Staying Put

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For most Canadians, the following narrative is well known. You graduate from school, land your first job, get married, buy your first house, start a family, and after a number of years, move up to a larger house to accommodate your growing family. However, there are many indications that this cycle that dominated the Canadian housing market for decades, is breaking.

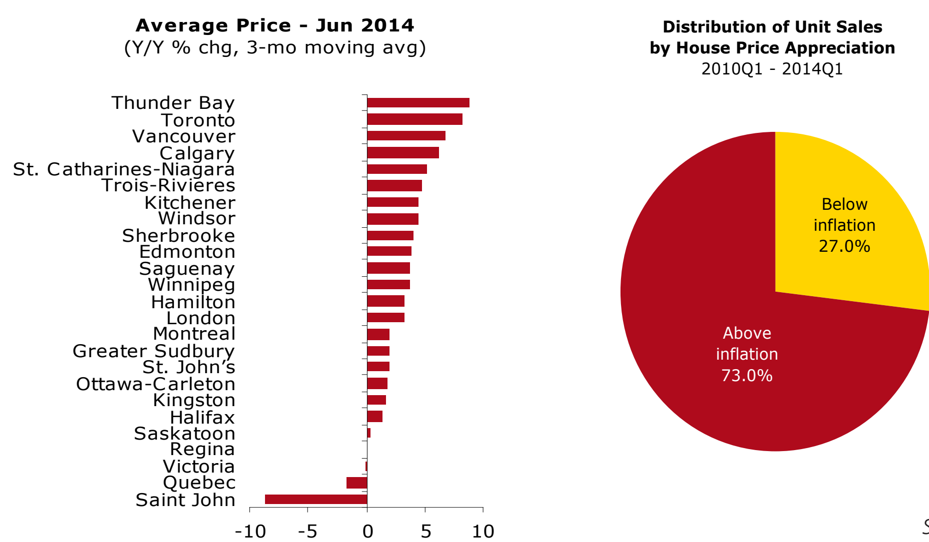
Gravity-defying home valuations, exacerbated by tighter mortgage insurance regulations, have worked to price out a notable portion of the first-time homebuyers' market. At the same time, an asymmetrical trajectory of price appreciation is starting to paralyze the "move up" market. The value of bigger and pricier properties is rising notably faster than less expensive properties—widening the gap between starter home and dream house. These dynamics go a long way in explaining the current stage of the housing market in Canada and provide some hints regarding the nature and trajectory of any future market adjustment.

Hidden Behind The Average

When it comes to housing activity in Canada, average numbers hide more than they reveal. The 5% increase in the average annual home price over the past year masks many tales such as falling prices in Saint John, Québec and Victoria, and still very strong markets in centres such as Toronto, Vancouver and Calgary. More than one-quarter of the sales are now in cities that see prices rising by less than the current rate of inflation (Chart 1).

Chart 1

The Canadian Housing Market



Source: CREA, CIBC

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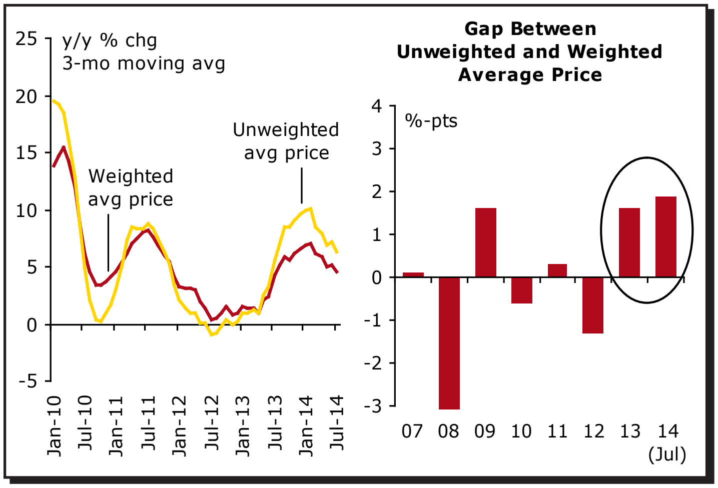
Chart 2

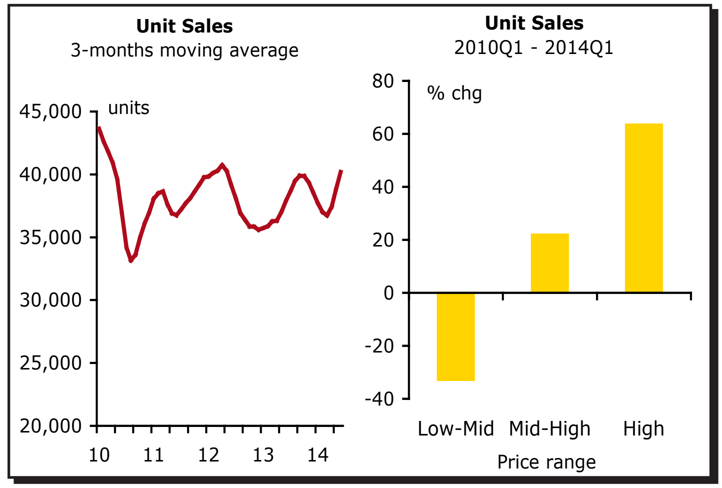
Robust Activity in Pricy Centers Bias Average Price



Source: CREA, CIBC

Chart 3

Stable Unit Sales (L) Mask Diverse Activity by Price Level (R)



Source: CIBC calculations based on CREA's unpublished tabulations

More robust activity in cities with above-average prices also works to bias the widely quoted average price. In fact, the spread between the simple average price measure and the weighted measure (which compensates for changes in provincial sales activity by taking into account provincial proportions of privately owned housing stock) has been widening over the past eighteen months, suggesting that a growing proportion of price increases in Canada are due to activity in large and more pricy cities (Chart 2).

Asymmetrical Sales Picture

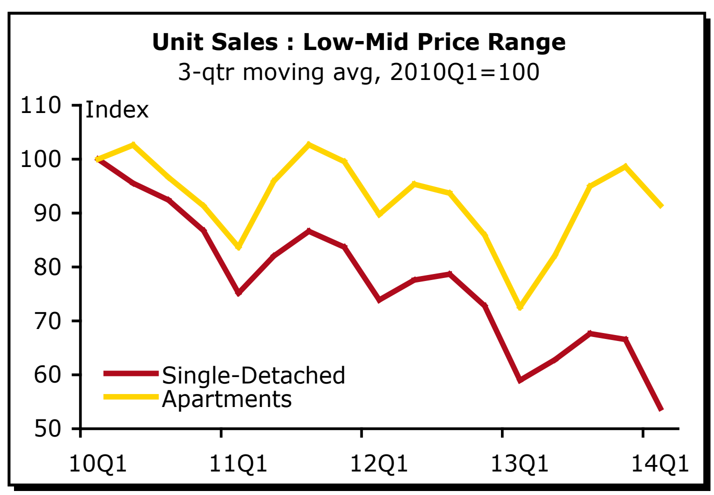
The multi-dimensional nature of Canadian housing goes way beyond geography. Despite the speculation and trepidation regarding home valuations, resale activity in Canada has been relatively stable over the past few years. Unit sales have fluctuated at a relatively narrow range of between 35,000 and 40,000 units per month (Chart 3, left). But again, this apparent stability masks a more complex story. Sales of units at the low-to-mid price range fell notably since 2010[1]. Sales rose modestly for the mid-to-high price range, and advanced rapidly for units in the upper end of the market[2]. In other words, over the past few years, sales have been positively correlated with price levels (Chart 3, right).

Zooming in on the decline in sales at the low-to-mid price range, most of the decline is in the single-detached category (Chart 4). In fact, total sales at the lower and mid-price range would have been much more dismal if it were not for the more robust activity in the condo market. This activity is driven largely by investors and first-time homebuyers who see condo ownership as a cheaper alternative to unaffordable low-rise units. That's a good illustration of the important stabilizing force played by the condo market in recent years.

This picture of soft sales at the low-to-mid price range of the single-detached market has affordability written all over it. Tightening mortgage regulations in general, and the reduction in amortizations from 40 years to 25 years for high-ratio mortgages in particular, alongside

Chart 4

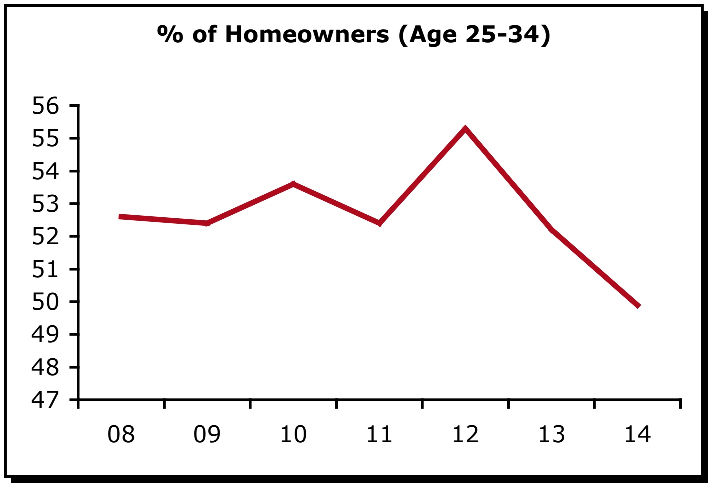
Soft First-Time Buyers Activity Mainly in Single-Detached Units



Source: CIBC calculations based on CREA's unpublished tabulations

Chart 5

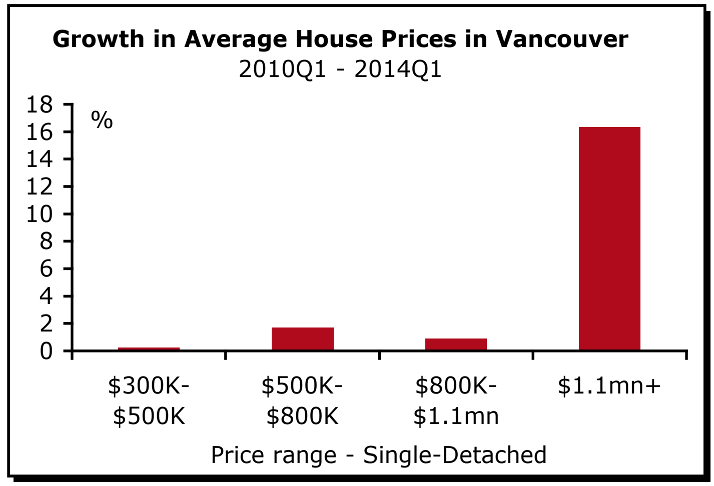
Lower Homeownership Rate Among Young Canadians



Source: Canadian Financial Monitor, CIBC

Chart 7

Vancouver—Most Price Activity is in the High-End Market



Source: CIBC calculations based on CREA's unpublished tabulations

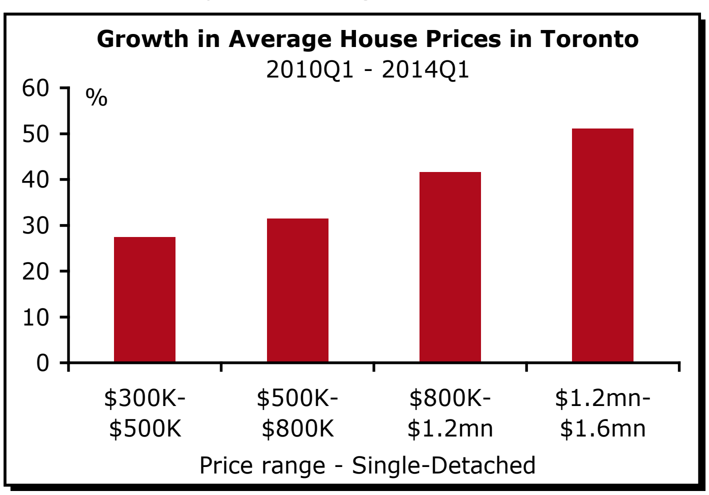
rising prices worked to price out many first-time homebuyers that dominate activity in this price range[3]. The homeownership rate among Canadians aged 25-35 (first-time homebuyers) has fallen from 55% in 2012 to the current 50% (Chart 5). For those over the age of 35, the homeownership rate remained stable.

Not Moving Up

That asymmetrical sales activity is evident in the price trajectory. Zooming in on the Toronto market (Chart 6),

Chart 6

Toronto—Pricy is Getting Pricier



Source: CIBC calculations based on Brookfield's unpublished tabulations

we can easily see that the more expensive the property is, the faster its price rises. That is, a household that owned a single-detached property valued at say $600K and would like to move up, would have to pay extra not only for the jump in category (say $900K) but also for the fact that the price of the move up property has risen faster than the price of their own property. In other words, regardless of what your starting point is, and by how much your property has appreciated, the desired move up target is getting further and further out of reach. Ditto for other cities such as Ottawa, Calgary and Edmonton where the move up category has risen notably faster than the start-up category.

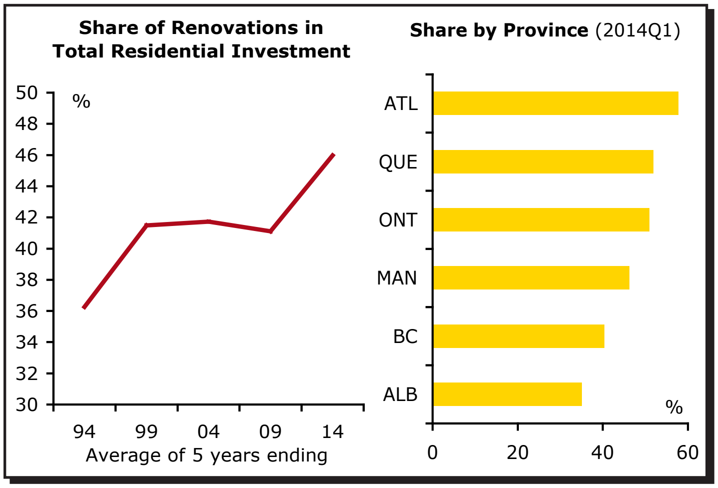
In Vancouver, almost all of the increase in the average price of single-detached units since 2010 was due to a run-up in the value of properties over the $1.1 million mark (Chart 7). However, given that the average price of single-detached units in the first-time homebuyer category is north of $1 million—upgrade options in the city are becoming even less affordable.

With limited move up options, it's no surprise then that many Canadians choose to renovate their existing homes. Over the past five years, spending on home renovations as a share of total residential investment averaged close to 46%—by far the largest share on record (Chart 8).

The picture that emerges is of a much more static market than perceived by many. Worsening affordability clearly hurts demand, mainly among first-time buyers, but the

Chart 8

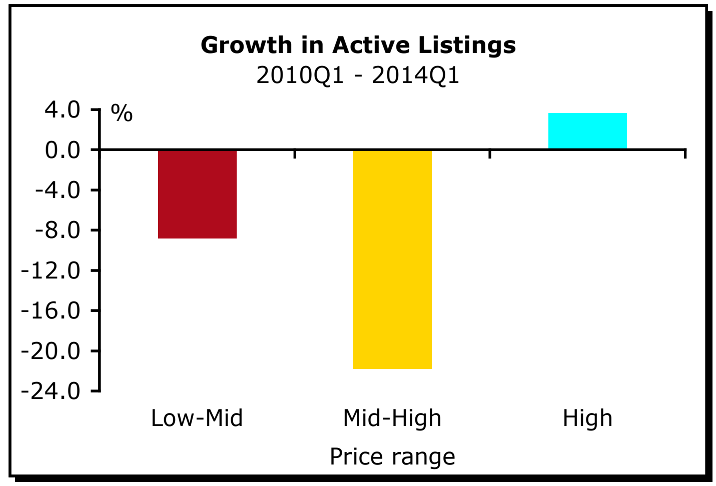
Do It Yourself



Source: Statistics Canada, CIBC

Chart 9

Signs of Excess Supply at the Upper End of the Market



Source: CIBC calculations based on CREA's unpublished tabulations

impact on the market is being offset by three powerful forces: the stabilizing role played by the condo market in major urban centres to provide a cheaper alternative to single-detached units and to accommodate the shift from ownership to rental activity; the significant constraints on land availability which works to limit the supply of new housing; and the asymmetrical nature of the price trajectory that works to distract and limit the natural flow of move up activity in the resale market. The only segment of the market where move up related supply factors are not at play is naturally the high-end portion, which is the only market that has seen the number of existing listings rise (Chart 9).

Implications:

- For the market as a whole, downward pressure on prices are limited by supply factors in both new and existing markets.

- The static "move up" market in the single-detached space and its impact on supply will work to limit downward pressure on prices—mostly in the low and mid-range of the price spectrum. The higher-end segment of that market appears to be more vulnerable to price adjustments.

- Same goes for the condo market. Excess supply will challenge valuations in the market as a whole, and higher interest rates might lead to increased supply of units at the low-to-mid price range. This, however, would be partly offset by reduced sales by potential move up condo owners due to the significant widening in the price gap between single-detached and condo units. However, the high-end of the condo market is more vulnerable, in part, due to the fact that this segment of the market is not part of the stabilizing force played by the low-to-mid price range condo space.

- The supply restrictions in both the new and existing units along with affordability factors suggest that the homeownership rate in Canada at close to 70% is probably at its peak for the current cycle.

- Renovation activity will remain robust and, in fact, might accelerate in the coming years.

Note:

1) Naturally part of the decline in this category was due to a smaller stock of properties at the price range.

2) The aggregate measure is based on data for Vancouver, Toronto, Calgary, Edmonton and Ottawa. Each price range was adjusted to reflect the price spectrum in each city in the following way:

	Low-Mid	Mid-High	High
	$	$	$
Vancouver	<600K	600K - 1.1 mn	1.1 mn+
Toronto	<500K	500K - 1.1 mn	1.1 mn+
Calgary	<350K	350K - 600K	600K+
Edmonton	<300K	300K - 550K	550K+
Ottawa	<275K	275K - 525K	525K+

3) Other factors such as the Land Transfer Tax in Toronto also played a role here.