

# HOUSING MARKET ASSESSMENT

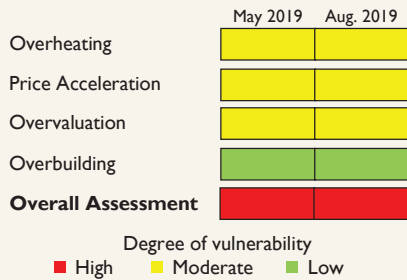
Victoria CMA

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## Highlights

### Results Overview Victoria CMA



- CMHC's Housing Market Assessment (HMA) framework maintained a high degree of housing market vulnerability in Metro Victoria.<sup>1</sup>
- Overvaluation remained moderate as the average of all overvaluation models remained below the threshold for significant overvaluation.
- Market balance indicators for single-detached homes were in line with the 10-year average and resembled balanced market conditions, while apartments and attached homes remained in sellers' market conditions.
- Single and semi-detached units dominated an upward trend in completed and unsold inventory of new homes, but total inventory remained below the threshold for overbuilding.

## 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

The rating for overheating was maintained as moderate in the first quarter of 2019. The sales-to-new-listings ratio (SNLR) was 53%, 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 in the third quarter of 2016 and the first quarter of 2017.

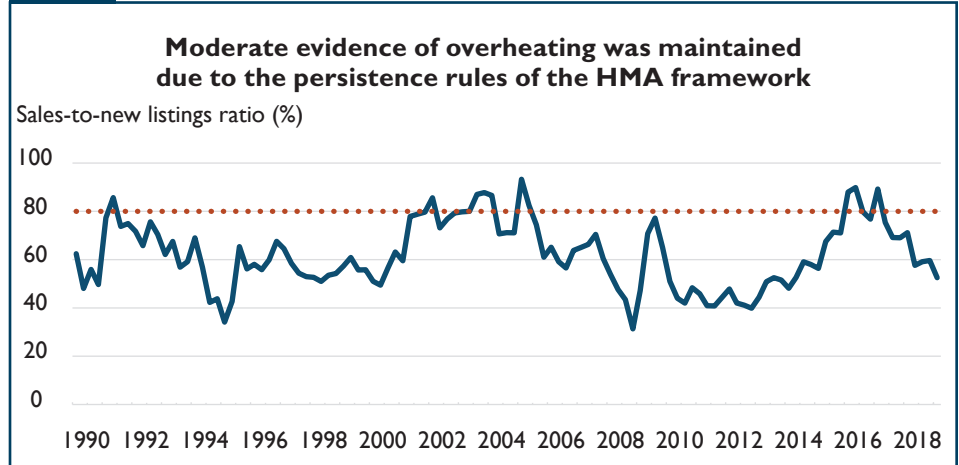
The SNLR lost about 7% over from the previous quarter on a seasonal rise in new listings. Sales did not rise on the normal seasonal pattern,



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*"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 threshold in the first quarter of 2019. Prices declined modestly in single-detached homes as market availability of these homes moved from historic lows to a more normal level in recent quarters. However, fundamental demand side growth has come most notably in additions to the young-adult population, a demographic with a higher propensity to be first-time buyers but also less likely to have the down payment or equity to move directly into the single-detached market."*

Figure 1



Last data point: 2019Q1

Sources: CREA and calculations by CMHC

but remained low. The trend for both variables, however, was a decline. As of March 2019, the trend in total sales was 63% below a peak reached in 2016 Q1, which was the first time the overheating indicator was triggered.

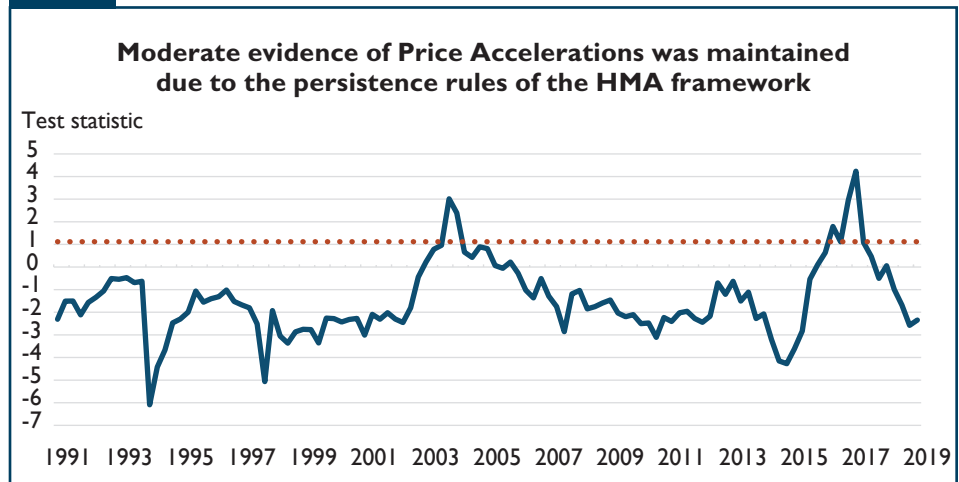
Active listings for single-detached homes reached the ten-year average, and constituted the majority of homes available for sale. The detached market appears to be moving into balance, with 20% of listings selling every month. A higher share of available apartments and attached homes

sold, indicating a two speed market with stronger activity on relatively more affordable homes.

### Price Acceleration

The moderate price acceleration rating was maintained for Metro Victoria. The test for price acceleration did not exceed the critical threshold in the first quarter of 2019, however the rating endures for three years after a positive signal was detected. The price acceleration indicator was last detected in the second quarter of 2017, and has not since been detected.

Figure 2



Last data point: 2019Q1

Sources: CREA and calculations by CMHC

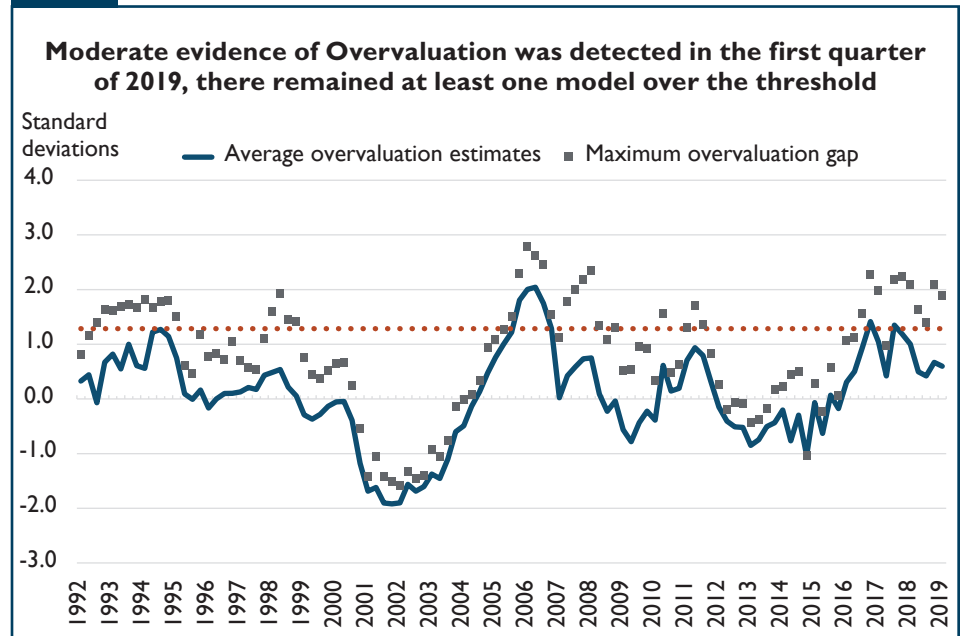
Annual MLS® price declined in Victoria. The price drop was concentrated first in an anomalous drop during the month of January followed by a quick recovery, but a more sustained trend of decline in the price of single-detached units persisted through Q1. Apartment and attached units, meanwhile, maintained price growth, reflecting the relative higher sales activity in those categories.

## Overvaluation

Moderate evidence of Overvaluation was detected for Metro Victoria in 2019 Q1. The average of all overvaluation models remained below threshold. Three of nine models that 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 most notable trend in fundamentals is the continued growth of the population of young adults, a cohort of 25-34 year olds who tend to form new households, who then go on to either buy or rent. However, the relative supply of homes that fits this cohort's average budget is at a mismatch with the increasing availability of single-detached homes that tend to command higher prices. The cost of carrying a mortgage has

Figure 3



Last data point: 2019Q1

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.

improved in comparison to one year prior, although in recent quarters the average 5-year mortgage rate began to rise again. Disposable incomes showed a relatively flat trend going into the first quarter of 2019, with a slight uptick to place modest upward demand pressure on home prices. The labour market has exhibited mixed signals as total

employment in the Victoria HMA receded from a high water mark reached early in 2018. The decline in workers coincided with an increase in people not in the labour force, which is consistent with a high rate of retirement in the metro area. Thus, it is not clear that this decline would have much impact on the demand for housing directly.

In summary, the decline in average MLS® price has worked to lessen the gap between observed house prices and the level of house prices that can be statistically explained by fundamental factors; however, the gap remained above the threshold for overvaluation for three models.

## Overbuilding

The HMA framework did not detect overbuilding in the Metro Victoria housing market. Per capita completed and unsold units were well below threshold. Single- and semi-detached units mirror the available homes in the resale market, as complete and unsold inventory rose to historical norms into the first quarter. Row and apartment units, conversely, continued to have low inventory. As a result, the inventory data is consistent with the demand and supply picture painted by other indicators, where more affordable units continue to sell on rising demand pressure from young adults. 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 4

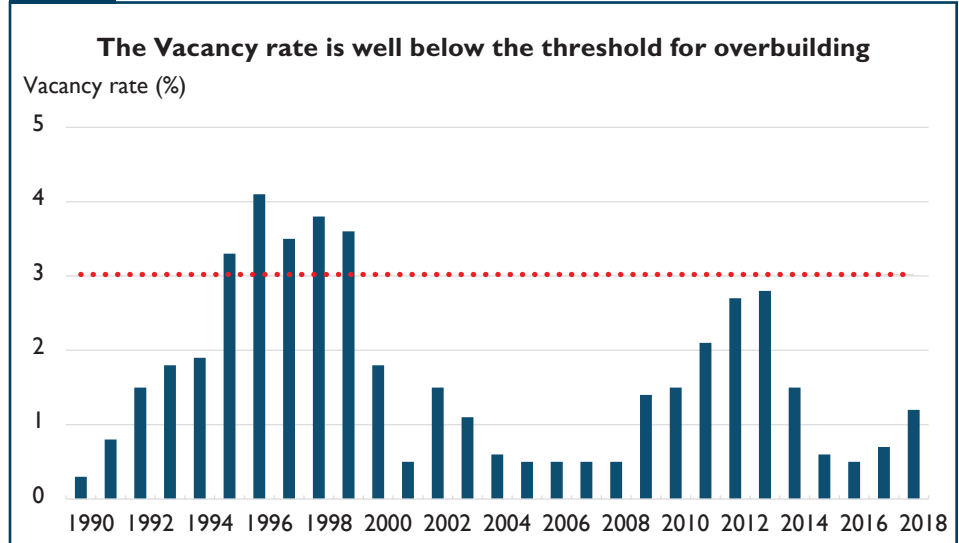
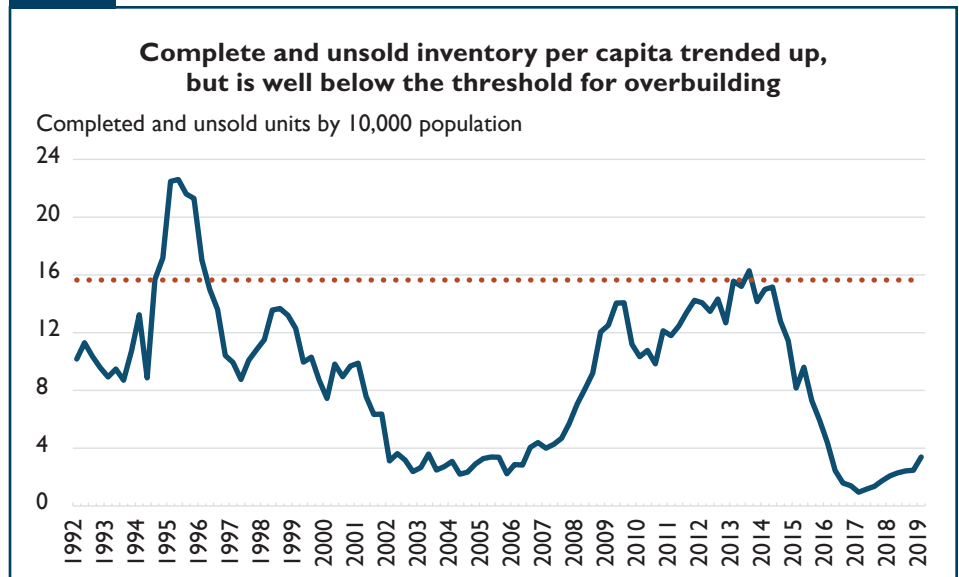


Figure 5



## 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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