

A Canadian Real Estate Market Doesn't Exist in 2011, So Don't Be Fooled



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What does 2011 hold for Canadian Homeowners and Real Estate Investors?

As we enter a brand new year, so many people are looking for 'predictions' of what the year will hold. That's why you see so many pundits come out of the woodwork at this time of the year to share their insights. I do find this a bit strange as nothing has really changed from December 2010 to January 2011 other than you get a new picture on your kitchen calendar. Those who pay close attention to the underlying economic fundamentals aren't struggling with what is coming next.

But having said that, let's take a look at what the next 12 to 18 months hold for Canadian real estate.

Quick 2010 Overview – Multiple Levels of Confusion

In order to look forward, we do need a quick review of 2010. The year in real estate turned out to be exactly as predicted in January 2010. It was a year of turmoil and confusion (the big economic 'W') and those who did not stay aware that we were riding this 2010 'W' allowed themselves to be shaken out of the market (right at the wrong time).

The economic 'W' does have a real cleansing effect on the market as it always chases out most of the speculators (those who only profit by values dramatically increasing) and leaves the market to the real professional investors and landlords.

This confusion was especially felt by those using housing market numbers to analyze the market. Investors understand that:

**If You Are Making Decision based on Housing Market Numbers
... You are Driving By, Looking In The Rear-view Mirror, and Will Crash!**

Government Meddling Led To Unsustainable Mini-Boom

More confusion was thrown into two very large markets (BC and Ontario) with the announcement of the HST. Despite some limited efforts by both provincial governments, how the HST was going to affect real estate purchases and sales was not clear, and into this vacuum sped confusion and an almost breathless panic to get purchases done before July 1st. This caused a higher percentage of purchases to be pushed into the first half of the year than would normally be expected. These two markets hold such a high percentage of the Canadian real estate transactions, due to their size, that this activity made the Canadian average price and activity jump despite most other markets underperforming.

This cursory analysis led some housing analysts to predict that a bubble was forming. This, of course, turned out to be false as markets slowed down again later in the year. Those of us who analyze the real estate market by looking at underlying economic conditions knew this boom would be short lived and was a product of desperation rather than true market sentiments.

‘Canadian’ Real Estate Market Does Not Exist

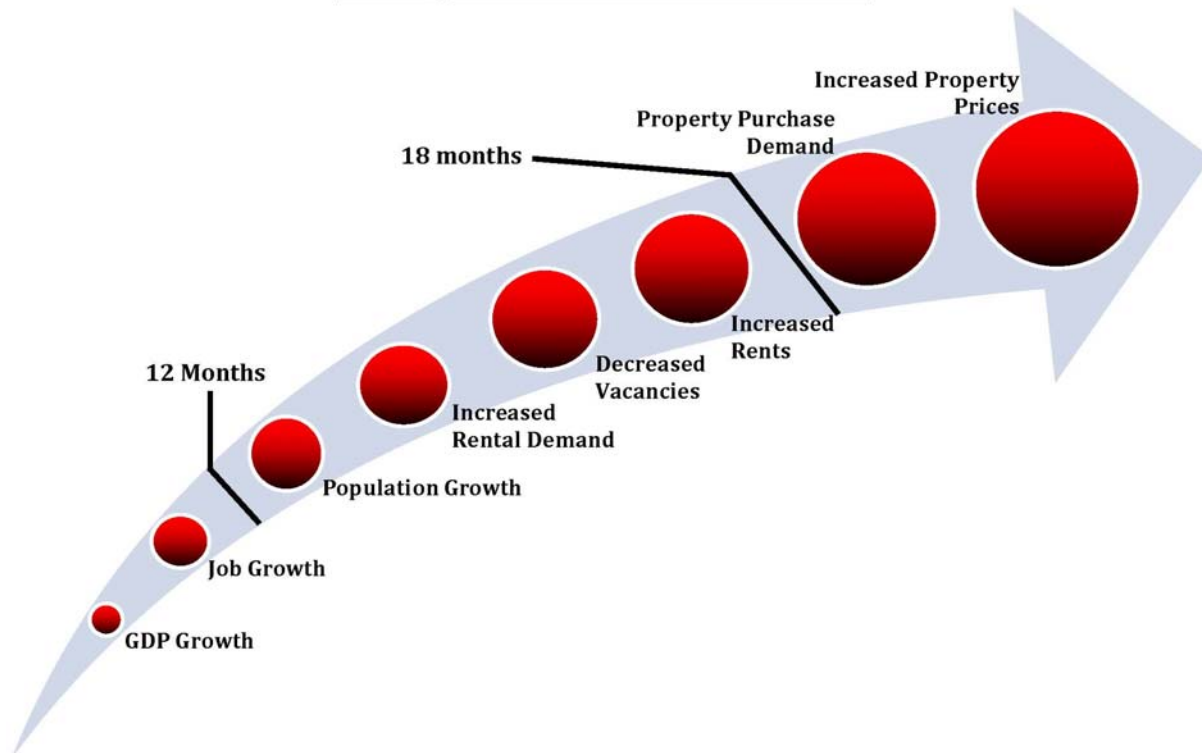
Overall, 2010 proved to investors and homeowners alike that a ‘Canadian’ real estate market doesn’t exist in and of itself. The Canadian real estate market is actually a series of very regional markets all which perform relatively exclusive of each other.

In fact, in 2010 and in 2011 the market really will be a ‘Goldilocks’ story. Some markets will be too hot (compared to underlying economics), others will be too cold, and some will perform just right. As our regions continue to detach from each other economically this trend will continue for many years to come and will compel investors and homeowners to ignore national real estate numbers and trends. They must focus on what is happening in their region.

2011 Market Predictions

To make it easier to predict what is going to occur in their local real estate markets, investors can use the formula shown below. Long term increasing prices of real estate stem from economic (GDP) growth. Without economic growth a real estate market is not sustainable. Sure there can be upward and downward blips not attributed to economic growth, (such as when the governments meddle as in 2010), but these are just short term unsupported blips.

The Long Term Real Estate Success Formula



1 Long Term Real Estate Formula

Long Term Real Estate Formula

GDP Growth = Job Growth = (12 months later) Population Growth = Increased Rental Demand = Decreased Vacancies = Increased Rents = (18 months later) Property Purchase Demand = Increase in Property Prices

This cycle works both ways, over roughly the same time lines. Sustainable real estate price increases occur approximately 18 months after a region's economy begins to grow and they drop approximately 18 months after the economy in a region begins to shrink.

We can use Alberta's markets as the perfect illustration of this formula in action. Alberta's GDP grew so quickly for years in a row and the real estate markets skyrocketed over that time and even after the economy began to slow down. This set up a number of high expectations and assumptions by people not understanding this formula and scared a lot of people out of the market. Even today, despite the fact that Alberta is going to lead the nation in economic growth in 2011, those who experienced the 20% annual increases in the past are sitting on the sidelines waiting for the market to come back. Smart investors who understand the inevitability of this formula are quietly picking up Alberta cash-flowing real estate, positioning themselves for the inevitable increase in demand 12 to 18 months from the start of the strong economic growth.

Because Canada's 2011 market is going to be even more regionally fractured than in 2010, it is imperative that investors and homeowners understand this formula and they make their investment decisions based on it, rather than the fluctuating housing market numbers.

CREA & Competition Bureau Settlement Leads to Unintended Consequences in 2011

As with any structural changes to an industry, the settlement imposed by the Competition Bureau on Canadian Real Estate Association's MLS website will have many unintended consequences on the health of the Canadian real estate market. We are currently completing a full report and analysis of these consequences (some of which are OK and some of which are not good news). This report will be released in the latter part of January 2011; however, here are some preliminary conclusions that will affect the overall market:

1. Housing metrics will indicate incorrect readings of the health of the market, leading to inaccurate analysis by some market commentators during the year
2. Often used metrics such as '**sales to listings ratio**', '**days on market**', and '**overall number of listings**' will be impossible to use as comparisons to previous year's performance. This is because, under the new rules, there will be many more listings being posted by people just fishing the market at very little cost (many poorly priced, poorly managed listings left in the system too long).
3. These additional listing will lead to average price increases being softened more than the underlying economics would usually lead to.

The complete *Unintended Consequences of the CREA Settlement with the Competition Bureau* report will be publically distributed to all who have subscribed to the Real Estate Insider Newsletter at www.reincanada.com.

2011 Regional market Overviews

BC

This year we will witness extreme variances in regional results, more so than most other provinces. With forestry having a bit of a renaissance (compared to the last few years) and mining having a strong comeback, economic growth will be in specific regions. Following are the regions where the real estate markets will perform different to underlying economics and expectations:

Over-performers:

Maple Ridge, Surrey, Ft. St. John, Dawson Creek, Penticton, Princeton

Under-performers:

Vancouver's mid-price market, Abbotsford, Kelowna, Nanaimo, Port Alberni

The province as a whole will enjoy a flat and balanced market. There will be lots of talk of housing market health when housing starts come in lower than expected. Resale homes will outperform new homes across the province as HST continues to have an effect (although mostly psychological).

ALBERTA

Alberta's economic recovery won't be felt until after 'spring breakup' (an annual time of short term layoffs). After that the province is poised to enjoy nation leading economic growth status in many regions. Oilsand's and oil drilling jobs are beginning to come back on stream with billions being invested across the province. However, this time companies are being more careful with project scheduling, trying to keep a cap on the inevitable cost increases (labour and materials) that hurt the province during the last boom period. This will help to keep a cap on inflation as well as prolong the recovery – managing it at a sustainable pace.

This economic and population growth will lead to in-migration and a reinvigorated real estate market later in the year.

Although there will be more hiring activity in the northwest of the province a natural economic cap is in place with low natural gas prices. This situation will combine with the high supply, low demand condition of the residential real estate market to keep Grande Prairie and its surrounding region from performing at the same level of the hot-spots of the province.

Calgary, Edmonton, Red Deer and Lethbridge will lead the way in property and rental demand growth, with Ft. McMurray following very close behind. Remember the **Long Term Real Estate Formula**, with the economic growth not translating directly to the real estate market until 12 – 18 months after it occurs. 2011, especially spring, will be a good time for investors and homeowners to position themselves for this inevitable growth.

PRAIRIE PROVINCES

Saskatchewan has been an economic star for Canada over the last few years as they aggressively develop their untapped resources. As the world's economies begin to awaken there will be an increased demand for everything the province produces – Food, Fuel and Fertilizer. This will help to soften the inevitable hangover of the overheated real estate market that many cities and towns in the province experienced. The markets will come back to a sense of reality to be more balanced or even dip slightly into a buyer's market.

Manitoba's economy and real estate markets seemed to almost ignore the economic downturn that the rest of the country experienced. Historically they miss boom-bust cycles, providing investors, who do their homework and who choose their neighbourhoods with care, a consistent, not spectacular, return on their investment. This trend will continue into 2011.

ONTARIO

The biggest question that investors and homeowners should have leading into 2011 in Ontario is, "Will the many levels of government control themselves and not meddle with the housing market for a whole year?" As it is an election year, this is doubtful.

Government meddling (including Toronto adding additional Land Transfer Taxes, Provincial Government adding HST expenses landlords can't pass on to renters, and the 2010 ridiculously low rental increase percentages) has had completely unpredictable and long term effects on the province's real estate market and its ability to provide affordable housing in a province that needs it the most.

Economically, the province will be divided into two regions, one with job growth and one with job stagnation. Obviously, when applying the formula discussed earlier, the regions with the job growth will dramatically out-perform the rest of the province. Here's a quick overview:

Ottawa: Ottawa will continue to be the consistent performer in the province's real estate market. Investors and homeowners are poised to see their market perform at a non-spectacular but very acceptable level. Vacancy rates will begin to decrease later in the year, and a balanced market will ensue.

Hamilton: Hamilton is poised to be one of the top real estate performers in later 2011; however, a lot of question marks still sit poised on the sidelines to derail this. Once again, these are not truly economic fundamentals, but government issues including, but not limited to, where (if at all) the Pan Am stadium will be built, and whether or not Metrolinx will build out the proposed LRT. The Economic Development team is working hard to bring jobs to (and back to) Hamilton and the results are already starting to be felt. As per the formula, these jobs lead to inevitable real estate value increases.

Kitchener-Waterloo-Cambridge (Tech Triangle): KWC is the economic and real estate winner in the province in 2011. Already job growth is being felt across the region and this is just the beginning. The leadership, both in the government as well as the corporate arenas, are working hard at turning this area into Canada's job growth region and investor and homeowners should be doing what they can to support this policy as it will inevitably lead to money in their pockets down the road. In all cases, it is important that investors choose their neighbourhoods carefully, focusing on regions where demand is occurring and where they can create positive cash flow.

Toronto: A tale of many regions – all in one city. Some neighbourhoods are poised to outperform (i.e. Scarborough and the Beach) while others will lag. Finding positive cash flow properties is going to be critical for Toronto investors as they won't see values skyrocket, as was witnessed over the last few years. New condos will still come on the market and will be sold on a 'per square foot' or 'replacement cost' basis rather than comparison basis. This 'break it down to small numbers' selling strategy is what the auto industry had to start doing to move their vehicles (selling by \$\$\$ per month instead of stating the full price). Best deals will be found in the secondary and resale markets with an increasing number of motivated vendors hitting the market later in the year keeping a cap on price increases. Remember, 'Average Price' means nothing in a market as large and diverse as Toronto. The overall Toronto market will underperform.

The rest of the province will experience a return to sane markets – not too hot and not too cold.

Maritimes

New Brunswick

New Brunswick's new political leadership will be focused on getting a good start on their new mandate and this should keep them out of the housing market for a while. Over the last 5 years businesses have migrated to the province based on tax incentives and lower labour costs. This is a fragile growth that will have to be considered when any government decisions are made. The job growth and economic diversification has lead to generally strong real estate markets especially in larger centres. The shelving of large projects like the Irving refinery left some speculators holding properties they expected to sell quickly which lead to more listings coming on the market than would normally be expected by the underlying economics. Construction jobs should be down this year with the completion of the nuclear plant refurbishment and lack of new housing demand. This will prove to be a year that New Brunswick markets will seem confused and disoriented as they send out mixed signals.

Newfoundland

After having very strong economic growth in 2010, new leadership comes in to take Newfoundland to the next stage of its economic development. With the loss of the province's most fervent booster and biggest personality the province could experience a small financial hangover, but should pull out of that to show strong economic growth again this year.

The province discovered that a lot of the GDP growth didn't translate directly into on-shore job growth as much of it was in off-shore development. Therefore did not translate into supporting the real estate market as much as it would normally have done. The largest impact was from speculators from out of province expecting to see the 'next Alberta' occur. Like the other Maritime provinces this will be a year of mixed signals both economically and in the real estate market, however Newfoundland's economy will grow more quickly than many provinces in the country on a percentage basis. It is projected that the provincial economy will stay relatively strong in 2011. By the end of the year we will see a balanced real estate market settling in, with average growth.

Nova Scotia

Nova Scotia skirted the economic downturn better than most provinces, seeing a growth of about 1.9%, and this not overheated rate is poised to be repeated in 2011. Job growth will continue slowly; however, there are some economic head winds that the province will have to work against. You can expect a real estate market very similar to 2010 in 2011 with no big surprises either up or down.

OVERALL FOR INVESTORS

Overall, smart investors will be studying specific regions and specific neighbourhoods to identify the hidden gems in 2011. Winners will be those investors who don't get caught in the positive or negative hype and who focus on properties located in regions with an economic future that produce positive cash flow (yield) on an annual basis. Speculating only on value increases will be fraught with risk in 2011.

Remember the Long Term Real Estate Formula as you make your investment decisions.

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