

HOUSING MARKET ASSESSMENT











Victoria CMA




Date Released: Fourth Quarter 2018



Highlights

Results Overview Victoria CMA

| | Jul. 2018 | Oct. 2018 |
|--------------------|---|---|
| Overheating |  |  |
| Price Acceleration |  |  |
| Overvaluation |  |  |
| Overbuilding |  |  |
| Overall Assessment |  |  |

Degree of vulnerability
 High  Moderate  Low

- The HMA framework indicated a high degree of housing market vulnerability in Metro Victoria¹.
- Market balance improved, largely due to an increased availability of the most expensive units on the market.
- New apartment inventory remained low while single-detached inventory rose, but total inventory remained below the threshold for overbuilding.
- Price growth slowed in the second quarter of 2018, but observed housing prices remained unexplained by fundamental factors, signalling overvaluation.

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 degrees of vulnerability 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 resolve 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 degree of market vulnerability. The HMA is a comprehensive framework that considers both 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 low evidence of vulnerability. As the number of intense and persistent signals increases, the associated degree of vulnerability becomes stronger.

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¹ Results are based on data as of the end of June 2018 and local market intelligence up to the end of September 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](#).

In Detail

Overheating

The rating for overheating was maintained in the second quarter of 2018. The sales-to-new-listings ratio (SNLR) was 58%, below the threshold of 80%. However, the rating is due to the persistence rule of the SNLR having exceeded the threshold for at least 2 quarters in the past 3 years. Under the HMA framework's persistence rule for Overheating, the rating will be maintained until this condition is no longer true.

The change in the SNLR is largely driven by a decline in sales. As of August 2018, the trend in total sales was 35% below a peak reached in April 2016, which is also concurrent with the first time the overheating signal was triggered. Since the peak in sales, the share of single-detached sales shifted from roughly 60% to 50% as a share of total sales, while apartments shifted from 30% to 40%. In other words, demand in the market

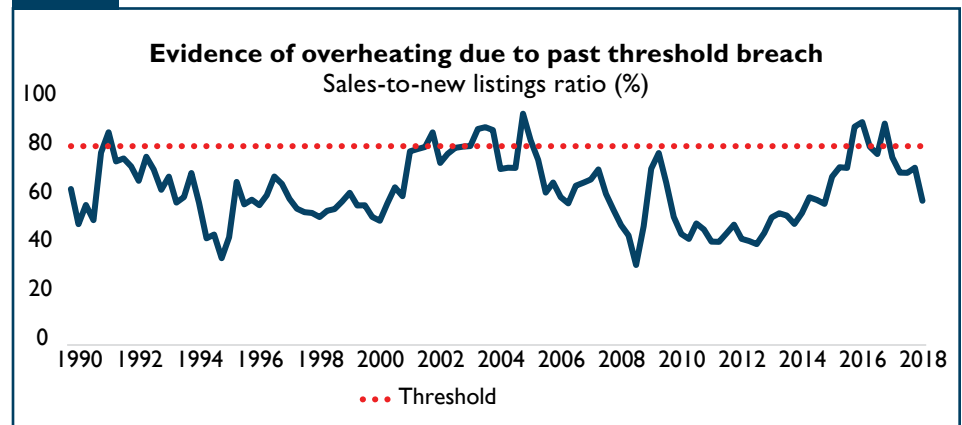
shifted to units with relatively greater affordability. The remaining 10% of sales were row and semi-detached units.

The trend in new listings has also declined every month in 2018, but at a slower rate than the sales decline. The decline in new listings was driven by fewer apartment listings. This contraction in apartment listings dominated an uptick in attached and single-detached new listings. As a result, sales of apartments may be limited by a lack of inventory as the

SNLR of apartments was 71% in August, or sellers' market conditions, and active listings of apartments remain at historic lows.

Other indicators point to a market trending towards greater market balance. Single-detached active listings are now in line with the five-year average, however condo listings remained low historically. Days on market have increased for all product types, and fewer homes were sold above asking price.

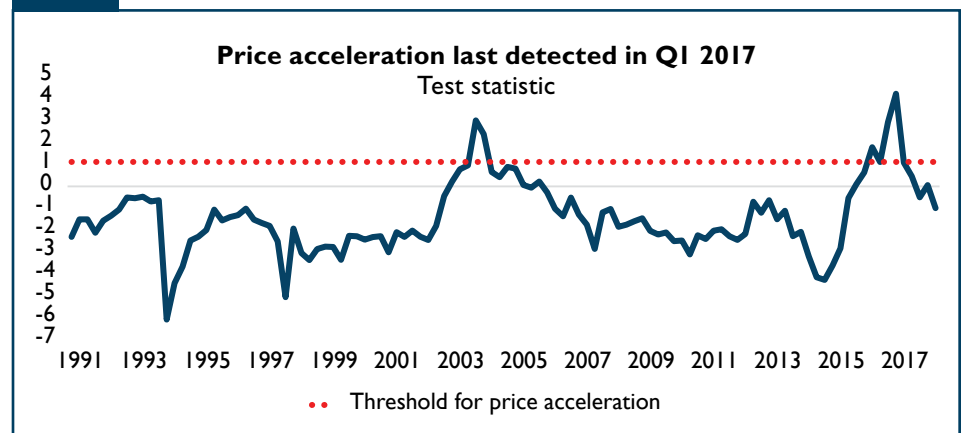
Figure 1



Braden Batch
Senior Analyst,
Economics

"A high degree of vulnerability was detected for the Metro Victoria housing market. A high degree of Overvaluation was maintained by the framework in the second quarter of 2018 as recent history in the market exhibited prices not fully explained by fundamentals. Similarly, overheating and price acceleration ratings were maintained due to persistence rules."

Figure 2



Price Acceleration

The signal for price acceleration was maintained for Metro Victoria. The test for price acceleration did not exceed the critical threshold, however, once detected, the rating will remain for three years. The price acceleration indicator receded below threshold in the second quarter of 2017, and has not since crossed. Average MLS® price growth exhibited smaller year-over-year gains at 6% in the second quarter of 2018 compared with 9% in the first quarter.

Overvaluation

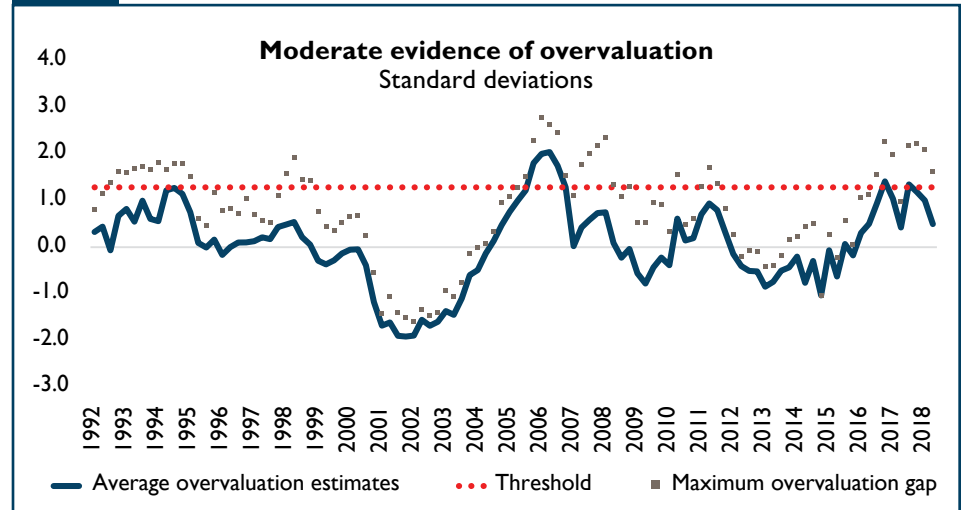
The HMA framework maintained a rating of high evidence of overvaluation in Metro Victoria for the sixth consecutive quarter due to the HMA framework's persistence rule for Overvaluation. The average of all overvaluation models was below threshold in the second quarter of 2018. Yet, the high evidence of overvaluation rating was maintained as the average of overvaluation models was above the critical threshold for at least two quarters in the previous year.

In the second quarter of 2018, the population of young adults increased, which is seen as a key driver of household formation. In addition, the tight labour market in Metro Victoria contributed to wage growth. Growth in these fundamental factors worked to lend support for higher house prices. However, due to rising interest rates, the carrying cost for home ownership increased from the previous year to take some

support out of price growth. Accounting for all factors, housing prices remained stronger than what could be explained by fundamentals,

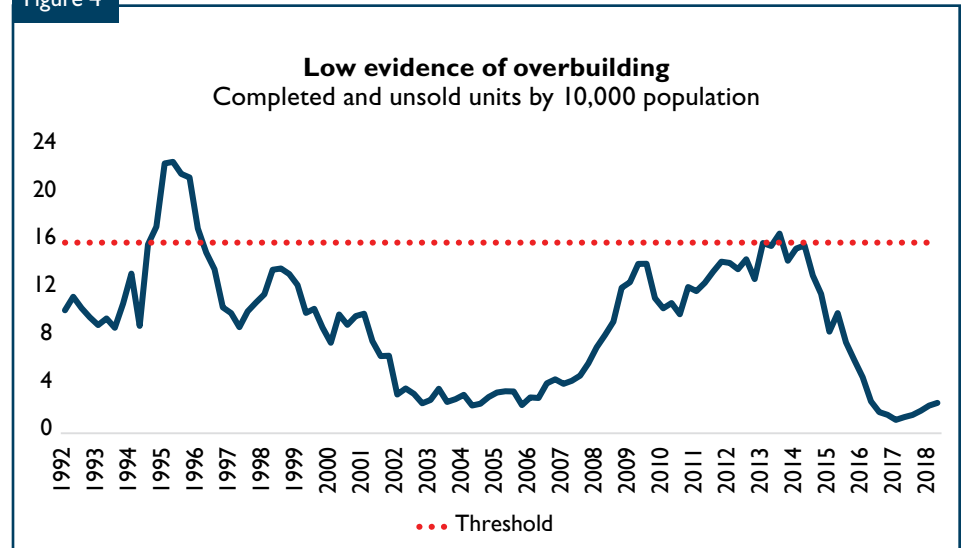
and overvaluation was detected. In particular, models that use an affordability factor detected imbalances.

Figure 3



Source: CREA, Statistics Canada and calculations by CMHC.
Last data point: 2018Q2

Figure 4

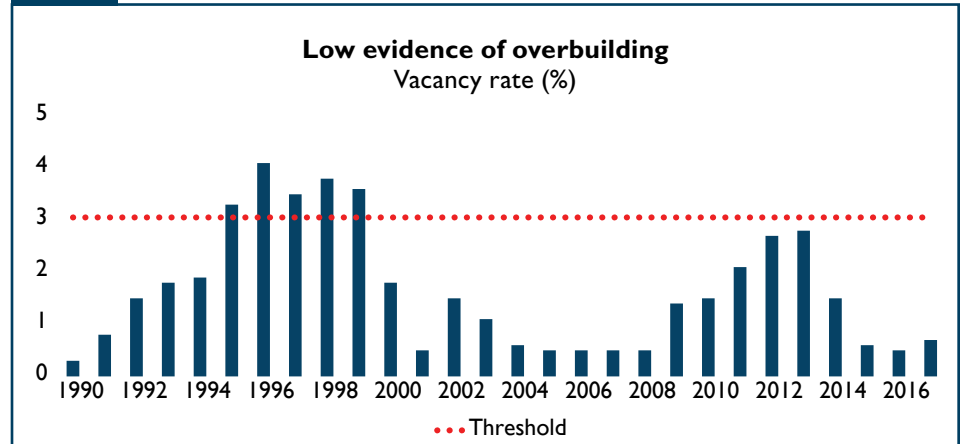


Source: Statistics Canada and CMHC
Last data point: 2018Q2

Overbuilding

The HMA framework did not detect overbuilding in the Metro Victoria housing market. Per capita complete and unsold units were well below threshold. Homes over \$1,000,000 dominated the inventory of complete and unsold units. On the other hand, there has been a higher share of apartment sales observed in the resale market. As a result, the inventory of condo apartment and row house units remain at historically low levels while single detached and semi-detached units have trended up to levels experienced in 2014 and 2015. In the rental market, the vacancy rate remained low.

Figure 5



Source: Statistics Canada and CMHC
Last data point: 2018Q2

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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