If You Buy Toronto Real Estate Now, You'll Hate Yourself Later

Description

The most common question I get from family and friends concerns real estate: "Toronto housing prices are soaring; is there still time to invest?"

You can't predict the next turn in the market. No one has any special insight into future trends. That said, we can say that buying Toronto real estate at current prices makes no business sense.

Let me explain…

Last week, real estate bulls got some bad news from one of the world's largest home builders. On Friday, **Toll Brothers Inc** (NYSE: TOL) CEO Douglas Yearley admitted that he had "snooped around" the Toronto market. By his estimate, 60% to 70% of condo buyers had no plans to live in their homes.

"We saw a lot of people buying with no intention of living there – they just planned to flip," Mr. Yearley told reporters. "When you have a lot of flippers, that's when a bubble comes."

Yearley isn't the only one seeing crazy numbers. The city's real estate boom has produced some jaw dropping figures. For instance…

- **$951,000:** Toronto is about to become the second Canadian city where a single-family home costs more than $1 million. Last month, the average detached house sold for $951,000, up 8% year-over-year.
- **130 skyscrapers:** Toronto has more skyscrapers under construction than any other city in North America. Today, there are 130 high-rise projects underway.
- **39,000 realtors:** The number of realtors in Toronto has doubled over the past 10 years. Today, there's one realtor for every 140 people in the city.
- **37x rental income:** Toronto housing prices are valued at 37x annual rental income. Typically, the market has traded between 15x and 20x rental income.
- **3.7% cap rate:** Toronto capitalization rates — the rate of return based on what a property is expected to earn in rental income — have hit new lows. This was highlighted last year when the Bayview Village shopping mall sold for a record low cap rate around 3.7%.

You have to ask yourself if a 3.7% return is enough to justify the risks of owning real estate. Of course, housing can still be a good purchase if prices keep climbing. There's lots of money to be made if others are willing to pay ever higher multiples.

But I don't play that game. You should buy assets that make sense based on cautious assumptions. Nobody should be speculating that people will pay growing premiums for a house.

Am I some sort of anti-housing zealot? No. Real estate is an great way to build wealth – but only at the right price. Thankfully, there are other areas of the market that are more modestly valued.

Take **H&R Real Estate Investment Trust** (TSX: HR.UN), for example. The firm invests mostly in commercial and industrial properties across Canada. Prices in these markets are far more affordable. Or consider **Canadian Apartment Properties REIT** (TSX: CAR.UN). This trust owns apartment buildings throughout North America. Housing prices are downright cheap throughout the rest of the country, at least compared to a hot market like Toronto.

The bottom line is that nobody has any insight into the housing market's next move. But based on today's prices, buying Toronto real estate doesn't make any sense from a business point of view. There are better options elsewhere.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:TOL (Toll Brothers, Inc.)
2. TSX:CAR.UN (Canadian Apartment Properties Real Estate Investment Trust)
3. TSX:HR.UN (H&R Real Estate Investment Trust)

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Author
rbaillieul