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Murtaza Haider Stephen Moranis

HITTING TOO CLOSE TO HOME

Lack of supply and the housing affordability crisis in Canada

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TRUE NORTH IN CANADIAN PUBLIC POLICY

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Executive Summary

The rapid escalation of housing prices in the past six years, especially during the pandemic, has alarmed many in Canada. An increasing number of Canadian families believe that homeownership might have slipped out of their hands for good.

Average housing prices have risen by approximately $300,000 or 70 percent since the Liberal government first came to power in October 2015 – and by 31 percent just since the onset of the pandemic. Pre-pandemic, skyrocketing housing costs were mostly experienced in Toronto and Vancouver. During the pandemic, with more people stuck at home and seeking space, rising prices spread to mid-sized cities and rural areas. This took many by surprise. The Canada Mortgage and Housing Corporation, for instance, forecast that housing prices would decline significantly by the first quarter of 2021.

Renters face acute housing affordability challenges and are more likely to face homelessness than homeowners. When low-income households are priced out of the rental market, housing affordability becomes a serious issue – one that cannot be resolved without direct assistance from government.

The primary driver of rising housing prices is a lack of housing supply. Canadian housing markets have experienced a chronic undersupply of new housing since the early 1970s, resulting in a steady rise in prices. Since the early 1990s, the new housing construction rate has remained at less than half of what was observed in the 1970s. In effect, Canada needs an additional 1.8 million dwellings to be comparable to other G7 countries.

The problem is worst for families with children – in addition to historically lower construction rates for housing overall, recent construction activity has focused on smaller units like condos.

What is causing housing supply shortages? For one, urban planners often view builders and land developers in pejorative terms, and hold the industry responsible for promoting urban sprawl. Then there is jurisdictional gridlock. Even when higher tiers of government realize the urgency to construct more housing, regional and local governments can frustrate such efforts. Applications to develop subdivisions take years to approve. Finally, we often see resistance from residents who oppose any new development in their neighbourhoods.

What solutions are proposed by federal politicians? Since 2015, the Liberal government has embarked on an ambitious housing agenda under the National Housing Strategy (NHS), a 10-year long program with a total investment of $37 billion. However, it has failed to make a marked improvement in housing affordability.

During the recent election, three issues were highlighted in the Conservative, Liberal and NDP platforms:

- Foreign homebuyers were identified as responsible, at least partially, for Canada's rapid escalation of housing prices and proposed restrictions or bans. This is welcome, though only 5 percent of Canadian homes are foreign owned and among those are Canadians living abroad.
- Measures to assist first-time homebuyers were prioritized, including higher tax credits, interest-free tax savings accounts, relaxation of the mortgage stress test, and lengthening of mortgage durations to lower monthly payments. First-time homebuyers would likely benefit to varying degrees, but such measures are also likely to increase the demand for housing, thereby exacerbating the problem of high prices.
- Investment plans were offered to encourage the construction of new housing in Canada. In essence, both the Liberal and Conservative plans promised roughly 250,000 extra new homes over three years. However, it is not clear how affordable these additional units will be or how the federal government would encourage their construction. The NDP focused on proposals to build additional affordable-housing units for low-income Canadians.

Even though Canadians have access to 10 times more land per capita than their American counterparts, local resistance to new developments, legislative constraints, and often challenging topography have rendered developable land a scarce commodity in Canada.

These structural and ideological constraints must be addressed to achieve an adequate supply of housing in Canada. Housing policy should bring together stakeholders from all tiers of governments to increase the supply of housing along with a significant increase in federal government spending on affordable housing, financial guarantees, and targeted support to key regions. In particular, federal spending power should be used to induce other levels of government to reduce regulatory barriers holding back private sector investment in housing.

Sommaire

L'escalade rapide des prix du logement au cours des six dernières années, en particulier durant la pandémie, inquiète de nombreux Canadiens. Un nombre croissant de familles estiment maintenant que l'accession à la propriété pourrait leur avoir échappé pour de bon.

Les prix des propriétés ont augmenté d'environ 300 000 $ (ou de 70 pour cent) en moyenne depuis l'arrivée au pouvoir du gouvernement libéral en octobre 2015 –et de 31 pour cent depuis le début de la pandémie uniquement. Avant la pandémie, la montée en flèche des prix s'était surtout fait ressentir à Toronto et à Vancouver. Or, comme un bon nombre de gens confinés à la maison pendant la pandémie se sont mis à chercher des logements plus spacieux, la hausse des prix s'est étendue aux villes de taille moyenne et aux zones rurales. Cette évolution en a surpris plus d'un. En effet, les prix ont continué d'augmenter pendant la pandémie, alors que la Société canadienne d'hypothèques et de logement prévoyait à l'époque qu'au premier trimestre 2021, ils auraient considérablement diminué.

Les locataires éprouvent des difficultés à trouver des logements abordables et courent plus de risques de se retrouver sans abri que les propriétaires. Lorsque le marché locatif exclut les ménages à faible revenu, l'accessibilité au logement devient un problème grave – qui ne peut être résolu qu'au moyen d'une aide directe du gouvernement.

Le principal moteur de la hausse des prix du logement est le manque d'offre. Depuis le début des années 1970, une sous-offre chronique de logements neufs sur les marchés canadiens a fait progresser les prix de manière constante. Depuis le début des années 1990, la construction immobilière s'est maintenue à moins de la moitié des taux observés durant les années 1970. En fait, le Canada a besoin de 1,8 million de logements supplémentaires pour que sa situation devienne comparable à celles des autres pays du G7.

Le problème est pire pour les familles avec enfants – non seulement les taux de construction ont été historiquement bas en général, mais ce sont surtout de petites unités comme les copropriétés qui ont été construites.

Quelles sont les causes de la pénurie de logements? En premier lieu, les urbanistes jugent souvent les constructeurs et les promoteurs immobiliers de manière défavorable et tiennent le secteur pour responsable de l'étalement urbain. Ensuite, il y a le carcan des frontières administratives : même lorsque les ordres supérieurs de gouvernement s'entendent sur l'urgence de construire davantage de logements, les gouvernements régionaux et locaux font parfois obstacle aux efforts déployés. En effet, il faut des années pour que les demandes d'aménagement de lotissements soient approuvées. Enfin, on constate souvent la résistance de la part du voisinage, souvent opposé à tout nouveau développement adjacent.

Quelles sont les solutions proposées par les politiciens fédéraux ? Un peu après 2015, le gouvernement libéral a entrepris un ambitieux programme dans le cadre de sa Stratégie nationale sur le logement (SNL), qui prévoit un investissement de 37 milliards de dollars sur 10 ans. Cependant, il n'a pas réussi à améliorer de façon notable l'accessibilité au logement.

Au cours de la dernière élection, les plateformes des conservateurs, des libéraux et des néo-démocrates ont mis en évidence trois enjeux :

- Les acheteurs étrangers sont ressortis comme les responsables, au moins en partie, de l'escalade des prix du logement au Canada. Les partis ont proposé des restrictions ou des interdictions sur la propriété étrangère. Ces restrictions ont été accueillies favorablement. Toutefois, seulement 5 pour cent des logements au Canada sont de propriété étrangère et certains de ceux-ci appartiennent à des Canadiens vivant à l'étranger.
- Les mesures visant à aider les acheteurs d'un premier logement ont été jugées prioritaires, notamment l'augmentation des crédits d'impôt, le lancement de comptes d'épargne libre d'impôt, l'assouplissement du test de résistance pour les prêts hypothécaires et l'allongement de la durée des prêts en vue de réduire les paiements mensuels. Ces acheteurs en bénéficieront probablement à des degrés divers, mais les mesures sont également susceptibles d'accroître la demande de logements, ce qui exacerbera le problème lié aux prix élevés.
- Certains programmes d'investissement sont prévus pour encourager la construction de nouveaux logements au Canada. Essentiellement, les libéraux et les conservateurs ont promis environ 250 000 nouveaux logements sur trois ans. Il reste qu'on ne sait pas très bien dans quelle mesure ces unités supplémentaires seront abordables ni comment le gouvernement fédéral envisage d'encourager leur construction. Le NPD s'est concentré sur des propositions visant à construire des unités supplémentaires de logements abordables pour les Canadiens à faible revenu.

Même si les Canadiens ont accès à dix fois plus de terres que leurs homologues américains, la résistance locale aux nouveaux développements, les contraintes législatives et la topographie souvent difficile ont fait des terres aménageables une denrée rare au Canada.

Il faut s'attaquer à ces contraintes structurelles et idéologiques pour parvenir à une offre adéquate de logements au Canada. Les politiques en matière de logement devraient rassembler les intervenants de tous les paliers de gouvernement afin d'accroître l'offre, et prévoir parallèlement une augmentation importante des dépenses du gouvernement fédéral en logements abordables, en garanties financières et en soutien ciblé aux régions clés. Encore mieux, le pouvoir de dépenser du gouvernement fédéral devrait servir à inciter tous les paliers de gouvernement à réduire les obstacles réglementaires qui freinent les investissements du secteur privé en logements.

Introduction

The rapid escalation of housing prices in the past six years, especially during the pandemic, has alarmed many in Canada. An increasing number of Canadian families believe that home ownership might have slipped out of their hands for good. While prices have been rising at unprecedented rates, the increase in household incomes has been modest at best.

Writing in *Maclean's*, Nicholas Steed observed that "if you don't own a house by now, there's a strong chance you never will. That's the central, disturbing fact about the most widespread – and least understood – social revolution of our times."

The *Maclean's* commentary reflected how housing affordability has worsened in Canada; it appears topical. However, these words were written in May 1967. Even when the average house price in Vancouver was just $15,200, it was unaffordable for many. Today, the average house price in Vancouver has crossed the million-dollar mark. Many still deem housing unaffordable, though it is nevertheless being hurriedly consumed by others across Canada. A review of Canadian sentiments about housing over the past several decades suggests that, irrespective of price levels, housing will be deemed unaffordable by some cohorts who may need state assistance to meet their shelter needs.

The 2021 federal election in Canada brought renewed attention to declining housing affordability. The election was held during a pandemic, so the physical well-being of all, especially seniors, and the pandemic-induced economic slowdown and uncertainty were first and foremost in the minds of most Canadians. Still, polling data highlighted that eroding housing affordability is one of the top challenges facing Canadian families today and solutions to it were included in each of the federal parties' election platforms.

Following the federal election, we have an opportunity to review what role, if any, the federal government should play in managing housing outcomes for Canadians. The federal government's role in housing dates back to the 1935 *Dominion Housing Act*, which was replaced by the *National Housing Act* (NHA), which itself has been updated and revised several times. Given that subnational governments influence access to land and determine what gets built, and where and when, the federal contribution to housing outcomes must be negotiated and coordinated with provincial, regional, and local governments. Hence, the NHA must accommodate what is mandated in provincial legislation and local regulations.

Since the 1990s, the federal government's role in housing has ebbed and flowed – initially dropping and later expanding. The federal investment in social housing has, as a result, also declined and increased proportionally over the period. Since 2015, the Liberal government has been pursuing initiatives outlined in the 10-year National Housing Strategy (NHS), which significantly increased spending and investment in housing compared to the average spent in the years prior to NHS. However, despite the massive increase in spending to support households facing affordability challenges, and investments to stimulate housing construction for rental and ownership markets, housing affordability remains a challenge in Canada. The number of households in core housing need has stayed at 1.7 million for years.

Housing affordability remains a challenge in Canada. The number of households in core housing need has stayed at 1.7 million for years.

Housing affordability manifests itself in several ways. Tenure is the obvious point of differentiation. Prospective homebuyers are concerned about housing affordability because housing of a specific size and quality in desirable locations might have slipped out of their reach. This does not imply that prospective homebuyers cannot purchase any dwelling of any size, quality, or location. Given an adequate level of housing supply in the resale market, most homeowners interested in buying could find a dwelling that may meet some or most of their criteria, except perhaps in the most expensive markets.

Affordability in the rental housing market is starkly different from that in the owner-occupied market. When low-income households are priced out of the market such that they cannot pay market rent for a rental dwelling of any quality or size, housing affordability has been eroded in a way so dire for them that it cannot be resolved without direct assistance from one or more tiers of government.

Housing affordability also varies by location. At any given time, local housing markets could be characterized as unaffordable in some jurisdictions while affordable in others. In Canada, housing affordability before the onset of the pandemic was a growing concern in more populous urban centres, such as Toronto and Vancouver. However, housing markets in other medium-to-large cities had not experienced the same affordability concerns as Toronto and Vancouver. Even Montreal, Canada's second-most populous urban centre, had not experienced a rapid escalation in housing prices and rents before the pandemic.

The pandemic changed the dynamics of housing price appreciation. The preference for large-sized dwellings increased considerably and concurrently with the increase in the prevalence of working from home. Initially, housing prices rose rapidly in remote suburbs of large cities where large-sized housing was relatively more common. However, the increasing demand for housing generated by those working from home spilled into satellite towns bordering major employment urban centres and smaller towns far from the three largest employment hubs in Toronto, Montreal, and Vancouver. Hence, housing prices escalated even in smaller towns like Sydney, Nova Scotia, and Barrie, Ontario.

What roles, if any, should the new federal government have in addressing housing challenges? An election year is an opportune time to reflect on that question and to identify clear housing affordability targets that accommodate all facets of affordability.

This paper is organized as follows. In the following section, we explore how housing affordability has changed for homebuyers and renters. We begin by reviewing housing affordability in large cities and small towns and distinguish between owners' and renters' housing needs. Then we discuss how housing supply has lagged demand in Canada for decades, creating a shortfall of dwellings. Next, we explain the enablers of the inadequate housing supply in Canada and briefly outline the federal government's role in housing in Canada. Subsequently, we discuss the competing visions for improving affordability that the three major political parties put forward prior to the September 2021 election. We conclude by calling on the federal government to think imaginatively and act boldly on housing, primarily by accepting that Canada has not built enough housing in the past 50 years.

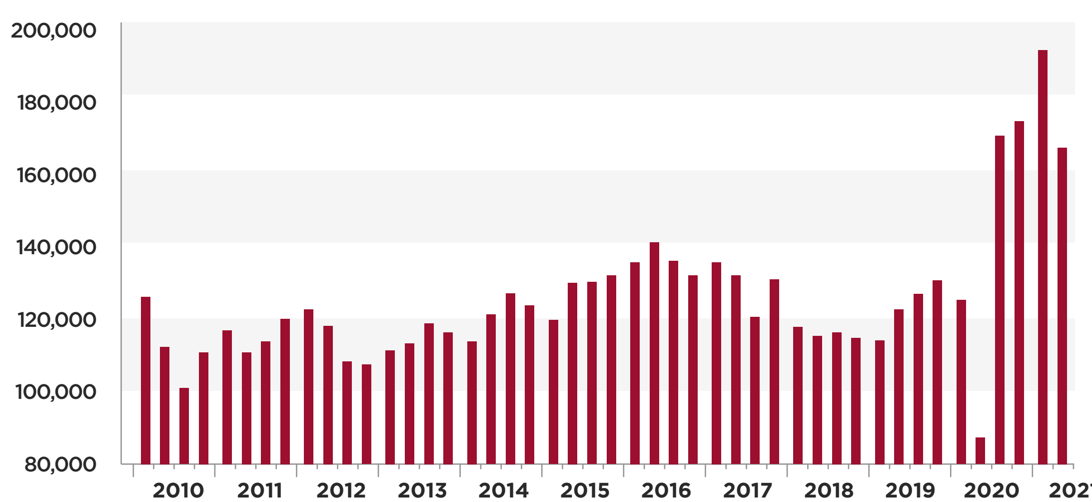
Dimensions of housing affordability

Housing affordability is a complex phenomenon with competing narratives and nomenclature. At times, it is challenging to determine whether housing has indeed become unaffordable when home sales are at record levels and prices are unprecedented highs. High demand at a time of high housing prices suggests that housing continues to be affordable for some, while others might see affordability erode with growing prices. Note that seasonally adjusted annualized housing sales in Canada crossed 650,000 for the first time in the third quarter of 2020 (Figure 1).

This paper relies on housing sales and rental data to help define the extent of affordability in Canada and assist in setting the targets for improving housing affordability.

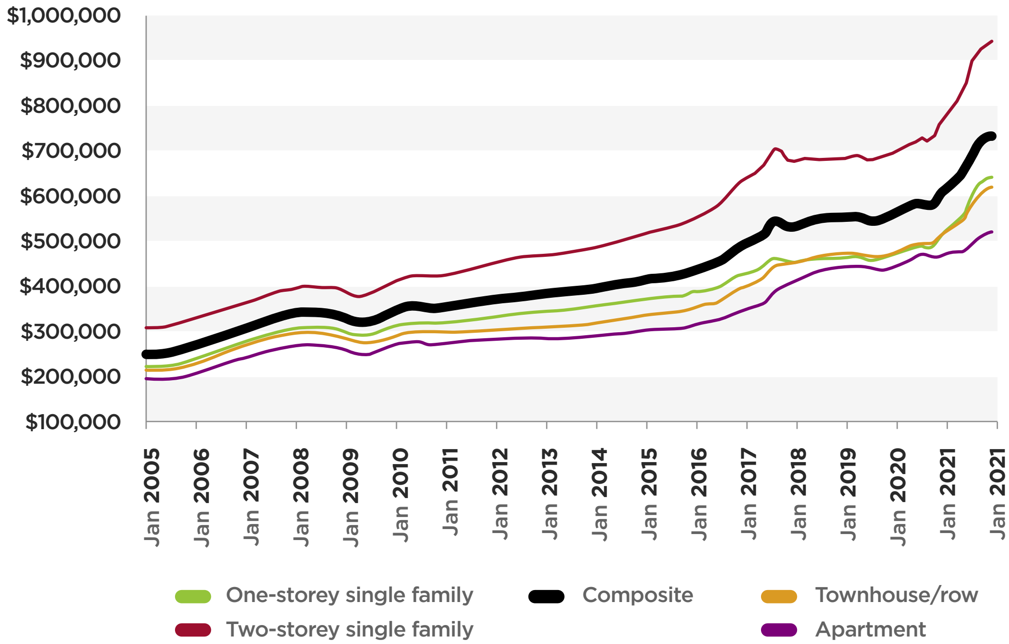
The Canadian Real Estate Association's (CREA) quality-adjusted benchmark housing price estimate has increased by approximately $300,000, or 70 percent, since the Liberal government first came to power in October 2015 (Canadian Real Estate Association 2016). The fast-escalating prices under the first and second tenures of the Liberal government have been extensively debated and presented as evidence of weak stewardship on housing. A breakdown of the housing statistics, though, presents a more nuanced picture (Figure 2).

FIGURE 1: SEASONALLY ADJUSTED QUARTERLY HOUSING SALES IN CANADA, 2016-2021



Source: Canadian Real Estate Association 2021.

FIGURE 2: MLS AGGREGATE BENCHMARK HOUSING PRICES FOR CANADA, 2005-2021



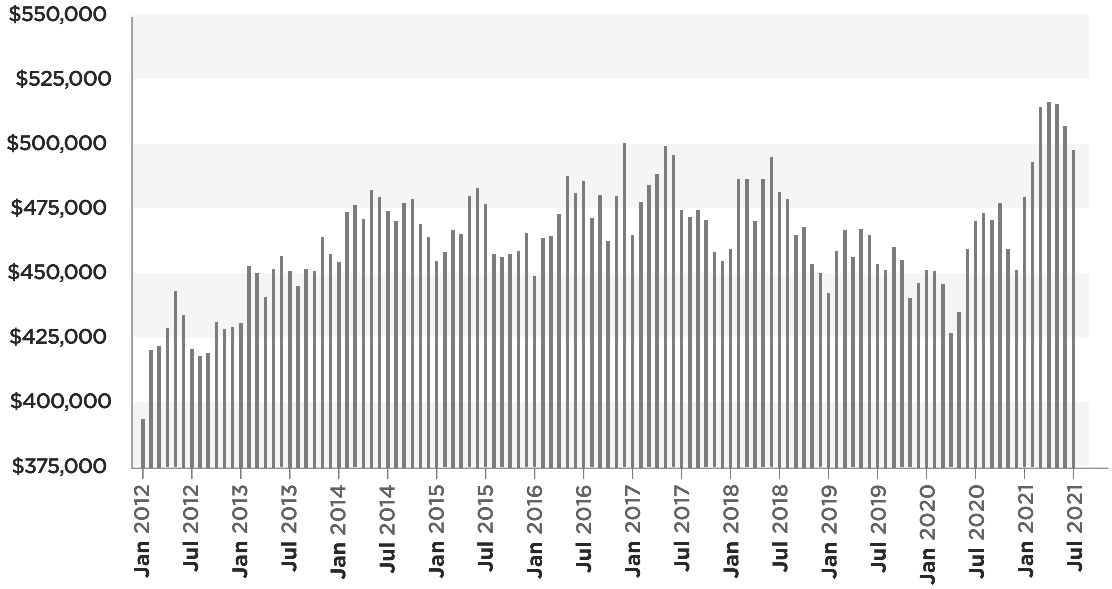
Source: Canadian Real Estate Association 2021.

The increase in prices has been observed for all types of housing. However, housing prices escalated faster after April 2020, when the pandemic resulted in an extreme shortage of listings on the Multiple Listing Service (MLS) system. Concomitantly, with mortgage rates remaining at record low levels, prospective homebuyers entering the market benefited as those lower rates helped reduce their monthly mortgage payments. As a result, housing prices have increased by 31 percent since the onset of the pandemic. In comparison, between the third quarter of 2015 and the first quarter of 2020, housing prices increased only 27 percent.

Furthermore, the escalation in housing prices observed before the pandemic was confined mainly to Toronto and Vancouver's high-demand housing markets. Some less populous towns did experience a pre-pandemic acceleration in housing prices. However, the relatively low initial base price in small towns meant that the large percentage increase still amounted to lower average housing prices there than in larger cities.

Other mid to large cities did not see a significant increase in housing prices before the onset of the pandemic. For instance, in Calgary, benchmark housing prices were lower in the first quarter of 2020 than in the third quarter of 2015 (Figure 3) because of the downturn in the province's resource sector, which

FIGURE 3: AVERAGE HOUSING PRICES FOR CALGARY, 2012-2021



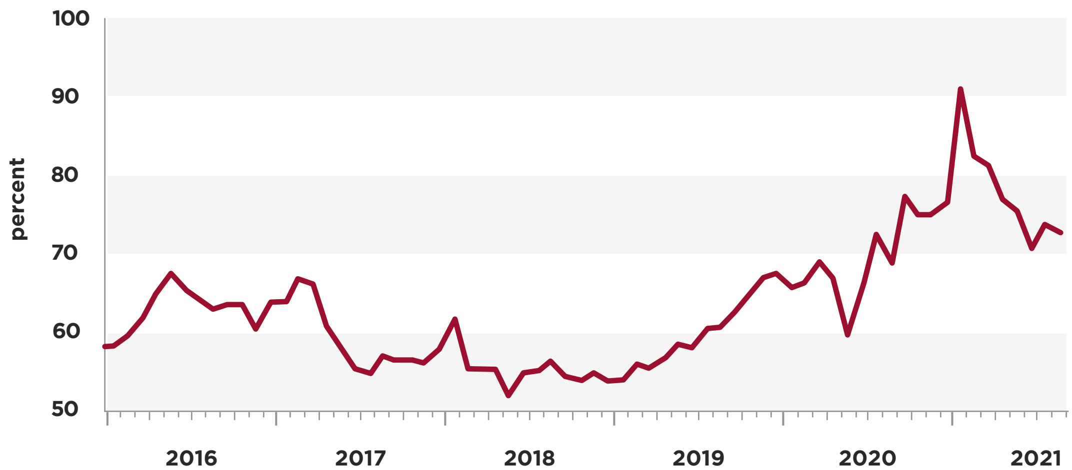
Source: Canadian Real Estate Association 2021.

was the driving force behind Alberta's economy. However, given that the greater Toronto area and the Vancouver region constitute a large proportion of the housing that transacts through the MLS, their impact on aggregate average housing prices in Canada is significant.

That housing prices rose rapidly during the COVID-19 pandemic took many by surprise. Initial forecasts had suggested that the pandemic would lead to an imminent drop in housing prices. The Canada Mortgage and Housing Corporation (CMHC), for instance, forecasted that housing prices would decline significantly by the first quarter of 2021 (Haider and Moranis 2021a). The national housing agency repeatedly stood by its forecast during 2020 and early 2021. In reality, however, the Canadian housing markets in large and small towns broke new records for sales and housing prices month after month.

As mentioned earlier, when the pandemic began, the initial increase in housing prices resulted from a severe shortage of available housing due to COVID-related restrictions imposed on mobility and assembly. Many would-be home sellers were concerned that prospective buyers would visit their homes to inspect the property and in doing so might compromise the seller's health and well-being, so they held off listing their homes. Many home sellers also stayed on the sidelines fearing that homebuyers would not be able to visit their property because of the restrictions on mobility. As a result, the

FIGURE 4: SEASONALLY ADJUSTED SALES-TO-NEW-LISTING RATIO IN CANADA, 2016-2021



Source: Canadian Real Estate Association 2021.

sales-to-new listing ratio (SLR) increased rapidly in May 2020 and reached 90 percent after January 2021 (Figure 4). Though the SLR declined from its 90-percent-plus peak in early 2021, it remains higher than it was pre-pandemic, suggesting that the demand for housing continues to outpace the supply of homes in the resale market.

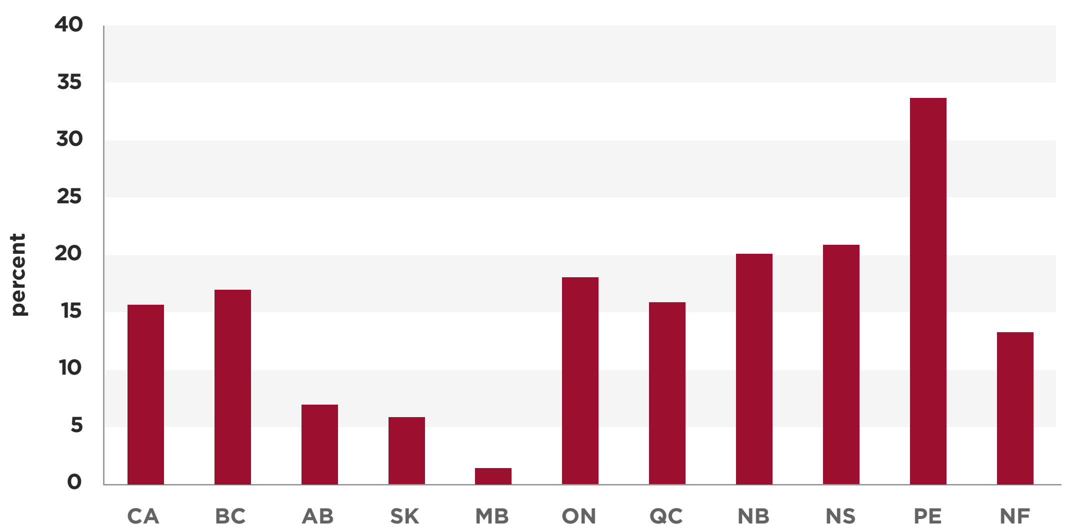
Once the restrictions on mobility and accessibility were relaxed, homebuyers and sellers returned to the market in large numbers. As mentioned, the significant decline in mortgage rates helped make monthly mortgage payments relatively smaller, thus allowing homebuyers to bid for more expensive properties.

Working from home was another factor that resulted in a sudden increase in demand for larger homes. Before the pandemic, approximately 12 percent of the labour force worked from home either partially or entirely. At the peak of the pandemic in April and May 2020, almost 40 percent of Canada's labour force was working from home (Urban Analytics Institute 2020). The sudden change in work locations resulted in a shift in housing demand. Whereas workers once favoured centrally located neighbourhoods near employment hubs, their preferences changed during the pandemic since they could work from almost anywhere, thanks to computers, information technology, and cloud computing and storage. Hence, proximity to employment hubs, such as downtowns, was no longer as big a priority for many workers. This resulted in a slight decline in the demand for housing near downtowns, primarily apartments, condominiums, and small-sized homes, and an increase in the demand for large-sized dwellings that are more frequently found in the suburbs and satellite towns.

Consequently, small and mid-sized satellite towns, such as Windsor, Ontario, saw a year-over-year increase in housing prices of over 40 percent. Moreover, the rapid and unprecedented escalation in housing prices in smaller towns was not confined just to those at the periphery of large urban centres, but it manifested in less populous towns in smaller provinces that had not seen their populations increase in the past few decades. Hence, property markets in remote places like Cape Breton, Nova Scotia and Moncton, New Brunswick also witnessed significant price increases.

Figure 5 illustrates the unequal landscape of house price appreciation across Canada. In July 2021, the year-over-year increase was the highest in PEI. The prairie provinces reported lower price appreciation than the Canadian average, reflecting the struggling resource-sector-based economies in three provinces. Interestingly, New Brunswick and Nova Scotia posted higher price increases than did BC or Ontario, albeit from a lower base price.

FIGURE 5: YEAR-OVER-YEAR INCREASE (%) IN HOUSING PRICES ACROSS PROVINCES, JULY 2020 TO JULY 2021



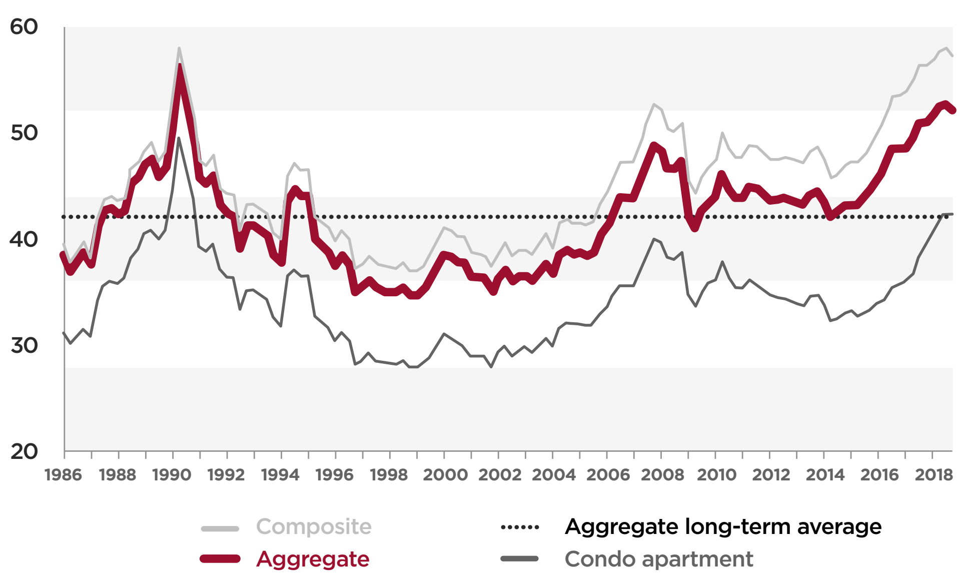
Source: Canadian Real Estate Association 2021.

Measuring housing affordability for ownership markets

Several measures of housing affordability have been developed and applied in local and national settings. They frequently use metrics that set a percentage of pre-tax household income as an upper threshold for housing. For instance, households spending more than 30 percent of their gross income on housing could be deemed as facing affordability challenges.

RBC Economics has developed a housing affordability metric that tracks the cost of ownership relative to median household income in several housing markets in Canada. The aggregate long-term average since 1986 has been slightly over 40 percent, which implies that home ownership costs in Canada represented 40 percent of the median household income. However, Figure 6 illustrates significant departures from the long-term average rate as housing affordability worsened in the late 1980s and early 1990s when households living in single detached homes were spending almost 60 percent of their median household income to cover ownership costs. At the same time, Figure 6 also illustrates how ownership costs as a percentage of median household income declined from the early 1990s to 2000, primarily reflecting a decline in borrowing costs.

FIGURE 6: HOME OWNERSHIP COSTS RELATIVE TO MEDIAN INCOME (%) IN CANADA, 1986-2019



Source: RBC Economic Research 2019.

The share of income spent on housing increased from 2000 and 2008 but reversed course again when the Great Recession hit Canada. Figure 6 also shows that housing costs relative to incomes rose again beginning in 2013. What the figure does not show is the tremendous heterogeneity that exists in housing affordability across Canada. For example, in the fourth quarter of 2018, ownership costs accounted for 52 percent of the median household income in Canada. However, in Vancouver, home ownership costs were as high as 85 percent of the median household income. Toronto, at 66.1 percent, was the second-highest in the markets monitored by RBC Economics. In comparison, home ownership costs accounted for 40.3 percent of the median household income in Calgary that year, and 35 percent of the median household income in Edmonton. In Montreal, ownership costs accounted for 44.5 percent of the median household income, despite Montreal having a large share of rental housing.

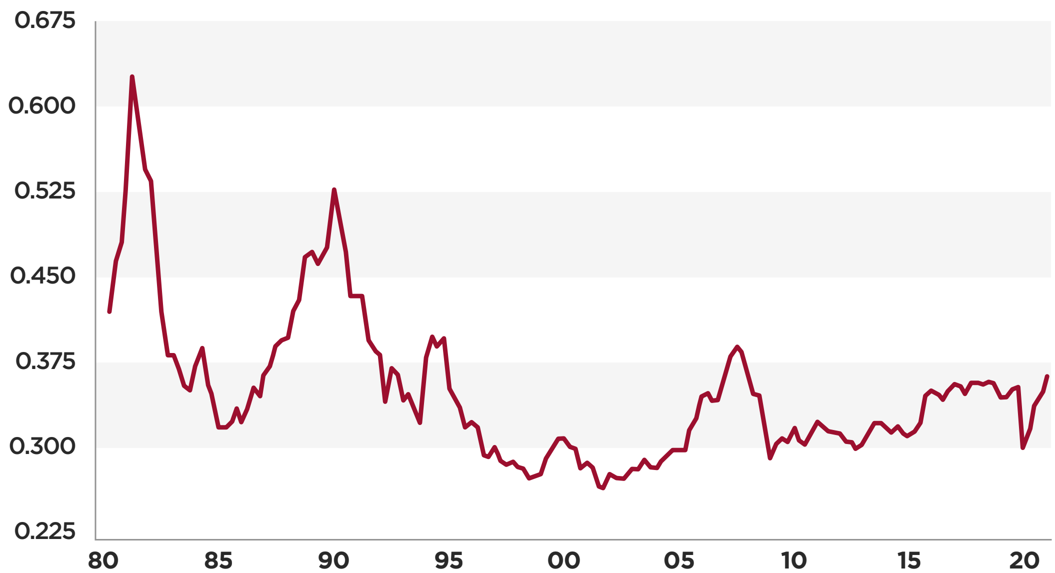
> *Ownership costs as a percentage of median household income declined from the early 1990s to 2000.*

A long-term view of housing affordability is available from the Bank of Canada's Housing Affordability Index. The index is the ratio of the average quarterly mortgage payment to the average quarterly income (Figure 7). The bank's index is simpler to calculate than RBC's but offers a longer perspective – from the 1980s to 2021. The index reveals that housing affordability in home ownership markets fluctuated wildly in the eighties and then declined steadily in the '90s. Moreover, the moderate decline in affordability proxied by the increase in the share of income required to cover mortgage costs since 2010 indicates that increasing housing prices counteracted against the mortgage payment relief one would have experienced because of the low mortgage rates.

In summary, Figure 7 suggests that housing affordability has not continually worsened in Canada. The decline in the share of income required for mortgage payments in the '90s and a relatively moderate rate of increase in the past 20 years suggests that housing affordability was a more considerable challenge in the '80s than it is today.

The affordability discussion has focused on the monthly payments that homeowners and renters make. Yet the rapid increase in housing prices creates the additional challenge of coming up with the initial savings required

FIGURE 7: HOUSING AFFORDABILITY INDEX: RATIO OF THE AVERAGE QUARTERLY MORTGAGE PAYMENT TO THE AVERAGE QUARTERLY INCOME (NSA: NON SEASONALLY ADJUSTED)



Source: Bank of Canada Undated; Haver Analytics 2021.

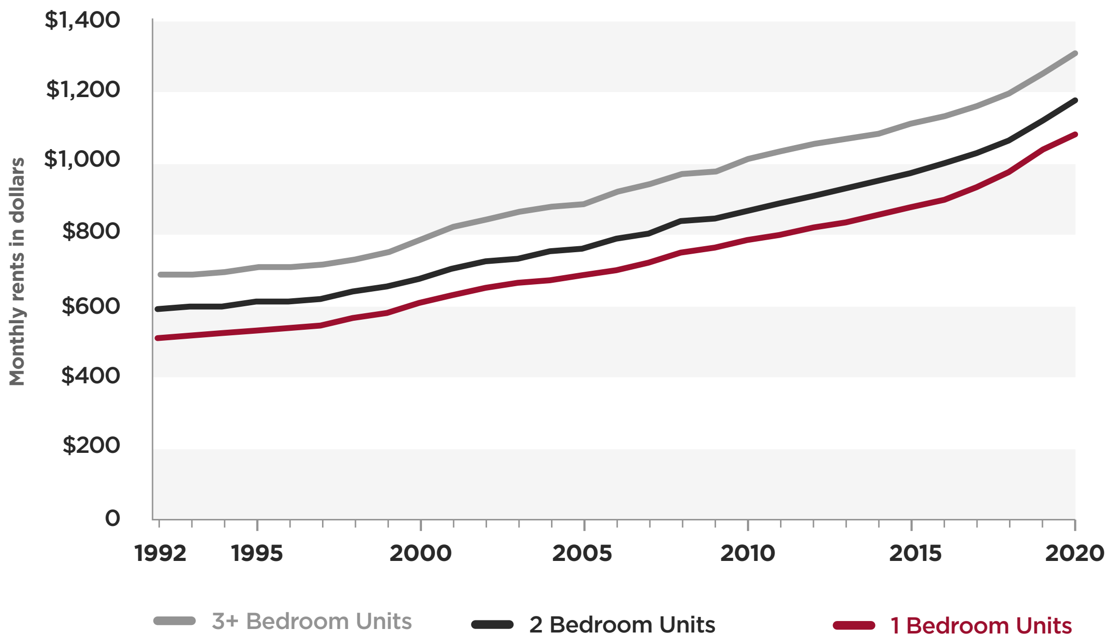
for the down payment, which for qualifying first-time homebuyers is at least 5 percent of the purchase price. Repeat homebuyers require a 20 percent down payment. When housing prices grew by 70 percent since 2015, the required down payment increased accordingly. For most Canadian households whose incomes did not increase in step with escalating home prices, the down payment itself became a formidable affordability challenge.

Rental Markets

The 2016 Census reported that over 70 percent of Canadians lived in a house owned by a household member. The rest lived in rented or band housing. Though in the minority, the proportion of renters is more pronounced in large urban centers where their numbers are much more significant. In the Montreal Census Metropolitan Area, renters account for 37 percent of the population. Rents have been rising in Canada for the past several decades (Figure 8). Renters face acute housing affordability challenges, are more likely to face homelessness than homeowners, and are much more likely to be in core housing need because of affordability issues.

Rental housing is provided through two distinct channels. Purpose-built rental housing comprises mid- to high-rise dwellings where all units are

FIGURE 8: AVERAGE RENT BY DWELLING SIZE IN CANADA, 1990-2020



Source: Haver Analytics 2021.

rented. The private rental market comprises individual dwellings rented out by investor landlords. The average rent for purpose-built rental dwellings is often less than that for units in private markets because the former are often older properties with limited amenities. In addition, given that the average household income of renter households is significantly lower than owner households, an increase in rent over time has an adverse impact on affordability for renters given the disproportionate increase in rents relative to their incomes.

Because of the lack of adequate construction of purpose-built rental housing since the early 1970s, vacancy rates have been very low in rental markets. The vacancy rate was 2.1 percent in the city of Toronto in October 2019. Given the move during the pandemic to larger dwellings by larger sized households, and university students relocating from centrally located rental units to their parents' homes, the demand for rental housing declined such that the vacancy rate increased to 5.7 percent in the city of Toronto in October 2020. Interestingly, the increase in vacancy rates in suburban Toronto, outside of the city, was less than that in the core city, providing further evidence of a greater preference for large suburban dwellings during the pandemic.

In 2018 the Canadian Housing Survey (Claveau 2020) revealed some differences between owner and renter households. It further divided renter households into those who live in social and affordable housing and those who pay market rents. According to the survey, 18.2 percent of the owner households said they had significant difficulties meeting their financial needs, while 29 percent of renter households reported the same. A full 44 percent of those living in social and affordable housing reported having difficulties meeting their financial needs. Similarly, whereas only 1.3 percent of all owner households reported ever being homeless, 3.8 percent of the renter households reported being homeless in the past. In comparison, 13 percent of those living in social and affordable housing reported having being homeless at some time in the past.

Furthermore, whereas 8 percent of owners reported fair or poor mental health, 15.2 percent of renters reported the same. These statistics illustrate how renter households, especially those living in social or affordable housing, are much more vulnerable because of affordability concerns.

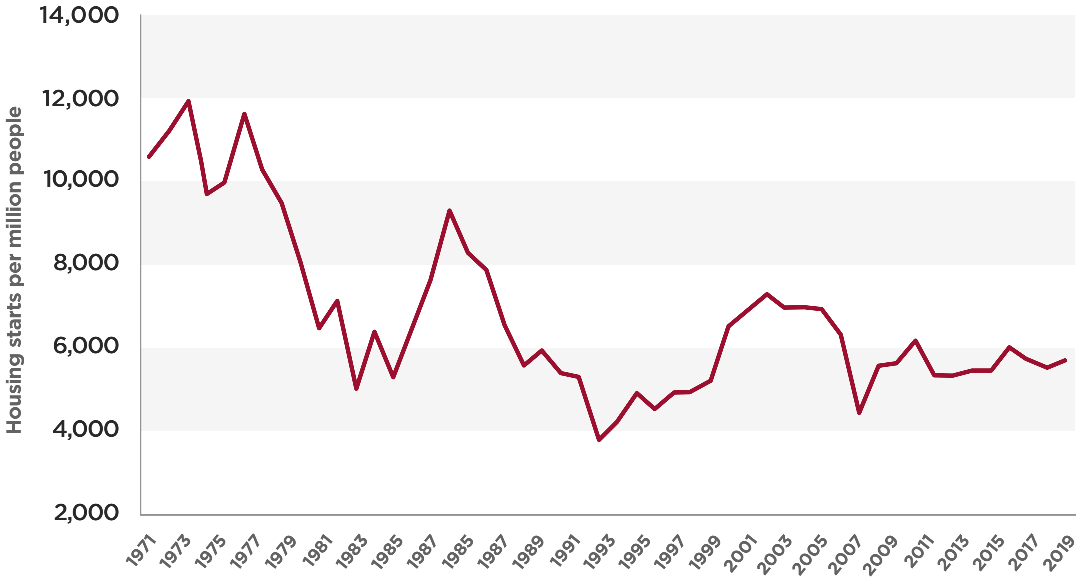
Supply and demand in housing markets

The price of a commodity is an outcome of the interactions between demand and supply. As the demand for a product grows, its producers realize the potential for profit and increase the supply. When the demand grows while supply lags, the price of a commodity continues to increase. Finally, prices moderate as supply catches up with the demand providing consumers more choice and diversity for the goods demanded.

Surprisingly, Canadian housing markets have experienced a chronic undersupply of new housing since the early 1970s. Over the past five decades, the Canadian population grew steadily, primarily due to immigration. However, the housing stock, especially in large urban centres, did not rise commensurately with the population increase. This meant that a larger number of potential homebuyers were competing for a limited number of dwellings, which resulted in a steady rise in housing prices in Canada. In fact, nominal housing prices in the country doubled almost every 10 years.

Figure 9 illustrates the persistent gap in housing supply in Canada since the early 1970s when Canada was building more than 10,000 dwellings per million people. Construction activity declined starting in the mid-1970s, though it did recover somewhat in the late 1980s. However, since the early 1990s, the rate of new housing construction has remained at less than half of what it was in the 1970s.

FIGURE 9: THE HOUSING CONSTRUCTION RATE IN CANADA HAS DECLINED SINCE THE 1970S



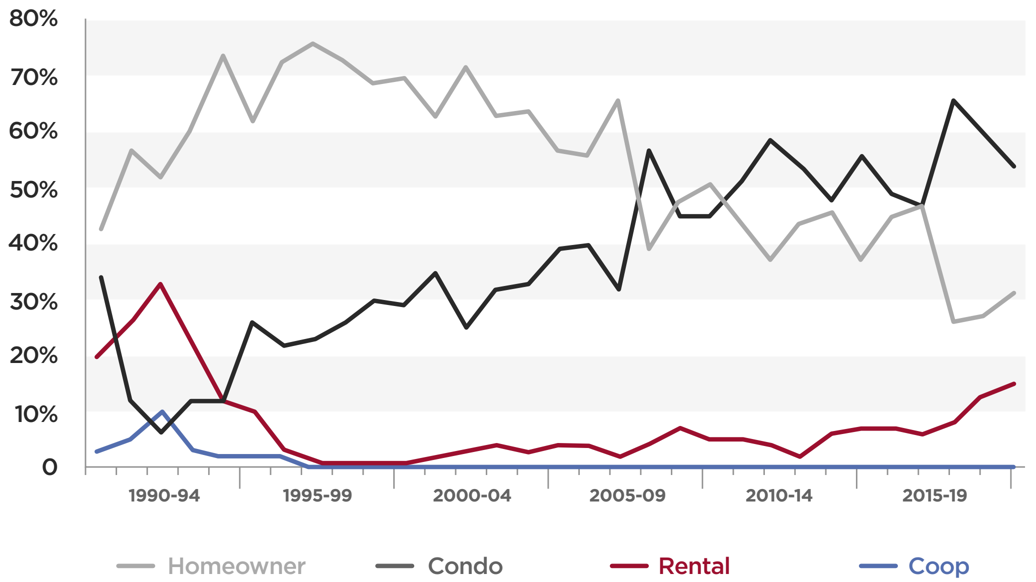
Source: Statistics Canada 2021a; 2021b. Computations by authors.

The undersupply of housing in Canada has two separate dimensions. First, as discussed, Canada has not built sufficient housing relative to the growing size of its population. Second, the housing that has been built has concentrated on housing typologies that are not conducive to sheltering families with children.

Consider the trends presented in Figure 10, which differentiates construction of residential units by housing types in the Toronto Census Metropolitan area. In the late 1990s, the homeowner segment represented over 70 percent of the new dwellings built in the city. Condominiums accounted for most of the other construction. Interestingly, in the early 1990s rental housing starts represented over 30 percent of the new housing construction in Toronto CMA. Yet rental housing construction has declined precipitously since then, and has increased only moderately over time. What is also interesting is how condominium construction has risen steadily since the mid-1990s, such that more than half of the new dwellings constructed in the recent past have been condominiums. The homeowner housing starts declined from over 70 per cent in the mid-'90s to around 30 percent in the recent past.

The trends presented in Figure 10 suggest that in addition to historically lower construction rates, recent construction activity has focused on smaller units, specifically condominiums and rental apartments, that may not be suitable for sheltering families with children. Consequently, the average

FIGURE 10: HOUSING STARTS IN THE TORONTO CMA, BY TENURE, 1990-2020



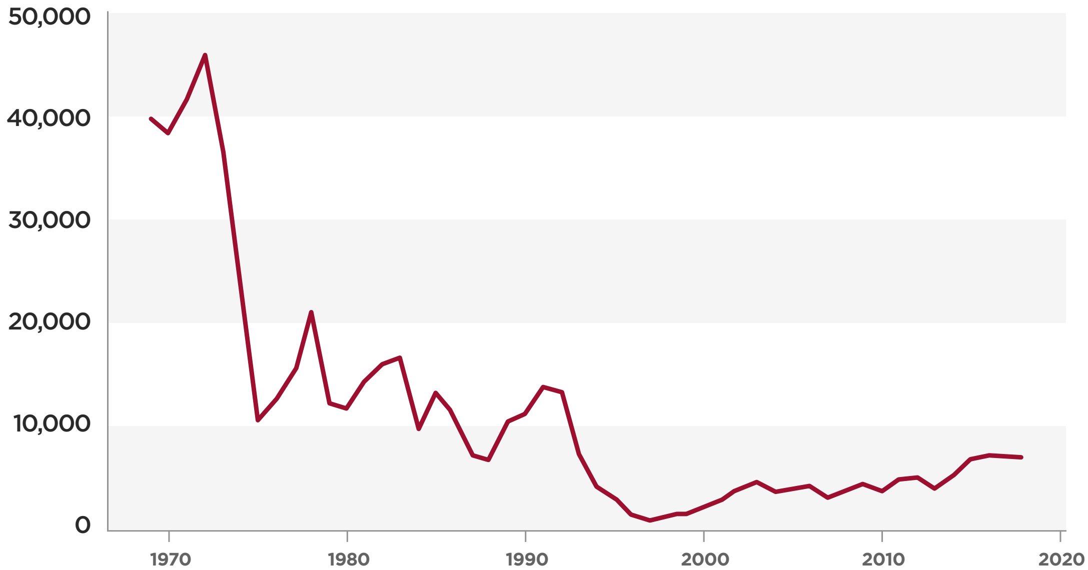
Source: Custom tabulations provided by the Canada Mortgage and Housing Corporation. Additional tabulations by authors

price of low-rise housing in Toronto exceeded the million-dollar threshold recently, owing in part to the lack of new supply for low-rise housing targeted at homeowners.

The other untold part of the story of the lack of adequate housing construction in Canada is the dramatic decline in the construction of purpose-built rental units. Following the implementation of the capital gains tax (CGT) in the early 1970s, which was applied to the sale of purpose-built rental units with no provisions for inflation, rental housing construction declined. Furthermore, changes to the tax regulations restricted owners of rental properties from using the capital cost allowance to lower their taxes on income from other sources.

Figure 11 starkly illustrates the rental housing construction trends in Ontario. Purpose-built rental construction peaked in the early 1970s when over 40,000 rental units were being constructed annually. However, by 1975, soon after the CGT came into force, rental housing construction in Ontario declined from a peak of 45,000 dwellings to just 10,000 rental units annually. And rental construction continued to slide. By the second half of the 1990s, rental housing construction had almost come to a halt in Ontario. Since then, there has been a welcomed increase in the construction of rental dwellings in Ontario. However, the rate of rental construction in the recent past pales in comparison to that in the 1970s. The decline in the construction of purpose-

FIGURE 11: NUMBER OF RENTAL UNIT STARTS IN ONTARIO, 1969-2018



Source: Data compiled from several sources and publications.

built rental dwellings partly explains why rental vacancy rates are so low in large urban centres, suggesting a lack of choice for renter households.

In summary, not only has Canada built significantly fewer housing units relative to its population since the early 1970s, but it has also increasingly faltered on constructing purpose-built rental units. Furthermore, the construction of dwelling types appropriate for growing families with children has been lacking in populous urban centres even as there has been an unprecedented increase in the price of low-rise housing.

How large is the housing deficit in Canada?

A recent Bank of Nova Scotia report compared the population-normalized housing stock in the Group of Seven (G7) countries and concluded that Canada lags the other G7 nations in the population-adjusted number of dwellings. The bank estimated that to reach the G7 average of 471 dwellings per thousand residents, Canada would require an additional 1.8 million dwellings (Almazora 2021).

If Canada had continued to build on average 10,000 dwellings per million population from the 1970s onwards, it would have constructed almost 14.7 million new dwellings over the past five decades. Instead, Canada constructed 9.7 million new dwellings from 1970 to 2020, a shortfall of 5.0 million had the construction rates from the 1970s persisted.

While there is a consensus that Canada has not built an adequate number of new homes, one can still debate the magnitude of the undersupply. What is needed to solve the problem is a consensus amongst all tiers of governments with a stake in residential construction to recognize the large gap in supply and collaborate to set targets to address the shortfall. Unfortunately, this is easier said than done.

The determinants of undersupply

The discussion about a lack of housing supply will not be complete without an exploration of the determinants of inadequate housing construction. We have identified several structural and ideological reasons for Canada having the fewest population-adjusted dwellings among the G7 countries.

"Supply skepticism" amongst urban planners has been one of the contributing factors to the lack of adequate housing construction. Urban planners often view the builders and land developers who comprise the development industry in pejorative terms; they sometimes hold the industry responsible for promoting urban sprawl. Often, applications to develop subdivisions take years to approve if the proposed plan contains a variance from the master plan or local land-use zoning regulations that might have been determined years and at times decades earlier.

Federal, provincial, regional, and local governments must reach a consensus to increase the supply of dwellings.

Furthermore, some in planning circles are skeptics and believe that increasing the housing supply would not improve housing affordability. Interestingly, supply skepticism has been a focus of academic research, indicating how misplaced beliefs amongst those responsible for managing land use have contributed to slow growth in housing stock and a rapid escalation of housing prices (Been, Ellen, and O'Regan 2019).

The other significant contribution to the lack of adequate housing supply in Canada is jurisdictional gridlock: federal, provincial, regional, and local governments must reach a consensus to increase the supply of dwellings. Even when the federal government can provide seed funding for new housing construction, provincial and local constraints on new housing construction may result in a less than adequate increase in supply. Furthermore, even when higher tiers of government realize the urgency to construct more housing rapidly, regional and local governments can frustrate such efforts if the local land use regulations are not flexible enough to accommodate new housing development.

Material and labour shortages are constraints. The lack of skilled or certified labour and disruptions to global supply chains have contributed to the increase in the cost of construction.

Lastly, resistance from residents who oppose any new development in their neighbourhoods has also contributed to less than adequate housing supply in urban Canada. Even though Canadians have access to 10 times more land per capita than their American counterparts, local resistance to new developments, legislative constraints, and harsh topography not conducive for development have rendered developable land a scarce commodity in Canada.

The structural and ideological constraints must be addressed to achieve an adequate supply of housing in Canada.

The federal role in housing

The federal role in housing dates to the *Dominion Housing Act* of 1935. In 1938, Canada's Parliament replaced that act with the *National Housing Act* (NHA). The NHA aimed to support new housing construction and repair and refurbish existing homes. The stated purpose of the NHA was to provide financing for housing "to promote housing affordability and choice, to facilitate access to, and competition and efficiency in the provision of, housing finance, to protect the availability of adequate funding for housing at low cost, and generally to contribute to the well-being of the housing sector in the national economy." The Act has been amended repeatedly in the intervening years. The CMHC was first launched as the Central Mortgage and Housing Corporation in 1945 to implement the provisions of the NHA.

The federal role in housing has gone through several phases of expansion and contraction. For example, postwar housing construction in the 1940s and 1950s led to a period of government expansion, while the 1990s witnessed a contraction in federal government's intervention in housing (Wolfe 1998). In essence, one can segment Canadian housing policies into three periods: from the 1930s to the 1980s (Rose 1980), the 1990s, and from the 1990s to the present time.

Since this paper focuses on recent developments in Canadian housing policies, the brief discussion that follows focuses on housing investments that federal governments have made over the past two decades. Since 2015, the Liberal government has embarked on an ambitious housing agenda under the National Housing Strategy (NHS), a 10-year long program with a total investment of $37 billion. In addition to that sum, the program also includes soft loans and contributions from subnational governments totalling $38 billion (Haider and Moranis 2021b). The $3.7 billion per year investment in housing promised under the NHS is, on average, 50 percent higher in nominal terms than federal government spending in the 10 years before 2015.

While the increase in federal interest in housing is welcome, additional spending has failed to make a marked improvement in housing affordability. For instance, a Parliamentary Budget Office (PBO) report revealed that the number of vulnerable households with core housing needs remained unchanged from 2016-17 to 2020-21 at 1.7 million in Canada (PBO 2021). This implies that the increase in spending has only maintained the status quo.

The current yearly $3.7 billion spending by the federal government essentially translates into $182 per month for each of the 1.7 million households with core housing needs. The PBO estimates that the affordability gap is much higher than that, and suggests an amount of $8 billion per year, far more than the current $3.7 billion in federal government spending, to help address housing affordability in Canada.

Competing visions for housing policy

The 2021 federal election gave political parties an opportunity to share their visions of how housing outcomes could be improved for Canadians. The three leading parties, namely, the Liberals, Conservatives, and the NDP, put forward a series of measures they believed would assist Canadians with their shelter needs.

In essence, one can aggregate the diverse set of proposals into three categories. First, the three political platforms unanimously identified foreign homebuyers responsible, at least partially, for Canada's rapid escalation of housing prices. Second, the platforms offered measures to assist first-time homebuyers with purchasing a home and to assist renter households with rental accommodations. Third, the platforms offered investment plans to encourage the construction of new housing in Canada.

The Conservatives and Liberals promised to ban foreign homebuyers from purchasing homes in Canada for at least two years. The NDP proposed the imposition of a 20 percent tax on foreign homebuyers, but would not restrict them from purchasing homes in Canada. The parties also proposed that a beneficial ownership registry be established to bring transparency to housing ownership in Canada.

While such measures were welcome, they were always unlikely to have a meaningful impact on housing affordability. Data collected from Statistics Canada suggest that non-residents own fewer than 5 percent of the homes in Canada. Non-residents also include Canadian citizens who might be living abroad and own property in Canada. Although explicit details on the national origins of homebuyers are not available, the ownership structure of the Canadian housing stock in 2018 suggests that foreign homeowners are a small minority of homeowners in this country.

The parties' platforms proposed a whole host of measures to improve affordability for first-time homebuyers. These measures included higher tax credits, interest-free tax savings accounts, relaxation of the mortgage stress test, and lengthening of mortgage durations to lower the monthly mortgage payments. First-time homebuyers are likely to benefit to varying degrees from such interventions, but such measures are also likely to increase the demand for housing. Hence, in the absence of a considerable increase in housing supply, one can foresee that measures that enable an increase in housing demand are likely to exacerbate the problem and put additional pressures on housing prices.

The three major political parties also set targets for new home construction above and beyond current levels. Each year, 250,000 to 275,000 new homes are built in Canada. The Conservatives offered to build an additional one million dwellings over the next three years. The Liberal plan proposed an additional 1.4 million dwellings including the refurbishment of existing units over the next four years. In essence, both the Liberal and Conservative plans promised roughly 250,000 extra new homes over three years. However, it is not clear how affordable these additional units will be or how the government will encourage their construction. On the other hand, the NDP promised to build 500,000 affordable dwelling units over the next 10 years. The NDP platform distinguished itself from those of the other two parties by identifying the affordable units it has promised to deliver.

In summary, the three competing visions to improve housing affordability in Canada were not that distinct from each other. Moreover, the likelihood of any of the plans making a definitive change in housing affordability in Canada is low given that the PBO has indicated that Canada needs two to three times more in federal government spending each year to address the affordability gap. The stated measures, therefore, appear unlikely to make a meaningful difference in reducing the affordability gap.

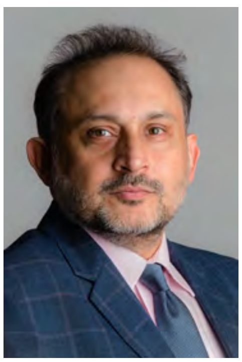
Conclusion

Housing affordability has been called a crisis in Canada for decades. In the 1960s and 1970s, when housing prices were much lower, Canadians considered average housing prices out of reach for many. Decades later, housing prices have increased many times over. However, average household incomes have not kept pace with the increase in prices. As a result, certain housing affordability measures, such as the ratio of average mortgage payment to median household income, worsened in the 1980s and 1990s. Those metrics did improve somewhat because of the decline in mortgage rates that reduced monthly mortgage payments. While interest rates have remained at record low levels for the past five years, housing affordability metrics have worsened again thanks to a steep escalation in housing prices.

Interestingly, the economic and labour market uncertainty that followed the onset of COVID-19 did little to restrain housing prices in Canada. On the contrary, housing prices escalated even more during the pandemic. Furthermore, the rapid escalation in housing prices before the pandemic was confined to a few populous cities in Canada. The pandemic brought changes that meant that people could choose to live and work remotely and were no longer constrained to finding residences near employment hubs. Working from home increased housing demand at the urban periphery and beyond, extending the housing affordability challenge to Canadians living in small towns.

The fundamental challenge facing housing policy in Canada is a lack of adequate supply. Housing construction has lagged far behind the increase in population, and estimates of the housing gap are between 1.8 to 5.0 million dwellings. A national housing policy that brings together stakeholders from all tiers of government to increase the supply of housing paired with an increase in combined-level government spending on affordable housing, financial guarantees, and targeted support in regions of especially high demand, is a must to improve housing outcomes for all Canadians. In particular, federal spending power should be used to induce other levels of government to reduce regulatory barriers holding back private sector investment in housing.

About the authors



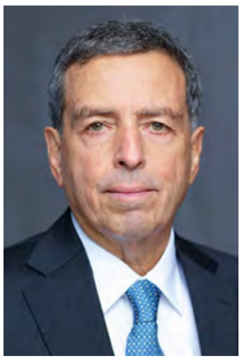
Murtaza Haider is a professor of Data Science and Real Estate Management at Ryerson University. He also serves as the research director of the Urban Analytics Institute. Professor Haider holds an adjunct professorship of Engineering at McGill University. In addition, he is a Director of Regionomics Inc., a boutique consulting firm specializing in the economics of cities and regions.

Dr. Haider is the author of *Getting Started with Data Science: Making Sense of Data with Analytics* (2016).

Professor Haider's research interests include business analytics, data science, housing market dynamics, transport/infrastructure/urban planning, and human development in Canada and South Asia.

Professor Haider is a syndicated columnist with Post Media. His weekly column on real estate markets appears nationally in *The Financial Post* and local newspapers including *Ottawa Citizen*, *Vancouver Sun*, *Calgary Herald*, *Edmonton Sun*, and *Montreal Gazette*. He also writes occasionally for *The Globe and Mail* and *The Toronto Star*.

Murtaza Haider holds a Masters in transport engineering and a Ph.D. in Civil Engineering from the University of Toronto.



Stephen Moranis is a strategic and seasoned real estate leader with broad international experience in the private, public and non-profit sectors. A proven track record with the ability to guide executive and board teams and function as a member of both the controlling and the ownership groups. Combining work attributes and personal skills resulting in creativity, innovation and strategic analysis.

Stephen is a former president of the Toronto Real Estate Board. He holds an MBA from the University of Toronto and holds additional professional designations from Real Estate Institute of Canada.

Stephen contributes regularly to local and international media. He is a sought-after commentator and an advisor on property markets.

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