

# HOUSING MARKET INSIGHT

## St John's CMA



CANADA MORTGAGE AND HOUSING CORPORATION

Date Released: July 2016

*"The current and enduring low oil price environment is having a greater impact on the provincial economy and St. John's housing market compared to the shorter-lived 2008 oil price decline, when the housing market experienced no measurable negative impact on sales, construction activity, or prices."*

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



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## Enduring Oil price decline and impact on provincial economy and St. John's housing market

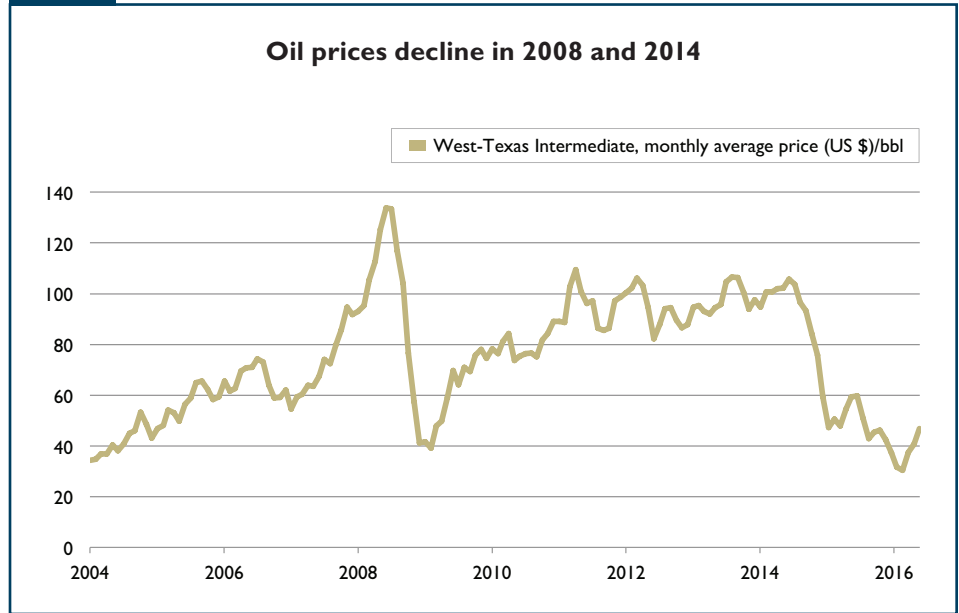
*In the province of Newfoundland and Labrador (NL), oil has played a vital role in the overall economic performance of the provincial economy and the St. John's housing market, with the oil sector being a significant contributor to GDP and provincial government revenue historically. Although oil prices have been volatile over the past decade, overall, oil prices did not have a significant negative impact on housing activity prior to 2014. During the beginning of the global financial crisis in 2008, oil prices declined from a record high of above \$130 per barrel West Texas Intermediate (WTI) to below \$40, but rebounded relatively quickly in the months that followed. In mid-2014, oil prices declined again, moving from over \$100 per barrel WTI to below \$30 in early 2016. In 2008, the rapid decline in oil prices and the low oil price environment that followed, had very little effect on the local economy and housing market. However, the current and enduring oil price decline is having a negative impact on the economy, the provincial government's fiscal situation, as well as the housing market.*

## Current oil price decline much different than 2008

The economic environment prior to and after oil prices declined in 2008 was much different than that of the current and significant decline that began in mid-2014. The rapid decline in oil prices in 2008 was primarily the result of lower demand and coincided with the beginning of the 2008-2009 global financial crisis. Oil prices were also lower for a much shorter time and rebounded relatively quickly. Driven by significant government spending and major capital project activity, NL actually fared very well, with economic activity surging to new highs as oil prices stabilized and recovered. Despite the global economic headwinds during this period, general economic conditions in NL remained positive and exceeded national trends in employment growth, income growth, consumer spending and housing market activity.

With no global financial crisis at play, the current oil price decline has been driven by a supply issue with the Organization of the Petroleum Exporting Countries (OPEC) intent on reducing prices and thereby hurting North American supply. Also, financial issues with Europe since 2010 and Japan continuing to languish economically, have affected world demand up to the present day. Oil prices have also been much lower for longer versus the previous 2008-2009 correction and prices have not rebounded as quickly as many people had expected. Oil dependant provinces such as NL, Saskatchewan,

Figure 1



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

Note: 2016 = January to May

and Alberta, have continued to struggle fiscally and economically. Also, major oil exploration and production companies around the globe have been forced to cut capital expenditures and staffing levels significantly in order to survive the current low oil price environment. Outside of the energy dependant provinces, other Canadian provinces have not been impacted materially by lower oil prices. Most in fact, have benefited from lower energy costs.

## Current oil price decline and the economy

NL's relative GDP position improved dramatically since the first barrel of oil was produced offshore at Hibernia back in November of 1997.

As a result of Hibernia and the other two low cost projects, Terra Nova (2002) and White Rose (2005), NL is insulated to an extent from lower oil prices with offshore projects able to produce and remain profitable at low prices (\$30-\$40). This is because the majority of sunk costs have been recovered due to the longevity of these projects, with only the variable costs of production remaining a going concern. However, the negative impacts of lower oil prices have still been evident throughout the local economy since the end of 2013.

GDP fell 2.2 per cent in 2015 following a decline of 2.3 per cent in 2014, led of course by significant declines in the oil sector. In 2015, lower oil prices also contributed to sharp declines in both oil and gas engineering construction and in support activities for oil and gas extraction in NL. During this period, NL has also been affected by large projects like the Vale Hydromet in Long Harbour being completed in the absence of any incremental support from new projects. Newer projects such as the Hebron offshore oil

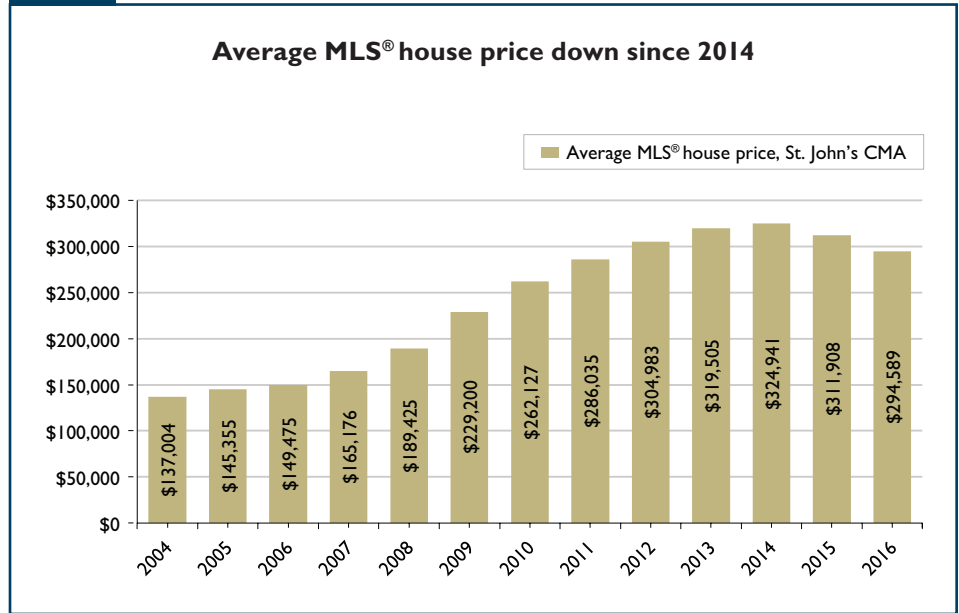
*"With sustained lower oil prices hitting government royalties considerably hard, recent fiscal deficits have grown persistently higher and in an effort to mitigate this, the NL government announced the introduction of numerous tax and fee measures and steep expenditure reductions as part of the April 14th budget."*

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Senior Market Analyst (St. John's)

development were not planned to ramp up until beyond 2015 and this was known by the NL government and industry prior to oil prices declining. With many high paying oil sector engineering and support jobs located in the St. John's area, the number of job losses in the region has been unprecedented and labour market conditions have continued to soften for the fourth year in a row in 2016. This suggests that even as oil prices recovered after 2010, there was no additional benefit to the economy regarding employment. In fact, the greatest benefit was government's fiscal position due to the significant share of oil revenue bolstering the budget, irrespective of jobs or job growth over this period.

Current economic weakness has resulted in additional labour pressures throughout NL and the St. John's area within a labour market that was already being impacted by the rise in the number of unemployed people who commute to Alberta for work. These unemployed individuals have remained here at home hoping to go back to commuting to Alberta for work at some point and the recent Fort McMurray fire has certainly complicated their situations significantly. The unemployment rate will likely remain elevated as labour force and employment pressures continue to mount around a weakening economy that is being impacted negatively by maturing capital projects, a lack of new capital project activity and the NL government's fiscal situation. Looking forward, weaker employment in NL compared to other non-oil producing regions of Canada will likely continue to force people to look for work outside the province, increasing the level of out migration to other parts of the country.

Figure 2



Source: NL Association of REALTORS®

MLS® is a registered trademark of the Canadian Real Estate Association

Note: 2016 = January to May

It is interesting to note that outside of parts of the last ten years, NL had fiscal deficits for every year except three since confederation in 1949. Therefore, the current deficit is not a new phenomenon, but the size of it is historic, at about \$1.8 billion, with total net debt increasing accordingly<sup>1</sup>. Despite higher spending levels by the former NL government, high oil prices leading to higher oil related revenues helped net debt come down moderately during the surplus years after 2006. With sustained lower oil prices hitting royalties considerably hard, however, recent fiscal deficits have grown persistently higher and net debt has risen in tandem. In an effort to mitigate this, the NL government announced the introduction of numerous tax and fee measures and steep expenditure reductions as part of the April 14<sup>th</sup> budget. This unprecedented fiscal challenge the NL government is facing will undoubtedly have further negative implications for the

provincial and St. John's economies if oil prices remain lower for longer. Under this lower oil price scenario, the NL government will continue to be pressured to look for new revenue sources and expenditure cuts going forward.

### Mixed reactions to oil price declines within the MLS® residential market

In terms of the St. John's area MLS® residential market, there was no negative impact on sales or prices during the 2008-2009 period when oil prices declined. In fact, heading into 2008, an unexpected surge in sales and a reduction in active listings or inventory had shifted the market from buyers' to balanced to sellers' during the second half of 2007. As a result of this market momentum, the local housing market was one of the only housing markets in Canada that was relatively unaffected by the 2008 oil price decline. During this

<sup>1</sup> NL Budget 2016.

time, prices were increasing, but average weekly earnings were also rising which helped offset some of the house price growth. Prices were driven up by speculation, increased land costs due to new development charges throughout the St. John's area, lot size restrictions that favoured single-detached developments over multiple unit developments, as well as larger upscale homes being built versus more standard average home types prior to 2008.

Unprecedented economic activity saw NL post very solid GDP growth during this period and the St. John's area housing market surged with near record sales and double-digit price growth. The local housing market was the only major market in Canada with positive price growth in the fourth quarter of 2008, with prices up 27 per cent over the fourth quarter of 2007. The benefits of this paired with employment and income growth led to increased economic activity as well as higher confidence among both consumers and business, while home owners' equity grew at a pace that had never been experienced before.

With regards to the current oil price decline, recent market activity indicates the St. John's area MLS® residential market has been somewhat aligned with lower oil prices, with flat-to-lower MLS® sales and evident price pressures since mid-2014. The province's fiscal situation has hit consumer confidence negatively and has caused many potential home buyers to likely hold-off on their home purchase intentions for the time being. However, there has not been a significant decline in housing activity despite oil prices having been cut in half. Sales were moderately below the longer-term average of 3,623 in both 2014 and 2015 and average

prices decreased for the first time in over ten years, down four per cent in 2015 after peaking at \$324,491 in 2014. These declines, however, have not been as significant as those seen in other oil-based centres. The real issue for the local housing market is expected to be the provincial government's current fiscal situation, likely leading to further economic decline as new taxes and reduced income take hold and as the reduction in employment leads to higher out migration. This is likely to eventually result in an increase in homes available for sale and lower prices. To date, however, in the absence of distressed sales and prices, it is difficult to conclude with conviction that lower oil prices have indeed hurt the housing market materially.

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The previous decline in oil prices coincided with an increase in active listings in 2008-2009, rising by 27 per cent during this period. Driven by a very buoyant economy and increased housing market activity, active listings decreased prior to the 2008 decline in oil prices and the global financial crisis. There was also a material increase in newly built home MLS® listing inventory during this period in conjunction with a surge in single-detached housing starts activity. An increase in active listings was expected, but has not yet occurred during the current oil price decline. In fact, active listings have actually decreased five per cent

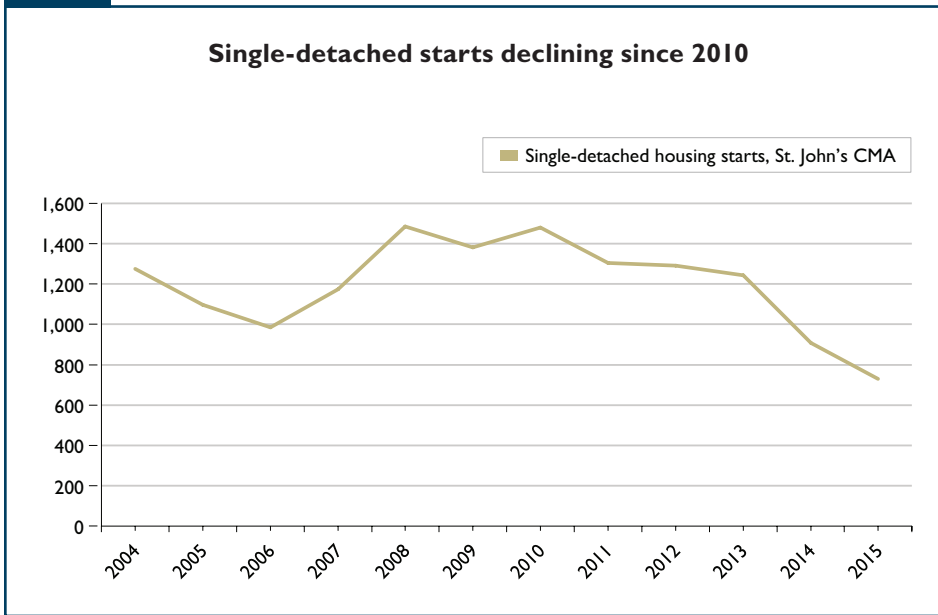
and are down consecutively month over month since September 2015. The longest consecutive month over month decline in inventory prior to this was two months (May/June) in 2012. These divergent directions with respect to active listings in the two oil decline scenarios can be explained by the vastly different states of both the economy and the housing market during these time periods and by price changes.

As previously mentioned, during the first oil price decline the St. John's area MLS® residential market was in sellers' territory and had moved close to being an accelerated market during the summer of 2008 when price growth was faster than market fundamentals supported at close to 20 per cent. Materially higher selling prices led more homeowners to easily list and sell their existing homes in order to move up to newer larger custom homes and this put upward pressure on existing home inventory. However, sales also increased five per cent during this time, which led to the St. John's area being the only housing market in Canada with positive sales growth in 2008. The increase in existing home inventory did not dampen prices or sales, which would normally be the case in a buyers' or balanced market.

During this time, in addition to pent-up demand, there was a considerable amount of speculative activity going on as well, whereby real estate investors bought into the local market for new and existing two-apartment homes. Throughout the global financial crisis and the shorter-lived 2008 oil price decline, businesses and consumers did not lose confidence in the local economy or housing market and the buoyant MLS® residential market performance was not what was expected. After the strong sellers' market during the summer of 2008, a nine per cent decline in sales and higher inventory



Figure 3



Source: CMHC

during the fourth quarter caused the market to shift quickly towards balanced conditions by year end. As time moved on, MLS® residential sales activity remained solid, despite much higher prices and balanced market conditions continued during 2009 onwards, well after oil prices had declined.

Prior to the 2014 oil price decline, the St. John's area resale market had just transitioned from balanced to buyers' conditions. Price growth had moderated within the five to seven per cent range compared to the double-digit gains seen in prior years and active listings continued to grow as a function of a growing housing market driven by buoyant new home construction activity. When oil prices started to decline in mid-2014, industry and media speculated the decline would be temporary in nature and just a shorter-term response to excess global oil supply. It is likely that many households in the St. John's area shared in this belief and in turn did not react negatively and rush out to list their homes out of fear of anticipated house price declines.

As a result, active listings did not increase materially. The oil price decline continued to gain speed, however, contributing to oil industry capital expenditure slowdowns and by November 2014, house prices began to decline. This continued into and throughout 2015, as some homeowners and investors either became anxious or were forced to leave the market due to job losses and were therefore willing to lower their prices accordingly. On the other end of the spectrum, with prices trending down about three per cent during most of 2015, many potential home sellers chose to delay listing or simply withdrew the sale of their home because they would not likely obtain what they wanted for it and were not in a forced sale situation. This actually led to a decline in active listings from September through to December 2015 that has continued so far in 2016, in addition to further price pressure.

Although home inventory has declined to date, lower demand for housing has kept both sales and prices under pressure and flat-to-lower sales activity presents a risk that prices

may continue to decline through 2017. The most recent consumer spending data shows retail sales are flat in tandem with flat residential sales and not declining significantly. The only current issue in terms of an adverse impact on residential sales is evolving within the labour market, where average weekly earnings have come down over the last two years and employment has also pulled back. Based on this and CMHC's expectations for economic growth, it is likely that the worst could be yet to come for the local housing sector.

### Mixed reactions to oil price declines with respect to housing starts activity

Prior to the 2008 oil price decline, housing starts throughout the St. John's area were already trending higher. New home construction activity was boosted by the August 2007 signing of the memorandum of understanding (MOU) for development of the Hebron offshore oil mega project, major oil field expansions and extensions at Terra Nova and White Rose, and significant provincial government surpluses. With an abundance of significant announcements and positive news during this period, total housing starts increased 16 per cent after a surge from June 2007 onward and rose 38 per cent in the fourth quarter of 2007 alone. This was driven in

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large part by speculative building, where housing starts activity was outpacing expected household formation. Improving in-migration, paired with increased economic activity and a solid labour market, also injected renewed new home demand throughout the St. John's area during this time. Slower price growth and moderate interest rate increases in the years prior to 2007 had conditioned buyers to higher mortgage carrying costs. Also, growth in personal incomes and home equity boosted consumer confidence during this period leading up to the 2008 oil price decline. This, as well as record oil production and GDP growth of almost ten per cent in 2007, were significant contributors to very positive momentum and activity in the local residential construction market heading into 2008.

The 2008 calendar year saw a thirty three year high in housing starts, where total housing starts increased 26 per cent to 1,863. Single-detached starts set a record, up 27 per cent to 1,485 and multiple starts climbed 24 per cent to 378 – all well above their respective ten year averages. This record single-detached starts activity was driven by unprecedented demand and resulted in construction backlogs that drove most builders over capacity with build times of eight to twelve plus months. Highly qualified workers returning from the oil patch slowdown in Alberta at the time, increased the local pool of skilled trade professionals and provided some labour relief for builders. 2008's frenetic pace of construction activity subsided in 2009 as pent-up demand waned and builders got back to normalized capacity levels, with total housing starts down nine percent off 2008 highs. As economic prosperity continued, 2010's total housing starts rebounded back to near 2008 levels.

By comparison, prior to the current and enduring oil price decline, new home demand was already slowing. Housing starts were trending down from their 2008-2010 period peaks and this was only exacerbated by the lower oil price environment. In 2014, total housing starts decreased 29 per cent to 1,230. Single-detached starts were at their lowest level since 2001, down 27 per cent to 907 and multiple starts fell 34 per cent to 323 – all well below their respective ten year averages. As oil prices continued to slide, 2015 was worse yet again, with total housing starts down 20 per cent to 985. Single-detached starts declined 20 per cent to a mere 729 and multiple starts were down 21 per cent to 256. In hindsight, the start of the current oil price decline, paired with a weakening economy and higher inventory of newly built homes for sale, likely drove demand for single-detached housing starts down considerably. When oil prices began to decline, the reaction within the new home construction market was not obvious at the time because, as previously mentioned, most people believed lower oil prices and the negative impact on the economy and housing market would be shorter-lived. However, new home demand from mid-2014 onwards continued to fall off and completed and unsold inventory levels remained high. In fact, unsold inventory had been climbing since 2010 and peaked at new highs in 2014, with many new homes sitting empty for several months before finally selling. Slower demand continued into 2015 and housing starts activity remained at multi year lows along with the price of oil.

New home Inventory levels remained persistently high and did not begin to decline until after August 2015. Since many builders were already

carrying high inventory levels heading into and during the current oil price decline, some were forced to sell at or below cost in order to avoid the high carrying costs associated with holding unsold inventory through the winter months. Accordingly, many of these new homes were sold during the latter part of 2015. With the completed and unabsorbed inventory problem having, to a large extent, worked itself out so far in 2016, nimble builders will now be able to respond quickly to market needs whenever oil prices and economic conditions improve and demand for new homes returns to the St. John's region.

In light of the negative economic impacts of the oil industry's downturn and the provincial government's fiscal situation, housing market softness is expected to continue for the remainder of 2016 and 2017, as buyers and sellers wait on the sidelines amid an array of unprecedented economic and housing sector uncertainty. Beyond the obvious income and employment pressures, current concerns are centred on evolving housing and economic trends as well what it will take to see the local economy return to some form of a recovery. The current economic decline and lower oil price environment could have other effects on the housing sector, especially with an aging population and a possible negative shift in migration and population if a recovery does not take hold sooner than later. Exacerbating this, is the fact that many workers in the St. John's region are dependent not only on NL economic growth, but also economic growth and benefits from the Alberta economy. With the current problem with Fort McMurray, this will likely continue to be an additional drag on housing demand and economic growth for NL and the St John's region in the coming months.

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