

# Housing Market Digest

Greater Toronto Area, September 2022

## Interest Rates

Some time ago, I concluded that the qualifying interest rate used in the stress tests should be the greater of:

- 3.75%, or
- The actual contract rate.

This gives consideration to:

- Income growth that will accrue during the initial 5-year term of the mortgage, and
- The amount of principal that will be repaid based on the amortization schedule (and more might be repaid via pre-payments).

The policy team at the Canadian Home Builders Association thought about this, and made a useful addition, that the qualifying rate should be increased by a quarter point for each year that the initial term was shorter than 5 years.

In retrospect, I'm comfortable that this old conclusion was correct.

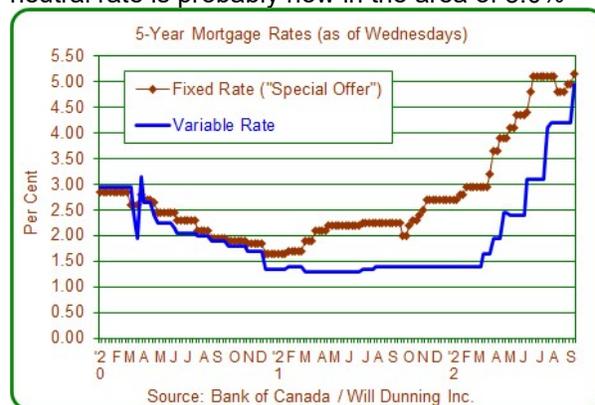
Let's assume that someone who bought in 2017 with a 5-year fixed rate mortgage at 3.0%) was qualified at 3.75%. Given the income growth that has typically occurred (20% during the five years) and the amount of principal that has been repaid, in most cases that mortgage borrower would be able to afford a renewal today at about 5% - unless their income has been disrupted.

Today, if a buyer takes a 5-year fixed rate mortgage at 5.15%, they should be tested at that rate. If they take a 2-year fixed at 5.2%, they should be tested at 5.95%, and if they take a variable rate at 4.95%, the test should be at 6.2%. Instead, they will be tested at about 7%.

The OSFI stress test regulations also require that mortgages transferred to a federally-regulated lender must be stress tested (at 2 points above the contract rate). This policy does nothing to reduce risk in the financial system, because, the risk already exists, and at best all the policy does is influence where the risk is located. But, it also adds risk to the borrowers (including that they might lose their financing, or they might be exploited by their current lender), and this raises risk for the financial system. This policy was always wrong, and now it is even more wrong.

I have some more comments on the stress tests in the Canada edition of HMD.

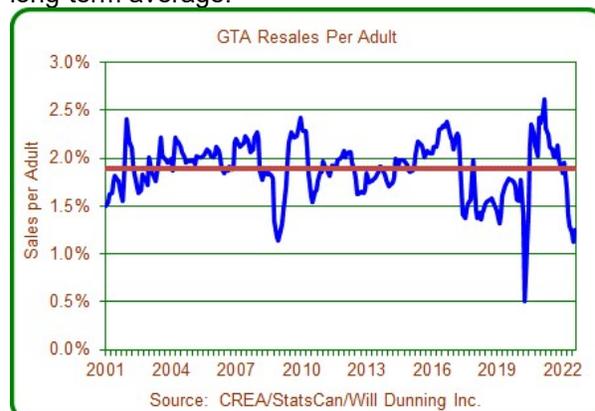
A while ago, using data on pricing and rents as of May, I calculated that the "neutral" mortgage interest rate in Canada was 2.6%. Since then, prices have fallen and rents have increased. The neutral rate has increased a bit. I might update that analysis next month. I'm guessing that the neutral rate is probably now in the area of 3.0%



## Resale Market

I wasn't expecting this: sales for the GTA jumped by more than 10% in August, to an annualized rate of 70,600. This can be attributed to what has happened with interest rates. During August, people were still able to rely on interest rates locks that were issued in April and May (often 3.5-4%). With rates now in the area of 5%, there was incentive to act quickly before those locks expired. During September, available locked rates will be in the area of 4-4.5%, and by October the range will be 4.5-5% (unless there is soon a reversal, and I don't expect to see that). Therefore, it won't be until we get the numbers for October that we get a strong sense of the impact of the sharp rise in interest rates.

On a population adjusted basis, August sales in the GTA were still very weak, at 34% below the long-term average.



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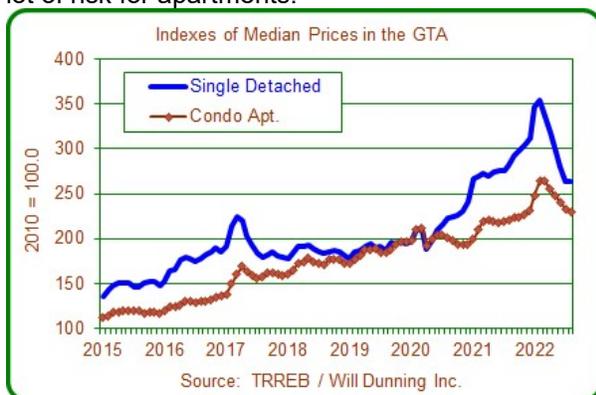
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The sales-to-new-listings ratio improved slightly in August, but at 47.6% it is still below the balanced market threshold (52% for the GTA).

The price data remains murky, with different signals being sent, depending on what measure is used.

Based on the average, prices are close to the year-ago figure, but down by 12% from the peak in February. On the other hand, CREA's House Price Index indicates that prices are up by 9.7% versus a year ago, although down by 8.6% versus February.

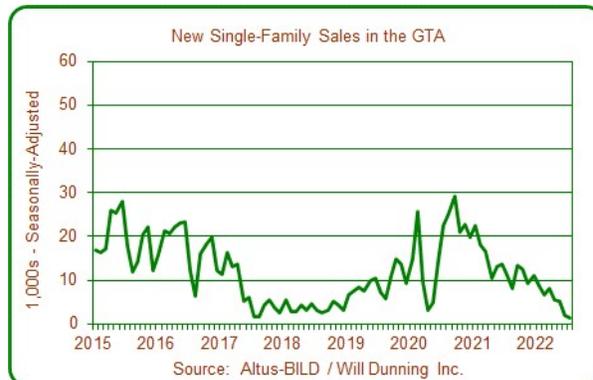
I continue to rely on my alternative price measure (a constant-weight average of the median prices by house type). This data is consistent with what I am seeing in the detailed analysis I'm doing for my own neighbourhood. This alternative data shows a year-over-year price drop of 3.9%, and a 24% drop versus February. Looking at the details, the reduction is larger for singles (25%) than for apartments (13%). But, singles had been more over-heated and had more room to fall. I still see a lot of risk for apartments.



## New Homes

Data on new home sales (produced by Altus for BILD) indicates that sales have slowed quite sharply (the most recent data is as of July). For the most recent three months, the average sales rate was about 22,400 (annualized). We need at least 50,000 just to meet the requirements from population growth and a further large increment to reduce existing shortages. These sales figure will feed into falling numbers for new starts during 2023 and 2024: higher interest rates mean that the housing shortage is going to get even worse.

Low-rise activity has been hit especially hard.



Apartment sales have been less affected (although the trend is clearly weakening). There will be a lot of construction completions for apartments in the coming year. It remains to be seen if financing difficulties will be disruptive.



## Other News

I'm still worried about the kids and Covid. This short Twitter thread provides a very good overview of what is known. This doesn't work as a link, but you can copy it. Please feel free to share this:

<https://twitter.com/MeetJess/status/1570259687894908928>

We need to do a much better job of protecting kids and preventing transmission.

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