NICOLA WEALTH

# COMPASS

*A newsletter designed to help affluent families navigate their financial possibilities*

## *Perspectives on Canada's housing market*

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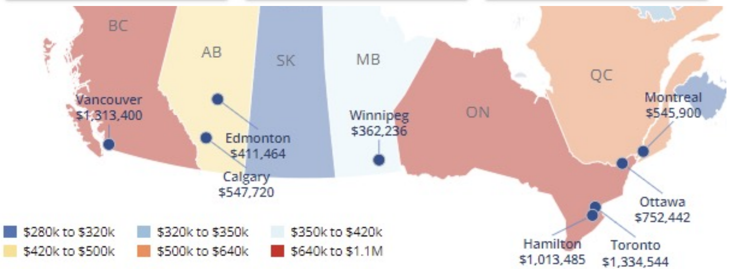
*This map tells the story of Canada's housing market, with benchmark prices up about 25% over the past 12 months. So, it should come as no surprise that Toronto and Vancouver lead the way as arguably two of the most unaffordable cities in the world with respect to housing.*

| Transactions | Average Sold Price | MLS® Benchmark Price |
|---|---|---|
| 49,403 | $816,720 | $869,300 |
| ↓ -7% | ↑ 20% | ↑ 25% |
| vs. Feb 2021 | vs. Feb 2021 | vs. Feb 2021 |




*Source: wowa.ca/reports/canada-housing-market*

Our purpose in this newsletter is to examine Canada's housing market in more detail by looking at it from different perspectives.

One perspective suggests that:

A. Canada's housing prices have risen much faster than other countries over the last 40 or so years.

B. Much of this increase is triggered by foreign ownership.

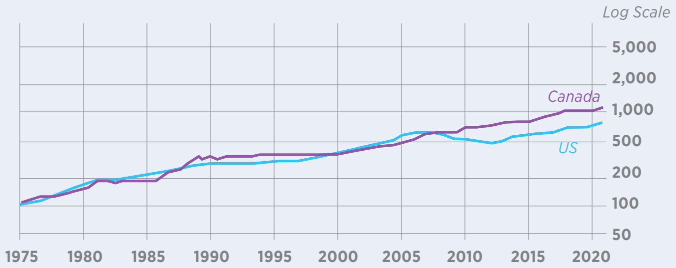
C. Millennials and Gen Z will never be able to buy a home in markets such as Toronto and Vancouver.

Let us look first at the data which supports these statements. The Economist magazine has a housing website that looks at relative changes in house prices over the last 47 years (since 1975) between countries. The graph below compares Canada and the US from 1975 to 2021. While US housing prices have risen by a factor of eight, Canada's housing prices have increased by more than 1,300%.

If we just look at Vancouver detached home prices between 1977 and 2022, the increase is far higher at about 25-times over

### RELATIVE CHANGES IN HOUSING PRICES: CANADA & US

FROM 1975 TO 2021

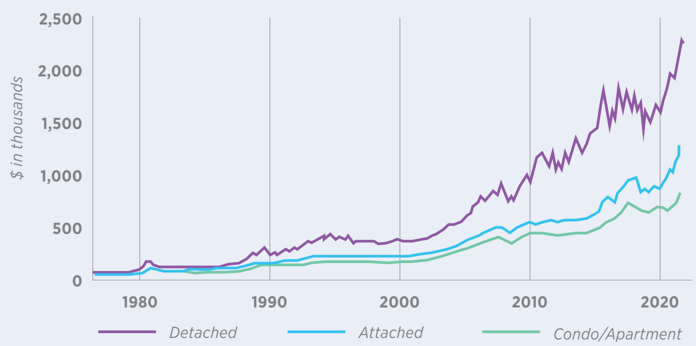



Housing prices the US are **816%** higher than in Q1 1975
Housing prices Canada are **1,319%** higher than in Q1 1975

*Source: The Economist. Nov 24 2021. Global house prices. retrieved from economist.com/graphic-detail/global-house-prices*

### AVERAGE RESIDENTIAL SALE PRICES IN VANCOUVER

FROM 1977 TO 2022




*Source: Real Estate Board of Greater Vancouver* those 45 years (7.7% per year). During this same period, Median household income in Canada rose by a factor of about seven.

When adding in other factors (such as foreign buyers - especially in Toronto and Vancouver - acquiring a home that sits empty for most, if not all, of the year), it is no wonder that Canadians who do not already own their own home feel that they will never be able to afford one - at least in certain markets. For example, consider this table from *Oxford Economics* showing Vancouver and Toronto being 1st and 3rd in unaffordability in North America. *I must admit, I would not have thought Boise would have come in second!*

| RANKING NORTH AMERICAN METROS BY HOUSING AFFORDABILITY | | | |
|---|---|---|---|
| MOST AFFORDABLE | | LEAST AFFORDABLE | |
| City | HAI (Q2 2021) | City | HAI (Q2 2021) |
| **Chicago** | **0.62** | **Vancouver** | **1.71** |
| Quebec City | 0.65 | Boise | 1.61 |
| Columbus | 0.66 | Toronto | 1.56 |
| Edmonton | 0.67 | Portland, OR | 1.54 |
| Atlanta | 0.68 | Hamilton | 1.51 |
| Winnipeg | 0.69 | Las Vegas | 1.47 |
| Raleigh | 0.70 | San Jose | 1.45 |
| Dallas | 0.71 | Los Angeles | 1.45 |
| Calgary | 0.76 | Ottawa | 1.39 |
| Nashville | 0.80 | Tampa | 1.27 |

So, these indeed appear to be irrefutable facts that explain the egregious cost of housing in many parts of Canada. And that is undoubtedly one perspective!

> *"The difference between a mountain and a molehill is your perspective."*
>
> \- Al Neuharth

Now, let us consider housing from an unfamiliar perspective, starting with the assumption that Canadian housing is among the world's most expensive.

I went back to *The Economist's* housing website and added a few more countries to the comparison mix. As you can see from the results in the chart below, Sweden, Australia, Great Britain, and New Zealand all show more significant increases in housing prices over the last 46 years than Canada. However, it should be noted, that there are many factors impacting housing prices in any jurisdiction, including:

- Inflation
- Currency fluctuations
- Immigration
- Interest rates
- Economic Growth

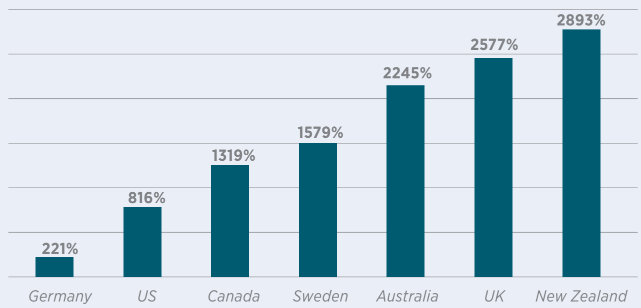
Nevertheless, housing prices rising between 8 and 29 times since 1975 seems daunting, if not excessive. Here are two questions, the answers to which may change that perspective.

1. After adjusting for inflation and currency, what has the annual rate of housing prices been in each of these countries?
2. How does the increase in housing prices compare to other assets?

The chart below shows that, except for Germany, housing prices have increased between 1.33% and 2.7% net of inflation for the last 46 years. I have included Vancouver as a separate category because other factors are critical to outcomes there.

**HOUSE PRICE INFLATION**

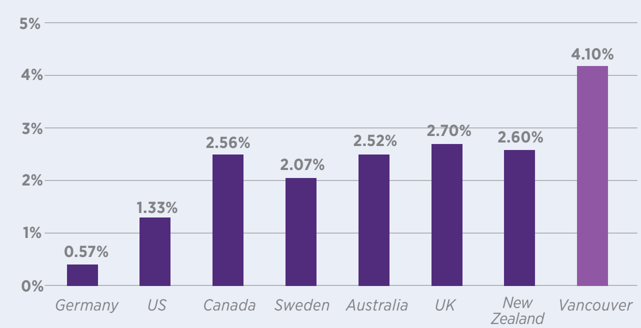
FROM 1975 TO 2021




*Source: The Economist. Nov 24 2021. Global house prices. retrieved from economist.com/graphic-detail/global-house-prices*

**HOUSE PRICE INFLATION**

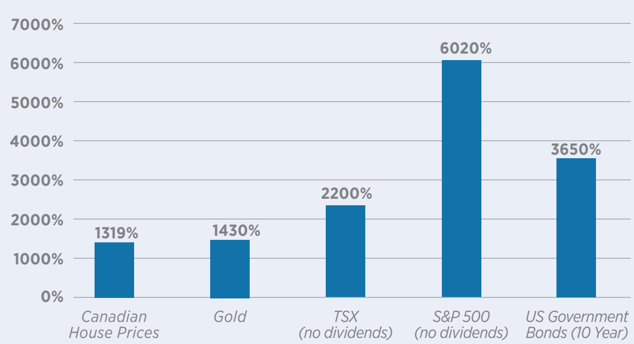
FROM 1975 TO 2021 - ANNUAL CHANGE ADJUSTED FOR INFLATION




*Source: The Economist. Nov 24 2021. Global house prices. retrieved from economist.com/graphic-detail/global-house-prices*

**ASSET PRICE CHANGE**

FROM 1975 TO 2021




*Source: Nicola Wealth*

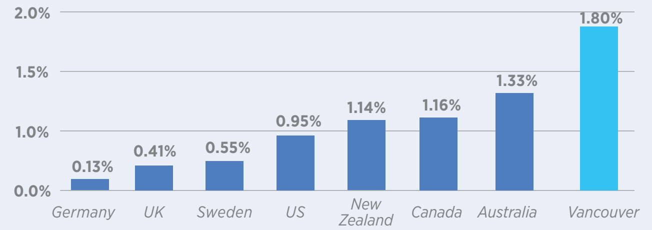
When we compare Canadian housing prices to changes in the price of gold or price returns on the S&P 500 and TSX (not including dividends) or US government bonds, we see that Canadian housing prices have, in fact, underperformed.

## Impact of Population Changes

Arguably one of the biggest drivers for changes in home prices is net population change - births minus deaths plus immigration (and in the case of Vancouver, migration from other areas of Canada).

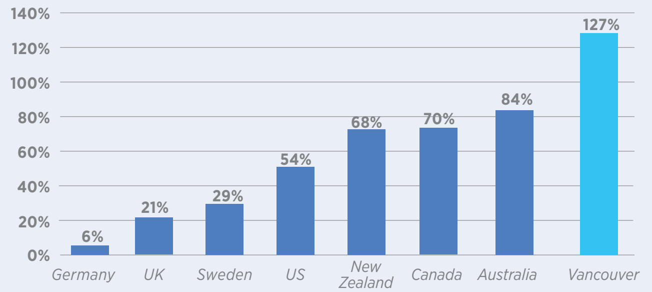
These two graphs show the same numbers but with far different perspectives.

**ANNUAL POPULATION CHANGE**
FROM 1975 TO 2021




*Source: The World Bank. 2022. Population Indicators. retrieved from databank.worldbank.org/indicator/SP.POP.TOTL/1ff4a498/Popular-Indicators*

**CUMULATIVE ANNUAL POPULATION CHANGE**
FROM 1975 TO 2021




*Source: The World Bank. 2022. Population Indicators. retrieved from databank.worldbank.org/indicator/SP.POP.TOTL/1ff4a498/Popular-Indicators*

When population changes are compared cumulatively, things look quite different.

Small annual differences add up to a great deal over time. Since 1975 population increases in Vancouver have been 6-times that of Britain and 20-times that of Germany

Margaret Atwood wisely observed this about reality:

> *"Reality simply consists of different points of view."*
>
> \- Margaret Atwood

In the case of Canadian housing, is *Oxford Economics* right and prices will drop 24-40% over the next two years and that we are in denial if we do not see that we are in a housing bubble?

CANADA

### Canadian Real Estate Prices Expected To Drop 24%, Can Crash 40%: Oxford Economics

*Source: Better Dwelling*

Or are there mitigating circumstances that might (at least in the case of Vancouver) be described as unique and special circumstances which create the "Perfect Storm " for rising house prices?

In the case of Vancouver, the key factors can be described as:

- Livability
- Population Growth
- Limited Land Supply
- Falling interest rates

**THE PERFECT STORM**


The last factor has ended for now, but the other three may become more critical in the future.

In doing the research for this newsletter, the following observations occurred to me,

- All asset prices rise and fall, so the probability of a housing crash in any jurisdiction is likely under the right circumstances. However, if fundamental factors such as supply vs. demand or quality of life remain, prices should continue to rise inexorably.
- Overall, the performance of housing prices can be at best described as "average" when compared to other assets such as stocks, bonds, and gold.
- Even in countries with strong housing markets, the total inflation-adjusted returns over time (price appreciation and

net rents) are about 5% annually. That is a good result but not better than most public equity markets and not better than other types of assets such as private equity and commercial real estate.

Investors often choose housing as a preferred asset because it is simple to understand. In most markets in Canada, there is usually a strong demand for rental properties. The basic model is buying an investment condominium or home, getting a mortgage for 70% of the value, using the rents to repay the debt, and finally, after the mortgage is paid off or significantly reduced, consider refinancing to buy another investment property. If you do not mind being a landlord, this model works quite well.

However, if you are willing to use leverage as an investor, then the returns over time would have been far better borrowing - within reason - to buy a portfolio of bank or insurance company stocks.

Unfortunately, we do not have records for Canadian real estate trusts back to 1975, but that data exists for US REITs at the website REIT.com. From 1975 to 2021 (the same timeline as The Economist's housing price data), $100,000 invested in the REIT index would have returned about $12M by 2021 (assuming a 1% management fee each year). That compares to $100,000 invested in Canadian Housing in 1975 being worth about $1.3M in 2021. If we add in just over 2% annually for the rental income one could earn on the home (net of expenses), the total return value does increase significantly. However, even with this factored in, the total return is about $3.4M or just over 25% of the value of the NAREIT total return index. If you want to earn consistent returns with growing cash flows in real estate, there may be much better ways to accomplish that than buying houses.

Individuals and families are making decisions that will impact their lifestyles and their finances for decades when it comes to how to manage to own a home. And with much of the mainstream media dedicating more column inches to housing than any other financial asset, it is critical to have a clear perspective regarding these decisions.

While our analysis makes the case that the rise in housing prices in Canada is not particularly extraordinary, we cannot ignore that there are genuine issues and concerns for Millennials and Gen Zers when we consider Vancouver and Toronto specifically.

In relation to household income, these two markets, according to the Economist, have risen considerably higher than the rest of the country (about 2600% vs 1300% since 1975). Historically, lower house prices and a buyer's market are much more likely to occur towards the end of a recession. Rising interest rates are already impacting mortgage costs and, ultimately, selling prices. First-time home buyers and those looking to move up might be well served to wait and be patient in this environment.

Recessions are inevitable, and higher mortgage rates are definitely on the table. Together they might, in the end, bring a price correction in Canadian housing markets. And while it is true that higher rates would initially create more significant mortgage payments, a recession would also likely bring those rates back down. In the end, housing tends to work much the same as many assets - ***It is best to buy when all others are selling.***