Canada’s Housing Market: Is it a Bubble?

Description

Experts are getting worried that Canada’s housing market is becoming a bubble. Over the past year, analysts at **BMO**, the CMHC, and the Bank of Canada have expressed concern about an overheated market.

One economist leading the charge is David Rosenberg. After years of steady price gains and a recession, he thinks Canada’s housing market looks worse than America’s before the 2008 crash. While Rosenberg stopped short of predicting a correction, he made clear that all the signs of the bubble are present. In this article, I’ll explore Rosenberg’s claims and the implications they have for investors.

Signs of a bubble

According to Rosenberg, Canada’s housing market is showing several signs of a bubble, including

- High home price-to-income ratios;
- High home price-to-rent ratios; and
- High exposure to residential housing on the household balance sheet.

Taken together, Rosenberg said that these signs looked worse than the U.S. in 2005 and 2006. Prior to the 2008/2009 financial crisis, U.S. houses got overly expensive, as measured by the metrics above. The combination of steep prices and low quality mortgages led to a housing market crash. Eventually, that spilled over to the broader economy, including stocks.

A real reason for house prices to increase

Despite all of the alarming signs Rosenberg pointed to, there is one genuinely strong reason for Canadian house prices to continue rising: low interest rates.

When you buy a house, you aren’t just paying the price of the house. You’re also paying the interest expense on the mortgage. Over the life of a mortgage, that can add up to several hundred thousand dollars. When interest rates are low, it lowers the overall cost of buying a house.

As part of its response to the COVID-19 recession, the Bank of Canada lowered interest rates. Eventually, mortgage rates followed suit. Today, Canadians can borrow more cheaply than they could in 2019. As a result, they can theoretically afford to buy more expensive houses. There are some practical limits to this, of course. You'd expect COVID-19-related layoffs to curb peoples' ability to buy, for example. But all other things the same, lower interest rates allow people to buy more expensive houses.

What is a buyer to do?

If you're feeling locked out of the housing market due to surging prices, you're not alone. Long before the COVID-19 housing market surge, Canada's housing market was one of the least affordable in the world. Many younger Canadians can't afford homes, and that's more true today than ever before.

If you want to buy a house to raise a family in, an unaffordable housing market is just a cold fact of life, unfortunately.

But if you're interested in real estate purely as an investment, there is a very accessible alternative you can consider.

Real estate investment trusts (REITs)

REITs like **Northwest Healthcare Properties REIT** (TSX:NWH.UN) are pooled real estate portfolios that trade on stock exchanges. Like stocks, they can be bought in units typically costing between $5 and $100. This allows you to start building your real estate portfolio with whatever pocket change you have lying around.

NWH.UN units currently cost $13. So, if you have, say, $1,300 to invest, you can buy 100 units of NWH and start building your investment over time. Given NWH.UN's 6.1% yield, you could expect approximately $80 back in income each year. That doesn't sound like much, but remember, your return doesn't only come from dividends. Like stocks, REITs rise and fall with daily market fluctuations. If NWH.UN doubled to $26, your $1,300 position would grow to $2,600. That's not an insignificant gain.

Now, this analysis applies to pretty much any REIT. But Northwest Healthcare is specifically worth mentioning because of its business model. As a healthcare REIT, it rents to large, government-backed tenants whose ability to pay is second to none. This means that it can cope with COVID-19-related business closures better than the average retail or residential REIT. That is borne out by NWH's recent results. In a period where most REITs struggled with collections, NWH.UN grew its revenue by 2% and funds from operations by 1% in 2020. This goes to show that it is more stable and dependable than the average REIT.

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1. TSX:NWH.UN (NorthWest Healthcare Properties Real Estate Investment Trust)

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andrewbutton