Why Canada’s Housing Market Isn’t As Bad As Some Believe

Description

Much has been made about the state of Canada’s housing market lately, with many drawing comparisons between where the Canadian real estate market is today and where the U.S. and U.K. markets were shortly before they fell into recessions.

To be perfectly honest, I’ve found myself going back and forth on this debate, but more recently the scales have begun to tip for me in one direction more than the other.

There’s no question that housing in some of Canada’s largest metropolitan markets isn’t cheap; in some cases, it’s close to being downright unaffordable for the average middle-class working person or family.

A lot of that has to do with how a declining interest rate environment that goes back close to 20 years has contributed to a massive expansion of debt being taken on by Canadian households, most of which is tied to first mortgages that have been used to finance the purchase of residential real estate.

But there’s more to the story.

The thing is, when you dig deeper into the numbers, the real estate landscape today and the condition of the Canadian credit market isn’t all that different from how things were in the early 1980s.

Now, you might be saying, *there’s no way that can be true.*

In the early 1980s, borrowers were faced with interest rates bordering on 20% annually and the average cost to buy a home in Canada was $71,800 compared to a figure that’s closer to $303,500 today.

However, when you consider the relationship between the average Canadian borrower’s disposable income in 2019 and the amount of that money being directed toward servicing monthly mortgage payments (debt service being the critical element of credit risk, after all), things are just about the same as they were forty years ago, if you can believe it.

Granted, we're now dealing with much larger dollar figures in absolute terms, and generally speaking, younger homeowners are more indebted than older homeowner.

Also, those living in our country's larger, more expensive urban centers also tend to carry a higher debt burden on average than what's been the case in prior market cycles.

However, another emerging trend which has concerned some is the introduction of more flexible mortgage products.

These products include HELOCs ("Home Equity Lines of Credit"), which allow homeowners to borrow against their available surplus equity and mortgages that only require borrowers to make monthly interest payments — albeit interest-only mortgages have been a mainstay in several Scandinavian countries for decades now.

But because these types of financial products contain fewer onerous provisions that what's existed previously, it's easy to see how they could be perceived to carry more risk and threaten to perpetuate the threat of an inflated housing bubble.

However, another way to look at it would be that the enhanced flexibility that's offered with these types of products means that owners aren't as constrained towards putting all their "eggs" into the primary residence "basket," so to speak.

Foolish bottom line

Despite the fact that all of this has helped to quell many of my own fears about the imminent threat of a housing collapse, I'm also sure that the debate will continue to roll on between the bulls and the cynics.

But one thing we can all agree on is that both regulators and the Bank of Canada have been monitoring this situation extremely closely for several years now, and have already enacted several provisions aimed to cool down a hot market, including interest rate stress tests introduced last year and new policies aimed at restricting the extent of foreign ownership in the residential real estate market.

The other more positive way to look at it of course is that the historical rise in housing prices that Canada has enjoyed over the past 20 years or so has also been responsible for generating a significant amount of wealth in our economy.

Provided that newfound wealth is managed responsibly, there shouldn't be quite so much reason for Canadians to worry.

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