

Options To Deal With The GTA Housing Market — Addressing Supply & Speculation More Important Than Foreign Buyers

Action is required to cool Toronto's housing market, which continues to reach new dizzying heights. Home sales in February set yet another monthly record, while benchmark home prices soared 24% y/y (charts 1 and 2). The momentum in single-family home sales and prices continues to spill over to other segments of the market, as well as surrounding communities throughout southern Ontario.

The main factors driving GTA housing markets remain strong domestic fundamentals, including low borrowing costs, solid job gains, aging millennials, provincial in-migration, increased immigration, and a lack of supply. Active listings in Toronto are at a decade and a half low. While housing starts are well above the rate of household formation, the inventory of completed and unsold new homes adjusted for population growth also is below its long-term average (charts 3 and 4). This suggests that new supply has not kept up with demand.

Compounding the supply-demand imbalance, there appears to be some evidence of speculative activity in light of the speed of price appreciation. Based on the historical relationship between the sales-to-new listings ratio and price appreciation, current market conditions are more consistent with price appreciation in the 15% y/y range, roughly 10 percentage points less than the most recent readings (chart 2).

WHAT POLICIES TO PURSUE?

A number of tools are available at all levels of government to foster a more balanced housing market. Ontario Finance Minister Sousa has indicated that he is considering some action in the context of the next budget, and specifically highlighted the potential use of a foreign buyers' tax akin to the one in Vancouver. He noted, however, that this was but one of many options he was considering.

Policy intervention should be guided by a diagnostic of what the pressure points are, and how they can best be addressed. Our analysis suggests a number of factors driving the price increase:

- There is clear evidence that supply is not keeping up with demand despite the strength of housing starts in the GTA. The inventory of unsold homes is below its historical average once adjusted for population (chart 4). This suggests that not enough homes are being built.
- Listings of existing homes are extremely low. This reflects a number of factors, such as difficulties in finding homes to move into if one did sell their house, the high cost of moving exacerbated by the Toronto Land Transfer Tax, and an aging population that tends to stay put far longer than younger generations.
- As noted above, domestic fundamentals remain very strong.

CONTACTS

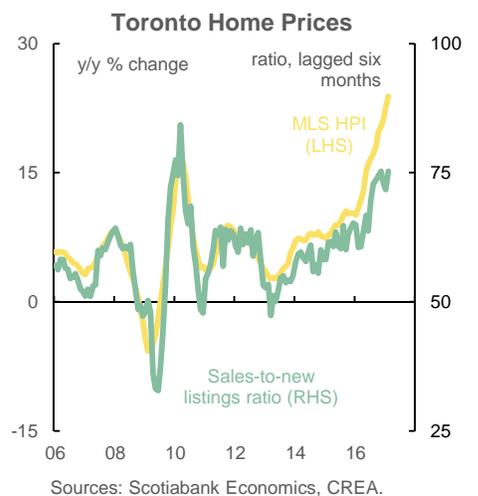
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Chart 1



Chart 2



- The sales-to-new listings ratio has historically been a very good predictor of house price changes, and suggests that the current evolution of house prices in Toronto reflects a degree of speculation (chart 2).

In our view, it is clear that more must be done to increase the supply of housing in the GTA. This could include, for example, zoning amendments, increased density allowances in established neighbourhoods, a streamlined development approval process, and incentives to encourage more rental unit construction. There are a range of options at the provincial and municipal level to encourage this. This is, however, a measure that would only affect the supply-demand imbalance over an extended period of time. It is unlikely to affect price dynamics or affordability in the near-term.

Since much of the increase in prices likely reflects speculative activity, tackling speculation directly has the potential to affect the housing market in a more timely manner. The idea, simply, would be to raise the cost of speculation, without excessively interfering with the market mechanism. Stricter enforcement of property owners paying a capital gains tax if the home is not a principal residence will begin to address speculation but more specifically targeted measures are needed. A number of possibilities exist to do this, such as introducing a tax on sellers who flip a property within a certain period of time.

Any changes along these lines should be neutral from a fiscal perspective. The revenues derived from implementing a new tax approach at the provincial level could then be used to reduce other taxes or redirected to increase the stock of affordable housing.

We do not think a foreign buyers' tax would be the best tool. There is no solid data on the number of foreign buyers in the GTA, though the Ontario government has committed to implementing new procedures to track citizenship information on home purchases. Anecdotal evidence suggests foreign buyers account for roughly 5% of the market in Toronto, as opposed to the 10% in Vancouver prior to the implementation of the foreign buyers' tax. Moreover, recent developments in Vancouver's housing market suggest that a foreign buyers' tax may not have the sustained cooling impact on prices it hopes to deliver.

House price appreciation has slowed significantly in Vancouver, from a peak of 33% y/y in July to 14% y/y last month (chart 5). This largely mirrors a shift back toward more balanced market conditions, as a 37% y/y drop in new listings has been more than matched by a 42% y/y slump in home sales. Vancouver home price trends are largely tracking the ratio of sales-to-new listings, with a six month lag—the typical time it takes both buyers and sellers to adjust their price expectations to a shift in market conditions (chart 6).

The primary driver behind the cooling in Vancouver's housing market over the past year appears to be the ongoing erosion in affordability compounded by additional policy tightening measures since February 2016—the peak month in home sales (chart 7). In addition to federal policy measures raising down payment requirements on homes priced over \$500,000, tougher loan qualifying criteria on insured mortgages, and the 15% foreign buyer tax on non-resident purchases in Metro Vancouver, the BC government has implemented a number of other initiatives aimed at cooling its housing market. These include a 3% luxury tax on homes sales over \$2 million, significant new investments in affordable housing, a ban on shadow flipping of

Chart 3

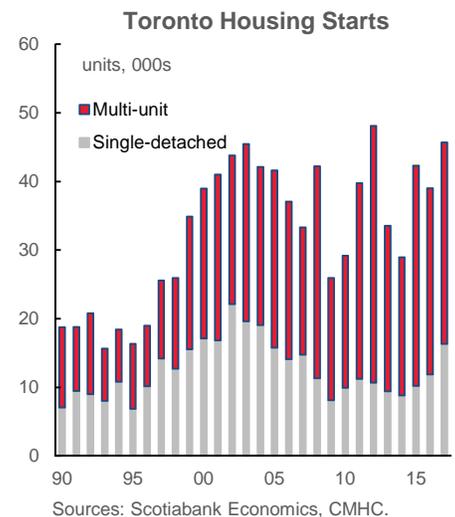


Chart 4

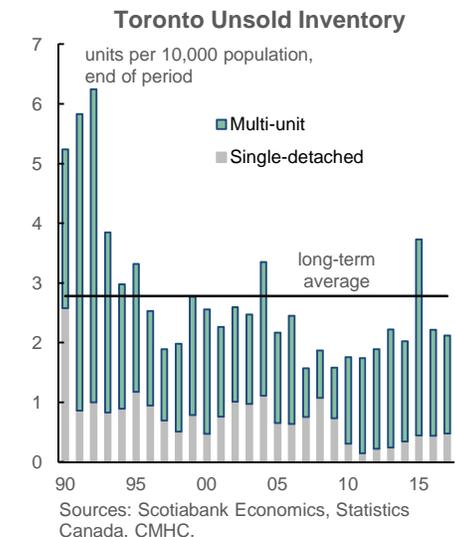
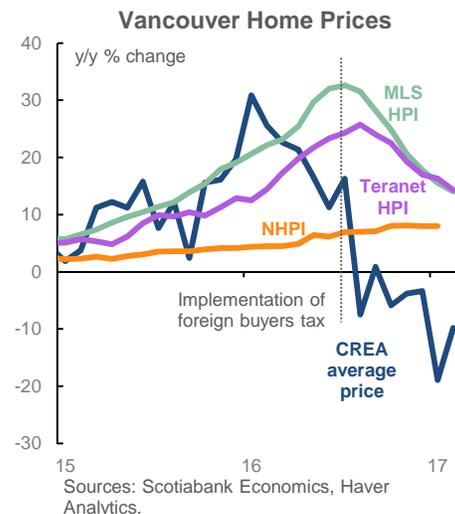


Chart 5



properties, cash incentives to municipalities to speed up development approvals, and a law allowing municipalities to tax vacant homes.

Foreign purchases fell sharply subsequent to the implementation of the foreign buyers' tax in August, but have since shown signs of stabilizing. Foreign purchases edged back up to 4% of total residential sales in Metro Vancouver and province wide over the final months of last year (chart 8).

The most recent data suggest that home prices in Vancouver may be picking up again. The benchmark MLS HPI rose 1.2% m/m in February, while the Teranet-National Bank HPI showed consecutive back-to-back gains in January and February. With sales showing signs of stabilizing and resale listings remaining constrained, Vancouver's housing market could see renewed price gains in the coming months. Demand also could get a boost from the BC government's recently launched interest-free loans program for first-time buyers and the enhancement of the first-time homebuyers' property transfer tax exemption.

Given these developments, it is premature in our view to argue that the foreign buyers' tax has led to a sustained cooling of the Vancouver housing market. This should limit its appeal to the Ontario government, though a measure to more broadly slow speculation among both domestic and foreign buyers may be more effective. This could allow a longer period of greater price stability to give supply measures sufficient time to gain traction.

Chart 6

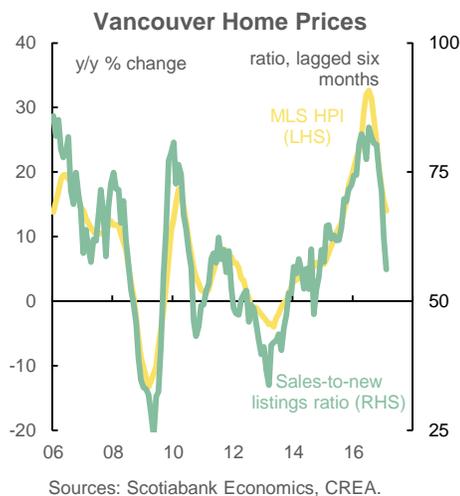


Chart 7

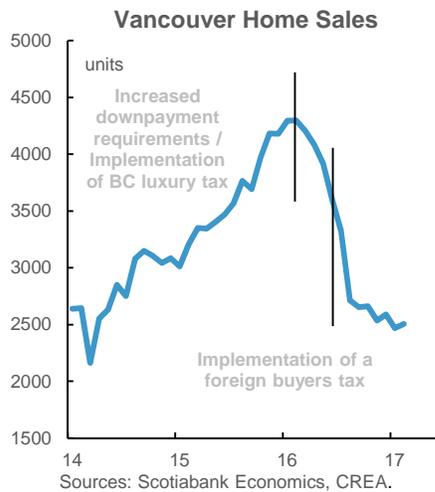


Chart 8

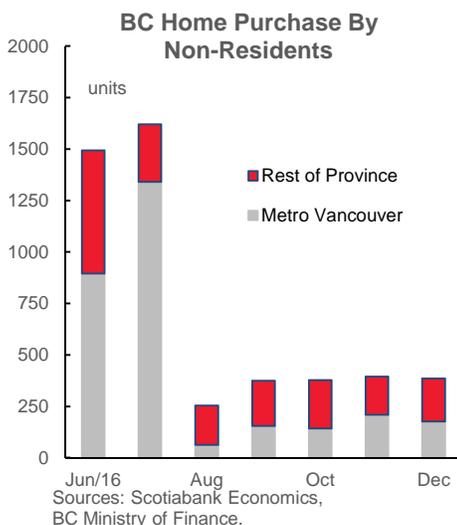
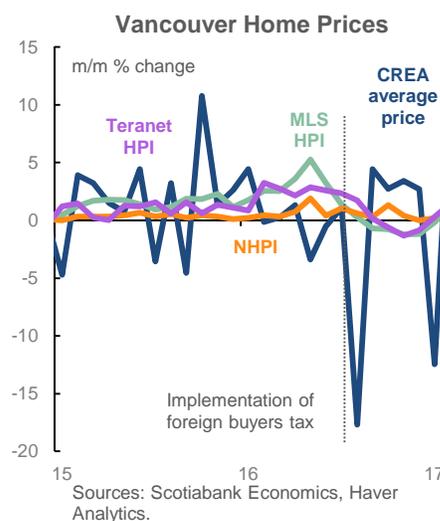


Chart 9



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