Duking out home prices

Bill Johntson TREB PRESIDENT'S COLUMN AS IT APPEARS IN THE NATIONAL POST February 11, 2011

The Greater Toronto resale housing market started 2011 on a strong footing. While we were off the record pace from a year ago, January sales amounted to 4,337. The average selling price for January transactions was $427,037 – up by over four per cent compared to January 2010.

With these numbers as a backdrop, I want to focus in on the direction of home prices over the next year. There are certainly no shortage of opinions as to the direction of home prices in the GTA and indeed Canada-wide. I asked Jason Mercer, the Toronto Real Estate Board's (TREB's) Senior Manager of Market Analysis, to help me dig deeper into the home price debate. He started by outlining his view on the average selling price in the GTA over the next year:

"One of the most important things to consider when forecasting the direction of home prices is affordability. Most people purchase a home using a mortgage. Therefore, affordability should be assessed based on what percentage of the average gross household income in the GTA is going toward mortgage payments, property taxes and utility costs associated with the purchase of an average priced home. A percentage in the 30 to 35 per cent range is generally deemed affordable by lenders," said Mercer.

"Assuming a moderate increase in borrowing costs and accelerating household income growth, the average selling price should grow at a moderate pace in 2011. Growth rates in the three to five per cent range will be sustainable from an affordability perspective," Mercer argued.

I pointed out to Mr. Mercer that other market commentators have been talking about double-digit home price declines in the future, albeit in relation to Canada as a whole. I asked him to contrast these views with his own.

"A number of reports have been published by different individuals and organizations suggesting that ownership housing is overvalued in Canada. Many of these reports have employed a price-to-income ratio approach, where the current ratio in Canada is above the long-term average. The argument is that prices should decline in order for the price-to-income ratio to revert to the long-term average," said Mercer.

"In my view, using a price-to-income ratio on its own to forecast the future direction of home prices is problematic. This approach ignores the fact that average home price growth over the past decade in Canada has been largely mitigated by low interest rates. This is why the share of the average household income dedicated to major home ownership costs, including mortgage payments, has remained consistently within accepted borrowing standards over the past ten years," concluded Mercer.

Based on my experience in the Greater Toronto real estate market, I have to agree that borrowing costs and their impact on the home buying decision are paramount. Thinking back to the late 1980s and early 1990s, we saw average home selling prices fall after a spike in interest rates. A household earning the average household income during this period would have had to dedicate 50 per cent or more of their income to major housing costs alone. This didn't make sense and the market corrected.

Today we are not facing the same concern. So, as the economy and labour market continue to improve and, according to the consensus view, interest rates remain relatively low, a major drop in home prices just doesn't seem to be in the cards.

I look forward to discussing housing market issues with you again in future articles.

Bill Johnston is President of the Toronto Real Estate Board, a professional association that represents 31,000 REALTORS® in the Greater Toronto Area.

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