



Is Canada's Housing Bubble About to Burst?

Description

Naysayers have been saying the Canadian real estate market has been a ticking time bomb for the better part of a decade now.

This has the potential to impact millions of investors. Some 30% of Canada's population lives in the three largest metropolitan areas. Many of these investors have significant real estate holdings in the form of their personal residence. Others have purchased a rental property or three, hoping to capture even more gains in the property market.

These investors could doubly be at risk if the real estate market falls at the same time as the stock market. Combine that with a recession, and we could see thousands of landlords being unable to pay their mortgages. This calamity would ripple through the whole economy.

Before you say this could never happen in Canada, remember it was just over a decade ago we saw this very situation play out in the United States, leading to the worst economic downturn since the Great Depression.

Will this actually happen, or will the bears continue to be wrong? Let's check out both sides of the argument.

The bear case

Real estate naysayers say the property market in Toronto, Vancouver, and even Montreal is disconnected with reality. Landlords are content to accept pitiful returns on their investment, convinced they'll make it up with the inevitable price appreciation.

I recently stayed in an apartment in Toronto that illustrated this point vividly. An identical unit in the same building was for sale. After deducting condo fees and other expenses, my math showed a landlord who paid full price for the asset would get a 3.5% return on the investment. That's barely enough to pay the interest on the mortgage, never mind other operating expenses.

Regulators are doing everything they can to slow down the market, too. Canadian home buyers have to pass a special stress test that sees if they can afford higher mortgage rates upon renewal. [Mortgage default insurance](#) premiums have been hiked. And land transfer taxes in major markets are a significant cost. We also see the media reporting regularly on how Canada's top cities are losing out because people simply can't afford to live there.

Eventually, the bears say, all this will catch up with the market and values will decline.

We may be seeing the early innings of this in [Vancouver](#), which has posted declining real estate prices for months now. The average Vancouver home now sells for about \$100,000 less than a year ago. The recent spring market was weak as well, suggesting this move isn't over yet.

The bull case

Real estate bulls make a simple argument. Fundamentals haven't mattered in top markets like New York, London, or Hong Kong for decades now. Toronto and Vancouver have joined those places because so many people want to live there. This will keep prices inflated until this status is lost.

Think about if you were a wealthy immigrant. Where would you rather go: to a large city with an already significant immigrant population or somewhere in the middle of nowhere? I'd choose the city every time, no matter what it cost.

Folks calling for a nationwide decline in house prices must also remember real estate is a local market. Vancouver and Toronto raced forward between 2010 and 2018. Other markets, like Calgary and Edmonton, have seen prices decline since peaking in 2014. And Montreal's market was tepid until taking off more recently.

Vancouver's decline hasn't really impacted anything. Foreclosures in the area are still at a very manageable level. Folks who bought at the top continue to hang on. Most real estate downturns are weathered easily. We need a catastrophic event to send the whole nation's real estate market into a tailspin, and these things are rare.

The bottom line

Personally, I think housing bears will eventually be right and the value of the typical property in Canada will decline. It's inevitable. The question is whether they get the rest of the equation right. A typical decline is nothing to sweat. Softness followed by an economic catastrophe would be very bad. Ultimately, however, the risk of this is very low.

Investors don't have to sweat it. Canada's real estate market isn't poised to implode. However, saying that, I personally wouldn't invest in a condo today, especially in downtown Toronto.

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