Housing Market Digest

Greater Toronto Area, September 2017

Synopsis: The GTA housing market is in the process of adjustment following two years of over-heating (mistakes were made, but in fortunately limited numbers). The GTA is almost never in a "balanced" situation, but that is a starting to look like a possibility for 2018.

Resale Market

Data from the resale market shows tentative signs that the downturn has ended. The annualized sales rate for August was 75,000, versus 68,400 in July. Mid-month activity hints at a rate close to 80,000 for September.

The rises in mortgage interest rates during the summer complicate the interpretation, as they should cause some buyers to accelerate to take advantage of pre-approvals. In consequence, there is a possibility that the recovery will be short-lived and sales could weaken again late this year.

Tame activity for listings (modest inflows of new listings and a still-low level of activity listings) is re-assuring that there is no panic on the sell-side.

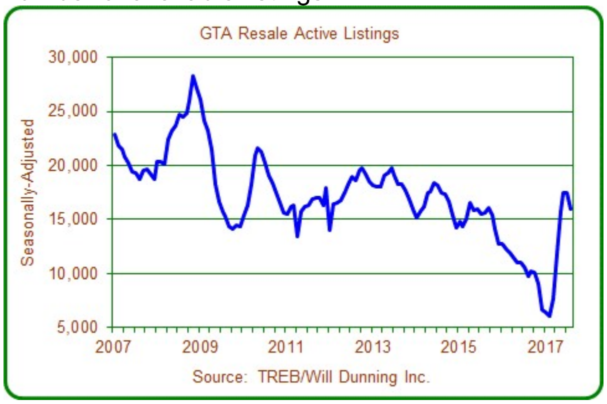
During January 2015 to April 2017, resale activity in the GTA was about 15,000 units higher than it should have been, based on economic fundamentals (the annualized sales rate averaged 109,000, whereas my model says the average should have been 103,000). The retrenchment since then means that the excess demand has been partially reversed (during May to August, total sales were 5,500 lower than they should have been). Sales should have fallen, due to movements in interest rates, but the drop was larger than it should have been.

My take-away from this is that while the market got out-of-whack for some time, the total amount of excess activity (15,000 units) was not very large in the context of a market area that has over 2.4 million dwellings.

During that period of excess activity, expectations became increasingly inflationary. This caused a few potential sellers to delay listings their homes (the volumes of new listings that were flowing in to the market fell slightly).

The combination of increased sales and reduced new listings pushed the sales-to-new-listings ratio far into sellers' market territory (I estimate the balanced market level at 52%).

Even more importantly (and this has not gotten enough attention) there was a collapse in the number of available listings.

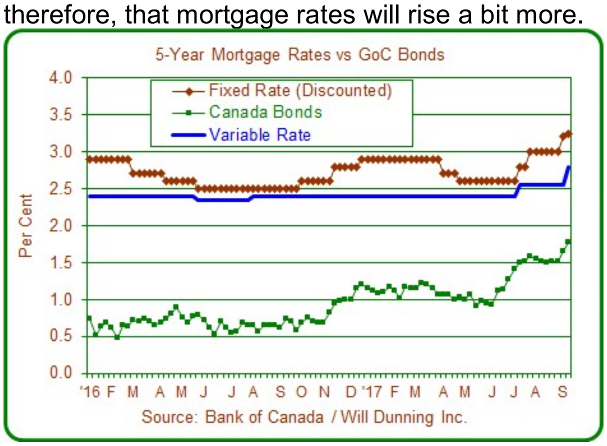


The severe and worsening supply shortage caused price growth to accelerate, so that by early this year there was a short-lived period of panic. Buyers started to make horrible mistakes, but in reality, the number affected was negligible, too small to do any real damage to the market or to the broader economy.

I have commented in the last few issues that there is risk around psychology – if enough people expect a crash then a crash can happen. Given recent trends for sales and listings, that risk is rapidly retreating.

The Outlook

Bonds yields (5-year GoCs) are now up by 1 point compared to the average seen during 2015 and 2016. Mortgage interest rates, on the other hand, have followed only partially (up by about a half-point versus the 2015-2016 average). It is likely, therefore, that mortgage rates will rise a bit more.



Higher interest rates may bolster resale activity in the short term, but we should expect that they will ultimately reduce sales by 5-10% (compared to what we should have seen during 2015 and 2016).

We should also assume that new listings will flow into the market at a normal rate. This would cause the sales-to-new-listings ratio to be slightly above the balanced market threshold of 52%, and therefore result in a moderate rate of price growth. The forecast table shows that the average price will be lower in 2018 than in 2017. This is because of the excessive prices seen early in 2017. Comparing the forecast December figures, by the end of 2018, the average price should be about $25,000 higher than at the end of 2017.

In the new homes market, sales have been much lower than they should be, due to a severe supply shortage. Future sales will be determined by supply rather than demand. If the supply situation can be improved, sales would expand next year.

On the other hand, new high-rise sales have been shockingly strong. Higher interest rates are likely to reduce demand next year.

Housing starts are projected to be roughly flat, although the mix will shift, with a large drop for low-rise dwellings and increased starts of apartments.

The apartment vacancy rate is projected to rise in 2017 (to 1.6%, versus 1.3% in 2016), due to increased completions of new housing. That said, the vacancy situation will remain quite tight, resulting in rapid rent growth.

One more comment: the OSFI proposal for a stress test for all federally-regulated mortgages is a major risk factor.

How to Reach Will Dunning Inc.

Telephone: 416-236-5115
Email: wdunning@sympatico.ca
Web site: www.wdunning.com

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Toronto Indicators

	2016 Actual	2017 Forecast	2018 Forecast
Job Growth (Toronto CMA)	1.2%	1.8%	2.1%
Resales (units)	113,725	97,400	96,100
Sales-to-New-Listings Ratio	73.4%	57.8%	55.3%
Ch. in Avg. Resale Price	17.3%	12.1%	-1.7%
GTA New Home Sales			
Low-Rise	17,975	9,300	11,300
High-Rise	29,186	34,300	24,400
Total	47,161	43,600	35,700
Housing Starts (Toronto CMA)			
Low-Rise Ownership	17,581	16,500	12,000
Condo Apartment	18,769	22,500	28,800
Rentals	2,677	2,500	2,500
Total	39,027	41,500	42,500
Apartment Vacancy Rate	1.3%	1.6%	1.5%
Rent Increase	2.6%	3.4%	2.7%
Source: forecasts by Will Dunning Inc. (Sept 18/17)			