

HOUSING MARKET ASSESSMENT Ottawa¹

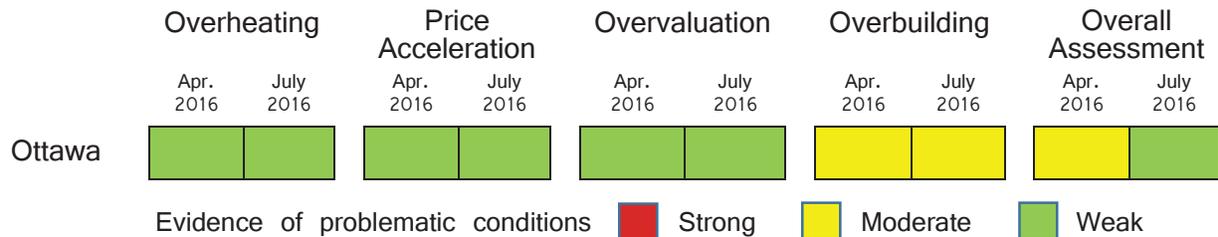
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Housing market intelligence you can count on

¹ Ontario part of Ottawa-Gatineau CMA

Highlights



- The overall assessment for the Ottawa CMA is weak evidence of problematic housing market conditions.²
- We detect moderate evidence of overbuilding due to a high inventory of completed and unsold condominium³ units, as well as a rise in vacancy rates.
- We detect weak evidence of overvaluation as price growth has declined.
- 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 Overview⁴

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.

Color 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.

² Results are based on data as of the end of March 2016 and local market intelligence as of the end of June 2016. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

³ Unless otherwise specified, condominiums or condominium units refer to condo apartments and condo rows. Condominium apartments make up about 99 per cent of total condominium starts on the new home market since 2010. On the resale market however, over the same period, condominium apartments made up around 50 per cent of total condominium transactions, while condo rows took up 35 per cent and the remaining share was taken up by stacked townhouse condos. Total condominium sales represent on average 20 per cent of all resale market activity.

⁴ A detailed description of the framework is available in the appendix of the [National edition](#).

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As the number of intense and persistent signals increases, the associated evidence of problematic conditions becomes stronger.

In Detail

Overheating

We detect weak evidence of overheating in the existing home market in the Ottawa CMA. The threshold for overheating is a sales-to-new-listings ratio (SNLR) of 80 per cent or higher, where demand is running far ahead of supply. With an average sales-to-new listings-ratio of 46 per cent in seasonally adjusted terms in Q1 2016, supply and demand on the resale market were in balance.⁵ A SNLR of this magnitude implies that, on average, just below half of all newly listed properties were sold. The SNLR did see a decline from 50 per cent in the previous quarter as seasonally adjusted sales declined in Q1 2016 while listings rose slightly pushing down the SNLR. Noteworthy is that

this is the first time since Q2 2015 where listings rose slightly. More recent data to June indicated that a greater increase in sales compared to the increase in listings has propped up the seasonally adjusted SNLR from May and compared to the first quarter. Demand and supply were in check in the first quarter. However, activity by market segment was divergent in Q1 2016. Supply and demand on the freehold⁶ side remained in balance with a SNLR at 50 per cent. In contrast, the SNLR for condominium units was 38 per cent as listings for condominium units grew in the face of weakening demand, signaling the prevalence of buyer's market conditions. Condominium sales accounted for about 20 per cent of total sales transactions in Q1 2016 and condominium listings accounted for about 25 per cent of total listings, so that their effect on overall market

balance is more minor than the effect of freeholds, which make up the bulk of sales and listings.

Price Acceleration

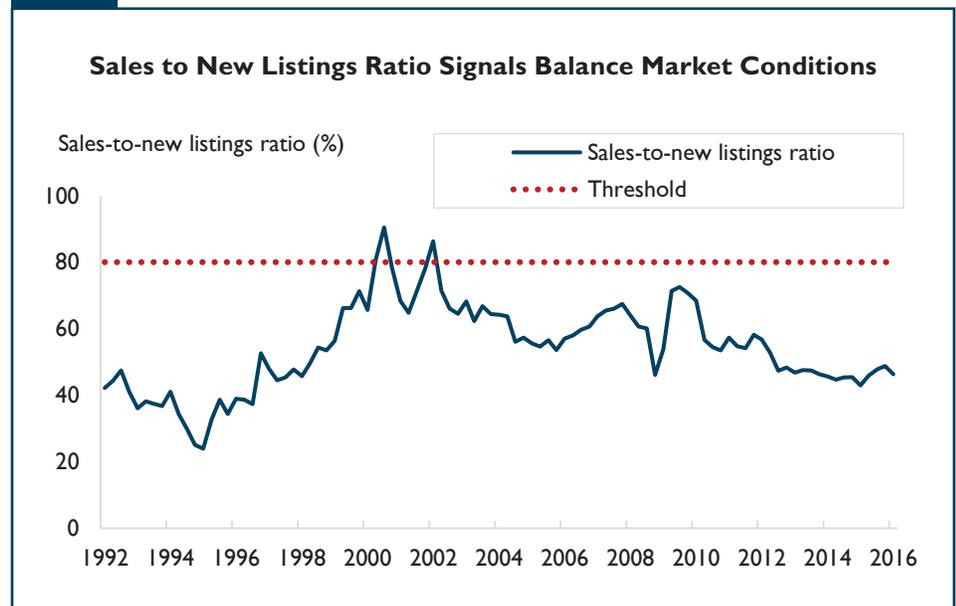
We detect weak evidence of price acceleration in the Ottawa market. Soft employment and earnings growth in Q1 2016 have dampened demand, which coupled with rising supply of resale homes has limited price growth around the rate of inflation over the last few years. And while demand had held up in 2015 growing at modest rates in all but the last quarter, seasonally adjusted sales went down 6.5 per cent in Q1 2016. This is the largest rate of quarterly decline seen since Q3 2012. Lower demand and rising supply pressured prices slightly down so that they declined in Q1 2016 by 0.3 per cent. By market segment, condominium prices continued to decline while

"We detect moderate evidence of overbuilding in Ottawa due to a high inventory of completed and unsold condo units relative to the population."



Anne-Marie M Shaker
Senior Market Analyst

Figure 1



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

⁵ Balanced market bounds are 40 to 60 per cent. Lower than 40 per cent, the ratio implies a buyer's market; 60 to 80 per cent implies a seller's market, 80 per cent and above implies overvaluation.

⁶ Freeholds include homeowner single-detached homes, semis and rows.

freehold prices rose slightly. In seasonally adjusted terms, the overall average CREA MLS® HPI benchmark price came in at \$332,554 in Q1 2016 up only modestly (0.2 per cent) compared to the fourth quarter. The most recent data in May point to a general minor upward to flat trend in the benchmark price and stronger growth in employment.

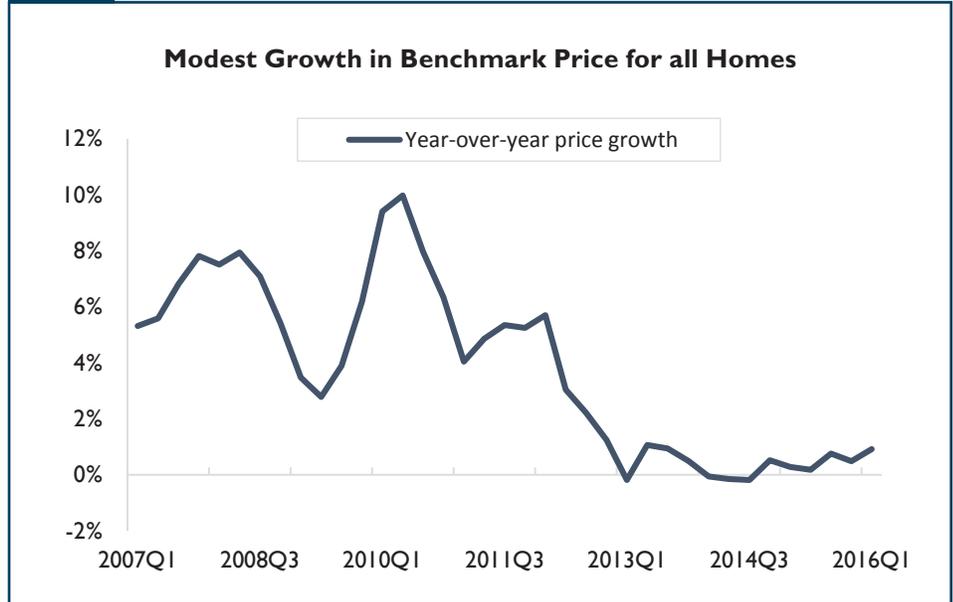
Overvaluation

We detect weak evidence of overvaluation for the Ottawa CMA in Q1 2016. The moderation in house price growth of the past four years⁷ together with a price decline in Q1 2016 is slowly dissipating the effect of previous stronger growth in prices seen in the early and late previous decade. The moderation in price growth has meant that the evidence of overvaluation is dipping just below the problematic threshold. Soft growth in prices together with historically low mortgage rates have kept growth in mortgage payments also at bay. In Q2 2016 both employment and average weekly earnings⁸ grew at a faster rate than prices and mortgage payments, also reinforcing evidence of dissipating overvaluation.

Overbuilding

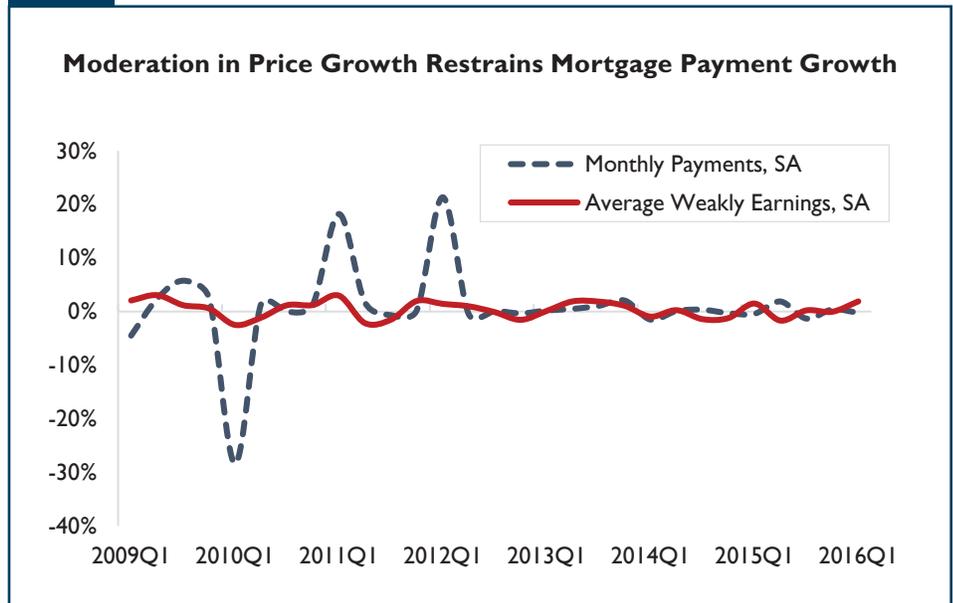
We detect moderate evidence of overbuilding in Q1-2016 for Ottawa. The number of newly completed and unsold units per 10,000 population had been on a rising trajectory over the last seven quarters due to rising completions during the 2013-2015 period following the condo construction boom two years prior. Most of the unsold new construction inventory is made up of condominium units as the

Figure 2



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

Figure 3



Sources: CREA, Statistics Canada, and growth calculations by CMHC. Last data point: Q1 2016

remaining dwelling types are generally started with a higher proportion of presold units. Soft employment conditions for the 25-44 age group have resulted in weaker demand for

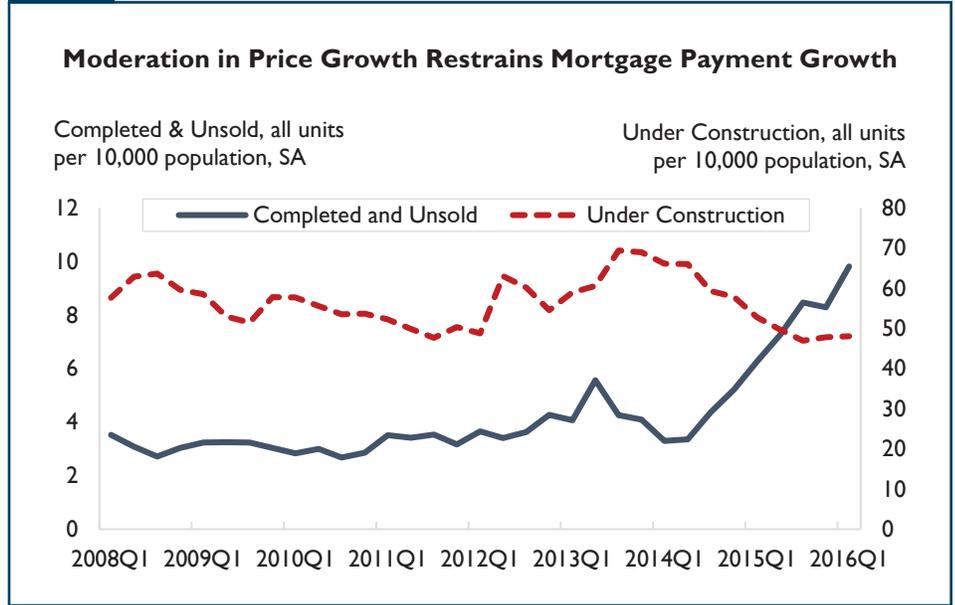
condominiums on the resale market as well, not just the new home market. There, seasonally adjusted sales of existing condominium units retreated 4.3 per cent in Q1 2016

⁷ The MLS average price growth has been hovering around two per cent since 2012.

⁸ Average weekly earnings are used here as a proxy for income.

compared to Q4 2015 after posting growth in all but the final quarter in 2015. It must be noted that growth in 2015 was up from a low base, as 2014 had seen a decline in sales. Data to June indicates that the condominium market has been at the upper edge of a buyer's market for five out of the last six quarters underlining the prevailing soft demand conditions. A weakening on the demand front is also evidenced by the rising vacancy rate for purpose-built apartments and condominiums offered for rent as per the latest CMHC October Rental Market Report. Although the total number of condominium apartment units under construction has come down to 1,279 at the end of Q1 2016 from 1,488 in December, inventory management remains necessary until the high number of completed and unsold units are absorbed by the market. Recent data up to June 2016 indicates that the number of unsold units has slightly declined compared to the end of the first quarter both in absolute terms, and per 10,000 population.

Figure 4



Source: Statistics Canada and CMHC (calculations). 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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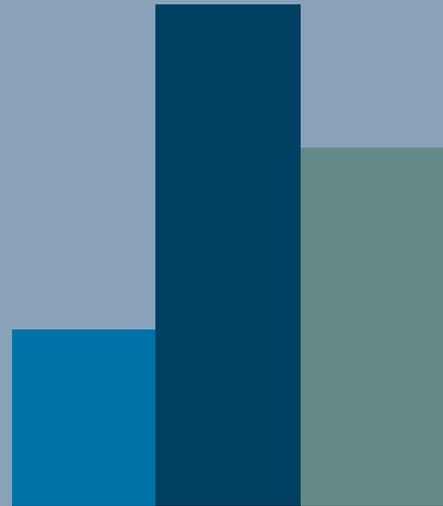
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