8 Reasons Why Canada's Housing Market Is a Bubble

Description

The numbers coming out of the real estate market are ominous. Thanks to massive injections of phony paper money and cheap debt, housing prices have increased at a high single-digit annual clip over the past decade. Valuations are now completely out of whack with their long-term averages.

Is Canada's housing market a bubble? A growing number of experts are starting to sound the alarm bells. Here are eight reasons to be worried.

1. House prices have outpaced incomes: According to billionaire investor Kyle Bass, Canadians now pay nine times their median income for a new house. Historically, they paid between three and four times their median annual income. At the height of the U.S. subprime bubble, Americans paid seven times their median annual incomes for housing.

2. Real estate valuations are looking stretched: In the rush to become homeowners, Canadians are paying record premiums for the privilege to buy a house. Since 1975, housing prices have risen 53% faster than rent prices. As a result, it has never been less affordable to own a home relative to renting.

3. We've never been so dependent on real estate: This real estate boom has reshaped the country's labour market. Today, 13.5% of Canadian jobs are now linked somehow to construction — the highest level in four decades. If this figure were to revert back to the 7% average, it would result in hundreds of thousands of job losses.

4. Canadians are up to their eyeballs in debt: What's fueling this real estate boom? Debt. To pay for ever-higher real estate prices, Canadians are borrowing at record rates. In June, household debt-to-disposable income hit a record 163%. This is approaching comparable levels to the United States in 2005.

5. Canada is expensive relative to the rest of the world: The IMF's Global Housing Watch has Canada ranked as the second least affordable place in the world to buy a house – behind only Belgium.

6. REITs have never been so expensive: Record valuations are not limited to residential housing, but the institutional market as well. Today, the yield on the **iShares S&P/TSX Capped REIT Index Fund** (TSX: XRE

), a basket of Canadian real estate investment trusts, is nearing a record low at 4.3%. Historically, the sector has yielded between 7% and 8%.

7. Valuations are starting to worry industry insiders: “I think it’s driven primarily by the fact there’s a lot of capital chasing apartments,” said Thomas Schwartz, president and CEO of **Canadian Apartment Properties REIT**, on the recent price rally in August. “I’m not sure they’re looking at CapEx [capital expenditures] in quite the same way we do. And again, at this point, I’m just not comfortable making the deals that are being made out there.”

8. Canadian banks have gone all-in on housing: According to Morningstar analyst Dan Werner, “In a worst-case scenario, if all of the uninsured loans were losses and residential prices fell 30%, we think nearly half of most banks’ tangible equity would be affected.” Werner thinks that largely domestic institutions like the **National Bank of Canada** (TSX: NA) and the **Canadian Imperial Bank of Commerce** (TSX: CM)(NYSE: CM) would be the most impacted.

CATEGORY

1. Investing

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1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. TSX:CAR.UN (Canadian Apartment Properties Real Estate Investment Trust)
3. TSX:CM (Canadian Imperial Bank of Commerce)
4. TSX:NA (National Bank of Canada)
5. TSX:XRE (iShares S&P/TSX Capped REIT Index ETF)

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Author
rbaillieul