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IMPROVING HOUSING AFFORDABILITY IN MONTREAL BY REDUCING CONSTRUCTION REGULATION

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The issue of housing affordability is increasingly present in the public debate, both nationally and locally. Rents increased an average of 10.9% in 2022 across the country,[1] and the situation is much the same in Montreal. Even back in 2016, it was estimated that over 260,000 renter households in the metropolitan area devoted more than 30% of their incomes to housing.[2]

There is no doubt that we are facing a housing crisis. However, we need to ask the right questions and determine the cause of the problem in order to know how best to address it.

The case of Montreal is relevant, as the City plays a direct role in the affordability crisis by inflating construction costs through a multitude of regulations and arbitrary decisions, which has the effect of increasing the prices of housing, for sale or for rent. Montrealers are unfortunately the main victims of the barriers to housing construction erected by the City.

HOUSING PRICES DEEMED TOO HIGH

When it is observed that housing prices are too high, it is normal to consider the role of supply and demand in the market. Very often, there is talk of a housing shortage,[3] namely a situation in which demand exceeds supply.

To determine if there is a housing shortage, the vacancy rate is often used. This indicator "corresponds to the number of unoccupied dwellings compared to the entire rental stock in a residential sector."[4] Some consider the market to be unbalanced when the vacancy rate is below 3%.[5]

Montreal experienced such a situation in the early 2000s, hitting a record low of 0.6% in 2002 (see Figure 1). The situation is different today, with the rate gradually increasing of late. Looking at Greater Montreal, the vacancy rate was an estimated 3% in 2021, which corresponds to over 26,200 unoccupied dwellings.[6]

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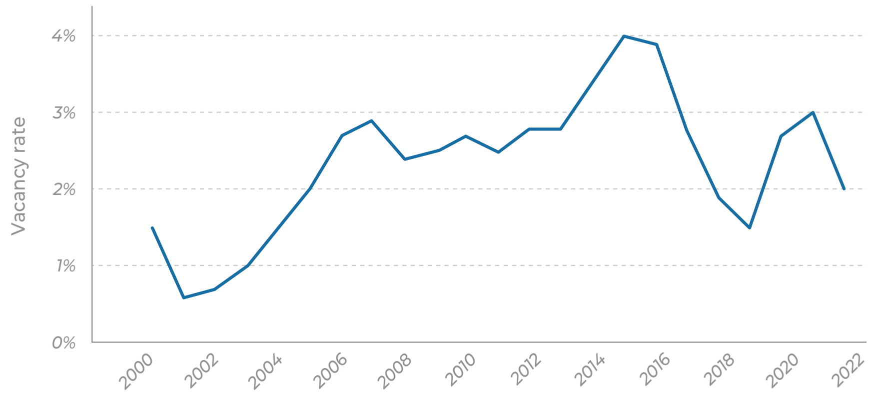
This rate even reached 6.3% in the downtown core.[7] However, the vacancy rate in the metropolitan area has now fallen again to reach 2% in 2022 according to the latest data from the Canada Mortgage and Housing Corporation (CMHC),[8] and it does consider supply to be insufficient in Montreal.[9]

This helps keep prices high, exacerbating the affordability problem. The CMHC deems housing to be unaffordable when it costs more than 30% of a household's income.[10] By this measure, even back in 2016—when the vacancy rate was almost 4%—over 260,000 households lived in unaffordable dwellings in Greater Montreal.[11]

Figure 1

Evolution of the vacancy rate for private dwellings in Greater Montreal, 2000-2022



Source: Statistics Canada, Table 34-10-0130-01: Canada Mortgage and Housing Corporation, vacancy rates, row and apartment structures of three units and over, privately initiated in census metropolitan areas, weighted average, February 21, 2022.

Several other factors help explain these prices considered high by officials, including the inflation of construction and housing maintenance costs observed in recent years.[12] Restoring affordability requires a reduction in construction costs, which would improve the profitability of real estate projects and thus enable price reductions. When municipalities erect hurdles for developers by increasing regulatory costs, it is difficult for affordability to improve.

Even back in 2016—when the vacancy rate was almost 4%—over 260,000 households lived in unaffordable dwellings.

To understand current housing prices, the role played by the City of Montreal must be taken into account, notably its numerous regulations (urban plans) and arbitrary decisions, which raise construction costs. These costs inevitably get transmitted to housing prices. Therefore, Montreal's housing shortage is really a shortage of reasonably priced housing.

THE REGULATORY COSTS BEHIND HIGH PRICES

The By-law for a Diverse Metropolis, commonly called the "20-20-20" bylaw[13] (20% social housing, 20% affordable housing, and 20% family housing) is a City of Montreal urban plan that came into effect in 2021.[14] The stated goal announced by the Plante government is to ensure a better supply of affordable housing and to guarantee diversity in the city.[15] But what does it really involve?

The bylaw applies to any entity undertaking a construction project of over 450 m^2, equivalent to five dwellings.[16] The builder must reach an agreement with the City and is obliged to include three kinds of dwellings in the building: i) social housing, ii) affordable housing, and iii) family housing.[17]

i) A housing unit is considered social if its construction is subsidized by a municipal or provincial social housing program. A developer can contribute to the social housing component in three ways:

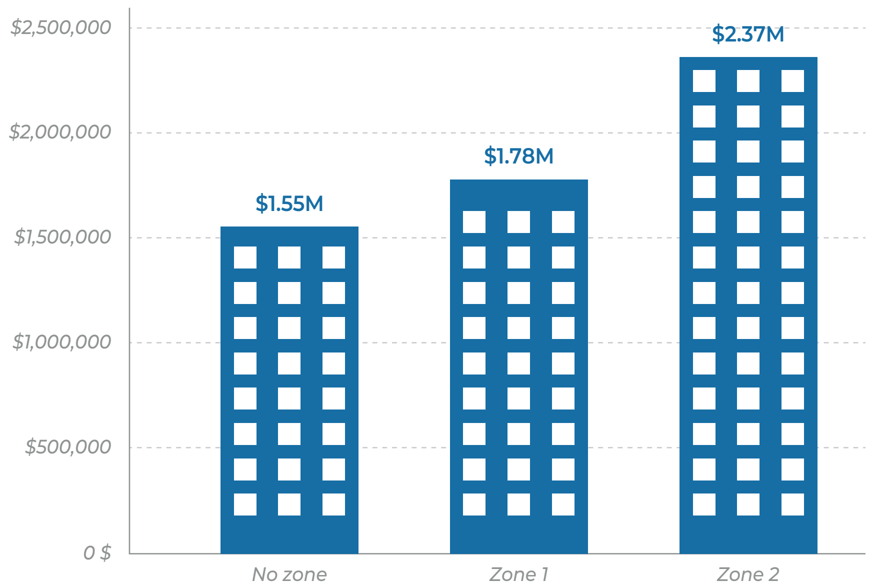
1. by directly adding such units to the construction project;
2. by transferring the land or building in exchange for a financial contribution from the City;
3. by making a direct financial contribution of a sum calculated by the City.

ii) For the affordable housing component, the City designates "affordable housing zones" in which 10% or 20% of such units, depending on the zone, must be included in every construction project. If a project is not within an affordable housing zone and is over 4,500 m^2, a financial contribution is calculated. A housing unit is considered affordable if it is sold or rented for 10% below its market value. As with social housing, a developer can instead choose to pay a financial contribution.

iii) As for family housing, this is defined as having at least five rooms and a surface area large enough to accommodate a family—between 86 m^2 and 96 m^2 depending on the area. All projects of 50 units or more are subject to this requirement. Unlike the other two types of housing, a developer cannot opt to pay a financial contribution and is obligated to build them.

Figure 2

Total contribution paid to the City, three scenarios



Note: For the social and affordable housing components of a 14,000 m^2 project in downtown Montreal, which must also include 11 family housing units.
Sources: Author's calculations. City of Montreal, Outil de calcul : contribution pour logements sociaux, abordables et familiaux, updated January 24, 2023; Altus Group, "Canadian Cost Guide," 2023, p. 4.

These requirements pose serious problems for developers, as they often do not correspond to local housing market expectations. For example, including family housing in a student neighbourhood is very unlikely to correspond to the demand.

It is clear that the "20-20-20" regulation entails direct costs for developers, and that these costs drive up housing prices.

Let us take a concrete example to calculate the additional costs stemming from the "20-20-20" regulation, like a 14,000 m^2 project in downtown Montreal. This corresponds to the Mansfield project[18] currently under construction, for instance, which has an area of 13,979 m^2 and a total of 225 units. This example is relevant given that Montreal is seeing more and more construction projects of this scope.[19]

Suppose that the developer refuses to build social or affordable housing units and prefers to pay a financial contribution. There are three possible scenarios[20] (see Figure 2):

1. If the construction project is not within an affordable housing zone (which would be the case for this downtown site), the developer must pay the City $1,185,176 for the social housing component and $369,740 for the affordable housing component. Moreover, the project must include 11 family housing units. That's a total of $1,554,916 to be paid to the City.

2. If the project is in Affordable Zone 1, the total to be paid climbs to $1,777,764.

3. If the project is in Affordable Zone 2, the total amounts to $2,370,352. (The two zones are established in accordance with the urban plan for the neighbourhood in question.[21])

For 225 units, this means that an additional amount of $6,911 (Scenario 1), of $7,901 (Scenario 2), or of $10,535 (Scenario 3) will be added to the selling price of each unit, or to its rent. This is far from a negligible amount for the average household. If we calculate that such a project represents average construction costs of some $35 million to $45 million,[22] fees of $2 million to $3 million represent a substantial portion of the total cost, not to mention other regulations or the costs associated with potential delays related to decisions made by the City of Montreal.

It is clear, then, that the "20-20-20" regulation entails direct costs for developers, and that these costs ultimately drive up housing prices. The result of this regulation is that only a minority of Montrealers have access to social or affordable housing units, if they are ever actually built, while for most Montrealers, the new housing that is built is more expensive. A vicious cycle is thus set in motion in which new dwellings are not affordable compared to the rest of the rental stock,[23] and their price cannot come down since supply is limited.

ARBITRARY DECISIONS AND INCREASED LEGAL UNCERTAINTY

Several other very real examples show how the "20-20-20" regulation interferes with the supply of housing.

The Square Children's project on the site of the former Montreal Children's Hospital is one of these.[24] The project was supposed to have 20 floors and included a financing agreement with the City for the social housing units to be built. However, the developer and the City were unable to agree on the construction costs for the social housing.[25] The City therefore backed out of its agreement and decided to reduce the height of one of the project's towers to 4 floors, going against the recommendation of the Office de consultation publique de Montréal.[26] On top of imposing additional costs, the City therefore goes so far as to reduce the number of units built.

The Proment construction project on Nuns' Island[27] is another example of the arbitrary nature of the City of Montreal's decisions obstructing the construction market. Following a zoning change, the City reduced the tower from 37 floors to 26, despite the inhabitants of the island having been in favour of the original size of the project. The City also demanded $2 million from the developer to finance social housing, for a total of $6 million in development fees, including financing for the REM, which will open a new station in the neighbourhood in 2024.

CONCLUSION

Several economic factors play a role in the high housing prices seen in Montreal and elsewhere in Canada. There are the low interest rates that prevailed for years, which stimulated demand, and the inflation that raised construction costs for developers and maintenance costs for landlords.

The City exacerbates the housing affordability problem when it blocks or delays construction projects, or adds on regulatory costs.

Nonetheless, the City exacerbates the housing affordability problem when it blocks or delays construction projects, or adds on regulatory costs. The "20-20-20" regulation applied to all new construction projects in Montreal is a good example of this; when regulatory surcharges amount to millions of dollars, it is hardly surprising to find that we are facing an affordability problem.

If it really wants to lower housing prices, the City must reduce the regulatory burden, because at the moment, it is falling far short of its goal to offer affordable and adequate housing to all.

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