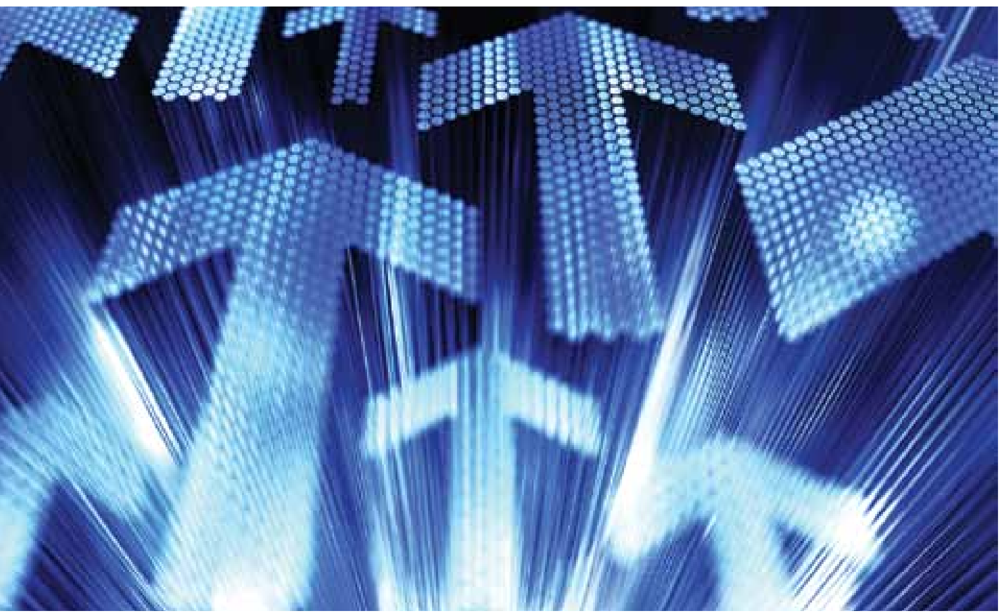
A cat with nine lives

Author and investor *Peter Kinch*, one of the foremost experts in financing real estate portfolios, assesses a challenging 2010 and looks ahead to a year that may offer possibilities



2010 has been a roller-coaster year of emotions for Canadian borrowers; one that has included fear, hype, anxiety and, in some cases, relief. Homebuyers and real estate investors alike entered the year with a sense of anticipation that they had dodged the recession bullet and the perceived loss of equity that the 'Mother of all Recessions' was going to bring about had not actually materialized.

Then there was the fact that Mark Carney and the Bank of Canada, who had lowered rates as low as they could possibly go, stated that he would keep them there until July of 2010. As the real estate market drove into the spring of 2010, it started gaining momentum, fueled by historically low interest rates on one side and a fear that these low rates would be taken away forever on the other. Combine this with the fact that markets in B.C. and Ontario had the pending fear of HST looming on July 1 and the 2010 spring market was one of the busiest on record. The hype around this flurry of activity resulted in the fear of a recession being replaced with the fear of a housing bubble. Headlines in the summer of 2010 now stated that the recovery was unsustainable and that a housing bubble was looming due to lack of affordability.

As we entered the fall and winter of 2010, consumers and investors braced for a drop in prices and a rise in rates, some knowing that either one could be near fatal to their investment dreams. Yet, after raising rates three consecutive times, Mark Carney had to forego plans to continue raising rates and take a pause and like a cat with nine lives, the housing market continued its resiliency and carried on.

While all the talk about bubble markets and the lack of affordability was creating a degree of fear and anxiety in the market, there was one key fundamental that was being under-reported. In order for a bubble in the housing market to burst, it would require a spike in interest rates combined with a spike in unemployment combined with a high percentage of 'low quality mortgages.'

So let's take a look at this:

1 First let's look at what will cause the rates to rise – inflation at or above two per cent. In other words, a strong vibrant economy. The fact is, although we have an incredibly strong and resilient Canadian economy, we are far too reliant on the U.S. and global markets to sustain a full recovery on our own. The combination of ongoing economic issues and the threat of a double-dip recession in the American economy have taken its toll on our own recovery and effectively 'stalled the engine'. Result: inflation to stay below two per cent through the end of 2010 and potentially well into 2011.

Translation: The Bank of Canada will have to put a future rate hike on hold for now. Rates will stay low and the housing market will yet again avoid the anticipated rate hikes that are doomed to make it unaffordable.

2 Canada has had a very strong domestic market and unemployment has not been a significant issue as compared to the U.S. The direct result of this is the fact that when an individual is confident about their employment, they are a confident consumer. Consumer confidence is one of the single biggest driving forces behind major purchases such as housing. Again, combine this with a prolonged period of low rates, and the housing market should easily be sustainable through 2011.

3 One of the most under-reported factors in this conversation is not the quantity of mortgages in Canada but the quality of them. Virtually every argument supporting the 'bubble theory' warns us that we are not impervious to the housing and mortgage issues that have wrecked havoc on the U.S. market. But to suggest that the two markets are the same is simply false. Simply put, the number of U.S. mortgages that were considered 'high risk' – that is, over-leveraged with low income – were four times higher per capita in the U.S. than in Canada. The Canadian banking system had significant checks and balances that did not allow this and, in fact, was one of the only banking systems in the world that did not require a bailout during the credit crisis of 2008-2009. In fact, the Canadian banking system has become the beacon of the world and one to be modeled. As such, we cannot ignore the fact that the quality of our mortgages will be able to sustain a period of higher rates and higher unemployment – even though neither is likely.

We entered 2010 with a sense that the era of low interest rates will end, that we better get in while we still can and that house prices may falter. But as 2010 comes to an end, we find that the feared 'spike in rates' just won't happen. The global economy has faltered and as such stalled our own. The result is that we will go into 2011 much the same as we did 2010 – with the promise of a prolonged period of low rates and a housing market that just won't die.

But remember – the U.S. will eventually have to start printing money to pay off their debt and that is bound to result in inflation at one point, which is bound to result in higher rates at one point. We have dodged the bullet for now, but my question is this: What will you do differently this year to prepare for the inevitability of higher rates in the future? The market has given you another life – use it wisely.

Peter Kinch is an author, speaker, entrepreneur and investor who has been educating Canadian mortgage consumers for over 10 years, and is recognized as one of the foremost Canadian experts in financing real estate portfolios.