Canada's Housing Market: Relief Is Coming

Description

The Canadian housing market has been a national crisis for over a decade. Over the last 10 years, house prices have risen faster than incomes, making housing unaffordable to Canadians who weren't lucky enough to get into the market early. Many younger Canadians report being unable to afford homes, and the stats seem to bear this out. According to the CREA, the average house cost $796,000 in March, while the average Canadian earned only $65,000 last year.

So, we've got housing that costs about 12 times the average Canadian's income. That's much more expensive than in the U.S., where incomes are higher and house prices are far lower.

This year, the federal government is introducing a number of measures to cool the housing market. In addition to the Bank of Canada's aggressive interest rate hikes, the government is rolling out a number of fiscal and tax policies to make housing more affordable.

In this article, I will explore two policies the government is rolling out to tame the housing market and try to evaluate whether they will work.

New tax-free savings account

One new program the government is rolling out this year is the First-Home Savings Account (FHSA). It is a new tax-free savings account that blends aspects of TFSAs and RRSPs. Like RRSPs, it offers tax deductions on contribution. Like TFSAs, it offers tax-free withdrawals. So, it offers the best of RRSPs and TFSAs. There are, however, three catches:

1. The FHSA has a very low lifetime contribution limit ($40,000).
2. You can only contribute $8,000 per year, so it takes five years minimum to even hit the full $40,000.
3. You have to show that you are saving to buy a home in order to use it.

The FHSA's contribution room is pretty limiting, but when you combine it with the existing First-Time Home Buyer Program, you can get up to $70,000 in tax-free space to save for a home. So, the two programs combined could make a big difference to Canadians saving up to buy their first homes.

Temporary ban on foreign buyers

A second policy the federal government is rolling out to cool the housing market is a temporary ban on foreign buyers. The ban will last two years and will apply to foreigners still living in foreign countries.

This measure is not as extreme as it probably sounds at first glance. Foreign-born people who acquire permanent residency will still be able to buy homes in Canada; it is foreign speculators who buy up real estate for profit who will be locked out of the market for two years. According to studies, these buyers make up about 3% of Canada's home buyers. So, the ban may cool demand somewhat but will not necessarily have an enormous impact.

Banks to play a big role

One interesting player to watch in the Canadian housing market drama is the banking sector.

Banks like **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) play a huge role in the housing market as the primary issuers of mortgages. Already, they are adapting to the measures that the Bank of Canada and the federal government are rolling out. For example, they are raising mortgage rates.

In 2020, mortgage rates went as low as 2%. Today, Canadian Imperial Bank of Commerce has a five-year fixed mortgage with a sky-high 4.79% interest rate. Higher interest rates increase the cost of borrowing, which may make housing undesirable to some buyers. The 3% sequential decline in house prices in March coincided with the Bank of Canada's rate hikes, which lends credence to the theory that higher rates are cooling the market somewhat.

Among Canadian banks, CM is the bellwether for the housing market. It is by far the most domestic oriented of the Big Six, with only a tiny sliver of its earnings coming from foreign countries. Its earnings in the year ahead will be heavily impacted by the policies the federal government is rolling out today. So, it is a bank stock worth keeping an eye on in the year ahead.

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