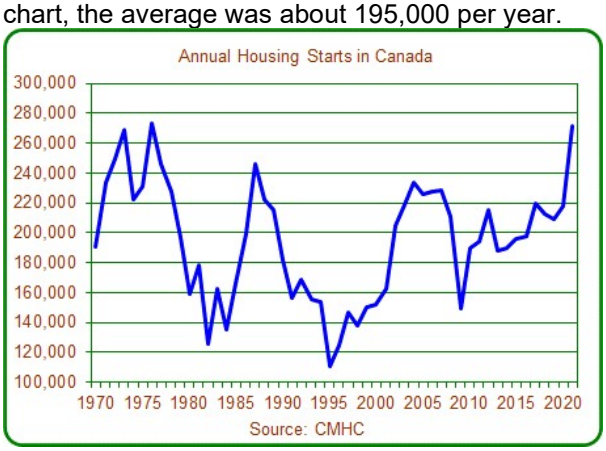
Housing Market Digest

Canada, July 2022

The CMHC Report

A new CMHC report (June 23) concludes that to restore housing affordability in Canada, the housing inventory needs to expand to more than 22 million dwelling units by 2030 (versus about 16.3 million in 2021). About 5.8 million dwellings must be created by 2030, almost 650,000 per year. By contrast, during 2017 to 2021, housing starts in Canada averaged about 226,000 units per year. Prior to that, annual production figures were even lower. Over the period shown in this chart, the average was about 195,000 per year.



You can access the CMHC report via the Download button on this page: https://www.cmhc-schl.gc.ca/en/professionals/housing-markets-data-and-research/housing-research/research-reports/accelerate-supply/housing-shortages-canada-solving-affordability-crisis

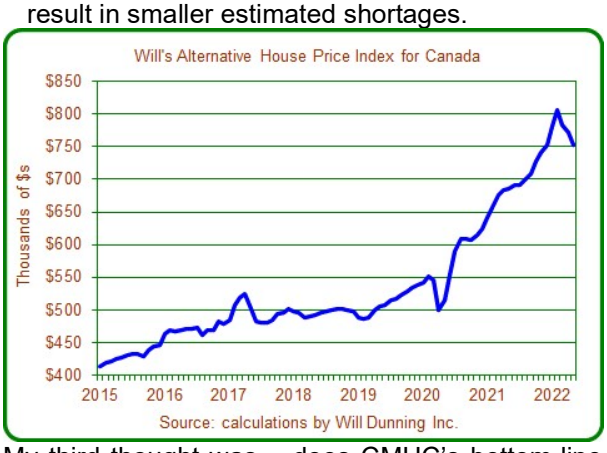
I have some thoughts and questions.

This must be causing some animated discussions in Ottawa: CMHC's website says its aspiration is that "by 2030, everyone in Canada has a home that they can afford and that meets their needs". Does the federal government want to have accountability to achieve this production target? What new federal programs will be required? Is the federal government willing to spend tens of billions of dollars per year on this (via direct investment, subsidies, and tax expenditures)?

My second thought was – is the methodology sound and are the assumptions reasonable? The concept is original and creative and I like it: how much housing supply is required as of 2030 so that the level of affordability will be the same as in 2003/04 (the period of the best affordability of the past three decades.) That said, I'm not in a position to assess the execution of the analysis.

I do see two points for discussion, on assumptions and methodology – interest rates and recent price trends. Both of these points suggest that CMHC has significantly over-estimated the shortages.

- The assumption about interest rates will profoundly affect the estimates of future housing costs and therefore how much housing prices need to be reduced and how much new housing is needed. The analysis assumes that "The 5-year fixed discount mortgage rate will be just over 5% in 2030." The Bank of Canada produces data on actual contracted rates. For the period of the available data (January 2013 to May 2022), the average rate for insured mortgages was 2.94%. If future interest rates are materially lower than the >5% assumption, CMHC's calculation of the amount of housing required should be much lower. Today, it might appear that 5-year fixed rates (just over 5%) are supportive of CMHC's assumption. But, variable rates are considerably lower. And, I argue in the Toronto edition of HMD that interest rates have overshot and are likely to fall back quite a lot.
- Another way to put this is – if interest rates are at the >5% level assumed by CMHC, that alone would be enough to drive very large price reductions, even without additional supply (see the GTA edition for July).
- Recent price trends are also an important consideration. It appears that CMHC made its calculations of how much prices need to fall (and therefore how much additional supply is needed) based on average prices for 2021. If that calculation had been made using the prices that were even higher earlier this year, the calculated shortages would have been even larger. But, with the price reductions that are now developing, in a few months prices will be below the 2021 averages: future calculations should result in smaller estimated shortages.



My third thought was – does CMHC's bottom-line conclusion seem realistic? I'm skeptical.

The average household size in Canada has slowly trended downwards, due to aging of the population of Canada and long-term trends for reduced marriage and child-bearing.

There are several ways to calculate household size. For the purpose of this discussion, it's best to use the total population divided by the total number of dwellings (this includes occupied and unoccupied dwellings).

In the CMHC projections, the average number of persons per dwelling in 2030 would be far below the prior figures and the trend. This large drop in household size would move us from a condition of housing shortages to one of extremely large surpluses. This would result in some combination of very large numbers of vacancies and very sharp reductions of rents and prices.

Total Persons per Total Dwellings			
Period	*Total Population*	*Total Dwellings*	*Ratio*
2001	30,007,094	12,548,588	2.39
2006	31,612,897	13,576,855	2.33
2011	33,476,688	14,569,633	2.30
2016	35,151,728	15,412,443	2.28
2021	36,991,981	16,284,235	2.27
2030 CMHC	41,431,019 (1)	> 22,000,000	< 1.9
Source: Statistics Canada, Census data Note: (1) the CMHC report indicates that the 2030 population will be about 12% higher than in 2021.			

There has often been commentary that Canada has over-invested in housing. I argue the contrary: housing prices have increased so much because we have under-invested. The CMHC analysis, to me, is consistent with that view. But, the CMHC scenario would result in an extreme amount of over-investment (I think that the target for 22 million dwellings in 2030 would be 10-15% more housing than is realistically needed). While this would be great on the consumption side, it would be catastrophic to the wealth of Canadians and very stressful for the financial system.

CMHC has become very involved in the discussions about housing shortages. But, a lot of its conclusions are about what should be done by other bodies. Its commentary could be even more useful if it gave more attention to discussing what roles it could play directly.

I argue that mortgage regulations that inhibit home buying (the stress tests and the 25-year limit on amortizations for insured mortgages) have suppressed new housing supply. For example: https://twitter.com/LooseCannonEcon/status/1531970613719482374
CMHC should discuss this issue.

CMHC has also released a report on government-imposed costs on housing. They make the useful point that uncertainty about those costs impede supply. But, more important is that the levels of those costs contribute to price growth and are an impediment for new housing construction. That is an issue that desperately needs to be fixed, and CMHC could directly help with that.

Half a century ago, housing-related infrastructure was funded by debt (loaned by CMHC, by the way). The borrowings were repaid out of municipal realty tax revenues. That funding system was very supportive of housing supply (the first chart on Page 1 shows that the 1970s was a golden age for housing construction, with starts averaging about 234,000 per year). On the other hand, the current system of funding via immense add-on charges is a deterrent, which has blunted the response to the strong signals that were sent by rapid price growth. CMHC could make a big contribution by leading a discussion about whether we should return to the old funding model.

Resale activity continues to slow: for June, the annualized sales rate was 481,000. I look at sales on a population-adjusted basis: sales in June were 12% below average (and that indicator is deteriorating rapidly). In June, my alternative price measure was down by 3.3% versus May and there is a total drop of 9.5% versus February. As I argue in the Toronto edition, at current interest rates there is a strong likelihood of large further drops that are going to create a lot of economic damage.

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