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This could be the cause of the next housing crash

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A major cause of the last two downturns in housing prices was an oversupply of properties for sale. Could it happen again?

Veritas Investment Research set out to answer this question recently using an informal, quick and dirty survey of more than 200 real-estate investors across the country on their intentions over the next 12 months. The goal: Gauge the level of risk that real-estate investors will try to sell en masse, thereby saturating the market and putting downward pressure on prices.

Asked whether they planned to sell one or more properties in the next year, an overwhelming 84 per cent said no. Only 6 per cent planned to sell because they anticipated lower investment returns or a decline in real-estate prices. One-third of current real-estate investors said they planned to buy additional properties.

Veritas analyst ***Nigel D'Souza*** said these findings suggest a stable housing market. "Very few people are selling because they expect prices to go down, because they expect rental income to go down or because of financial stress," he said.

Now for the not-so-good news. Exactly half of the survey participants said their investment properties did not generate positive cash flow after mortgage, maintenance and other ownership-related costs. Eighteen per cent overall were in a break-even position, while 32 per cent were in a negative cash-flow position.

The risk to house prices is that we get a recession that makes it untenable for the 50 per cent of real-estate investors not generating positive cash flow to hang onto their properties. "If everyone who is cash-flow-negative lists their property for sale, you would get the worst supply shock on record for Canadian real estate," ***Mr. D'Souza*** said.

If the economy keeps chugging along slowly, as it has in recent years, then house prices should remain stable. There would be no pressing reason for real-estate investors to sell and overwhelm the market with new listings. But ***Mr. D'Souza*** noted that there are signals of impending economic downturn, including a yield curve that has frequently been inverted in recent months. That's where short-term interest rates are higher than long-term rates, the opposite of what is normal.

A modest economic downturn might not matter for real estate investors. ***Mr. D'Souza*** said that in 2000-01, the pullback in the economy wasn't enough to inflate supply and drive prices lower. Oversupply was a big factor in the 1989-90 and 2008-09 price declines.

Looking ahead, the question is whether an economic downturn would be sharp enough to scare investors and speculators away in a hurry. "Unless you get a supply shock, you're not going to have a real estate price correction," ***Mr. D'Souza*** said.