The Evolving Canadian Housing Market: Perspectives for Investors

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For almost 30 years, we have seen housing prices in Canada rise with little interruption, conditioning many to view residential property as a safe and profitable investment.

The younger generations have only ever experienced a booming housing market. However, it hasn't always been this way. The last housing crisis in Canada occurred in the 1990s, during a time of recession, weakening commodities prices, high national debt and poor economic sentiment. Between 1989 and 1995, residential property values dropped by 25 percent and commercial values fell as much as 50 percent.[1]

Yet, this difficult period was far from many peoples' memories until recent times when the housing market began to slow. To start the year, sales were at a 14-year low and the average Canadian home price hovered around $612,000, a decrease of 18 percent year-over-year and the lowest level seen since November 2020.[2]

One of the main reasons for the slowing market has been the rapid rise in interest rates that began last March. The historically low rates prior to this time made the cost of holding a mortgage affordable for many. However, rising rates have substantially increased the cost of borrowing.

Consider the impact of an increase in interest rates of 3 percent on a $160,000 mortgage. On a 5-year, fixed rate mortgage with a 25-year amortization and 3 percent interest rate, monthly payments would be around $757. For the same mortgage with an interest rate of 6 percent, monthly payments would be around $1,024, or $267 more. At first glance, this may not seem significant, but over the life of the mortgage this equates to an additional $80,000 in total interest costs! Increasing borrowing costs can also make it more difficult for prospective homebuyers to qualify for a mortgage and can reduce the mortgage amount that others could be eligible for.

WHERE TO FOR THE HOUSING MARKET?

While we will never know with certainty where interest rates are headed, they will likely remain higher than the historical lows we've experienced over recent years. At least for the near term, the central banks are expected to keep interest rates elevated as they continue their fight to control more persistent inflation. This will continue to put downward pressure on the housing market.

A number of new rules are also expected to reduce housing demand and increase supply. As housing prices ballooned over recent years, especially in major metropolitan cities, many speculators entered the market further pushing up prices. In response, various government initiatives have been implemented to try and limit speculation. For instance, the federal "Residential Property Anti-Flipping Rule" took effect on January 1, 2023. If an individual sells a residence that has not been held for at least 12 months since acquiring it, the residence will be deemed to have been "flipped" (subject to certain exemptions, including life events like divorce, death, job relocation and others) and profits from its sale will be subject to tax as business income. The federal "Underused Housing Tax" began in 2022 and generally applies an annual tax of one percent on the value of vacant and underused residential properties owned by non-resident, non-Canadian owners. A similar "Empty Homes Tax" was introduced back in 2017 in Vancouver, and the rate of taxation was raised to 5 percent for 2023.[3] This tax is believed to have significantly reduced the number of empty homes.[4] Toronto has since followed suit with its own tax this year. Starting January 1, 2023, the federal government passed an act to prevent non-Canadians from buying residential property in Canada for two years, although it was recently announced that some of the restrictions have eased.[5] Many of these initiatives are new, so it is yet to be seen how they will impact the housing market. However, it is expected that they will help to increase supply and reduce the amount of speculation that contributed to driving prices higher.

At the same time, certain fundamentals haven't changed – there continues to be a residential housing supply issue, especially affordable housing. With the demand for housing exceeding supply, this is expected to continue supporting prices, especially as Canada's population grows largely due to immigration.[6]

CHALLENGES FOR INVESTORS

Because of the rapid rise in housing prices, many were conditioned to believe that a house is a guaranteed investment. However, we suggest caution with adopting this perspective. It hasn't always been this way – recent price appreciation in many metropolitan cities has been unprecedented. A house isn't a liquid asset – in non-bubble times, it often takes time to sell a home. Home ownership has many hidden costs, such as maintenance, property taxes and insurance and, unlike other investments, purchasing a home usually involves a significant up-front cost. As we look forward, the likelihood of more elevated interest rates, alongside new government regulations, may continue to put downward pressure on housing prices.

For many investors, the evolving housing market has changed how we think about retirement planning. As advisors, here are two challenges that our clients often encounter as we work to prepare them for retirement and beyond:

Helping younger generations with the purchase of a home. As the cost of home ownership has become increasingly out of reach for younger folks, many clients have questions about the opportunity to assist (grand)children with buying a home or condo. There was a time when a gift of $20,000 or $30,000 could provide a meaningful contribution towards a down payment; today, this amount may not make a noticeable difference. Given the likely need for more substantial assistance, it is essential for (grand)parents to carefully factor in how any financial support may affect their own future retirement plans.

Equally important are the potential family law issues that may arise. Consider the various ways to help fund a (grand) child's property, including purchasing the property in your name, gifting cash for the purchase or lending funds to the child. Each comes with various tax and family law issues. For example, if the home is not designated as a principal residence, there may be future significant tax consequences to the owner on any capital gain realized upon its sale. Or, if the child is married/common-law, there may be concerns about what will happen to the property if the couple splits. As always, we recommend seeking advice from tax professionals and family law experts.

Relying on home equity in retirement planning.
Often, individuals view a home's value as a potential source of retirement income – and with rising prices, some may have an expectation of the perceived value of their own home. Yet, consider that future real estate prices may be less than anticipated. Even if you were to downsize in retirement, it may not necessarily provide the income you thought it would. You will still need a place to live and a move to a new residence – even to a market with lower real estate values – may end up costing more than you expected. There may also be other unanticipated costs, such as renovations or maintenance to an old house prior to its sale. And, for others, selling a lifelong home can be emotionally challenging, causing them to reconsider this decision.

Of course, there are exceptions – some will choose to sell their homes and become renters; others may retire abroad to more affordable destinations. Yet, even in these circumstances, we caution investors to plan for contingencies. There may be surprises, including being unable to find suitable tenancy or an eventual desire to move back to Canada, such as for healthcare support.

WE ARE HERE TO ASSIST

As the housing market continues to evolve, these are just a few perspectives for investors to reflect on. We are here to factor in these changes and considerations as we help our clients, and their families, to plan for the future to achieve their retirement goals and beyond. Should you wish to discuss this, or any other investing matters, please get in touch – we would be happy to provide support.

Notes:

1. https://www.mpamag.com/ca/mortgage-industry/business-growth/revisiting-the-90s-recession/287925
2. January 2023 figures based on year-over-year monthly comparisons. Data accessed Feb. 20, 2023. https://stats.crea.ca/en-CA/; https://www.newswire.ca/news-releases/canadian-home-sales-begin-2023-at-14-year-low-844680389.html
3. https://vancouver.ca/home-property-development/empty-homes-tax.aspx; The tax rate for the 2023 reference year will increase to 5%.
4. https://vancouversun.com/news/local-news/astonishing-drop-in-number-of-empty-homes-in-metro-vancouver-census
5. https://www.cbc.ca/news/politics/government-housing-ease-restrictions-non-canadians-1.6793247
6. https://www.cmhc-schl.gc.ca/en/blog/2022/canadas-housing-supply-shortage-restoring-affordability-2030; https://financialpost.com/real-estate/much-worse-before-it-gets-better-why-theres-no-quick-fix-to-canadas-housing-supply-woes

BUYING A FIRST HOME:

Planning Ahead with Children or Grandchildren

If (grand)children are still years away from a first home purchase, the First Home Savings Account (FHSA) may be a valuable tool. The FHSA is a registered plan that combines the tax benefits of the RRSP and TFSA; tax-free in and tax-free out. Eligible Canadian residents ages 18 years and over can contribute up to $8,000 per year to the plan, to a maximum of $40,000, for the purposes of purchasing a new home. Contributions are tax deductible, and qualified withdrawals are tax free. The FHSA can remain open for 15 years.*

While the limit has been criticized as too low given current housing prices, the potential to invest funds and allow them to grow in the FHSA may be significant (chart). A couple who are both first-time home buyers could potentially each access the FHSA. The rules also permit the use of the existing Home Buyers' Plan (HBP) alongside the FHSA.1 The HBP allows first-time buyers to withdraw up to $35,000 from the RRSP, subject to repayment in 15 years and other conditions. Together, these tools could provide a substantial down payment for a home.

Potential Growth of FHSA in 15 Years – Assuming 5% Annual Growth; Not Including Tax Benefit from Contribution

Year	Contribution	Start of Year	Growth	End of Year
1	$8,000	$8,000	$400	$8,400
2	$8,000	$16,400	$820	$17,220
3	$8,000	$25,220	$1,261	$26,481
4	$8,000	$34,481	$1,724	$36,205
5	$8,000	$44,205	$2,210	$46,415
...15	—	$72,005	$3,600	$75,606

If you are having conversations with (grand)children about saving for the future, the FHSA may be an important consideration. If you would like to learn more about the FHSA, or require support with financial literacy discussions with adult children, please don't hesitate to reach out.

Notes:

1. This is a distinct change from the original budget proposals.

*This is not meant to be a broad discussion of the FHSA. Please get in touch for greater details on the rules and the potential for FHSA growth.