Alert: Mortgage Rates Could Go Higher in 2021

Description

Mortgage rates across Canada are at an all-time low. You can currently lock in a five-year fixed rate for as low as 1.35%. That's allowed more homebuyers to enter the market and push prices up. However, the rate could be poised to surge later this year, which could have far-reaching repercussions for the Canadian economy, stock market, and property prices.

If you're an investor or homeowner, here's what you need to know.

Mortgage rates

Mortgage rates are a pivotal metric for the Canadian economy. Somewhere around 10-12% of Canada's Gross Domestic Product (GDP) is derived from financing, renting, selling, and constructing real estate. All these activities surge when mortgage rates are low, because buyers, investors, and developers can qualify for large loans.

However, banks and lenders offer mortgages based on the Canadian government's cost of borrowing. In other words, the bank can offer mortgage rates that are slightly higher than the Canadian government's bond yields.

Canada's five-year treasury bond yield dipped to 0.32% in March last year. Since then, the rate has more than doubled. Today, it crossed 0.86%. The highest level since the pandemic erupted. Some experts believe the rate could keep climbing higher. This could ultimately push mortgage rates up.

Impact

Ron Butler of Butler Mortgage doesn't expect an immediate impact from bond yields climbing. "
Last time in 2018 we didn't see any clear reduction of activity until five-year rates went over 3.00%," he told me on **Twitter** today. Meanwhile, the Bank of Canada has assured Canadians that rates could stay lower for longer.

However, if the bond yield continues to spike at this rate, the central bank may be compelled to push rates higher. Tighter mortgages expenses could make many rental units unviable and squeeze landlords. It could also cut access to the property market for a significant chunk of buyers.

Meanwhile, properties across Vancouver and Toronto remain some of the most overvalued in the world. A drop in residential property prices could impact real estate investment trusts such as **Canadian Apartment Properties REIT** (TSX:CAR.UN).

Canadian Apartments offers a 2.7% dividend yield at the moment. The stock price is up 21% since the crisis erupted in March last year. It’s now trading on par with book value per share.

However, a drop in real estate prices could plunge book value lower. Meanwhile, a rise in mortgage rates could increase Canadian Apartment’s cost of debt. Combine that with high unemployment and low rental income, and you can see why 2021 could be an ugly year for this REIT.

The impact of interest rates stretches beyond REITs. Growth and dividend stocks are currently trading at historically high valuations because interest rates are low. Put simply, investors don’t have anywhere else to place their cash and earn a decent return. As rates rise, some capital could shift from the stock market to treasuries and savings accounts.

These risks should be on everyone’s radar.

Bottom line

Canadian bond yields are climbing, which could push mortgage rates higher. Keep an eye on this trend.

CATEGORY

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1. TSX:CAR.UN (Canadian Apartment Properties Real Estate Investment Trust)

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