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The Runaway Home

Why the best time to buy is now

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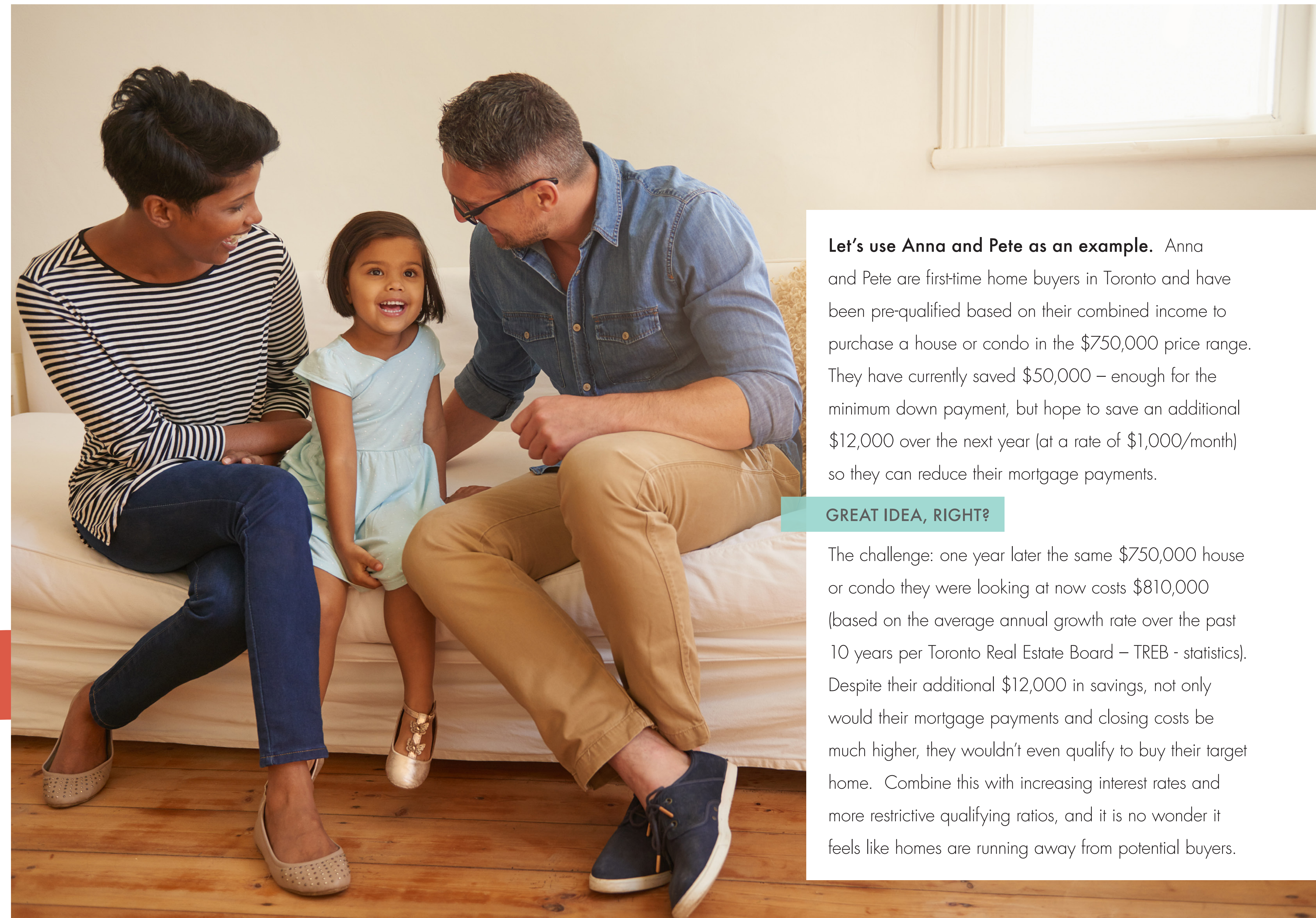
Why the best time to buy is now

WHY WAITING MAY NOT BE YOUR BEST OPTION IN THE TORONTO REAL ESTATE MARKET

Toronto first-time home buyers often believe the best approach to entering the market is to take the extra time to save for a larger down payment in order to reduce their monthly mortgage payment. Unfortunately, given the dynamics of the Toronto real estate market, this thoughtful approach can often cost them their dream home.

MINIMUM DOWN PAYMENT*	MAX PURCHASE PRICE
$20,000	$400,000
$25,000	$500,000
$35,000	$600,000
$50,000	$750,000
$75,000	$999,999
$200,000	$1,000,000
$300,000	$1,500,000



Let's use Anna and Pete as an example. Anna and Pete are first-time home buyers in Toronto and have been pre-qualified based on their combined income to purchase a house or condo in the $750,000 price range. They have currently saved $50,000 – enough for the minimum down payment, but hope to save an additional $12,000 over the next year (at a rate of $1,000/month) so they can reduce their mortgage payments.

GREAT IDEA, RIGHT?

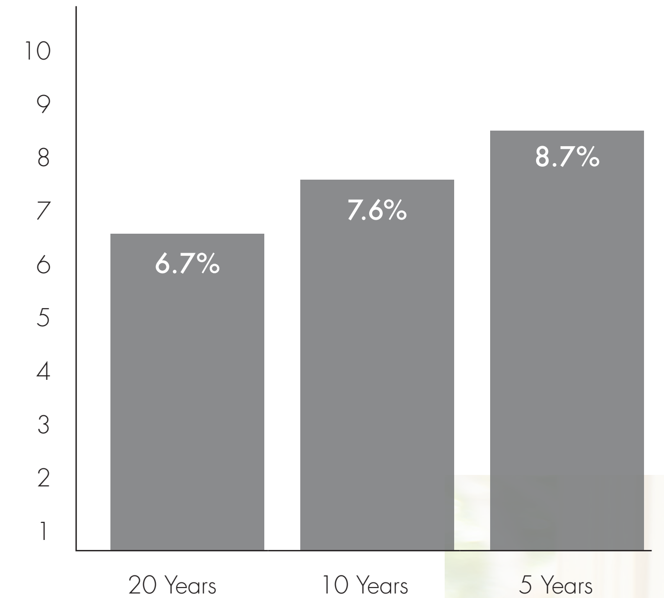
The challenge: one year later the same $750,000 house or condo they were looking at now costs $810,000 (based on the average annual growth rate over the past 10 years per Toronto Real Estate Board – TREB - statistics). Despite their additional $12,000 in savings, not only would their mortgage payments and closing costs be much higher, they wouldn't even qualify to buy their target home. Combine this with increasing interest rates and more restrictive qualifying ratios, and it is no wonder it feels like homes are running away from potential buyers.

**Note: in addition to down payment, buyers will also be required to provide closings costs such as land transfer tax, legal fees, etc. Your real estate lawyer can provide you will full details*

Why your buying power erodes in the Toronto market

STEADY INCREASE IN HOME PRICES

Toronto house prices have steadily climbed. On a compound annual growth rate basis, Toronto properties (all TREB regions) have grown 8.6% per year over the past 5 years, 7.6% per year over the past 10 years, and +6.7%* per year over the past 20 years. There are market blips you read about in the media reflective of short-term volatility that occur in any market. But, if you step back and look at the longer-term picture, the growth in Toronto real estate prices has been very consistent.



COMPOUND ANNUAL GROWTH RATE BASIS

TORONTO PROPERTIES*

Toronto is a high-demand real estate market, and while overall results are impressive, pockets of the housing market have outperformed whether it be on a geographic or property type basis. While your realtor can provide you with a full analysis for your specific circumstances, one example of this would be the recent outperformance of the "416" region condo market. Given tighter lending guidelines, rising interest rates, and the higher price point of other property types, this relatively affordable segment of the market has experienced an annual growth rate of over 13%* per year over the past 3 years. To put that in perspective, Anna and Pete's target home priced at $750,000 could have increased to almost $850,000 just one year later.

Note: past performance may not be reflective of future results. For illustrative purposes only.

CHANGING LENDING GUIDELINES

Canadian lending guidelines have changed significantly and regularly from 2010 through to the present. While the long-term goal of these changes is to strengthen the real estate market, unfortunately, if you are looking to purchase, each change can have a dramatic and immediate impact on your affordability. While a complete list of changes is available from Outline Financial or your realtor, an example of one such change is the **Benchmark Qualifying Rate** implemented on April 19, 2010 and further restricted on Oct 17, 2016. This simple change had a dramatic impact requiring that a buyer must qualify at a higher interest rate than they would actually be paying. For example, Anna and Pete's $750,000 affordability on Oct 16, 2016 would have dropped to $630,000 literally overnight.

While no one can predict exactly when and how regulators will make a policy change, there is no doubt the impacts can be profound.

RISING INTEREST RATES

After a 7-year period of flat interest rates, the Bank of Canada started increasing its overnight lending rates in mid-2017 which directly impacts Lenders' Prime Rates and Mortgage Rates. In fact, the Bank of Canada has already increased its overnight lending rate by 1.25% since July 2017, and many economists anticipate another 0.25% to 1.00% of increases by the end of 2019.

SO HOW WOULD THIS IMPACT ANNA AND PETE?

Simply put, if Anna and Pete qualify for $750,000 today and rates go up by 0.25% tomorrow, their buying power would drop to approximately $735,000. On a more long-term basis, if rates were to increase by 1.00%, their buying power would drop to approximately $695,000.

While every situation is different and should be analyzed by a mortgage professional, one strategy Anna and Pete could employ if they bought today is to lock into a 5-year fixed mortgage rate to insulate them from any future increases. In fact, many economists anticipate rates to increase over the next number of years, but then decrease which could be timed well for when Anna and Pete's mortgage comes up for renewal 5 years later.

Why there is no slowing down the runaway home

Supply shortage in a high-demand city drives up prices

Toronto real estate has a supply issue caused by rapid population growth and finite land to develop that is driving up the house prices at a steady rate with no signs of slowing down.

> "The main issue facing Toronto is supply. There is simply not enough supply, while demand is rising due to demographics."
>
> BENJAMIN TAL
> Deputy Chief Economist of CIBC World Markets Inc.

This systemic supply issue is confirmed when looking at months of inventory (i.e., how fast would all existing homes on the market sell assuming no additional listings are added). Generally, if there is 0 to 3 months of available inventory it is considered a sellers' market, 4 to 6 months is a balanced market and above 6 months is a buyers' market. According to the Canadian Real Estate Association (CREA), the long-term average across Canada is 5.2 months of inventory. Toronto, on the other hand, has averaged a mere 2.4 months over the past 15 years – and some property categories and locations have trended even lower.

Anna and Pete are up against a long-term sellers' market with low supply, high demand that shows no signs of reversing.

BUYING POWER TODAY VS. WAITING

Overall, while it may seem like a good strategy to sit on the sidelines and wait for the perfect time to buy, given the dynamics of the Toronto market, this strategy can often cost people their dream home.

Let's look back through the example of Anna and Pete. They have their heart set on a home at the target price of $750,000 and have saved the minimum down payment amount of $50,000. If they decide to postpone their decision to purchase, their circumstances could change as follows after one year's time:

- The $750,000 home could have increased to $810,000 based on the 10-year average price average, or significantly higher based on more recent trends especially for homes at this price point.
- If interest rates were to increase by 1.00% over the next year, their maximum buying power could be reduced to $695,000.
- Any mortgage rule tightening could further erode the purchasing power.

How to catch your runaway home

The first-time homebuyers' market has experienced some of the fastest price increases given the growing demand and relative lack of supply for this segment.

If you are in a position to buy today, speak with your realtor to request a tailored multi-year statistics report for the Toronto real estate market to help guide your investment and catch your runaway home.

**Note: TREB results are updated with historical figures through December 2018. Please contact Outline Financial or your realtor for an updated document when available.*

Outline Financial is a top-rated mortgage and insurance team offering direct access to rate and product options from over 20 banks, credits unions, mono-line lenders and insurers all in one convenient service. The Outline team was formed by senior level bankers and financial planners that wanted to offer their clients choice with an exceptional service experience.

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This report is brought to you in collaboration with:

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For up-to-date Toronto real estate statistics, and access to available, or soon to be available properties in the Toronto market, please contact:

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