

***Canadian Housing Industry
– Performance and Trends***

CANADIAN HOME BUILDERS' ASSOCIATION

OCTOBER, 2011

CANADIAN HOUSING INDUSTRY – PERFORMANCE AND TRENDS

The Canadian Home Builders' Association is the voice of Canada's residential construction industry, representing more than 8,000 member firms across the country.

The CHBA's membership includes new home builders, renovators, developers, suppliers, trades, manufacturers, lenders and other professionals in the housing sector. 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. Starts remain well below the unsustainably high average of over 220,000 units annually during the 2002-2008 period.

Housing starts in 2011 are forecast by Canada Mortgage and Housing Corporation (CMHC) to total 183,200 units, a modest decline from the 189,900 starts recorded in 2010. Housing activity has been buoyed by the historically low mortgage interest rates which have masked the effects of increasing housing costs on homeownership affordability.

In 2012, CMHC forecasts that starts will be between 161,700 and 207,200 units – with a point forecast of 183,900. The wide range of housing starts forecasts reflects the high degree of economic uncertainty in Canada at the present time.

Many major markets, such as Toronto and Vancouver, are benefiting from buoyant housing demand – in part, spurred by foreign investment in housing. However, as is always the case, housing activity is unevenly spread from market to market – some are experiencing low levels of demand for new housing, while others have abnormally high levels of demand.

While the current volume of new housing activity overall is below the average annual housing starts during the 2002-2008 period, this is still 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

Residential construction is comprised of spending on both new housing and residential renovations. Over the past four decades, real spending on residential construction has more than doubled.

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.

There was a recovery in expenditures on both new residential construction and renovations in 2010. In 2011, expenditures are forecast to ease somewhat to \$103 billion due to lower expenditures on new housing.

Expenditures on residential construction are a significant contributor to the Canadian economy – accounting for over 6% of Canada’s GDP.

Spending on residential renovations tends to be more stable from year to year than spending on new residential construction, which fluctuates with changes in housing starts. 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 the fourth quarter of 2008 and the first half of 2009 helped to put the Canadian economy in recession.

The increase in residential construction spending was a major factor behind Canada’s strong economic performance in the second half of 2009 and the first half of 2010. Now, with the leveling off of new housing activity, the spur to overall economic growth provided by the housing sector is waning.

Residential construction spending comprises only part of the overall impact of housing on the economy. According to estimates from CMHC, housing-related spending accounts for over one-fifth of total GDP. 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.” (CMHC, *Canadian Housing Observer*, 2010, page 17)

3. Drivers of Housing Activity

Continued employment growth, record low interest rates and high levels of immigration have been the key drivers behind the recovery in housing activity from the very low level of 2009.

While employment and GDP have more than 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 employment growth over the next few years; however, the outlook is far from certain. In particular, the weak U.S. economy and the European debt crisis threaten continued economic growth in this country.

While overall employment has recovered to well above 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.

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.

Record low interest rates have been a key factor behind the continued strength in housing activity. Many of the potential buyers who have been able to purchase a home at today's interest rates may not have been able to purchase a home at more normal interest rates, though research indicates that most borrowers have been prudent in their choice of 5-year mortgages and would be able to weather an increase in interest rates upon mortgage renewal.

While these extremely low interest rates will not last indefinitely, it is unlikely that they will increase significantly until the economic recovery is more firmly underway.

4. Household Debt

Low interest rates, and high levels of home purchases, have contributed to an increase in the debts of Canadian households.

Most economic forecasters, and others, including the Minister of Finance, the Governor of the Bank of Canada, and the International Monetary Fund, 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 150% of personal disposable income. In addition to mortgage debt, which is used to purchase a tangible asset (a home), these debts include credit card debt and personal loans – which are typically unsecured, and would therefore be more worrisome for lenders if these borrowers run into financial difficulties.

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 manageable, 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).

In response to concerns about the increasing debt levels of Canadians, the federal government has introduced a variety of measures (over the period from late 2008 to April 2011):

- Reducing the maximum amortization period for government-backed insured mortgages from 40 years to 35 years (in 2008) and later to 30 years (in 2011);
- Requiring a minimum downpayment of 5% for government-backed insured mortgages;
- Establishing a consistent minimum credit score requirement for government-backed insured mortgages;
- Requiring the lender to make a reasonable effort to verify that the borrower can afford the loan payment;
- Introducing new loan documentation standards to ensure that there is evidence of reasonableness of property value and the borrower's sources and level of income;

- Requiring that borrowers meet the standards for a 5-year fixed rate mortgage even if they choose a mortgage with a lower interest rate and shorter term;
- Lowering the maximum amount Canadians can withdraw in refinancing their mortgages from 95% to 90% of the value of their homes (2008), and later to 85% (2011);
- Requiring a minimum downpayment of 20% on non-owner-occupied properties purchased for speculation; and,
- Withdrawing government insurance backing on lines of credit secured by homes, such as home equity lines of credit.

In part no doubt due to these measures, the growth in household debt appears to be waning. Growth in consumer debt, in particular, has declined markedly, and it appears likely that the demand for mortgage financing will diminish as a result of more moderate existing housing sales.

The Bank of Canada Financial System Review (June) noted that “the growth of household credit will likely moderate from the pace observed in early 2011 to a rate closer to that of disposable income”.

Also, CMHC recently announced that mortgage refinancing activity declined by nearly 40% since the introduction of the latest mortgage insurance regulations by the federal government.

Even so, it appears that most mortgage borrowers are not at risk. Most borrowers are choosing 5-year terms and are unlikely to face difficulties, even if, as seems likely, interest rates increase upon renewal.

Also, while household debts have increased compared to disposable income, debt servicing costs have eased. Debt

service ratios for mortgages have been roughly 4% of disposable income for most of the past decade – down from over 6% in the early part of the 1990s. For consumer debt (e.g. credit cards and personal loans), on the other hand, debt service ratios have increased, on average, over the past decade.

At present, the proportion of mortgages in arrears is 0.4%. While this is modestly above the levels of earlier this decade, it is well below the levels of the 1990s. In terms of mortgage defaults, the greatest fear is job losses. There is a significant correlation between mortgage arrears and employment – or, more particularly, unemployment.

The CHBA asked the Altus Group to examine the question of whether further measures are needed to cool the Canadian housing market. The conclusion reached by the Altus Group was:

“Macroprudential policies [the use of regulation and rules] are being increasingly relied on as tools to control asset prices and financial system stability. Canada has introduced several measures in recent years to control housing and debt market conditions, over and above traditional fiscal and monetary policy tools. Concerns over household debt conditions in Canada, alongside seemingly strong housing prices, have had some suggest that more such measures could be ahead.

“Recent housing market performance alongside recent data on the performance of household balance sheets suggest that policies already introduced are probably already having the effect of cooling the market, and further measures are unnecessary. Moreover, with housing prices already flat or falling in Canada, and consumer deleveraging emerging, there is a risk that further measures undertaken by

government to cool the housing market could have longer-term pernicious effects.”

5. 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 the Altus Group 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.

6. Housing Prices

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

Recently, housing prices have stabilized and the resale housing market in most major centres 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 recovered strongly and have reached new highs in most major markets.

Some have expressed concerns that housing prices may soften substantially (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.**

Canada did not engage in the degree of sub-prime lending that occurred in the U.S. Also, in contrast to the U.S., where mortgage interest deductibility encourages homeowners to retain mortgages, in Canada, most homeowners seek to pay off their mortgages.

In addition, in Canada, mortgages in arrears, and inventories of foreclosed or otherwise unsold homes are at normal levels – a very different situation than has occurred in the U.S.

7. The State of Homeownership Affordability

Homeownership affordability has deteriorated significantly in the past two years. While somewhat better than the extreme 2006-2008 period, affordability today is worse than at any time since the early 1990s – despite historically low interest rates.

The deterioration in affordability is due to the significant increases in housing prices over the past several years – price rises driven, in part, by inexorably rising government-imposed costs and more burdensome regulation.

This deterioration, at a time when mortgage interest rates are being held at extremely low levels because of concerns about

economic growth, calls for clarification of the concept of ‘homeownership affordability’.

There used to be a clear understanding of the differences between ‘homeownership affordability’ and ‘homeownership accessibility’:

- **Homeownership affordability** is determined by housing prices in relation to income levels;
- **Homeownership accessibility** refers to the availability of financing and related mechanisms, and is determined by interest rates, downpayment requirements, gross-debt-service ratios, and other borrowing conditions.

Given the current record low interest rates, access to homeownership is extremely positive. However, overall affordability levels, as measured by the share of income required to purchase an average home, are markedly worse than in the decade prior to 2005.

Rising housing prices, based on ever more costly and complex government regulation, and ever increasing government levies, fees, charges and taxes, have caused an extremely serious deterioration in homeownership affordability.

In recent years, this deterioration has been masked by the record low interest rates – which have improved *access* to homeownership. However, in the future, as interest rates inevitably rise to more normal levels, the deterioration in affordability will become more evident – and will be reflected in a marked reduction in housing activity levels as would-be purchasers are priced out of the market.

8. Challenges Facing Homeownership Affordability

Government-Mandated Costs

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.

GST New Housing Rebate Thresholds

The fact that the GST rebate phase-out thresholds have been frozen for the past two decades 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 more than 50%. Had the GST New Housing Rebate thresholds been adjusted to take account of this increase in new house prices, the thresholds would now be roughly \$550,000-\$705,000. Freezing the thresholds has meant that an increasing number of households no longer receive a full or even a partial rebate.

When the GST rebate thresholds were introduced, the federal government estimated that roughly 95% of new home buyers would be eligible for the rebate – it was intended that the rebate would apply to all homebuyers except the “very wealthy”. However, with rising prices, many new home buyers (a majority in many urban centres) do not qualify for the rebate. In short, new home buyers are paying more GST than would be the case had the rebate thresholds been adjusted to reflect rising housing prices. This has had a negative effect on housing affordability.

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 20 years, the CHBA is recommending that the federal government adopt the rebate model for new housing that is being applied for the new HST in Ontario. 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 tax in Ontario, and a rebate threshold of \$400,000, the federal government would have received roughly \$380 million less in GST revenues in 2011.

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

9. 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 fuels 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% Federal Sales Tax (FST) applied only to the materials portion of home renovation expenditures. Also, the FST was applied to the price of products at the factory-gate, rather than on the full retail price. Since materials account for only a portion of the full cost of a renovation (labour and profits were not taxed under the FST), it is estimated that the FST represented only 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 very much greater.

To restore fairness to how home renovations are taxed by the federal government, and to provide an incentive for homeowners to hire legitimate tax-paying contractors rather than underground operators, the federal government should introduce a permanent Home Renovation Tax Rebate equal to 2.5% of the total cost of a home renovation.

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.

For Canada as a whole, Statistics Canada estimates that underground activities in construction (excluding repairs) total up to \$10 billion annually.

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.

In addition, 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. Such a requirement would make it more difficult for underground operators to hide their activities from the CRA.

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

10. 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 *extremely* 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, and more centres are experiencing tighter rental markets than in recent years.

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.

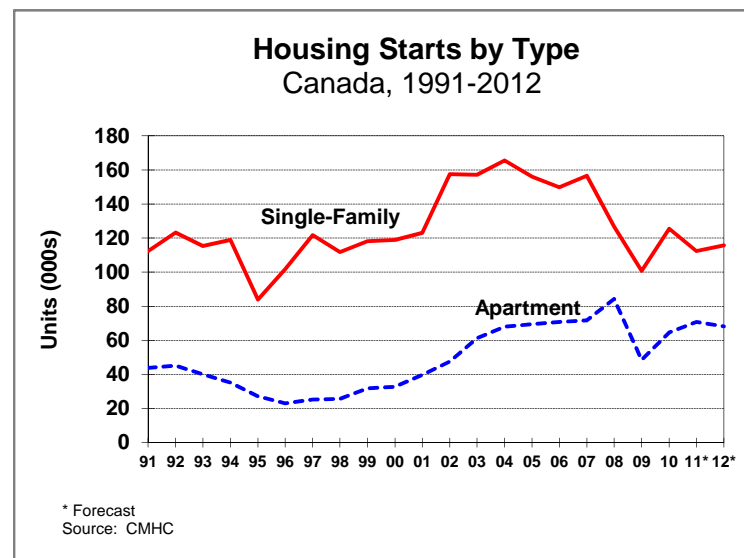
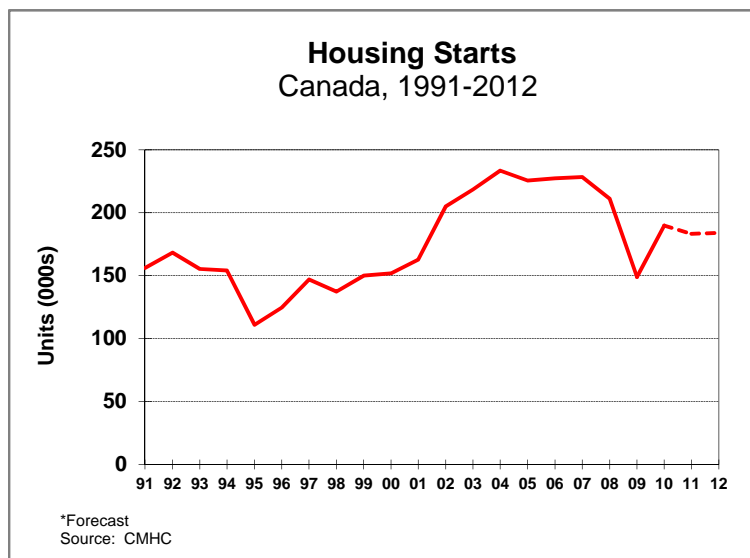
The CHBA calls for reforms to the federal tax treatment of purpose-built rental housing, including consideration of:

- ***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 but cannot charge GST/HST on their products or services.***

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

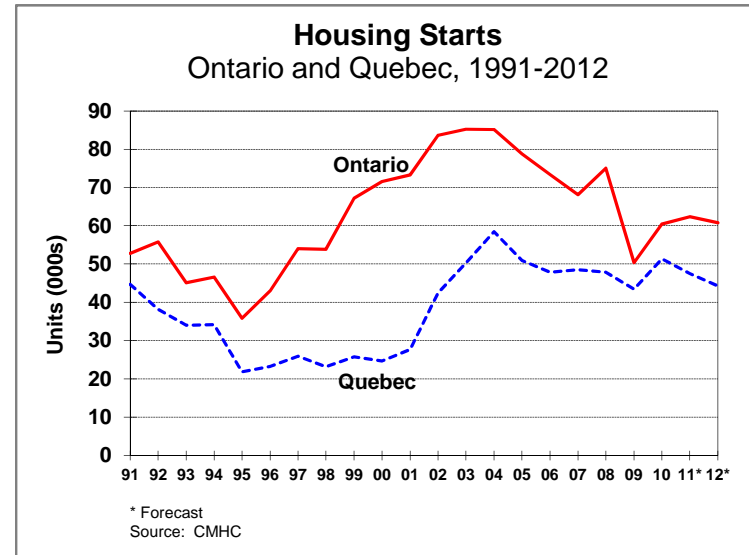
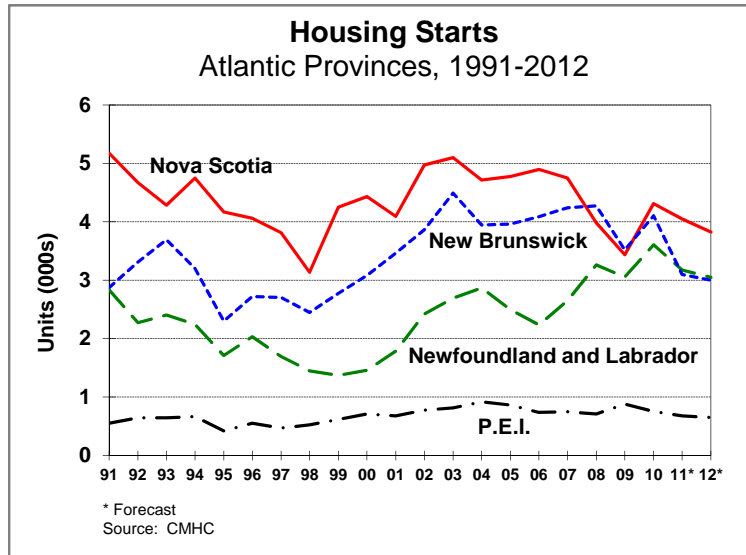
New Housing Activity Above Low Level of 2009 – Both Singles and Multiples Have Shared in the Recovery



- Average annual housing starts were above 220,000 units during the 2002-2008 period – an unsustainably high volume of activity. Prior to the surge in housing starts after 2001, new housing activity had been very low.
- In 2009, due to the recession, starts dropped to 149,000 units.
- Starts bounced back to 189,900 in 2010.
- CMHC’s ‘point forecast’ for housing starts is for a modest decrease in starts to 183,200 in 2011.
- Due to the uncertain economic environment, CMHC has prepared a range of starts forecasts for 2012 – 161,700 and 207,200 units. CMHC’s ‘point forecast’ for 2012 is for 183,900 units – little change from 2011.

- 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. Both have since recovered, though not to their previous levels.
- Apartments (mainly condominiums) are expected to comprise more than 37% of total starts in 2011 and 2012. This continues a trend towards a higher share of apartment starts over the past decade.

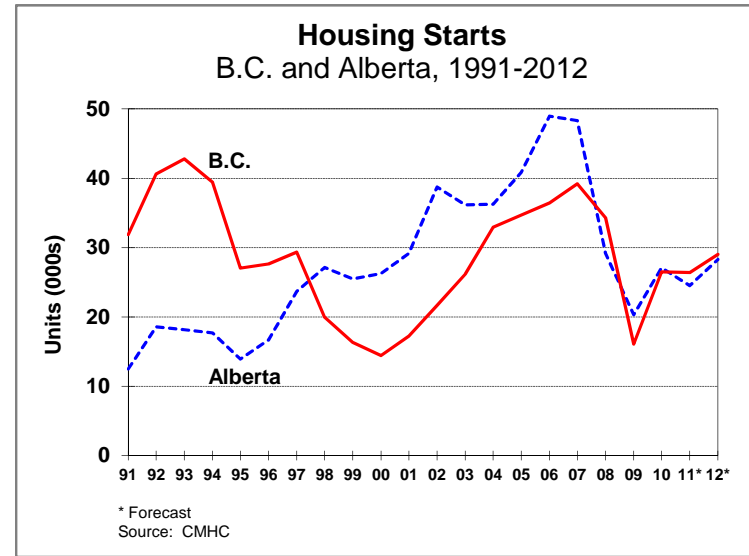
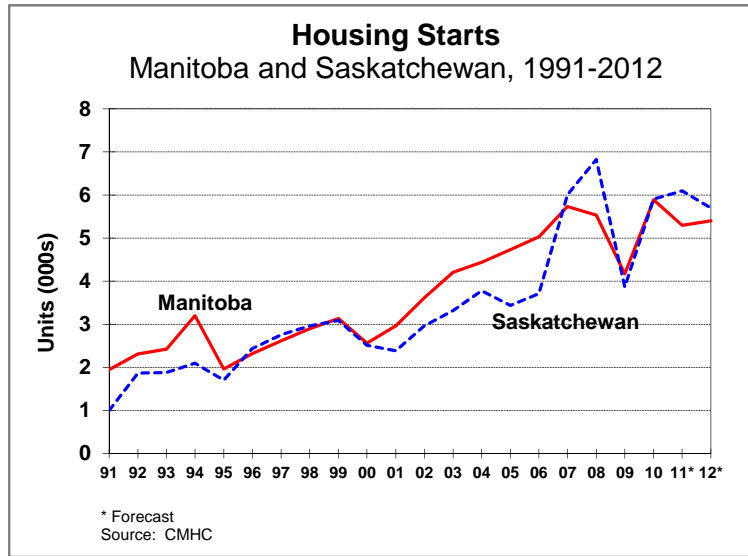
**Lower Starts in 2011 in All Eastern Provinces Except Ontario
 – Further Modest Declines Expected in All Eastern Provinces in 2012**



- Housing starts in the four Atlantic Provinces as a whole are forecast to decline by 14% in 2011 compared to 2010, according to CMHC. Starts are forecast to decline modestly by 4% in Atlantic Canada in 2012.
- In Nova Scotia, 2011 starts are forecast to total 4,050 units – down from 4,309 starts in 2010. In 2012, starts are forecast to ease further to 3,825 units.
- New Brunswick starts are forecast to be 3,100 units in 2011 and 3,000 units in 2012, compared to 4,101 units in 2010.
- Starts in Newfoundland and Labrador are forecast at 3,175 units in 2011 and 3,050 units in 2012 – compared to 3,606 units in 2010.
- In Prince Edward Island, 675 and 650 starts are forecast in 2011 and 2012, respectively – down from 756 in 2010.

- Ontario starts are forecast to increase to 62,400 units in 2011 – an increase of 3% from 60,433 starts in 2010, but well below the average of 74,000 starts annually during 2005-2008. In 2012, Ontario starts are forecast to ease slightly to 60,750 units.
- Starts in the Toronto CMA, the largest housing market in Canada, are forecast to total 34,950 units in 2011 and 33,200 in 2012 – compared to 29,195 starts in 2010.
- Starts in other centres in Ontario are mixed – some markets such as Windsor are particularly weak.
- Quebec starts are forecast to total 47,500 units in 2011 – down 8% from 51,363 starts in 2010. Starts in the province are forecast at 44,300 units in 2012.

**Lower Starts in Alberta and Manitoba in 2011
 – Increased Starts in All Western Provinces Except Saskatchewan in 2012**

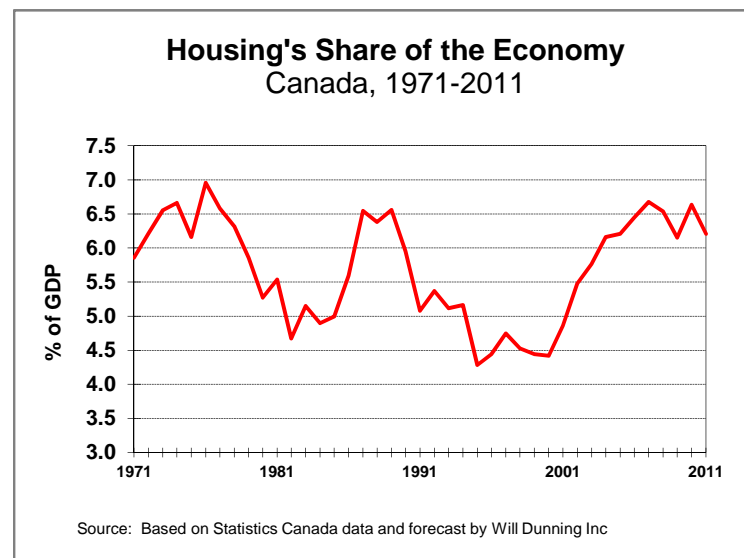
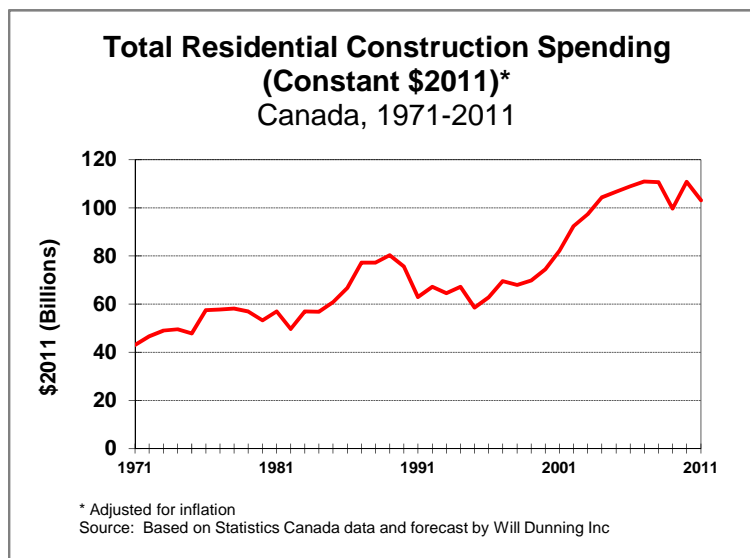


- In Manitoba, starts are forecast to decrease by 10% to 5,300 units in 2011 – from 4,174 units in 2009. Starts in Manitoba are forecast to increase slightly to 5,400 units in 2012.
- Saskatchewan starts are forecast to increase by 3% in 2011 to 6,100 units, compared to 5,907 units in 2010. Starts in Saskatchewan are forecast to ease to 5,700 units in 2012.
- Starts in Alberta are forecast to decline by 10% to 24,500 units in 2011 – compared to 27,088 starts in 2010. Alberta starts are forecast to rise to 28,300 units in 2012.

- B.C. starts are forecast to remain steady at 26,400 units in 2011 – slightly below the 26,479 starts in 2010. Starts in B.C. are forecast to increase to 29,000 units in 2012.
- The Vancouver CMA comprises well over half of the total starts in B.C. – 16,300 starts forecast for 2011 and 17,500 starts in 2012. While housing activity is buoyant in Vancouver, markets in many other parts of the province are relatively weak.
- The pending removal of the HST in B.C. (and uncertainty about the mechanics of the tax changeover relating to new housing) is having an unsettling effect on B.C. housing markets.

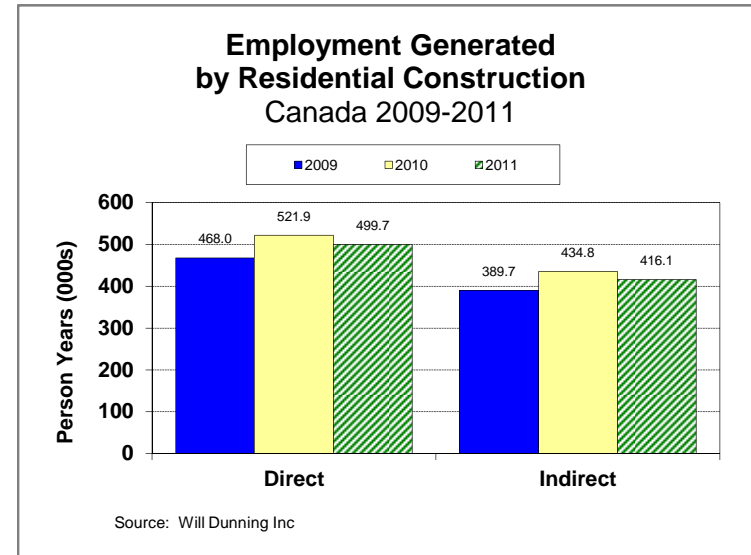
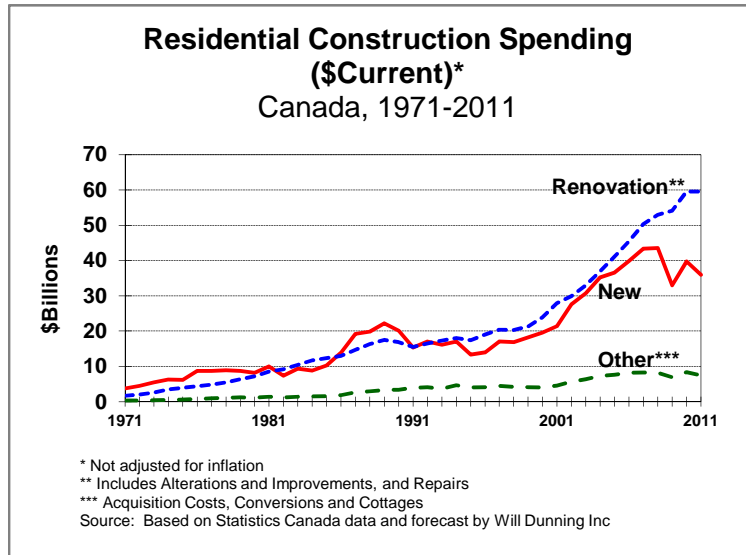
2. RESIDENTIAL CONSTRUCTION AND THE ECONOMY

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 more than doubled over the past four decades. In terms of constant (inflation-adjusted) 2011 dollars, the value of residential construction spending increased from \$43 billion in 1971 to over \$100 billion annually since 2004.
- Even with the downturn in new housing activity in 2009, real residential construction spending still reached \$100 billion (in 2011 dollars).
- Residential construction spending includes new housing, renovations to existing dwellings, cottages, conversions and acquisition costs for new housing.
- Total spending on residential construction is forecast to reach \$103 billion in 2011.
- 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 after 2000. 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.
- In 2011, the forecast \$103 billion in total residential construction spending will represent roughly 6.2% of GDP.

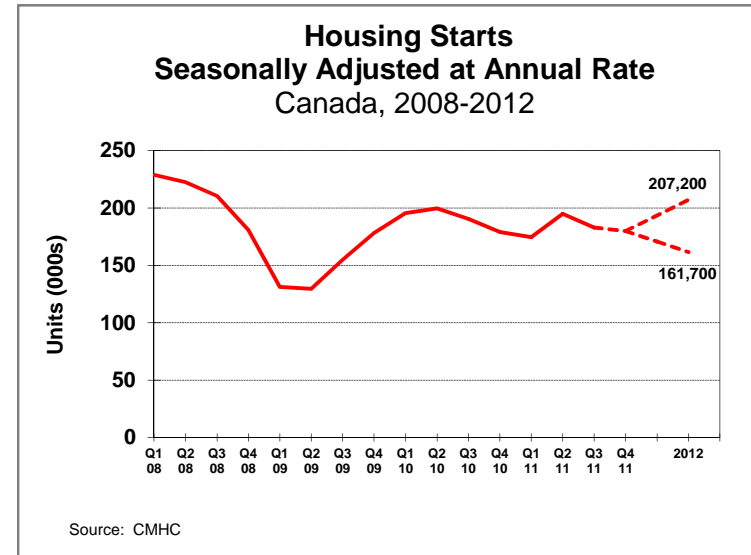
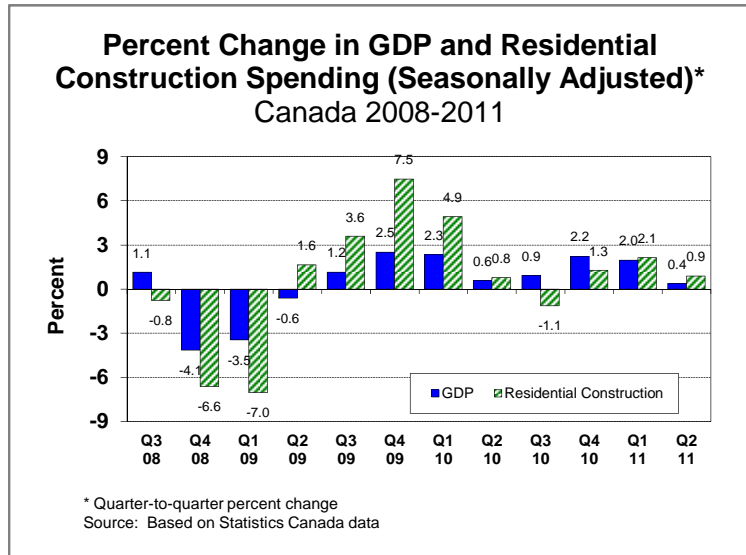
Spending on Residential Renovations Exceeds Spending on New Housing – Significant Employment Generated by Residential Construction



- Housing’s contribution to the economy is comprised of new housing activity, residential renovation work, and ‘other’ which includes expenditures on acquisition costs, conversions and cottages.
- 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 is forecast to total \$36 billion in 2011.
- Renovation expenditures are forecast to total almost \$60 billion in 2011.

- 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 2011.
- The 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 – New Housing Activity No Longer a Spur for Economic Growth

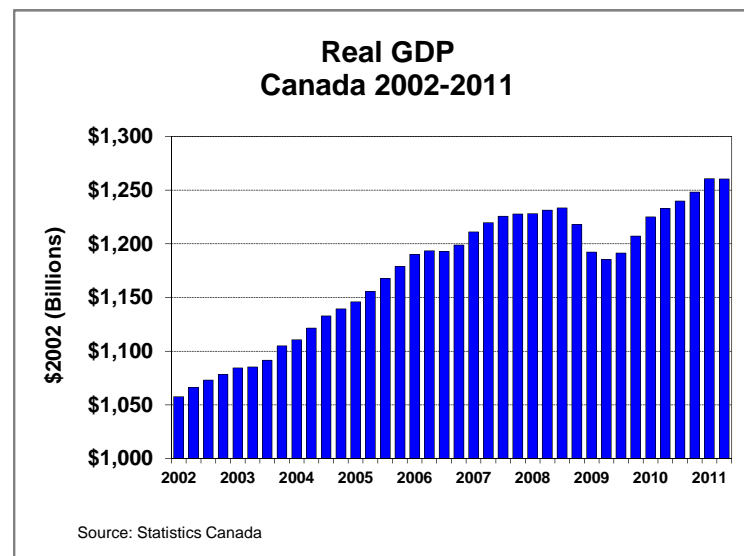
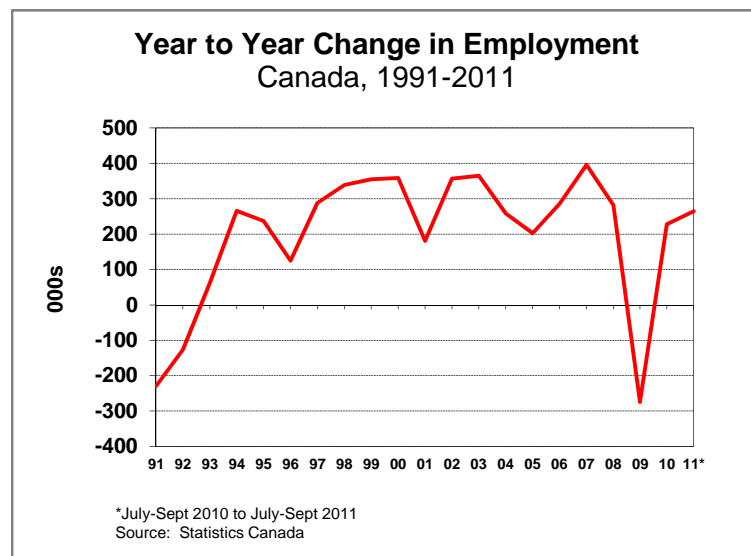


- Housing is important to the Canadian economy – a decline in housing activity leads to lower economic growth; an increase helps to spur economic growth. This is clearly illustrated by an examination of quarterly changes in GDP and residential construction expenditures over the period since mid-2008.
- Reductions in residential construction expenditure in the last half 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 second half of 2009 and the first quarter of 2010 – strong increases in residential construction spending helped to lift GDP growth and pull Canada out of recession.
- Since the second quarter of 2010, there has been relatively little quarterly change in housing expenditures.

- With the leveling off of housing activity since mid-2010, 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 183,900 starts for 2012 is similar to recent levels of activity – and would not provide a significant additional impetus to overall economic growth.

3. DRIVERS OF HOUSING ACTIVITY

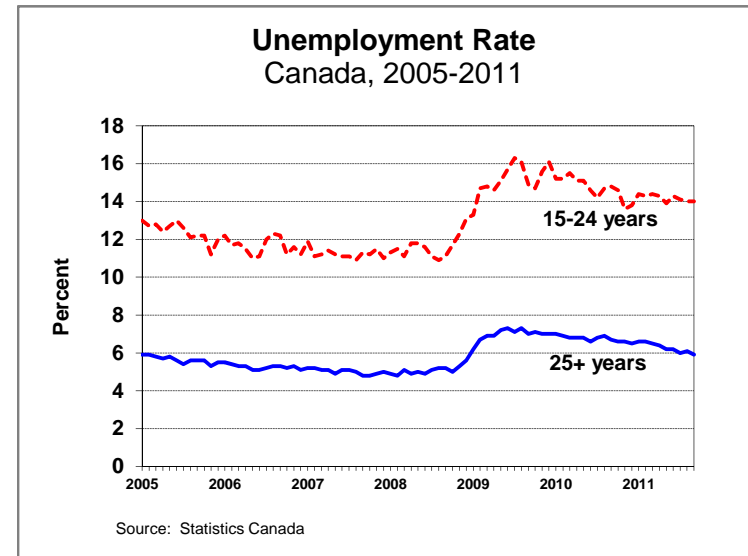
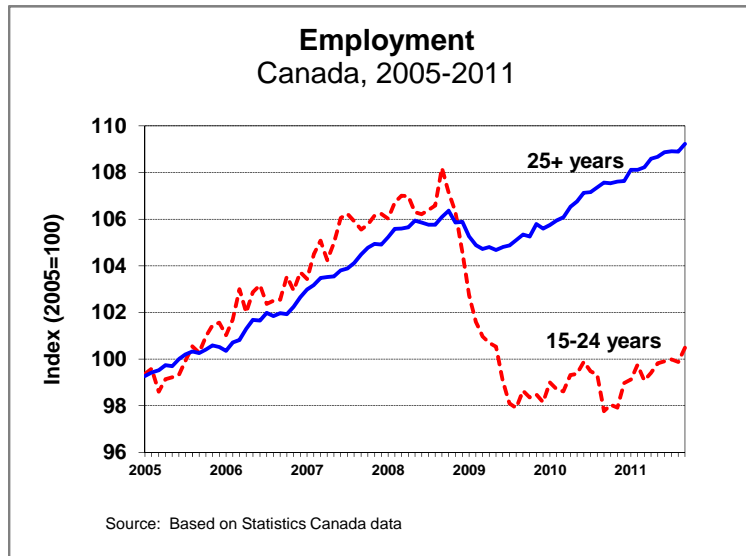
Strong Employment Growth Assisted the Recovery in Housing in 2010 and 2011 – However, Economic Outlook is Uncertain



- 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 two years, employment levels have risen dramatically and job growth has surpassed the number of jobs lost during the recession.
- The improved employment picture in 2010 – and the continuation of job growth in 2011 – was a prerequisite for the recovery in housing activity in the past two years. 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 more than 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 slow economic growth over the next year; however, the outlook is far from certain. In particular, the weak U.S. economy and the European debt crisis threaten continued economic growth in this country.

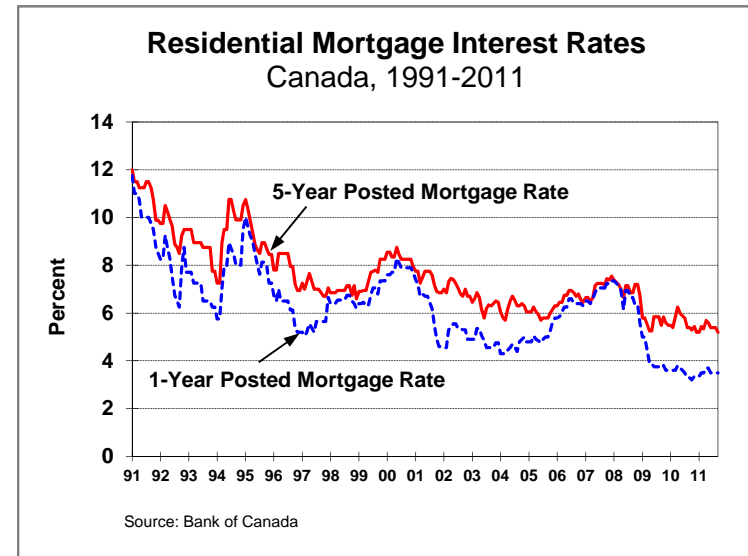
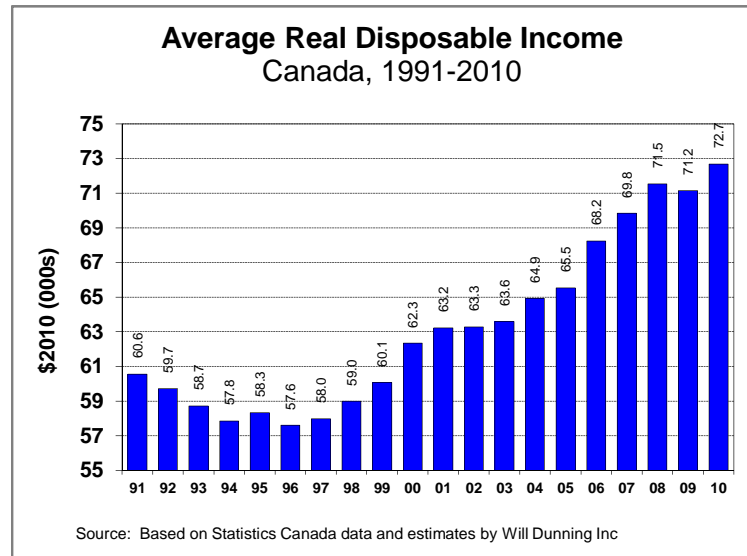
**Recovery in Employment Growth Confined Mainly to Older Workers
 – Poor Job Growth Among 15-24 Year Olds Has Negative Implications for Housing Demand**



- While overall employment is well above pre-recession levels, the recovery has been uneven.
- The drop in employment during 2009 was 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.

- 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.

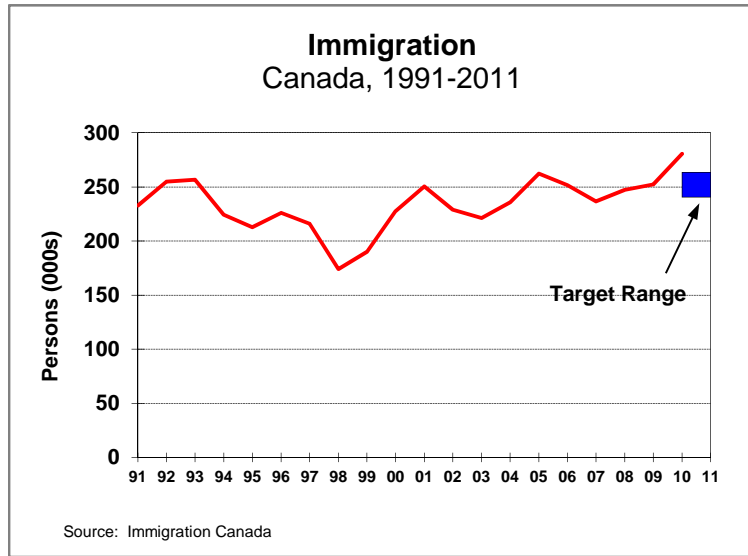
Recovery in Real Disposable Income – Positive for Housing Demand – Mortgage Interest Rates At Historically Low Levels



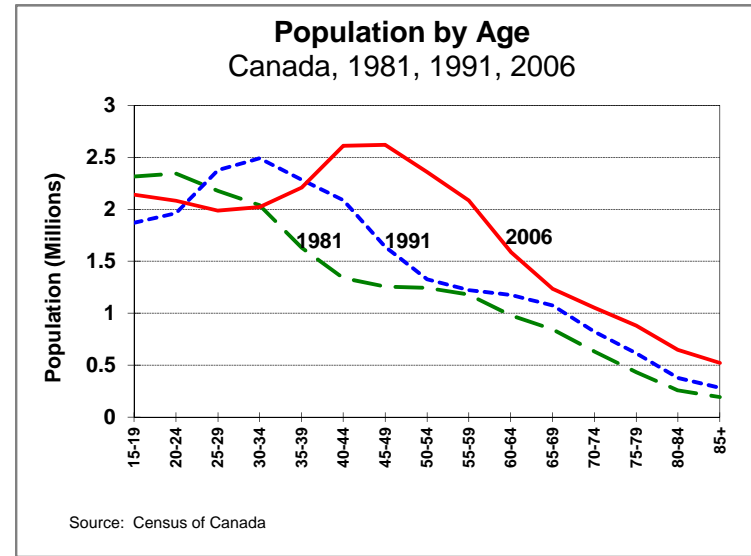
- The combination of strong economic growth and reduced taxes led to a substantial increase in the average real disposable income of Canadian households during the decade leading up to 2008. This provided an important boost to housing activity during that period.
- Disposable income is the share of income 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 during the recession.
- The increase in average real disposable income in 2010, following the dip during the recession, was a positive factor in the recovery in housing activity.

- Mortgage interest rates are critical for homeownership accessibility and for the economics of investment in rental housing.
- The historically low mortgage rates have been a key factor behind the continued strength in housing activity.
- At present, chartered banks' 5-year posted rates are roughly 5.2%, while 1-year rates are in the 3.5% range. However, by negotiating, borrowers can generally get mortgages at less than the posted rate. For example, some mortgage lenders 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.

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



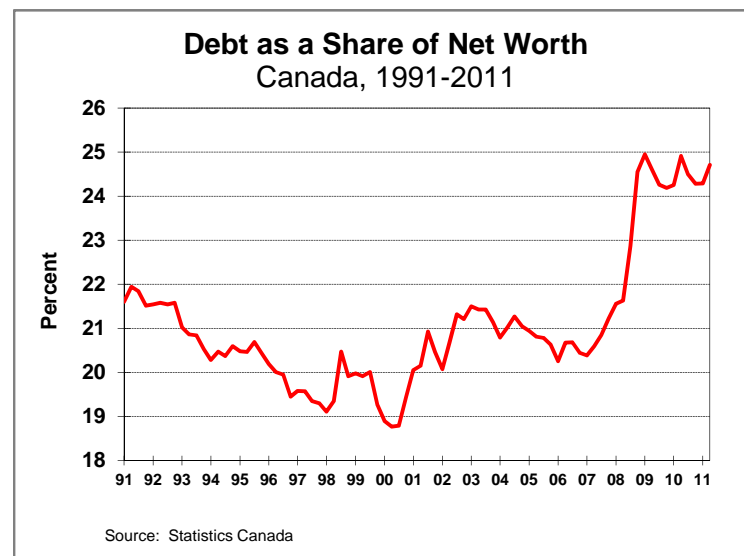
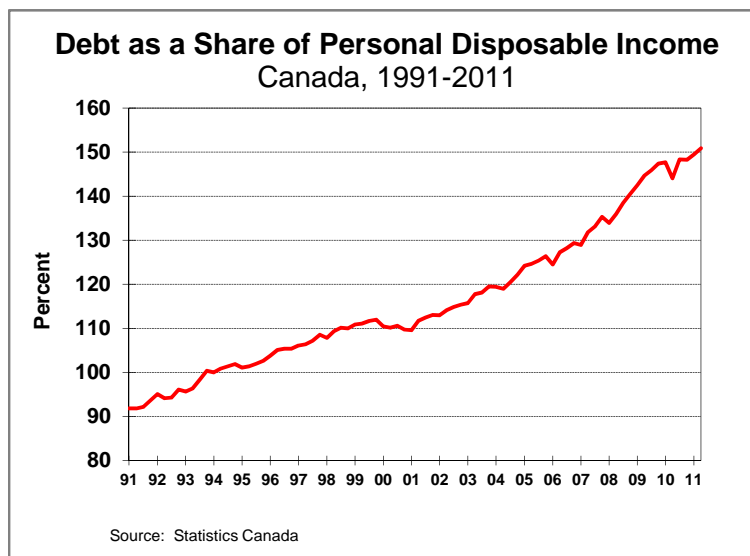
- Immigration increased to 280,000 in 2010 – higher than the 220,000-260,000 immigrants recorded annually for the previous decade.
- The target range for immigrants in 2011 is 240,000-265,000.
- Research indicates that, over time, immigrants have housing occupancy characteristics similar to native-born 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 a later section, all other things being equal, this will underpin household growth – and housing demand – in the future.

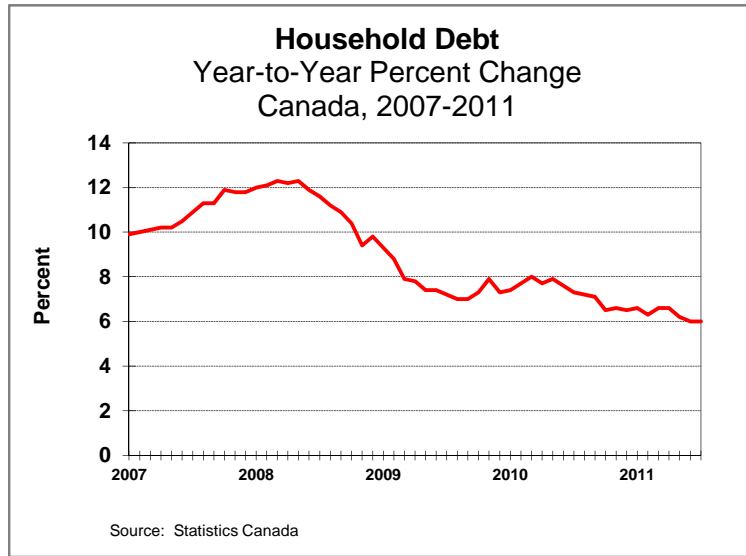
4. HOUSEHOLD DEBT

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 150%.
- These increased debts include credit card debt and personal loans, but they are predominantly mortgages.
- 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 others, including the Minister of Finance, the Governor of the Bank of Canada, and the International Monetary Fund, have expressed concerns about the high debt levels of Canadians – and the dangers of high household debt to the Canadian economy.
- More recently, as discussed in the next few pages, it appears that the growth in household debt is easing and there seems to be less cause for concern.

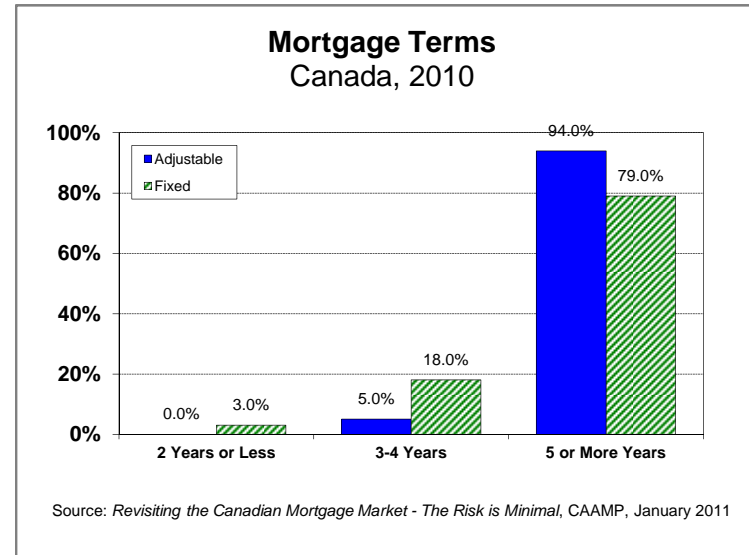
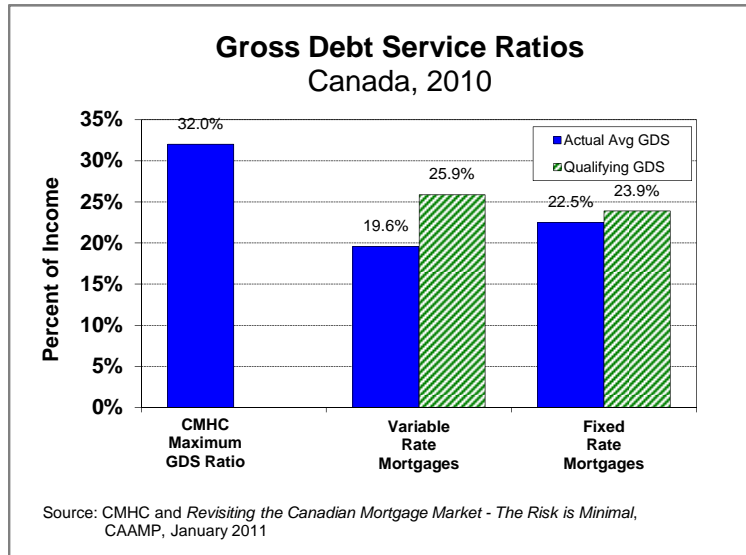
**Rate of Growth in Household Debt Has Declined
– Significant Drop in Growth in Consumer Debt**



- The growth in household debt appears to be waning. From annual rates of growth of 10-12% in 2007-2008, the rate of growth in total household debt has declined to 6% in recent months.
- In part, this decline in the rate of growth of household debt is due to measures undertaken by the government – most recently, effective April 2011. These included reduced mortgage amortization periods, tighter restrictions on lending, and withdrawing government insurance backing on home equity lines of credit.
- Household debt is comprised of mortgage debt (which is backed by a tangible asset – a home), and consumer debt such as credit cards and personal loans (which are typically unsecured) and would therefore be more worrisome.

- Growth in consumer debt, in particular, has declined markedly from the levels of recent years.
- Growth in mortgage debt continues to be strong, though well below the levels of 2007-2008. It appears likely that the demand for mortgage financing will diminish as a result of more moderate sales in the existing housing market.
- CMHC recently announced that mortgage refinancing activity declined by nearly 40% since the introduction of the latest mortgage insurance rules by the federal government.
- According to the Bank of Canada Financial System Review (June 2011), “the growth of household credit will likely moderate from the pace observed in early 2011 to a rate closer to that of disposable income”.

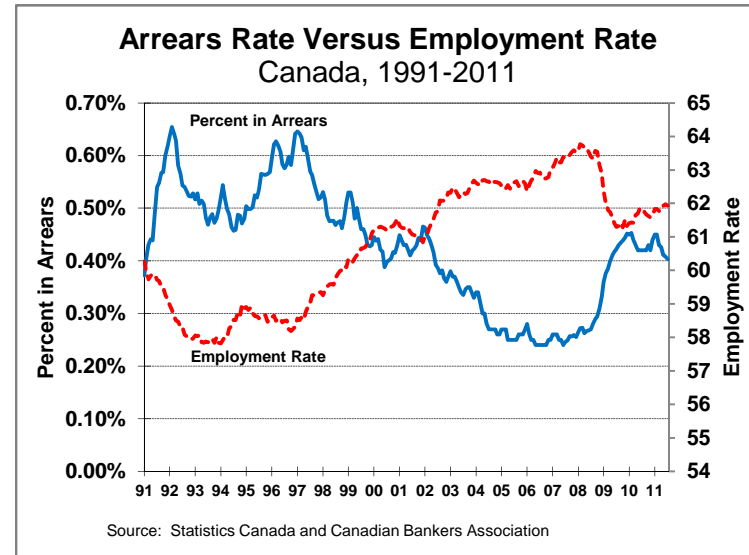
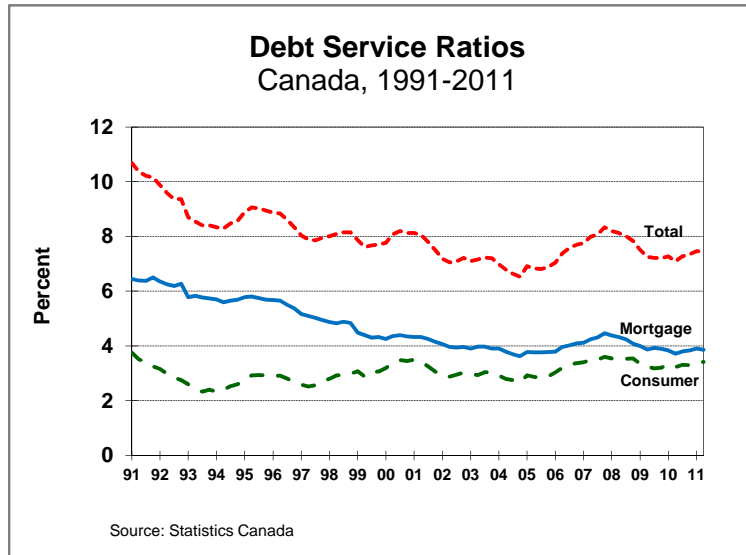
**Mortgage Lenders and Borrowers Have Been Prudent
 – Most Borrowers Are Choosing the Stability of 5-Year Terms**



- Research by the Canadian Association of Accredited Mortgage Professionals (CAAMP) indicates that most mortgage borrowers have left themselves considerable room to absorb increases in interest rates.
- In part, this is due to the fact that under new federal government regulations, lenders are required to qualify borrowers based on the 5-year fixed rate mortgage rather than the actual interest rate on the mortgage.
- GDS ratios represent the proportion of income required to cover mortgage payments, property taxes and heating costs. To qualify for mortgage insurance, CMHC has a maximum GDS ratio of 32%, based on the lenders’ posted 5-year mortgage rate.

- According to the CAAMP research (shown in the chart at left), the average GDS ratios for mortgages taken out in 2010 was less than 20% for variable rate mortgages and 22.5% for fixed rate mortgages – in both cases, well below the GDS ratios used to qualify the borrowers.
- To protect themselves from future increases in interest rates, the vast majority of mortgage borrowers are choosing 5-year mortgages rather than shorter terms (chart at right).
- Even most borrowers who choose variable rate mortgages are protected from increases in interest rates since, according to information from an Altus Group report, two-thirds of variable rate mortgages are fixed payment (with changes in interest rates reflected in adjustments in the remaining amortization period).

**Debt Service Ratios Have Declined Over Time
– Arrears Have Increased, But Still Well Below Historical Levels**

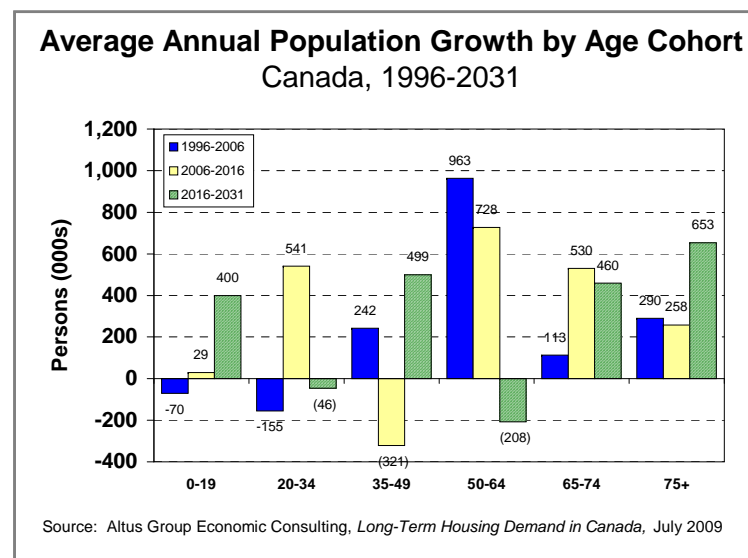
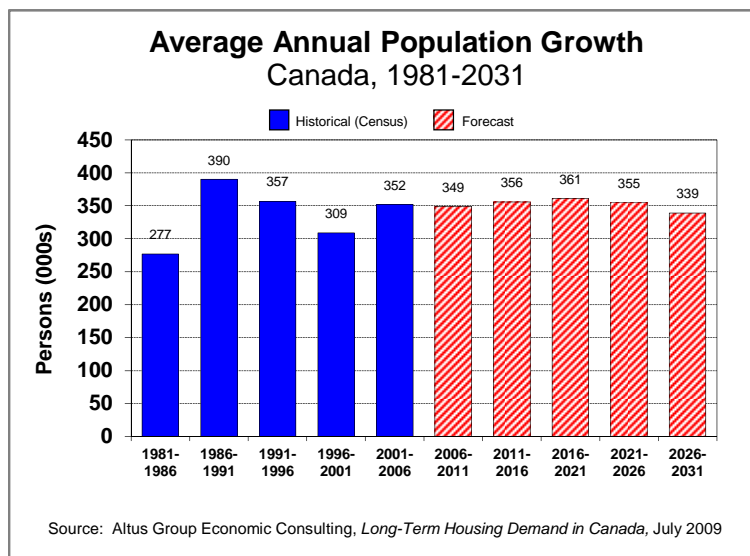


- While, as indicated on previous charts, household debts have increased substantially compared to disposable income, the low interest rates have eased the cost of servicing debts.
- Debt service ratios for mortgages have been roughly 4% of disposable income for most of the past decade – down from over 6% in the early part of the 1990s.
- For consumer debt (e.g. credit cards and personal loans), on the other hand, debt service ratios have increased, on average, over the past decade.

- As indicated on the previous page, most borrowers can easily afford their mortgage at present and, under reasonable assumptions, would not face difficulties on renewal – even at higher interest rates.
- The largest fear, in terms of mortgage defaults, is job losses. There is a significant correlation between mortgage arrears and employment – or, more particularly, unemployment.
- At present, mortgage arrears, while above the levels of earlier this decade, are relatively low (0.4%), compared to the 1990s.
- Therefore, unless there is a significant slowdown in the economy, it appears unlikely there will be a significant increase in mortgage defaults.

5. PROJECTIONS OF HOUSING DEMAND

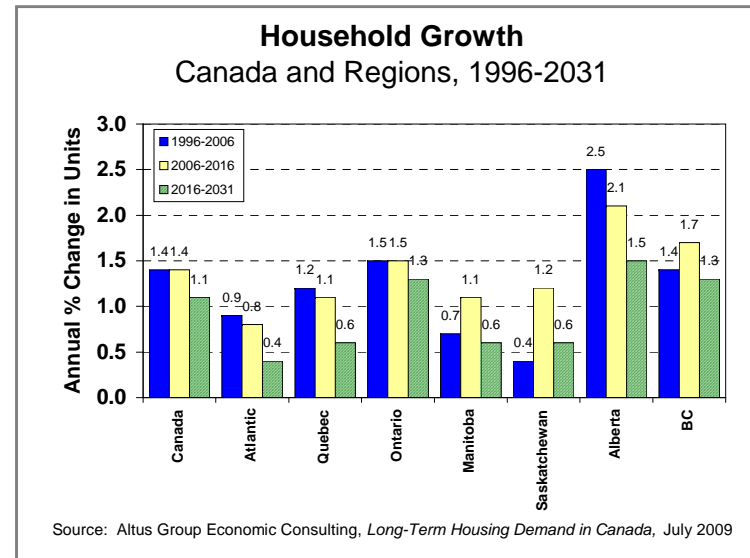
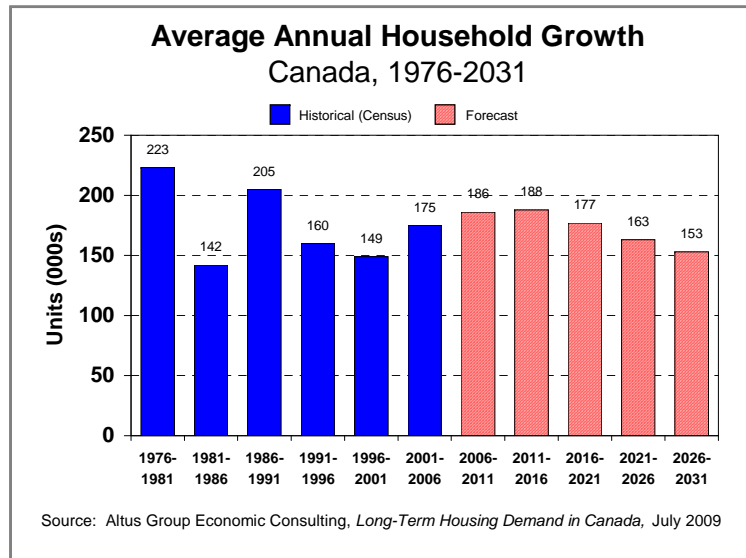
Population Growth Projected to Remain Strong for Next Two Decades – Shift in Growth to First-Time Buyer and Empty-Nester Age Groups in 2006-2016 Period



- 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 niche market opportunities for innovative home builders.

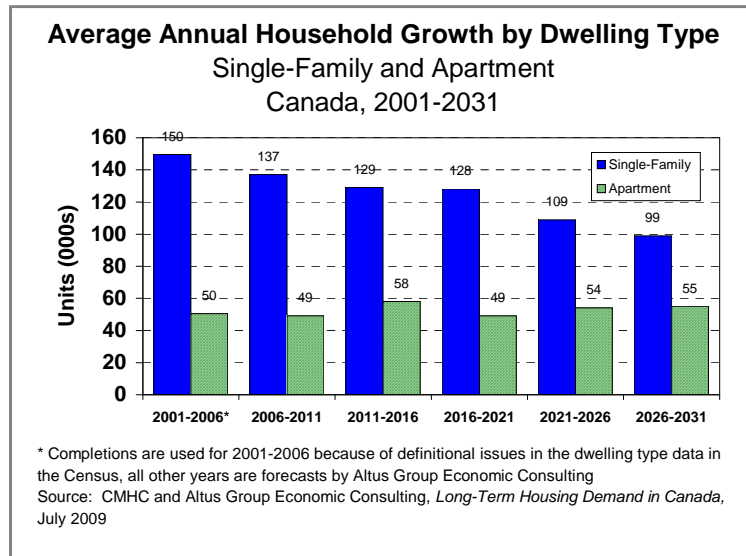
**Household Growth Projected to Average 188,000 Annually in 2011-2016
 – Alberta, B.C. and Ontario to Continue to Have Strongest Rates of Growth**



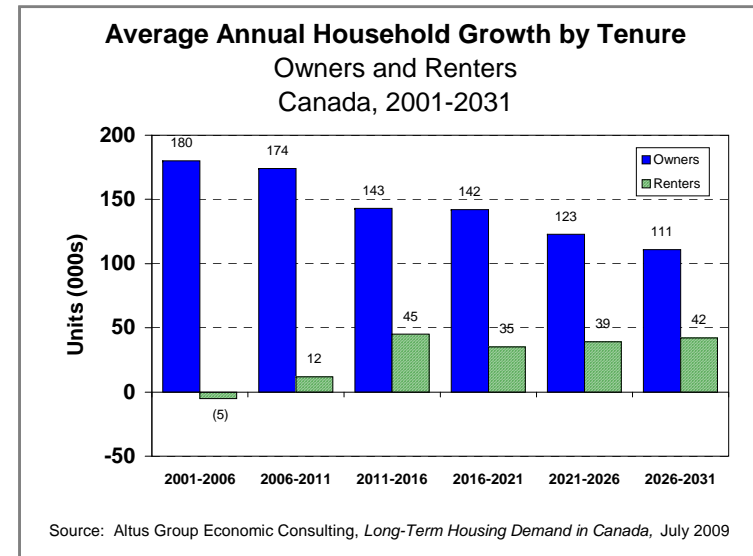
- The number of net new households advanced by 155,000 units annually through the 1990s, and accelerated modestly to 175,000 annually in the 2001-2006 period.
- The rate of household growth has increased in the past few years and is expected to average 186,000 for the 2006-2011 period as a whole.
- All 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



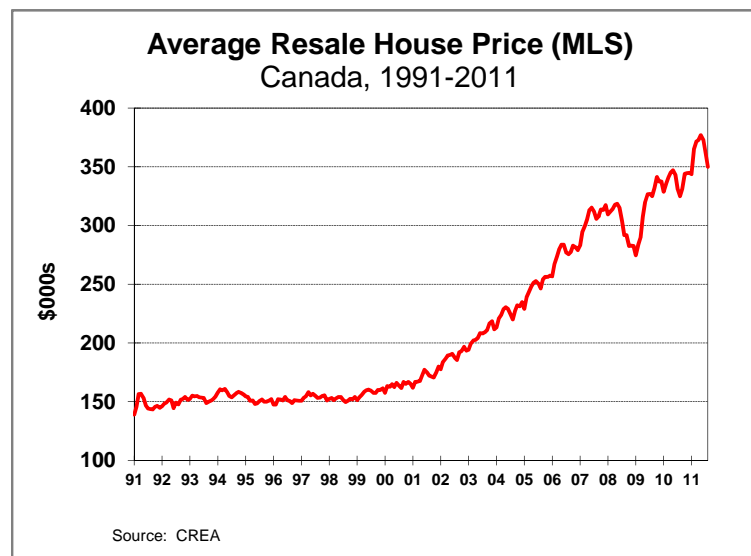
- Single-family homes account for most of the demand for new housing – now and into the future. However, as a share of total household growth, apartments (both condominiums and rental units) are projected to increase in importance.
- The increase in households occupying single-family homes is projected 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.



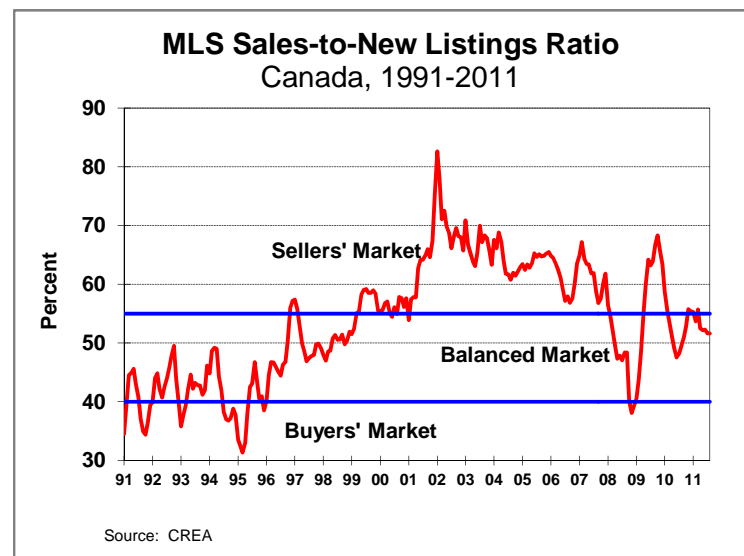
- During the 2001-2006 period, there was a decline in the number of renters. This was a period of very high demand for ownership housing as renters migrated to homeownership.
- Similar patterns applied during the early part of the current 2006-2011 period; however, in total, there is expected to be a small net increase in renter household growth.
- 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.

6. HOUSING PRICES

Recovery in Resale House Prices Following Decline During the Recession – Balanced Resale Markets in Most Major Centres

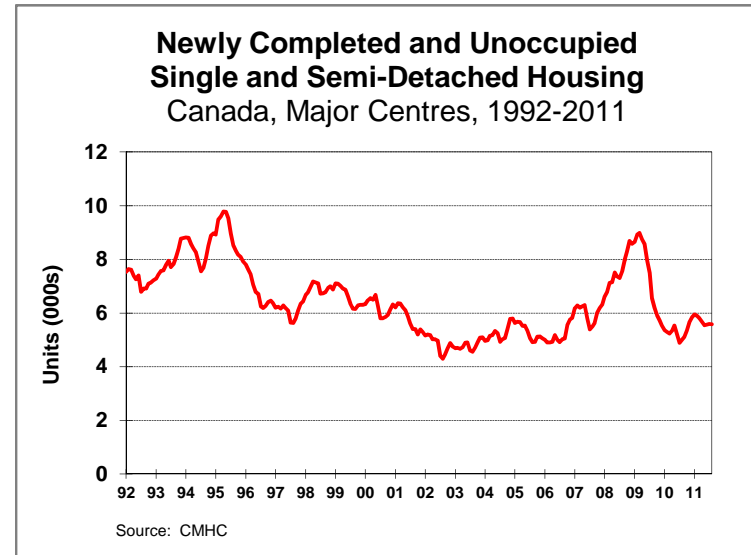
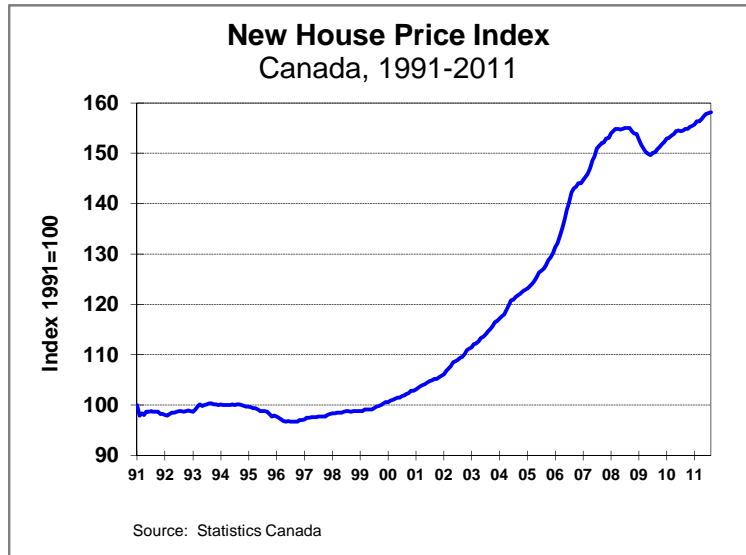


- Strong housing markets in the period up to 2008 led to significant increases in housing prices. Average MLS resale house prices across Canada increased by roughly 10% each year during the 2002-2007 period.
- However, with the economic downturn in 2008-2009, home sales declined – and resale house prices dropped sharply.
- With the economic recovery, there was a dramatic upturn in resale housing activity – and a commensurate rise in resale housing prices. The average resale house price in Canada has eased from the peak of almost \$375,000 in the second quarter of 2011, but remains well above the levels of 2010.
- CMHC forecasts that the average MLS price will be roughly \$367,500 in the fourth quarter of 2011, and \$372,400 in 2012.



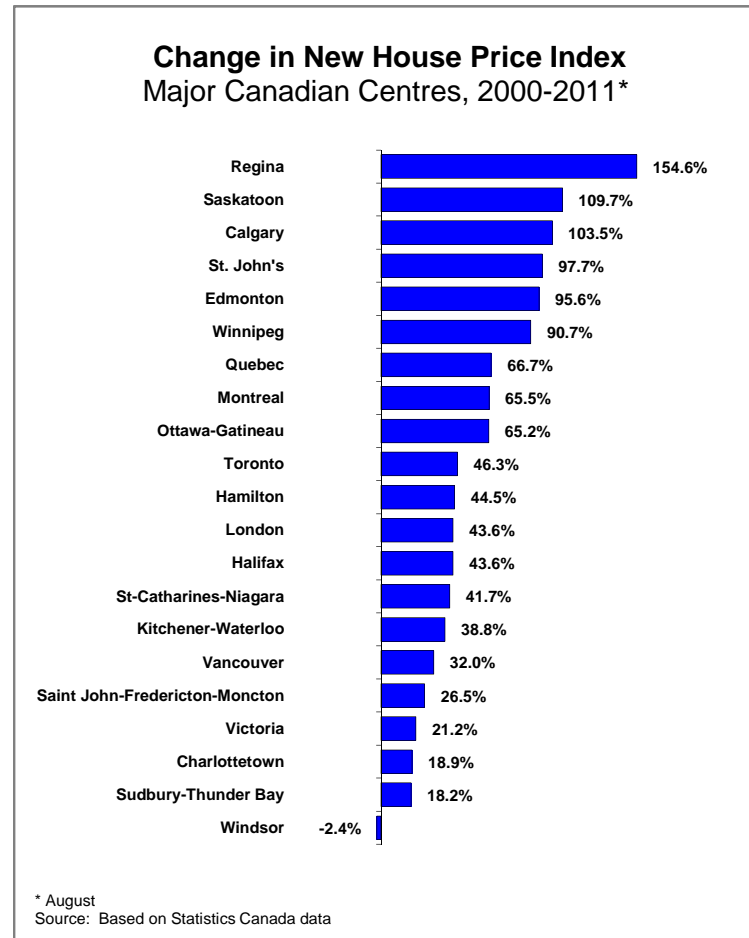
- Changes in housing prices tend to reflect changes in the balance of the market. When the sales-to-new listings ratio is above 55%, it is considered a sellers' market and prices tend to rise – as they did during the period from 2000 to 2008.
- When the sales-to-new listings ratio is in the balanced 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 overall resale housing market in Canada is balanced, with a reduction in sales in recent months. This suggests that changes in housing prices will be relatively modest on a national basis. However, prices in any particular market will depend on the local supply and demand balance.

Continuing Rise in New House Prices – Low Inventories of Unoccupied New Houses



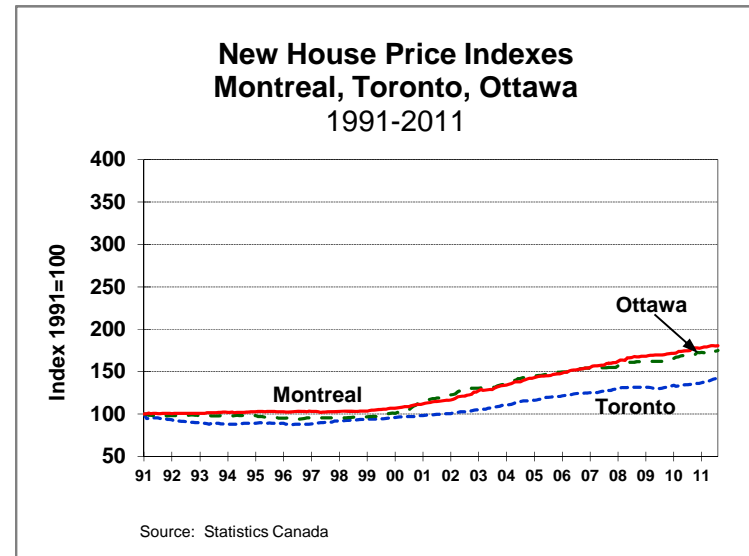
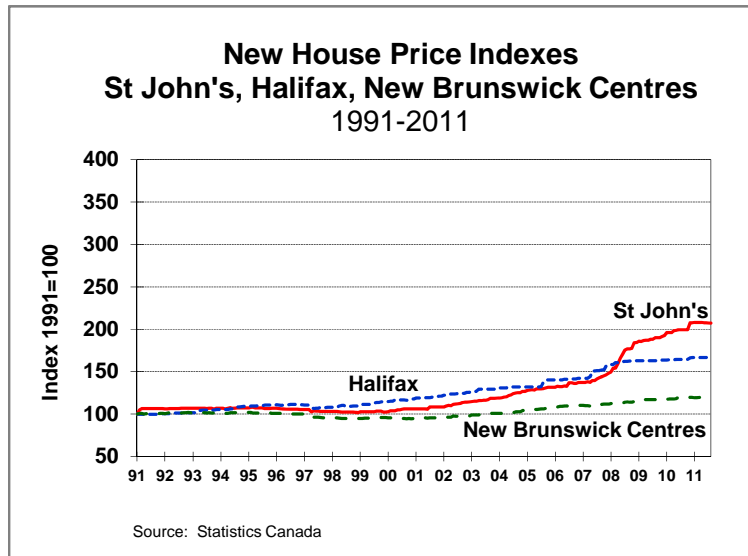
- Over the period to 2008, new house prices in most of Canada lagged somewhat behind the rise in prices in the resale market. However, new home prices increased significantly as well – particularly in 2006-2007.
- New house prices peaked in mid-2008 and declined in the early part of 2009. Since the spring of 2009, new house prices have increased steadily and are above 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.
- As with the ‘balanced’ resale market, there is no oversupply of new single-family homes which might threaten to erode price levels significantly.

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



- 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 2011 period.
- While overall national new house prices have risen by 56% over the period from 2000 to August 2011, changes in house prices in local markets varied from an increase of over 154% in Regina, to a decline of over 2% 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 90% 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.

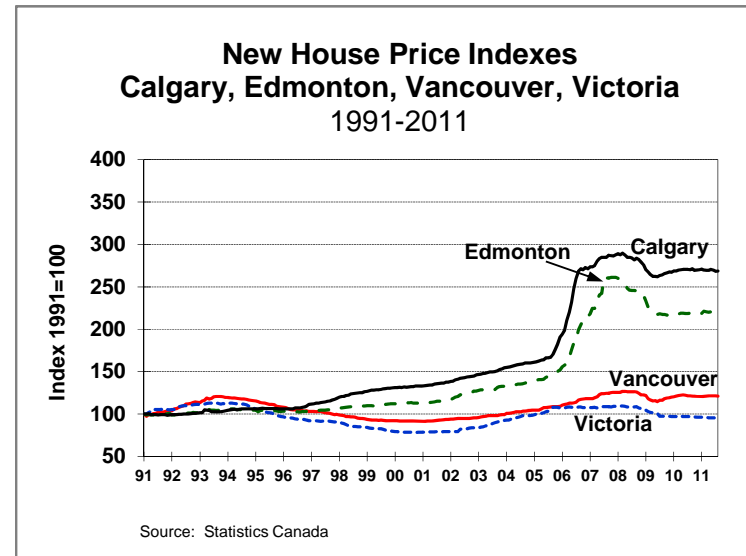
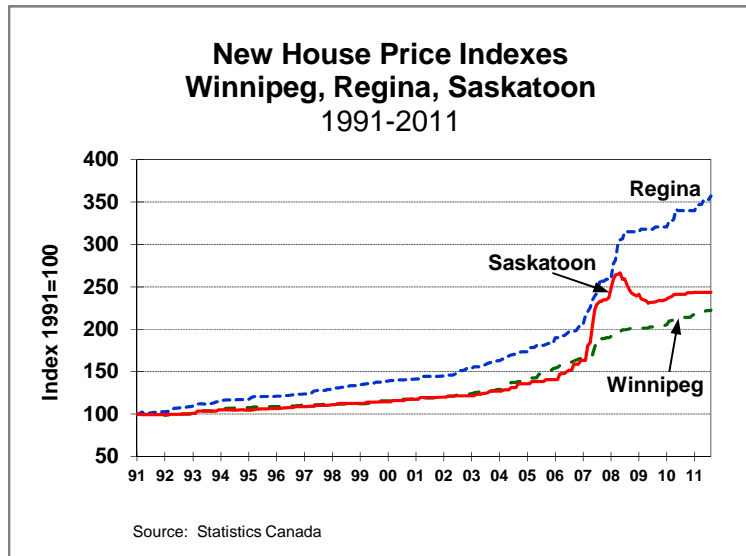
**Strong Increase in House Prices in St. John's in Recent Years
– Other Eastern Centres Show More Modest Rises in Prices**



- The house price changes during a relatively short period (e.g. 2000-2011, 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 1991-2011 period as a whole, St. John's (108%) has had the largest price increase among the eastern Canadian centres presented here, followed by Montreal (81%), Ottawa-Gatineau (75%), Halifax (67%) and Toronto (42%).
- New Brunswick centres (Saint John, Fredericton and Moncton) had relatively modest increases in housing prices over the period – 20% for the 1991-2011 period as a whole.
- As shown on the next page, house price increases in centres in Saskatchewan and Alberta have been much more substantial.

**Relatively Stable Housing Prices in Most Western Centres in Recent Years
– Continued Rising Prices in Regina and Winnipeg**

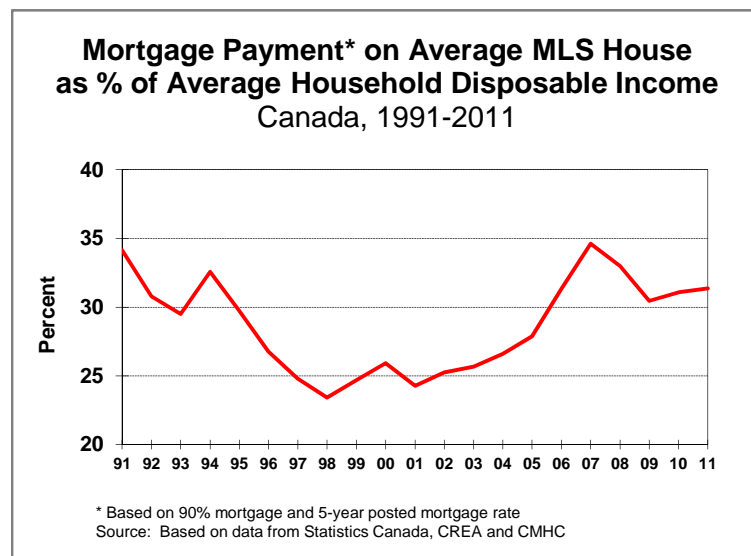


- Over the 2006-2008 period, the precipitous increases in new house prices in Regina, Saskatoon, Calgary and Edmonton outpaced all other major centres in Canada. Since then, prices have eased in three of the four centres; however, prices in Regina continue to surge.
- Compared to 1991, new house prices in Regina are up by 257%. In Saskatoon, new house prices have also increased significantly – up by 144% 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 123% 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 169% in July 2011, while Edmonton prices were up 121%.
- 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. July 2011 prices are up 21% from 1991.
- Prices in Victoria have declined slightly in the past two years and are modestly below 1991 levels.

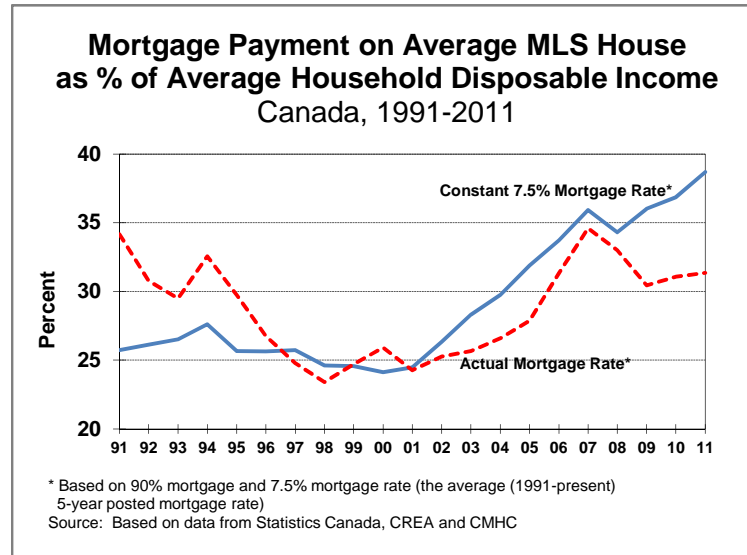
7. THE STATE OF HOMEOWNERSHIP AFFORDABILITY

Despite Historically Low Interest Rates, Affordability Has Deteriorated Due to Significant Increases in Housing Prices



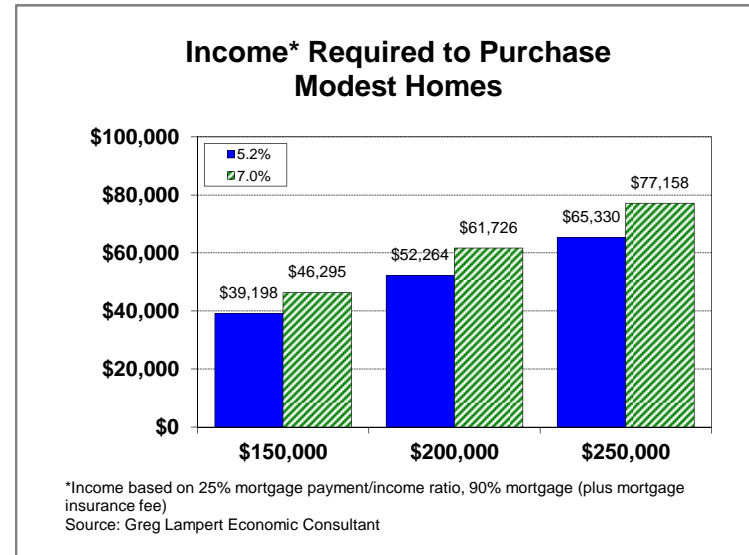
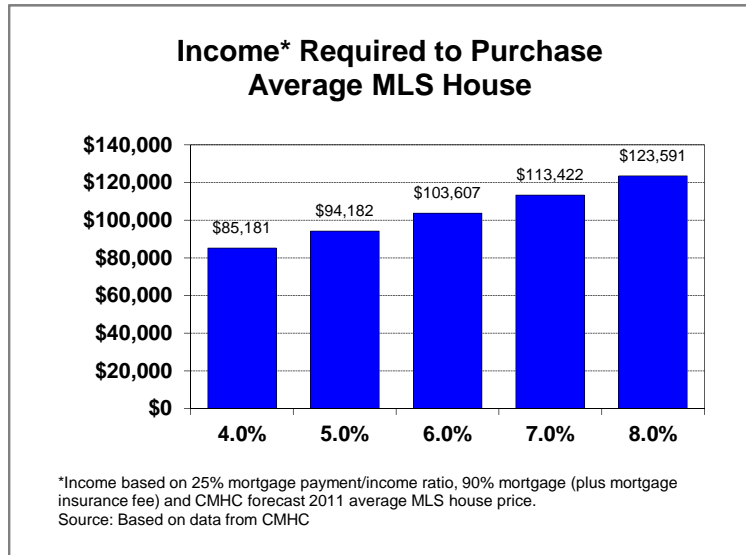
- Homeownership affordability, as measured by the share of average disposable income required to buy the average MLS home, has deteriorated in the past two years.
 - While somewhat better than during the extreme 2006-2008 period, affordability today is worse than at any time since the early 1990s – despite historically low interest rates.
 - This deterioration in affordability is due to the significant increases in housing prices over the past several years – price rises driven, in part, by inexorably rising government-imposed costs and more burdensome regulation.
- This deterioration in affordability, at a time when mortgage interest rates are being held at extremely low levels because of concerns about economic growth, calls for clarification of the concept of ‘homeownership affordability’.
 - There used to be a clear understanding of the differences between ‘homeownership affordability’ and ‘homeownership accessibility’:
 - **Homeownership affordability** is determined by housing prices in relation to income levels;
 - **Homeownership accessibility** refers to the availability of financing and related mechanisms, and is determined by interest rates, downpayment requirements, gross-debt-service ratios, and other borrowing conditions.
 - Given the current record low interest rates, access to homeownership is extremely positive. However, overall affordability levels, as measured by the share of income required to purchase an average home, are markedly worse than the decade prior to 2005, even with this extremely positive interest rate environment.
 - Rising housing prices, based in part on ever more costly and complex regulation, and ever increasing government levies, fees, charges and taxes, have caused an extremely serious deterioration in homeownership affordability.
 - In recent years, this deterioration has been masked by record low interest rates – which have improved *access* to homeownership. However, in the future, as interest rates inevitably rise to more normal levels, the deterioration in affordability will become more evident – and will be reflected in a marked reduction in housing activity levels as would-be purchasers are priced out of the market.

Improvement in Homeownership Accessibility Due to Historically Low Interest Rates Has Masked the Effect of Rising Housing Prices on Homeownership Affordability



- There are two lines on this chart:
 - *Actual mortgage rate* – the proportion of income required to purchase an average home over time – based on actual average interest rates in each year. This is the same information as presented in the chart on the previous page.
 - *Constant 7.5% mortgage rate* – the proportion of income required to purchase an average home – based on an interest rate of 7.5% (the average mortgage interest rate for the past two decades). This illustrates the extent to which the decline in interest rates has masked the deterioration in affordability in recent years.
- Assuming the average 5-year posted rate for the 1991-2011 period (7.5%) for each year, the chart illustrates the effect of year-to-year change in housing prices and, to a lesser extent, disposable income.
- As illustrated in the chart, with interest rates constant, affordability was relatively flat during the 1990s (a period of modest changes in housing prices) but deteriorated progressively after 2001 – a period when housing prices (driven by more onerous government regulation and government-imposed costs on housing) have risen significantly.
- Improved homeownership *accessibility* (through lower interest rates) has masked the deterioration in homeownership *affordability* (as a result of significantly higher housing prices).
- Clearly, when interest rates inevitably rise from their current record low levels, the extent of the deterioration in affordability over the past several years will become more evident.

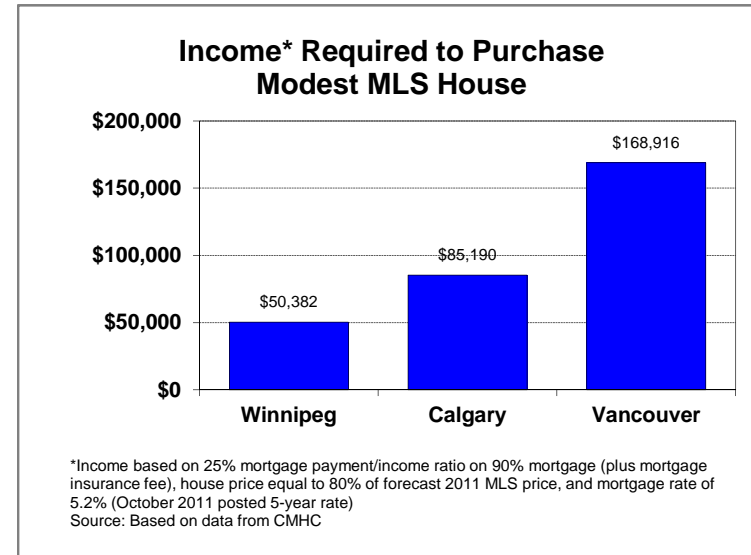
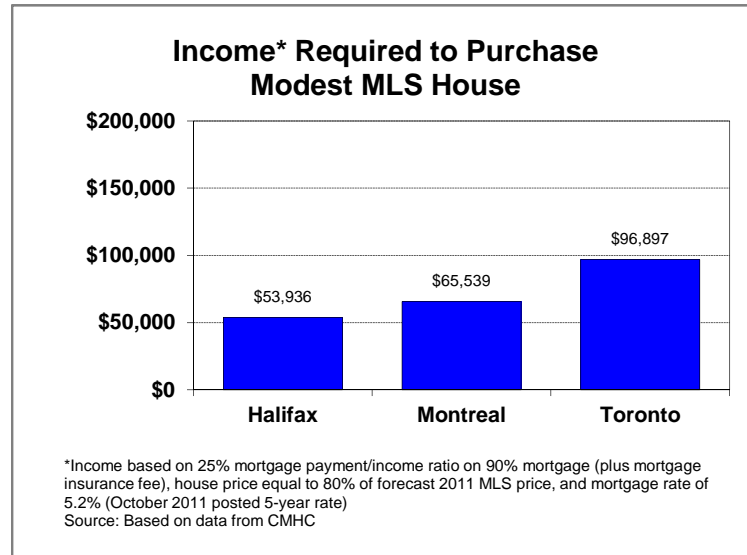
Incomes Required to Purchase a Home Will Increase Significantly When Interest Rates Rise



- When mortgage interest rates rise, the incomes required to purchase a home will increase as well.
- CMHC requires that mortgage payments, plus property taxes and heating costs cannot exceed 32% of income. For the analysis here, the minimum income required to buy an average home is defined to be mortgage payments alone totaling a maximum of 25% of income.
- Assuming a 4% mortgage rate (available as a ‘special offer’ from most lenders), an income of roughly \$85,000 is required to purchase the average MLS house (forecast by CMHC to be \$367,500 in 2011). However, federal regulations require lenders to ‘qualify’ borrowers at their current posted rates (roughly 5.2%, rather than use special offers), so the income required to qualify for a posted rate would be over \$95,000.

- When interest rates rise from their current rock-bottom levels to more normal levels, homeownership accessibility will deteriorate substantially. At 7%, for example, less than the 7.5% average rate for the past two decades, the income required to purchase the average MLS house is over \$113,000 (chart at right).
- Even with more modest homes than the MLS average (chart at left), an increase in mortgage rates will have a dramatic impact on homeownership accessibility.
- For a \$200,000 home, for example, an increase from current posted mortgage rates to 7% would raise the required income from \$52,300 to almost \$62,000.

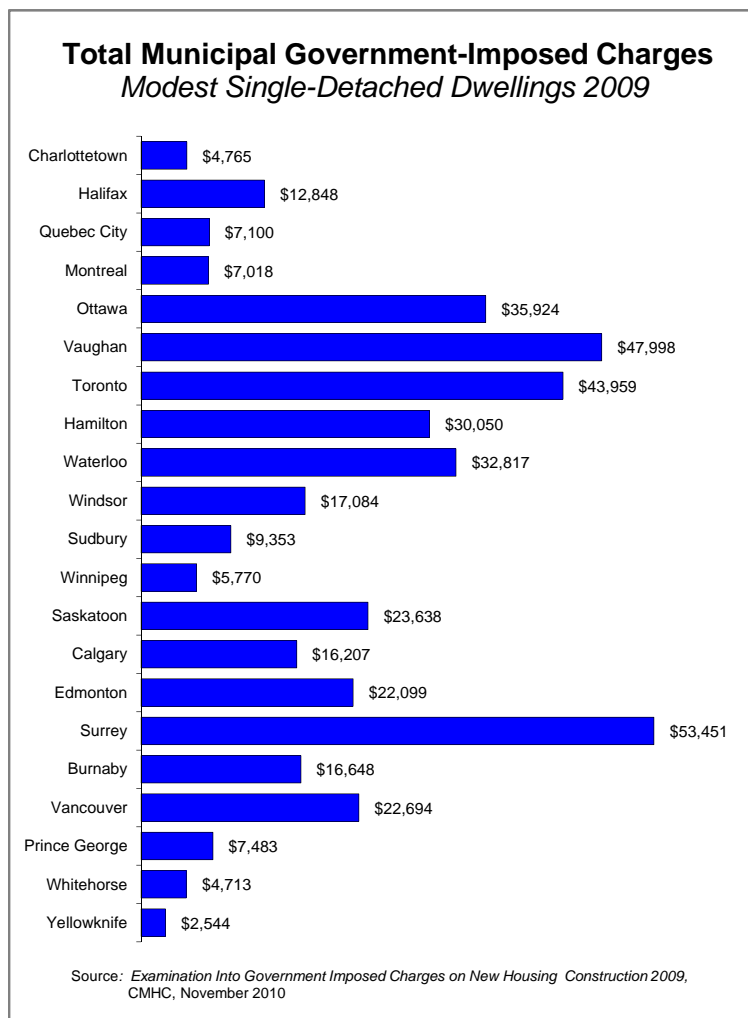
Higher Incomes Required to Purchase a Home in High-Cost Centres Such as Vancouver, Calgary and Toronto



- The income required to purchase a typical home varies significantly across the country.
- Based on similar assumptions to the analysis on the previous page (i.e. 90% loan; mortgage payments equal to 25% of income; the current posted mortgage rate of 5.2%), and assuming a modest home price (80% of the average MLS price), a first-time buyer would require an income of almost \$170,000 to purchase a home in Vancouver (80% of the forecast 2011 average MLS price is \$646,000).
- Similarly, in Toronto and Calgary, also high-cost centres, a first-time buyer would require an income of roughly \$97,000 (Toronto) and \$85,000 (Calgary) – based on modest homes of \$371,000 in Toronto and \$326,000 in Calgary (80% of the forecast 2011 average MLS house price).
- In Montreal, an income of over \$65,000 is required to purchase a house priced at 80% of the MLS average (\$250,000).
- In lower-cost centres, such as Winnipeg and Halifax, houses are much more affordable.
- In Winnipeg, an income of \$50,000 is required to purchase a house priced at 80% of the MLS average (\$193,000).
- In Halifax, an income of \$54,000 is required to purchase a house priced at 80% of the MLS average (\$206,000).
- As noted, these estimates are based on the current posted mortgage rate (5.2%). With special deals, 5-year mortgages are available at rates below 4%. However, as discussed, due to federal regulations, borrowers must qualify for the mortgage using the posted rate – not a discounted rate.

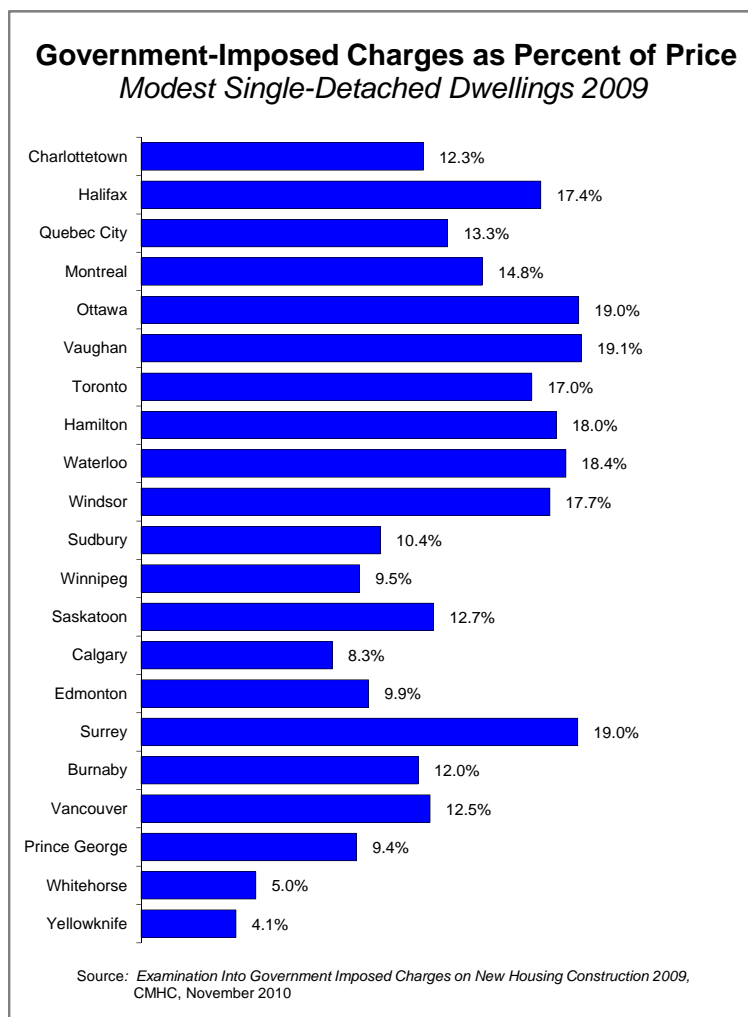
8. CHALLENGES FACING HOMEOWNERSHIP AFFORDABILITY

Heavy Municipal Levies, Fees and Charges on New Homes Reduce Housing Affordability – Charges Total Over \$50,000 in Some Municipalities



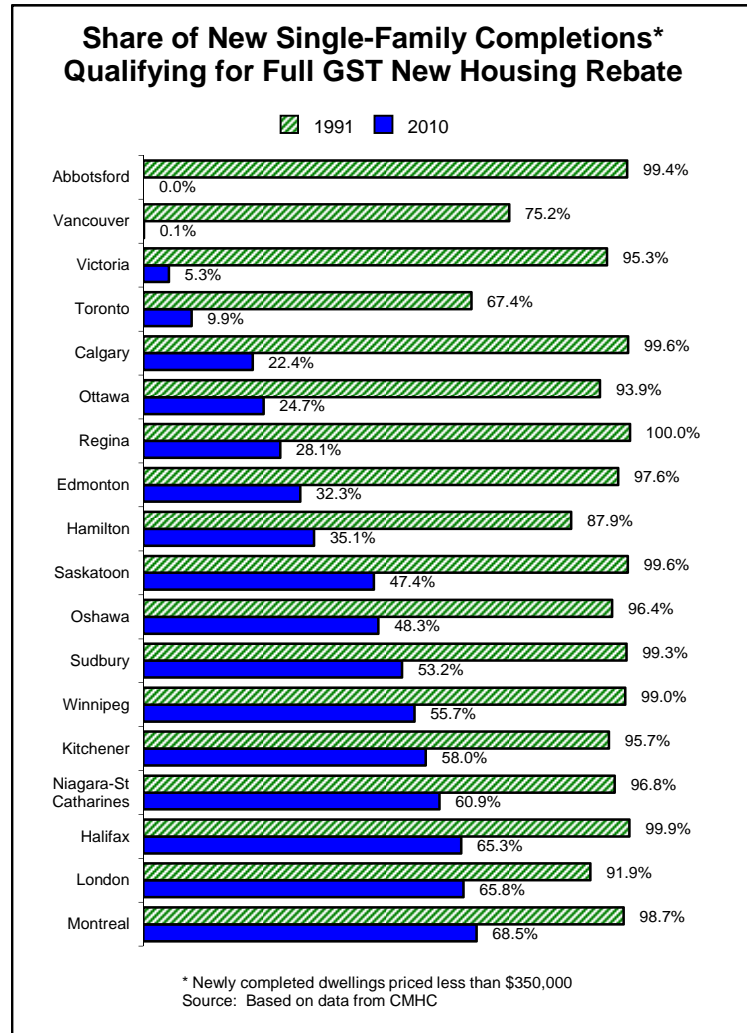
- Municipalities impose a variety of charges on new homes. These include development cost charges (DCCs) and lot levies, other infrastructure-related charges, development application processing fees, building permit fees, etc.
- *Examination into Government Imposed Charges on New Housing Construction*, a study conducted for CMHC, documented the total municipal charges for typical modest dwellings in 21 municipalities across Canada in 2009. According to the study, municipal government-imposed charges (GICs) on typical new houses range from over \$50,000 in Surrey, B.C. and \$48,000 in Vaughan, Ontario, to less than \$5,000 in some smaller centres in the country.
- The most important factor influencing the differences in total GICs 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 2009 updated the results from similar studies in 1996, 2002 and 2006 – though with fewer municipalities. The study confirmed that municipal charges on new housing continue to increase.

GST/HST, Provincial Taxes and Municipal Charges – Almost 20% of House Prices in Many Parts of Canada



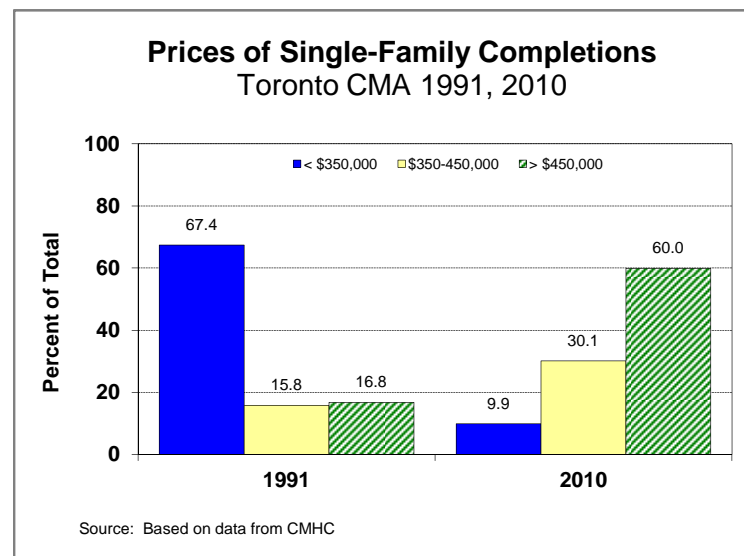
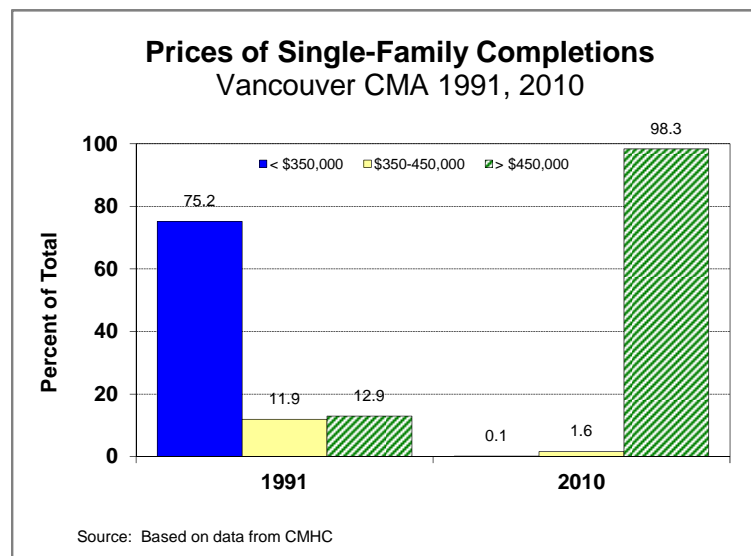
- In addition to the charges imposed by municipalities, both the federal and provincial governments collect significant revenues from new housing through the GST, and provincial sales and land transfer taxes.
- Taxes such as the GST/HST and land transfer taxes are applied to the price of a home. Since 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 almost \$100,000 in Vancouver.
- 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 19% or more of the price of a new house.
- 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, even with the reduction in GST, the total government-imposed costs on new houses have been rising. In the previous analysis (for 2006), none of the municipalities had total GICs of more than 18% of the price of a new house.
- In 2006, on average, GICs represented 12.6% of the price compared to 13.2% in 2009.

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



- 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 \$350,000-\$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.
- For example, only 0.1% of the purchasers of new single-family homes completed in 2010 in Vancouver qualified for the full GST rebate. In Abbotsford, the number was ZERO.
- 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 10% of the purchasers of new houses completed in 2010 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 98% of New House Purchasers in Vancouver
– 60% of New House Purchasers in Toronto Receive Zero GST Rebate**



- In the Vancouver CMA in 2010, 98.3% 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 (1.6%) received a partial rebate (homes priced at \$350,000-\$450,000).
- As indicated on the previous page, only 0.1% of the purchasers of single-family homes completed in Vancouver in 2010 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.

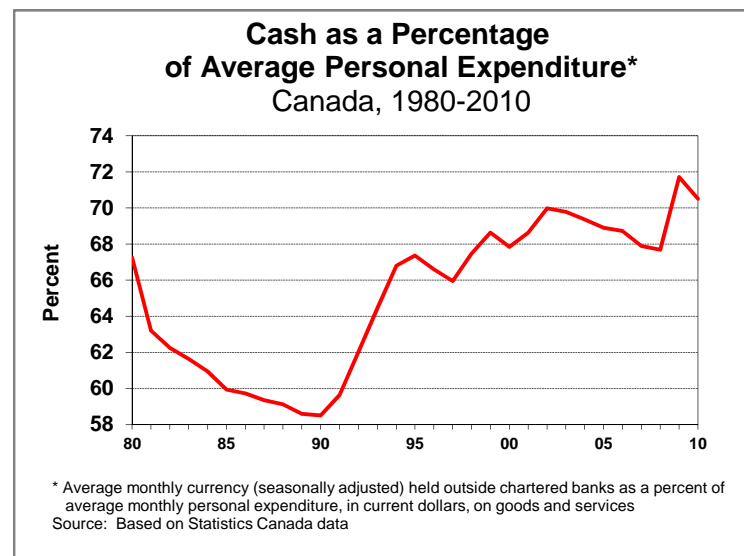
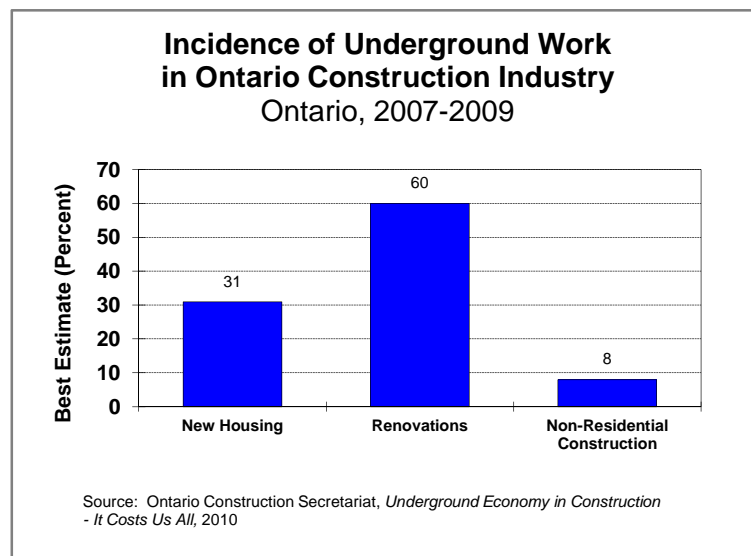
- In the Toronto CMA, 60% of the purchasers of new houses completed in 2010 received **zero** rebate – up from 16.8% in 1991. Only 9.9% received the full GST rebate.
- In 1991, in contrast, two-thirds (67.4%) of the purchasers of new houses received the full GST rebate.
- The Toronto CMA includes not 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. With harmonization in Ontario, the problem has worsened since Ontario has 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 Vaughan, 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 \$35,528 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.

9. CHALLENGES FACING THE RENOVATION SECTOR

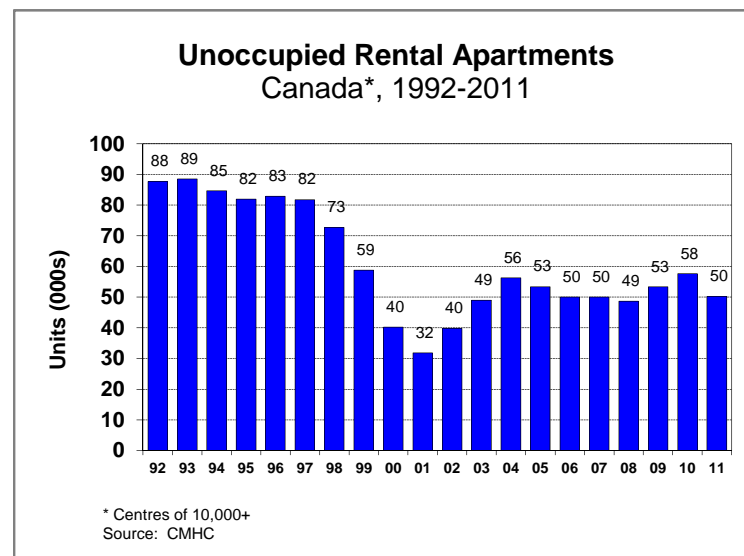
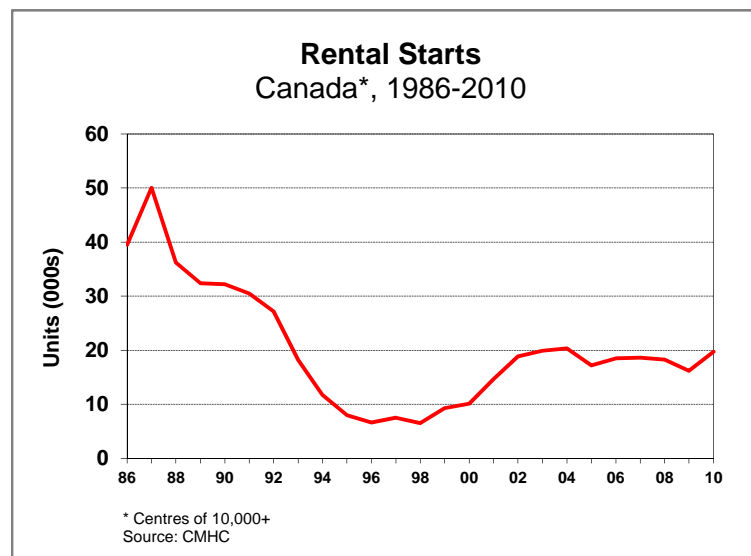
Underground Activity – A Serious Problem for the Residential Renovation Sector – Strong Link Between GST and Growth in Underground Practices



- A report prepared for the Ontario Construction Secretariat (OCS) estimated that revenue losses to governments in Ontario resulting from underground work in construction totaled \$1.4-\$2.4 billion annually during 2007-2009.
- The OCS report estimated that 60% of residential renovations were undertaken by underground operators. Underground practices are less common in other types of work.
- For Canada as a whole, Statistics Canada estimates that underground activities in construction (excluding repairs) total up to \$10 billion annually.
- The high volume of underground work is a serious problem. Legitimate tax-paying renovators have a severe competitive disadvantage with underground operators 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, the growth of the underground economy in renovations is likely to intensify.

10. CHALLENGES FACING THE RENTAL SECTOR

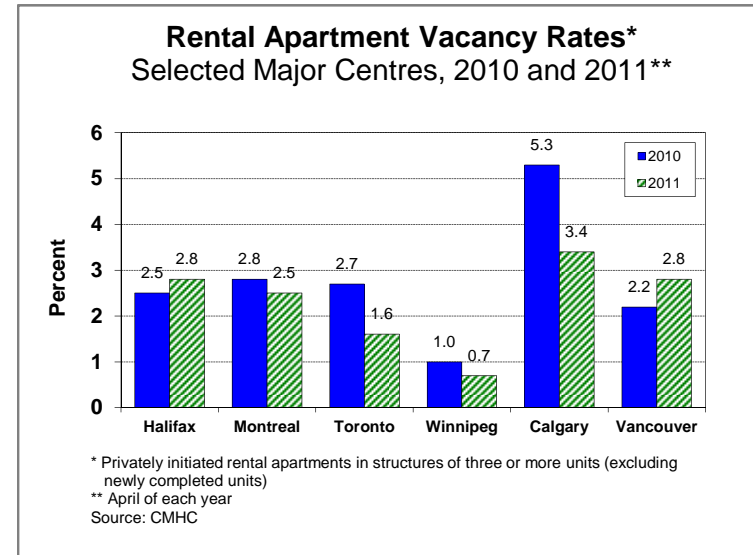
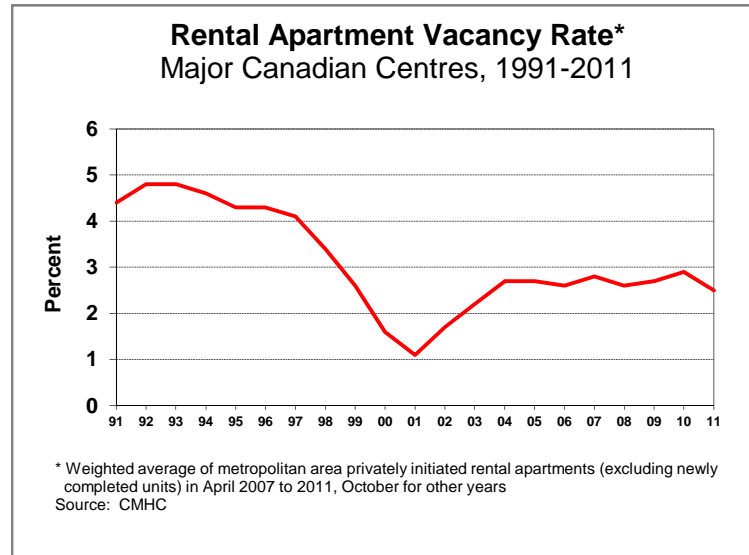
Low Volume of New Rental Construction Due to Poor Investment Economics – Declining Unoccupied Rental Units Bad News for Renters



- 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 and a greater number of rental condominiums.
- In 2011, there was a substantial decline in unoccupied rental apartments.
- 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.

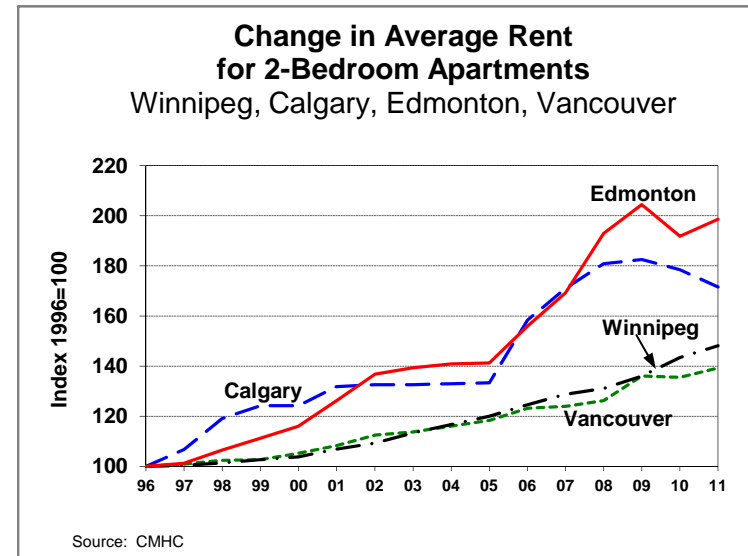
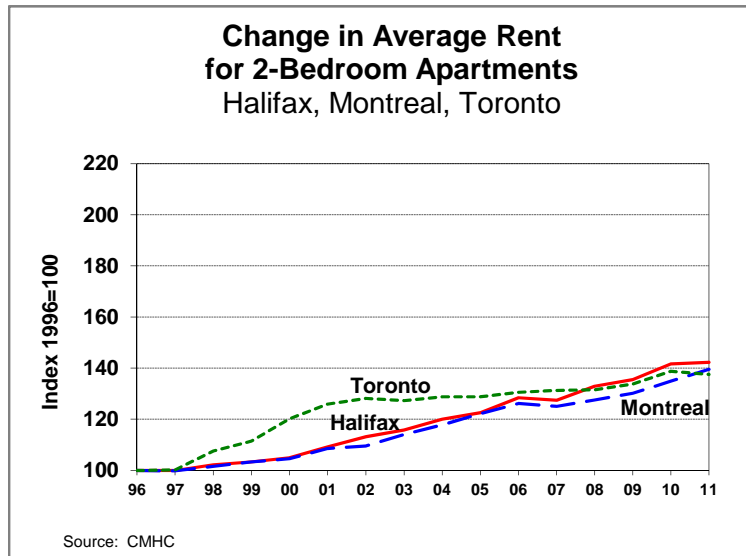
Drop in Rental Vacancy Rates in 2011 After Several Years of Relative Stability – Few Major Centres Have Extremely Tight Rental Markets



- The national rental apartment vacancy rate dropped to 2.5% in April 2011, according to CMHC – well below the 2.9% in 2010. Low levels of rental construction, a decline in the completions of condominiums (which are often rented) and an increase in immigration all contributed to the drop in vacancy rates.
- However, the overall national vacancy rate is within the 2-3% range indicative of a ‘balanced’ rental market.
- While lower than in 2010, the national vacancy rate is still well above the low of 1.1% in 2001, when rental markets were very tight in most major centres in Canada.
- 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.

- Sixteen of Canada’s 35 major centres have vacancy rates of more than 3%; 9 have vacancy rates in the ‘balanced’ 2-3% range; 8 have vacancy rates of 1-2%; and, 2 (Regina and Winnipeg) have *very* tight rental markets (vacancy rate of <1%).
- Among major regional centres, only Halifax (2.8%) and Vancouver have higher vacancy rates in 2011 compared to 2010. Vacancy rates in Calgary (3.4%) and Toronto (1.6%) have declined 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.

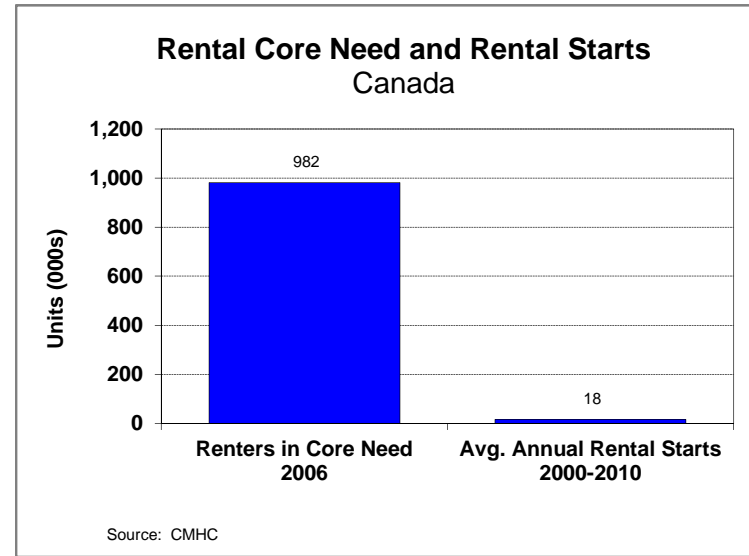
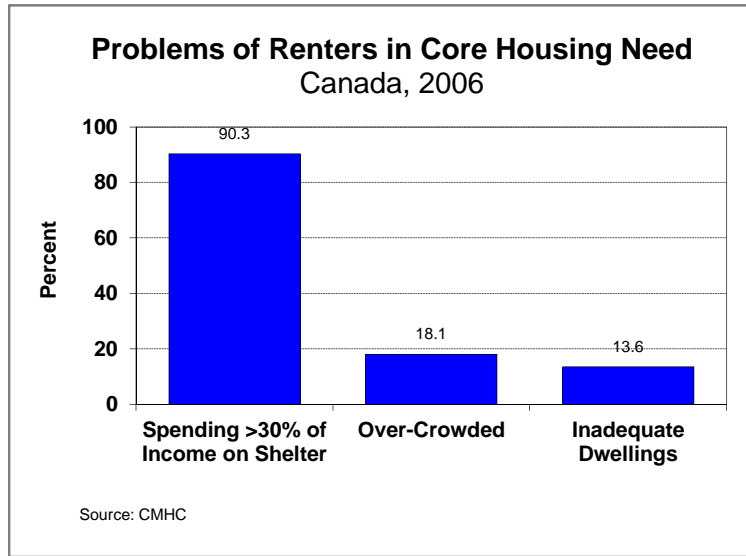
High Vacancies Dampen Rent Increases in Calgary and Edmonton – Low Vacancies Fuelling Rent Rises in Winnipeg



- 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.
- In Winnipeg, rents have been rising faster than inflation – a reflection of the substantial reduction in the vacancy rate.
- Rent increases in Montreal, Halifax and Vancouver have been relatively more modest – a reflection of more balanced markets.

**Affordability the Predominant Problem Faced by Renters in Need
– 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.