



3 Canadian Real Estate Charts You Have to See

Description

Since the beginning of the financial crisis, the Bank of Canada has printed over \$300 billion in a desperate attempt to reignite the economy.

Where did all that money go? Based on the charts below it went into shiny new condo towers and housing developments. It was sunk into kitchen renovations and stylish furniture.

Canada's booming real estate market is probably the most important economic trend of the past five years. And the statistics coming out of the industry are truly remarkable. Here are three charts you have to see.

Canadian mortgages are a ticking time bomb

House prices have surged ahead of incomes. In 1996, the average Canadian paid 4.9 times their annual income for a home. Over the past 17 years, incomes have risen at about 3% per year, while home prices have climbed 6% annually. Today, the average Canadian now pays almost 8 times their income for a home.

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How has this impacted household budgets? Not that much, actually. Based on a typical 25- year amortization mortgage, 5- year term, and a 20% down payment, a new homeowner will have to dedicate 32% of their pre-tax income to housing costs. That's well within historical averages.

But this has only been accomplished through rock bottom interest rates. If a 5- year term mortgage were to rise to 6% – still well below historical averages – affordability would drop drastically. Even a small increase in interest rates would require a massive adjustment in the real estate prices.

Housing valuations have reached unprecedented heights

Owning a home has never been more expensive relative to renting. In Montreal, the average home is priced at 30 times annual rent. In Calgary, this ratio is 32. In Toronto, this ratio is over 37. These are all well above historical averages.

As seen in the chart below, the OECD estimates that the nation's real estate market is 60% over valued relative on a price-to-rent basis. Canada is in dark red.

2

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The price-to-rent ratio isn't a perfect indicator. For example, a single-family Vancouver house that is priced at 100 times annual rent isn't necessarily evidence of a bubble. It may indicate that the land could be repurposed for say a condo development. That is what's being reflected in the price. Not a future stream of rental income.

However, this does not explain the massive surge in housing valuations we've seen over the past three years. Nor would this explanation likely apply to the whole country.

Like a growth stock, a high price-to-rent ratio could also indicate that the market is optimistic that rents will rise in the future. And this could be true. But the experiences of the U.S. and U.K. housing bubbles of the previous decade show that high multiples are usually a sign of irrational exuberance.

REITS are pricey

Cheap money isn't just affecting the residential housing market. It's also impacting the institutional side of the industry as well.

In a desperate search for yield, income investors have bid the price of real estate investment trusts, or REITS, to record heights. This spring, the yield on the **iShares S&P/TSX Capped REIT Index** ([TSX: XRE](#)) hit a record low of 4.2%. That's remarkable because the index has historically yielded between 7% to 8%.

More concerning is the low rate REIT investors are earnings relative to other asset classes. The yield spread between Canada's REIT index and a risk-free 10- Year Government of Canada bond is still near record lows. This could suggest that investors aren't being compensated for the risks they're

taking.

Foolish bottom line

As investors, our job isn't to call tops in the housing market. Rather, we're tasked with finding wonderful businesses at reasonable prices.

However, the data coming out of the Canadian real estate industry is looking a little bit bubbly. And as our American neighbours can attest, big changes in the housing market can have drastic consequences for the entire economy. This will certainly be a development investors should keep an eye on.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:XRE (iShares S&P/TSX Capped REIT Index ETF)

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