

Will the slowdown in the housing market also affect Toronto and Vancouver?

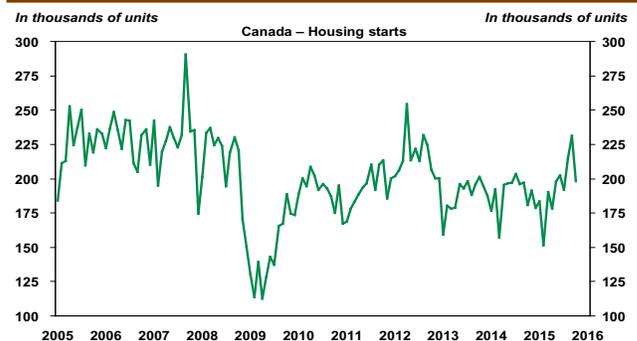
A slowdown, or even a decline, in the housing sector is already perceptible in most parts of the country. But the Toronto and Vancouver markets are still advancing strongly, inflating the national data. This vitality is due to demographic factors and certain particular circumstances of these areas, which have been boosting demand. But that demand could run out of steam in the next few years, paving the way for a possible slowdown in the Toronto and Vancouver housing markets.

Canada's housing market has been skyrocketing since the beginning of the 2000s. Both new builds and sales of existing properties have been vigorous, contributing to a significant rise in prices. Indeed, the very high prices of real estate have aroused some concern in recent years, as the debt levels of Canadian households keep increasing.

Right now, the high household debt levels are not causing too much of a problem, since interest rates are remaining very low. The concern relates more to what would happen in the event of interest rates climbing, or of the unemployment rate rising, in which case a larger proportion of households could find themselves struggling to meet their financial obligations. But in recent years the federal government has announced several measures designed to restrict mortgage credit with the goal of slowing down housing market activity, thereby reducing the financial risks hanging over households.

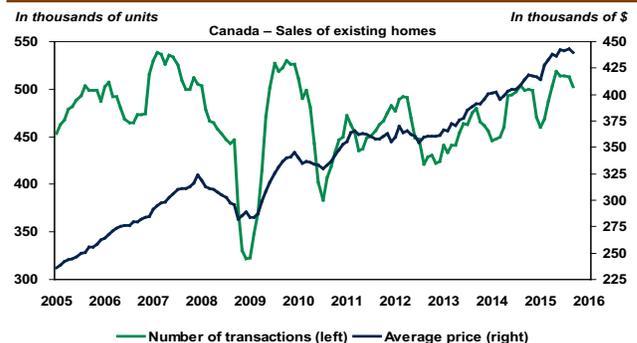
In these conditions, a slowdown, or even a slight contraction, in the housing market has been forecast for some time now. Yet the trend in Canadian data keeps confounding that prediction, and still shows no sign of a noticeable slowdown. The number of housing starts in this country has remained quite high—around 190,000 units—for nearly two years now (graph 1). The same finding applies to sales of existing homes. Not only is the number of transactions very high from a historical perspective, but the trend is still heading up. Prices of existing homes also keep increasing (graph 2).

Graph 1 – Homebuilding is still quite strong in Canada



Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

Graph 2 – Resales of existing homes are still brisk, and prices keep rising



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

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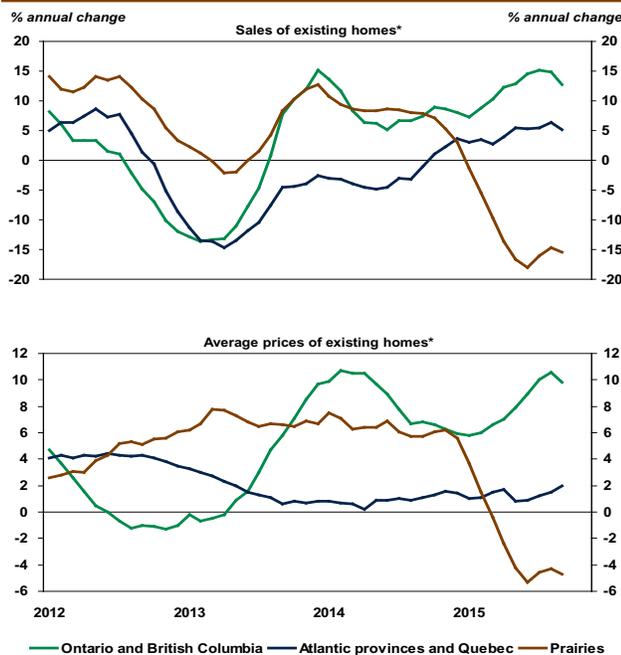
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SIGNIFICANT REGIONAL DISPARITIES

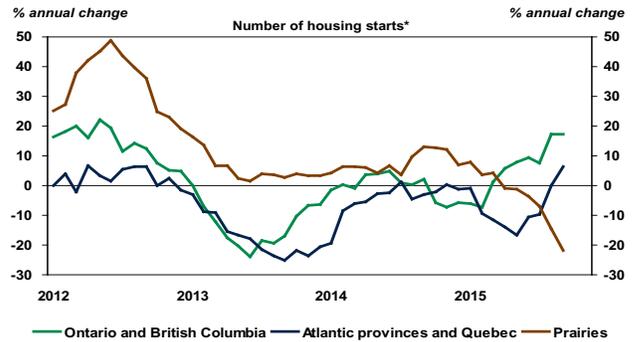
However, this apparent vitality in the Canadian data hides some major divergences from one region to another. On one hand, the housing market is still strong in Toronto and Vancouver, considerably inflating the national numbers due to the relative sizes of those two markets (graphs 3 and 4). On the other hand, conditions are quite different in Quebec and the Atlantic provinces, which exhibit moderate growth, and in the Prairies, where a downturn has been observed in recent months. This change of pace is mainly attributable to the restrictive measures that have been introduced by the federal government in recent years. It also represents a natural adjustment between supply and demand following the significant price increases that have taken place during that period. Finally, there is no denying that the recession affecting the oil-producing provinces has played a major role in the recent tribulations of the housing market in the Prairies. In short, it would be a misconception to think that the Canadian real estate market is not making adjustments. Rather, it is the continued growth in Ontario and British Columbia that is skewing the national numbers. That said, should we expect the slowing pace of the housing market to eventually spread to Ontario and B.C.? To answer that question, an analysis of the factors that influence real estate market trends in those two provinces is called for.

Graph 3 – The housing market is still robust in Ontario and British Columbia



* Six-month rolling averages. Sources: Canadian Real Estate Association and Desjardins, Economic Studies

Graph 4 – Homebuilding is picking up steam in many regions

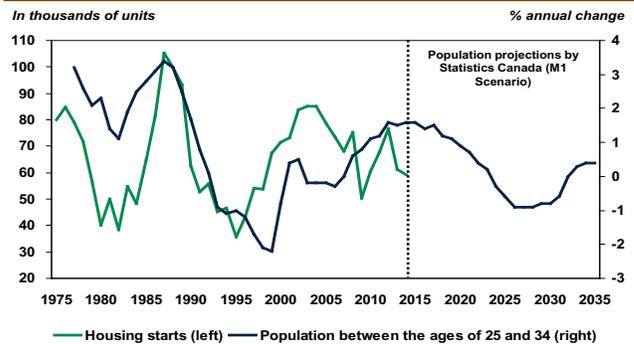


* Six-month rolling averages. Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

AN EXPANDING POPULATION

Fundamentally, demand for real estate is largely influenced by changes in the population. More people means a larger number of households and, consequently, greater demand for homes. More specifically, the population between the ages of 25 and 34 is the source of most new household creation. As may be seen in graph 5, the growth in that segment of the population has accelerated significantly in Ontario since the beginning of the 2000s. This has obviously promoted the construction of new homes. According to demographic projections by Statistics Canada, this population segment is likely to keep growing robustly for a few more years in Ontario. But a gradual slowdown could begin in 2018, which should lead to contraction in demand for homes.

Graph 5 – Growth in young households could taper off in the coming years in Ontario



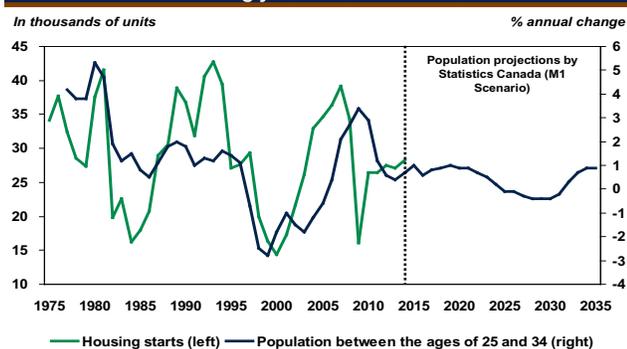
Sources: Statistics Canada, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

In theory, growth in a province's population arises from three sources: natural growth, taking into account births and deaths; international migration, and interprovincial migration. As far as natural growth is concerned, population growth in Ontario has been pretty much in proportion with what has been observed in Canada as a whole in recent years. Thus the province does not stand out particularly in that regard. But things are different in the area of

international migration. Since 2000, Ontario has taken in nearly 1.8 million international immigrants. This represents nearly one of every two immigrants in the country. But during that period, Ontario has also experienced a net loss of a little over 100,000 inhabitants through interprovincial migration, in particular to the Western provinces. All told, Ontario's population has greatly benefited from a major contribution by international immigration in recent years. The Greater Toronto Area has obviously greatly benefited from that momentum.

British Columbia's position in terms of population is a little different. Growth in the population between the ages of 25 and 34 has certainly increased considerably since the beginning of the 2000s, but a plateau was observed earlier, starting in 2010. Since then, growth in that segment of the population has slowed, stabilizing at a level slightly below 1%. According to Statistics Canada projections, we can expect growth in that population segment to remain close to that level for several years to come. In these conditions, the number of housing starts should stay at a more moderate level, in line with its historical average (graph 6).

Graph 6 – Growth in young households should be fairly stable in the coming years in British Columbia



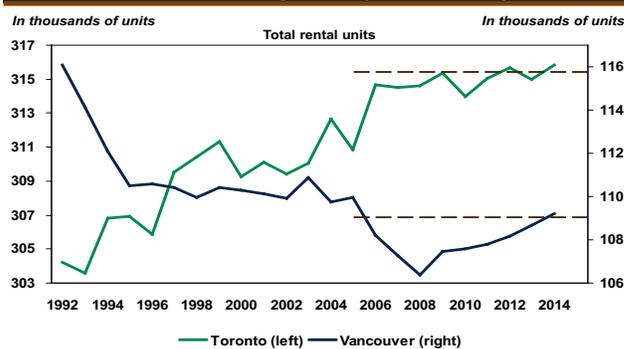
Sources : Statistics Canada, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

Looking at the various sources of change in British Columbia's population, natural growth has put the province at something of a disadvantage, since the balance between births and deaths in recent years has been weaker there than in Canada as a whole. But the province makes up for that with significant growth in international immigration. British Columbia has welcomed nearly 590,000 international immigrants since 2000; this represents over 15% of the country's international immigration, a proportion higher than the province's relative weight in the country's total population. B.C. also stands alone with Alberta in posting a positive balance of migration with the other provinces. Since 2000, the province has enjoyed a net gain of over 57,000 inhabitants from other parts of the country.

A SHORTAGE IN RENTAL DWELLINGS IS MAKING ITSELF FELT

Another factor that greatly influences the Toronto and Vancouver housing markets is the trend in rental vacancies. As may be seen in graph 7, the number of rental units in Toronto has hardly increased at all between 2006 and 2014. In Vancouver, the number of rental units has indeed risen in recent years, but prior to that (between 2005 and 2008) it declined significantly. As a result, the number of rental units in Vancouver was about the same in 2014 as it was in the mid-2000s. Yet, as mentioned earlier, the populations of Ontario and B.C. have grown significantly in recent years. Moreover, the surge in prices (especially of single-family dwellings) has made homes considerably less affordable. Thus, demand for rental dwellings has been quite strong in recent years, while the supply has remained limited.

Graph 7 – The number of rental units in Toronto and Vancouver has not increased significantly in around 10 years



Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

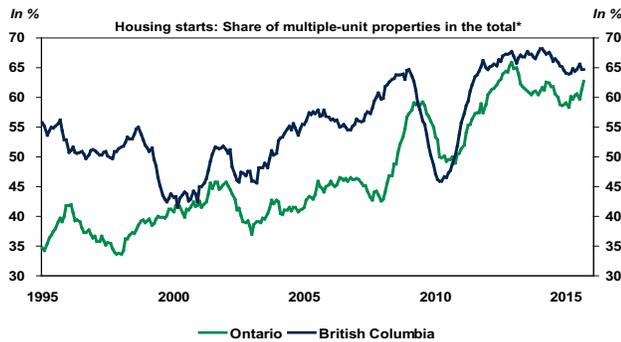
In these conditions, many households have turned to renting condominiums. Slightly over 29% of the condo inventory in metropolitan Toronto was offered for rent in 2014. In Vancouver, nearly 25% of condos were rented out. By comparison, the proportion of the condo inventory offered for rent was only 13% in Montreal, and 10% in Quebec City.

To meet this growing demand, condos have become a significant component of the Toronto and Vancouver home-building sectors lately. The proportion of condos in total housing starts has risen sharply in recent years in both Ontario and British Columbia (graph 8 on page 4).

A BRISK RESALE MARKET

Obviously, resales of existing properties move up and down in complementary fashion with housing starts, according to changes in demand for homes. In recent years, sales of existing homes have advanced significantly in Ontario and British Columbia, mainly due to the vitality of the Toronto and Vancouver markets. Average prices in those areas keep

Graph 8 – The proportion of multiple-unit properties has increased in the Ontario and B.C. building sectors



* 12-month rolling averages.
Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

setting new records, which for some time now has been arousing concern about overheating.

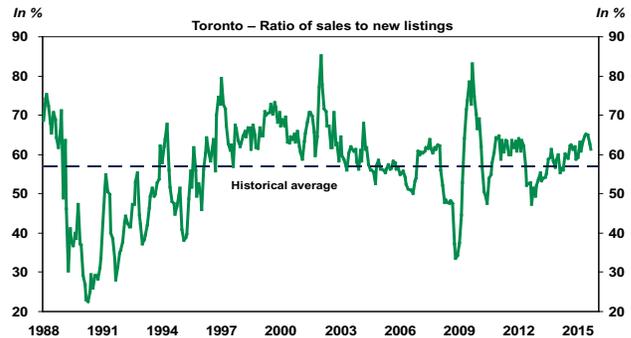
What needs to be understood is that the average home prices in Toronto and Vancouver are subject to some upwards distortion, since a small proportion of the market is facing very high prices, which inflates the average of the total transactions. Moreover, the prices of the most expensive properties have risen faster in recent years than those of other market segments. For example, the average home price in Vancouver’s west end is nearly 3 million dollars. That very high level gives a big boost to the average of all transactions in Greater Vancouver, which was \$857,272 last September. The MLS Home Price Index calculated by the Canadian Real Estate Association corrects these distortions to some degree. Thus, the latest MLS benchmark price for Vancouver is \$722,300, well below the average determined based on transactions. The same finding may be seen in Toronto: the MLS benchmark price (\$567,000) is lower than the average of prices based on transactions (\$627,502). These lower average prices suggest that the imbalances in these areas are not as huge as one might initially think.

Actually, the trend in the ratio of sales to new listings paints a fairly positive picture of the Toronto and Vancouver real estate markets (graphs 9 and 10). In both cases, the ratio is surpassing its historical average, providing evidence of fairly lively demand and, consequently, promoting price growth. Moreover, the inventory of existing homes currently on the market is quite low compared with demand. The number of months of inventory is now particularly low in both Ontario and British Columbia (graph 11).

A MARKET DECREASE IS NOT INEVITABLE... AT LEAST IN THE SHORT TERM

In the final analysis, demand in the Toronto and Vancouver housing markets appears to be quite robust. The combination of demographic factors, a shortage of rental units, very

Graph 9 – Sales are quite high in relation to listings in Toronto



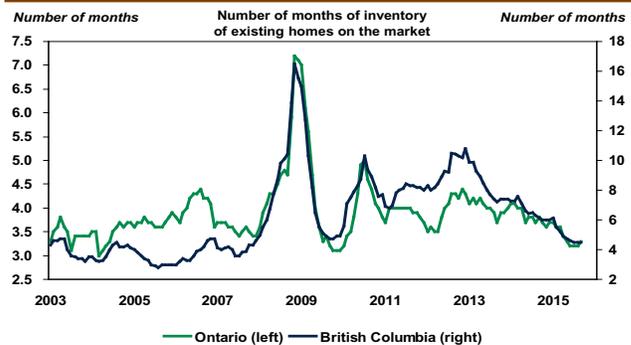
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

Graph 10 – Sales are quite high in relation to listings in Vancouver



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

Graph 11 – The inventory of existing homes on the market is low in Ontario and British Columbia



Sources: Canadian Real Estate Association and Desjardins, Economic Studies



attractive financial conditions (with historically very low interest rates) and the presence of investors¹ has stoked demand in recent years. Moreover, economic conditions are quite sound in both Ontario and British Columbia, since both provinces could well post the fastest real GDP growth in the country in 2015 and 2016.

Obviously, the very high prices are increasingly fuelling the issue of affordability. According to the Desjardins Affordability Index², the Toronto and Vancouver areas are among the least affordable in the country. Therefore, it would be surprising to see those two housing markets maintain such a high pace of growth; some degree of slowdown is to be expected.

That said, the real decrease that people are worrying about in the Toronto and Vancouver housing markets could take a while yet to materialize. According to demographic projections, growth in the Ontario population between the ages of 25 and 34 will not start to slow significantly until 2018. In British Columbia, a slight slowdown in growth of that population segment has been perceived since the beginning of the 2010s, and the phenomenon could intensify in the next decade. This slower population growth will inevitably mean diminishing demand in the housing market. Therefore, within two years or so, we could start to see a slight decline in housing starts, resales and prices of existing properties in Toronto and Vancouver.

There is also a risk that investors, whether Canadian or foreign, could eventually lose interest in the Toronto and Vancouver real estate markets. If so, the loss of that support could bring forward, or accelerate, the expected pullback in those housing markets.

Finally, the gradual rise in interest rates expected starting in 2017 will be an additional factor that will contribute to the winding down of the housing market across the country. Ontario and British Columbia could feel the effects more severely, however, since they are the only regions that have not already seen a slowdown.

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¹ On the subject of investors, it should be noted that a certain proportion of them come from outside Canada. However, the current data do not enable us to quantify this phenomenon accurately. Work is underway at the Canada Mortgage and Housing Corporation (CMHC) that could eventually shed some light on the relative weight of foreign investors. That said, the fragmentary information that is currently available suggests that the weight of foreign investors is, on the whole, fairly low on average in Canada, but that the Toronto and Vancouver areas attract more foreign investors.

² Desjardins, Economic Studies, Desjardins Affordability Index, "Access to ownership improves in Canada and Ontario, but stagnates in Quebec", October 29, 2015, www.desjardins.com/ressources/pdf/iad1015e.pdf?resVer=1446123526000.