Housing prices in hottest Canadian markets a concern

OTTAWA -- Steep housing price increases in six of Canada's hottest real estate markets since 2002 have all the hallmarks of an "accident waiting to happen" if mortgage rates rise too sharply, warns a new report.

The report by the Centre for Policy Alternatives says smart mortgage rate setting is needed to prevent the bubbles hanging over the housing markets in Vancouver, Edmonton, Calgary, Toronto, Ottawa and Montreal from bursting.

"The hottest six real-estate markets could be in for a correction at best or, at worst, a bubble burst," writes David Macdonald, author of the report. "Rate setters at the big banks are in the driver's seat now as mortgage rates inch up. They need to hit the breaks lightly."

The chief concern is the price increases in those markets are outside the "historic comfort level," which makes them much more susceptible to mortgage rate changes, the report said.

The average, inflation-adjusted house price in the cities has historically held stable at between $150,000 and $220,00 in today's dollars. But the current average price in all six major markets now is over $300,000, it said.

Macdonald says a housing bubble burst has been a rare phenomenon in Canada. Since 1980, it has only happened three times — in Vancouver in 1981 and 1994 and in Toronto in 1989.

"But the steep rise in house prices in so many cities displays all the hallmarks of an accident waiting to happen," Macdonald writes, adding the price increases have exceeded the growth in inflation, household incomes and economic growth.

"Canada is experiencing for the first time in the last 30 years, a synchronized housing bubble across the six largest residential real-estate markets in Canada."

The report traces the trend in large part to low mortgage rates and access to easy credit, which can encourage buyers to purchase homes they might not otherwise be able to afford.

“While housing may be ‘affordable’ based on record low rates, the affordability situation in Canada could change rapidly if mortgage rates return even part way to their historic norms,” the report says.

Macdonald, a research associate with the centre, said in an interview he doesn’t expect mortgage rates to increase much in the near term. His concern is three to five years down the road.

Macdonald called on the big banks and other mortgage lenders to stick to slow, gentle increases to avert the bottom falling out of housing prices.

He also recommended returning to pre-2006 mortgage rules, which required a down payment of 10% and a 25-year mortgage. The current rules call for five per cent down and a 35-year mortgage.

Macdonald says the best scenario would be to have housing prices stagnate over the next five to 10 years while inflation slowly eats away at their value.

The goal should be to get prices back to the “comfort zone” where house prices are in line with inflation, he said, and where owners will neither gain nor lose a lot of money when they sell.