THE SARETSKY REPORT

AUGUST 2022

SARETSKY
GROUP

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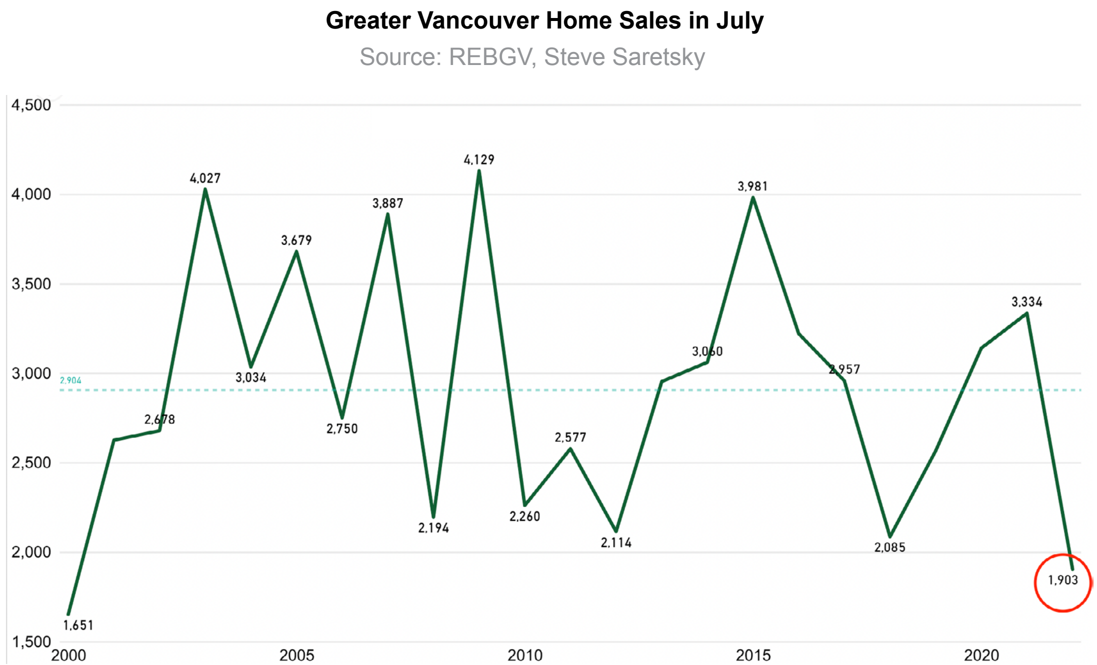
OPENING THOUGHTS

Continuing on the theme from last month, housing activity continues to slow as expected when the Bank of Canada raised interest rates by 100bps last month and instantly reduced borrowers purchasing power. Remember, over 50% of new mortgage applicants this year have been going with variable rate mortgages, in large part to dodge the pain of a higher mortgage stress test that accompanies fixed rate mortgages. The pain is not over yet, as we should see another rate hike from the Bank of Canada on September 07.

While rising interest rates are needed to squash inflation, the housing market is the casualty. Buyers have shifted to the sidelines and that is evident when looking at the latest housing data. Greater Vancouver home sales fell to a 22 year low in the month of July. There were just over 1900 sales this July, a low not seen since we recorded 1651 sales in July of 2000. Keep in mind this is not even adjusting for the increase in population and housing stock which has increased rather significantly over the past couple decades.



Demand is weak and it's not hard to figure out why. A doubling of mortgage rates has eroded affordability. Just for context to understand where we are right now. House prices would need to drop about 25% in order for mortgage payments to be as "affordable" as they were at the peak of the market earlier this year.

Let's assume 80% LTV, 30 year amortization on a million dollar house. Mortgage rates double, but price declines 25%.

$800k mortgage at 2.5% = $3156
$600k mortgage at 5.0% = $3202

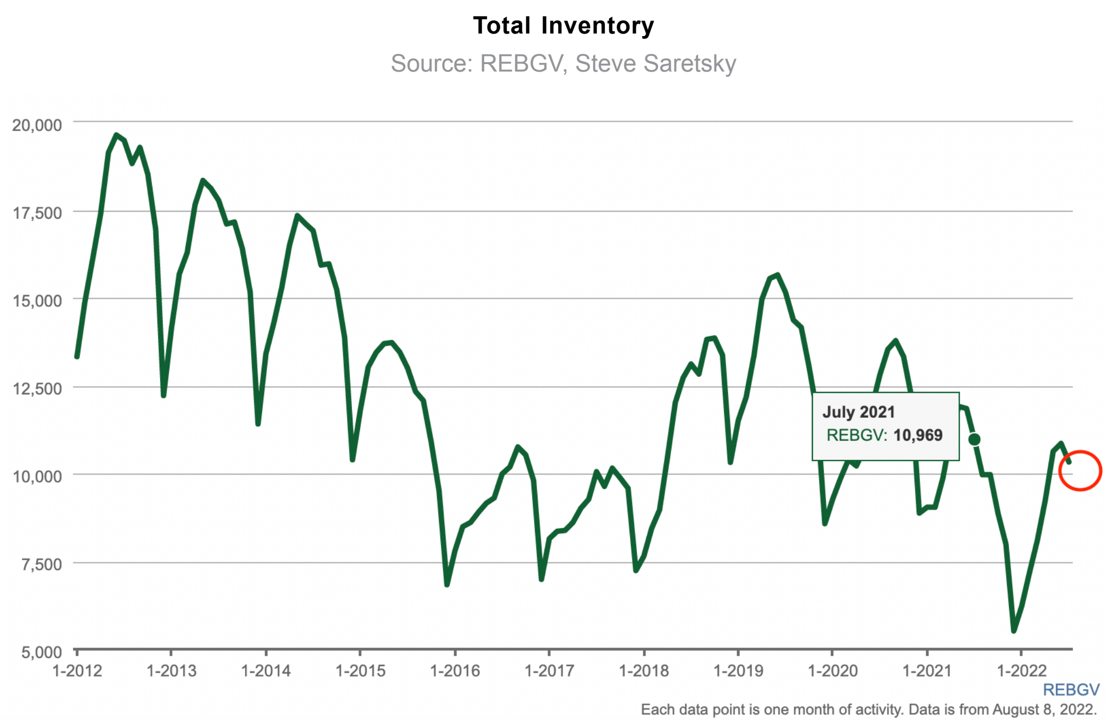
There are now two questions to consider.

1. How long will it take sellers to reduce prices? Home sellers are

notoriously slow to cut prices, and total inventory for sale remains historically low still.

2. Will mortgage rates hold at these levels?

The number of new listings for sale in July was actually DOWN from last year. Meanwhile total inventory for sale was also DOWN from last July. In other words, there are fewer homes for sale today than there were a year ago.



Despite inventory being lower, total months of supply on the market pushed higher, solely due to incredibly weak demand. If this bear market is going to continue we are going to need more inventory. I suspect

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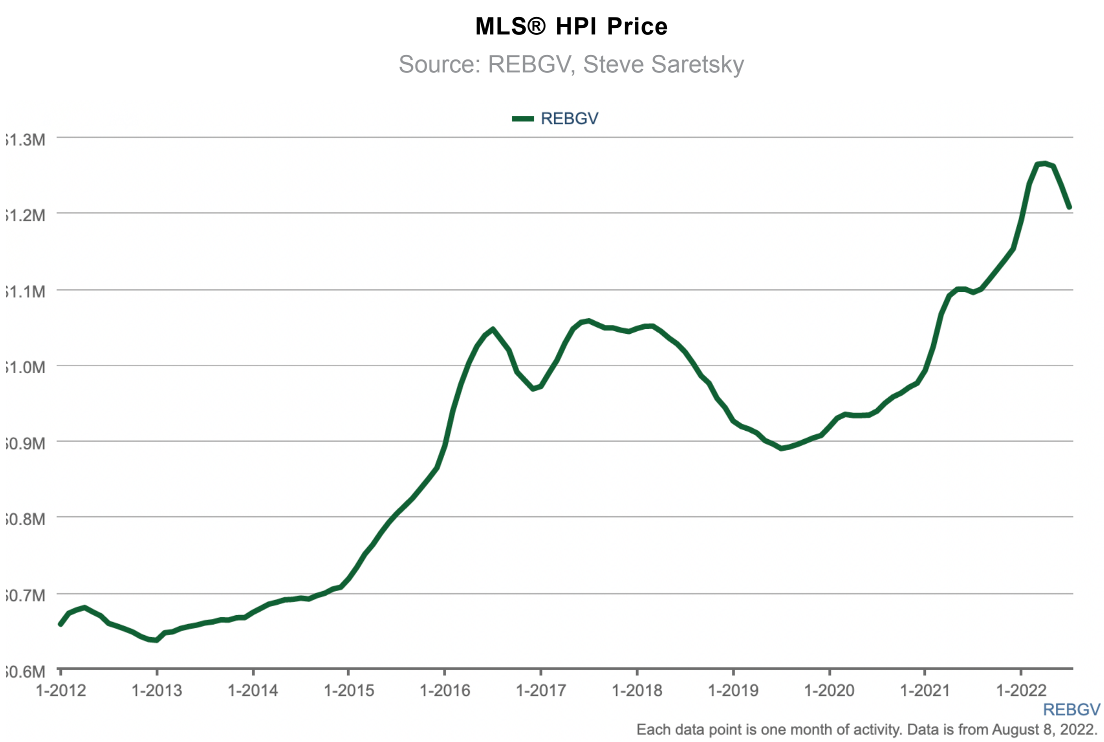
more inventory is coming but it is something we need to watch closely.

Meanwhile, the Canada 5 year bond yield is down nearly 100bps since peaking just over a month ago. The bond market is telling us a recession is right around the corner and this should be driving fixed rate mortgages lower. However, we have yet to see any of the major banks cut rates yet. They are pricing in a risk premium, at least for now, but it's not unreasonable to expect fixed rate mortgages to begin moving lower very soon. We could soon be in a situation where variable rate mortgages are HIGHER than fixed rate mortgages.

Mortgage rates remain too high for a highly levered housing market and that will keep weighing on the housing market in the months ahead. Home prices are adjusting, with the home price index now down 4.5% from peak.



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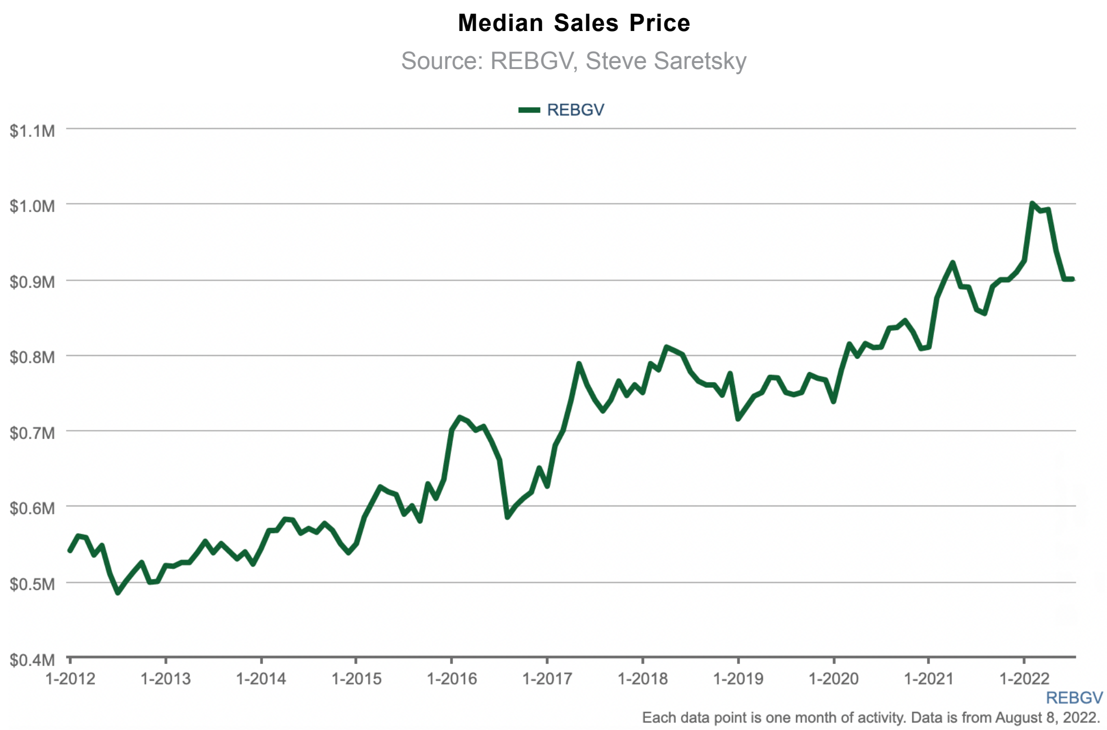
This is understating the decline in prices. As we've talked about before, the home price index is a lagging indicator and does not capture rapid changes in market conditions. The median sales price does a better job, but still not perfect. It suggests market prices are down 10% from the peak, but still up nearly 5% from last year.



Here's basically what you need to know. Home buyers are incredibly tepid right now, everyone wants a deal, and most want to keep waiting for a better entry point. Sentiment is pretty terrible. However, inventory remains pretty sparse in most areas so there really isn't an abundance of selection. Buyers will have better selection once the fall market kicks off in September. We're seeing a ton of accepted offers collapse on

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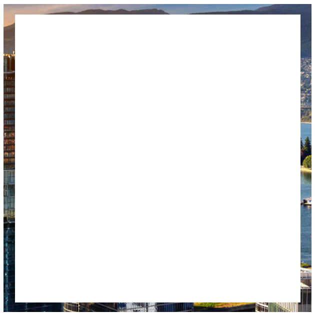
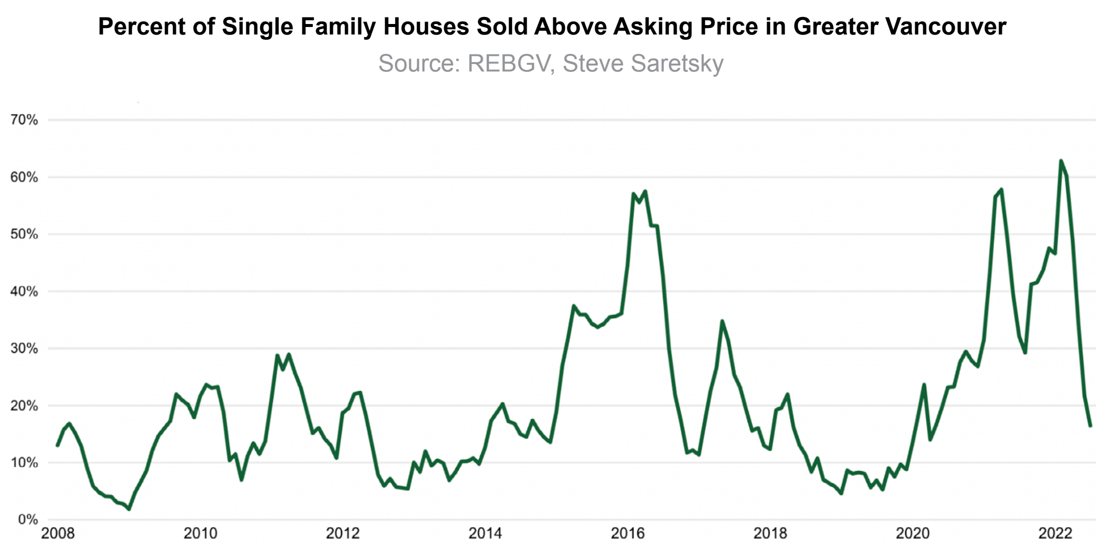
financing. Buyers are tying up properties with a subject to financing clause, only to figure out mortgage rates are punitively high or they no longer qualify for the loan amount they were offered several months ago. Buyers making offers subject to the sale of their existing home is becoming a lot more common.

Ultimately the path forward for the housing market looks choppy at best. We should get more clarity once we enter the normally busier fall market.



NO MORE BIDDING WARS

Long gone are the days of underpricing a house with the expectation of receiving ten offers and driving the price to record highs. Buyers are tepid, and no longer interested in competing for homes. This is best highlighted by looking at the number of homes sold above the asking price. In July, just 16% of all single family house sales sold above the asking price, that's down from a record high of 63% in February this year.



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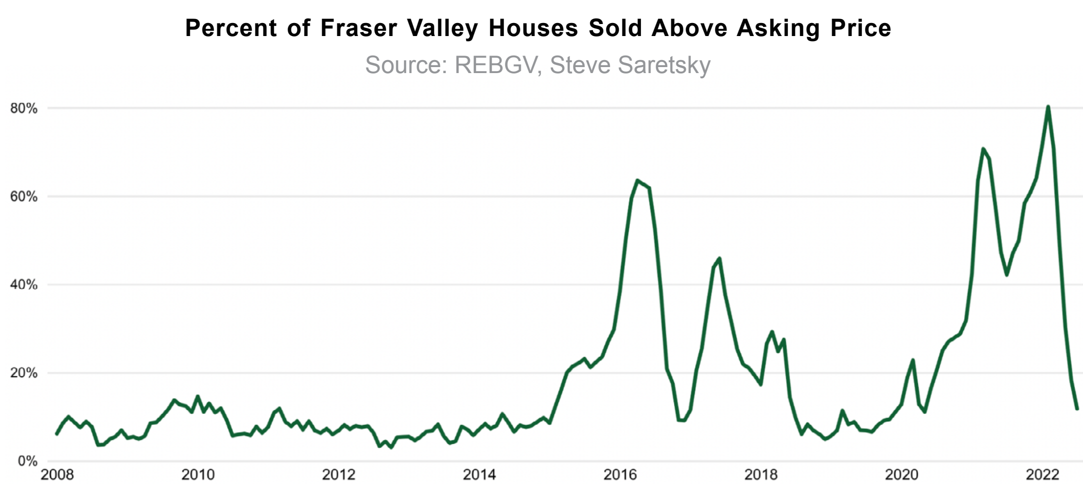
I know what you're thinking, isn't 16% still high considering sales are touching multi-decade lows?

This metric isn't perfect but it's a good barometer to highlight speculative excesses. The homes you see selling over asking price today are much different than back in early 2022. A house worth $1.6M might get listed at $1.3M, get five offers, all with subject conditions, and then sell for $1.5M. In this case buyers aren't bidding up houses, in fact they are underbidding them and sellers are arguably worse off. It makes more sense for a seller to list at $1.7M, wait for your one buyer and give yourself $100k worth of negotiating room. However, some sellers don't have the luxury of waiting a month to sell their home and want it moved ASAP- it's for this reason they price low for multiple offers and properties are still "Sold over asking price".

As we've talked about over the past several months, things look even more dramatic in the Fraser Valley. The number of single family homes sold above asking price hit a cycle high of 80% in February, and have since fallen to 12%.



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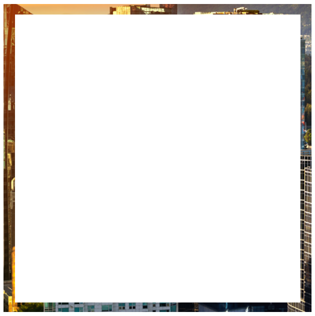
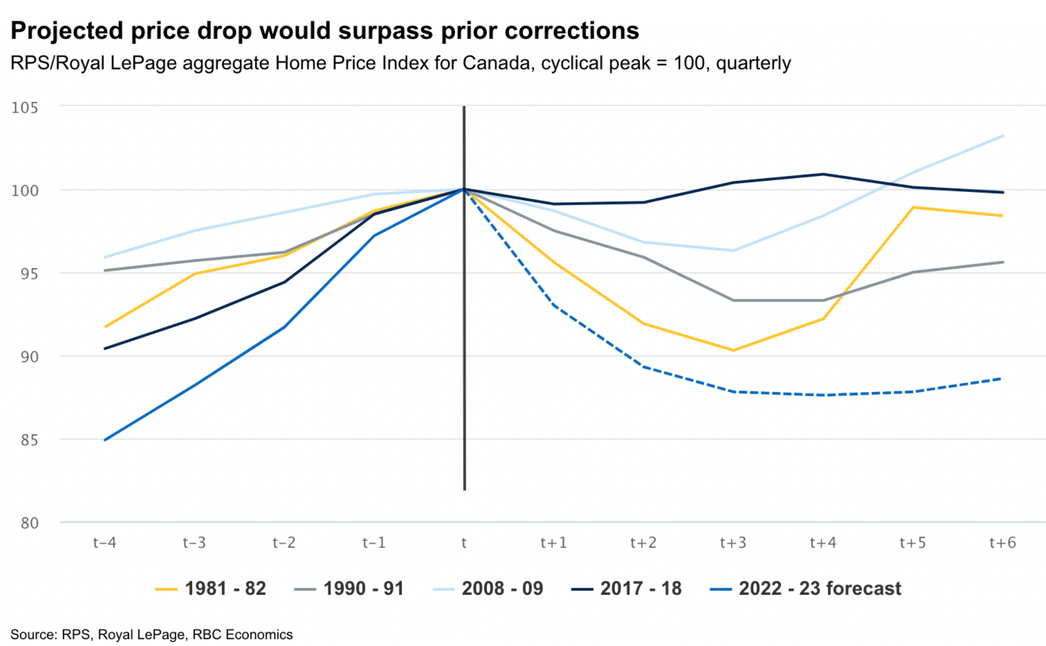
In summary, If you're looking for a quick sale you can still price low and get multiple offers, just don't expect a good price. Buyers are in the drivers seat and they're looking for deals.



RBC CALLS FOR HISTORIC CORRECTION

The team at RBC economics made headlines this past week, calling for a "historic" correction underway in the nations housing market. I typically don't put much weight on forecasts as they really should be called guesses. However, it's an important sentiment check when our largest bank calls for a 23% decline in home sales this year and 12% decline in the nationwide house price index from peak to trough by the second quarter of 2023. Again, this is highly unusual for a major bank to make comments like this.



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Just for context, RBC's forecast would rank as the steepest correction of the past five national downturns. While 12% might sound low, remember this is measured using the national home price index, not average house prices in Toronto's suburbs which have already blown through 12%.

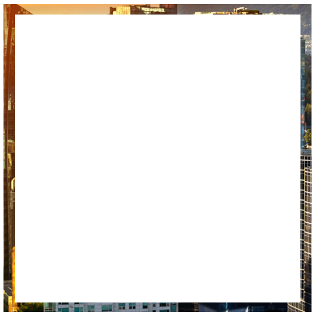
During the financial crisis of 2008-09, national home prices declined 9%. So far we are down 6.7% from peak, so if RBC's guess is correct, we are about half way through this correction. Again, all very hypothetical but it's fun to pontificate. Remember, US house prices crashed 19% on a national level from a peak in 2007 before ultimately bottoming in 2012, and it was much worse in certain areas. Keep this all in mind when you see numbers being forecasted left, right and center. At the end of the day nobody knows what's going to happen, but here are a few things I feel quite confident about:

1. Mortgage rates are still too high and are hurting demand

2. More pain to come for variable mortgage holders

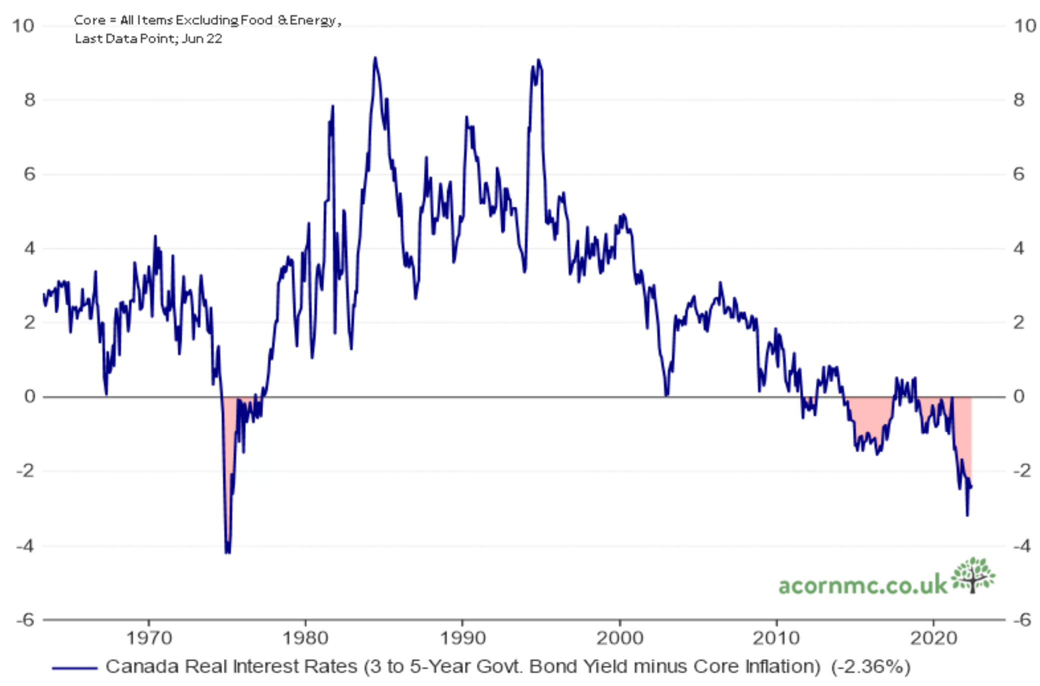
3. Central banks are always two steps behind

Sock away some extra cash and enjoy your summer, we'll have more clarity in the fall.



MORE RANDOM MUSINGS

While interest rates have surged higher, Canadians are still being paid to borrow. Real interest rates are still deeply negative, coinciding with our belief of a prolonged era of financial repression. In essence, there is too much debt and it will be extremely difficult to run positive real interest rates for a sustained period of time.



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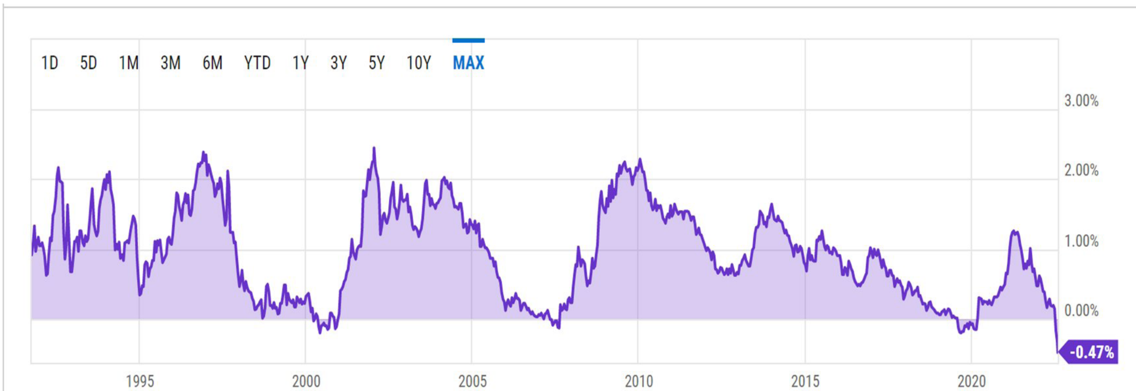
Even with mortgage rates at 5% and inflation at 8% you are being paid to borrow. Let's see how far the Bank of Canada can push rates up. The bond market seems to think the BoC is making a policy error, with the spread between the 2 year, 10 year government bond now negative 50bps. This is the deepest yield curve inversion in recent history.



What this is basically saying is that the Bank of Canada is raising interest rates so much that they're going to choke the economy and kill economic growth. The 5 year bond yield is also telling us this, down nearly 100bps since peaking in June. Despite this, the big 5 banks have refused to cut mortgage rates, preferring to bake in a risk premium given the negative outlook for not just the housing market but the economy in general. Banks are getting much more conservative on the lending side, another reason we are seeing a lot of deals fall apart on financing. One big bank tells me mortgage applications were down over 50% last month.

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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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