FEDERATION OF CANADIAN MUNICIPALITIES
FÉDÉRATION CANADIENNE DES MUNICIPALITÉS

THE HOUSING MARKET AND CANADA'S ECONOMIC RECOVERY

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The Federation of Canadian Municipalities (FCM) has been the national voice of municipal government since 1901. With close to 2,000 members, FCM represents the interests of municipalities on policy and program matters that fall within federal jurisdiction. Members include Canada's largest cities, small urban and rural communities, and 21 provincial and territorial municipal associations.

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Executive Summary

A healthy housing sector, able to meet a broad range of needs, is a vital part of the economic and social wellbeing of any community. Whether they are recent college graduates, new immigrants, or senior citizens, Canadians at various income levels and stages of life have different housing needs. To build a strong economy, healthy communities, and a mobile workforce, our housing market must be able to accommodate changing needs.

Canadians are feeling the strain of increasing costs of home ownership. They are also feeling the impact of decades of low levels of purpose-built rental accommodation, low vacancy rates, and rising rents. Meanwhile, a surge in the building of new condominiums has tended to push multi-residential land values up, further worsening the prospects for rental development.

High home prices, fueled in part by low mortgage rates, have contributed to the taking-on of high levels of debt by many households, and there may now be an imbalance in Canada's housing system.

Canada's home-price-to-rent ratio is at an all-time high. At the same time, new housing starts remain well below previous averages. The dramatic decline from 228,343 in 2007 to 149,081 in 2009, following the global financial crisis in 2008–2009, has resulted in the loss of 50,000 construction jobs, and a serious impact on both the construction sector and the economy. While starts have rebounded slightly, they are still well below the peak.

Current fiscal challenges facing all orders of government highlight the need to explore innovative and low-cost near-term solutions, in order to address persistent housing problems in communities across the country.

Although Canada's rental sector plays a critical part within a healthy housing system, it has been largely overlooked. Measures to create new rental housing, while also retrofitting what already exists, will help address a weakening housing system and contribute to a healthy economy.

The Federation of Canadian Municipalities (FCM) is proposing three initiatives designed to lower barriers to private-sector investment in rental housing; to stimulate the construction of new rental housing and retrofits; and to preserve existing affordable rental stock.

Increasing the construction of rental housing will protect construction jobs in the future. Canada cannot count on another boom in the new-housing market to replace jobs already lost. The fundamentals that supported growth in home ownership—declining mortgage rates, extended mortgage terms, low down payments, and a strong economic outlook—have ended.

Nor can we rely solely on home ownership to meet Canadians' housing needs. For many Canadians, the cost of buying a home has become prohibitive. Average costs for single detached homes doubled between 2001 and 2010, while household incomes have not kept up. At the same time, the Bank of Canada has warned about the historically high personal debt loads carried by Canadian households,[1] with mortgages making up 68% of this debt.[2]

We have entered a period during which a growing number of Canadians will need access to rental accommodation.

All orders of government must work with the housing sector, in order to provide a balanced mix of housing options able to meet the long-term financial realities of a changing population. New demographics include young people entering the rental market; new immigrants, who are sorely needed to fill labour gaps; a more mobile labour force; and Canada's aging population, which is projected to downsize and save for retirement.

1 Canadian Press, "IMF warns about Canadian household debt, housing prices", December 22, 2011, CTV on-line http://www.ctv.ca/CTVNews/TopStories/20111222/imf-warns-household-debt-housing-prices-111222/

2 CMHC, *Canada Housing Observer*, 2011 p.35

The Federation of Canadian Municipalities (FCM) is proposing the following three initiatives:

1. **The Building Canada Rental Development Direct Lending Program** to stimulate investment in new market-priced rental units.
2. **The Rental Housing Protection Tax Credit** to preserve and stop the serious erosion—through demolition and conversion to condominiums—of existing lower-rent properties.
3. **The Eco-Energy Rental Housing Tax Credit** to improve the quality of rental stock; reduce high utility costs for tenants; reduce emissions and environmental impact; and increase resale and future rental value to landlords.

While the private sector must drive creation of a more robust rental market, governments must act to lower barriers to investment, and implement supportive policies across the housing spectrum.

Housing and the Economy

Housing activity has long been recognized as an important contributor to economic performance.

Housing, along with municipal infrastructure, was identified by the federal Department of Finance, in Canada's Economic Action Plan (CEAP), as the activity with the highest multiplier effect and impact on GDP recovery. Each dollar spent on housing contributed to a $1.4 increase in GDP. Housing and infrastructure investment together added 82,000 of the estimated 220,000 jobs retained or created as part of economic recovery measures in 2009–2010.

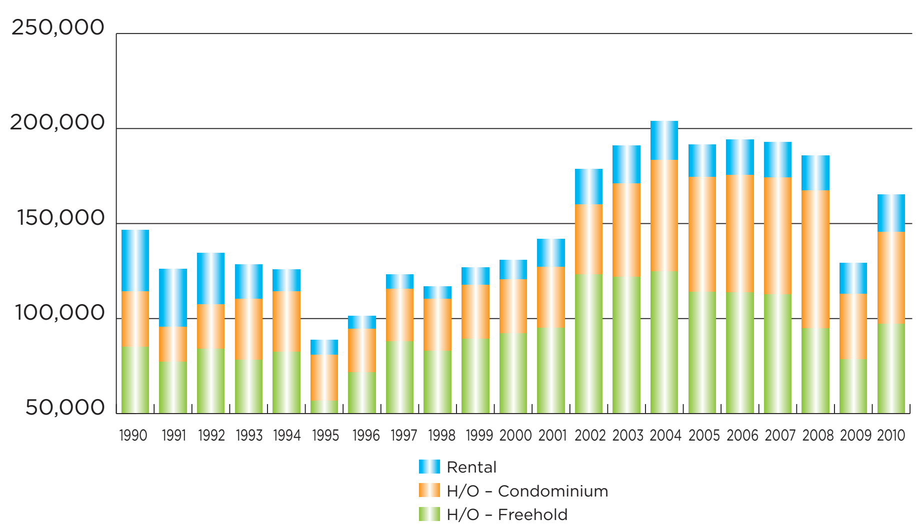
While varying in size and quality, each constructed house generates, on average, roughly 2.0 person years of employment. Fiscal measures directed towards housing are also effective in leveraging further private investment, because housing is typically financed such that direct investment often represents only 10–25% of total household expenditure. These effects are further enhanced when directed to lower-income households, where any assistance typically results in immediate consumption, rather than in savings.

Equivalent expenditures on renovations generate a similar, albeit slightly lower, employment multiplier (due to the purchase of imported appliances and equipment). For both new construction and housing renovations, an expenditure of $1 million generates roughly three full-time-equivalent jobs, and a further ten indirect and ancillary jobs.[3]

Housing starts are a leading economic indicator. Seasonally adjusted housing starts peaked in the third quarter of 2007 at 246,000, and subsequently fell to only 130,000 homes, representing a substantial impact on construction employment. CMHC is forecasting housing starts in 2011 to reach 183,000—a substantial recovery, but still well below the 2007 peak.

There is clearly underutilized capacity in the construction industry. Compared to much of the past decade, current and forecast housing construction levels are 25,000–30,000 below previous averages. This translates to potentially 50,000 fewer jobs, and an associated decline in related economic activity and government tax revenues.

Housing Starts by Type 1990-2010, Canada Centres 10,000+ (Rental starts, including social, average less than 10%)



Source; CMHC Canadian Housing Observer 2011

3 Figures generated by the author from CMHC Socio-economic Series Issue 69 Economic Impacts of Residential Construction, by deflating multipliers from 1986 dollars to 2010 dollars).

Rental Housing and Economic Recovery

Tenants are a significant part of the housing market. While this varies across cities, on average tenants make up almost one-third of all households: 4 million dwellings with over 10 million people.

The rental sector plays a critically important role in Canada's housing system. Reflecting transitions in life, many tenants are young, creating new tenant households when they leave the family home. Others are older, seeking apartment living when they no longer need or want to maintain larger family homes. Similarly, immigrant households, a critical component of labour market supply, initially rent before they transition to ownership.

Many tenants choose to rent because it is convenient. They can quickly end a lease and move, for example, to seek work in another location. Other "lifestyle renters" simply don't want the burden of mortgage payments and maintenance obligations. Many, however, are tenants by default: they are unable to access home ownership, usually because they lack the income and down payment to make the leap to ownership.

Tenants generally have lower incomes (with a median income less than half that of owners), sometimes because they are just starting out in the labour market, or have retired. For others, it may be that an individual or family lacks the skills, capacity or opportunity to earn the income necessary to afford ownership. Accessible and affordable rental options are critical in meeting the requirements and needs of this segment of the population. The default, for those unable to rent, is homelessness.

While Canada's small social-housing portfolio—representing 5% of all housing—helps almost 700,000 lower-income households, it is too small to help all of those in need. Expiring federal operating agreements—which will see a growing reduction in federal annual housing expenditure, reaching $500 million by 2020—further threaten the viability of one-third of Canada's social-housing stock. Most low-income tenants live within the private-housing sector, and there is a need to preserve and enhance the affordability of this part of the housing system.

Barriers to Rental Market

In light of collapsing ownership markets in Britain and the United States, many households have sought rental accommodation as they re-establish themselves after personal financial crises, including loss of their owned home. In economies only indirectly hit by the global financial crisis, such as Australia and New Zealand, attention is turning towards ways of ensuring an effective and robust rental sector. Canada has an opportunity to be proactive, and to get ahead of these issues, by ensuring that the rental sector is a sound component of a healthy housing system.

Rental markets have already reversed, following a trend towards increasing vacancy rates in many cities, as households moved out of rentals in the early 2000s. Through the economic and housing boom of the past decade, to 2008, vacancies gradually increased from 1.7% in 2002 to 3.0% by late 2009 (weighted national rate). The rate then declined from 2.9% in April 2010 to 2.2% in October 2011. The 2009–2011 trend was evident in 21 of 35 metropolitan centres in Canada.

This is evidence of tightening markets in two of every three metropolitan centres (over 100,000 population) in Canada. Lower vacancies contribute to pressure on rents and issues of affordability—which are five times higher among tenants than among owners (CMHC 2010).

Although tenants make up one-third of all households, rental construction over the past 15 years has accounted for only 10% of all housing starts. Low supply creates constraints and places upward pressure on rents.

A number of factors underlie the lack of rental production, including rent regulation and taxation of rental investment income; foremost among these factors, however, are the fundamentals of new construction. The rental income generated is insufficient to offer a reasonable rate of return for investors, because costs are out of balance with revenues. This disincentive to invest in rentals is in large part attributable to the impact of condominium development, which sets the price for multi-residential land.

In some cases, municipal and provincial intensification policies result in the demolition of existing rental housing, with the new housing predominantly built for the condominium market (although some indirectly becomes rental when owners buy as rental investors). This further erodes rental stock, and usually removes older, more affordable, rentals.

Further underlying the cost imbalance, many of the aforementioned policies and incentives to facilitate and encourage ownership—such as first-time-buyer tax credits, RRSP down payments and favourable mortgage terms—have increased the consumer's capacity to pay. This has in turn raised house prices and condominium values.

High condominium apartment prices have thus undermined the viability of new rental construction: they are competing for the same multi-residential-zoned land; but condominiums generate a higher yield, thus causing higher land values. As a result, the rental sector is not growing. Indeed, because the loss of existing units exceeds low levels of new construction, the availability of private rental stock is contracting. For the first time ever, the absolute number of rental dwellings, as recorded in the Canadian census, declined between 2001 and 2006.

The contraction of rental supply is occurring precisely at a time when demand is shifting back to this sector. This is expected to lead to continued tightening in rental vacancies, and upward pressure on rents.

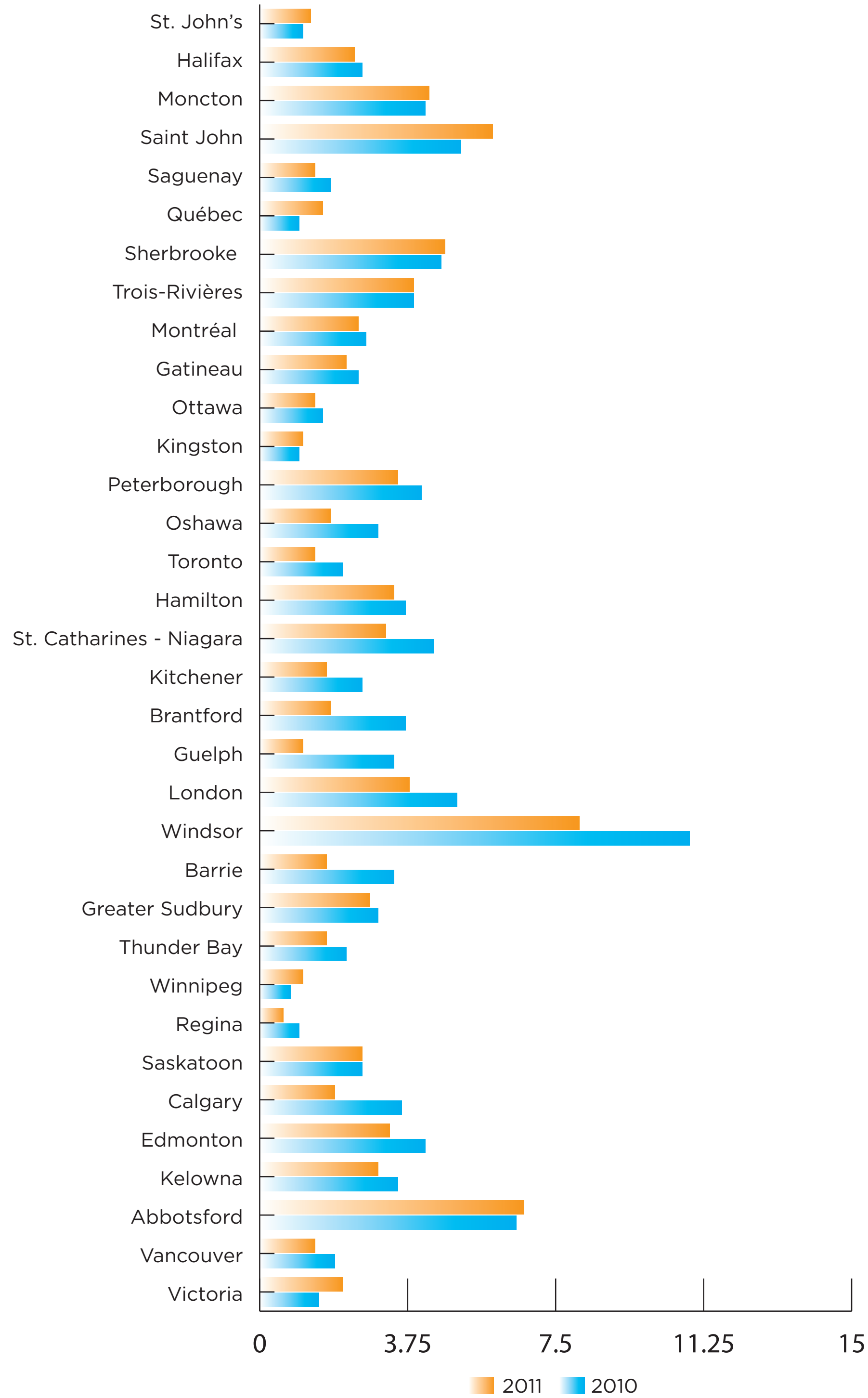
Growth and Rental Demand

In addition to shifting demand and tenure preferences, population growth creates a need for rental housing. Recently updated projections of household growth (CMHC 2011) identify anticipated levels of total household growth, as well as a demand for different housing types: family vs. non-family, and rental vs. ownership.

Although the projections use a range of scenarios, mid-range forecasts suggest total growth of roughly 150,000–170,000 households annually.

As noted above, when conditions were favourable, there was a significant trend towards home ownership between 2001 and 2006.

2011 Rental Vacancy Rates, Canada and CMA's (In private structures of 3+ units)



Source: CMHC (Rental Market Survey)

With moderation of the key factors discussed above—mortgage rates already low and likely to rise, and a slowing of employment and income growth—it is unlikely that this rate of ownership will continue. Assuming a lower rate of growth in ownership means that more households will continue as tenants.

CMHC mid-range estimates suggest that **growth in tenant households over the next decade could range around 50,000 annually** This growth in tenancy far exceeds the supply of new purpose-built rental construction for any time in the past decade—which has generally been 15,000–20,000 units, much of which is related to affordable housing and stimulus initiatives. Again, without a supply response, there will be upward pressure on rents and a potential increase in affordability issues.

Addressing both lack of supply and affordability could result in a requirement for high levels of subsidy: $120,000–150,000 per unit, for example, under the new Federal—Provincial/Territorial affordable housing framework initiative. This will likely limit the volume of units produced: the Affordable Housing Initiative has generated fewer than 5,000 units of new housing per year since 2001.

Increased Market Supply and Affordable Housing

It is important to identify the impact of supply on affordability. Although many provinces are now considering the possibility of addressing the latter via housing allowances or housing benefit programs, the need for a supply response remains, albeit not necessarily at low rents.

General rental supply (e.g., rents at 120–140% of average market price) can fill an important supply gap, and such supply helps to mitigate the pressures that push rents on existing stock higher. At these rent levels, development begins to be more realistic for investors, although some additional encouragement is still required.

There is an economic argument to be made for building new units at moderate-to-high rents, in order to increase the overall supply. Concurrent options to preserve the more affordable existing rental stock—for example, by facilitating the purchase of existing investment properties by non-profit operators who will preserve existing affordability—must be pursued to separately address affordability.

Providing rental assistance to tenants in non-profit-operated units also involves lower inflation in program costs over time, as rents are cost-based, rather than market-based.

Municipalities Respond

Cities and communities across Canada have been implementing an array of initiatives to increase and preserve affordable and market-rate rental housing. Federal-provincial affordable-housing initiatives have been vital to this development.

The **City of Vancouver**, which has the highest cost of home ownership of all Canadian urban centres, estimates the need for an additional 1,070 rental units each year to meet current requirements. Vancouver offers a suite of incentives and initiatives to encourage the development of purpose-built rental housing, including condominium conversion restrictions, demolition restrictions, and the monitoring of rental-housing supply. Meanwhile, the **City of Regina** offers developments with five or more rental units in any part of the city a 90% property-tax exemption for a period of three years.

The **Region of Waterloo** recognizes housing as a key component of community sustainability, and as a regional priority that makes economic sense. Between 2001 and 2008, the Region saw $128 million in capital expenditure by the local construction industry, including the construction of more than 1,500 affordable rental units. Waterloo has also been highly successful in finding housing partnerships: every dollar spent by the Region on housing initiatives leveraged $13 from other sources.

The demand for adequate, suitable and affordable housing in the **City of Calgary** continues to grow, along with the city's high rents ($1,084 for a two-bedroom apartment); low vacancy rates (1.9%), increased immigration; and a continuously declining rental supply due to condominium conversions.

Among its several housing initiatives, Calgary launched the Secondary Suites Grant Program in 2009, ending in May 2012 (primarily using provincial funding). This $6-million program provides up to $25,000 in grants to upgrade an existing suite, or to create a new suite. The homes must be owner-occupied, and the suite must be rented at no more than average market rent for five years. To date, 180 suites have been committed under the Program.

The **City of Gatineau** is planning to build 175 social housing units in 2012. In addition, Gatineau will contribute $1.1 million to the Office municipal d'habitation for affordable housing, and another $1.1 million to the Rénovation Québec program.

In August 2009, the **City of Toronto** adopted "Housing Opportunities Toronto: An Affordable Housing Action Plan 2010–2020". This established a plan to deal with the spectrum of housing needs in Toronto, including a shortage of affordable housing supply, and an increasing number of people waiting for social housing.

Under Canada's Economic Action Plan (2009–2011), the City of Toronto has successfully partnered with the federal and provincial governments to create 2,712 new affordable homes for some 5,200 Torontonians. Toronto residents being served include seniors, persons with disabilities, single mothers and their children, Aboriginal persons, and other low- and moderate-income families and individuals. The creation of new affordable homes has also had a significant impact on the economy, in that it has created more than 6,700 jobs.

Moving Forward

Although the short-term CEAP measures were highly successful in helping the Canadian economy weather the storm caused by the global financial crisis, recent turmoil in the Eurozone, and the continued weakness of the U.S. recovery, have created ongoing uncertainty for the near-term future of the Canadian economy. Recent forecasts by leading economists and by the Governor of the Bank of Canada suggest a period of slow growth (GDP growth below 1%).

Accordingly, while the federal government is seeking to contain deficit spending, there is also a need to ensure a "soft landing" and prevent a return to recession. However, given that the government also seeks to contain its expenditures and begin reducing the deficit, low cost–high leverage mechanisms (as suggested here) are a desirable option, as compared to the much higher expenditures under CEAP.

As noted, reduced housing activity can have a significant impact on employment; conversely, sustaining and expanding construction activity generates employment and significant multiplier effects.

Forecast requirements for rental housing, coupled with a potentially weakening economic outlook, provide an opportunity to direct cost-effective incentives for the rental sector. Initiatives to encourage construction of new rental units which would fill the net shortage (20,000–30,000 units annually) could offset anticipated declines in new housing starts, while sustaining the economic benefits of the home-building industry.

Various housing-related measures under Canada's Economic Action Plan targeted two of three parts of Canada's housing system. The home buyer tax credit and renovation tax credit were directed to homeowners, or future home owners; meanwhile a series of social housing measures ($2 billion in total) supported the construction of housing for the disabled, for seniors, and for northern regions, as well as the rehabilitation of existing social housing.

Unfortunately, rental housing was not included in these earlier measures (other than social housing) and, as in other housing policies, this important part of the housing system is being overlooked.

Rental housing has unique and important attributes, and can be an effective part of economic stimulus:

- Rental housing accommodates many low- to moderate-income households. The federal Department of Finance has noted the direct consumption effects of enhancing the disposable income of lower-income households. Reducing their shelter expenditures can have a similar effect to reducing their taxes: increased consumption of non-housing consumer goods.

Rental investment has a positive impact on labour productivity, and can avoid some of the negative effects on productivity caused by an ownership market with inflating prices:

- When house prices rise, as they have done consistently over the past decade, households have to invest more (and take on larger mortgage payments), simply to afford existing fixed assets. Buying new homes is a very small component of total housing expenditure—most flows through existing stock. Because the assets already exist, **there is no effect on productivity related to higher housing expenditure**. Indeed, there is a negative effect as investment shifts away from more productive goods-producing activities (Maclennan 2008 Mark Carney 2011).[4]

- Tenure is associated with labour mobility: tenants have a much higher rate of mobility.
- High housing prices/costs create labour-mobility traps. In particular, owners in lower-cost markets (often with fewer job opportunities) cannot afford to move to higher-cost areas. This causes an imbalance in labour supply, and contributes to higher unemployment, higher Employment Insurance payments, and lower tax revenues.
- Tenants are generally more mobile; but even here, mobility is impeded by a lack of rental accommodation.
- Businesses—especially small businesses—in higher-cost labour markets have difficulty recruiting workers, due to high housing costs.

Most tenants, and many low-to-moderate-income tenants, occupy properties that are privately owned and managed. These are typically older structures, often in need of repair. Many have poor energy efficiency, thus imposing substantial utility costs on both tenants and landlords.

CEAP energy initiatives have demonstrated potential utility-cost savings of up to 20% in household energy bills. Such reductions for low-to-moderate-income tenants would significantly improve issues of fuel poverty, while also aiding landlords.

Even modest energy measures—such as efficient lighting, replacing water boilers, and adding heat recovery—can reduce utility costs by up to 15%. And these are low-cost investments. Additional measures to improve insulation of the building envelope, and perhaps replace windows and appliances, can further enhance savings. In most cases, such measures can be self-financed via reduced costs, although this then removes the benefit to low-income tenants who have high fuel-cost burdens.

4 Maclennan, Duncan, *Housing for the Toronto Economy*, Research Paper 212 Cities Centre, University of Toronto, 2008; Carney, Mark, *Housing in Canada*, Remarks by Mark Carney Governor of the Bank of Canada Vancouver Board of Trade, June 15, 2011, Vancouver, B.C.

Conclusion

Smart investments in the rental sector support a strong economy through labour mobility and productivity. A shift in focus to the rental component of Canada's housing system can create important economic benefits, generated by the housing sector. Increasing the supply of our overall rental stock will further support a broad range of housing needs and ensure a more robust housing sector.

Proposed Rental Initiatives

FCM has outlined three initiatives to strengthen the rental sector, while enhancing the economic impact of the housing sector.

The options outlined below propose targeted policy solutions to preserve and enhance Canada's rental stock; expand the construction sector; and contribute to a stable, vibrant housing sector.

1. **Building Canada Rental Development Direct Lending Program** to stimulate investment in new market-priced rental units.

The need for excessive investor equity can be significantly reduced through a low-rate lending facility, drawing on CMHC's ability to obtain funds under the Crown Borrowing Framework. The maturing of social-housing mortgages is creating new room under CMHC's authorized direct-lending cap. A portion of this could be reallocated and used to create a rental-housing loan program.

With the primary objectives of increasing rental supply and injecting funds into the construction sector, this program would target new rental housing—not just at affordable rents, but also at market rates.

- Drawing on CMHC's ability to obtain funds under the Crown Borrowing Framework (2.5–3.5%), this program provides low-interest loans to reduce the need for excessive investor equity.
- These financing rates are possible at no cost to the Government of Canada.

The program has further potential to increase incentives for rental properties that commit to a moderate rent (within 10% of the market average), by providing an interest-rate subsidy that reduces rates to 1% or 2%.

Potential Cost: None for current low-interest loans.

Utilizing the Crown Borrowing Framework could stimulate additional rental units at no cost to the federal government, save for a contingent liability to manage the risk inherent in high-ratio rental loans (and this can be managed via CMHC mortgage insurance).

Further subsidies for a 1% or 2% rate would require annual subsidies of roughly $2,000 per year for each year in a ten-year term: nominally $20,000 per unit. A target of 10,000 moderate-rate new rental units would imply an ongoing annual subsidy of $20 million (for ten years). The size of lending capacity required for each 1,000 market units built would be between $145 million and $184 million per year over ten years. The parallel facility to support affordable development assumes stacking with existing CMHC AHP grant subsidies, and ignores the subsidized 1% interest rate. It thus has lower financing requirements: roughly $100 million/year for each 1,000 units financed.

2. **Rental Housing Protection Tax Credit** to stop the serious erosion—through demolition and conversion to condominiums—of existing lower-rent properties.

- Credits property owners for selling relatively affordable assets to eligible non-profit providers and providers who agree to hold rents at average market prices for 20 years, thereby preserving the asset and ongoing affordability.
- Targets small investors who purchased assets for investment, but who face significant tax liability upon sale.

This tax credit could facilitate the transfer of up to 10,000 existing affordable rental units to non-profit ownership.

Potential Cost: Assuming a maximum credit of $25,000 per unit, and a target of 10,000 units transferred, maximum expenditure would be $250 million annually.

3. **Eco-Energy Rental Housing Tax Credit** to improve the quality of rental stock, reduce high utility-cost burdens for tenants, reduce emissions and environmental impact, and increase resale and future rental value to landlords.

- Provides credit for low-to-moderate rental property owners when they invest in energy-efficiency upgrades (as tenants commonly pay utilities, no incentive currently exists).
- Contributes to improving the quality of rental stock; lowers utility costs for tenants, thus increasing affordability; and reduces emissions and environmental impact.

Potential Cost: Five percent of renters experience high home-energy costs. With an estimated 20% of uptake by small landlords (20,000 units), at a maximum credit of $7,500/unit, the total expenditure would be $150 million.

A parallel credit can also be designed for landlords in which they pay a portion of utility costs (e.g., those with central heating systems). There is a more direct benefit in this case, and some potential to securitize energy savings as a way to partially fund the cost of retrofitting.

This would contribute to the improved quality of rental stock, directly improve high utility-cost burdens for tenants, and reduce emissions and environmental impact.

At a maximum credit of $7,500/unit, with take up of 20,000 units, the total expenditure would be $150 million. This expenditure would contribute to employment in the energy retrofit industries. Each $1 million of expenditure is expected to contribute to three full-time-equivalent jobs, and up to ten full-time-equivalent jobs in ancillary sectors (although this is mitigated when energy components involve imports).