Independent Real Estate Intelligence

Reflections on Housing

Prepared by Altus Group for CHBA

Housing Starts to Pause Ahead:

- The recession is well behind us, and recent housing market activity has been buoyant;
- Upcoming factors such as new taxes and higher interest rates will raise the cost of housing and consumers are surely aware of this. Recent activity has been fuelled by these consumers trying to beat these higher costs;
- The result of the demand "pulled forward" will be **lower housing demand and starts** over the next 4 or 5 quarters;
- Builders should be cautious about relying on assumptions of strong sustained growth through the next few years.

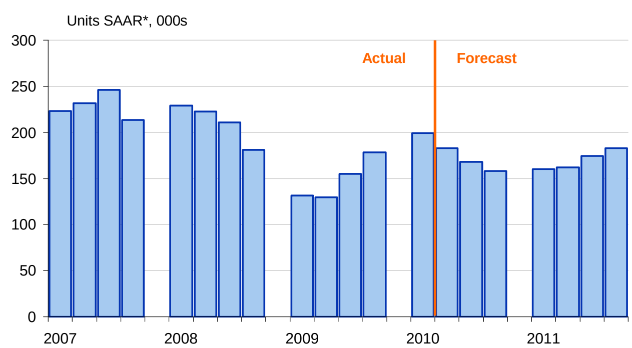
A Good time for Caution

Canada is considered to have slipped out of its recession about one year ago (June 2009) and economic indicators suggest that a slow but steady economic recovery is underway.

The housing market in Canada was hard hit by the recession, but bounced back at a remarkable pace, in large part due to low interest rates and attractive house prices in the months immediately after the recession. Initially, this housing recovery showed up in elevated sales and rising prices in the resale market, and in more recent months in higher housing starts.

Housing starts in Canada, which averaged 201,400 units per year in the decade leading up to 2008, fell sharply to 131,200 units (at a seasonally adjusted annual rate – SAAR) in the first quarter of 2009, due to the effects of the recession. Since then, starts have steadily improved to an average of 200,100 units SAAR in the first four months of 2010.

Housing Starts, Canada, A Double Dip



* Seasonally adjusted at annual rate

Source: Altus Group Economic Consulting based on data from CMHC

On the surface, therefore, it would appear that the market is right back to normal with respect to new housing demand and supply. However, a number of **dark clouds are lurking on the horizon**, and builders should assess the strength of potential housing demand with some caution.

Recent past not necessarily reflective of demand ahead

There are a number of emerging factors that could increase the cost of housing later in the year. There is strong evidence that potential homebuyers both know about and understand the potential effects of these factors.

Buying a new or existing home in Canada is likely to become more costly later in 2010 and beyond with the introduction of new or higher sales taxes in four provinces and an expectation of higher mortgage interest rates.

Taken together, these factors, alongside tighter eligibility rules for insured mortgages, have created an urgency to buy – a combination of a strong incentive to buy now and a strong disincentive to buy later.

Thus, it is very likely that a significant portion of recent new and existing home sales are among buyers who may otherwise have bought late in 2010 or 2011, but moved their purchases forward responding to these incentives.

Obviously, the flip side of a market buoyed by buyers who have moved purchases forward is the potential for a market later in the year and into 2011 to be somewhat suppressed by a lack of buyers.

The economy is recovering, but the pace of recovery may be slower than some anticipate

Increasingly positive economic indicators are emerging in Canada, which are encouraging signs of better times ahead. But a strong employment report, or an up-beat story about business confidence needs to be taken in context.

The recession destroyed almost half a million jobs in Canada and, despite a slow steady pace of job growth since the middle of last year, the Canadian economy has only replaced about two out of every three of the jobs lost in the recession. There is still a long way to go before job levels, the foundation of household income, are back to where they were two years ago.

That being said, the jobs report from April was particularly strong – Statistics Canada reported a gain of some 108,000 net new jobs in the month. While that announcement is certainly encouraging, it is interesting to note that based on the composition of those jobs – largely in the construction, finance, real estate and building support sectors – most of these could be considered spin-off jobs from the recently buoyant housing sector, rather than a sign of a sustained and accelerating general economic improvement across the economy.

Implications for new housing demand ahead

All told, the recent increase in activity in the housing sector is encouraging, but it is too early to be confident about its sustainability. Much of the recent activity and demand for new homes is likely due to pulled forward sales. This implies softer demand for new homes in the quarters ahead.

The Altus Group baseline forecast for housing starts, therefore, is for a decline from recent activity (around 200,000 units SAAR) to levels around 160,000 units SAAR by late in 2010 and early 2011 (see Chart, previous page). Assuming continued improvements in the economy and job growth, the forecast is for a gradual improvement in housing starts thereafter. All told, annual starts are forecast to be some 173,000 this year and 169,000 next.

As with any forecast, there are risks on the up and the down side, which could affect the pace of housing starts.

- On the down side, it is possible that a slower-than-expected recovery in the U.S. economy, coupled with worse-than-expected fall-out from the evolving European debt crisis, could have a dampening effect on Canadian economic growth, possibly stalling job creation and placing even greater-than-expected upward pressure on interest rates. There are also risks that the private sector will not adequately take over as government stimulus monies start to dry up. This type of scenario would likely significantly slow the pace of housing starts going forward into the 150,000 to 160,000 unit range for the next few years.
- On the up side, stronger and more broadly-based private-sector employment growth in Canada, coupled with softer commodity prices (which would have the effect of a lower Canadian dollar value and lower Canadian interest rates), would probably provide a prolonged boost to new housing demand. Under these circumstances, housing starts in the 190,000 to 200,000 unit range over the next few years could be achieved.

Home builders should greet current conditions with some optimism, but remain cautious. Prudent builders will limit their exposure to housing inventories later this year and into 2011.