# *Addendum to*

# *Comparing Housing Costs – Owning versus Renting Homes in Canada*

***Completed by:***

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Economic Research

# *Renting-and-Investing as a Housing Option*

In a report published in September (available via this page: https://www.wdunning.com/recent-reports and from the Royal LePage website) I compared the costs of owning versus renting homes for 278 cases across six Canadian provinces.

The original report was sponsored by Royal LePage Real Estate Services/Bridgemarq Real Estate Services. This additional research is unsponsored.

In the September report, I compared the costs of owning and renting in four different ways:

- Using the most recent data (the second quarter of 2021), what does the comparison show for the cost of owning a home versus renting the same dwelling?
- Looking backward: during the recent past, what have been the initial (first-month) costs of buying a home versus renting a similar dwelling and how has that evolved over time?
- Looking forward, for someone buying a home now, how might the costs of home ownership compare to the costs of renting the same dwelling during the coming decade?
- Then, for that 10-year period (at which time the dwelling would be sold), how might home ownership perform if it's looked at as an investment?

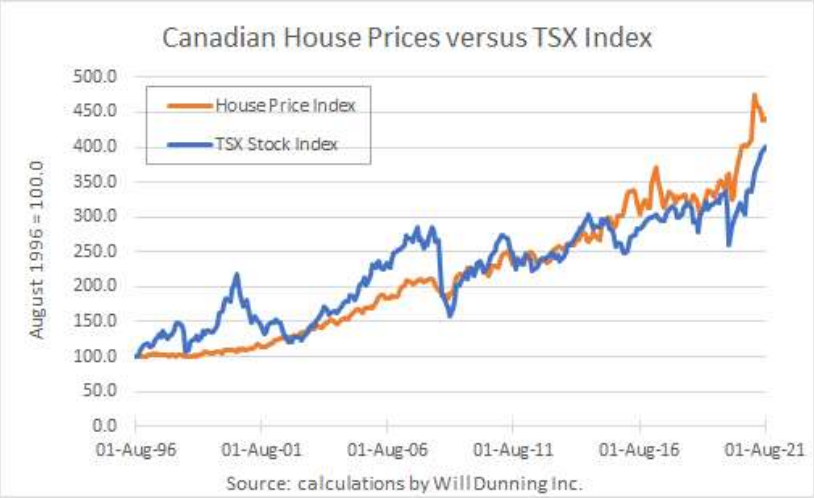
This additional research makes a fifth set of calculations, looking at housing-as-an-investment in another way:

- Instead of buying a home, a person (or family) rents the equivalent dwelling. The money that would have been invested in a 20% down payment plus an allowance for closing costs (2% of the purchase price) is placed in an investment account.
- In addition, to the extent that the total monthly cost of ownership exceeds the cost of renting the same dwelling, the differences are added to the investment account each month.
- The investment account is fully invested at all times (in the broad Canadian TSX-300 index), receiving dividends and experiencing capital gains, and these accumulate in the investment fund.
- Four different scenarios have been calculated, based on assumptions for growth rates for home values and stock indexes.
- The calculations estimate the financial positions of owners and renters in 10 years (for renters, the value of the investment portfolio; for owners, the net equity in the home, after deducting a 6% allowance for selling costs and repaying the remaining mortgage balance).

In addition, on the last page of this short report, I'm making a brief comment on home owners' repair costs.

What should be assumed about growth rates for house prices and stock indexes, and the yields earned by dividends? The results of the calculations will obviously be highly sensitive to those assumptions.

I started by looking at changes in house prices and the TSX-300 stock index, for the past 25 years (starting in August 1996). In this chart, I converted both of the data sets, to be equal to 100.0 at the start. There is strong correlation between the two, although there can be significant differences at times. Over this particular 25-year period, Canadian house prices and the TSX index have increased by similar amounts, averaging 6.1% per year for the average house price and 5.7% per year for the stock index. I wasn't expecting the results to be so close. Some of the major influences are similar. Home buying and therefore house prices are influenced by the state of the economy, as is the stock market. Interest rates are important factors for both: falling rates mean that required yields on investments are reduced, causing capitalized prices to rise for stocks. Falling rates also make it possible for house prices to rise and still be affordable.




In light of this data, I'm choosing to assume that during a 10-year projection period, house prices and the stock index will rise at the same rate. Four scenarios are analyzed, in which the annual rates of increase for both house prices and the stock index are 5.0%, 2.5%, 0%, or -2.5%.

For dividends, the current yield in the Canadian stock market is in the area of 2.5%, and the calculations assume that this yield will be sustained.

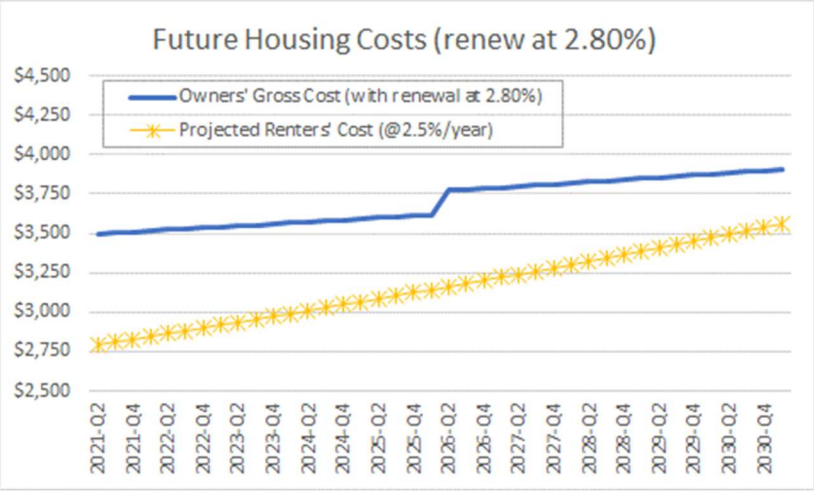
Some other assumptions made in this analysis are:

- Stock trading is costless (there are no sales commissions, management fees or expenses, or account fees).
- The renter makes the required transfer of funds without fail.
- The account is fully invested at all times.
- Taxes: while dividends and capital gains are generally taxable, which will reduce the rates of return on investment, in this analysis no income taxes are deducted from the dividends or capital gains.[1]
- To the extent that these conditions are not met, growth of the renters' investment portfolios would be less than projected.

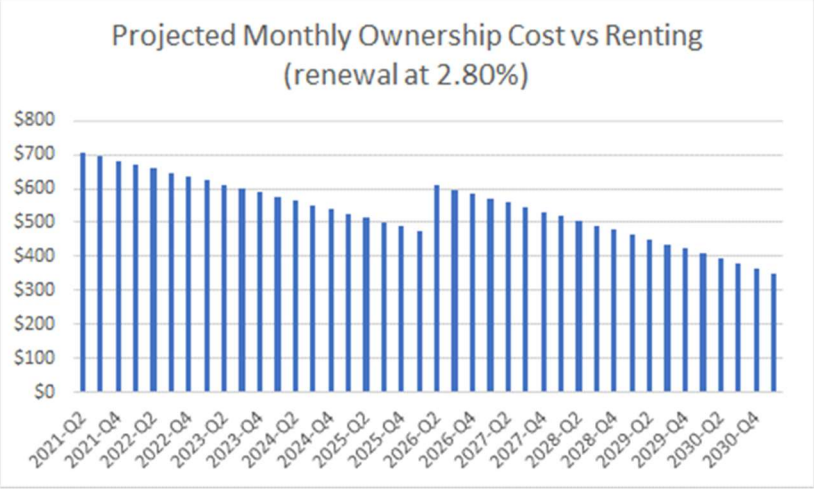
[1] There are some possibilities to reduce taxes. For example, some of the initial investment could be placed in a Tax-Free Savings Account ("TFSA"): for 2021, the maximum possible deposit (if no prior deposits have been made) is $75,500, or slightly less than one-half the initial investment (which on average is just over $160,000). In subsequent years, some of the excess ownership costs (or leftovers from the initial investment funds) could be deposited, using the additional $6,000/year contribution room. While single people often won't be able to tax-shelter all of the funds, couples might come closer. Additionally, some people might choice to invest via RRSPs (although this defers taxes until later years, rather than making investments tax-free).

- Tenants and owners don't move during the 10-year analysis period.[2]

The amounts of funds that could be added to the renter's investment fund in future are substantial. In these scenarios, the average amount is $705 per month in the first period (the second quarter of 2021). However, the amounts fall gradually over time, because the total cost of owning rises less quickly than the cost of renting the same dwelling.




This chart contrasts the total cost of ownership and the total cost of renting the same dwelling. The cost of owning rises less quickly than rent because the mortgage payment is flat for the first five years (because there is a fixed-rate mortgage). It is assumed that when the mortgage is renewed in five years, the interest rate increases to 2.8%, which raises the monthly mortgage payment and the total cost of ownership. The 2.8% interest rate for the renewal is based on the average interest rate seen during the analysis period covered in the original report (2014-Q4 to 2021-Q2).




This chart shows the differences between the costs of ownership and renting. The initial gap is $705 per month. At the end, it is $351 per month. For the entire period, the average is $538 per month. These are the amounts that the renter could add to the investment account each month.

(In the detailed analysis, there are some situations, especially in the later years of the projection period) in which the total cost of ownership is less than the cost of renting: the excesses are actually negative numbers, and instead of adding to the investment fund, money needs to be taken out of the fund, to cover the extra cost of renting).

*I am not suggesting that any one of these scenarios is most likely for the next 10 years, or even that the averages for the scenarios are likely. I am indicating a range of possible outcomes, and*

[2] My tabulation from the 2016 Census (Public Use Microdata File, hierarchical file) indicates that among home owners, 26% of households had moved into their then-current home during the prior 5 years. For renters and band members, the share was 61%.

*there are many more possibilities. In the original report and in this addition, I am describing issues that potential home buyers can consider, and attempting to contribute to the policy discussions that are happening with respect to housing markets and mortgage regulations. In that light, if you haven't looked at the last four pages of the original report, I hope you will.*

### *The Estimates*

Table 1 shows results for the scenarios, as the averages for the total sample of 278 cases. Table 2 shows further details, the average results for the six provinces that are in the dataset.

In Table 1, the bottom line shows that in the event that house prices and the stock index rise by 5% or 2.5% per year, the financial outcomes are considerably better for home ownership than for the rent-and-invest alternative. If there is no growth in values for homes or the stock index, the outcomes are similar (in the third scenario, the end value for home ownership is slightly higher than for the rent-and-invest alternative). If values fall by 2.5% per year (the fourth scenario), renting-and-investing provides a better outcome.

***Table 1***
***Results of Rent-and Invest Analysis for 278 Cases, for Four Scenarios***

| | | | | |
|---|---|---|---|---|
| ***Results Common to All Scenarios*** | | | | |
| Initial Value | 733,459 | | | |
| Initial Investment (Down Payment + 2% Closing Costs) | 161,361 | | | |
| Average Amount Available for Investment per Year | 6,454 | | | |
| Remaining Principal in 10 Years | 394,514 | | | |
| ***Results in 4 Scenarios*** | | | | |
| | ***Scenario 1 5% annual value growth*** | ***Scenario 2 2.5% annual value growth*** | ***Scenario 3 no value growth*** | ***Scenario 4 2.5% value loss per year*** |
| Home Value in 10 Years | 1,194,727 | 938,890 | 733,459 | 569,406 |
| Proceeds After 6% Disposition Cost | 1,123,044 | 882,556 | 689,451 | 535,242 |
| Net Proceeds from Selling | 728,529 | 488,042 | 294,937 | 140,727 |
| Renters' Portfolio | 426,742 | 345,495 | 279,082 | 225,006 |
| **Net Assets for Owning versus Renting, After 10 Years** | **301,787** | **142,546** | **15,855** | **-84,279** |
| Source: calculations by Will Dunning Inc. | | | | |

Results will vary, of course, for different housing situations. The summary in Table 2 indicates that the results are most favourable for ownership in Newfoundland, followed by Quebec and Alberta. To generalize (the averages of the bottom lines across the four scenarios, as shown in the final line of Table 2), the outcomes are least favourable to ownership in British Columbia, followed by New Brunswick and Ontario.

- In the first and second scenarios (value growth at 5% or 2.5% per year), ownership produces better financial outcomes than renting-and-investing in all of the six provinces (the "Net Assets for Owning versus Renting" are positive numbers).
- In the third scenario, with the assumption that there will be no growth of values, the rent-and-invest option produces better financial outcomes in British Columbia and Ontario, but ownership has a better outcome in the four other provinces.

- In the fourth scenario, assuming that values fall by 2.5% per year, rent-and-invest produces better financial outcomes in four provinces (except for Newfoundland and Alberta).

***Table 2***
***Results of Rent-and Invest Analysis for 6 Provinces***

| | *All Areas* | *Alberta* | *New Brunswick* | *Newfound -land* | *British Columbia* | *Ontario* | *Quebec* |
|---|---|---|---|---|---|---|---|
| ***Results Common to All Scenarios*** | | | | | | | |
| Initial Value | 733,459 | 396,129 | 344,052 | 370,810 | 1,211,599 | 932,543 | 501,978 |
| Initial Investment (Down Payment + 2% Closing Costs) | 161,361 | 87,148 | 75,691 | 81,578 | 266,552 | 205,159 | 110,435 |
| Average Amount Available for Investment per Year | 6,454 | -1,233 | 3,672 | -23,753 | 21,378 | 13,890 | 613 |
| Remaining Principal in 10 Years | 394,514 | 213,070 | 185,059 | 199,452 | 651,697 | 501,598 | 270,005 |
| ***Scenario 1 - 5% value growth*** | | | | | | | |
| Home Value in 10 Years | 1,194,727 | 645,252 | 560,424 | 604,010 | 1,973,567 | 1,519,014 | 817,670 |
| Proceeds After 6% Disposition Cost | 1,123,044 | 606,537 | 526,799 | 567,770 | 1,855,153 | 1,427,873 | 768,610 |
| Net Proceeds from Selling | 728,529 | 393,466 | 341,740 | 368,318 | 1,203,456 | 926,275 | 498,605 |
| Renters' Portfolio | 426,742 | 162,567 | 209,454 | -173,042 | 859,156 | 624,367 | 237,322 |
| *Net Assets for Owning versus Renting, After 10 Years* | *301,787* | *230,899* | *132,286* | *541,360* | *344,300* | *301,907* | *261,282* |
| ***Scenario 2 - 2.5% value growth*** | | | | | | | |
| Home Value in 10 Years | 938,890 | 507,078 | 440,416 | 474,668 | 1,550,949 | 1,193,733 | 642,575 |
| Proceeds After 6% Disposition Cost | 882,556 | 476,653 | 413,991 | 446,188 | 1,457,892 | 1,122,109 | 604,020 |
| Net Proceeds from Selling | 488,042 | 263,583 | 228,931 | 246,736 | 806,195 | 620,511 | 334,015 |
| Renters' Portfolio | 345,495 | 126,608 | 170,261 | -168,769 | 706,956 | 511,527 | 188,102 |
| *Net Assets for Owning versus Renting, After 10 Years* | *142,546* | *136,975* | *58,671* | *415,505* | *99,239* | *108,984* | *145,913* |
| ***Scenario 3 - no value growth*** | | | | | | | |
| Home Value in 10 Years | 733,459 | 396,129 | 344,052 | 370,810 | 1,211,599 | 932,543 | 501,978 |
| Proceeds After 6% Disposition Cost | 689,451 | 372,361 | 323,409 | 348,561 | 1,138,903 | 876,590 | 471,860 |
| Net Proceeds from Selling | 294,937 | 159,290 | 138,349 | 149,109 | 487,206 | 374,992 | 201,855 |
| Renters' Portfolio | 279,082 | 97,637 | 138,165 | -162,857 | 581,583 | 418,779 | 148,208 |
| *Net Assets for Owning versus Renting, After 10 Years* | *15,855* | *61,654* | *185* | *311,966* | *-94,378* | *-43,787* | *53,646* |
| ***Scenario 4 - values fall by 2.5% per year*** | | | | | | | |
| Home Value in 10 Years | 569,406 | 307,526 | 267,098 | 287,871 | 940,600 | 723,960 | 389,701 |
| Proceeds After 6% Disposition Cost | 535,242 | 289,075 | 251,072 | 270,599 | 884,164 | 680,523 | 366,319 |
| Net Proceeds from Selling | 140,727 | 76,004 | 66,013 | 71,147 | 232,467 | 178,925 | 96,314 |
| Renters' Portfolio | 225,006 | 74,436 | 111,979 | -155,817 | 478,619 | 342,793 | 116,039 |
| *Net Assets for Owning versus Renting, After 10 Years* | *-84,279* | *1,568* | *-45,966* | *226,964* | *-246,152* | *-163,868* | *-19,726* |
| ***Average Bottom Line for 4 Scenarios*** | ***93,978*** | ***107,774*** | ***36,294*** | ***373,949*** | ***25,752*** | ***50,809*** | ***110,279*** |

Source: calculations by Will Dunning Inc.

### *A Note on Repair Costs*

This research has assumed that home owners spend an average of $60 per month on home repairs (the amounts vary by type of dwelling and location). That figure is based on a calculation I made several years ago, using the Statistics Canada microdata file from the 2009 Survey of Household Spending. The cost estimates have been updated using the Consumer Price Index for "Homeowners' maintenance and repairs".

I have noticed some comments that $60 per month seems too low. A few people have argued that I should have assumed that the annual cost of repairs is equal to 1% of the value of the property, which would be in the order of 10-times the factor I used. That 1% factor would be ridiculous: it would require a very large repair every year, such as re-shingling the roof or replacing the furnace and air conditioning system.

One kind person went into the most recent edition of the consumer spending microfile (the data for 2017) and calculated that the cost now would be $79 per month. A difference of $19 per month would have a very small effect on the estimates (less than 1% in relation to an average rent of $2,795 per month). Even if the repair cost were doubled to $120, the effect would be small and would not materially change the conclusions (as of 2021-Q2, the net cost of ownership was calculated as $705 per month lower than the cost of renting the same dwelling; a $60 reduction of the "ownership advantage" due to doubling the repair cost would still leave the net cost of owning far below the cost of renting).

In addition, I did not include tenant insurance as a cost of renting (since the StatsCan microfile did not show that cost) and I did not include any estimate for repairs made by tenants (for example, deductions from damage deposits). Those additional costs of renting would to some extent offset any under-estimation of home owners' costs.

### *About the Author*

Will Dunning is an economist, and has specialized in the analysis and forecasting of housing markets since 1982. Since the fall of 2000, I have operated a consulting company that specializes in housing market analysis. Clients of Will Dunning Inc. have covered a wide range of interests, including:

- Departments and agencies in federal, provincial and municipal governments.
- Non-governmental organizations, including non-profit advocacy groups, agencies, and industry associations.
- Private sector clients include financial institutions, builders, investors, investment and asset managers, and law firms.

*More information and a variety of reports can be found at: https://www.wdunning.com/*

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