Why Is Housing in Canada Still So Expensive?

Description

A lot of people expected Canada's housing market to crash this year. The *CMHC* forecast an average house price decline between 9% and 18%. Many top banks echoed that forecast.

So far, none of these predictions have come true. In fact, just the opposite has happened. In major markets like Toronto, housing is up. According to the CREA, house prices are up 18% this year nationwide. That's not only not a crash but an actual boom.

The question is, *why* is Canada's housing market still so pricey? And will it crash eventually?

People are getting back to work

One factor behind the strength in Canada's housing market is people getting back to work. In September, Canada added 378,000 jobs. In August, the country added 246,000. Since June, more than [one million jobs] have been added — or, perhaps more accurately, re-filled. In the early months of the COVID-19 pandemic, many businesses were forced to shut down. Later, when the lockdowns were eased, a great many people returned to work. It's likely that much of the job growth we've seen has been from formerly laid off people being re-hired.

It goes without saying that lower unemployment is good for the housing market. When people have work, they are more likely to be able to make mortgage payments. High unemployment was one of the reasons cited when people predicted a market crash earlier this year. However, in the earliest months of the pandemic, banks granted mortgage deferrals. That may have saved unemployed people from having to sell their homes. Today, the mortgage deferral period is over. But with Canadians getting back to work, the deferrals may no longer be needed. That leads into the second point I'll explore below.

Housing supply is low

A big reason why Canadian housing stayed expensive this year is because supply was low. For much of the year, Canadians stayed at home and cancelled plans to move out. At the same time, mortgage deferrals saved unemployed homeowners from having to sell. So, the supply of housing was kept lower than normal. If demand is held constant, a decline in supply will result in a lower price. So, it’s not surprising that housing prices have been rising this year. Even with flat demand, lower supply will have that effect.

An alternative to housing

If you’re looking to buy a new house in 2020, you’re likely to pay a steep price. Unless you live in a rural area, houses where you live are likely more expensive this year than last year.

That doesn’t mean you can’t invest in real estate though. You can always get your exposure through REITs like **RioCan Real Estate Investment Trust** (TSX:REI.UN). REITs are pooled investment vehicles that invest in malls, office buildings, apartment buildings, and other real assets. Unlike with a single house, you don’t need a mortgage to buy them. And their income potential is substantial.

RioCan, for example, has a 9.75% dividend yield at today’s prices. In other words, you get $9,750 in cash back each year for every $100,000 you invest. That’s thanks in no small part to the fact that its stock has fallen 43% so far this year. Unlike houses, REITs actually have declined in value in 2020. RioCan is a perfect case in point. However, that doesn’t necessarily make them bad investments.

Don’t get me wrong: there have been some tailwinds for REITs this year. Collection rates have been a big one — although data from NAREIT shows that they’re back up over 95% now. RioCan itself is at a 73% cash collection rate. That’s less than ideal, but it arguably doesn’t justify a 43% stock price decline. The company did have a big GAAP loss in the second quarter, but FFO was healthy at $109 million.

All in all, RioCan is a cash flow positive REIT that’s much cheaper relative to income potential than a direct investment in housing is. If your interest in real estate is purely financial — i.e., you want property for no other reason than to earn income from it — then RioCan units could make a good alternative to buying a house.

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