HOUSING MARKET INFORMATION

# HOUSING MARKET INSIGHT

## St John's CMA

CANADA MORTGAGE AND HOUSING CORPORATION

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*"Economic weakness and uncertainty has caused homebuyers to shift towards lower priced housing options and translated into increased sales at lower price points within the St. John's area housing market as well as a resurgence in multiple housing segment construction activity."*

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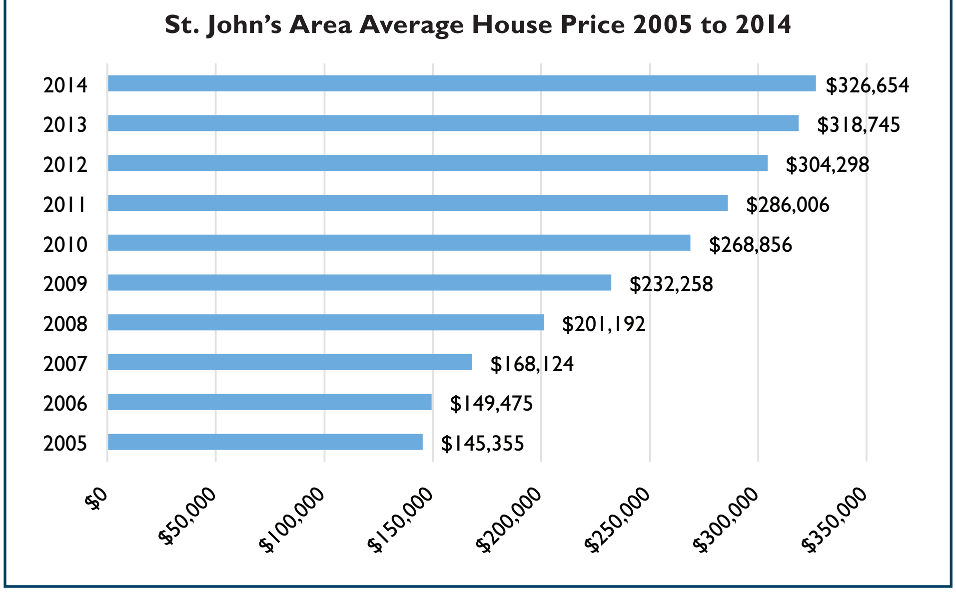
# Economic weakness and uncertainty drives shift to lower priced housing options

*The development of the offshore oil sector played a critical role in transforming the St. John's area economy and housing market since "first oil" in 1997. This economic transformation was most notable over the 2005 to 2014 period. Over this decade, approximately 25,000 full-time jobs were created throughout the St. John's area economy. Since mid-2014, however, the decline in oil prices and subsequently the economic landscape, has impacted the housing market quite negatively. The provincial government's oil royalties have taken a significant cut and this has created unique fiscal issues and budget related challenges in the province. This all has indeed hit the economy hard and in terms of housing market dynamics, resulted in considerably lower new home construction activity, lower existing home sales and lower house prices. In reaction to this unprecedented economic weakness and uncertainty, homebuyers have shifted towards lower priced housing options. This shift has translated into increased sales at lower price points within the market and a resurgence in multiple housing segment construction such as row, duplex and triplex. In light of current economic, demographic and housing market dynamics, this trend can be expected to continue in the coming years.*

## Lower oil price environment sustained much longer than expected

Unlike the decline in oil prices during the financial crisis of 2008/2009, the post-2014 decline has been driven by excess global supply. Oil prices have been down for much longer than expected relative to previous retractions and have not rebounded to levels many sector professionals expected. Current forward oil price contracts return to above $100 a barrel starting in late 2020, but some analysts argue that prices under the century mark could very well be the new reality.
Oil dependant Canadian provinces like Newfoundland and Labrador (NL), Saskatchewan and Alberta, continue to face difficult economic and fiscal challenges. At the same time, major oil exploration and production companies have been forced to get "leaner and meaner" in order to operate within this new realm of lower prices. This has meant fewer current jobs for longer-term opportunities and returns. On a positive note, this has saved many current and future projects within these three provinces that had been put on the shelf temporarily or even cancelled. In NL for example, momentum has been building in the oil sector recently with record commitments for offshore exploration, first oil from Hebron and the green light for construction of Husky Energy's White Rose West project in Placentia/Argentia, NL. Other Canadian provinces have not been impacted materially by lower oil prices and most have prospered as is evident by recent growth within the context of the broader Canadian economy.

Figure 1



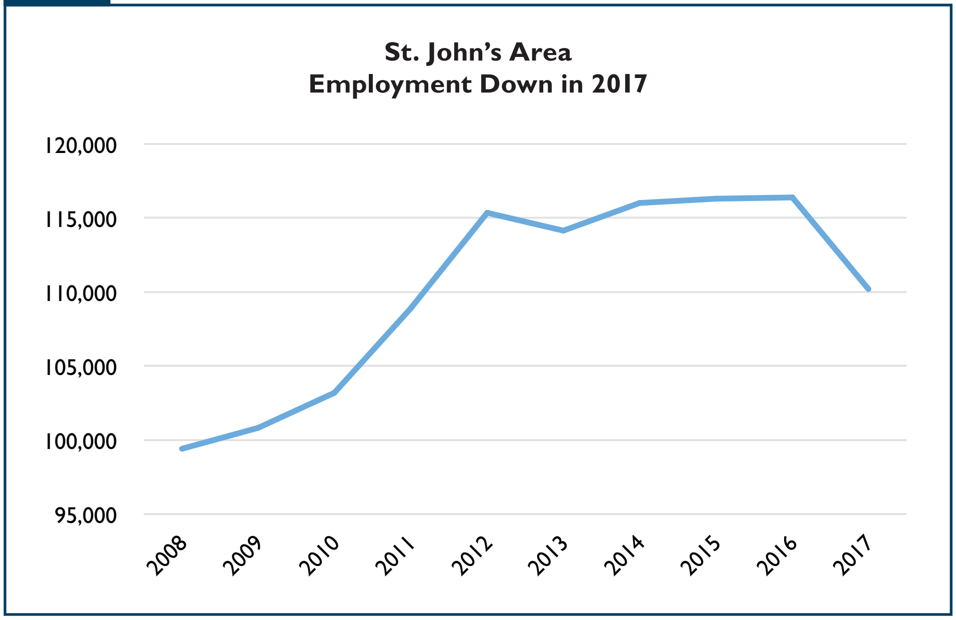

Source: CREA; NLAR.

## Local economy takes a hit

NL's economic situation improved dramatically since the first barrel of oil was produced offshore at Hibernia 20 years ago. Subsequent to this, the addition of two more major offshore oil projects; Terra Nova in 2002 and White Rose in 2005, set the stage for an historical economic transformation. The equalization changes negotiated in 2006/2007 provided additional revenue for the province, which stimulated economic growth and provided additional stimulus to the housing market. This unprecedented economic activity resulted in record provincial per capita GDP growth for NL and between 2005 and 2012 the St. John's area added almost 25,000 full time jobs. As a result, the housing market surged to new highs with robust sales and housing starts activity and double-digit house price growth in some years. This housing market activity, paired with record employment and income growth, translated into higher consumer and business confidence and increased retail trade throughout the St. John's region. At the same time, home owners' equity grew at a pace never experienced before and created enormous wealth and confidence for home owners.

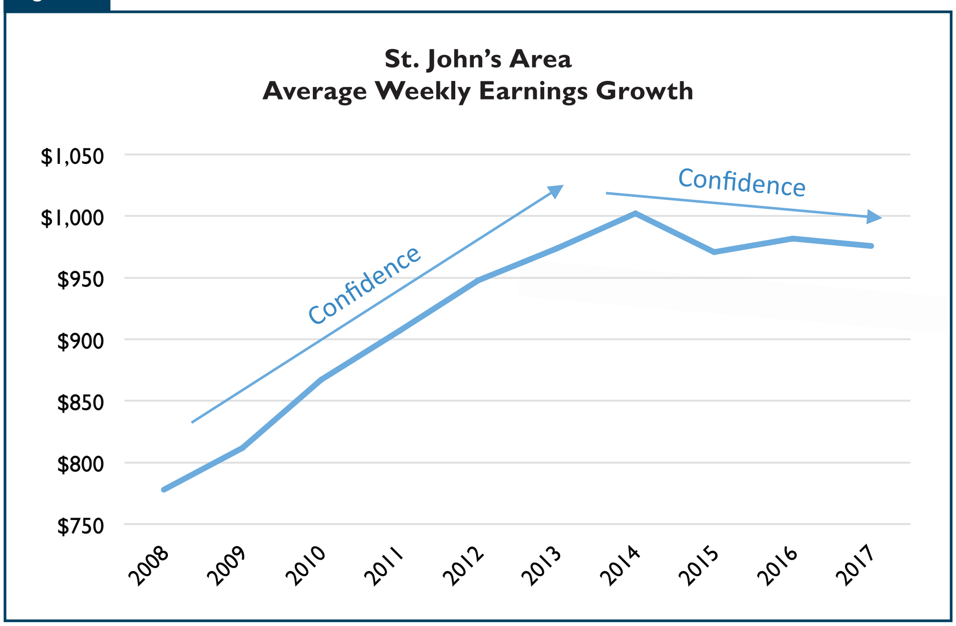
Since 2014, however, the local economy has been hit particularly hard. GDP growth has been negative, led by declines in the value of production within the oil sector. Employment has decreased in both oil and gas engineering construction and in oil and gas extraction support activities as well. Compounding NL's weaker relative economic performance are high paying job losses due to construction completion of the Vale Hydromet in Long Harbour and the massive Hebron offshore oil platform at the Nalcor fabrication site in Bull Arm. In fact, with flat to negative employment growth ongoing since 2012, labour market conditions weakened materially in 2017, with total employment down over 5% in the St. John's area. This occurred within a labour market already reeling by a lack of work for people who used to commute to western Canada for steady jobs as well as the loss of approximately 4,000 public administration jobs from 2013 to 2016. Looking forward, weaker employment relative to other non-oil producing regions of Canada will likely pressure income growth and force some people to seek employment opportunities outside the province. Furthermore, persistently low oil prices will undoubtedly continue to have negative implications for the local economy and government will remain pressed to find a balance among lower royalty revenues, lost employment tax revenues, higher expenditures and an aging population if the province is ever going to return to growth and prosperity.

Figure 2




Source: Statistics Canada Labour Force Survey.

Figure 3



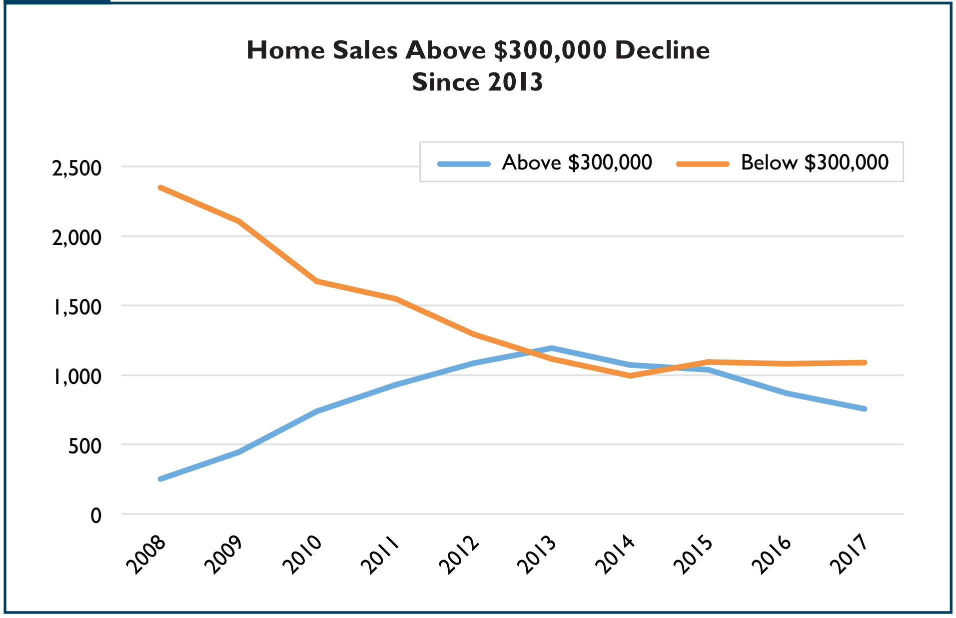

Source: Statistics Canada Labour Force Survey.

## General growth trend in housing market leading up to 2014

With a few exceptions along the way, the St. John's area housing market experienced a significant uptrend overall during the multi-year period prior to 2014. Even during the 2008/2009 financial crisis, the local housing market was one of only a few markets in Canada that fared relatively well. In fact, the city garnered attention from the New York Times as a result of what was happening here relative to the housing market malaise in the United States. Expansionary activity was boosted by the signing of the agreement for development of the Hebron offshore oil project, major oil field expansions and extensions at Terra Nova and White Rose, and significant provincial government surpluses. These surpluses resulted in sizable wage increases and hiring for public sector employees and significant spending on infrastructure needs throughout the province. With an abundance of notable announcements and positive news seemingly every other day, as expected, the housing market soared to new highs. Fundamentally, unprecedented housing demand during this period was driven by buoyant in-migration, notable increases in average weekly earnings and a solid labour market.

During this time, the average house price was driven higher by speculation, new development charges, lot size restrictions that favoured single-detached dwellings and the emergence of large upscale custom home construction ranging from $500,000 to $1,000,000. The end result was that both new and existing house prices doubled over this decade after having increased at a pace below the rate of inflation as well as below the Canadian long-term average trend prior. Additional housing activity came in the form of aggressive speculative single-detached new home building and selling by anyone who was willing and able to get involved. Accordingly, housing starts outpaced expected household formation and resulted in a thirty three year high for total housing starts in 2008 and a record for single-detached starts. As the economic transformation continued, total housing starts activity continued to increase up to a 2012 peak of 2,153 after which demand began to decline.

Figure 4




Source: CREA; NLAR.

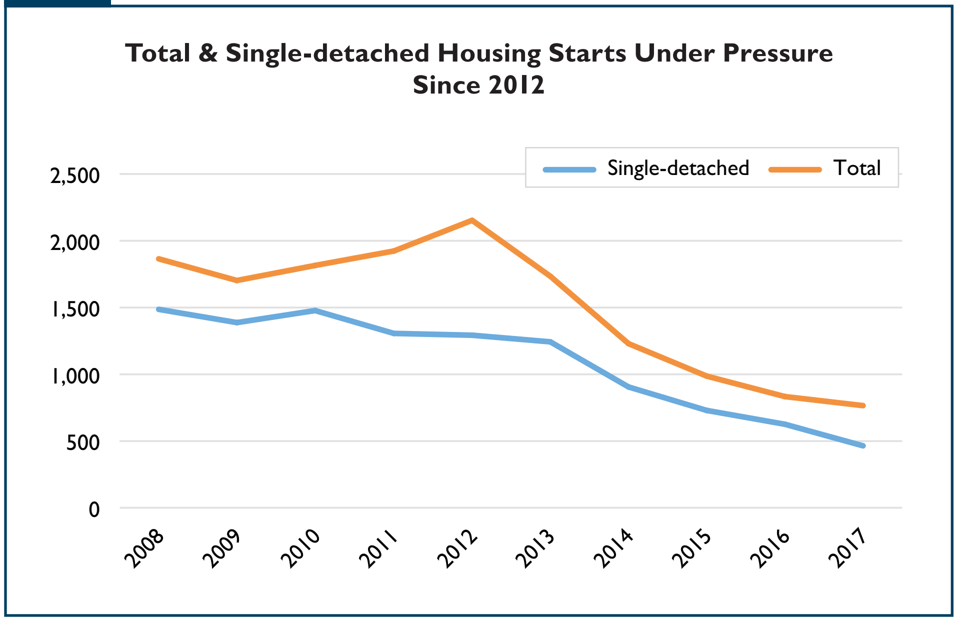
## Identifiable shifts in housing market in recent years

It is evident that the current downturn in the economic cycle has had a negative impact on housing market activity and the resulting move to lower priced housing options. Whether it be existing homes or newly built homes, there have been identifiable shifts in current housing trends. One trend in particular, has been the shift away from higher priced homes above $300,000 which have been declining, to homes below $300,000 where activity has remained relatively stable. From a new home construction perspective, this shift has resulted in increased construction levels of higher density multiple offerings such as row, duplex and triplex products below $300,000. This, in turn, has also led to lower basement apartment construction activity within single-detached homes. They have typically been included in many newly built homes in past years to help with the mortgage of these more expensive homes of which sales have been declining. This can also be tied to weaker economic activity and lower rental demand resulting in higher vacancy rates for basement apartments overall. Although it is expected to continue, it remains to be seen how this trend toward lower price segments will shape future development within the local housing market.

Market analysis and insight indicates the St. John's area housing market has continued to follow the economic decline over the last three years relatively closely. This has been presented in the form of a 60% plus retrenchment in new home construction activity since 2012, as well as lower home sales and prices across all segments of the market. In fact, sales above $300,000 have been declining rapidly since 2013. The province's fiscal situation has hit consumer confidence very negatively, with many potential home buyers choosing to hold-off on their intentions to build or buy a home out of fear of being under water on their future property value. Prices have trended lower since 2014, but the pace of decline slowed somewhat in 2017, particularly during the second half of the year, with the average MLS® house price down only 1.2% to $303,713 in the St. John's region.

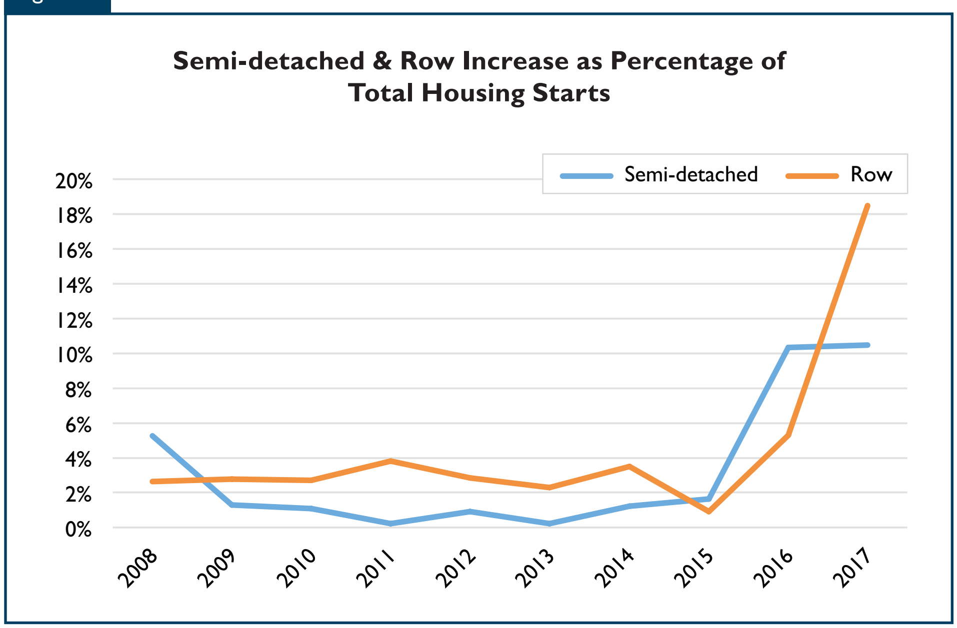
On a positive note, the majority of households in the St. John's area have not overreacted to market pressures and rushed out to list their homes for sale out of fear of anticipated price declines and erosion of their equity. Certainly there have been homeowners and investors who have been forced to exit the housing market due to a loss of employment and this has resulted in increased numbers of distressed home sales. The biggest price declines occurred in 2015/2016, which indicates that more people chose to sell or were forced out of their homes shortly after the economic downturn began. That being said, with average house prices trending down about 10% from their 2014 peak, many potential sellers not affected by employment losses have decided to hold off on listing their

Figure 5




Source: CMHC.

Figure 6




Source: CMHC.

homes for sale and this has boded well for existing home inventory levels which were down 2.3% in 2017.

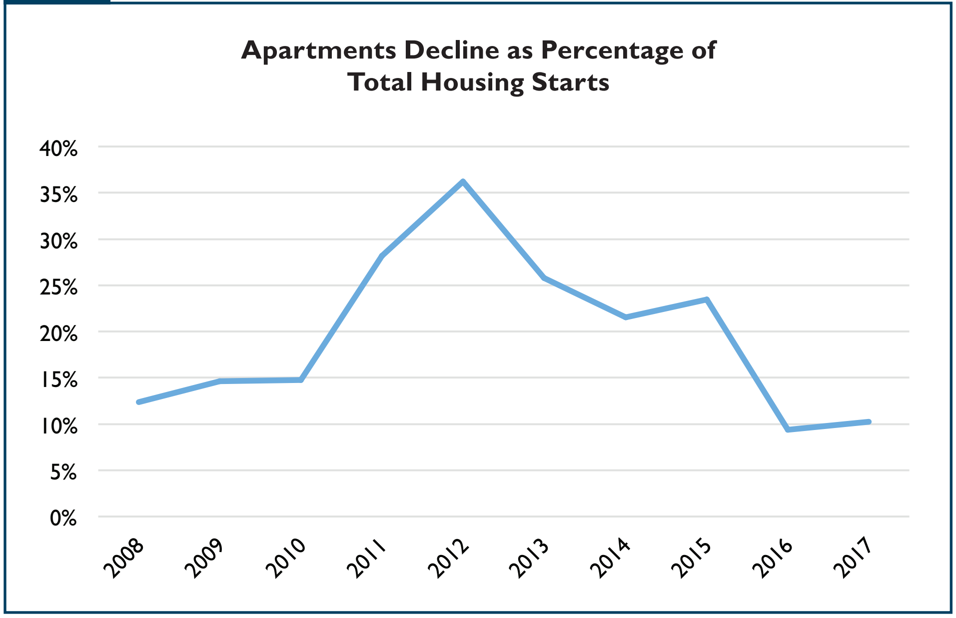
In hindsight, the start of the 2014 oil price decline paired with an already weakening economy, drove demand for new homes down considerably from 2015 to 2017. New home Inventory levels remained persistently high after 2014 because building activity continued to follow longer-term business plans that did not have the ability to switch gears quickly in reaction to the economic shift that was occurring. In fact, inventory levels did not begin to decline materially until 2016. Many builders were already carrying high inventory levels of completed homes prior to the market slowdown, so some were forced to sell at or below cost in order to free up their capital. Nimble builders who reacted quickly and those well in tune with the broader housing market dynamics, however, shifted their focus to lower price point multiple unit construction, where demand opportunities still exist.

Overall, new home demand remains very low with total housing starts activity at multi year lows in 2017, but market insights show demand still exists for products at lower price points. The most interesting trend has been the shift away from larger single-detached homes to the multiple segment, particularly the increase in semi-detached and row housing starts as a percentage of total housing starts since 2015. This shift in demand has been driven by both price and choice, mainly by millennials and first time-buyers looking for more affordable options, as well as retirees downsizing. In prior years semi-detached starts represented less than two percent of total starts on average, while row represented less than three percent. However, in 2016 and 2017, semi-detached starts surged in reaction to market demand and accounted for 10.3% and 10.5% of total starts, respectively, with row starts accounting for 5.3% and a notable 18.5%, respectively. These numbers represent ten-year highs for semi-detached and record highs for row starts.

Also of note is that at 60.8% of total starts, single-detached housing starts are back to build levels of the 1990's. This is in line with increased market activity targeted at price points below the average MLS® price of approximately $300,000. In fact, some newly constructed semi-detached triplex units were offered as low as $230,000 in the St. John's area in early 2017, with the average price for these units around $250,000. Standard new semi-detached duplexes are averaging in the range of $250,000 to $295,000 depending on location and amenities such as higher quality finishing and in-house garages. At under $300,000, demand for these products has been very brisk, particularly among first-time buyers and singles. In light of current housing market dynamics and economic and demographic factors, it is likely the newly emerged trend away from single-detached housing towards multiple housing segment offerings will continue.

One very unique segment of the St. John's area housing market historically has been the basement apartment or accessory suite. They have typically been included in past years to help with the mortgage carrying costs associated with more expensive detached homes, particularly among first-time buyers. As house prices climbed rapidly after 2007 throughout the St. John's area, so too did the number of newly built single-detached homes with basement apartments, which peaked at a record high in 2012. A secondary source of demand for two-apartment detached homes during this time came in the form of property investors and speculators. They were able to purchase these homes and rent out both the main floor unit and the basement apartment unit at rental rates that covered their entire monthly and annual carrying cost on their investment. Declining new home sales, rising construction costs and increased construction of higher density multiple offerings, however, has led to much lower basement apartment construction recently. This can also be tied to weaker economic activity in general, which has translated into lower rental demand and rents resulting in higher vacancy rates for basement apartments and thus, fewer of them being added to new homes.

Figure 7




Source: CMHC.

## Conclusion

Change is inevitable and there is no doubting the fact that the local economy and housing market have both been privy to a lot of change historically and perhaps no more so than in recent years. "What goes up must come down" as the saying goes. As presented throughout this analysis and discussion, the oil driven economic cycles of the past and present have steered local housing market activity in very different directions during very different times and turns at historically quick paces. The most recent being the shift in demand to lower priced housing options. Whether it be existing homes or newly built homes, there have been clear trends at play. Many housing market stakeholders refer to it as normal housing market cycles and while single-detached and total housing starts have suffered materially during the current cycle, higher density multiple segment housing offerings have emerged with strength. Current conditions reinforce that in light of weaker economic growth and the obvious demographic factors at play, demand will likely continue to shift from traditional single-detached homes to other lower cost options, particularly among millennials, first-time home buyers, singles and retirees. With all change comes opportunity and the current trend towards lower priced housing options during uncertain and challenging economic times will remain an opportunity and shape future development within the St. John's area housing market accordingly.

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