Warning: Canada's Real Estate Market Could Plunge 33%

Description

Cracks are appearing in Canada's real estate market. The residential property sector has been kept afloat by robust immigration, strong job numbers, and easy liquidity. Now, all three factors have receded, which means a housing market crash could be imminent in 2020.

Things are worse for the commercial real estate sector. Shops, malls, hair salons, and office buildings have been abandoned altogether. These businesses aren't designed to withstand a prolonged shutdown. With income drying up, tenants could be at risk of missing rent payments, which ultimately dents the landlord's balance sheet.

Here's a closer look at what's ahead for Canada's real estate sector and how investors can protect themselves.

Real estate correction

For much of the past decade, Canada's real estate sector has been a source of immense wealth creation. A booming economy coupled with strong immigration created ample demand for houses, shops, and office space across the country. Record-low interest rates amplified this demand further. Debt was cheap, so landlords splurged.

In fact, the market was so strong that real estate investment trusts (REITs) outperformed the rest of the stock market over the past 10 years. The **iShares S&P/TSX Capped REIT Index ETF** delivered 6.9% compounded annual growth since 2010. The **iShares TSX 60 Index** delivered only 4.4% over the same period.

However, the real estate market was, arguably, overvalued. The rental yield was too low, and the leverage ratio was too high. In other words, investors were counting on capital appreciation rather than income to drive results. Now, the market could lose value.

REITs at the epicentre

Online searches for keywords like “force majeure” or “can’t pay rent” have skyrocketed in recent weeks. Meanwhile, major banks and private lenders have become more risk averse. It’s a lot more difficult to get a mortgage now.

Commercial landlords, like **American Hotel Income Properties** and **Brookfield Property Partners** are particularly vulnerable. Small businesses are shutting down on an unprecedented scale. This could expand the vacancy rate and lower the rental yield on all their properties.

With banks pulling back on lending and unemployment skyrocketing, the residential market could face a similar problem. According to the International Monetary Fund, real estate in Canada’s largest cities were nearly 50% overvalued last year. That means a 33% correction could make the properties “fairly valued.”

Now that the economy has been disrupted, that plunge to fair value seems like a real possibility in 2020. Stocks like **Boardwalk REIT** and **Minto** are particularly vulnerable to a correction in the residential real estate sector.

Investors who’ve relied on these rock-solid dividend stocks may have to take a step back. I wouldn’t be surprised if a number of high-profile REITs cut or suspended their dividends over the next few months.

Essential REITs

Some businesses and sectors are booming, because the government has deemed them essential during this crisis. Grocery stores and healthcare properties, for example, have seen a surge in demand. These properties are better placed to withstand the ongoing economic storm.

Investors looking for a robust income stream during this crisis should take a closer look at **Northwest Healthcare Properties** and **Brookfield Infrastructure Partners**. These REITs offer attractive dividend yields and better prospects for the years ahead.

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Date
2025/08/27
Date Created
2020/04/19
Author
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