



## Thinking About Buying Toronto Real Estate? Read This First

### Description

One of the most common questions I get from my family and friends these days concerns real estate: “Toronto housing prices have gone up so fast; is there still time to invest?”

Here’s my take: I won’t be chasing these prices. This is not because I have some special insight into future market trends, but because at current prices, the numbers just don’t make sense.

Let me explain.

The best investors rarely consider market trends when it comes to buying real estate — or any other investment, for that matter. Instead, they make an initial assessment based on the relationship between the price of the property and how much rent it will generate.

Industry veterans use a rule of thumb to spend no more than eight times the annual rental income a property could generate. In real estate lingo, this is called the gross rent multiple, or GRM.

Obviously, this oversimplifies the investment process. However, by sticking to this rule, you can better ensure a satisfactory return on investment without the speculation that housing prices will keep rising.

This handy little rule has a great track record. For example, using a GRM of eight, you would have been forced out of the U.S. real estate market long before the collapse of 2007. This is not because this indicator can foresee a crash — rather, you would have stopped buying rentals simply because there were no properties with a GRM of eight or less.

How would I apply this metric to today’s market? Let’s take an example from Toronto’s rental market.

Consider a typical one bedroom condominium in Toronto’s downtown CityPlace neighbourhood, which is located right across the street from the CN Tower and rents for about \$1,600 per month. That would be \$19,200, or \$1,600 times 12 months, in rental income each year.

As a conservative investor, you would not want to pay more than eight times this annual rental revenue. This is especially true if you want to generate respectable cash flow. That means you

shouldn't pay more than \$153,600, or \$19,200 times eight years, for the unit.

Good luck finding a one bedroom condo in CityPlace at that price! Most condos in this area sell for two to three times that figure. This closely matches valuations found throughout the entire Toronto rental market.

Of course, if real estate prices continue to climb at a double-digit clip, then Toronto condos are a great investment. There is plenty of money to be made if other investors pay ever-higher prices for the same asset.

However, I don't like playing that game. Cautious investors buy assets that make sense immediately based on conservative assumptions. I don't like to speculate that someone, somewhere will pay ever-higher premiums for an asset.

Does this make me anti-real estate? Of course not! Real estate is a great hedge against inflation and an excellent way to build wealth — but only if the price is right. Thankfully, there are other real estate markets that are priced at more conservative valuations.

Take **RioCan Real Estate Investment Trust** ([TSX: REI.UN](#)), for example, [which I highlighted last week](#) as my favourite REIT for monthly income. RioCan invests primarily in commercial properties, an area of the market that's dominated by cash-flow-focused institutions. Gross rent multiples and other valuation metrics in this segment are nowhere near the nosebleed heights of Toronto real estate.

For residential exposure, consider **Canadian Apartment Properties REIT** ([TSX: CAR.UN](#)). This trust owns apartment buildings, manufactured home communities, and office properties across Canada and the United States. Relative to hot markets like Toronto and Vancouver, residential real estate prices are downright cheap throughout the rest of the country.

The bottom line is that Toronto's real estate prices don't make sense from an investment perspective. I have no insight into the market's next move, but based on the current numbers, there are better alternatives elsewhere.

## CATEGORY

1. Investing

## TICKERS GLOBAL

1. TSX:CAR.UN (Canadian Apartment Properties Real Estate Investment Trust)
2. TSX:REI.UN (RioCan Real Estate Investment Trust)

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