OBSERVATION

TD Economics

March 10, 2014

HOUSING IN THE GREATER TORONTO AREA – SEVERAL MARKETS, SEVERAL TALES

Highlights

- While robust GTA existing home price growth has been grabbing attention, headline numbers can be deceiving. The GTA market is made up of several different markets each with varying fundamentals.
- The region's housing market can be split into the resale and new home segments. While the former remains robust, the latter has been cooling significantly. Together, these two areas paint an overall picture of a balanced market as well as moderate sales and price growth.
- The market for existing single-detached homes continues to be the hottest of all segments. Demand is being impeded by lack of homes for sale on the market, leading to bidding wars and double-digit price growth.
- The condo market has been relatively balanced, but even there, one can't paint all areas with one brush. Low-rise units remain in short supply, while the high-rise segment is facing excess supply as some 70,000 units are completed over 2014 and 2015.
- The new condo market is increasingly finding it more difficult to compete with condos on the resale market, which are both large and cheaper.
- The 416 and 905 area code regions have been recording similar trends overall in recent years, although the former has been registering much faster price growth in the single- and semi-detached components.
- We expect home sales and price growth to cool gradually over the next few years. The condo market is likely to bear the brunt of the housing slowdown, but there will be knock-on effects to other segments of the market.

Toronto's skyline of cranes is now about to transform into a skyline of condo buildings. The number of new units scheduled to be completed in the GTA over the next two years is striking at a time when new condo sales are dwindling. Meanwhile, the market for single-detached homes remains drum tight, keeping average resale home price growth in the GTA near 9% (Y/Y) in February, further igniting fears of a bubble. One market is facing too much supply, while another appears to be heating up. Other distinctions exist across condo types and regions. The GTA housing market is a tale of several markets with divergent conditions.

Table 1: Toronto Housing Market

		Annual Level (000's)			Annual % Chg.		
		2011	2012	2013	2011	2012	2013
Sales	New	46	33	28	24.5	-29.7	-12.7
	Resale	92	88	89	4.0	-3.9	0.9
Listings	New	22	26	30	-4.1	19.4	15.1
	Resale	148	159	157	-4.0	7.4	-1.1
Prices	New	481	503	522	5.6	4.6	3.7
	Resale	464	495	522	7.6	6.8	5.4
Combined	Sales	138	121	117	10.1	-12.6	-2.8
	Listings	170	185	188	-4.0	9.0	1.2
	Prices	470	497	522	7.1	5.9	4.9

Source: RealNet, Canadian Real Estate Association

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New and existing balance out

Most recent headlines have focused on the strength in resale home prices in the GTA, suggesting that the market may be too hot for comfort. Indeed, the recent upward swing in the sales-to-active listings ratio has rebounded close to its cyclical peak. This ratio serves as a proxy for demand relative to supply, and hence, market tightness. But, the new home market accounts for almost 25% of home sales in the GTA. When one combines the performances of the new market (where conditions have been weaker) with that of the resale market, the overall housing situation is considerably more balanced and prices are growing at a more moderate rate of about 5%.

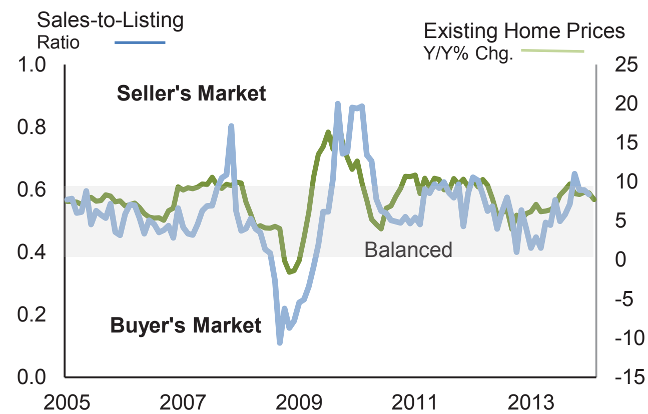
Some of the gap in the relative performance between the new and resale markets reflects shifts in demand. Sales in the new market have plummeted by around 30% from their peak in 2011. In contrast, resale activity has fallen by only 3% over the same period. The most important culprit behind the upward pressure on prices in the resale market has been due to the limited number of homes available for purchase. This unusually low level of listings has tipped the balance close to a seller's market, which is consistent with strong growth in prices (see Chart 1). On the other hand, new homes have been more plentiful, with the remaining inventory of new homes for sale doubling since 2011. As such, new home price growth expanded by just 2.6% (Y/Y) in January 2014.

Single-detached home a hot commodity

Digging further into the details, we find that tighter market pressures are truly emanating from one specific segment of the market – detached single family homes. This is the market where balance is most skewed in favour of sellers and prices are growing the fastest (see Chart 2). In January, the Y/Y appreciation of the average single family dwelling in the GTA reached 12%.

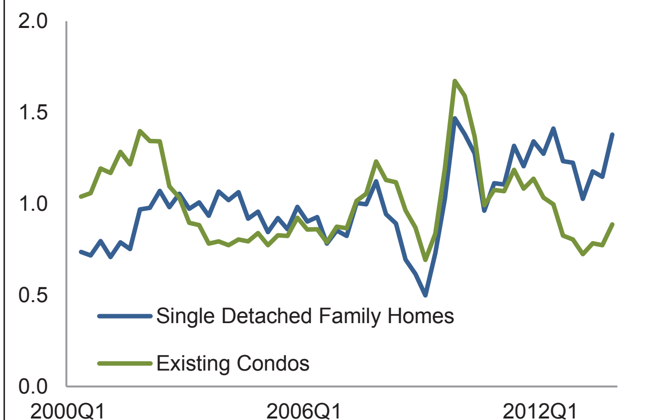
Perhaps a surprise to many residents, sales in this segment of the housing market have been running at levels well below their historical average. But, scarcity has been a major issue in this pocket of the marketplace. The existing home market is the overwhelming source for supply of detached houses. While 43,000 detached homes were sold in the resale market, only 9,900 were newly constructed in 2013, which compares to 22,000 in 2002. And even then, it has been slim pickings. The cost of a single detached family home ($718,000) is high – and largely out of reach for a family earning an average income in Toronto.

Chart 1: Toronto Existing Home Market



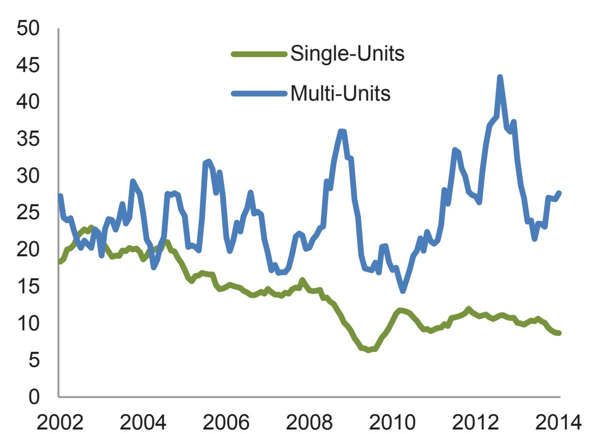
Source: Canadian Real Estate Association.

Chart 2: Toronto Existing Home Sales-to-Active Listings Ratio, 3-month moving average



Source: Canadian Real Estate Association

Chart 3: GTA Housing Starts
000's



Source: Canadian Mortgage and Housing Corporation

The building boom over the last few years is unlikely to alleviate market pressures in the single family segment. Given the high costs of land, recent changes in government land regulation and a lack of available infrastructure, builders have been incented to produce condos rather than detached homes. For every three condos built, only one detached home is constructed in the GTA. The split between the two markets was more evenly split prior to 2005.

Condos, Condos, and More Condos

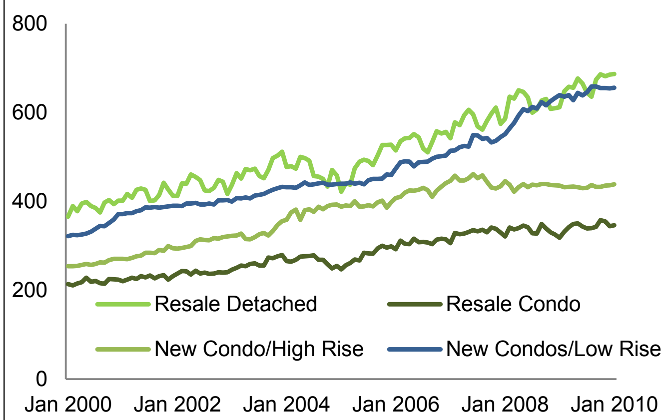
Within the condo market, there are in turn two distinct areas. Similar to the single-detached segment, the market for new homes in low rise buildings (including condos and townhomes) is fairly tight and prices have been growing rapidly (see Chart 4). Units in low rise buildings provide more space, privacy and are a better alternative to detached single family homes.

Condo development in the GTA has focused on high rise projects where the economics of construction has been the most favourable. Condos in high rise buildings have accounted for over 60% of supply of overall new homes in the region since 2011, compared to just 28% in 2000.

In the resale condo market, supply has been sufficient to keep pace with demand, which has kept the market well balanced and prices growing at a modest and sustainable pace. However, in the new condo market, supply has been outstripping demand. The inventory of new condos in high rise buildings (both under construction and in the pre-construction stage) available for sale has been expanding rapidly (see Chart 5). A combined 70,000 units are expected to be to be completed over 2014 and 2015 – twice the pace of the historical average. While a majority of these units have been sold, roughly 9,000 of the units remain to be absorbed (Chart 6).

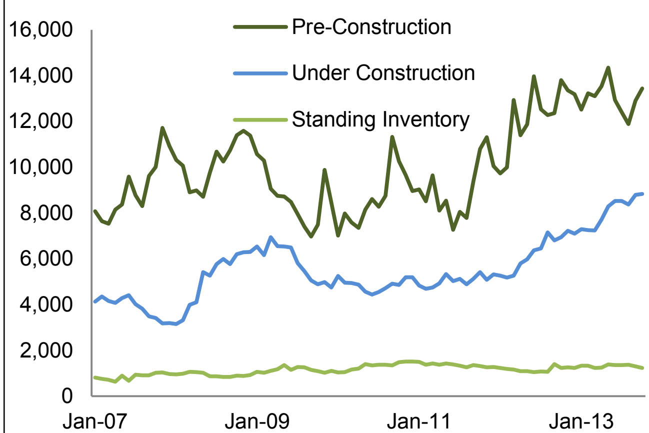
Among the concerns surrounding the high-rise market is that a significant amount of these units are held by investors. Surveys suggest that 26% of condos in the GTA are used for rental purposes. Further evidence of increased investor activity is the decline in the average size of a condo (see Chart 7). The average size of a condo peaked in 2005 at 925 square feet. The average size of a condo under construction in January 2014 was 798 square feet. The worry is that investors 1) may be planning to sell upon completion of the project or 2) can flee the market rather quickly in hard economic times. It is likely that a good portion of these rented units will ultimately end up on the market, but not to the point of exerting extreme downward pressure on prices.

Chart 4: Toronto Home Prices
C$, 000's



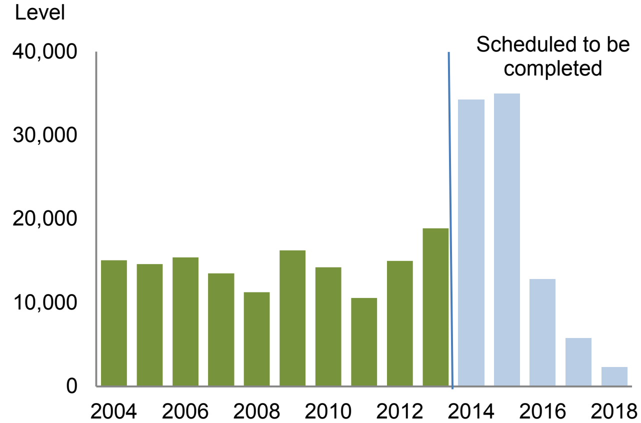
Source: Canadian Real Estate Association

Chart 5: GTA New Home High Rise Remaining Inventory
Units



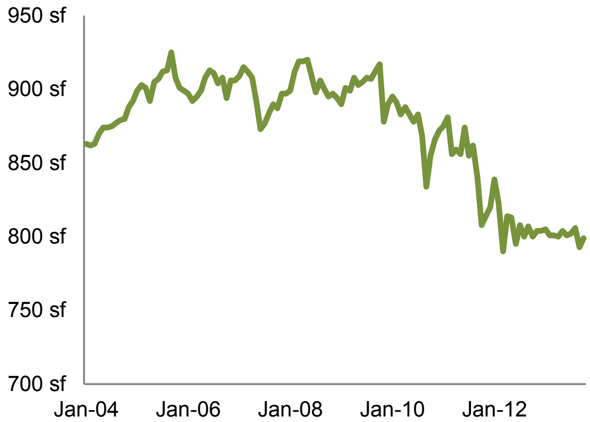
Source: RealNet

Chart 6: GTA New Home Completions
Level



Source: RealNet

Chart 7: GTA New Condo Market
Average Square Foot



Source: RealNet

More recently, new condos in high rise buildings are having a hard time competing with resale condos. The higher land, construction and regulatory costs have made it more difficult for newer buildings to compete with older buildings on price. As such, resale condos have become more attractive because they are larger and more affordable. Resale condos are cheaper, by almost $100,000 on average. On a per square basis, the average new condo cost $300 per square foot in 2004. A condo under construction in December 2013 was priced at $545 per square foot.

416 versus 905

The distinction in housing market conditions within the GTA has a regional story to it as well. The GTA comprises of two distinct markets – which can be broken down into the 416 area code (markets within mid-town to downtown Toronto) and then the 905 area code which encompasses smaller areas outside of Toronto, like Markham, Mississauga, Newmarket and others.

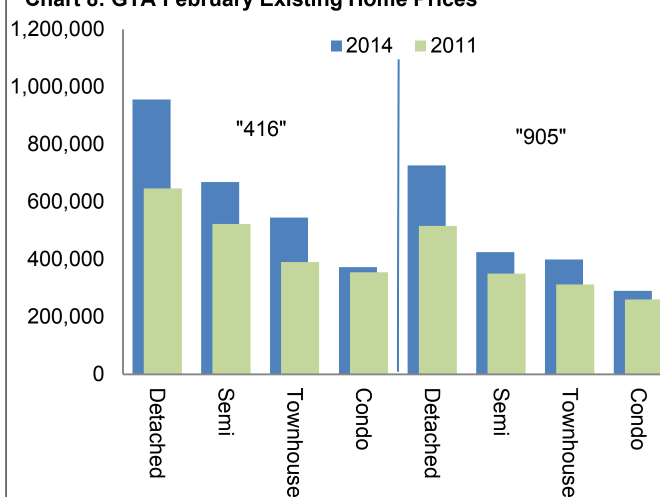
Overall, the 416 and 905 area codes have been experiencing similar trends in both existing home sales and prices over the last three years (Chart 8). The only difference between the two markets has been the stunning price growth in detached and semi-detached homes in the 416 area relative to that in the 905 area.

The story in the new home market by area is very different. Over the last decade a shift into the downtown core by young professionals has helped drive demand for condos in the area. And despite loftier prices, homebuyers in the GTA are still showing a preference for new homes in the 416 area. As of December, sales in key Toronto areas like North York, mid-town and the downtown core were up

Stylized facts about the GTA Market

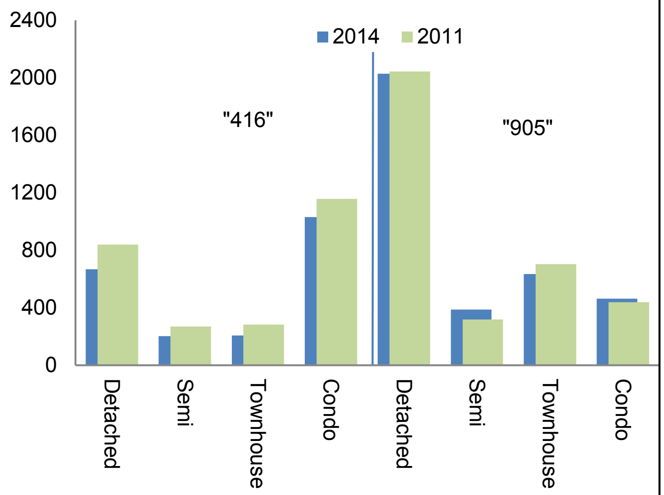
- New and existing condos account for 60%. New Condos accounted for 24% of homes sales in 2013.
- Multi-units accounted for almost 80% of construction in 2013, up from just 50% in 2002.
- The average single-detached home costs $718,000, while an existing condo sells for $347,000 and a new condo is priced at $545,000.
- 26% percent of condos are purchased as a rental investment. Average rent on a condo in the GTA is $1,700.
- Interestingly, 75% of GTA existing home sales occur in the 905 area – which geographically is larger. Given more land space, the 905 area has been more conducive to the building of detached single family homes. The 416 area, however, makes up a larger segment of the condo market.
- Every home type is more expensive in the 416 area. However, detached and semi-detached homes have the most striking price difference. A detached or semi-detached home in the 416 area can cost $300,000 or more than a similar home in the 905 area. The price differential between resale condos and townhouses is roughly $80,000.
- The 416 accounts for the lion's share of new homes, given its high concentration of condos. 70% of new home sales in the GTA occurred in Toronto in December.
- The average price per square foot for a new home in Toronto is a hefty $688. This compares to $400 to $500 dollars a square foot elsewhere in the GTA.

Chart 8: GTA February Existing Home Prices



Source: Toronto Real Estate Board

Chart 9: GTA February Existing Home Sales



Source: Toronto Real Estate Board

handsomely relative to last year. In contrast, condo sales in areas closer to the outskirts and 905 area experienced a sharp drop in condo sales. Meanwhile, for now, the rising inventory problem appears to be less of a concern in the downtown core, North York and the Toronto waterfront where sales are largely keeping pace with inventory. In fact, the top selling project in 2013 was the Yorkdale project, located conveniently near York University.

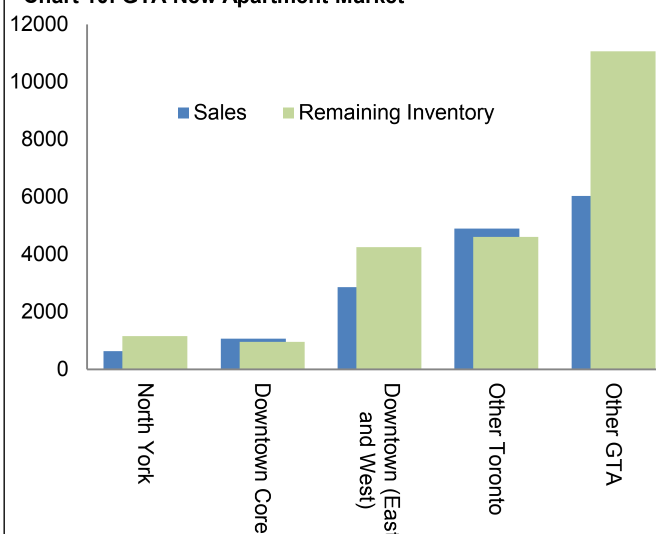
The GTA housing market to continue to beat by various drums

Looking ahead to the next few years, we expect home sales and price growth to cool gradually as a moderate upward trend in interest rates continues to chip away at affordability and demand. And, given the overvaluation in the market, GTA home sales are likely more vulnerable to even small interest rate movements than they have been in the past.

Yet, as we've pointed out, divergent fundamentals suggest that no segment of the market is created equally. In addition to the burgeoning supply of new units, the eroding economics of investing in rental properties are likely to put a significant damper on the region's condo market, especially the high rise segment. The cost of carrying an average priced condo has been exceeding the rent that can be earned on it. The combination of static demand and rising inventory of condos is likely to put downward pressure on prices over the next few years. Overall, condo prices are expected to fall on average by around 4% per year in 2014 and 2015.

There are bound to be some knock-on effects of weaker condo activity to the single family home market, as it could impede potential move-up buyers from taking their next step. However, the strong fundamentals of the single detached home segment should keep it well supported going forward. We expect average price growth in this area to continue to grow, but at a more modest 2 to 3% rate. In general, markets that have a higher concentration of single detached and low rise condominiums – including many regions in the 905 area code – are expected to outperform relative to those with a higher concentration towards high-rise condominiums.

Chart 10: GTA New Apartment Market



Source: RealNet