For Local Housing Markets, One Ratio Does Not Fit All

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REALTORS®, market analysts and economists frequently describe the housing market as balanced, meaning that the supply of listings and the demand from potential homebuyers is in equilibrium. Measures have been devised over the years as a guidepost for that balance, usually taking the form of the ratio of home sales-to-new or active listings. The attractiveness of these ratios, in that they are simple to calculate and understand, has meant that analysts often take a one-size-fits-all type approach to analyzing markets. However, as the popular saying goes, all real estate is local.

Of course, housing markets have some common drivers. For example, interest rates are uniform across cities and provinces and are determined based on national factors like inflation and economic growth. However, other market drivers like demographics and income trends have significant variation within a province. This variation can lead to very different dynamics when it comes to local housing markets.

To address this variation, we have performed a regression analysis to uncover how the six-month trend in the sales-to-active listings ratio in each of our member board areas correlates with year-over-year changes in Multiple Listing Service® (MLS®) average home prices. In our analysis we assume that balanced markets are markets in which home prices grow in line with inflation. Based on estimates from our regression analysis we can ask what level of sales-to-active listings ratio correlates with zero real growth in prices after adjusting for inflation.

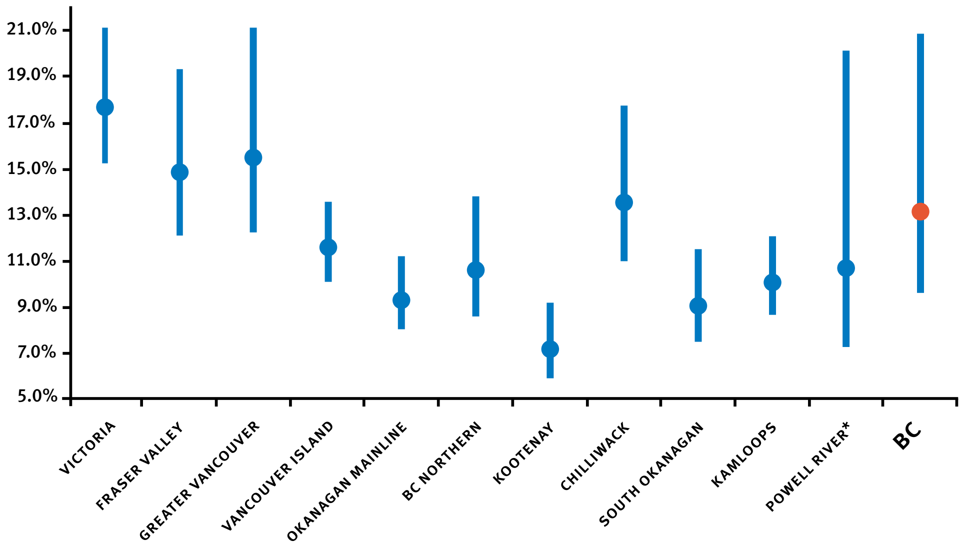
After determining a statistically significant relationship between the sales-to-active listings ratio and home prices, we then constructed a statistical confidence interval around that estimate for each member board area. That interval serves as the upper and lower limit of market balance.

The commonly used rule of thumb for a balanced sales-to-active listings ratio is a range between 15 and 20 per cent. Values above that level characterize a seller's market in which price appreciation above inflation is likely. A sales-to-active listings ratio below 15 per cent is a buyer's market in which price appreciation will be less than expected inflation.

Regions with high population density tend to conform with the conventional balanced market definition of a 14 to 20 per cent sales-to-active listings ratio. However, a balanced market in a board area with lower population density tends to be defined by a much lower range of the sales-to-active listings ratio. Notably, in the Kootenay Real Estate Board region, a balanced market is associated with a sales-to-active listings ratio of six to nine per cent.

Member board areas with high population density tend to include major metropolitan areas that attract a higher level of net migration and include a greater share of first-time homebuyers. While much of this new demand will eventually be met by a growing housing stock, that adjustment takes some time. That means that there will be re-sale activity that is not matched with listings in the same area. Therefore, higher population areas tend to have a higher equilibrium level of the sales-to-active listings ratio. Conversely, activity in lower population areas is more likely to reflect movement within the same region.

Ultimately, our research confirms that real estate is indeed local and our statistical guideposts for market balance should be updated to reflect differences in market dynamics.



Note: Bars represent a 99% confidence interval of the value of sales-to-active listings ratio that would correlate with 2% nominal price appreciation or approximately 0% real appreciation; A 95% confidence interval is used in markets where the relationship between sales-to-active listings ratio and changes in home prices was statistically significant, but less precisely estimated.

*The relationship between average MLS® home prices and the sales-to-active listings ratio in the Powell River Sunshine Coast Real Estate Board was statistically significant, but imprecise to the extent that the resulting confidence bands are too wide to accurately classify a balanced market.