November 2021
Metro level deep-dive

Quick links:

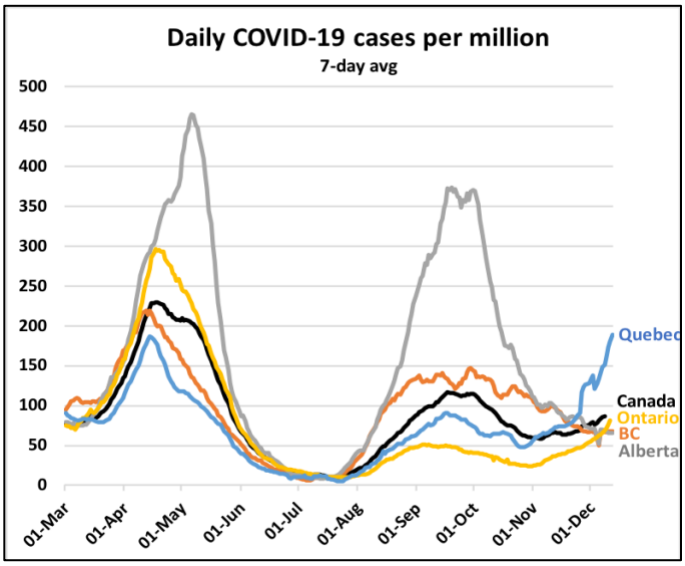
Key takeaways:

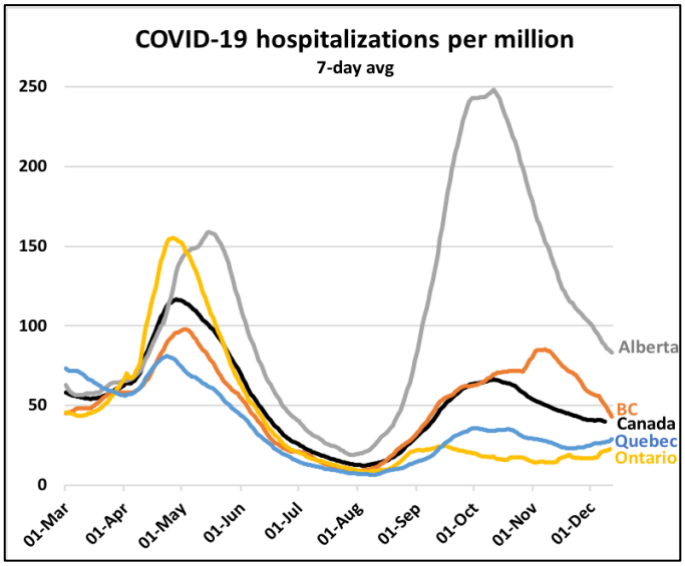
- Omicron is here, and the question now is not what SHOULD be done, but rather what policy makers likely will do. It won't be good for economic growth to end the year.
- Condo demand is surging as affordability erodes in the single-family segment and investors increasingly jump head-long into this market.
- Inventory levels remain challenged across the country, with most metros outside of the prairies at 20-year lows.
- Surging prices are getting attention from policy makers and regulators. Expect action early next year.
- Alberta metros are quietly heading for a record year for home sales. Prices do not yet reflect the extent of the tightening we've seen in Calgary and Edmonton this year.

1) Economic commentary: Bracing for Omicron

In any policy discussion, it's always important to remember that key the question is not what SHOULD be done, but rather what likely will be done. I'm not making a value judgement here as to whether it's the right or wrong approach, but one thing should be clear: If Omicron is anywhere near as contagious as it appears, we'll almost certainly see COVID-related restrictions in coming weeks irrespective of more important metrics like hospitalizations and deaths.

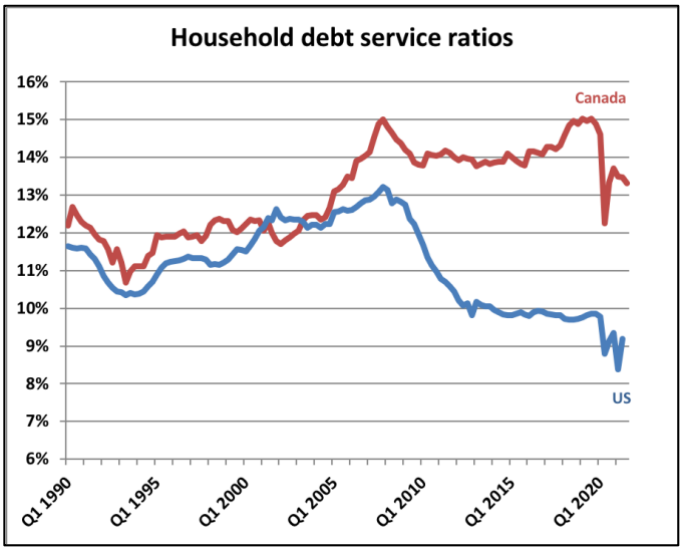
Already the case trend is worrisome (at least to a policy maker) in Quebec and Ontario:





Now the good news, as it were, is that this provides exactly the sort of cover the Bank of Canada would need to walk back some of the rate hike expectations being baked into the bond market. As readers will know, I'm highly skeptical that we'll see more than 2 hikes next year in spite of the bond market pricing in as many as 5 as recently as last week. In my mind, 50bps is just not enough to upend the housing market and the broader economy.

As just one piece of supporting evidence on that point, consider the household debt service ratio. This ratio represents the share of disposable income that is needed to service principal and interest payments on outstanding debt owed by households. New data last week showed that ratio falling sharply in Q3. If we set aside Q2 2020 when the government went overboard on income support programs and caused disposable incomes to spike, this is the lowest debt service ratio in 16 years! And with the savings rate still in double digits, there's plenty of capacity for households to absorb a couple rate hikes without the wheels falling off. More on that in the next Edge Report.

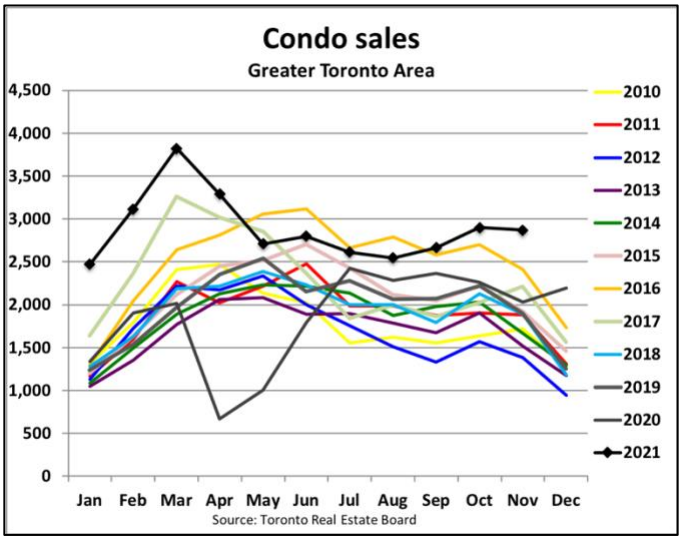


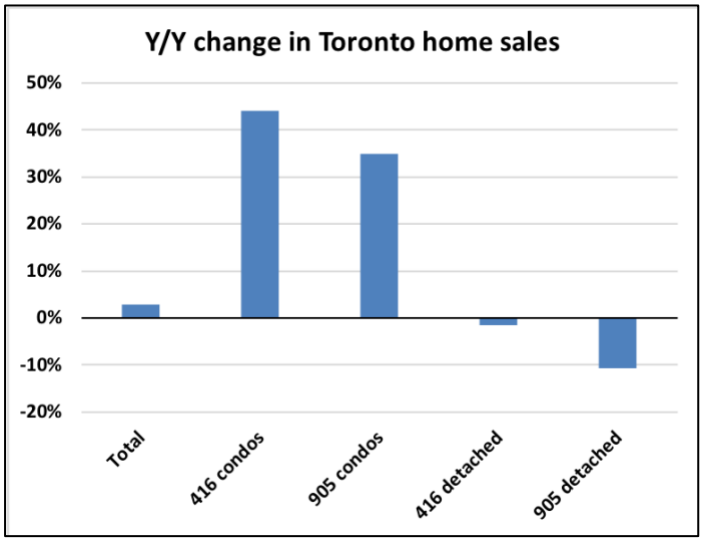
2) Toronto housing boom drawing unwanted attention from policy makers

Let's jump straight to the main takeaways:

i) The condo market is booming

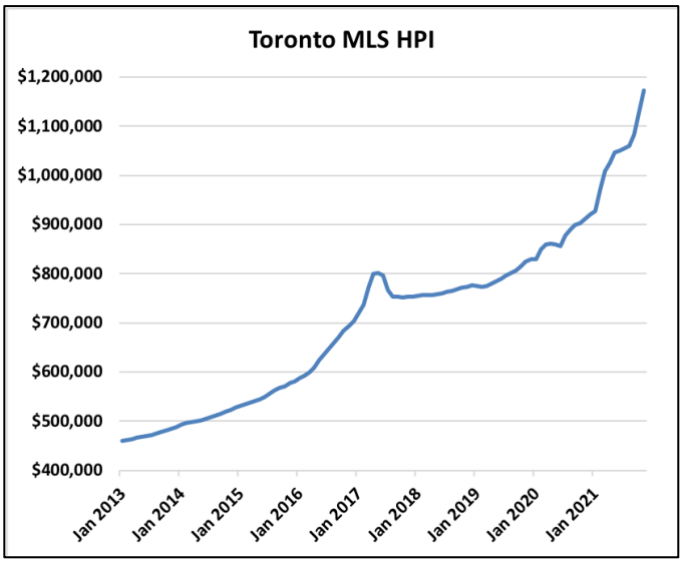
We're already at an annual record for condo sales with one month still to go. Sales in the 416 are up almost 45% y/y, vastly outpacing the broad market. Let's chalk this up three main dynamics: "return to the city" for some workers, increasing unaffordability of single-family dwellings that are forcing first-time buyers into this segment, and increasing investor participation.

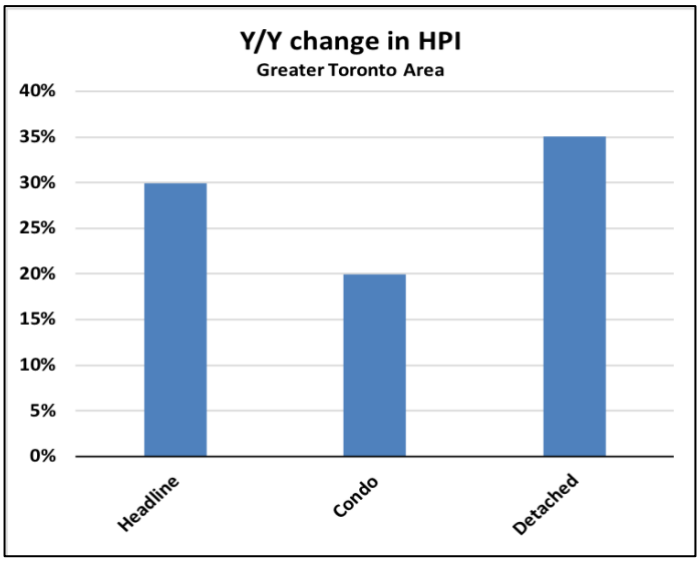




ii) Prices are accelerating at an alarming rate

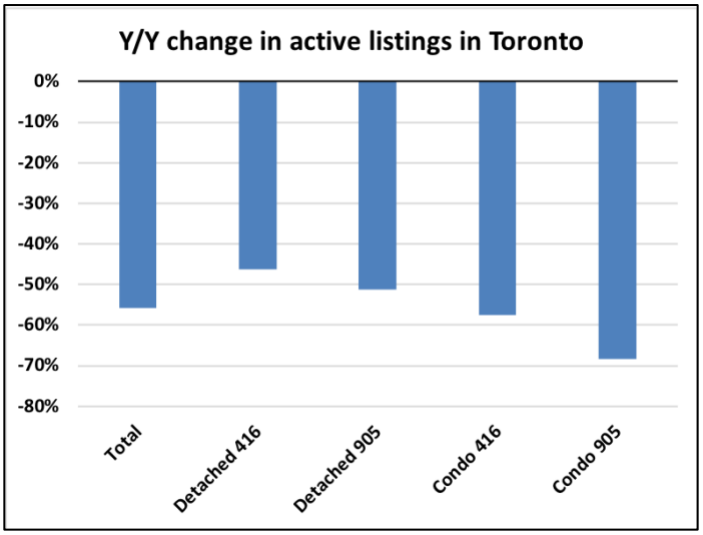
Average house price gains of 22% y/y are actually understating things. With more condos being sold, the "average" price is artificially constrained due to changing composition of the sales mix. If we instead look at the MLS House Price Index, which adjusts for composition, the change in the typical home is nearly 30% y/y!!!!! That's more than enough to get the attention of politicians and policy makers, and it's the sort of thing that just begs for intervention. More on that in a moment.



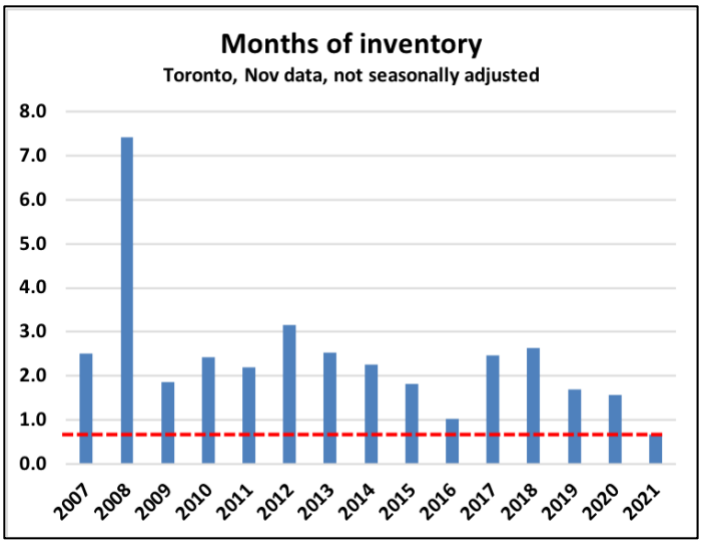


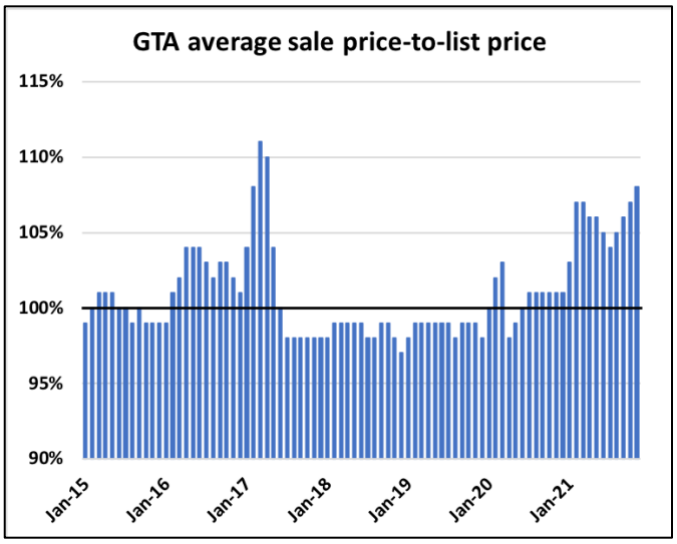
iii) Inventory continues to plunge

Do you recall this time last year at this time when house prices in Toronto were rising double digits and we were all concerned about the growing imbalance in supply and demand? Fast forward to today and inventory levels have fallen by nearly 60% compared to last year. It's hard to emphasize just how crazy that one stat is.

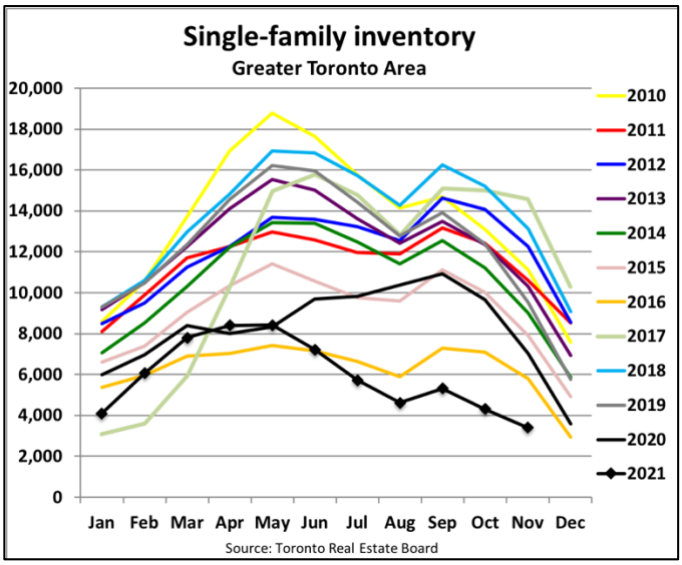


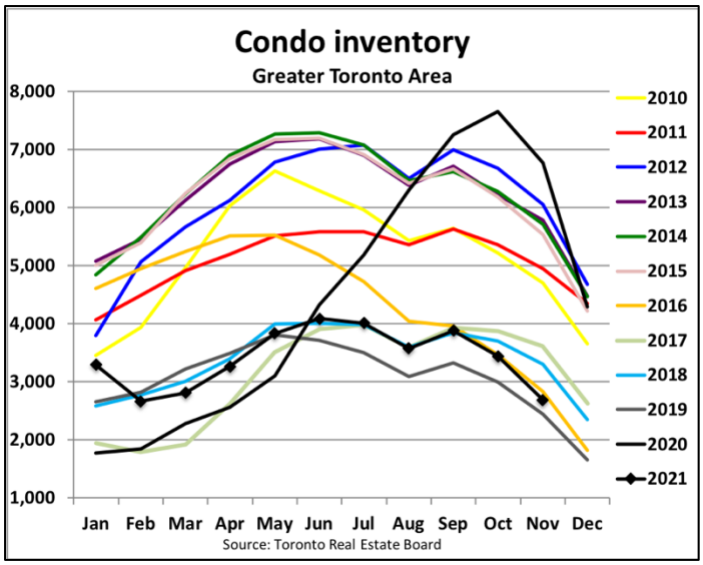
Months of inventory have fallen to the lowest on record, well under the 2016 lows. With supply and demand so out of line, the average home in Toronto sold for 108% of asking price last month…a stone's throw from the record set in 2017 and a clear sign that bidding wars are rampant:





The inventory shortage is most acute in the single-family segment but even condos are closing in on the 2019 lows:





Things aren't getting better on the new listings front either….they were down 13% y/y in November and came in at the second lowest reading for that month in the past 5 years.

iv) Pressure builds on policy makers

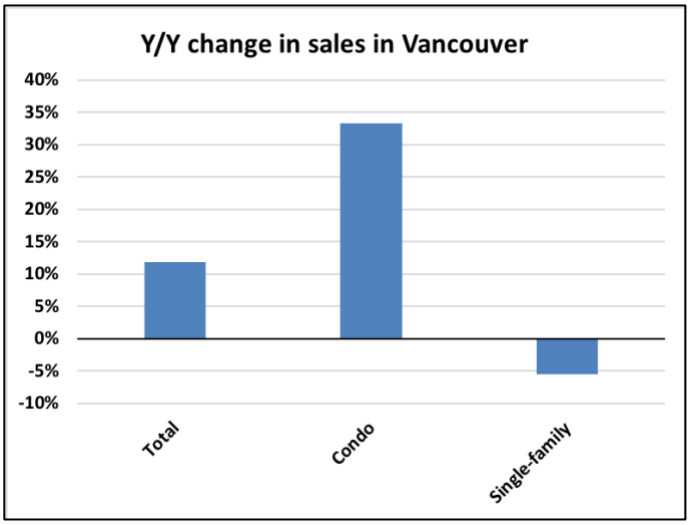
Remember, policy makers and regulators respond to the news cycle. If it's not in the news, it's not top of mind. What we're seeing now is a clear crisis that's set to dwarf the 2017 period, and the media is picking up on it. Case in point:

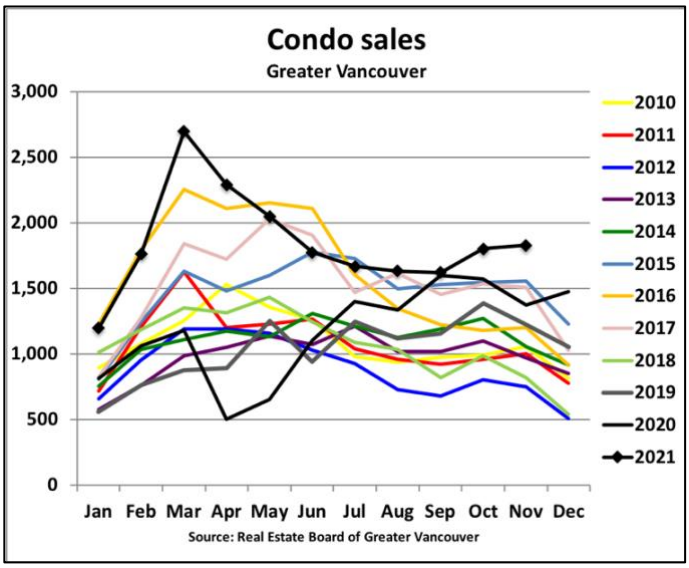
> **Toronto councilor pushes for speculation tax to cool 'insanity' of escalating real estate prices- CBC**
>
> […] Colle is calling on the Ontario government to introduce a speculation tax on the sale of homes that are not principal residences to deter speculators and what he calls "home flippers."
>
> It wouldn't be the first time a tax like this was introduced in Ontario. The Bill Davis government brought in a speculation tax in the 1970s to cool Ontario's real estate market.
>
> While some experts say the province needs to address sky-high prices that have outpaced incomes, they caution such a tax could have an "aggressive" impact. They further say the rate of the tax and how it's implemented are crucial.
>
> Others warn it could crash the market and that any measure to deter investors could have unintended consequences.

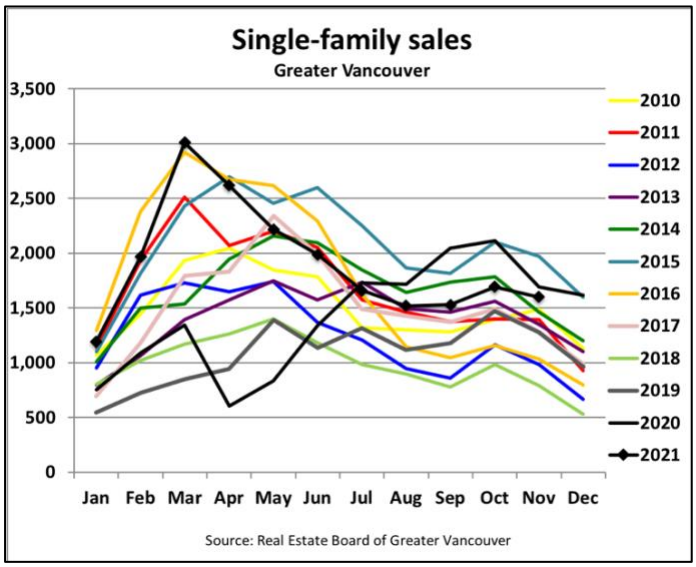
The longer this goes on, the more we should expect disruptive new policies similar to B20 and the foreign buyer tax that followed on the heels of the 2016-2017 runup. It's coming! I'd expect OSFI to drop the hammer on investors in early 2022 (see last week's 2022 Outlook report for more on that).

3) Vancouver also sees surging demand for condos

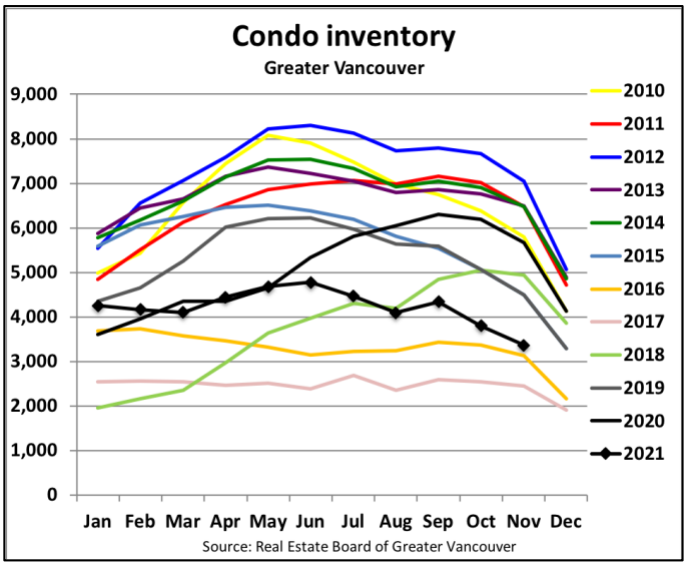
Many of the same dynamics at play in Toronto are also apparent in the latest data out of Vancouver. Condo demand is through the roof for all the same reasons. Sales were up by 1/3 compared to 2020 levels:

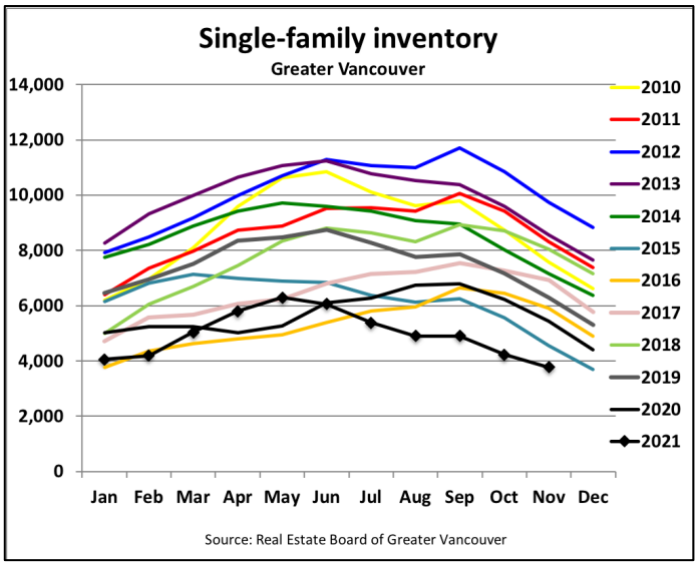




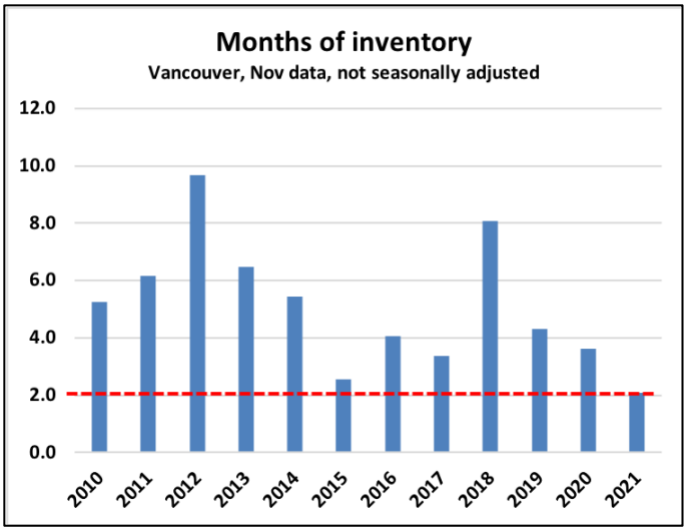


This is happening even as inventory levels plunge across all property types:

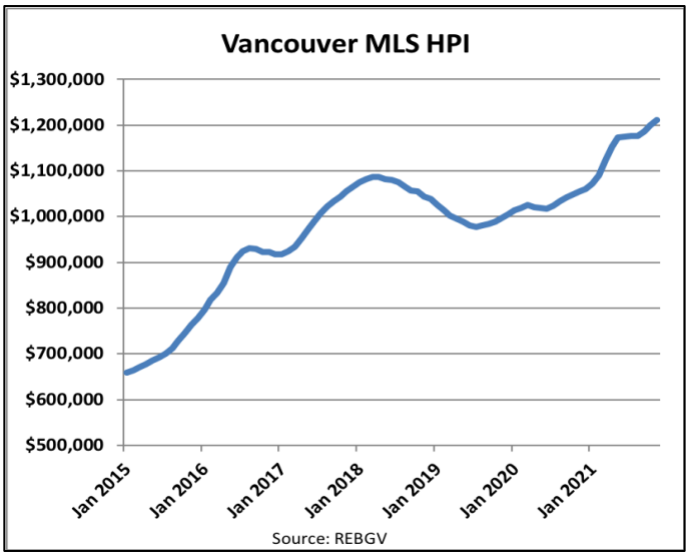


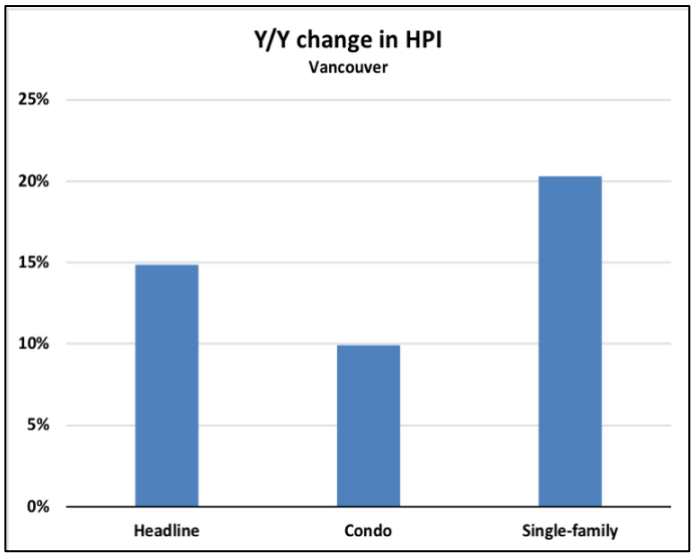


Similar to Toronto, Vancouver is also seeing a record low for months of inventory:



That level of tightness in the market is leading to a dramatic surge in prices that looks set to get worse from here They're not up as much as in Toronto, but 15% y/y on the MLS HPI is nothing to scoff at:



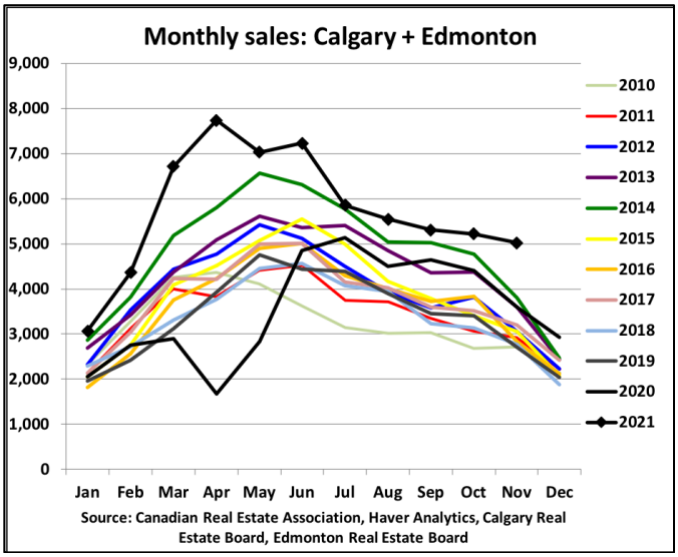


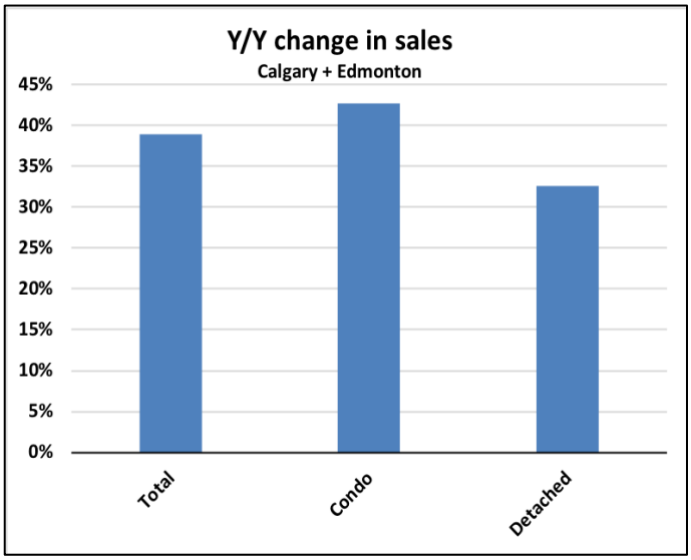
4) Alberta house prices not yet reflecting underlying strength

Way back in April I laid out the case for a "catch-up" trade in Alberta. Among the positive developments I saw:

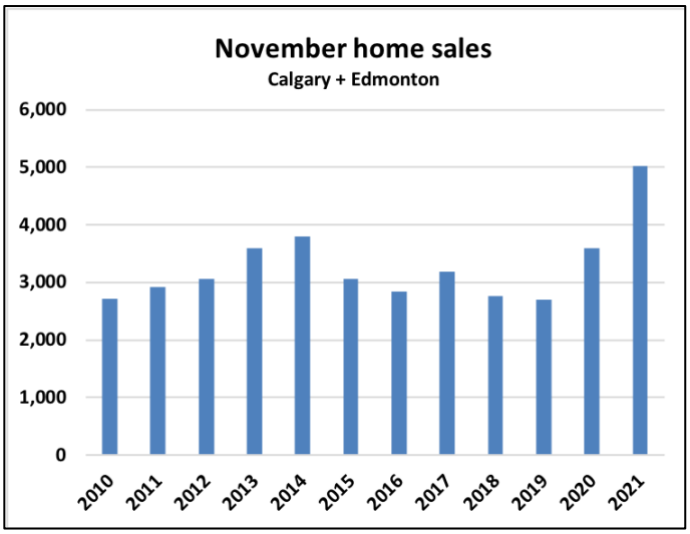
- Young, educated workforce
- Exceptionally cheap rents for new businesses
- Booming tech startup scene
- The most affordable real estate in the country
- World-class city
- Overly negative sentiment on energy

Fast forward to today and Calgary and Edmonton are quietly putting in an amazing year in their respective housing markets. Both are on track for record annual sales with collective transactions up nearly 40% y/y last month alone:

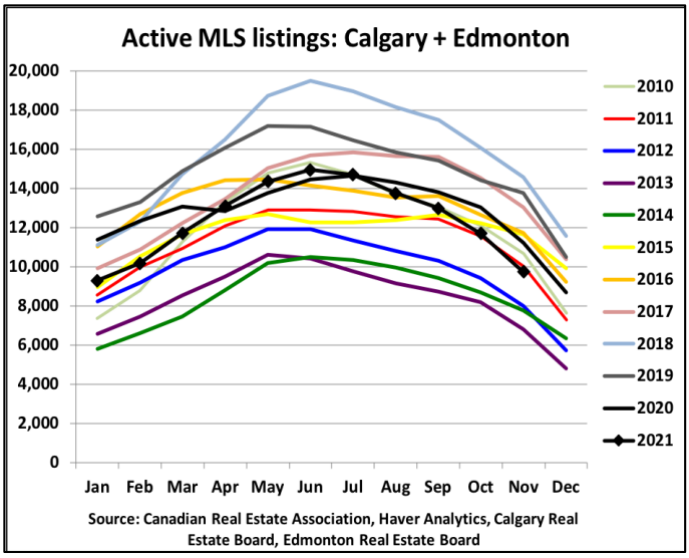


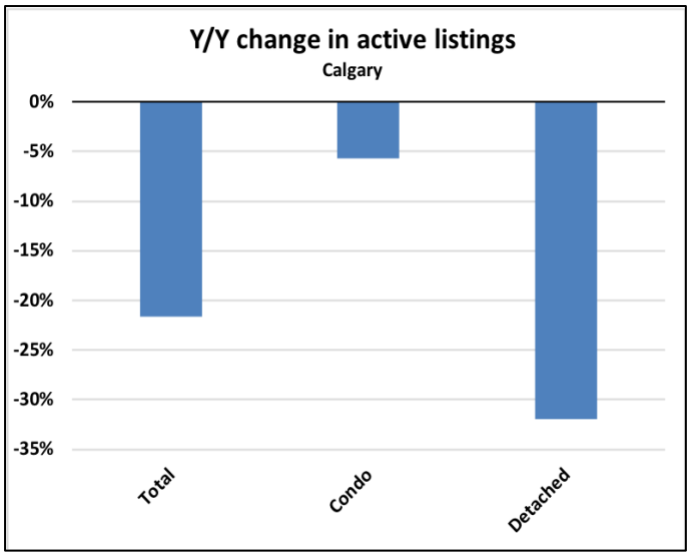


Just to add more context, I've zoomed in on November home sales since 2010. Last month is truly a massive outlier:



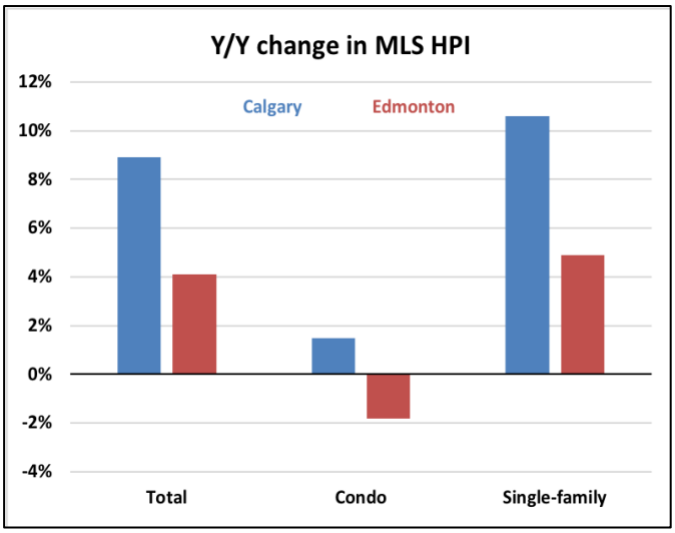
The bigger story is that inventory is really starting to roll off now, down 22% y/y overall in November.





But unlike Toronto and Vancouver, at least there's a healthy flow of new listings coming to market (+15% y/y last month). It's not keeping up with sales, but it's at least preventing the sort of melt-up in prices we're seeing in other markets.

The MLS HPI was up 8.9% y/y in Calgary and 4.0% in Edmonton. But those numbers are really understating the extent of the market tightening we've seen in recent months. Expect a big move in 2022 unless things change quickly.



5) Quebec home sales set for strong finish to 2021

Ignore the headline 17% y/y decline in sales across the province of Quebec last month, and contextualize it against the insane levels of November 2020 in the chart below. Last month was a monster month for home sales across the province no matter how you slice it:

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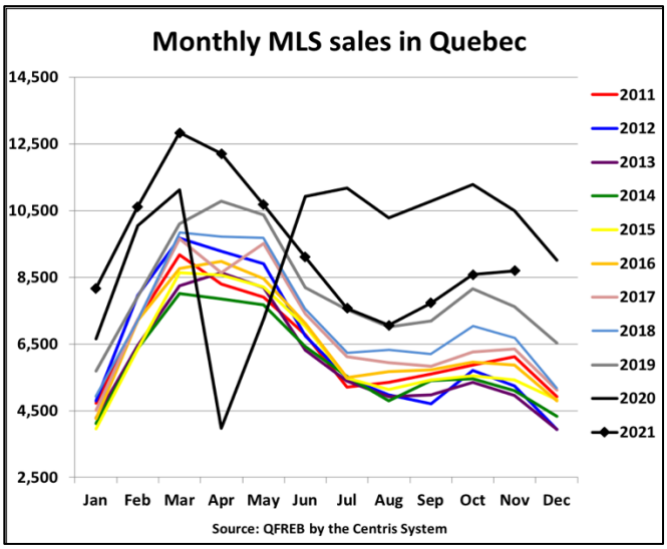
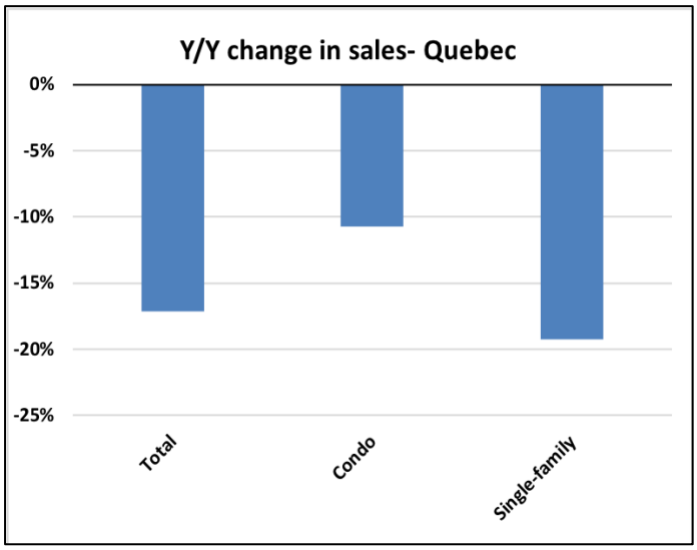
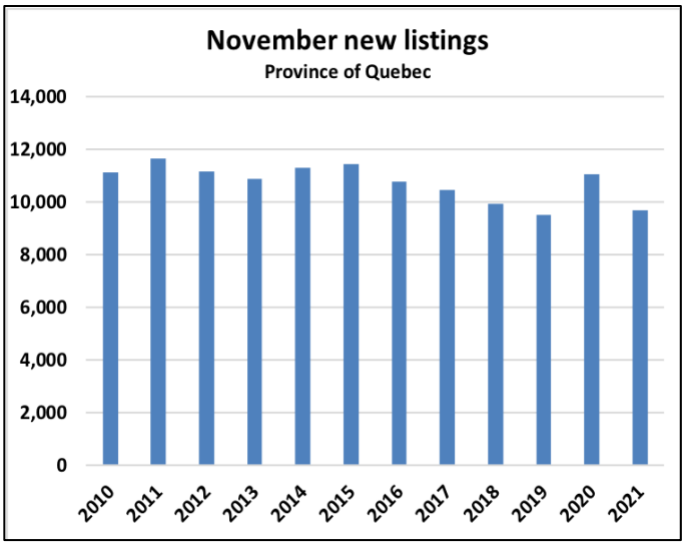
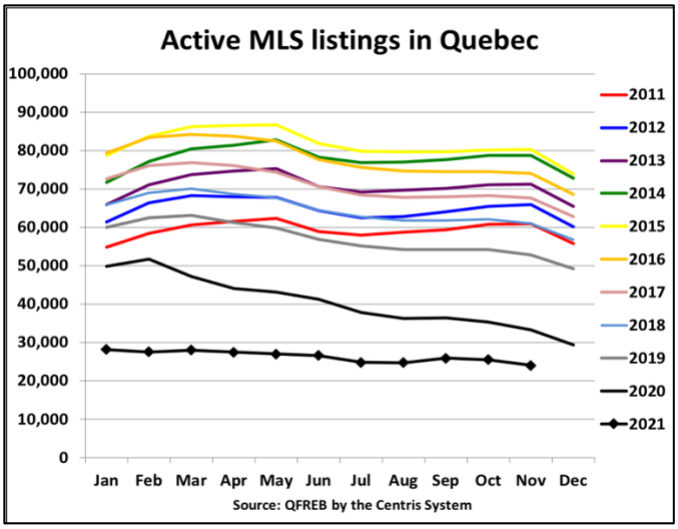
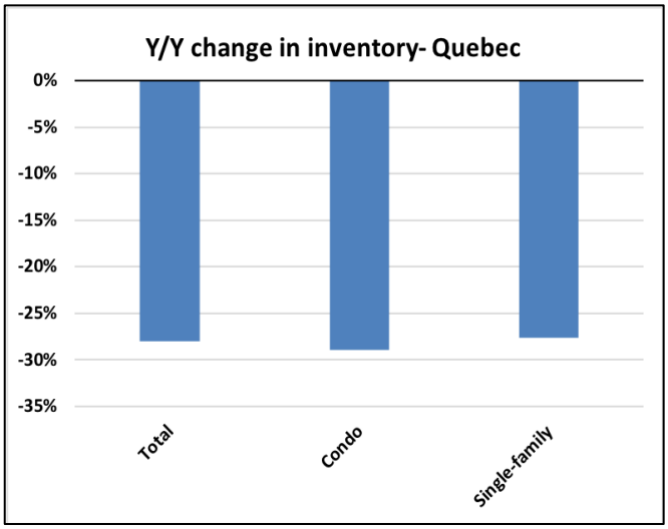




New listings continue to bump along near decade lows, and until that changes, resale inventory will remain at rock-bottom levels:







Median house prices were up 17% y/y for condos and 19% in the single-family segment: