RESEARCH BRIEF
CANADA CONSTRUCTION

IPA INSTITUTIONAL PROPERTY ADVISORS
A DIVISION OF MARCUS & MILLICHAP, BROKERAGE

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Building Intentions Begin to Slow as Elevated Borrowing Costs Take Hold

Permitting activity losing momentum. When the Bank of Canada started its interest rate hiking cycle, residential permitting activity began to decline, down 17 per cent between May 2022 and February 2023. As a result, housing starts in Canada dropped nearly 8.0 per cent year-to-date as of November 2023 when compared to the same time period in the prior year. However, once Canada's Central Bank paused its interest rate hiking cycle in March of last year and uncertainty began to show early signs of abating, residential development activity gained some momentum. The value of building permits issued was up 5.3 per cent as of November, and housing starts began to trend up. This was mainly fueled by strong gains in the multifamily sector as permitting increased by just under 10 per cent over the course of 2023. Stabilizing interest rates, healthy rent growth, historic population gains, and low-cost financing provided by the CMHC all helped support this uptick in construction activity.

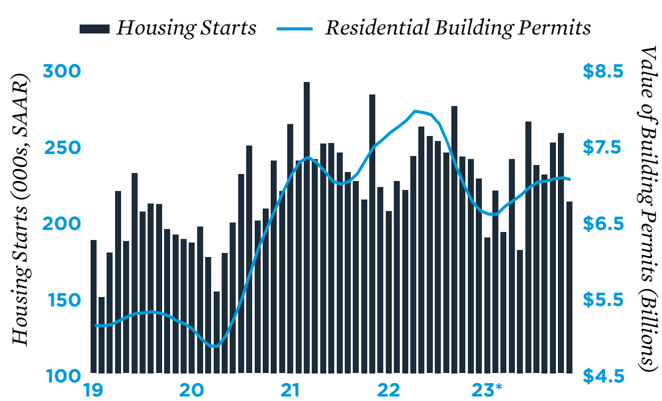
New supply to be limited over the medium-term. Robust population growth amid historic immigration, combined with government policy created in order to kickstart purpose-built rental construction, will likely keep housing starts above historic standards over the course of this year. Despite a fall that is forecast for the second quarter, borrowing costs will still be historically elevated, likely leading permitting activity and housing starts to trend lower in 2024. Past weakness in home sales are set to flow through into new supply, while ongoing labour shortages will continue to hinder the feasibility and timeliness of new projects.

Commercial Real Estate Outlook

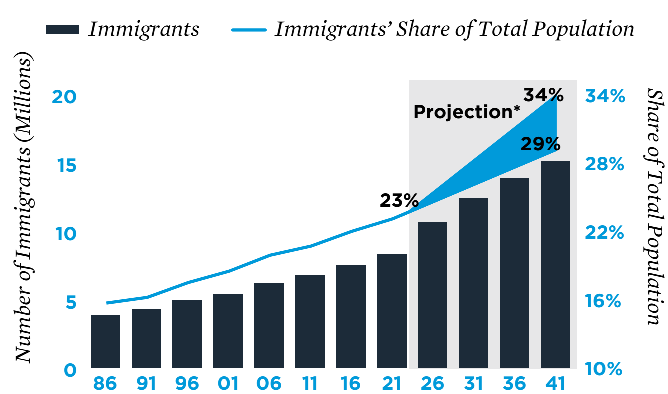
Housing imbalance to widen. Canada's population expanded at a record-setting pace as of the end of the third quarter of last year, growing 3.2 per cent annually amid historic immigration. The nation is set to welcome an additional 1.5 million new permanent residents over the next three years and will likely continue to see elevated levels of temporary residents, as the nation is the world's third-most popular destination for international students. Combined with the expectation that housing starts will drop amid elevated borrowing costs and weak home sales, Canada's housing supply-demand imbalance is set to grow. As a result, multifamily performance will remain robust. The nation's vacancy rate is expected to end 2024 hovering around 2.0 per cent, which will help keep annual rent growth in the 4.0 to 5.0 per cent range.

Supply of purpose-built rentals to see a boost in the long-term. Canada's ongoing housing imbalance has resulted in an increasing need for purpose-built rentals, in order to provide more affordable housing for Canada's growing population. Consequently, increasing apartment supply has become a major area of focus for levels of government. Recent policy changes, such as the Housing Accelerator Fund, the Enhanced GST Rental Rebate and the expansion of the Canada Mortgage Bonds issuance limit, allowing for more low cost financing provided by the CMHC are all examples of such initiatives put forward to increase rental supply across the country. With such incentives now being offered, combined with healthy rent growth seen across the sector, purpose-built rental construction should gain momentum once borrowing costs return to a more neutral level.

Development Activity Begins to Cool



Immigration Driving Population Growth



* Through November

Sources: IPA Research Services; Altus Data Solutions; Canada Mortgage and Housing Corporation; Capital Economics; CoStar Group, Inc.; Statistics Canada; TD Economics