Interest Rates: Are Houses Actually Cheaper?

Description

This year, Canadian house prices are going down, and it looks like housing is becoming more affordable. Prices have fallen every month since February, and bargain hunters are getting excited. However, they may be making a big mistake. While prices are going down, interest rates are going up. Those who buy "all cash" are certainly paying less, but Canadians who have to take out mortgages may not be — particularly if their loan amount is high relative to the value of their home.

In this article, I will explore Canada's cooling housing market, and pose the question of whether housing is really getting cheaper.

Price isn't the same as cost

To understand why housing going down doesn't necessarily make it cheaper, you need to know the difference between price and cost. "Price" is what the buyer gives the seller; "cost" is whatever expenses the buyer incurs in making the sale. The cost of buying a house includes

- The list price;
- Interest on the mortgage;
- Brokers' fees; and
- Lawyers' fees.

Combined, all of these costs can make a house much more expensive than advertised. Potentially, a house can fall in price yet rise in cost for an average buyer.

House prices are going down

When it comes to list prices, housing is unquestionably getting cheaper this year. The average house price in the Greater Toronto Area (GTA) has fallen 14% since February, and it's a similar story nationwide. If you have all the cash you need to pay for a house, then the total cost is going down. But we still need to look at the matter of interest rates.

Interest rates are going up

Interest rates are going up this year, which is causing the total cost of buying a house to go up (holding price constant). In 2020, you could find banks like **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) offering mortgages with rates as low as 2%. Today, a typical CM mortgage is closer to 5%. What difference does that make? Potentially, a pretty big one. A 2% interest payment on a $1 million mortgage is $20,000. A 5% interest payment on a $900,000 mortgage is $45,000. So, the $900,000 house is actually more expensive than the $1 million one due to the higher interest rate.

Also, you'll want to think about the matter of getting a mortgage in the first place. Banks like CM know that people are less able to afford mortgages when interest rates are higher, so they often tighten lending standards during times like these. The government also requires them to have certain standards, such as requiring a down payment of a certain size, having enough income to pay interest, etc. So, don't expect getting a mortgage this year to be as easy as it was in 2020.

The verdict: It depends on the size of your down payment

To answer the question I started this article with (*"are houses getting cheaper?"*):

It really depends on the size of your down payment. If you have enough cash to pay for a house, then yes, the cost has come down. If you have just a 5% down payment and are in a city where prices have only come down 10%, then no, the cost has not really come down.

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