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Trouble ahead? Will the US economy impact our real estate market?

The downturn in the US economy has some Metro Vancouver home owners and home buyers worried and asking, "Could it happen here?"

The US situation

Right now in the US, a combination of a housing slowdown and a credit crisis are heightening recession fears and slowing the economy. As a result, the economic downturn is becoming one of the most severe in decades.

It all began in 2003 when home prices were rising at a rate of more than 10 per cent per year, the economy was growing at a good pace, employment was high and the future looked rosy for Americans. Home buyers who couldn't afford high prices in urban centres such as San Francisco looked to other suburbs like Stockton, California, now known as the foreclosure capital of North America with 1.4 billion in bad mortgage loans. In Stockton 4,200 homes are in default or foreclosure and it's far from over.

Depending on the mortgage lender, a home buyer with poor or no credit history could get financing to buy a home. Typically lenders offered "teaser rates" as low as two or three per cent, typically for two to three years, for 100 per cent or even more of the purchase price. These became known as sub-prime mortgage loans.

Often the lender sold these mortgages to investors or investment firms, who re-packaged and resold them.

With strong demand for homes, prices rose to record highs. This resulted in declining affordability. For the first time in decades, this led to slowing demand and, in turn, decreasing prices.

By 2005, home owners with sub-prime mortgages began to see their mortgage rates adjusted to as high as 10 or 11 per cent.

Home price: \$450,000

Mortgage loan: \$450,000 (25-year amortization)

Teaser rate for first two years: 3% Rate after two years: 11%

Monthly payment: \$2,134 Payment jumps to: \$4,411

The ripple effect had begun. As arrears, delinquencies and foreclosures rose, prices further declined. Home owners saw the value of their homes decrease while they scrambled to pay their sky-high payments.

Some buyers chose or were forced to walk away. Lenders foreclosed, depressing prices and delaying the housing recovery. California, Florida and Nevada were hardest hit and housing starts declined in some areas to the lowest in 27 years. In turn, the stock markets dropped.

Measures for recovery

To counter the housing correction, on January 21, 2008, the US Federal Reserve implemented the largest bank rate cut in decades – three-quarters of a percentage point and on January 30, 2008 they cut the rate a further half a per cent.

As well, on January 29, 2008 the US introduced a House Bill, an economic stimulus legislation to jump start the housing market. If passed, interest rates will be temporarily frozen for troubled homeowners or will help them refinance. This will allow an estimated 200,000 homeowners to refinance and potentially keep their homes. It is expected to create half a million jobs by the end of 2008.

Could this happen here?

No. As opposed to the lax lending and easy financing practices of the US, Canada's mortgage lending standards and practices, are rigorous and don't encompass sub-prime loans or loans for more than the amount of the home value.

What is the impact on our real estate market?

The weak US housing market directly impacts demand for our forest products. Canfor has shut down a mill in Fort Nelson and laid off 500 workers.

"The longer US housing starts remain at current low levels, the more likelihood that troubles in the BC forest sector will trickle down to the BC consumer," says BC Real Estate Association Chief Economist, Cameron Muir. "The forest industry is a large component of our economy and includes a broad range of workers and professions from forest workers to truck drivers to accountants."

Overall, Muir is optimistic, explaining that the health of the housing market has a great deal to do with the confidence of those who live, work and raise families in our communities. "We have high employment and rising wages and the economy is growing. Barring any unexpected shocks, home sales should remain strong in 2008."