Housing Market Digest

Greater Toronto Area, March 2019

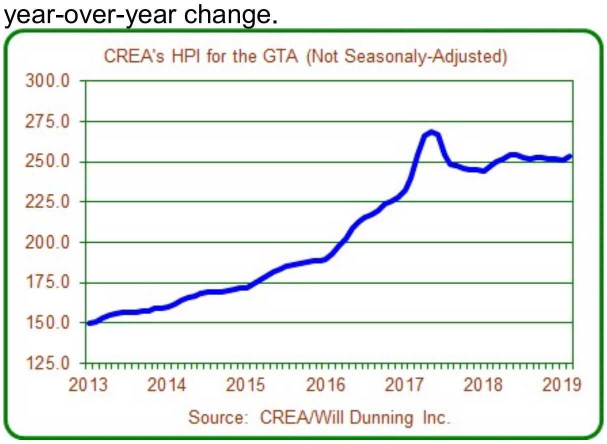
Synopsis: The federal budget - once again, the government has failed to respond to the real concerns that have been expressed about the mortgage stress tests. The damage will continue to accumulate. Eventually, they will have to act.

Resale Market

February weather was much more harsh than usual, which is probably the main reason that the sales rate dipped sharply (a seasonally-adjusted annualized rate of 71,500). I won't be surprised if there is an off-setting jump in the March data (due from CREA about April 15). Therefore, I will be looking at the average for the entire 1st quarter.

The sales-to-new-listings ratio dipped to 48% in February, and the 12-month moving average is 49.7%, versus the balanced market threshold (which I now estimate at 54% – I have updated this using my forecasting system).

The recent sales-to-new-listings ratio is consistent with prices that are flat or falling slightly. In fact, prices have been flat for about 10 months. The 2.3% year-over-year increase in CREA's House Price Index is misleading because of rises that happened almost a year ago. Soon, that data will fall out of the calculations and we'll see negligible year-over-year change.



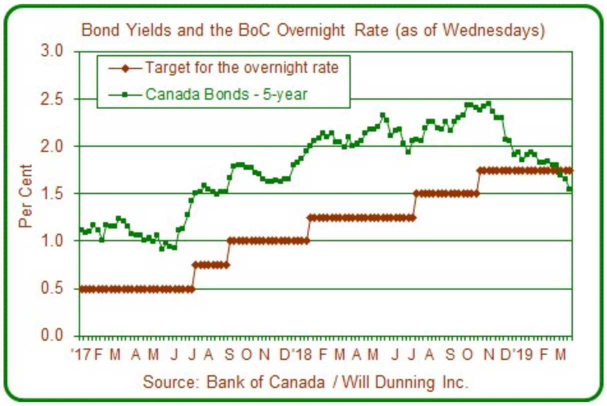
New Homes Market

New home sales remain weak: the annualized sales rate for February was just 17,500, but should be well over 40,000, to accommodate population growth. Low-rise sales improved, but the February rate of 7,200 is only about one-third of what it should be. This is the 32nd consecutive month with sales being far below 20,000. Apartment sales fell to a rate of just 10,300. It is difficult to create a trend line for this volatile data, but this part of the market has clearly slowed sharply.

Interest Rates

It takes time for changes in interest rates to play-out in the economy, typically 2-3 years for the effects to <u>largely</u> occur. Thus, when rates change, they tend to overshoot (rise or fall by more than is necessary), followed by a subsequent partial reversal. Recent events are demonstrating this. Bond yields (and other rates) rose too much, and are now reversing. Currently, I suspect that maybe the 5-year GoC should settle at about 1.75%, versus the current flirtation with sub-1.5%. Similarly, maybe the 1.25% rise for the Bank of Canada overnight rate (starting in July 2017) went too far, and I expect it will reverse by a quarter or half-point before the end of the year. Events, of course, will prove me wrong.

I propose “Willard’s Law”: “in most circumstances, in any period of 2 to 3 years, interest rates should not change by more than three-quarters of a point”. 25 years from now, all discussions about interest rates will start with a recital of Willard’s Law.



PS. I have reduced my opinion-estimate of major lenders’ “special offer” rate (5-year fixed-rate mortgages). It also overshot (to a peak of 3.75%), and is now 3.25% (which might be a bit too low).

Other News

The federal budget proposed a “shared equity mortgage” to assist first-time home buyers. Too little is known about the details to draw substantive conclusions. Here are my quick impressions:

- If this program is fully subscribed, the impact is 10-15K users per year, or just 3-5% of 300K first-time purchases per year.
- People qualifying for it would have been able to pass the stress tests even without it, so this is unlikely to stimulate very much incremental activity – the main effect will be that it reduces monthly costs for people who were going to buy regardless.
- It does not address any of the issues from the stress tests, which are substantive (reduction of as much as 100K sales per year for resales+new construction) and will do major economic damage (200K fewer jobs by mid-2021).
- An alternative way to achieve the same end (lower monthly costs) would be to allow 30-year amortization for insured mortgages. For a resale buyer, the shared equity program would reduce the monthly payment by about 6%. With 30-year amortization, the reduction would be larger (10-11%), with the added benefit that the borrower does not have to give up 5% of their future equity.
- Therefore, the government should offer two options – the shared equity program or 30-year amortization – and ***let Canadians decide for themselves (with their lenders) what works best in their own situations***.

The Outlook

I have updated my forecasts. They suggest that sales will remain depressed in both the resale and new home sectors. Prices are projected to be flat. Some of you might be surprised by the drop expected for sales of new high-rises: this is due to the deceleration of prices, which may reduce enthusiasm of investors and owner-occupants. As well, there is a high volume (all-time record) under construction. As that inventory is completed, there will be a lot more choice in the condo resale market. The projection of improved low-rise sales may be too optimistic (but activity will be far too low). Low vacancy rates in the rental sector will continue to drive rapid rent growth. Of course, when the federal government finally comes to its senses about the stress tests, everything changes.

Toronto Indicators		
	2018	**2019**
Job Growth	1.9%	2.8%
Resales (units)	77,909	74,400
Sales-to-New-Listings Ratio	49.8%	50.6%
Ch. in Avg. Resale Price	-4.4%	0.0%
GTA New Home Sales		
Low-Rise	3,831	7,700
High-Rise	21,330	15,500
Total	25,161	23,200
Housing Starts		
Low-Rise Ownership	11,468	9,000
Condo Apartment	26,349	17,200
Rentals	3,290	2,800
Total	41,107	29,000
Apartment Vacancy Rate	1.1%	1.0%
Rent Increase	5.5%	4.0%
Source: forecasts by Will Dunning Inc. (March 23/19)		

How to Reach Will Dunning Inc.

Telephone: 416-236-5115
Email: wdunning@sympatico.ca
Web site: www.wdunning.com

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