



## **INFLATION, CREDIT CRUNCH, NEW RULES, GLOBAL FOOD CRISIS AND AN OLYMPIC MEDAL DROUGHT...**

Geez, you'd almost be excused for having a negative outlook these days if you spend your time reading the headlines. I was driving my 9 year old son to the ice rink this morning – yes the ice rink in August for summer hockey camp (this might explain our country's weak performance in the current Olympics), when suddenly from the back seat he asks, "Dad, is this the 'Dog Days' of summer?"

Well, some real estate investors may be feeling that way right now, given the doom and gloom that is being touted in most headlines you read these days. But the truth is there is no need for anyone in the Canadian mortgage market to panic. In fact, if anything, it's time for a little perspective.

Real estate, when bought for investment purposes or home ownership, should be thought of as a long-term investment. As such, fluctuations in the value of your asset have no real, tangible meaning to you until the day you sell or refinance. We all know that nothing goes up in a straight line forever – be it stocks or real estate. We also know that we're not supposed to measure every peak and valley, but rather buy for the long-term and measure peak to peak growth over a number of years. As such, it should be considered completely normal that after years of unprecedented growth, we are now moving into a period of 'normalization' in the markets. Be it Vancouver, Edmonton, Calgary or Saskatoon, there is no way that the markets could sustain 20%+ growth year over year. Think about it – if your property went up by 50% over the past two years and drops by 3% this year – that's a 47% increase over 3 years! If you offered me that 3 years ago, I'd take it in a heartbeat. Yet, read the headlines (or some of the emails we get) and you'd think the sky is falling.

Yes, your property values across the board (with a few exceptions) will drop if they haven't already and yes, we are experiencing the fallout from the US Sub Prime/Global Credit Crisis and yes, Federal Banks around the world are extremely concerned about the US recession and rising inflation. But again, this is more a time for perspective than panic. The simple fact is, if you are a sophisticated real estate investor you cannot afford to buy real estate using one universal set of rules that never change. You have to keep abreast of the changing market conditions and adjust your strategy accordingly.

Six months ago, I was recommending that all my clients take a front-end loaded variable – it made sense when Prime was on a downward slide and the Bond rates were expected to go lower. Today, Prime has flattened and is poised to go up – it's simply a matter of not if, but when and by how much. So now might be a good time to look at locking in. The Bank of Canada (BOC) has made it very clear that it will shift its focus to inflation, especially given the impact of the cost of oil and increasing food prices. As such, we know rates will go up. But that does not mean that we are going to have a repeat of 1982 when rates were as high as 22%. In fact, consumers have an ace up their sleeve – the Canadian dollar. Again, the BOC finds itself in between a rock and a hard place. In an effort to control inflation they feel the need to raise rates, but if in the process of raising rates, the Canadian dollar goes up, they will negatively impact the national economy – especially in Ontario and Quebec (not that the Federal government has any concerns over the number of votes in those Provinces...). So, as much as the BOC may voice concerns over inflation, they will find that as long as the Greenback down

South is impacted by recessionary issues, they will have to walk a thin line between controlling inflation and keeping the Canadian dollar in check.

Bottom line – look for moderate rate increases over the course of 2009. Should you lock in your rate? Well, mathematically, Prime would have to go up by more than 1.5% over the next year and a half in order for a fixed rate to be a better choice. Is that possible? Of course it is. Is it likely? Probably not – so again, it comes down to comfort zone. There is no right or wrong answer – but remember, even today's long-term rates are historically low, so no one would question your logic for locking into a long-term rate today given the market uncertainty in today's changing world.

### **OTTAWA ANNOUNCES CHANGES TO THE MORTGAGE RULES:**

Speaking of the need for perspective, there has been a lot of fuss over the rule changes that Ottawa announced at the beginning of the summer so let's address this.

First of all, the fact that the Federal Government came out and used the US Sub Prime crisis as the reasoning behind their decision making is more political grandstanding than anything. There is absolutely no way you can compare the Canadian mortgage market to that of the US.

Ottawa decided to go after 2 rules in particular. One was the 40 year amortization and the second was zero down mortgages. Let's look at each of these.

#### **40 Year Amortizations:**

The argument that the Canadian Government is protecting us by limiting the length of the amortization from 40 years to 35 is, in my opinion, hogwash (sorry, that's the only technical description I could come up with in print). There is no way that extending an amortization on your mortgage to 40 years is equivalent to the irresponsible lending/borrowing habits that precipitated the colossal meltdown of the US sub prime market. To draw any correlation between the two is ridiculous.

The other argument was that extending the length of the mortgage over 40 years was adding a significant cost to the borrower – well yes, this is true – If the borrower actually takes 40 years to pay off their mortgage. However, last time I looked, the average term that homebuyers take is 5 years, which means they will be renewing that mortgage within 5 years. In fact, the average length of a mortgage in Canada is only 3.5 years before it is renewed.

Ideally, clients will take the 40 year amortization to either assist with qualifying for a mortgage, ease the pain of getting into a new home, or (in the case of investors) increase cash flow in the early years of borrowing. I believe that virtually all borrowers are aware that taking this option will increase the cost of borrowing over the course of 40 years, but given the fact that they will likely be renewing their mortgage once every 5 years – at which time they can adjust the amortization, what are the odds that anyone will take the entire 40 years to pay off their mortgage?

Having said all that, again it is time for perspective. As much as I think there is no foundation in the change to the 40 year amortization rule, keep in mind that the concept of having a 40 year amortized mortgage is barely

a year old. If you go back 18 months, your best option in the market was a 25 year amortization. Fast forward 18 months and now you can get 35 years. So if you forget the fact that you had the 40 year option for a short while, you have much better options today than you did a year ago.

### **Zero Down Option:**

Now, unlike the 40 year amortization, this is a change that I agree with. If there is one area that lenders and borrowers can be over-exposed to market corrections – this is it. If you paid full market value for a property a year ago in certain markets with zero down, then it is quite likely that the amount you owe on your mortgage today is more than the current value of your home – especially if that property was a rental with a 7% insurance premium tacked onto the original mortgage. This has always been an area that I am not a fan of. If you're a first-time homebuyer it makes sense to get into home ownership if you can create equity over time at a cost that is equal to or better than renting. So the fact that Ottawa has tightened the rules for the minimum down payment is a good thing. But again, this is nothing for you – the mortgage client, to be concerned about. Part of your goal is to create equity anyways, so having to put 5% down should have a negligible impact on your future purchasing power.

### **The Bottom Line:**

Don't get caught up in all the negative news and stay focused on the fundamentals. If you own a property that has gone down in value, be thankful you'll pay less in real estate taxes this year. If you're shopping for properties this year, be thankful that real estate is 'On Sale' and you don't have to worry about multiple offers with no conditions... and if you are a real estate investor and, like some people I've spoken to, finding yourself in the 'dog days of summer' thinking that 'geez, this isn't as easy as it was last year, or wow, I didn't realize the work that was involved in building a real estate portfolio.' My advice to you is to take some time to turn on the TV, watch some of the Olympics and ask yourself; 'In striving for a Gold medal, was it always easy for these athletes? How much have they sacrificed? What kept them focused?'

What's your Gold Medal? What keeps you focused?

Keep your eye on the goal and above all else, keep perspective.

Until next time, Happy Investing,

Peter Kinch