The Home Sweet Home Edition

House prices are up big time. Pundits have claimed house prices are about to crash, taking Canadian bank profits with it. Some have pointed to the US as a sign. Canadian politicians have been racing each other to come up with someone to blame for high prices (billionaires, immigrants, developers, speculators) blaming those parties on excess demand, (ignoring supply) bringing in regulations to address a 'housing affordability' including additional tax and fees (think empty condo-tax). Such moves are unlikely to increase supply. They will have the opposite effect.

'Housing Boom to Continue' – Brian Wesbury First Trust Apr 12, 2021

Brian Wesbury looks at US housing. He concludes in the USA, it's a lack of supply, not excess demand, causing house prices to rise. We see these same stats in Canada and have been making the same argument here for a while.

https://www.ftportfolios.com/Commentary/EconomicResearch/2021/4/12/housing-boom-to-continue

Have house prices on Southern Vancouver Island been expanding at a crazy price? Recently prices have certainly accelerated.

Victoria Real Estate Board Stat's

The VREB posts average prices for detached single family dwellings since 1978

https://www.vreb.org/media/attachments/view/doc/3_2020_historic_summary_of_single_family_detached_sales_by_year_2/pdf/3_2020_historic_summary_of_single_family_detached_sales_by_year_2.pdf

Looking at these stats, potential real estate investors often confuse a change in 'average prices' as representing the actual dollar return on an investment. Average prices will increase with average costs. If the cost to build goes up, the price must go up or the building won't be built. Costs will be increased by regulations, property taxes, fees, rising financing rates, materials inflation, rising cost of labor (wages and income taxes), renovations/repairs, increasing square footage, number of baths, size of the garage, technology features, heating/cooling, ongoing maintenance, etc.

Average prices do not tell us much about costs. They will reflect costs but do not represent an accurate measure of 'investment return'.

With those caveats, in 1978 the average cost of a single-family dwelling (SFD) in Victoria area was $63,733. In 2020 the average was $1,004,077 representing an average annual rate of change in cost of 6.8%. This was not the average 'return on investment'.

An individual Victoria-area property blogger calculated the cost to keep his house livable in 2017 at $11,050. That figure did not factor major costs like roof/waste water systems etc. and excluded mortgage financing costs (perhaps he had none).

https://househuntvictoria.ca/2017/01/19/what-it-cost-to-run-our-house/

Taking that party's all-in cost experience of $11,050 in 2017 vs the Victoria-area single family dwelling average cost of $859,871 gives us 1.3% cost in that year. If we assume those costs are roughly constant (a stretch but let's go with it) this takes the annual average price change after factoring in increasing maintenance costs (a seller will want those back or won't sell to then rent) from 6.8% down to 5.5% excluding mortgage finance costs.

Inflating the 1978 VREB SFD average cost of $63,733 by BC's annual CPI inflation rate takes that value to $202,870 by 2020 for an average annual inflation rate of 2.8%.

https://inflationcalculator.ca/british-columbia/

Factoring the 5.5% average cost increase for inflation rate of 2.8% takes the average cost change net of maintenance/tax/insurance/inflation to 2.7% (ignores financing costs).

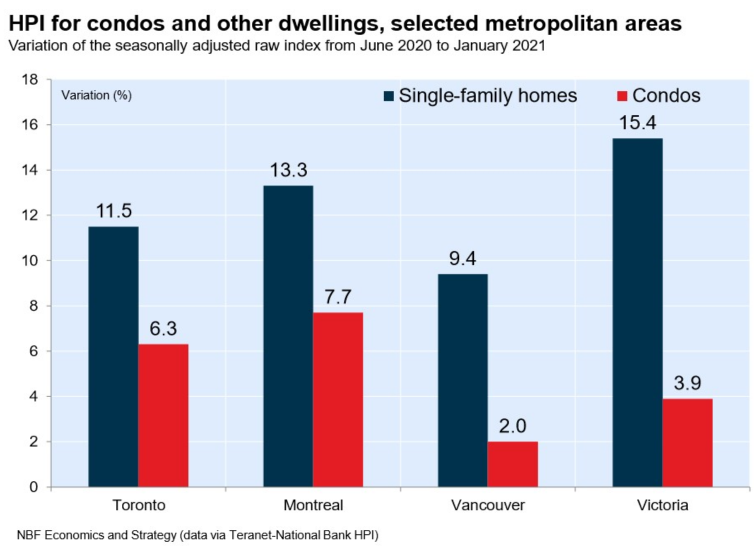
If we then factored in a 75% loan value at current rates of around 2.5%, applying that carrying cost against the price change (the seller needs to get their financing costs back or won't sell) we're down to a net return around 1%.

As price change doesn't tell us anything about the features of the house (larger?) or the cost of borrowing, we don't know how much of this cost increase is the result of buyers being able to borrow more money at much lower rates than in 1978 (mortgage interest rates were on their way to 15% in 1981 – I paid that rate), how much of the increase is due to larger and better appointed homes and/or how much is the result of lack of supply/increased demand?

To be clear, I'm not saying owning a house to live in is a bad deal. If the house price keeps pace with all your costs over a long period of time, when you sell you might get most of your costs back as a lump sum. You lived there for free. Kind of a forced savings program resulting in a large lump of inflation protected money. That's a very good deal. It is not necessarily an attractive investment return on the capital deployed.

How do third party owner/landlords then get rich? They leverage a small down payment, using rents to cover costs and financing, leveraging the resulting price cost inflation over time. This really works in a declining interest cost environment. If rates go up, not so good. Note successful landlords often focus on multi-family dwelling rental property, not single-family dwellings. More families per building smooths out the risk of individual renter's skipping town or damaging their unit.

'Home prices up in February for a 16th straight month' – NBC Teranet House Price Index update - Mar 17, 2021



The first chart tells us house prices were flat in Victoria from late 2006 to 2015. They did't collapse, they just went nowhere. That flat spell was preceded by a large price surge. Will this property price pattern repeat?

The second chart tells us house prices are up, while condos are much less frothy. It appears Millennials are suddenly wanting a back yard. The Millennials are a larger demographic group than the Baby Boomers. Inflation in many things seems likely.

National Bank will be updating their Teranet House Price index next week.

BOTTOM LINE: House prices are not likely to crash. To solve the 'crises' in house prices, the ONLY thing that will improve affordability is to encourage building addition supply. NIMBY's take note.

'The New Rental Boom That Could Help Kill NIMBYism' – Bloomberg Apr 13, 2021

https://www.bloomberg.com/opinion/articles/2021-04-13/home-rental-market-is-the-secret-weapon-against-nimbys

'How America's Great Economic Challenge Suddenly Turned 180 Degrees' – NY Times Apr 9, 2021

https://www.nytimes.com/2021/04/09/upshot/economy-supply-shortages.html

Clearly a contracted supply in house has led to higher prices (inflation). Will lack of supply for broader goods lead to inflation as well? Scott Grannis thinks so.

'Updated outlook and some interesting charts' – Calafia Beach Pundit – Scott Grannis Apr 14, 2021

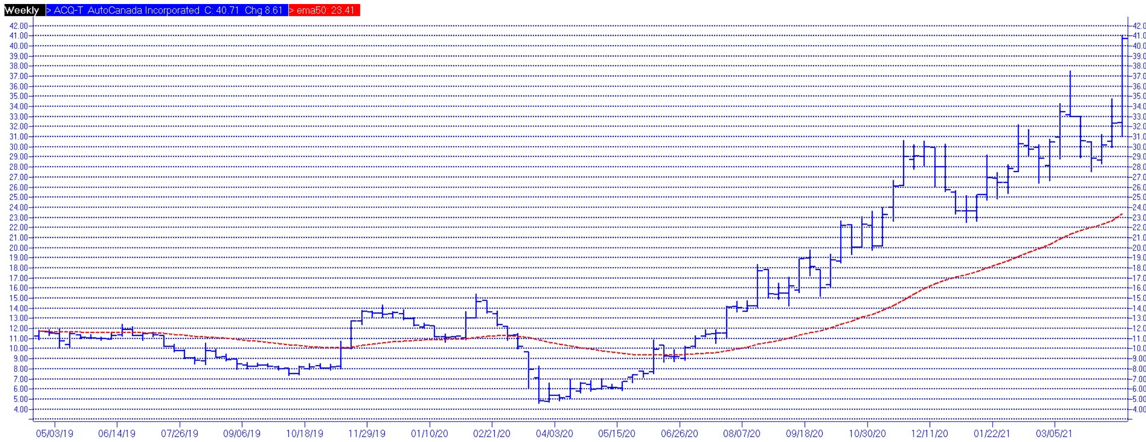
Mr. Grannis looks at inflation (he thinks higher) and equity prices (he thinks reasonable). He provides great charts and commentary.

http://scottgrannis.blogspot.com/2021/04/updated-outlook-and-some-interesting.html

Moving on to driving….

The narrative around electrifying the transportation fleet says auto-dealers are in trouble. This notion stems from the fact car dealers selling North American cars, make most of their profit from servicing, not selling cars. Our car-dealer clients confirm this. They also note the service department is the largest single expense in a dealership. They point out large US used-car dealers, think Car Max, have little to no service department costs yet make gobs of money. They tell us if electric drive replaces internal combustion the service profit plummets…along with the associated costs.. How is the sector doing? Will your local dealership remain in business? Our car-dealer clients say they've never been busier. The collapse in car sales last year is being made up for.

Edmonton based **Auto-Canada (ACQ-TSX-$40.63)** owns dealerships across Canada and has a division in the US. They brought their earnings this week. The numbers surprised the market, driving up prices 30% on the day.



ACQ went public in May/2006 a $10.00, one year in advance of the 2007 economic crash. Auto-Canada bottomed around 68 cents per share in March/2009 (yes-cents) at the extreme bottom of the 2008-09 Credit Crunch. With wide swings, it's been straight up since. CQ

In hindsight, the private owners taking ACQ public at $10.00 per share did a good job of picking an exit. Perhaps car sales people know when to sell. Auto Canada traded around $12.00 in August/2020. Investors have been sensing a turn in the industry.

Speaking of knowing when to sell, we've been hearing that markets are frothy.

'David Rosenberg: I haven't been this excited about going against the herd in years' - Financial Post Apr 14, 2021

David Rosenberg was out in the news yet again this week, advising he's never been more convinced he's right to be contrarian and bearish. As he's always convinced he's right, and usually bearish, this is nothing new. He takes great pains to point out he 'picked the top' at crucial points in the past. If he was generally bullish, then turned bearish at time, this could be a valid claim. If memory serves, he has been consistently bearish for a decade. A stopped clock is right twice a day.

https://financialpost.com/investing/david-rosenberg-i-havent-been-this-excited-about-going-against-the-herd-in-years

Some pundits claim insiders doing more selling than buying signals a broad sell-off in major equity indices is due.

Insiders Are Sending A Pretty Clear Signal About The Stock Market – Jesse Felder – Apr 14, 2021

https://thefelderreport.com/2021/04/14/insiders-are-sending-a-pretty-clear-signal-about-the-stock-market-and-the-economy/

Yes, insiders will know more about the likely near-term future of their company than any analyst and yes paying attention to their trading is important. BUT, I believe we should be cautious in conflating individual insider decisions in aggregate as a comment on broad stock market valuations and near-term price direction. With the huge decline in stock prices in 2020, most insiders who didn't have to sell would have deferred doing so. If they needed money in the first half of 2020, given the cheap borrowing rates on offer they would have been far better off carrying some debt. Now they have a chance to catch up from last years deferrals, paying down a bit of debt. With all the talk of coming tax changes to both capital gains and income tax, there is an additional incentive to sell now vs. waiting. I do not believe this year's insider selling means stocks are about to plunge.

I believe we have seen a rebound in stock prices to something like fair value. Prices for the stocks we own no longer extraordinarily cheap. Given our experience with Seasonality, April-May often provide good points to reduce some risk. Some, not all. The alternative to holding a 4% dividend-and-growing paying stock for 10 years is 1.52% in a Govt Canada Bond. Doesn't seem like a good swap to me. We have been doing some trimming lately.

Active Equity: "Reports of My Death Are Greatly Exaggerated" – CFA Institute – Apr 16, 2021

We believe we can continue to add value to our clients through both active management of their wealth and active management of them! Client behavior is half the battle.

https://blogs.cfainstitute.org/investor/2021/04/15/active-equity-reports-of-my-death-are-greatly-exaggerated

Weekly Economic Watch – NBF

NBF's Economics team noted property prices this week. See their notes.

See 'Weekly Economic Watch' NBF in the PDF links section

I remain optimistic human ingenuity will carry us forward to a brighter future. Here's why.

https://www.youtube.com/watch?v=oCYHMVlQezA

It finally looks to be warm enough for to practice the banjo on the back porch this weekend. On that uplifting 'note' ….

Steve & Anna Hilberry

Have a Great Weekend!

FOR THE RECORD

DOW INDUSTRIALS:	34,178
S&P 500:	4,182
S&P/TSX COMP:	19,336
WTI:	$63.26
LOONIE IN $USD:	$0.7994 $US

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