

Residential Sales Summary & Housing Market Overview

British Columbia Q2, 2022

April - June

LANDCOR[®]
We *Value* Homes

Inside Our Quarterly Report

Landcor's Residential Sales Summary-All BC (by region & property type)

Economist, Will Dunning's BC Housing Market Overview



MESSAGE FROM OUR PRESIDENT

"Over the years we've helped hundreds of clients achieve their goals by offering the most comprehensive real estate data, analysis and insights available.

From real estate valuations to land economics research and systems development, our staff of highly qualified experts are here to help you find solutions to your real estate analysis and data needs.

Landcor maintains the largest, most complete database of historical sales and current information on BC residential real estate."



*Rudy Nielsen, RI, FRI
President & Founder*

Q2 Provincial Snapshot:

| | <i>Total Number of Sales</i> | <i>Total Value of Sales</i> |
|-------|----------------------------------|---------------------------------|
| | 35,113 | \$37.13B |
| April | 10,693 | \$10.93B |
| May | 12,056 | \$12.92B |
| June | 12,364 | \$13.28B |

Across the Regions at a Glance:



| | Q2 Total Number of Sales | Q2 Total Value of Sales (Billions) |
|----------------------------|-------------------------------------|---|
| Greater Vancouver | 14,380 | \$19.86B |
| Vancouver Island | 5,917 | \$5.81B |
| Kootenay | 1,653 | \$0.78B |
| Okanagan | 5,580 | \$4.32B |
| Fraser Valley | 4,788 | \$5.33B |
| BC North /Northwest | 2,795 | \$1.01B |

Regional Highlights Summary includes all property types (Detached, Condo, Attached).

Residential Sales Summary Report

April - June

Landcor's Quarterly Residential Sales Summary reports on property sale values within BC. Providing sales information on a regional level, these charts compare average and median pricing on different property types: Detached, Condo and Attached, on a quarterly and monthly basis.

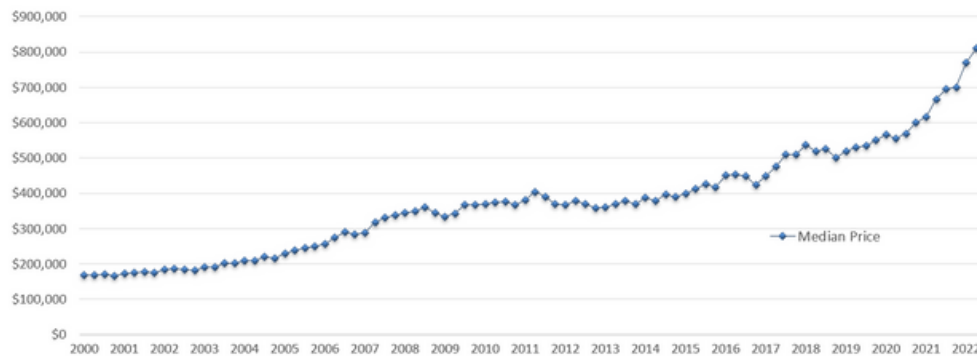
British Columbia All

| Quarterly Sales | | Q2 2022 | Q1 2022 | % Chg ¹ | Q2 2021 | % Chg ² |
|-----------------------|---------|-------------|-------------|--------------------|-------------|--------------------|
| Total Number of Sales | | 35,113 | 26,589 | 32.06% | 48,682 | -27.87% |
| Total Value of Sales | | \$37.13B | \$27.32B | 35.92% | \$42.14B | -11.89% |
| Detached | Average | \$1,351,626 | \$1,432,686 | -5.66% | \$1,190,006 | 13.58% |
| | Median | \$1,161,306 | \$1,250,000 | -7.10% | \$990,000 | 17.30% |
| Condo | Average | \$691,464 | \$685,573 | 0.86% | \$596,460 | 15.93% |
| | Median | \$625,000 | \$615,000 | 1.63% | \$525,000 | 19.05% |
| Attached | Average | \$911,177 | \$900,650 | 1.17% | \$767,340 | 18.74% |
| | Median | \$852,500 | \$833,000 | 2.34% | \$689,999 | 23.55% |

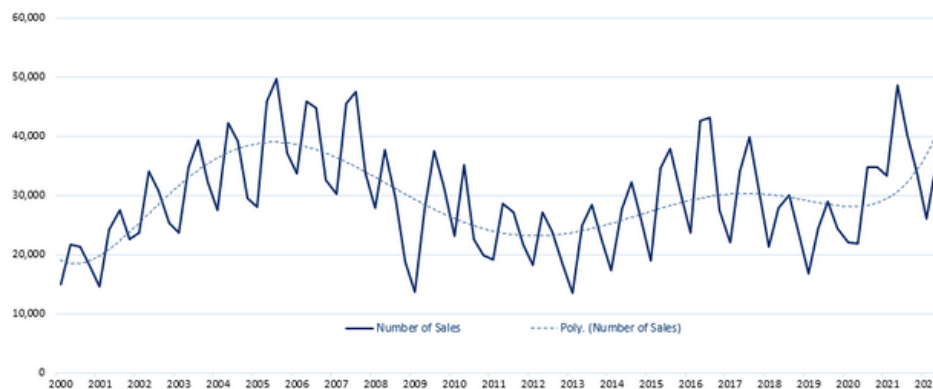
(1) % change Q2'2022—Q1'2022; (2) % change Q2'2022—Q2'2021

Note: When sales is grouped at the ALL – BC level all are weighted equally. This means each data point contributes the same amount of information to the average. In this sense, when there are sales that are much higher in Q3 than Q4, the average in Q3 would be higher than Q4.

Median Sale Price Trends | British Columbia All



Sales Count Trends | British Columbia All



Residential Sales Summary Report

April - June

(1) %change Q2'2022—Q1'2022 (2) %change Q2'2022—Q2'2021 (3) %change month to previous month

Greater Vancouver Region

| Quarterly Sales | | Q2 2022 | Q1 2022 | % Chg ¹ | Q2 2021 | % Chg ² |
|-----------------------|---------|-------------|-------------|--------------------|-------------|--------------------|
| Total Number of Sales | | 14,380 | 12,355 | 16.39% | 20,789 | -30.83% |
| Total Value of Sales | | \$19.86B | \$16.28B | 22.02% | \$23.88B | -16.81% |
| Detached | Average | \$2,159,743 | \$2,175,788 | -0.74% | \$1,860,960 | 16.06% |
| | Median | \$1,880,000 | \$1,830,000 | 2.73% | \$1,560,000 | 20.51% |
| Condo | Average | \$789,586 | \$772,349 | 2.23% | \$699,617 | 12.86% |
| | Median | \$696,000 | \$677,000 | 2.81% | \$612,000 | 13.73% |
| Attached | Average | \$1,144,556 | \$1,131,954 | 1.11% | \$947,645 | 20.78% |
| | Median | \$1,045,000 | \$990,000 | 5.56% | \$825,000 | 26.67% |
| Monthly Sales | | April | May | % Chg ³ | June | % Chg ³ |
| Total Number of Sales | | 4,418 | 4,989 | 12.92% | 4,973 | -0.32% |
| Total Value of Sales | | \$5.85B | \$7.05B | 20.57% | \$6.97B | -1.17% |
| Detached | Average | \$2,107,352 | \$2,195,395 | 4.18% | \$2,166,470 | -1.32% |
| | Median | \$1,862,000 | \$1,880,000 | 0.97% | \$1,886,000 | 0.32% |
| Condo | Average | \$784,761 | \$800,881 | 2.05% | \$782,586 | -2.28% |
| | Median | \$694,100 | \$710,000 | 2.29% | \$685,000 | -3.52% |
| Attached | Average | \$1,131,147 | \$1,171,389 | 3.56% | \$1,129,881 | -3.54% |
| | Median | \$1,025,000 | \$1,075,000 | 4.88% | \$1,040,000 | -3.26% |

Vancouver Island Region

| Quarterly Sales | | Q2 2022 | Q1 2022 | % Chg ¹ | Q2 2021 | % Chg ² |
|-----------------------|---------|-------------|-------------|--------------------|-------------|--------------------|
| Total Number of Sales | | 5,917 | 4,037 | 46.57% | 7,568 | -21.82% |
| Total Value of Sales | | \$5.81B | \$3.57B | 62.74% | \$5.58B | 4.19% |
| Detached | Average | \$1,081,276 | \$1,070,157 | 1.04% | \$922,054 | 17.27% |
| | Median | \$949,900 | \$925,000 | 2.69% | \$819,500 | 15.91% |
| Condo | Average | \$606,760 | \$618,354 | -1.87% | \$477,748 | 27.00% |
| | Median | \$554,000 | \$555,000 | -0.18% | \$445,000 | 24.49% |
| Attached | Average | \$767,483 | \$715,313 | 7.29% | \$614,771 | 24.84% |
| | Median | \$740,000 | \$677,450 | 9.23% | \$589,900 | 25.44% |
| Monthly Sales | | April | May | % Chg ³ | June | % Chg ³ |
| Total Number of Sales | | 1,753 | 2,102 | 19.91% | 2,062 | -1.90% |
| Total Value of Sales | | \$1.61B | \$1.98B | 23.03% | \$2.23B | 12.68% |
| Detached | Average | \$1,044,205 | \$1,096,746 | 5.03% | \$1,094,897 | -0.17% |
| | Median | \$937,500 | \$936,650 | -0.09% | \$960,000 | 2.49% |
| Condo | Average | \$643,502 | \$587,814 | -8.65% | \$593,731 | 1.01% |
| | Median | \$560,000 | \$551,000 | -1.61% | \$552,500 | 0.27% |
| Attached | Average | \$784,885 | \$750,532 | -4.38% | \$768,812 | 2.44% |
| | Median | \$745,000 | \$717,500 | -3.69% | \$750,000 | 4.53% |

Residential Sales Summary Report

April - June

(1) %change Q2'2022—Q1'2022 (2) %change Q2'2022—Q2'2021 (3) %change month to previous month

Kootenay Region

| Quarterly Sales | | Q2 2022 | Q1 2022 | % Chg ¹ | Q2 2021 | % Chg ² |
|-----------------------|---------|-----------|-----------|--------------------|-----------|--------------------|
| Total Number of Sales | | 1,653 | 1,011 | 63.50% | 2,046 | -19.21% |
| Total Value of Sales | | \$0.78B | \$383.15M | 104.51% | \$0.78B | 0.70% |
| Detached | Average | \$601,110 | \$554,230 | 8.46% | \$526,562 | 14.16% |
| | Median | \$542,000 | \$500,000 | 8.40% | \$469,000 | 15.57% |
| Condo | Average | \$290,059 | \$274,914 | 5.51% | \$238,735 | 21.50% |
| | Median | \$275,000 | \$249,000 | 10.44% | \$225,000 | 22.22% |
| Attached | Average | \$438,191 | \$394,538 | 11.06% | \$409,027 | 7.13% |
| | Median | \$416,000 | \$391,000 | 6.39% | \$380,000 | 9.47% |
| Monthly Sales | | April | May | % Chg ³ | June | % Chg ³ |
| Total Number of Sales | | 499 | 539 | 8.02% | 615 | 14.10% |
| Total Value of Sales | | \$227.10M | \$255.77M | 12.63% | \$300.70M | 17.57% |
| Detached | Average | \$601,743 | \$599,500 | -0.37% | \$601,943 | 0.41% |
| | Median | \$525,000 | \$530,000 | 0.95% | \$550,000 | 3.77% |
| Condo | Average | \$309,787 | \$308,125 | -0.54% | \$253,314 | -17.79% |
| | Median | \$319,000 | \$308,500 | -3.29% | \$204,750 | -33.63% |
| Attached | Average | \$486,918 | \$416,774 | -14.41% | \$421,479 | 1.12% |
| | Median | \$469,000 | \$369,250 | -21.27% | \$413,750 | 10.76% |

Okanagan Region

| Quarterly Sales | | Q2 2022 | Q1 2022 | % Chg ¹ | Q2 2021 | % Chg ² |
|-----------------------|---------|-----------|-----------|--------------------|-----------|--------------------|
| Total Number of Sales | | 5,580 | 3,635 | 53.51% | 7,905 | -29.41% |
| Total Value of Sales | | \$4.32B | \$2.53B | 71.03% | \$4.77B | -9.41% |
| Detached | Average | \$973,726 | \$918,745 | 5.98% | \$832,090 | 17.02% |
| | Median | \$860,000 | \$829,000 | 3.74% | \$727,500 | 18.21% |
| Condo | Average | \$474,612 | \$435,509 | 8.98% | \$411,584 | 15.31% |
| | Median | \$439,900 | \$391,501 | 12.36% | \$386,450 | 13.83% |
| Attached | Average | \$661,395 | \$643,509 | 2.78% | \$541,437 | 22.16% |
| | Median | \$610,000 | \$600,010 | 1.66% | \$504,950 | 20.80% |
| Monthly Sales | | April | May | % Chg ³ | June | % Chg ³ |
| Total Number of Sales | | 1,703 | 1,819 | 6.81% | 2,058 | 13.14% |
| Total Value of Sales | | \$1.32B | \$1.42B | 7.80% | \$1.59B | 12.11% |
| Detached | Average | \$981,437 | \$987,497 | 0.62% | \$956,598 | -3.13% |
| | Median | \$876,000 | \$850,000 | -2.97% | \$858,000 | 0.94% |
| Condo | Average | \$465,033 | \$462,980 | -0.44% | \$497,255 | 7.40% |
| | Median | \$436,611 | \$435,000 | -0.37% | \$450,000 | 3.45% |
| Attached | Average | \$679,727 | \$681,788 | 0.30% | \$633,205 | -7.13% |
| | Median | \$612,108 | \$625,000 | 2.11% | \$595,000 | -4.80% |

Residential Sales Summary Report

April to June

(1) %change Q2'2022—Q1'2022 (2) %change Q2'2022—Q2'2021 (3) %change month to previous month

Fraser Valley Region

| Quarterly Sales | | Q2 2022 | Q1 2022 | % Chg ¹ | Q2 2021 | % Chg ² |
|-----------------------|---------|-------------|-------------|--------------------|-------------|--------------------|
| Total Number of Sales | | 4,788 | 3,946 | 21.34% | 7,420 | -35.47% |
| Total Value of Sales | | \$5.33B | \$4.05B | 31.81% | \$6.16B | -13.38% |
| Detached | Average | \$1,479,328 | \$1,432,406 | 3.28% | \$1,166,530 | 26.81% |
| | Median | \$1,350,000 | \$1,290,000 | 4.65% | \$1,029,988 | 31.07% |
| Condo | Average | \$530,945 | \$504,939 | 5.15% | \$416,101 | 27.60% |
| | Median | \$520,000 | \$499,000 | 4.21% | \$409,900 | 26.86% |
| Attached | Average | \$833,748 | \$807,206 | 3.29% | \$654,864 | 27.32% |
| | Median | \$828,000 | \$799,900 | 3.51% | \$635,000 | 30.39% |
| Monthly Sales | | April | May | % Chg ³ | June | % Chg ³ |
| Total Number of Sales | | 1,499 | 1,664 | 11.01% | 1,625 | -2.34% |
| Total Value of Sales | | \$1.65B | \$1.87B | 13.31% | \$1.81B | -3.47% |
| Detached | Average | \$1,505,384 | \$1,480,137 | -1.68% | \$1,456,417 | -1.60% |
| | Median | \$1,390,000 | \$1,350,007 | -2.88% | \$1,303,500 | -3.44% |
| Condo | Average | \$533,020 | \$535,490 | 0.46% | \$523,753 | -2.19% |
| | Median | \$525,000 | \$517,500 | -1.43% | \$518,000 | 0.10% |
| Attached | Average | \$852,350 | \$842,098 | -1.20% | \$811,112 | -3.68% |
| | Median | \$849,625 | \$835,400 | -1.67% | \$805,000 | -3.64% |

Region: BC North / Northwest

| Quarterly Sales | | Q2 2022 | Q1 2022 | % Chg ¹ | Q2 2021 | % Chg ² |
|-----------------------|---------|-----------|-----------|--------------------|-----------|--------------------|
| Total Number of Sales | | 2,795 | 1,605 | 74.14% | 2,954 | -5.38% |
| Total Value of Sales | | \$1.01B | \$0.51B | 98.84% | \$0.98B | 3.56% |
| Detached | Average | \$441,073 | \$408,930 | 7.86% | \$409,100 | 7.82% |
| | Median | \$425,000 | \$397,500 | 6.92% | \$390,000 | 8.97% |
| Condo | Average | \$161,233 | \$190,633 | -15.42% | \$167,067 | -3.49% |
| | Median | \$130,000 | \$187,000 | -30.48% | \$127,001 | 2.36% |
| Attached | Average | \$299,231 | \$310,430 | -3.61% | \$310,279 | -3.56% |
| | Median | \$290,000 | \$316,000 | -8.23% | \$304,500 | -4.76% |
| Monthly Sales | | April | May | % Chg ³ | June | % Chg ³ |
| Total Number of Sales | | 821 | 943 | 14.86% | 1,031 | 9.33% |
| Total Value of Sales | | \$281.47M | \$343.83M | 22.15% | \$387.17M | 12.60% |
| Detached | Average | \$412,616 | \$458,306 | 11.07% | \$446,235 | -2.63% |
| | Median | \$390,000 | \$440,000 | 12.82% | \$432,500 | -1.70% |
| Condo | Average | \$156,251 | \$169,634 | 8.56% | \$156,915 | -8.11% |
| | Median | \$130,000 | \$129,500 | -0.38% | \$122,500 | -5.71% |
| Attached | Average | \$306,130 | \$290,454 | -5.12% | \$302,584 | 4.18% |
| | Median | \$292,607 | \$285,250 | -2.51% | \$315,450 | 10.59% |

BC Housing Market Overview – Q2, 2022

This section of our report is prepared by economist WILL DUNNING. Views expressed by Will Dunning are his own and do not necessarily represent those of Landcor Data Corporation. Will Dunning operates a consulting firm that specializes in analysis of housing markets.

I see the second quarter as an “in-between” time. Clearly, large rises in interest rates are causing a downward transition in housing markets in BC, and across the country. Yet, it is too soon to have a clear picture of where this is headed. In the last edition of this report, I commented that “mortgage interest rates have far surpassed the levels that I consider neutral, and if that situation persists, substantial negative effects might spread beyond housing into the broader economy, in BC and across the country.”

Since then, I have used my private database on rents and house prices to calculate that as of last May, the “neutral” mortgage rate was 2.6%. As I write this (on August 24), typical rates are now 4.8% for 5-year fixed rate mortgages and 4.2% for variable rate mortgages. I fear that the current excessive levels of these interest rates might become severely disruptive, starting with the housing market and then infecting the broader economy.

Figure 1

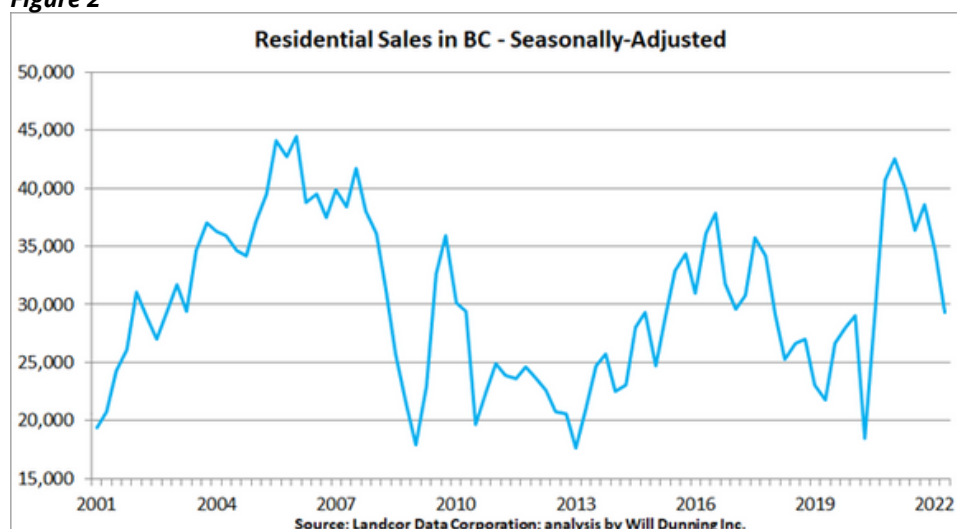


Landcor reports that there were 35,113 sales in the second quarter this year, which was 28% lower compared to a year earlier. In a long-term perspective, this is a decent performance, almost exactly equal to the long-term average (34,671) for second quarters.

Figure 2 on the next page shows that in a shorter-term view, on a seasonally-adjusted basis, second quarter sales (29,300) fell versus the first quarter (the drop versus Q1 was 15%). BC housing markets have quite rapidly transitioned from being stronger than average to close-to-average, and the direction is ominous.

(In some charts, trend lines have been added, where I judge that they help improve understanding of trends. Where those trend lines are present, they are labelled “Poly.”)

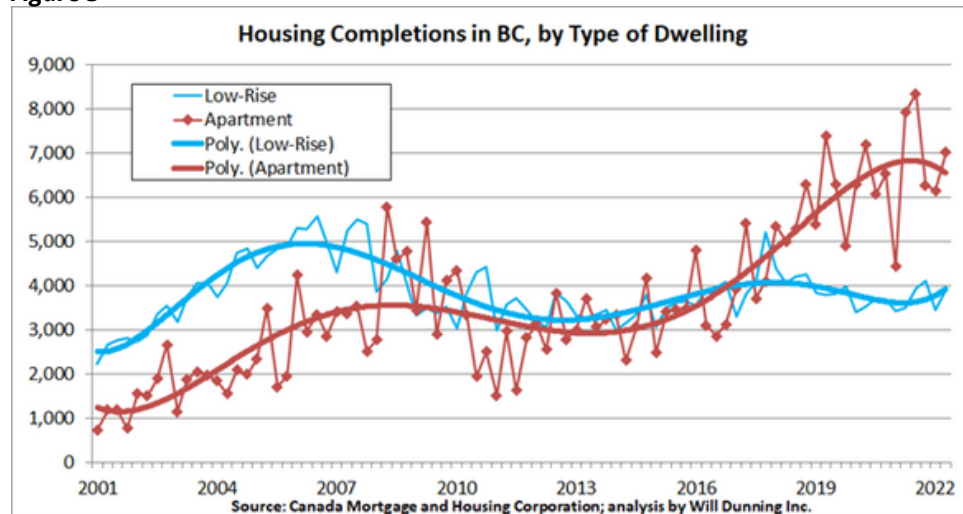
Figure 2



Sales in the second quarter only partly reflect the rise in interest rates, for several reasons that imply that sales are going to fall further in the coming months:

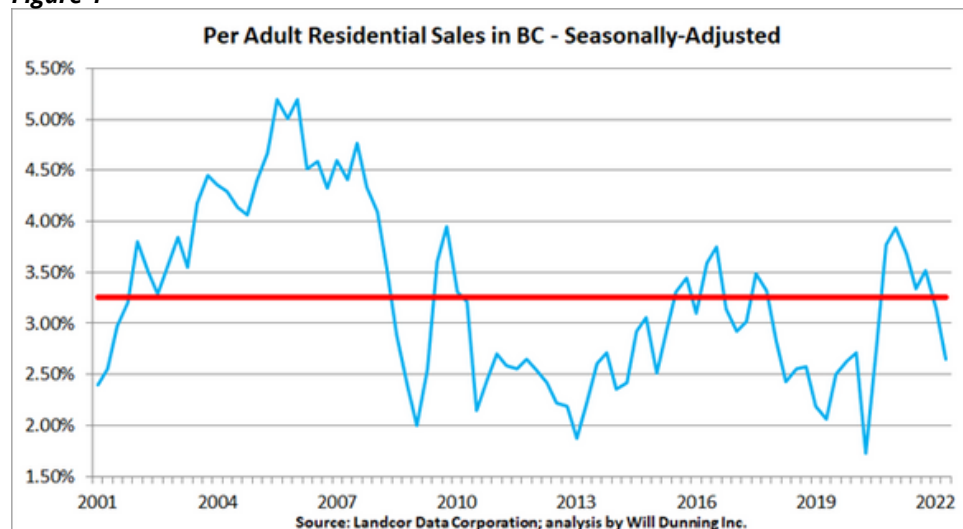
- Interest rates were rising during the second quarter. For the entire quarter, the average rate for fixed rate mortgages was 4.3%; for variable rates, the average was 2.55%. With rates now considerably above those averages, affordability is now worse than it was during the second quarter (and even more so compared to the first quarter, when the average rates were 2.96% and 1.50%, respectively).
- Many of the sales that were recorded during the second quarter reflect conditions that existed earlier: many buyers were taking advantage of rate guarantees at lower interest rates. Now, attractive guaranteed rates have largely expired.
- Housing completions remain elevated, due to high levels of housing starts that occurred earlier (see Figure 3). As new homes have been completed and the buyers have taken possession of them, those closings have supported the quarterly sales totals. Housing completions accounted for about one-third of sales in the second quarter. That component of activity has been relatively stable at a high level, as it reflects the very favourable conditions that existed previously. The more-immediate component of activity (resale transactions) is clearly falling very rapidly. This implies that pre-construction sales of new homes may also be dropping rapidly, which would result in lower numbers of completions during 2023 and beyond.

Figure 3



The next chart looks at Landcor's sales data in a different way (a population-adjusted basis). The population is growing (and there are more people who could potentially buy homes). The total stock of housing is expanding because of on-going construction (and as a result there are more homes that could potentially be sold). We should expect that sales will trend upwards over time. Figure 4 shows that in historic terms, population-adjusted sales for Q2 were 19% below the long-term average (the flat red line). By this metric, sales within BC are becoming weak in historic terms.

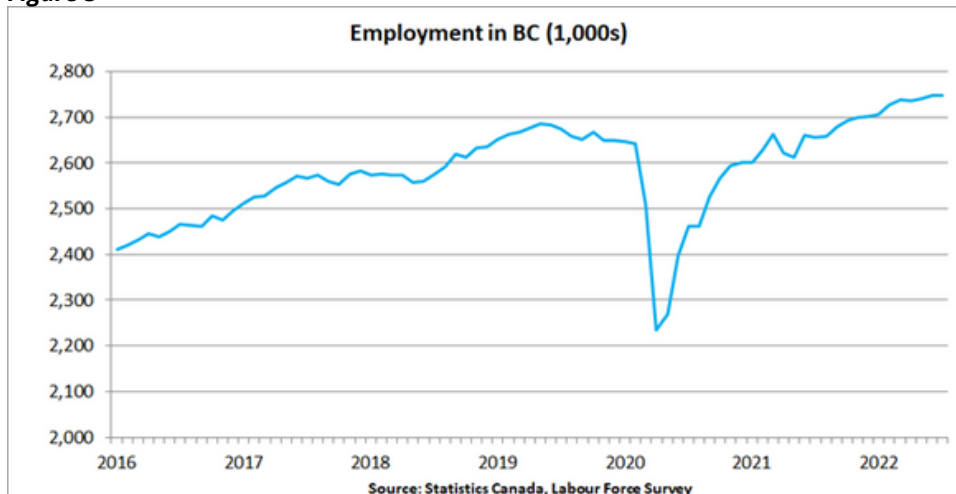
Figure 4



The employment situation has been a strongly positive factor for housing demand in BC. Figure 5 (which includes monthly data up to July) shows that the level of employment in BC is now about 100,000 higher than before the start of the pandemic. The large amount of job growth that has happened during the past six years means that there are a lot of potential home buyers in BC.

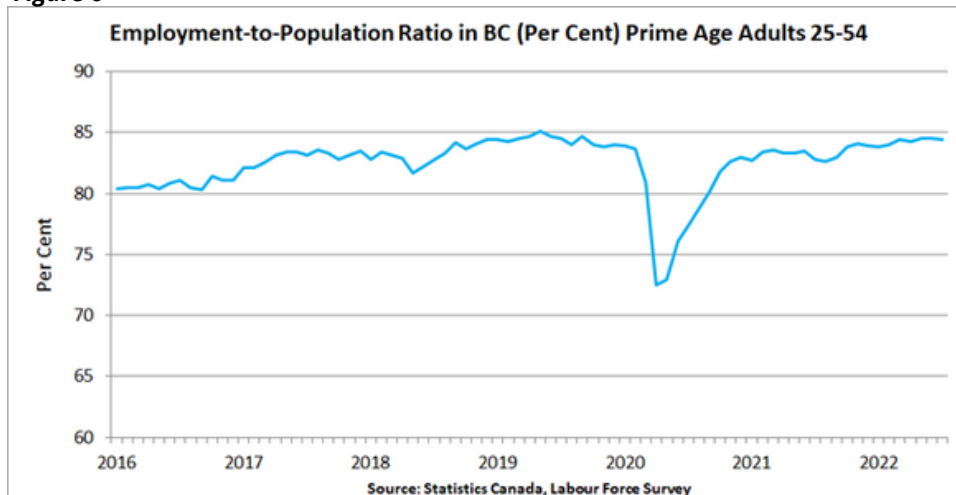
Yet, there has been little change in employment during the past four months. It is possible that this is erroneous data (which sometimes happens). It is also possible that we are seeing the early stages of an economic reaction to high interest rates. I believe that it is too soon for this, and the economic effects shouldn't materialize until late this year. Higher interest rates are intended to reduce inflation, through a weakening of the economy. Regardless of the uncertainty about the current employment situation, it seems quite possible that later this year and into next year, employment will begin to fall. I confess to feeling very uncertain about how strong that downturn might be, and therefore to what extent the economy will result in further drops in housing activity (on top of the drops that are resulting from high interest rates).

Figure 5



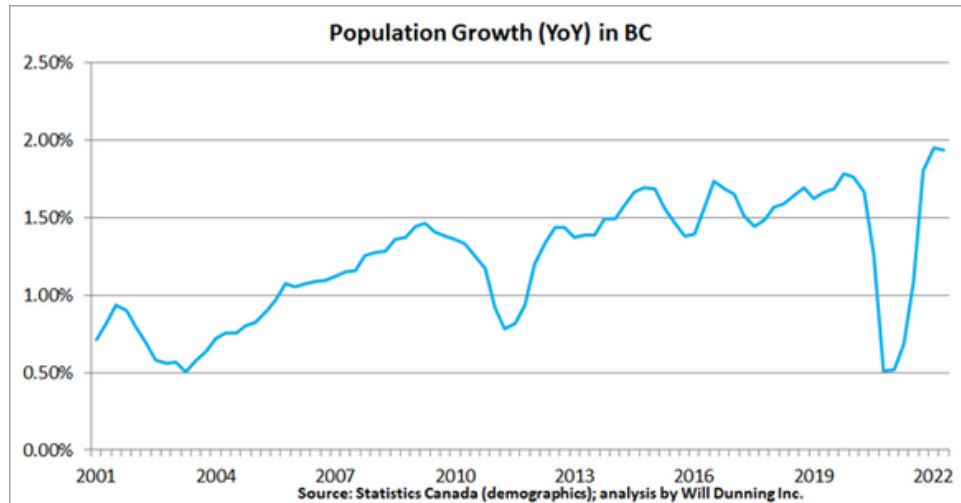
In understanding the economy, and especially how it might affect the housing market, my preferred indicator is the percentage of the population that has jobs, in the 25 to 54 age group. As is shown in Figure 6, this indicator has been very strong for some time, and, with the recovery from the early days of COVID-19, the employment situation should now be resulting in very strong home sales. Again, this data is suggesting that BC is now entering a transitional state, in which falling employment for prime age adults will weigh on housing transactions.

Figure 6



Statistics Canada estimates that population growth is very rapid in BC. For the year ended April 1, 2022, the estimated growth rate for BC is almost 2%. Growth is now the fastest of the past two decades. This growth is adding to the requirements for new housing, which were already elevated.

Figure 7



As was shown earlier (in Figure 3) housing completions have been elevated within BC during the past three years, and the trend rate is now at an annualized rate of just over 40,000 dwelling units.

BC has for a long time suffered from an inadequate total supply of housing. As I commented in the first quarter edition of this report, I have calculated that there is an accumulated housing shortfall of more than 100,000 dwellings for the province.

(To address that deficit, there is a need for BC to produce a lot more housing. More details on this can be found in a report I published in May, the first item on this page: <https://www.wdunning.com/recent-reports>. For some of the results for BC, see Table 2 on Page 16 (which shows the estimated deficits as of 2021) and Table 4 on Page 21 (which provides estimates of how much housing production is required for the coming 15 years).)

Reduced home sales and downward price adjustments in the coming months might create an impression that there is less pressure in the market, and some people might conclude that supply is no longer an issue. But, this slowing will just be a short-term variation away from a long-term trend in which inadequate housing supplies will continue to make it very difficult for the people of BC to meet their reasonable housing needs.

Regional Variations for Sales

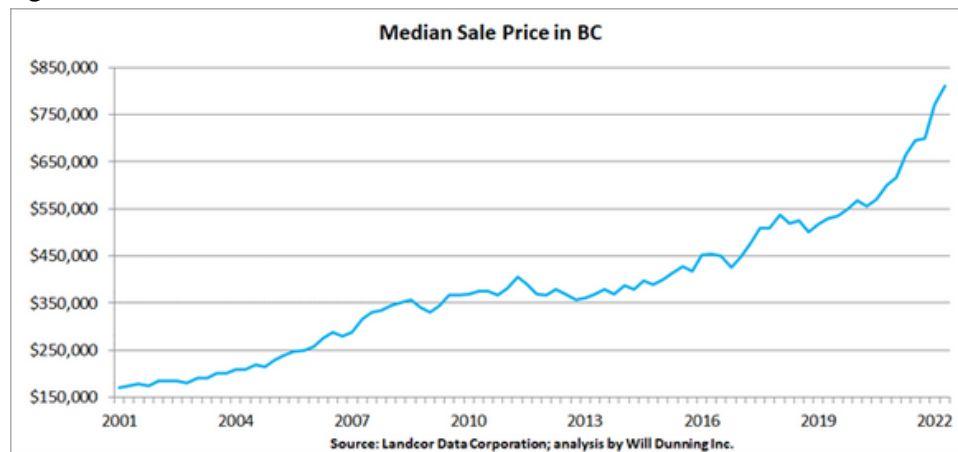
Landcor's data shows that during 2022-Q2, residential sales were down by 28% compared to a year earlier. As is shown in the following table, sales dropped in all of the six regions. The largest drops were for Fraser Valley and Greater Vancouver. Northern BC saw the smallest drop (just 5%). My expectation is that in the initial stages of the downturn, the largest drops will occur in the most expensive ("move-away") market areas of Greater Vancouver and Fraser Valley, and so far, the data shows this. More substantial reductions for the "move-to" regions are likely to follow during the second half of this year.

| Residential Sales in British Columbia, by Region 2021-Q2 and 2022-Q2 | | | | | |
|---|-----------------|---------|----------|-------------|---------|
| Region | Quarterly Sales | | % Change | Share of BC | |
| | 2021-Q2 | 2022-Q2 | | 2021-Q2 | 2022-Q2 |
| Greater Vancouver | 20,789 | 14,380 | -31% | 42.7% | 41.0% |
| Vancouver Island | 7,568 | 5,917 | -22% | 15.5% | 16.9% |
| Kootenay | 2,046 | 1,653 | -19% | 4.2% | 4.7% |
| Okanagan | 7,905 | 5,580 | -29% | 16.2% | 15.9% |
| Fraser Valley | 7,420 | 4,788 | -35% | 15.2% | 13.6% |
| BC North/Northwest | 2,954 | 2,795 | -5% | 6.1% | 8.0% |
| BC Total | 48,682 | 35,113 | -28% | 100.0% | 100.0% |
| Source: Landcor Data Corporation | | | | | |
| Note: Figures may vary from other published data due to on-going revisions. | | | | | |

Prices

The median price rose in the second quarter, to \$810,000 versus \$770,000 in the first quarter and was 22% higher than the \$665,000 recorded a year ago. During the past two years, the median price has increased by \$252,000 (36%). For the entire period shown in this chart, the average increase is 7.6% per year.

Figure 8



In earlier reports, it was seen that shifts in consumer choices to low-density housing options (at least partly due to COVID-19) caused price growth to be strongest for detached homes. With the developing turn in housing markets, a new pattern seems to be emerging, with higher interest rates causing a depressurization for the most expensive homes, and a shift in interest towards attached (townhouse) options, which for Q2 showed the most rapid price growth. As of the second quarter, price growth was still very strong, but this reflects transactions that were started earlier. As high interest rates are increasingly felt in the market, we may soon see a sharp turn in price trends.

| Year-Over-Year Changes in Median Selling Prices by Region and Type of Dwelling, 2021-Q2 to 2022-Q2 | | | |
|---|----------|-------|----------|
| Region | Detached | Condo | Attached |
| Greater Vancouver | 20.5% | 13.7% | 26.7% |
| Vancouver Island | 15.9% | 24.5% | 25.4% |
| Kootenay | 15.6% | 22.2% | 9.5% |
| Okanagan | 18.2% | 13.8% | 20.8% |
| Fraser Valley | 31.1% | 26.9% | 30.4% |
| BC North/Northwest | 9.0% | 2.4% | -4.8% |
| BC Total | 17.3% | 19.0% | 23.6% |
| Source: Landcor Data Corporation | | | |
| Note: Figures may vary from other published data due to on-going revisions. | | | |

Shifts for Affordability

The affordability situation is changing very rapidly. As was shown in Figure 1, interest rates for 5-year fixed rate mortgages have increased sharply. For the second quarter, the average rate was 4.31% versus 2.96% in Q1 (and there have been further increases, with the current rate at 4.8%, as of mid-August).

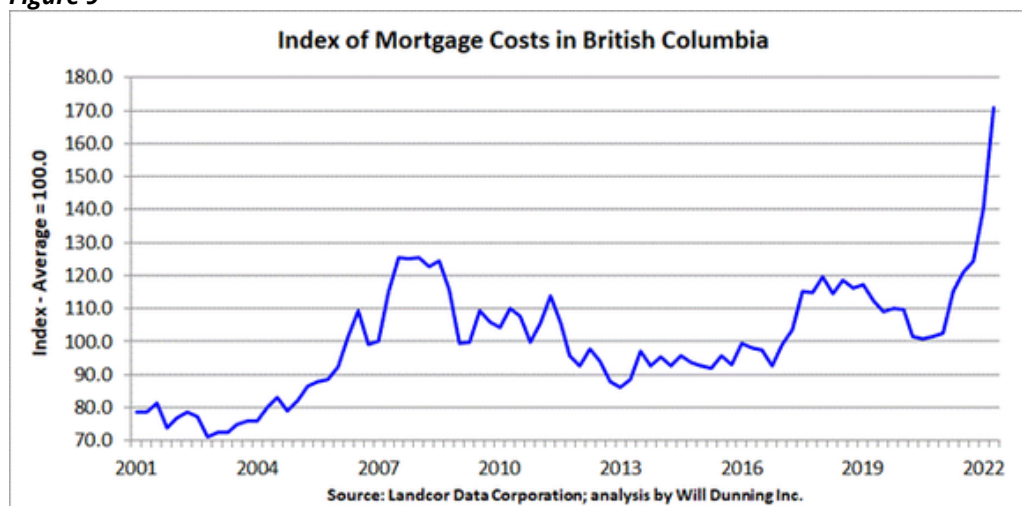
With the recent increases in mortgage interest rates, layered on top of sharply higher house prices, affordability has been rapidly reduced.

The next two charts show estimates that compare mortgage costs for median-priced homes to incomes. In these charts, low values indicate that mortgage payments require low percentages of incomes (i.e., low values indicate improved affordability).

In these charts, the index is equal to 100 over the entire period shown. Therefore, index values below 100 indicate that affordability is better than the long-term average, and values above 100 show affordability is worse than average.

Figure 9 looks at total mortgage payments. It shows that affordability has recently deteriorated very badly and very rapidly. The second quarter value of this index (170.9) is now - by a very large margin - the worst seen in the history of this data. And interest rates are now even higher than the 4.31% figure that was used for the second quarter. If the current rate (4.8%) is used, this index would be even higher, at 179.4.

Figure 9



But I don't consider this the final word on affordability, for two reasons.

Mortgage payments include two components: payment of interest and repayment of the mortgage principal. I argue that the principal repayment is actually a form of saving, and that the "true" cost of borrowing is the interest portion only. Potential mortgage borrowers have to be mindful of the total payment, because they have to qualify for the mortgage, and then they need to budget for the full payment. But most borrowers are also aware of the distinction between interest and principal. At the second quarter interest rate (4.31% for 5-year fixed-rates), about one-third (34%) of the payment is principal repayment and 66% is interest.

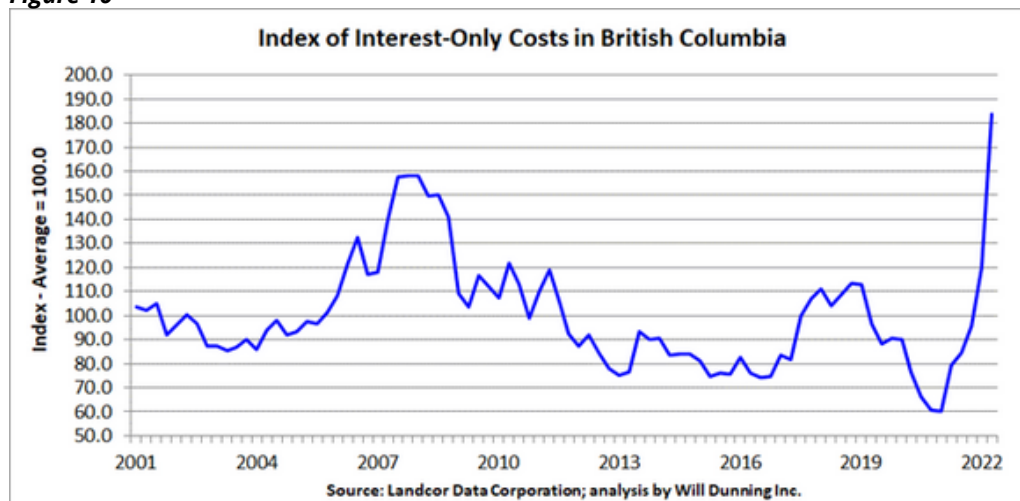
Therefore, the next chart (Figure 10) looks at the relationship between the interest component of payments versus incomes. Until recently, interest-only costs were below the long-term average. But, as of 2022-Q2, the combination of much higher prices and interest rates raised the interest-only cost to 84% above the long-term average. This is now the worst-ever result.

Furthermore, if the current interest rate (4.8%) is used in this calculation, the interest-only cost would be a massive 104% above average.

These calculations go a long way in explaining why the sale rate has slowed recently, and imply that we should expect further, and larger, drops.

While economic conditions remain quite positive (apart from interest rates and affordability), the deterioration of affordability is likely to be the dominant factor for the remainder of this year.

Figure 10



Another consideration around interest rates is that until recently, variable rates had been much lower than fixed rates, which mitigated the potential effects of higher fixed rates and delayed the slowdown for home buying. But, with multiple rises in the Bank of Canada's "policy rate" (the "Overnight Rate") variable rates are now much higher than they had been (as was illustrated in Figure 1, my opinion-estimate is currently 4.2%). At that interest rate, interest-only affordability is now slightly "less bad", but still really bad, and this can be expected to contribute to further housing market weakness in the coming months.

Earlier this year, low variable rates encouraged a lot of buyers to go with that mortgage option. Those buyers are now finding that their mortgage costs have escalated. The rapid rise in the variable rates isn't going to affect only the housing market – it will cause a lot of real economic hardship for some mortgage borrowers.

The Outlook

Economic forecasts are rarely accurate, even under the best of conditions. In the COVID-19 era, there have been countless, very large surprises, and economic forecasts have been especially non-useful.

Somehow, I managed to anticipate this, and in March 2020, I gave myself permission to stop publishing forecasts. I have tried to avoid making statements about what will happen. Instead, I have talked about possible directions. I now concentrate on thinking about risks – what kinds of surprises might we encounter, and what can we do about those risks to minimize the damages?

There are new risks (which are very hard to anticipate), and old risks (which are a bit less hard to think about). Risks are also two-sided. We tend to give more attention to downside than upside risks, because downside risks can hurt us, while upside risks sometimes surprise us by making us better-off.

Here is an old, downside risk that is often on my mind, especially during the past few months.

During the past decade, I have commented a lot of times that in a modern economy, one of the greatest risks is that a material reduction in house prices could impair the broader economy. The housing market is very influential within the broader economy. A house price drop that is large enough to affect the confidence of a lot of people, can cause house prices and employment to push each other downwards in a “feedback loop”. When that happens, the consequences can be devastating and long-lasting.

This hasn’t happened very often: looking back on my 40 years as a housing market analyst, I can think of three cases where downward spirals have started in housing markets, resulting in a lot of pain, and in each case, there was a lost half-decade for the economy: the US starting in 2007/08, southern Ontario starting in 1990, and BC starting in 1981.

(The opposite can happen, when rising prices interact with the economy in an upward direction, and I’ve seen some examples of this in the past. This kind of an upward feedback loop might have been a contributing factor in the economic strength we’ve seen in the past few years.)

Looking at BC from a distance of 3,000 kilometers, there was another period (about a decade ago) when prices fell, but the drops were not large enough to cause a material economic crisis.

So, I am now alert to a possibility that excessively high interest rates could cause house prices to drop by enough to kick-off a downward economic spiral.

That said, I am not predicting that this will definitely happen, but there is a risk that it might. The longer that interest rates stay too high, the greater the risks will become.

As people in BC know very well, once an avalanche or a landslide starts, there is nothing that can be done to stop it. Once it starts, all that can be done is to survive it, and then get to work on the recovery, through an expensive and heart-breaking clean-up. But there is something that can be done before the avalanche starts: don’t cause an avalanche.

Will Dunning has been analyzing housing markets since 1982. He provides analysis to clients in the private, public, and non-governmental sectors. Services include presentations and briefings, in addition to larger custom research projects. His website is www.wdunning.com.

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