THE MARKET MANU-SCRIPT

SPRING 2016
FORECASTS AND ANALYSIS OF
MAJOR CANADIAN HOUSING MARKETS
Toronto | Calgary | Edmonton | Ottawa | Winnipeg

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ABOUT

This is the fifth edition of a bi-annual market report published by Fortress Real Developments Inc. (Fortress) on the Canadian housing market, with a specific focus on select Census Metropolitan Areas where the company has active development projects.

This report includes original research and surveys created and compiled by Fortress, supplemented by statistics, charts, infographics and data from several independent sources. National and metro level forecasts for 2015 are reviewed, and 2016 forecasts accumulated and summarized. In addition to the numbers, the report incorporates quotes and notable conclusions from some of Canada's leading housing analysts, and highlights key passages from writings, presentations and commentary from Fortress' Senior Vice President and report author Ben Myers.

THE MARKET MANUSCRIPT | #MM5

CONTENTS

01 CANADA

KEY HIGHLIGHTS CANADA

1. **Just under 196,000 houses started construction in Canada in 2015, slightly above the 50-year average of 191,000, but below the ten-year (199,000) average. The consensus forecast is calling for 185,000 starts in 2016.**

   Only 7% of respondents to Fortress Real Developments' social media survey believe that overbuilding nationally will be a catalyst for a major housing correction in Canada. Builders and developers are building the appropriate number of homes based on demand, and there is little evidence of overbuilding nationally.

2. **New household creation in Canada is primarily supported by the population between the ages of 25 and 34, the elder half of the millennial generation. A recent study showed that 91% of millennials still plan to buy a home at some point in the future.**

   The demand for homes from millennials should remain strong for several years. Based on three forecast scenarios by Statistics Canada, population growth in this younger demographic is expected until 2021 under the "low-growth" projections. Under the less conservative medium-growth and high-growth projections, this key home-buying group would continue to increase until 2023 and 2024, respectively, supporting new home construction.

3. **Forty-two percent of respondents to the Fortress Real Developments' social media survey believe that speculation and greed are inflating house prices to unsustainable levels in Canada.**

   Overvalued housing was most frequently cited as a potential catalyst for a housing market correction in Canada, followed by rising interest rates at 30%. Top Canadian economists believe the models that determine housing valuation are inadequate, and based on affordability, price growth has not gotten out of line with economic fundamentals. Low interest rates have kept monthly mortgage obligations low, and most forecasters expect rates to stay unchanged in 2016.

4. **The poll of Canadian mortgage professionals conducted by Fortress Real Developments showed that the majority of agents and brokers are not concerned with domestic mortgage fraud. Conversely, about 14% said that mortgage fraud was rampant, while 24% indicated they were somewhat concerned.**

   There are approximately 5.7 million households with mortgages in Canada, of which 590,000 purchased a home (new or resale) over the past year, according to data from Mortgage Professionals Canada. Lawyers were accused of illegal mortgage activity in 54 cases (last available annual data) over 590,000 new mortgages, which represents less than 0.01% of the total market.

INTRODUCTION

As the calendar turns over once again, the Canadian economy faces much uncertainty: plunging oil prices coupled with a depreciating Canadian dollar have many economists forecasting slow growth this year. The ultimate question for my employer, Fortress Real Developments, and the real estate industry in general is what does a slow-growth economy mean for the residential housing market in Canada?

There was a mini-recession in Canada in 2015 that BMO Chief Economist Douglas Porter described in November as the *"Best. Recession. Ever."* He pointed out that over 170,000 jobs were created nationally last year, there were record auto sales, record home prices, housing starts rose, and there was a balanced federal budget.

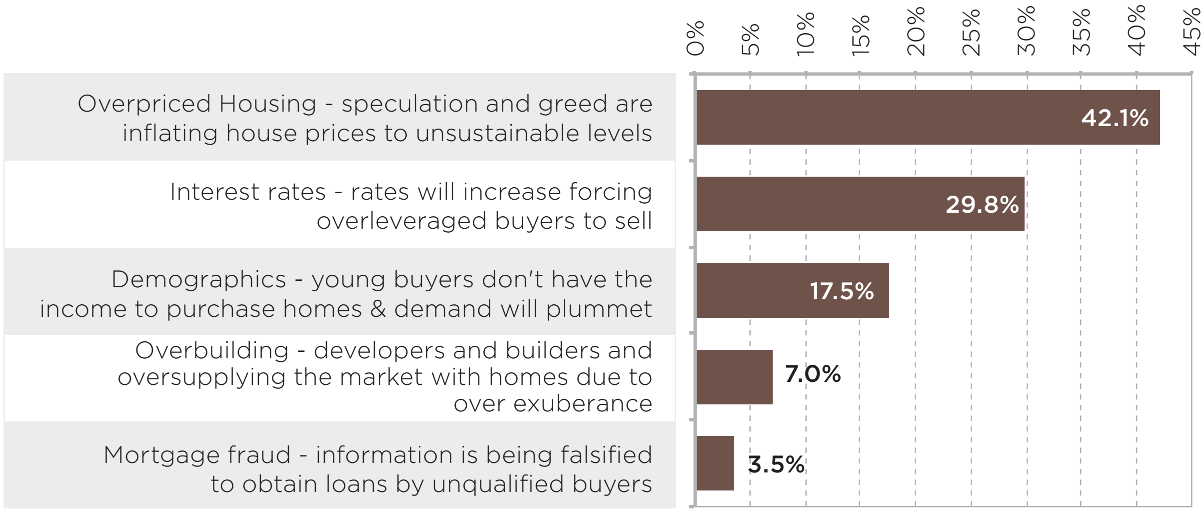
> **"The housing market has been a significant driver of Canadian Economic growth over the past decade. The drivers have been both direct, via construction output and employment, as well as indirect, via the support to consumption from increased wealth resulting from home price gains."**
>
> *— Brian DePratto, TD Economics, November 2015*

Despite the encouraging data highlighted by BMO, much of the focus has remained on the negative externalities associated with the energy market slowdown and the perception that a low Canadian dollar is a clear signal of an economy in trouble. Bloomberg journalist Luke Kawa points out that a *"lower Canadian dollar has been supporting foreign demand, which in turn sustains domestic production, employment, and aggregate income,"* and our labour market has remained surprisingly resilient to the decline in crude prices, as annual employment growth last year was greater than both 2013 and 2014. Kawa pointed out the social media outrage at higher food prices, but concludes that *"while groceries may be more expensive, the wherewithal of Canadians to purchase them has been, at least in many cases, diminished, not destroyed."*

Social media outrage is becoming a more frequently cited phrase, but these platforms are tremendous aggregators of opinions, facts, and frustrations. There was backlash on Twitter regarding the commentary of Bank of Canada (BOC) Governor Stephen Poloz when he said in early January that no catalyst existed that would bring about a housing downturn or crash. TD Economics made similar remarks in late 2015: *"significant price declines need a catalyst, however, and this is lacking at the national level, making the likelihood of a more significant decline very remote,"* adding that *"a meaningful recession along the lines of the global financial crisis in 2008/2009"* would be required in Ontario or British Columbia to precipitate a domestic market correction. *"Economic out-turns of these magnitudes are rare and are not in the cards in our forecast"* concluded TD Economist Brian DePratto.

Despite the opinions of the BOC, TD, and other financial forecasts, the belief remains that a catalyst exists for a major house price collapse in Canada. Since the last Market Manuscript was published in September 2015, five potential correction 'triggers' have been most frequently cited based on my observations: the classic three being overpriced/overvalued house prices, overbuilding and rising interest rates, and two relatively new catalysts, mortgage fraud and unfavourable demographics. In early 2016, I took to social media via Twitter, LinkedIn and Facebook, and offered those five choices to the question, *"What could cause a major housing correction in Canada?"* The responses are presented in **Figure 1**.

FIGURE 1 **FORTRESS SOCIAL MEDIA SURVEY**
What Could Cause a Major Housing Correction in Canada?



Source: January 2016 Fortress RDI Social Media Housing Survey

Approximately 42% of respondents believe that speculation and greed are inflating house prices to unsustainable levels, while 30% are concerned that rising interest rates will force overleveraged buyers to distress-sell their properties. Almost 18% of respondents believe that the catalyst for a house price correction will be demographics related, that young buyers don't possess the financial wherewithal to purchase higher-priced homes, resulting in a decline in housing demand, while there was little concern with overbuilding and mortgage fraud.

Each of the five topics will be covered in greater detail in the sections that follow in order of the least-mentioned response to the most-cited response.

MORTGAGE FRAUD

Less than 4% of responses to my social media housing poll named mortgage fraud as a huge vulnerability for the residential real estate market in Canada. This is very low given the topic gained traction in the second half of 2015 when Home Capital Group, a Canadian alternative mortgage lender, suspended over 40 brokers after it was revealed that incomes were being overstated on mortgage applications originating from these individuals.

Jeremy Rudin, the Superintendent of Canada's banking and insurance regulator (OSFI), was quoted as saying, *"institutions have been, I would say inadvertently, making mortgages to people whose income has been falsified."* While Stuart Levings, the CEO of Canada's largest private mortgage insurance company said, *"fraudulent applications have become less of a problem for the mortgage industry in the wake of the global financial crisis."*

> **"The industry takes misrepresentation very seriously, and as a group we've all taken some very strong actions over the last few years to reduce instances of misrepresentation and fraud in the industry. "**
>
> *— Stuart Levings, Genworth MI Canada Inc., August 2015*

There is very little hard data to support either side of the argument. Genworth asserts that it rejects 7% to 10% of all loans and *"unmitigated, recurring material deficiencies in the underwriting process"* is a *"very rare occurrence."* By comparison, a 2015 survey conducted by the National Association of Realtors in the United States revealed that only 4% of mortgage applications were rejected by lenders. It could be argued that fewer marginal prospective homebuyers are submitting mortgage applications in the US given the tepid housing market conditions south of the border, however, one could also suggest that the lenders would be even more stringent in their underwriting given the mortgage market meltdown in 2008.

Mortgage Professionals Canada (formerly CAAMP) conducted a survey of 2,000 homeowners across Canada in 2015, and 6% of mortgage holders admitted to *"stretching the truth"* on their mortgage applications. FCT, one of Canada's leading providers of title insurance, indicated in a 2014 release that ***"transactions where real estate fraud is suspected by our underwriters still constitutes less than 1% of our overall business,"*** but in 2009 they were *"flagging suspicious residential frauds about once a week. That average has increased to almost twice a week five years later."* However, the dollar volume of fraud is smaller overall, but the incidences are more frequent, which FCT suggested was fraudsters' belief that low-value properties would be less scrutinized.

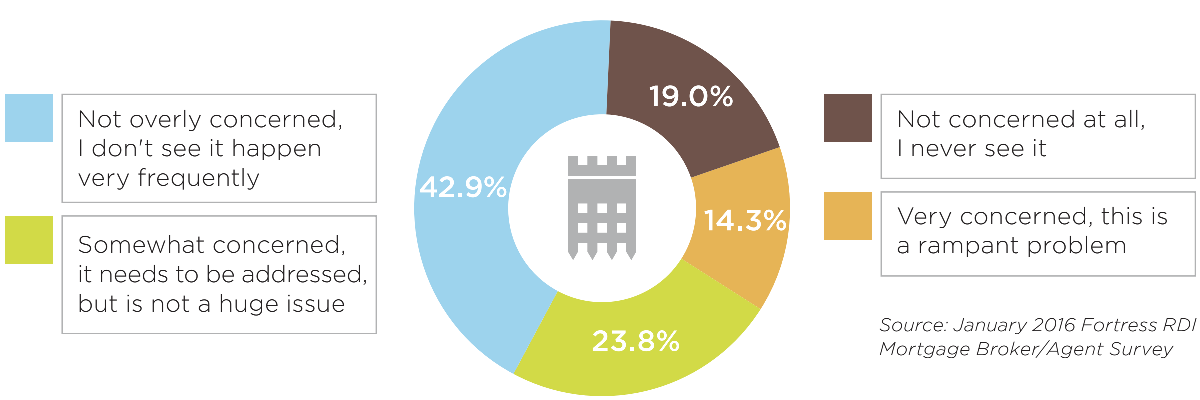
The Law Society of Upper Canada has the closest thing to a time series for mortgage fraud incidences as this author could uncover, as they report on lawyer investigations commenced each year as they relate to mortgage fraud. The number of complaints increased for three straight years, from 28 in 2009 to 34 in 2010, 48 in 2011 and 52 in 2012. The new lawyer complaints declined to 36 in 2013, before rising to a six-year high of 54 in 2014 (the last year annual data was available). The Executive Director of the Law Society advises that their objective is to complete investigations within 18 months of a complaint. Their professional regulation division reports on the number of active cases and lawyers allegedly involved in fraudulent mortgages on a quarterly basis. In Q1-2013, there were 88 active cases involving 76 different lawyers, which increased to 103 active cases involving 83 lawyers as of Q1-2015.

Despite the increases in cases involving mortgage fraud, it should be kept in mind that there are 5.71 million households with mortgages in Canada, of which 590,000 purchased a home (new or resale) over the past year, according to data from Mortgage Professionals Canada. Fifty-four cases over 590,000 new mortgages represents less than 0.01% of the total market, so clearly lawyers have not been active participants in illegal mortgage activity.

The data presented above appears pretty tame, but to get a better sense of the perceived issue of mortgage fraud, I conducted a survey of Canadian mortgage brokers and agents in January 2016. One of the questions asked, *"How concerned are you with mortgage fraud in Canada?"* Of respondents, 14.3% said they were very concerned and the problem was rampant, and 23.8% indicated they were somewhat concerned, that it was an issue that needs to be dealt with, but not a huge problem (see **Figure 2**). On the flip side, 42.9% were not overly concerned, they don't see fraud happen regularly, while 19.0% are not concerned at all, that they never see it happen. Some will argue that mortgage professionals wouldn't admit to seeing fraud as it would bring unwanted attention to their profession, however, it also makes sense for a mortgage professional to raise an alarm bell and eliminate the problem, if a problem existed. Having a cloud of mistrust over your industry is not positive for a mortgage broker's business.

FIGURE 2

FORTRESS MORTGAGE BROKER/AGENT SURVEY
How Concerned are you with Mortgage Fraud in Canada?



Source: January 2016 Fortress RDI Mortgage Broker/Agent Survey

Like Fortress, Veritas Investment Research also took notice of the increased media attention on Home Capital Group and mortgages in the fall of 2015, and set about conducting their own analysis, sending secret shoppers out to ten independent mortgage brokers, posing as prospective borrowers. There were very different responses from the brokers when Veritas floated the idea of exaggerating their income on the mortgage application. Not a single broker supported income falsification for submission of an application to the 'A' lenders (Scotiabank, TD Canada Trust and National Bank), while three of the ten were *"ok with this type of income falsification with a 'B' lender"* reported Veritas.

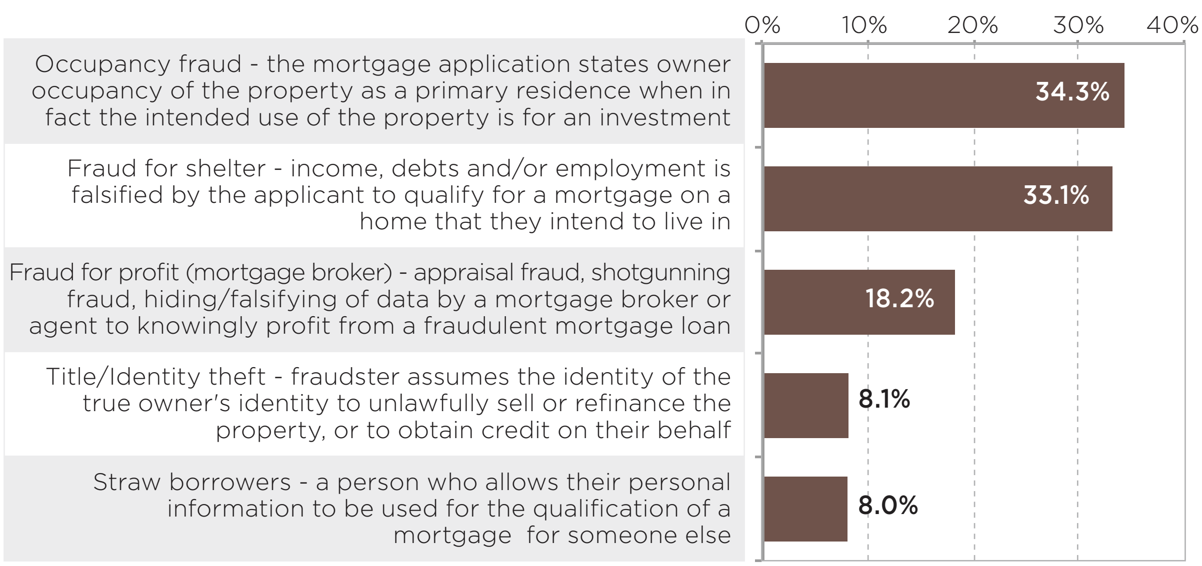
> **"Based on our analysis, the large banks are much more stringent when approving mortgages emanating out of the independent broker channel (for both insured and uninsured mortgages). As such, we do not believe that the three large banks participating in the channel are exposed to any material amount of fraud-related risk."**
>
> *— Mike Rizvanovic, Veritas Investment Research, August 2015*

Income falsification by a borrower to obtain a house to live in, a form of 'fraud for shelter' is less concerning than other types of mortgage fraud, but creates greater vulnerability in the housing market when these less-qualified buyers are allowed to purchase homes because of their higher probability of default. The other type of soft fraud is 'occupancy fraud,' where the mortgage applicant states they plan to use the property as their primary residence, when in actuality they intend to rent the property out. Based on the results of the Fortress mortgage broker/agent survey, fraud for shelter and occupancy fraud account for approximately 67% of mortgage fraud (see **Figure 3**).

The more egregious fraud types like 'fraud for profit,' 'title or identity theft,' and 'straw borrowers' accounted for 18%, 8% and 8% of frauds, respectively, based on the responses of the mortgage professionals polled.

FIGURE 3

FORTRESS MORTGAGE BROKER/AGENT SURVEY
What is Breakdown of Mortgage Fraud by Type?



Source: January 2016 Fortress RDI Mortgage Broker/Agent Survey

The fact that soft fraud constitutes the majority of mortgage market fraud cases in the opinion of our survey participants doesn't provide any greater assurance that Canada's housing market is any less vulnerable to shock. By the same token, **the claim that housing is being propped up by a fraudulent mortgage market in need of better underwriting standards has little merit** as well. According to the FBI's Mortgage Fraud Report from 2009, *"when the market is down and lending is tight, perpetrators gravitate to loan origination schemes involving fraudulent/manufactured documents,"* and new fraudulent mortgage schemes are developed as real estate industry participants look to *"maintain the productivity and profitability they enjoyed during the boom years."* According to CoreLogic, a global property analytics company that publishes a mortgage fraud report, their National Mortgage Application Fraud Index in the USA, has actually trended upward since 2010, despite the tighter mortgage lending rules and supposed tight credit market.

There are definitely competing arguments for the increase or decrease in fraud based on the overall housing market conditions: 1) market is strong, people want to take advantage of appreciation, more willing to falsify documents to get their foot in the door; 2) the market is poor, credit is tight, must falsify application in order to qualify for much-needed home.

However, caution must always be raised when comparing Canada to the US, as there are fundamental differences in the housing and mortgage markets in the neighbouring countries. An RBC investor presentation from Q4-2015 provided a great summary of the *"structural backdrop to the Canadian housing market"* in comparison to the United States, highlighting that mortgage interest is tax deductible in the US and thus American homeowners have less incentive to pay down their mortgage debt. Additionally, RBC noted that most US mortgages are securitized, while most Canadian mortgages are held on the balance sheet of the lender, which leads to better and more conservative underwriting and lower delinquency rates. The data backs up this claim as well; **outside a small period in the late 1990s, mortgage delinquencies (mortgages 90+ days in arrears as a percentage of total mortgages) has been lower in Canada than the US for the past 25 years.** In most provinces in Canada, lenders have the ability to foreclose on non-performing mortgages with no stay periods with full recourse against borrowers, while the stay period in the US is 90 days to one year to foreclose on non-performing mortgages, with limited recourse against borrowers in key states. With no recourse, a borrower could simply walk away from an underwater mortgage with no financial penalty. Lastly, the Canadian government influences mortgage underwriting policies through control of insurance eligibility rules, while in the US, private mortgage insurers are not government-backed and there is no regulatory loan-to-value (LTV) limit; it can be over 100%.

RBC also points out that Canadians' equity ownership (owners' equity as a percentage of the total value of their residential real estate assets) has been higher than the US in each of the last 25 years, and relatively stable at 70%. Between 2006 and 2009 in the United States, equity ownership dropped from about 60% to under 40%, an almost unfathomable decline.

> **"The relatively robust position of Canadian financial institutions, more stable sources of mortgage funding and higher mortgage underwriting standards in general all contribute to the resilience of the Canadian financial system."**
>
> *— Bank of Canada, December 2015*

To further amplify the divide between the Canadian and American housing markets, it is worthwhile to review data summarized by the Bank of Canada from its December Financial System Review (FSR), which compared the debt situation between Canada in 2012–2014 to the US in 2007. Conditions were clearly much worse from a debt perspective: 77% of American households were indebted pre-crash, compared to 69% in Canada in 2012/2014. Approximately 26% of 'highly-indebted' US households (debt-to-income ratio of 350% and above) had a financial-assets-coverage ratio of less than one month (21% in Canada), and a whopping 71% of the highly indebted US households had a debt-service ratio of 40% or more, compared to just 36% in Canada.

It is abundantly clear that the Canadian and American markets were, and still are, fundamentally dissimilar, especially as it related to the mortgage, credit and debt conditions. Despite this reality, average debt levels in Canada are repeatedly compared to our neighbours to the south. Many Canadians are actually reducing debt, according to a November Manulife Bank homeowner debt survey of nearly 2,400 Canadians, 55% reduced their debt over the past 12 months.

Canadian economic research continues to conclude that Canadian debt levels are under control and manageable. Diana Petramala of TD Economics concluded that *"Canadian household financial vulnerability has stabilized since 2011 as households have eased off the debt accelerator and low interest rates have helped keep monthly debt payments manageable."* Laura Cooper of RBC Economics writes that Canadians *"devote close to 14% of their disposable incomes to costs associated with servicing outstanding debt balances. The measure remained relatively steady over the past several years as rising debt levels offset the decline in financing costs due to exceptionally low interest rates."* Lastly, the Bank of Canada included Canadian debt levels in their assessment of vulnerabilities and risks in their latest FSR, indicating that *"**household asset growth continues to outpace the growth in household debt,** pushing down the aggregate debt-to-asset ratio...the debt-service ratio has remained stable since 2007, with declining interest rates and rising incomes offsetting a higher level of debt."*

> **"Canadian household finances are not flashing warning lights. While household debt has increased significantly, close to two-thirds of that borrowing has been through mortgages that have purchased an appreciating real estate asset, which has helped to boost the net worth of many Canadians."**
> *— C.D. Howe Institute, December 2015*

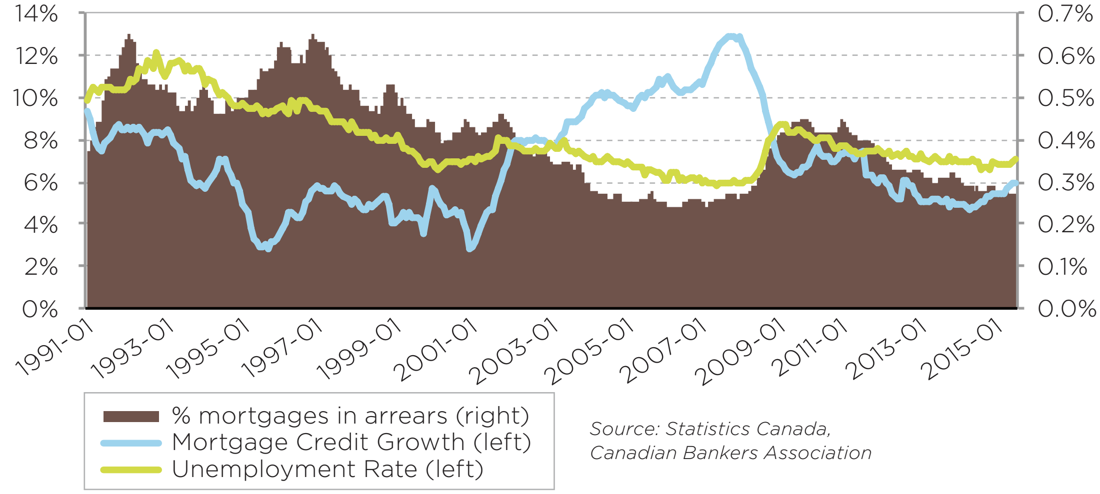
Despite the reputable sources that have maintained that debt levels are manageable given the current low-interest-rate environment, housing bears continue to focus on the mortgage market and Canada's overreliance on credit. Perma-bear David Madani of private research firm Capital Economics believes that population growth is not what is keeping Canadian housing markets hot; he contends that *"the amount of credit households are allowed to borrow is the more important factor."* However, year-over-year mortgage credit growth in Canada was 6.0% as of Q3-2015, below the 25-year average of approximately 7.0%. Will Dunning, the Chief Economist for Mortgage Professionals Canada, expects the growth rate to slow gradually to about 5.25% in 2016. **Figure 4** (on page 12) presents data on annual mortgage credit growth in Canada since 1991 (blue line – left axis), the unemployment rate (green line – left axis) and the mortgage arrears rate (brown bars –right axis).

Mortgage credit growth has only recently increased after trending downward for five years, while mortgage arrears are near record lows. C.D. Home notes that *"the pace of mortgage growth...slowed to a pace more in line with income growth since 2013,"* and Will Dunning feels *"mortgage credit growth has been slower than we would expect"* when interest rates are taken into account. The unemployment rate has been essentially flat for three years, providing no real indication of future upward pressure on mortgage arrears at a national level.

Although the arrears rate is a lagging indicator, and it often takes time for employers to lay off workers when the economy hits a rough patch (Alberta employment is only down 0.6% annually), there is little hard data to suggest that Canadians are taking on too much credit and/or massive defaults are on the horizon. In fact, Veritas Investment Research noted in a November presentation that CMHC continues to pull back on insurance-in-force, with forecasted declines of 2.5% annually to 2019 (from $557 billion

FIGURE 4

ANNUAL MORTGAGE CREDIT GROWTH VS MORTGAGE ARREARS
Canada: Jan 1991 to Sep 2015



Source: Statistics Canada, Canadian Bankers Association

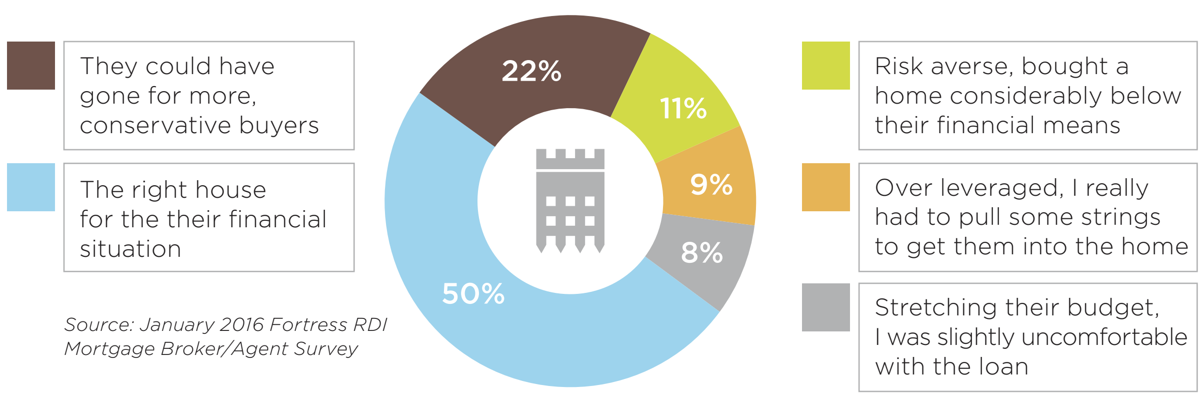
in 2013 to $471 billion in 2019). It is also clear that many Canadian homeowners are making the effort to decrease their mortgage debt obligations. Mortgage Professionals Canada reported that 35% of the homeowners they surveyed in the fall of 2015 either increased the amount of their monthly mortgage payment, made a lump-sum payment, or increased the frequency of payments over the past year.

The next logical argument will be that despite the total growth in the mortgage market slowing, and that some people are reducing their debt, that homeowners are still overleveraged. A recent report from the C.D. Howe Institute showed that mortgage debt as a share of disposable income climbed from 66% in 1999 to 104% in 2014. They were quick to point out this 'fuzzy math,' writing *"these economy-wide averages understate the degree of financial risk for those that carried mortgages because they divide the value of mortgages across the income of households with and without mortgages."* The not-for-profit research institute added *"to assess the pure degree of mortgage leverage, one needs to examine the value of mortgages compared to the value of assets,"* concluding that the increase in leverage *"has been very small because of the increase in home prices,"* and *"less acute than the mortgage-to-income stats suggest."*

C.D. Howe believes Canadians have been *"responsible in their borrowing,"* and the mortgage professionals surveyed by Fortress in January agreed. The brokers felt on average that half of their clients bought the right house for their financial situation, while 23% of their clients were conservative buyers, and a further 11% were very risk averse, buying a home considerably below their means. The brokers felt that just 8% of their clients were stretching their budget, while 9% of their clients were over leveraged, and bought a house beyond their means (see **Figure 5**).

FIGURE 5

FORTRESS MORTGAGE BROKER/AGENT SURVEY
What Percentage of Your Mortgage Clients Fall into These Categories?



Source: January 2016 Fortress RDI Mortgage Broker/Agent Survey

To summarize so far, mortgage fraud remains a relatively unknown entity, but **common sense would suggest that greater scrutiny has been placed on the mortgage market given the subprime mortgage crisis in the United States.** The majority of mortgage brokers and agents surveyed for this edition of the Market Manuscript were not concerned with mortgage fraud in Canada at this time. Canadians are in a much greater position than our American counterparts pre-housing crisis, with a lower percentage of mortgages in arrears, slowing mortgage credit growth, fewer highly-indebted individuals, greater home equity, and a mortgage market that doesn't allow a homebuyer to simply drop the keys off at the bank should they decide they no longer want their mortgage (select provinces excluded).

From my perspective, the various pro-active mortgage market interventions have removed a significant amount of risk from the market, as evidenced from the summary above. Desjardins Economic studies summarized a similar opinion from the Bank of Canada, writing that *"credit quality has improved in recent years, as the Canadian government gradually introduced several mortgage credit tightening measures, thereby excluding borrowers with less favourable credit histories."*

Despite the BOC's findings, the new Liberal Government was feeling pressure regarding house price growth in Vancouver and Toronto, and made the decision to further tighten the mortgage market in a way that could specifically target those two metro areas, requiring a greater down payment on homes priced above $500,000. Many housing industry participants, including myself, applauded the move, as a 5% deposit on a residential unit above $500,000 is not enough 'skin in the game' in my opinion. Since 1849, the United States has had 12 systematic banking crises, and Canada has had none according to Columbia and Stanford professors in their new book entitled Fragile by Design. The authors believe that politics is the reason why. As the RBC comparison of the mortgage market between countries shows, the legal framework in which the Canadian and American banks operate is very different, and the government here has been very proactive in altering that framework when necessary to prevent financial, banking, or housing crises.

This latest round of mortgage tightening is not expected to impact the market negatively. Mortgage Professional Canada expects that the changes *"will not have significant adverse effects on the housing market."* TD Economics expects the impact will be *"relatively modest and short-lived"* and *"less impactful than the changes made between 2008 and 2012."* Both CIBC Economics and BMO Capital Markets expect the rule changes to impact between 3% and 4% of transactions in Canada, with BMO adding that the *"impact could be even smaller given low down payments are skewed more towards the lower end of the market."* Laurentian Bank Securities estimates that the *"new macroprudential measure will affect about 7% of future transactions in the two largest markets of the country,"* but just 0.5% in areas like Ottawa and Winnipeg. CIBC's estimation was lower, expecting 5% of sales in Toronto and just 2.5% in Vancouver would be impacted.

The Fortress Mortgage Broker/Agent Survey showed that 83% of respondents' first-time buyer clients put less than 10% down, while none of their move-up/across buyers or move-down buyers put less than 10% down. Clearly the only group to be impacted by the new rules are first-time buyers. The Altus Group's FIRM Survey of Canadian households provided some additional context: *"based on first-time buyers' behaviours in recent years, the majority (roughly 2 in 3) of those buying homes above the half million mark made downpayments of 20% or more,"* and *"less than 1 in 5"* first-time buyers put down only 5%. The average first-time buyer surveyed by Mortgage Professionals Canada made a down payment of 21% on average, similar to the findings by Altus. The average down payment of approximately 20% is consistent by the time period the home was purchased.

However, there has been additional concern regarding homebuyers 'skin in the game' and borrowers' use of their own equity. Veritas Investment Research noted that *"banks generally require a 5% down payment to be sourced from personal savings,"* and from their secret shopping discovered that *"among the advisors we met, 60% were willing to accept that the down payment would be primarily sourced from borrowed funds from another financial institution"* and banks were cavalier regarding down payment gifts (which may actually be loans from family members). Although concerning, the data suggests that first-time buyers are not getting loans from other financial institutions for down payments nearly as frequently as the past. Mortgage Professionals Canada data shows the percent of first-time buyers borrowing down payments has steadily decreased from 30% for homes purchased before 1990, to 25% for homes purchased from 2000 to 2004, to 19% in homes bought between 2011 and 2015.

Additional concerns have been raised regarding the 14% increase in the value of uninsured mortgages year-over-year (October data). According to data summarized by Veritas, all of the major banks have increased their shares (over their total mortgage portfolio) of uninsured mortgages over the past two years. However, the BOC notes that *"banks must hold additional capital against uninsured mortgage loans to protect them and the financial system from potential losses due to defaults."* Given that uninsured mortgages have 20% down payment requirements, defaults on uninsured mortgages are less likely given the high-home equity — assuming households are not borrowing all or a significant chuck of that 20%. The BOC notes that *"available evidence suggests, however, that borrowing of down payments to meet the 20 per cent threshold is not large."*

> **"Hot markets in Ontario and B.C. are being driven by purchasers with larger down payments, whether it be millennials getting help from their parents, move up buyers, and/or domestic or foreign investors."**
> *— TD Economics, December 2015*

In addition to the latest mortgage insurance rule change, OSFI announced its plan to update capital requirements for loans secured by residential mortgages, and CMHC is raising fees charged to lenders. A poll conducted on CanadianMortgageTrends.com showed that 70% of respondents expect further mortgage rule tightening in 2016. C.D. Howe suggested other possible changes include *"lifting required credit scores, capping total debt-service ratios at lower levels, lifting qualifying interest rates when doing income testing"* or further altering the down payment structure on higher-priced homes. I do not expect further mortgage market intervention this year.

TD Economics noted that the recent rule changes do not *"address concerns that borrowers have increasingly been relying on less regulated non-banks and private lenders, or so called shadow lending."* A Toronto Life article by Philip Preville entitled 'Mortgages for All' includes this insinuation: *"the regulations have done nothing to stem access to credit; they have merely created a stronger market for alternative lenders. Any schmuck can get a mortgage, and a great many of them do."* The Toronto Life article continues to warn of the dangers of shadow lending: *"the least risky of the risky borrowers"* would qualify for an Alt-A mortgage with an interest rate just slightly below 5%, while private lenders usually range anywhere from 7% to 15%.

While shadow banking sounds very scary and ominous, in reality 57% of mortgage holders surveyed by Mortgage Professionals Canada used a representative from a Canadian bank, and the average mortgage interest rate of the over 2,000 people they surveyed was 3.07%. Only 6% of mortgages have interest rates of 5% or more, and just 1% have rates of 8% or more.

It is clear that shadow lending is a very small market, however, the mortgage professionals surveyed by Fortress for this report indicated that private mortgages and second mortgages are on the rise (see **Figure 6**).

FIGURE 6 **FORTRESS MORTGAGE BROKER/AGENT SURVEY**
Indicate The Usage Trends of The Following Debt Vehicles

	DECREASING	NO CHANGE	INCREASING
Private Mortgage		11%	89%
Credit Card Debt		26%	74%
Second Mortgage		24%	76%
Unscecured Credit Lines	17%	28%	55%
Helocs	13%	31%	56%
Student Debt		81%	19%

Source: January 2016 Fortress RDI Mortgage Broker/Agent Survey

Almost 90% of the brokers and agents surveyed felt private mortgages were increasing; 76% felt second mortgages were increasing and 56% felt HELOCs were increasing. According to Mortgage Professionals Canada, 9% of homeowners took out equity from their homes or increased the amount of mortgage principal within the past 12 months, but this is actually a decline from previous surveys (typically around 11%). Additional noteworthy findings show that the average HELOC holder has only accessed 43% of the funds available to them, 97% of Canadians with a HELOC only (no mortgage) still have 25% or more equity in their homes and 84% equity on average, and 90% of Canadians with a mortgage and a HELOC have 25% or more equity in their homes and 54% equity on average.

Overwhelming, the data confirms that only an extremely small portion of homeowners are in a vulnerable position should there be widespread job losses and house prices declined 10% to 15% nationally. Just **6% of homeowners in Canada have less than 15% equity in their homes** according to Mortgage Professionals Canada findings. I'll reiterate how much stronger Canadian homeowners' equity is in comparison to Americans in 2007.

Many of the respondents to the Fortress Social Media Survey indicated in the comment section that a recession is likely the biggest factor that would precipitate a housing market correction, and it is often repeated in the media that job losses would hit the highly indebted households hard. Research by the Bank of Canada found that *"the majority of household debt (about 80 per cent) is held by households that have an average or lower-than-average risk of a layoff,"* and *"there does not appear to be a significant difference between highly indebted and less-indebted households regarding above-average risk of losing their jobs."*

In the latest Manulife Bank survey, 73% of respondents indicated they were prepared for unexpected expenses like a major car repair or a new furnace. Economist Will Dunning has repeatedly asserted that **Canadians have substantial room to tolerate increased interest rates,** and even if the average homeowner that purchased over the past four years (about 890,000 households) saw their interest rate increase at renewal by about 50 basis points, about 55% would see their monthly mortgage payment increase by less than $100 per month.

Mortgage fraud and highly indebted homeowners have been frequently cited topics recently, with many believing these factors will be catalysts for a housing market correction in Canada. Markit, a global financial information services company, regularly reports on Canadian stocks that are the most popular among short sellers. Home Capital Group, Canadian Western Bank, and Genworth MI Canada are repeatedly on those lists due to their exposure to the Canadian residential mortgage market. Markit wrote in October that *"short sellers have been trying to call the top of the Canadian property market for some years now, which has proven to be a tricky trade"* given the continued cheapness of credit. Credit may be cheap and easy to obtain, but the data above suggests that Canadians have not abused the privilege, and continue to be conservative in their home buying and borrowing behaviour.

OVERBUILDING

Based on the social media survey conducted for this report, there is not a huge concern that there is overbuilding nationally (7% of responses). The outcome was surprising, given the constant attention to the monthly starts data, and whether the results come in above or below *"analysts' expectations."* If the over occurs, an inevitable warning about overbuilding is included in the media's coverage, and a typically poor reason is given for the miss. What is just as amusing occurs when starts don't meet economists' expectations, which is usually blamed on a decline in condominium demand, when in reality, many of the high-rise condos that start in any given month (CMHC data) may have actually launched for sale 15 to 25 months earlier. The much more likely reason is data is very lumpy, and the economists surveyed likely did nothing more than look at building permit data when formulating their starts forecasts.

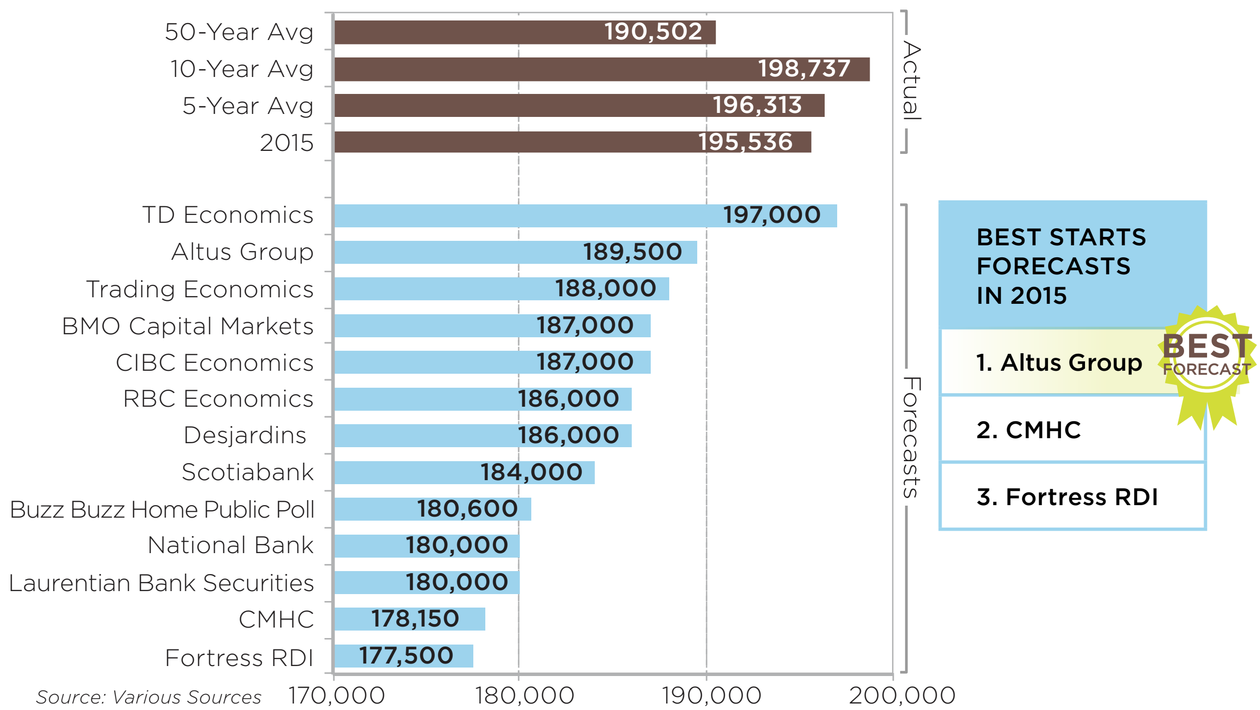
One of the questions asked in the Fortress social media survey was, *"How do you interpret the media's coverage of the Canadian housing market?"* Fifty-three percent of respondents feel the media is too negative, and the housing market is not as bad as portrayed. The remaining respondents were even split between too positive, and neutral. The analysis of starts and overbuilding is the perfect example of why the majority of people feel the media is depicting the market as worse than it is in reality. Attempting to find “an angle” in monthly starts data that is increasingly volatile (given the timing and multiplying market share of high-rise apartment projects) is misleading.

As I’ve said in previous Market Manuscript reports, there is no such thing as a Canadian housing market; conditions are very regional, and 2015 was a perfect example of the regional divide in residential ownership housing market conditions. That being said, looking at data at a macro-level basis is a way to smooth out some of the data lumpiness and provide readers of this report better context for the articles that cover the CMHC and Statistics Canada monthly data releases.

The best place to start is to look at historical averages, and compare that central tendency to the result for the Canadian market in 2015, and to where 2016 is expected to finish. **Figure 7** presents data on the average level of housing starts in Canada over several time periods, and forecasts for Canadian housing starts in 2016. Approximately 196,000 houses started construction in Canada in 2015, slightly above the 50-year average of 191,000, below the 10-year (199,000) average, and matching the 5-year (196,000) average. Only TD Bank is expecting starts to rise in 2016, calling for 197,000 nationally. I currently have the lowest forecast at 177,500, as I believe the energy market slowdown will further impact starts in Alberta, and my expectation is just a natural drop-off from the extremely strong results in British Columbia and Ontario in 2015, despite solid building permit data overall in Canada.

The point forecast for respondents to a poll run on BuzzBuzzHome.com is for 180,600 starts in 2016, however, 30% felt starts would range between 165,000 and 180,000 in 2016, while 28% were quite bullish, calling for starts above 195,000.

FIGURE 7 **HOUSING STARTS IN CANADA**
Historical Averages, 2015 Result & 2016 Forecasts



Source: Various Sources

The Altus Group had the best forecast at the start of 2015, calling for 195,000 starts. CMHC had the second best, and my forecast was third. TD Economics revised their forecast up during the year, and were the closest forecast by mid-year. The BuzzBuzz forecast was the worst in 2015, followed by Laurentian, CIBC, and BMO at 180,000.

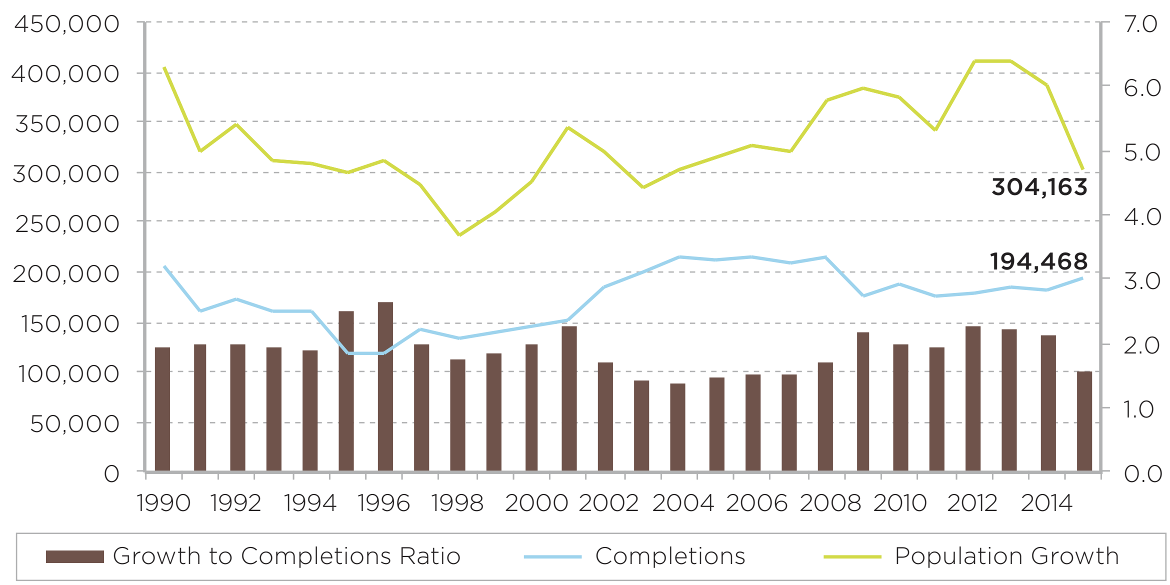
CMHC’s ‘potential housing demand’ model estimates that the *“average annual pace of household formation”* in Canada is 190,000 units (for the 2011 to 2016 period). All but one forecast from Figure 7 is calling for starts activity to be below that threshold in 2016.

> **"The Canadian housing market can support housing starts (ownership plus rental) of about 195,000 units annually including replacement demand and second-home purchases."**
>
> *— Adrienne Warren, Scotiabank Economics, November 2015*

Based on the consensus, there should be less housing starts activity in 2016 in comparison to the long-run averages. Desjardins Economic Studies recently wrote that *"fundamentally, demand for real estate is largely influenced by changes in population. More people means a larger number of households and, consequently, greater demand for homes."* Based on this observation, it makes sense to look at the number of annual housing completions in comparison to population growth, to get a basic sense of the long-term relationship between the two variables (see **Figure 8**).

FIGURE 8

POPULATION GROWTH, HOUSING COMPLETIONS & RATIO
Canada: 1990 to 2015



Source: CMHC, Statistics Canada

The annual population growth is shown in the top line (use left axis), while housing completions are below (left axis) and the relationship between the two variables is represented by the bars (use right axis). In 2015, the population in Canada grew by approximately 304,000 people, the lowest level since 2003, and the relationship to completions was the lowest since 2007. However, six of the top ten biggest years for population growth since 1990 have occurred since 2008, and the relationship between completions and population growth have been above the long-run average in five of the last seven years, suggesting underbuilding.

Economist Will Dunning looks at the overbuilding/underbuilding conundrum in a slightly different way. He compares housing starts to an employment-to-population ratio. There has been a close relationship in this multi-variable scenario in the past. Dunning concludes *"the Canadian housing market is responding appropriately to the conditions that exist"* and the data suggests *"there may currently be a slight degree of under-production, which would be part of the continuing negative effects of the mortgage insurance policy change that took effect in the summer of 2012."* Scotiabank Economics came to a similar conclusion, asserting in November that *"notwithstanding the ongoing high level of construction, there is little evidence of significant overbuilding at the national level."*

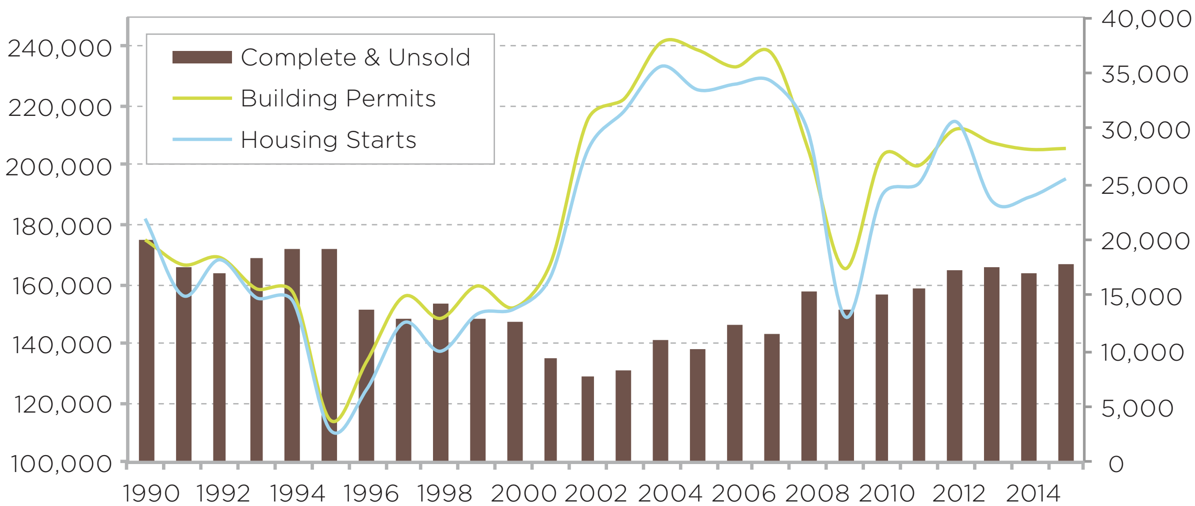
It should be noted that several factors can skew the relationships between population/employment and starts/completions, and that is the number of demolitions, the number of vacation and second home purchases, the number of temporary residents in Canada (especially students), and the increase in the use of residential units as "hotel-like" units on sites like AirBnB. The lower Canadian dollar will attract a much higher number of Americans buying Canadian vacation properties, a greater number of tourists looking for short-term rentals, temporary workers for the resurgence of "Hollywood North" and international students taking advantage of cheaper tuition.

According to a study by CMHC on Census data, 199,000 additional housing units were added between 2006 and 2011 annually in Canada. They also showed that only 177,000 annually were added to the 'occupied private dwellings' category. This suggests that 11% of the housing stock is vacant, being used as a vacation/second home, or occupied by a temporary resident or student. Data on vacation home properties is difficult to obtain, but a recent national Association of Realtors' study from the US showed that 4% of the population owns one or more vacation properties (twice that amount for seniors).

Lastly, there are a couple of other ways to determine if there is overbuilding: is there an increase in the number of completed and unoccupied units, has there been a significant change in the percentage of units sold when a developer completes a project, and is there any decline in the average price of completed and unsold developer inventory?

Building permits and housing starts correspond to the left axis and are represented by the lines in **Figure 9**; they are both well below the market peak from 2002 to 2007. The level of completed and unabsorbed supply has increased to its highest level since 1995.

FIGURE 9 **COMPLETED & UNABSORBED, BUILDING PERMITS*, HOUSING STARTS** | Canada: 1990 to 2015



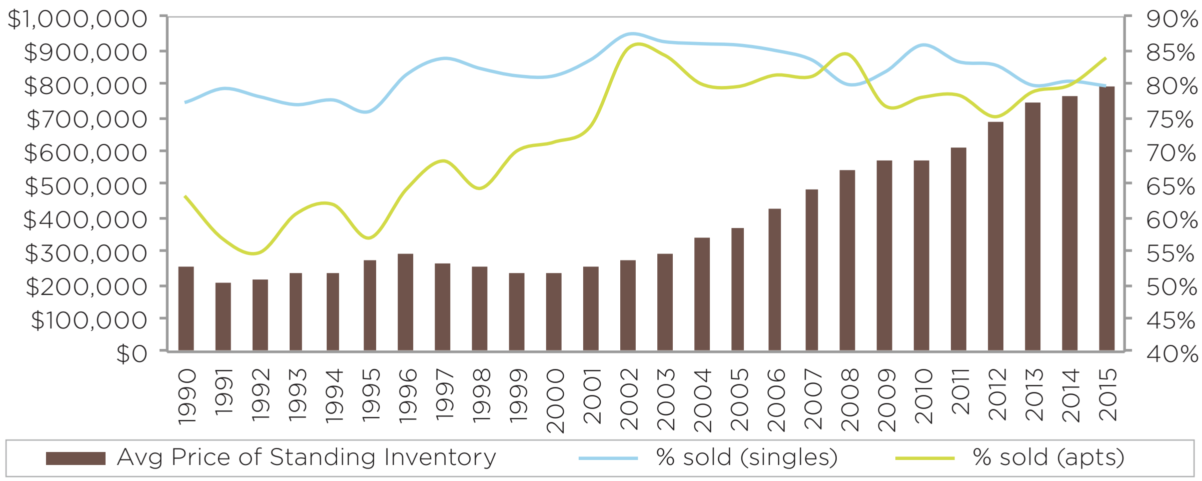
*Source: CMHC, Statistics Canada *Building Permits for 2015 = Last 12 months: Dec 14 to Nov 15 (left axis)*

The rising inventory of unsold units (not all will be vacant, as developers often rent out unsold supply) is worth reviewing in greater detail. How much stress is on those units, meaning are developers being forced to lower prices to pay back senior debt or other financial obligations? This occurs when absorption at completion is low as a percentage, and we'd see those price declines in the unabsorbed pricing.

Figure 10 presents data on the absorption rate at completion for new single-detached homes and condominium apartments from 1990 to 2015 (right axis) and the average asking price for unabsorbed single-detached houses (left axis). Over the past 25 years, approximately 82% of single-detached homes that have been built were sold at completion; the rate was 80% in 2015. This level of absorption is virtually unchanged over the past three years, keeping in mind that unabsorbed units is not always a bad or negative thing; it often represents a developer's willingness to build spec homes (which is high during strong market conditions). As for condominium apartments, the 84% absorption rate in 2015 was the highest rate since 2008, and significantly above the 73% average since 1990.

To get a sense of price pressures, it is worth looking at developers' standing inventory of single-detached houses. There are just over 5,200 unsold singles, which represents about 30% of the total completed and unabsorbed supply on the market, and of greater importance in comparison to condominiums given the bigger price tags and the fact that condos are near record high absorption levels nationally. The average unsold new single-detached house was approximately $790,000 in 2015, an increase of 3.6% annually, while the median was just $500,000 and increased by 1% in 2015. Typical appreciation has been 4% to 5% a year over the past 25 years. For comparison, when Canada was experiencing a significant recession in the early 1990s, the average and median single-detached standing inventory declined 20% and 15%, respectively, on a year-over-year basis (in 1991).

FIGURE 10 **SINGLE-DETACHED & CONDO APARTMENTS SOLD AT COMPLETION & AVERAGE UNABSORBED SINGLE-DETACHED HOUSE PRICE** | Canada: 1990 to 2015



Source: CMHC (all metros w/ 50,000 population)

The big gap between the median and average price indicates there are some very high-priced completed homes on the market, and there was a slight decline annually in the homes in the 80% percentile, dropping from $880,000 on average to $855,000 on average in 2015. The decline could be compositional, however, the luxury market is one to keep an eye on (not a market that my firm actively engages in). The homes in the 20% percentile are still increasing (+5.7% annually), indicating there is still strong demand from first-time buyers in many markets.

Other than some slight downward price pressure on unsold single-detached houses priced above $850,000, there is zero evidence that the Canadian housing market overall is overbuilt. The individual metro-level sections of this report will examine more micro-level supply trends, which will likely produce much more meaningful results, given the bifurcated housing market conditions in Canada.

DEMOGRAPHICS

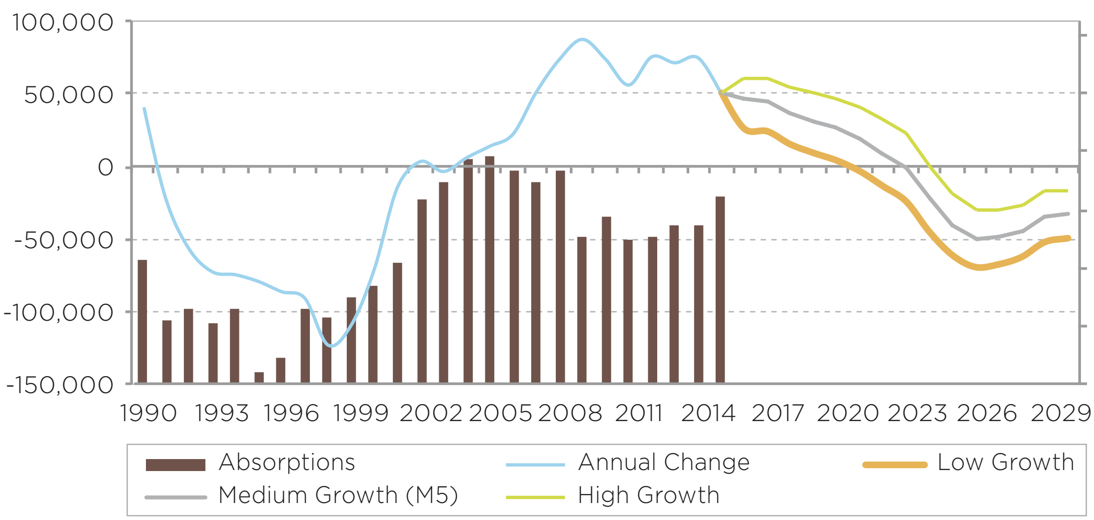
According to results from the Fortress social media survey, respondents believe demographics are a potential catalyst for a housing market correction, falling third behind rising house prices and interest rates (the top answer for 18% of the respondents). The question implied that young buyers would not have the income to purchase homes and demand in the market will plummet. This section will primarily focus on younger buyers, specifically millennials, while also briefly touching on the housing intentions of boomers.

> **"The millennials' footprint on demand for homes, housing-related goods and autos will persist for a few more years, especially if interest rates stay low."**
> *— Sal Guatieri, BMO Capital Markets, November 2015*

Sal Guatieri of BMO Capital Markets did a demographics analysis in November that started with this description of millennials: *"often described as people born in the early 1980s to the turn of the millennium"* they are now *"in their mid-teens to mid-30s. The eldest half of this generation is now between 25 and 34"* and are *"looking for their first home."* The older millennials are extremely important because *"the population between the ages of 25 and 34 is the source of most new household creation"* according to Desjardins Economic Studies.

Figure 11 presents data on housing absorptions (newly completed homes that are sold – right axis) and the annual change in Canadians between the ages of 25 to 34 from 1990 to 2015 and the expected growth in this prime home buying group under three Statistics Canada forecast scenarios (low, median and high growth – left axis) to 2030. In the 1990s, this primary home-buying age range declined rapidly, which only exacerbated an already troubled housing market that saw absorptions (in metros with 50,000 population or greater) fall to a low of just 80,000 in 1995. As the size of this age group increased, so did housing demand and ownership absorptions, rising to a high of 153,000 in 2005. Over the past ten years, Canada has added approximately 50,000 to 90,000 new 25- to 34-year-olds, while absorptions have been strong yet not booming. Some of this can be explained by an increase in rental housing construction, some by prospective homebuyers living at home longer; either way, there appears to be a lot of excess demand for ownership housing in the market.

FIGURE 11 **NEW HOUSING ABSORPTIONS & CHANGE IN 25-34 YEAR OLD POPULATION**
Canada: 1990 to 2015 (Actual), 2016 to 2030 (Projected)



Source: CMHC, Statistics Canada

With the three scenarios forecasted by Statistics Canada, there appears to be growth in this younger demographic for several years to come. We won't see any declines in the 25- to 34-year-old age group under the low-growth scenario until 2021, while the medium growth would not decline until 2023 and high growth until 2024. It must be kept in mind that it is much more difficult to forecast the age of immigrants into this country, which will account for much of the variation between the three forecasts, and even the decreases associated with this age group under the low-growth scenario isn't anywhere near as deep as the decline felt in the 1990s.

There are certainly plenty of potential millennial buyers out there, but will they be able to afford (or even want to purchase) residential housing over the next five to ten years? BMO's Guatieri concluded that *"Canada's economy has been somewhat kinder to millennials than other workers in the past year, likely because of continued robust job growth in high-tech and other professional services."* Even with improved employment opportunities, it is remarkable that 65% of Canadian homeowners in their 20s surveyed last year by Manulife Bank indicated that housing in their area was either somewhat affordable or very affordable. When comparing domestic millennials to their American counterparts, TD Economics observed that *"millennials in Canada have faced better job conditions alongside greater availability and access to credit since the 2008/2009 recession. They also carry lower student debt loads."*

To get a sense of the intentions of Canadian millennial homebuyers, a review of the opinions of American millennials would be advantageous, given their exposure to a recent housing market failure. **Despite the recent market crash, 91% of American millennials still plan to buy a home at some point in the future,** according to the August Fannie Mae National Housing Survey. The same survey asked renters what their primary reason for renting was, and 44% of Americans between the ages of 25 and 35 are renting now to make themselves financially ready to own, 18% believe renting gives you more flexibility, 7% believe renting a home is less hassle, 1% believe renting allows you to live in a better neighbourhood, while surprisingly, just 1% felt renting protects against declines in house prices.

A report entitled Global Generational Lifestyles by Nielsen showed that homeownership was a top priority for only 22% of millennials, getting married was important for only 17%, and having children was a goal for only 13% of millennial respondents. This suggests that even though the Fannie Mae survey showed millennials want to buy eventually, they may be pushing back those purchases until later (a recent Zillow study says Americans rent for six years on average before buying, up from 2.5 years in the 1970s). According to the Canadian section of the Emerging Trends in Real Estate publication by PwC and the Urban Land Institute, *"attitudes about renting have changed"* and *"renting is no longer seen only as a temporary step on the road to homeownership, but as an alternative."* The *"rise of the permanent renter"* as the report dubbed the phenomenon, was a subject I investigated for my keynote presentation to kick off the ULI Toronto Symposium in November. My findings revealed that rental units under construction in Montreal, Calgary, Vancouver, Ottawa and Toronto were 170%, 105%, 81%, 73% and 58% greater than their five-year averages, respectively.

The Nielsen survey also showed that 41% of millennials are likely to leave their jobs within two years. This rise of transient employment and short-term contracts lends itself towards a renter's lifestyle. At Fortress we have witnessed the massive success of the condominium rental market in Toronto; a number of our development partners have suggested looking at rental projects, given the new appetite to finance and hold these developments by institutional capital. We believe there is an appetite for rental in secondary locations, but rental projects that are in close proximity to the transit and employment pockets will continue to be the most popular with renters and large investors.

> **"The high-rise construction boom also has played an important role in supplying a resurgent rental market. Strong rental demand from immigrants and millennials has lifted purpose-built apartment construction to its highest level in more than two decades."**
>
> *— Adrienne Warren, Scotiabank Economics, November 2015*

Being close to work is hugely important to millennials; 66% of American respondents to a recent Merrill Lynch study under the age of 35 indicated that being near work was very important, the highest among all age categories. **The top three factors influencing millennial home buying was their neighbourhood, their proximity to work, and the affordability of the residence** according to the Fannie Mae National Housing Survey. The Neilson study showed just 26% of millennials want to live in the suburbs and 54% want to live in a big city.

There are a lot of competing forces in the findings above. Millennials want to be close to work in their preferred neighbourhood in the big city, but want affordable housing, which is often lacking in major centres. Based on the criteria, the first two conditions are clearly winning out; Scotiabank has observed *"the growing trend toward higher-density living, not just in Canada's largest urban centres but in mid-sized cities as well, has been well established for over a decade."* Downtown urban centres are gaining critical mass, and millennials want to be where the action is — with easy access to entertainment, employment prospects, and social connections.

The NAR survey on US homebuyers also showed that millennials place higher value on avoiding renovations and being green/energy efficient than any other age group, which fits well with newer downtown condominium projects. Will the appeal of the condo lifestyle and the attachment to a specific neighbourhood be enough to keep these folks from leaving the urban centres? The NAR survey also revealed that the average millennial (and the 35 to 49 years age grouping) moves just 10 miles from their previous residence, compared to 30 miles for homebuyers in their 60s. I would expect a similar study in Toronto or Vancouver would result in much smaller distance between moves given the sprawling nature of many American cities.

The massive influx of condominium apartments, especially units with small square footages, have allowed many millennials to get into the housing market at an early age, and start climbing the property ladder. TD Economics writes, *"as of the first half of 2015, over 50% of millennials in Canada owned a home and entered into homeownership at a younger age than their parents."* It is clear that millennials believe in the benefits of homeownership.

It is a common housing bear refrain that younger buyers haven't witnessed a major housing correction; they think house prices will go up forever, and irrational exuberance is leading to this high share of home buying among millennials. As is typical with contrarians, they ignore the data. We only have to turn to the United States for opinions, where a deep and destructive housing market correction occurred: 79% of respondents to the 2015 NAR survey indicated that a home is a *"good financial investment,"* and 40% believe houses are a better financial investment than stocks. For American millennials, the percentages are higher at 84% and 42%, respectively. There is no doubt that if American millennials feel so strongly about housing that young Canadians will continue to pursue home ownership in 2016 and beyond.

Both American and Canadian millennials feel strongly about homeownership, but our millennials have a major advantage over their Yankee counterparts in that they have less student debt according to TD Economics (approximately $16,000 versus $27,000 on average). This head start would accelerate purchasing decisions by Canadians, as they have a better handle on their finances.

> **"Less collateral damage from the 2008/2009 financial crisis has meant that millennials in Canada have maintained better access to mortgage credit and stronger income gains...first-time buyers have helped contribute significantly to the strength in the Canadian housing market since 2009."**
>
> *— TD Economics, December 2015*

It is not easy for millennials to get a handle on their finances and save money, but as Mortgage Professionals Canada points out, homeownership is a *"very aggressive forced saving"* program. *"While principal repayment is a cost, it improves the homeowner's bottom line by reducing mortgage indebtedness"* writes economist Will Dunning, and this *"net affordability"* demonstrates *"why housing activity remains quite strong in Canada."*

For the Fortress social media survey, I asked a hypothetical question about what type of house a person might buy with a comfortable $750,000 budget. I was surprised at how many people added the comment *"I would invest the money and rent"* — there remains a small group of people that seem allergic to debt.

TD Economics acknowledged in a December report that *"millennials in Canada have used debt to help build housing wealth,"* acknowledging that carrying debt can be scary, but everyone must have a different interpretation of what I was implying by the use of 'comfortable,' but the survey required an answer. The choices included: 1,000 sf downtown condo, 1,500 sf condo outside of downtown, 2,000 sf townhouse in the inner suburbs, 2,500 sf single-detached house in the outer suburbs, or a 3,000 sf bungalow in the country. Not surprisingly, no millennials chose the country home, but 42% wanted the townhouse, 25% of respondents chose the downtown condo, 25% the suburban single, and 8% the condo outside of downtown. Clearly, low-rise remains the most popular, but buyers don't want to venture too far from the big-city action.

A look at buyer demographics wouldn't be complete without at least a brief look at seniors. Respondents to our social media survey above the age of 55 wanted the townhouse too (60%), or the country home (40%). This older demographic won't have the same impact on the housing market as millennials in the coming years, but their decision to stay put (and not move to the country) could influence access to supply for millennials. Thirty percent of American seniors have lived in their home for 20 years or more, however, the median stay is only 13 years per NAR data (5 years for millennials), suggesting there is still significant migration in this demographic. The Merrill Lynch survey touched on earlier indicated that 36% of retirees didn't plan to move, while the majority of those that did want to move wanted a smaller home.

If seniors begin to move out of the metro areas, to the 3,000 sf country home I proposed in our social media survey, that would take a lot of pressure off home prices. As young millennials eventually want to move up from their urban condo to a low-rise house, an outflux of seniors would see more supply and, potentially, more supply at affordable prices. The responses to the lifestyle surveys don't support that hypothesis, as proximity to health facilities, shopping, and family/friends were the most frequent responses by seniors on why they would choose a neighbourhood to live in (NAR study). When asked by Merrill Lynch for the likely reasons they would move in retirement, the highest responses were to be close to family, reduce home expenses, and change in health status.

One other noticeable data point from the NAR study was the value seniors put on amenities in new home communities (twice as much as millennials), and the increasing market share that apartments and condominiums capture over all product types when moving up the age spectrum.

Seniors want to be close to family and friends, shopping, hospitals and health facilities, have less expenses, but want more amenities! Based on that list of desires, new suburban mid-rise condominium projects would have tremendous appeal. In any event, there doesn't appear to be a huge rush to move out of the metro areas, to Florida or to a crusty retirement home, and this will continue to strain supply in many markets (which leads to price appreciation), especially in Toronto where supply is already constrained by the greenbelt and Lake Ontario.

In summary, millennials in Canada will continue to grow in numbers for at least five more years, and many of them want to buy homes or rent downtown. This high demand will continue to support new urban developments, providing tenants for investors, and motivation to develop purpose-built rental apartments. Seniors remain a wild card; they have a desire to stay close to desired services and personal acquaintances, but their proclivity to move, and the potential destinations for those relocations, haven't been established. This absence of a definite trend or recognizable inclination of future behaviour is difficult for developers and city planners. However, it doesn't appear that the seniors living in major census metropolitan areas will look to leave those metro areas for cheaper, more rural communities. Therefore, supply is likely to remain constrained.

RISING INTEREST RATES

Nearly 30% of respondents to the Fortress Social Media survey felt rising interest rates would be the catalyst for a housing market correction in Canada. Few are forecasting a rise in interest rates in 2016, as represented by the target overnight rate, despite the recent increase in rates by the US Federal Reserve. Central 1 Credit Union writes, *"the Fed's interest rate hike signals a stronger U.S. economy and that is positive for Canada. With the Canadian economy on a weaker growth trajectory than the U.S. economy, the Bank of Canada will not be following Fed hikes any time soon."* This policy divergence coupled with low commodity prices has negatively impacted the Canadian dollar, and caused the price of imports to rise (most notably groceries), but overall inflation is not expected to rise precipitously and trigger a need by the Bank of Canada to raise rates.

In actuality, there was more discussion of lowering rates further given some of the sluggish economic conditions outside of B.C. and Ontario. Bank of Canada Governor Stephen Poloz recently discussed the central bank's unconventional monetary policy tools, which include negative interest rates. This discussion further upset the anti-ownership housing crowd that claims too much credit is inflating Canadian house prices. In reality, several banks will not lower their mortgage rates if the overnight rate is decreased, and CIBC observed that *"growth in household credit did not show any notable acceleration after the January [2015] easing move."* **The lower mortgage rates go, the less impact they have on purchasers' buying decisions.** *"We determined that negative interest rates could be an effective tool for bringing the Canadian dollar down, but not for stimulating credit"* determined Desjardins Economic Studies.

Of the mortgage brokers and agents that responded to our January poll, 45% expect interest rates to stay the same in 2016, 45% are forecasting a hike, while just 9% are calling for a decline. The majority of economists are calling for no movement on rates this year. *"The Bank of Canada is expected to keep its overnight rate steady until the latter part of 2017 in light of continued adverse impact of low commodity prices on trend growth"* writes TD Economics. Central 1 agrees, stating the BOC *"is expected to remain on hold through 2016 until around mid-2017."* BMO, National, Central 1, CIBC, Desjardins and TD are not calling for rate hikes in 2016 (see **Figure 12**).

RBC is actually calling for a 50-basis-point increase in Q4-2016, stating, *"our expectation that the Bank of Canada will reverse the 2015 rate cuts in the final quarter of 2016 then gradually pull back the amount of policy stimulus with 100 basis points of hikes in 2017 tees up for a slowing in consumer and housing activity during the next 24 months."*

RBC is clearly the outlier; most sources believe borrowing costs for housing will remain low over the next year, as do we.

FIGURE 12 CANADIAN INTEREST RATE FORECASTS

SOURCE	NEXT INCREASE
RBC Economics	Q4-2016
Central 1 Credit Union	Q2-2017
CIBC World Markets	Q2-2017
Desjardins Economic Studies	Q3-2017
TD Economics	Q4-2017

Various Sources

OVERPRICED HOUSING

The clear winner in our social media survey regarding the potential catalyst for a housing market correction in Canada is overpriced housing, which captured 42% of the responses. This was not an unexpected outcome, as commentary around housing speculation and greed inflating the domestic housing market is a common theme. We are not alone, as these topics are also talked about frequently in the UK, Australia, and even parts of the US.

As my Market Manuscript reports have discussed in great detail, **determining if a housing market is overvalued or overpriced is extremely difficult given the lack of quality and comprehensive publically available data, and the simplified methodology that is typically applied to these price-to-income or price-to-rent valuation studies.** Most of the 'overvaluation' metrics are statistically unsound, and the results are terribly misleading.

One thing most analysts can agree on is that speculation, or simply the belief that prices will not decline in the future, is one of the major causes of asset bubbles. However, the major difference between housing and other assets like stocks is that housing functions as a consumption good (you can live there), as opposed to a stock, which is simply an investment good. The problems arise when too many people view housing as an investment, or housing is viewed too strongly as an investment, and house prices depart from underlying economic fundamentals. Mortgage Professionals Canada asked domestic homebuyers in 2015, *"How do you think of your home from these two perspectives [as a place to live versus as an investment]?"* On average, respondents' homes were viewed as 73% a place to live and 27% an investment, and the results were *"remarkably stable"* by *"age groups, period of purchase of the current home or the first home, income groups or region of the country."* Millennials' breakdown exactly matched the overall split.

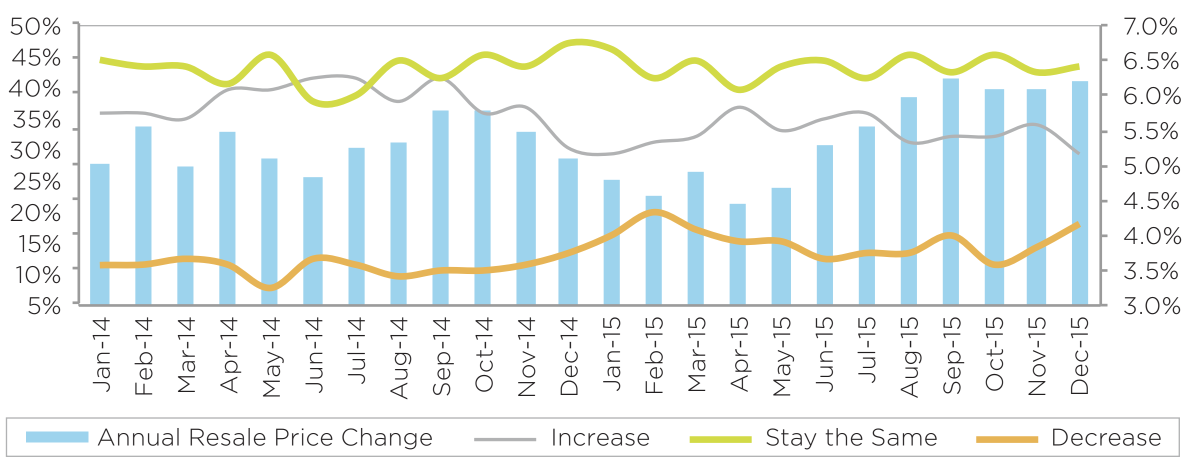
Merrill Lynch posed a similar question to American homeowners, asking what is more important, their home's emotional or financial value? For millennials, financial value was slightly higher (52% versus 48%), while emotional was noticeably higher for the 65–74 age group (44% versus 56%) and 75-plus group (37% versus 63%). As mentioned in the demographics section earlier, millennials will be driving the housing market for years to come, and the emotional or intrinsic value is very much a motivating factor in their home-buying decision, equal to or larger than the financial aspect. Completely ignoring the reality that housing is a consumption good, a necessity and a fiercely emotional decision is another major deficiency in the usefulness of valuation studies.

> **"Housing market activity in Canada is very much determined by economic fundamentals rather than by 'speculative attitudes' (or, alternatively, by fear about 'missing out')."**
>
> *— Will Dunning, Mortgage Professionals Canada, December 2015*

Despite the above findings, the Bank of Canada expressed concern with the *"high price levels and the speed of the price increases"* in Toronto and Vancouver, and that these two markets are being artificially inflated by *"self-reinforcing expectations of future price gains."* There are a couple of worthwhile surveys conducted regularly that provide data on house-price expectations. According to survey data from Manulife Bank, 20% of Torontonians and 25% of Vancouverites think house price will increase significantly over the next 12 months, while 62% and 55%, respectively, think prices will increase slightly. In Canada overall, those figures are 11% and 52%.

The results of the weekly Bloomberg Nanos Canadian Consumer Confidence Index are not as bullish as the findings by Manulife. As of January 29th of this year, 32% of respondents expected real estate prices to increase, 44% felt prices would stay the same and 22% expected prices to decline in Canada. **Figure 13** presents the survey findings for 2014 and 2015, against the actual annual movement in prices as tracked by the Teranet resale house price index. The chart shows some correlation between consumer sentiment about prices and the actual results. In late 2014, there was a decline in the number of survey respondents that felt prices would increase, and an increase in the number of people that felt prices would decline — in the following months the annual appreciation in the market moved from 5.8% to 4.4%. As confidence in the market improved, so did the year-over-year price gains. The share of respondents that think house prices will decline is the highest since February 2015. The bulk of Canadians think house prices will remain unchanged, which has been the case in 22 of the 24 months shown in Figure 13**,** despite the fact that house prices have increased annually in all 24 months — these are hardly irrational expectations.

FIGURE 13 **REAL ESTATE PRICE EXPECTATIONS VS ANNUAL RESALE PRICE CHANGES** | Canada: 2014 to 2015



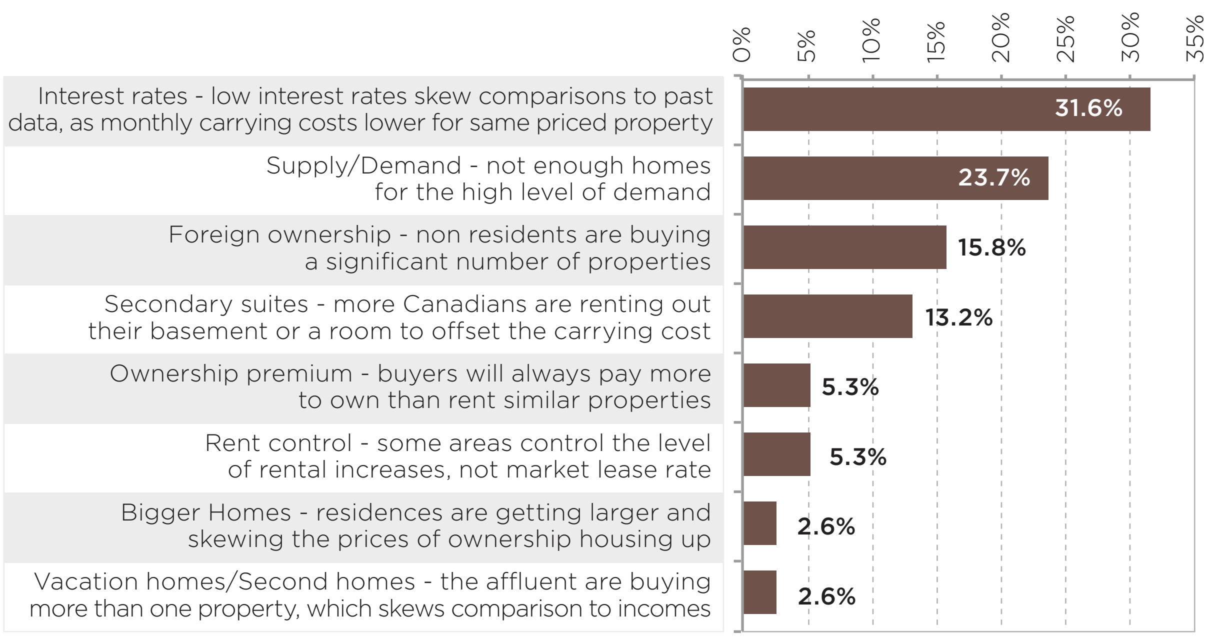
Source: Bloomberg/Nanos, Teranet/National Bank

The difficulty in addressing the topic of speculation and rational expectations again comes back to the divergence in market conditions and attitudes in different regions of the country. TD Economics has documented that Canadians who purchased a home since the late 1990s have experienced a *"financial windfall"* and their gains have been *"approximately double the rise in the TSX equity index,"* adding *"it is hard to think of an asset class that is so widely held by Canadians that has outperformed housing over time."* They later add a caveat that *"the evolution of the Canadian housing market has not been homogenous across provinces."* Anyone that has paid attention to housing in 2015 understands the divergence of conditions not only by province, but by metropolitan area. National Bank notes that Vancouver, Victoria, Toronto and Hamilton are very strong because they are in *"provinces blessed with above-average employment creation and solid immigration levels."* Seven of the 11 major housing areas in Canada are experiencing stagnant or slightly poor market conditions yet the media and others that cover the market continue to use the phrase 'the hot Canadian housing market.' It is easy to see why many are confused about the market overall, and with the national, metro and neighbourhood level valuations.

The regional divide in housing market conditions, the wide-ranging differences in the composition of built forms (for example, some provinces build a much higher share of rental), and age/growth of the housing stock makes it difficult to compare house prices to incomes and rents on a national level. This obviously doesn't stop many outlets from doing so, and the public eats up the results year after year. Fortress asked mortgage professionals what they thought caused a divergence between house prices and rents/incomes, despite what they felt about housing overvaluation (see **Figure 14**).

FIGURE 14

FORTRESS MORTGAGE BROKER/AGENT SURVEY
Why Have House Prices Diverged from Rents & Incomes?



Source: January 2016 Fortress RDI Mortgage Broker/Agent Survey

The top response was interest rates at 32% — low rates skew comparisons to past data as homebuyers have lower carrying costs for an identically priced home. **The declining cost of borrowing is why affordability nationally has been virtually unchanged for five years** per RBC Economics calculations. RBC concluded that housing affordability measures in Canada have *"been fairly flat since 2010,"* and there are *"limited signs of undue stress being exerted on homebuyers"* outside of Toronto and Vancouver. Looking back on 2011 National Household Survey data, Altus Group observed that just 26% of ownership households are spending more than 30% of their income on shelter costs, compared to 40% of renters.

Just under 24% of respondents to our mortgage poll felt supply and demand is a reason why house prices have risen faster than incomes and rents — demand is greater than supply. *"Home price growth in Toronto and Vancouver has been the result of tight supply conditions, in the wake of strong demand"* determined TD Economics in December. Central 1 Credit Union's Chief Economist Helmut Pastrick believes **price-to-income and price-to-rent ratio analyses don't adequately capture scarcity of land.** *"The available supply of land for urban development is limited by regulation and geographic constraints, which raise the price of land needed to accommodate growth. Land supply data is nonexistent or very difficult to obtain, which makes the inclusion of a land variable into models next to impossible"* finds Pastrick.

> **"The bigger picture fundamentals driving home price gains in Toronto and Vancouver – restricted detached-home supply, demographic demand, low mortgage rates and inflows of foreign wealth – remain firmly in place."**
> *— Robert Kavcic, BMO Capital Markets, December 2015*

The commentary by TD and Central 1 nearly mirrors the opinions of the developers and builders survey conducted by PwC and ULI for their latest Emerging Trends report, *"land prices continue to rise, and many believe that provincial government policies are a key factor: greenbelt legislation in Ontario and British Columbia, for example, is limiting land supplies in an effort to promote urban densification. In addition, lengthy approval processes and significant development charges also are limiting supply and driving up costs across the country. And then there are the construction costs themselves, which continue to rise."* The Bank of Canada had been criticized by myself and economists like Pastrick from Central 1 and Tal from CIBC for ignoring supply in their housing valuation calculations, finally acknowledged the influence of supply in a recent paper. *"The high and rising real house prices and debt levels in Canada since the late 1990s can mostly be attributed to long-run movements in incomes, housing supply, declining mortgage interest rates and increased access to credit"* concluded a BOC staff working paper.

The BOC specifically points out supply and interest rates, the two top responses from the mortgage broker and agent survey, but didn't mention foreign ownership, which survey results indicated has contributed to the skewed valuation comparisons. Foreigners do not state their income in Canada, and have reportedly increased their housing purchases in Canada in recent years, which could potentially distort the house price-to-income ratio. The problem is determining how prevalent foreign ownership is in Canada, and their potential influence on housing values. The mortgage professionals we surveyed for this report indicated that approximately 7% of their clients are foreign buyers or recent immigrants. CMHC's survey of condominium apartment property owners shows that 5.4% of condos in the City of Vancouver are foreign owned, compared to 3.8% in Toronto. All relatively small numbers, albeit growing.

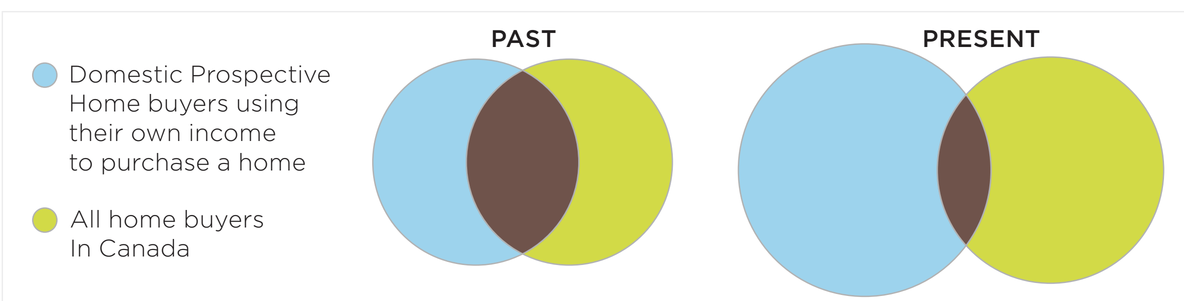
Canadian builders and developers expect foreign investment to continue in Canada, *"global investors continue to see Canada as a safe haven for their capital, and the lower Canadian dollar only adds to the allure"* writes Hugh Kelly in the Emerging Trends report. Unfortunately when many contrarians hear foreign capital, they theorize that these funds must be illegal in nature, or in some way moved through shady intermediaries. BMO Capital Markets is not buying into those fears, *"most foreign money is likely from newcomers to Canada or non-residents planning to move here (i.e., not 'hot' money), rather than from investors intending to stay abroad,"* adding that buyers from Russia, Iran and India are *"influential players in some local markets."* Toronto condo **developers I've spoken to expect Chinese buyers to maintain or increase their interest in pre-construction condominiums in 2016, due to the lower Canadian dollar, and continued uncertainty in their economy.** Benjamin Tal of CIBC believes there is a crisis of confidence in China, as residents that once believed their government could prevent major financial calamities are spooked by the major stock market volatility, and will look to move more funds into North American hard assets. BMO highlighted American NAR data in a recent report that showed that buyers from China (plus Hong Kong and Taiwan) are the biggest overseas buyers of US real estate, surpassing Canada at 2% of home purchases by dollar volume, concluding that *"the inflow of foreign wealth isn't likely to ebb anytime soon."*

The fourth-highest response from mortgage brokers regarding why average prices have appreciated faster than incomes and rents was a bit surprising; they feel that the additional rental income of secondary suites (i.e., basement apartments) offsets the cost of carrying a mortgage and allows prospective homebuyers to target a more expensive home. A household's income suggests they couldn't afford the house they are buying, but the additional rental income allows them to afford it. There is some data and anecdotal evidence to suggest this phenomenon is increasing. For a study I conducted on the Town of Wood Buffalo, which includes Fort McMurray, we looked at hydro numbers to conclude there were many more basement apartments based on average electricity consumption than the building permits indicated. Data from Mortgage Professionals Canada's latest survey reveals that about 14% of homeowners rent or plan to rent an area of their home, but only 21% of those need to rent that space to afford their mortgage.

Tied for fifth-most-frequent response from Figure 14 was the ownership premium — **buyers will always pay more to own than rent a similar property. It is more than the pride of ownership; there are security and stability issues, as well as the ability to create value,** with basement apartments as a perfect example. Central 1 Credit Union points to a number of benefits/advantages of homeownership that warrants the premium, including that renters have *"less security of tenure"* and can have their residence sold at any time, which is a huge problem for families with school-age children. *"A homeowner facing a sudden large increase in mortgage payments due to a rate spike may be able to tap into equity to recast the mortgage in affordable terms"* adds Central 1 — this could also come in handy if someone loses their job, a big advantage over landlords who are not typically flexible when rent is missed or they are short changed (it is much cheaper for a landlord to evict you and find a new tenant than it is for a bank to foreclose and find a new buyer). *"A homeowner is able to make changes to the property in order to improve its services"* is a third example provided by Central 1 — a homeowner can add rental cash flow, immediately create tremendous value by building a second storey on a bungalow, or renovate the kitchen or master bathroom. Lastly, Central 1 mentions that *"homeowners use housing equity to help finance their retirement."* This forced savings plan (which is also tax-advantaged) is a popular way to save; you're essentially investing in property in which you are the tenant — a perfect example of aligned interests. The alternative is to rent and invest the difference, which is daunting for many, and often opens the individual to greater volatility.

Figure 15 provides a visual representation of why these valuation studies fail; they are not comparing apples-to-apples, and considering the changes in the new home landscape over time. More foreign buyers, more investors, more down-payment assistance, consideration of rental income — all of these factors reduce the overlap between Canadian prospective buyers in the market buying homes with only their domestic income, and the actual homes purchased in Canada. The greater divergence of those figures, the less reliable the time-series comparing them will be.

FIGURE 15 **CHANGING LANDSCAPE OF HOME BUYERS**



WHY IS THERE LESS OVERLAP?

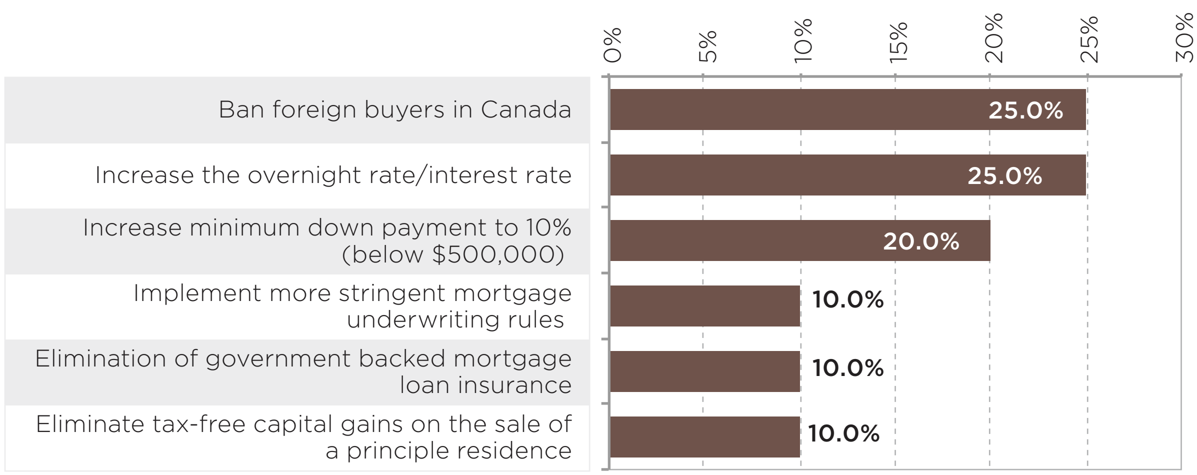
- More foreign buyers
- More vacation or 2nd home purchasers
- More Investor-held properties
- More downpayment assistance from parents/relatives
- Rental income considered by CMHC when qualifying for mortgage
- Pool of prospective buyers has grown faster than supply of homes
- More home-rental suites (ie. AirBnB)
- Individuals buying with business income

Central 1's Pastrick adds, *"the long term evolution of house prices is telling and reveals how historical ratios are not up to the task. Ratios deemed well-above historical norms two or four decades ago are now viewed as the new benchmark, but they too will be supplanted by new higher reference bars in future decades."* Pastrick emphasizes that *"high prices and price-ratios were previously at record highs, they were considered as defying logic, unsustainable, out of whack with incomes, and so on."* There is clear disconnect here, as **people think if they can't afford something as basic as a home, that housing must be overpriced or overvalued.** In reality, they will soon have to view a single-detached house in a major urban centre the same way they view a Lamborghini, as a luxury item suitable and attainable only for the well-off.

The realization by many young families that they will never be able to afford a single-detached house in their desired neighbourhood, or a similar neighbourhood to where their parents lived, does not sit well with them (as you can imagine). The phrase 'housing crisis' has been bandied about more frequently lately; just as gentrification pushed poor people out of marginal neighbourhoods, the sharp accumulation of wealth has displaced the middle class from upscale neighbourhoods. A groundswell has emerged, demanding the government to take action. I asked for the opinion of the mortgage brokers and agents on what they thought would be the best solution to curb house price increases and prevent a housing market correction in Canada (see **Figure 16**).

FIGURE 16

FORTRESS MORTGAGE BROKER/AGENT SURVEY
What is the Best Solution to Prevent a Housing Correction in Canada?



Source: January 2016 Fortress RDI Mortgage Broker/Agent Survey

The final results of this question were surprisingly even numbers, with the mortgage professionals believing that **a ban on foreign buyers or an increase in the interest rate would be the best solutions to avoid a housing market downturn.**

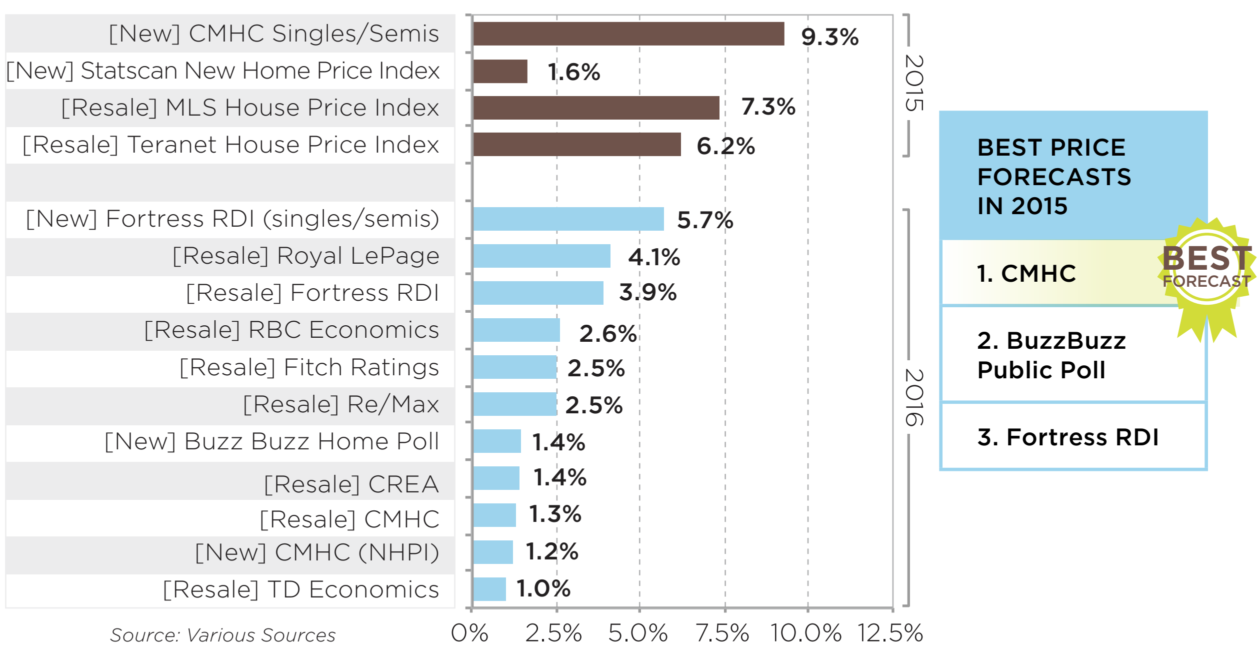
It is unclear whether bans on foreign ownership would have the desired impact on house prices, and how that radical change would influence Canadian immigration, a huge source of growth in our economy. Journalist Richard Macauley of Quartz wrote in early January that *"Australia announced new investment rules that mean foreigners can only purchase homes if they prove that their investment will add to the total housing stock. This means they could buy newly built property but not a secondhand home – and they must pay an added fee,"* while *"Hong Kong has also made efforts to reduce property prices by curbing foreign investment: since 2012, non-locals have been charged an extra 15% property tax."* The results were not as expected, as house price growth in Australia *"reached an 18-month high"* in Q3-2015, and in Hong Kong the *"measures slowed the rate of transactions but have had no visible effect on price rises,"* writes Macauley.

It is likely that most of the other choices would clearly dampen housing activity in Canada, but if the government oversteps and pushes housing down too far, the negative impact on the economy could potentially be big. As house prices rise, Canadians feel better about their financial situation, and spend on products, goods and services that help the economy grow. TD Economics says this *"boosted* *household wealth"* supports consumption and is called the *"wealth effect."* They estimated that *"21% of consumer spending growth is attributed to the benefits of positive housing wealth effects."* The Altus Group Economic Consulting prepared a report for the Canadian Real Estate Association (CREA) that showed that between 2012 and 2014, **ancillary spending associated with home purchases was approximated at $51,000 per transaction,** and created nearly 172,000 jobs in that three-year stretch. Think new appliances, furniture, window coverings, paint, area rugs, lawnmowers, etc.

The next logically proposed argument: *"is Canada too reliant on housing as a percent of GDP?"* According to data from Statistics Canada and presented by Scotiabank Chief Economist Warren Jestin, residential investment has essentially ranged from 6.5% to 7% of GDP for the last seven years and *"is no longer driving domestic growth,"* concludes Jestin. Taking action that artificially impacts the market to curb house price gains and reduce housing's share of GDP will likely curtail house price gains, but may also cost thousands of Canadians their jobs via reduced consumption (decreasing wealth effect) and by lower housing transactions (decreasing ancillary spending).

CREA has already forecast a decline in resale housing transactions in 2016, a decrease of approximately 1.1% annually as *"activity in B.C. and Ontario moderates and housing market conditions soften in Alberta."* Their national pricing forecast calls for growth of 1.4% year-over-year in the average price to just under $450,000. This author feels that forecast is low, as CREA was very conservative last year as well, calling for just 0.9% price growth, when in reality annual growth was 7.3% according to the MLS House Price Index (HPI) and 6.2% per the Teranet HPI. New single-detached and semi-detached house prices increased 9.3% annually in 2015, while Statistics Canada's New Home Price Index showed growth of just 1.6%. Very different methodologies for the two measures of new low-rise house prices accounts for the discrepancy in results, but the true figure is likely somewhere in the middle. **Figure 17** presents data on the actual 2015 price growth, and includes forecasts from several different sources for new and resale prices in 2016. Please note that every single forecast made by these sources for 2015 missed low (underestimated growth).

FIGURE 17 **ANNUAL HOUSE PRICE CHANGES (NEW & RESALE)**
2015 Price Growth (Actual), 2016 Forecasts



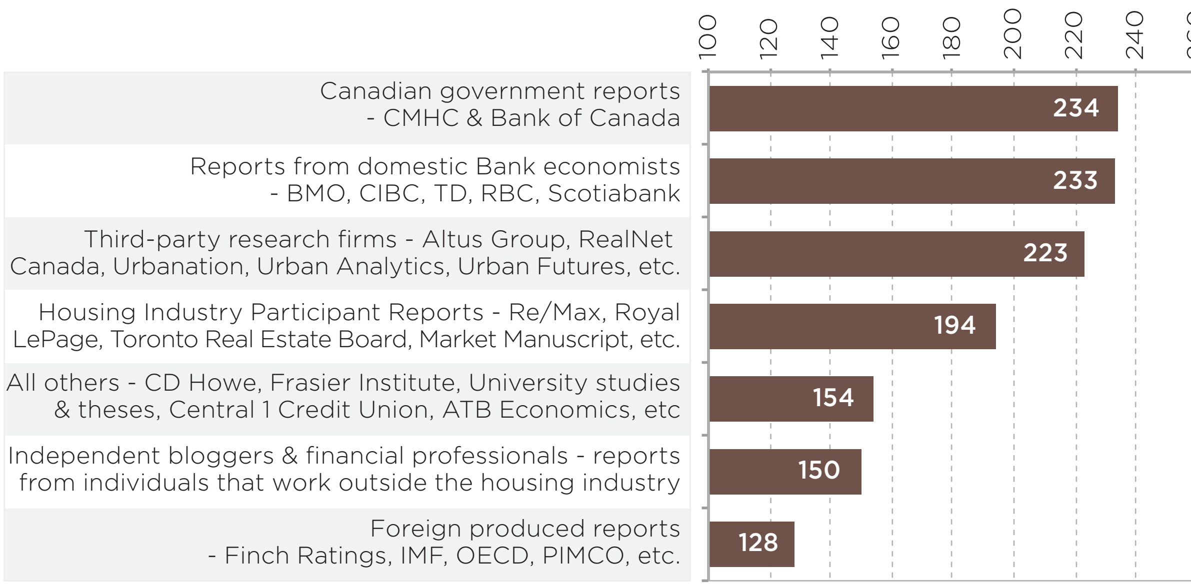
Source: Various Sources

Royal LePage has the highest resale price forecast for 2016 at 4.1%; they had the third highest in 2015 at 2.9%, as CMHC had the best 2015 resale forecast (they called for 4.0% price appreciation nationally). My forecast of 1.7% price growth was too bearish, despite the claims that I am too bullish, and you shouldn't trust the opinions of anyone in the real estate business!

There is a level of distrust among the general public regarding data or opinions produced by anyone that works in real estate, or even economists of the big five banks because *"their banks sell mortgages."* These ignorant statements will never go away, despite the transparency and comprehensiveness of reports like this one. That being said, the Fortress social media survey asked respondents to rank which housing reports and analysis they trust the most (from one to seven), and the results are presented in **Figure 18**.

FIGURE 18

FORTRESS SOCIAL MEDIA SURVEY
Rankings of the Trust in Sources of Analysis on the Canadian Housing Market (higher = more trustworthy)



Source: January 2016 Fortress RDI Social Media Housing Survey

Canadian government reports such as those produced by the Bank of Canada and CMHC are the most trusted reports according to the poll, with 12 first-place votes and 234 points in total (7 points for first-place vote, 6 for second place, etc.). Reports and housing analysis by bank economists were just narrowly defeated with 233 points, but were very close to the respect given to third-party research reports by firms such as RealNet and Urbanation. Likely the most surprising result was how high the 'housing industry participants' scored in these results with 194 points, but you *"shouldn't ask a barber if you need a haircut,"* should you? The truth is that **many members of the real estate industry have a unique perspective and inside knowledge of what is occurring in the residential marketplace, and are often quite conservative in their forecasts and analysis** (as I noted earlier, CREA, myself, Royal LePage and Re/Max all underestimated average resale price increases in 2015).

The reports for a category deemed 'others' didn't score very well, despite that they include arguably the most unbiased sources of opinion, with the inclusion of not-for-profit independent think tanks. Interestingly, the opinions of bloggers and financial professionals outside of the housing industry scored significantly better than the foreign-produced reports like Finch Ratings, PIMCO, IMF, and the OECD. **These foreign organizations have repeatedly made claims regarding how poor the Canadian housing market is, when the likelihood is that the person authoring those reports has probably spent little time, if any, in this country,** and is not likely aware of the micro-level trends, data shortcomings, and intricacies that are required to fully understand a market and its statistics.

It is clear the public has zero trust in the reports from these non-domestic sources, yet the minute they mention the Canadian housing market, their results are quickly disseminated and publically discussed. Recently, the OECD concluded that Canada was 87% overvalued based on rents and 33% overvalued based on incomes. Economist Will Dunning used OECD's research methodology to then compare rents to incomes, and that results in Canada's rental market being 36% undervalued. One would be hard pressed to find a single person that would agree that the average tenant is Canada is paying 36% less than they should be. It becomes abundantly clear when the methodology is examined that they are oversimplified and bunk.

> **"Analysis indicates that house price rises have been influenced by falling interest rates. Calculations of affordability tell us that price growth has not gotten out of line with economic fundamentals."**
>
> *— Will Dunning, Mortgage Professionals Canada, December 2015*

On the other hand, Canadians place a lot of trust in CMHC, and they have provided some mixed messaging on the conditions in the Canadian housing market. CMHC's final Housing Market Assessment report in 2015 indicated there was strong evidence of problematic housing conditions in Regina, Winnipeg, and Toronto, but weak evidence of problems in Vancouver, Calgary and Edmonton. Vancouver has often been characterized as one of the most unaffordable housing markets in the world, but CMHC thinks there is only a moderate evidence of overvaluation. The Edmonton and Calgary markets are slumping due to the energy market slowdown, yet these are not problematic in the eyes of CMHC. Interestingly, the same week that the Housing Market Assessment report was released, a separate report showing CMHC's forecasts for 2016 and 2017 was published, which showed they anticipated new, resale (prices) and rental rates to increase in all of the six markets mentioned earlier.

Central 1 Credit Union reiterates the difficulty in determining appropriate valuations in Canadian housing, and despite CMHC's attempts to look at four different models to assess the market, their method has its drawbacks. *"It understandably relies on historical relationships, but if those historical relationships continue to change, or if important variables are omitted, the models and assessment will be inadequate,"* says Central 1's Pastrick. *"The metrics cannot identify a housing recession, which is the most important risk factor."*

As many of the respondents to our social media survey indicated in the comments section, house prices will decline when there is a significant recession in Canada. RBC Economics believes the biggest short-term risk to housing is a *"material weakening in the Canadian economy and broad rise in unemployment."* Canada added jobs in 2015 as noted in the intro.

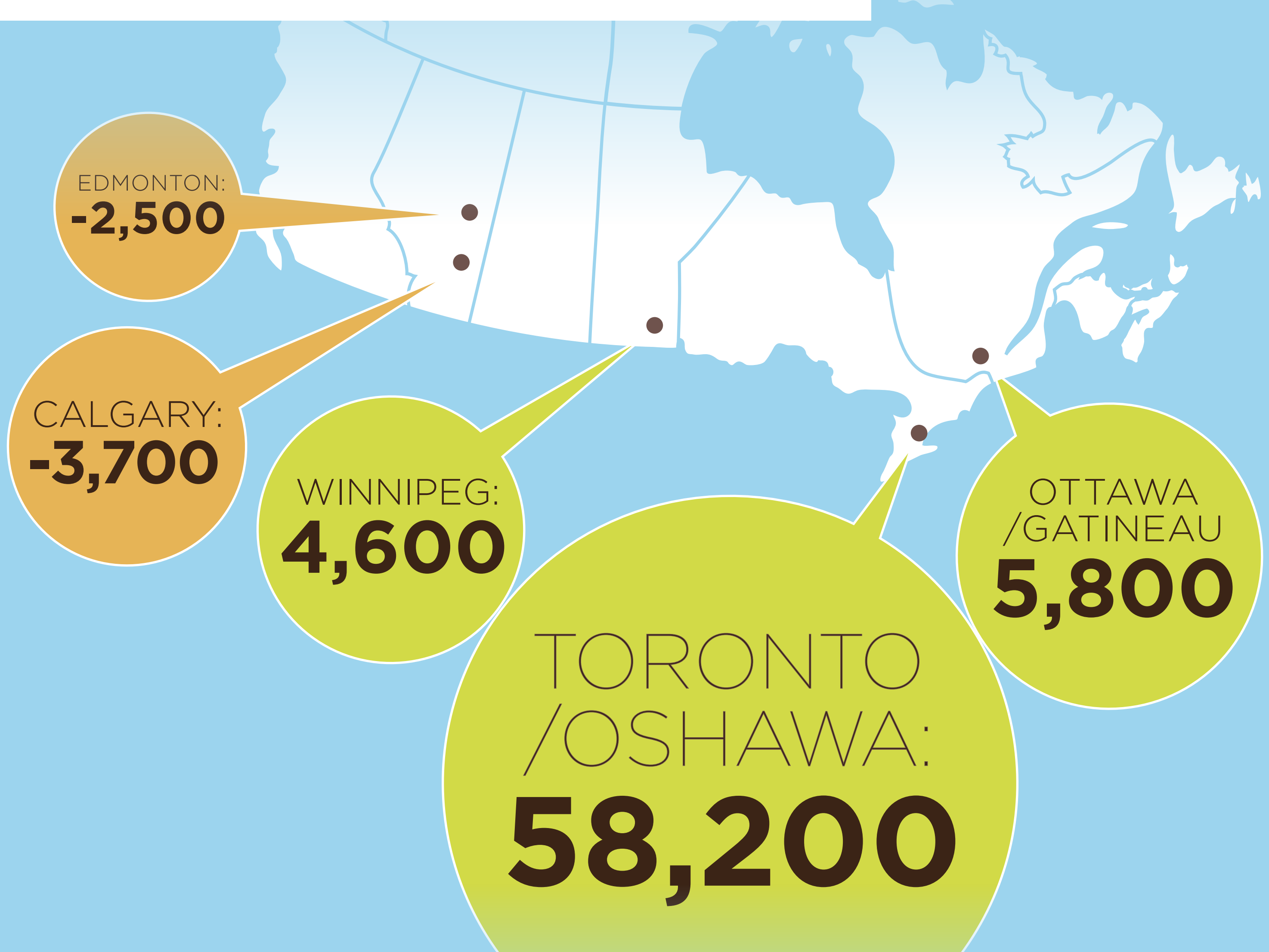
It is more likely that the catalyst that eventually causes national house prices to decline in Canada will be another Black Swan, or a completely unexpected global financial event, as opposed to 'greedy and speculative' homebuyers, or a completely unexpected and sharp increase in interest rates.

The following sections will review the housing market conditions on a metropolitan-area basis to shed further light on the asymmetrical regional market conditions in Canada.

2016 JOB GROWTH FORECAST

BY CMA

SOURCE: ALTUS GROUP



According to the Q2-2016 *Manpower Employment Outlook Survey* for Canada, 78% of employers polled didn't expect to change their staffing levels in the second quarter, while 15% planned on hiring, and 5% expected to reduce staff for a net employment outlook of 10% (7% seasonally adjusted). By comparison, in Q1-2016 the figures were 81%, 9% and 7%, while one year ago, the final survey results were 75%, 18% and 5%.

According to the *Canadian Professional Employment Forecast* from Robert Half released in March 2016, 26% of Canadian chief financial officers (CFOs) expect their company to create new full-time, professional-level jobs in the next six months. Another 56% plan to hire only for open roles, 18% are not fling vacant positions or creating new roles, while just 1% are eliminating positions.

02

TORONTO CMA

KEY HIGHLIGHTS TORONTO CMA

1. **Almost every major statistic that measures the new housing market in the Toronto CMA increased in 2015. New Home Sales were up 4% annually, while building permits, starts, and completions also increased; unsold supply and units under construction declined.**

   Housing starts were up 46% annually in 2015 to approximately 42,300 units. For the second straight year, Fortress Real Developments had the closest starts forecast. The consensus forecasts is calling for 37,800 housing starts in the Toronto CMA in 2016, with Fortress' call of 42,600 being the most bullish.

2. **Unsold ground-oriented new home supply has fallen to its lowest level since the 1990s, and supply constraints such as geography and land-use regulation have amplified the effect of strong housing demand on prices.**

   The average price of a new low-rise home increased by 18% in 2015, while the value of the average new condominium apartment grew by 3%. Overall, annual resale price growth was 10% last year in the GTA. The Greenbelt Act, increasing commuting times, strong employment and consistent migration, have all contributed to the supply/demand imbalance. The suburban supply deficit is enormous, as there are shortages of serviced lots for ground-related housing in the major '905' area municipalities.

3. **The increase in housing sales activity from non-residents of Canada is expected to continue in 2016. The low Canadian dollar, economic instability in other countries, and the recognition of Toronto as a global city will result in further capital inflows into GTA real estate.**

   High-end homes continue to appeal to foreign buyers, especially purchasers from China and the Middle East. The share of non-domestic owners of condominiums also increased in Toronto in 2015, as they've taken notice of the favourable data in comparison to other global cities. The value of an ownership apartment in Hong Kong is approximately 79% greater than Toronto, while London is 78% more. Rents in Hong Kong and London are 50% to 60% more than Toronto, while residents in those cities only make about 14% more in their average salary after taxes.

4. **Annual new condominium apartment sales in 2015 were very strong, reaching the second-highest level on record for the GTA. Despite the sales boom, developers continued to launch new developments at relatively modest average prices.**

   The number of short-term speculators in the Toronto condo market has decreased significantly as price growth has been relatively subdued. The average new condominium launched in 2015 was offered at $617 per square foot (psf), an increase of less than 1% annually, and below the 2012 average price ($631 psf). There is very minimal unit flipping by investors, as just 3% of units in newly registered projects turned over in 2015, compared to over 8% in 2011.

Housing market conditions in the Toronto Census Metropolitan Area (CMA) and the larger Greater Toronto Area (GTA) were very good in 2015, relatively consistent, and a lot better than many in the industry forecasted.

Strong conditions are expected to continue in 2016, despite weakening conditions in several other Canadian provinces. The Toronto Real Estate Board's Market Outlook says, *"the region is home to a diversity of economic sectors and is therefore more immune to shocks in one particular component of the economy, such as the energy sector."* Although low oil prices didn't translate into as much savings at the pump as analysts predicted, the drop in commodity prices and the loonie are positive for Ontario and the GTA. Toronto has been *"relatively immune (if not benefiting) from the plunge in oil prices,"* said Robert Kavcic, Senior Economist at BMO Capital Markets. Another Canadian Senior Economist, Robert Hogue of RBC writes, *"we believe that several stars will be in alignment to elevate Ontario's economic game in 2016, including a strong US economy, low Canadian dollar, still-low interest rates, confident household sector, the late stages of a housing boom, rising business investment, and increased public infrastructure building."*

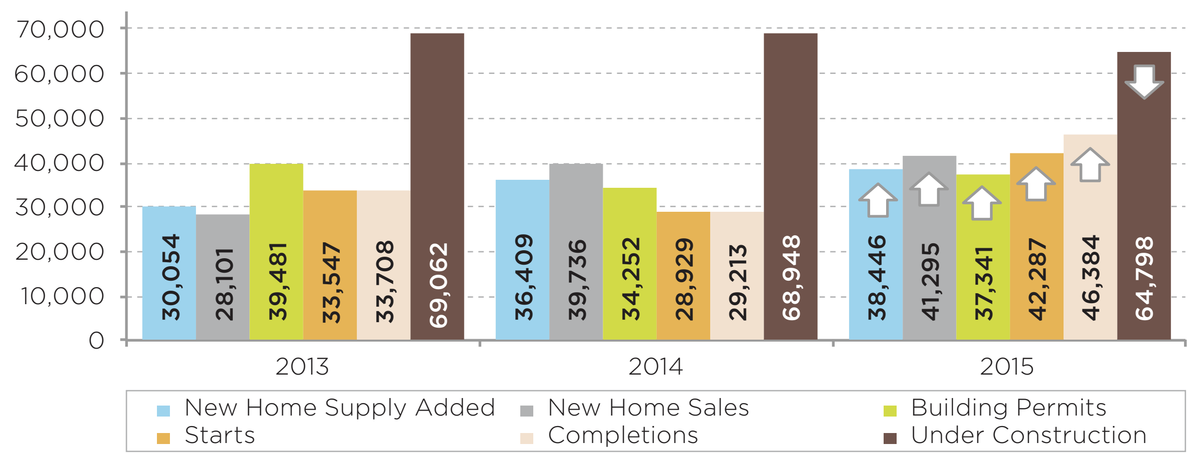
It is debatable as to which stage of a housing boom we are in, but the unprecedented success of the residential market in the GTA, and to a much lesser extent in other major markets in Ontario, can be attributed to population growth and solid employment. *"Since 2000, Ontario has taken in nearly 1.8 million international immigrants. This represents nearly one of every two immigrants in the country,"* per Desjardin Economic Studies, concluding that the GTA has *"obviously greatly benefited from that momentum."* Provincial employment growth in Ontario trailed only British Columbia in terms of annual percentage gain in 2015, with most of that increase attributed to a resurgent jobs market in the GTA. **The Toronto CMA added over 137,000 new jobs in 2015.** The Altus Group forecasts that the combined Toronto and Oshawa CMAs will add nearly 60,000 new jobs in 2016, well above the ten-year average. A BMO Capital Markets survey listed the City of Toronto as having the seventh-best labour market in Canada, an increase from 19th last year.

With the economic backdrop firmly in place, the metro area housing market in Toronto performed admirably and consistently in 2015. **Figure 19** presents annual data on supply launched in new home developments, new home sales, building permits, housing starts, units that completed construction, and units under construction.

FIGURE 19

NEW HOME SALES, NEW HOME SUPPLY, BUILDING PERMITS, HOUSING STARTS, COMPLETIONS & UNITS UNDER CONSTRUCTION

Toronto CMA/GTA: 2013 to 2015



Source: CMHC (CMA), Statistics Canada (CMA Dec to Nov), RealNet (GTA New House Sales)

Builders and developers in the GTA launched 38,446 new units in 2015, an increase of 5.6% over 2015. However, for the second straight year, new home sales eclipsed new units launched. With demand outpacing new supply, the unsold inventory declined for both the high-rise and low-rise markets, with the latter at record lows since RealNet began tracking the data in the late 1990s. Building permits increased about 9% last year, while starts jumped 46% to 42,287. It should be kept in mind that the 2014 starts were at the second-lowest level since 1998 (behind only recession-impacted 2009), following a relatively subdued new home market in 2013.

Completions increased almost 60% year-over-year, but myself and others in the industry suspect that 5,000 to 7,000 units listed as completing in January 2015 by CMHC actually completed in 2014, which would bring 2014 and 2015 completions more in line with longer-term averages in the mid to high 30,000s. With the strong completions, units under construction declined 6% annually.

For the second straight year, Fortress had the closest housing starts forecast for the Toronto CMA, with the Altus Group a close second (see **Figure 20**). The public's opinion called for just 29,700 starts (from to a poll we ran on BuzzBuzzHome last January), off by 42%, and clearly the worst forecast. Uneducated and under-researched opinions once again proven to be wildly inaccurate.

Fortress is forecasting the highest level of starts activity for 2016 at 42,600, which is above the consensus view of approximately 37,800. By comparison, the five-year average for housing starts in the Toronto CMA is 38,500, while the 25-year average is 32,200. **The 'household formation' rate in the metro area has been estimated at about 37,000 annually** (based on 2006 and 2011 Census data), so Toronto will likely be above that level in 2016. I want to point out that household formation can be much lower than actual completions as there is a large non-permanent resident population in Toronto, including vacation home owners, second-home owners (i.e., many affluent Torontonians have a suburban house and downtown condo), temporary students, short-term workers, an increasing 'shared hospitality' market (AirBnB), and inexplicably there are units kept vacant for no reason. Also remember that plenty of GTA houses are being demolished to make way for denser townhouse and condominium communities, as well as for larger McMansions!

FIGURE 20 **CONSTRUCTION STARTS FORECAST**
Toronto CMA | 2015 Actual & 2016 Forecast

BEST FORECAST

Year	TD Economics	Buzz Buzz Home Public Poll	Altus Group	Conference Board of Canada	CMHC	Fortress RDI	Will Dunning Inc	Average
2015 Forecast	29,000	29,700	36,500	34,576	36,000	37,400	35,200	34,896
2015 Actual	42,287	42,287	42,287	42,287	42,287	42,287	42,287	42,287
Difference	46%	42%	16%	22%	17%	13%	20%	21%
10-year avg	36,034	36,034	36,034	36,034	36,034	36,034	36,034	36,034
2016 Forecast	39,000	34,225	38,300	33,095	35,950	42,600	41,508	37,811

Source: Multiple Sources

Despite the strong starts and completions in 2015, and the expectation that both will be above average in 2016, Central 1 Credit Union believes new construction *"can only meet part of the market's supply needs."* The Bank of Canada has finally recognized that insufficient residential housing inventory is putting upward pressure on house prices in Toronto (and Vancouver), stating, *"supply constraints such as geography and land-use regulation have amplified the effect of strong housing demand on prices,"* while also acknowledging that *"migration, driven in part by employment opportunities, is likely an important factor for explaining the strength of demand and price growth in these two centres."*

FORTRESS FORECAST:
42,600
HOUSING STARTS
TORONTO CMA
2016

Data Time Series	Actual 2015	Actual 10-yr Avg or 10-yr avg annual change	Forecast 2016 + Forecast Source	
ECONOMIC INDICATORS - STATISTICS CANADA				
Population	6,129,934	88,158	116,469	
Pop Annual Change	1.3%	1.6%	1.9%	
			Conference Board of CAN	
Employment (15 yrs +)	3,220,000	45,340	80,500	
Emp Annual Change	4.5%	1.5%	2.5%	
			Conference Board of CAN	
Unemployment Rate	6.5%	7.1%	7.1%	
			Conference Board of CAN	
NEW HOUSING MARKET DATA - CMHC				
Housing Starts	42,287	36,034	36,000	
			TD Economics	
Completions	46,384	33,953	37,300	
			Fortress RDI	
Completed & Unabsorbed	2,351	1,239		
Under Construction	64,798	55,807		
Median Single-Detached Price	$725,000	$60,000	$746,025	*
Annual Change	9.0%	6.8%	2.9%	
			CMHC	
Rental Vacancy Rate	1.6%	2.2%	1.6%	
			CMHC	
Avg Rent 2 Bedroom Rent	$1,286	$23	$1,291	*
Annual Change	2.8%	2.0%	0.4%	
			CMHC	

* *Estimate based on % increase*

Even CMHC, which has repeatedly stated that Toronto is overvalued (but strangely not Vancouver), concedes that *"declining inventories of both new and resale single-detached homes contributed to rapid price growth."* **Figure 21** exhibits just how rapid that price growth was in 2015 (brown bars at top), while listing house price forecasts below (blue bars).

The value of completed and sold new single-detached and semi-detached homes in the Toronto CMA increased almost 14% annually in 2015, while the average asking price for all low-rise new homes increased 17.6% last year. The new condominium apartment index price increased 3.0% in 2015, consistent with the past two years — ample supply has kept price appreciation more tepid. On the resale front, GTA pricing was up about 10% based on findings from Teranet HPI and Brookfield RPS, while the MLS Home Price Index shows much of the increase is attributable to single-detached houses, which jumped 11.6% year-over-year. In the face of strong completions, resale condos appreciated by 4.7% on average over 2014.

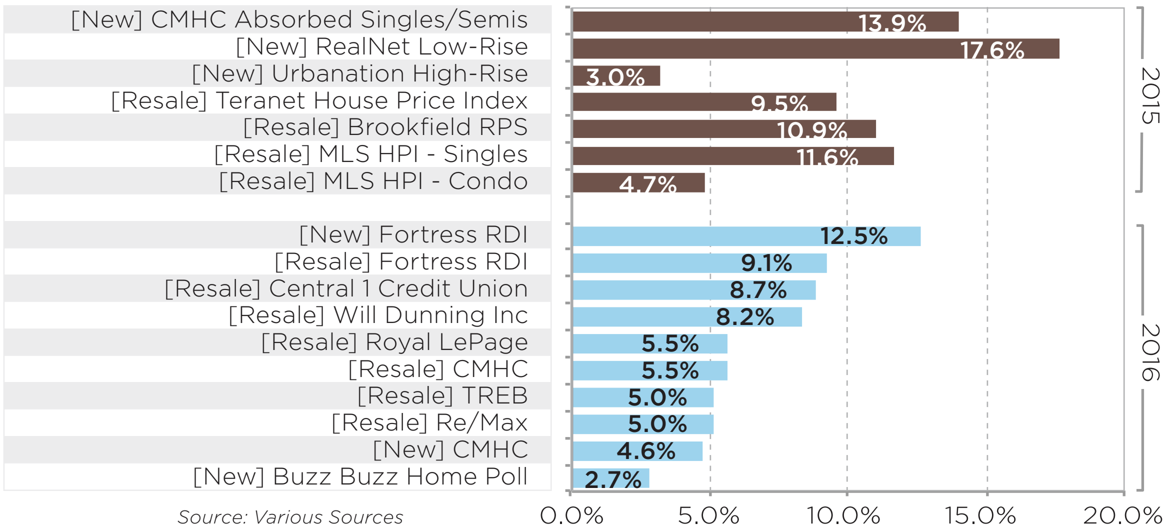
These results over performed all analysts' forecasts for 2015. I had the highest new and resale price forecasts at 6.8% and 5.4%; clearly, we were all too bearish, as uncertainty surrounding the energy sector resulted in cautious predictions from the economists and analysts that cover the market. My forecast calls for 12.5% new home price growth, and 9.1% resale price growth in 2016. Central 1 Credit Union and Will Dunning Inc expect price increases to be substantial as well. CMHC, Re/Max and the public (through BuzzBuzzHome poll) had the worst price forecasts in 2015, and coincidentally are being the most conservative with their calls for this year.

With another banner year for real estate in Toronto, and further price gains, the same questions and concerns are raised from both locals and international observers: how is this happening? What are the real growth drivers? It can't be legitimate, can it?

The first thing to consider when looking for answers to these questions is the most fundamental concept of economics: supply and demand. There is a lack of supply in the Toronto housing market, particularly as it relates to ground-oriented housing (singles, semis and rows). For the new home market, the City of Toronto is essentially completely built out, meaning there is no greenfield land remaining for new developments, thus the existing use of the site must be changed (demolished,

FIGURE 21

ANNUAL HOUSE PRICE CHANGES (NEW & RESALE)
2015 Price Growth (Actual), 2016 Forecasts: Toronto CMA/GTA



Source: Various Sources

repurposed, etc.). Many of the suburban markets are running out of land as well, due to strong demand, and the removal of nearly two million acres of land from development under The Greenbelt Act from 2005. Ryerson University's Centre for Urban Research and Land Development noted there are *"shortages of serviced lots for ground-related housing in key 905 region municipalities."* Another overlooked restriction on new housing supply is the availability of adequate water and sewer services (allocation), as each new community must be connected to water and sanitary sewage treatment facilities.

Many regions within the Toronto CMA restrict the amount of residential development based on these available services, by providing allocation to each municipality. According to the City of Markham website, *"since 1996 the construction and delivery of these services have not kept pace with the market demand for residential development."* There are likely many other suburban municipalities that have experienced artificially restricted residential housing supply for 20 years!

The spillover from not building enough ground-oriented family friendly new housing units is a shortage of available properties in the resale market. *"Over the last year, the supply of low-rise homes types remained constrained while demand was at record levels. Months of inventory for low-rise home types trended at or near record lows,"* according to the Toronto Real Estate Board (TREB). *"Toronto's sales-to-listings ratios are the highest in several years, which correlates well with substantial price increases. Active listings are the lowest since the recession and the flow of new listings is only three percent higher than last year, compared to a 10% sales increase,"* writes Central 1.

A survey conducted by Ipsos Reid for TREB in November showed that upfront costs associated with moving was the key reason people chose not to relocate, and in Toronto the additional land transfer tax has further reduced listings and thus contributed to the rapid price appreciation. Other factors influencing listings/supply and pricing include the fact that people are working longer (by hours and to older ages) and less likely to move out of the GTA than previous generations, and the increase in higher-paying jobs for females has resulted in more income to purchase homes, and the greater likelihood that at least one person in the household is working in Toronto, and the ability or desire to move farther afield is reduced.

> **"Relative to previous generations, baby boomers have higher home-ownership rates, have longer life expectancies, are working longer and have benefited the most from rising house prices."**
> *— Bank of Canada, December 2015*

In additional to lack of supply, the other key fundamental has been an increase in demand. Lower borrowing costs typically increase demand for ownership housing, and BMO noted that *"the Bank of Canada's two rate reductions and falling global bond yields have reduced mortgage rates about 30 basis points in the past year. This effectively lowered mortgage service costs by over 1% of income, thereby accommodating a 3% price gain."*

As mentioned several times previously, lower rates keep the monthly cost to service a mortgage low, and can offset some of the affordability concerns that arise with high house prices. Manulife Bank's recent survey revealed that 53% of respondents felt that housing was affordable in Toronto (just 32% in Vancouver). Almost 75% of households looking to buy a Toronto area home *"were not planning on using a mortgage at all or were planning on making a down payment of 20% or more,"* per TREB survey findings. Many existing homeowners find housing affordable because they have built up substantial equity in their homes during Toronto's lengthy housing bull run, and can further leverage themselves into bigger and more expensive homes. A simple example shows the power of low rates coupled with substantial price growth. A family that put 5% down or $25,000 on a $500,000 house in 2011 have seen their principal outstanding fall to $400,000 by 2016, and the value of their home increase to over $700,000. This household can now afford to put down 30% ($300,000) on a million-dollar home just five years later. Baby boomers, having taken advantage of price increases for approximately 20 years have either cashed out, or are pulling equity from their homes to gift down payments to their children to buy starter homes.

With parents helping with down payments and an ample supply of relatively affordable condominiums on the market, young buyers are jumping into the ownership housing market. TREB's survey indicated the 53% of GTA home purchasers in 2015 were first-time buyers and 60% in the City of Toronto. The ability of Toronto to service so many first-time buyers, young professionals, and young entrepreneurs is a reason top talent and desirable employers are flocking to Toronto. In the Emerging Trends report by ULI and PwC, a major concern was raised about Vancouver: *"the high cost of living is making it harder to attract head offices and other major firms to the city."* At the ULI Toronto Symposium, similar remarks were made about San Francisco by American panellists, as the high housing costs are resulting in highly recruited graduates choosing to live in areas like Austin or Nashville due to a lack of affordable housing in San Francisco (the average cost to rent a one-bedroom suite in their core is over $4,000 per month in Canadian dollars).

Toronto's problem is not necessarily affordability, but an expectations and perception challenge. Fortress polled mortgage brokers in Canada and asked them which home attributes their clients were most willing to sacrifice when looking for a place to live. The two areas where prospective buyers didn't want to compromise: location and product type. They are willing to accept a smaller home on a smaller lot, but there are only so many ground-oriented houses in good locations available (regardless of size or condition). This synopsis by Central 1 is apt: *"the homes and buildings people want to own are in limited supply and are located on land that cannot be reproduced."* Peter Norman of the Altus Group has estimated the GTA demand for single-family housing is 20,000 to 25,000 units per year, while the market has produced less than half of that in some years. When TREB surveyed GTA buyer intentions, nearly 50% of respondents aged 18 to 34 want a single-detached house — unless these perceptions change, or downtown high-rise communities do a better job at catering to families and their needs, 'housing affordability' (read low-rise affordability) will only get much worse. About 40% of respondents to TREB's study want to buy a new home; while typically less than 30% of annual GTA transactions are new home sales, expectations are not aligned with reality.

Torontonians remain very bullish on the market, with 82% of respondents to Manulife Bank's household survey believing that house prices will rise over the next 12 months. Even if buyers can't get the exact home they covet, they still want to buy something, and several divergent trends continue to mature. The continuation of renovation spending is our first key trend, and an under examined root cause of housing price increases. One of the key benefits of homeownership is the ability to create new value from a property by adding a basement apartment, adding a second storey, or upgrading the interior finishes. Prospective homeowners that can't find what they want are buying properties and adding additions, gutting them, and rebuilding them. According to Central 1, *"renovation spending, which is larger than spending on new construction, is forecast to grow at a good clip, averaging around 7.5% annually"* in the Toronto region in 2016.

Re/Max Condos Plus predicts that stacked townhouses will be a hot market segment, mentioning this hybrid product type in their *"Five Trends for 2016."* At Fortress, we have also recognized the rising demand for a home type that is not a high-rise condo, but doesn't come with the high price of an urban infill townhouse. A third trend to watch is the 'drive to affordability' and the leapfrogging of the Greenbelt. In their 2016 Housing Market Outlook, Re/Max writes *"price increases for single-family homes have outpaced the condo market, making it difficult for condo owners to trade up. Many of these move-up buyers have been selling their centrally-located condos and moving to single-family homes in the outer suburbs,"* adding buyers looking for *"value and affordability"* are looking an hour outside the City of Toronto for single-family homes in their price range. Re/Max singled out Keswick as a growth area, but sales in places like Caledon, King, West Gwillimbury, East Gwillimbury and Clarington have been very strong, and are the areas we identified as prime areas for greater absorption activity and price growth.

The last trend worth noting is an increase in foreign ownership of housing in the GTA. Re/Max notes last year that *"high-end homes continue to sell well in 2015, appealing to local move-up buyers as well as foreign buyers, primarily from China and the Middle East."* Although CMHC indicates that foreign ownership of condominiums remains relatively low on a percentage basis, anecdotal evidence suggests an increasing interest in low-rise luxury accommodations in the GTA, similar to what Vancouver is allegedly experiencing. More than one developer personally expressed to me that they expect much more Chinese capital to flow into Toronto in 2016.

Benjamin Tal, Chief Economist at CIBC, noted there is a crisis of confidence in China, as the government's inability to prop up the stock market has locals very nervous. Despite increased efforts to curb capital outflow, Chinese funds are flowing out rapidly, and the lower Canadian dollar has made domestic real estate even more appealing. Outsiders continue to recognize and appreciate the quality of life and economic stability of Canada, especially Toronto, and view downtown and inner suburban real estate in the GTA as severely undervalued.

There continues to be denial that Toronto is a global city, and continued unsubstantiated claims that investors will "exit on mass" if market conditions change (it didn't occur in 2009). The reason foreign investors target Canada is because they already have relatives living here or plan to move here in the future. In the unlikely absence of these two reasons, domestic real estate brokers and sales and marketing professionals have told me they view Toronto as an upcoming financial centre, a place of political stability, a non-violent nation, a country absent of geopolitical strife, and a place with underpriced real estate in comparison to where they are from. International buyers believe Toronto real estate will appreciate rapidly, based on comparisons to other major world markets. **Figure 22** presents data on real estate prices, rents, wages and major household costs using figures compiled by Numbeo and UBS last year.

FIGURE 22

COMPARISON OF PRICES, RENTS, INCOMES & PURCHASING POWER | Select Global Cities, 2015

City	Numbeo Data*				UBS Data (in comparison to Toronto)			
	City Centre Monthly Rents		Average Apt Price PSF	Average Annual Salary After Tax	Housing	Wage Levels (Gross)	Food Costs	Cost of Services
	1 Bdrm	3 Bdrm						
Toronto	$1,491	$2,592	$692	$40,937	-	-	-	-
Hong Kong	$2,897	$6,359	$3,297	$47,082	70%	-45%	22%	-42%
London	$3,330	$6,642	$3,167	$47,720	63%	5%	30%	17%
New York	$3,953	$8,019	$2,419	$53,642	71%	29%	37%	21%
Paris	$1,559	$3,555	$1,362	$39,294	40%	-14%	7%	3%
Sydney	$2,317	$4,525	$1,236	$52,285	57%	20%	27%	12%

*Source: Numbeo, UBS *US data converted to Canadian at rate of $1.33 in Nov 2015*

According to Numbeo, the average price of a 'city centre' condominium apartment in Toronto is $692 psf (Canadian funds), which is surprisingly close to the average index price of a downtown core resale condominium in Q4-2015 as tracked by Urbanation Inc of $666 psf, and new downtown core condo of $696 psf. Numbeo data shows that a Hong Kong ownership apartment is $3,297 psf, or 79% more than Toronto, and a London unit is $3,167 psf or 78% more. Rents in Hong Kong and London are 50% to 60% more than Toronto, while residents only make 13% and 14% more in their average salary after taxes. Parisians make 4% less than Torontonians, pay approximately 49% more for a condo, but only achieve a 4% premium for rents on a one-bedroom apartment.

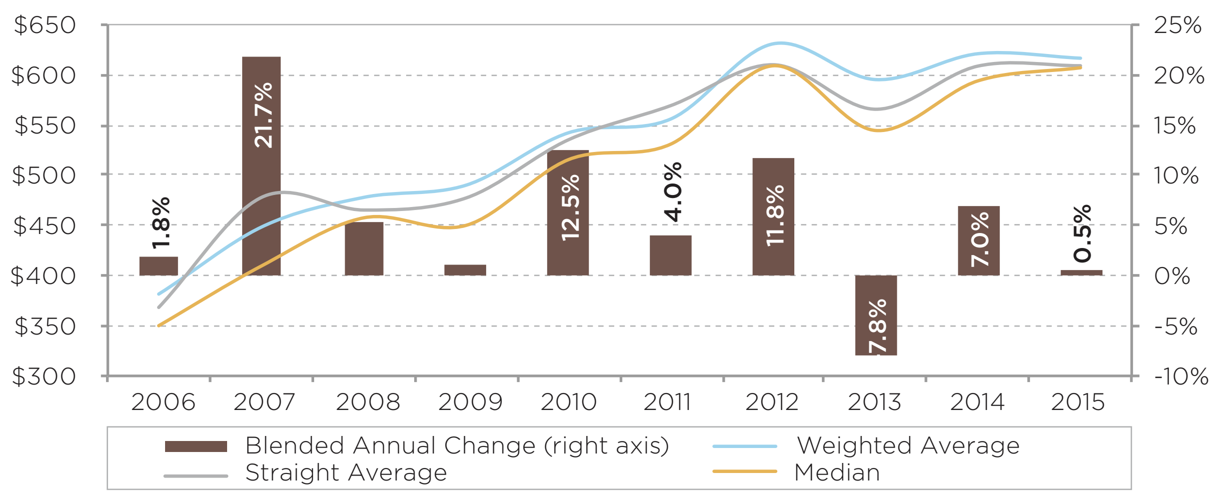
The housing figures used by UBS appear to be a blend of ownership and rental costs, but regardless shows similar huge premiums paid by buyers/tenants for housing in the comparable five cities. Wage levels are 20% to 30% higher in Sydney and New York, but similar or lower in London, Paris and Hong Kong. It costs more to eat in the other global cities in comparison to Toronto, and services are more expensive in four of the five areas.

When presented with the data, it's easy to see why a condominium investor would be interested in Toronto. Lower prices mean lower down payments, the price-to-rent ratio is the most favourable among the group, wages are relatively good in comparison to rents and prices, and residents' purchasing power for food and services is higher as well.

Despite a condominium market that has functioned relatively well and orderly over the past decade with a high share of investor buyers, there is still a big degree of apprehension and anxiety from the general public, the media, and even lenders from outside of Ontario about the long-term health of high-rise housing. **There is an immediate assumption that investors are short-term speculators, when the data clearly shows they are not.** Most developers require a 20% deposit pre-occupancy (35% for foreign investors), the majority of lenders require a building to be 75% sold or greater before funding construction financing and many developers charge a fee to 'assign' a unit (but the original purchaser remains on the hook to close that unit should the assignee fail to do so).

The folks that continue to call Toronto condo investors 'speculators' need to be reminded that speculation increases when the values of that asset are rising rapidly. As mentioned earlier, price appreciation in the new condominium market has been approximately 3% over the past three years according to data from Urbanation Inc, but that doesn't tell the true story because of the blending of data from much older projects. There are still 28 projects tracked by Urbanation that launched in 2009 or earlier, these projects are still factored into their average sold index price of $579 psf. When these projects sell out and are dropped from the sample, it creates the illusion of increasing prices. A much better method to detect froth or overheating in the new condominium market is to look at the values of projects that launched by year (see **Figure 23**).

FIGURE 23 **NEW CONDOMINIUM LAUNCH PRICES BY YEAR & ANNUAL PRICE CHANGE** | GTA: 2006 to 2015

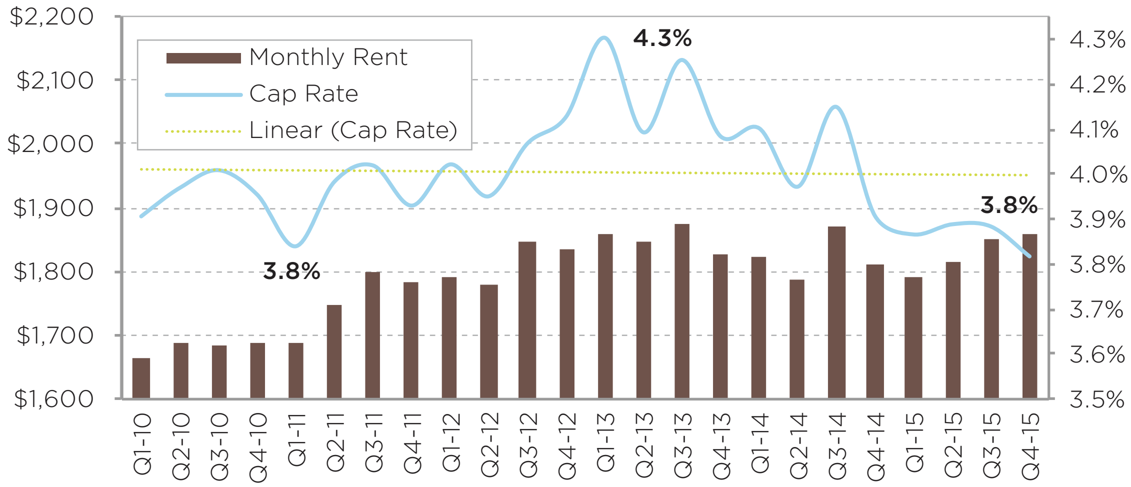


Source: Urbanation Inc.

We looked at three measures of central tendency: a weighted average by units, a straight average of projects and the medium project. Additionally, we looked at the average annual change based on the three measures. Interestingly, the most aggressive year for annual price increases was 2007 at 21.7%. The massive sales year of 2011 witnessed price growth of just 4%, while 2015, the second-highest year ever for new condominium apartment sales, saw prices jump by just 0.5%. Overall prices have essentially been flat since 2011. Investors are purchasing to hold and rent long term, banking on future appreciation when high-rise land availability shrinks. Urbanation data shows that just 3% of units in newly registered projects turned over in 2015, compared to over 8% in 2011 — there is no flipping occurring, and little to no assignment activity.

A second common argument is that cap rates on condo rentals are too low, that these real estate investors will turn elsewhere to seek higher returns. **Figure 24** looks at average monthly rents in the GTA (left axis – bars) and the capitalization rate (right axis – line) or *"the rate of return on a real estate investment property based on the income that the property is expected to generate."* A cap rate of approximately 4% has been the norm for the better part of five years. There is nothing to suggest investors will radically change course in the coming years; if anything they should be more comfortable with condo investing, as many have gone through the entire process, and have a better idea of their costs and revenues.

FIGURE 24 **AVERAGE MONTHLY RENT AND CAPITALIZATION RATE FOR CONDO RENTALS** | GTA: Q1-2010 to Q4-2015



Source: Urbanation Inc, Fortress Real Developments

Another reason to feel confident in the Toronto condominium market moving forward is that there were several project failures in 2015. Let me explain that dichotomy, when projects do poorly while others experience blow-out sales successes, it shows that investors are doing their homework and not just "buying anything because the price is going up," which was happening to an extent in 2011. Re/Max Condos Plus expressed a similar sentiment: *"investors are becoming smarter and more selective. They are only looking at projects from major condo developers and buying those projects where prices are at current market levels. It is easy to make the case that there will be a shortfall in housing in five years."*

The mere mention of a shortfall in condominiums in the Toronto metro area is enough to get the blood boiling among the countless members of the anti-real estate crowd. The major increase in completed and unsold condo supply in the Toronto CMA in the first half of the year created a stir in 2015, and outside housing observers called for a future decline in resale condo prices as developers slashed prices to liquidate this inventory. These observers likely don't have access to the paid subscription data on a project-by-project basis, likely have never spoken to a condominium developer or sales and marketing director, and don't understand the data they are analyzing. In Fortress' last Market Manuscript published in September 2015, we showed that the average condo project coming to completion in the Toronto CMA was well over 90% sold (completions were high, so unsold units on an absolute level rose), and when looking at the micro-level data, the issue was isolated to a few developers and a few projects, many of the sites belonging to well-heeled developers, many of which were leasing out unsold inventory.

> **"One of the arguments put forth suggested we would see a glut in inventory and a steep drop-off in condo apartment prices. This argument has proved to be false."**
> *— Toronto Real Estate Board, January 2016*

The explanation of the situation regarding standing condo inventory received little mainstream attention, and an editor at a major magazine went as far as to suggest that *"if someone has an explicit bias they're going to gerrymander the data to support it"* in clear reference to myself and Fortress' participation in the real estate industry. In late October, CIBC Chief Economist Ben Tal wrote a report on unsold condo units in the GTA market that mirrored my results. *"Almost one-third of all unabsorbed units in the GTA are concentrated among only four developers (out of 77),"* and *"one quarter of all unabsorbed units are concentrated among five projects (out of 139),"* were Tal's key findings. His conclusion stated that *"for now, those who look at the rise in unabsorbed units as a sign of increased vulnerability are barking up the wrong tree."*

I was extremely happy to see that Tal and I were on the same page and looking at the data in the same way. Several media outlets picked up Tal's conclusions, but I have yet to hear of a journalist accuse Tal of gerrymandering data. Even Canada's most trusted sources of housing analysis freely admitted the number of unsold condos is of little consequence, as units held by private landlords and developers are in high demand by tenants. In December, The Bank of Canada wrote, *"Toronto's apartment vacancy rate is in line with its long-term average and has been stable over the past year, suggesting that demand is strong enough to absorb supply in the rental market."* In January, CMHC made a comparable judgement about the Toronto market: "*a low vacancy rate in the rental market suggests that unsold inventory could be steadily absorbed."*

As observed by the BOC, CMHC, and just about anyone looking to lease a suite, the rental market in Toronto remains red hot, especially the condominium apartment rental market. Re/Max Condos Plus noted that rentals now outnumber sales on the Toronto Real Estate Board's Multiple Listing Service (MLS). Urbanation stated that *"a total of 27,166 units were leased through the MLS system, growing 19% from 2014 and doubling the level back in 2011."* Index rents increased 4.1% annually, and the lease-to-listings ratio, a measure of market demand, was 74% in the GTA in Q4-2015, the highest fourth quarter level since Urbanation began tracking the data five years ago. I can't have a conversation with a developer these days without the mention of building purpose-built rentals — the unrelenting demand for rental product in the GTA can't be ignored. There were nearly 5,000 rental apartments under construction in the Toronto CMA at the end of 2015 according to CMHC, the highest since 1993. Urbanation began tracking newly built rental apartments (completed since 2005, about 35 projects), and indicated that the vacancy rate for these developments was 0.6% in the GTA (0.8% in the City of Toronto and 0.2% in the '905' region). Despite the formidable market conditions, the majority of developers still believe the economics favour building condominiums. Colliers International noted that in downtown Toronto, there will be more rental apartment completions than condominium apartment completions in 2017.

For some reason the public tends to be more supportive of rental apartments than condo apartments, mistakenly believing that rents will be lower. The average unit in rental apartments built since 2005 was approximately $1,950 per month in the fourth quarter, while the average rented condo was $1,857 per month according to Urbanation data. With the realization that high demand and rising rental rates can now support the development of rental projects, a lot of patient capital is chasing downtown development sites. This influx of institutional funds could explain the rise in high-density land values in the GTA in 2015 (14%), despite the relatively flat new condo prices.

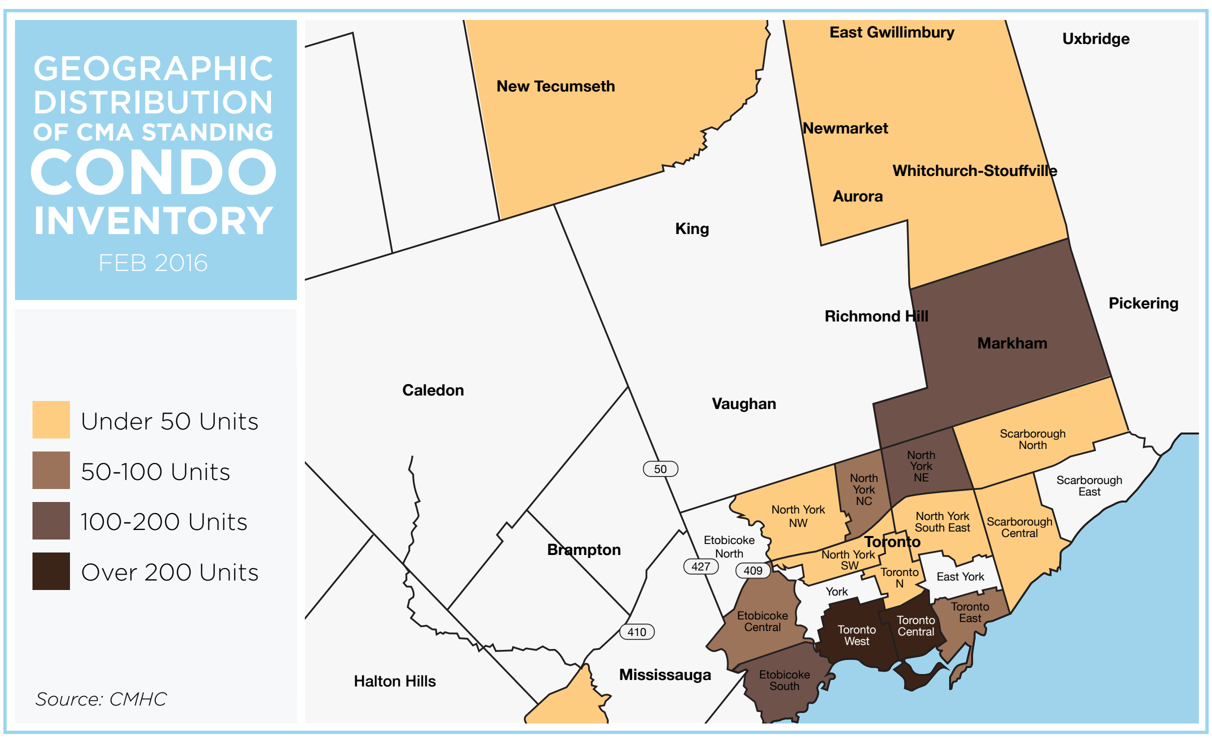
Higher land values and increased development charges should put a lot of upward price pressure on new condominium developers in the new reality of slower price growth (but still growth). Despite the potential for higher prices, resale transaction volumes shouldn't be impeded for affordability reasons. Both RBC and BMO chimed in on condos in late 2015: *"condo affordability remains largely in check — the trend in RBC's measure barely deteriorated in the past five years,"* and *"condos are still affordable, with the typical buyer in Toronto needing just 22% of income to service a mortgage on a newly purchased unit. That's little different from a decade ago."* **Analysts that rely on foolish analyses of affordability based on rising price-to-income ratios should note that ratio increased in the 1970s, the 1980s, the 1990s, and the 2000s in the US (per Zillow)**. Each successive decade setting a new benchmark that is being ‘dangerously’ exceeded — despite the market plunge, I expect the 2019 ratio to be higher than the 2009 ratio south of the border. Affordability in the GTA, as mentioned earlier, is essentially about the ground-oriented market, not the condo market.

The new mortgage rules changes will hurt affordability among low-rise house buyers, but protects the market from overleveraged buyers, and will ultimately increase condo demand. Robert Kavcic of BMO believes rookie buyers will feel the brunt of the new mortgage rules: *“first-time buyers at the margin who don’t quite meet the new down payment requirements could be forced to move down the price spectrum, defer purchases or find alternative financing for bigger down payments.”* Kavcic suggests the alternative funds might come from mom and dad. A recent National Association of Realtors study showed that 31% of American millennials received a gift or a loan from a friend or relative to be used for their down payment on a house.

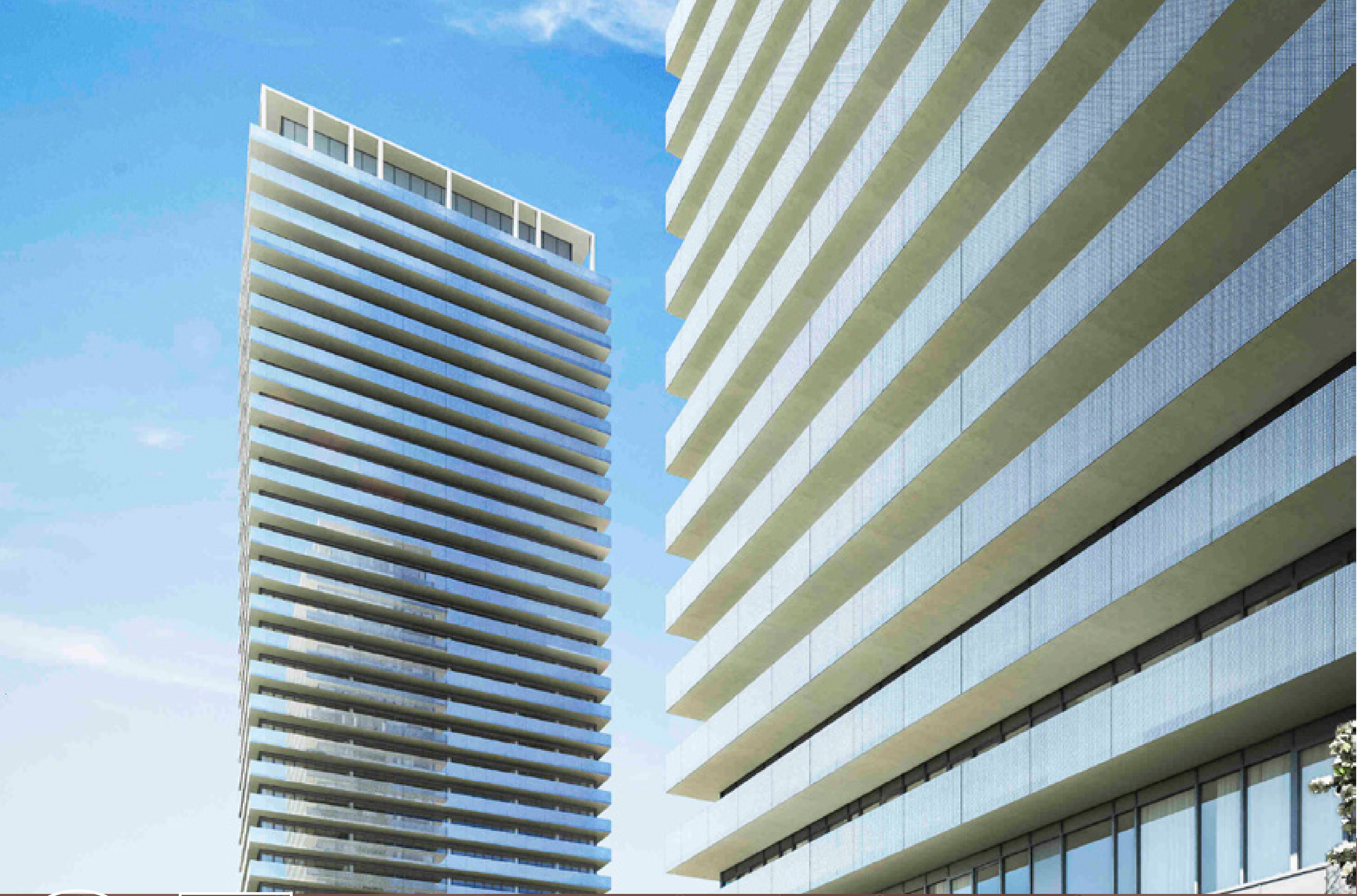
According to TREB survey data, just 6% of properties that sold for between $500,000 and $700,000 had down payments of less than 10%, and for properties between $700,000 and $1 million, that share dropped to 3%. Re/Max Condos Plus believes these mortgage changes will have no impact on the market.

Based on the data offered above and the expert analysis and commentary, the key issues and influential trends are the same as in previous years. Families will continue to search for larger more affordable properties, with the reduced cost to commute (lower gas prices) incentivizing them to do so. Any community within a one hour’s drive of Toronto will be ripe for residential housing growth. Students, single graduates, young professional couples, new Canadians, start-ups, major employers, and foreign capital will continue to flood into Toronto and the expanding urban core. This creative class will continue to drive demand for high-density product like stacked townhouses, and condo or rental apartments.

> **“Employment and lifestyles are headed downtown. Unlike large American cities, there are several employers present in the downtown: in government, education, health, finance, investment, hospitality and cultural industries.”**
> *— Consumers Council of Canada, January 2016*



Source: CMHC



03

CALGARY CMA

KEY HIGHLIGHTS

CALGARY CMA

1. **Housing starts in the Calgary CMA were down 24% from 2014 to 13,033 in 2015, nearly identical to the five-year average of 12,976. Construction activity was boosted due to forward momentum from strong new home sales in 2014. The market needed to catch up to the record immigration and strong economic growth over the previous three years.**

   In Q3-2015, Alberta welcomed the highest number of immigrants in a single quarter in the province's history, while Calgary added over 35,700 people in 2015 according to the City of Calgary Civic Census, the second-highest total over the past ten years. This high level of population growth coupled with a consensus forecast of just 10,800 starts for 2016 should prevent the metro area from experiencing major oversupply issues.

2. **The average completed and absorbed single-detached and semi-detached home increased 16.6% annually in the Calgary CMA in 2015. The average asking price of a completed and unsold single or semi was up 7.2% annually, meaning developers were not slashing prices on standing inventory.**

   The lagging indicator that is absorbed new house prices demonstrated how hot the Calgary market was prior to the energy market correction. More reflective of current market conditions is resale prices, which declined 2.6% annually on average according to Teranet in 2015, while Brookfield RPS reported a decline of just 0.6%. CMHC expects Calgary CMA resale prices to increase in 2016 by 0.7% year-over-year.

3. **The future of the energy market remains uncertain, with the global oversupply of oil expected to persist for some time. Forecasting oil prices is nearly impossible, and scenarios that could result in $20-per-barrel or $80-per-barrel oil in 2016 are being forwarded by analysts.**

   Forecasts have trended toward $50 oil for 2016, which will likely lead to further job losses in this sector in 2016 in Calgary. However, other industries are thriving in Calgary — the services sector added jobs last year, while the forestry industry has taken advantage of the lower Canadian dollar and the improving American housing market. A recent survey showed that 86% of Calgarians believe their quality of life is good, compared to just 67% in 2007 during the last economic downturn.

4. **In 2015, there were 3,134 new multi-family houses sold in the Calgary area, a decrease of 21% from the booming 2014. However, there was an increase in sales volumes in each quarter, with Q4-2015 being one of the strongest quarters in the past two years.**

   Developers continue to bring product to the market, albeit at values about 10% below 2014 price levels. Investors and entry-level homebuyers are the primary purchasers, as the downsizing and move-up buyer groups remain reluctant to purchase due to uncertainty regarding the ability to sell their current home at their desired price. Builders remain bullish on the future high-density market, as development permit applications for large-scale multi-residential projects continue to flood into the City of Calgary, with nine applications for projects of 100 units or more in December alone.

The slumping energy markets continue to weigh on the housing markets in Alberta. The oversupply of oil and OPEC's decision to no longer act as a swing producer are likely to keep oil prices at very low levels in 2016. The economics and research team at ATB Financial notes that the *"global oil supply glut, economic instability in China and tensions in the Middle East have pushed oil prices to 12-year lows."* National Bank states that OPEC's failure to agree on a production ceiling means there *"isn't as much of an incentive as before to cooperate and restrict output in the oil market"* thanks to new supply coming from outside of OPEC, and a *"a strategy of restraining output is now more likely to result in lost market share than higher prices."*

Benjamin Tal, Chief Economist with CIBC, believes that OPEC's desire to maintain market share by disrupting high-cost oil producers is just part of their strategy. OPEC also wants to curb investment in alternative energy, and push back greener options as far as possible says Tal. Sales of SUVs were up in 2015, while there was a significant decline in several hybrid car models last year.

Regardless of the reasoning behind OPEC's decision, the result was oil producers cutting capital investment *"by an estimated 34% in 2015"* according to the Alberta Government. Luckily for the labour market and the housing market (but not for the oil oversupply), many producers keep pumping oil. An article in the Economist sheds some light on why extraction hasn't stopped: *"some high-cost production is closing, but once wells are drilled, it usually makes sense to keep pumping, even at a loss. It is better to make a little money rather than none."* In a document produced by the province, they note that *"oil sands projects have long life cycles and most have already committed large amounts of capital. Major projects are still proceeding, and firms are focusing on containing costs and delaying or slowing developments to reduce capital spending."*

Instead of mass layoffs, the Economist article observes that the *"oil industry's immediate reaction is to squeeze costs out of its supply chain. So wages and margins are falling fast."* Cost pressures from the employment side have come way down in an industry where average weekly earnings *"shot up 56% over the last 10 years,"* says economist Todd Hirsch, compared to *"an average increase of 29% for earnings in other sectors of Canada."* ATB Financial finds that many companies are *"scrambling to increase efficiencies and reduce costs,"* and they are seeing *"a reduction of both wages and overtime hours" among Alberta oil producers.*

The massive drop in oil prices was a 'black swan' says CIBC's Tal, a completely unpredictable event. In May 2015 the Wall Street Journal surveyed ten banks on their oil price predictions; not one expected prices to drop below $50 USD per barrel, and as we know, prices have already dipped below $30 per barrel. ATB Financial believes that *"forecasting oil price movements even a few weeks from now is nearly impossible,"* and DBRS puts it appropriately that "*the outlook is exceptionally unclear."* Based on various scenarios, ATB Financial indicates that oil prices could go as low as $20 a barrel, and as high as $80 per barrel in 2016.

TD Economics doesn't believe a *"V-shaped rebound in investment and growth in oil-rich regions"* should be expected in 2016 and a *"meaningful recovery to $65 per barrel is not expected until 2017."* Laurentian Bank remains one of the only voices calling for an energy market revival this year: *"we forecast crude oil prices to recover in 2016, as growing evidence of capitulation among high cost producers should send a signal to OPEC that it's time to cut production."* Laurentian expects the WTI oil price to increase to $70 in 2016 and $80 in 2017. Based on my look at forecasts from both domestic and foreign sources (RBC, TD, Scotiabank, National, Desjardins, EDC, the Alberta Government, PIRA, Spoule, and the US Energy Information Administration), collectively these forecasts call for $50 oil in 2016.

> "The oil sector is struggling, but other industries are thriving."
> *— ATB Financial, January 2016*

Despite all the uncertainty related to the energy markets, *"Alberta's economy is expected to see a modest recovery in 2016,"* according to the Alberta Government, with further acceleration expected in 2017. The recession in Alberta was relatively mild in 2015, as job losses were not as bad as expected in the energy sector. Hours and wages were reduced for many employees, and some employers held back on shedding workers on the off chance of a quick market rebound. The province noted that employment was stronger than projected, as *"gains in services offset losses in the energy related industries."* Strong employment numbers were realized in educational services, health and social assistance and retail, but as ATB notes, *"these jobs are part-time and generally lower paying than jobs in oil and gas extraction."* However, underemployed workers are much better than unemployed workers (and less likely to migrate out of the province and ultimately hurt house prices).

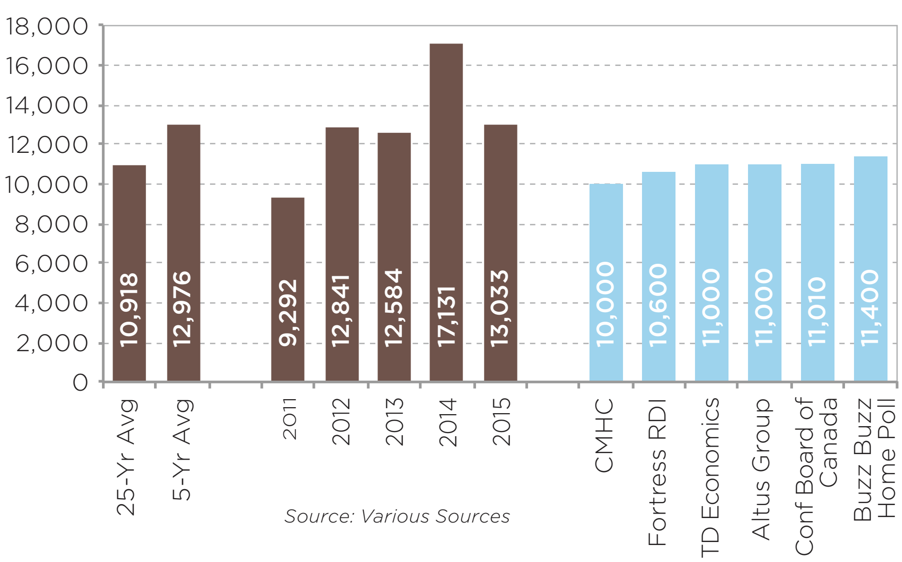
BMO Capital Markets Regional Labour Market Report Card listed Calgary as the 18th-ranked labour market in Canada (out of 33), down from 6th in 2014. However, ATB notes that despite negative conditions in the petroleum sector, *"other industries have been quietly adding jobs,"* and the *"forestry sector continues to be one of the star performers in the province this year."* The slide in the Canadian dollar has helped the forestry industry, especially with a growing US economy and improving new home sales south of the border. Alberta's economic outlook report notes that *"a weaker Canadian dollar and strengthening US economy are supporting exports and growth in non-energy sectors."*

> **"Economic activity is expected to gradually improve into 2017 supporting job creation, income growth and migration."**
> *— CMHC, Fall 2015 (Calgary market outlook)*

Employment outside of the oil-related businesses must be doing well, as households' after-tax income growth in Calgary was 5.4% through the first nine months of 2015 (over Q1–Q3 of 2014), the largest among metro areas in Canada. Additionally, people continued to move to the province last year, suggesting there are still meaningful opportunities. *"Alberta led the country in population growth in the third quarter,"* according to the Office of Statistics and Information at the province, and there was 1.8% population growth in the 2015 Census year. *"Alberta welcomed 13,982 immigrants between July and September, the province's highest number ever in a single quarter,"* noted Alberta's Jennifer Hansen. Calgary grew by 3%, or over 35,700 people in 2015 according to the City of Calgary Civic Census, the second-highest total over the past ten years.

According to findings presented in the Fall 2014 Market Manuscript, Calgary historically needs 0.37 new housing units for each net new person that migrates to the metro area annually. Therefore, the population growth of 35,700 translates into a need for 13,217 new homes in 2015 (12,502 if you use Statistics Canada's growth figure for the Calgary CMA for 2015). There were 13,033 new housing starts in the Calgary CMA in 2015 according to the Canadian Mortgage and Housing Corporation. Starts were down 24% from 2014, but actually exceeded the five-year average of 13,000, finishing the year at the second-highest level since 2007 (see **Figure 25**).

FIGURE 25 **CALGARY CMA HOUSING STARTS**
Historical Averages, 2011 to 2015 Annual Totals, 2016 Forecasts



Source: Various Sources

BEST STARTS FORECASTS IN 2015

1. **CMHC** BEST FORECAST
2. **BuzzBuzz Public Poll**
3. **Fortress RDI**

FORTRESS FORECAST:
10,600
HOUSING STARTS
CALGARY CMA
2016

Data Time Series	Actual 2015	Actual 10-yr Avg or 10-yr avg annual change	Forecast 2016 + Forecast Source
ECONOMIC INDICATORS - STATISTICS CANADA			
Population	1,439,756	35,182	27,355
Pop Annual Change	2.4%	2.8%	1.9%
			Conference Board of CAN
Employment (15 yrs +)	800,900	17,380	10,412
Emp Annual Change	-1.1%	2.5%	1.3%
			Conference Board of CAN
Unemployment Rate	6.7%	4.7%	6.2%
			Conference Board of CAN
NEW HOUSING MARKET DATA - CMHC			
Housing Starts	13,033	12,245	11,000
			TD Economics
Completions	14,542	11,686	11,900
			Fortress RDI
Completed & Unabsorbed	807	773	
Under Construction	13,773	11,723	
Median Single-Detached Price	$655,000	$38,000	$634,695 *
Annual Change	21.3%	9.7%	-3.1%
			CMHC
Rental Vacancy Rate	5.1%	2.4%	3.7%
			CMHC
Avg Rent 2 Bedroom Rent	$1,319	$51	$1,330 *
Annual Change	0.6%	5.3%	0.8%
			CMHC

* *Estimate based on % Change*

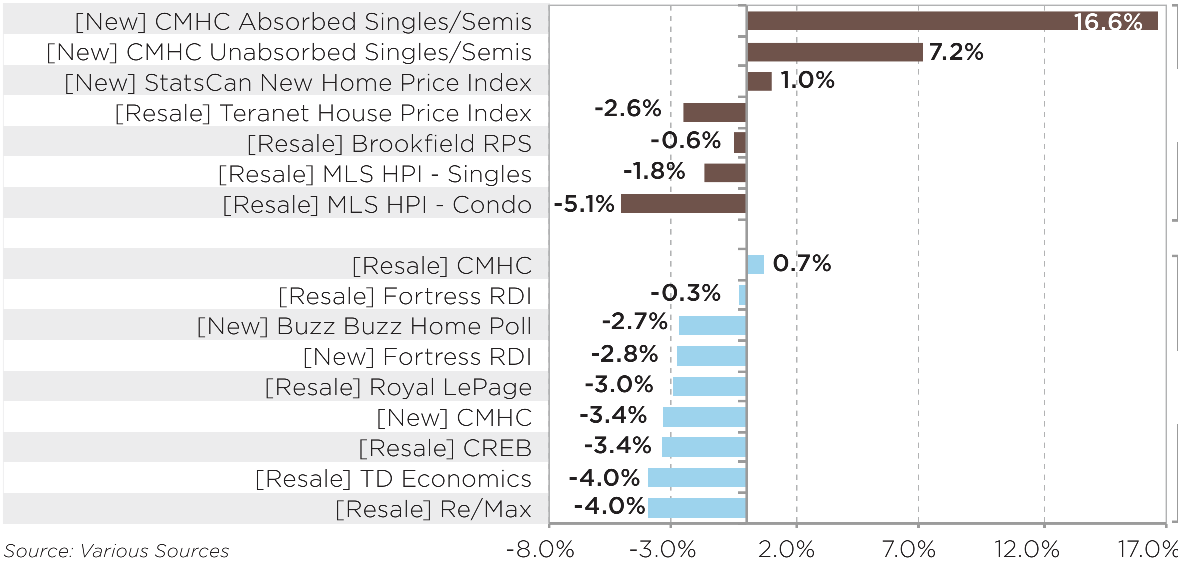
Starts were relatively high due to forward momentum from strong new home sales in 2014, and the lag time between sales and starts. Construction activity needed to *"catch up after three years of record immigration and strong economic growth"* according to the province's economic outlook. However, a significant drop-off is expected in 2016, with forecasts ranging from 10,000 to 11,400 annual starts for the Calgary CMA. The high forecast is a generated 'point forecast' based on a poll conducted on BuzzBuzzHome in January, however, 47% of respondents expected less than 10,000 starts this year. CMHC had the best forecast for Calgary housing starts in 2015.

As mentioned, the carry-over from the strong new housing market in 2014 resulted in relatively strong starts from a historical perspective in 2015. The same 2014 tailwind influenced new home prices (and in a big way). Only 1% of respondents to our January 2015 BuzzBuzzHome poll expected new home prices to increase by 7% or more, when in actuality, they increased by 16.6% annually when using CMHC absorbed single-detached and semi-detached price data. The average asking price of a completed and unsold new single-detached or semi-detached house in the Calgary CMA was up 7.2% annually (meaning developers are not slashing prices on standing inventory). By comparison, Statistics Canada's New Home Price Index, which tracks real house prices and attempts to control for the quality and size of the homes (and is more reflective of current prices, not homes sold in previous periods) was up 1% in 2015. **Figure 26** presents data on year-over-year changes in new and resale house prices, and includes forecasts for 2016 price movements from a number of third-party independent sources.

Resale house prices declined 2.6% on average according to Teranet, while Brookfield RPS reported a decline of just 0.6%. A third source of data, the MLS House Price Index, reported a decline of 2.3% overall, with condos declining more (-5.1%) versus single-family homes (-1.8%). Resale transactions declined 26% in 2015 according to the Calgary Real Estate Board (CREB), but so far house prices have not been as equally impacted. TD Economics concluded that the market remained well balanced, and this has kept *"home prices remarkably stable."*

Re/Max noticed a real split in the market between first-time buyers and move-up buyers. *"Calgarians who work in non-oil related jobs have taken the opportunity to get into the*

FIGURE 26 **ANNUAL HOUSE PRICE CHANGES (NEW & RESALE)**
2015 Price Growth (Actual), 2016 Forecasts: Calgary CMA



Source: Various Sources

market and entry-level homes prices under $400,000 have seen the most activity" while the *"upper-end of the market has seen the most significant slowdown, as buyers are hesitant to make larger investments under the current market conditions."* First-timers have jumping in at the new lower prices, but luxury homes have languished on the market as prospective move-up buyers worry about the resale value of their existing residences.

> **"Alberta's housing market continues to be affordable on the basis that RBC's measures stand at attractive levels both from a historical perspective and compared to other provinces."**
> *— RBC Economics, August 2015*

Only 6% of respondents to Manulife Bank's household survey felt housing in Calgary and Edmonton was *"not affordable at all"* compared to 13% in Montreal and Toronto, and 37% in Vancouver. This is very positive for the province, as buyers are more likely to jump into a stagnant housing market if they view it as affordable than they would to stretch their budget to get into a stagnant market. Interestingly, that same Manulife survey showed that 56% of respondents from Calgary and Edmonton expect house prices to increase over the next 12 months. CREB President Corinne Lyall was quoted in January as saying *"buyers in this market are continuing to be much more cautious as the impact of further oil price declines weighs on their confidence."* The key point made by CREB is confidence, despite thinking prices will go up, prospective homebuyers are still holding off purchasing anything. *"Long experience with boom-and-bust cycles has helped Albertans excel at taking the long view: They are opting to hold onto what they have and wait as long as it takes before buying or selling"* is a summary option expressed in the most recent Emerging Trends in Real Estate report by PwC and the Urban Land Institute.

A November 2015 telephone survey conducted by Ipsos Public Affairs showed that 25% of Calgarians are worried about losing their job, which gives you an idea why the 'hold' strategy has been implemented by many in the area in relation to their real estate holdings. The survey also indicated that 62% of Calgary residents believe their personal financial situation is strong, while only 19% described their situation as weak. When asked what they expected over the next six months, almost 60% expected no change (another reason to hold), while 23% felt their financial situation would be stronger (versus 16% weaker).

A separate survey by Ipsos conducted on behalf of the City of Calgary in August and September showed that 80% of respondents still think Calgary is a great place to make a living, down from 90% in 2013 and 86% in 2014. The biggest reason this author doesn't expect mass exodus from the province is that Calgarians still feel their quality of life is good; in fact 86% do, compared to 88% in 2013 and 87% in 2014. The last time Calgary was experiencing a market downturn, only 67% felt the quality of life in Calgary was good (2007) — they are much more confident in the resiliency of their province than they have been in the past.

Benjamin Tal of CIBC recently compared Calgary to Texas 20 years ago; Calgary is on its way to becoming a much more diversified economy like Texas, a state that weathered the recent market correction much better than many. Interestingly, Dallas is now embracing the condominium lifestyle, much like Calgary has over the past decade. People are choosing to live downtown, despite an abundance of land to sprawl into.

This is still a slowly developing trend in the Calgary CMA, as suburban multi-family activity continues to outsell inner-city activity (the opposite of Toronto). Overall in 2015, there were 3,134 new multi-family (condominium apartments and townhouses) sold in the Calgary area, a decrease of 21% from the booming 2014. There was an increase in sales volumes in each quarter, with the fourth-quarter activity picking up drastically. Urban Analytics writes, *"the 1,046 sales achieved during the quarter is a 3% increase over the same quarter in 2014 — one of the strongest quarters for new multi-family home sales in the past two years."*

> **"Calgary's new condominium market fared relatively well over the summer months despite the economic uncertainty, layoff announcements and negative outlook coming from the energy sector."**
> *— Altus Group, October 2015*

Urban Analytics has ascertained that *"investors and entry level homebuyers continued to be the primary purchasers of new multi-family home product in Calgary in Q4-2015,"* but *"downsizers were somewhat reluctant to make a decision to purchase a new multi-family home due to uncertainty of the ability to sell their current home."* Several developers have enticed purchasers with discounts from $10,000 to $50,000 off suites. Both Urban Analytics and the Altus Group noted a number of newly launched multi-family projects undercut existing inventory by up to 10%.

Unsold inventory is up in Calgary despite the stronger sales in the second half of the year, as **developers continue to bring product to the market, which is a testament to their confidence in the marketplace.** By comparison, in Q1-2009, only one new condominium apartment project was launched in the Toronto CMA. This newly launched and newly positioned product is getting noticed; Urban Analytics writes that *"investors were driven to new affordably positioned concrete condominium projects launched in higher profile locations."* Sales of concrete condos (as opposed to wood frame construction) increased 61% in Q4-2015 over the third quarter.

The renewed interest in inner-city concrete condominium apartment projects is fantastic news for my firm, as Fortress has a couple of centrally located high-rise developments on the go in Calgary. Other major developers must also be feeling bullish on the market, as Anthem Properties, Concord Pacific and Embassy Developments are all launching major concrete developments in early 2016 according to Urban Analytics.

Development permit applications for large-scale multi-residential projects continue to flood into the City of Calgary, with nine applications for projects of 100 units or more in December alone. One of those applications came from Ontario developer Minto Properties, following a trend of developers that currently operate in Toronto looking out west. Fram Building Group, Metropia, Great Gulf, and this author's employer in partnership with Lamb Development Corporation have all bought sites in recent years. Other developers have indicated to me that they have been checking in with local brokers looking for 'blood in the water,' but no such liquidation sales on behalf of stressed landholders and developers are occurring.

Despite major uncertainty in the energy markets, there is still some positive data coming out of Calgary, and house price declines were not nearly as large as many predicted. First-time buyers continue to seek out affordable resale homes and pre-construction condominiums, taking advantage of lower-launch prices at several projects brought to market in 2015.

> **"The primary multi-family buyer is purchasing their first home. An economic slowdown can be an opportunity for buyers, as they get a good interest rate and are likely to see better home prices, which results in a significant cost savings."**
>
> *— Gary Siminiuk, Streetside Developments, November 2015*

WTI OIL PRICE FORECASTS

	GOLDMAN SACHS	ENERGY INVESTMENT ADMIN (EIA)	CITIGROUP
2016	$38	$34	$39
2017	$58	$40	$57

Various Sources ($US/Barrel)

04

EDMONTON CMA

KEY HIGHLIGHTS

EDMONTON CMA

1. **Housing starts in the Edmonton CMA increased 23% in 2015, boosted by demand for multi-family product carrying over from 2014. Construction in the apartment market more than doubled year-over-year, with condo starts increasing 163% annually, and rental starts jumping 71%.**

   In December 2007, Edmonton builders and developers had applied for over 15,000 building permits over the previous 12 months. Only 6,615 units started in 2008 due to major uncertainty on the part of lenders. In December 2014, builders and developers had applied for 16,684 buildings permits over the previous 12 months. Construction started on 17,050 new housing units in 2015, the highest level in 25 years, and a demonstration of the assurance lenders have in the Edmonton residential housing market going forward.

2. **The average price of newly completed and absorbed single-detached and semi-detached houses increased by 6.6% annually, while the standing inventory of singles and semis grew by just under 3%.**

   The average price of all residential resale properties was approximately $373,000 in Edmonton in 2015, an increase of 1.5% over 2014. New home prices were up, but it is being reported that many builders are cutting prices on unsold pre-construction supply by about $10,000 per unit, which represents a discount of about 1.7% based on the average price of $600,000 for a new single-family home.

3. **With just over 1,600 sales in 2015, Edmonton's new condominium sales volumes fell 55% annually from the record 2014 activity, and were 38% lower than the average sales during the 2011–2014 period. Completed and unabsorbed supply increased 63% overall and 112% for condominium apartments.**

   It is estimated that upwards of 30% of high-density sales over the past four years can be attributed to investors, and this buyer segment was non-existent in 2015. The biggest buyer group has been young first-time buyers, which have focused more on townhouses and singles on small lots, as opposed to pre-construction condominium apartments. By the end of the year, incentives in the new home market were less frequent, and entry-level townhouse demand picked up steam.

4. **Edmonton was ranked as having the sixth-best labour market in Canada in 2015, while experiencing the highest percentage growth in population among the top-ten ranked labour markets.**

   Edmonton clearly held up better than Calgary in the face of the energy market slump, adding both new residents and new jobs in 2015, just not at the same torrid pace as 2014. The City of Edmonton's Chief Economist expects population to grow by 1.6% in 2016, while the Conference Board of Canada is forecasting population growth of 1.8% for the metro area. Additionally, both the Conference Board and Altus Group expect further Edmonton area job growth in 2016.

The Edmonton CMA continues to feel the negative impacts of the energy-sector decline, but the housing market has been surprisingly resilient, as homeowners have 'stuck to their price,' and transaction activity remains near longer-run averages. A lack of widespread job losses has prevented a major housing contraction. The Alberta Government noted in their recent Economic Trends publication that *"housing markets tied more closely to the energy sector (like Calgary) took the biggest hit, while Edmonton's held up relatively well."*

Edmonton added new residents and new jobs in 2015, just not at the same torrid pace as 2014. A diverse economy and significant forward momentum from 2014 were commonly cited reasons for Edmonton's better-than-expected results last year. The City of Edmonton's Chief Economist expects the population to grow by 1.6% in 2016, while the Conference Board of Canada is forecasting population growth of 1.8% for the metro area. Additionally, both the Conference Board and Altus Group expect further job growth in 2016.

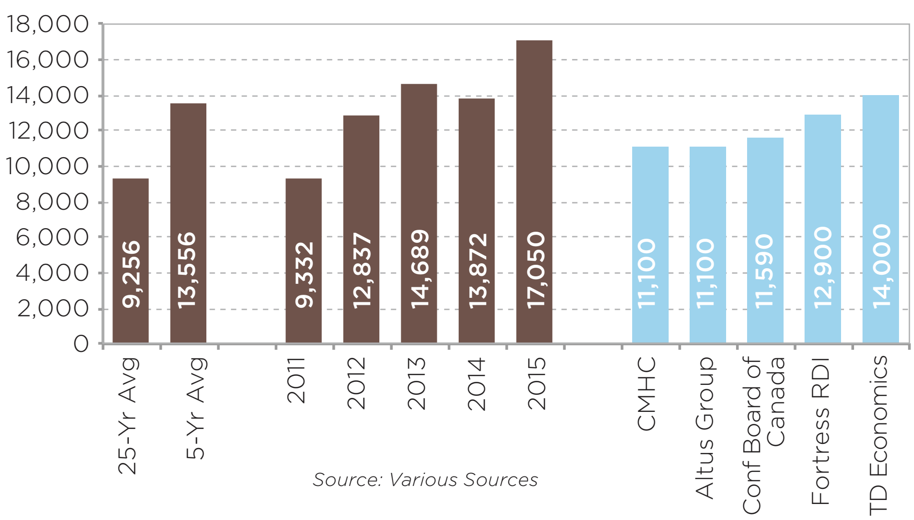
> **"The region's diverse economy has so far been able to absorb this negative shock and continue to expand."**
> *— City of Edmonton, February 2016*

In BMO Capital Markets' Region Labour Market Report Card, Edmonton is listed as having the sixth-best labour market in Canada (down from fifth last year), while realizing the highest percentage growth in population among the top ten-ranked labour markets. The City of Edmonton chalks up the expansion in the jobs market to favourable demographics: *"the continuing growth in the working-age population – up 2.3% from January 2015 to January 2016 – highlights Edmonton's relatively good job prospects compared to the rest of Alberta and Canada."*

The natural reaction of locals and outsiders is to assume that the drop in the price of oil would have a similar adverse effect on the economy as the previous decline in 2008. Alberta, and Edmonton in particular, was in the midst of a very strong (but not overly speculative) residential housing market at the time of the oil price drop in 2014, and most international economies are sounder now than during that prior period of global economic crisis in the late 2000s. CMHC made this assessment when comparing 2015 to 2008/2009 as it related to the Edmonton CMA: *"there is no financial crisis in the current lower energy environment and the U.S. economy is expanding. Mortgage rates have also moved lower. These factors have contributed to a smaller impact on Edmonton's economy and housing market in the months following the 2014 oil price drop."*

The greatest indication that the economic situation is significantly different during this energy slump in relation to the last is the ability of developers to secure construction financing. In December 2007, Edmonton builders and developers had applied for over 15,000 building permits over the previous 12 months. Only 6,615 units started in 2008 due to major uncertainty on the part of lenders. In December

FIGURE 27 **EDMONTON CMA HOUSING STARTS**
Historical Averages, 2011 to 2015 Annual Totals, 2016 Forecasts



Source: Various Sources

BEST STARTS FORECASTS IN 2015

1. **CMHC** (BEST FORECAST)
2. **TD Economics**
3. **Fortress RDI**

2014, builders and developers had applied for 16,684 building permits over the previous 12 months. Construction started on 17,050 new housing units in 2015, the highest level in 25 years. **Figure 27** presents data on the long-run averages for housing starts in the Edmonton CMA, annual housing starts data over the past couple of years, and forecasts for 2016.

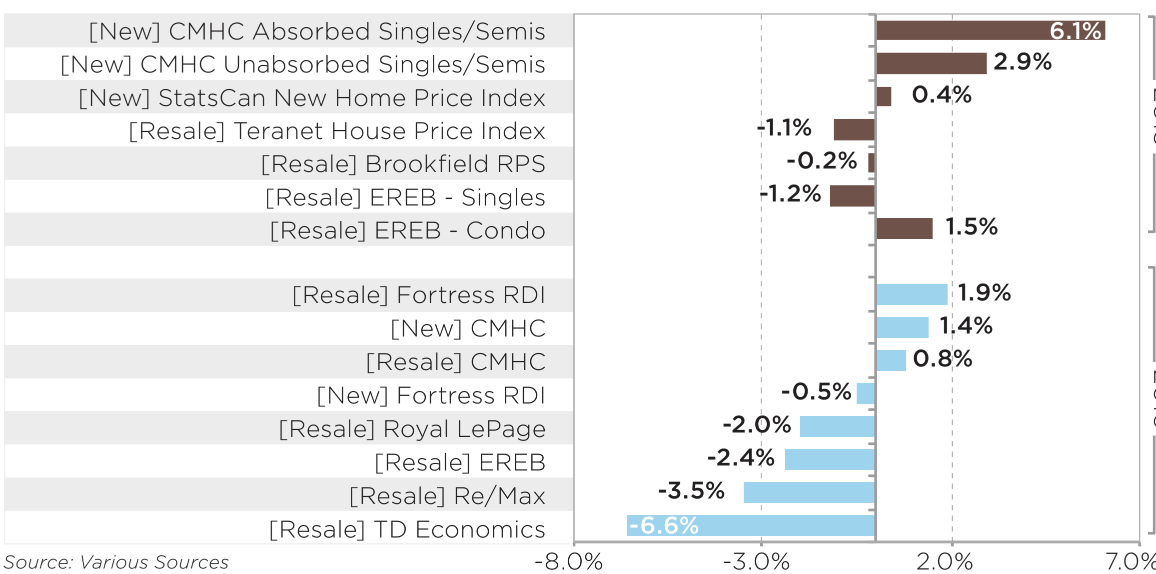
All of the expert forecasts for starts for the CMA in 2015 were terrible! CMHC had the best forecast at just 12,700 (versus 17,050 actual). Forecasts for 2016 range from 11,000 for CMHC to 14,000 from TD Economics, with the average of just over 12,100. This consensus forecasts is below the five-year average but above the 10- and 25-year averages. Fortress is calling for 12,900 starts in 2016.

The record-high starts last year can be attributed to apartments; this built form realized a 120% increase in construction activity over 2014 (and the five-year average for apartments). A further breakdown of the apartment market shows condo starts jumped 163% year-over-year, and rental starts increased 71%. The City of Edmonton concluded that this *"demand for multi-family housing is largely driven by recent strong net-migration to the [City of] Edmonton and the CMA."* It was also driven by the 32% annual increase in condominium sales in 2014; these projects likely made up the bulk of condo apartment starts in 2015.

Although there was still a relatively high level of building permit activity in the Edmonton area in the second half of the year, this author's housing starts forecasts (and its drop from 2015) is primarily based on two factors, a significant decline in new condominium sales, and the 25-year high in completed and unabsorbed new housing supply. The Altus Group, which tracks new condo activity in the Edmonton marketplace, wrote in February that *"Edmonton's new condominium sales volumes fell 55% year-over-year,"* and *"the 2015 sales total of just over 1,600 units is consistent with the experiences of 2009 and 2010 and 38% lower than the average sales during the 2011-2014 period."* Much fewer projects will reach the pre-sale targets necessary to secure construction financing, and coupled with the fact there were fewer launches in 2015, this should lead to much fewer apartment starts in 2016. The 63% increase in completed and unsold supply of new units will focus much of the attention of builders and developers on clearing out existing inventory, and not on building new product.

Over 7,000 single-detached houses completed in the Edmonton CMA in 2015, the highest level since 2007. Surprisingly, 78% of these singles were sold when construction was finished, which was the highest level of absorption since 2010. CMHC notes that since *"single-detached builders did not enter the current oil price crash with high inventory, they should be able to avoid the extensive build-up in inventory that occurred in 2008."* **So far there are no clues in the data that would suggest that builders and developers with standing inventory of single-detached and semi-detached houses will be slashing the price of these homes**. Prices for completed and unsold singles and semis increased 2.9% annually, while single-family homes that were sold increased 6.6% year-over-year. The average price of absorbed units is a lagging indicator; the Stats Canada New Home Price Index is a better reflection of current market pricing, and it showed a 0.4% annual increase in 2015 (see **Figure 28**).

FIGURE 28 **ANNUAL HOUSE PRICE CHANGES (NEW & RESALE)**
2015 Price Growth (Actual), 2016 Forecasts: Edmonton CMA



Source: Various Sources

FORTRESS FORECAST:
12,900
HOUSING STARTS
EDMONTON CMA
2016

Data Time Series	Actual 2015	Actual 10-yr Avg or 10-yr avg annual change	Forecast 2016 + Forecast Source
ECONOMIC INDICATORS - STATISTICS CANADA			
Population	1,363,277	32,131	24,539
Pop Annual Change	2.4%	2.7%	1.8%
			Conference Board of CAN
Employment (15 yrs +)	777,400	21,700	9,329
Emp Annual Change	3.8%	3.4%	1.2%
			Conference Board of CAN
Unemployment Rate	5.8%	4.6%	5.1%
			Conference Board of CAN
NEW HOUSING MARKET DATA - CMHC			
Housing Starts	17,050	12,053	14,000
			TD Economics
Completions	16,530	11,534	14,900
			Fortress RDI
Completed & Unabsorbed	1,622	1,301	
Under Construction	14,912	12,158	
Median Single-Detached Price	$535,000	$28,500	$544,095 *
Annual Change	8.1%	8.6%	1.7%
			CMHC
Rental Vacancy Rate	4.3%	2.6%	3.5%
			CMHC
Avg Rent 2 Bedroom Rent	$1,261	$53	$1,291 *
Annual Change	2.5%	5.7%	2.4%
			CMHC

* *Estimate based on % increase*

While new home prices increased in 2015, as the Altus Group noted, incentives were pervasive throughout the market. *"While the incentives programs vary, the typical value of these incentives is approximately $10,000 per home"* determined Altus. However, with the average price of a new single-family house clocking in at over $600,000 in 2015 per CMHC data, that represents a discount of just 1.7%. This minor discount is congruous with the declines in the resale housing market. The Teranet/National Bank Price Index showed that annual prices declined 1.1% in 2015, while the Brookfield RPS data indicated a decline of just 0.2%. December data from the Edmonton Real Estate Board (EREB) showed that single-detached house prices were down, but condominium prices were up. *"For 2015, the average price of a condo was $252,954 (up 0.4% from 2014) and the average price of all residential properties was $372,511 (up 1.5% from 2014),"* wrote the REALTORS Association of Edmonton in a press release.

> **"With many home sellers holding firm on their price, price movements in the market have been minimal."**
> *— CMHC, November 2015*

Association Chair Geneva Tetreault was quoted as saying that Edmonton *"remained relatively stable"* in 2015. The expectation for price growth in 2015 from several independent sources called for prices to increase at a rate of 2% or more: Re/Max said 4.0%, Royal LePage 2.5% and EREB 3.0%. CMHC had the closest forecast, calling for 1.5% price growth, while the Fortress forecast was second best at 1.8%. One of the main reasons we didn't see a huge decline (or any decline at all depending on the source of the pricing data) was because there was no huge run-up in pricing in the years leading up to the oil price plunge. CMHC notes that *"price gains had been relatively modest compared to the gains seen in the two years prior to the 2008 oil price crash,"* and the 2014 market was *"much more balanced."* Another key observation by CMHC was that *"there was also less evidence of speculative activity"* in 2014 in comparison to 2008.

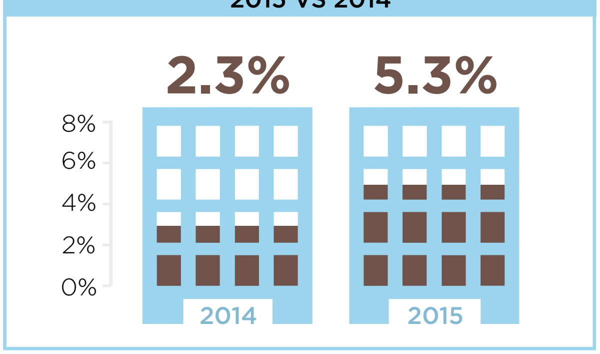
Moving forward, this lack of speculative buyers (short or long term) or real estate investors of any kind will result in much fewer new home sales. *"Upwards of 30% of apartment sales over the past four years"* have come from the investor segment per Altus Group findings. This buyer *"has been non-existent over the first nine months of the year,"* wrote Altus in their Q3 Market Update. Although this is not good news for real estate developers, the high-rise market currently consists of "real" buyers that intend to occupy their units, and pricing better reflects the actual level of demand, as opposed to future expectations, or a rental calculation.

> **"The moderate decline of condominium apartment units on the resale market relative to the sharp downturn of the new market speaks to current demand being driven by an immediate housing need rather than the positive future investment outlook required to drive large volumes of pre-sale transactions."**
>
> *— Altus Group, October 2015*

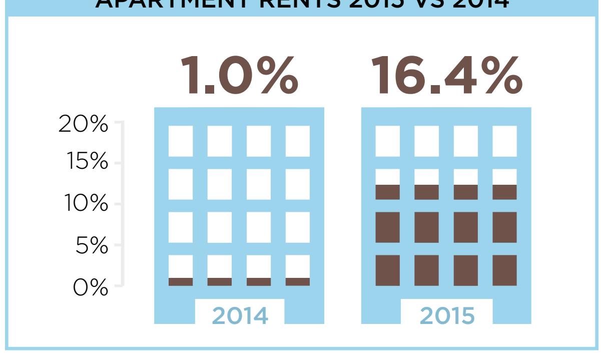
On the low-rise side of the new home market, developers are focusing on narrow lots to target young price-sensitive families. The Alberta Government notes the relatively young population in the province contributed to a robust natural population increase, meaning people are having a lot of babies. They will want to jump into the market, and a new home in a community of young families is always very appealing. Altus notes that *"less expensive lots are finding favour in the market with budget-focused buyers"* that want large homes on smaller lots. Altus also observed a shift in messaging from builders and developers away from discounts and incentives by the end of the year; the intent was to focus buyer's attention on the features of the homes, and away from comparison shopping for the best 'deals.' Altus also wrote about the townhouse market, which *"is expected to remain highly competitive, yet steady demand will provide stability, especially within the more value-focused market position."*

The greater focus on single-detached homes on smaller lots, value-priced row homes, and first-time buyers is the impetus behind my forecast of a 0.5% decline in new home prices in 2016. With developers dropping their moderate incentives by the end of the year, it is clear they are not yet in the desperate position of needing to slash prices. Expect continued new home sales activity this year among the most affordable product in each built form.

CONDO APARTMENT VACANCY RATE 2015 VS 2014



ANNUAL CHANGE IN AVERAGE CONDO APARTMENT RENTS 2015 VS 2014



Source: CMHC (Edmonton CMA)

05 OTTAWA CMA

KEY HIGHLIGHTS

OTTAWA CMA

1. **There were 4,972 housing starts in the Ottawa CMA in 2015, the lowest annual total since 1999. Slow new home sales activity in 2014 contributed to the depressed level of starts.**

   There were 4,019 new home sales in 2015, an increase of 4.3% over the multi-year low in 2014. With the uptick in new housing transactions in 2015, the consensus forecast for 2016 housing starts in the Ottawa CMA is 5,200, a 4.6% increase over 2015.

2. **Ottawa new home prices declined for the first time since 2009, dropping 2.5% annually. The Ottawa Real Estate Board reported that the average price of a resale unit in 2015 increased 1.9% over 2014.**

   Resale transactions increased 5.3% in 2015, culminating in a record December where the number of units traded improved by 10.2% in comparison to December 2014. The predominant motives behind the increase in sales activity were the pent-up demand from local buyers that waited until after the election was over, and new residents moving to Ottawa to accept positions with the new government. Every forecaster is calling for annual resale price growth of 2% or greater in 2016.

3. **The Ottawa market is not expected to see a lot of new condominium apartment launches in 2016 given the supply overhang of newly built condos. Additionally, slower activity has resulted in several new condo projects being cancelled or delayed due to high inventory.**

   Several high-profile Ottawa developers indicated that sales office traffic has picked up post-election, with renewed interest by first-time buyers. However, many young prospective purchasers have been more interested in affordable townhouses, as opposed to buying a condo. Others have delayed purchasing altogether to rent the abundant supply of upscale apartments. Rental demand remains very strong, with multiple rental apartment projects set to break ground in the Ottawa CMA in 2016.

4. **A recent survey of real estate industry professionals showed that Ottawa is ranked as the fourth-best real estate market in Canada. A growing technology sector is expected to boost employment and attract new start-ups.**

   A low Canadian dollar will help the competitiveness of firms in the Ottawa region. Beneficiaries include high-tech manufacturing and the growing software and mobile app sector, which will be further bolstered by improving U.S. demand. Central 1 Credit Union, the Conference Board of Canada and the Altus Group all expect job growth in 2016, which should support household formation and housing demand.

The Ottawa housing market may have finally turned a corner in late 2015 after a couple years of stagnant activity. Two main drivers of future housing demand have been identified: an emerging technology sector, and a renewed confidence following the recent election.

In the *Emerging Trends in Real Estate* report published by PwC and ULI, Ottawa is ranked as the fourth-best real estate market in Canada based on their industry survey results, behind Vancouver, Toronto and Montreal. That same document quotes Conference Board of Canada findings that Ottawa's business services sector is *"set to grow significantly faster,"* with the nation's capital *"buoyed by a strong technology sector and heightened investor interest in a number of Ottawa startups."* A similar sentiment was presented by the Credit Unions of Ontario and the Ontario Chamber of Commerce in a recent 2016 outlook report: *"a low Canadian dollar will help the short-term competitiveness of firms in the region. Beneficiaries include high-tech manufacturing and the growing software and mobile app sector, which will be further bolstered by improving U.S. demand and capital renewal."*

In BMO Capital Markets' Regional Labour Market Report Card, Ottawa ranks as the 19th best labour market in 2015, down from 10th in 2014. The drag on the economy was the result of *"fiscal restraint on the part of the federal government"* said Central 1 Credit Union (which is expected to change dramatically with the new political regime), which had *"offset an increasing active technology scene."* However, the tide is quickly shifting in Ottawa, and CMHC believes *"the labour force will see robust growth in 2016 and rise at an even stronger rate in 2017 partly spurred by recovering migration levels."* Central 1, the Conference Board of Canada, and the Altus Group all expect job growth in 2016, which should support household formation. It is clear that the real estate market was buoyed by this positive employment outlook during the second half of the year.

> **"Sales in the Ottawa region in recent months are up to their highest level since 2012, and with sales increasing faster than new listings, prices are rising after some slippage earlier in the year."**
> *— Central 1 Credit Union, October 2015*

The second-half improvement culminated in a December surge: there were 703 resale housing transactions in the Ottawa market, a new record high for the month, and an increase of 10.2% annually. Ottawa Real Estate Board (OREB) president David Oikle thinks the bump can be attributed to *"buyers moving to Ottawa to accept positions with the new government"* and pent-up demand from prospective homeowners *"who chose to sit on the sidelines until after the election was over."* OREB and many others believe the *"post-election enthusiasm"* was responsible for the strong final quarter in the resale housing market in Ottawa. *"Electoral success by the federal Liberals bodes well for federal government workers, given increased spending measures and deficit spending outlined in their electoral plan,"* writes Central 1 Credit Union.

> **"Improved prospects for federal hiring are likely to induce higher international and interprovincial migration inflows."**
> *— Credit Unions of Ontario & Ontario Chamber of Commerce, December 2015*

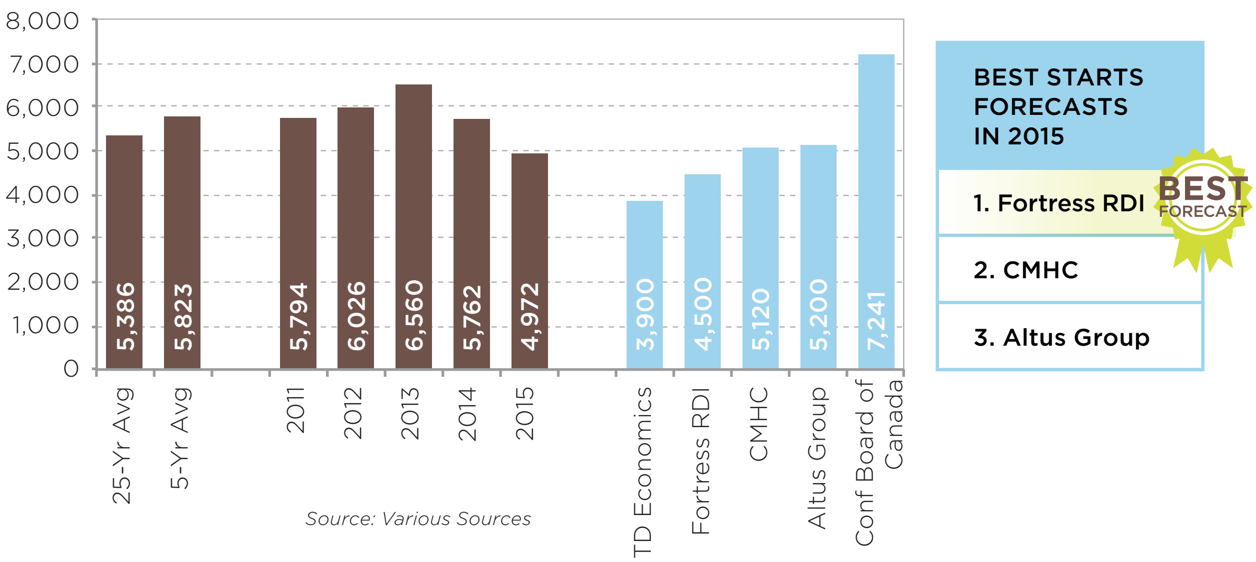
PMA Brethour Realty Group President Andrew Brethour believes the market rebound can be traced back to the election. Brethour, whose firm also tracks new homes sales data in Ottawa, said the absorption rate in the new market has been trending higher since October, a headway brought about from the *"Justin time bounce"* as he calls it. The vice president of one of Ottawa's top multi-family developers, Claridge Homes, identified the same shift, telling the Ottawa Citizen that he *"has seen an upswing in company sales since the federal election,"* which has *"brought certainty back into the marketplace."*

The renewed confidence and certainty in the housing market has resulted in increased activity among young buyers. Minto Communities Senior Vice President Brent Strachan told the Citizen that *"we're seeing a bit of pent-up demand from first-time buyers"* and *"cautious optimism"* overall. John Rogan of Royal LePage Performance Realty notes *"Ottawa has seen a big push from millennials purchasing their first homes."* Brethour added that *"the recovery is being led by the entry-level buyer scooping up value-based townhomes in all parts of the city."* Despite the strong interest from millennials in townhouses metro wide, and high-rise units downtown, Ottawa remains flush with condos overall. The supply issue and flat pricing have resulted in many first-time buyers delaying purchasing condos to buy residential houses says CMHC.

The shift back to ground-oriented housing was evident in the starts data in 2015. Over 70% of the starts were single-detached, semi-detached or townhouses, the highest share since 2011. Overall the 4,972 starts in 2015 were the lowest annual total since 1999, which was needed given the increasing number of completed and unabsorbed units. **Figure 29** presents data on long-run averages for housing starts in the Ottawa CMA, the annual totals over the past five years, and a number of forecasts for 2016 activity. Very slow new home sales activity in 2014 contributed to the depressed level of starts last year.

FIGURE 29

OTTAWA CMA HOUSING STARTS
Historical Averages, 2011 to 2015 Annual Totals, 2016 Forecasts



Source: Various Sources

The Fortress forecast of 5,100 starts for 2015 was the closest among the analysts and economists that looked at the Ottawa market, followed by CMHC and the Altus Group. The Conference Board of Canada had the worst forecast in 2015, and is calling for a whopping 7,241 starts in the Ottawa CMA in 2016. The other forecasts range from 3,900 to 5,200 starts. My forecast for 2016 starts of 4,500 is consistent with the trend in building permits and new home sales from 2015.

FORTRESS FORECAST:

4,500

HOUSING STARTS OTTAWA CMA

2016

Data Time Series	Actual 2015	Actual 10-yr Avg or 10-yr avg annual change	Forecast 2016 + Forecast Source
ECONOMIC INDICATORS - STATISTICS CANADA			
Population	1,001,197	12,767	10,012
Pop Annual Change	1.1%	1.4%	1.0%
			Conference Board of CAN
Employment (15 yrs +)	532,800	5,940	10,123
Emp Annual Change	-1.3%	1.2%	1.9%
			Conference Board of CAN
Unemployment Rate	5.7%	5.3%	6.2%
			Conference Board of CAN
NEW HOUSING MARKET DATA - CMHC			
Housing Starts	4,972	6,075	3,900
			TD Economics
Completions	5,933	5,952	5,800
			Fortress RDI
Completed & Unabsorbed	897	411	
Under Construction	4,926	5,348	
Median Single-Detached Price	$475,000	$13,500	$486,875 *
Annual Change	-2.1%	3.5%	2.5%
			CMHC
Rental Vacancy Rate	3.5%	2.3%	2.0%
			CMHC
Avg Rent 2 Bedroom Rent	$1,174	$25	$1,200 *
Annual Change	3.8%	2.5%	2.2%
			CMHC

* *Estimate based on % increase*

Despite the housing starts forecasts calling for further declines in new housing activity, every forecast for new and resale house prices call for positive gains in 2016. Outside of PMA Brethour's bullish estimate of 5% price growth in 2016, all of the resale house price forecasts call for increases of 2.0% to 2.8% (see **Figure 30**).

"Higher demand has led to a rebalancing of market conditions this past year, and is expected to underpin price growth of around 2.5 to 3.0 per cent," writes Central 1 Credit Union. According to the Ottawa Real Estate Board, resale transactions increased 5.3% in 2015 and the average unit price increased 1.9% over 2014; the average condo decreased 1.5% over 2014. The average home spent 86 days on the market.

The OREB average price showed higher growth than the benchmark price, which attempts to control for the composition of units in the sample. Ottawa's MLS House Price Index overall increased by 0.6% in December: a 1.1% increase for single-family homes and a 0.9% decline for condominium apartments. Interestingly, the Teranet/National Bank House Price Index showed an annual decline of 2.1% in 2015, while the Brookfield RPS data indicated an increase of 2.4%.

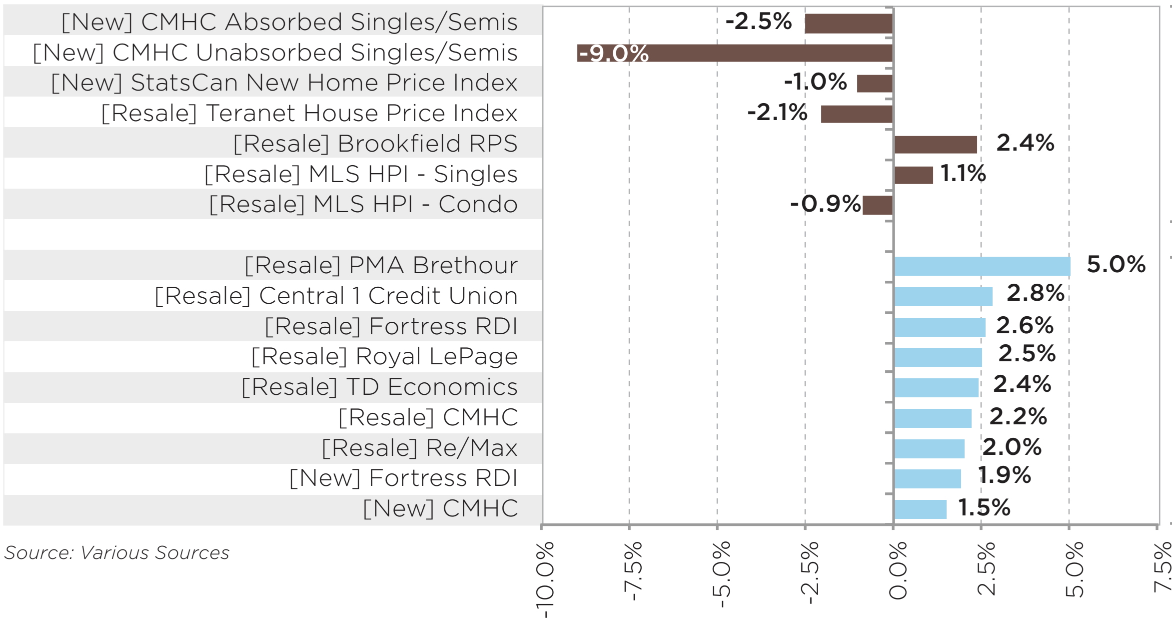
The resale results were more reflective of current market conditions, as new home prices reported by CMHC are lagged, reflecting absorbed homes that actually sold in previous periods. The average price of a new single-detached or semi-detached home declined by 2.5% annually, while completed and unsold singles and semis declined by 9%. The big decline in the asking prices of standing inventory is likely a combination of a higher share of smaller units in outer suburban areas, and some price reductions in other areas. The Statistics Canada New Home Price Index declined by 1% year-over-year. Both CMHC and Fortress anticipate new home prices rising in 2016, moving back to 2014's record-high level of $514,000.

The record price of newly absorbed single-detached and semi-detached housing in the Ottawa CMA in 2014 is ironic given new home sales were the worst in ten years that year. There were 4,019 new home sales in 2015, an increase of 4.3% over 2014 according to data from PMA Brethour. Transactions in the new home market are expected to increase by more than 7% in 2016 according to Brethour (to 4,300 to 4,500 sales). This would still result in volumes below the ten-year average of 4,832 sales.

FIGURE 30

ANNUAL HOUSE PRICE CHANGES (NEW & RESALE)

2015 Price Growth (Actual), 2016 Forecasts: Ottawa CMA



Source: Various Sources

Despite the expected pick-up in new home sales activity, the Ottawa market is not expected to see a lot of new condominium launches given, as RBC Economics puts it, a *"plentiful supply of newly built condos"* and the reality that several new condo projects have been *"cancelled or delayed due to high inventory"* per Re/Max. There is enough confidence in the market for a couple of developers to bring huge projects to market in 2016; a 30-storey tower is planned for Little Italy and a 32-storey tower in Hintonburg are set to launch this year according to an Ottawa Citizen article. A key factor preventing builders from launching projects is the *"temporary tapping out of the investor market,"* says John Thomas of Azure Urban Developments — the key word in that sentence being 'temporary.' In Re/Max's 2016 Housing Market Outlook, they conclude that *"millennial buyers are increasingly entering Ottawa's real estate market by purchasing newly-built condos in the city centre. These buyers often choose walkable neighbourhoods with good amenities over square footage."* CMHC noted in their Fall 2015 Housing Market Outlook that *"high-rise starts are here to stay in the Ottawa skyline as demographics have been playing a large role in this shift toward more multi-family dwellings. Sixty per cent of Ottawa households are small one to two-person households that are more likely to demand smaller more manageable accommodations."*

The demand for small, affordable units remains strong, but likely not strong enough to peak investor interest yet. The desire for manageable residential spaces, coupled with uncertainty in the condominium market, has shifted developers' focus to rental apartments. Brigil Construction is planning two new 14-storey rental towers, while Urban Capital and Tamarack Home are converting their Smart House project to rental tenure. Our Bronson project with Lamb Development Corporation will likely be built as a rental project as well, depending on market conditions. CMHC indicates that Ottawa market circumstances currently favour the rental market: *"employment of the 15-24 age group has strengthened, increasing this group's rental demand,"* adding *"rising student registration, especially among international students, will also support rental demand of these younger age cohorts."*

Data from CMHC shows that the average rental rate in the Ottawa CMA increased 3.3% in 2015, the largest increase in six years, and rents have increased in 17 of the last 18 years. CMHC is forecasting a decline in vacancy rates in 2016, and another increase in average rental rates this year.

With improving rental conditions, the condo market activity will eventually pick up, but the supply overhang on the market may take some time to clear up. On the ground-oriented side of the ledger, it appears the market may have finally turned a corner, but it may take a couple months to ascertain if the big improvement at the end of the 2015 housing market was a temporary or fleeting jump due to Trudeau-mania or the start of a V-shaped recovery. The consensus appears to be for a U-shaped recovery from the conservative and careful Ottawa buyers.

06

WINNIPEG CMA

KEY HIGHLIGHTS WINNIPEG CMA

1. **There were 4,400 housing starts in 2015 in the Winnipeg CMA, an increase of 3.6% annually, topping the five-year average of 4,150. Almost 40% of the starts in 2015 were for units with rental tenure, the highest rate in three decades.**

   Net migration to Winnipeg increased 17% in 2014, which helped boost demand for residential housing, especially rental apartments. The average rental rate in the Winnipeg CMA increased 3.8% in 2015, and rental rates have increased by 3% or more in 12 of the last 14 years. This rapid increase has sparked demand from investors in Winnipeg pre-construction condominiums.

2. **The average single-detached and semi-detached house in the Winnipeg CMA increased 1.4% annually in 2015 per CMHC data, while Statistics Canada reports new home prices rose by 1.1% last year.**

   Despite a slight overhang of unsold and completed housing supply, both new and resale house prices increased in 2015. Brookfield RPS data indicated that resale housing increased by 1.8% over 2014, while the WinnipegREALTORS Association showed an increase of about 1.7% annually. There was even a healthy boost in sales above $1 million, which is a great sign, as luxury homes trade much more frequently in strong markets. The majority of forecasters are calling 2016 resale price growth of 1.4% to 2.5%.

3. **Winnipeg has one of the most diverse economies of any major city in Canada, slotting higher than Toronto, Edmonton, Regina, Calgary, and Ottawa-Gatineau in a ranking of the diversity levels within municipalities' economic structure.**

   Less than 0.2% of the labour force in the Winnipeg CMA is employed in the oil and gas industry, and the decline in energy markets and the Canadian dollar has been a net positive for the metro area. Two more significant segments of the Winnipeg economy are manufacturing and transportation, with the former expected to benefit from the lower dollar in 2016, while the 'transportation and warehousing' sector took advantage of lower gas prices in 2015 and employment increased by 5%.

4. **The Winnipeg CMA added 13,700 jobs in 2015, a major improvement over the small decline that occurred in 2014. The average annual increase in the CMA labour force was 3,800 between 2004 and 2013, so 2015's jump was over three times the long-run average.**

   Winnipeg experienced high after-tax income growth in 2015, and full-time employment growth has been rising, increasing personal disposable income and supporting home price valuations. In 2016, the Conference Board of Canada expects employment growth of 2.1% in the Winnipeg CMA, tied with the Vancouver CMA as the second highest among metro markets in Canada behind Toronto's 2.5%.

There seems to be a perception that Manitoba must be due for an economic decline because of its proximity to Alberta and its oil-related woes, but the data doesn't support that thesis. According to Manitoba Finance, the estimated 2% GDP growth in Manitoba in 2015 was *"tied for second best among provinces and above the national average of 1.2%."* On the energy front, TD Economics writes that *"the province enjoys more economic diversity than its prairie trading partners."* Economic Development Winnipeg makes a similar observation on the municipal level: *"Winnipeg has one of the most diverse economies of any major city in Canada"* slotting higher than Toronto, Edmonton, Regina, Calgary, and Ottawa-Gatineau in a ranking of the diversity levels within municipalities' economic structure by the Conference Board of Canada (from 2014). Winnipeg's top industries include aerospace, finance and insurance, transportation, agribusiness, information technology, and apparel industries according to Economic Development Winnipeg — none of these industries would be negatively impacted by an energy-sector slowdown.

The reality is that the labour force category of 'forestry, fishing, mining, quarrying, oil and gas' employs approximately 1,000 people in the Winnipeg CMA per data from Statistics Canada, or just 0.2% of the nearly 425,000 metro-level workers. This category actually added 200 jobs in 2015! Manufacturing is 40 times larger and employs just under 10% of the CMA population. Despite a slight decline last year, the low Canadian dollar will ultimately help the manufacturing industry once a full adjustment to a lower loonie occurs. One of the fastest-growing industries in the Winnipeg CMA (5% increase in employees last year), is 'transportation and warehousing.' This industry sector now accounts for 6.5% of the labour force, and has taken advantage of cheaper gas. **The drop in the price of oil has likely been a net positive for the province and the Census Metropolitan Area.**

Overall, the Winnipeg CMA added 13,700 jobs in 2015, a major improvement over the small decline experienced in 2014. The average annual increase in the CMA labour force was 3,800 between 2004 and 2013, so 2015's jump was over three times the long-run average. BMO Capital Markets ranked Winnipeg as having the tenth-best labour market in Canada in 2015, up from 15th in 2014, while Desjardins Economic Studies showed in an October report that Winnipeg had the second-highest after-tax income growth in Canada.

> **"Full-time employment growth has been rising in Winnipeg, increasing personal disposable income and supporting home price valuations. As well, the pool of first-time home buyers has also increased."**
> *— CMHC, January 2016*

In addition to the major increase in employment, which would support the need for almost 10,500 housing units (based on the historical relationship between these variables), population continued to grow in 2015, which is also supportive of household formations. *"Winnipeg's economic growth is persuading more people to stay put, it appears, as domestic out-migration to other provinces is falling,"* writes PwC/ULI in their 2016 Emerging Trends report: *"Winnipeg is experiencing a rise in new migrants from across Manitoba and around the world."* CMHC expects net migration to *"ease after increasing 17% in 2014, but will nonetheless remain near historical highs."* The Conference Board of Canada expects the population to grow by 1.3% in the Winnipeg CMA in 2016, compared to 1.4% in 2015.

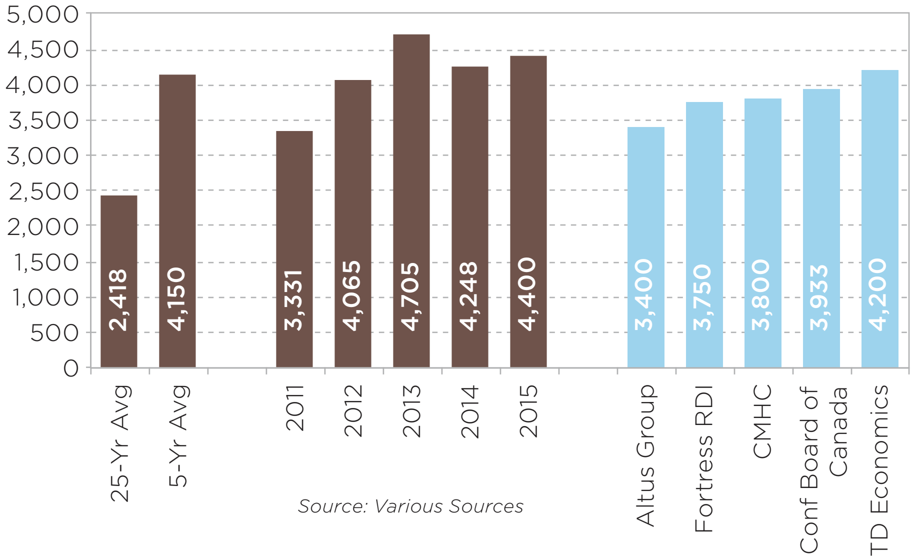
> **"Employment gains and increased immigration to the province have led to more demand in Winnipeg's housing market over the past few years, a trend that is expected to continue into 2016."**
> *— Re/Max, December 2015*

The 1.4% population growth in 2015 translates into an increase of nearly 11,000 residents in the metro area, which based on the historical past relationship would translate into the need for just over 5,200 new housing units. There were 4,400 housing starts in 2015 in the Winnipeg CMA, an increase of 3.6% annually, and above the five-year average of 4,150 annual construction starts. **Figure 31** presents data on annual housing starts over the past five years, historical averages, and various 2016 forecasts.

FIGURE 31

WINNIPEG CMA HOUSING STARTS

Historical Averages, 2011 to 2015 Annual Totals, 2016 Forecasts



Source: Various Sources

BEST STARTS FORECASTS IN 2015

1. **Conference Board of Canada**
2. **CMHC**
3. **TD Economics**

I had the worst forecast for 2015, calling for just 3,450 starts in 2015, as I expected to see builders ease up on production due to job losses in 2014, uncertainty in the Canadian economy, and growing unsold inventory. The Conference Board of Canada had the closest forecast in 2015 at 4,266, followed closely by CMHC at 4,225, as builders moved forward despite the supply threat. There were improvements in the absorption rate at completion for single-detached, semis, and ownership apartments in 2015 over 2014. However, the 61% absorption rate at completion for all product types is much lower than most major markets, and has resulted in the highest level of completed and unabsorbed supply in over 25 years in the Winnipeg CMA.

The good news regarding the ownership housing supply problem is that **38% of the starts in 2015 were for units with rental tenure.** Rentals were started at *"the fastest pace in three decades"* proclaimed the Winnipeg Free Press. Lai Singh Louie, CMHC's regional economist for the prairies said, *"with the rise in rental starts, this tells us rental investors feel that demand is sufficient and rents are enough to take the risk of building rental units."* The average rental rate in the Winnipeg CMA increased 3.8% in 2015, and **rental rates have increased by 3% or more in 12 of the last 14 years!** At Fortress, we were surprised when we launched our SkyCity Winnipeg project in the downtown area, as nearly all of our "investor-sized" units sold on the opening weekend. Tenants downtown are paying relatively high rents in buildings with limited views and amenities.

FORTRESS FORECAST:
3,750
HOUSING STARTS
WINNIPEG CMA
2016

Data Time Series	Actual 2015	Actual 10-yr Avg or 10-yr avg annual change	Forecast 2016 + Forecast Source
ECONOMIC INDICATORS - STATISTICS CANADA			
Population	793,428	8,037	10,315
Pop Annual Change	1.4%	1.1%	1.3%
			Conference Board of CAN
Employment (15 yrs +)	425,300	4,610	8,931
Emp Annual Change	2.3%	1.2%	2.1%
			Conference Board of CAN
Unemployment Rate	5.6%	4.9%	5.2%
			Conference Board of CAN
NEW HOUSING MARKET DATA - CMHC			
Housing Starts	4,400	3,518	4,200
			TD Economics
Completions	4,182	3,178	4,325
			Fortress RDI
Completed & Unabsorbed	815	392	
Under Construction	4,606	2,790	
Median Single-Detached Price	$415,000	$18,500	$419,980 *
Annual Change	-5.7%	6.2%	1.2%
			CMHC
Rental Vacancy Rate	2.9%	1.7%	3.0%
			CMHC
Avg Rent 2 Bedroom Rent	$1,043	$36	$1,074 *
Annual Change	2.8%	4.3%	3.0%
			CMHC

* *Estimate based on % increase*

Manitoba Home Builders President Mike Moore told the Free Press that the high price of single-detached homes are driving people into condominiums and rental apartments. Moore blames changes to local building codes and increased permit fees for the rise in new home prices. The average single-detached and semi-detached house in the Winnipeg CMA increased 1.4% annually in 2015 per CMHC data, while StatsCan reports new home prices rose by 1.1% last year. The average price of unsold singles and semis declined 4.7% in 2015, suggesting some developers may be lowering the prices of their unsold inventory, or there was a big increase in completions of smaller homes. **Figure 32** looks at new and resale price changes year-over-year and projected annual changes for 2016 from various sources.

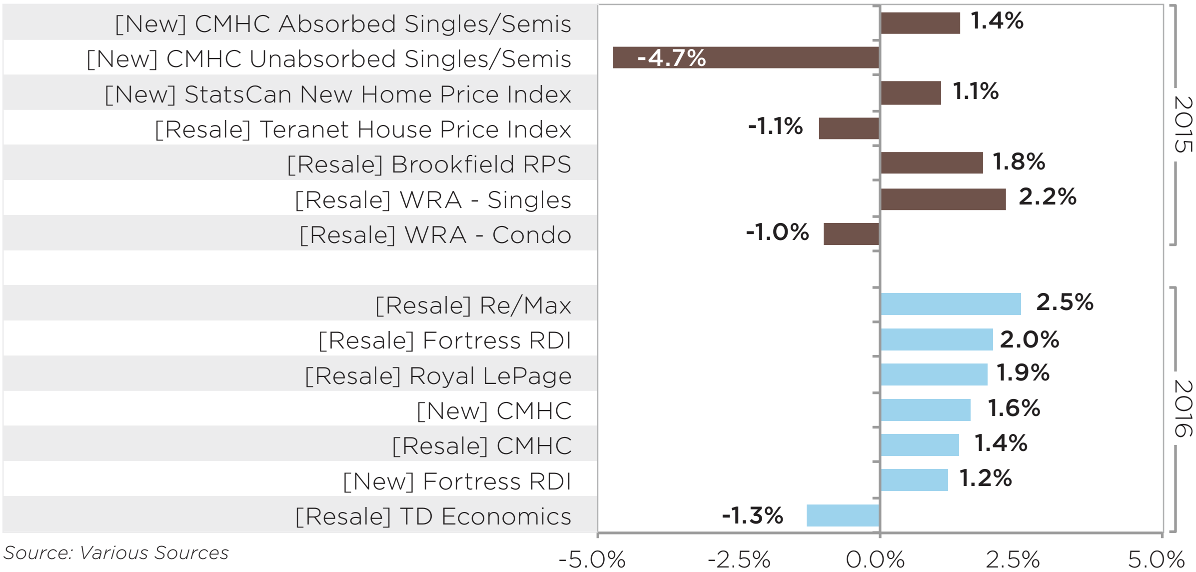
In the resale market, Teranet showed a slight decline annually, while Brookfield RPS showed an increase of 1.8% over 2014. According to the Royal LePage House Price Survey, Winnipeg prices were up 1.2% annually in 2015. Lastly, the WinnipegREALTORS Association showed an increase of about 1.7% annually in the existing home market, with the average price of a single-detached home increasing 2.2% annually, and the median price increasing 3.1%. The higher growth in the median price in relation to the average is likely due to more higher-priced homes selling. *"This year saw a healthy increase in sales of homes prices $1 million and above, which may be due to more wealthy residents choosing to stay in the city rather than relocate to British Columbia, Alberta or Ontario,"* remarked Re/Max late last year. Re/Max is the most bullish on Winnipeg for 2016, calling for resale prices to increase by 2.5%.

Overall, the resale housing market is fairly balanced with most sources expecting 1% to 2% price growth for the new and resale housing markets in 2015. TD Economics warned that listings in the market were on the rise and the sales-to-listings ratio was at its lowest level since the early 2000s, however, sellers got 98% of their asking price overall in the resale market in 2015, while single-detached houses sold in a respectable 33 days on average (condos took longer at 49 days). CMHC expects modest increases in resale transactions and prices, but another significant increase in average rents of 2.9% annually.

Fewer starts in 2016 is a good thing for the Winnipeg CMA, which is suffering from an overhang of unsold supply, however, it has not impacted the resale market in any way, as all but one of the data sources indicated prices

FIGURE 32

ANNUAL HOUSE PRICE CHANGES (NEW & RESALE)
2015 Price Growth (Actual), 2016 Forecasts: Winnipeg CMA



Source: Various Sources

increased in 2015. Employment was extremely strong last year and many of those newly employed individuals will start to look for a home this year, if they haven't already. In 2016, the Conference Board of Canada expects employment growth of 2.1% in the Winnipeg CMA, tied with the Vancouver CMA as the second highest among metro markets in Canada behind Toronto's 2.5%. The Altus Group is forecasting job growth of 4,600, below the massive gain in 2015, but still above the long-run average. With those data forecasts in mind, another above-average year should be expected for Winnipeg's housing market in 2016.

WINNIPEG CMA CONDOMINIUM RENTAL MARKET

	2014	2015	Change
Total Condo Universe (Units)	14,345	15,994	753
Condo Rental Universe (Units)	2,707	3,011	304

Estimated Investor Share of New Supply: **40.4%**

Source: CMHC

HIGHLIGHTS

ARTICLES BY BEN MYERS

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RENX.CA

Excerpt from RENX.ca

INVESTORS ARE RESHAPING THE HIGH-RISE CONDO MARKET IN TORONTO

September 2015

Despite record condominium apartment completions, the condo rental market in Toronto remains red hot. However, developers continue to shrink units to allow investors to purchase them at a price where they can rent them out for a profit, and in theory that trend can only be sustained for so long.

Institutional capital has recognized the insatiable demand for high-quality downtown rentals, the quandary that developers and their private investors will soon be faced with as it relates to small unit sizes, and are looking to get involved in rental apartment development. With lower return metrics and longer-time horizons for institutional owners and many of their partners, new purpose-built rental projects will feature slightly larger average unit sizes and professionally managed buildings. Will an onslaught of these projects choke off rental demand for micro-suites owned by private landlords?

BUZZBUZZHOME

Excerpt from BuzzBuzzHome.ca

ARE WE BUILDING TOO MANY HOMES IN CANADA?

September 2015

It is very hard to tell if we are building the right number of houses in Canada. We need to consider immigration levels, how many children people are having, how long boomers are going to stay in their big empty houses or millennials in their downtown condos, what level of vacancy is acceptable for landlords, the level of vacation and cottage home demand, recessionary impacts on buying decisions, how long young adults live with their parents, fluctuating student housing demand, and the accuracy of the data being collected.

I'm reading an interesting book right now called The Next 100 years, A Forecast for the 21st Century. The author, George Friedman, believes a major disruptive force will be a population bust. Declining birth rates and a major flattening out of the average lifespan will curb population growth and potentially lead to population declines. It will be interesting to see if something similar happens in Canada and how it will impact the housing market.

TORONTO SUN

Excerpt from Toronto Sun

NOT BUILDING ENOUGH HOMES MEANS HIGHER PRICES

October 2015

The major increase in new downtown high-rise condos, has been more than offset by the major decrease in low-rise housing available in the GTA. In fact, according to data from RealNet Canada Inc, the number of unsold low-rise (single-detached, semi-detached and row) housing units was just 4,550 as of the end of July 2015, a 37% decrease annually. By comparison, there was over 17,000 new low-rise housing units available to purchase 10 years ago. This lack of inventory has caused new low-rise house prices to skyrocket to approximately $806,000 overall as of July, with new single-detached price hitting $975,000. Looking for something already built and ready to move into? Well the average price of a newly built and unsold single-detached house in the Toronto area is over $1,660,000!

GTA NEW CONDO GUIDE

Excerpt from GTA New Condo Guide

ANOTHER DAY, ANOTHER WARNING. SHOULD YOU PAY ATTENTION TO THESE HOUSING MARKET STUDIES?

November 2015

In November I had a chance to speak at The Great Canadian Housing Conference hosted by Veritas Investment Research and hosted by Globe and Mail journalist Tamsin McMahon. Speakers from Diamondcorp and Mattamy Homes suggested that the introduction of the Greenbelt in the GTA has driven up low-rise house prices by removing developable land, and forced many buyers to live in high-rise apartments due to affordability concerns. The low supply of ground-oriented housing is driving up prices for single-detached, semi-detached and row homes. Sean Hildebrand of Urbanation pointed out that 94% of the units in condominium apartment buildings that are occupied and not registered have already been sold, and 87% of the units under construction are sold. I added that there shouldn't be widespread concern over the high-rise condo market, as many developers are leasing out their completed and unsold supply due to super high rental demand.

COLLECTIONS MAGAZINE
by Harvey Kalles

Excerpt from Collections Magazine by Harvey Kalles

5 LIES YOU'RE BEING TOLD ABOUT THE TORONTO HOUSING MARKET

December 2015

Although it is unknown how many buyers from outside of Canada are buyer Toronto real estate, we can safely say that they are not keeping their units vacant. Foreign buyers purchase homes here for their relatives or children, or buy them to rent them out. Domestic buyers also purchase homes to rent them out – the nationality of the buyer is really irrelevant. If investors are buying a lot of houses, you may see prices go up more than 'typical'. In addition, we would never know the price that a domestic buyer would have paid for the same house? 1% less, 2% less. Lastly, foreign buyers in the pre-construction condominium apartment market are likely helping prices stay reasonable. They buy early, allow developers to build bigger buildings, and help create housing supply. The additional supply has prevented condominium housing prices from rising as quickly as low-rise house prices.

HUFFINGTON POST

Excerpt from Huffington Post

TORONTO AND VANCOUVER REAL ESTATE IS UNDERVALUED - GLOBALLY SPEAKING

December 2015

So maybe high price-to-rent and price-to-income ratios don't signal overvaluation, too much property speculation, or impending doom. Perhaps they signal the ascension of Toronto and Vancouver into the highest of global ranks. This revelation won't make you feel any better if you're in an affordability crunch, but may give prospective homebuyers on the fence some comfort that these markets are viewed by international investors as global destinations with long-term value, so their home price won't crash.

With each successive ranking from a major publication that puts Toronto and Vancouver as top cities to live in the world, foreign investors compare the value of real estate in Canada's major markets to theirs, and see great value.

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BEN MYERS

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Ben Myers is an industry-recognized residential housing analyst with 15 years of private sector real estate research experience in Canada and the United States. He specializes in single-family and condominium apartment market feasibility studies on both a macroeconomic and site-specific level. He joined Fortress Real Developments in 2013, assuming the role of Senior Vice President, and is one of the five executives at the firm.

Fortress is a real estate development and investment firm that builds commercial, mixed-use, ground-oriented residential, and high-rise apartment projects across Canada. The firm sources equity capital on behalf of their entrepreneurial or operating partners, and Ben helps underwrite those developments from a revenue and product perspective. Over the past three years, Ben has also been heavily involved in VIP sales, marketing, design, and corporate branding at Fortress.

Ben is an in-demand housing market observer and commentator, in 2015 he was a keynote speaker at ULI's prestigious Emerging Trends event, a panel moderator at a BILD Young Leaders event, a presenter at Veritas' Great Canadian Housing Conference and MCAP's Fall Breakfast Seminar, and a guest on CityAge Toronto's city building panel. He discussed Canadian housing valuation on BNN, general real estate and investment conditions on Global TV, and foreign condo buyers on CFNW radio in Vancouver. Ben also consulted with Statistics Canada on their new condominium price index.

The media regularly seek out Ben's opinion, his TV experience also includes appearances on CBC's The National, CTV's Canada Am, and CP 24, he has been a radio guest on CFRA in Ottawa, CJOB in Winnipeg, and Newstalk 1010 and Zoomer Radio in Toronto. Additionally, he has been quoted in the Wall Street Journal, Globe and Mail, Financial Post, Money Sense magazine, and had a weekly feature in the Toronto Star. Ben has spoken at the Canadian Real Estate Investor Forum, The Property Show, The Condo Conference, World Money Show, Real Estate Investment Network, and OHBA's economic forum, among many other industry events.

Ben conceived and created two well-read industry reports, Urbanation's UrbanRental report during his tenure at the helm of Toronto's leading condominium research firm, and Fortress' Market Manuscript. The blog posts summarizing the two Market Manuscript reports released in 2015 were viewed online over 5,000 times from users in 50 countries.

Ben writes regularly for the Huffington Post, Toronto Sun, New Condo Guide, RENx, Buzz Buzz Home and the Fortress blog. He studied economics at UTA and UBC, as well as real estate finance at MIT. He is a licensed mortgage agent with Building and Development Mortgages Canada Inc.