during the early part of this decade. Total residential construction spending as a share of GDP increased to over 6.5% in 2007 and 2008, and was a key driver behind Canada's strong economic growth during the 2001-2008 period.
- With the downturn in new housing activity in 2009, the economic impetus provided by the housing sector weakened – an important factor behind the overall weaker performance of the Canadian economy.

## *Spending on Residential Renovations Exceeds Spending on New Housing – Significant Employment Generated by Residential Construction*




* Not adjusted for inflation
** Includes Alterations and Improvements, and Repairs
*** Acquisition Costs, Conversions and Cottages
Source: Based on Statistics Canada data and forecast by Will Dunning Inc

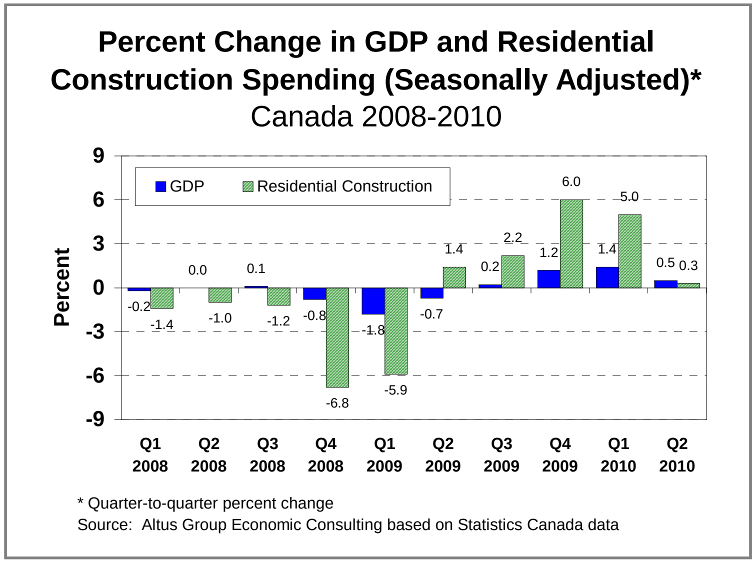


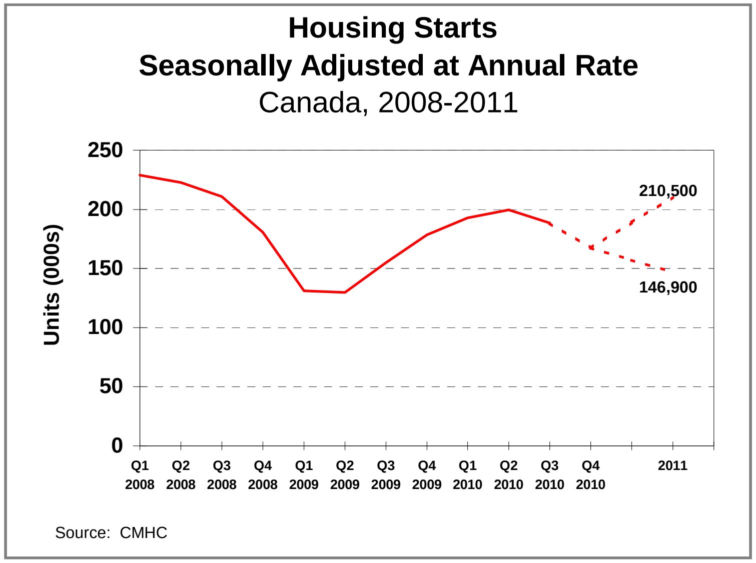

Source: Will Dunning Inc

- Housing's contribution to the economy is comprised of both new housing activity and residential renovation work.
- Renovation expenditures (repairs and improvements to existing housing) have grown progressively over the past three decades – since the early 1990s, they have been greater than expenditures on new housing construction.
- Expenditures on *new housing* tend to be more volatile than renovations. New residential construction spending totaled roughly $43 billion in both 2007 and 2008, but dropped to $33 billion in 2009.
- Forecasts prepared for the CHBA indicate a recovery in spending on new housing in 2010 to $37 billion.

- Residential construction generates substantial employment, not only in the residential sector itself (direct employment), but also in other industries which provide inputs to construction.
- Estimates prepared for the CHBA indicate that the direct and indirect jobs generated by residential construction will total over 900,000 person-years of employment in 2010.
- These indirect jobs are in a wide range of industries which supply inputs to construction. These include manufacturing industries (mainly wood and metal products as well as cement, etc.), wholesalers and retailers, financial and service industries, and primary industries.

## *Housing Sector Helped Pull the Economy Out of Recession – Decline in New Housing Activity Negative for Economic Growth*



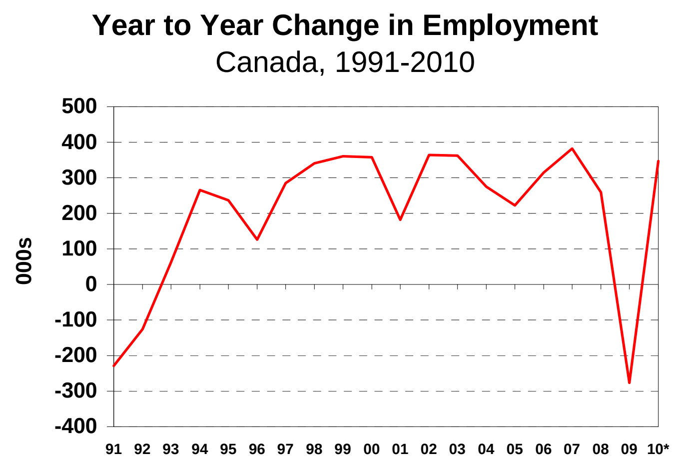




- Housing is important to the Canadian economy – a decline in housing activity leads to lower economic growth; an increase helps to spur economic growth.
- This is clearly illustrated by an examination of quarterly changes in GDP and residential construction expenditures over the period since the beginning of 2008.
- Reductions in residential construction expenditures throughout 2008 – and especially in the fourth quarter of 2008 and the first quarter of 2009 – helped to put the economy in recession.
- Similarly, starting in the second quarter of 2009 – but especially in the fourth quarter of 2009 and the first quarter of 2010 – strong increases in residential construction spending helped to lift GDP growth.

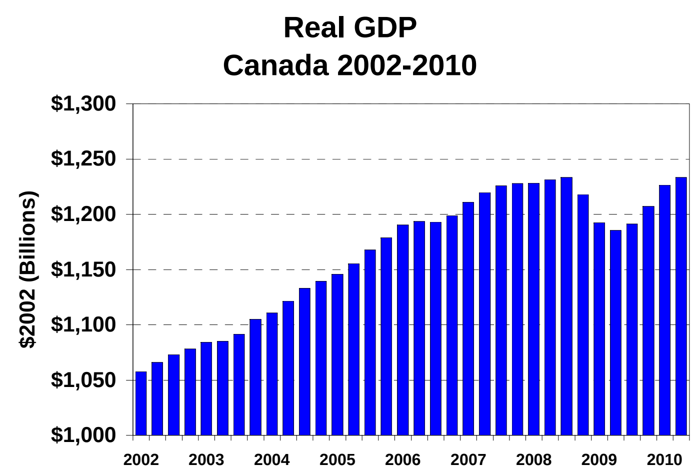
- With the decline in new housing activity in the third quarter of this year, and an expected further decline in the fourth quarter, the spur to GDP growth provided by the housing sector has waned.
- Due to the uncertain economic outlook, CMHC has provided a range of possible starts forecasts for 2011. CMHC's point forecast of 176,900 starts for 2011 is lower than recent levels of activity – and would be a drag on overall economic growth.

## 3. DRIVERS OF HOUSING ACTIVITY

### *Strong Employment Growth Assisted the Recovery in Housing – GDP and Employment Have Regained Pre-Recession Levels*



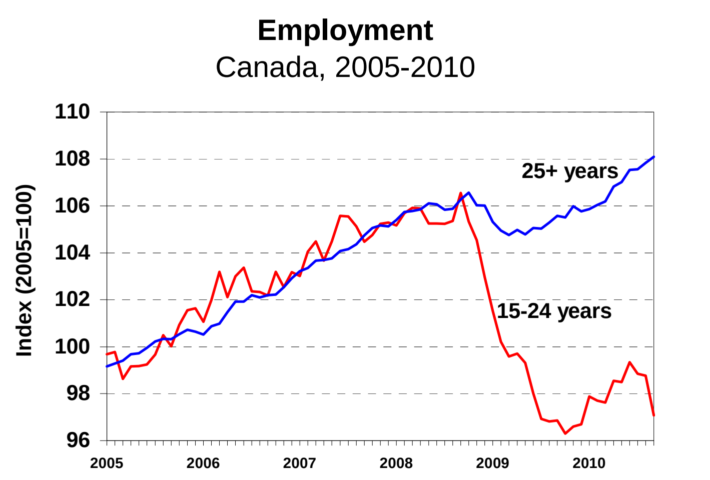

*September 2009 to September 2010
Source: Statistics Canada



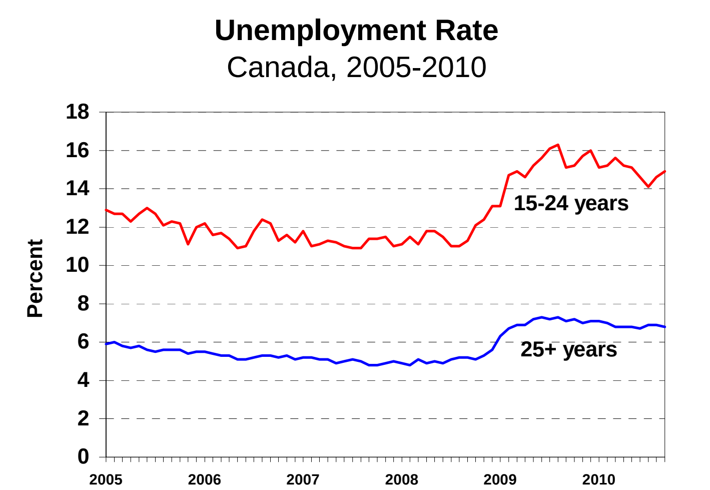

Source: Statistics Canada

- Families who have lost jobs or are in danger of losing jobs do not buy homes. The drop in new housing activity in 2009 was, in large part, due to the 275,000 jobs lost in the Canadian economy in 2009.
- Over the past 12 months, employment levels have risen dramatically and job growth has surpassed the number of jobs lost during the recession.
- The improved employment picture in 2010 was a prerequisite for the recovery in housing activity. However, this is something of a ‘chicken and egg’ situation since increased housing activity was itself a major factor in the improvement in employment.
- While employment and GDP have regained the levels attained prior to the recession, there is a significant output gap in the Canadian economy. GDP is still well below the level which would have occurred if economic growth had continued at the rates enjoyed prior to the recession.
- The slack in the economy is reflected in higher rates of unemployment and an economic growth rate which is significantly lower than traditionally occurs during an economic recovery.
- Most forecasters expect continued though slower economic growth over the next few years, however, the outlook is far from certain. In particular, the U.S. economy (Canada’s primary export market) remains very weak.

## *Recovery in Employment Growth Confined Mainly to Older Workers – Poor Job Growth Among 15-24 Year Olds Has Negative Implications for Housing Demand*



Source: Altus Group Economic Consulting based on Statistics Canada data

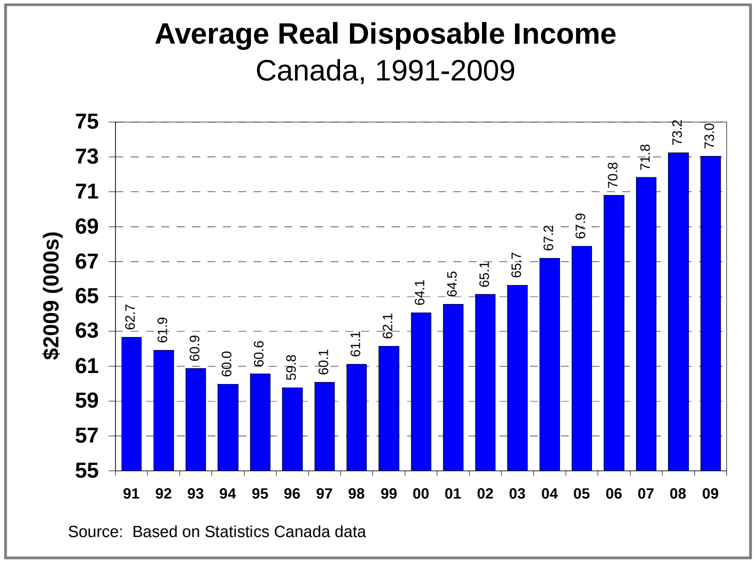


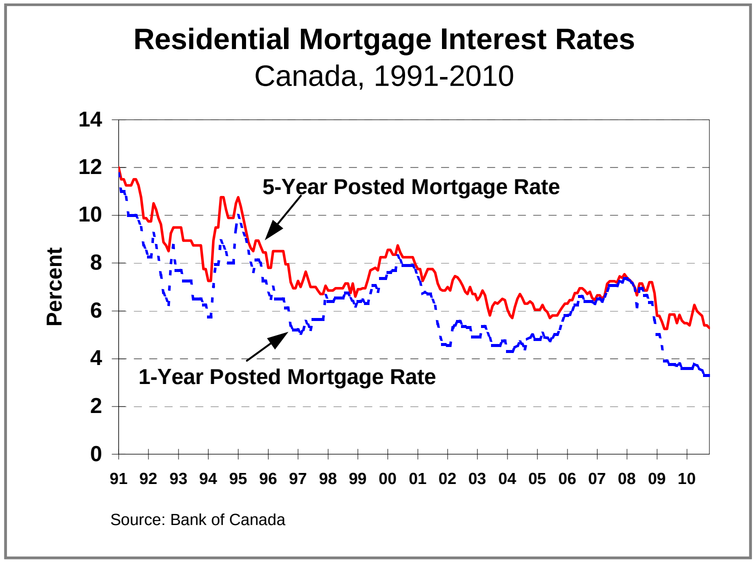
Source: Statistics Canada

- While overall employment has recovered to pre-recession levels, the recovery has been uneven.
- The drop in employment was much more pronounced among young people (aged 15-24) than among workers aged 25+. And, the jobs recovered in the second half of 2009 and so far in 2010 have been predominantly among older workers.
- Employment levels among those aged 15-24 are only marginally above the depth reached during the recession. Also, the slowdown in job growth in recent months appears to be affecting the young age cohort more than older workers.

- Unemployment rates are always higher for young people compared to those aged 25+. This reflects the difficulty of young people finding appropriate initial employment.
- However, the situation since the onset of the recession is much worse than normal. Jobs lost during the recession have not been recovered and the unemployment rate is significantly higher than prior to the recession.
- These young people are in the household-forming age groups – and in the early part of the first-time buyer age groups. Reduced employment in this age cohort can have significant implications for housing demand in the future – and, if not redressed, can affect the economic well-being of this cohort far into the future.

## *Steady Real Disposable Income – Not As Positive for Housing Demand – Mortgage Interest Rates At Historically Low Levels*

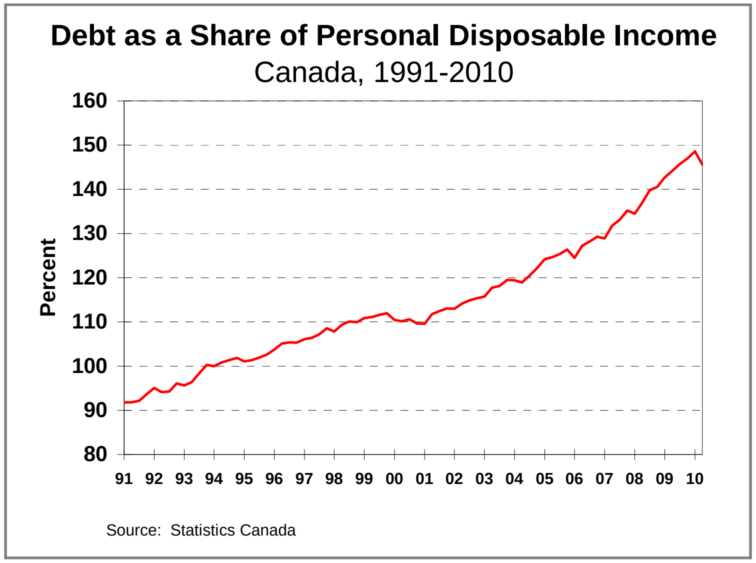


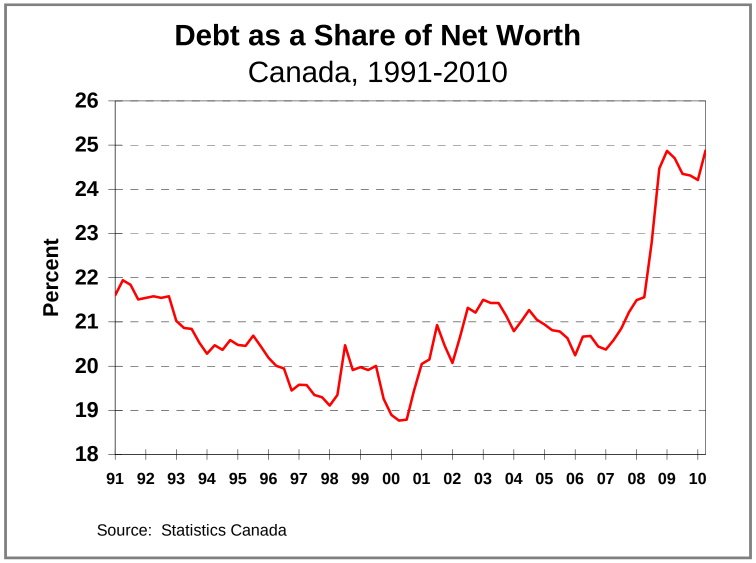




- The combination of strong economic growth and reduced taxes led to a substantial increase in the average real disposable income of Canadian households during the decade leading up to 2008. This provided an important boost to housing activity during that period.
- Disposable income is the share of income left over after accounting for income taxes and other deductions.
- The slowdown in the economy in 2009, with job losses and reduced work hours, led to a modest decline in average real disposable income – another negative factor for housing demand last year.

- Mortgage interest rates are critical for housing affordability and for the economics of investment in rental housing.
- The historically low mortgage rates were a key factor behind the recovery in housing this year.
- At present, chartered banks' 5-year posted rates are roughly 5.3%, while 1-year rates are in the 3.2% range. However, by negotiating, borrowers can generally get rates lower than those posted by lenders. For example, banks are offering 'special deals' of less than 4% for 5-year mortgages.
- While these extremely low mortgage interest rates will not last indefinitely, it is unlikely interest rates will increase significantly until the economic recovery is more firmly underway.

## *Rising Debt of Canadian Households A Serious Concern – Repayment Will Be More Difficult When Interest Rates Rise*

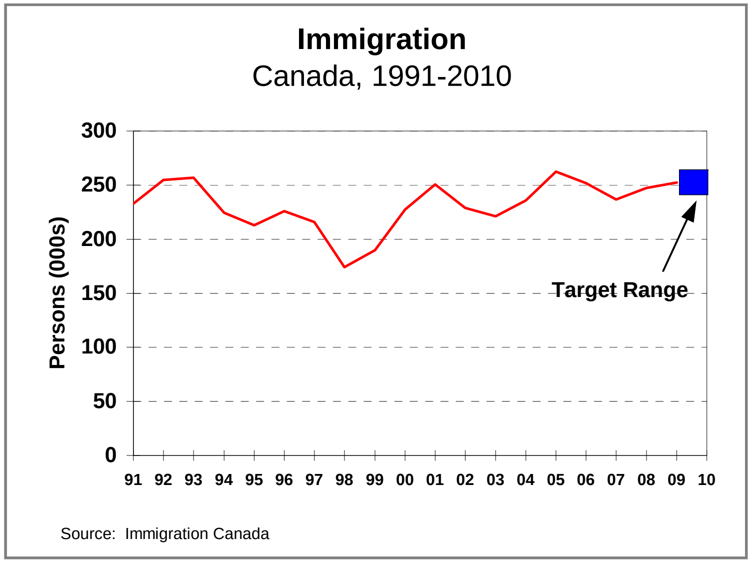


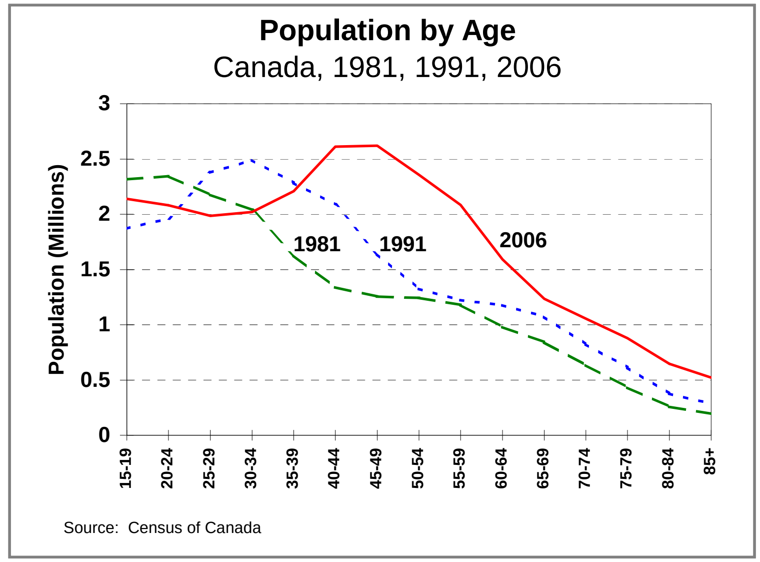




- Canadians have been on a ‘borrowing spree’ for the past two decades. The debts of Canadian households have increased from less than 100% of personal disposable income during the early 1990s, to recent levels of almost 150%.
- These increased debts include credit card debt and personal loans, but they are predominantly mortgages.
- The rise in Canadians’ debts continued through the recession and has only recently abated.
- The long-term decline in interest rates has allowed Canadians to service a greater amount of debt. However, large debts will become more burdensome when interest rates inevitably rise from their current abnormally low levels. This will be a drag on the economy (and the housing sector).

- Not only has debt increased as a share of personal disposable income, it has also increased as a share of Canadians’ net worth. The ratio of debt to net worth is almost 25% – well above the levels of the 1990s and earlier this decade.
- Most economic forecasters, and both the Minister of Finance and the Governor of the Bank of Canada, have expressed concerns about the high debt levels of Canadians – and the dangers of high household debt to the Canadian economy.
- The Bank of Canada has identified a component of the population with high debt service ratios which are considered to be financially vulnerable. Simulations undertaken by the Bank indicate that this vulnerable group could grow significantly in size with increases in interest rates.

## *Positive Demographics Point to Continued Strong Housing Requirements – Immigration and Baby Boom 'Echo' Generation Support Demographic Housing Requirements*



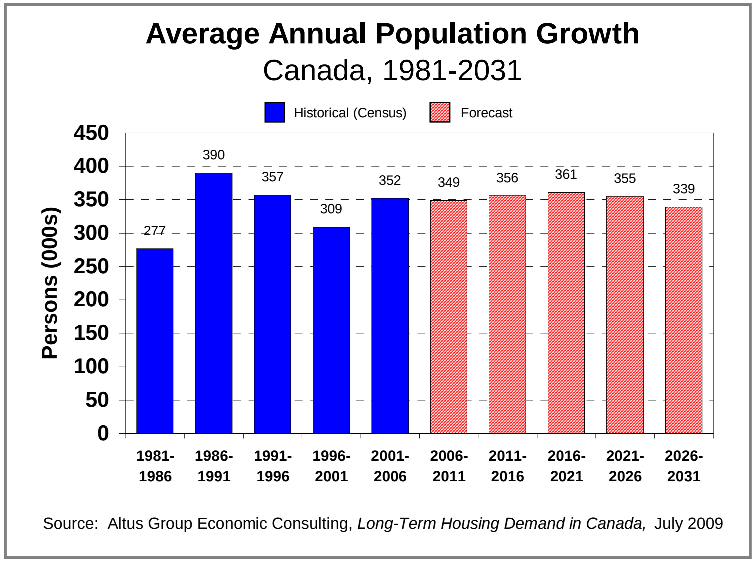



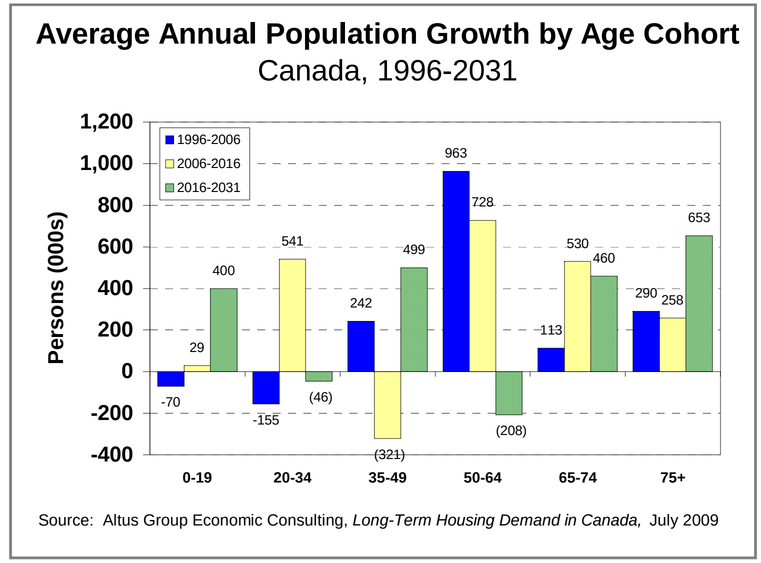

- Immigration has fluctuated in the 220,000-260,000 range for the past several years.
- In 2009, immigration totaled 252,000 – within the target range of 240,000-265,000.
- Research indicates that, over time, immigrants have housing occupancy characteristics similar to native-born Canadians. Therefore, immigration is a key source of housing demand.
- Immigration is also extremely important for providing skilled people to many industries – including construction.

- The ageing of the baby boom generation has had a pronounced effect on the volume and nature of housing demand in Canada since the late 1960s.
- The baby boom 'echo' generation – the children of the baby boomers – has aged into the household forming age groups. As is discussed in the next section, this will underpin household growth – and housing demand – in the future.

# 4. PROJECTIONS OF HOUSING DEMAND

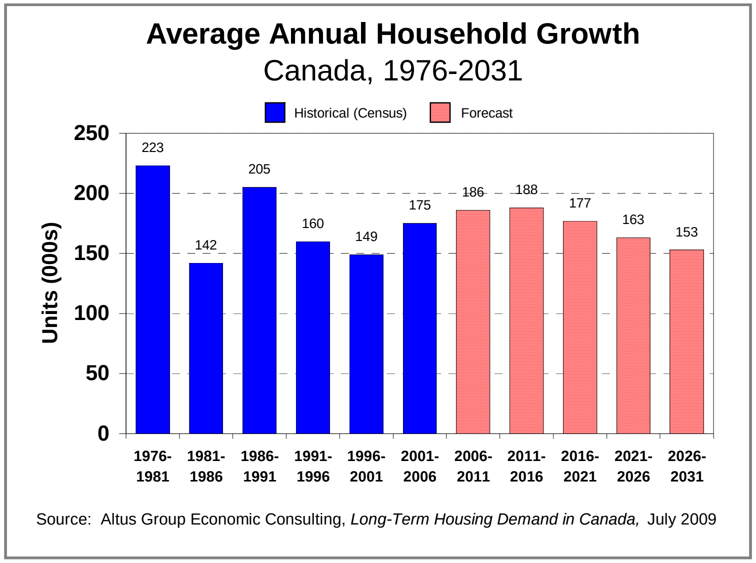
## *Population Growth Projected to Remain Strong for Next Two Decades – Shift in Growth to First-Time Buyer and Empty-Nester Age Groups in 2006-2016 Period*

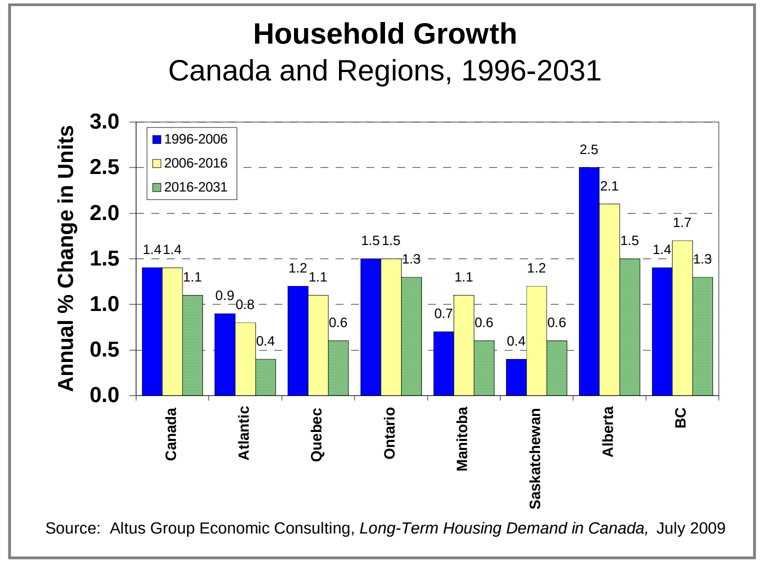



- The CHBA commissioned Altus Group Economic Consulting to prepare the report *Long-Term Housing Demand in Canada*. The report examines the drivers of housing demand, including economic and demographic factors, and provides projections of future housing demand for Canada and the provinces.
- This section presents highlights from that report.
- Population growth is projected to remain strong over the period to 2031. In general, the contribution to population growth from the natural component (the net of births and deaths) is expected to moderate, and be compensated by immigration.
- The age groups accounting for the fastest growth in the 2006-2016 period are the 50-74 years old age groups (empty-nesters and retirees) and the 20-34 age group (the baby boom 'echo' generation). Thus, all other things being equal, first-time buyers and move-down and/or lifestyle buyers will overshadow the traditional move-up market over the period to 2016.
- After 2016, those aged 65 years and above will account for a significant component of growth. Most Canadian households traditionally 'age in place' (i.e. they do not move house after retirement), but those who do move will present unique market opportunities for innovative home builders.

## *Household Growth Projected to Average 188,000 Annually in 2011-2016 – Alberta, B.C. and Ontario to Continue to Have Strongest Rates of Growth*



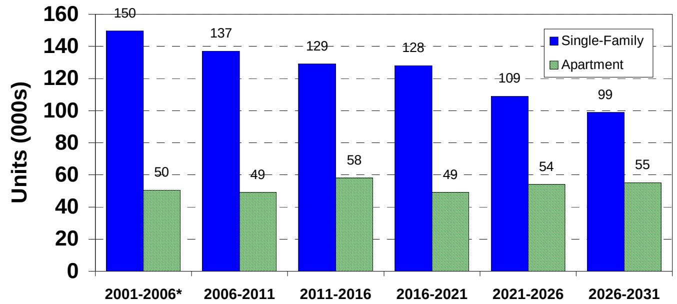




- The number of net new households advanced by 155,000 units annually through the 1990s, and accelerated modestly to 175,000 annually in the 2001-2006 period.
- The rate of household growth has increased in the past few years and is expected to average 186,000 for the 2006-2011 period as a whole.
- All other things being equal, growth is expected to remain strong (188,000 annually) during the 2011-2016 period.
- Household formation is projected to decelerate between 2016 and 2031.

- Regional patterns of household growth depend on a number of factors, including relative economic performance, relative demographic growth and the differing base demographic profiles.
- Generally speaking, growth in the current 2006-2016 period is projected to be similar to growth in the decade leading up to 2006.
- For Canada as a whole, household growth is expected to advance at about 1.4% annually through 2016. Alberta, B.C. and Ontario are projected to be the leading growth regions during this period.
- All regions are expected to see decelerating rates of household growth in the 2016-2031 period.

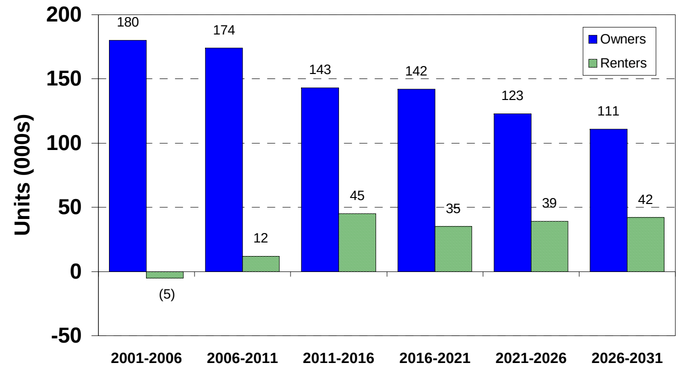
## *Single-Family Homes Projected to Continue to Account for Most Household Growth – But Rising Share for Apartments and Increased Demand from Renters*

**Average Annual Household Growth by Dwelling Type**
Single-Family and Apartment
Canada, 2001-2031




* Completions are used for 2001-2006 because of definitional issues in the dwelling type data in the Census, all other years are forecasts by Altus Group Economic Consulting
Source: CMHC and Altus Group Economic Consulting, *Long-Term Housing Demand in Canada,* July 2009

**Average Annual Household Growth by Tenure**
Owners and Renters
Canada, 2001-2031



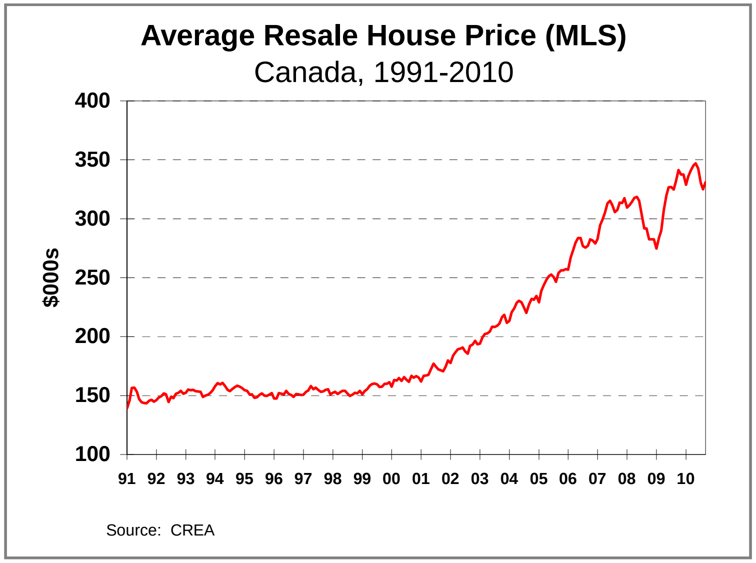

Source: Altus Group Economic Consulting, *Long-Term Housing Demand in Canada,* July 2009

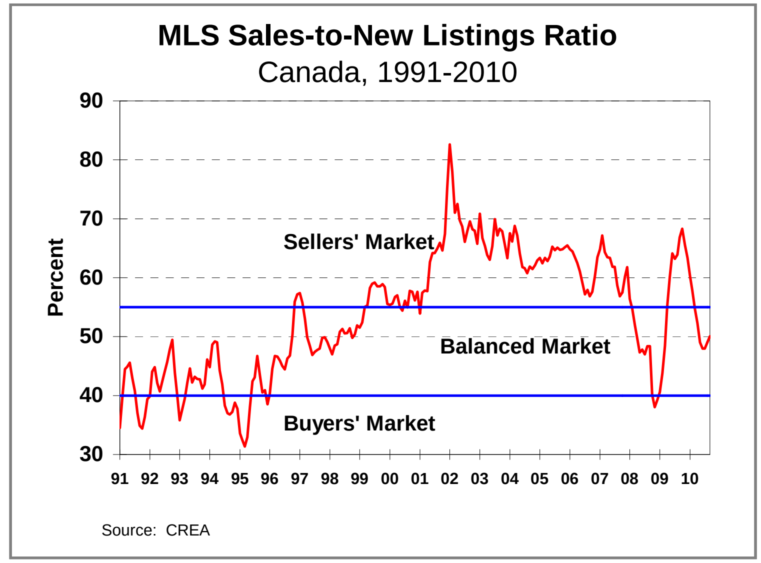
- Single-family homes account for most of the demand for new housing – now and into the future. However, as a share of total household growth, apartments (both condominiums and rental units) are projected to increase in importance.
- The increase in households occupying single-family homes is projected to average almost 130,000 annually during the 2011-2021 period, before declining to an average of roughly 105,000 annually over the following decade.
- Household growth among apartment dwellers is projected to increase from the current level of roughly 50,000 units annually to 58,000 in 2011-2016. Over the remainder of the projection period, apartments are projected to average over 50,000 units annually.

- During the 2001-2006 period, there was a decline in the number of renters. This was a period of very high demand for ownership housing as renters migrated to homeownership.
- Similar patterns applied during the early part of the current 2006-2011 period; however, in total, there is expected to be a small net increase in renter households.
- In the 2011-2021 decade, ownership household growth is expected to average over 140,000 annually. Renter household growth is expected to average 45,000 annually during 2011-2016, and 35,000 annually in the following five-year period.
- Ownership household growth is expected to ease somewhat in the next decade, while renter household growth will stabilize at roughly 40,000 households annually.

## 5. HOUSING PRICES

### *Recovery in Resale House Prices Following Last Year's Declines – Balanced Resale Markets in Most Major Centres*

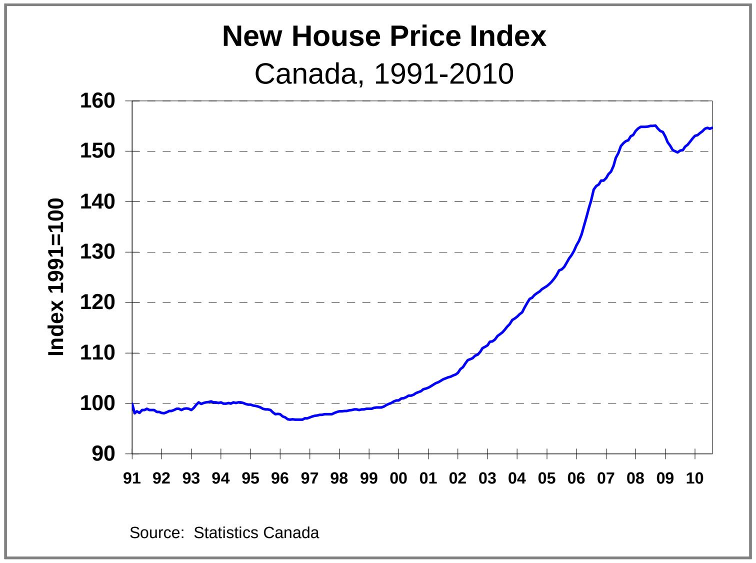


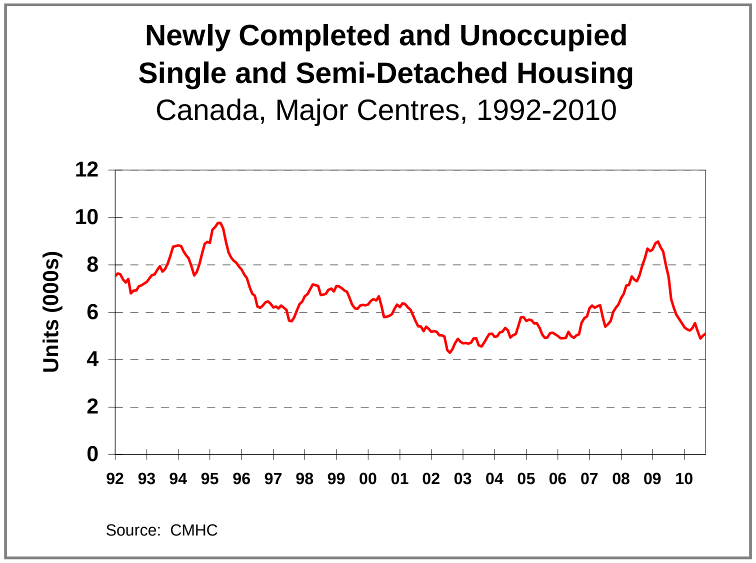




- Strong housing markets in the period up to 2008 led to significant increases in housing prices. Average MLS resale house prices across Canada increased by roughly 10% each year during the 2002-2007 period.
- However, with the economic downturn in 2008-2009, home sales declined – and resale house prices dropped sharply.
- This has been reversed by a dramatic upturn in resale housing activity in the past year – and a commensurate recovery in resale housing prices. In the second quarter of 2010, the average resale house price in Canada peaked at almost $345,000. Since then there has been a modest decline to an average of $331,000 in September 2010.
- CMHC forecasts that the average MLS price for the fourth quarter of 2010 will be roughly $337,000.

- Changes in housing prices tend to reflect changes in the balance of the market. When the sales-to-new listings ratio is above 55%, it is considered a sellers' market and prices tend to rise – as they did during the period from 2000 to 2008.
- When the sales-to-new listings ratio is in the balanced 40%-55% range, prices tend to be relatively stable – as occurred during most of the 1990s. During the recession, the sales-to-new listings ratio dropped dramatically – and this was reflected in a drop in the average MLS house price.
- At present, the resale housing market in Canada is balanced. This would suggest that changes in housing prices will be relatively modest on a national basis. However, housing prices in any particular market will depend on the supply and demand balance in that market.

## *New House Prices Have Leveled Off – Low Inventories of Unoccupied New Houses*

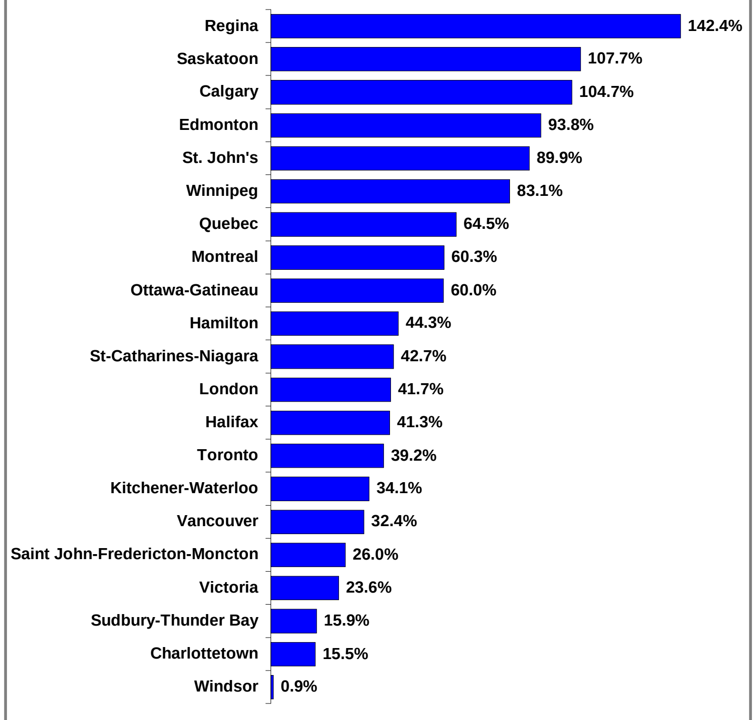



- Over the period to 2008, new house prices in most of Canada lagged somewhat behind the rise in prices in the resale market. However, new home prices increased significantly as well – particularly in 2006-2007.
- New house prices peaked in mid-2008 and declined in the early part of 2009. Since the spring of 2009, new house prices have increased modestly and are currently back to near their 2008 peak for Canada as a whole – though, as discussed later, trends in individual markets have varied.
- There are concerns that housing prices may soften (as they have in the U.S.) in response to lower levels of demand in coming months. However, Canadian housing markets are not subject to anything remotely close to the oversupply that continues to plague U.S. housing markets.
- In general, Canadian home builders do not build many homes 'on spec' – i.e. they typically sell homes prior to building them. Therefore, the numbers of new unoccupied single-family homes are usually relatively modest in most major centres.
- At present, the inventory of new single-family homes which are unoccupied is well down from 2008 and 2009 – and near the lowest level for the past two decades. There is no oversupply of new single-family homes which might threaten to erode price levels.

## No National Housing Market – Instead a Series of Local Markets Which Respond to Local Economic Conditions

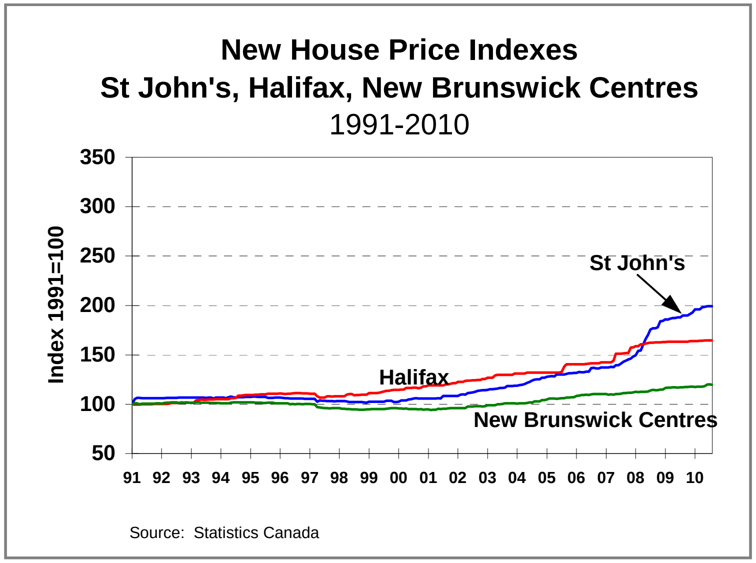
**Change in New House Price Index**
Major Canadian Centres, 2000-2010*

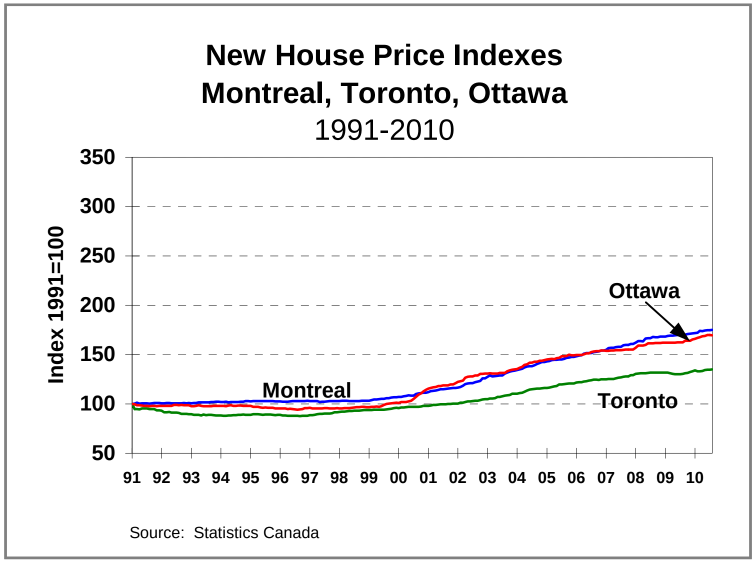



* August
Source: Based on Statistics Canada data

- National house price trends, as presented on the previous page, are an amalgam of trends in local housing markets – each of which responds to local economic and demographic factors.
- This is evident through an examination of house price trends in major Canadian centres in recent years – using data from Statistics Canada's New House Price Index, which measures price changes in a 'constant quality' new house over time. The analysis here covers the changes in the price of the full package of a new house plus land in each centre over the 2000 to August 2010 period.
- While overall national new house prices have risen by 52% over the period from 2000 to August 2010, changes in house prices in local markets varied from an increase of over 140% in Regina, to a negligible increase (0.9%) in Windsor.
- New house prices in other centres varied between these extremes: Saskatoon, Calgary, Edmonton, St. John's and Winnipeg all had increases in new house prices of over 80% during this period – though, as discussed later, except in Regina, prices in some of these formerly red-hot housing markets have moderated from last year's highs.
- Other markets with house price increases of 50% or more were: Quebec City, Montreal, and Ottawa-Gatineau.

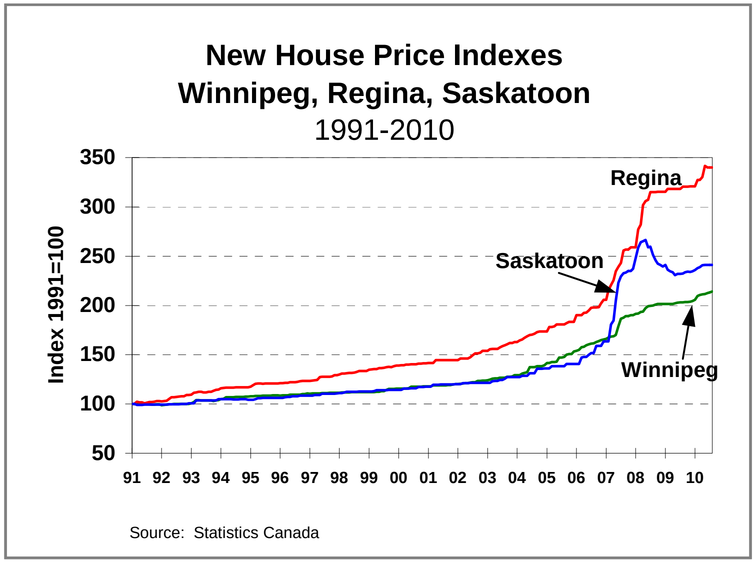
## *Strong Increase in House Prices in St. John's in Recent Years – Other Eastern Centres Show More Modest Rises in Prices*

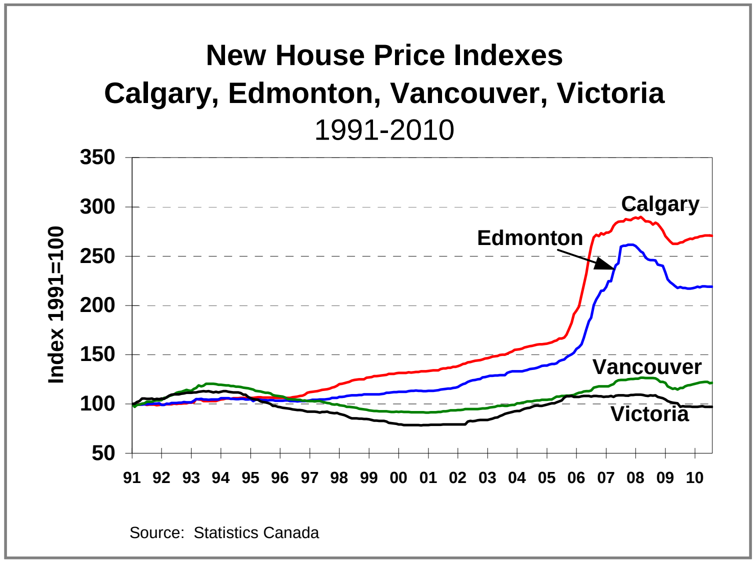



- The house price changes during a relatively short period (e.g. 2000-2010, as shown on the previous page) must be viewed within the context of trends over the longer-term.
- For example, Toronto has among the lowest rates of increase among major Canadian centres in the period since 1991. However, during the second half of the 1980s (not shown in the chart), Toronto had by far the strongest housing market in Canada – with prices rising by 80% in only three years. Subsequently, Toronto prices moderated and have not experienced increases as substantial as other major centres since 1991.
- Over the 1991-2010 period as a whole, St. John's (99%) has had the largest price increase among the eastern Canadian centres presented here, followed by Montreal (75%), Ottawa-Gatineau (70%), Halifax (65%) and Toronto (35%).
- New Brunswick centres (Saint John, Fredericton and Moncton) had relatively modest increases in housing prices over the period – 20% for the 1991-2010 period as a whole.
- As shown on the next page, house price increases in centres in Saskatchewan and Alberta have been much more substantial.

## *Easing Housing Prices in Most Western Centres – Continued Rising Prices in Regina and Winnipeg*

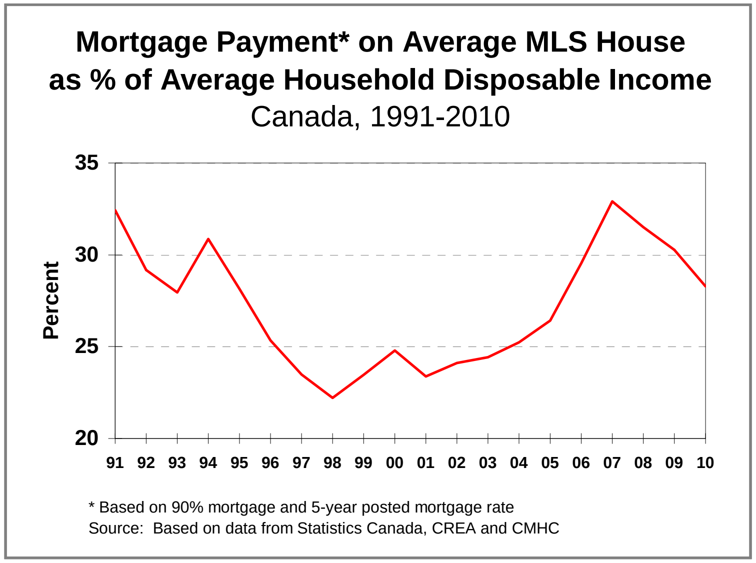


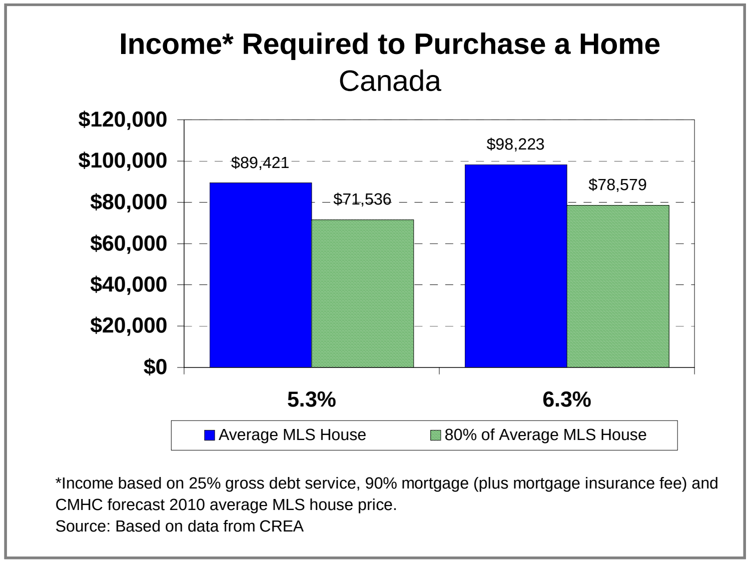




- Over the 2006-2008 period, the precipitous increases in new house prices in Regina, Saskatoon, Calgary and Edmonton outpaced all other major centres in Canada. Since then, prices have eased in three of the four centres; however, prices in Regina continue to surge.
- Compared to 1991, new house prices in Regina are up by 240%. In Saskatoon, new house prices have also increased significantly – up by 141% since 1991. Regina prices have resumed their rise after leveling off in early 2009. Saskatoon prices declined in late 2008 and early 2009 but have since increased somewhat – though not to their early 2008 peak.
- Winnipeg house prices are up by 114% since 1991. New house price levels in Winnipeg have not been as volatile as in many other western Canadian cities.
- After very significant increases in 2006 and 2007, new house prices in Calgary and Edmonton eased to lower levels in 2008 and 2009. Prices in both markets have been relatively steady for the past year.
- Compared to 1991, Calgary new house prices were up 171% in August 2010, while Edmonton prices were up 119%.
- In Vancouver, new house prices started to rise in 2002 after declining progressively since the peak reached in 1993. Prices have increased modestly in the past year. August 2010 prices are up 21% from 1991.
- Prices in Victoria have declined slightly in the past two years and are modestly below 1991 levels.

# 6. THE STATE OF HOMEOWNERSHIP AFFORDABILITY

## *Affordability Has Improved Significantly Due to Lower Interest Rates – Substantial Incomes Still Required to Buy a Home*

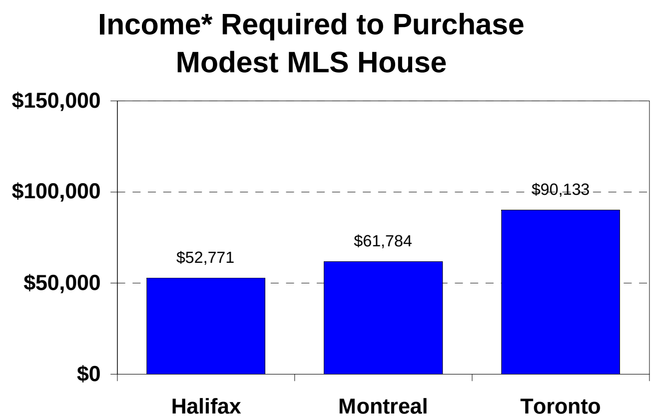


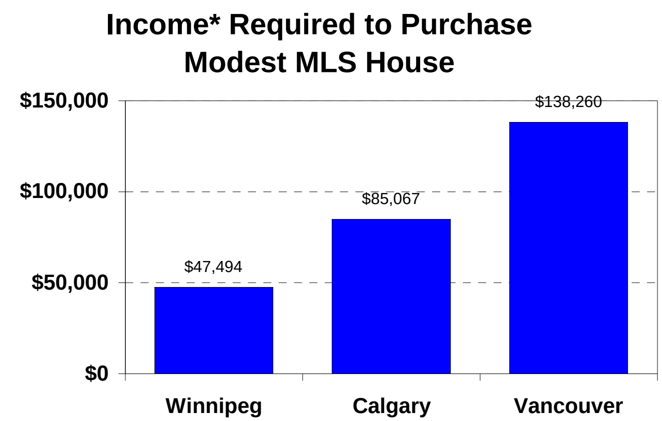

- Homeownership affordability has improved substantially due mainly to the current extremely low interest rates.
- Due to rising housing prices and higher interest rates, the share of average disposable income required to buy the average MLS home increased significantly in 2006 and 2007. However, due mainly to lower interest rates, there has been a substantial improvement in affordability since the 2007 peak.
- This type of analysis illustrates the impact of changing housing prices, incomes and interest rates on the 'average' household – including those who already own a home. As noted earlier, many young people are having difficulty finding a job. Even those who have jobs would typically have incomes lower than the average, so they would face a more difficult situation than that presented in the chart.

- First-time buyers need large incomes to buy a home – or help from others (e.g. parents) to provide a larger downpayment.
- CMHC requires that mortgage payments, plus property taxes and heating costs cannot exceed 32% of income. Since heating costs and property taxes vary, the minimum income required to buy an average home is defined here to be based on mortgage payments totaling a maximum 25% of income.
- A first-time buyer would need a minimum income of $89,400 to buy the average MLS house in Canada ($338,900 – CMHC forecast 2010) and $71,500 to buy at 80% of the MLS average – assuming an interest rate of 5.3%.
- If interest rates rise, the required income would also rise. At 6.3%, buyers would need almost $100,000 to buy the average MLS house and $78,600 to buy at 80% of the average price.

## *Higher Incomes Required to Purchase a Home in High-Cost Centres Such as Vancouver, Calgary and Toronto*




*Income based on 25% gross debt service on 90% mortgage (plus mortgage insurance fee), house price equal to 80% of forecast 2010 MLS price, and mortgage rate of 5.3% (October 2010 posted 5-year rate)
Source: Based on data from CMHC

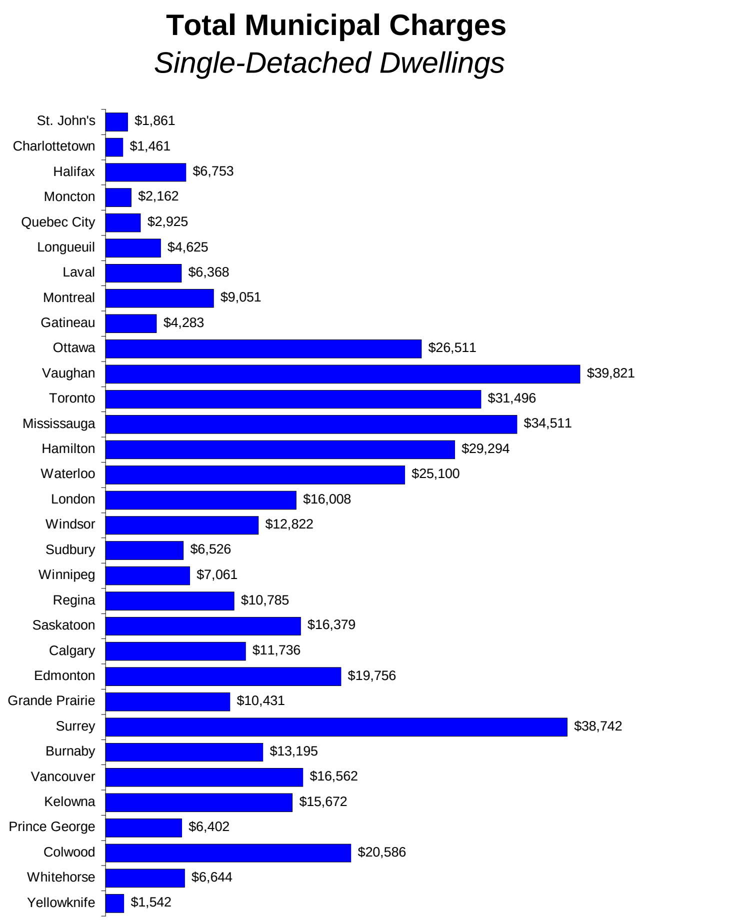



*Income based on 25% gross debt service on 90% mortgage (plus mortgage insurance fee), house price equal to 80% of forecast 2010 MLS price, and mortgage rate of 5.3% (October 2010 posted 5-year rate)
Source: Based on data from CMHC

- The income required to purchase a typical home varies significantly across the country.
- Based on the same assumptions as the analysis on the previous page (i.e. 90% loan, mortgage payments equal to 25% of income, the current posted mortgage rate of 5.3%, home price of 80% of average MLS price), a first-time buyer would require an income of $138,200 to purchase a home in Vancouver (80% of the forecast 2010 average MLS price is $524,000).
- Similarly, in Toronto and Calgary, also high-cost centres, a first-time buyer would require an income of roughly $90,100 (Toronto) and $85,100 (Calgary) – based on modest homes of $341,600 in Toronto and $322,400 in Calgary (80% of the forecast 2010 average MLS house price).
- In Montreal, an income of $61,800 is required to purchase a house priced at 80% of the MLS average ($234,200).
- In lower-cost centres, such as Winnipeg and Halifax, houses are much more affordable.
- In Winnipeg, an income of $47,500 is required to purchase a house priced at 80% of the Winnipeg MLS average ($180,000).
- In Halifax, an income of $52,800 is required to purchase a house priced at 80% of the MLS average ($200,000).
- As noted, these estimates are based on the current posted mortgage rate (5.3%). With special deals, 5-year mortgages are available at rates below 4%; however, due to new federal regulations, borrowers must qualify for the mortgage using the posted rate – not a discounted rate.

# 7. CHALLENGES FACING HOMEOWNERSHIP AFFORDABILITY

## *Heavy Municipal Levies, Fees and Charges on New Homes Reduce Housing Affordability – Charges Total Almost $40,000 in Some Municipalities*



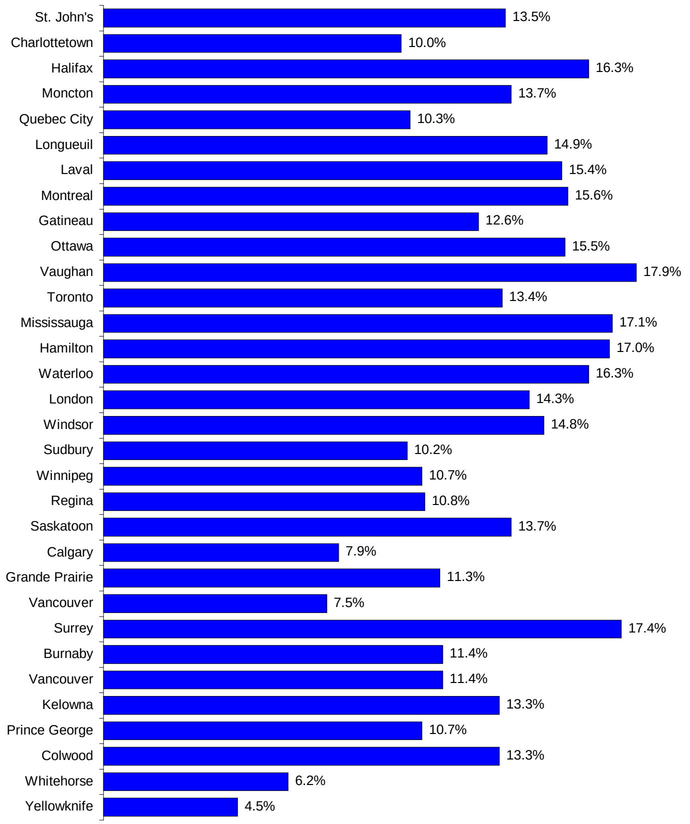
Source: *Government-Imposed Charges on New Housing in Canada*, CMHC, January 2009

- Municipalities impose a variety of charges on new homes. These include development cost charges (DCCs) and lot levies, other infrastructure-related charges, development application processing fees, building permit fees, etc.
- *Government-Imposed Charges on New Housing in Canada*, a study of 32 municipalities across Canada conducted for CMHC, documented the total municipal charges for typical modest dwellings in each municipality in 2006. According to the study, government-imposed charges on typical new houses range from almost $40,000 in some Ontario and B.C. municipalities, to less than $5,000 in other parts of the country.
- The most important factor influencing the differences in total charges among the municipalities is the amount of infrastructure charges – mainly DCCs. These sometimes include charges for 'soft services' such as education and recreational facilities.
- Some of the variations in infrastructure charges among municipalities reflect differences in the methods of providing infrastructure – some municipalities do not charge DCCs but instead require developers to cover the cost of installing infrastructure through special agreements. These costs are not documented in the CMHC study and are therefore in addition to the estimated charges shown in the chart.
- The CMHC study covering the year 2006 updated the results from similar studies in 1997 and 2002. The study confirmed that municipal charges on new housing continue to increase.

## *GST/HST, Provincial Taxes and Municipal Charges – Almost 18% of House Prices in Many Parts of Canada*

**Government-Imposed Charges as Percent of Price**

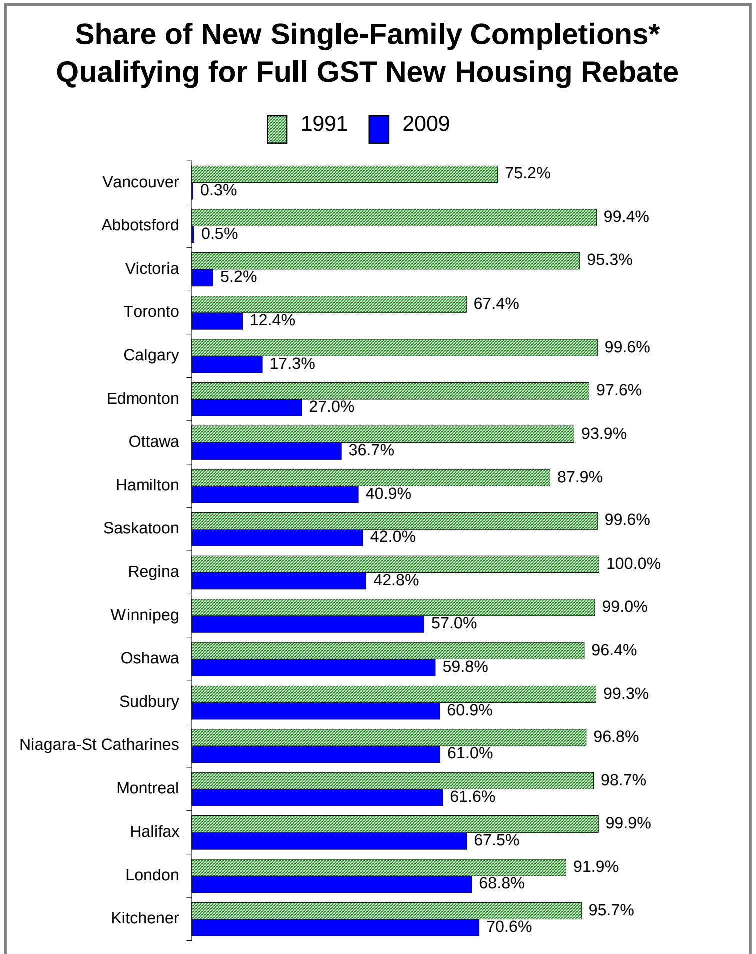
*Single-Detached Dwellings*




Source: *Government-Imposed Charges on New Housing in Canada*, CMHC, January 2009

- In addition to the charges imposed by municipalities, both the federal and provincial governments collect significant revenues from new housing through the GST, and provincial sales and land transfer taxes.
- Taxes such as the GST/HST and land transfer taxes are applied to the price of a home. Since municipal charges, such as DCCs, are built into the price of a new home, there is a significant element of pyramiding ('tax on tax') in the application of these taxes on new homes.
- Adding the federal and provincial taxes to municipal charges raises the burden on new homes to over $80,000 in several municipalities – and over $100,000 in Toronto.
- Municipal, provincial and federal government-imposed charges totaled over 10% of the price of a new house in most municipalities. In several cases, the charges accounted for 17% or more of the price of a new house.
- From similar studies undertaken in the past, it is evident that these government-imposed costs have risen significantly.
- The costs associated with levies, fees, charges and taxes are passed on to purchasers through higher housing prices.
- Not all government-imposed charges are rising. The reduction in the general rate of GST from 7% to 5% resulted in a reduction in the GST payable on new homes eligible for the GST New Housing Rebate from 4.48% to 3.2% (the rebate reduces the GST payable on eligible new homes by 36% of the GST).
- However, only homes priced less than $350,000 are eligible for the full GST rebate and, since the price thresholds for eligibility for the GST rebate have been frozen since 1991, increasing numbers of home buyers are not eligible for the full rebate due to rising housing prices.

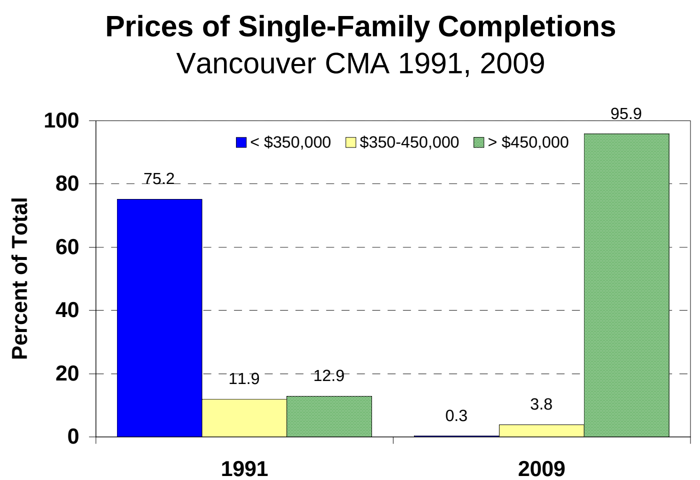
## *Increases in Housing Prices Have Pushed Many New Homes Above the GST Rebate Thresholds – Particularly in High-Cost Centres*



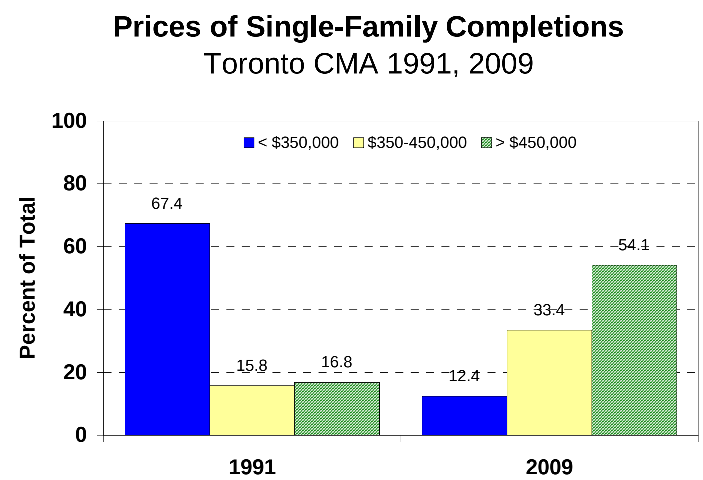

* Newly completed dwellings priced less than $350,000
Source: Based on data from CMHC

- The New Housing Rebate of GST is 36% of the GST payable on new homes priced up to $350,000 – i.e. the effective rate of GST on these homes is 3.2%.
- There is a phase-out of the rebate for homes priced between $350,000 and $450,000. For new homes priced above $450,000, there is no rebate – the full 5% GST applies to the price of a new home.
- These price thresholds have been frozen since the GST was introduced in 1991, despite a federal commitment to "review these thresholds at least every two years and adjust them as necessary to ensure that they adequately reflect changes in economic conditions and housing markets".
- Freezing the GST rebate thresholds has eroded housing affordability across Canada, with homebuyers in high-cost centres particularly disadvantaged.
- In Vancouver and Abbotsford, for example, less than 1% of the purchasers of new single-family homes completed in 2009 qualified for the full GST rebate.
- In contrast, in 1991, 99% (Abbotsford) and 75% (Vancouver) of the purchasers of new homes qualified for the full rebate.
- Similarly, in Toronto for example, only about 12% of the purchasers of new houses completed in 2009 qualified for the full GST rebate. In 1991, two-thirds of the purchasers of new houses in Toronto qualified for the full rebate.
- The negative impacts of freezing the GST rebate thresholds on housing affordability extend to centres all across Canada.
- The data presented here relate to the Census Metropolitan Areas (CMAs) of each of the cities – i.e. in Vancouver, the data do not relate only to the (very high cost) City of Vancouver, but also include suburban municipalities such as Surrey, Burnaby and Richmond.

## *Zero GST New Housing Rebate for 96% of New House Purchasers in Vancouver – Almost 55% of New House Purchasers in Toronto Receive No GST Rebate*




Source: Based on data from CMHC




Source: Based on data from CMHC

- In the Vancouver CMA in 2009, 95.9% of the purchasers of new single-family homes received ***zero*** rebate of the GST on their homes – i.e. their homes were priced at more than $450,000. A small number of purchasers (3.8%) received a partial rebate (homes priced at $350,000-$450,000).
- Less than 1% (0.3%) of the purchasers of single-family homes completed in Vancouver in 2009 received the full GST New Housing Rebate.
- This contrasts with the situation in 1991, when over 75% of new houses completed in the Vancouver CMA qualified for the full GST New Housing Rebate – i.e. their homes were priced at less than $350,000.

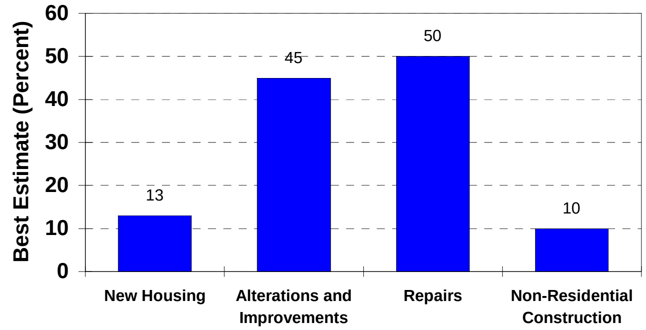
- In the Toronto CMA, over half (54.1%) of the purchasers of new houses completed in 2009 received ***zero*** rebate – up from 16.8% in 1991. Only 12.4% received the full GST rebate.
- In 1991, in contrast, two-thirds (67.4%) of the purchasers of new houses received the full GST rebate.
- The Toronto CMA includes not only the City of Toronto, but also suburban municipalities such as Mississauga, Vaughan and Brampton.
- The purpose of the federal government's commitment to adjust the GST thresholds was to protect housing affordability over time. With almost all new houses in some major centres now ineligible for the GST rebate, it is essential to act on this commitment on an urgent basis.

## *Tax Pyramiding – A Major Challenge for the Housing Industry – Worsened by Harmonization of Provincial Sales Taxes with the GST*

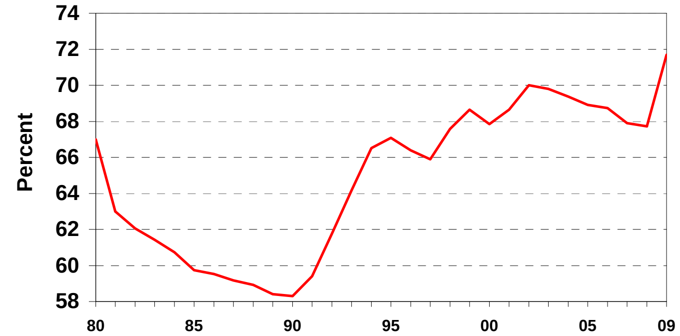
- The harmonization of provincial sales taxes with the GST significantly increased the problem of tax pyramiding ('tax on tax') for housing in Atlantic Canada and Quebec. This year, with harmonization in both Ontario and B.C., the problem has worsened since these provinces have among the highest levels of government-imposed charges in Canada.
- The GST/HST applies to the final sale price of a new home – a price which, as discussed, includes a variety of government-imposed costs such as DCCs, building permit fees, land dedications, etc.
- Therefore, for example, in Mississauga, a municipality with one of the highest levels of government-imposed charges in Canada, the HST applies not only to the construction and land costs, but also to the DCCs (estimated at $25,310 for the sample house used in the CMHC research study highlighted earlier) and other charges on the house.
- The CHBA commissioned a report from the Altus Group, *Tax Pyramiding in Canada: A Growing Concern* (July 2009), to examine the issue of tax pyramiding in Canada.
- The report concluded that government-imposed charges embedded into the prices of new homes are a form of 'tax on tax' that is of growing concern. Over the past decade, the amount of government-imposed charges on new housing has been rising sharply, making the 'tax on tax' issue more acute.
- The report found that 'tax on tax' schemes score poorly in terms of principles of good taxation, including equity and fairness, simplicity, accountability, certainty, stability, transparency, visibility, and neutrality.
- When municipalities impose DCCs on new homebuyers, they effectively transfer public sector debt into household mortgages, which itself is a cause for real concern from a public policy perspective. Also, the 'tax on tax' nature of this system means that municipalities are not accountable for the full impact on homebuyers of their tax policy decisions.

## 8. CHALLENGES FACING THE RENOVATION SECTOR

### *Underground Activity – A Serious Problem for the Residential Renovation Sector – Strong Link Between GST and Growth in Underground Practices*




Source: Ontario Construction Secretariat, *Underground Economy in Construction - It Costs Us All,* 2008

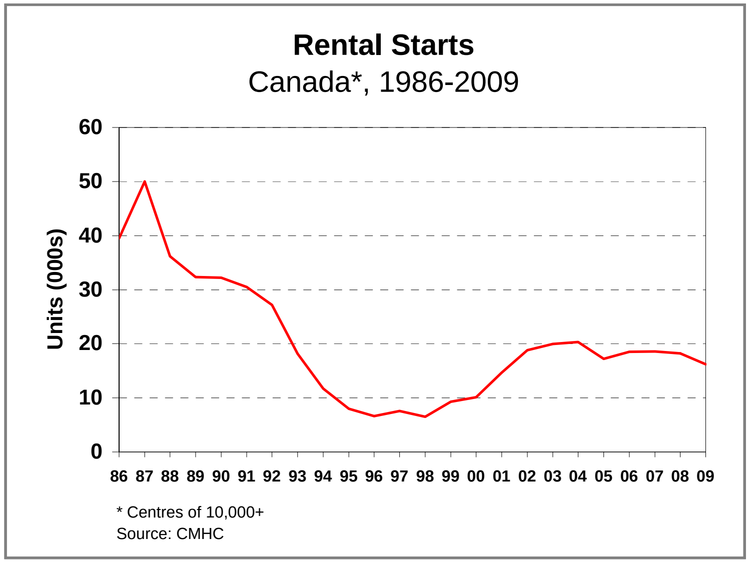


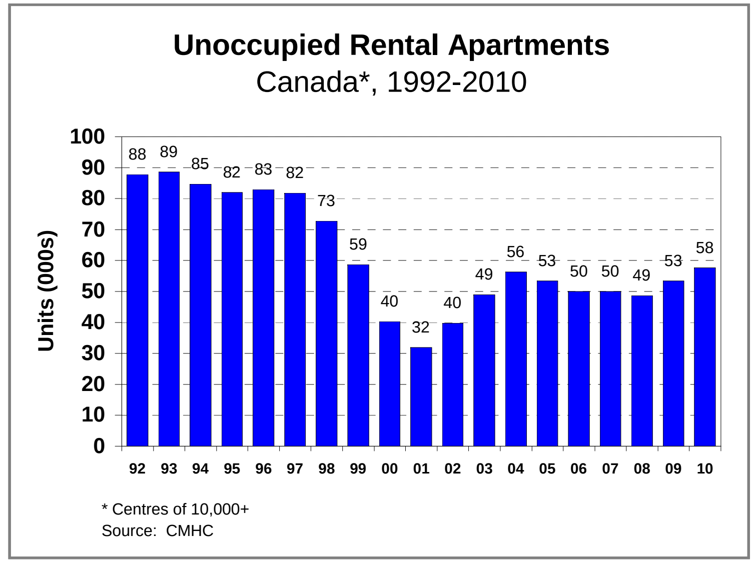

* Average monthly currency (seasonally adjusted) held outside chartered banks as a percent of average monthly personal expenditure, in current dollars, on goods and services
Source: Based on Statistics Canada data

- Reliable estimates of the size of the underground economy in construction are elusive. However, a report prepared for the Ontario Construction Secretariat (OCS) in 2008 provides estimates which indicate that the incidence of underground employment is greatest in the residential renovation sector.
- The OCS report estimated that 45% of major renovations (alterations and improvements), and 50% of repairs were undertaken by underground operators. Underground practices are less common in other types of work.
- The high volume of underground renovation work is a serious problem for the housing industry. Legitimate tax-paying renovators have a severe competitive disadvantage compared to underground workers who will work for ‘cash-deals’ on which no taxes or other charges are paid.
- The OCS study draws a strong link between the growth in underground construction practices and the introduction of the GST in 1991.
- Cash is the currency of the underground economy. There was an upsurge in the use of cash starting in 1991 – the year the GST was introduced.
- Prior to 1991, because of increased use of credit cards, etc., there was a progressive decline in the use of cash in the economy.
- This provides strong evidence of a link between the GST and underground activity – especially for residential renovations.
- With the harmonization of provincial sales taxes with the GST in Ontario and B.C., the growth of the underground economy in renovations is likely to intensify.

# 9. CHALLENGES FACING THE RENTAL SECTOR

## *Low Volume of New Rental Construction Due to Poor Investment Economics – Rise in Unoccupied Units Only Temporary*

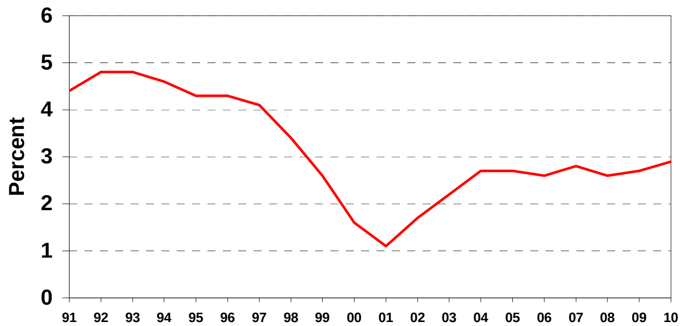



- While above the very low levels of the second half of the 1990s, purpose-built rental housing starts remain well below historical levels – and housing requirements.
- In part, the low volume of rental construction is due to the termination of social housing supply programs. However, changes in the income tax treatment of rental housing, unfair treatment of rental housing by the GST/HST, and higher municipal charges (particularly DCCs) have led to a decline in the economic viability of new rental investment.
- The reduction in the GST from 7% to 5%, together with the continuation of the rebate, has somewhat improved the economics of rental investment but more needs to be done to encourage the construction of new private purpose-built rental housing.
- With the low volume of rental construction, the number of unoccupied rental units dropped substantially in the period from 1997 to 2001.
- There was an increase in unoccupied rental units over the 2002-2004 period, due mainly to an increase in the migration of renters into the very strong homeownership market during this period. Recently, unoccupied rental apartments have increased due in part to a greater number of rental condominiums.
- Renter household growth is projected to average 45,000 annually over the 2011-2016 period. In the absence of additional new rental supply, the number of unoccupied rental units will drop further from current levels. This will be bad news for renters.

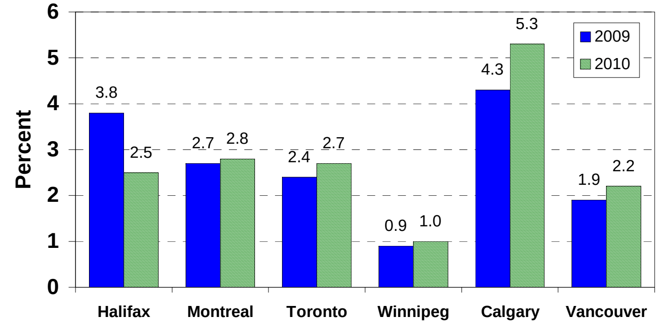
## *Stable Rental Vacancy Rates for Past Few Years*
## *– Few Major Centres Have Very Tight Rental Markets*

**Rental Apartment Vacancy Rate***
Major Canadian Centres, 1991-2010




* Weighted average of metropolitan area privately initiated rental apartments (excluding newly completed units) in April 2007 to 2010, October for other years
Source: CMHC

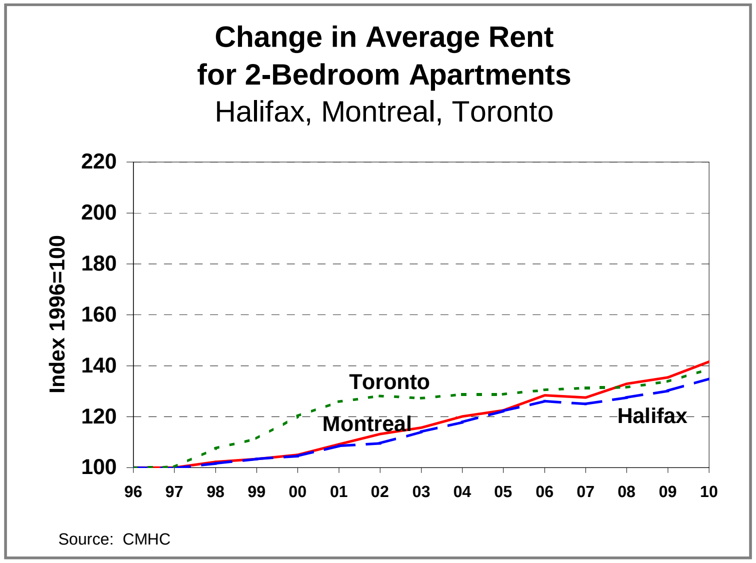
**Rental Apartment Vacancy Rates***
Selected Major Centres, 2009 and 2010**

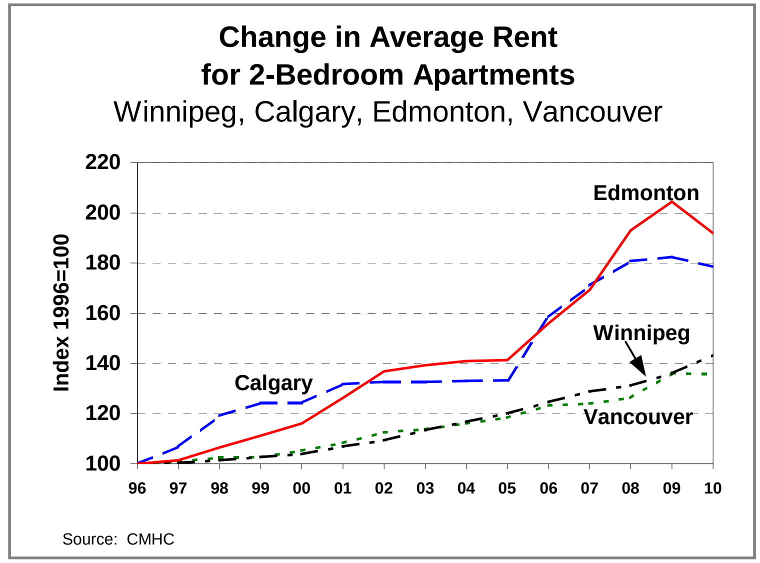



* Privately initiated rental apartments in structures of three or more units (excluding newly completed units)
** April of each year
Source: CMHC

- The national rental apartment vacancy rate is within the 2-3% range indicative of a 'balanced' rental market.
- The average vacancy rate for rental apartments in major centres in April 2010 was 2.9%, according to CMHC.
- This is modestly above the national vacancy rates of the past several years and is the highest rate since the late 1990s. Vacancy rates are well above the low of 1.1% in 2001.
- Since the volumes of new rental construction are well below the levels of demand for rental housing, vacancy rates are expected to decline over the next few years.
- Seventeen of Canada's 35 major centres have vacancy rates of more than 3%; 13 have vacancy rates in the 'balanced' 2-3% range; 3 have vacancy rates of 1-2%; and, 2 (Regina and Quebec City) have *very* tight rental markets (vacancy rate of <1%).
- Among major regional centres, all except Halifax (2.5%) have higher vacancy rates in 2010 compared to 2009. Vacancy rates in Calgary (5.3%) have increased significantly since last year.
- While welcome for tenants, the predominance of oversupplied and/or balanced rental markets in most parts of Canada is only temporary. The combination of high demand for rental housing and low volumes of rental construction will lead to reductions in vacancy rates in future years.

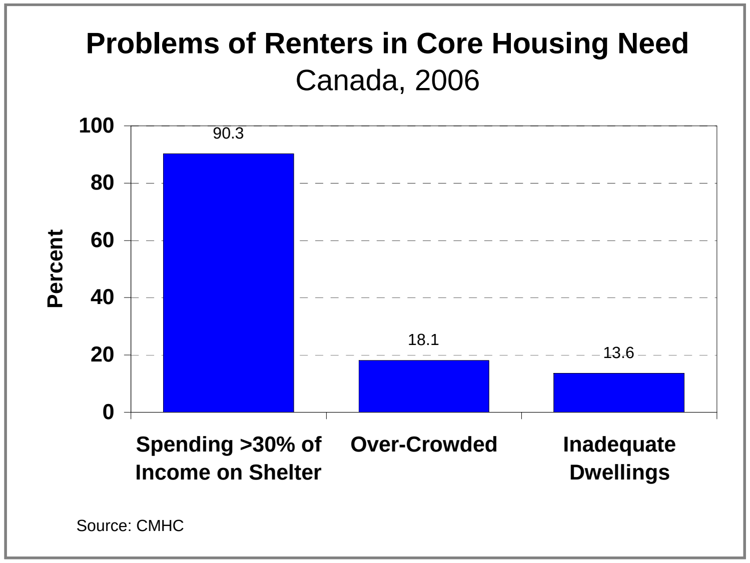
## *Increased Vacancies Dampen Rent Increases*
## *– Rent Rises in Calgary and Edmonton Have Been Softened by Higher Vacancies*

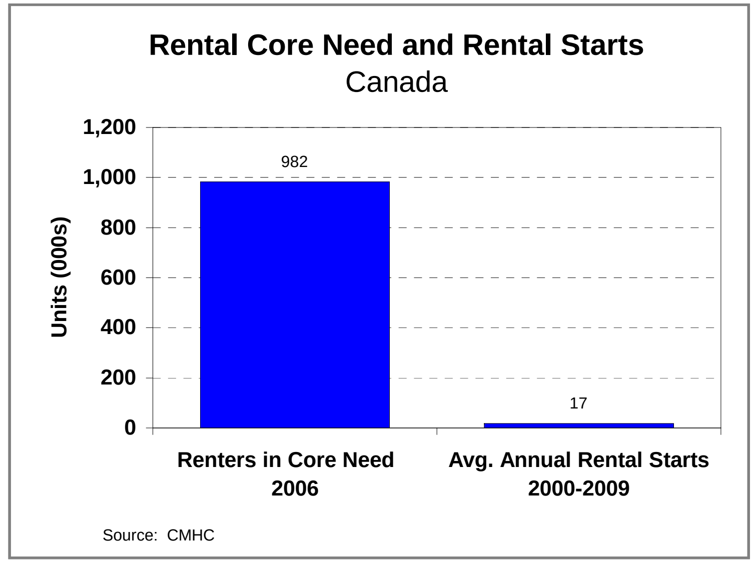



- Vacancy rates are an indicator of the supply/demand balance in the rental market. When vacancy rates drop, demand is outpacing supply and rents tend to rise.
- The opposite occurs when vacancy rates increase – higher numbers of vacant units mean that landlords need to moderate their expectations regarding rent levels in order to attract tenants.
- This is evident from a review of trends in average rents in selected major markets in Canada.
- In Toronto, rents rose rapidly during the 1997-2001 period due to very tight rental markets (vacancy rates of less than 1%) and relaxation of the very strict rent control regime in Ontario. However, in the past few years, due to increased vacancy rates, rent increases have been more moderate.
- The situation in Calgary and Edmonton was similar – rapid rent increases in the late 1990s, followed by a tapering off due to increased vacancies – at least until 2005 (as shown in the chart).
- In 2006, the market tightened significantly (and rents in both centres increased substantially).
- Due to significant increases in vacancy rates in both centres in the past two years, rents have declined in both Calgary and Edmonton.
- Rent increases in Montreal, Halifax, Winnipeg and Vancouver have been relatively more modest – a reflection of more balanced markets.

## *Affordability the Predominant Problem Among Renters – Almost 1 Million Renters in Core Need*




- CMHC's 'core need' estimates are recognized as the most comprehensive source of information on 'housing need'.
- Renters are considered to be in 'core need' if they must pay more than 30% of income to obtain suitable housing – or if they live in overcrowded housing or housing in need of major repair, and have insufficient income to remedy their situation.
- The overwhelming problem faced by those in need (90.3%) is *low income* – they are paying more than 30% of their income to obtain accommodation which meets their needs.
- The incidence of overcrowding and inadequate dwellings is much lower. Also, many core need tenants who live in such conditions have incomes which are too low to obtain suitable housing without spending more than 30% of income on rent.

- Almost 1 million Canadian renters were in core need in 2006.
- The vast majority of renters in core need live in private rental housing. As indicated in the chart at left, low incomes are the main problem faced by these tenants – in most cases, their housing is suitable, but they cannot afford the rent. *They do not need new units; they need help paying the rent.*
- Potential programs to assist those in need should recognize the reality that new subsidized housing projects assist only a *very small fraction* of the outstanding need annually. Even if all new rental starts were for subsidized housing, that would assist less than 2% of the outstanding need annually.
- Programs which provide assistance to tenants in the existing stock (e.g. portable housing allowances) would be much more effective in addressing the problems of core need renters.