ECONOMIC VIEWPOINT

Start Me Up: Estimating the Impact of Recent Housing Supply Measures on Housing Starts in Canada

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- In this note, we estimate what the recently announced federal homebuilding policies could mean for housing starts, with implications for housing affordability and Canadians' quality of life.
- The federal government forecasts that Canada's Housing Plan could translate into an additional 1M net new homes by 2031. If those projections come to fruition, before the end of the decade Canadian housing starts could exceed the previous annual record of 273K reached in 1976. And that's half the number of net new homes the federal government claims should be built over that period because of its efforts.
- But those numbers are arguably optimistic given regulatory hurdles and constraints on labour, materials and financing. They would also still leave us well short of the 3.5M additional homes (and 5.8M total) that the Canada Mortgage and Housing Corporation (CMHC) estimates is necessary to restore affordability by 2030.
- Even if Canada can't meet its targets, the housing supply crisis can still be lessened through increasing homebuilding by however much is feasible. Going forward, governments should focus on regulations, financing costs and labour supply for construction, areas over which they have the most influence.

Canada's housing affordability crisis has become one of the defining economic and political issues of this generation. While many debates rage on, it's widely accepted that affordability can't be restored without more supply, and governments of all political stripes across the country have announced policies to stimulate homebuilding. But it's also broadly acknowledged that conditions are exceptionally challenging for homebuilders. Against that backdrop, can Canada achieve its homebuilding targets?

With that question in mind, this note estimates what recently announced federal homebuilding policies could mean for housing starts. We find that these measures are undoubtedly steps in the right direction. But even so, myriad forces will make achieving these lofty homebuilding ambitions exceedingly difficult.

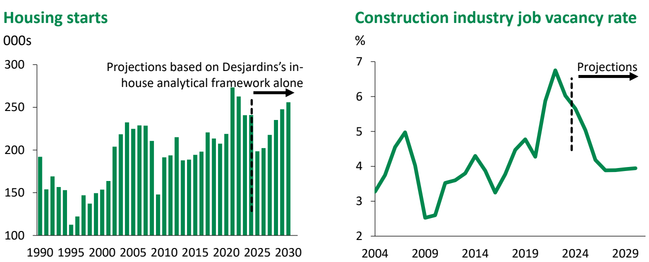
A World without the New Housing Supply Measures

To guide our housing starts forecast, we use an analytical framework that includes both demand- and supply-side factors but excludes recent federal housing supply policy measures. Demand-related variables include home sales, the unemployment rate, and our in-house population growth projections. Inflation-adjusted interest rates, lumber prices, and construction industry unit labour costs represent the key supply-side inputs into our projections. This last indicator—which measures the cost of producing one unit of construction industry output—is determined by the sector's job vacancy rate.

The outlook for these variables suggests a challenging road ahead for homebuilders. Weak household formation via much softer population growth could temper building plans, even amid the massive current supply shortfall. Ditto for interest rates, which we expect to only gradually come down but to never reach the rock-bottom levels seen for much of the pre-pandemic decade. Perhaps most troubling, the construction industry job vacancy rate remains near record highs, and many forces will make filling sectoral labour shortages exceptionally difficult in the near- to medium-term.

Before taking into account the recently announced federal government housing measures, these economic fundamentals suggest it will be hard for starts to remain much higher than 200k in 2025–26. As some of the current constraints are (hopefully) alleviated by decade-end, our framework projects housing starts near 250k per year by 2030 (graph 1).

Graph 1
Economic Fundamentals Suggest Homebuilding Will Slow in 2025–26



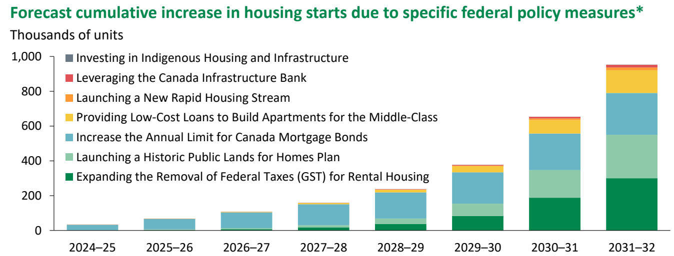
Canada Mortgage and Housing Corporation, Canadian Federation of Independent Business and Desjardins Economic Studies

All the Housing Starts You Could Hope For?

The good news is that since summer 2023, the federal government has opened a fire hose of new spending to help douse the housing affordability fire in Canada. Many of these measures have overlapped with recommendations we published at that time, and we're generally optimistic that these will boost Canada's housing supply. The question now is: by how much?

According to the Government of Canada, "Budget 2024 and Canada's Housing Plan lay out the government's bold strategy to unlock 3.87 million new homes by 2031, which includes a minimum of 2 million net new homes on top of the 1.87 million homes expected to be built anyway by 2031." 1.2M net new homes are expected to result from measures taken since summer 2023 alone, roughly 1M of which are estimated to be due to the federal government's recent housing plan (graph 2).

Graph 2
Federal Housing Plan Envisions an Additional Million Homes by 2032

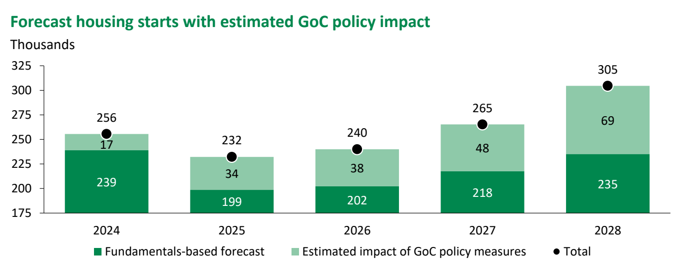


*Annual profile based on estimates by Desjardins Economic Studies
Government of Canada (GoC) and Desjardins Economic Studies

While these forecasts are likely toward the high end of the range of possible outcomes for these specific measures, they don't include the impacts of other, more modest supply measures. Projections also don't include the estimated 750k homes expected to be fast tracked under the Housing Accelerator Fund (HAF). The HAF's centrepiece is ending exclusionary zoning, and that's been shown to have outsized positive impacts on housing supply and affordability in cities like Minneapolis. Budget 2024 and Canada's Housing Plan projections also exclude potential policy measures introduced by the provinces, territories and municipalities.

On an annual basis, the federal government's housing plan could translate into nearly 70K additional housing starts in 2028 (graph 3). That's on top of the roughly 235K projected in that year in the absence of those measures—an increase of about 30%. That would take total housing starts to over 300K in 2028, far exceeding Canada's previous record of 273K reached in 1976. While impressive, those figures come well short of the pace needed to build 3.5M additional homes (and 5.8M total) by 2030 the CMHC says are needed to restore affordability.

Graph 3
If the GoC Is Correct, Housing Starts Could Top 300K in 2028



*Numbers may not add up exactly due to rounding
Canada Mortgage and Housing Corporation, Government of Canada (GoC) and Desjardins Economic Studies

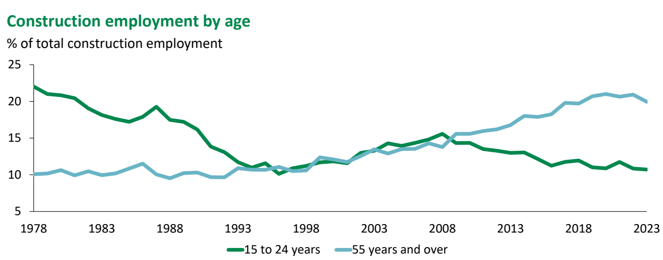
A Housing Starts Boom Too Good to Be True

While this projected surge in housing starts may give Canadians room for optimism, there are myriad reasons to think it's unlikely to happen. Constraints on labour, materials, financing and the efficient use of these inputs are all roadblocks to getting more housing built in Canada, as we detailed in our recent housing outlook.

Construction Labour Is Highly Constrained

The construction industry faces a significant gap between the demand for skilled labour and the available workforce. Indeed, the Canadian Home Builders' Association (CHBA) estimates that Canada needs more than 1 million additional residential construction workers to meet CMHC's target. And this shortage will be exacerbated by an aging workforce (graph 4).

Graph 4
Construction Workers Are Aging While Youth Choose Other Careers



Statistics Canada and Desjardins Economic Studies

While immigration could help address the labour gap in construction, it's not a panacea. A recent Desjardins Economics analysis found that newcomers increase demand for housing more than supply. It also highlighted the poor integration of newcomers to Canada into the construction sector, both versus other industries and relative to migrants to the US. That despite programs like the Federal Skilled Trades Program, which allows for express entry into Canada, and exceptions for construction workers having been made in recent announcements to reduce NPR admissions. Moreover, credential recognition is an issue for both international immigrants and workers seeking to move across provincial borders.

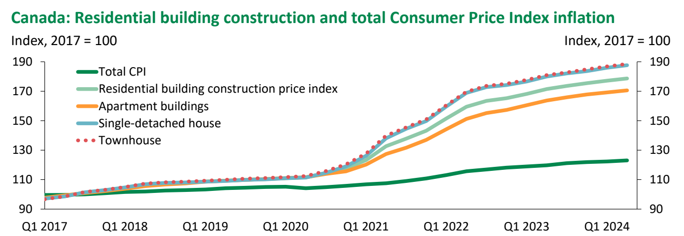
Financing for Construction Is Expensive

Elevated interest rates increase the cost to finance construction projects. Construction has proved resilient to monetary policy tightening over the past couple of years, largely due to project financing negotiated prior to rate hikes. Looking forward, the lagged effect of higher rates is expected to cause construction to slow even as rates are starting to come back down.

Construction Costs Are Already High

Inflation in the price of building materials is another significant constraint on residential construction. Between Q1 2020 and Q2 2024, building costs skyrocketed by more than 50% versus just 17% for overall consumer prices (graph 5). These inflationary pressures strain developers' budgets, impacting project feasibility. They also ultimately reduce housing affordability as building plans are scaled back, reducing new supply. Recent declines in condo presales in the Greater Toronto Area suggest this process is already underway.

Graph 5
Residential Construction Costs Have Skyrocketed

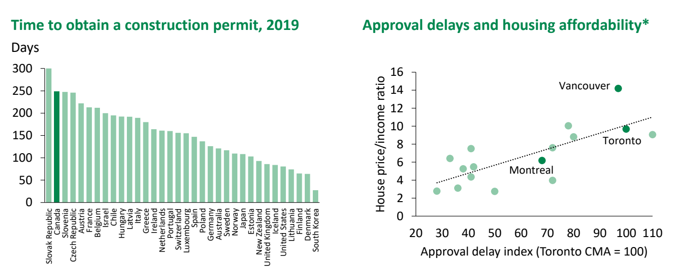


Statistics Canada and Desjardins Economic Studies

Regulatory Barriers Remain a Major Obstacle

A plethora of regulatory hurdles each add their own headwinds to the residential construction sector. These include Canada having among the longest permitting delays in the OECD (graph 6). Zoning laws can result in sub-optimal use of land, and while the HAF is intended to address this, the results have been mixed. Additionally, builders may need to use more costly climate-resistant building materials in an era where extreme weather events are becoming more common, further pushing up costs.

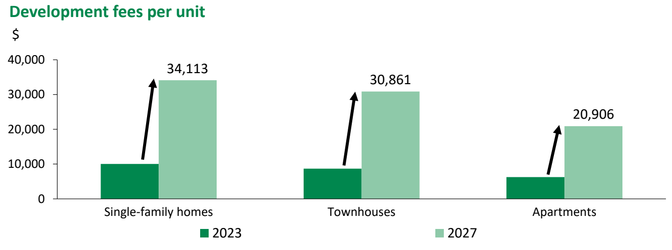
Graph 6
Canada Has among the Longest Construction Permit Delays



* Includes municipalities that responded to the 2022 Municipal Land Use and Regulation Survey. House price and household income data obtained from the 2021 Canadian Census.
World Bank, CMHC and Desjardins Economic Studies

High and rising development fees add a significant amount to the cost of construction. In Ontario, they've risen 1,200% over the past 15 years. In 2023, Vancouver voted to triple development fees over a period of three years (graph 7). And this in the context of research by the CMHC (2022) which found that government fees increase development costs of new units and erode affordability.

Graph 7
Vancouver's Development Charges Will Triple over Three Years



Business Intelligence for BC and Desjardins Economic Studies

Additional barriers to housing construction include limited land availability and inadequate infrastructure of roads, public transit, schools and utilities such as waterworks or storm drainage systems. While the new Canada Housing Infrastructure Fund proposed in the 2024 federal budget will help address the latter issue, more needs to be done.

Construction Productivity Is Low

Canada's weak labour productivity growth is well-documented but it's particularly low in the construction sector. (See our reports here and here.) As a sector dominated by SMEs, the construction industry can find the upfront costs of adopting new technologies to be prohibitively expensive, time consuming, and uncertain in its application and outcome. There could be a role here for public policy to support the widespread adoption of new productivity-enhancing technologies.

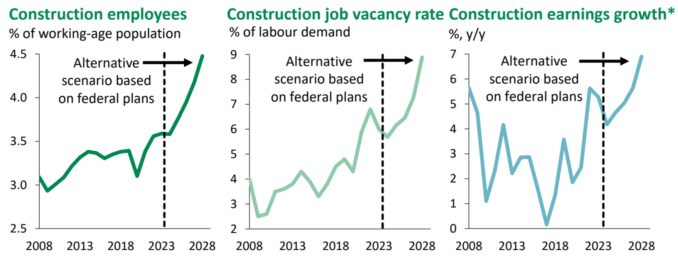
Housing Supply Ambitions Meet Reality

Canadian policymakers need to focus on what they can influence to have any hope of materially increasing the housing supply and improving affordability. They have no control over the price of commodities used in residential construction, such as copper, steel and cement. Greater construction sector productivity is also largely beyond the influence of governments, at least in the near term. Instead, what they have more direct influence on are the regulations, financing costs and labour supply for construction.

The federal and provincial governments have taken steps to reduce the regulatory hurdles and financing cost of construction. This includes measures such as foregoing the HST, providing low-cost loans and making subsidized insurance available for select types of housing, notably purpose-built rental apartments. But these measures would need to be expanded to include a broader set of housing types if affordability is to be improved, albeit in the context of maintaining sustainable public finances.

However, it's the lack of skilled labour that is the primary constraint on homebuilding. Amid slower population growth and an immigration system that is not focused on attracting skilled tradespeople, an even greater share of domestic resources will need to be dedicated to residential investment to meet federal housing targets. But even if annual growth in the number of construction employees were to gradually increase to a nearly 10% pace by 2028, the construction job vacancy rate would still approach 10% that year to achieve the numbers laid out in the federal government's housing plan—close to double its current level (graph 8). Consequently, construction sector wage growth would continue to accelerate toward 8%, reaching the fastest pace on record well before the close of 2028. And that's assuming 2028 ends with 450,000 more construction employees than there are today—an increase of nearly 40%. That would be equivalent to over 4.5% of the working-age population based on our projections, up from 3.5% today. It also doesn't include self-employed construction workers (as they aren't included in the job vacancy rate), who make up more than half of employment in the industry.

Graph 8
There Is Not Enough Skilled Labour to Meet Housing Supply Plans

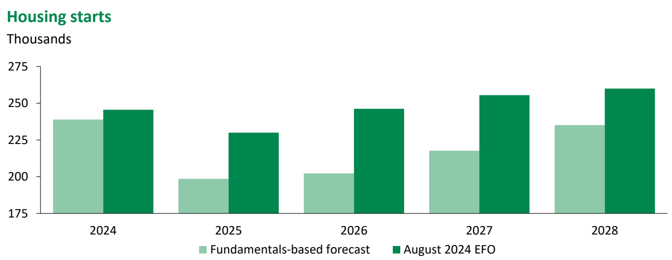


*Refers to average weekly earnings from the Labour Force Survey
Statistics Canada, Canadian Federation of Independent Business and Desjardins Economic Studies

In this alternate scenario, the combination of higher construction labour costs and demand for materials would push up the price of home construction. These price gains could also boost inflation more broadly, possibly forcing the Bank of Canada to keep rates higher than would otherwise be the case. Ultimately, these myriad secondary effects could mitigate affordability improvements stemming from greater housing supply.

Desjardins's August 2024 Economic and Financial Outlook (EFO) reflects the view that housing starts will come well short of the level desired by the federal government. The more muted outlook for housing starts of 230K in 2025 rising to 260K in 2028 would keep the job vacancy rate and average weekly earnings growth in the construction sector to around the highs set during the pandemic (graph 9). While below the recent peak of 271K housing starts reached in 2021, that projected pace would still be an improvement over the annual average of around 200K in the decade preceding the pandemic. And recent federal housing supply policy measures should play an important role in boosting housing starts beyond what just the fundamentals of supply and demand would suggest.

Graph 9
Federal Housing Supply Policies Should Lead Starts Higher



EFO: Economic and Financial Outlook
Canada Mortgage and Housing Corporation and Desjardins Economic Studies

Conclusion

At the end of the day, building 5.8 million new homes in the next 8 years would be an ambitious plan even if all the stars aligned. With significant labour, materials, financing and regulatory constraints, the stars aren't currently aligned in Canada. In fact, it took three decades to build the last 5.8 million homes.

That said, simply because Canada is highly unlikely to meet that lofty goal doesn't mean it should throw in the towel. Even if it can't meet "affordability" as defined by the CMHC by decade end, the housing supply crisis can still be lessened through building as many homes as possible.