Market Crash: Is Real Estate the Next Market to Fall?

Description

I would stay away from real estate at the moment, especially when it involves leverage. Real estate has hung in pretty well for a while, leading many to believe that real estate is a much more stable asset than equities and the like. Don't be fooled by that opinion. There is a much more dire reason it is holding together.

In a market collapse, people sell all their liquid assets first so that they can quickly cover margin positions and the like. It is easy to sell stocks, so they tend to fall before illiquid assets. Real estate is likely to fall later, because the real estate market is far more illiquid than the stock, bond, foreign exchange, or commodity markets.

Real estate falls when it can't receive a bid. This becomes especially dire in a credit crunch. Since lenders are less likely to lend money when their capital is at greater risk, real estate prices can drop incredibly quickly. This can escalate, as real estate prices drop below the debt levels on that land.

When will real estate fall?

It is, of course, impossible to know when or even if real estate will collapse. The state of the global economy indicates that there very well could be a contraction in the real estate market. After all, real estate investors count on people to pay their rents, so the current situation is especially dire.

I fear that this may be especially true for individual investors in residential real estate. Many individuals have bought real estate in the hope of capital gains, especially in the large metropolitan cities such as Toronto and Vancouver. Because the prices were already elevated, many people actually have negative cash flow, where the cost of interest is greater than the income they receive in rent.

If you are going to invest in real estate, use an ETF

Right now, the only way you should really invest in real estate is through an ETF such as **iShares S&P TSX Capped REIT Index** (TSX:XRE). Aside from utilities and infrastructure, this REIT is your best bet to make it through difficult times in Canada. However, I would personally not invest in any real estate at the moment.

At least you will be getting income while you wait, since it has a yield of about 6%. It charges a reasonable management expense ratio of 0.61%, so you get to hold these stocks for a relatively low cost. It is also pretty cheap on a P/E basis with a ratio of 6.8 times earnings. I would expect that ratio to climb higher, however, as earnings are hit in the coming months.

The biggest downside to the REIT is that it only has 19 holdings. This does provide some limited diversification. It is also focused on Canadian companies, so it does have a large amount of exposure to this country's faltering economy.

The Foolish takeaway

I am not a fan of real estate at the moment. Sure, interest rates are low, but if no one is willing to lend, that really doesn't matter. Also, we are living in a time of extreme leverage when a deleveraging event is underway. In this market, I wouldn't take a risk on an individual company. If you're going to try to invest in real estate, at least go with a basket of the professionals.

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