Reprint:

Five Things You Should Know About Canada's Housing Market

BMO Capital Markets

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Sal Guatieri, Senior Economist

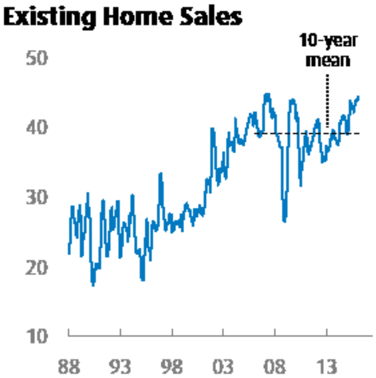
Concerns about a Canadian housing correction have ebbed with each passing month of record sales and prices (**Chart 1**). Increased minimum down payments on insured mortgages in February (on homes priced between half- and one-million dollars) had no discernible effect on sales or mortgage growth. Activity in most regions will remain healthy this year, outside the oil-producing regions. In the meantime, the revving Vancouver and Toronto markets are likely to stay on full-throttle, raising the risk of overheating.

Here are five things you should know about the Canadian housing market.

First, there is no "Canadian" housing market. Rather, there are three distinct markets depending on where you live. Home buyers living outside the depressed resource regions or the manic Vancouver and Toronto markets face generally steady sales and prices. In most cities, valuations (**Table 1**) and affordability (**Table 2**) are healthy, with prices hovering just above three-times family income and mortgage payments on typical purchases consuming less than a fifth of income. Housing costs are only moderately higher in Montreal, where sales are off low levels. Conditions are much weaker in the oil-rich provinces, where first-time buyers (with jobs) are benefitting from moderately declining prices. By sharp contrast, double-digit price increases have mostly slammed the door shut on potential first-time buyers of detached homes in Vancouver and Toronto (**Table 3**), spurring many to look to the outskirts, condos or apartments. Recently, price pressures have spilled outside the metro regions to Victoria, the Fraser Valley, Niagara, Hamilton, Kitchener, Waterloo, London and Barrie. One might say there are actually four distinct markets in Canada, as Vancouver distances itself from Toronto with prices for detached two-story homes now twice as high (at $1.46 million in February) and rising twice as fast (by 26%).

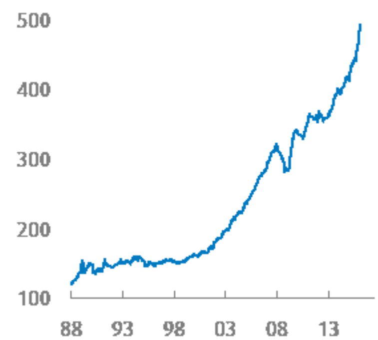
Chart 1
Record Demand and Prices

Canada (000s of units : s.a.)
Existing Home Sales



Sources: CREA, Haver Analytics

Canada (C$000s : s.a.)
Average Home Price



Sources: CREA, Haver Analytics

Table 1
Valuations Diverge Across Regions

Price-to-Median Family Income Ratios[1]	2001 Q4	2005 Q1	2015 Q1	2016 Q1[2]	Trend[3]	% change in price since 2005
Vancouver[4]	5.3	6.5	8.4	9.8	↑	179
Toronto[4]	4.3	5.0	7.0	7.5	↑	100
Victoria	3.8	5.2	5.4	5.8	↑	53
Canada ex Vancouver, Toronto	2.7	3.3	4.0	4.1	↑	75
Calgary[4]	2.8	2.9	4.2	3.9	↓	83
Montreal[4]	2.3	3.3	3.9	3.8	↓	72
Winnipeg	1.7	2.1	3.3	3.2	↓	117
Ottawa[4]	2.5	2.8	3.0	3.0	▪	46
Halifax	2.5	2.8	3.1	2.9	↓	46
Saskatoon[4]	2.1	2.1	3.1	2.9	↓	142

[1] Median family income is estimated after 2013 using average annual growth in previous 10 years;
[2] As of Jan.-Feb. 2016;
[3] Based on year-over-year change of latest quarter (flat if <±0.1);
[4] MLS benchmark home price used after 2004, average price used otherwise.

Sources: Statistics Canada, CREA, Haver Analytics

Table 2
Most Regions Affordable

Mortgage Payments as a % of Median Family Income[1]

	2001 Q4	2005 Q1	2015 Q1	2016 Q1[2]	Trend[3]	2016 Q1
Mortgage Rate	5.7%	5.7%	3.8%	3.9%		If 5.9%
Vancouver[4]	36	45	49	58	↑	70
Toronto[4]	28	33	40	44	↑	53
Victoria	25	35	31	33	↑	40
Canada ex Vancouver, Toronto	16	20	21	23	↑	27
Calgary[4]	17	18	23	21	↓	26
Montreal[4]	14	21	21	20	↓	25
Winnipeg	9	12	17	17	▪	21
Ottawa[4]	15	17	16	15	↓	19
Halifax	15	17	16	15	↓	18
Saskatoon[4]	12	12	16	15	↓	18

Table 3
...But Not Vancouver and Toronto Detached Markets

	2005 Q1	2015 Q1	2016 Q1[2]	Trend[3]	2016 Q1
Mortgage Rate	5.7%	3.8%	3.9%		If 5.9%
Vancouver – Single Family	65	79	97	↑	118
Vancouver – Single Family 1-Storey	52	62	78	↑	95
Toronto – Single Family	38	47	52	↑	64
Toronto – Single Family 1-Storey	34	42	46	↑	57
Vancouver – Condo	28	28	32	↑	39
Toronto – Condo	20	23	24	↑	29

Based on 25-year amortization, average of 1- and 5-year posted fixed mortgage rates, down payment equal to half of annual median family income (about 10% today);

[1] Median family income is estimated after 2013 using average annual growth in previous 10 years;

[2] As of Jan.-Feb. 2016;

[3] Based on year-over-year change of latest quarter (flat if < ±1);

[4] MLS benchmark home price used after 2004, average price used otherwise; Excludes other housing related costs such as property taxes, home insurance, heating and condo fees; Note that the ability to borrow at lower rates than assumed in our calculation (e.g., BMO's 5-year fixed rate of 2.69%) suggests that current affordability is better than shown in the table.

Sources: Bank of Canada, Statistics Canada , CREA, Haver Analytics, BMO Economics

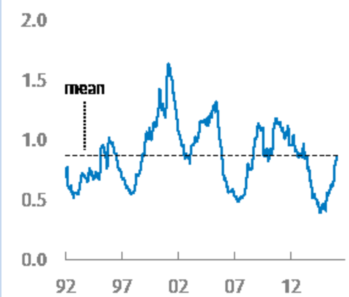
Second, Alberta is weathering the current downturn much better than the last one. Benchmark prices in Calgary, for example, are down just 3.5% in the past year to March, compared with a 14% dive in 2009. Providing support, the province entered the current slump with a tight supply of new homes (**Chart 2**), as well as with only moderately elevated valuations. One big difference this time is that hefty hiring in the public sector (mostly in the capital Edmonton) has cushioned the blow from major layoffs in the oil patch. As well, while Albertans are the most indebted Canadians, low interest rates have helped to hold down delinquencies. While consumer insolvencies have spiked higher, mortgage defaults remain low (**Chart 3**). It's noteworthy that the downturn in sales is already slowing and the economy and housing market should stabilize next year as oil prices recover moderately.

Third, like Alberta prior to its slump, the national housing market is not overbuilt. If it was, prices would be falling, not rising. Averaging 197,000 housing starts in the past six months and 192,000 in the past three years, builders are largely keeping up with household formation and replacement rates. In the resale market, the current run-rate for demand has chopped the number of listings to six-year lows (**Chart 4**). In Vancouver and Toronto, lean

Chart 2
Still No Glut in Calgary

Calgary (000s : n.s.a. : 3-mnth m.a.)

Unsold New Housing Units[1]



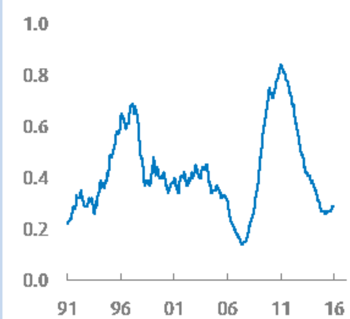
[1] completed and unabsorbed

Sources: CMHC, Haver Analytics

Chart 3
Alberta Defaults Still Low

Alberta (% of total mortgages)

Mortgages in Arrears 3+ Months

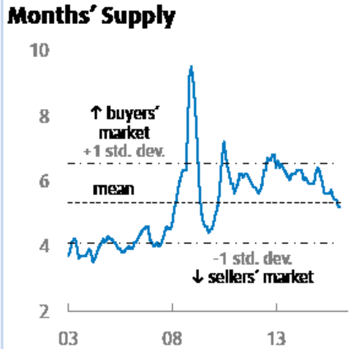


Sources: CBA, Haver Analytics

Chart 4
National Market Balanced

Canada (s.a.)

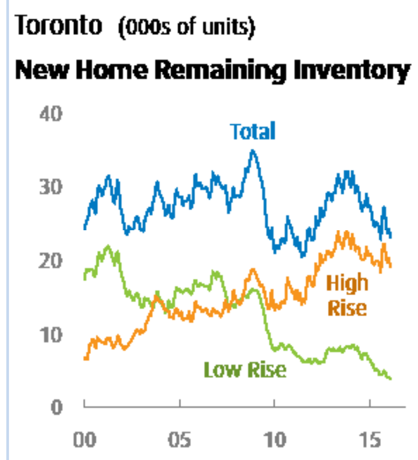
Months' Supply



Sources: CREA, Haver Analytics

inventories partly explain the acceleration in benchmark prices, up 23% year-over-year in the former to March and 12% in the latter. Even resale condo prices have jumped (by an eye-popping 19% in Vancouver and 7% in Toronto). Despite an ample supply of new condos for sale, the total inventory of new homes in Toronto is actually below long-run norms due to a record low number of detached properties for sale (**Chart 5**). Low rental vacancy rates also suggest no overhang of homes.

Chart 5
No Overhang in Toronto

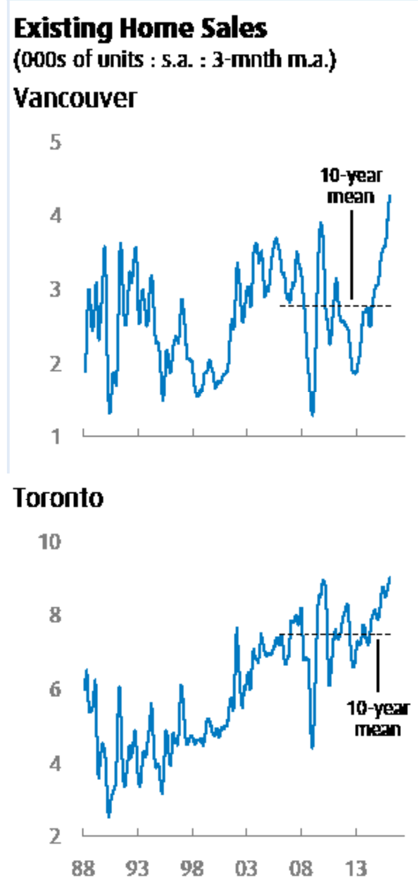


Sources: RealNet Canada

It's not just a tight supply of land that's propelling Vancouver and Toronto house prices to dizzying heights. Demand also remains red hot (Chart 6), stoked by low borrowing costs, international migrants, millennials starting careers and families, strong job growth, and foreign wealth inflows spurred by the low loonie.[1] None of these demand drivers will change much this year, though 4%-plus job growth is clearly unsustainable.[2] The federal government aims to boost immigration, while the number of echo boomers entering their prime first-time home-buying years (ages 25 to 34) will increase until early next decade. The takeaway is that it's likely **clear sailing ahead for both cities in 2016**, which is the **fourth** thing you need to know. The heat could simmer down next year if interest rates creep higher.

The final thing to know about Canada's housing market is that too much of a good thing can turn sour. While supportive fundamentals and land restrictions will temper a price correction in Vancouver and Toronto, both regions are increasingly vulnerable to a jump in unemployment or interest rates, or to a pullback in foreign wealth inflows. Longer term, fading affordability could undercut economic competitiveness. If prices continue to outrun incomes, workers will look to live elsewhere. In response, companies will need to raise wages faster than warranted by productivity growth to retain and attract highly-skilled workers from other regions and countries. This could erode the cost advantage of a weak currency and slow economic growth in the two cities that are home to one-in-four Canadians: if they retrench on spending, the rest of the nation will feel the sting.[3] It's noteworthy that, despite its allure for young people (one survey ranked Toronto first among 35 global cities as the most economically desirable place for young people), metro Toronto's net migration was the lowest in years (about 54,000 in 2015 according to the CMHC), partly because of a net outflow of migrants to other areas of the province.

Chart 6
Hot Demand



Sources: CREA, Haver Analytics

The Bottom Line: The dramatic regional shifts in Canada's housing landscape will widen this year – good news for current owners in British Columbia and Ontario, but not for Albertans. However, these differences could narrow in 2017 if oil prices rise. Longer term, any disruption to the inflow of foreign wealth (say due to China tightening capital controls or the Canadian dollar rising sharply) would likely cool the Vancouver and Toronto markets, as income is clearly no longer the major driver of home values in these two cities.

[1] To sustain price increases well in excess of income growth requires excessive credit growth (which does not appear to be the case today) or a steady influx of wealth. The latter could be sourced domestically (e.g., parental gifting of large down payments) or externally. Two recent studies (MacDonald Realty, University of B.C.) suggest buyers from mainland China are an important driver of high-end home sales in Vancouver.

[2] Toronto and Vancouver have created an eye-popping 171,000 jobs in the past year to March, more than the national economy usually creates in a year.

[3] Though accounting for 30% of Canadian home sales, Toronto and Vancouver account for 50% of the total value of transactions.