



WEEKEND READING

Shedding the light on what's happening - our world - our finances - our times

Election 2021: No Fairy Dust Edition Part 3...

This three part series looks at the election issues of government deficits, debt, taxes and housing. **Part 1** covers deficits, debts past and present. **Part 2** covers current and proposed tax changes. **Part 3** focuses on housing – one rationale for tax proposals in Part 2.

McLean's Magazine provides a handy summary of the various party's election platforms. The guide provides direct links to the platform issue. I've relied on the party platform publication for any data in my commentary

<https://www.macleans.ca/rankings/2021-federal-election-platform-guide/>

Canadian Election Opinion Poll updates: (8) <https://338canada.com/>

Part 1 and 2 discuss deficits, debt and taxes. All of the party platforms say we need to help young people buy houses. Surely that's a good thing?

Before we get into the new promises let's review programs already in place. *Mortgage Pal* provided a handy summary in 2019 (I can't confirm all are still in place).

<https://mortgagepal.ca/first-time-home-buyer-government-grants/>

One of the existing plans is a 'First Time Homebuyers Incentive' that places the Federal Govt (via CMHC) in an equity participation with a first time buyer of 5% of a pre-existing home or 10% of a newly constructed one. The maximum 'interest-free' loan = \$40,000. If CMHC lends you 10% of \$400,000 house cost = \$40,000, you must share 10% of the eventual house appreciation when/if you sell it. This of course assumes there will be appreciation.

<https://www.placetocalhome.ca/fthbi/first-time-homebuyer-incentive>

Time for a little math.

MLS provides a '*Historic Summary of Single Family Detached Sales By Year*' in January of each year. Here are the stats for Victoria, BC (note link must be on one line for it to work hence the size):

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

The MLS 'average price' derives from dividing the cumulative value of all single family dwellings sold, by the number of houses sold. A new house built for \$10 million then sold skews the stats, a significant failing of this approach. MLS represents property agents. Real Estate agents are ultimately paid for helping sellers. Their motivation is to achieve as high a price as possible for the seller. Their datasets are correct as to average prices but don't tell the whole story. The US based *Case-Schiller House Price Index* is based on 'Repeat Home Sales'.

<https://www.investopedia.com/articles/mortgages-real-estate/10/understanding-case-shiller-index.asp>

The US Case-Schiller Home Price Index tracks the price of a single house, between purchase and subsequent later sale. The Index tracks existing homes excluding newly constructed ones. That data is available in the US due to individual house price gains being taxable as a capital gain to the seller. Personal residence gains are tax-free in Canada so are not reportable. Tracking individual Canadian house prices would be more onerous.

With those caveats, according to MLS *House Price index* for Victoria, the 2000 annual avg house price was \$251,398. The 2010 average was \$629,925. In 2020 the average was \$1,004,077. The 2000-2020 average price increase was 7.1%. The 2010-2020 average price increase was 4.3%. I repeat that these 'average price increases' do NOT, mean a single house purchased in Victoria in 2000 increased at an average price of 7.1% per year. The average cost did. With that caveat, assume a first-time buyer purchased a newly built home for \$400,000 under the CMHC 'equity loan' program and that the price increased at 7% per year. In ten years it would have doubled. The owner then sells it for \$800,000. The owner owes \$80,000 to CMHC. They borrowed \$40,000. The 'interest-free' loan cost them \$40,000 over ten years or 7% per year. If they hadn't borrowed the \$40,000 under that programme, they could keep all of the \$80,000 tax-free. If the house drops by -7% per year the borrower would be better off (?). If after paying \$400,000, one is selling ten years later at the -7% per year implied price of \$180,000, they're probably bankrupt and our economy is in trouble. I wonder how many buyers will take advantage of this 'interest-free incentive' offer?

All the major Federal parties running in the Sept/2021 election have more goodies for first time home buyers.

The Liberal Plan: <https://storeys.com/liberals-new-housing-plan-election-2021/>

The Conservatives: <https://storeys.com/conservative-party-housing-plan-election-2021/>

The NDP: <https://storeys.com/ndp-housing-plan-election-2021/>

One aspirant made this accusation: “Justin Trudeau allowed rent to skyrocket and housing prices to balloon by more than 20% in less than a year in Vancouver.” That’s giving Mr. Trudeau a lot of credit! The accusation also implies the accuser will be able to prevent the same in the future. Will Vancouver home owners like that idea?

One plan makes a \$30,000 cash grant, funded by the Federal Govt, available to first-time homebuyers under the age of 40 to add to their savings in their purchasing a first house. One promises 1 million ‘new homes’ over three years (where does that number come from?). Another party offers 500,000 new homes over 10 years. Another idea is a tax-free ‘First Time Home Buyers Savings account’ that permits up to \$40,000 be saved tax-free by those under 40. This last idea was revealed by the Financial Post Wed Sept 15.

<https://financialpost.com/news/election-2021/first-home-savings-account-called-voter-candy-for-millennials-by-mortgage-insider>

Another plan would force CMHC to reintroduce the 30-year mortgage, spreading the amortization out reducing the monthly charge (increasing the total cost significantly that compound interest thing again). Recall the 30-year mortgage was restricted to shorter amortizations in an effort to reduce borrowing power, the idea being that would keep prices from accelerating and protect borrowers from getting in too deep. That didn’t work.

Some plans want to discourage ‘foreign ownership’ by applying (you guessed it) a 20% tax on those buyers. Funny how taxes solve everything. Other plans intend to restrict landlords ability to evict tenants and to cap their ability to raise rents.

Plans that hand additional cash to buyers, artificially increase their purchasing power, artificially restrict buying, limit landlord flexibility or attempt to build housing beyond the cost of doing so (subsidized) will not make housing more affordable other than for those few directly benefitting from subsidies. Why not?

All first time homeowners will be suddenly armed with \$30,000 or or \$40,000 or whatever more buying power. This means all those selling a house to a first time buyer will immediately jack the price up \$30,000 or \$40,000 or whatever, ultimately handing more money to the sellers. Sellers tend to be older. Buyers tend to be younger. Guess who votes more? We’ll make house-sellers richer by the tax-free amount of the gain, meaning no revenue to government, meaning Federal and Provincial governments will be forced to add debt for each dollar granted. We’ll have to increase taxes to pay the interest on that debt. This is sounding familiar.

Restricting landlord’s ability to evict tenants certainly won’t encourage more investors to become landlords. Neither will restricting their ability to increase rents. **Q:** *Why do developers build condos and not rentals? Why would they give up the potential huge long-term rental income from a reliable source, in a building they own and can maintain, with borrowing costs at historical lows?* **A:** *Because regulations make building risky. Regulations make renting riskier. Builders are reluctant to become targets for rentor advocates. They don’t want to be saddled with a building they can’t sell. The results are often poorly maintained SRO’s.*



The problem is supply.

House prices are entirely driven by supply and demand. The supply of housing is entirely under the regulation of Provincial and Municipality Govts. The Federal Govt can have very little impact on either the availability or the price of housing. The ONLY answer to Canada's housing affordability problem is more supply and increased organic purchasing power – IE better paying jobs that provide a higher after-tax income. Most of the elect-me ideas on offer artificially reduce prices (bad for Mom & Dad who vote) artificially increase purchasing power, or artificially force supply with government money. When the economics aren't there, they aren't there. Has Vancouver's Empty Condo Tax had any effect on prices in that city?

The main blockade to supply is NIMBY resistance. Homeowners in Burnaby are quite content to have their single-family dwelling acquired at \$400,000 in 2001 to now be worth \$1.7 million. Why would they want a sky-rise multi-family apartment rental unit on their street? Victoria has a building height limit. Residents don't want their view of the Olympic Mountains interrupted. Duncan makes building new units onerous. The lower the community plan density, the more regulations, planning department response delays, permitting application costs, materials sales taxes and building code related expenses, the higher the end cost must be to warrant private developers taking the risk. Nothing complicated about it.

One plan makes Federally owned lands available for development providing municipalities agree to increase density. Will the residents of that street in Burnaby be any more likely to agree to an increase in density under a social housing project? All three major parties appear to support subsidized housing. They argue taking on debt is needed.

What about 'affordable' subsidized housing? Wouldn't that increase supply?

This has been tried before. I grew up in Detroit Michigan. My mother worked evenings as a lifeguard at the Brewster-Wheeler Recreation Center. To keep us busy and keep an eye on us, she brought my younger brother and I to the swimming pool in the evenings. Brewster Rec Center saw Joe Lewis and Mohammed Ali (when he was Cassius Clay) train there. The Brewster Rec Center was across the road from the Brewster-Douglass housing project. I urge readers to research the history of socialized housing projects.

Brewster-Douglass Housing Projects

https://en.wikipedia.org/wiki/Brewster-Douglass_Housing_Projects

Why is America pulling down the projects? BBC 2016

<https://www.bbc.com/news/magazine-35913577>

The problems with ‘the projects’ weren’t with the philosophy but in the execution. Political promises of social housing, no matter who makes them, are soon discovered to be expensive and soon become compromised. Getting the one-off money to build is one thing. Maintenance is another. Promises are trimmed. The money isn’t quite as liberal, the quality not quite as high, maintenance less than needed and pride of ownership declines. The Brewster Projects became condensed slumification. The buildings became hell holes. The buildings were demolished. The promised replacements for the demolished units were never built. After huge expense, the city was back to where it started with even more folks on the street. Local voters are well aware of this history and become militant against such ideas. It doesn’t have to be this way, it often is. NIMBY’s get a lot of voter support.

So, what is the solution? It isn’t more Government housing.

Housing is waaay outside the Federal Government’s mandate. It is always a local issue. Solving the local issue requires local expertise. Ottawa is a long way from Duncan. Appointing a Federal Housing Tzar sounds like a great idea. That individual is likely to end up based in a politically friendly riding to the party in power (Miramichi? Laval? Edmonton?). Solutions will be bureaucratic, slow, compromised and poorly matched to the local challenges. As an example of Federal Government execution of what seemed a good idea – under both the Conservatives and the Liberals – look up the Phoenix Payroll System. It has its own Wikipedia page. https://en.wikipedia.org/wiki/Phoenix_pay_system. Neither party managed to pay their own employees. The system is still limping along. The Government’s Phoenix page discussing the cost of the system makes for interesting reading. A tad defensive.

<https://www.tpsgc-pwgscc.gc.ca/remuneration-compensation/services-paye-pay-services/centre-presse-media-centre/investissements-phenix-investments-phenix-eng.html>

What about that supply thing?

A client owns 75 acres bordering on a medium sized community here on Vancouver Island. The property falls within a Regional District (Provincial) and is across the road from the town’s border (municipality). The Regional director and municipal planner want him to develop the property into 5 acre lots. He took both to task asking “Why should I break the property up into 15 lots that can only be acquired by those who can afford to pay \$1.2 million per lot before building a large house, when I could develop the property into 63 lots? I could build nice new houses to sell at \$680,000 each for a nice profit. That cost is within reach for many families” He added he could develop the property to provide over 100 single level, slab-on-grade patio homes that would sell all-in for \$300,000 each. He could build a mix of multi-family and single family units, at costs average citizens could afford. Those new arrivals in the community would then pay property taxes in the area and increase the economic/tax base. He’d make a pile more money doing it too. He’d pay tax on the gains, pay more GST/HST on the increased materials. Everybody wins. Neither the Regional District Director nor the city planner want to lose their jobs encouraging increased density. Eventually density is accepted. There are no single-family homes in Manhattan or Tokyo.

If Federal politicians REALLY want to increase housing, they’re going to have to take on the local voters. They won’t. A polite way of describing Federal-level politicians making promises

on housing is ‘they are making tough and expensive commitments’. I believe, in this instance the only viable solution is to reduce regulatory hurdles, not to increase them. I’m not a Libertarian, less-government-all-the-time guy. Sometimes it’s the right answer.

A final thought on ‘The Rich’. How could it happen?

This year’s election features a roaring debate about The Wealthy - the identity of which is a moving target. Some policies imply wealth above a certain level (IE “*more than I have*”) is immoral, that being stinking rich goes against Canadian sensibilities and the accumulation of such wealth must have come off the backs of ‘the rest of us’.

As a wealth manager, I have met a few investors who got rich by abusing their employees, screwing their business partners, defaulting on their lending obligations, gaming the tax system and being greedy in the fashion of US Pres. candidate Donald Trump who responded to similar charges by proudly proclaiming “*I was just a smart businessman*”. It is also true a few ultra-rich continue to abuse the system. Some get elected! These types make for nasty clients. I won’t deal with them. In my experience, our wealthier clients care about their community’s health and well being. In my experience, none of our higher net worth clients got there via abuse, graft, corruption, or theft. They got there by financial discipline, hard work, offering value they could charge for, **and time**. That compound interest thing. Earlier in this series I used it to demonstrate the power to cause harm. It goes the other way too.

Q: How to achieve \$20 million Canadian?

A: Invest \$6,200 USD in the S&P500 Jan 1, 1950. Re-invest all your dividends. Present Value \$15,723. At today’s FOREX = \$20,003,370 \$CDN

NOTES:

- 1950 median cost of a single-family dwelling in the United States: \$7,354
 - 1950 avg square footage of new homes being built in USA: 950 sq
 - Avg cost per square foot \$7.74 = \$82.11 in 2019 dollars.
 - 1950 avg US family size: 3.3 persons
- 2019 median cost of single-family home in USA: \$274,600
 - 2019 avg square footage of new single-family homes built in USA: 2,531
 - Peak avg square footage all S-F dwellings USA was 2015 at 2,740:
 - Avg cost per square foot: \$108.49 2019 dollars
 - 2019 avg US family size 2.6:

CONCLUSIONS:

1. Maybe the problem with housing is ‘affluenza’. We demand 2.8X more space to house 21% fewer people per house at 32% more cost (more do-dads and fancy counters).
2. Investing 84% of the cost of the average US home..ONCE...into the S&P500 in 1950 made you rich by today’s standards. Not many 71-year-old Canadian’s had \$6,200 at their 1950 birth to plop down on the S&P500. If one invested \$1,200 US each year



1950 to 1960, the result would also be \$20 million Canadian today. No Fairy Dust required.

Sources: S&P500 historical returns:

<https://www.officialdata.org/us/stocks/s-p-500/>

US average house size:

<https://www.statista.com/statistics/529371/floor-area-size-new-single-family-homes-usa/>

Steve & Anna Hilberry

Have a Great Weekend!



FOR THE RECORD Sept 17, 2021

DOW INDUSTRIALS:	34,613
S&P 500:	4,445
S&P/TSX COMP:	20498
WTI:	\$71.81
LOONIE IN \$USD:	\$0.7855 \$US

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