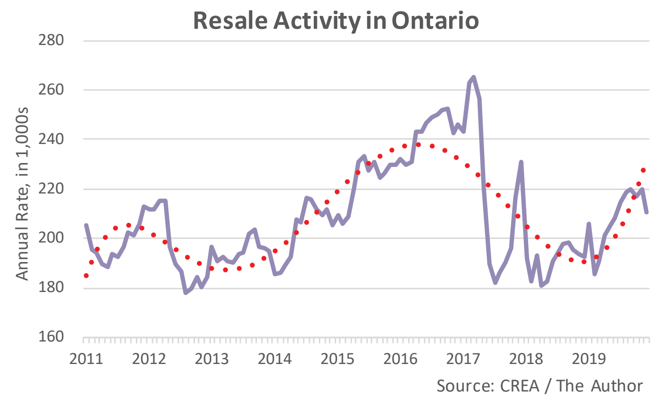
FOURTH QUARTER 2019

HOUSING MARKET DIGEST ONTARIO

MORTGAGE PROFESSIONALS CANADA

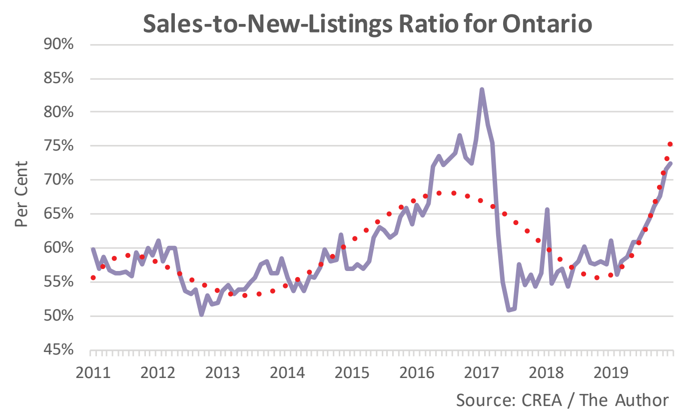
Resale Market

Resale activity improved during the spring and summer, but it appears to have peaked: the sales rate for the fourth quarter was about 1% lower than in the third quarter. Recent rises in mortgage interest rates might have given a push to sales, as buyers take advantage of pre-approvals before they expire. That positive effect may now be ending and we might see a slowing during the first half of this year.



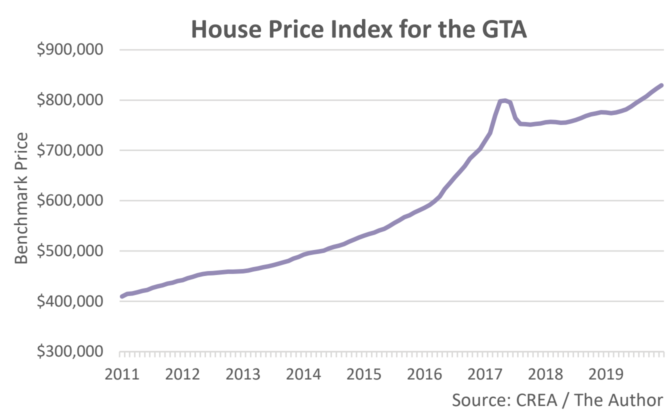
For the entire year, sales increased by 9%, to about 208,000.

On a population-adjusted basis, sales in 2019 were 8% lower than the long-term (2001-2019) average. Considering the very favourable economic fundamentals (a strong employment situation during the past three years, population growth at the most rapid in a generation, and low interest rates), activity should be above average, not 8% below average. This confirms that the mortgage stress tests continue to suppress home buying.



The sales-to-new-listings ratio ("SNLR") continues to tighten, to 71% in the fourth quarter (versus 64% in the third quarter). This is far above the threshold (estimated at 53%) for a "balanced market" (this is the level at which prices are expected to rise by 2% per year).

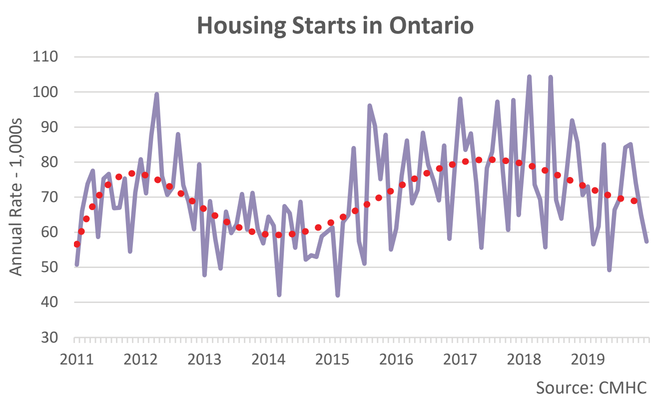
Prices are responding to the shift in the supply-demand balance: the benchmark house price for the Greater Toronto Area, calculated by the Canadian Real Estate Association ("CREA"), has increased by 6% versus the fourth quarter of 2018. We can expect continued rapid price growth for a while yet.

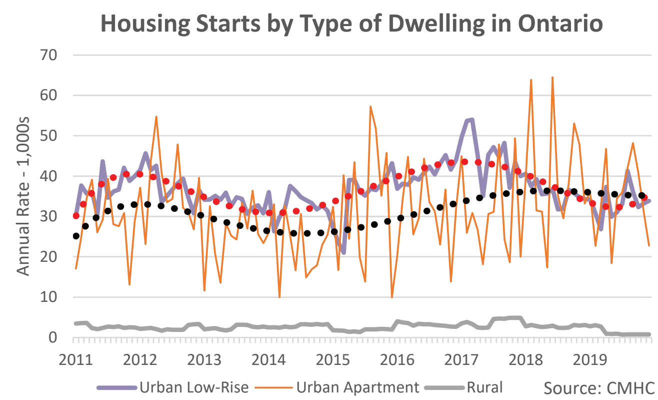


Housing Starts

The rate of housing starts fell in the fourth quarter (to 65,400, versus 78,700 in the third quarter). For the year, starts totaled just under 69,000, which was 12% lower than in 2018, and 4% below the 20-year average of 72,082.

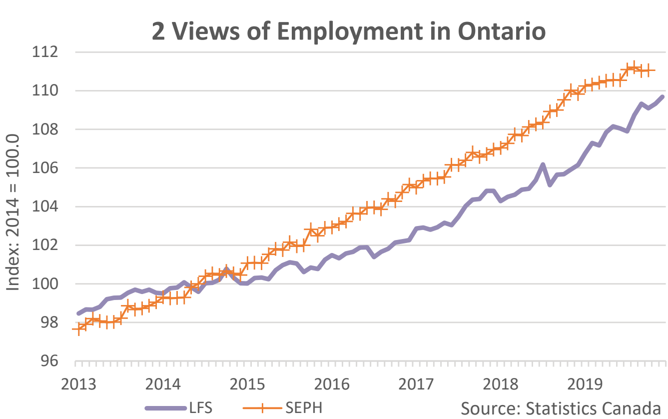
Starts of low-rise homes remain weak (particularly single-detached homes - for 2019, singles starts were 41% below the 20-year average). But, apartment starts have been quite strong (starts in 2019 were 42% above the 20-year average).

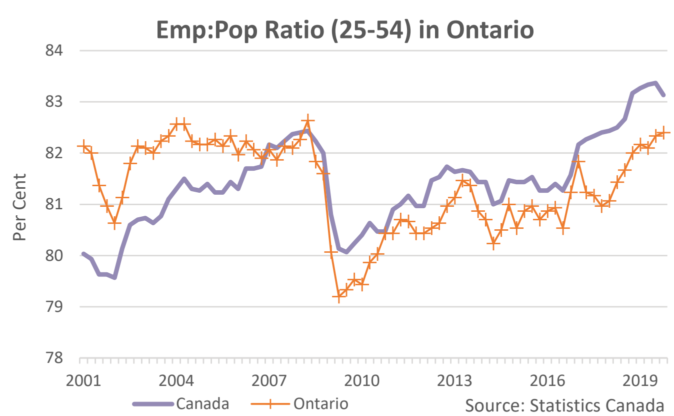




Employment Trends

Statistics Canada's two surveys of employment are telling different stories for Ontario. The Labour Force Survey shows continued rapid growth (3.3% year-over-year, as of December). The Survey of Employment, Payrolls and Hours shows growth of just 1.4% (but as of October). This discrepancy creates added uncertainty about the housing market outlook.



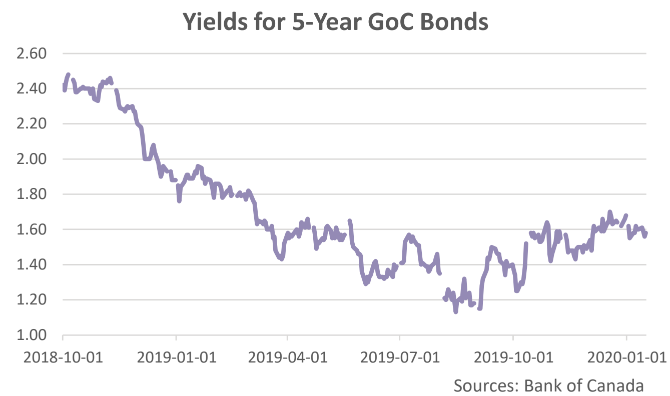


Employment Trends (Continued)

The employment-to-population ratio for "prime working age" adults (25-54) has improved during the past three years and is relatively strong in Ontario. This data also shows that while Ontario, for many years, had an employment rate above the national average, it has been below the national average during the past decade. This is a negative factor for future population growth, as Ontario has become comparatively less attractive to job seekers.

Interest Rates

Bond yields are now more-or-less where they should be: the current yield for 5-year Government of Canada bonds is 1.57% (as of January 16), within the range of 1.5-1.75% that I think is appropriate, and I don't expect these yields to change materially during the next few months. My opinion-estimate of a typical advertised "special offer" mortgage interest rate (5-year fixed-rate from major lenders) has been 2.85% since early November.



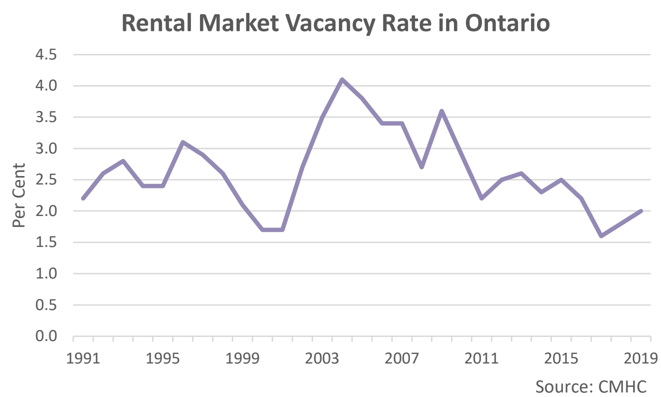
The spread between mortgage rates and bond yields remains skinny (in the area of 1.2-1.3 points versus a long-term average of 1.8 points), due to intense competition. Variable rates are unchanged (my opinion-estimate remains at 2.95%).

Rental Markets

Every October, Canada Mortgage and Housing Corporation does a comprehensive survey of residential rental markets in Canada. The results for 2019 were released on January 15. For the urban areas of Ontario, the October 2019 vacancy rate was 2.0%, which was a slight rise from 1.8% a year earlier. This is the fifth lowest figure of the past three decades. The average vacancy rate for the period shown in this chart is 2.6%.

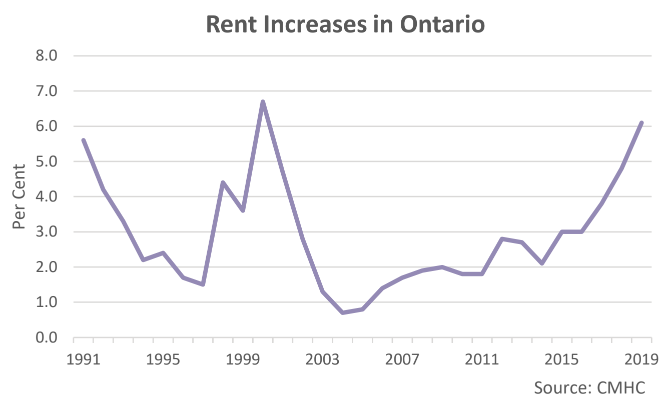
I attribute the low vacancy rates to insufficient production of new housing. It's not just construction of rentals: insufficient production of housing for ownership reduces movements out of rentals. During 2019, there were about 58,900 housing completions. This is 13% below the 20-year average, but at a time when strength in employment (and population growth), are creating a need for more production of new housing. Based on trends for housing starts (as shown earlier), we should not expect the vacancy rate to loosen materially, which will result in continued upward pressures on rents.

Rental Markets (Continued)



CMHC estimates that rents increased by 6.1% during the past year, which is the second fastest rate of increase within this dataset.

Occasionally, comments are made that a healthy vacancy rate is 3%. I have investigated the origins of this, and as far as I can tell, this has never been supported by actual research. In response, I have calculated the statistical relationships between vacancy rates and rent increases. For Ontario, we should expect rents to increase by 2% per year when the vacancy rate is 3.1%. This is my opinion on a healthy ("balanced market") vacancy rate. The calculated balanced market vacancy rates vary across the provinces and cities of Canada. For Toronto and Ottawa, the balanced market vacancy rates are in the area of 2%. In most other urban areas of Ontario, the rates are at or above 3%. For all of Canada, the estimated threshold is 3.7%.



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