THE GLOBE AND MAIL
GLOBEINVESTOR MAGAZINE

INVESTMENT STRATEGY

Five things to know now if you're thinking of buying real estate

Prices and interest rates are both low, and there's plenty to choose from

By Lesley Scorgie
Globe Investor Magazine Online

The Canadian real estate market is cooling, caught in the downdraft of a slowing economy. Average house prices dropped 3.6 per cent in July, compared with June, while housing starts fell 14.8 per cent to the lowest level in six years. According to Statistics Canada, this marked the sixth straight month of sliding home prices.

Still, property has proven to be a solid investment in recent history. Real estate has appreciated throughout the past 60 years, except for two short periods of time, 1981-1982 and 1990-1992, according to a study by the University of Toronto.

Here are five things property investors should know about buying right now.

No U.S.-style bubble in Canada

Canada's more-strictly regulated lending practices have warded off a U.S.-style housing bubble. Unlike in the U.S., Canadian homeowners cannot write off mortgage interest and property taxes, so there aren't as many incentives to load up on debt. Also, the Canada Mortgage and Housing Corp. reins in over-spending by capping mortgages at 32 per cent of a homeowner's gross monthly income.

The federal government recently decided to stop backing 40-year mortgages - a sign that it is determined to prevent a bubble, says Justin Charbonneau, an adviser at investment management firm McLean & Partners.

"The economy is rocky and the federal government is tightening its lending practices," he says. "This will encourage buyers to save up rather than extend the amortization period of their mortgages."

Canada's conservative approach to lending has saved the country from mass foreclosures and frightening bankruptcy statistics. Housing prices in some parts of the U.S. rose more than 80 per cent between 2001 and 2006, compared with growth of over 55 per cent in Canada. The average Canadian house price has climbed at about 6 per cent annually throughout that same period.

Why buy now?

Not only are prices low, current interest rates on mortgages are still historically low, Mr. Charbonneau says. A review of interest rates at canadamortgage.com shows five-year closed rates range from 5.25 to 6.85 per cent, compared with more than 8 per cent in 2000.

There's also plenty to choose from. Annual listings growth is still outpacing sales in 22 of 25 major markets across the country, and the ratio of new listings to sales remains near a nine-year high, Robert Kavcic, economic analyst at BMO Nesbitt Burns Inc., writes in a research note.

According to Nancy Ball, a top realtor for CIR Realty, "Buyers have enough time to decide what is best as the prices have stabilized when compared to two years ago."

The low-down on down payments

You'll need at least 20 per cent of the value of the home to have an uninsured mortgage.

Alternatively, you pay a fee of up to 3.1 per cent of the mortgage as an insurance premium and get a high-ratio mortgage that lets you borrow up to 95 per cent of the value of your home.

Banks also offer zero per cent-down mortgages, a practice that encourages home-ownership but doesn't support healthy saving habits.

"Zero per cent-down mortgages are frightening. Buyers in this category can't sustain any downward price movement in their home value because there's no equity," says Mr. Charbonneau.

The RRSP borrowing quick fix

The RRSP Home Buyers Plan lets you borrow up to $20,000 tax free from your RRSP to put towards your down payment. You'll then have 15 years to repay the funds into your RRSP. But, in a market that's been badly beaten-up in recent months, the value of your RRSP portfolio may have dwindled dramatically.

"Selling at a time like this isn't recommended. Hang in there," says Mr. Charbonneau.

If you kept that $20,000 in your RRSP for 15 years earning 8.5 per cent in compound interest annually, it would be worth over $67,000. With housing prices appreciating at about 6 per cent, based on past history, you might lose out on greater potential returns in your RRSP portfolio.

The simplest way to save is to have money automatically withdrawn from your bank account on payday and transferred into a GIC or high-interest savings account. Starting in 2009, you'll be able to open a tax-free savings account which will allow you to grow your money tax free. This account is going to be helpful for short-term down-payment savings, and you can put any type of investment inside the plan.

Negotiate everything

Everything is negotiable - the house price, real estate fees and mortgage interest rates. Shop around to get competitive rates on both realtors and mortgages. If you prefer one bank or broker over another, present a competing offer and ask them to match it.

Ms. Ball recommends getting a pre-approved mortgage through a qualified mortgage broker or financial institution. And when you bid on a house, it's best to put forth an offer with as few conditions as possible and have a strong deposit ready to put towards the down payment, such as $5000 or more, Ms. Ball suggests.

"Your offer will be taken more seriously," she says.

Lesley Scorgie
Author of: Rich by Thirty: A Young Adult's Guide to Financial Success
lesley@richbythirty.com www.richbythirty.com

Special to The Globe and Mail

http://v1.theglobeandmail.com/partners/free/globeinvestor/investment/sept08/online/realestate.html