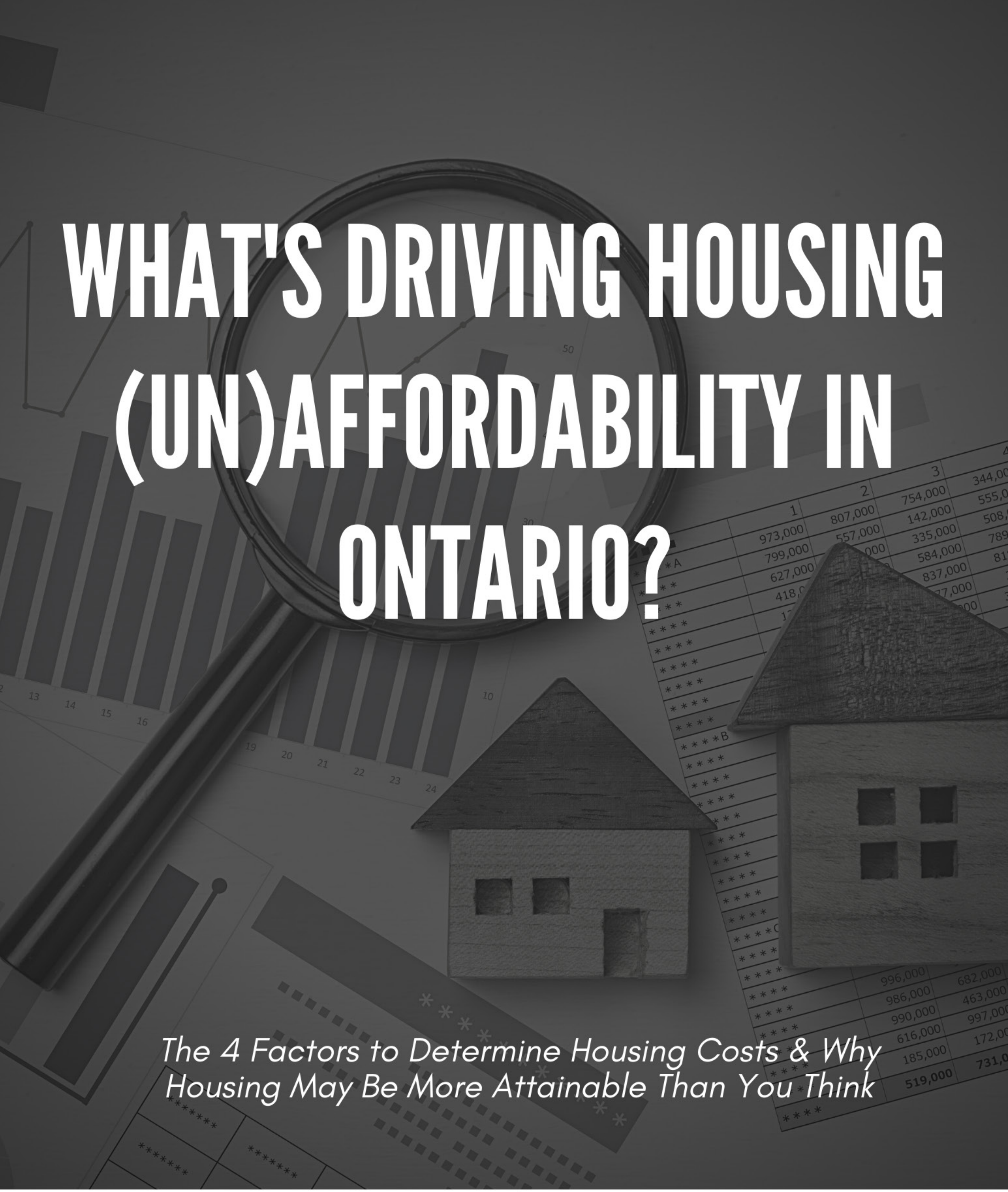


WHAT'S DRIVING HOUSING (UN)AFFORDABILITY IN ONTARIO?

The 4 Factors to Determine Housing Costs & Why Housing May Be More Attainable Than You Think

ROCKSTAR
INNER CIRCLE

Imagine a group of angry, fed-up Canadians descending on Ottawa, demanding change from the Canadian government.

Not hard, right?

Well, history is cyclical.

Back in 1981, a group of Canadians ran a "Marathon of Despair", running from St. Catharines to Ottawa in protest… of the astronomically growing cost of homeownership.

41 years is a long time… this is likely before you were buying real estate, maybe before you were even born yet.

When millennials (the largest demographic entering the housing market) look back at their parents' generation, it's easy to be jealous of what they paid for their house. The average sale price for a house with the Toronto Real Estate Board in 1981 was $90,203. In 2021, the average sale price is up to $1,095,419.

That $90k price point wouldn't even cover a 10% down payment on today's prices. It seems wild and truly unbelievable.

How could houses be "unaffordable" at that price?

4 Factors of Housing Affordability

Today, Canadians have a bad habit of associating house prices with housing affordability, but there's more to it.

In reality, there are 4 main contributing factors:

1. Household income and debt

How much does your household earn?

Someone who makes $100k/year will be able to afford more money to go towards housing than someone who makes $50k. And a household with multiple incomes may be able to afford more than a single-income household.

On the flip side, how much debt do you have? Car loans, student loans, credit card debt, etc.

The more debt you're already committed to paying back, the less you're going to be able to put towards housing.

Banks look at how much you make and how much debt you have to determine how large of a loan you can qualify for.

Right off the bat, income levels are becoming an issue for affordability.

The average income in Ontario (calculating for inflation) has flatlined over the last 45 years.

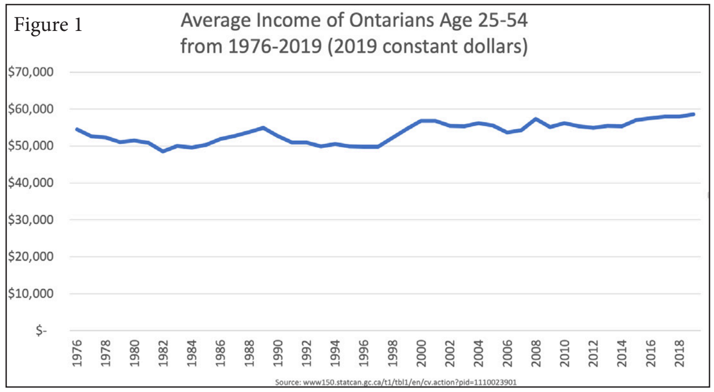


Figure 1

Yet, people have more debt than ever!

In 1990, which is as far back as recorded by Statistics Canada, Canadians owed an average of 82% of their annual disposable income. At the end of 2021, that ratio of debt to disposable income has risen to **177%!**

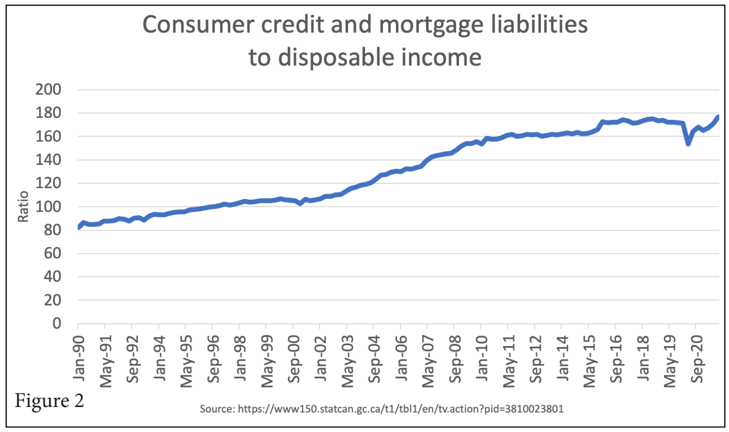


Figure 2

Debt isn't going to shrink, however, if income were to suddenly spike, people could "afford" larger monthly payments.

2. House prices

House prices grew quickly in the late 80s, and then dropped in the early 90s. There was then a 20-year window where prices grew steadily.

Now, in the last few years, house prices have once again skyrocketed, seeing high percentage growth.

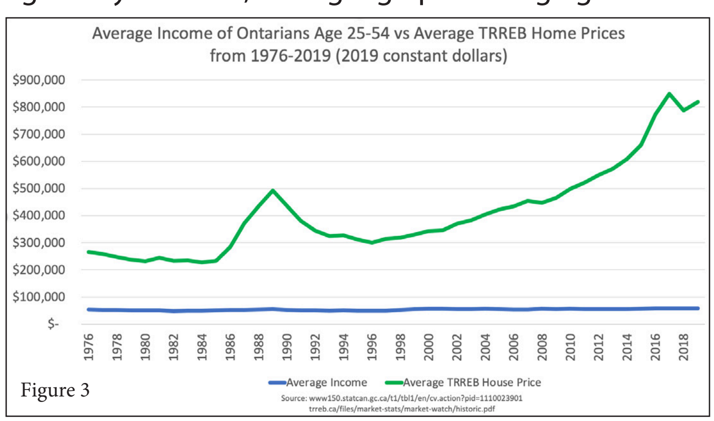
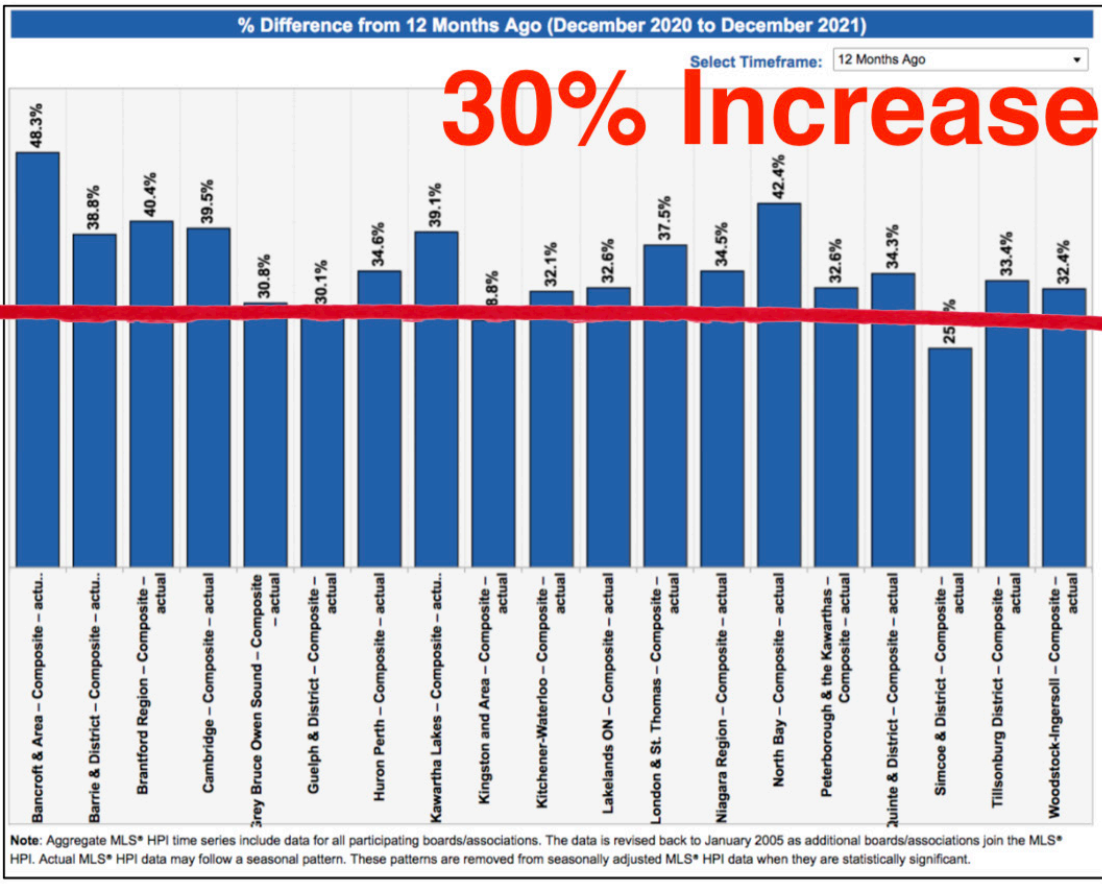


Figure 3

And this is just looking at the sales with the Toronto Regional Real Estate Board. Prices have been raising even faster in other parts of Ontario...



Prices may not continue to increase at this pace long-term, but this jump will have a lasting impact on affordability.

3. Down payment

What percentage do you have to put down to buy the home?

There's a big difference between 5% down and 20% down on a million-dollar home (roughly the average house price in Ontario as of January 2022).

A higher percentage down will mean a smaller mortgage, and smaller monthly payments.... but saving enough for 20% will take longer and house prices could drastically go up in that time.

Smaller down payments may get you into the market sooner, but you'll have to purchase mortgage insurance, you'll have a larger mortgage, and larger monthly payments.

4. Mortgage (rates and term length)

Fixed or variable, 3-year or 5-year term, amortization period… there are many factors that'll determine what your monthly payment will be, which ultimately determines how large of a loan you can qualify for.

Historically, the standard amortization period in Canada has been 25 years. However, increasing that to 30 years reduces your monthly payment, and could make homeownership more affordable.

Variable rates are generally lower than fixed, but fixed rates offer stability for those looking for consistent payments. Also, as we're about to see, locking in at a fixed rate could help you weather rising rates in an unstable economy.

Interest rates can have a massive impact on affordability.

Millennials have never had to deal with high interest rates when qualifying for a mortgage.

We've had years of "cheap" money with low interest rates. And those low rates have allowed home-buyers to borrow more than ever before.

That makes it easy to look at past house prices and not see the whole picture.

So, we wanted to look back at what spawned Canadians to march to parliament and demand change…

Historic Interest Rates In Canada

In the late 70s and early 80s, life was becoming increasingly expensive. Inflation was rapidly climbing, and it was hard on the economy.

To make matters worse, by 1981, inflation had been outpacing Canadian wages for 4 years straight.

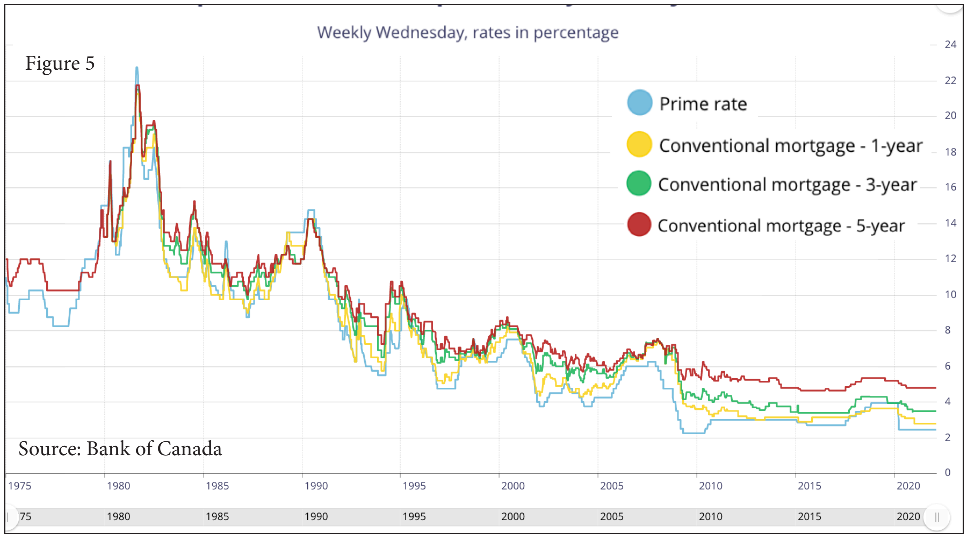
Year after year, people could afford less and less. Wages fell further and further behind… first 2%, then 4%, then 6%... It was devastating. How do you budget? How do you prepare for that level of inflation?

So, to tackle inflation, the Bank of Canada cranked up interest rates (which were already double digits).

Rising Interest Rates

These days when we talk about interest rate increases, we're looking at maybe a quarter or half-point increase. In the early 80s, you were looking at 5+% increases over roughly 18 months.

Figure 5



Five-year fixed-rate mortgages were more than 15% for about 2 years, from the fall of 1980 to the fall of 1982. Rates peaked in August 1981 at over 21% (Figure 5).

Imagine having locked in your mortgage for a 5-year fixed rate in 1976 at 10.25%... when it came time to renew, your mortgage rate was double! It would almost double your monthly mortgage payment!

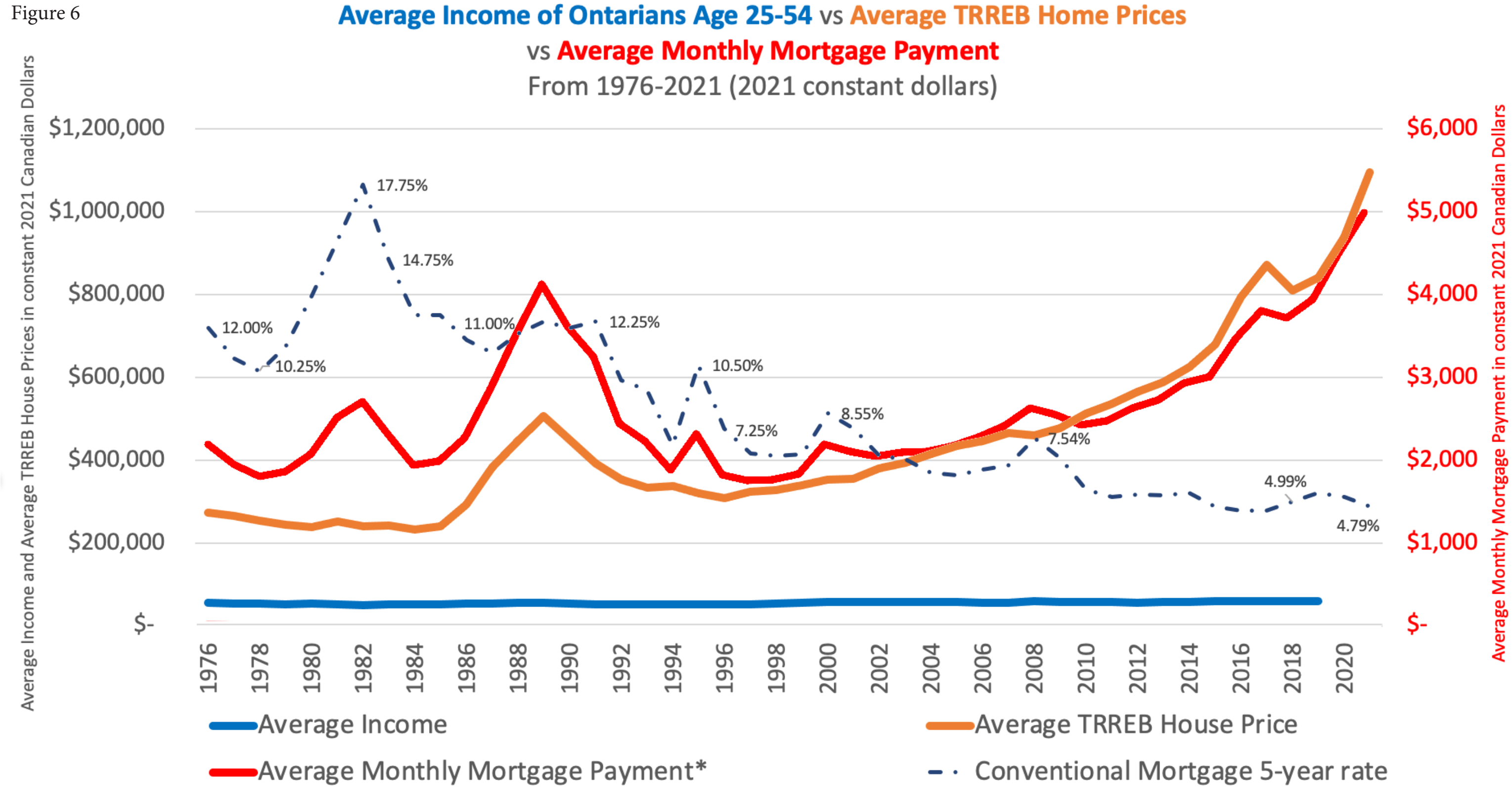
It was devastating to homeowners who were already struggling to keep up with rising prices.

And while rates peaked in '81, high interest rates were a reality for a long time. Five-year fixed mortgage rates didn't fall below 10% for a full 18 years – from 1973 to 1991.

Below, we've charted out housing affordability since 1976 (adjusting prices using an inflation calculator to the equivalent of the 2021 Canadian dollar). To do so, we've charted:

- The average income of Ontarians
- Average home prices (listed with the Toronto Regional Real Estate Board)
- Mortgage rates

Figure 6



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*Based on 20% down payment at the Bank of Canada posted conventional 5-year mortgage rate with a 25 year amortization period

- And what the monthly mortgage payment would be.

We already looked at how income has flatlined over the last 45 years, and how prices are quickly ramping up... but when you add in interest rates you can determine what the actual monthly carrying cost would be.

Yes, the sale price of the house is important, but when looking at how "affordable" a house is, we want to know how much is it actually going to cost every single month to own that home.

High interest rates in the early 1980s raised the average monthly payment, but when rates went down, payments went down too.

Then, in 1990, when interest rates sat in the low double digits and house prices went up, the monthly payments soared to a point of unaffordability and the market had to adjust. In fact, the average monthly mortgage payment didn't surpass those of 1990 (in 2021 dollars) until 2020!

So, housing has now reached a new level of unaffordability, this time due to house prices instead of interest rates.

But what if interest rates started to go up?

Will History Repeat Itself?

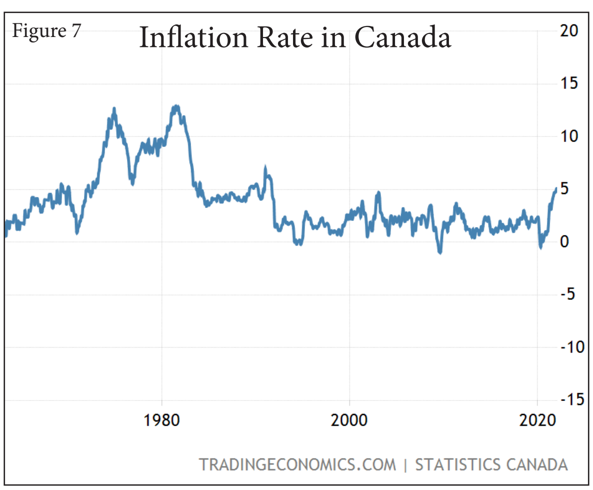
Today, inflation is once again climbing in Canada.

In March 2022, inflation in Canada hit a 31-year high.

The Bank of Canada has continued to say they're going to raise interest rates, and they started that increase with a 0.25 increase in March 2022... but don't expect massive rate hikes to come your way.

Small rate increases have a much larger impact these days, so you don't need 10+% interest rates to deal with inflation.

Figure 7



That's because Canadians now have far more debt relative to their incomes than they did in decades past.

Like we said earlier, Canadian debt to disposable income has risen to **177%!**

The Canadian government also has more debt.

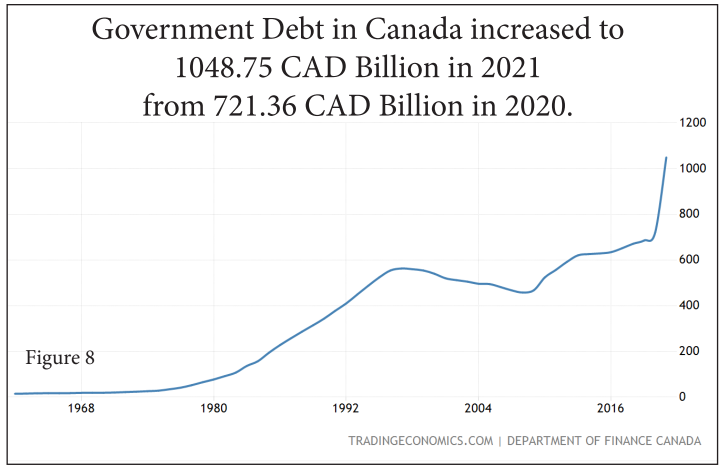


Figure 8

Every increase in interest rates makes that debt more expensive for the country, which limits how much the Bank of Canada can actually raise rates.

Moving forward, it likely won't be a change to interest rates that'll impact housing affordability. But, Canadians are once again demanding change from our government to address affordability. History doesn't always repeat itself exactly, but it can look awfully similar!

What Can Make Housing More Affordable?

Ontario's housing affordability task force recently released a proposal of ways to make housing more affordable. The focus, how we can create more housing.

It addresses affordability by increasing the supply to bring housing inventory more in line with the demand that's in the market, and the future demand expected based on population growth targets.

The report suggests:

- Removing some of the red tape for building housing
- Change zoning to allow more units on single-family zoned lots
  - » We're already seeing the benefits of converting single-family homes to have 2-3 units. By building multi-unit properties, it's allowing owners to live in one unit and rent out the remaining units. The rental income covers some of the carrying costs, and makes homeownership more affordable. Plus, it

creates additional rental units, which are in need across the province.

- Allow underutilized commercial properties to be converted into residential
- Increase density in major corridors

The proposal doesn't delve outside of increasing supply to address affordability. But there are a few other viable options we wouldn't be surprised to see come into play in the coming years. Options like:

- **Increasing amortization period:** Right now, 25-year mortgages are the most common length for a mortgage. But if you could spread out the mortgage over 30, 40, 50-year, the payments would go down making them more manageable.
- **Changing minimum down payments for first-time buyers:** Previously zero percent down mortgages have been available. While they went away some years ago following the US financial crisis, the government could reintroduce them for first-time homebuyers to get them into the market?

These are just some of the ways homes could be made more affordable in the coming years. However, one thing is clear. Right now, for the average Ontarian entering the housing market, real estate is less affordable than ever.

Yet, housing remains a basic need for survival, and also happens to be an excellent asset to protect your wealth.

What You Can Do To Protect Yourself

For us, it's simple. Keep investing in income-producing hard assets.

No one has a crystal ball, we can't predict the future...

But we can look at past trends and make strategic moves to help protect ourselves in the future.

Canadian housing is not keeping up with demand, and with projected population growth, t**here's a massive housing crisis** headed our way.

Those who own property now are likely going to benefit the most.

The key is buying good properties, in good areas, that produce enough income to pay for themselves. We don't believe in or recommend buying properties purely for appreciation.

That's why we are big believers that investing in properties that have great cash flow is the ideal way to thrive over the next several years.

At first glance, house prices are outpacing rental income...

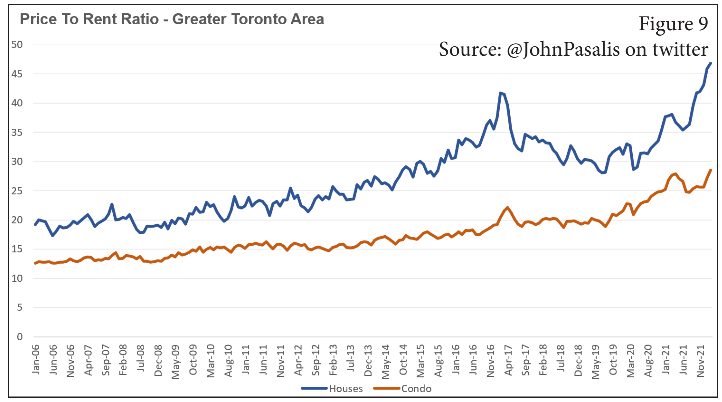


Figure 9
Source: @JohnPasalis on twitter

Rents fairly steadily increase, yet house prices are jumping year over year.

So, how can real estate still make money?

One way is by adding more units to existing properties.

Earlier, we highlighted how converting single-family properties to have secondary and third suites was a good way to make housing more affordable.

Well, it can also significantly increase the rental income from a property. Done right, a well-finished basement unit and primary unit will generate more rent than renting out an entire house.

Learning not only how to get involved in real estate, but keeping up with current trends and strategies, has helped us benefit from a gold mine that most don't even know exist and helped us consistently live life on our own terms.

With historically low-interest rates and hundreds of thousands of people pouring into the Greater Golden Horseshoe area over the next several years, we believe there will be continued demand for good properties in good areas.