The nesto-meter

December 2020

nesto
mortgage agency

December 14th, 2020

November isn't generally known to be a busy period for the mortgage industry, yet, according to the Toronto Real Estate Board (TREB), the number of home sales in the Toronto area has increased by 24.3% in the month of November 2020 compared to the same period last year! With a busy summer and an even busier fall season for both brokers and lenders, it seems pretty fair to admit that COVID-19 has shifted our users' general habits as well as the overall market seasonality in terms of homebuying, at least, for 2020.

Amongst the highlights this month, rate volatility remained pretty low, following October's trend. The rates kept going down, with the best fixed rate being temporarily lower than our best variable rate for the first time since nesto's inception(and most mortgage professionals careers). On the other hand, home prices have never been this high across Canada, and we are observing a switch in our users behavior, from "ready to buy" just a month ago to now "just looking".

In this December issue, you will find updated data on our 4 key monthly metrics: Rates volatility and variance, mortgage type trends, purchase price vs down payment and purchase timing intent.

As this particular year (to put it mildly) is coming to an end, we decided to look a bit deeper into a new subject: The effect of the increased property values and their projected property taxes influence on the pre-approval process for actual buyers. For this last report of 2020, we also followed up on two of our most interesting topics: Approval delays in Quebec and short-term buying in Canada

KEY TAKEAWAYS

With only 2 best rate changes in the whole month, mortgage rates seem to have gained in stability.

For the first time since nesto's inception, our best fixed rate was lower than our best variable, by .01%

In November, refinances remained popular

After remaining stable for months, both the targeted purchase price and the planned down payment dropped significantly in November

In Quebec, a lot more of our users are now "just looking" instead of "ready to buy"

Buyers are pre-approved for a bit less than they can actually afford as a result of calculating property taxes at default values based on a % of the property value as property value increases greatly outpace municipal tax updates.

#1

RATES

A. Volatility

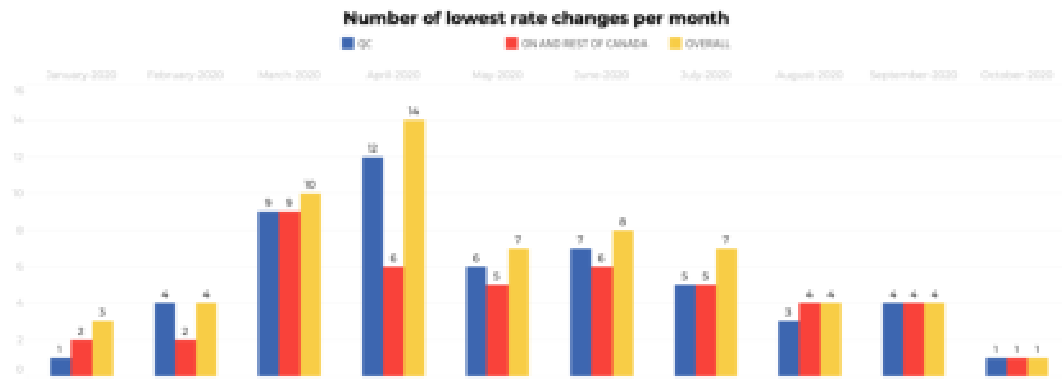

Fig. 1: Number of times the lowest rates offered by nesto to its users changed per month across provinces between January 1st and December 1st, 2020. Lowest rates looked at were fixed and variable insured (5-19.99% down payment) as well as fixed and variable insurable (20%+ down payment) and corresponds to the lowest rate nesto could offer its clients at the time.

Looking at our lowest rates for both insured (5-19.99% down payment) and insurable (20%+ down payment) mortgages, both 5-year fixed and variable, from January to November 2020, we counted a total of 64 rate changes, for an average of 5.82 rate changes per month.

As October previously recorded the least amount of volatility seen so far in 2020, November, with only 2 best rate changes in the whole month, followed the same trend. Compared to the beginning of the year, mortgage rates, despite being very low, seem to have stabilized.

Volatility - by type

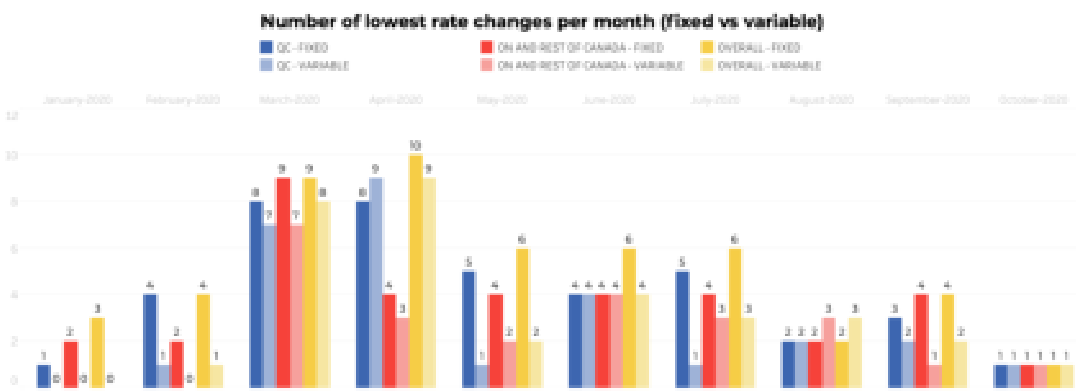

Fig. 2: Number of times the lowest rates offered by nesto to its users changed per month across provinces between January 1st and December 1st, 2020 and comparing fixed to variable rates. Lowest rates looked at were fixed and variable insured (5-19.99% down payment) as well as fixed and variable insurable (20%+ down payment).

Looking at this rate volatility by type, we notice that our best fixed rates were the ones fluctuating again this month. While all provinces saw 2 changes to our best rates, Quebec only saw one. This is attributed to the fact that there are fewer lenders in Quebec, therefore, lower competition and fewer chances to see fixed rates fluctuating.

Looking back to 2018 and 2019, we would see end-of-the-year specials at this time of the season from one or multiple lenders. However, likely related to currently record low rates and the fact that 2020 was a unique, difficult and exhausting year for many in the industry, we have not seen any of our lending partners produce a similar newsworthy special, yet. HSBC on the other hand has likely already hit your newsfeed with their .99% 5 year variable rate special. Apart from the multiple hour phone waiting list to speak with someone from HSBC to see if you are a part of the small group of qualifying borrowers, this offer appears to be as good as it sounds, but we will keep you posted!

B. Variance: Lowest rates

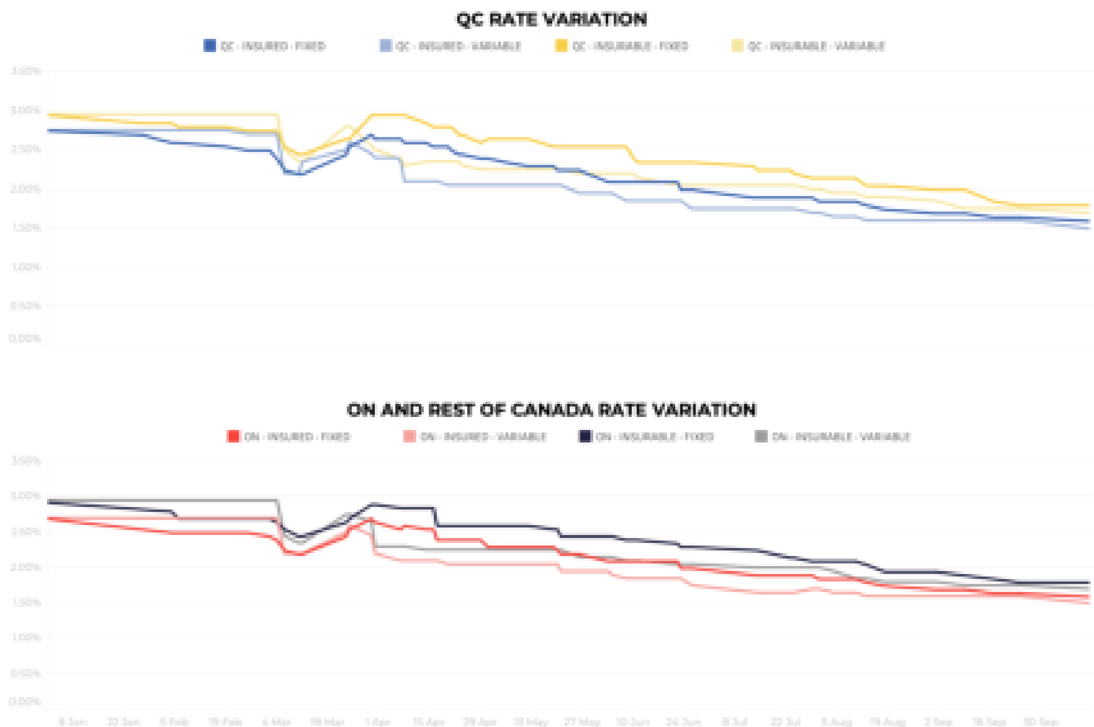

Fig. 3: These graphs show the rate variance from January 1st to December 1st 2020 in Quebec compared to Ontario and the rest of Canada.

So, our best rates have changed 64 times since January 2020 but, by how much?

According to this graph, the highest insurable variable rate was at 2.75% while the lowest was at 1.50%, a 1.25% difference. We also noticed that fixed and variable rates for the same category (insured or insurable) remain quite close again in November, with only a 0.04-0.09% difference between them currently. Noteworthy about this spread is that often, a borrower would choose a variable rate primarily for the mortgage freedom associated with the smaller break penalty compared to a fixed rate, with the historically lower variable rate being icing on the top of the reduced penalty exposure. But with the rates so close together, one can no longer add “immediate interest savings” to the Pro’s column of selecting a variable rate. Most of our borrowers choosing a variable rate today are doing so with the assumption that there is a fair chance that they will need to break their mortgage within 5 years, or that the Bank of Canada(BoC) will not make them regret it when they(BoC) look to increase the rates back to pre-pandemic levels.

Differences between highest and lowest rate in 2020

$350k property
10% down payment
25 year amortization
5 year term

	Lowest rate	Highest rate	Difference
Rate	1.50%	2.75%	-1.25%
Monthly payment	$1,298.00	$1,469.00	-$171.00
Total payments	$77,888.00	$89,735.00	-$11,847.00
Total interest paid	$22,263.00	$41,215.00	-$18,952.00
Total principal paid	$55,626.00	$48,519.00	$7,107.00
Money saved	$11,847.00		
Balance remaining	**$269,139.00**	**$276,246.00**	**-$7,107.00**

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Table 1: This table represents the effect of a 1.25% rate difference on a 350k home, with 10% down payment and a 25 year amortization after a 5 year term.

This table represents the effect of a 1.25% rate difference on a 350k home, with 10% down payment and a 25 year amortisation after a 5 year term. So let's say you decided to sign a mortgage at 2.75%, the highest variable rate we offered this year. Over 5 years, this 1.25% rate difference would end up costing you 18,952$ when you consider interest expense and money leaving your pockets!
That's huge!

#2

MORTGAGE TYPE TRENDS

Purchase vs Renewal

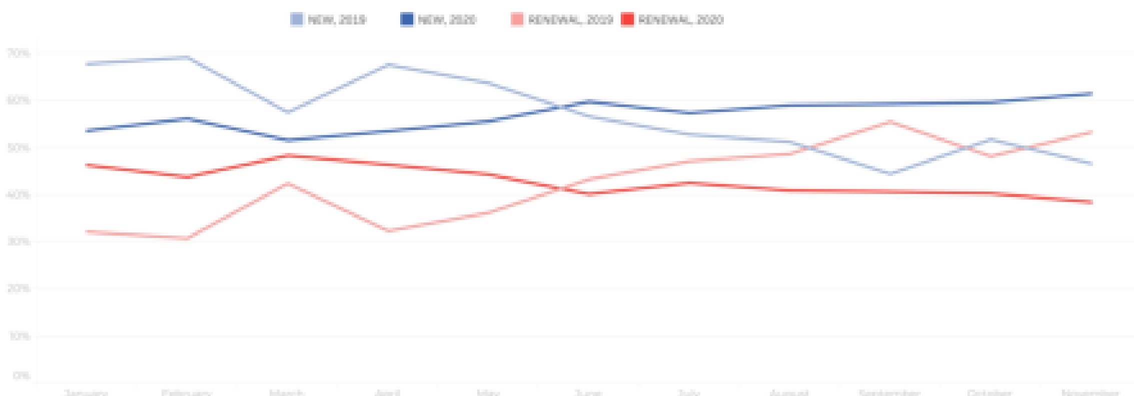

Fig. 4: Trends for proportion of purchases (new mortgages) vs renewals from January 1st to December 1st, 2020 vs 2019. Sum is 100% for each month.

Focusing on purchases vs renewals year over year, we notice two very different trends. From August to November 2019, our users kept switching behaviors, from purchase to renewal, almost every month and always trending closer to the 50% mark, while for the same period this year, the tendency is pretty clear and steady. From July 2020 to now, we've seen more new mortgages, and fewer renewals.

We have yet to determine whether or not this renewal data illustrates that borrowers have less time, or are less interested in shopping around for a better mortgage renewal option, or if they are less able to, as a result of the pandemic's impact on their finances. We do know however, that the market has not yet satisfied all of the would-be buyers out there as we are still in a sellers market in most of Canada.

Purchase vs Renewal vs Refinance

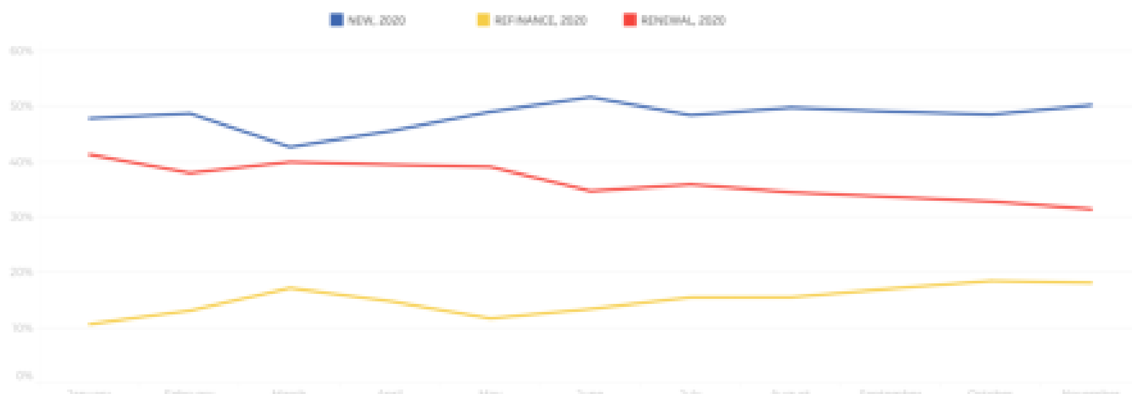

Fig. 5: Trends for proportion of purchases (new mortgages) vs renewals vs refinances from January 1st to December 1st, 2020. Sum is 100% for each month.

Looking at the proportion of new mortgages vs renewals and refinances, the trend we saw last month is still holding steady in November, meaning refinances are taking up more and more of nesto's user requests.

This could mean many things, including but not limited to: financing to renovate the place in which our users spent more time than ever this year (ie: home), consolidating higher interest rate debt into low rate mortgage debt, withdrawing equity to invest in other attractive markets or simply to extend the amortization for cash-flow improvements. In the cases where the borrower just wants to take advantage of today's low rates with no extension of the amortization period or equity withdrawal, a borrower can often simply "early renew" by changing lenders and paying a penalty to the existing lender. An early renewal provides the borrower access to the record low rates you see online that are not available for a "refinance" transaction.

#3

PURCHASE TIMING INTENT

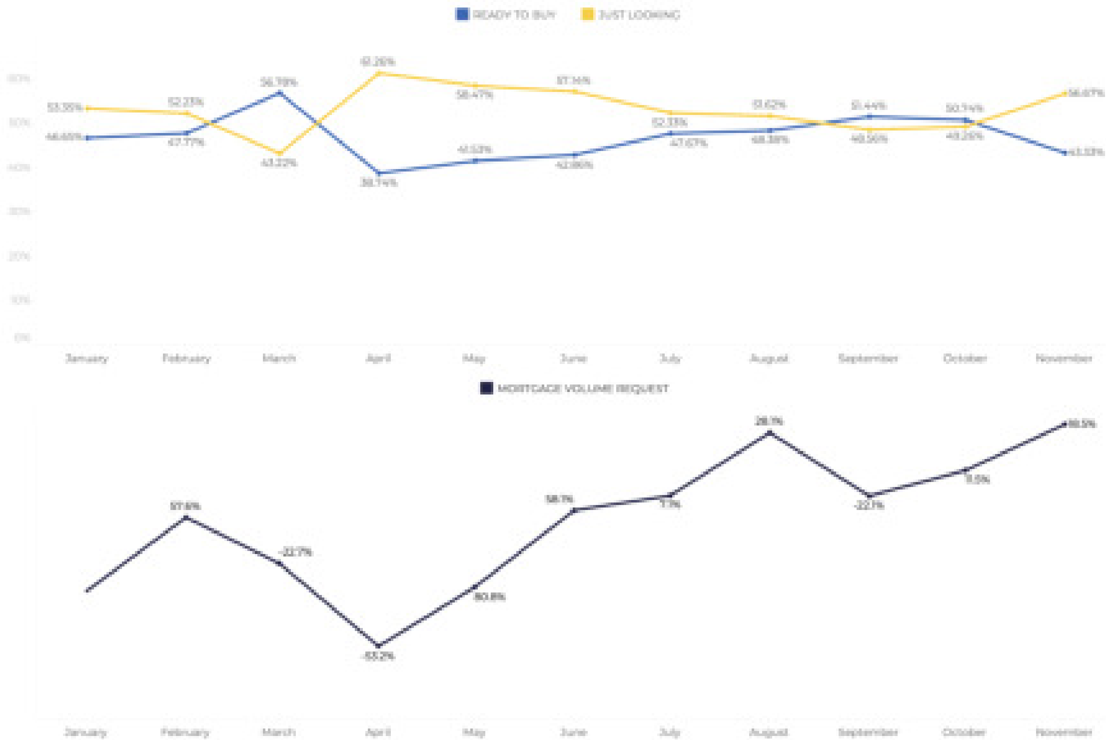

Fig. 6: Purchase intent: proportion of users "ready to buy" vs "just looking" in nesto's mortgage process, showing month by month from January 1st to December 1st, 2020.

While last month's data showed us an almost equal proportion of our users being "ready to buy" and "just looking" (after a sharp increase of active transactions since April 2020), in November, we see far more people just looking than being actively ready to purchase a property. Some might say it was to be expected with seasonality, but since this year is so exceptionally different from others, it is hard to identify and confidently understand the influences of these patterns.

Interesting fact: Despite a slight decrease in live transactions in November, there was an 18% increase in overall requests, showing potential homebuyer's curiosity and strong interest for low rates.

By Province

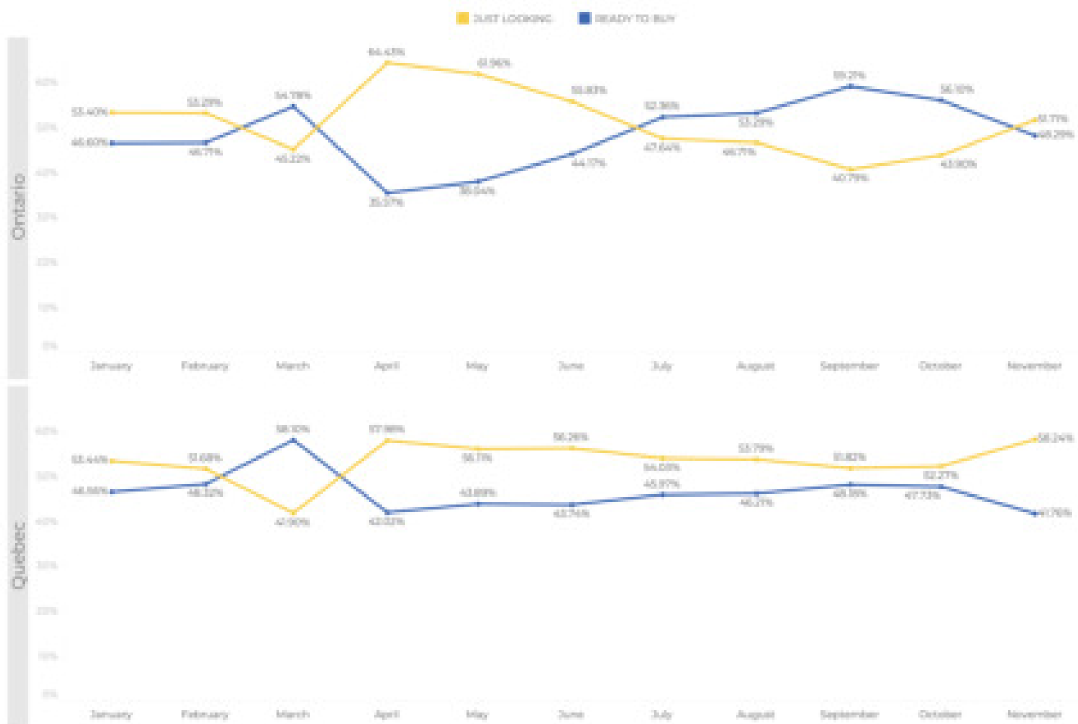

Fig. 7: Purchase timing intent proportion of users “ready to buy” vs “just looking” in nesto’s mortgage process, from January 1st to December 1st 2020 in Quebec and Ontario. Highlighted is the first lockdown period, from end of March to June 2020.

Comparing our data by province, Ontario is following the same trend we noticed in our overall data for November : More users “just looking”, with less “ready to buy”. The difference between the two is marked by a small 3%.

In Quebec however, the same trend is strongly marked, with 42% of our users “ready to buy” against 58% that are “just looking”. A noteworthy 6% decrease in the % of users “ready to buy” since October that will be keeping our eyes on.

#4

Property value and down payment

Property value and down payment - pre, during and post-lockdown

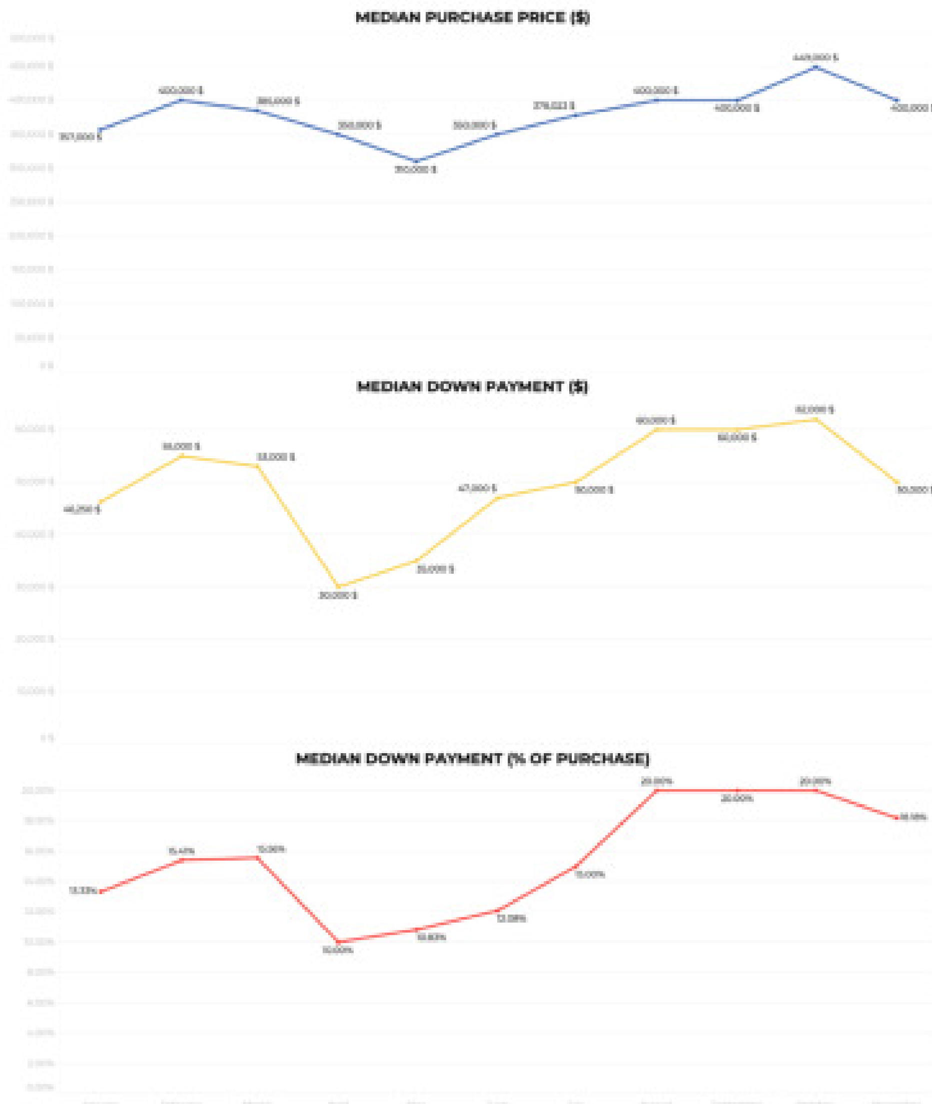

Fig. 8: Graph of intended purchase price vs down payment (in dollars and percentage) from January 1st to December 1st 2020. Highlighted is the first lockdown period, from end of March to June 2020.

After remaining exactly the same for 2 months in a row back in August and September, the median amounts for both the projected property value and down payment all increased in the month of October. Then, most recently, in November, the same amounts dropped again, our median purchase price going from 449,000$ back to 400,000$ and our median down payment amount, down from 62,000$ to 50,000$. Following the same downward trend, the median down payment percentage lowered by 2%, down to 18% of the purchase price.

By province

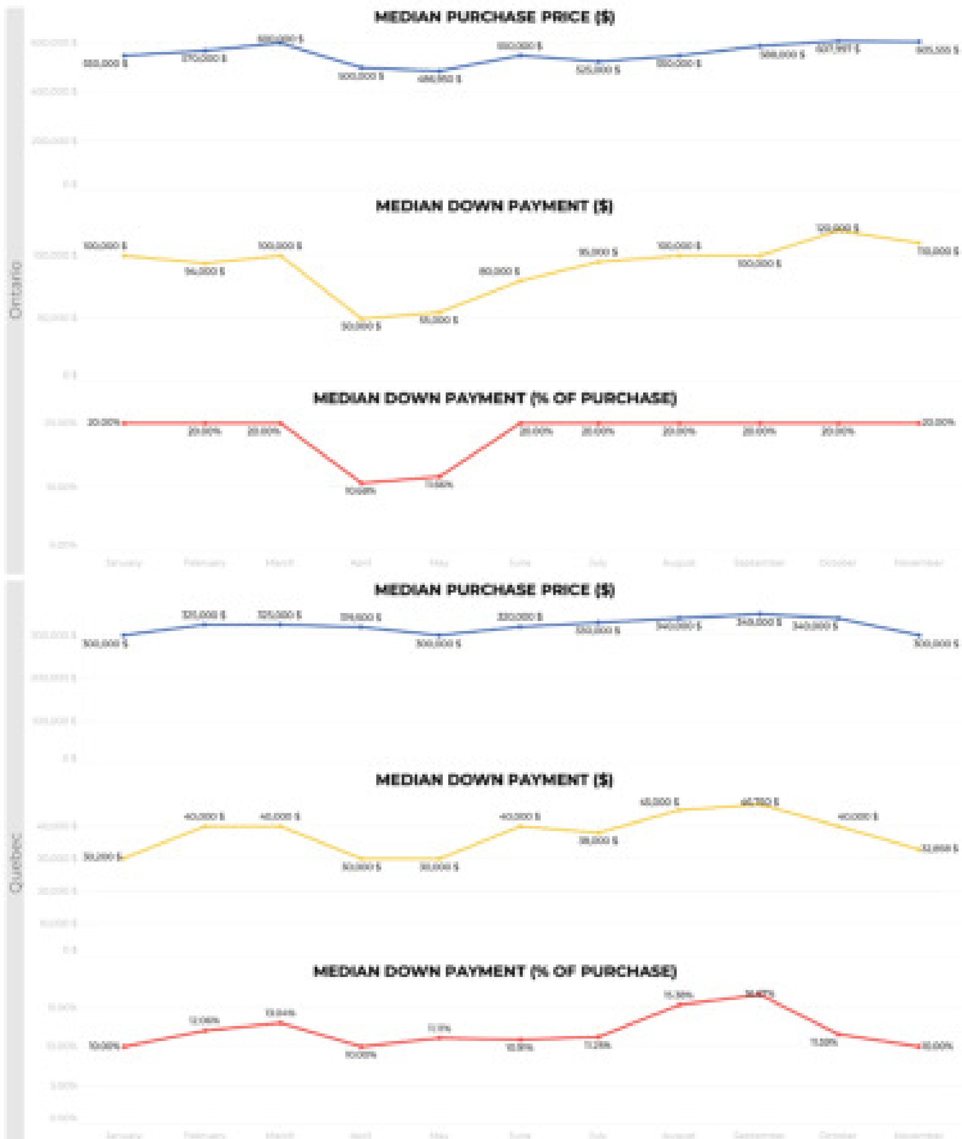

Fig. 9: Graph of intended purchase prices vs down payment (in dollars and percentage) from January 1st to December 1st, 2020 in Ontario and Quebec. Highlighted is the first lockdown period , from the end of March to June 2020.

Looking at the same numbers, organized by province, helps us understand the bigger picture, and highlights the fact that these November changes had a much bigger impact in Quebec than they had in Ontario.

While amounts have dropped a little in Ontario, the median down payment percentage remains stable, at 20% for the sixth month in a row, in Quebec, all 3 median values dropped again in November, with the median down payment percentage down from a small 12% to an even smaller, 10%.

The thing is, house prices haven't gone down, rather the opposite. If our QC users have lowered their target purchase price along with their desired or available down payment amount, could this be linked to the overall reduction of "ready to buy" borrowers? Have home prices reached a ceiling that causes buyers to take a step back and revisit their plans?

DEEP DIVE

1. Increased property value & property taxes

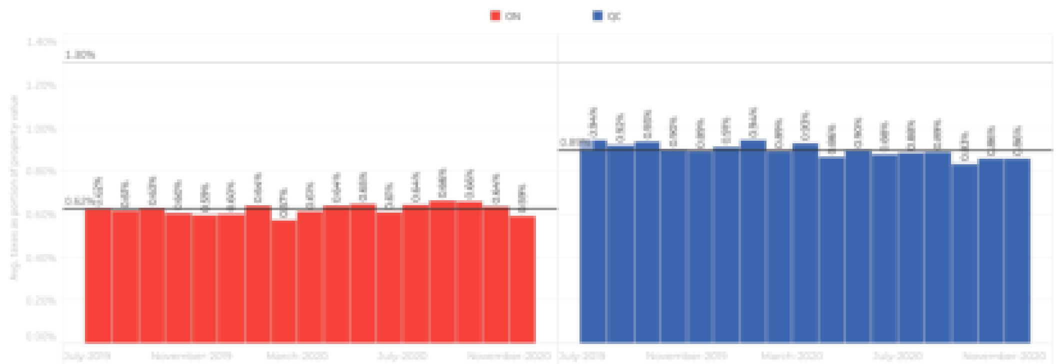

Fig 10: This graph illustrates the evolution of the % of the property taxes related to the value of the property, for Ontario and Quebec, between July 2019 and November 2020.

Hypothesis 1

Potential buyers are pre-approved for less than they could be, due to lenders calculating property taxes at 1% to 1.3% of the property value, which is almost double the actual figures in many cases.

Findings

Looking at this graph, we notice that property taxes in Ontario represent, on average, 0.62% of the property value, as in Quebec, this proportion is up to 0.89% in November 2020. While it's not necessarily fair to put the provinces up against one another from a property tax expense perspective, an interesting take away from these numbers is the impact on the pre-approval process from a borrower's perspective.

Knowing this discrepancy exists, why are lenders calculating property taxes with values much higher than actual when determining how much a would-be homebuyer may qualify for? It may appear this way, but the intention certainly wasn't a secondary "stress test". This pre-approval formula was appropriate prior to the real estate boom many Canadian markets have experienced over the last decade. Looking back 10 years, it was possible to use the default formula and still underestimate actual property tax expenses when issuing a pre-approval to a home shopper. This previously common concern is nearly impossible to run into today. As home value increases greatly outpace a cities ability to manage and update property taxes, this default formula becomes more dated and also adds a bit of confusion to the pre-approval journey. The reality for some Canadians is, believe it or not, receiving a formal bank document confirming that they are pre-approved for a purchase price of $360,000, with the text body of the email trying to explain that they would actually qualify for $368,000, as long as the property taxes don't exceed a certain amount. We don't believe the remedy is as simple as updating the default formula, but we do think there is room to compromise between the formula and the reality.

2. Approval delays in Quebec

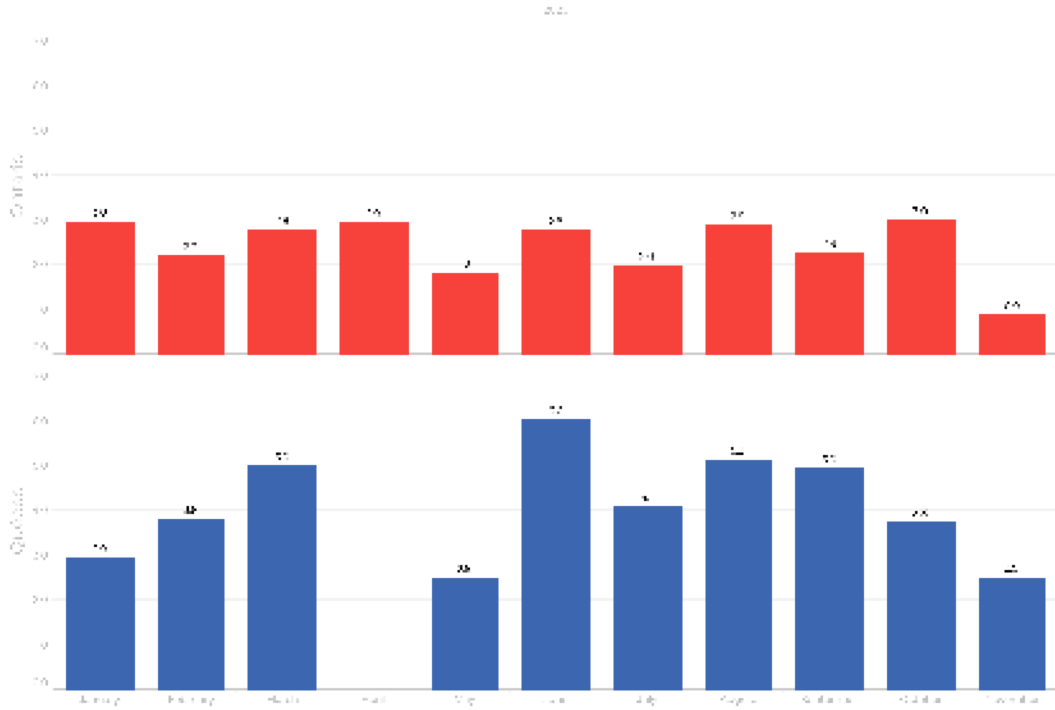

Fig 11: This graph compares the median number of days between a file being submitted to a lender and the lender approving it in Ontario vs Quebec. Data only for purchases (new mortgages).

Hypothesis 2

Seasonality and mortgage industry players getting used to the “new normal” have brought approval delays back down to acceptable levels.

Findings

We first brought up this subject in September 2020. At the time, remote work, economic uncertainty and months of pent up demand had a major impact on approval delays in Quebec and Ontario, but mostly Quebec! How is the situation in November now that things have settled a bit, with lenders and other players more used to the new “digital way” of doing things?

Looking at the upper graph, it is clear that Quebec approval delays are still much longer than Ontario’s, but it’s not fair to compare the two at face value. In Ontario, an approval can be issued with requirements still outstanding and revoked if not met, whereas in Quebec, the approval is not formally issued until all conditions within have been satisfied.

Comparing the median number of days between a file being submitted to a lender and the lender approving it, only for Quebec, we see a clear improvement in the last 4 months. From 5.2 days in August to 2.5 days in November, Quebec homebuyers are definitely experiencing shorter delays and therefore, facing less stress when it comes to getting their approval within the deadline period. Again, a few elements such as seasonality and remote employees finally getting more comfortable within their new remote work situation definitely have an impact on this significant gain in time.

3. Short-term buying

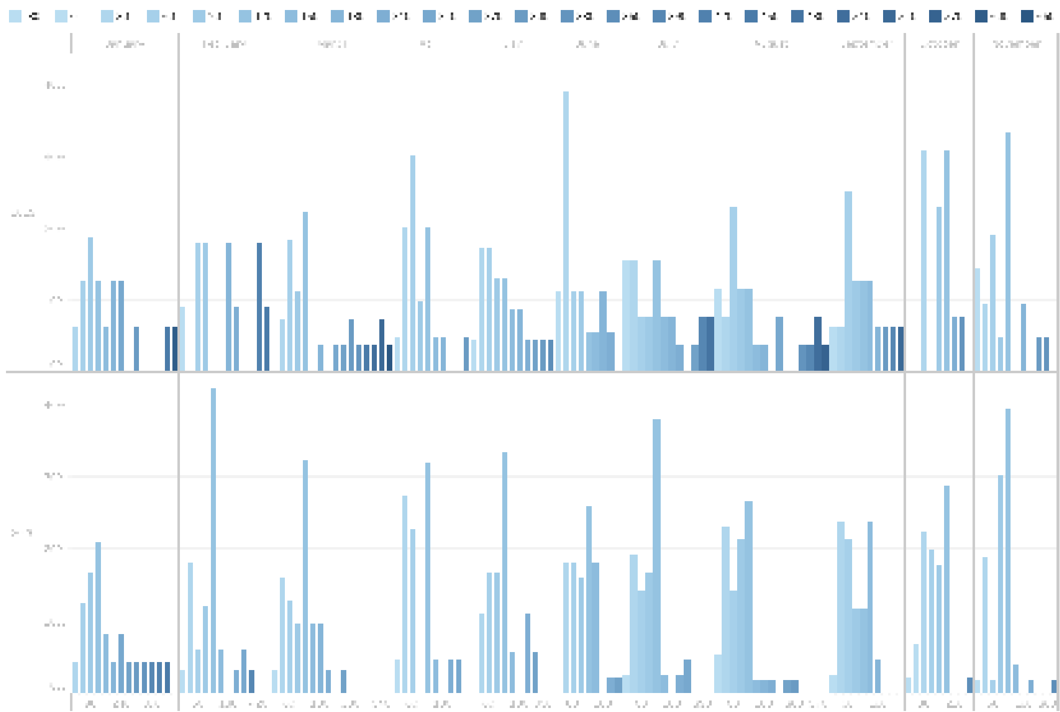

Fig. 12: This graph illustrates the number of days between the time a digital application was filled and the moment the mortgage was officially signed, comparing 2019 to 2020.

Hypothesis 3

In November, the current context is still driving people to commit to shorter timelines for their purchases.

Findings

This question was first tackled in August, as we noticed a huge difference in the purchase timeline of our users from 2019 to 2020. Before the pandemic, a lot more purchases were planned as far out as 600 days (a little less than 2 years) in advance. Since February 2020, we've been seeing a much lower number of long term purchases, signaling that our users, amongst other things, are opting for resale homes as opposed to new construction. It also tell us that our users looking to purchase a home are also looking to move now rather than in two years.

The same trend continues in November, with very few clients seeking guidance today that are looking to buy far into the future and the vast majority of our homebuyers and inquiries focusing on short term purchases, with an average of only 60 to 90 days between the moment they filled out their application to their move-in date.

CONCLUSION

November was just like most of 2020 and behaved quite differently than anything that could have been predicted a year ago. We felt a bit of this seasonality, with a slight decrease in live purchase activity and a sizable improvement to approval delays.   Another interesting piece of November was that many Canadians entered the Holiday season while still being under lockdown measures, and yet, nesto saw an 18% increase in overall request volume in the last month. Could this be the low rates effect? Most probably. For the 6th month in a row, media of all kinds is reminding us that rates are still at, or reaching, new record lows, closing November at 1.44%, 5-year fixed.

METHODOLOGY

The data used for this study comes from nesto's online application and is solely based on the experience of nesto.ca customers/users, not the national market as a whole.

Data is collected from thousands of monthly users declaring their intent or completing online applications across Canada. The data is anonymized and aggregated for analysis.

Data presented within our Rate volatility and variances report refer to nesto's "best rate" at any given moment. nesto's best rate comes from any one of our many lending partners at any given moment.

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