CIBC
ECONOMICS

Canadian Housing Market: No Distance Too Far?

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At this point the narrative is well known. The housing market came to a virtual standstill for a brief period in the spring of 2020. But since then it's been racing ahead with no looking back. As we've indicated in the past, the secret behind that success has been the asymmetrical nature of the recession, which saw many Canadian households financially unharmed by the pandemic. The phenomenon allowed them to pass stress tests with flying colours and take full advantage of the historically low interest rates.

The nature of the pandemic also led to a notable increase in demand for detached housing at the expense of high-rise units. We estimate that this compositional factor accounts for no less than one-third of the current home price inflation in Canada as measured by average selling prices. What's more, affordability issues in large urban centres, along with an increased ability to work from home, have triggered a surge in demand for single-family homes in smaller and more remote centres. At the same time, reduced immigration numbers are acting directly and indirectly as a negative force on overall demand for housing and rental units, particularly for high-rise condos in urban centres.

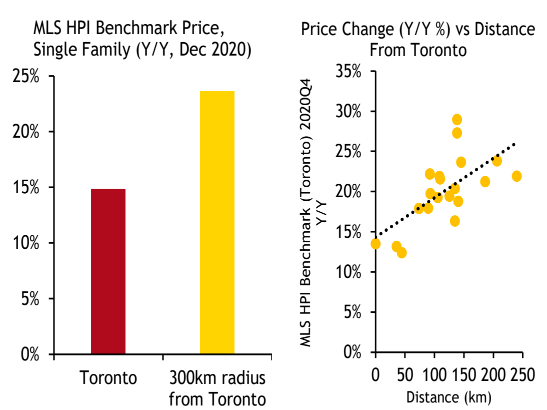
In the following note we put those forces in perspective and suggest that the impacts of these trends on the market in general, and large cities in particular, might have swung too far.

Is It Worth the Drive?

The phenomenon of moving out of urban centres makes complete sense at the moment. With real estate in Canada's largest cities becoming increasingly unaffordable, and working from home now the norm for many, why not move to a cheaper locale where you might be able to buy your dream house for a fraction of the cost? In the past, your employment probably would have kept you from making the move. But currently you can move while still keeping your high paying city job. Using the GTA and the surrounding area as an example, Chart 1 tells the tale. There's a clear positive correlation between the distance from the city and home price inflation.

Chart 1

House Price Inflation Outside of Toronto Has Risen Faster (L); With Houses Further Away Rising Most (R)

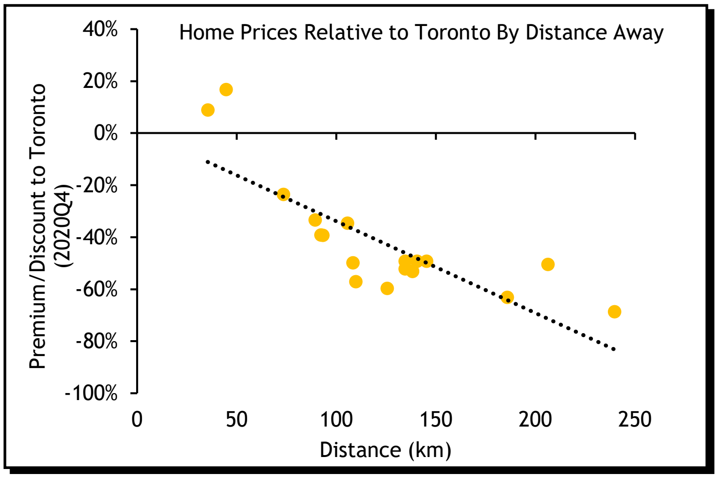


Source: CREA, www.distance.to, CIBC

http://economics.cibccm.com

Chart 2

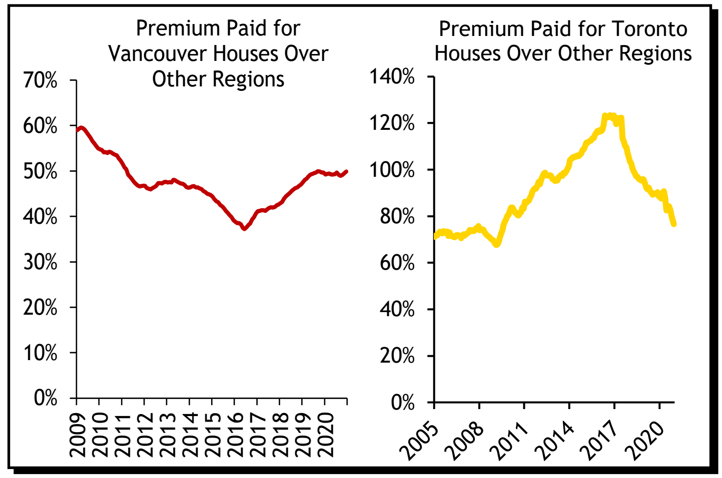
The Longer The Drive, The Cheaper the House



Source: CREA, www.distance.to, CIBC

Chart 4

Narrowing Gap Between Vancouver and Locales Further Away Reached Resistance in 2016 (L); Toronto Might Be Heading This Way (R)



Source: CREA, CIBC

The further you are from the city, the more house you can afford (Chart 2). On average, beyond the first 50 km, every 10 km drive further away from the city will buy you an extra $25,000 of house. Of course that's nothing new. Moving away from the city to buy a bigger home has been the trend for years. However, the pace has clearly accelerated during the pandemic.

We explore the evolution of that trend in Chart 3. The post financial crisis period between 2009 and 2014 saw a notable divergence in price trajectory as centres closer to the city experienced a much faster pace of price appreciation. The period between 2014 and the correction of 2017 saw more equal performance across locales of different sizes. But since then, we've seen the script completely flipped, with more remote centres leading the way.

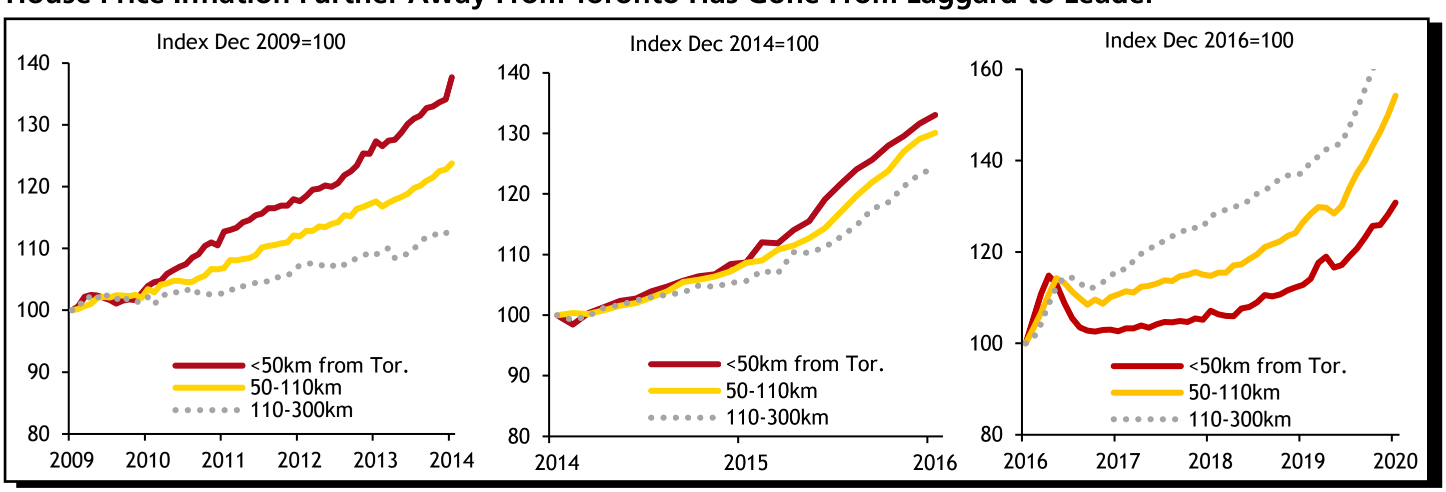
Still, while prices in more remote centres are rising faster than in Toronto and its immediate suburbs, total sales in centres that are between 50km and 300km removed from the city account for no more than 5% of total sales. Will that share grow?

Yes, it's possible that the share continues to grow in the near term, but prices in those centres have been rising so fast already that they risk reaching a resistance level, in which the premium paid to live in a big city has narrowed enough to trigger second thoughts about moving.

While each centre has its own price resistance level, Chart 4 left suggests on average that might already have occurred in Greater Vancouver and the surrounding areas. The premium paid had been narrowing until 2017, but since then, home price inflation in Vancouver has

Chart 3

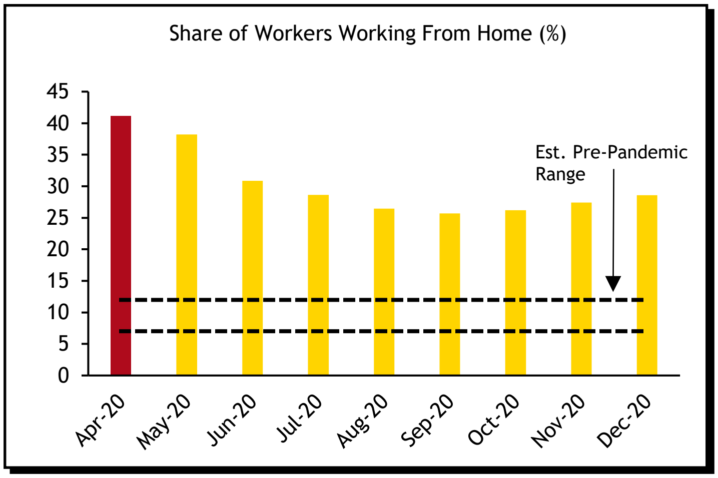
House Price Inflation Further Away From Toronto Has Gone From Laggard to Leader



Source: CREA, CIBC

Chart 5

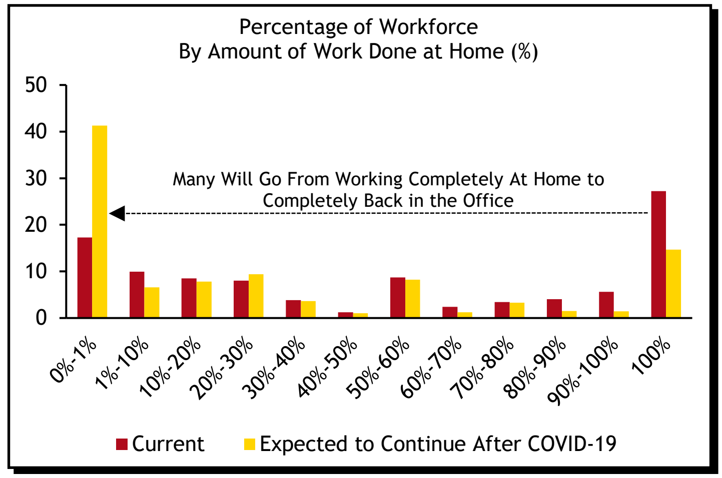
Many More Workers Doing Their Jobs at Home



Source: Statistics Canada, CIBC

Chart 6

But Many Businesses Expect Workers to Be Back in the Office After the Pandemic



Source: Statistics Canada, CIBC

outpaced that seen in more remote centres. Given that Toronto traditionally lags Vancouver when it comes to housing trends, it's not surprising to see that Toronto is now where Vancouver was pre-2017 (Chart 4 right).

The Remote Work Effect

The question is whether remote work can change the level of resistance. The sudden shift to working from home undid the shackles that kept many living in or close to large metropolitan centres (Chart 5). With remote work most prevalent among those earning higher wages and having young children, there was both the ability and desire to find more space for work and play. But even for those earning higher wages, that option was only affordable for many of them outside of large metropolitan centres. While the tradeoffs for relocating seemed obviously worthwhile during the pandemic, will they remain so after?

The reality is that despite the wave of companies announcing permanent work-from-home policies, much of the post-pandemic world might revert back to operating like the pre-pandemic one. A survey by Statistics Canada taken in the third quarter of last year suggests that many employers of workers currently doing their jobs solely from their homes expect them to go back into the office full time after the pandemic is in the rearview mirror (Chart 6). Not two days a week. Not three days a week. Full time.

According to panelist comments made at CIBC's Future of Remote Work webinar in November of last year, the question for many employers is not if they will end work-from-home policies, rather it's simply a question of when they will require employees to return to the office.

That's not to say that more work won't be done from home than pre-COVID. After the pandemic, there will almost certainly be more workers doing more than half their job at home. But making decisions based solely on current working arrangements could be a mistake for many. Employers have to take into account a whole host of issues, including but not limited to training new workers, privacy and security of information and collaboration, which make having employees work from a central office more attractive despite technological advancements.

Moreover, even if those moving to more remote locations guess right, and they're actually able to do all their work from home post-COVID, there's still a catch. Other employers might not be so flexible. So moving out of the city might limit future job opportunities. For the highest earners, purchasing a condo in the city to stay at during the workweek, as seen in other high-priced cities like London and New York, might be an option to insure against a potential return to the office or future employment mobility. But now might be a good time to make that investment. As we explore in the next section, the demographic developments haven't been as weak as reported.

Demographics: Not As Weak As Advertised

According to preliminary estimates from Statistics Canada, 2020 was the worst year on record in terms of population growth. The total population of the country grew by just over 200k people, down from more than 550k seen in 2019. While that might make sense at first glance given the situation, there are reasons to believe that the deceleration in overall population growth was not as dramatic as indicated by those official statistics.

The largest contributor to the reported slowdown in population growth last year was the close to 85k-person decline in the number of non-permanent residents coming to Canada in the first three quarters of the year (which most likely reached a roughly 100k shortfall for the year as a whole). The official count by Statistics Canada includes those that hold current Canadian visas but were unable to arrive to Canada due to restrictions. What the official statistics do not count, however, is the number of non-permanent residents that stayed in Canada with expired visas. Their stay here is legal due to a series of administrative announcements in place since July 14, 2020 that extended the deadline for expired visa renewals. Overall, we estimate that adjusted for that factor, the shortfall reported by the official numbers needs to be trimmed by 60k people.

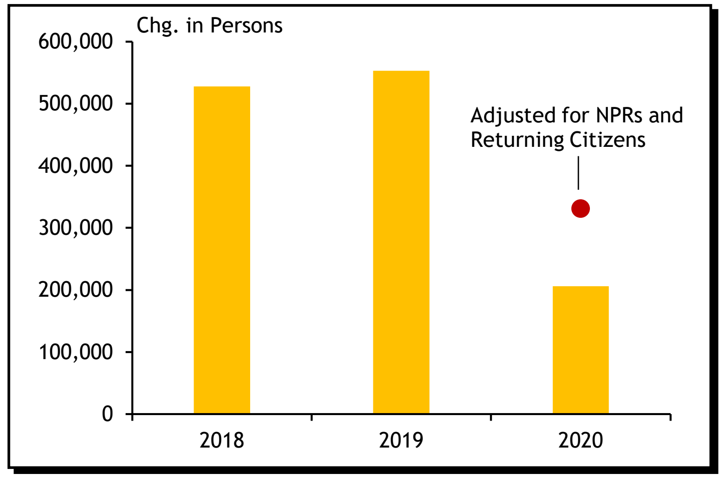
Another factor not fully captured by the headline statistics is the measurement of returning citizens. As we have indicated in previous research, Statistics Canada uses tax information that is two years old to assess the share of returning citizens in total entries by Canadian citizens. It also uses Global Affairs Canada's Registration of Canadians Abroad (ROCA) service as part of the calculation. But since most Canadians living abroad do not register with that database, it represents only a limited sample of the actual number of Canadians in other countries.

Furthermore, the official statistics capture only Canadians that arrive to Canada by air, which is typically only about one-third of entries to the country, and Statistics Canada did not make any adjustments for travel behaviour due to Covid.

Another factor to consider is the increased likelihood that due to the situation in Hong Kong, many Canadian residents there are choosing to return to Canada. And that number probably could accelerate in the coming year given that the Chinese authorities are starting to enforce a decade-old law that denies dual citizenship. The official estimate is that there are currently 300,000 Canadian citizens in Hong Kong, but that estimate is based on 2006 statistics. It's not unreasonable to assume that the current number is close to 400,000. Based on the above shortcomings, we estimate that the number of returning citizens in 2020 was close to 60k people higher than suggested by official estimates.

Chart 7

Population Growth Numbers Not As Bad As Feared After Adjusting For Non-Permanent Residents and Returning Citizens



Source: Statistics Canada, CIBC

Overall, when adjusted to account for the returning citizen and NPR factors, we estimate that population growth in 2020 was around 125k people higher than official statistics suggest (Chart 7).

The better population numbers make the case that fundamental demand for city living wasn't as bad as perceived, and some of the fears surrounding downside risks for real estate tied to urban population growth might be overdone.

Granted, due to weak activity in the first half of the year, it's reasonable to assume that Canada will fall short of the 2021 immigration targets, but the desire to make up for lost ground along with improved efficiency of immigration processing means that population growth and demand for housing, particularly in urban centres, is coming back.

The bottom line is that Covid seems to have accelerated some trends that were occurring prior to the pandemic. But the pendulum might have now swung too far. The discount for moving away from cities has narrowed, some of it under false pretenses regarding expectations about the future. Should Covid fade into the background, as is expected, the vibrancy of cities will return and so will the demand for housing within them.