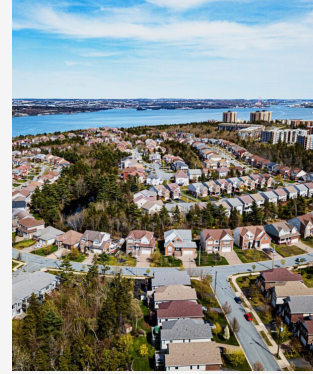


# How dense is too dense? Challenges of urban densification

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During the height of the pandemic, we witnessed a greatly accelerated increase in online shopping and the resulting impact it had on real estate – the demand for industrial space became insatiable while the demand for physical retail space was tepid at best. This trend appears likely to continue for the foreseeable future, though concerted efforts towards return to office in some sectors has provided some assistance to physical retail space in core urban markets with dense office populations.

We are now witnessing another societal-induced effect on real estate, albeit one that has been much more gradual in the making – the “densification” of urban real estate. While this trend is arising primarily in response to urban migration and resulting shortages in affordable residential real estate, it is likely to have ripple effects in many other real estate sectors. These changes therefore bear watching by every participant in the real estate space.

## Challenges arising from urban migration

It has long been a trend in Canada that our population has been steadily migrating to urban centres, notwithstanding the promise of work-from-home alternatives. With a proposed significant increase in immigration over the next three years, this trend will not only continue, but may accelerate. This growth of our cities presents very real challenges. The need for more public transit is constant; no matter how much gets added, many of our cities still suffer from gridlock and inefficient transportation, damaging our productivity. Similarly, the need for more housing, and in particular affordable – in the broad sense of the word – housing, has become critical. The current supply cannot satisfy current demand, let alone any increase in that demand. This shortage causes prices to rise beyond the reach of many who need or want homes, notwithstanding recent price decreases driven in part by rising interest rates. This has now become a dominant political issue.

So what's a city to do? Municipal governments control zoning in their cities. By exercising such control, they have a direct impact on how much housing, and what type, gets built and where. We are seeing municipalities implementing zoning changes to encourage more density along public transit lines, in the hopes that this added supply of housing will not increase traffic. We are also seeing shopping centres make better use of their parking lots, putting them underground and adding new multi-residential components to help support retail. In addition, we are seeing a renewed interest in the buying of air rights to create more density for developments.

However, these incremental initiatives are more in the nature of the gradual and natural evolution of a city. They are not nearly enough to address the ever-increasing need for affordable housing. Demand continues to outpace supply, while municipal politicians regularly face resistance from local activists who oppose large scale housing projects in their neighbourhoods. In addition, most city councils have their own political priorities that rarely place more affordable housing high on the agenda – it's traditionally not been a politically popular topic.

## Legislative responses emerge in 2022

Accordingly, the stage was set for provincial governments across Canada to consider overriding municipalities by implementing legislation at the provincial level to promote the supply of housing. For example, the introduction of Ontario's [Bill 23 – More Homes Built Faster Act, 2022](#) is part of the province's [Housing Supply Action Plan](#) to bring 1.5 million homes to market by 2031. This is the second piece of legislation aimed at addressing scarce housing supply in 2022. Our [Osler Update](#) from November 29 provides blacklined versions of the affected legislation.

The first was [Bill 109 – the More Homes for Everyone Act, 2022](#), which imposes penalties on municipalities if decisions are not made within set time frames for housing development applications made on or after January 1, 2023. Ontario is also seeking to provide cost certainty in relation to the fees and costs associated with development. This includes proposing to phase in increases to development charges and providing a cap on the amount of parkland that can be required. Ontario is also considering limiting the circumstances in which development approvals can be appealed to the Ontario Land Tribunal. This Tribunal is a unique body in the province that can overturn municipal decisions on development approvals. Not surprisingly, opposition is beginning to mount. Local ratepayer groups and environmental groups have already voiced their objections to losing standing at appeals to the Land Tribunal. Presumably, municipal councils will also make their views known about losing control over development charges and zoning affairs within their jurisdictions.

While Ontario is at the forefront of this trend – not surprising, given that Premier Ford has previously demonstrated his willingness to override municipal decisions – other provinces seem poised to take a similar approach. The [Alberta Housing Amendment Act](#) was passed in April 2022. The legislation lays the groundwork to improve and expand Alberta's affordable housing system by enabling key initiatives under a newly developed 10-year affordable housing strategy.

In British Columbia, the legislature has introduced a speculation and vacancy tax and an increased foreign buyers tax in an effort to reduce speculation on housing and the resulting price escalation. Additionally, the province is considering measures to increase funding and shorten the approval process for new housing in recognition that there is a supply issue as well as a speculation problem.

In Québec, recently re-elected Premier Legault campaigned in part on the promise of increasing affordable housing. His critics are demanding even more to address that province's needs.

In Nova Scotia, investigations concluded that local land use and planning decisions and the relevant approval process had become a barrier to building enough housing. A provincially appointed executive panel has therefore recommended that the municipal affairs and housing minister supersede local councils to push through a number of potentially unpopular housing developments in identified special planning areas.

Another unique and notable attempt to address the housing supply crisis is the Senakw development near downtown Vancouver by the Squamish First Nation. This First Nation is using the special legal status of one of its reserves, which is exempt from local zoning and by-laws, to create an ultra dense community for 10,000 people. These specific circumstances have provided yet another way to get over or around municipal bureaucracy or resistance.

The success of these initiatives remains to be seen, but clearly there is now widespread recognition that significantly more housing is desperately needed in Canadian cities. It remains unclear whether this new focus by provincial governments will allow the residential sector to overcome the current increased costs of construction, higher interest rates and lower selling prices. As the Canadian population grows and continues to migrate to urban centres, increased densification will inevitably result – more and more housing will be needed, along with transportation infrastructure, schools and medical facilities, and places for employment, retail and hospitality.

## Impact on other asset classes

As noted above, we were already witnessing examples of densification, so it will be interesting to see what impact this new focus on providing more housing will have on other asset classes.

These initiatives should accelerate the addition of multi-residential developments, including at shopping centres to buttress the value of retail assets. In the industrial sector, a growing population might continue the demand for warehouse space, notwithstanding the strained supply and high rents. In the office sector, it remains unclear whether occupancy levels of offices, which remain well below pre-COVID levels, will be affected.

This densification of urban real estate could bode well for all asset classes of Canadian real estate. However, effectively managing this inexorable growth in urban populations is critical, especially if municipal barriers continue to impede it. The reaction of provincial governments to the housing crisis highlights this issue, but provincial governments cannot be expected to “override” to the rescue repeatedly. Perhaps this is a signal to municipal governments across the country to ramp up their resources to better service their growing populations.

In addition, more tools will be needed to address this inevitable growth. This may include targeted zoning with increased density levels, encouraged air right transfers, incentives for multi-use projects and more public transit. Not only will population growth drive demand for places to live, but new residents will also need somewhere to work, somewhere to shop, somewhere to eat, somewhere to play and the means to get around effectively. Those cities that can successfully handle these challenges will continue to attract investment and growth. Those municipalities that do not, will risk the opposite.