Canada's Housing Bubble: Investors Beware

Description

The national economy is heavily reliant on real estate. From renting to appraising, all the services associated with the property sector together contribute 20% of the country's gross domestic product (GDP). Some experts are now worried that the sector has become so big it could buckle under its own weight.

A recent report by *Bloomberg Economics* found that Canada's housing market was the most vulnerable to a price correction. Their calculations are based on the median household debt burden and the ratio of average incomes to median house prices across the country.

Households are now spending over 50% of their monthly budget on mortgage payments, the house price-to-rent ratio has surpassed the levels of the housing bubble in States during 2006, and the private sector debt burden is more than double the nation's annual GDP.

All these red flags clearly indicate a frothy market in uncharted territory. A deleveraging and consequent correction in house prices seems imminent, but timing the market is nearly impossible. The best investors can do is to avoid the companies that are over-exposed and seek out assets that are relatively insulated from the housing market.

Focus on leverage and diversification

As housing is such a large part of the Canadian economy, it may be fair to assume that a dip in house prices will cause a domino effect across the ecosystem. The most vulnerable stocks are those with the highest leverage ratios and the lowest rate of diversification.

Allied Properties Real Estate Investment (TSX:AP.UN), for example, has a portfolio heavily concentrated in Toronto and Montreal, the former of which is the frothiest market in the country. Also, the trust's valuation seems to have overshot its fundamentals. The stock currently trades at a price-to-funds-from-operations (P/FFO) of 21.75, while its average FFO growth rate over the past five years has been 2.3%.

Similarly, a deleveraging will have a direct impact on the balance sheets of the nation's top banks, particularly those with higher exposure to mortgages.

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM) recently reported a 0.9% decline in its real estate secured lending portfolio over the most recent quarter.

The company missed analyst expectations for earnings growth this quarter, "…due to the [housing] market turning out differently than we had anticipated, impacting us more than our peers due to our strategic focus," according to CIBC's Cristina Kramer.

Safe havens

Similarly, focusing on lower debt and higher diversification in the portfolio could lead savvy investors to safe havens if the market downturn continues. Real estate investment trusts (REITs) focused on under-supplied office buildings, retirement homes, or big box retailers could serve as a hedge for the downturn in residential housing.

Similarly, banks with exposure to foreign assets and better capital adequacy ratios are better bets than those focused on mortgages and private sector lending in Canada at the moment.

Bottom line

There are several red flags in Canada's residential property market that should be concerning for investors. In my view, the best thing to do is to focus on firms and investment trusts with diversified portfolios, lower debt burdens, and perhaps a few international assets to mitigate the risks of the Canadian housing bubble.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. TSX:AP.UN (Allied Properties Real Estate Investment Trust)
3. TSX:CM (Canadian Imperial Bank of Commerce)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Bank Stocks
2. Dividend Stocks
3. Investing

Date
2025/07/02
Date Created
2019/07/15
Author
vraisinghani