

# Condo market driven by easy credit and faulty math: analyst

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National Post/Aaron Lynett "[W]e believe that buyers in the current condo market exude hope over experience," **Ohad Lederer**, an analyst at **Veritas Investment Research**, said in a report, adding that despite claims of a buoyant rental market investors are ending up with "an astonishingly low return on invested capital."

Economists will tell you that one of their biggest challenges is figuring out why Canadians still gather in long lines for a chance to buy a condo in a major city even as the economy deteriorates and the housing market looks more and more wobbly.

To the development industry, the answer is simple: The population is expected to continue to grow and as long as it does, demand for living space, such as condos, will move up as well. On top of that you've got the foreign investors, especially from Asia, arriving in significant numbers in search of a safe place to stash their money.

Admittedly, there's a degree of logic to that — prices are going up because demand is going up. But those in search of more detail have been left scratching their heads. How many Toronto condos were bought by foreigners in the last year? What proportion of units are purchased as investment properties? How big a role in the market does CMHC insurance play? Nobody seems to know.

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Enter **Ohad Lederer**, an analyst at **Veritas Investment Research**, a Toronto-based provider of independent analysis to the investment industry. Like many others, **Mr. Lederer** was surprised by the extraordinary growth of the condo industry and wanted to understand it better. But instead of setting off on a wild-goose chase for non-existent numbers, he took a different approach, examining some of the basic assumptions about the market. The project included mystery shoppers dispatched to a couple of downtown Toronto sales offices. **Mr. Lederer** comes to some some interesting conclusions.

“We believe that buyers in the current condo market exude hope over experience,” he said in the report, adding that despite claims of a buoyant rental market investors are ending up with “an astonishingly low return on invested capital.”

**Mr. Lederer** starts out by trying to figure out the math behind the buy-to-rent market, said to represent a large chunk of overall buyers. After looking at 84 units for sale in Toronto and Vancouver and comparing them with similar rental units, he concluded that buyers looking to rent their properties are facing annual returns on their investment of below 4%. Simply put, they'd have been better off with some good-quality dividend bearing shares.

When a 15% market correction is added to the equation — not beyond the realm of possibility — the picture gets worse.

Perhaps the most intriguing aspect of the report was the use of mystery shoppers to suss out action on the ground. Two pairs of researchers posing as husband and wife visited sales offices for two downtown Toronto developments close to Yonge Street. According to the report, the only requirement to make a purchase was a cheque and a valid driver's license. “No mortgage pre-approval was required . . . This is surprising because banks generally talk about pre-approvals being in place for approximately 70% of units before the development loan is released to the developer.”

**Mr. Lederer** speculates that perhaps the buildings had already topped the 70% level so funding was no longer a question, but even if this was the case it's still cause for concern.

Meanwhile, the sales staff did their best to present a rosy outlook for condo ownership, “mightily” stretching the truth.

“The salesman at Project Y misrepresented immigration statistics, saying 70% of immigrants settle in Toronto and that 370,000 immigrants in total are expected next year, when the real numbers are 30% and 250,000. Meanwhile, at Project X, the saleswoman said achievable rents in the neighbourhood are \$3.50 a square foot; we have checked rental sales at a number of nearby condos, which are actually in the \$2.50 — \$3 a square-foot range.”

One sales centre even featured representatives from one of the big banks offering to lend potential buyers half of the minimum 20% condo down payment. **Mr. Lederer** concludes that the bank is qualifying prospective borrowers for a full mortgage before approving the down payment loan, a practice “indicative that the industry is bending over backwards to make it easy to take the plunge.”

While banks have the benefit of Canada Mortgage and Housing Corp. insurance to protect them if things turn out badly, buyers are not protected, the report said, adding that a hard landing could also impact more than 300,000 construction workers currently employed in the industry.