Is The Canadian Real Estate Market About to Implode?

Description

Despite stock markets falling substantially on COVID-19’s impact on the economy, the Canadian real estate market hasn’t felt as much of an impact.

April sales data has just been released and the numbers are mixed. Sales collapsed, falling more than 50% on a year-over-year basis. Just over 20,000 houses traded hands last month. To put this into perspective, the plunge was worse than anything the market experienced over the 2008-09 financial crisis.

The good news for the Canadian real estate market is prices have remained firm. The average price for a property in Canada was $488,000 in April, a mere 1.3% decline over last year’s number. In other words, sellers are being patient and waiting for buyers to come to them.

With the economy now entering month three of a virtual standstill, can the Canadian real estate market continue to stay strong? Or is your house about to get a whole lot cheaper?

Let’s take a closer look at both sides of this debate.

The bear case

There’s been a very vocal group of bearish investors warning against excesses in the Canadian real estate market for years now.

These folks consistently point at the same issues with the underlying market. Affordability ratios like price-to-rent and price-to-income metrics are all inflated, especially in major markets like Toronto and Vancouver. Buyers are forced to retreat to the suburbs, real estate that has also become grossly overvalued.

In fact, many landlords were happy to buy property that didn't generate positive cash flow. They subsidized the mortgage with cash from their own pockets because they were banking on the property increasing in value. That's not investing, Canadian real estate bears argued: it's speculation.

We're also potentially in the early innings of COVID-19's impact on the economy. Even in areas where businesses and restaurants have opened back up, things are still incredibly slow. If folks who are nervous about the economy won't even go out to a restaurant, why would they buy a house?

This could get even worse if a second wave of the virus forces everyone to head back home for renewed lockdowns.

The bull case

During a typical recession, inventory floods the market as nervous sellers rush to get out of a falling market. I'm not sure that happens this time, since there's so much stimulus money out there. That extra cash should be enough for many folks to continue paying the mortgage. And if it isn't, our banks are taking a proactive approach and allowing deferrals.

This will ensure a glut of homes don't enter the market at exactly the wrong time.

Lower interest rates will also help prop up the Canadian real estate market. Five-year mortgage rates are comfortably under 3%, something that helps both new buyers and people who are due to sign their mortgage renewals. Ultimately, lower rates create more affordable homes, even if prices stay firm.

Many investors are still holding out hope we get a quick recovery. If virus numbers continue to go down and stay there, the market could turn more bullish in a hurry. Folks may take the opportunity to move around the country for a new job, which will undoubtedly help the real estate market.

What will happen with the Canadian real estate market?

Nobody really knows where the Canadian real estate market will be six months from now. After all, there's a lot of uncertainty in today's market and each individual city has local issues that influence the housing market.

At this point, I'm not particularly bearish. Yes, affordability in Toronto and Vancouver is a problem. But other cities — like Montreal, Calgary, Edmonton, and Winnipeg, to name a few — remain quite affordable. Lower interest rates will help as well.

Still, investors should keep an eye on their local markets and take steps accordingly if cracks begin to form. It could get pretty scary out there if the economy doesn't recover quickly.

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