

# HOUSING MARKET ASSESSMENT

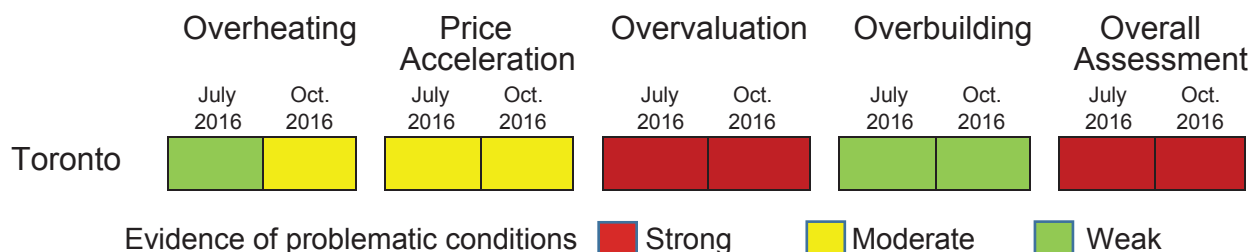
## Greater Toronto Area

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## Highlights



- Recent results from the Housing Market Assessment indicated strong evidence of problematic conditions in the Toronto CMA<sup>1</sup>.
- We detected moderate evidence of overheating and price acceleration, and strong evidence of overvaluation.
- We detected weak evidence of overbuilding. The inventory of completed and unsold units continued to subside.
- 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 Overview<sup>2</sup>

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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<sup>1</sup> Results are based on data as of the end of June 2016 and local market intelligence up to end of September 2016. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

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

## In Detail

### Overheating

For the first time since the inception of the HMA framework, we detected moderate evidence of overheating. In Q2-2016 the seasonally adjusted sales-to-new listings ratio reached 75 per cent, up from 71 per cent the quarter earlier. This was the second consecutive quarter that the ratio was above our threshold of 70 per cent, leading to the classification of a moderate problematic condition.

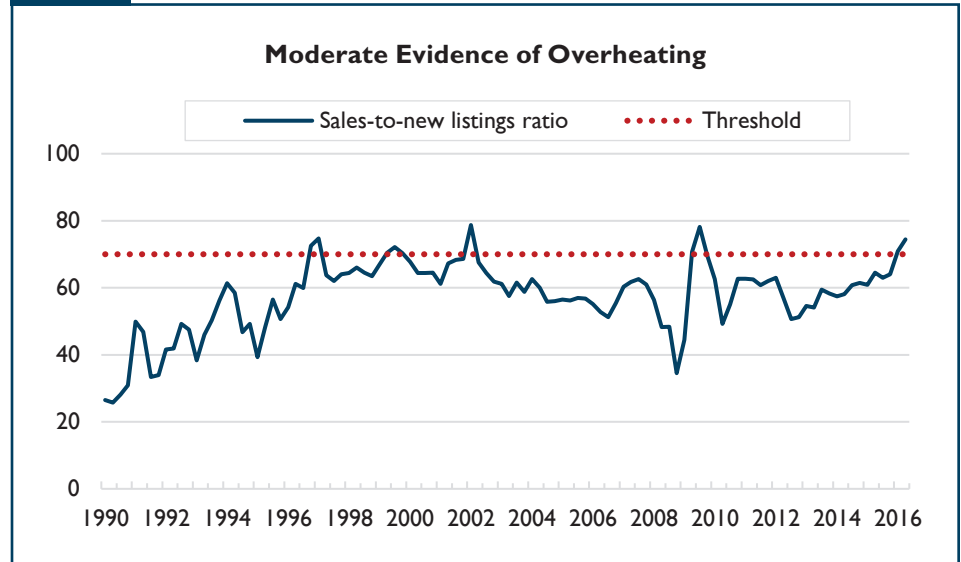
The rising sales-to-new listings ratio was the result of both a decline in the number of new listings and growth in the number of sales. There was a 3.9 per cent decline in the seasonally adjusted number of MLS® new listings in the resale market in Q2-2016 from the previous quarter, while the corresponding number of MLS® sales grew by 1.0 per cent. Declining new listings suggest homeowners have been slow to react to recent price gains, thus there were fewer repeat buyers active in the housing market.

*"We have detected evidence of market overheating for the first time, while evidence of price acceleration and overvaluation persist. Careful monitoring of the housing market remains warranted."*



Dana Senagama,  
Principal, Market Analysis (GTA)

Figure 1



Sources: CREA and calculations (threshold) by CMHC  
Last data point: Q2-2016

**Table 1: Sales-to-New Listings Ratio (August 2016)**

|                 | Single-Detached | Row | Apartment | Total |
|-----------------|-----------------|-----|-----------|-------|
| Halton Region   | 92%             | 96% | 71%       | 92%   |
| Peel Region     | 69%             | 81% | 80%       | 75%   |
| City of Toronto | 71%             | 83% | 79%       | 76%   |
| York Region     | 77%             | 81% | 91%       | 80%   |
| Durham Region   | 85%             | 97% | 100%      | 88%   |
| GTA             | 77%             | 82% | 81%       | 79%   |

Source: TREB

It may be that homeowners are no longer enticed to list their homes for sale because of a shortage of desirable listings, or because of the growing costs associated with selling a home and moving.

More recently in August 2016, the sales-to-new listings ratio sustained its high level, and produced notable differences by dwelling type. For the first time in many years, the market was tighter for condominium apartments than for single-detached

homes (see Table 1). Rapid price increases and low inventory for single-detached homes have likely started to push many buyers into the condominium market. Regions that had more affordable low-rise housing had the highest demand levels. Halton and Durham Regions had a ratio of 92 per cent and 85 per cent for single-detached homes, respectively. The market conditions for row homes in these two areas was even more constrained.

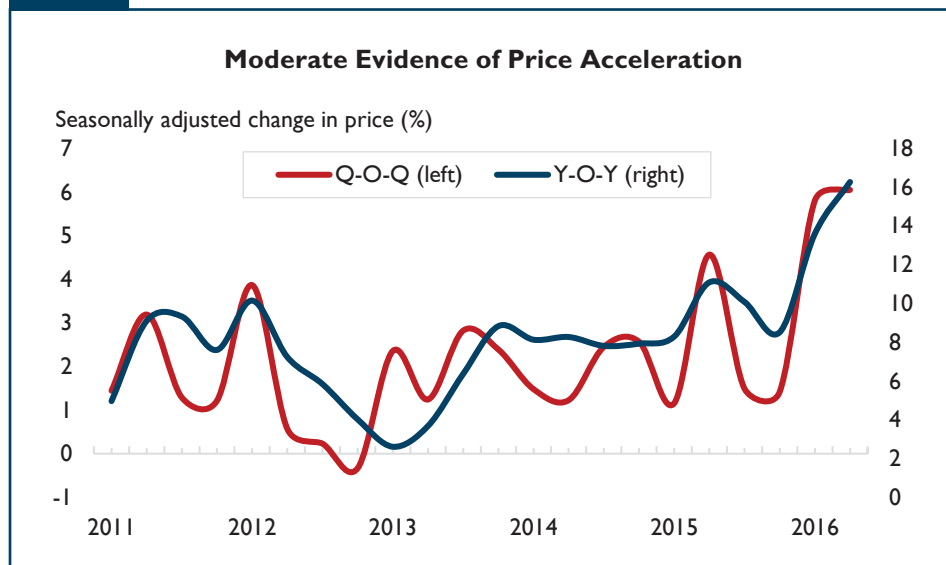
## Price Acceleration

We detected moderate evidence of price acceleration in Q2-2016. The MLS® average house price grew by a seasonally adjusted 6.0 per cent in Q2-2016 from the previous quarter. Prices grew at a more pronounced rate of 16.3 per cent on a year-over-year basis. Due to a high number of sales and lower number of new listings, price growth was stronger, and in many circumstances, the sale prices often exceeded the list prices - the consequence of competition among homebuyers.

Price growth continued to differ across housing types in the GTA with single-detached homes posting the highest growth rates due to low listings supply. The price gap between single-detached homes and condominium apartments continued to grow in Q2-2016. The median single-detached home was nearly \$500K higher on average in the second quarter, compared to \$442K in the first quarter. The seasonally adjusted median price of a single-detached home and condominium apartment climbed 7.6 per cent and 1.6 per cent from the previous quarter, respectively. As the sales-to-new listings ratio for condominium apartments has climbed in recent months, their inventories have also declined, and this gap in price may start to close if this trend continues.

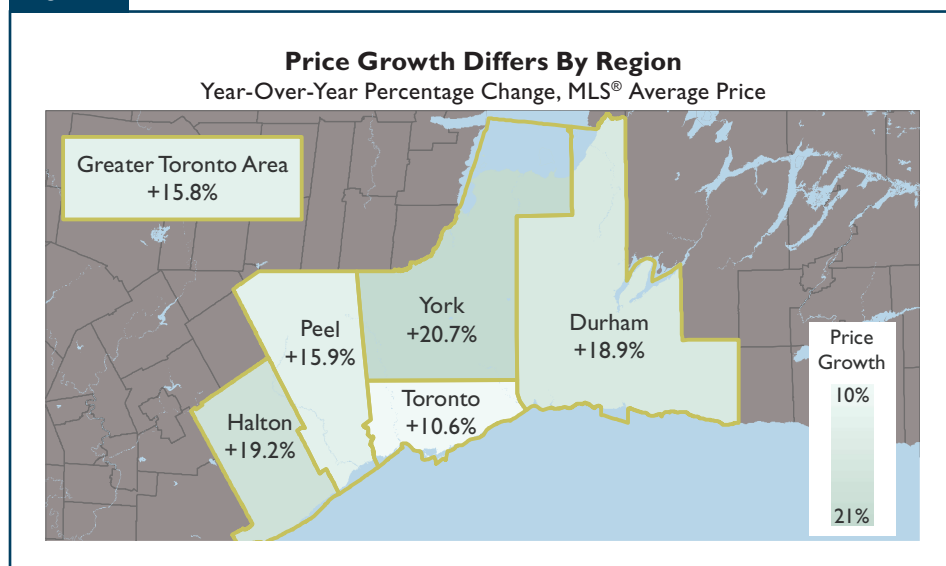
Annualized price growth was strong across the GTA, but did show some significant differences across sub-markets. For the most part home prices increased at a faster rate in suburban areas, such as in York, Halton and Durham Regions, where the market has been the tightest over the past year (see Figure3). Sales in these regions were also skewed towards low-rise housing, which helped push up prices.

Figure 2



Sources: CREA and calculations by CMHC  
Last data point: Q2-2016

Figure 3



Sources: TREB, six-month moving average  
Last data point: August 2016

The gap between the average and median price of a home has increased, thus indicating that price growth has been relatively faster among homes that are more expensive. By price range, there has been a significant increase in the number of homes selling for over \$1M. Price growth has

now pushed the year-to-date share of homes selling over this mark to 16.3% in 2016, up from 7.9% in 2014. Almost all of the growth in the number of homes sold over \$1M were single-detached homes. As of August, 30.5% of single-detached homes sold in 2016 were over the \$1M mark.

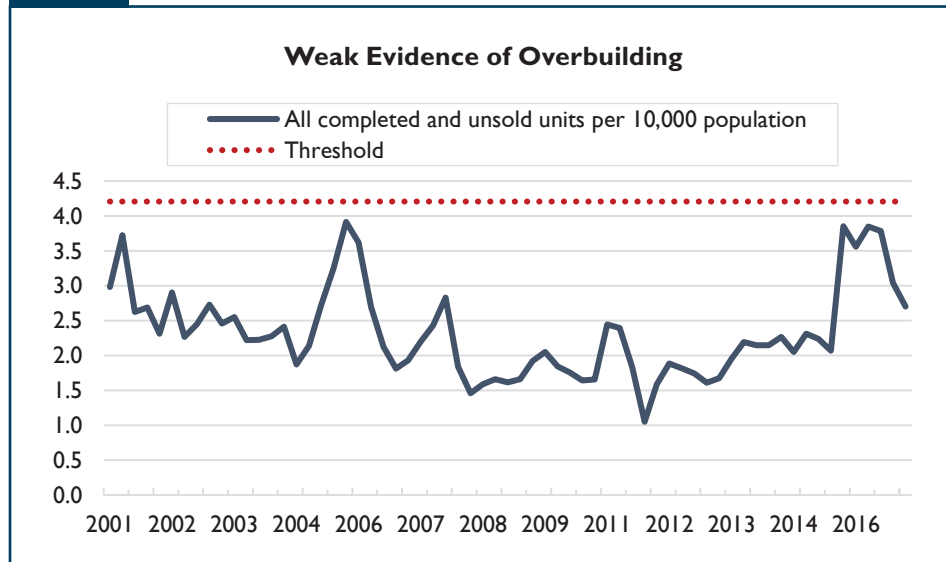
## Overvaluation

We detected strong evidence of overvaluation in Q2-2016, driven by strong house price growth that outpaced growth in economic and demographic fundamentals. The gap between actual home prices and prices supported by economic fundamental drivers has been above its problematic threshold since Q1-2015.

The average price of a house in the GTA grew by a seasonally adjusted 6.0 per cent in Q2-2016, compared to the previous quarter. Meanwhile, an important fundamental like disposable income declined by 0.3 per cent (although low mortgage carrying costs due to low interest rates have enabled more entrants into the homeownership market). 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, many fundamental drivers of housing have seen growth in Toronto CMA, and justified home price growth to some degree. Growth in population and full time employment for those aged between 25 and 44 years has been encouraging since they are a particularly important home-buying segment. Another vital housing market driver is access to low cost credit. Lower mortgage rates have offset some of the current price growth by keeping mortgage carrying costs relatively low which has also resulted in increased household borrowing for more expensive home purchases.

Figure 4



Sources: CMHC, Statistics Canada and calculations (threshold) by CMHC  
Last data point: Q2-2016

## Overbuilding

We detected weak evidence of overbuilding in Q2-2016. The second quarter saw the total number of completed and unsold units at 1,818 units, which represented 2.7 units per 10,000 population. The threshold for evidence of overbuilding in the Toronto CMA was determined to be 4.2 units per 10,000 population. This measure of overbuilding has declined steadily since the end of 2015.

Despite an increased number of completions of new homes, robust demand for both ownership and rental housing has meant lower inventories. The number of completed and unsold units fell further in August 2016 to 1,255, of which 921 were condominium apartments. The inventory of unsold

condominium apartments was down 53 per cent from August 2015. The inventory of unsold single-detached homes remained relatively unchanged at 236 units.

Nevertheless, an increasing number of new homes were under construction (69,048 units) in August 2016, roughly two-thirds of which were condominium apartments. The high number of condominium apartment units under construction points to higher completions over the next couple of years, which will add to supply (in terms of both new listings and unsold units) in the future. Inventory management among high-rise builders continues to be necessary to make sure that units currently under construction are absorbed upon completion.



## 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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