

HOUSING MARKET ASSESSMENT

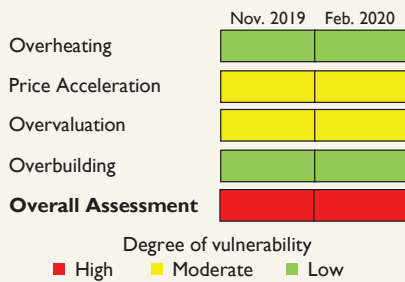
Victoria CMA

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Highlights

Results Overview Victoria CMA



- CMHC's HMA Framework detected a high degree of vulnerability in the overall assessment for Victoria¹.
- Evidence of price overvaluation remained moderate as one of the models persistently detected overvaluation in at least two quarters within the last year.
- Multiple segments of the market continued to stabilize and trended toward balanced conditions, especially apartment homes.
- Single-family homes remain the majority of inventory although the recently added inventory includes apartments as well.

HMA Overview²

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 fundamentals³. 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.

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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

Low Evidence of Overheating

CMHC’s HMA framework continued to detect low evidence of overheating in Victoria in the third quarter of 2019 as the sales-to-new-listing ratio (SNLR) remained well below the critical threshold of 80%, for the past 9 quarters. The most recent observation of overheating with SNLR over the critical threshold was in the first quarter of 2017. Therefore the low rating was maintained in Q3 2019.

Both sales and new listings trended downwards in Q3 2019, even though the SNLR is slightly higher compared to the previous quarter. This is due to a greater decline of new listings by 21%, relatively to a smaller decline of sales by 18%. Active listing has also

gone down by 5% between Q3 and Q2. As supply adjusts to the slower pace of the resale market, Victoria continues to trend towards balanced market conditions.

Although single detached homes continued to be the majority of the homes available for sale, sales in Q3 2019 increased compared Q3 2018 while active listing remained flat, resulting in a slightly upward trending sales-to-active-listing ratio (SALR). The apartment market trended towards balanced conditions, with fewer sales and active listings

between Q3 and Q2 in 2019, as well as a 9 percentage point decline in SALR year-over-year.

Moderate Evidence of Price Acceleration

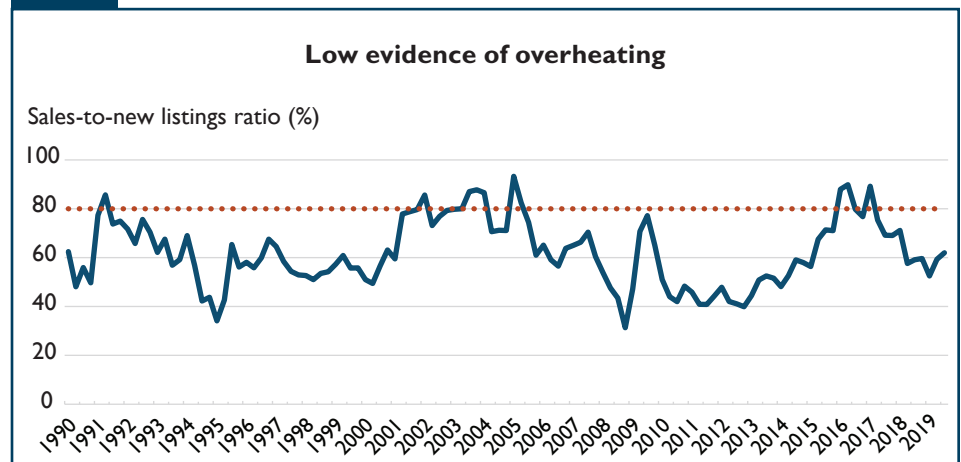
The moderate rating of price acceleration remained in the third quarter of 2019 for Metro Victoria. The test for price acceleration did not exceed the critical threshold in Q3 2019, however, since the last observation of an over-the-threshold signal was detected within the last three years, the moderate rating remained.



Pershing Sun
Senior Analyst
Economics

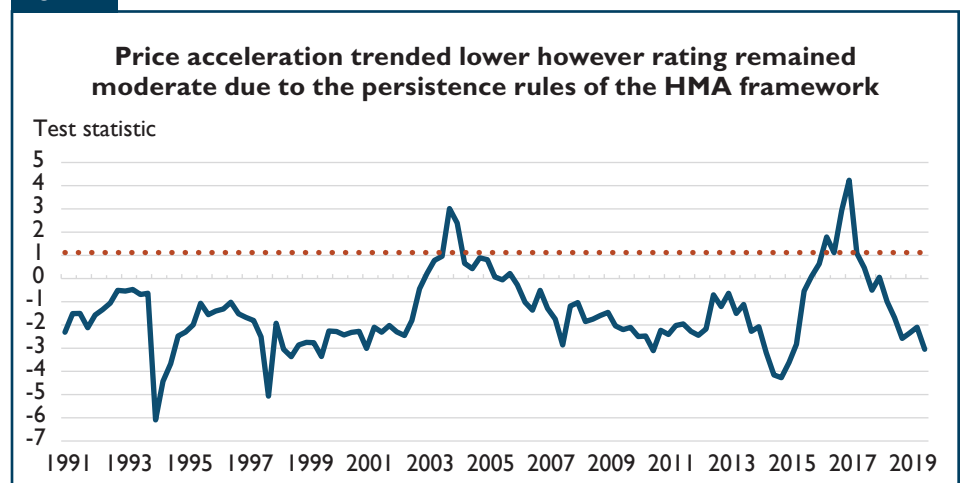
“The HMA framework maintained a high degree of vulnerability for Metro Victoria in the third quarter of 2019. Moderate ratings remained for price acceleration and overvaluation due to persistence rules as positive signals were detected in recent history. Home prices continue to stabilize along with listings in many segments, especially single-family homes. As the market trended towards balanced conditions, growing population added to stronger demand in both ownership and the rental market especially when income growth has remained below inflation.”

Figure 1



Source: CREA and calculation (threshold) by CMHC

Figure 2



Source: CREA and calculations by CMHC

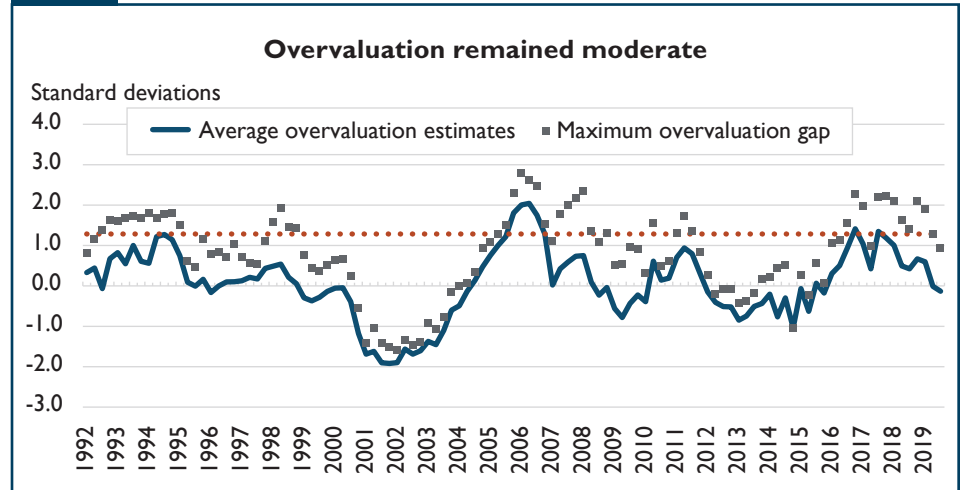
Home price declined on a year-over-year basis, reflected by various price indexes adopted in the HMA framework. This includes the inflation adjusted average MLS® price (down 6.32%), the Teranet® House Price Index (down 1.62%) and the New Housing Price Index (down 3.46%), indicating a general cooling condition in both new home and resale home segments of the ownership market. The monthly average home price of townhouses declined by 4% between Q2 and Q3 in 2019, whereas single-family homes and apartments prices decline by less than 1%.

Moderate Evidence of Overvaluation

The HMA framework continued to detect moderate evidence of overvaluation in the third quarter of 2019. The average gap between actual home price and estimated home prices remained below zero, indicating that the actual home price declined, while the average of estimated home price based on economic fundamentals increased between Q2 and Q3 2019. This resulted in a smaller imbalance as the market adjusted downwards while economic and demographic fundamentals continued to grow, reflected though the lower-trending average overvaluation estimator shown in Figure 3.

The estimated home prices takes into consideration a number of factors, including population growth,

Figure 3



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.

personal disposable income, mortgage rate, carrying cost for homeowners, and labor productivity (construction sector). In Metro Victoria, the young-adult population, a group that contribute the most to the growing housing demand in either form of ownership or rental, continued to increase in Q3. Similarly, the inflation adjusted personal income also continued to grow in Q3, although at a slower pace than inflation, which might contributed to a weakened demand as purchasing power has gone down.

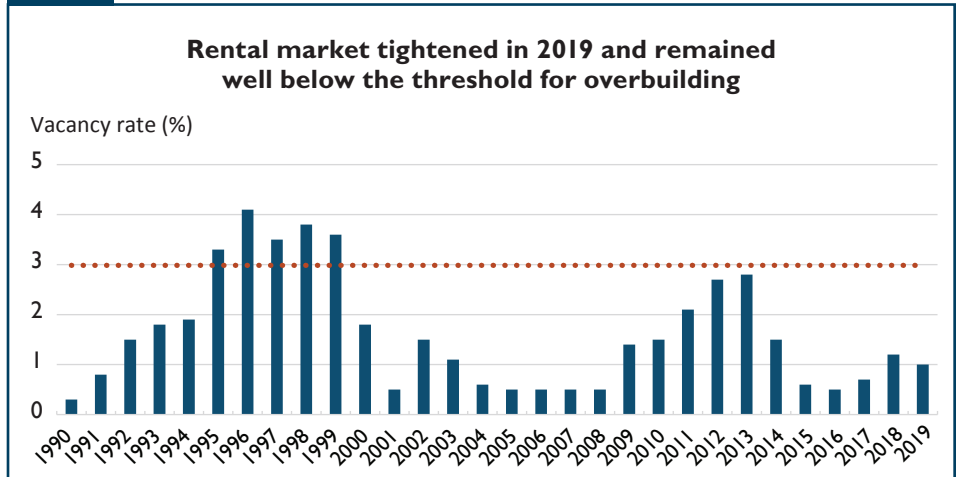
Labor market remained relatively flat, as average monthly unemployment rate in Q3 grew slightly higher than Q2 with fewer jobs created on average every month between Q3 and Q2. However, a lower mortgage rate contributed to the increase of the estimated home prices through incentivizing higher demand.

Overall, taking into consideration all of the factors and models, the moderate rating is maintained, as a result of one of the models detected overvaluation for two quarters persistently in the past year.

Low Evidence of Overbuilding

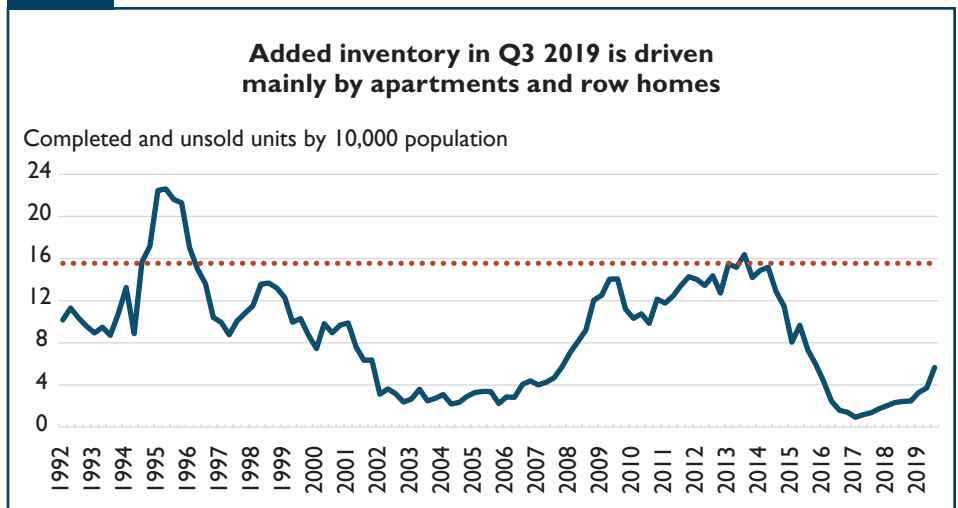
Victoria continued to indicate low evidence of overbuilding. Although the rental market tightened in 2019 as vacancy rate declined from 1.2% in 2018 to 1% as of October 2019, it is still well below the threshold of 3%, indicating continued strong demand for rental homes. New rental supply remained relatively flat since the peak construction period of late 2018. Inventory of completed and unsold units (per 10,000 population) continued to trend higher since the trough in Q1 2017, and remained below the threshold of 15.6. The majority of the added inventory in Q3 2019 are apartments and row homes, as the demand for more affordable homes outgrew that of single-family homes in previous quarters. This has directed builders to multi-family homes and rental projects that were completed in Q3 2019.

Figure 4



Source: CMHC

Figure 5



Source: Statistics Canada and CMHC

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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