AUGUST 2019

HOME BUYING IN 2019 IS HARD WORK

AN IN-DEPTH ECONOMIC ANALYSIS OF THE PERCEPTIONS AND BEHAVIOURS OF CANADIAN FIRST-TIME BUYERS AMID CHALLENGING CONDITIONS AND A RESTRICTIVE MARKETPLACE

MORTGAGE PROFESSIONALS CANADA | PROFESSIONNELS HYPOTHÉCAIRES DU CANADA

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1.0 Introduction and Summary

Since the fall of 2005, Mortgage Professionals Canada has published semi-annual reports on the residential mortgage market in Canada.

This edition takes a very different approach, to concentrate on first-time home buying.

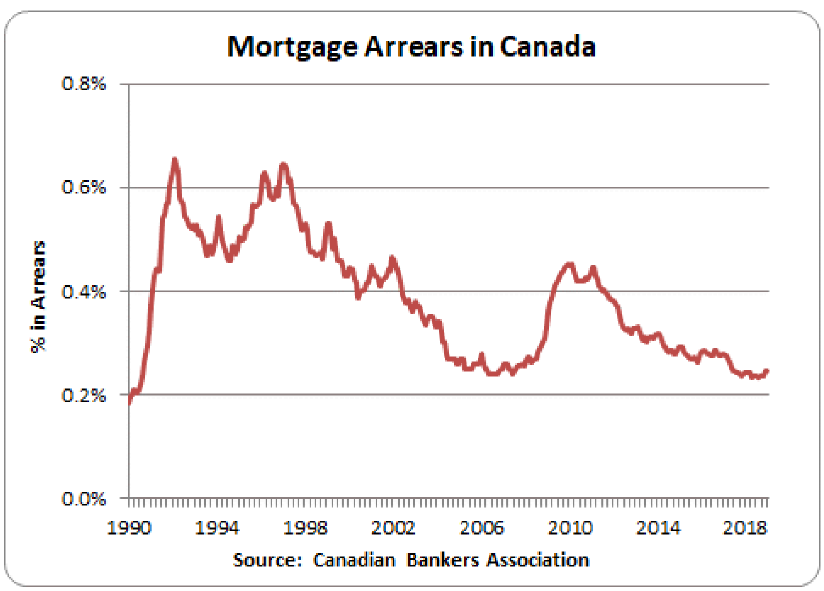
Rather than cover the entire age range of the population, our consumer survey was targeted to ages 23 to 54. The survey was conducted during July 3 to 15. The total sample was 1,991, of whom 71% are home owners, 24% are renters, and 6% are others (not renters or owners – they live with parents or family). This sample design enabled us to more thoroughly look at recent and potential first-time home buyers.

Prior editions of our consumer surveys have presented us with a paradox: Canadians as a group are inclined to agree with a statement that "low interest rates have meant that a lot of Canadians became homeowners over the past few years who should probably not be homeowners". But, as individuals, we are highly comfortable with the choices we have made: year after year, the survey has shown that most Canadian home owners feel that they are well-positioned to handle a downturn in housing prices. Few of us regret the size of the mortgage we took.

Recently, we have started asking Canadian home owners if they regret the purchase of their current home. Only a small minority express regret (90% are "happy" with the purchase), and where there is regret it is mostly about the particular property purchased rather than about home ownership in general. Interestingly, levels of regret for the most recent home buyers are the same as for all home owners, which seems to belie the opinions about bad choices being made in the past few years. This was shown in the yearend 2018 report (published in January 2019), in Table 4-4 (page 53). That report can be found here: https://mortgageproscan.ca/docs/default-source/membership/annual-state-of-res-mtge-mkt-2018.pdf

Further support is in data from the Canadian Bankers Association, which shows that the rate of mortgage arrears is flat at a very low level.

Our explanation for this paradox has been that these beliefs about "other people" are shaped by messages in the media and from pundits, more so than by actual behaviour.



Consumer Sentiment

Consumers continue to generally agree with a statement that "low interest rates have meant that a lot of Canadians became homeowners over the past few years who probably should not be homeowners". However, the strength of that agreement has been reduced, to a current 6.52 out of 10, versus a long-term average of 6.93[1].

As was noted already, a different picture is painted by responses about their individual circumstances: concerning their ability to weather a potential downturn in home prices, the current figure is 6.81 out of 10.

There is a strong belief that "real estate in Canada is a good long-term investment" (7.16) and that mortgages are "good debt" (6.99).

Canadians remain mildly optimistic about the economic outlook for the coming 12 months, at an average of 6.07, slightly above the neutral score of 5.5.

They believe that this is a good time to buy a house (average score of 6.31) but concerning condominiums the score of 5.35 is fractionally below the neutral level. They expect price growth to continue for both houses (6.71) and condominiums (6.40). There are variations across the country, which are shown later in this report, in Table 2-2.

Buying a Home is Hard Work, and It's Stressful

We tried something new in this edition: an exploration of factors that influence decisions to buy homes. As is discussed in detail in the body of this report, home buyers consider a lot of factors, and they exert considerable mental effort when they decide to buy homes.

Buying a home is very stressful: out of a list of six major decisions, the consumers rated the decision to buy a home as the second most stressful (the most stressful is the decision to move to a different city). Deciding to get married or to have children are both less stressful than buying a home.

The point here is that some commentary implies that Canadians are buying homes irresponsibly, recklessly, or frivolously. While there might be a small amount of that, for the vast majority of home buyers, it is a very careful and conscious process.

Canadians believe by a very large majority that home ownership is in their long-term best financial interests. In our consumer survey, 76% of Canadians opined that they would be better off as a

[1] The change in the sample or this version of the survey (excluding people aged 55 and older) might have contributed artificially to the reduction in the average score.

home owner, just 8% see themselves better off financially as renters (and 16% indicated "don't know/not sure").

While many people will argue that this belief about the financial advantage of ownership is outdated, research completed a year ago (by this author) indicates that it is still true: in most situations, owning a home provides a positive (and tax-free) "rate of return" on the owner's investment of equity, and that rate of return rises over time.

The Federal Government's Mortgage Regulations

There are two main criticisms of the mortgage stress tests:

- Firstly, they are based on a possibility that when the mortgage is renewed, the new interest rate could be considerably higher. Based on present conditions, the testing will assume that the future interest rate will be at least two percentage points higher than the original, actual interest rate, and therefore it is assumed that the monthly mortgage payment will increase substantially. Yet, the testing does not consider that during the same interval, the borrower's income will increase and therefore they will have more capacity to afford that payment. In consequence, the required calculations over-estimate the consequences of future mortgage renewals and the regulations inhibit home buying to an excessive degree.
- Secondly, there is a requirement that in order to transfer an existing mortgage to a different, federally-regulated lender, the mortgage must also be stress tested. In some circumstances this might cause the borrower to be "trapped" at their current lender, and this could be exploited by the lender. This testing raises risks to the borrowers, and thereby to the broader economy.

A subsidiary concern is that the reference interest rate is determined by the lenders who are being regulated, and their rate-setting decisions will be based on their own needs and preferences rather than by any market mechanism. There are two problems with this. Firstly, there is no reason why this process would necessarily produce an estimated interest rate that is "correct" for the purpose. Secondly, the regulations might give lenders some incentive to keep the reference rate artificially higher than they would otherwise (so that they have more opportunity to "capture" their clients).

In this section of the survey, we gathered opinions from consumers on the mortgage stress tests. The survey showed:

- Only about one-half of Canadians were aware of the stress test requirements before we did the survey. This isn't necessarily a problem, since most people don't have a current need to know about them. But, this limited awareness is also present among people who expect to buy a home during the coming year: there is a risk that some buyers could have unexpected difficulty in obtaining the financing they need.
- There is moderate agreement that the rules will make it harder to buy homes (in general) and slightly more difficult to make a preferred purchase.

- Opinions are neutral on whether the policies will keep house prices from rising significantly.
- There is more substantive agreement (an average of 6.84 on a scale of 1 to 10) that the stress tests will achieve their stated objective, to "ensure that home buyers will still be able to afford their homes if interest rates rise by a large amount in the future".
- There is also substantive agreement (an average of 6.62) that the stress tests "will result in more people having to turn to more expensive mortgage options from lenders".
- The consumers agreed with the statement that the stress tests "unfairly use interest rates as the only criteria for assessment, ignoring other important factors (e.g. the potential for your financial situation to improve in the future, offsetting potential interest rate increases)". The average rating of 6.43 was above the neutral threshold of 5.5.
- At an average of 5.73, opinions are fractionally above neutral that "the new mortgage rules will reduce my options when it comes time to renew my current mortgage". This weak result actually isn't surprising: in previous research, we have suggested that only a small minority of renewing mortgage borrowers would fail the stress test. Most borrowers don't have a personal need to be concerned about this. The issue is what will happen to that small minority, who might be in quite vulnerable situations.

For a decade, the federal government (under both of the main parties) has actively impeded home buying, through successive tightening of mortgage lending regulations. The final major section of this report provides a review of housing market trends for Canada and the provinces. This data shows very clearly that since the advent of the mortgage stress tests, home buying has been sharply suppressed, and housing construction is slowly following in the same downward direction.

Considering the responses made by Canadians in this survey and the unfolding conditions in housing markets, I believe that **if they were shown a clear set of facts and arguments** about the mortgage regulations, **Canadians would decide that they do not consent to those policies.** I have recently authored a report entitled "The False Binary" (https://mortgageproscan.ca/docs/default-source/government-relations/the-false-binary-report-may-2019.pdf) describing this problem directly. In short, calls for policy makers to review the stress tests are typically met with public criticism and a spin that mischaracterizes the request as a call to abolish all stress testing. This is generally followed with commentary describing catastrophic results of such a move, even though such a move was never actually suggested. The federal government's housing agency (Canada Mortgage and Housing Corporation, or "CMHC") publicly acknowledged as long ago as March that it has conducted research on the housing market impacts of the mortgage stress tests, but it has still not published that research, and it has not substantively countered the research conclusions offered by critics.

Opinions about the stress tests vary greatly across the country. Much of the discussion about the impacts is centered on Toronto, and there has been much less attention to the dramatic downturns that are occurring on the prairies (which are due to the combination of weakened economic conditions plus the stress tests).

Three Policy Options to Support First-Time Home Buying

This section summarizes consumer opinions on three options to support first-time home buying.

"First Time Home Buyer Incentive"

This program starts on September 2. The government (through its housing agency, CMHC) will invest equity in newly-purchased homes. This will reduce the buyers' mortgage requirements and thereby reduce monthly costs. In turn, the government would share in any gains or losses of the property value.

The survey responses indicate that:

- There is a moderate degree of agreement that "This plan will make it easier for Canadians to afford their first home".
- But, among actual home owners, most say they would not have used the program when they bought their first home and among potential first-time buyers, opinions are lukewarm.
- Most Canadians say they would not be willing to give up equity in their home, even if it reduces their monthly costs.
- The discussion of the survey results concludes that in order for the program to be successful, it doesn't need to appeal to everyone. It just needs to meet the needs of some people.

Simulations of the impacts show that in many scenarios, the FTHBI will be financially advantageous, and in theory a large share of first-time buyers should choose to enrol. But, there are issues:

- The limit of 4-times income (for the total mortgage plus FTHBI) means that many potential clients would have to lower their housing expectations.
- As noted already, there is resistance to giving up equity.
- The requirement for mortgage insurance will be a substantial impediment (close to one-half of first-time buyers do not buy mortgage insurance).
- The program is complicated and will add to the already-substantial stress of buying.
- Most of the clients would purchase even without the FTHBI, reducing the true incremental impact of the program.
- FTHBI may possibly result in less than 5,000 incremental first-time purchases per year.

"First Home Buyers Plan"

Under this program ("HBP"), first-time buyers can take funds out of their RRSPs as a source of down payments. Recent enhancements increase the maximum withdrawal from $25,000 to $35,000.

The survey results show that:

- Awareness of the program is limited, even among people who expect to buy their first home during the coming year.
- Only a minority of first-time buyers use the program (35% among recent first-time buyers).
- The survey data indicates that among recent buyers who used the HBP, about 38% made the maximum withdrawal.

Because only a small minority of first-time buyers (10-15%) fully utilize the program, the increase to the maximum withdrawal amount will have a small impact.

30-Year Amortization for Insured Mortgages

Since July 2012, the maximum amortization period for insured mortgages has been 25 years. Industry associations in mortgage lending, real estate sales, and home building argue that allowing 30-year amortization would be a responsible means to enhance access to home ownership.

The survey collected consumer opinions on four related issues. Those responses show that consumers see risks and benefits, as there was agreement that there are two positive aspects and two negative aspects of the proposal.

- There is substantial agreement that this would make home ownership more affordable (average score of 6.71 on a scale of 1 to 10) and that it would “allow home owners to control their payments in the critical early stages of their mortgage” (6.85 out of 10).
- On the other hand, there is agreement (6.15 on the 10-point scale) that this would “result in more Canadians being worse off overall at the end of their mortgage” and that it would “result in more Canadians purchasing homes that they can’t afford” (6.72 out of 10).

This mixture of positive and negative responses doesn’t give us a clear thumbs-up or thumbs-down conclusion, especially since we can assume that most of the respondents have not done extensive analysis of the four issues. We might get a better overall picture about opinions if we could look at the choices that people actually make. To that end, we tried to get a better view of their choices by asking a blunt question: “which would be a better option to make first-time home buying more affordable?”

Both of the options (30-year amortization and FTHBI) have supporters. By a notable margin, 44% of the 1,991 Canadians who took part in the survey prefer 30-year amortization while just 27% prefer the FTHBI. The remaining 29% indicated “don’t know/no opinion”.

The Government Needs to Respond…

"Watch what I do, not what I say."

The government says it wants to make home ownership more affordable and accessible, but its actions say otherwise.

The mortgage stress tests have sharply curtailed access to home ownership. On the other hand. the government's proposals to improve access are likely to have only small positive effects.

Statements from the federal housing agency CMHC tacitly admit that the impacts of the FTHBI will be trivial:

- In March, CMHC said that the stress tests have caused Canadian house prices to be 3.4% lower than they would be otherwise. This implies that stress testing has caused a substantial reduction of sales, although CMHC has not commented on the magnitude of the demand effect, or published its research. As well, the estimated price impact is from some effective date in the past and with the continued constraint on demand, the negative price impact has no doubt become larger, although CMHC has not commented on that.
- In April, CMHC said, regarding the forthcoming "First Time Home Buyer Incentive" (sometimes referred to as the "shared equity" program), "We do not expect the FTHBI's inflation impact to be beyond a maximum of 0.2-0.4%". Once again, CMHC has not commented on the magnitude of the impact on sales, but the price estimate implies that the impact on sales is expected to be quite small. (Within this report, I have reached a similar conclusion, that the program will most likely have a quite small effect on home buying, perhaps less than 5,000 incremental purchases per year.)
- CMHC expects 100,000 buyers to utilize the program during its duration of three years. If this is achieved, it would amount to about one-tenth of all first-time purchases during that period (however, the 100,000 estimate seems to exceed what might be achieved within the budget of $1.25 billion). This report discusses that many of the FTHBI clients would have purchased anyway, even without the program. Therefore, the true, incremental impact of the program will be even smaller.
- Contrasting CMHC's two estimates of price impacts (positive 0.2-0.4% from FTHBI versus negative 3.4% from the stress tests), CMHC is tacitly implying that the positive demand effect from the FTHBI might offset only about a tenth of the negative effect of the stress tests.
- Regarding the enhancements to the Home Buyers Plan ("HBP" – this is the option to withdraw funds from RRSPs to increase down payments), the survey data shown in this report indicates that only about 10-15% of recent first-time buyers have fully taken advantage of the program. Therefore, the incremental effect of increasing the maximum allowable withdrawal will most likely be small. The survey data indicates that 35% of recent first-time buyers - purchases during 2015 to 2019 - used the HBP. Among these buyers, it is estimated that 38% took out the maximum allowable amount. Combining these two

estimates, the survey data implies that only 13% of recent first-time buyers took full advantage of the HBP.

- However, the budget also included an expansion of eligible participants to include those who had recently been divorced or part of a dissolved common-law relationship. This will have some impact on overall activity as these people are older and are more likely to have RRSP savings to draw from.
- Within the body of this report, it is argued that under current conditions, the HBP is not attractive: the annual cost of meeting one's obligations under the HBP is less than the benefit that would result from using it! Buyers who do the math will tend to not use the HBP. Even with the enhancements, this will continue to limit use of the HBP.

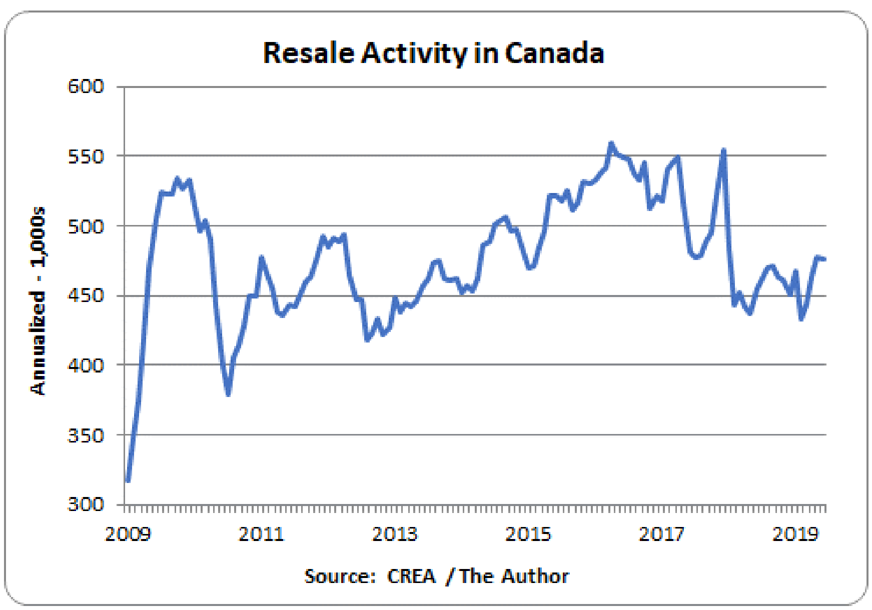
In short, the support that the government will provide to first-time buyers via these two new initiatives ("FTHBI" and the enhancement to "HBP") will not come anywhere close to offsetting the negative effects of the mortgage stress tests.

This report concludes that if the federal government is serious about supporting the reasonable home buying aspirations of Canadians:

- It will add 30-year amortization periods for insured mortgages to the toolkit.
- Perhaps first-time home buyers could be offered a choice, either the FTHBI or 30-year amortization.
- In addition, the government needs to adjust the mortgage stress tests, so that they consider not just the hypothetical large rises in mortgage interest rates, but they also incorporate the very reasonable expectation that incomes will continue to rise in Canada.

Housing Market Trends

Reductions in mortgage interest rates this year have recently resulted in some improvement of home buying. However, as is shown in this chart, activity remains relatively weak.

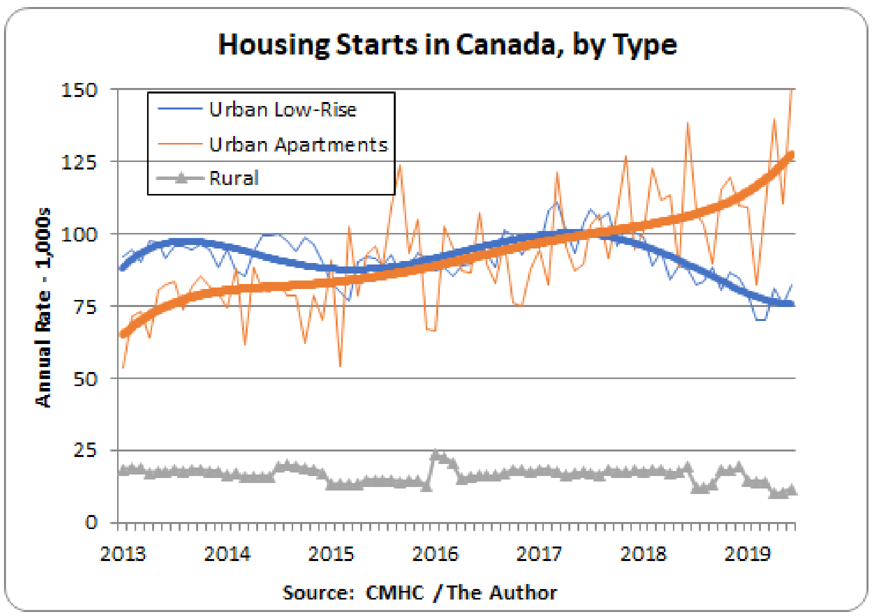


Over time, we expect sales to trend upwards because the population is growing (there are more potential buyers). Additionally, on-going construction of new homes means that the inventory of housing is expanding (there are more properties that could potentially be sold). When we adjust for population growth, resale activity during 2018 was 10% below the long-term average. During the first half of this year, the sales rate was 11% below the long-term average. Even with increased sales during the second quarter of this year, the sales rate is still 9% below average.

Data in the chart above (and in the remainder of this report) ends in June, reflecting what was available as of August 8. Data for July is expected to be published on August 15. At this time, partial data from real estate boards across Canada hint that there will be rise for July, with the annualized rate of sales possibly in a range of 510,000 to 520,000, which would be close to the long-term average. Conditions are currently very favourable for home-buying, with very strong job creation during the past 2.5 years, the fastest rate of population growth in a generation, and with interest rates having fallen sharply this year: resale market activity should now be above-average, not below-average.

It is clear that the mortgage stress tests are weighing very heavily on home-buying.

Looking at the new housing sector, starts of low-rise homes (single-detached, semi-detached, and town homes) have followed the downturn in the resale market. Again, this activity should be expanding, due to the very favourable conditions.



Starts of apartments have increased, but this reflects pre-construction sales that occurred some time ago. Partial information from the home building industry indicates that there has been a sharp drop in pre-construction sales of condominium apartments. This will, eventually, result in a slowdown for apartment starts.

Inadequate volumes of new housing construction will, in the long-term, make it increasingly difficult for Canadians to meet their housing needs, in both the home ownership and rental sectors.

The body of this report reviews housing market trends for all of Canada and then very briefly for each of the provinces. The data shows that in some of the provinces, home buying activity is now worryingly weak, to the extent that prices are eroding. In a modern economy, one of the most dangerous risks is that if house prices fall, the impairment of consumer confidence will weaken the broader economy. The mortgage stress tests are worsening the risks for house prices and the economy of Canada.

About Mortgage Professionals Canada

Mortgage Professionals Canada (MPC) is the national mortgage industry association representing over 11,500 individuals and 1,000 companies, including mortgage brokerages, lenders, insurers and industry service providers. Our members make up the largest and most respected network of mortgage professionals in Canada. MPC represents members' interests to government, regulators, media and consumers. Together with our members, the association is dedicated to maintaining a high standard of industry ethics, consumer protection and best practices.

The association ensures an effective and efficient mortgage marketplace by:

- Promoting consumer awareness of the benefits of dealing with the mortgage broker channel.
- Advocating for member interests on legislative and regulatory issues.
- Developing, monitoring and promoting responsible mortgage industry standards and conduct.
- Providing timely and relevant information to members and mortgage consumers.

About the Author

Will Dunning is an economist, and has specialized in the analysis and forecasting of housing markets since 1982. In addition to acting as the Chief Economist for Mortgage Professionals Canada, he operates an economic analysis consulting firm, Will Dunning Inc.

About Bond Brand Loyalty

Bond Brand Loyalty is a Canadian-owned global customer experience and engagement agency that specializes in building brand loyalty for the world's most influential and valuable brands. We build measurable, authentic, and long-lasting relationships through a combination of services that includes marketing research, loyalty solutions, customer experience measurement, marketing and management, customer analytics, live brand experiences, and proprietary technology platforms.

Disclaimer

This report has been compiled using data and sources that are believed to be reliable. Mortgage Professionals Canada, Bond Brand Loyalty, Will Dunning, and Will Dunning Inc. accept no responsibility for any data or conclusions contained herein.

The opinions and conclusions in this report are those of the author and do not necessarily reflect those of Mortgage Professionals Canada or Bond Brand Loyalty.

2.0 Consumer Sentiment

Attitudes to Topical Questions

Since 2010, the consumer surveys have investigated attitudes on current issues related to housing markets and mortgages. The survey respondents have been offered various statements and asked to indicate the extent to which they agree or disagree with each, on a 10-point scale. A response of 10 would indicate complete agreement and a response of 1 indicates complete disagreement. Average responses of 5.5 out of 10 would indicate neutrality.

The next table summarizes responses, showing the average scores. The responses have changed relatively little over time.

- There is moderately strong agreement that "low interest rates have meant that a lot of Canadians became homeowners over the past few years who should probably not be homeowners". However, in the most recent survey, there was a notable drop in the average score, to the lowest score in the history of this question (6.52 out of 10, versus the historic average of 6.92). Scores showed little variation across the country.[2]
- On the other hand, consumers seem to be increasingly satisfied with the mortgage choices they have made: they have low levels of regret about their mortgage choices (this question is asked only of mortgage holders). These scores have trended downwards over time, and this year a new record low was set (3.31 out of 10, versus the average of 3.71 for the entire period). As we have commented in prior years: on a collective basis, consumers believe their choices have been responsible, but collectively they believe that other people are being irresponsible. This inconsistency suggests that these beliefs about "other people" are shaped by messages in the media and from pundits more so than by actual behaviour.
- Levels of regret about mortgages show minor variations across the provinces. The highest levels of regret are in Saskatchewan (3.74) and Alberta (3.64). Elsewhere, the scores are close to the national average of 3.31. In the two highest cost provinces, the average scores are fractionally below the national average (British Columbia at 3.27 and Ontario at 3.28).
- Canadians' confidence about their ability to weather a downturn in the housing market fell slightly in the new survey (to 6.81, just slightly below the long-term average of 6.87). The average scores are lowest in Saskatchewan (6.41) and Alberta (6.44).
- Canadians continue to agree strongly that real estate is a good long-term investment. The average score this year (7.16) is slightly below the historic average of 7.25. There are minor variations across the country. The highest ratings are found in Ontario (7.33), Quebec (7.30), and Manitoba (7.22). Scores are below the national average in British Columbia (6.98), Atlantic Canada (6.93), Saskatchewan (6.91) and Alberta (6.69).
- The level of confidence about the economy is slightly below average this year (6.07 versus the historic average of 6.15). Looking across the country, confidence is above the national average in Quebec (6.72) and Manitoba (6.37). Scores are below the national average in

[2] The change in the sample or this version of the survey (excluding people aged 55 and older) might have contributed artificially to the reduction in the average score.

Atlantic Canada (6.02), Ontario (5.90), Alberta (5.85) British Columbia (5.58), and Saskatchewan (5.57).

- There is agreement that mortgages are "good debt". The figure for this year (6.99) is fractionally below the historic average of 7.04. Opinions show very little variation across the country, as most provincial averages are close to the national average.

Table 2-1
Summary of Consumer Responses to Topical Question, by Date of Survey
(Average Scores on a Scale of 1 to 10)

	Fall 2010	*Fall 2011*	*Fall 2012*	*Fall 2013*	*Fall 2014*	*Fall 2015*	*Fall 2016*	*Fall 2017*	*Fall 2018*	*Mid-Year 2019*
Low interest rates have meant that a lot of Canadians became homeowners over the past few years who should probably not be homeowners	6.88	7.11	7.01	7.04	6.98	6.80	7.03	7.15	6.76	6.52
I regret taking on the size of mortgage I did	3.86	4.04	3.88	3.82	3.89	3.67	3.60	3.67	3.37	3.31
I/My family would be well-positioned to weather a potential downturn in home prices	6.54	6.72	6.67	6.93	6.95	6.92	7.02	7.09	7.02	6.81
Real estate in Canada is a good long-term investment	7.13	7.27	7.26	7.44	7.35	7.37	7.17	7.15	7.22	7.16
I am optimistic about the economy in the coming 12 months	N/A	6.02	6.13	6.36	6.25	6.23	5.99	6.26	6.01	6.07
I would classify mortgages as "good debt"	N/A	7.07	7.05	7.20	7.15	7.06	7.02	6.94	6.87	6.99

Source: Mortgage Professionals Canada survey, Fall 2010 to Mid-Year 2019; Estimates by the author.

Expectations

Since 2010, questions have been asked about expectations. Again, the responses are given on a 10-point scale.

- Some changes have been made in this area of the survey. Previously, we asked whether this is a good time to buy a home or condominium. This time, the two housing forms were separated. This year's results show that attitudes are much more positive towards houses (average of 6.31 out of 10) than for condominiums (5.35). Unfortunately, this change in methodology makes it impossible to compare the current results to prior surveys.

- The average scores concerning houses are above the neutral threshold in all regions, signifying that Canadians in all regions consider this a good time to buy. Attitudes about house buying are most positive in Atlantic Canada (7.01) and Alberta (6.96) and least positive in British Columbia (very close to the neutral level, at 5.52) and Ontario (5.94).
- Concerning condominium purchases, the average scores are below the 5.5 neutral level in all regions except for Alberta (slightly above neutral, at 5.77).
- For expectations about price growth, this year's survey also asked separately about houses and condominiums.
- For house price growth, expectations are above the 5.5 neutral level in all regions, signifying that there are expectations for prices to rise (this occurs notwithstanding that prices currently seem to be eroding in some of the provinces). The strongest expectations are in Quebec (7.25 out of 10) and Ontario (7.03). The weakest expectations are in Saskatchewan (5.65) and British Columbia (5.84).
- For condominiums, price expectations are a bit weaker, but the national average of 6.40 is still well above the neutral level. Expectations are strongest in Ontario (6.91) and Quebec (6.63). Expectations are below the neutral level in Saskatchewan (5.20) and Alberta (5.43).

Table 2-2
Attitudes about Buying Conditions and Price Expectations
(Average Scores on a Scale of 1 to 10)

Region	*"Good Time to Buy"...*		*Price Expectations for...*	
	A House	*A Condo*	*Houses*	*Condos*
Atlantic Canada	7.01	5.34	6.40	6.24
Quebec	6.62	5.44	7.25	6.63
Ontario	5.94	5.27	7.03	6.91
Manitoba	6.90	4.88	6.50	5.97
Saskatchewan	6.67	5.00	5.65	5.20
Alberta	6.96	5.77	6.01	5.43
British Columbia	5.52	5.18	5.84	5.75
Canada	6.31	5.35	6.71	6.40

Source: Mortgage Professionals Canada survey, Mid-Year 2019; Estimates by the author.

Throughout the entire history of our consumer survey, Canadians have expected some rises for mortgage interest rates, as the average scores have been above the neutral level of 5.50. This has occurred despite the fact that during this history, interest rates have fallen more often than they have risen. Expectations rose in the 2017 survey and last year, but this year the average of 6.33 has returned to close to prior levels.

In previous editions of our reports, it has been commented that expectations about interest rates may be "adaptive" (influenced by recent events, not by thorough economic analysis). The rise in expectations about interest rates that happened in 2017 and 2018 reflected that interest rates had risen at those times. The retreat that happened to expectations this year reflects that interest rates have fallen recently (see next chart).

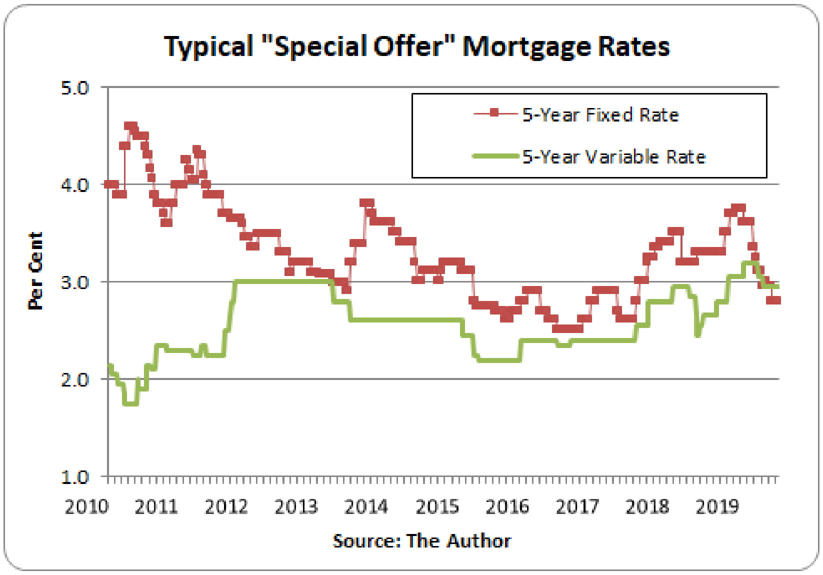


Table 2-3 *Summary of Consumer Responses on Expectations for Rising Interest Rates, by Date of Survey (Average Scores on a Scale of 1 to 10)*										
	Fall 2010	*Fall 2011*	*Fall 2012*	*Fall 2013*	*Fall 2014*	*Fall 2015*	*Fall 2016*	*Fall 2017*	*Fall 2018*	*Mid-Year 2019*
Expectations for rising mortgage interest rates (the coming year)	6.54	6.56	6.51	6.21	6.21	6.16	6.24	6.93	7.15	6.33
Source: Mortgage Professionals Canada survey, Fall 2010 to Mid-Year 2019; Estimates by the author.										

Housing as an Investment

In several editions of these consumer surveys we have asked:

> *Some people view their homes as both a place to live and an investment. How do you think of your home? In the two spaces below, please indicate by percentage, how you think of your home from these two perspectives?*

Consistently, the surveys have yielded average estimates that housing is about 70% a place to live and 30% an investment. The consumer responses have also yielded results that are very similar across different groups of people and different locations.

In the current edition of the survey, results are similar to prior findings: on average, housing is 71% a place to live and 29% an investment. And, once again, the results are very similar across the regions, as is shown in the table below.

Owners and tenants give similar responses. People who expect to buy a home during the coming year or the next few years also indicate that they see housing as 70% a place to live and 30% an investment.

People with the highest expectations for house price growth also see housing as about 70% a place to live.

Very few people see housing as primarily an investment: just 6% see housing as more than 50% an investment.

Table 2-4
To What Extent is a Home a Place to Live or an Investment?

Region	*A Place to Live*	*An Investment*	*Total*
Atlantic Canada	75%	25%	100%
Quebec	70%	30%	100%
Ontario	70%	30%	100%
Manitoba	72%	28%	100%
Saskatchewan	69%	31%	100%
Alberta	72%	28%	100%
British Columbia	71%	29%	100%
Canada	71%	29%	100%

Source: Mortgage Professionals Canada survey, Mid-Year 2019; Estimates by the author.

3.0 Buying a Home Is Hard Work, and It's Stressful

This section is based on several sets of questions that we have never attempted before. Broadly speaking, the intent is to explore how strongly various factors were considered when home owners purchased their first homes.

Importance of Factors

In this section of the survey, we listed 18 different factors that home buyers might consider. Home owners were asked how strongly they considered each factor when they bought their first home. Non-home owners were asked how strongly they will consider each factor when deciding whether or not to buy a home. The results are summarized in Table 3-1, which is 3 pages below.

A few notes on the methodology:

- We thought that asking each consumer to consider all 18 factors was too much, so for each person, nine of the factors were randomly selected.
- Those nine factors were presented at the same time (on one screen) so that the respondents could, if they wanted to, compare the factors.
- While the responses are presented in a "ranked" order here, in the survey they were presented in random order.
- For each of the factors, the consumers were asked to rate how strongly the factor was considered or should be considered (by future buyers), on a scale of 1 to 10, where 1 indicates "did not consider at all" or "not considering at all" and 10 indicates "strongly considered" or "strongly considering".

In analyzing the results, we looked at differences across the regions. In general, there were not substantial differences. We have commented below on some variations that seemed noteworthy.

The most significant variation is that non-owners provided higher rankings than owners for most of the factors (for 15 of the 18 factors). For that reason, the next table shows separate results for owners and non-owners. However, it isn't clear that the differences are very important, since the non-owners are thinking about a hypothetical situation while the owners are remembering (to the best of their ability) actual events.

But, in the comparison of owners and non-owners, there are some interesting differences in the rankings: non-owners attach more importance to saving a down payment, how long it will take to pay off a mortgage, and the amount of interest paid. Owners give higher rankings to the investment aspect of home ownership, the security of having a stable home base, and confidence about future employment situations.

For recent first-time buyers (who made the purchase during 2015 to 2019) scores given are slightly higher than for all home owners. There isn't a clear interpretation for this: it might be that recent buyers have been more thoughtful than prior groups, but it could also mean that recent experiences are felt more strongly than older experiences. That said, the ranking of priorities for first-time buyers is not substantially different than for prior buyers.

The most eye-catching difference is that for first-time buyers, getting a mortgage is the second most prominent factor (versus fourth place for all home owners). This switch is not surprising, given the challenges that are now posed by the mortgage stress tests.

While some of these factors are rated more highly than others, most of the 18 factors were given quite high scores. It isn't surprising that the total cost of home ownership is at the top of the list. But, it is interesting that many of the other factors are only slightly behind.

Our takeaway from this is that deciding to buy a first home is very complicated and very challenging.

There are a few surprises in the results.

- Consideration of future costs for child care is at the bottom of the list. Taking this at face value, it seems worrisome. But, on reflection, it is actually an ambiguous result. For many actual and potential home buyers there are very good reasons to be unconcerned about these costs: they might not have children and don't expect to have children. Or, if they have children, they might have or expect to have limited child care costs. For example, care will be provided for free by a relative or friend, or via a low-cost government program, or the children are old enough to not need a care program. Or, the thinking might be that their child care costs will not increase in future, so that future changes are not an issue. We just don't have enough information to be able to interpret this result.
- Similarly, the low ranking for transportation costs is initially surprising and potentially of concern, but in this data, we don't know about people's actual or potential costs and therefore cannot be confident about how important this should be. Average scores for transportation costs were slightly above the national average (5.89) in Ontario (6.05) and Quebec (5.98). The score for British Columbia was below average (5.54).
- It is also surprising that housing as an investment was the third highest ranked factor. However, we asked how much consideration was given to each factor, and we don't know from these results how important it was as a factor in the actual decisions. Given all of the noise around house price trends, maybe it isn't surprising that people think a lot about this. It is notable that how much the home's value might rise in future is considerably farther down the list of factors (13^{th} out of 18 factors). Value growth receives slightly more consideration in the two highest priced provinces, at 7.33 out of 10 in British Columbia and 7.20 in Ontario, versus the national average of 7.02.
- The amount of funds available for discretionary purchases is surprisingly low on the list. Even so, this factor does get a substantial amount of consideration. I hope recent home buyers are remembering to have enough fun.
- The survey included a few factors that are strictly non-financial. The security of having a stable home base ranked highly (5^{th} out of 18), with an average score (7.54), showing that

this is a quite important consideration. On the other hand, the prestige of being a home owner is ranked quite low (17th). Interestingly, the scores for prestige are highest in the provinces with the lowest house prices. The province with the highest prices (British Columbia) produced the lowest score for this factor (4.93, versus the national average of 5.26).

The most important criticism of the mortgage stress tests is that while they assume that interest rates will be substantially higher when the mortgage is renewed in future, they do not consider that incomes will have also changed. Consumers' home buying decisions do give substantial consideration to both of these factors, with future incomes being more prominent (an average of 7.23 out of 10) than future interest rates (6.83). It is a shame that the government's mortgage regulations fail to consider both of these factors that will determine the outcomes of future mortgage renewals.

Table 3-1
Strength of Consideration for Factors Around First-Time Home Buying

Factor	*Average Rating (Scale of 1-10)*				*Rank (1=Highest Score)*			
	Non-Owners	*Owners*	*Recent FTBs*	*Total Sample*	*Non-Owners*	*Owners*	*Recent FTBs*	*Total Sample*
Monthly house-related costs (i.e. mortgage payment, hydro, heat, insurance, etc.)	8.14	7.81	7.98	7.90	2	1	1	1
Monthly cost of ownership compared to renting	7.88	7.61	7.72	7.70	4	3	3	2
Owning a house as a long-term investment	7.49	7.73	7.65	7.66	9	2	4	3
Getting a mortgage	7.73	7.57	7.80	7.61	6	4	2	4
The security of having a “stable” home base	7.49	7.55	7.47	7.54	10	5	7	5
Saving for a down payment	8.19	7.20	7.48	7.52	1	9	6	6
The amount of time it will take to pay off the entire mortgage	8.04	7.25	7.41	7.49	3	8	8	7
The amount of the mortgage you would pay off per year	7.72	7.27	7.39	7.39	7	6	9	8
Your confidence in being employed over the next several years	7.33	7.26	7.49	7.28	13	7	5	9
The amount of interest you would pay per year	7.82	7.00	7.19	7.23	5	12	11	10
The amount your income might increase or decrease in the future	7.66	7.03	7.12	7.23	8	11	13	11
The amount of funds available for discretionary purchases (i.e. dining out, shopping, vacations, etc.)	7.41	7.05	7.20	7.16	12	10	10	12
The amount the value of the home might increase or decrease in the future	7.45	6.86	7.13	7.02	11	13	12	13
The amount that interest rates will increase or decrease in the future	7.17	6.70	6.69	6.83	14	14	14	14
The amount your transportation costs will change in the coming years	6.61	5.59	5.69	5.89	15	15	15	15
Possibility of having to move a lot in the future	6.03	5.18	5.55	5.42	16	17	17	16
The “prestige” of being a home owner	5.15	5.31	5.56	5.26	18	16	16	17
The amount your child-related expenses will change in the coming years	5.82	4.99	5.24	5.23	17	18	18	18

Source: Mortgage Professionals Canada survey, Mid-Year 2019; Analysis by the author.

Buying a Home is Stressful

In addition to being complicated and challenging, buying a home is stressful. In this edition of the consumer survey, we listed six life events (which we thought might show a range of stress levels) and asked Canadians "In your opinion, how stressful would the following decisions be?" A 10-point scale was used, where 10 means "very stressful" and 1 means "not stressful at all". While the results are shown here according to rankings, in the survey the six items were presented in random order.

As is shown in the table, the consumers indicated that the most stressful of the six decisions is deciding to change city. Deciding to buy a home came second, ahead of deciding to have children or get married.

In analyzing the data, it was found that the reported stress levels vary by age group. In general, the youngest age groups have the highest levels of stress. This is certainly the case for deciding to buy a home.

Table 3-2
Stressfulness of 6 Life Events (Average Scores on a Scale of 1-10), by Age Group

Decision	*23 to 27*	*28 to 33*	*34 to 38*	*39 to 54*	*Total*	*Rank*
Deciding on moving to a new city for a career opportunity	7.72	7.59	7.74	7.46	7.61	1
Deciding to buy a home	7.63	7.35	7.18	6.88	7.18	2
Deciding to have children	7.55	7.28	6.82	6.30	6.86	3
Deciding to get married	6.45	6.42	6.06	6.08	6.21	4
Deciding which post-secondary school to attend	5.44	5.49	5.28	5.19	5.33	5
Deciding to buy a vehicle	5.67	5.53	5.33	4.98	5.31	6

Source: Mortgage Professionals Canada survey, Mid-Year 2019; Analysis by the author.

Yet, We Still Buy Homes

Buying a home is complicated and challenging, and stressful. Yet we still buy homes. We do it because we believe that it will make us better off than if we rent. (In the next section, I argue that this belief has more validity than is generally accepted.)

We also buy homes because we see non-financial advantages (such as the stable home base mentioned previously).

After taking the consumers through the list of 18 factors that was discussed above (and having previously investigated stress levels), our survey asked Canadians:

*Based on your knowledge and experience with all of these considerations, in your opinion, over the course of a person's life, would they be better off **financially** as a home owner or a tenant/renter?*

By an enormous margin, Canadians believe that they will be financially better off as home owners. As is shown in the next table, 76% believe they would be better off as owners versus just 8% as tenants (and 16% responded "don't know or not sure"). This applies across age groups.

Table 3-3 *Which is Better Financially? By Age Group*					
	23 to 27	*28 to 33*	*34 to 38*	*39 to 54*	Total
Home ownership	73%	72%	77%	79%	76%
Renting	13%	7%	8%	7%	8%
Don't know/Not sure	14%	20%	15%	14%	16%
Total	100%	100%	100%	100%	100%
Source: Mortgage Professionals Canada survey, Mid-Year 2019; Analysis by the author.					

A second view of the survey data looks at home owners versus renters and others (people who do not rent, e.g. live with parents, family). This also shows very strong dispositions towards home ownership.

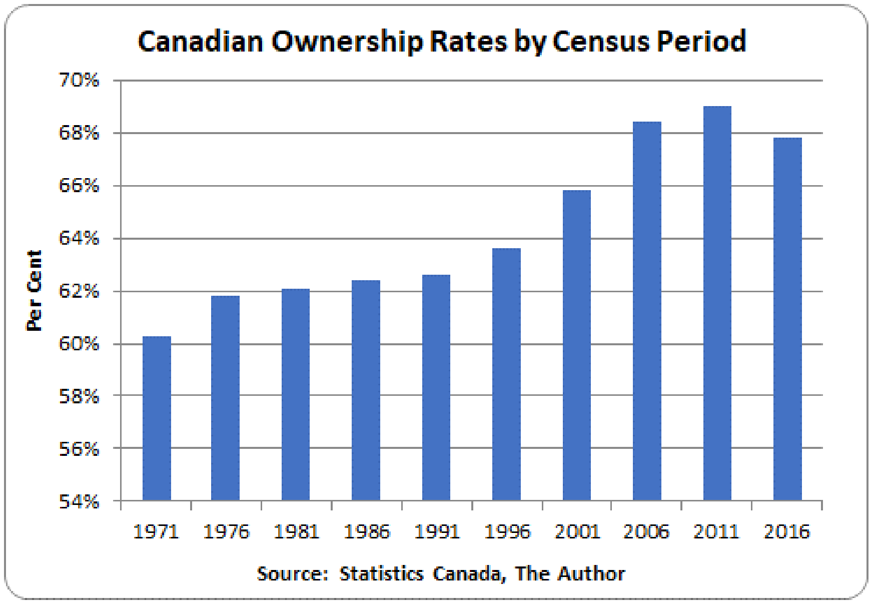
Table 3-4 *Which is Better Financially? By Current Housing Situation*				
	Home Owner	*Renter*	*Other*	Total
Home ownership	81%	63%	67%	76%
Renting	5%	16%	12%	8%
Don't know/Not sure	14%	21%	22%	16%
Total	100%	100%	100%	100%
Source: Mortgage Professionals Canada survey, Mid-Year 2019; Analysis by the author.				

While Canadians believe strongly that there are substantial benefits in being home owners, the federal government holds a very different view. Since the fall of 2008, the government (Conservative party, up to October 2015, and Liberal party since then) has taken multiple steps that have made it increasingly difficult to obtain the mortgage financing that is needed. For those interested in a refresher on those multiple actions, a summary was provided in the November 2017 report "Annual State of the Residential Mortgage Market in Canada" (see pages 15-16 for a summary of the changes, and the following pages for brief descriptions of the impacts). That report can be found here:
https://mortgageproscan.ca/docs/default-source/consumer-reports/november-2017-report/november-2017-report.pdf

To briefly summarize some lengthy discussions:

- The policy changes were not equal in their impacts. Out of the first six sets of changes, only one had substantial and long-lasting effects – the elimination of mortgage insurance for amortization periods exceeding 25 years, which took effect in July 2012.
- The seventh and eighth changes (the mortgage stress tests for insured mortgages, in the fall of 2016, and then for uninsured mortgages from federally-regulated lenders, at the start of 2018) would in combination have substantial and long-lasting depressive effects. Subsequent economic impacts that would develop, with a gradual worsening into 2021.

Data from the Census of Canada (conducted every five years) shows that the home ownership rate in Canada rose during 1971 to 2011, but then fell in 2016. That downturn is attributable to a substantial degree to the federal government policy changes that have made it more difficult to buy homes. We don't have more recent-data, but it is highly likely that the ownership rate has fallen further since 2016.



In addition, the policy-induced suppression of home buying is resulting in reduced housing construction (at a time when there are multiple factors that should be driving increased construction activity). If this suppression continues, we will find in future that inadequate supplies of new housing will have serious long-term impacts on the ability of Canadians to meet their legitimate housing needs, in both the ownership and rental sectors.

Home Ownership Does Appear to be Financially Advantageous

Canadians believe that home ownership is financially better than renting. A lot of well-informed people would argue that this belief might have been true looking at the past, but looking into the future it will be wrong and home ownership no longer makes sense financially.

I agree that conditions have changed, but I'm not persuaded that the belief is wrong. In a September 2018 report ("Owning Versus Renting a Home in Canada", September 2018) I looked at the costs of owning versus renting (for comparable properties) for a large number (266 cases) of locations and housing types across Canada[3]. The key conclusions are:

- In terms of total monthly costs, it is true that renting costs less than owning, and very often by quite large amounts.
- However, the monthly cost of homeownership includes large amounts of repayment of principal, which is a form of saving. Therefore, it is reasonable to net-out principal repayment from the cost of ownership. On that basis, the costs of owning and renting are closer. In fact, on this net-cost basis, the cost of ownership is lower than the cost of renting in 202 of the 266 cases (76%).
- This is for the first year. Once the person is in the home, the monthly cost will increase more rapidly on a rental basis than for an owner-occupant, because the largest component of the owners' monthly costs (the mortgage payment) is fixed and the costs that do inflate (taxes, utilities, and condominium fees, if applicable) are a small share of the total cost.
- Home ownership, in comparison to renting, provides a positive rate of return on the owner's investment of equity, and that rate of return will increase over time.
- Even if interest rates increase at a future mortgage renewal, the effect will most likely be to reduce the financial advantage of owning, not to eliminate it entirely.
- That study used the data and assumptions that would apply as of a year ago. The data and assumptions to be used today would be quite similar and the conclusion would not be materially different, that over the course of a lifetime, ownership is much better financially than renting.
- Statistics Canada data show that home owners have much more "net wealth" than renters who are in the same situations (people in the same age groups and the same income brackets). In part, that is because of their home equity. But, they also have more savings in other forms. This is because the lower cost of home ownership over their lifetimes-to-date has allowed them to save more in other forms.
- A short additional comment in the report extends this argument to investments in rented condominiums and other forms of housing. It has been widely reported that these investors often have monthly costs higher than the rents they are receiving (they have a negative cash flow), and this is often taken to mean that these investors are unsophisticated (or worse). To the contrary, these investors may be looking realistically at the total returns on their investments, including the return that results from reduction of mortgage principal, as well as the rapid improvement to the cash flow that will result from growth of the monthly rent being faster than the growth of monthly costs.

Government policies that are aggressively impairing home buying will harm the long-term financial interests of Canadians.

[3] The report can be found here: https://mortgageproscan.ca/docs/default-source/government-relations/owning-vs-renting-2018.pdf

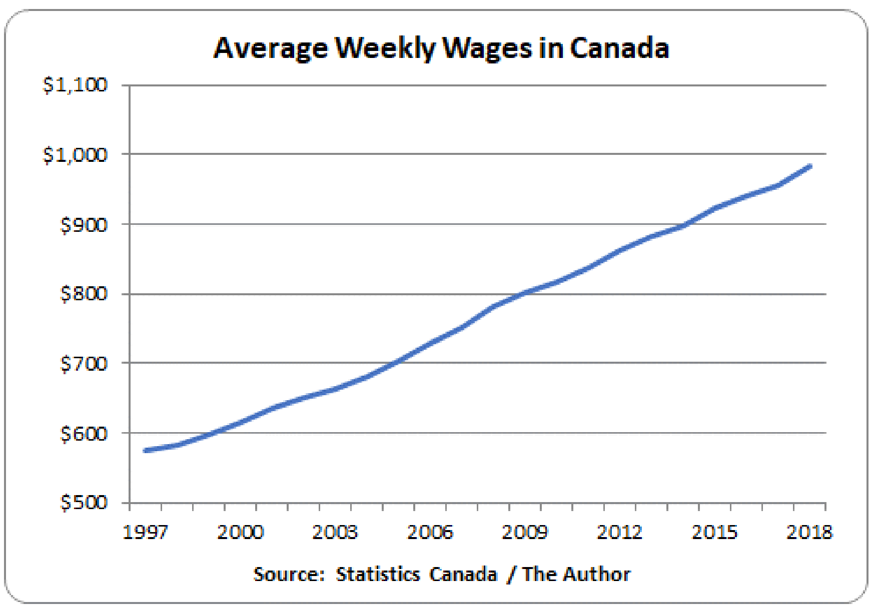
4.0 The Federal Government's Mortgage Regulations

There are two (slightly different) mortgage stress tests in Canada.

- For new insured mortgages (generally, where the down payment is less than 20% of the purchase price), the testing must be done at the "posted rate" for 5-year fixed rate mortgages (as published by the Bank of Canada).
- For new uninsured mortgages that are issued by federally-regulated financial institutions, the testing is done at the greater of the posted rate or 2 points above the contracted interest rate. In addition, testing is required when an existing mortgage is transferred to a federally-regulated lender.

For most of this year, the posted rate was 5.34%. At mid-July, it was reduced slightly, to 5.19%.

By contrast, considerably lower actual rates are available: my opinion-estimate of a typical advertised rate by major lenders is now 2.80% for 5-year fixed rate mortgages and 2.95% for 5-year variable rate mortgages. The variable rate has been higher than the fixed rate since mid-June. The recent "negative spread" between fixed and variable rates is unusual: during this decade, the average spread has been +0.7 points. For the year-to date (up to August 7), the averages are: 3.18% for 5-year fixed rate mortgages and 3.05% for 5-year variable rate mortgages. Lower rates are available for terms shorter than 5 years, and, as noted, these are advertised rates: even lower rates can often be negotiated. In consequence, most new mortgages are being tested at rates that are 2 or more points above the actual contracted rates.



As was noted in the Introduction and Summary, the stress testing does not consider that incomes will rise. Data from Statistics Canada's Labour Force Survey indicates that during 1997 to 2018, the average weekly wage in Canada rose in every year, and by an average of 2.6%[4] per year. If it should happen that interest rates rise by the substantial amounts assumed by the stress tests, then it is highly likely that this would be in the context of a strong economy, in which wages are increasing robustly (at or

[4] This equates to 13.7% per 5-year period. During the last 5 years, the average weekly wage increased by 11.6%.

above the long-term average). In consequence, the stress tests are badly under-estimating the ability of mortgage borrowers to afford their future payments.

The Survey Data

The survey asked several questions about the stress tests.

Firstly, the data showed that just 50% of Canadians were aware of the stress tests before we asked about them. This isn't necessarily a cause for concern: most people do not expect to imminently buy a home and therefore they don't have a pressing need to be informed.

But, when we looked at the data for people who expect to buy a home in the next year, just 49% were previously aware of the stress tests. That is concerning. Some of them might make binding commitments to buy, but then find they are unable to get financing on good terms.

Then, we asked the people who were previously aware of the policies how well they understood them. On a scale of 1 to 10, the average self-rating was quite high, at 7.72. (1 indicates "do not understand at all", 10 indicates "understand completely".) Just 11% indicated a poor understanding (5 or less on the 10-point scale), while 89% believe they have a good understanding (6 or more in the 10-point scale)

Among people who expect to make a purchase in the next year (and were previously aware of the policies), the average self-rating was even higher, at 7.90 out of 10. Again, only a small minority (10%) indicated that they have a poor understanding.

We asked eight questions about the expected effects of the regulations (in each case, answers are given on a scale of 1 to 10, where 1 indicates "completely disagree with the statement" and 10 indicates "completely agree with the statement"). The different statements were presented in random order. The results are summarized in the next table, in which we are showing the average responses for the three groups: the entire sample, people who expect to buy a home in the next year, and then for people who expect to buy in the next year, were previously aware of the policies, and consider themselves to be well-informed (i.e., they gave a rating of 6 to 10 for their understanding of the policies).

The responses indicate that consumers believe:

- The policies will make it moderately more difficult to buy a home.
- Furthermore, there will be added difficulty in making a preferred purchase.
- There is lukewarm agreement that the policies will limit price growth.
- There is moderately strong agreement that the policies will achieve the stated objective of reducing risks around rising interest rates.
- But, there is also moderately strong agreement that the policies will force more home buyers to pay higher interest rates.

- There is moderately strong agreement that it is unfair to not consider factors other than interest rates (such as the potential for income growth).
- There is moderate agreement that the requirement for stress tests of mortgage transfers will reduce options.
- Finally, substantial numbers of potential mortgage borrowers feel that they don't understand the rules (see the middle column).

Table 4-1
Opinions Concerning Impacts of the Mortgage Stress Tests
(Average Scores on a Scale of 1 to 10)

Statement	*Total Sample*	*Expect to Buy Within 1 Year (1)*	*Expect to Buy Within 1 Year and Consider Self Well-Informed (1)*
"With these changes in the mortgage rules, it will be harder for me to buy a home or condominium."	5.92	6.48	6.25
"The new mortgage rules will make it harder for me to buy a home in my preferred neighbourhood."	6.06	6.90	6.78
"The new mortgage rules will keep housing prices from increasing significantly in my neighbourhood."	5.39	5.47	5.17
"The new mortgage rules will ensure that home buyers will still be able to afford their homes if interest rates rise by a large amount in the future."	6.84	6.49	6.63
"These new mortgage rules will result in more people having to turn to more expensive mortgage options from lenders."	6.62	6.64	6.47
"The new stress tests unfairly use interest rates as the only criteria for assessment, ignoring other important factors (e.g. the potential for your financial situation to improve in the future, offsetting potential interest rate increases)."	6.43	6.63	6.16
(For Owners with Mortgages) "The new mortgage rules will reduce my options when it comes time to renew my current mortgage." ***See Note 1***	5.73	5.98	5.71
"I don't really understand how these rules will affect me personally."	4.71	4.48	2.80

Source: Mortgage Professionals Canada survey, Mid-Year 2019; Analysis by the author.
Note: (1) For the statement about mortgage renewal, the second and third columns are for mortgage borrowers who expect to renew during the remainder of this year or in 2020.

5.0 Three Policy Options to Support First-Time Home Buying

The federal government (in its spring 2019 budget) announced two policies that are intended to support first-time homebuying. In addition, associations representing mortgage professionals, real estate professionals, and home builders are advocating for a third policy option. The consumer survey investigated opinions relevant to these options.

"The Shared Equity Plan"

The federal government's First Time Home Buyer Incentive Plan starts on September 2. It is safe to say that there is a substantial amount of uncertainty about how the program will operate and how consumers will respond to it.

In the survey, we described it as follows:

> Recently, the federal government announced plans to launch the new First Time Home Buyer Incentive Plan, to assist first time buyers with their monthly payments. Qualified buyers still require a minimum 5% down payment, but the federal government (through the Canada Mortgage and Housing Corporation) may also invest an additional 5%, meaning the home purchaser need only finance 90% of the purchase price with a traditional insured mortgage (instead of 95%). In exchange for this, the government becomes a co-owner of the home. The government's co-ownership is considered to be an equity mortgage and must be repaid at the time the home is sold, refinanced[5], or the traditional mortgage is finally paid. The key components of the plan are as follows:
>
> 1. The government will purchase 5% of a resale home and up to 10% on a newly built home.
> 2. The government's contribution will reduce your monthly payments. That is, if you provide 5% down payment, you would usually finance 95% of the purchase. Under the program, you provide 5% down payment, the government purchases 5%, and you only have to finance 90% through a traditional mortgage.
> 3. Your household income must be less than $120,000.
> 4. The total combined value of your mortgage and the government's contribution can not be higher than 4 times your household income.
> 5. The government is legally part owner of the house, which means it is entitled to share in the gains if the property increases in value, as well as suffer losses if the property decreases in value.

In the survey, we asked Canadians to respond to eight opinion statements about the plan (on a 10-point scale, where 1 indicates "disagree completely" and 10 indicates "agree completely"). The next table summarizes the responses. Average responses of 5.5 out of 10 would indicate neutrality.

[5] Since then, CMHC has clarified that refinancing will not trigger a requirement for repayment. The wording in the survey questionnaire reflects the information that was available at the time.

The next table summarizes the responses.

There is some agreement that the program will help Canadians buy their first homes – the average score is 6.35, versus the neutral threshold of 5.5. The number of people with positive expectations (29%) is almost triple the number (10%) with negative expectations.

There is stronger agreement (6.92 on the 10-point scale) that the program will have limited effectiveness in major cities. This, in fact, appears to be the government's intention, to create a policy that will not stimulate demand in the most expensive communities.

Overall, Canadians believe that the program will result in higher house prices. In April, CMHC suggested that the price impact would be quite small, raising national housing prices by just 0.2% to 0.4%.

By a slim amount (at an average score of 5.99, which is slightly above the neutral level of 5.5) Canadians see the shared equity feature as fair.

Among first-time home buyers (both past buyers and potential future buyers), only a minority believe that they would use the program, and larger numbers believe that they would not.

The seventh and eighth statements were, in part, a small experiment to explore the idea that for some questions, the answers depend on how you ask them. The statements are essentially the same, offered once as a negative proposition and then as a positive proposition. In a perfect world, these two formulations would be answered in exactly opposite ways.

- The sum of the average scores should add to 11. Here, the sum is close to that, at 11.37.
- Also, we should expect that the number of "no opinion" should be the same in both formulations (not quite, at 31% versus 34%).
- And, the number of positives in one formulation should match the negatives in the other. Again, the actual responses didn't quite match this.
- Looking at the individual responses, there were perfect matches for just 38%. The results were very close for 61% of the sample (either perfect matches, or responses that were off by just one point).
- While there is a discrepancy, the reasonable consistency between the two formulations indicates that overall, opinions are negative about using the program.

But, to be successful, the program does not have to be to everyone's taste – it just has to provide some relief to a reasonably large number of first-time home buyers, and ultimately, they need to be reasonably happy about the way it works out for them.

Table 5-1 *Summary of Consumers' Opinions About the First Time Home Owner Incentive* *(Average Scores on a Scale of 1 to 10)*						
Statement	*Average Score*	*% No opinion*	*% Strongly Positive (8-10)*	*% Neutral (4-7)*	*% Strongly Negative (1-3)*	*Total*
"This plan will make it easier for Canadians to afford their first home"	6.35	8%	29%	53%	10%	100%
"The income limits will not help those wanting to purchase a home in major cities"	6.92	12%	37%	45%	7%	100%
"The proposed plan will increase prices of starter homes"	6.49	14%	29%	50%	7%	100%
"If the government provides funds to become a co-owner and helps lower monthly payments, it is fair that the government should make money if the value of the home increases"	5.99	9%	31%	41%	19%	100%
[For HOMEOWNERS only] "I would have used this incentive if it existed when I purchased my first home"	4.49	11%	18%	32%	38%	100%
[For NON-HOMEOWNERS only] "I will use this incentive if it is available when I purchase my home"	5.28	9%	24%	39%	28%	100%
"Even if it reduces my monthly payments, I would never give up part-ownership of my home to the government"	7.12	8%	48%	31%	13%	100%
"Because it reduces my monthly payments, I would be willing to give up part-ownership of my home to the government"	4.25	10%	14%	34%	41%	100%
Source: Mortgage Professionals Canada survey, Mid-Year 2019; Estimates by the author.						

Some further comments:

- Canada Mortgage and Housing Corporation expects that the program will have 100,000 clients during its three years. The annual average of 33,000 would be equal to about one-tenth of the total number of first-time buyers that we would expect to see in a normal year (about 300,000).

- With a total budget of $1.25 billion, for 100,000 clients the average "shared equity" investment would be $12,500. If all of the purchases were for existing properties (and therefore the investment was 5% of the purchase price), that would mean that the average purchase price was $250,000. That seems too low. Moreover, to the extent that some clients buy new homes and the investment is 10%, the average purchase price would be even lower. It seems quite likely that the average investment amount will be larger than the $12,500 (more likely, in excess of $20,000), and therefore the $1.25 billion would accommodate considerably less than the expected 100,000 purchases. (Notably, in CMHC's discussion of FTHBI, the examples it uses have FTHBI investments that are far larger than the assumed average of $12,500: it uses a new home costing $400,000, with an FTHBI investment of $40,000, and a new condominium priced at $350,000, with an FTHBI investment of $35,000)[6].

Another consideration is the program's limit (for the combined total of the mortgage plus the FTHBI investment) of four times the borrower's income, which is substantially lower than could typically be borrowed (say, 4.8 to 5 times income). Almost everyone who qualifies for this program would be able to qualify to buy (and obtain a mortgage) without the program. Many potential clients of the program might find that they would have to lower their housing expectations, and therefore decide not to use it.

Other limitations include:

- The survey shows that a majority of Canadians are resistant to the idea of the government having partial ownership of their homes.
- The requirement for mortgage insurance will be a deterrent. Many first-time buyers prefer to make down payments exceeding 20% so that they can avoid the cost of insurance and, of course, to limit their mortgage costs and they might be further motivated by a desire to take an amortization period longer than the 25 years that is permitted for insured mortgages (our survey data indicates that among recent first-time buyers, slightly over one-half have insured mortgages).
- A large share of clients of the program would buy homes even if the program was not available as they can get the financing they need without the FTHBI. Therefore, the program might not result in very much incremental buying – it would just change the financing arrangements.
- All of this considered, even if there is full take-up of the available budget, the impact of the program will most likely be less than 5,000 additional first-time purchases per year.,

[6] The CMHC examples can be found here: https://www.placetocallhome.ca/fthbi/first-time-homebuyer-incentive

"The Home Buyers' Plan"

In the survey, we described this federal government program as follows:

> The Canada Revenue Agency Home Buyers' Plan is an initiative aimed at helping first time buyers. Eligible purchasers can now withdraw up to $35,000 (previously $25,000) of their RRSPs without tax penalty for the purpose of making a down payment on a home. The amount withdrawn from the RRSP must be replaced over the next 15 years.
> Additionally, beginning in 2020, individuals whose circumstances have changed due to a divorce or breakdown of a common law relationship can also use the Home Buyers' Plan, even if they are not a first-time buyer, to help more quickly re-establish a new home for themselves and their family.

The survey responses indicate that just over one-half of Canadians (54%) were aware of the program prior to the survey. Among people who expect to make a first-time home purchase during the coming year, 61% were previously aware of the program. This limited awareness could be an impediment to success of the program (and its recent enhancements).

Further questioning indicates that only a minority of first-time buyers utilized this program when they bought their first home. Among recent buyers (2015 to 2019) just 35% report using the Home Buyers' Plan.

Furthermore, the survey data indicates that among those who use the program, just a small minority have taken full advantage (withdrawing $25,000 or more). Among recent first-time buyers who used the plan, just 38% reported taking out $25,000 (or more).

This combination (two layers of minority utilization) shows that only a small minority of first-time buyers utilize the program to its fullest, and this implies quite strongly that few first-time buyers will take advantage of the enhancements.

A consideration in consumer decisions is that when they look at the numbers, the Home Buyers' Plan doesn't help very much (if at all, and they might conclude that it would make them worse-off). Yes, it does reduce the mortgage amount and therefore the monthly mortgage cost. At an interest rate of 3% (and assuming a 25-year amortization period), the annual saving is equal to 5.7% of the amount utilized. But since money must be returned to the RRSP (in 15 annual installments) the Home Buyers' Plan has a larger payment factor of 6.67% per year. Moreover, if the client has borrowed any money to make the contribution into the RRSP, they would have to make payments on that loan, in addition to the repayment of funds into the RRSP. These numbers go some distance in explaining why there has been limited take-up of the Home Buyers Plan, and imply that take-up of the enhancements will be limited.

30-Year Amortization for Insured Mortgages

Associations representing mortgage professionals, real estate professionals, and home builders are encouraging the federal government to allow 30-year amortization periods for insured mortgages (this was previously allowed for several years, until July 2012; for non-insured mortgages, 30-year amortization is still allowed under federal regulations, although utilization will depend on the policies of the lenders).

In the survey, we described the issues as follows:

> An initiative that's been talked about to help housing affordability overall (not just for first time buyers), is the introduction of a 30-year amortization period for insured mortgages (i.e. insured mortgages are those that have been approved with less than a 20% down payment). *The amortization period is the amount of time it will take to repay the full value of the mortgage.* Currently, the maximum amortization period for an insured mortgage is 25 years.
>
> A mortgage with a longer amortization period allows for smaller monthly payments, compared to a mortgage of the same value with a shorter amortization period. However, the longer the amortization period, the more total interest is paid over the course of the mortgage. If available and used instead of the new First Time Home Buyers Incentive Plan (discussed previously), the government would not be a co-owner of your house: you would own it solely by yourself. It is also important to note you are not locked in for the full 30 years: amortization periods can be adjusted when terms renew, and pre-payment options are usually available. Historically, mortgages in Canada are generally paid in full within 22 years.

The survey obtained responses to several related statements. Once again, the responses are on a 10-point scale, where 1 indicates "disagree completely" and 10 indicates "agree completely".[7] The responses are summarized in the next table.

Out of the four statements tested, two have premises that are favourable for 30-year amortization and two are unfavourable. Interestingly, overall the consumers agreed with all of the statements whether or not those statements were favourable or unfavourable (the average scores were all above the neutral threshold of 5.5, and in all four cases there were substantially more strongly positive responses than strongly negative responses). The analysis also looked at responses by potential future first-time buyers, and those responses were very similar.

One of the four results strikes me as ambiguous. The concern that "30-year amortizations will result in more Canadians purchasing homes that they can't afford" looks similar to the long-standing opinion that low interest rates have caused "other people" to be irresponsible (I think that this belief has been debunked, as discussed earlier): if we could get our survey participants to realistically assess whether they personally would act irresponsibly, the survey result might be very different.

[7] Through an oversight, we did not include a "no opinion" option in this section of the survey questionnaire.

Table 5-2 ***Summary of Consumers' Opinions About 30-Year Amortization Periods for Insured Mortgages (Average Scores on a Scale of 1 to 10)***					
Statement	*Average Score*	*% Strongly Positive (8-10)*	*% Neutral (4-7)*	*% Strongly Negative (1-3)*	*Total*
"Allowing 30-year amortizations on insured mortgages will help make home ownership more affordable in Canada"	6.82	40%	53%	7%	100%
"30-year amortizations will result in more Canadians being worse off overall at the end of their mortgage"	6.09	29%	58%	13%	100%
"30-year amortizations will result in more Canadians purchasing homes that they can't afford"	6.72	39%	53%	8%	100%
"30-year amortizations will allow home owners to control their payments in the critical early stages of their mortgage"	6.92	41%	54%	5%	100%
Source: Mortgage Professionals Canada survey, Mid-Year 2019; Estimates by the author.					

At the end of all of these explorations, we asked a blunt question:

> Based on what you know and read about these initiatives, in your opinion, which would be a better option to make **first-time** home buying more affordable?

Both options have supporters. The responses indicate a stronger preference for 30-year amortization rather than FTHBI.

Table 5-3 ***"In your opinion, which would be a better option to make first-time home buying more affordable? "***	
Option	*% Selecting*
The First Time Home Buyers Incentive Plan, where the government helps to lower monthly payments by investing in your home and becoming a co-owner	27%
The allowance of 30-year Amortizations for insured mortgages, which lowers monthly payments by spreading them out over a longer period, potentially resulting in higher interest paid in the long run	44%
Don't know/No opinion	29%
Source: Mortgage Professionals Canada survey, Mid-Year 2019; Estimates by the author.	

Results vary for different groups within the sample:

- For potential future first-time buyers, the First Time buyer plan receives fractionally more support (35%, versus 33% for 30-year amortization).
- On the other hand, among recent (2015 to 2019) first-time buyers, there is a strong preference for 30-year amortization (45%, versus 29% for the First Time buyer plan).

These results suggest that Canadians would welcome the addition of 30-year amortization for insured mortgages to the toolkit that supports home ownership aspirations.

These responses are, of course, still somewhat abstract, and resulted much more from gut feel rather than any rigorous analysis.

When they are in a more concrete situation of actually choosing between options, home buyers will look at some numbers. Here are some estimates.

In its communications on the FTHBI, CMHC is using an example of a $400,000 home (a newly constructed home, so that the FTHBI investment is 10% of the purchase price). The buyer makes a 5% down payment. The analysis below uses that situation, and also considers the purchase as a resale, with a 5% investment by the FTHBI. The analysis shown here uses a 3.0% interest rate, which at present would be readily available to most of the clients (when CMHC constructed its examples earlier this year, it used a higher interest rate of 3.7%, so its estimates of the savings due to FTHBI are larger than would be calculated today). And, of course, CMHC assumes the maximum mortgage amortization period of 25 years.

The first stage in the analysis is to calculate the monthly mortgage costs that would result in a baseline scenario, then in two alternatives: firstly, with FTHBI and secondly, without FTHBI but with 30-year amortization.

As is shown in the next table:

- For a new home, FTHBI would reduce the monthly cost by $216; 30-year amortization would have a slightly smaller effect, at $208 per month. As is shown in the last two lines of the table, the monthly cost for FTHBI is $8 per month lower than for 30-year amortization.
- For a resale home, FTHBI would reduce the monthly cost by $114; 30-year amortization would (once again) reduce the cost by $208 per month, which is an advantage of $94 per month compared to FTHBI.
- In this initial analysis, for a buyer of a new home, it would be a close call between the two options. For a resale, 30-year amortization appears to be much more attractive.

Table 5-4 *Estimated Cost Savings Due to Two Policy Alternatives*					
	Baseline	**New Home**		**Resale Home**	
	First Mortgage Only, 25-Year Amortization	*With FTHBI (10%)*	*No FTHBI; 30-Year Amortization*	*With FTHBI (5%)*	*No FTHBI; 30-Year Amortization*
Purchase Price	400,000				
Down Payment	20,000				
FTHBI Investment	0	40,000	0	20,000	0
Mortgage Required	380,000	340,000	380,000	360,000	380,000
Mortgage Insurance Premium	4.00%	2.80%	4.00%	3.10%	4.00%
Insurance Premium	15,200	9,520	15,200	11,160	15,200
Mortgage Amount	395,200	349,520	395,200	371,160	395,200
Monthly Payment	1,870	1,654	1,662	1,757	1,662
Difference versus Baseline		-216	-208	-114	-208
Difference for 30-Year Amortization vs FTHBI			8		-94
Source: Estimates by the author.					

But, of course, the buyer should go farther and consider what will happen when they repay the FTHBI investment. The consumer will have to make some assumptions, including how much the value of the property will change. The next table looks at one set of calculations, in which the assumption is that the price will rise by 10% during a period of five years (other scenarios for price change are considered shortly). In addition, there are calculations of how much mortgage principal will remain (if the owner makes only the minimum required payments). Also, it is assumed that selling the home costs 6% of its value.

In this scenario, the home owner will have the most equity in the baseline scenarios (but, they will have made larger mortgage payments during that period, which is an additional consideration that should influence their decisions).

Table 5-5 *A Scenario for Home Equity in 5 Years*				
	Baseline - First Mortgage Only, 25-Year Amortization	New Home *With FTHBI (10%)*	Resale Home *With FTHBI (5%)*	*No FTHBI; 30-Year Amortization*
Assumed Change in Value	10%			
Assumed Value	440,000			
Selling Cost (@6%)	-26,400			
Repay Remaining Mortgage	-337,796	-298,751	-317,248	-351,239
Repay FTHBI	0	-44,000	-22,000	0
Net Equity	75,804	70,849	74,352	62,361
Source: Estimates by the author.				

The next table shows the calculated amounts of net equity in five years, for a range of assumptions about how much the property value will change. In each of these scenarios, the largest amount of home equity results in the baseline analysis (but again, these calculations don't yet consider the impacts of the higher monthly mortgage payments that occur in the baseline).

Table 5-6 *Scenarios for Home Equity in 5 Years,* *For Various Rates of Price Growth*				
Assumed Change in Value in 5 Years	*Baseline - First Mortgage Only, 25-Year Amortization*	New Home *With FTHBI (10%)*	Resale Home *With FTHBI (5%)*	*No FTHBI; 30-Year Amortization*
-10%	604	3,649	3,152	-12,839
-5%	19,404	20,449	20,952	5,961
0	38,204	37,249	38,752	24,761
5%	57,004	54,049	56,552	43,561
10%	75,804	70,849	74,352	62,361
15%	94,604	87,649	92,152	81,161
20%	113,404	104,449	109,952	99,961
25%	132,204	121,249	127,752	118,761
Source: Estimates by the author.				

The final calculations (shown below in Table 5-7) combine the estimates that were calculated above, to show a "bottom-line" comparison of the program options:

- The scenarios for equity that were calculated in Table 5-6.
- Then, subtracting the total of the monthly mortgage payments (shown in Table 5-4), multiplied by 60 to represent the mortgage cost over the five-year analysis period.

For the two versions of the FTHBI, the bottom-line comparisons are better than the baseline in all of these scenarios. For example,

- In the scenario that assumes 10% growth of the property value, the new home FTHBI has an advantage of $8,016 (or $134 per month) over the baseline.
- For the resale option, the FTHBI has an advantage of $5,374 versus the baseline ($90 per month).

This occurs for two reasons. Firstly, the shared equity mortgage from the government is interest-free. At an interest rate of 3% this is worth about $100 per month ($6,000 over five years) for the new home and $50 per month ($3,000 over five years) for the resale. Secondly, the cost of mortgage insurance is considerably less (because the loan amount and the insurance premium rate are lower under FTHBI). As is illustrated in Table 5-4, the FTHBI reduces the mortgage insurance cost by $5,680 for the new home and $4,040 for the resale.

In all of the scenarios, the bottom-line outcome for 30-year amortization is slightly lower than in the baseline (by $960 over 5 years, or $16 per month). This occurs because slightly more interest will be paid. Considering that the regular monthly payments will be much lower with 30-year amortization – helping the borrowers to manage the payment burden – many buyers would consider this small bottom-line cost reasonable and decide that 30-year amortization is a better option than 25-year amortization.

The bottom-line outcomes for the two FTHBI options are better than for 30-year amortization. This is due to the factors already discussed: the interest-free component of FTHBI, the difference in the cost of mortgage insurance, and the slightly larger interest costs that result from extended amortization. An additional consideration for consumers will be the differences in the monthly mortgage payments: for a new home, the FTHBI results in a slightly smaller payment (by $8 per month, as shown in the bottom row of Table 5-4). But, for a resale home, 30-year amortization results in a substantially lower monthly payment (by $94 per month).

Table 5-7
"Bottom-Line" Calculations: Net Home Equity Minus Mortgage Costs, Over 5 Years, For Various Rates of Price Growth

Assumed Change in Value in 5 Years	*Baseline - First Mortgage Only, 25-Year Amortization*	**New Home** *With FTHBI (10%)*	**Resale Home** *With FTHBI (5%)*	*No FTHBI; 30-Year Amortization*
-10%	-111,612	-95,596	-102,238	-112,572
-5%	-92,812	-78,796	-84,438	-93,772
0	-74,012	-61,996	-66,638	-74,972
5%	-55,212	-45,196	-48,838	-56,172
10%	-36,412	-28,396	-31,038	-37,372
15%	-17,612	-11,596	-13,238	-18,572
20%	1,188	5,204	4,562	228
25%	19,988	22,004	22,362	19,028

Source: Estimates by the author.

Based on these estimates, "rationality" might dictate that a large majority of first-time buyers should choose to enrol in the FTHBI, to take advantage of the interest saving and the reduced mortgage insurance cost. But, there are other considerations that will limit take-up.

- The people who expect the largest benefit from FTHBI would be those who expect reductions in home values, but people with this expectation will be less likely to buy.
- As was noted earlier in the discussion of the survey results, a majority of consumers are resistant to the idea of sharing ownership of their homes with the government.
- Uncertainty about future changes in housing values and therefore about the financial outcome will be inhibiting (making it harder to decide to enrol in the FTHBI).
- The program is complicated: understanding the details, assessing the implications, and then making a decision to enrol will be hard work, on top of the hard work that is already involved in buying a home.
- The limit of four-times income (for the combined total of the mortgage plus the FTHBI investment) means that many potential clients would have to reduce their housing expectations compared to what they could otherwise achieve.
- As was noted earlier, close to one-half of first-time buyers make down payments of 20% or more so that they don't need the insurance. For this group, it is hard to imagine that the FTHBI would induce them to switch from zero cost for mortgage insurance to a substantial cost.

The Government Needs to Respond...

Looking broadly, considering results from the consumer survey, plus the other research, the two recent initiatives (the FTHBI and the enhanced Home Buyers Plan) might have very little incremental effect on actual first-time buying.

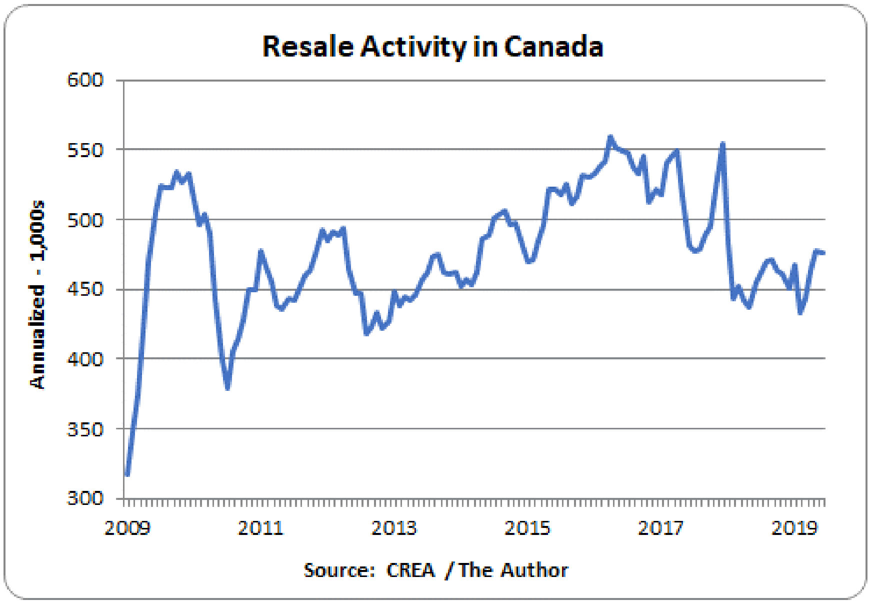
If the government is seriously interested in supporting home ownership aspirations – which, by the way, Canadians hold onto quite strongly – it will add 30-year amortization to the toolkit.

And, it would thoroughly – and in public – assess whether the parameters need to be adjusted for the mortgage stress tests.

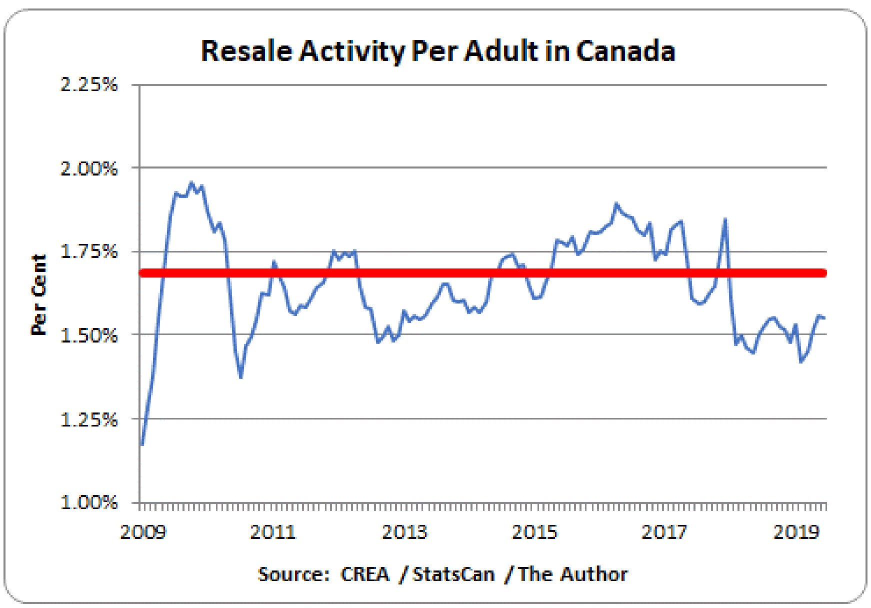
6.0 Housing Market Trends

Trends in the Resale Market

Resale housing activity in Canada fell substantially early in 2018, coinciding with the start of the second mortgage stress test (for uninsured mortgages made by federally-regulated lenders). For all of 2018, total sales (458,848) were 10.8% lower than in 2017, and 15.0% lower than in 2016. So far this year, the sales rate (460,100) is fractionally better than last year. However, there has been further improvement during the past few months (the average sales rate for the second quarter was 472,000).

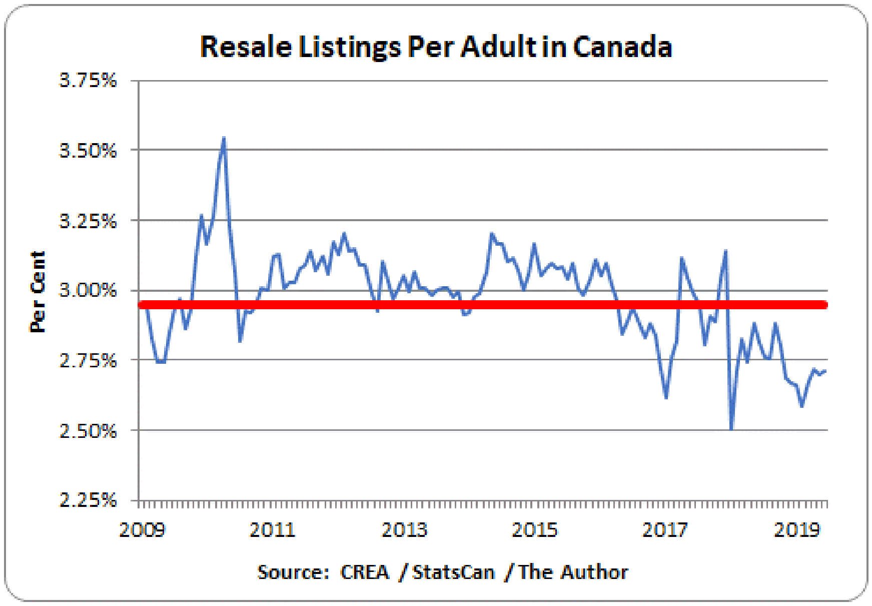


Resale activity should trend upwards over time: as the population grows there are more potential buyers; also, construction of new homes means that there are more properties that could possibly be sold. Therefore, it is useful to look at resale market activity relative to the size of the population. This analysis shows that during the first half of this year, the average sales rate was 1.50%, which was 11% below the long-term average for 2000 to the present (1.68%, which is shown by the flat red line).



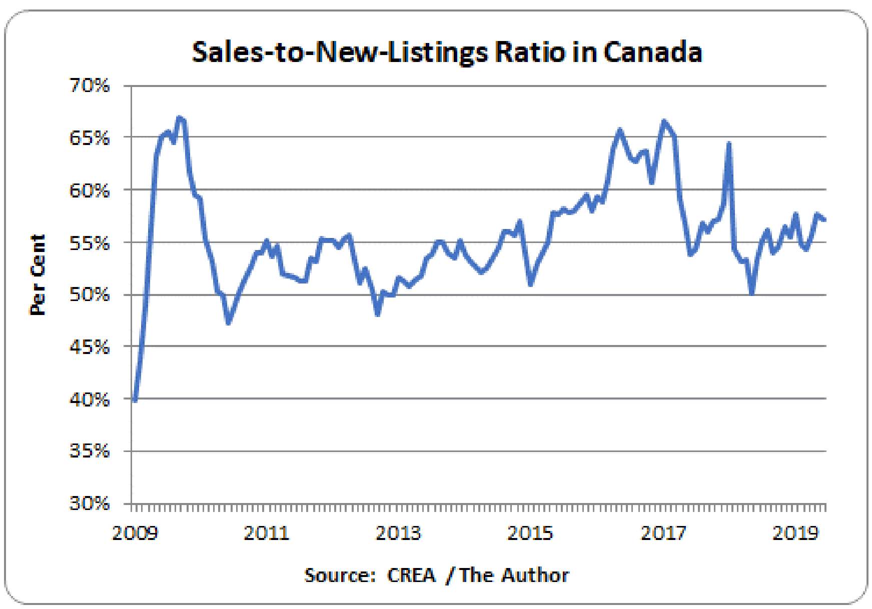
As was discussed in the Introduction and Summary, fundamental conditions have been highly favourable, and the below-average performances for sales since the start of 2018 are highly disappointing. Even if the July data (which will be released after this report was finalized) shows a return to an average level of sales, that performance should still be seen as weaker than we should expect given the economic conditions that currently exist.

Flows of new listings into the resale housing market have also been reduced. Expressed as listings per adult, the rate of inflows of new listings is currently 9% below average. Listings have dropped in large part because potential move-up buyers are finding that the mortgage stress tests have made it more difficult to move, because it has become harder to sell their homes and/or because they wouldn't be able to get the financing they would need.



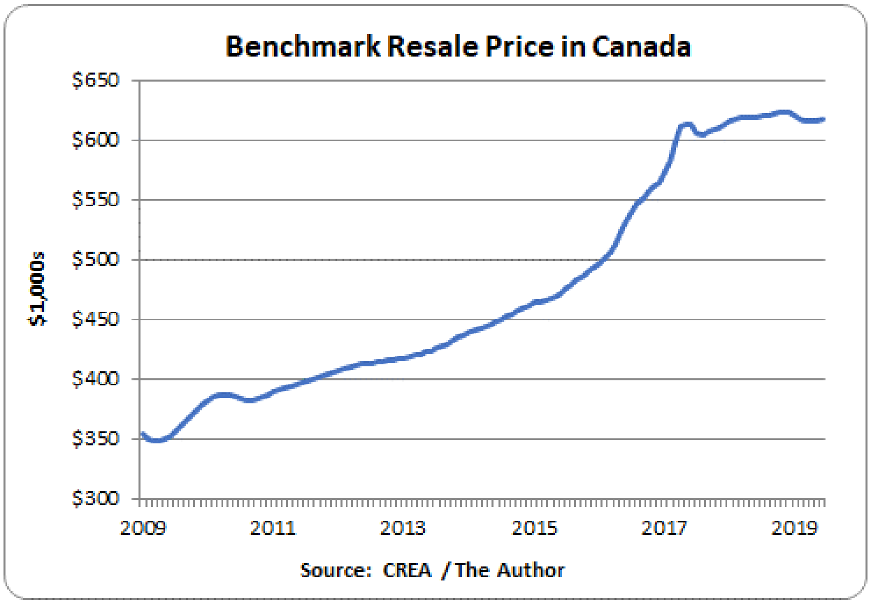
The repression of sales and listings has now lasted for a year and a half, and this could continue for a prolonged period.

With reduced sales and listings, the sales-to-new-listings-ratio ("SNLR") has fallen, from elevated levels seen during 2016 until early 2017. The average SNLR for the first half of this year is 54.9%. This is slightly above my estimate that the threshold for a "balanced market" in Canada is 52% (this is the level at which prices would be expected to rise by 2% per year. On this basis, we might expect that house price inflation in Canada would be in the area of 2-3%

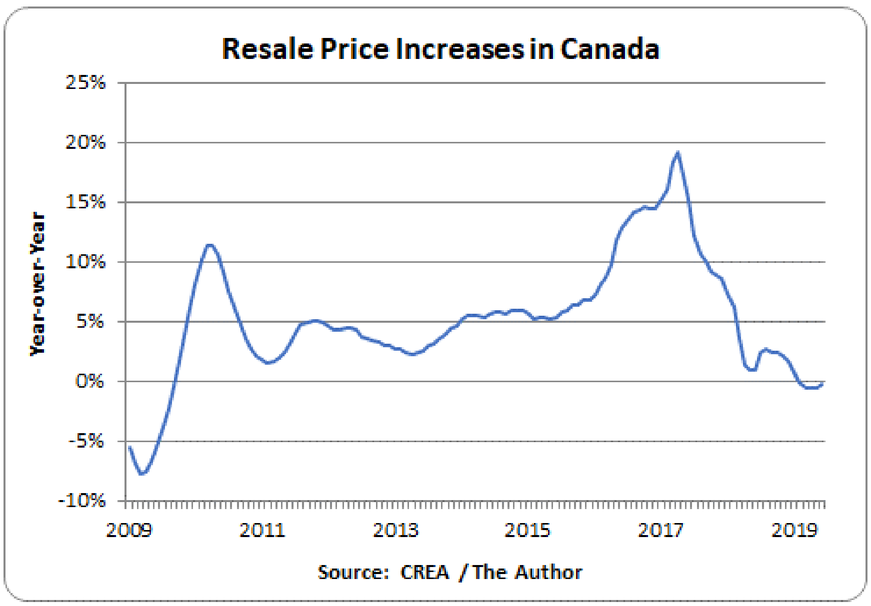


Estimated thresholds for balanced markets vary across the country, depending on the market dynamics that exist in individual areas.

A long period of rapid house price growth in Canada has ended. The House Price Index calculated by the Canadian Real Estate Association ("CREA") suggests that the period of rapid growth ended at about the beginning of 2017. The index has fallen slightly (by 0.3%) during the past year.

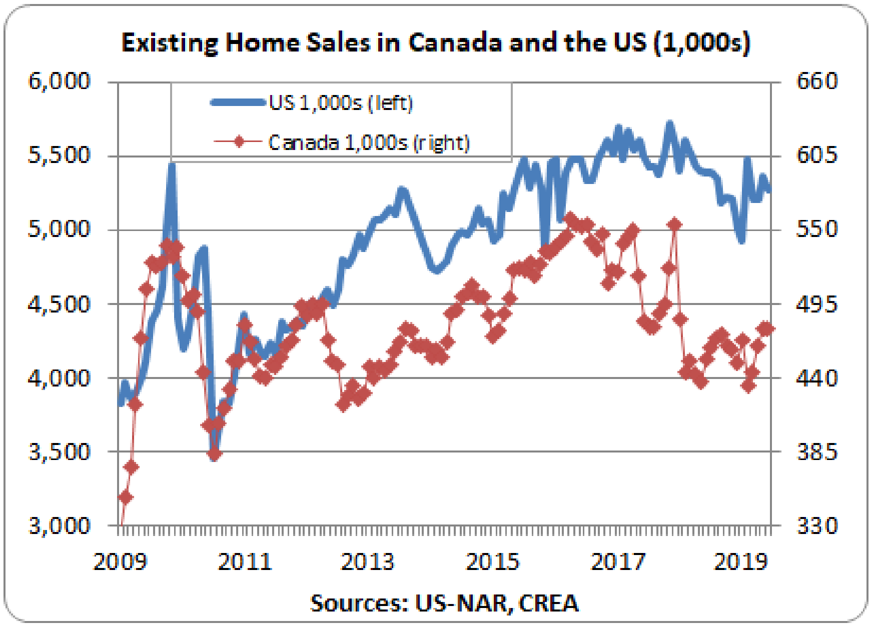


From this data, it appears that prices are under-performing, since the SNLR ratio suggests that we should be seeing moderate price growth. The change in prices nationally is, of course, the result of diverse events occurring across the country. Conditions are currently very mixed: some areas (notably the province of Quebec) are showing very tight conditions (a high SNLR) with rapid price growth, while the three westernmost provinces are seeing quite weak activity, with price erosion.

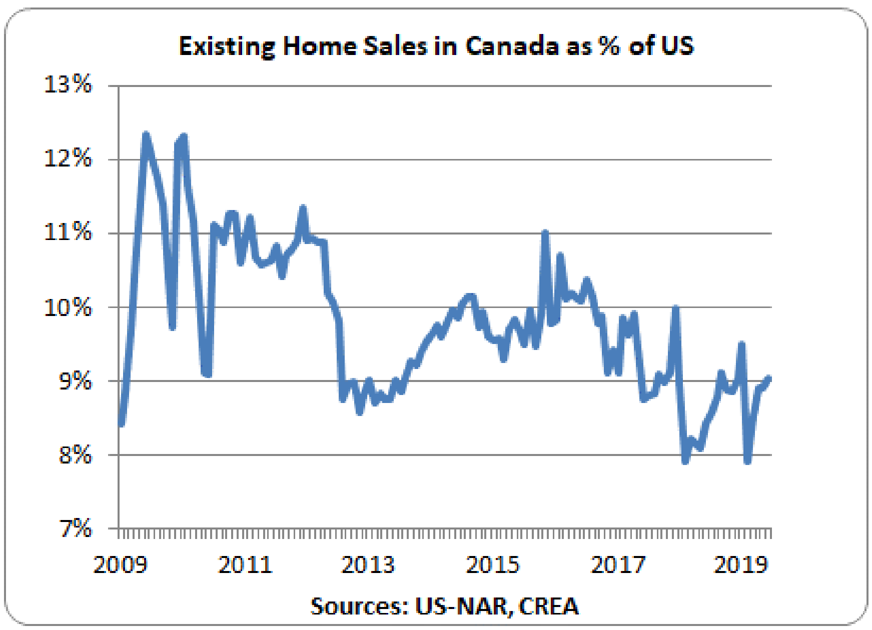


Canada is not alone in experiencing a housing market slowdown. Therefore, it could be that recent weakness in Canadian housing activity is due to forces that are operating throughout the world, rather than to the mortgage stress tests. As a quick check of that theory, Canadian resale activity is compared to the US, in two charts.

The population of Canada is equal to roughly 11% of the US figures. Therefore, in this chart, resale activity in Canada is scaled at 11% of the US figures. This data shows that during 2009 until mid-2012, sales in Canada and the US followed very similar (wild) changes. After mid-2012, the relationship between the Canada and US data broke down. This can be attributed to a significant change in Canadian mortgage insurance policies (the elimination of amortization periods longer than 25 years) that had severe and sustained consequences for home buying. This has been discussed at much greater length in previous editions of these reports, especially the fall 2017 edition.



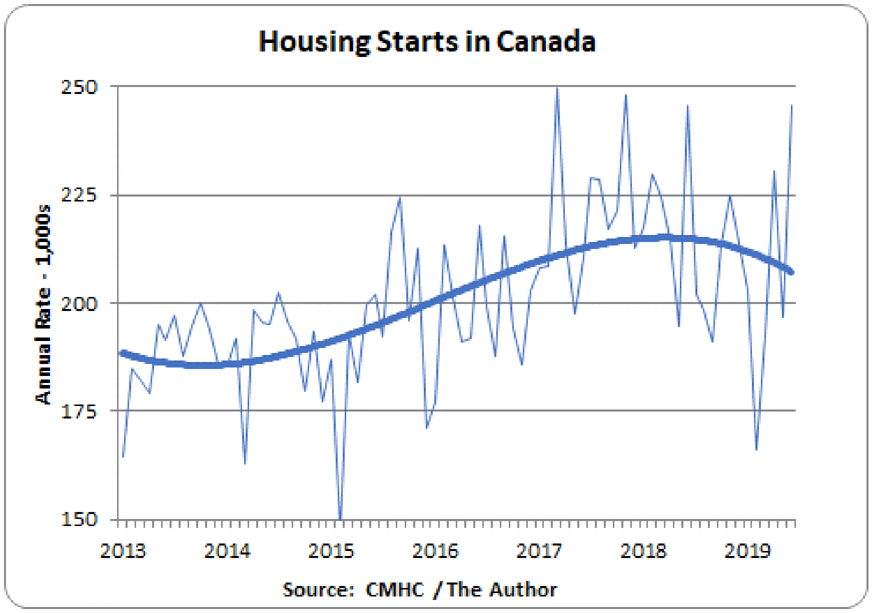
The second chart looks at resale activity in Canada as a percentage of US figures. During 2009 to mid-2012, the shares contained some large month-to-month variations, but overall the share was roughly stable, with an average of 10.8% (very close to the 11% population share). Since then, the Canadian share has been lower, at an average of 9.6% for mid-2012 to the end of 2016. Furthermore, the share has dropped even more, averaging 9.3% during 2017 and then just 8.6% in 2018 and 8.8% for the first half of 2019.



- Canada and the US continue to experience fundamental conditions that are broadly similar, including strong rates of job creation and interest rates that have moved in similar ways.

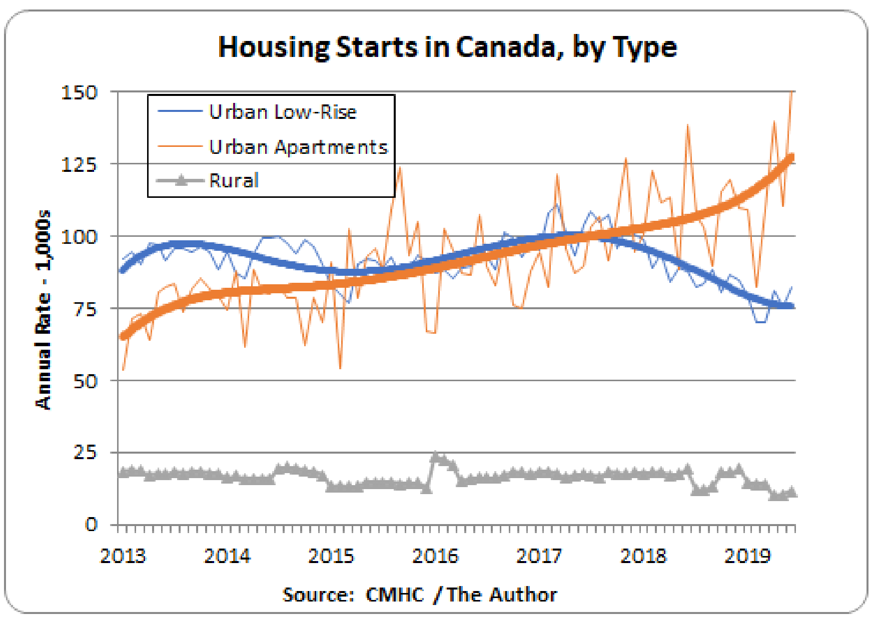
- The on-going deviation since mid-2012 has to be due to factors other than the economic fundamentals. The tightening of mortgage regulations at mid-2012, and again during late 2016 and at the start of 2018 has to be considered a major factor in the on-going relative weakness of Canadian housing activity.

Housing Starts



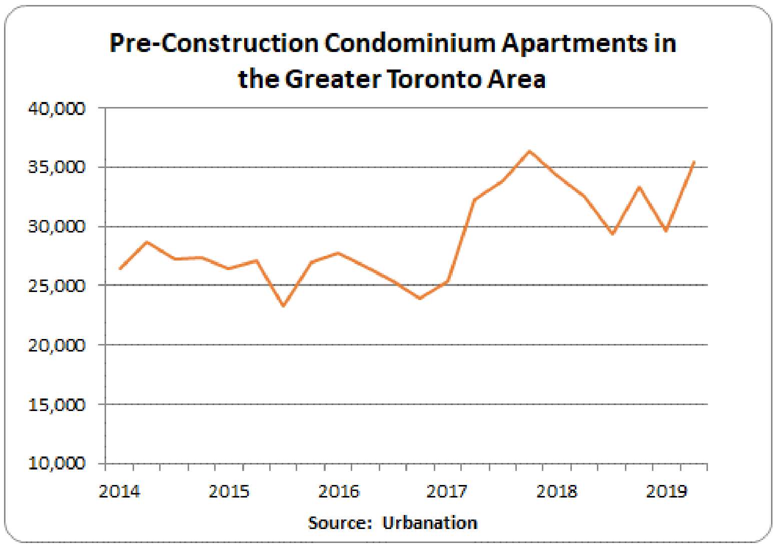
Housing starts in Canada have been quite volatile from month to month, making it difficult to decide what the trend is. In this chart, the trend line suggests that total housing starts in Canada have slowed, but remain at a fairly high level (however, it is possible to generate other trend lines that show a sharper reduction, or even a recent rise in the trend).

The national trend for total starts results from varied conditions across Canada.



Moreover, there are different trends for apartments versus other forms of housing. Starts of low-rise dwellings (single-detached, semi-detached, and town homes) in urban areas have unambiguously turned sharply downwards. With a slight delay, low-rise starts have followed the slowdown in resale activity, which has been caused in large part by the mortgage stress tests. This "transmission" from resales to new starts is exactly what we would expect based on a theory of the housing market. Similarly, there has been a drop for housing starts in rural areas (although it is harder to see this in the chart).

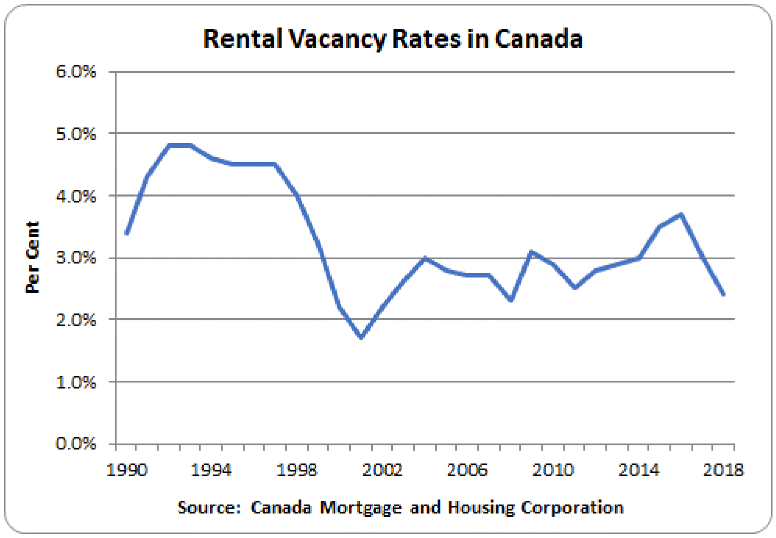
On the other hand, apartment starts have not been reduced, they have actually increased. But, this does not invalidate the theory. Construction of new apartments is largely for condominiums. It results from pre-construction sales that occurred previously. In recent times, the delays between sales and construction have become increasingly long: recent starts for apartments reflect sales that were made considerably earlier. Scattered data from home builders indicates that there has been a sharp reduction in pre-construction sales of new apartments. Eventually, this will result in a downturn for starts of apartments, but the timing of that is uncertain.



Data from a housing market consultancy (Urbanation - https://www.urbanation.ca/) indicate that in the Toronto area there is still a very large inventory of projects that are being marketed but have not yet started construction. This data suggests that there is still a considerable potential for future apartment starts.

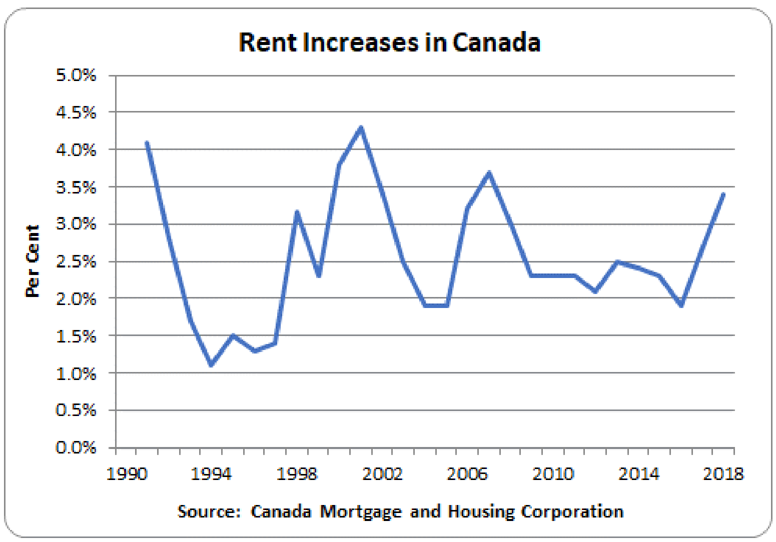
Housing construction is an important generator of jobs. The numbers of low-rise homes that are under construction is now falling, which will increasingly become a negative factor for the Canadian economy. Negative effects from reduced apartment construction will be farther in the future.

Rental Markets



Forecasting for Canada's rental market is a difficult and frustrating exercise. In large part, this is because we only get one datapoint per year, which covers a short period of time (the first half of October). This makes it almost impossible to create the statistical models that are at the heart of "structured" forecasting.

That said, attempts over many years, for many locations across Canada have consistently shown this analyst that the two most important factors for vacancy rates are how many jobs are created (which generates new demand) and how many new dwellings are built (the total, not just in rental buildings).



Recent very robust job creation in Canada caused the vacancy rate to fall in both 2017 and 2018. In 2018, the vacancy rate of 2.4% was substantially below the long-term average of 3.3%. As of October 2018, average vacancy rates were at or below 2% in four of the 10 provinces (Prince Edward Island, Nova Scotia, Ontario, and British Columbia). Lower vacancy rates are now resulting in faster rates of rent increases (estimated by CMHC at 2.7% for 2017 and 3.4% for 2018).

Strong job creation will result in sustained downward pressure on vacancies this year (and possibly beyond). Meanwhile, the developing slowdown for housing starts means that construction completions for new dwellings will begin to fall later this year, and by a larger amount next year, and almost certainly with further reductions for 2021 and beyond. On this basis, it should be expected that the vacancy rates will fall further during the coming years, and this will add to pressures for rents to rise.

A Scan Across the Provinces' Housing Markets

In this section, market trends are reviewed for the 10 provinces, utilizing data on resale markets from the Canadian Real Estate Association ("CREA"), as well as data on population from Statistics Canada and housing starts from Canada Mortgage and Housing Corporation. The analysis covers January 2009 to June 2019. For each province, six charts are shown:

- Sales (seasonally-adjusted and converted to an annualized basis),
- Sales per adult,
- The sales-to-new-listings ratios,
- Average resale prices,
- Year-over-year growth in the average prices, and
- Housing starts (expressed as seasonally-adjusted annualized rates, in 1,000s).

Since the data can be volatile from month-to-month, trend lines have been added where the author sees fit. Yet, in some cases, the mechanically-generated trend lines are not especially trustworthy, often because of volatility at the end of the available data.

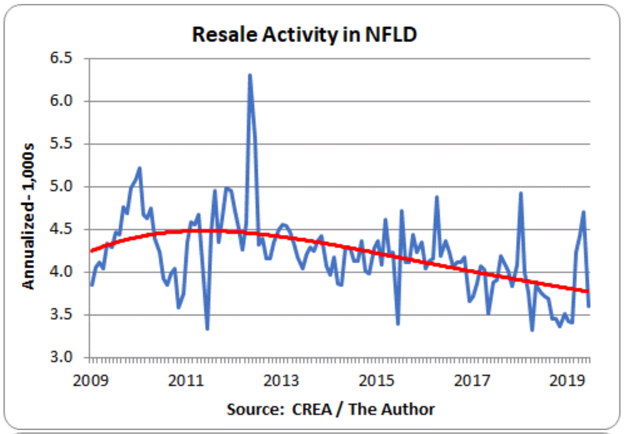
Housing market trends have deteriorated:

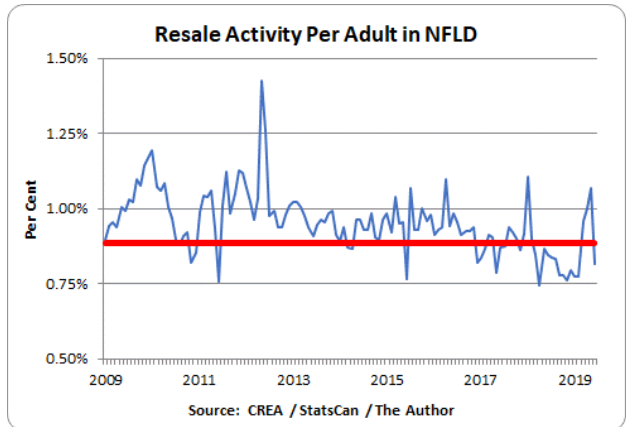
- In most of the provinces, resale market trends have clearly turned down, and often sharply. In some provinces, the deterioration takes the form of interruptions of growth trends. Quebec and New Brunswick appear to be the only provinces experiencing continued growth of resale activity.
- In several provinces, resale trends appear to have stabilized, but at low levels. This is not good news – at present, this looks like stagnation.
- Sales-to-new-listings ratios have shifted downwards, with the result that rates of house price growth have slowed.
- Housing starts are tending to follow behind resale markets, although in some provinces, further rises in apartment starts are masking the reductions that have developed for low-rise homes.

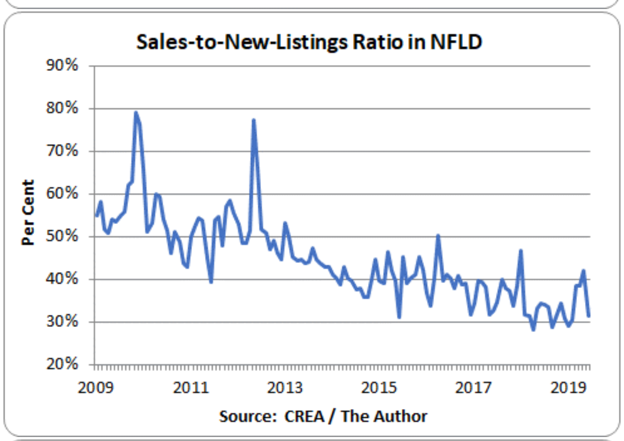
Regarding prices: in both Ontario and British Columbia, the average provincial resale prices are highly influenced by changes in "composition" (the locations of sales and the types of homes sold). As an alternative, the author has used CREA's House Price Indexes for major market areas, to create "composite" prices.

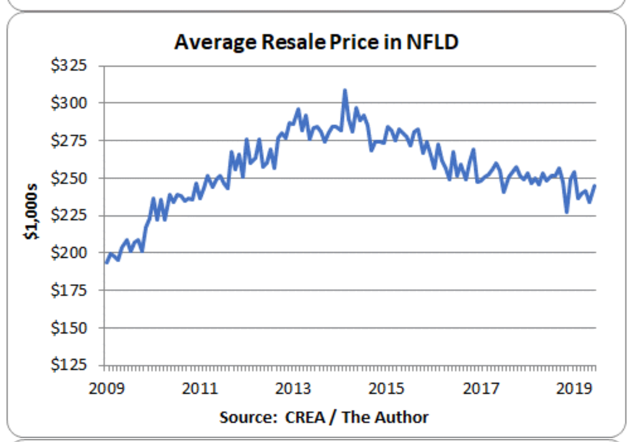
Newfoundland and Labrador

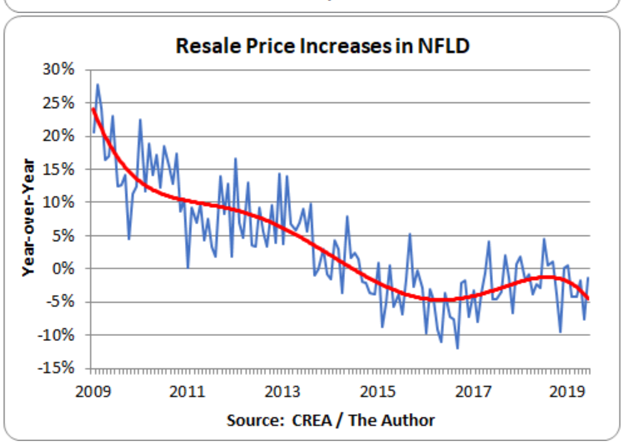
Resale activity has trended downwards (although activity improved during this March to May – it remains to be seen if this will be sustained). A combination of the mortgage stress tests and a weakened provincial economy has been very challenging. The SNLR is far below the province's balanced market threshold (which is estimated at 42%). Due to volatile movements in the average price, there is uncertainty about the recent price trend. The data suggests that prices are eroding slightly, which is consistent with the very low SNLR. Housing starts have weakened very badly, and are now following the further downtrend for resales.

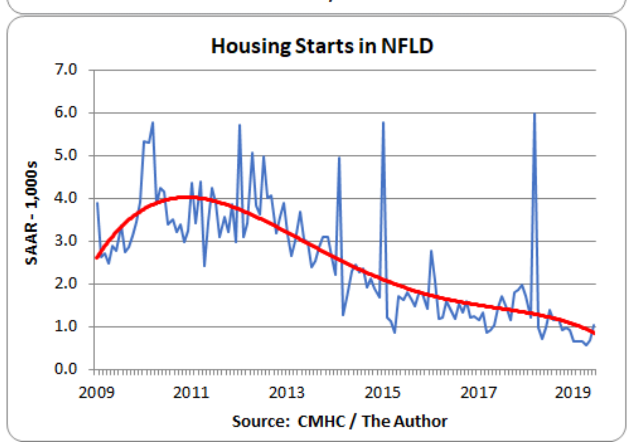






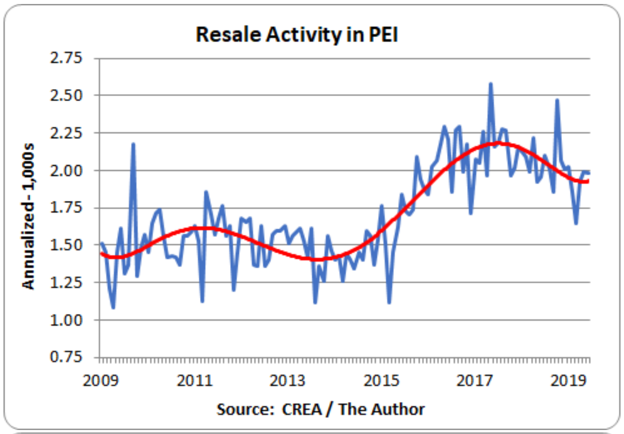


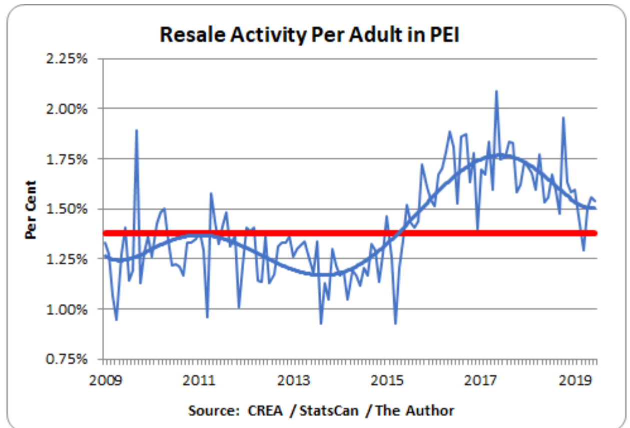


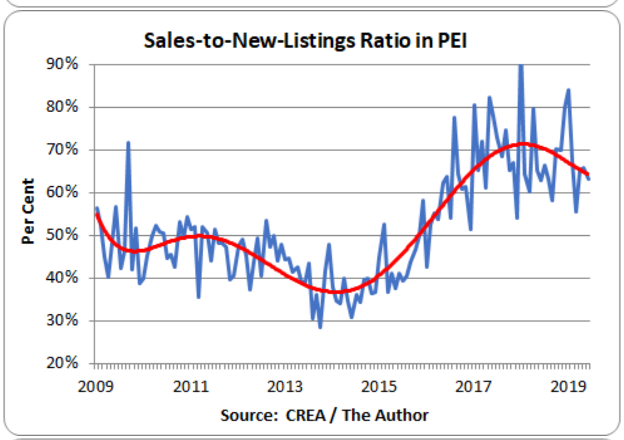


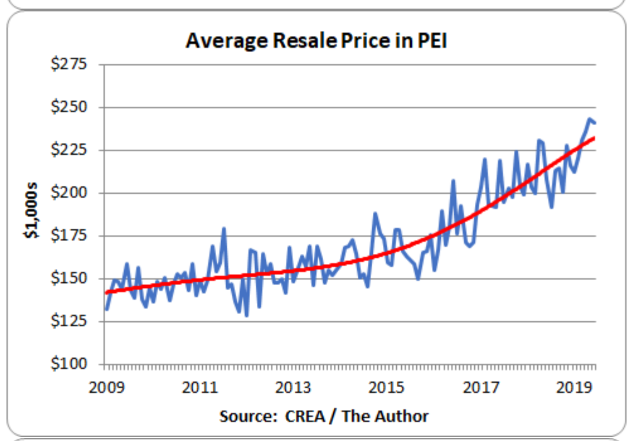
Prince Edward Island

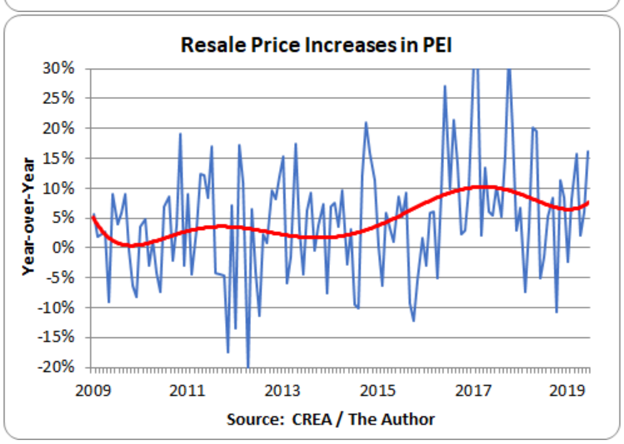
The provincial resale market has slowed, but remains strong in historic terms. It isn't possible to estimate the province's threshold for a balanced market using statistical analysis. That said, it is clear that the high SNLR is far into "sellers' market" territory, which has resulted in rapid price growth. Price growth has recently tapered to some degree. Housing starts have responded to the very strong market conditions, but may be getting close to peaking.

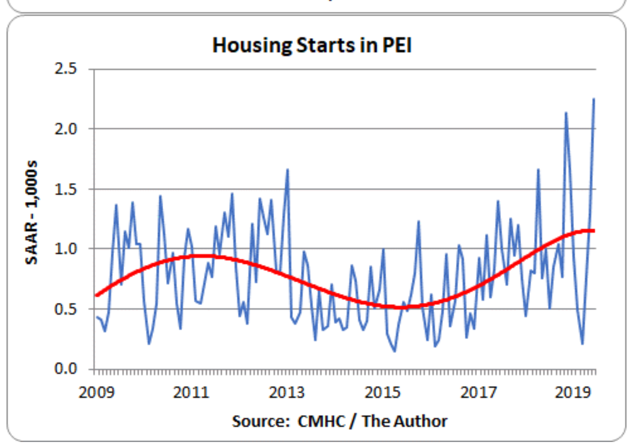






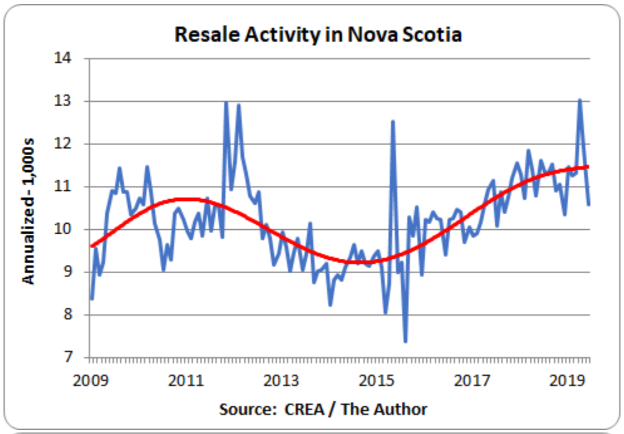


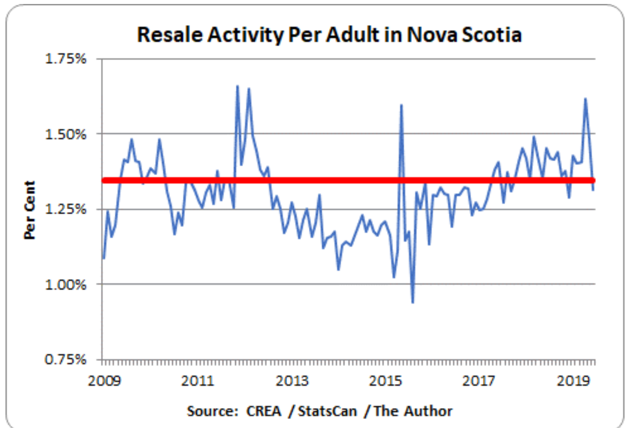


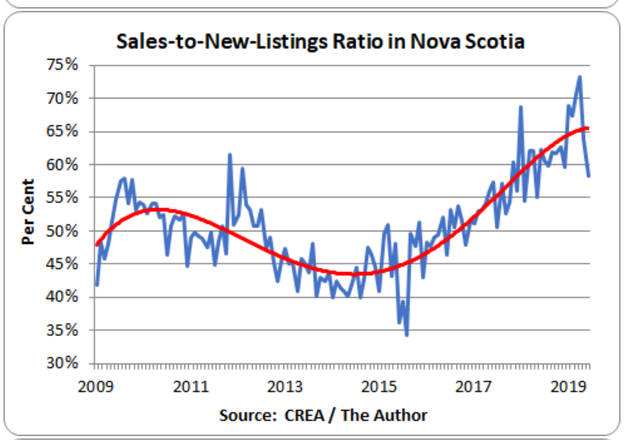


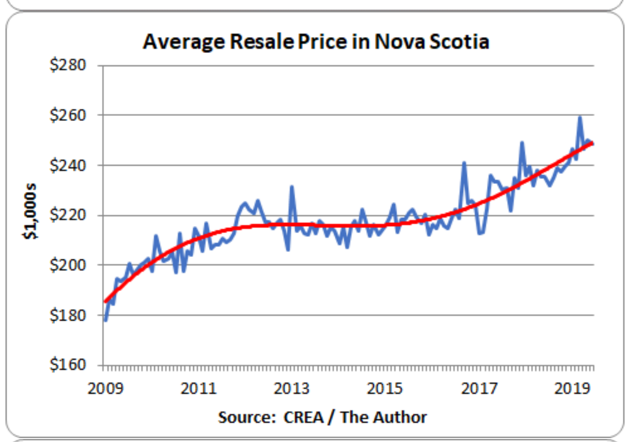
Nova Scotia

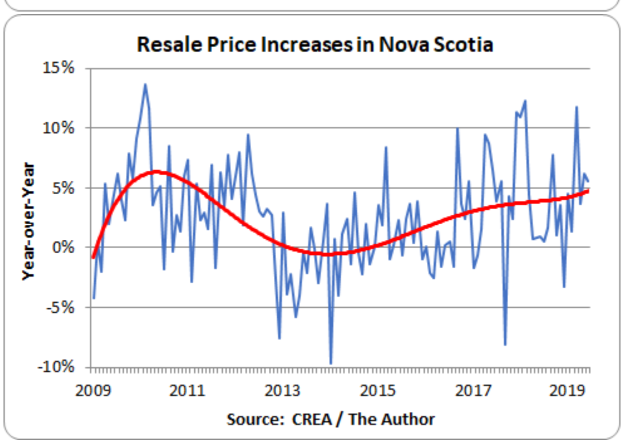
Resale activity has recovered strongly from a period of weakness. But with some wild swings in the recent data, it is unclear whether activity might now be stabilizing (at a high level). The province's SNLR remains far above the balanced market threshold (which is estimated at 48%), resulting in an acceleration of price growth (this follows a long period of flat prices, and in a longer perspective, the average rate of increase is still moderate). Housing starts remain at a high level, reflecting the strength that has emanated from the resale sector.

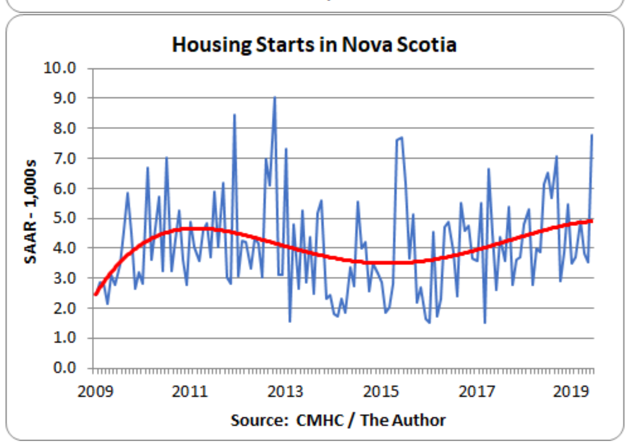






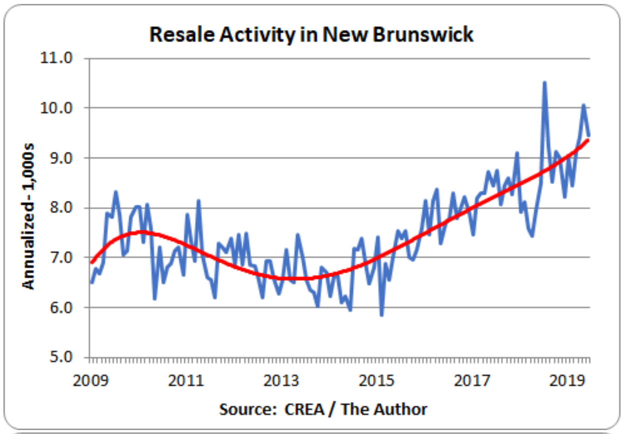


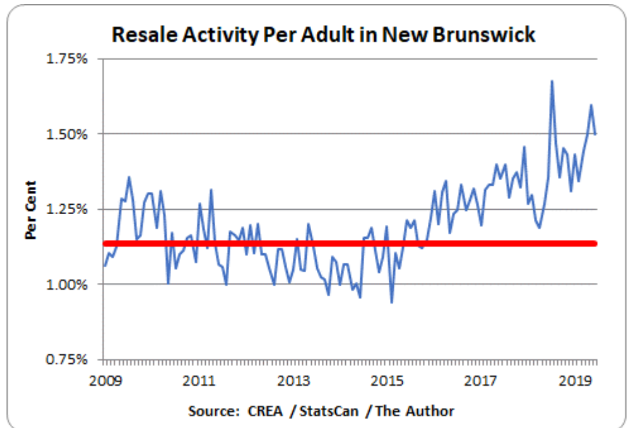


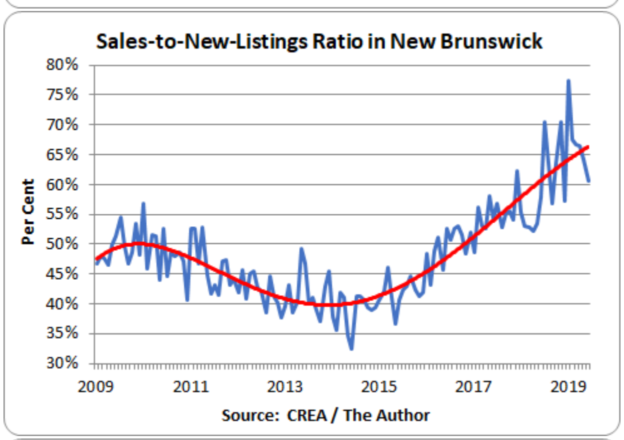


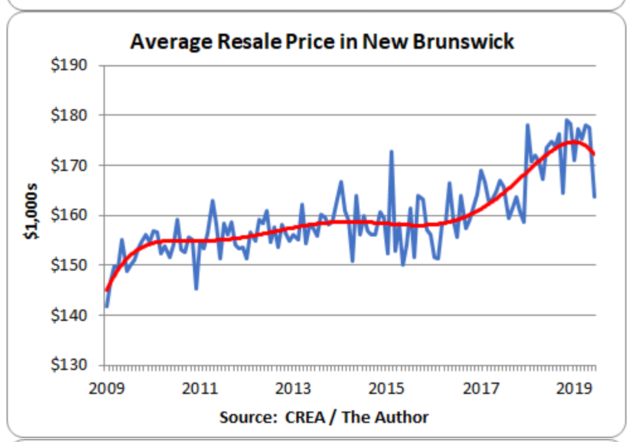
New Brunswick

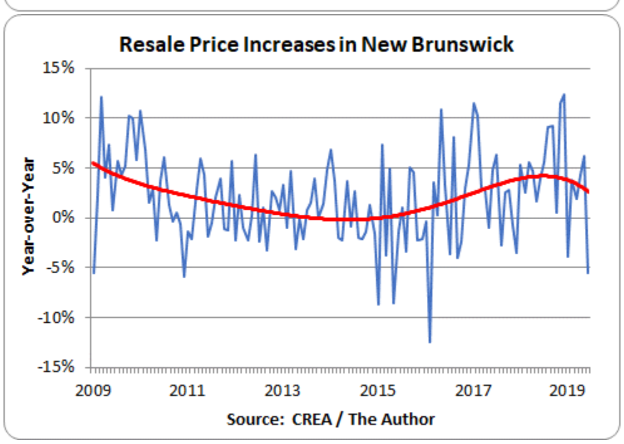
The province experienced a lengthy period of quite weak resale activity, but has recovered very strongly. The SNLR is now far above the balanced market threshold (which is estimated at 44%), leading to growth of the average price. However, this follows a lengthy period of flat prices and in a long-term perspective, the average rate of price growth is very modest. Following the trend in the resale market, housing starts are improving from a very low level. Further recovery of the starts trend is likely.

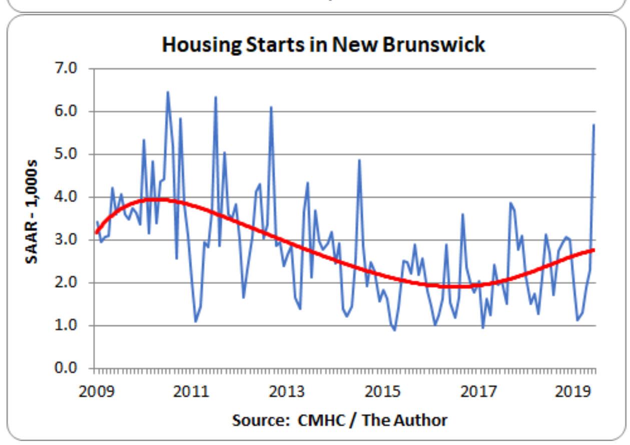






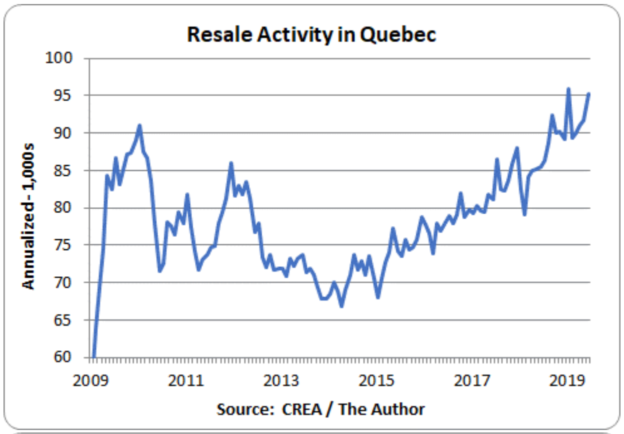


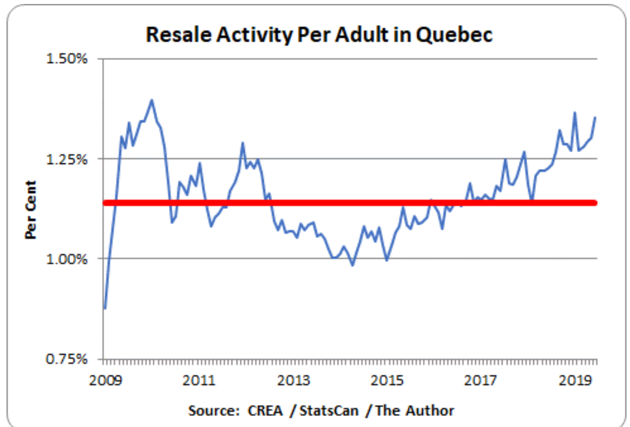


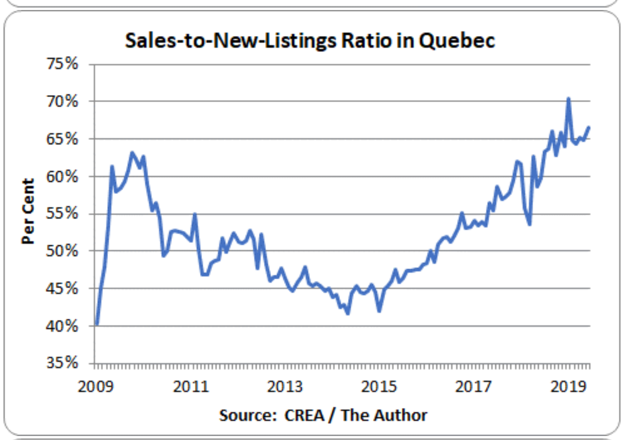


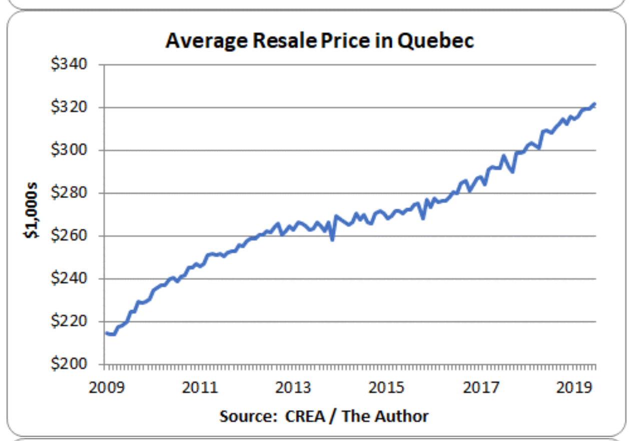
Quebec

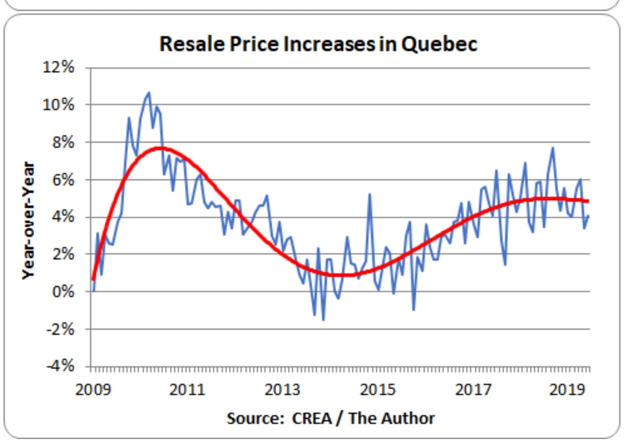
Resale activity has improved steadily during the past five years, and is now quite robust in historic terms. The balanced market SNLR threshold is estimated at just under 40%, and the actual rate has been far above that level for some time. Recent data points to a stabilization at a very high level. Volatile data creates uncertainty about the trend for price growth, but it appears that prices are increasing at about 5% per year. The trend for housing starts is also quite robust.

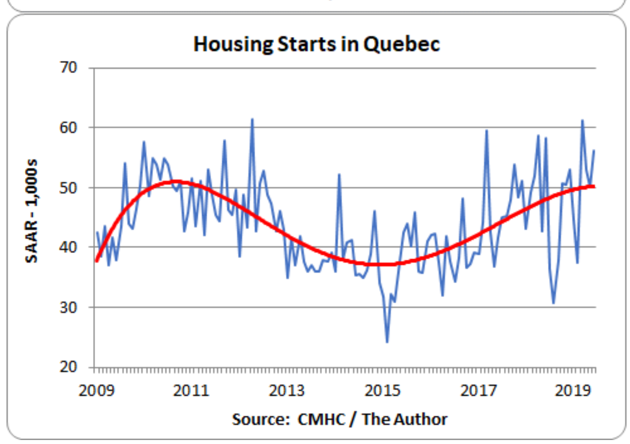






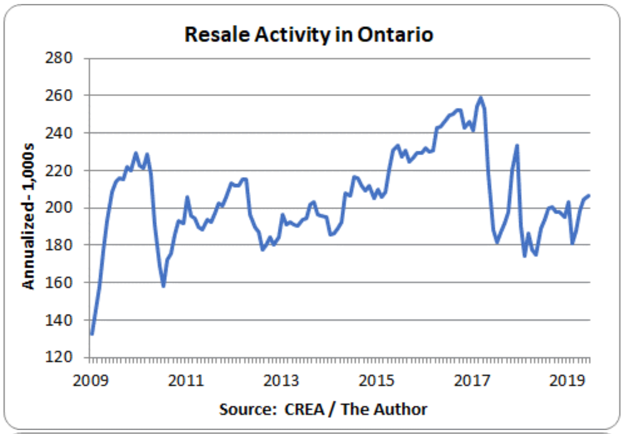


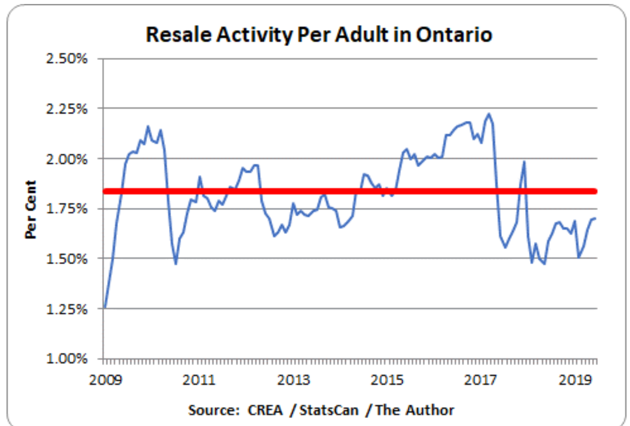


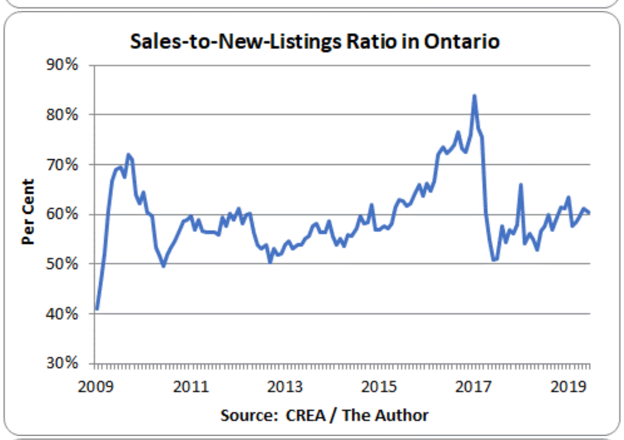


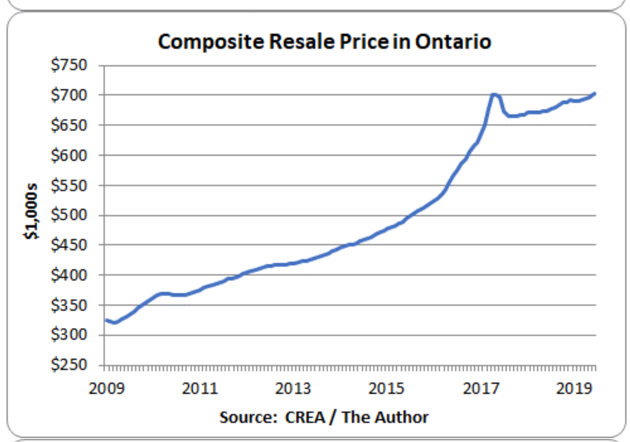
Ontario

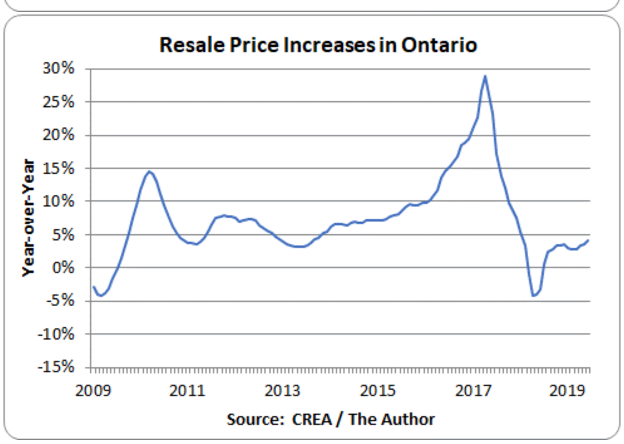
Ontario's resale activity has fallen sharply and is now quite weak in historic terms. However, the SNLR has fallen from a previously very high level: it remains above the balanced market level, which is estimated at 50%. In consequence, prices are increasing, but at a slower rate (the estimated composite is now rising by 3-4%). Housing starts have followed the downturn in the resale market, and further reductions are likely.

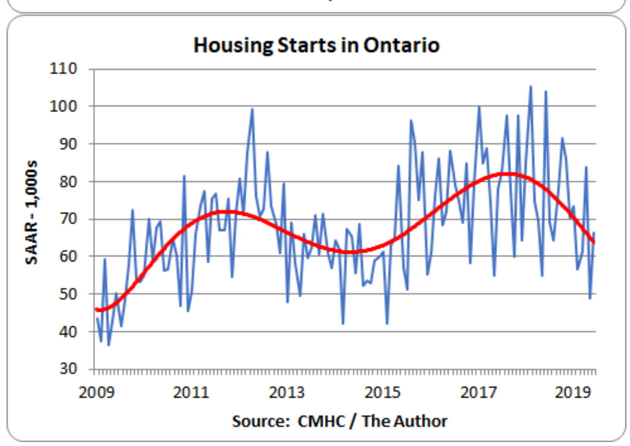






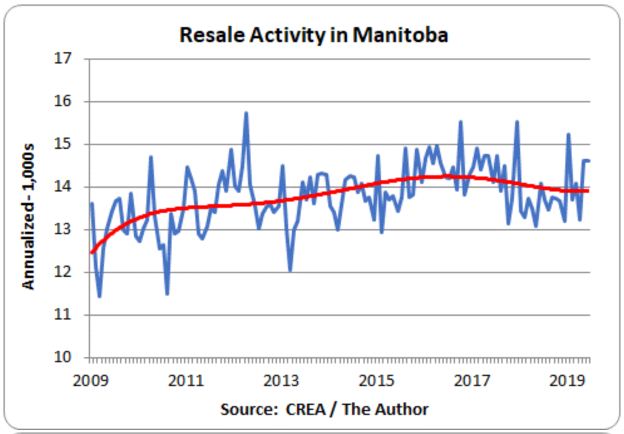


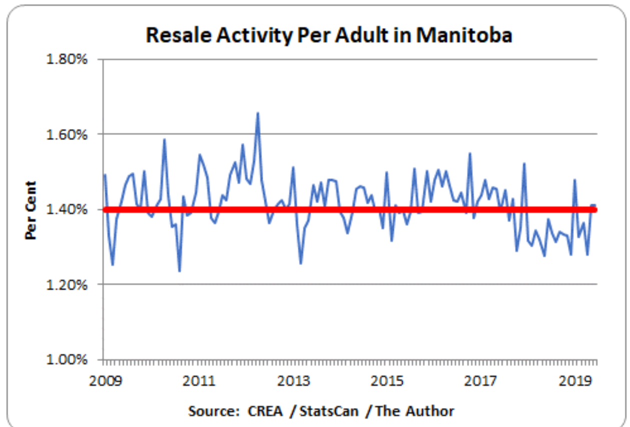


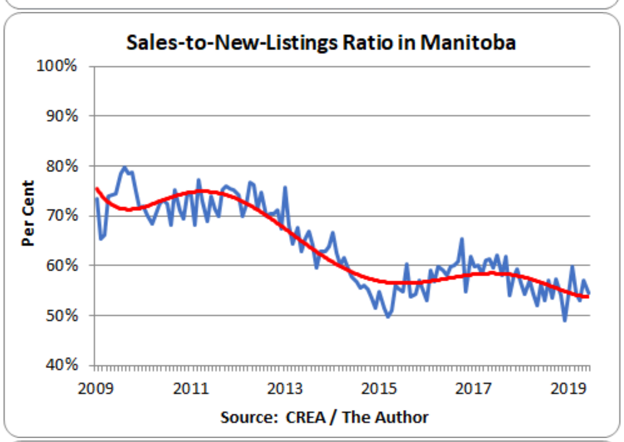


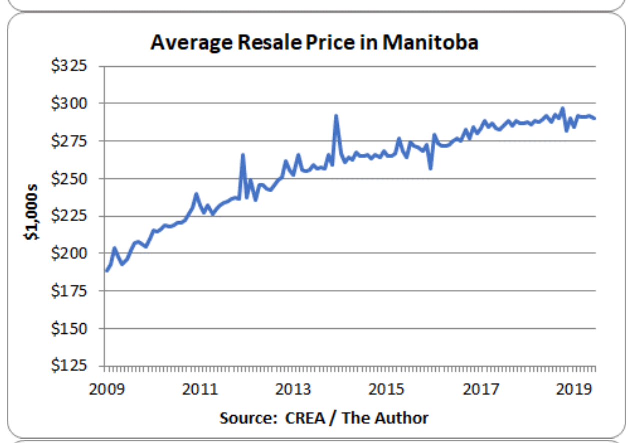
Manitoba

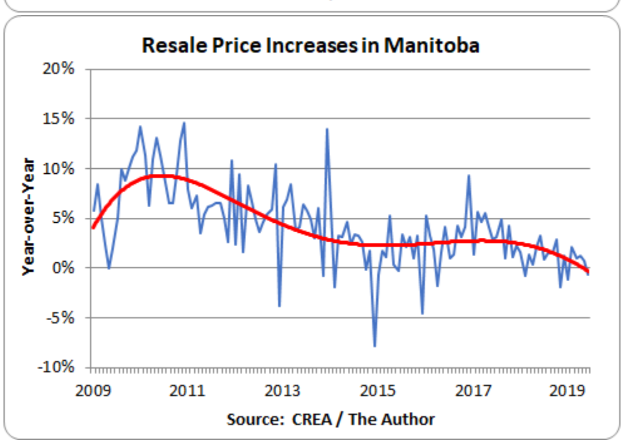
Resale activity appears to be roughly stable in Manitoba, although there is uncertainty about the trend. Flat sales mean that on a population-adjusted basis, there has been a deterioration. The SNLR remains slightly below its balanced market level (which is estimated at 58%). The result is that prices are now close to flat. Housing starts increased during 2017 and 2018 (in response to prior encouraging signals from the resale market). Recent data hints that starts are at or close to a (downward) turning point.

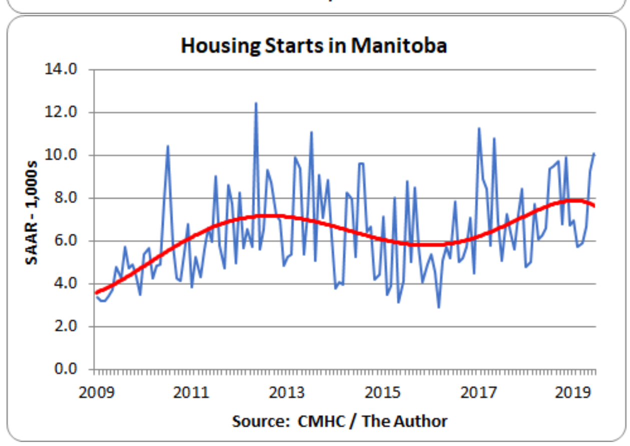






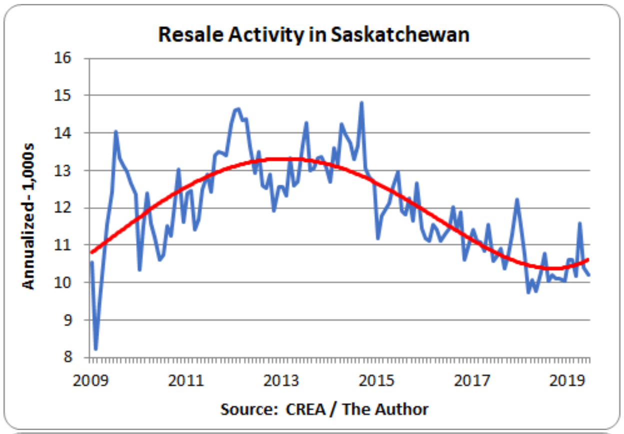


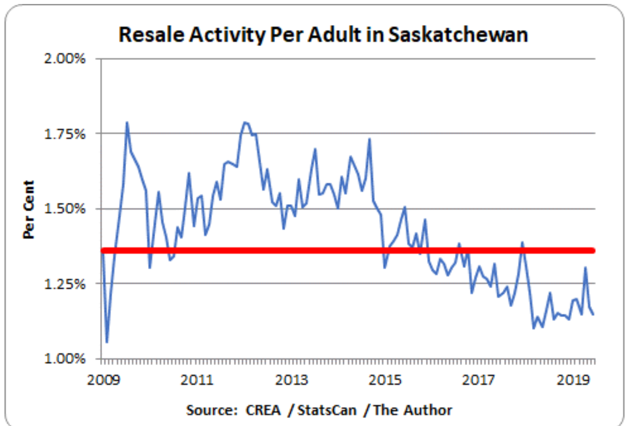


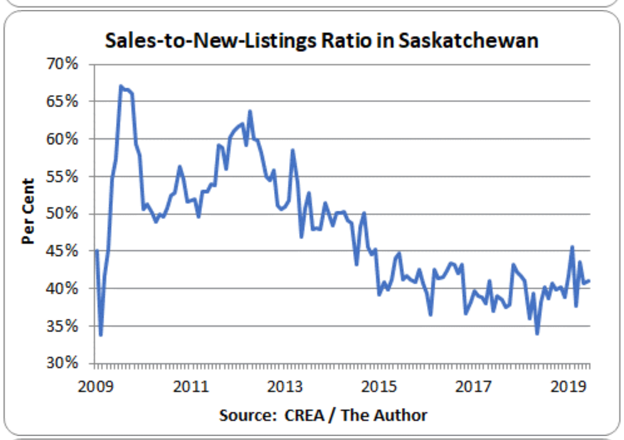


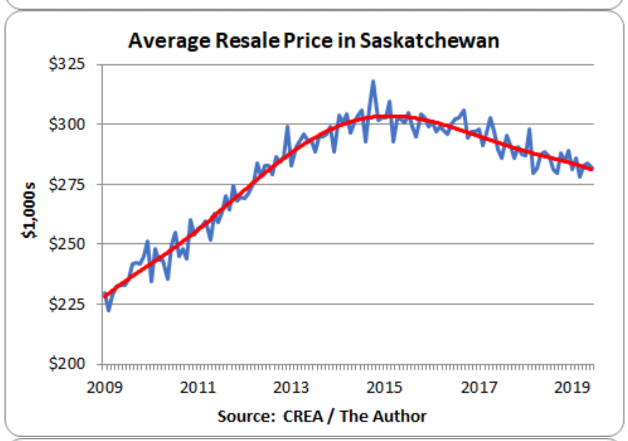
Saskatchewan

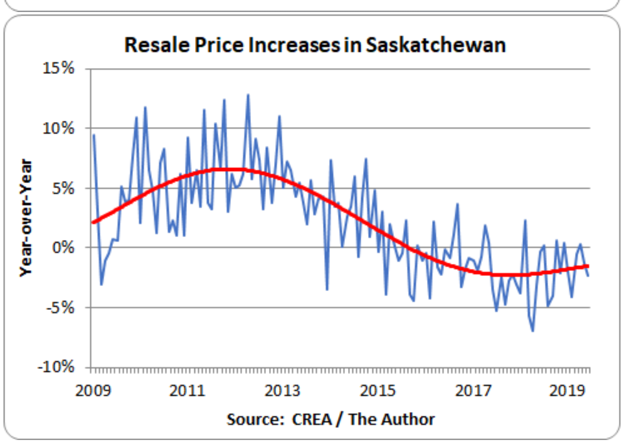
Resale activity in Saskatchewan might be stabilizing, but at a very weak level, as the negative effects of the mortgage stress tests have been added to the effects of a weakened economy. The SNLR is far below the balanced market threshold (estimated at 54%). Prices have eroded gradually, for four years. The total fall in the trend during that period is in the area of 7-8%. Housing starts have fallen very sharply.

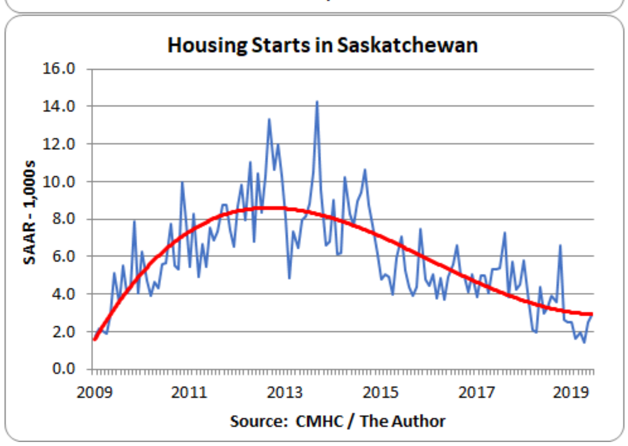






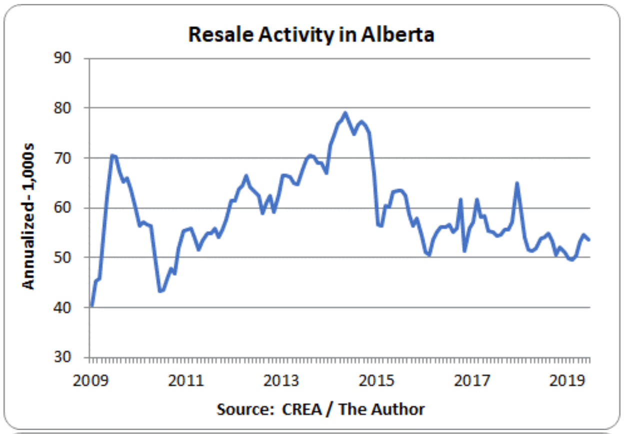


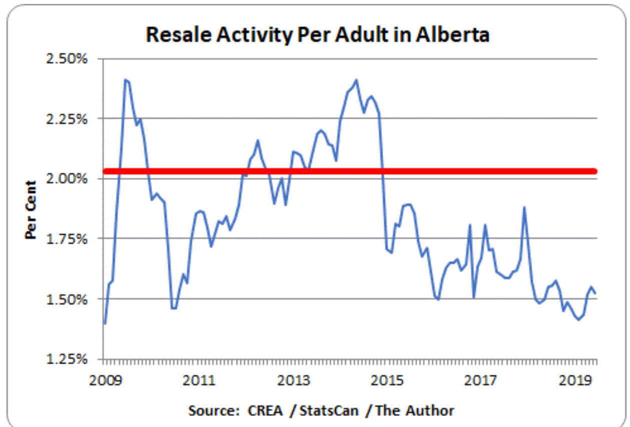


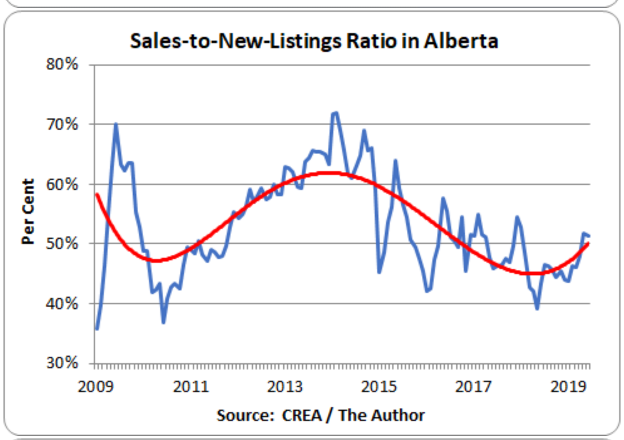


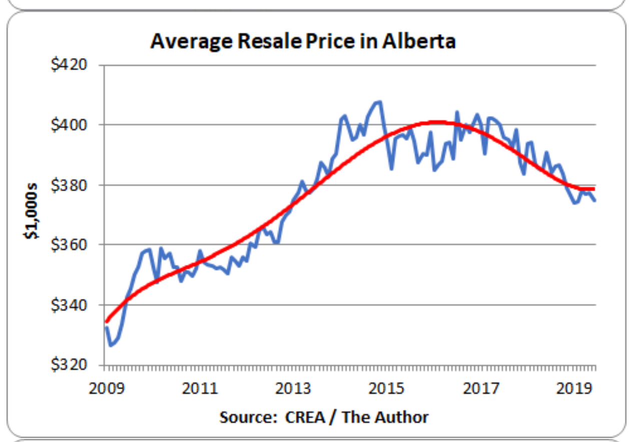
Alberta

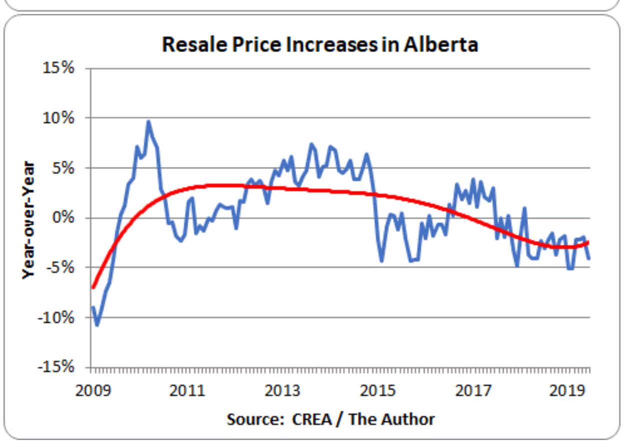
Resale activity remains extremely weak. The trend for the SNLR has turned up, but this is based on just two months of data. It is still far below the balanced market threshold, which is estimated at 56%. Prices have eroded during the past two years, and are now down by a total of about 5%, Housing starts have slowed sharply, with the trend down by at least 25%.

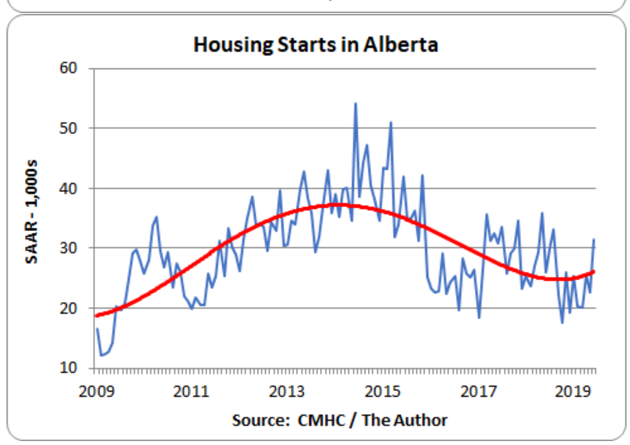












British Columbia

Resale activity remains sharply weaker in BC. In addition to the impact of the stress tests, provincial policies that are intended to reduce buying by non-residents and investors are having substantial effects. The SNLR has fallen sharply, to about the balanced market threshold of 47%. The composite price estimate is trending sharply downwards. The trend for housing starts remains very high, due to a late surge for apartments: a rapid downturn could soon develop.