HOUSING MARKET INSIGHT
Edmonton CMA

CANADA MORTGAGE AND HOUSING CORPORATION

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"Given the importance of the energy sector, when oil prices post a large decline it affects key drivers of Edmonton's housing market, including employment, wages and consumer confidence. However, the reaction from the housing market is not consistent, and varies depending on the conditions in the housing market leading into an oil price crash."

Christina Butchart
Principal, Market Analysis (Edmonton)

Oil price declines and their effect on Edmonton's housing markets

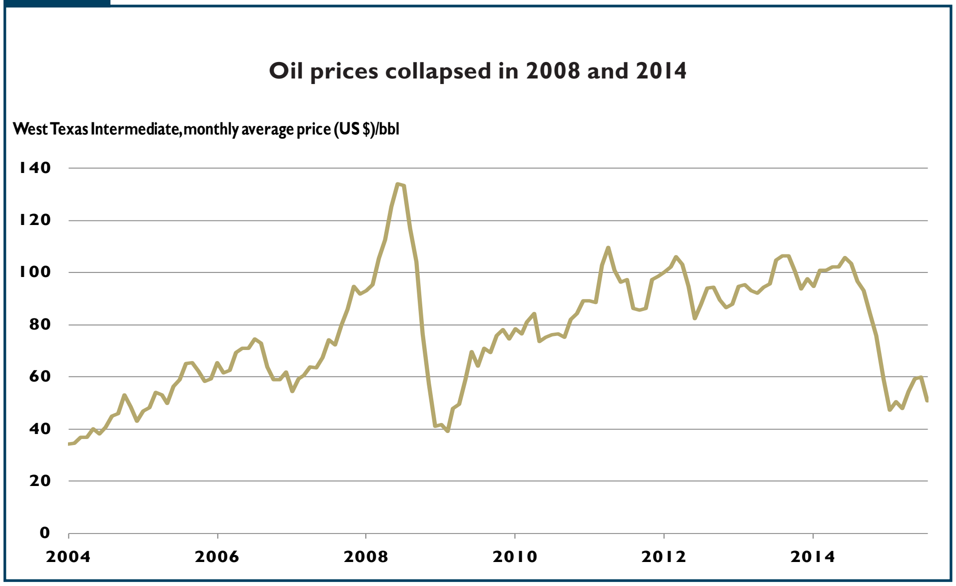
Oil prices play an important role in Edmonton's economy and, by extension, Edmonton's housing markets. Over the last several years, oil prices have recorded dramatic swings that have been reflected in housing activity. In 2008, oil prices declined from their record high of above $130 per barrel West Texas Intermediate (WTI) to below $40. Six years later, in 2014, prices declined again; moving from over $100 per barrel WTI to below $40. In both cases the rapid decline in oil prices, and the low oil price environment that followed, affected both Edmonton's economy and its housing market. However, there were key differences in how the housing market reacted to each significant oil price decline which can be traced back to the economy and the state of the housing market before and leading into each price decline.

Supply-side factors led to 2014 oil price declines

The economic environment both heading into and after oil prices dropped in 2008 was much different than that of the 2014 crash. In 2008, the rapid decline in oil prices was primarily a result of falling demand and it coincided with an economic and financial crisis that was felt not only in Edmonton, but was global in nature as many countries moved into a recession, including Canada and the United States.

Unlike in 2008, the 2014 oil price crash was driven by increased supply and has primarily impacted the oil and gas industry. Economic activity in parts of Canada which are not dependent on energy investments and energy exports

Figure 1



Source: U.S. Energy Information Administration (EIA)

were not directly impacted by lower oil prices, and to some extent have benefited from lower energy costs. There is no financial crisis in the current lower energy environment and the U.S. economy is expanding. Mortgage rates have also moved lower. These factors have contributed to a smaller impact on Edmonton's economy and housing market in the months following the 2014 oil price drop.

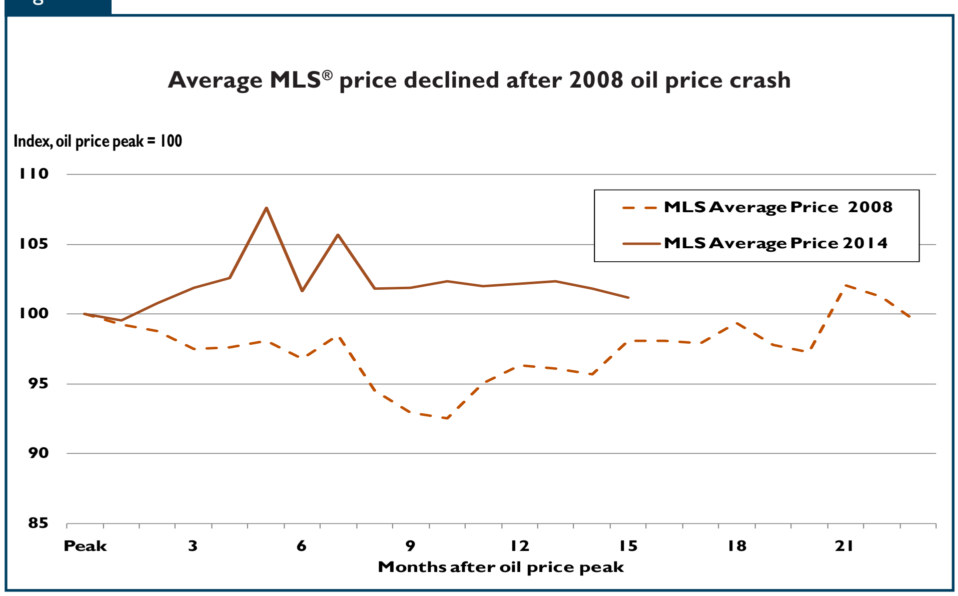
Mixed reactions to oil price declines in the resale market

Reviewing the resale market in Edmonton in both 2008 and 2014, oil price declines aligned closely with pull backs in MLS sales. Edmonton's resale market was arguably the first segment of the housing market to feel the effect from both oil price crashes. A lack of consumer confidence led potential buyers to hold-off on their purchases.

The decline in oil prices also coincided with an increase in new listings in the final months of 2014 and into 2015. However, this did not occur in the 2008 crash as new listings had increased prior to the drop in oil prices and the financial crisis. The varying paths with respect to both new listings and active listings in the two oil crash scenarios can be explained by the state of the resale market before the crash, and by price movements.

In 2007 the Edmonton resale market was in sellers' territory and had moved close to being an accelerated market where price growth was faster than market fundamentals dictated. High selling prices led more homeowners to list their homes, and this put upward pressure on new listings and active listings. However, the increase in supply did not stave off price increases in 2007, which would normally be expected. There was likely a high amount of speculative activity where investors, hoping to make quick gains, bought into the market. In the face of higher prices, sales declined and the resale market began to transition from sellers' market conditions to buyers' market conditions. This market movement occurred prior to oil prices declining. When oil prices crashed and the financial crisis began, the market quickly reacted as consumers lost confidence in the economy and the housing market. As a result, the upward pressure that had driven new listings higher began to dissipate. House prices declined quickly as some homeowners and investors were anxious to leave the market and were willing to lower their prices. Once house prices moved lower, many potential home sellers chose to delay the sale of their

Figure 2



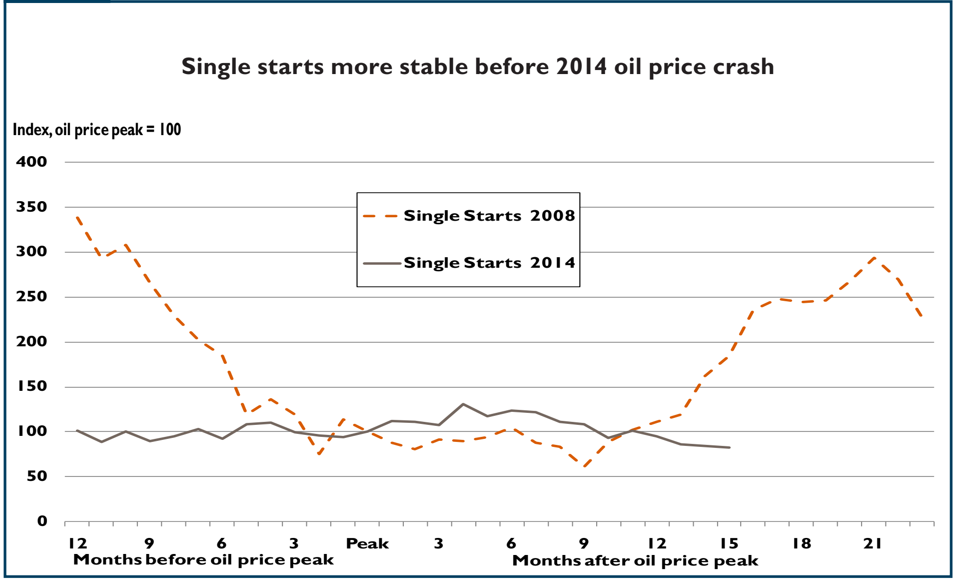
Source: CREA, Seasonally Adjusted Annual Rates, CMHC calculations home. This led to a decline in new listings and active listings. Although supply declined, lower demand in the market kept prices down.

By comparison, prior to the 2014 crash, Edmonton's resale market was much more balanced. Price gains had been relatively modest compared to the gains seen in the two years prior the 2008 oil price crash; moreover, active listings had been on the decline. There was also less evidence of speculative activity. When oil prices dropped many households listed their homes, wanting to complete a sale before anticipated price declines, driving up the supply in the market. Since the crash, supply has remained elevated and price growth has stalled, but prices have not declined. This is likely due to less speculative activity in the market prior to the crash, such that fewer homeowners were in a position where they had to sell their homes. With many home sellers holding firm on their price, price movements in the market have been minimal. Moving forward, given the increased selection on the marketplace and the slower sales activity, there is a risk that prices will soften, and decline in the short term.

Lower oil prices lead to higher vacancy rates

Leading into both the 2008 and 2014 oil price crash, Edmonton's vacancy rate was low. In October 2007, the vacancy rate in the Edmonton CMA was 1.5 per cent, while in October 2014 it was 1.7 per cent. By 2009, the vacancy rate had climbed to 4.5 per cent. Demand for rental units fell from 2007 to 2009 in the face of lower migration and declining employment. Presently, Edmonton's rental vacancy rate is forecast to increase to about 3.0 per cent in 2015 and 3.5 per cent in 2016. With employment growth expected to stay positive in Edmonton, demand in the rental market is not anticipated to fall

Figure 3



Source: CREA, Seasonally Adjusted Annual Rates, CMHC calculations

as much as it did when the economy was losing jobs. However, rental construction has been elevated in Edmonton which is leading to a larger number of apartments available for rent. This will put upward pressure on the vacancy rate over the next two years.

Lower inventory in 2014 limits decline in single-detached starts

Prior to the 2008 oil price crash single-detached starts in Edmonton had reached a record level year in 2006. Another strong year of construction activity in 2007 led the market entering 2008 oversupplied. Inventory levels had started to climb higher in the second half of 2007, and by the time oil prices reached their peak, inventory on the single-detached market was also peaking. The rise in inventory prompted builders to slow production, even before oil prices fell. However, once oil prices dropped inventory was well-above market demand, and levels did not return to more normal levels until 2010. This, in turn, slowed production in the single-detached market substantially in 2008. Production levels only began to recover as inventory moved lower.

By comparison, prior to the 2014 oil price crash, the single-detached market was posting strong gains. Low inventory on the resale market, coupled with strong employment gains and relatively low inventory on the single-detached market had pushed demand for single-detached starts up. When oil prices crashed, the response by the single-detached market was delayed. Demand from the late-summer and early fall months led to a strong increase in production

> *"Since single-detached builders did not enter the current oil price crash with high inventory, they should be able to avoid the extensive build-up in inventory that occurred in 2008. This would then allow activity to respond quicker when economic conditions improve and housing demand expands.."*
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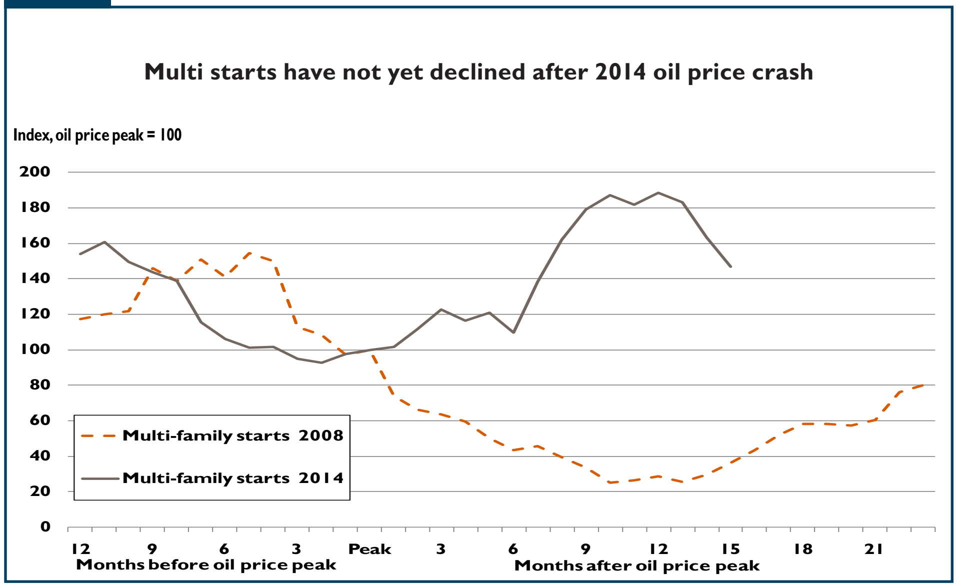
in the fall of 2014. Inventory levels remained low, as the majority of homes were absorbed at completion. Slower demand began in the early months of 2015, but with builders still busy filling demand from the fall 2014, production did not slow until mid-2015. Inventory levels also remained low, and did not begin to increase until the second quarter of 2015. Since single-detached builders did not enter the current oil price crash with high inventory, they should be able to avoid the extensive build-up in inventory that occurred in 2008. This would then allow activity to respond quicker when economic conditions improve and housing demand expands.

Figure 4



Source: CREA, Seasonally Adjusted Annual Rates, CMHC calculations

Multi-family market slow to react to 2014 oil price drop

Prior to both the 2008 and 2014 oil price crashes, strong employment growth and migration, coupled with low inventory spurred elevated levels of construction in the multi-family market. In 2007, multi-family starts reached 7,206 units, up 22 per cent from 2006. The strong performance in 2007 led the number of units under construction to reach a new record high. This led the multi-family market to begin to pull back housing starts in the early months of 2008, before oil prices fell. When oil prices did drop, inventory of multi-family units was starting to trend higher and the competing resale market had moved into buyers' market conditions. This also coincided with the onset of the financial crisis which made it more difficult for multi-family developers to secure funds for new projects. These factors together led to strong declines in 2008 and 2009.

By comparison, in 2014, the multi-family market also saw the number of units under construction increase to near record high levels. However, unlike in 2008, this has not yet triggered a significant decline in starts. Prior to the oil price decline, employment growth, a relatively low vacancy rate and low inventory on the ownership market supported growth of both ownership and rental units. The oil price crash has, so far, had minimal impact on new construction in the multi-family market, as the industry was operating at a record setting pace in the early months of 2015. However, like in 2008, low oil prices and the associated lower employment growth and migration are expected to draw down multi-family housing starts in 2016 and 2017.

In summary, given the importance of the energy sector, when oil prices post a large decline it affects key drivers of Edmonton's housing market, including employment, wages and consumer confidence. However, the reaction from the housing market is not consistent, and varies depending on the conditions in the housing market leading into an oil price crash. As oil prices remain low one year after the 2014 oil price crash, the housing market is still reacting and the low oil price environment continues to pose downside risk to all segments of the housing market.

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