# Is A Real Estate Crash Canada'a Next Black Swan?

## Description

This is definitely a bubble.

That was my thought two years ago when I looked out at the Toronto skyline. From from my Cityplace balcony – ground zero for Canada's real estate boom – you could count 27 construction cranes.



So is this proof of impending doom for Canada's housing sector? Will a real estate crash be the country's next black swan? I have no idea and it's not something savvy investors should worry about.

**Is this a bubble?**
The nation's lofty property prices have once again made international news. 'Canada's Housing Market Teeters Precariously' was the headline in the *Financial Times* on Monday. Anjli Raval writes,

*'As home prices rally and construction projects proliferate – particularly in Toronto, Montreal, and Vancouver – industry analysts say the country's property sector is perched precariously at its peak. […] Alongside Norway and New Zealand, Canada's overvalued property sector is most vulnerable to a price correction, according to a recent OECD report. It is especially at risk if borrowing costs rise or income growth slows.'*

Mr. Raval laid out the usual statistics to back up his story. According to StatsCanada, household debt has risen to a record high 163% of disposable income. On a price-to-rent basis housing prices are more than 60% above their long-term average. And today, Canadians spend 30% of their income on housing. That's closing in on the 1996 record when interest rates were substantially higher.

So, is this a bubble?

**I have no idea…**
The obvious truth is that none of the experts can predict how monetary policy, interest rates, or economic growth will impact the real estate market. Sure, housing bulls can cite immigration and a strong jobs market to justify higher prices,but in reality neither the optimists or the pessimists can reliably predict the next move in the market.

Could a real estate crash be the next black swan? Maybe, but I doubt that as well. By definition black swans are unexpected. Read the conference call transcripts of **Royal Bank** and **TD Ameritrade**. The nation's top bankers were well aware of the heated property market as early as three years ago. This isn't news.

Another black swan is lurking, to be sure. But it's far more likely to be a hedge fund I never heard of, trading a derivative product I don't understand, in a country whose name I can't pronounce that will blow up the financial system. The catalyst for the next financial crisis won't be discussed in the business section of a national newspaper with much advance notice.

The other mistake people make when discussing Canada's real estate market is to look at a city like Toronto or Vancouver and extrapolate this to the whole country. But these are skewed data points that don't necessarily represent everywhere else. As someone who has lived across Canada these past three years and a proud Nova Scotian, I know most Canadians don't wake up to the opening bell on the TSX.

**…but this I do know.**
Given we can't predict the future of the real estate market, how should investors position themselves? By using the same investment principles that we would apply to any other industry: entrust your capital to an experienced management team and avoid excessive debt.



First, I'm going to advocate for what I'll call the 'grey hair indicator'. We haven't had a major downturn in the Canadian real estate market in over 20 years. That means that only the most grizzled veterans have seen a bear market and have any idea how to exploit one if it occurs. Investors should only consider the most seasoned executives.

That's why I'm a fan of **RioCan REIT** (TSX: REI.UN) Chief Executive Ed Sonshine. Sonshine started his career in the early 1990s when prices were plummeting and firms were going bankrupt left and right. Since then he has grown RioCan into the nation's largest property manager while generating healthy returns for unit holders. Being baptized during that period of industry turmoil was an invaluable experience.

Second, avoid debt. While I don't know when the next property bust will occur, it's safe to assume one or two are bound to happen over the next 30 plus years. Over-leveraged firms are destined to go broke. Reserved companies will survive, pick up some bargains, and continue to prosper when the smoke clears.

Once again, a company like RioCan thrives in this department. The trust has one of the most conservative balance sheets in the industry. Additionally, many of its tenants are high quality retailers like **Wal Mart**, **Target**, and **Staples**. This firm is like a cockroach (and I mean this in a good way). It will be the last thing alive in the event of a real estate nuclear meltdown.

**Foolish bottom line**
Is the Canadian real estate market a bubble? Are housing prices bound to collapse? I have no idea. But investors can prosper regardless by following time-tested investment principles.

**CATEGORY**

1. Investing

**TICKERS GLOBAL**

1. TSX:REI.UN (RioCan Real Estate Investment Trust)

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