

# Is There a Bubble in the Toronto Housing Market?

Will Dunning

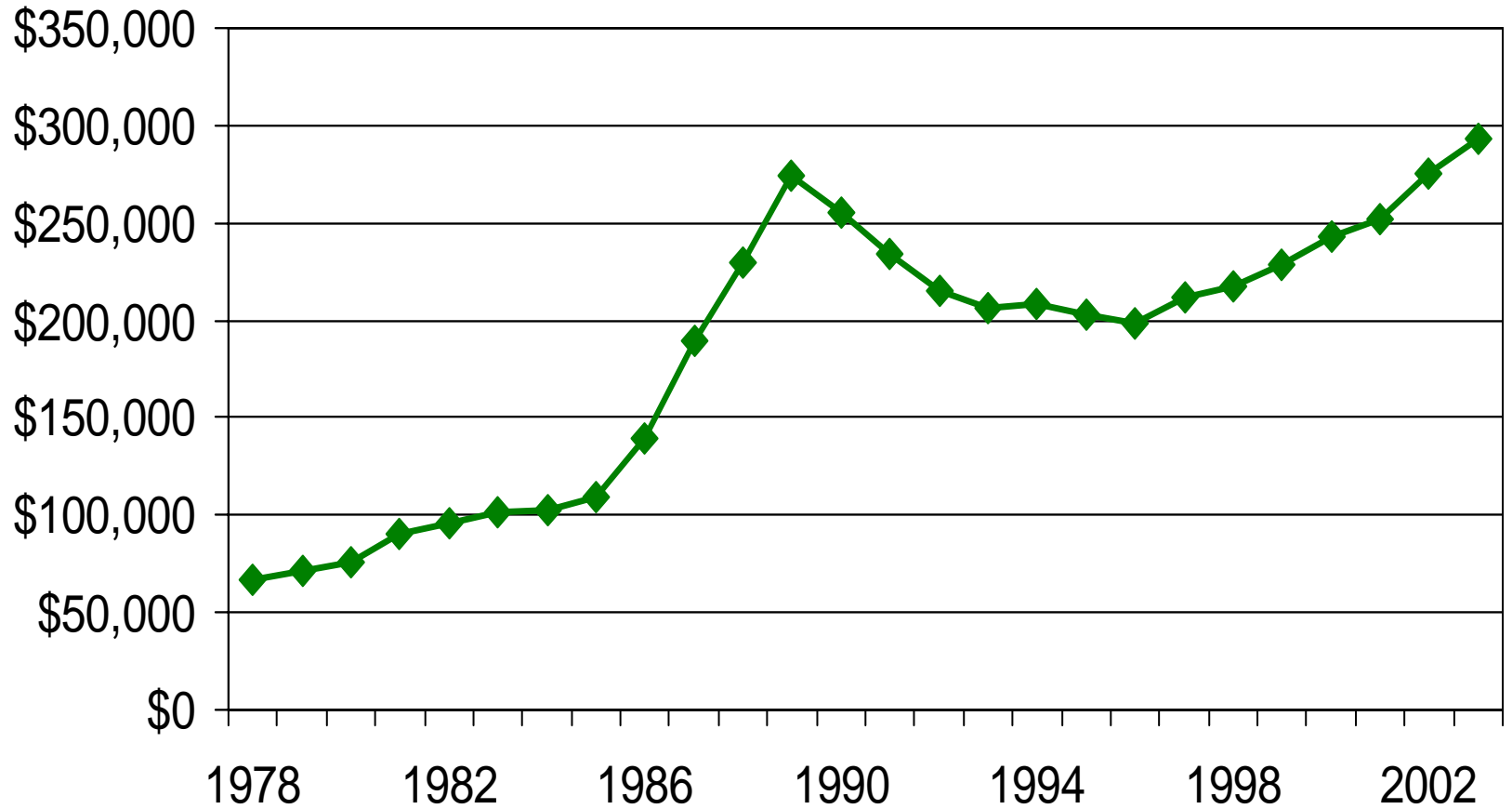
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# GTA Average House Price



Source: Toronto Real Estate Board

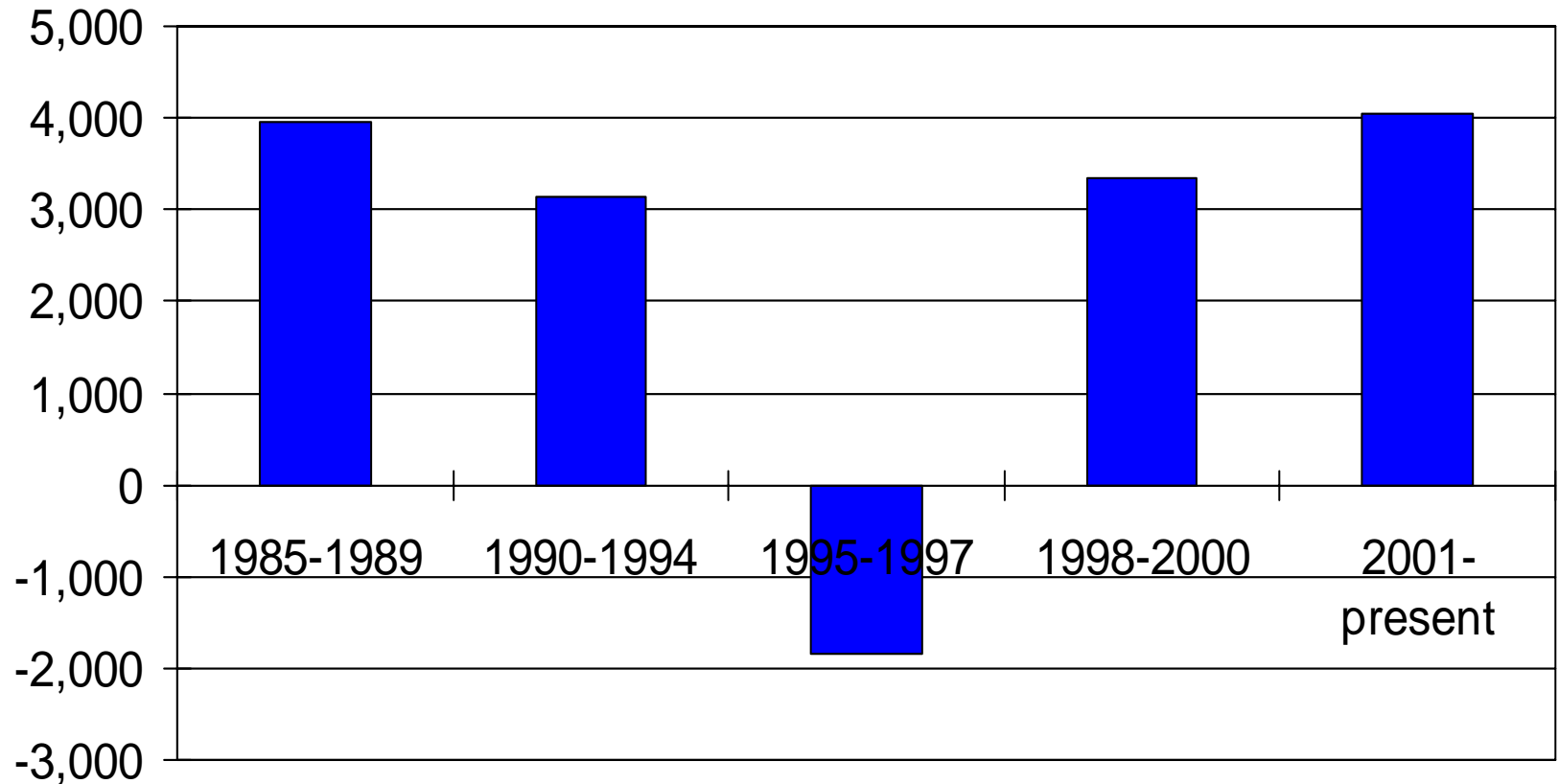
# Elements of a Bubble

- Expectations of price increase are a primary motivator
- Expectations unrealistic
- Prices divorced from “value”
- Speculation/flipping
- Panic buying
- Little appreciation of risk
- Creation of a self-contained feedback loop & self-fulfilling expectations

# A Weak Investment Motive is Healthy

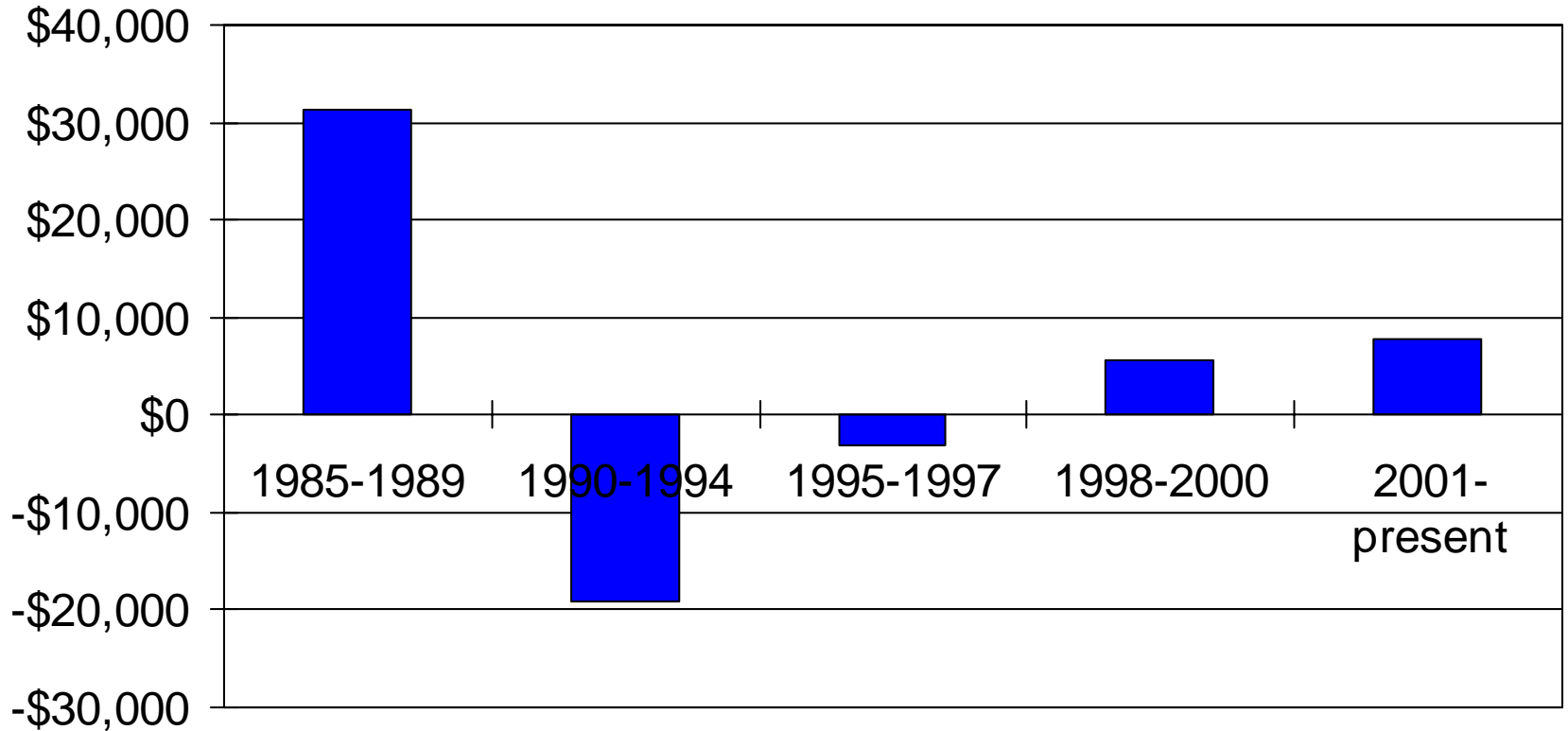
- Real property is an inflation hedge
- Living costs match income flows
- Principal residences may be tax-favoured
  
- Investment motive appears to be suitably weak at present

# Impact of \$10,000 Real Price Increase on Annual Sales



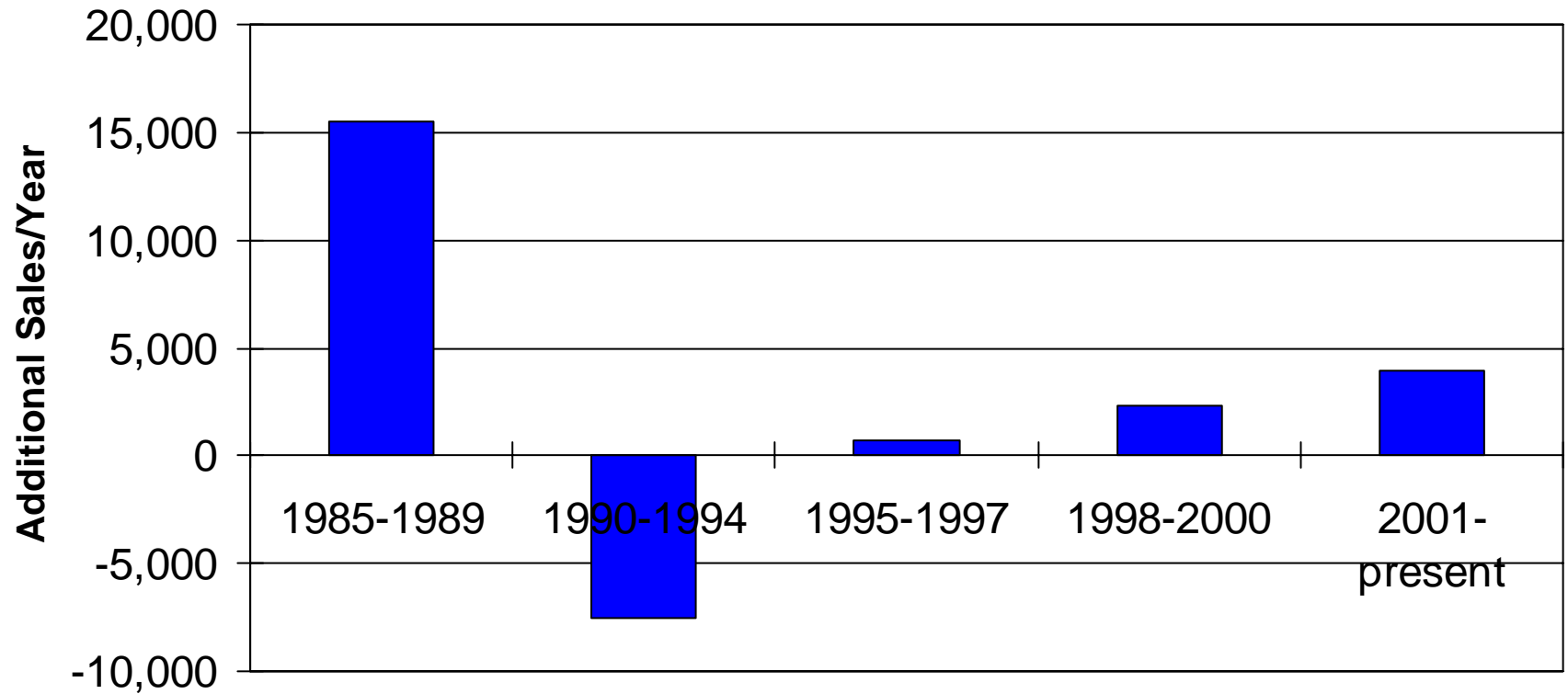
Source: Will Dunning Inc.

# Annual Average Price Increase in “Real” Dollars



Source: Will Dunning Inc.

# Impact of “Real” Price Increase on Annual Sales

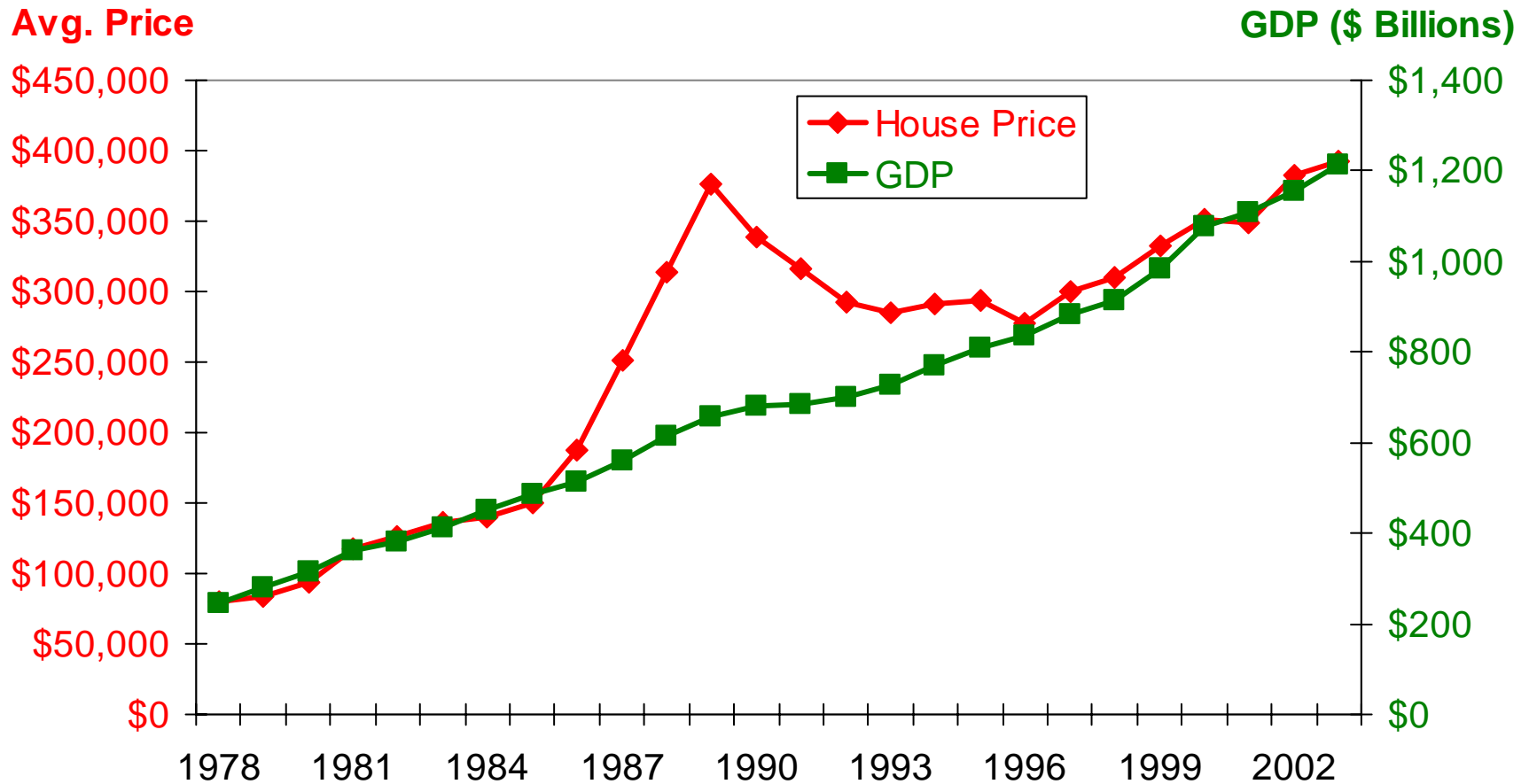


Source: Will Dunning Inc.

# What are Realistic Expectations About Value Growth?

- David Ricardo – 1817. Economic growth is related to land value increases in excess of inflation.
- In an expanding urban area, value growth exceeds inflation inside the frontier.
- Ricardo's theory might imply that “intra-marginal” house price growth might match economic growth.

# Central Toronto Average House Price Tracks Canada's GDP

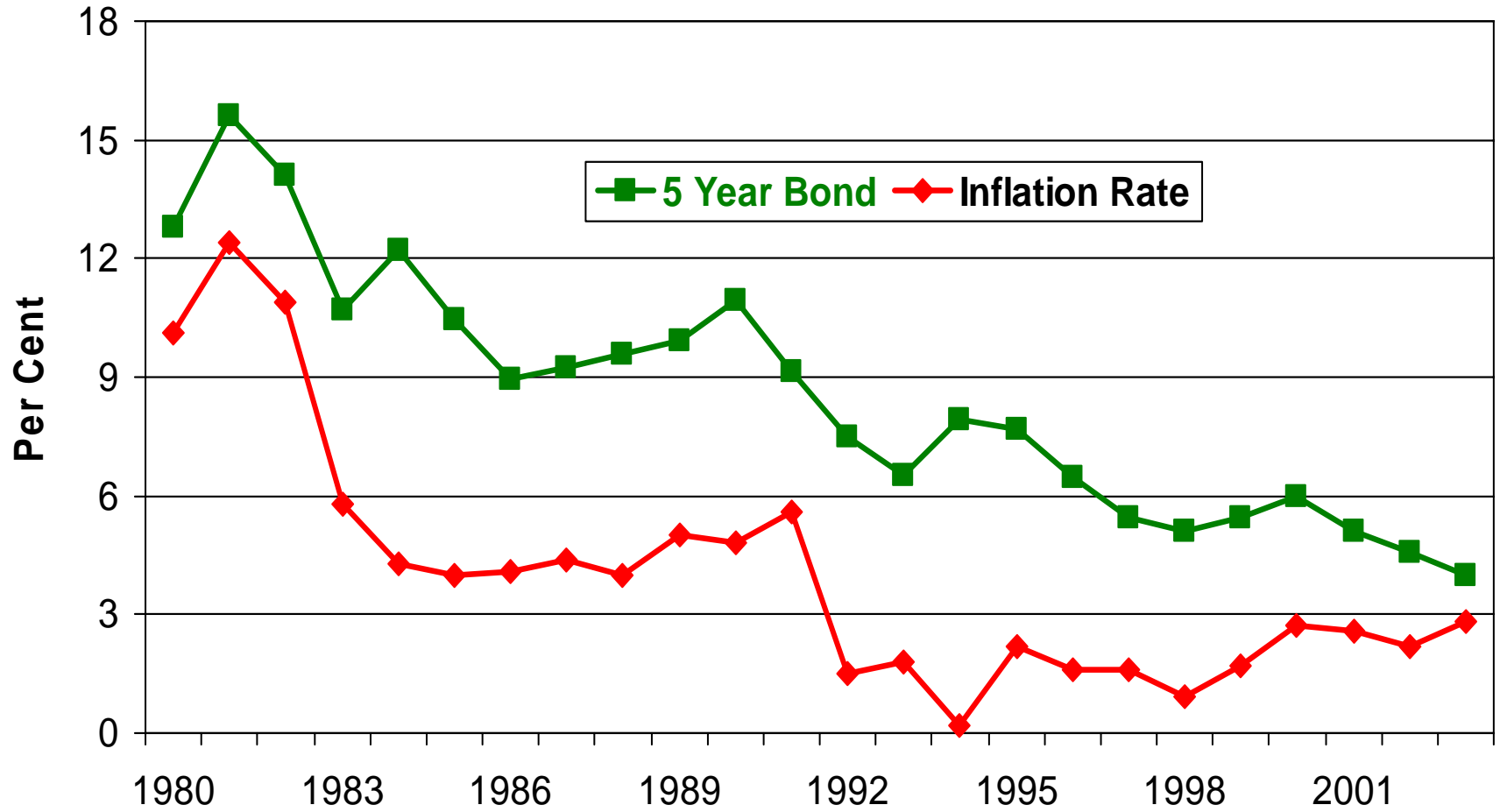


Sources: TREB/Statistics Canada

# Do House Prices Match “Use Value”?

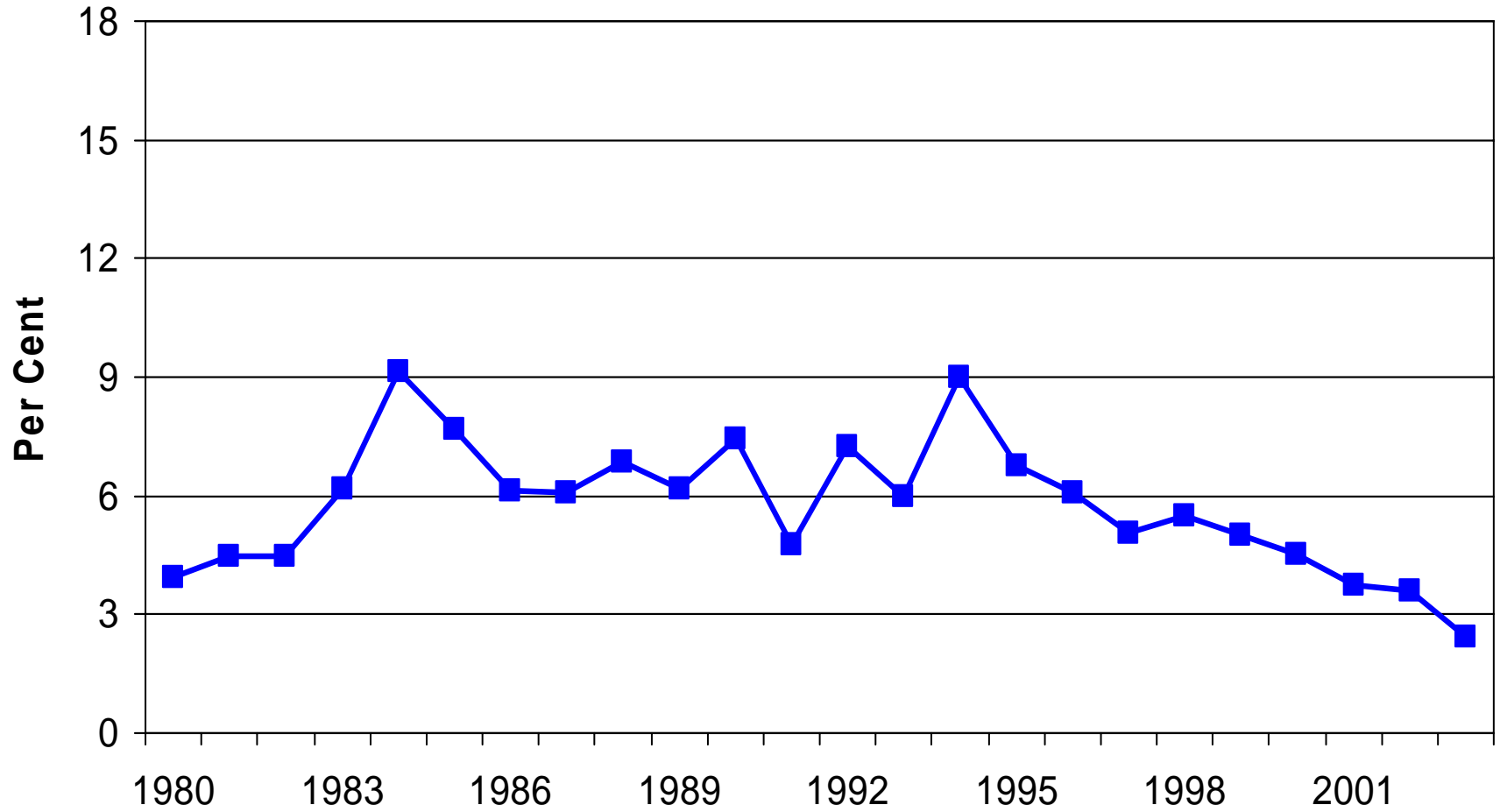
- What is “use value”?
- Value that results from enjoyment, convenience, etc.
- NPV of stream of annual use values.
- If assume annual use value is constant in real terms, total “Use Value” is a function of the “real” discount rate.

# Bond Yields and Inflation



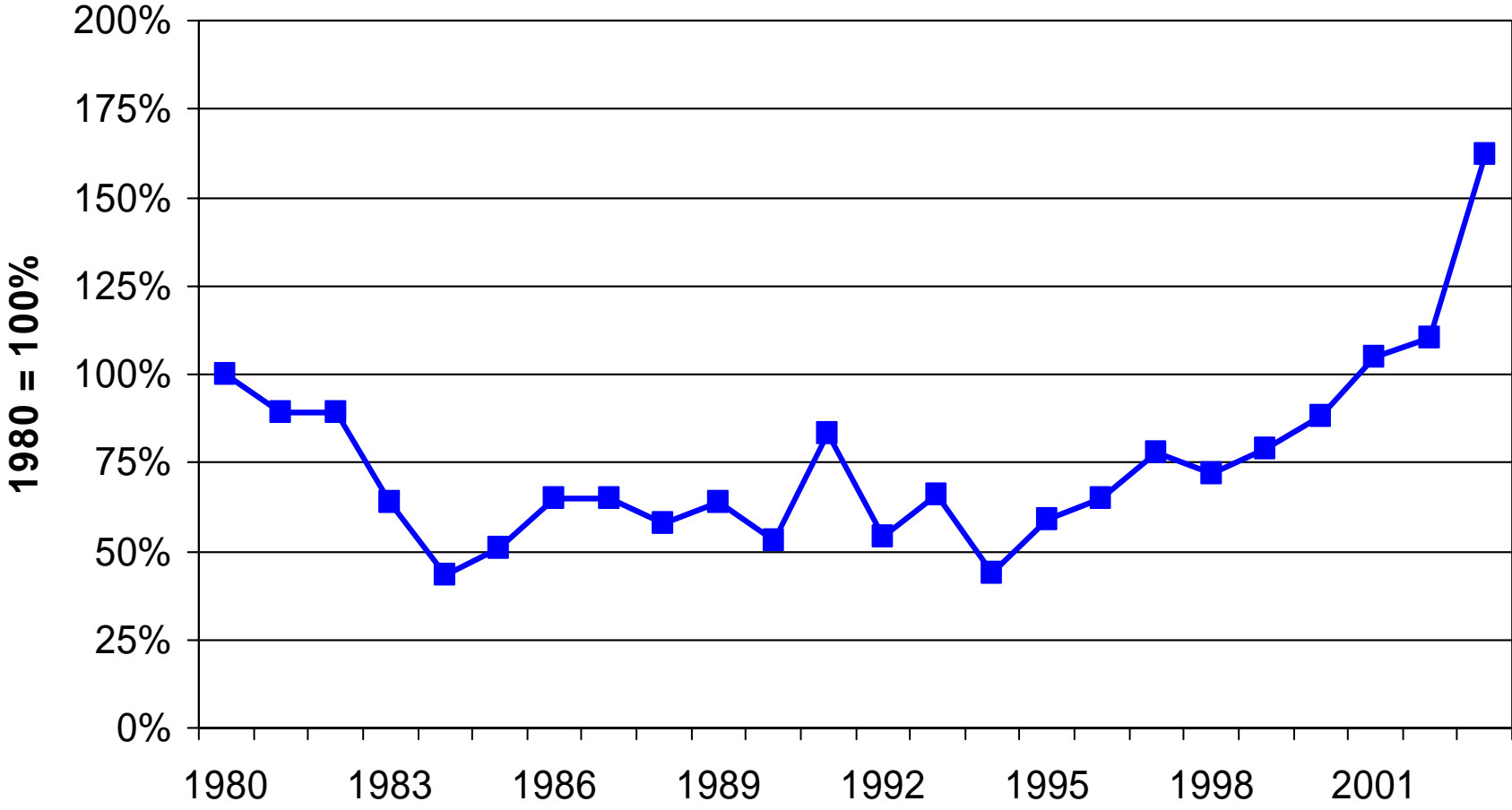
Sources: Statistics Canada/Will Dunning Inc.

# Real Discount Rate



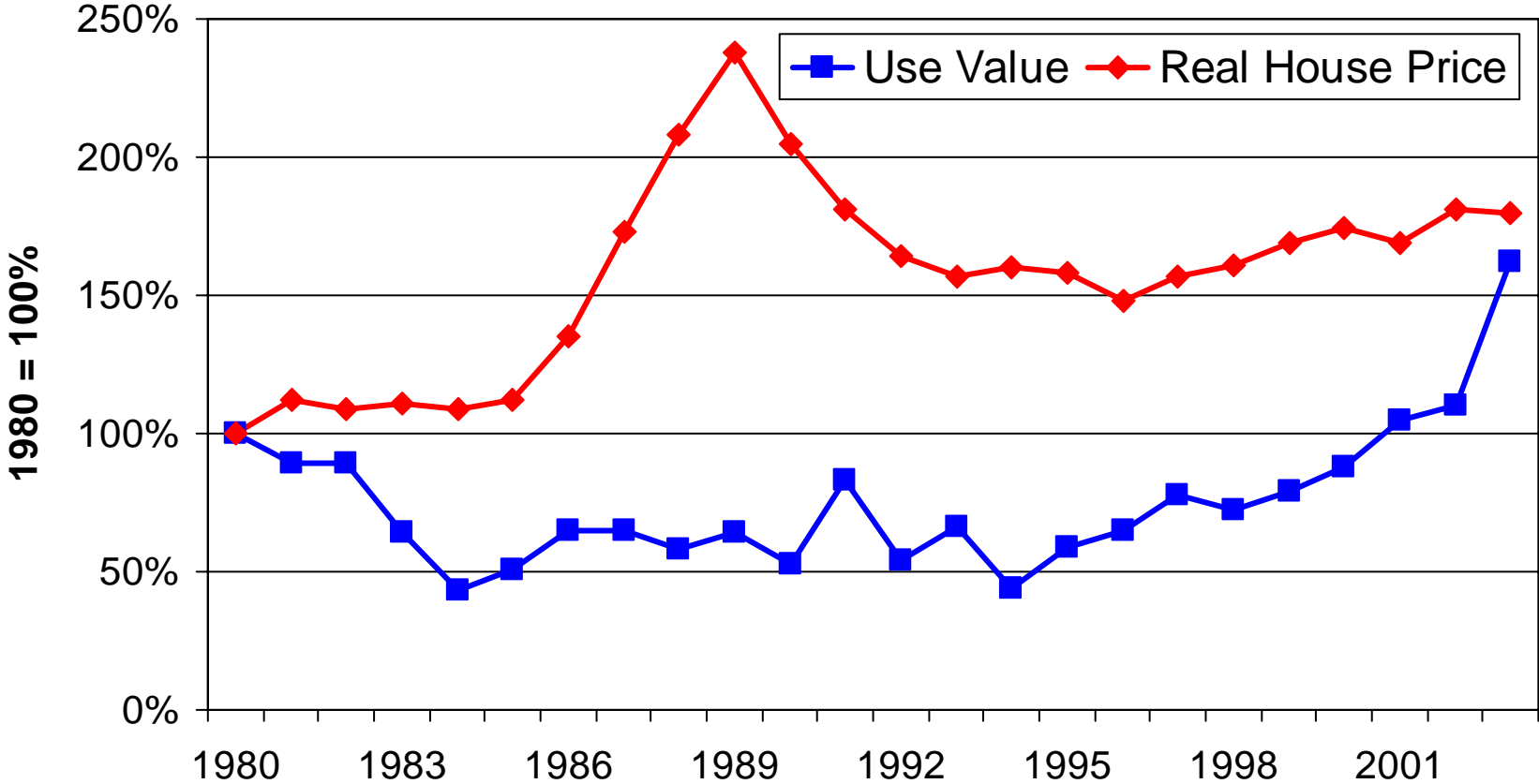
Sources: Will Dunning Inc.

# Index of Housing "Use Value"



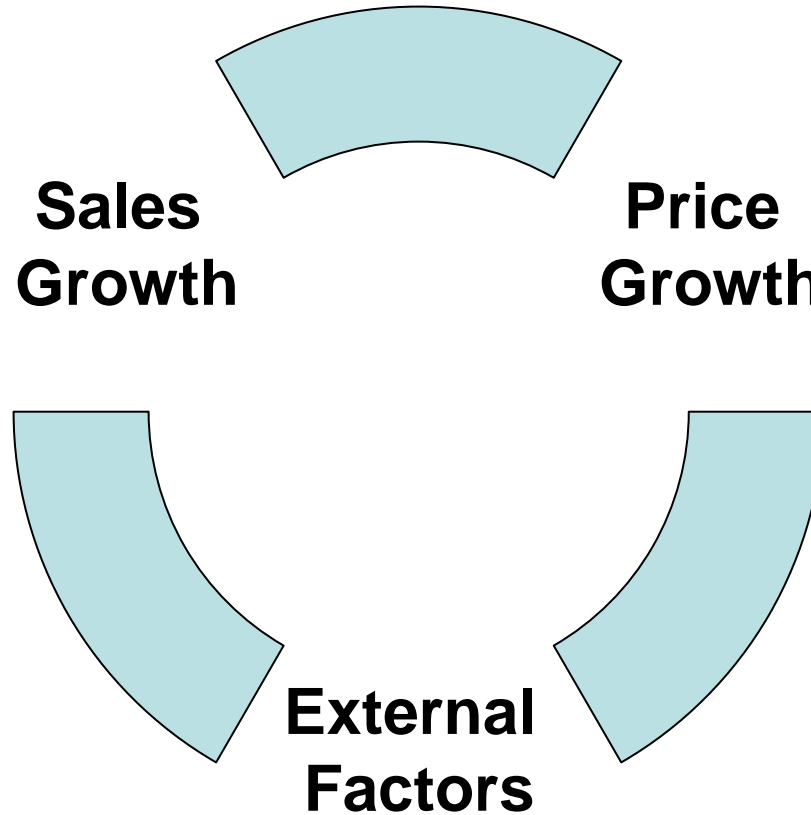
Sources: Will Dunning Inc.

# House Prices in Central Toronto Versus “Use Value”

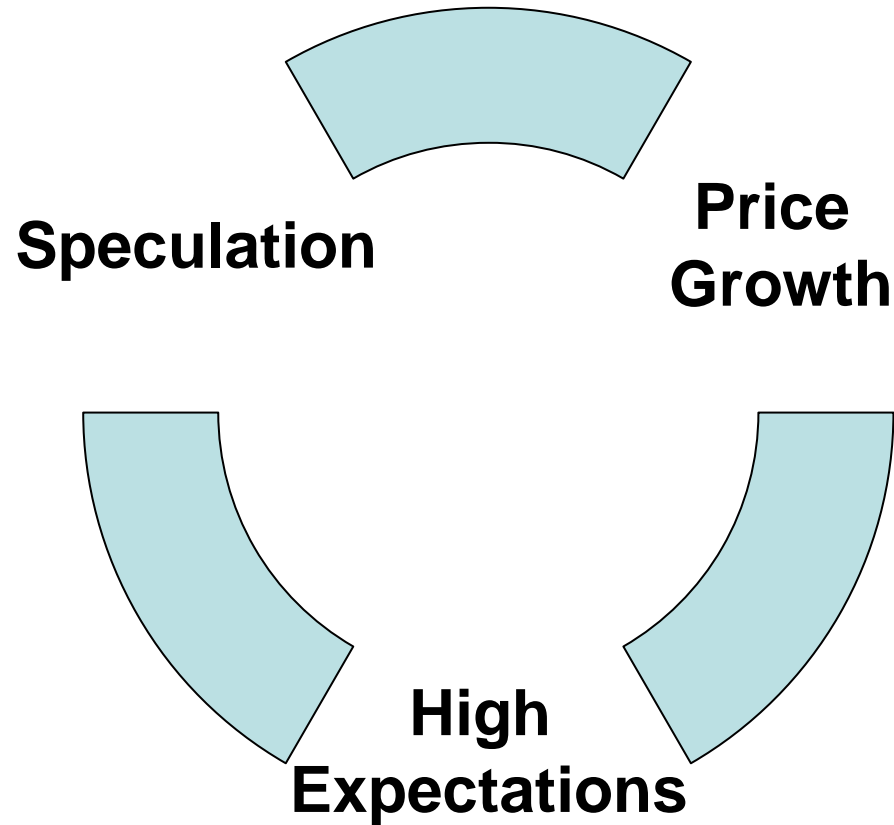


Sources: WDI/TREB/Statistics Canada

# A Healthy Market Cycle



# A Bubble



# Conclusions

- Toronto housing market is driven by fundamentals: job creation, affordability, and a reasonable investment motive.
- No evidence of excessive expectations.
- Recent value growth can be explained without recourse to a bubble theory.