SPECIAL REPORT
CANADA FEDERAL BUDGET

INSTITUTIONAL PROPERTY ADVISORS
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Canada's Federal Budget Takes Aim at Housing Affordability Problem

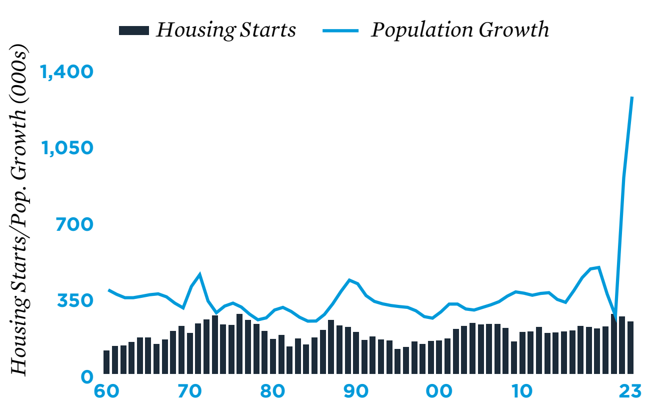
Housing affordability takes centre stage. Canada's federal government recently announced its 2024 budget, which largely outlined further spending increases and higher taxes. The government plans on spending roughly $53 billion over five years, which it expects to fund through stronger economic growth and raising taxes from 50 per cent to 67 per cent for all capital gains realized annually above $250,000. Some spending measures allocate funds to defense, artificial intelligence, education, childcare and health initiatives. However, the largest share of the budget will be directed toward housing, specifically increasing the supply of purpose-built rentals and protecting affordable housing options. This comes after housing affordability hit an all-time low in 2023 amid the combination of rising interest rates and historic population growth outpacing supply. While these policies are a step in the right direction, solving housing affordability is still a long ways away.

Demand tailwinds boost the need for further housing supply. Rising interest rates over the past two years pushed homeownership out of reach for a growing share of Canadians. Many of these potential buyers were redirected to the apartment rental sector as it offers a more affordable housing solution. The population also grew by a near record high of 3.2 per cent in 2023 — a level not seen since the 1950s — which was mainly fueled by an increase of 800,000 temporary residents. Canada is now home to 2.7 million non-permanent residents as of the end of 2023, a near doubling in just two years. These newcomers tend to rent, putting further pressure on an already tight multifamily market. As a result, this surge in demand is one reason why housing development is a key priority for Canada's government.

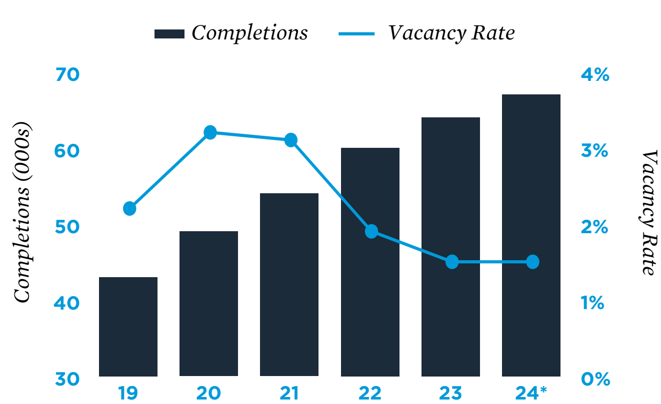
Supply unable to keep pace. Residential construction investment fell 12 per cent last year, while housing starts dropped 7.0 per cent. At a time when Canada is experiencing historic population gains and an already unaffordable housing market, ongoing supply growth is needed now more than ever. However, the combination of rapidly rising interest rates, soaring construction costs, lengthy approval timelines and widespread labour shortages have made many housing development projects unfeasible. The 1.3 million surge in the population last year implies that Canada needed to add 500,000 new homes; however, total completions were less than 200,000. Building permit data has also been trending down since mid-2023 and new home sales have been weak, suggesting development could slow further. This deterioration in supply growth — along with robust demand — is the main reason why the federal government has put such a heavy weight on growing Canada's housing stock.

Multifamily construction holding strong, but more is needed. Despite total housing starts being down in 2023, apartment starts were up 3.0 per cent and the under-construction pipeline sat at its highest level on record. This can largely be attributed to healthy fundamentals, as the national vacancy rate reached an all-time low of 1.5 per cent in 2023, supporting historic annual rent growth of 8.4 per cent. The recently announced GST Rental Rebate and the expansion of low-cost financing provided by the CMHC have also improved the feasibility of new projects. Despite this, demand is continuing to outpace supply as vacancy is forecast to remain sub-2.0 per cent to end 2024, indicating that further housing is needed.

Policy Needed to Address Housing Gap



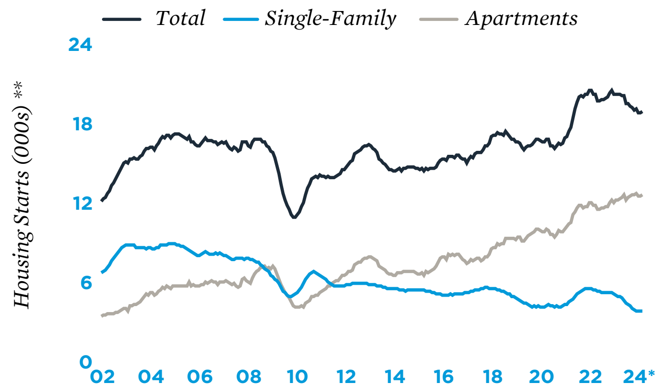
Multifamily Fundamentals



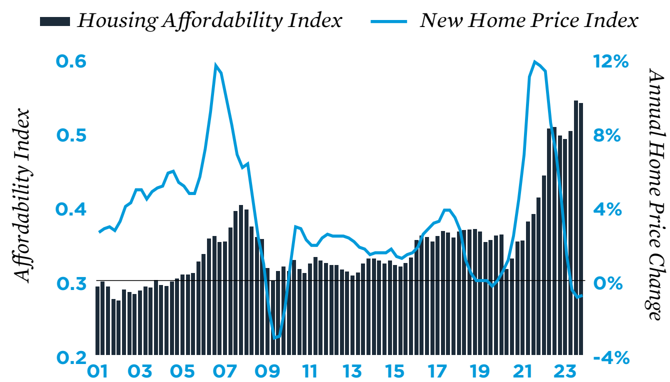
* Forecast

Sources: Bank of Canada; Altus Data Solutions; Capital Economics; CMHC; CoStar Group, Inc.; Federal Government of Canada; Statistics Canada

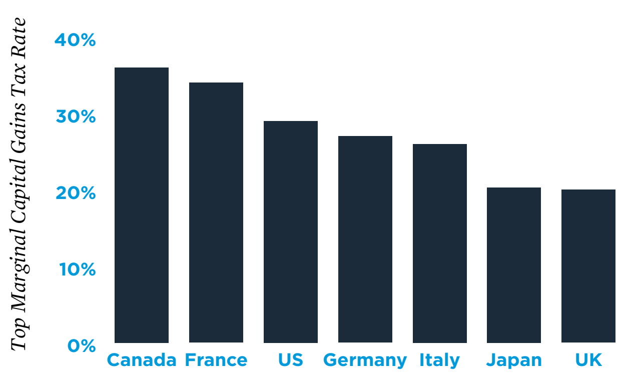
Home Building Activity in Need of a Boost



Homeownership Challenges Hit New Highs



Canada Holds Highest Capital Gains Tax in G7



** Through February; ** Trailing-12-month average*

Select policies directly linked to building more homes. The government set out a list of policies that will make development more accessible and feasible. Ottawa will provide $6 billion to improve the infrastructure for housing development, such as roads, sewers and transit. The government also announced an additional $15 billion for the Apartment Construction Loan Program, which provides low cost financing to builders that offer some affordable rental housing. Ottawa also budgeted $100 million to support homebuilding technology and innovation that will make construction faster and more efficient. In addition to subsidies, the fed will also provide tax write-off incentives. The budget will raise the capital cost allowance to 10 per cent, allow for some interest and financing expenses to be deducted, and it no longer subjects student rentals to HST — an add-on to the GST Rental Rebate program that was announced last year.

Legislative efforts aimed at buying homes. Given affordability challenges, the government also outlined policies that could make it easier to own a home. Ottawa is extending mortgage amortizations for first-time buyers purchasing newly-built homes. This will not only make it more feasible to purchase a house, but it will also incentivize developers to build new homes as they will generate higher demand among first-time buyers. The fed will also raise the Home Buyers' Plan withdrawal limited to $60,000, enabling first-time buyers to further use the tax benefits of a Registered Retirement Savings Plan for down payments. Lastly, Ottawa will allow rental payments to improve credit scores, making it easier for potential buyers to secure financing.

New budget opens up some risk to investors. The recently announced housing initiatives are a step in the right direction; however, Canada's government has yet to find a source of funding. In order to do this, Ottawa announced it will raise taxes from 50 per cent to 67 per cent for all capital gains realized above $250,000. While this tax is meant to target only a small fraction of the population, it could result in a pullback in overall investment, with capital being redirected to other economies. This is especially true for commercial real estate as investors tend to hold properties for an extended period, and when it comes time to sell, capital gains are usually much greater than the $250,000 limit. Combined with falling productivity and ongoing labour shortages pushing up overall costs, this could discourage investment in housing development, making it challenging to reach the government's goal of 3.9 million new homes and affordability by 2031.

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