

HOUSING MARKET ASSESSMENT

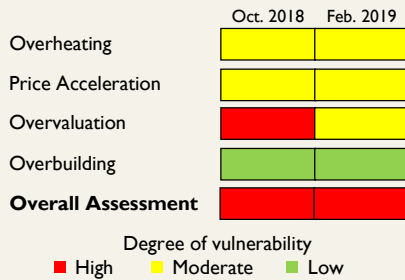
Greater Toronto Area

Date Released: First Quarter 2019



Highlights

Results Overview Toronto CMA



- Recent results from the Housing Market Assessment indicated a high degree of market vulnerability in the Toronto CMA¹ housing market.
- Overheating and price acceleration assessments are maintained while continued strong demographic and economic factors coupled with moderate price growth has resulted in the evidence of overvaluation being changed from high to moderate.
- We continue to detect weak evidence of overbuilding, as the number of completed and unsold units remains low.

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 and contribute to an orderly adjustment of housing market imbalances.

The HMA is an analytical framework that provides a comprehensive view of housing market vulnerabilities. It should be noted that it intends to identify short-term imbalances in the housing market. As such, it is not aimed at being a framework to identify long-term fundamental affordability challenges. It considers 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 fundamentals³. Overbuilding is flagged when the rental apartment vacancy rate and/or inventory of newly built and unsold housing units are higher than normal.

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.

Colour codes indicate the degree of market vulnerability. The HMA is a comprehensive framework that considers both the intensity (magnitude) and the persistence of signals of imbalances. 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 higher.

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¹ Results are based on data as of the end of September 2018 (the annual rental apartment vacancy rates are from October 2018) and local market intelligence up to the end of December 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](#).

³ Other fundamental factors include mortgage-borrowing capacity of households, required minimum down payment, and labor productivity.

In Detail

Overheating

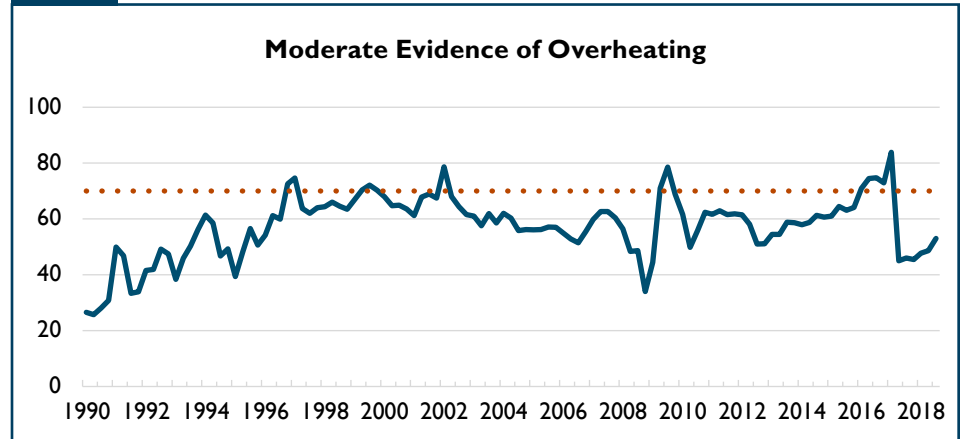
The signal for overheating was maintained in Q3 2018 from the previous quarter. Following relatively cooler market conditions in the first half of 2018, seasonally adjusted sales and new listings trended higher in the third quarter as a strong labour market, signs of stabilizing home prices and more listings choice encouraged some buyers to enter the market. The growth in sales outpaced that of new listings, which resulted in a higher sales-to-new listings ratio (SNLR) of 53.0%. While market activity picked up, the SNLR in Q3 2018 was still well below the threshold of 70% set to signal market overheating. However, the yellow (moderate) rating was maintained because the ratio was above the threshold for at least two quarters over the past three years (see Figure 1). The condominium apartment market remained the most active during this period, with a seasonally adjusted SNLR of 61.3%, driven by a further shift in demand towards these relatively affordable units. While the City of Toronto boasted the highest SNLR within the GTA, the Halton and Durham regions saw a significant boost in market activity compared to the previous quarter. York Region,



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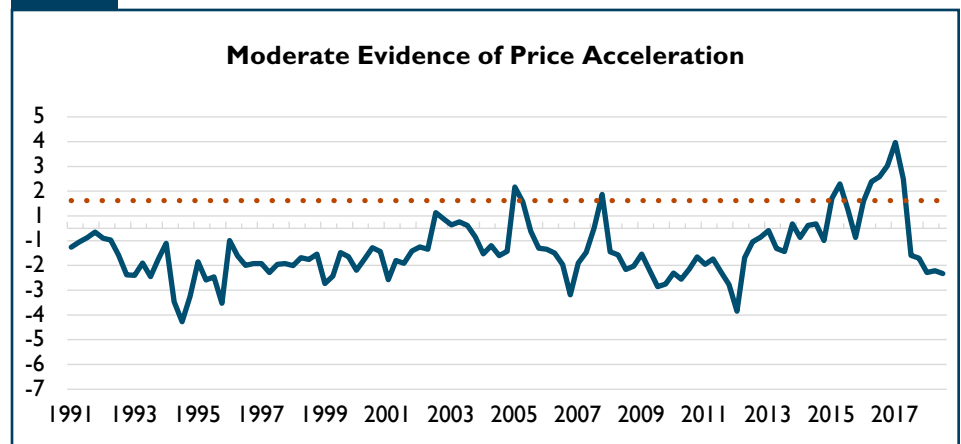
"We continue to detect a high degree of market vulnerability in the Toronto CMA housing market"

Figure 1



Sources: CREA and calculations by CMHC
Last data point: 2018Q3

Figure 2



Sources: CREA and calculations by CMHC
Last data point: 2018Q3

which typically boasts greater market activity in low rise homes, had the lowest SNLR during Q3 2018 in the GTA, as a result of softening demand for higher priced single-detached homes.

Housing market activity trended slightly lower in Q4 2018, with both seasonally adjusted sales and new listings moving lower. The decline in sales outpaced that of new listings, which pulled down the seasonally adjusted SNLR to 50.0%. The condominium apartment remained tight, with a seasonally adjusted SNLR of 62.8%.

Price Acceleration

The signal for price acceleration was maintained in Q3 2018. The seasonally adjusted average MLS® price grew significantly (4.85%) from the previous quarter and was the most growth observed in a quarter since Q1 2017 (9.13%). This price growth was primarily driven by multi-unit homes such as condominium apartments and townhouses. Housing market conditions for condominium apartments remained tight, resulting in stronger price growth for this housing type. All GTA regions, besides York, saw significant price growth in Q3 2018.

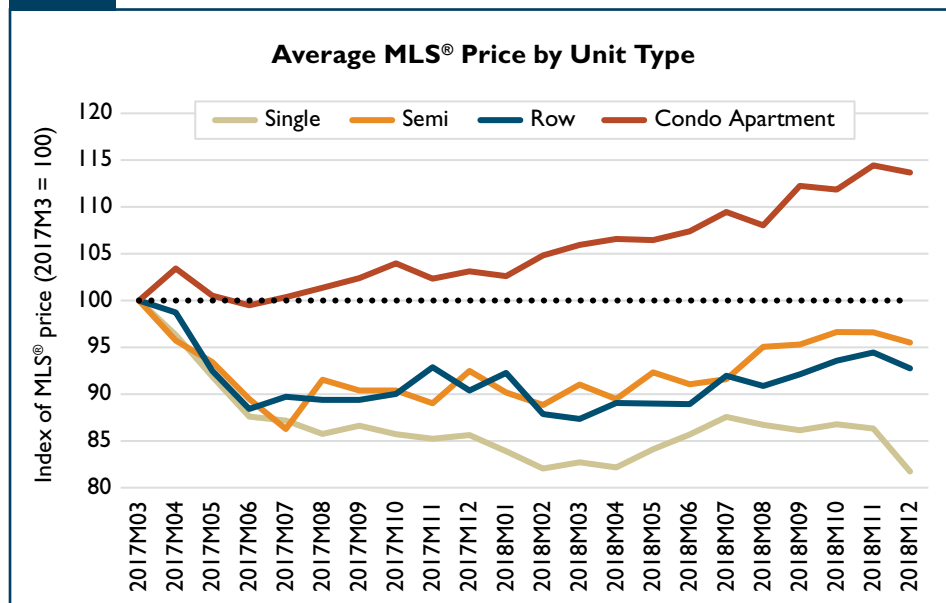
Price growth in Halton and Peel regions surpassed the City of Toronto with 4.0% and 5.9% growth in average prices respectively. These regions boasted a higher composition of multi-family homes, specifically townhomes and semi-detached homes, which had higher average prices than the condominium apartments sold in the City of Toronto.

In Q4 2018, price growth was relatively stagnant following the previously strong quarter, with the average seasonally adjusted MLS® price declining by 0.2%. Price growth in this period continued to be largely influenced by affordability considerations, with lower priced condominium apartments seeing continued price recovery on a seasonally adjusted basis, while price growth for single-detached homes remained flat (See Figure 3).

Overvaluation

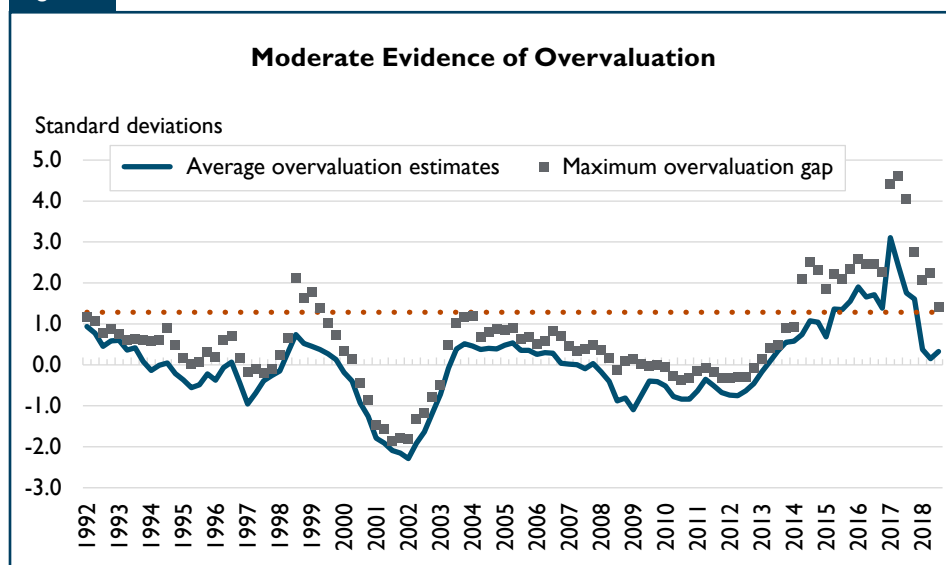
The evidence of overvaluation changed from high to moderate due to the average gap between actual house prices and price levels predicted by the fundamentals remaining below the threshold over the past three quarters. Year-over-year growth in the real MLS® average house price and real personal disposable income was modest (+0.85%) in Q3 2018 and was outpaced by economic and demographic factors, such as full-time employment and the young-adult population (which grew by 3.68%).

Figure 3



Sources: TREB and calculations by CMHC

Figure 4

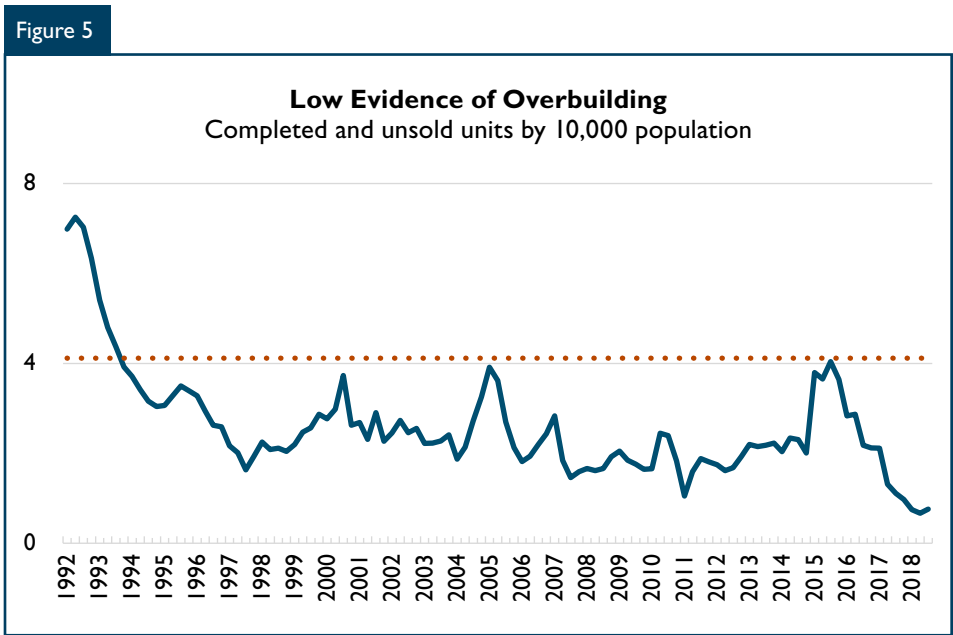


Sources: CREA, Statistics Canada and calculations by CMHC

Note: The average estimate of overvaluation is the average gap between actual house prices and price levels estimated from a group of selected models. Baseline models 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 1.29 for a confidence level of 80%. Overvaluation is signaled when overvaluation estimates lie above the threshold.

Overbuilding

Low evidence of overbuilding remains as the inventory of completed and unsold units per 10,000 individuals (0.76) remained well below the threshold (1.42). Rising prices of low rise homes prompted a shift in demand for lower priced condominium apartments throughout 2018 and resulted in lower inventories of completed and unoccupied condominium units. Ultra-low vacancy rates in primary and secondary rental markets prevailing throughout 2018 meant higher demand among investors for new condominium units and added to the supply crunch.



Sources: Statistics Canada and CMHC
Last data point: 2018Q3

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. 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 in the existing home market; (2) sustained acceleration in house prices meaning that the rate of increase in prices is itself increasing; (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 the intensity (magnitude) and the persistence of signals. 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 number, intensity, 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 recent 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 in the resale market. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions. 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.

Acceleration in House Prices

House price acceleration occurs when the growth rate in house prices continuously increases. Acceleration in house prices over an extended period would

lead prices to unsustainable levels, hence increasing housing market vulnerability. To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating growth in 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—based on economic theory—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 apartment vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current levels and recent trends in these indicators with thresholds.

Note 1: 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.

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: 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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