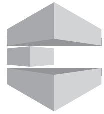
Edge Realty
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The Edge Report

June 2022

Hyperlinks:

1) Affordability under pressure as rates continue to surge

2) Takeaway from May home sales: Sales down, prices in Ontario under pressure

3) Supply and demand: Housing starts jump, immigration hits yet another record

4) Credit trends: Mortgage boom peaks in Q1, no uptick in insolvencies yet

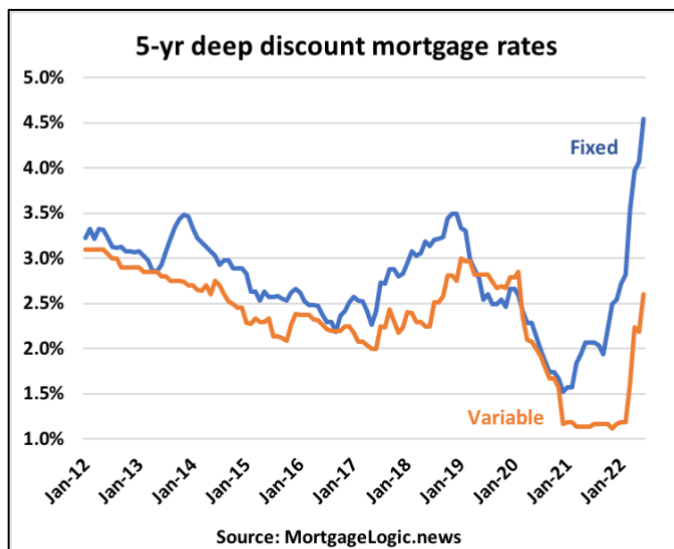
1) Affordability under pressure as rates continue to surge

Another 50-75bp rate hike expected in 3 weeks

Markets are pricing in a nearly 100% chance of a 50bp rate hike on July 13 and over 50% chance that we see 75bps as the Bank of Canada continues to battle inflation that is expected to break the 7% level when the CPI numbers are released on Wednesday this week. That would be the highest CPI print since March of 1983.

Fixed rates grind higher

Fixed mortgage rates continued to grind higher last week with fully discounted 5-year rates hitting 4.54% and discretionary fixed rates spiking to 5.14% according to Rob McLister at MortgageLogic.

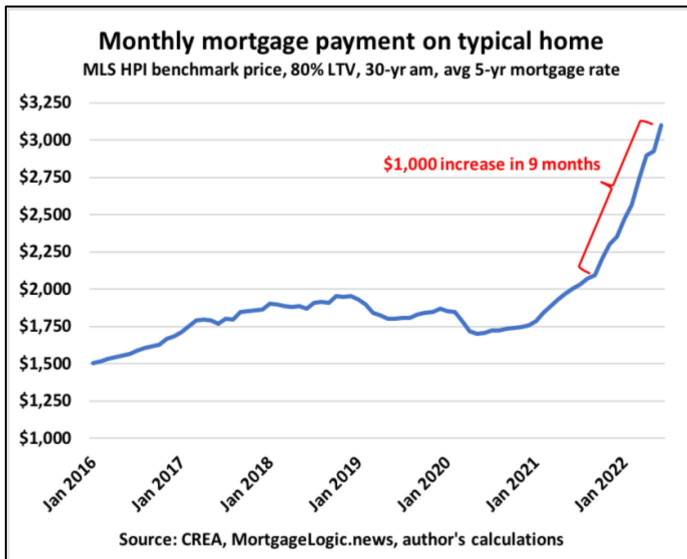


The good news is that 5-yr bond yields have backed off sharply in the past week, from 3.6% to closer to 3.4%, so that should put a cap on further fixed rate increases for a while.

Affordability under pressure

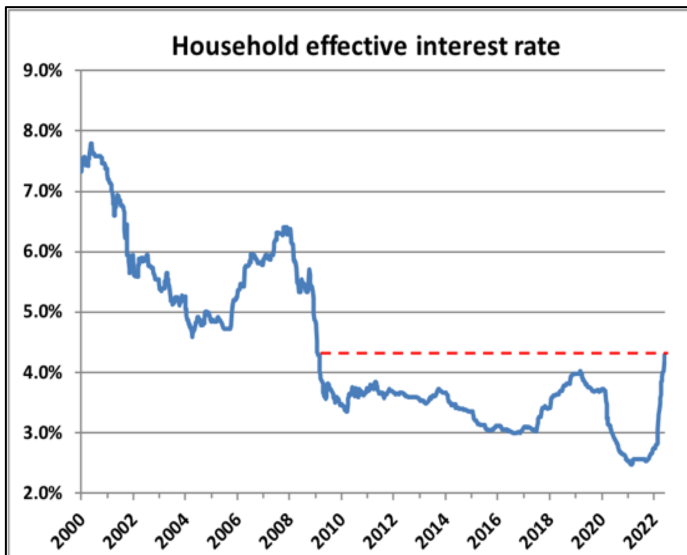
In terms of what this means for affordability, monthly mortgage payments needed to service the mortgage on a typical home when financed at 80% LTV continue to spike and are now up by $1,000 or nearly 60% in the past 9 months alone.

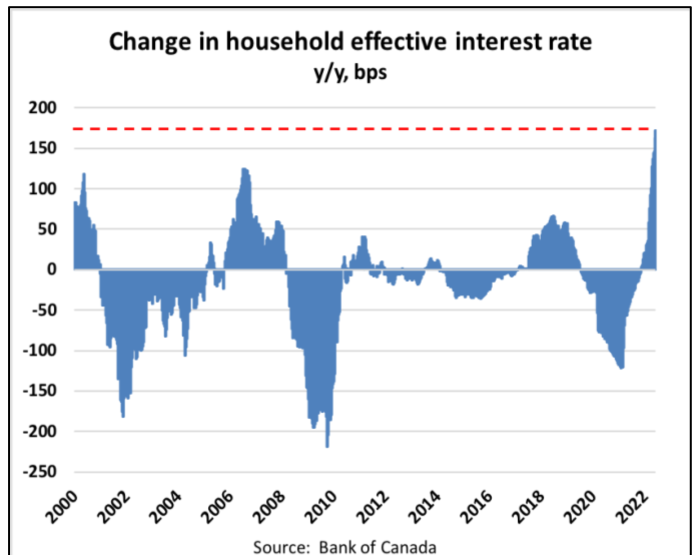
This remains the most important Canadian housing chart. Longer-term supply/demand dynamics will matter eventually but for now they take a backseat until this gets resolved…either via lower rates or lower prices:



Household borrowing rates hit new highs

The effective household interest rate (ie the average weighted interest rate paid across all debt outstanding) has jumped another 28bps in the past month and is now at the highest level since 2009 and rising at the fastest rate since the early 1990s:





I'll say it again: Rates at these levels are going to start to break things. It's not clear to me how much longer the Bank of Canada can keep this pressure on before we start to see serious collateral damage across the broader economy.

2) Takeaway from May home sales: Sales down, prices in Ontario under pressure

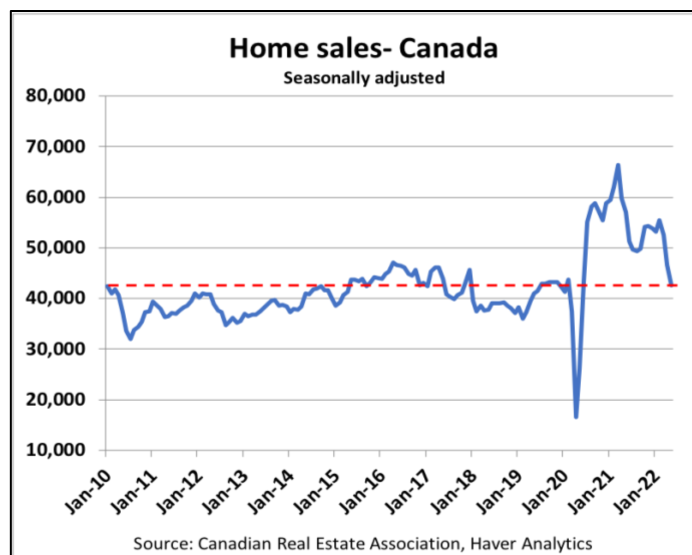
The high level summary in a nutshell:

- Trends in southern Ontario are weakening significantly
- Inventory is rising across the country, including a 37% y/y jump in Ontario where listings are building at the fastest rate since the 1990s.
- BC is starting to show signs of rolling over.
- The rest of the country is seeing weakening sales but inventory trends still look benign and pricing is holding firm.

	Sales		New listings		Active inventory		House prices (HPI for Canada, average for provinces)	
	y/y	m/m seasonally adjusted	y/y	m/m seasonally adjusted	y/y	m/m seasonally adjusted	y/y	m/m seasonally adjusted
Canada	-25.3%	-8.6%	+2.5%	+4.5%	-0.8%	+6.9%	+19.6%	-0.8%
BC	-37.0%	-16.3%	-7.2%	+2.7%	+4.7%	+7.0%	+8.6%	-4.7%
AB	-3.3%	-10.5%	+1.2%	-1.0%	-17.1%	+2.7%	+7.6%	+0.1%
ON	-35.6%	-9.9%	+6.7%	+0.8%	+37.6%	+9.8%	+9.2%	-2.5%
QC	-13.5%	-0.9%	+4.9%	+19.4%	-9.7	+8.6%	+14.7%	-0.3%

Sales fall 8.6% nationally in May

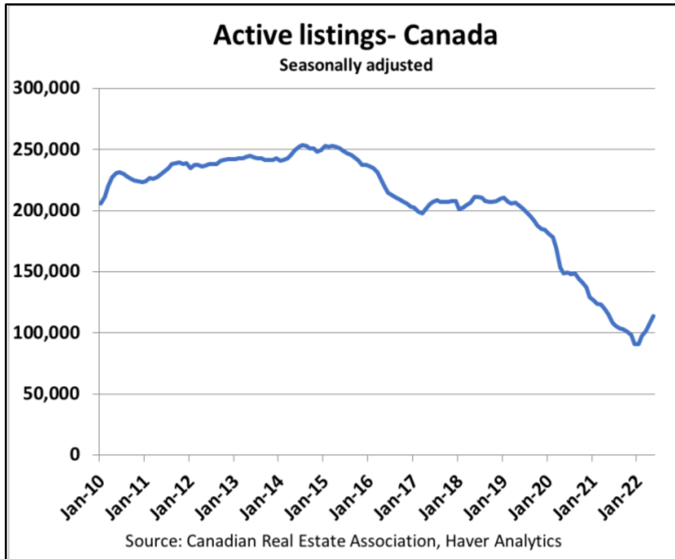
Home sales nationally fell another 8.6% m/m seasonally adjusted in May, with BC (-16.3%) and Ontario (-9.9%) leading the decline. Sales have now fallen 23% in just 3 months including a 31% plunge in Ontario.

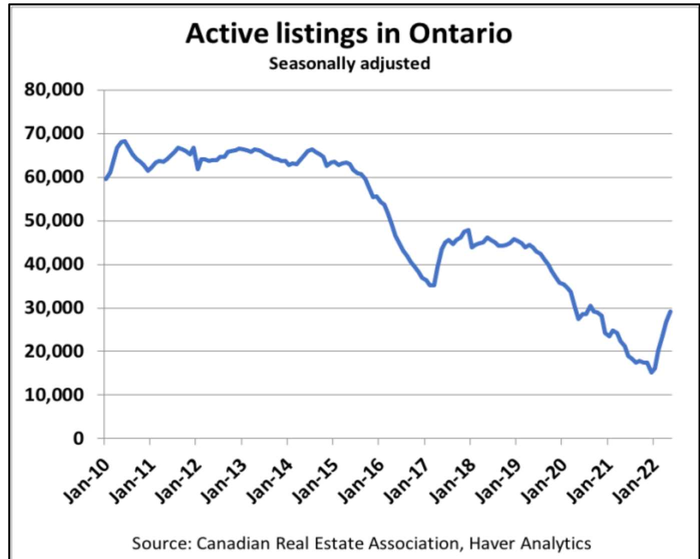


Inventory on the rise

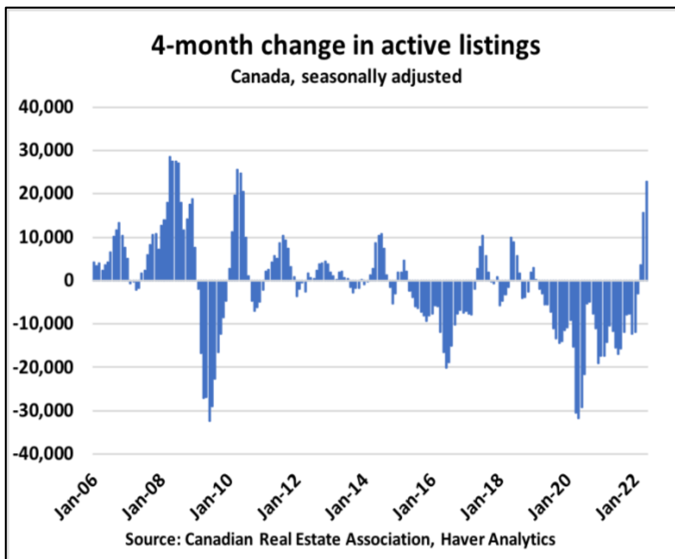
New listings coming to market jumped 4.5% m/m nationally in a sign that selling pressure may be intensifying….although the bulk of the increase was due to a 19% m/m surge in Quebec.

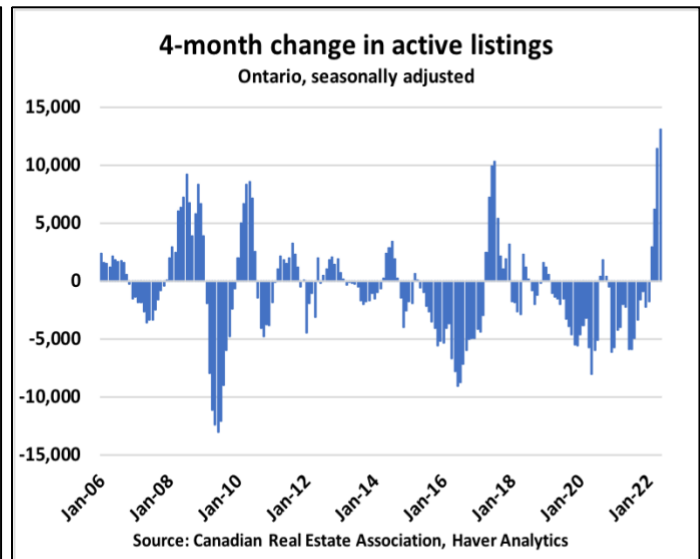
This helped push active inventory up another 7% m/m nationally and up 9.8% in Ontario where the cumulative inventory build off the lows is now greater than in the 2017 downturn:





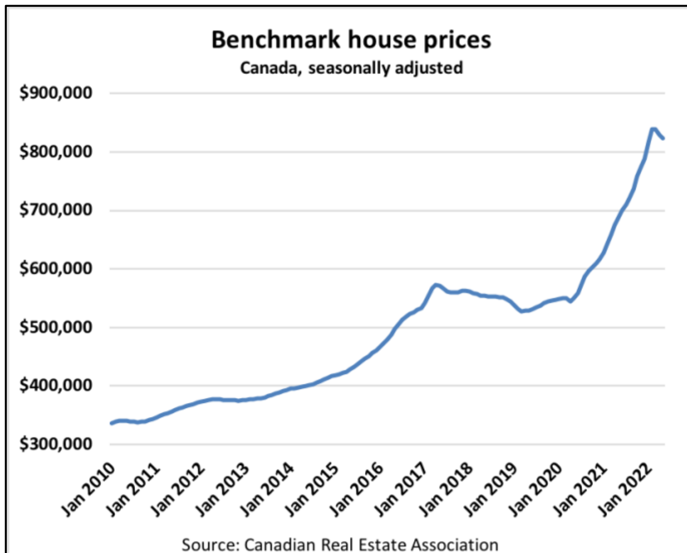
Since hitting a low 4 months ago, active listings nationally have increased at the fastest rate since 2010. And in Ontario, we're looking at the fastest inventory build since the 1990s.





Prices drop again

House prices nationally have now decline for 2 consecutive months for the first time since 2019 after slipping 0.8% m/m in May.

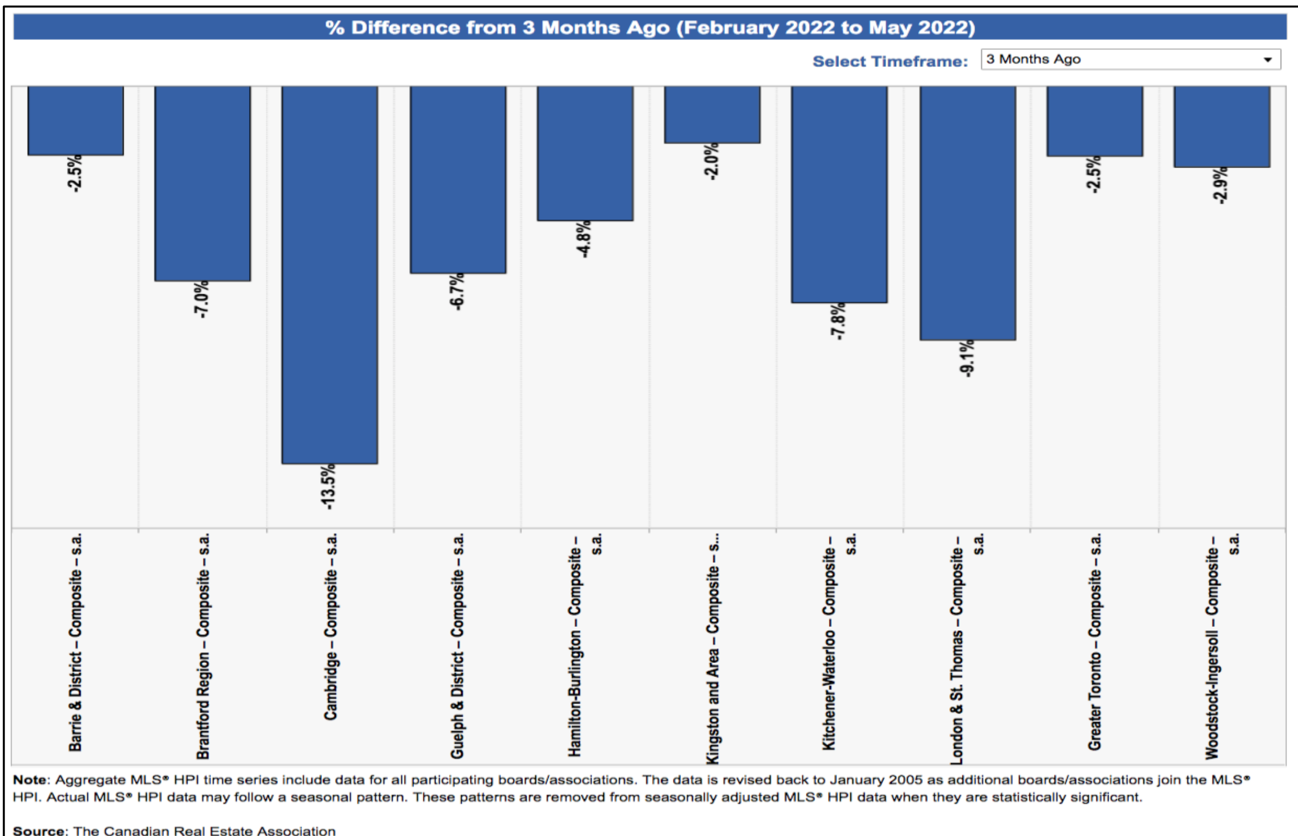


Blame Ontario!

For now declining prices remain primarily an Ontario story where 20 of 29 real estate boards reported a monthly decline in seasonally adjusted prices last month. Hardest hit are “commuter cities” within an hour or so of Toronto where prices are under significant pressure:

- Cambridge -4.6% m/m
- Woodstock -3.9%
- Huron-Perth -3.6%
- London -3.5%
- Guelph -3.3%
- Kitchener -2.9%
- Hamilton -1.7%

Headline prices are now down by as much as 14% in 3 months in some of these cities:



But keep in mind, the methodology of the MLS HPI strips out "outliers" such as highly distressed sales that deviate too sharply from the trend. That, and data smoothing by using rolling averages means house price indexes like the HPI and Teranet do a poor job of capturing sharp inflections.

Consider the examples below, all from these "commuter" cities and all selling at significant declines from prior sale prices (failed sales that never closed) just months before.

View Listing In Full Map

11 Stirling Place
Guelph - Downtown/Exhibition Park
Single Family Residence

Listed for: ~~$ 799,900~~
Sold for: $ 868,000
Sold 8 days ago

3+1 Bedrooms | 5 Bathrooms | 0 Garage

Listing History — **29% less than February**

Buy/sell history for 11 Stirling Place, Guelph (Single Family Residence)

Date Start	Date End	Price	Event	Listing ID
2022-05-26	2022-06-08	$868,000	Sold	40267964
2022-04-04	2022-05-26	$899,900	Terminated	40236193
2022-03-28	2022-04-04	$899,900	Terminated	40231387
2022-02-02	2022-02-08	$1,217,000	Sold	40206255

View Listing In Full Map

58 Campbell Road
Trent Hills - Warkworth
Single Family Residence

Listed for: ~~$ 850,000~~
Sold for: $ 900,000
Sold 23 days ago

2+1 Bedrooms | 2 Bathrooms | 3 Garage

Listing History — **22% less than February**

Buy/sell history for 58 Campbell Road, Trent Hills (Single Family Residence)

Date Start	Date End	Price	Event	Listing ID
2022-05-13	2022-05-24	$900,000	Sold	40259494
2022-03-01	2022-03-07	$1,220,000	Sold	40217087

View Listing In Full Map

Unit L1 - 70 Willowrun Drive
Kitchener - Grand River South
Row/Townhouse

Listed for: ~~$ 674,888~~
Sold for: $ 750,000
Sold 10 days ago

3+1 Bedrooms | 3 Bathrooms | 1 Garage

Listing History **17% less than February**

Buy/sell history for Unit L1 - 70 Willowrun Drive, Kitchener (Row/Townhouse)

Date Start	Date End	Price	Event	Listing ID
2022-05-26	2022-06-06	$750,000	Sold	40262318
2022-05-10	2022-05-26	$699,888	Terminated	40256278
2022-05-04	2022-05-10	$748,888	Terminated	40252472
2022-02-18	2022-02-19	$905,000	Sold	40209769

View Listing In Full Map

162 Preston Dr
Orangeville - Orangeville
Freehold Townhouse

Listed for: ~~$ 880,000~~
Sold for: $ 850,000
Sold 8 days ago

3 Bedrooms | 3 Bathrooms | 1 Garage

Listing History **22% less than February**

Buy/sell history for 162 Preston Dr, Orangeville (Freehold Townhouse)

Date Start	Date End	Price	Event	Listing ID
2022-05-12	2022-06-08	$850,000	Sold	W5615879
2022-04-20	2022-05-12	$999,000	Terminated	W5583737
2022-02-11	2022-02-18	$1,093,000	Sold	W5498594
2014-11-07	2014-12-09	$330,000	Sold	W3062255

So why is it that these suburbs are cooling faster than the rest of the country?

The main reason is simply that they ran up the most. The Bank of Canada this week released a study looking at house price growth around major cities during COVID. Their findings confirm what we already knew: The "flight to the suburbs" was a real thing, and house prices have risen much more sharply in those areas than in the city centers:

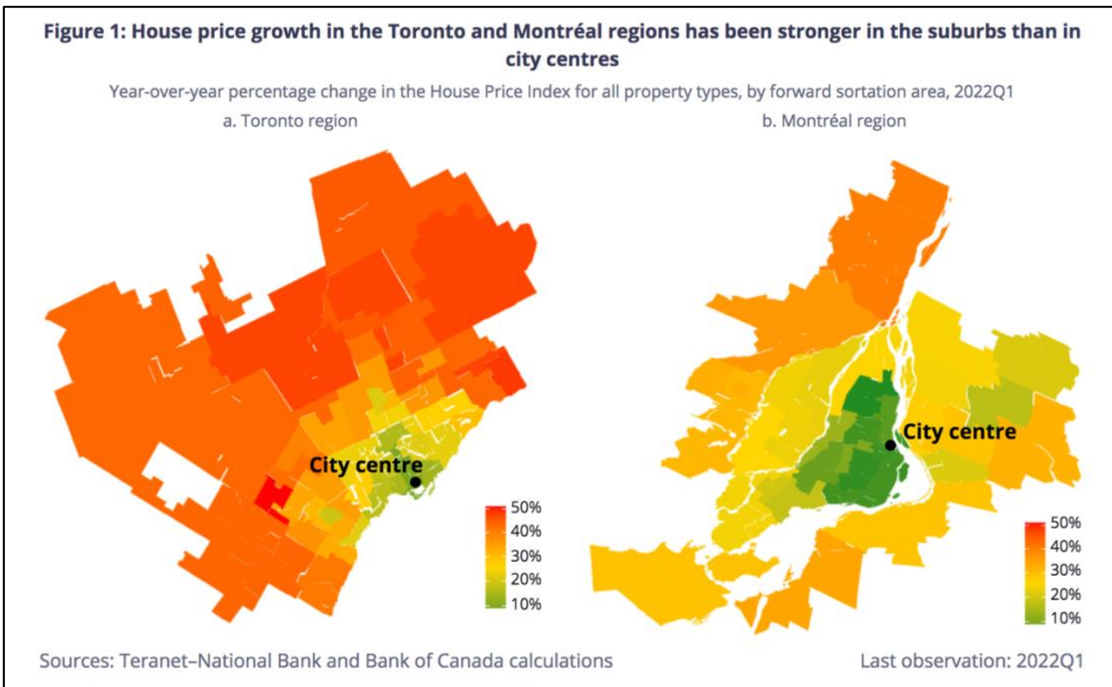


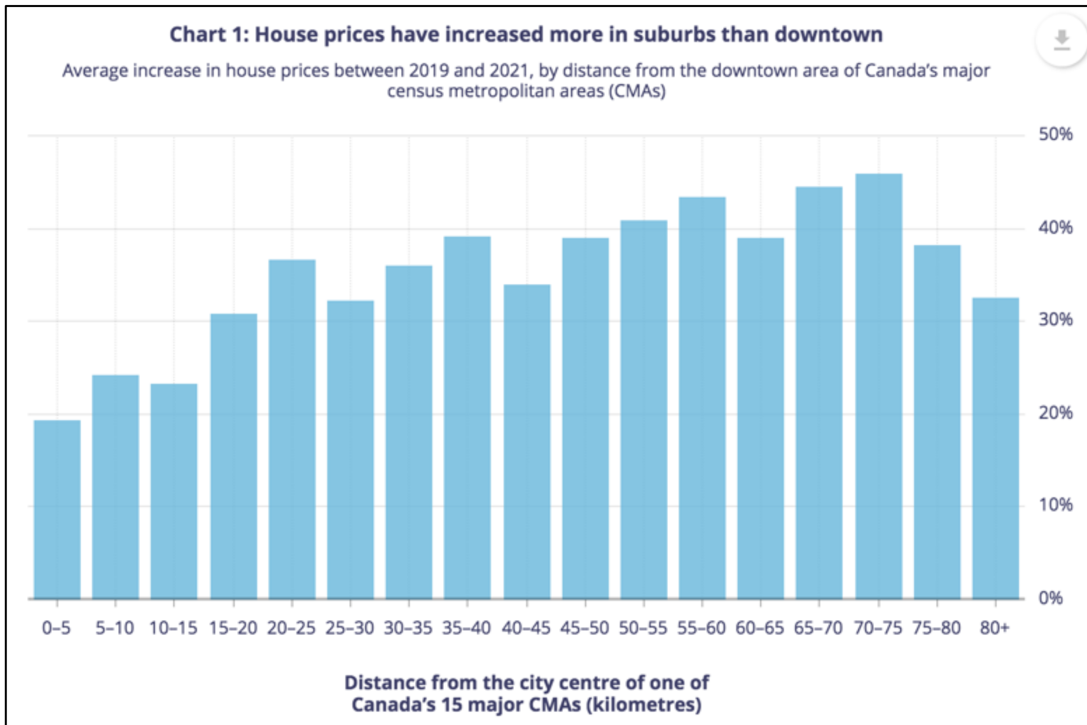
Figure 1: House price growth in the Toronto and Montréal regions has been stronger in the suburbs than in city centres

Year-over-year percentage change in the House Price Index for all property types, by forward sortation area, 2022Q1

Sources: Teranet–National Bank and Bank of Canada calculations

Last observation: 2022Q1

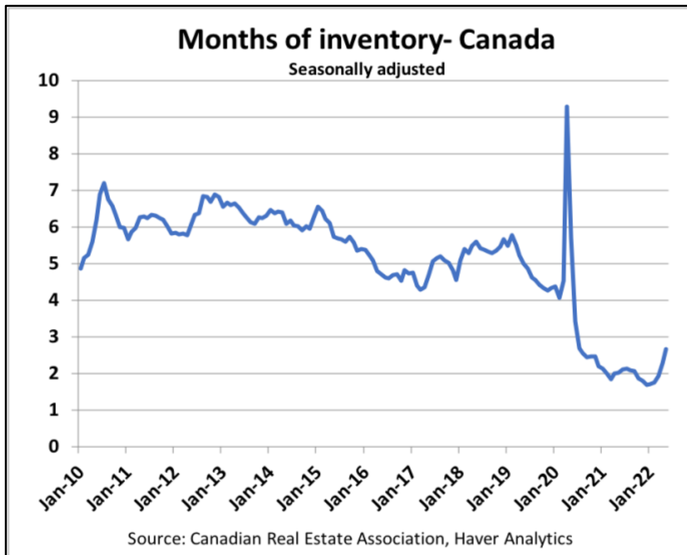
One of the more compelling charts is below showing house price change based on distance from the city center. The fastest appreciation was roughly 55-75km away from downtown:



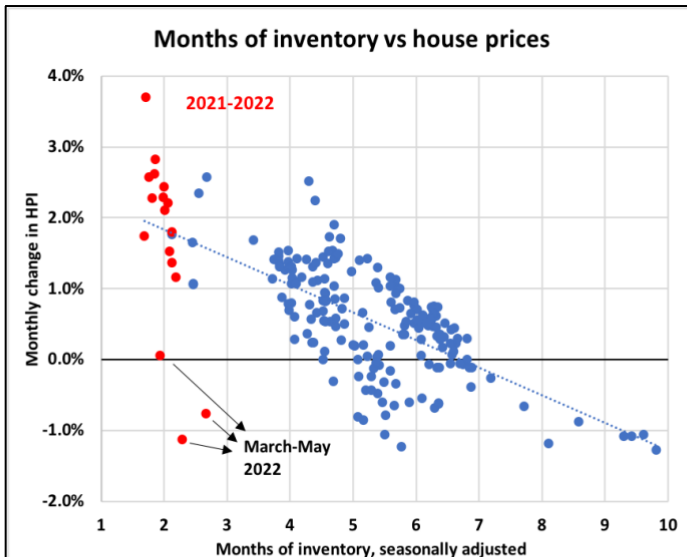
It's these areas that are now under some pressure after experiencing sharp runups. Not helping the situation is the price of gasoline for those commuting from these suburbs….now above $2.10/L nationally for the first time ever:

Distressed sales still driving "artificially large" price declines

Months of inventory have risen to 2.7 nationally which is as high as it's been since June 2020, but it's still way below normal levels:



Prices frankly shouldn't be falling with the market balance still this tight. There's normally a relatively predictable negative correlation between months of inventory and prices. But as shown below, the past 3 month have been complete outliers that have broken the model:



This is pretty strong evidence that highly distressed sales are setting marginal pricing in an increasingly illiquid market. There are still no signs that things are getting better yet. From real estate lawyer Mark Morris earlier this week:

MarkMorris
@MarkinMetaForm

This week I had a record number of people call me seeking a way out of their deals. I am torn between wanting to help them and trying to figure out how to bill for hardship given the countless hours this is starting to take up. We are entering into a new real estate world.

7:48 PM · Jun 10, 2022 · Twitter for iPhone

30 Retweets 2 Quote Tweets 148 Likes

Beth O'Donoghue @BethODonoghue · Jun 10
Replying to @MarkinMetaForm
What are most of the reasons people want out?
1 3

MarkMorris @MarkinMetaForm · Jun 10
Some with buyers remorse. More common though is that appraisals are now falling short. This afternoon's was typical - purchased for 1.15M appraised at 950k with no ability to fund the delta. Appraisal is a killer issue as Private Lenders are dependant on those numbers too.
3 1 16

It will take most of the summer for these to clear, and by then we'll have a much better read on the true state of the market.

Household balance sheets still very exposed to housing

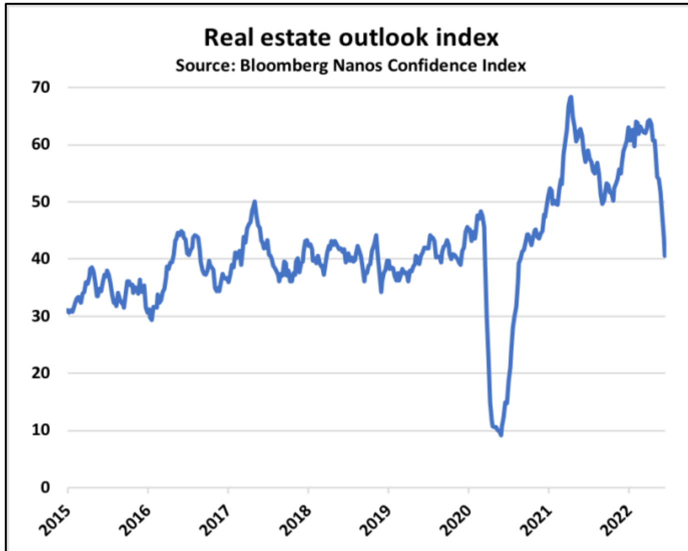
Should the trend in falling house prices continue, I worry about the fallout on household balance sheets and consumer spending. We learned this week that household net worth increase by only 1.2% q/q in the first quarter, the weakest growth since Q1 2020 and the weakest outside of COVID since late 2018.

But what remains particularly concerning is the sharp increase in real estate as a share of household assets. It's at record levels by a wide margin just as house prices have started to roll over, which does not bode well spending going forward.

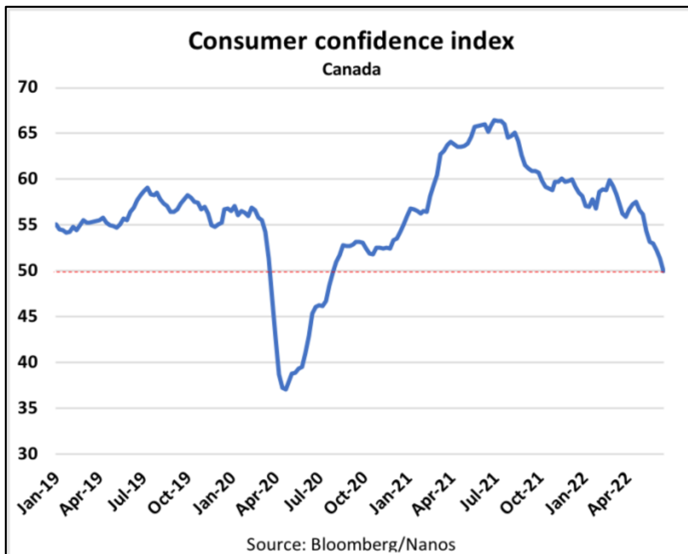
There's a well-known phenomenon known as the *wealth effect* which is just basically the concept that people spend more when they feel wealthier. The reverse is also true, and a decline in value of the largest asset on household balance sheets is not good news for consumer spending.

Consumer sentiment is plunging on housing concerns

Housing sentiment is now in free fall according to the Bloomberg Nanos confidence index. We're now seeing the steepest deterioration in this index since the onset of the COVID pandemic:

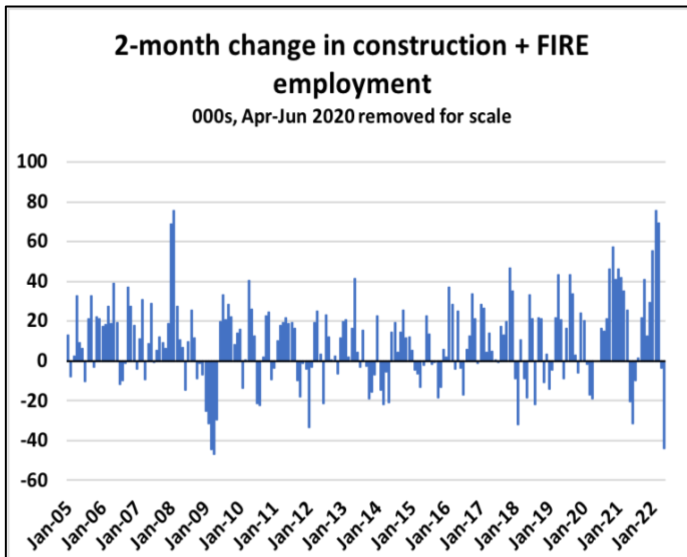


This weakening outlook on housing is dragging down overall consumer confidence, notably in Ontario where it's now closing in on the COVID lows….a shocking deterioration in the past month. When people lose confidence, they save more and spend less, and that can create a self-feeding dynamic for a period of time:



Housing slowdown already weighing on employment

It doesn't take long for the weak housing to filter through to the labour market. The construction and FIRE industries (finance, insurance, real estate) have just posted the largest 2-month contraction in total employment since the Financial Crisis (notwithstanding April 2020):



This shouldn't be a total shock. Let's remember that there are 72,000 realtors in the Greater Toronto Area alone (compared to somewhere around 40,000 teachers for reference), so a slowdown in transactions is going to impact that group at the margins.

It wasn't just housing industries that were weak last month. The entirety of the employment gains came from the public sector. The private sector shed 95,000 positions on net. Outside of pandemic-related shutdowns over the past 2 years, this was the largest monthly decline in private sector employment since 2009. Perhaps it will serve as a warning shot to the Bank of Canada to cool their jets?

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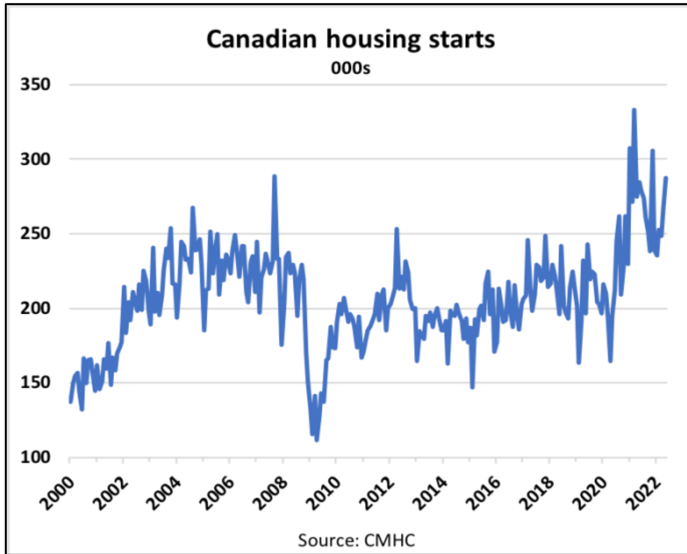
3) Supply and demand: Housing starts jump, immigration hits yet another record

Housing starts jump 8% m/m in May

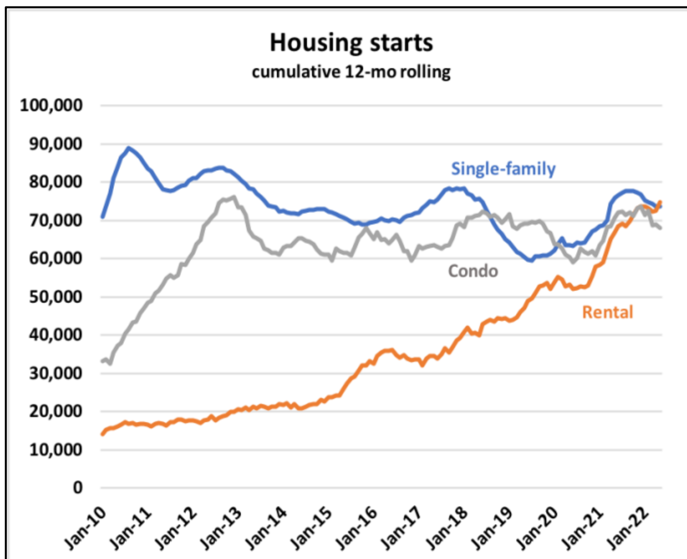
Housing starts jumped in May to hit nearly 270,000 on an annualized basis. Even with strong population growth, this level of new starts is well above any estimate of household formations, though it can certainly be argued that we need some "catch up" after years of under-building.



Rental starts now above single-family for the first time in at least 30 years

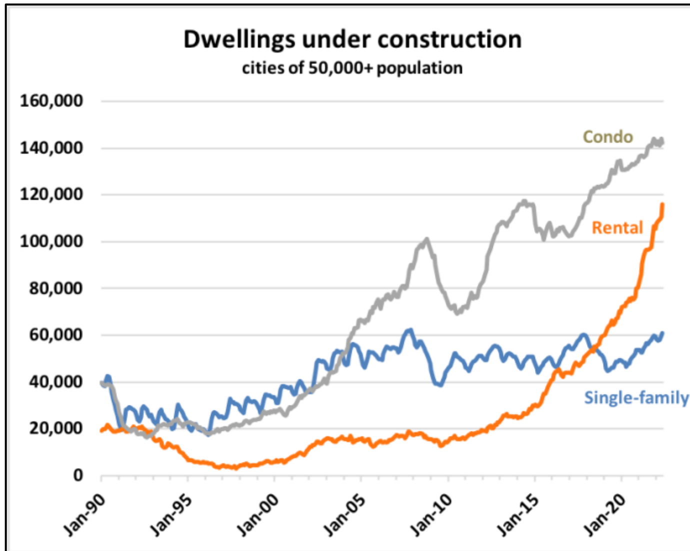
Most people would likely assume that we're building mostly condos, then single-family, and then rentals….in that order. But that's no longer the case. In fact, over the past year, there have been more rental starts than either condo or single family. That hasn't happened since at least 1990 and likely not since the 70s if at all.

It's a good news story, but with nearly 120,000 rentals in the construction pipeline, I do worry about a potential temporary oversupply in places like Quebec and to a lesser extent BC and Alberta.



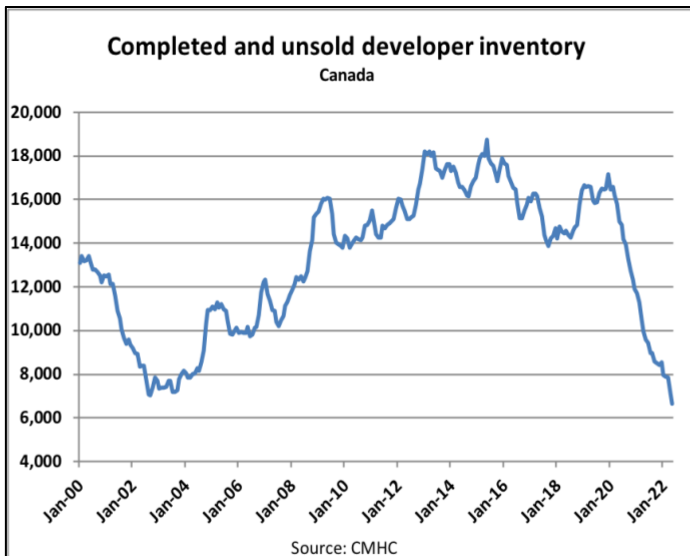
Pipeline of new construction jumps again in May

The number of dwellings under construction in cities of 50,000+ population jumped another 1.5% in May to hit a new record high of 320,000. Condos and rentals continue to drive most of the increase, though we now have the most single-family homes under construction that we've had since 2008:



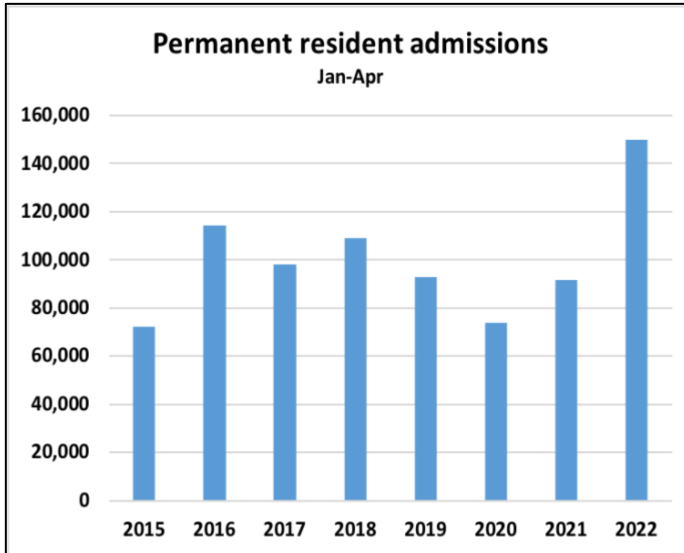
Unsold developer inventory falls:

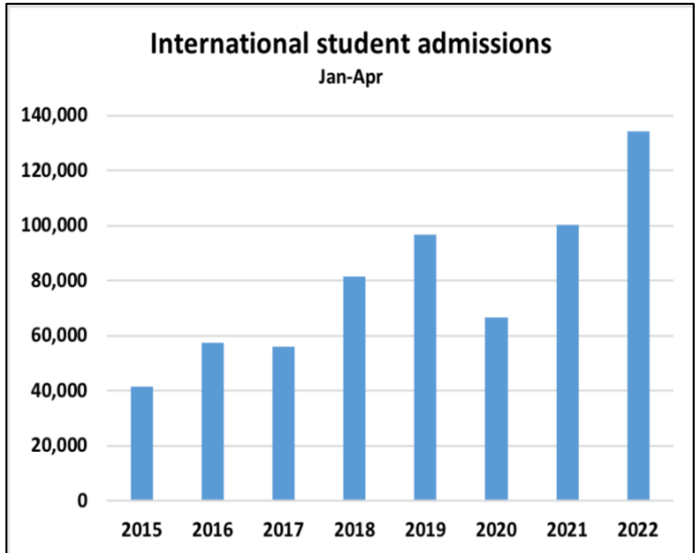
Another month, another big decline in unsold developer inventory. Based on trends in the resale market, I suspect this will bottom within a couple months, but this chart speaks to how undersupplied the new housing market has been in recent years:



Permanent resident and international student admissions smash records in April

Canada continues to hold the door wide open for new residents and international students. Through April, admissions of permanent residents were up 64% y/y while international student admissions surged 37%.

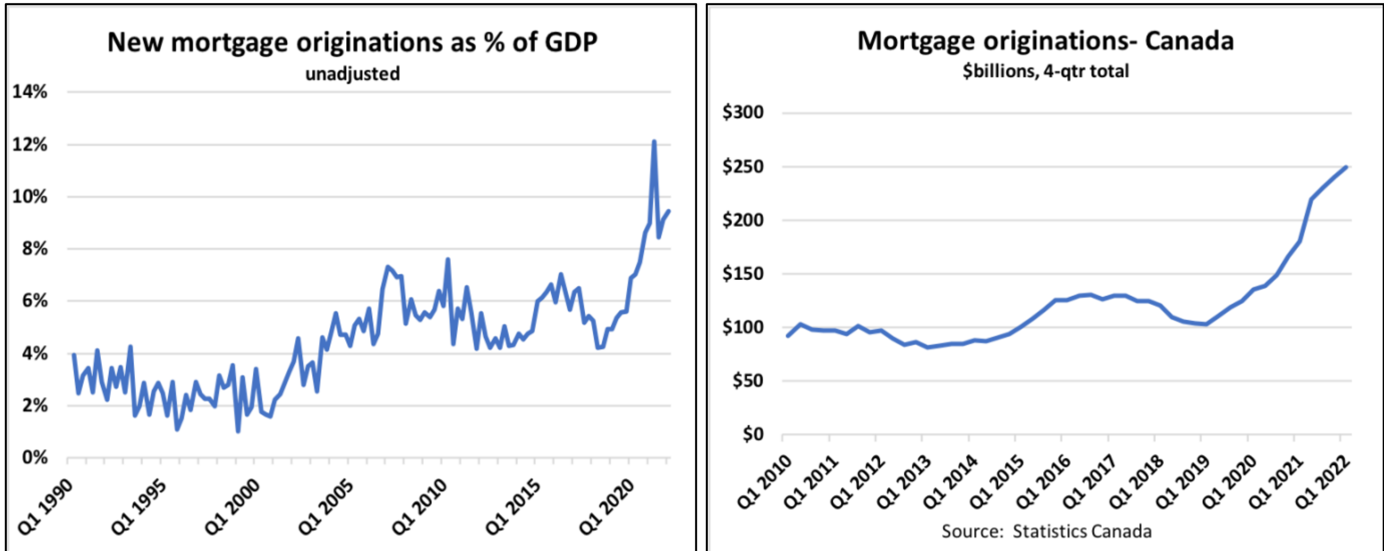




4) Credit trends: Mortgage boom peaks in Q1, no uptick in insolvencies yet

Mortgage growth peaked in Q1

Canada's borrowing binge likely hit its peak in Q1. Balance sheet data shows mortgage originations last quarter were the equivalent of over 9% of GDP….an absurdly high number relative to the past 30 years. Credit growth is running 150% higher than pre-COVID levels.

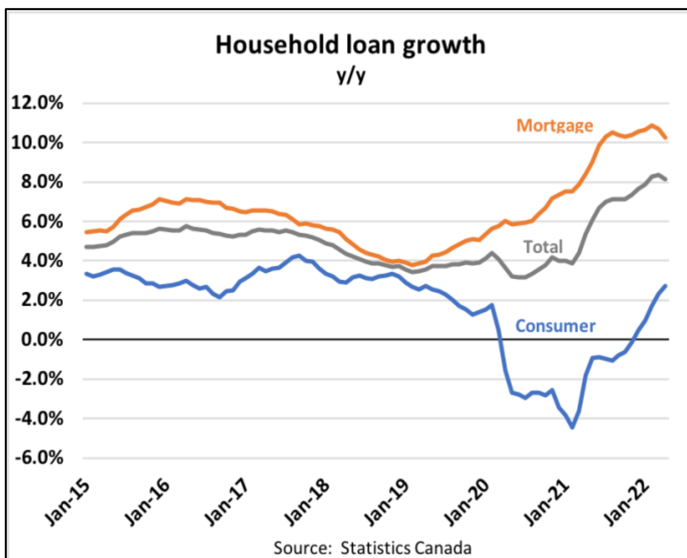


But those heady days are clearly behind us. From Rob McLister's latest newsletter:

> *Multiple broker-channel lenders have confidentially reported 30-45% drops in volumes to us. That's year-over-year, for the month of May.*

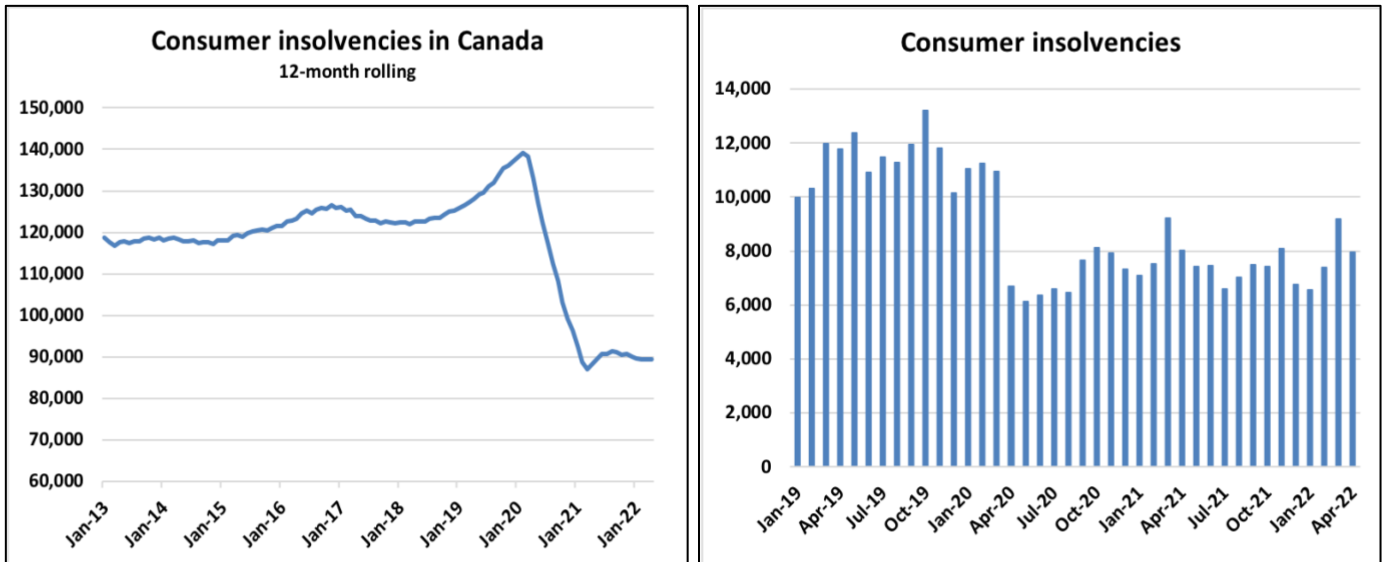
Expect Q2 numbers to be much more muted.

Mortgage growth on a y/y basis is also beginning to roll over, down to 10.3% from nearly 11% just a couple months ago:



Consumer insolvencies remain low and stable

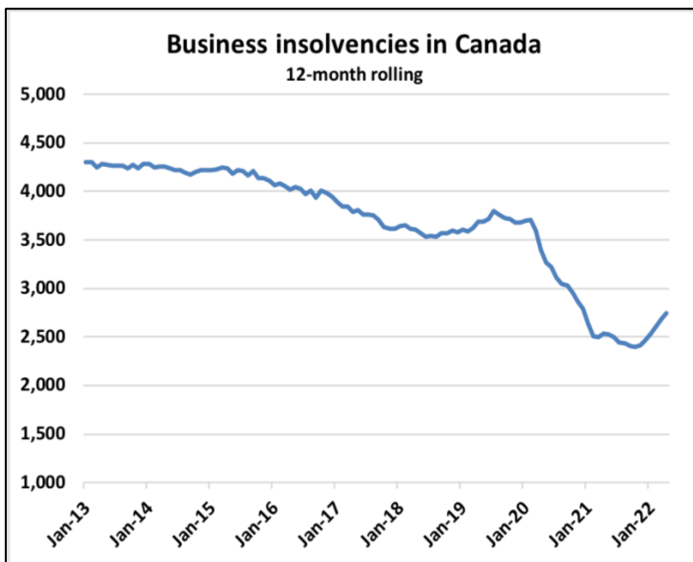
There's still no sign of consumer distress in the latest insolvency data. Consumer insolvencies were effectively unchanged in April and remain roughly 40% below pre-pandemic levels:



I expect we'll begin to see insolvencies tick up within a couple months, in part due to rising rates and cost of living, but also because of the unexpected tax liabilities that are now being aggressively pursued by Canada Revenue Agency.

For context, fully 35% of the entire labour force received CERB benefits during COVID, with the average recipient receiving payments for 17 weeks. That amounts to $8,500 on average. Crucially, taxes were not withheld at source, which means that after the 1-yr grace period granted by the government in 2021, that nasty tax bill is due right about now.

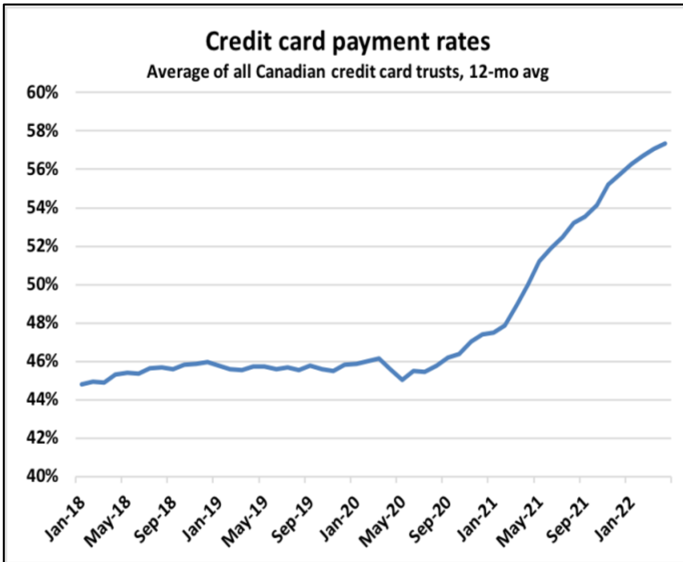
Things are different on the business side where insolvencies were up another 29% y/y in April including a 42% increase in Ontario.

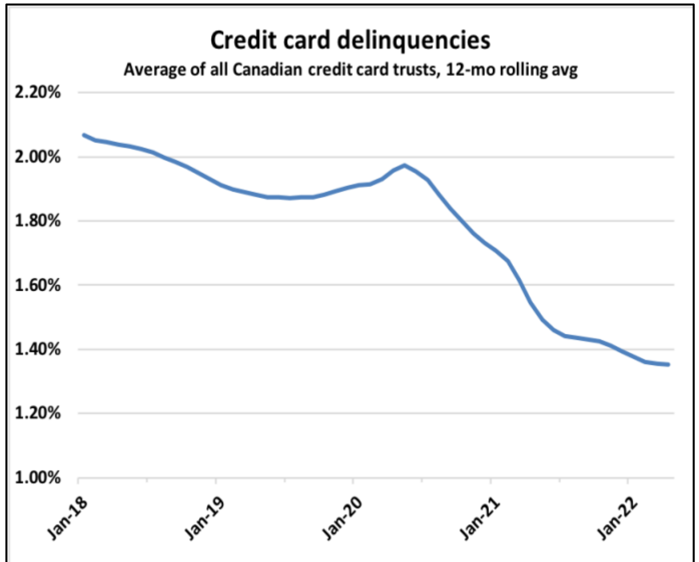


The construction industry is leading the charge with insolvencies up 41% y/y so far in 2022 and up a whopping 150% y/y in April. Chalk this up to rising costs, construction delays due to labour and supply chain constraints, and now a bit of weak demand.

Credit card trust data still looks really good for now

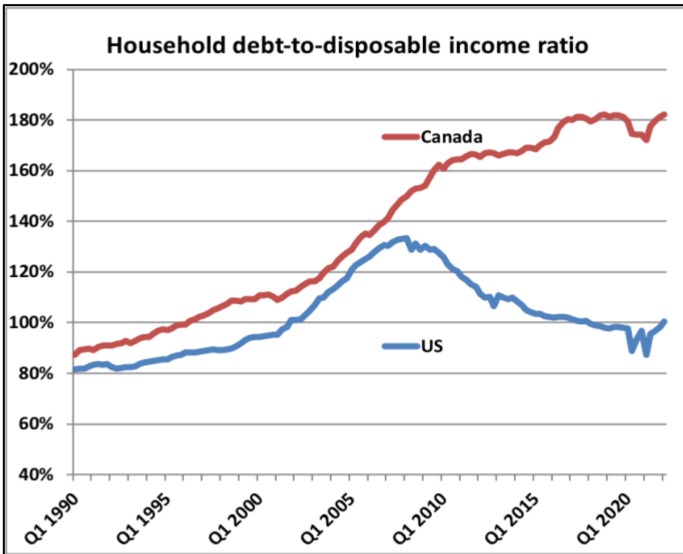
Credit card trust data remains an important signal for housing watchers. No one defaults on a mortgage without missing some credit card payments, and there's still just no signs of that. Payment rates are at record highs and delinquencies are at dead lows.

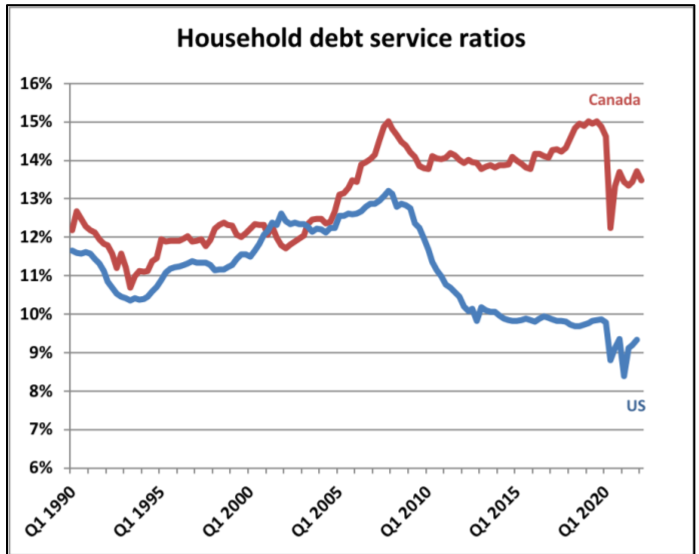




Debt-to-income ratio hits new highs in Q1

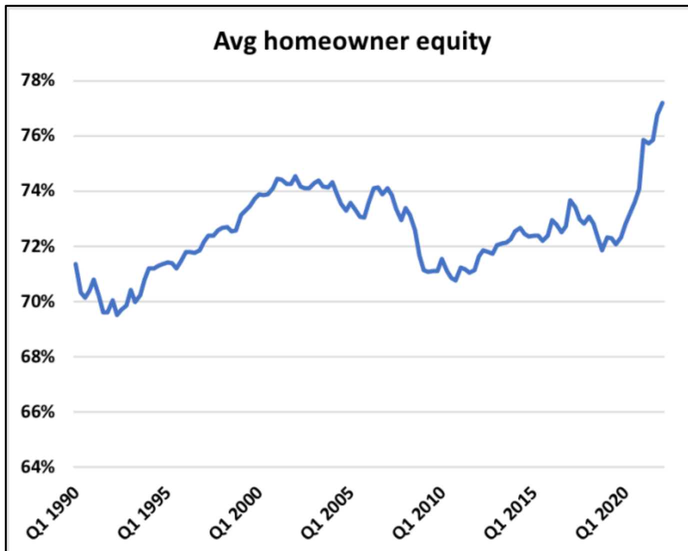
The household debt-to-disposable income jumped to a new record high in Q1 at 182.4%. The more important debt service ratio remained near decade lows, but that will change big time as interest rate increases filter through starting in Q2:





Owner equity sets new record

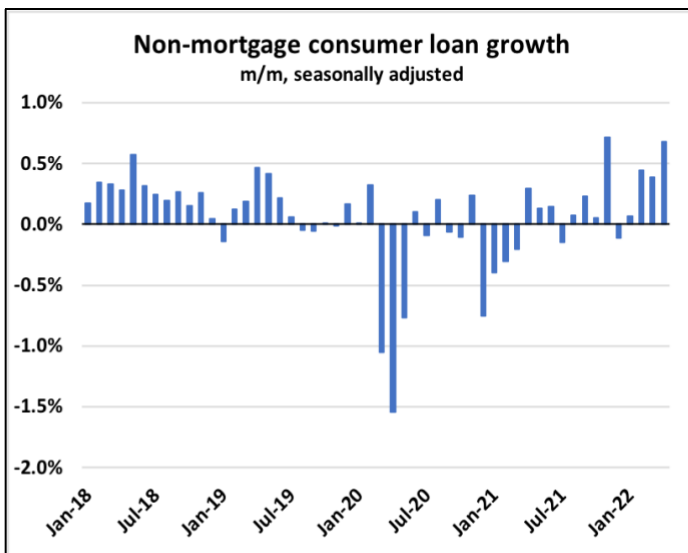
The average homeowner in Canada had record equity levels in their home in Q1. This is important since declining or negative equity is a predictor of mortgage defaults.



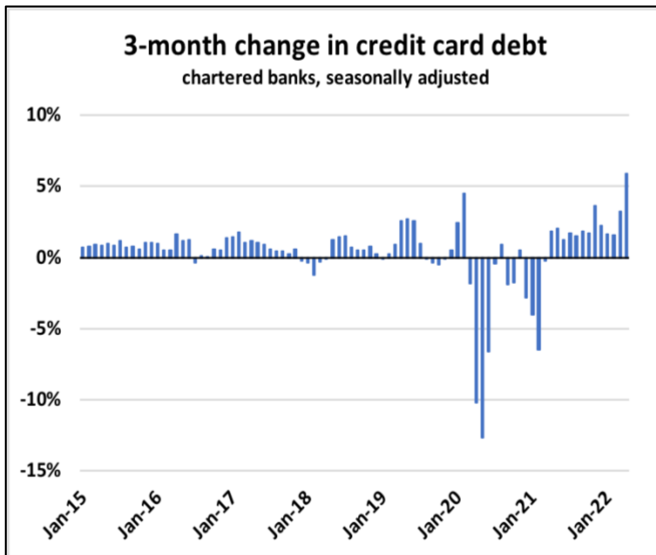
Still, as the old saying goes, “you'll drown wading across a river that's 4 feet deep on average”. Averages can mask risks in the distribution, and the fact that the average homeowner has solid equity is little comfort to the first time buyer in southern who jumped into the market in February and is now down up to 20% from peak:

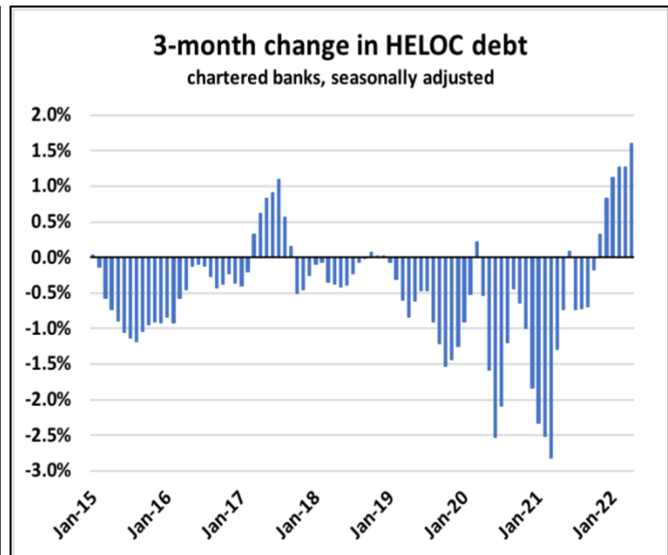
Credit card balances rise in the first sign that consumers may be hitting a wall

Non-mortgage consumer credit growth accelerated sharply in April. It was the second highest monthly increase since 2013:



The culprit is primarily credit card debt which has now seen that largest 3-month increase in over a decade….followed by HELOC debt which also continues to accelerate:





We may be seeing the first signs that some consumers are tapping credit to stay afloat.