How to Protect Yourself From a Housing Market Crash

Description

Canada's economy hinges on three things: jobs, oil, and homes. Unfortunately, the job market has been decimated, and the price of crude oil has nosedived. Commercial real estate, such as retail stores and offices, have also taken a brutal beating. The last leg standing is residential properties. Should we prepare for a housing market crash, too?

There seems to be plenty of red flags. Nearly half a million people have applied for mortgage deferrals since the shutdown began. Many more could apply in the weeks ahead. Millions have lost their jobs, so their ability to pay rent or mortgages is impaired.

Meanwhile, banks and real estate lenders might become more risk averse in 2020. If it becomes more difficult to access mortgages, the housing market crash could become inevitable. This sequence of events will impact nearly every household and investor in the country. However, there are ways you can mitigate the impact.

Shun leverage

The key trigger for any housing market crash is leverage. Borrowed money is excellent when house prices are ascending. However, it becomes toxic when prices decline. This isn't just an issue for the borrower but also for the lender.

Consider a real estate investment trust (REIT) that borrows money from a big bank. In the event of a housing market crash, the REIT's assets are worth less. Meanwhile, cash flow from rent also declines. This makes it difficult to service the debt. The bank, meanwhile, may never fully recover all the loans it sanctioned. It's assets (loans) also decline.

To mitigate the impact, investors need to reduce their exposure to REITs with too much borrowed capital. Cutting out banks or lenders over-exposed to the Canadian residential market is also a good idea. **Royal Bank of Canada** and **Canadian Imperial Bank of Commerce** both have extensive exposure to housing. I'm highly concerned about **Equitable Bank's** balance sheet in 2020.

Meanwhile, **Boardwalk REIT's** risks are magnified, because its portfolio is concentrated in Alberta. A potential housing market crash could be more destructive in the oil-dependent province.

Housing market crash opportunities

If you've reduced exposure to real estate or never had much to begin with, a potential housing market crash could be an opportunity. Well-funded firms could bolster their portfolio with cheaper assets during a crisis.

Robust REITs with low debt and enough cash could see competition diminish. These companies could bounce back stronger when the housing market crash is over. The real estate market could consolidate over time. Betting on big names is a clever strategy.

CAP REIT, for example, has little debt and low payout ratio. Long-term debt was a mere 60% of the value of equity. The dividend-payout ratio was just 18.2%. Both ratios are far lower than the rest of the industry. Already the largest REIT in the country, CAPREIT could get larger after the housing market crash settles.

Similarly, REITs focused on defensive sectors such as warehouses and healthcare won't suffer much regardless of a housing market crash. **Granite REIT** is a good example. Investors could certainly add these to their portfolio at bargain prices.

Savvy investment decisions could limit your downside risk and reinforce your wealth over the long term. Stay safe!

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