COVID-19: Brace for a 30% Drop in Canada's Housing Market

Description

Ever since the onset of COVID-19 prevention measures, there has been talk about a potential impact on Canada's housing market. The economic effects of lockdowns and business closures were priced into stocks early, but real estate initially showed strength. This may have been deceiving. Real estate sales take time to close, whereas stocks can be bought and sold immediately. So, we'd naturally expect real estate to take longer to react to a downturn than stocks.

In April, we're finally beginning to see the effects of COVID-19 measures on real estate. So far, they're not looking pretty. Early indicators from Canada's largest cities indicate a major downturn in sales volume. While prices are still up, sellers are having a harder time finding buyers. One major Canadian bank is saying this lack of demand will result in lower prices eventually. We'll explore that in just a minute. First, though, let's take a look at the early data from one of Canada's largest housing markets.

Early indicators from Toronto

Toronto's housing market has historically been one of the hottest in Canada. According to a presentation by realtor Scott Ingram, Toronto condo prices grew at 10.59% CAGR over the five-year period ended November 2019. In the same period, the city's house prices grew at 7.88% CAGR.

These are solid numbers. However, it's now looking like COVID-19 could put the brakes on them. According to a recent *Financial Post* article, Toronto house sales declined 38% in the week after social-distancing measures came into effect. New listings were down 14%. The fact that sales fell more than listings indicates that homeowners had a hard time finding buyers. We haven't seen an actual decline in house prices yet, but we'd expect to see one if this situation persists.

RBC's projections

Recently, **Royal Bank of Canada** chimed in on the Canadian housing market situation, saying it expects to see a 30% slowdown in home sales nation-wide. The bank's analysts added that they expect a pullback in prices, although they didn't say by how much. While RBC's report clarified that both the sales decrease and price pullback will be temporary, the short-term forecast was decidedly bearish.

What this means for investors

The downturn in real estate is a significant concern for investors in REITs like **RioCan Real Estate Investment Trust** (TSX:REI.UN). Any decline in housing prices could signify lower demand for other types of real estate. If you look at RioCan, it mainly invests in retail space and apartments. Both of these could be impacted by the COVID-19 downturn. Retailers are under threat from forced business closures, which apply to virtually all non-essential businesses. Restaurants, bars, and even electronics stores are basically shuttered.

If this goes on long enough, we can expect some of RioCan's tenants to start missing payments. We already saw Cheesecake Factory tell its U.S. landlords it won't be paying in April. We could see Canadian retailers start doing the same. As for residential tenants, it's almost guaranteed that some of them will miss payments. According to a survey by Goodman Commercial, Vancouver landlords are reporting that up to 50% of their tenants aren't paying rent.

The longer people are out of work, the more that trend will accelerate.

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