



October 21, 2016

IMMINENT PULLBACK FOR VANCOUVER AND TORONTO HOME PRICES

Summary

- *For various reasons, home sales began declining in Vancouver well before the introduction of a 15% tax on purchases by non-residents and the latest measures announced by the federal government. The latter factors will only accentuate an existing trend.*
- *The Teranet–National Bank House Price Index shows Vancouver home prices essentially flat from August to September after an accelerated rise over the previous seven months. The reason the sharp drop in sales has yet to translate into a price decline is that the resale market remained tight despite the drop in sales.*
- *We think Vancouver home prices will soon start correcting. We expect a decline over 12 months of 10% overall and 20% for detached homes.*
- *In Toronto, home sales have been setting records month after month while listings have shrunk sharply. The result has been a spectacular acceleration of prices. Sales will eventually cool in response to this rise, as well as to federal government measures and a rise in mortgage rates. But since supply is unusually tight, prices are likely to drop less than in Vancouver. We expect a 3% decline in 2017.*

Vancouver: The decline of home sales began back in March

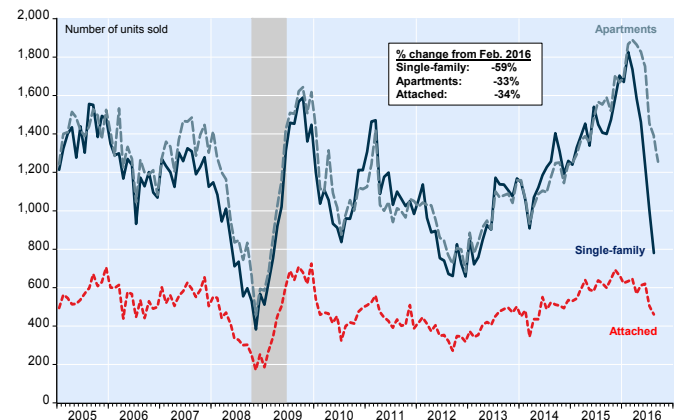
Some observers expected the July 25 announcement of a new 15% tax on the value of homes acquired by a non-resident, effective August 1, to have an immediate and dramatic effect on existing-home sales in the Vancouver market.

A downtrend has indeed begun. But it began in March, well before the new tax was announced.

Data from the Real Estate Board of Greater Vancouver (REBGV), seasonally adjusted by us, show a decline beginning first in single-family dwellings, which incidentally are Vancouver’s most expensive category of homes and the category most subject to purchase by non-residents. In July, the decline spread to multiple-unit housing (attached and apartments).

Chart 1

Vancouver: Number of housing units sold, by category
Monthly data seasonally adjusted by NBF; last reading September 2016



There are several plausible explanations for this trend. The Teranet–National Bank House Price Index™ reports that Vancouver-area home prices – already the highest in the country – took off in February, rising an average 2.5% monthly through August (chart 3). That could have put prices out of reach for some potential buyers. Also in February, the minimum down payment for new insured mortgage loans was raised to 10% from 5% for the portion of the price exceeding \$500,000, a threshold often exceeded in Vancouver. Again in February, the B.C. government

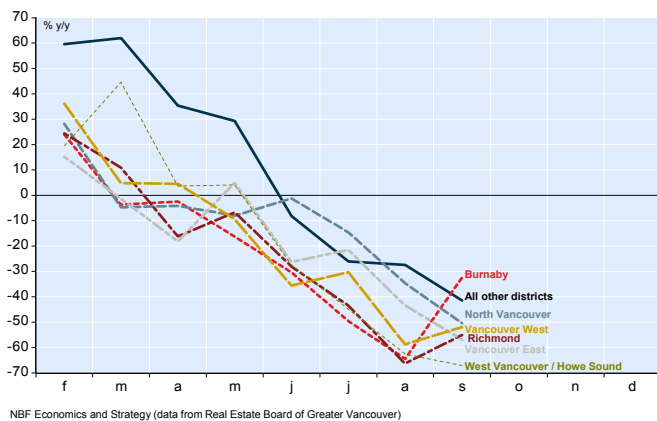
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introduced a 3% tax on the value of homes sold for more than \$2 million. And finally, China's anti-corruption campaign is suspected of crimping the flow of capital from that country.

The 15% tax that took effect August 2 may have intensified the sales decline reported by the REBGV. The Canadian Real Estate Association (CREA) reports that the seasonally adjusted number of units sold in August was down 18% from July.¹ The Canada Mortgage and Housing Corporation (CMHC) reports that in August the number of units sold for more than \$1.5 million (most often detached dwellings) was down 59% from the monthly average of the previous six months, compared to a 23% decline for units sold for less than \$500,000 (most often condos).² Finally, the 12-month decline in sales of detached homes was generally sharper in districts of median selling price greater than \$1.5 million than in other districts, though this trend began before announcement of the new 15% tax.

Chart 2

Vancouver: Change in number of detached homes sold, by district
12-month % change in districts of median sale price greater than \$1.5 million and all other districts combined



Unfortunately, these data do not allow breakout of sales to non-residents. The new data from the B.C. government - which modified its Property Transfer Tax Form, effective June 10, to require home purchasers to declare their nationality - cannot be used for that purpose. In the government data, the transaction date is the date of submission of the tax form. Since the same transaction could be dated differently by the REBGV,³ the government data and the REBGV data are not comparable. For instance, the government reports a spike in forms submitted July 29, the last business day before the new tax came into

¹ The CREA data are generally consistent with the REBGV data.
² CMHC, *Preliminary Impacts of the Foreign Buyers Tax on the Vancouver Housing Market*.
³ The REBGV requires brokers to report a sale within five business days of its becoming unconditional.
⁴ A true home-price index like the Teranet-National Bank House Price Index reflects only changes in same-unit prices. Unlike

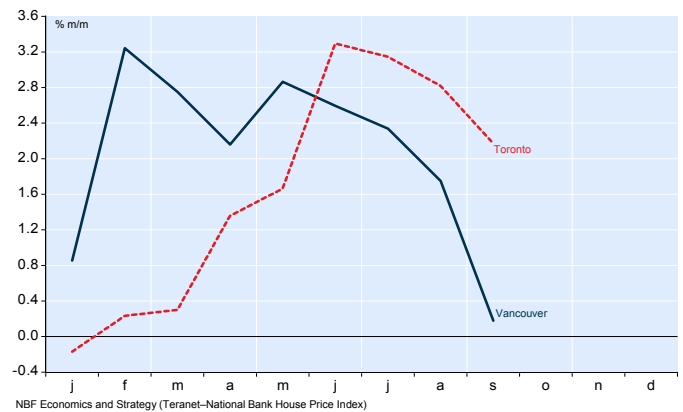
effect. Thus sales July-dated by the government could plausibly have been attributed to later months by the REBGV.

A price correction on the radar

The Teranet-National Bank index for September shows Vancouver home prices essentially flat from August.

Chart 3

Monthly changes in Vancouver and Toronto home prices in 2016
Teranet-National Bank House Price Index™



The index has not so far shown a decline of prices. This would seem to contradict the REBGV's report of a 17% drop from July to August in the average selling price of detached homes. But it doesn't - the REBGV noted that the decline it reported was due not to a decline in property values but to a decline of the share of the most expensive homes in the total number of units sold.⁴

So why have Vancouver prices not retreated in step with the substantial decline of sales since March? Because despite the drop in sales, the market has remained tight. We estimate that in September, after seasonal adjustment, the ratio of listings to monthly sales (the number of months required to sell the listed units at the current monthly sales rate) had risen only to 3½, leaving Vancouver still a buyer's market.⁵

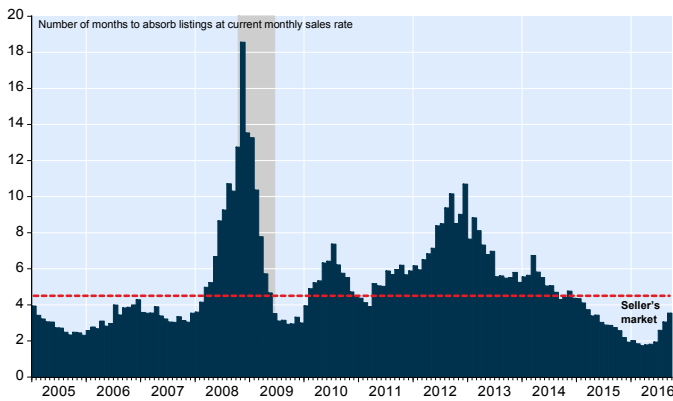
average or median selling price, it is not skewed by changes over time in the mix of sales by price brackets.
⁵ The REBGV considers the market to be a seller's market when the listings-to-sales ratio does not exceed 4½. (REBGV practice is to report the inverse, or sales-to-listings, ratio. The market is a seller's market when sales equal or exceed 22% of listings.)

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Chart 4

Vancouver: Resale market conditions

Ratio of listings to monthly sales; last reading September 2016



NBF Economics and Strategy (data from Real Estate Board of Greater Vancouver, seasonally adjusted by NBF)

In our opinion, sales will decline further. In addition to drag from the factors listed above, the federal government recently decreed that buyers seeking an insured mortgage loan at the five-year fixed rate must qualify on the basis of the posted rate rather than the negotiated rate. This hurdle for first-time homebuyers will be higher in markets where prices are higher relative to incomes. It is no surprise that the Vancouver and Toronto markets have Canada's highest percentages of insured mortgages (used to purchase) with high loan-to-income ratio, that is, of an amount exceeding 450% of income (see chart 8).

In the case of Vancouver, we think a price correction will begin soon. We expect the Teranet–National Bank index for this metropolitan area to decline 10% over 12 months. That correction would be moderate after the 24% rise of the last 12 months. Indeed, the impact on sales of the new federal government measures should not be over-estimated. It could drive some potential homebuyers from the market, but other buyers could still be in a position to acquire a home in this urban area, albeit less expensive.

The magnitude of the price decline will vary with the type of home. An overall decline of 10% would be consistent with a drop of 20% for detached dwellings, 9% for attached dwellings and 5% for condos.

Toronto is now a red hot market

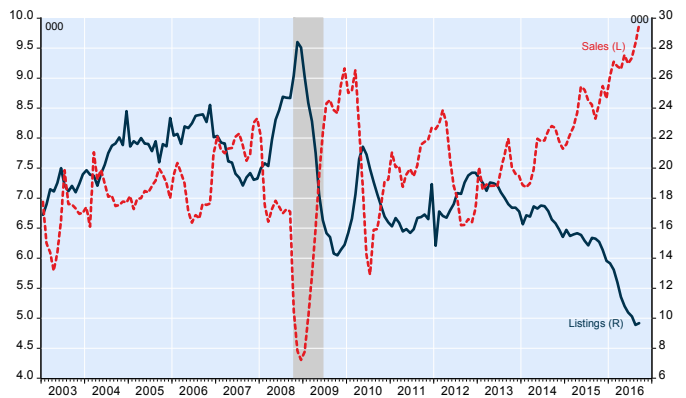
Over the last four months, as chart 3 illustrates, Toronto home prices have risen an average 2.9% *monthly*. The Toronto market is now red hot.

The behaviour of the Teranet–National Bank index for Toronto is consistent with the seasonally adjusted number of home sales, which has set new records in each of the last three months.

Chart 5

Toronto: Home sales vs. listings

Last reading: September 2016



NBF Economics and Strategy (listings: Toronto Real Estate Board seasonally adjusted by NBF; sales: Canadian Real Estate Association)

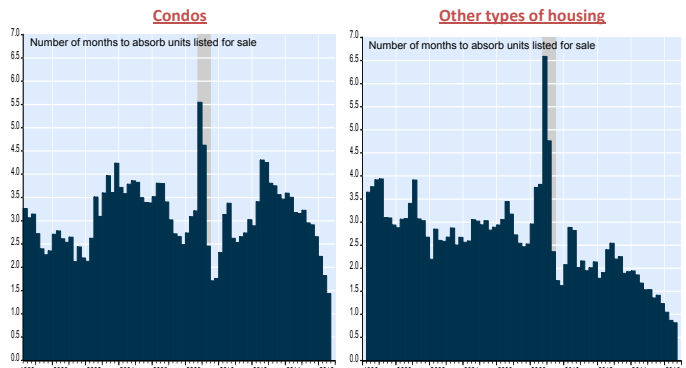
But in Toronto, the supply of homes for sale (number of units listed for sale) has shrunk even more strikingly than its sales volume has risen. The Toronto Real Estate Board reports a 37% decline of listings over the last 12 months together with a 21.5% increase in number of units sold.

Chart 6, plotting the combined effect of these two developments, shows the Toronto market now the tightest in at least 18 years for both condos and other types of dwellings. Hardly surprising, then, that September prices were up sharply from a year earlier – 9.6% for condos and 19.0% for other categories, for which the market is especially tight.

Chart 6

Toronto: Resale market conditions

Quarterly ratio of listings to monthly sales, seasonally adjusted by NBF; last reading Q3 2016

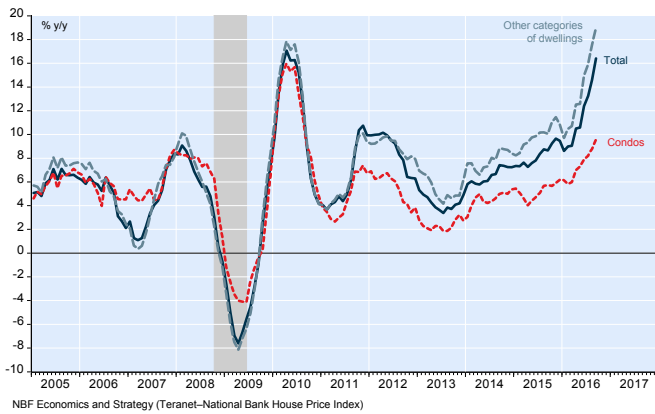


NBF Economics and Strategy (data from CREA and Toronto Real Estate Board)

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Chart 7

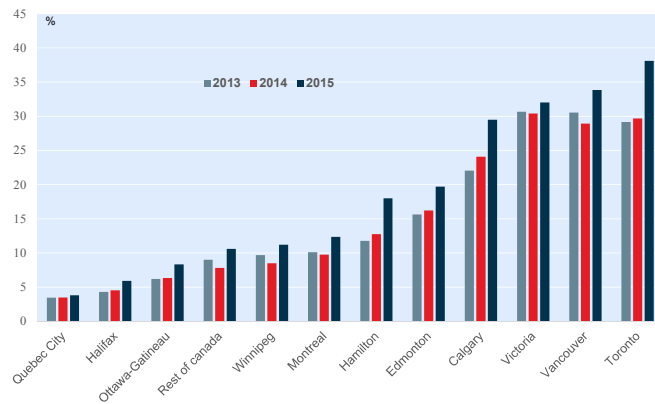
Toronto: 12-month % change in Teranet–National Bank House Price Index
Last reading September 2016



We see home sales as about to slow in Toronto. Though prices are not as high as in Vancouver, the percentage of insured mortgages with a high ratio of mortgage amount to income in 2015 was higher than in Vancouver. Thus the new federal government measure may weigh on demand at least as much in this market.

Chart 8

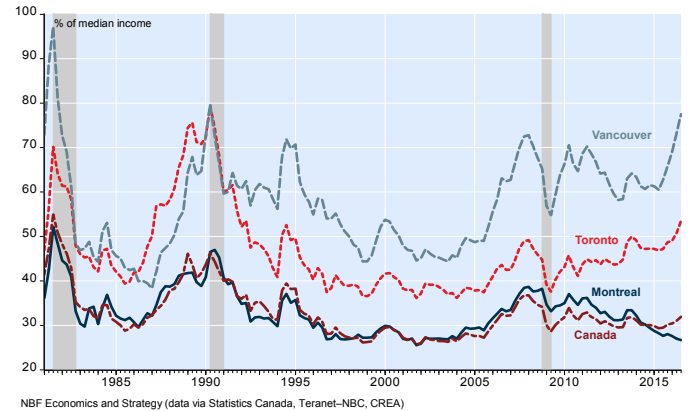
New insured mortgage loans with high loan-to-income ratio
Percentage of new mortgages (used to purchase) with a loan-to-income ratio above 450%



Moreover, the steep price rise of recent months has crimped affordability for first-time homebuyers. Furthermore, mortgage rates can be expected to rise, given the outlook for financial markets and perhaps also in consequence of insured mortgages risk-sharing between insurers and lending institutions in accordance with Ottawa’s recently announced intentions.

Chart 9

Canada: Perspective on housing affordability
Monthly mortgage payment for median home price (25-year amortization, 5-year term)



However, a decline of sales in Toronto is unlikely to have as much effect on prices as a similar decline in Vancouver, given Toronto’s especially tight supply. We accordingly see a smaller price pullback than in Vancouver, on the order of 3% in 2017.

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