

# Housing Market Digest

Greater Toronto Area, October 2017

**A Friendly Reminder to the Federal Government: if your regulations for mortgage lending damage the housing market, you will also hurt the economy. If the impact of OSFI's B-20 is as bad as many people think it will be, then in two years Canadians won't be in a very good mood.**

## A New Risk for Housing Markets

The Office of the Superintendent of Financial Institutions ("OSFI") has amended its "Guideline B-20" and now requires that all residential mortgages by federally-regulated lenders must be "stress-tested", at two percentage points above the contract interest rate (or the 5-year posted rate, if that is higher). In combination with the requirements for mortgage insurance, about 90% of all new mortgages will be tested. This can be expected to reduce housing activity by 10-15%. It is on top of the impact from recent rises for mortgage interest rates (another 5-10% drop in activity). The combined 15-25% drop in housing activity will affect the broader economy. In two years, employment (for all of Canada) could be 150,000-250,000 lower than it would otherwise be. There is a risk that house prices will fall in some communities. In a modern economy, a sustained drop in house prices is one of the most dangerous things that can happen: as happened in the US a decade ago, falling house prices can turn into widespread economic decline

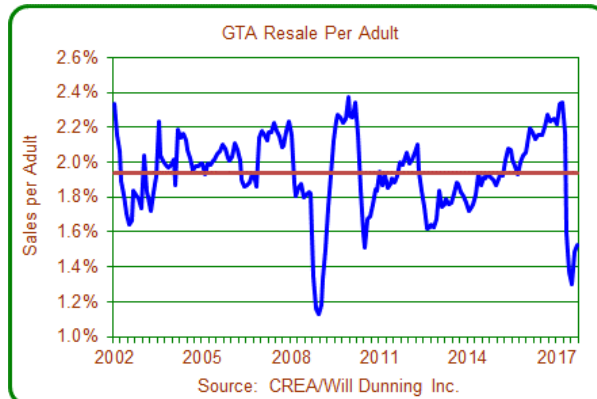
## Resale Market

During the past five months the sales rate has averaged 77,000, which is a 30% drop from what was seen in the prior two years (111,000). I would agree that the prior sales rate was excessive (resulting in an unhealthy rate of price growth), and a pause is welcome.

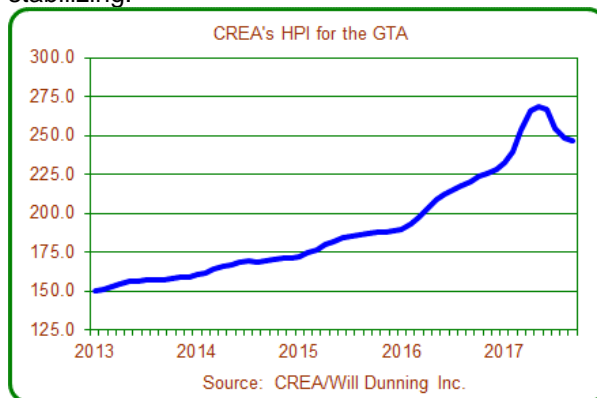
I like to look at sales on a per capita basis. The sales rate has now moved to considerably below average, whereas it had been considerably above average. A gradual return to the average level during the coming months would be healthy. This would mean seasonally-adjusted sales of just over 100,000 (on annualized basis), or 8,500 sales per month (again, seasonally-adjusted).

Yet, there are several factors weighing on the GTA housing market, including higher interest rates and the mortgage insurance stress test that took affect a year ago. My forecasting system suggests that those two factors will limit the rebound of sales, to a rate in the mid-90s (and a per adult sales rate of 1.75%, which would remain below the long-term average of 1.95%). The addition of the OSFI stress test could have an incremental impact of a

10% sales reduction (the moderate end of the expected range), leaving the sale rate at a very weak 1.55%.



CREA's House Price Index indicates that the excessive price growth seen last year has been partially reversed, and also that prices are now stabilizing.



The sales-to-new listings ratio ("SNLR") has fallen sharply, to 44%, from an average of 71% during the prior two years. With the "balanced market" threshold in the low 50s, the GTA has rapidly transitioned from an over-heated "sellers' market" condition to a "buyers' market". During the coming months, the SNLR should move into the mid 50s, which would bring moderate price growth. But, the new stress test is likely to prevent that recovery, and there could be some continued downward pressure on prices.

## New Homes Market

New home sales have fallen very sharply. During the past three months, low-rise sales have averaged just 2,600 (annualized). They should be around 20,000. Condo apartment sales have averaged about 16,000, which is drop of one-half compared to the average of 31,000 seen during

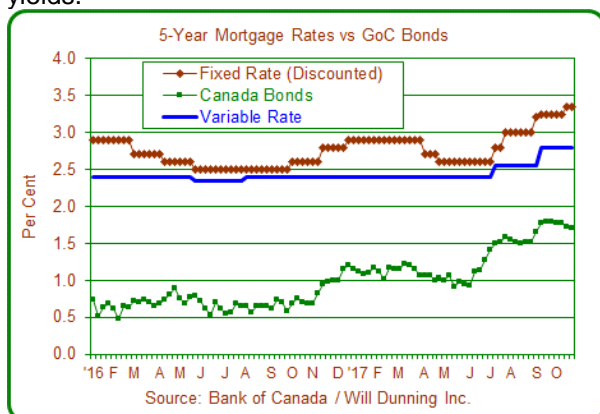
2016 to mid-2017. The current level is “about right”. Total new home sales have averaged just 19,000 during the last three months, but should be in the range of 35,000 to 40,000.

While new home sales should rebound next year from recent depressed levels, the OSFI stress test can be expected to limit the recovery.

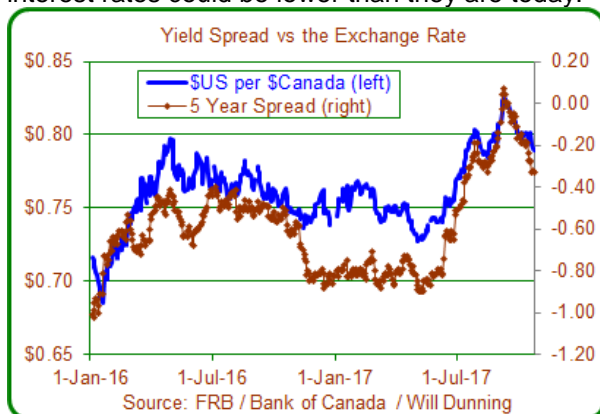
Housing starts lag behind sales of new homes, and therefore, OSFI might have little effect on starts in 2018. There would be an impact in 2019.

### Interest Rates

Bond yields (5-year GoC) have eased slightly during the past month. They are now 0.9 point higher than the average for 2015/16. Increases for mortgage rates have more-or-less followed bond yields.



A month ago, 5-year bond yields in Canada and the US were about equal. More recently, the spread has turned negative once again, which has contributed to a weaker dollar. But, the dollar is still relatively strong compared to the past few years. That plus higher interest rates and the OSFI stress test are significant factors that will increasingly weigh on the Canadian economy. Consequently, it is possible that by next spring our interest rates could be lower than they are today.



### The Outlook

Forecasts have been updated, with a scenario that estimates the impacts of OSFI's B-20. The scenario assumes that resale activity will be reduced by about 10% (this is on top of the effect that results from higher interest rates). This assumption of a 10% reduction in resale activity is at the low end of expectations. Impacts include a slowdown in job creation. By the end of 2018 the level of employment in the Toronto CMA would be about 15,000 lower than it would otherwise be.

The negative effects would most likely continue into 2019, because there is a strong “feedback loop” between the economy and the housing market. Job creation would continue to be weaker than it should be (by a further 15,000), which would further constrain housing activity, and so on.

Toronto Indicators			
	2017 Forecast	2018 Without B-20	2018 With B-20
Job Growth	2.0%	2.8%	2.3%
Resales (units)	93,400	94,300	84,100
Sales-to-New-Listings Ratio	54.3%	54.6%	47.3%
Ch. in Avg. Resale Price	12.3%	-3.1%	-7.1%
GTA New Home Sales			
Low-Rise	8,900	10,100	9,500
High-Rise	32,900	26,600	24,000
Total	41,800	36,700	33,500
Housing Starts			
Low-Rise Ownership	16,600	11,300	11,200
Condo Apartment	22,400	27,000	27,000
Rentals	2,700	2,500	2,500
Total	41,700	40,800	40,700
Apartment Vacancy Rate	1.6%	1.4%	1.4%
Rent Increase	3.4%	2.8%	2.8%

Source: forecasts by Will Dunning Inc. (Oct 27/17)

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