

SPECIAL REPORT

TD Economics



March 22, 2012

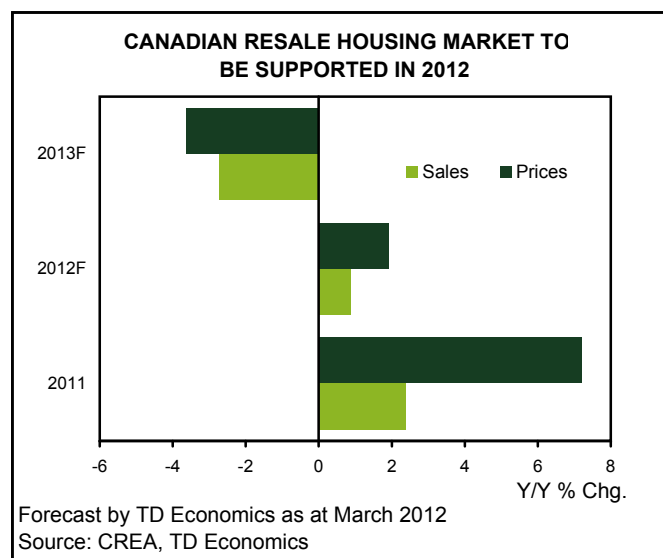
SUPPORTIVE FACTORS IN PLACE FOR THE CANADIAN HOUSING MARKET IN 2012

But, risks surrounding home price overvaluation persist

Highlights

- A better-than-expected economic outlook, low borrowing conditions and ameliorated home affordability should result in both the new and resale housing market being propped up in 2012. From a bigger picture perspective, these gains are small in magnitude, and levels are still elevated above historical norms.
- We stand behind our assessment that the resale housing market is overvalued by roughly 10-15% and that an oversupply of new home projects exists. These excesses should be gradually unwound over 2013 and 2014, with higher interest rates the impetus for the adjustment.
- Québec and New Brunswick are expected to undergo their price correction journey beginning this year, due to negative headwinds attached to their economic and employment profile. All of the other provinces are slated to see modest price gains in 2012.
- Over the medium term, the housing markets of Ontario and British Columbia are at the top of our list of concerns. Recent trends and new government policies in the case of British Columbia leave us to believe that price gains and starts will put forth a decent yearly showing. But, the greater degree of price appreciation and homebuilding recorded between now and mid-2013 heightens the risks of a sharper adjustment and/or more negative economic impacts over the longer term.

In our last comprehensive regional housing [report](#) released in December, we forecast that a tug-of-war would emerge in the Canadian real estate market for 2012, with economic uncertainty winning the battle. However, just this [week](#), we upgraded our Canadian economic outlook for 2012 as a result of better momentum to close out 2011 than we had expected and international risks simmering down, as opposed to flaring up. These developments result in the Canadian housing market being propped up in 2012. Still, we cannot gloss over the fact that only a modest economic environment will prevail and negative headwinds continue to lurk in the shadows. As such, we expect that new housing starts and resale prices and activity will record modest positive gains; levels, however, will remain elevated above historical norms. Growth this year must be placed in context with our assessment that the resale housing market is already overvalued by roughly 10-15% and that an oversupply of new home projects exists. We forecast that these excesses will be gradually unwound once interest rate increases come into effect in mid-2013.



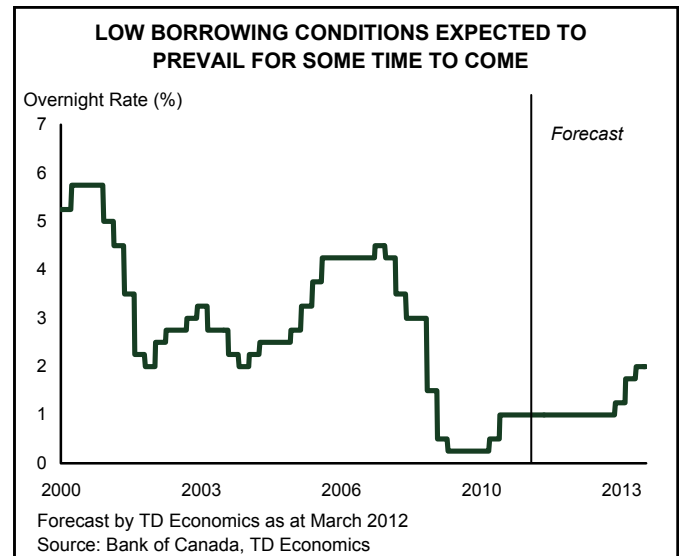
Canadian housing market to be supported in 2012

Relative to our December call, we have an improved economic profile in 2012 for Canada which stems from positive international developments – a milder recession in the euro zone given recent progress to avoid a Greek default and a better economic trajectory for the U.S. – and higher domestic confidence levels among consumers and businesses. In addition, we now expect record-low borrowing conditions to persist in Canada until mid-2013. This positive backdrop results in many supportive factors for the Canadian housing market in 2012. First, brighter income and economic growth prospects will trickle down into housing demand. Second, we are already seeing record-low interest rates emerge so far this year; lower mortgage rates translates into ameliorated home affordability and a more magnetic and attractive home-buying environment.

At the national level, we forecast that resale activity will grow by 1.0% on an annual average basis this year. Fewer listings should help spur resale price appreciation of around 2.1%. Growth of new starts, 2.2%, is also on tap, as builders look to break ground to meet the demand. While these gains are positive – a welcome development as compared to our previous call of annual declines – they are quite small in magnitude. In turn, we are of the view that in-year housing growth trends should be interpreted as essentially flat. At the same time, when compared to historical results, the level of sales, prices and starts remain elevated.

Not all markets are equal

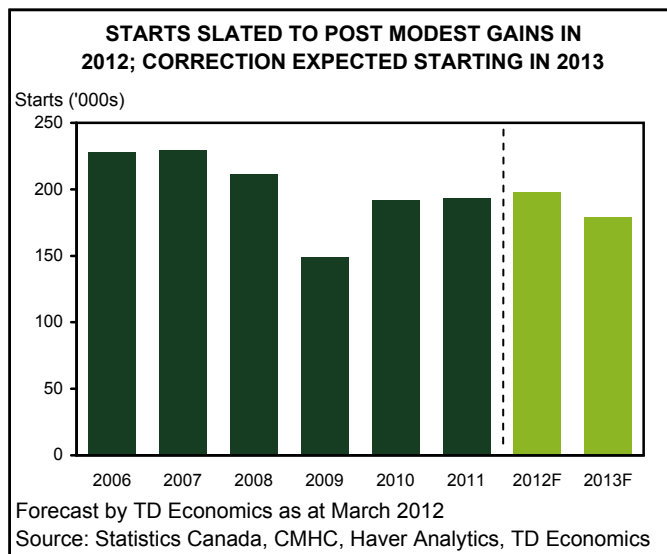
In the accompanying tables at the end of the report, we provide a break down of how housing markets are expected



to unfold over 2012-13, but this time at the provincial level. Over the next few days, we will be releasing our provincial economic publication with thoughts on the near term profile.

In our provincial housing forecast, we see that not all homebuilders will be experiencing heightened year-over-year activity. Increases are concentrated to Ontario and the western provinces. Among this group, British Columbia is a noticeable standout – starts are poised to grow by roughly 11%, a showing helped in part by the modest upgrade to the economic outlook, but also new provincial government policies which dole out \$10,000 to first time new home buyers and a more generous sales’ tax rebate for newly built homes (expected to cover 90% of all new purchases).

For the resale side of the market, we see that price and sales’ gains are not widespread across all regions in 2012. Half of the provinces are set to experience sales’ declines. In some cases like Newfoundland and Labrador and Manitoba, the correction comes as a result of outsized gains in 2011 and poor momentum seen so far this year. In the case of British Columbia, out-sized gains in the new side of the market are likely to come at the expense of resale activity. New Brunswick and Québec, on the other hand, are expected to buck the national trend and record both price and sales decreases in 2012. In the former’s case, the province continues to experience difficulty gaining traction on job creation and many of its key industries like natural gas and pulp and paper are still recovering from the blow of the 2008-09 financial crisis. Moving over to Québec, a higher rate on the provincial component of the Harmonized Sales Tax and provincial pension premiums are fiscal drags on overall economic prospects. These types of initiatives





should translate into a small increase in the jobless rate and a sub-par housing performance for 2012.

In the winner's column for both sales and prices in 2012 are Saskatchewan and Ontario, both of which are seeing early momentum in year-to-date figures. In Saskatchewan's case, housing demand is being driven by healthy immigration flows, but also above average income gains, given the province's concentration on resource development and our firm commodity price profile. For Ontario, price appreciation is once again being recorded in the Greater Toronto Area. Momentum on the price front ought to subside from the near double digit gains witnessed so far this year, but Ontario should still record the best price showing, 4.2%, on an annual average basis.

Correction punted to the medium term

While positive news has rippled through the forecast for 2012, the same cannot be said for the medium term, 2013 and 2014. In looking ahead, we stand behind our view that the Canadian housing market is ripe for a correction. Admittedly, there is no definitive way to measure the degree of overvaluation currently embedded in resale prices – some forecasters estimate homes to over-priced by as much as

20-25%. Our analytic assessment leads us to believe that a conservative estimate resides in the 10-15% range based on historical trends and housing fundamentals like demographics and affordability rates.

In looking at the crystal ball in front us, higher interest rates seem to be the catalyst to return the housing market to more balanced territory. However, increases to mortgage rates are expected to occur in a step-wise fashion, and in turn, we anticipate that home prices will slowly unwind in a similar way. To bring it back to concept of a housing bubble, we do not believe that one exists in the Canadian housing market. Instead, we use the analogy of an over-inflated balloon, and higher interest rates will be the impetus for air to be slowly let out from the vessel. More generally and as we pointed out in a recent [perspective](#) by our Chief Economist, Craig Alexander, the balloon could get larger from now until mid-2013, which heightens the risk of a steeper and more severe housing market correction down the road.

It is important to note that not all markets deserve the same level of concern, as some bear more a risk than others. In our past regional housing forecasts, we have repeatedly put Ontario and British Columbia at the top of our list of concerns. For the second part of 2011, both regions saw a deceleration in prices, striking debate about whether each market had already begun the correction journey. However, year-to-date in 2012, we have seen price momentum pick up in both provinces. Standard metrics like price-to-income and price-to-rent are already significantly higher than what we consider to be warranted based on underlying factors. Both regions are expected to realize small price appreciations in 2012, which pushes up the magnitude of adjustment of about 15% that is waiting for them come 2013 and 2014.

The housing-related weakness in store for Ontario and British Columbia will be concentrated in the two largest urban centres, Toronto and Vancouver, respectively. Other regional markets like Calgary, Edmonton and Halifax have not seen this same build up in prices. In turn, less of an adjustment is required to return to more balanced territory.

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HOUSING STARTS					
Thousands of units					
	2009	2010	2011	2012F	2013F
CANADA	148.2	191.3	193.3	197.5	179.0
N. & L.	3.0	4.1	3.5	3.1	3.1
P.E.I.	0.9	0.8	1.0	0.9	0.8
N.S.	3.4	4.4	4.7	4.7	4.4
N.B.	3.5	4.5	3.2	3.0	2.8
Québec	43.9	51.0	48.2	46.5	42.3
Ontario	49.8	60.8	67.7	69.3	61.7
Manitoba	4.0	6.1	5.9	6.1	5.6
Sask.	3.8	6.1	7.2	7.6	7.1
Alberta	20.0	26.9	25.5	27.0	25.0
B.C.	16.0	26.7	26.4	29.3	26.2

F: Forecast by TD Economics as at March 2012
Source: CMHC / Haver Analytics

HOUSING STARTS					
Per cent change					
	2009	2010	2011	2012F	2013F
CANADA	-30.0	29.1	1.0	2.2	-9.4
N. & L.	-4.5	34.6	-14.0	-11.0	0.6
P.E.I.	22.9	-8.8	25.8	-9.7	-9.1
N.S.	-16.8	30.1	6.3	0.7	-6.4
N.B.	-20.2	28.7	-28.5	-7.2	-6.7
Québec	-8.6	16.3	-5.4	-3.6	-9.0
Ontario	-34.1	22.2	11.4	2.3	-11.0
Manitoba	-26.8	50.5	-2.9	3.2	-8.2
Sask.	-45.1	60.9	18.2	5.8	-6.6
Alberta	-31.8	34.8	-5.3	6.0	-7.4
B.C.	-53.2	66.8	-1.3	11.1	-10.6

F: Forecast by TD Economics as at March 2012
Source: CMHC / Haver Analytics

EXISTING HOME SALES					
Thousands of units					
	2009	2010	2011	2012F	2013F
CANADA	464.5	446.3	456.9	461.7	449.1
N. & L.	4.4	4.2	4.5	4.5	4.5
P.E.I.	1.4	1.5	1.5	1.6	1.5
N.S.	10.0	10.0	10.3	10.9	10.4
N.B.	7.0	6.7	6.6	6.5	6.4
Québec	79.1	80.0	77.2	76.8	73.3
Ontario	195.8	195.4	200.3	204.7	196.3
Manitoba	13.1	13.2	13.9	13.9	13.7
Sask.	11.1	10.9	12.0	12.9	13.2
Alberta	57.5	49.7	53.8	54.9	54.5
B.C.	85.0	74.6	76.7	75.1	75.3

F: Forecast by TD Economics as at March 2012
Source: Canadian Real Estate Association

EXISTING HOME SALES					
Per cent change					
	2009	2010	2011	2012F	2013F
CANADA	7.6	-3.9	2.4	1.0	-2.7
N. & L.	-5.9	-4.1	5.8	-0.3	-0.1
P.E.I.	-0.6	5.8	2.4	4.0	-2.1
N.S.	-7.8	0.1	2.8	5.8	-4.5
N.B.	-7.3	-4.3	-1.5	-1.4	-1.0
Québec	3.1	1.2	-3.5	-0.5	-4.6
Ontario	8.2	-0.2	2.5	2.2	-4.1
Manitoba	-3.2	0.6	5.9	-0.3	-1.2
Sask.	5.3	-2.1	10.3	7.4	2.1
Alberta	2.7	-13.6	8.1	2.0	-0.7
B.C.	23.4	-12.2	2.8	-2.1	0.4

F: Forecast by TD Economics as at March 2012
Source: Canadian Real Estate Association

AVERAGE EXISTING HOME PRICE					
Thousands of C\$					
	2009	2010	2011	2012F	2013F
CANADA	320.1	338.9	362.8	370.3	356.9
N. & L.	206.3	235.3	251.5	259.1	249.0
P.E.I.	146.0	147.3	149.5	152.4	148.9
N.S.	196.7	206.2	212.4	215.6	208.3
N.B.	155.0	157.3	160.5	156.6	158.5
Québec	225.4	241.5	252.2	249.3	241.4
Ontario	318.6	342.6	366.4	381.9	363.3
Manitoba	201.3	222.1	234.6	239.0	233.3
Sask.	232.8	242.3	258.5	262.3	258.0
Alberta	341.8	352.3	353.4	357.4	347.9
B.C.	465.7	505.2	561.3	566.3	544.8

F: Forecast by TD Economics as at March 2012
Source: Canadian Real Estate Association

AVERAGE EXISTING HOME PRICE					
Per cent change					
	2009	2010	2011	2012F	2013F
CANADA	5.1	5.9	7.1	2.1	-3.6
N. & L.	15.6	14.1	6.9	3.0	-3.9
P.E.I.	4.4	0.9	1.5	1.9	-2.3
N.S.	3.6	4.8	3.0	1.5	-3.4
N.B.	6.4	1.5	2.0	-2.4	1.2
Québec	4.7	7.2	4.4	-1.2	-3.1
Ontario	5.3	7.5	6.9	4.2	-4.9
Manitoba	5.8	10.3	5.6	1.9	-2.4
Sask.	4.0	4.1	6.7	1.5	-1.6
Alberta	-3.4	3.1	0.3	1.1	-2.7
B.C.	2.4	8.5	11.1	0.9	-3.8

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Source: Canadian Real Estate Association



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