No Bubble to Burst

Bill Johntson | TREB PRESIDENT'S COLUMN AS IT APPEARS IN THE NATIONAL POST | September 11, 2010

In August, there were 6,232 Multiple Listing Service® (MLS®) transactions through the Toronto Real Estate Board, which represented a 22 per cent decline compared to August of 2009. The average price for these transactions was $411,012 – up six per cent compared to last year. Through the first eight months of the year, sales were up by eight per cent and the average selling price was up by 11 per cent compared to the January to August period in 2009.

Since May, sales have been lower than last year's results. At the same time, the average selling price has continued to grow. This has led some individuals and organizations to suggest that a housing price bubble has emerged and that it is ready to pop at any time. An oft cited argument goes something like this:

"Average selling prices have been rising above the rate of inflation for the better part of the last decade, so we should expect the average selling price to fall."

I asked Jason Mercer, TREB's Senior Manager of Market Analysis to comment on whether or not house prices are currently in a bubble in the GTA. Here are some interesting points he put forth:

"Many recent analyses addressing housing markets in Canada have not fully examined the interplay between home prices, borrowing costs and incomes. In the past, home prices have dropped markedly when a household earning an average income could no longer afford to carry a mortgage on an average priced home," said Mercer.

"As a rule of thumb, lenders will often consider a mortgage affordable if the annual principal and interest payments coupled with property taxes and utilities are less than 32 per cent of a household's gross income. Average home ownership costs have been less than or equal to 32 per cent of the average household income in the GTA for 14 of the last 15 years.* It is no coincidence that home prices have grown at a sustained clip over this same period," continued Mercer.

"The last time we experienced a prolonged drop in home prices was in the early 1990s when high home prices and mortgage rates combined to push the average cost of home ownership to more than 50 per cent of the average gross household income. A large increase in home prices and borrowing costs coupled with flat or declining household incomes would have to take place before a prolonged drop in home prices was once again justified," concluded Mercer.

Ownership housing in the GTA is certainly more affordable today than in the early 1990s when we experienced a correction in home prices. During that period of time sales dropped dramatically, as affordability eroded, while listings remained very high. With a lot of choice in the marketplace, selling prices were negotiated downward. New listings spiked earlier in the year, but have since dropped back off. This means that we continue to see enough buyers competing for listings to push home prices up year-over-year.

I will continue to discuss the different components of housing affordability in future articles as we progress through the fall market.

*Author's Note: The TREB affordability indicator assumes the purchase of an existing home for the average selling price with a 20 per cent down payment, a five year fixed rate mortgage at the average rate, a 25 year amortization period and the estimated average property taxes, utility costs and household income.

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