

# HOUSING MARKET ASSESSMENT

Canada

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## Highlights

- The Housing Market Assessment (HMA)<sup>1</sup> continues to indicate a high degree of overall vulnerability at the national level. However, with house prices moderating, conditions of overvaluation are easing for Canada as a whole.
- Overvaluation is still detected in Vancouver, Victoria, Toronto and Hamilton, but house prices are moving closer to levels supported by housing market fundamentals. All these centres continue to exhibit a high degree of overall vulnerability.
- Evidence of overbuilding remains high in Edmonton, Calgary, Saskatoon and Regina, so they continue to receive a moderate degree of vulnerability in the overall assessment.
- A low degree of overall vulnerability is sustained for Ottawa, Québec City, Moncton, Halifax and St. John's where house prices continue to follow the path of fundamentals.
- However, the Montréal resale market is close to overheating, creating significant upward pressure on prices as a result of a sharp tightening between supply and demand.
- Winnipeg's results are most notable, where evidence of overbuilding as well as the degree of overall vulnerability changed from low to moderate, reflecting increases in the inventory of newly completed but unsold units.

## Overview of HMA Results

The Housing Market Assessment (HMA) is an analytical framework that provides a comprehensive view of vulnerabilities to housing market instability. It contains four main factors: overheating, price acceleration, overvaluation and overbuilding.

Overheating is detected when sales greatly outpace new listings in the market for existing homes. Price

acceleration is signaled when the growth rate of house prices increases rapidly. Overvaluation indicates that house prices are elevated compared to price levels supported by personal disposable income, population, interest rates, and other fundamentals<sup>2</sup>. Overbuilding is flagged when the rental apartment vacancy rate and/or inventory of newly built and unsold housing units are higher than normal.

Colour codes indicate the degree of market vulnerability. Overheating and price acceleration are measured by

single indicator. Colour scales for these factors vary between green and yellow only. Overvaluation and overbuilding are measured by multiple indicators. Their colour scales, as well as the colour scale for the overall assessment, change among green, yellow and red to reflect different degrees of imbalances.<sup>3</sup>

<sup>1</sup> Results are based on data as of the end of June 2018 and market intelligence as of the end of September 2018. This national report provides the housing market assessment at the national level and summary assessment results for 15 Census Metropolitan Areas (CMAs). For each of these CMAs, CMHC also issues a local report with more information and analysis.

<sup>2</sup> Other fundamental factors include mortgage-borrowing capacity of households, required minimum down payment, and labor productivity.

<sup>3</sup> More technical details on the HMA are provided in the Appendix.

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Table 1

## Comparisons between the July 2018 and October 2018 reports

	Overheating		Price Acceleration		Overvaluation		Overbuilding		Overall Assessment	
	Jul.18	Oct.18	Jul.18	Oct.18	Jul.18	Oct.18	Jul.18	Oct.18	Jul.18	Oct.18
Canada										
Victoria										
Vancouver										
Edmonton										
Calgary										
Saskatoon										
Regina										
Winnipeg										
Hamilton										
Toronto										
Ottawa										
Montréal										
Québec										
Moncton										
Halifax										
St. John's										

## Degree of vulnerability

Low

Moderate

High

**Note 1:** Colour codes indicate the degree of market vulnerability. Overheating and price acceleration are measured by single indicators. Colour scales for these factors vary between green and yellow. Overvaluation and overbuilding are measured by multiple indicators. Their colour scales, as well as the colour scale for the overall assessment, change among green, yellow and red to reflect different degrees of imbalances.

**Note 2:** The HMA detects the presence or incidence of market imbalances when indicators are above thresholds. It also measures the intensity of signals by how much indicators are above thresholds, and the persistence of signals by how long signals stand above thresholds. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of imbalances increases.

## HMA Results for Canada

### Canada: ■ High degree of vulnerability

The HMA continues to indicate a high degree of overall vulnerability at the national level. However, conditions of overvaluation are easing for Canada as a whole. Having stood above the critical threshold

for the past four years, the maximum overvaluation gap went below the threshold in the second quarter of 2018 (Figure 1). The average estimate of overvaluation, represented by the solid line in Figure 1, has also declined over the past two quarters.

In the second quarter of 2018, the inflation-adjusted MLS® average price dropped by 8.7% from the same period in 2017. Taken together—tighter mortgage rules, rising interest rates and weaker

growth in inflation-adjusted personal disposable income—likely led to reduced demand for housing, resulting in the decline of house prices. A compositional effect in the type of units traded—a decline in sales of more expensive single-detached homes—is also dampening the MLS® average price. Meanwhile, the young-adult population increased by 1.9% from a year ago, which increased the pool of potential first-time homebuyers. As a result,

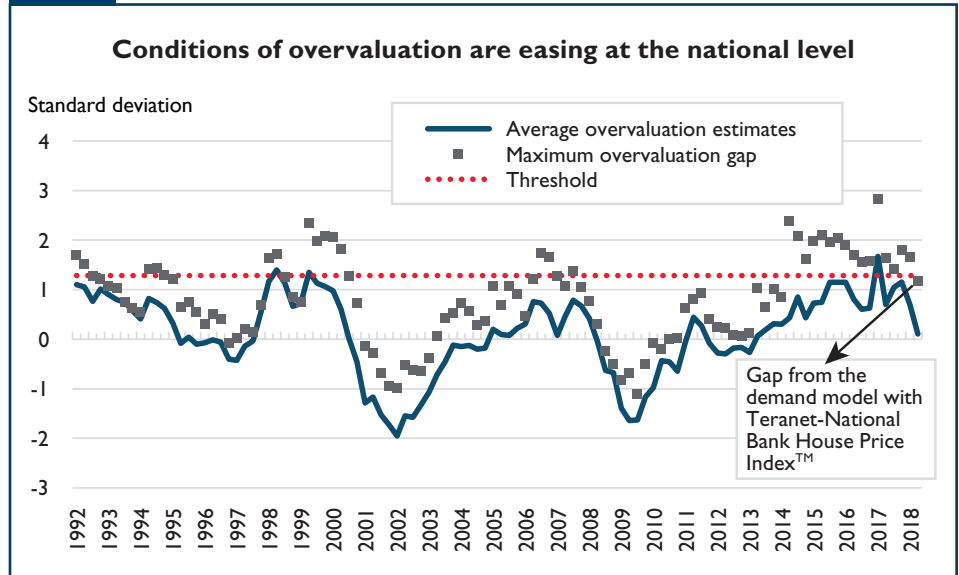
house prices are more in line with the underlying fundamentals. Despite this, the moderate rating of overvaluation is maintained for the national level in the current release, as a longer period of improved alignment between house prices and fundamentals is required for overvaluation to be deemed low at the national level<sup>4</sup>.

At the same time, price acceleration continues to be signaled at the national level. Fast-rising house prices may indicate that expectations of future house-price appreciation are excessive, further attracting investors wanting to benefit primarily from short-term capital appreciation, leading to further acceleration in house prices. That is, speculative behaviours can feed on themselves and push house prices further in an upward spiral. Though the test statistic has stayed below the threshold since price acceleration was initially detected in the first quarter of 2016 (Figure 2), the rating is kept for three years after it is initially flagged to account for the possibility that excessive expectations of future house-price appreciation may persist for a period of time.

The combination of overvaluation and price acceleration being signaled contributes to the overall assessment that the national housing market remains highly vulnerable. However, for Canada as a whole, evidence of overheating and overbuilding remains low (Figures 3, 4 and 5).

Regional disparities continue to be observed. A high degree of overall vulnerability is maintained for Vancouver, Victoria, Toronto and Hamilton with price acceleration

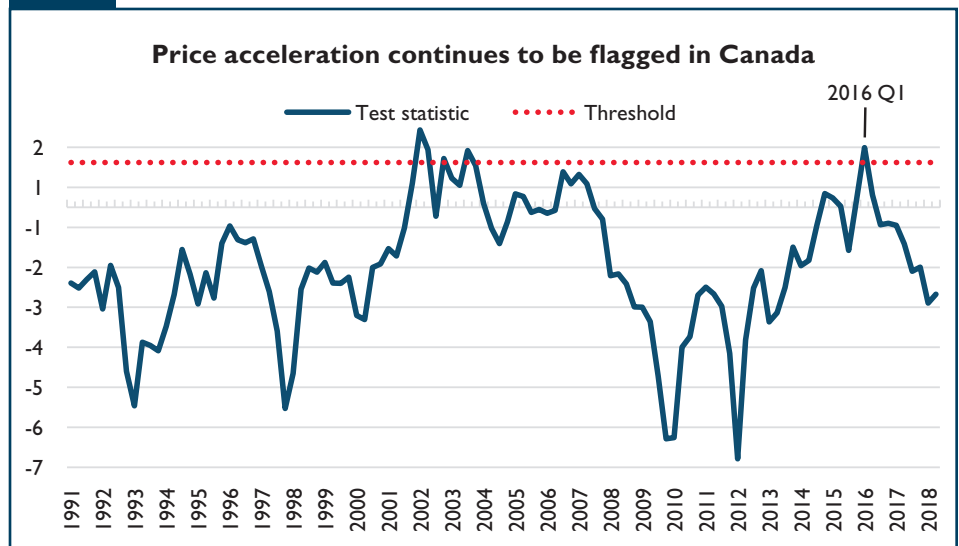
Figure 1



Sources: CREA, Statistics Canada, Teranet and National Bank of Canada, and calculations by CMHC.

Note: The average estimate of overvaluation is the average gap between actual house prices and price levels estimated from a group of selected models. These include demand, supply, hybrid, and affordability models, each of which is estimated using four measures of house prices to generate sixteen unique estimates of overvaluation. The selection of models is conducted with a set of cointegration tests, and the selected models are estimated with Dynamic Ordinary Least Squares (DOLS). The maximum overvaluation gap is obtained from the model that has the largest gap between the actual price and the estimated price. The threshold is fixed at a critical value of 1.285 for a confidence level of 80%. Overvaluation is signaled when overvaluation estimates lie above the threshold.

Figure 2



Source: CREA and calculations by CMHC.

Note: The test is done using the MLS® average price. Other price indices are also monitored.

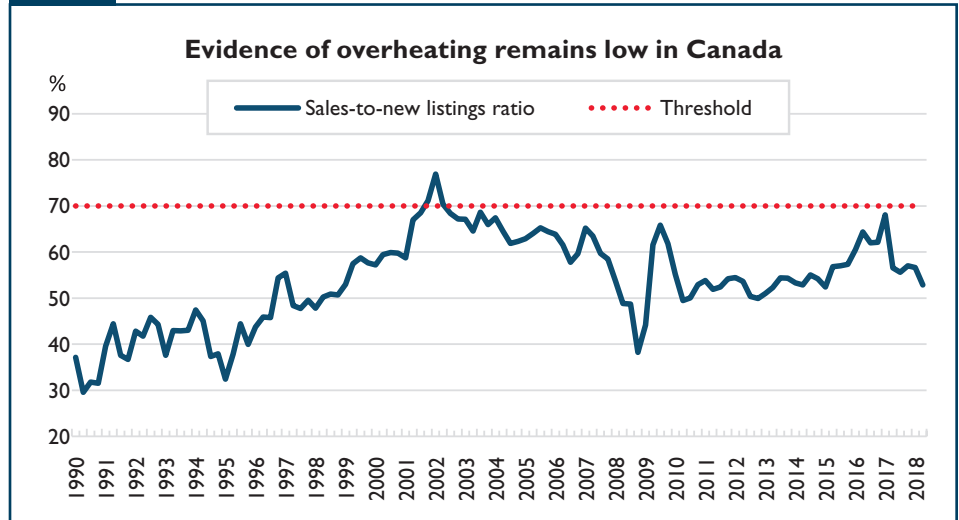
<sup>4</sup> The maximum overvaluation gap needs to stay below the critical threshold for another two quarters for the national housing market to receive a low rating of overvaluation.

and overvaluation being indicated. Over the past year, evidence of overvaluation continues to be observed in these four centres, since house prices are higher than the price levels supported by the fundamentals. However, with price growth moderating and the young-adult population growing, the conditions of overvaluation are easing in all four centres.

Evidence of overbuilding remains high in Edmonton, Calgary, Saskatoon and Regina. Hence, they continue to receive a moderate overall assessment of vulnerability. A low degree of overall vulnerability is maintained for Ottawa, Québec City, Moncton, Halifax and St. John's, where house prices continue to follow the path of fundamentals. A low degree of overall vulnerability is also maintained for Montréal, but we observe that there are significant upward pressures on prices as a result of a sharp tightening between supply and demand in the resale market.

Winnipeg's results are most notable, where the inventory of newly completed but unsold units have accumulated over the past two quarters. As a result, the degree of overall vulnerability went from low to moderate in Winnipeg.

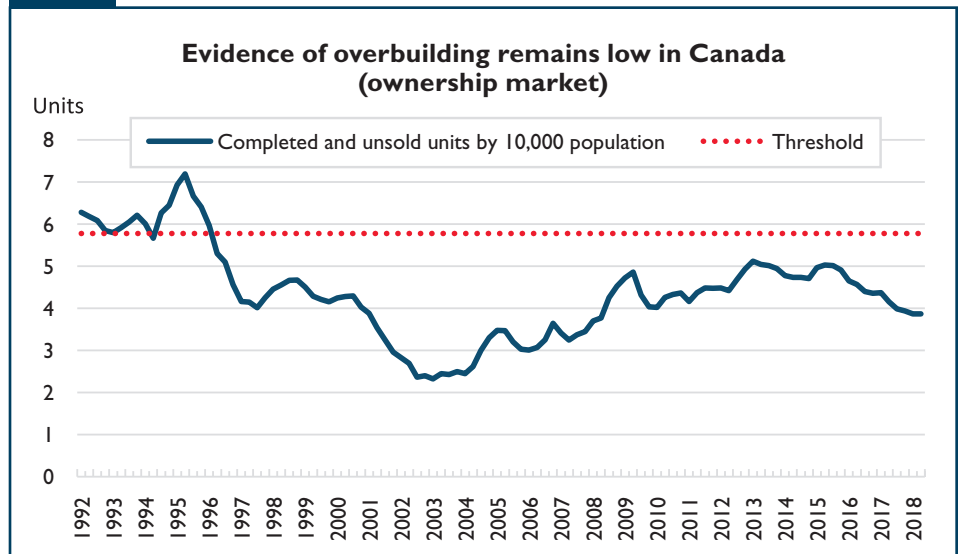
Figure 3



Source: CREA and calculations by CMHC.

Note: The sales-to-new listings ratio is the number of existing home sales divided by the number of new listings entering the market.

Figure 4



Sources: Statistics Canada and CMHC.

Note: Overbuilding is signaled when the supply of readily available housing units significantly exceeds demand. This figure presents one of the two indicators the HMA uses to assess overbuilding conditions in the housing market: the inventory of newly completed but unsold housing units per 10,000 population.

## HMA Summary Results for 15 Census Metropolitan Areas (CMAs)

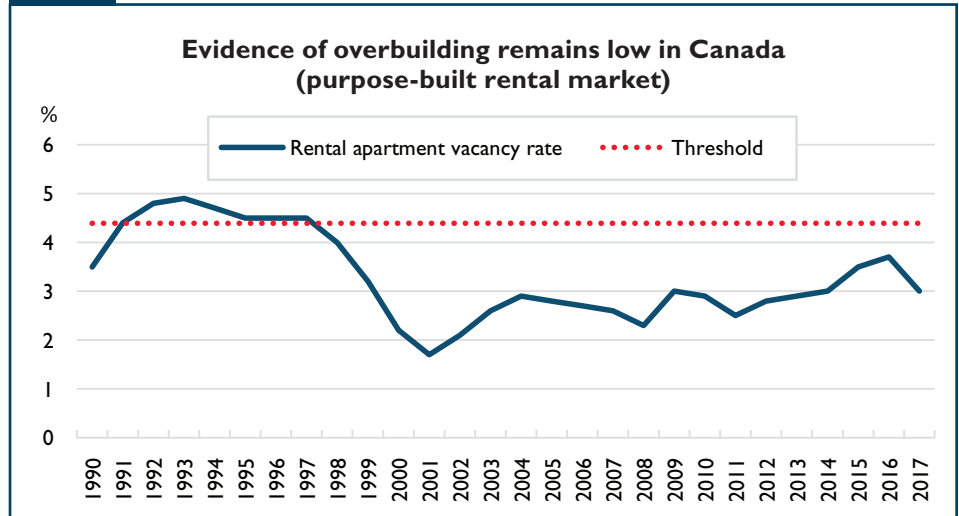
### Victoria: ■ High degree of vulnerability

The HMA framework maintains an evaluation of overheating, price acceleration, as well as high evidence of overvaluation for Metro Victoria in the second quarter of 2018. Market balance improved in the second quarter of 2018 on rising inventories of completed and unsold new homes, reflecting a sharp decline in sales activity. While price growth continued to outpace inflation, it did not exhibit double-digit annual increases as seen in prior assessments.

### Vancouver: ■ High degree of vulnerability

The Vancouver housing market continues to be assessed as showing a high degree of vulnerability, with strong evidence of overvaluation continuing to be detected. Despite declining prices for properties in different segments of the resale market in the most recent quarter, home price growth over the past few years significantly outpaced local income growth. The ratings for overheating and price acceleration continue to be maintained. However, low inventories of completed and unsold new homes and a low vacancy rate in the rental market suggest that there is low evidence of overbuilding.

Figure 5



Source: CMHC (Rental Market Survey).

Note: Overbuilding is signaled when the supply of readily available housing units significantly exceeds demand. This figure shows one of the two indicators the HMA uses to assess overbuilding conditions in the housing market: the rental apartment vacancy rate. CMHC conducts the Rental Market Survey every year in October. The last data point presented in this figure is from October 2017.

### Edmonton: ■ Moderate degree of vulnerability

The elevated level of inventory of completed and unsold units continued to provide evidence of overbuilding in Edmonton. Construction of single-detached units coupled with rising choices for buyers in the resale market has pushed inventory levels higher. On the other hand, unabsorbed inventory for row and apartment units has decreased indicating that the multiples segment of the market is moving toward a more balanced state. Driving this trend has been a declining number of row and apartment starts combined with support from recently stronger employment growth among young adults, who have a greater propensity to seek housing on the generally more-affordable multiples segment.

### Calgary: ■ Moderate degree of vulnerability

There continued to be high evidence of overbuilding as elevated inventory levels persisted in the second quarter of 2018. A substantial number of purpose-built apartment and condominium units are under construction, posing a risk of rising inventory, especially given the current buyers' market conditions and the recent decline in the population aged 25 to 34, who tend to be first-time buyers.

### Saskatoon: ■ Moderate degree of vulnerability

Fundamentals remain mixed with weaker economic conditions resulting in a contraction in real personal disposable income<sup>5</sup>, while growth in the young-adult

<sup>5</sup> Inflation-adjusted personal disposable income.



population has remained positive and relatively strong. Buyer's market conditions in Saskatoon continue with a downward trend in several house price measures. As evidence of overbuilding remains high in Saskatoon, it continues to receive a moderate degree of vulnerability in the overall assessment.

### **Regina: ■ Moderate degree of vulnerability**

The overall assessment remains unchanged from the prior quarter. There continued to be high evidence of overbuilding as the inventory of completed and unsold units increased further during the second quarter of 2018. Observed house prices remain largely in line with those estimated from fundamentals. However, buyers' market conditions in Regina continue with downward pressure on several house price measures.

### **Winnipeg: ■ Moderate degree of vulnerability**

A moderate degree of overbuilding was detected as the inventory of completed and unsold units increased to elevated levels in the second quarter of 2018. Overvaluation continued to be assessed as moderate. While real disposable income decreased, there was an increase in the population aged 25 to 34 years and growth is easing for some house price measures. According to the HMA decision rule, a high degree of overall vulnerability should be indicated when both overvaluation and overbuilding factors exhibit evidence of imbalances. However, Winnipeg's overall assessment was adjusted to moderate in this quarter as evidence of overvaluation and overbuilding observed is marginal.

### **Hamilton: ■ High degree of vulnerability**

Overvaluation in Hamilton was maintained, with house prices remaining high relative to underlying economic and demographic fundamentals. The degree of overvaluation though continues to diminish. Notably, in the second quarter, population in Hamilton grew at the fastest pace in 16 years.

Overheating and price acceleration conditions were also maintained. Although the sales-to-new listings ratio declined and settled at about 60%, the change was not observed for long enough to dismiss the risk of overheating. Sales in the area trended down to reach the lowest quarterly level in almost 20 years. Declining new home listings averted a more significant market rebalance.

### **Toronto: ■ High degree of vulnerability**

The average gap between actual house prices and price levels estimated by economic fundamentals remains below the threshold. In fact, overvaluation has been easing since this time last year. In the second quarter of 2018, the MLS® average house price adjusted for inflation and real personal disposable income decreased compared to the same time period in 2017, while the young-adult population increased. However, the high degree of overvaluation is maintained as the average gap has been above the threshold from the second quarter of 2015 until the fourth quarter of 2017. Low evidence of overbuilding remains as the inventory of completed and unsold units moved lower in the second quarter of 2018.

### **Ottawa: ■ Low degree of vulnerability**

The low evidence of vulnerability is maintained for Ottawa for all indicators. Housing demand has been strengthening in Ottawa since 2017, the number of completed and unsold units trended down to reach its lowest level in over three years this July, underscoring the low evidence of overbuilding. Ottawa shows low evidence of price acceleration and overvaluation despite stronger price growth in recent quarters due to strong growth in employment.

### **Montréal: ■ Low degree of vulnerability**

For a seventh consecutive quarter, the degree of overall vulnerability remains low for Montréal. The level of personal disposable income, combined with population growth among young adults, indicates that housing prices have remained at levels corresponding to economic and demographic activity.

Nevertheless, given the sharp tightening between supply and demand, the Montréal resale market is approaching overheating, creating significant upward pressure on prices. Evidence of overbuilding remains low, as the inventory of completed and unsold apartment condominiums continues to be relatively low.

### **Québec: ■ Low degree of vulnerability**

Overall, house prices remain close to levels supported by economic and demographic fundamentals. Evidence of overvaluation therefore remains low. In addition, we did not detect any evidence of overheating or price acceleration. At the same time, the inventory of completed and unsold

properties and the vacancy rate for rental apartments were below the thresholds. It should be noted, however, that a significant number of purpose-built rental units are under construction or have recently been completed, likely placing upward pressure on the vacancy rate.

### Moncton: ■ Low degree of vulnerability

Residential construction starts in the first six months of 2018 were the lowest on record since 1991. There is however, lots of construction activity already underway. Moncton's economy and labour market have been very strong lately. Consequently, home sales increased in the second quarter of 2018 compared to the same period in 2017. While demand is up, the number of homes for sale keeps trending down, decreasing to a six-year low. As a result, the sales-to-new listings ratio increased to 67.8% in the second quarter of 2018, getting closer to the overheating threshold for Moncton. With increased sales and a record low level of active listings, the average resale price, after adjusting for inflation, increased in the second quarter of 2018 compared to the same period in 2017.

### Halifax: ■ Low degree of vulnerability

The Halifax CMA continues to exhibit a low degree of housing market vulnerabilities. With strong MLS® sales growth and limited resale supply, the sales-to-new listings ratio increased for the third consecutive quarter. Strengthening demographic and economic fundamentals, including population gains and improving employment levels, support low evidence of overvaluation. With the number of completions of single-

detached units increasing significantly compared to last year, new home inventories remain elevated which would generally tend to increase the likelihood of detecting evidence of overbuilding. However, population growth has helped to more-than-offset this factor, causing the overbuilding indicator to trend downward.

### St. John's: ■ Low degree of vulnerability

There are no significant signs of overheating, price acceleration, overvaluation or overbuilding in the St. John's housing market. Weak housing market activity is attributed to low growth in the economy, a flat young-adult population and real personal income. While there are no significant signs of overbuilding, the inventory of completed and unsold units relative to the population was 6.3 in the second quarter, higher than the threshold of 5.3.

## Appendix

### What is CMHC's Housing Market Assessment?

The objective of CMHC's Housing Market Assessment is to identify locations in which there are heightened vulnerabilities to housing market instability from the level of house prices and/or from factors that are known to influence house prices.

The HMA is an analytical framework that provides a comprehensive view of housing market vulnerabilities, relying on a combination of indicators of housing market conditions for several metropolitan areas across Canada, and for Canada as a whole<sup>6</sup>.

Specifically, the framework considers four main factors with different possible degrees of vulnerability that may provide an early indication of imbalances in housing markets. Overheating and price acceleration are measured by single indicator. Colour scales for these factors vary between green and yellow only. Overvaluation and overbuilding are measured by multiple indicators. Their colour scales, as well as the colour scale for the overall assessment, change among green, yellow and red to reflect different degrees of imbalances.

1. **Overheating:** Sales greatly outpace new listings in the market for existing homes.
  - Moderate: Sales-to-new listings ratio lies above the threshold of overheating for at least two quarters over the past three years.
  - Low: Otherwise.
2. **Sustained acceleration in house prices:** Fast-rising prices often indicate that expectations of future house-price appreciation may be excessive.
  - Moderate: The Augmented Dickey-Fuller (ADF) test statistic stands above the critical threshold for at least one quarter during the past three years.
  - Low: Otherwise.
3. **Overvaluation:** House prices are higher than levels supported by personal disposable income, population, interest rates, and other fundamentals.
  - High: The average of the gaps obtained from a group of selected models is above the critical threshold for at least two quarters during the past year. The gap measures the distance between

<sup>6</sup> The data for Canada include areas beyond the 15 CMAs covered in this report.



the actual price and the price level estimated from fundamental variables of housing markets.

■ Moderate: At least one of the selected models exhibits overvaluation.

■ Low: Otherwise.

4. **Overbuilding:** Inventory of newly built and unsold housing units and/or rental apartment vacancy rate are higher than normal.

■ High: The inventory of newly completed and unsold units is above the threshold for at least two quarters during the past year, while the annual rental apartment vacancy rate is also above the threshold.

■ Moderate: Either the inventory of newly completed and unsold units is above the threshold for at least two quarters during the past year or the rental apartment vacancy rate is above the threshold.

■ Low: None of the previous conditions is present.

**Overall assessment:** Assess the degree of market vulnerability considering the combination of multiple factors.<sup>7</sup>

■ High: More than one factor of price acceleration, overvaluation or overbuilding exhibits moderate or strong evidence of imbalances.

■ Moderate: The rating reflects three scenarios. The first is when the overall assessment is red in the past six quarters. The second

is when only one of the factors of overbuilding or overvaluation is assessed red for at least two quarters during the past year.

The last is when one factor is showing moderate evidence of imbalances, but another factor lies slightly below the threshold.

■ Low: Otherwise.

The framework takes into account economic, financial and demographic determinants of the housing market such as personal disposable income, interest rates and population 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.

<sup>7</sup> The framework was tested against CMHC's mortgage insurance claims rate. The results show that the detection of more than one HMA factor is more problematic for insurance claims than the detection of just one factor. Therefore, the individual factors are jointly analysed to provide an overall assessment of the state of a given housing market, which is rated on our three-coloured scale (green, yellow, and red).

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