Canadian Housing Update: Climate Change

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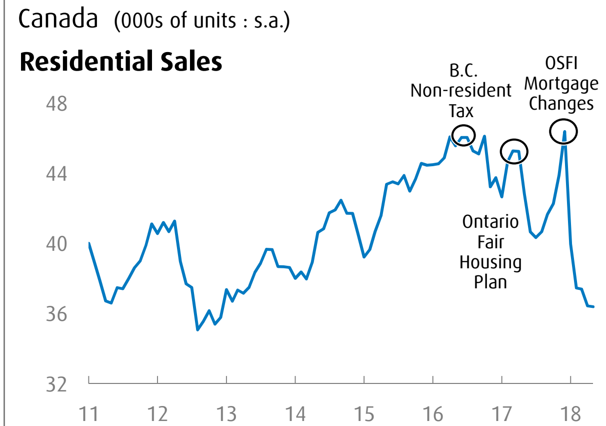
A cool breeze has swept across the Canadian housing landscape. Overheated markets in Southern Ontario and British Columbia have cooled in response to policy measures and a slower economy. But the blunt measures, largely what the doctor ordered for Vancouver and Toronto, have also chilled other regions, notably the still-struggling oil-producing provinces.

Nationally, existing home sales fell 16.2% in the year to May, declining every month this year to their lowest level in five years (*Chart 1*). Four of every five cities posted annual declines, with parts of British Columbia and Southern Ontario hit hardest. Excluding Vancouver's 35% tumble and Toronto's 23% drop, sales in the rest of Canada fell 12.9% in the past year, with most provinces feeling the pain. Although markets are largely balanced, more tilt toward buyers than sellers. The national sales-to-listing ratio (50.6) is the lowest in five years and below long-run norms (54). Hence, benchmark prices are rising at their slowest rate (1.0% y/y) since the 2009 recession.

The cooldown is intentional. The central bank no longer sees the need for crisis-level interest rates, the federal government is worried about household debt, and B.C. and Ontario fear that foreign investors have made their two largest cities too expensive for most families. Higher rates and tougher mortgage rules have cooled household borrowing to a sub-5% pace for the first time in 3½ years, halting the upward trend in the debt-to-income ratio (*Chart 2*). The new rules, which took effect January 1, pulled some sales into late last year, only to see them nosedive in January (-13.8% s.a.), notably in Toronto (-24.9%) and Vancouver (-13.5%). Provincial policy measures such as the non-residents buyers' tax, combined with poor affordability, had already thrown a wet towel on these two sizzling markets.

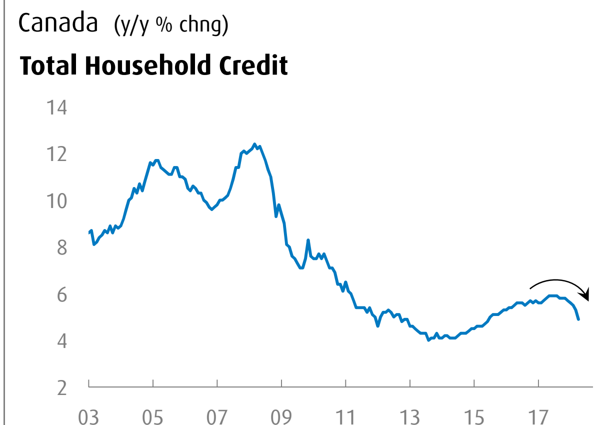
Several factors are restraining the downturn. A net inflow of nearly 400,000 international migrants has lifted the population 1.4% in the past year to 37 million, the fastest since 1991 (*Chart 3*). More young millennials are also looking for a place to live. At more than 5 million strong and growing 1.6%, the cohort of 25 to 34 year olds is in peak home-buying form. Outside Toronto, Vancouver and Victoria, housing remains inexpensive (*Table 1*). In most cities, a typical property costs less than 4-times family income, while mortgage payments consume less than 20% of salaries, little changed from the mid-2000s. Borrowing five-year money costs little more today than five years ago and remains well below historic norms. Government intensification policies that restrict the supply

Chart 1
Policy Pummeling



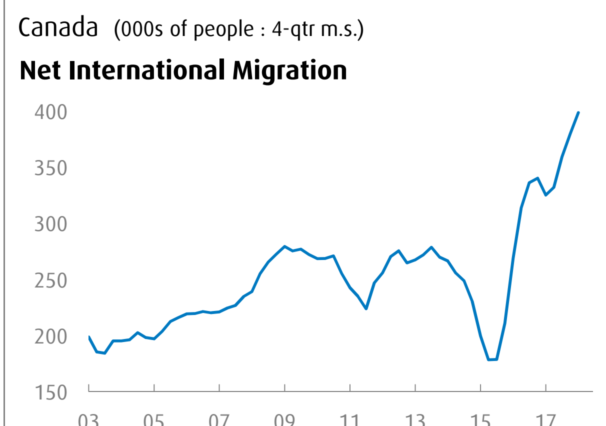
Sources: BMO Economics, Haver Analytics

Chart 2
Rolling Over



Sources: BMO Economics, Haver Analytics

Chart 3
Record Migration



Sources: BMO Economics, Haver Analytics

of ground-related units, low joblessness and well-paying, high-tech jobs are also cushioning prices.

Of course, with real estate, the eye-catching trends are at the local level. Here's what the **regional thermometer** is showing:

Red hot—Vancouver condos: Lean inventories, a tiny 0.6% rental vacancy rate, one of the lowest jobless rates in the country (4.1%), some speculation (according to the Bank of Canada), and baby boomers buying for their children have combined to lift Vancouver's benchmark condo price 20% in the past year and 42% in two years (*Chart 4*). Vancouver has the highest condo share of residential units in the nation (32% in 2017), due to zoning restrictions. Prices are also supported by delayed permit approvals and rising material costs. However, the gains are bound to slow as rising interest rates squeeze affordability. The median family requires 44% of income to service a mortgage on a typical condo, up from 34% a year ago. Supply is also mounting amid a near-record number of condo starts and overall completions running near 24,000 in the past year, more than enough to meet household formation (15,000 to 18,000). Foreign investors are likely looking eastward after the sales tax was expanded to 20% from 15% and broadened to more areas.[1]

Hot—Toronto condos: Resale condo prices in the GTA topped \$500,000 for the first time ever in May. But after popping 8.3% in the past year and 41% in two years, the market is showing signs of fatigue, with sales down 29.7% y/y in Q1. Non-residents, who already own 6.3% of condo units and 2.6% of all properties in metro Toronto, have bristled at the 15% sales tax. While affordability is less daunting than in Vancouver, it is fading fast. The median family spends 32% of income on mortgage payments, up from 27% a year ago. Investors, who typically buy half of new units, have stepped back as rents no longer cover carrying costs. Mortgage payments on a typical resale condo tally \$2,200 per month (based on a 3.29% five-year rate, 25-year term and 10% down payment), more than gobbling up the average \$1,995 rent on a one-bedroom condo in the GTA in Q1 even before maintenance and taxes. True, rents have soared—one-bedroom up 11.4% y/y in Q1—due to a 0.7% vacancy rate, but so too have prices. Although a record-low inventory of unsold condos and fewer resale listings will support prices, the record number of units started and under construction in Q1 will moderate future gains.

[1] In 2017, 7.8% of Vancouver's condo units and 4.6% of all properties were owned by non-residents of Canada, the highest share in the nation.

Table 1: Based on the benchmark price, 25-year amortization, discounted 5-year fixed mortgage rate and down payment equal to half of annual income (national average about 10% today, lower in Vancouver and Toronto). [a] = median family income is estimated after 2015 using average annual growth in past 10 years; [b] = average house price used.

Table 1

Cheap and Dear

Mortgage Service Costs (% of median family income)[a]

	2005:Q1	Apr.-May 2018	
Mortgage Rate	4.9%	3.3%	If 5.3%
Vancouver	42	70	86
Toronto	31	51	62
Victoria	28	37	46
Montreal	20	21	26
Calgary	17	19	23
Winnipeg[b]	11	17	21
Ottawa	16	17	21
Halifax[b]	16	17	20
Quebec City[b]	12	14	17
Saskatoon	11	13	16

Sources: BMO Economics estimates, Haver Analytics, Bank of Canada, Statistics Canada, Canadian Real Estate Association

Chart 4

Reach for the Skies

Vancouver (C\$ 000s)

HPI Benchmark Price—Condos

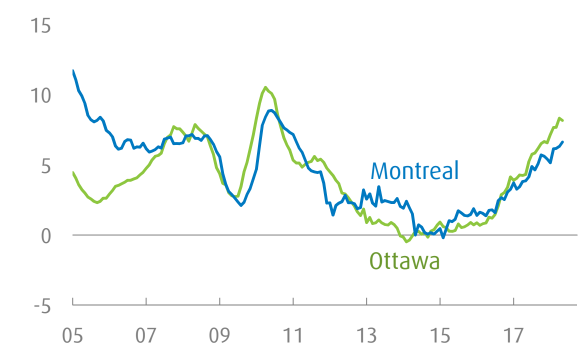
Sources: BMO Economics, Haver Analytics

Chart 5

Heating Up

(y/y % chng)

HPI Benchmark Price—Composite



Sources: BMO Economics, Haver Analytics

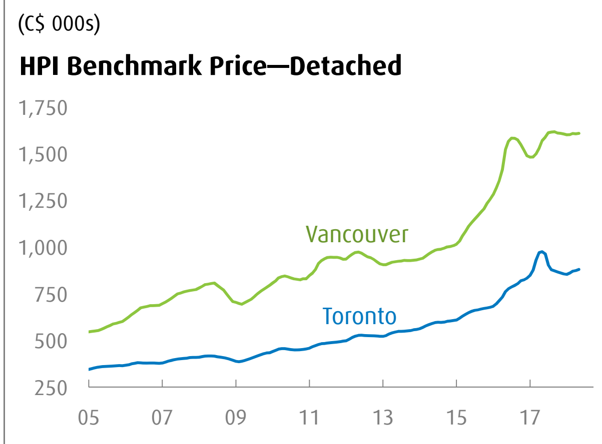
Heating up—Ottawa and Montreal: Sellers are seeing the best price increases in years (*Chart 5*). Stoking demand are healthy affordability, strong job growth and some shift in non-resident buyers to these regions (though they still command a relatively small share of residential property owners; e.g., 1.4% in Ottawa). Montreal's earlier condo glut is gone, slicing rental vacancy rates to 1.8% in October 2017 from above 3% the previous year. Look for the solid price increases to continue this year.

Lukewarm—Much of the country: Sluggish sales and modest price gains are the norm for most regions. Despite healthy affordability, the triple-whammy of higher borrowing costs, tougher qualifying rules and slower job growth has taken a toll. These trends are unlikely to change this year.

Room temperature—Vancouver detached: With the spotlight on a fiery condo market, Vancouver's detached properties have been sidelined. After unwinding 2016's mini-correction, the price of a single-family home has gone sideways in the past year (*Chart 6*). However, at a cool $1.6 million, it's still well out of reach of most families. The expansion of the non-residents buyers' tax and new taxes on vacant and high-end homes have sapped demand. New listings are elevated relative to weak sales, suggesting prices could weaken this year.

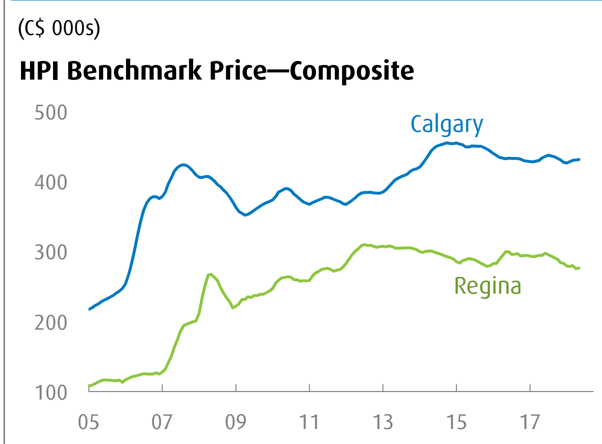
Cool—Oil-producing regions: For Alberta, Saskatchewan, and Newfoundland & Labrador, the price of black gold hasn't risen enough to defrost a previously icy property market. Elevated inventories and weak sales mean buyers are in command, notably in Regina where prices are down 6.2% y/y (*Chart 7*). Calgary's prices are off slightly amid a glut of condos, with no help from a 23% office vacancy rate. Average prices in Newfoundland & Labrador are also below year-ago levels, though steadying. Barring a further jump in oil, prices are likely to stay down in all three provinces this year given the tougher borrowing climate.

Chart 6
Steady Now



Sources: BMO Economics, Haver Analytics

Chart 7
Still Sagging



Sources: BMO Economics, Haver Analytics

Chilly—Toronto detached: After surging 28% y/y in May 2017, single-family prices have fallen 10% in the past year. Steeper declines of near 20% occurred north of the city (Richmond Hill, Markham) after investors and speculators drove prices to dizzying heights in early 2017. Buyer fatigue has set in, and bidding wars appear isolated to coveted areas and lower down the price ladder. While prices have steadied recently, they could sag further as the market balance continues to tilt toward buyers. Still, the declines should be limited by policies that promote high-rise construction at the expense of ground-related units.

Bottom Line: Most regions should see sluggish sales and modest price gains this year, though Ottawa and Montreal will likely continue to outperform. The oil-producing regions and detached properties in Toronto and Vancouver should remain soft. Nationally, after falling 5% last year, existing home sales are expected to slide 14% in 2018, before stabilizing in 2019. Price gains should slow markedly from last year's 13% clip to 3% this year and 1% next year. Starts are expected to decline about 7% through next year, while staying above 200,000 units to meet sturdy demand from migrants and millennials. Outside of pricey Vancouver and Toronto, Canada's housing market is at little risk of a correction. But both cities, home to one-in-four Canadians, remain vulnerable to a shock, such as a nasty trade war.