

HOUSING MARKET ASSESSMENT

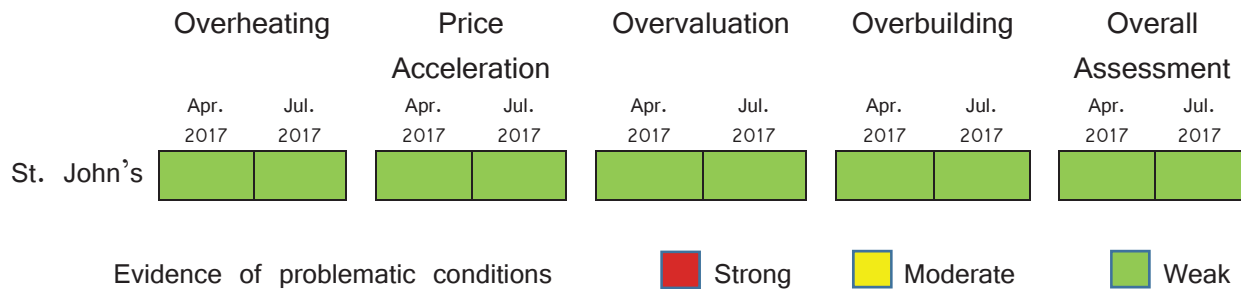
St. John's CMA

Date Released: Third Quarter 2017



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Highlights



- Overall, there is weak evidence of problematic conditions in the St. John's CMA.¹
- House prices remain under pressure, partially due to economic uncertainty and a resulting shift in sales to lower-priced homes.
- There is weak evidence of overbuilding because inventory has declined over the previous quarters and is currently below the problematic conditions threshold.
- There is weak evidence of overheating and price acceleration because of excess supply of existing home inventory and lower sales activity overall.
- The 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 5 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 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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¹ Results are based on data as of the end of March 2017 and local market intelligence up to end of June 2017. 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

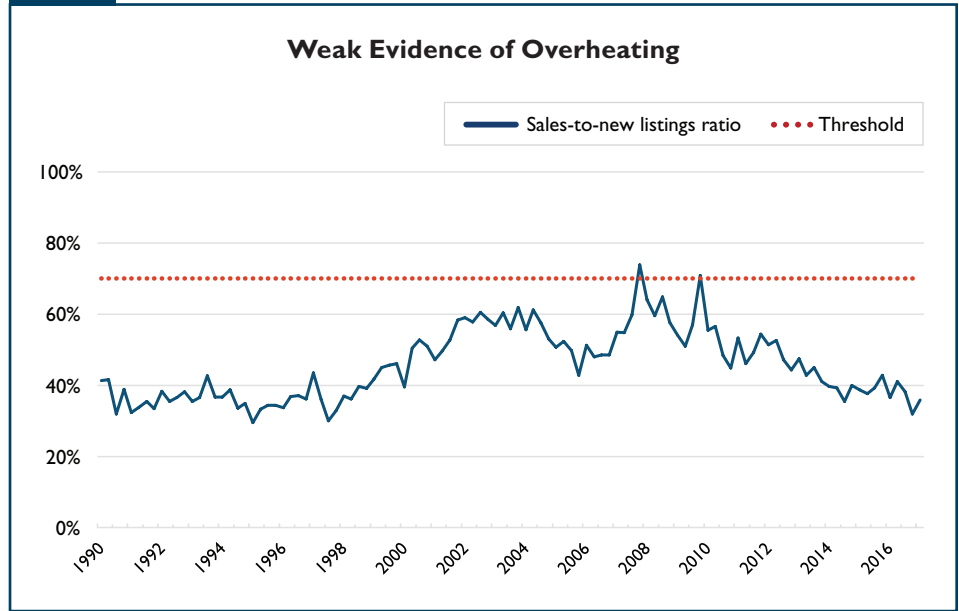
There is weak evidence of overheating in the St. John's CMA housing market. A lack of economic growth within the local economy, increased numbers of empty nesters downsizing and fewer newly built custom homes have resulted in excess inventory. This, paired with lower home sales throughout the area has muted the level of growth in the market. With various housing options and price points available, prospective buyers remain very patient in their purchase decision in the current environment of a buyers' market. Despite a relatively flat year-over-year change in new and active listings, a continued retraction in sales activity has resulted in the sales-to-listings ratio trending away from the threshold for problematic conditions.

"There is weak evidence of problematic conditions in the St. John's CMA housing market. A lack of growth in the local economy has muted growth in key housing market drivers such as population, income and employment and this continues to weigh negatively on housing market demand."



Chris Janes
Senior Market Analyst (St. John's)

Figure 1



Source: CREA and calculations (threshold) by CMHC. Last data point: 2017 Q1.

Price Acceleration

There is weak evidence of problematic price acceleration in the St. John's CMA housing market. An increase in the supply of homes for sale has continued to outpace demand since the end of 2012, with no average price growth over this period. A lack of employment growth since 2014, paired with economic uncertainty and a shift to lower priced home sales activity have contributed to ongoing downside average price pressure. A high availability of serviced building lots and developable land will provide relief to any potential increase in future housing demand and price movement, with home builders able to react accordingly if required. Price adjustments have gradually kept pace with declines in economic and demographic fundamentals, especially with declines in real personal disposable income. The compositional effect of a shift to lower priced homes has also been a contributing factor to the lower overall average house price for both new and existing homes.

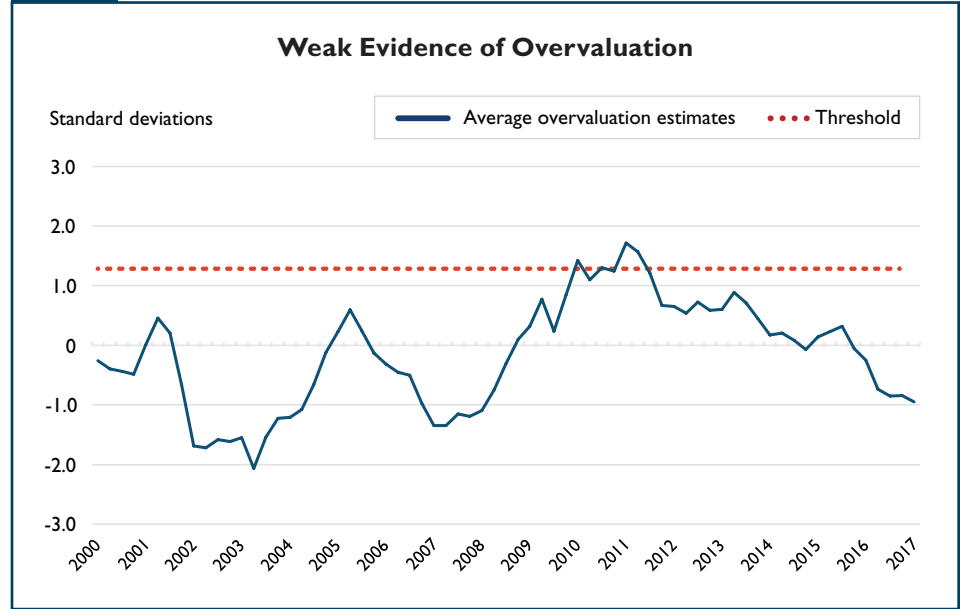
Overvaluation

There is weak evidence of overvaluation in the St. John's CMA housing market. Lackluster economic conditions, a negative shift in fundamentals and lower average house prices indicates weak evidence of overvaluation in the St. John's area. Population growth, though still positive, is below historic rates of growth with the absence of employment and income growth in the region. Growth in house prices and income have tended to move in tandem historically, but in recent quarters, declines in house prices have outpaced the decline in income. This marks the first time in over ten years where the decline in house prices have outpaced the decline in income on a relative basis. This, combined with a relatively weak labour market provides further evidence of a housing market in which house prices will remain under pressure.

Overbuilding

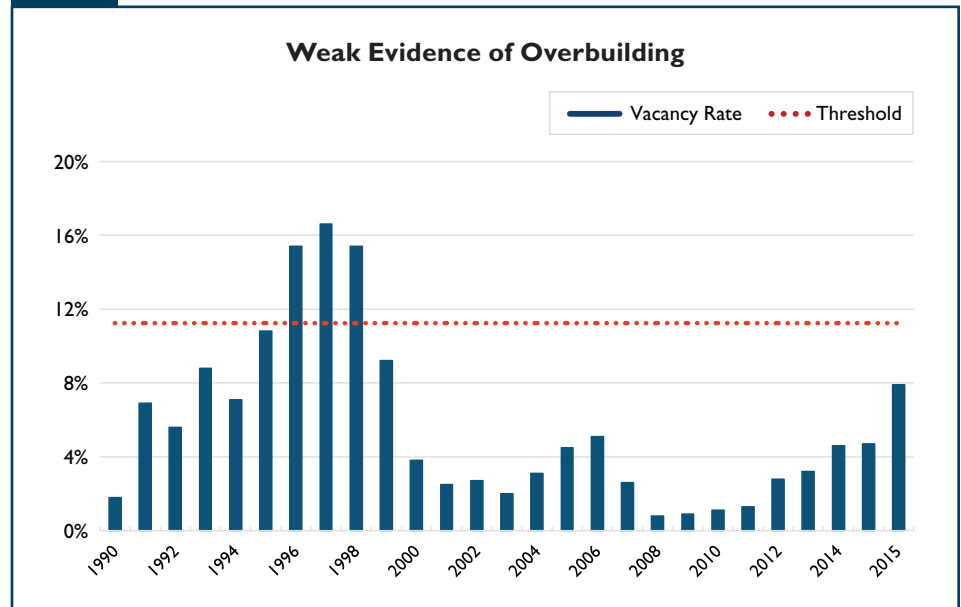
There is weak evidence of overbuilding in the St. John's CMA housing market. The inventory of completed and unsold units relative to the population declined to 4.2 which is lower than the threshold of five for a fifth consecutive quarter. Inventory has declined due to local builders holding off on new housing starts in response to lower demand for new home construction due to the weaker economy. As a result, units under construction are also lower. Economic uncertainty and higher completions of rental units relative to the increase in the St. John's CMA population brought the vacancy rate up to 7.9% in October 2016, from 4.7% in the prior year. Despite this, the vacancy rate remains under the threshold of 11.2. Completed and unsold units by 10,000 population increased significantly after 2011, but have declined since 2015. The vacancy rate also increased materially during this time and has also remained above 4% since 2013. The St. John's CMA saw very few rental units added prior to 2012, but since then, over 1,000 new rental units have been added to the local rental universe.

Figure 2



Source: CREA, Statistics Canada and calculations by CMHC. Note: A standard deviation larger than 1.29 is considered as significant. 10% of observations are above the threshold. Last data point: 2017 Q1.

Figure 3



Source: Statistics Canada and CMHC. Last data point: 2017 Q1.

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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