

HOUSING MARKET ASSESSMENT

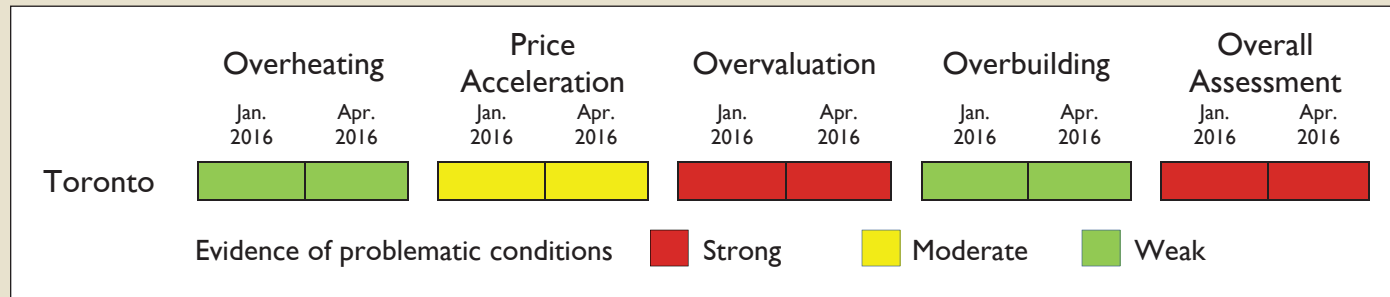
Greater Toronto Area

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Housing market intelligence you can count on

Highlights



- Recent results from the Housing Market Assessment (HMA) indicated strong evidence of problematic conditions in the Toronto CMA.¹
- Moderate evidence of price acceleration, and strong evidence of overvaluation were detected in Toronto CMA.
- We detect weak evidence of overheating. While we do not detect overbuilding, we have some concerns about the high inventory of completed and unsold condominium apartments.
- The Housing Market Assessment (HMA) analytical framework considers four factors to assess the evidence of problematic housing market conditions: overheating; acceleration in the growth of house prices; overvaluation; and, overbuilding. A brief summary of the framework is presented on page 6 of this report.

HMA Overview²

As Canada's authority on housing, CMHC contributes to market stability by providing information on potential imbalances that could affect housing markets. With the Housing Market Assessment (HMA), CMHC offers information and analysis that can help Canadians make more informed decisions.

The HMA combines the results from a technical framework with insights gained through CMHC's Market Analysts' knowledge of local market conditions. These insights position CMHC to provide additional context and interpretation to the results of the HMA framework.

The HMA framework detects problematic market conditions in local housing markets by identifying imbalances. An example would be the detection of overbuilding, a situation in which the inventory of unsold new homes accumulates due to supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolving an excess supply imbalance by supporting stronger demand and/or reducing supply. However, other unexpected development that do not originate from the housing market could accentuate or reduce an imbalance.

Colour codes indicate the level of evidence of problematic conditions. The HMA is a comprehensive framework that considers the intensity of signals of imbalances (that is, how far the indicator is from its historical average), and the persistence over time. Generally, low intensity and persistence are associated with potential weaker evidence of problematic conditions. As the number of intense and persistent signals increases, the associated evidence of problematic conditions becomes stronger.

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¹ Results are based on data as of the end of December 2015 and local market intelligence up to end of March 2016. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

² A detailed description of the framework is available in the appendix of the [National edition](#).

In Detail

Overheating

We detect weak evidence of overheating. The balance between supply and demand in Q4 2015 remained in favour of sellers. The seasonally adjusted sales-to-new listings ratio was 64 per cent; a rate that signalled demand was running ahead of supply. This ratio is still below the 70 per cent threshold that would signal evidence of overheating.

The overall sales-to-new listings ratio masked underlying differences among housing types. Strong demand resulted in the sales-to-new listings ratio for ground-oriented homes moving above the overall average, while the condominium apartment sector, where new listings grew faster, was below the average at 56 per cent. Nevertheless, the condominium segment has tightened as well due to significant sales growth.

“Overall we detect strong evidence of problematic conditions. Of particular concern is the evidence of price acceleration and overvaluation”



Dana Senagama
Principal, Market Analysis (GTA)

Price Acceleration

We detect moderate evidence of price acceleration in Q4 2015. The average house price grew by a seasonally adjusted 1.4 per cent from the previous quarter. A tight resale market, with demand outpacing supply has led to higher price growth.

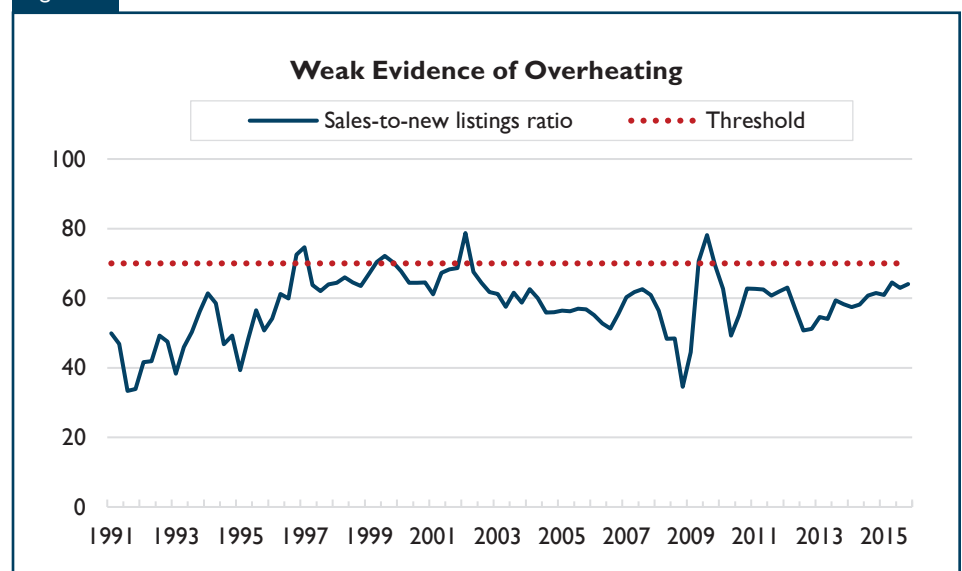
Price growth has not been uniform across all housing types and sub-markets within the Toronto CMA. Given record low inventory levels of single-detached homes, and to some extent other types of ground oriented homes, price growth has been more pronounced in this category. Thanks to more balanced market conditions in the high rise market, the rate of price increase for apartments is roughly half that of single-detached homes. Price growth has also not been uniform across sub-markets within the Toronto CMA, with seasonally adjusted prices increasing at a faster rate in suburban areas such as Halton and Durham Regions than in the City of Toronto. This was owing to the fact that apartments accounted for a relatively larger share of the City's resale market.

Overvaluation

We detect strong evidence of overvaluation in Q4 2015. The growth in house prices has persistently outpaced economic and demographic fundamentals, thus giving rise to strong evidence of overvaluation. The gap between actual home prices and prices supported by economic fundamental drivers has been above its problematic threshold for the past three quarters.

Most price growth was concentrated in the low-rise housing market. Record low inventories of low-rise homes in the Toronto CMA resulted in stronger price growth compared to that of condominium apartments. In fact, the price gap between these two dwelling types continued to grow in the fourth quarter. The seasonally adjusted median price of a single-detached home climbed 1.3 per cent in the fourth quarter from the third quarter, but was virtually unchanged for condominium apartments. More recent data for the first two months of 2016 show a pick-up in condominium apartment prices, however growth still remains below that of single-detached homes.

Figure 1



Source: CREA and calculations (threshold) by CMHC
Last data point: 2015Q4

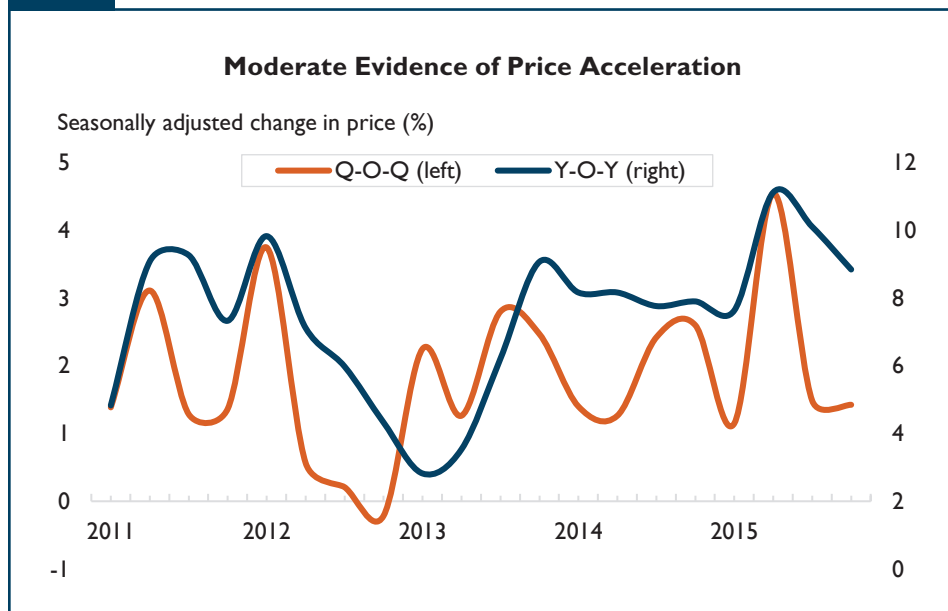
The average price of a house in the GTA grew by 9.8 per cent in 2015, compared to the previous year. At the same time the typical growth engines, such as disposable income and borrowing capacity could not keep pace. Additionally, population growth and net international migration have slowed over this time period. Given this disconnect between price growth and growth consistent with our fundamental drivers in our house price models, prices warrant further monitoring.

Overbuilding

We detect weak evidence of overbuilding in Q4 2015. However, a higher number of condominium apartment completions has led to an increase in the number of completed and unsold units. Inventory management therefore continues to be necessary to make sure that condominium units currently under construction do not remain unsold upon completion. Some of this potential excess inventory may be absorbed by a tighter resale condominium market, as well as a strong rental market. According to CMHC's Fall Rental Market Report released in December 2015, the vacancy rates in the purpose-built and condominium rental markets remained low at 1.6 per cent and 1.8 per cent respectively.

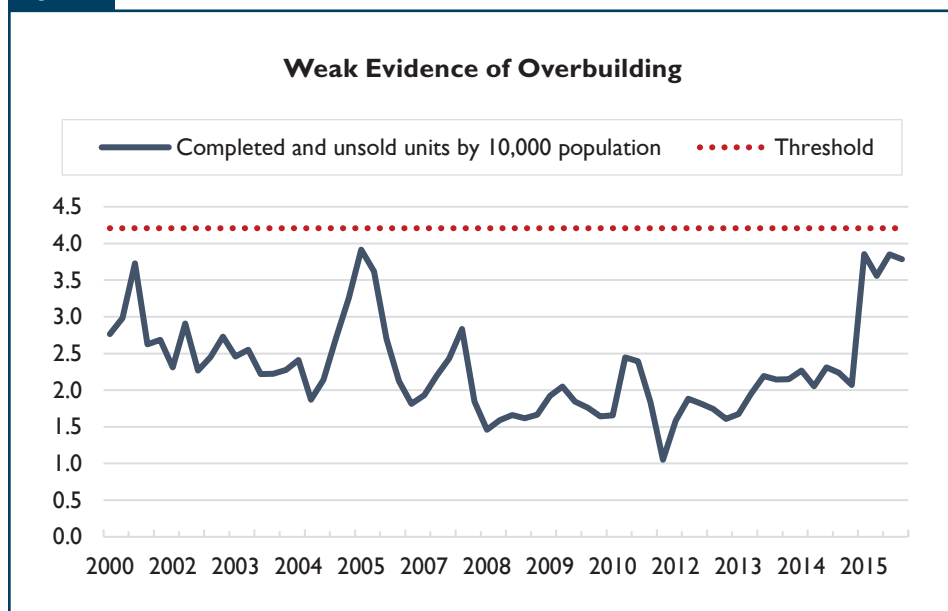
New home completions reached a record high in 2015. Total housing completions in the Toronto CMA reached 46,384 units in 2015, of which 32,822 were condominium apartment completions. Despite more units reaching completion, units under construction remained at 64,798 units at the end of the Q4 2015, of which 43,303 units were condominium apartments. By historical standards this represents a significantly large number, but the levels have come off the peak

Figure 2



Source: CREA and calculations (percentage change) by CMHC
Last data point: 2015Q4

Figure 3



Source: : Statistics Canada and CMHC
Last data point: 2015Q4

reached in 2014. Much of this build-up in units under construction has been a result of the new home market's shift to meet new high-rise demand, and has been compounded by increases in the average length of

time to construct these units. The majority of apartment condominium projects currently under construction are large in scale and concentrated within the downtown core, which has increased construction times.

Special Topics

Overvaluation is not a sufficient condition for a price correction

According to the HMA, the Toronto CMA currently exhibits strong evidence of overvaluation. Overvaluation can occur when home prices remain significantly above the level warranted by

fundamental drivers (see HMA framework on page 6). As well, overvaluation does not mean a price adjustment is imminent.

Overvaluation can resolve itself in a number of ways. For example, overvaluation would be eliminated if house prices decline towards their level warranted by fundamental factors. Alternatively, overvaluation

would also be eliminated if, over a given period, actual house prices increase by less than what would be consistent with fundamental drivers. Also, even if actual house prices keep their pace of increase, relatively stronger improvements in economic and demographic fundamentals could result in a closing of the overvaluation gap.

Overview of the Housing Market Assessment analytical framework

To obtain an accurate picture of the overall state of the housing market, it is important to consider multiple data points and lines of evidence rather than relying on just one measure or indicator.

The Housing Market Assessment (HMA) analytical framework provides a comprehensive and integrated view that relies on a combination of signals from several indicators to assess housing market conditions.

Specifically, the framework considers four main factors that may provide an early indication of potentially problematic housing market conditions: (1) overheating when demand outpaces supply; (2) sustained acceleration in house prices; (3) overvaluation of house prices in comparison to levels that can be supported by housing market fundamentals (listed below);

and, (4) overbuilding when the inventory of available housing units is elevated.

For each factor, the framework tests for: (1) the presence or incidence of signals of potentially problematic conditions, but also considers; (2) the intensity of the signals, i.e. how their magnitude compares with their historical average or how consistent they are with known or suspected house price bubbles, such as for Toronto in the late 1980s and early 1990s; and, (3) the persistence of signals over time.

Generally, a situation in which we detect few signals with low intensity or lack of persistence is associated with weak evidence of problematic conditions. Conversely, as the intensity, number, and/or persistence of the signals increases, the likelihood of a factor becoming problematic increases.

The framework takes into account demographic, economic, and financial determinants of the housing market such as population, personal disposable income, and interest rates to detect potentially problematic housing market conditions. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect problematic housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect current problematic conditions relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

Housing Market Assessment Factors

Overheating

Overheating is caused by demand significantly and persistently outpacing the supply of housing. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions in the existing home market. To identify problematic overheating conditions, the framework compares the sales-to-new listings ratio to thresholds. When demand is strong relative to supply, house prices typically grow at a faster rate. Sustained overheating conditions on the existing home market may lead to acceleration in house prices for existing and new homes. However, as supply and demand begin to balance out, indicators of overheating (and acceleration) would begin to soften and house prices would gradually moderate.

Acceleration in House Prices

Under balanced market conditions, house prices are expected to increase over time, in line with increases in households' cost of

living. House price acceleration occurs when the growth in house prices strengthens over time on a persistent basis. Acceleration in house prices over an extended period can cause their pace of increase to depart from the overall price inflation and eventually lead to overvaluation.

To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating asset prices.

Overvaluation

Overvaluation is detected when house prices remain significantly above the levels warranted by fundamental drivers of housing markets such as income, population, and actual and expected financing costs.

The HMA framework uses combinations of different house price measures and models to estimate house price levels warranted by fundamental drivers.

The difference between observed house prices and their estimated levels consistent with housing market fundamentals allows for an estimation of the degree of over- and undervaluation. The use of different price measures and models improves the reliability of results.

Overbuilding

Overbuilding is detected when the supply of readily available housing units significantly exceeds demand. In such a context, downward pressure on house prices would occur until the excess supply is eventually absorbed.

To assess overbuilding conditions in the housing market, the HMA framework uses two indicators that relate to the supply of readily available housing units: the rental vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current level and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the level of evidence of problematic conditions. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of potentially problematic conditions, but also considers the intensity of signals (that is, how far the indicator is from its historical average) and the persistence of signals over time. Generally, low intensity and persistence are associated with a lower potential of upcoming problematic conditions. As the number of persistent signals increases, the evidence of a problematic condition developing increases.

Note 2: Results at the CMA level are not segmented by housing type or neighbourhood. They represent an assessment of the entire CMA. However, specific CMA reports provide further detailed analysis of these markets.

Note 3: The colour scale extends to red only for those factors that have multiple indicators signaling significant incidence, intensity and persistence of potentially problematic conditions. As a result, only overvaluation and overbuilding can receive a red rating, since they are assessed using more than one indicator.

Note 4: To ensure the framework is as current as possible, on a regular basis, we undertake a model selection process whereby our house price models for overvaluation are tested for statistical significance at the national and CMA level. The result of this process may change the number of indicators of a problematic condition from the previous assessment.

* See Phillips, Wu and Yu (2008) "Explosive Behaviour in the 1990s NASDAQ When Did Exuberance Escalate Asset Values?" for further details on the methodology.

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