THE SARETSKY REPORT

FEBRUARY 2022

SARETSKY
GROUP

CONTENTS

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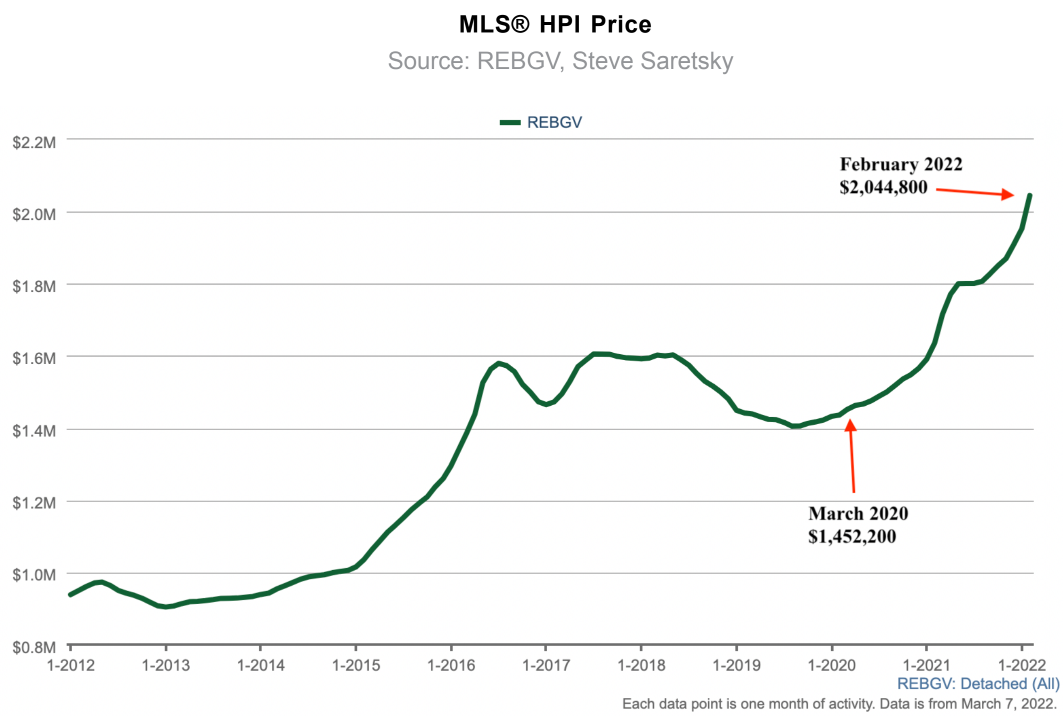
OPENING THOUGHTS

I'm about to walk you through the usual Saretsky Report where we highlight all sorts of charts and data points pertaining to the housing market. What I want to emphasize is that the situation is changing rather quickly. A war has erupted in Ukraine, commodity prices are ripping- adding to inflationary pressures, and the Bank of Canada has begun raising interest rates. To suggest it has been a busy few weeks would be an understatement. All of this to say that real estate data works on a lag. The housing market is beginning to turn and that will not show up in the data for perhaps another month or two. So what exactly are we seeing?

Buyer activity is beginning to slow. On the ground we are seeing fewer offers. Instead of eight or nine offers on a house which was typical four weeks ago, now we are seeing two or three offers and sometimes no offers. Pricing strategy is beginning to shift. The days of grossly underpricing a home for bidding wars is becoming a risky strategy. For example, homes that are worth \$1.8M but listed for \$1.5M might only get bid up to \$1.7M which then prompts the seller to reject all offers and then re-list the house at \$1.8M (the price they actually want).

At the end of the day none of this should be surprising. We've had back to back years of record home sales, and insane price growth. Nothing lasts forever. Buyers are exhausted and the macro backdrop is shifting from euphoria to concern (Ukraine/ Russia, record prices at the pumps and rising food prices).

Eventually rubber meets the road and you hit a price ceiling. Since the start of the pandemic, the typical house in Greater Vancouver has increased $592,600. That's nearly $300,000 / year!!



It's important to note that we are still in a sellers market. Inventory is still incredibly tight. However, anecdotally it appears the market has peaked and we are turning a corner. We are now entering the busy

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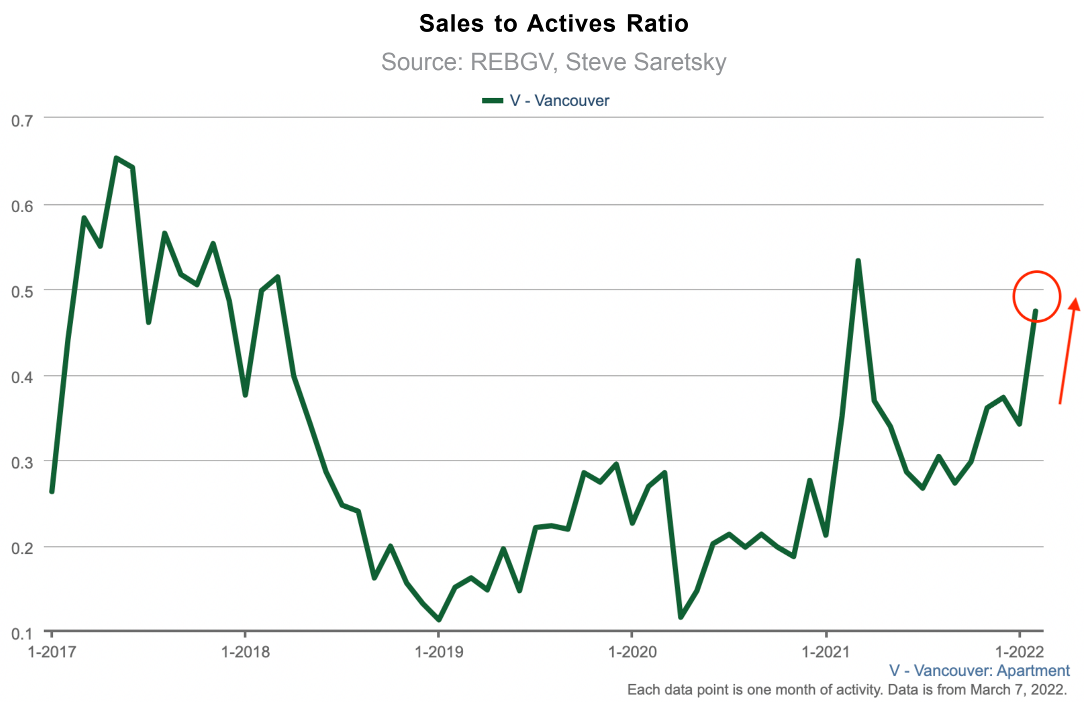
spring market which typically brings a lot of new listings. I believe it is quite likely this will allow inventory to build and alleviate pressure on the housing market. Sellers are still in the drivers seat but that is changing.

A subtle reminder that this shift in market sentiment will not show up in the data right away. In fact, the home price index is likely to point higher in the coming months because it works on a lag. However, the best time to sell your house was in January/ early February during the blow-off top.

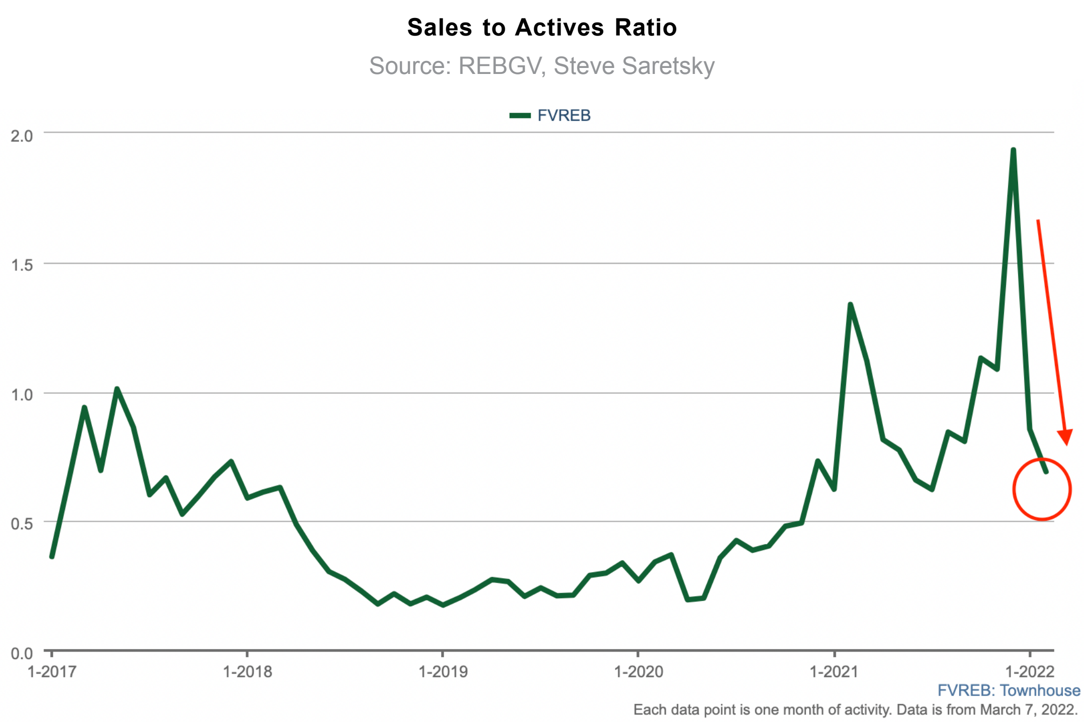
VANCOUVER CONDOS MOVING HIGHER

Just to clarify my views when we say the housing market has likely peaked I am largely talking about the pandemic winners. Houses, and townhouses, particularly in the suburbs are starting to slow. That is not the case for condos in the city. While housing markets tend to move in unison across the world, largely based on global liquidity provided by central banks, housing is still hyper local. In other words, it is very possible to see a price decline in suburban houses while seeing an increase in condos downtown for example.

Vancouver condo inventory dropped 20% year-over-year in February as sales increased 8%. The best way to look at this is the sales to actives ratio which has now climbed to 47% in February and is on its way to make its usual highs this spring.



Now lets look at townhouses in the suburbs, which appear to be going in the opposite direction, slowing into the spring market.



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Yes, townhouses in the suburbs are going from red hot to just hot. More importantly it is the change in direction that matters. Townhouse prices in the suburbs have nearly doubled in two years, while condo prices in Vancouver are still trading at their peak 2018 levels. Ask yourself, which one has a stronger likelihood of price declines as the pandemic comes to an end and a good portion of the labor force heads back to the office?

We have lift-off! Bank of Canada raises interest rates

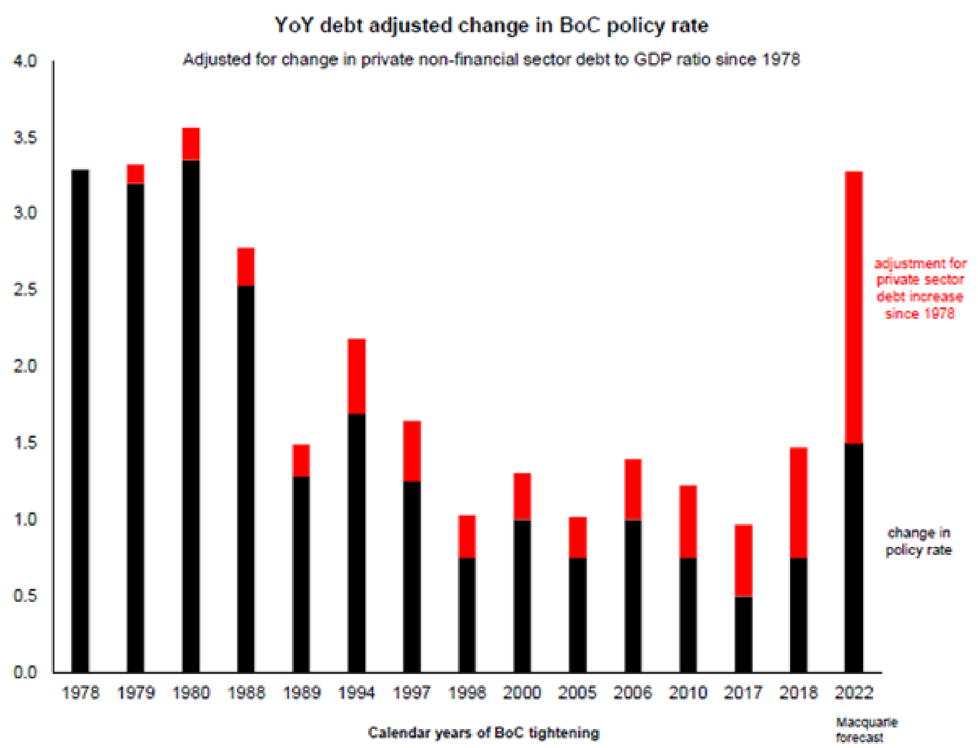
Brace yourselves, we have liftoff! The Bank of Canada officially raised interest rates a mere 25bps last week. This was the first move since 2018 and comes at a time when inflation is running at 30 year highs. Markets believe another 5-7 rate hikes are still coming this year and some are calling this the Paul Volcker moment.

In case you forgot, Paul Volcker was the head of the US Federal Reserve in the 1980's, the last time inflation was running this high. Volcker raised rates from 11% to 21% in order to squash inflation which undoubtedly caused a lot of pain. Things got so bad that home builders started mailing 2x4 lumber in the mail to Volcker as part of a protest, claiming their lumber was no longer needed since nobody was buying houses.

So is this our Volcker moment?

I think some much needed context is in order. Back in the 1980's, Canada's household debt to GDP sat at roughly 40%. Today it is over 100% of GDP. In other words, it's not going to take much to severely tighten financial conditions. Per David Doyle at Macquarie Macro Research, when you account for private sector debt levels in Canada, assuming we get a total of 6 rate hikes this year (25bps each time), this will equate to the largest tightening cycle since the 1980's. In other words, our Paul Volcker moment will be bringing rates from zero to 1.5%. Let that sink in.

Fig 2 … accounting for private sector debt levels, we expect 2022 to be the most severe year of rate hikes since 1980

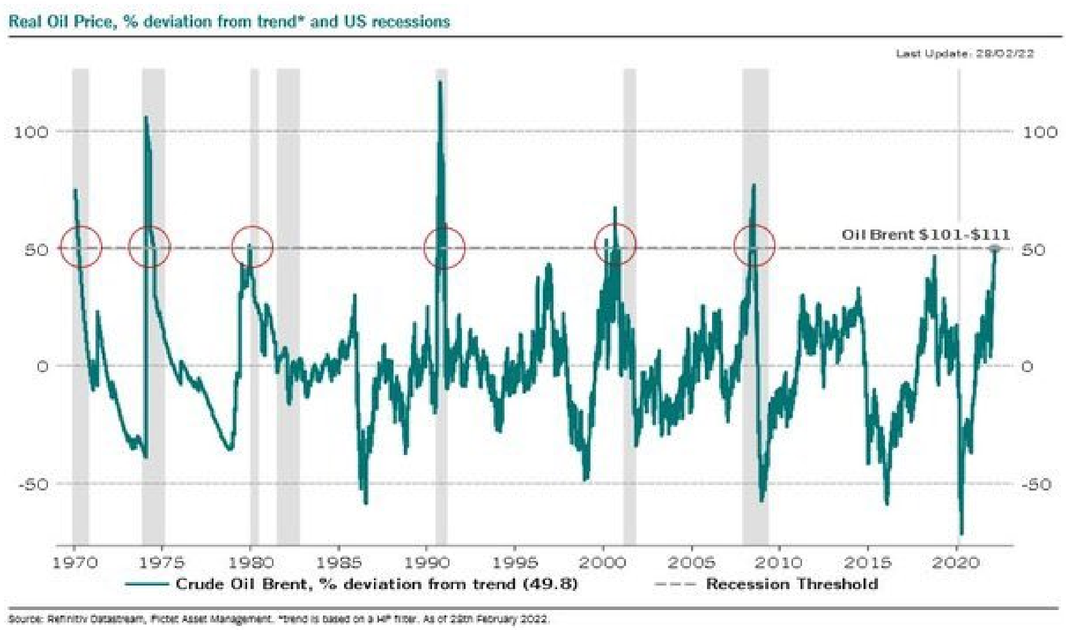


Source: Statistics Canada, BoC, Macquarie Macro Strategy

These are rather precarious times. Not only are we are saddled with debt but we have inflation running at 30 year highs. The central bank is going to try and tame inflation by raising debt servicing payments at a time when commodity prices are poised to surge even higher. Rising fuel prices, food prices and debt payments is not bullish for the Canadian consumer. This is going to be a painful squeeze and households will be forced to pare back spending. This will ultimately feed through into housing, we already seeing activity begin to cool in parts of the country.

Per Hedgeye Research, there have been 12 recessions since 1946. 8 have followed major oil price shocks, while a further 3 have occurred immediately following more modest, but still notable, oil price run-ups.

Surge in Energy Prices Suggests Probability of Recession



In other words, it isn't going to take much for the Bank of Canada to tip the scales, markets are already doing much of the tightening.

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NEW HOME SALES HIT RECORD IN 2021

With the resale housing market remaining extremely competitive, buyers are looking for opportunities in the new construction market. I have personally sent quite a few clients the pre-sale route in order to avoid the intense bidding wars percolating in both the resale townhouse and condo markets. If you can find pre-sales that are priced well and with low deposit structures they can be quite lucrative. Unfortunately they are becoming increasingly hard to find as developers have been ratcheting up prices to account for the strength in the market and rising construction costs.

Per Urban Analytics, it was a record year for new home sales. In 2021 we set record sales for new units, surpassing the previous high set in 2016 by 30%. Per UA, The primary difference between 2021 and 2016 was where the sales occurred. In 2016, just 22 percent of new multi-family home sales were recorded in the suburban South of Fraser sub-markets, whereas in 2021 these areas accounted for 43 percent of all new multi-family home sales. Sales have been particularly strong in the suburban submarkets of Langley, Surrey and South Surrey where townhomes and low-rise condos have been in high demand.

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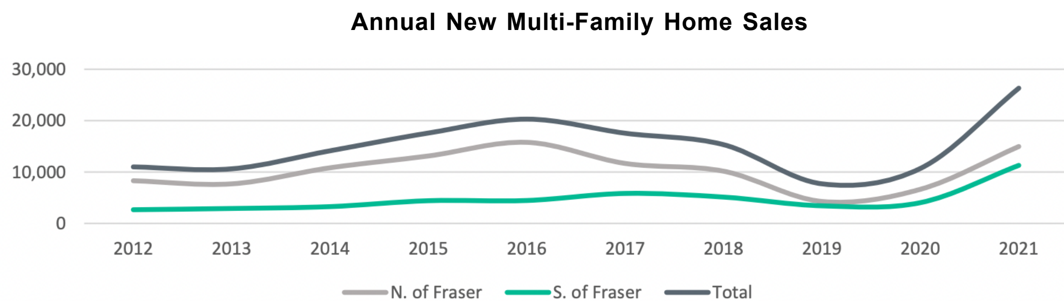

While there has been a boom in the valley and most of the lower mainland, we are still seeing weakness for pre-sales in Downtown Vancouver. The high-end luxury market remains sluggish. This should not be a surprise considering new high-rise condos in Downtown Vancouver are averaging north of $2000/sqft and offshore buyers have not participated in this cycle like they did in 2016.

ABOUT STEVE

Steve Saretsky is a Vancouver residential Realtor and author behind one of Vancouver's most popular real estate blogs. Steve is widely considered a thought leader in the industry with regular appearances on BNN, CBC, CKNW, CTV and as a contributor to BC Business Magazine. Steve has advised developers, hedge funds, and fund managers on the Vancouver housing market and is a regular speaker at industry events.

Steve Saretsky provides real estate services throughout Greater Vancouver. To inquire about listing or buying a property, please email: steve@stevesaretsky.com.

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