

HOUSING MARKET ASSESSMENT

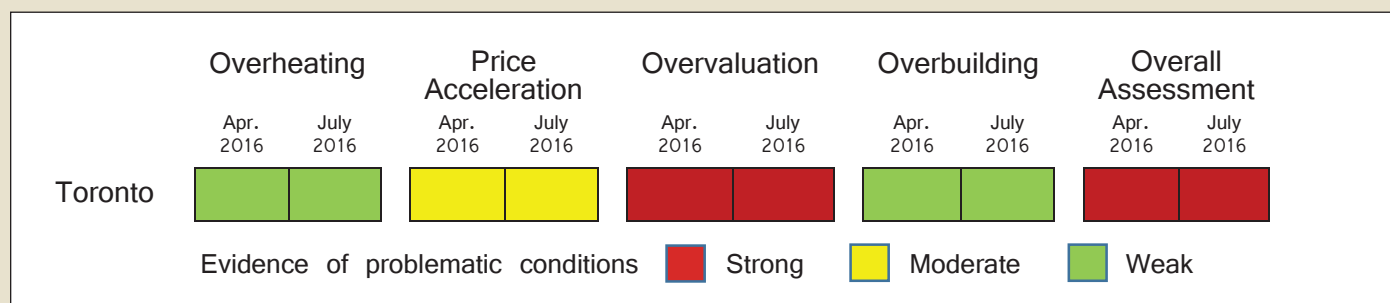
Greater Toronto Area

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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. We do not detect overbuilding, and the inventory of completed and unsold condominium apartments has subsided.
- 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 developments 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 March 2016 and local market intelligence up to end of June 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. Housing market conditions favoured sellers in Q1 2016 with the seasonally adjusted sales-to-new listings ratio reaching 71 per cent; a rate that signalled demand was running well ahead of new supply. This ratio was slightly above the 70 per cent threshold that would signal strong evidence of overheating, however it did not meet the requirement regarding persistency that would trigger a problematic condition classification.

The rising sales-to-new listings ratio was a reflection of strong demand outpacing supply. In fact, Q1 2016 saw a five per cent drop in the number of new listings in the resale market while sales grew by

5.4 per cent. Despite rapid price growth, fewer homeowners were enticed to list their homes for sale due to a shortage of desirable listings, forcing many to stay put and renovate instead. Some may have had expectations of even further price growth. Transaction costs associated with moving as well as a growing trend among seniors to 'age in place' may also be contributing to the lack of new listings supply.

The sales-to-new listings ratio differed significantly by dwelling type. Single-detached homes, which have always been in short supply, had a sales-to-new listings ratio of 76 per cent, while it was lower for condominium apartments at 64 per cent. Since single-detached homes represent the largest portion of sales in the resale market, they were the largest driver of price increases. Single-detached homes priced over \$2M saw

the largest increase in the number of sales at 41 per cent from the previous quarter. Nevertheless, both single-detached and condominium apartments saw their respective sales-to-new listings ratios jump higher in Q1 2016.

Price Acceleration

We detect moderate evidence of price acceleration in Q1 2016. The average house price grew by a seasonally adjusted 5.8 per cent from the previous quarter. Prices grew at a more pronounced rate of 13.6 per cent on a year-over-year basis.

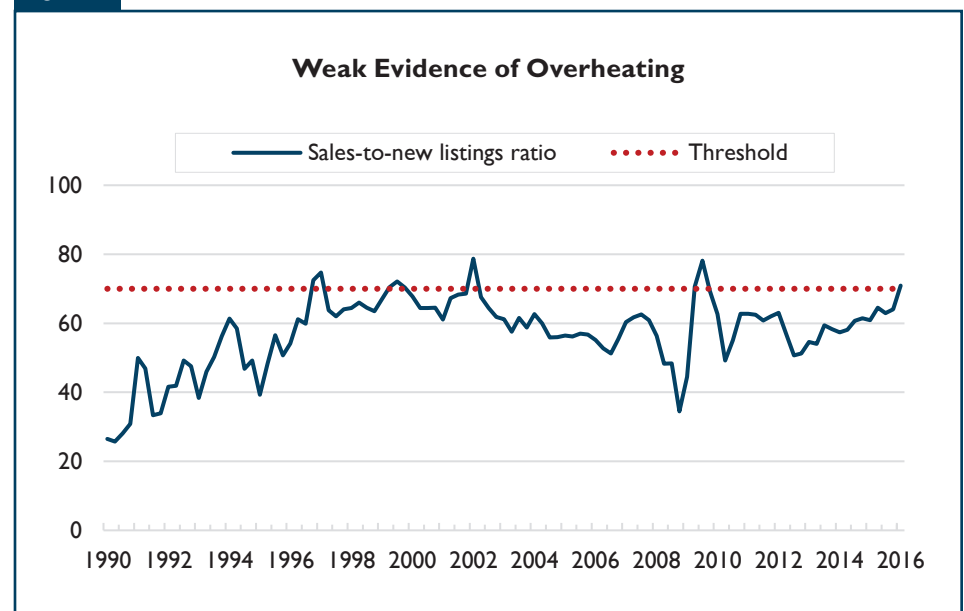
Shortages in the supply of home listings led to sale prices often exceeding the list prices – the consequence of competition among homebuyers for fewer listings. In March 2016, the average ratio of sale

"Our concerns continue about the evidence of price acceleration and overvaluation. Careful monitoring of both aspects is warranted."



Dana Senagama,
Principal, Market Analysis (GTA)

Figure 1



Sources: CREA and calculations (threshold) by CMHC. Last data point: Q1 2016

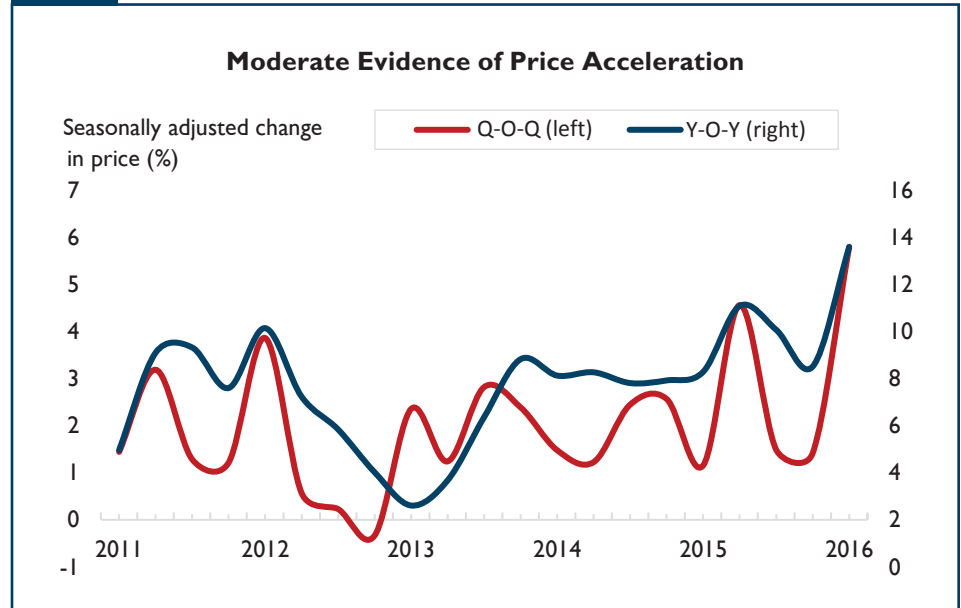
price to list price was 102 per cent, but in some areas, such as East Toronto, Markham and Richmond Hill this ratio reached as high as 108 per cent.

Price growth has not been uniform across all housing types and sub-markets within the Toronto CMA. Given low inventory levels of single-detached homes, and to some extent other types of ground-oriented homes, price growth was higher in this category. In fact, the price gap between single-detached homes and condominium apartments continued to grow in Q1 2016. The seasonally adjusted median price of a single-detached home and condominium apartment climbed 7.9 per cent and 4.6 per cent respectively in Q1 2016 from the previous quarter. The median price of a condominium apartment was 42 per cent of the price of a median single-detached home, which was down from 45 per cent a year ago. Additionally, price growth was not even across sub-markets within the Toronto CMA, with prices increasing at a faster rate in suburban areas, such as in York and Durham regions, where demand has strengthened the most. In part, this was owing to the fact that prices for low-rise homes in the suburbs were relatively lower and those looking for more space gravitated to these areas.

Overvaluation

We detect strong evidence of overvaluation in Q1 2016. The growth in house prices persistently outpaced economic and demographic fundamentals, thus giving rise to strong evidence of overvaluation. The gap between actual home prices

Figure 2



Sources: CREA and calculations by CMHC. Last data point: Q1 2016

and prices supported by economic fundamental drivers has been above its problematic threshold for the past year. The average price of a house in the GTA grew by 5.8 per cent in Q1 2016, compared to the previous quarter. At the same time the typical growth engines, such as disposable income and borrowing capacity could not keep pace. Given the disconnect between the observed rate of price growth and growth consistent with our fundamental drivers in our house price models, prices warrant further monitoring.

Notwithstanding, the fundamental drivers of housing have proven resilient in Toronto CMA, and some home price growth is supported. Growth in population and employment remained strong especially for those aged between 25 and 44 years, a particularly important home-buying segment.

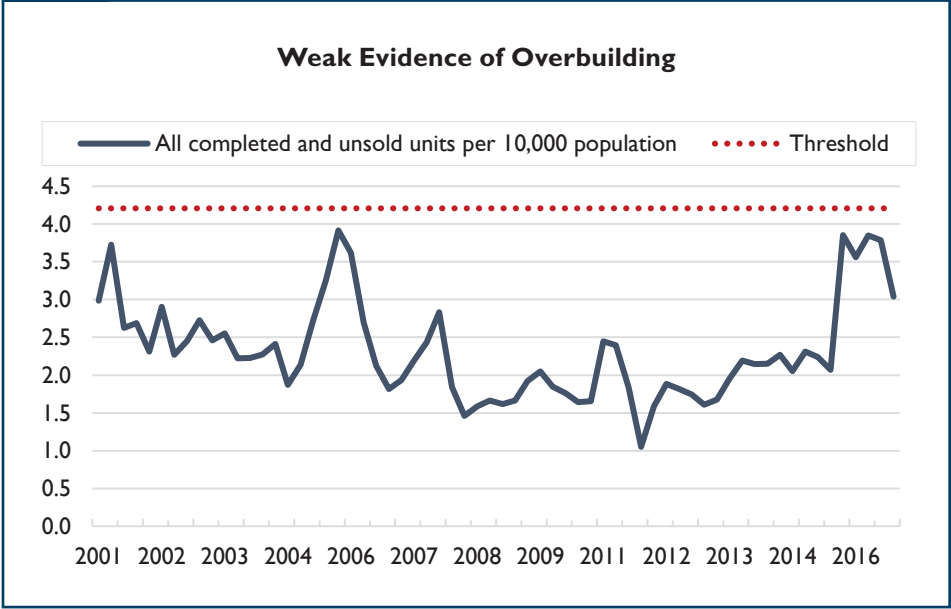
Much of this job growth has been in higher paying industries, such as construction, finance and professional services that has resulted in higher average weekly earnings growth. Growth in these industries also appears to be a positive spin-off from increased housing demand itself.

Another important housing market driver is credit availability. Lower mortgage rates have offset some of the current price growth by keeping mortgage carrying costs relatively low. Declining mortgage rates have also resulted in a pickup in household borrowing that has led to more funds being available for home purchases. On the other hand, down payments for first-time homebuyers have become more difficult, and price growth has resulted in greater affordability pressures for this group of buyers.

Overbuilding

We detect weak evidence of overbuilding in Q1 2016. The first quarter saw the total number of completed and unsold units decline to 1,742 units, and moved further below our threshold for problematic conditions. The threshold in the Toronto CMA was determined to be 4.2 units per 10,000 population. Nevertheless, a large number of condominium apartment units (43,860 units in March) were under construction during this time and their number of completed and unsold units was 1,373 units. The high number of units under construction points to higher completions over the next couple of years, which will add to supply pressures (in terms of both new listings and unsold units) in the future. Inventory management therefore continues to be necessary to make sure that condominium units currently under construction do not remain unsold upon completion.

Figure 3



Sources: CMHC, Statistics Canada and calculations (threshold) by CMHC.
Last data point: Q1 2016

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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