INTERLUDE – WHEN TIME STOOD STILL (Newsletter Summer 2002)

Margaret Lucas

The 1990s were not good years for Canadians; most saw their income shrink in real terms in the first half of the decade and only grudgingly expand in the latter half. By 1990 the average Canadian was back where they had been economically ten years before. The evidence was all the more striking when one ventured south of the border or to Europe; two areas that had forged ahead whilst we trod water paying the price for earlier government excess. Our standing in the world wealth order had plunged from fifth position, based on per capita gross domestic product at purchasing price parity, to seventeenth. Our shrinking dollar was a dismal reminder of our reduced means. The most striking evidence of our laggardly progress in the wealth stakes, were the gains in house prices beyond our borders. In fact over the past decade, only three countries in the developed world; Canada, Germany and Japan, missed out on this housing boom. Even when the growth years of the 1980s are included we occupy the lower rungs of the ladder.

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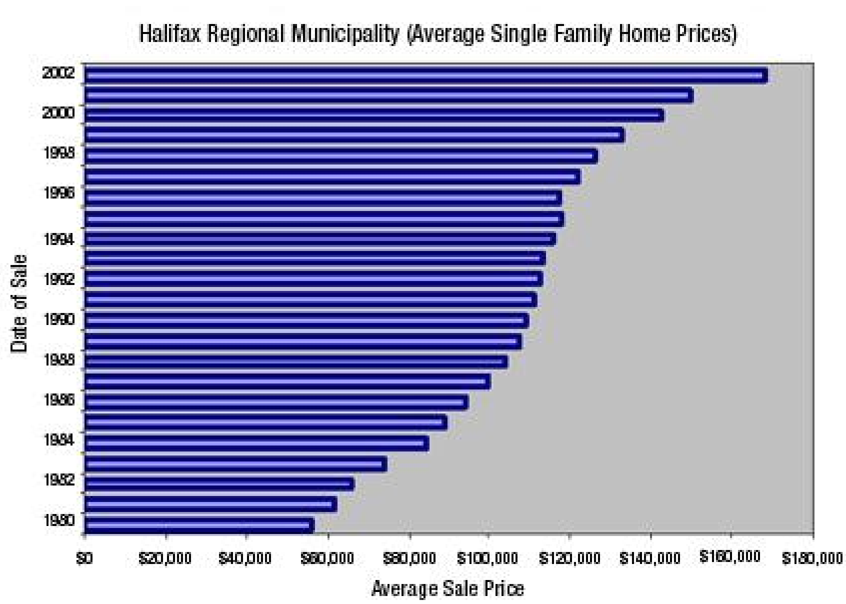
Country	Change In House Prices 1980-2001	
	Nominal	Real
Spain	726%	124%
Ireland	451%	95%
Britain	389%	89%
Netherlands	181%	66%
Belgium	140%	23%
United States	158%	20%
France	155%	15%
Japan	52%	15%
Canada	152%	13%
Italy	343%	13%
Australia	213%	10%
Sweden	183%	6%
Germany	33%	-21%
Global Index	148%	19%

Source: The Economist (March 30th - April 5th 2002)

Of Kings and Castles

Why should we care? The average Canadian is comfortably housed: palatially perhaps compared with much of the world. In fact in Atlantic Canada a housing dollar goes much further than in many other places on the continent. For many however, their home is not just their castle, it provides financial security as well as shelter. It is an important vehicle for saving, more so than any other type of investment. The family home represents about 30% to 40% of household wealth in Western Europe and almost 25% in America (and presumably, Canada). Best of all it is "real" wealth because it is tax free: we can liquidate our investment without the government appropriating part of it for the "public good" … or we can release funds for business or personal ventures by re-mortgaging the family home. It provides an excellent hedge against inflation because the two are highly correlated: if inflation increases, so do house prices. Hardly surprising, the ability to borrow, and hence buy, is a function of family income. If inflation pushes up family income it has a concomitant effect on housing demand. Best of all there is little downside risk if the property is located in a major urban area in Atlantic Canada. During the past thirty years nominal average single family house prices in the region's largest urban community, Halifax Regional Municipality, have never registered a significant year over year reduction.

click for full sized graph



Source: Turner Drake & Partners Ltd Compuval™ Database.

Home ownership offers the upside potential of the stock market without the latter's downside risk. 63% of Canadians own their own homes. This repository of wealth affords an important cushion against recession. As house prices rise family wealth increases and home owners are more likely to spend. A National Bureau of Economic Research study, released in November 2001, which compared property prices with the stock market in 14 countries, discovered that changes in the former had at least twice the impact on consumer spending as the same change in share prices ("Comparing Wealth Effects: The Stock Market Versus The Housing Market" by K.E. Case, J.M. Quigley and R.J. Shiller. NBER Working Paper 8606). The quantity and quality of the housing stock which is owner occupied, and the movement of house prices are important indicators of consumer spending in the community. We have tracked house prices in the Halifax Regional Municipality continuously for the past 24 years: our Compuval™ residential database contains 2.8 million pieces of information on 93,000 sales. It

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reveals some interesting fluctuations in real, i.e. inflation adjusted, sales prices over the past three decades.

Ebbs and Flows

Even under conditions of zero inflation, stable mortgage interest rates and an unchanging housing mix, the average price of a single family home will trend upwards because quality is constantly improving. Thirty years ago R12 insulation was standard in the walls, with R20 in the attic. Today R20 in the walls and R32 in the roof is a minimum requirement. Accoutrements such as energy efficient heating systems, security monitoring, Jacuzzi tubs, European kitchens, and hardwood floors are commonplace. Nonetheless we estimate that the annual impact of this "quality" effect on house prices is quite low, probably about 0.5%.

If the distortion due to inflation on house prices is removed, the real increase in property values looks like this:

click for full sized graph

Is Atlantic Canada now starting to participate in the world housing boom that passed us by in the late 1980s and most of the past decade? Are we now "banking" our wealth in real estate so that we can sail through future recessions in a relatively painless manner? It's a curious paradox; the recent recession itself contained the seeds of this revival. The absence of inflation allowed the Bank of Canada to follow the U.S. Fed. in lowering interest rates in the run up to the recession. This placed mortgages within the financial reach of a greater pool of purchasers and stimulated demand. Since housing stock is fixed in the short run, prices rose. In areas where land available for new development is fixed in supply, the increase in residential lot prices has been dramatic. This is very much in evidence in the south end of Halifax Peninsula (homes there have risen by 321% since 1978 versus 169% in the suburbs). Homes with water frontage, particularly the ocean, have also experienced major price increases over the past three years throughout the Maritime Provinces but particularly in Prince Edward Island and along Nova Scotia's south shore. The large increase in P.E.I. water frontage values is partly the result of the May 1997 opening of the Confederation Bridge which finally ended

Canada's isolation from the Island, and the twinning of the Trans Canada Highway through New Brunswick. The most rapid increase in house prices however coincided with the fall from grace of the stock market: humble Hodge, with his modest hovel of thatch and wattle proved to be a more astute investor than those Nortel high flyers so beloved of pundits such as Garth Turner (no relation … and anyway he's from Ontario). We suspect that the trend will continue: people will invest in their own homes rather than the stock market. It has its corollary in investment real estate; particularly rental residential units. Demand is strong and anecdotal data suggests increasing interest from investors who were formerly active in the stock market and have the bruises to prove it.

Urban Animals

The May 2001 Statistics Canada census confirmed what every parent in Atlantic Canada knows. … we are loosing our offspring to parts foreign: the United States, Alberta and Ontario. Only little Prince Edward Island experienced positive population growth … and that individual was probably only there on a day pass. Within the Atlantic Region people are gravitating to the urban areas; our lumberjack activities are now more likely to be conducted within the comfortable confines of Kent Building Supplies … we are urban animals:

Jurisdiction	Population		
	2001	1996	% Change
Canada	30,007,094	28,846,761	4.00%
Nova Scotia	908,007	909,282	-0.10%
New Brunswick	729,498	738,133	-1.20%
Newfoundland	512,930	551,792	-7.00%
Prince Edward Island	135,294	134,557	0.50%
Atlantic Canada	2,285,729	2,333,764	-2.10%
Halifax CMA	359,183	342,966	4.70%
St John's CMA	172,918	174,051	-0.70%
Saint John CMA	122,678	125,075	-2.40%
Moncton CMA	117,727	113,495	3.70%
Fredericton CMA	81,346	78,950	3.00%

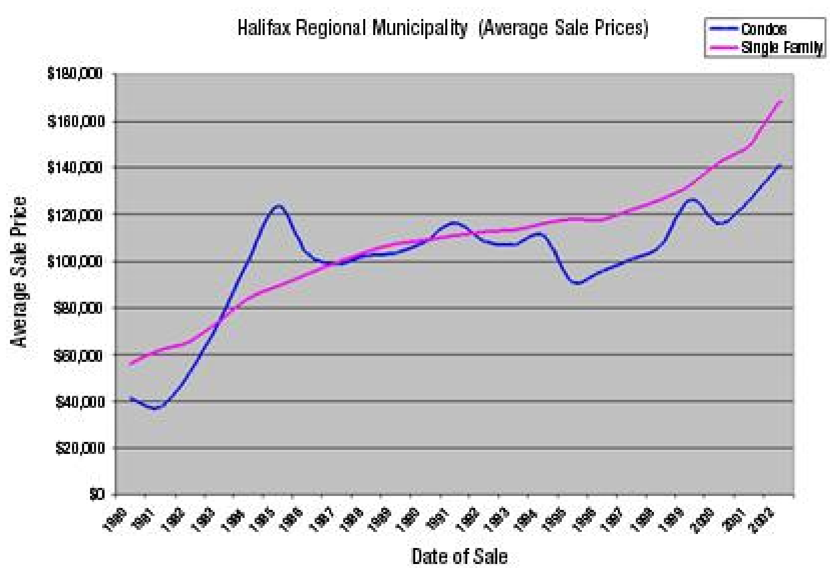
Charlottetown CMA	58,358	57,224	2.00%
Metropolitan Areas	912,210	891,761	2.30%

Source: Statistics Canada

City Centre Citizens

As our population ages it is moving back to the city core. Retired empty nesters are sacrificing the joys of property maintenance, selling their suburban homes and renting or buying apartments closer to downtown amenities. This presages a revival of city centres many of which are ignored by the municipal governments because they lack voters. (Businesses pay the bills but are deprived of any say in how they are spent). As a result central business districts such as Halifax are dirty, neglected, disfigured with graffiti, "wild" postering and vacant lots (many government owned). Yet Atlantic Canada contains many fine buildings, some classic Georgian structures dating back to the early 1880s: the demand is there, only the political will is lacking. Condominium apartments in our downtowns are relatively inexpensive: that is changing.

click for full sized graph



Source: Turner Drake & Partners Ltd, Compuval™ database

Our graph shows the average sale prices, in current dollars, of condominium apartments on the Peninsula area of Halifax Regional Municipality, compared with the average price of a single family home in the municipality. The entire Peninsula is within walking or biking distance of the Central Business District. Condominium prices rose sharply in the first half of the eighties; the market then softened in response to over-building and "bottomed out" again in 1995. Prices are now on a steep upward projectory, shadowing the performance of single family homes. At a current day average price of $141,000 they represent one of the world's better buys. A similar apartment in New York will set you back a nifty $1.33 million, London a lavish $1.25 million, Dublin a doubtful $578,000 and bargain basement Brussels $234,000. Oh, and Toronto a terrible $371,000.

So Real Estate is King?

Well maybe not the king, but Canadians continue to put their money where their castles are, building family nest eggs to cushion the effects of the next recession. Move over John Roth, humble Hodge has a few tips he'd like to share with you.

For the full text of "Comparing Wealth Effects: The Stock Market Versus the Housing Market" NBER Working Paper 8606: visit NBER's web site at www.nber.org/papers/w8606.

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