THE SARETSKY REPORT

SEPTEMBER 2022

SARETSKY
GROUP

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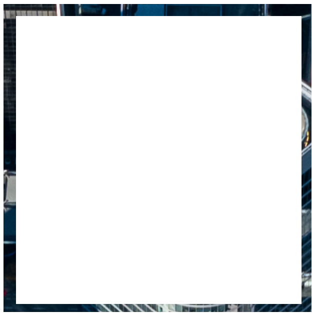
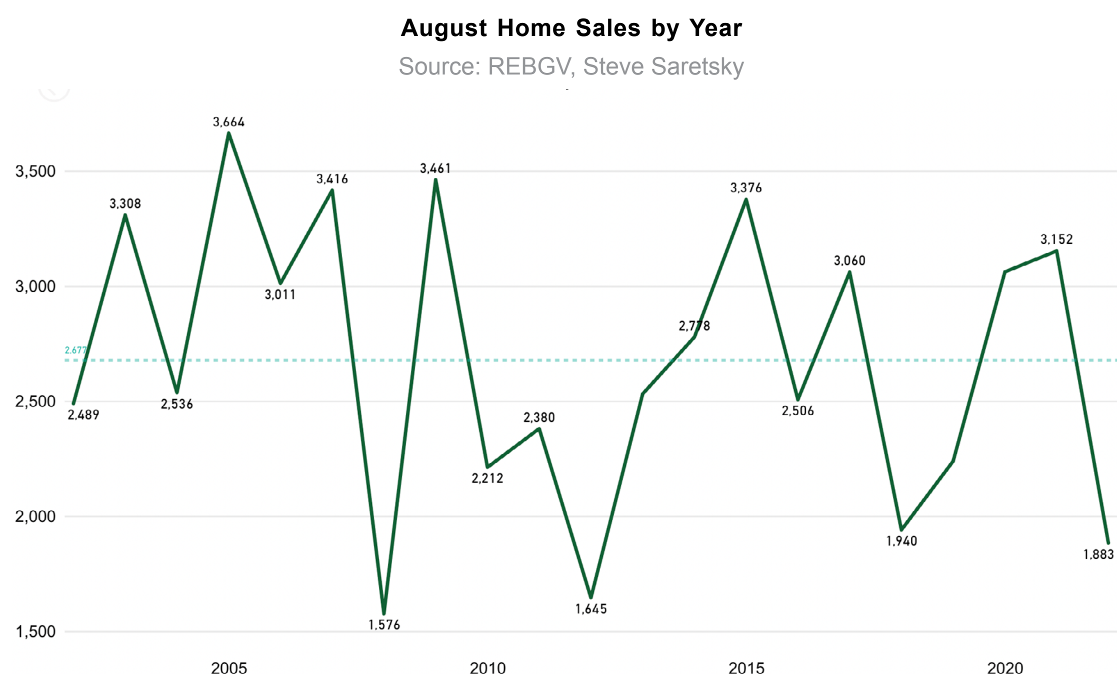


OPENING THOUGHTS

There's always lots to talk about in the Vancouver housing market, especially these days. We have plenty of updates this month on interest rates, trigger rates, and the investor/ rental market. Housing activity remains on the same course it's been on over the past few months. Greater Vancouver home sales dropped 40% y/y in August. Over the past two decades only the years 2008 & 2012 have seen weaker sales volumes in August.



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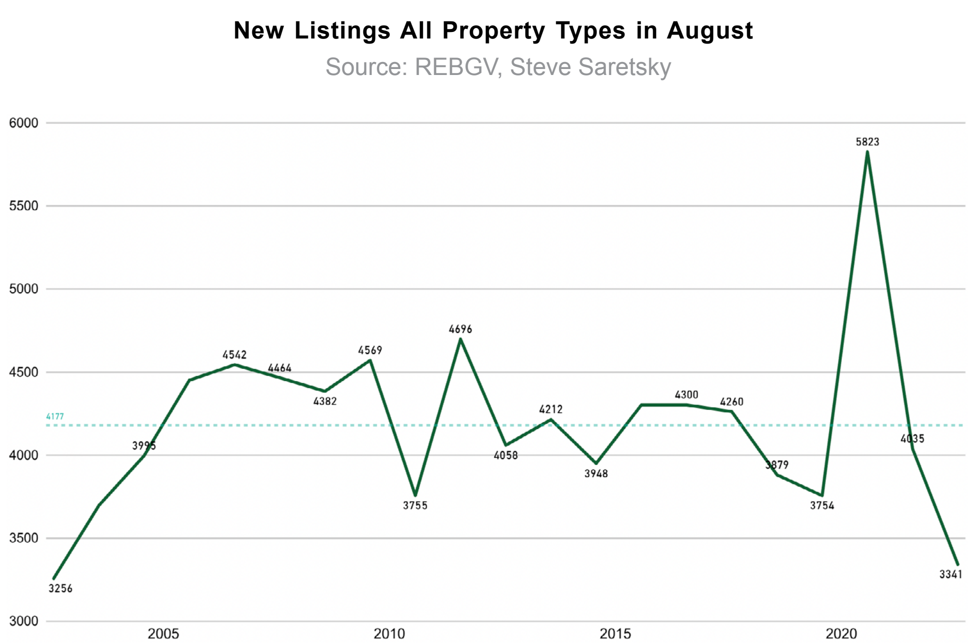
What I can tell you anecdotally is that sales activity has been picking up ever so slightly. I think the initial shock from higher rates is wearing off a bit. This does not mean sales are about to normalize, nor does it mean prices have bottomed. It simply means there is a bit of liquidity coming back to the market after a complete standstill over the past few months. Lower prices are bringing some buyers back to the market, albeit very slowly. We saw a similar dynamic in 2016 when the foreign buyers tax was announced. There was a giant shock to the market, sales activity froze for several months before slowly picking up again as the market digested it. In markets, nothing ever moves in a straight line.

So sales remain incredibly weak but are picking up off the lows. Downwards pressure on price remains fully intact, however, incredibly weak levels of new listings are providing support. In August, new listings for the month fell to twenty year lows! It appears sellers are equally as frustrated with prices and are opting to delay listing or pulling existing listings off the market.



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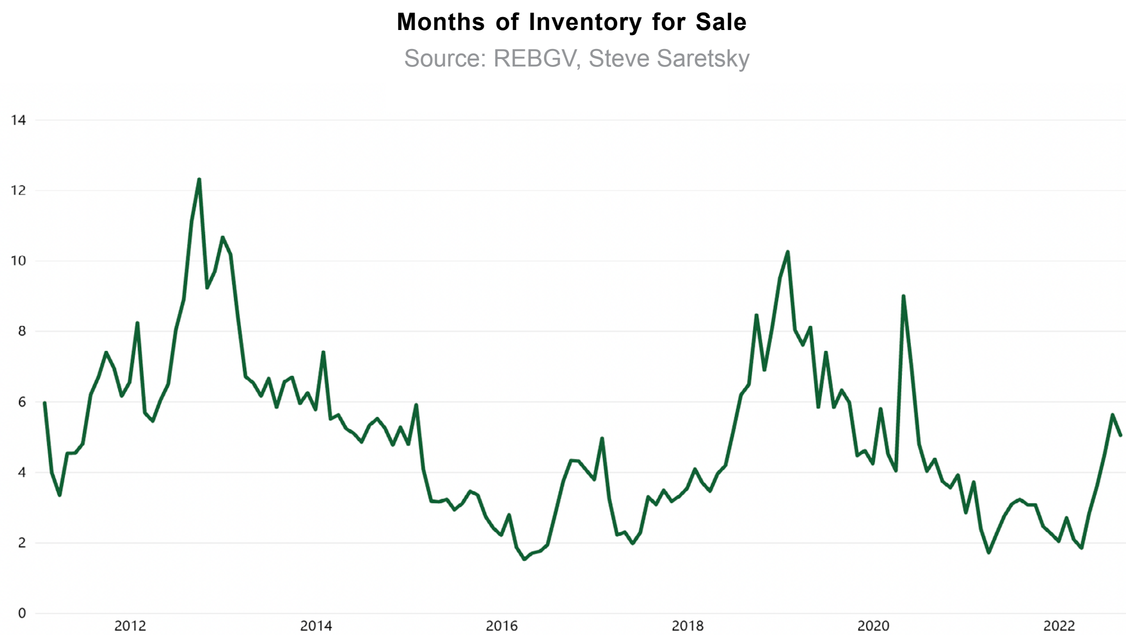
While sales are incredibly weak, so too are new listings. This continues to be the story over the past few months. If we're going to see another leg lower in prices we will need more inventory. We currently have 5 months of inventory for sale, that's elevated, but certainly not problematic.



Months of inventory at 5 is still considered a buyers market and prices are reflecting that. The largest price corrections are still showing up for detached houses. The median price is now off 15% from the February peak.

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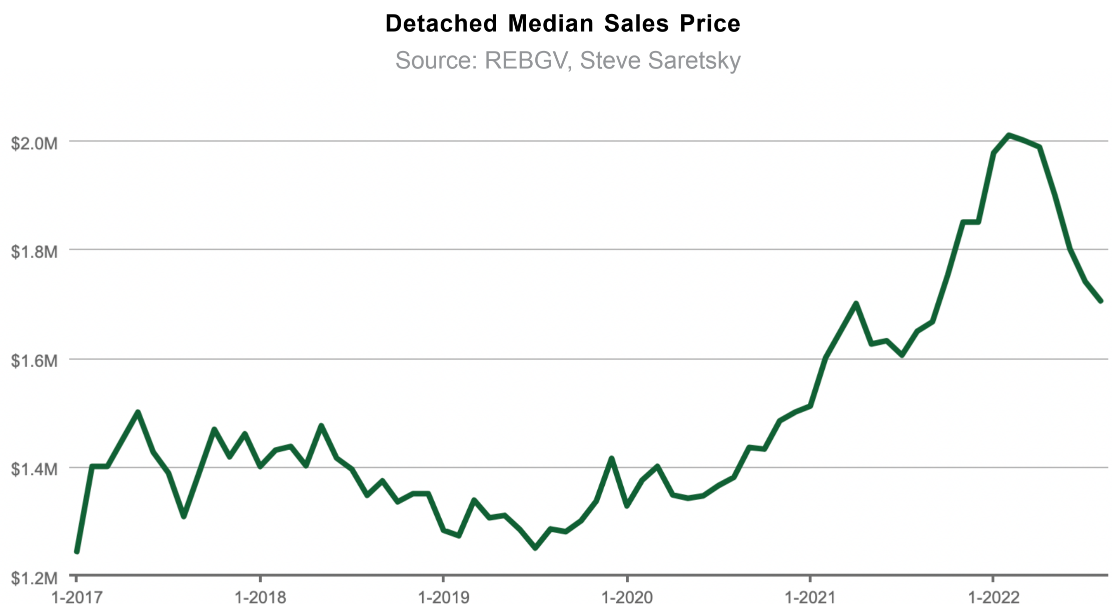
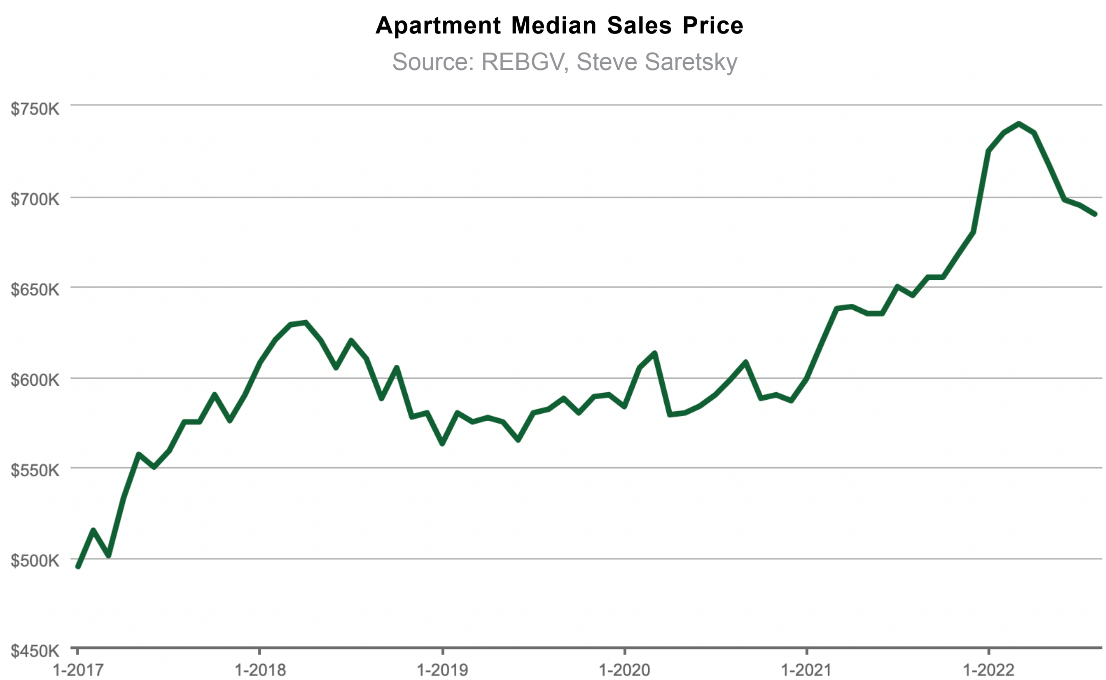


Price declines are less severe in the condo market, where prices have officially dropped 6.7% from the peak. Keep in mind, as we have discussed many times in the past, condo prices tend to lag detached.



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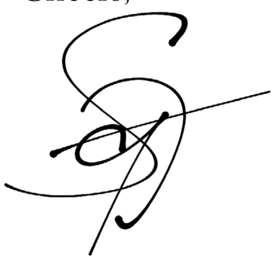
They are the last to increase in price and the last to correct in nearly every market cycle. I'd expect more downside coming.

To summarize, housing demand remains weak, buyers are slowly coming off the sidelines but not at a quick enough pace to reverse course. The initial shock of a doubling of interest rates is starting to wear off but mortgage rates of 5% are still too restrictive for a highly levered property market. Investor demand remains the weakest given deteriorating cash flows following higher cost of borrowing and increased cost of maintaining a property. This will likely prompt more investors to sell, and is something we are watching closely over the next 6 months. It should be a pretty uneventful fall market. Let's see.

Cheers,



Steve

BANK OF CANADA WITH ANOTHER JUMBO RATE HIKE, RAISES RATES 75BPS IN SEPTEMBER

The Bank of Canada lifted interest rates another 75bps on September 07, bringing the overnight rate to 3.25%. Interest rates are now up 300bps this year, making it the quickest tightening cycle on a percentage basis since the 1980's. Markets are still pricing in another 50bps of rate increases to round out the year, whether they're right or not is irrelevant at this point, the damage has been done. The banks prime rate is now at 5.45%, which as per the always brilliant Rob Mclister, implies the following:

1. Payments on a run-of-the-mill prime - 1.00% adjustable rate mortgage (ARM) will now be about $154 higher per month—per $100,000 borrowed—compared to March 1 (before the BoC started this campaign).

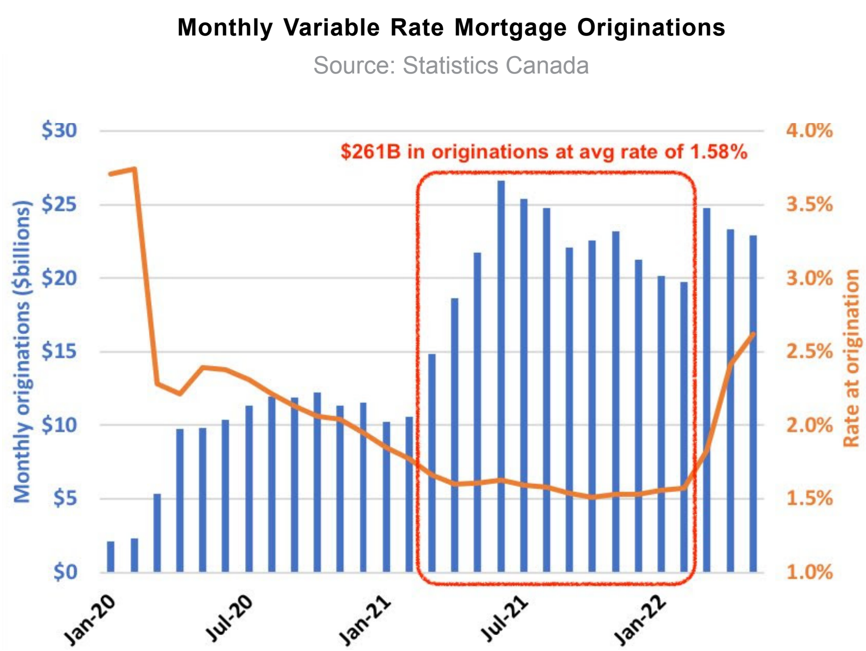
2. Interest-only HELOC payments will leap by about $63 a month, per $100,000 borrowed.

3. The lowest nationally available stress test rates have risen to:

- 6.59% uninsured (a 4.59% one-year fixed from Manulife Bank)
- 6.20% insured (a 4.20% five-year ARM from Nesto)

After today's hike, Canada's effective minimum qualifying rate (6.59% uninsured) will stand at its highest point in over two decades. Before March, it was 5.25%. That change equates to a roughly 11.3% drop in maximum theoretical buying power for a typical bank borrower with no non-mortgage debt.

Following the rate hike we will also see our first round of fixed payment variable mortgages getting "triggered", banks will begin asking some borrowers to increase their monthly payments as there is not enough principal being paid down on the loan. Canada's largest bank, RBC, says interest rate hikes may trigger higher monthly payments for 80,000 customers with variable rate mortgages. The increases will average about $200 per month. Furthermore, data from Ben Rabidoux of Northcove Advisors suggests, nearly 15% of total outstanding variable rate mortgages were originated between Mar 2021 and Feb 2022 at an average rate of 1.58%.



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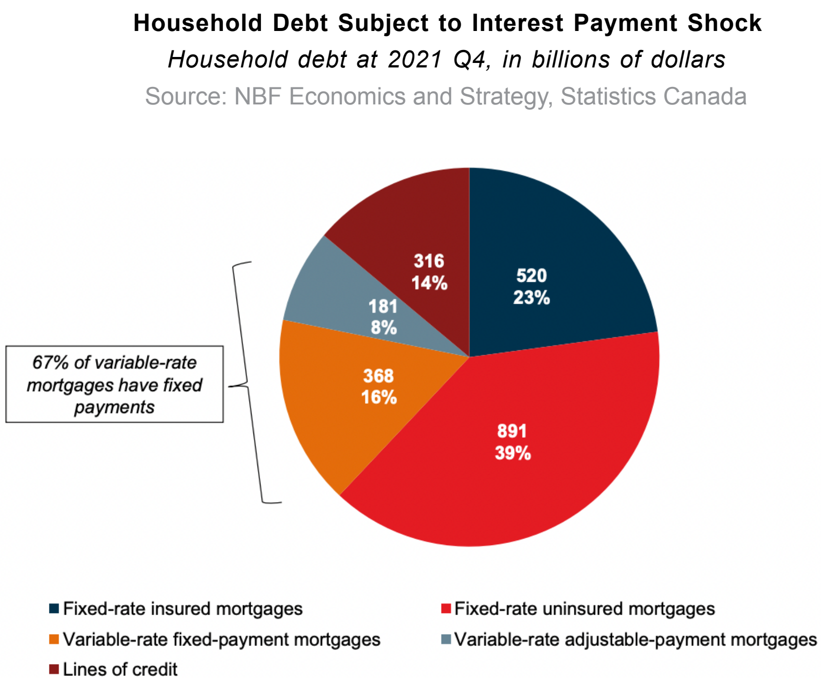
The typical trigger rate is about 300bps higher than the original contract rate, so a lot of this depends on what your original contract rate is.

According to National Bank, fixed payment variable accounts for 67% of all variable mortgage product outstanding. The other 33% are floating rate variables, and they've already been feeling the pain.



Interest rates are up 300bps from the lows, which means if you've got a million dollar mortgage, originated at the lows of this rate hiking cycle, your monthly payments are up nearly $1500 so far. Now imagine you've got several rental properties with floating rates. This is the unfortunate situation for some. The good news, markets (which can sometimes be wrong) are pricing in another 50bps of rate increases before the Bank of Canada hits pause, it seems increasingly likely we are nearing the end of this rate hiking cycle. Let's see.

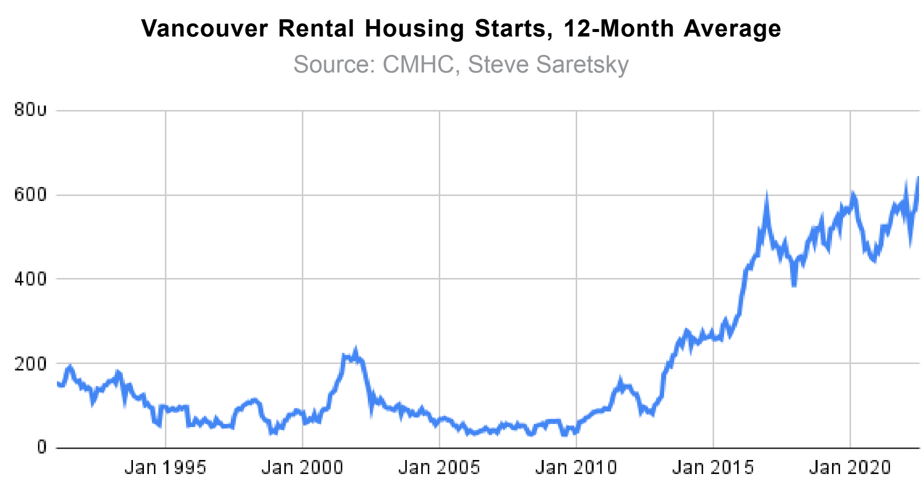
BC GOVERNMENT CAPS RENT INCREASES TO 2% IN 2023

Speaking of landlords, they were delivered more bad news this month as the BC Government announced rent increases will be capped at 2% in 2023. The allowable increase is typically calculated based on the 12-month average percent change in the Consumer Price Index for B.C. ending in July of the previous year. Using this formula, the allowable rent increase should have been 5.4%. For a renter paying $2,000 in rent, this will mean saving up to $816 next year.

While I understand very few people will have sympathy for the landlords, lets push our political views aside and try to look at what this might mean for the market. Inflation is surging and the costs to maintain a rental property are up significantly over the past few years, including insurance, materials and labor for maintaining a property, and of course, property taxes. Now tack on the rising cost of financing and suddenly many landlords are now subsidizing tenants. Suddenly, the idea of negative cash flow investments look a lot less appetizing with the prospect of falling resale prices. Just to reiterate I am not saying any of this in order to generate sympathy for a landlord, but more so how it will impact the resale market and the rental market moving forward.

In the resale market we are seeing very little investor purchase activity at the moment. In fact, we are seeing quite a few investors with rising variable rate mortgages and an inability to raise rents being prompted to sell. These units are often stuck with tenants at below market rents, making them harder to sell to future investors, as they are required to absorb the existing tenants, often at below market rents.. Yes there are ways around this, it typically requires hefty payouts to the tenants in order to incentivize them to leave. I find most mom and pop investors prefer not to get involved in this process. So yes, the many changes around the BC tenancy act in BC has discouraged investor activity, perhaps this was the goal?

Now, as for new rental construction and the maintenance of rental property that is where things get interesting. Landlords are not running a non-profit organization. If the numbers don't work, rental housing doesn't get built, and or doesn't get repaired. As of right now, rental housing starts are running at record highs in Vancouver. This is largely been facilitated through generous CMHC financing which was introduced several years ago. It's a brilliant program that is clearly working.



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However, based on my conversations with those in the industry and some simple number crunching, rental construction is becoming unfeasible once again, largely due to the rising cost of financing and the cost of construction which remains elevated despite some improvements in the supply chain.

This is a space worth watching. As we know, rents in Vancouver are at all time highs and surging which perhaps offsets some recent policy from the BC Government. However, the risk/reward on rental construction is starting to fade. If we want to lower rents or prevent them from rising further, open the floodgates and incentivize developers to build. I have yet to see an oversupply of rental housing and I think any tenant would agree, vacancy rates remain incredibly tight- a drastically different situation than the resale market right now.

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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