Housing Market Outlooks for 2023

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This report has been compiled for the Agency for Co-operative Housing by Will Dunning Inc. Opinions expressed here have been based on data that is partial, and largely out of date. Moreover, at this time there is great uncertainty about the economic outlook for Canada, which adds to the difficulty in developing any opinions on the outlooks for rental markets across Canada.

Current Conditions

The absence of current data significantly hamstrings the researcher attempting to make projections about Canadian rental markets. Currently, the most recent data from CMHC's survey are for the fall of 2021. Those data showed that the national vacancy rate had not yet recovered from the effects of COVID-19: for the fall of 2021 it was 3.1 per cent, the same as in 2020 (versus 2.3% in 2019). The 2021 survey estimated that rents had increased by 3.0 per cent over 2020 (a slower rate of increase than the 3.7% for 2020 and 4.1% for 2019).

Data on rent increases from Statistics Canada's Consumer Price Index are generated monthly and provide a more current view. Those data indicate that the pace of rent increases has speeded up this year. With increases limited by rent controls to amounts of less than two per cent in PEI, Ontario and B.C., the accelerating growth in rental levels in those three provinces indicates that additional, and very large, increases are occurring on tenant turnover and/or through applications for larger increases. Rent increases for Alberta are not regulated but are constrained by high vacancy rates.

Vacancy Rates and Rent Increases for Four Provinces

	PEI	Ontario	Alberta	BC	Canada
Vacancy Rates					
2019	1.1	2.0	5.4	1.5	2.3
2020	2.2	3.2	6.9	2.5	3.1
2021	1.3	3.4	6.5	1.4	3.1
Rent Increases – CMHC (1)					
2019	2.7	6.1	1.3	4.2	4.1
2020	3.1	4.9	0.9	2.5	3.7
2021	2.2	2.8	1.0	2.8	3.0
Rent Increases – Statistics Canada, Consumer Price Index					
2020	5.9	1.3	-0.7	1.7	1.0
2021	6.0	2.0	0.4	1.7	2.0
2022	9.0	5.6	2.7	5.0	4.7

Source: CMHC and Statistics Canada; compiled by Will Dunning Inc.

Note: (1) rent increases are based on CMHC constant-sample analysis, except for Alberta for 2020 and 2021, which were calculated by Will Dunning Inc. using data on average rents.

Additional insights into current conditions in rental markets can be gleaned from the quarterly reports of REITs (Real Estate Investment Trusts) active in the residential rental sector. The two main actors are Canadian Apartment Properties ("CAP REIT") and Boardwalk Equities. CAP REIT mainly operates in Ontario, but has portfolios in the three other provinces of interest and is also a presence in Quebec, Nova Scotia and Saskatchewan. Boardwalk Equities mainly operates in Alberta, but also in Ontario, Saskatchewan and Quebec, with one small project—114 dwelling units—in British Columbia.

The quarterly financial reports for CAP REIT can be found here: https://ir.capreit.ca/ir-overview/default.aspx

The third-quarter report shows that in three of the four provinces of interest, occupancy rates were higher as of 30 September 2022, as compared with a year earlier (i.e., vacancy rates were reduced in 2022 versus 2021). For occupied units, CAP REIT's rent increases were slower than is indicated by the Consumer Price Index in three of the four provinces, but matched the CPI increase in Alberta. In both Ontario and B.C., rent increases were above the annual rent increase guidelines (1.2% and 1.5%, respectively), which implies that for units where occupancy changed, rent increases were substantial.

CAP REIT Data				
	% Occupancy Rate		% Increase in Average Rent for Occupied Units, as of Sept. 2022	Portfolio of Residential Units, as of Sept. 2022
	30 Sept. 2022	30 Sept. 2021		
PEI	99.5	99.5	1.0	637
Ontario	99.4	98.9	3.4	23,439
Alberta	98.6	98.3	2.7	2,383
B.C.	99.6	99.3	4.0	5,860
Source: quarterly report for 2022-Q3, page 10				
Note: for "same property portfolio"				

Financial reports for Boardwalk Equities can be found here: [https://www.bwalk.com/en-ca/investors/financial-reports/.](https://www.bwalk.com/en-ca/investors/financial-reports/)

The Boardwalk Equities data show that, for the total portfolio, the occupancy rate was about one point higher in Q3-2022 than a year earlier (the data provided are for the total portfolio, not by province). Rents in Ontario and Alberta increased by more than in the CAP REIT portfolio. A table on page 25 of Boardwalk's third-quarter report indicates that locations within Alberta showed occupancy higher by one percentage point or better. Smaller increases were seen elsewhere.

Boardwalk Equities Data				
	% Occupancy rate		% Increase in Average Rent for Occupied Units, as of Q3-2022	Portfolio of Residential Units as of Q3-2022
	Average for Q3-2022	Q3-2021		
PEI				
Ontario			4.7	3,019
Alberta			4.5	21,084
B.C.				114
Total Portfolio	97.23	96.08	4.9	
Source: quarterly report for 2022-Q3, pages 2 and 3				
Note: rent increases for "same property portfolio"				

Based on the data found in these two quarterly reports, CMHC's survey results for 2022, when released, will likely show reductions in vacancy rates for British Columbia, Ontario and Alberta. The national vacancy rate might be one-third to one-half of a point lower than in 2021 (that is, perhaps 2.75%, versus 3.1% in 2021). The available data on rent increases (from the Consumer Price Index and the REITs' reports) suggest that CMHC's calculations of rent increases will be considerably higher than for 2021.

The Outlook for 2023

Even at the best of times, economic forecasts tend not to be dependable. For the rental market, forecasting is especially challenging. In part, this is because data are provided only once per year, making it difficult to analyze relationships between the rental market and the broader economic environment.

That said, attempts at forecasting rental markets for centres across Canada have consistently shown that the two most important drivers of changes in vacancy rates are the following:

- Growth in employment tends to push vacancy rates downwards because job creation increases the number of people able to form new households.
- Housing completions tend to push vacancy rates upwards because of increased housing opportunities. Examination of the data has indicated that the total number of completions is more important than the number of rental completions.
- One initially surprising finding was is that resale-market activity does not appear to affect vacancies materially. The explanation is that resale activity does not greatly affect either the number of people who want housing or the amount of housing available, merely resulting in a re-sorting of who lives where.

The Bank of Canada has plainly signalled its belief that the economy is over-heated, which is causing the elevated inflation currently experienced in Canada and around the world. Senior officials have stated that the level of employment is unsustainably high. When the Bank of Canada says it will do whatever it takes to reduce inflation, it clearly implies a need to reduce the level of employment. Interest rates in Canada are now quite high: the Bank of Canada describes the "neutral" level for its policy rate (the "Overnight Rate") as ranging between two and three per cent.

At 3.75 per cent, the rate is now well above that range, and a further increase (0.5 or 0.75) is anticipated at the next policy meeting on 7 December 2022.

I have calculated that the neutral mortgage interest rate for the housing market is now about 2.6 per cent. Currently, typical "special offer" rates are roughly 5.5 per cent for both fixed rate and variable-rate mortgages.

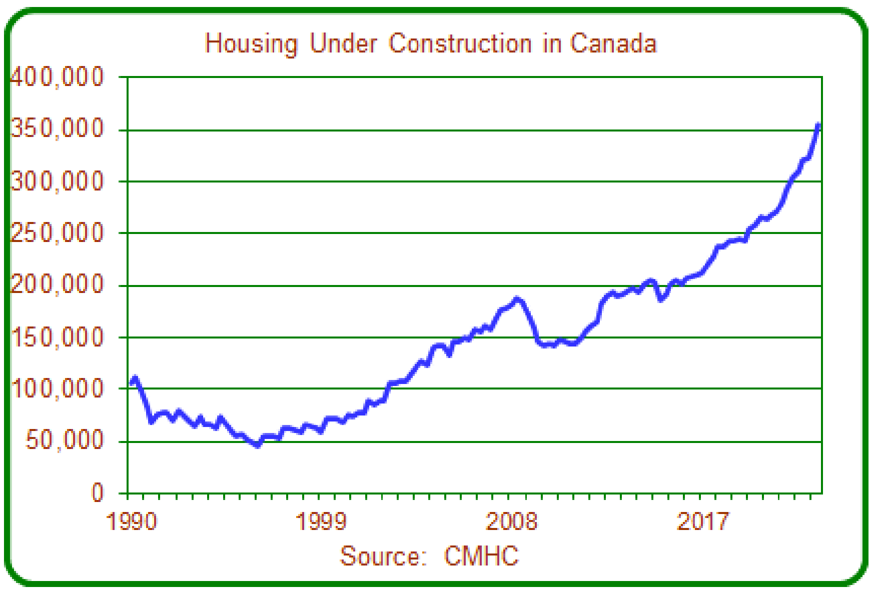
These high interest rates have already set the stage for a significant economic slowdown during 2023. Early signs are now clearly visible in the housing market, where resale activity is far below historic levels, and property values are showing downward pressure in in many communities across the country, especially in Ontario and British Columbia. Housing-market events will result in job losses through direct effects: fewer people employed in housing activities and sectors dependent on housing, such as financial services. Industries that provide related goods and services will also be affected. According to estimates from CREA, each unit of resale activity supports about one-third of a job. With resales now at about 125,000 units (annualized rate) lower than normal, the impact is about 40,000 to 50,000 lost jobs. We should also expect that construction of new housing will slow during 2023 and into 2024, as will renovation activity. In research for the Canadian Home Builders Association, I calculated that, in 2021, residential construction supported about 1.4 million jobs through direct and indirect effects. Conceivably, employment related to residential construction could be lower by at least 10 per cent, or at least 150,000 jobs, a year from now.

Additional negative economic effects can be expected to result from the following:

- Reduced consumer confidence and willingness to spend, due to lower home values (the effect of reduced wealth).
- Reduced consumer spending owing to unaffordable increases in mortgage costs because of rises in rates for variable-rate mortgages and cost increases for people renewing fixed-rate mortgages.
- Furthermore, negative economic consequences should be expected in economic sectors other than the housing market.

It takes time for interest rates to affect the economy. We are now just beginning to feel the consequences of the initial rate rises from early this year. The large total rise in interest rates will start to have economic consequences during 2023.

Considering all these factors, by late 2023 the level of employment in Canada could be one-quarter of a million, and possibly one-half million, lower than at present. The consequences of falling employment will begin to emerge in rental markets as 2023 progresses.



On the other hand, a very large volume of housing is under construction in Canada, which will result in unusually high numbers of housing completions during 2023 and into 2024.

During the coming year, both employment and housing completions will point towards higher vacancies. For Canada, the average rate might rise during 2023 by as much as 1.0 to 1.5 percentage points; by the fall of 2023 the vacancy rate for Canada might be as much as 4.0-4.5 per cent, versus 3.1 per cent as of 2021.

The rise in the vacancy rate should reduce pressures for rent increases, but in recent years landlords have become much more aggressive in rent-setting. While a vacancy rate of about four per cent for 2023 should leave rates flat, or even lower in “real terms,” that result should not be taken for granted in this changed market environment.

Moreover, we need to convert the growth in real rents into a nominal rate of increase. To do that, we need an assumption about what will happen to overall inflation. While the Bank of Canada says that it will reduce inflation to its target range of one to three per cent, we should not assume its success:

- Inflation in Canada, and around the world, is largely being driving by supply-side economic events: by disruptions in production, largely as the result of COVID-19, and by events affecting energy markets (the war in Ukraine; production decisions by members of the Organization of the Petroleum Exporting Countries ("OPEC").
- In the economic models being used now, interest rates attack the demand side of the economy as job losses reduce workers' ability to negotiate higher wages. In the current environment, with inflation driven by supply issues, an economic recession caused by high interest rates might have little impact on inflation. If inflation fails to return to the target rate, the Bank of Canada might stay on its current course for some time.
- Furthermore, recent events in China could add to inflationary pressures around the world, and therefore might lead to policy decisions to raise interest rates further.

It remains to be seen how Bank of Canada policies will change in response to a future economic downturn. To the extent that it holds to its current course, during 2023 we could remain in an economic environment characterized by falling employment and weak wage growth that increasingly fails to keep up with a rising cost of living. In that world, as vacancies rise in the rental market, affordability problems will become even worse. On the other hand, should the Bank of Canada changes its policy direction, an economic recovery could emerge that would gradually constrain the rise in vacancy rates.

Some Quick Thoughts on Impacts on Housing Co-ops

Rental market data from CMHC includes interesting details on vacancy rates, sorted by periods of building construction, by rent levels and by quartiles of rent (dividing the rental inventory into four groups).

For this discussion, the quartile data show that when vacancy rates change, in many communities the largest changes (upwards or downwards) take place in the upper half of rental distribution, and especially in the top quarter of rents.

The implication is that if vacancy rates rise during 2023, the effects will appear mainly at the high end of the market. The co-op inventory is at the bottom half of the local housing markets. Therefore, the effects of the coming recession will not likely cause substantial rises in vacancy rates for co-ops, but more members will have difficulty paying their housing charges and the need and demand for rent-geared-to-income housing across the country will only increase.