

# HOUSING MARKET ASSESSMENT











Victoria CMA

Date Released: Second Quarter 2019



## Highlights

### Results Overview Victoria CMA

|                           | Feb. 2019   | May 2019  |
|---------------------------|---|---|
| Overheating               |  |  |
| Price Acceleration        |  |  |
| Overvaluation             |  |  |
| Overbuilding              |  |  |
| <b>Overall Assessment</b> |  |  |

Degree of vulnerability  
■ High ■ Moderate ■ Low

- The HMA framework maintained a high degree of housing market vulnerability in Metro Victoria<sup>1</sup>.
- The overvaluation rating was maintained as moderate as the average of all overvaluation models remained below the overvaluation threshold.
- A decline in new listings moved the sales-to-new-listings-ratio (SNLR) upward in the fourth quarter reversing prior growth in available homes for sale, however the SNLR remained below the threshold for overheating.
- Completed and unsold inventory of single and semi-detached units continued to climb, but total inventory remained well below the threshold for overbuilding. Vacancy rates remained below threshold, as well, despite an uptick in 2018 as new supply entered the market.

## 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 December 2018 (the annual rental apartment vacancy rates are from October 2018) and local market intelligence up to the end of March 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

The rating for overheating was maintained in the fourth quarter of 2018. The sales-to-new-listings ratio (SNLR) was 60%, which is below the threshold of 80%. The rating is maintained due to the persistence rule of the SNLR having exceeded the threshold for at least 2 quarters in the past 3 years. Under the HMA framework’s persistence rule for Overheating, the rating will be maintained until this condition is no longer true. The last two observations of overheating were observed in the third quarter of 2016 and the first quarter of 2017.

The SNLR gained about 2% from the previous quarter. Both sales and new listings declined in the Q4 2018, however new listings declined at a greater rate. As of Q4 2018, the trend in total sales was 62% below a peak reached in 2016 Q1, which was the first time the overheating indicator was triggered. Single detached units drove the decline in new listings through 2018, causing the active listings of single detached units to

decline despite falling sales. A pullback in new listings like the one observed in 2018 was last seen in the mid 1990’s, a period with flat price growth.

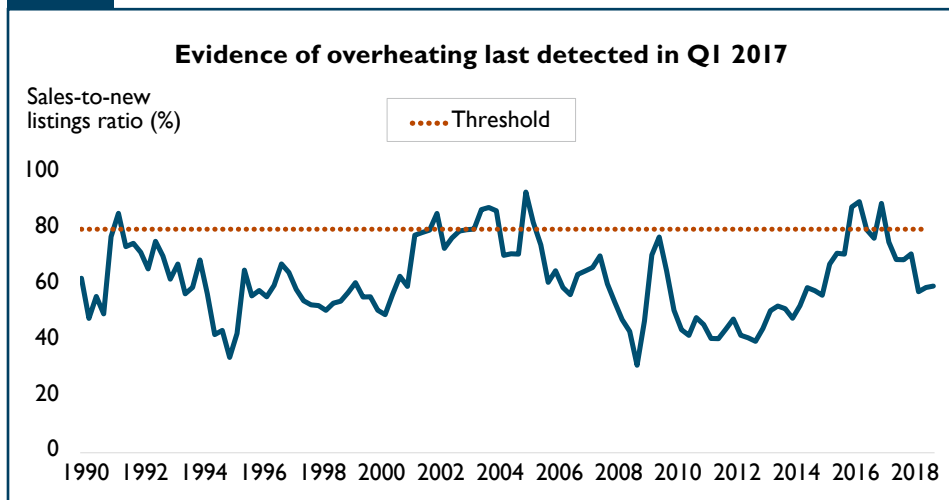
Since overheating was detected, sales shifted towards apartments and away from single detached units. The share of single detached sales was roughly 60% from 2013 Q2 to 2016 Q1, but has since fallen to about 50%, with apartments making up the difference to a total sales share of about 38% by 2018 Q4. Days on market for all unit types increased year-over-year by the end of the fourth quarter and

sales-to-list price ratios were down, both continued to indicate weaker sell-side market conditions into the first quarter of 2019.

### Price Acceleration

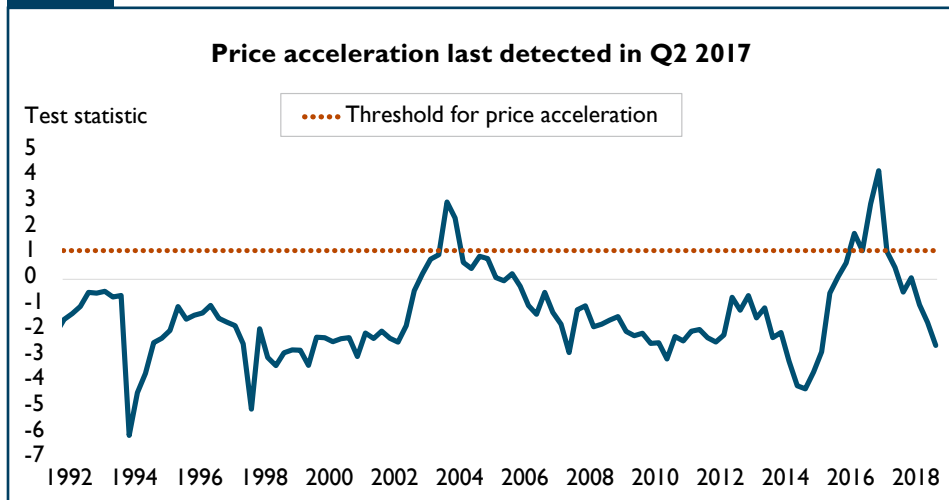
The signal for price acceleration was maintained for Metro Victoria. The test for price acceleration did not exceed the critical threshold in Q4 2018, however the rating endures for three years after a positive signal is detected. The price acceleration indicator was last detected in the

Figure 1



Sources: CREA, calculations (threshold) by CMHC  
Last data point: 2018Q4

Figure 2



Sources: CREA, CMHC calculations  
Last data point: 2018Q4



**Braden T. Batch**  
Senior Analyst  
Economics

*“The HMA framework maintained a high degree of vulnerability for Metro Victoria. Both overheating and price acceleration were detected at least once within the past three years, while at least one model of overvaluation was over the threshold in the fourth quarter of 2018. Population growth, especially for young adults, added to demand side growth while price growth eased in the Victoria area.”*

second quarter of 2017, and has not since been detected. Annual MLS® price growth exceeded inflation on average in 2018 Q4, however the trend in year-over-year price growth has been on the decline, while inflation, as measured by the consumer price index, rose in Victoria.

### Overvaluation

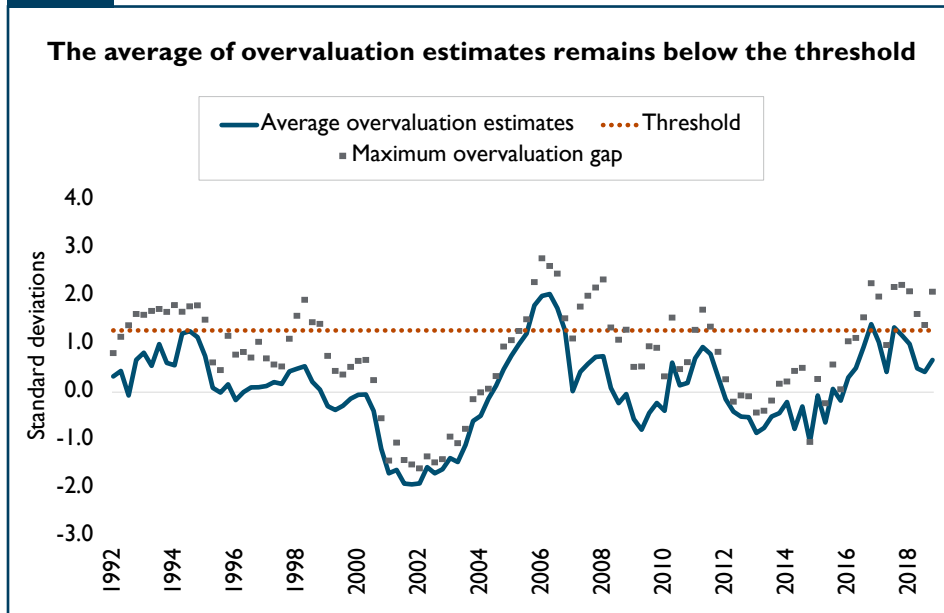
Moderate evidence of Overvaluation was detected for Metro Victoria in 2018 Q4. While, the average of all overvaluation models remained below threshold, three of the nine models that were estimated to compare fundamentals with house prices exceeded the threshold for overvaluation. The models that detected overvaluation utilised an affordability calculation which was not present in any of the models that did not exceed the threshold of overvaluation.

The population of young adults, which is seen as a key driver of household formation, increased in Q4 supporting house price growth. The cost of carrying a mortgage likewise improved as the average 5-year mortgage rate fell in the fourth quarter. The labour market, however, put downward pressure on house price growth, since personal disposable income declined and Metro Victoria experienced a contraction in overall employment. The relative support in fundamental factors is contrast with slower price growth as different measures of house prices showed more modest growth when compared with the recent past. Taken together, the gap between fundamental factors and house prices lessened, on average.

### Overbuilding

The HMA framework did not detect overbuilding in the Metro Victoria housing market. Per capita completed and unsold units were well below threshold. There was little change in the overall inventory level.

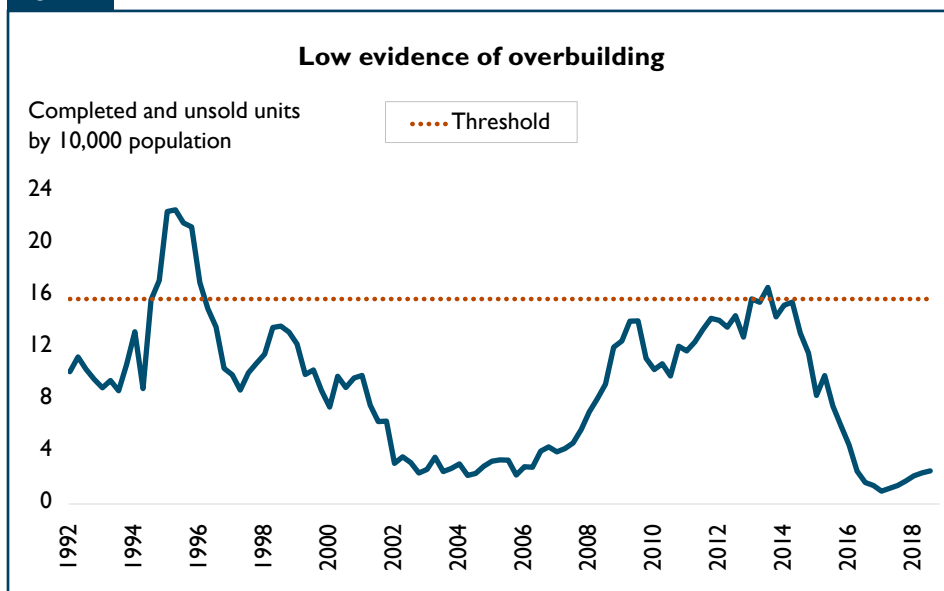
Figure 3



Sources: CREA, Statistics Canada and calculations by CMHC  
Last data point: 2018Q4

Note: The average estimate of overvaluation is the average gap between actual house prices and price levels estimated from a group of selected mode.

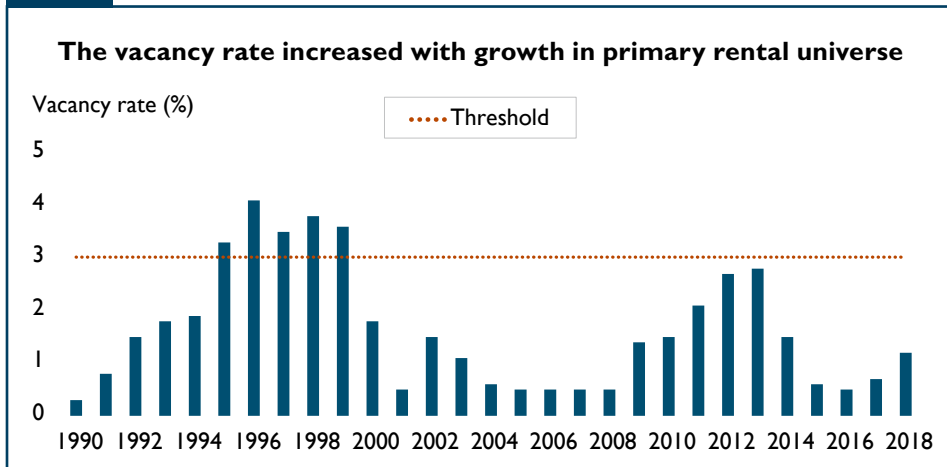
Figure 4



Sources: Statistics Canada and CMHC  
Last data point: 2018Q4

Single-detached and semi-detached homes inventories increased slightly while row and apartment units remained low. This implies that inventory levels increased for relatively more expensive units, but relatively affordable units continued to sell. The vacancy rate in Metro Victoria remained well below the threshold. However, an increase in new rental supply created a modest increase in the primary rental market universe which in-turn helped increase the vacancy rate to 1.2% in October 2018.

Figure 5



Sources: Statistics Canada and CMHC  
 Last data point: 2018

## 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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