

## The Housing Crisis ~ September 2008



**By Brian Madigan LL.B.**

You might be quite concerned about the present housing crisis. Could it happen in the GTA?

The crisis in the US stock market, and world financial markets occurred because of deflation in the US housing sector. In large measure this was due to the fact that houses were built and sold to consumers who could not afford them. They were financed in no money down transactions. The more that were sold, the more that were built. Vast sections of the US, Florida in particular were overbuilt.

From an economic perspective, there was an over supply. But, you have to remember that the recent purchases were basically give-aways to people who would otherwise not qualify. When the prices declined, they simply walked away. They had no equity, so there was no reason to stay. This threw more houses into the supply side of the equation. The inevitable result: plunging prices. The collateral damage was to the banking industry and those who held the financing on these properties.

So far, with bank failures and bailouts, this will cost the US taxpayer about \$4 trillion dollars. A rescue plan is underway in advance of the US election.

You will also notice that the stock market has dropped about 20% taking it officially into bear market territory. However, you should also be aware of the fact that with any little bit of good news billions of dollars sitting on the sidelines is reinvested. This clearly demonstrates that there is a strong underlying sense of optimism and a significant potential demand.

### **The GTA market**

Canada's banks cannot lend on a first mortgage in excess of 75% of the value of a property without the mortgage being insured. Most mortgages are insured through CMHC. The qualifications for approval have been stringent. A no-money down program introduced earlier this year by CMHC has been cancelled.

However, it was very difficult to qualify for that program when it was in force, and represents only a miniscule percentage of the total mortgage portfolios (less than 1/10 of one percent).

Consequently, the real estate market in the GTA is not subject to the same financial risks. The substantial overbuilding never took place.

### **The Real Estate Cycle**

You need to know that there is a rather clear and predictable pattern and seasonal nature to the real estate market:

In any year, the market will increase from January to May when it will reach its height, then it will decline from June to August, increase slightly in September, and reach its height once again in October. Thereafter, the market will decline for the balance of the year.

This cycle repeats itself year after year.

### **ORES Index**

I set up the ORES Real Estate Index last year. It is like the CPI (consumer price index) in the sense that it is designed to track values over a period of time.

The Index commenced 1 January 2004. All related prices were converted to 100, so everything to be compared would have a common starting point.

When you are looking at house prices for single family homes in the GTA, you will find the following:

123.60.....31 August 2008  
125.36.....31 July 2008  
131.53..... 30 June 2008  
132.11.....31 May 2008  
132.24 .... 30 April 2008  
127.42..... 31 March 2008  
127.86..... 29 February 2008  
125.63..... 31 January 2008  
126.31..... 31 December 2007  
130.76..... 30 November 2007  
130.98..... 31 October 2007  
100.00..... 1 January 2004

This means that the average price for single family homes in the Greater Toronto area has increased 23.60% in 56 months. This works out to 5.06% annually. And, this performance is in the right range, that is about a 5% return measured over 20 year periods of time. In fact, there is over a thousand years of history to support that conclusion. The basic rule of thumb: the value of real estate will double every 20 years.

You will also see that the height of the market was reached in April 2008. And, the market has declined every month thereafter. This is just slightly off the predictable cycle.

### **The Opportunity**

With troubled times comes opportunity. There are excellent values in the stock market for investment. There are also excellent opportunities in real estate market.

Muskoka offers properties right now at substantial discounts, and properties in the Windsor area have declined to 10 year lows. Most of the really good deals are outside of the GTA.

For those following the GTA market, you will just have to try to negotiate something now. The timing is excellent but the pricing will continue to be relatively stable because of the strong demand.

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