Clarke Wealth Management's
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Wealth Management
Dominion Securities

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While certain aspects of Canada's housing market bear watching, calls from some corners for a hard landing seem overdone. The country's housing market is diverse and defined by more than just Toronto and Vancouver. RBC Economics' senior economist surveys the landscape and explains why he sees little basis for concerns of a broad-based collapse.

Clarke Wealth Management

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Q. Some commentators seem to think there is a Canadian "housing bubble" that is ripe for collapse. Where does RBC Economics stand in the "hard versus soft landing" debate?

A. Talking about a "Canadian housing market is an oversimplification that masks varied and unique circumstances across regional markets. Worries of a bubble are typically directed at Vancouver and Toronto – Canada's hottest markets. For the most part, other markets continue to be in balance and raise little concern. In Vancouver and Toronto, land restrictions-either set geography or policy-have skewed the supply of new housing over the past many years towards higher-density forms, such as condos, while demand for single-detached homes remains strong in both markets. So we are witnessing the law of demand and supply in action: not enough single-detached homes for sale to satisfy demand leads to escalating prices while plentiful supply of condos leads to more moderate price increases.

Does this mean that there isn't any localized bubble in Canada? With single family home prices running 27% above year-ago levels in Vancouver, it would be imprudent to dismiss the possibility that some buyers in some neighbourhoods are getting carried away. But our point is that from a broad perspective, unless interest rates spike or unemployment surges in Canada, we don't see the basis for a Canada-wide hard landing in the near term.

Q. Some people worry that home ownership has become unrealistic for today's younger generation in light of deteriorating affordability in certain urban markets. Is this a valid concern?

A. The concern in question really is about housing affordability (or rather the lack thereof) in Canada's two highest-priced markets-Vancouver and Toronto. No doubt that the very high bar to become an owner of a single-detached home in Vancouver and Toronto can be a deterrent for some people to move to or stay in either market.

However, we would argue that the risk to a region's economy has more to do with a broader definition of housing affordability

However, we would argue that the risk to a region's economy has more to do with a broader definition of housing affordability that encompasses ownership of other forms of housing as well as rental options. The fact is that, while not exactly cheap, other housing alternatives in both Vancouver and Toronto remain affordable for most. Facein much higher hurdles to own a sing detached home doesn't necessarily mean that the younger generation will skip town. It might just require a change in expectations on their part.

Q. Many comparisons have been made concerning rising household debt levels and home prices here in Canada relative to those in the U.S. in the period leading up to the financial crisis. Can you speak to any relevance you see in that comparison?

A. It is true that the debt-to-income ratio is at a record high in Canada, although when comparing on an apples-to-apples basis it is not quite as high as the U.S. ratio was at its peak in 2007 just prior to the financial crisis. Moreover, the debt-to-income ratio is not a very useful measure of the health of the household sector because it ignores the effect of interest rates.

A better measure to look at is the bet-service ratio, which compares the cost of carrying edebt (principal and interests) in any given year to income in the same year. This ratio has been quite stable in Canada since 2010 thanks to low and declining interest rates.

Despite its shortcomings, the debt-to-income ratio is a gauge of vulnerability for the household sector and therefore cannot be totally ignored. It points to significant risks should adverse conditions similar to those in the U.S. in 2008-09 develop.

Q. Interest rates are a key factor in determining housing affordability. Can you speak to the market's ability to adjust to higher interest rates in the near term?

A. Overnight interest rates in Canada are currently at historical lows and prospects are for only a modest rise in rates starting next year. As rates move higher, we will likely see affordability becoming more challenged. Given the current slow growth, low inflation environment around the globe as well as in Canada, a significant spike in interest rates looks unlikely. A gradual rise in interest rates would be manageable for housing given the low starting point, the predominance of fixed-rate mortgages, prudence in qualifying mortgage holders and an expected firm labour market.

Q. The subject of foreign investment in the Canadian housing market has received considerable attention. How do you think about the impact of international investment on housing prices and its potential to act as a destabilizing force?

A. Indeed, this is a topic receiving a lot of attention but for which we have few hard facts. To be sure, there is plenty of anecdotal evidence of buyers coming from abroad in pockets of the Vancouver and, to a lesser extent, Toronto markets. Until we are able to quantify this phenomenon, it is difficult to gauge the extent to which these buyers contribute to price increases. We must keep in mind that both Vancouver and Toronto are economically vibrant migration magnets, and that is a good thing. The rise in home prices resulting from "foreign" capital in-flows cuts both ways: while it may raise the ownership bar for local buyers it also boosts the housing asset value for many current owners.

Q. As you point out, escalating prices in the country's most expensive markets-Vancouver and Toronto-have garnered much of the headlines. If I live outside of those markets, would a correction in the Vancouver and/or Toronto market impact me?

A. In our opinion, a 15% -20% correction in housing prices in Vancouver and/or Toronto would pose little risk for other markets across Canada. In fact, policymakers could well view this as a desirable outcome. If we are dealing with some form of collapse (say, 30%-50% decline) then the main risks for markets across Canada lie with the institutional and regulatory responses. Such a scenario could trigger measures that ultimately restrain mortgage credit from coast to coast and therefore, negatively impact markets that would be sound otherwise.

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The Importance of your Will

A valid Will is an important document that all adults should be encouraged to maintain throughout their lifetime. Unfortunately, while the need for this document is widely accepted, its creation is commonly overlooked. Your will should be prepared within the context of an overall estate plan. This may include alternate methods of passing assets to your beneficiaries, for example by designating a beneficiary on a registered plan or holding assets in joint names with a right of survivorship. An estate plan can help ensure that all elements of your current situation are addressed and your estate objectives are met.

What happens to the estate if you do not have a will or the will is considered invalid

If you die without a valid Will or if your Will cannot be located, you are considered to have died "intestate." Similarly, if you do not dispose of all your assets in your Will or by alternate methods you are considered to have died "partially intestate." In either case, your estate is to be administered under the provincial or territorial intestate succession legislation for the province or territory where you live.

All provinces and territories have laws that govern the distribution of your property if you die without a Will. If you die leaving surviving family members, no matter how distant the relationship, your assets will be divided among those family members who are most closely relate to you.

In the unlikely event that you do not leave a Will and have no living relatives those assets that would have been distributed according to the terms of the Will go to the province or territory in which you lived. This is referred to as property that is "escheated" to the government.

Estate assets that pass to beneficiaries who have not reached the age of majority may be held in trust by the court until the minor reaches the age of majority or until the minor's guardian is granted custody of the assets.

Administration of the Estate

If you leave a will you have the opportunity to appoint an executor to administer your assets. If you do not leave a valid Will, the court must appoint someone (commonly referred to as an "administrator") to manage your affairs after your death. There is no one with authority to act on behalf of your estate until this appointment has been made. When an administrator has been appointed, that person performs duties similar to those of an executor appointed under a Will.

The administrator will pay your debts and testamentary expenses from your assets and then distribute the rest of your estate in accordance with the laws of the province or territory where you lived.

Rules of Distribution of the Estate

There is a common belief that your spouse will inherit everything upon your death if you die without a Will. In most provinces or territories, if you die leaving a spouse and children, your spouse will receive a preferential share of the estate. The definition of spouse for intestacy purposes varies from province to province. However, in British Columbia "spouse" includes common-law partners of the same or opposite sex. Most provinces and territories initial provide the spouse with a "preferential share" – a predetermined amount of the deceased's assets that is awarded to the spouse. If your estate is greater than the preferential share, the balance is then divided between your spouse and children. In B.C. the spouse's preferential share of the estate is $65,000.

Please contact us for further information on Will & Estate planning.

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