

HOUSING MARKET INSIGHT

Edmonton CMA



CANADA MORTGAGE AND HOUSING CORPORATION

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“Due to higher inventory levels and softer economic conditions in the Edmonton market, housing starts are expected to remain below demographic fundamentals in both 2016 and 2017. This period of underbuilding will be necessary to draw inventory down to a more sustainable level and bring balance back into the new home market.”



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Examining the link between household formation and housing starts

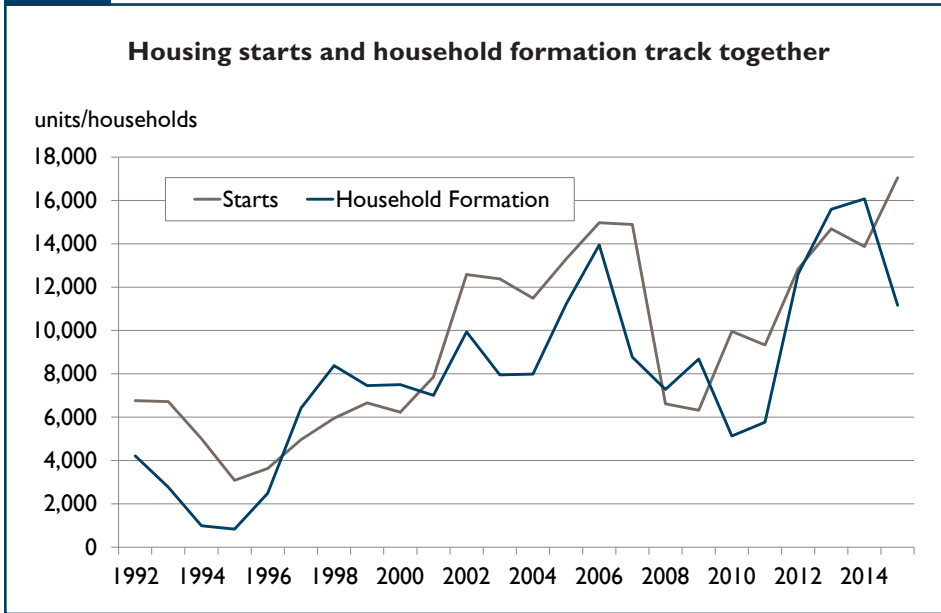
Housing starts and household formation are closely linked in the Edmonton Census Metropolitan Area (CMA). Periods where housing starts have exceeded household formation have led to rising inventory. Conversely, when housing starts are below household creation inventory tends to fall. This relationship can therefore be used to help forecast future housing construction. In 2015, housing starts were well above demographic fundamentals and this has led to a build-up in inventory. Over the next two years, the Edmonton CMA can expect housing starts to fall below the rate of household formation, as excess inventories are absorbed to move the market to a more balanced position.

Demographic fundamentals drive housing demand in the long run

Household growth is a fundamental driver of housing demand. Additions to the housing stock and household creation, which is fueled by population growth, generally move in line over the long term. However, changes in economic conditions including employment, wages, and the interest rate also have a large impact on housing demand at any given time. Indeed, housing demand, and by extension housing construction, are swayed by current economic conditions. When economic conditions drive housing demand too far away from the demographic fundamentals, the market will eventually correct. The Edmonton CMA has seen many such cycles.

Housing starts are the main source of new housing supply. In the long run, the average number of housing starts should be in line with the number of new households. This is not expected to be a perfect relationship as additional

Figure 1



Source: CMHC, Statistics Canada, CMHC Calculations

sources of housing supply, including conversions, are not included in housing starts estimates. Further, deletions from the housing stock are not captured with this measure. Despite these exceptions, housing starts should remain fairly close to household formations, which can be due to both new household creation within the current population and from migration.

An examination of the past two decades in the Edmonton CMA show the market response to periods when housing starts and household formation diverged. Housing starts exceeded household formation levels by about 1,500 units, on average, on an annual basis from 1992 to 2015. However, economic cycles led to larger discrepancies between housing starts and household formation over this same period.

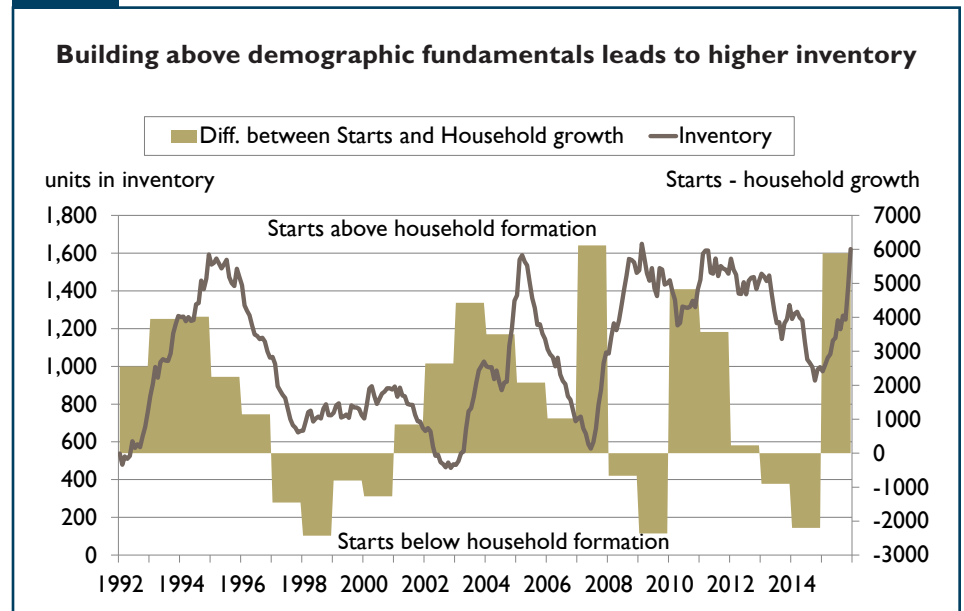
In eight years from 1992 to 2015, housing starts were below household formation. The short term consequences of this underbuilding was apparent by examining inventory levels of new homes. In general,

when housing starts were below housing formation, inventory declined either in the current year or in the following year. There were some exceptions to this, particularly in those years where the difference between housing starts and housing formation was relatively low.

There were four periods where housing starts exceeded household formation. In each case, this led inventory to trend higher. This, in turn, led builders to decrease production to levels below demographic fundamentals, drawing inventory down and bringing the market back into balance.

Economic conditions are typically the driving force behind the divergence between housing starts and housing formation. An example of this was in the 2006 to 2010 period. Edmonton's economy experienced strong growth from 2006 to early 2008. Large employment gains were made and incomes moved higher. This supported strong demand for housing, particularly in 2006 and 2007. This fueled an elevated level of new home construction in 2006 and 2007. By the end of 2007 and into 2008, demand for housing began to wane. Economic fundamentals also started to erode in mid-2008 and supply in both the new and competing resale market was increasing. When the financial crisis occurred, the economic slowdown exacerbated the situation and

Figure 2



Source: CMHC, Statistics Canada, CMHC Calculation

declining sales led to a further increase in inventory. Over the next two years, housing starts fell below household formation which helped bring inventory down. Although strong economic fundamentals had temporarily supported housing construction above demographic fundamentals, this could not be sustained.

These findings are aligned with the CMHC's Housing Market Assessment¹, which uses inventory as one measure to indicate whether there is evidence of overbuilding in a CMA. When inventory rises beyond threshold levels, this suggests that supply has significantly outpaced demand.

The current threshold for the Edmonton CMA housing market is 14.32 complete and unsold new homes per 10,000 people.

Most recently, the gap between housing starts and household formation widened in 2015. Housing starts totalled 17,050 units², while population growth and household formation rates slowed. This has led to an elevated number of units under construction, and has pushed inventory up. Indeed, as of May 2016, the number of newly completed homes in ownership inventory was over 67 per cent higher than one year prior, and at 1,901 units³ was the highest level on record⁴.

Given that the number of units under construction remains elevated, there is a risk that inventory will move higher as more units move into completion. Due to higher inventory levels and softer economic conditions in the Edmonton market, housing starts are expected to remain below demographic fundamentals in both 2016 and 2017. This period of underbuilding will be necessary to draw inventory down to a more sustainable level and bring balance back into the new home market. Eventually, housing starts will increase to move back in line with demographic growth.

¹ [Edmonton HMA](#)

² [HMI Portal](#)

³ [HMI Portal](#)

⁴ Data is available from 1991

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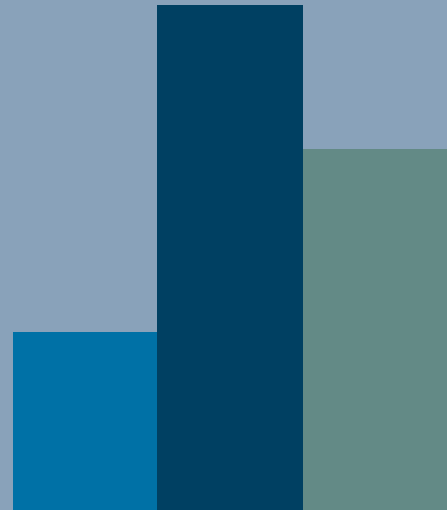
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