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Canada Housing Market Outlook: The Tide Starts to Ebb

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Introduction

After a three-year period of acceleration, house price growth in Canada has started to slow. Policy interventions by the Department of Finance and by the British Columbia government have started to make themselves felt in the housing market. Overall, the imbalances present in the national housing market are no longer getting worse, but they are still a long way from returning to balance with income and demographic trends. Prices in Vancouver and Toronto are still seriously overvalued, while prices in the Prairie provinces have been flat for almost three years since the late-2014 decline in oil prices and are, in some cases, undervalued relative to median income and construction costs. Moody's Analytics forecasts that the Brookfield RPS composite house price index will slow to 0.1% year-over-year growth by late 2018. In addition, there is still the upward trend in mortgage rates driven by the higher-interest rate environment over the next few years, as the Bank of Canada and the Federal Reserve normalize rates to precrisis levels from the past decade. Finally, the Ontario government announced their own transfer tax in April as part of the effort to put a brake on house price growth and overvaluation, and the likely effects of this tax are discussed in the report.

Canada Housing Market Outlook: The Tide Starts to Ebb

BY ANDRES CARBACHO-BURGOS

Policy interventions by the Department of Finance and by the British Columbia government have started to make themselves felt in the housing market, though they have not yet had the serious downward effect that critics have been warning about. The combined effects of tighter national mortgage lending rules and the Vancouver transfer tax on purchases by nonresidents of Canada seem to have slowed the market but are very far from generating a correction. Indeed, in the region that has some of the highest house prices—the Golden Horseshoe area of Ontario stretching from St. Catharine's to Peterborough and including Toronto—house prices have only recently started to slow and are still on a strong upward trend. As part of the effort to put a brake on house price growth and overvaluation, the Ontario government announced its own transfer tax a few days after the April forecast was run for the Canada regions and for the Brookfield RPS house price indexes. The likely effects of this tax are discussed at the end of this report.

Overall, the imbalances present in the national housing market are no longer getting worse, but they are still a long way from returning to balance with income and demographic trends. Prices in Vancouver and Toronto are still seriously overvalued, while prices in the Prairie provinces and in Newfoundland have been flat for almost three years since the late-2014 decline in oil prices, and are in some cases undervalued relative to median income and construction costs. Although the hazards to the housing market of the tighter national mortgage lending restrictions may have been overstated, there is still the danger that the new regulations may restrict needed purchase demand in areas of the country outside of Vancouver and the Golden Horseshoe.

Recent Performance

With one exception, housing markets across Canada have slowed but have not shifted from expansion to correction. The momentum of the housing market has slowed: Total annualized sales in the first quarter came in at approximately 540,000, according to the Canadian Real Estate Association, about the same level as in mid-2016; prior to mid-2016, sales had been increasing steadily for the better part of four years. Prices in the Golden Horseshoe are still rising at up to 20% year over year but have slowed significantly since late 2016.

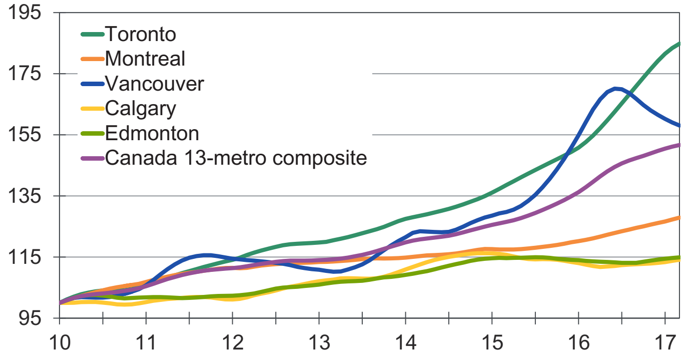
The exception to the national trend is Vancouver, where sales have declined year over year and overall prices have at best leveled out or at worst gone into decline, depending on the price index used. The strongest effect in Vancouver seems to be on rapid resales of homes, and may be prompted not just by the transfer tax on foreign purchases but also by new real estate regulations restricting shadow flipping and other forms of rapid resale. The Brookfield RPS house price index, which counts all transactions within its purview and therefore leverages a broader unit count, has shown a stronger downward effect from these restrictions compared with other house price indexes, which exclude sales pairs for the same unit taking place within six months of each other.

Chart 1 shows the Brookfield RPS composite, transaction-weighted indexes for the five largest metro areas and the 13-metro composite index. Toronto and Vancouver have pulled up the 13-metro index all by themselves over the past five years, though the pull on short-term resales has started to push down Vancouver house prices. For these 13 metro areas, Charts 2 and 3 show that over the past six months, Toronto and nearby Hamilton have started to slow while Vancouver has entered correction territory at least in the short term. The overall trend of other metro areas has changed less: Medium-size metro areas such as Ottawa, Quebec and Winnipeg have slowed slightly but are still making solid if unspectacular price gains.

While policy is starting to have an effect in reducing upward price pressure, it has not had much help from construction until recently. Total completions recorded by

Chart 1: Vancouver Slows, Toronto Persists

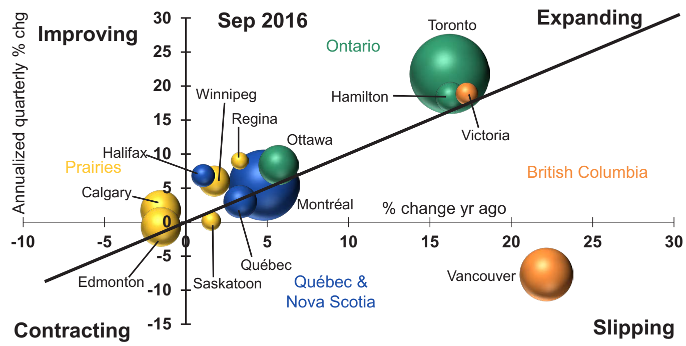
Brookfield RPS composite house prices, Jan 2010=100, SA



Sources: Brookfield RPS, Moody's Analytics

Chart 2: Market Was Still Rapid Last Year…

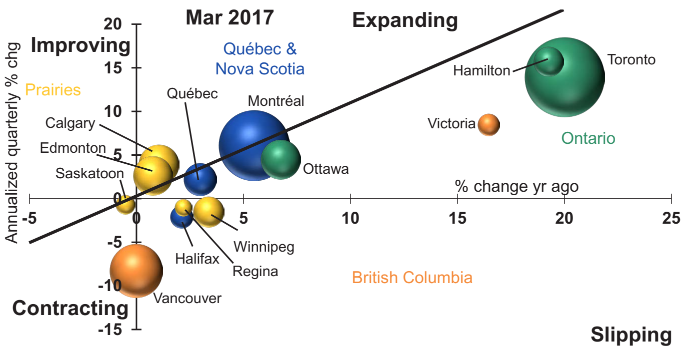
Composite index, 1-yr vs. 1-qtr performance, 3-mo MA



Sources: Brookfield RPS, Moody's Analytics *Bubble size indicates # of households

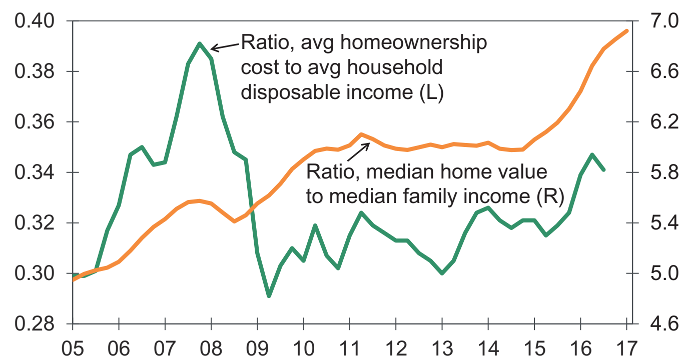
Chart 3: …But Has Since Started to Slow

Composite index, 1-yr vs. 1-qtr performance, 3-mo MA



Sources: Brookfield RPS, Moody's Analytics *Bubble size indicates # of households

Chart 4: Affordability Is Still Deteriorating



Sources: Brookfield RPS, Bank of Canada, Statistics Canada, Moody's Analytics

the Canadian Mortgage and Housing Corp. have been mostly flat over the past three years, though the falling share of single-family completions has not helped to bring down new single-family home prices and has in all likelihood worsened the already-tight existing single-family home market in most regions. The one good sign so far is an increase in housing starts for the first quarter of 2017, including a significant number of single-family starts. This increase is likely to be sustained over the next two years, but the outlook is subject to downside risks as policy rates, and soon afterward mortgage rates, will start to tighten at the same time.

The late pickup in construction has also not helped the supply-demand situation in the existing-home market. According to Canadian Real Estate Association, the ratio of national listings to sales is at a five-year low, with Toronto in particular being at a record low level of listings relative to sales. Part of the reason for the tight supply situation is the house price dynamic itself: As long as prices are rising at a rate above the historical average, potential sellers will have a financial incentive to hold on to their homes, selling only when absolutely necessary. This incentive is especially prominent for older households that are thinking of downsizing and pocketing the price difference for retirement. Therefore, the price spiral in Toronto, and Vancouver through last year, was not a product simply of foreign capital inflows but of a tight supply situation exacerbated by rising prices.

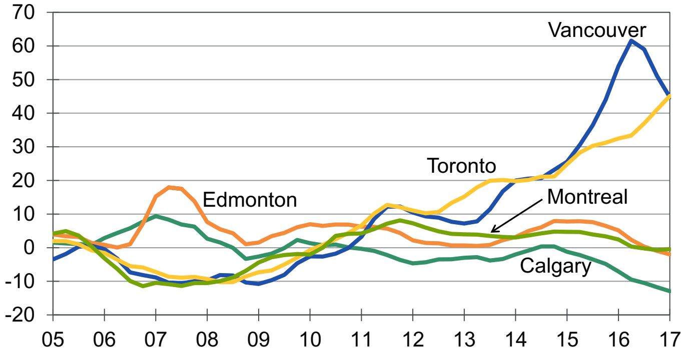
Valuation

As the main concern in policy interventions over the past year, affordability has been a key concern. Although there are not sufficient data to determine whether there is a steady long-term trend in affordability, data for the last two years point to increased downside risks. The ratio of the national median home value measured by Brookfield RPS to median family income was steady at approximately six from 2010 to 2014, but since then it has likely increased and is now at nearly seven (see Chart 4).[1] Only low mortgage rates have prevented the deterioration in this ratio from eroding demand so far. The Bank of Canada's affordability ratio, which includes the effect of mortgage rates, has been steadier since 2008, but it too started to deteriorate after 2014. Over the last 2½ years, the increased household share of homeownership costs has thus been a primary danger signal in the eyes of housing market analysts.

1 The series for 2015-2017 is an estimate given that there are no hard data on median family income after 2014, but median family income growth has likely slowed starting in 2015 as a result of both slower per capita GDP growth and slower growth in average wage and salary income per household.

Chart 5: Vancouver Starts to Correct

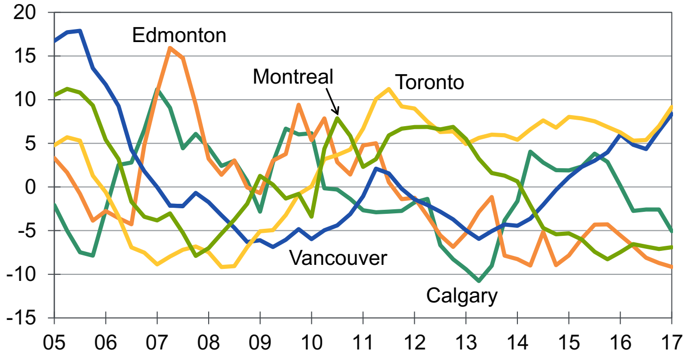
Brookfield RPS house price, s-f detached, % deviation from trend



Sources: Brookfield RPS, Moody's Analytics

Chart 6: Condo Valuation Is More Moderate

Brookfield RPS median condo apt. price, % deviation from trend



Sources: Brookfield RPS, Moody's Analytics

Household income is only one of the determinants of the long-term price trend in any region. The Moody's Analytics forecast model for the Brookfield RPS house price indexes compares current house prices to long-term trend prices which are influenced by income, population size, the overall new house and land price index, and for a few metro areas, the deflated stock market price index as a proxy for national wealth (there is no easily available data for international wealth inflows that engage with the housing market). The divergence between the current price and this long-term trend price determines the degree of over- or undervaluation, which is an important driver of the house price forecast.

The deviation of house prices from trend bears an implicit forecast for long-term stability. In geographies with highly overvalued housing, house price growth would normally start to slow because of a combination of reduced affordability, excess construction, and a possible decline in mortgage debt performance leading to distress sales. Highly undervalued metro areas are likely to see a wave of opportunistic purchases, either to flip dwellings or to make them available on the rental market, with resulting appreciation as such purchases start to act on a limited supply of homes.

However, there is no guarantee of stability in the short term, especially on the overvalued side and especially for larger metro areas subject to international capital flows. Such flows, combined with the tendency for listings to fall as house price growth accelerates, can keep a housing market overvalued for a long time, and indeed Chart 5 shows that Vancouver and Toronto single-family home prices have been overvalued since 2011, though Vancouver has recently started to correct. By contrast, the market for condo apartments does not seem to be seriously overvalued (see Chart 6), but only if the assumption holds that condo apartment demand is more affected by average household income than by median family income; a greater share of median-earning families in the condo market might actually reduce overall demand in the largest metro areas. Also, the range of over- or undervaluation for condo apartments in Chart 6 is much narrower than that for houses in Chart 5, as a look at the vertical axis scale clearly shows; the condo apartment market has tended to be more stable over time.

Even if home purchase demand by foreign buyers and from the nonlocal incomes of the top tier of income earners persists, however, an overvalued market can become exceedingly fragile for other borrowers, especially if mortgage rates increase. The Department of Finance's fear that the housing market is in danger of becoming a bubble is not groundless.

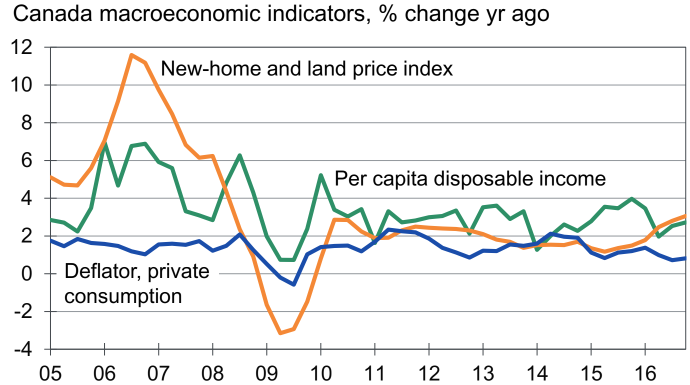
The macroeconomic forecast

Despite a slowdown in recent GDP growth (much of it energy-related), and tremors over possible trade policy disputes with the Trump administration, the macroeconomic environment for Canada is quite stable. Per capita disposable income growth has averaged slightly over 2% per year over the past five years, whereas consumer price inflation has averaged around 1.5% per year (see Chart 7). Growth in the national new house and land price index has started to pick up over the past year but is now at only about 3%, well within safety margins. For Canada as a whole, residential construction will run slightly ahead of household formation over the next few years, putting downward pressure on new-home prices.

The most recent macroeconomic forecast for Canada from Moody's Analytics, as well as the forecast for the main Brookfield RPS national house price indexes, is shown in

Chart 7: Inflation, New-Home Prices Are Subdued

Canada macroeconomic indicators, % change yr ago



Sources: Statistics Canada, Moody's Analytics

Table 1. The influence of the more restrictive mortgage lending rules, especially the new stress test for borrowers who can meet down payment requirements, is evident in the table as the composite index slows to 0.1% year-over-year growth by late 2018. In addition, there is still the upward trend in mortgage rates driven by the higher-interest rate environment over the next few years, as the Bank of Canada and the Federal Reserve normalize rates to precrisis levels from the past decade.

As in the December report, the macroeconomic forecast incorporates a significant increase in residential construction through the end of 2017, after which housing starts will slowly decrease over the next three years. Even so, housing starts will stay ahead of projected household formation. The real question is the regional distribution of construction: Despite significant activity, all indications are that construction has been insufficient relative to new-home demand in Toronto and Vancouver.

The one substantial change in the forecast from the December report is a slower projected growth rate for real per capita income after 2017. This change to the forecast is most likely trade-related. Not only have oil prices been slow to recover, but the world economy continues to operate below capacity: China's slower growth will not be reversed and is likely to continue, while Europe's slow growth will be made more difficult by increased hostility to the EU and the euro, of which Brexit is only one symptom.

The effects of this slower income growth will be to worsen affordability and valuation problems in the short term, so house prices will definitely have an uphill climb over the next few years.

The regional forecast

There have been some substantial changes in the regional outlook for house prices since the December report. Vancouver's correction will be relatively minor and not as deep as originally projected, while Ontario in general will have slower though still strong price growth. The Prairie provinces overall look slightly better thanks to the continuing recovery of oil prices, though most of the improved outlook is for Alberta rather than Manitoba or Saskatchewan.

Table 2 summarizes the short-term regional outlook for the single-family market. The first two columns of the table highlight the most recent house price dynamics that affect the forecast. The first column is the percentage of overvaluation by metro area. Of the larger metro areas, Toronto, Ottawa and Vancouver are still the most overvalued, though Vancouver has started to correct. Overvaluation has also started to spread to smaller metro areas near Toronto such as Hamilton, Brantford and Barrie. Undervaluation is less severe but is perceptible in Calgary, Saskatoon and Winnipeg, and helps to improve the house price outlook in these metro areas.

The second column shows house price growth in the first quarter of this year, the last quarter with full data. Compared with the previous year, the immediate standout is the house price decline Vancouver thanks to the effects of the transfer tax and new regulations on the Real Estate Council of British Columbia intended to reduce the prevalence of rapid resales. Edmonton and Calgary have picked up slightly, but house prices have slowed in a few metro areas adjacent to Toronto such as Kitchener and Oshawa, reducing overvaluation. House price inertia has not changed much for the other metro areas.

The third column shows average annualized house price growth from the first quarter of 2017 to the first quarter of 2018, when persistence effects would be more likely in evidence but also where the now-established change in mortgage lending rules would also have the strongest effects. The most evident effect is in Greater Toronto, where the Moody's Analytics forecast indicates that house price growth will slow substantially because of a combination of the new mortgage lending restrictions and slower overall income growth in Canada between the November and April macroeconomic forecasts. The Alberta metro areas have improved slightly in outlook, though Edmonton will still go through a minor house price correction. In far worse condition are Manitoba and Saskatchewan, where restricted lending will combine with low income growth as a result of still-low oil and agricultural commodity prices; during the 2017-2020 period, real median family income in Regina and Saskatoon will stagnate at best and fall at worst,

Table 1: Canada Housing Market, History and Baseline Forecast

	Most recent	2014	2015	2016	2017	2018	2019	2020	2021
Detached single-family house price index, % change *	9.8	4.5	6.7	11.0	1.4	0.4	1.3	1.6	1.6
Condo apt. price index, % change *	9.4	3.4	3.9	8.8	2.4	0.1	0.9	1.1	1.2
Composite house price index, % change *	9.8	4.6	5.9	10.6	1.2	0.1	1.0	1.3	1.3
Real per capita income, % change	1.1	0.5	2.1	1.0	1.1	0.8	0.8	0.6	0.4
Unemployment rate, %	6.7	6.9	6.9	7.0	6.7	6.7	6.7	6.8	6.9
Avg mortgage rate, 5-yr, %	3.71	4.08	3.77	3.70	4.04	4.89	5.83	6.27	6.19
Housing starts, ths	201.2	188.8	194.5	199.2	225.2	212.8	196.3	184.6	182.3
% change	1.2	0.4	3.1	2.4	13.1	-5.5	-7.7	-6.0	-1.2
Ratio, median dwelling price/median family income	6.9	6.0	6.2	6.7	6.9	6.7	6.6	6.5	6.5
Ratio, outstanding mortgage debt/disp. income	1.1	1.1	1.1	1.1	1.2	1.2	1.3	1.3	1.4

*Fourth quarter, year over year

Sources: Brookfield RPS, Statistics Canada, CMHC, Moody's Analytics

Table 2: Canada Subnational Forecast, Median Detached House Price

	% deviation from trend price, 2017Q1*	% change annualized, 2017Q1	Avg annualized house price growth, %, 2017Q2-2018Q1	Avg annualized house price growth, %, 2018Q2-2019Q1
Canada		**6.5**	**-0.3**	**0.8**
Alberta		1.3	-0.0	-0.8
Calgary, census metropolitan area	-12.9	1.7	1.1	0.5
Edmonton, census metropolitan area	-2.0	1.8	-2.3	-3.5
British Columbia		-5.8	-0.1	1.2
Abbotsford, census metropolitan area	14.1	8.6	-1.1	1.5
Kelowna, census metropolitan area	4.8	6.2	-0.5	1.1
Vancouver, census metropolitan area	44.7	-11.0	-0.4	1.2
Victoria, census metropolitan area	6.6	6.6	-1.8	-0.0
Manitoba		-1.0	-7.4	-0.5
Winnipeg, census metropolitan area	-12.4	0.2	-8.0	-0.4
New Brunswick		0.7	-0.6	2.5
Moncton, census metropolitan area	-9.4	5.5	-0.5	2.8
Saint John, census metropolitan area	-4.6	14.3	-0.8	2.4
Newfoundland and Labrador		2.2	-10.3	-7.4
St. John's, census metropolitan area	23.7	0.3	-13.2	-10.1
Nova Scotia		-0.8	-0.8	2.8
Halifax, census metropolitan area	-5.8	-5.2	-1.1	2.6
Ontario		16.1	3.2	2.1
Barrie, census metropolitan area	24.7	10.3	0.8	0.7
Brantford, census metropolitan area	21.7	16.4	3.1	3.5
Greater Sudbury, census metropolitan area	14.0	8.5	-2.8	-2.4
Guelph, census metropolitan area	21.3	14.4	3.0	3.9
Hamilton, census metropolitan area	38.3	17.4	3.8	3.0
Kingston, census metropolitan area	-5.3	6.2	-2.8	-0.8
Kitchener, census metropolitan area	18.3	16.7	2.2	0.6
London, census metropolitan area	8.0	10.5	-1.4	-1.4
Ottawa-Gatineau, census metropolitan area	50.9	14.8	2.9	2.1
Oshawa, census metropolitan area	-0.7	5.1	-0.3	2.9
Peterborough, census metropolitan area	5.7	10.6	0.7	-0.5
St. Catharines-Niagara, census metropolitan area	15.1	18.8	0.7	-1.9
Thunder Bay, census metropolitan area	20.4	12.3	-1.4	-2.6
Toronto, census metropolitan area	45.2	19.8	4.9	3.8
Windsor, census metropolitan area	-8.9	4.2	-3.1	-1.4
Prince Edward Island		-3.0	-2.8	2.3
Quebec		4.8	-1.1	1.1
Montreal, census metropolitan area	-0.5	5.9	-1.0	1.5
Quebec, census metropolitan area	13.3	1.9	-3.7	-0.9
Saguenay, census metropolitan area	7.5	7.1	-2.5	-1.0
Sherbrooke, census metropolitan area	-7.3	7.3	0.4	2.4
Trois-Rivieres, census metropolitan area	5.0	-3.1	-4.5	-0.3
Saskatchewan		-1.7	-11.7	-4.7
Regina, census metropolitan area	-0.5	-2.9	-15.2	-8.8
Saskatoon, census metropolitan area	-16.6	-4.5	-11.5	-2.8

Italicized metro areas are part of the Brookfield RPS 13-metro area composite index.
*Census metropolitan areas only

Sources: Brookfield RPS, Moody's Analytics

Table 3: Medium-Term House Price Outlook, Census Metropolitan Areas

Avg annualized projected single-family house price growth, %, 2016Q4-2021Q4

	Nov forecast	Apr forecast
Canada	1.3	1.3
Toronto	5.1	5.0
Guelph	4.8	4.3
Hamilton	3.9	4.1
Brantford	3.5	3.8
Oshawa	3.7	2.8
Ottawa-Gatineau	4.1	2.3
Moncton	2.5	2.1
Sherbrooke	1.8	2.1
Kitchener	1.7	2.1
Saint John	2.4	1.8
Barrie	1.7	1.4
Halifax	1.1	1.4
Calgary	0.3	1.2
Montreal	0.7	1.1
Abbotsford	0.3	1.0
Kelowna	0.2	1.0
Vancouver	-0.4	-0.3
St. Catharines-Niagara	-1.3	-0.4
London	-0.7	-0.4
Peterborough	0.3	-0.5
Victoria	-0.3	-0.5
Saguenay	-0.1	-0.5
Kingston	0.7	-0.8
Trois-Rivieres	-0.8	-0.9
Quebec	-1.0	-0.9
Winnipeg	-1.2	-1.1
Saskatoon	-2.2	-1.2
Thunder Bay	-2.8	-1.2
Greater Sudbury	-1.6	-1.2
Edmonton	-2.4	-1.4
Windsor	1.4	-1.8
St. John's	0.0	-3.4
Regina	-4.7	-4.3

Italicized metro areas are part of the Brookfield RPS 13-metro area composite index.

Sources: Brookfield RPS, Moody's Analytics

dragging house prices down with them. Newfoundland also fares poorly because of slow demographics and the still-incomplete recovery in oil prices.

Compared with the December report, house price growth in the coming year will be led more by Ontario, with Toronto having the largest weight but with Ottawa, Brantford, Guelph, and Hamilton also showing good demand and price growth. It is in fact no exaggeration to say that only the Ottawa and Greater Toronto housing markets are keeping Canada as a whole out of house price correction territory.

The fourth column shows average annualized house price growth from the first quarter of 2018 to the first quarter of 2019, when persistence effects from early 2017 are no longer evident and the shock from tighter mortgage lending rules has abated, so that mean reversion and median family income growth provide the main house price drivers. Vancouver house prices have started to recover from the earlier downturn, as have prices in Montreal. Quebec in general has not been subject to the capital inflow-fueled demand push of Toronto and Vancouver, so the tighter mortgage lending rules will result in a brief downturn for Montreal and a somewhat longer downturn for the other Quebec metro areas. The Prairie metro areas other than Calgary will still be correcting because of their reduced income growth prospects: Oil prices will recover only gradually, making it more difficult to quickly return oil production and oil-related income growth to pre-2015 rates.

Lastly, Table 3 ranks the metro areas from strongest to weakest growth for single-family house prices and compares the current April forecast to the November forecast in the immediate aftermath of the change mortgage in mortgage lending practices. Average house price growth for Canada in the five-year period from 2017 to2021 has not changed significantly, though the distribution of HPI growth between metro areas has. In particular, a slight slowing of HPI growth in Toronto and a more perceptible slowing in Ottawa counterbalance slight gains in projected HPI growth for the other metro areas. Both forecast vintages incorporate the estimated effects of the new mortgage lending rule and significant changes to regional economic drivers between November and April. For example, the income forecasts for the Prairie metro areas include slower projected oil price growth over the next few years: The slight improvement in the house price outlook for these metro areas is due more to undervaluation and increased household formation than to income dynamics.

House price growth in Toronto will still lead the country and has had only very slight slowdown over the last three forecasts and reports, for three reasons. First, higher median family income relative to median prices in Toronto will minimize the effect of the new mortgage lending stress test. Second, Toronto's mean reversion effect will be much slower despite overvaluation, in line with previous historical data. Third, Toronto will continue to have significant capital inflows, even if these are restricted from entering the housing market. Because of this, Toronto and nearby smaller metro areas will continue to show good house price growth and will turn what would otherwise be a significant national house price decline into only a brief and very mild downturn in the coming year.

Risks

The standard alternative scenarios for Canadian house prices incorporate the effects of the new mortgage lending rules in addition to the baseline forecast. But there are other sources of downside risk, though these may not be incorporated in downside scenarios.

Supply-side problems pose one particular source of risk. Though the residential construction outlook is adequate, there are no methods of predicting with any certainty the degree of supply in the existing-home market. The pronounced reduction in listings evident over the past year could persist, especially if house price growth in Greater Toronto remains strong, prompting potential home sellers to keep their homes off the market. In addition, demographics could provide pull rather than push: The projected share of the population aged 45 to 54 will decline through 2025. This portion of the population, during which "empty nest status" is attained, can be considered the prime home-selling age cohort, so its relative decline, even if moderate, will pull against listings regardless of house price dynamics.

On the demand side, another risk is that the new capital gains reporting rules, as well as the transfer tax in Vancouver, restrict high-tier demand to the point where a significant number of developers or temporary buyers find themselves unable to sell homes at a high enough price and have to default on debt payments, leading to financial distress. While high-end markets in Toronto and Vancouver are unlikely to be large enough to lead to any sort of financial tremors at the national scale, such risk is inherent whenever government authorities try to deflate an asset bubble. The new mortgage lending regulations may have been necessary, but they are not completely devoid of risk.

Macroeconomics south of the border are still a possible downside risk. The most straightforward case is if a combination of U.S. federal tax cuts and increased spending leads to higher than predicted U.S. interest rates, which could lead the Bank of Canada to raise its policy rates in order to offset downward pressure on the Canadian dollar. Such a higher interest rate environment would drag on Canada's housing market, adding to the medium-term downward pull from more restricted mortgage lending.

Trade, through its effects on local incomes, remains a source of downside risk, though less likely than macroeconomic pressure. The likelihood that the U.S. will impose tariffs on Canadian softwood lumber might affect incomes outside of the larger metro areas, while any downturn in world oil prices due to overproduction will hurt the Prairie provinces in particular, with subsequent downward pull on family income and home prices.

Postscript: Ontario follows

Ontario's new transfer tax on purchases of homes by foreign nonresidents was announced in the last week of April 2017. The tax works in the same way as the earlier British Columbia transfer tax on foreign purchases in Vancouver. The tax is limited to the Greater Toronto or Golden Horseshoe area, including nearby census metropolitan areas such as Hamilton, Guelph and Kitchener. The tax rate is 15%, the same as in Vancouver, but would allow foreign nonresidents to get a rebate on the tax if they gain resident status within one year after purchase. As in British Columbia, this transfer tax is only one of a set of province measures (16 in total in the Ontario Fair Housing Plan) intended to brake house price growth and maintain affordability. These other measures include new rent control regulations and restrictions on quick resales (for example, shadow flipping) that drive up both house prices and realtor commissions. Even so, the transfer tax is the most prominent and is likely to have the most immediate short-term impact, whereas other regulatory measures will act to slow demand in the long term.

The likely effect of these measures will depend as much on the reaction of potential nonresident purchasers and real estate agents. In Vancouver, the downward price pull of the transfer tax was transmitted not so much through the tax itself as through purchaser expectations, which started to change even before the tax went into effect. A significant number of potential foreign buyers withdrew from the market. How long the Vancouver and Greater Toronto taxes have this effect depends on how easily foreign purchasers find ways to legally bypass the tax, for example through real estate investment trusts in which they are minority owners, and whether other Canada or foreign markets become significant substitutes for Toronto and Vancouver. Similarly, real estate agents, if determined enough, can find ways to legally evade restrictions on quick resales.

If the effects on the Vancouver market so far are any indication, the transfer tax will lead to a temporary slowdown in house price growth, though probably not a decline given that Greater Toronto housing is still more affordable than Vancouver's was before its tax. But the Ontario tax and associated restrictions are another reminder that any house price growth that consistently outpaces income growth will sooner or later lead to a policy correction, as policymakers intervene seeking to reduce the downward push on housing affordability.

About the Author

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