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CURE Policy Brief

Speculators beware: You won't get rich flipping homes in the next decade

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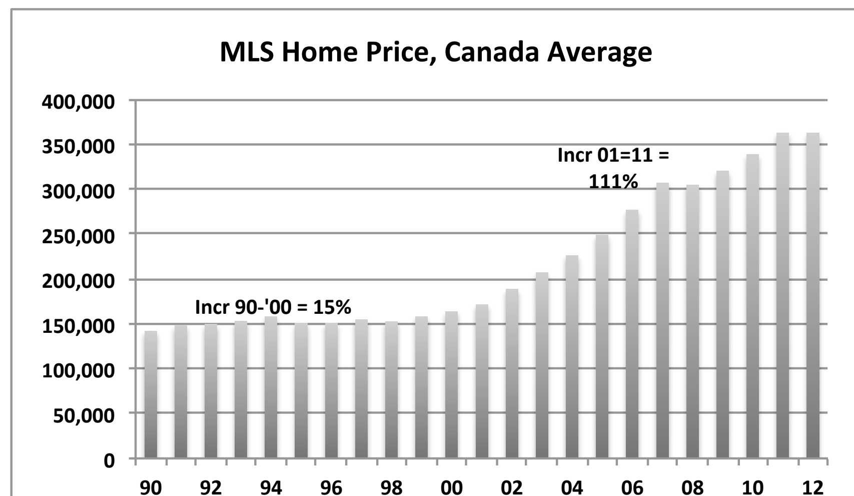
The experience of the housing market over the past decade has been unprecedented. People that purchased homes more than a decade ago have benefitted from substantial, and in some cases triple digit, gains in home values, curtailed only marginally by the 2009 recession.



Source: Rates - CMHC Housing Observer 2012

So why did this happen? And more importantly, will this trend continue into the coming decade, or, will prices behave as they did in the 1990s, a period of stagnant price change?

Fundamentally, home prices are driven by two factors: the number of people buying homes and the amounts they are willing to pay. The number of buyers is dictated by demographics (especially immigration) as well as economic conditions. If young adults have low wages or no job, they remain in, or return to, the family home; when they have a good income, they move out and form new households, creating demand initially in the rental market and later, in the ownership market. As reported recently by CMHC, in the first decade of this century, net immigration was higher than in any decade of the twentieth century. As a result, the annual rate of population growth in Canada from 2001 to 2011 (1.1%) was stronger than in the previous decade (1.0%). On top of population growth, more people were employed over this period. Annual growth in employment in the same decade was consistently strong—above 2% per year for much of the decade. And they were

About the Center

The Centre for Urban Research and Education (CURE) is a multidisciplinary network of researchers, primarily from Carleton University, who share an interest and commitment to strengthening municipal and urban affairs. With diverse experience, expertise and perspectives, the CURE network carries out collaborative research in areas including community governance, citizen engagement and local capacity building around planning for infrastructure to support social, economic, and environmental sustainability.

Vision and Goals

We are committed to strengthening governance, policy making, and management in urban areas through collaborative research, community engagement, and education.

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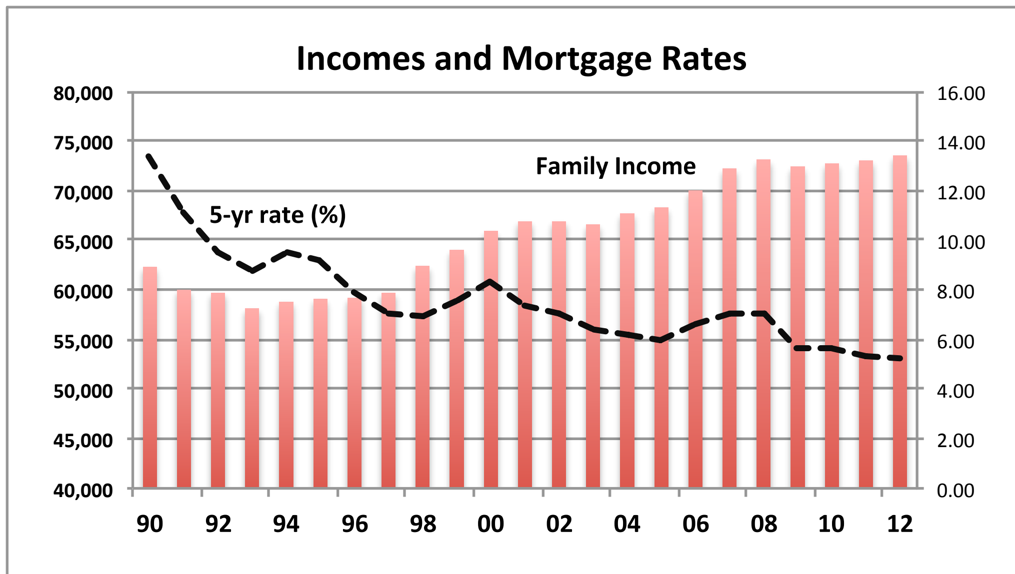
earning increasingly higher wages. Per capital disposable income—the money people have to spend—also rose consistently and strongly over the decade. Real incomes rose by more than 3% annually, and even during the recession, continued to increase at 2% per year. So, more people were working, and most had growing incomes and accordingly, had an increasing capacity to buy homes. This alone would place upward pressure on prices. But reinforcing these two key factors was a third combination: interest rates and related changes in mortgage lending rules.

Mortgage rates were declining through the '90s but were still relatively high: still over 9% in 1995. Thereafter rates continued to fall to historically low levels. Five-year rates fell below 7% in 2002 and were down to 5% by 2010, where they have stabilized. Lower rates allow buyers to borrow more with the same payment. With higher incomes and lower rates together, households can borrow larger mortgages and afford high cost homes.

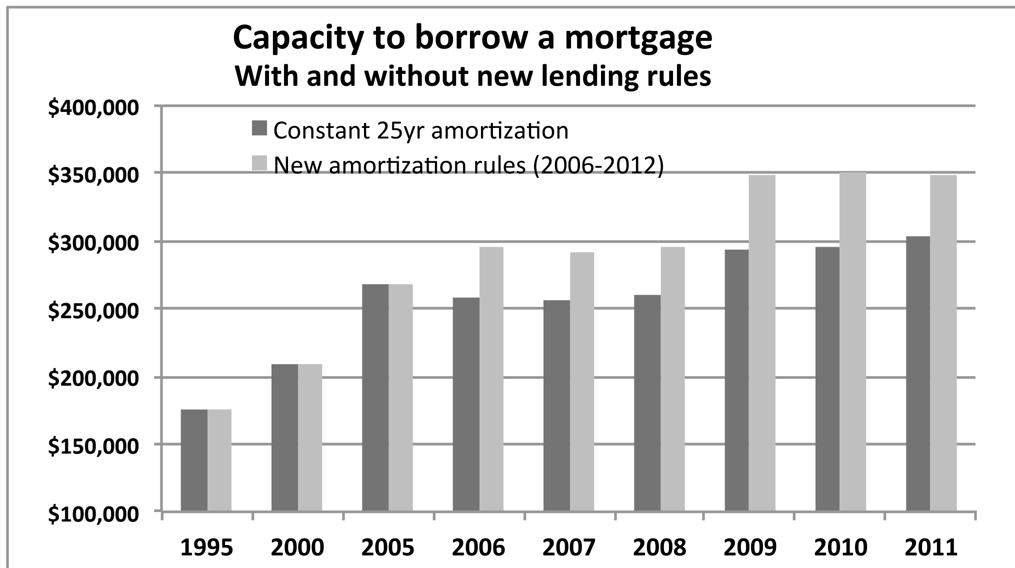


Source: Rates - CMHC Housing Observer 2012; Income - Statistics Canada, Cansim

This capacity to borrow was further enhanced by the Federal government regulations for insured mortgages. This adjusted the amount of time (amortization period) that the borrower has to repay the loan. A 25-year loan was standard prior to 2006, but in that year the government raised this up to 40-years. They subsequently withdrew this policy, on a gradual basis, lowering the maximum loan to 35 years in 2008, 30 years in 2011 and by July 2012 the maximum was back to 25 years. Family income is not yet available for 2012 so it is not possible to update capacity with this final reduction back to 25years. However mortgage rates declined slightly (5.37 to 5.24 between 2011-12, so this would have an offsetting effect.

During the interim six years, the impact of this policy was profound, especially coming on top of the other drivers. Notably, with the extension to 40 years implemented in 2006 and in place to 2008, the slight upturn in mortgage rates in 2007-08 was completely negated – the longer amortization period fully offset the impact of higher rates on the maximum a household could borrow.

In combination the three drivers – rising income, low rates and more favourable lending rules dramatically increased capacity to borrow. In 1995 the average family could qualify for a mortgage of $175,000. With income gains and declining mortgage rates, by 2005 this was up to $270,000. Even with the pullback on amortization, back to 35 years in 2008-2011, for the average family the potential to borrow reached $350,000.



Source: Calculated based on Family incomes, prevailing annual interest rates and amortization periods

Inevitably, this increased capacity to borrow, further aided by the longer borrowing rules translated into buyers bidding higher prices with the result that home prices increased significantly in this decade.

This has been a huge benefit for existing owners, whose home asset value and equity has doubled or tripled. It has also provided healthy returns to investors that purchased with expectations to generate large capital gains, which they have achieved. But it is also harder for young buyers to buy a home.

But where is this trend now heading? Global economic issues especially the Eurozone and US debt levels suggest a slowing economy. Employment growth and incomes will be slower that in last decade. Interest rates have bottomed out and, depending on strengthening of the economy may see a small increase. Regardless, the beneficial effect of low rates is already fully capitalized in the market. So these two key drivers are at best stagnant to marginal factors. The only remaining variable is mortgage-lending policy. Here the Government and the Bank of Canada have clearly signaled their intention to constrain borrowing capacity. And more recent home price trends suggest they have had an effect in stalling price increases in most markets.

What this all adds up to is a decade that will look a lot more like the 1990s that the '00s. At best, prices might follow the rate of inflation, but the double-digit price gains of the recent decade are not about to continue.

Sources:

MLS home prices, published by the Canadian Real Estate Association, this are available in the CMHC 2012 Canadian Housing Observer, Table 4.

Mortgage rates are also available from this source in Table 1, together with a wider range of market indicators.

Download the Canadian Housing Observer at http://www.cmhc-schl.gc.ca/odpub/pdf/67708.pdf?fr=1363870746906

Family Income is based on tax filer data and is available as a Cansim data file Table 111-0013 on the Statistics Canada website.