7 Mind-Blowing Facts About the Canadian Real Estate Market

Description

In the last decade, it's been good to be a homeowner in Canada.

The average price of a house has more than doubled, going from $200,000 to more than $400,000. That's a return of more than 7% annually, more than double the historical return from the asset class. This has led to thousands of real estate millionaires, especially in Toronto and Vancouver, where properties in good neighborhoods regularly change hands for more than $1 million.

But what if the party is on the verge of coming to an end? There's evidence that Canada's real estate market is overvalued. Here are seven reasons why you might want to reconsider an investment in the sector.

1. Record debt levels

Canadians are awash in debt. Mortgage debt is to be expected, but it isn't just houses we're borrowing against. Credit card and vehicle debt are also at record levels and student loan debt continues to be a problem. In the fourth quarter of 2014, Canada's debt-to-disposable-income ratio grew to 163.3%, setting a brand new record. To put it into context, the ratio in the U.S. peaked at around 160% back in 2007.

2. First-time buyers are stretched

According to a recent survey by the **Bank of Montreal,** more than 40% of first-time home buyers are expecting their parents to help out with the down payment, with the average expectation being 12% of the purchase price. Additionally, 42% of borrowers looking to upsize in the next few years are also expecting parental assistance in order to afford their new place.

3. HELOC growth

In 2000 Canadians collectively owed approximately $29 billion in home equity lines of credit (HELOC). By the end of 2013 that debt exploded to $225 billion, an almost tenfold increase. If this borrowing slows because of a decline in real estate, Canada could plunge into a recession. Between 4-5% of current consumer consumption is because of cash extracted from home equity.

4. Toronto condos

At the end of 2014 more than 56,000 condos were under construction in Toronto. That's more than any other major city in North America, including New York, Chicago, or Los Angeles, all metros with much higher populations. To put that in perspective, condos under construction in Toronto averaged less than 10,000 during the 1990s.

This has to be especially troubling for investors in **Home Capital Group Inc.** (TSX:HCG), a sub-prime lender which specializes in Toronto-area real estate. Out of the $22 billion in loans on its balance sheet, only $8 billion are insured against default. If Toronto's condo market cracks, that weakness will likely affect the whole market.

5. Price-to-rent ratio

According to a recent report by the OECD, Canada's price-to-rent ratio is a whopping 66% higher than normal levels. That puts us as the second-most overvalued country in the world according to that metric, losing out only slightly to New Zealand.

This is actually good news for a company like **Canadian Apartment Properties REIT** (TSX:CAR.UN). At some point, investors will be unwilling to buy up rental properties at such anemic cap rates. This creates less competition for the company's apartments, since it has been forced to compete against amateur landlords hoping for price appreciation.

6. Everyone thinks it's overvalued

The number of smart people who think Canada's housing market is in a bubble is astounding. *The Economist* thinks prices are 35% overvalued. Deutsche Bank thinks houses are 63% overvalued. The IMF says the market is "overheated" and at risk for a "hard landing." Citibank, Goldman Sachs, Bank of America, and JP Morgan have all warned clients about the bubble. Are all these smart analysts wrong?

7. Similarities to the U.S. market

Count legendary Yale economist Robert Shiller as another pundit who worries about Canada's housing market. The man well known for predicting the decline in the U.S. sees many similarities between our two markets.

"Canada's success story is uncomfortably similar to the U.S. success story. It might be offensive to Canadians, but we're like two peas in a pod," Shiller told *Macleans* magazine back in 2014. "But maybe this time is different."

CATEGORY

1. Investing

TICKERS GLOBAL

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

2. TSX:HCG (Home Capital Group)

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