THE SARETSKY REPORT

NOVEMBER 2022

SARETSKY
GROUP

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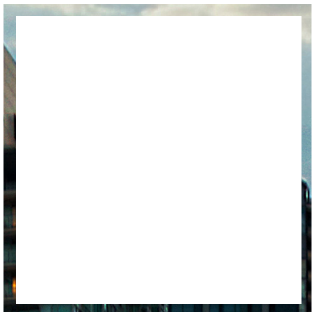

OPENING THOUGHTS

As we expected and discussed in last months report, the Bank of Canada raised interest rates another 50bps in October. Markets were pricing in a 75bps rate hike but the Bank of Canada failed to deliver, citing growing concerns around financial stability. It's the first time in awhile they have flagged financial stability concerns, which suggests we are likely near the end of this rate hiking cycle. Still, the damage is already done. Prime rate now sits at 5.95%, meaning nearly all variable rate mortgages are now north of 5.5% and closing in on 6% when we get our next (and perhaps final??) rate hike in December. Short term fixed rates are now north of 6% in many cases, particularly for renewals where borrowers have less flexibility in changing lenders. Just for curiosity sake, I called one of the big banks the other day to inquire about converting a variable rate mortgage to a two year fixed rate mortgage and I was quoted 6.14%. This was the best rate they could offer. Suffice to say, mortgage rates of 6% are hard to stomach and the market is not digesting it well at all.

Greater Vancouver home sales in the month of October totalled just over 1900 sales, it was the lowest count since October of 2008.

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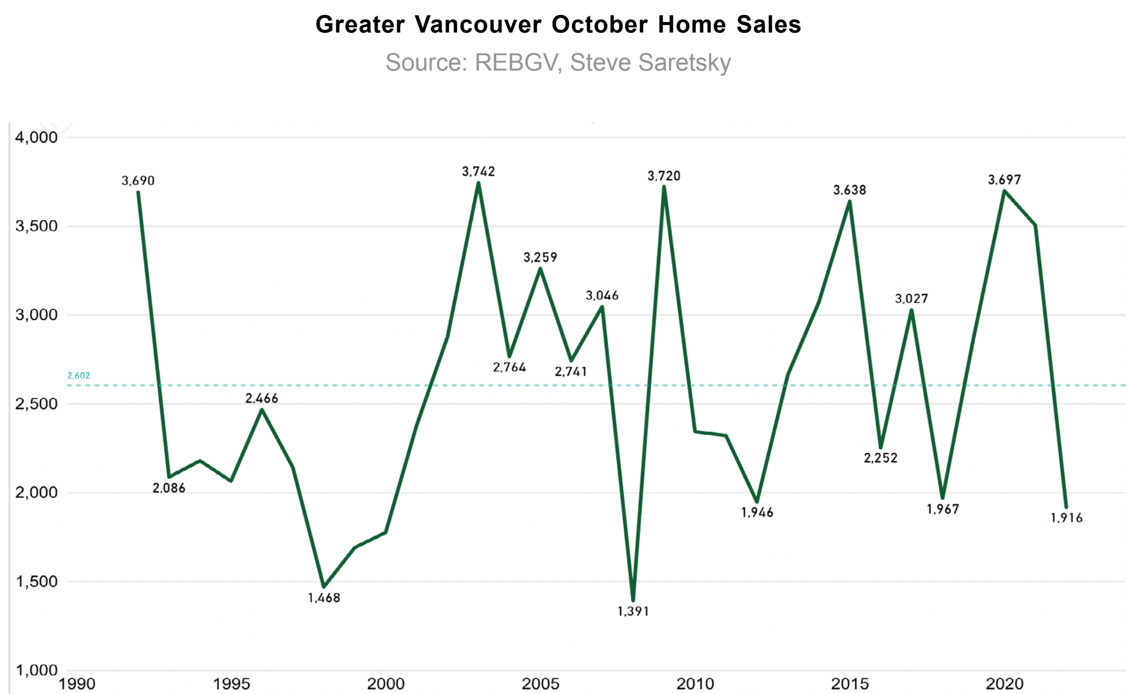

In other words, home sales haven't been this weak since a month after Lehman Brothers collapsed in 2008. That might be a bit dramatic but the reality is that the population has grown a lot since 2008 and so has the total housing stock. Sales volumes at these levels are definitely concerning.

Following a similar trend over the past several months, both buyers AND sellers are on strike! New listings are running 8% below their long term, 20 year average. Despite sales running at or near multi-decade lows since the summer, active inventory for sale has hardly grown at all. Inventory for sale is HALF of what it was in October 2008.

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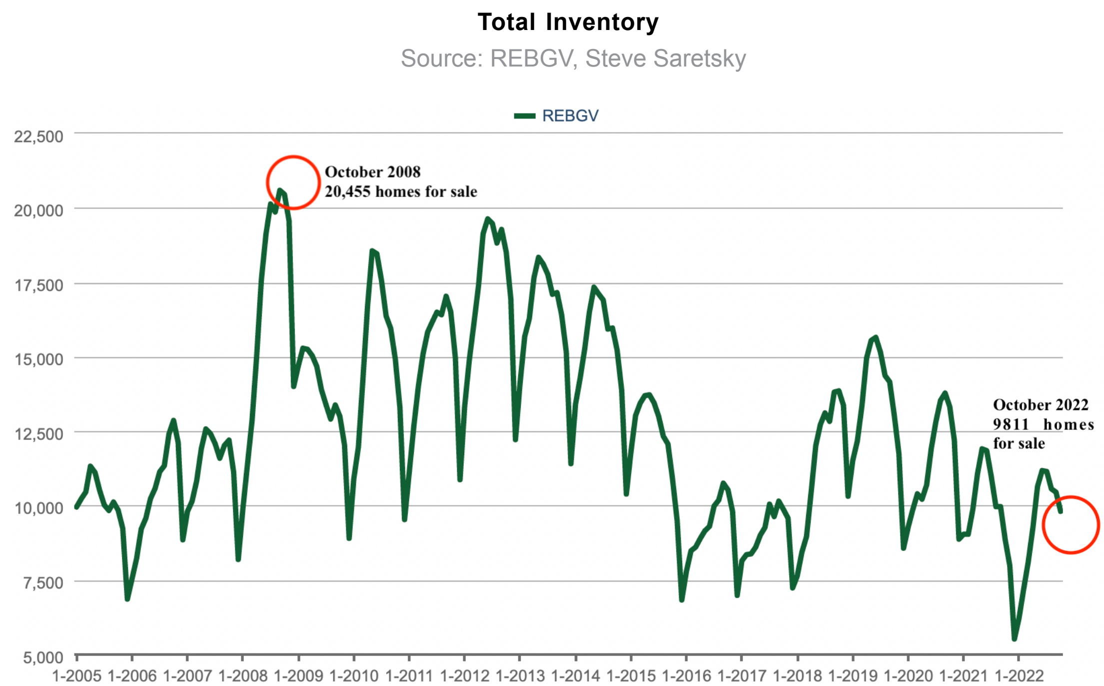

There is simply no panic showing up on the inventory side. However, this could change sometime next year. There are a few risks worth flagging. First off we are seeing more condo investors listing their units for sale, cash flows are impaired due to rising interest rates and the inability to pass through rent increases due to tenancy laws. I am also concerned about the pre-sale market where there will be a cohort of buyers who will not qualify for mortgages when their pre-sale units come due for completion. Remember, most pre-sales were purchased when mortgage rates were HALF of what they are today. Lastly, if interest rates remain elevated throughout 2023 then we are likely to see an increase in court-ordered sales. I must emphasize that none of the three issues highlighted above are of concern today, but they are real risks that could materialize in the year ahead.

Prices are still inching lower, albeit at a slower pace. We cleared out many of the panic sellers earlier this summer when some people were

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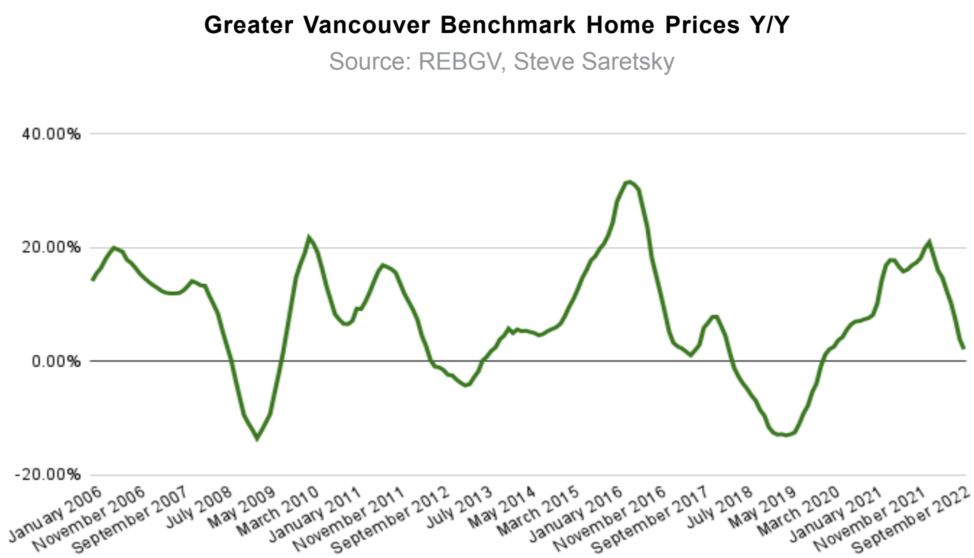
caught offside having bought before they sold. For the first time since February, median sales prices were up on a month-over-month basis across all product types, however I think that is mostly noise and not something that signals a change in market conditions. Benchmark home prices are still up 2% year-over-year but will slide into contraction in the months ahead.



While it might sound hard to believe, not everyone is levered to their eyeballs in debt. There are a surprising number of mortgage free homeowners in Canada, and in Vancouver. These are the would-be sellers that are opting to sit tight and wait for conditions to improve.

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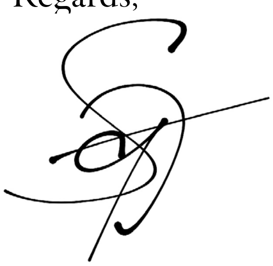
Share of Mortgage-Free Owner Households by Metro Area

Source: Jens von Bergmann, Stats Canada

And so, right now we have a tug of war. Both buyers and sellers are not happy with current market conditions. I think we get more clarity on how this plays out once the spring market rolls around in 2023. I've highlighted the risks, and I think there is a decent probability that some of those risks will surface in the new year. Again, this largely hinges on the course of inflation and interest rates which we are all watching with bated breath. Be careful out there.

Regards,



Steve

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PRE-SALE AND ASSIGNMENT RISKS

So mortgage rates are way up, and resale prices are falling. Investors are nervous and have moved to the sidelines. This is obviously not good news for developers who rely on investors to buy pre-sales in order to obtain construction loans. According to Zonda Urban, In the third quarter of 2022, there were 1,522 pre-sale condo and townhome transactions, down 72 per cent from an all-time peak of 5,481 for the same period last year. In 2020, that number was 3,015. In 2019, it was 1,835. These are the lowest totals since 2012. Yes, decade lows in new home sales.

Another way of looking at this is via pre-sale absorption rates (homes launched for sales vs units sold) which is tracked by MLA Canada. At last reading, pre-sale absorption rates fell to 30% in September.

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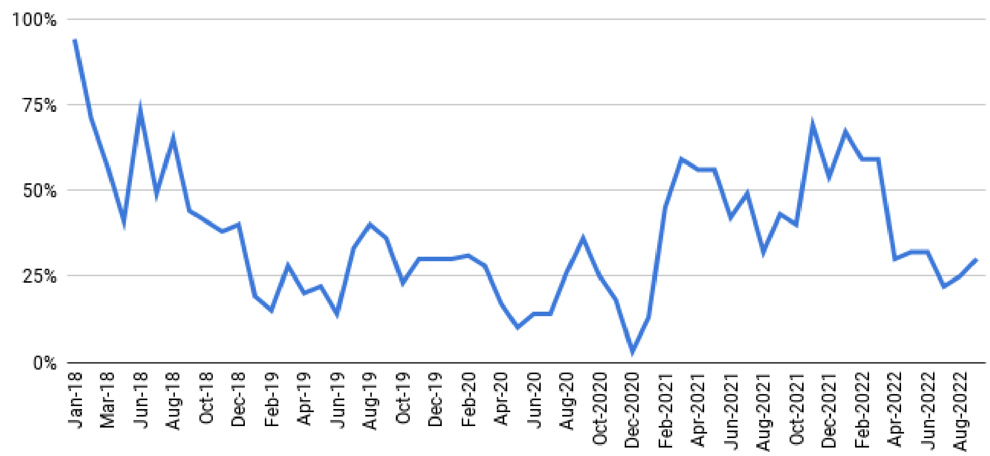
Vancouver Pre-Sale Absorption Rate, Greater Vancouver and Fraser Valley

Source: MLA Canada, Steve Saretsky



Many developers need to hit pre-sale targets in order to secure financing, in many cases lenders want to see 60% of units pre-sold. If developers feel they can't hit those targets in a timely manner then they will simply delay launching. That's exactly what we are seeing today, developers are hitting the pause button. Layoffs in the construction sector are coming very soon.

The Index of business confidence in the FIRE industries (finance, insurance, real estate) has fallen below Financial Crisis lows. The only time its been lower over the past twenty years is during the depths of the pandemic in March/April 2020.

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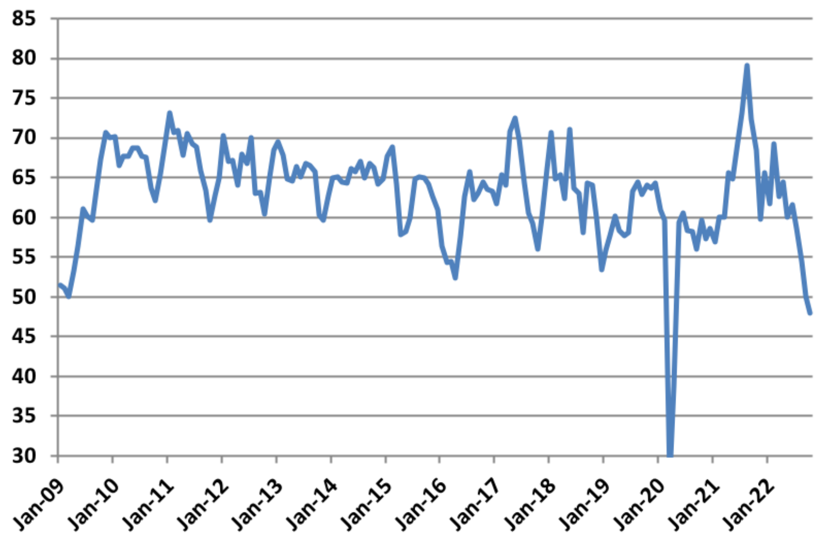
Small Business Confidence Index: Finance & Real Estate

Source: Canadian Federation of Independent Businesses, Ben Rabidoux



According to my good friend Ben Rabidoux of Edge Analytics, if construction employment falls back to its long term share of total employment that means losing roughly 2% of all jobs in the country.

Construction Share of Total Employment

Source: Ben Rabidoux, Edge Analytics; Statistics Canada, BLS

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If you're looking to bring inflation down, that will certainly do the trick, but obviously at a major cost to the economy.

We also have to keep a close eye on the assignment market. While many developers don't allow assignments on the MLS, some do. Here is a chart of assignments listed for sale on the MLS system.

You'll note that assignments were very elevated in 2019/2020 and no real issues surface. Will this time be different? My opinion is that 6% mortgage rates, if sustained, will make this more of an issue this time around.

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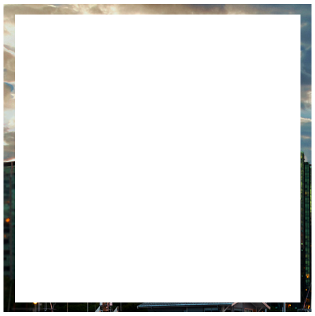
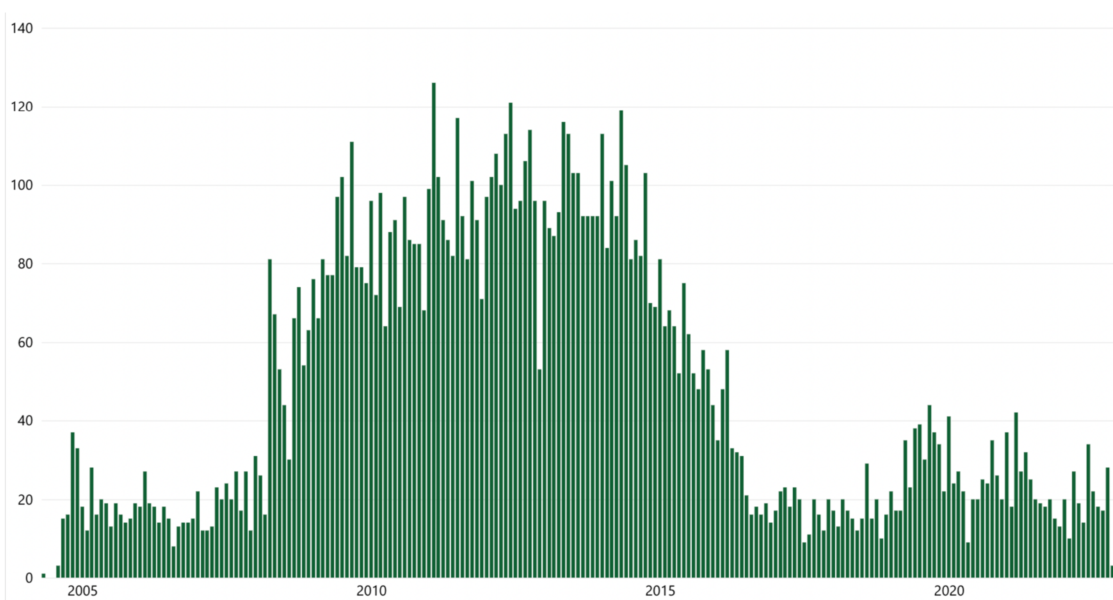


COURT-ORDERED SALES REMAIN SUBDUED

Rising interest rates cause everyone to talk about overleveraged owners and the forced selling that comes with it. We are not seeing any evidence of this when looking at new listings, inventory, or the number of 'court-ordered' homes listed on the MLS.

Court Ordered Listings on the MLS, Greater Vancouver & Fraser Valley

Source: REBGV, Steve Saretsky



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Keep in mind it takes lenders up to a year or more to get delinquent homeowners listed on the MLS and then sold. Initially lenders will try to work with delinquent homeowners, if that fails they need to request power of sale through the courts. This is a lengthy legal process in BC and for most of Canada. In other words, if you're worried about foreclosures it's likely a discussion towards the end of 2023.

The bigger risks are borrowers who are stuck at private lenders and alternative lenders (B lenders). These loans are typically 1-2 year terms and are facing large payment increases at renewal, and unless these borrowers have had a sudden improvement in their finances they will have difficulty refinancing into a traditional tier 1 lender. For example, According to National Bank, Home Capital borrowers could face up to an $1190 increase in their monthly mortgage payments over the next 12 months as ~66% of its borrowers will need to renew their mortgage within 12 months. These are where the risks lie.

You're likely to see more private lenders (Mortgage Investment Corps) gating funds in the new year as liquidity becomes more of an issue with loans not turning over to pay out withdrawal requests.

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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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