Warning: A 2020 Canadian Housing Market Crash Could Decimate Your Portfolio

Description

Housing bears have been convinced the bottom is about to fall out of the market for years now — especially in cities like Toronto and Vancouver, which are ridiculously overvalued.

These folks point out what they see as obvious truths about these markets. Valuation methods like price-to-income and price-to-rent ratios have never been higher for leading Canadian cities. Interest rates are at record lows, too. And everyone seems gaga over real estate.

Real estate bulls, however, take a different stance. They point out that major Canadian cities should have expensive real estate, because they're good places to live and raise a family. They also say that sought-after areas like downtown Toronto and Vancouver will always offer a lower return on investment, because investor demand keeps prices high. And most immigrants end up in these major cities.

Personally, I'm on the fence. I think both sides make good points. Aside from a little exposure to the Toronto market through some REITs, I have no skin in the game. I figure as long as only a small portion of my portfolio is tied to these markets, I have nothing to worry about.

Unfortunately, other people aren't so lucky. If you own a house in one of these expensive markets, you need to read this — especially if you plan to retire soon.

A terrible double-whammy

There are millions of Canadian homeowners with a significant chunk of the net worth tied up in their principal residence.

For most of these people, this happened solely by accident. They set out to buy a normal middle-class house in a good neighborhood, building a foundation for raising their families.

But this prudent move has had an important, unintended consequence. These houses — which only cost $100,000 or $200,000 back in the day — are now worth anywhere from $500,000 to $1 million (or even more), depending on location.

This puts many baby boomers in a tough spot. They're millionaires, but the majority of that capital is tied up in a property they're using. It's a rather unproductive asset.

Many plan to sell these properties during retirement, unlocking the capital and then downsizing to a condo. Some plan to put even more cash in their pockets by moving to a smaller city with much cheaper real estate. For many, however, this is more of a long-term plan. It's something they're looking at doing Five to 10 years down the road.

There's one big problem with this view. How will these major real estate markets perform over the next few years? If the bears are right, and prices decline even moderately, there are millions of homeowners who will lose billions in collective wealth, right when they need it the most.

That's the major risk here. And it could really affect you, especially if selling your house is a big part of your retirement plan.

What should you do?

The easiest solution is the most drastic one, unfortunately. Move the decision up a few years and sell now. You'll lock in these succulent gains and lessen your exposure to real estate.

But what if the bulls are right and you leave gains on the table? You might be kicking yourself for years if you sell today.

Baby boomers can also utilize a reverse mortgage to extract some of their home's equity. Sure, it's going to cost you some interest, but it's entirely possible the overall value of the home grows enough to more than offset that cost. This allows you to extract cash and benefit if the home rises in value. It transfers some of the risk from the homeowner to the bank.

Finally, for many homeowners with ample retirement savings as well, a big move in home prices simply won't matter. All it'll really impact is the size of the inheritance left for the kids.

The bottom line

Don't think you aren't at danger of a big housing correction if your home is already paid off. It could have a major impact to your retirement. Perhaps it's time to take steps to guard against this major potential threat against your net worth — even if you think real estate is still poised to go up.

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