

# HOUSING MARKET ASSESSMENT

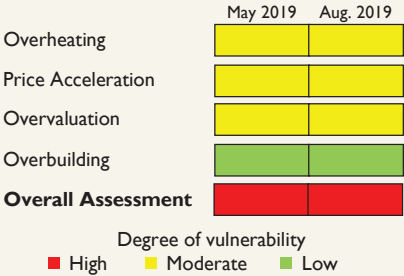
Greater Toronto Area

Date Released: Third Quarter 2019



# Highlights

## Results Overview Toronto CMA



- Recent results from the Housing Market Assessment continue to indicate a high degree of market vulnerability in the Toronto CMA housing market.
- We continue to detect moderate evidence of overvaluation, overheating and price acceleration despite market conditions easing.
- We continue to detect weak evidence of overbuilding, as the number of completed and unsold units remains low.

## HMA Overview<sup>2</sup>

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 imbalances in the housing market; 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 fundamentals<sup>3</sup>. Overbuilding is flagged when the rental apartment vacancy rate and/or inventory of newly built and unsold housing units are significantly above normal levels.

The HMA combines the results from a technical framework with insights gained through CMHC’s market

analysts’ knowledge of local market conditions. These insights allow 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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<sup>1</sup> Results are based on data as of the end of March 2019 (the annual rental apartment vacancy rates are from October 2018) and market intelligence up to the end of June 2019.

<sup>2</sup> A detailed description of the framework is available in the appendix of the [National edition](#).

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

## In Detail

### Overheating

We continued to detect moderate evidence of overheating in 2019Q1. Seasonally adjusted sales and new listings continued to trend lower in 2019Q1. The decline in new listings outpaced that of sales, which resulted in a higher sales-to-new listings ratio (SNLR) of 52.5% compared to the previous quarter. Despite rising, the SNLR in 2019Q1 is well below the threshold of 70% set to signal market overheating. However, the yellow (moderate) rating is 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 more active during 2019Q1 with a seasonally adjusted SNLR of 60.6%, and was driven by a further shift in demand towards relatively affordable units. Housing market conditions in the City of Toronto and Peel and Halton regions were balanced with seasonally adjusted SNLRs ranging between 50 and 55%. On the other hand, home buying activity in York Region, which typically boasts greater transactions of higher priced low rise homes for which demand has softened recently, remained low

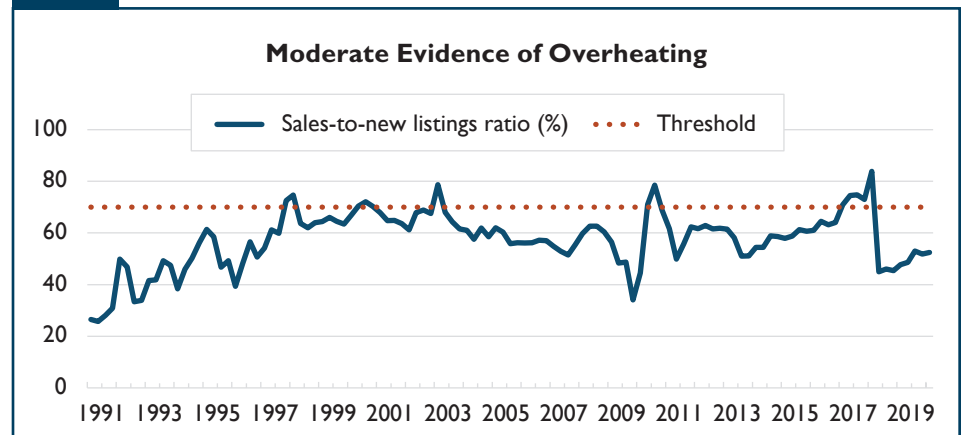
(SNLR of 36.3%). Additionally, the York Region saw stronger price growth over the 2015 to 2017 period, and as a result the current adjustment to relatively more balanced market conditions and sustainable activity is more pronounced in this region<sup>4</sup>.

Housing market activity picked up in 2019Q2 as seasonally adjusted sales grew by 10.3% while new listings remained relatively unchanged, which drove the seasonally adjusted SNLR up to 55.5%. Notably, the SNLR for condominium apartments grew substantially to 67.1%, edging closer towards the overheating threshold.

### Price Acceleration

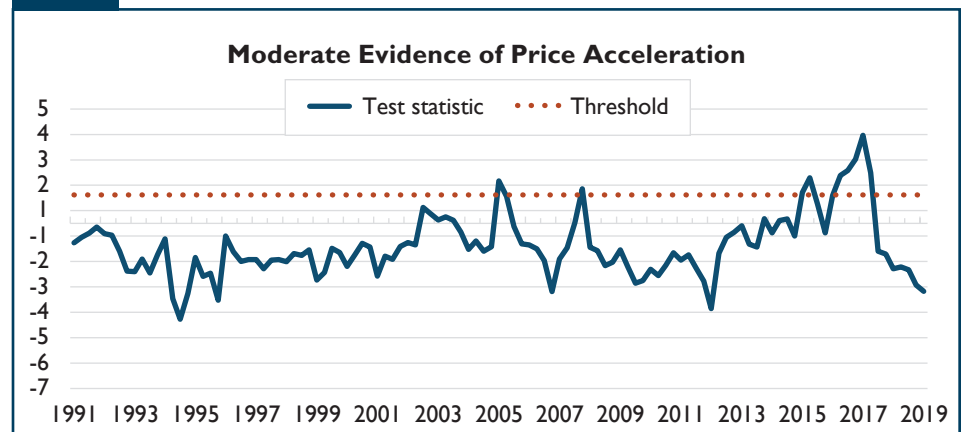
We continued to detect moderate evidence of price acceleration in 2019Q1. The seasonally adjusted average MLS® price declined by 4.1% in 2019Q1. All units saw price declines during this period, the largest being in single-detached and row homes (5% and 4% respectively). The test statistic for price acceleration remained well below the threshold (See Figure 2). However, this threshold was recently surpassed back in Q2 2017, and in order for us to discount any evidence of price acceleration, the GTA would have to experience moderate price growth for a longer period of time<sup>5</sup>.

Figure 1



Sources: CREA and calculations by CMHC  
Last data point: 2019Q1

Figure 2



Sources: CREA and calculations by CMHC  
Last data point: 2019Q1



**Dana Senagama**  
Principal Market  
Analyst (GTA)

*"While the average house price growth has eased and more balanced conditions exist in the resale home market, our overall assessment continues to detect a high degree of vulnerability in the Toronto CMA housing market."*

<sup>4</sup> See the CMHC report entitled Examining Escalating House Prices in Large Canadian Metropolitan Centres for more details.

<sup>5</sup> Specifically, when the test statistic for price acceleration rises above the problematic threshold in any quarter (see Figure 2) the signal is maintained for 3 years.

In 2019Q2, the average seasonally adjusted MLS® price grew by 3.0% from the previous quarter. Stronger market activity across the board has resulted in seasonally adjusted MLS® prices rising for all unit types during this period (See Figure 3).

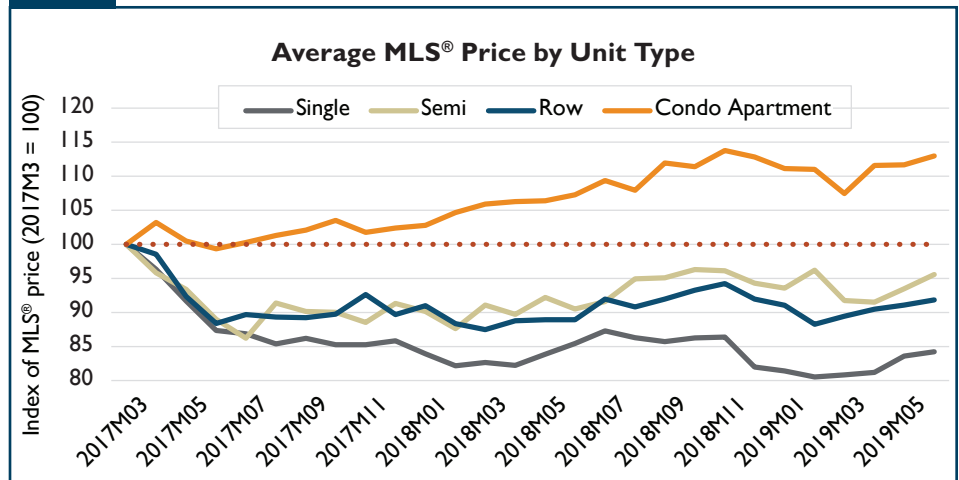
## Overvaluation

We continued to detect moderate evidence of overvaluation in the Toronto CMA during 2019Q1. The average of the gaps between actual house prices and price levels predicted by the fundamentals remained below the threshold set to signify overvaluation in 2019Q1. However, the intensity and the persistence of these signals would have to be stronger to warrant a change in the rating. The real MLS® average house price decreased by 0.50% in 2019Q1 from the same time period a year earlier, while growth in real disposable income edged lower by 0.63% and the young adult population (25-34 years) increased by 3.69%.

## Overbuilding

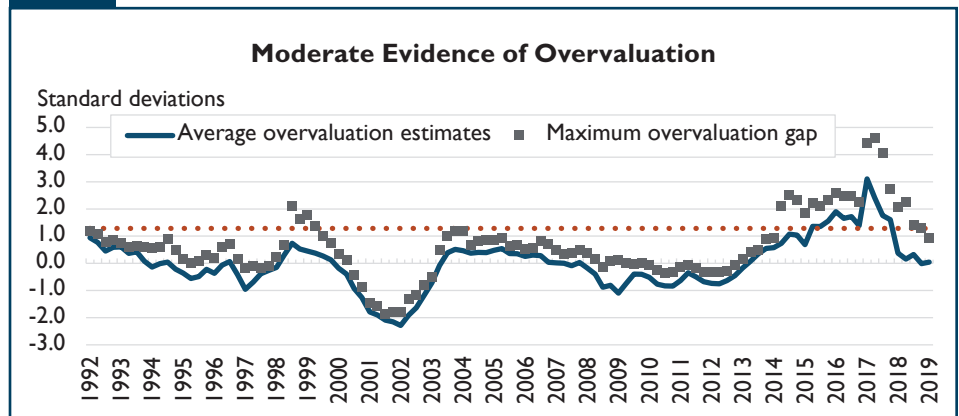
A low degree of vulnerability continues to be detected in overbuilding with the inventory of completed and unsold units per 10,000 population staying low (0.85) in 2019Q1 while edging up slightly from the previous quarter but remaining well below the threshold (4.11). Demand for lower priced multi-unit housing types such as condominium apartments continued to be strong thus resulting in fewer units remaining unsold upon completion.

Figure 3



Sources: TREB and CMHC Calculations  
Last data point: 2019M06

Figure 4

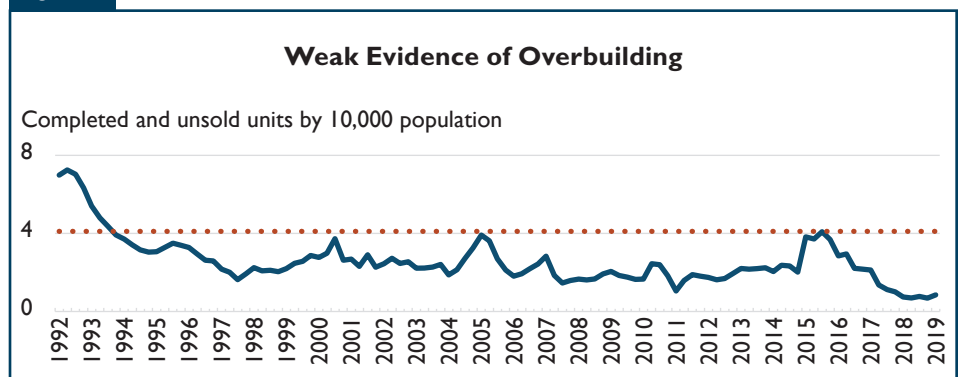


Sources: CREA, Statistics Canada and calculations by CMHC

Last data point: 2019Q1

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.

Figure 5



Sources: Statistics Canada and CMHC  
Last data point: 2019Q1

## 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 each assessed with a single indicator. Colour scales for these factors vary between green and yellow only. Overvaluation and overbuilding are assessed with 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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