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VERICO Economic Report

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5 *Very Significant* Numbers You Should Know

0.0025%

The percentage of mortgages over 90 days in arrears in Canada. (0.17 of a percent [0.0017%] in BC and 0.10 of a percent [0.001%] in Ontario.)

$112k

How much the Canadian average price of a home drops when Vancouver and Toronto are removed from the calculation. ($487,000 to $375,000)

↓ 21%

The average decline in Toronto's home prices since April when the Ontario Liberals introduced their 16 point plan to cool the market.

$961.00

The size of the cheque each taxpayer would have write every year for the next five years to eliminate the federal government's projected deficit through to 2022-23.

$78 Trillion

Citibank's estimate of the total value of the 20 OECD members unfunded or underfunded government pension liabilities. (see further for the impact on housing prices)

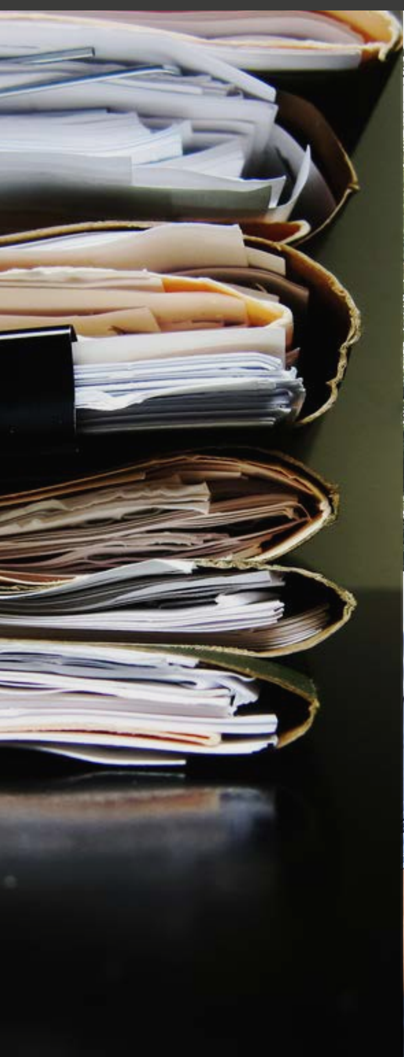
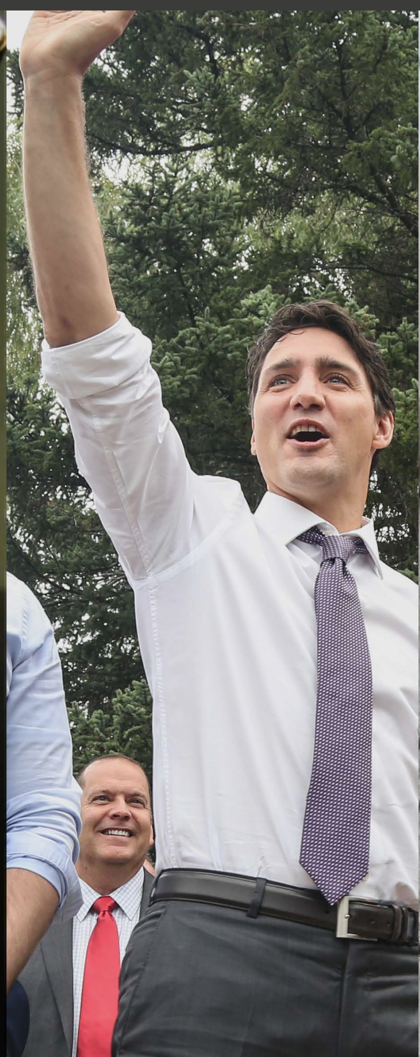
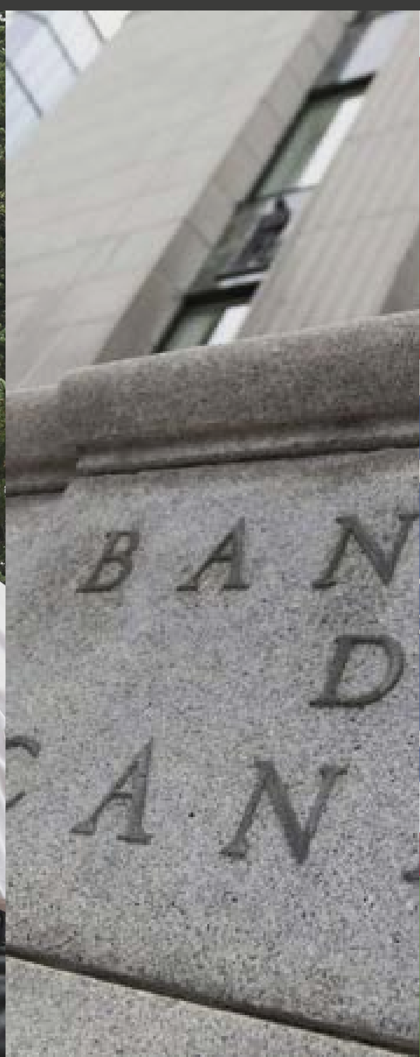
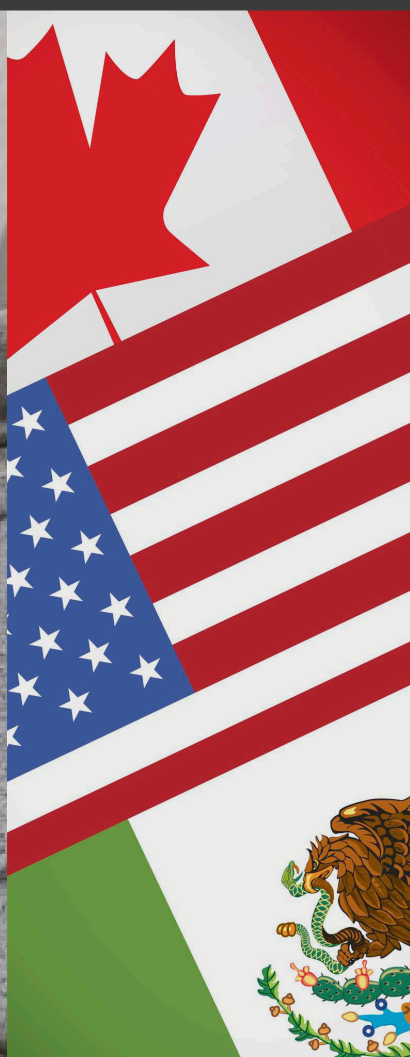
Quote of the Month

> The word 'politics' is derived from the word 'poly', meaning 'many', and the word 'ticks', meaning 'blood sucking parasites.'

Larry Hardiman

What's Going On?

- Get ready to be busy
- Politicians still confused about affordability
- Bank of Canada holds steady…for now
- NAFTA noise

So What's Going On?

In the tug of war between affordability and protecting the banks, as the new stress test rules remind us, the government has come down clearly on the side of the banks. Remember the good old days when only insured mortgages were subject to the stress test – as you know, now it's everybody.

Effective January 1st, 2018, everyone will be subject to the new rule that dictates that anyone applying for a mortgage, even those that require an uninsured (80% LTV or less) mortgage, must qualify under one of the following rules, whichever is higher: (1) as if the rate was 2% higher than the "contract rate" or (2) using the Bank of Canada "Benchmark Rate". That is unless they are borrowing from a credit union. In a twist that has not been explained, Credit Union mortgage applicants are not subject to the new stress test rules.

The banks are going to be especially happy with the provision that dictates that those people who are renewing their mortgage will not be subject to the stress test as long as they stay with their current lending institution. However, if they want to transfer their mortgage at renewal to a different lender (i.e. they found a better rate elsewhere), excluding a Credit Union, they will now be subject to the new stress rules, no matter what their LTV is. Banks will no longer need to match rates with other institutions for existing customers.

The percentage of buyers who are going to be priced out of the market by the new eligibility rules remains to be seen but the consensus seems to be in the neighbourhood of 15 to 20% but not all markets will be impacted equally. Given there is no change for people putting down less than 20%, high priced markets like Vancouver and other major urban centres may not be as effected as some smaller markets.

The bottom line is that many people who up until now didn't need insurance will now only qualify for a smaller mortgage thereby limiting their buying choices. Of course they could always move to Windsor or Moncton, which Century 21 says have Canada's least expensive homes - 90% lower than Vancouver based on price per sq/ft.

The immediate impact of the news rules will be that many people will be scrambling to get approved before the new stress test comes into affect on January, 1st. Mortgage brokers could be very busy between now and year end – although if history is any guide, it's a good bet that some financial institutions will implement the rules even earlier.

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So Why the Stress Test?

Simply put, the government is trying to limit the exposure of the financial system and the CMHC from a downturn in housing prices.

Keep in mind that Moody's credit rating service has already downgraded Canada's banks because of their exposure to a real estate downturn.

The Organization of Cooperation and Development, the International Monetary Fund, Deutsche Bank… basically everyone's warned about the dangers of a housing bubble.

There's little doubt that Canada's financial institutions would be vulnerable if there's a significant price drop given the record amount of loans secured by real estate.

Cooling The Market

You can't help but notice that while the government, through the Office of the Superintendent of Financial Institutions, is worried about the impact of falling prices on lenders, politicians like Ontario's Kathleen Wynne and BC's John Horgan talk about cooling down the market, which is code for lower prices.

Despite the fact that historically, problems don't occur when asset prices rise but instead when they fall, they seem determined to have housing prices lower all in the name of affordability.

Think about that for a moment. Toronto's average home price is down 21% since April – are we really better off? Because if that was the case – let's bring on the next depression. There is nothing like a depression for lowering house prices.

I still can't find a politician who can tell us how far would prices have to fall in Vancouver and Toronto to make a single detached home affordable – 30%, 40%?

It's nothing short of bizarre that some politicians don't see any problem with lowering the price of the principal asset of about 2 million people in BC, 5 million in Ontario and over 14 million in Canada as a whole, in the name of affordability.

And in the process, they want to slow down the most important industry in 7 out of 10 provinces. Confused is putting it politely.

So is there a problem?

Obviously the spectre of the subprime mortgage crisis keeps government regulators up at night but there are no reports of the kind of shady lending practices that were widespread in the States that contributed to the subprime mortgage crisis.

Canadians have an admirable record of paying their mortgages. The latest numbers in September show that across the country less than 12,000 mortgages are 90 days in arrears, out of a total of over 4.75 million mortgages.

In Ontario the number of mortgages in arrears is .1 of one percent – while in Vancouver the number is .17 of 1%. Even in the aftermath of the credit crisis the number of mortgages in arrears in Canada was under .45 of a percent so it's difficult to make the case based on the historical evidence that there's a big risk of default even with a price decline.

Pensions – A Real Estate Story You're Not Hearing About

On the surface pension problems don't seem to be related to real estate but in the States they're about to be. Unfunded pension liabilities have already bankrupted Detroit, Stockton California, Atlantic City and there is much more to come.

So what's the relationship to real estate? It's straightforward. As cities and states struggle to meet their pension obligations they raise taxes. Chicago has a $20 billion dollar pension shortfall and in response they instituted the largest property tax increase in the city's history and are now planning to increase it again.

Illinois has a monster pension problem, which has forced it to raise business and individual income tax. The result is that people and businesses moved away to avoid the taxes. Neighbouring states like Wisconsin are the beneficiaries. In the meantime – far fewer people want to move into cities like Chicago that are raising their property taxes, which means that the demand for housing falls and that brings prices down.

But it's just beginning. Over the next five years unfunded pensions liabilities are going to be a major issue.

Interest Rates

This time last year the Bank of Canada was talking about lowering rates while suggesting that an increase wouldn't happen until mid 2018. Six months later in response to four quarters of strong growth they changed their tune and hinted broadly that higher rates were coming. They followed through by raising rates in July and September. So now what?

In a nutshell, they're not sure. They didn't raise rates in the recent meeting because of the uncertainty surrounding the NAFTA negotiations, low inflation, the impact of a stronger dollar as well as uncertainty over the real estate market's response to the new mortgage rules and higher mortgage rates. Bank of Canada Governor Stephen Poloz still says the Bank expects to raise rates but he'll let the data dictate his actions.

While I appreciate how hard our politicians at all three levels of government are working to slow economic growth (and who the heck knows with President Trump and NAFTA), if I had to bet I would put my money on a couple of more increases.

One More Quote

"We are trying to do a difficult thing. We're asking two countries to give up some privileges that they've enjoyed for 22 years. And we're not in a position to offer anything in return." Wilbur Ross, US Secretary of Commerce

Wilbur Ross, US Secretary of Commerce

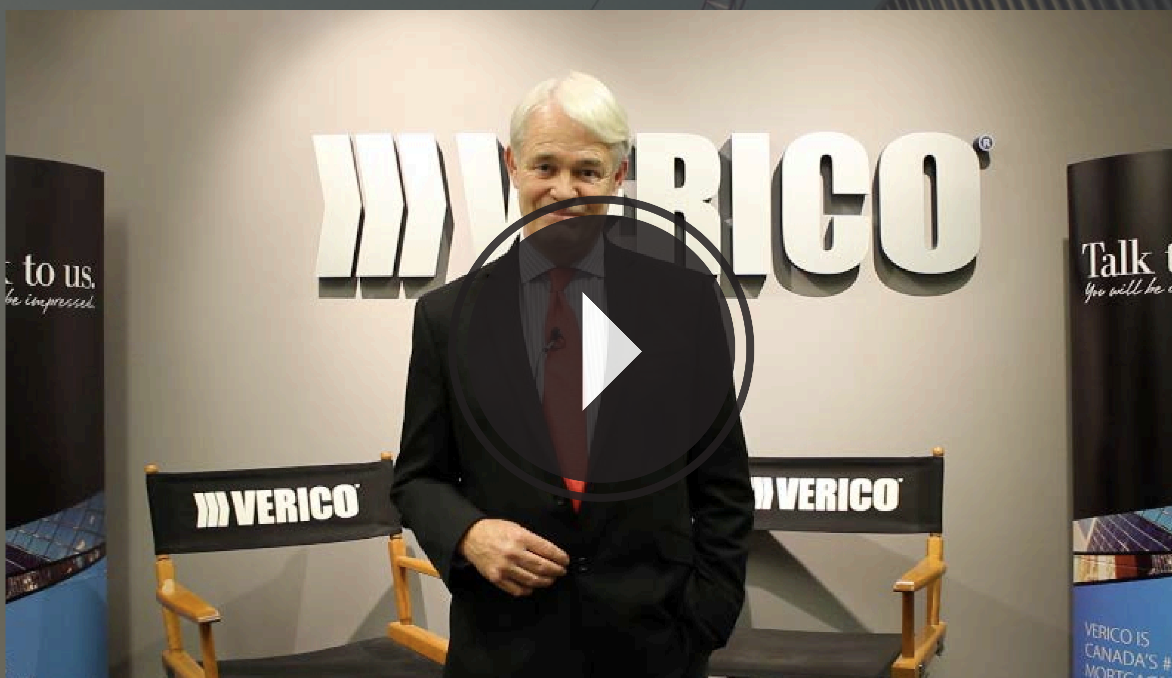
Final Question

If toast always lands butter-side down, and cats always land on their feet, what happens if you strap toast on the back of a cat and drop it?

Steven Wright

Mike's
MINUTE UPDATE

Click to see a short update from Michael Campbell.



About
Michael Campbell

One of Canada`s most respected business analyst, Michael is best known as the host of Canada's top rated syndicated business radio show MoneyTalks, and Senior Business Analyst for BCTV News on Global.

Mr. Campbell is the Economist for VERICO, Canada's most respected network of independent mortgage brokers.

VERICO®

About
VERICO Canada

VERICO was founded in 2005 with a single idea: to unite top mortgage originators in Canada and create additional opportunities for this group of highly driven professionals. Together, we knew we could make a mark on the Canadian mortgage industry.

In 2010, we reached $10 billion in collective loan volume, a number that rivaled the mortgage business of the big 5 banks in Canada.

Operating at the highest degree of professionalism, excellence and ethical standards, we originate over $15 billion by helping 45,000+ families annually with their mortgage needs.

VERICO was named Best Broker Network of the Year in 2009, 2013, 2014 and 2016.

BROKER NETWORK
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