Housing Market Digest

Canada, September 2021

Costs imposed by governments on new housing are a major contributor to the mess we are in. On September 8th, I released a report that compares the costs of owning versus renting, the first item on this page: https://www.wdunning.com/recent-reports

A Program That Ended Before Many of You Were Born

We need to discuss how we finance infrastructure associated with new housing. Half a century ago, that was done by federally-led lending (by CMHC) to cities, and then the cities would pay back the loans from their tax revenues. Now, the funding model is that builders have to pay very large amounts of money up front (often in the area of $100,000 per home in the major cities where housing demand is concentrated). The builders need to raise their prices to cover those costs, and that has two effects. It has delayed building of new homes. And, because new housing is more expensive, prices need to rise for resales.

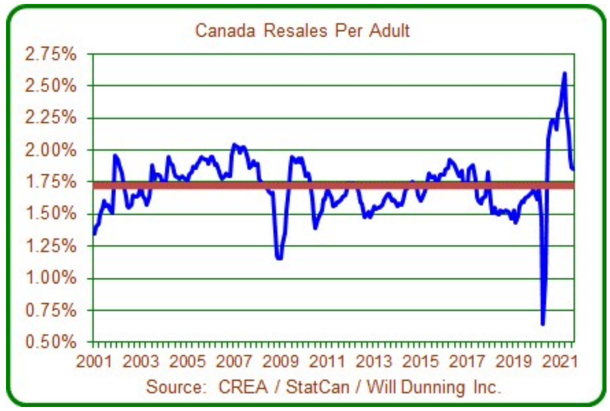
Maybe we should revive that old model of paying for infrastructure by borrowing and taxes. This is something that the federal government could make happen, in consultation and co-operation with the provinces and cities.

According to the way that I understand the housing market, eliminating those huge up-front costs would result in a gradual adjustment: a large jump in builder profits would result in more supply being offered, which would eventually mean that the cost reductions result in lower prices. The adjustment would take a long time, and the process could be bumpy. And, obviously, there has to be an environment in which it actually is possible for builders to offer more housing.

During the next decade, this would negatively affect the value of the house that I own, which would be disappointing to me. I still think this is the right thing to do.

Resale Markets

The sales rate fell slightly in August, the fifth consecutive drop. The annualized rate was 580,500 for the month. While there has been a sharp reduction from the all-time record that was set in March (811,000), August sales were still 8% above the long-term population-adjusted average (which I estimate as 540,000). While some commentary points at the recent drop in the sales rate as a sign of weakness, I continue to see quite strong home buying activity across the country, reflecting a favourable combination of low interest rates and the quite healthy employment situation, as well as on-going adjustments of housing choices in the wake of Covid-19.



Flows of new listings into the market remain inadequate, with the consequence that the sales-to-new-listings ratio is elevated. My estimate of the balanced market threshold is an SNLR of 52%. For August, the actual rate was 72% (and for the last 12 months, it averaged 77%). The imbalance between supply and demand continues to create very stressful conditions for potential buyers.

There are several measures of price growth available. All of them show very large growth compared to a year ago. For example, the average price is up by 18%.

But, there is some uncertainty about most-recent trends. My alternative measure (a constant-weight average of the provincial average prices) suggests that prices have not changed very much since March. For the moment, it appears that, despite the market imbalance, many potential buyers are resisting current pricing.

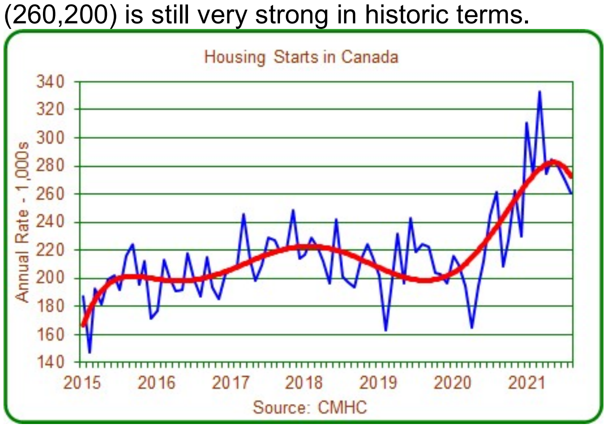
Employment

Statistics Canada estimates that employment grew by 90,000 in August, and that the level of employment is now just 0.8% (156,000) lower than it was in February 2020.

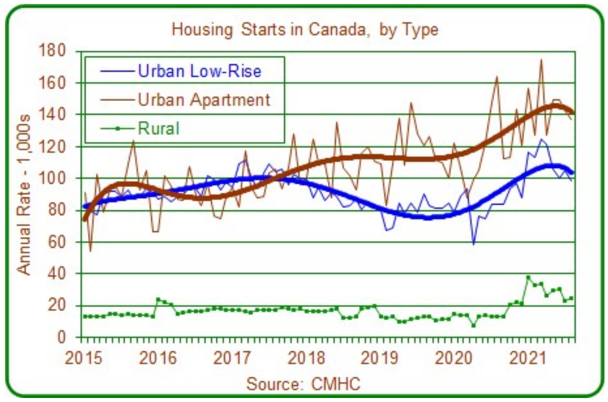
The employment rate (the share of people who have jobs) for the "prime working age" (and prime home buying) age bracket of 25 to 54 shows that the level is still lower than before the crisis. But, at that time, the employment situation was the strongest ever in Canada. The current situation is, in a long-term view, very strong, and quite favourable for housing demand.

Housing Starts

Housing starts continue to fall from the peak that was seen early this year. The rate for August (260,200) is still very strong in historic terms.

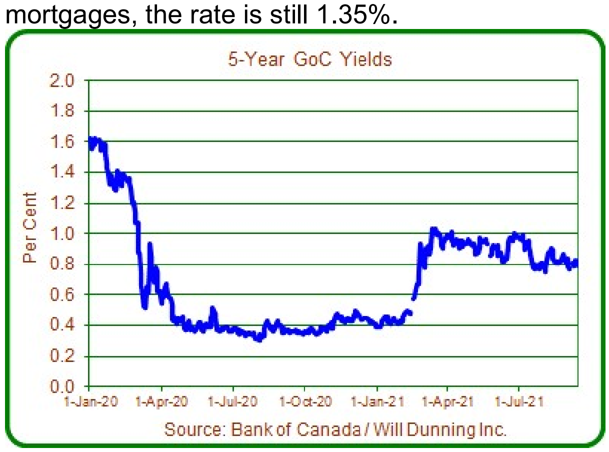


I continue to see the mix as problematic. Apartment activity remains too strong (the delayed result of an overshooting of rents for new units that started in 2016, combined with extremely low interest rates). High volumes of apartment completions in the coming years might result in disappointment for investors (more vacancies, with soft rents and pricing). Meanwhile, low-rise activity has fallen from levels that were already far too low.



Interest Rates

The yield for 5-year Government of Canada bonds is currently in the area of 0.8% to 0.9%. My opinion-estimate of a typical "special offer" rate for 5-year fixed rate mortgages (advertised by major lenders) is unchanged, at 2.25%. For variable rate mortgages, the rate is still 1.35%.



I still believe that the Bank of Canada should allow interest rates to normalize. A 1.25% yield for 5-year Government of Canada bonds would result in mortgage rates at 2.5% to 2.75%. The Bank's policy rate should be increased by a half point.

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