Can Your Retirement Survive an Upcoming Real Estate Crash?

Description

Housing bears are convinced: Canada's inflated real estate market — especially in and around Toronto and Vancouver — is overdue for a massive correction.

These naysayers have plenty of evidence to back up their hypothesis, too. Cap rates are anemic in most major Canadian markets, which implies landlords are content to make up a lack of rental income via capital gains. Valuation metrics like price-to-household income and price-to-rent ratios are at record highs. And the catalyst needed to bring prices down is upon us, as the Bank of Canada continues to raise interest rates. Add in Canada's massive consumer debt problem and we have a recipe for disaster.

But there's plenty of evidence real estate could keep marching higher, or at least stay on this plateau for a while. Immigration is still strong, and most of these new Canadians are choosing to settle in our largest cities. The world is filled with expensive real estate; Toronto and Vancouver are hardly unique there. And cities like Montreal, Winnipeg, and Ottawa still offer plenty of affordable real estate.

In other words, there's plenty of healthy debate on both sides.

Personally, I think we're in a new reality where real estate remains expensive in our largest cities. Any significant downturn will be met by a rush of investors looking to get back in before prices appreciate again, offering support on the downside.

Still, that doesn't mean I'm not taking steps to protect my portfolio against such a catastrophic event. Here are some steps you can take to make sure your most important savings aren't wiped out in a real estate crash.

Rent

Despite significant rent inflation impacting downtown Toronto condos right now, I still think the best long-term decision for people living there is to rent.

There are thousands of landlords in Toronto who aren't making enough in rent to pay their expenses.

Rent might be enough to cover the condo fees and the mortgage, but not enough for the property taxes and other expenses. Remember, the ideal rental property investment is one that covers all expenses and still produces a healthy profit.

Renters can then take their extra income and put it to work in more productive assets. If they do this well, a renter can eventually own a portfolio of great real estate spinning off all sorts of passive income.

Avoid the riskiest real estate stocks

Some investors have shorted Canada's largest banks, convinced a big real estate correction will wipe them out. This is not a good bet. These banks have been through real estate corrections before and have taken steps to protect themselves for the next one.

There are some stocks investors should avoid if they're bearish on real estate though. Two of the easiest choices are **Equitable Group** (TSX:EQB) and **Home Capital Group** (TSX:HCG). If housing declines in a serious way, investors in these two subprime lenders will sell first and ask questions later. Home Capital already saw a crisis of confidence in 2017, with shares falling more than 60% from their peak.

Another stock investors worried about a housing bust might want to avoid is **Genworth MI Canada** (TSX:MIC), the nation's only private mortgage insurance provider. This one is a little tougher though, since the company's management has had years to solidify the balance sheet in preparation for the worst.

Mortgage insurance is a wonderful business. It doesn't take much in additional expenses to scale it over time, and the longer the policies stay in place the safer they get, since the borrower is reducing their loan-to-value ratio over time. Additionally, Genworth has an investment portfolio of some $6 billion, which is enough to weather a lot of foreclosures. Still, if real estate sinks, Genworth will sink with it.

The bottom line

It doesn't really matter how you feel about Canadian housing. If it declines in a big way, these three stocks will fall with it. Investors must guard against that. Risk management is all about limiting your losses. Fortunately, doing so in this situation is really easy. Investors must simply limit their position sizes in these three controversial stocks.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. TSX:EQB (EQB)
2. TSX:HCG (Home Capital Group)

PARTNER-FEEDS

1. Msn
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