



Buy vs. Rent: If You're Thinking About Buying a House, You Need to Read This

Description

Millions of Millennials are eager to buy their first house, but one financial expert is urging new home buyers to slow down.

Garth Turner is a best-selling author and financial speaker. From his popular blog GreaterFool.ca, Garth warns that soaring debt levels have created an epic housing bubble, especially in cities like Toronto and Vancouver.

Renting, he argues, could be a smarter move in some cases. Disciplined renters who plough their savings into a balanced portfolio—made up of say, the **iShares S&P/TSX 60 Index Fund** ([TSX:XIU](#)), the **iShares S&P/TSX Capped REIT Index Fund** ([TSX:XRE](#)), and the **iShares DEX Short Term Bond Index Fund** (TSX:XSB)—could actually come out ahead of homeowners with less risk.

Last week, I had a chance to chat with Garth about home-ownership, Canada's housing boom, and the future of the real estate market. The following is a transcript of our conversation. It has been lightly edited for clarity.

Robert Baillieul: With regards to renting, I often hear slogans like, “You’re paying your landlord’s mortgage,” “Don’t throw your money away,” or “You need to build equity.” What’s your case against home-ownership?

Garth Turner: I don’t necessarily try to build a case against home-ownership, but I do try to build a case against a one-asset-investment strategy. Sadly, we have a cultural preference to real estate. It leads people into putting all of their net worth into one asset. That’s dangerous. It augments risk.

I try to get people to think about diversification. It’s hard, though. We have this cultural bias in favour of real estate. That’s okay if business conditions are supportive. In other words, if we have good economic growth and inflation is diminishing the impact of debt. Under those conditions, real estate can be fine. However, we haven’t had those conditions for a while. We certainly don’t now. There is a considerable element of risk.

So, to answer your question, should I choose between throwing money away on rent or being a

responsible little kid and buy a house? My view is that money spent on rent is not throwing it away at all. Today, most renters are subsidized by landlords. It's actually cheaper to live in the same asset as a tenant than it is as an owner.

People do not properly calculate the cost of home-ownership. It's not just the monthly payment, which is depressed artificially right now by low interest rates. It's the opportunity cost—the amount of money tied up in home equity that is not earning anything, plus insurance, property taxes, and closing costs.

I don't see an argument [for home-ownership] right now unless you can be assured that house prices will continue going up forever, and that ain't going to happen.

Baillieul: I just spent the past winter living in South Carolina. It was strange because none of the young folks I met had any interest in ever buying a home. This was the total opposite of my friends in Toronto, who want to buy a condo at any price. Why is there this disconnect between how Americans and Canadians think about real estate?

Turner: The experience of the American housing collapse was absolutely traumatic for the entire middle class. Most Canadians just don't understand how much net worth was destroyed in the U.S. real estate meltdown.

When Americans saw their property values fall by an average of 32%, which put millions of people underwater because they didn't have that much equity, it pretty much destroyed them. This came after the run-up in real estate values because there was this speculative bubble in the early 2000s—similar to what we're seeing in Canada right now.

A lot of people in the States adopted that one-asset strategy. They got whacked. Their kids are terrified after seeing what happened to their parents.

Here in Canada, it's different. If there's anybody horny for houses, it has to be the boomers. This is the biggest group of house-lusty people ever and they have parted those values to their kids. They think it's 1982 and we have 14% inflation. The boomers are living in the past. They're encouraging their kids to take on an asset at inflated values with mortgage rates at historic lows, but they don't see the inverse relationship between the two.

It's so dangerous, what's happening in Canada.

Baillieul: How did we get into this mess?

Turner: Financial illiteracy has a large amount to do with it. Most Canadians aren't risk takers. They've been concerned about the stock market. They're distrustful of financial assets. When 2008-09 came along, a lot of people bailed out at the bottom. They blamed the market for their own stupidity and that lesson has really stuck.

On the other hand, they think real estate always goes up. It's risk-less. We have a huge emotional attachment to real estate because we think it's safe.

Canadians are a risk-averse people. We have so much money in GICs [Guaranteed Investment Certificates]. Over 80% of the money stashed inside TFSAs [Tax Free Saving Accounts] is sitting in cash. That gives you a good indication of the financial illiteracy in the entire country.

Coming up next...

How safe is your retirement from Canada's housing bubble? On Monday, Garth and I discuss where real estate prices are heading next.

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