OBSERVATION

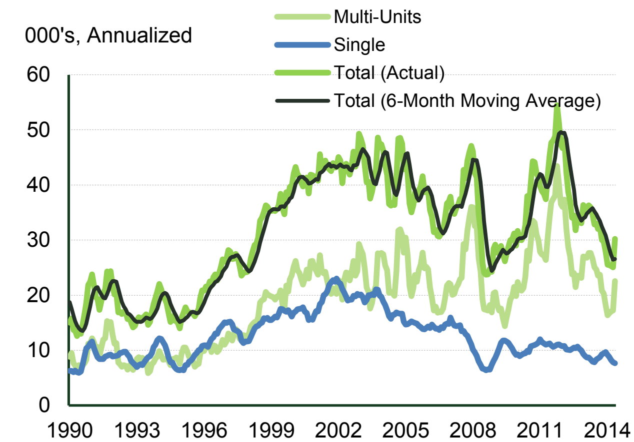
TD Economics

April 10, 2015

THE GTA BUILDING BOOM COMES TO AN END

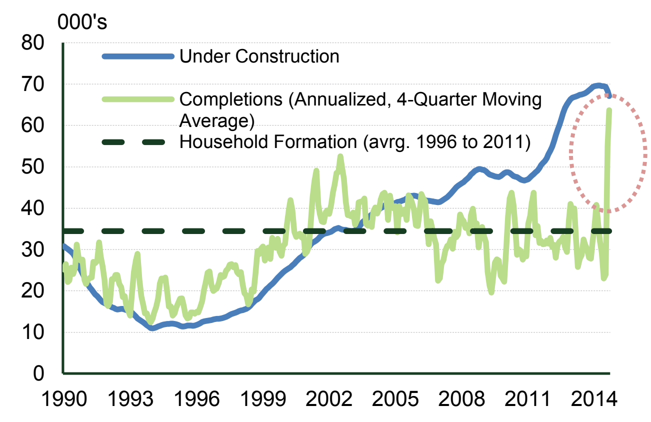
- This week's news that Toronto annual home price growth topped a blistering 10% received considerable attention. However, the fact that Toronto remains a tale of two markets was further reinforced by this morning's data on housing starts. While the single-family home market remains hot, activity in the new home market has cooled significantly, reflecting a softening in condo market conditions.
- Despite a sharp 20% increase in Toronto housing starts in March, there has been a trend decline in new home construction in Toronto since early 2013. The current level of starts is well off the peak reached in 2012, and on a six-month moving average the pace of new home construction in Toronto is hovering near 2008/2009 recessionary levels (Chart 1). Housing starts are also trending below demographic fundamentals, such as household formation.
- The gain in March can be chalked up to increased volatility in new home construction, due in large part to shifting weather patterns. In addition, condo development now accounts for 80% of construction activity in the GTA. Multi-unit starts tend to be more volatile than starts of single-family homes.
- Chart 2 is the real attention grabber. Analysts have been warning for years that the Toronto housing market was overbuilt. Yet, despite lofty levels of building, delays in project completions have contributed to a tighter market than otherwise would have been the case. However, the most recent data suggest that completion rates have started to accelerate. Completions were three times their historical average in January and February of this year.
- The completions data bear watching going forward, as growing excess supply of condos remains the greatest near-term risk facing the market. While new and resale condo sales remain strong (+13% Y/Y), there are already three condos available on the market for each one sold, compared to the detached home market where there are only 1.5 listings for every sale. As such, new condo prices have flat lined (even on a per square foot basis), while resale condo prices are rising by just 3% year-over-year.
- Given that there is still a relatively high level of new homes under construction, many of which

CHART 1: GTA HOUSING STARTS



Source: Canadian Mortgage and Housing Corporation, Statistics Canada

CHART 2: GTA NEW HOME BUILDING AND HOUSEHOLD FORMATION



Source: Canadian Mortgage and Housing Corporation, Statistics Canada

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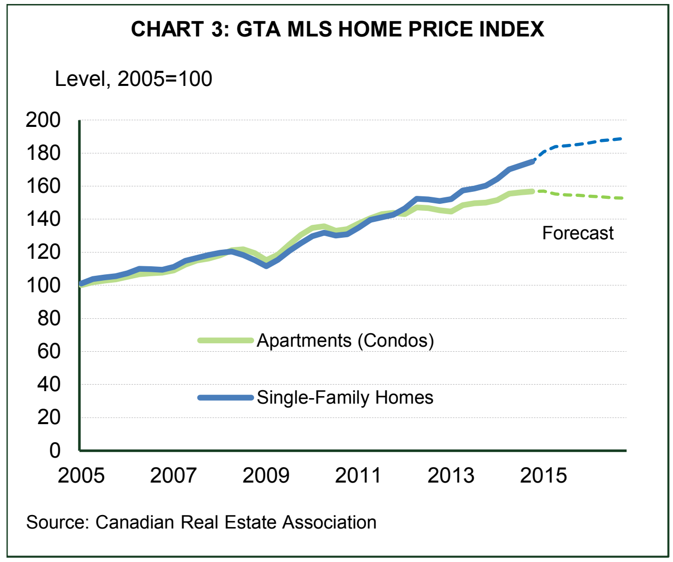
likely began construction in 2011 and 2012, we expect completions to remain elevated through 2015 and 2016. Many of these units have already been purchased in the pre-construction phase, and many will be held as long-term investments. CMHC estimates that 40% of condos currently under construction are held by investors who intend to rent them out. However, many of these units are likely to end up on the resale market – pushing the condo market further into buyer's territory.

- TD Economics is not expecting a crash in the condo market, but a cyclical cooling off. New construction is prone to periods of overbuilding, followed by a period of underbuilding. Toronto has already embarked on what is expected to be a multi-year period of underbuilding. However, there is a risk that low interest rates entice more new home building in the near term, which will only exacerbate excesses.
- The consequences of many years of overbuilding are likely to linger through the next two years. The increase in the supply of condos on the market is expected to push condo prices down by a moderate 3-4% over the next two years. Some of the weakness in the condo market will flow into the single-family home market as move-up buyers find it more difficult to move from a condo to a single-family home. We still see growth in single-family home prices. but at a more moderate rate.



- There has already been a cooling in housing market conditions in Montreal, Quebec City and Ottawa, following a extended period of overbuilding. In these urban markets, prices for both single-family homes and condos have weakened as a result, but have not crashed. While the Toronto market has remained resiliant so far, we do expect the GTA to go through a similar experience.