

HOUSING MARKET ASSESSMENT

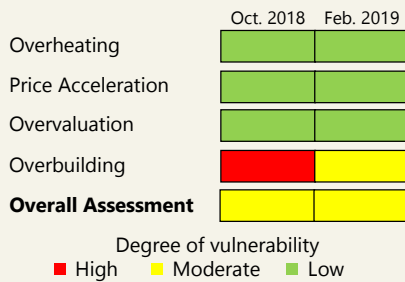
Edmonton CMA

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Highlights

Results Overview Edmonton CMA



- CMHC's Housing Market Assessment (HMA) Framework detected a moderate degree of vulnerability in the overall assessment for Edmonton.¹
- Evidence of overbuilding in Edmonton moved from high to moderate as the annual purpose-built rental vacancy rate decreased from 7.0% to 5.3% in October 2018.
- There remained an elevated supply of units in the ownership market relative to demand, which contributed to low evidence of overheating and price acceleration.

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 short-term imbalances in the housing market. As such, 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 higher than normal.

The HMA combines the results from a technical framework with insights gained through CMHC's Market

Analysts' knowledge of local market conditions. These insights position 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 September 2018 (the annual rental apartment vacancy rates are from October 2018) and local market intelligence up to the end of December 2018. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

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

Low Evidence of Overheating

CMHC's HMA framework continued to detect low evidence of overheating in Edmonton in the third quarter of 2018 as the sales-to-new listings ratio (SNLR) remained well below the critical threshold. Edmonton continued to face economic challenges due to a slow recovery from the past recession. On a year-over-year basis, sales decreased slightly in the third quarter, keeping the SNLR low and reinforcing buyers' market conditions. Similar to other markets across Alberta, Edmonton's unemployment rate continued to remain above pre-recession levels, which has put downwards pressure on sales. Higher interest rates and a lack of growth in real personal disposable income has impacted purchasing power.

Low Evidence of Price Acceleration

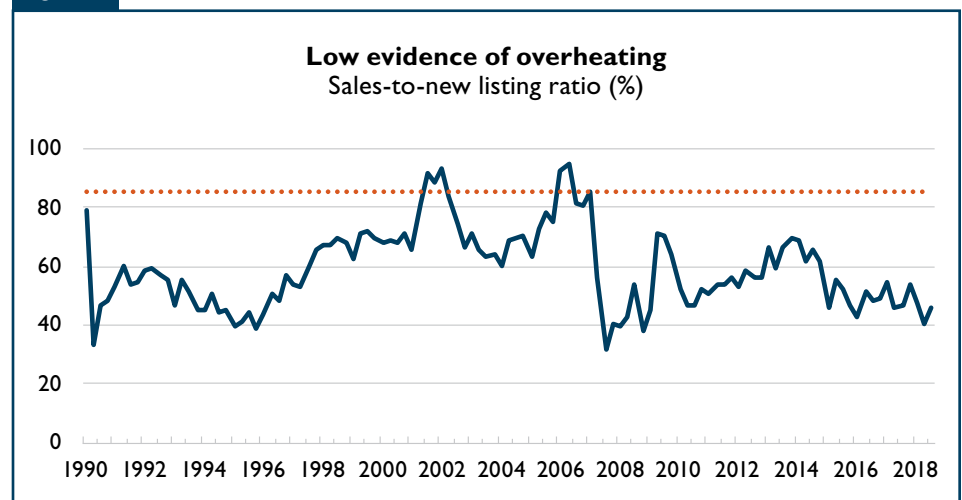
A moderation in the demand for housing in the ownership market has kept inventories elevated in both new and resale homes, therefore putting downward pressure on house prices. Evidence of price acceleration remained low in the third quarter of 2018 as the real Teranet® house price index and the average MLS® price both decreased by 3.7% and 5.4%, respectively. The real new housing price index also decreased by 3.7% year-over-year indicating that both

the new and resale segments of the ownership market continued to experience slack in the market due to elevated inventories.

Low Evidence of Overvaluation

While economic conditions in Edmonton remained relatively weak compared to their pre-recession levels, all of the eight selected overvaluation models indicate that current market prices are in line with what is expected by current economic fundamentals such as real

Figure 1



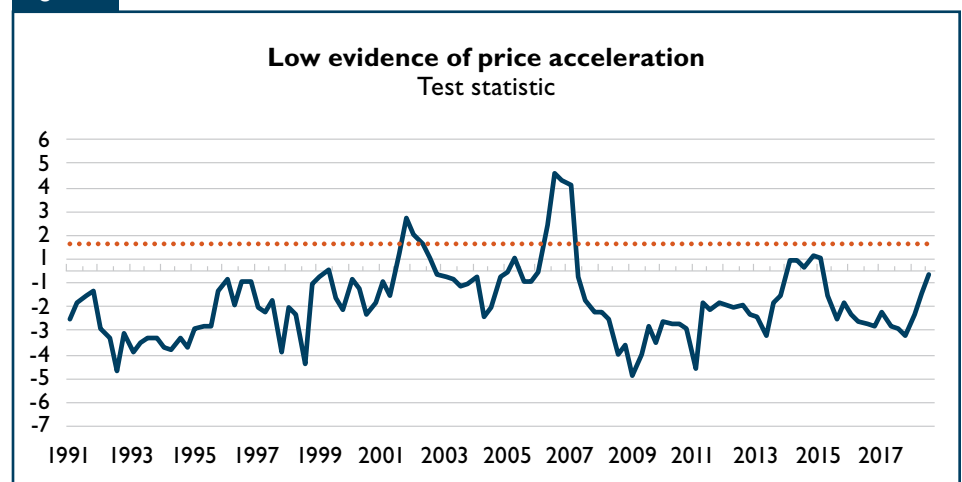
Sources: CREA and calculations (threshold) by CMHC



James Cuddy
Senior Analyst
Economics

"While elevated inventories in the ownership market continued to persist, demand for rental units increased and the vacancy rate moved lower in 2018, shifting evidence of overbuilding from high to moderate."

Figure 2



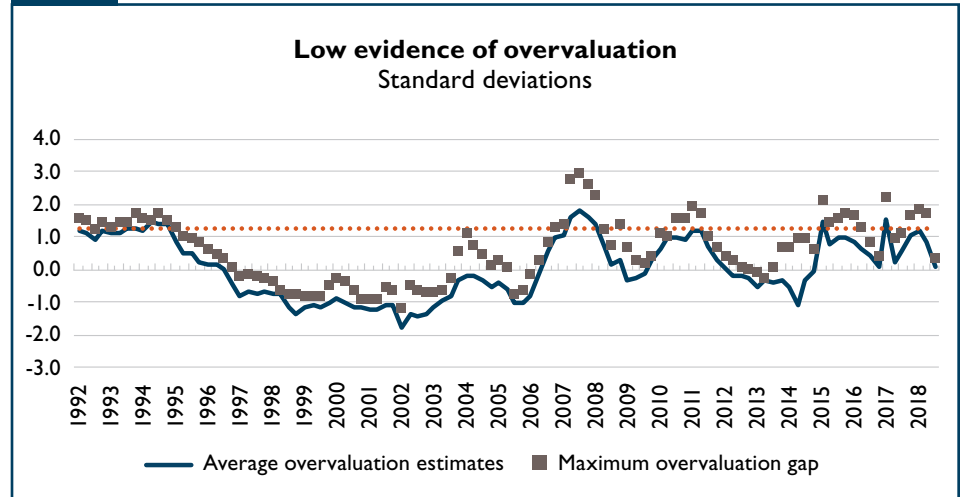
Sources: CREA and calculations by CMHC
Last data point: 2018Q3

personal disposable income, young adult population growth, borrowing rates, and other factors. As a result, the HMA framework continued to detect low evidence of overvaluation in Edmonton.

Evidence of Overbuilding Lowered to Moderate

While elevated unsold inventory in the ownership market remains a persistent challenge for Edmonton, the rental market has begun to buck this trend. The annual purpose-built rental vacancy rate decreased from 7.0% to 5.3% in October 2018, moving the indicator below the critical threshold of overbuilding. Tightening of the rental market has shifted evidence of overbuilding from strong to moderate. The relatively stronger demand for purpose built rentals and rental condominium units has helped move Edmonton's rental market towards more balanced conditions. The current economic climate continued to pose a challenge for the absorption of inventories in the new home market.

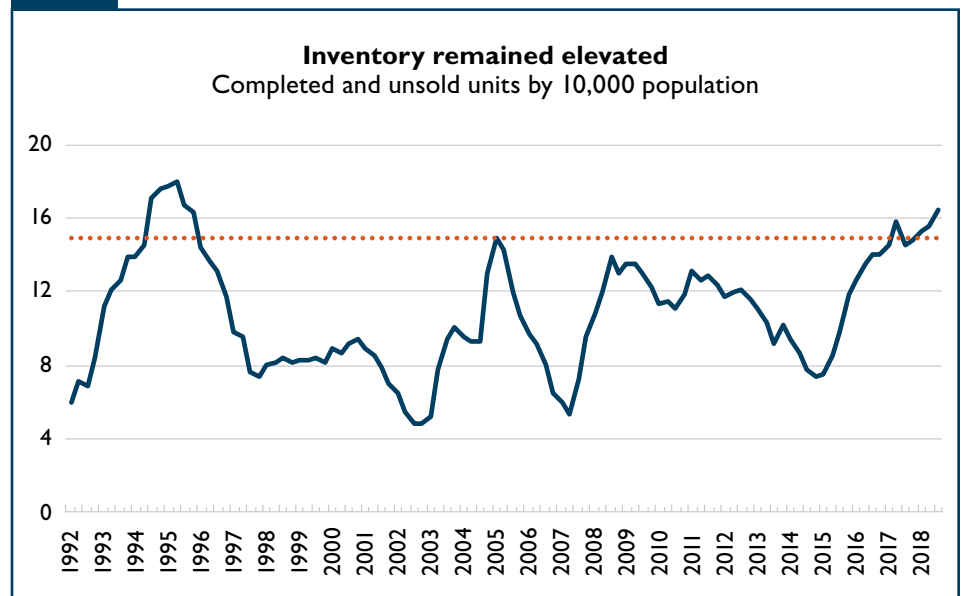
Figure 3



Sources: CREA, Statistics Canada and calculations by CMHC
Last data point: 2018Q3

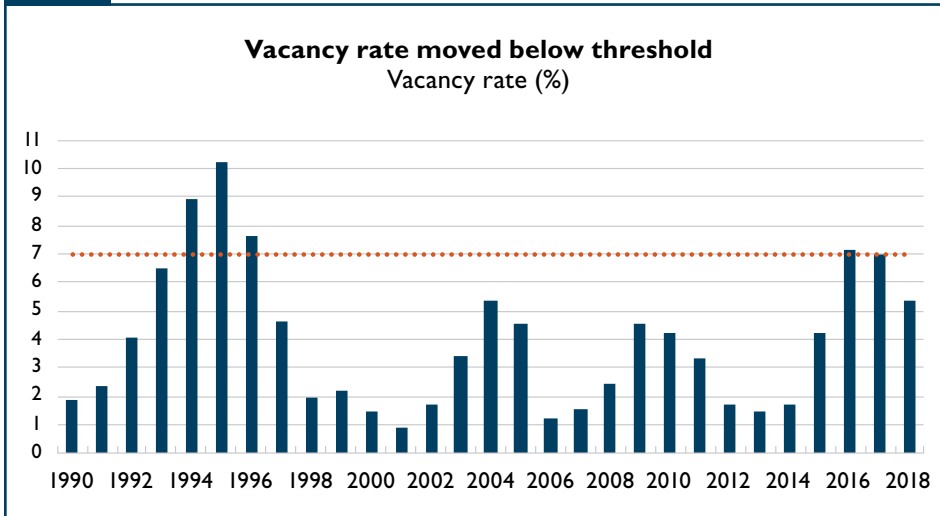
Note: The average estimate of overvaluation is the average gap between actual house prices and price levels estimated from a group of selected models. Baseline models include demand, supply, hybrid, and affordability models, each of which is estimated using four measures of house prices to generate sixteen 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 4



Sources: Statistics Canada and CMHC
Last data point: 2018Q3

Figure 5



Source: 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 measured by single indicator. Colour scales for these factors vary between green and yellow only. Overvaluation and overbuilding are measured by 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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