

HOUSING MARKET ASSESSMENT

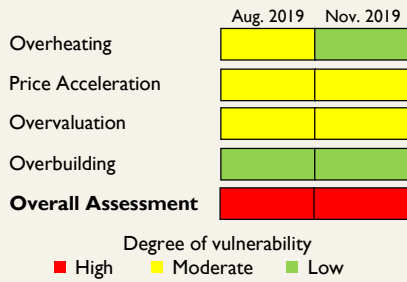
Victoria CMA

Date Released: Fourth Quarter 2019



Highlights

Results Overview Victoria CMA



- CMHC’s Housing Market Assessment (HMA) framework maintained a high degree of housing market vulnerability in Metro Victoria.¹
- The overvaluation indicator remained moderate as at least one model used in the framework detected overvaluation.
- The balance between buyers and sellers moved in favour of buyers. Multiple segments of the market had a greater availability of homes for sale, previously only single-detached units had rising listings, but listings for apartment units also increased in the second quarter.
- Units that are more expensive continued to dominate the inventory of new homes, as younger demographics favor more affordable options.

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 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 fundamentals³. 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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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

Overheating

Evidence of overheating was low in the second quarter of 2019. The sales-to-new-listings ratio (SNLR) was 59%, which is below the threshold of 80%. The SNLR has consistently remained below the threshold with only one observation above threshold in the past three years. The last observation of overheating was in the first quarter of 2017.

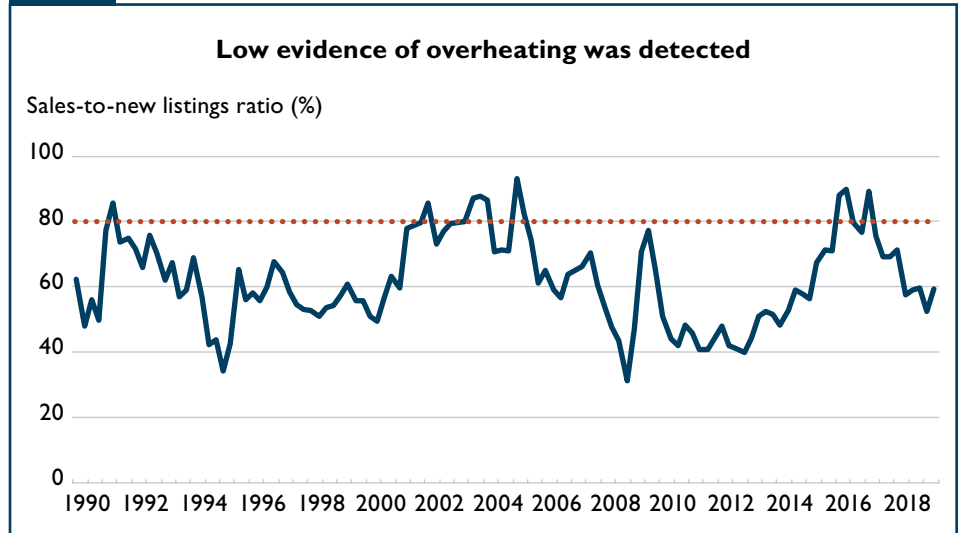
The SNLR gained 6 percentage points over the previous quarter as sales activity improved in Metro Victoria. However, looking over a longer time horizon, growth in new listings outpaced sales, and the SNLR indicator overall trended lower. As of June 2019, the trend in total sales remained 39% below a peak reached in 2016 Q1, a point in which the market



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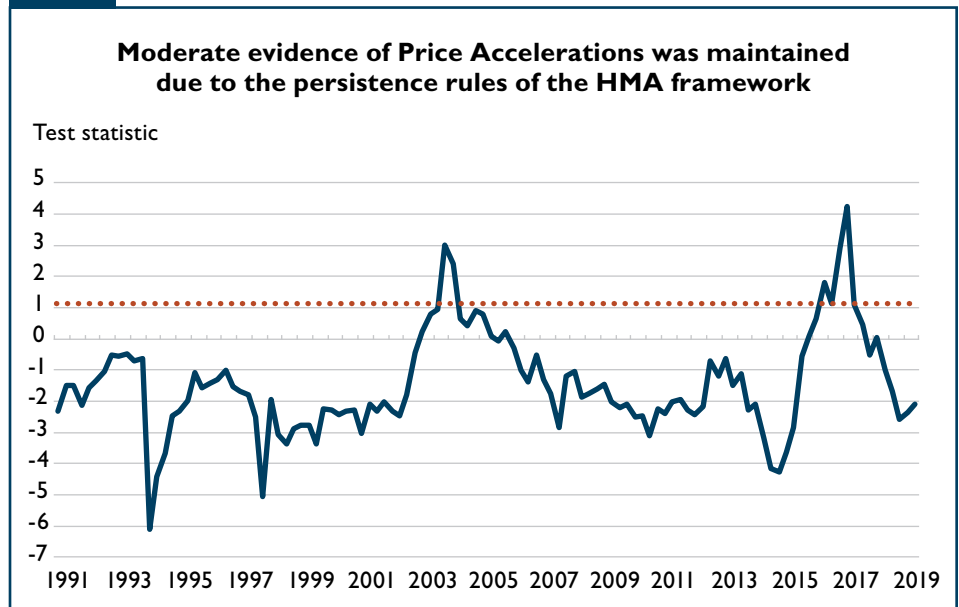
“The HMA framework maintained a high degree of vulnerability for Metro Victoria. The price acceleration and the overvaluation indicators both exhibited moderate evidence of vulnerability. Prices continued to decline in single-detached homes as market availability of these homes moved from historic lows 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



Sources: CREA and calculations (threshold) by CMHC

Figure 2



Sources: CREA and calculations by CMHC

was overheating. Market conditions recently have been more balanced between the buy and sell side.

Active listings for single-detached homes were well above the ten year average, and constituted the majority of homes available for sale. The detached market moved towards balance, with about one in four listings selling every month. The same was true for the apartment segment of the market, which had previously exhibited more of a sellers' market.

Price Acceleration

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

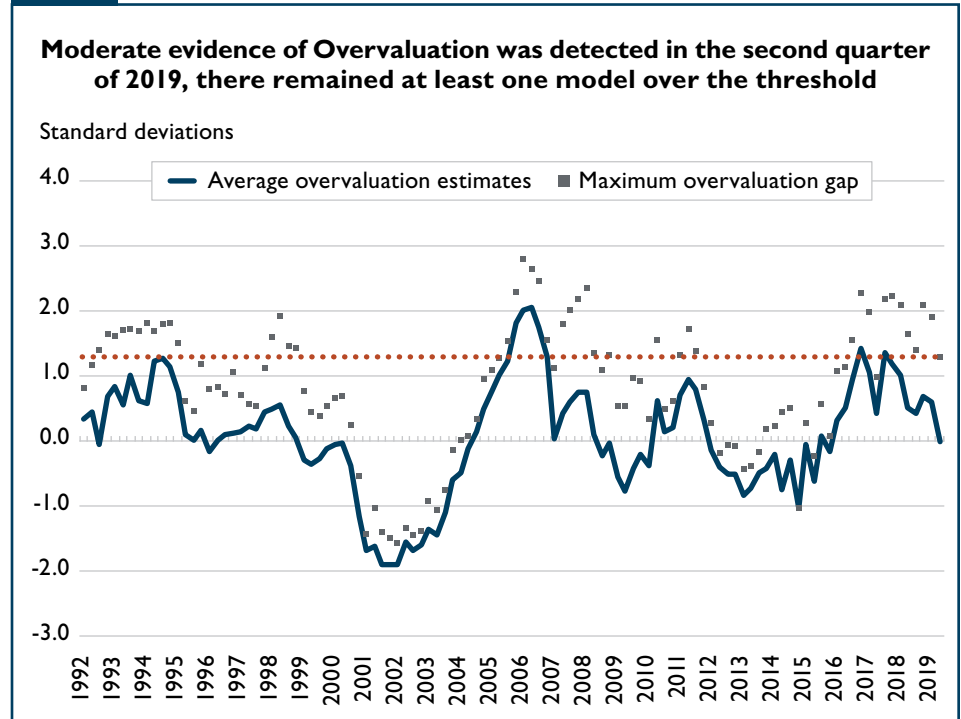
Overall, prices declined in Metro Victoria into the second quarter of 2019. Single detached units experienced the greatest decline in prices, but apartment units also slipped in value, as a greater availability of all housing types reduced competition amongst buyers.

Overvaluation

Moderate evidence of Overvaluation was detected for Metro Victoria in 2019 Q2. The average of all overvaluation models remained below threshold, but at least one model exceeded the threshold for overvaluation.

Fundamental factors showed a growth in a number of indicators. First, the demand supporting trends include a growing population of young adults (aged 25-34) in Metro Victoria, a group that forms new households, and increases demand for rent or ownership. Second, the cost of carrying a mortgage decreased in comparison to one year prior, as the average 5-year mortgage rate declined to a recent low. Third, the labour market has rebounded from a recent lull early in 2019. The previous 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. However, growth in the labour force throughout the year has coincided with job creation, and is consistent with the growth in young adults already cited. The return of growth in the labour market has also supported demand for housing.

Figure 3



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.

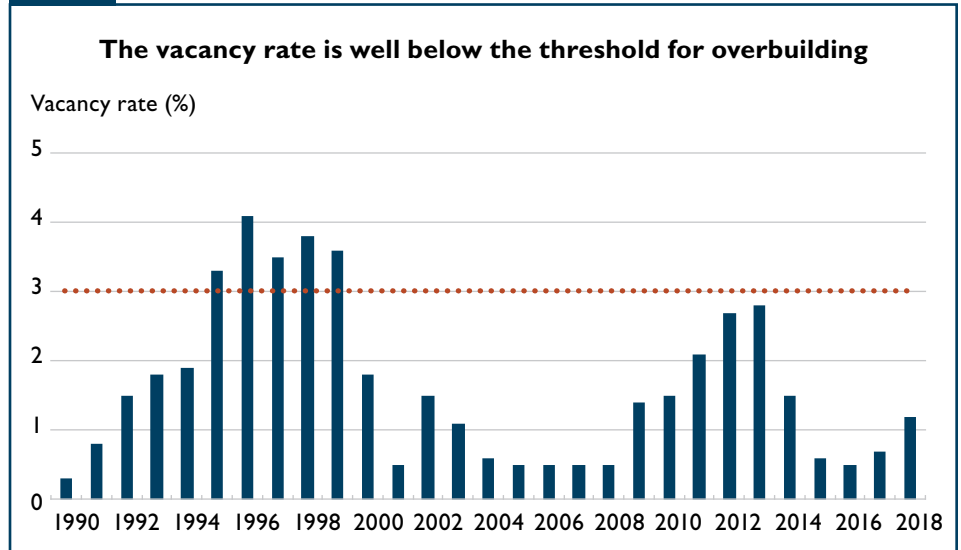
On the other hand, there were also some drags on demand growth. Disposable incomes grew slower than inflation, leading to a net loss in spending power by households, which acted to decrease housing demand. Further, overall population growth slowed when looking at all ages, which acted to reduce demand, and is plausibly related to the rise in available houses in the resale market.

On balance, when all of these factors are taken together, house prices remained higher than what could be explained by these factors by at least one of the methods of comparing fundamental factors to different measures of house prices.

Overbuilding

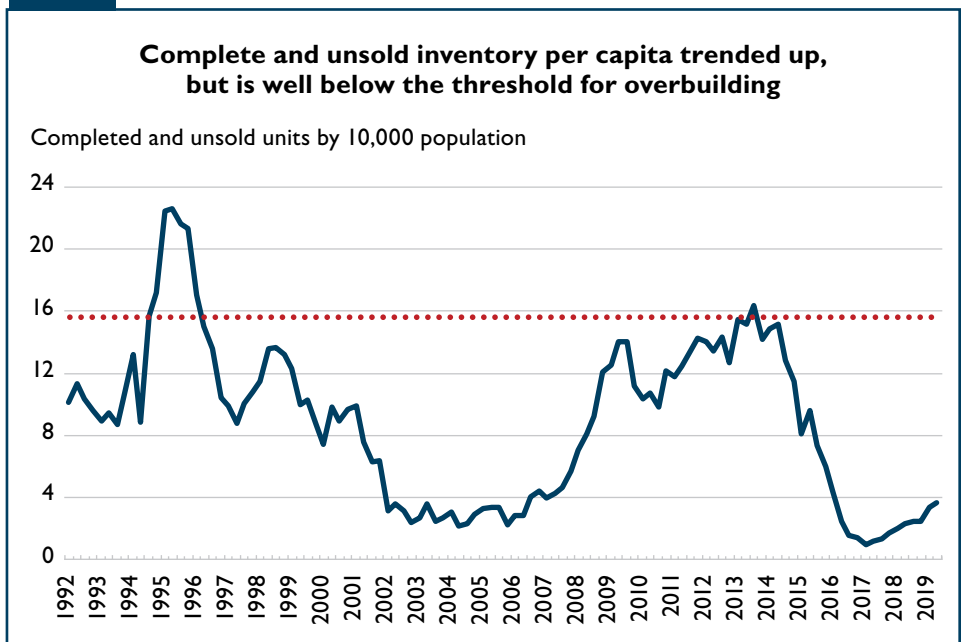
The HMA framework did not detect overbuilding in the Metro Victoria housing market. Per capita completed and unsold units were well below threshold. The inventory data is consistent with the demand and supply picture painted by other indicators, where more affordable units continued to sell on rising demand pressure from young adults. The majority of the rising inventory was in the form of units over \$700 thousand. However, in more recent monthly data, a number of condo units have pushed inventory levels higher, mirroring the rising listings of even the relatively affordable units in the market, and indicating a modest return to balance in between buyers and sellers. 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



Source: CMHC

Figure 5



Sources: Statistics Canada and CMHC

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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