

# The real estate market in edmonton canada economics essay



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The City of Edmonton has been a shining star performer within Canada's economy. It's GDP has performed as well as the nation average if not better with it's stable employment growth and low unemployment. Real estate prices average \$335, 662 according to CREA June 2010. We will see that rents are in line with sales but are sales affordable?

Part 1: Assess the affordability of the area

1. List two methods for determining the affordability of real estate

If house prices are so high that very few people can actually afford to buy them, then the value will likely fall in the future but how to measure affordability when prices are overvalued? A reasonable measure of value is an area's GDP/capita, as a multiple of house prices per sq. m.

The house price cycle can be viewed as a kind of circle. House prices tend to revolve around a Price to Rent ratio, P/R, range. High Price/R tends to put downward pressure on house prices. If house prices are much higher than the building construction costs, developers are motivated to put up buildings. As supply is renewed into the housing market, pressure is applied on housing stock prices. So when house prices are far larger than new-build costs, it's a likely sign that prices are to come down.

Home buyers do tend to regard houses for owning and not equivalents to rented houses. There are several good reasons why people should pay attention to the valuation parameters.

If rental yield levels are high, this will tend to mean that the interest cost of buying a house is low, compared to the cost of renting a house; the low P/R

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pushing the market higher. Buyers will pay less to borrow from the bank to buy than they pay when renting a house. Comparing to the cost of renting a house, low rental yield levels will tend to mean that the interest cost of buying a house is high.

The gross annual revenue generated by the property divided into the sale price of the property provides a comparable value. Compare that resulting value with other candidate properties. From a buyer's point of view, the lower the GRM, the more undervalued and affordable the property is.

How much an individual buyer can afford will depend on the amount of down payment and their total debt service ratio, which is about 32%. GDS ratio is the gross household monthly income versus housing costs, include monthly mortgage principal and interest, taxes and heating expenses and, if required, 50% condo fees. 1.

2. Is the area currently considered affordable?

Edmonton's GDP per capita was at level with the national average until the early 1990s when it has grown more rapidly than the national average to reach about the midpoint

between Canadian and Alberta GDP per capita. While the GDP has been expanding at a rate almost two times faster than the median income<sup>2</sup>, real estate growth has sprinted. Edmonton's detached bungalows posted the largest year-over-year price increases, rising 6.2 per cent over last year. 3

also applies to Pt2, 2b Comparison

There has been a 27% increase in Edmonton's GDP over the past ten years, compared to Canada's past ten year increase of 14%.

Where the ratio of house prices to GDP/capita is high, it's a fair bet that houses are overvalued.

Pt 2, 1 Affecting price factors

Source: TD Economics topic paper oct 2005 note: 2006-2008 projected figures.

Source: Statistics Canada, CANSIM table 326-0020

Source: REALTORS Association of Edmonton Jun 2010 quarterly stats.

Also applies Pt2, 2b Comparison, Pt 3, 2

Looking comparatively at Edmonton vs. Calgary through 2001, both cities' ratios remained relatively consistent but from that period through 2007 they steadily increased at a rate of around 2 points per year. A reflection of the big run up in prices, but interestingly this trend was very much evident long before prices really exploded in 2006.

As the ratios for both cities fell off to about 4 points in 2008, the effects of the drop off in price reflect the drop off in price while rents continued to go up as evident in the earlier CPI graph. Very evident is the 2005 spike of residential sales led the spike in the 2006 rent increases.

Both these upwards and downward movements display how rents are generally more resistant to movement than prices, in both directions. This

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should not be surprising though as sale prices concern only one-off transactions that take place that month, while rents are determined by ongoing agreements/relationships/leases that can be made months earlier.

Source: CMHC

Pt 1, 2 Affordability

The GDP and Sales/Rent values vs. the median earnings show Edmonton residents are no better off than they were 25 years ago. An obvious conclusion is that homes are not as affordable today as they were then.

Source: StatsCan Income Trends in Canada2

3. Compare home purchase to rental

Typically priced home in the north central area of Edmonton's Rosslyn area, is compared to renting similar home:

## **V121764: Conventional mortgage – 5-year**

04/08/2010

5. 79

Bank of Canada

Here we have two comparable homes, both in the north central area of Edmonton.

The house for rent is comparable in size and its assessed value is \$267, 500 by the City of Edmonton (tax roll 6295364) 2009. A very good value for it's asking rent.

The house for sale \$302, 000

20% down payment \$ 60, 400

Mortgage \$241, 600

Lending rate 5. 79%/5yr/25yr

Mortgage payment \$1, 516

Rent \$850

Monthly cash savings \$666

The rental alternative allows a saving and investment of both the down payment of \$60, 400 and the monthly rental savings, initially at \$666. At the end of the 60 month term the investment will have grown to \$107, 075, assuming the savings rate of 2 % per annum as offered by ING.

The balance owing on the mortgage at term's end will be \$216, 378. The overall difference between buying and renting over the initial 5 year term will be 21, 452 from the original home equity. This would require a home appreciation of 7. 1%.

Generally, renting is less than the cost of buying as renters do not usually have the initial down payment. If they require saving the down payment, this would add slightly more than \$1, 000 to their monthly savings requirement.

Below is an image taken from the New York Times web site. With a few differing variables, it shows home ownership is favourable in the long run based on a 30 year mortgage.

Source: <http://www.nytimes.com/interactive/business/buy-rent-calculator.html>

Pt. 1, 3; Costs affecting renting and owning Pt 2, 1 Affecting price factors

Many factors play into the parameters of what makes a property affordable, both tangible and not.

Housing near public transportation hubs, hospitals and universities, ex U of A, provides added competition between rental and owner occupied units. The value of being closer to places of work, education and public transportation is translated into the price of the property. This of course makes it favourable for those without personal transportation which, in turn, also offers some form of savings in vehicle purchase and maintenance expense. This is favourable to high density locations which often surround such locations.

Following are some considerations to owning and renting:

## BUYING

Positive:

Flexibility of payment choice

Builds equity

Personalize property

Sense of stability and security

Community is more accepting

Capital gains exemption – resident owner

Tax deductions – landlord

Negative:

Property/school taxes/insurance

Risk of equity loss

Risk of costly maintenance

Less mobility

RENTING

Negative:

No control of rent increase

No equity build-up



Can not personalize structure or landscape

Possibility of eviction

No favourable tax treatment

Positive:

No tax obligations

May invest the difference more favourably

Landlord responsible for most repairs

Easy to relocate as needs change

The issue of personal financial stability is probably the most crucial pivot in the decision to become either a buyer or renter. Stability in life and in the market, which translates towards financial favour of purchase, leads one to be a buyer or renter.

Part 2: Comparing the fundamentals to the Prices

Source: Edmoton Real Estate Board, Statscan

1. Collect, graph research market shifts

2. Influential factors to shift graphs

The dramatic rise in commodity prices that took place between 2002 and mid-2008 had a profound effect on the Canadian Real Estate.

2004 – falling long term rates set the stage for a commodity boom. The \$US/\$CDN dollar hit a low of 15% change<sup>6</sup>

2004 – the 10yr less 2yr bond yield curve narrowed to inversion fuelling a 3-4 year buying spree

2006 – Amortizations extended to 35 years and interest only payments allowed for up to 10 years. This led to an increase in financing.

2007 – the Alberta real estate market stalled and began to sell off. Bank of Canada slashed its rates as the markets cooled, ending a five year bull run on real estate.

Affordability was beginning to be a constraining factor on first-time buyer activity. The buy-versus-rent premium, the difference between a typical mortgage payment and a typical rental rate, approaches or exceeds \$500. Edmonton homeowners carried the 6th largest average mortgage payments \$1398 in the country. <sup>7</sup>

2007 – Volatility in financial markets creates another level of uncertainty on the housing market. Weaker US growth spurs Bank of Canada to drop rates 4.75% to 0.5% over 17 months which ignites a continuation rally out of the February 2008 low.

2010 – 2 yr bond jumped 24 bps and the 5 yr mortgage rate surged 40 bps. Alberta resource investment and production flow into the manufacturing and service industries, providing optimistic growth while housing prices are expected to cool, as reported by the ScotiaBank Group's Provincial Trends

June 2010 report.

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Source: [http://www.chpc.biz/Yield\\_Curve\\_Chart.htm](http://www.chpc.biz/Yield_Curve_Chart.htm)

also applies to Pt3, 1

The booming economy requires immigrants from other provinces and the favourable mortgage conditions make a comparable supply and oxygen to supply Edmonton's real estate surge. The difference is very apparent in the chart comparing the CPI index and the price of new homes. As property is not as mobile as other goods, we see the beginning of the rise of values. For Edmonton's economy overall, this is not a bad thing as people who delay buying and therefore choose to rent will have more surplus disposable income to spend on retail goods. This is indicated in the Residential Sales v. Disposable Income chart. House prices will balance with available stock and the cycle will repeat itself.

Source: CMHC, Statscan

Source: CMHC, Edmonton Economic Development Corp

When comparing two bedroom townhouses against the average selling price, it is apparent that rental prices are beginning to surge ahead. As interest rates begin to rise, this could provide a change in direction for house prices as rental costs outpace carrying costs and more tenants consider their options of either a home purchase or a move.

Source: Boardwalk Rentals, EREB

Part 3: Analyzing data

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## 1, 2 . Fundamental factors; comparisons

As the main benefactor of energy development, the graphs reflect the economic success of Edmonton and the recent real estate boom. Observing the selling values, it appears that the market is cooling off. Although, with income and rents not slowing down, the labour force characteristics may hold the market steady to avoid any sharp decline. Housing prices were up more than previous year. Despite mortgage rate increases throughout the last few months the banks have slightly reversed rates which ensure they not out of reach of most home buyers.

## 3. Analyse news articles; type of buyers

Following in the Appendix are the release of an article by two real estate agents who paint a positive picture of Edmonton's real estate market. Not such a difficult job even with the present day slump being experienced. It's noted that Condo buyers are still supporting the market in comparison but price drops are only subtle when compared to past performance. Many of the indicators are with regard to decline in listings of sales, which as a real estate agent one wants to let the public know with less houses on the market that they are still performing. A more positive indicator would be the performance of the economy which supports the full recovery of the real estate market and this is just a more opportune time for buyers as opposed to sellers. After all, an agent needs both to make a commission.

The second article chosen is from the City of Edmonton which announces a \$4 million dollar investment in low income housing to correct the market

failure of providing to this group. This is also significant not only to the <https://assignbuster.com/the-real-estate-market-in-edmonton-canada-economics-essay/>

additional supply of stock it brings to market, which helps to drive down prices but the timing to support the construction industry when new homes sales are stalling. This is a good timing to take advantage of the natural pause of real estate and help it to stall out and take stalk of values.

The third and last article included as a topic of media discussion also speaks of the drop of property prices but also focuses a bit more on the rise of rents as landlords prepare to take advantage of inertia of established rent levels and home owners who either wait to list their homes or hold out for higher than market supported prices. The writer concludes on the positive outlook of Edmonton's economy and how, in effect, people will have money to spend on consumer goods to keep the economy progressing ahead.

These three articles collectively speak of the real estate cycle and how the affect of surplus stock has affected rents and cooled the construction industry, if only long enough for everyone to catch their breath to find more workers. With a skilled labour shortage in several sectors and the surging rental prices, Edmonton's position as one of the most affordable housing markets in Canada could be eroding. This only highlights the need of government intervention with housing projects.

#### 4. Type of active buyer to this market

The present market conditions may be developing well for home buyers and investors who are looking to take advantage of any lull in the home sales market to find a motivated seller. The market is still affordable but only if you have to live there.