Playing With Fire: BMO Economist Warns About the Housing Market

Description

Something unusual is happening in Canada's housing market. Ever since the lifting of pandemic-related lockdowns in May 2020, homebuyers came out in droves to start a never-before-seen buying frenzy. Market observers thought it was a temporary blip. However, the housing market shattered records month after month.

We're in the first quarter of 2021, but the pent-up demand didn't disappear. Home prices keep surging, notwithstanding the economic distress and unemployment risks. **Bank of Montreal's** senior economist Robert Kavcic warns that Canada is "playing with fire." The real estate housing bubble could burst soon.

Unusual factors

Bank of Canada Deputy Governor Lawrence Schembri said, "We've taken note of the fact that house prices have increased relatively rapidly in recent months." He points to a combination of "unusual factors" related to the pandemic and why home prices are spiking.

While many Canadians want larger spaces while working from home, homeowners are reluctant to put their properties on the selling block. However, BMO's Kavcic believes the current situation is rapidly developing into a bubble. The market is bound to hit classic bubble levels.

Textbook disaster

Kavcic said a real estate textbook disaster looms if rates rise or stay the same and home prices continue at the same pace. He adds that low-interest rates motivated sales activity but created a debt trap. Canadians can easily load up on high debt levels due to cheap carrying costs.

BMO's senior economist further warns, "If this is left unchecked, then at the rate we're going right now,I think by the time we get into the second half of this year, prices are going to look quite a bit more stretched than they already are today."

Speculative activities could compound the problem now that the national real estate market is in full-on boiling mode. Kavcic calls the situation a perfect storm for rising home prices.

Stable income generator

Investors can opt to invest in real estate investment trusts (REITs) instead of buying physical properties for investment purposes. While REITs are stable income-generators, many suffered from COVID-19's fallout. If you seek rental income without direct ownership, industrial REITs are the best bets during the pandemic.

Yield-hungry investors can purchase a share of **Dream Industrial** (TSX:DIR.UN) for $13.40. This $2.32 billion REIT pays a hefty 5.22% dividend. A $150,000 investment will produce $7,830 in passive income. Your cash outlay is lower, and you do away with other costs associated with buying and managing rental properties.

The stock's performance was hardly affected by the health crisis. Dream Industrial rewarded investors with a 6.4% total return in 2020, while dividend payouts remained intact. Thus far, in 2021, the year-to-date gain is 2.8%.

Dream Industrial owns and operates 271 properties whose composition is diverse and well-positioned to capitalize on the growing e-commerce demand. The 177 industrial assets are in Canada, the United States, and growing industrial markets in Europe.

Market outlook

The Canada Real Estate Association (CREA) forecast the average home price to increase over 16% in 2021. It expects the volume of transactions through the Canadian MLS systems to be nearly 702,000 properties, or 27.3% higher than 2020. The association's outlook suggests home sales will post a record number of sales then start to cool next year.

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