A Housing Market Crash Would Ruin Canada's Retirees, Study Says

Description

In 2020, the possibility of a housing market crash has been a spectre haunting the Canadian economy. Ever since the COVID-19 recession began in March, experts have been predicting a steep decline in housing prices. At one point, the CMHC forecast an average price decline in the 9-18% range. So far, that has not materialized. But some say the real test will come in the fall, when expiring mortgage deferrals will bring more inventory on the market.

The possibility of a housing market crash has been thoroughly discussed already. The effect on one group of Canadians, however, has received less attention. There's a specific demographic that would be hit particularly hard by a decline in housing prices. Many of them live on fixed incomes, and few have significant savings apart from home equity. If the housing market crashed, this demographic could face financial ruin.

In case you haven't guessed yet, I'm talking about retirees.

65% of retirees' wealth is tied up in real estate

According to a study by the CD Howe Institute, 65% of Canadian retirees' wealth was tied up in real estate in 2018. That implies that for every $500,000 in an average Canadian retirees' net worth, $325,000 was in housing. A demographic with 65% of its wealth tied up in real estate will see their wealth decline precipitously in the event of a housing market crash.

If you have 65% of your wealth in a home, and your home value goes down 10%, and your other asset's prices don't change, then your wealth decreases by 6.5%. In reality, your other assets' prices *wouldn't* remain unchanged. If they went up, they'd offset the decline in your home equity. If they declined too, they aggravate your loss of net worth. But regardless, the heavy weighting in real estate would make a decline in net worth likely.

In 2020 the percentage could be even higher

As we've seen, Canadian retirees' heavy real estate holdings make them vulnerable to a housing market crash. What's worse is that in 2020, their exposure to real estate may be higher. The figures I was just using were from 2018. Since then, housing prices have increased.

In fact, they've risen faster than income. According to *Better Dwelling*, Canada's house-price-to-income ratio is rising. If that's true, then Canadians with most of their wealth in real estate in 2018 probably hold an even higher percentage in 2020. That category describes most Canadian retirees.

Foolish takeaway

All of the above shows that Canadian retirees are vulnerable to a housing market crash. The big question, then, is whether one will actually happen. So far, it has not — at least not on a national level. But respected authorities believe it could.

What does this mean for you as a retiree?

It's quite simple: you need to diversify.

It's never a good idea to have all your eggs in one basket, be it one stock, one bond, or even one house. Of course, the practical realities of home ownership make diversification *within* that asset category hard. You can't easily borrow the money to get a portfolio of 20 rental houses. But you can still diversify into other asset categories.

One great asset category for retirees would have to be bond funds. Generally, retired investors are advised to focus on income and preservation of capital. Bond funds offer both in spades.

One good example of a bond fund is the **BMO Mid-Term U.S. Corporate Bond Index ETF** (TSX:ZIC). It's an index fund built on bonds issued by major U.S. corporations. Bonds have a higher claim to income than stocks, making ZIC "safer" than an average stock fund. Technically, government securities are the safest of all — but they rarely beat inflation.

A corporate bond fund like ZIC is a good middle ground. With its 3.4% yield, its expected return exceeds an average year's inflation. Yet it has a level of safety that you won't get with stocks. For retirees who need income and capital preservation, it's very much an investment worth looking into.

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