HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

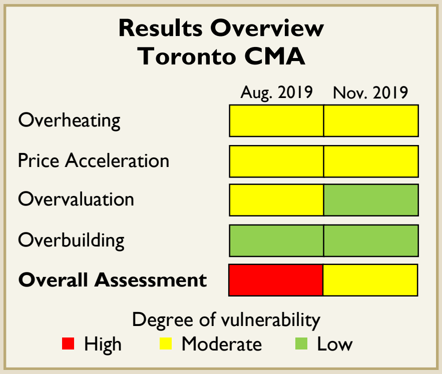
Greater Toronto Area

Date Released: Fourth Quarter 2019

Canada

CMHC SCHL

Highlights



- Recent results from the Housing Market Assessment (HMA) indicated a moderate degree of market vulnerability in the Toronto CMA housing market.[1]
- Overheating and price acceleration assessments are maintained however declining prices alongside growing incomes and population since early 2017 resulted in easing of overvaluation conditions.
- We continued to detect low evidence overbuilding, as the number of completed and unsold units remained low.

HMA Overview[2]

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[3]. 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.

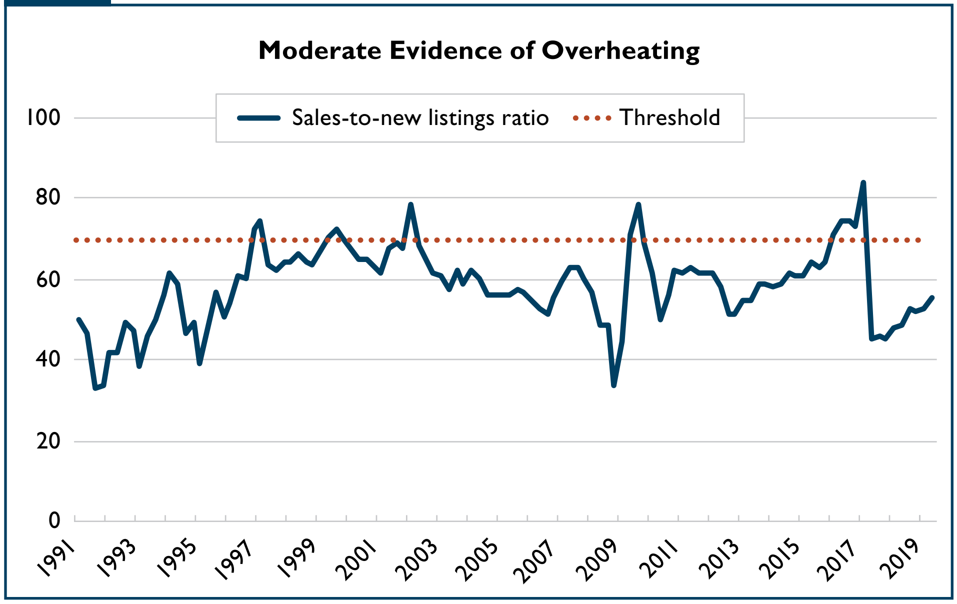
1 Results are based on data as of the end of June 2019 (the annual rental apartment vacancy rates are from October 2018) and local market intelligence up to the end of September 2019.

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

Figure 1



Sources: CREA and calculations (threshold) by CMHC
Last data point: 2019Q2

Overheating

We continued to detect moderate evidence of overheating in 2019Q2. Seasonally adjusted sales and new listings both grew substantially from the previous quarter. The growth in sales nearly doubled that of new listings, which resulted in a higher sales-to-new listings ratio (SNLR) of 55.5%. Despite rising, the SNLR in 2019Q2 is well below the threshold of 70% set to signal market overheating. However, we maintained the yellow (moderate) rating as the ratio was above the threshold for at least two quarters over the past three years (see Figure 1). Multi-unit housing saw the largest increase in market activity, driven by a further shift in demand towards relatively affordable higher-density units. Specifically, the seasonally adjusted SNLRs for semi-detached (73.3%), row (69.6%), and condominium apartments (67.2%) were at or near the threshold set to signal market overheating (70%). The City of Toronto, Peel, Halton and Durham Regions remained relatively active with seasonally adjusted SNLRs ranging between 55% and 60%. Housing market activity in the York Region remained low compared to the rest of the GTA, which has been the case recently as this region typically boasts greater market activity in higher priced single-detached homes, for which demand has softened. However, York Region saw its seasonally adjusted SNLR rise above 40% for the first time since 2017Q1 to 43.9%, indicating a transition from a buyer's market to a more balanced market.

Housing market activity continued to rise in 2019Q3. Seasonally adjusted sales saw significant growth (12.3%), outpacing that of new listings (3.7%), pushing the seasonally adjusted SNLR up to 60.2%. Housing market activity for semi-detached, row, and condominium apartment units remained high, with seasonally adjusted SNLRs near or at the threshold set to signal overheating (70%).

Dana Senagama
Principal Market
Analyst, GTA

"Imbalances continued to persist in price acceleration and overheating while overvaluation eased."

Price Acceleration

We continued to detect moderate evidence of price acceleration in 2019Q2. The seasonally adjusted average MLS® price grew by 3.3% in 2019Q2, relative to the previous quarter. Prices grew at a relatively similar rate across unit types. The City of Toronto saw the largest growth in seasonally adjusted prices at 4.4%, followed by Halton (2.7%), Durham (2.5%), Peel (1.4%), and York (0.1%). The test statistic for price acceleration remained well below the threshold set for price acceleration (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.[4]

[4] 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 2019Q3, the average seasonally adjusted MLS® price grew by 5.6% from the previous quarter. Higher market activity across the board resulted in seasonally adjusted MLS® prices seeing significant growth for all unit types during this period (See Figure 3).

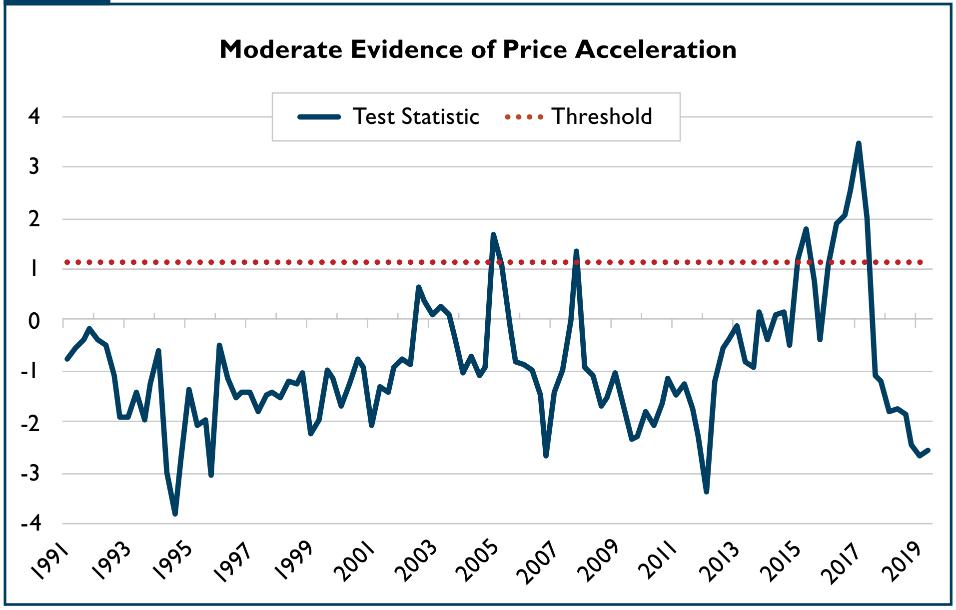
Overvaluation

The average of the gaps between actual house prices and price levels predicted by housing market fundamentals continued to remain below the threshold set to signify overvaluation in 2019Q2 resulting in low evidence of overvaluation. Overvaluation was easing for nearly a year. The real MLS® average house price edged up by 0.79% in 2019Q2 from the same time period a year earlier, while growth in real disposable income edged up by 0.50% and the young adult population (25-34 years) increased by 3.70%.

Overbuilding

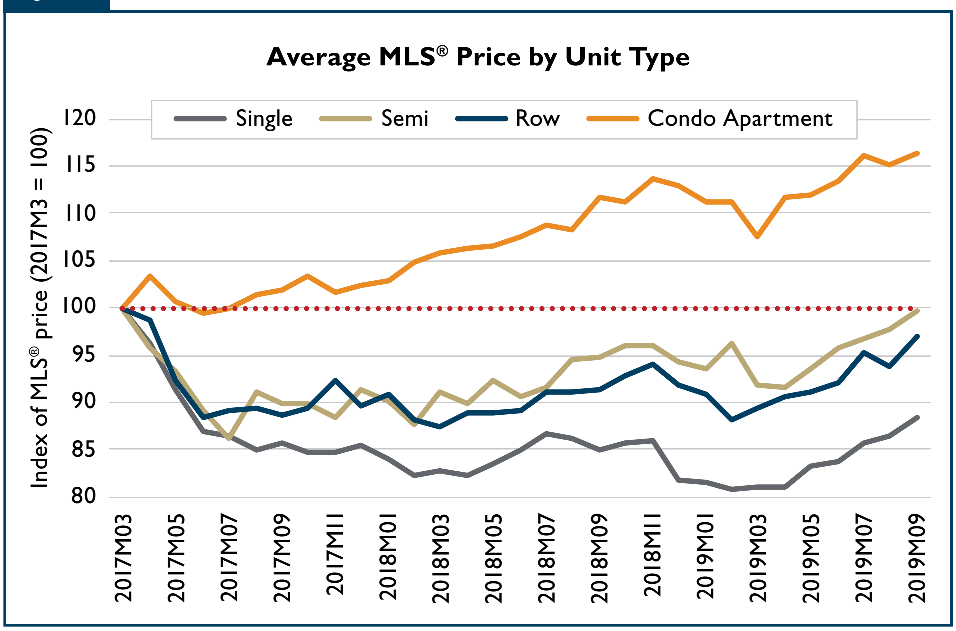
We continue to detect a low degree of vulnerability in overbuilding. While the inventory of completed and unsold units per 10,000 population edged up slightly from the previous quarter to 1.27, it remains well below the overbuilding threshold (4.10). Low inventories are a result of demand for high-rise units from end-users (wanting affordable home buying options) and investors (looking to rent in a tight rental market) with fewer units remaining unsold upon completion.

Figure 2



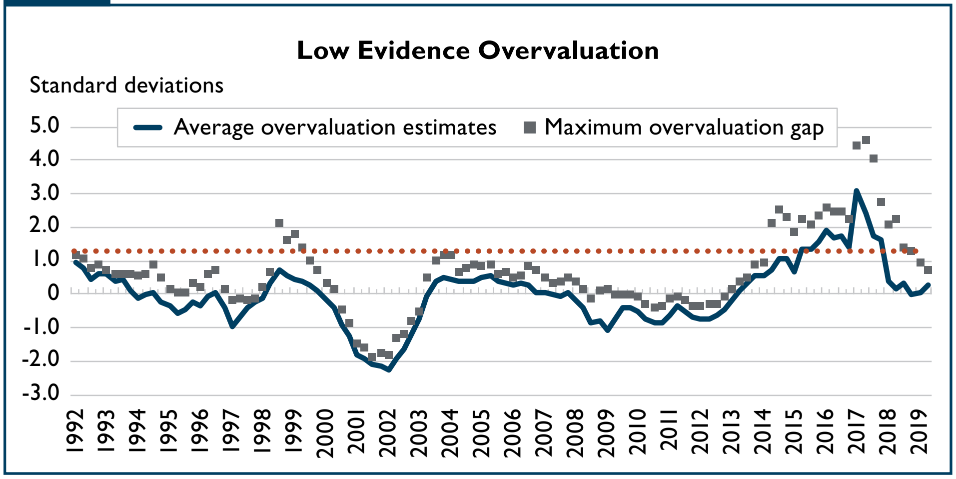
Sources: CREA and calculations (threshold) by CMHC
Last data point: 2019Q2

Figure 3



Sources: TREB and CMHC Calculations
Last data point: 2019M09

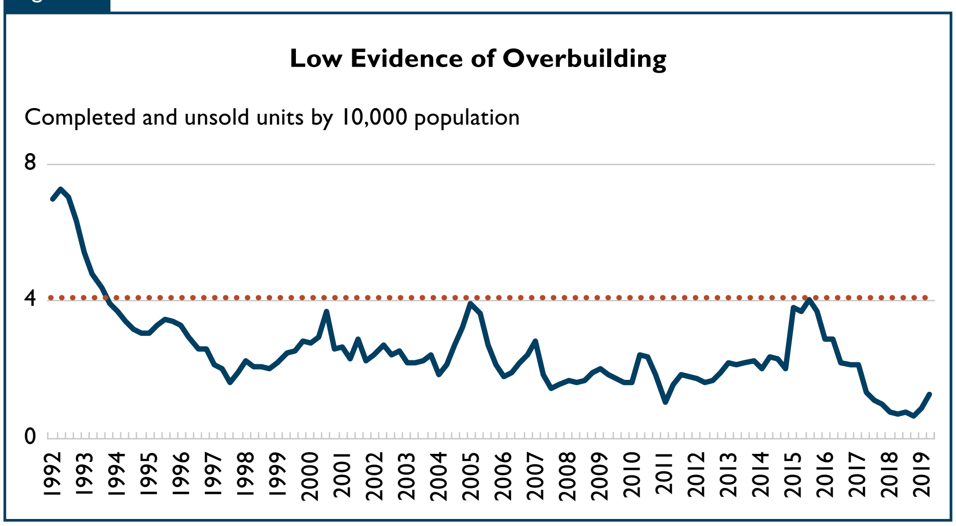
Figure 4



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 (as of the fourth quarter of 2019, there are five models in total), each of which is estimated using four measures of house prices to generate twenty unique estimates of overvaluation. The selection of models is conducted with a set of cointegration tests, and the selected models are estimated with Dynamic Seemingly Unrelated Regression (DSUR). 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 5



Sources: TREB and calculations by CMHC

Last data point: 2019Q2

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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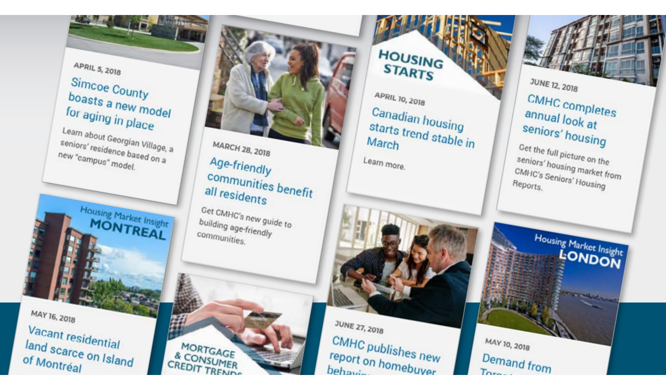

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