

HOUSING MARKET ASSESSMENT

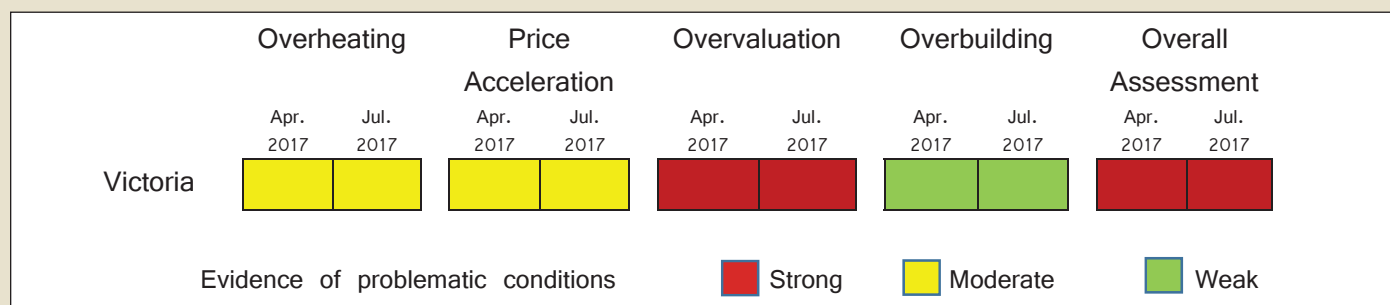
Victoria CMA

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Highlights



- The HMA framework detected strong evidence of problematic housing market conditions in the Victoria CMA for a third consecutive quarter.
- Fundamentals did not support the high level of house prices in the first quarter of 2017.
- Supply remains low relative to demand in the Victoria CMA¹, leading to rapid price growth.
- Despite elevated new construction, low inventory and a tight rental market vacancy rate continue to indicate weak evidence of overbuilding.
- 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 7 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 developments 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 a problematic conditions becomes stronger.

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¹ Results are based on data as of the end of March 2017 and market intelligence as of the 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

The HMA framework continued to detect moderate evidence of overheating in the Victoria CMA. In the last quarter of 2016, a falling sales-to-new-listings ratio (SNLR) had indicated improving balance in the market. Since then the trend has reversed course, growing to 89% by the end of the first quarter of 2017. Once again, the SNLR is above the 80% threshold for overheating. The typical range for a balanced market is between 50% to 70%.

Demand fundamentals indicate growth. Sales have fallen from a record-setting year, but they remained 10% above the 5-year average in the first quarter. Fewer and fewer people have been selling their homes, limiting existing supply (figure 1).

“Strong evidence of problematic conditions were detected for the Victoria CMA. The source of problematic trends had been mainly concentrated in single-detached sub-markets, but have since developed across multiple housing types and geographic areas. Low inventories and strong price growth appear to be nearly universal across the CMA and across product types.”



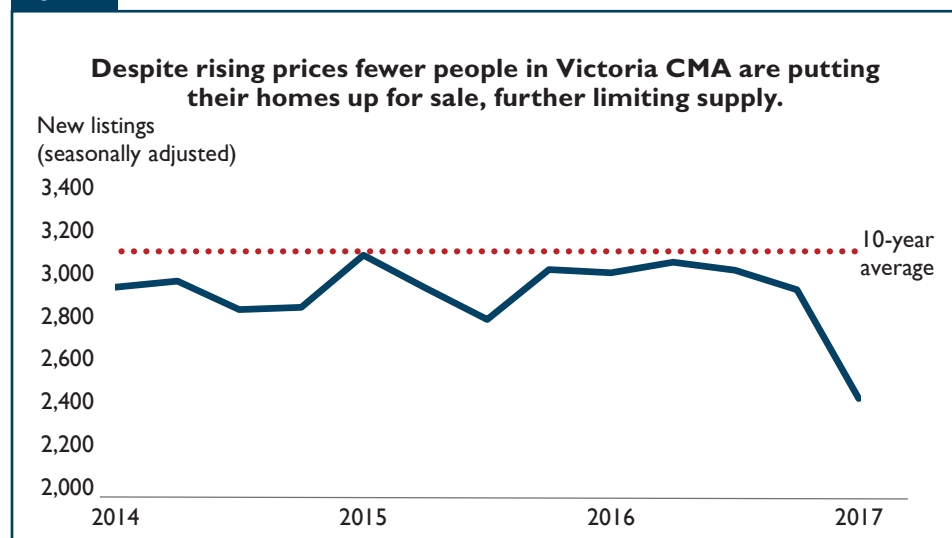
Braden Batch
Senior Market Analyst

Combined with a heightened rate of sales, the availability of market housing worsened in the Victoria CMA.

There are more people looking for housing, but fewer homes to buy than what is normal for the Victoria CMA. Active listings have drawn down to par with the level of new listings, which is unprecedented (figure 2). The total existing home supply recorded at the end of June roughly matched the rate at which units were added over the course

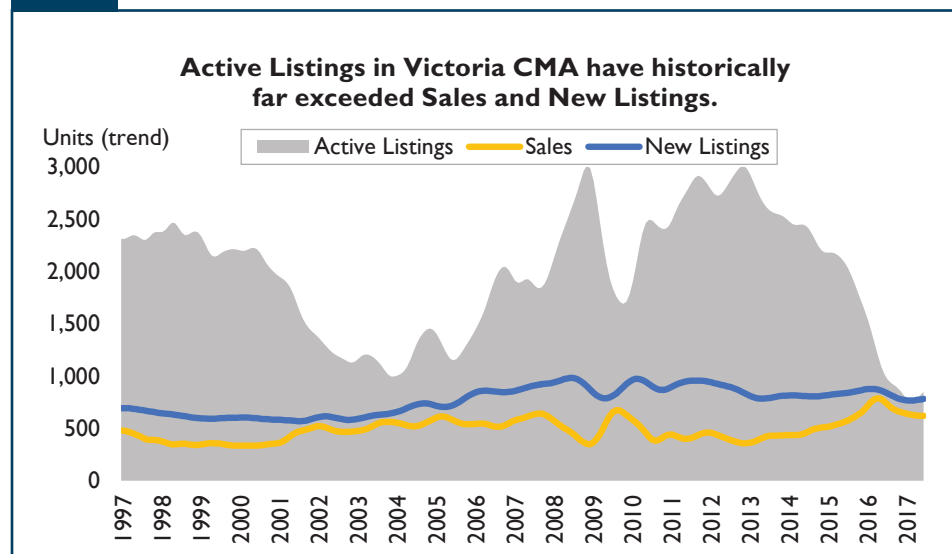
of the month. That is despite some share of properties staying listed for a much longer timeframe. In addition, the data on average days-to-sell fell below the one-month mark, or below 31 days, both for single detached and condos as of June 2017. The data strongly suggests that properties have been moving much faster than usual. Buyers have had less time to locate a home and decide whether to buy or not, and they have also faced far fewer options than buyers in any other historical time frame.

Figure 1



Sources: CREA. Last data point: 2017Q1

Figure 2



Sources: Victoria Real Estate Board, CMHC calculations. Last data point: June, 2017

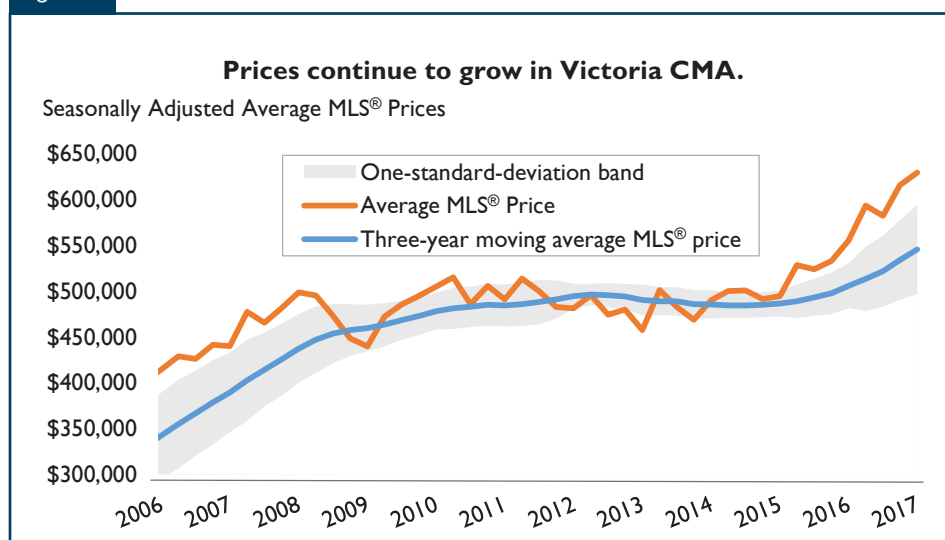
Price Acceleration

Moderate evidence of price acceleration was detected in the Victoria CMA for the fourth consecutive quarter. Since the second quarter of 2015, the average MLS® price in the Victoria CMA rose faster than in the past decade, and by a significant margin (see figure 3). This change in the trend of house price growth is a direct result of declining supply in the resale market. Sales also appear to be held back by lack of supply. In the first quarter of 2017, sale prices were greater than asking prices and the sale-to-list price ratio exceeded 100%. This is a strong indicator that buyers, on average, were willing to outbid competitors to secure a property rather than negotiate a lower price. We would not expect this behavior in a well-supplied market.

In previous reports, price growth was most pronounced in single-detached homes on a year-over-year basis. However, it is no longer a simple case of single-detached properties driving the market. In the past 12 months, apartment price growth has matched that of single-detached houses, and townhouses/semi-detached prices have outpaced the other housing forms (see figure 4).

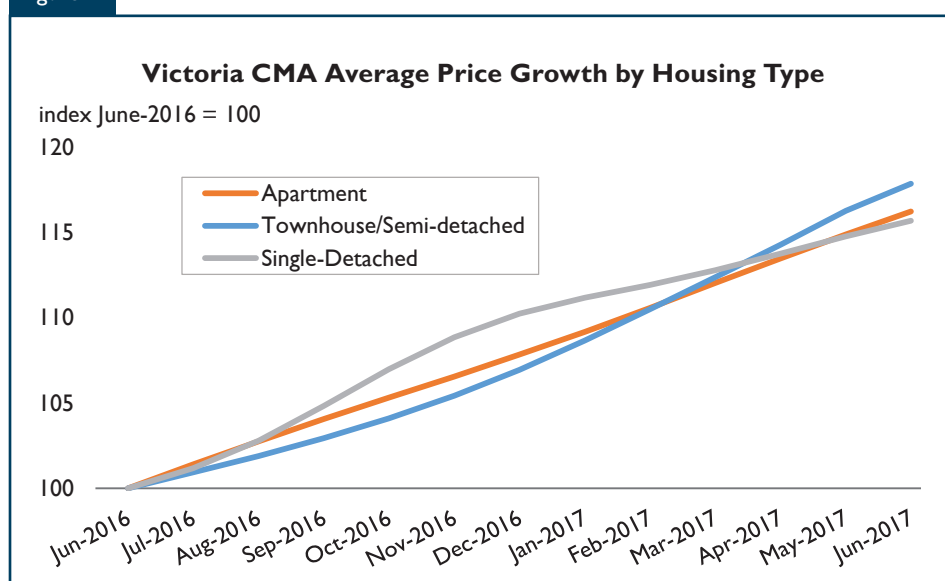
Sales data show that a larger share of activity is going to the relatively more affordable options, potentially

Figure 3



Sources: CREA. Last data point: 2017Q1

Figure 4



Sources: Victoria Real Estate Board. Last data point: June, 2017

Single-Detached Homes (Q2 2017 vs. Q2 2016)

Area	Average MLS® Price*	% Change from	Single-Detached MLS® Sales as % of Total	
	2017 Q2	2016 Q2	2016 Q2	2017 Q2
Urban Core	\$964,000	15%	53%	47%
West Shore	\$640,000	20%	67%	58%
Saanich Peninsula	\$862,000	9%	71%	70%
Victoria CMA	\$839,000	14%	60%	54%

Source: VREB, CMHC calculations

*Waterfront single-detached homes are not included in calculating the average MLS® price. Average MLS® prices are rounded up to the nearest thousand.

Note: Urban Core includes Victoria (Victoria West), Esquimalt, Oak Bay, View Royal and Saanich (Saanich East/Saanich West); West Shore includes Sooke, Langford, Colwood, Metchosin, Highlands; Saanich Peninsula includes Sidney, Central Saanich, and North Saanich.

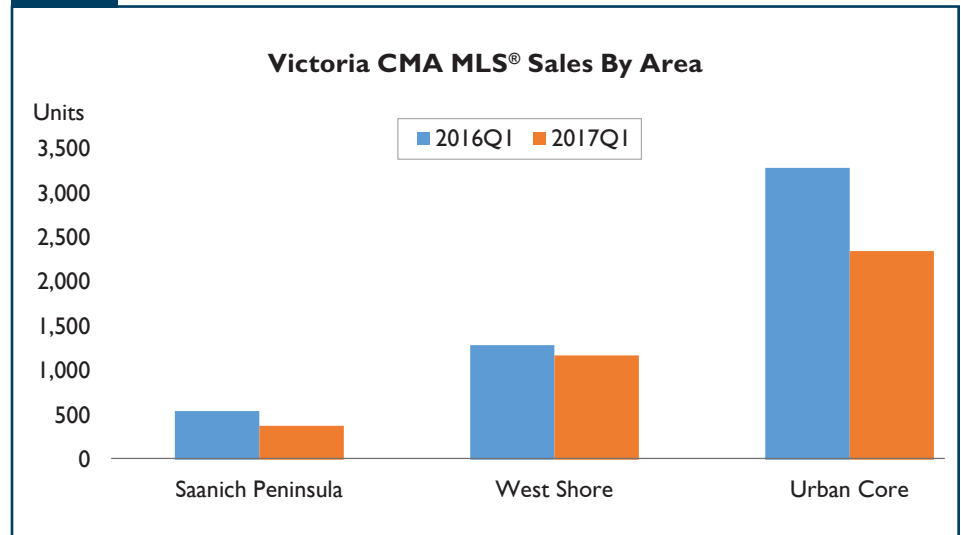
understating the actual price growth in the market. The trend occurred across both geography and housing type. While sales levels have declined from a peak, the overall share of sales dropped most in the more-expensive Urban Core and declined least in the less-expensive West Shore (see figure 5). This led to stronger price growth in the West Shore, where single detached prices grew by 20% year-over-year, faster than the overall CMA price growth. On a housing type basis, the share of total sales across the CMA represented by townhouses and apartments increased, as the share of single-detached fell from 60% to 54% year-over-year. Similarly, growth in townhouse apartment prices surpassed single-detached price growth (figure 4).

Overvaluation

The HMA framework detected strong evidence of overvaluation in the Victoria CMA for the second consecutive quarter. Continued price growth is above that supported by fundamental demand-side factors.

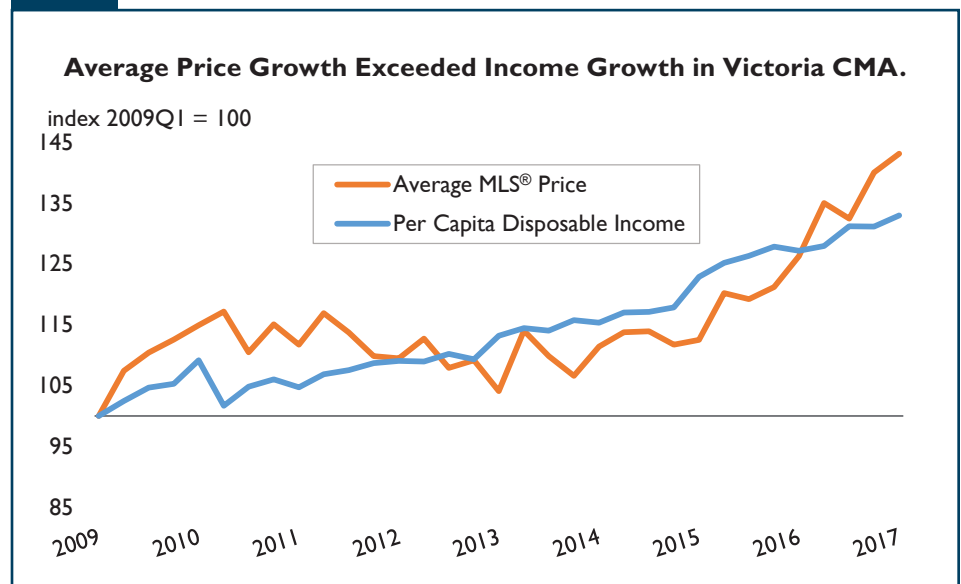
Fundamental demand-side factors support growth. For example, the population associated with first-time buyers is growing, contributing to elevated sales³. In addition, local economic activity has been strong, leading to growth in employment, but average wage growth has not kept pace with house prices (see figure 6). It is worth noting that price acceleration was first detected in the second quarter of 2016, roughly the same time

Figure 5



Sources: VREB

Figure 6



Sources: CREA, Conference Board of Canada. Last data point: 2017Q1

that house price growth started to outpace growth in incomes. For the first quarter of 2017, the sustained home price growth in the Victoria

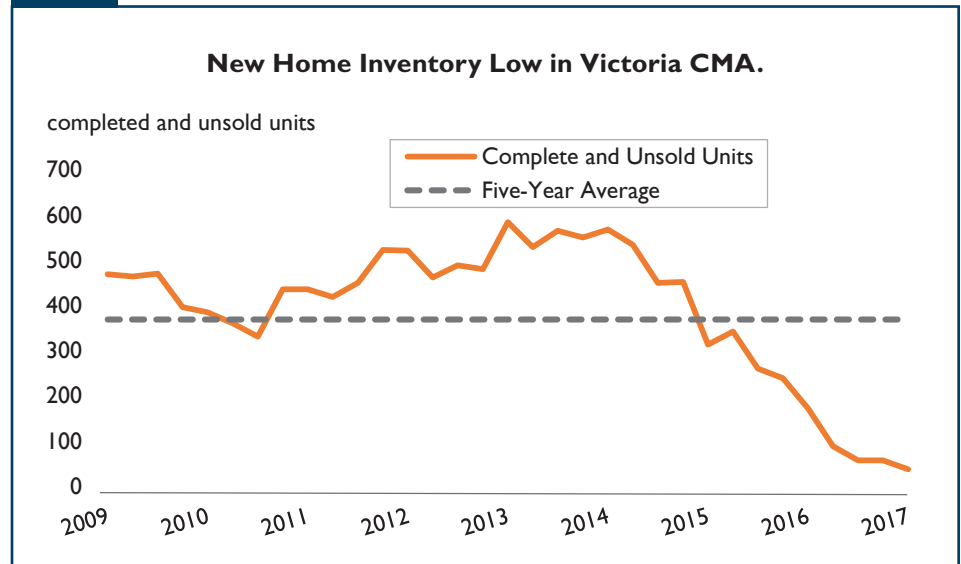
CMA led multiple signals in the HMA framework to detect overvaluation, leading to strong evidence of overvaluation in the Victoria CMA.

³ The age group of 25-34 year olds increased by 1.69% year-over-year, adding roughly 900 young adults to the Victoria CMA.

Overbuilding

The HMA framework detected weak evidence of overbuilding in the Victoria CMA's housing market in the first quarter of 2017. Supply levels in the new home market reflect the low level of active listings in the existing home market. Builders have responded to low inventories, low vacancy rates, and rising prices, by increasing housing starts. However, complete and unsold units numbered just 37 at the end of the first quarter while the five-year average was 369 units (Figure 7). Similarly the October 2016 Rental Market Report showed a decline in the apartment vacancy rate from 0.6% in 2015 to 0.5% in 2016. Both measurements indicated low supply rather than overbuilding.

Figure 7



Sources: CMHC

Last data point: 2017Q1

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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