HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

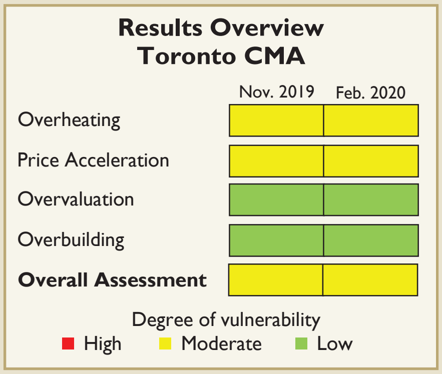
Greater Toronto Area

Date Released: First Quarter 2020

Canada

CMHC SCHL

Highlights



- Recent results from the Housing Market Assessment indicated a moderate degree of market vulnerability in the Toronto CMA housing market.[1]
- Overheating and price acceleration assessments are maintained due to imbalances in these factors in recent years.
- Evidence of overvaluation remains low as prices in 2019Q3 remained close to the levels supported by housing market fundamentals. However, price growth continues in all housing types and the average overvaluation gap has worsened since 2018Q4.
- We continued to detect low evidence of overbuilding with the number of completed and unsold units remaining 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 housing market 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 September 2019 (the annual rental apartment vacancy rates are from October 2019) and local market intelligence up to the end of December 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

We continued to detect moderate evidence of overheating in 2019Q3 due to imbalances witnessed in recent years. Specifically, the Sales to New Listings Ratio (SNLR) for Toronto stood above the threshold at least twice over the past 12 quarters preceding 2019Q3 (in 2016Q4 and 2017Q1). Strong growth in seasonally adjusted sales compared to the previous quarter, coupled with declining new listings resulted in the SNLR reaching nearly 60% in 2019Q3. Housing market activity continued to increase across all housing types, with the multi-family sector having tighter market conditions (e.g. the SNLR for condominium apartments in 2019Q3 was 67%, near the threshold set for overheating, compared to 60% during the same time a year prior). Housing markets across the Greater Toronto Area (GTA) continued to recover in 2019Q3. The City of Toronto, Halton and Peel Regions had SNLRs around 60% compared to Durham and York Regions, which had SNRLs around the 50% mark.

Dana Senagama
Principal Market Analyst

"A moderate degree of vulnerability persists in the Toronto market with heightened market activity."

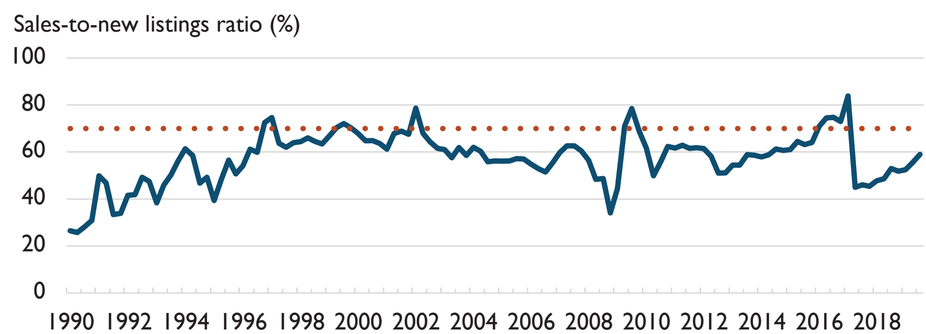
Housing market activity continued its upward momentum in 2019Q4 with the seasonally adjusted SNLR reaching 66% for all housing types. Strong sales coupled with some pullback in the new listings supply helped to push the ratio into sellers' market territory and towards the threshold (70%) set to signal market overheating.

Price Acceleration

We continued to detect moderate evidence of price acceleration in 2019Q3 (see Figure 2). This is because the test statistic for this factor stood above its critical threshold at least once over the 12 quarters preceding 2019Q3 (in 2016 Q4, 2017Q1, and 2017Q2). 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]. The seasonally adjusted average MLS® price grew by 3.8% in 2019Q3, compared to the previous quarter. Prices grew for all housing types across all regions of the GTA. Price growth for condominium apartments was the strongest, in line with tighter market conditions for that housing type.

Figure 1

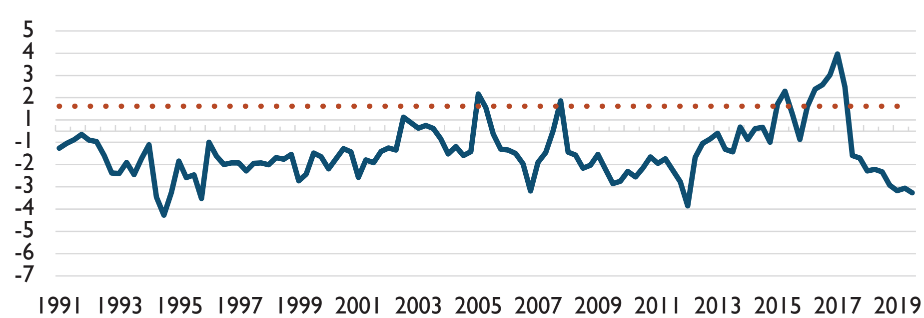
Moderate Evidence of Overheating



Sources: CREA and calculations by CMHC
Last data point: 2019Q3

Figure 2

Moderate Evidence of Price acceleration



Sources: CREA and calculations by CMHC
Last data point: 2019Q3

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. MLS® is a registered trademark of the Canadian Real Estate Association.

In 2019Q4, the average seasonally adjusted MLS® price continued to grow, albeit at a slightly lower pace of 2.6% from the previous quarter. Price growth was strongest for multi-unit homes; although single-detached home prices showed signs of recovery (see Figure 3).

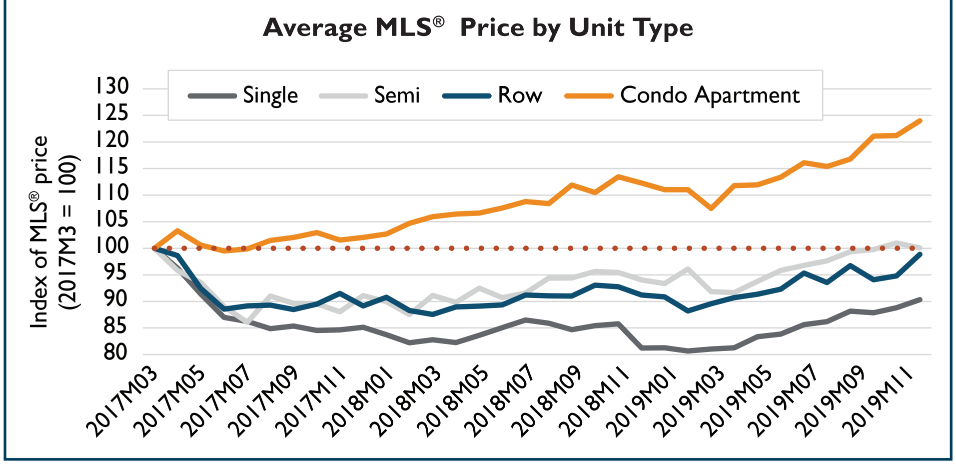
Overvaluation

We continued to detect low evidence of overvaluation in 2019Q3. However, the average overvaluation gap (between actual house prices and price levels predicted by housing market fundamentals) had been trending upwards since Q4 2018. Overvaluation was easing for nearly a year until 2018Q3. The real MLS® average house price increased by 1.16% in 2019Q3 from the same time a year earlier, while growth in real disposable income edged up by 0.33% and the young adult population (25-34 years) increased by 3.81%.

Overbuilding

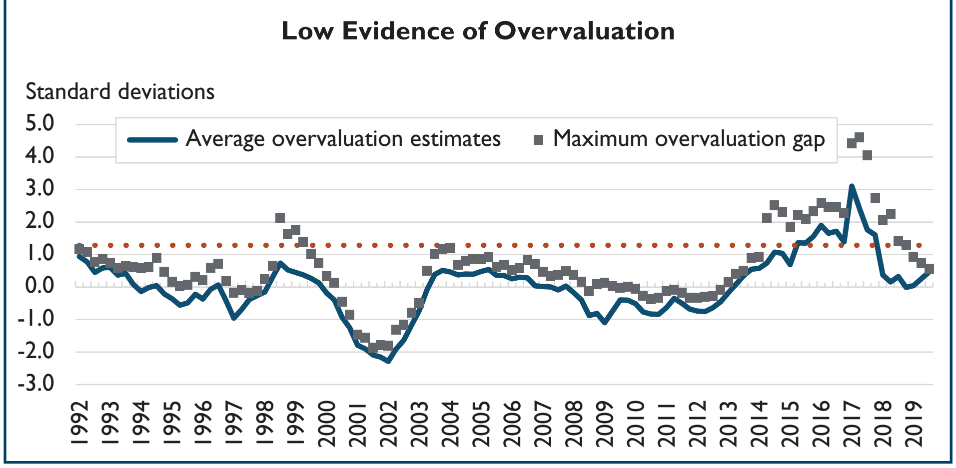
A low degree of vulnerability in overbuilding is maintained for 2019Q3. While the inventory of completed and unsold units per 10,000 population edged up to 1.61 from the previous quarter, it remains well below the overbuilding threshold of 4.10. Demand for condominium apartments from homebuyers as well as investors (encouraged to rent in a tight rental market) remained strong and as a result, fewer units remained unsold upon completion.

Figure 3



Sources: TREB and calculations by CMHC

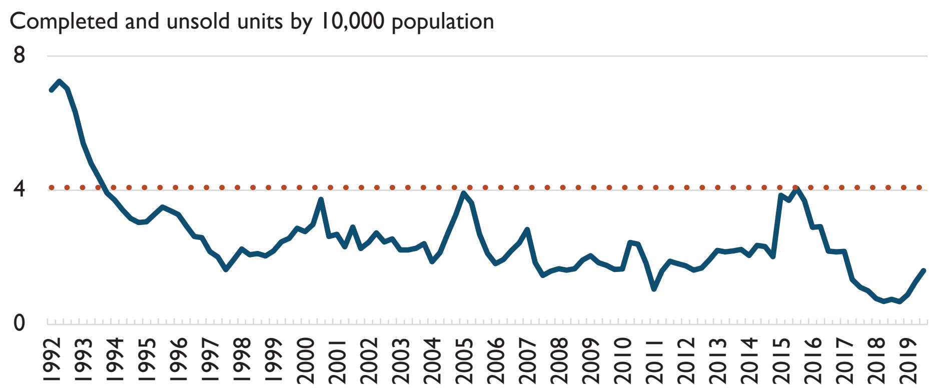
Figure 4



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 their fundamental level estimated from a group of selected models. These include demand, supply, hybrid, and affordability models. 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 90%. Overvaluation is signaled when overvaluation estimates lie above the threshold.

Figure 5

Low Evidence of Overbuilding



Sources: Sources: Statistics Canada and CMHC
Last data point: 2019Q3

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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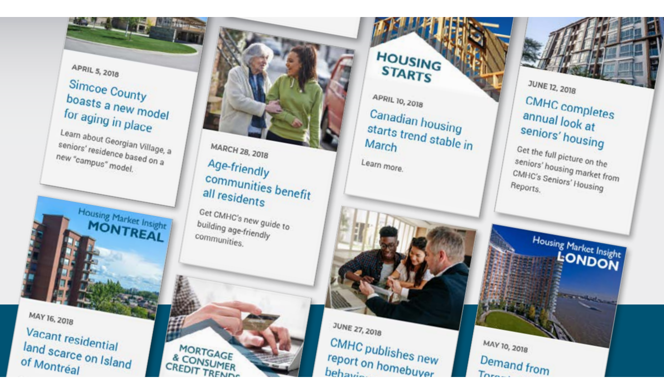

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