

Housing Market Digest

Canada, July 2021

Repeating myself from last month: In Canada, there is a connection between aggressive immigration targets and overheating of housing markets. I'd like to see the federal government discuss the conflict between those two areas of policy and how to resolve it. Prior to Covid-19, our population was growing by 1.4% per year. I think part of the solution to the housing crisis would be to slow that growth rate by one-half, for the next five years.

Thinking About Our Kids

A former very senior government official in BC has written a long, and very good, essay on what's happened to the Canadian middle class:

<https://ppforum.ca/publications/don-wright-middle-class/>

The key statement is: 'It will require conscious and coordinated changes in key policy areas that will move the Canadian labour market from being the "buyers' market" which it has largely been over the past 40 years, to a "sellers' market" where real wages begin to rise again.'

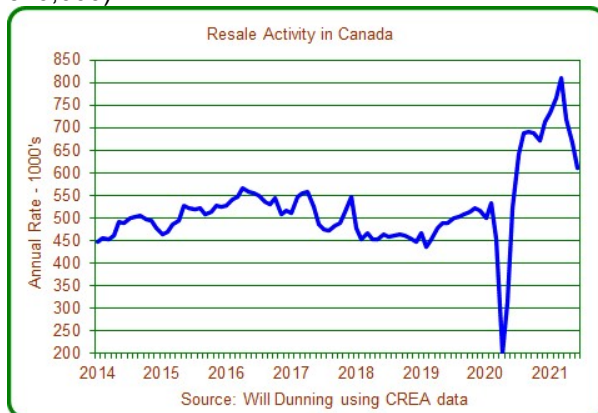
Along the way, he touches on housing, including that high immigration targets are contributing to weakened affordability in our major cities (due to insufficient supply and because of wage suppression). This has been very much on my mind.

If you haven't read my report on housing shortages in Canada, you should (it's not very long). It's the first item on this page:

<https://www.wdunning.com/recent-reports>

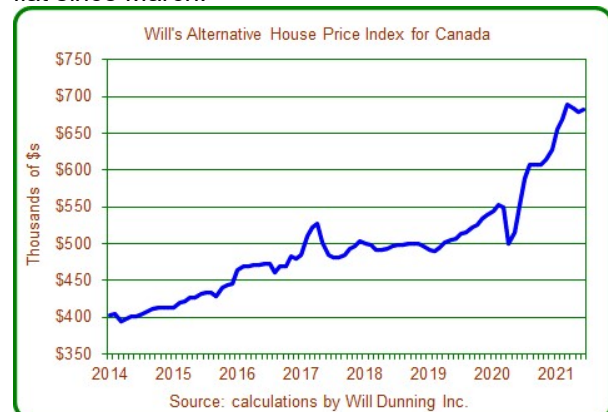
Resale Markets

The sales rate slowed in June for the third consecutive month. The annualized rate for June (609,700) was 25% below the record set in March. But, the June rate was 14% above the long-term population-adjusted average (which I estimate as 540,000).



Looking at major centres across the country, there is a small group where the sales rates for June weren't very different than the long-term population-adjusted average (Vancouver, Victoria, Halifax, Barrie, Hamilton, Kitchener, Ottawa, Thunder Bay, and the Greater Toronto Area – the available data does not include cities in Quebec)). In most other locations, June sales were significantly above average. I see this as part of the "sorting process" caused by Covid-19, with increased movement away from large, high-cost centres, towards smaller cities with more affordable housing markets. This process has definitely slowed, but I expect that it will continue for some time, as (1) people become more confident that their working arrangements are supportive for the long-term and (2) retired people cash out.

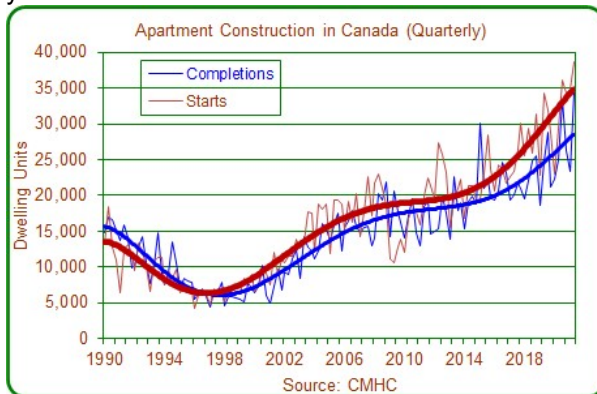
There is some uncertainty about recent price trends. A lot of the discussion focuses on year-over-growth in averages or price indexes. But, this misses that in a lot of places prices have shown little change since March. Price indexes should in theory be useful in showing recent trends, but they usually have some smoothing built-in: in consequence, they were slow to show the acceleration that happened late last year and now they aren't fully showing the deceleration. Another issue is that averages can be distorted by changes in composition (the locations and types of properties sold). As an alternative, I have constructed a simple alternative measure, a fixed-weight average of provincial average prices. This data suggests that prices have been more-or-less flat since March.



Excess Apartment Activity?

Last month, I mentioned my 1990 report on rental housing in Canada. One of the main conclusions was that individual investors require lower rents than large companies (and investment funds), and therefore most new rental supply will come from individuals. During the past two decades, rents have increased more rapidly than inflation or incomes. Combined with falling interest rates, new rental construction has become much more viable, and is now resulting in a substantial volume of so-called purpose-built rental development. If my old conclusion still holds, this implies that the environment has become even more attractive to individual investors, which will stimulate a lot of investment buying. Therefore, there is a possibility of excessive amounts of apartment construction that might eventually result in rent reductions.

Rents have fallen for new and newish rentals during the last year, but this is due to the demand effects of Covid-19 (also of note, the rent reductions have been for the newest, most expensive options, not for the bulk of the older rental stock). The supply of new apartments has increased in terms of starts, but this is not yet fully reflected in availability (completions). Therefore, it is still too soon to see effects from the expanding supply (this chart shows total apartment activity for condominiums plus rentals). Any impacts of the increased supply on rents (and on condominium pricing) will develop slowly during the next few years.



Interest Rates

Bond yields have changed little during the past four months. The yield for 5-year Government of Canada bonds is currently in the area of 0.9%. My opinion-estimate of a typical “special offer” rate for 5-year fixed rate mortgages (advertised by major lenders) has increased fractionally, to 2.25% from

the prior 2.2%. is 2.2%. For variable rate mortgages, the rate is now 1.35%.



I'll continue to argue 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 2.5-2.75%. A half point rise in the Bank of Canada Overnight rate would also be appropriate. Interest rates at something approaching a cyclically-normal level would depressurize housing markets in a healthy way. Interest rates could then stay at those levels for a prolonged period. Delaying the increases until the economy has tightened could very well result in larger rises, which would have negative economic consequences down the road.

Other News

Each year, for the Canadian Home Builders Association, I generate estimates of the economic impacts of residential construction (new construction as well as renovation and repair) for many communities across the country. This year, CHBA used the estimates to compile a massive report, that probably includes your community. You can also find individual Fact Sheets on this page: <https://www.chba.ca/impacts>

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