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- AdvisorAnalyst Practice Growth -

Hard Facts on House Prices

Posted By Dan Richards, ClientInsights.ca On May 5, 2010 @ 6:13 am In Dan Richards | No Comments

Not many topics are more emotionally charged than house prices. Part of the reason is the amount of myth, anecdotal conversation and pure misinformation on this topic.

In many cases, that creates a big opportunity for advisors to add value by introducing facts and objective information.

That's been the subject of my last two Globe columns – last week's looked back at the historical returns on home ownership, today's examines what current house valuations look like by historical standards.

Links to both columns can be found at the bottom of today's email, should you want to email them to clients.

Houses as an investment – the verdict of history

The last ten years have seen annual increases of 8% in house prices – the best decade on record.

Some Canadians expect those kinds of gains to continue – and are almost sure to be disappointed.

So last week's Globe column tackled the question: What are the facts on historical returns on houses?

Depending on your source, the answer is that after inflation, returns on houses have been either slim or nonexistent.

Phil Soper of Royal Lepage said that since the early 1960s, Canadian house prices have seen an average annual gain after inflation of 2.4% – this compares to a long term real return on stocks of over 6%.

Another perspective came from Cynthia Holmes, who teaches real estate at the Schulich School of Management at York. She suggested that over the longer term, on average house prices only increase with inflation and there are no real returns at all – this is supported by a study of houses in central Amsterdam going back 350 years.

Confirming her view, in this weekend's National Post Robert Shiller of Yale was quoted that from 1880 to 1990, US housing prices yielded a zero rate of return.

Today's email contains an interview with Cynthia on this – you can also watch it here:

http://www.clientinsights.ca/video/cynthia-holmes-a-long-term-view-on-real-estate-returns/type:investor [1]

Housing prices today – fairly valued or a bubble?

Today's Globe column shifts from the past to the present, examining the substance behind recent suggestions that housing prices are at bubble levels.

In March, the New York Times devoted a rare article on Canada to this topic.

And a couple of weeks back, David Rosenberg of Gluskin Sheff released a report suggesting house prices could fall by 20%.

Here's the Rosenberg report:
https://ems.gluskinsheff.net/Articles/Coffee_with_Dave_042310.pdf [3]

Here's how it was covered in the Toronto Star:
http://www.yourhome.ca/homes/realestate/article/799961-canadian-housing-market-correction-in-the-cards-says-economist [4]

And here's the New York Times story:
http://www.nytimes.com/2010/03/20/business/global/20real.html [5]

Housing prices through the lens of affordability

Phil Soper of Royal Lepage points out that over time housing prices and incomes move together – although there are lots of periods along the way where incomes get ahead of prices or prices get ahead of incomes.

Since 1985, RBC economics has tracked affordability of houses in 100 neighbourhoods across Canada, looking at the percentage of the median household's income it would take to carry a 1200 square foot bungalow, assuming a 25% down payment and including utilities and property taxes. The higher a percentage of a household's income it takes, the less affordable houses are.

Today's Globe column contains a chart of historical and current affordability in Calgary, Montreal, Toronto and Vancouver – this chart is found at the bottom of this article.

Since 1985, the average proportion of income to carry a bungalow across Canada has been 39% – Montreal 's been 37%, Calgary 40%, Toronto 49% and Vancouver 57%.

There have been big variations along the way of course – as house prices ran up in the 1980s, affordability declined to the point that by 1990 it took an average of 53% of income to carry a bungalow, with Toronto hitting 73%. The high prices and the poor affordability that resulted led to the lost decade for house values in the 1990s, when prices actually declined in real terms.

At the end of December, affordability in most markets was close to historical levels, although RBC points out this was partly a function of mortgage rates well below what would normally be expected. When they did the calculation assuming normal mortgage rates, affordability dropped below the long term average – the good news was that affordability was still well above the all time highs.

The only market where alarm bells went off was Vancouver – assuming normal mortgage rates, at the end of December it would have taken 81% of a median household's income to carry a bungalow, just below the all time high set in early 2008.

Based on this analysis, today's column draws two conclusions.

First, with the exception of Vancouver, houses do appear expensive but are not at bubble levels.

And second, there's no rush to buy – while house prices could continue to increase, if they do it's likely they'll correct back down.

Here's a link to the RBC report on affordability, which contains historical data on twenty cities across Canada: http://www.rbc.com/economics/market/pdf/house.pdf [6]

And here's the summary of long term affordability that's in today's Globe:

% of typical household's income required to carry an average bungalow

	Long term	at 12/31/09	12/31/09 adjusted	All time high average for normal mortgage rate
National	39%	41%	45%	53% (Q2 1990)
Vancouver	57%	69%	78%	81% (Q1 2008)
Toronto	49%	49%	55%	73% (Q2 1990)
Montreal	37%	39%	44%	53% (Q2 1990)
Calgary	40%	37%	42%	58% (Q2 1990)

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