HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

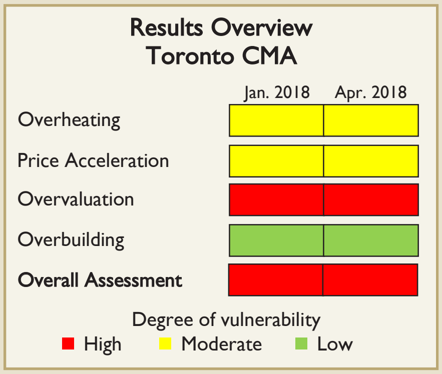
Greater Toronto Area

Date Released: Second Quarter 2018

Canada

CMHC SCHL

Highlights



- Recent results from the Housing Market Assessment indicated a high degree of market vulnerability in the Toronto CMA[1] housing market.
- Despite some easing in price growth, we continued to detect moderate evidence of overheating and price acceleration, and strong evidence of overvaluation.
- We detected weak evidence of overbuilding, as the number of completed and unsold units remained low.

HMA Overview[2]

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.

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.

In Detail

Overheating

We detected moderate evidence of overheating in Q4 2017. The seasonally adjusted sales-to-new listings ratio (SNLR) was 46%, virtually unchanged from the previous quarter. With both demand and supply rebounding equally in the last quarter of 2017 as a result of buying likely brought forward due to new rules set by the Office of the Superintendent of Financial Institutions (OSFI) in 2018, the balance between demand and supply was not affected. Although the sales to new listings ratio was well below the threshold of 70%, which is meant to signal market overheating, the change was not persistent enough to disregard our concern of market imbalances.

In October 2017, OSFI announced that mortgage stress testing requirements would be extended to all new mortgages issued by federally regulated financial institutions beginning in January 1, 2018. In combination with strong economic fundamentals, the new legislation prompted more sellers and buyers to act prior to that date. With sellers being concerned about new rules potentially depressing demand for homes, the supply of new listings in Q4 2017 reached a record seasonally adjusted annual rate of 210,444 units. With buyers taking advantage of generally more relaxed mortgage qualification requirements, the number of sales trended up to reach 96,440 units.

Since the implementation of the new rules, the market took a breather as was evident by the lower number of sales, and higher new and active listings (available for sale at the end of the quarter) in Q1 2018. The seasonally adjusted SNLR during that time averaged at 52%, well below the threshold set for market overheating. Demand appeared to have shifted further towards the relatively affordable housing types

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[1] Results are based on data as of the end of December 2017 and local market intelligence up to end of March 2018. 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.

such as condominium apartments where tighter market conditions, with the average SNLR hovering around 71% in Q1 2018, were evident. More balanced market conditions persisted for single-detached homes across the GTA, with York Region seeing the lowest SNLRs.

Price Acceleration

We continued to detect moderate evidence of price acceleration in Q4 2017. Despite moderating house prices across the GTA, the average seasonally adjusted MLS® house price was relatively unchanged from the previous quarter. Moderate price increases would have to persist longer in order for us to discount any evidence of price acceleration. While price declines in single-detached homes were more pronounced during Q4 2017, market conditions for condominium apartments tightened resulting in stronger price gains. Slightly higher mortgage rates and new OSFI rules have shifted demand to more affordable housing options. Due to their weight in terms of dollar value, the drop in sales and decline in the average price of single-detached homes weighed heavily on the overall average price.

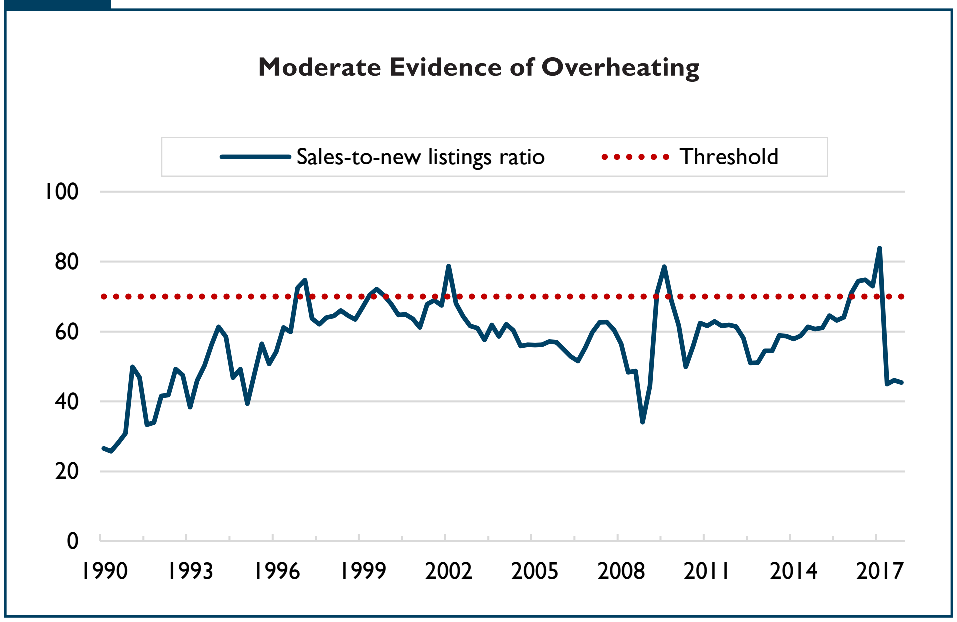
Dana Senagama,
Principal, Market Analysis (GTA)

"As the Toronto CMA housing market continues to adjust, our current assessment continues to show a high degree of vulnerability in housing market. Home prices have softened, but still remain above rates justified by economic and demographic fundamentals such as income and population growth."

In Q1 2018, the MLS® average house price declined 12% compared to the first quarter last year, when prices were up by 30%. Notably, price changes differed by dwelling types. Condominium apartments saw year-over-year price growth at 9%, compared to single-detached homes, which declined by 16%.

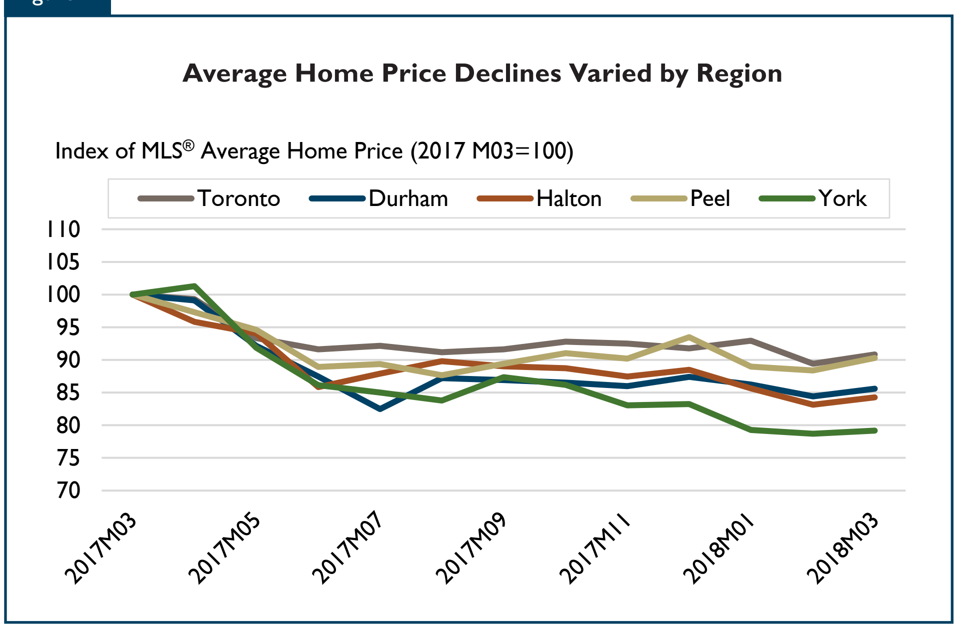
Areas of the GTA that contained a higher portion of sales among expensive single-detached homes experienced the highest increase in inventories, and thus relatively greater price declines over the past year. Since Ontario's Fair Housing Plan was introduced, the average home price declined by a greater amount in York and Halton Regions (see Figure 2).

Figure 1



Sources: CREA and calculations (threshold) by CMHC Last data point: 2017Q4

Figure 2



Source: TREB, CMHC calculations

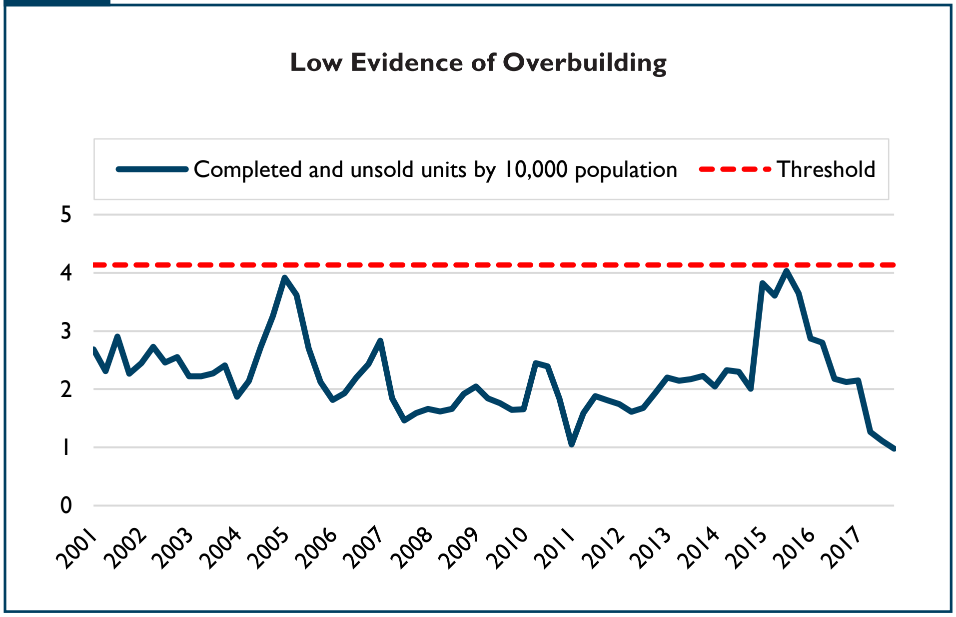
The average home price in the City of Toronto, where many of the GTA's condominium transactions took place, had less of a decline, while areas which contain higher concentrations of single-detached homes, such as the former municipality of North York, had a greater decline.

Overvaluation

We continued to detect high evidence of overvaluation in the Toronto CMA during Q4 2017. The gap between actual home prices and levels that are historically supported by economic and demographic fundamental drivers such as income and population continued to shrink, but remained above the problematic threshold. In Q4 2017, the real MLS® average house price declined by 1.2% on a year-over-year basis, while fundamentals driven by growth in real disposable income and the young adult population accelerated to 0.5% and 2.9% respectively.

Other indicators of economic activity pointed to progress in economic fundamentals. Toronto's labour market showed marked growth in the last quarter of 2017, as the number of those employed full time increased by a seasonally adjusted rate of 3.3% from the previous quarter. This strong job growth reduced the unemployment rate to 6.0%, which was the lowest reading since 2001. A tight labour market also resulted in strong wage growth with the seasonally adjusted average weekly earnings going up by almost 2% in Q4 2017 from the previous quarter. In addition, the number of net migrants in 2017 grew by 19.4% compared to a year earlier.

Figure 3



Sources: CMHC. Statistics Canada and calculations (threshold) by CMHC
Last data point: 2017Q4

Overbuilding

We continued to detect low evidence of overbuilding in Q4 2017, as the number of completed and unsold units declined further to 0.98 units per 10,000 population-one of the lowest levels ever recorded and well below the threshold of 4.2 units required for evidence of overbuilding in the Toronto CMA. The decline in inventories was evident for all housing types.

The lower number of new homes completed in Q4 2017 was one reason as to why unsold inventories continued to dwindle. However, robust demand for new housing in Toronto has been the foremost factor for a high share of homes being sold at completion. Most homes being currently completed were sold prior to the start of their construction, during the time when demand levels peaked. Furthermore, condominium apartments continue to gain popularity as more price-sensitive homebuyers cannot afford low rise homes. Low vacancy rates and strong rent growth also encouraged a growing share of investors to purchase pre-construction condominium apartment units as rental properties. A tight condo market with low inventory also pushed buyers into purchasing newly completed but unsold condominium apartments.

The total number of homes under construction in February 2018 reached an all-time high at 72,056 units. The increase has been driven by condominium apartments, which made up 76% of these units. Given that the absorption rate of condominium apartments at completion is above 97%, the risk of the market becoming oversupplied is low at this point, however developers should continue to carefully monitor and manage inventories.

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 detect imbalances in housing markets.

Specifically, the framework considers four main factors that may provide an early indication of vulnerability in the housing market: (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 incidence of signs of vulnerability, 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 a low degree of vulnerability. Conversely, as the intensity, number, and/or persistence of the signals increases, so does the evidence of imbalances in the housing market.

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 vulnerability. 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 vulnerable 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 vulnerabilities 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 signs of overheating, 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 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 signs of overbuilding 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 degree of market vulnerability. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of imbalances (that is, how far the indicator is from its historical average), but also considers the intensity and the persistence of these signals over time. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of an imbalance 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 that can identify imbalances. 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 showing vulnerability 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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